How I Did It...

Pierre Omidyar is the founder and chairman of eBay and a cofounder and chairman of Omidyar Network.

EBay's Founder on Innovating the Business Model of Social Change

by Pierre Omldyar

THE IDEA

Omidyar was inspired by eBay's social impact to create a hybrid model for his philanthropic Omidyar Network: a combination of nonprofit and for-profit.

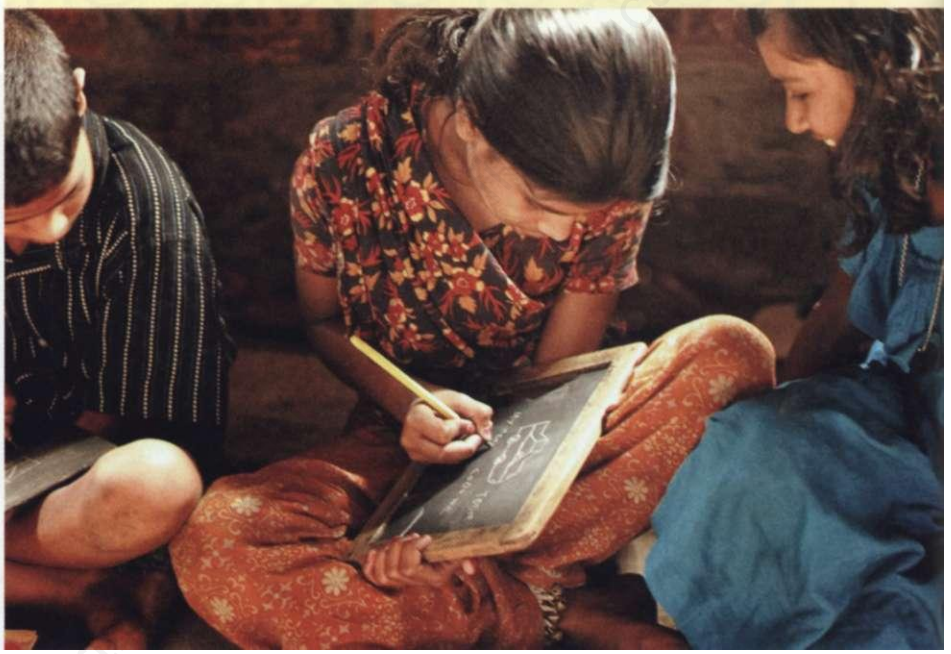
PHOTOGRAPHY: GETTY IMAGES

My journey as a philanthropist began in September 1998, on the day eBay went public. I'd spent two weeks helping with the pre-IPO road show, and we'd arrived at the New York office of Goldman Sachs. I was exhausted. The actual moment was pretty anticlimactic. We'd always assumed that when you go public, your stock starts trading the moment the market opens, but it doesn't work that way. You have to wait for the bankers to do their initial trades. So when the market opened, we just stood around on the trading floor with nothing to do. Nobody was really paying attention to us. There was an electronic ticker on the wall, and after about 45 minutes somebody gave us a heads-up that we should start looking for eBay. Sure enough, a few minutes later we saw our ticker symbol coming across from right to left. We cheered; we hugged; we high-fived.

We had priced the initial public offering at $18 a share, which made my stake worth a few hundred million dollars. During the course of the day the stock rose to nearly $54. My shares, like those of all the other insiders, would be locked up for six months, so at this point it was just paper wealth. But on paper my stake was more than $1 billion. It was shocking and completely unexpected.

The Virtuous Cycle of Microloans

Pierre Omidyar took these photos in March 2008. Clockwise from right: a microlending group in Andhra Pradesh, India; two microloan recipients in Bangladesh; children at a school in Dhaka, Bangladesh, run by BRAC, an Omidyar Network investee.



Soon afterward I began having conversations with my fiancee, Pam—now my wife—about what we were going to do with all that wealth. It was clearly far more than we would ever need, and it had accumulated very quickly: EBay went public three years after I wrote the original software, so there wasn't a great sense of "Wow, we really deserve this—I've spent my whole life building up to it." We felt we had a responsibility to make sure those resources got put to good use.

Within a few months we'd created a nonprofit family foundation, which is what new philanthropists typically do. We took an informal approach. A friend of the family served as the executive director. We gave money to this charity or that charity. It was a responsive thing—we would read about something in the newspaper and it'd be "Let's give money." After a couple of years we realized we needed to professionalize the foundation and become strategically driven. We recruited some executives to help us think about how to take lessons from eBay and apply them to philanthropy.

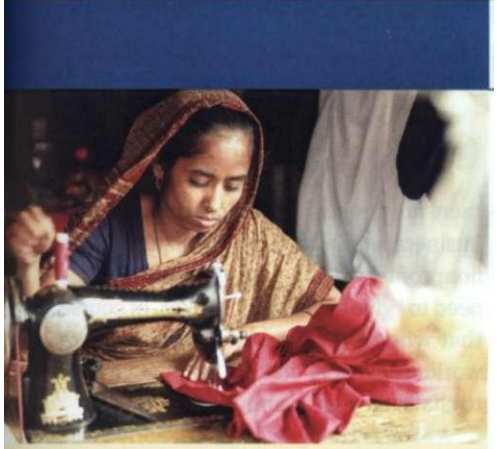
Many people don't distinguish between charity and philanthropy, but to me there's a significant difference. When I use the word "charity," I think of what's needed to alleviate immediate suffering. It's just pure generosity driven by compassion, and it's important but never-ending work—there will always be more suffering. Charity is inherently not self-sustaining, but there are problems in the world, such as natural disasters, that require charity.

Philanthropy is much more. It comes from the Latin for "love of humanity." Philanthropy is a desire to improve the state of humanity and the world. It requires thinking about the root causes of issues so that we can prevent tomorrow's suffering. And if we want to make sustainable change, we have to put all the tools at our disposal to their best possible use.

By the early 2000s I'd realized what a profound social impact eBay was having as part of its business. It had about 100 million users, and it was teaching people that they could trust a complete stranger over the internet—at least, trust him or her enough to make a transaction. It was providing people with new careers and livelihoods. This was large-scale impact. I began to wonder: If I had created a nonprofit organization and set a 10-year goal to build a trusted network of 100 million people, with a start-up grant of $10,000 and no additional grants, would it have succeeded? Probably not. But somehow a business had been able to reach this level of social impact in less time, using less outside capital.

A Small Price to Pay

In thinking about philanthropy, I began looking for ways to harness the incredible power of business in order to make the world better. By 2003 I'd begun talking to my advisers about this issue. I was told that philanthropy consists entirely of nonprofits, and the tax system limits what you can do in that format. Specifically, it would be extremely difficult for employees of my nonprofit family foundation to look at proposals that might result in a for-profit equity stake instead of a grant. The complexity of the tax code—and the risks of running afoul of it—were high, so I began pressing at this point, asking my team to find a way for us to start investing in businesses philanthropically. Mike Mohr, my family adviser, said, "There's a way to do it, but you're going to lose a whole bunch of tax deductions." So I asked, "How much? Give me a figure." He went off to calculate it: If we stopped deducting the salary and overhead costs for the foundation, it would mean $1 million to $2 million a year in extra tax liability. My immediate reaction was that this was a no-brainer. In the context of spending $100 million a year, $1 million to $2 million seemed like a small price for get-



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PHOTOGRAPHY: PIERRE OMIDYAR

ting the flexibility to use every possible tool to improve the world.

It was a challenge to structure this properly. We ended up creating a limited liability corporation called Omidyar Network, which employed all the staff members. That freed them to conduct due diligence without regard to whether the work turned into a nonprofit grant or a for-profit investment. The nonprofit entity remained a 501(c)(3), but it was in essence just a checkbook we used for making grants.

We were breaking new ground here—our attorneys had never seen a structure like this. We actually had to terminate all the foundation's employees and rehire them in the LLC. Today there's a name for people who make investments that can produce both impact and profit: impact investors. And the field is gaining a lot of attention and popularity. But at the time, there was no name for what we were trying to do.

Finding the right structure wasn't the biggest obstacle. We also faced a cultural challenge. The way a program officer does due diligence for a foundation is vastly different from the way an investment analyst does it for a venture capital firm. The main difference is that the two view risk in very different ways. Program officers are expected to be much more risk averse: If a foundation makes a grant to an organization that doesn't succeed, it's considered a big mistake. In contrast, the very best venture capitalists are happy if they get two out of 10 investments right, and they get incredible financial rewards when they judge risks correctly.

While we were making the structural shift, we needed to hire people with experience doing for-profit investing—people who understood how to evaluate a company's management, competitive landscape, and financial returns. This created even more challenges. How can you have nonprofit program officers and for-profit venture capitalists on the same team? How should you compensate them? We didn't get it right in the first few years—we weren't able to successfully blend the two cultures. It was difficult to incentivize the for-profit employees without disincentivizing the nonprofit staff. Some of the for-profit people we brought in didn't stay long, and the nonprofit employees may have felt they weren't valued. It took a lot of learning.

A Focus on Microfinance

Some of our first for-profit equity deals included companies like Ethos Water—which uses a share of proceeds to provide clean drinking water in India, East Africa, and elsewhere—and Meetup, which enables people with similar interests to create communities offline.

But soon we began investing heavily in microfinance—and it was then that we started to see the full value of the hybrid structure we'd created. During the 1980s and 1990s, most microfinance was conducted by grant-funded NGOs. That has

changed: Today most of the biggest microlenders are for-profit, and we now had the ability to invest in them. These funds enabled the poorest of the poor to start enterprises and take advantage of educational opportunities. For instance, a family might borrow to buy a cow and sell dairy products, or to buy sewing equipment and sell clothing, and then use the profits to send their children to school. Since 2004 we've invested in 28 organizations—15 not-for-profits and 13 for-profits. We recognize that microfinance has come under increasing scrutiny because some organizations have paid insufficient attention to consumer protection and education. But it's critical to remember how much good microfinance has accomplished: It has given 150 million people, most of whom live on less than a dollar a day, the means to start businesses, generate income, and break the cycle of poverty.

In 2007 we made a big shift, restructuring Omidyar Network to get rid of the traditional hierarchical model and institute a partner style of leadership and governance. Simply put, we decided that because the organization was operating more like a venture capital firm, we should structure it more like one. We brought in our first-ever managing partner, Matt Bannick, who had built the international business at eBay and had led PayPal during its integration into eBay and its rapid international expansion. Over the past four years Matt has made a lot of changes and assembled a great team; right now we have more than 50 employees, of whom only one or two are from the early, purely nonprofit days. We've focused on figuring out how to use the levers of for-profit when necessary and the levers of nonprofit when necessary. To date Omidyar Network has committed a total of $442 million—$239 million in nonprofit grants and $203 million in for-profit investments. More than $100 million of that has been in microfinance.

Today our operation includes more than 10 employees in Mumbai, and that city has become a focus of our work. Obviously it has tremendous poverty, but it also has an incredible amount of intellectual capital. The juxtaposition of impoverished people and ambitious, educated entrepreneurs is extraordinary, and it's a juxtaposition that exists nowhere else in the world. In Mumbai wealthy bankers walk to work on the same sidewalks as beggars. The fundamental investment reason for our being in India is that the innovations created there over the next five to 10 years will dramatically improve the quality of life for people in extreme poverty worldwide. Many of those innovations will come from entrepreneurs and businesses. I'm excited to play a small part in that process.

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For example, we've helped fund a company called d.light, which creates small, affordable solar-powered lamps. Most people don't realize that one in four families in the world lacks access to electric light. The main alternative is kerosene, but many people can't afford it—and it is harmful to both health and the environment. We've also helped fund a for-profit school initiative in Africa, and we're looking at health care applications there, too.

Use Every Tool

Initially we drew some criticism for our hybrid approach combining nonprofit with for-profit. The basic concern was "Here's a guy who was going to give most of his money to charity, but now he says he's giving some of it to for-profits, and he's probably just looking to make more money." Our critics believed it was going to be a net loss for the nonprofit community. Their concern was amplified by the fact that at the time, a lot of businesspeople were getting involved with nonprofits, which created a culture clash and some animosity. But there are deeper ideological issues at play. Businesspeople going into philanthropy or nonprofits typically have the idea that they need to "give back." This implies, of course, that when they worked in the business world, they were "taking away." I've tried to challenge that assumption.

A lot has changed since our early years, and many of the debates have calmed down considerably. Today there are numerous examples of social enterprises and businesses that try to provide services to the very poor and to do so in a responsible way. And people within the nonprofit sector understand that there's a role for business to play.

I'd like to think our work is just beginning. I'm now 44, and if I'm lucky I have another 50 years ahead of me. In the past few years we've learned that to have the biggest impact, you need the right capital structure and the right leaders. We have three full-time recruiters on our staff. That's really unusual for a philanthropic organization, but par for the course in venture capital. And like most venture capitalists, we take governance seriously. We have formal board memberships or advisory roles in roughly 50% of our portfolio organizations.

One of the biggest things I've learned in more than a decade of this work is that you really can make the world better in any sector—in nonprofits, in business, or in government. It's not a question of one sector's struggling against another, or of "giving back" versus "taking away." That's old thinking. A true philanthropist will use every tool he can to make an impact. Today business is a key part of the equation, and the sectors are learning to work together.

Fonte: Harvard Business Review International, Boston, v. 89, n. 9, p. 41-44, Sep. 2011.