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# Better Ventures: Backing Entrepreneurs Building a Better World

*"It was truly this little snowball that started to roll, and it just got bigger and bigger over time."*

—WES SELKE, BETTER VENTURES

As the year was drawing to a close, Wes Selke (MBA '07) and Rick Moss (**Exhibit 1**), the two co-founders and managing directors of Better Ventures (BV), an early-stage impact investment firm, reflected on their key recent achievement: Successfully closing their first large-scale fund, Better Ventures Fund II (BVFII) and surpassing their $20 million goal, at just over $21 million.

As an early stage impact investing fund, BV had the dual purpose of generating attractive venture returns and creating significant social and environmental impact by investing in promising mission-driven technology startups. Selke and Moss raised BVFII by building upon their prior experience of identifying early-stage, mission-driven ventures for an accelerator that they managed from 2011-2013 called Hub Ventures (HV), which was initially part of Impact Hub San Francisco.[1] Since that time, the team relocated to Oakland, California, and raised a significant fund, pivoting from their accelerator model to more of a seed stage venture capital firm. As Selke and Moss met in their shared office on the second floor of the Impact Hub Oakland[2]—a converted auto dealership that provides 16,000 square feet[3] of shared office space for impact-oriented startups in the emerging high-tech Uptown District of Oakland — they began mapping out their next steps.

Foremost, Selke and Moss debated how to best allocate their management fees of over $500,000 annually, now that their first large-scale venture fund, was closed. For example, should they create a more robust

[1] http://sanfrancisco.impacthub.net/
[2] http://oakland.impacthub.net
[3] Impact Hub Oakland informational brochure, May 2016.

Social Impact Fellow and Lecturer Jennifer M. Walske and Professor of Business Administration and Economics and Director of the Institute for Business & Social Impact Laura D. Tyson prepared this case, with assistance from Case Writer Dickson L. Louie of the ClearLake Group, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Jennifer M. Walske also serves as an Advisory Board member for Better Ventures.

system for tracking their leads and investments? Should they double down on their PreSeed events and workshop series for entrepreneurs? Given that one of BV's key differentiators in the investment space is their "hands-on" approach with their investees, should they hire additional staff that could both help them with operational activities and with the management of their portfolio companies? As **Exhibits 2** and **3** show, BV now has 24 investments across two funds. The BV founders expect to make another 10 to 15 investments in BVFII over the next two years, which, combined with the firm's existing active portfolio companies, is quite a few investments for just two partners to manage.

Another big question that Selke and Moss debated daily was should BV continue to make more concentrated investments of $250,000-400,000 at the pre-seed and seed-stages,[4] targeting ownership stakes of five to ten percent in 20 to 25 portfolio companies? Or should they instead make smaller investments, take smaller ownership stakes, and build a larger portfolio of companies to mitigate risk? Very early stage investments, like those made by BV, are high risk because at this stage it is difficult to predict if the portfolio companies will successfully grow and scale.[5] Moss explained:

> "A topic we discuss constantly is do we go broad and shallow or more narrow and concentrated? We talk about it a lot because it influences how many investments we can make. So, we have considered 50 investments as a firm versus 20. We see a lot of peer funds in Silicon Valley going for a 'spray and pray' strategy by investing a $20 million fund in 60 to 70 companies, with small stakes in each, hoping for unicorn-like exits."

Another looming question was, how long should Selke and Moss wait before they raise their third fund? And how large should the next fund be? Even though the life of a venture fund is typically ten years,[6] most successful venture firms will close a follow-on fund within two to three years of their last fund. In fact, a key factor in determining a venture fund's viability and success is its ability to raise subsequent funds,[7] which allows the venture firm to continue investing in its portfolio companies over time. Follow-on funds are also continued sources of management fees, including the venture firm's operating expenses.

Finally, in looking toward Better Ventures Fund III (BVFIII), how might BV best position their focus on mission-driven companies as a competitive advantage against both impact investing and traditional venture funds, while ensuring interest from mainstream institutional investors?

As both Selke and Moss listed the next steps on the large, wall-sized white board in their shared office, they wondered how to best prioritize the many tasks that they were juggling including the success metrics that they needed to manage over the next two to three years and beyond.

## Venture Capital, Impact Investing, and Social Venture Capital in a Nutshell

When raising BVFII, both Selke and Moss were at the intersection of two key trends in the investment community: the emergence of micro-VC firms and the rise of impact investing.

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[4] See Exhibit 4 for stage definitions.
[5] For a complete listing of what is typically meant by the different stages of investing, refer to Exhibit 4.
[6] Paul A. Gompers and Josh Lerner, *The Venture Capital Cycle (Cambridge*, MA: MIT Press, 1999).
[7] Jennifer M. Walske and Andrew Zacharakis, "Genetically Engineered: Why Some Venture Capital Firms Are More Successful Than Others," *Entrepreneurship Theory & Practice*, 33/1 (January 2009): 297-318, doi: 10.1111/j.1540-6520.2008.00290.x/full

## *Venture Capital*

Venture capital (VC) funds finance the creation and expansion of many notable startup companies, often within certain sectors such as the high-tech or bio-tech sectors. Unique to VC is the infusion of capital into privately held companies that are not yet publicly listed. These investments are, therefore, considered risky as investment shares are not readily tradeable on securities markets (i.e., Nasdaq or NYSE). Some well-known companies that received venture funding include: Facebook, Starbucks, Staples, Whole Foods Market, eBay, JetBlue, Microsoft, Intel, Apple, and Google, to name a few.[8] In return for a percentage of equity in the startup, venture capitalists often require a board seat, giving them both ongoing visibility into their investments' operations as well as management control over key decisions that investees might contemplate,[9] which helps off-set investment risk. The standard limited partnership structure for VC funds follows the model of private equity funds—with the general partners of the funds responsible for the investment decisions within their portfolio companies. The limited partners contribute the fund's capital but take a passive role in a venture fund's management decisions and portfolio company monitoring, thus limiting their liability. Traditionally, VC general partners are compensated with an annual management fee of about two to three percent of the fund's total capital raised. They also earn "carried interest," or a share of an investment fund's returns in excess of the initial capital contributed by investors, of up to 20 percent of the partnership's profits.[10]

Pre-1980, investors in VC funds, known as limited partners, were most likely to include high net worth individuals and family offices. However, in 1979 the Employee Retirement Income Security Act (ERISA) was revised to allow pension funds and endowments to invest in VC and other high-risk asset classes.[11] This dramatically changed the amount and sources of capital into VC funds, moving from individual investors to large institutional investors, such as insurance companies and pension funds. Specifically in 2015, the largest investors into U.S. VC funds based in North America were pension funds (25 percent), foundations (15 percent), endowments (14 percent), and funds of funds (eight percent), while wealthy individuals represented only seven percent[12] of venture fund investors. As such, larger pension funds have become the dominant investors in traditional U.S. VC funds, including public pension funds such as the California Public Employees' Retirement System (CalPERS), which manages pension funds for more than 1.6 million California public employees and retirees.[13]

Since its founding, the U.S. based VC industry has continued to grow significantly, reaching almost $59 billion in 2015, according to the National Venture Capital Association (NVCA).[14] While a venture fund has the benefit of diversifying a limited partner's investment in startups, unlike investments in stocks and bonds, the investments are illiquid and appreciation of the fund is often unknown precisely until the fund matures. This is because VC funds do not realize an actual gain on each investment until that investment "exits," either through its sale to another company, or through an initial public offering (IPO). On average, in traditional VC funds, investment exits occur seven years from the initial venture fund investment. The return of an entire fund, though, is only realized when the fund matures, which usually takes ten years. Interim return rates on investments are quite varied and inaccurate, as the size of the return is predicated on a few portfolio companies' exits and on the "mark-ups" of other non-exited portfolio companies, which are "marked-up" based on the perceived appreciation of a startup due to the

[8] http://mthightech.org/wp-content/uploads/2015/11/NVCA-Yearbook-2015.pdf
[9] National Venture Capital Association, 2016 report.
[10] History of private equity and venture capital, Wikipedia, https://en.wikipedia.org/wiki/History_of_private_equity_and_venture_capital#Early_venture_capital_and_the_growth_of_Silicon_Valley_.281959.E2.80.931981.29
[11] Gompers and Lerner (1999), op. cit.
[12] https://www.preqin.com/docs/reports/Preqin-US-Venture-Capital-December-2015.pdf
[13] https://en.wikipedia.org/wiki/CalPERS.
[14] http://nvca.org/pressreleases/58-8-billion-in-venture-capital-invested-across-u-s-in-2015-according-to-the-moneytree-report-2/

subsequent investment rounds achieved. It is also important to note that many VC firms go through "boom and bust" cycles, as the success of venture funds often reflects the health and munificence of public markets, which can in turn dramatically change the values of "marked-up" venture investments. Finally, as stated previously, the illiquidity around venture investments makes them risky investments, as investments cannot be publicly traded, and if public markets become more restricted, so does a startup's ability to go public. The uncertainty in a startup's exit makes venture funds "high risk" with usually only a small percentage of asset allocation allowed by large institutional investors.

Despite the continued in-flow of total capital committed to venture firms since 1974, recent studies have shown that, on average, venture fund performance declines as the fund size increases above $250 million.[15] A 2012 Kauffman Foundation report also found that 62 out of the 100 venture capital funds studied had failed to exceed returns above public markets after fees were taken out. The report also showed that only four out of 20 venture funds that had committed capital of $400 million or more delivered returns greater than the publicly traded small-cap index.[16]

Since 2010, there have been an increasing number of micro-VC firms. This growth accompanied a simultaneous leveling off in the number of pure accelerator funds,[17] which often make investments in startups at the earliest stages. Well-known accelerators include Y Combinator, TechStars, 500 Startups, DreamItVentures, and AngelPad.[18] The most widely known is Y Combinator, where both Dropbox and Airbnb were incubated; Well-known VC firms including Greylock Partners, Sequoia Capital, and Accel Partnerswere funded these companies almost immediately after the accelerator program.

There have also been an increasing number of Micro-VC firms within the last five years. Micro-VC firms went from less than 50 firms in 2011 to 236 in 2015, with a projected peak of 350 firms nationwide by 2018.[19] Micro-VC firms are less capitalized than traditional venture firms, with many having less than $50 million in capital.[20] By contrast, in 2015 the average venture fund size was almost three times that amount at $135 million.[21] Approximately half of the micro-VC firms are based in Silicon Valley with the balance located in New York, Los Angeles, and Boston areas.[22] Many of the limited partners in these funds are family offices and high net-worth individuals. BVFII, with $21 million in capital raised, is considered a micro-VC fund.

The growth in accelerators and micro-VC firms is in response to the fact that venture firms infrequently invest in seed stage startups with only two percent of all VC dollars going into those types of investments, down from 16 percent in 1995. The amount of capital in VC instead swings towards expansion or later stage[23] investment opportunities. This is because the capital needs of more mature companies is greater, but also investments are less risky in a more mature startup that can more easily forecast its revenue.

## *Impact Investing*

The concept of impact investing has its roots in community development funds, starting with ShoreBank (now defunct) in the late 1970s. The emergence of microfinance followed in the 1980s, with Grameen

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15 Diane Mulcahy, "6 Myths About Venture Capitalists," *Harvard Business Review*, 91/5 (May 2012): 80-83.
16 Kauffman Foundation, "We have met the enemy…and he is us," May 2012.
17 https://www.cbinsights.com/blog/past-present-future-micro-vc/
18 http://www.forbes.com/sites/tomiogeron/2012/04/30/top-tech-incubators-as-ranked-by-forbes-y-combinator-tops-with-7-billion-in-value/#295aa07f6dfe
19 Samir Kaji, "The Past, Present and Future of MicroVCs," CB Insights blog, August 4, 2015, https://www.cbinsights.com/blog/past-present-future-micro-vc/
20 Ibid.
21 2016 NVCA Annual Yearbook, p 9. .
22 Samir Kaji (2015), op cit.
23 National Venture Capital Association, 2016 report, p. 14.

Bank, founded by Noble Peace Prize recipient Muhammed Yunnus, which gave, for the first time, very small uncollateralized loans to impoverished borrowers with no credit history. In both of these cases, financial markets began to appreciate that these "social oriented" funding vehicles could not only provide societal benefits, but also—and more importantly to the broad financial sector—a noticeable financial return. In the 1990s, the impact investing space developed further with Heron Foundation's launch of "mission related" investing. Subsequently, thought leader Jed Emerson[24] coined the term "blended value" while at the social enterprise investment fund REDF.[25] "Blended value" spoke to REDF's desire to earn both a social and financial return on investments or a "double bottom line."

By the early 2000s, Jacqueline Novagratz[26] founded Acumen Fund to invest in growing social enterprises located in developing countries. Calvert Foundation and RSF Social Finance followed, providing social enterprise lending domestically as well. At the epicenter of this movement was Good Capital, the ImpactHub San Francisco, and the Social Capital Markets conference,[27] all of which launched under the same corporate umbrella, and further defined and validated the impact investment sector. Over time, investment banks began establishing impact investing divisions, and J.P. Morgan touted that the impact investing "segment of the market offers the potential over the next 10 years for invested capital of $400 billion to $1 trillion and profit of $183 billion to $667 billion."[28] In fact, most major investment banks have now created an impact investing practice. Private equity firms have also jumped into the fray, with both Bain Capital[29] and TPG[30] announcing impact investing practices in 2016.

Impact investing, which includes both public and private securities, is therefore a more credible and growing field now, believed to be further fueled by the interest of millennials.[31] Specifically, "85 percent of millennials consider social, political or environmental impact important," and six in ten investors now consider the social and environmental impact of the companies they invest in as part of their investment decision-making process.[32] At the end of 2015, there was an estimated $77.4 billion in impact investments worldwide, with impact investors expected to increase committed capital by 17 percent in 2016.[33] While the exact percentage of investments in impact VC is unknown, investments into private equity and private debt were made by 21 percent of all impact investing funds.[34] Despite this growth, impact investing is still considered a relatively new field, compared to more traditional financial sectors.

Examples of other notable firms currently focused on impact investing include venture firm DBL Partners and social accelerator, Village Capital. San Francisco-based DBL closed its most recent fund at $400 million, putting its fund size in-line with non-impact venture firms.[35] DBL's portfolio companies have included high profile companies such as Tesla, Solar City, OffGrid Electric, and Revolution Foods.[36] Village Capital is a social incubator that provides seed funding to start-ups solving major global problems in agriculture, education, energy, financial inclusion, and health.[37] While DBL and Village Capital have benefitted from making investments primarily in the tech and sustainability-related sectors, early-stage and impact investing is their key differentiators compared to traditional venture funds and accelerators.

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[24] http://www.blendedvalue.org/about-jed-emerson/
[25] http://redf.org/who-we-are/.
[26] http://acumen.org/people/board/jacqueline-novogratz/
[27] http://socialcapitalmarkets.net/
[28] J.P. Morgan, *Impact Investments: An Emerging Asset Class*, November 2010.
[29] https://www.baincapital.com/businesses/double-impact
[30] http://www.nytimes.com/2016/09/13/business/dealbook/tpg-social-impact-fund.html?_r=0
[31] https://en.wikipedia.org/wiki/Millennials
[32] Anna Snider, "Impact Investing: The Performance Realities," Merrill Lynch, November 2013, p. 3.
[33] Ibid.
[34] A. Mudaliar, H. Schiff, and R. Bas, "*The 2016 Annual Impact Investor Survey*," J.P. Morgan.
[35] http://blogs.wsj.com/venturecapital/2015/06/23/early-tesla-motors-investors-raise-400-million-impact-vc-fund/
[36] https://www.crunchbase.com/organization/dbl-investors#/entity
[37] Ibid.

## Better Ventures' Challenges and Opportunities for Growth

There are several unique challenges facing BVFII. First, it is a micro-VC fund, which, while a fast-growing category, is still relatively new and undercapitalized compared to traditional venture funds. Second, it is BV's first large standalone fund. Third, this fund is positioned as an impact fund with both social and economic return aims. While impact investing has received much positive attention as a growing sector, it is still a new sector. As with any new sector, this means that those involved serve as early missionaries and educators, which requires Selke and Moss to explain to potential investors not only their firm but also (in some cases) this emerging asset class.

### *Early Beginnings*

Five years earlier, Selke and Moss began working together on Hub Ventures (HV), an accelerator program based at ImpactHub San Francisco, which ran from 2011 to 2013. HV had three annual "cohorts" of mission-driven entrepreneurs totaling 29 startups, 16 of which HV invested in (**Exhibit 2**). HV was capitalized with $500,000 in investment capital plus additional operating funds, which were used to provide investments into the participating startups and to run the accelerator. Each startup received shared workspace, mentorship, support, and investor introductions at demo day. In exchange, HV received a six to seven percent ownership stake in each startup participating in the 12-week accelerator.

While small, the Hub Ventures Fund experienced early success, laying the foundation for a much larger second fund. In early 2015, HV's portfolio company UClass, an Education Technology company providing a curriculum sharing platform for public schools, was acquired by Renaissance Learning,[38] resulting in a 19x return on this investment and an 80 percent return of capital for investors.[39] In addition to the UClass exit, five other HV portfolio companies raised additional rounds of capital at higher valuations compared to when HV invested, resulting in valuation "mark-ups" of these investments ranging from 1.5x to 21x. In total, HV portfolio companies have raised over $30 million in follow-on financing, meaning these companies have increased their market value, leading to a total value to paid-in capital (TVPI)[40] ratio of 3.4x[41] as of September 30, 2016.[42] This is well above the average TVPI ratio of 1.5x for vintage 2011 funds.[43] This fund also achieved a 38 percent internal rate of return (IRR) and over the same period of time, a 14.43 return for publicly traded securities,[44] well above the Russell 3000 Index.

### *Co-Founders' Backgrounds*

Both Selke and Moss took different career paths to arrive in the impact investing space. Selke began in the financial services sector. After graduating from the University of Michigan in 1999 with an undergraduate degree in finance and accounting, Selke first worked as an associate in Ernst & Young's merger and acquisitions group, and then as an equity research associate at William Blair & Company. After completing an MBA at Berkeley-Haas in 2007, Selke joined San Francisco-based Good Capital,

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[38] https://techcrunch.com/2015/02/19/renaissance-learning-acquires-uclass/
[39] "Better Ventures Overview," internal document, May 17, 2016.
[40] Paid-in capital is the amount of capital "paid in" by investors during common or preferred stock issuances, including the par value of the shares themselves. Paid-in capital represents the funds raised by the business from equity, and not from ongoing operations.
[41] "Better Ventures Overview," internal document, November 21, 2016.
[42] It is important to note that valuation mark-ups are not realized gains, as gains are only realized when the portfolio company exits.
[43] https://www.bison.co/blog/tag/venture-capital-benchmark/
[44] "Better Ventures Overview," internal document, November 21, 2016.

eventually becoming the firm's investment manager. Good Capital was one of the early "purpose-driven" investment firms that sought to increase the flow of capital into new ventures dedicated to finding market-based solutions to solve inequality and poverty.[45]

Moss, on the other hand, worked predominately in high tech and corporate venture capital. After a brief stint on Wall Street at Salomon Brothers in New York, Moss received his MBA from the Tuck School of Business at Dartmouth in 1994. He then founded the Modern Shop, selling networking gear online in the earliest days of Internet commerce. Afterwards, Moss was the Director of Business Development for wine.com and Senior Director of Corporate Development for Sun Microsystems, where he made many venture investments before the company was acquired by Oracle.

Selke met Moss during a networking event at Good Capital's office in the Mission District of San Francisco in late 2009. Moss sought to move into impact investing and desired a career that was more personally meaningful. Selke, who was involved with the initial launch of ImpactHub San Francisco, was already thinking about creating an early-stage fund and accelerator to back startups based at the ImpactHub. Given their common vision for impact investing, by late 2010 they decided to co-found Hub Ventures, the precursor to BV.

## *Hub Ventures Fund*

Wes and Rick co-founded HV with Good Capital continuing to pay Selke a full-time salary and Moss funding his work by doing consulting on the side. This allowed HV to launch with very minimal funding. As an accelerator, HV provided the initial funds for selected startups while simultaneously mentoring the startup teams, providing space at the ImpactHub San Francisco, facilitating workshops, and connecting startup founders to investors through an end-of-program demo day. HV's inaugural class of 2011 included 16 participating startups that were selected from a pool of over 75 applicants. Three startups received funding of $75,000 each at the end of the program, with half of the funding coming from HV and the other half coming from Village Capital. Selke recalled the first few meetings that launched HV:

> "We sat in the 'Hubble' conference room at the San Francisco Hub and asked ourselves: 'What would an accelerator look like? What do startups here at the Hub need? What kind of workshops would we provide? What kind of mentors would we recruit?' We sketched out a program with inspiration from other mainstream tech accelerators such as TechStars and Y Combinator, but focused on impact startups. Then we created a website, published the program dates, and announced that applications were open. We had yet to raise any capital, so we basically launched the program knowing we'd be on the hook for figuring out a way to fund it. Fortunately, nothing lights a fire like announcing program dates, and we were able to go out and raise about $115,000 with help from the Good Capital team to come up with our match for Village Capital."

With a successful first year and a "proof of concept" under their belts, Selke and Moss decided to take HV to the next level in its second year. They set out to raise enough capital to invest about $20,000 in all participating startups at the beginning of the program, rather than selecting a smaller number of "winners" at the end. They also wanted to raise operating funds to expand the accelerator program. A turning point came when Selke and Moss met the founders of Lakeland Ventures Development (Lakeland), a corporate VC group from Detroit, Michigan, that sought to make investments in startups and funds focused on health and transportation safety. After a series of conversations, Lakeland decided to enter into a service

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[45] Wes Selke, LinkedIn, https://www.linkedin.com/in/wdselke

agreement whereby Lakeland would pay HV to provide deal screening, selection, and acceleration of select companies that fit Lakeland's investment criteria. Once the second year's cohort kicked off with seven companies, all of which received funding from the program, it was clear that HV was filling a gap in the impact startup sector that traditional tech accelerators were missing. Selke continued:

> "In 2012 we knew we had something. Our many conversations with Lakeland went really well, and they clearly liked what we were doing. Lakeland decided to invest in our fund and provide operating funds to support our work. Now we had capital to invest in each startup in our program, a budget to hire someone to help run the program, and funding to actually start paying ourselves."[46]

## *The Decision to Spinout*

After running a third successful cohort of six companies in 2013, Selke and Moss decided to spin HV out of Mission Hub, the operating entity that owns ImpactHub San Francisco and SOCAP. Selke and Moss knew that going forward they needed to raise more capital to be in a position to take larger equity stakes in each investment, reserve capital for follow-on rounds and generate a sustainable management fee to cover two full-time salaries plus operating expenses. This change in direction set the stage for HV to evolve from a pure accelerator to more of an early-stage VC firm (**Exhibit 5**). Selke explained the rationale for making this transition:

> "The accelerator was a great way for us to start. We were super scrappy, running on an extremely low budget, which allowed us to start working together and prove out our investment thesis. But the main reasons we evolved from an accelerator to a high-engagement early-stage venture firm were: One, it's a lot of work to run an accelerator; two, we wanted to invest year-round instead of just one batch per year; and three, we wanted to be able to reserve capital for follow-on investments."

Despite some challenges with HV's accelerator model, there were many positives. The founders' investment experience confirmed that there was a market need for seed-stage impact startup funds. Selke and Moss found that other impact investors were often too risk averse to invest in young impact startups at the earliest stages, preferring instead to invest in companies after they had gained significant market traction. Selke and Moss also discovered that they worked well together and were able to build on each other's strengths. Selke was the resident "numbers guy," coaching entrepreneurs on their business models, how to project their financials and how to attract investors in subsequent financing rounds. Moss pulled more from his entrepreneurial background, advising the startups on issues around product strategy and team dynamics.

Both founders were therefore eager to continue their work, but with one important pivot: they wanted to move away from an accelerator model to a high-engagement seed fund model. By having a full-fledged venture fund, both Selke and Moss could build upon their investment success and access more capital. They could also take larger ownership stakes in each investment, potentially allowing them to better protect each investment's value and ensure they had board voting authority for key decisions. A larger fund also meant that management fees were of the level such that both Selke and Moss could draw sustainable salaries. They positioned their second fund to invest in "early stage technology companies pursuing social and environmental outcomes with business models that scale"[47] focusing primarily on the three investment themes of opportunity, health, and sustainability."

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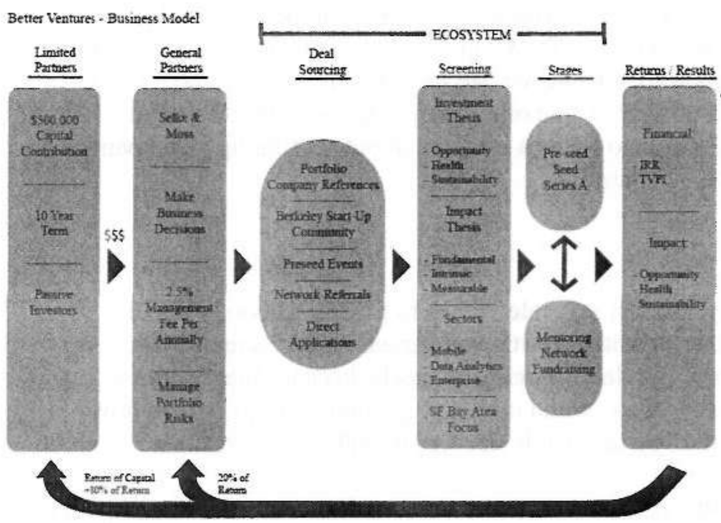
[47] Better Ventures Fund II, L.P., First Amended and Restated Private Placement Memorandum, October 1, 2015

## The Better Ventures Business Model

Therefore, in 2014, Selke and Moss decided to raise a much larger standalone second fund with a target of $20 million. A fund of this size could provide them with the flexibility to make larger initial investments in early stage companies—either as equity or as convertible debt—of between $100,000 to $250,000, as well as the ability to reserve capital for follow-on investments of up to $1 million per company in later financing rounds, often Series A.[48]

Building upon their experience with HV, they believed that BV's ecosystem business model differed from other impact venture funds in three key ways: robust deal flow, investment and impact thesis, and post-investment engagement with the management teams of their portfolio companies during the early stages, primarily at the pre-seed and seed stages (see **Figure A**).

**Figure A** Better Ventures Business Model




Source: *Case writer analysis*

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[48] Ibid.

## Deal Sourcing

BV sourced deals from five main channels (**Exhibit 6**):

- referrals from existing BV portfolio company founders;
- the UC Berkeley startup community;
- BV's monthly PreSeed events;
- referrals from BV's investor network (including accelerators, seed funds, and downstream funds); and
- applications through BV's website (although it was highly unlikely that BV would fund an investment through this channel without some type of referral or direct contact).

Oakland-based Localwise, founded by Ben Hamlin, was one of BV's early portfolio companies that focuses on helping companies find employees in their local communities. Hamlin recalled the time he first met Selke at the Global Social Venture Competition[49] at Berkeley-Hub and then at one of BV's sponsored PreSeed workshops at the Oakland Hub:

> "Coordinating the regional judging finals for the Global Social Venture Program was actually how my relationship with Wes kicked off. We just stayed in touch and that's how we got to know each other. Once Localwise launched, we joined their startup school at the Oakland ImpactHub that also included four or five other early-stage startups. We went through an entire program that enabled us to know a lot more about starting up a company and creating processes for running a company."

Selke added:

> "When we're talking to a company, we can say, 'Hey come to this workshop.' People will sign up, and it's free. It's on our website, and it's just a great way to screen deals. Localwise, actually, straddled two of our deal sourcing channels, because they were UC Berkeley students at the time, but they also started coming to our workshops. That's how we got to know them and a year later, we ultimately decided to make an investment."

Another of BV's portfolio companies, UtilityAPI, is an Oakland-based software startup that provides access to energy usage data.[50] Emily Kirsch, the director of Powerhouse, an Oakland-based accelerator program that backs software startups focused on solar energy referred UtilityAPI to Selke and Moss. BV became one of UtilityAPI's first investors in 2014. Elena Foukes Lucas, the founder of UtilityAPI, remembered:

> "Emily from Powerhouse introduced us to Rick and Wes. We sent over our deck and they said 'Let's meet.' They were a couple of blocks away. We were at 17$^{th}$ and Broadway in Oakland, and they are at 23$^{rd}$ and Broadway. We just walked up and met them. I am from Michigan as is Wes, so we had that connection right off the bat. That's how we started our first conversation."

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[49] http://gsvc.org/
[50] UtilityAPI.com

## Investment and Impact Theses

Most traditional venture firms screen investments across three axioms: stage of the startup, industry of the startup, and geographic location (of the startup as well as the geographic market that the startup serves).[51] For BV, close proximity to its seed stage investment was paramount, and when Selke and Moss were located in San Francisco, most HV investments were in San Francisco-based startups. Now that BV was operating out of Impact Oakland, there is a preference for funding social startups located in the East Bay. BV's investment and impact theses further had a two-step screening process based on the startups industry sector, and the startup's social impact.

### *Investment Thesis*

BV focused on information technology-based startups that were "paving the way for the emergence of a more prosperous, healthy, and sustainable economy."[52] These startups were also "uniquely positioned to solve some of the world's most pressing problems—from work and education to health and sustainability—with models that scale and generate attractive returns."[53] BV believed that there would be a substantial upside in solving these problems. The solutions also represent enormous, often unaddressed market opportunities. They had three thematic areas where technology played a significant role in building a "better world":

- *opportunity*—universal low-cost access to the web closing the opportunity gap and empowering individuals through improved education, work opportunity, and financial services;
- *health*—always-on connectivity and cloud analytics enabling improved diagnosis and better healthcare delivery; and
- *sustainability*—information technology services lowering the costs of transitioning to a more sustainable economy.[54]

### *Impact Thesis*

BV sought investment opportunities in startups focused on serving under-represented populations, creating jobs for similar populations and reducing carbon emissions. BV screened for startups that demonstrated three social and environmental impact characteristics:

- *fundamental impact*—developing products and services that provide "the building blocks for a more prosperous, healthy society, primarily in education, health, and clean energy;"
- *intrinsic impact*—creating products and services "that create direct social and/or economic value through its use or through the supply chain that produces it;" and
- *measurable impact*—ensuring impact outputs are observable and measurable over time.[55]

BV believed that impact investing did not necessitate concessionary returns and that mission-driven companies can outperform the market by leveraging their mission as a competitive weapon. BV felt that there are three main sources of creating this competitive advantage. First, impact entrepreneurs are intrinsically motivated to succeed, desiring to solve a big problem and change the world for the better. Second, purpose-built companies are able to attract and retain top talent because some of the best

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[51] Gompers and Lerner (1999), op. cit.
[52] Better Ventures II, LP, Private Placement Memorandum, October 1, 2015.
[53] Ibid.
[54] Ibid.
[55] Ibid.

and brightest minds want to find meaning and purpose in their work. And, third, customers want to do business with companies that espouse strong values, similar to Whole Foods and Patagonia, which have a strong "halo effect." Selke explained:

> "We believe these attributes, along with the fact that these companies are solving big problems that represent big market opportunities, make mission-driven companies a very attractive niche for investment. And this is more than just a thesis now, as we are seeing it play out in our portfolio, particularly with our companies being able to attract top-notch talent that could've made more money elsewhere."

Once a startup satisfied BV's investment and impact thesis criteria, like other VC firms, BV screened investments based on the quality of the founding team and its ability to address a large, market need with a unique value proposition. For a startup's leadership team, BV looked for a minimum of two co-founders—described internally as the "hacker and the hustler" combination. Selke explained:

> "We generally invest during the early stages, but the complete founding team needs to be there, and one of the co-founders needs to be a technical person. On the product side, we want to see that they have a minimal viable product[56] that's already in the market place, in the hands of customers, and getting some engagement. They don't need to have lots of users, although we prefer revenue positive startups—or very close to revenue positive. We don't like deals with companies that have lots of pilots but little revenue to show for it. Otherwise, it becomes a startup in perpetual pilot mode.
>
> "We do a lot of reference checks on the founders, including working our network to find out what off-list reference [that have not been given to us by the startup] are saying about the co-founders. We're looking for intelligence, tenacity, and intentionality—something indicating that they've been thinking about this problem for a really long time and maybe it affected them personally."

## Post Investment Engagement

Closely aligned with BV's strategy to invest in fewer companies is its high engagement approach (**Exhibit 7**) during the post-investment phase, with the portfolio companies' management team. Engagement includes mentoring, customer development, scaling, recruiting, providing co-working space, and raising capital. Moss explained the importance of scheduling regular meetings early on:

> "We tend to meet with our portfolio company founders every two weeks until things get on a sustainable path, and then we switch to monthly, and then once they're off to the races with a successful a Series A round, we generally switch to quarterly meetings."

Lucas, from UtilityAPI, commented:

> "[Better Ventures was] one of the first funds to invest in us, and we just hit it off very well. There was an alignment in terms of what we did and what they do. They were very supportive with what we were doing, even with establishing basic metrics of the business. We met with them weekly to go over what's happening with our business. [This took]

[56] https://en.wikipedia.org/wiki/Minimum_viable_product

> usually about an hour, maybe an hour and a half. We would talk about the different aspects of the business, and it helped to keep us on track."

Hamlin of Localwise added that because of BV's credibility, they were able to obtain additional financing, which they might not have otherwise been able to get:

> "We had a $400,000 investment from them. And then within a week-and-a-half, we had received another $400,000 in the same round [from another source because of BV's network]. We basically doubled our institutional financing because of their credibility. It was awesome. Additionally, they're just really good sounding boards, because they're aligned with us. That's why we always want to get in the same room with them."

Ryan Levinson, the co-founder of SunFunder, a solar finance business that provides capital for off-grid solar projects and another of BV's portfolio companies that Selke and Moss originally invested in through HV's accelerator program, recalled how Moss coached him on how to handle first-time outside board relationships after they had reached the Series A financing stage. Levinson emphasized:

> "We now always have a pre-board meeting call with every board member to get their feedback so that they get some buy-in [beforehand] on what we are going to talk about, what we are going to cover and to make sure there are no surprises. There's a lot of feedback I've gotten from Rick on managing our equity investors, board members, and structure and on how to design the board meeting."

Anand Kulkarni of LeadGenius—another of BV's portfolio companies that BV had invested initially through its HV accelerator program and also a winner of the Big Ideas competition,[57] sponsored by the Blum Center for Developing Economies[58]—added:

> "We go to [Wes and Rick] when we're raising every round. We go to them for advice and to talk about what's happening with the business. Even though they're a small firm, they have sent us customers and potential hires. At one point, Rick introduced me to the COO of a very large company who was leaving and offered to set us up for lunch to try and hire him, which was a pretty impressive sort of value-add given how small their stake was."

BV's geographic focus is primarily the East Bay—although they have made several investments outside of the San Francisco Bay Area with two companies that were investments in their HV days, Project Repat in North Carolina and Massachusetts and Africa's Talking in Nairobi, Kenya. Being nearby allows for immediate in-person contact with the co-founders, if needed. Selke said:

> "There are three main reasons why we want to work with companies that are here locally in the East Bay, going forward. Number one: we like to sit down in person with them and engage with them. There's so much more that can happen in person than over the phone. Number two: we help them raise their next round, and future investors are also often geographically local. Number three: we are passionate about the burgeoning startup ecosystem here in Oakland and we want to be one of the go-to funders here."

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[57] http://bigideas.berkeley.edu/
[58] http://blumcenter.berkeley.edu/

## Fundraising Challenges and Finding the Sweet Spot

Investors choosing to become limited partners in BV's most recent fund did so for a minimum capital contribution of, ideally, $500,000.[59] Financial reports were provided to the limited partners quarterly, and an impact metrics report was sent annually.

Both Selke and Moss found that there were many challenges in trying to raise capital for a social venture fund in balancing impact with financial returns. Selke explained this dilemma:

> "Some hardcore impact investors say 'you're not impactful enough for us,' and then you talk to a hardcore financial investor and he says 'looks like a lot of impact but the financial returns aren't enough for us.'"

Moss added that most of BV's limited partners were primarily individuals or family offices. He explained:

> "We found that our sweet spot is individuals and family offices that are aware of impact investing and curious about it, but they're not immersed in it. Another reason why family offices work for us, is because they can make relatively unencumbered decisions without having to worry about 22 guidelines or processes.
>
> "I remember we were pretty much laughed out of the office at a big, Midwestern institutional investor. One of the first questions was about mission-driven companies and he was like, 'What the hell does that mean?'"

Another challenge for small funds like BV is that large pension funds (e.g., CalPERS) need to invest at least $50 million per fund, while at the same time, not own more than 10 percent of the fund. This often disqualifies new and smaller venture funds like BV that are not fundraising at this level.[60] Further, potential investors will also ask for disclosures on fund performance before considering investing in a venture fund. The interim internal rate of return (IRR) on a new fund is subject to great volatility.[61] Therefore, for a first-time venture fund to attract these types of institutional investors, its partners often reference their successful investments at prior venture funds.[62] This gives new venture funds, founded by experienced venture capitalists, a competitive advantage when fundraising. For those first time funds that do not have prior venture capitalists as founders, it is more common to rely on individuals and corporations rather than "institutional funds" (e.g., pension funds or endowments) as sources of capital. BV was somewhere in between. While HV did have one exit, UClass, and did successfully run an accelerator program, it its first fund was not a true venture fund. However, the accelerator experience did make Selke and Moss much more experienced than a brand new venture partnership. Also, Moss, with his prior entrepreneurial experience, provided a nice balance to Selke's financial experience. Prior research has shown that some entrepreneurial experience is advantageous to first time venture funds that have an early stage or seed focus.[63]

Selke also observed that the "clean energy" portfolio companies that HV had invested in (**Exhibits 2 and 3**) could also be an advantage when meeting with potential investors. Raoul Salvin, the managing director of Treehouse Investments, a family office fund based in Puerto Rico, echoed that sentiment, saying that

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[59] In some cases, they did take investments of $250,000, which was their true minimum.
[60] C. Braunschweig, "Emerging Managers Have Trouble Emerging," *Venture Capital Journal,* April 1, 2003.
[61] W.A. Sahlman, "The Structure and Governance of Venture Capital Organizations," *Journal of Financial Economics*, 27/2 (October 1990): 473-521.
[62] J. Burton and R. Scherschmidt, "First-Time Venture Fundraising: Challenges and Best Practices," *The Journal of Private Equity*, 8/1 (Winter 2004): 9-21.; Gompers and Lerner (1999), op. cit.
[63] Walske and Zacharakis (2009), op. cit.

they decided to invest in BV's second fund because of its investment in one of HV's investments from cohort three, SunFunder. BV satisfied all of Treehouse's requirements on an internal checklist for investments during the vetting process. Salvin explained:

> "SunFunder was a company that we became very excited about. Maya Chorengel [managing director of Elevar Equity Fund Management and a Better Ventures Board Advisor] knew that Better Ventures was involved in SunFunder, so she made the introduction. That was back in July 2014 when we first were introduced to Better Ventures."

Jennifer Kenning, the managing director of Align, a subsidiary of Santa Monica-based Abacus Wealth Partners, summarized why they chose to become one of BV's investors:

> "We loved the ecosystem building that they're doing, that they have been doing and they are doing. The PreSeed program and the entrepreneur's roundtable really provide the resources within the platform for the early stage entrepreneurs in the Bay Area. So it's not just the capital, but it's also that there are so many other things that are needed. We love that they're building the ecosystem that's very much in alignment with what their portfolio companies and doing."
>
> "And then their reporting is very solid. They're not just working with the companies. They're building a community around the companies. They're building a community of investors/companies. They're doing resource sharing. When you think about those four things—the unique strategy, the direct mentoring, the ecosystem build-out, and the solid impact reporting—we felt like if we were to take a risk in this early stage VC tech area domestically, we would want it to be with them."

## Looking Ahead

As the year drew to a close, both Selke and Moss were still undecided on how to prioritize BV's next steps. Nevertheless, they were proud of what they had achieved. Selke summarized:

> "It was this little snowball that started to roll and has just gotten larger each year. In Hub Ventures' first year, we raised $115,000. Then, in each of the second and third years, we raised $130,000 plus some operating capital. In 2014, we did a first close on $6 million for BVFII, and now here we are: we've raised over $20 million, which is 40 times the amount of the total capital we raised with Hub Ventures. We've come quite a long way."

But questions remained: What should BV do as it evolved from a two-person operation into something possibly larger? How will they demonstrate to the larger financial sector that mission-driven investments can perform in keeping with or outperform the venture industry overall? How can BV also serve as a case statement to show that impact investing is a legitimate, long-term investment category, proving to be much more than just a social experiment?

## Case Discussion Questions

1 Is BV's focus unique in the marketplace of startup financing (i.e., crowd funding, accelerators, VC)? Why or why not?

2 Should BV continue to invest at the pre-seed and seed stages investments at $250,000-400,000 per investment, or should they do a higher number of investments at lower commitment amounts of $100,000-150,000?

3 What are the most important next steps for Selke & Moss to take with respect to building-out BV? What will be important to lay the foundation for successfully raising their next fund in two to three years?

**Exhibit 1** Management Team

**WES SELKE**, *Managing Director*

Wes is Managing Director and Founder of Better Ventures. He's the resident "numbers guy" and enjoys helping startups figure out how they're going to make and raise money. Wes has 15 years of venture capital and financial advisory experience with Good Capital's Social Enterprise Expansion Fund, William Blair, and Ernst & Young's Mergers & Acquisitions group. He earned an MBA from the Haas School of Business at UC Berkeley and a BBA from the University of Michigan. Wes has volunteered with organizations around the globe, which has fueled his passion for applying his business skills to build a better world. He lives in Oakland, CA with his wife and two young kids and enjoys road cycling in the East Bay hills and Sunday trips to the farmers market.

**RICK MOSS**, *Managing Director*

Rick is Managing Director and Founder of Better Ventures. He thrives on solving customer development challenges for startups and spends most of his waking hours at the whiteboard. He has 18 years of technology, entrepreneurship and corporate venture capital experience with Oracle, Sun Microsystems, Computer Sciences Corporation, The Modem Shop (which he founded) and Kleiner Perkins-backed WineShopper.com (acquired by Wine.com). He holds a BA from Trinity College and an MBA from the Amos Tuck School at Dartmouth College. Rick believes passionately that technology should be used to address the world's most important problems. Rick lives in Oakland, CA with his wife and two kids, is an avid cyclist and a craft beer enthusiast.

*Source: Better Ventures*

**Exhibit 2** Hub Ventures Fund (HV) Portfolio Companies

| | | |
|---|---|---|
| **Eko Devices** | Berkeley, CA | Harnessing the power of smartphone computing and cloud data for diagnosis and treatment. |
| **UCLass** | San Francisco, CA | Connecting students and teachers to their counterparts around the world to improve social and economic mobility. |
| **SunFunder** | San Francisco, CA | A financing platform for off-grid solar projects in the developing world. |
| **LeadGenius** | Berkeley, CA | Human-powered lead generator and prospecting tool that employs workers around the world. |
| **NBD Nano** | Boston, MA | A nano-scale surface to enhance water condensation and collect water in most arid regions of the world. |
| **SharePractice** | San Francisco, CA | A clinical reference tool that helps doctors identify and understand the most effective treatments based on the success of other doctors. |
| **Africa's Talking** | Nairobi, Kenya | Developing communications solutions for connected Africa. |
| **Repat** | Boston, MA | Creating fair wage employment by upcycling excess textiles into fashionable accessories. |
| **StreetOwl** | Oakland, CA | Smartphone platform that empowers consumers to find maximum discounts available based on their driving habits. |
| **CheckInOnMe** | San Francisco, CA | Proactive, automated personal safety system designed for mobile devices. |
| **GivKwik** | San Francisco, CA | Makes giving to non-profits easy, fun, and social |
| **Sisu Health (DIIME)** | Ann Arbor, MI | Medical technology company tailored for Sub-Saharan Africa. |
| **CloudPay** | Santa Cruz, CA | Next generation managed services global payroll solutions for multinational businesses with complex payrolls. |
| **TransitHero** | San Francisco, CA | Utilizes crowdsourced data to guide more efficient transit choices across all transit options with its Urban Transit App. |
| **Acopio** | Oakland, CA | Social platform for professionals that allows like-minded professionals to network offline or online. |
| **Hoop Fund** | San Francisco, CA | An e-commerce and crowdfunding platform, used to run local small business networks. |

*Sources: Better Ventures, Angel List*

**Exhibit 3** Better Ventures Fund II (BVF II) Portfolio Companies (through November 2016)

| | | |
|---|---|---|
| **SunFunder** | Nationwide | A financing platform for off-grid solar projects in the developing world. |
| **Localwise** | Oakland, CA | Connects local people to jobs at local businesses, making stronger local communities. |
| **Utility API** | Oakland, CA | An enterprise software company that is accelerating the worldwide shift to renewal energy by making it easier and more cost-effective to switch to solar. |
| **Augary** | Oakland, CA | A software company that saves lives by using computer vision and artificial intelligence to help fleets drive more safely while capturing valuable visual information about the world. |
| **Fluid** | Oakland, CA | Invoice management software and short-term loan for freelancer economy. |
| **NextRequest** | San Francisco, CA | Information request software that improves government transparency. |
| **Iris** | Austin, Texas | Digital health start-up that provides advanced care planning solutions for patients facing chronic illnesses. |
| **BrightCurrent** | Oakland, CA | Customer acquisition platform for residential solar and other clean energy solutions. |
| **LeadGenius** | Berkeley, CA | Human-powered lead generator and prospecting tool that employs workers around the world. |
| **K4Connect** | Charlotte, NC | A technology integration company that makes life similar and easier for seniors. |

*Source: Better Ventures*

**Exhibit 4** Stage Definitions for Venture Capital Investing

*Seed Stage Financing*

This stage is a relatively small amount of capital provided to an inventor or entrepreneur to prove a concept. This involves product development and market research, as well as building a management team and developing a business plan, if the initial steps are successful. This is a pre-marketing stage.

*Early Stage Financing*

This stage provides financing to companies completing development where products are mostly in testing or pilot production. In some cases, product may have just been made commercially available. Companies may be in the process of organizing or they may already be in business for three years or less. Usually such firms will have made market studies, assembled the key management, developed a business plan, and are ready or have already started conducting business.

*Expansion Stage Financing*

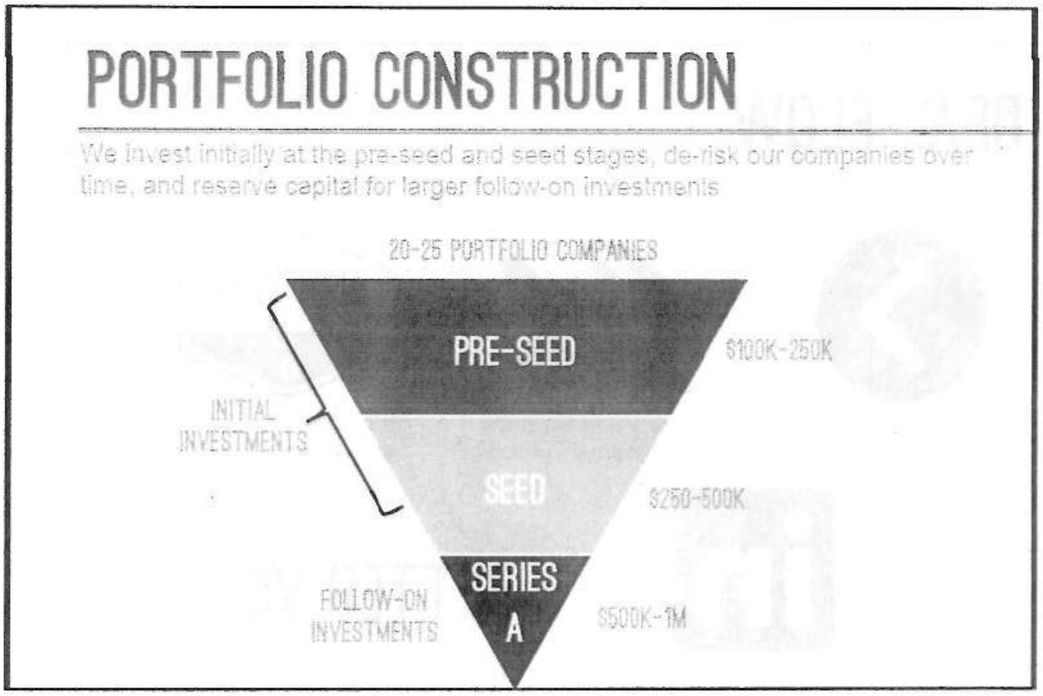
This stage involves working capital for the initial expansion of a company that is producing and shipping products/services, and has growing account receivables and inventories. It may or may not be showing a profit. Some of the uses of capital may include further plant expansion, marketing, working capital, or development of an improved product. More institutional investors are more likely to be included along with initial investors from previous rounds. The venture capitalist's role in this stage evolves from a supportive role to a more strategic role.

*Later Stage*

Capital in this stage is provided for companies that have reached a fairly stable growth rate; that is, not growing as fast as the rates attained in the expansion stages. Again, these companies may or may not be profitable, but are more likely to be than in previous stages of development. Other financial characteristic of these companies include positive cash flow. This also includes companies considering an initial public offering (IPO).

*Source: NVCA Yearbook 2016*

**Exhibit 5** Portfolio Construction

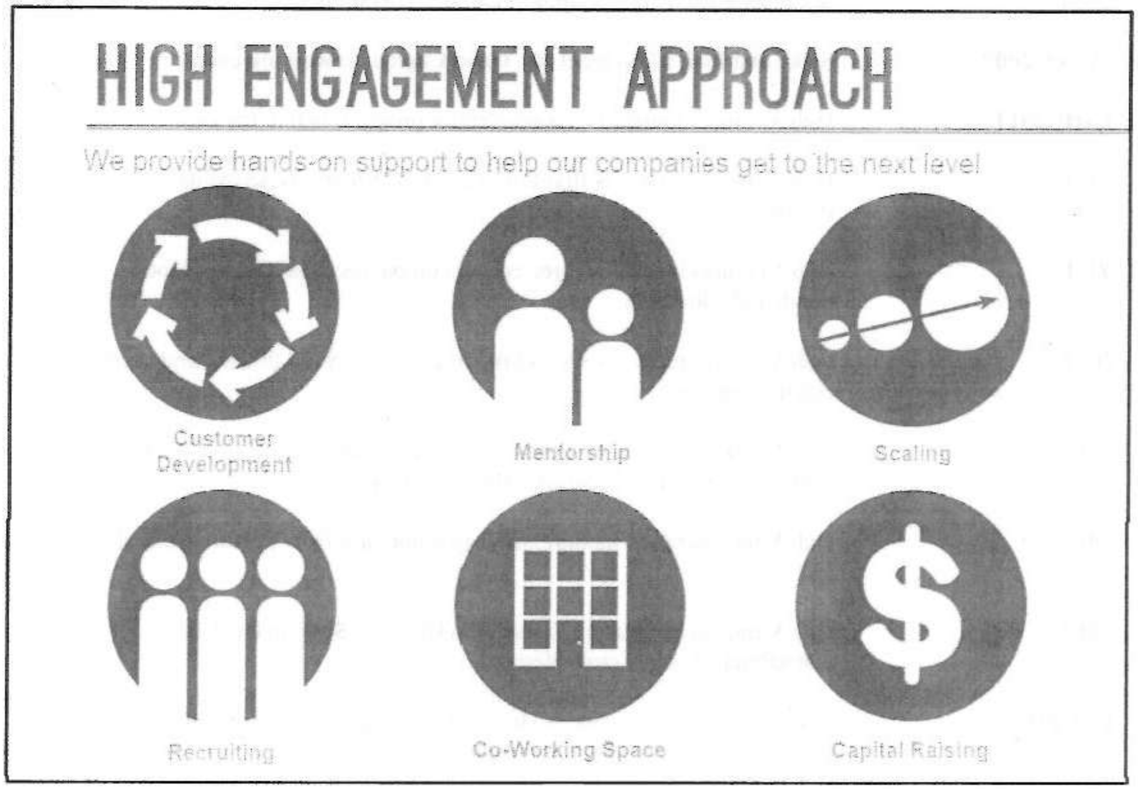



*Source: Better Ventures*

**Exhibit 6** Deal Sourcing


*Source: Better Ventures*

**Exhibit 7** High Engagement Approach




*Source: Better Ventures*

**Exhibit 8** Better Ventures Timeline

| | |
|---|---|
| **2006** | Wes Selke joins Good Capital as an investment manager. |
| **March 2009** | Selke and Rick Moss meet at a Good Capital networking event. |
| **Early 2011** | Hub Ventures founded—an accelerator program within the Hub. |
| **2011** | Hub Ventures raises its first funding, $115,000 and kicks off its first cohort. |
| **2011** | Hub Ventures invests in three cohort companies: LeadGenius, Hoop Fund, and CloudPay. |
| **2012** | Hub Ventures raises its second funding round—$150,000 to fund seven cohort companies. |
| **2012** | Hub Ventures invests in Africa's Talking, Repat, StreetOwl, Check On Mobile, and GivKwik, SusuHealth, and Acopio. |
| **2013** | Hub Ventures raises its third funding round into Hub Venture Central LLC. |
| **2013** | Hub Ventures invests in UClass, Eko Devices, SunFunder, NBD SharePractice, and TransitHero. |
| **Fall 2013** | Better Ventures spins out of Hub Ventures; Selke and Moss become managing directors of the new entity. |
| **2014** | Better Ventures Fund II holds first close on $6 million in commitments. The Fund makes its first two investments, in in Augary, and Utility API. |
| **2015** | Better Ventures invests in BrightCurrent and K4Connect. |
| **2016** | Better Ventures invests in Localwise, NextRequest, Fluid Financial, LeadGenius, and Iris Plans |
| **December 2016** | Better Venture Fund II closes with $21 million+ raised. |

*Sources: Better Ventures, LinkedIn*