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Unintended Consequences

By David Bank & Dennis Price

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How a strategic investment steered an educational-technology startup into trouble.

BY DAVID BANK & DENNIS PRICE

Jamie Glenn, chief executive of a once-hot social media startup, was between a rock and a hard place. Or rather, between a binding legal agreement and a faltering business model.

Uversity, formerly known as Inigral, had been first to market with an app, built on the Facebook platform, that provided a safe, professional environment for incoming college students. As a condition of a $2 million investment from the Bill & Melinda Gates Foundation two years earlier, Uversity had agreed to focus a portion of its sales efforts on community colleges in addition to the four-year colleges that were its primary market.

Now, near the end of 2012, Glenn sat in his office, wondering how he was going to meet the year-end deadline for signing up eight community colleges as customers. The company had agreed to that goal as a condition of the Gates Foundation investment. Uversity's pipeline was thin. Even setting up initial sales calls with college administrators was challenging.

For the Gates Foundation, the binding agreement was meant to ensure that community college students, especially low-income students, had quick access to the capabilities of Uversity's app. It was based on a hypothesis that stronger social engagement would lead to increased retention and ultimately to higher graduation rates. Even now, barely one in four low-income community college students gains even a two-year degree.

Glenn and his team met the deadline. But determined not to have another near miss in 2013, the company offered deep discounts to the community colleges that pitched the best social media strategies. Glenn put a salesperson on the project full-time, and he and his sales chief stepped in to close deals.

Ultimately, Uversity surpassed the target by signing up 31 community colleges, but at an average price of only $3,000, compared to average annual licensing fees of $18,000 from the company's primary targets, the four-year colleges for whom the product was designed.

The investment in Uversity was the Gates Foundation's first equity program-related investment (PRI) in a for-profit startup, and Uversity had been eager to land it. Beyond the capital, the investment provided the company with the perception of a high-profile validation that helped establish its credibility. The foundation's focus on community colleges helped the company identify new customers and also make inroads into the higher-education market, where the foundation is well-connected.

But with the investment came a commitment to meet the charitable requirements of a PRI. In retrospect, both the company and the Gates Foundation now recognize that Uversity's decision to meet these special requirements diverted a portion of Uversity's efforts from its core market, just when it needed to prove it could scale up its business model quickly. The distraction also delayed the company's ability to break even in cash flow; Uversity's weaker financial performance contributed to a falling valuation and ultimately its loss of independence. Uversity was acquired by TargetX in 2015.

"That's the cost of capital," says Glenn. "You need to devote time and resources to the commitments." He adds, "As a startup pivots, as they all do, the charitable commitments can become out of whack with where the company needs to go."

The College of DuPage, a community college in Glen Ellyn, Ill., held its graduation ceremony in 2014.

PHOTOGRAPH COURTESY OF THE COLLEGE OF DUPAGE

To be sure, Uversity faced other challenges that are typical of an early-stage company, including an unproven business model, enterprise sales challenges, inexperienced management, and difficulty raising capital. Still, "The charitability requirements were an extra burden that distracted the company

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from potentially more profitable institutional sales activity," says Greg Ratliff, who led the investment from the Gates Foundation's postsecondary education program.

Larry Mohr, a veteran Silicon Valley venture capitalist and early investor in Uversity, agrees. "Today, if you talk to anybody around the deal, targeting community colleges with the product was just a mistake," he says. "There's no doubt that what they were trying to do was a diversion. It was not part of the main strategy path."

The experience taught the foundation's investment team that the best intentions of an impact investor to steer technology innovation toward neglected markets and disadvantaged customers has the potential to harm a company's success, if those markets are different from the company's core market. The requirements that came with the Gates Foundation's funding were not well aligned with the strategies needed to grow a nascent educational-technology company.

It's a cautionary tale for entrepreneurs and commercial investors looking to tap the growing pool of mission-driven investors. Such capital carries its own kinds of costs. Although an investment from a high-profile funder like the Gates Foundation may provide the perception of validation and cachet, fulfilling the required charitable commitments may, without clear alignment of objectives, pull a company away from commercial success.

Julie Sunderland, who managed the Gates Foundation's strategic investment team at the time, says she doesn't regret the investment, but she wishes the foundation knew then what it knows now. "We learned a lot about the types of support community college students need as well as how to invest as a foundation," she says. "We now are much more careful in looking for a high degree of overlap between the company's goals and our charitable goals. We won't do the deal if we anticipate significant potential for conflict," she says. "Undermining the long-term viability of a company also undermines our ability to achieve our charitable goals. The first thing we think about is 'Do No Harm.'"

SIDE LETTER

A partnership between an educational-technology social media startup and the world's largest private foundation held a world of possibility. In 2010, the potential of social media was not widely understood. Uversity (then Inigral) attracted name-brand venture investments from Peter Thiel's Founders Fund and Mohr's Retro Venture Partners.

The company's "Schools" app was built on Facebook, combining a familiar user interface with a protected environment designed for incoming and new college students. The idea was to help students navigate the college experience together with other students, faculty, and school administrators. One school admissions counselor described it as interacting in an online student union. Other social media environments were more like meeting students at a bar.

That caught the attention of the Gates Foundation's Postsecondary Success program team. If an online environment could replicate some of the peer support and friendship that had been shown to increase student retention at residential colleges, Ratliff thought it might help two-year community college students succeed as well.

"The first thing I got asked by investment committee: 'What is a social media technology?'" says Ratliff, who before coming to the Gates Foundation had managed PRIs for the John D. and Catherine T. MacArthur Foundation "People were unclear about what this was at that time."

At the time, Uversity had only a dozen customers and barely $100,000 in revenues. The company's founder, 25-year-old Michael Staton, was eager to get the Gates Foundation's endorsement. He flew to Seattle with Mohr to meet the investment team.

The investment took months to negotiate, in part because of the need to document the charitabile commitments required for the foundation's first-ever equity PRI in an early-stage company. The Gates Foundation's legal and investment teams used an approach that opened the door for all of its subsequent equity PRIs. Along with the typical financial deal terms, the teams negotiated a legally binding side letter that defined Uversity's agreed charitable commitments. As a condition of the investment, the Gates Foundation and Uversity agreed that the company would focus a portion of its sales efforts on reaching community colleges, which disproportionately serve students from low-income households. Uversity agreed to sign up a quota of new community college customers each year.

As a legal and programmatic matter, the foundation needed the company to meet its charitable obligations. The agreement included a right of withdrawal—requiring that Uversity repay the Gates Foundation if the company was unable to meet those objectives. Ratliff says he told Glenn to "Hold fast to the charitable goals." Putting it bluntly, he added, "If you're not valuable to those students, you're not valuable to us."

PRODUCT/MARKET FIT

With the legal framework in place, the Gates Foundation made a $2 million PRI to acquire a 20 percent stake in the company. The investment was part of the company's 2010 Series B financing round of $3.4 million led by Mohr at Retro Venture Partners.

The Gates Foundation also provided a $1 million grant to a consortium of community colleges to establish and test the feasibility and effectiveness of social media programs, which often included signing up for Uversity's product. The grant supported researchers at the University of Arizona to partner with the company to study the effect of its products on student retention and engagement and to publish the results. "Having Gates on board gave us immediate credibility within higher education, which is a significant challenge for a startup," says Glenn, who took over from Staton as CEO in 2011.

Most of Uversity's early community college clients were effectively handed to it as part of the research project. The company achieved the community college target in 2013. But meeting the charitable commitments took the company six months, during which it neglected higher-paying, potentially longer-term customers—four-year private colleges. The company missed its revenue targets. Between defections and layoffs, Glenn lost most of his sales team.

In those two years, between 2011 and 2013, it became clear that the problem wasn't just that community colleges couldn't pay as much as others; the app, which was designed for four-year colleges, was a poor fit for two-year schools. The core value of Uversity's social media product for four-year colleges was as a recruitment tool, to encourage college applicants who had been admitted ultimately to choose to attend. That's of little value to community colleges, which accept all qualified students.

Although the research suggested that community college students who used Uversity's app indeed showed increased retention and higher GPAs, not enough students took advantage of the app, and most community colleges didn't have the time or budget to launch the product properly.

Still, the company had delivered on program and operational goals, and the Gates Foundation stood by its investee. Two subsequent investments, for which the foundation received commitments that aligned with its programmatic objectives, totaled $1.75 million. The last infusion was in a "down" round that valued Uversity at less than the previous investment, effectively wiping out the foundation's previous equity investment.

Members of the Gates Foundation's team did make efforts to ameliorate the conflict between its charitable goals and the company's business goals. They allowed some four-year colleges with large numbers of low-income students to be counted against Uversity's charitable commitment. They made introductions to community colleges and other potential customers. They featured the company and the research at conferences and panels and pushed the notion that social media could benefit students in higher education. "We became in some ways proselytizer of the potential of this," Ratliff said.

Mohr says the new crop of mission-driven investors bears some resemblance to "strategic" corporate investors who also dabble in funding startups to identify technologies or products for acquisition. Impact investors are similarly looking for approaches that fit into broader strategies.

"The parallel is that they both have objectives that are totally unrelated to the company," Mohr says. "As a venture capitalist, I want the manager to make a lot of money on the deal. That doesn't matter to the Gates Foundation or the corporate investor."

Despite the difficulties, Mohr said he would do the deal with the Gates Foundation again. The foundation brought considerable value with its perceived endorsement of the product and access to customers and partners. "Having the Gates Foundation as an investor was quite valuable."

Glenn agrees. He says the zigs and zags were just part of the startup game. "Ultimately the product evolved and was no longer a fit for community colleges, as the company found more opportunity by focusing on the recruitment challenges faced by four-year traditional institutions," he says. "Startups move much faster than a foundation, and they need to realize this and be more fluid when things change on the ground." ◆

Banking on the Poor

Using the off-grid solar revolution to unlock credit for low-income customers in Africa.

BY DENNIS PRICE

Leah Talam, of Eldama Ravine, Kenya, uses M-KOPA solar lighting to help her child do homework at night.

PHOTOGRAPH BY GEORGINA GOODWIN, COURTESY OF M-KOPA

The convergence of low-cost solar technology, nearly ubiquitous mobile phones, and increasingly robust systems for mobile payments has unleashed a wave of entrepreneurship and investment across Africa and Asia. Off-grid solar electric systems are leapfrogging decrepit utility grids in much the same way as mobile phones leapfrogged landlines.

And solar power is just the start of an even bigger revolution in consumer finance. Pay-as-you-go financing is making electricity accessible and affordable for low-income households where the power grid is unreliable or nonexistent. By demonstrating that low-income customers can pay for high-value goods and services reliably, the new business model has the potential to bring products and services even to villages at "the last mile."

Indeed, it was finance, not solar, that attracted the Bill & Melinda Gates Foundation to M-KOPA, one of the hottest off-grid solar startups. The foundation turned down a chance to invest in 2011, when the Nairobi, Kenya-based M-KOPA was raising money from impact investors and venture capitalists. Worthy as it was, solar energy solutions had plenty of other sources of capital.

The Gates Foundation, however, was interested in demonstrating something perhaps even more powerful: that low-income consumers, making affordable payments for products and services that improved their lives, represented a new financial asset class safe enough to qualify for commercial bank financing. The test was whether commercial

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