LASTING SOCIAL IMPACT
Community Development Venture Capital Investing

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Abstract

Community Development Venture Capital Funds (CDVC) funds are an emerging group of Community Development Financial Institutions, that make equity investments in businesses in economically distressed areas. As equity investors, CDVC funds, like mainstream VC funds, exit investments to generate financial returns. Unlike mainstream VC investors, they also seek social returns. Social returns are continuous throughout the investment cycle, and in ideal CDVC investments continue after the CDVC exits from an investment.

This thesis examines CDVC investments, focusing on the the point of investment exit. At the exit, this thesis asks the questions: What happens to social value? Is there lasting social impact for CDVC investments? What aspects of CDVC investments contribute to lasting social impacts?

To answer these questions this thesis explores pre-exit and post-exit financial and social conditions of five companies financed by three CDVC funds. These companies are in different industries and geographies, but studied in aggregate they demonstrate that three factors can greatly influence lasting social impact. First, a CDVC fund’s investment choice to invest in a business whose value is dependent upon employees, a specific location, or a unique management team. Second, CDVC fund assistance to expand employee benefits, including improved job training and profit sharing, can increase the wealth and earning capacity of low-income employees. Third, the structure and type of an exit. This final factor is both influenced by how a CDVC fund markets a business, and how a new owner or new investor values a business, at the exit. In presenting these factors, this thesis concludes that CDVC funds are true double bottom line investors, and can motivate sustainable social impact alongside generating financial returns for investors.

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I would also like to thank Andrew Chen, Nat Henshaw, and Anne Claire Broughton, who are all industry professionals who committed time and energy outside of their normal course of business to participate. Thank you also to the employees, entrepreneurs, and owners of A & B Electronics, Innov-X Systems, CV Finer Foods, City Fresh Foods, and Ryla Teleservices, whose involvement added breath and depth to this thesis.

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Chapter 1: Introduction

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Chapter 1: Introduction

Between the late 1800s and early 1900s over 900,000 French Canadians left Canada and migrated to the United States. Many of these Canadian emigrants transplanted to Manchester, New Hampshire, to work in the industrial textile factories. The United States was ahead of Canada in terms of industrial development, and immigrants were drawn by higher wages and a more stable economy.¹

During this migration, many French Canadians transitioned from farmers to factory workers. But even with gainful employment and a substantial presence in Manchester, language and prejudice kept them from participating in cultural activities and social clubs of the native-born Manchesterites. Although new immigrants had stable incomes, they were denied the privileges of savings and credit from existing banks. As a result, the immigrants started their own credit union—St. Mary’s Bank.² Members pooled their finances and the credit union provided a way for the community to use its own financial resources to meet its own financial needs. Named “La Caisse Populaire Ste-Marie,” the bank became “The People’s Bank, of St. Mary.”³

At the turn of the century, throughout the industrializing United States, credit unions began forming to serve the financial needs of laborers and wage workers. Similar to St. Mary’s, these credit unions offered a place for savings, credit, and investment. Pre-existing commercial banks were not generally interested in providing financial services to

¹ One of the causes of French-Canadian emigration was the unequal level of industrial development between Canada and the United States. This industrial gap, combined with structural problems that plagued Quebec’s agricultural economy during the 19th and the first half of the 20th century, created an economic climate where thousands of French Canadians were pushed to emigrate in order to earn a living. Generally speaking, the regions of Quebec that began to be actively colonized in the second half of the 19th century suffered either from a lack of fertility, a difficult access to major markets, a short growing season, or a combination of all three factors. This additionally hindered Canadians from farming the land or simply sustaining themselves as farmers (Bélanger, 2007; Cotnam, 1977).

² The French-Canadian community of Manchester began its own clubs, churches, and even mutual-benefit societies which helped immigrants transition to American life, helped preserve the French-Canadian language and culture, and organized social gatherings (Bélanger, 2007).

³ A credit union is a financial institution formed by an organized group of people with a common bond. Members of credit unions pool their assets to provide loans and other financial services to each other. Credit unions finance themselves with deposits, like traditional savings banks, but they are not-for-profit cooperatives, meaning they are owned by their members and they are usually controlled by volunteer boards (St. Mary’s Bank, 2008).
individuals, especially to newly-arrived individuals. Therefore, the credit union extended financial services to an underserved market.

These early credit unions represent one of the first examples of community-based financial institutions. A century later, four models of community-based financial institutions, or Community Development Financial Institutions (CDFIs) have emerged: community development banks, community development credit unions, community development loan funds, and community development venture capital funds. Each model has a different structure and targets different financial needs of communities. Some CDFIs provide grants to urban nonprofits, others extend debt obligations to rural small business, and an emerging group of CDFIs extends capital as equity investors—which is the focus of this thesis.

Today the CDFI industry faces liquidity pressures similar to those faced by mainstream financial institutions. Some economic development academics suggest that this is due to the fact that federal funding for community development has slowly declined over the last 25 years (Andrews, 2001; Curtis, 2006; Pinsky, 2001). Others argue that the industry is more aligned with mainstream financial institutions than before, and so is subject to competitive pressures inherent to mainstream capital market (Curtis, 2006; Nowak, 2001). Whether it is because of funding cuts or competition, it is widely argued that to amend for liquidity shortfalls, CDFIs must adapt to conventional capital market systems to ensure (and sustain) an adequate supply of capital to economically disadvantaged people and communities (Okagaki & Moy, 2001; Pinsky, 2001). One way in which CDFI’s can restructure and adapt is to meld “wealth creation,” or investing for financial returns into economic development practices; or “integrate accountability for long-term social and environmental impacts into the very wealth creation process. . .” (Tasch, 2003).

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4 The community development banks and credit unions are federally regulated and take deposits and extend credit to individuals and sometimes small businesses. The loan funds and venture funds are non-depository, and are capitalized through institutional investors, including foundations, government grants, and private investors (including mainstream financial institutions or banks); they are positioned to provide credit to businesses in underserved communities. Banks and credit unions act as depository institutions for individuals and businesses. Loan funds and venture funds are investment entities which provide debt and equity to businesses, respectively (Pinsky, 2001).
This thesis describes an emerging group of CDFIs known as Community Development Venture Capital funds (CDVC funds). CDVC funds have the potential to succeed in a competitive liquidity environment because they operate through a mainstream financial structure and do meld "wealth creation" with economic development. CDVC funds use the tools of mainstream venture capital (VC)—equity capital and business management expertise—to generate financial returns for investors. As economic development entities, CDVC funds also target investments to businesses in low-income or underinvested markets to create a social impacts. The combination of CDVC funds' investment structure and target is double bottom line investing. Jeb Emerson, author of "The Blended Value Proposition," explains this investment philosophy: "the issue isn't wealth creation or social change—[rather] it is the creation of value, applying resources to the creation of the greatest value possible and the simultaneous pursuit of both economic and social good for investors and investees, as well as the greater community" (Emerson, 2000).

CDVC funds accomplished their double bottom line mission by creating "good job" opportunities for people who are "too often left behind by mainstream economic growth . . . [including] people with limited job skills or educational attainment, people who are transitioning off of welfare or public assistance, people seeking work through state or local employment agencies, and people living in low or moderate income areas" (Measuring Impact Toolkit, 2005). "Good jobs" are employment opportunities that pay good wages, provide benefits, offer wealth-building opportunities, and provide training and opportunities for advancement (Measuring Impact Toolkit, 2005). Therefore, social returns/social impact is measured by changes in employment (both qualitative and quantitative) for many CDVC funds. Examples of social returns/social impact include an increase in low-income or moderate-income jobs or an increase in health insurance, or the

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5. The Community Development Venture Capital Alliance (CDVCA) is an alliance of CDVC funds. The Alliance formed in 1993, with the goal of providing guidance and assistance for CDVC funds and investors. At the present time there are over 100 members of the Alliance, with over $1.2 billion under management domestically. As an industry trade organization the Alliance brings together practitioners at all experience levels to facilitate peer-learning and to share best practices. The Alliance promotes the CDVC industry through advocacy, investment, research, consulting, and communications. The CDVCA also has a Central Fund, which make two types of investments: Fund of Funds investments and Co-investment Fund investments (CDVCA, 2007).
addition of retirement benefits for employees (Bartlett & Steinglass, 1998; Hagerman, 2007a).³

Problem:

CDVC funds are venture capital funds. As equity stakeholders, CDVC funds take on an ownership position in portfolio companies. In pure equity investing there is no guarantee of repayment. Therefore, unless a business shows potential for "an enhancement opportunity...equity is not the appropriate investment vehicle" (Hamerman, Sommer, Orville, & Pickering, 2007). As double bottom line investors, CDVC funds desire to enhance both social and financial value.

For all equity investors, value or enhancement is realized at the exit. The exit is when an investor sells his ownership position, and "capture[s] the difference between the initial purchase [price] of that ownership stake and the subsequent sale price [of that ownership]" (Hamerman, Sommer, Orville, & Pickering, 2007). The exit is therefore synonymous with a change in ownership, and, after the exit, an equity investor is no longer in a position to influence the business as a partial owner.

Stereotypically, VC investing is associated with a “buy it, strip it, flip it” mentality. This is to say VC investors will invest in businesses without a track record and without access to conventional debt financing. Then they will help these businesses grow (often taking over the direction of operations and management, as may be required to protect their investment), and eventually they will sell off the business’s most valuable assets to generate returns. Mainstream VC firms largely invest in high technology and biotechnology firms, where the “most valuable assets” are not dependent upon a certain production process or operational structure. These companies’ value is tied to innovation and patented technology, or “intangible assets.” Consequently, VC investors are not

³An ongoing debate exists for both CDVC funds and other double bottom line investors, concerning what constitutes impact verses outcome. The “Double Bottom Line Project Report” catalogs different methods used by investors to measure social impact, and defines impact as “the portion of the total outcome that happened as a result of the activity of the venture, above and beyond what would have happened anyway” (Clark, Rosenzweig, Long, & Olsen, 2004). This Project cites that most methods are unable to unilaterally link social impact to investments because they lack a counterfactual claim, or are unable to answer the “but for” question, meaning what would have occurred anyway, if the investor had not invested? “But for” the investment would the social impact or social returns have been generated anyway, as a result of existing economic conditions? (Hagerman, 2007a, 2007b).
focused on creating businesses with stand alone operations post-exit, but are focused on increasing the value of a business while they are invested. Usually firms finance the development, marketing, and distribution of an innovation in order to optimize sufficient growth to permit a profitable exit.\(^7\) Then, at the exit, the business is usually sold and operations can be consolidated, merged, or dissolved because the “most valuable assets” are not connected to existing operations or production (National Venture Capital Association Yearbook, 2007).

Therefore, although this stereotype does not entirely hold true for the whole VC industry, can CDVC funds carry out venture capital investing while maintaining an altruistic desire for long term social returns/social impact? Is it possible to invest through this traditional highly lucrative financial model with a double bottom line? If an exit is necessary to generate returns in a relatively short time period (which is in line with the VC model), and if VC exits are usually synonymous with consolidation of operations, plant closures, and layoffs, is it possible to create lasting or long-term sustainable social impact post-exit?

Purpose of Thesis:

The purpose of this thesis is to study how successful CDVC investments can have lasting social impact for individual employees and a community. Lasting social impact is when the social returns/social impact generated from a CDVC investment is maintained or enhanced after a CDVC fund exits (post-exit). This thesis describes different scenarios where lasting social impact occurred, and highlights what can influence lasting social impact across different investments.

Julia Sass Rubin, in numerous publications, suggests that an “unwillingness of many CDVC fund managers to force an exit that would be detrimental to their social objectives of high-quality job creation for low-and-moderate income individual and economic development” often complicates exits (Rubin, 2001, 2002, 2006, 2007a,

\(^7\) Recent studies demonstrate that venture capital investments contribute to employment growth, patent discovery, and general wealth creation in key U.S. cities and metropolitan areas. But no study is able to track post-exit performance or impact as many venture capital investment are exited through initial public offerings or merger & acquisition, both of which often cause business consolidation and/or relocation (Bates, Bradford, & Rubin, 2006; Carlson & Chakrabarti, 2007a; Gompers & Lerner, 2001; Schmitt, 2002a, 2002b).
Elyse Cherry, President of Boston Community Venture Fund and CEO of Boston Community Capital, agrees with this idea and considers it a factor that can impede CDVC funds because “a CDVC fund can not ignore the social impact of its exits” (Cherry, 2001).\footnote{Cherry suggests that the unique nature of CDVC investments, compared to VC investments, impedes CDVC funds from generating the same level of financial returns at the exit. This is because CDVC funds are usually unable to exit investments through mainstream VC methods of an IPO or a merger or acquisition. Cherry cites two main reasons for why CDVC funds are unable to exit through these mainstream methods. One reason is mentioned above—the social desires of CDVC funds. The second reason is the “difficult nature of [CDVC] portfolio companies.” Compared to mainstream VC investments CDVC funds usually make relatively small investments in young companies, in a wide range of industries, and in more diverse geographies. Therefore, at the exit, a new owner/investor that is attracted to a mainstream VC backed company probably is not attracted to CDVC funds portfolio companies. This thesis does not address how these factors also can create liquidity pressure for funds, because they often can impede exits. Rather this thesis only assesses why CDVC investments have certain exits and, in general, certain investment characteristics that can contribute to lasting social impact post-exit. For further information in regard to CDVC funds and exit see Cherry’s work entitled “No Exit: The Challenge of Realizing Returns on Community Development Venture Capital Investments” (Cherry, 2003).}

CDVC fund manages that were interviewed explicitly stated that financial returns are rarely compromised for lasting social impact. Therefore, the purpose of this thesis is to position CDVC investing as an economically-influential community development financial model, where lasting social impact can come in tandem with financial returns. This thesis explores Cherry’s assessment of CDVC exits, and confirms that CDVC funds are positioned to have unique exits compared with mainstream VC funds. This thesis does not address the challenges of the CDVC exit, because of its dissimilar nature to mainstream VC exits, but this thesis does suggest that it is an influencing factor in terms of generating lasting social impact. Therefore as the CDFI industry tries to “get serious about fitting . . . into the more conventional” financial markets, this thesis presents CDVC funds as financial institutions that have the structure and capacity to provide sustainable financial support to promote economic development in tandem with lasting social impact (Pinsky, 2001).

Research Question:

In order to demonstrate how lasting social impact is possible, and to highlight what contributes to lasting social impact, this thesis presents case study examples of investments. Case studies center on the exit and what happens after a CDVC relinquishes its ownership position. This is because when a CDVC exits an investment the change in

(2007b).
ownership can also cause a change in operations, which presents the risks of change in a firm’s location, management, and/or employment base. All of these factors can adversely affect social returns/social impact.

In the same way that mainstream venture capital funds guide operations or management to increase profitability and financial return, CDVC funds guide changes in benefits or employee compensation to ensure positive social returns. But unlike financial returns (which are primarily generated via the exit, and which directly benefit the CDVC fund) social returns benefit a community and are not created or realized at a specific point in time. Rather, these returns are continuous (and hopefully increasing) throughout the investment cycle. Therefore in each investment example, or case study financial and social conditions pre-exit and post-exit are described, and the following research questions are posed: What is meant by lasting social impact? What contributes to lasting social impact? What specific investment characteristics are shared by many case study investments, which can influence social impact/social returns? What measures do CDVC funds take to influence or guide lasting social impact?

Methodology:

This thesis presents five investments by three CDVC funds. Each investment demonstrates that lasting social impact can occur. This thesis is not meant to provide industry standards or industry trends, but rather highlights possible outcomes of investments—through stories of individuals who were personally affected by a CDVC fund’s investment or through stories of how a community benefited from a CDVC fund’s investment in a local business. These stories are of employees becoming owners, of low-income individuals becoming middle-income management, or of entrepreneurs achieving their dreams of owning a socially responsible and profitable business. A more detailed methodology follows in Chapter 2.

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9 Throughout this thesis “funds” either means a single VC or CDVC fund or the parent firm that manages multiple funds. For example this thesis presents investments from three funds, CVI, SJF, and BCVF each of which manages at least two funds.
Contents of Thesis:

Chapter 2 Methodology. This thesis examines case studies of CDVC investments. It describes the way in which case studies were chosen for inclusion, how data were collected concerning each investment and fund, and the way in which findings or information was analyzed is detailed.

Chapter 3 Community Development Venture Capital in Context. This chapter defines economic development and presents the evolution of domestic economic development practices and community development financial institutions. It answers the questions: What definition of economic development do CDVC funds occupy? How are CDVC funds’ targeted investing practices in line with contemporary notions of economic development practices?

Chapter 4 Community Development Venture Capital as an Industry. This chapter describes the current CDVC industry, and the structure and focus of CDVC investing. By presenting the similarities and differences between CDVC funds and mainstream VC funds this chapter defines the investment parameters of CDVC funds. It concludes with a discussion of the social impact of the CDVC industry compared to the perceived social impact of the mainstream VC industry.

Chapter 5 Summary of Findings: Fund Overview. Since investments and their exits occur in the context of the mission and goals of specific CDVC funds, this chapter begins with a discussion of the history, investment philosophy, and social impact of each fund. The chapter ends with a summary of the exit history and an overview of “lasting social impact” for each fund.

Chapter 6 Summary of Findings: Lasting Social Impact Case Studies. This chapter continues the presentation of findings and presents each case study through a narrative of pre-exit and post-exit social and financial conditions. Pre-exit is when the CDVC fund is invested and post-exit is after the full or partial exit (when financial returns are mainly generated). These stories, or narratives, define lasting social impact for each case study investment, and demonstrate that lasting social impact is possible in CDVC investing.

Chapter 7 Summary of Findings: Achieving Lasting Social Impact. This chapter highlights characteristics that affect lasting social impact or lasting social value in case
study investments. These investment characteristics are presented in four categories and are compared across investments. Categories are investment cycle related and include pre-existing conditions, social positioning, financial performance, and exit conditions.

Chapter 8 Conclusion. This chapter presents an overview of thesis findings and case studies, describes a summary of what affects lasting social impact, and presents ways in which CDVC funds can contribute or influence lasting social impact.
Chapter 2: Methodology

This thesis explores five case studies of Community Development Venture Capital (CDVC) fund investments from three funds. There are specific parameters for "Case Study Inclusion," or the way in which case studies were chosen or selected to be included in this thesis; for the "Research Method" or the way in which research and data was collected concerning financial and social conditions of investments; and for "Case Study Analysis" or for the way in which findings were analysed in aggregate. Additionally, this thesis presents a "Summary of Findings" which highlights investment characteristics across all case studies, and which reveals how and why lasting social impact was possible.

Case Study Inclusion:

Through the Community Development Venture Capital Alliance (CDVCA), the industry's trade organization, seven funds were solicited for participation. These CDVC funds are the oldest, largest, and most active in the industry. The funds have substantial experience, geographic diversity, and most have been in existence for at least 10 years. Funds which participated were required to share investment practices for two or three past investments.

Solicitation began with an initial letter to fund managers at each fund. Each fund manager was asked to choose a few investments that they had exited, and deemed successful investments, as well as to review a survey protocol of questions in regard to that investment. Fund managers participate included reviewing a list of general fund level questions concerning their fund's history and social and financial performance. Then through telephone and in-person interviews, each fund manager reviewed and answered survey protocol questions (Appendix A).

This method for inclusion meant that first the industry's trade organization was identifying funds and second that fund managers were identifying investments. The combination did not result in an industry wide data collection nor an unbiased representation of cases for research. Rather, cases were chosen because investments came from a prominent fund in the industry, and that that fund deemed them as successful.
Each fund evaluates investments by measuring returns and has their own definition of a successful investment. For each fund surveyed success is based on the fund’s investment criteria and mission. All funds specifically stated that investments included in this study had financial returns and an increase in the number of employees or a change in employment benefits as social returns. On average, CDVC investments yield a 15.5% gross IRR. Although all funds in the study do not define a successful investment, by evaluating what happens after the exit all case studies have continued social returns or lasting social impact. Additionally, seven funds were contacted and interviewed and three funds (and a few of their investments) are presented in this thesis.

Research Method:
Research was done through interviews of fund managers, and through interviews of business owners and employees of past-portfolio companies. A survey was distributed to fund managers to guide each interview (Appendix A). The purpose of interviews was to conduct research for case study investments, and to specifically compile both anecdotal stories of lasting social impact and to define lasting social impact for proposed case study investments. Research was not conducted to highlight industry wide norms or to assess current measurement practices, but to demonstrate examples of how lasting social impact can occur for CDVC fund investments.

Specific research questions guided each interview (see Appendix A for “Interview Protocol”). Through interviews discrete information was gathered, in regard to social and financial conditions at distinct investment cycle periods. Table 2.1 and Table 2.2 outline these conditions. All information is from the perception of how employment was affected, by changes in social and/or financial conditions. All information gathered in presented in Appendix B, and bold items give summary information and/or highlight changes from one period to another.

As Julia Sass Rubin presents in “Community Development Venture Capital: A Double Bottom Line Approach to Poverty Alleviation,” measuring social returns, or the

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10 This figure is from the CDVCA and is reported from the three oldest funds in the United States, and is calculated on 31 investments made between 1972 and 1997 that have since been realized. Of these investments, 7 were write offs. The funds surveyed were unable to release their gross IRR for all investments, but did state that in each of the investments included in case studies returns yielded between 4 and 10x financial return on initial equity investment (CDVCA, 2007).
social impact of an investment, is challenging because “there is no broadly accepted metrics on poverty assessment for investment purposes” unlike financial returns which are usually measured by an investment’s internal rate of return (Rubin, 2001). The internal rate of return (IRR) for a portfolio of investments or a single investment is a financial return rate which is a discounted rate that equates the net present value of an investment’s (or fund’s) cash inflows with its cash outflows. Cash inflows to the business are investments that the investor makes and cash outflows for the business are returns that the investor receives. The exit is usually synonymous with a “liquidity event” meaning the investor generates returns and received “liquid compensation” for their shares or ownership position. Therefore the exit is usually the largest cash outflow (from the business’ perspective) and can significantly affect an investment’s IRR. The IRR is a baseline for measuring financial returns in the venture capital and private equity industries (Schmitt, 2002b).

The closest industry-wide mechanism or metric to measure social returns is the Community Development Venture Capital Alliance’s “Measuring Impact Toolkit” or “MIT.” Although there is much industry debate both within the CDVC industry and for the larger community of double bottom line investors, the MIT is presented as the most comprehensive measurement mechanism for CDVC funds. Each fund surveyed has their own social impact measurement and assessment but for the purposes of comparing investments, and aggregating information from all investment, the MIT was used as a guide to develop the above conditions. The MIT is a product of private foundation funding and coordinated efforts of five CDVC organizations. Five categories (see Table 2.3 for an outline of these categories) compose the core survey.

By tracking social and financial conditions, this thesis presents the circumstances that may influence lasting social impact. The bold categories in Table 2.3 (from the MIT) are included in this thesis. It is important to add that these changes were not tracked in isolation but accompanied stories and reactions from employees, business owners, and fund managers. No social or financial conditions were recorded without asking why something happened or what contributed to a change. Each data point was collected through personal interviews and was not through a written survey. This gives breath and depth to each value recorded. Chapter 6 presents these conditions (pre-exit and post-exit).
for each case study. This is prior to the analysis portion of the thesis and presents what lasting social impact is for each investment. Additionally all information is from the perspective of employees, therefore ownership means employee ownership.

**Table 2.1: Investment Conditions**

<table>
<thead>
<tr>
<th>SOCIAL CONDITIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment (number of jobs)</td>
</tr>
<tr>
<td>Benefits (healthcare, pension plan, 401(k), stock options, job training, advancement opportunities)</td>
</tr>
<tr>
<td>Profit Sharing &amp; Employee Ownership</td>
</tr>
</tbody>
</table>

**Table 2.2: Investment Conditions**

<table>
<thead>
<tr>
<th>FINANCIAL CONDITIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth (sales, profits)</td>
</tr>
<tr>
<td>Location</td>
</tr>
<tr>
<td>Type of Exit</td>
</tr>
</tbody>
</table>

**Table 2.3: MIT Core Survey**

<table>
<thead>
<tr>
<th>SURVEY CATEGORIES</th>
</tr>
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<tbody>
<tr>
<td>Background</td>
</tr>
<tr>
<td>Employees &amp; Employment Changes</td>
</tr>
<tr>
<td>Wages &amp; Career Ladders</td>
</tr>
<tr>
<td>Benefits, Wealth Building &amp; Training</td>
</tr>
<tr>
<td>Additional Social Impacts - Community Involvement, Environmental, Export-Oriented Sales, Taxes</td>
</tr>
<tr>
<td>Additional Company Info - Ownership/Control, Description of Business</td>
</tr>
<tr>
<td>Open Ended Questions</td>
</tr>
</tbody>
</table>

**Case Study Analysis:**

Case study analysis included an evaluation of these social and financial conditions (in Table 2.3 and Table 2.2) and an assessment of additional anecdotal information from interviews. The following questions directed this analysis: What influenced lasting social impact? What were pre-existing conditions and what were changing in social and financial conditions that contributed to or influenced lasting social impact? How did a CDVC fund’s involvement increase or decrease the probability of lasting social impact? With these questions this thesis does not question the *success* of investments but re-evaluates investments to describe or characterize what impacts lasting social returns for employees and a community.
Robinson Hollister, in “Measuring the Impact of Community Development Financial Institutions’ Activities,” suggests that it is difficult to measure a CDFI’s impact and draw correlations between social outcomes and a CDFI’s investment practices. Hollister states that it is “impossible to isolate the effect of the CDFI from the general noise created by natural change. . .to get the net benefits of the CDFI [particularly in terms of] jobs one needs a counterfactual indicating the proportions who would have gained or lost in the absence of the CDFI” (Hollister, 2007). Additionally, the introduction to the MIT suggests that it is not possible to “always have a counterfactual” and adequately deal with the ‘but for’ question, “that is, if the investment had not been made, what would have happened anyway? But for the CDVC investment what would have occurred?” (Measuring Impact Toolkit, 2005).

Therefore in addition to not questioning the success of case studies this thesis also does not attempt to directly prove causality by suggesting that social return/social impact (and lasting social impact) is a direct outcome of certain investment practices or investment characteristics. Rather this thesis presents instances of successful investments in which social impact and lasting social impact occur and assumes that the CDVC model is strong in relation to other economic development strategies in terms of impact. As the MIT states:

“it is likely that a provider of flexible equity capital financing at an early stage of a company's development, along with extensive entrepreneurial and managerial assistance offered through participation on the company's board of directors, will have a very strong “but for” effect on the success of the company and the resulting social impact. In fact, perhaps the greatest strength of the CDVC model is that it is a powerful tool to make things happen in markets and economies that otherwise would not have happened,” (Measuring Impact Toolkit, 2005).

The specific way in which case studies where analyzed is reflective of these two realities. After interviews were conducted all information and research was compiled and aggregated into four categorizes of investment characteristics: pre-existing conditions, financial performance, social positioning, and exit conditions (these are explained in Table 2.4: Investment Characteristics, and demonstrate aggregate investment practices).

“Exit conditions” was the most challenging categories to record practices and to gauge characteristics. Fund managers were only able to judge or predict why a new
owner/investor purchased a business or tool on a partial ownership position. Additionally, fund managers were unable to confidently confirm what happened after the exit and only could describe if the purchase and/or transfer of ownership had an immediate impact on the business. When possible, employees and/or original owners, who were with the business through the CDVC investment and post-exit were interviewed. New owners/investors were also interviewed for post-exit information.

Table 2.4: Investment Characteristics

<table>
<thead>
<tr>
<th>CATEGORIES</th>
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<tbody>
<tr>
<td>Pre-existing</td>
<td>What were pre-existing business conditions that impacted the value of the business?</td>
</tr>
<tr>
<td>Conditions</td>
<td>Was the business a certain number of years in operations?</td>
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<td></td>
<td>What product or service did the business produce or provide?</td>
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<td></td>
<td>Did the business have an employee dependent or location specific operating structure?</td>
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<tr>
<td>Financial Performance</td>
<td>Did the company sales grow?</td>
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<td></td>
<td>How/why did this occur? Did operating efficiencies or production change?</td>
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<tr>
<td></td>
<td>How did the CDVC fund contribute to these changes?</td>
</tr>
<tr>
<td>Social Positioning</td>
<td>Where there qualitative and/or quantitative changes in employee pre-exit?</td>
</tr>
<tr>
<td></td>
<td>Did the investment structure include any employee wealth building?</td>
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<tr>
<td>Exit Conditions</td>
<td>What was the type of the exit? What attracted the new owner/investor to the business?</td>
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<tr>
<td></td>
<td>Did the location or management change at the exit?</td>
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<td></td>
<td>What did the CDVC fund do to facilitate the exit?</td>
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Summary of Findings:

This thesis presents all case study investments within the context that CDVC funds are positioned to successfully promote economic development as double bottom line investors. This thesis first presents the history, investment philosophy, and the historical social impact of funds, which made case study investments (Chapter 5), then by presenting pre-exit and post-exit conditions for case study investments highlights what is meant by lasting social impact (Chapter 6), and then concludes by evaluating what contributed to lasting social impact for each investment (Chapter 7). By aggregating the above investment characteristics conclusions are draw about what can affect or influence lasting social impact factors (Chapter 8).

Just as a picture can tell one thousand words, the stories behind each investment are an integral part of explaining why and how lasting social impact occurred. Each investment included in this thesis is a distinct example of lasting social impact. Funds
share common investment practices with each investment but the unique circumstances that employees faced at each firm tell a story of the true benefits of CDVC financing. As the MIT explains, even with good data and the appropriate benchmarks there is no way to convey the full spectrum of social impact without the stories about how a job opportunity changed someone’s life, or how a portfolio company became a career ladder for an individual, or even how good, stable employment in a certain community reached beyond the original employees and helped build wealth for a family. “Telling stories does not just put a face on the numbers—though that is important—it actually explains how CDVC works,” (Measuring Impact Toolkit, 2005). The Appendix shares some of these stories.

Measurement within the field of socially responsible investing is a complex and often debated topic. Therefore, this thesis does not present ways of changing or creating measurement tactics, nor does this thesis evaluate current practices. Further, there are no inferences in this thesis made to specific reasons to have or not to have a standardized measurement for the CDVC industry or for socially responsible investors as an entire industry. Instead this thesis simply presents investments, qualitative and quantitative information regarding those investments, and then draws conclusions about ways in which social impact can be sustained.
Chapter 3: Community Development Venture Capital in Context

Community Development Financial Institutions (CDFIs) are specialized financial institutions dedicated to addressing inefficiencies in existing financial markets while promoting economic development. CDFIs accomplish this mission by providing financial services and capital access to underserved markets, usually low-income or moderate-income communities. For over a century CDFIs have served the "underserved" in communities throughout the United States. Current practices of CDFIs began to emerge in the late 1960s and early 1970s. Bolstered by the Johnson Administration's "War on Poverty" campaign some Community Development Corporations (CDCs) evolved into CDFIs. These early CDFIs improved the economic capacity of communities through locally based economic development. Some of these organizations were also capitalized through private funds, unlike their predecessors which were usually funded by state and federal government allocations (Rubin, 2007b).

Today CDFIs operate as economic development financial institutions "working just outside the margins of conventional finance and in thousands of economically disadvantaged communities" (Curtis, 2006). This chapter presents a brief history of the CDFI industry. The subject of this thesis is Community Development Venture Capital (CDVC) investing, a model or institutional type of CDFI. This background chapter provides a historical context for CDVC funds, and positions CDVC funds as one of the newest models of CDFIs.

Logistically, this chapter begins with the definition of economic development that CDVC funds occupy; then this chapter traces the evolution of the CDFI industry and how it developed as a result of changing economic conditions and changing public policy environments. Finally, this chapter describes CDVC funds as economic development entities—which have a unique structure, a specific means of capitalization, and a targeted investment practice. This chapter demonstrates that CDVC funds are contemporary
economic development entities, which meet the pressing capital needs of communities, and function as sustainable financial institutions.

**Community Development Venture Capital as Economic Development**

In the 1980s, the American Economic Development Council (AEDC), the largest and oldest economic development society in the U.S., defined economic development as "the process of creating wealth through the mobilization of human, financial, capital, physical and natural resources to generate marketable goods and services," (AEDC, 1984). In this definition, economic development is a process to generate wealth. Today the International Economic Development Council (IEDC) has expanded this definition of economic development and states that economic development is "a program, group of policies, or activity that seeks to promote the economic well-being and quality of life for a community, by creating and/or retaining jobs that facilitate growth and provide for a stable tax base" (IEDC, 2007).

Karl Seidman, in *Financing Economic Development*, agrees with this definition and explains that the outcome of economic development is more than just an increase in "jobs, income, and wealth. . .[and] includes an area’s quality of life.” Effective economic development practices are those that are a “process” which is “maintained over time” and which can be “reproduce[d]” to generate continuous “positive economic and social returns” (Seidman, 2005).

Agreeing with this definition Michael Hall Kieschnick and Julia Ann Parzen, in *Credit Where It’s Due*, state that economic development is developing mechanisms or creating a catalyst for an “increase in economic activity that results in a wider distribution of the quantities being measured (income is more evenly distributed, the housing stock is not simply in a few very large homes)” (Parzen & Kieschnick, 1992). This is similar to Seidman’s idea which considers economic development as a way to increase economic activity that can change the quality of life for individuals in a community. Moreover all three authors, Kieschnick, Parzen, and Seidman, agree that optimal practices lead to “sustaining the higher level of activity in the future.” Richard Bingham and Robert Mier,

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1 In 2001 the International Economic Development Council was created as a result of the merger between the American Economic Development Council and the Council for Urban Economic Development, a multi-service membership organization and strong advocate of economic development since 1967 (IEDC, 2008).
in *Theories of Local Economic Development*, also agrees with this definition and suggest that an effective economic development tool serves the broad population in this sense that it addresses both short and long run interests. They also warn that it is remiss to define economic development without considering economic development finance and citing the role of the private sector "to create wealth" (Bingham & Mier, 1993). As Kieschnick and Parzen suggest it is also remiss to not consider "how that wealth is distributed" (Parzen & Kieschnick, 1992).

In a similar discussion Seidman suggests that within economic development finance has two roles: as an input into the process and as motivating the quality and supply of other inputs. Therefore effective economic development financing "transcends the use of specific tools and programs to encompass broader issues" and ensures a sustained level of capital availability but also supports an increase in the capacity of a community and its economy. This can be accomplished through support local business development, as businesses are the primary units of economic activity and "require many conditions and inputs to be viable"(Seidman, 2005).

Ron Shaffer, in "Rethinking Community Economic Development," also agrees that changing the capacity of a community "to act and innovate" widens the definition of economic development finance beyond the addition of more jobs and greater wealth. Economic development finance promotes a change in the structure of a local economy and the "technology, ownership patterns, occupational mixes, product mixes, industry mixes, and institutions." Shaffer writes that successful tools are those that are able to simulate change and a certain type of growth that is longer term, purposeful, and permanent (Shaffer, Deller, & Marcouiller, 2006).

Shaffer's idea of changing the structure of a local economy coincides with Henry Cisneros' notion of urban enterprise in "Urban Entrepreneurship and National Economic Growth." Cisneros suggests communities need to expand from their existing assets and create change through the development of businesses which "examine their region's heritage, its comparative advantages, in light of its national and international market trends and develop a strategic vision to guide realist development" (Shaffer, Deller, & Marcouiller, 2006). Cisneros also writes that economic change can happen "[by
supporting] existing entrepreneurs and helping them expand locally rather than rely on new firms from other regions to come in and spur growth” (Cisneros, 1995).

CDVC funds share a common mission of creating “good jobs in solid businesses to advance the livelihoods of low-income individuals” (Measuring Impact Toolkit, 2005). By expanding employment opportunities CDVC funds are promoting the economic well-being of individuals. Given Kieschnick and Parzen’s definition of economic development, which is summarized as financial support to businesses that increases the economic activity of a community, and by targeting investments to low-income areas to promote low-income job growth, CDVC funds are a catalyst for changing the distribution of financial gains (Parzen & Kieschnick, 1992). As Bingham and Mier state this means that CDVC funds are changing the overall “distribution of wealth” (Bingham & Mier, 1993).

Operating as CDFIs, CDVC funds are intermediaries which bring capital to local business to support local entrepreneurs. This lends itself to two conclusions. First, CDVC funds carry out Cisernos’ and Shaffer’s idea of economic development by changing the “capacity” or “structure of a local economy” through the financial support of a local business or an “existing entrepreneur’s vision.” This is because CDVC investments finance businesses which are unable to find financing from mainstream sources (Rooney, 1999). Second, as equity investors CDVC take on an ownership position and help guide the operations and management of a business that they invest in. Therefore, parallel to Seidman’s suggestion, that financing is only one input into the process of successful and sustainable economic development, CDVC funds’ investments are positioned to generate sustainable economic activity by “affecting the quality and supply of other inputs.” A CDVC fund’s investment can be a catalyst for individual wealth creation, can facilitate improved employment opportunities, and can enhance a business’s marketability and production capacity (Seidman, 2005).

Evolution of Economic Development and CDFIs

Ted Bradshaw and Edward Blakely, in Planning Local Economic Development, present three waves of economic development theory. From a historical perspective many scholars define economic development through three waves or phases (Bingham & Mier, 1993; Bradshaw & Blakely, 1999; Deller & Marcouiller, 2006; Friedman & Ross, 1990).
CDVC investing is arguably within the second wave of theory, but can be considered a third wave practice. Some theorize that these waves or phases do not coincide with professional practices. Other scholars argue that academic theory is generated from observation and noted behavior, and therefore the economic development theory from a “wave” is reflective of economic development practices and the then contemporary tools utilized. There is also a large debate between the “waves” and an inconsistent view of when each begins and ends. (Bingham, Hill, & White, 1990; Bradshaw & Blakely, 1999).

Aligned with Bingham and Mier, this chapter does not “declare economic development an academic discipline” but gives a historic background of economic development (Bingham & Mier, 1993). This is necessary because the “economic environment is never static” and consequently economic development is “continually improvising” in an attempt to change current domestic economic conditions for the better (Jacobs, 1990).

Typical first wave policies are business-attraction focused. These economic development practices provide direct support or subsidies to firms to relocate to areas of high unemployment. The roots of these policies can be traced to the 1930s when southern states, with relatively undeveloped industrial bases, actively recruited manufacturing firms from the more fully developed, high-wage areas of the north. Specifically, in 1936 Mississippi issued the first tax-exempt bonds for private industry financing. For Mississippi, the hope was that the existing labor base and the this below market financing option would attract industrial and manufacturing firms to the state (Waits, 1998).

After World War II, southern states continued to use large tax inducements to attract manufacturing plants to low-income communities. At that time the agricultural industry in the south was slowing and many southern states felt a need to attract outside firms to bring employment opportunities and tax revenues. Industrial Development Bonds (IRBs), as part of location based incentive programs, promised cheap land, cheap labor, and a low cost of financing (Eisinger, 1988).2 The intention of these first wave

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2 In Mississippi the first tax-exempt bonds were general obligation state bonds, meaning they were backed by the full faith and credit of the state. If the company that used the bond revenues went bankrupt the taxpayers of Mississippi were responsible for paying off the bond holders. This meant that Mississippi was risking its own financial position when issuing the general obligation bonds for the benefit of business development. Industrial Revenue Bonds do not hold this liability, but instead are issued by a state or local government which bears no responsibility for repayment. The bonds are only backed by the revenues and collateral of the beneficiary firm. These bonds offer a reduced interest rate on capital and in term bond holders do not pay state or federal income tax from profits (Eisinger, 1988).
programs focused on increasing taxes and socially focused on creating employment. The initial affects of these programs reflects these intentions. A large number of jobs moved into southern states and these states received additional tax revenues (Blakely & Bradshaw, 2002; Eisinger, 1988). Further, the widespread growth of industrial relocation agencies suggests that political leaders thought these tactics were effective and productive in promoting economic development. Yet, historians find that after many states adopted these programs they were competing against one another for manufacturing plants. This caused employment to plateau as programs became ineffective, and even became a financial burden on already fragile state economies (Blakely & Bradshaw, 2002).

These relocation-based incentive programs were coined “smokestack chasing” tactics. Until Post-War World II, there was enough innovation and industrial growth to deem them somewhat successful. But even with their apparent success, they were still faulty in terms of spurring economic opportunities and improving the “quality of life” for individuals. This is because political leaders charged with enacting the programs often made little effort to specify what sort of jobs were desirable to bring into a community:

“In the urgency that often surrounded the search for an industrial employer, distinguishing between union scale versus minimum-wage jobs, employment in growing versus dying industries, and permanent versus seasonal work could be dismissed not only as an indulgence but as potentially self-defeating. . .growth, pure and simple, was the limit of the developer’s aspirations” (Eisinger, 1988).

Historian James Cobb, in *The Selling of the South*, wrote that these efforts were built on the appeal that southern states could offer “an abundance of docile workers willing to work for wages well below the national average” (Cobb, 1993). In general, this meant that for poor neglected communities “any job was the right job” (Eisinger, 1988).

During this first wave of economic development practices there was no formal established CDFI industry or even a group of financial institutions that both extended access to capital to low-income communities and promoted economic development. Rather, there were self-help financial institutions (primarily credit unions) that fostered financial and cultural networks for individuals and small businesses. Separately, there
were state and federal economic development programs focused on making large-scale changes in the economy of a state (including the tax base, capital investment and labor force). Overall, there was little focus on community-based economic development or community economic development supporting local businesses (Curtis, 2006).

The first wave continued through the early 1960s and President Lyndon B. Johnson's “War on Poverty” reforms. The “War on Poverty” campaign focused on the alleviation of poverty and inequality through providing a “hand up” rather than a “hand out.” Social service programs repositioned from giving cash subsidies to individuals to providing opportunities for “self improvement.” These programs were directed at changing the earning capacity of the poor, by giving individuals avenues to improve their own job skills and earning potential. (Rubin, 2007b).

In 1964 the Economic Opportunity Act (EOA), which was part of the “War on Poverty,” brought national political attention to low-income communities through supporting the establishment of the first Community Development Corporations (CDCs). These corporations gave communities a political voice and encouraged community participation in community development measures. These early CDCs also provided a platform for the implementation of “self-help” programs, which directly served the low-income and unemployed to “help themselves” improve their position. Overall, most CDCs strived to transfer “decision making authority from the federal to state and local governments,” including responsibilities for “designing, implementing and evaluating” of community development programs and activities. As local entities CDCs also tried to carry out locally based economic development tactics. Still in line with first wave business attraction programs or “smokestack chasing” CDC’s attempted to bring big business into communities (Nolan & Wong, 2004). Many early CDCs would provide job training and act as employment agencies, and then would market a community as an ideal place to relocation, for an outside large company.

Julia Sass Rubin presents, in *Financing Low-Income Communities*, a history of how “trial and error” lead some CDC’s to transition their focus to local business development practices. Rubin explains that an example of this is the Bedford-Stuyvesant Restoration Corporation (BedStuy). BedStuy began as a CDC to attract large businesses to the depressed urban community of Bedford-Stuyvesant Brooklyn, New York. After
bringing only one IBM plant to the community, the CDC was unable to attract other large businesses to foster new employment opportunities. Therefore the CDC began financing neighborhood entrepreneurs, as an alternative way to promote job growth. Trying one intervention and failing resulted in rerouting efforts to focus on local businesses (Rubin, 2007a).

Similarly, Rubin presents Job Start Corporation, a Kentucky based CDC which used federal funds to stimulate community and economic development in the rural region of Appalachia, in southern Kentucky. In the early 1970s, the region was experiencing employment decline as industrial plants were consolidated or moved from the region. Kentucky Highland Investment Corporation (KHIC) began as a subsidiary of Job Start to specifically address employment concerns. KHIC’s mission was to development business plans and start businesses, and KHIC employees would run and manage these businesses which would provide job opportunities in the region. But, even will the necessary funding, the organization’s staff was too small to run a large enough business to have an impact on area job growth and create a substantial number of employment opportunities. The CDC was not able to both finance and run a business ventures. Therefore instead of financing their own ventures, the CDC began to look to local entrepreneurs who already had business plans and the organization and ambition to run their own companies. KHIC invested in a few local entrepreneurs and is cited as the first CDVC firm as they often invested equity capital. Today KHIC is a well capitalized and influential CDVC that still invests in rural Kentucky businesses (Rubin, 2007a).

Separate from these isolated cases which diverged from a business attraction model (first wave) to a local business development model (second wave), a major shift in economic development policies began nationwide in the 1970s. This resulted in the modern notion of economic development practices, and CDFIs—which focused on strengthening a state’s and a community’s economic performance from within (Fosler, 1992). This transition began “home-grown” development, where each state started to control its own economic development through supporting business development and in-state expansion of existing industries (Friedman & Ross, 1990). States were also taking on innovative entrepreneurial functions and promoting high technology development and
even export-oriented production promotion programs (Eisinger, 1988; Friedman & Ross, 1990; Liou, 1998).

Historians suggest that the shift to this second wave was “driven by necessity,” and four major factors contribute to the shift in economic development practices and policies. The first factor was that policymakers began to realize the pitfalls of smokestack chasing. Although in the beginning these programs netted more employment opportunities in certain states, the states experiences slightly lower-than-average levels of personal income growth. As mentioned this was because programs did not concentrate of what kind of jobs were created and were often fostered by a sense of “naïve boosterism” where “more is equated with better” for employment growth. Programs did not differentiate between growth and development. More jobs or the growth of employment opportunities did not directly mean the development of economic capacity or a change in economic conditions for individuals. Eisinger explains this distinction:

“... development properly refers to a process of qualitative change to which the mere addition of jobs may make little contribution. Employment ought to be conceived of less as an end in itself than as a means to well-being... the fundamental normative assumption here is that the local growth rate is a lever through which desirable changes in the level, distribution, and stability of income may be achieved” (Eisinger, 1988).

The second factor was the new economic reality of globalization. Global competition rapidly changes the way industries produce goods. During this period, technology and telecommunications advancement mean that industries are able to shift operations to anywhere in the world—to where productivity and efficiency is maximized. With the absence of trade regulation in the early 1980s, the United States was “plagued by plant departures or shutdowns as manufacturers of everything for hosiery to silicon chips moved abroad or went bankrupt in the face of foreign wage competition” (Drabenstott, 2005). This caused a decline in employment and resulted in the U.S. experiencing its first significant trade deficits. By the mid-1970s, much of the imbalance

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3 Many states with right-to-work laws, the most explicit legislative measure designed to preserve low-wage employment, cites that between 1979 and 1994 the average per capita income growth rate for all 50 states was 72%. Thirteen of the 20 states that had -right-to-work laws in 1980 fell below 72%, and for all 20 right-to-work states the average income growth rate for that same period was 70.2% (Eisinger, 1988).
in trade was attributed to the United States’ dependence on oil from abroad. Therefore, as a nation, economic development tactics were more and more necessary to bolster the U.S. economy. First wave practices would no longer be effective as other nations—beyond other states—were attracting industry.

The third factor coincides with David Birch’s controversial work, *The Job Generation Process*, published in 1979. Birch’s piece shows the importance of small firms in creating jobs and suggested that over 80% of all new jobs were created by small businesses. National economic activity was shifting from large to small firms as the Fortune 500 companies represented 20% of employment opportunities in 1970s and only 8.5% of employment opportunities in 1990. During this same shift historians note the “demise” of mass production and the “promotion” of specialization in the U.S. economy (Bingham, Hill, & White, 1990).

Today policymakers recognize Birch’s findings but question the accuracy of his assessment of the then contemporary shift. Many question Birch’s methods of analysis and the actual truth behind his assumptions; but, regardless of this uncertainty, the impact of Birch’s work on public policy and economic development practices was substantial. States started using public funds to encourage business start-ups, and expansions and retention of existing businesses. This resulted in indigenous businesses being offered a broad range of help that included capital, new technology, management assistance, and even workforce training (Waits, 1998).

The fourth and final factor that impacted the change to the second wave was the federal government’s retreat from economic development support. Republican administrations in the mid to late 1980s reduced federal involvement in economic development steadily cut program from the budget, and restricted the use of program funds to narrowly-defined categories. Examples include Reagan’s new federalism policies which cut over $7 billion in aid to cities in the early 1980s. States and local governments began to expand their own efforts with this shift (Waits, 1998).

These four factors contribute to the way public policy perspectives and economic activities changed in two major ways. First, the reality that smokestack chasing was not

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4 According to the United States Department of Commerce 70% of all American products were competing with imports by the mid-1970s, and between 1960 and 1980 the U.S. share in world trade manufactured goods, measured in terms of value, declined from 24% to 17% (Eisinger, 1988).
developing sustainable and beneficial economic opportunities meant that new economic
development efforts were redefining the very essence of economic development. The
Council of State Planning Agencies stated “economic development [is] the process of
creating wealth... [and] development is more than the creation of jobs” (U.S. Congress
House 1985). Strategies were then geared away from generating the largest number of
jobs possible and growth for growth’s sake. Rather each state emphasized the quality of
jobs and “more rewarding prosperous employment and business opportunities” (Eisinger,
1988). Second, pressures of globalization, the rapid development of small business and
their seeming contribution to the economy and employment, and declining federal
involvement in state economic development all created the urgency for communities to
focus on their internal business development tactics. States had to either create ways to
finance economic development internally or had to seek financial support from the
private sector. For many communities this meant that local organizations took on the role
of economic development and solicited support from the private sector at the local level.

CDCs were positioned as local community-based entities and therefore were
already addressing issues of inequality and poverty. But with budget cuts because CDCs
were originally “experiments in democratic community development,” they struggled to
grow and create social benefits as they relied on federal and state grants for funding
(Pinsky, 2001). Therefore many turned to non-governmental support to carry out their
mission. Support came from religious institutions for many urban CDCs in New York
and Boston. With this private financial backing some CDCs expanded their mission to
address unequal access to financial services and capital.

It is difficult to cite the exact reasons for the expansion of many CDCs to CDFIs,
but one impetus for the transition is remembered as the uneven wealth of the American
population. As Americans gained personal assets and experienced an increase in wealth,
financial institutions began servicing individuals and devising products and accounts
specifically made for personal savings. Again, resting on the value of equality, in terms
of access to social services, political decision making, and even community development
CDCs transitioned to provide financial services. If all Americans were generating greater
wealth, CDCs questioned if all Americans why all American were not being offered
financial services to save and invest.
At the same time national political attention was focused on financial disinvestment in low-income communities. Low-income communities not only were not being offered equal financial services from mainstream financial institutions, but they were also being overlooked by mainstream investors. In the wake of the 1970s and the Civil Right Movement this further propelled political attention to “underserved” communities:

“As structural disinvestment proceeds, several important changes start to occur in the neighborhood economy. Jobs disappear, and with them the income for families whose members held those jobs. … [H]ousing values start to drop, so that even those families who have an investment in a house find that the value of the house is declining faster than their equity is building up. Taxes start to decline, and government is likely to cut back some of the normal maintenance. … Families and individuals who have lost some or their entire income bases become dependent upon welfare and unemployment support. … [G]overnment expenditures will continue to rise while the job base erodes and financial institutions divert money out of, rather than into, the community” (Bradford, 1981).

Recognizing a need to counter disinvestment, the Community Reinvestment Act of 1977 (CRA) was passed by President Carter. The CRA “recognized a continuing obligation on the part of federally insured depository institutions to help meet the credit needs of their entire communities, including [low and moderate income] areas and individuals, consistent with safe and sound banking practices” (Hagerman, 2007; Pinsky, 2001). Although the CRA was monumental for communities, in the first 10 to 15 years after it was passed banks committed more than $1 trillion to minority and lower-income communities. Only 2% of these funds was actually allocated. The CRA did not specify ways in which financial institutions could implement their regulated commitment to communities, therefore they were allocating resources for investment but were unable to direct funds to projects, businesses, and individuals. They were unaccustomed to servicing the targeted communities that the CRA was passed to support.

Then in just two years between 1990 and 1992 almost 98% of these stagnant allocated funds were invested. The reason for the change was partly due to the booming economy, and the expansion of financial markets, and partly due to President Bill Clinton’s enforcement of the CRA. Clinton also supported the formalization of the CDFI industry. CDFIs made is easy to invest in low-income or minority markets and gave an
connection to these markets for mainstream financial institutions. This translated into an avenue for CRA targeted funds to be utilized. New CRA regulations soon recognized CDFIs as “qualifying investments and borrowers, making it easier for banks to finance CDFIs and, in turn, for CDFIs to finance community development projects” (Pinsky, 2001).

**Current View of Economic Development**

Today economic pressures, political pressures, and overall changes in the financial services industry continue to impact the flow of capital to CDFI. The most recent influence is the consolidation of many large financial institutions, and the increasing liquidity strains on mainstream markets. CDFI’s are changing and economic development policies and practices are forming a new third wave strategy. Unlike the first and second wave academics argue that this third wave does not eliminate the first and second wave but builds on their foundations. This wave creates a greater context for how economic development can encompass sustainable financial practices, to become flexible and prepared for challenges ahead (Blakely & Bradshaw, 2002; Gaither, 2002).

Many economic development theorists argue that third wave approaches need to leverage capital (both human and financial) to increase local business competitiveness. Specifically, there is a need for the third wave to invent new organizational approached to create a “supportive economic development marketplace of ideas” within local communities (Friedman & Ross, 1990). This is a concern for the overall performance of the economy and achieving higher levels of productivity (Fosler, 1992). One way to reach this idea is through public-private partnerships and utilizing mainstream models of financing and mainstream capital sources.

From a historical perspective this aspect of the third wave is similar to that of the second wave. The CRA was part of the second wave and was created to redirect mainstream capital to finance economic development. But, as the CRA is over 30 years old and communities need more sophisticated capital infusion it is no longer an effective answer by itself. Additionally, although the CDFI fund still is able to provide grant funding from the government it is not able or expected to solely support the entire CDFI industry’s liquidity needs. Instead the CDFI fund mainly provides supplemental support,
and places a priority on equity or net worth financing. The fund does not emphasize using federal funds for absolute community benefit; rather the fund encourages public-private partnership. One recent example is the New Markets Tax Credit (NMTC) program administered by the Treasury Department as part of the CDFI fund. The NMTC program emphasizes using CDFI funds to leverage private sector capital, shifting to encourage public-private partnerships and possibly mitigating for federal budget cuts. Tax credits are given for private investments in targeted communities.

Blakely suggests that this third wave is evolving to transition economic development tactics to use “regional resources to support the growth of specific industrial cluster of related firms.” This is similar to second wave tactics which emphasize focusing on local businesses for employment growth, but is also an attempt to recognize that the skill sets of a given labor force and given geographic constraints may actually be essential to the ability of new economic firms to compete (Blakely, 2001; Blakely & Bradshaw, 2002).

Merging the idea of creating public-private partnerships with the importance of supporting a region's local resources to develop the capacity of a community creates an interesting position for CDFIs. As financial intermediaries CDFIs must develop their own capacity to be financially sustainable. As this thesis will demonstrate CDVC financing fits within the newest paradigm of economic development theory, because CDVC funds make “investments” in a business to serve as a catalyst for “new” growth. CDVC funds also finance opportunities in low-income or underserved communities for improving individual's wealth. This is because CDVC funds specifically focus on “good jobs,” which is in line with second wave ideas of developing individuals. In economic development practices the importance of this factor can not be overlooked, as Steven Greenhouse's book *The Big Squeeze: Tough Times for the American Worker* explains:

"one of the least examined but most important trends taking place in the United States today is the broad decline in the status and treatment of American workers. . .that began nearly three decades ago. . .[and] a profound shift has left a broad swarh of the American workforce on a lower place than in decade past, with health coverage, pension enefit,s job security, worklodas, stress levels, and often wages growing worse for millions of workers" (Greenhouse, 2008).
Therefore, CDVC funds are essentially developing economic opportunities through investing in new business entities to motivate growth, motivate change, and build the capacity of a community and individuals. While investing CDVC funds also generate financial returns and are positioned to be financially sustainable entities because they are not fully dependent upon government funds or grants. Woody Tasch, the Chairman of Investor's Circle, said that the future of economic development is directed by the fact that "the philanthropic institutions that arose out of the last century's historic explosion of financial wealth now stand on a new threshold." Tasch argues that "ahead is [a] new vision, a new world of social investing and shareholder advocacy and definitions of fiduciary responsibility that integrates accountability for long-term social and environmental impacts into the very wealth creation process itself," (Tasch, 2003).

Merging the "wealth creation process" with "social impact investing" is known as "double bottom line" investing, which is exactly in line with CDVC financing.

In summary, CDVC funds invest with a double bottom line, in low-income communities, to promote sustainable economic development and financial returns. The key for CDVC funds is both their own sustainability and creating a sustainable impact. Therefore as CDVC funds operate to create or enhance value and create "good jobs" for individuals, while regional economies are pressured to create new value opportunities which are "fueled by innovation" CDVC funds are positions to directly "open up new economic vistas," (Drabenstott, 2005). Remembering Joseph Schumpeter's definition of entrepreneurs as the "fundamental impulse that sets and keeps the capitalist engine in motion," CDVC funds are essential for creating economic development growth. Mark Drabenstott, in Rethinking Federal Policy for Regional Economic Development, put it best by writing "if innovation is the fuel in the process, then entrepreneurs are the engines—turning ideas and knowledge into jobs, income and wealth. Whereas past development strategies often aimed at big firms, small entrepreneurial companies are the pack mules for economic development," (Drabenstott, 2005).
Chapter 4: Community Development Venture Capital as an Industry

What does it mean to be a venture capitalist?

Comparing Venture Capital and Community Development Venture Capital

Industry Challenges and Obstacles

Chapter 4: Community Development Venture Capital as an Industry

As noted in Chapter 3, Community Development Venture Capital funds (CDVC funds) occupy the newest paradigm of CDFIs through mission-driven venture capital investing. Funds act as equity investors, and supply capital to local businesses to promote economic development. They are an integral part of the CDFI industry. With a majority of CDVC funds financed by mainstream financial institutions, they are also financial intermediaries that connect mainstream capital to underserved markets. The combination of providing capital access and acting as market intermediaries positions CDVC funds to influence the economic capacity of communities.

Moving forward from describing the context in which CDVC funds operate, and their role as economic development entities, this chapter presents the current CDVC industry. It begins with a description of CDVC investing and describes how the investment structure is based on a venture capital (VC) model. This chapter then describes how CDVC funds are both similar and different from traditional or mainstream VC funds. Because CDVC funds strive for both financial and social returns (a double bottom line approach to investing), the chapter ends with a discussion of how the structure of double bottom line investing leads to an economic development impact.

What does it mean to be a venture capitalist?

As VC investors, CDVC funds invest with "money and expertise necessary to make a company a success" (Lubar, 1990). They financially support businesses through equity investments and strategically guide them through management involvement. As venture investors they invest in "the most innovative and promising companies" that show potential but are "young firms...in their early years," (Rubin, 2007b). Therefore, investments are longer-term than debt, and are without a required debt service. This is one beneficial aspect of positioning investments to meet the needs of early-stage businesses. The rationale behind this investment structure is that businesses in their early-

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stage need not immediately worry about repayments and debt service obligations. Instead early-stage businesses should focus all of their financial resources on growing and expanding. New businesses require a start up period and this structure helps prevent a business from failing under the burden of too much debt financing early on (Hill & Shelley, 1990).

An investor expects that the business will generate substantial returns, and therefore forgoes immediate repayments. By not investing in mature and profitable firms venture investors are making a “calculated bet or wager,” as investments are essentially “illiquid and worthless until a company matures.” VC investments fund “new ideas that could not be financed with traditional bank [debt],” causing a tremendous amount of uncertainty for the investor behind this equity capital (National Venture Capital Association Yearbook, 2007).

To mitigate risk venture investors take on an ownership position. As a partial owner they guide the operations and productivity of the business they are invested (also known as a portfolio company). For CDVC funds, and VC funds, investments are strategic and often result in a partnership between a fund and a business. A fund manager may sit on the board of a portfolio company and actively plan for the growth of that business. This management involvement may mean that a CDVC fund manager guides a business to hire a new CFO or CEO, or helps a business raise additional financing from other investors.

The purpose of the ownership position is also to maximize a business’s potential while a venture capitalist is invested. The entrepreneur or business owner that a VC or CDVC fund financially supports usually has limited experience beyond overseeing day-to-day operations. Rarely do they have the time or expertise to plan for long term growth. Venture capitalist investors are usually experienced business consultants, who have reviewed thousands of business plans, evaluated which plans have potential to be successful, and have then overseen the development and growth of many businesses. Therefore even if a fund has never had the opportunity to invest in the specific industry of the business, they still can provide business development expertise. Overall venture capitalists only survive in the industry if they are able to generate ongoing profits; therefore they are very strategic investors and have insight into general business practices.
that can make a business a success. Further, they probably have extensive experience with different financial constraints across sectors. Although they may not have specific industry experience they have the financial experience. Usually this means they can predict what a business needs to do well and become profitable (Venture Impact, 2007).

Finally, VC investments have defined life cycles that are unique to equity investors. This begins with organizing a fund and raising capital (or fundraising), then transitions to investing (in businesses and/or entrepreneurs), and then concludes with exiting investments. How a fund is financed or capitalized often guides decisions concerning where the fund invests. Some funds are focused on the high tech or bio tech industry and therefore are capitalized by soliciting investments from entities that are interested in this industry.

The life cycle of an investment ends with the exit. As discussed in the introduction, the exit is the time when financial returns are realized for investors. For all equity investors, value or enhancement is realized at the exit, when an investor or fund sells its ownership position. This is because at the exit an investor can “capture the difference between the initial purchase [price] of that ownership stake and the subsequent sale price [of that] ownership.” The exit is then synonymous with a change in ownership (Hamerman, Sommer, Orville, & Pickering, 2007).

Comparing Venture Capital and Community Development Venture Capital

As financial intermediaries VC funds play a distinct role within a financial market. A market is defined as the space within which funds flow between investors and investees—or from lenders or borrowers. Capital market theory states that markets act competitively, in perfect efficiency, if there are many buyers and sellers who all make rational decisions, focused on maximizing profits. Further, four factors must exist for pure competition and efficiency in a market: (1) all information is transparent, that is no firm or consumer has more information concerning a product or service than any other; (2) there are no barriers to entry into the market; (3) there are no transaction costs of doing business; and (4) all firms product identical goods or offer identical services. (or borrowers) (Seidman, 2005).
In financial markets intermediaries or institutions match the risk profile of investors (what risk investors are willing to take on) and the returns investors are hoping to generate. Intermediaries essentially match “buyers” and “sellers” in the “capital market.” Financial transactions with less risk are assumed to yield lower return, and those with higher risk a higher return. VC funds are positioned as intermediaries within a distinct capital market, known as the private equity market. Investors in this market invest through four four sub-specialized mechanisms: through leverage buyout transactions, through venture capital, through mezzanine debt/distressed debt, through fund-of-funds, and/or through secondary purchases. Overall private equity investors are seen as making very high risk investments, because investments are illiquid and are usually made in companies that have no other financing options (Venture Capital Association Yearbook, 2007). With this in mind VC funds do not invest in every deal presented, but have a high level of scrutiny, and for every 100 business plans that come to a VC fund only about 10 get a serious look. Only one may end up being funded (Venture Impact, 2007).

Due to this selection process and risk profile the VC industry is a highly competitive way to finance a business, and is only appropriate in specific situations. Within the industry there are four common reasons as to why a business will seek venture capital. These reasons reflect the importance of VC financing, and explain the obstacles that a business may confront from mainstream public market, which draws them to the VC arena. These reasons are uncertainty, information gaps, the nature of the firm’s assets, and market conditions. Uncertainty is the most common reason that businesses seek VC financing because venture financed businesses are usually without a solid history of profitability, therefore banks or other institutions (that provide debt) are unwilling to invest. Information gaps usually mean the inability of financial institutions to “see what an entrepreneur sees.” Gomper and Lerner explain:

“Because of his day to day involvement in a firm [or industry] an entrepreneur knows more about his company’s prospects than investors, suppliers, or strategic partners. . .investors are unable to make appropriate decision regarding where and when to invest [if they are unfamiliar with a business or that businesses’ industry]” (Gompers & Lerner, 2004).
Venture capitalist are strategic investors and often invest in specific industries over and over, therefore they develop expertise within a certain market. The composition of a prospective portfolio company's assets is an obstacle because debt financing, in particular, is often impossible if a business is unable to offer tangible assets for assurance or collateral. Usually an entrepreneur does not have his business up and running or does not have the hard assets necessary to back debt financing. Instead, an entrepreneur seeks financing based upon an idea and a vision, but not usually on an already successful and tenured business. To compensate for a lack of hard assets as collateral a venture capitalist takes on an ownership position for security. The final constraint that businesses face is market conditions. Both the financial markets and business market (that the business is in) can influence the supply of capital to a business. This is usually caused by liquidity pressures in the economy or an adverse market for a business's goods or service (Gompers & Lerner, 2001).

These four reasons suggest that VC firms provide businesses that are unable to gain financing elsewhere access to expansion stage equity. Therefore some economists suggests that VC investing goes beyond its equity investment structure and that VC investing is inherently related to economic development—extending capital to business's who are unable to obtain financing from mainstream public markets (Gompers & Lerner, 2001). These economists also suggest that VC funds contribute to regional economic development through job creation (Venture Impact, 2007). The National Venture Capital Association argues that the industry has created over 4 million domestic jobs since the mid-1970s (National Venture Capital Association Press Release, 2007).

In general, although VC investors may in fact be expanding capital to businesses which are unable to receive financing from mainstream financial institutions, funds do not have a focused attention on stimulating or creating economic development. As explained “the objective of a venture capital firm is to generate long term capital appreciation through . . . investment. Even though venture capitalists assist in the creation of jobs and the economic development of businesses within a region, the important driving factor is the realization of substantial capital gains” (Davis, 1986). The intention of a VC firm is to enhancement the value of a business to realize “capital gains” for investors, not specifically to generate widespread “gains” for employees, individuals or a
community to change the "distribution of wealth" and the "capacity of a community." Therefore, even if a VC fund creates jobs or generates wealth (for employees or individuals) it is a byproduct and not an intended outcome.

This is the main difference between CDVC and VC funds. CDVC funds have a double bottom line missions, focused on not only generating wealth for investors but also on generating economic improvements for individuals and a community. Furthermore, even though VC funds operate to improve capital access to business, which may be overlooked by mainstream public financial institutions, there are still capital supply gaps. CDVC funds amend for these failures and extend capital to businesses which are often not attractive to mainstream VC investors—businesses they are smaller, in alternative industries, and/or in different geographic areas, including both urban and rural low-income communities.

Table 4.1: Industry Overview

<table>
<thead>
<tr>
<th></th>
<th>CDVC INDUSTRY²</th>
<th>VC INDUSTRY³</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funds</td>
<td>89</td>
<td>1,343</td>
</tr>
<tr>
<td>Average Deal Size</td>
<td>$10,000 - $250,000⁴</td>
<td>$3.6 - $9.6 million</td>
</tr>
<tr>
<td></td>
<td>$250,000 - $1 million</td>
<td></td>
</tr>
<tr>
<td>Average Fund Size (fund)</td>
<td>$1.5 - $5 million⁴</td>
<td>$175.6 million</td>
</tr>
<tr>
<td></td>
<td>$10 - $20 million</td>
<td></td>
</tr>
<tr>
<td>Capital Under Management</td>
<td>$935 million</td>
<td>$235.8 billion</td>
</tr>
</tbody>
</table>

¹ See Chapter 3 discussion and definition of economic development.
² Industry information concerning CDVC funds is from the Community Development Venture Capital Alliance, personal interviews with the Alliance's president Kerwin Tesdell, personal interviews with researcher Julia Sass Rubin, *Financing Low-Income Communities* (Rubin's most recent book), presentations from the CDVCA Annual Conference, and from the CDFI Data Project. The number of CDVC funds includes capitalized funds, fully invested funds, and funds in formation.
³ Industry information concerning VC funds is from The National Venture Capital Association, Yearbook 2007. The Yearbook is produced in conjunction with Thomson Financial which classifies venture capital firms as private independent firms, financial institutions, corporation, and other entities. Number of funds is those funds that are not liquid, meaning a majority of capital is invested (National Venture Capital Association Yearbook, 2007).
⁴ The first amount in each row is the average size from CDVC funds' original funds. Most CDVC firms have a second fund which is larger and deal size is consequently greater. The second amount is the average deal size and fund size of firm's second and/or third fund. The industry has experienced a "bifurcation" in the last 5 years, and second funds by CDVC firms are usually larger with more mainstream capital investors behind them. This is discussed in the "Investment Characteristics" section and in the "Capitalization" section to follow.
For economic development theorists, this is defined as the supply side of economic development. CDVC funds make investments in businesses that mainstream VC funds do not and increase the supply funds. To fully demonstrate the difference between how CDVC funds operate from mainstream VC funds is to recognize how their double bottom line approach affects all parts of the venture capital investment cycle. Table 4.2 describes both industries, by number of firms, average deal size, average fund size, and capital under management. Today there are almost 800 VC firms in existence in the United States, and they manage and run 1,343 VC funds. Most are organized with a general partner and limited partners. The general partner takes over all responsibility for management of the fund and the limited partners provide the financial capital for investments. Firms usually have more than one fund, and even begin fund-raising for a second or third fund when the prior fund still has investments outstanding. As the CDVC industry becomes more established, firms are able to raise a second and third fund, and grow their average investment size (*National Venture Capital Association Yearbook*, 2007; Tesdell, 2008).

In understanding the VC industry and CDVC industry it is important to clarify the differences between capital under management and committed capital. **Capital under management** is the amount of money that a fund has raised from outside sources and currently has invested. It is the “cumulative total of committed capital less liquidated funds or those funds that have completed their life cycle.” **Committed capital** is the total amount of money that a fund raised from private sources, or that private sources have “committed” to the VC fund. If an entire fund is invested, and no portion is liquid, then committed capital is equal to capital under management (*National Venture Capital Association Yearbook*, 2007).

Today, many CDVC firms are in expansion stage. The first CDVC fund in the United States was Kentucky Highlands Investment Corp. (KHIC), formed in the 1970s in rural Appalachia. In the past 10 years the industry has seem dramatic growth, from just over 50 funds to 89 funds. The amount under management has increased from

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5 Corporate venture capital groups do not raise outside venture capital in the traditional sense. The National Venture Capital Association does not include their capital in possession as capital under management (*National Venture Capital Association Yearbook*, 2007).
approximately $400 million to $935 million. The industry had a large increase in activity in the late 1990s, fueled by the overall expansion of financial markets and record-breaking profits in the then strong economy (Rubin, 2007b).

For the mainstream VC industry, from the 1990s into the early 2000s, there was considerable industry expansion. But, since the millennium there has been a contraction in the number of VC firms, from over 1,500 to just over 600 (from 2000 to 2007, respectively). The cause of this decline is the internet bubble burst. In the past 2 years the mainstream VC industry has seen modest growth (National Venture Capital Association Yearbook, 2007). Other recent trends in the mainstream VC industry have been caused by the most recent liquidity pressures on capital markets and although “venture capitalist are still investing in new projects...[they] now [invest] with a sense of caution.” Specifically in their concentration areas of Silicon Valley and New England, which both experienced between a 20% and 30% drop in investment activity, from January to March of 2008 (Weisman, 2008).

Capitalization:

In the last 30 years, the pool of capital managed by VC and CDVC funds grew dramatically. The VC industry experienced a large shift in capital contributions from pensions funds in the early 1980s, following the United States Department of Labor’s clarification of the prudent man rule (National Venture Capital Association Yearbook, 2007). Overall the CDVC industry’s capitalization has increased as it attracts more capital from public financial institutions, and from socially-responsible high-net-worth individuals.

Today, pension funds are the single largest supplier of new capital to the VC industry. Over a 10 year period (from 1990 to 2000) they supplied over 44% of all

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6 Capital under management was about $1 million in the mid-1990s and there were approximately 6 funds (Rubin, 2007).

7 The shift in capital from pension funds is in line with the clarification of the “prudent man” rule in 1979 by the UNITED STATES Department of Labor of the Employment Retirement Income Securities Act’s (ERISA). Before this time pension funds were obligated to invest with the care of a “prudent man” and consequently many avoided investing in venture capital entirely. The clarification of “prudent man” stated that portfolio diversification was a consideration in determining the prudence of an individual investment. Thus the ruling implied that “an allocation of a small fraction of a portfolio to venture capital funds is not imprudent” (Gompers & Lerner, 2004).
capital to the industry. Endowments and foundations were the second largest source (17%), and insurance companies the third (16%). Other sources include private investors, investment banks, and funds of funds. California, New York, and Massachusetts-based investors provide, on average, 65% of the capital under management for mainstream VC funds. This concentration of investors is parallel to the geographic concentration of investments that mainstream VC funds make in the United States (discussed below) (National Venture Capital Association Yearbook, 2007).

The way in which CDVC funds are structured and capitalized contributes to their investment practices. As noted in Table 4.1, the CDVC industry is "bifurcated." This is represented by the way funds invest and by their capitalization. Older and smaller funds are usually nonprofits that raise funds from investors with stringent social requirement. Going forward, as firms create their second and third funds, there is increasing similarities between CDVC funds and mainstream VC funds. While capital still comes from socially minded individuals and institutions, CDVC funds are also soliciting support from mainstream financial institutions who seek market-rate returns. Of newer funds (second and third funds of CDVC firms), 90% of capital comes from financial institutions. Overall banks are the largest investors in CDVC funds (contributing 42% of capital in the industry) (CDFI Data Project, 2006; Tesdell, 2008). This is largely due to CRA targeted

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8 Each year the National Venture Capital Association tracks sources of capital investment, under management and new capital raised. The Association presents this information with the caveat that from firm to firm the definition of capital under management differs. Therefore comparing where funds raise their capital, or sources of capitalization, can be inconsistent. In general these percentages are an average from the United States Department of Labor and from the Association.
investments. As mentioned there is a growing amount of capital from public financial institutions, and also from pension funds. Additionally the entire socially responsible investment industry has attracted attention from mainstream investors, bringing more capital to the entire spectrum of socially responsible investing (Rubin, 2007b; Simpkins, 2006; Tesdell, 2008). Overall the CDVC industry is still capitalized from a much more diverse group of investors than the VC industry.

Investment Characteristics:

Comparing investment characteristics mainstream VC funds make much larger investments than CDVC funds, and the average minimum deal size for VC funds is triple the average maximum deal for CDVC funds ($3.6 million verses $1 million). For the mainstream VC industry the size of deals is reflective of the stage financing a business needs. For example seed or early stage companies had an average deal size of $3.6 million, expansion stage an average deal size of $9 million, and late stage an average deal size of $9.6 million (Private Equity Primer, 2008; National Venture Capital Association Press Release, 2007).

For CDVC funds the size of deals is usually based on a fund’s nonprofit or for-profit status. As seen in Table 4.1 and mentioned under “Investment Characteristics” this has also caused a “bifurcation” within the industry (Rubin, 2007b). Typically smaller investments (in absolute dollars between $10,000 and $250,000) are from smaller funds that are nonprofits, and target specific distressed rural and urban areas. Larger investments are from larger capitalized funds, which have a for-profit structure and make investments in a broader geographic region and invest in a wider variety of businesses (Rubin, 2007b).

Today, in the VC industry, “a business concept needs to address world markets, have superb scalability, be made successful in a reasonable timeframe, and be truly innovative...a concept that promises 10 to 20 percent improvement on something that already exists is not likely to a get a close look,” (National Venture Capital Association Yearbook, 2007). As noted, especially in the first few months of 2008 the industry has seen a slowdown and therefore has become more and more subjective concerning investment decisions. But, VC investing is still much larger than CDVC investing in the
United States. Also, most VC firms are very specialized and often invest in only one field or industry, and/or one stage of business, and/or one geographic region (Private Equity Primer, 2008). An example of this focus may be telecommunications in the San Francisco Bay area, utilities and oil in southern Texas, or emerging clean technologies (cleantech) along Route 128 in Massachusetts. In the past 5 years there have been specific geographic concentrations of VC investments in New England and Silicon Valley, California (Weisman, 2008).

CDVC funds are much less concentrated in terms of geography, stage, and even industry than are VC funds. Although CDVC funds concentrate investments in certain areas of high unemployment or because of a low-income population they are not motivated by geography in the same way that mainstream VC funds are. VC funds argue that investments are “pooled in areas offering the highest rates of returns” or are made in businesses that are geographically in a “position to win.” This is unlike CDVC geographic desires—which are focused on areas that are not positioned in places of economic prosperity or economic opportunity (National Venture Capital Association Yearbook, 2007). For VC funds this is evident by the fact that two thirds of mainstream investments are made in five concentrated areas (San Francisco/San Jose, Boston, New York, Houston, and Los Angeles), and two areas (Silicon Valley and Boston) account for nearly half of all committed capital. “Secondary cities,” meaning those cities in the United States which account for roughly half of the population and over two fifths of payroll, account for less than 15% of all domestically generated investments (Carlson & Chakrabarti, 2007). This information is not available for the CDVC industry but recently funds have made investments in Maine, Ohio, North Carolina, Kentucky, Philadelphia, and even in rural Appalachia. There is no geographic concentration of funds or investments but over 30% of investments made to date have been in rural areas (Henderson, 1987; Rubin, 2001; Tesdell, 2008).

VC funds are usually attracted to businesses in the computer software/high technology sector, biotechnology sector (which below is included in healthcare), media

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9 Stages’ refers to the length of time and profitability of a business that a fund is investing in. Start up or seed stage is usually associated with financing an entrepreneur who needs capital to purchase a building, hire employees, and literally start their firm. From here business ‘stages’ usually transition to ‘early stage,’ and then to ‘growth’ or ‘expansion stage’ and then to ‘later stage.’ As a business becomes more profitable and established they are considered at a later stage in their life cycle.
and entertainment sector, and/or retail/communications sector. Cleantech is an emerging area of concentrated VC investing. In 2007 VC firms invested over $2 billion in cleantech companies (National Venture Capital Association Press Release, 2007).

In the CDVC industry there is less of a focus on a single industry or sector. In 2006 retailing/media and service/food sectors received the most funding (22% and 24% respectively) and industrial/energy and healthcare sectors the second most (18% and 16% respectively). The CDVC industry is also experiencing a shift from manufacturing to cleantech and to more “information” investing, which is investing in businesses that have emerging technologies (Tsedell, 2008; CDFI Data Project, 2006). These investments are similar to those in the mainstream VC industry, but are deemed a socially responsible investment because of their specific environmental focus.

**COMMUNITY DEVELOPMENT VENTURE CAPITAL**

![Community Development Venture Capital Pie Chart]

**VENTURE CAPITAL**

![Venture Capital Pie Chart]

Exits:

For traditional VC funds the most common forms of exit are through an initial public offering (IPO) or through a merger or acquisition (M&A). An IPO is the sale or distribution of stock of a company to the public for the first time. A merger or acquisition is when a company is sold and its operations are either acquired by or merged

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10 The mainstream VC industry does not segment clean technology companies in their own investment industry category. Clean technology (or cleantech) comprises alternative energy, pollution control and recycling, power supplies and conversation (Venture Impact, 2007; National Venture Capital Association, 2008).

11 Historically IPOs have been the main mechanisms for exit for venture capital funds, but today the most common exit for venture capitalist is through a merger or acquisition. Joseph Bartlett of VCExperts suggests that the industry will soon reverse this trend and “get back more in balance,” (Bartlett, 2008). Many issues of Venture Expert, the trade magazine for venture capital funds, also suggests this shift.
with another existing firm. In both cases, it is common for a business to consolidate or change operations, in which “greater efficiency us supposed to be achieved by the elimination of duplicate plant, equipment, and staff, and the reallocation of capital assets to increase sales and profits,” (VC Experts, 2008). Therefore, as an inherent and necessary part of the venture capital cycle, the exit often “arouses considerable controversy” and many “critics have claimed huge job losses” are inevitable with both of these types of mainstream venture capital exits (Lerner & Gurung, 2008; , Measuring Impact Toolkit, 2005).

For CDVC funds the most common type of exit via an external sale or through the addition of a debt-based financial instrument. \(^{12}\) An exit through an external sale is when the CDVC fund sells its ownership position to an unrelated party, and an exit through the addition of debt is when a business takes on a loan to repay the CDVC fund. In both cases an outside investor, financial institution, or company replaces the CDVC fund's financial support. For an external sale, an outside investor acquires an ownership position in the business and there is a transfer of ownership from the socially responsible CDVC fund, (Hamerman, Sommer, Orville, & Pickering, 2007; Tesdell, 2008). If the CDVC fund's equity is replaced by debt the CDVC still relinquishes its ownership position, either to existing employees or a new owner. Also, in both instances, post-exit operations usually remain intact.

Although, the CDVC industry is rapidly expanding, many investments are in industries that are service based (retail, media, business/financial services, or food service related) or light manufacturing (including food production and natural product production). The value of these businesses is tied to each company's ability to produce, create, and/or offer a unique product or service. This is further discussed in the “Pre-Existing Conditions” section of Chapter 7, including an explanation of how this

\(^{12}\) Kerwin Tesdell, Community Development Venture Capital Alliance President, at the Community Development Venture Capital Annual Conference on March 26, 2008, stated that the two most common types of exits for CDVC funds are through an external sale or near-equity loan repayment. The Alliance’s trade publication, The CDVCA Equity and Near Equity Primer defines ‘near-equity’ investments as debt-based instruments that attempt to capture some of the “upside return characteristic of equity.” Near-equity investments are debt obligations that either are combined with royalties (a loan with the right to a percentage of company sales or profits), with warrants (the option to purchase equity at a pre-negotiated price), or with a convertible option—meaning the debt can be converted to equity within a given time frame (Hamerman, Sommer, Orville, & Pickering, 2007).
characteristic of CDVC investments usually impacts the exit. Overall Chapter 7 explains that a CDVC portfolio company is usually purchased for its operations. In some cases this is because the acquiring company wants to increase its product line to include the unique product or service that these companies provide. Additionally, the way in which a product or service is produced or offered is unique and therefore is an inherent part of the value to the business. An example of this type of acquisition is seen in the purchase of Burt’s Bees by Clorox. Clorox does not have a socially responsible nor environmentally sustainable business model, but Burt’s Bees produces an all natural product and is a socially and environmentally-minded company. Clorox purchased Burt’s Bees and kept operations and production in tact. This is because the value of Burt’s Bees brand is tied to the company’s socially responsible and environmentally sustainable business model. The value of Burt’s Bees brand would be compromised if operations changed post-exit, and the company was consolidated and merged into Clorox.

Financial Returns:

In terms of financial returns most VC funds measure returns in two ways: first, an annualized internal rate of return (IRR) since fund inception, and second the internal rate of return (IRR) over the last year, three years, five years. The first way is known as the cumulative returns method and the second is known as the “investment horizon” method. The National Venture Capital Association tracks deal flow and VC return information for the entire industry, on an investment horizon or “time horizon basis; that is the one-year, three-year, five-year, 10-year, or 20-year time periods ending September 30, 2006” (National Venture Capital Association Yearbook, 2007). The association also segments return information by investment stage. Seed/early stage VC funds had a 10-year IRR of 38.3% and a 20-year return of 20.5%, for the period ending September 2008. Balanced funds, meaning funds that do not invest only in businesses in one specific stage, had a 16.9% 10-year IRR and a 20-year return of 14.6%. Later stage funds had a 9% 10-

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13 By convention the industry reports IRR net to investors (meaning after the management fees, the general partners’ interest, and all other fund expenses have been covered). To calculate the IRR fund usually use cash out flows (or amount invested) and the cash returns (amount in dividends, partial interest, or stock). To calculate the cumulative rate of return before the fund is fully exited of investments, VC funds usually have evaluate the net value of the investment (Schmitt, 2002).
year IRR and a 13.7% 20-year IRR (National Venture Capital Association Yearbook, 2007).

For the CDVC industry the Community Development Venture Capital Alliance tracks industry information, but is unable to yearly generate industry-wide financial return information. Individual funds are also hesitant to suggest an annualized IRR or historic IRR for their funds. This is because the industry is still young and relatively immature. But, two studies suggest that double bottom line investors are able to yield substantial financial returns from investments. One study conducted in 2003 by Harvard Business School analyzed the financial returns generated by 110 early-stage companies backed by Investors’ Circle, a national network dedicated to early-stage investments in companies that deliver “commercial solutions to social and environmental problems,” (Salls, 2003). Although Investors’ Circle does not restrict investments to double bottom line returns, as CDVC funds do, this study gives a good indication what can be expected from CDVC funds. The study indicated that 32% of Investors’ Circle members received a positive IRR and 15% achieved capital preservation. The remaining 42% either had capital loss or a negative IRR. Additionally, the Community Development Venture Capital Alliance (CDVCA), the industry trade organization for CDVC funds, assembled a model portfolio of all exited investments from the three oldest CDVC funds in the United States. CDVCA looked at all exits of investments made between 1972 and 1997. These included 24 full and partial exits and seven complete write-offs. This model portfolio yielded a 15.5% annual internal rate of return, weighted by dollars invested, including write-offs. Because two of the three funds include in this study were not-for-profits, it is reasonable to assume that returns for the newer for-profit funds with pressure to exit within a limited period of time will produce higher financial returns (Rubin, 2001; Simpkins, 2006; Tesdell, 2008).

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14 IRR is the internal rate of return on investments. This is the discounted rate that equate to the net present value of an investment’s cash inflows and cash outflows. IRR is a standard measure of financial returns for venture capitalists, but it is often a complex measurement and can vary dramatically depending on timing of cash flows. Therefore venture capitalists do not take IRR in isolation when measuring financial returns. They usually combine IRR with an annualized rate of return since fund inception and the rate of return over a given time period-month month, year, 5 year period, (Schmitt, 2002).
Social Returns:

For the VC industry the most recognized research on the industry’s impact on the economy (and social returns) is presented in *The Money of Invention*, by Paul Gomper and Josh Lerner. As mentioned the VC industry is not focused on generation social returns from investments, as most funds are not double bottom line investors. Therefore they do not track or record social returns from investments. But, Gomper and Lerner provide evidence that VC investing has had a positive impact on job creation, revenues, and earnings potential of American businesses. Gomper and Lerner also suggest that VC funds contribute to society through supporting new innovations, and the discovery of patented technologies. Finally, when post-IPO performance is tracked venture-backed firms demonstrate a significantly stronger financial performance in the long run (compared to other companies that are publicly traded by not originally back by venture capital) (Gomper & Lerner, 2004).

With regard to job growth Gomper and Lerner do not specifically address the “long-run” impact of VC investing on jobs, but do state that venture-backed firms are accountable for 6.5% of job growth between 2000 and 2003. There is no indication as to weather these jobs are sustainable after an IPO or M&A exit. Recently the World Economic Forum published Volume 1: The Global Economic Impact of Private Equity Report, as part of a larger study entitled “Globalization of Alternative Investments,” shedding light on this question. The report focuses on the demography of private equity deals and both the willingness of private equity investors to make long-term investments and the impact of private equity investment on employment. It gives evidence that society may fear that equity-backed businesses may have employment decline after an investment (or post-transaction, meaning after the exit), it states that two years before an ‘exit’ or buyout a company cuts, on average, “more of its work force compared with its peers [which are not back by private equity], probably because it is struggling or trying to prepare for a sale.” One can infer that this means that the need for an exit or sale of ownership (which is necessary for equity investors to generate a return) requires job losses pre-exit. After the exit the study is not specific concerning employment growth or retention of original employees, but does state that if the exit is through an acquisition “on average, a business eliminates 7% of its work force over two years.” The study then
suggests that "there are usually new positions at a rate of, on average, 6% a year in a new location" or at a new facility, (Lerner & Gurung, 2008; Sorkin, 2008). One can deduce from these findings that there is a net loss of jobs by 1% from private equity investments in the long-run (meaning after 3 years). Joseph L. Rice III, who sat on the study's advisory board, commented that "a fair conclusion from the numbers is there [are no] pluses or minuses. You wouldn't say that private equity is the demon that some say it is, nor would you say it is the savior" (Sorkin, 2008). Both Gomper and Lerner's earlier works and this new study do not directly counter the fear that a change in ownership (at the exit) can result in job loss or displacement (Lerner & Gurung, 2008).

CDVC funds are double bottom line investors; therefore they actively are measuring and managing social returns, alongside financial returns. Each year the CDFI Data Project, a CDFI Industry collaborative of CDFIs, produces an impact report for the entire industry, which includes specific information for each CDFI model. The report cites the employment impact of 16 CDVC funds, as the total number of full-time-equivalents (FTEs) at the time of each fund's initial investment into portfolio companies, and at the end of 2005. FTEs grew from just over 4,000 to over 6,000, a 48% increase in total employment (CDFI Data Project, 2005). CDVC's commitment to low-income job growth also is seen by that fact that in portfolio companies (of CDVC funds included in the study) job absolute job growth as 56% from the time the CDVC fund first invested until the end of 2005. Additionally, 32% of investments were in rural areas, as compared to less than 1% of investments for mainstream VC investors (CDFI Data Project, 2006).

15 "The Global Economic Impact of Private Equity" focuses on private equity investing and "distinguishes private equity transactions as equity investments by professionally managed partnerships that involve leveraged buyouts or other equity investments with a substantial amount of associated indebtedness" from mainstream "venture capital investments in start-ups" which do not have the same leveraged position (Lerner & Gurung, 2008). In above mentioned discussion it is assumed that CDVC funds are more comparable to the general private equity industry and not the sub-set of mainstream venture capital firms, because even though CDVC funds sometimes investment in start-ups often they are part of multi-part financing packages in different stage of growth or development. A business is usually highly leverages and the equity investment a CDVC fund makes is complimentary to the existing financial structure. Further, at the exit, a majority of CDVC fund are able to exit investments through the addition of near-equity or debt related financing.
Industry Challenges and Obstacles

There are many challenges facing the CDFI industry as a whole (presented in Chapter 3) and these challenges also affect CVDC funds (as a sub-set of the CDFI industry). But, for CDVC funds specifically, many obstacles are rooted in capital flows—both in a fund’s ability to raise capital and then in a fund’s ability to disperse investments. The challenge of disbursement is seen as a demand side obstacle, and is the challenge of finding businesses that are not only in need of equity but that will provide both social and financial returns in targeted underserved communities. The challenge of raising capital is a supply-side obstacle, meaning it is an obstacle that may impede a CDVC fund from fundraising or generating a supply of adequate capital (which is necessary to fund subsequent investments).

Demand-side challenges are not isolated to CDVC funds. Quality deal flow is essential for CDVC and VC funds alike. But, CDVC funds finance businesses in industries or geographies that do not attract mainstream investors (including mainstream VC funds). Therefore “picking a winner” is a challenge for CDVC funds, and it further complicated by their investment practices which include the desire to generate both social and financial returns. CDVC funds target funds to businesses that will create social returns for a community and financial returns for investors.

Another demand side challenge that also complicates investing for CDVC funds is the fact that CDVC funds usually target businesses that have less developed and inexperienced management teams, which require substantial entrepreneurial and managerial assistance. CDVC fund managers can steer an entrepreneur or business owner, but do not take over operations. Therefore, a CDVC fund must find businesses with managers that are willing to learn and grow, and have the leadership and management skills to bring a company forward. Often a CDVC fund may recommend a change in management, but there has to be some leadership already in place for a CDVC fund to be confident that the business will expand, grow, and be profitable.

Supply-side challenges are not restricted to CDVC funds. With the economic slowdown of 2000, many CDVC and VC funds were unable to exit companies as quickly as anticipated, meaning that capital was committed longer than planned, which constrained their profitability levels. Specifically for CDVC funds, this limited the ability
of firms to raise capital for second and/or third funds. During this time, as the CDVC industry was in its infancy, this was somewhat of a set back. But, CDVC funds overcame this challenge and today, even with economic downturns, many funds are strategically raising capital for third funds. Today, the imminent challenge of being able to show a historical risk-adjusted rate of financial returns, to attract new capital, complicates fundraising. Some argue that the industry is simply not large enough, while others suggest that there are no consistent measurement tools available. Overall, in general, with limited performance history they can’t demonstrate financial success that is parallel to the mainstream VC industry. Challenged by competition from other socially responsible investors this further impedes funds. This is seen on the supply-side as more dollars are being invested, but more socially responsible investment intermediaries or financial institutions are soliciting this capital. On the demand-side, as capital access increases to low income communities there may evolve more competition between investment intermediaries to finance the most viable deals in these communities.

A final challenge facing the CDVC industry is that funds’ mainstream financial structure is often questioned because it is associated with highly lucrative financial intermediaries, which often are synonymous with creating a negative social impact on communities. Therefore CDVC funds are confronted with the challenge of abutting a mainstream stereotype simply based on their structure. This challenge was the subject of a discussion at the “September 2007 Peer Learning” Session hosted by the industry’s trade organization, the Community Development Venture Capital Alliance. Fund managers asked if there were industry patterns or characteristics of exited companies that stayed in place and grew after the exit, verses those companies that were shut down. As part of an ongoing industry debate, fund managers were concerned with how the industry was balancing between maintaining social value and financial profits, and what usually was happening to social impact at the exit and after. The next chapter of this thesis begins to address these concerns (CDVCA, 2007).
Chapter 5: Summary of Findings: Funds Overview

History and Investment Philosophy, Social Impact for Each Fund

CEI Ventures, Inc (CVI)

Boston Community Venture Fund (BCVF)

SJF Ventures (SJF)

Exit History of Funds

Chapter 5: Summary of Findings in Aggregate: Funds Overview

As Chapter 4 suggests, many challenges face the CDVC industry that relate to capital flows, both on the supply side and on the demand side. One way to attract socially motivated capital is to demonstrate the economic impact of investments and that CDVC investing is a sustainable way to motivate lasting social value. The introduction to this thesis asks the questions: What is lasting social impact? What contributes to lasting social impact for case study investments? What specific investment characteristics are shared by many case study investments, which can influence social impact/social returns? And, what measures do CDVC funds take to influence lasting social impact?

In an effort to answer these questions this thesis presents case studies of CDVC investments where lasting social impact occurred. Such investments and their exits occur within the context of the mission and goals of specific CDVC funds. Therefore this chapter presents an overview of the three funds that the five case study investments were made from. This chapter describes the history, investment philosophy, and self-measured social impact of each fund. This chapter then concludes with a discussion concerning the exit experience of each fund.

History and Investment Philosophy, Social Impact for Each Fund

Community Development Venture Capital funds are double bottom line investors, striving to generate both financial and social returns. Unilaterally, funds are focused on serving low-income communities and a distressed population, but each fund has a slightly different mission. The three funds in this thesis, CEI Ventures, Inc (CVI), Boston Community Venture Fund (BCVF), and SJF Ventures (SJF) demonstrate this variance.
CEI Ventures, Inc (CVI) – History and Investment Philosophy

CEI Ventures, Inc. (CVI) has a commitment to community development and seeks financial opportunities in a broad range of underserved markets. The fund mostly invests in businesses in New England. CVI began as a for-profit subsidiary of Coastal Enterprise, Inc. (CEI) a local CDC in Maine. CEI began in the 1970s when a local commercial fishing wharf burned down in Boothbay, Maine. Commercial and local fishermen scrambled to rebuild and CEI financed the reconstruction as a partial equity investor. After this initial equity investment, CEI invested in other local fisheries and natural resource companies in Maine.

In 1993 CEI Ventures, Inc. was founded as a community development venture capital fund to bring “focus and scale to CEI’s equity investing” (Bisson, 2002). Since inception CVI has “leverage[ed] its strong relationship with CEI, which is based on a shared vision and mission to jointly stimulate community and economic development” (Daigle, Hall, Jamal, Silva-Leander, & Tagar, 2004). CVI works with CEI and many times CEI provides technical assistance or employee training to CVI businesses. CEI also facilitates Employee Training Agreements (ETAG) with CVI portfolio companies to help fulfill each company’s responsibility to hire low income employees.

CVI states that each of its funds is a balanced equity portfolio diversified by industry and stage of development. Historically CVI has invested in businesses specifically related to Maine’s natural resources and its growing natural food industry, in small New England cities and town which are economically distressed, and in communities in upstate New York. Today it

An ETAG is a contract between an investor and a business to ensure that a certain percentage of new hires are of low-income. For CEI (the parent company to CVI, which oversees the ETAG) the agreement also means that a business commits to provide standard benefits and health coverage and CEI is the ‘first source’ for employment opportunities and openings. If a company that CEI is invested in has an opening, CEI acts as an intermediary and broker between the company and public funded employment, training & education programs. If a person is low income and in need of training and skill development the public program and CEI work together to prepare the individual for this opportunity (Biswas, 2007).

1 Information that is not cited in regard to CEI and CVI was generated from interviews and/or was compiled from internal CEI documents, including CVI mission statement and investment criteria pamphlets. Additional information came from presentations at the CDVCA Annual Conference, March 27-28, 2008 and industry information produced in conjunction with that conference.
invests in companies that are emerging, growing, or undergoing transformation. Investment criteria for CVI include: 1) a quality management team with relevant experience, visionary leadership, deep commitment and cohesive approach; 2) prospects for attractive returns with an appealing market opportunity, realistic projections, appropriate valuation and pragmatic exit plan; 3) competitive advantage through proprietary interest in technology, intellectual property, distribution system or other unique attributes; and 4) social benefit including quality employment opportunities, which is secured by an Employment and Training Agreement (ETAG). All investments require this agreement with CVI.

Successful investments for CVI usually meet the fund’s ideal investment strategy. This includes the fulfillment of a pragmatic exit plan. Even though the mission of CVI is to help individuals reach an “adequate and equitable” standard of living, it is difficult to state unilaterally every “pragmatic exit” results in lasting social impact for successful investments. In fact, Nat Henshaw, co-founder of CVI, explains that it is even complicated to draw a clear distinction between a successful and unsuccessful exit—from a social perspective: “In an ideal world [one would] look at sales and financial performance and if they are increasing [then] an investment is successful. . . on both social and financial levels.” This is “because increasing sales probably means increasing employment . . . and possible increased wages and benefits” (Henshaw, 2008). Then, at the exit in an ideal case, operations stay in the same location and employment is preserved or even increased post-exit. But, if a firm underperforms and sales remain flat or decline—a fund usually has to exit its investment without financial benefit. There are no financial returns generated and the business may close down—resulting in job loss for a community. At first this may appear as an unsuccessful exit all around, but from a social standpoint the business probably would have gone out of business much earlier had the CDVC fund not initially invested. Therefore, jobs were maintained or preserved for a certain period of time, and employees benefited from a longer duration of employment (which also means more experience in their job positions). Henshaw questions if this is truly a socially unsuccessful exit.
CVI's successful case studies presented in this thesis are: A & B Electronics, CV Finer Foods (now World Harbors), and Innox-V Systems. Each investment generated positive financial returns and has continued lasting social impact. Although CVI is unable to measure impact, post-exit interviews with current employees and owners confirmed that the social value generated when CVI was invested in the case study businesses was maintained post-exit. Further, in many cases, lasting social impact included an increase in social value. A & B’s exit was through a sale back to employees, CV to a larger competitor, and Innov-X to a mainstream private equity fund.

**CEI Ventures, Inc (CVI) - Social Impact**

CVI tracks social performance of investment through 46 measures. For CVI’s first equity fund CVLP (the first fund CEI established, which is currently fully invested and winding down):

- 95% of portfolio companies’ employees have health insurance
- 58% of portfolio companies have retirement benefits
- 23% of portfolio companies have educational assistance
- 47% of portfolio companies’ employees are partial owners or full owners
- 27% of portfolio companies have some type of profit sharing benefit

**SJF Ventures (SJF) – History and Investment Philosophy**

SJF Ventures (SJF) began through a partnership between David Kirkpatrick and Rich Defieux, who met at a recycling investment forum organized by Kirkpatrick in the late 1990s. Kirkpatrick ran an economic development firm and Defieux was a successful venture capitalist. Together they conceived the idea of forming a fund to invest in sustainable businesses that provided employment for low-to-moderate income individuals.

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2 Not all investments that are case studies cited as CVI investments where originally financed by CVLP or CVII LLC, the venture capital funds managed by CVI. But, investments received multiple rounds of funding and in most cases at least some capital was invested from one of the two CVI funds. Overall all investments were equity or mezz-equity, even if the first round of funding came from the parent CEI.

3 CVI is comprised of two venture capital funds, CVLP and CVII LLC. For the purposes of citing historical commitment to social impact equity investments from CEI, the parent non-profit CDFI is included.

4 CVLP records 46 social indices each quarter. These percentages are from internal CVI reports.

5 Information that is not cited in regard to SJF and SJF AS was generated from interviews and/or was compiled from internal SJF documents, the SJF website, mission statement, and investment criteria. Additional information was from presentations at the CDVCA Annual Conference, March 27-28, 2008 and industry information produced in conjunction with that conference.
They targeted environmentally sound and sustainable companies which often generate quality jobs in low-income areas. These companies were usually hampered by a lack of access to sufficient capital. In 1999 and 2000, Kirkpatrick and Defieux raised their first fund, SJF Ventures, Inc., based in Durham, North Carolina and had an office in Philadelphia (which was later moved to New York City). In 2001 SJF Ventures formed an affiliated business services firm, SJF Advisory Services (SJF AS), a nonprofit firm that provides entrepreneurial and management assistance and training to businesses. It also provides in-depth workforce assistance to cleantech and environmentally-focused companies. Because many SJF investments are in these fields, SJF AS further showcases new innovations in the field and possible investment opportunities at events it organizes. Further, it tries to match innovation with capital in emerging industries.

SJF is deeply interested in providing rewarding and sustainable jobs, investing in businesses that positively impact the world—such as reducing carbon emissions, providing healthier food, increasing access to information, and creating engaging work environments. At the present time, it is invested in or directing funding to the premium consumer product sector, cleantech, tech-enhanced services, and green technology firms. Representative investment areas include renewable energy and efficiency, organic and healthy consumer products, digital media and marketing services, electronic recycling, and outsourced business services. SJF distinguishes itself from other CDVC funds as it does not have a specific economically distressed targeted geography for investments, but rather focuses on businesses that employ low-to-moderate income individuals, throughout the Eastern United States. Ryla Teleservices, a case study for this thesis, is an example of this commitment. Though it is not based within a low-income community, it does hire from surrounding urban low-income neighborhoods.

SJF investment criteria includes investing in targeted businesses which are: 1) in a growth stage that require $1 million to $5 million in equity financing to produce rapid expansion (typically already revenue $1 to $20 million); 2) offering compelling solutions to urgent problems with socially responsible innovations that provide a competitive

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6 Cleantech covers a range of industry segments from alternative energy to water purification to advanced materials. Essentially, cleantech products optimize productive use of natural resources, while eliminating or reducing waste and adding economic value. Clean technology (cleantech) companies can also comprise alternative energy, pollution control and recycling, power supplies and conversation (National Science Board, 2006).
advantage in large high growth market; 3) representing management teams with deep domain expertise in their respective industries and a commitment to positively impact the world.

Additionally, SJF invests in firms that show promise of premium exits which can generate financial returns for employees, owners, and the CDVC fund. Anne Claire Broughton, the co-founder and Senior Director of SJF AS, suggests that it is critical to know that there will be an exit—but exactly what the exit will look like it is difficult to anticipate at the initial investment stage. Based on the stage and type of business in which SJF invests most, successful investments generate both financial returns and lasting social impact because when sold the new owner (often either a larger private equity fund or a larger business) is buying the firm for the overall value created by the products or services and the employees creating that value. New owners/investors are not looking for consolidation of businesses after the exit but many times grow the business they are purchasing in the existing location or nearby. The unique nature of the businesses means that it is not just a purchase of company and assets but a strategic decision for operations, management, and production.

In 2004, SJF AS compiled a study of how to best build the assets of low-wealth employee during employment and how employees can share in the financial benefit of a CDVC exit. SJF recognizes that the most common fund exits entail a company sale, which can potentially cause business relocation and subsequent loss of jobs. But, if the exit is synonymous with generating financial returns for owners/investors, the exit can also be a time when employees can financially gain—even if their jobs are not sustained post-exit. Therefore the study is focused on outlining ways in which employees can generate assets, including broad-based stock options, employee stock ownership plans (ESOPs), IDAs and Home Ownership Assistance Programs, Retirement Plans and Profit Sharing, and Financial Literacy Training.

Broughton wrote in the study that “obviously the question of sharing financial gains is moot unless the company is financially successful” (Broughton, 2004). This is a similar conclusion to Henshaw’s discussion of exits and CVI’s history. SJF suggests that profitability is the “core agenda of any early stage enterprise and its employees. . . [and that] company management has to be strong to help the company succeed.” Studying
investment performance from 17 CDVC funds, Broughton explains that the study proves that properly implemented employee ownership can lead to better company performance, and equity “ownership such as stock options maybe even more effective when coupled with a system of open-book management whereby all employees fully understand the company’s business model and goals” (Broughton, 2004).

SJF Ventures (SJF) - Social Impact

SJF tracks its own social performance through annual Mission Reports, which are a combined report of SJF and SJF AS. Overall the report for 2007 noted that as a percentage of the 13 most active portfolio companies:

- 100% of companies have some healthcare coverage (15.4% have 100% employer-paid, and 53.8% have 70-90% employer paid insurance)
- 83% of companies offer dental insurance
- 75% of companies offer retirement plans
- 92% of companies offer stock option plans, profit sharing, or retirement plans
- 50% of companies offer Employee Assistance Plans, including home buying and childcare assistance, wealth building or financial training

Boston Community Venture Fund (BCVF) – History and Investment Philosophy

Affordable housing in the Boston area was a major issue in the mid to late 1980s, as it still is today. In 1985 Boston Community Loan Fund (BCLF) was formed as a nonprofit organization to make loans to support the restoration and construction of affordable housing to address this pressing issue. In 1994, the organization established Boston Community Capital (BCC) and expanded its mission. BCC was a new nonprofit holding company to respond to new credit and capital needs in low-income communities. After reorganization, Boston Community Capital became the holding company of three nonprofit entities: Boston Community Loan Fund (BCLF), Boston Community Venture Fund (BCVF), and Boston Community Management Assets Corporation (BCMA). This

7 Information that is not cited in regard to BCC and BCVF was generated from interviews and/or was compiled from internal BCC documents, the BCC and BCVF websites, each organization’s mission statement, and investment criteria. Additional information was also gathered from case studies prepared by Ann Leamon, for the Community Development Venture Capital Alliance.
organizational structure was directed by BCC’s effort to figure out a way to “not only create wealth but to keep that wealth within communities” (Chen, 2008).

Boston Community Venture Fund invests in New England, but is interested in deals across the United States. The fund has a similar mission to those of CVI and SJF: to invest at the intersection of strong community values and solid business practices. BCVF does not impose a strict set of investment criteria but looks for businesses with: 1) strong management talent; 2) a clear competitive advantage and strong growth potential; 3) ability to generate social returns to the community; 4) revenue history demonstrating profitability; and 4) desire to be a long term partner with BCVF. The fund views job creation as a primary indicator of social return, and invests in businesses that provide quality goods and services to lower-income communities or disadvantaged populations, enhances the stability of lower-income or rural neighborhoods, or are businesses owned or operated by women or minorities. In addition, BCC seeks to invest in companies that produce products that enhance the environment or reduce pollution, but does not limit investments to one industry or geographic location.

BCVF fund manager Andrew Chen notes that he has never seen BCVF has never been involved in an investment where social and financial returns are completely opposite. “What tends to happen with investments that perform at less-than-expected levels is that there is a loss of social returns because the business isn’t doing well financially and can’t sustain itself.” Chen agrees with Henshaw’s notion that it is hard to distinguish a successful social value without considering the entire context of the investment and what may have happened without the CDVC capital. Part of BCVF’s investment process is to make sure social and financial returns are aligned and that the social benefits emerge as part of a company business model instead of being externally imposed. Although Chen notes that the exit is difficult to predict and it is impossible to entirely direct what happens post-exit, but this investment philosophy can help set up socially responsible practices or “institutionalize” socially responsible practices.

**Boston Community Venture Fund (BCVF) – Social Impact**

Boston Community Venture Fund in “A Platform for Transformation,” which is Boston Community Capital’s Strategic Plan for all organizations under its umbrella,
stated that BCVF is consciously trying to improve its performance both financially and socially. BCC is one of the most successful CDFI's in the nation and is a leader within the CDVC industry. The organization is constantly working on innovative methods to raise capital, disperse capital, and create social impact. Since inception BCC has:

- Generated over $50 million in equity for low-income and first-time homeowners
- Financed creation and preservation of more than 8,500 affordable and safe homes for families and individuals
- Committed more than $20 million to companies that generate social and financial returns
- Invested in more than 200 community organizations
- Created and/or preserved over 1,400 jobs, that provide living wages to an underserved population

Exit History of Funds

CVI, SJF, and BCVF are located in different geographic areas (Maine, New York and North Carolina, and Boston) but look for similar businesses to finance in low-income communities or to provide opportunities for low-income individuals. CVI has made many investments in companies related to food production, natural resources, and environmental (or cleantech) industries. CVI is focused on a balanced portfolio and does not target one industry or sector. SJF has a strong focus on the cleantech sector, but is also investing in the technology-enhanced service industry and premium consumer products industry. BCVF has financed food service or food production-related companies, a recycling company, and even a car sharing business. Therefore these funds present a wide range of investments across a wide range of industries, geographies, and business conditions.

Table 5.1 compares investments and exits from all funds of each firm (CVI, SJF, and BCVF). The table includes the number of companies each equity fund invested in or the “companies invested in” (this is not the number of investments but rather how many...
companies they have financially supported) and the number of "exits" each fund had from past portfolio companies. Exits include partial exits, meaning when a fund was able to generate financial returns from an investment, but did not entirely relinquish its ownership position. For a partial exit, a CDVC fund may sell shares back to a business or to a new investor, but generally the impetus for the exit is that the business has become profitable enough to provide financial returns to the CDVC fund. The CDVC fund usually has a less active role in the company after the partial-exit. Table 5.1 also presents the number of "financial & social exits." This is the self-reported number of successful exits that each fund has had. Each fund categorizes success differently, but in these cases a fund invested in a business, social impact or social returns were generated for the community, and the CDVC exited and financial returns were generated for investors. Financial returns were usually above the initially invested amount of capital.

It is important to note that absolute positive financial returns (the net gain verses amount invested) is not a typical way of measuring financial returns for investments. Rather mainstream VC funds usually measure returns by the internal rate of return (IRR) of investments. Mainstream VC funds also usually measure an entire fund’s IRR in aggregate. Most investors argue that you can have one "home run" investment that yields a tremendous return for investors, which can off set any losses. "You can lose $50,000 in an investment, or even $1,000,000, from a few investments and then you can make $10,000,000 from another..." and the entire portfolio can still yield substantial returns (Chen, 2008). Therefore looking at "social & financial exits" is only to shed light on the direction of how exits have been in the past for case study funds, and is not a true quantitative measure of returns or success rate for these funds.

It is also important to cite that many fund managers interviewed insisted that it is impossible to guarantee that whatever social impact or social value that is created from an investment continues post-exit; but when asked to describe instances of successful investments from both a social and financial perspective many immediately spoke of those investments that created lasting social value. Therefore, in Table 5.1, "financial & social exits" are not equated with lasting social impact in isolation, but are instead cases in which a social impact occurred, financial returns were generated, and in all instances (to the best of the fund manager’s knowledge) lasting social impact occurred. In many
cases, this means that social impact (an increased level of employment or wages or benefits while the CDVC fund was invested) were maintained after exit, and in some cases this also means that additional social impact was created post-exit. Therefore post-exit social impact was maintained or enhanced, or maintained and then enhanced, in all cases of “financial & social exit.” Finally, “jobs created” in Table 5.1 is one uniform measure that all funds were able to track and is usually an estimate; although, as this thesis presents effective and successful economic development practices do not simply mean more jobs or more wealth. Rather successful economic development financing creates sustainable jobs that can increase the wealth and well-being of individuals in a low-income community. Therefore even though job creation in isolation on the table it is not an appropriate measure of social impact, without understanding that underlying this value (jobs created for each fund) is the notion that these jobs were high-quality positions or “good jobs.” Each fund emphasizes that it does not focus on only creating job growth but on the development of quality opportunities.

Table 5.1: Exit History

<table>
<thead>
<tr>
<th>Fund</th>
<th>Companies Invested in</th>
<th>Exits</th>
<th>Financial &amp; Social Exits</th>
<th>Jobs Created</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEI</td>
<td>13</td>
<td>8</td>
<td></td>
<td>Over 2,000</td>
</tr>
<tr>
<td>CVLP</td>
<td>20</td>
<td>7</td>
<td>4</td>
<td>1,274</td>
</tr>
<tr>
<td>CVIILLC</td>
<td>15</td>
<td>3</td>
<td>2</td>
<td>465</td>
</tr>
<tr>
<td>Fund I (SJF)</td>
<td>19</td>
<td>6</td>
<td>*</td>
<td>1,306</td>
</tr>
<tr>
<td>Fund II (SJF)</td>
<td>7</td>
<td>0</td>
<td>0</td>
<td>439</td>
</tr>
<tr>
<td>BCVF (Fund I and II)</td>
<td>14</td>
<td>10</td>
<td>3</td>
<td>1,400</td>
</tr>
</tbody>
</table>

* For SJF three exits were successful from both a financial and social perspective in the short-term, but all other exits had some type of financial and/or social benefit, to investors and/or employees.

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9 CEI, CVLP, and CVIILLC sometimes make multiple investments in one business (and often CVLP will first invest in a business and CVIILLC will make a subsequent investment). This is common for venture capital funds and is referred to as ‘rounds of investments.’ Therefore the number of ‘companies invested in’ does not equal the number of total equity investments made to date.

10 Nat Henshaw of CVI noted ‘successful exits’ are difficult to describe therefore ‘Financial & Social Exits’ mean recent exits that generated both marked financial returns for the fund and social benefit (employment based) for a low-income community. The percentage of employment increase was not considered, only that the quantity of jobs or the quality of existing jobs was improved, but both did not have to occur.

11 CEI is not a venture capital fund but a nonprofit Community Development Corporation, therefore it’s mission is not tied to investing equity in businesses. CEI’s equity investments were made only to meet specific needs of businesses prior to the formation of CVI (and the 2 funds, CVLP and CVIILLC). Outstanding investments total 626 in both loans and investments.

Table 5.2: Fund Overview

<table>
<thead>
<tr>
<th>Firm &amp; Funds</th>
<th>Fund</th>
<th>Year Established(^{13})</th>
<th>Under Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>CVI (with CEI equity)</td>
<td>CEI</td>
<td>1984</td>
<td></td>
</tr>
<tr>
<td>CVI</td>
<td>CVLP</td>
<td>1996 (closed in 1999)</td>
<td></td>
</tr>
<tr>
<td>CVI</td>
<td>CVIILLC</td>
<td>2001 (closed in 2004)</td>
<td></td>
</tr>
<tr>
<td><strong>CVI Total</strong></td>
<td>2 funds</td>
<td>$25.5 million</td>
<td></td>
</tr>
<tr>
<td>SJF</td>
<td>Fund I</td>
<td>1999 (closed in 2000)</td>
<td></td>
</tr>
<tr>
<td>SJF</td>
<td>Fund II</td>
<td>2004 (closed in 2007)</td>
<td></td>
</tr>
<tr>
<td><strong>SJF Total</strong></td>
<td>2 funds</td>
<td>$45 million</td>
<td></td>
</tr>
<tr>
<td>BCVF</td>
<td>Fund I</td>
<td>began in 1997</td>
<td></td>
</tr>
<tr>
<td>BCVF</td>
<td>Fund II</td>
<td>began in 2001</td>
<td></td>
</tr>
<tr>
<td><strong>BCVF Total</strong></td>
<td>2 funds</td>
<td>$21.5 million</td>
<td></td>
</tr>
</tbody>
</table>

As presented in Chapter 4 the CDVC industry is far less developed, with less capital under management, than in the mainstream VC industry, as noted in Table 5.1. Table 5.2 indicates the year each fund was established and funds under management. The parent firm (of each CDVC fund) is historically prominent within the CDVC industry, and all have at least one fund that is over 10 years old. Usually each fund takes between one and three years to capitalize. For BCVF two funds are fully committed; CVI and SJF are actively investing their second funds. All funds express an interest in raising a third fund.

Of the ten exited companies, Henshaw (CVI fund manager, which includes CVIILLC and CVLP) said six made solid financial returns for investors, and had positive social impact during the time of investment and initially at the exit. In any of the six instances there is no reason to believe that the social benefits created have disappeared post-exit (three of the six are presented in this thesis and it is therefore confirmed that lasting social impact occurred for Innov-X, CV Finer Foods, and A & B Electronics). Henshaw believes that all are still operating in the same communities. Three of these businesses have experienced significant increase in employment since exit, one had slight employment growth, and three maintained the increased level of employment (which was initiated while the CDVC fund was invested) post-exit.

SJF’s history is not as long as CVI’s, but SJF has had two successful funds and has invested in 26 companies. Its social commitment to communities is demonstrated by

\(^{13}\) This is usually the year that a fund started to raise funds or capitalize, and is not the year that funds started to invest.
the employment growth and employee asset accumulation in portfolio companies. Anne Claire Broughton, SJF AS co-founder, explained that in nine portfolio companies asset accumulation measures exist for employees. Therefore even businesses that maybe bought and/or relocated at the exit, which will consequently cause job losses, employees are positioned to financially benefit from the exit and/or from the companies financial success. Usually asset accumulation measures are employee stock options, which can be exercised at the exit. Broughton also explains that SJF looks for companies where employees get training and skills and where there is promotion from within. This further is a way for employees to expand their earning potential even if a company relocated and they loose their job post-exit. A fund cannot guarantee nor predict actions of a new owner, which is why the exit is so uncertain. Broughton says that SJF strives to create lasting social impact at the individual employee level. Therefore it is not practices to cite SJF investments as “socially successful” simply if jobs stayed in place. This is further supported by the fact that if any employees loose their job at the exit SJF and partner organization SJF AS has employment programs and would never “abandon” employees, but would actively ensure that they find other opportunities. In these cases defining lasting social impact by the maintenance of existing jobs post-exit is inaccurate.

For BCVF all portfolio companies experienced job growth while the CDVC fund was invested. BCVF is unaware of job growth or social gains since the initial exit, but the fund believes that at least three of the successfully exited companies are still located in the same location and continue to add jobs. Andrew Chen explains that this demonstrates that “building financially strong companies definitely [is a] critical part of social returns” (Chen, 2008). Chen also mentions that every company invested in received multiple investment rounds. When discussing successful investments, it is therefore important to not only consider the profitability of a company, but to also consider a CDVC fund’s financial ability to support growth.

For BCVF, the exits which did not yield financial and social returns reveal a different story for each firm. Seven investments were not deemed financially successful (out of the ten exits), but three of these still had employment growth while the BCVF was invested. Each of these investments did not return more than the firm’s invested capital. Overall this may appear counter to Chen’s claim that financial success is critical to social
returns, but by examining the lessons that BCVF learned from these investments a different situation is presented. In some cases BCVF was unable to stay invested for a long enough period to support the full capital needs of the business, and then to experience an enhancement in its equity stake (or increase in the financial worth of its ownership position). Chen explains that what usually happens is that if a company grows larger (and hence increases its social returns), the amount of equity required to continue to growth the business is often dilutive of investor value, in the short term. “Having enough capital to go through this phase and have the company to a scale where you begin to realize an increase in shareholder value is something that BCVF found to be challenging given the fund size” (Chen, 2008). BCVF learned that they needed sufficient capital to support growth.\(^{14}\) BCVF also learned that other investment partners (when investing as part of a large syndicate), and a company’s management team can also impede investment returns. If other investment partners desire to exit, or in BCVF’s case did not make additional rounds of investments which were necessary for the company to grow, the profitability of a business can be compromised. If the existing management team of a business is also unable to raise outside capital this can additionally adversely impact a company’s performance. Therefore the reasons for “less than ideal” returns, while a CDVC fund is invested, are not always tied to a business’s long-term financial performance.

A clearer relationship between financial and social success exists for CVI. Of the four investments that did not yield both financial and social returns two “did not go well for anyone.” For one investment the company was sold and jobs were lost with the consolidation. But before the sale the original firm filed bankruptcy and therefore jobs would have probably have disappeared anyway—as the company probably would not have recovered from its bankruptcy even if it was not consolidated through an acquisition.

\(^{14}\) “A Platform for Transformation,” Boston Community Capital’s Strategic Plan from 2006, cites reasons why BCVF did benefit from some of the first fund’s initial investments. The plan cites that the limited capital resources of BCVF’s first fund prevented the fund from providing the necessary amount of capital to grow to a level where the CDVC fund would benefit. In these cases BCVF had to “exit early” from the investment (“A Platform for Transformation,” 2006).
Chapter 6: Summary of Findings: Lasting Social Impact Case Studies

What is Social Impact? What is Lasting Social Impact?

Community Development Venture Capital funds' investments target companies that provide “good jobs,” or employment opportunities that pay good wages, provide benefits, offer wealth-building opportunities, and provide training and opportunities for advancement (Measuring Impact Toolkit, 2005). In this chapter social impact/social returns are measured by both the amount of jobs created and any changes in the quality of employment opportunities. This chapter assumes that all jobs created are “good jobs,” and specifically cites “lasting social impact” by comparing pre-exit (or when a CDVC is invested in a business) and post-exit (after the exit of an investment) conditions and qualitative and quantitative changes in “good jobs.” Lasting social impact is beyond what occurs immediately after an exit and includes a sustained or increasing level of improved social conditions. Therefore this thesis compares the conditions during these two time periods and draws conclusions (in Chapter 7) concerning what impacted these changes.

Each Case Study: Pre and Post Exit Descriptions

For this thesis, five investments from the three firms (SJF, CVI, and BCVF) demonstrate that lasting social impact is possible, in CDVC fund investing. Below these investments are presented in narrative form. What is meant by “lasting social impact” is described for each investment from the perspective of fund managers and current employers and/or owners. Information is then categorized into Table 6.1 and 6.2, and is presented in Appendix B for each investment.

<table>
<thead>
<tr>
<th>Social Conditions</th>
<th>Financial Conditions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment (number of jobs)</td>
<td>Growth (sales, profits)</td>
</tr>
<tr>
<td>Benefits (healthcare, pension plan, 401(k), stock options, job training, advancement opportunities, etc.)</td>
<td>Location Change</td>
</tr>
<tr>
<td>Profit Sharing &amp; Employee Ownership</td>
<td>Type of Exit</td>
</tr>
</tbody>
</table>
This chapter presents a narrative of investments, in order to focus on the story behind each investment and to fully understand what contributes to lasting social impact (or pre-exit conditions that positioned a business to have lasting social impact). Influencing factors or investment characteristics are then presented in aggregate in Chapter 7.

These stories provide a larger picture of circumstances. As Rob Hollister wrote “to expect a CDFI to have a measurable, sizable effect on the degree of poverty in a given area is unrealistic” (Hollister, 2007), therefore the stories do not attempt to suggest that CDVC investing is a universal solution or economic development tool which can entirely alleviate poverty problems. Rather, these stories provide evidence that there is social impact and lasting social impact for some communities and individuals. James Nixon, a CDVC fund consultant, suggests that there are important facts that are “behind the aggregate numbers” which can only be seen by understanding the “rich stories” that accompany investments (Hagerman, 2007a, 2007b).

While the CDVC funds are invested (pre-exit), each fund changes in both social and financial conditions. Still, post-exit information is usually not recorded since the CDVC is no longer an investor or partial owner after the exit. In a few cases, the CDVC fund had a partial exit, and therefore the fund still records these measures. Otherwise all information was collected through interviews with each company.

**CEI Ventures, Inc’s investment in Innov-X Systems, Inc. (Innov-X)**

Innov-X Systems, Inc. manufacturers a hand-held elemental analyzer, a point-and-shoot tool to confirm and measure the presence of elements. The company is based in Woburn, MA. When Innov-X first came to CVI it was seeking funding for product development. Co-founders Don Sackett and Brad Hubbard were running the business. As entrepreneurs, Sackett and Hubbard invented the first hand-held element analyzer and the company was already rapidly growing. The founders originally capitalized Innov-X through individual private investors and their own financial assets.

**Pre-Exit:** While CVI was invested in Innov-X, sales grew from $4 million to $40 million. The company’s rapid expansion accelerated employment growth from 14 employees to over 100 employees. All employees had healthcare and were able to
participate in a 401(k) retirement account. A fairly broad-based employee stock option plan remained in place for employees to financially benefit from the company’s profitability. An entrepreneurial team of inventors led Innov-X, and had a combination of sales and marketing experience with technological product and development experience. They also had a combination of academic backgrounds in chemistry, nuclear physics, and engineering. The founders remained in control of the company, with the addition of ownership positions of CVI and a mainstream private equity firm.

**Post-Exit:** CVI had a partial exit from Innov-X after approximately three years. Today CVI owns less than 10% of the company and plays a less active role in management. CVI financially benefited from the exit. Post-exit the company continues to grow and revenues are rising. Operations are expanding constantly to meet demands and the company now has worldwide offices in Woburn, The Netherlands, and Hong Kong. The foundering owners have a smaller ownership position today, and at the exit a mainstream private equity firm purchased a significant portion of the business. As the company continues to improve profitability, benefits have also increased. Employees pay a small percentage of healthcare costs and have the option to set aside pre-tax dollars for healthcare (flexible spending accounts). The company still maintains a 401(k) plan and has incorporated an employer matching program. Management recognized that low-income employees were not taking advantage of the 401(k), and consequently mid-level and upper-level management were limited to their contributions. To allow for additional contributions and to stimulate more low-income employees’ participation the company created the matching program. With internal sales growing rapidly, Innov-X also expanded its incentive-based stock option plan, which is guaranteed for employees who remain with Innov-X for one year or more. This means that after one year of service every employee gets some stock options. Innov-X is in the 90th percentile for pay scale, compared with other firms in related industries: Sackett explains that “the environment at [Innov-X is that] we expect quality [and] you will be rewarded for it well” (Sackett, 2008). Additionally the company now offers research grants as part of an Academic Relations Program. Innov-X offers free training through the grant program and technical assistance for innovative ways of using its product—including to academic institutions, nonprofits, consultants, and technicians in a wide variety of fields. With time social
conditions continue to increase for employees and the company hopes to improve training for mid-level management. Sackett explains that with rapid growth mid-level managers have expanding responsibilities. Managerial requirements “go past existing employees skillsets very quickly” as the firm’s sales exponentially increase. Sackett explains that sales team managers in a $1 million or $5 million company are very different than in a $40 million or $50 million company—therefore mid-level managers are just not equipped with the leadership skills and training. Consequently, the company hopes to expand training and to add additional management to its firm.

**CEI Ventures, Inc. investment in A&B Electronics (A & B)**

A & B Electronics is located in Berlin, NH and manufactures electrostatic precipitation pollution control equipment also known as solenoid rappers. Rappers are used in the pollution control industry to “rap” electrostatically charged grids which collect pollutants from smokestack emissions. Berlin is a low-income small city that suffered from the decline of the domestic paper industry in the 1990s. The city is adjacent to the Androscoggin River which also suffered from pollution problems related to the paper mills. Before CVI invested in A & B the company was controlled by an absentee owner.

**Pre-Exit:** While CVI was invested in A & B, employment slightly grew; health insurance (100% paid by the company) and a pension fund remained in place. CVI’s investment helped two long term employees, Sue Martin and Ron Goyette, become owners. CVI’s equity was combined with debt from other economic development lenders and was used to buyout the absentee owner. Once acquired by Martin and Goyette with the support for CVI, A & B’s sales slightly grew and operations became more efficient as the company could produce an expanded product line of coils without major capital expenses or changes in operations. If CVI had not stepped, in the business would have been sold to an out0of-state investor. CVI helped facilitate an exit in which the two owners were able to buy out CVI with net assets and the addition of debt financing. Again, this was helping A & B stay in the community of Berlin. A & B also signed an ETAG with CVI, ensuring that even if a few job opens occurred at the company A &B
would contact CVI and the CDVC fund would work with local employment program to
direct the openings to those in need as a “first source” (Henshaw, 2008).

Post-Exit: Since CVI has exited this investment, Martin and Goyette have remained
sole owners. Martin and Goyette were once the controller/bookkeeper and a lineman at
the plant. Since the exit revenue growth continues at a steady pace and the owners have
personally increased their individual earning potential and financial positions. There is
not a tremendous amount of employment growth but under their management the
business is still located in Berlin and still provides low-income job that benefit the
community. A & B is known as a place for those transitioning off welfare and other
social service programs in an economically distressed region. The company is still a
small firm of less than 30 employees.

CEI Ventures, Inc. investment in CV Finer Foods (CV)

CV Finer Foods began in Winthrop, Maine by entrepreneurs Garth Vdoviak and
Frank Carr. Both are food industry veterans who had worked in New England in the
natural food industry for many years. Vdoviak was a specialty foods product developer
and Carr was a specialty foods distributor for a large supermarket chain. The company is
known for its World Harbors line of high quality healthy easy to use sauces and
marinades.

Pre-Exit: While CVI was invested in CV Finer Foods the company was located in
Winthrop (a rural low income community). The company expanded from 13 employees
to 22 employees and maintained healthcare, dental and life insurance. The company
increased their portion of healthcare coverage and began a 401(k) plan while CVI was
invested. Employment opportunities also became more technical as production shifted
away from manual labor. As equipment was upgraded, existing employees were retrained
to oversee more automated operations. This didn’t displace existing workers but changed
their role to inspectors and managers, rather than physical laborers. Wage scale also
increased to above minimum wage for all workers. At the exit a significant number of
employees benefited from broad-based distributions, even though the company did not
have a formal plan in place. Most employees received $13,000 at the exit, which was a
substantial portion of most of their salaries. At the exit the company also relocated to a
nearby town of Auburn, Maine. Although this is a 35-mile distance from the original plant almost all employees transitioned to the new plant. The move was necessary for business expansion of product lines. Garth Vdoviak, a co-founder of CV Finer Foods, remembers the move and that almost all employees stayed with the company initially. In fact even a few who left came back to CV post-exit.

**Post-Exit:** When CVI exited its investment in CV Finer Foods the large food industry firm of Angostura bought the company. Vdoviak remains involved in the company and oversees product development for Angostura's World Harbors division. Immediately at the exit the business was profitable but did not expand at the pace projected by management. Recently, the business experienced a slight increase in employment and all employees still have extensive benefits and constant job training. Safety and production skills are taught that are specific to the food industry. This means that employees are developing industry-specific skills, which makes them marketable to firms in the growing natural food production industry of Maine and northern Vermont. It was important to Garth Vdoviak, as well as his co-founder Frank Carr, that the business be sold to someone who would continue to "take it forward" and "build the brand up." Therefore when CVI and CV were entertaining an exit it was important to find an investor or company that would keep CV Finer Foods in Maine. Vdoviak recalls that he could predict lasting social impact even before CVI was entertaining an exit.

**Boston Community Venture Fund investment in City Fresh Foods (City Fresh)**

City Fresh Foods came to Boston Community Venture Fund because they signed a new contract but couldn't cover the payroll to fulfill that contract. Instead of financing short term liquidity needs, BCVF saw an opportunity to partner with City Fresh. The company was founded by Glynn Lloyd in Roxbury, an urban neighborhood of Boston. The company originally provided meals to the elderly through a contract with Meals on Wheels. City Fresh meals were unique for Meals-on-Wheels as they were community-made and included Latin, Caribbean, and North American soul foods. City Fresh was started by Glynn Lloyd who wanted to create a business to hire local low-income individuals and give them opportunity for advancement.
**Pre-Exit:** While BCVF was invested in City Fresh the business started catering meals to charter schools and daycare centers. BCVF helped the business grow and install management systems by working with the two founders on regulating operations—including mechanisms to track orders and to coordinate deliveries. BCVF also helped City Fresh secure long-term bank financing. When the business first started it offered minimal healthcare coverage. As profitability and sales grew the company expanded benefits to include healthcare and a 401(k) retirement plan. Additionally, before the exit City Fresh expanded operations and purchased its own building in Dorchester, Massachusetts. Although this meant a move from the original location in Roxbury, City Fresh became an anchor in a low-income community for stable employment. While BCVF was invested, employment grew from 10 to 32 jobs. The company experienced double digit revenue growth every year.

**Post-Exit:** When BCVF exited, Unidine purchased City Fresh. Today the company is still in Dorchester. Unidine was attracted to City Fresh because it was able to gain access to minority business contracts and a new market with the acquisition. The acquisition also expanded Unidine’s operations to service this new market. This meant that employees and the actual business were valuable to Unidine. Lloyd remains committed to keeping the business in the Boston urban area and City Fresh has expanded its employment base to 63 people from the community and reached $4 million revenues in 2006. In one year, sales increased by $500,000, and City Fresh is still 51% owned by the founders. City Fresh continues to have a core service of meal delivery. The partnership with Unidine was optimal for employees because operations remained in place post-exit. The very nature of the business was dependent upon contracts from the immediate community and employees from the community. Unidine recognized this importance and kept the location, management, and operations the same post-exit. The company was a compliment to Unidine’s existing operations.

**SJF Ventures, Inc. investment in Ryla Teleservices (Ryla)**

Ryla Teleservices is a telephone service company that originally provided support for Dun and Bradstreet financial service agency. Today it is a customer contact solution company, still based on providing high quality teleservices. The company is located in
Kennesaw, Georgia, which is a suburb of Atlanta, and draws employees from all over the metro area Atlanta. Although the company is not in an economically distressed community, it does hire low-income individuals from nearby urban Atlanta. The company was founded by Mark and Shelly Wilson, socially-minded owners who are focused on empowering associates and providing opportunities to grow personally and professionally. The Wilsons’ business philosophy is unique for the teleservices industry which services financial institutions, healthcare companies, and insurance agencies. Wilson formed the business based on a philosophy that he wanted to reward employees for providing high quality service and wanted to ensure that the company did not have high turnover (which is consistent within the industry). Therefore from the beginning Wilson treated employees as part of the Ryla team, and was in tune with how to make the workplace profitable, productive, and additionally motivating for employees.

**Pre-Exit:** While SJF was invested in Ryla, the founding entrepreneurs expanded the business from 16 employees to over 300 employees and went from a single-shift operation to a double-shift operation. The business also expanded healthcare coverage to pay almost 100% for employees. SJF initiated the development of a broad-based stock option plan for key employees who had been with the company since inception. Additionally, Ryla improved job training classes to encourage employee advancement. Ryla grew to become the Local Service Firm of the year for the U.S. Department of Commerce’s Minority Business Development Agency in 2004.

**Post-Exit:** Since this was a partial exit for SJ, the CDVC fund still owns approximately 10% of Ryla, but the CDVC fund did make a substantial financial profit from this investment Ryla has continued to expand since the exit, and moved operations to a nearby location—in another suburb of Atlanta. It still offers quality jobs and many benefits (including personal financial literacy classes, broad based stock options, 401(k) retirement plans, in-house management skillset classes). Today the company has over 350 employees and spends approximately $250,000 per year on employee retention programs. In an industry where high turnover is expected, Ryla strives to develop employees and promotes from within, therefore encouraging employees to stay with the company. The broad-base stock option plan is still in existence and the firm boasts that it "has an accessible management team, and establishes an environment where people can
advance...[and] makes sure everyone's connected with the mission of the business” (Covel, 2007).

Summary of Lasting Social Impact

In summary, the above investments had lasting social impact; that is, there has been a change or a sustained level of social impact since the exit of the CDVC fund. This is NOT the change that occurred while the CDVC fund was invested in these businesses, but is rather the actually “lasting social impact.” Again, for a more in-depth display of changes at all stages of investments (before, anticipated, during, at the exit, and after the exit) please see the Appendix and Social and Financial Conditions (Appendix B).

In all cases management was retained as well as any increase in employment that occurred while the CDVC fund was invested in these businesses (pre-exit). Usually post-exit employee training expands and there is an increase in asset accumulation benefits for employees after the exit. These generally mean an enhancement to an existing stock option program for employees. This shows a commitment by the new owner (or the employee/owners if the business is now owned by former employees) to profit sharing. Full employee ownership only existed in one instance (A & B) and partial ownership for another three companies (City Fresh, Ryla and Innov-X). In these cases original owners and/or employees still own a portion of each business. This information is summarized in Table 6.3, and in Chapter 7 these cases are presented and investment characteristics are explained that describe what may have contributed to lasting social impact.

<table>
<thead>
<tr>
<th>Company</th>
<th>Employment Qualitative</th>
<th>Employment Quantitative</th>
<th>Ownership</th>
<th>Type of Exit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innov-X</td>
<td>Increased</td>
<td>Increased</td>
<td>Partial Ownership</td>
<td>Private Equity</td>
</tr>
<tr>
<td>A &amp; B</td>
<td>Maintained</td>
<td>Maintained</td>
<td>Full Ownership</td>
<td>Employee Buyout</td>
</tr>
<tr>
<td>CV</td>
<td>Increased</td>
<td>Slightly Increased</td>
<td>No Ownership</td>
<td>Acquisition</td>
</tr>
<tr>
<td>City Fresh</td>
<td>Maintained</td>
<td>Slightly Increased</td>
<td>Partial Ownership</td>
<td>Acquisition</td>
</tr>
<tr>
<td>Ryla</td>
<td>Increased</td>
<td>Increased</td>
<td>Partial Ownership</td>
<td>Private Equity</td>
</tr>
</tbody>
</table>
What Contributes to Lasting Social Impact?

The Introduction to this thesis posed two questions: First, can a CDVC fund achieve a double bottom line mission and create a sustained or lasting social impact? Second, are there characteristics that case study investments share, which contribute to lasting social impact? Chapter 6 answered the first question through presenting social conditions pre-exit and post-exit for case study investments. Chapter 7 now answers the second question.

Although for each case study a CDVC fund may have had a different investment strategy, and each business a different operational structure, business model, or even geographic dependency in terms of a customer base, there are characteristics which can affect lasting social impact in common across almost all case study investments. These characteristics are categorized in this chapter in relation to the investment cycle. (Table 7.1 indications questions or subtopics for each investment cycle category, which are answered in aggregate for all case study investments).

In addressing these characteristics, it is important to reiterate the definitions of social impact and lasting social impact, to clarify the fact that it is nearly impossible to measure outcome verses impact for investments. First, in this thesis social impact is defined as a change in the quantity or quality of employment opportunities.\textsuperscript{15} Therefore lasting social impact is the retention or increase of social impact post-exit. If a change in the quantity or quality of jobs occurs while a CDVC fund is invested in a business, this is the social impact of a CDVC investment. If this increased level of employment (qualitative or quantitative) is sustained or further increases post-exit then this is lasting social impact.

The second clarification is to address the inability of measuring outcome verses impact for CDVC funds. Although many characteristics outlined in this chapter...
Influence the overall social impact generated through CDVC investing, there is the imminent concern that no counterfactual exists to link the social impact directly with the investment. This is presented by fund managers as the "but for" question: What would have happened if the CDVC fund had not invested? ‘But for’ the CDVC fund’s investment would this business become a profitable business that offers stable employment in this low-income community, and consequently provide for social impact? (Hagerman, 2007a, 2007b; Hollister, 2007; Measuring Impact Toolkit, 2005; Tasch, 2003).

The same lack of a counterfactual flaws this presentation of characteristics that are cited as contributing to lasting social impact. But, as stated in the Introduction, this thesis is not presenting a tool for measuring lasting social impact nor offering an industry-wide standard that, if followed, will guarantee lasting social impact. Rather this thesis suggests that investment characteristics (both those pre-existing and those that a CDVC can control or influence) can contributed to lasting social impact post-exit.

Investment Characteristics Overview

As explained, this chapter now will present characteristics which are related to the investment cycle and are in four categories: “Pre-existing Conditions” which are characteristics prior to the CDVC fund investing and include pre-existing business practices (industry, operations); “Financial Performance” and “Social Positioning” which are characteristics that describe the changes that occurred while a CDVC fund was invested in a business; and “Exit Conditions” which are characteristics that directly impact the exit structure, including the structure of the exit and the perspective of the new owner/investor.

As VC investors, CDVC funds make investments in anticipation that they will enhance a business and eventually exit that investment. The double bottom line mission of CDVC funds means that they focus on generating both financial and social returns. Therefore this chapter describes that “Financial Performance” and “Social Positioning” characteristics are strategically important in growing a company and instilling operational efficiencies and socially responsible practices to ‘enhance’ a business. Still,
characteristics in the categories “Pre-existing Conditions” and “Exit Conditions” are the strongest influencing factors when considering lasting social impact.

The reason for the higher influence of “Pre-existing Conditions” and “Exit Conditions” is discussed in each category and can broadly be explained by highlighting what contributes to the value of a business. At the exit, a new owner/investor is attracted to a business because of this value. This value is usually a combination of a business’s ability to produce a unique product or service (and generate products or services in an efficient way that is different from peer firms) and a new owner’s/investor’s perspective. The perspective is reflective of how a business will compliment current business practices and/or diversify existing portfolios of investments.

If the value of a business is tied to the business’s ability to produce a unique product or service, then the value is tied to existing operations, location, and employees. Therefore a new owner/investor will most likely purchase a company and keep operations in place. Likewise, if the value of a business is tied to the fact that it is a compliment to the existing business practices of the new owner/investor, then again the business will most likely be kept in place and operations will continue post-exit. In both cases, lasting social impact is possible because the business operations are valued and consequently are maintained post-exit. Case study investments demonstrate these conclusions, both concerning the how of a unique product or service (in terms of operations) and a new owner’s/investor’s perspective affect business value at the exit, and subsequently lasting social impact.

Table 7.1: Investment Characteristics

<table>
<thead>
<tr>
<th>CATEGORIES</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-existing</td>
<td>What were pre-existing business conditions that impacted the value of the</td>
</tr>
<tr>
<td>Conditions</td>
<td>business?</td>
</tr>
<tr>
<td></td>
<td>Was the business a certain number of years in operations?</td>
</tr>
<tr>
<td></td>
<td>What product or service did the business produce or provide?</td>
</tr>
<tr>
<td></td>
<td>Did the business have an employee dependent or location specific operating</td>
</tr>
<tr>
<td></td>
<td>structure?</td>
</tr>
<tr>
<td>Financial</td>
<td>Did the company sales grow?</td>
</tr>
<tr>
<td>Performance</td>
<td>How/why did this occur? Did operating efficiencies or production change?</td>
</tr>
<tr>
<td></td>
<td>How did the CDVC fund contribute to these changes?</td>
</tr>
<tr>
<td>Social</td>
<td>Where there qualitative and/or quantitative changes in employee pre-exit?</td>
</tr>
<tr>
<td>Positioning</td>
<td>Did the investment structure include any employee wealth building?</td>
</tr>
<tr>
<td>Exit</td>
<td>What was the type of the exit? What attracted the new owner/investor to</td>
</tr>
<tr>
<td>Conditions</td>
<td>the business?</td>
</tr>
<tr>
<td></td>
<td>Did the location or management change at the exit?</td>
</tr>
<tr>
<td></td>
<td>What did the CDVC fund do to facilitate the exit?</td>
</tr>
</tbody>
</table>
Category: Pre-existing Conditions

As stated, “Pre-existing Conditions” are characteristics of a business prior to the CDVC fund’s investment. These characteristics often contribute to the social impact/social returns that occurred pre-exit (while a CDVC fund was invested in a business). For this thesis, these characteristics are isolated as conditions that affected or influenced lasting social impact.

Table 7.2: Pre-existing Conditions

<table>
<thead>
<tr>
<th>Company</th>
<th>Yrs</th>
<th>Product / Service</th>
<th>Employment/ Locat.</th>
<th>Owned/Managed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innov-X</td>
<td>3</td>
<td>High tech, environment related</td>
<td>Yes / Yes</td>
<td>Entrepreneur commitment</td>
</tr>
<tr>
<td>A &amp; B</td>
<td>20+</td>
<td>Technology and environment related</td>
<td>Yes / No</td>
<td>Employee ownership</td>
</tr>
<tr>
<td>CV</td>
<td>3</td>
<td>Food manufacturer, distributor</td>
<td>Yes / Yes</td>
<td>Entrepreneur commitment</td>
</tr>
<tr>
<td>City Fresh</td>
<td>3</td>
<td>Food producer, distributor</td>
<td>Yes / Yes</td>
<td>Entrepreneur commitment</td>
</tr>
<tr>
<td>Ryla</td>
<td>2</td>
<td>Teleservice</td>
<td>Yes / No</td>
<td>Entrepreneur commitment</td>
</tr>
</tbody>
</table>

For “Pre-existing Conditions” four characteristics are outlined in Table 7.2: “Years” is the number of years a business was in operations before the CDVC invested; “Product/Service” is the produce or service produced or offered, and the industry of the business; “Employment/Location” describes whether the existing business operations and value are tied to its employees or its locations; and “Owned/Managed” defines the ownership structure prior to the CDVC fund investing. As the Table shows all case study businesses were operating for three or more years when the CDVC fund invested. City Fresh was at breakeven profitability and Ryla and Innov-X were just beginning periods of tremendous growth. All three companies were expanding their service or product line and taking on additional contracts from customers. CV Finer Foods was transitioning from a shipping and distribution company, to a manufacturer and distributor of their own unique line of sauces and marinades. Each investment was therefore in a business that was relatively young, but with a minimal level of historical financial performance. A & B is the exceptional case as the business was at a steady state in terms of growth.
As the “Financial Performance” section will demonstrate this “Pre-existing Condition” not only eased a CDVC fund’s ability to encourage greater financial efficiencies and profitability but mitigated investment risk. This is because beginning with an already operational business, which was servicing an existing customer base for at least a few years, almost guaranteed a minimal level of returns. This indirectly contributes to lasting social impact as many fund managers attest that without positive financial performance lasting social returns are nearly impossible. The value in a business is supported by its historical performance.

In terms of “Product/Service” (described in Table 7.2), Innov-X and A & B were manufacturing technology-related products, which were used in part by the pollution control industry. City Fresh and CV Finer Foods were producing natural food product. Ryla offered a teleservice with strong customer support and customer relations. Each company produced a unique product or service, and differentiated itself from peer firms because of the unique quality of the product or service. For City Fresh and CV Finer Foods this is evident by the high quality of natural ingredients that each used to prepare each product. Ryla and Innov-X both offered (and continue to offer) a very high level of quality service, which distinguishes each business from competitors.

Anne Claire Broughton cites this as “brand purity” and “brand integrity.” Broughton explains that this is connected to lasting social impact because it insinuates that the value of a business to a new owner/investor is in the “purity” of a product. Also, if the production process (for a unique product) is essential to the brand then the value of the business is consequently related to operations, management, and employees. If a new owner/investor is attracted to a business because of the unique product or services (at the exit) the business’s production process or operations will most likely remain in tact post-exit, to maintain “brand purity.” This results in jobs being maintained and lasting social impact.

The unique product or service of a business is a pre-existing condition. Although a CDVC fund can influence the financial performance and social impact of a business, usually a fund’s investment will not dramatically change a company’s business model. Therefore the nature of a business’s product or service is a “Pre-existing Condition” that affects lasting social impact.
This “Pre-existing Conditions” also influences lasting social impact because it affects other “Pre-existing Conditions” to support and uphold the “purity” or “integrity” of the business. Further the value associated with these other pre-existing conditions (including employees, location, and management) can directly affect lasting social impact and mitigate exit risks associated with a change in operations.

In general all case studies “Pre-existing Conditions” that affect lasting social impact (and which mitigate for exit risks associated with operations including changes in management, employment, and location) are connected to how and why a business is valuable to a new owner/investor at the exit. These are presented for case studies in Table 7.2 as “Employment/Location” and “Owner/Managed.” “Employment/Location” is specifically how the existing employees and location contribute to a business’s value and support operations. If a business’s operations are dependent upon an existing employment base, in a particular location, then a “Yes” is under “Employment.” If a business’s value is tied to a location for other reasons (industry cluster, customer base) a “Yes” appears under “Location.”

Most businesses were tied to location because of an industry cluster and/or customer base (beyond an employment base). Only in the cases of A & B and Ryla was each business’s inherent value not tied to location because of these reasons. But, as will be described in “Exit Conditions,” the perception of the new owner/investor (two former employees and a private equity firm) greatly affected the value of the business and why location stayed the same post-exit. Specifically for A & B, even though the business’s operations were not directly tied to its rural New Hampshire community, (only for an employment base, and not for an industry cluster or customers base) lasting social impact occurred and the business did not move at the exit. This is because from the perspective of the new owners (former employees) the location was essential to how they valued the business—because maintaining the location meant that individual their jobs would be saved post-exit. For Ryla the location was important to the new investor because it attracted a unique contract base compared to peer firms. As the “Exit Conditions” will demonstrate the new investor recognized Ryla’s ability to offer a domestic service and attract many United States government contracts.
In terms of employment base contributing to value, both Ryla and Innov-X are strategically located in areas where they can draw from an existing low-income community for employees. Unlike peer firms, Innov-X and Ryla were (and still are) hiring low-income employees, providing extensive training and benefits, and offering advancement opportunities and “good jobs.” Mark Wilson explains that this contributes to the value of Ryla because “a little extra investment in [employees] . . . pay[s] for itself by making [employees] more productive” (Field, 2003). Ryla has a unique ability to offer high quality customer service and customer contact through an experienced employment base, which again differentiates the business from its competition. This lower turnover also cuts costs in relation to human resources and recruitment making the business model more efficient. At the exit, Ryla was valued for its operational efficiencies and high quality customer service, which was described by the new investor as an “exceptional level of service” compared with any international or national firm (Field, 2003).

For Innov-X, a similar focus on the value of the business was seen by the new investor Summit Partners (Summit). Summit’s investment helped facilitate CVI’s exit from Innov-X. The company’s president recalls that when he decided to first invest in Innov-X the company had “the right blend of research, unique technology, and global reach” (Russell, 2007). Summit valued Innov-X for the company’s operations, research and development capacity, and its technology. Even though a new investor may have taken Innov-X’s patented technology and liquidated the rest of the business (and relocated or consolidated operations), Summit kept Innov-X’s operations and management in place—and recognized its ability to produce, invent, and market a highly specialized product.

This operational structure was (and still is) contingent upon Innov-X’s constant attention and high expectations of employees. Don Sackett is the original owner and one of the founders of Innov-X. Recently, Sackett explained that Innov-X was in the 90th percentile for pay scale, compared with other firms in related industries at the exit. Went Summit first invested “the environment at [Innov-X was that we] expect quality [and] you were rewarded for it well” (Sackett, 2008). Today the company still holds this mentality, and to investors the value of the company rests on not only its technology but also on efficient business practices and the ability of the company to produce, market,
and sell its product internationally. At the exit, Summit recognized that production and sales were dependent upon a high level of performance from employees, the leadership of the existing owners, and the research and development capacity of the original entrepreneurs.

In terms of location and employment contributing to “brand purity” or the value of a company to a new owner/investor, City Fresh and CV Finer Foods business models carry similar characteristics. Both companies hire local low-income employees to produce unique products. Each business’ production is very high quality and dependent upon these employees. This affects the value of each business at the exit, and contributes to lasting social impact.

Specifically for City Fresh, Andrew Chen explains that the business is dependent upon its immediate vicinity for new contracts and an employment base. “City Fresh would never survive if it wasn’t community based...they need to get food out to customers quickly...therefore it has to be made fresh locally in the community. . . . people also work in the kitchens are the ones from the neighborhood” (Chen, 2008). City Fresh produces ethnic foods specifically targeted to meet inner city community needs of elderly service organizations, schools, and community groups.

Therefore, City Fresh is both location-dependent for contracts and location-dependent for employees. One example of this dependence is cited by founder Glynn Lloyd, who recalls that early on “it was not a problem finding cooks.” Lloyd explains that they have always hired “people from the neighborhood and [taught] them to cook in greater volume” and produce the same meals that they would for their own family just in greater quantity. Today the company still has a “workforce [which] walks in off the streets, many of them desperate for a job, determined to stay off welfare” (Leamon, 2003).

At the exit, Unidine recognized City Fresh’s business model and the value of its location and employment base. Richard Schenkel, president and CEO of Unidine, recalls that Unidine invested in City Fresh when BCVF exited because of the appeal of City Fresh’s “brand recognition and brand integrity...” This was built on City Fresh’s ability to interact with the immediate community, both for employees and for contracts (McFadden, 2007). City Fresh’s unique product was also highly respected, adding to the appeal of keeping the existing production in place. “Everywhere we went, everybody
[whom City Fresh had dealt with] has a really high degree of satisfaction, and we felt that it was a great model that they had worked for,” recalled Schenkel (McFadden, 2007). This value contributed to lasting social impact at the exit, as Unidine purchased a portion of City Fresh for its operations and “niche market” penetration (Schenkel, 2007). CV Finer Foods was established in Maine in a rural region and drew employment from the local community. In 2000 Angostura purchased CV, which changed its name to World Harbors. CV (World Harbors today) was producing a unique line of sauces and marinades known best for their natural ingredients and ethnic flavors. The brand was built by food industry veterans and the value of the business was in the business’s ability to produce a healthy easy-to-use high quality product.

At the exit, founder Garth Vdoviak recalls that Angostura recognized the business’s ability to efficiently produce a consistently high quality product. In a highly competitive industry this set CV’s products apart. Therefore operations were essential in maintaining the integrity of the brand and the value of the business. At the exit Angostora maintained operations, management, and employees, and considered each a dependent factor which influenced the business’s success. Lasting social impact (maintaining employees and business operations) was necessary to maintain brand integrity.

Vdoviak suggests that even line workers at CV have always been thoroughly trained and an important part of quality control, which is essential to the operations. CV Finer Foods also benefits from its location, which is in a growing natural product and natural food production cluster. Over the last 20 years, the region has developed a reputation for producing high quality natural products. Therefore when Angostura purchased CV the location was amenable to production, an integral part of the business model, and added to the value of the business.

The final “Pre-existing Condition” that affects lasting social impact is the ownership structure and management of businesses. Except for A & B, all businesses were operated by the original founders or entrepreneurs prior to a CDVC fund’s investment. The “Owned/Managed” column in Table 7.2 indicates the pre-existing commitment of the founder/entrepreneur to grow and develop a business. Often mainstream VC firms describe “lifestyle” companies as businesses that do not have an entrepreneur’s commitment behind them, but rather are run by an owner to solely support
his/her own “lifestyle” from the income from the business. The business owner is not interested in exponential growth or creating a solid business infrastructure in “lifestyle” companies. All case study investments were in business which were not “lifestyle” companies and often an opposite scenario was present. Therefore in the “Owned/Managed” column a entrepreneur’s commitment to a business is noted for almost all investments.

Ryla and City Fresh demonstrate instances of entrepreneurial capacity and management adding to a business’s value. Although for Ryla the business management was socially grounded, Mark Wilson, the originally owner/founder, ties his own socially responsible management to contributing to efficient business practices. Under Wilson’s leadership the business is more efficient (with less turnover and higher sales performance) than peer firms. This is because of the careful attention Wilson pays to including employees in skillset training and advancement programs. Wilson also rewards employees with performance based incentives.

Similarly, City Fresh founder’s social commitment and management practices go hand in hand. City Fresh’s business model included socially responsible production and management. When seeking capital support at the exit, potential investors recognized City Fresh’s niche market product and the founders’ leadership, which accompanied a desire to continue in “running a socially conscious business.” In both cases of Ryla and City Fresh, lasting social impact and maintaining operations where possible because of the original founder’s commitment to stay with the business post-exit, which was valued by the new investor/owner.

For the case of A & B, Sue Martin recalls that she never imagined owning a business or seeking venture capital financing. Additionally, no other mainstream lender would offer the company the last portion of equity which was required to buy out the absentee owner. The investment was considered too small and was not in a key venture capital geographic region or industry. Therefore there was limited investment interest from outside investors, when the CDVC fund first invested. Moreover, at the exit, the value of the business was largely based on the perception of the new owners, two former employees.
In terms of lasting social impact A & B’s unique product or business model was not as influential as other case study investments. Although CVI (the CDVC fund) was attracted to A & B because an equity investment would help transfer ownership to two rising employees, there was an almost guaranteed lasting social value from the beginning of the investment. When CVI invested, the business was already profitable and by eliminating the absentee owner’s salary draw from the company’s cashflow the business would be more profitable. The CDVC fund could therefore easily predict that at the exit employees could gain majority ownership and the fund would be sufficiently compensated. Consequently, the investment was targeting a business to promote lasting social impact post-exit. This lasting social impact resulted in the maintenance of low-income jobs, employee asset accumulation and employee ownership.

Both CV Finer Foods and Innov-X were founded by entrepreneurs and inventors. Each business was built around a unique product. At the exit the new owners/investors valued the business’s management and under the leadership of these original founders invested in each company. At CV Finer Foods one of the founders, Gardth Vdoviak, remains head of product development for the acquiring company’s line of World Harbors. Vdoviak’s skill in developing and marketing new products, alongside managing high quality production, are valuable to the business model. His experience in the food industry was also attractive to Angostura. Therefore, Vdoviak’s leadership contributed to the value of the business at the exit. Post-exit he continues to lead product development for the World Harbor’s brand.

In summary, what attracted the new owner/investor to these businesses was the value placed on a business. If this value was associated with a business model and a company’s ability to product or develop a unique product or service lasting social impact usually occurred. This is because the quality of a unique product or service was often employee or management dependent, even if it was not location dependent (for an employment base or customer base). At the exit, a new owner/investor often purchased a firm and kept the location, management, and employees as an essential part of production or development. Anne Claire Broughton explains “many of the jobs and companies remain in place after the sale... [because of]... the nature of what they do... and how they do it,” (Broughton, 2008).
**Investment Characteristic: Financial Performance**

As Henshaw, Broughton, and Chen all agreed financial performance is almost a necessary factor when considering lasting social impact. A profitable firm will be valuable and attract a new owner/investor at the exit, and an unprofitable business rarely is able to yield any lasting social impact. The main connect to lasting social impact is that an unprofitable business will not be able to support growth (increased employment) or distribute returns (through wealth-sharing employee benefits).

<table>
<thead>
<tr>
<th>Table 7.3: Financial Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRE-EXIT, WHILE INVESTED</strong></td>
</tr>
<tr>
<td><strong>Company</strong></td>
</tr>
<tr>
<td>Innov-X</td>
</tr>
<tr>
<td>A &amp; B</td>
</tr>
<tr>
<td>CV</td>
</tr>
<tr>
<td>City Fresh</td>
</tr>
<tr>
<td>Ryla</td>
</tr>
</tbody>
</table>

In Table 7.3, in describing “Financial Performance,” all businesses are cited as experiencing substantial growth while the CDVC fund was invested. Growth is described under “Description” and “Sales Growth.” Table 7.3 also indicates increased production efficiencies and expanded operations. All case study investments were true venture capital investments as the CDVC fund sat on the board of each business, guided growth, and motivated a company to increase profitability and their overall value.

In the exceptional case of A & B, the CDVC fund (CEI) knew the expected financial returns where not based on increased revenue or business expansion. Sales grew slightly and operations continued to be profitable. But CVI predicted that when they first invested adding back the absentee owner’s salary as an expense would improve cashflow and make the company’s net income stronger. This prediction was correct and the
business's financial performance generated ample returns for all investors. Operational efficiencies also improved the company's financial bottom line for A & B.

For City Fresh, Innov-X, Ryla, and CV Finer Foods revenues grew dramatically. In each instance the CDVC fund offered financial advisory to help guide the growth. In particular, for City Fresh the CDVC fund (BCVF) helped the company’s establish management practices and improve everyday accountability. Glynn Lloyd, founder of City Fresh, recalls “our operational method had been bootstrapping since day one,” (McFadden, 2008). Andrew Chen remembers that BCVF was able to “look at the company [and see] an opportunity for [BCVF] to really grow [City Fresh].” Chen recalls that the company “needed some proper management systems . . . [and BCVF] spent a lot of time working with them to understand their kitchen capacity, order fulfillment, delivery methods, sales cycle. . .” (Chen, 2008).

For Innov-X, the CDVC investment contributed to stimulating growth and Don Sackett, one of the founders recalls, the investment impacted the business in three ways. First, Innov-X became financially accountable to an outside investor. This was cumbersome at first and required financial systems and processes to be put in place. Because there was a greater level of scrutiny on the firm, eventually this resulted in greater efficiencies and better managed operations. Second, the investment financed the product development of a new instrument which directly affected financial performance. Lastly, the CDVC funds from CVI helped the company “see a bigger picture and look at the firm as a large company” and isolated weaknesses in management. This included realizing the need for a CEO which also contributed to improving Innov-X’s financial condition. Sackett recalls that each of these factors contributed to the business’s bottom line and meant that Innov-X was positioned for a strategic buyer at the exit. “It was critical that the systems be in place to attract a buyer that would appreciate the business because [we] didn’t want a situation where the new owner would come in and change everything” (Sackett, 2008). This contributes to the “Exit Conditions” and affects lasting social impact as the company’s value was beyond their product or technology and included management, operations, and efficient financial performance.

The additional equity capital, provided to CV Finer Foods, supported automated production and packaging of products. Although this meant that the business could
expand its production capacity it was essential that with expansion the quality of the product was not compromised. The value of the product rested within its high quality and Garth Vdoviak recalls that this was critical throughout expansion. Automation could not compromise production, because it would consequently compromise the value of the business. Therefore, Vdoviak recalls that throughout the automation all employees were retained but were retrained to supervise the automated production. Changing skillsets for many employees contributed to lasting social impact, as post-exit many employees now have higher earning potential and have skills that are transferable to other natural product or food production companies, including those located within the growing industry cluster of Maine businesses (this is mentioned in “Social Positioning”).

There is a similar story at Ryla, as the CDVC fund (SJF) helped finance the initial expansion and growth of the business but then worked with the company to determine the optimal way to finance future growth. The fundamental difficulty with Ryla’s expansion was that the owners wanted to maintain as owners, to maintain the Ryla’s business status as a minority owned enterprise. Mark Wilson explained:

“Being a minority owned business differentiates us and allows us the opportunity to have discussions with potential clients. We’re a start-up call center and there are dozens of start-up call centers. But our minority status makes us different. Of course, the key to selection as a partner is our ability to perform. We know we can do that. Without our designation as a minority owned business some of our potential clients would not have even opened conversations with us,” (Leamon, 2003, 18).

The CDVC fund (SJF) was able to help Ryla initially raise capital to expand through alternative financial mechanism that did not require selling ownership shares (subordinated debt with warrants). Today Ryla is partially owned by Frontier Capital and the original owners still maintain an ownership stake.

Overall, each case study represents how a CDVC fund financed a successful business, and how a CDVC fund contributed to the financial performance and possible growth of a business. CDVC funds usually contributed to performance through advisory, including advising a business concerning how to grow and maintain product integrity, advising a business in terms of financial accountability with growth, and/or advising a business on how to make operations more efficient with growth. As suggested, these
cases demonstrate that supporting growth and financial performance perpetuated lasting social impact, because it positioned businesses as efficient financial entities with historically profitable business practices at the exit. This enhanced the value of each business and specifically the value of each business’s operations. As “Pre-existing Conditions” demonstrated, when operations are a valuable (and highly profitable) part of a business then a new owner/investor will most likely be inclined to continue operations post-exit, consequently affecting lasting social value.

The CDVC fund’s advisory role can also contribute to lasting social impact for two additional reasons. First, the CVDC fund’s management advisory can help market the business as valuable because of a unique product and unique operations which produce this product. As discussed in “Pre-Existing Conditions,” a CDVC fund cannot create a brand or business model, but can encourage the development of a brand’s identify and work with a business to improve the value of a company through enhancing this identity. For instance if a product is unique because of its all natural organic ingredients, a CDVC fund can introduce the company to other natural food distributors for collaboration to learn best practices in terms of product distribution. This can help the business market their product when a CDVC exits and the business seeks a buyer or new owner/investor. This affects “Exit Conditions” and the value of a business from a new owner’s/investor’s perspective. Second, reporting to an outside investor additionally makes each company more responsible in terms of financial business practices. This again can be attractive to an outside buyer and will increase the likelihood of operations being maintained post-exit.

**Investment Characteristic: Social Positioning**

“Social Positioning” measures are changes in the qualitative and the quantitative aspects of employment. These changes can affect the working environment and directly change the quality of employment opportunities or the amount of employment opportunities within a community, while a CDVC fund is invested. These are again changes pre-exit or while a CDVC fund is invested. Therefore although Table 7.4 maybe considered as presenting the social returns/social impact of each investment, this section
on “Social Positioning” demonstrates what changes in social returns/social impact can impact “Social Positioning” of a business to promote lasting social impact post-exit.

Table 7.4: Social Positioning
PRE-EXIT, WHILE INVESTED, QUALITATIVE ONLY

<table>
<thead>
<tr>
<th>Quantitative</th>
<th>Innov-X</th>
<th>A &amp; B</th>
<th>CV</th>
<th>City Fresh</th>
<th>Ryla</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased</td>
<td>Slightly Increased</td>
<td>Increased</td>
<td>Increased</td>
<td>Increased</td>
<td>Increased</td>
</tr>
</tbody>
</table>

Qualitative

<table>
<thead>
<tr>
<th>Health Benefits</th>
<th>Maintained</th>
<th>Maintained</th>
<th>Increased (%) employer</th>
<th>Increased (%) employer</th>
<th>Increased (%) employer</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>401(k) / Pension Plan</th>
<th>Maintained</th>
<th>Maintained</th>
<th>Maintained</th>
<th>Created</th>
<th>Created</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Job Training</th>
<th>Maintained</th>
<th>Enhanced</th>
<th>Created / Enhanced</th>
<th>Enhanced</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Partial</th>
<th>Partial / Full</th>
<th>Partial</th>
<th>Partial</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Wealth Creation</th>
<th>Enhanced, broad based stock</th>
<th>Created employee ownership</th>
<th>Distributions at exit only, through options</th>
<th>Entrepreneurs compensated at exit</th>
<th>Broad based stock options</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Other</th>
<th>Wages increased</th>
<th>Wages increased</th>
<th>Wages increased</th>
<th>Wages increased</th>
<th>Financial Literacy</th>
</tr>
</thead>
<tbody>
<tr>
<td>ETAG</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In general, all CDVC fund investments experienced an increase in employment and either maintained, enhanced or increased employee benefits while a CDVC fund was invested. Table 7.4 sites these changes and “Maintained” in the table means benefits or employment levels remained constant; “Enhanced” means an improved condition (i.e., higher % of healthcare covered by employer, better stock option plan, more job training, more low income jobs); and “Increased” is the addition of new benefits or new employees. If an item is **bold** in Table 7.4, this characteristic was created, enhanced, or increased, rather than sustained or maintained. If healthcare “increased” in the table, it is the percentage that the employer contributes to healthcare costs, and for most business this was (and still is) between 95% and 100%. The one time distributions that occurred at
the exit for CV and City Fresh are not a permanent change for either business. But, as will be discussed, they did contribute to lasting social impact.

For each case study investment, as “Pre-existing Conditions” notes, all businesses were operational and either profitable or at breakeven operating levels. Additionally, all businesses were already offering a high level of employee benefits and provided “good jobs” to a low-income community. Therefore many social return/social impacts are simply the generation of new low-income employment opportunities or the enhancement of already good benefits. This is noted in terms of “Quantitative” changes in Table 7.5. The table cites that all business experiences employment growth with the CDVC fund’s investment. City Fresh, CV Finer Foods, and A & B had less absolute employment growth, and Innox-V and Ryla had over 10x employment growth (today City Fresh employs 65, CV employs 35, A & B employs 11, in contrast to Innox-X which employs over 150, and Ryla which employs almost 400).

Any quantitative or qualitative changes can be considered not only social returns/social impact from a CDVC fund investment, but can demonstrate how each business “prepared” or socially enhanced a business while invested. This is demonstrated through the CDVC funds (CEI and SJF) encouraging higher living wages for Innov-X and Ryla, firms which already provided higher wages than peer firms.

Many fund managers also argue that by encouraging changes in the quality of employment or in the increase of low-income job opportunities prior to an exit a CDVC can contribute to lasting social impact by “institutionalizing” socially responsible practices. The only case studies in which this occurred was for Ryla and City Fresh, in which 401(k) retirement plans were created while the CDVC fund was invested in each business. All other case study businesses each had healthcare, at least minimal job training, and existing owners or employees held ownership positions. Therefore the “institutionalization” of socially responsible practices did not unilaterally occur across investments, and consequently did not change or affect lasting social impact.

Specifically, three types of changes during a CDVC fund’s investment directly affect lasting social impact: (1) job training; (2) asset accumulation/profit sharing; and (3) employee ownership. These three critical characteristics are cited in Table 7.5 as “Job Training” “Wealth Creation” and “Ownership.” All three can directly affect lasting social
impact because they can influence individual employees, both in terms of their existing financial condition and in terms of their earning potential.

(1) Job Training:

In the case of job training, Ryla and CV Finer Foods expanded their operations while the CDVC fund was invested. In each case, automation and technology were part of this training. Ryla employees began to use voice over IP (VOIP) service and CV Finer Foods had a more technologically advanced assembly line and automated production process. Additionally, Ryla’s business model was associated with training employees, and from the beginning has provided “good jobs” for low-income.

City Fresh’s focus on training also results in lasting social impact because like Ryla it employees from a population that is mainly “welfare to work” individuals, giving people a means to generate earning potential skills. Andrew Chen explains the connection between job training and lasting social impact as he suggests that “some of the employees that companies are able to offer employment to are ‘welfare to work,’ individuals . . . so you have folks that have NEVER been employed before, in their whole lives. The concept of holding a 9 to 5 job is [unknown], even if that job goes away for whatever reason, [this is] one step forward for this person,” (Chen, 2008). Although this is not true for most case studies presented, as jobs were usually maintained post-exit, many fund managers agreed with this assessment. In one case study Garth Vdoviak, of CV Finer Foods, suggests that his employees are better equipped with marketable skills because of the growth and automation of his company (as mentioned in “Pre-existing Conditions”).

Innov-X has a similar attention to job training, which was maintained through the CDVC investment. Recently, this attention has changed to focus on job-training for management level employees, which contributes to lasting social impact because the firm is focusing on preparing existing employees to advance their abilities as the company grows.

(2) Wealth Creation:

Adding wealth creation benefits, including profit sharing or stock options plans, to a business contributed to lasting social impact for most case study investments. This is
demonstrated in two ways: either a company created this type of benefit for employees pre-exit so that at the exit employees financially benefited through a one-time distribution; or a company created this type of benefit while a CDVC fund was invested and “institutionalized” wealth creation or asset accumulation benefits for employees. If the second scenario was true, usually a stock option plan was created and the plan was usually maintained post-exit. The second idea, of “institutionalizing” benefits, directly contributes to lasting social impact, as it is a change in the social conditions of a business. The one-time distribution can also be considered a lasting social impact because it does positively impact employees at the exit. An employee loosing his/her would then have had an immediate financial cushion post-exit. This is an immediate post-exit lasting social impact, but not an increase in social condition.

City Fresh owners and CV Finer Foods employees both received one-time distributions at the exit. In the specific case of CV Finer Foods, employees gained a minimum of, $13,000. For the middle to low income employees this was a significant percentage of their income. The new owner needed the employees and operations to be maintained for the production of the high quality product. Therefore, this one time distribution was created to attract employees and reward them for staying through the transition of ownership. For City Fresh, the distribution helped pay off existing debt and paid off the original owners for their ownership stake. Both one-time distributions enhanced individual employees’ and owners’ financial position post-exit and contributed to lasting social impact.

Innov-X and Ryla had stock option plans, which were enhanced or created while the CDVC fund was invested. Today, even after the exit, employees still are able to maintain this benefit. At the exit, many employees exercised options and benefits from the change in ownership. In “Beyond Paycheck-to-Paycheck” Anne Claire Broughton explains how the broad-based stock options for Ryla were structured. SJF (the CDVC invested in Ryla) worked on creating this structure to benefit all employees:

“[Ryla] . . . decided to issue restricted stock awards (RSAs) for the key managers who had taken most risk upfront, leaving secure jobs at D&B to start this new venture. This would give them stock right away. The current and future management employees would receive incentive stock options as part of the option pool set aside at the time of SJF investment. The rank and file employees would be part of a phantom stock option plan, which would not dilute the existing
option pool and also would be better from a tax standpoint for lower level employees, as the proceeds from a phantom plan are triggered at a liquidity event and are taxed as ordinary income” (Broughton, 2004).

This structure was optimal for Ryla and enhanced the lasting social impact at the exit, when employees were able to exercise these options. Today Ryla employees continues to benefit from stock options as part of a comprehensive wealth creation or asset accumulation benefits package.

(3) Ownership:

In almost all case study investments, the business’s original owners/founders remained majority owners while the CDVC fund was invested. Only in the case of A & B did two employees become owners. Post-exit only CV Finer Food’s and Ryla’s original founders did not remain majority owners. CV was bought by a larger food company and a majority portion of Ryla was purchased by a private equity firm. At City Fresh and Innov-X, the original founders remained partial owners post-exit. In the case of A & B Electronics the two employees who became owners demonstrate that a CDVC investment can truly provide lasting social impact for existing employees. In fact, CDVC investment facilitated the transition for two employees (who both began as wage workers) to become owners.

Investment Characteristic: Exit Conditions

As much as the above characteristics or factors contribute to the social returns or lasting social impact of investments, they are all in preparation for the exit. The exit is the point in time when change in ownership can affect changes in operations and subsequently changes in location, management, and employment. A business’s operating performance is also vital to have a socially and financially successful exit, but what is the largest factor is how a new owner/investor values a business. As discussed in the Introduction of Chapter 7, value of a business is often reflective of both the inherent value of a business’s product and/or service and the perspective of the potential new owner/investor. If a product or service that a business produces or offers is dependent upon specific infrastructure (including location, management, employees) then the value
of a business is tied to operations and a specific business model. Therefore, as “Pre-existing Conditions” describes, the value of a business at the exit is connected to how the product or service is valued by a new owner/investor.

Table 7.5 “Exit Conditions” presents each case study through the exit. “Type, Reason” is the type of exit and reason the new owner/investor was attracted to the business, “Location” is if the location moved (this usually indicates it the value of the business is inherent in the location of operations); “Management” describes the management structure post-exit; and “Exit Facilitation” describes how the CDVC fund impacted or facilitated the exit.

Table 7.5: Exit Conditions

<table>
<thead>
<tr>
<th>AT THE EXIT</th>
<th>Type, Reason</th>
<th>Location</th>
<th>Management</th>
<th>Exit Facilitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innov-X</td>
<td>Private Equity; technology, research, operations</td>
<td>No change</td>
<td>Maintained, partial owner</td>
<td>X – IB, board seat, partial exit</td>
</tr>
<tr>
<td>A &amp; B</td>
<td>Employees; employment security</td>
<td>No change</td>
<td>Maintained</td>
<td>X – Local lender, board seat</td>
</tr>
<tr>
<td>CV</td>
<td>Acquisition; operations, product development, management, compliment</td>
<td>Moved nearby</td>
<td>Maintained</td>
<td>X – IB, board seat</td>
</tr>
<tr>
<td>City Fresh</td>
<td>Acquisition; operations, product development, management, compliment</td>
<td>Moved while invested</td>
<td>Maintained, partial owner</td>
<td>X – Local, board seat</td>
</tr>
<tr>
<td>Ryla</td>
<td>Private Equity; management and operations</td>
<td>Expanded nearby</td>
<td>Maintained, limited owner</td>
<td>X – PE firm, board seat</td>
</tr>
</tbody>
</table>

In most cases the exit was a change in ownership and a private equity firm or a larger company replaced the CDVC fund’s position. In one case, employees took on ownership and now manage and own A & B Electronics. In all cases the reasons for why a new owner/investor was attracted to a business is related to operations, management, or product development capacity of a business, indicated by “Type, Reason” in Table 7.6. This directly contributes to lasting social impact because it means that each new owner/investor was interested in a business for the business’s operational and production capacity. Moreover, the way in which a new owner/investor valued a business, either as a compliment to an existing business or simply because of the ability to produce a unique product or offer a unique service reflects how the business was marketed to a new
owner/investor. Therefore, considering both the "Type, Reason" and the "Exit Facilitated" columns in Table 7.6 can reveal both why lasting social impact occurred and how a CDVC was able to encourage lasting social impact at the exit.

Type/Reason and Exit Facilitation:

The "Type/Reason" and "Exit Facilitated" explain the exit for Innov-X and reaffirm this reality. Innov-X was a partial exit for CVI (the CDVC fund invested). At the exit, the private equity firm Summit Partners took on an ownership position. Summit purchased Innov-X for the company’s operations and potential “robust growth” and research and development capacity. It desired to work with the existing business and to “further accelerate [their] development of new products and technology, expand [their] global presence, and [continue to] exceed customers’ expectation for quality.” This indicates that Innov-X’s technology and production capacity were both attractive to Summit. While maintaining operations and employment this contributed to lasting social impact (Russell, 2007).

In order to attract a buyer who valued the business and saw potential to grow operations, CVI hired an investment bank to facilitate the Innov-X exit and advised Innov-X throughout the investment cycle on how to improve internal financial controls to position the company for the exit. The investment bank and CVI worked together and both were “very critical to the partial exit.” Sackett explains the combined efforts were essential in creating a partial exit that would not “change everything and be against our goals for growth.”

Similarly, CV Finer Foods and City Fresh offered (and continue to offer) unique product lines. At the exit, both companies were purchased as complimentary operations to the new owner’s existing business. Specifically for CV Finer Foods, Garth Vdoviak recalls that Angostora was attracted to CV because of the business’s unique ability to produce a high quality product. This was a compliment to Angostora’s existing line of spices and other natural food products. Therefore, Vdoviak knew that although “in many situations you are promised nothing will change,” Angostora would continue operations and appreciate the value in the production and operations of CV.
City Fresh was also a direct compliment for the new owner Unidine. “Unidine recognized in City Fresh a group of people and a set of contracts that would fit nicely” within their existing operations. “Unidine bought out the investors interest as well as some of the founders’ interest in the company, and City Fresh became a subsidiary of Unidine,” recalls Andrew Chen. This made sense for Unidine because it allowed the company to expand its market and operational capacity, and additionally allowed Unidine an easy way to gain access to minority business contracts.

BCVF, the CDVC fund invested in City Fresh, facilitated the exit by helping position City Fresh as a prominent local food service provider. This was accomplished through consistent business advisory that kept the owners/founders attention on their original product and brand identity. Further, BCVF helped create a board of directors for the business, which included socially responsible business owners and investors. This further established the company in a unique market. Glen Lloyd recalls that City Fresh was able to “lean on Unidine’s expertise and resources to help growth” post-exit. This is because of the exit structure and partnership created between the two businesses. “Unidine provided joint management of the on-site service, including sales and marketing support to help drive new business,” (Mcfadden, 2007). This specifically contributes to lasting social impact because it illustrates how the new owner, Unidine, valued the existing operations. This assured job security for employees post-exit as management, operations, and the business model remained intact post-exit.

Frontier Capital (the private equity firm) purchased a large percentage of Ryla at the exit. Frontier stated that it was impressed with Ryla’s business operations and “the exceptional level of service the business provided.” Frontier wanted to “figure out how to scale Ryla into a bigger business” through Wilson’s management. Although Frontier Capital is not known as a socially responsible investor Mark Wilson explains this commitment to maintaining and growing operations was a commitment to employees, which are the backbone of this customer service focused business (see “Financial Performance” for additional information). Therefore, Frontier maintained operations and has grown the business post-exit so lasting social impact has occurred. SJF (the CDVC fund invested in Ryla) facilitated this exit through encouraging Ryla to market its minority business enterprise (MBE) status and unique operations to a new investor. The
MBE status is valuable because it connects Ryla to specific government-related contracts, and helps market the unique nature of the business’s United States based business model. After the exit Frontier Capital explained that it was “attracted to the specific niche Ryla serves” in a “diverse marketplace.”

For Ryla and Innov-X, with sales to another investment firm (at the exit) there is still uncertainty concerning lasting social impact in the future. Both companies were not purchased as compliments to an existing business, and/or sold to a business that market similar products. But, as explained, both private equity firms were interested in expanding Ryla and Innov-X from their existing operations. This, in the relative short term, helps sustain lasting social impact and the retention of jobs. But, this does not amend for risks that will arise when each investor enhances each business enough to generate financial returns and desires to exit. Because these are mainstream investors, and each business is substantially larger than when the CDVC fund originally invested, both business may be positioned for a merger and/or acquisition or an IPO.

Location and Management:

The two remaining “Exit Conditions” affecting lasting social impact are management and location. For almost all case studies, investment location stayed during the investment cycle. City Fresh relocated prior to exit to expand business, but to a neighboring low-income community. There are many clients and potential employees in both Roxbury and Dorchester; therefore the move did not negatively affect social impact for employee or a community. Additionally, the company is an asset to the new community. Ryla moved to a neighboring suburb and still draws from the urban low-income communities in and around Atlanta. In the case of CV, all employees remained with the business and the expanded location allowed for greater product development and distribution. The new location is less than 30 miles, also in a rural low-income Maine community.

In terms of management, in the case of City Fresh and Innov-X the original owners still maintain ownership positions in the businesses. Ryla’s original entrepreneurs have a limited ownership position, but still manage the company. The founders of CV Finer Foods no longer hold ownership positions, but one of the founders is still actively
involved in management. At A & B the two top employees became owners and post-exit remained as the sole owners.

The connection between retention of ownership/management and lasting social impact is exemplified in the case of A & B. As discussed in Chapter 6, A & B maintained the same employment levels post-exit, but today continues to provide stable employment opportunities for some of the most needy in the community of Berlin, NH. Although this is only a “maintain” level of social impact post-exit, for employees, it is an “increased” level of social impact and furthers lasting social impact as the two owners (former employees) continue to increase their personal financial positions as the business continues to be profitable and generate returns.
Thesis Overview

CDVC funds are positioned as financial intermediaries to amend for inefficiencies in existing financial markets. They provide equity to businesses in communities, to promote low income job growth. As the CDFI industry is met with capital flow challenges, CDVC funds are positioned to be sustainable economic development engine, which both provide financial returns and create lasting social impact.

A concern within the CDVC industry is that its highly lucrative mainstream financial model is stereotypically associated with job loss, business consolidation, and negative social consequences. This is because the venture capital model outlines an investment cycle that ends with an exit. The exit is a necessary part of the investment cycle, because it is when a fund generates significant financial returns. It is also when there is a change in the financial structure of a business and usually involves a change in ownership. This change can influence operations and presents three main risks: location risk, management risk, and employment risk. Location risk is the risk that a change in ownership will cause operations to consolidation or merge and the relocation of a firm, management risk is that management will be replaced or consolidated, and employment risk is that these two aforementioned risks will cause a change in the business’s employment and layoffs will occur.

This thesis demonstrates how CDVC investments are able to mitigate these exit risks and describes investment characteristics that contribute to “lasting social impact.” “Lasting social impact” is a maintained or increased level of social impact/social returns post-exit. Investment characteristics include pre-existing conditions, financial performance, social positioning, and exit conditions. All investment characteristics are related to a business during specific stages (pre-investment, while CDVC fund is invested, at the exit).
Case Study Review

This thesis presents cases studies of CDVC investments in which post-exit lasting social impact occurred. They demonstrate that post-exit social conditions do not have to be compromised because of the exit, and suggest that what is valuable about a business and the reason why a new owner/investor is attracted to a business can enhance lasting social impact. Usually a new owner/investor purchases a business for its operations and existing business model. Consequently, the perceived value in the business is derived from the business’s ability to produce a high quality and unique product or service.

For CDVC funds, as venture capital investors, there is constant attention to positioning a company for the exit. Therefore what attracts a new owner/investor at the exit is reflective of both how a company is marketed or positioned and also the existing business structure. In each case study investments, a CDVC fund worked to improve a business’s value, by supporting efficient operating practices and improved financial performance. But, part of the value, which is derived from the unique product or service, existed prior to a CDVC fund’s investment. This is unlike mainstream venture capital investing, when the exit is usually synonymous with the sale of a business for its technological capacity or patented invention. In each case study when a new owner/investor valued a business the existing operations, management, and production capacity were important. A new owner/investor also usually saw potential to grow the business and continue to enhance its performance post-exit.

What Affects Lasting Social Impact

Therefore, for all case studies, what occurs post-exit is a result of who the new investor/owner is and what they assess as the value of the business at the exit. The exit structure is directly impacted by the new owner/investor ambitions for the business. Usually a CDVC fund exits an investment through a sale to an outside equity investor, a larger company, or employees. Financial returns are gained from the enhanced value of ownership share from when the CDVC fund was initially invested.

Case studies in this thesis portray that at the exit often a business’s value is tied to lasting social impact. This is for two reasons. First, at the exit a potential new owner/investor was usually attracted to a business because of its ability to produce,
generate, or offer a unique high quality product or service what had “brand integrity” or “brand purity.” Therefore, operations (and ability to produce or provide a service or product) usually were fundamental to a business’s value and preserving “brand purity,” and businesses often stayed in place post-exit. Because a CDVC fund usually invested in a low-income community and in business which provided “good jobs” to low-income individuals, if a business stayed in place post-exit the preservation of jobs and the business resulted in lasting social impact. The specific reasons as to why “brand purity” can be tied to lasting social impact are:

1) Brand Purity usually requires operations to remain intact intact
   Lasting Social Impact = Employment security post-exit

2) Brand Purity is usually enhanced by a specific location, either because of an existing customer base or industry cluster
   Lasting Social Impact = Location remains in low-income community post-exit

3) Brand Purity is usually possible through strategic management oversight to ensure quality of product or service remains constant with growth
   Lasting Social Impact = Maintained management post-exit

The second reason for a potential new owner/investor to be attracted to a business, and consequently creating lasting social impact, is also tied to how a new owner/investor values a business. This reason is based on the perspective of the new owner/investor. From the new owner’s/investor’s viewpoint, if a business will serve as a compliment to existing operations or enhance an existing business model then it is valued.

In all case study investments, the perceived value of a business was influenced by the existing operations or investments of a potential new owner/investor. The case study businesses represent diverse products and services, but often a new owner/investor was attracted to these firms because they complimented their existing assets/business model. Therefore, often the new owner/investor often desired to keep operations in place post-exit and even grow the business. The new owner’s/investor’s perspective is important and affects lasting social impact because:

1) As a compliment to a business the operations remained in place
   Lasting Social Impact = Employment secured post-exit
1) As a compliment to a business there was value in growing the company
   Lasting Social Impact = Maintained management to help guide growth while
   maintaining quality production and hired additional employees to support this
   growth

2) As a compliment to a business the new owner/investor was willing to financially
   invest in a business to improve operations
   Lasting Social Impact = Continued attention to training employees and
   management to improve business practices

**How Can a CDVC Contribute to Lasting Social Impact?**

Overall the most powerful way a CDVC fund can contribute to lasting social
impact is by investing in business’s whose value is tied to their existing operations, and
consequently their location, management, and/or employees. CDVC funds make strategic
investment decisions to invest in business that show potential for generating financial and
social returns. If funds also invest in specific industries and unique businesses, where
“brand purity” is tied to operations, case studies demonstrate that lasting social impact is
often guaranteed. Beyond a CDVC fund’s investment choice, case studies reveal three
additional ways in which a CDVC fund can contribute to or influence lasting social
impact:

1) A CDVC fund can offer financial advisory and management guidance
   to optimize business efficiencies pre-exit
2) A CDVC fund can facilitate the exit and help market the business to a
   new owner/investor
3) A CDVC fund can encourage job training pre-exit
4) A CDVC fund can structure wealth building and asset accumulation
   benefits pre-exit

The first two ways in which a CDVC fund can influence lasting social impact
include financial advisory, management guidance, and facilitation of an exit. Although
these do not directly affect lasting social impact, fund managers present that all are
important and necessary in strengthening a business’s performance pre-exit. Additionally
because a business is often purchased for its operations (to preserve a business’s “brand
purity" post-exit) improving operational efficiencies and management improves the value of the business (this is referred to as changes in “Financial Performance” throughout this thesis).

In some cases a business was purchased as a complimentary entity and operations remained post-exit. A CDVC fund can support lasting social impact by facilitating this type of exit. If a CDVC fund seeks to exit an investment via the acquisition of a business by a larger company, that is purchasing the business as a compliment, lasting social impact is affected. CDVC funds can market portfolio companies to larger businesses at the exit, through understanding what is necessary for the business to become a division or complimentary unit of existing operations.

This is demonstrated through Innov-X and City Fresh, which both cite that the CDVC fund helped ensure that they were financially “positioned” for the exit. In the case of Innov-X, one of the original founders recalls that a larger private equity investor would not have been interested in Innov-X unless the “corporate stuff” was in order, which included financial accountability measures that the CDVC fund helped put in place. City Fresh was marketed to a buyer who would continue operations and would utilize City Fresh’s existing customer base to expand their own market share. To service this customer base, City Fresh’s operations and management remained in tact.

The last two ways in which a CDVC fund can contribute to lasting social impact are through encouraging job training and structuring wealth building or asset accumulation benefits for employees. These directly affect lasting social impact because they both improve either the wealth or the potential earning power (the capacity) of the individual employee (this is referred to as “Social Positioning” throughout this thesis).

Most CDVC investments are in low-income communities and promote hiring low-income individuals for “good jobs.” Therefore employees truly benefit from job training. As many fund managers suggest the ability to train a low-wage employee with marketable skill sets is often the most valuable way to influence lasting social impact. Even if a business does not continue operations post-exit, an individual has gained skills from their employment, and is in a better position to find a new job.

CV Finer Foods and City Fresh are key examples of this lasting impact characteristic. In both cases, employees gained from job training and developed skill sets
that are marketable in the food industry. For CV Finer Foods, employees are often trained by the company as certified natural food industry workers. These skills and certifications are transferable to other food industry companies. Additionally, CV Finer Foods is located in the growing industry cluster of natural product companies in Maine, so these skill sets are directly marketable within the region that many employees are drawn from. Although CV and City Fresh operations were maintained post-exit if operations were consolidated, moved, or merged with the larger company’s which purchased each business, employees were in an optimal positional to gain new employment.

The Future

As CDVC firms start to raise second and third funds, many funds increase their capitalization levels. They also are seeking a larger percentage of their financial support from mainstream sources. This support accompanies a higher expected rate of return on investments, and redirects CDVC funds’ investments to support investments that will yield larger returns. Consequently, deal size is increasing across the industry and CDVC funds are making more efficient investments.

With this shift, many CDVC funds are also widening their investment target to include businesses to which mainstream venture capital firms are also attracted. Over the past 5 years there has been a steady decline in the percentage of dollars invested in manufacturing firms, out of total dollars invested across all industries. There has also been a rise in “information investing” or technology-based firms, including cleantech businesses. This shift results in the fact that CDVC investments are often no longer geographically bound by customers (like City Fresh) or service-oriented where the value of a business is directly related to management and existing employees (like Ryla). These businesses are sometimes attracting mainstream venture capital attention, unlike the food service or natural product industry (which historically has attracted CDVC funds only, like CV Finer Foods and City Fresh), CDVC fund may face competition from mainstream investors.

Consequently, the nature of exits will change as these businesses attract a different type of new owner/investor at the exit. The question is then raised how the exit will be structured if the value of these businesses is not inherently related to operations
and production? Will lasting social impact be possible? How will CDVC funds continue their practices as economic development engines and motivate lasting social value, if the reasons that are thought to contribute to lasting social impact (brand purity, value of a business associated with operations, management, and/or location) are no longer valued as part of a business?

Many are optimistic that increased size of funds, deal flow, and expansion of geographic areas and industries puts funds in a positive position to increase their social impact while supporting their own financial sustainability as economic development entities. Additionally, supporting businesses able to generate high levels of returns and greater profits means that they can afford higher quality benefits for employees (including increased job training and stock options). Employees then benefit from increased profitability. But, from the perspective of lasting social impact, the future of CDVC investing is complex. If funds shift to invest in businesses which can generate more efficient returns through fewer transactions (as less transactions means less transaction costs) and these investments are in businesses whose inherent value is more “information” or technology-based, then at the exit the perceived value of the business is different than traditional CDVC investments. As this thesis claims the value of the business at the exit can directly impact whether operations, management, and location are sustained, and consequently guides lasting social impact.

Therefore, as the CDVC industry becomes more developed, it is important for funds to remember their socially responsible mission. Ron Phillips, CEO of Coastal Enterprises, Inc. (CEI) suggests this is an issue of “achieving scale.” As the CDVC industry grows funds are pressured to “achieve scale” and “broaden their market reach,” but are challenged to not “lose contact with the community.” Phillips explains that while trying to “achieve some measure of scale” funds should recognize the difference between scale and impact. A fund does not have to have a national presence to make an impact on a local community. Funds can continue to focus on “financially lucrative and socially meaningful activities,” and they can be successful double bottom line investors, if they continue to expand capital access to underserved markets, which are not supported by mainstream financial institutions (Phillips, 2006).
APPENDIX A: Interview Protocol

A. DESCRIPTION OF COMPANY
Name: Location (city, state, demographics):
Primary Business:
Number of Employees when CDVC fund first invested (overall and low-income):

Number of Employees at exit (overall and low-income):

Number of Employees today (please estimate if unavailable):

History of Business:
(year established and founder, significant events in history)

B. THE INVESTMENT
1. Describe the investment that your CDVC fund made in this business?
   Date of investment, amount, and financial structure (eg. debt, equity, combination)

2. Why did you invest in this business?
   (eg. promising financial returns, low-income area, social benefit for a community)

3. What did you anticipate, in terms of social benefit for this investment?
   (eg. job growth, improvement in employment quality and wages, employee ownership)

4. Describe what happened during the investment?
   Company growth?
   Operations or location change?
   Employment growth for low-income employees? For others? By how much?

   Did the company make any changes in compensation, benefits, or other policies during
   the time of your investment? What was your fund’s role in implementing or
   encouraging these changes?
   - Changes in compensation?
   - Changes in benefits (including health insurance)?
   - Changes in other policies (eg. employee training, hiring from within)?
   - Changes that result in employee wealth building or asset accumulation (eg. 401K,
     stock options, profit sharing)?

5. Did your CDVC fund take on a management role while invested (board seats)? How did you
   add value to this company?

C. DESCRIBE THE EXIT
1. Describe the form of the exit? Why this structure?
APPENDIX A: Interview Protocol

2. What occurred to allow this exit to be made?
   (eg. market share reached, buyout presented, financial goals met)

3. What role did your fund play to facilitate this exit?

4. Did your CDVC fund in any way guide the exit to increase or maintain social value or returns?

D. EXIT IMPACT AND EMPLOYMENT
   1. Describe what happened at the exit? Were there any changes in firm location, firm size, business or industry?

2. What happened to the employees of the company as a result of the exit?
   At the exit did the company make any changes in compensation, benefits, or other policies during the time of your investment? What was your fund’s role in implementing or encouraging these changes?
   - Changes in compensation?
   - Changes in benefits (including health insurance)?
   - Changes in other policies (eg. employee training, hiring from within)?
   - Changes that result in employee wealth building or asset accumulation (eg. 401K, stock options, profit sharing)?

   Was there an increase/decrease in the number of jobs? By how much? Was there a specific change in the number of low-income employees?

3. What happened to social value of the business? Why?

E. AFTER THE EXIT and TODAY
   1. What has happened since the exit? Has the business or operations gone through any significant changes? (Location change, management, ownership, product)

2. Why did these changes occur? Have these changes occurred because of the exit?

3. What has happened to employment? Has the number of low-income employees changed? What happened to the firm’s original employees?

4. What happened to the financial success of the business since the exit? Who has benefited from this success (ie. original owners, original employees)?

F. SOCIAL VALUE AND THE EXIT (BEYOND THIS CASE STUDY)
   1. Beyond this case study what usually happens to a business at the exit? What is your view of social value and employment at the time of the exit?

   2. Beyond this case study how do exits impact a community and economic development?
3. What, if anything, can a CDVC fund do to increase social value at the exit and after? What are the limits for a CDVC fund?

**G. ADDITIONAL FUND LEVEL INFORMATION**

Please provide information in regard to your CDVC fund:

1. Established how/why, main mission or goals:

2. Historical Investment Experience:

3. Number of jobs created from investments, designated by fund: (i.e. fund 1 had 5 investments and 200 jobs created from these investments)

4. Current fund(s) size and capitalization, and number of investments outstanding - Number of jobs created from these investments, - Number of recent exits

5. Historical capitalization (date and amount)

6. Number of exits to date (as a percentage of total investments). With the format of: in x investments y are considered financially successful, x socially, and z are both socially and financially successful.

7. For these exits what does success mean and how is this measured by the fund, in general. Low income job growth? Job growth? Is there a way in which your fund measures success? Or the social and/or financial returns from investments?

8. Please complete the following:
   - in x investments y had job growth during investment or while company was held in portfolio
   - in x investments y had job retention after exit
   - in x investments y had job growth after exit

9. Is there a typical exit structure or model for these exits?
## APPENDIX B: FINANCIAL CONDITIONS

<table>
<thead>
<tr>
<th>FINANCIAL CONDITIONS</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INNOV-X</strong></td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Sales growth, $4 million to $40 million, product development, rapid expansion</td>
</tr>
<tr>
<td>At the Exit</td>
<td>- Sales growth, dramatic growth</td>
</tr>
<tr>
<td>After the Exit</td>
<td>- Sales continue to growth and new product development, rapidly growing all over the world</td>
</tr>
<tr>
<td><strong>A&amp;B</strong></td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Sales growth slightly, operational efficiencies</td>
</tr>
<tr>
<td>At the Exit</td>
<td>- Sales maintained, company was strong positioning employees to be able to buy back stock</td>
</tr>
<tr>
<td>After the Exit</td>
<td>- Sales maintained and slightly grew</td>
</tr>
<tr>
<td><strong>CV FINER FOODS</strong></td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Sales growth, $1.6 million to $7 million, more automation, operational efficiencies</td>
</tr>
<tr>
<td>At the Exit</td>
<td>- Acquired by larger firm and continued to grow, Strong growth and 40% market penetration in US supermarkets</td>
</tr>
<tr>
<td>After the Exit</td>
<td>- Sales continue to growth and new product development, still looking to grow</td>
</tr>
<tr>
<td><strong>CITY FRESH</strong></td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Sales growth, 5x from 1998 to 2001, $10,000 to $4M, operational efficiencies</td>
</tr>
<tr>
<td>At the Exit</td>
<td>- Attracted larger food service company</td>
</tr>
<tr>
<td>After the Exit</td>
<td>- Continue growing today, Able to buy building with loan, and no remaining need for equity</td>
</tr>
<tr>
<td><strong>RYLA</strong></td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Began call center in Woodstock, GA, small profit in first year, monthly revenue doubled in first 6 months</td>
</tr>
<tr>
<td>At the Exit</td>
<td>- Performing 5 different types of telemarketing work</td>
</tr>
<tr>
<td>After the Exit</td>
<td>- Continues to grow and prosper ($250,000/year on retention programs to keep employees)</td>
</tr>
</tbody>
</table>
## FINANCIAL CONDITIONS

<table>
<thead>
<tr>
<th>Company</th>
<th>Location Change</th>
<th>Type of Exit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INNOV-X</strong></td>
<td>During Investment: Stayed in place</td>
<td>Partial exit to PE firm</td>
</tr>
<tr>
<td></td>
<td>At the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td></td>
<td>After the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td><strong>A&amp;B</strong></td>
<td>During Investment: Stayed in place</td>
<td>Employee buyout, employees own entirely</td>
</tr>
<tr>
<td></td>
<td>At the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td></td>
<td>After the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CV FINER FOODS</strong></td>
<td>During Investment: Stayed in place</td>
<td>Complimentary buyer</td>
</tr>
<tr>
<td></td>
<td>At the Exit: New building nearby</td>
<td></td>
</tr>
<tr>
<td></td>
<td>After the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td><strong>CITY FRESH</strong></td>
<td>During Investment: Moved from Roxbury to Dorchester</td>
<td>Complimentary buyer, support from PE Firm</td>
</tr>
<tr>
<td></td>
<td>At the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td></td>
<td>After the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td><strong>RYLA</strong></td>
<td>During Investment: Stayed in place</td>
<td>Partial exit to PE firm</td>
</tr>
<tr>
<td></td>
<td>At the Exit: Stayed in place</td>
<td></td>
</tr>
<tr>
<td></td>
<td>After the Exit: Moved to another suburb</td>
<td></td>
</tr>
</tbody>
</table>
## APPENDIX B: SOCIAL CONDITIONS

<table>
<thead>
<tr>
<th>SOCIAL CONDITIONS</th>
<th>Employment</th>
<th>Profit Sharing &amp; Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INNOV-X</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>14 jobs</td>
<td>- Very broadbased stock options</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td>- 26 jobs in &lt; 3 yrs. (12 added)</td>
<td>- Very broadbased stock options</td>
</tr>
<tr>
<td>During Investment</td>
<td>About 80 jobs (64 added) Increased</td>
<td>- Very broadbased stock options</td>
</tr>
<tr>
<td>At Exit</td>
<td>- About 110 jobs (30 added)</td>
<td>- Very broadbased stock options</td>
</tr>
<tr>
<td>After Exit</td>
<td>- 145 jobs¹ Increased</td>
<td>- Very broadbased stock options enhanced, original owners partial</td>
</tr>
<tr>
<td><strong>A&amp;B</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>9 jobs</td>
<td>- Eventually ownership for 2 employees</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td>15 jobs (retention and 6 added)</td>
<td>- Ownership (2 employees own company with CVLP)</td>
</tr>
<tr>
<td>During Investment</td>
<td>- 11 jobs (2 added), Slightly Increased</td>
<td>- Ownership (dividends as profit sharing)</td>
</tr>
<tr>
<td>At Exit</td>
<td>- 11 jobs (maintained) large turnover</td>
<td>- Ownership (dividends as profit sharing), employees as owners</td>
</tr>
<tr>
<td>After Exit</td>
<td>- 11 jobs Maintained</td>
<td></td>
</tr>
<tr>
<td><strong>CV</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>13 jobs (6 employees began)</td>
<td>- Founding entrepreneurs own</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td>21 jobs (8 added) (almost 30 in 2 years)</td>
<td>- Founding entrepreneurs own a portion</td>
</tr>
<tr>
<td>During Investment</td>
<td>- 22 jobs (9 added) Increased</td>
<td>- Founding entrepreneurs own a portion, broad-based distributions at exit</td>
</tr>
<tr>
<td>At Exit</td>
<td>- 24 jobs (all maintained) Slightly Increased</td>
<td>- No longer ownership or stock options</td>
</tr>
<tr>
<td>After Exit</td>
<td>- 11 jobs Maintained</td>
<td></td>
</tr>
<tr>
<td><strong>CITY FRESH</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>10 jobs</td>
<td>- Founding entrepreneurs own</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td>Anticipate jobs growth</td>
<td>- Founding entrepreneurs receive some compensation at exit</td>
</tr>
<tr>
<td>During Investment</td>
<td>- 25 jobs Increased</td>
<td>- Founders as employees still have some ownership, no options</td>
</tr>
<tr>
<td>At Exit</td>
<td>- 32 jobs</td>
<td>- Founders as employees receive some compensation at exit</td>
</tr>
<tr>
<td>After Exit</td>
<td>- 45 jobs Increased</td>
<td>- Founders as employees still have some ownership, no options</td>
</tr>
<tr>
<td><strong>RYLA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>16 jobs</td>
<td>- Broad based stock options</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td>120 jobs² Increased</td>
<td>- Broad based stock options</td>
</tr>
<tr>
<td>During Investment</td>
<td>300 jobs Increased</td>
<td>- Broad based stock options</td>
</tr>
<tr>
<td>At Exit</td>
<td>- 2 shifts of employees</td>
<td>- Broad based stock options</td>
</tr>
<tr>
<td>After Exit</td>
<td>- Over 357 jobs (75% are LMI) Increased</td>
<td>- Broad based stock options enhanced, original owners partial</td>
</tr>
</tbody>
</table>

¹ 151 jobs, entry level roughly half (service, manufacturing, service guys in Europe, technician or entry level)

² For LMI (entry-level, full-time jobs to reach 49 and 60 by end of 2002 and 2003)
## APPENDIX B: SOCIAL CONDITIONS

<table>
<thead>
<tr>
<th>Social Conditions</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INNOV-X</strong></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>- 401(k), Family Healthcare, stock options, minimal job training</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- 401(k), Family Healthcare, stock options, Increased job training</td>
</tr>
<tr>
<td>At Exit</td>
<td>- 401(k), Family Healthcare, stock options</td>
</tr>
<tr>
<td>After Exit</td>
<td>- 401(k)-with matching, Family Healthcare, stock options-enhanced, flexible spending accounts, employee training of management</td>
</tr>
<tr>
<td><strong>AAB</strong></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>- Healthcare, pension plan</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Healthcare, pension plan</td>
</tr>
<tr>
<td>At Exit</td>
<td>- Healthcare, pension plan</td>
</tr>
<tr>
<td>After Exit</td>
<td>- Healthcare, pension plan, hopes to have additional employee ownership in the future</td>
</tr>
<tr>
<td><strong>CV</strong></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>- Healthcare, Dental, Life Insurance, Disability (pays at least $90/month/employee), 401(k), minimal job training</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Job training, employee stock options</td>
</tr>
<tr>
<td>At Exit</td>
<td>- Healthcare, Dental, Life Insurance, Disability (pays at least $90/month/employee), job training enhanced, increased healthcare coverage</td>
</tr>
<tr>
<td>After Exit</td>
<td>- Healthcare (100%), Dental, Life Insurance, Disability (pays at least $90/month/employee), 401(k), job training, broad based distributions</td>
</tr>
<tr>
<td><strong>CITY FRESH</strong></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>- Minimal benefits</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Healthcare, 401(k) (employee initiated) and job training</td>
</tr>
<tr>
<td>At Exit</td>
<td>- Healthcare, 401(k) (employee initiated) and job training</td>
</tr>
<tr>
<td>After Exit</td>
<td>- Healthcare, 401(k) (employee initiated) and job training, sales and marking training, increased wages</td>
</tr>
<tr>
<td><strong>RYLA</strong></td>
<td></td>
</tr>
<tr>
<td>Prior to Investment</td>
<td>- Anticipated healthcare (pay 65% to 85%), and minimum wages, job training</td>
</tr>
<tr>
<td>Anticipated Growth</td>
<td></td>
</tr>
<tr>
<td>During Investment</td>
<td>- Training and advancement potential, Healthcare (pay 100%), 401(K), higher wages (larger % of healthcare costs paid), job training enhanced</td>
</tr>
<tr>
<td>At Exit</td>
<td>- Training and advancement potential, Healthcare (pay 100%), 401(K), higher wages</td>
</tr>
<tr>
<td>After Exit</td>
<td>- Training and advancement potential, Healthcare (pay 70%), 401(K), higher wages, personal financial training, flexible spending accounts</td>
</tr>
</tbody>
</table>
Works Cited


118


Publications.


Interview List

Throughout this thesis the author’s personal interviews are cited. These interviews were conducted in person, on the telephone, or via email correspondence with the following individuals. These interviews were conducted at multiple times from October 2007 to April 2008:

Tessa Hebb, Senior Research Associate
Labor & Workforce Program, Harvard Law School

Julia Sass Rubin, Assistant Professor
Edward J. Bloustein School of Planning & Public Policy, Rutgers University

Anne Claire Broughton, Co-Founder and Senior
SJF Advisory Services

Andrew Chen, Managing Director, Venture Fund
Boston Community Capital, Boston Community Venture Fund

Belden Daniels, President and CEO
Economic Innovation International, Inc.

Nat Henshaw, Managing Director
CEI Ventures, Inc.

Frank Levy, Daniel Rose Professor of Urban Economics
M.I.T., Department of Urban Studies and Planning

Ray Moncrief, Executive Vice President and Chief Operating Officer
Kentucky Highlands Investment Company (also with Southern Appalachian Fund, Meritus Ventures)

Pete November, Managing Director of Business Services
Pacific Community Ventures

James Nixon, Chair of the Board
Sustainable Systems, Inc.

Rebecca L. Regan, Chief Financial Officer and Loan Fund President
Boston Community Capital, Boston Community Loan Fund

Casson Rosenblatt, Program Associate
Community Development Venture Capital Alliance

Karl F. Seidman, Lecturer in Economic Development
M.I.T., Department of Urban Studies and Planning

Kerwin Tesdell, President
Community Development Venture Capital Alliance

Deborah Dubin, Vice President
Advantage Capital
Interview List, Case Study Investments

Case study interviews were conducted in person, on the telephone, or via email correspondence with the following individuals. These interviews were conducted at multiple times from October 2007 to April 2008:

Glynn Lloyd, City Fresh Foods

Sue Martin, A & B Electronics

Don Sackett, Innov-X Systems, Inc.

Garth Vdoviak, World Harbors Division, of Angostora (formerly CV Finer Foods)

Mark Wilson, Ryla Teleservices