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Making Venture Capital More Inclusive in South Africa

Prepared by Briter Bridges for Global Alliance Africa

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Foreword

Innovate UK KTN is pleased to present the report Making Venture Capital More Inclusive in South Africa, prepared by Briter Bridges, as part of the exciting and on-going work in Gauteng under the Place-Based Innovation (PBI) activities which is an important part of the Global Alliance Africa project – a 6 year (2019 – 2025) UK Aid funded project which aims to build stronger local innovation ecosystems and enhanced UK- Africa collaborations that lead to self-sustaining economic growth in Kenya, Nigeria and South Africa by the potential of innovation to meet current and future socio-economic challenges.

With a specific focus on strengthening township economies in Gauteng and the enabling innovation support ecosystem, a key challenge identified is the ecosystem's shortcomings in finding new and innovative ways to increase and unlock access to investment opportunities. Acknowledging that regulation is a challenge within the South African context, there are other more systemic challenges that also need to be addressed. New ways of thinking are required to make investing in entrepreneurship in South Africa more inclusive. Coming together to think differently about the partnerships and models that can make this a reality and support socio-economic and development outcomes is crucial.

This report is a culmination of discussions, interviews, research and learning across the three countries, with a focus on addressing challenges of the Gauteng ecosystem, and is the first output in the journey to finding practical solutions that the ecosystem can coalesce and collaborate around in trying to address the challenges with particular focus on early stage start-up investments.

The report would not be possible without the time and expert inputs from the project. This includes Makhosazane Luthuli from Allgero Enterprises, Obakeng Pitsoane from the Gauteng Department for Economic and Melanie de Nysschen from the Southern Africa Venture Capital and Private Equity Association (SAVCA).

In addition, the authors would like to thank the local and regional investors who provided their inputs into the international investor dialogue and follow-on interviews including Abel Boreto from Novastar, Arthur Chupeau from Baobab Network, Charmaine Hayden from GOODSoil VC Dayo Koleowo from Microtraction, Dotun Olowoporoku from Ventures Platforms, Keet van Zyl from Knife Capital, Lee Zuk from Dazzle Angels, Rekha Govender from the Technology Innovation Agency (TIA), Shelly Lotz from SAVCA and Uwem Uwemakpan from Ingressive Capital[1].

And finally, KTN would like to thank the authors themselves – **Briter Bridges**, who have successfully delivered the stakeholder roundtable, follow-up discussions and this report.

1. A list of the stakeholders involved in the report can be found in Annexure A

Glossary

Term	Definition
Angel	An individual that provides early stage funding for startups through personal funds, typically in return for equity or, in the case of non-priced rounds, convertible notes or SAFEs. Angels sometimes work within syndicates or rolling funds to distribute funds, meaning they collaborate or partner with a network of angel investors to find interesting opportunities.
Accelerator/ Incubator	'Incubators' and 'accelerators' often overlap, as most so-called facilities offer fixed-term programmes between a few months to a year, providing technical and non-technical assistance such as workspaces, business training and mentorship, in-kind support (such as equipment or tools), and grant or equity funding. The core purpose of these services and resources is to help startups refine their business models and value propositions, as well as support early-stage ventures to achieve self-sufficiency or prepare for a raise. Accelerators and incubators provide technical and non-technical assistance to startups through the early and fragile stages of growth.
Acquisition	An 'acquisition' happens when one company acquires the majority or all of the shares of another company. An acquired company might be merged with the acquirer, or dissolved to remove them as a player in the market, with the assets, products, and customers transferred to the acquirer.
Debt	The capital raised through the sale of a debt instrument or a fixed income item, such as a bond. A key difference with equity funding lies in the fact that debt needs to be paid back and counts as a liability on the company's balance sheet.
Development Finance Institution (DFI)	An institute typically owned by national governments or represents regional and international banks that provide patient and risk capital for public and private sector projects with overarching social, economic, and environmental objectives prioritised over financial returns.
Early stage	An 'early stage' company is still developing the different elements of the business, from the product to the team, and the strategies of the business model. The company is just starting to gain traction and is in the process of building a user base, and is starting to generate some revenue.
Equity	Money that is invested into a company in exchange for a share of the company.
Grant	A sum of money, often awarded for a particular purpose, that does not need to be repaid.
Merger	Refers to when two or more companies come together to form one. By merging, the companies may be able to offer better products and/or increase their market share.
Venture Capital	Refers to investments provided to early and growth stage businesses in exchange for an equity stake in the company.
Fund	A pool of collective investments that are managed and invested by a firm.
Pension fund	A fund that provides pensions to employees when they retire. Pension funds can also invest money to increase the pool of money in the fund.
Pre-seed	One of the very first rounds of fundraising for a business, sometimes even before there is anything more than an idea in place.

Private Equity	A company where accredited and institutional investors and funds join forces to invest directly into companies or engage in acquisitions.
Seed	Refers to the first (or one of) injection of capital to help your startup grow. It is often the first equity funding raised and provides capital to develop a product or prototype, carry out market research, and onboard or ensure financial sustainability of the 'early team'.
Series A	'Series A' funding is somewhere in between early and growth stage funding. Companies look to raise a Series A round once they have gained initial traction and are reaching certain performance indicators, such as building a customer base or generating revenue.
Series B–F+	After Series A, 'Series B-F+' funding is associated with the growth of a company, such as growing your product suite or expanding your team or offices to new markets.
Venture Capital (VC) Firm	A firm or fund is an investor type that provides funding to high-potential and high-growth, typically in return for a stake in the company.

1. Introduction

Venture capital matters for South Africa.

Venture capital is an important instrument for financing for early stage businesses that are considered high risk. Unlike traditional forms of business financing, such as bank loans, venture capital is intended to be used for high risk investments.

This is why it has been so effective in promoting financing for small businesses and startups in Africa that have typically been out of reach for traditional financial institutions. Briter Intelligence data finds that since 2015, more than 1700 startups in Africa have received $15bn in disclosed funding. The majority of this funding is equity from venture capital firms, corporates, impact funds, accelerators and incubators, and angel investors.

In South Africa, more than 700 startups raised more than **$2.7billion**.

More than 20 startups have raised more than $20m, including Aerobotics, Jumo, MFS Africa, Yoco, Clickatell, and Skynamo, amongst others. The growth of these ventures is helping to add jobs to the economy. A recent report from the World Bank highlights how the startup ecosystem could contribute to reducing unemployment by half[2].

Further, many startups are addressing social and economic challenges in South Africa through improving the access and affordability of education, financial services, commerce and more.

Venture capital is more than venture capital firms.

Venture capital is not limited to venture capital firms. As we have seen over the last decade, there has been a growing number of stakeholders deploying venture capital including angels, incubators and accelerators, corporates, governments, financial institutions and donors.

These stakeholders see venture capital as a way to tap into high-potential markets and viably address financing challenges in Africa to unlock innovation and support broader social and economic outcomes.

In South Africa, several government agencies and departments support the startup ecosystem including the Technology Innovation Agency (TIA), the Small Enterprise Development Agency (SEDA), the Department of Communications and Digital Technology (DCDT), amongst others.

Several funds have also been set up to target startups including the SA SME Fund, through their fund of funds structure, and the Women's Economic Fund (WEF). More recently we have seen several partnerships emerging between the government, corporates, financial institutions and VCs to unlock more venture financing for startups.

2. World Bank (2022) Building back better from covid-19 with a special focus on Jobs. Available at: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/161431626102808095/building-back-better-from-covid-19-with-a-special-focus-on-jobs (Accessed: November 4, 2022).

South Africa lags behind its regional peers in venture funding to startups despite being well positioned for it.

South Africa has the most developed capital markets in Africa. Its stock market capitalisation is **more than 200% of GDP.**

The next closest country is Mauritius at 69%. Nigeria is only at 8%. It also has the deepest financial sector. Domestic credit to the private sector as a percentage of GDP in South Africa exceeds 120%. The next closest country, Morocco, is at 89% and Kenya and Nigeria are at 12% and 33%[3], respectively . It is also home to the most private wealth on the continent with $651 billion.

The next closest country is Egypt with $307 billion[4]. The investment industry has an estimated ZAR4.26 trillion in total assets under management[5]. Yet despite this mix of private wealth and a well developed financial sector, venture capital remains constrained. It lags regional peers Kenya and Nigeria in terms of the amount of venture funding its startup ecosystems have received since 2015. Further, countries like Egypt, Rwanda and Ghana are fast catching up.

Constrained venture capital, particularly for early stage startups, undermines its contribution to social and economic outcomes.

While venture capital has the potential to contribute to social and economic outcomes in South Africa, it is not guaranteed. Currently, the majority of venture capital goes towards later stage startups that are deemed less risky.

In South Africa, a demographic breakdown of the deals over the past 7 years reveals that a high portion of funded startups have founders who are male, white, and attended the top universities. It is also likely that many come from wealthy urban areas. Limited venture capital is going to startups[6] with female or black founding teams coming from outside of the wealthy urban areas. Stakeholder interviews confirmed that the majority of startups with these demographics are at the early stage, where the current venture capital ecosystem and related models is struggling to reach.

3. Financial Services Conduct Authority (2022) Financial sector outlook study. Available at: https://www.fsca.co.za/Documents/FSCA%20Financial%20Sector%20Outlook%20Study%202022.pdf (Accessed: November 4, 2022).
4. Quartz (2022) Three countries possess over 50% of Africa's total wealth. Available at: https://qz.com/three-countries-account-for-56-of-africa-s-wealth-1849538625 (Accessed: November 4, 2022).
5. Financial Services Conduct Authority (2022) Financial sector outlook study. Available at: https://www.fsca.co.za/Documents/FSCA%20Financial%20Sector%20Outlook%20Study%202022.pdf (Accessed: November 4, 2022).
6. For the purpose of this report we consider deals below $500,000 at the pre-seed and seed round as investment for early stage startups.

This report identifies barriers and potential solutions to unlock investment into early stage startups in South Africa.

This report draws on data from Briter Intelligence as well as input from an investor dialogue with ten participants and follow-on interviews with eight local and regional stakeholders to identify barriers and opportunities to unlock investment into early stage startups in South Africa. The purpose of the report is to identify practical solutions that stakeholders in South Africa can work together to implement with the support of KTN and Southern Africa Venture Capital Association (SAVCA). It draws on insights from other countries in Africa and abroad as well as lessons learned from South Africa.

The report is structured as follows:

Section 2
Explores the landscape of investment for early stage startups in South Africa

Section 3
Identifies barriers to investment for early stage startups in South Africa with a particular focus on startups with female and black founders

Section 4
Considers lessons learned and potential solutions from Africa and abroad for addressing these barriers

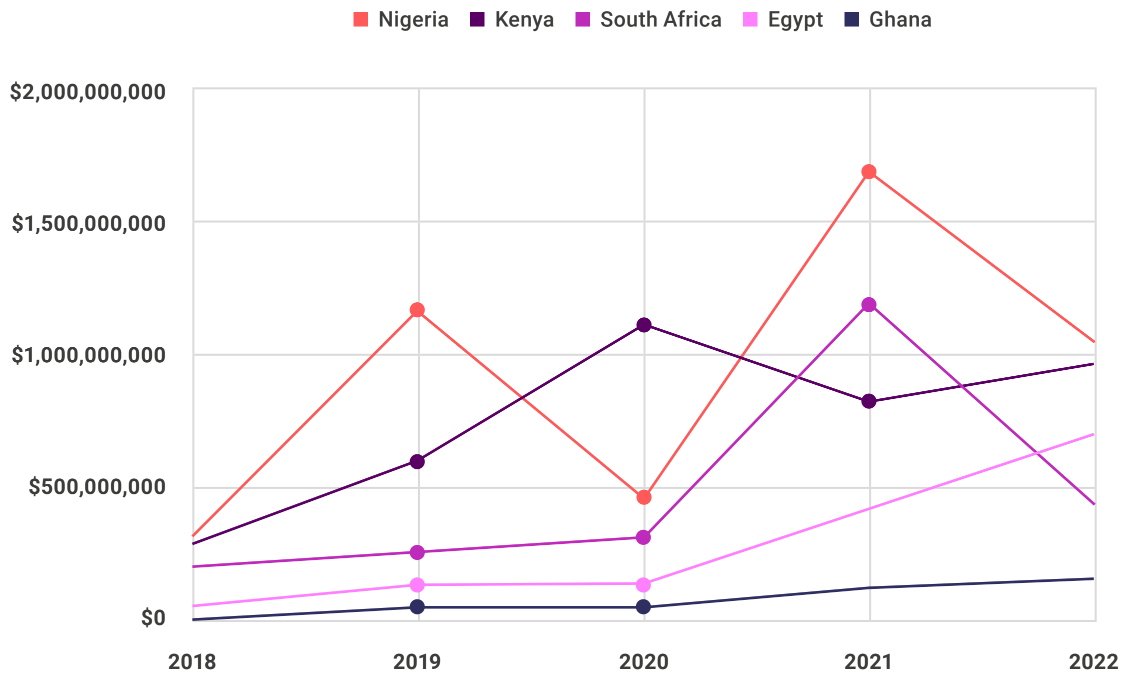
Section 5
Introduces a way forward for South Africa stakeholders to unlock investment into early stage startups rather than to address underlying barriers in South Africa.

2. Landscape of investment into early stage startups in South Africa

Venture capital in Africa is on the rise, but South Africa is lagging.

Investment into Africa's startup ecosystem is on the rise. Since 2015, startups have received $15bn. Already in 2022, investment in startups has exceeded $4bn. The majority is equity funding from venture capital firms. However, grants, debt and mezzanine funding all play a role.

Debt particularly for later investment rounds to fund acquisition and expansion, and grants at earlier stages to fund early stage startups. South Africa has been one of a handful of countries in Africa that has received the lion's share of this funding into Africa. However, its share has been declining. The figure below shows that since 2015 investment into South African startups lags behind regional peers such as Kenya and Nigeria and Egypt is catching up.



Source: Briter Intelligence Data, 2022[7]

7. Please note that the deals for 2022 are only up to September 2022.

Early stage investment deals are rising, but volumes remain low.

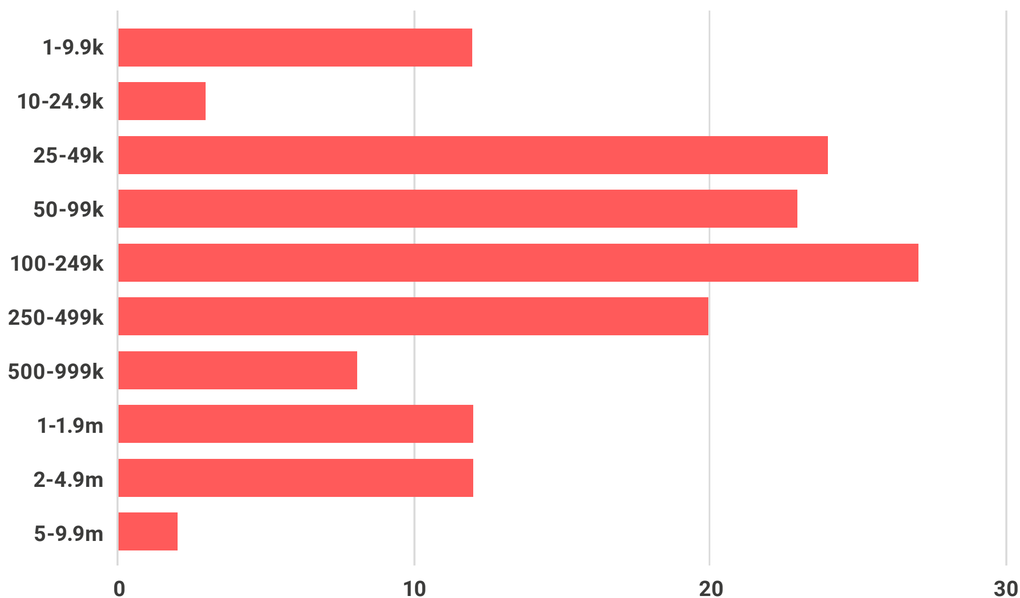
Investment into early stage startups in South Africa accounts for a large portion of the total deals into startups. It has grown from just less than a quarter of deals in 2018 to nearly half of deals in 2022.

Volumes have also grown strongly from **$1.5m in 2018** to more than **$32m in 2022.**

Equity accounts for more than 95% of these figures with grants making up the remaining portion. However, this still only represents a small percentage of the total funding value. In terms of total funding by the sum of deals, funding to early stage startups made up less than 5% of funding from 2018 to 2021, with a small increase to 7.5% in 2022. This lags behind regional peers such as Kenya which saw early stage financing reach 10% in 2022.

The majority of early stage investment deals are small ticket, equity deals.

A major driver of the increase in the number of investment deals into early stage startups in South Africa has been the size of deals. Nearly 65% of deals are below $500,000. The figure below shows that the majority of deals are between $25,000 and $250,000 with several deals reaching as low as $10,000. Briter intelligence data shows that the majority of deals below $250k are from accelerators, incubators and angels. Venture capital firms only really start investing in early stage startups when the ticket size is $250k and above. Interviews with venture capital fund managers confirmed that investments of less than $250k are very challenging for the business model of VCs, let alone deal sizes of $10k - $100k. The size of these deals is a major challenge for their due diligence models.



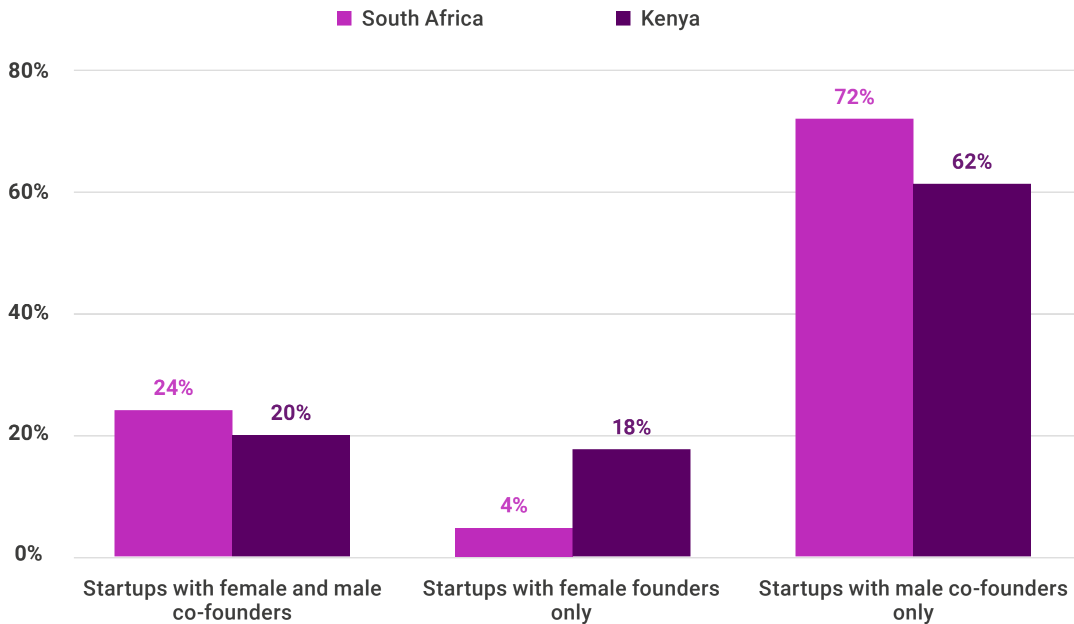
Source: Briter Intelligence Data, 2022

The majority of investment into early stage startups goes to white, male founders.

The figure below provides a breakdown by gender for funding to early stage startups in South Africa. It shows that between 2018 and 2022, nearly three quarters of funding and deals went to all-male teams in South Africa. Only a quarter went to startups with at least one female founder.

Less than 5% went to startups with all-female founding teams. In comparison, **18% of funding** went to startups with all-female founding teams in Kenya.

This is a similar trend that we observe with funding to early stage startups with black founders. Funding to startups with all black founding teams accounted for only a third of all early stage funding into startups in South Africa.



Source: Briter Intelligence Data, 2022

The majority of early stage investors have similar demographics to the demographics of the startups they invest in.

The most notable investors in early stage startups in South Africa are angels. There are several syndicated angel networks in South Africa, such as Dazzle Angels and Jozie Angels, as well as numerous individual angel investors. Briter intelligence data tracks the demographics on publicly disclosed deals from angel investors. It shows that 16 out of 23 angels who publicly disclosed their investments into early stage startups in South Africa are male and white.

Only 3 are black and 4 are female. Interviews with stakeholders confirmed that this was a major challenge for startups with black and female founders in South Africa as most investors rely on personal networks and referrals for sourcing startups and follow-on investments.

This is common across Africa. In a recent survey of angel investors across Africa by Briter Bridges, ABAN and the African Angel Academy, nearly half of respondents identified personal networks and referrals as the way they source startups for investing[8]. The lack of representativeness has a direct impact on what startups are visible to investors and which are not.

8. Briter Bridges (2022) ABAN Africa Angel Investment Survey 2022. Available at: https://briterbridges.com/aban-africa-angel-investment-survey-2022 (Accessed: November 4, 2022)

3. Barriers to investing in early stage startups in South Africa

Lack of institutional capital in the VC ecosystem in South Africa limits the amount available for investing in early stage startups.

As we saw in 2021 and the first half of 2022, when more capital is available for funding for startups, it is more likely that funding is allocated to earlier stage startups.

For example, in Kenya pre-seed and seed rounds accounted for **nearly 30% of investments** in 2021.

Interviews with stakeholders in South Africa highlighted that the biggest constraint to increasing the amount of capital available for venture funding in South Africa is the lack of access to local and international institutional capital. Institutional investors include pension funds, banks, mutual funds, hedge funds, endowments, and insurance companies.

In more developed markets, like the United States, these institutional investors are one of the main sources firms target when looking to raise for their venture funds. This has generally not been the case in South Africa and Africa more generally. To date, the ecosystem has largely been driven by individual investors. Institutional investors consider venture capital as the 'risky asset class'.

There have been several attempts to catalyse institutional capital in the venture capital ecosystem. For example, the South Africa SME Fund raised ZAR1.3bn from a large local financial institution which has become one of the bigger backers of venture capital in South Africa. Standard Bank and Allan Gray have started to allocate funding towards venture capital funds as well.

These initiatives have the potential of raising capital from institutional investors for venture funds, but it still remains limited. Further, unlike in other ecosystems in Africa, global institutional investors and development financial institutions (DFIs) play a limited role.

The current exchange control regulations make South Africa unattractive to most global institutional investors, who prefer to wait until startups have offshored before investing. DFIs consider South Africa too developed for them. When they do play a role, it is usually in making direct investments into startups rather than working with local venture capital firms.

More capital increases the likelihood of investing in early stage startups, but does not guarantee that it will be equally distributed.

While raising from institutional investors for venture capital funds can play a big role in increasing the amount of capital, it by itself will not ensure funding gets to early stage startups or that it is evenly distributed. Even with the increase in the availability of capital for venture funding for startups in South Africa in 2021 and the first half of 2022, it still did not go to startups with female and black founders.

Interviews with stakeholders in South Africa confirmed that it is not only about capital, but also about addressing entrenched habits, patterns, and behaviours across the ecosystem in the country, and the continent at large. These barriers need to be addressed to create the right incentives for venture funding to go towards these early stage startups.

A deeper understanding of the barriers to investing in early stage startups is needed.

Interviews with stakeholders in South Africa revealed that there are several unique barriers to investing in early stage startups. For example, high due diligence costs are not possible for early stage investors. They need to know enough about the business that they can confidently invest without due diligence becoming prohibitive to the deal. Further, at the early stage there is more emphasis on sourcing as there is no existing pipeline of deals that have already received funding to rely on. Lastly, more resources are needed to build the capacity of startups to attract future funding as many are greenfield. These barriers and where they present themselves for early stage investors can be further unpacked below:

1. Sourcing

Sourcing startups is a particular challenge for early stage investors as it often relies on personal networks and referrals. There are two challenges for the venture capital ecosystem in South Africa for sourcing early stage startups. The first is representativeness. While there have been a number of efforts to increase the representativeness of venture capital fund managers and angel investors, the demographics still remain heavily male and white. The second is the fragmented nature of the venture capital ecosystem in South Africa. Even where there is representativeness, it remains siloed and in pockets due to its fragmented nature. This undermines the ability to pool networks to increase the visibility of startups at the sourcing stage of financing. Syndicated angels networks have been established to address this such as Dazzle Angels and Jozie Angels. They have demonstrated the potential that pooling resources can have in addressing these challenges.

2. Screening

Screening is the first step in identifying startups to take to an investment committee or for making a personal investment. It is typically a light touch activity to see if the startup aligns with the investor thesis or criteria. More often than not this is a “gut” decision by investors meaning that it relies on entrenched habits, patterns, and behaviours that can reinforce the challenges associated with representativeness identified above.

3. Assessing

Due diligence is expensive and time consuming and is one of the biggest barriers for getting early stage deals done. Most venture capital firms cannot make the business model for investing in early stage startups because of the cost of due diligence. Even at the later stages they will pool their resources with other venture capital firms to share the cost and reduce the time it takes to do due diligence. Interviews with venture capital fund managers confirmed that investments of less than $250k are not possible, let alone deal sizes of $10k - $100k. Some venture capital firms are exploring partnerships with incubators and accelerators to tap into this market. For example, venture capital firm Knife Capital partnered with accelerator Grindstone to launch Grindstone Ventures, a fund targeting early stage startups with black and female founders in South Africa.

4. Supporting

Supporting startups is a key role that early stage investors play. Early stage startups tend to be greenfield and require more technical and business-related support than later stage startups. Early stage investors need to assist them with growing their business for follow on investment. This is a major challenge for early stage investors as supporting startups is resource intensive. Further, early stage investors often need to source follow-on investors. They act both as venture builder and fundraising often getting their hands dirty in the business.

5. Exiting

Interviews with stakeholders confirmed that exiting is a big focus for early stage investors as it is when they get their money back. While many early stage investors express a desire for patient or passionate capital, at a market level, it is critical that liquidity events are created for early stage investors so that capital can be recycled and reinvested into early stage startups in the ecosystem. Many early stage investors are getting smarter and smarter with their approach to exits. For example, mergers and acquisitions are likely a more sustainable exit strategy than second raises or IPOs in Africa. As we have seen in Nigeria and Egypt with the exits for early stage investors for Paystack, Flutterwave and Careem, it also creates liquidity for more early stage investment and a demonstration effect which attracts more investors into early stage investing. South Africa had some notable startup exits over the years like Thawte to Verisign, GetSmarter to 2U and Payfast to DPO. Examples of venture capital firms with lucrative exits include Knife Capital (Fundamo to Visa, CSense to General Electric, orderTalk to Uber Eats) and Invenfin (Ad Dynamo to Aleph Group).

Regulation makes it harder in South Africa.

While regulation is not the top priority for the venture capital ecosystem in South Africa, it does make raising and deploying capital harder. Exchange controls present the biggest regulatory barrier for local venture capital firms and startups looking to raise. Simply put, the exchange control regulations in South Africa prohibit transactions where capital or the right to capital requires permission from the National Treasury when directly or indirectly exported from South Africa.

This extends to intellectual property (IP) as well as IP generates revenue and therefore can be taxed. For international investors, this means that getting their money or assets out of South Africa after they've made an investment is subject to government approval. This often discourages international investors from investing in startups or local venture capital funds. The result is that less capital flows directly to the South Africa investment ecosystem and many startups look to offshore as quickly as possible to more favourable jurisdictions where it is easier to raise. Further, there are no tax incentives for local or international investors to invest in startups in South Africa.

Capital gains tax is **more than 20%** and the Section 12J amendment to the South Africa tax code to attract investors to venture capital was discontinued.

The only relevant tax breaks for startups are related to a general provision for research and development. As seen in other ecosystems, these incentives are critical to attract investors to take risks with their capital that they would not otherwise take. These incentives can be focused on specific ticket sizes or specific groups that are reached.

4. Lessons learned and potential solutions from Africa and abroad for addressing these barriers

Collaboration cuts across all solutions.

Collaboration is critical for addressing all the barriers identified above. It is required to unlock more venture capital, increase the representativeness of investments and unlock new models for early stage investing. This includes partnerships between the government and investors to de-risk investment for early stage startups, partnerships between financial institutions, corporates and investors to unlock more funding for venture capital, as well as partnerships between different types of investors to pool networks, events, resources and capital to reach more and more diverse startups.

For example, stakeholder interviews highlighted the importance of **early stage investors bringing in follow-on investors** to earlier rounds for them to act as a lead investor or anchor for the next investment round. It ensures that the support and direction provided to the startups are aligned across early and late stage investors.

For example, Novastar led the seed round for their investment in Turaco, an Insurtech operating in Kenya and Uganda, and then sourced additional follow-on investors for the Series A round who could lead the later Series B and Series C rounds. This also applies to angels and VCs. Recent research from Briter Bridges, ABAN and the African Angel Academy highlighted that nearly three quarters of angels bring their portfolio companies on as the following investors[9].

9. Briter Bridges (2022) ABAN Africa Angel Investment Survey 2022. Available at: https://briterbridges.com/aban-africa-angel-investment-survey-2022 (Accessed: November 4, 2022).

Several potential solutions are emerging to unlock early stage investing in South Africa.

The investor dialogue series identified seven potential solutions to address barriers to capital, representativeness and incentives for earlly stage investing.

1. Making more capital available for early stage investing.

Increasing the amount of capital available for venture funding is a critical step to unlocking early stage investing. There are different ways that this can be unlocked. Below are four potential solutions for South Africa:

Launching a fund for early stage startups.

The investor dialogue highlighted that Nigeria and Kenya have similar challenges with institutional investors as South Africa. Nigeria is starting to see some pension funds investing in venture capital as a result of the attention Paystack and Flutterwave have received, but it is still limited. Most pension funds invest in real estate and government debt. Mandating government pension funds to invest in venture capital is an option, but not the only one. Institutional investors have already shown some interest in venture capital.

As highlighted above, the SA SME Fund raised **over ZAR 1.3bn** from banks and other financial institutions in South Africa.

Interviews with venture capital fund managers in South Africa have confirmed that this helped to change attitudes towards venture capital amongst institutional investors. More initiatives that can create these demonstration effects are needed, particularly for early stage investing. They are more effective than education or awareness buildings as they have tangible results. A similar fund of funds model could be considered in South Africa that focuses exclusively at the pre-seed and seed stage with ticket sizes of between $50k and $250k.

Creating tax incentives for individual investors.

South Africa is home to the most millionaires in Africa. As more and more startups exit through acquisitions or other liquidity events, an increasing number of individuals will have capital that they will be looking to reinvest into startups. As we have seen with “PayPal Mafia” in the United States, “Paystack Mafia’’ in Nigeria and “Careem Cartel” in Egypt, these startup founding teams and early investors play a key role in supporting early stage investing. They often have a high risk appetite and strong local networks for investing. Tax incentives can help unlock this capital for South Africa as we saw with the Section 12J amendment to the South Africa tax code that has now been sunsetted. Venture Capital firms like Knife Capital and Kalon Venture Partners were able to raise funds of R400m ($24m) and R250m ($15m) from individual investors for their Section 12J funds.

Partnerships between early stage investors and banks and other financial institutions.

Venture capital firms can look at different ways to collaborate directly with banks and other financial institutions. For example in Egypt several banks and other financial institutions partnered to launch the Avans Manara fund, a fund of funds to support entrepreneurs and small businesses[10]. Egyptian banks have also partnered with Global Ventures to launch Nclude by Global Ventures, an $85 million MEA-focused FinTech fund. South Africa has also seen interest from banks in venture capital with some even reaching early stage startups. NedBank Ventures has invested in several startups at the Series A Stage. Standard Bank has a partnership with Founders Factory that directly invests into startups at the pre-seed stage.

10. Wamda (2022) Egypt launches $109 million Avans Manara fund of funds. Available at: https://www.wamda.com/2022/03/egypt-launches-109-million-avans-manara-fund-funds (Accessed: November 4, 2022).

Partnerships between early stage investors and corporates.

Corporates have shown interest in venture capital, often with a focus on the sector in which they operate. For example, Imperial Logistics partnered with Newtown Partners, an early stage venture capital firm, to invest in disruptive startups in the supply chain and logistics industry, with an initial investment of $20 million. However, the most impactful corporate in addressing early stage funding for startups has been Naspers.

> Naspers venture fund, Naspers Foundry, was set up in 2019 to target early stage technology companies and has **distributed ZAR 700m** in 12 businesses since 2019[11].

This capital has helped keep successful startups, like Aerobotics and SweepSouth, registered in South Africa. Several of their investments have also been to startups with at least one female or black founder.

2. Increasing representativeness of investors in early stage startups.

Making more capital available for early stage investing does not guarantee that it will be distributed equally. More needs to be done to ensure funding goes to early stage startups with female and black founders. Stakeholder interviews and research by Briter Bridges, ABAN and the African Angel Academy have highlighted the importance of networks in sourcing deals at an early stage[12].

This applies to startups as well. The report found that female and black founders are more likely to reach out to investors within their networks as well. For example, the Baobab Network in Kenya has been successful in reaching female startups. Interviews with the team confirmed that a major driver of this has been diversifying the team who makes investment decisions.

At Baobab, 70% of this team are women. Baobab is able to tap into these networks and be more deliberate about targeting female founders. It also helps in marketing to female founders as well. Baobab Network is very deliberate about the way they craft information and messaging to ensure it relates to the startups they are trying to reach. GoodSOIL, a venture capital firm targeting diverse startups teams at the pre-seed and seed investment rounds across Africa and Europe, has a commitment to mirroring the demographics of the founder's they want to invest in.

Both investors highlight that this has sent a signal to the ecosystem that they are serious, which has helped in attracting startups with more diverse teams and follow-on investors looking to fund them. Interviews with local and international stakeholders confirmed this was a challenge in South Africa.

11. Business Insider (2022) Naspers Foundry has invested R700m in 12 businesses since 2019. Available at: https://www.businessinsider.co.za/naspers-foundry-has-invested-r700m-in-12-businesses-10-of-these-in-this-fin-year-2022-6 (Accessed: November 4, 2022).
12. Briter Bridges (2022) ABAN Africa Angel Investment Survey 2022. Available at: https://briterbridges.com/aban-africa-angel-investment-survey-2022 (Accessed: November 4, 2022).

3. Promoting new models for early stage incentives.

Even if more capital is made available for early stage investing and the representativeness of early stage investors is increased, it does not address the business model incentives for early stage investing. Early stage investing is risky and the ticket size does not always justify the cost of due diligence. New models and incentives are required. The following are two potential solutions for South Africa:

Partnerships between early stage investors and government.

Governments can play a catalytic role in shaping where early stage investment goes. For example, the Technology Innovation Agency (TIA) partnered with Dazzle Angels to implement a matching fund where they invested side by side in startups. The fund offered incentives for startups with female founders or startups that brought on female directors. They did have some success. Several deals were made and they jointly invested $26k in Jobox, a student work experience platform which connects businesses with high-quality students.

However, the partnership struggled to make deals together. While they had a joint investment committee, they did not invest together and they each did their own due diligence which slowed down the process for getting deals done. Interviews with stakeholders involved in the partnership suggested that future matching initiatives with the government should be implemented through one fund structure to align processes and share resources. Further, they suggested that the government may be better placed to act as a first client or to provide grant funding to early stage startups that can help them get initial market traction without needing to give up equity.

Partnerships between investors and across rounds.

Investors need to work together to pool resources within and across investment rounds to ensure the largest number of potential successful startups are reached and empowered. For example, Dazzle Angels partnered with local incubators in South Africa to leverage their networks and pipeline for their own investments. They have also brought in Angel investors with different backgrounds and expertise. This helps to grow the networks and expertise available to Dazzle Angels and their startups known as “Zebras”.

Another example is Knife Capital who partnered with Grindstone Accelerators to launch Grindstone Ventures, a US $6.5m (R100 million) fund dedicated to seed funding. It invests in startups that have been through the Grindstone Accelerator programme, which acts as an early due-diligence mechanism for the fund.

5. Way forward

Global scarcity will require more local innovation.

The last year has seen a big change in global market conditions. Liquidity has been pulled out of global markets, risk appetites have decreased, deal flow slowed in the second half of the year and there has been downward pressure on valuations. This is creating challenges and opportunities for ecosystems. First, it puts more pressure on local capital markets to address this gap. South Africa has an advantage in this regard.

It is not as reliant on global markets as Kenya and Nigeria and has strong local capital markets that it can leverage. Already more and more financial institutions and corporates are allocating capital towards venture funding by partnering with existing venture capital firms or setting up their own funds. Discussions are picking up with industry leaders and the government to direct more institutional capital, such as pension funds, towards venture funding.

All of this can go towards South Africa regaining its **leading position in Africa.**

Second, it reduces the competition between local investors and global investors that have pushed up valuations for startups. This creates an opportunity for local investors in South Africa to get access to startup deals and prices that they would not have previously gotten. Last, the slowing deal flow and decrease in risk appetite amongst investors puts more pressure on innovation around due diligence, particularly for early stage investors. This is where government, development partners like KTN and associations like SAVCA have an even more important role to play in testing and promoting partnerships and models that can support early stage investing.

Venture capital firms as market makers.

Venture capital firms are the market makers for early stage investing. They have the capability and willingness to make investing work across investment rounds. Interviews with venture capital firms and angel investors confirmed they are incentivised to play the market maker role where they source both early stage investors and later stage investors for startups. They help to create the "baton relay race phenomenon" where different investors work together to move startups from one round to the next. This has already been seen with the trends from many venture capital firms to establish partnerships and funds with early stage investors and accelerators. SAVCA and venture capital firms can play a key role in helping to educate the wider industry on this role and why it is key to work with them.

Further, given the important role of venture capital firms, more needs to be done to help increase the representation of fund managers. SAVCA is already leading on this with their Venture Capital Fund Manager Programme (VCFMP) to crowd in and build skills for VC fund managers in South Africa. Directing this programme more deliberately to increase the representativeness of fund managers can help take the industry beyond virtual signalling to really mimicking the demographics they are intending to reach.

1. Briter Bridges (2022) ABAN Africa Angel Investment Survey 2022. Available at: https://briterbridges.com/aban-africa-angel-investment-survey-2022 (Accessed: November 4, 2022)

Collaboration and partnerships are key.

There is a need to pool capital, technical skills and networks across ecosystems. Particularly at the early stage where capital is limited, networks are fragmented and technical skills are in high demand.

This is needed amongst all stakeholders. Government and investor partnerships are needed to create the right incentives to de-risk investment for early stage startups. Partnerships between institutional investors and venture capital firms are needed to change attitudes and create demonstrated effects that can unlock more capital.

Partnerships between **accelerators, incubators, angels and venture capitals** are needed to create the right incentives across investment rounds to ensure the relay race baton is not dropped.

SAVCA and IUK KTN can play a key role in helping to broker and support these partnerships. They already represent industry and are working with a number of government partners.

More evidence on innovations for early stage funding.

The investor dialogue and follow-on interviews highlighted that innovation is ripe for early stage funding for startups in Africa. This is resulting in more convergence in the industry. Incubators and accelerators are increasingly raising for early stage venture funds.

Venture capital firms are increasingly setting up their own accelerators. Governments, DFIs, banks and corporates are all establishing their own venture funds or backing accelerators and incubators to deploy early stage funding. These innovations need to be supported, but more is needed to understand what works best in what context and for what purpose.

Certain models make work better for different barriers and context. There is much that can still be learned from other developed countries and emerging markets that have been successful in raising funding for early stage startups such as India or Brazil. The UK KTN can play a key role here in generating and sharing this evidence with industry and government.

Government as a partner and enabler.

Similar to the need to change attitudes towards venture capital from institutional investors, venture capital firms and investors need to change attitudes towards government. The government has demonstrated its willingness to collaborate with early stage investors and this needs to be further nurtured.

Changing regulation will take time and there is a strong collaboration platform, the South Africa Startup Act movement, that is driving this. But more can be done within the existing regulatory landscape. Partnerships like the ones between TIA and Dazzle Angels show the potential of the government to de-risk investment for early stage startups. There should be continuous learning between industry and government to extract learnings from these partnerships for future collaborations. For example, learning about the best way to structure investment committees, conduct due diligence or identify and source follow on investors.

Further, the government has other support that they can offer. Grants provide critical working capital for early stage startups to build their initial idea and get traction in the market. Acting as a first customer can provide early startups with the initial revenue they need to attract investors.

These can also create demonstration effects for the government and help them to raise more internal funding and resources for these initiatives. SAVCA and IUK KTN can play a key role here in identifying and supporting potential collaborations.

Where to next?

This report on making venture capital more inclusive in South Africa is only the start of a journey to address barriers and promote solutions to unlock investment into early stage startups. It draws on input from stakeholders across the region as well as Briter Intelligence data. Going forward the findings from the report will be used by GAA to engage the industry and government to identify potential solutions that can already be tested or better understood.

Beyond this, there is a need to deepen the evidence in the ecosystem about what type of investing models work under what context and for what purpose. The change in global capital markets will put more pressure on local ecosystems to innovate and South Africa is well positioned to shine during this time.

Annexure A: Stakeholder list

Global Alliance Africa | Gauteng Innovation Advisory Group | SAVCA		
Name	**Organisation**	**Role**
Bhavya Srinivasan	KTN -Global Alliance Africa	Knowledge Transfer Manager
Marisa Naidoo	KTN - Global Alliance Africa	Knowledge Transfer Manager
Chiara Bassetti	KTN - Global Alliance Africa	Interim Country Lead - South Africa
Obakeng Pitsoane	Gauteng Department for Economic Development	Deputy Director International Relations
Makhosazane Luthuli	Allegro Enterprises	CEO
Melanie de Nysschen	Grovest + Southern African VC & PE Association (SAVCA)	NED and Development Programmes Manager
Shelley Lotz	Southern African VC & PE Association (SAVCA)	Head of Regulatory Affairs
Manusha Parshotum	Southern African VC & PE Association (SAVCA)	Head of Operations

Participating Investors		
Name	**Organisation**	**Role**
Keet van Zyl	Knife Capital	Co-Founder & Partner
Lee Zuk	Dazzle Angels	Co-Founder
Uwem U	Ingressive Capital	Partner
Dayo Koleowo	Microtraction	Partner
Abel Boreto	Novastar	Investment Director
Arthur Chupeau	Baobab Network	Head of Ventures
Charmaine Hayden	GOODSoil VC	Founding Partner
Dotun Olowoporoku	Ventures Platform	Ventures Partner

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