

Recoverable and Redeemable Grant Capital as Force Multipliers for DivInc, Its Founders and Funders

May 16, 2022

Laurie Felker Jones

lfj@lauriefelkerjones.com

Introduction

The following case study was created as part of an executive masters assignment for a Financing Impact course required by the Entrepreneurship and Social Business program offered through the Marshall Institute at London School of Economics and Political Science.

More than an academic exercise, the following case study will put forth a practical plan for an additional revenue stream for DivInc, a social enterprise based in Austin, Texas. To ground this recommendation, we will first review the purpose of the organization, the current revenue structure, and existing business model. Next, this report will include an exploration of alternative revenue streams and the related advantages and challenges. This report will then make a recommendation and offer a plan for seeking and deploying recoverable and convertible grants for both the organization and its recipients. Recoverable and convertible grants are achievable and exciting revenue streams that positively increase intended outcomes for the organization, the recipients of its programming, and their respective financial backers.

About DivInc

Mission

Founded and led by women and people of color since 2016, DivInc is focused on advancing early stage ventures founded and led by people of color and women. Based in Austin, Texas, DivInc offers in-person and virtual programming in Austin and Houston that services founders from across the United States.

The explicit mission of DivInc is to, “generate social and economic equity through entrepreneurship.” Their stated outcome objectives are to, “bridge the gap between underrepresented entrepreneurs and the resources they need to build profitable, high-growth companies.” They do this “by staying laser-focused on building programs and infrastructure that remove barriers to entrepreneurship” so that, “we enable underrepresented founders to build viable tech startups.” Their Theory of Change (ToC) is that historically excluded tech startup founders serviced by DivInc’s programming and infrastructure-building efforts are more successful than those who aren’t. (Home, n.d.)

Model

DivInc’s model targets people of color- and women-led early stage for-profit tech or tech-enabled ventures with a prototype, beta, or early product offering ready for growth inside a

scalable, ultimately venture-backable business model. Historically, DivInc has offered accelerators that are either sector-agnostic or focused on particular sectors. Previous and upcoming sector-specific programming has been focused on Emerging Tech, Sports Tech, and Social Justice.

Note: While the organization has an explicit social impact mission, only the Social Justice accelerator has an explicit thesis for ventures to include produce purpose as well as profits. The initial pilot of the Social Justice accelerator included one non-profit, which ultimately proved that DivInc is not a match for non-profits. Some of the Social Justice themed ventures may be hybrid models and not-venture backable.

DivInc offers the following value propositions which are free to recipients and supported by grants and philanthropy:

1. a 12-week accelerator offering culturally competent business training, access to an aligned network, coworking, and a \$10k grant;
2. an Alumni Program offering ongoing support to founders post-program;
3. and, a Pre-Accelerator Business Validation clearinghouse with content provided by LEANSTACK.

Additionally, DivInc offers one paid-program in their pre-accelerator on-ramp. This is an “Early Stage Validation Bootcamp”, valued at \$1,400 that idea-stage founders purchase for \$500; the balance (\$900) is subsidized by capital granted to DivInc. This program is serviced by an experienced independent consultant.

Revenue Structure

The legal structure of DivInc is a 501(c)(3) non-profit. DivInc does not take equity from its founders, and does not charge founders for the vast majority of its programming. DivInc’s current funding model is a mix of grants, philanthropy*, corporate sponsorships, and earned revenue provided through the pre-accelerator bootcamp.

*This report distinguishes philanthropy from grants as: philanthropy providing the most unrestricted capital, and grants tied to a set of parameters, programming and/or program or organizational outcomes. Grants are generally deployed by Non-profits, Foundations, Corporate or Government entities; these same entities may also deploy philanthropic capital. Individuals are the primary source of philanthropic capital deployed into DivInc.

Per IRS 990 records (2020), DivInc reported raising \$246k in 2018, \$278k in 2019; in 2020, DivInc reported raising \$1.1m (2020-2021 *Impact Report*, n.d.). According to DivInc’s 2022 Impact Report, the approximate revenue structure by streams for the 2020-2021 fiscal year is as follows:

\$1,100,000	Source by %	Total raised in 2020-2021
--------------------	--------------------	----------------------------------

\$700,000	63.64%	Grants (philanthropic capital, restricted)
\$260,000	23.64%	Corporate sponsorships (donations, unrestricted)
\$100,000	9.09%	Champions of Change Award Event (donations, unrestricted)
\$60,000	5.45%	Individual donors (philanthropy, unrestricted)
\$30,000	2.73%	Founders Circle (philanthropy, starts at \$2,500 unrestricted)

(2020-2021 Impact Report, n.d.)

DivInc's corporate partners include JPMorgan Chase, Bank of America, Verizon, Bumble, Dell Technologies, Kendra Scott, Baker Botts, Atlassian, Indeed, BBVA, Cirrus Logic, Wilson Sonsini, GLG, and others.

Exploring New Streams of Revenue

As is, DivInc's 501(c)(3) business model is likely to continue funding programming largely through philanthropic and grant-based capital.

In addition, DivInc has tapped its Board Members to raise a pilot "micro-VC" of \$500k to offer ten investable companies post-program \$50k in pre-seed convertible note funding. This effort is being supported by Bank of America set up under a separate corporate structure "DivInc Ventures" operating alongside the 501(c)(3).

In addition to venture capital to sit alongside the organization, DivInc could explore other revenue streams to support its intended outcomes. Included below is an overview of a few potential streams and their associated advantages and hazards. Additional revenue streams are explored in Appendix A.

Potential Revenue Stream	Value Proposition	Advantage	Hazard
Paid Speaking Opportunities, Consulting, and Selling DivInc curriculum to other accelerators or innovation partners	DivInc has garnered expertise on running an accelerator in general, and specifically for diverse founders, while building an allied network. Like other market specific knowledge and specifically because of the momentum around investing in diverse founders, this unique value proposition can be monetized on the speaker circuit, through paid consulting about topics related to their expertise, or by licensing their content and/or programming as an “accelerator as a service” to corporate or innovation partners who don’t have or want to build the expertise.	If structured well, getting paid for the knowledge one already has can be a great value-add. In contrast to a full-blown product, DivInc could consider a structured offering with little production time that delivers value in exchange for a high-hourly rates. Paid speaking opportunities could also reinforce strategic goals of lead generation for sourcing funders, founders, and allies.	A potential hazard with these schemes is “scope creep”. It is especially important for this mission-driven organization to remain focused on leveraging existing work products <i>that are currently centered on the founder</i> vs. an understandable desire to center short-term cash infusions even if they distract from the core business model. Regarding speaking and consulting, ROI (Return on Investment) is a major consideration: while monetizing these opportunities could be a value-add when they also advance strategic goals, these are not likely to become a significant source of revenue. Regarding licensing their content or adopting an “accelerator as a service” model, DivInc would need to validate that their curriculum is attractive for the needs of external partners (stage, sector, cultural competency), and that if they licensed their content to external partners they aren’t cannibalizing their own market.

Potential Revenue Stream	Value Proposition	Advantage	Hazard
Talent referral (former founders)	According to Startup Genome (2019), 90% of startups fail. Therefore, one of the expected outputs of DivInc is diverse talent with superior innovation and entrepreneurial skills to those not trained. DivInc already garners corporate support for its efforts to diversify innovation through grant funding of its programing; DivInc also encourages its corporate partners to become early customers of their founders. Another opportunity to partner on a shared need could be talent referral. From the corporate perspective, they have paid recruiting and referral budgets, and are increasingly expanding their budgets to source diverse talent. From the founder perspective, after a period of time of early stage building (with very limited funding) DivInc's alumni founders sunsetting their companies likely have a need for financial stability in an environment that values their innovation and entrepreneurial skills. This could be a great opportunity to make (paid) matches.	Due to the pre-existing relationships DivInc has on each side of this referral proposition, this could be a low lift to monetize what they already have.	Entrepreneurship and intrapreneurship are distinct, and not all founders make for great employees. All parties would be wise to make sure employment opportunities are well-matched. Eg. An anecdote from the AWS startup team is that they have come to the conclusion and have aligned their expectations that they are "renting founders" who will contribute tremendous output to the organization's goals in a typical 18-24 month "tenure".

Potential Revenue Stream	Value Proposition	Advantage	Hazard
Financing with management fees	Because DivInc has several unique value propositions (a <u>mission-based non-profit</u> accelerating <u>minority-led for-profit</u> entities), they have garnered capital interest from a variety of sources. DivInc could consider expanding its role as an intermediary of capital from funder to founder, and take a management fee appropriate to the product. Given the current structures in place, the following financial products may be most of interest: 1. Convertible and recoverable grant opportunities 2. Revenue share 3. Invoice factoring 4. Deal origination fee (scout model) 5. For-profit investing holdings company (ROI ranging from sub-100% to venture returns based on the thesis)	With a keen focus on aligning incentives, DivInc and prospective funders have an opportunity to create a virtuous cycle for all parties by generating further capital and impact per the thesis. Additionally, in the case of debt financing like revenue share and invoice factoring, there is the opportunity for increased retained ownership for the entrepreneur.	With a shift for DivInc to have “skin in the game” as a funder and investor, the power dynamic could change. All parties would be wise to make sure incentives remain aligned to center the entrepreneur; this could be done through alumni-advisory structures, caps on upside, or other structures. Also, per local tax laws and reporting, providing a “kaleidoscope of capital” may also create administrative challenges. Finally, as a potential intermediary founders and primary funders would need to acknowledge <i>the unique value exchange provided by DivInc as an intermediary</i> is larger than any perceived opportunity cost of direct funding from funders to founders.

Flexible, Virtuous Grant-Based Capital for DivInc and its Founders

The What & Why

The following section will focus on a combination of recoverable and convertible grants as exciting new streams of revenue for DivInc. The practicality and value of offering both will be defined in a later section.

First, some definitions:

- “A recoverable grant is a loan that must be paid back only if the project reaches certain previously defined milestones. If the milestones are not reached, the recoverable grant is converted into a grant. This mechanism can be used if success of the project enables the social enterprise to repay the loan to the social investor.” (Technical University Munich et al., 2011)
- “A convertible grant is another financing instrument with hybrid capital character. The social investor provides the enterprise with a grant that is converted into equity in the case of success.” (Technical University Munich et al., 2011)

Some comparables in the market of organizations utilizing convertible grants for social impact alongside and upside for profit include Artha Initiative, d.o.b foundation, Ferd Social Entrepreneurs, Nexii. (Technical University Munich et al., 2011)

These products are recommended for consideration given the following:

1. DivInc already receives a significant amount of grant capital from support by philanthropic and corporate sources, and is already producing aligned results and the associated reports;
2. DivInc already serves as an intermediary for grant capital in the form of grants to its founders who successfully complete their program;
3. Because grant-based capital is generally a match for impact-aligned organizations not expecting a financial return, these options map easily to early-stage companies which are generally deemed to “high risk” for financing that requires demonstrated traction or credit history;
 - a. For many of DivInc’s founders, their first external capital is from DivInc. These options can be used as a proxy for the “Friends and Family” round utilized by founders with access to that early capital.
 - i. Note: a powerful comparable from another industry is the political funder Emily’s List. They raise and deploy early capital for women running for office. Based on their assertion that early investment is catalytic for creating momentum for later rounds of growth, their name is an acronym from the following adage: “Early Money Is Like Yeast: it makes the dough rise”.
4. These financing options solve a capital challenge for both DivInc and its founders:
 - a. Both options offer *flexible* metrics-based capital for early stage companies;

- b. Recoverable grants would fund founders with a non-dilutive option and allow DivInc access to semi-liquid, recycled capital from *successful* founders at rates of up to 105%, which they could funnel back into funding portfolio companies or other uses (like operating costs); further, this option allows founders to build a debt-like credit history which can be beneficial to securing future capital;
 - i. Note: as a parallel path for securing debt financing post-grant, DivInc could offer external funding partners the opportunity to serve as guarantors for founders building their credit for their business.
 - c. Convertible grants would also fund DivInc's early-stage portfolio and allow invested parties with the appropriate tax status (DivInc and primary funders) to hold long-term assets of equity for companies going venture way.
- 5. Numerous studies, including the latest from DropBox DocSend (2022), show that historically excluded entrepreneurs receive no more than 3% of venture capital; therefore, *the very act of deploying capital into their ventures* increases equity for this group of entrepreneurs and reinforces DivInc's stated objectives to "generate social and economic equity through entrepreneurship". (Home, n.d.)
 - a. Furthermore, given these particular financial products are very entrepreneur-friendly (metrics-based payback vs. time-based, "forgive-able" if metrics aren't reached) by utilizing these mechanisms, DivInc and its financial partners increase the ownership of historically excluded entrepreneurs in their own businesses, thereby contributing to closing the wealth gap and increasing equity over time.

The How

Fortunately, DivInc already has relationships and a track record with philanthropic and grant-based capital funders. Therefore, DivInc's path to implement these instruments is relatively straightforward.

It should also be noted that it is allowable under DivInc's status as a 501(c)(3) organization for a non-profit organization to both earn interest-based revenue from a convertible grant and hold equity in a for-profit company. Because these potential income streams are directly related to DivInc's mission, any earned income remains tax-free. (Bray, 2017)

With approval from DivInc's Board of Directors, DivInc could easily choose to devote a portion of its current grant allocation budget to piloting these models. Additionally, DivInc could adopt a "land and expand" model to pilot these mechanisms with additional capital from existing funders. Typically, funders are excited to hear about grantees' ability to deliver increased ROI on their impact funds.

While grants, recoverable grants, and convertible grants are distinct entities, per the current structure of DivInc's funding and the advantage of offering optionality to early stage founders running many business models, this paper proposes the following structure:

Metrics-based grant capital issued upon successful completion of the program, which includes a 24-month trigger. The trigger at month 24 is an opportunity for the founder to decide and execute one of the following “choose your own ‘Adventure (Finance)’” options per the most appropriate path for the founder (Power, 2021):

1. If assessed metrics show the venture is unlikely to grow, the founder will have an honest conversation about winding down or pivoting the venture, and in return, no expectation of return of financial investment is expected;
2. If assessed metrics show revenue or a path to revenue *and* the founder is interested to build credit, execute a recoverable grant structure with an interest rate based on a percentage of revenue not to exceed 5%. (This is similar to revenue-based financing, except the initial capital is based on a grant, which is treated as revenue, versus revenue-based debt issued pre-revenue);
3. If assessed metrics, based on revenue or engagement metrics, show a path to venture-style growth and likely future external funding, execute a convertible grant structure with terms similar to a convertible note. (Similarly, this structure would appropriately delay valuation and utilize a valuation cap; distinctly, the convertible grant sits on the balance sheet as income versus debt.)

Terms can be issued specifying the options in the grant agreement itself, with the “founder’s choice” side letter executed at 24 months.

[Here is a simple model](#) projecting gross returns to DivInc at different levels of funding:

Total Capital Granted to DivInc	\$250,000	\$1,000,000	\$2,500,000.00	Inputs - ok to change
Opex % "management fee"	0.05	0.05	0.05	
\$ to DivInc for Opex	\$12,500	\$50,000	\$125,000	Earned Income/ROI
Funding to Entrepreneurs	\$237,500	\$950,000	\$2,375,000	
Size of Grants	\$10,000	\$25,000	\$50,000	
Amount of Grants	23.75	38	47.5	
Startup Failure rate @ 2 years (impact IRR still 100%)	80%	80%	80%	
Amount of startups for ROI pool	4.75	7.6	9.5	
% projected to choose Recoverable Grants	.5	.5	.5	
Recoverable Grant interest rate/RBF rate	105%	105%	105%	
ROI on recoverable grant (liquidity begins @ 25 months)	\$24,938	\$99,750	\$249,375	

% projected to choose Convertible Grants	0.5	0.5	0.5	
Avg multiple on equity	5	5	5	
ROI on convertible grant (exit 5-8 years)	\$118,750	\$475,000	\$1,187,500	
Total Earned Income	\$143,688	\$574,750	\$1,436,875	
Total Return on Philanthropy (0% expected ROI)	160.50%	160.50%	160.50%	

A few things of note about these projections:

- While research from Startup Genome (2019) notes that 90% of companies fail within 2 years, the thesis of DivInc implies that those who go through their programs have improved odds of success. Therefore, the model puts the failure rate more optimistically at 80%.
- Even those who do not succeed in growing their companies still deliver positive ROI for DivInc on impact metrics based on DivInc's ToC to drive equitable access to entrepreneurship for under-represented founders. Said simply, in the case of DivInc: a negative financial ROI, can still prove a positive impact ROI.
- The return multiple of equity-financing is based on an presumed average between 3-10x.
- Finally, while a 1.6x return on investment is certainly not a "market rate return" of 10%, *it is definitively a value-add when compared to the 0% expected rate of return on the philanthropic capital.*

The Who - Internal

Given their expansion into venture capital, DivInc has precedent with their Board of Directors in navigating governance around deployment and potential conflicts of interest between their programming and financing. Additionally, DivInc already maintains positive working relationships with attorneys, financiers, and impact investors who have expertise in alternative financing and are excited to support alternative funding options as a complement to venture.

Additionally, DivInc would likely need a dedicated leader to raise, launch and manage these new capital strategies. This individual would need to have specialized interest and experience in alternative financing as well as the communications and relationship building skills to bring interested parties together in a piloted program. The new program could be resourced by:

1. expanding the responsibilities of an upcoming Venture Fund Manager to include alternative forms of catalytic capital;
2. engaging a contract-to-hire specialist as an Alternative Financing Principal who would partner with the Venture Fund Manager to assess the best options for the entrepreneur based on stage and model.

The Who - External → Raising the Pilot Capital

Fortunately, DivInc can take a “land and expand” approach with existing partners in corporate philanthropy. Every beneficiary makes the case that with more capital, they can create more impact. However, in this case, DivInc can show an attractive, virtuous cycle of reinvested capital that acts as a force multiplier for both impact and financial returns.

Additionally, as DivInc seeks *new* philanthropic capital partners including other corporate partners, high-net worth individuals, or foundations, their ability to use these instruments as force multipliers can be a competitive advantage for engaging philanthropists looking for innovative ways to expand their impact. New philanthropic capital partners may include other corporations engaging in corporate social responsibility efforts, and foundations who are aligned in mission to DivInc.

Finally, given the financial returns now promised by these capital allocations, DivInc can engage mission-aligned social impact investors who are investing as angels, syndicates, or through family offices. **It is important to note that these external funders are not engaging in philanthropy, therefore returns received would not wholly be to DivInc.** However, DivInc could consider engaging these parties individually or as a group on an ad hoc basis to co-invest directly into DivInc companies through Special Purpose Vehicles (SPVs) while charging a management fee, membership fee, or another structure to earn income for the value exchange of facilitating the transactions. Whether individually or as a group, the timing of the opportunity to co-invest pooled capital may be through the DivInc convertible grant structure or as follow-on equity investments into individual ventures in DivInc’s portfolio. These impact investors are recommended fundraising prospects due to the fact that their investment decisions are generally governed by an individual versus groups of people (such as governing Boards or Limited Partners); this is important because it oftentimes means they can be more flexible and creative with their capital both in terms of structure and returns (including accepting returns below market, or even sub 100%). Simply put, sometimes it can be easier to convince one person about a novel strategy, than mitigating groupthink which may trend more conservative. *(On balance, a word of caution about attracting “creative”, “independently-minded” investors is the importance of continuing to ensure terms and conduct are consistent with DivInc’s proposals and values.)* One final thing to note is that for some very well-endowed family offices the expected investment return timeline can span into a future generation; very seldom is this true with individual angels.

Conclusion

The very nature of entrepreneurs and specifically DivInc is to innovate. It has been the aim of this paper to explore additional revenue and financing options for DivInc, its funders, and the entrepreneurs DivInc serves. Looking beyond a “one-size-fits-*almost no one*” product like venture finance, and considering a “choose your own ‘Adventure Finance’” path for itself, its partners, and beneficiaries, seems only fitting for an organization focused on diversity!

Hopefully, the information provided here gives readers an actionable primer for piloting new streams of revenue (through convertible and redeemable grants) based on structures and partners DivInc already has in place. Additionally, as mentioned in the analysis of potential revenue streams within “financing with management fees”, there are financing options available to DivInc, its funders, and entrepreneurs even beyond what is discussed in depth in this paper. So, rather than a “conclusion”, readers are encouraged to internalize this case study as a catalyst for creating equitable and sustainable finance models.

Appendix

Appendix A

Analysis of Additional Revenue Streams

Potential Revenue Stream	Value Proposition	Advantage	Hazard
Vendor directory with paid advertising, referral fee, or paid membership	<i>If and when funded (through internal or external sources)</i> , DivInc founders represent business development opportunities for associated vendors (attorneys, bankers, talent acquisition partners, commercial real estate brokers, and others).	Linking a monetary exchange to the value exchange based on success-based incentives could be beneficial to all parties.	To maintain both functional and trust-based metrics, DivInc would be wise to keep an eye on the quality of mission- and skill-alignment of vendors referred through DivInc channels. While it would be good to not leave money on the table, because DivInc services <40 founders a year, this revenue stream may not produce a meaningful amount of revenue in comparison to relative program or administrative management.
Tiered memberships: philanthropy, model of sustaining donors (philanthropy)	Like a lot of mission-driven non-profits popular with consumers, DivInc could consider a tiered membership model to garner sustaining, unrestricted funds.	Community supporters of DivInc would have the ability to financially support the organization year-round at a level that is meaningful and affordable for them. This expands community support for their “category-building” efforts since people literally are – and <i>feel</i> – invested.	Given DivInc’s ability to successfully engage six-figure corporate sponsorships and grant funding, the Return on Investment of administering this low-dollar program is not likely to be compelling.
Co-working/buy a building	Because DivInc is hosting founders in a physical location for their programs, and successful ventures will continue to grow, DivInc could consider	This would provide an appreciating asset, earned income through rent of excess space to allied ventures (including founders and associated vendors), and yield programmatic synergies created through a physical	Real estate is a capital intensive, non-liquid, ongoing liability.

	investing in real estate.	center of ecosystem development.	
--	---------------------------	----------------------------------	--

Appendix B

Proposed Corporate Structures

DivInc is planning to organize its capital and related activities into the following legal structures.

Brand	Legal Structure	Purpose
DivInc.org	501(c)(3)	Programmatic and operating activities related to running the accelerator, supporting alumni, and ecosystem building
DivInc Foundation	501(c)(3) public charity	Grant-making to DivInc Founders
DivInc Ventures - Fund 1	Limited partnership (LP) or limited liability company (LLC)	This micro fund aims to serve as a pilot. A target raise of \$500k will deploy \$50k in convertible notes or SAFE agreements into ten pre-seed stage DivInc companies.
DivInc Ventures - Fund 2	Limited partnership (LP) or limited liability company (LLC)	With a target ranging from \$5-10mm (maybe \$25mm), this fund is proposed based on success of the micro-fund, and with an identified institutional investor who will seed this fund. The model is to return 80% back to investors, 15% to Fund Managers, 5% back to DivInc.org.

References

- 2020-2021 *Impact Report*. (n.d.). DivInc. Retrieved April 30, 2022, from <https://www.divinc.org/2020-2021-impact-report/#ourimpact>
- Bray, J. I. D. (2017, January 30). Tax Concerns When Your Nonprofit Corporation Earns Money. Www.Nolo.Com. Retrieved May 9, 2022, from <https://www.nolo.com/legal-encyclopedia/taxes-nonprofit-corporation-earnings-30284.html>
- DivInc. (2020). *Tax Year 2020 Form 990*. IRS.gov. https://apps.irs.gov/pub/epostcard/cor/813052133_202003_990_2020112017429695.pdf
- DropBox DocSend. (2022). *The Funding Divide 2022: Tracking Bias in Early-Stage Fundraising*. <https://docsend.com/view/ytshcechjuufnp27/d/gbh34qv8v8reep5m>
- Home. (n.d.). DivInc. Retrieved April 30, 2022, from <https://www.divinc.org/>
- Morales, M. (2021, July 30). *Expansion into Houston* [Press release]. <https://www.divinc.org/blog/houston-press-release>
- Our History. (n.d.). EMILY's List. Retrieved May 8, 2022, from <https://www.emilyslist.org/pages/entry/our-history>
- Power, P. A. (2021). *Adventure Finance: How to Create a Funding Journey That Blends Profit and Purpose* (1st ed. 2021 ed.). Palgrave Macmillan.
- Startup Genome. (2019, May). *Global Startup Ecosystem Report 2019*. <https://startupgenome.com/reports/global-startup-ecosystem-report-2019>
- Technical University Munich, Schwab Foundation Community of Social Entrepreneurs, & Schwab Foundation for Social Entrepreneurship. (2011, September). *Social Investment Manual, An Introduction for Social Entrepreneurs*. https://www3.weforum.org/docs/WEF_Social_Investment_Manual_Final.pdf