Ross Baird

Village Capital's Peer Selection Model
Empowering Entrepreneurs and Investors to Create Value Together

Innovations Case Narrative:
Village Capital

Innovation can be anywhere. While most people in the entrepreneurial world define innovation as the products and services that entrepreneurs are selling, Village Capital's core innovation—peer-allocated capital— transforms the way that investment capital builds companies. Ultimately, our peer-selection model changes the power dynamic between entrepreneurs and capital providers in a way that leverages the comparative advantage of each actor, and enables them to create more value together.

Since 2010, Village Capital has launched 22 programs in seven countries and made over 30 peer-selected investments. Through these programs, we have served over 350 ventures worldwide, building disruptive innovations in energy, environmental sustainability, agriculture, health, and education. Enterprises started by program graduates have raised more than $40 million in follow-on funding to date, creating 5,000 jobs and serving five million customers worldwide. While the entrepreneurs and programming have changed significantly over time, one question has always been at the core of Village Capital: What if entrepreneurs could invest in each other?

In this case I describe how we developed the Village Capital peer-selection model as a disruptive approach to building and developing ventures: the model's origin, evolution, results to date, and implications for funding innovations worldwide more efficiently.

Ross Baird is the Executive Director of Village Capital. Before Village Capital, Ross worked with the impact investment fund First Light Ventures, where he helped build a 20-enterprise portfolio over the past three years. He has startup experience in Hyderabad, India, with the Indian School Finance Company, and also started two independent ventures in the U.S. focused on civic participation. He has an MPhil from the University of Oxford, where he was a Marshall and a Truman Scholar, and a BA from the University of Virginia, where he was a Jefferson Scholar.

© 2013 Ross Baird

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

WHY PEER SELECTION?

The Problem: Entrepreneurs are building enterprises that funders, not customers, want.

Entrepreneurs need cash—in the form of either revenue or investment—to fuel the growth of their businesses. Historically, when teams launch a business, they are working hard on one side to discover customers, while simultaneously meeting with angel investors, foundations, venture capital firms, and banks. At their best, these processes work together, but all too often the two kinds of activities create wildly different messages for the entrepreneur.

The primary reason a firm should raise money is that the current revenue (and underlying demand) from customers is not strong enough—yet—to support the expenses of the company, constraining its operations and growth. Entrepreneurs often need time to find the right product and the right market—and in these early stages, investors typically fund the cost of this discovery. This process can take years. For example, Amazon.com, founded in 1994, did not turn its first profit until 2001, but two years earlier, in 1999, Jeff Bezos, its founder and CEO, was already being named Time Man of the Year.

So, on the business side, entrepreneurs are discovering exactly what products or services their customers want, but on the financial side they are looking for the cash they need to deliver those products or services. In theory, these two processes should be linked, but in practice entrepreneurs often face a harmful dissonance. While both activities are equally important, entrepreneurs often find themselves spending more time on raising capital, believing that injecting more cash will ease their operations and facilitate growth more than customer validation could on its own. Too often, "getting funded" is their primary goal, rather than finding authentic demand from real customers.

Because of this situation, investors have tremendous power to dictate which enterprises get a shot, and which don't. This power dynamic is most detrimental to the most innovative businesses that have the potential to be revolutionary but are considered too high-risk. Why? Two reasons. First, banks have little ability, mandate, or incentive to lend to higher-risk concepts, no matter how transformative they may be. Second, because venture capital firms have become more professionalized over the past 25 years, investors are now looking for quick wins, specifically, IT-based consumer technology that can be acquired or go to an IPO in three to five years. As a result, in their early days, entrepreneurs cannot adequately finance their businesses just from customer revenue, and they have a very specific incentive to build the type of business that investors want so they can get the necessary cash from them.

Founding Village Capital

I entered the investment world not from a traditional finance background but as an entrepreneur. In 2009, I went to work for a mentor of mine, Bob Pattillo, at First

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

Light Ventures, an independent seed fund affiliated with Gray Ghost Ventures, a large impact investment firm that Bob had created. Bob, a successful entrepreneur, had dedicated his career to building and supporting enterprises worldwide that provided attractive financial returns *and* solved major social and environmental problems. Bob created First Light as a vehicle to change the way that businesses were built, and he hired me to join his team and build a different way of starting businesses.

I originally got to know Bob in 2004, when he invested in an education enterprise I had started in the United States; I later worked for an education startup in India that Bob had also invested in. So when I began working for First Light, I approached our investment strategy through the lens of an entrepreneur, not an investor. First Light's mandate was very broad; we were looking at enterprises around the world that were solving social and environmental problems, and we were very open-minded and experimental about what might work.

Immediately, though, I felt three pain points as an early-stage investor trying to work with impact-oriented enterprises.

1. Entrepreneurs talked about what we—the investors—wanted to hear, not what their customers wanted to buy. In conversations with entrepreneurs, we noticed that they asking about our "investment criteria"—and we didn't really have many. And they were crafting their strategies around what we were saying. "What do we need to do to get investment?" was a common question.

2. The skewed power dynamics between the entrepreneurs and investors limited the value many investors can actually add to the businesses. In some sectors where I had more experience (specifically education) I saw some areas where I thought we could add value, but I felt our suggestions had undue influence over entrepreneurs. I saw entrepreneurs jumping through hoops to get funding from people who were not tangibly adding value, simply because that was the only cash available, without feeling free to pursue what customers were telling them if it was at odds with the investors' ideas. And I saw that investors like us were ultimately constrained in our ability to add value because we always felt we had a target on our backs, from entrepreneurs who were targeting us for dollars rather than for advice, contributions, or value.

3. When investors did add value, the scale was quite small. Each year, First Light Ventures got thousands of business plans from eager entrepreneurs requesting financial and advisory support. Like most venture capital firms, First Light Ventures only had the bandwidth to conduct due diligence on a fraction of the plans we received—and we could provide investment and advisory support to even fewer. This meant that literally thousands of innovative ideas buried in business plans flooded our desks, but each year we only reviewed 60 to 80 of them, and only 10 to 12 of them ended up becoming part of our portfolio. This highly inefficient due diligence process was—and still is—the status quo practice of most venture capital firms and angel investing groups. I became frustrated at the amount of time, work, money, and energy it wasted. There *had* to be a more efficient way to source, vet, support, and invest in enterprises.

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

I had frequently experienced the worst-case scenario: investors ultimately say no to the businesses, partly because the combination of an overwhelming flood of opportunities, and limited bandwidth to act on a subset, makes them too risk-averse in the end. Then the entrepreneurs fail, because they are building what funders want instead of what customers want. It was painful to see so many businesses and investors waste so much time either evaluating or being evaluated—time that could instead be spent on developing and investing in innovation.

In short, the traditional due diligence method of venture capital creates adverse incentives for entrepreneurs to actually discover customers, and it seriously limits the value that good investors can add. In the end, it takes a great deal of time to request information from entrepreneurs without creating positive growth for the company.

Barriers to Innovation

So Bob and I, and the rest of the team, began to think. How could we do this better? As we thought through the development of a solution to enable more transformative enterprises, we identified three key problems that thwart early-stage innovation.

Problem 1: Enterprises' demand for support drives the supply of venture capital support services.

Reality: Enterprises' demand for financial and advisory support far outweighs firms' capacity, even collectively, to conduct due diligence on all these ventures and to provide the most promising ventures with the mentorship and investment capital they deserved. "Going for funding" is opaque and frustrating, and delivers very little value to the enterprises that are not funded.

Result: Countless innovations that have the potential to change the world are never tested or scaled. Everyone loses: the entrepreneur fails to launch a world-changing enterprise, the investors miss out on a lucrative investment opportunity, and the lives of the theoretical customers and beneficiaries of the innovation miss out on its potential.

Reaction: How could an investment and due diligence process provide more enterprises—especially early-stage enterprises with untested innovations—with more extensive mentorship, feedback on products, and helpful advice, but without necessarily investing immediately? How could all the enterprises seeking advice and investment from investors benefit from the due diligence process instead of it being a zero-sum game?

Problem 2: Lack of early-stage capital and risk aversion thwarts the testing of new innovations.

Reality: At any stage, the process of due diligence is expensive and impossible to do at the early stages in a cost-effective way. According to one institutional investor cited in a 2013 World Economic Forum report, "the due diligence time required for a US$10 million investment is the same as the time required for a US$100 mil-

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

lion investment; our resources are best spent on the larger deal."[1] This economic reality explains why seed-stage investments (those between US$25,000 and US$250,000) in early-stage companies are so rare. Even the early-stage investors that do exist must pay the salaries of a professional investment team to source enterprises, conduct due diligence, and manage the portfolio to bear the pressure of producing market-rate financial returns. This naturally makes them risk-averse.

Result: The cost of deploying capital at the seed stage is one of the largest barriers preventing new hypotheses from being tested. This means that investors—including the few early-stage ones—continually pass over the most risky, but undoubtedly the most revolutionary and game-changing, ideas.

Reaction: What if entrepreneurs were given a space to test their ideas with customers and the time to receive feedback from their peers? And in a format that appropriately addressed and mitigated risk. Would more revolutionary ideas grow legs?

Problem 3: Skewed power dynamics between entrepreneurs and investors warp innovations.

Reality: Few entrepreneurs have the capital necessary to test and scale their innovation, especially first-time entrepreneurs who cannot self-finance. Therefore, most entrepreneurs must rely on investors to make their vision become a reality.

Result: To secure investment, entrepreneurs cater their innovation and vision to the criteria of the investors, ultimately building ventures that fit investors' vision, rather than creating products or services customers need and want in reality.

Reaction: What if the seemingly inherent power dynamics of the venture capital world were balanced by having entrepreneurs also play the role of investors? Would entrepreneurs receive more useful feedback from potential customers, industry practitioners, and other innovators who are creating products and services that address a problem or pain point similar to the one their product or service is designed to address?

Real Problems, Potential Solutions

How could we solve these three problems? Over many months (and lots of coffee, Diet Coke, and beer), we developed three keystones for a Village Capital process:

- **Make the due diligence add value.** The enterprise evaluation process could be changed so it would be relational rather than transactional, especially at the early stage, where traditional elements of due diligence, such as historical cash flows, were nonexistent. And it could focus more on adding value to enterprises instead of just evaluating them.
- **Focus on customers, not investors.** Entrepreneurs should interact more with customers during their product refinement phase and hone their product or service based on customer feedback, rather than investors' critiques or criteria.
- **Make the peer-review and investment process collaborative.** Together, entrepreneurs should leverage their collective experiences and expertise to provide honest reviews of peers' products and services, accelerate each others' feedback

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

loops, hold each other accountable for meeting milestones, and select the companies that are ready to receive investment in an equal, open, and noncompetitive group setting.

Could we put these potential solutions into practice? What would this look like in the real world? Could we find any existing models to build on?

The solution: What if entrepreneurs could teach and invest in each other?

In late 2009, Bob and I began to focus on a different way to make investments—one that would put more power in the hands of the entrepreneur.

We both brought our personal experiences to the program design. As one of the world's first, and largest, microfinance investors, Bob kept coming back to a transformative experience he had with the village bank methodology pioneered by microfinance banks: village women would fill the role of the traditional loan officer, with lower transaction costs and more empowerment to entrepreneurs. This methodology led to the creation of the microfinance industry, which has provided access to credit for hundreds of millions of people worldwide.

Separately, I was thinking about a similar kind of village and its role in the creative process. I attended the University of Virginia, designed by Thomas Jefferson to be an "Academical Village," where students and teachers lived next to each other on the Lawn at the center of the university. Innovation and true learning, Jefferson said, do not happen with the top-down delivery of knowledge from expert to learner. Instead, the process is iterative, and side by side: teachers facilitate the conversion from hard knowledge to useful information through a free exchange of ideas and concepts. (This setup at the University of Virginia is alive and well today.)

Both models—the financial village bank and the educational academical village—placed a heavy emphasis on transparency and community. Inspired, we asked this question: What if entrepreneurs could teach, and invest in, each other?

Could this model be applied to early-stage investing? With a helping hand from the original team—Kyle Salyer, John Hardman, Nikhil Dandavati, Alex Caselli, Mark Hand, and Jen Soltis—we decided to give it a try. Our original hypothesis held that entrepreneurs could hold each other accountable for meeting milestone goals, and entrepreneurs, given their acute understanding of risk from having launched their own businesses, could evaluate one another better in areas where traditional credit scores and risk assessment did not apply.

So our original design for the peer-selection model was simple: at the start, we would gather a group of entrepreneurs small enough so we could all get to know one another, but large enough to produce a diversity of opinions, maybe 15 on average. We invited experienced entrepreneurs and industry experts to deliver content-based sessions to the entrepreneurs through presentations, expert panels, group exercises, and one-on-one mentoring sessions.

We recognized the importance of in-person group interactions, but also understood that entrepreneurs could not, and should not, be taken away from running the operations of their startup on the ground for more than a few days. So we

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

decided to deliver the curriculum during in-person sessions, requiring minimal time commitments, over three months. (We have tweaked this plan over the course of several pilots, but it is the model we still use.) In between sessions, entrepreneurs would be responsible for completing relevant assignments that applied the most recent training to their own business operations. They would also have weekly calls and email correspondence to stay connected between the meetings.

During the final session of each program, the entrepreneurs would rank each other. Peers would primarily evaluate each other based on their ability to deliver solutions. After all the scores were added and averaged, the two enterprises with the highest scores would receive investments. We initially designed an investment of $50,000 to $100,000 to the ventures with the top peer rankings. And that was it.

Skeptics and Cynics

At first, most mainstream investors rejected the idea of the peer-selection model. One told us, "This is going to be worse than Shark Tank. They're going to rip each other apart—and they won't even know what they're talking about." Another said we were "bonkers." This idea was—and still is—somewhat threatening to professional investors. Many made, and still make, the argument that entrepreneurs do not have the training, experience, or expertise necessary to reliably identify the most promising innovations that are ready for investment, nor do they know how to add value to each others' companies.

We readily accepted the feedback and admitted we could be wrong. On the flipside, though, we thought—and still think—that the peer-selection model is not a comparable replacement for expert selection. Instead, it is a completely different paradigm for early-stage investment. True, entrepreneurs do not have the formal training of analysts in venture capital firms, but they are much closer, personally, to the customer problems being addressed. And, in most cases, they have a much stronger personal understanding of risk. And yes, there was the risk that the sessions would be more competitive than cooperative, but our instinct was that transparency and openness would foster a collaborative spirit, like that of the village bank.

In 2009, the night before we launched our first pilot, in New Orleans, Bob and I were having a beer and listening to jazz, and we reviewed the pushback. "What if it fails?" we asked. We ran through the ways it could fail, and eventually realized that if it failed it would not be that different from following a venture capital model that we thought was fundamentally broken. So our response to the skeptics was, "Yes, it might fail, but that isn't any worse than the current way of doing things. But what if it succeeds?"

IDEA TO IMPLEMENTATION: THE BIRTH OF VILLAGE CAPITAL

Baby Steps: Pilot Phase

In late 2009 and early 2010, we launched a series of pilots, which we informally dubbed Village Capital, to test the peer-selected model, partnering with groups we

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

knew in San Francisco (the Hub), Mumbai (Dasra), New Orleans (the Idea Village), and Boulder (the Unreasonable Institute). We wanted to test the model in a variety of contexts. We chose San Francisco as an entrepreneurial hotbed; Mumbai as a rapidly growing emerging market; New Orleans as an underserved, high-poverty domestic market, and we partnered with the Boulder team as a global, residential incubator. We received over 500 applications globally and accepted 81 enterprises, averaging about 20 enterprises per program.

The biggest success of the first four pilots was how proactively the entrepreneurs embraced the model. Teams showed up, in full force, for each session, and pushed forward their own businesses—and evaluated others—with enthusiasm. Of our pilot enterprises, 96 percent said they would recommend the program to their peers, and we ended up investing in nine ventures; for all of them, we were their first investor. One early investee was Jen Medbery, a Teach For America alumna who founded Kickboard, which uses data management to improve learning outcomes in low-income schools across the United States. Kickboard now has customers in 25 U.S. states, has raised over $3,000,000 in follow-on investment, and is a leader in U.S. education reform. As Jen says, "Without Village Capital, we would not have been investable. Period."

Yet we also had some major early failures. Perhaps the biggest was our failure to appropriately structure the process. In the spirit of democracy, we asked the entrepreneurs themselves to design the ranking process by which they would select the investments. Mistake. We found that, in general, entrepreneurs spent far more time developing and implementing their ranking process than working on and evaluating their ventures. The end result was not that different from traditional due diligence: the program structure did not give the teams incentives to actually discover customers and build enterprises.

Growing Pains

We learned three key lessons during this period.

The first was about structure: form affects function. What differentiates Village Capital programs is our emphasis on empowering entrepreneurs, but asking them to design the selection process in addition to making the investment decision caused tension between the entrepreneurs. Their attention shifted from learning and improving their businesses to designing a ranking strategy that would let them win the program's precommitted investment. Who could blame them, given the potential $50,000 investment? Clearly, each had a vested interest in strategizing about the ranking process that would favor them the most, and this made it nearly impossible for them to reach a consensus about either the ranking process or the winning enterprises.

The second was about standards. We learned that objectivity trumps subjectivity. In the pilot programs, particularly in San Francisco and Mumbai, we realized that the ranking process was too subjective. At this point, the ranking required entrepreneurs to do a straight rank of all the enterprises from most favorable

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

(highest score) to least favorable (lowest score). This led them to give the highest score to the peers they liked the most and/or those who needed the most support, instead of giving the highest score to those with the strongest businesses that were ready for investment—which was the ultimate goal.

In response, we replaced the rudimentary scale that had a subjective ranking with a more focused system that forced them to directly analyze how the business was able to deliver on its promises. We designed a core curriculum around six key areas: human resources and team development, product/service refinement, customer validation, financials, results and scalability, and strategy for liquidity/return of capital to investors. At the end, we developed a matrix that the entrepreneurs used to evaluate one another on these criteria. Over time, we have made the ranking criteria more sophisticated, and we now weight the ranks using standard deviations to correct for how generous or tough the individual graders are on each other.

The third lesson was that trust comes through transparency. During the early pilot phase, entrepreneurs' rankings of each other were not made public. This made sense at the time, given that peer selection could quickly come to look like a popularity contest. But we discovered that the entrepreneurs who lost would frequently question the results of the rank. And, as they lost trust in the system, they became more interested in gaming it.

So, to increase their trust in the process, we made the scores transparent. (This was *after* we replaced the straight rank with the six predetermined investment criteria.) Transparency dramatically increased trust. And, even more important, it gave real-time, 360-degree feedback to the ventures in a much more productive way. Now that we publicize each entrepreneur's score with the name of the person giving that score, the entrepreneurs approach their peers and dig more deeply into the reasons they got certain scores in each category. This policy—which one of our partners calls "militant transparency"—has created an open and communicative environment for entrepreneurs to receive constructive criticism, which they in turn use to actively address problems and thus improve their venture.

We also introduced the concept of "trial ranks"—two full rankings (using the same criteria as the end-of-program rank) introduced one-third and two-thirds of the way through the program. This gives entrepreneurs familiarity with the ranking process over time, and also provides interim feedback in a way that gives teams the chance to improve their scores.

In the end, the entrepreneurs face complete public accountability from their peers for all of their decisions. Thus, if one cohort member attempts to torpedo another, they will have to justify their action to the entire cohort. Though it may seem counterintuitive, since we made the rankings transparent, the sessions have become more cooperative than competitive.

Although they were difficult to work through at the time, we needed these early growing pains so the peer-selection process could develop into what it is today. And the early trials did provide an indication of success: four years later, when we look at the first-year group in the Village Capital peer-selected invest-

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

Entrepreneurs in the Atlanta program gathering and sharing their innovations for feedback, Spring 2012

ment portfolio, we see they are performing comparably to the expert-created portfolio of First Light enterprises. And the overhead cost to build them was only 20 percent of that for the "expert"-selected portfolio.

Having decided on initial pilots that we deemed promising, we decided to take Village Capital independent and to test our strategy fully, and globally.

MATURATION: GROWING BY DOING

After the initial pilot results, we realized that peer selection had the potential to offer more than just one investment strategy of First Light. We decided that I would spin Village Capital out as an independent organization, and Bob would remain a trusted advisor, investor, and board member. On November 22, 2010, the transition became official: Village Capital incorporated as an independent organization and started growing legs of its own.

In early 2011, we launched five more programs: in San Francisco, New Orleans, India, London, and Brazil. In this second series of pilots, we discovered that most of the ventures we selected had been referred by alumni entrepreneurs. So, even through all the bumps and warts, we began to see that the program offered compelling promise for our graduates.

We also decided to launch programs with co-investors. This meant that, to launch a program, we needed local groups that would co-invest capital, along with us, into the peer-selected pool. Our first co-investors were Hub Ventures in the Bay Area, GrowthAfrica in Nairobi, Artemisia in Brazil, Transist in China, and VentureWell in Boston. They expanded our reach and proof points for the model. Since then, we have continued to offer more programs, to vet enterprises, to serve entrepreneurs, to fund ventures, and to expand our network of partner organizations. Table 1 shows how we are growing.

Continuing to Iterate

We tell each group of entrepreneurs that each Village Capital cohort has a secret member: Village Capital itself. Key to the organization's growth are the internal feedback loops that gather learning from each cohort, apply those learnings to our

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

	2010	2011	2012	2013 (to date)
Number of programs	4	5	6	7
Enterprises vetted	489	375	1,375	1,014
Enterprises served	81	90	85	85
Enterprises funded	12	9	10	13
Partner funders/investors	0	3	18	18

Table 1. Village Capital's growth.

model, and iterate, literally, within days. In the past few years, we have developed several powerful iterations on the model that have made us far more successful.

Customer Forum

While most organizations that support entrepreneurs worldwide—incubators, accelerators, seed funds—focus their activities around an Investor Day, or a Demo Day, we have evolved to operate a bit differently. The core of our theory of enterprise development is that customers, not investors, should drive enterprise growth.

The Customer Forum is essentially a pitch-fest aimed at customers instead of investors. The Village Capital team gathers a varied sales pipeline for each venture, and through an afternoon or evening session, teams actively sell their solutions to customers. They hear, in real time, what customers think about their own products—and their peers'. These suggestions and constructive criticism from their users let them iterate and improve. And this firsthand feedback helps them both evaluate others' enterprises and develop their own.

This external input has become essential because the entrepreneurs are asked to evaluate based on one's ability to deliver the solutions they promise—and on how well these solutions solve the problem they are trying to address.

Financial Literacy

While most of our programming is peer-driven, we did gradually identify a consistent area of breakdown across ventures where we could be very helpful: offering financial literacy. Specifically, our entrepreneurs need to understand about revenues, costs, profitability, and financial management over time. Expertise in specific financial skills can lower the risk that ventures will mismanage cash, raise more money than they need, or run out of money before they can prove their concept.

In 2013, Village Capital formed a partnership with the James Lee Sorenson Global Impact Investing Center to create one finance associate in each cohort.

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

Entrepreneur presentations in India program, October 2013

Finance associates are trained in accounting and financial management, and act as a shared CFO for the other companies in their cohort. They enable each entrepreneur to build pro forma financials for the company and implement a financial management plan. At the end of each cohort, they also prepare basic due diligence on each venture for participant investors, developing a deal book so that those invested in the program can have a frictionless way to get involved with the enterprises that most interest them.

The Problem-Based Approach

In the early days of Village Capital, cohorts were organized around a particular geography, for practical reasons: the New Orleans program worked with entrepreneurs around New Orleans, and so on. Other incubators and accelerators have developed an industry focus; for example, HealthBox-US focuses on health care. As we have evolved, we have thought about cohort composition a bit differently and developed what we call the problem-based approach.

At its heart, entrepreneurship is about solving problems, and we found that entrepreneurs working on the same problems (e.g., financial inclusion in East Africa, quality affordable education in India) have much more in common than enterprises living in the same geography or the same industry. We saw a significant opportunity to build a community of practice around entrepreneurs solving similar problems.

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

Customer Forum breakout session in East Africa program, October 2013

We launched our first cohort using this approach in Louisville, Kentucky, in the summer of 2013. This program, managed by our Global Program director James Watson, and co-run with VentureWell, a project of the National Collegiate Inventors and Innovators Alliance, tackled the problem of emissions in the agricultural supply chain. In the United States, depending on the city, that supply chain is responsible for between 20 percent and 80 percent of a city's carbon emissions. The program focused on working with the entire value chain of the problem. That is, all the entrepreneurs convened in this program had enterprises focused on reducing carbon emissions and/or making farming more sustainable. They were working on a range of goals: creating electric batteries; developing smart irrigation to cut water usage and costs; and enabling people across the US put solar panels on their homes or buildings through an intuitive design technology that anyone can use. Since the teams were addressing different angles of the problem, they were not direct competitors but collaborators—and sometimes each other's customers.

The program was located in Louisville because it was uniquely suited to solve this cohort's problem related to sustainable production and reducing carbon emissions. The high number of family farmers in the region would serve as the enterprises' customers, or would at least volunteer to provide feedback on their products and services during the Customer Forum. People in the Louisville area also have considerable expertise in logistics and energy, and the region's universities provide intellectual and human capital. Thus Louisville is better positioned to address this particular cohort problem than New York, or Washington, D.C., or Silicon Valley.

Deep Content Expertise

The problem-based approach also led us to start working with experts in each problem focus area. For example, in the fall of 2013, we launched Edupreneurs, a collaboration with the Pearson Affordable Learning Fund (PALF), which has taken

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

Audience participating in exercise at the Venture Forum for the Louisville program, September 2013.

the problem-based approach even deeper. The program focuses on entrepreneurs providing solutions that enable the growth of low-cost private schools in India; according to some estimates, they educate over 10 million of India's poorest children. PALF, a venture arm of the world's largest education company, has contributed both deep expertise in educational content and significant technical expertise in education. Thus it could deliver specific content relevant to the entrepreneurs' work. PALF associates led sessions on pedagogy, efficacy, and education sales: valuable technical content.

To the Customer Forum they brought valuable stakeholders from the educational sector across India. One was a lead decisionmaker in the Delhi Public School system—the largest in India and thus key to many of these companies getting significant revenue. Thus PALF brought tangible, substantive value to the enterprises in the India Edupreneurs program to complement and complete the existing Village Capital program. PALF also helped us update our curriculum and program content, making it more relevant and timely to our ventures.

Village Capital plans to run more programs with PALF and other organizations that have specific expertise on specific problems. Our goal is to recruit more program partners and co-investors who will have deeper relationships, knowledge, and technical expertise in targeted problem areas.

Investing in the Peer-Selection Model

Between 2010 and mid-2013, we raised $2 million to cover the precommitted investment capital for the peer-selected enterprises that the cohorts chose during these two and a half years. These funds were managed in partnership with ImpactAssets as a donor-advised fund (DAF)—a vehicle that takes charitable contributions and can use them to make investments in for-profit companies—or a program-related investment (PRI)—a vehicle that makes investments (not grants) from charitable contributions. I brought on an outstanding teammate, Victoria Fram, to manage the investment capital. During this time, I approached dozens of investors who said they were interested in Village Capital's unique investment

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

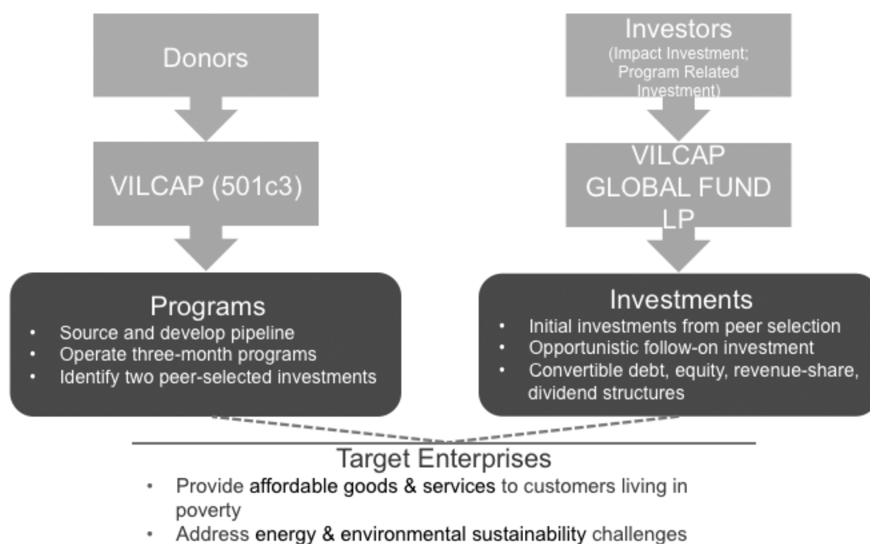

Figure 1. Structure to support Village Capital's peer-selection model

approach, but they didn't want to make a DAF, a PRI, or a charitable contribution. They wanted to make a traditional investment.

Investors continued to advise Village Capital to create a traditional investment fund to support the peer-selected companies. Such a fund would provide incentives for more traditional investors, and it would drastically reduce the time required to raise funds for each individual program, allowing Village Capital to launch programs more quickly and focus on adding value to each participating enterprise. Plus, we could spend more time on more targeted enterprise recruitment, program development strategy, curriculum specialization, entrepreneur and alumni services, investor relations, and portfolio management.

So, late in 2013, Village Capital began to restructure. Under the new framework, Village Capital, the independent nonprofit organization, is responsible for running the programs and providing advice and mentorship to the entrepreneurs. The VilCap Global Fund, the affiliated investment vehicle, is responsible for deploying the investment capital in the companies chosen by the entrepreneurs at the end of the programs.[2] The benefit of this larger long-term investment vehicle is that it can also make follow-on investments in around 20 percent of the peer-selected companies in the portfolio, and offer additional support services to the peer-selected ventures. In its earlier structure, Village Capital did not have the funds or bandwidth for these two activities. Figure 1 (previous page) shows our updated structure.

And we're still learning. We recruited a colleague, Lily Bowles, to manage our knowledge around capturing outcomes from peer selection; if the data prove that we are selecting better enterprises in a more effective way, the global implications

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023

are transformative. We're seeing early insights that suggest we're on to something: although 15 percent of our initial applicants are teams with women cofounders (comparable to your average startup organization), 40 percent of teams selected by their peers have women co-founders (well above the average). Why does that matter? Controlling for confounding variables, teams co-founded by women are outperforming their male peers in revenue growth, even though they are raising 50 percent as much money. We are seeing a consistent bias—selecting against women co-founders in the early stage—actually hurting the performance of investments—and peer-selection correcting against that bias.

FUNDING FUTURE INNOVATIONS

Revolutionizing the Way We Build Enterprises

We believe that the peer-selection model is the most efficient way for entrepreneurs to hone their enterprises' value propositions, validate their business models, acquire customers, and become part of a larger community of problem-solvers. And it is the most efficient way for investors to find and deploy capital into high-potential early-stage enterprises that offer innovative solutions to social problems worldwide. It's a win-win.

The participants in past Village Capital programs have consistently chosen the enterprises that have proven they can deliver the most effective solutions the most efficiently. This suggests that the peer-selection model ultimately invests in the innovations that offer the most promising solutions to the most pressing problems. We hope the Village Capital model will be used by venture capitalists—and other professional funders of innovation—as it proves to perform, or outperform, portfolios sourced and compiled solely through the traditional high-cost, time-consuming, resource-draining due diligence process.

The Village Capital Model: Empowering Entrepreneurs and Investors

The Village Capital model can fundamentally shift the power dynamic between those with resources and those with ideas. Over the past several months, we have engaged with entrepreneur support organizations from Hawai'i to Appalachia to a refugee community in Clarkston, Georgia, and with schools from the United States to Switzerland, to talk about peer-allocated capital as a transformative learning opportunity. We're eager to see a world in which those with ideas hold the power over the innovation of the future. The Village Capital model is beginning to make that world possible.

---

1. World Economic Forum (WEF) Investors Industries, in collaboration with Deloitte Touche Tohmatsu, *From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors*. Geneva: WEF, 2013, p. 24.
2. Village Capital's investments now take various forms including grants, loans, equity, royalties, and revenue sharing on returns that are appropriate for the selected enterprise.

Downloaded from http://direct.mit.edu/itgg/article-pdf/8/3-4/55/705076/inov_a_00187.pdf by guest on 08 September 2023