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What Works

Rolling Corporate Justice

New mechanism allows private investors to back socially responsible startups

By Michael Fitzgerald

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STARTUP FUNDING

Rolling Corporate Justice

New mechanism allows private investors to back socially responsible startups by Michael Fitzgerald



You want to start a small, socially responsible business that aims to donate its profits to charity. You need to attract investors so that you can grow, generating profit for your cause, but why would anyone want to invest in a startup company that gives away profits? Not only is it a highly risky investment with little promise of return, but an investment in a for-profit company also can't be written off as a charitable deduction.

This was the dilemma faced by John Sage, president and co-founder of Pura Vida, a Seattle-based firm that sells organic gourmet coffee to individuals, businesses, churches, and universities via toll-free phone and over the Internet.

The solution that he came up with is an innovative funding plan that has attracted wealthy investors – and not simply because it is exciting and novel. It holds the tantalizing promise of creating an ongoing funding source for an investor's designated charity, one that will grow each year

with profits.

"This," says businessman and philanthropist Paul L.H. Olson, a Pura Vida investor and board member, "is an exciting new way for private investors with charitable intent to be able to invest in a socially responsible company, actually creating wealth to drive into philanthropy."

For Sage, now 42, the chain of events that would lead to the founding of Pura Vida began in 1987 at Harvard Business School, where he met fellow student Chris Dearnley. Sage went on to work in marketing for Microsoft and Dearnley went into the ministry, but the pair stayed in touch, and in 1998, they reunited to found a company with a charitable vision. The company buys coffee beans in far-flung locales across Central America, Indonesia, and Africa, but only if they are "Fair Trade," a certification that ensures local farmers receive a living

wage from coffee sales, and preferably "shade grown" – under a canopy of indigenous trees without synthetic pesticides or chemical fertilizers. Meanwhile, it aims to funnel profits to support programs run by Dearnley in San Jose, Costa Rica, including a soup kitchen, computer classes, youth soccer teams, and a literacy program. Sage and Dearnley dubbed the company "Pura Vida," which means "pure life" in English and "way cool" on the streets of Costa Rica.

"We want to create rolling social justice," Sage explains, "from the moment the coffee is planted to the moment when coffee sale generates a profit."

If social justice is your goal, why not just launch a new nonprofit? In part, it's because Sage is a businessman. He wanted to find a way to combine elements that entrepreneurs understand – marketing a product and selling it for a profit – with something they care about – funding charity.

Sage, who retired from Microsoft a millionaire in 1994,



invested \$1.7 million of his own money to start and maintain Pura Vida, and in its first year, sales reached \$34,000. By the end of 2001, with sales hitting \$380,000 but still no profits, he knew he would need outside investors to grow, and he approached wealthy individuals – most of whom he knew through religious and philanthropic affiliations – seeking loans. Only, no one was interested. Potential investors told Sage that the interest Pura Vida could return on a loan would not be enough to justify the risk. And Pura Vida didn't make sense for conventional philanthropists either, since there is no tax deduction for investing in a for-profit business, even if the company gives its profits to charity.

Olson, who had co-founded a publicly traded software and services company that was sold in 2000 for \$3.9 billion, was one of those who turned Sage down. In his philanthropy, Olson was looking for greater involvement than lending provided. Simply making a loan to fund someone else's endeavor was not compelling to him, as a businessman or a philanthropist. "I'm an entrepreneur," he recalls telling Sage. "I want to participate in a way that is not passive." Olson told Sage he would be interested if Sage could figure out a way for the investment to benefit Olson's favorite charities.

Sage realized that by asking for a loan, he was presenting Pura Vida as if it were just another business venture that might yield a financial return. That pitch failed on two counts: First, Pura Vida's overarching aim is to generate a social return, not a financial one; and second, financial return was no longer a primary motivator for the people Sage was courting. To gain their support, Sage needed to involve them more in the philanthropic decision making to let them participate more fully.

So working with Thomas Gilman, a lawyer whose practice includes financing for startups, the two men came up with a plan.

In brief, Pura Vida would create its own security to sell to investors. Like a bond, the security promises to pay investors interest, in this case, 6 percent a year for a term of five to seven years. At the end of the term, investors get their principal back; at that time, each security they own entitles them to buy a 1 percent equity stake in Pura Vida for a nominal fee. Investors designate a charity as owner of their equity stake, entitling that charity to a proportionate share of Pura Vida's annual profits.

Here's how it has worked in practice. In 2002, Sage divided the company into 100 Pura Vida securities, each worth \$50,000, for an effective value of \$5 million. Sixty securities were transferred to Pura Vida Partners, a nonprofit Sage and Dearnley created to fund the company's charitable endeavors, primarily the Costa Rica programs, but also to help at-risk children in other coffee-growing regions of the world.

Sage then began selling the remaining 40 securities at \$50,000 apiece – in effect, putting 40 percent of the company up for sale. To date, he has sold 21 securities to 14 investors, raising \$1.05 million. When the securities are retired in five to seven years, each of the investors will designate a charity to receive 1 percent of Pura Vida's profits for each equity stake they owned.

For example, Jeff Keenan, a project manager at a high-tech manufacturer in Seattle, bought one security for \$50,000. He will earn 6 percent interest, and when the note is retired, he will get his principal back. At that point, he can designate a charity to receive a 1 percent stake in Pura Vida. Unlike traditional stock in a public company, which a charity could opt to sell, the stake in Pura Vida entitles the charity to a proportionate share of the company's annual profits – after 25 percent is taken out for working capital. If the company makes a \$400,000 profit, Pura Vida would retain 25 percent, leaving \$300,000 to be divvied up among

stakeholders; Keenan's charity would receive 1 percent, or \$3,000. As profits grow, so would the charity's revenue.

To some extent, the plan remains a work in progress. The first securities will be retired in 2007, at which time the recipient charities will be designated. But in the meantime, the cash infusion has spurred sales, projected to reach \$1.5 million in 2003. Sage predicts profitability at the end of 2004.

Pura Vida is not required to register its security with the U.S. Securities and Exchange Commission because it is only dealing with so-called "accredited" investors, those who have a net worth of more than \$1 million.

For now, Sage is content to focus on fundraising from wealthy investors. "In the first half of our lives, we all benefited personally from the multiplication, acceleration, magnification power of capitalism," says Sage. "Now we're asking, 'Why can't the same forces be used to produce a return for charity?'" □

"This is an exciting new way for private investors to be able to invest in a socially responsible company, actually creating wealth to drive into philanthropy."
