PROTOTYPE

Capital Ideas and Social Goals

Heidi Schumann for The New York Times

The San Francisco-based owners of Evergreen Lodge, Lee Zimmerman, left, Dan Braun, center, and Brian Anderluh, hire low-income young adults.

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SINCE 2001, Lee Zimmerman's Evergreen Lodge has helped almost 60 low-income young adults get their lives on track, while consistently paying 9 percent back to investors backing his business. Pura Vida Coffee, of which John Sage was a co-founder in 1997, has generated $2.7 million in cash and resources for health and education programs for children and their families.

Both companies deserve praise for their good deeds. But what might be more remarkable about the founders of Pura Vida and Evergreen Lodge is the way they raised capital to build businesses that have two bottom lines: one financial and one social.

Such business models are becoming increasingly popular among philanthropists and foundations, which like the idea of self-sustaining charities. They also want their investments to have the same kind of social impact as their donations, an idea called mission-related, or program-related, investing. A study released earlier this year by FSG Social Impact Advisors, a consultancy founded by Michael E. Porter, a Harvard Business School professor, and Mark Kramer, a former venture capitalist, calculated that mission-related investing has grown by 16.2 percent a year over the last five years.

At the same time, businesses like Pura Vida and Evergreen blur the line between charities and companies. That's a hurdle to raising money, because investing in a for-profit company does not yield a tax deduction. And such businesses often need extra time to succeed. Grameen Bank, which won the Nobel Peace Prize in 2006 for validating

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the idea of microfinance, was subsidized for 15 years, notes J. Gregory Dees, a professor at the Fuqua School of Business at Duke University. (In 2006, Grameen made $20 million on $135 million in revenue.)

There is not yet a template for financing such businesses, says R. Todd Johnson, a lawyer at Jones Day who has handled a number of deals for social entrepreneurs and is writing a book to be called "Greed Is Bad." Because the entrepreneurs want to make sure that investors can't change the social mission for the sake of profits, "you get these one-off, crazy, debt-equity weird structures," he says. "People say, 'Gosh, you're making my head hurt.'"

Mr. Sage's efforts to fund Pura Vida show just how migraine-inducing these deals can be. He set up Pura Vida Coffee as a for-profit company, earmarking all profits for its nonprofit arm. To raise money the first time, and to allow Pura Vida to accept grants, he created the nonprofit organization, Pura Vida Partners, which became the owner of Pura Vida Coffee. Pura Vida Partners issued $1.8 million in interest-paying bonds, each of which would, when paid off, convert into a warrant for a share in the parent organization. Shareholders were required to donate dividends to a charity but couldn't claim that as a tax deduction.

The structure of the deal wound up biting Mr. Sage, as it tied his hands early on. Pura Vida grew faster than he expected, in part because its mission struck a chord with college students. The company needed money to buy new equipment and supplies, but interest payments were eating up all of its cash. Led by Mr. Sage, the largest debt holder, 18 of the 19 other investors agreed to restructure their debt into common stock that would dilute their holdings from 60 percent of Pura Vida Partners to 12 percent and to allow the company to create preferred stock, which it sold to raise more capital. It was thus similar to a typical private offering, but with a twist: the common shares — held by those original investors focused on the mission — are the only ones with voting rights, to insulate the social goals of the company.

Freshly capitalized, Pura Vida eventually was able to fund growth from its operations. It's on track to make a net profit in 2008.

The contrast between Mr. Sage's financing experience and that of Mr. Zimmerman and his co-founders suggests that a simple and traditional financing structure makes the most sense for businesses that are considered socially responsible. Evergreen Lodge, just outside of Yosemite National Park, hires promising young people from low-income areas. The three co-founders believed that they could give these people a foundation for more stable lives by putting them in a rural environment with a full-time "counselor" who paid close attention to their needs.

Evergreen Lodge's holding company, First Light Destinations, raised money through a conventional debt-equity financing, in which a third of its money came in the form of equity from investors and two-thirds from a bank loan. Its results have been strong enough that First Light has paid dividends to its investors for the last two years. It also has in place a provision allowing it to issue debt in the future to pay back investors the full amount of their original investment, without requiring them to give up their shares. That allows investors to get a good financial return on their investment without having to push for the company to go public or be acquired.

Mr. Zimmerman and his partners and their investors are still refining the model. But he's excited that the basic model has worked, and he says that "what we're trying to do can be applied to many different kinds of businesses."

If he’s right, the timing is excellent. Billions of dollars could soon start flowing to social entrepreneurs, especially from foundations. Recently, the Annie E. Casey Foundation, the F. B. Heron Foundation and the Meyer Memorial Trust called on all the nation’s foundations to invest 2 percent of their endowments into such organizations. If answered, that call would bring an estimated $10 billion into the social investing realm over the next five years.

Mr. Dees at Duke cautions that there still aren’t well-developed market mechanisms for double-bottom-line investors. But he called what’s happening on the financing side of Pura Vida and Evergreen Lodge “extremely exciting” and said he thinks that “these kinds of companies will make headway against serious social problems.”

Mr. Sage calls it compassionate capitalism, while stating the obvious: if the capitalism doesn’t work, there will be no compassion.

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