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The Leapfrog Model: Venture Capital As A Cure For Africa's Funding Paralysis

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Venture Capital is one of the financing options open to privately-held startup companies and small businesses. It is a type of private equity provided by venture capital firms interested in investing in startups with high growth potential in exchange for equity or partial ownership in the company. VC funds fill a void created by high bank lending rates, which cannot be afforded by small companies, especially in their early stages of growth. For instance, the prime lending rate in Nigeria, as of December 2018, was pegged by the CBN at 16.17%. [1] These growing companies are also unable to access public equity funds via initial public offerings because most of them cannot meet up with the listing requirements of the Securities and Exchange Commission.

In recent times, Nigeria has increasingly attracted venture capital investments. Within the period of 2012 2017, Nigeria accounted for 73 percent of the US$10.7 billion value of private equity funding in the West African region. [2] Partech Ventures, a global investment platform for tech and digital companies, reports that in 2017, $560m was invested into African tech startups by VCs focused on African markets. This was a whopping 53% increase from the amount invested in the previous year, and over a 100% increase from that invested in 2015. South Africa, Kenya, and Nigeria took a lion share of the investments in the continent with 30, 25 and 20 percent respectively. [3] Using a different methodology, Disrupt Africa's African Tech Startups Funding Report placed the amount invested into Africa in 2017 in excess of $195m, with 45 startups from the Fintech industry raising one-third of total funding. South Africa, Kenya, and Nigeria remained the top three investment destinations for the third year running. [4]

In its 2018 Tech Startup Funding Report, it records that 210 African tech startups secured $334.5 million worth of investment. This time, Nigeria emerged as the premier investment destination on the African continent, with South Africa and Kenya falling behind it. [5] The FinTech sector also remained the most attractive amongst investors attracting a significant 39.7 percent of total funds raised. [6] In its 2017 Annual Limited Partner Survey, the African Private Equity and Venture Capital Association AVCA listed Nigeria as the most attractive country for Private Equity investment in Africa over the next three years, with Kenya and Ethiopia coming behind it. [7] Majority of Limited Partners identify Consumer Goods, Financials and Healthcare as the top three sectors for investment in Africa. [8]

The United States, which has the most developed and sophisticated venture capital industry in the world, has largely benefited from the tremendous benefits of VC funding. Over the past 20 years, VC backed companies, such as Amazon, Google, and Apple, have been a prime driver of both economic growth and private sector employment. [9] Reports show that in

2008, venture capital-backed companies employed more than 12 million people and generated nearly $3 trillion in revenue. [10]

Venture capital certainly holds the potential to drive economic development in Africa. It creates a ripple effect, which improves R&D, promotes innovation, and increases intellectual property assets – which also becomes a source of wealth creation. Venture capitalists provide not only financing but also mentorship, strategic guidance, network access, and other forms of support. The frontiers of Africa are gradually opening to venture capital investment and responsibility is placed on African governments to strategically create policies and the right investment environment needed to attract increased funding of the private sector.

Based on current trends, Africa's population is projected to double in size by 2050. Lagos leads this exponential population explosion as the fastest growing city in Africa, growing at 77 people per hour. [11] By 2030, Africa's middle- and high-income groups are expected to grow by 100 million. [12] Africa's 1.1 billion population is expected to have doubled in 2050 and quadrupled in 2100. [13] This significantly increases the consumer population and makes Africa a rapidly expanding market that attracts investors. Despite these projections, the African continent is palpably not ready. A fact reflecting this is the ease of doing business in many African countries which is at an all-time low, albeit slowly improving. In the World Bank's Doing Business 2019 report, South Africa, Kenya, and Nigeria are ranked at 82, 61, and 146 respectively on the ease of doing business. The ranking measures the ease of starting a business, getting a location, accessing finance, dealing with day-to-day operations, and operating in a secure business environment.

Other significant obstacles facing African economies are lack of financing [14] and the absence of effective business regulations needed to create an economic environment that fosters entrepreneurship and innovation. The private sector, which holds the key to an economic reawakening in Africa, has become a victim of these. Strategic financing can be key to developing key sectors in Africa's economy. Through the provision of mouth-watering incentives targeted at private equity investors investing in certain key sectors of their economies, African countries can create a strategic flow of private sector financing that will have a positive impact on other sectors and the economy as a whole. Furthermore, this will create alternative financing options for SMEs. African governments should also create a unified legal and policy response to the increasing interest of private equity investors in Africa.

Footnotes

1. Central Bank of Nigeria, 'Money Market Indicators', https://www.cbn.gov.ng/rates/mnymktind.asp?year=2018&month=12 (accessed 03 February, 2019 .

2. African Private Equity and Venture Capital Association, 2017 Annual African Private Equity Data Tracker, February 2018, 4.

3. Charles Giles, 'Record-breaking $560m for African Tech Startups in 2017, says Report', CNN, 23 February 2018 (www.edition.cnn.com/2018/02/23/africa/increase-investment-african-tech-startup/) accessed 17 February 2019.

4. Tom Jackson, '7 Most Active Investors in African Startups in 2017' Disrupt Africa, 26 January 2018 www.disrupt-

africa.com/2018/01/7-most-active-investors-in-african-startups-in-2017/) accessed 17 February 2019.

5. Disrupt Africa, Funding Report (www.disrupt-africa.com/funding-report/) accessed 17 February 2019.

6. ibid

7. AVCA 2017 Annual Limited Partner Survey, 7

8. ibid 8

9. Stanford Graduate School of Business, 'How Much Does Venture Capital Drive the U.S Economy?' (www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy) accessed 3rd February, 2019.

10. Global Insight, Venture Impact, The Economic Importance of Venture Capital-backed Companies to the U.S. Economy, p.2.

11. Joe Myers, 'These are Africa's Fastest-growing Cities', World Economic Forum, 6 May 2016 (www.weforum.org/agenda/2016/05/these-are-africa-s-fastest-growing-cities) accessed 5 March 2019.

12. International Finance Corporation, Shaping the Future of Africa: Markets and Opportunities for Private Investors, New York, 2018, 6.

13. ibid

14. ibid

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.