Rethinking Startup Finance in Africa

Berkman Centre for Internet & Society

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Participants: 30

REPORT

The Berkman Center for Internet & Society at Harvard University hosted an important discussion on *Rethinking Startup Finance in Africa*. The discussion was attended by over thirty participants from the US, Kenya, Ghana, Cameroon, South Africa, Swaziland, Uganda, Boston as well as remotely. These participants were entrepreneurs and professionals from a diversity of industries where they played equally diverse roles, for example: including venture capital, angel investing, incubators, technology consultants, finance and others. Common among this group was an in-depth experience with start-ups in Africa.

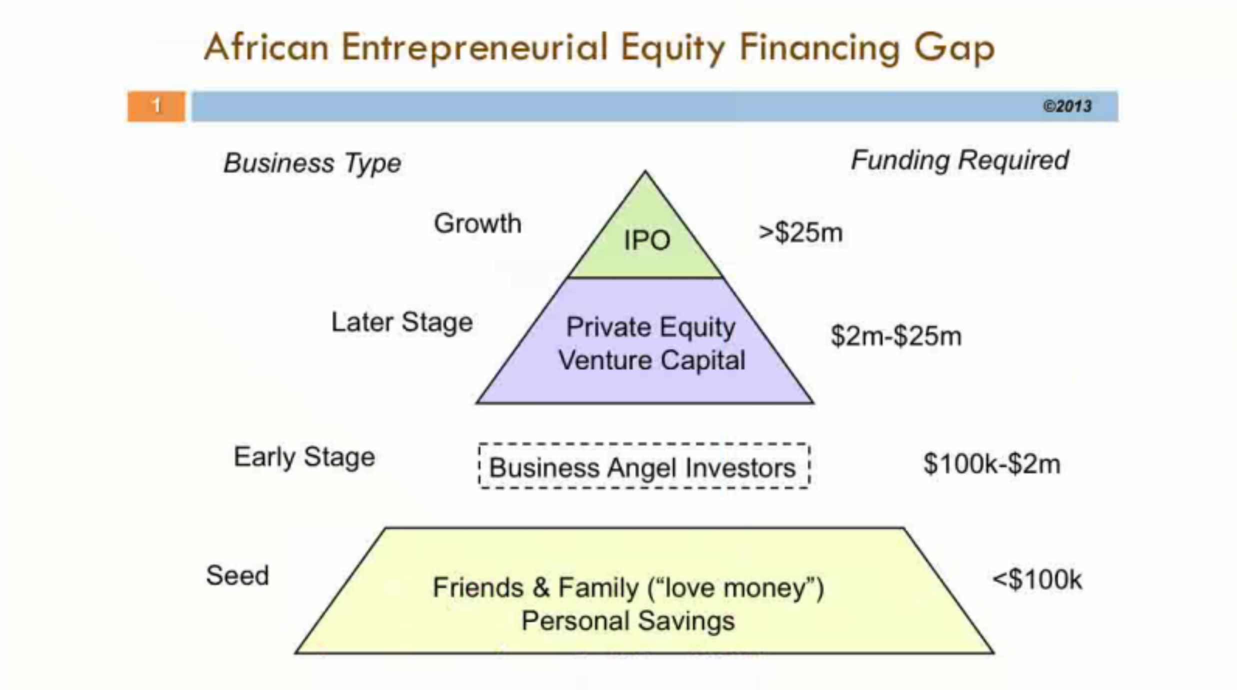
PART I – THE ROUNDTABLE DISCUSSION

The discussion was centred on reconsidering the model of scarcity funding for startups in Africa, drawing from personal experiences from both investors and entrepreneurs. This discussion was inspired by the increasing number of innovative and successful companies coming out of Africa, challenging the misinformed perception of a scarcity of bankable ideas from the continent. Ethan Zuckerman, Director of the MIT Center for Civic Media, was chair and moderator of the event. He opened the discussion with a brief background and outline of the event. He then introduced Mr. Craig Mullet of Branison Group who was the first speaker.

1. Craig Mullet – Branison Group, AngelHub

Mullet defined the concept of angel investment. Referring to Fig. 1 below, he explained the various sources of funding for entrepreneurs based on the stage of business growth. He observed that there is a gap at the early stage, and explained this represented a business opportunity for investors willing to provide funding for entrepreneurs in that space – that is, business angels.

Figure 1



Mr. Mullet, who is South African, gave an example of his involvement in angel investing in Africa through AngelHub, which operates in South Africa, and has a US-based investor base. AngelHub, as an angel investment group, specializes in bringing together funding, expertise and networks from South Africa principally, to help accelerate growth in South Africa. Mr. Mullet asked the question, "how do we create a cross functional entrepreneur?" In his submission, he indicated that a lot of opportunity existed on the African continent for angel investors who are willing to play not only as latter stage investment role but business angels in the early stage.

2. Jim Foster – International Network Investments (INI)

Jim Forster of INI and the author of *Wireless Networking in the Developing World* (Orange Grove Texts Plus, 2009) shared about his involvement, mainly within the tech sector, in startup companies in India, Africa and the US. Jim who does for-profit and non-profit investments is an ex-Cisco Distinguish Senior Engineer turned Junior Businessman. He introduced the concept of Investo-Tourism – a phrase coined to explain the increase when it comes to investment, in patience and appetite for risk in Africa on the back of a tourism visit. Foster also introduced "royalty base financing," an investment model that gives royalty or returns on the investment. In addition, Foster introduced the idea of "boring business" in startups – such as construction, infrastructure, and others. His observation was that most angels in the West were not looking to fund startups in these boring businesses. In contrast, they looked for start-ups in sexy industries, especially those in the technology sector. He has invested in AirJaldi in India, Esoko in Ghana, Village Telco in SA, Flashcat and Savannah Fund in Nairobi and WABco in West Africa.

3. Steve Smith – Former GE Capital, The 4-Hour Rule

The third speaker was Steve Smith, formerly of GE Capital, who drew from a selection of the business initiatives he undertook when he was at GE. He talked about the importance of proximity to the businesses that he is investing in. He introduced the concept of the 4-Hour Rule, a time frame that made Africa too far from most angels. The questions of "how do we bridge the distance gap?" and "what are some of the things that can be done to fix this gap and make it easier to link angels with entrepreneurs in Africa?" emerged. Smith's resounding contribution to the discussion was this: to reduce the proximity risk, trust has to be built first – hence, the 4-Hour Rule.

Mullet shared on his research on this 4-hour rule concept. His findings indicated that with international angel investing, most investments were made within a 4-hour drive of the angel's home. The rationale behind this rule is that proximity is needed to bridge the trust factors required for such high-risk, early stage investing. Therefore, for the purposes of startup finance in Africa, while there may be opportunities for international investors, particularly those with sector knowledge and contacts, the largest amount of angel capital for Africa should come from Africans in their home countries. This further enables angels to effectively contribute intellectual and social capital that resides in these countries.

4. Pule Taukobong – Africa Angels Network

Pule Taukobong spoke on how his angel company, Africa Angels Network, began by investing in family members. He remarked that the success of angel investing rests on diversity, and emphasized the importance of a portfolio effect. Taukobong suggested crowdfunding as a solution for Africa, a concept that has gained significant popularity in the US and Europe. In crowdfunding, people come together around a common purpose and, by changing how each interacts with the group, achieve the common goal. Taukobong listed five conditions he used as an angel investor – Mentorship, Network, Patience, Faith, and Capital. He laid a strong case for business angel investors since some of the ideas that emerge require limited funding initially, but had the capacity to grow exponentially once they had the required funding.

5. Ashifi Gogo – Sproxil

Entrepreneur and founder of Sproxil, Ashifi Gogo, spoke on the importance of investors looking beyond hot industries or models as Foster had explained, and into the type of business most investors regards as not "sexy", such as Sproxil. Gogo shared that for Sproxil, the key funders were the startup's customers. That is how they were able to grow the company – through organic growth. This model allowed their loyal customers to pay on terms. He indicated the difficulty in attracting funding as the most crucial part.

6. Comfort Ocran – Legacy & Legacy

Comfort Ocran, entrepreneur, further emphasized the scarcity of capital Gogo touched on. She spoke about her experience in Ghana, where she grew her company from the bottom up with no investors. Ocran talked about the importance of having a common space, where future investors and entrepreneurs can meet, share ideas and allow fruition to begin. She underscored her contribution with the fact that at present, there are several organisations with brilliant ideas but are stagnating due to lack of funds and the banks are a no go.

7. Oluchi Enuha – iRoko Partners

Oluchi Enuha, representing Iroko Partner, spoke about Iroko's modest beginnings in a room with only three employers, and its rapid growth. The founders saw an opportunity in the media sector and made the bold decision to have a piece of the action.

Conclusion: The "A" Angel

Following the informative presentations from entrepreneurs and investors, the discussion progressed from the theme *"rethinking start-up finance in Africa"* to *"how do we connect and educate future entrepreneurs and investors in Africa?"* The Berkman Centre's Colin Maclay in particular posed the question: *"how do you get that expertise?"* It brought to fore the need for a forum based on developing a model that can work for Africa. A case was also made about how angel investors had helped the Mo Ibrahims' of Africa realize their dreams.

Other ideas that rose in the ensuing discussion on other ways of financing start-ups included working capital lending. It was noted that it was unlikely that many African start-ups would be acquired (the model used in developed markets); as such investors should explore structures that gave them a return on their capital even without an exit for the founders, who remained in control. In addition, the importance of startups pursuing early customers as a means to secure initial cash flow that helps validate their business was identified as this immensely in closing funding deals down the line. There is a disconnect between the excitement about startup finance in Africa, which far outstrips the way funds looking at the continent typically operate, leading to disappointed entrepreneurs and investors seemingly frustrated by lack of good deals. This underscores the need for entrepreneurs to focus on client revenue to keep the business going in the early days, an entrepreneur's lifeline that rarely gets a mention.

The point of sexy versus boring startups raised was the need for increased vanilla investment - that is, investment that does not look at the *"hot business models ...[that] are only applicable to the top of the pyramid in Africa*" such as crowdfunding, big data and selling eye-balls, similar to startups in the United States. An example was made of Soros Economic Development Fund (Soros EDF) that specialises in investments located in post-conflict areas with a focus on finance, agribusiness and logistics. An observation was made that a majority of startups in Africa focused on providing services that maybe routine in the West, which performed well in the African market space. Although not innovate in the eyes of investors, however, they are known market spaces with a strong potential market base and are hence deserving of the investor attention as well.

In conclusion, the argument for having angel investment in Africa was undoubtedly made. From this emerged the need to have an Africa angel model, one that is specifically designed and suited for the African continent – the African Angel.

PART II – AN OVERVIEW ON THE GROWTH OF STARTUPS IN AFRICA

This discussion brought to the table the importance of rethinking startup finance in Africa, which needs revision, based on the experience of entrepreneurs and investors presently. Albeit an unstated understanding among the participants of the Berkman discussion, it bears stating verbatim that the success of startups in Africa has answered the question of *whether startups can do well in Africa.*

The Market Responds

The word on successful African startups is out: the world is no longer questioning the viability of startups in Africa. Every month, major local and international publications routinely write about this success. A quick internet search yields the following for example: "*10 African Startups You Need To Know"* (CNN, July 2013); *"20 Important African Startups You Need To Know"* (Mashable, June 2013); *"300 Technology Startups Apply to Launch at Demo Africa"* (AllAfrica, August 2013);*"Top 20 Tech Startups in Africa"* (Forbes, February 2013).

In short, the market for African startups has been validated.

Across the African continent, moves to create collaborative communities or hubs, with mentors for entrepreneurs and limited seed funding for game changing ideas has gained significant traction. From Cape to Cairo, there are over thirty innovation labs, a number of competitions, with the who's who of tech companies supporting, including, Google, Nokia, Microsoft, Intel, and Samsung.

The successes of startups such as Dropifi, recently inaugurated in Silicon Valley's 500 Startups, the first African startup to get investment from this program, according to founder Dave McClure, is further evidence of the success if startups born and bred in Africa.

The annual VC4Africa Demo Africa, which takes place in Nairobi this October, this year received over three hundred applicants from entrepreneurs across the continent, is further proof. For some entrepreneurs enjoying this success, this presents an astute fist-mover advantage in capitalising on this opportunity. An example is Iroko Partner's Jason Njorku, who recently raised over $2million in nine days for his latest venture Spark, three months after its launch. Spark brings the bankability of start-ups in Africa home by investing in other startups in Nigeria.

Successful Business Models, But Funding Lags

Financing for small businesses is a perennial issue in most African countries. As the technology revolution continues raising Africa, nascent challenges on capital start to emerge. In his white paper, *Towards A Business Model for Funding African Startups* (January 2013), Brian Aoaeh, partner at KEC Ventures, a venture capital focusing on early stage investing, defines seed funding as*"...an early stage investment in a startup ...[that] represents the investment round that follows capital raised from an entrepreneur's friends and family"*. He further goes to identify, among others, that there is a *"...dearth of angel investors as well as a lack of local awareness and interest from international investors and venture capitalists to fund investments in African startups"* (Aoaeh, 2013).

In 2011 Erik Hersman, founder of iHub Nairobi, raised the same point in his blog post, *Broadening the Base of the Startup Pyramid.* Hersman concludes, *"If your job is to see more innovative new tech companies come out of Africa, the recipe is quite simple: invest seed fund into local tech entrepreneurs"*.

In the pre-emptive article to the discussion held at the Berkman Center, Eric Osiakwan had a conversation with Afrinnovator founder, Will Mutua, in an article titled *Rethinking Startup Finance in Africa (*Afrinnovator, 2013). Osiakwan, who has invested in start-ups in more than thirty countries across Africa, reflects *"There is no such thing as a bad or poor idea. Many ideas look like they are not worth anything initially but in time they find their place"* - a nod to companies such as Google and Facebook.

The Role of Government

Emeka Okafor, author of Timbuktu Chronicles, a web log of technology, innovation and entrepreneurship in Africa, by Africans, and a participant in the discussion, succinctly drew out the topic of start-up finance within a larger development context with his comment *"the bulk of African trade and business isn't within these so-called 'formal' models"* – a comment pregnant with the question of thriving "startups" in the informal sector receiving no investor intervention. Toni Acevedo introduced another intervention to the topic with her point *"Yes angel investments is very important, but [government] support is key"*. The truth is some African countries such as Kenya, Nigeria, Ghana and South Africa, dubbed KINGS because of startup successes in these countries relative to the rest of Africa, there is concerted support for start-ups from both the public and private sectors.

However, the level of success and support for startups varies across the African continent, with the trend leaning towards lack of a significant role played by the public sector. Data shows that government is the biggest spender in most African countries. Hence, government can spur startup viability by patronizing their products and services, and in the process providing much needed credibility.

Conclusion

The numbers don't lie when it comes to the growth and progress of the African continent. As the start-up ecosystem congeals around technology, and in particular Internet access, where penetration on the African continent reached 15% in 2013 at a growth rate of 3600% since 2000 (US Census Bureau), coming up with an investment model for growing businesses becomes central.

This discussion was held in part as a preamble to the inaugural Angel Fair @ www.angelfair.net - the first event that brings together angel investors, venture capitalists together with accelerators, incubators and their emerging businesses in Africa, for the sole purpose of doing deals.