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BCVF and City Fresh Foods: Engineering an Exit

On a bright September day in 2001, Elyse Cherry, CEO of Boston Community Capital (BCC) and President of its subsidiary, the Boston Community Venture Fund (BCVF), glanced at the decrepit Dartmouth Hotel building across from her office as she gathered her papers on the way to a board meeting. Not too long ago, the Palladio, which now housed her office, had looked like that. Located in downtown Roxbury, a once-thriving area of Boston, the building had been a shadow of its formerly grand self before BCC's agreement to lease space there had served as the collateral for bank funding of a major restoration effort. Soon her organization would be funding a renovation of the Dartmouth. She smiled at the thought of the area's extraordinary turnaround. Similar organizations across the country were having a similar effect, as the community development venture capital (CDVC) industry, represented nationally by the Community Development Venture Capital Association (CDVCA) had grown substantially since 1995.

The company with which Cherry was meeting, City Fresh Foods, had had a revitalizing effect on a neighboring area, Dorchester. Cherry felt ambivalent about her imminent meeting with the firm. She and Mac McCabe, of the Institute for Civil Society (ICS), would be speaking with Glynn Lloyd, the CEO of City Fresh Foods, who was considering the possibility of redeeming the preferred stock held by his two investors—BCVF and ICS (for a detailed discussion of preferred and common stock, see **Appendix 1**). It looked as if Lloyd would have the money. But was this the best use for it?

City Fresh, founded in 1994, was a prepared foods manufacturer providing authentic ethnic meals to seniors and schools. It had tripled its sales and reached profitability since BCVF and ICS had invested in 1998. Much of the growth had stemmed from having larger premises—Lloyd and his partner, his brother Sheldon, had been able to move the company to a much larger building with the equity backing. The building was located in the Four Corners area of Dorchester, a place similar to Roxbury in its budding economic revival. City Fresh's move to the area and its rehabilitation of the building had created 25 new jobs, in addition to the independent contractors who delivered the food. Lloyd was using the proceeds from a loan backed by the building to do the recapitalization.

Cherry was proud of Lloyd's work with City Fresh and pleased that she and her co-investor could consider exiting the preferred position. "It's all linked," she thought:

> City Fresh is doing well, Glynn is doing well, there's a vibrant business in a corner of Dorchester that hadn't seen commercial investment for 20 years, and 25 well-paying jobs have been created in an area where unemployment has been rampant. And for BCVF to be able to get our money out is tremendously exciting. It proves that equity has a real role to play in inner city development, that we can offer real returns. And, as we're in the middle of raising a $16 million second fund, it proves that investors can do well by doing good.

Ann Leamon prepared this case for the use of the CDVCA. Cases are developed solely as the basis for class discussion and are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

At the same time, though, the board members disagreed about the proper valuation to place on the preferred position. Cherry and McCabe wanted to use the deal set in the original agreement. Lloyd felt that this far overvalued the company, especially looking at its selling price as set by a business broker. All the board members were also aware that whatever they agreed upon would not be the end of their involvement. "We still own 27% of the common," said Cherry. "At some point, we will need to figure out what to do about that."

Cherry wondered whether insisting on full repayment of the preferred, and whether Lloyd's use of funds for this purpose, were the right things to do—for BCVF, for City Fresh, and for the future of equity in community development.

Exiting Venture Investments

The classic venture capital (VC) model posited a three-part model: fund raising, investing, and exiting.[1] Limited partners (LPs) would commit to a venture capital fund with a ten-year life. The general partners invested the money in deals as defined by the prospectus, usually over a four- to six-year period. Some VC firms targeted early stage companies; others preferred investing in firms with more established records; some focused on particular sectors while others might invest more opportunistically across sectors and company stages. Once the investments had been made, they would be managed and then harvested in the latter part of the fund's life, with profits distributed to the limited and general partners, usually on a 80/20 proportion, with the LPs receiving their initial capital back first.

Traditional venture capitalists had a number of options for exiting investments, chief among them being initial public offerings (IPO), in which a company floated its shares on the public market, and merger and acquisitions (M&A), when another firm bought the portfolio company. In addition, they could exit the investment by selling their shares to another venture capitalist or to a financial institution. The company itself could buy out its VC backers. In the worst circumstance, the venture capitalists would write off the company, an option that returned no money to investors.

The Internet bubble of the late 1990s and 2000 had seen an unusual contraction of the entire cycle. Historically, the holding period for a company averaged five to seven years. During the bubble, this shortened to two to four years, with some investments yielding triple and quadruple digit returns after just a few months. With the crash in the NASDAQ and the subsequent inability of VC firms to exit via IPO, holding periods appeared to be returning to their historic levels. The methods of exit had shifted dramatically, favoring M&As over IPOs. In Europe, which broke down its exit types more precisely than did the U.S., write-offs as an exit method had risen from 5.5% in 1998 to 22.8% in 2001. (See **Exhibit 1** for types of exits over time).

For community development venture capital groups (CDVCs), exits were more complex.[2] Because these groups invested with an eye toward both social and economic return, exits forced investors to consider more factors than just the structure and price of the deal. Even an exit that offered significant financial returns would be undesirable if it involved job losses or otherwise reduced the social or environmental benefit that the fund had originally been set up to provide. In addition, CDVCs faced other challenges. As an industry, 49% of their investments were in manufacturing, a less immediate candidate for an IPO, the type of exit that most often sustained job opportunities and economic growth.[3] By contrast, 2001 data showed that conventional VC firms had backed no companies classified as "Manufacturing," although computer hardware firms might manufacture

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[1] Josh Lerner & Paul Gompers, *The Venture Capital Cycle,* (MIT Press, Cambridge, MA, March 2002), *passim.*

[2] This discussion draws on Elyse Cherry et al., *No Exit: The Challenge of Realizing Return on Community development Venture Capital Investments* (Report to The Ford Foundation, October 5, 2000), *passim.*

[3] Data from CDVCA.

some of their prototypes.[4] Mergers and acquisitions generally meant that the CDVC-funded company would be folded into the acquiring firm and forced to move some or all of its operations because of an out-of-the-way location—often the very reason for funding the firm in the first place. Finally, the very discussion itself could become futile, as the companies funded by CDVCs frequently were too small to warrant an IPO or to interest a potential acquirer.

As a result, CDVCs tended to structure their deals to exit through other means. Debt instruments might offer limited up-side, but they had the great advantage of being self-liquidating. Other options included debt instruments with equity-like features, such as loans with royalties (a stream of payments in the future contingent upon certain performance measures) or warrants (the option to purchase shares at a certain price in the future). Another method was to write a "put" and a "call" into the deal. The former allowed an investor to compel the company to repurchase its shares, and the latter allowed the company to compel the investors to sell their shares back to the firm. Both were often contingent upon the achievement of certain performance objectives. All of these exit options limited the upside potential, making it difficult to offer venture-level returns to limited partners, while still providing a more definite path to liquidity.

To resolve this difficulty, the Boston Community Venture Fund and Elyse Cherry had proposed the creation of a publicly traded holding company that would buy the shares of the portfolio companies. The holding company itself would be floated on a public market, where individuals or institutions that either chose or were required to support community development aims would hold its shares. Ideally, the companies themselves would continue to operate and grow as they had in the past and the shares of the holding company would appreciate as its component companies became increasingly successful. In addition, the holding company could serve as a bargaining agent, consolidating the demand from its subsidiaries to achieve price breaks on products ranging from health insurance to copying paper.[5] This concept was still in the discussion phase.

Implications of Exits for CDVCs

The difficulty of exiting their investments had serious implications for CDVCs. Not only did it reduce investor interest in the funds and thus hinder their ability to effect positive economic change in depressed areas, but by forcing the use of non-equity vehicles, it reduced the positive impact of equity in the first place. Entrepreneurs of young and growing companies turned to equity because such investors had a long time horizon and expected to be actively involved in helping the company achieve its potential. Debt instruments had a fixed contractual repayment schedule that might not coincide with the young company's growth and financial needs. In addition, equity gave a young company enough liquidity to attract bank financing. If the equity investment occurred through a debt-like instrument, it might crowd out additional bank financing.

The discussion of exits was fraught with philosophical issues for CDVCs. Not only was there the issue of potential job losses due to an acquisition by a less-community-oriented owner, but there was a general uncertainty around the ethics of expecting venture returns from companies that provided social benefits. Furthermore, many of the entrepreneurs themselves were unfamiliar with the mechanics of private equity. They often interpreted the investment as a high-interest loan with meddling bankers, but they had no option. When they were successful, redeeming a preferred stock position with a 12% coupon or having a portion of the company's sale proceeds go to someone else felt like an affront, especially since if they had failed they would not have had to repay anything. At the same time, they often forgot, looking back at their success, that when they received venture funding, not only could they not qualify for bank loans, but no conventional VC firms would have taken them either.

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[4] NVCA 2002 Yearbook.

[5] Elyse Cherry et al., *No Exit: The Challenge of Realizing Return on Community development Venture Capital Investments* (Report to The Ford Foundation, October 5, 2000), *passim.*

Said BCVF's Cherry:

> Because these entrepreneurs are doing something so new and so important to the community and to society as a whole, we as investors cut them some slack. We may forgive some penalties on late payments, for instance. But in the end, we have to show our investors a reasonable return. With the industry's 30% failure rate, that means we have to get 15% or so from our successes to give the fund an overall 11% return. If we don't do that, there won't be any more money. It's that simple. Socially broad-mindedness only goes so far, and if we want to be able to raise $16 million funds, we need to give those investors reasonable—and I'm not saying triple digit—returns. If we can't, we lose this tool and we lose this chance to make real economic change.

Background: Boston Community Venture Fund

The Boston Community Venture Fund (BCVF) was an affiliate of Boston Community Capital, which had been founded in 1985 under the name Boston Community Loan Fund with $3,500 and a primary mandate to create affordable housing. In 1992, the organization decided to expand its mission into meeting the growing and changing need for capital. Four years later, in 1996, it reorganized into a holding company, Boston Community Capital, with three non-profit operating affiliates (Boston Community Loan Fund, Boston Community Venture Fund, and Boston Community Management Assets Corporation) and a for-profit company, BCLF Ventures I, LLC. The Venture Fund managed BCLF Ventures I.

BCC raised capital from socially concerned investors and donors, which included individuals, religious organizations, banks (in part, to comply with community reinvestment criteria), foundations, and corporations. BCC defined itself as "a community development financial intermediary whose mission is to create and preserve healthy communities where low-income people live and work"[6] and provided loans through the loan fund for housing, community facilities, and social services to low-income individuals and neighborhoods. Since its inception, BCC had created and preserved over 4,000 units of housing and loaned more than $100 million. Elyse Cherry had been on the founding board of the Boston Community Loan Fund. With a background in real estate law, she was a partner at the well-known Boston law firm of Hale & Dorr, which also handled a large number of venture capital transactions.

Cherry explained how the organization had decided to move beyond housing:

> The Boston real estate market simply crashed in the early 1990s. We at BCC often found ourselves junior to a bank that had failed. We became very good at working out loans, and we did so without putting people on the street or losing any money for our investors. We restructured a huge number of loans. As a result of this experience, we developed an expertise about investing in low-income communities and how to get our money back. We began to look at the tools to encourage this, and realized no one was using equity to build businesses in these areas. It just wasn't seen as a way of getting things done in the inner city. There were loans and there were grants, but no one was acquainted with the concept of equity. And yet it could be such a powerful tool.

The fund-raising for BCVF I in 1996 started with $500,000 from various investors and $1 million from the Community Development Finance Institutions Fund, part of the U.S. Treasury. In late 1997, Cherry, who had left Hale & Dorr a few years before, came in as President of the fund. "I immediately began raising more money," she said:

> …because I realized that it's a virtuous cycle: if you have enough money, you can hire good people and back good projects. Early on, we identified that the major threat to our

[6] www.bostoncommunitycapital.org, accessed January 10, 2003.

companies was under-capitalization—either the company doesn't grow fast enough and needs more money, or it grows faster than expected and needs more money. But we raised $5.3 million in total, which was enough to make a difference.

The first fund did not even project a return. Cherry explained, "There were about 10 groups doing this nationwide, and we had no idea what was possible." The second fund projected an 11.3% return to its investors and defined its mission as providing "equity investment to high-potential, emerging businesses that create stable jobs, provide quality goods and supply valuable services to low-income communities across Massachusetts." By 2001, BCVF with a staff of three investment professionals had fully invested Fund I, a year ahead of schedule, and had raised $13.5 million toward its $15 million - $20 million Fund II. Its portfolio included nine active companies (see **Exhibit 2** for portfolio company profiles). In 2000, Cherry had been named CEO of the parent group, BCC, in addition to her position as president of BCVF.

By 2001, more than 50 CDVCs operated in the United States. Just as its fellows did, BCVF assessed its investments on their prospects for both financial and social return (see **Exhibit 3** for evaluation criteria). Social returns included employment and training opportunities for low-income people, management diversity and quality, workforce diversity, and the potential for bringing economic growth to blighted areas.

City Fresh Foods

When Cherry encountered City Fresh, the company was three years old and constrained by its tiny space and lack of financing. She said, "They came in at the end of 1997 looking for $10,000 to get to the end of the week. We started talking with them about options."

Glynn Lloyd, the founder and CEO, had been born in Dorchester but grew up in the suburbs. He had founded City Fresh in 1994 with a grant of $20,000 from the City of Boston,. Working out of a 900 square foot kitchen [roughly the size of a small two-car garage] on Dudley Street in Roxbury, the firm had landed a contract with Central Boston Elder Services to provide Latin meals to homebound elders. The agencies paid slightly over $4.00 per meal. By the end of 1997, City Fresh was providing roughly 450 traditional and heart-healthy Latin, Caribbean, and North American soul food meals per day (see **Exhibit 4** for sample menus). This involved not only preparing the food, but packaging and delivering it to area elders. The company was not profitable and could not become so without a larger facility. Lloyd said, "No one would touch us. We were a food service business, we were new, even our vendors would only give us seven-day terms."

The scarcity of financing had been a continuing problem for City Fresh. When the company had first received its contract with Elder Services, a business consultant had identified an impending cash flow crisis—City Fresh's vendors had seven day terms, while the agency paid in 45 days. Even though the agency agreed to seven-day terms, Lloyd had to factor his accounts receivable with Princeton Capital. "There were huge fees and high interest," he said, "but it was my only option. I had to have a line of credit."

By mid-1997, Lloyd, who by then had been joined by his brother, Sheldon, approached the city looking for larger space in Dorchester or Roxbury. Part of the criteria was that it had to have an existing kitchen. To his surprise, such a property existed in the Four Corners Area, the former economic heart of Dorchester, and the City of Boston had taken it for unpaid taxes. It had been a lounge and then a Haitian restaurant, and renovations would cost $150,000. The Four Corners area had seen virtually no new investment for 20 years. Lloyd said, "It was the same story – no one would touch us. We had no assets, no profits, and wanted $150,000 to rehab a place in Four Corners? Not a prayer."

At that point, a friend in city government directed him to BCVF, where Cherry was trying to raise her first fund. "We needed to get some good deals to get good money," Cherry said. "City Fresh was looking for guidance as the business grew and was totally new to the concept of equity. Glynn did know that BCVF could help—with contacts and business knowledge. And he was willing to learn."

Investing in City Fresh

Throughout the winter of 1997-1998, City Fresh and BCVF worked out the terms of the investment and, with various city departments, of the building's rehabilitation. Frederic (Mac) McCabe of the Institute for Civil Society (ICS) learned of the deal and was willing to invest as well. McCabe had a long history of advising progressive companies. He had graduated from Harvard Business School with an MBA in 1971, but as one of the first hippies on the campus had felt, as he put it, "like a fish in a tree." After a stint as a buyer at Filene's, he had signed on to restructure and run the museum shop businesses of the Museum of Modern Art. Since 1985, he had consulted, advised, and occasionally run socially conscious companies such as Northeast Cooperatives, Eilene Fischer, and Greyston Bakery. He had spent time at the Institute for Civil Society, a nonprofit educational foundation established to advance civil society and the institutions on which it rested. ICS had never invested in a company before, although it was a limited partner in BCVF's fund, but it was willing to back City Fresh because, as McCabe said, "Opportunities are hard to find. There is money to fund entrepreneurs in the inner city, but you need more than money for a business to succeed—you need a strong, disciplined manager with a vision that has potential for growth."

ICS invested $60,000 and BCVF put in $130,000 for a total investment of $190,000 in redeemable preferred and 27% of the common(see **Exhibit 5** for the capitalization table). The preferred stock carried an interest rate of 12%, with payments of interest only during the first two years, and redemption of the entire position starting in June 2001, and continuing through 2003 (see **Exhibit 6** for payment schedule). Each investor had a board seat, City Fresh had two, and they chose the fifth member together.

Growing City Fresh

The final agreement with the City put City Fresh in its new building, but kept it on the City's books. BCC and Lloyd negotiated a rent of $2 per square foot, with the added provision that any money invested in the building would be offset against the building's eventual purchase price, should City Fresh choose to buy it. Both Lloyd and Cherry agreed, "We've had longstanding good relations with the City. Different divisions of the mayor's office have all been extremely helpful in the entire process."

City Fresh managed the rehabilitation process with technical assistance from BCVF's sibling, Boston Community Loan Fund. The kitchen construction was completed on budget and on schedule.

In June 1998, City Fresh had its official ribbon-cutting ceremony at its new quarters, 2-8 Bowdoin Street. Cherry contacted the U.S. Treasury, whose Community Development Financial Institution Fund had been an early investor in BCVF's first fund, and asked if Robert Rubin, the Secretary of Treasury at the time, would attend a combined opening for City Fresh and closing of BCVF I. She then invited the local banks. As a result, City Fresh hosted Rubin, former Senator Joseph Kennedy, Senator John Kerry, and the Mayor of Boston with *arroz con pollo* for breakfast.

Once City Fresh was in the building, the two investors began a focused effort to help the Lloyds increase their revenues. At first, interactions with the board, both formal and informal, occurred weekly. Both Cherry and ICS's McCabe helped the Lloyds think about their business strategically and create the tools that would achieve their vision on a tactical level. The Lloyds began to produce income statements, balance sheets, and other financial reporting tools. "At first" said McCabe, "they thought of it as just something that the investors wanted. But then they realized they could be useful for them, too."

With enough capital, ample space, and some debt from U.S. Trust, City Fresh could finally expand, doubling its daily meal production to 1,000. The company also pursued empowering work force policies. The Lloyds recruited their workers from the local community, and provided training, both in computers and in English as a second language. The starting hourly wage of $8.00 to $9.00 rose to $16.00 for supervisory employees. Lloyd said:

> It's not a problem finding cooks. We hire people from the neighborhood and teach them to cook in volume. Our workforce walks in off the streets, many of the desperate for a job, determined to stay off welfare. And we've found that our customers like the food so much that they talk to other elders, and even elders who aren't ethnic will sign up with us because our food is so much better.

The Lloyds' employment policies, while empowering, were also motivated by economics. By training its employees, City Fresh had a more flexible and stable workforce. "The Lloyds make economically rational decisions," commented Cherry. In 2000, Lloyd had made all the delivery drivers independent contractors.

Shortly after the business moved into its new space, Lloyd had, in his words, his "first experience of having investors." After an initial stab at providing take-out dinners failed, Lloyd wanted to make the space into an "events area" for community gatherings. The Board of Directors squashed the idea, because, as Cherry said, "We hoped that the business would need the space. In addition, we weren't sure there was a market." McCabe recalled:

You could see that he wasn't happy with that. But we didn't want them distracted. This was a huge challenge, and we wanted them focused on just getting it right before they expanded. Besides, we hoped they would grow and that they'd need that space for the business at hand.

Meals on Wheels

City Fresh targeted one of the few areas of the $400+ billion U.S. food service industry that looked poised for growth.[7] The mainstay of City Fresh's business was delivering meals to home-bound seniors through the Meals on Wheels program. This was a highly fragmented part of a highly fragmented industry. Even the three major players of the $123 billion "non-commercial" sector, which included everything from school food services through vending machines, operated fragmented conglomerates ranging from uniform rental to hotel operation and facilities management.[8] These companies, Aramark, Sodexho, and Compass Group, had grown primarily through acquisitions. Aramark provided facilities management, uniform rental, and childcare and education services in addition to institutional food service; Sodexho had recently purchased the Marriott hotel chain with its facilities management business; and Europe-based Compass operated vending machine and several hotel chains. Aramark and Sodexho were also expanding into elder meals. For Sodexho, these made up 6% of revenues,[9] and Aramark had just entered the market in May 2001, when it contracted with a county in New York State to prepare senior meals in a kitchen that also served the inmates of a local jail, which also had a contract with the company. The elder-meal program served 1,000 meals per day. Aramark had bid $1.45 per meal. [10]

The food service industry was bracing for a slow-down after the booming years of the late 1990s. Operators serving schools and nursing homes actually seemed likely to see an increase close to 3% due to demographic factors. Student populations were rising and the aging population increased residency in nursing homes.

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[7] Schuster, Karolyn & Lawn, John, "2001: A cross-segment business forecast," *Food Management*, February 2001, p. 30.

[8] Janice Matsumoto, "Institutional Giants," *Restaurants and Institutions*, October 15, 2001.

[9] Sodexho investment report - find cite.

[10] Thomas J. Prohaska, "Jail Kitchen to Cook Need Senior Citizens' Meals," *Buffalo News*, May 21, 2001, p. B3.

The home-delivered meal segment was not tracked separately. Delivery was seen mostly as an adjunct for pizza parlors or Chinese restaurants, with widespread home delivery offered only in major metropolitan areas. A few niche businesses had explored delivering specialty meals, especially those that featured nutritionally enhanced foods or catered to people on special diets, but they had not been particularly successful.[11] The biggest home-delivered meals business was Meals on Wheels.

Meals on Wheels was part of an over-arching elder nutrition program funded by the federal and state governments with supplemental support from other sources including the United Way and the elders themselves. Generally, an agency (in Boston, the Council on Aging) contracted with providers who prepared and delivered meals, either to group dining facilities or to home-bound elders. Nationwide, the total expenditure on elder meals for 1999, the most recent year with data, had reached $1.06 billion, less than one-half of 1% of food service revenues, with slightly less than half of this ($499.5 million) in home-delivered meals.[12] The home-delivered meals usually included a hot lunch five days per week, but some agencies provided frozen dinners, or frozen lunches for weekend use, as well.

The program worked as follows: The U.S. Administration on Aging provided grants to 57 state agencies on aging that made grants to 655 area agencies on ageing that contracted with 4,000 local nutrition service providers. In 1999, the program supplied 247 million meals nationally to 2.6 million older adults; 134.6 million of those meals were home-delivered to 884,000 home-bound elders.[13] The meals had to provide at least 33% of the daily recommended dietary allowances, and were to be "designed to be appealing to older adults and to take into account their special diet needs due to health or medical conditions, cultural preferences, or religious beliefs."[14] Evaluations had found the program to be both popular and effective, providing almost half of many clients' daily nutritional needs and often representing the primary meal of the day. The demand for home-delivered meals was expected to rise based on the aging of the population, the expansion of home and community-based long-term care, and the reduction in hospital stays, which increased the need for short-term support services.[15]

Local vendors would bid for a contract to provide meals to the Meals on Wheels program. The business was awarded on a geographic basis, so vendors could bid just for those neighborhoods easily accessed from their facilities. The meals had to meet certain nutritional guidelines. With the reimbursement rate slightly under $5.00 per meal, delivered, it was a volume business. There was one major national provider, the privately-held Valley Management services. This firm had started in Mississippi delivering meals for its Meals on Wheels programs in 1976. In the 25 years since, it had expanded to handle 15,000 hot meals per day in that state alone, in addition to contracts with senior nutrition programs in 21 other states. Overall, the company served over 100,000 meals per week. In addition, it had expanded into frozen meals. Some were shipped directly to the elder's home, some delivered to a group dining area, and yet others to agencies that warmed them and delivered the now-hot meals to elders at home. The frozen meal division projected gross sales for 2001 of $7.5 million, and had just opened a plant that could produce 140,000 meals per week per shift. Other divisions of the company targeted other institutional catering opportunities, especially the corrections industry.[16]

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11 Anon., "Takeout meals for specialized diets," *Food Management*, June 1999, p. 10. Neither of the profiled companies could be found.

12 Administration on Aging, www.aoa.gov, accessed December 26, 2002.

13 Administration on Aging, www.aoa.gov, accessed December 26, 2002.

14 Ibid.

15 Ibid.

16 Anon., "Valley widens senior meals," *Foodservice Director*, August 15, 2001, p. 28.

Providing nutritional meals that could be made in advance and withstand delivery and still appeal to the elders' often-reduced sense of taste was a huge challenge. Producing such food in volume was even harder. McCabe from ICS observed, "Most of the food served in these programs came in small portions and tasted lousy. So City Fresh was pretty revolutionary."

A senior could sign up for various government-funded services, including Meals on Wheels, with a case manager. These case managers would present the options for Meals on Wheels vendors, and if the client was indifferent, could sign that person up for any of the available providers. Lloyd made sure to take care of the 90 case managers who were his immediate clients:

> We have one person dedicated to ensuring that every meal is delivered. When we get a new customer, Jose [the routing manager] allocates that person to a driver's route, depending on the address. Then the driver will deliver the lunch, and everything is delivered by 2 PM. If the person isn't there, the driver will try again, in case they're in the shower or on the phone. If they still don't answer, the driver will radio the office to report that they weren't there. The office will call the customer and if the person is there, they'll tell them we tried to deliver their lunch, do they still want it. If they do, the driver tries again. If they're not home, we'll call the agency and let them know. This is all meticulously recorded. That way, we make the case manager's job easier because we can track down needed information. And, honestly, it's good customer relations. If a senior is wavering between meal providers, some of the case workers will sign them up with us because they know we'll take good care of them.

Buying the Building

In mid-2001, City Fresh was using its entire space to prepare and package 2,500 meals per day. At this point, the City of Boston's Neighborhood Development Department began trying to sell the buildings on its books. One of these was City Fresh's location. BCC approached the city about issuing City Fresh a Request for Proposal to purchase its building.

City Fresh itself was at a $2 million annual run rate, and it was profitable (see **Exhibit 7** for financials). It employed 25 people, along with 15 drivers who were independent contractors. A small catering business, mostly to corporate events such as annual meetings, made up 10% of revenues, but was used mostly for building word-of-mouth awareness. The company provided meals to charter schools and other institutions, including a Harvard University theatre workshop, in addition to elders. The employees participated in corporate decision-making and had recently voted to implement a 401(K) plan. The company was also pursuing a number of environmentally- and socially-aware policies, including the use of an electric van to do some deliveries, and the purchase of organic produce from several growers, including a project that mixed suburban and urban teens. Said Lloyd, "I'd love to buy free-range chickens, but no one around here can guarantee me a sufficient supply. We use half a ton of chicken a week."

As City Fresh started shopping for a loan to buy the building, Lloyd had a pleasant surprise—"Now, LOTS of people would loan us money!"

The city had appraised the building at $240,000. The RFP stipulated that the new owner would have to maintain the present tenant at the present low rent. City Fresh bid the appraised value, $240,000, but, since its lease agreement allowed it to offset the cost of any improvements made to the site, it could credit the $170,000 it had invested in remodeling. Thus, its cash consideration fell to $60,000. Lloyd said, "The people at the City said they had never seen such a complete package as the one we presented." City Fresh's bid won.

Citizens Bank agreed to loan up to 80% of the building's appraised value at a 7% annual rate. City Fresh received title to the building in August 2001. With a loan from Citizen's of $310,000, the company could pay the City and redeem the preferred position.

Paying the Preferred

In September of 2000, Lloyd had looked at buying out his investors entirely, both preferred and common:

> It's hard having someone else owning part of your business. Even when I was a kid and had a lawn-mowing business, I could always call the tune. This is different. But ICS and BCC have been at the table the whole time, all during the negotiations with the city. They worked hard to get me into the building. They gave me good coaching, and probably put me in touch with people I never would have accessed on my own.

A year later, with the increase in his revenues and with the building as collateral for the Citizen's Bank loan, Lloyd could at least buy out the preferred. He said, "The preferred had been weighing on me. I'd made some payments, about $50,000, but it was out there like a hammer about to fall on my head."

Cherry calculated that redeeming BCVF's preferred position, plus the outstanding interest, would cost $171,840, while ICS's would be $79,310 (see **Exhibit 8** for calculations). This would yield both organizations roughly a 15% return, while they retained their 27% holding in common stock. Lloyd protested that this was not community-based, that he was in effect being punished for being successful. "After all," he said, "if I had failed, they would have lost everything. As it is, I'm one of the 30% that's successful, so I'm supposed to provide the return."

He felt that paying the preferred plus dividend was excessive. "A business broker says City Fresh is only worth $280,000, if anyone would even buy it. So why should I have to pay the investors $256,000 and still have them owning common?"

Cherry disagreed on several aspects of this argument:

> For one thing, business brokers measure something completely different—they are looking at the current value of the business, and just in terms of the cash generated. A venture investor isn't buying a business, we're buying potential, we're funding the future uncertain growth of the business. We're making a bet on the entrepreneur's dedication and vision and we're in there with him, helping to grow the business so that we all gain. As for repaying a dividend on top of the preferred—that's part of the deal. We're not a charity, we're investors and we have a fiduciary responsibility to our limited partners. We have to make a decent return from City Fresh because if we don't, we've let our investors down. We'd be mortgaging the future of other businesses, entrepreneurs, and residents, because no one will invest in our next fund if we don't perform. That would be the end of community development venture investing, and that would mean a lot of important work that wouldn't be done in the future.

Lloyd was unconvinced: "I feel that I could get a better deal now. The relationship has changed and the risk has fallen. I should be able to just pay principal and interest."

"But you were raising money three years ago, Glynn," said Cherry:

> And you weren't profitable and no one, venture firm or bank, would back you. Yes, you can get a better deal now, because we took that risk three years ago. And we could take that risk because we had investors who were willing to fund us to do so, on the expectation that we would back good businesses that would allow us to give them a reasonable return, given the risk involved. Three years ago, you were a very risky business. For my investors to want to invest in vehicles like BCVF again, and for other businesses or even City Fresh to get venture backing again, we need to give them returns. Not just their money back, nor a good feeling that they've helped employ people—a money market account will do the first and giving to charity does the second. We're not a charity, we're a financial institution but one with a social mandate. So we don't look for 40% returns, but we do look for enough of a return from our successful businesses that we can hope to raise another fund. And part of that is covering the

> losses in the companies that fail. But face it, Glynn—would you prefer to be where you are, successful, expanding, profitable, about to buy out your preferred, or dealing with a failed business?

Lloyd was indeed hoping to raise more money in the future, at more advantageous terms. He had looked at expanding into other cities that had similar ethnic mixes, and expanding his client base. "I know that we can replicate this in other places. But at the moment, we're focusing on filling in holes in the local area."

The Meeting

Regardless of Lloyd's protests, Cherry strongly believed that full redemption of the preferred was important, not just for her fund but for the growth of a private equity culture in the inner city. As McCabe had said, part of the challenge in funding inner city businesses was finding a disciplined entrepreneur.

As she looked out the window at the Dartmouth Hotel across the street, where BCVF's funding would create the first single occupancy units there in years, she thought about the prospect of actually exiting the City Fresh position. "This is terrific," she mused. "Yet it's a one-off solution, unique to this situation. And it doesn't achieve full liquidity of our position; we still have the common. We need to keep focusing on the ultimate exit and eventually get out entirely."

Exhibit 1: Exit methods for conventional venture capitalists

Venture-Backed M&A and IPO Activity by Quarter

Quarter	Total M&A Deals	Total IPOs	Total Exits	M&A as % of Total Exits
2000-1	90	81	171	53%
2000-2	89	50	139	64%
2000-3	68	76	144	47%
2000-4	53	23	76	70%
2001-1	70	9	79	89%
2001-2	87	9	96	91%
2001-3	85	5	90	94%

Source: Adapted from National Venture Capital Association, "Liquidity Options Remain Limited For Venture Capitalists," NVCA press release, www.nvca.org, May 13, 2002, accessed August 30, 2002.

Exhibit 2 BCVF's portfolio as of September 2001

Bari & Gail, Inc. manufactures and distributes fine chocolate candies to retail and department stores

City Fresh Foods is a prepared foods manufacturer that provides African-American and Hispanic meals to community and corporate clients.

Cooperative Home Care of Boston, Inc. provides in-home health care in the greater Boston area.

Jessica's Wonders is a baked goods company located in Providence, Rhode Island.

SelecTech, Inc., recycles commingled plastic scrap into a variety of semistructural products including planters, landscape timbers, and floor tiles..

SpringBoard Technology

SpringBoard Technology Corporation provides off-site repair and spare parts services, and contract manufacturing services primarily to the computer and telecommunication industries.

TracRac

TracRac, Inc. manufactures rack systems for pickups and vans and power tool workstations.. .

WorkSource Staffing Partnership provides permanent placement services to assist welfare recipients and other at risk groups in securing stable jobs.

zipcar

Zipcar, Inc. is a car sharing company that provides its customers with maintained and conveniently located vehicles by the hour.

Source: www.bcvfund.com, accessed December 8, 2002.

Exhibit 3: BCVF's Evaluation Criteria

BCVF conducts a preliminary analysis of a company by reviewing the business plan to determine the investment's potential for financial and social returns. We may conduct initial research into the market potential and may also meet with the entrepreneur or management team. While we do not impose a strict set of criteria, we do look for strong management talent, a clear competitive advantage, strong growth potential, and a social return to the community. We also typically invest in companies with revenue history.

Source: http://www.bcvfund.com/investment_process.html, accessed December 8, 2002.

Exhibit 4 City Fresh Sample Meals on Wheels Menus

	Haitian	Latin American	Heart-Healthy Southern
Monday	Cabri en Sauce, Riz Blanc, Riz with Pois en Sauce, Salade Goat Stew, White Rice, Peas & Sauce, Salad	Albondigas de Carne con Salsa, L- Espageti y Pan , Zanahorias Meatballs & Sauce, Spaghetti & Bread, Carrots, Chocolate Pudding	Pizza, Potato Puffs, Baked Tomatoes, Chocolate Pudding
Tuesday	Vinde de Boeuf, Riz & Pois Noir, Mais Ground Beef, White Rice with Black Beans, Mexi-corn	Patita de Cerdo, Arroz Blanco, Maiz Mejicano Pigs Feet, White Rice, Mexi-Corn, Fresh Fruit	Pepper Steak, Buttered Noodles/Dinner Roll, Mexi-Corn, Fresh Fruit
Wednesday	Espagetti et Poulet, Pain, Salade Spaghetti & Chicken, Bread, Salad	Pollo Guisado, Puree de Papas, Vegetales Mixtos Stewed Chicken, Mashed Potatoes, Mixed Vegetables, Pears/halves	BBQ Ribs, Wild Rice, Mixed Vegetables, Pears/Halves
Thursday	Boulettes de Viande, Riz Blanc, Salade, Riz et Pois Vert Meatballs, White Rice, Salad	Higado Rojo, Arroz con Gandules, Ejotes Beef Liver, Rice w/Pidgeon Peas, Green Beans, Fresh Fruit	Southern Fried Chicken, Candied Yams, Green Beans, Fresh Fruit
Friday	Poisson Frits, Puree de Pomme de Terre, Mais Fried Fish, Mashed Potatoes, Corn	Pescado Asado, Arroz Amarillo, Brocoli Baked Fish, Yellow Rice, Broccoli, Pineapple Chunks	Stuffed Salmon, White Rice, Broccoli, Pineapple Chunks

Source: www.cityfreshfoods.com, accessed December 7, 2002.

Exhibit 5: Capitalization Table for City Fresh Foods

Date of Investment	May 29, 1998
Co-Investors	Institute for Civil Society
Total Amount	$ 190,000
BCVF Investment	$ 130,000
ICS Investment	$ 60,000
Founders' Ownership	73%
Structure:	Redeemable Preferred Stock, 18% cumulative dividend
	18.47% Common Stock (BCVF)
	8.5% Common Stock (ICS)

Source: BCC Information

Exhibit 6 Payment Schedule

	1998	1999	2000	2001	2002	2003
Investment: BCVF	130,000					
- ICS	60,000					
Total Investment	$190,000					
Payments						
Interest (@18%)	19,950	34,200	34,200	34,200	22,800	11,400
Payment on Preferred	0	0	0	63,333	63,333	63,333

Source: BCVF information.

Exhibit 7a: City Fresh's Income Statement as of September 2001

	FY 1999	FY 2000	YTD 2001
Revenue	936,936	1,358,710	1,492,861
Gross Profit	347,475	485,034	459,986
Operating Profit	41,038	98,410	50,153

Source: BCVF information .

Exhibit 7a City Fresh's Income Statement with Projections