

# **Frog With A Baseball On Its Tongue**

## **Speed, Scale and Venture Capital For A Sustainable Future**

*Or, Ruminations on My Favorite Cap*

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An Open Letter to the Attendees of the  
Investors' Circle National Conference, 2000

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Dear Attendee:

My uncle collects hats. Mostly baseball-style caps. I never paid it much attention along the way, but, somehow, now, it comes to mind: an impressive collection of caps, mostly festooned with the logos of the various companies with which he had been involved, as a financier, in one way or another over the years. There were dozens of them, stacked on one of the shelves of his office at home. Some people have credenzas full of transaction tombstones in acrylic. My uncle collects company caps.

As I address you, I think of these hats because my favorite comes from your neighborhood. It's the cap of the Everett Aquasox, a minor league team from Everett, WA.<sup>1</sup> I've brought one with me today. The moment I first saw it several years ago – the brightly colored tree frog, its legs extended as if in mid-jump, wearing a baseball cap with the letter “E” on it and balancing a baseball on its extended tongue – it leapt into the canopy of my imagination, where it has remained ever since.

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### **First, there is the baseball.**

What do baseball and venture capital have in common? The Decade of the Home Run.

Venture capital is a game of home runs. In a typical portfolio of 20 early stage venture capital deals, you might expect as many as a third of the investments to result

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<sup>1</sup> Attendees at the 1999 Investors' Circle conference in Boston each got one.

in complete write-offs, five to ten deals to survive as “walking wounded” – companies that stay in business, attract subsequent financing, but dilute your investment substantially or never reach a liquidity event that allows you to realize a return – a few to be successful enough to return several times your money, and a few to be home runs. A venture capital home run is a deal that gives you 10 times, 20 times your money, or, sometimes, much more. The returns of a venture capital portfolio are driven by its home runs.

The use of this bit of baseball terminology seems rather telling at this point in time. This was the decade of Mark McGwire’s 70 home run record. This was the decade when Babe Ruth’s seemingly immutable record<sup>2</sup> was obliterated, the decade of the \$2.7 million baseball.<sup>3</sup> It was as if baseball were mirroring, in almost mythic fashion, the gravity-defying lift off of our entire culture, powered by the twin rockets of money and technology.

Speed and explosive growth were, perhaps, the defining aspects of the 1990s. Perhaps nothing so captured the seemingly inexorable conquest of our lives by the concepts of speed and economic growth as the hegemony over our daily lives of the stock market.<sup>4</sup> Stratospheric market caps for e-commerce companies – trading at 100s of times revenues – became commonplace, as was their coverage on the evening news. 100% returns replaced 20% returns as the yardstick for venture capital home runs. I do not need to adumbrate for you who live here, in Seattle, one of the hubs of the computer revolution, the far-reaching economic, cultural and psychological impacts of the growth of processing speed and the reach of the internet. Whether it be Microsoft’s “Where do you want to go today?” or Compaq’s “Limits? What limits?” messages of a boundary-less world abounded during the 1990s. Somebody somewhere has probably called it the Decade of the Virtual. Or the Decade of Ones and Zeros. Or the Digital Decade.

We could reasonably think of it, however, as the Decade of the Home Run.

Leaving aside the rather mundane observation that all home-runs do come back to earth, whether it be in a fan’s mitt or bouncing off an empty seat in the stands, or the scoreboard, or the hood of a parked car outside the stadium, I’d like to turn our attention for a moment from the home run itself to the relationship between dollars and home runs. Or, you might say, from baseball caps to salary caps.

I’m not going to bother with the details. The big picture is obvious enough. Today’s home run hitter may make \$10,000 or so per at bat. We don’t need calculators, or baseball historians, to fill in the rest of this story. The big leagues are big business. As they have become so, many aspects of the game of baseball have been

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<sup>2</sup> Ruth’s 1927 record of 60 home runs during 154 regular season games stood for over 70 years, and was widely considered one of the titanic accomplishments of 20<sup>th</sup> century sports. Roger Maris hit 61 homers in 1961, but the baseball season contained 162 games; he hit 59 home runs through 154 games.

<sup>3</sup> McGwire’s 70<sup>th</sup> home run ball was auctioned off for this whopping sum.

<sup>4</sup> I wonder if anyone has studied the percentage of Americans who know the approximate level of the Dow Jones Industrial Average or the NASDAQ, relative to the percentage who knew in 1990? My guess is that this percentage has grown dramatically, along with the perceived importance of these numbers as an indicator of national well-being, even among Americans who are not active players in the markets.

impoverished. Stadiums are bigger. Security is fiercer. Distance between player and fan more pronounced. Expectations of mega-salaried-celebrity-players extreme. Player loyalty to team and team loyalty to city, increasingly meaningless. Anyone who has ever kept a young fan company while he or she has tried to get an autograph from a baseball player knows what I am talking about. Intimacy, friendliness, just plain old-fashioned fun: these qualities are virtually absent from major league baseball.

Which brings us back to the Everett Aquasox. I have never been to their stadium. But I have been to the stadium of the minor league Pawtucket Red Sox, as well as to quite a few spring training stadiums in Florida. While new major league ball parks accommodate 50,000, the smaller venues of minor league teams generally seat 5,000 or so. Aquasox promotional literature reports that the Everett franchise set a season attendance record in 1998 of 119,396 fans, thanks in part to the “enlarged” but still “cozy” 3,700 seat stadium. The word “cozy” will never be uttered anywhere near a new major league ball park. In fact, it is hard to see much of a future for the term “ball park” in a world of “stadiums.”

The march from ball park to stadium is just one of the myriad aspects of economic growth that I would put in the “Losses” column, were I to tally the wins and losses of the 20<sup>th</sup> century. The scale of a minor league ball park is more agreeable to the senses, more accessible, more humane. What goes on there seems somehow less intense, more personable. There is an almost palpable relief in the absence of major celebrities and national attention. You wouldn’t expect to find teams with the names Mudhens and Buzz, Riverdogs and Sea Dogs, Shorebirds and Pelicans<sup>5</sup> playing in 50,000-seat stadiums.

I’d like to ask you to imagine, for a moment, this Investors’ Circle conference as a kind of minor league baseball park.. Which is to say, let’s imagine what we are gathered here to do over the next few days as being quite distinct in a number of respects from what I will loosely refer to as “major league venture capital.” Our confreres in the major leagues are managing venture capital funds of hundreds of millions or even billions of dollars. They are seeking to place investments \$5 million and \$10 million at a time. They are looking for long-balls: even the ones that are “foul” will make impressive strikes.<sup>6</sup> Their mandate is to swing for the fences. They are going for the record books. They are looking to back the next World Series winners.

Few of us, here, are in that ballpark. The funds we are managing are, generally, not of the same scale. Occasionally, due to the unpredictability and opportunistic nature of the process by which deals come into our purview, we may see some of the same deals as our major league counterparts. Much of the time, however, we are reviewing investment opportunities that are too small or too early stage for larger funds. And

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<sup>5</sup> As in, Toledo Mudhens, Charlotte Buzz, Charlestown Riverdogs, Portland Sea Dogs, Delmarva Shorebirds and Myrtle Beach Pelicans.

<sup>6</sup> With apologies to those who do not know baseball. The reference here is to long foul balls, as in a ball that is hit long enough to be a home run, but falls outside the foul poles, which mark the boundaries of fair territory. A 500 foot home run over the centerfield fence is something for the statistics keeper. A 500 foot blast just to the left of the left field foul pole will never be noted in any accounting, but makes quite an impression for a few moments on those who watch its flight.

sometimes, some of us explicitly turn our attention to deals that interest us for social and environmental reasons, primarily, and for financial reasons, only secondarily.

I would like to suggest that for us to succeed, to get the most out of what we are doing, we are going to have to have the strength of character to accept ourselves as minor league fans. No, let me state it more affirmatively. We are going to have to learn how to *celebrate* the differences between the 3,700 seat ball park in which we find ourselves, today, and Yankee Stadium. This is not a statement of deficiencies of intellect or character, or of setting our sights too low, or of lack of savvy as individual investors. It's not because we *can't* get a ticket to a game in Yankee Stadium. It is because we *choose* not to.

This issue of choice is something I will come back to in a few minutes.

It's time to leave the ballpark for the rainforest.

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### **Then, there is the frog.**

What do venture capital and frogs have in common? Again, the 1990s. This decade has been pivotal to both, but for very different reasons.

Venture capital, which has been around as an industry for only 20 years, exploded during the 1990s, with assets under management growing from a few billion dollars in 1990 to over \$50 billion by the decade's end, and all aspects of the industry – average fund size, average size of investment, money invested per annum, investment returns – grew dramatically.

Frogs, on the other hand, have been around for 350 million years and yet, in that same 1990s, suddenly began to suffer dramatic population declines and unexplained deformities.

Since the first World Congress of Herpetology held at Canterbury, England in 1989, the worldwide decline in the frog and toad populations has been the subject of growing scientific concern. The International Union for the Conservation of Nature has set up a Declining Amphibian Populations Task Force, and researchers around the world have been trying to determine the cause of the decline. “The widespread nature of the reports and the magnitude and rapidity of many of the declines (some having resulted in extinctions) suggested some far-reaching, damaging environmental cause or causes, rather than simply natural fluctuations in population densities.”<sup>7</sup>

Interestingly, the foregoing citation came from a study that was published prior to the startling discoveries of frog deformities in Minnesota in 1995, which brought the issue into the limelight of America's national media. Newspapers carried stories with headlines like:

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<sup>7</sup> Robert Stebbins and Nathan Cohen, A Natural History of Amphibians, Princeton University Press, 1995, p.210.

## “Hundreds of Deformed Frogs Pose Environmental Warning”

(Washington Post, September 30, 1996)

## “Eerie Quiet of Frogs and Toads Isn’t Part of Normal Cycle”

(New York Times, April 30, 1996)

Frogs with severe birth defects were discovered in 54 of Minnesota’s 87 counties, across Wisconsin, and into the St. Lawrence River Valley in Quebec, Canada. Deformities included missing legs, extra legs, misshapen legs, fused legs and other severe abnormalities, including missing eyes. At one site in Minnesota, 96% of the frog population was deformed. “The whole state appears to be affected,” concluded Robert McKinnell, a University of Minnesota geneticist and cancer researcher who initially believed that the deformities were naturally occurring birth defects. “We should be alarmed.”<sup>8</sup>

A single cause of the deformities has not been identified, although parasites, pesticides, increases in ultraviolet radiation and global warming have all been implicated. Because they live both in water and on land, and because they breathe through their skin, amphibians are particularly sensitive to chemical pollution and other environmental changes, including temperature, humidity and radiation.

“Frogs, after all, have been around more than 80 times longer than humans—we’ve seen only a fraction of their ecological story,” writes journalist William Souder.<sup>9</sup> “Many scientists regard frogs as a sentinel species—a kind of biological early warning system of trouble in the environment. So the one question everyone wanted most to answer is not what is causing deformities in the frogs, but rather what it all might mean in the larger scheme of things. . . . The frog has sensed a change, a displacement in the order of life as we know it.”<sup>10</sup>

Now, the frog populations experiencing the difficulties in North America are primarily northern leopard frogs. They do not appear on the cap of any sports franchise, lacking the photogenic qualities of the tropical Red-Eyed Tree Frog of Aquasox fame. But as it happens, our little baseball cap friend has an environmental pedigree of his own, playing “a symbolic role as a representative of the tropical rain forests currently under siege and disappearing at the rate of approximately one and a half acres a second.”<sup>11</sup>

I may be forgiven, therefore, for wondering whether the “E” on the frog’s baseball cap mightn’t stand for “environment,” particularly since the frog has often been used symbolically in a much more general way to illustrate the difficulty human beings have

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<sup>8</sup> *Rachel’s Environment & Health Weekly*, 3/9/99.

<sup>9</sup> *A Plague of Frogs*, William Souder, Hyperion, New York, 2000

<sup>10</sup> It is interesting to note we are in a race against time to document frog species: at the same time as we are documenting the decline of certain frog species, we are still in the process of identifying others. Some 4,000 frog species have been documented, with scientists expecting that hundreds more remain to be discovered if tropical deforestation doesn’t eliminate them first.

<sup>11</sup> *Frogs*, David Badger, Voyageur Press, Vancouver, B.C., 1995

in discerning and responding to environmental degradation that is gradual and global. As the story goes, throw a frog into a hot frying pan and it will jump right out. Put it in a pot of cold water and bring the pot to a boil, and the frog will never jump out. Substitute “greenhouse effect” for boiling water and “human beings” for “frog,” and you have what keeps many people lying awake at night.

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## **Now, comes the leaping.**

To the question “What do venture capital and frogs have in common?” we might also observe: *leaping*.

Technologies that have the potential to dramatically advance the state-of-the-art of a given industrial process are often referred to as leap frog technologies, and their development is often funded by venture capitalists. In fact, Seattle is home to a venture capital firm named Leapfrog Ventures, who describe the process, and their name, as follows:

**Why do we call ourselves *Leapfrog*?** The answer is simple. We believe that the most successful company in any industry gains a disproportionately higher return for its shareholders. Our mission is to help our portfolio companies Leapfrog their competitors and achieve industry-leading levels of competitive and market performance as quickly as possible.

There’s also a firm named Venture Frogs. Their web site displays, rather mysteriously, only three words under their logo: Investments, Restaurant, Charity. (An exploration of the relationship between these three aspects of their site is beyond the scope of this address.) While they do not explicitly identify the reason for their amphibian moniker, we can assume the logic is similar:

Venture Frogs was formed by two members of the founding team of LinkExchange (acquired by Microsoft for \$265 million in November 1998). Focusing on the Internet, e-commerce, information, and telecommunications technology markets, Venture Frogs provides investment in and consulting for private companies which are in early development of new strategic opportunities and in a phase of unusual growth.

As it happens, Paul Hawken uses the term *leapfrog* to describe advances that make it possible to envision the hypercar, a super-efficient car of the future: “By the 1990s, revolutions in electronics, software, materials, manufacturing, computing, and other techniques had made it possible to design an automobile that would leapfrog far beyond ordinary cars’ limitations.”<sup>12</sup>

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<sup>12</sup> Natural Capitalism, Paul Hawken, Little, Brown & Company, 1999. The use of the term leapfrog in the context of efficiencies in locomotion is interesting given the biomechanics of the frog’s leap, which is a phenomenon of enormous efficiency, as it turns out. Bullfrogs jump nine times the length of their body; leopard frogs, 15 times; the Southern cricket frog, an astonishing 36 times its body length.

It seems to me that there is no shortage of venture capital in the world for the funding of leapfrog technologies. As we have noted, billions of dollars per annum are streaming in this direction as we speak. Venture capital that makes the world a safer place for leaping frogs? Now, that is another matter.

It seems to me that if we are going to preserve the natural systems upon which all life depends, so that the places we drive to in our hypercars will be healthy to live in, work in and visit, what is needed is a leap of faith. This would be the leap of faith from a worldview that posits the centrality of growth and speed to a worldview the posits the centrality of health and permanence. This would be the leap of faith from a proliferation of means to a clarification to ends. This would be the leap of faith from an economy built upon industrial agriculture (that uses biocides and petrochemicals to produce, process and transport cheap food with long shelf life across nations and continents) to an economy built upon sustainable agriculture (that uses organic inputs, minimizes processing and shipping, and promotes the health of local food systems).

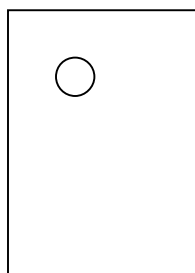
Last but not least, this would be the leap of faith from 50,000-seat-stadium venture capital to a 3,700-seat-ballpark kind of venture capital, a kind of venture capital that is unafraid to hold not just financial capital, but social and natural capital, in its embrace.

Integral to this leap of faith will be the courage to create new ways of measuring our success as investors.

In what I am about to say I do not speak for Investors' Circle as an organization, or even, I would guess, for a majority of our members. For there is little as contentious between our members, or between any bunch of social investors, as a discussion of financial returns. Most, today, seem to believe that in order to be successful at socially responsible investing you must prove that you can "do good" while at the same time "doing well," defined as achieving a competitive rate of return.

I have suggested the term "external rate of return" to try to turn the notion of financial returns inside out. "ERR" is meant to be a kind of philosophical antidote to "IRR," or internal rate of return, that peculiarly time-sensitive measure of investment return that is the ultimate arbiter accepted by the modern fiduciary.

Thanks to someone in this room today, I started my journey towards ERR five years ago or so, standing in a conference room in Duluth, Minnesota, where – no, it wasn't a gathering of frog lovers, and I'd wager that none of us in the room that day had anything even vaguely amphibian on our mind – the early members of the Community Development Venture Capital Alliance were meeting. We'd spent two days gnashing our teeth on the question of returns: What kind of financial returns could we reasonably promise investors to attract capital to small venture funds that were targeted at economically disadvantaged communities? At the urging of Matt Sanford – thank you, Matt – I walked up to the flip chart at the meeting's conclusion and offered a few closing remarks "from the heart." I found myself drawing a small circle in the upper left hand portion of the page:



Inside the circle, I explained, are the few thousand companies that are invested in each year by professional venture capitalists, the few thousand companies that have extraordinary growth potential and that are the universe of venture investments that yield a high IRR. This is a very narrowly defined set of companies, a tiny fraction of the total number of new companies started every year. Outside the circle is the rest of the economy, including everything that we are concerned about as citizens trying to restore or protect the health of our communities: child poverty, AIDS, toxics in water, the death of Main Street. . . you name it. Wasn't it a losing proposition, I asked, to measure our success investing outside the circle in terms of the high IRR generated by investments inside the circle?

We need new measures. We need the courage to reassert what E.F. Schumacher called "the primacy of the qualitative." We need the courage to not live and die by the numbers. Which is to say, we must determine that we will not solely evaluate our success by the extent to which our investment multiplies our capital, but also by the extent to which our investment achieves desired social and environmental ends.

This runs directly counter to the prevailing monetary theology of our times.

Consider the following citation from George Soros, who I will offer up as an apologist for this theology:

I realized that my moral scruples would make no difference to the real world, given the conditions of effective or near-perfect competition that prevail in financial markets; if I abstained somebody else would take my place. In deciding which stocks or currencies to buy or sell, I was guided by only one consideration: to maximize my profits by weighing the risks against the rewards. My decisions related to events that had social consequences: When I bought shares in Lockheed and Northrop after managements were indicted for bribery I helped to sustain the price of the stock. When I sold sterling short in 1992, the Bank of England was on the other side of my transactions and I was taking money out of the pockets of British taxpayers. But if I had tried to take the social consequences into account, it would have thrown off my risk/reward calculations and my chances of being successful would have been reduced. Fortunately I did not need to bother about the social consequences because they would have occurred anyway: Financial markets have a sufficiently large number of participants so that no single participant can have an appreciable effect on the outcome. Bringing my social conscience into the decision-making process would not make any difference in the real world. Britain would have devalued anyway. If I were not single-minded in the pursuit of profit, it would affect only my own results.

. . . I blessed the luck that led me to the financial markets and allowed me not to dirty my hands. The fact remains that anonymous market participants are largely exempt from moral choices as long as they play by the rules. In this sense, financial markets are not immoral; they are amoral.<sup>13</sup>

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<sup>13</sup> The Open Society, George Soros, p. 197.

Now, consider the words of David Korten, who is in the audience today, and who offers up a very different view:

Life rather than money is the appropriate standard for evaluating economic choices and performance. Using money as a proxy measure of our well-being shifts our attention from life's priorities to money's priorities. We thus seek to maximize the returns to money rather than the returns to life. If we were to use life as our measure, it would lead us to ask which among a number of financially viable options will yield the highest anticipated contribution to improving our lives and the health of the planet. These, of course, become questions of values that cannot be reduced to simple numbers and therefore call for broadly participatory choice making.

Using life as the measure, the evaluation of economic performance would not be reduced to asking how much aggregate economic output has increased. Generally the best indicators of the health of human society center on the condition of the most vulnerable among us. We might therefore ask how many more people enjoy secure and adequate diets this year over last. Since children are our most vulnerable members, their status is an especially sensitive indicator. Know the rates of infant mortality, childhood malnutrition, teenage crime, and out-of-wedlock pregnancies and you have a remarkably clear picture of a society's state of health. For natural systems, biodiversity and the size of fragile fish, bird, and frog populations are excellent indicators of the state of ecosystem health. Taking life as the measure requires developing new tools for making choices about how we will use our productive resources for measuring market performance by its contribution to healthy living.<sup>14</sup>

Could there be a starker choice between the theologies we will use to understand our roles as investors in today's world? I use the term "theology" because it does seem to me that the choice between "internal" economic measures and "external" indicators of the health of living systems is, at its root, a question of faith.

In a recent discussion, a member of Investors' Circle said to me, "Something is trying to happen. Capitalism won. But now, something else is trying to happen. I don't know if it's just capitalism trying to become more compassionate, or something deeper."

*Something is trying to happen.*

One small part of this "something" is groups of us, networking together in organizations like Investors' Circle, the Social Venture Network, the Social Investment Forum and so many other coalitions, alliances and voluntary associations, trying to steer commercial enterprise in a more humane, ecologically sound direction. We are tinkering with the possibility of "sustainable investing," even though our understanding and our lexicon is incomplete. Facing the choice between money and life, we are collaborating in our search for new ways to use life as the final measure of our investment success.

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<sup>14</sup> The Post Corporate World: Life After Capitalism, David C. Korten, Berrett-Koehler Publishers, 1999, p. 156.

Here, in the city that hosted, last year, the World Trade Organization meeting and its attendant confrontations, let us take a tiny leap to one side and consider, briefly, the following little-known trade statistic:

**The U.S. imports over 1.25 million pounds  
of frog legs annually, from Bangladesh,  
Southeast Asia, Australia and New Zealand.<sup>15</sup>**

Reflecting not on the volume of international trade in amphibian body parts, but on the broad implications of Seattle's WTO protests, Paul Hawken observed what he calls a "clash of chronologies," a dissonance between the dominant time frame of commerce, with its inherent bias for speed and change, and the far slower time frames of culture and natural history: "Commerce requires the governance of politics, art, culture, and nature, to slow it down, to make it heedful, to make it pay attention to people and place. It has never done this on its own. The extirpation of languages, cultures, forests, and fisheries is occurring worldwide in the name of speeding up business. Business itself is stressed out of its mind by rapid change. The rate of change is unnerving to all, even to those who are benefiting. To those who are not benefiting, it is devastating. What marched in the streets of Seattle? Slower time strode into the WTO."

(Had he happened to spend a day or two in Everett, he might have noticed that slower time had actually *leapt* onto the streets of Seattle.)

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Protest, advocacy, the political process, philanthropy – these are all tools for social change. We do not tend to think of investing as another such tool. And, certainly, the aspect of venture capital that resembles a bunch of greedy MBA's betting on billion-dollar technologies does not immediately strike the casual observer as much of a tool for promoting sustainability.<sup>16</sup>

Yet among the various asset classes of investing, venture capital has the potential to be a particularly powerful tool for promoting the transition to a more sustainable economy. Because venture investors can play a direct, sometimes even central role in the development of early stage companies, venture investors who are concerned about long-term social and environmental impacts have an opportunity to mobilize substantial amounts of capital in support of a whole generation of entrepreneurs who recognize that "something is trying to happen."

The new economy – the current NASDAQ slide notwithstanding – is creating 25,000 or more new angel investors each year. Because angels are investing their own capital, as *principals*, rather than someone else's capital, as *fiduciaries*, they – or should I say, we – have a unique opportunity to participate in the process of creating new models of sustainable investing. I believe that our success in this undertaking, our success collectively, will depend on the degree to which we are able to choose between

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<sup>15</sup> Badger, op. cit., p. 19.

<sup>16</sup> In some ways, building a traditional venture capital portfolio has about as much overall intention in it as kissing 20 frogs in hopes that one or two of them will turn into a prince.

traditional measures of investment success and new measures that take a more inclusive view, a broader, longer, slower view.

For my part, faced with the choice between leapfrog technologies and frogs that can leap, I choose the frogs.

Woody Tasch  
October 15, 2000