

Start-up funding in South Africa



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May 2013

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Market for technology & innovation



*Our business is innovation
management and
commercialisation*

Creators of technology & innovation



Enablers in the innovation eco-system



Start-up funding in SA

- Basics of why people seek funding
- *Different investment approaches*
- *Stages of investment*
- *Forms of finance*
- *Recent figures*
- *Reality check*
- *Role of Due Diligence*
- *Remember...*

Investees

- Why seek finance?
 - Transform a great idea into a competitive venture;
 - Entrepreneurial and market activity require additional funding to support growth and development;
 - Take on development of new technology;
 - Move into new markets;
 - Acquire competitors or strategic partners.

Investees need money to grow.

Investees

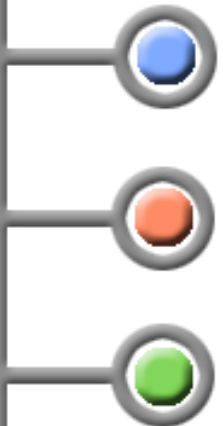
Growth needs may vary depending on the stage of the business and the objectives of the owners/shareholders



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Investees

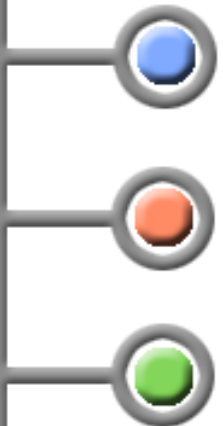
Different routes to success



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Investors

Why invest in other's business interests?



Investors

- Differentiate between government and private investors
- Each has different objectives
- Government: public good
- Private investors: ROI

Investment approaches

- Typically entails a process of taking equity in a new venture to offset risk and to have a command in the future of the business
- Equity investment in return for cash injection into the business
- Cash is used to fund development, growth or expansion
- Pre-bubble: cash used for cars and parties
- Gave VC a bad name
- Investor becomes a director in the business actively participating in the management of the venture

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Investment approaches

- Find deals (how?)
 - 300 per year
 - Mostly not able to invest
 - Best one's through referrals
 - Screen (5%)
 - Invest
 - Mature investment
 - Exit
-
- **Important: Exit needs to generate more revenue than [original investment less costs]**

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Basic investment process

Investment motivations

Investment criteria

Finding deals

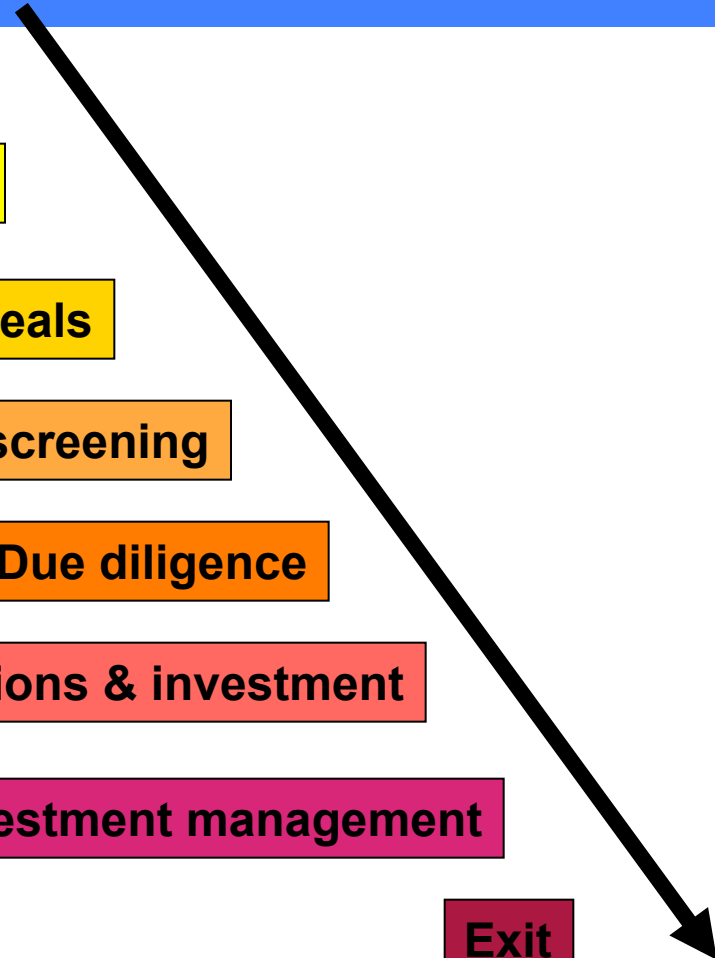
Initial screening

Due diligence

Negotiations & investment

Investment management

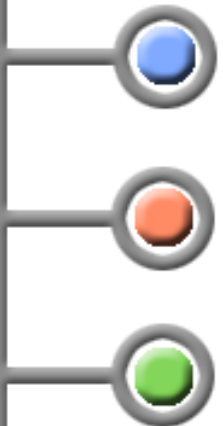
Exit



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Investment approaches

What is an exit?



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Investment approaches

- Exits in the US making headlines: IPO's
- Reality similar to South Africa:
 - Trade sale
 - Management buy-out
 - Sell to other investors



Investment approaches

- Differentiate between different approaches to investment:
 - Portfolio approach (traditional)
 - Open-ended approach
- Private investors tend to focus on a type of portfolio approach to spread risk and manage returns to investors
- Typical setup is raising a fund or capital line:
 - Fund (contributors to the pool of money)
 - Fund manager (screen, manage and exit investments)
- Government normally works on similar basis
- Even then: need to show ROI

Investment approaches

- Portfolio approach:
 - Offset individual risks by staggering risk in a pool
 - If invest in 10 transactions, then typically expect:
 - 5 to be total loss
 - 3 to break even
 - 2 to big radical success so as to make up for loss in portfolio

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Investment approaches

- Main contributors to funds:
 - High net worth individuals
 - Families
 - Corporations
 - Institutional money (insurers, banking, etc)
- Contribution to fund to achieve ROI
- Can be set up as a full contribution for a period of time
- Or set up as a draw-down facility
- Typically:
 - Enclosed fund
 - 7 to 10 year horizon
 - Fund manager paid on annual basis as % of funds under management
 - ROI calculated on exit positions at end of fund

Investment approaches

- Focus of investors normally in the technology domain
- Some operate purely in specified sectors and in specific growth stages
- But, no-one will walk away from a good deal
- Some are keen to look at anything

Investment realities

- % of funds under management means that VC teams are normally quite small
- In South Africa, dominated by accounting professionals, many with experience in banking industry
- Big criticism!
- Investment teams in South Africa gaining experience, but still relatively young and inexperienced

Stage of investment

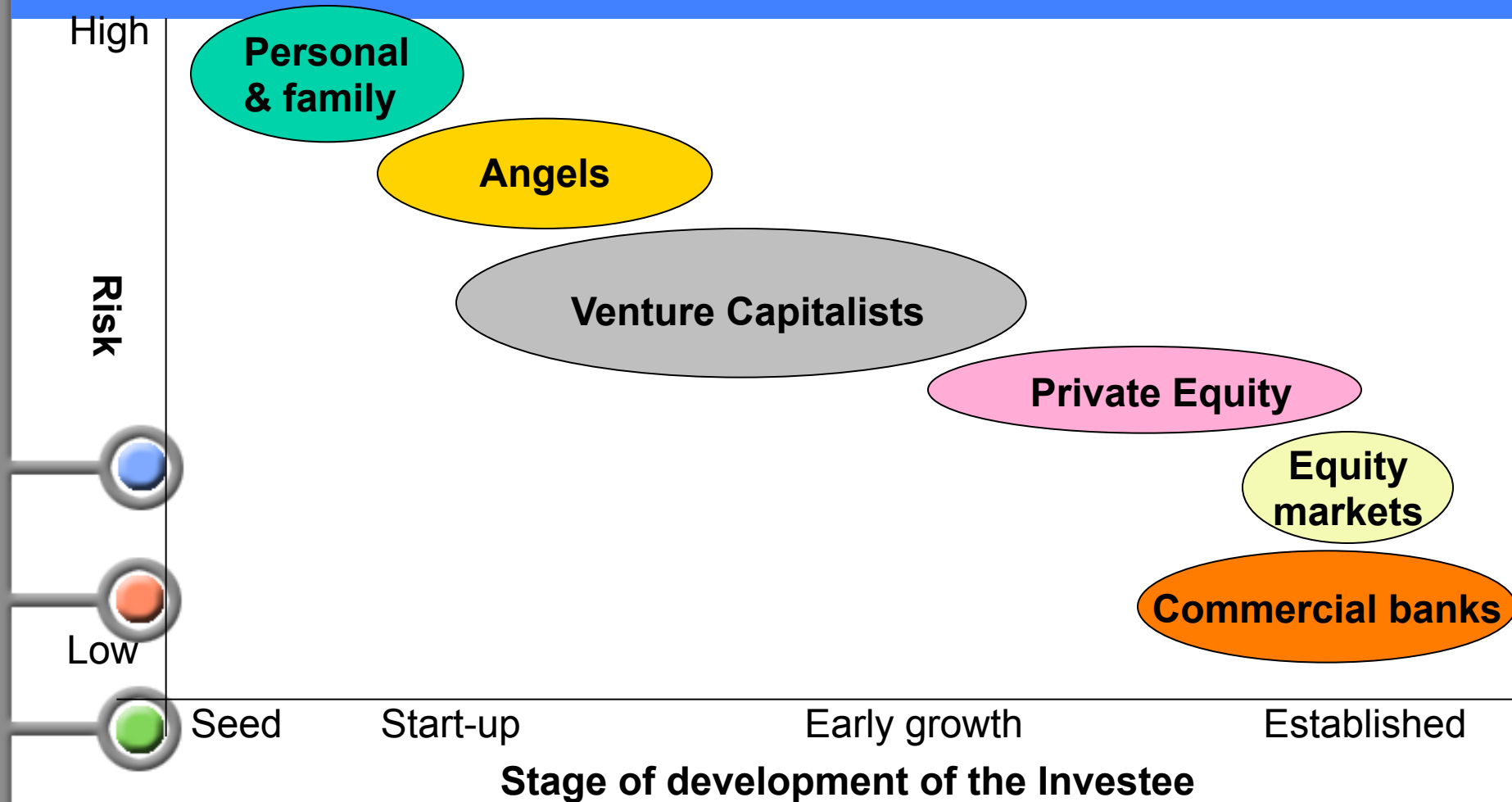
- **Seed funding:** The initial capital used to start a business. Seed capital often comes from the company founders' personal assets or from friends and family. Seed money is typically used to pay for such preliminary operations as market research and product development.
- **Start-up capital:** Early funding used for example in setting up operations (hiring staff, renting office space, equipping the production system, etc), commercialising intellectual property, and other activities involved in starting the business

Stage of investment

- **Development capital (mostly pre-revenue deals):** Rounds of finance used after start-up capital to further launch the business and obtain market share so as to turn revenue positive and profitable.
- **Growth capital (post-revenue deals):** Rounds of equity type investments used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/technology lines, accelerating production and/or acquiring competitors.

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Forms of finance in SA

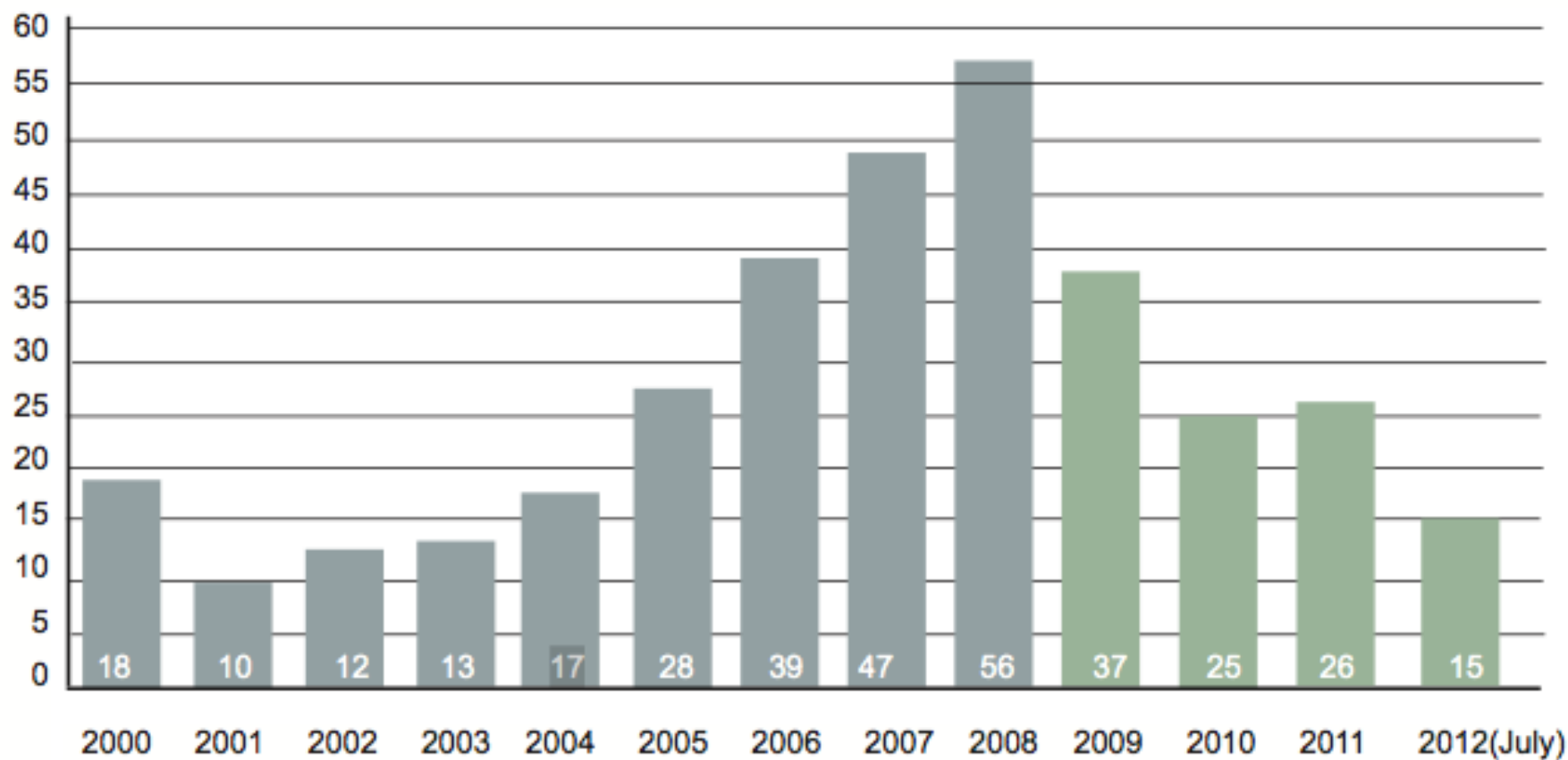


Sources of funding in SA

- Pre-revenue (primarily public domain):
 - Business plan competitions (new) and prizes
 - Government grants and rebates (SPII, Thrip)
 - TIA, Innovation Fund, BRICS
 - If clear IP, inVenfin
 - Business Partners
 - Angels
- Post-revenue (public and private)
 - Business Partners
 - IDC Venture Capital
 - HBD, 4di, Hasso-Plattner, etc
 - Private equity, banks.

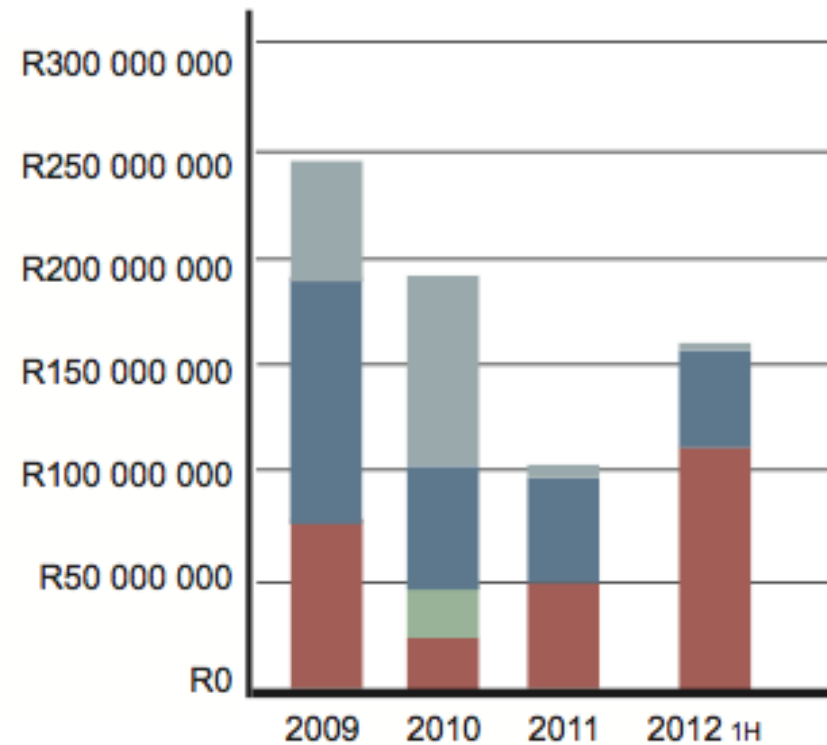
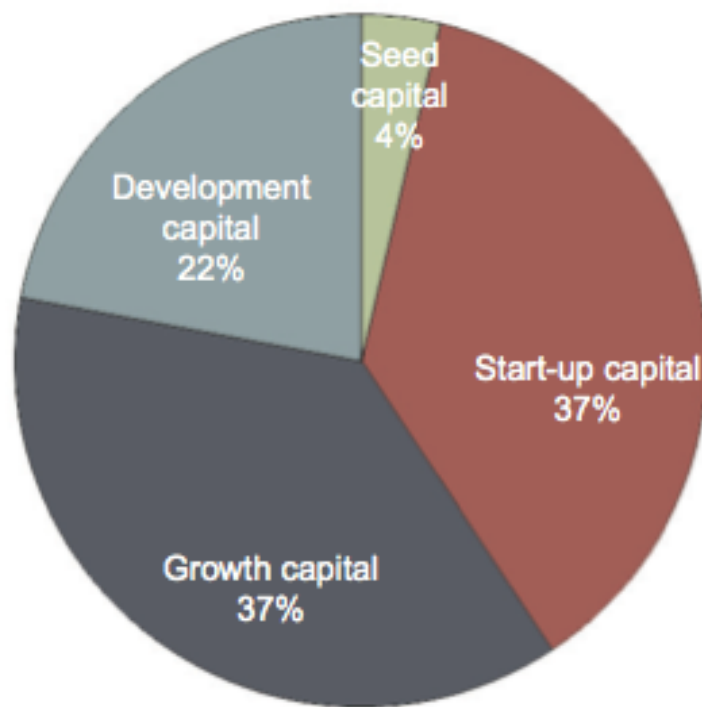
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Transactions per year
(number of transactions 2000 to July 2012)



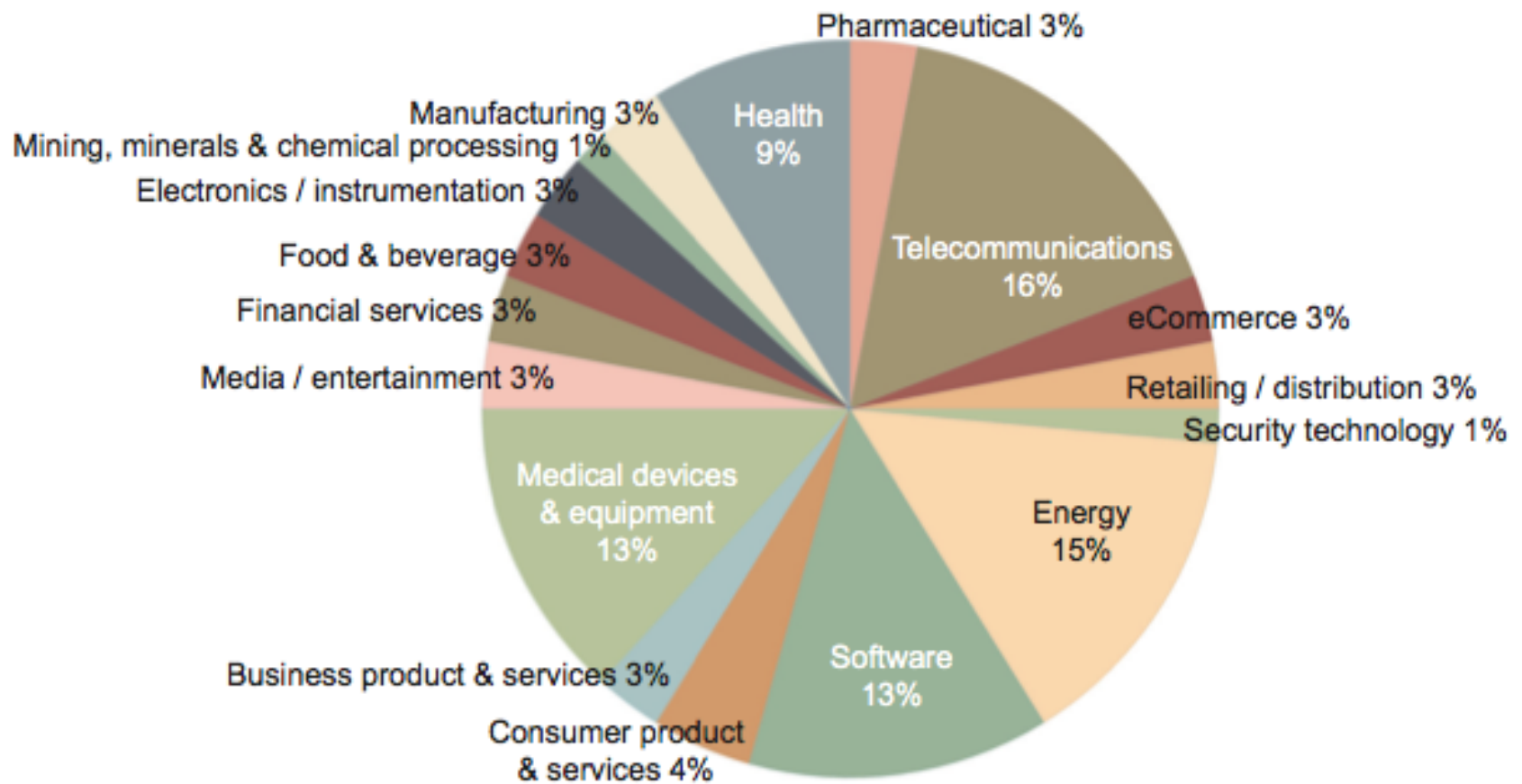
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Contribution by stage of deal (by value)



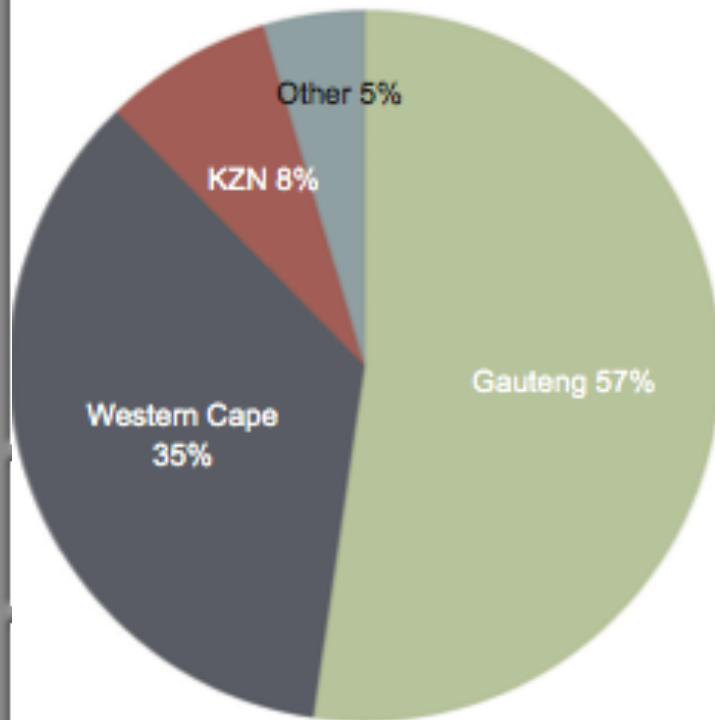
Start-up capital Development capital Seed capital Growth capital

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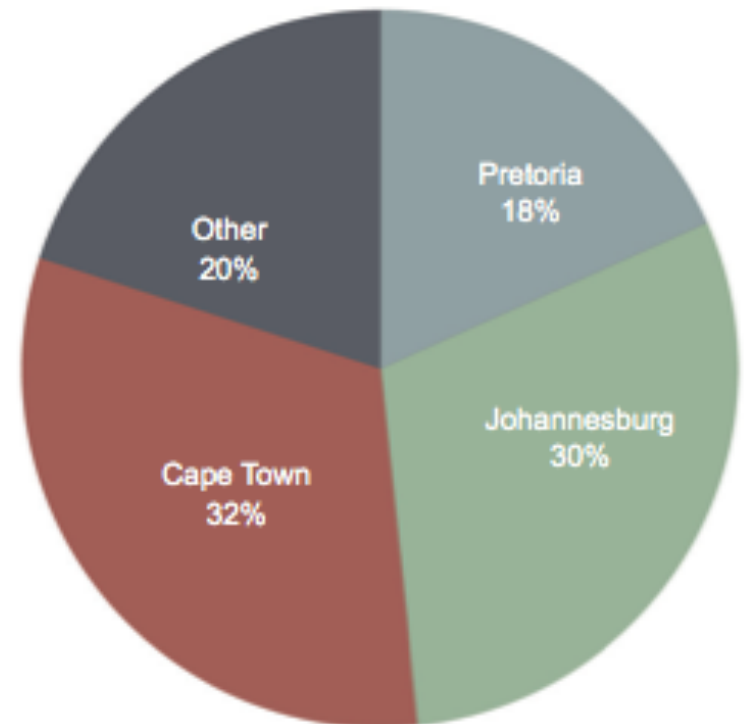


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Location of transaction by province



Location of transaction by city



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Summary of Investments

	2000-2010	2009-2012
Number of venture capital fund managers invested in period	33	22
Number of investments made during the period (Venture capital fund managers only)	197	103
Average transaction (value)	R10.5m	R8.11m
Total amount invested in survey period	R 2,638bn	R 0,835bn
Total amount invested in venture capital asset class at end of survey period	R 2,324bn	R 3,084bn

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So there is money yes...

But two sides to the coin.



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South Africans new to entrepreneurship
think its all about the money



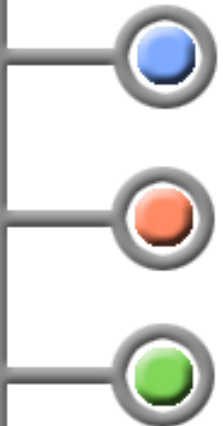
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Three ways to scale a business



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We are too focused on technology



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SAVCA survey avg deal size	R 10 million	
Typical portfolio size	10	R 100 million
ROI to beat banks	10%	R 110 million
ROI to offset risk	30%	R 130 million
	10%	30%
10 deals: 5 fail, 3 break-even	R 80 million	R 100 million
Value of 2 investments	R 20 million	
ROI therefore:	300%	400%
Or, each deal grow to	R 40 million	R 50 million

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Consider some of the investors in SA investing up to R 30 million in single VC transaction:

- 400% growth = R 140 million business!
- Value, not turnover!
- There are not many businesses in SA that can grow to a R 140 million
- Consider the number of employees, size of management, the offices and operations

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What is our competitive advantage in South Africa?



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Deal governing principles

- People
- People
- People
- Investors typically don't invest in products or technologies, but in people who can make money for them by selling products or technologies to the market and develop and maintain a pipeline.
- Good management more important than products.

DDR and IP

- Understand the difference between:
 - Products/services;
 - Technology; and
 - IP rights.
- Thus:
 - What value does new technology bring to product/service offerings?
 - Will it be commercially acceptable?
 - What is the time to market (conservative, worst-case)?

What about the market?

- IT'S THE MARKET STUPID!
- No 'product', no commercial viability.
- Best technology not necessarily the best product.
 - Beta vs. VHS
 - C1 vs. Vespa
 - Microsoft PowerPoint vs. Apple.
- Cannot have a solution without a problem – LASER.

Key issues for DDR

1. Understand difference between products, services, technology and IPRs:
 - Experienced management and product more important than technology.
 - Secure strong IPRs.
2. Identify products early on and assess commercialisation route:
 - No product, no commercial viability.
 - Assess best use of exploitation mechanisms.

Key issues for DDR (2)

3. Can management sell IP/technology?

- If management can't explain practical use of technology, how will they sell it to the market?
- Priorities:
 - 1 Management
 - 2 Product
 - 3 Market
 - 4 Technology
- Align due diligence in same sequence.
- Be careful of the techies: will promise the moon.
- However: don't miss the diamonds in the rough.

Key issues for DDR (3)

4. Assess alignment between IP and business strategy:
 - Look beyond patents
 - Know-how a significant component of new technology.
 - Assess current and future IPRs.
 - Address each IPR separately and as a whole
 - Class.
 - Territory.
 - Duration.
 - Enforceability.
 - Secure only IPRs that you need – thus significance of product rather than technology focus.

Key issues for DDR (4)

5. If all of above checked out, assess and test IP assets:
 - Scope;
 - Validity;
 - Duration; and
 - Fit.
6. Remember the Exit!
 - Covey: “start with the end in mind”.
 - Contracts;
 - Ownership;
 - Joint liabilities;
 - Maintenance and fees.

Key issues for DDR (5)

7. Always think about the downside

- Long-term agreement/relationship.
- New technology, market unknown.
- Fundamentally dealing with uncovering one or more unknowns.
- Use a lawyer!

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Remember

- It's a two-way street
- Due diligence not only about the investor, but also for the investee to learn about the investor



VC is a specialised class

- Venture Capital is not an inevitable
- Many (most) businesses grow without external investment
- Some case studies show that businesses not taking on investment have more stable and longer growth
- Need to understand the purpose of seeking investment

Alternatives

- Understand your value and objectives
- What do you want to achieve?
- Look at the options and ask help
- Alternatives include:
 - Boot strapping
 - Friends and family (if...)
 - Growing organically
 - Taking a duel/parallel approach

Alternatives

- Seed money: no client = no business
- Recognition in US today of: "Lean Start-ups"
- Investment needs in ICT/Web 2.0 age have decreased. Why?
- If not necessary to bring on an investor, then don't
- If need to, then accept realities
- Appears that SA reluctant to give away equity; not international best practice
- Your idea, sure; but it's my money!

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Consider

- Equity should be used sparingly
- Don't give away equity for services
- Investor should not be approached purely based on money
- What can your investor do for you?
 - Networks
 - Experience
 - Reputation
 - Credibility
 - Clients

Government

- Big focus on ramping up tertiary research and public funded IP
- Implication is that government will be in the background
- Universities should be breeding ground for new ideas, but...
- Consider new public funded IP bill
- If dealing with universities, probably mean taking a licence and having university on your board
- Consider alternatives

Practical: how to raise VC

1. Do soul searching to understand your true objectives and interests
2. Understand your business, now and in the future
3. Consider the alternatives
4. Know your partners

Practical: how to raise VC

- 5. Innovation is not once off, therefore build network
- 6. Most VC's invest through referrals; ensure that you maintain a good reputation and awareness
- 7. If seek investment, then do proper homework – speak to other investments

Practical: how to raise VC

8. Be realistic and plan properly
9. Don't wait until you are out of money to seek investment
10. Get help from advisors and brokers
11. Make use of other instruments
12. Get to know an angel

Practical: business plans

- 300 deal flow means no time to correct spelling mistakes
- Most interested only after seeing proper Executive Summary
- Business plan needs to be balanced
- Ask for pro-forma or requirements before setting up your own
- Reality in SA: money chasing deals
- Most VC's are willing to speak, even help, before setting up appointment
- Nurture your relationships, continuously

Practical: remember

- This is a long-term process
- It involves partnering for life
- Can you work together?
- Do you share common vision?
- What is the value-add?
- What is the reputation?

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In general...

- Not a lack of funding, but
- Inability to show business case:
 - Investors (not government) make money by return on investment
 - Can only show ROI if able to successfully innovate, i.e. sell products and services
- Need to speak business language
- Research undertaken based on ability to get funded, not market feasibility
- Not the product/technology/idea, but
- The ability to derive revenues.

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That's it!

Questions?



Venture Capital in South Africa



For more info & advice

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