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## What Works

### **Nothing Ventured, Something Gained When Honest Tea said no to venture capitalists, it waded into uncharted territory**

By Katherine Barr

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## STARTUP FUNDING

# Nothing Ventured, Something Gained

When Honest Tea said no to venture capitalists, it waded into uncharted territory *by Katherine Barr*

Honest Tea needed cash.

In 1998, the Bethesda, Md.-based tea maker's first year, Seth Goldman and business partner Barry Nalebuff had raised about \$500,000 – from family, friends, and their own contributions. But in 1999, they needed another \$1.2 million. Venture capital firms were an option. But Goldman and Nalebuff believed VC firms were often focused on exit strategies – buying companies cheap, and selling them at great profit. The pair had social vision for Honest Tea that they feared would conflict with the VC approach. Instead, they wanted to raise the money from private “angel” investors, retaining control over mission and direction.

The decision to forgo venture capital and rely instead on angel investors was an eventful one for Honest Tea. It meant that Goldman would have to develop a strategic approach to courting and managing company shareholders, and it has been a time-consuming – but ultimately rewarding – pursuit. “What is valuable,” he says, “is being able to work with investors who have values aligned with your own.”

Honest Tea's roots go back to 1995, when Goldman was a student in Nalebuff's class at the Yale School of Management. During one class, students considered what kinds of products were missing from the beverage market. Many felt there was a huge unexploited niche between supersweet drinks like Coke, diet drinks with artificial sweeteners, and flavorless drinks like water and seltzer. Two years later, after graduating and moving to Bethesda, Goldman e-mailed Nalebuff and raised the issue of bringing a less sugary drink to market. Soon thereafter, the two founded Honest Tea, dedicated to creating teas made with all natural ingredients, harvested responsibly from developing communities, without all the extra sugar and calories.

The tea maker has since partnered with I'tchik Herbs, a company based on the Crow Reservation in Montana, which supplies mint leaves for “First Nation Peppermint.”

Honest Tea provides royalties to the Native American company and helps it write business plans and grant proposals. Honest Tea has also partnered with organizations in South Africa and Guatemala to buy honeybush and lime tea products, supporting local community development. Additionally, Honest Tea donates a portion of the sales of “Community Green” bottled tea to City Year, a national youth service corps.

Goldman (who calls himself the “TeaEO”) and Nalebuff believed it was important to have investors who agreed with the company's social goals. “We wanted to be able to remain flexible and make decisions based on our company values and mission,” explains Melanie Knitzer, national account manager. “We've all worked hard to build this company and didn't want to lose control and just be run by bottom line financial decisions.”

That meant courting a particular kind of investor, investors like Jeffrey Swartz, president and CEO of Timberland, and now an Honest Tea board member. “For socially responsible entrepreneurial companies,” says Swartz, “funding should come from people who invest themselves in the entrepreneur's vision and are committed to the company's values.”

In 1999, Goldman received many inquiries from consumers who loved the product. They often e-mailed or phoned (the tea labels include a toll-free number for consumer feedback). Goldman focused almost exclusively on courting this self-selecting group, and he spent much of his time talking to them on the phone and setting up meetings. Goldman circulated company business plans to all who inquired.

Part of Goldman's pitch was that investors could get more out of their money than just money. “We were very focused on creating a strong brand proposition, one that would be distinctive and compelling to our target customer, one that would clearly define what we were offering and what our company stood for,” Goldman explained. “And a

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**Some months Goldman devoted 80 percent of his time to courting angel investors. “It was clear to me that, boy, if we end up doing this every year, it's not going to work,” he said.**

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commitment to social responsibility was a logical and savvy component of the brand and the business.”

Swartz, for one, resonated strongly with that approach. He said that in the aftermath of corporate governance scandals, he was more interested in passionate social entrepreneurs like Goldman than in those merely interested in the bottom line. He believes that “a blend of commerce and justice is what we signed up for as investors.”

Goldman pitched more than 120 people in 1999, eventually securing \$1.2 million from 30 angel investors, including Andrew Tobias, best-selling author of “The Only Investment Guide You’ll Ever Need,” and Berkeley Breathed, author of the comic strip “Bloom County.” (One of the largest shareholders, a Cleveland-based family partnership that invested \$145,000, had initially contacted Goldman via e-mail.)

Still, by year’s end, Goldman was spent. Some months, he devoted 80 percent of his time to courting angel investors. “It was clear to me that, boy, if we end up doing this every year, it’s not going to work,” he said.

In 2000, Goldman entered into serious discussions with a New York City venture capital firm. Honest Tea needed another \$1 million, and the VC firm represented “one-stop shopping.” Backing by a VC firm would have given Honest Tea legitimacy in the beverage market, as well as in the eyes of customers, sales partners, and employees. Furthermore, professional investors from a VC firm lend financial and strategic expertise, to say nothing of their Rolodexes of talent and connections.

The VC firm asked Honest Tea to offer shares to current stakeholders – as a way to measure their satisfaction with the investment. Goldman was able to raise \$940,000, and Honest Tea punted out of the VC deal. “It was unexpected, that our investors would step up as aggressively as they did,” he said. But it was also another lesson learned. Strategically, especially if control is an issue, it makes sense to

approach pre-existing shareholders first. Additionally, Goldman said, it’s important to stand firm on what you believe your company is worth, and not give into venture capitalists who insist on lower valuation.

Honest Tea today has about 70 angel investors, and has raised \$6.3 million in equity capital. The key now, Goldman says, is managing this large group of people, and keeping them happy. Goldman does this in a number of ways. Honest Tea sends all investors copies of its newsletter, *Honest Times*, which has updates on company progress. (A recent edition announced that “Lori’s Lemon Tea” and “Haarlem Honeybush” were underperforming, and were being phased out of production.) All 70 investors are invited to take part in the annual shareholder meeting via conference call.

But perhaps most importantly, they all have Goldman’s e-mail address and phone number, and can reach out to him with questions or comments.

Sometimes, providing this level of access can be draining, and amount to high-level hand-holding. But more often, Goldman says, investors offer sales leads, or report that Honest Tea has been displaced on a shelf at the local store. “They are our advocates in the market,” he says. “In almost all cases, it’s helpful.”

The company’s \$5 million in sales last year means it is flirting with profitability for the first time, and Goldman may not have to find angel investors this year. Honest Tea is the best-selling

bottled tea brand in the natural foods industry with 30.2 percent market share, according to one industry report. At least so far, investors have not pushed for a liquidity event, and Goldman, who says he has had serious offers, is not interested in selling. Today, Goldman spends less than 10 percent of his time courting and managing investors, which means he is able to spend more time growing the business.

“Now I can focus on selling tea, and building the brand,” Goldman said. “And that’s what I need to do.” □

