Snowden Perspectives: *Spectrum of Impact in America*

April, 2012

Executive Summary

In Snowden's previous "Introduction to Social Impact" Perspectives piece, we introduced the concept of adapting new business approaches to create not only financial profit, but social and environmental benefit as well. In this article, Mark Newberg further explores the concept of "Impact Businesses" and the variety of impact structures in America. Focusing primarily on for-profit companies pursuing "profit + impact," this article provides specific examples of firms incorporating impact strategies into their basic business strategies, and offers a glimpse into the future of American Impact.

In the Bay Area, an entrepreneur launches a company producing healthy, organic foods for school lunches, and gains the backing of a leading venture fund. It's called "Revolution Foods."

In New England, a team of scientists develops a world-leading battery storage technology, founds a company, and takes it public. It's called "A123 Systems."

Down in New Orleans, an educational technology entrepreneur offers a return to investors, by changing the way children learn. It's called "Drop the Chalk."

In New York, a former investment banker names her company after a Bob Marley album, matches skilled professionals with non-profits to donate their *pro bono* professional skills, creates a for-profit market that didn't previously exist, and makes money doing it. It's called "Catchafire."

Each of these businesses is an American success story. And each of these businesses is part of the Impact Economy.

The "Impact Economy", a term defined by the use of revenue-generating business activities to achieve social benefit, is an emerging area of investor, academic, and policy focus. A 2010 report by JP Morgan proclaimed "impact investments" an "emerging asset class" with potential invested capital of $400 million to $1 trillion, globally, by the year 2020[1]. In April of 2011, the White House and the Aspen Institute co-sponsored "Building an Impact Economy," gathering some of the most influential leaders from across the Impact Economy in order to better understand the policy mechanisms that could help, or hinder, the growth of the Impact Economy. The resulting report, issued by the Aspen Institute[2] outlines a number of areas, ranging from impact-specific purchasing, to support of standardized metrics, to addressing certain regulatory barriers, where government action might positively affect the flow of capital to impact investments.

While the types of investments that might legitimately earn the mantle of "impact" have received increasing attention, a critical underlying question has not yet been resolved: What kinds of businesses produce impact? And, for prospective investors and investment managers, an even more critical question: Regardless of what these "Impact Businesses" look like, how can they make money?

[1] www.jpmorgan.com/directdoc/impact_investments_nov2010.pdf
[2] http://www.aspeninstitute.org/publications/building-impact-economy-america-2011

About Snowden

Snowden is a global, independent financial services firm. We provide wealth and corporate advisory services to high net worth individuals, families, institutions, and governments. In the end, each of our clients is trying to get from Point A to Point B — Snowden provides the pathway from point to point.

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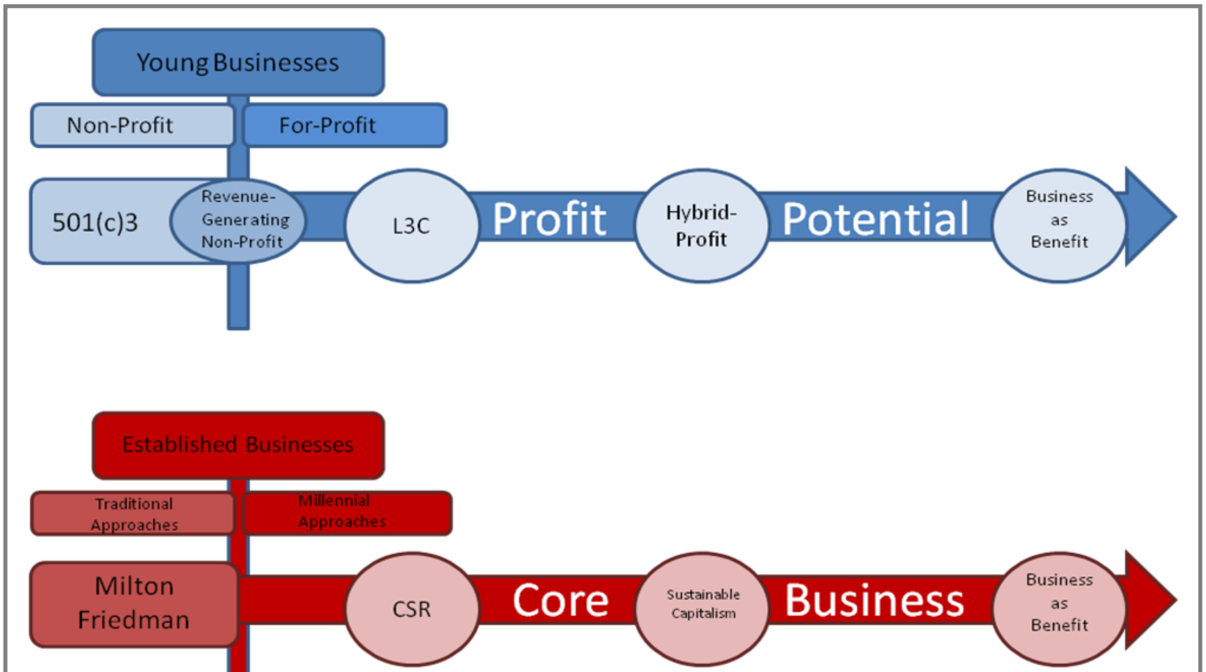
Mark Newberg is Snowden's Senior Impact Advisor, advising on Snowden's impact offering, providing expertise and industry bandwidth, and developing business opportunities. Mark previously served as a Senior Policy Advisor at the US Small Business Administration, where he helped lead Impact Investing policy efforts while handling issues related to high-growth entrepreneurship, innovation, and disaster recovery. Prior to his time at SBA, Mark was a post-Katrina Advisor to the New Orleans City Council. Currently based in Washington, DC., Mark advises several high-growth, high-impact startups and has written occasional opinion pieces for various media outlets. Mark holds a BA from Tulane University, a JD from Tulane Law School, and was a Visiting Student at Harvard Law School.

To answer these questions, let's look at the diagram below. The diagram highlights the types of businesses operating in the Impact Economy, and is particularly focused on the for-profit side of the equation. We'll call it: The Spectrum of Impact in America.



"The Spectrum of Impact in America"
2012

The Spectrum is divided into two broad categories: "Young Businesses" and "Established Businesses." This division recognizes that the ways in which entities are able to pursue impact strategies differ by the age, size, and structure of the company[3] in question.

The "Young" category includes non-profits, small businesses, and high-growth startups that are neither publicly-traded, nor operating at such a scale as to seem publicly-traded[4]. The "Established" category focuses exclusively on for-profit companies that are or appear to be, by virtue of their size, publicly-traded. Established entities are divided into "Traditional" business approaches represented by the theories of Milton Friedman, and "Millennial" approaches incorporating at least some corporate focus on positive social outcomes.

Young Businesses

Non-profits

Non-profits do fantastic work. They address many social problems for which there are no readily apparent business cases to resolve. They rely on philanthropic capital to fund operations. While forward-thinking financiers have begun developing and deploying innovative capital markets solutions (most notably the Social Impact Bond) focused on the outcomes of non-profit interventions, the underlying non-profits are not the investable "Impact Businesses" sought by Impact Investors.

Revenue-generating Non-profits

These entities blur the line between non-profit and for profit, by running revenue-generating activities from within the non-profit. Examples include the Delancy Street Restaurant in San Francisco (run by recovering addicts and ex-convicts) and Café Reconcile in New Orleans (staffed by "severely at-risk youths"). In both instances employees learn life skills in a job-based environment, furthering the charitable mission of the parent non-profit while generating revenue that is used to sustain its charitable activities. While the revenue-generating outlets may look like for-profits, they are structured as non-profits and, therefore, can accept donations and loans, but not investment-grade capital, and must use the revenue to further their charitable purpose.

[3] While a non-profit is not technically a company, we use the term to cover the various types of operating entities discussed in The Spectrum.
[4] SC Johnson, Cargil, Mars, and Hilton are examples of privately held companies that are too big to be "young."

L3C (Low Income, Limited Liability Company)

As the first modern "social enterprise" corporate form to be adopted, the L3C attempted to make it simpler for businesses to embed their social mission within the DNA of the company, while simultaneously catalyzing the flow of foundation dollars into those L3Cs through Program Related Investments (PRIs). The PRI approach for L3Cs has been fraught with difficulties and is best discussed elsewhere. For the Spectrum, we simply note that an L3C is an LLC with an identified social mission, and ought to be viewed by investors as such. Because the operating agreements of LLCs are often easily changed (convenient for entrepreneurs, potentially perilous for investors), they may not be the preferred form for angels, funds, or institutional investors. This holds true for L3Cs and, as such, L3Cs tend to be local businesses, designed without the intention of scaling broadly.

Hybrid-Profit

Here, we begin to see the true ability of Impact Businesses to generate profit, investor return, and social benefit, *at the same time.* To explain, let's take a few examples:

1. **TOMS Shoes**: TOMS has become famous for its pledge: "With every pair you purchase, TOMS will give a pair to a child in need." Organized as a for-profit company, TOMS sells shoes around the world. At last count, over 600,000 pairs of shoes since 2007.

   Just selling the shoes, however, does not make TOMS an impact business. TOMS partners with non-profits around the world to donate a culturally appropriate "Giving Pair" for each pair sold in the marketplace.[5] In this way, TOMS sells its core product (the regular shoes) and uses revenue from those sales to fund the donation of the "giving" shoes through its global partners.

2. **Ethos Water**: Now available at almost every Starbucks, Ethos was founded as an independent bottled water company with a mission: "It seems hard to imagine, but more than 1 billion people on our planet can't get clean water to drink. Ethos® Water was created to help raise awareness about this terrible crisis and provide children with access to clean water."[6] Ethos determined that it would donate a portion of revenue from the sale of each bottle of water (the core product) to fund clean drinking water projects run by non-profit partners around the globe.

   As a privately held company, Ethos leveraged its commitment to positive impact (the "giving") to increase brand awareness, turning its "giving" activities into a mechanism that increased the company's value by enhancing the power of its brand. In essence, the "giving" served as a socially beneficial version of an advertising budget. And it worked. The reason Ethos, a private, independent company now sees their product sold in Starbucks is because it was acquired. By Starbucks.

The lesson to be drawn from the example of hybrids like TOMS and Ethos (and others, like Warby-Parker Eyewear), is that "benefit" can enhance brand value. It can serve as the best kind of advertising— the kind that drives customers to buy a particular product, over its competitors, because the purchase produces "good". But it's a difficult model to get right, and it can be a difficult model to sell to investors. After all, an investor who looks only at income statements might see the transfer of revenue to a non-profit, regardless of the benefit it produces, and think, "that's reducing the value of my portfolio."

Business as Benefit

When the benefit delivered by a company is derived directly from the sale of its core product or service, it has become the most inherently investible form of Impact Business. These are the companies that, by the act of selling their product, or service, are generating profit, and delivering benefit, from within the same transaction. In structural terms these are, by and large, C-Corporations. They are designed for future investors, shareholders, and for the broad scaling of their business models. They are exhibiting, perhaps, the most exciting trend in early-and-growth-stage business today: The ability to do good, and do well, at the same time.

[5] http://www.toms.com/our-movement-giving-pair
[6] http://www.starbucks.com/responsibility/community/ethos-water-fund

The most recognizable examples of this type of Impact Business come from the clean energy sector. A wind farm, a solar operator, or a micro-hydro operator, by producing its basic product (electricity), is also producing its chief benefit (zero carbon output). An electric car manufacturer (like Tesla), produces its core benefit (carbon-free transportation) only by selling its core (and arguably cool) products. But, as the opening of this article shows, clean energy is not the only sector in which we find these companies:

1. **MinuteClinic** is a leader in the "Retail Medical Clinic" sector labeled a "Disruptive Innovation" by Harvard Business School's Clayton Christensen.[7] Placing licensed Nurse Practitioners in dedicated patient treatment rooms within select CVS stores, MinuteClinics are able to provide basic physicals, evaluations, and diagnosis, are able to prescribe medication, and perform certain diagnostic tests. Minute Clinic accepts insurance, but has also driven the cost of treatment down to a price point accessible to the un(or under) insured, reducing unnecessary emergency room visits while increasing access to basic care. Founded as a small business, MinuteClinic was acquired by Caremark for approximately $200 million.[8]
2. **Honest Tea** produces healthy, organic, bottled beverages and packaged teas. Founded in 1998 as a small business, Honest Tea is sold in supermarkets and convenience stores across the country and around the world. In 2007, The Coca-Cola Company purchased 40% of Honest Tea for a reported $43 million, and acquired the remaining 60% in 2011 for an undisclosed amount.[9]
3. **Method** is a consumer cleaning products company, dedicated to non-toxic, environmentally friendly, and recyclable products and packaging. Now available in retail outlets across the country and in several foreign markets, and a recognized leader in sustainable consumer products and certification, Method was #7 on the 2006 Inc. 500 list of fastest growing private companies.
4. **Naked Pizza**, a New Orleans-based purveyor of healthy, probiotic pizza is dedicated to eliminating harmful ingredients from daily diets, and has become a leading social media voice for sustainable food systems. The firm is experiencing rapid growth, and investors include Robert Kraft (owner of the New England Patriots) and Mark Cuban (owner of the Dallas Mavericks).

In order to make it easier for Impact Businesses, like the four discussed above, to embed a social mission within their core business, a number of states have adopted a new form of business registration, called "**Benefit Corporation**." The "Benefit Corporation" statutes seek to do for C-Corps what L3Cs do for LLCs; embed a social mission into the founding documents of a for-profit company. The intricacies of the various forms warrant exploration in a different paper, and there is some question as to the ultimate utility and adoption of the forms (none of the four businesses in this section are Benefit Corporations), but the trend of lawmakers devoting time to the issues facing Impact Entrepreneurs makes clear that, around the country, the Impact Economy is seen as a growth sector.

Large Businesses

When it comes to impact, publicly traded companies (and some large privately-held companies) are in a different category. Because of their large number of shareholders, existing corporate documents, and established business models, the Fortune 500 companies of today will not become Impact Businesses. It's simply not realistic to believe that a General Electric or a Wal-Mart will (or could) shift its entire business model to Impact.[12] But while Milton Friedman asserted in his 1970 *New York Times* Essay, "The Social Responsibility of Business is to Increase its Profits" that the purpose of a corporation is to maximize profit and that, if the corporation (through its individual executives) wishes to do "good" it should contribute to charity, major corporations are discovering new ways of merging business and impact, in ways that aid their bottom-line.

[7] http://www.claytonchristensen.com/disruptive_innovation.html.
[8] http://www.r.umn.edu/academics-research/bicb/research-program/events/past/making-a-difference/
[9] http://www.ajc.com/business/coca-cola-buys-remainder-857010.html

Corporate Social Responsibility (CSR)

At the narrow end of the spectrum, CSR represents a concerted effort on the part of a corporation to have a charitable impact. CSR is a good thing, driving billions of dollars to charity on an annual basis, but CSR bears no necessary relationship to the corporation's core business model. It may be related, but it doesn't have to be.

Target Stores runs one of the best-known CSR programs in America. 5% of Target's income is donated to charitable causes. Money goes to public schools, environmental organizations, health providers, and more.[13] However, this type of giving has little connection to Target's core business: It's a big-box retailer deriving profit from selling consumer products.

Sustainable Capitalism

McKinsey & Company released a 2011 report called "The Business of Sustainability: Putting it Into Practice."[14] The report represents a positive evolution in the theory of Sustainable Capitalism, in which the McKinsey Global Institute has long been a thought leader. Sustainable Capitalism encourages corporations to incorporate aspects of sustainability into day-to-day business decision-making. The value proposition is quite simple: if a business focuses on where it can reduce resource use, or conserve energy, it can increase its bottom line, effectively generating profit from focusing on impact.

For example: Back when Wal-Mart was evolving its CSR program into something more, the management team in Bentonville started focusing on resource use, both in and out of stores. This led to initiatives designing more energy-efficient stores and supply depots (some estimates had energy costs as high as 40% of overhead). It also led Wal-Mart to work with suppliers to excise excess water from detergent. Less water meant smaller bottles. Smaller bottles meant less weight, less space, and less plastic. It meant that more bottles (and therefore more loads of laundry) could fit on each shipping pallet. More laundry loads per shipment meant more revenue per truck, and fewer trucks per store, increasing profit margin and decreasing the operating (and environmental) costs of sending all those trucks to all those stores. So Wal-Mart changed the way we do laundry. Not because it wanted to save the planet, but because it found a way to make more money by doing the right thing.[15]

The McKinsey Report offers numerous other examples of companies deriving profit from considerations of sustainability, including GE's "Ecomagination", Waste Management adding "waste to energy" and "waste reduction" offerings to its product and service mix, and Nestle's drive for sustainable cocoa. Importantly, the McKinsey report now recognizes the importance of Environmental, Social, and Governance (ESG) factors as drivers of corporate decision (and profit) making: "Companies should integrate environmental, social, and governance issues into their business model-and act on them."[16] The point is that, for insightful management teams, sustainability isn't just a "nice to have." It's a way to unlock new markets and uncover value hidden within the existing operations of the company.

Business as Benefit

If the large publicly-traded companies of today can go as far as Sustainable Capitalism with their current business models, it's today's emerging companies who will become the Impact Titans of tomorrow. The young companies that have incorporated impact into their core products and services, and are producing profit and ROI from their impact proposition, are the companies that can make the "impact leap." It won't be easy. Going from "startup" to "Google" never is. But we've already seen Impact Businesses, especially in the "clean" sectors, exploring IPOs. Tesla has already launched. FirstSolar and SunPower are publicly listed. So is Comverge. And that's just a sampling. The number of Impact Businesses being accepted into accelerator programs is increasing. Business plan competitions are seeing ever-growing numbers of Impact Businesses participate. Top Tier Business Schools are running programs on Impact, and the idea of Impact and Social Enterprise even found their way into the Startup America: Reducing Barriers Report[17]. Around the nation, Impact and Business are aligning. Opportunities are emerging, entrepreneurs are pursuing, investors are watching, and the next American success stories have Impact written all over them.

[13] http://sites.target.com/site/en/company/page.jsp?contentId=WCMP04-031084
[14] http://www.mckinsey.com/~/media/mckinsey/dotcom/client_service/Sustainability/PDFs/Putting_it_into_practice.ashx
[15] http://www.environmentalleader.com/2007/10/01/wal-mart/
[16] Bonini and Gorner, 2011 McKinsey & Co.
[17] http://www.sba.gov/sites/default/files/Startup%20America%20Reducing%20Barriers%20Report.pdf

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