

# Sunday Business

Section 3

## Make Money,

## Save the World

By STEPHANIE STROM

**A**LTRUSHARE SECURITIES is a brokerage firm, engaged in the sort of things you might expect of a Wall Street outfit, like buying and selling stock, and providing research on companies. Unlike its peers, however, the firm is majority-owned by two charities that each control about one-third of it.

So is it a for-profit business? Or a nonprofit fundraising machine?

In fact, like hundreds of new businesses starting up around the country, it is both. Altrushare is an example of the emerging convergence of for-profit money-making and nonprofit mission.

The practice is even creeping into corporate blue-bloods like General Electric, whose \$12 billion Ecomagination business promotes its products' minimal environmental impact as well as their positive impact on the bottom line.

"We're a for-profit institutional brokerage, and we have to compete on execution and commissions and do so with the same technology and talent you would expect from a top-tier firm," said Peter Drasher, a founder of Altrushare, which is based in Bridgeport, Conn. "What makes us different is our nonprofit ownership and our mission, which is to support struggling communities with our profits."

The nonprofit sector is also part of the movement. Motivated by growing competition to attract donor dollars, charities are going beyond longstanding practices. Some are adopting innovative investment strategies or owning other ventures outright.

"I think what people are increasingly looking for, whether in the for-profit or nonprofit sector, is how you harness the vitality and promise of capitalism in a way that's more fair to everyone," said Juliana Eades, the president of the New Hampshire Community Loan Fund, a nonprofit mortgage lender that has begun dabbling in other types of financing.

The result is a small but budding practice — what some label the fourth sector — composed of organizations driven by both social purpose and financial promise that fall somewhere between traditional companies and charities. The term "fourth sector" derives from the fact that participants are creating hybrid organizations distinct from those operating in the government, business and nonprofit sectors. But because the types of participants vary widely and much of the activity is nascent, no single name for what is occurring has gained broad use.

"There's a big movement out there that is not yet recognized as a movement," said R. Todd Johnson, a

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Tony Cenicola/The New York Times

## Businesses And Nonprofits Are Spawning Corporate Hybrids

# Making Money, Saving the World

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lawyer in San Francisco who is working to create an online wiki to engage in the give and take of information for what he calls "for-benefit corporations," another name for fourth-sector activities.

Consumers, employees, managers and — perhaps most important — investors are driving the phenomenon.

"Young M.B.A. students are not satisfied with going to work for a normal corporation because they are passionate to do good in the world and do it in business," Mr. Johnson said. "People of faith want exactly the same thing, and there is a whole generation of people who've become extraordinarily wealthy as a result of the technological revolution and are now asking themselves if they can create change in the world."

Those desires are reflected in the growth of so-called sustainable enterprise programs at the nation's most prestigious business schools, in the corporate marketing campaigns that emphasize social benefits instead of mere sex appeal, and a blossoming of new investment vehicles like Good Capital, Investors' Circle, Underdog Ventures and the Social Venture Network.

**S**TILL, whatever participants call it, the fourth sector faces challenges. Current legal and tax structures draw strict lines between for-profits and nonprofits, and fiduciary obligations prevent asset managers from making investments with any aim other than maximizing profit. The social benefits that fourth-sector firms seek to unlock are not easily quantified and often take decades, not quarters, to attain.

"You run into fundamental problems in trying to grow good because neither for-profit nor nonprofit is set up to do what new entrepreneurs and others are trying to do — namely, harness the power of private enterprise to create social benefit," said Jay Coen Gilbert, co-founder of B Lab, a start-up organization based in Philadelphia that will develop what he calls "B corporations," which engage in fourth-sector pursuits.

Even so, some mainstream companies say it makes sense to give the emerging fourth sector serious consideration. Goldman Sachs, the Wall Street investment bank, has a four-member research team that assesses the environmental, social and management performance of companies in the same way that more traditional colleagues analyze financial performance.

Goldman's efforts grew out of a report it produced in 2003 for the United Nations Environment Program Finance Initiative. It was asked to come up with ways to measure corporate response to issues ranging from gas emissions to employee health and safety practices and to determine how they related to the companies' financial performance.

To the firm's surprise, investors began asking for the report, which it had regarded as a one-time project, and requesting more of them. So far, Goldman has produced similar reports on the media, mining, steel and food and beverage industries. Each week, it sends out an e-mail message on sustainable investing to about 400 contacts at 80 institutions worldwide.

"Integrating factors such as environmental impact and corporate governance is an increasingly critical part of investment research," said Marc Fox, a research analyst at Goldman. "What began as a niche market of socially responsible investors has expanded to mainstream institutions such as pension funds and insurance companies who seek long-term investment performance."

In 1993, Mr. Coen Gilbert was a founder of And 1, a \$200-million footwear company based in Paoli, Pa., committed to enriching its employees' work lives while using its profits to support youth development and educational programs.

Long before the Internet era, And 1 provided a gym, yoga classes and other perks to its employees. It also required suppliers to avoid engaging in sweatshop labor practices and hired an independent auditor to monitor compliance. It contributed 5 percent of its profits to charity, and gave money "even when there weren't any profits," Mr. Coen Gilbert said.

And 1 was privately held and thus faced none of the pressure to produce quarterly returns that confront public companies, yet it struggled to maintain socially minded programs as it grew. Another privately held company bought And 1 in 2005 and ended the employee wellness programs and charitable activities.

"Under our corporate documents, we had a single fiduciary responsibility, to maximize return for shareholders, and that's how we made the decision to sell the company," Mr. Coen Gilbert says.

Legions of companies that have sought to occupy the middle ground between nonprofit and for-profit have bowed to pressure to sell to conglomerates, including Ben & Jerry's (sold to Unilever) and the Body Shop (now owned by L'Oréal). Others, most notably Patagonia, have simply refused to sell or to go public.

Similar companies today are evolving in a different environment. Investors, customers and consumers are developing a more holistic approach and focusing on the longer term, attitudes that support changes in the way business is done.

Companies themselves are beginning to understand that what appears to be an expense today may in fact produce lucrative long-term benefits, either by reducing costs or resulting in products and services that can be sold. And investors are increasingly rewarding companies for such actions.

"There are many motivations for this," said Abby Joseph Cohen, Goldman Sachs's influential chief United States portfolio strategist. "Companies are taking a broader view that allows them to see that a cost today may reduce future liabilities, and the reduction of those future liabilities in turn has a positive impact on their cost of capital."

Among major investors, perceptions of profit and value are changing, too. For instance, the California State Teachers' Retirement System, the \$162 billion pension fund, has taken a hard look at insurance companies. It decided that companies in the industry were not paying enough attention to climate change and thus were a riskier investment than in the past, according to Jack Ehnes, the chief executive of the fund.

"In the past, we've created this dichotomy between financial and social, and investors have been ridiculed for placing too much emphasis on social factors," Mr. Ehnes said. "Maybe that bright line test is really phony and in fact there has to be a commingling of these factors in investment analysis. If you're really going to be thinking long term about a company's profitability, you'll need a better tool kit for your analysis."

The pension fund holds stakes in wind farms, solar panel manufacturers and developers of low-income housing in its alternative-investments portfolio, and it has assigned a team to assess the impact of factors like environmental stewardship on risk and financial performance across its portfolio.

Funds like the teachers' pension fund are big clients of Wall Street firms, as are many of the wealthy individuals who are looking for opportunities in the fourth sector. By and large, however, investors like those are not looking to invest in companies like the Farmers Diner in Quechee, Vt. — which tend to be extremely risky, no matter how well intentioned they may be.

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"Companies like us have no conventional road map to follow in building our businesses and thus are greeted with a lot of skepticism," said Tod Murphy, who founded the diner nine years ago.

**Farmers Diner** is aiming to build a new food sourcing and distribution model. About 65 percent of its budget for food ingredients is spent within 70 miles of the restaurant, and it tries to educate local farmers about new business practices. The goal is to create a network of four restaurants served by a central kitchen that draws most of its ingredients from the local market.

Making the model work has been difficult, though. The diner's original location, in Barre, Vt., was too small to generate the revenue needed to cover expenses. Banks would not back the venture, and Mr. Murphy's angel investor, a money manager named Cathy Berry, eventually was tapped out.

The diner closed for a year, re-opening in a much larger space in Quechee. Mr. Murphy says that it is on track to have more than \$1 million in revenue this year, and that another person has promised to make an investment if the diner can demonstrate consistent profitability.

For her part, Ms. Berry remains enthusiastic about enterprises like the diner; she is on the board of Investors' Circle, one of many organizations working to link investors to hybrid companies.

"What we are constantly coming up against is our tax laws and our culture," Ms. Berry said. "The whole fabric of society wants us to make money on one side and do good with it on the other. What we're saying is: What if we did both things at once?"

She and others argue that current laws, tax structures and definitions of fiduciary responsibility encourage companies to shift costs onto society. "We have created cheap food by investing in huge agricultural conglomerates — but is it really cheap?" she asks. "No. Look at the pesticides those businesses use and then look at the cleanup costs to society. Look at the health costs."

Ms. Berry, Mr. Murphy and others like them want tax breaks to offer incentives that compensate businesses for absorbing the social costs of their activities.

"We want social responsibility to be completely embedded in everything we do, not something that oc-



Karen Tam for The New York Times

Heerad Sabeti, left, and his wife, Maja Palej, chose to manufacture products for their company, TransForms, in the United States.

curs as a sort of sideline," said Heerad Sabeti, co-founder of **TransForms**, a company started in 2005 in Raleigh, N.C., that makes removable wall decorations. "It has to be an integral part of our business."

Mr. Sabeti says he is tired of advisers who tell him to run TransForms as a purely commercial venture and to simply direct a portion of its profits after the fact to a foundation for distribution to good causes. "What good does that do if I'm using plastic for my packaging and helping to contribute to job losses by manufacturing in China?" he asks.

Mr. Sabeti and his wife, Maja Palej, the chief executive, chose to manufacture their products in the United States rather than in China, despite the higher labor costs, to support jobs here. They also hired a nonprofit group that offers training, education and employment to disabled people to handle packaging.

TransForms, with revenues of almost \$2 million, has financially succeeded, its owners say, in part because it landed a steady client: Bed Bath & Beyond, the housewares company. Thanks to that relationship and new ones with QVC and Target Online, TransForms has not needed outside investors. But Mr. Sabeti knows that he needs such backing to gain credibility, and he is hoping to attract one or two angel investors to supply \$1 million or more in capital.

**H**E worries, however, that bringing in investors will force him to compromise his commitment to his principles. "I don't know that as a for-benefit company, you're going to spin off the kind of returns venture capital demands, or that you'd want to," he said.

That's the reason fourth-sector financiers are so important to the growing movement; they're willing to invest patient capital that supports businesses that produce both

profit and social benefits. For instance, the New Hampshire Community Loan Fund, a 23-year-old nonprofit organization that was one of the first to develop resident-owned mobile home parks, has branched out into a form of venture capital.

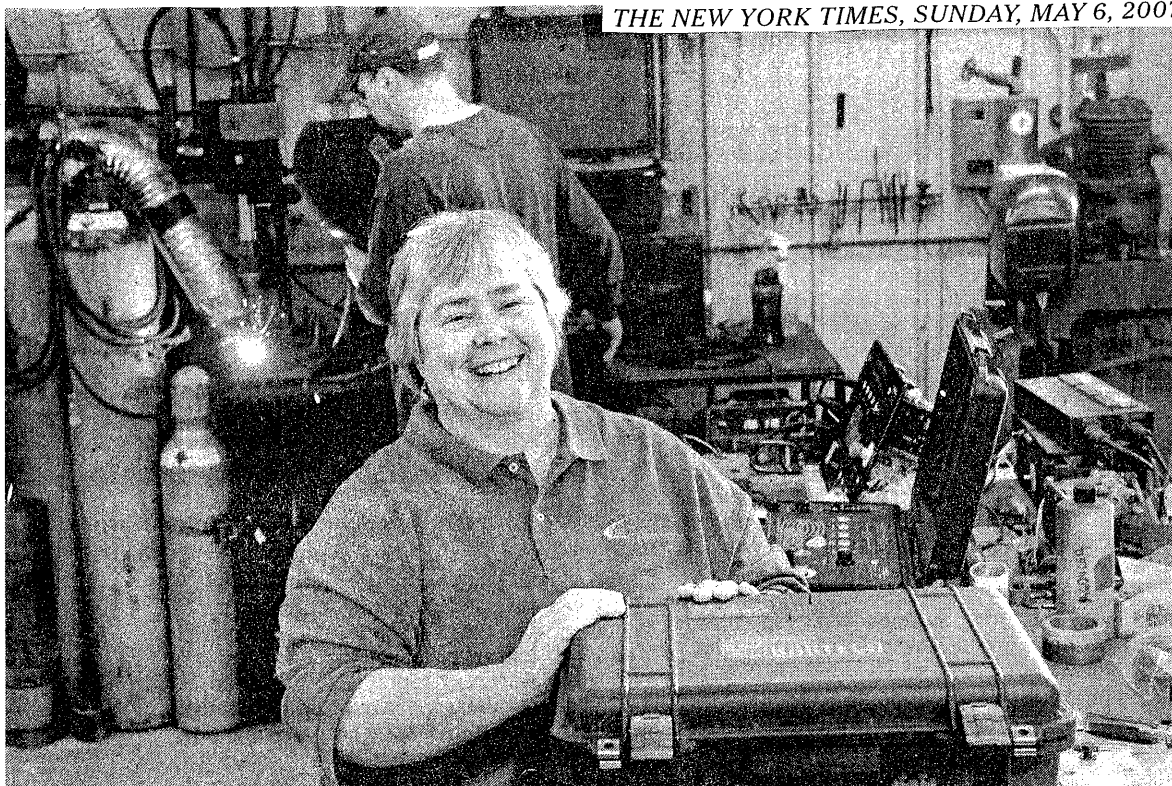
In many ways, the loan fund operates under even greater fiduciary constraints than mainstream investment managers. Nonprofits are risk-averse, given their role as stewards of charitable donations, and their tax-exempt status limits what they can do in operating a business.

So, in 2002, when the loan fund wanted to keep alive Bortech, a tiny machine-tools company in Keene, N.H., to preserve jobs, it used an investment structure that combined aspects of equity without giving the fund outright ownership of Bortech. When a founder wanted to sell the company, the loan fund provided a local buyer with a \$500,000, 10-year loan at 9 percent interest; the buyer agreed that the fund would also be paid a percentage of Bortech's revenues for the next five years.

"Our goal in making this investment was to keep the company from leaving the region, and if we structured the deal to give us a piece of the equity, all we would really be doing was delaying the inevitable because it would have to be sold if we were to realize that value," says John Hamilton, who oversees the loan fund's venture financing.

To foster socially minded business practices, the fund also gave the company's new owner, Leo White, revenue-sharing rebates for reducing Bortech's environmental impact or for broadly engaging employees in its business.

Today, the loan fund's investment has been replaced by bank financing, Mr. White's business has thrived, and Bortech now has 14 employees, twice the number it had when the loan fund first jumped in. The loan



Nancy Palmieri for The New York Times

Juliana Eades is the president of the New Hampshire Community Loan Fund. The fund wanted to preserve jobs at Bortech, a small machine-tools company in Keene, N.H., and gave a loan to a local buyer.

fund itself is tapping a source of capital that many fourth-sector participants would like to see become more available to hybrid businesses — so-called program-related investment.

Most common program-related investments, or P.R.I.'s, are low-interest loans that foundations provide to nonprofits. The Ford Foundation, which helped pioneer the concept in the late 1960s, has some \$170 million in assets sunk into program-related investments in 99 nonprofit groups, including the loan fund.

Ford's average loan is \$2 million, far larger than its average grant, and such investments help nonprofits establish a credit and repayment history that can help them get bank financing in the future.

Investors and others are pushing to expand the use of such loans, perhaps through changes to the tax code that would make them available to businesses as well as nonprofits. Foundations, however, would likely be wary of extending the reach of P.R.I.'s, because they can be risky. For instance, many of the roughly 15 percent of P.R.I.'s that the Ford Foundation has written off went to for-profit businesses run by nonprofits rather than for the operation of the nonprofits, the foundation says.

**D**ESPITE the potential pitfalls, business relationships between for-profit and nonprofit players are increasing. Mr. Drasher, Altrushare's founder, has even commissioned a study of the phenomenon because he was surprised by how many nonprofits have a piece of for-profit businesses.

During a 20-year career as a trader on Wall Street, he grew to appreciate the power that capital markets had to foster and build emerging markets around the world. "I really did see what this industry has done for regional emerging markets, which have become a legitimate and desirable asset class, and I started asking myself, 'Why aren't we doing the same thing for our own emerging markets, our underserved communities?'" Mr. Drasher said.

Many pension funds invest in low-income housing development and other types of real estate in poor neighborhoods, "but communities are about more than real estate," he said. "You're not going to change people's lives by giving them low-income housing alone," he added. "They need job opportunities and education."

Altrushare has created a mentoring and jobs program with the New York Institute of Finance for college students. The goal is to put each student in the program into a paid internship at a Wall Street firm.

Could Altrushare or any other budding hybrid become another G.E.? Perhaps the better question is whether G.E. and other corporate titans could themselves become hybrids.

Shortly after Jeffrey R. Immelt took the helm at G.E., he traveled around the world talking to customers, who asked for energy-efficient technologies, says Peter O'Toole, a G.E. spokesman.

Mr. Immelt committed \$1 billion toward research and development that would reduce the environmental impact of its products — leading to

the unveiling in 2005 of Ecomagination, a unit that sells products like the GE90-115B aircraft engine.

"Each year, a fleet of 16 twin-engine aircraft powered by GE90-115B engines will emit 141,000 fewer tons of greenhouse gas emissions than if it used the competing airframe requiring four engines," the division's Web site says. "That equals the carbon dioxide absorbed by 35,000 acres of forest, an area twice the size of Manhattan." Ecomagination products make up more than 7 percent of G.E.'s sales and are expected to produce \$20 billion by 2010.

But G.E. also promotes the engine's ability to help the customer's bottom line by increasing fuel efficiency. "This wasn't something we did to make ourselves feel good," Mr. O'Toole says. "It has a real business rationale." □