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Entrepreneurs in low-income and minority neighborhoods encounter numerous problems in securing capital. To address this capital gap this paper considers a new role for private foundations as community development venture capitalists (CDVCs). It is suggested that through grant making and program-related investments, foundations may assume an equity stake in neighborhood-based entrepreneurs and acting as CDVCs apply lessons from the value-added component of private equity financing, including drawing on their expertise, professional contacts and financial resources to contribute to entrepreneurial efforts in the inner city.

I. INTRODUCTION

There is much discussion and documentation of the problems in securing capital encountered by entrepreneurs in low-income and minority neighborhoods. The explanations include those which are common to many entrepreneurs—limited experience, lack of personal assets to use as collateral, and insufficient access to patient, high-risk, value-added equity capital. In the "farm system" where new ventures are spawned the capital markets are characterized by a lack of informed buyers and sellers and high transaction costs, the antithesis of an efficient market. Due to this inefficiency research indicates that there is a substantial capital gap in seed and start-up financing (Fiet 1995; Freear, Sohl & Wetzel, 1995; Mason & Harrison, 1992). The gap ranges from around $25,000 at the low end, the point at which the money raised from friends and family and second mortgages runs out, to the high six figures on the upper end, the time when the venture becomes attractive enough to catch the eye of venture fund investors. At this critical early stage of the

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entrepreneurial venture, private equity investors provide the largest source of equity financing for emerging high growth ventures (Freear, Sohl & Wetzel 1994).

Compounding the capital gap for entrepreneurs in the inner city are the relatively high risks associated with ventures in low income neighborhoods (with relatively high crime rates and limited local buying power) and racial discrimination. Given their lack of access to traditional sources of capital, there may be benefit from non-traditional sources—including private and institutional venture capital investors—funding "neighborhood" entrepreneurs. Lending further credence to the role of private equity financing is research indicating the possibility of nonfinancial motives underlying some venture capital decisions. Such motives include a willingness to accept a lower return in order to support local economic development and minority entrepreneurs and similar nonfinancial incentives (Hoffman 1972; Sullivan 1994; Wetzel 1983). However, it is most common for venture capitalists first to come into contact with prospective entrepreneurs through professional and/or informal networks. Unfortunately, neighborhood-based and minority entrepreneurs have traditionally been outside these networks, and unable to connect with these investors.

To fill this "compounded" capital gap encountered by entrepreneurs in low-income and minority neighborhoods this paper considers a new expanded role for private foundations as "community development venture capitalists." There can be great variety of investments made by private philanthropic organizations to foster community development which fall within their fiduciary obligations. For example, the target of some grant money could be private ventures with significant potential for generating benefits beyond personal profit in low income and minority communities.[1] Other investment avenues for private foundations funders could be more similar to traditional equity positions. For example, program-related investments (PRIs) could be used to take an equity stake in promising neighborhood-based entrepreneurs.[2] This would help the new ventures overcome the problem of limited access to capital, effectively spread risk between entrepreneur and foundation-funder, and at the same time allow for the eventual recycling of investment money.

This paper is exploratory. It draws on a unique case study to consider the potential role of private foundations as community development venture capitalists. In the conclusion, some lessons from the value-added component of venture capitalists will be considered, including how foundations might draw on their expertise and professional contacts (e.g., with financial and legal institutions), as well as their own financial resources to contribute to entrepreneurial efforts in the inner city. The target of investments would be private entrepreneurs with special commitment to inner city neighborhoods and with significant potential for their activities to result in the realization of private *and* community-wide benefits.

The case study involves an in-depth examination of an innovative privatization initiative in New York City in which city-owned housing is being transferred over to neighborhood-based entrepreneurs. The Neighborhood Entrepreneur Program (NEP) is a joint effort of the NYC Partnership (a non-profit privately funded organization whose membership includes many of the Fortune 500 companies headquartered in NYC) and its subsidiary organization the NYC Housing Partnership (mainly concerned with increasing the supply of affordable housing), the City of New York (Department of Housing Preservation and Development), and the Rockefeller Foundation. With the NEP, the city is selling some of its *in rem* properties (property which the city took over ownership after non-payment of taxes) to private businesses. The city has restricted this privatization initiative to neighborhood-based entrepreneurs who must meet specific criteria indicative of their potential to provide long-term benefits to the communities in which they would own property.

A major national private foundation, the Rockefeller Foundation, has invested in the "Neighborhood Entrepreneurs" through their participation in NEP and have helped the Entrepreneurs establish industry knowledge and contacts, in a manner similar to the way that many successful private investors and venture capital funds work with the companies they invest in. This value-added component of early stage equity investing, where private investors and venture capital funds invest their know-how and access to contacts as well as their capital in the ventures they finance, is a unique feature of the early stage equity markets (Ehrlich et al 1994; Harrison & Mason 1992; Freear, Sohl & Wetzel 1995). As discussed below, the Rockefeller Foundation's experience with NEP suggests lessons for other foundations and important areas for future inquiry.

II. NEP: THE PROMOTION OF NEIGHBORHOOD-BASED ENTREPRENEURS

The Neighborhood Entrepreneurs Program commenced in the fall of 1994. It included 11 "cluster neighborhoods" (in Central and East Harlem, Central Brooklyn, and the South Bronx) each with approximately 10 buildings and 100 housing units. A survey of tenants in the properties included in NEP indicated that: 70% of cluster households had no one employed; households in the clusters had an average income of less than $7,000 per year; 25% of tenants had moved to their apartments from homeless shelters; and 71% of households were headed by women.[3] In addition, many of the residents had severe problems with drug and alcohol abuse.

Under NEP, *in rem* properties are being sold to private businesses. However, NEP is more than a privatization effort. NEP targets opportunity to a particular group of businesses, it includes objectives other than economic efficiency, and it involves public and other support of private ownership. To participate in the NEP, businesses had to be based (i.e., currently manage property) in the neighborhoods where program activity was concentrated. Individual clusters were assigned to a Neighborhood Entrepreneur selected in a competitive process. Selection was based on criteria (see discussion below) which gave priority to small minority-owned firms in their early/start-up phase. Many of the firms which applied had no previous property ownership experience and desired to use their participation in NEP to increase the size and scope of their business operations.

The support of private ownership took many forms in NEP, including below market rate financing for the Entrepreneurs, low cost technical and managerial support of Entrepreneurs, assistance to Entrepreneurs in hiring new personnel, and rent subsidies for tenants. The subsidy of private Neighborhood Entrepreneurs was justified by: (1) concerns for the quality of life, equity/equal opportunity, and economic efficiency in the cluster neighborhoods; and (2) recognition of the negative consequences city-wide associated with the deterioration of neighborhoods and the social infrastructure of the City.[4] The hope of NYC's Department of Housing Preservation and Development (HPD) and its main program partners the New York City Housing Partnership (the "Housing Partnership") and the Rockefeller Foundation was that Neighborhood Entrepreneurs would provide better service to *in rem* residents (than the city government and Entrepreneurs/Businesses based outside the cluster areas) and that enhancement of *in rem* properties would eventually increase local property values and encourage additional private investment. In addition, there was the issue of government inefficiency and cost in managing *in rem* housing—it cost the City of New York more than $100 million dollars per year to manage *in rem* properties. Turning these properties over to Neighborhood Entrepreneurs, even with the 'additional' cost of subsidizing their ownership and management, could save the City money.

A second related goal of NEP was to generate employment opportunities for residents of *in rem* properties. The Rockefeller Foundation funded the NYC Housing Partnership to conduct a one-year pilot employment project as a component of NEP. The objective was to test the potential for inducing Entrepreneurs and Contractors (hired to rehabilitate cluster properties) to hire and train unemployed tenants for entry level positions in construction, property management and maintenance created through the program. Its first year goal was to place 100 tenants in jobs, half in construction jobs and the other half in employment with Entrepreneurs.

To achieve this second goal, the Housing Partnership and Rockefeller Foundation sought to organize a support infrastructure of community-based social service providers/advocacy organizations (CBOs) and organizations affiliated with an employment training network. A key consideration was that the training, social services and other needs of hired tenants receive attention, so that tenants could meet employer's expectations and successfully make the transition to work.

The rationale for NEP was *not* that the private market *alone* (i.e., privatization) would alleviate the problems with *in rem* properties and in the cluster neighborhoods—the private market had failed, that was one of the main reasons why the properties were *in rem*.[5] The program was designed to achieve a particular type of private market, blending market incentives with community goals. Program design took into account the reality that socio-economic conditions and the history of neglect of the cluster property (and neighborhoods in which cluster property is concentrated) were deterrents to the type of private market investment that was desired (i.e., investment which would contribute to the neighborhood revitalization and to the quality of life of current residents). The potential external benefits from private Neighborhood Entrepreneur efforts, and profound problems with the 'status quo' (i.e., the City spending millions of dollars a year managing the properties and at the same time developing the reputation as its own 'worst landlord') justified NEP.

III. NEP's FIRST YEAR EXPERIENCE: WHAT HAPPENED AND WHY

In its first year NEP had significant accomplishment. This included attracting a pool of nearly 100 (Neighborhood Entrepreneur) applicants, which included thirty-five applicants that met the rigorous threshold qualifying criteria; the selection and retention of eleven highly qualified and committed Neighborhood Entrepreneurs (see more detailed discussion below); and improved housing conditions and tenant services, as reported by the tenants themselves and the community-based advocacy organizations representing the tenants. To date, there has been limited improvement in community-wide conditions and property values and investment levels have not changed significantly, however, this is not surprising given the short tenure of program effort. The most significant shortcoming to date, has been the small number of *in rem* residents that have found employment through NEP—only 17 tenants have been employed by the Entrepreneurs. This is significantly below the target of 100.[6] The short-term employment results are not surprising and highlight some of the problems for any program geared towards *in rem* residents (or similar populations). Most residents are simply not ready for and/or interested in employment, regardless of any short-term effort. Of the 1,642 housed in NEP property (and included in the tenant survey), only 203 (12 percent) indicated an interest in employment through NEP.[7] Of those, over ten percent reported no particular skills or career interest related to NEP employment. Of the remaining tenants reportedly interested in employment through NEP, less than two-thirds had any relevant experience for employment in NEP-related jobs.[8]

In spite of the short-term shortcomings the longer term prospects are encouraging. The best prospects for NEP is tied to the long-term business viability and sustained commitment of Entrepreneurs to the cluster neighborhoods. Thus, the success of NEP strongly depended on the selection and performance of Entrepreneurs and the Entrepreneurs' ability to meet specific program objectives (e.g., minimize dislocation, upgrade housing conditions, hire tenants) while maintaining profitable business operations. *The selection of Entrepreneurs was therefore of critical importance.*

The Housing Partnership (with funding from the Rockefeller Foundation) played the lead role here and appears to have done an excellent job. The selection process was extensive and guided by clearly specified criteria. The criteria included that Entrepreneurs had to: (1) be neighborhood-based for-profit business owners; (2) have managed at least 50 residential units, or have managed an average of 50 units in the last three years, without owning or having a substantial ownership interest in more than 250 units of housing; (3) have experience with oversight or performance of rehabilitation or repair of occupied multi-family housing; (4) meet one of the following two criteria in full and not exceed the maximum limit for the other criterion by more than 50%: (a) gross annual business revenue (average for the last 3 years) not exceeding $1.5 million; and (b) combined personal and corporate net worth (exclusive of primary personal residence) not exceeding $1.5 million.

Housing Partnership staff undertook rigorous review of program applicants, instituted a formal rating system, conducted personal interviews with Entrepreneurs and their current tenants, and visited properties under the management of Entrepreneurs. The Housing Partnership also consulted with CBOs and local public officials on the selection of Entrepreneurs. The selection process was very competitive. Ninety-five Entrepreneurs applied. Of those applicants, thirty-five met the threshold criteria (described above). Those that met the threshold were then ranked according to: management experience, financial experience, rehabilitation experience, work experience with non-profits, and neighborhood base. Neighborhood base (i.e., criterion #1 above) was the most heavily weighted. Eleven Entrepreneurs were selected and all accepted the offer and all are still active. This is significant given the extensive requirements, time commitment and financial uncertainty involved with participation.

Compliance with the formal criteria ensured that the Entrepreneurs had strong ties to the cluster neighborhoods which they were assigned. All but one of the Entrepreneurs was a member of a minority group (this is significant in an industry where the large majority of businesses are not minority owned). There was some variation in terms of Entrepreneur's previous experience—more than half had no previous ownership experience, two were larger property owners/managers (with over 2,000 units under management), half were smaller companies with fewer than 200 units under management.

Four key factors help explain why the Neighborhood Entrepreneurs offer promise for long-term job opportunities and community revitalization. These include: (1) the "grounding in the neighborhood" of entrepreneurs; (2) the profit motive and low risk for entrepreneurs; (3) the links between profit and community improvement; and (4) the establishment of support infrastructure for the entrepreneurs.

Grounding in the Neighborhood

The motivations of 'grounded' Entrepreneurs appear (from personal interviews and observations of initial NEP-related activities) to go beyond short-term profit. In many ways the Entrepreneurs can relate to the difficulties and problems experienced by their cluster tenants, as they seem to truly care about the residents and have a sincere interest and commitment to the improvement of the neighborhoods in which they will own NEP property. In addition, they have not only dollars and their professional reputation at stake with their performance, but also their personal reputation in the community and city.

As mentioned earlier, Neighborhood Entrepreneurs must be relatively small business operations (criteria #2 and #4). This necessitates a 'hands-on' ownership approach by the large majority of Entrepreneurs. The result will be reinforcement of the Entrepreneur's awareness of the connection between their contributions to community improvement (e.g., employing tenants, fighting drug traffic) and profitability. In addition, their frequent personal contact with residents can help to overcome mis-perceptions about tenants and the tenants mis-perceptions about property owners. This contact can foster cooperation, and in the language of collective action theory, 'mutual gains seeking.'

Having Entrepreneurs who are grounded in the neighborhoods where they operate have other benefits, including the likelihood that individual manager/owners can serve as mentors and role models in the community, and contribute to employment and service networking possibilities for residents. In addition, there is evidence that minority business owners (as are all but one of the Neighborhood Entrepreneurs) tend to hire minorities more than non-minority owners, regardless of where their businesses are located.

Profit Motive and Low Risk

The main incentive for attracting a highly qualified pool of Neighborhood Entrepreneurs was the combination of (a) the profit potential, together with (b) low 'up-front' financial commitment. HPD, the Housing Partnership and the Rockefeller Foundation assumed virtually all the initial financial costs, while the Neighborhood Entrepreneurs have the potential to earn significant profits, especially if the buildings and neighborhoods are 'turned around.'

While the initial financial commitment by the Entrepreneurs is small, NEP requirements of Entrepreneurs are significant. To ensure that the properties will be transferred over to their ownership-(after a period in which properties are being rehabilitated and the Housing Partnership assumes interim ownership) Neighborhood Entrepreneurs must meet several program conditions, including that they: (1) work with the community-based organizations assigned to their clusters to address the needs of tenants; (2) attend program meetings and meet with Housing Partnership staff on a regular basis; (3) not displace current tenants; and (4) demonstrate 'willingness' (not formally defined, but monitored by Housing Partnership staff) to employ tenants. Finally, while their initial financial stake was low, the Entrepreneurs' stake/risk in terms of reputation and potential effect on future business prospects was significant, as we highlight below.[9]

The financial arrangements with the Entrepreneurs is intended to encourage long-term ownership, with most profits (at least in the near-term) coming through management fees.[10] The capital costs of renovation are funded by city and federal grants, which are structured as a low-cost loan. There are strong indications that in the event of revenue shortfalls, the city would exercise forbearance on its loans and allow the Entrepreneurs sufficient cash flow to operate their property profitably.

HPD and the Housing Partnership appeared to have too much at stake on the 'success' of NEP and the Entrepreneurs to not offer some guarantee (however modest and informal it may have been) that the Entrepreneurs would earn some profit from their participation in NEP.[11] This was not a deterrent to the program given the fact that even with significant financial obligations to the Entrepreneurs, significant savings could be realized by removing the properties (and hundreds of millions of dollars in management expenses) from the City's direct responsibility.

The greatest uncertainty remaining for the Entrepreneurs is the 'up-side' (i.e., profit) potential of the properties. This will be most strongly affected by the future rent stream and the future market/re-sale value of the property[12] which will be most strongly influenced by the physical condition of property and neighborhood conditions. This suggests that Entrepreneurs, even with some guarantee from the City that they will profit from ownership of NEP property, still have strong incentive to commit themselves to property maintenance and investing in community improvement.

Because the rents and market value of the buildings they will own depends on the maintenance of the buildings and the physical, economic, and social conditions in the larger cluster neighborhoods, the Entrepreneurs have a strong material incentive to provide quality services to secure good long-term tenants and to contribute to neighborhood improvement through such efforts as promoting the employment of tenants.[13] Furthermore, with the assignment to Entrepreneurs of a cluster of properties, rather than scattered sites, they are positioned to capture the benefits from the local community revitalization to which they contribute. These tendencies to invest in property maintenance and neighborhood improvement are reinforced by the 'unique' position of Entrepreneur's in the property ownership/management industry in NYC.

All the Entrepreneurs perceive NEP and ownership of property (in neighborhoods similar to the cluster neighborhoods) as their main business growth opportunity. For the large majority, NEP represents their single opportunity to 'step-up in the business' and increase their earnings. NEP provided approximately half of the Entrepreneurs their first opportunity to own property. Prior to NEP, their ownership opportunity was limited by a lack of capital and experience and discriminatory practices in real estate and banking. Furthermore, the Entrepreneur's relatively small scale of other business activities and their commitment of money, sweat equity, and reputation to NEP, makes cluster properties a significant part of their business portfolio and fosters commitment and effort. And finally, the Entrepreneur's main competitive advantage (as property owners) is their ability to draw on their indigenous experience and hands-on ownership approach in neighborhoods like the cluster areas.

NEP offered a truly unique business opportunity for Neighborhood Entrepreneurs. This together with the prospects for future rounds of NEP (i.e., *in rem* privatization by the city government) reinforced the Entrepreneur's commitment to: (1) NEP and its success (thus furthering the chances of program expansion and their chances to participate in future rounds of NEP and similar types of initiatives undertaken by HPD and the Housing Partnership): (2) their property (i.e., the buildings they own in the clusters); and (3) the cluster neighborhoods and residents. Indicative of their business focus and where they see profit opportunity, several of the Entrepreneurs have already branched out from real estate to open accounting, travel, and construction businesses in the cluster neighborhoods.[14]

Linkage Between Profit and Community Improvement

Closely related to the profit incentive is the perceived and real linkage between individual Entrepreneur's profit and their contributions to community improvement. All of the Entrepreneurs recognized some potential linkage between their future profits and community improvement. Most cited the lowered cost of operation and maintenance with reduced crime and drug traffic as the most direct link. Also frequently mentioned were the increased demand for, and value of, apartments and property as cluster conditions improve.

With regard to the employment of residents, the main perceived benefits were that residents would be more likely to pay their rents, be able to pay higher rents over time, and be able to contribute to community improvement. Furthermore, tenants hired by Entrepreneurs and/or Contractors working in the cluster would have a 'double stake' in their work, as it would directly affect both the conditions of their apartment and income. Many of the Entrepreneurs mentioned that tenant employees were potentially more valuable (i.e., productive) than 'other' workers because they would be more sensitive to the problems and needs of residents and would always be 'on the job,' and therefore helpful with building maintenance and security at all hours of the day.

To sustain Entrepreneur's commitment to community improvement will require the continued perception and reality of private pecuniary benefit from more general contribution to community improvement (e.g., hiring of tenants, efforts to reduce drug traffic). There is strong likelihood that most Entrepreneurs will, at some point, feel that their efforts to improve the community are in vain and that the long-term profit potential is not significant. For this reason, it is important that the network between Entrepreneurs, CBOs, HPD, the Housing Partnership and the Rockefeller Foundation be continually strengthened. Entrepreneurs will need positive reinforcement and supportive actions to not abandon their commitment to property and tenants and their contributions to community improvement.

The Establishment of Support Infrastructure

All start-up businesses need support, especially if they have to fight discrimination and are currently outside industry networks. The Housing Partnership, in partnership with HPD and the Rockefeller Foundation, played the critical role in establishing the necessary infrastructure, i.e., support network, for the Neighborhood Entrepreneurs. The Housing Partnership has drawn on its unique experience and industry connections (through the NYC Partnership) in housing, banking and community development to establish the necessary support.

The Entrepreneurs have benefitted from their frequent contact with Housing Partnership staff. The main contact involves Partnership staff 'walking' Entrepreneurs (collectively and individually) through various stages of NEP. The least experienced Entrepreneurs have benefitted the most from Housing Partnership staff efforts, particularly with securing financing, and legal and tax issues.

Perhaps, most importantly, the Housing Partnership and Rockefeller Foundation have helped Entrepreneurs establish beneficial relations with bankers, CBOs, and the city government. For example, one Entrepreneur commented that before his involvement with NEP he could not get a banker to meet with him. After being introduced to bankers by the Housing Partnership, they are competing for his business and inviting him to lunch.

The Housing Partnership also helped Entrepreneurs overcome business difficulties as they arose. And, not least significantly, the Housing Partnership was able to rely on their good standing and prominence together with the reputation and status of the Rockefeller Foundation to assure the Entrepreneurs "that things would work out" when there was uncertainty and/or confusion about particular aspects of NEP—such as the previously discussed financial uncertainty preceding final financial arrangements with HPD.

Summary of NEP Progress to Date

The Neighborhood Entrepreneur Program (NEP), while still early in implementation, is overcoming some traditional obstacles hampering successful minority business development including lack of access to markets, lack of access to capital, and lack of managerial ability. NYC government, through its Department of Housing Preservation and Development (HPD), provided market opportunities for the businesses. The NYC Housing Partnership, through its connection to banks, provided access to capital and technical assistance for Entrepreneurs. And the Rockefeller Foundation through the provision of grant money to the NYC Housing Partnership has helped to upgrade the Entrepreneurs' capacity to succeed. Careful selection of Entrepreneurs and strong support of their efforts (mainly by the Housing Partnership with grant money provided by the Rockefeller Foundation) has helped to ensure that Entrepreneurs are experienced and capable managers.

Over the longer term, there could be city-wide benefits from NEP. NEP's requirements of Neighborhood Entrepreneurs (e.g., hiring of tenants, improving housing conditions) along with the prominence of program participants (e.g., Housing Partnership, HPD and the Rockefeller Foundation) can contribute to the upgrading of industry standards with regards to the hiring of neighborhood residents and contributions to broader community development. Furthermore, there is a good possibility that Entrepreneurs will replicate their efforts, i.e., expand their efforts in assigned clusters and in similar neighborhoods in other parts of the city. In this way, the cluster neighborhoods and the city can benefit from the Entrepreneur's financial motivation to leverage the lessons and learning from their experience with NEP.

The NEP program has embryonic elements of systemic change. Over time, residents can get better housing, more access to needed services, increased job opportunities, and general community improvement; minority Entrepreneurs can get property ownership opportunities, and better access to markets, credit, and profits; intermediaries (e.g., the Housing Partnership) can play a larger role in improving the delivery of services to neighborhood where they have a significant investment; and, government can get reduced social welfare costs and increased tax revenue.

IV. INVESTING IN NEIGHBORHOOD ENTREPRENEURS: STRATEGIC INVESTMENT BY FOUNDATIONS

The experience with NEP suggests a potential benefit from foundations and other private supporters of community development complementing their traditional grant making to non-profits and community-based groups, with indirect and direct investment in private ventures that show promise to contribute to community development. Insight about the potential value of foundations and others investing in private entrepreneurs, and the relationship between funder and fundee, can be gained from the research on the private venture capital market.

Institutional and private venture capital money has been credited with fueling the growth and development of some of the most innovative and fastest growing companies in the U.S. and the world. When the young Scot Alexander Graham Bell needed money in 1874 to complete his early experiments on the telephone Boston attorney Gardiner Green Hubbard and Salem leather merchant Thomas Sanders helped out. Later, these same two individuals put up the equity capital to start the bell telephone company in Boston (Lample 1989). In the 1930s and 1940s, members of the Rockefeller, Bessemer, and Whitney families invested in promising early stage ventures (Gompers 1994). This same involvement of private investors in early stage ventures continues today. A portion of initial capital for Apple, Federal Express, Starbucks, and Microsoft (to name only a few) did not come from 'traditional' sources—bank financing or personal and/or family savings—but from private equity investors willing to take a risk on a start-up venture that demonstrated some unique promise. Similarly, prospective Neighborhood Entrepreneurs lack access to traditional sources of capital because of their small savings, limited experience and history of discrimination, particularly in housing markets. So they too could benefit from non-traditional sources of capital at the critical early stage of development.

Foundations and other community development funders can play the role of community development venture capitalists. The dual investment criteria of foundations would be financial return on investment and return in the form of progress on community revitalization. The main use of foundation grants and/or subsidized loans (e.g., PRIs) would be: (a) as 'start-up' funding; (b) to assist entrepreneurs in developing necessary skills and industry (e.g., banking, accounting) contacts/connections; and (c) assumption of some of the initial risk of new ventures. This is similar to the role private investors and venture capitalists play with promising new ventures. With start-ups, private investors provide patient capital to ventures with the prospect of a long- term capital gain commensurate with the risk inherent in early stage investing. These investors want to ensure that the new venture is motivated by the potential long-term return from their effort, however, there is also benefit to making sure that the entrepreneur has something at risk to further their commitment and stake in the venture. For the Neighborhood Entrepreneurs, while their initial financial stake was low, their stake/risk in terms of reputation and potential effect on future business prospects was significant.

Early stage equity investors invest largely in individuals, since at the early stage the major assets of the ventures are the entrepreneurs themselves. The criteria which they use include: (1) personal integrity; (2) business acumen; (3) commitment to their work; and (4) willingness to work hard, i.e., 'go the extra step' to be successful. Since the private investor is committing funds for a substantial period of time, during which the venture is likely to face a myriad of problems and opportunities, the relationship with the entrepreneur is critical. These are very similar to the informal criteria used by the Housing Partnership in the selection of Neighborhood Entrepreneurs in light of the fact that both groups are investing at the early stage of the firm.[15] Additionally, the Housing Partnership used more formal criteria and ratings to assess what we call 'grounding in the community' as an indication of the potential to realize external benefits from the Entrepreneur's activities.

There can be great variety of investments made to foster community development. The target of investments, we are suggesting here, would be private ventures with special skills and commitment and with significant potential for generating benefits beyond personal/firm profit. Investment could be similar to that taken by the Rockefeller Foundation in NEP. With NEP the investment was in the form of a grant which helped to subsidize the start-up costs of Neighborhood Entrepreneurs likely to provide long-term external benefits to the communities in which they would own property. Furthermore, the Rockefeller grant provided an incentive for the Entrepreneurs to engage in particular activities (e.g., the hiring of tenants) capable of bringing significant external benefit to the community as a whole.

Other investment avenues for community development funders could be more similar to traditional equity positions. For example, program-related investments could be used to take an equity stake in promising neighborhood-based Entrepreneurs. Through an equity investment the community development venture funder, much like the private investor and venture capitalist, would be investing in precisely the area where credit financing alone cannot sustain the appetite for capital. While access to credit is critical for many small business owners, early stage high growth ventures cannot be capitalized with additional debt. For the early stage innovative venture, the major asset of the firm is the entrepreneur. These firms are short on hard assets and cannot offer the collateral required by most lenders. By focusing only on the credit side of the balance sheet and its high fixed cost interest payment burden, a substantial debt to equity imbalance will persist, further restricting the firms access to the capital that is critical for the long term growth and survival of the venture. Through the assumption of an equity position. the community development funder would help the new ventures overcome the well-documented problem of limited access to capital, effectively spread risk between entrepreneur and foundation/funder, and at the same time allow for the recycling of investment money.

The most successful private investors and venture capitalists bring more than money to the new ventures they fund. Especially in the early stage equity financing, the venture capitalist is a 'value-added' investor. In addition to capital, the investor/funder brings industry contacts, professional guidance and personal support to the relationship with the entrepreneurs. In this role the investor and entrepreneur become partners in the long term growth and development of the firm and as equity investors, share with the entrepreneur the financial rewards of this growth. Research indicates that entrepreneurs typically derive value from their individual investors that is above and beyond the provision of equity funding (Freear, Sohl & Wetzel 1996). This value-added component suggests lessons for foundations and other community development funders. To be successful they can not be passive investors. Start-up ventures—especially if they have to fight discrimination—need patient capital and expertise. More specifically, they need help with the following: (1) establishing relations/contacts in the industry (e.g., with bankers, contractors, city officials); (2) developing "in-house" industry expertise; and (3) establishing their professional reputation.

The Housing Partnership, in partnership with the Rockefeller Foundation, provided much of this 'non-pecuniary' support to Entrepreneurs. And as we have suggested, their contributions were a main factor contributing to the progress made to date.

V. CONCLUSION

Initial findings indicate that the return from the investment and related activities by the Rockefeller Foundation will be viable businesses: serving an "underserved" population; helping to enhance the quality of life of residents; increasing employment opportunities for residents; and contributing to community improvement. The experience with the NEP also suggests lessons from the venture capital market which are useful for inner-city development. More specifically, there are potential benefits from private foundations and other supporters of community development complementing their traditional grant making to service oriented non-profit community organizations with indirect and direct investment in private ventures. Considering the "compounded" capital gap faced by entrepreneurs in low-income and minority neighborhoods, much can be derived from the role of foundations as community development venture capitalists. Private equity investors are currently partially filling the capital gap through patient equity capital and value added investing at the early stage of the ventures development. Through the experience of the private investor community, foundations can take on the role of community development venture capitalists and provide the patient capital, access to industry contacts and opportunities to develop entrepreneurial skills that are critical to the survival and growth of the firm. As community development venture capitalists, foundations can begin to address the true capital formation challenge facing entrepreneurs in inner-city and minority neighborhoods.

Important lines of future inquiry include: (1) how private foundation funding of new ventures in the inner city can best be blended with public support and private investment; (2) appropriate exit strategies, i.e., when should subsidy be removed and private ventures be expected to "stand on their own"; and (3) how to aid foundations in thinking more strategically about their role as community development venture capitalists. These and other important questions will be considered in on-going assessment of the NEP and comparing and contrasting the experience in NEP with similar efforts in other cities and regions.

NOTES

1. Benefits from increased entrepreneurial activity in low income neighborhoods could include general community improvement—e.g., reduction in crime—as more local residents are employed in local business establishments and as the entrepreneurs become neighborhood leaders and mentors for their employees and neighborhood youth.
2. Among the U.S. grant making community the number of PRI-makers is very small. Since the beginning of PRI activity, 74 funders have disbursed or guaranteed PRIs totaling $718 million. Nearly one-third of total PRI amount has been loaned or invested by the Ford Foundation, and close to another 10 percent by the John D. and Catherine T. MacArthur Foundation. Only 7 percent of total PRIs have been used to "promote self-sufficiency in recipients." (The Foundation Center, "Program-Related Investments: A Guide to Funders and Trends," 1995).
3. The survey further indicated that most of the households were receiving some kind of public assistance. For example, in 7 of the 11 clusters every respondent who answered the question reported receiving some kind of public assistance. For the remaining clusters, more than 70% of respondents reported receiving public assistance. (Non responses to this question make it hard to quantify for the survey sample as a whole). Completing the tenant profile, approximately two-thirds of the households were African-American and another quarter Hispanic, and half of residents had lived in their buildings for more than 10 years. There were some differences in socio-economic characteristics across the clusters. In general, the clusters in Brooklyn were the most segregated with the highest percentage of African Americans and the clusters in the Bronx had the highest percentage of Hispanic residents. There was also some variation in the percentage of residents who were formerly homeless, ranging from 8 to 44 percent.
4. Neighborhood decline has concentrated effects in the neighborhoods themselves and on its residents. However, it also has significant negative consequences city-wide. Neighborhood decline contributes to increased crime, decline of employable workforce, and the reduction in the quality of life in individual neighborhoods and the city. It also affects the attractiveness of a city for businesses and residents, and thus is of concern to the private sector (employing city residents and with investment in the city) and to the public sector (concerned for the general public good).
5. Market failure—more often than not—coincided with and was exacerbated by generalized neighborhood decline, followed by ill-conceived government interventions.

6. The Employment Pilot made some progress increasing labor demand—there were more job offers by the Entrepreneurs (to tenants) than there were tenants ready for employment. However, a qualified supply of workers from the tenant pool was not forthcoming.
7. The number of tenants who reportedly expressed an interest in the employment pilot (as indicated by them filling out the employment assessment forms) is a questionable figure. This was revealed when Housing Partnership staff followed-up with tenants. However, the pool of qualified tenants is still estimated by the Housing Partnership at approximately 200.
8. Thirty-five had self-reported maintenance experience, 31 construction experience, 15 experience as a receptionist, 14 had experience with computers in an office and 12 had secretarial experience.
9. The structuring of the transfer of property from the City to the Entrepreneurs was negotiated between HPD and the Housing Partnership. The financial arrangements were not finalized until June 1995, several months after the Entrepreneurs had all made significant commitment to meeting with NEP officials and attending to the needs of the assigned NEP properties. This supports our earlier observations of the Entrepreneur's faith in the Housing Partnership and HPD, i.e., that they would negotiate a 'good deal' for them, and of their apparent patience toward this program.
10. The City's financial commitment included $100,000 for the rehab of each unoccupied unit and $50,000 for each occupied unit. It also included a provision that prior to their ownership of the properties the Entrepreneurs would be reimbursed for working capital expenses and would get management and development fees from the City. A portion of the latter would be payable to the City as the purchase price for the buildings once rehabilitation was completed. The after-rehabilitation rent structure included a profit to the owner-managers, provided they complied with all subsidy record-keeping and tenant eligibility requirements and achieved market rents on vacant units.
11. An indication of the low financial risk placed on the Entrepreneurs (and high risk assumed by NYC) are the terms of purchase and sale. In a letter dated June 1,1995 from Jerry Salama, Deputy Commissioner of HPD, to Kathy Wylde it was stated that "the City in determining the final mortgage loan arrangement shall seek to ensure affordability for existing tenants, adequate cash flow and long-term financial viability."
12. HPD restrictions on re-sale and the restrictions attached to federal subsidies make re-sale an unlikely source of profit in the short-term. In the long-term, however, it is not inconceivable that the Entrepreneurs could profit from re-sale, especially if the cluster neighborhoods are revitalized.
13. If at any time the profit potential (or perception of the potential) drops dramatically there will be an incentive to abandon properties. The City and/or Housing Partnership is suggesting that they would intervene if this was the case to change the financials such that Entrepreneur's retain their commitment to their property. The city's ability to forbear on its loan repayments is the key mechanism for adjusting to economic hardship over the next 30 years.
14. A problem with reliance on material incentives is that without an explicit non-displacement policy as a condition of program participation (and/or explicit financial incentive not to displace tenants), Entrepreneurs may tend to evict the more difficult or impoverished families from their buildings. (This could have mixed implications for community improvement.) However, if there are strong messages that displacement is undesirable (and/or incentives not to displace), Entrepreneurs will be reluctant to evict tenants. Another caution with the reliance on private incentive is that non-displacement will require continued subsidy of rents. The support community (e.g., HPD and the Housing Partnership) will have to help ensure that these funds remain available for some tenants, even with changes in federal government programs.

15. The informal assessment was done in extensive interviews and personal contact with prospective Entrepreneurs.

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