Nonprofit Finance Fund®
Where Money Meets Mission®

NFF 2013 SEGUE℠ Portfolio Performance Report

Dear Friends,

In 2006, Nonprofit Finance Fund (NFF) piloted a financial innovation intended to improve how nonprofits and funders work together to scale social impact. Philanthropic equity seeks to apply the for-profit concept of "equity capital" to organizational growth in the social sector, equipping social entrepreneurs with the flexible resources they need to evolve promising programs and helping funders play a catalytic role in scaling positive social outcomes. To maintain transparency, NFF developed an accounting methodology, called SEGUE, to track the 'burn' of philanthropic equity dollars separately from other revenue and capture the growing impact of an organization.

When we launched the philanthropy equity initiative, we surmised the following hypotheses:

- It would enable organizations to increase their impact
- It would help participating nonprofits leverage additional business model revenue
- It would allow nonprofits to grow more sustainably, with a greater likelihood of stability at the end of its phase of growth

Eleven organizations and their funders made this concept reality, taking on an infusion of philanthropic equity and using it to grow, take risks and ultimately deliver more or enhanced services. Since the beginning, each organization has used NFF's SEGUE methodology and accounting principles. Today, eight years into the program, we can see exactly how the organizations in this program have evolved. In short, we see astounding results that support our hypotheses:

- The cohort has increased impact by a compound annual growth rate of 23%
- Business model revenues for these organizations have grown on average by a factor of 3.7x, representing a total of $142 million additional dollars annually
- Sustainability has increased by 16 percentage points across the cohort, with those in the later stages of their growth plan experiencing 36 percentage points of improvement

Eight years of data also reveals much about the critical ingredients and practical strategies for growth. We've seen that growth does not always happen exactly as planned. At the outset of their campaigns, most organizations anticipated a one-time, high intensity growth spurt as a result of philanthropic equity. And many achieved it. Donors Choose, for example, grew dramatically, scaling by 11-fold in both program delivery and business model revenue while increasing sustainability from 15% to 111%. Others, however, experienced unanticipated trajectories. YES Prep and Year Up experienced growth as significant as anticipated, but upon achieving that growth recognized and seized the opportunity to grow again using the same tools. Other organizations successfully adjusted their plans in the face of new circumstances. Both VolunteerMatch and Neighborworks' Success Measures raised less capital than anticipated but were able to achieve exceptional results by adjusting their plans real-time.

Philanthropic equity has become an organizing principle that gives both nonprofits and funders a common platform on which to engage in transparent conversations about the goals of growth. It also enables nonprofits to build out timelines that anticipate funders' winding-down from capital support, while having in place mechanisms for ongoing revenue at the end of that road.

Perhaps most importantly, philanthropic equity makes a distinction between two different categories of funding: building and buying. Builders invest in a nonprofit's enterprise—for specific purposes that include scaling, risk-taking, and business model adaptations. Buyers pay for services, providing ongoing revenue for nonprofit leaders to carry out programs that work. For decades, confusion between these two types of funding -- each critical for its distinct purpose -- has handicapped organizations in their aspirations for stability. Both are essential, but conflating the two leads to unintended challenges, particularly for organizations in times or growth of change.

"Building and buying" is a mindset that asks funders and investors to keep the specific goals they are seeking to achieve at the heart of their grantmaking approach and align their funding, reporting, and engagement with their chosen role. It asks nonprofits to share this understanding of how money works within their own organizations, to communicate more clearly and rigorously, and to bridge the communication gaps that still plague our sector on all sides. As a nonprofit ourselves, we recognize how difficult it can be to live these practices.

The organizations that have leveraged this distinction in building and buying capital through the use of philanthropic equity have by in large undergone healthy growth and produced impressive impact results. However, interest in the field has gravitated toward less formal approaches to "build" capital. The benefit of informal approaches may be that these concepts play out more broadly and reach more organizations. The risk is that without robust financial information and accounting structures in place, investments intended to function in an equity-like manner may be absorbed for other needs and never secure a sustained increase in impact. Or worse, that the concept will be applied for fundraising or marketing goals in the absence of corresponding strategic and operational plans, again limiting the opportunities for success.

As we look at the experience of cohort organizations and their partners, we can offer the following observations about how the concept of "build" money can be applied by funders and nonprofits:

- Funders: The most successful campaigns have been driven by engaged funders to champion the effort and engage other funders to support the campaign. We encourage funders to continue to seek out grantees with the potential for growth and to continue to collaborate with other funders to support high-potential organizations.

- Nonprofits: Nonprofits that are data driven, transparent with their funders and that are not afraid to market what they do, and what they need to do it, have achieved astounding results. We encourage nonprofits to rigorously collect and analyze data (and to seek funding to build those capabilities) and work with funders to determine a path toward sustainability.

Our philanthropic equity methodology is one effort among many to help nonprofits and funders get the most out of their collaborations. As we continue to see the "build/buy" mindset take hold, we believe that our sector will transform the communities we serve by enabling great nonprofits to reach their potential. We have come a long way. And we have quite a long way to go.

Sincerely,

Craig Reigel	Julia Bromka
CFO, NFF	Associate Director, NFF

The question of financial sustainability in the nonprofit sector is an important and perennial point of discussion, and the Nonprofit Finance Fund (NFF) model of philanthropic equity offers a conceptual breakthrough in what had become a stalled conversation. By introducing a new way of thinking about investing in the impact and long-term viability of nonprofit organizations, "philanthropic equity" provides a measurable and targeted way for donors to understand how their investments contribute to the health and productivity of individual organizations. But it also is an important contribution to how we think about the sector as a whole.

Philanthropy – and other forms of donor support – function as part of a complex system driving positive change in our world. Whether catalyzing innovation, sponsoring time-bound impact-oriented projects, funding ongoing service delivery, or providing core support, philanthropic spending still only constitutes one of many critical inputs to the process of social change. We must always seek more sophisticated and sector-specific knowledge of how philanthropy contributes to change within this complex system. This systems-oriented approach to philanthropy has relevance to government, private sector entities engaged in social change, and, of course, to the nonprofit sector. We need to work collectively to deploy funding models that are tailored to the incentives and dynamics of each of those parties in our social system.

In recent years, some foundations and nonprofit organizations have developed sophisticated understandings of how this collective thinking can unlock previously untapped private and public financial capital for social change by acknowledging and addressing risk, ratings, and returns metrics. For example, The Rockefeller Foundation participated in the New York Acquisition Fund, which pooled philanthropic resources from multiple foundations to absorb the high-risk tranche of an investment structure. This approach drew in $190 million in private capital, supporting the construction of 5,000 units of affordable housing. And NFF's philanthropic equity framework helped Yes Prep, an educational nonprofit, secure federally subsidized bond financing for buildings, greatly reducing the direct cash cost required to build out its schools. Social impact bonds are another rapidly developing impact investing tool that connects philanthropic, government, and private financial resources for social good.

Working with nonprofit organizations, the key partners for most philanthropies, requires an equally sensitive and sophisticated understanding of the incentives, dynamics, and financing structures that best support both individual nonprofits and the ecosystem of nonprofits as a whole. Providing philanthropic equity investments for our essential nonprofit partners supplements existing forms of financial support, including traditional project-targeted grants, program related investments, core support, and many others. Equity investments that support change within organizations are another tool to ensure impact on specific goals, and to provide growth and change capital.

Throughout its history, The Rockefeller Foundation has explored and developed new models of philanthropy, tapping into the newly emerging forces across the sectors that influence our work. We believe that NFF's philanthropic equity ideology is a critical asset in our capacities to create positive social change. We have directly supported philanthropic equity campaigns with Ashoka Changemakers, VisionSpring, and Shared Interest, serving as lead funder in the successful Ashoka Changemakers campaign. We have also supported NFF's efforts to bring this idea into the mainstream of the philanthropic sector, recognizing that growth capital helps us support the long-term health of a sector.
This report on Nonprofit Finance Fund's SEGUE portfolio offers more evidence of the benefits of this compelling model of philanthropic support, and we are happy to support NFF in this innovative new approach to growing the capacities of the nonprofit sector.

Sincerely,
Robert Garris
Managing Director, The Rockefeller Foundation

THE ROCKEFELLER FOUNDATION

Building is Not Buying

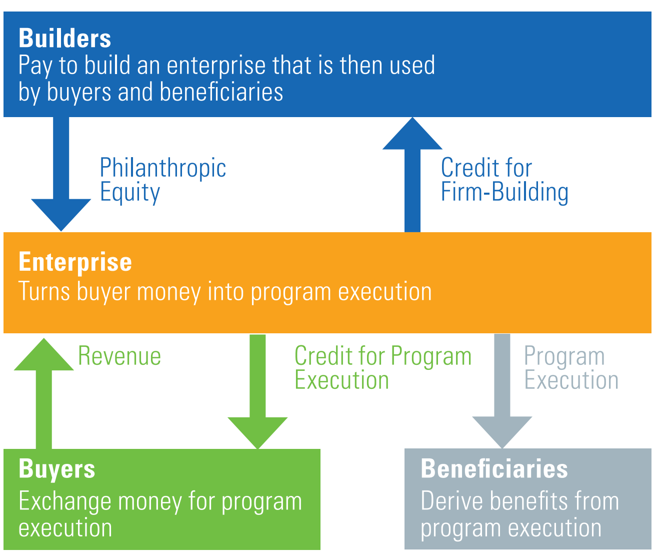
Thriving nonprofits, like all businesses, need two distinct types of funding: funding that helps build the foundation of an organization and funding that buys the services it provides. Nonprofit Finance Fund's work in philanthropic equity is based on the principle that defining and enabling distinct builder and buyer roles has the potential to transform the sector.

Buyers Provide Regular Revenue

Nonprofits are in the business of turning money into effective program execution. Buyers purchase program execution; they buy tickets for museum admission or provide scholarship grants that pay for individual tutoring sessions. Without buyers, programs don't happen. However, buying doesn't pay for growth, trial and error, shifts in strategy, or changing what an organization is capable of doing. It's about asking the enterprise to continue to do what it already does, year in and year out.

Builders Provide "Change" Capital

What if a nonprofit needs to change what it can offer to the public, modify its operations, or improve its efficiency? This is where builders come in. They provide philanthropic equity. The equity is used to rebuild the business model; a builder fills the normal gaps in revenue incurred throughout the period of change. The equity provider's aim is to build an organization that is not only better at executing mission but also attracts even more reliable buyers for the foreseeable future.



For more information on the distinction between building and buying, see George Overholser's seminal article at http://nonprofitfinancefund.org/files/docs/2010/BuildingIsNotBuying.pdf

What Are the Benefits of Build-Buy Consciousness?

- Focus on enterprise strategy: Philanthropic equity puts the organization's strategy at the center of the conversation, aggregating funders around a single theory of change.
- Funder exit strategy: Build-buy accounting allows equity holders to track whether they have given rise to a sustainable enterprise, from which they can confidently exit without program demise.
- Equity holder's ethic: Equity holders protect the enterprise from overexploitation. Given sufficient equity, managers can turn down grants that don't fully cover costs, or resist the temptation to grow too fast.

Philanthropic Equity Done Right

At NFF we believe that the following characteristics are fundamental to the meaning and purpose of philanthropic equity and should be incorporated into field-wide standards.

- **Invested at the Enterprise Level.** Unlike essential program-level finance, enterprise-level finance is unambiguous. Deficits and surpluses cannot be "manufactured" or transferred elsewhere through discretionary allocations between programs. Thus, as is the case with for-profit equity, philanthropic equity should be deployed and monitored at the enterprise level.
- **Funds Cumulative Deficits Incurred En Route to Sustainability.** Philanthropic equity is designed to subsidize an organization until it reaches a point where its activities are fully sustained by buyer-type funders, under a chosen business model. Beyond this point of sustainability, enterprises should be viable without further infusions of equity.
- **Transparent, Intentional, and Provides Feedback.** Philanthropic equity requires intentionality up front and transparency throughout. Builders of an organization will not invest without clearly laid-out enterprise-level plans for the achievement of sustainability and a guarantee of prompt and efficient feedback on the impact of their investment.

Portfolio

To date, NFF has supported 21 campaigns for philanthropic equity, involving a grand total of $327 million in philanthropic commitments. Eleven comprehensive engagements have yielded $97 million of campaign commitments, eight advisory engagements have yielded $196 million, and two redirected campaigns have yielded $34 million.

Comprehensive SEGUE engagements, which are the focus of this report, typically consist of:

- An assessment of the organization's capacity to launch a campaign;
- Due diligence on the organization's leadership, track record, strategy, operations, finances and sustainability outlook;
- Pressure-tested and refined operating plans;
- Development of a formal investment prospectus;
- Implementation of NFF's SEGUE accounting methodology[1];
- Development of financial and social metric reporting methodology.

It is important to note that NFF neither invests its own philanthropic equity nor acts as an agent to raise funds on behalf of its clients. NFF empowers and supports organizations in their efforts to raise philanthropic equity. The money raised in these campaigns is raised by the organizations themselves, often with the help of their existing funders.

All $ values in millions

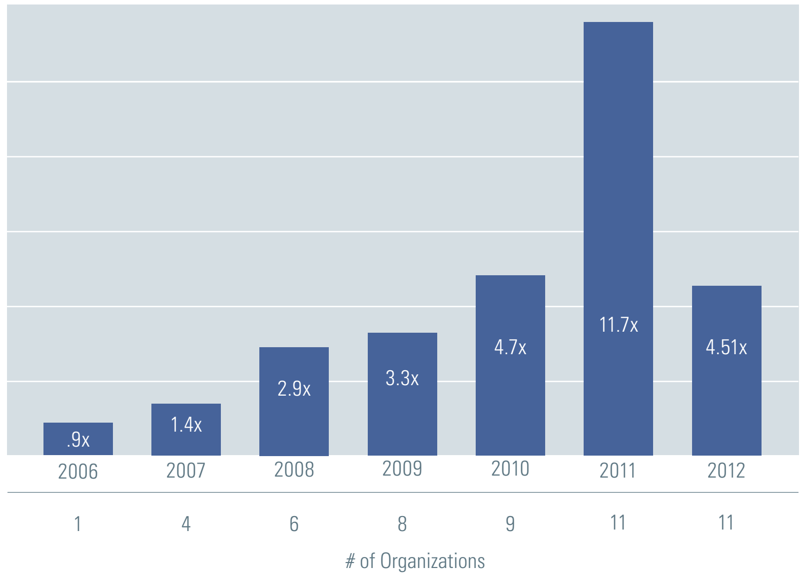
Campaign Start	Organization	Description	Philanthropic Equity Raised to Date
Comprehensive Engagements			
2006	GlobalGiving	International Giving Portal	$10
2007	DonorsChoose.org	Education Giving Portal	$14
2007	VolunteerMatch	Enabler of Volunteerism	$4
2007	Year Up	Workforce Development	$19
2008	Ashoka Changemakers	Online Social Impact Competitions	$3
2008	VisionSpring	Base of the Pyramid Eyeglasses	$3
2009	Stand for Children	Education Advocacy	$6
2009	YES Prep Public Schools	Charter Management Organization	$25
2010	Health Leads	In-Clinic Resource Connections	$11
2011	Shared Interest	International Development Finance	$2
2011	Success Measures	Participatory Outcome Evaluation	$.25
		Total Comprehensive Engagements	$97
		Total Redirected	$34
		Total Advisory Engagements	$196
		Total Philanthropic Equity Raised	**$327 Million**

Program Delivery Growth

For each group, we select a key metric as representative of the evolution of impact. Obviously, for most nonprofits no single measure truly represents impact. Additional metrics are actively measured by each organization.

Among the 11 comprehensive engagements for which multi-year data are available, annual program delivery has grown on average by a factor of 4.5x, with a compound annual growth rate of 23%. Although a few organizations experienced significant fluctuations that brought down the average rate, most organizations continue to perform well above the industry average.

Average Program Delivery Growth[2]
(Compared to Pre-Campaign Baselines)



Campaign Start	Organization	Program Delivery			
		Metric	Baseline	Current[3]	Growth Multiple
2006	GlobalGiving	Project Resources Delivered	$1,684,000	$20,000,000	11.9x
2007	DonorsChoose.org	Student Resources Delivered	$2,600,000	$28,900,000	11.2x
2007	VolunteerMatch	Value of Volunteer Hours	$294,000,000	$745,000,000	2.5x
2007	Year Up	Youth Served	352	1,525	4.3x
2008	Ashoka Changemakers	Innovation Funds Seeded	$7,000,000	$700,000	0.1x
2008	VisionSpring	Eyeglasses Sold	35,000	369,000	10.5x
2009	Stand for Children	Education Reform Victories	15	20	1.3x
2009	YES Prep Public Schools	Students Enrolled	2,008	6,679	3.3x
2010	Health Leads	Clients Served	4,487	8,871	2.0x
2011	Shared Interest	Total Guarantees Outstanding	$1,500,000	$1,800,000	1.2x
2011	Success Measures	Organizations Served	167	241	1.4x
				Average Growth Multiple[4]	**4.5x**
				Average CAGR[5]	**23%**

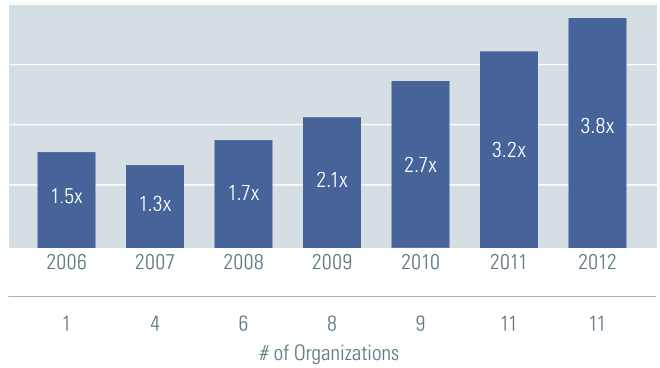
Business Model Revenue Growth

Each organization's business model represents the revenue-generation methods by which it intends to sustain its long-term enterprise operations. By definition, business model revenues exclude philanthropic equity and other extraordinary (i.e., non- recurring) revenue. However, it is important to note that an organization's recurring revenues may be made up of either contributed (philanthropic) or earned revenue, or a combination of the two.

Among the 11 comprehensive engagements for which multi-year data are available, annual business model revenue has grown on average by a factor of 3.7x, with a compound annual growth rate of 28%. In aggregate, business model revenues have expanded by $142 million compared to pre-campaign baselines. We expect ongoing business model revenue to expand further as the organizations continue to implement their sustainable growth strategies.

The growth multiple for each organization describes the extent to which it has increased business model revenue (recurring "buy" revenue), compared to revenue in the last year prior to their campaign.

Average Business Model Revenue Growth[6]
(Compared to Pre-Campaign Baselines)



All $ values in millions

Campaign Start	Organization	Business Model Revenue[7]		
		Baseline	Current[3]	Growth Multiple
2006	GlobalGiving	$1.0	$4.1	4.1x
2007	DonorsChoose.org	$3.5	$40.5	11.6x
2007	VolunteerMatch	$2.5	$4.5	1.8x
2007	Year Up	$11.1	$47.8	4.3x
2008	Ashoka Changemakers	$0.9	$4.8	5.3x
2008	VisionSpring	$1.2	$3.3	2.8x
2009	Stand for Children	$4.2	$16.4	3.9x
2009	YES Prep Public Schools	$17.9	$ 57.8	3.2x
2010	Health Leads	$3.3	$7.4	2.2x
2011	Shared Interest	$0.87	$1.0	1.1x
2011	Success Measures	$1.8	$2.5	1.4x
			Average Growth Multiple[4]	**3.7x**
			Average CAGR[5]	**28%**

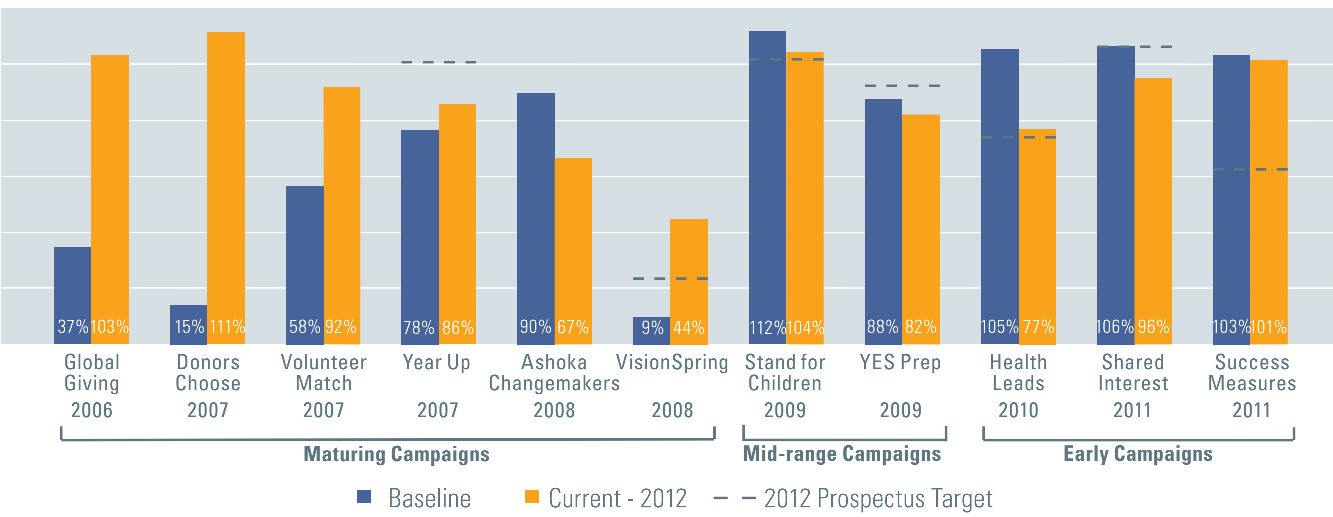
Sustainability

Any organization is sustainable when its full cost of operating is covered by the revenues from its business model. While NFF firmly believes healthy nonprofits need profits to thrive, a first step is simply reaching sustainability. This is particularly true for growing or changing organizations. Tracking progress toward sustainability is a defining feature of philanthropic equity, and SEGUE in particular.

The sustainability ratio is measured as the ratio of business model revenue to total operating costs. Those business model revenues are the collectively reliable, recurring sources of income. They need not be strictly earned. For example, public radio has been sustained for decades by contributed revenues. What is important is that business model revenues pay for the programs that are offered year over year. Operating costs are simply the ongoing costs of doing business. These are generally all costs, including non-cash items such as depreciation, but excluding one-time, extraordinary expenditures.

It is important to not assume a sustainability ratio of 100% as a standard. In planning growth, organizations often intentionally spend in advance of revenues, expecting the revenue to catch up later. The most common use of philanthropic equity is to fund such intentional, interim deficits. In fact, many organizations' sustainability dips as they invest in growth. Mature organizations should seek more than 100% to build reserves and allow for investment. The critical issue is that they reach (or return to) sustainability at the far end. Thus, we also include the planned level of sustainability for each client in the analysis below.

Among the 11 clients for whom multi-year data are available, on average, sustainability has increased 16 percentage points from their baseline year. More tellingly, clients in the later stages of their planned growth average a gain of 36 percentage points.



Campaign Start	Organization	Sustainability Metric[8]		
		Baseline	Current[3]	Prospectus 2012 Target
2006	GlobalGiving	37%	103%	n/a
2007	DonorsChoose.org	15%	111%	n/a
2007	VolunteerMatch	58%	92%	n/a
2007	Year Up	78%	86%	101%
2008	Ashoka Changemakers[9]	90%	67%	n/a
2008	VisionSpring	9%	44%	32%
2009	Stand for Children	112%	104%	102%
2009	YES Prep Public Schools	88%	82%	93%
2010	Health Leads	105%	77%	77%
2011	Shared Interest	106%	96%	106%
2011	Success Measures	103%	101%	62%

Client Summaries

Social entrepreneurs post their vetted projects on GlobalGiving.org, giving donors an intimate look at the projects' unique needs and work. Donors and corporate partners research causes by topic or location, and donate to projects that match their interests. GlobalGiving is sustained by percentage- of-donation fulfillment fees and fee-for-service consulting revenue.

DonorsChoose.org's online marketplace allows citizen philanthropists to find and fund classroom projects posted by public school teachers around the country. Project sponsors receive direct feedback and "thank-you" packages from sponsored classrooms. The business model is sustained by an optional percentage-of- donation fee.

VolunteerMatch offers a variety of online services to support a community of nonprofit, volunteer and business leaders committed to civic engagement.

Year Up is a one-year, intensive training program that provides urban young adults with six months of technical and professional skills and college credits, and six months of a corporate internship. Operations are supported by a combination of corporate internship revenues and local and national philanthropy.

Ashoka Changemakers supports ideas, mentors, donors, and networks in achieving social change through an online community at Changemakers.com. Changemakers uses a fee-for-service model in which foundations pay Changemakers to host topic- specific online competitions.

VisionSpring has established proprietary distribution channels in India and El Salvador to provide the BoP consumer with access to high-quality, affordable eye care services and glasses. The Global Partnership program enables VisionSpring to leverage existing networks, broadening the scope of the work while adding value to other organizations.

Client Summaries

By building local and statewide networks of grassroots support, Stand for Children focuses on helping children succeed in school, ensuring that public schools are adequately funded, and promoting education policy reforms. Stand for Children trains ordinary citizens to be leaders in addressing the issues that are most critical to children. Stand for Children's business model is sustained by local and national philanthropic support.

YES Prep Public Schools is a charter management organization (CMO) that operates 6th-12th grade, open- enrollment charter schools in the Houston area. The model is sustained by a combination of federal and state education funds, student activity fees, community support, and philanthropic fundraising.

Every day, doctors prescribe antibiotics to patients who have no food or are living in a car. Of course, medicine alone won't solve these problems, and many of these patients will return with more serious and expensive illnesses. In the clinics where Health Leads operates, healthcare providers can prescribe food, heat, and other basic resources their patients need to be healthy. Patients then take those prescriptions to our desk in the clinic waiting room, where our well-trained college student advocates work side-by-side with patients to access community resources and public benefits. We envision a healthcare system that addresses all patients' basic resource needs as a standard part of patient care and leverage our on-the-ground work as a platform to realize this vision.

Shared Interest enhances South and Southern African banks' abilities to meet the pent-up demand for credit in their country's majority market through loan guarantees, training & technical assistance, and engagement with banks. The organization is sustained by loan guarantee fees.

Success Measures provides community development organizations and their funders with participatory outcome evaluation tools, consulting, training, and technical assistance services supported by a subscription to the Success Measures Data System (SMDS). The organization is sustained by fees for service and SMDS subscriptions.

Notes

1. The Sustainable Enhancement Grant (SEGUE) accounting methodology is a set of grant stipulations and accounting techniques that clearly delineate the flows of business model revenue and philanthropic equity in an organization's audited financial statements. These techniques allow providers of philanthropic equity and other stakeholders to track the amount of capital that is deployed for the purposes of building the organization versus revenue attracted to fund program execution.
2. Program Delivery Growth is the evolution of a key impact metric. Example: Among the six organizations for which multi-year data were available in 2008, the straight average of Growth Multiples was 2.9x.
3. The current values referenced for all organizations are from fiscal year 2012.
4. For each client, "Growth Multiple" was calculated separately as the ratio of the "Current" level of program delivery to the "Baseline" level of program delivery. "Average Growth Multiple" was then calculated as a straight average of Growth Multiples across the clients for which multi-year data were available in that year. Example: Among the six organizations for which multi-year data were available in 2008, the straight average of Growth Multiples was 1.7x.
5. For each client, "Compound Annual Growth Rate (CAGR)" was calculated separately as the compound annual growth rate in service delivery during the period spanning between the Baseline year and Current year. "Average CAGR" was then calculated as a straight average of CAGRs across the clients for which multi-year data were available in that year.
6. Business Model Revenues are repeatable, reliable revenues that sustain an organization over time.
7. Business Model Revenue excludes Philanthropic Equity. For some clients, it further excludes extraordinary revenues that were raised using methods that differ from the revenue generation methods intended to ultimately sustain the organization.
8. For example, if an organization has a $5 million budget and receives $3 million in fees and $1 million in annual fund contributions, it would be 80% sustainable.
9. Ashoka Changemakers' Prospectus Metric includes Direct and Indirect Innovation Funds Seeded. The metric was mislabeled in previous versions of this report. In 2012 Ashoka Changemakers underwent a rebuilding year. Their 2013 sustainability metric was 100%.

About

As one of the nation's leading community development financial institutions (CDFI), Nonprofit Finance Fund (NFF) makes millions of dollars in loans to nonprofits and pushes for fundamental improvement in how money is given and used in the sector. Since 1980, we've worked to connect money to mission effectively so that nonprofits can keep doing what they do so well.

We provide a continuum of financing, consulting, and advocacy services to nonprofits and funders nationwide. Our services are designed to help great organizations stay in balance, so that they're able to successfully adapt to changing financial circumstances—in both good and bad economic times—and grow and innovate when they're ready. In addition to providing loans and lines of credit for a variety of purposes, we organize financial training workshops, perform business analyses, and customize our services to meet the financial needs of each client. For funders, we provide support with structuring of philanthropic equity and program-related investments, manage capital for guided investment in programs, and provide advice and research to help maximize the impact of grants.

Visit us! **nff.org**

This Performance Report was made possible through the generous support of The Rockefeller Foundation.

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