Hybrid Organizations
Innovations Toward Sustainability

Master’s Project

by:

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Agenda

- Definition and Background
- Project Overview
- Methodology
- Survey
- Case Studies
- Learnings and Conclusions
- Q&A
What is a hybrid organization?

Kim Alter - Virtue Ventures Definition

Hybrid Spectrum

Traditional Non-profit | Non-profit with Income-Generating Activities | Social Enterprise | Socially Responsible Business | Corporation Practicing Social Responsibility | Traditional For-profit

Mission Motive • Profit-making Motive
Stakeholder Accountability • Shareholder Accountability
Income reinvested in social programs • Profit redistributed to shareholders or operational costs

source: http://www.virtueventures.com/
Our Multi-dimensional Definition

Mission Motivation

Profit Motivation

Hybrid organizations exist that are highly driven by both profit and mission.
Literature Review

Well Studied Research Areas

- Corporate Social Responsibility
- Sustainable Entrepreneurship
- Nonprofit Social Enterprises

Gap Area

Mission-driven for-profit companies
Hybrid Organization

a market-oriented and common good mission-centered organization that may exhibit the following characteristics:

- non-financial performance valuation
- privately held by a connected set of shareholders
- sub-market rates of return
- alternative capitalization

Hybrids are also known as
- The fourth sector
- Blended Value
- B-Corporations
- For-Benefit
Environmental sustainability mission-driven companies encompass those where direct business activity (products or services), or where the most significant inputs, raw materials, or resources, contribute to at least one of the following basic human needs:

- Clean water
- Clean air
- Clean energy
- Sustainable food/ag
- Sustainable housing
Project Overview

- **Objective**: explore the effectiveness of hybrid organizations in contributing to positive environmental sustainability outcomes

- **Goals**:
  - Identify **innovative business trends** that help hybrid organizations meet environmental and profit objectives
  - Understand **critical challenges** faced by hybrid organizations and the solutions used to overcome them
  - Document learnings to **create value** for other practitioners and **provoke discussion** about hybrids
Methodology

Phase 1
- Literature Review
- Project Design
- Define Company Criteria

Phase 2
- Survey Design
- Company Selection & Outreach
- Survey Distribution & Analysis

Phase 3
- Case Study Selection & Design
- Interviews
- Case Writing

Phase 4
- Final Report Write-up
- Presentation of Findings
In addition to meeting our definition of a hybrid organization with an environmental sustainability mission, the companies also needed to meet the following criteria:

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Rationale</th>
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<tr>
<td>For-profit companies only</td>
<td>Aligns with research gap identified in literature review</td>
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<tr>
<td>No restriction on size, revenue, or age</td>
<td>Desire to gain comprehensive insights on sector</td>
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<td>No intermediaries, consulting companies, or investing companies</td>
<td>Desire to focus on practitioners in the hybrid sector to optimize lessons learned from those “on the ground”</td>
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<tr>
<td>No organizations with publicly traded shares (subsidiary of public company permitted)</td>
<td>Desire to focus on private companies, without legal fiduciary responsibility to shareholders</td>
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Survey Design

- Five focus areas
  - Business Model and Strategy
  - Finance
  - Organization
  - Process and Metrics
  - Innovation

  5 to 7 questions were created for each category

- Survey pre-testing with DTE, Green Order and Goodwill Industries

- Survey Monkey used to administer online
Company Selection & Outreach

- Sources: internet research and personal contacts
- 160 companies met initial screen
- Outreach conducted in 3 phases over 2 months

CEOs were preferred person to complete survey

<table>
<thead>
<tr>
<th>Initially Contacted</th>
<th>Expressed Interest</th>
<th>Submitted Survey</th>
<th>Included in Analysis</th>
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<tr>
<td>160</td>
<td>87</td>
<td>53</td>
<td>47</td>
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</table>
Sample Respondents

- CLIF Bar
- Stonyfield Farm
- Eden Organic
- Seventh Generation
- Freeplay
- New Belgium Brewing
- Annie's Naturals
## Survey Analysis

### Identity of Questionnaire Respondents

#### Median Demographics

<table>
<thead>
<tr>
<th>Company Age</th>
<th>Annual Revenue</th>
<th>Number of Employees</th>
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<tbody>
<tr>
<td>7 years</td>
<td>$1.5 million</td>
<td>20</td>
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</table>

#### Headquarters Location

<table>
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<tr>
<th>North America</th>
<th>South America</th>
<th>Europe</th>
<th>Asia</th>
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<tr>
<td>85%</td>
<td>5%</td>
<td>7%</td>
<td>3%</td>
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#### Environmental Focus

<table>
<thead>
<tr>
<th>Clean Air</th>
<th>Clean Energy</th>
<th>Clean Water</th>
<th>Sustainable Food / Ag</th>
<th>Sustainable Housing</th>
</tr>
</thead>
<tbody>
<tr>
<td>40%</td>
<td>50%</td>
<td>35%</td>
<td>40%</td>
<td>10%</td>
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</table>
### Summary of Hybrid Organization Trends

<table>
<thead>
<tr>
<th>Organizational Characteristic</th>
<th>Observed Pattern for Hybrid Organizations</th>
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</table>
| **Business Model and Strategy**    | ‣ 66% believe they do something *completely different from competitors*  
‡ Innovative product and environmental features are key sources of competitive advantage |
| **Finance**                        | ‣ 50/50 split between positive and negative profit margins  
‡ 59% of hybrid funding comes from patient capital |
| **Organization**                   | ‣ 75% are led by transformational or participative leaders  
‡ 83% have “fully-integrated environmental sustainability” |
| **Processes and Metrics**          | ‣ 55% track environmental metrics |
| **Innovation**                     | ‣ 65% have “notable innovations” relating to innovative product or service |
Hypothesis: Hybrids have to define new go-to-market strategies to be successful vs. traditional firms

Observation: 66% of hybrids believe they do something completely different than the competition

Conclusion: While hybrids may carve out niche territory, competition follows quickly

“SpringStar provides effective, non-toxic and environmentally safe pest control products; it's a [n]ew way to do an old thing - organic food is analogous” – SpringStar
Hypothesis: Hybrids cater their products to LOHAS consumers

Observation: Innovative product and higher quality are best sources of competitive advantage

Conclusion: Product innovation and quality suggest premium pricing as method to differentiate hybrids

“Our all-natural composition [an Environmental Feature] is a significant competitive advantage.” – Burt’s Bees
Proficiency Analysis

- **Hypothesis:** Hybrid organizations have limits to profitability to meet their environmental mission.

- **Observation:** 50% of hybrids willing to disclose their profitability were actually profitable.

- **Conclusion:** Profitability continues to be a challenge for hybrid organizations, however, our study was skewed toward younger organizations.

"We are a new business (at least on the US end of things), and therefore still in the red! .... On the Zambian side of things .... the farmers have been profitable for over 5 years" – Zam-Bee-A Honey.
Financing Analysis

- **Hypothesis:** A significant proportion of hybrids are financed from patient funding sources.

- **Observation:** 59% of the respondents’ financing comes from patient capital sources.

- **Conclusion:** Hybrid investors may balance investment return with environmental performance.

Patient financing is an advantage that "allows us time and flexibility to test and de-risk our model rather than having to rush to market to earn profits." — Cleanstar Energy
Observation: 83% of respondents believe environmental sustainability is “fully integrated”

Hypothesis: Hybrids integrate environmental sustainability throughout all levels of the organization

Conclusion: Hybrids believe they succeed at adopting environmental sustainability throughout their firms

“The mission-first nature of our organizational structure has been a source of advantage in achieving environmental sustainability goals because the founders have set lofty personal environmental goals that radiate down through the company.” – Reforest Teak
Observation: 55% of respondents track environmental metrics somewhere in the value chain

Hypothesis: Hybrids track environmental performance of suppliers, customers, and internal operations

Conclusion: Hybrids may lack resources to track metrics or may believe it to be unnecessary based on integration of mission

“Our company is all about environmental sustainability - it's what we do. Our processes result in cleaner air - [the metrics] are intrinsic.” – CleanAir Logix
Leadership Analysis

- **Hypothesis:** Hybrids are driven by charismatic and passionate leaders

- **Observation:** 75% of respondents are led by “transformational” or “participative” leadership

- **Conclusion:** Hybrids tend toward collaborative over command-and-control styles of leadership

“Michael's [CEO] door is always open. He doesn't always agree, but is willing to take time to look at your idea”

– Eden Foods
Observation: 65% of respondents have “notable innovations” but 80% of those are product-related

Hypothesis: Hybrids have innovative business models in order to meet market and mission goals

Conclusion: Hybrids believe their innovations come primarily from product and service design

Notable Business Model Innovations:
- Market Driven Restoration
- Personal Supply Chain Relationships

“We have been designated as the first Certified Green Fast Food Restaurant in the United States ... as a result of our purchasing local food [and] having as close to a zero waste stream as is possible.”

– The Grille Zone
2 Key Criteria

1. **Environmental Stewardship**
   - Founded with environmental mission
   - Fully integrate environmental sustainability
   - Positive operating margin

2. **Profitability**

9 “Best-in-class” Companies

- Burt’s Bees
- Eden Foods
- Guayakí
- Jasco Organics
- Maggie’s Organics
- Method
- PAX Scientific
- SUN OVENS International
- Zam-bee-a Honey
Eden Foods

**Mission:** To provide the finest whole food, procured from growers and processors we personally know and trust. Making food that tastes great and is good for you.

**Market:** Producer and distributor of organic foods

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<th>Eden Foods, Inc 2008</th>
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<tr>
<td>Year Founded</td>
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<tr>
<td>Annual Revenue</td>
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<tr>
<td>No. of Employees</td>
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<tr>
<td>Headquarters</td>
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</tbody>
</table>
| Environmental Focus                                                                  | • Clean Air  
• Clean Water  
• Sustainable Food / Agriculture |
| Profitability Level                                                                  | 0 – 5% Profitability |
Eden Foods

Lasting Leadership

- Oldest U.S. natural foods company
  - Helped define industry
  - Weathered increasing competition
  - Mission consistent for 40 years

- Michael Potter, President and CEO
  - With company since the beginning
  - Dedicated and passionate leader

“We do it the hard way. We do it the right way and that gives me peace of mind to sleep at night”

– Sue Becker, Director and VP of Marketing and Sales
Mission: To work directly with growers to deliver unique and beneficial products that enhance personal health and well being. To create economic models that drive reforestation while employing a living wage.

Market: Distributor of organic, rainforest grown, fairly traded yerba mate, a healthy caffeine and energy alternative to coffee.

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<th>Guayakí 2008</th>
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<tbody>
<tr>
<td>Year Founded</td>
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<td>Annual Revenue</td>
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<tr>
<td>No. of Employees</td>
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<tr>
<td>Headquarters</td>
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</tbody>
</table>
| Environmental Focus| • Sustainable food/ agriculture  
|                     | • Sustainable housing  
|                     | • Fair traded commodities |
| Profitability Level| Operationally Profitable |
Creating an entirely new value chain

- Market Driven Restoration
  - Environmental stewardship: rainforest preservation
  - Social justice: support Guayakí people
  - Economic viability: premium product

“All of our decisions are mission-centered which explicitly includes social and environmental stewardship of our whole supply chain.”

– Pierre Ferrari, Guayakí VP of Marketing and Sales
Maggie’s Organics

**Mission:** To produce and provide comfortable, durable, affordable and beautiful articles of apparel and accessories made from materials that restore, sustain and enhance the resources, including human, from which they are made.

**Market:** Oldest U.S. distributor of organic apparel

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<td>No. of Employees</td>
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<tr>
<td>Headquarters</td>
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<tr>
<td>Environmental Focus</td>
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<tr>
<td>Profitability Level</td>
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Maggie’s Organics

Connecting Producers and Consumers to the Cause

- Producers
  - Direct, personal relationships
  - 100% worker-owned cooperatives
  - Education on benefits of organic

- Consumers
  - Storytelling packaging and marketing
  - Distribution to “organic” consumers via natural food retailers

“I am not a fair trade person and I am not socially responsible. This is simply the way we choose to do business and we wouldn’t do it any other way.”

– Bená Burda, Founder and President
Mission: PAX applies nature’s core design principles to engineer energy efficient products that enhance and sustain life on Earth.

Market: Biomimicry inspired engineering research company that develops fluid handling equipment.

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<th>PAX Scientific 2008</th>
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<td>Environmental Focus</td>
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<tr>
<td>Profitability Level</td>
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PAX Scientific

From Crawling and Walking...Learning to Run:

- Struggled to enter fan technology market
- Modest success in water applications
- Shifting gears to scale
  - Funded by Khosla Ventures
  - Spin-off PAX Streamline
  - More aggressive emphasis on financial return

“We have our eyes on a very big prize...reducing energy use on the planet by 20%” – Francesca Bertone, COO
**Mission:** To develop solar cooking solutions that radically decrease dependence on fuel wood and dung while benefiting the environment, raising the standard of living and improving the health of the poor worldwide.

**Market:** Manufacturer and distributor of solar-powered ovens for the world’s poor

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**SUN OVENS International 2008**

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<tbody>
<tr>
<td>Year Founded</td>
<td>1998</td>
</tr>
<tr>
<td>Annual Revenue</td>
<td>~$700,000</td>
</tr>
<tr>
<td>No. of Employees</td>
<td>6</td>
</tr>
<tr>
<td>Headquarters</td>
<td>Elburn, IL, USA</td>
</tr>
<tr>
<td>Environmental Focus</td>
<td>• Clean Air</td>
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<td>• Clean Energy</td>
</tr>
<tr>
<td>Profitability Level</td>
<td>Positive Operating Margin</td>
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</table>
The Patient Deal Maker: Combining Morality and Patience

- Financial Uncertainty
  - Skirting with bankruptcy
  - Fending off takeover offers
  - Recovering from Y2K losses

- Market Risks
  - Finding appropriate local entrepreneurs
  - Educating customers on cost and benefit
  - Handling geopolitical strife

“It is morally wrong and inconsistent to go bankrupt to escape the creditors” – Paul Munsen, President and CEO
Implementing the mission in action

- Creative practices or ingrained learning that continuously reinforces the mission
- Mission embedded in business model and all decisions

“Sharing out of the same vessel breaks down barriers and is a real unifier for the employees. It keeps everyone connected.”

- Chris Mann, CEO, Guayakí
Uncommonly Close, Personal Relationships

- Deliberate personal connections to suppliers, producers and customers
- For hybrids, business is clearly personal

“Developing relationships with people who work in mills and sew our garments is one of the unique things about Maggie’s”
- Bená Burda, Founder & President, Maggie’s Organics
Ambitious missions across generations require patience for all stakeholders.

"Know who you are and let that guide your decisions...practice continual humility."
- Francesca Bertone, COO, PAX Scientific
Limits to Growth Rate

- In balancing mission and profit goals, hybrid organizations can be challenged to scale their business.

“We have to make sure our product is sustainable and it takes more time. Other companies, who do not take [mission-driven] sourcing into consideration would be able to scale up much faster.”

- Chris Mann, CEO, Guayakí
Many hybrid organizations compete as quality market leaders in their industry.

New game strategies build novel market segments.

"Eden is all about stewardship and responsibility...another company can purchase from China...our responsibility is to support North American agriculture and organics.”
- Jon Solomon, Purchasing Director, Eden Foods
Integrated Innovative Practices

- Combination of several innovative business practices makes hybrids distinct from traditional organizations and allows them to meet mission- and market-centric goals.
- No single practice, rather an integrated system of the parts that bridge the gap of mission and finance.
Effective, But Limited

- Hybrid organizations are effective in contributing solutions to some of the world’s most pressing issues
- Evidence of targeted, self-sustaining successes
- But, potentially limited scale, particularly for place-based solutions
Sincerest Thanks and Appreciation to:

<table>
<thead>
<tr>
<th>University of Michigan</th>
<th>Hybrid Organizations</th>
<th>Advisors</th>
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<tbody>
<tr>
<td>• Andy Hoffman</td>
<td>• Survey respondents</td>
<td>• Andy Hoffman</td>
</tr>
<tr>
<td>• Kelly Janiga</td>
<td>• 5 case studies</td>
<td>• Kelly Janiga</td>
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<tr>
<td>• John Branch</td>
<td>• Survey pre-test</td>
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A special thank you to all of our family and friends who have supported us over the past year!
Q&A