Phillip Kim Impact Investing - SullivanSays

SUMMARY KEYWORDS
michelson, founders, companies, students, impact, investment, student aid, venture, investable, world, phillip, called, organization, market, terms, continue, koji, emergency, mission, business

SPEAKERS
Phillip Kim, Jerry Sullivan

Jerry Sullivan  00:01
This is Jerry Sullivan for 'Making an Impact with Michelson Philanthropies.' This edition has been recorded remotely in observance of social distancing, please excuse any inconsistencies in the audio. Today we're going to talk with Phillip Kim, Managing Director of Michelson Impact Ventures. Phillip brings his background and venture capital to the entrepreneurship that melds with philanthropy under the Michelson umbrella. Welcome, Phillip.

Phillip Kim  00:30
Thank you, Jerry.

Jerry Sullivan  00:32
Let's start with the basics. There's a lot of concepts out there: social enterprises, environmental, social, and governance investment approaches. And in the case of your organization, impact investing. Can you just give us a little walk through the lexicon there? And are there differences? And how would you explain them?

Phillip Kim  00:51
Sure, I guess first, it should be noted that this is an actively evolving space. And there's still some debate about how those different terms of art kind of Venn diagram or you know, sit and nest within each other. And so there's a lot of confusion. So I don't know if I need to throw up a legal disclaimer or anything, but generally how we think about it, and I think everything that you just mentioned sits under this term of socially responsible investing or SRI. And the unifying theme across all those categories comes down to deploying capital with an intentionality, an intentionality of generating some sort of positive social outcome or social impact. And within that, mission related investments is kind of that main subset of SRI where we live. And it's probably the most widely used term and is usually interchangeable with impact investing. And MRIs are what they sound like, they are investments that generate a reasonable rate of return while aligning to some social mission of the organization. But MRIs do not have any specific legal definition or requirement under charitable guidelines or other constraints. And so Michelson Impact Ventures, we say that we are social change fund, deploying impact investment capital into early stage, purpose driven, but for-profit startups, and we work in the education technology, healthcare, future of work, future of food, human-animal bond, and sustainability sectors.
And the specific vehicle that we use, because we are routing all of these through our 501c3 organizations is a subset of MRI called program related investments. So program related investments are essentially MRIs but PRIs have additional requirements that they must, for example, further an explicit charitable exempt purpose of an organization and cannot be solely focused on profit. And this is where our entire 50 company portfolio lives. There's also the additional requirement in most of these sectors that profits that are realized must be used then in the future for exempt purposes with PRIs, so in practice, we of course, see these investments as direct impact vehicles, but also as a means to power future impact investment work, grant making, or programmatic capacity as well.

Jerry Sullivan 03:21
And so you have a foot in two worlds, philanthropy and the world of commerce, and where do you fit in each? When you try and explain to somebody from the commerce side, what are we, and when you try to explain to the philanthropic side, where do you fit in each of them?

Phillip Kim 03:35
Well, I think in the 12 years that I've worked with Dr. Michelson and and Alya, we realized that there are real limitations to grant making, and often that in those blind spots, a complimentary market oriented, market driven approach can be extremely effective. I think we all can acknowledge or sense that there's an agility, a nimbleness, a scale factor often and maybe some sustainability elements as well that are inherent to profit driven startups that are absent from the nonprofit world. So all of our portfolio companies, though, are very closely aligned to our programmatic areas of focus. In terms of where we sit in that universe, we are very close to the look, feel and function of traditional early stage venture capital investments. So we try to always be catalytic capital, the earliest riskiest capital that's vital for these companies to survive to that next phase of venture funding and broader impact. And we stay with those companies through growth rounds and hopefully an exit. And so most of our 50 company portfolio has come through one of our accelerator programs, Michelson Runway, in the education and work space and Leap Venture Studio in the healthcare and sustainability and that world. So where we bring in cohorts of founders and provide not just capital but support on everything from product market fit to customer equity, fundraising, branding and more, this really goes back to the DNA of our founder, who's a physician, but made his fortune as an inventor, and is really still very deeply entrenched in the innovation ecosystem. So it's really sort of that spirit and legacy that really binds us to these earliest stages. And we want to be with innovators at that critical point.

Jerry Sullivan 05:24
And so you have the entrepreneurial drive captured in the DNA. And of course, the mission of backing ideas, innovations that improve life are really truly the broader mission of the whole Michelson Philanthropies approach. Is this a case of looking to do well by doing good? Is it that simple? And how difficult can it get?

Phillip Kim 05:46
Yeah, if you think about it at the individual investment level, at the portfolio company level, yeah, I think all those common addages broadly apply, companies that do well, by doing good, that marry purpose and profit, conscious capitalism. You hear a lot of the two sided labels there. And I think as the space
matures, and more investors come into it, we hear different ways that people explain how these companies can be characterized, as the engine and tires of a race car, the train tracks on the locomotive. One metaphor that I found, actually, to be pretty succinct recently was from an MD at another major foundation, and they described one of these companies in the sense of a simple bicycle, where the back wheel which is generating all the forward force, is profit. So the enterprise is driven by financial return. But the front wheel that's guiding and steering the business is impact and purpose. And so for us, I think we go a little bit further and we are pretty deliberate in our impact first philosophy, where we say we will only invest in a company where its financial success is wholly contingent on its success from a social impact perspective. One exemplar from our portfolio is a company called Wild Earth. This is a company that recognized that meat and kibble is responsible for up to a third of the environmental impact of meat consumption in the US. And they engineered a proprietary Koji based protein creation process, and you're familiar with Koji if you've had miso soup, that produces natural, clean and extremely efficient protein. And that's the heart of their business. And already in their brief time in market, they've replaced 10 million meals. The impact is the core of that company. So that really is what we look for. But at the same time, we do want those companies to be able to scale that impact. So making sure that we are picking founders and betting on companies that will be able to grow the business to the point where that exponentially grows, that 10 million meals save that impact of their protein is able to continue on a climb. And while they were, for example, it was just able to raise another round of funding at somewhere north of $100 million valuation, so this is the kind of story that we're looking for, where it's core to the business, and we can hope for that large scale factor impact.

Jerry Sullivan 08:03
And of course, a key to the story will always be execution. So you want to make the impact and of course, also looking to have it to make business sense, and that requires execution. You have an example in Edquity. Tell us about Edquity as a challenge and how that's gone. And maybe that's a good example for our listeners.

Phillip Kim 08:24
Yeah, instead of challenge, I might use the word opportunity for Edquity. And it's one that we're at the moment very excited about, because it's just so core, and so well aligned to one of our programmatic priorities, which is emergency student aid. Edquity in a nutshell, is a platform that is bringing emergency student aid out of the dark ages. The idea is that, for many students, particularly lower income students, an unforeseen expense of $300 or something like that can mean the difference of dropping out or finishing out a semester. There's a lot of research now that shows that a car break down a dental bill, anything like that, can really derail a student on their educational path. So more and more institutions have emergency student aid dollars that are earmarked for situations like that, but the way that they're delivered, it was extremely underutilized. It was inefficient. There was no way often for many of those institutions to even track the impact of those dollars after students received aid. It was done in a physical location on campus, so a student might go in, and it could be two or three weeks before they got an answer on these things. And so that I think fundamentally is at odds with the idea of emergency student aid. And with Edquity, those applications can now be finished by a student on their mobile device in seven minutes on average, decisions are turned around within 24 hours and funds hit the very next day. And not only that, the process removes stigma and biases and actually allows for institutions
to track the impact of the aid for those particular students, as crazy as that idea sounds. So Edquity did a recent pilot with our friends at Compton College and found that the students that were on the Edquity platform and had access to this resource were twice as likely to graduate as students that weren’t. And if you think about what that means for the system, and the reason why Edquity for us is such a promising company, is that the very existence of that platform should change the way system leaders, legislators, other folks manage the purse strings of emergency student aid. It should change the way they think about that. The research is there to show that this is a very effective and high return intervention. And that now you have a legitimate tool in your kit to help these students in their time of need, and be able to support them and persist to a degree hopefully. Now, Edquity has already deployed almost $30 million in aid, but as we realize in this era with COVID and everything else, and we start to have a better understanding of just how food and housing insecure students in the California Community College System, but Community College systems across the country, are, we do think that Edquity is going to be at the forefront of changing the conversation of how we think about emergency student aid. And this is exactly, it’s a perfect exemplar of what we want to surface and uplift in our investments. This is something that can directly impact millions of students. But it has another level of scale factor to it, because it fundamentally transforms the calculus and the nature of the way we talk about it even in a legislative context or in a policy sphere.

Jerry Sullivan  11:34
And just to let listeners know, we're talking about student aid, not student loans. So this is not microlending. The company itself is really a service provider that would facilitate this for a school or campus or system, is that the way to understand it?

Phillip Kim  11:50
Correct. These are sort of small grants, in time grants for students for their educational success.

Jerry Sullivan  11:55
And you mentioned earlier Dr. Gary Michelson, who started his foundation with his wife Alya, and he’s described the mission as ‘making life a little less unfair.’ What does that mean in practice for your wing of the organization?

Phillip Kim  12:11
That philosophy from Dr. Michelson and Alya, I think really permeates all the different branches of the Michelson entities. Specifically for us, our vision statement is ‘to accelerate progress towards a more just and compassionate world.’ The example of Edquity is definitely emblematic of that. We want to support companies and founders that will better serve the underserved, that will foster more equitable opportunities and greater access. Another example is our latest investment as well in a company called New Apprenticeship, which focuses on bringing underrepresented minorities into tech careers by providing them earn-as-you-learn pathways. And these are for students that have historically not had the luxury of being able to take an unpaid internship. These are real pathways into tech jobs. But I think we also take that idea of making the world less unfair in a different context, not just in terms of the audiences or markets we serve, but also in terms of the founders and the companies that we invest in. At the moment, we hope to continue to grow this because we’ve been very deliberate about it, 64% of
our portfolio companies have a female founder or founder of color, which is about four times the
broader venture market. And it's not just about setting a quota and meeting it, it's about really
supporting and growing the ecosystem of diverse founders, and actually recognizing that companies
with diverse founders tend to outperform the broader market. As an example, in this vein, we're part of
a new platform called Coalition Venture Studio, which is trying to further address this VC funding gap,
where if you look at the broader market, less than 1% of total venture capital is going to Black founders.
So we alongside groups like Silicon Valley Bank, Harlem Capital, Mag Venture Capital, are a founding
partner for this new model of innovation platform powered by a big national agency called RGA. And
this is the digital agency behind Nike, Mercedes, Netflix, Samsung, a lot of marquee brands. The
intention here is to open up the world of those agency resources and connections to those different
corporations to up-and-coming Black founders, and that could result in mentorship pilot programs,
direct investments. It's about continuing to uplift that entire ecosystem so that we have more
representation at the founder level, because we think those folks have insights that can serve the
audiences and markets that we care about as well.

Jerry Sullivan 12:27
We hear a lot about de-risking, of course, everybody likes to remove as much risk as possible from any
investment or business or anything else. And it seems to be really at the heart of trying to blend that
marketplace drive with the desire to make life a little more fair. Talk to us a little bit about de-risking.
How do you try to do that and at what point do you say, there is some risk so we're going to go forward?

Phillip Kim 14:57
Well, we are always of the mindset that we're okay with the risk. We want to de-risk opportunities for
others. Again, it goes back to that Michelson DNA, that legacy that we want to be with founders at that
critical point. And the idea of de-risking, it goes back to one of those common venture frameworks.
There's this moment for many startups, I think all startups, where you cannot generate enough revenue
to effectively fundraise and be investable but you need to fundraise in order to get to that revenue level.
So it's this classic catch-22 moment where these founders are just not investable, and they're
struggling. This is referred to generally as the 'pioneer gap.' And it is often most pronounced for impact
oriented companies versus your traditional consumer or enterprise play, just because there's more
friction on that path to get to that early revenue. So our role as we see it is to provide that patient, risk
tolerant and expert capital to carry companies through, to de-risk them enough so that they are more
investable to the broader venture market, and therefore their mission of making the world fair gets to
see the light of day because they're able to cross this chasm, which is for many founders, the end of the
road. We see our place kind of playing that critical role, particularly for founders and companies that are
mission aligned, and then you feel it when they hit that next phase of their evolution. It's happening now
with Edquity. It certainly happened with Wild Earth. There's another company in our portfolio called
Shameless Pets, they saw an opportunity into the 63 million pounds of food waste that's generated
every year and they go out and rescue unused ingredients or upcycle to create functional treats for
dogs. And since our involvement with them through our Leap Venture Studio, they now have
distribution in thousands of Whole Foods locations Wegmans, Target, Costco, they're upcycling
500,000 pounds of food, and raising now another round from a much more traditional set of venture
capitalists. So for us, that's exactly the outcome we're looking for. We play at that stage to make sure
that we can be part of that inflection point where they are de-risked to become more investable, and therefore their impact tends to have a better shot of seeing the light of day.

Jerry Sullivan 17:12
And you have 50 companies.

Phillip Kim 17:13
We do.

Jerry Sullivan 17:14
Is there room for more? Is that a number you can see growing? Do you have a limit to your capacity on that?

Phillip Kim 17:20
Well, the venture model, unfortunately, is that there's quite a bit of attrition, you know, for most. We've been lucky that most of those companies are still around and operating. It's pretty amazing that a 50 company portfolio still exists in its form, but we will start to see acquisitions and exits. Four of our companies were recently acquired, and we hope to see many more in the next 12 to 24 months. A lot of our companies now are nearing cumulatively a $200 million mark in terms of follow on funding since our participation. So that kind of growth and the pace at which the companies will continue to progress will also hopefully lead to more acquisitions and exits there as well. 50 is a pretty large number for any fund. But I think we continue to see great companies in the ecosystem. So our hope is that we can continue and we'll start to realize some of the successes there as well, but keep on moving forward at a similar pace.

Jerry Sullivan 18:14
And where would someone go to learn more about the organization?

Phillip Kim 18:17
Our current landing page, because this is sort of a new banner for us at Michelson Impact Ventures, is at michelsonventures.com, and certainly you can look at any one of our single accelerator programs, Leap Venture Studio and Michelson Runway, but feel free to reach out if there's any interest. If you're a founder that's looking for funding and are mission aligned or if there's anyone in your orbit that is, please don't hesitate to reach out.

Jerry Sullivan 18:39
Great job. Phillip, thank you for your time and your insights. It's been a pleasure and keep up the good work.

Phillip Kim 18:45
Thank you.

Jerry Sullivan 18:47

This has been 'Making an Impact with Michelson Philanthropies.' For more information, visit michelsonphilanthropies.org. That's Michelson spelled M I C H E L S O N.