Building a Model for Culturally Responsible Investment

CAROLINE WILLIAMS and LISA SHARAMITARO

Throughout the 1990s, internal and external environmental shifts were affecting the cultural sector. The nonprofit arts were being challenged by an increasing awareness of the need to diversify traditional revenue streams. In addition, arts organizations were experiencing real and enduring shifts in available resources, as well as rising resistance to the view of the cultural sector as deserving and comfortable in its reliance on donated assets (foundation grants, corporate giving and individual philanthropy) for ongoing operations.

A look beyond the nonprofit arts reveals an economy increasingly driven by capital investment, revenue generation, and income. In the latter part of the 1990s, the New York Stock Exchange repeatedly shattered trading records. New technology and biomedical industries erupted with force, creating new wealth and a more involved and informed populace. As the "new philanthropists" created by this boom began to scrutinize the impact of their financial support and involvement, talk began to focus on venture philanthropy and socially conscious investing. Venture philanthropy would combine business approaches with grant making, and socially conscious investing would put traditional investment options through social filters. Both ideas have received wide coverage, but neither matured before the investing markets changed and "new wealth" diminished.

Caroline Williams is chief financial and investment officer of the Nathan Cummings Foundation, a nonprofit organization. She has worked for twenty years as an investment banker and ten years as a financial consultant for tax-exempt organizations and socially responsible companies. Lisa Sharamitaro is a doctoral student who serves as the research and information systems project manager in the Arts Policy and Administration Program at the Ohio State University.

The “irrationally exuberant” stock market ended in April 2000. Since then it has been further undermined by the terrorist attacks of 11 September 2001. The result was a weakened and struggling U.S. economy. Nine months later, just as the economy appeared to be recovering and the stock markets had begun to stabilize, the investment markets were rocked again, this time by corporate accounting and governance scandals. Investor confidence is once again shaken. In the past it has taken the markets years to recover from such scandals, but history indicates that they do ultimately recover.

In this article we take the position that, current trends aside, the investment strategies that emerged over the last ten years can inform the cultural sector in exciting and innovative ways. We explore three specific financial investment strategies for their potential applicability in the cultural sector:

- Socially responsible investing, or the selection of publicly traded stocks based on screens for social impacts and values
- Venture capital, or investing in equity securities of small, young companies before the stocks become publicly traded
- Community investing, or financing that generates resources and opportunities for economically disadvantaged people in urban and rural communities in the United States and abroad that are underserved by traditional financial institutions

We explore ways to adapt and combine these ideas to assess the feasibility of *culturally conscious investing* as an infrastructure development strategy for the arts and culture. Although both socially responsible investing and venture capital have positive aspects, their adaptation to the cultural sector poses significant challenges. Eventually, we found the most promising model in the evolution of *community investing*, which combines the most applicable aspects of venture capital and socially conscious investing.

In the following section we provide a short overview of the norms and trends in venture capital and socially responsible investing. Following that, we introduce community investing as a model of socially responsible venture capital, using a series of organizational profiles. Finally, we present four models for potential culturally responsible investment vehicles to aid in understanding how these tools might be applied in the cultural sector.

SOCIALLY RESPONSIBLE INVESTING AND VENTURE CAPITAL

Little information is available on individual investment decisions based on social screens. Instead, the studies on socially responsible investing cover the investment of monies under professional management in publicly traded stocks. But given that the field of investing in publicly traded stocks has come to be dominated by institutions, including mutual funds, the studies can be said to reflect current trends and investor sentiment.

Venture capital appears to be more evenly divided; monies directed by individual investment decisions are approximately equal to professionally managed monies. Beyond aggregate estimates, though, little information exists on the direct activities of individual or "angel" investors, a term that refers to individuals who regularly provide capital to one or more start-up companies with the expectation of a high rate of return.[1]

Because these strategies are instrumentally different investing activities, it is instructive to consider their structural differences. The primary distinction is that socially responsible investing takes place in the public stock market and venture capital in the private equity capital market.

The Stock Market—The Context for Socially Responsible Investing

Thirty years ago the stock market was primarily a market of individual investors. Today it is dominated by institutional investors: primarily mutual funds and retirement funds, such as pension funds, 401K plans, and similar investment vehicles.

The growth of pension funds and their increased activity in the stock market led Wall Street to provide the institutional investors with more comprehensive research and trading services. Increasingly, individual investors found themselves at a disadvantage, competing in the market with full-time professional managers using sophisticated analytical techniques. Also, as the U.S. business sector and other economies and stock markets grew, individual investors faced a dizzying array of investment options. In response, individual investors began turning increasingly to professional management by investing in mutual funds.

Much is written about individuals' pouring money into the stock market and thereby fueling its growth. However, except for the day-trader phenomenon in the late 1990s, most of the individual investor money goes into mutual funds, not directly into the stock market. Similarly, retirement funds have become major investment vehicles. Some, such as the California Public Employees Retirement System, have become major stock market investors.

Strategies of Socially Responsible Investing

The Social Investment Forum (SIF) *2001 Trend Report* found that "nearly one out of every eight dollars under professional management in the United States today is involved in socially responsible investing" (5). Socially responsible investing incorporates three main strategies that work together to promote socially and environmentally responsible business practices, which in turn contribute to improvements in the quality of life throughout society.

Screening is the strategy most widely practiced, showing a 36 percent growth rate since 1999 and accounting for combined assets of over $2 trillion in 2001. Shareholder advocacy, which is a close second, falls outside the scope of this article. Community investing reported a 41 percent growth rate between 1999 and 2001 (6).

Screening employs positive ("only if") and negative ("never if") criteria for compiling buy lists of stocks of companies whose employee relations, environmental, human rights, or other policies align with the investor's preferences. It is worth noting that during the recent market downturn socially screened mutual funds outperformed their unscreened counterparts; they also suffered only a 54 percent drop in total new dollars invested compared with the 94 percent drop that the overall mutual funds market reported (Social Investment Forum 2001, 12). With some of the early funds now a decade old, several studies are under way to assess if the social investing strategy was inherently more stable, or whether it was a matter of investing in technology and service companies that happened to be the fastest-growing segments of the market.

Types of Screens Used in Selecting Publicly Traded Stocks

As social investing developed through the decade of the 1990s and into the new century, screened portfolios have consistently developed the screens employed, both screening out companies for their poor environmental and social records and screening in companies with excellent records.

The most widely used screening factors (in use in 50 percent or more of screened portfolios) include tobacco, environment, human rights, employment/equality, gambling, alcohol, and weapons. Screens in use in 30–50 percent of screened portfolios include labor relations, animal testing/rights, community investing, and community relations. Specialty screens (in use in 30 percent or less of screened portfolios include fair executive compensation policies, abortion and birth control policies, and international labor standards (Social Investment Forum 2001, 14).

Conventional wisdom in the field suggests that there is a progression and connection between shareholder advocacy and social screens. The SIF speculates that

> new issues of social and environmental concern, such as international labor standards, emerge first through the shareholder advocacy process and then, over time, quantitative criteria are developed to apply them as portfolio screens. Screens that are now used by less than 30 percent of screened portfolios may, over time, become more commonly used. (2001, 15)

The progression from specialty screen to common screen may be connected as well.

As one might suspect, the process of screening stocks for socially responsible issues requires extensive specialized research. Several firms have emerged to provide this service to institutional investors, including Investor Responsibility Research Center, Institutional Shareholder Services, and Kinder, Lydenberg, Domini & Co. (KLD). The social issues that these services cover range from the traditional ones such as tobacco, firearms and gambling, to the environment, to abortion, contraception, and fetal research, as well as to human rights and sweatshop labor. KLD also includes some positive screen, such as level of charitable contributions, support for housing and education, and employee policies and benefits, and provides an investment vehicle for individual investors in the form of a mutual fund.

Does Socially Responsible Investing Transfer to the Cultural Sector?

Although socially responsible investing is an appealing avenue, it brings challenges that make it a questionable model for the cultural sector. Certainly the track record is attractive; for example, in comparison to the universe of professionally managed investment vehicles, socially responsible investing grew over 1.5 times as fast, a 36 percent growth rate compared to a 22 percent rate overall. And the social motivation shows no signs of losing pace. In 2001, 230 mutual funds employed social investment criteria, up from 168 in 1999, 139 in 1997, and just 55 in 1995 (Social Investment Forum 2001, 4–6).

What does all this imply about the applicability of social investing to the cultural sector? The first step to improve its viability would be to raise shareholders' awareness of cultural issues. One might expect social investing that takes into account issues of the arts and of culture to follow the trend of other social issues, initially appearing on the social investment radar screen through shareholder advocacy and initiatives on proxies. However, that would take a long time. Even environmental issues, which are now considered almost "mainstream," routinely get less than 10 percent support from shareholders. Second, for the issue to be taken "seriously," indicators (positive and negative) related to culture must be created. This would be a daunting and delicate task. If workable screens could be developed, the process is certain to require the leadership of a professional investment research firm. The increasing competition for social investment dollars raises questions about whether this strategy targets a market that is pushing its capacity already.

The biggest question is whether this approach would accomplish the ultimate goal of attracting capital to the cultural sector. Social investing is a strategy for channeling investment dollars into companies that are publicly traded. Because that list in the arts traditionally has not been extensive, one might conclude that more could be gained from a venture capital approach that increases cultural endeavors headed for IPOs (initial public offerings of stocks).

Private Equity Capital—The Context for Venture Capital

Private equity capital refers to investment directly into privately owned companies, rather than in the stocks of publicly traded companies through the stock market. It is risk capital for starting, expanding, and acquiring companies. The term "venture capital" once referred to all of these activities. However, as the sector has expanded, venture capital has come to be associated mostly with early-stage companies. Merchant banking or buyouts refer more to investments in larger, more mature companies, although there can be some overlap.

Venture capital is equity investing specifically into early-stage companies to finance their development. The target companies have not yet reached a size or scale to attract broad investor interest, and their stocks are not publicly traded. The venture capital investor takes more risk than the stock market investor. For example, a company at an early stage of development has a less-established business. As well, the investor cannot readily sell the investment until there is a stock offering. Often, the investor may take an active role in the company.

To compensate for the greater risk and involvement, the venture capital investor commands a higher expected rate of return on investment. In actuality, venture capital returns have varied substantially over time. Attractive returns were realized in the 1970s, which led to a significant expansion of the field as new and inexperienced participants entered. Returns realized through the 1980s were considerably lower, 8–12 percent, as the economic and investing markets deteriorated. The early-to-mid 1990s saw a rebound in venture capital returns, as well as returns for the stock markets, due in large part to sustained economic expansion. Since early 2000 fortunes have reversed again.

Venture capital focuses on relatively small companies, anything from startups to companies in various stages of implementing their operating plans and establishing financial viability. Investments typically range from several hundred thousand dollars to several million dollars. The exceptions in the late 1990s were Internet deals and technology; investments in these fields typically reached into tens of millions of dollars. This segment of the investment market is made up of professional firms, professionally managed funds, and individual investors.

In addition to size considerations, venture capital funds may also focus on specific industries. Some invest in a broad range of basic industries, and others develop expertise in highly technical fields. The "hottest" areas in the late 1990s were Internet-related, including e-commerce and broadband applications. Often the combination of stage of development and industry focus determines the investment strategy of the fund. In table 1 we show total money invested and number of deals by industry during the fourth quarter of 2001, according to a recent survey (PriceWaterhouse et al. 2002, 1).

Interestingly, of the forty-one investments listed under "Media and Entertainment," only five fall within the general parameters of the arts and culture industry, as detailed below. However, those five together represent 25 percent of the $307 million invested in the category.

How Well Does Venture Capital Transfer to the Cultural Sector?

Again, like socially responsible investing, venture capital has pros and cons. Alternative Assets, a service organization specializing in information resources for the venture capital field, estimates that, in the 1990s, venture capital funds realized returns of 40–50 percent and higher. However, those rates of return began to suffer in 1999. This rippled through the broader stock markets in early 2000. When the "tech bubble" burst, the stock markets plunged and dramatic reductions in mutual fund and venture capital reserves occurred. According to an industry survey,

> after a brief period of stability in late 2001, venture capital investment continued its two-year decline in the first quarter of 2002. Total investments fell to

Table 1.—Investments by Industry, Quarter 4, 2001

	% Total	Investment ($ millions)	Number of Deals
Software	22.60	1609	211
Networking and Equipment	13.90	989	77
Telecommunications	13.80	983	102
Biotechnology	13.80	980	66
Retailing/Distribution	6.60	471	85
Semiconductors	5.50	392	35
IT Services	4.50	320	57
Media and Entertainment	**4.30**	**307**	**41**
Medical Devices and Equipment	4.00	285	52
Industrial/Energy	2.10	153	29
Financial Services	1.90	135	8
Computers and Peripherals	1.80	129	24
Consumer Products and Services	1.30	94	18
Electronics/Instrumentation	1.20	88	16
Business Products and Services	1.20	84	17
Other	0.80	55	7
Healthcare Services	0.60	39	10

Source: PricewaterhouseCoopers/Venture Economics/National Venture Capital Association 2002. MoneyTree Survey Highlights, Q1 2002. Available at <http://www.pwcmoneytree.com/highlights.asp>.

> $6.2 billion, a 24 percent decrease from the prior quarter. A total of 787 companies received venture backing compared to 994 companies in the fourth quarter of last year. The pace of investing was similar to 1998, which was the last pre-bubble year.[2] (National Venture Capital Association 2001, 1)

What does this imply? Leaving aside the observation that times are lean for new investment dollars, because that can, and likely will, change eventually, is there a place for the arts and culture in the venture capital model? In table 2, we show figures indicating that equipment manufacturing and national performance venue chains both found support from venture capitalists in 2001, which means that venture capital funding is reaching beyond technology-based cultural projects. However, because venture capitalists target early-stage projects that show potential for very big returns, culturally related prospects would need to be in or near that 18–40 percent return rate that technology and e-commerce have promised in recent years to attract them. That narrows the field considerably. Another obstacle is that few cultural organizations initiate public stock offerings. With the right incentive, that could change.

COMMUNITY INVESTING AS A MODEL OF SOCIALLY RESPONSIBLE VENTURE CAPITAL

This overview suggests that the cultural sector might be best served by venture capital with social overtones, an approach that prioritizes targeted building and strengthening of infrastructure. One version of this combination is called "community investing." This particular approach to financing has often targeted the economically disadvantaged urban and rural communities in the United States and abroad that are underserved by traditional financial institutions.

Table 2.—Venture Capital Investments in the Arts and Culture, Quarter 4, 2001

Company	Amount
Fender Musical Instruments Corporation, Brea, CA Manufactures and distributes musical equipment	$57,882,000
House of Blues Entertainment, Inc., Hollywood, CA Manages eight House of Blues clubs that offer dinner and a show	$15,000,000
Musician.com, Inc., Los Angeles, CA Provides community and resource center for musicians	$200,000
NextStage Entertainment Corporation, Houston, TX Develops and operates mid-size, live-performance theaters	$5,000,000
Zilo Networks, New York City, NY Manages a web site that offers entertainment content for college students	$703,000

Interest is growing in the potential of venture capitalism combined with social investing. For instance, a recent movement in the social investing circles advocates that all mutual funds designate 1 percent of their portfolios for community investing, with overtones of the "1 percent for art" programs in cities across the United States.[3] Socially responsible venture capital funds still tend to be small and are relatively new, with little in the way of a track record. Most also incorporate some form of sponsorship or subsidized funding. They include community development financial institutions, small business investment companies and most recently, funds sponsored by nonprofit organizations or international governmental agencies. To date, few socially responsible venture capital funds exist independently.

Existing community investing business models range from a "pure" venture capital model to mixed revenue models that combine private investment with philanthropic or public funding. In the abstract, transferring the concept of community investing to the cultural sector means finding investors interested in financing cultural enterprises that show rapid growth potential but are also stable, self-supporting sources of jobs, entrepreneurial activity, and infrastructure.

MODELS FOR THE CULTURAL SECTOR

The original objective for our project was to work out several alternatives for structuring a fund to invest in culturally responsible enterprises. The project focused on the fully commercial, or "standard," fund. However, concerns arose that investors would question whether there were sufficient investment opportunities in culture with competitive potential returns. The range of fund structures developed for the project, therefore, represents various fall-back positions, including mixed funding models combining commercial and concessionary capital and a nonprofit model started entirely by philanthropic resources.

The Venture or Subsidized Fund Model

A subsidized cultural fund was designed to provide support for returns to commercial investors. This was done by having a sponsoring investor agree to subordinate its return on investment until a minimal level of return had been realized by the commercial investors. This strategy assumed that some commercial venture capital could be raised, so long as the subsidy was there to support commercial returns. The Sustainable Jobs Fund, which uses foundation and Small Business Administration funds, is an example of this model. This is the closest to the "pure" venture capital approach.

Sustainable Jobs Fund, L.P.

The Sustainable Jobs Fund (SJF) is a community development venture capital fund. It makes investments in growth enterprises that create quality jobs in economically distressed regions in the eastern United States. SJF focuses on recycling, remanufacturing, environmental, and other sectors that are uniquely suited to generating employment for former welfare recipients and low-income individuals. SJF finances seed, growth, and expansion-stage private companies that meet its job creation and financial criteria. The fund provides essential patient capital structured as equity or subordinated debt with revenue participation agreements.

Structured as a standard ten-year limited partnership, SJF charges the standard annual management fee of 3 percent. Supports built into the partnership structure help underwrite the high costs of operating in the difficult market that SJF addresses. To provide supplemental monies for operations, the foundations investing in the fund pay in 100 percent of their commitments at the initial closing, whereas other investors pay in their commitments as the fund needs the money. The interest earned on the foundations' money is explicitly designated as a supplemental management fee. The manager of the fund receives 10 percent profit participation instead of the standard 20 percent. This approach increases potential returns to investors and is an indication that the investments are not expected to perform as well as "standard" venture capital investments. In addition, the fund received Small Business Administration (SBA) funding. This limited return money, in effect, provides support for commercial returns to investors.

Women's Growth Capital Fund

According to the SBA, women are starting businesses at twice the rate of men and own approximately 40 percent of all U.S. firms. However, women-led businesses receive only about 2 percent of the capital invested annually by venture capital funds. Therefore, a fund focused on providing capital to such businesses meets a socially responsible standard.

The Women's Growth Capital Fund was established in 1997 to make equity investments primarily in early- and expansion-stage, women-owned or managed businesses. It raised $10 million from approximately seventy investors—predominately individuals, not institutions—and 70 percent of the individual investors were women. In 1998, the fund leveraged these investments with $20 million of Small Business Investment Company (SBIC) funding. It is the largest venture capital fund in the eastern United States, and perhaps nationally, that focuses its investments on women-owned or managed businesses.

A fund that followed this model might raise investment capital from private and institutional investors and seek to realize full commercial return on their investments. However, it will require a layer of financing from foundations or other friendly investors willing to subordinate or defer their own returns. To attract capital, potential commercial investors would have to be convinced that there is a sufficient level of deal flow and that it would be possible to realize competitive venture capital returns from such investments. The extra support provided by the subsidized funding would be viewed as an insurance policy.

The Demonstration Fund Model

A second model, a "demonstration" fund, was designed to establish an organizational structure and management track record to make the case for the viability of the venture capital model in the cultural sector. This model assumed that commercial venture capital funds could not be raised, but that there would be sufficient foundation funding for getting it started.

Such funds have been viewed as commercial by investors in the recent past. However, because such funds have a very limited focus, potential investors need to be convinced that there is adequate deal flow and that returns are achievable. To prove the concept for arts and culture, several foundations would have to provide the initial capitalization.

The Terra Capital Fund

The Terra Capital Fund was designed by the International Finance Corporation (IFC), an affiliated entity of the World Bank. It targets the alternative agriculture, forestry, ecotourism, and biodiversity sectors. Environmental Enterprises Assistance Fund (EEAF), a nonprofit organization, manages the fund.

It was originally conceived by the IFC over five years ago as a $30–$50 million fund combining IFC and private investor capital. After several years of concept refinement, the selection of a fund manager, little progress on implementation, and a change in the fund manager, the fund has now received commitments for approximately $15 million from a combination of IFC, other agencies, and foundations.

At least one of these commitments comes from a major foundation. Its equity investment is from program dollars in the form of a program-related investment (PRI) to further foundation's environmental mission. Because it is an equity investment in a for-profit entity and potentially will yield commercial returns (20 percent or more), the foundation sought an IRS private-letter ruling that would qualify its investment as a PRI.

Two points should be noted in this example of a narrowly targeted venture

capital fund. First, the fact that the foundation did receive a favorable ruling from the IRS could have a positive impact on how foundations use program dollars to promote market solutions through investment in for-profit enterprises. Second, the fund did not demonstrate an ability to attract funding from private investors. One could infer from this that investors either (*a*) don't consider the return sufficient for the risk of investing in small, conservation-related enterprises in developing countries, or (*b*) they do not believe that these returns can be realized.

EcoEnterprises Fund

In 1998, the Nature Conservancy and the Multilateral Investment Fund (MIF) of the Inter-American Development Bank entered into an agreement to form the EcoEnterprises Fund. This was designed to be a $10 million fund, with half of the monies committed by the MIF. The Nature Conservancy was responsible for raising the other half .

EcoEnterprises seeks to combine venture capital financing and technical assistance to environmentally responsible business projects in Latin America and the Caribbean. It targets alternative agriculture, including organic, apiculture, and aquaculture; sustainable forestry; nontimber products; and nature tourism. Investments range from $50,000 to $800,000, with the average expected to be $250,000.

The fund has two components—a $6.5 million Venture Fund and a $3.5 million Technical Assistance Fund. The Venture Fund will make development capital available to small-scale private environmental businesses in cooperation with local nonprofit institutions in the region. The Technical Assistance Fund will provide business advisory services to companies in which the fund is investing, such as strategic and business planning, marketing, training, and financial management, and can be drawn on to absorb the high costs of managing the fund. The fund is managed by the Nature Conservancy, which has hired a dedicated staff for the effort. The Nature Conservancy receives a 3 percent management fee and will also be able to draw on the Technical Assistance Fund to cover its costs. It will not receive any share of the profits of the fund.

The offering materials explicitly state the high costs and, therefore, low expected investment returns of this hybrid venture capital and technical assistance fund. Furthermore, the standard management fee of 3 percent is insufficient to fully cover the Nature Conservancy's expenses in operating the program because of the venture fund's development-oriented conservation mandate, low initial capitalization, small-scale transactions, and increased portfolio management responsibilities. The fund will seek a minimum target return of 20 percent on equity investments with lower returns on debt instruments.

Based on assumed capital gains, losses, management fees, operating expenses, and expected liquidation after 10 years, total returns are projected to be around 5 percent.

Of the total of up to $10 million to be raised the Nature Conservancy committed $500,000, and the MIF up to $5 million on a dollar-for-dollar matching basis. The MIF's commitment was contingent on the Nature Conservancy's raising an additional $1.8 million by 31 July 1999. This minimum target was met just before the deadline, though it is not presently known to what extent the monies came from outside investors. The lack of investor interest in the fund to date, despite the strong institutional support, brings into question whether investors will be interested in small investment funds, particularly ones that try to do many things and are not expected to provide a market rate of return for investors.

Cultural Capital Fund

A Cultural Capital Fund was designed to focus on the needs of for-profit entities involved in arts and cultural activities, rather than on the return objectives of investors. This structure, also to be funded by foundations, would seek commercial returns on approximately 50 percent of its portfolio of investments. On the rest of the portfolio the return expected would be only return of capital plus inflation.

A fund that followed this model, in addition to investing in deals considered to be commercial, might use approximately 50 percent of its funds to make equity and debt investments that are not expected to generate full commercial returns. The entity would be structured as a nonprofit organization and would depend on grants and PRIs for its investment capital. Returns realized beyond a nominal interest rate owed on PRIs would be retained by the organization to fund future investments and operations.

Cultural Support Fund

A Cultural Support Fund was also designed to the focus only on the capital needs of for-profit entities and affiliates of nonprofit entities involved in arts and cultural activities. Capital would be provided to them on a concessionary basis. The financial objective would be to recycle investment funds, with the expectation that grant funding would be needed for operating expenses.

The objective of the fund following this model would be essentially philanthropic, in that it does not seek to validate the availability of deal flow with potential to provide full investment returns. Instead, it would use a disciplined investment approach to provide capital to entities in the arts and culture sectors. However, it would structure the terms of each investment to fit the needs

and capacity of the situation, instead of seeking a commercial return on investment. Like the Cultural Capital Fund, the Culture Support Fund would be structured as a nonprofit organization that would seek grant and PRI funding. The limited returns realized on investments would be retained by the organization to fund future investments; additional funds would likely be required to support future operation costs.

CONCLUSION

Subsequent to the development of these fund models, the venture capital market has changed significantly, beginning with the break in the stock market in April 2000. Investors began to question whether all the young technology and dot-com companies that had successfully sold stock to investors through initial public offering (IPOs) could meet their lofty growth expectations. This break in confidence rippled back through early-stage venture capital markets in several ways:

- If the young, growth companies could not do IPOs, professional venture capital investors would not realize the quite high rates of returns they had come to expect
- If these young companies could not access additional capital, they would be unable to continue building the expensive business models aimed at future profits
- Professional venture capitalists were faced with deciding which of their investments to support with additional capital and which to simply close
- Less-sophisticated investors, including angel investors in start-up companies, came to realize that successful investing was not that easy after all

The result is that little private capital has gone into new companies for the past two years.

What does this mean for culturally responsible venture capital and the creation of a culture fund model? We have to look at the alternative structures that we outlined above in reverse order. Instead of starting with the most commercial and falling back, there will likely be the need to prove the case over time. In this market, it is not possible to raise meaningful amounts of commercial venture capital for investing in the unproven arena of culturally responsible companies. This would be true even if the fund had a layer of subordinated capital to support investor returns.

In this market environment, the focus should be on meeting the capital needs of emerging companies and ventures. Over time, some may prove to be not only commercially viable, but also successful in terms of investor return. The case may then start to build for the possibility of successful commercial investments in culturally responsible enterprises.

Private capital investing goes as in cycles. A next wave of enthusiasm for venture capital investing will come, although we cannot know when or which industries will be considered particularly attractive. However, if a track record of successful culturally responsible entities develops during this period, the sector may be positioned to attract private commercial capital in the next cycle of venture capital investing.

Key words: venture capital, social investment, cultural investment, screening, investment models

NOTES

1. In the arts, the term "angel" is reserved specifically for backers of theatrical productions. Specifically, angels put up capital to get a show into production, in exchange for "units," an equivalent of shares of stock in the production. However, the range of motivations for becoming a "Broadway angel" makes the term an imperfect parallel for the venture capital "angel investor."
2. From the National Venture Capital Association press release, available at <press/VEpress 05_01_02.pdf>. Data tables can be accessed at <www.pricewaterhousecoopers.com>.
3. Information on the "1 percent in Community Campaign" can be found at <http://www.communityinvest.org/1percent.htm>.

REFERENCES

Social Investment Forum. 2001. 2001 Trend Report on Socially Responsible Investing Trends in the United States. Washington, DC: Social Investment Forum.

PricewaterhouseCoopers/Venture Economics/National Venture Capital Association 2002. MoneyTree Survey Highlights, Q1 2002. Available at <www.pwcmoneytree.com /highlights .asp>.

National Venture Capital Association. 2001. "Venture Capital Investments Resume Downward Trend In Q1 2002."