ed Surge A weekly newsletter for innovations in education

OPINION Blended Capital: What Happens When Companies Tap Both VCs and Foundations For Funding?

By **Julie Petersen** and **Shauntel Poulson** Mar 24, 2016

It takes a village to raise a successful education technology company—and for that matter, to build an ecosystem for education innovation that creates meaningful, sustainable change in our schools and for our students. But one of the most critical sources of that capital and expertise has been sitting on the sidelines—until recently.

In a new article for Stanford Social Innovation Review [ssir.org/articles/entry/new_approaches_to_ed_tech_funding], we explored the increasing number of philanthropies that are investing in education technology, through the lens of companies that have raised funding from both venture capital investors and foundation donors. (We use the term "blended capital" to refer to this mix of grants and equity investments.) We wondered whether companies that had raised blended capital would find themselves torn between philanthropic goods and venture gains, or whether those different dollars would mingle happily, building better technologies that meet real educational needs.

We started exploring this question back in 2014 [www.edsurge.com/news/2014-10-07-philanthropy-s-essential-role-in-k-12-edtech-and-strategies-for-impact], unpacking some of the potential motivation and strategies behind philanthropic engagement in education technology. Just as venture capitalists have financial incentives for backing education technology ventures—to the tune of $1.85 billion in the U.S. last year alone—and relevant expertise to bring to bear on their efforts, foundations have financial as well as social motivations, and their knowledge and expertise can come in handy, too.

Over the past several decades, foundations have plowed billions of dollars of grant funding into education, mostly aimed at expanding the supply of quality public schools, improving techniques for training teachers, addressing the instructional needs of low-performing students, and sometimes combining all of the above into structural improvements in how schools and districts operate. At the same time, many newer foundations have waded past investing only in existing school systems and institutions, and have helped jumpstart a range of nonprofits that can address these challenges.

But like so many others, they've come to realize that technology can address some of these challenges in high-leverage or cost-effective ways, and that for-profit structures are often vital to attracting the engineering and management talent necessary to develop technology tools and companies.

By avoiding equity investing in edtech, foundations were missing a significant opportunity to do social good. However, in other areas of their work, many of these same foundations had begun experimenting with making "impact investments" in private companies that aligned with their mission, either through program-related investments (PRIs) that are expected to earn below-market rates of return or mission-related investments (MRIs) that are expected to achieve both positive social impact and market-rate returns.

These trends are converging in education technology. Both the Bill & Melinda Gates Foundation and the Michael & Susan Dell Foundation have made a handful of education investments. Gates has made eight such investments in two tools (BloomBoard and Uversity), three funds (Charter School Growth Fund, Owl Ventures, and Reach Capital), and three deals related to charter school facilities (Aspire Public Schools, KIPP Houston, and Civic Builders). The Dell Foundation has made four investments, three of which are tools (BetterLesson, BloomBoard, and MasteryConnect) along with one fund (Reach). Small and regional foundations are beginning to join these larger players as well.

Company (Year Founded)	Description	Employees	Reach	Funding & Sources
BetterLesson (2009)	Offers Web-based professional development resources that allow teachers to learn from one another and from master teachers	38	400,000 teachers who visit the site each month	$22 million from Highland Capital Partners, General Catalyst Partners, NSVF, Reach Capital, New Markets Venture Fund, National Education Association, the Learning Accelerator Bill & Melinda Gates Foundation, Michael & Susan Dell Foundation
Bloomboard (2010)	Develops evaluation tools and aggregates professional development resources to increase educator effectiveness	54	More than 250,000 teachers in 7,000 schools	$16 million from Birchmere Ventures, Learn Capital, Bill & Melinda Gates Foundation, Michael & Susan Dell Foundation
Ellevation (2011)	Offers software for schools and teachers to manage instruction for ELL (English language learner) students	50	12,000 teachers and more than 1 million students in 475 districts	$11.5 million from Emerson Collective, NSVF, Berylson Capital, Omidyar Network, Michael & Susan Dell Foundation, Zuckerberg Education Ventures
LearnZillion (2011)	Develops and aggregates video-based lessons in alignment with	37	1,000,000 teachers in about 50,000 schools	$23 million from DCM Ventures, Learn Capital, Owl Ventures, the Omidyar Network, Emerson Collective, NSVF, Bill & Melinda

Company (Year Founded)	Description	Employees	Reach	Funding & Sources
	Common Core State Standards			Gates Foundation
MasteryConnect (2009)	Develops software to measure and track student progress	140	2.4 million teachers in 2,000 schools and districts	$29 million from Trinity Ventures, Zuckerberg Education Ventures, Pelion Ventures, Catamount Ventures, Michael & Susan Dell Foundation
Schoolzilla (2013)	Offers a software platform that helps K-12 schools visualize and manage data about school operations and student learning	70	1,300 schools	$8.5 million from Impact America Fund, Kapor Capital, NSVF, Reach Capital, Serious Change LP, Charles and Helen Schwab Foundation, Michael & Susan Dell Foundation

Note: This table is an updated version of the table that appears in the SSIR article. Funding figures indicate the amount of money that each company had raised through February 2016. The list of funding sources for each company is not necessarily complete.

These investments are still modest in comparison with the many millions of dollars in education grants—let alone against the backdrop of the conventional financial investments their endowments make to sustain their ongoing operations. However, it does mean more available capital that is—at least in theory—aligned with the needs of children in high-need communities.

To get under the hood of what's happening, we talked to foundations, venture capital firms, angel investors, and entrepreneurs themselves about the advantages of philanthropic involvement in education technology, as well as the potential pitfalls.

Good Neighbors: What Foundations Can Do

Quickly spot real needs in public education. Because of their work with schools and districts, foundations can spot needs earlier. Our article in the Stanford Social Innovation Review opens with the story of LearnZillion, a successful education technology company that might not exist today if the Gates Foundation hadn't awarded charter school educator Eric Westendorf a $250,000 grant through its Next Generation Learning Challenges program back in 2011. The company has since raised $23 million from a range of investors, with more than one million teacher users accessing a collection of more than 10,000 video-based lessons.

Understand how education purchasing really works. Likewise, the Gates Foundation was an early supporter of Bloomboard but through equity investments in its series A and B rounds. The foundation knew that curriculum resources and teacher development tools were at the top of school districts' priority lists, and founder Jason Lange says the foundation's insights have been useful to product development and pricing strategy.

Help companies move into new markets. With its origins and deep roots in the unique Texas market, the Dell Foundation gave Ellevation a $200,000 grant to adapt its English language learner software to Texas requirements. “Texas is now our fastest-growing market,” says Jordan Meranus, founder of Ellevation. “We’re in 75 districts there now, and that wouldn’t have taken place—[at least] at the speed it has—without that initial grant.”

Reward companies for focusing on impact. Philanthropies say they can encourage companies to serve the highest need populations, not just the lowest hanging fruit, and that their capital is vital to attracting more activity into this space. “New companies looking to break into the sector will not automatically train their attention on the pressing needs of students, families and educators in our nation’s low-income communities,” Dell Foundation education program officer Micah Sagebiel has said. “Nor will traditional venture capital (with its pure focus on financial returns) be likely to back them if they do.”

Provide patient capital. It can take considerable time to build a successful business in education, where administrators are understandably cautious about deciding what systems and products to use (or discontinue) given their impact on teachers and students. This is slower than the 3-5 years it might take for a business software venture to scale and exit, so traditional venture capitalists might prioritize quick revenue over deep impact in their quest for rapid returns. “We live in an era in venture capital when people will risk squandering a lot to pursue big outcomes, but education is like health care: You can’t spend a lot of money fast and well,” adds angel investor Chris Gabrieli, a former partner at Bessemer Venture Partners.

On the Other Hand: Good Intentions Are Not Enough

May slow down the process. The flip side of foundations’ patience is their extreme caution. Foundations are notoriously risk-averse, rarely rewarded for significant successes and often shamed for attempts that fall flat. That can make their diligence process excruciating compared with the pace of venture investing, and with reporting requirements that might weigh an entrepreneur down. “If you’re deploying PRI dollars directly in a company, there are a lot of restrictions that can be new and overwhelming to an entrepreneur, who at that stage should be singularly focused on building a team and delighting customers,” says Tory Patterson, a cofounder and partner at Owl Ventures.

Not accustomed to playing with other investors. When for-profit companies raise money, they pitch dozens of potential investors over the course of a few months and then quickly arrive at decisions on participating investors and investment amounts (and on the equity stake that each investor will receive). “When you invest in ventures, it’s a club sport and you’ve got to work with other members of the club,” Gabrieli told us. This process requires more cross-investor communication than the slow and self-contained process that foundations usually follow.

Grant funding can send the wrong signal. Foundation involvement can create a perception that their company’s business prospects aren’t strong enough to merit private investment, hampering future fundraising efforts. “I am opposed to grants as a means of funding a company in lieu of venture capital and believe that [accepting grants] makes your chances of raising venture capital practically zero,” says MasteryConnect CEO Cory Reid. “Some venture capital firms are reluctant to get involved with a company that has only financed [itself through] grants.”

A Third Option: Aggregating Capital

It's worth remembering that relatively few foundations have the capacity or the willingness to engage in investment activity, at least directly. Only 3,200 of the more than 86,000 foundations in the United States even employ paid staff members, and many of these employ just one or two people. Those foundation staff members are trained to evaluate whether a given organization can achieve certain social outcomes, but are rarely equipped to evaluate an organization's business model or its likely financial returns.

That's why some foundations, large and small, are choosing to put money to work through sector-specific venture funds like Reach Capital, Rethink Education, Learn Capital, or Owl Ventures. This approach is indirect and forgoes control over specific investments, but does allow foundations to pool capital with other organizations, draw on the expertise of professional investors, and avoid selecting and monitoring funded companies. For example, many donors contributed to the $12 million NewSchools Seed Fund, including the Dell Foundation, the Gates Foundation, the Sobrato Family Foundation, and the Wasserman Foundation, as well as many individual donors. That fund has since spun out to become Reach Capital and raised a $53 million fund from philanthropic sources (including the Gates and Dell foundations), as well as education companies and individuals.

It Takes a Village

So what can we make of all this activity? We're optimistic that the increased syndication of private, philanthropic, and public dollars is resulting in more education technology companies than ever before that are prioritizing the needs of students in low-income communities—and not merely the needs of those from well-off communities. What's more, we believe that blending capital from both venture firms and foundations can increase the likelihood that these companies will grow into profitable entities that deliver for the schools and students that need them.

So while education technology companies still need to keep a firm grip on their intended impact and a watchful eye on anyone that's offering them investment capital, we're glad the village doors are opening up to new entrants.Shauntel Poulson (@SLP_EDU) is a cofounder and general partner at Reach NewSchools Capital. Julie Petersen (@jmlpetersen) is a freelance writer who was previously director of communications at NewSchools Venture Fund.

Disclosure: Through their involvement with NewSchools Venture Fund (NSVF), the NSVF Seed Fund, and Reach Capital, Julie Petersen and Shauntel Poulson have both had direct or indirect connections to the investments by those organizations in the following companies: BetterLesson, Ellevation, LearnZillion, MasteryConnect, Schoolzilla, and Wireless Generation. The Michael & Susan Dell Foundation and the Bill & Melinda Gates Foundation are investors in Reach Capital and donors to the Seed Fund. In addition, Zuckerberg Education Ventures and the Omidyar Network are investors in Reach Capital.

Reach Capital is an investor in EdSurge.