Venture capital investing boom neglects startups tackling poverty

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The venture capital investing boom has sent billions of dollars to startups that serve the upper crust of society with an app to deliver your laundry or order a valet to park your car, yet many VCs continue to resist investing in viable businesses bringing toilets, water and electricity to the rural poor.

For years, companies whose aim was to improve the lives of the poor or downtrodden were dismissed as charity work, not for calculating investors. These days, social-impact businesses are increasingly proving to be profitable investments, but VCs still pass on companies that offer access to the potentially huge market of developing Asian and African nations, where billions of people are poised to enter the middle class with money to spend and access to technology, according to interviews with dozens of entrepreneurs and investors.

"Silicon Valley has a lot of money," said Peter Scott, founder and CEO of BURN, which sells clean-burning stoves to Kenyan families and helps them finance the purchase. "We thought money would just flow to us. But it's not. I'm worried that I can't raise more capital."

Scott was one of nine entrepreneurs selected for the Social Entrepreneur Fellowship funded by tech giant SAP and impact investing firm Acumen, a program that offers social-impact entrepreneurs three months of mentorship and access to Silicon Valley leaders during a weeklong stay here. Their visit in July, say experts, highlights the disparity in access to funding between Silicon Valley startups and companies working in rural, poor communities.

"It's very unlikely that you're going to invest in a social company that has the payoff of, say, Uber," said Eric Nee, managing editor of the Stanford Social Innovation Review. "So Benchmark or Kleiner, they're not going to do this."

But if investors can find the same courage to fund social-impact startups that the early institutional backers of the fledgling venture capital industry showed decades ago, social entrepreneurs could have the chance to move the needle on ailments - poverty, disease and lack of education - affecting billions of people, and deliver financial returns at the same time, according to William Sahlman, a professor of entrepreneurship for 35 years at Harvard Business School, who in 2013 co-authored a paper titled "Social Impact Investing Will be the New Venture Capital."

"It's always really frustrating to hear really, really terrific entrepreneurs doing terrific things and they can't get funding," Sahlman said in an interview.

Some VCs are starting to show interest. VC investments into U.S.-based companies working on technology for rural agriculture, malaria treatment, water purification, new stove technology, toilets and hygiene, microfinance and other technologies to assist communities in poverty grew from $151.9 million in 2010 to $267.2 million in 2014, according to data provided by Dow Jones for the San Jose Mercury News. That's a 76 percent jump, but still just 0.5 percent of the $50.1 billion invested by VCs nationally last year.

Impact investing generally refers to investments in companies that, in addition to promising a financial return, also offer a benefit to society or the environment. The pedigrees of the other SAP social-impact fellows show just how compelling those benefits can be.

Consider John Waibochi, whose company, Kenya-based Virtual City, builds mobile technology for small farmers to track their harvests and get paid through a mobile cash advancement that can be used to buy fertilizer, farm equipment or even pay for school. The technology is used by more than 350,000 tea farmers and 90,000 dairy farmers. Waibochi says he has raised $4.5 million, but needs another $6 million to grow the company.

David Auerbach, a Massachusetts Institute of Technology graduate who lives in Nairobi, Kenya, says his startup, Sanergy, sells toilets to community members living in slums, whose alternative has been a plastic bag or public toilets that are notorious grounds for sexual assault. The company collects the waste and turns it into fertilizer that is sold to farms in Kenya, a growing revenue stream that will help the company break even in 2017. Its finances might look promising, but it tackles problems alien to VCs.

"It really does involve a commitment from Silicon Valley to take the time to get to know us and get to understand what we're doing," Auerbach said.

But some VCs argue their job is to take calculated risks on technology they are familiar with, in a ZIP code they know, to find the next Google or Facebook - not to make bets on a company halfway across the world working under the threat of an Ebola outbreak or a military coup.

"It is seen as a distraction from maximizing your return for your investors," said Ashmeet Sidana, founder and managing partner at VC firm Engineering Capital.

VC firms raise money from institutional investors that include endowments and pension funds, which have a fiduciary responsibility to protect peoples' money, not bet it on better hygiene in East Africa, say experts.

"If I run CalPERS, I'm not going to try and simultaneously solve an investment problem and a social problem," Sahlman said, referring to the California Public Employees' Retirement System.

Yet the mainstream VC industry is increasingly in the minority in its aversion to impact investing, an increasingly profitable, if risky, business. The field has grown to include investors of all types: Big banks such as Bank of America and JPMorgan Chase have cut checks for tens of millions of dollars to nonprofit or boutique impact investing firms - the number of which has soared in the last five years.

JPMorgan says it one day hopes to sell its financial services to that part of the world, which is why it has dedicated $100 million to businesses serving poor and rural communities. These startups can bring more technology and economic power to consumers, the theory goes, so they are one day ready to be JPMorgan customers.

"This is a business opportunity for a lot of organizations," said Amy Bell, head of principal investments for social and sustainable finance at JPMorgan. "We are intentionally trying to invest in markets that are important and where we see our business is going to grow."

Others include SAP, which has made a $500 million investment in 51 African countries through 2020. San Francisco-based impact investing firm DBL Ventures just raised its third fund, a $400 million pot. Massachusetts-based investment fund Root Capital has made more than $900 million in loans to social-impact companies, and gotten 97 percent of that capital back.

LeapFrog Investments has raised $535 million in two funds "which in the impact field is pretty unheard of," said Stephen Bowey, a partner at the global impact investing firm. "But we think that's just the start.

"There is a financial return in this business, and not just any financial return, but exceptional returns," Bowey said. "We don't aim to compromise on that issue."

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