

# **LESSONS FROM THE LIFE AND DEATH OF THE VIRGINIA EASTERN SHORE CORPORATION**

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# PART I: LAY OF THE LAND

## INTRODUCTION

In mid-1995, with high hopes and \$2.25 million in capital, The Nature Conservancy (TNC) launched a new model for conservation – a for-profit business designed to preserve the environment of Virginia’s pristine Eastern Shore while developing its weak economy. The Virginia Eastern Shore Corporation (VESC) was a flagship in a growing flotilla of experiments by conservation organizations in the US to use economic development in the service of environmental outcomes. Its business plan called for the company to become profitable in four years, and in its fifth year, to generate \$2 million in revenues from environmentally-compatible enterprises in agriculture, tourism, craft gifts, and real estate development. It proposed to invest \$400,000 to help 15 small, environmentally-compatible businesses grow, to spend \$700,000 to develop a lodge for nature tourists, and, by year four, to have acquired nearly \$2.3 million in commercial, agricultural, and residential properties. In the process, TNC planned to raise additional investment capital and to replicate the VESC model in other sites around the nation.

Fewer than six months later, however, storm clouds were forming: the agricultural and crafts businesses had run into problems. After little more than a year in operation, VESC adopted amended projections that pushed back profitability to late into a ten-year plan. The real estate and small business financing efforts were put on hold (and would never be revived). After two years, the company had lost more than \$1 million – 86 percent of its initial capital. Very little additional capital had been obtained. By June 1998, with VESC less than three years old, one board member wondered aloud if the entire concept should not be reconsidered, with the company reconfiguring itself as a research and development operation. By year’s end, VESC had lost an additional \$755,000. Conservancy officials had abandoned the idea of replicating the VESC model. Three months later, VESC’s CEO resigned under pressure. In August 1999, the board of directors authorized the dissolution of the company. The flagship had sunk in a sea of red ink.

In October 2000, the Ford Foundation and the Mary Flagler Cary Trust commissioned -- through the Corporation for Enterprise Development (CFED) – Brian Dabson, Peter Plastrik, and Richard Turner to tell the story of the demise of the Virginia Eastern Shore Corporation. Ford and Cary had provided the majority of the debt financing for the initial capitalization of VESC. They were anxious to extract lessons from the experience for the benefit of the investors and lenders, and for the broad field of policymakers and practitioners interested in business development and environmental stewardship. In particular, they wanted to understand whether and how enterprise development can be a tool for conservation, and what the appropriate role for nonprofit organizations is in establishing enterprises. The funders also expressed interest in how VESC’s experience compared with that of other similar ventures.

The three authors interviewed nearly all the principal actors in the VESC story, who were cooperative and forthcoming. They reviewed the 35-page business plan for VESC and its appendices, four years of board minutes and other internal documents, including financial reports and related materials. They also drew on their previous engagements with VESC.

## PROTECTING AN INCOMPARABLE WILDERNESS

Virginia's Eastern Shore is the narrow peninsula of land between the Atlantic Ocean and the Chesapeake Bay. It is one of the most significant natural areas in the United States – an unspoiled coastal wilderness of uninhabited barrier islands, salt marshes, and shallow bays and tidal waterways. Over a period of 25 years, The Nature Conservancy's Virginia Coast Reserve (VCR) has acquired 47,000 acres to protect what the TNC has designated as one of the "Last Great Places" – a major national initiative "to work with local communities to protect entire ecosystems, not just isolated islands of biodiversity."<sup>1</sup> Its designation by the United Nations as a Biosphere Reserve identifies the Eastern Shore as being of global ecological significance.

When TNC first appeared on the Eastern Shore in the late 1970s, its relations with the local community were not healthy. There was widespread and vocal opposition to the aggressive acquisition of land by an unknown outsider whose intentions was not clear nor understood. When the current VCR director, John Hall, took over in 1984, he began a long-term process of engaging with the community, to increase public understanding of TNC's objectives and activities, and to build trust and confidence. This process took VCR beyond typical TNC concerns of conservation and science to the social and economic health of the broader community.

The original focus of TNC's land acquisition activities had been on the string of sandy barrier islands that had escaped the attentions of condominium and golf course developers who had been active elsewhere on the Atlantic coast. But it was not long before TNC realized that simply buying these islands was not going to be enough. "Island systems and salt marsh depend on shallow bays depend on shore watercourses depend on land use on the seaside of the peninsula," explained W. William Weeks, now the Conservancy's executive vice-CEO, in his book, *Beyond the Ark*. "Commercial and residential development was beginning to present a challenge that had to be addressed. Seventy miles of seaside coast was in play, to say nothing of the Chesapeake Bay shore on the western side of the peninsula. The land acquisition approach that had taken the Conservancy so far was not going to be the sole conservation tool of the future."<sup>2</sup>

The first moves TNC took still involved land acquisition. It began to acquire land around deep water ports along the seaside not as nature preserves but as a means of influencing the nature and pace of development along the coast. TNC also introduced a program to negotiate conservation easements that would prohibit residential development on seaside farms and keep them in productive agricultural use. A third strategy was to acquire land that was going out of farming use and reselling it with conditions to ensure that future residential development was ecologically compatible.

## RESPONDING TO THE COMMUNITY'S CHALLENGE

The Eastern Shore was settled in 1620 and is home to about 45,000 people. Today the Eastern Shore communities are under tremendous economic stress. In the last few years several local seafood and vegetable processing plants have shut down, forcing hundreds of people out of their jobs, most of them black women working to support their families. The average per capita income is \$6,436. One third of the African American population and one-seventh of the white population live at or below the poverty level – the Shore's poverty rate is twice the national average<sup>3</sup>. Recently, the area came under the withering spotlight of media attention when Bayview, a small black community dating back to the Emancipation, "became an international symbol of rural poverty, its indefensible neglect and deterioration."<sup>4</sup>

The VESC story begins in 1992, when more than 100 local residents participated in a major community planning process sponsored by the Northampton Economic Forum with the active support of VCR.<sup>5</sup> An outcome of the process was a plan identifying a set of strategies and action steps. The plan's purpose was "to build upon the area's assets and to craft creative strategies for promoting more widely shared and sustainable development."<sup>6</sup>

The spark for the creation of the Virginia Eastern Shore Corporation is said to have come from a challenge to TNC from Jane Cabarrus, the local leader of the NAACP and participant in the planning process. She wanted to know, "where's the beef?"<sup>7</sup> Poverty, particularly among the African American population, was an issue that could no longer be ignored, and the area was, according to a recent VCR publication, attracting "economic development plans that more prosperous and politically influential communities would not consider, such as a maximum security prison, a soil remediation plant, and a facility for the treatment of medical waste."<sup>8</sup> TNC had important land interests to protect and if its mission was to mean anything to the local residents, there had to be a response.

## THE ORIGINS OF VESC

The Nature Conservancy created the Virginia Eastern Shore Corporation in 1995 as a for-profit corporation<sup>9</sup> "to develop successful markets for farmers, watermen, and crafts people; to help set a course for development that preserves the environment; and to serve as a model from which those from other areas can learn."<sup>10</sup> This coincided with the formation by TNC of a new operating unit, the Center for Compatible Economic Development (CCED), the focus of which was the creation of effective conservation through community-based compatible development. CCED was the primary interface between TNC and VESC<sup>11</sup>.

As presented in VESC's business plan, four goals were set:

- **Jobs**... generate products and markets that create at least 250 new jobs in the first five years.
- **Environmental protection**... develop compatible businesses and land uses that address key ecological stresses.
- **Replicability**... develop a structure and approach that can be replicated in other communities and ecosystems.
- **Profitability**... secure an adequate return for investors.

TNC's concept for VESC was bold and imaginative. The fact that TNC -- one of the leading and best resourced environmental organizations in the United States saw in VESC its model for the "next generation" of conservation approaches, attracted widespread interest. Investors and funders were intrigued by the prospect of TNC, an organization with considerable credibility and track record, pursuing such a concept for sustainable development, and moreover putting its money and resources where its mouth was. As one investor put it, "we invested in (VESC) because we trusted TNC and because the project represented an interesting new approach to accomplishing conservation objectives on the Eastern Shore." Others were very much concerned for the economic health of the area and wanted to demonstrate their commitment to do something to improve conditions. By the time VESC was launched, \$1,225,000 in equity and \$1,500,000 in debt had been raised.<sup>12</sup>

The vehicle for selling the concept to investors and lenders was the Business Plan,<sup>13</sup> which described how VESC was to be organized and operated, provided a market analysis for proposed products and services, and outlined plans for three operating units:

- **Eastern Shore Products**...to develop, license and market an array of products that capture the local area's strengths and comparative advantages.
- **Eastern Shore Venture Fund**...to provide loans and investment capital to new and existing local businesses that meet ecologically compatible and economically sound development criteria.
- **Eastern Shore Lands**...to purchase, sell and lease sustainable agricultural lands, affordable housing and commercial enterprises for local farmers, watermen, businesses and citizens.

The plan's ten-year projections of cash flow forecasted profitability by year four of operations, together with the creation of 57 new businesses, and 273 new jobs after five years.

VESC was a radical approach for TNC. It was born of a recognition that its land acquisition model was not going to be enough to protect its major land and conservation interests on the Eastern Shore, and from the expectation that TNC should act to improve the economy and safeguard the lifestyle of the local community.

It was conceived as being a new piece of institutional infrastructure on the Eastern Shore that would focus on business development much in the way that the Virginia Coast Reserve focused on conservation. It would both serve the economic needs of the local community and provide the model for replication to other TNC sites across the country; thus VESC would pilot an organizational transformation of the Conservancy. It would be experimental by trying out new approaches to business development with a "triple bottom-line" – generating financial, environmental, and community outcomes – yet it would be structured as a for-profit corporation yielding a return to investors. It would seek to get to scale quickly through assembling a significant capital base and by pursuing a broad range of business lines. Its board would be drawn primarily from the private sector, as would its management. In short, this would be the flagship for sustainable development in environmentally sensitive regions and communities across rural America.

Of course, the VESC experience did not occur in a vacuum. The field of conservation or environmentalism in the United States was evolving, as were many of the organizations within it. In the early 1990s, leading thinkers and practitioners – The Nature Conservancy, Ecotrust, the Greater Yellowstone Coalition, the Environmental Defense Fund, the Appalachian Mountain Club, the Grand Canyon Trust, and the Audubon Society – began to develop an approach to conservation that used economic forces – market incentives and business innovations – to protect and preserve the environment. Some of those involved saw these efforts as signaling the emergence of a new worldwide field of "environment and development."

As thinking within the environmental field shifted toward linking development and conservation, other types of organizations also got in on the effort: community and economic development entities, such as the Center for Neighborhood Technology, Penn Center, the Sonoran Institute, and Bethel New Life, as well as individual businesses, particularly larger corporations, or groups of businesses – chambers of commerce or sectoral alliances – began experimenting with ways to concurrently improve environmental and economic performance. As well, some of the conservation and community economic development players introduced into their efforts the goal of achieving another take on a "third bottom line," the reduction of poverty and economic equity. Thus the phrase, "the three Es" – meaning environment, economy, and equity – came to characterize some of these efforts.

To pursue the general approach, conservation/environmental organizations used three basic strategies:

- **Business partnering.** In some cases, they developed partnerships with businesses – large corporations such as Monsanto or industry sector groups – to change the production processes or products of companies in ways that might appeal to customers because they generated better environmental outcomes.
- **Community planning.** In other cases, they worked with communities – residents and organizations in a town or city, county or region – to promote vision-based planning processes in which community members developed plans to improve both the local economy and the environment.
- **Enterprise development.** In a relatively few cases, such as TNC/VESC, Ecotrust/Shorebank Enterprise Pacific, and Sustainable Forest Futures, they designed, established and capitalized entities to develop and finance special enterprises, start-ups as well as existing firms, that would pioneer the approach.

VESC was firmly rooted in the enterprise development strategy, but some of its origins were in TNC's community planning strategy – indeed, the idea for VESC emerged out of the Northampton Economic Forum process. Thus, VESC is also bound by the context of place: an isolated rural area, with a centuries-long history of agricultural production and little of the amenities-driven economic boom that other picturesque rural places have experienced. VESC, then, was an enterprise development strategy in a chronically underdeveloped rural area – an extremely difficult proposition, as any experienced economic developer would agree. “Ruralness” is a characteristic of many of the places where conservationists plant their flags, because that's where the natural resource systems worth saving are. And TNC, which since the 1950s has owned and operated preserves involving millions of acres, has a particular set of rural places to care about.

When a triple-bottom line is added to the VESC equation – making it an enterprise development entity that must create jobs in a rural place in profit-making ways that contribute to its environmental quality – then the degree of difficulty that VESC faced seems formidable and sets it apart from most other prominent efforts in the field, which themselves face substantial barriers.

But there is still more that differentiates VESC in the emerging field of environment and development: its particular method for developing enterprises. VESC, in its practice (as opposed to what was articulated in its business plan), was a start-up business that designed, produced, procured, and marketed a variety of products and services – Hayman potatoes, kayak trips, and craft gifts. It did not finance existing businesses or provide them with technical assistance services, as other rural enterprise development entities have. In this regard, VESC looks quite distinct in the emerging field. It was a triple-bottom line, for-profit business starting up multiple lines of products and services in a poor rural area.

What the field can learn from the VESC experience – from its concept to business plan to execution – is bounded by these clear distinctions in a field of numerous, diverse experimental efforts.

## PART II: WHAT WENT WRONG

### FLAWED CONCEPT

There is no particular reason why nonprofit organizations cannot operate for profit businesses – indeed, some have and do with success – but in launching VESC, TNC went beyond its capacity. It had been accustomed to being a catalyst and community problem-solver, and thus when confronted with the challenge to do economic development on the Eastern Shore economy, it saw no reason not to do so. In many ways, TNC was being commendably entrepreneurial. What became clear later, however, was that TNC had been ill-advised to become involved in the direct operation of businesses, instead of being the broker of relationships, the promoter of deals, or perhaps the prover of new markets.

The concept that emerged had three fundamental flaws. First, the idea of a creating a start-up business (or a series of businesses) limited by the constraints of a triple-bottom line, although clearly exciting and cutting-edge, was asking a lot. To do this on the Eastern Shore in a relatively isolated rural community, remote from markets and without an adequate business infrastructure was asking too much. Triple bottom-line business innovations require a strong set of inputs – management capacity, markets, strong community connections – that can be used in creative ways to yield, economic, environmental, and community benefits. In the absence of these inputs, which proved to be the case for VESC, substantial time and money is required to build them – unfortunately, VESC did not have enough of either of these.

The second flaw was the structuring of VESC as a for-profit company while at the same time promoting the venture as a social experiment. William Weeks gives three reasons why TNC decided to organize VESC as a for-profit. “First, TNC believed that a bottom line of some kind with which people inside and outside the community are familiar and comfortable would allow the effort to be better understood, more like the development that communities traditionally look for. Second, the Conservancy thought the for-profit model would enhance the effort’s potential to (and reinforce its own resolve to create) a replicable model. Third, it believed that the for-profit form, specialized though it was, would interest investors in providing capital to empower TNC’s conservation efforts that it could not otherwise attract.”<sup>14</sup> It should be noted that Weeks does not mention the feasibility of actually making a profit, which is a driving factor in most for-profit start-ups. Rather, TNC’s leadership seems to have been attracted to the for-profit model because of its power to shape the perceptions of its main audiences: the community, others at TNC, and potential conservation investors.

Designing an organization that responds to both a profit-making mandate and a social mission is a worthy task – and an enormous challenge. It embeds into the organization’s genetics a persistent tension between the commercial rules and values of the marketplace and the quite different rules and values that social visionaries live by. The concept of VESC internalized both the financial structure and expectations of the commercial world, as well as an approach to economic development drawn from the social mission world, and a culture of governance based mainly on TNC’s mission orientation. As the consultants appointed by TNC to assess VESC’s options in 1998 put it, the complexity of dealing with “the tension between the rigors of bottom-line for-profit orientation and a social demonstration experiment... cannot be minimized.”<sup>15</sup>

However, as will be apparent later, the for-profit status of VESC was in name only. None of Weeks' justifications for such a structure materialized, no profits were realized, and in conflicts between profit and mission, the latter was always the default position. Nevertheless, the for-profit structure led to a series of design decisions and execution challenges that contributed to VESC's eventual demise.

The third conceptual flaw was the “plopping down” on the Eastern Shore of an initiative that looked good on paper but which had not paid any real attention to the place or to local realities. The idea was that TNC had already created an environmental institution in the form of the Virginia Coast Reserve; what was needed was a parallel institution to provide a focus for enterprise development. VESC was conceived as that institution, with a Board and staff populated mainly by outsiders, without clearly established links with local institutions. Even the relationships with VCR, TNC's main asset on the Eastern Shore, although structured through Board membership, were not clearly thought through, and in the event were undermined in practice. The consequences can be tracked through the business plan and the execution – planning assumptions that bore little relation to reality, a tendency to internalize production, distancing from Eastern Shore companies, and many others.

In summary, the concept of VESC did not take into account the time and energy that would be required to build the business capacities it envisioned for the Virginia Eastern Shore; did not anticipate the difficulties of operating from both a commercial and social mission perspective; and did not acknowledge the problems associated with economic interventions that have little connection to the way business is conducted in rural communities. These failures did not, in our opinion, spell doom for VESC from the outset – although they did set into motion a series of malignant realities that, as we shall see, were never really set right during the planning and execution of VESC.

But the failures do raise questions about the judgment of the investors. Why did they invest in VESC? Did they not see, or did they ignore, VESC's conceptual flaws? The Ford Foundation's role was particularly important, for it was their assessment that brought in other investors. As mentioned earlier, there was much interest in what TNC was trying to do and many were intrigued by the bold attempt to apply sustainable development principles in an economic development context. Ford's Rural Poverty Program staff were particularly interested in an approach that had direct benefits for low-income residents on the Eastern Shore. This desire to see something happen provided the context for the Program-Related Investment (PRI) staff at Ford who had the task of structuring a loan to VESC.

It appears that many of the conceptual flaws and the assumptions of the Business Plan were indeed identified by the PRI staff, who after requiring several revisions to the plan, attached a number of conditions to a \$1 million loan in attempt to minimize the foundation's risk exposure. These included making the loan in two stages with payout contingent upon maintaining an equity-to-debt ratio of at least 50 percent, and TNC putting some of its own capital in as equity.

## **FLAWED BUSINESS PLAN**

An analysis of the original Business Plan<sup>16</sup> shows that the ambitions of the concept translated directly into a series of fundamental flaws that can be summarized as a triumph of optimism and hope over essential research and clarity of purpose, and of mission over business reality.

The sheer problem of reaching critical mass in a depressed rural area led to the plan to create, develop, and nurture several start-up small businesses – Products (agricultural, crafts, and tourism),

and Lands (real estate). Not only were these initiatives expected to be launched at the same time, they were individual businesses in different and only somewhat related fields of economic activity. It is most unusual in the small business sector for an entrepreneur to launch from cold several different efforts at the same time. It can be seen sometimes in the case of a franchised business, where operations might start in several locations more or less at once. However, the basic business is the same across all locations, and the entrepreneur has the benefit of a franchise system with its experience and control points underpinning the expansion – she does not have to start from scratch. This factor in and of itself introduced a major element of risk into VESC's design.

Possibly as a reflection of an embrace of mission over business discipline, the Business Plan devoted only a few short pages to consideration of market adequacy for the entire spectrum of activities anticipated by the company. These pages made a few broad assertions about the size of the ecotourism market in the central Eastern seaboard, for example. But this smacks too closely of the very common conceit of many who are contemplating start-ups, who look at the gross size of the national or the regional market for their intended product or service, and then cite the miniscule percentage of those overall markets they must secure in order to break even or turn a small profit.

Market research should have been done in much more depth before launching the ventures, rather than leaving it until reality began to test – and refute – assumptions just when the businesses needed to be generating revenues. As a principal in the start-up of VESC told us, the projections in the plan, as well as those made later, were designed primarily to satisfy funder and investor demands and expectations – admittedly, not an uncommon characteristic of business plans. The irony, however, was that everyone wanted to believe these projections.

Although the Eastern Shore Lands operation never got off the ground, the assumptions in the Business Plan provide a good illustration of the designers' approach to forecasting. If one looks at the consolidated profit and loss projection for VESC as a whole, the scale of the Lands part of the constellation was dwarfed by the presumed profit potential of the Products sector. In year 5, for instance, Products was projected to generate gross revenues of \$1,368,537, while those of Lands was \$309,950. Products' profit was projected at \$479,169, Lands' at \$85,250. Both of these 'profit' figures were gross profit – that is, before any levy for corporate expenses.

This shows more than where the plan anticipated the bulk of gross profit generation to lie. The Products division could only generate these levels of revenues if the small businesses through which it was acting were generating the levels of sales to make it possible. Although there was no reference in the plan to any experiential basis for the projection of the sales volumes in the target small business population, the raw numbers would be impressive if they could have been achieved – slightly more than \$2 million in new sales for the Eastern Shore at the end of the fifth year of VESC.

However impressive such numbers might be, they in turn were diminished in their projected impact upon VESC by the realities of cash flow. Staying with the example of year 5, the cash flow for Lands was projected to be a negative \$1,405,780. The cumulative cash flow deficit for the Lands operation through year 5 was posited at \$4,312,290. So while that part of the operation was contributing modestly but steadily to the profit potential of VESC, it was doing so by dint of consuming extremely large volumes of cash to support its property acquisition efforts. Yet, there was no indication or even a presumption in the plan of where such large amounts of cash would come from – only the figure of an additional \$2 million in new capital in year 5, following a similar infusion of \$2,250,000 in year 3.

Such operating projections in and of themselves may have been defensible. The point is that the design of the business operation played a critical role: in this instance, it mandated that a part of the company that contributed only modestly to overall profit would nonetheless need major capital infusions to keep going. The projections for Lands were baselessly optimistic about the *progression* of property sales and leases. That is, there was no allowance for much un-evenness either in transactions themselves or in the price of land. From a business point of view, this reveals another defect, that VESC's cash flow position would have been substantially aggravated if for some reason, the company after having purchased land was unable to sell or lease it in the quick, neat fashion the projections anticipated, and instead was forced to hold it. A slowdown in the fifth year of 50 percent, for instance, would have created an additional \$650,000 of negative cash flow for the year and increased cumulative negative cash flow for Lands to nearly a negative \$5 million. Put another way, the negative \$650,000 would have entirely wiped out the projected net income for the whole corporation that had been anticipated for year six.

A similar spirit of extreme optimism pervaded the Business Plan's projections for Eastern Shore Products. However, a different design feature present in this section of the plan probably played a substantial role in VESC's problems. This was the size of the royalty and marketing levies to be imposed upon participating small businesses. At 5 percent of sales for royalties and 7.5 percent of sales for marketing, they represented an expense well beyond that of typical franchises, even the most successful and most familiar to small businesspeople, such as McDonald's. Few small businesses fail to complain about fees of this generic type, even with established franchisers, and the VESC Business Plan took a great leap of unsubstantiated faith in assuming that such a fee structure would be acceptable.

This point is pivotal, for these fees formed the revenue base for the *entire* Products effort, and that base was crucial to the profitability of VESC. Using VESC in this way as a marketing and distribution agent was also a central design feature of the whole underlying concept. Thus, the dynamics of the concept and design placed VESC in a bit of a box. If fee revenues dropped, there would be an immediate and substantial impact upon VESC as a whole that would limit its ability to provide services to farms and small businesses on the shore. Here again can be seen the hybrid nature of VESC's incarnation – a mandate rooted in corporate-control but needing entrepreneurial energy and drive to succeed, and couched within a visionary and untested – not necessarily wrong – mission.

The Products projections then, like those for Lands, were forced into an overweening optimism in order to produce the revenue dollars to support the necessary VESC organization and infrastructure in the implementation of its mission and charge.

The ecotourism programs were scheduled for a 700 percent increase in sales revenues to \$706,000 from year 1 to year 2. Absent a very similar model somewhere else operating under equivalent market conditions and demonstrating that this could be done, this projected increase while the operation was barely out of the start-up phase was patently ill-advised.

The projections for the local products and small business program were also flawed, though not so overtly. Product line sales averaging \$50,000 each, for instance, on the face of it may seem on the optimistic side, but not abnormally so. However, when it is remembered that these averages were assumed for the first two years, and that there were as many as 20 different product lines, the number takes on a different cast.

A sales growth rate of 15 percent was assumed for the first four years. Again, this is not a stratospheric figure, especially for established small businesses in growing demographic regions around the country. For one or two-person artisans in a depressed area, however, sustaining a 15 percent growth rate is another matter. The projections also contained the unwritten assumption that this small business population embraced the proposition of growth on such a scale. Subsequent investigation three years into VESC's history by the TNC-selected consultant team cast doubt upon this assumption. What the Business Plan might have considered was the 'independent streak' often displayed by small businesspeople, especially artisans, with their desire for autonomy and their own stamp, or brand, on their product. Had the plan done so, of course, it would have had to concede sales increases far less dramatic than projected, and some 'hiccups' even within those increases. This would have pushed breakeven for VESC still further out into the future.

As far as VESC's projected general operating expenses were concerned, it's not difficult to contend that they were set too low. A close scrutiny by line item shows, however, that they were not underestimated as badly as revenues were overestimated. Legal fees, consultant fees, and miscellaneous in particular should have been beefed up, and as a whole, projections for general operating expenses could have reasonably been increased by at least \$50,000 per year.

There is another crucial aspect where the business design for VESC fell short. The Business Plan contains no real analysis of the ramifications of pursuing several lines of activity that would be seasonal to some degree. Bad weather, for instance, could have serious negative impact on revenues.

Obviously, seasonality can have a significant impact upon certain types of businesses and their cash flow. It encouraged the principals in VESC to continue their belief in opportunity – such as, the weather might be better next year for growing Hayman potatoes – while suspending hardheaded judgment and economic measurement. Thus they postponed facing up to the consequences of VESC's disappointing actual performance.

The wide spread of VESC's planned business activities introduced another potentially destabilizing factor into the design. It required the CEO to be able to operate with some degree of success in a number of different business personae: land developer, tour operator, conference planner, and because of the proposed product and gift branding programs, franchiser. Although VESC never got its venture fund off the ground, the original design would have added the responsibility of running a small venture capital fund, in itself a full-time job. Also, because marketing of all these programs and products had to be carried forth on a sustaining basis, the CEO should have been a marketing specialist. To find someone with such an extraordinary range of skills and experience would be difficult, if not impossible.

The Business Plan implied that VESC, and therefore its CEO, would assume an operational role in all of its activities. That is, the CEO, because of the nature of the organization, capitalization and budget, would have to involve himself in the day-to-day work of the company, from ongoing market research on how best to reach the ecotourism market, to helping agricultural producers and craftsmen better rationalize their production, while promoting higher standards of quality to fit the market image VESC wanted to project.

This was a recipe for failure, or at least substantial disappointment. For someone, even with a reasonably allocated staff, to be able to hit the ground running, breathe life into the envisaged entity, and then sustain a proportionate effort across such a range of competencies was too much to expect, almost too much to imagine.

In summary, our careful reading of the Business Plan, in which the designers of VESC articulated how their concept would be set in motion, reveals a set of important flaws – from too many start-ups and inadequate market analysis to groundless, extreme optimism, unsupported assumptions, and too many roles for a hands-on CEO. These flaws set the stage for implementation that would be attempted by the management and board of directors recruited to the VESC enterprise in 1995.

## **FLAWED EXECUTION**

A very early indication of storm clouds forming came in an early Board meeting on January 24, 1996, when the CEO revealed that agricultural products had run into resistance from farmers and that a lag in demand had been caused by the flooding of the organic vegetables market by Californian produce. Importantly, he also contended that ‘mere stickers do not add value,’ although the Business Plan had assumed that the stamp of VESC on their products would help enterprises enter markets and generate revenues. As for gifts and crafts, he noted there was “no production going on,” and that those contacted as sources of products displayed “low energy.” It is always the easiest of tasks to criticize in retrospect, but the CEO’s report bore the marks of something more important than a temporary operating difficulty.

If the projections had been subjected to a hardheaded critique before the company had launched into operation, or even shortly after it had begun, this report might have set off an alarm. There might have been some recognition that embracing very aggressive revenue assumptions had created a large risk if those assumptions failed to materialize. Specifically, a ‘hardhead’ somewhere among the VESC stakeholders might have wondered if the report that branding didn’t seem attractive to the market and that gift and craft producers were lacking energy, wasn’t an early sign that something at the heart of VESC’s business design was wrong.

At a minimum, such a hardhead might have insisted on an alternative set of projections that would have scaled down substantially the revenues. He might have then asked how costs would be affected by the CEO’s recommendation for agricultural products to “take a more conventional approach” by growing items not easily grown elsewhere. Switching strategies in the face of unanticipated but nonetheless real difficulties is good management. By not preparing at least another set of numbers, VESC was moving into the unknown through its own volition.

The next Board meeting was held in early June of 1996. Shouldn’t the company have held more frequent Board meetings, at least during the critical first year or eighteen months? After all, VESC was a series of start-ups, not just a start-up. If more frequent meetings of the full Board were not feasible, why didn’t VESC form an executive committee of the board or similar body to look at the company’s activities during the period between meetings?

Why was the Board apparently so disengaged? Why did it not respond to the early warning signs and other indications that all was not well with the business? The core of the answer is that, for the most part, the Board acted as if it were overseeing a non-profit organization rather than a for-profit business. On paper and in the beginning, the Board was populated by people with a range of relevant skills and backgrounds. The initial Board included a major bank director, a venture capitalist and business owner, a partner in a large national law firm, a development (fundraising) specialist, a foundation CEO, and a couple of influential members of the local community. But The Nature

Conservancy selected them, and they were there because they were supporters of TNC. They were not called upon to use their business judgment, they were reluctant to challenge management, and they remained passive. The Board Chair – Greg Low, a TNC official and VESC's founder – and the VESC CEO tended to make joint presentations at Board meetings, which had the inevitable effect of closing down debate on most issues, since TNC's views were made obvious.

There was dissent, although it was rarely noted in the minutes. The major non-TNC equity investor in VESC resigned in frustration because he had not been getting the financial information needed to make proper decisions, and he was unhappy with management and the decisions being made. A Board member who lived in the community repeatedly challenged management on the lack of impact that VESC was having on employment opportunities on the Eastern Shore. Another questioned the for-profit structure and asked whether a non-profit research and development approach might be more appropriate. Yet another challenged the quality of the design and production of gifts made under VESC's name.

But these indicators of dissatisfaction or concern had little impact on the direction the company was heading. The result was disengagement and, in the face of VESC's poor financial performance, an unwillingness of Board members to look for extra capital that was clearly needed – they left that to TNC. The passivity of the Board thus reinforced the further deterioration of the VESC structure.

Untimely oversight did nothing to prevent some damaging events. Halfway through the critical initial year, when the CEO had reported that organic products could not be pursued due to resistance from local farmers, an alternative of processing locally-grown foods was seriously considered, although it was not anticipated that product could be available for sale for another 15 months. At the same time, the lodge program was unavoidably delayed, and other ecotourist activities, it was admitted, would lose money for a while, although a bed-and-breakfast biking program was succeeding.

Since there was no mention in the Board minutes of the cost implications of these variations from the plan, it must be assumed that the VESC's overhead cost structure continued as was planned, even though the company had no activity that would produce revenue anywhere near projections. In fact, as the audited financials for 1996 would later show, in several key categories – salaries, marketing, consulting fees – the company was spending appreciably above the original plan.

On September 4, 1996, there was a meeting of the Board's Community and Environmental Goals committee. The only item appeared to be the CEO's proposal to adopt a monitoring system developed at Old Dominion University for measuring jobs and business creation. He also reported that the Small Business Development Center chosen to work with VESC had assisted eight individuals. At the risk of sounding unnecessarily harsh, VESC management appeared to be easing itself into a classic response when confronted with unanticipated and perhaps intractable problems: go bureaucratic. With a cost structure that had been based on much, much higher revenue assumptions, and with no relief in sight for at least a year, management was spending time on measurement systems when there was so little to measure.

Although this was not a regular Board meeting but that of a specific sub-committee, its formation and its use of the CEO's time and energy at such a critical point in the company's history, reveals a failure to prioritize.

Scarcely two months later, at the Board meeting of October 31, 1996, the entire enterprise, Board and management alike, seemed to recognize a turning point. An amended Business Plan was adopted, but the CEO explained that the breakeven point was late in the ten-year period, in contrast

to the original plan's fourth year. The Board's comment that an earlier breakeven was "desirable" sounds timorous given the situation. There was some overt comment about the company pursuing so many different activities simultaneously. But there appeared to be no follow-up with this notion, at least not at the Board level.

Oddly enough, the written record of the following Board gathering on January 29, 1997, states that the company faced "four years of losses before it turns the corner financially." There was recognition at this meeting that the real estate development portion of the company's activities needed to be put in abeyance. A Business Goals committee agreed to meet in six weeks to review alternative real estate measures as well as changes to the Business Plan pursuant to the upcoming capital-raising campaign.

Heartening as the increasing awareness of the need to make changes was, there does not seem to have been a sense of urgency commensurate with the CEO's reporting that "cash in 1997 will probably go down to the \$600,000 level." Although audited financial statements for 1996 were not yet available, surely management must have known of at least the range of losses for the year, or it could not have been so specific about upcoming cash levels.

The loss for 1996 turned out to be \$478,058. Of the company's three broad areas of work, there was no mention of attracting venture capital, and the approach to real estate was being reconsidered. That left Products to carry the entire burden. But how much optimism could accrete here? Total revenues for 1996 were only \$25,000 rounded, and low energy among small businesses for the company's plans had been reported. Processed foods would not make their appearance until rather late in the year, late summer at best.

The point here is that a serious Board examination of the realistic prospects would have concluded that VESC was already in dire straits after less than two years' operations. The company's operating expenses for 1996 had been \$537,000. Continuing these alone would eat up the bulk of the corporation's cash in 1997, if the CEO's estimate was correct, assuming no change in the revenue outlook.

No estimates of 1997 Products revenue appear on the record, but a conservative outsider would have been hard pressed at this time to project revenues for this sector greater than had been anticipated by the original Business Plan for the initial year of operation. Indeed, 1997 was bearing most, if not all, of the hallmarks of another start-up year. Those original figures projected were \$108,051; the actual for 1997 turned out to be \$118,382. With a cost of goods sold of nearly 70 percent – a cost unanticipated in the original plan – the gross profit available to help offset corporate expense was negligible. This could have been reasonably predicted.

What perhaps would not have been predicted was a substantial increase in operating expenses in 1997 – for instance, there was a nearly 80 percent increase in VESC salary expense. Given the CEO's own estimate of cash remaining for 1997, it would not have been hard to conclude that such a rise in operating expenses, together with limited revenue prospects for the year, would consume all or most of the \$600,000 he had said would be available. And of course that was exactly what happened – the net loss for the year would come in at \$602,316.

The Board was cognizant of the need to raise more capital. Yet in June of 1997 the only tangible prospect of additional capital, at least on the record, was the apparent willingness of one director to invest \$75,000. And the final Board meeting of that crucial year, at the very end of October, was apparently a very abbreviated one at which "there was agreement as to the need to raise additional

capital as well as to cut costs.” As previously noted, the responsibility for raising capital fell mainly on the Chairman’s shoulders. Much of his effort focused on raising philanthropic dollars rather than business capital but he met with limited success. One foundation, the Heinz Endowments, did agree to make a grant directly to TNC, which could in turn be used to invest in VESC.

The company’s losses for its first two years of operation of about \$1,080,000 had depleted 86 percent of the company’s initial capital. Just as importantly, the financial dynamics of VESC were headed in the opposite direction of where they should have been. With no mention of the revenue base at the final Board meeting for 1997, there were no grounds for optimism about even much of an increase beyond 1997 for 1998, to say nothing of approaching the original plan’s anticipation of revenue from Products of \$557,000 and revenue from Lands of \$70,000.

Corporate operating expenses were headed up rather than down. Despite vague injunctions from the Board to cut costs, the huge increase for 1997 in VESC salary expense, caused total operating expenses to come in at a staggering \$665,600. Even with the prospect of new capital, unless expenses were reined in drastically and at once, the paucity of revenues placed the company at the beginning of 1998 in the position of looking at another year where losses might approximate \$600,000.

There is a baffling quality to management’s actions, especially in mid-1997. The CEO’s assertion of “no threat to ultimate success” certainly contained little evidence of entrepreneurial spirit, nor for that matter of managerial acumen. More than anything else, it seems bureaucratic, and also strangely passive.

The VESC Board can be faulted for not pushing management harder in a variety of ways on a variety of issues. However, management’s continual increasing of the corporate expense burden, in spite of the fact there was no evidence that revenues would rise above what was expected in the plan for the start-up year, was little less than derelict.

By the June 1998 Board meeting, one director was wondering if the entire concept should not be reconsidered, with the company reconfiguring itself more as a research and development operation. This was an eminently valid proposition, and one that might have saved the day had it been made at least a year earlier. Management’s response was again curious, promoting the nebulous idea of the company operating as a combination of a for-profit business and non-profit R&D organization, while developing as a model for the rest of the country.

Management had to be cognizant by mid-1998 that not only was the financial picture still bleak, but it was going to be even gloomier by the year’s end, absent fundamental changes. This was because, for the second year in a row, revenues were going nowhere. In fact, revenues for the year would show a roughly 10 percent decrease from 1997. How much more confirmation of the state of affairs on the revenue side was needed, when the company’s total revenues in its second year approximated little more than the original plan’s estimate for a single business line, Products, in the first year of operations?

It was also going to be gloomy because of another significant increase in operating expenses. Once more salaries were the chief culprit, rising to about \$405,000 for 1998 from the earlier \$311,000. Management simply cannot have been unaware of this. The contention that money had to be expended to create revenues was of course not baseless. However, the Board and stockholders of VESC were due far more than this. Even with some tangible evidence that additional bodies at the corporate level could produce revenues, it should have been *de rigueur* for a responsible management to

explain in detail how that would come about, and within what specific time frame, especially when the company was engaged in capital raising and was planning to sell its landholding (the original TNC investment in VESC) to raise an additional \$500,000.

The loss for 1998 was \$755,477, but if nearly \$69,000 in grant income is ignored, the operating loss was almost \$818,000. Thus, VESC had an accumulated deficit of nearly \$2 million by the end of 1998. From a financial point of view, it seems fair to conclude that, whatever the flaws in concept and business plan, the deficit was larger by a significant measure than it need have been, if only the business execution had been better.

In the Fall of 1998 the main lenders, Ford Foundation and Mary Flagler Cary Trust, began to understand the magnitude of the problem. VESC was in default of the equity-to-debt ratio requirements of Ford's loan, and before any decision could be made on releasing the second stage of the loan, Ford insisted that TNC commission a strategic review from independent consultants. This was the I Point study referred to earlier. By the Spring of 1999, both Ford and Cary were considering their options to protect their investments, and making it clear that they had lost confidence in the ability of VESC to survive. VESC's Board took the decision to dissolve in August of that year.

This extensive catalogue of flaws and failures in execution appear overwhelming, but they can be attributed to three basic factors. The first is that the design flaws embodied in the Business Plan were operationalized. The second is that power arrangements rendered the Board impotent and presented real obstacles to getting VESC on track. Finally, and perhaps most critically, management was seemingly closed to feedback, whether from the market, financial statements, Board discomfort, or an independent consultant's report.

## PART III: THE NATURE CONSERVANCY'S ASSESSMENT

### THE WEEKS MEMORANDUM

Given the importance that TNC had placed on VESC as its flagship project – its next generation of sustainable development approaches – it is instructional to turn to a memorandum<sup>17</sup> prepared by one of the key conceptualizers of VESC, William Weeks, Executive Vice President of The Nature Conservancy, the director of the Center for Compatible Economic Development from its inception in 1995, and CEO of VESC during its last eight months. While accepting that TNC was ultimately responsible for VESC's performance and as such its failure, Weeks places most of the blame on management. He does not pay much attention to the shortcomings of the concept or the business plan.

In Weeks' view, what went wrong was that “management consistently over-estimated revenues and its ability to reach and claim the markets that would create those revenues.” This combined with a “failure to trim expenses...in response to weak revenues did, eventually, seal the Company's fate.” In fact, he argues that “management's view was that expenses were not the critical problem, and that cutting expenses would only reduce the Company's likelihood of generating markets of the size needed to realize the Company's' vision.” He went on to identify six factors that contributed to VESC's demise:

- A conscious decision was made to hire a business leader with institutional experience and a deliberative temperament. This reflected TNC's concern with both protecting its reputation and that of the investors, and protecting the environment from impulsive business decisions. Weeks ruefully notes, “The business might have done better with more duct tape and less gold-plated plumbing.”
- The possibility of a second infusion of \$500,000 from the Ford Foundation encouraged a belief that VESC had the time to get revenues on course, “even in the absence of firmly persuasive data...”
- TNC unwittingly gave the impression to management, after twice providing additional capital along the way, that “there would be more money where that came from.” Both TNC and the Board provided a clear message to management of encouragement to continue in its efforts to succeed, and backed off from expressing doubts or criticisms of the course VESC was on. Moreover, the CEO responded to criticism by threats of resignation, an outcome that neither TNC nor many on the Board were prepared to contemplate.
- Management had no direct financial stake in VESC. “No one...has said or could say that management was not working hard. But watching someone else's capital account melt away is unavoidably a different experience than watching your own capital disappear.”
- “TNC allowed itself to be persuaded by management that outside help...would be unhelpful...and would distract management from pursuing central and essential tasks.”
- The seasonal nature of two of the three businesses had the effect of “causing financial difficulties to turn into a crisis.” Haymans produced revenue from November through March, tourism May through October. “When a line of business did not meet expectations, we did not have the opportunity to watch for another quarter, and respond accordingly. Our choices were limited to planning for a new season, or abandoning the line of business.”

Weeks concluded, “TNC should...have realized the Corporation needed to change course at a time that insisting on its doing so might have made a difference. TNC kept faith with the highly qualified management it recruited for too long. And if breaking faith was too much to ask, TNC could,

perhaps, have helped management by being a tougher critic and a more demanding investor, instead of a staunch supporter.” After noting that “lenders lost three quarters of their money (and) equity investors, led by The Nature Conservancy, lost their entire investment,” Weeks nevertheless asserts “it is fair, appropriate, and correct to say that the money invested in this major compatible development effort was not wasted.”

The major question that arises from Weeks’ analysis is “Why didn’t TNC change course earlier?” TNC had so much at stake with its investment in VESC – not just money, staff time and energy, but also an important component of its scheme for organizational transformation. The most likely answer is a combination of factors: an almost blind commitment to the concept coupled with unwavering optimism that it would all work out in the end, and perhaps the fact that TNC never fully understood what it was getting into when it set out to develop a for-profit business with multiple business lines. In the end, Weeks was prepared to accept even the most modest of outcomes as vindication for TNC’s investment in VESC.

## **VESC’S LEGACY**

The impact of VESC’s demise given its very short life span is hard to gauge with any certainty. Bill Weeks provided one dimension, “Lenders lost three quarters of their money. Equity investors, led by The Nature Conservancy, lost their entire investment, retaining only (at their choice) ownership (appraised as valueless) in a much smaller, still struggling young business selling Hayman Potatoes and chips.”<sup>18</sup>

He also cited what he believed to be VESC’s three main accomplishments. The first, “TNC’s willingness to plan, capitalize, and launch a compatible business in response to Northampton County citizens’ vision was a critical affirmation at that time that compatible development was possible.”<sup>19</sup> The investment in VESC helped to catalyze the creation of an eco-industrial park in the county, and these together with other initiatives “represented a sort of critical mass of activity that solidified a fairly durable commitment of the civic leadership of the County to seek sustainable, rather than any available development.”<sup>20</sup> He went on to assert that the threat to ecological systems on the Shore brought about by high unemployment “was a critical one in 1993, and the existence and early performance of the VESC kept hope alive at a critical time. No small achievement.”<sup>21</sup>

Certainly, the I Point consulting team selected by TNC in 1998 supported the view that “civic leadership on the Eastern Shore has increasingly embraced the notion of compatible economic development and overwhelming evidence exists that these values are increasingly aligned with TNC objectives.” However, it gave much of the credit for this evolution of collective civic will toward compatible development to John Hall and the Virginia Coast Reserve. Hall acknowledges that VESC stimulated his interest in engaging in the local economy as means of heading off destructive economic development, and looking for new tools for conservation. He points to the fact that Hayman chips are now being marketed by the Blue Crab Bay Company – one of the firms highlighted in I Point’s report as a good example of a compatible business operating on the Eastern Shore – and to the creation of the Conservation Business Alliance.

The Alliance is a new TNC initiative that has two stages. The first encourages local employers to sign on to a statement of principles relating to environment, economy, community, and quality, and links employees directly to the work of TNC on the Eastern Shore. To date eight companies employing 500 people have signed. The second stage involves the striking of mutually beneficial deals. One example is where a combination of land transfers and measures to ensure clean water has

enabled a mariculture business to double the number of its employees. The apparent success of this approach represents a natural progression of the patient long-term, community-based approach that the Virginia Coast Reserve has been practicing for at least a decade, a lesson that VESC failed to apply.

The second VESC accomplishment identified by Weeks was that it “designed, built, and operated three growing lines of business with environmental and community consciousness” noting that each line of VESC’s business catalyzed activity that is ongoing. As examples, he referred to the fact that new castings are still being made of some of the craft designs, the Hayman business has been reorganized and is still operating, and the Escapes business produced significant revenue for local vendors, hundreds of satisfied customers, and interest in establishing nature tourism as a component of existing travel and tourism businesses in other areas where TNC is working. Unfortunately, I Point’s calculations of cost benefit of jobs created and enhanced showed that the impact that VESC had on business development had been achieved through investments per job way in excess (by a factor of 8) of credible cost ratios from the community development industry or from federal programs. This points to the fact that VESC adopted an extremely costly strategy in incubating businesses, and may have had greater impact through brokering commercial activities or investing in existing businesses.

The third accomplishment claimed is that “there is obvious value inherent in the Conservancy’s having stopped simply talking about compatible development and starting to do it.”<sup>22</sup> There are three observations to be made here. First, although Weeks’ assertion is undoubtedly true, it really only has meaning if TNC *has* learned something from “doing it.” There does seem to have been some reflection at TNC’s Center for Compatible Economic Development (CCED). CCED raised the capital for VESC, hired the CEO, recruited the initial Board, and in April 1999 took over the management of VESC and oversaw the process of dissolution. From the remains of VESC, CCED had created a new limited liability company, Eastern Shore Enterprises, to house the Hayman potato and Hayman chip businesses. Eastern Shore Enterprises was structured in a way that showed that lessons had been learned from the VESC experience. The company is managed by a local person and with low overhead; it is modestly capitalized with a loan from CCED, it is focused on just one proven product and a value-added extension, with an existing market share. In other respects too, CCED appears to be applying its learning, by looking for partnerships to take forward some products and services and by providing loan capital to compatible businesses, rather than entering directly into business operations. Second, the VESC experience has raised questions and anxiety among funders and practitioners in the field of environment and development about the appropriateness and efficacy of investing in conservation through business enterprises. Thus, it is critical that the real lessons of VESC are clearly identified and learnt.

The final observation is the realization that VESC came and went without leaving much of an impact on the Eastern Shore. Bill Weeks noted that “the better overall performance of the nation’s economy in 2000, as compared with 1993 and 1994 has significantly eased the unemployment issue on the Shore; it is not, at present, essential for TNC to help create jobs...”<sup>23</sup> I Point observed that compatible development was underway on the Eastern Shore and that value-added production, a VESC primary focus, “is occurring...but VESC is not a significant influence.”<sup>24</sup> The irony is that the Virginia Coast Reserve, TNC’s original flagship on the Eastern Shore, has picked up the torch of conservation-based enterprise development through its creation of the Conservation Business Alliance and there is some evidence to suggest that it is beginning to make it work.



## PART IV: FIELD LESSONS FROM THE EASTERN SHORE

The Nature Conservancy launched VESC with the highest of motives and the best of intentions. All concerned admit that many mistakes were made, some elementary, others stemming from VESC's experimental nature. But the purpose of raking over the ashes of the failed venture is not to make TNC, funders and investors, Board members, management, and staff uncomfortable. It is to discern whether there are lessons that a wider audience of funders, practitioners, and others can learn from this experience. We believe there are three major lessons, and hope that articulating them here will provoke some further thinking about ways forward for conservation-based enterprise development.

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1. Conservation and environmental organizations can only become effective catalysts of economic development if they both consciously tailor the role they play to use their strengths and effectively manage the tensions that inevitably will arise.
  2. The strategy of developing businesses and markets to improve the environmental performance of a particular place, such as the Virginia Eastern Shore, depends crucially on understanding and obeying the fundamentals of place-based economic development.
  3. To successfully learn how to integrate economic, environmental, and community systems, and then to achieve scale, requires a profusion of experiments, openness to critical feedback, and the continuous revision of assumptions and actions based on experience.
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### **1. Conservation and environmental organizations can only become effective catalysts of economic development if they both consciously tailor the role they play to use their strengths and effectively manage the tensions that inevitably will arise.**

In part, the story of VESC is the story of a fish out of water, a conservation organization operating outside of its usual context. For nearly half a century, The Nature Conservancy had been a preserver, a guardian, of lands. To play that role, it has developed sophisticated methods and tools for assessing the condition and importance of particular places, for legally acquiring or protecting places, and for managing them. Indeed, this is precisely what The Conservancy did on the Eastern Shore before it also became involved, in the 1990s, in community development and economic development there. Other conservation and environmental organizations use many of the same practices as TNC, and also take on the role of political advocates for the environment. They work with public agencies, such as the National Forest and Park Services, which manage lands; they launch advocacy campaigns to influence public policies; they support political candidates who share their views.

As many of these organizations became aware of the limited effectiveness of their approaches, they turned – much as TNC did on the Eastern Shore – to the fields of community development and economic development for new approaches. As a result, they found themselves having to learn new tricks, such as community organizing, community-based planning, market analysis, and business financing. With this expansion in their role, some of these organizations also bumped into barriers, such as the difficulties of overcoming communities' suspicions about their motives and the tensions created by acting, on the one hand, as a collaborator with others in the community while, on the other hand, maintaining the freedom to be an advocate on behalf of the environment and a critic of others.

Undertaking community development, which builds the civic capacity of a place, is itself a guardian sort of activity: it seeks to preserve or build certain qualities of a place. It has tested conservationists, who were not used to collaborating with other interests in communities, such as social welfare or affordable housing. But it has not stretched them nearly as far as has the effort to undertake economic development. For-profit, commercial activities are in some ways fundamentally different from the civic, guardian activities of environmental protection and community development – a point that has been made by Robert Reich, Jane Jacobs, and many other analysts.

First, commerce is not bound by place; trade and markets include, but also transcend, place, and therefore respond to forces that are not local. Second, commerce is essentially not a process of preservation; it is an act of use and innovation, of “creative destruction.” Third, commercial activities are guided by very different “feedback loops” than conservation or community development: economic returns tend to be measured in much shorter cycles than environmental or community returns; furthermore, the financial indicators typically used in commerce measure a fairly narrow, highly tangible range of phenomenon, compared to the often less tangible measures of environmental or community conditions. Thus, the economic value that can be realized from a natural resource may be at its peak long before the greatest biological value of the resource is achieved – and the economic value that can be derived may ignore other potential value in the resource (e.g., seeing a forest for its lumber, while not noticing its value in cleaning water).

These differences make a big difference when a conservation organization, a guardian, wanders into the field of commerce. Does this mean that guardian organizations should not – cannot – engage in commercial activities? Not at all. Indeed, as we said earlier, the VESC effort was part of a broader set of absolutely critical experiments to learn how to integrate into commercial life some of the important values and outcomes that environmental guardians cherish. What it means is that when guardian organizations do this, they must recognize that they are entering *terra incognita*, a place they do not know and for which they are not yet well suited. Thus, they should carefully think through exactly what role they may best play. Should they be catalysts for new thinking by players already in the economy, or supporters of businesses seeking to be more sensitive to their impacts on the environment, or long-term investors in new businesses, or advocates for public policies, such as land-use restrictions, or builders of new economic development institutions? There are many possible roles, but not all can be undertaken. In short, an organization should take account of its capacities and capabilities. TNC had demonstrated excellence in conservation science, land acquisition and management, and community planning, and shown positive results in the area of enterprise development through brokering relationships, promoting deals, and proving ideas. But direct operation of businesses through VESC was a step too far.

Selecting the proper role is not enough. Guardian organizations should anticipate that playing *any* role in the commercial sector is likely to result in some dilemmas – the need to make tradeoffs between its interest in environmental and community preservation, versus economic innovation. There is little in the record of VESC that suggests an explicit, thoughtful, on-going management of these tensions occurred. As we have said, VESC’s unfortunate *modus operandi* was to ignore or explain away the negative signals it constantly received from the commercial world. The passiveness and disengagement of the board exacerbated this tendency; it operated in an arms-length nonprofit manner when it should have been offering sound and independent judgment on the business fundamentals. Indeed, the structure of power and relationships between the board and TNC was not given enough thought at the outset; it was not designed to help manage the tensions that would arise. The Business Plan for VESC compounded this problem. It was a sales document to give funders and investors what they wanted to read. It should have been a serious attempt to predict the

development of a complex business venture and its various components – and to articulate the deep risks of the venture that would have to be managed by the principals.

**2. The strategy of developing businesses and markets to improve the environmental performance of a particular place, such as the Virginia Eastern Shore, depends crucially on understanding and obeying the fundamentals of place-based economic development.**

VESC was quite a distinct experiment within the emerging field of environment and development: a triple-bottom line, for-profit business starting up multiple lines of products and services in a poor rural area (with the added burden of functioning as a tool for organizational transformation of a national conservation organization). Perhaps there has never been anything like it in the annals of economic development. But that does not mean that VESC's champions could not have learned from what is already known about the critical factors for success in the process of place-based economic development.

Perhaps the most important of these lessons, already touched on in this report, is that economic development is most successful when it recognizes, taps into, and unleashes local or indigenous potential – people and organizations – for wealth creation. This lesson was not lost on the VESC planners; their Business Plan suggested that VESC's role was to support local farmers, artisans, and business people. But early in its implementation, VESC lost sight of this vision and turned inwards, to its own capabilities, to produce businesses. In doing so, it became more of an intruder than a catalyst to local action. The trap that VESC fell into was that, in the absence of local production capacity, it took on all aspects of a business venture. In the case of Hayman potatoes, for instance, what started out as a proposition to provide marketing services for growers turned into advising farmers on growing and storage techniques, brokering supplies, packaging, branding, marketing and distribution, and eventually exploring chip production as a means of using non-standard sized potatoes. Not only did this mean that VESC would not be building the capacity of the Eastern Shore, it had significant, unanticipated implications for VESC's costs and staff priorities.

Another important lesson of economic development is that, in most instances, a place's economy is most powerfully affected by changes at the level of the economic *sector*, not just a new or changed business here and there. Sometimes, a company with an important new technology or innovation for providing services may emerge and transform a sector (think, the advent of the PC, or MacDonald's franchising model), but this is a rare occurrence. Usually, the norms and trends for businesses are established at the level of the sector, such as agriculture, forestry, manufacturing, or tourism. VESC intended to establish sectoral innovations – the adoption of organic farming by the agricultural sector, for example, or the adoption of eco-tourism by the tourist sector. But it did not seem to understand much about how those sectors functioned, what incentives drove them, what their norms were, and so on. And once VESC internalized its business development and shut itself off from other businesses, the chance that it would affect the sectors it had targeted declined greatly. Nonetheless, many economic development practitioners around the country have been quite successful at organizing sectoral behaviors.

A third lesson that comes from economic development is that investment decisions – whether they involve private, non-profit, or public funds – should be based on deep analysis of the particulars. As we've already said, VESC's analysis of the markets it wanted to affect involved fairly general information, the sort of data that perhaps suggests an opportunity for investment, but does not provide the detailed knowledge to guide actual investment. Planning with such general information, made it possible for VESC's business planners to imagine a scenario for business success (reaching breakeven within four years) that they could sell to some investors. But it was also a scenario that

began to fall apart within months of its implementation – when reality’s particulars, which had not been assessed, were encountered. Given the ambitious nature of VESC, a thorough environmental scan of what was realistic in the area would have been a prudent first step. Business planning projections should be based on carefully considered and realistic assumptions, which in turn stem from thorough market research to gauge the nature and scale of demand for products and services. Over-optimistic assumptions about market share, revenues, and cash flow—characteristics of VESC’s business plan – provided no sound basis for developing and running a business, or, in VESC’s case, multiple businesses.

The answer to the question of whether VESC – or any other enterprise seeking to wed environmental, economic, and community outcomes – should be a for-profit or a nonprofit depends crucially on this sort of deep analysis. If the analysis reveals the potential to generate profits within a time frame that investors would deem reasonable, the enterprise may be able to attract investments. If not, then for-profit investors may be offered incentives or subsidies, such as the opportunity to blend their capital with “concessionary” capital from foundations. And if a subsidized profitability cannot be foreseen, then it is highly unlikely that investors will be attracted to the enterprise. By definition, it is a nonprofit. Start-up ventures with triple-bottom lines raise many challenges – they demand strong management capacity, markets, and community connections, and they need time and money. Thus, it is unlikely – though not impossible – that they can be launched as for-profit businesses that can compete for private investment capital. A much more likely scenario is that existing businesses that are converting themselves to a multiple bottom line approach will be able to change their practices over time and generate profits. Although, VESC’s business plan called for the company to finance such enterprises, no such activity occurred.

A fourth lesson may seem obvious: if you’re starting a business, be clear what business you are in. VESC was in so many businesses – so many expectations had been piled on – that it was nearly impossible to focus on what to actually do. It had multiple business lines – tourism, agriculture, crafts, real estate, small business financing. It had multiple bottom lines – job production, environmental performance, community well-being. It had a for-profit mandate, but a nonprofit mission. All these ambitions placed an unreasonable burden on the CEO. Expensive as VESC’s cost structure was, little attention was paid to ensuring that VESC had all the relevant skills, experience, and contacts to cover all the businesses and activities it was expected to undertake.

A final lesson: successful business development depends primarily on the people running the business. Concepts, plans, and financial capital matter, of course, but it is human capital that makes them all go. This is particularly true for start-up businesses, which are fragile affairs from the outset. Creating any start-up venture demands a lean organizational structure so that investment capital is used primarily for growing the business and not wasted on unnecessary overhead. Burdening a new business with corporate trappings imposes a cost structure that makes it difficult for the venture to achieve profitability. This certainly happened to VESC: management and the board repeatedly failed to rein in costs, even in the face of declining revenues. This failure underscored the fact that TNC, in selecting management, bet on a managerial, rather than an entrepreneurial, personality. It handed a hired manager with experience in a large enterprise a business plan prepared by others and some \$2 million he had not had to raise.

The selection of management for these types of ventures is critical. The primary concern has to be their ability to start and grow a business – which suggests an entrepreneurial bent and a certain degree of unpredictability for the sponsors. Someone with managerial bent is probably more appropriate for later stages once the business has been established. The important characteristic, however, is the ability to build and sustain relationships with other businesses, with partner

organizations, with the community – the building of trust and credibility over the long haul. In our research, it became apparent that VESC’s CEO was uncomfortable about this sort of relationship-building, which compounded both his own managerial missteps and the flaws in the concept and business plan.

This raises a larger point for the field, a question that emerging fields usually confront: where is the pool of talent with the range of abilities needed to develop and grow triple bottom line businesses?

**3. To successfully learn how to integrate economic, environmental, and community systems, and then to achieve scale, requires a profusion of experiments, openness to critical feedback, and the continuous revision of assumptions and actions based on experience.**

VESC was sold to investors and to the community of the Eastern Shore as a *model*, as though its path to success was well understood. VESC would create jobs, improve the environment, and generate financial returns for investors in a few years. In other words, it would do what no one else had ever done – and show the rest of The Nature Conservancy, not to mention the world, how to do it. Thus, expectations were exceedingly high. This put enormous pressure on VESC to *seem* to be succeeding – even in the face of information, such as revenue reports, to the contrary.

Let’s be clear: VESC was an *experiment*, even though it was not presented or conducted as such. Instead of the openness and candor of experimenters hungry to learn, its principals seemed unable to recognize or acknowledge what the feedback they were getting said. There was at least some hubris in this stance. TNC had shown admirable responsiveness when challenged by the Eastern Shore community to do something about the local economy. Its can-do attitude, however, led it to create a fundamentally flawed concept; it sought to design “the answer,” even though it did not know enough to do so.

The general point here is that considerable caution is needed when designing a new initiative. There is a tendency -- and this is all too common in the economic development field – to overload it with too many ambitious and often contradictory objectives. There is nothing inherently wrong with having multiple goals, but there is a danger of building irreconcilable tensions into the effort. In VESC, these tensions included responding to local needs versus creating a model for replication elsewhere, creating a for-profit business structure versus promoting social experimentation, sensitivity to local capacities versus pressing the need to get to scale.

The decision to create VESC as a for-profit venture was a momentous one. TNC’s reasons centered on establishing the venture’s credibility in the marketplace, the community, and with potential investors. A perhaps unexpected consequence was that VESC’s status as a for-profit raised expectations about its behavior and performance – one could hardly acknowledge that VESC was an experiment in learning about what might work, for that would seem to risky to attract investors interested in financial returns. What might be tolerated in a nonprofit was not acceptable in a for-profit.

Because VESC was not genuinely open to feedback or critique that undermined the expectations it banked on, the flaws in the concept carried into the Business Plan, which had its own flaws, and both the conceptual and planning flaws were carried into the execution, which added flaws of its own. The messages conveyed by the financial statements and reactions from customers and partners were rarely heeded, Board members concerns were discounted, and criticism from whatever source, including TNC’s own (admittedly imposed by the Ford Foundation) consultants, was received with

hostility. Ironically, responsiveness to warning signs and market signals is critical to the survival of a business, which is what VESC purported to be.

The fact is that very little is known about how to create enterprises that meet a triple bottom line, or even how to transform existing enterprises to that end. In the face of little understanding about an obviously complex undertaking, a profusion of experimentation and learning is needed. While it is natural for those conducting the experiments or investing in them (as foundations do) to want to be able to declare success, they must recognize that new fields of practice, such as environment and development, are built as much on the lessons of many rapid and visible failures as from the success of a single effort.

## PART V: IN CLOSING

Flotillas have many ships. Social change rarely depends on a single individual, organization, or initiative. The tide of progress does not flow smoothly; it spreads across the land along a ragged edge; it falters and ebbs, and then flows again.

Although TNC's flagship, VESC, foundered and sank, the problem it sought to tackle remains real, and the need for responses is still urgent. Traditional approaches to conservation and economic development in America are inadequate to the challenge. Conservation practitioners and investors, such as foundations, have no choice but to try to develop the knowledge, tools, and institutions for economic development that improve rather than degrade the environment.

In this report, we have tried to be exactly clear about what went wrong with VESC – and what others might learn from the experience. No doubt, it is somewhat disheartening to read this account. But, as others before us have said, the front edge of innovation is a “bleeding edge,” because so much can go wrong when the unknown is probed. By definition, experimentation and innovation involve risk – many ventures will fail, only some will succeed. In the larger scheme of things, one innovation's failure is simply another innovation's lesson. The foundations that sponsored this report – to document, assess, and broadcast the lessons from VESC – understand this, as do the many practitioners in the field of environment and development whom we know. Perhaps, too, they will honor the principals behind VESC who, despite the flaws in how they conceptualized, planned, and executed VESC, nonetheless tried to make something important happen and, thus, met the standard for human creativity that John Keats wrote of nearly two centuries ago: *“I would sooner fail than not be among the greatest.”* They deserve our thanks.

## Endnotes and References

- <sup>1</sup> John C. Sawhill, *To Dream and To Care*, Nature Conservancy, May/June 1991, page 3.
- <sup>2</sup> W. William Weeks, *Beyond the Ark: Tools for an Ecosystem Approach to Conservation*, Island Press, Washington DC, 1997, pages 87-88.
- <sup>3</sup> This description is taken from a brochure, *Welcome to Broadwater: Building a World Model*, The Nature Conservancy's Virginia Coast Reserve, October 1998.
- <sup>4</sup> Patty Frost, *Changing Tides Rebuild Virginia's Eastern Shore: Planning to Stay*, Marketwise, Federal Reserve Bank of Richmond, 1999, Issue Three, page 1.
- <sup>5</sup> The process was funded by the Ford Foundation, the Virginia Center for Rural Development, The Nature Conservancy, and other local contributors.
- <sup>6</sup> The Northampton Economic Forum, *A Blueprint for Economic Growth*, December 1992, page 2.
- <sup>7</sup> Interview with Greg Low, December 21, 2000.
- <sup>8</sup> The Virginia Coast Reserve, *The Nature Conservancy's Conservation Business Alliance on Virginia's Eastern Shore*, Nassawadox, VA, undated, page 4.
- <sup>9</sup> The Virginia Eastern Shore Sustainable Development Corporation was incorporated in the Commonwealth of Virginia on February 10, 1995. Formal operations began in mid-1995.
- <sup>10</sup> Virginia Eastern Shore Corporation brochure, undated.
- <sup>11</sup> For the remainder of this report, references to TNC include CCED unless stated otherwise. Greg Low, a senior executive of TNC was the chair of VESC.
- <sup>12</sup> Equity was provided by The Nature Conservancy (\$500,000 in land), Virginia Environmental Endowment (\$400,000), Allen & Company (\$150,000), Crestar Financial Corporation (\$25,000), and individuals (\$150,000). Debt was provided by the Ford Foundation (\$500,000 program-related investment plus promise of a further \$500,000 if matched by additional equity), Mary Flagler Cary Charitable Trust (\$400,000), and the Lincoln-Lane Foundation (\$100,000).
- <sup>13</sup> Virginia Eastern Shore Sustainable Development Corporation: Business Plan, September 1994.
- <sup>14</sup> W. William Weeks, *Beyond the Ark: Tools for an Ecosystem Approach to Conservation*, Island Press, Washington, DC, 1997, pages 92-93.
- <sup>15</sup> Richard Anderson, Ben Butler, Brian Kahn, and Richard Turner, *An Assessment of Virginia Eastern Shore Corporation: The Final Report*, I Point, December 7, 1998, page 15.
- <sup>16</sup> Virginia Eastern Shore Sustainable Development Corporation, *Business Plan*, September 1994.
- <sup>17</sup> Bill Weeks, *Reflections on VESC*, Memorandum to Investors and Others Interested in the Virginia Eastern Shore Corporation, February 9, 2000, revised September 1, 2000
- <sup>18</sup> Bill Weeks, op. cit., page 10.
- <sup>19</sup> Ibid, page 10.
- <sup>20</sup> Ibid, page 11.
- <sup>21</sup> Ibid, page 11.
- <sup>22</sup> Bill Weeks, op. cit., page 12
- <sup>23</sup> Ibid, page 11
- <sup>24</sup> Richard Anderson et al, op.cit., page 10.