



# **ASSESSING PROVENEX PERFORMANCE AND IDENTIFYING DIRECTIONS FOR THE FUTURE**

**August 8, 2002**

# OBJECTIVES OF STUDY

Since 1998 ProVenEx (the Rockefeller Foundation's Program Venture Experiment) has made 11 investments totaling \$12.2M<sup>(1)</sup>

While it is too early to evaluate the returns of these investments, the ProVenEx Committee hired the Boston Consulting Group (BCG) to evaluate ProVenEx's performance to date across a number of dimensions and provide a landscape of the Double-Bottom Line (DBL) investing field

We define the core double-bottom line investing space as one where investors explicitly meet three requirements

- Require both a social and a financial return
- Target and try to measure a specific social return
- Are willing and able to accept sub-market financial returns<sup>(1)</sup>

(1) Including one exited investment of \$0.5M

# SUMMARY FINDINGS (I)

**ProVenEx (PVX) is a philanthropic investment tool. It fits with Rockefeller's mission and is a useful and important tool**

- **Each foundation theme\* has a set of low return higher risk ventures requiring patient capital**
- **PVX investment can help challenge and bridge grantees to greater self-sufficiency**
- **PVX is an important learning vehicle within and across themes**

**DBL investing is challenging and hard to execute well**

- **Inherent tension between SROI and FROI<sup>(1)</sup>**
- **Small pools of capital available and few models of success**
- **Few individuals with skill sets that bridge these worlds**

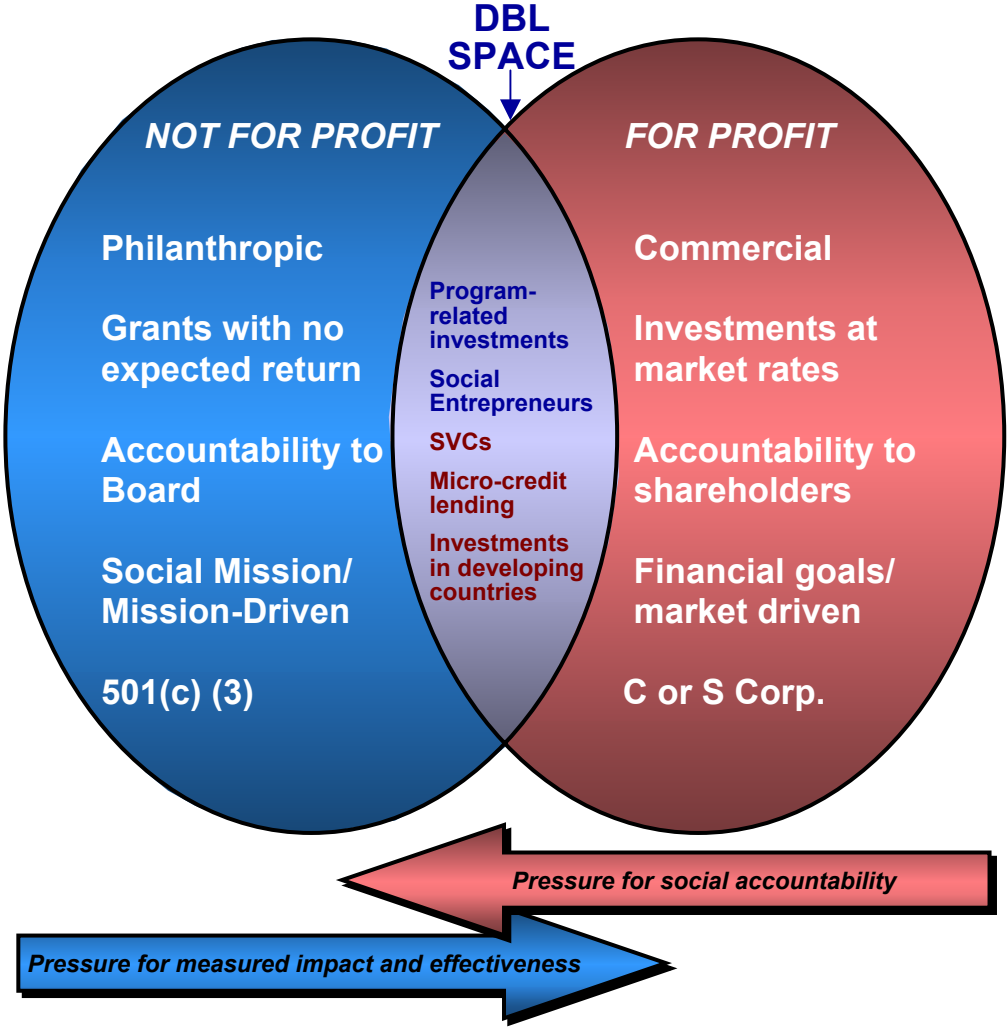
**DBL landscape currently consists of different approaches: investment in DBL funds/intermediaries and direct investment requiring more active intervention**

**Moving forward, ProVenEx should**

- **Define metrics by which PVX will be judged**
- **Explicitly set FROI, SROI, and risk targets by theme and port folio**
- **Consider strategic options specific to each sector's DBL landscape and needs**

(1) The tension between Social Return on Investment (SROI) and Financial Return on Investment (FROI) can be seen in the example of a jobs training program which could increase financial return by taking easier to train candidates who can be matched against multiple jobs, but could increase social return by working with a more at-risk and harder to place population.

# DOUBLE-BOTTOM LINE INVESTING ADDRESSES REAL NEEDS NOT SERVED BY GRANTS AND PRIVATE CAPITAL



# **THE U.S. DBL SPACE INCLUDES ABOUT \$400M IN SPENDING<sup>(1)</sup>**

**Trends over the last decade have prepared way for DBL investing**

- **Growth of program-related investments as a tool for foundations**
- **IRS ruling that allows nonprofits to have for-profit arms “related to mission”**
- **NGOs pressure on corporations to develop visions beyond pure focus on financial return to stockholders**
- **Development of “social investing” with ability to rate corporations on their track record and pools of capital only open to favorably rated companies (e.g., CERES ratings)**
- **Large pools of capital in hands of successful entrepreneurs looking for new philanthropic models**

(1) Findings based on research into pools of capital available, potential players and trends, and interviews with more than 20 DBL participants  
Summary of report by The Boston Consulting Group dated August 8, 2002

# KEY FINDINGS FROM THE DBL LANDSCAPE

Despite the favorable trends, the U.S. Double-Bottom Line (DBL) landscape is small, with less than \$1B in assets and \$400M in investments in 2000<sup>(1)</sup>

- **Core DBL investors include:**
  - **Foundations making Program-Related Investments (spending \$300M)**
  - **Social venture capital funds (investing \$100M)**
  - **Micro-credit lending (spending \$40M)**
- **Many of these are targeted to specific themes and geographies, or companies at specific stages of development and are not available for all deals**
- **Most PVX investees report real challenges finding additional capital**

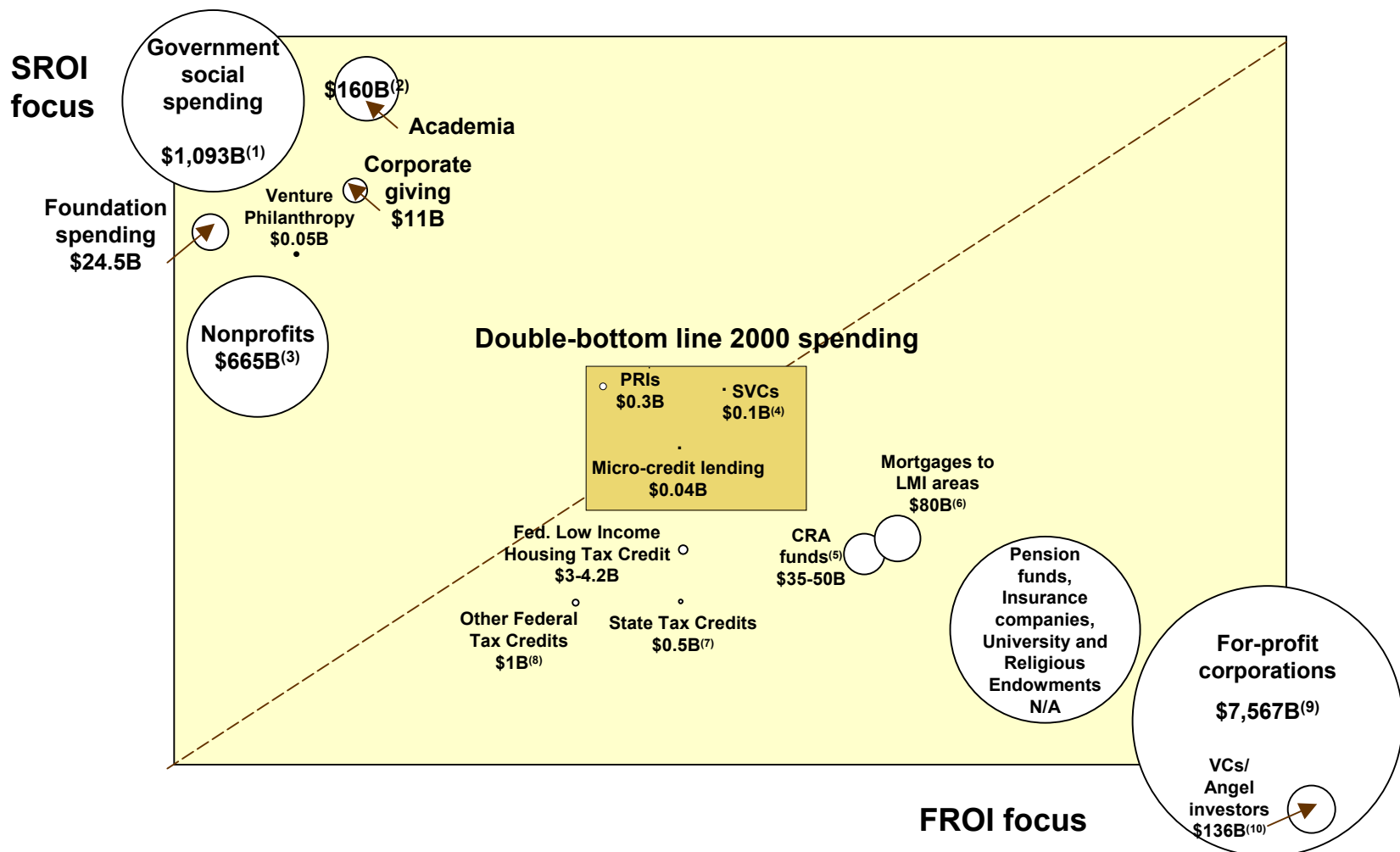
**Outside of the core DBL areas, more sizeable funds or subsidies exist that could be used for DBL purposes**

- **The Community Reinvestment Act of 1977 (CRA) has created \$35B-\$50B in annual lending for community development,<sup>(2)</sup> and mortgages to low- and moderate-income areas represent another \$80B**
- **The federal government and many states have tax incentives for investing in low income communities. Federal low income housing tax credit alone represents \$3B-\$4.2B in 2000 subsidies**
- **California has launched an initiative to commit state pension money to community development – a model other states may follow**

(1) U.S. DBL spending is growing and increased from \$200M in 1997 to \$400M in 2000

(2) Includes funds dedicated to community development and small business financing in low-to-moderate-income areas. Excludes lending for farms and businesses in medium-to-high-income areas. May include Federal Low-Income Housing Tax Credits. Includes CDFIs and CDCs. May overlap with mortgages to low-to-moderate-income areas

# APPROXIMATELY 75% OF THE \$400 MILLION IN CORE DOUBLE-BOTTOM LINE SPENDING IN 2000 FROM PRIs



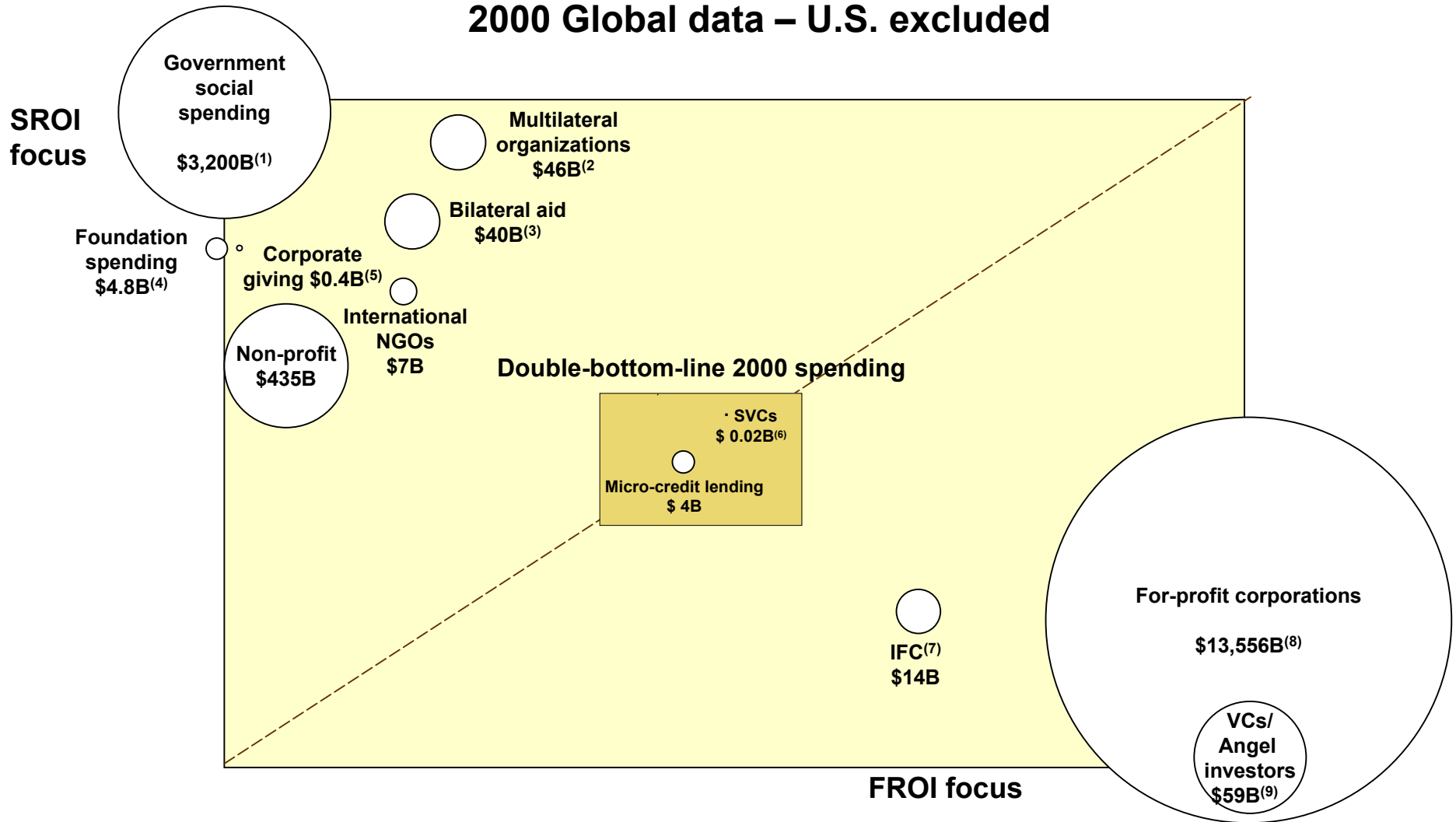
(1) Federal outlays for health, Medicare, Social Security, veterans benefits and income security, community development, housing assistance. (2) Total expenditures for public academic and private institutions. (3) The New Nonprofit Almanac, 1997 data. (4) Spending estimated at 20% of total committed assets. Total SVC assets \$0.5B. (5) Includes funds dedicated to community development and small business financing in low-to-moderate-income areas. Excludes lending for farms, businesses in medium-to-high-income areas. May include Federal Low-Income Housing Tax Credits. Includes CDFIs and CDCs. May overlap with mortgages in low-to-moderate-income areas. (6) HMDA national aggregate data. Includes conventional home purchases, refinancings, home improvement, and multi-family housing. (7) Consists of \$400M Capco credit for insurance companies and state low-income housing tax credits (8) Includes work opportunity tax credit (\$500M), welfare-to-work tax credit (\$100M), Empowerment Zone tax credit (\$200M) and eventually will include New Market Tax Credit among others. Excludes consumption credits and credits not benefiting community development such as Earned Income Tax Credit (\$28.5B), Mortgage Interest Deduction, Real Estate Tax Deduction, exclusion of capital gains, Deferral of Income from Installment Sales, Exemption from Passive Loss, Depreciation of Rental Housing, Exclusion of Bond Interest for Owners, Exclusion of Bond Interest for Rentals. (9) Total revenues from U.S.-listed companies. (10) \$30B of this amount in 2000 is angel capital going to 50,000 seed stage companies.

Source: U.S. Census Bureau; Foundation Center; Giving USA; SIF; National Capital Association; Venture Philanthropy Partners; FFIEC; LISC; NASVF; Compustat; Bernstein Research; Microenterprise FIELD 2000 Report; Joint Committee on Taxation; interviews; BCG analysis





# **GLOBALLY, THERE IS \$4 BILLION IN CORE DBL SPENDING MOSTLY THROUGH MICRO-CREDIT LENDING 2000 Global data – U.S. excluded**



(1) Estimate of total worldwide government social spending, excluding U.S. (2) Total aid from UN, IMF, World Bank (IBRD, IDA), Regional development banks (incl. African Development Bank), other international financial institutions. (3) Total bilateral aid from OECD countries – does not include aid to multilateral institutions. (4) Total grants made by European and Japanese foundations. (5) Total giving by European corporations. (6) Estimated at 20% of assets. (7) Total spending in 2000 – includes funding to micro-finance institutions. (8) Total 2000 revenues of listed companies worldwide, excluding U.S. (9) Total VC spending in 2000 in Europe and Asia.

# **GLOBAL DBL LANDSCAPE DIFFERENT FROM U.S. IN TERMS OF PARTICIPANTS AND STAGE OF DEVELOPMENT**

**New sources of funding exist on the global landscape that are not present in the U.S.**

- **Multilateral organizations (World Bank, UN, IMF, regional development banks)**
- **Bilateral aid, mostly from OECD countries**
- **International NGOs**

**Private investment in social projects generated by tax policy and legislation not a significant funding source on a global basis**

- **No equivalent of CRA funds identified outside the U.S. although several countries including U.K. considering idea of local legislation**
- **PRI equivalent mechanisms are driven by US tax considerations and may not be available to non-U.S. foundations**

**The DBL investing landscape is less developed internationally**

- **Small total spending by SVCs abroad, mostly located in the U.K.**
- **Micro-credit lending remains the main source of DBL spending globally and is mostly focused on lending to individuals/small businesses**

# DBL INVESTING STILL NEEDS TO PROVE ITS VIABILITY

## A FAD

**“Will decline of U.S. venture investing result in reduced interest/support for social ventures?”**

**“Right now it still feels like an experiment and a bit of a novelty”**

**“Everyone wanted to be a VC in 1999/2000. So in part, it’s a fad”**

**“A fad – it will fade away”**

**“Probably faddish, but potentially a new tool”**

## A TOOL IN FOUNDATIONS’ PORTFOLIO

**“The models need to be clarified, validated and then earn credibility”**

**“Will remain a small niche in overall capital markets but can add billions to areas that rely exclusively on philanthropic or subsidized funds”**

**“I do not see foundations making PRIs their main tool”**

**“Grants appropriately remain the mainstay of foundation work”**

## THE FUTURE OF PHILANTHROPY

**“There is a tremendous opportunity”**

**“If I started a foundation today, I would only do PRIs”**

**“We all know that grants are not part of a sustainable model. PVX offers a much more sustainable model that gives the investee a real voice”**

# **EXPERTS QUESTION THE FEASIBILITY OF FOUNDATIONS DOING DIRECT INVESTING<sup>(1)</sup>**

## **Consensus on a few issues:**

- **PVX goals need to be better understood**
- **Believe greater business expertise is essential within ProVenEx in specific sectors of investments**
- **Scale of fund is important – need to be able to do broad enough portfolio of deals to have some success**
- **No successful DBL model for success has yet emerged**

## **Disagreement around:**

- **Whether there is an inherent tradeoff between FROI and SROI**
- **Level of non-financial support required by recipients and ability of PVX to provide on a cost-efficient basis**
- **Whether foundations have enough business expertise to do direct investing without experiencing 30%-50% default rates**
- **Whether successful DBL investing can be done without going through intermediaries**
- **Whether advisors would invest their own funds in deals they are advising PVX on**

(1) Findings based on interviews with 12 ProVenEx advisors, 13 external experts, and 17 other foundations  
Summary of report by The Boston Consulting Group dated August 8, 2002

# PROVENEX EXPERIENCE TO DATE

**11 investments totaling \$12.2M; 3 more investments in pipeline totaling \$4M**

- **Exited from 1 deal at loss less than \$500.00**
- **Considered more than 150 investment opportunities**
- **30% of portfolio is PRIs, 70% of portfolio IRPs (Investments Related to Program)**
- **Investments range in size from \$300,000 to \$3.6M**
- **FROI expectations range from 0%-26%**

**All investments are made to further a specific program strategy of the Rockefeller Foundation and leverage expertise and networks that exist within the Foundation's program areas**

**On the whole, investments are at the high financial risk end of the spectrum and each deal is unique**

- **6 deals have a duration of 7 years or more**
- **Varied portfolio increases time required to both negotiate and manage deals**
- **After four years, all investments still in business, making progress towards social goals**

# **CONSENSUS WITHIN RF THAT PVX IS AN IMPORTANT TOOL THAT HAS RESULTED IN VALUABLE LEARNING<sup>(1)</sup>**

## **Consensus on a number of issues:**

- **Committee members value experience and learning as well as opportunity for cross-thematic collaboration**
- **Those not on Committee express a strong desire to be more informed and a few seek ways to be more involved**
- **All believe PVX represents an important tool in portfolio**
- **100% officers agree PVX has “met or exceeded” most expectations**

## **Disagreement around:**

- **Type of impact ProVenEx has and can have with \$17M**
- **Whether PVX should take greater or lesser risk**
- **What mission of PVX is and what it should be**
- **How success should be measured**
- **Which deals, if any, constitute models that should be replicated**
- **Expectation of likely financial return from current portfolio**

(1) Findings based on interviews with 11 committee members and 12 senior or former staff  
Summary of report by The Boston Consulting Group dated August 8, 2002

# SIGNIFICANT SUCCESSES SO FAR BUT MAIN CHALLENGES STILL UNRESOLVED

## PVX successes so far

### Potential high social return across the board

- Investees very committed to PVX's social goals

### Success in providing some types of non-financial support to investees

- Access to network of advisors and potential business partners
- Increased financial discipline built into business plans

### High buy-in of Committee

- Involvement of all four themes
- High participation from senior Rockefeller officers

## Unresolved challenges

### Potential for high default rate

- High failure rate part of any VC fund but VCs have home-run FROI deals to compensate for overall high risk. PVX may not have these deals in portfolio
- Some current investees struggling and hoping for more PVX capital

Large range of unique deals requiring customized support has high time and financial investment requirements

PVX may be taking more of a passive investor approach for some investees that require more active support

Need to leverage and share learnings with RF officers not on Committee and eventually with others in DBL field

# **INVESTEES GENERALLY SATISFIED WITH PVX; LOOKING FOR MORE POST-DEAL SUPPORT<sup>(1)</sup>**

## **Consensus on a number of issues:**

- **Time spent in investment review, due diligence, and negotiations perceived as too long**
- **PVX viewed as negotiating “tougher” terms than other PRI investors**
- **100% investees agree PVX has “met or exceeded” most expectations – although “follow on funding” cited as an open issue**
- **Need for PVX to take follow-on funding into consideration when making investment decisions**
- **Investees receive “less management support” than they expected**

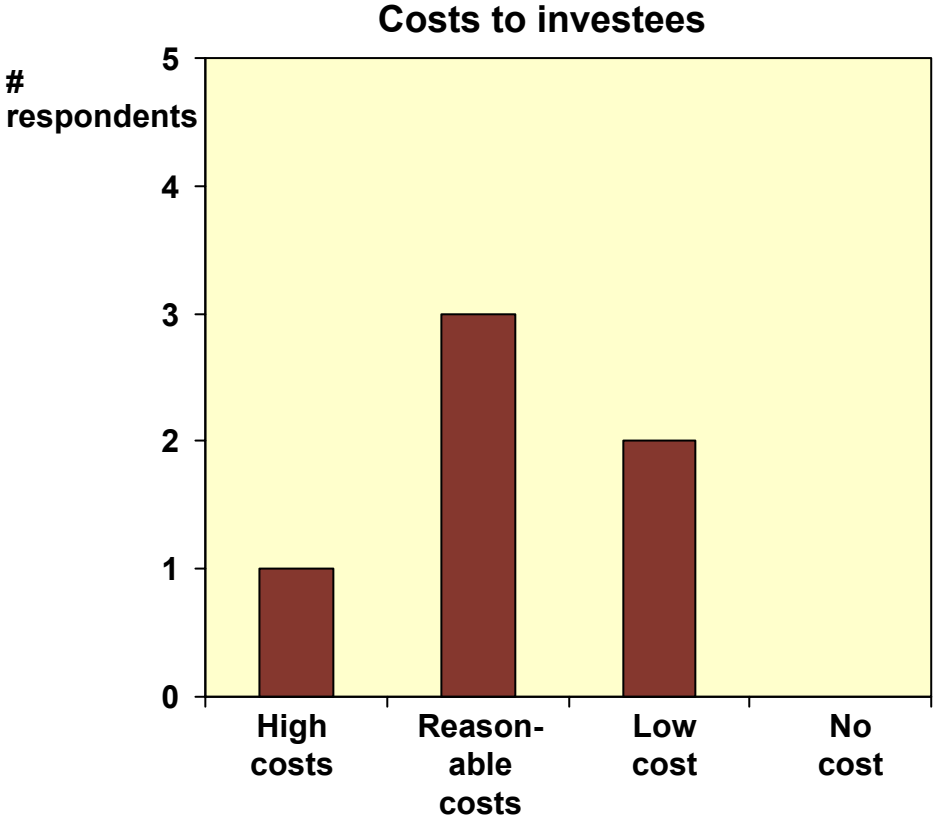
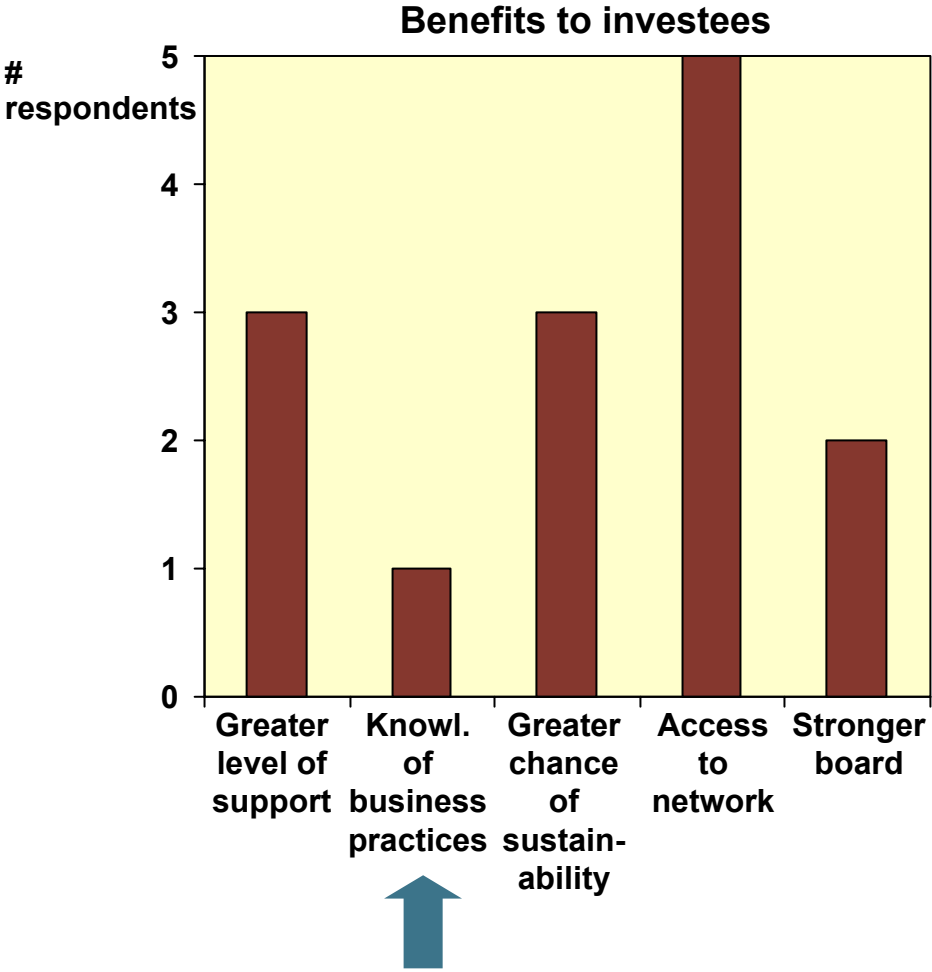
## **Disagreement around:**

- **Value brought by PVX – from key partner to “just a source of funding”**
- **How onerous PVX process is**
- **Expectations vary of types of PVX support from investees who “just wanted to get money” to “we thought they would help us find follow-on funding, not just gives us names”**

(1) Findings based on interviews with 9 investees and 4 declined investees

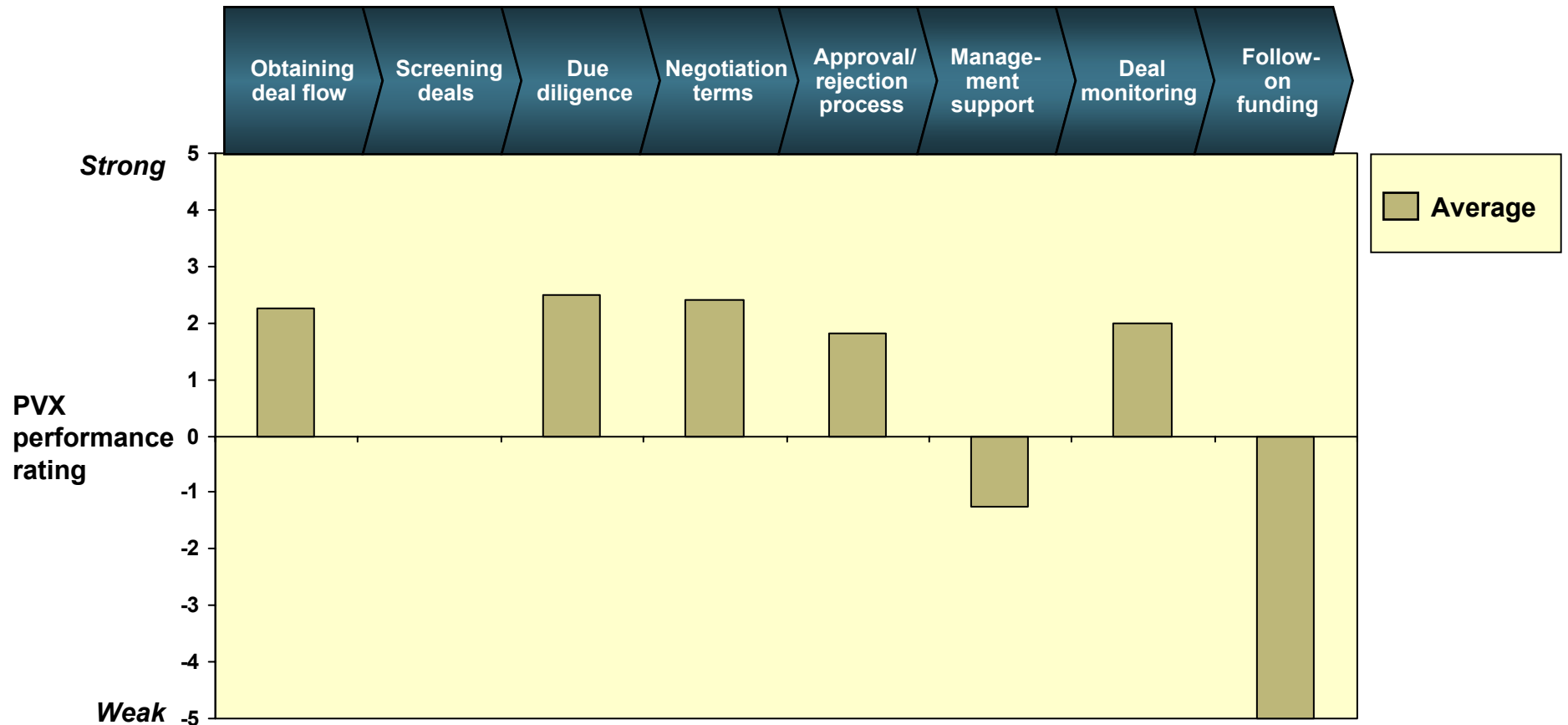


# INVESTEES EXPERIENCE NETWORK ACCESS AS MAIN BENEFIT; NEED GREATER ACCESS TO BUSINESS MANAGEMENT EXPERTISE



Note: Number of respondents: 8 investees. Multiple responses were given  
Summary of report by The Boston Consulting Group dated August 8, 2002

# ALL INVESTEES CITE FOLLOW-ON FUNDING AS AREA OF GREATEST NEED



**Investees generally satisfied but fear they will fail if follow-on funding not made available**

Note: Number of respondents: 5 investees

# **FOLLOW-ON FUNDING CRITICAL ISSUE FOR INVESTEES**

**Almost half of PVX's investees report difficulties in finding funding sources either for their next development stage or for their short term operating needs. Overall follow-on funding expected from PVX could be more than \$2.5M in next 6-12 months**

**Investees have high expectations for PVX to step in and:**

- **Connect with more potential funding sources (use RF convening power)**
- **Be a lead investor with at least the same amount as in first round financing**
- **Take a more active role (Board seat)**

# RECOMMENDATIONS

## **Clarify ProVenEx mission:**

- **Define measures of success, degree of risk tolerance and expectations for SROI and FROI**

## **Build an infrastructure that matches the type of investments in portfolio**

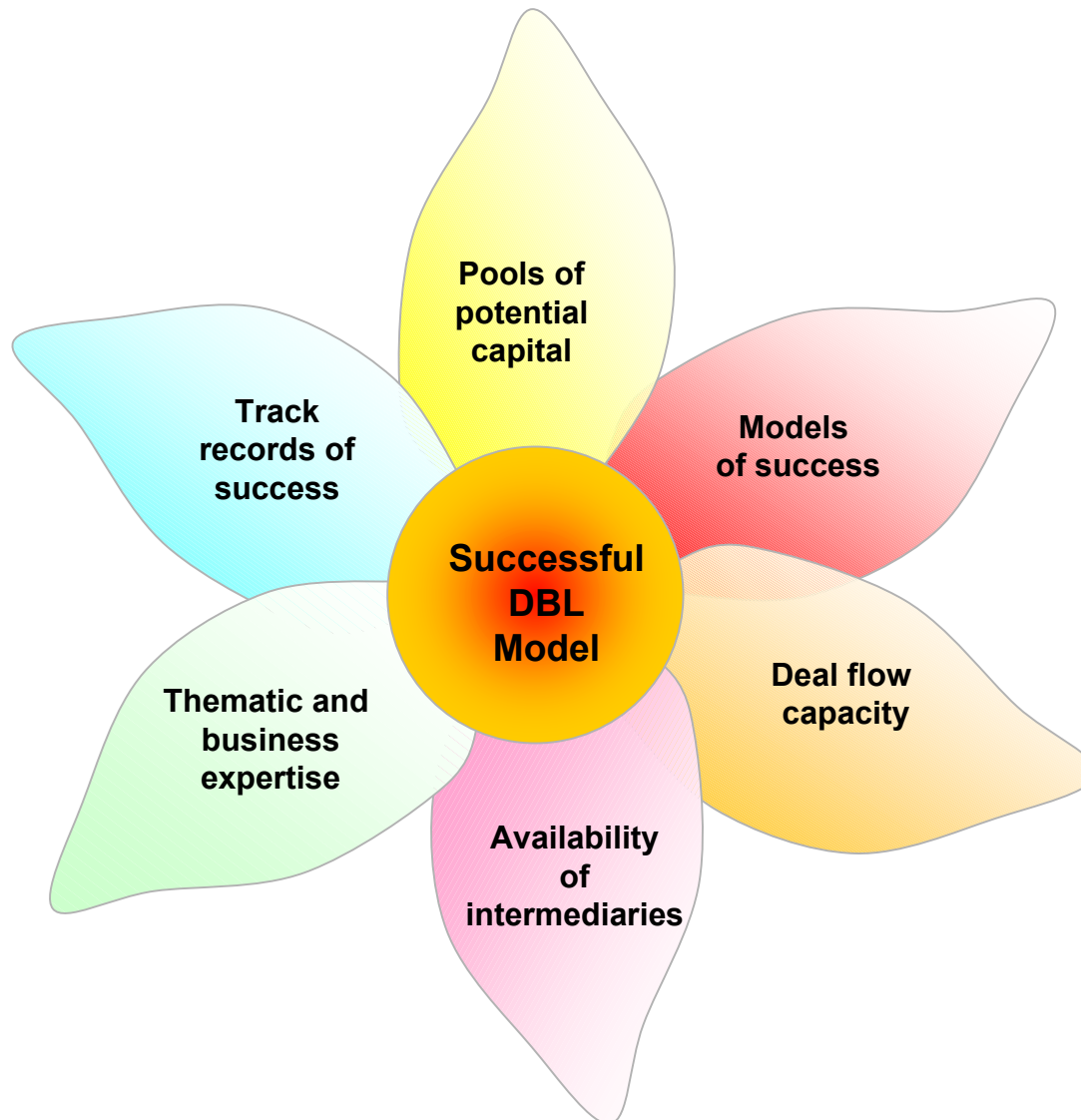
- **Higher risk or more innovative deals requires greater infrastructure & more active role**
- **Greater use of intermediaries**
- **Create a more formalized, accountable and incentivized team of advisors**

## **Mine the experience**

- **Share lessons learned internally and with broader philanthropic and double bottom-line investment community**

**Future strategic options will depend on double bottom-line landscape within each sector of interest to ProVenEx and the Rockefeller Foundation**

# DEVELOPING A SUCCESSFUL DBL INVESTING MODEL REQUIRES PULLING SIX LEVERS



# EACH LEVER HAS A NUMBER OF OPTIONS

Leverage tax subsidies  
Translate PPP model to other themes  
Raise pools of dedicated capital  
Increase use of partners  
Co-invest with WC

Develop models  
Develop replicable models  
Develop investee capacity  
Create/convene learning forum

Pools of potential capital

Models of success

Successful DBL Model

Deal flow capacity

Partner with other DBL investors  
Standardize investment process  
Leverage grantee network

Track records of success

Thematic and business expertise

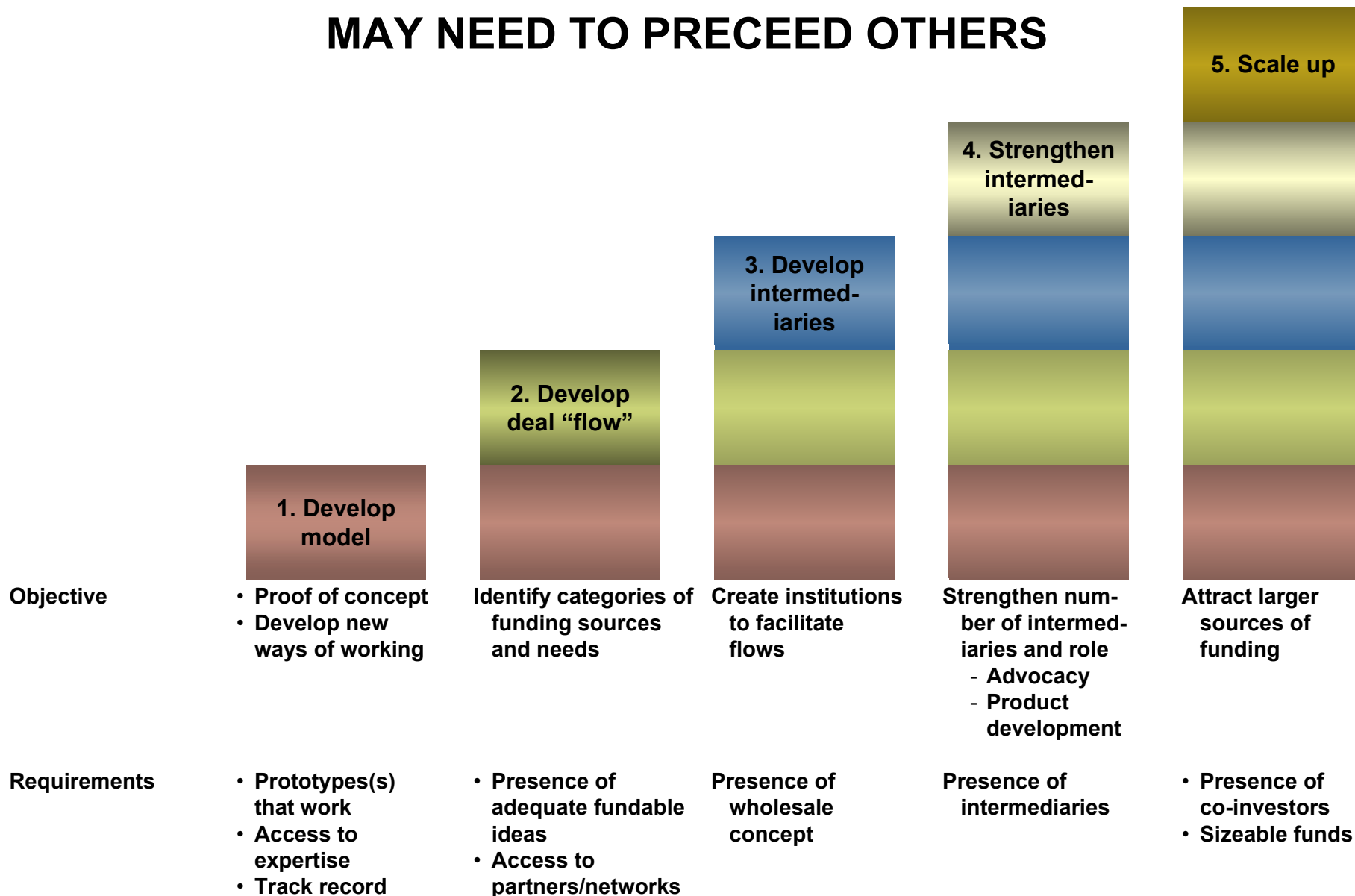
Availability of intermediaries

Tools/Metrics for measuring SROI  
Ongoing tracking

Develop active network of advisors for post-deal support  
Create a DBL tracking program  
Convene annual forum

Expand reach of CDFIs to other themes  
Create new intermediaries  
Strengthen existing intermediaries

# THEORY OF CHANGE SUGGESTS SOME STEPS MAY NEED TO PRECEED OTHERS



## Note:

\* In order to maximize its resources and leverage the Foundation's strengths, grantmaking is organized around four thematic lines of work: Creativity & Culture, Food Security, Health Equity and Working Communities. A cross-theme of Global Inclusion supports, promotes and supplements the work of these themes.