



Future Economy Lab Education Report

Advancing Impact-aligned Financing for P-16 Educational Ecosystems

June 2021





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EXECUTIVE SUMMARY

Today, the sectors of the economy that form the backbone of our communities--like education-- unjustly benefit some groups while excluding others. This status quo has created and perpetuated biases, policies, principles and practices that have left marginalized communities, the environment and the economies themselves vulnerable.

We believe it is time to reimagine the future of education financing. The industry of curriculum developers, publishers, technology products and service providers serving the K-12 and postsecondary market is ripe for transformation. Current practices and trends are leading to inconsistent delivery and outcomes for all learners, and more so for disadvantaged and unserved communities. Current business models are not sustainable, and there is a lack of adequate financing for innovative solutions that align the incentives of the multiple stakeholders in the education ecosystem.

At the Future Economy Lab (FEL) we are bringing together a select group of organizations to pioneer a new way of nurturing entrepreneurial ecosystems that create inclusive and resilient economies. For this specific FEL we wanted to understand the readiness of the education market for innovative, impact aligned forms of financing across the capital spectrum -- essentially looking beyond traditional VC and bank loans as options for funding education focused businesses. In addition, we seek to identify opportunities for addressing structural issues and barriers to increased investment in the K-12 and postsecondary education sector, particularly for entrepreneurs of color, women, and other marginalized populations. Our findings boil down to this: the education economy needs more capital in total, as well as more types of capital and more capital managed by people who reflect the diversity of the populations served by public education, in ways that holistically support innovative entrepreneurs in this space.

Over the course of a four month research and discovery period, we identified 14 building blocks for comprehensive approaches to transforming the sector, and used them to construct two preliminary designs for holistic system interventions in the education market.

One of these draft strategies is centered on creating the enabling conditions for entrepreneurs of color to develop, test, and grow innovative education businesses informed by their life experience, notably through the creation and expansion of sources of non-dilutive, revenue based capital.

The other is centered on the provision of specific incubation and acceleration services to support entrepreneurs at critical junctures of growing revenue with the capacity to effectively sell into public institutions and use design thinking to inform the design of impactful products.

In the next phase of this work we look forward to diving deeper into fleshing out these scenarios in collaboration with other thought and practice leaders in the education sector.

INTRODUCTION

About The Future Economy Lab

The Future Economy Lab (FEL) is a global research and design process focused on innovating how we create financial mechanisms and strategies that catalyze the growth of inclusive and resilient economies. Today, the economies that form the backbone of our communities inequitably benefit some groups while excluding others. This status quo has created and perpetuated biases, policies, principles and practices that have left marginalized communities, the environment and the economies themselves vulnerable.

Foundational to the work of the FEL is the belief that economies can generate more than financial returns for a select few. Economies of the future will protect and preserve the planet, benefit people from all cultures and communities, and incentivize innovation to create economies that are more resilient and sustainable. The FEL is predicated on the belief that this work doesn't have to take place over generations. This work can — and should — begin today.

We believe it is time to reimagine the future of education financing. The industry of curriculum developers, publishers, technology products and service providers serving the K-12 and postsecondary market is ripe for transformation. Current practices and trends are leading to inconsistent delivery and outcomes for all learners, and more so for disadvantaged and unserved communities. Current business models are not sustainable, and there is a lack of adequate financing for innovative solutions that align the incentives of the multiple stakeholders in the education ecosystem.



Therefore for this specific FEL, we wanted to understand the readiness of the education market for innovative, impact-aligned forms of financing across the capital spectrum. Our focus was going beyond traditional VC and bank loans as options for funding education-focused businesses. In addition, we were seeking to identify opportunities for addressing structural issues and barriers to increased investment in the K-12 and postsecondary education sector, particularly for entrepreneurs of color, women, and other marginalized populations.

Research Approach

Understanding the complexity and nuances of financing in the education sector requires a strong understanding of both the supply and demand side of capital in this space. Through primary and secondary research, the FEL team analyzed the pressing challenges and emerging opportunities in the P16 (pre-k through a 4-year college/university degree) ecosystem in the United States. The approach was multifaceted: video interviews, desktop research, report reviews, and a virtual workshop. We conducted interviews with over 30 individuals representing education-focused investors, start ups, non-profit organizations, consultants, schools and entrepreneur support organizations.



Historically, the financial mechanisms and tools at the heart of our economies have been developed through highly exclusive processes and behind the closed doors of elite institutions. Those with a seat at the table often represent a highly homogeneous group from similar cultural and socioeconomic backgrounds. Unsurprisingly, the resulting financial mechanisms and tools are disproportionately utilized by individuals with similar backgrounds. Therefore it was important that in our interviews we were able to hear the voices of women and BIPOC entrepreneurs that are often excluded from the prevailing systems.

We grounded both our primary and secondary research on three learning questions:

- 1 **How does an alternative funding taxonomy developed by [Village Capital](#) and [Zebras Unite](#) apply to capital markets challenges across P-16 ecosystems?**
- 2 **What tools, structures, and partnerships might increase alignment between funding and sustainable impact?**
- 3 **Are there opportunities to understand and address challenges for entrepreneurs of color?**

Following our interviews and desktop research, we synthesized emerging patterns and referenced them against the broader landscape of alternatives and complements to venture financing, using Village Capital’s [VIRAL framework](#), which we expanded using some unpublished research by Zebras Unite to include capital alternatives beyond venture. We surfaced 11 building blocks across three major themes¹. To further refine how these building blocks apply to the education sector and to generate new ideas, we conducted a workshop where we generated 4 additional building blocks. In this workshop we also began to explore what it would look like to create holistic interventions for the education sector based on the participants' expertise and the building blocks identified. This early thinking on integrated strategies serves as a foundation for further exploration in planning a future capital design workshop.

¹ Solutioning approach used by permission of Armillaria, a Zebras Unite Co-op founding member.

AN EXPLORATION OF THE P16 ECOSYSTEM IN THE US

The state of the education ecosystem

The U.S. education sector is a cornerstone of the U.S. economy and civil society. More than just an arena for building literacy and numeracy, the sector has tremendous potential for creating meaningful economic opportunities and wellbeing. Nonetheless, this potential has not been realized for many - particularly Black, brown and low income students. Innovation is needed along many dimensions, but progress has been slow. School systems tend to be risk averse in their decision making as they are beholden to wide coalitions of local and national stakeholders. There are diverse populations (student age, ethnicity, needs) of end users, making it harder to invest and scale. Procurement processes at the district and university levels are fragmented, and buyers have limited visibility into price and efficacy. Product adoption is more closely linked to sales efforts than impact, with buyers rarely being users. Finally, there is a general R&D deficit in education as compared to other industries. These challenges in many ways parallel those in other societally important legacy industries (e.g., healthcare, journalism) which suffer from public underinvestment. The global pandemic has created new challenges (declining tax bases, enrollment, higher costs for schools) and also opportunities (more demand for remote learning platforms, more investors interested in this space). The possibilities for change are like no other time in recent history.

Investment & entrepreneurial landscape

Education, as many other markets, is characterized by a lack of capital for entrepreneurs that do not fit a narrow set of demographic, geographic, and cultural criteria. Less than 2% of venture capital (VC) goes to founders of color and women; most VC is concentrated in just four coastal states; and it favors business models that are seeking rapid growth and quick exits. But there is a disparity between those that are funded and those that are most poised to design solutions that best address the needs and challenges of this market in particular. Black, Indigenous, and other People of Color (BIPOC) entrepreneurs, women, first generation immigrants, and those coming from poverty are more reliant and more represented within the public school system than those who are typically funded with traditional VC. As such, they have proximity to the sector and insights into nuances of the space based on lived experience. Our interviews revealed that this is valued by investors when making an investment decision.

Startups in this space rely on a variety of funding sources to advance their ideas, including public and philanthropic grants (e.g., SBIR, NSF), angel investors, and VC. Self funding is most common. While the pandemic brought about a surge in EdTech investment, with \$2.2b² in VC and private equity funding going toward U.S. startups, this type of capital is not always suited to the needs of EdTech startups. Many business models are a mix of technology and service offerings, which don't always lend themselves to rapid growth. In addition, the founders who we spoke with in this space - mothers, teachers, administrators - were motivated less by the chance for lucrative exits and more by the prospect of improving the lives of students and communities.

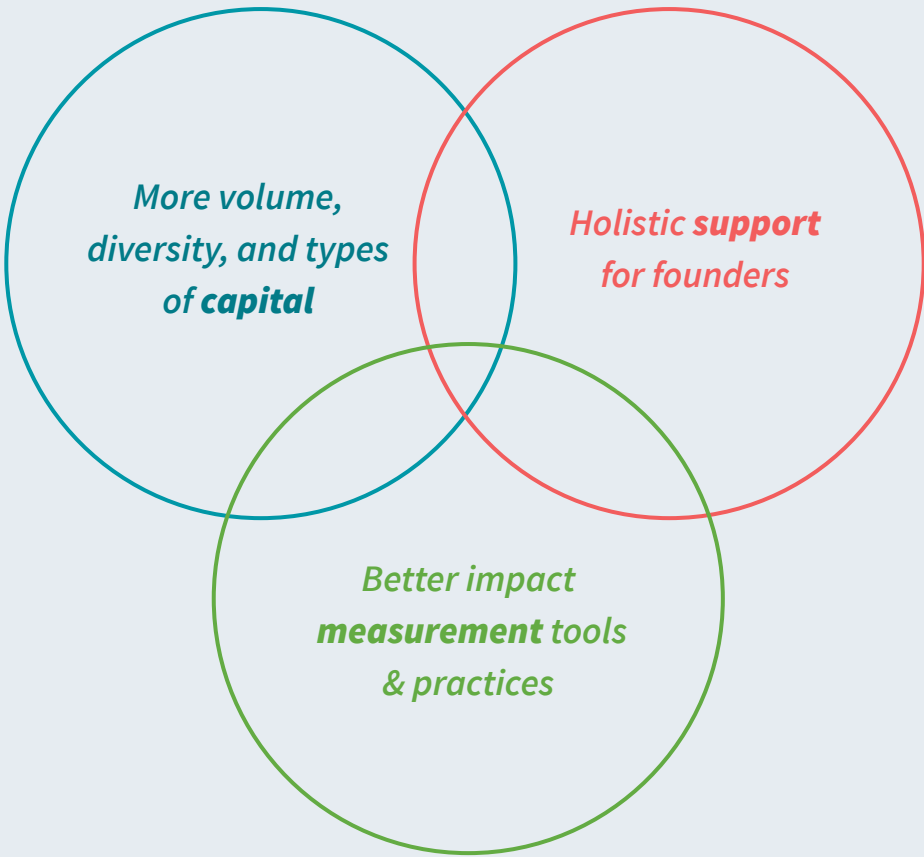
² Wan, T. (2021, January 23). A record year amid a Pandemic: US Edtech raises \$2.2 billion in 2020 - Edsurge News. Retrieved February 12, 2021, from <https://www.edsurge.com/news/2021-01-13-a-record-year-amid-a-pandemic-us-edtech-raises-2-2-billion-in-2020>



Needs of the ecosystem and entrepreneurs

Spurring innovation within the education sector requires addressing a combination of challenges. Incumbents are under pressure to create more affordable, quality offerings as startups offer more low cost, outcomes-based content. At the same time, decentralized, opaque procurement processes and diverse sets of end users represent substantial barriers to entry for startups. Entrepreneurs that we spoke to said that they often lacked enough capital or the right type of capital at early stages of their business and at the post-revenue stage as they prepared to scale. Additionally, we spoke to founders with great motives and promising ideas, but they lacked the connections and knowledge needed to reach financial sustainability. In some cases, support was needed in the form of introductions to the right investors or partners; in others, more robust marketing and sales support was needed. An important area of need that emerged was around assessing the efficacy of ed solutions. While key to creating better outcomes, we saw general misalignment between funders and entrepreneurs in terms of how to define and measure impact.

We are able to group these needs into three intersecting themes for designing interventions in the P-16 market environment.



THEMES & BUILDING BLOCKS FOR DESIGNING INTERVENTIONS

The role of alternative financing mechanisms in education

The recommended building blocks are informed both by our interviews and research within the education sector, as well as by the most current insights around barriers to entrepreneurship. The Kauffman Foundation’s 2019 “Access to Capital for Entrepreneurs: Removing Barriers” research report aligns with our recommendations. A summary of their research shows that a high percentage of entrepreneurs – more than 83% – do not access bank loans or venture capital. And, access to capital presents an even greater challenge when it comes to people of color, women, and individuals of limited wealth. Many of these entrepreneurs are left to rely on personal sources of capital (e.g., personal savings, credit cards, or home equity lines). Nevertheless, much of the attention continues to focus on questions such as, “how do you get more bank lending to small businesses,” or, “how do we expand venture capital to more people?”

The Kauffman Foundation’s research calls for the following interventions and underscores the premise of our building block recommendations:

- 1** **New industry standards, categories, and technologies**
to mitigate the friction that limits the flow of capital to entrepreneurs
- 2** **Professional communities of practice**
to help organize and clarify goals and objectives related to increasing access to capital
- 3** **New strategies for capital aggregation**
to help increase the flow of capital and close market gaps

One fund manager working on alternative vehicles said a common misconception about alternative capital, such as revenue-based financing, is that these products divert from mainstream capital, when in fact the opposite is true: it better positions them for commercial lending or venture capital investment.

“It isn’t an off ramp, it’s a **bridge** over the valley of death.”

— Fund manager working on alternative vehicles

The Kauffman Foundation’s suggestion is that “rather than creating and growing specific investment vehicles to invest directly in entrepreneurs, organizations with influence – such as large institutions, foundations, and governments – could instead build up market infrastructure to enable the marketplace of entrepreneurs and capital mechanisms to solve problems.” Our recommended building blocks represent a strategy that enables the marketplace to create this market infrastructure for entrepreneurs and capital innovators in the education sector. This is how these capital innovations map to the existing capital taxonomy, drawing on [Village Capital’s VIRAL framework](#) and expanded to include capital alternatives beyond venture. As you’ll see, the capital interventions we recommend most broadly apply to levels 3 - 7 below.

LEVEL	NAME	SCALE	BUSINESS MODEL	TYPICAL FUNDING	CAPITAL ALTERNATIVES
9	Exit in sight	Strong unit economics for multiple customer segments	Minimum 2x revenue for multiple years	Acquirers	Structured finance
8	Scaling up	Growth of customer base accelerates month-over-month	MOM meets industry standards	Institutional VC	Institutional VC, structured finance
7	Hitting product-market fit	Evidence of strong unit economics	Validation of strong unit economics	Institutional VC	Revenue based finance
6	Moving beyond early adopters	Company has cleared regulatory hurdles and is implementing a strong IP strategy	Sales map to projections. Decreasing CAC with high price point	Institutional VC Revenue	Revenue based finance
5	Providing a profitable business model	Vision and initial evidence of positive unit economics	Financial model with evidence of valid projects to reach positive unit economics	Angel / Early VC	Revenue based finance, income shares
4	Validating an investable market	Evidence that multiple types of customers find value in the solution	Financial model with cost and revenue projections	Angel / Seed	Character based loans, income shares
3	Solidifying the value proposition	Clear strategy to move multiple markets	Can articulate projected costs along the value chain and target cost points to reach target economics	Friends & Family / Grants / Bootstrap	Grants, character based loans
2	Setting the vision	Initial evidence that multiple markets face this problem	Understands regulatory hurdles to entering the market and plan for overcoming them	Friends & Family	Fellowships, grants
1	Establishing the founding team	Multiple customer markets and aspiration to scale	Has identified source of revenue	Friends & Family	Fellowships, grants

These building blocks sit within the three major themes we presented earlier (capital, holistic support, impact measurement). We show these three facets for designing interventions in this market as intersecting, since all too often they are considered in isolation. Strategies focusing on any one and not the other two will likely fail to address the complex systems challenges present in the education market. Just as entrepreneur support without the right capital is a bridge to nowhere, more capital without support will not equip an entrepreneur for success, let alone increase the diversity of founders in the education market. And no intervention is complete without effective ways to align business goals with impact goals, and measuring progress towards those goals.

These building blocks when paired together, could address structural issues and barriers to increased investment in the K-12 and postsecondary education sector. More specifically, these building blocks help support underrepresented entrepreneurs (women and BIPOC founders) and create businesses that have better educational outcomes. The following page gives an overview of these building blocks, and in the next sections we will go into each theme and building block in more detail.



Building Block	2 Sentence Overview	Requirements for Success
INCREASE THE VOLUME, DIVERSITY, AND TYPE OF CAPITAL		
REVENUE-BASED FINANCE	A company commits to returning capital, plus a fee (typically 3 - 8% of monthly revenue), using future revenue. A repayment cap represents the maximum multiple the investee must repay (typically equating to 1.5 - 3x the principal).	<ul style="list-style-type: none"> • Product-market fit • Minimum revenue requirements (\$50 - \$500 ARR) • Holistic support
FELLOWSHIP PROGRAM	A year-long, \$100,000 fellowship per entrepreneur to allow entrepreneurs to focus on their business, and offset living expenses.	<ul style="list-style-type: none"> • Holistic support • Alternative capital available at the fellowship's conclusion (to avoid a "bridge to nowhere")
CHARACTER-BASED LENDING	Uses a combination of personal knowledge of the entrepreneur and business, outside references, and cash flow projections to underwrite loans, rather than the cash position, personal credit score, and collateral required by traditional lending. CBL rates are typically set at slightly above commercial rates, to provide an incentive for entrepreneurs to "graduate" to other products.	<ul style="list-style-type: none"> • Product-market fit • Minimum revenue requirements (\$50 - \$500 ARR) • Holistic support
SUPPORTING EMERGING FUND MANAGERS	The start up cost for even a modest venture fund is upwards of \$250,000, making VC a pursuit for already successful entrepreneurs or already wealthy people. To break this pattern, more capital is needed for a growing number of programs that train, support and invest in emerging fund managers.	<ul style="list-style-type: none"> • Peer cohort and holistic support • Access to funding networks
EXIT TO COMMUNITY *	Apply design thinking to the corporate structure of the venture, with a view to preserving founder optionality and community through mechanisms for participation by the users and buyers of the product and services.	<ul style="list-style-type: none"> • Mentors and coaches experienced with co-operatives and other collective forms of ownership • Aligned capital
EQUITABLE SEED STAGE FINANCING *	Early stage risk capital that preserves founder optionality by exchanging equity for revenue, profit and / or income share combined with conversion options for investors in subsequent rounds.	<ul style="list-style-type: none"> • Investors and founders willing to use innovative term sheets • Aligned capital
CATALYZE HOLISTIC SUPPORT FOR ENTREPRENEURS		
COMMUNITY OF PRACTICE	Connects grantees/ investee organizations to each other to curate their respective offerings, develop shared offerings and harness synergies.	<ul style="list-style-type: none"> • Product-market fit • Minimum revenue requirements (\$50 - \$500 ARR) • Holistic support
FUNDS WITH WRAPAROUND TECHNICAL ASSISTANCE	A combination of financial capital and technical assistance. These models offer blended finance, taking traditional return-seeking investments and pairing them with philanthropic dollars to support technical assistance such as organizational development and back office support for portfolio companies.	<ul style="list-style-type: none"> • Holistic support • Alternative capital available (to avoid a "bridge to nowhere")
COMPANION TA PROVIDERS	Separately contract with providers of technical assistance (TA), and make these services available to the funds that a foundation or fund invests in for the purpose of supporting education entrepreneurs.	<ul style="list-style-type: none"> • Product-market fit • Minimum revenue requirements (\$50 - \$500 ARR) • Holistic support
"DREAMWORKS" OF EDUCATION	Akin to a movie studio that organizes the financing, talent, and production of a project, with entrepreneurs serving as the salaried directors hired to make it happen. The model offers an opportunity for entrepreneurs to implement and test time-delimited solutions and to build the reputation and credibility to take on subsequent projects that become standalone businesses.	<ul style="list-style-type: none"> • Peer cohort and holistic support • Access to funding networks
INSTITUTIONAL SALES & MARKETING *	Technical assistance focused on institutional, government and enterprise sales to scale the growth of revenue.	<ul style="list-style-type: none"> • Responsive to entrepreneurs' and market needs and requirements • Affordable for entrepreneurs
HUMAN-CENTERED DESIGN PRACTICES *	Apply the practice and principles of creating solutions to problems through an iterative process of ideation, implementation and learning to education products, implementation and procurement processes.	<ul style="list-style-type: none"> • Design expertise that is responsive to market needs and requirements • Affordable for entrepreneurs
BETTER IMPACT MEASUREMENT TOOLS & PRACTICES		
MANDATORY IMPACT TRACKING	LPs can leverage their positional power and require the funds they invest in to track impact metrics. These could be developed in-house or could use an externally developed framework.	<ul style="list-style-type: none"> • Needs to be cost effective to implement
INVEST IN ANALYTICS	Tools that foster greater visibility, transparency, and efficiency of measuring impact including real-time feedback loops between users of educational products and services and the providers, inventors, and other stakeholders.	<ul style="list-style-type: none"> • Needs to be cost effective to implement
ROLL-UP REDUNDANT PLAYERS	Buy—either directly or through the creation of or collaboration with aligned funds—a number of smaller companies centering on impact goals occupying different parts of the value chain and bring them under a new, merged entity.	<ul style="list-style-type: none"> • Experienced PE fund management • Capital

* Additional building blocks that were identified and developed during the design workshop




1

Increase the volume, diversity, and type of capital

The sector needs more capital in total, more types of capital, and more capital managed by people who reflect the diversity of the populations served by public education.

The need for more capital is at two critical businesses stages. The first is early on, when entrepreneurs with good ideas are looking for product-market fit, improving design for enterprise use cases, navigating the intricacies of public education procurement processes, and building out their teams and operations. Capital available during this phase is generally limited to government or foundation grants that often have limiting terms for how their grants can be used (e.g., SBIR grants can only be used for research and development and not sales and marketing). This makes it difficult for businesses to become financially sustainable as they are not able to use funding they have received to attract customers. This further incentivizes business models that become reliant on grant funding instead of being financially sustainable. The second is post-revenue, when companies are growing and need capital to scale and become sustainable in an industry where the growth path is longer than in many others and is thus less attractive to mainstream VC and PE investors. This lack of capital is even more pronounced in companies founded by BIPOC or women entrepreneurs who typically lack access to friends and family wealth and who suffer from the systemic biases of the financial system in both the equity and debt sides of the market. We saw this first hand in our interviews where one startup (whose founders are white) early on was able to receive a significant amount of funding from friends and family and another (whose founders are BIPOC) struggled to get a small initial grant even though they had a product and sales already in place.

“Overcoming the rich uncle problem is the **biggest challenge** entrepreneurs face when it comes to financing”

— *Education consultant*

Furthermore, there is a need for more types of capital, especially those that do not dilute the founders' ownership (especially given that ownership is such an important vector for creating intergenerational wealth in underserved communities). Entrepreneurs in the education sector are looking to make a positive impact in their communities and lives of the next generation. This means that 10X growth or a large exit with a corporate buyout is not always their end goal. Therefore this requires more patient capital or other forms of financing that don't require hockey stick growth and quick exits.

“**Unrestricted capital** would be the most useful; currently investors are asking for ~70% of my company in exchange for a salary”

— *Education entrepreneur*

To help overcome some of these implicit biases and systemic injustices in the financial sector, it is important that more capital is managed by BIPOC and women managers. Traditionally, the financial mechanisms and tools at the heart of our economies have been developed through highly exclusive processes. Those with a seat at the table often represent a homogeneous group with similar cultural and socioeconomic backgrounds. Unsurprisingly, these financial mechanisms and tools are disproportionately utilized by individuals with similar backgrounds. If we want to be investing in more BIPOC and women entrepreneurs, they need to have a seat at the table when it comes to funding decisions; and we also need entrepreneurs with an array of educational backgrounds making these decisions. It is one thing for women and BIPOC founders who attended a handful of elite institutions to lead investments decisions. It is something entirely different when those founders and/or funders studied at public schools or in vocational programs and can draw on their lived experience in this sector. The following is more detail about the building blocks that can be used when thinking about increasing volume, diversity, and type of capital.

REVENUE BASED INVESTING

Revenue based investing (RBI) has emerged in recent years as an innovative alternative to traditional venture and private equity for startups. A new report helpfully summarizes the key elements of RBI as follows: “Revenue-based investing occurs when a company receives capital and commits to returning that capital, plus a fee, using future revenue. Typically, the repayment of the capital is structured in such a way that a fixed percentage of capital is returned to investors, until the principal and the fee are paid in full. The typical percentage ranges from 3 to 8 percent of monthly revenue. Some agreements contain a repayment cap which is the maximum amount the investee must repay, often expressed as a multiple of the principal amount - equating to 1.5x - 3x the principal.”³

As the name suggests, RBI is predicated on a company having revenue, so is best suited for companies that already have some product-market fit. SaaS companies are a popular target for RBI investors, but the model works for any business with repeatable sales and a strategy for unlocking significant revenues in an industry or sector. Since the RBI model does not require a liquidity event like an IPO or acquisition to return capital to investors, it is well suited to purpose-driven businesses. Since RBI typically functions more like debt than equity⁴, there is less dilution of founder interests than in typical venture capital, which preserves more options for control and wealth creation for founders.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

RBF can serve as an important bridge for companies that are traversing the proverbial valley of death –the stage of a company’s life where it is trying to get from initial market validation and initial sales into a reliable sales and revenue cadence that ensures its long term success. The valley of death is known to be more pronounced in education, given the long sales cycles – as well as for entrepreneurs of color and women more broadly – making RBF a particularly interesting option for this market and these demographics.

³ Bootstrapp Inc. 2021. 2020 State of the Industry: Revenue Based Investing. 29pp. Available at <https://www.bootstrapp.co/2020-state-of-the-industry-revenue-based-investing/> , accessed 8 January 2021

⁴ Some RBI funds like Indie VC also use an equity component, in their case a convertible right to equity in a future financing round or sale. Indie has open-sourced their term sheet, which is available [here](#).

FELLOWSHIP PROGRAM

Entrepreneurs who have some of the most pertinent life experiences that could inform breakout solutions in the education space –people of color, women, veterans, first generation immigrants, people living in rural parts of the country –typically lack the friends and family wealth that would make it possible for them to pursue their idea. Black families, for example, have 1/14th the wealth of white families, making it that much harder for entrepreneurs to underwrite the early stages of their business idea by liquidating retirement savings, real estate and other assets. This is where a year-long, \$100,000 fellowship per entrepreneur could help unlock tremendous entrepreneurial energy. A fellowship is an example of unrestricted capital that would allow people with innovative ideas to reduce their current employment to part time or leave altogether, while still giving them the financial security that is needed while they build a minimum viable product and begin the process of business formation and market validation.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

Fellowships could serve as compelling inducements for people with the relevant life experience but without friends and family wealth to become entrepreneurs. In our interviews, investors revealed that an entrepreneur's relevant life experience and proximity to the public education sector was viewed as an asset; however, those with this experience often lack the friends and family wealth to become entrepreneurs. While there are now over 50 paid fellowship programs for social entrepreneurs⁵, only a handful (Camelback Ventures, New Schools) appear to target the education sector, and few are of sufficient cash value to provide a meaningful offset of living costs for participants.



⁵ ProFellow. 29 January 2019. 53 Social Entrepreneurship Fellowships for Innovators Around the World. Available at <https://www.pro fellow.com/fellowships/53-social-entrepreneurship-fellowships-for-innovators-around-the-world> Accessed 10 January 2021.



CHARACTER BASED LENDING

All conventional and most nonprofit lenders decide whether and how much to lend to a business based on: (1) how much cash the business has been able to historically generate; (2) how much collateral is available; and, (3) on the owner's personal credit score. This unfairly discriminates against some of the most entrepreneurial members of society – the underserved and underestimated populations who, in starting a business, typically have little or no collateral and a credit score impacted by events that may be unrelated to their ability to operate a successful business enterprise.

By contrast, character-based lending programs use a combination of personal knowledge of the entrepreneur and business, outside references, and cash flow projections to underwrite loans. Not relying on the conventional models of lenders (as stated above) allows character-based lending programs to stop replicating the biases in these systems. Programs like Colorado Main Street⁶, which makes loans up to \$50,000, have proven to have very low default rates and serve as on-ramps to traditional commercial lending and other forms of startup finance. Character-based loan programs typically work closely with the entrepreneur to help the business succeed, providing, for example, business plan coaching and other advice, which also serves as a mechanism to observe how the entrepreneur conducts themselves, responds to feedback, and leans into making their business work. Rates are typically set at slightly above commercial rates, to provide an incentive for entrepreneurs to “graduate” to other products; and programs are capitalized with a range of grants, impact investments, and government funding⁷.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

We see many SaaS and other technology enabled products with repeatable sales that fall outside the criteria of traditional bank lending and even factoring, which require several successive quarters or years of financial performance data. As such, character based loans could be an important financing option for early stage companies, helping them become bankable and “graduate” to mainstream commercial lending over time.

⁶ For more information about Colorado Main Street, please refer to the appendix.

⁷ See for example: L. Ortiz. 2017. *When a Person's Character Trumps Their Credit Score*. Shelterforce, 23 August 2017. Available at: <https://shelterforce.org/2017/08/23/persons-character-trumps-credit-score/> - Accessed 10 January 2021.



SUPPORTING EMERGING FUND MANAGERS

A persistent, systemic problem in finance is the intrinsic bias against people of color and women. The prevailing pattern matching in VC, for example, makes most traditional fund managers blind to the life experiences – and thus innovation potential – of underserved entrepreneurs. A remedy is to support emerging fund managers who are members of the communities most impacted by the systemic problems in education.

Becoming a fund manager, however, is just like becoming an entrepreneur, only more expensive: the start up cost for even a modest venture fund is upwards of \$250,000, making VC a pursuit for already successful entrepreneurs or already wealthy people. To break this pattern, there are a growing numbers of programs that train, support and invest in emerging fund managers – including Oper8or, Boston Impact Initiative’s Fund Building Cohort, and VC Include, – and adjacent programs like the Capital Access Lab, created by the Kauffman Foundation, which provides early capital into new funds.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

This phenomenon is particularly pronounced as so many VCs come from a handful of elite schools and, as one interviewee put it, may be a generation or two removed from having experienced public education directly. Given the role of pattern recognition in making investment decisions, it is thus desirable to encourage new funds led by people of color and women, as well as those with non-Ivy league degrees or with a different educational path; especially for funds who include education-related products and services in their investment thesis.

EXIT TO COMMUNITY

Most startup founders only imagine two exit options: get acquired or go public. Zebras Unite and others have been describing a new alternative, namely an “exit to community” that shifts ownership to the users, customers, workers, and other stakeholders who value (and add value to) the products and services produced by the startup⁸. In this approach, founders either design the corporate governance and structure from the beginning to share power and wealth with their community or transition to such a structure as part of a planned transition or alternative to, for example, an outside acquisition.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

Exit to Community could be part of a wealth building strategy in the broader community around an educational startup. Making teachers, parents, school districts and other stakeholders part of the business model could be a powerful way to address some of the underlying issues affecting educational outcomes in the US.

⁸ For more on Exit to Community, please see <https://e2c.how>.

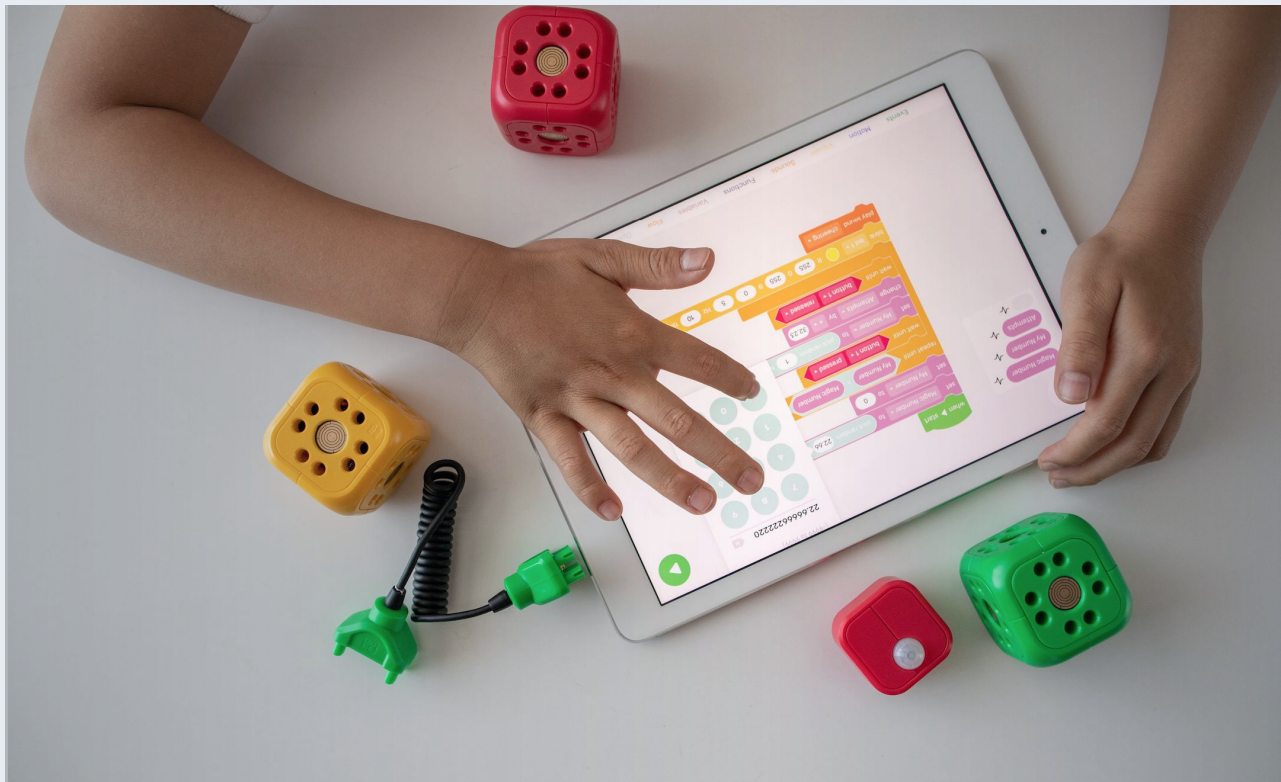


EQUITABLE SEED STAGE FINANCING

One of the biggest challenges of contemporary startup finance is that equity investments typically do not result in equitable outcomes. That is because most early stage equity investing that happens, can be prohibitively dilutive for enterprises (especially those who value impact over hockey stick style growth) – offering \$125,000 for 7% of the company and setting the entrepreneur on a journey of seeking successive rounds of funding that continue to dilute their ownership and control of the company. This same pattern is also at the root of the misalignment between financing and impact outcomes, since financially motivated investors drive purpose-centered companies in markets like education to seek growth over sustainability or rich customers over the right customers. Given that many startups require some form of risk capital to build their initial product, a new form of equitable seed financing that makes equity investments but focuses on the achievement of impact and revenue goals is desirable – thus maintaining better alignment between founders and investors and between founders and their purpose in starting the venture in the first place. An example of this approach is [Avesta Fund](#), which makes seed stage investments into technology enabled companies in a number of socially important sectors, including education.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

We see a need for this type of funding, given that the existing venture funds in this space are now focused on later stages and more mature companies.



Entrepreneurs need more than capital to succeed, especially when creating innovative products and services for legacy industries like education which have complex market dynamics, onerous procurement rules that are not clearly defined, separate users and buyers, and an already challenging macroeconomic environment made more so by a global pandemic. All too often we see entrepreneur support programs that provide mentoring and other educational resources but too little back office support, access to capital, and roadmaps to sustainability.

There are innovative examples of providing these support offerings in tandem with capital, as well as opportunities for encouraging novel partnerships among existing actors and leveraging a network of grantees more systematically to create a support ecosystem. This support ecosystem creates a collaborative mindset that does not require entrepreneurs to compete with one another to succeed, but instead encourages them to leverage the strengths of one another for success.

A persistent idea we heard was to take a project-based (rather than enterprise-based) approach to tackling the innovation needs in the education space, and to expand the model of venture studios and labs to take a comprehensive approach to incubating solutions while building the track record of entrepreneurs. For first time entrepreneurs, the lack of a track record makes it difficult to secure funding; at the same time it is difficult to have a track record if you are not able to receive funding in the first place. This is another area where philanthropic institutions can harness their positional power and create the mechanisms to foster collaboration and connective tissue between aligned efforts.

“A **rich ecosystem of players** is needed to enhance the performance of startups receiving investment; this ecosystem is the only way to mitigate or overcome capital needs in the first 18 months of the journey”

— *Education-focused entrepreneur support organization*

The following building blocks, covered in the next pages, can be used when thinking about holistic support for entrepreneurs.



COMMUNITY OF PRACTICE

Groups of current grantees and other affinity groups in the education space are an underutilized asset that could be harnessed to provide more support to more entrepreneurs. Philanthropic foundations in particular are natural conveners and could create a Community of Practice to connect grantee organizations to each other, curate their respective offerings, develop shared offerings and harness synergies. Making the group of grantees visible to each other and actively fostering collaboration among them could produce new solutions and services for target populations. Such a Community of Practice could also serve as the hub for education solutions more broadly, providing a resource and meeting place for anyone working on education solutions – not just those directly supported by the foundation.

IN THE CONTEXT OF THE EDUCATION SECTOR

A Community of Practice can be extremely rewarding for entrepreneurs that are already working in a fragmented industry. There are enough segments of the education sector and a broad enough user base that entrepreneurs do not need to compete with one another to succeed. Instead, working together will allow them to cross sell products when applicable and better understand how to navigate the complexities of public sector procurement.

FUNDS WITH WRAPAROUND TECHNICAL ASSISTANCE

Where we want to support entrepreneurs that are systemically locked out of the financial system, capital alone is not enough. There is a new breed of investment funds emerging that combines financial capital with human resources, organizational development, and back office support for portfolio companies. Many of these funds use a blended finance model taking traditional return-seeking investments and pairing them with philanthropic dollars. Unlike traditional VC firms that tend to limit these offerings to HR recruiting services, firms like 1863 Ventures⁹ go so far as to provide shared back office services in accounting, legal and operations, surrounding entrepreneurs with tools and service providers to help them succeed. In the case of 1863 Ventures, they pre-purchase services from affiliated providers, and make them available to portfolio companies.

IN THE CONTEXT OF THE EDUCATION SECTOR

A lot of early stage funding is currently coming from SBIR and NSF grants that restrict use of funds to research and development. Having funds with wraparound technical assistance provides added support that is instrumental for the growth of these businesses. Given that education is a sector of great public importance, a blended finance model is feasible, as education is able to attract both philanthropic and government funding – which often requires below market seeking returns alongside more traditional investors who have a higher risk and return appetite.

⁹ To learn more about 1863 Ventures please refer to the appendix.





COMPANION TA PROVIDERS

A variation on comprehensive, integrated fund design is to contract with service providers separately, and make these services available to the funds that the foundation invests in for the purpose of supporting education entrepreneurs. This is akin to the practice of making organizational development grants to nonprofit organizations in the form of direct payments to service providers. Only in this case, foundations would use their positional power to contract with providers of entrepreneur support to provide these services to a number of funds they have invested in. This would essentially subsidize the provision of this assistance to each fund's portfolio companies. Having central providers of these important support services would have the beneficial effect of generating data across funds and portfolio companies that could be used for impact measurements and benchmarking.

IN THE CONTEXT OF THE EDUCATION SECTOR

There are well known needs, notably around helping companies navigate the district and state procurement processes that require specialized technical and political expertise that could be more affordably and efficiently provided in a coordinated service program. This expertise is also further developed when providing this service to more than just one company.

“DREAMWORKS” OF EDUCATION

Unlike many other industries, in education there is broad agreement on the outcomes we are trying to achieve through entrepreneurial solutions. The problems are comparatively well understood. What if, instead of adopting the competitive, “every entrepreneur for himself” culture of mainstream venture finance we adopted a more holistic approach to solving the known problems? We could treat the development of solutions as time-limited projects, and approach the financing of them accordingly. This expands the venture studio approach of a [Camelback Ventures](#) or [Entangled Group](#) and organizes the financing, talent, and production of a project, with entrepreneurs in this analogy serving as the directors that are hired to make it happen. This could include an 80/20 type program like at Google (that encourages employees to spend 80% of time on core projects and 20% on innovation), with entrepreneurs-in-residence encouraged to explore side projects. For underserved entrepreneurs, this would put them in a salaried position to implement solutions and build reputation and credibility to take on subsequent projects on their own that become standalone businesses.

IN THE CONTEXT OF THE EDUCATION SECTOR

As discussed prior, those that have the closest lived experience and can therefore design products and services that best address the needs of students in the public education system are those that need the most support in getting their businesses off the ground; because they do not have that safety net in their networks. This idea is taking the corporate or university venture studio model and applying it to the education market.





CENTRALIZED INSTITUTIONAL SALES AND MARKETING SERVICES

Some of the most lucrative markets are enterprise sales, but they're also often the hardest to sell into especially government agencies and public institutions, as in the case of education. Startups benefit from highly specialized sales and marketing personnel, but that is often cost-prohibitive for early stage companies and sets them on a difficult path of bootstrapping to reliable revenue or taking equity financing to be able to afford sales and marketing talent. In mainstream venture finance, this is solved for competitively with venture firms providing access to and help with hiring sales and marketing talent. In impact sectors like education, however, there exists an opportunity for foundations and other interested stakeholders to create a centralized source of this talent and capacity as a service to a multiplicity of startups operating in multiple geographic markets and different market segments. This might include training and talent for government procurement and grant-based funding to secure these services.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

The central provisioning of sales and marketing services – and grant-based funding to obtain them – fills an important gap. While many educational ventures qualify for public grants from programs of the National Science Foundation or the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs of the Small Business Administration, these programs prohibit the use of funds for sales and marketing activities.

HUMAN-CENTERED DESIGN

Human-Centered Design (HCD) – or the practice of creating solutions to problems through an iterative process of ideation, implementation and learning that centers the human experience – is at the heart of much entrepreneurial activity. Often applied at the micro level of products and services, HCD principles can also be applied at more macro scales of a problem arena, and can take the larger context in which products and services are used into consideration in the iterative design process. For example, not only is it important to design the user interface of an online application or piece of hardware (like a tablet), but it also matters how that product is used in the broader context of the user's life. Such holistic consideration of HCD principles can be expensive, and thus elusive to early stage startups that are navigating the imperative to sell more before they can learn more.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

It could be very beneficial to apply HCD principles to the question of how tools, products and services fit into the instructional flow, and how they help or hinder student, parent, and teacher engagement. This is especially important for minority students and the educators that serve them who are not usually included as part of these design considerations and exercises. Another area that would benefit from applying HCD principles is how new tools and services interface with the constrained budgets of public schools and districts.



The ability to measure and track outcomes is key to driving change within the education sector. In our interviews, we found some funds have limited experience with impact aligned financing – either because investors are not as interested, they find it too costly, or they worry about the risk of adverse consequences stemming from a singular focus on a particular set of metrics. Founders were receptive to impact metrics as a vehicle for marketing the efficacy of their products and tapping into additional forms of funding. Yet across the board, we saw cost and lack of a common framework for measuring and incentivizing impact as barriers to expanding impact aligned financing.

There is a tension between the public good nature of education and the motivations of private businesses and investors in this space. Resolving this tension requires us to find better ways to incentivize founders and investors to track the impact of the products and services they create. There is a further tension between the long time horizon over which the most systemic impacts of educational products and services become apparent and the shorter cycles of investment, business practices, and philanthropic grantmaking. There are both procedural and operational opportunities for making the measurement of impact practicable in this sector, ranging from requiring the measurement of particular metrics by fund managers, to supporting analytics firms, to taking a more operational approach to disseminating a foundation’s insights gathered from grantees and investments, to providing market intelligence.

“Impact metrics should be aligned with the business operations of the company, so the **impact KPIs are a valuable indicator of performance...** and they should be easy and inexpensive to measure”

— *Education-focused entrepreneur support organization*

The following building blocks, covered in the next pages, elucidate some options for thinking about impact measurement.

MANDATORY IMPACT TRACKING

Not surprisingly there is some resistance from fund managers to tracking the social and environmental impacts of their portfolios, and there is a large body of work about making the measurement of investments more integral to the finance industry across all sectors. While this is not a new phenomenon among financial-return motivated investment managers, most operators acknowledge that in education there exist distinct and socially-desirable outcomes. There exists, therefore, an opportunity for institutional investors and other capital allocators with positional power – e.g., as lead or anchor investors in new funds– to simply require the funds they invest in to track impact metrics.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

Impact measurement frameworks could be developed in-house, as in the case of Reach Capital. Fund managers who don't want to spend the time and resources to develop their own impact measurement framework could use an externally developed one (including the Reach Capital one). Impact frameworks could also be prescribed by institutional investors such as foundations with programs in education, or be collaboratively created with the community of implementing organizations, investment fund managers, and entrepreneurs operating in this sector.



INVEST IN ANALYTICS

In many sectors of the economy, there are firms that solely specialize in providing market intelligence, analytics and benchmarking products and services that are consumed by entrepreneurs and investors interested in building solutions in the respective sector.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

This analytical layer is largely missing, and many informants pointed out that there is a need for a “Bloomberg of Education” and to invest in the mechanisms and tools that would foster greater visibility, transparency, and efficiency of measuring impact. These could include investments into businesses that solve for real-time feedback loops between users of educational products and services, the providers, inventors, and other stakeholders, as well as investments into service providers of analytical and other “interstitial” services such as the nascent [Center for Education Market Dynamics](#) that generate industry-wide insights, benchmarking, and other knowledge products that make it possible to compare the short and long term impacts of educational solutions.



ROLL-UP REDUNDANT PLAYERS

In many industries, there are actors who specialize in roll-up strategies—the process of acquiring and merging multiple smaller companies in the same industry into a larger company. Typically such strategies are driven by opportunities to consolidate operations, reduce costs, cross-sell into new markets, and increase revenues.

IN THE CONTEXT OF INCREASING IMPACT ALIGNED FINANCE IN THE EDUCATION MARKET

It could make a lot of sense to create an impact-first roll-up strategy to reduce redundant innovation, leverage the strengths of the multiplicity of companies, and reduce fragmentation for a greater impact outcome. After a decade or more of essentially fostering the competition of ideas with philanthropic funding, there is now an opportunity to implement roll-up and platform strategies centering on impact goals. Philanthropic actors could—either directly or in collaboration with aligned funds—buy a number of smaller companies occupying different parts of the value chain and bring them under a new, merged entity. In addition to producing the cost savings and operational efficiencies typical of mergers and acquisitions, this would facilitate the implementation of a unified impact measurement framework across a segment of the ecosystem. At one end of the spectrum, one of the incumbent publishing houses that has been severely impacted by the pandemic could be the target for a platform strategy and could streamline the access to multiple educational products and services.

POTENTIAL INTERVENTION MODEL IDEAS

Background / Disclaimer

We took the above 14 Building Blocks and worked as a group to generate draft concepts for interventions in the education sector: (i) one working at the ecosystem level to remove barriers for founders at each stage of the entrepreneurial journey, (ii) the other focusing on specific areas of technical assistance that could help education entrepreneurs reach critical milestones. We outline each in turn here. It is important to note that these models are far from complete and require further work in design and validation. We present them here to invite further discussion and to serve as inputs to a next phase of designing instruments and strategies for aligning impact and finance in the education market.

*Working at the **ecosystem** level*

When viewed through a systems lens, it is clear that the education market is riddled with barriers that inhibit the entrepreneurial journey along the path from initial idea to growing an education venture to scale and impact. Removing those barriers across the board could be a powerful organizing principle for philanthropic investments. The various building blocks we elucidated work in concert, with fellowship programs creating an on-ramp for entrepreneurs with the pertinent life experience but lacking family wealth to take the initial risks and explore innovative new ideas. Growing the supply of non-dilutive capital— including equitable seed funding, Revenue-Based Finance, Character-Based Lending and integrated mechanisms such as Venture Studios – provides support to entrepreneurs at various stages of business growth. These new forms of financing allow more entrepreneurs to grow their idea and preserve wealth as it flourishes into a business.

Diversity is not only needed in the forms of capital available to entrepreneurs, but also in the managers of capital. To address bias in investing, supporting the development of women and BIPOC fund managers is key. And there are a number of ecosystem initiatives that tackle this head on, including the Capital Access Lab, which invests in emerging fund managers, and the Inclusive Capital Collective, a growing, national network of women and POC operators of debt, equity and real estate funds who are committed to supporting entrepreneurs and building wealth in their communities.

Philanthropic funders in the education space have a natural role and the positional power to convene communities of practice to foster collaboration and mutual support. This applies to education entrepreneurs who benefit from peer and mentor communities to refine their offerings, generate new ideas, and leverage each other's comparative advantage. It also applies to investors who would benefit from a collaborative development of a unified impact measurement framework, whether that is mandated or emerges from new investments into market analytics firms.



As companies move from idea to scale, ready access to wrap-around technical support and institutional sales and marketing can fill critical needs not met by capital alone. Similarly, the central or coordinated provision of technical assistance services can help cohorts of entrepreneurs improve their offerings while also reducing the overall costs of getting education solutions to market. Finally, facilitating the adoption of exits to the community offers founders viable pathways to wealth creation while keeping control of the business closer to those most impacted by it.

Such an ecosystem-based approach benefits from partnering with other philanthropic funders and from taking a coordinated approach.

*Working at the **entrepreneur** level*

Our work revealed a couple of specific areas for focused support and capacity building of education entrepreneurs. They address particular “acupuncture points” for making education ventures more effective at getting to sustainable revenue. The first is concerted and specialized sales & marketing support to help ventures achieve revenue positivity and ultimately profitability by unlocking enterprise sales.

This could entail elements such as a fellowship program at the early stage to help entrepreneurs refine their business models, or supporting funds with wraparound technical services such as 1863 Ventures that can help entrepreneurs crack public sector procurement. In combination with revenue-based financing (RBF), this focus on institutional sales can help founders stay focused on growth and succeed in scaling.

The second is to provide financing and technical support that equips the entrepreneurs with the most shared lived experience with the priority student populations. This would take the form of a more robust incubation and acceleration model that combines flexible, non-dilutive financing with shared backend capacity around sales and marketing, data collection, and design thinking for product and process improvements to succeed both financially and in terms of impact in resource constrained public school systems.

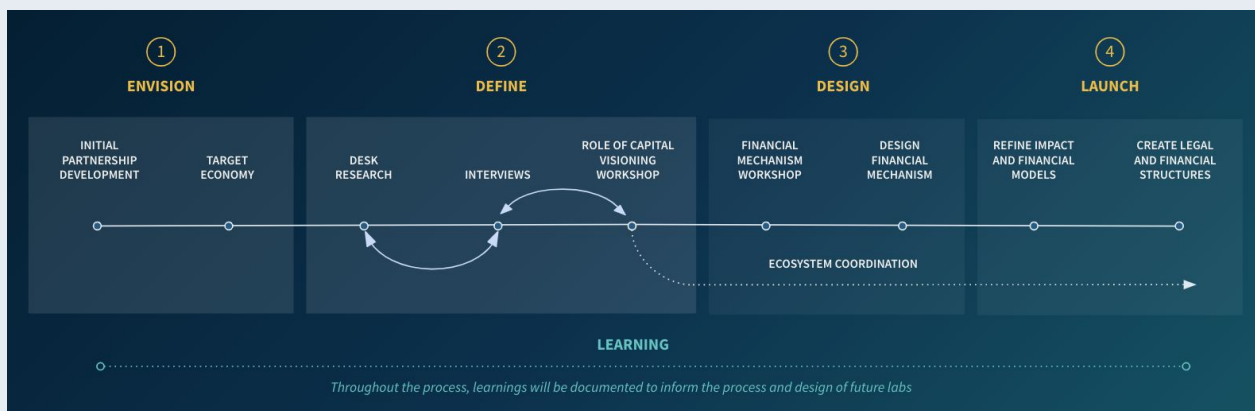
This strategy could include a fellowship program to help entrepreneurs bring their ideas to market to both expand the availability of revenue-based financing and to support emerging fund managers active or interested in the education space.



CONCLUSION

Given that education links to earning potential, health, and so many other determinants of wellbeing, can education enterprises themselves become vectors for community health and wealth? The answer is yes, when we use innovative structures that allow teachers, parents and other stakeholders to participate directly, and financially, in the success of the businesses that produce the products and services that are creating value and impact in education. What is needed is the creation of financial mechanisms that create opportunities for BIPOC, women, and other members of marginalized communities to grow businesses. This requires mechanisms that not only look at increasing available capital but also take into account holistic support for entrepreneurs and better impact measurement tools and practices.

Having spent the last four months better understanding the needs of entrepreneurs and capital providers in the education sector, we are ready to move into the design and launch phases of the FEL.



The FEL offers a new, innovative approach that informs the creation of financial mechanisms through a collaborative process, in partnership with the community they are intended for. The next step in this process will be to identify the key stakeholders whose voices inform the design. This includes entrepreneurs, educators, students, foundations, school district representatives, capital providers, and other stakeholders in the P16 ecosystem.

We would then conduct a series of workshops to collaboratively identify and design new financial mechanisms to serve the unique needs of the education sector, as identified during this research phase. FEL also integrates an iterative learning process throughout and begins to coordinate a broader group of stakeholders to ensure that the needs and constraints of entrepreneurs, government, capital providers and the broader community are represented, and that new learnings are shared with the community and integrated into the workshops.

After the financial mechanism has been designed, we enter a phase of preparing to raise capital. This includes further refinement of the financial and impact models of the mechanism. It also includes setting up the legal and financial structures that are needed. We have found that the participation of community stakeholders and funders in co-designing the financing mechanism leads to strong interest and support, which are critical in raising capital and launching the financing vehicle.

We are actively seeking partners in the next phases of this process.

ACKNOWLEDGEMENTS

We want to thank everyone who participated and was involved throughout this process. Your time, knowledge and insights were extremely valuable to us in informing our research and helping us shape the design.

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New Markets

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Jeff Coleman

BrainLeap Technologies

Jeff Livingston

EdSolutions

Jenn Watts

Remotely

Jessica Hinkle

Strada

Jessica Millstone

Copperwire Ventures

Julie Heath

The Speak Easy

Lewis Leiboh

BMGF

Matthew Greenfield

Rethink Capital

Melissa Bradley

1863 Ventures

Mike O'Donnell

Prairie Rose Development Corp

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Minds of Tomorrow

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*Peoples Foundation CCMVS /
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Tonika Cheek Clayton

NewSchools Venture Fund

Yichen Feng

Lumos Capital



Appendix



CAPITAL CASE STUDY

Character Based Lending

Character-Based Loans

Facilitated by Prairie Rose Development or white-labeled



Building Blocks Used

Character Based Lending

Mandatory Impact Tracking

Capital Innovator

Mike O'Donnell, Executive Director, Prairie Rose Development Corp.

Location

Colorado, USA
with nationwide reach and impact.

Year founded

2011: *Colorado Lending Source begins processing and promoting character-based lending*
2020: *Prairie Rose Development founded to scale and expand CLS innovation*

Instrument

Character based loans for new and growing early stage businesses

The pitch

This product uses underwriting practices that focus on financial fundamentals of the business, the character of the founder, and the coachability of the team. Character-based lending is a great fit for underserved and underestimated populations of entrepreneurs who lack the collateral and credit score at the center of conventional lending practices but have sound business ideas and practices.

Where the instrument sits on the capital continuum

The vast majority of early stage businesses don't offer the opportunity for returns high enough to interest most equity investors. This leaves bootstrapping (slow growth) or debt as the primary options, assuming that lenders would be willing to lend to that business, which is unlikely in the first few years of operation. Character-based lending fits on multiple rungs of the capital continuum ladder and is analogous to seed or early stage venture / angel capital where the decision to invest is a function of the lead entrepreneur, her support team, and her network. Character-based lending can also fit several notches higher on the capital continuum ladder to help a growing entity travel that "last first mile" in the lifecycle of a business before it becomes mainstream enough to secure access to traditional bank financing or be attractive enough to attract external equity. Character-based lending can provide needed startup capital for pre-revenue and older early-stage business. Character-based lending is not a good fit for product or service-based business in the absence of proof of concept.

By the Numbers

Lending thesis

The “character and capacity” of a small business, as measured by (1) the preparedness and passion of the lead entrepreneur(s), (2) the team she has assembled around her, (3) the network she has established to support the business, and (4) ready access to appropriate mentorship, is a better indicator of “repayability” than the “credit and collateral” model typically used by most profit-focused lending institutions.

Comparison Matrix

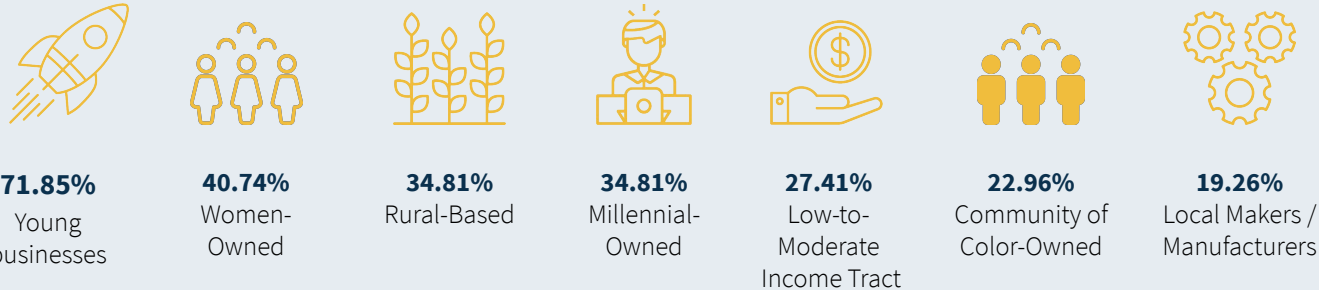
	Increases Access & Equity	% underrepresented entrepreneurs served	Average return	Typical funders/investors	Serves tech	Maintains founder ownership + control	Wrap around support/mentorship/TA
COMMERCIAL LOANS	No	26%	5%	SBA, CDFIs, mainstream institutions	No	Yes	No
VC/EQUITY	No	5%	250%	LPs, angel investors, Venture Capital	Yes	No	No
CHARACTER BASED LOANS	Yes	50%	2%	Philanthropy, regional economic development offices, mission-based lenders, CDFIs	Yes	Yes	Yes

The numbers below are from the Colorado Main Street loan program through 08/31/2020. CLS’ track record represents the highest number of character based loans made with highest known performance.

Loans Funded = **243** (in the last eight years)
 Total of Loans Funded = **\$7,372,216.97**
 Average Loan Size = **\$30,338.34**

Total dollars lost over life of the program = **\$335,925.10**
 Overall loss rate = **4.56%**
 % of outstanding principal lent out held in restricted loan loss reserve funds = **10.00%**

Loans to businesses *All industries served*



(42.22% pure start-up;
23.70% < 2 yrs old)

CAPITAL CASE STUDY

Revenue Based Financing

1863 Ventures & 1863 Venture Fund



Building Blocks Used

Revenue Based Financing

Supporting emerging fund managers

Funds with wraparound technical assistance

Companion TA Providers

Mandatory Impact Tracking

Capital Innovator

Melissa Bradley, Founder

"We have real businesses that need some fixing, not starting."

Location

Washington DC
USA

Year founded

2016: 1863 Ventures Founded
2019: 1863 Venture Fund first close

Instrument

1863 provides wraparound support and blended capital funding (\$10M fund, \$3.2M closed), which includes both revenue-based, non-dilutive financing (60% of fund) and opportunity for equity investment (40%).

Two sentence pitch

Revenue-based financing (RBF) is the leading alternative to equity financing for startups. Revenue-based financing is best used to bridge short-term gaps to support long-term outcomes. The RBF loans provide flexible repayment options tied to a company's monthly net revenue to accommodate the ebbs and flows of early stage cash flow businesses.

Where the instrument sits on the capital continuum

In the last year, as a result of calls for racial justice, a number of Black-led venture capital firms have emerged to serve Black founders. Bradley saw founders' ownership significantly diluted after one or two rounds of equity investment. On the lending side, Black entrepreneurs pay 1 - 2% more for debt. Often because of historical inequities they don't even qualify. 1863's fund addresses the wealth gap through non-dilutive capital that allows founders to maintain ownership, repay based on net revenues, and receive wraparound support. The areas of greatest need including marketing and sales, financing and hiring.

Existing problem in the capital ecosystem the instrument addresses

Research shows that it costs at least \$250,000 more for a Black founder to create the same exact business as their white peers in direct and indirect costs. Research also shows that Black founders are at a disadvantage when it comes to social capital, which fuels access to funding. As a result, Black founders take on side jobs to bootstrap their companies which, in turn, disadvantages them as being perceived by investors as unfocused. 1863's fund was born out of observing hundreds of Black entrepreneurs make it to break even, but fail to achieve profitability due to the lack of access to growth capital. The goal is to minimize the need for hard loans and predatory lending vehicles.

By the Numbers

Investment Thesis

1863 focuses exclusively on historically marginalized founders, as defined by race, lack of economic access and home ownership. Businesses are revenue generating for at least two years, with \$300 - \$400K average ARR. Entrepreneurs must also be alumni members of 1863’s accelerator programming.

Comparison Matrix

	<i>Increases Access & Equity</i>	<i>% underrepresented entrepreneurs served</i>	<i>Average return</i>	<i>Typical funders/investors</i>	<i>Serves tech</i>	<i>Maintains founder ownership + control</i>	<i>Wrap around support/mentors hip/TA</i>
COMMERCIAL LOANS	No	26%	5%	SBA, CDFIs, mainstream institutions	No	Yes	No
VC/EQUITY	No	5%	250%	LPs, angel investors, Venture Capital	Yes	No	No
1863 FUND	Yes	100% Historically marginalized	11-13% Estimated return	100% Philanthropy (e.g., Surdna, Kauffman, Rockefeller, Living Cities, Consumer Health Foundation)	Yes 10-15% of portfolio	Yes	Yes

IRR/Return

Estimated 11-13% over 10 year term



Number or spread of industries served

Industry agnostic

Capital Stack Across 1863

- **\$1.5M** in grants to non-profit arm to serve 1500 entrepreneurs in 13 cities (through grants and partnerships with Capital One, Target and other corporate sponsors). The non-profit training acts as a risk mitigator for the fund.
- **\$10M** fund

Funder Notes

Surdna is the only funder contributing to both grant and investment opportunities. 1863 is a grantee of the Kauffman Foundation’s Capital Access Lab which includes investment funding but no wraparound support, and of the Rockefeller Foundation, which provides grant support for a 1863’s new 1:1 program for entrepreneurs.

Entrepreneur Journey

- Enroll in 1863 entrepreneur support and receive 20 hours of training and virtual sessions provided by three support partners (Vistage, PCV, SSTB, PayPal) and/or 1:1 coaching
- Present deck
- Receive \$5K in grant funding
- Eligible for investment by the fund, matched to a coach and supported via an outcome-based approach that, for example, matches CPG companies with program partner Target.

1863 ACCELERATOR

Entrepreneur Profile

Fiveable

Capital Innovator

Amanda DoAmaral
Co-founder & CEO

Business Type

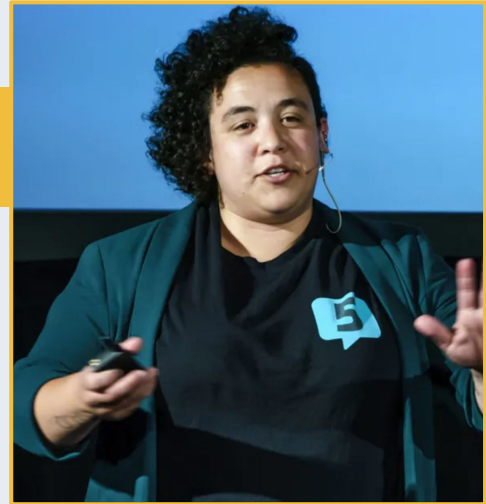
Edtech

Location

Milwaukee, Wisconsin

Year founded

2018



Story

After five years of teaching high school history, Amanda DoAmaral left the classroom without a clear idea of what she wanted to do next. Some of her former students reached out asking for help preparing for their advanced placement classes. She started livestreaming teaching sessions, and before she knew it, her audience grew to 2,500 kids. DoAmaral ended up founding Fiveable, a social learning community that provides live review sessions, interactive study guides and competitive trivia games aimed at helping both students and teachers prep for AP exams.

DoAmaral went on to participate in 1863's accelerator program. At three points in 2019, the company dipped close to \$0 in their bank account and was saved by strategic bridge rounds. Since a massive increase in demand post-COVID, Fiveable is engaging over 110,000 students in their online platform. They've now raised \$3.2M in equity financing, including from Chelsea Clinton's venture fund.



Join us

The Future Economy Lab – led by SecondMuse Capital, in partnership with Zebras Unite and the Bill & Melinda Gates Foundation – has recently completed the *define phase* of the lab’s process. There are ongoing conversations around programming to support existing fund managers and entrepreneur support organizations to think about financial mechanisms that provide diverse types of capital, holistic support, and impact measurement for businesses in the K-12 and postsecondary sector that are focused on better educational outcomes and reaching a diverse student population.

Our approach is collaborative in nature, and we are committed to designing with and for the community. We curate the mechanism for each city or region according to its aspirations, its social fabric, its intellectual capital and its innovation assets. Future economies are growing all around the world.

If interested in learning more please reach out to Natalia Arjomand at natalia.arjomand@secondmuse.com

Let’s work together to reimagine the future of education financing.

BILL & MELINDA
GATES foundation

ZEBRAS  UNITE

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