

Boom Time for Growth Capital?

Vincent Stehle

The summer of 2001 may not have seemed like the best time for a young technology enterprise to seek a new round of investment. The infamous dot.com crash of 2000 was still reverberating, as investors watched the high-flying, tech-heavy NASDAQ plummet from a high of more than 5,100 points to an eventual low of just over 1,000 in October 2002, taking with it more than \$8 trillion in market value.

But for upstart nonprofit technology service providers GuideStar and VolunteerMatch, the time was ripe for a capital infusion that would allow them to grow from proof-of-concept to full-scale development. In both cases, the Internet-based services <www.GuideStar.org> and <www.volunteermatch.org> had shown that they had the potential to revolutionize a fundamental function of successful nonprofits – GuideStar providing basic accountability information and VolunteerMatch recruiting volunteers – by making these activities cheaper and easier for nonprofits and individuals, no matter where they were located.

The challenge then: to stimulate investment in the form of grants – \$7.5 million for VolunteerMatch and \$13.5 million for GuideStar – that would enable them to reach their full potential. In fundraising campaigns from 2001 to 2002, both organizations were able to reach their funding targets and in the process they were able not only to grow their organizations to serve all nonprofits across the country, but also pioneered a form of fundraising that echoes the approach of venture capital funding syndicates, an approach that may be on the verge of significant growth.

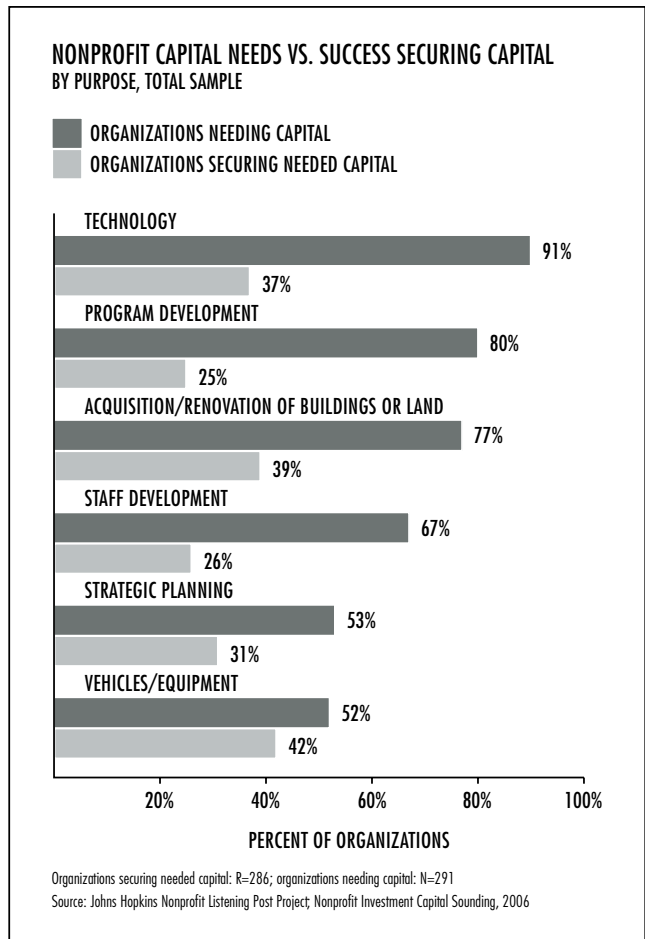
Throughout the nonprofit sector, there is an increasing awareness that successful nonprofits are often constrained in obtaining growth capital – those funds needed to help an organization grow beyond its existing service boundaries to a higher level of activity.

According to a recent survey, a vast majority of nonprofits have investment capital needs and very few of them have been able to secure such funds. Sounding out hundreds of nonprofit human service, community development, and arts organizations, the Listening Post Project, a program at the Johns Hopkins University Center for Civil Society Studies, found that over 90 percent of all respondents reported a need for investment capital, but in general they were not very successful in obtaining those investments.

The early nonprofit venture funding syndicates assembled by GuideStar and VolunteerMatch may provide valuable lessons for other organizations as they attempt to obtain similar investments. At the same time, there are several new efforts attempting to serve the burgeoning needs of investment capital for nonprofits, among them:

SeaChange Capital Partners and NFF Capital Partners, a program of the Nonprofit Finance Fund.

Back in 2001, a handful of leading foundations and corporations had become convinced that the nonprofit sector would benefit from the development of a few key technology infrastructure services, such as GuideStar and VolunteerMatch, that would harness the newfound power of the Internet to deliver critical information and other resources to all nonprofit organizations.



The financial challenge was particularly acute for these organizations; even though they promised benefits to all types of organizations and every philanthropic purpose, they did not fall squarely into any narrow program categories. The problem was akin to the tragedy of the commons: everyone benefits from it but nobody feels responsible for its maintenance. Equally, nonprofit technology groups that provide basic infrastructure services offer benefits to every type of nonprofit group, but few funders acknowledged their responsibility to pay for the services.

In addition, the financial challenge of developing a nationwide Internet service capable of serving all nonprofits meant that both groups needed a high level of up-front investment to execute their strategies, rather than bootstrapping themselves incrementally to a national scale over time. For both groups, it was all or nothing, they

would either receive full funding or they would not be able to execute their plans. Given these challenges, it was especially important that these two organizations assemble a group of philanthropic investors who would commit to fully fund their plans.

The impetus for a new type of funding coalition came from Jay Backstrand, founder and president of VolunteerMatch, who started the service when he was working in Silicon Valley for Sun Microsystems. "We wanted to break out of the month-to-month approach, securing the strategic resources we needed to execute the plan," says Backstrand, now a vice president for corporate development at Paul Capital Investments.

In February 2001, AOL Time Warner, the Atlantic Philanthropies, and the Surdna Foundation invited a dozen funders to join them for a presentation of the business case for expansion of VolunteerMatch. The centerpiece of the meeting was a lead investment of \$2.5 million in the form of a challenge grant from the Atlantic Philanthropies, which was intended to spark \$5 million in additional contributions.

The briefing went beyond the typical funders briefing, both in style and in substance. First, with support from Atlantic, VolunteerMatch worked closely with nonprofit management consultants at the Bridgespan Group to develop an airtight business case, which representatives of Bridgespan and VolunteerMatch delivered jointly to the assembled funders. The presentation followed a logical trajectory: recruiting and managing volunteers was costly and inefficient; volunteer recruiting could become much more efficient with a robust, inexpensive, and widely available online fulfillment system; VolunteerMatch had developed a business plan to deliver such a service; and the VolunteerMatch team was uniquely positioned to execute the plan.

For VolunteerMatch, the approach was intended to streamline the fundraising process, with a goal of obtaining enough contributions to pursue their growth strategy with confidence. And more to the point, it allowed VolunteerMatch to organize the funding discussions around the organization's strategy, rather than organizing their funding pitches to correspond to a dozen different funding strategies. "We were able to stake our future on one strategy, embodied in one plan, without being pulled off our game," says Backstrand.

For funders, the collaborative approach offered several benefits:

- Each funder was able to make a commitment to the VolunteerMatch growth plan with greater confidence that the funding coalition would assemble enough resources to reach their goal, rather than making independent grants and not knowing if the group would receive enough to accomplish its goals.
- The funding collaborative offers an efficient communications mechanism for ongoing grant discussions, with the funding recipient providing comprehensive reports on a quarterly basis.

Within a year or so, over \$6 million was raised from twelve foundations and corporations, with large contributions from the Carnegie, Ford, Knight, Packard, and Surdna foundations, among others. In three years, VolunteerMatch received \$9.4 million in contributions following this approach, and the payoff was enormous. VolunteerMatch calculates that the total social impact of volunteers referred by their services since 2001 exceeds \$1.2 billion.

At about the same time, GuideStar was establishing itself as the comprehensive information resource concerning

nonprofits. Built upon a foundation of all the information contained in all of the 990 federal tax forms filed by every nonprofit organization in the country, GuideStar

was fast on its way to becoming the authoritative information resource for nonprofit accountability. But like VolunteerMatch, GuideStar needed an infusion of capital that would permit it to achieve greater sustainability.

Again, the Atlantic Philanthropies played a leadership role, putting up a \$4.5 million challenge grant, with the stipulation that other foundations would provide an additional \$11.5 million in support, for a total investment package of \$16 million over three years. In meetings convened at the Ford Foundation and the Rockefeller Brothers Fund, GuideStar laid out a business plan – developed with the Bridgespan Group – that promised to deliver increasing earned income results, while decreasing its reliance on philanthropy over time.

Once again, a consortium of grantmakers joined together to provide the up-front investment needed for expansion. But this time, the funding consortium insisted on a few conditions in exchange for the package of funding: GuideStar had to work with a management consultant to insure that it would stay on track in hitting the goals in its business plan; it had to issue quarterly reports to all funders; and it had to convene regular conference calls for the funding coalition to voice concerns and hear directly from GuideStar management.

“The Consortium helped us do the economic modeling that resulted in our blended revenue model, helping us to achieve economic sustainability,” says Bob Ottenhoff, president of GuideStar.

Looking back on the impact of the funding consortium, it’s clear that the investment propelled GuideStar forward on a greatly accelerated trajectory. In just the first two years after the investment, the size of the GuideStar database doubled from 900,000 records to 1.8 million files. In the same time period, web traffic doubled and sales revenue shot up from less than \$500,000 to more than \$1.5 million.

Since then, the group has continued to grow and become increasingly self-sustaining. Now, earned revenue makes up 65 percent of GuideStar’s income, up from 2 percent in 2001. But the group would never have been able to develop its products and services without the patient capital provided by the consortium funders. “What was so profound for GuideStar,” says Ottenhoff, “you had a group of leading foundations all focused on the needs of one organization.” More than that, he says, “The consortium stuck with us.

There was a realization of what it took to achieve sustainability.”

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Ever since these initial funding consortia were established to finance the expansion of GuideStar and VolunteerMatch, these groups have operated in a culture of investment, with a commitment to business planning and accountability to their “investors” and themselves. In subsequent years, VolunteerMatch and GuideStar have been joined by online philanthropy portal Network for Good <www.networkforgood.org> in hosting joint investor summits, where each group presents its own report of past activities and future strategies. Network for Good is a giving and volunteering portal, a channel through which more than \$100 million has been given to charities.

In June 2004 and again in July 2006, the three groups assembled briefings for more than two dozen funders, including foundations, corporations, individual investors, and nonprofit debt providers like the Nonprofit Finance Fund, the Rudolf Steiner Foundation, and the Calvert Foundation. Going beyond a traditional reliance on philanthropic contributions, the three groups have taken a more sophisticated approach to the capital challenge, tapping nonprofit debt providers for additional expansion capital, as needed.

In recent years, other organizations have taken up similar strategies to obtain growth capital. And there is a burgeoning interest among organizations who would like to promote the practice on a wider scale.

In 2005, College Summit was a well-respected organization that helped low-income students get into college. But founder J.B. Schramm wanted to move beyond the grind of slow growth, always struggling to meet budget. With strong board leadership, College Summit sought an infusion of philanthropic capital to grow the organization strategically. Schramm turned to College Summit Board Chair Chuck Harris, an investment banker in early retirement from Goldman Sachs Group, to lead the effort.

For College Summit, Harris worked with Schramm to develop a business plan for expansion of the organization, which they pitched to high-net-worth individuals from the high-flying world of hedge funds and investment banking. The plan was designed to look like the documents investment bankers might use promoting a “private placement” seeking investment capital. In short order, Harris and Schramm had assembled \$15 million in commitments from less than a dozen contributors.

Now, Harris is preaching his own gospel of wealth, having started a new organization called SeaChange Capital

Partners whose objective is to repeat this approach for many other organizations. SeaChange intends to identify promising nonprofit growth

opportunities, working with nonprofits to help develop attractive and responsible investment opportunities. At the same time, SeaChange will stimulate interest among wealthy investors in the private-jet-set, like Harris.

The business plan for SeaChange lays out an ambitious goal. “The firm will work toward the goal of helping nonprofits raise a total of over \$100 million in growth capital during our first three years of operation.” Put simply, “We seek to enhance the flow of growth capital from wealthy donors to select high-performing nonprofits.”

And SeaChange is not alone. There are several venture philanthropy veterans like the Roberts Enterprise Development Fund, Venture Philanthropy Partners, and New Profit, Inc., who are all involved in loosely related activities, bringing an investment approach to the assistance of the charities they support. Even more closely related, NFF Capital Partners seeks to provide high-performing nonprofit organizations access to growth capital through a broad range of advisory services. NFF Capital Partners is led by Managing Director George Overholser, a former member of the NFF board of directors and a former senior manager with Capital One Financial Corporation.

All this effort seeking to expand the financial capacity of growing nonprofits may seem like a bland and bloodless affair. But Clara Miller, president of the Nonprofit Finance

Fund, suggests that nothing could be further from the truth. Quoting Bob Dylan's "It's Alright, Ma (I'm Only Bleeding)," Miller says, "He who is not busy being born is busy dying." And that's our concern, organizations that are busy being born.

Vincent Stehle is program officer, Nonprofit Sector Support, Surdna Foundation. This article began as a session at GIA's 2006 annual conference in Boston: "Philanthropic Investment Syndicates: A New Capital Strategy for Nonprofits." Presenters included Lincoln Caplan, partner, SeaChange Capital Partners; Clara Miller, president and CEO, Nonprofit Finance Fund; Bill Strathmann, CEO, Network for Good; and Vince Stehle. A packed room for a session at 8 am on a Tuesday morning suggested that the topic deserved a wider audience.

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