

From Strength to Strength:

Leveraging a Foundation-Owned Social Enterprise (FOSE) to Launch Social Change

A Global Momenta Study
for Gadian Health Systems

December 2014

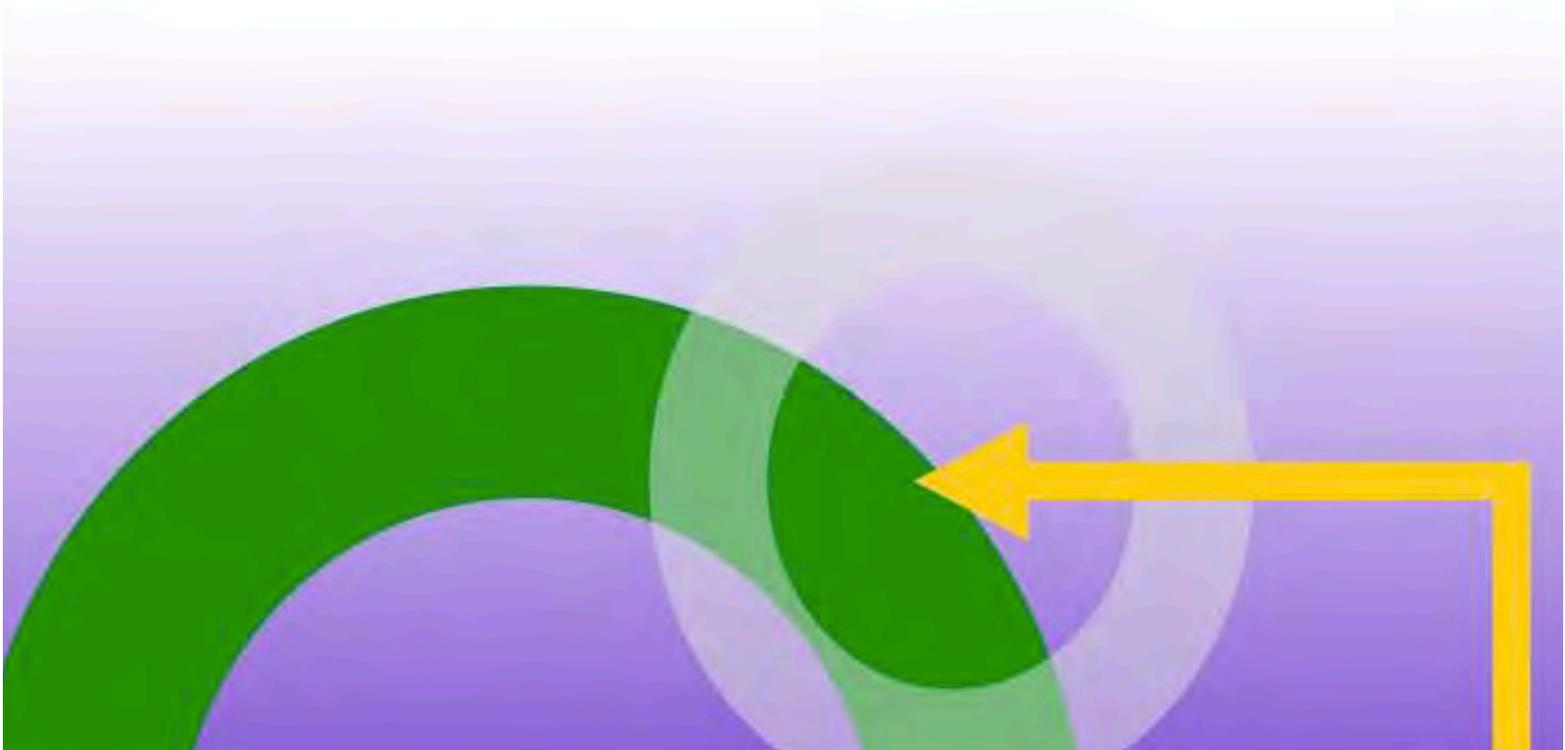


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Executive Summary

Gradian Health Systems equips hospitals around the world to deliver safe, reliable anaesthesia, providing access to emergency and essential surgical care for people who need it the most. Since its launch as a start-up in 2010, Gradian has emerged as an award-winning social venture with nearly 100 UAMs placed in 18 countries worldwide. As it considers options for development, growth, and sustainability, Gradian retained Global Momenta to study the strategic value of its business model, operating as a Foundation-Owned Social Enterprise (FOSE), wholly owned by the Nick Simons Foundation. The main driver for this study was the underlying question fueling much of Gradian's work: are we doing the best job we can, and how could we do it better? The goal was to understand how Gradian's model serves as an enabling vehicle for its business. In particular, what are the benefits, limitations, challenges and opportunities of the FOSE model for Gradian to advance its mission and optimize its impact?

Global Momenta undertook this research to sharpen Gradian's sense of where it is, where it could be headed, and what options & opportunities it could consider in determining how to get there. Research was carried out September-December 2014 largely through interviews and conversations with just over 40 thought leaders and practitioners in philanthropy and social innovation, along with participation in professional gatherings, research and review of relevant literature and related materials. Of those interviewed, 47% are funders (philanthropic individuals & families, private foundations or charitable funds), 53% are philanthropic "influencers" (professional advisors, thought leaders, academics, experts on philanthropy or social enterprise).

KEY FINDINGS

- THERE'S A REAL NEED TO INCREASE AWARENESS ABOUT FOSES IN GENERAL, AND GRADIAN IN PARTICULAR.

The study itself served as outreach to teach, share, and introduce others to the FOSE model, often for the first time. Most interviewees had little to no



experience or awareness of FOSEs as a social impact model and were eager to learn more. For the most part, interviews served as an initial educational & awareness building exercise for participants whose desire to understand more suggested an opportunity to engage further with external partners through joint learning and business development. The review of current and previous research on FOSEs echoes the need to raise awareness, as there is a striking lack of literature, scholarship, or case law. Gradian is uniquely well-placed to share its social innovation story and craft a compelling social impact awareness campaign.

- **ADVANTAGES OF THE FOSE MODEL ARE IDIOSYNCRATIC TO THE FUNDER AND ENTERPRISE.**

Whether or not a FOSE is the appropriate business model depends largely on the circumstances of the funder and the enterprise itself, namely who the foundation-owner (funder) is and what the social enterprise (enterprise) does. Considerations determining suitability of FOSE structure include: the enterprise's growth stage, scale, potential profitability, industry safety and volatility; the funder's liability and asset protection needs, risk threshold, business and management style, financial and professional capacity, timeline and exit strategy. FOSEs are especially valuable when they serve essentially as a Catalytic First-Loss Capital (CFLC) vehicle, benefitting both the funder and the enterprise.

- **FOSES ARE BEST SUITED TO EARLY STAGE ENTERPRISE DEVELOPMENT.**

As a CFLC vehicle, the FOSE model is best suited in the early stage of enterprise development, with potential diminishing returns of the model's benefit tied to scale and profitability. In the short-term, meaning the initial start-up years, a FOSE provides the enterprise with much needed financial stability, resources, and capacity to get up and running. While the commitment and relationship between funder and enterprise may be deep and long-term, the value of using a FOSE for the business model may diminish over time as the enterprise moves beyond its initial early stages when CFLC is critical for the enterprise and funder. After years of operational growth and development, FOSEs can become more complicated when the enterprise may have found its footing and seek growth either in new strategic directions (moving beyond the funder's focus, scope, or scale), or in its business development, financing, and potential profitability. This is where an exit strategy, or more accurately a "business model transition strategy", becomes so important.

- **UNTAPPED & UNDERTAPPED EXTERNAL INTEREST TO ENGAGE WITH GRADIAN.**

As Gradian and its FOSE model were introduced to colleagues through this study, conversations frequently led to questions of how others could participate as funders or partners. Across the board, there was considerable external interest in a range of potential engagement opportunities indicating untapped, or undertapped, resources for Gradian’s development and growth. Funders and advisors wanted to continue or deepen a relationship with Gradian either as (1) a potential partner or philanthropic investor, or (2) a peer or role model example of how they might want to direct or deploy social capital through their foundation, fund, or clients. Thought leaders wanted to explore ways to support and share Gradian’s experience advancing social innovation and impact. The bottom line is Gradian is doing great work and others want to get involved.

RECOMMENDATIONS

- **RAISE AWARENESS AND EDUCATION ABOUT FOSES AND GRADIAN.** Communication and educational outreach should encompass raising visibility and profile of Gradian’s work, thought leadership and experience operating as a FOSE. Awareness raising serves to reinforce Gradian’s stature as a trailblazing social venture, while also contributing to fields of philanthropy and social innovation and forging deeper connections with multiple stakeholders through various platforms. Telling the story of its launch as a FOSE demonstrates Gradian’s commitment to innovate, learn, improve, share and develop deep ties in its spheres of influence and interest.

- **FROM STRENGTH TO STRENGTH: ADAPTING GRADIAN’S BUSINESS MODEL FOR NEXT STAGE OF DEVELOPMENT & GROWTH.**

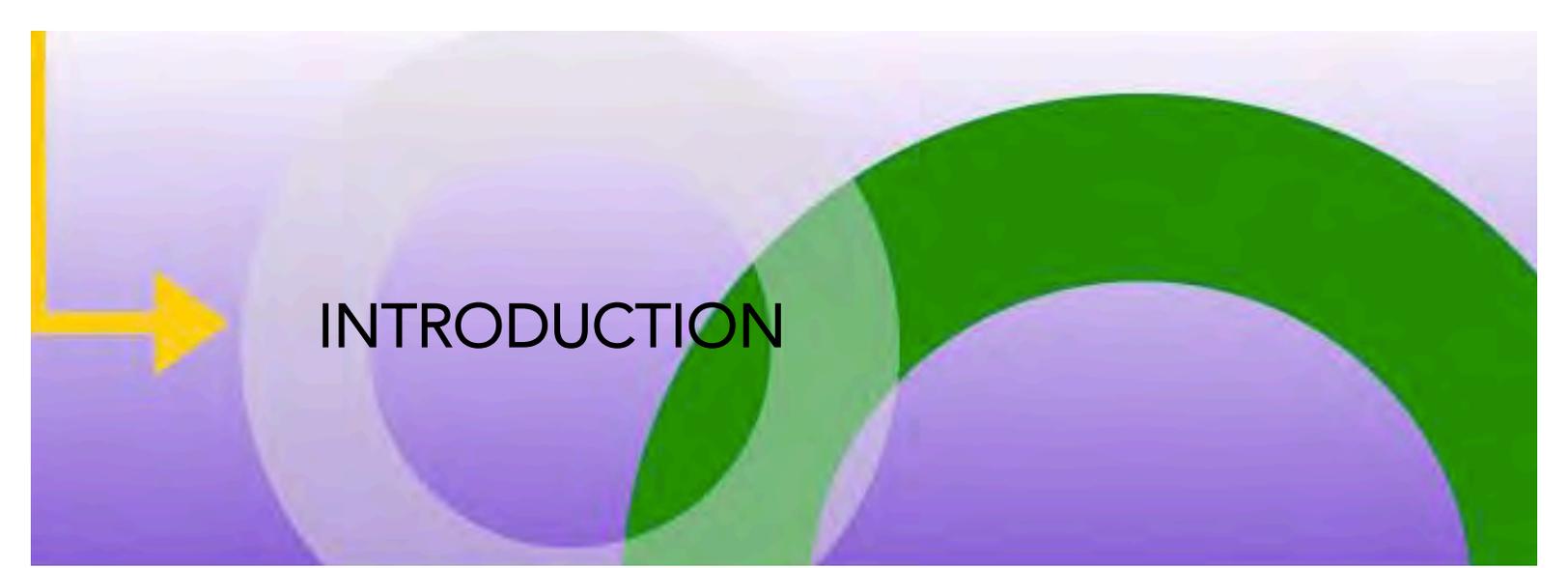
Gradian is uniquely well-positioned to adapt its business model of a Foundation-Owned Social Enterprise as it enters a new phase of growth and development. Operating as a FOSE since inception, Gradian has emerged as a strong and growing enterprise, increasingly attracting professional recognition and awards, media attention, talent, partnership and investment opportunities. Building on the commitment of its funder and the value of the CFLC it has received, Gradian is poised to adapt its business model to ensure long-term growth and sustainability. Whether it continues to operate as a FOSE with NSF as its foundation-owner, or transition to an independent entity with NSF as its funder, Gradian is in a strong position to augment this core support for its annual budget

with additional development, fundraising and financing. Ensuring its capacity to do so may mean renegotiating its structure, terms or operating strategy.

- **ESTABLISH EXTERNAL RELATIONS STRATEGY**

To support its growth and development, Gradian should create an external relations engagement program serving to recruit, cultivate, and steward strategic relationships with prospective donors, investors, partners and other High Net Impact Catalysts. External engagement will facilitate and foster high-level, long-term relationships with key funders needed to take Gradian to its next level of capacity and impact.





INTRODUCTION

Since its launch in 2010, Gradian Health Systems has promoted safe surgery by offering access to reliable, affordable anaesthesia where it is most needed around the world. Gradian equips and trains under-resourced hospitals with its Universal Anaesthesia Machine (UAM), providing safe anaesthesia for emergency and essential surgery. Through its innovative business model, Gradian uses market mechanisms to sell UAMs, while using philanthropic resources to address market failures and advocate a cause. How does it do this? Gradian operates as a Foundation-Owned Social Enterprise (FOSE), that is to say a *single member limited liability company* (SMLLC), wholly owned by the [Nick Simons Foundation](#). Also considered a *disregarded entity*, Gradian is both a *program-related investment* of the foundation and a commercial subsidiary of it. In this way, the SMLLC enjoys the tax exempt status of the parent company while operating as an independent legal entity. Taking the idea from initial prototype, product research and development,

manufacturing, marketing and distribution, Gradian has emerged as an award-winning social venture with nearly 100 UAMs placed in 18 countries worldwide.

Arriving at this inflection point, Gradian retained Global Momenta to study the strategic value of its business model, as it considers options for development, growth, and sustainability. The main driver for this study was the underlying question fueling much of Gradian's work: are we doing the best job we can, and how could we do it better? The goal was to understand how Gradian's model serves as an enabling vehicle for its business. In particular, what are the benefits, limitations, challenges and opportunities of the FOSE model for Gradian to advance its mission and optimize its impact? Specific objectives (see *Appendix A*) of the study were to:

- Analyze the FOSE as a new philanthropic business model and/or emerging trend;

- Share and exchange best practices & lessons learned with peers;
- Identify challenges, solutions, and emerging issues in the sector;
- Understand the legal parameters of this model;
- Explore new strategies to improve and/or adapt this philanthropic business model;
- Consider opportunities to accelerate and increase positive social impact and measurable results through this model
- Offer insights to inform business development and strategic planning for Gradian.

With these aims and agenda in mind, Global Momenta undertook this research and strategic development project to sharpen Gradian’s sense of where it is, where it could be headed, and what options & opportunities it could consider in determining how to get there. During the course of the project, the focus shifted in response to: (1) enthusiasm & curiosity from colleagues seeking to learn more about what the FOSE model is, (2) the realization that FOSEs are neither widely used nor well understood in the

philanthropic sector; and (3) interest from potential partners and funders to find ways to engage with Gradian’s work. As the project evolved, the scope expanded to consider how Gradian might engage externally to advance its social impact.

This report presents an overview of the research process, key findings, and recommendations, and an appendix of additional materials. The project was conducted late August through December 2014, working closely with Gradian leadership through Erica Frenkel. All opinions presented in this report are the responsibility of the author. This version of the report is intended as an internal working document serving as the basis for adapted formats to be prepared and shared both internally and externally with multiple stakeholder groups.





RESEARCH PROCESS OVERVIEW

To embark on the research project with clear parameters, we articulated several hypotheses (see *Appendix B*) and corresponding questions, then set out to prove or disprove these assumptions. Research was carried out largely through interviews and conversations with selected thought leaders and practitioners in philanthropy and social innovation, along with participation in professional gatherings, online research and review of literature and relevant materials. The abbreviated hypotheses were:

1. Gradian's business model, as a FOSE, is unique, or rare, due to (1) its particular circumstances, (2) risk aversion of other funders, (3) lack of awareness re:FOSEs.
2. The FOSE model offers particular advantages for both funders and implementers.
3. A FOSE is like "an enlightened variation" of university-funded research and innovation.
4. The FOSE model can be

improved, adapted, and replicated by peer-to-peer exchange of best practices and lessons learned.

5. A FOSE exit strategy from its Single Member "parent" is likely tied to profitability.
6. Better understanding of the legal parameters of FOSEs could help in its replication, application or adaptation.

Specific interview questions (see *Appendix C*) were prepared around six issue areas, corresponding to these research hypotheses (on average, seven questions per hypothesis). Interviewees were asked about their perspective on the FOSE business model in terms of its: status in the social impact field, advantages & challenges, legal and tax parameters, best practices & lessons learned, long-term strategy considerations, and comparable or alternative social innovation business models. The actual interviews varied considerably in length, depth, and breadth, depending on the

interviewee's interest, area of expertise, and experience level regarding FOSEs. Frequently, interviews and conversations led to more questions than answers, more interest in the idea of a FOSE than insight from experience working in or with this business model, because most people had not yet done so. Interviewees also invariably suggested another person whom they thought would serve as a valuable resource, offer another perspective on the FOSE business model, or be interested in potential partnership with Gadian.

Interviews and conversations took place with just over 40 people, carried out in person or by phone, depending on availability and location. Individuals were approached in their personal capacity, off-the-record and not for attribution to ensure candor, assure trust and facilitate genuine dialogue. People were selected based on their perspectives from direct professional experience and expertise, as well as their relationship or receptivity to develop ties with Gadian. Of those interviewed, 47% are funders (philanthropic individuals & families, private foundations or charitable funds), 53% are philanthropic "influencers" (professional advisors, thought leaders, academics, experts on philanthropy or social enterprise).

While most interviews were scheduled in

advance and occurred during October-November, several conversations came up opportunistically in the context of conferences or other gatherings. Two particularly helpful convenings were the High Water Women Investing for Impact Symposium, and the Wealth and Giving Forum. Both offer potential platforms for future Gadian participation and helpful content to understand the market of philanthropic innovation and impact investment. It was also valuable to participate in a few Gadian meetings with external organizations, namely with the Foundation Center's GrantCraft team, and with Total Impact Advisors. Conversations with both of these colleagues shed light on how Gadian in particular, and the FOSE model in general, are perceived in the field.

The scan of literature, informational material and other resources regarding FOSEs included articles, blog posts and comments, case studies, IRS tax code and explanation, as well as internal documents such as Gadian's original business plan. We also surveyed relevant philanthropy & social innovation resources, including briefing papers and reports addressing: catalytic capital or Catalytic First-Loss Capital (CFLC), philanthropic market overviews and forecasts, impact investment trends, High Net Worth giving profiles, family office and private foundation news.



KEY FINDINGS

Key Findings of the study include: (1) there is real lack of and need to increase awareness about FOSEs; (2) the advantages and disadvantages of the FOSE model are idiosyncratic to the funder and enterprise, proving especially valuable as a Catalytic First-Loss Capital vehicle; (3) when serving functionally as a CFLC, the FOSE model is best suited to early stage or slow growth enterprise development, with potential diminishing returns of the model's benefit tied to scale and profitability; and (4) there is a strong interest for external engagement with Gradian's work.

NEED FOR EDUCATION & AWARENESS BUILDING ABOUT FOSES

Though the study intended to learn from others' experience with FOSEs, it was evident early on that our outreach served to teach, share, and introduce others to the FOSE model, often for the first time. As such, the interviews and conversations proved to be more of an educational & awareness building

exercise, than discovery of best practices, lessons learned or other insights from their experience. Interviewees had little to no experience or awareness of FOSEs as a social impact model. For the most part, interviews generated an initial response of "What an interesting idea! I don't know of examples quite like that and it'd be great to learn more." This desire to understand more suggested an opportunity to engage further with external partners through joint learning and business development.

While SMLLCs are created all the time among corporate entities, it's still relatively rare for the "parent" Single Member owner of an LLC to be a 501(c)3, and even rarer for that to be a private family foundation. Mostly, funders and their advisors approached were simply unaware of the option to create an SMLLC as a social enterprise vehicle for philanthropic purpose. And even if they were aware of that structure, it didn't occur to them to consider it as a philanthropic strategy for social impact.



The review of current and previous research on FOSEs echoes the need to raise awareness, as there is a striking lack of literature, scholarship, or case law. The few articles found underscored how little this business model is known, utilized and understood in the nonprofit world. Of the 13 articles reviewed which dealt directly with FOSEs, nine were published in the past year, and of those nearly half were authored by Gradian staff. Clearly, this is an idea only beginning to receive attention, and that is largely being driven by Gradian itself.

Several recent articles and blogposts specifically about Gradian's structure as a FOSE are introducing what the model is and how it works. While direct comments were limited, GrantCraft indicated significant traffic (around 700 views) to its October 2014 post by Gradian's Erica Frenkel, "Foundation-Owned Social Enterprise: an Introduction." The post also inspired another article in *NonProfit Quarterly*, and was picked up or reposted on several other sites (including AGMConnect @Association of Grant Makers, Philanthropy 101 @Jewish Funders Network, Urban Social Entrepreneur) and platforms (e.g. Pinterest, Scoop.It). Gradian's leadership is not only pioneering use of the FOSE model, but also raising awareness and contributing to discussion about how to do the business of social change as a FOSE.

Given the scarcity of other examples and information about FOSEs, it's safe to say they are not yet taking off as an emerging trend, at least not as of now, though demand to learn more is growing. This interest may be attributed in part due to Gradian's leadership, increased visibility and the external engagement of the study itself. In any case, this lack of prior exposure and experience with FOSEs appears to be the main explanation that we don't see more FOSEs in philanthropy. With so few FOSEs in the social change sector, Gradian's approach stands out as highly innovative and potentially trailblazing, paving the way for others to follow. That said, awareness or lack thereof doesn't explain everything. The use of a FOSE as a business model also reflects the particular needs, style, and circumstances of its foundation-owner and its social mission, which may be less replicable and more idiosyncratic to Gradian.

FOSE ADVANTAGES ARE IDIOSYNCRATIC TO THE FUNDER AND THE ENTERPRISE

The advantages of the FOSE model correspond to who the foundation owner (funder) is and what the social enterprise (enterprise) does. There's no one size fits all FOSE, and sometimes, it's just not a match. Whether or not a FOSE presents more advantages or disadvantages depends largely on the

circumstances of the funder and the enterprise itself. To determine whether or not a FOSE business model is the way to go for social impact strategy, funders should consider: potential profitability of enterprise, industry volatility or risk of enterprise, the funder's liability and asset protection needs, risk threshold and management style, financial and professional capacity, timeline and exit strategy.

How FOSEs Benefit the Funder

The first and main advantage of a FOSE for the funder is the liability and asset protection it offers. This is especially important when the enterprise is engaged in a high risk industry, like biomedical devices, as is the case with Gradian. According to the legal and accounting professionals interviewed for this study, this is the primary advantage of a FOSE for the funder. As the central benefit for the funder of a FOSE, it also indicates the relevance of the particular nature of the business—what the social enterprise does and how it carries out its work—to determine structure of business model. Protecting the funder's interests, especially when there are liability risks or issues, is of paramount concern for a funder and its advisors. FOSEs can be an expedient way to while provide legal protection while pursuing social aims in high risk arena. Furthermore, as a *disregarded entity*, Gradian serves as a tax-free investment for NSF, fulfilling its 5% annual disbursement requirement.

For NSF, the decision to establish Gradian as a FOSE was primarily one of expediency. It seemed the best structure through which it could ensure liability protection, while working to achieve its goals and protect its interests: introduce the Universal Anaesthesia Machine into markets where it was most needed, maximizing efficiency and effectiveness in development and distribution.

Fundamentally, a FOSE offers the funder a great vehicle to explore creative philanthropic strategies using market mechanisms and innovative solutions not supported by commercial markets alone. As suggested by Patricia Weisenfeld, an advisor to NSF: this is where family philanthropy can play such an important role, experimenting where others can't with the understanding it might take ten years to know if this works. A traditional nonprofit can't afford that kind of time; commercial investment won't take that kind of risk.

How FOSEs Benefit the Enterprise

The main advantage of a FOSE for the enterprise is the benefit extended by the tax exempt status of its foundation owner, thereby relieving it from burdensome tax filing and reporting requirements. When the owner is also the funder, a FOSE also provides access to a reliable, steady stream of income. Operating as a FOSE is especially beneficial among early stage or slow

growth companies which are otherwise not competitively positioned for access to capital. For a start-up social venture, reducing or removing the burden of fundraising, financial insecurity, instability, and stress, not to mention extensive reporting and filing requirements, frees the enterprise leadership to focus on vision and execution, operational strategy, business management and development work. That is an enormous advantage especially in early stages when enterprises are typically under-resourced and insufficiently capitalized to stay in business as long as it takes to become stable or sustainable, let alone scalable, or even profitable.

For Gradian, the FOSE structure has been a terrific model operationally and strategically,

“– as a start-up social enterprise we are able to pursue non-profitable objectives with a steady, reliable source of funding (who gets to say that?!).” ERICA FRENKEL, VP GRADIAN HEALTH SYSTEMS.

In addition to the financial support and security, for Gradian, operating as a FOSE owned by the Nick Simons Foundation (NSF) has also meant benefitting from shared infrastructure, resources, a community of colleagues, and association with philanthropic

stature and “brand” integrity. Also, as a *disregarded entity*, Gradian enjoys tax exemption benefits effectively extended to the FOSE by the parent company’s charitable status.

Win-Win: Catalytic First-Loss Capital Benefits both Funder & Social Enterprise

A FOSE is especially advantageous in its function as vehicle for Catalytic First-Loss Capital (CFLC), which can benefit both the funder and the enterprise. In establishing a FOSE, the foundation-owner effectively provides the start-up with CFLC, directing purpose-driven capital to achieve a specific social goal, absorbs the first loss (or initial losses) as the enterprise builds out its business, and potentially reduces risk – and catalyzes participation – for other prospective investors. Creating Gradian as a FOSE allowed the funder to use a combination of market forces and philanthropic investment to achieve its goal, getting UAMs to operating rooms in low-resourced hospitals, equipping markets characterized by low purchasing power with the innovative medical technology needed for safe surgery. As a CFLC tool, the FOSE model benefits the funder with: accelerated or expanded impact, resource optimization, potential to attract additional philanthropic partners for the social enterprise.

“Philanthropy must do what it does best: peel back the first layer of risk, and

experiment where other sectors cannot, making development and commercial investment dollars more productive and less risky.” DR. JUDITH RODIN, PRESIDENT, THE ROCKEFELLER FOUNDATION.

Gradian is a great example of an enterprise well-suited for CFLC: a high impact venture with strong promise of social return on the investment (SROI), but low potential for competitive financial ROI short-term and quite possibly long-term (if ever). As such, the CFLC serves not only to finance Gradian’s operations, but also leverage its financial stability to potentially enhance its attractiveness for other philanthropic investors, donors, partners, or other social capital providers. Enterprises like Gradian need catalytic capital to finance their capacity to achieve social purpose using market forces that may never become profitable, or at least not competitively so within the current structure. CFLC is especially critical for Gradian as it employs a commercial strategy (sell UAMs) to under-resourced markets that often require philanthropic subsidy, assistance to improve access to capital, or other kinds of financial intervention to offset market failures.

Entrepreneurial Approach Reflecting Style of Funder & Enterprise

Another advantage of a FOSE that can benefit both the funder and the enterprise is the start-up, entrepreneurial style, image and

brand/marketing strategy. A FOSE is likely to appeal to practitioners and entrepreneurs who like the idea, image, and practice of working for a social goal or purpose through a private company. For some, there’s a theory of change or deeply held belief that market forces and commercial approaches yield better results than traditional nonprofit work. There’s also a kind of contemporary *cache* to being a social entrepreneur, applying innovative strategies and creative solutions that are inherently implied through a social enterprise, as opposed to a conventional, charitable organization. In contrast, more conservative social change advocates might prefer more tried and true, established organizations to achieve their goals. For them, a FOSE may not align with their business style, philanthropic theory of change, social impact strategy, or even their public presence or “persona”.

There’s also a question of risk threshold with entrepreneurial style. Some philanthropists seek out highly entrepreneurial (and high risk), innovative, social investments opportunities to pilot and test unproven strategies. For them, a FOSE could be a great way to try out an initiative with a start-up approach, harnessing all the creativity, energy, uncertainty, resiliency, and ingenuity that entails. By contrast, the FOSE model may not appeal to more conservative or risk-averse funders. The particular style of the

funder may suggest more traditional philanthropic investments through conventional grants or the program related investment (PRI) route. Risk-averse funders may also fear setting the burden of proof demonstrating that the social enterprise is truly mission-related and does not expose the foundation to any unrelated business income. This concern becomes more complicated as an enterprise grows in terms of profitability, scale, and engagement with additional donors or investors. This is to say, while FOSEs may offer advantages to funders looking to seed and launch early stage enterprises, the model may not be appropriate as an enterprise outgrows initial business development phases.

TIMELINE & EXIT STRATEGY: FOSE IS BEST SUITED FOR EARLY STAGE OF SOCIAL ENTERPRISE DEVELOPMENT

The advantages of the FOSE model are most important, both to funder and enterprise, during the early stage of enterprise development. In the short-term, meaning the initial start-up years, a FOSE provides the enterprise with much needed financial stability, resources, and capacity to get up and running. A FOSE can rely on CFLC to conduct research and development, prototype, pilot, evaluate, learn lessons, pivot, experiment, iterate and reiterate, all of which are necessary phases of the early stage innovation process. At the same time, the FOSE allows the funder

to try out new solutions to solve social problems through a *disregarded entity* able to use market forces to maximize expediency, effectiveness, and social impact. While the commitment and relationship between funder and enterprise may be deep and long-term, the value of using a FOSE for the business model may diminish over time as the enterprise moves beyond these initial early stages.

After years of operational growth and development, FOSEs can become more complicated when the enterprise may have found its footing and seek growth either in new strategic directions (moving beyond the funder's focus, scope, or scale), or in its business development, financing, and potential profitability. This is where an exit strategy, or more accurately a "business model transition strategy", becomes so important.

This is especially so when the FOSE has served as CFLC, making the enterprise attractive (and less risky) for other investors or donors.

The objective of the funder as a CFLC provider is "not to structure all the risk out of a particular investment; the goal is to provide just enough protection to entice investment and then let market forces (i.e., investment performance) drive future

*transaction terms.” –GIIN
Catalytic First-Loss Capital Report.*

If the FOSE, thanks to the CFLC provided, becomes profitable, and thereby investor ready, investor worthy, with competitive value-add in the market, it may pose issues for the funder. Namely, the funder may no longer need or want to be the *single member owner*, even if they retain their role as the primary investor. Likewise, the enterprise itself may need or want the independence and flexibility to pursue and receive other investor dollars, develop new business and revenue channels, or become more profit-driven. When there is high likelihood of profitability, the funder may convert its support into another financial structure or vehicle, so they can direct philanthropic capital to social programs, products, or services without prospect of profitability, or to other start-ups or enterprises needing early stage or subsidized support.

The FOSE business model adds value as a CFLC provider vehicle until ultimately and ideally it enables the enterprise to become *profitable* and attract additional investment. The FOSE model is also helpful for an enterprise that does not anticipate profitability, but is headed to *sustainability*. In that case, the FOSE model may enable the enterprise to attract additional *donors*. As such, the funder’s role as CFLC provider is really as a *philanthropic*

angel or incubator. This implies expanding our understanding of CFLC as a financial tool to seed nonprofit, philanthropic start-ups, regardless of potential profitability.

When the FOSE model enables the venture to become viable independently as a high impact, but *low or no profit* entity, the foundation may no longer need to be the *single member owner* of the enterprise, rather consider other philanthropic support vehicles to support it as an independent organization. As a high impact, nonprofit venture, the FOSE may become attractive to other donors and revenue sources. In this case, the exit strategy could be to spin off the FOSE into an independent nonprofit organization, converting the foundation’s *single member owner* status to that of primary funder or *donor*. Another strategy raised by interviewees would be to absorb the nonprofit into the foundation as an in-house program or operating division. Either way, being absorbed into the structure of a larger nonprofit organization or incorporating independently as a 501(c)3, the enterprise retains the benefit of its tax exempt status.

Over time, a long-term exit or transition strategy is also important as a FOSE finds its stride with its focus, scope, or scale developing in a direction beyond or different from the funder. While

adhering to its mission and the social values of the funder, the FOSE may have growth opportunities through entry into new markets, deepening presence into current markets, development of new products or offering additional services. In this case, the FOSE could be well served to transition to an independent entity (for profit, nonprofit, or hybrid), financially sustained by the funder as a donor or investor, but no longer as a single member owner to facilitate its new direction and capacity.

In any case, for the FOSE model to really benefit the enterprise over the long haul, it needs the assurance of a long-term, multi-year commitment from the funder. And if a funder anticipates an exit strategy from owning a FOSE down the road, it also needs to offer plenty of lead time and resources for the enterprise to transition responsibly and successfully into an independent structure. Given the significance of potential business model transitions for enterprise viability, organizational capacity, and social impact, ideally the principles of an exit strategy are mutually agreed upon at the outset of establishing a FOSE. By setting terms early on for when and how an exit strategy will occur, both funder and enterprise are guided and supported through structural transition to post-FOSE entity.

UNTAPPED OR UNDERTAPPED

EXTERNAL INTEREST IN GRADIAN INNOVATION & IMPACT

As Gradian and its FOSE model were introduced to colleagues through this study, conversations frequently led to questions of how others could participate as funders or partners. Across the board, there was considerable external interest in a range of potential engagement opportunities indicating untapped, or undertapped, resources for Gradian's development and growth. While the idea of the FOSE model is interesting and one that interviewees may want to learn more about, the bottom line is Gradian is doing great work and others want to get involved in some way. The timing and news of the Tech Awards and increased media attention this fall reinforced Gradian's appeal and cache to other funders, advisors, and thought leaders during the study.

Funders and advisors wanted to continue or deepen a relationship with Gradian either as (1) a potential partner or philanthropic investment, or (2) a peer or role model example of how they might want to deploy social capital through their foundation, fund, or clients. Gradian's work appeals to funders and advisors looking to direct the flow of philanthropic capital along the impact investment spectrum. In particular, Gradian sparks interest in philanthropists seeking investment and partnership opportunities with ventures

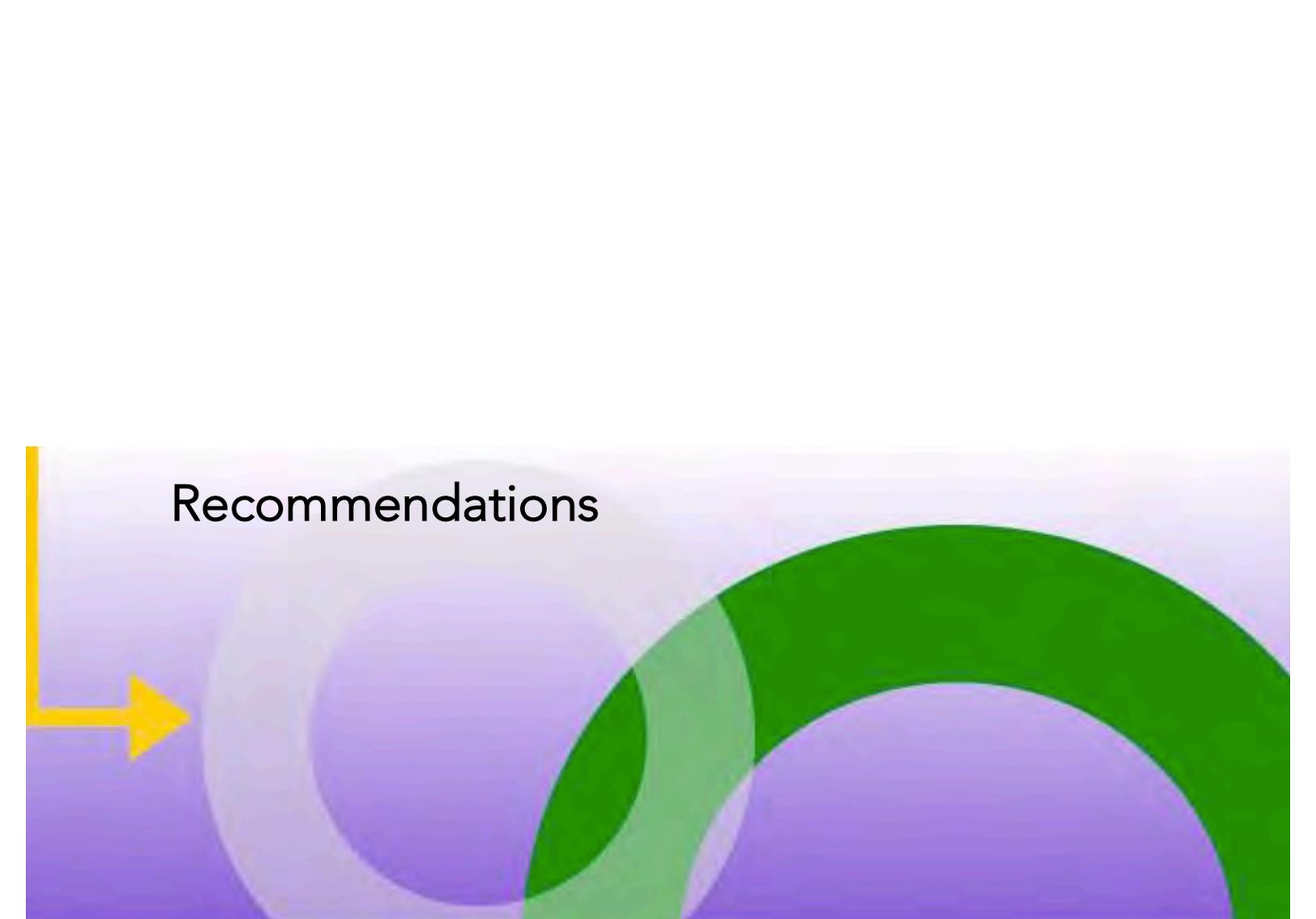
addressing global public health innovation with appropriate biomedical technology.

Upon learning about Gradian's use of the FOSE model, a prominent philanthropist in social innovation thought it would be great to share with other philanthropic families as another way "to connect the dots between options for how we move money for social good." Similarly, the head of an association of affluent families committed to high impact philanthropy thought this could be an interesting example to share with their membership.

Another value add people respond to is the quality and integrity of Gradian leadership. The fact that the study was being undertaken in and of itself generated respect and enthusiasm from other funders' for what were perceived as core company values: dedication to professional excellence, innovation and self-reflection, collaboration and transparency, entrepreneurship and resourcefulness, and ethical rigor. The commitment of Gradian's funder positions the enterprise as a solid potential philanthropic investment with very compelling value proposition and high SROI. Individuals interested in learning more about Gradian expressed receptivity to meet for further private conversations with Gradian, along with peers from private and family philanthropy.

Thought leaders and professional advisors wanted to explore ways to support and share Gradian's experience advancing social innovation and impact. Interviewees from leading philanthropy-focused professional firms (law, wealth management, accounting) all offered to host or co-host private events to facilitate engagement with Gradian, discuss findings from the study, and further explore how the FOSE model serves philanthropic innovation and impact.

GrantCraft, the philanthropy service program to share best practices and improve effective giving for funders, has offered to extend its platform and the Foundation Center's resources in whatever ways may be mutually beneficial to Gradian and their constituency of foundations and philanthropy. They've suggested another –or a series- of blog posts, a follow-up survey, hosting an event, webinar, participating on panels, creating products or services stemming from the study to share practical lessons with their constituency. Funder association and affinity groups have inquired to present Gradian's experience as a FOSE to their membership networks. Academics and scholars have invited further engagement with Gradian around the FOSE business model both as a subject of academic inquiry and of extracurricular program activity.



Recommendations

RAISE AWARENESS AND EDUCATION

Communication campaigns and educational outreach should encompass raising visibility and profile of Gradian's work, thought leadership and experience operating as a FOSE. Awareness raising serves to reinforce Gradian's stature as a trailblazing social venture, while also contributing to fields

of philanthropy and social innovation, and forging deeper connections with multiple stakeholders through various platforms. Telling the story of its launch as a FOSE demonstrates Gradian's commitment to innovate, learn, improve, share and develop deep ties in its spheres of influence and interest.

To share and build on the study, the report should be prepared and

presented in multiple formats

- internal presentation of final study to Gradian leadership & key partners
- adapted versions of study and/or key findings for various audiences, including: professional & popular outlets and platforms, selected blogs & website postings,
- Selective conference, panel, and other gatherings participation
- Public speaking & media venues
- Private events to be hosted, co-hosted, convened or facilitated with key partners

Gradian communication strategy should be closely integrated with development strategy. All educational outreach presents opportunities to articulate Gradian's core identity and narrative. Content from the study should be integrated into updated website & relevant findings should help inform branding strategy. To integrate communications with development, core development material should be prepared as part of Gradian's coordinated communications strategy, including: donor-investor deck, "for donor-investor" value proposition and information, reports, and other promotional material highlighting

Gradian's innovation, growth and impact.

FROM STRENGTH TO STRENGTH: ADAPTING GRADIAN'S BUSINESS MODEL FOR NEXT STAGE OF DEVELOPMENT & GROWTH

Gradian is uniquely well-positioned to adapt its business model as a Foundation-Owned Social Enterprise as it enters a new phase of growth and development. Operating as a FOSE since inception, Gradian has emerged as a strong and growing enterprise, increasingly attracting professional recognition and awards, media attention, talent, partnership and investment opportunities. Its geographic scope has expanded beyond that of its foundation-owner, and its social aspirations extend from increasing distribution of the Universal Anaesthesia Machines in under-resourced markets, to transforming operating theaters for safe surgery everywhere.

Building on the commitment of its funder and the value of the CFLC it has received, Gradian is poised to adapt its business model to ensure long-term growth and sustainability. Whether it continues to operate as a FOSE with NSF as its foundation-owner, or transition to an independent entity with NSF as its funder, Gradian is ready to augment this core support for its annual budget with additional development,

fundraising and financing. Ensuring its capacity to do so may mean renegotiating its structure and terms, establishing an endowment and multi-year funding commitments, and adapting its business operation to include dedicated professional management of high-level, external relations strategy and program.

ESTABLISH EXTERNAL RELATIONS STRATEGY

To support its growth and development, Gradian should create an external relations engagement program serving to recruit, cultivate, and steward strategic relationships with prospective donors, investors, partners and other High Net Impact Catalysts. External engagement will facilitate and foster high-level, long-term relationships with key funders needed to take Gradian to its next level of capacity and impact. In particular, external partners could be critical in helping Gradian overcome what it has identified as a key obstacle to scale: access to capital among its target market.

Building on the strength of its current position, stage of development, and long-term relationship with its founder and funder, engaging additional donor partners will serve to: validate and improve business viability; create a base for Gradian to expand its business; improve or develop new product and service lines; manage growth and scale;

experiment with new revenue streams; ultimately reach more markets needing safe & reliable anaesthesia and bring safe surgery to all. As Gradian explores new development opportunities,

Recommended engagement strategies include: offering customized philanthropic investment opportunities, creating new financial vehicles for donors, philanthropic business partnership development, convening private gatherings, hosting and co-hosting events, aligning with affinity funder groups, participation in selected conferences and meetings, strategic networking and presence in key groups and associations, and high-level, one-on-one relationship building & management.

Outward-looking engagement and fundraising will require a menu of philanthropic opportunities Gradian can offer funders. To support this program, Gradian should embark on an MBA financial modeling project. Top-tier MBA talent will analyze what financial vehicles exist or could be created to best serve Gradian and its potential funding base. Engaging prospective investors in this project may attract those looking to advance in philanthropic innovation.

Substantive engagement with thought leaders and professional advisors will deepen interest from thoughtful funders, generate content to cultivate

prospective donors, and reinforce Gradian's stature as a prime philanthropic investment opportunity. To do so, Gradian can undertake several strategies:

- Leverage the FOSE business model study with follow-up outreach to targeted pool of influential catalysts in philanthropy, social innovation and global health;
- Offer private briefings for professional advisors (wealth managers, philanthropic advisors, legal and tax firms) and their clients;

To manage high-level external relations, Gradian will need to dedicate professional attention and organizational commitment over an extended period as deep relationship building is a long-term process. To guide this program, an External Engagement Road Map should be prepared that directs how Gradian resources and leadership can be outwardly-oriented and focused. Informed in part by this study, the Road Map will set a plan of action to be implemented early 2015. The Road Map will position Gradian to raise its visibility and presence in high-impact networks, forge and deepen strategic partnerships and alliances, solicit and secure major funding commitments, and catapult its work forward into the next stage of development for business growth and

social impact.



Conclusion & Acknowledgments

This research analyzed the strategic value of Gradian's innovative business model, operating as a Foundation-Owned Social Enterprise (FOSE) owned by the Nick Simons Foundation. The aim of the project intended to sharpen Gradian's sense of where it is, where it could be headed, and what options & opportunities it could consider in determining how to get there.

Research was carried out by Global Momenta, September-December 2014, largely through interviews and conversations with just over 40 thought leaders and practitioners in philanthropy and social innovation, along with participation in professional gatherings, research and review of relevant literature and related materials. All opinions contained within this report are the sole responsibility of the author, Diana Ayton-Shenker. The author is grateful for the support, guidance, and input of Gradian Health Systems, its

leadership, Global Momenta team and research assistants, and all of the colleagues and interviewees who generously contributed their time and expertise to participate in the study.

The **key findings** from the study indicate: (1) there is real lack of awareness and need to increase understanding about FOSEs; (2) the advantages and disadvantages of the FOSE model are idiosyncratic to the funder and enterprise, proving especially valuable as a Catalytic First-Loss Capital vehicle; (3) when serving functionally as a CFLC, the FOSE model is best suited to early stage or slow growth enterprise development, with potential diminishing returns of the model's benefit tied to scale and profitability; and (4) there is a strong, largely untapped or *undertapped*, interest for external engagement with Gradian's work.

Based on these key findings, the study suggested **several action items as recommendations** for Gradian. Specifically, the study recommends that Gradian consider three next steps at this

junction: raise awareness and education about Gradian's innovative work and experience as a FOSE; adapt its business model to accommodate next stage organizational growth and long-term development; establish an external relations program to engage additional partners, investors, funders, and other High Net Impact Catalysts. Through these recommended action items, Gradian can expand its capacity and deepen its impact bringing safe anaesthesia and safe surgery where it is

most needed to save and improve lives worldwide.





APPENDIX

APPENDICES

- A. Project Goals & Related Questions
- B. Key Hypotheses & Research Questions
- C. Interview Questions
- D. Research Sources & Literary Overview

A. Original Study Goals & Objectives with related Research Questions:

- Analyze Gradian's approach as a new philanthropic business model and/or an emerging trend;
 - Is it a new model? Is it an emerging trend? Who else is doing this? How? If we are only ones doing this, why? what is the value of this model (Fdn ownership) v. fdn grant or PRI?
- Share and exchange best practices & lessons learned with peers;
 - What has Gradian learned as best practices & lessons to share?
 - What have others learned?
- Identify challenges, solutions, and emerging issues in the sector;
 - What are the primary sector(s) impacted by this model? what are sector-specific challenges, solutions, and emerging issues (from perspectives of social entrepreneurship?

- As a FOSE, what is our exit strategy? How do we manage growth, scalability, replicability?
- Understand the legal parameters of this model;
 - What are the constraints and opportunities for what we can & can't do?
 - How can we work with other stakeholders (investors, donors, partners)?
 - Is there a way to receive donations and/or investment money?
- Explore new strategies to improve and/or adapt this philanthropic business model;
 - What are the success factors for this model? (Consider: size, sector, industry, financing, operational system, structure)
- Consider opportunities to accelerate and increase positive social impact and measurable results through this model
- Offer insights to inform business development and strategic planning for Gradian.

B. Key Hypotheses & Research Questions include:

Hypothesis 1: Gradian is a unique (or one of very few) social innovator using the Foundation Owned Social Enterprise (FOSE) business model as a new (philanthropic) model, because of (1) its unique circumstances, 2) risk aversion of other funders, and 3) lack of awareness of this as an option.

- Is it a new model?
- Is it an emerging trend?
- Who else is operating as a FOSE? How are they doing this?
- If Gradian is the only one doing this, why?

Hypothesis 2: This model offers particular advantages for both funders and implementers. For implementers, there's greater relief, security, efficiency and effectiveness by not being reliant on external grants and fundraising efforts, and by lowering the burden of IRS reporting. For funders, a FOSE may provide direct access to advance social innovation and impact, and an easier exit than other philanthropic investment vehicles (including grants, PRIs, MRIs, Impact Investment products).

- What is the value of FOSE v. fdn grant or PRI or other vehicle?
- Is there greater efficiency and effectiveness by lowering the burden of a FOSE's fundraising & tax reporting requirements?
- Do funders want to incubate innovation directly? If yes, is there interest to do so through a FOSE?

- Does a FOSE increase or optimize social impact of funder?
- Does FOSE offer an easier exit for funder than other investment vehicles?
- What other advantages (tax, legal, operational) does a FOSE offer the funder?
- What other advantages (tax, legal, operational) does a FOSE offer the implementer?

Hypothesis 3: The FOSE business model is like “an enlightened variation” of universities funding PhD research on innovation. In that case, the University is in the role of the “parent company,” but is not in the business of commercializing products that come from that research – just publication and intellectual capital that comes with the affiliation. When the parent company is shifted to a Foundation, it can both fund the research and then hire the right staff to work on commercialization.

- How is a FOSE like University-funded innovation? How is it different?
- What are the comparative advantages & disadvantages of these two models?
- What can we learn from the model of University-funded innovation to apply to private sector through FOSEs?

Hypothesis 4: We can improve the FOSE model and encourage its adaptation & replicability as we share and exchange best practices & lessons learned with peers.

- What has Gradian learned as best practices & lessons to share?
- What have others learned from their experience with FOSE and/or FOSE-related models?
- What else do we want to learn? How can we share this learning?
- What are the primary sector(s) well-suited/not well-suited to this model?
- What are sector-specific challenges, solutions, and emerging issues (from perspectives of social entrepreneurship)?
- What are the success factors for this model? (Consider: size, sector, industry, financing, operational system, structure)

Hypothesis 5: A FOSE exit strategy is likely tied to profitability. If venture is not profitable from earned income, spinning off as stand-alone non-profit is most likely route. If venture is profitable, enterprise can spin off into independent company.

- As a FOSE, what is the exit strategy?
- How does a FOSE manage growth, scalability, replicability?
- What should be considered as a guide for a FOSE exit strategy, in general?
 - Is there an ‘ideal’ length of time to own the enterprise? How much does

that 'parent' company affect this?

Hypothesis 6: Better understanding of the legal parameters of this model could help in its replication, application and/or adaptation.

- What are the constraints and opportunities for what FOSEs can & can't do from a legal and tax perspective?
- How familiar are professional advisors with the FOSE model?
- How can FOSEs work with other stakeholders (investors, donors, partners)?
- Is there a way to receive donations and/or investment money?
- How can a FOSE partner with other investors (Calvert? Skoll?)

C. Interview & Survey Questions include:

Status of a SMLLCs in the social impact field:

- Have you previously heard of a 501(c)3 owning a single Member LLC, with itself as the sole Member? If so, since when? Which one(s)?
- What do we call this kind of entity? SMLLC? Foundation Owned Social Enterprise (FOSE)? Charity owned Disregarded entity? SMLLC? 501(c)3 owned SMLLC?
- What is your experience regarding philanthropic use of a SMLLC?
- What do you see or anticipate as greatest benefit and/or risk of a philanthropic SMLLC?
- Do you see 501(c)3 creating SMLLCs as a current or an emerging trend?
- Who else is operating as a FOSE? How are they doing this?
- Why are we not seeing many SMLLCs in the philanthropic & social enterprise landscape?

FOSE model advantages and challenges:

- What is the value of FOSE v. fdn grant or PRI or other vehicle?
- Is there greater efficiency and effectiveness by lowering the burden of a FOSE's fundraising & tax reporting requirements?
- Do funders want to own innovation directly (through enterprise) or indirectly (supporting incubators & innovation programs)?
 - If directly, is there interest to do so through a FOSE? Does this help funders feel closer to incubating impact directly? If so, is that more fulfilling? More frustrating?
- Do you think a FOSE would increase or optimize social impact of funder? How do we know? What are key indicators?
- Do you think a FOSE would increase or optimize social impact of implementer?

How do we know? What are key indicators?

- What other advantages or disadvantages (strategic, operational) does a FOSE offer the funder?
- What other advantages or disadvantages (strategic, operational) does a FOSE offer the implementer?

Legal & Tax parameters of philanthropic SMLLCs:

- What are the legal & tax constraints & opportunities for a 501(c)3 owned SMLLC?
- How familiar are professional advisors with the FOSE model?
- How can FOSEs work with other stakeholders (investors, donors, partners)?
- Is there a way to receive donations and/or investment money?
- Does this model appeal to other investors?
- What liability protection do SMLLCs offer? How is it different? How are assets protected?
- What other advantages or disadvantages (tax, legal) does a FOSE offer the Funder?
- What other advantages or disadvantages (tax, legal) does a FOSE offer the Implementer?

Other related Business Models of Social Innovation:

- How is a FOSE like University-funded or University-facilitated innovation? How is it different?
- How does business model of traditional foundation grant-making compare with a FOSE?
- How is FOSE similar/different from innovation commercialized in other ways?
- What are the comparative advantages & disadvantages of these models?
- What can we learn from the model of University-funded and/or industry-led innovation to apply to private sector through FOSEs?

Best practices & lessons learned through FOSE:

- Would this model be of interest to you your industry or practice?
- What has Gradian learned as best practices & lessons to share?
- What have you learned from your experience with FOSE and/or FOSE-related models?
- What else do we want to learn? How can we share this learning?
- What do you think are the primary sector(s) well-suited/not well-suited to this model?
- What are sector-specific challenges, solutions, and emerging issues (from perspectives of social entrepreneurship)?

- What are the success factors for this model? (Consider: size, sector, industry, financing, operational system, structure)

A FOSE long-term strategy considerations:

- How does a FOSE manage growth, scalability, replicability?
- As an SMLLC, what is the exit strategy for the non-profit Single Member?
- What should be considered as a guide for a FOSE exit strategy, in general?
 - Is there an 'ideal' length of time for the 501(c)3 to own the enterprise?
 - What determines exit strategy? Market profitability? Owner policy?
 - Does there have to be an exit? Could a FOSE be sustained within the 501(c)3?
 - Does an SMLLC offer an easier exit for funder than other investment vehicles?
 - To what extent does this open or close opportunities for the implementers?

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