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Africa Prize business guides

How to secure investment

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A guide to securing the right kind
of investment for your business

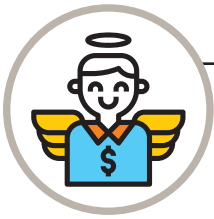


Funding a startup in a competitive environment

The first thing to understand about investment is that one size does not fit all; not all businesses or investors have the same goals, and it is essential to determine how to raise finance for each specific type of business. A startup needs to consider its industry, the stage it has reached and the speed it can scale when deciding whether and where to raise money. Some businesses may benefit more from 'no-strings' cash prizes than investments, which can either add debt to the balance sheet or reduce the founders' equity and control over their business. It is also important to ask why you need to raise capital; some businesses could be 'bootstrapped' without any outside funding or may only need a small loan.

Grants, prizes, investors and accelerators: deciding what type of investment you need

When making the decision, it is important to first understand the differences between investors. The profiles below describe the main types of investor, and the kinds of businesses they invest in.



Angel investors

Angel investors are ideal for startups because they are often more patient than venture capitalists (VCs) in waiting for a return on investment and can be more 'hands-on' investors. As they are investing their own money, they often support businesses they are genuinely interested in and will take the time to help them succeed even if they are not yet profitable. Angel investors invest in people as much as businesses, because they need to know they can work with the founders. Angel investment is known as 'mentor capital', which makes them ideal for businesses with great innovations but an inexperienced team in need of guidance. Crucially, as angel investors are giving their own time and money and often want to leave a positive legacy, they may be interested in the potential social or economic impact of a business as well as getting a return. They will usually take a significant amount of equity as this gives them a stake in the long-term success of the business.

Local angels

Local angels are sometimes less willing to take risks than international investors. They tend to invest in fields they are familiar with. For example, local angels often prefer traditional businesses in fields such as agriculture, financial services and related areas of technology such as agritech or medtech. They are also more likely to invest in technologies that address local challenges specific to their region or country, rather than challenges in other geographies where they have less experience and knowledge. They may also have a strong local or national network that can open doors in local markets.

National/international angels

Foreign or national angel investors may not be as motivated by local challenges but instead look for the national or international potential of a business. They have a better understanding of the long-term growth potential than local investors, often have greater resources and wider reaching networks, but less understanding of local demand, competition or markets.



Venture capitalists

Many, but certainly not all VCs can be 'arms-length' investors that look for a predictable exit and high return, making them ideal for established scale-ups with high growth potential and the in-house experience to achieve it. If a business cannot demonstrate profitability, they will look for evidence of scalability (such as rapid recent year-on-year growth in employees and revenue). VCs will invest more money in a business than an angel but they may demand a quicker or more predictable return because they are investing on behalf of other businesses or funds. They also invest at a later stage to reduce their risk, which means they will look for businesses with a good track record and an experienced team. VCs will typically take either an equity or ownership stake.



Grants/prizes

Grants and prizes are legitimate alternative routes to raising startup capital. They have the advantage of coming without strings attached. They are perfect for 'impact businesses' because prize judges or grant bodies are not looking for direct ROI but will instead consider the potential positive economic or social contribution a business can make. Winning high-profile awards can also give startups free publicity and credibility in the eyes of future investors, customers or partners. However, beware that private investors may avoid so-called 'prize junkies' that appear to spend more time applying for competitions than developing a credible business plan or acquiring customers. Many awards such as the Royal Academy of Engineering's Africa Prize offer shortlisted entrepreneurs free training and mentoring and access to a fertile pool of angel investors, potential partners and customers.

Here is a list of grants and prizes to consider:

- Africa Prize for Engineering Innovation - Royal Academy of Engineering
- Africa Energy Innovation Competition
- Africa Energy Generation Prize
- African Entrepreneurship Awards
- AppsAfrica Awards
- Empowering People Award
- FinTech: Catapult inclusion in Africa
- GSMA
- Innovation Prize for Africa
- Next Billion EdTech
- Start up of the Year Africa
- Sankalp Awards (East Africa)
- This is Hardware



Accelerators

Startup accelerators are a good source of funding because they not only provide seed investment but also offer free workspace, mentoring, access to a business network and help raise a business's profile. They have a highly-competitive but open application process and will only work with businesses that have a small team, rather than an individual entrepreneur.

Here is a list of accelerators across Africa:

- 100Ideas Online Accelerator Program
- Activspaces
- Afrilabs
- Alphacode Club
- Anza Tanzania
- Aurik Business Accelerator
- Baobab Network
- Barclays Accelerator (Techstars)
- Bluemoon Ethiopia
- Bongohive
- Co-Creation Hub
- CTIC
- Entrepreneurs Spot
- Etristars
- Fablab
- Fb Start Accelerator
- Founder Institute
- Founders' Factory Africa
- Global Cleantech Innovation Programme
- Google Launchpad Accelerator Africa
- Green Pioneer Accelerator
- Grindstone Accelerator
- GrowthAfrica
- GSMA Fund
- Impact Hub
- Indigo Trust
- Ingenious City DRC
- Injini
- Innovation Axis
- Jokkolabs
- Launchlab
- Leaders in Innovation Fellowships (RAEng)
- Merck Accelerator
- MEST
- Nest
- Nigeria Health Innovation Marketplace
- Roar Nigeria Hub
- Savannah Fund Accelerator
- Sote Hub
- Startupbootcamp AfriTech
- Suguba
- Sw7 Mentor Accelerator
- Ventures Platform Accelerator
- XL Africa
- Y Combinator



Crowdfunding

Crowdfunding is another innovative way to raise capital without taking on debts or giving away equity. However, the amounts it is possible to raise are low, with most successfully funded Kickstarter campaigns raising under \$10,000. The risk is that crowdfunding is all-or-nothing and comes with a high failure rate, as many businesses fail to hit their funding target and all money raised is then returned to the funders. The formula for success is to do creative marketing to build 'buzz' around a funding campaign before it has started. Incorporating user feedback into product design or engaging with customer reviews helps test the market for the product and build a network of potential customers and brand ambassadors before the campaign has launched. It is then easier to promote the campaign to this pre-existing community of stakeholders through social media and mailing lists.



Financing options for startups

Startup capital always comes with strings attached and different kinds of strings suit different kinds of businesses. It is important to understand the different types of finance available and the conditions attached to them in order to determine which is right for each particular kind of business.



Bank loans

Bank loans have the advantage of not diluting the founders' equity and control of the business. However, they are only suitable for more mature startups that have assets such as buildings against which to secure the loan and are confident of being able to pay back on time. They also charge interest, and often require a compound interest rate, which takes extra money from a growing business when it needs it most.



Convertible notes

Convertible notes are useful for very early-stage startups as they provide finance to a business before it is in a position to make a valuation or give away equity. They also give startups the flexibility to offer different prices to different investors and give the first investor a lower valuation, a powerful way to encourage someone to take a risk on a new business. The disadvantage to convertibles is that the business valuation is deferred and the convertible notes often hide how much the company will give away at a later stage. This means later angel investors can find themselves being suddenly diluted when the notes convert, causing anger among investors.



Equity finance

Equity finance gives businesses startup capital without the need to pay interest, and provides access to business networks and expertise as well as the credibility needed to pull in more investors. The disadvantage is that pitching for investment can be time-consuming, and could mean diluting equity or having to hand over the reins of the business to someone else.



Profit-based financing

This offers a good opportunity for companies that do not want to give away equity or ownership and also lack the cash or property assets to take on debt. The risk of defaulting on the payment is low, since the repayment is not a fixed amount but is based on future revenues. However, profit-based finance is only available to later-stage SMEs that already have at least some revenue or profits. Crucially, the long-term 'pain' of repayment can also exceed the short-term 'gain' of capital infusion, as the repayments increase with revenue.

Pitching dos and don'ts

Top pitching tips

Every investor wants to know if they will be able to sell their shares at a far higher price than they paid for them. The goal of any pitch for investment is to show investors the path to a profitable exit. Every pitch, from a 30-second 'elevator pitch' before an audience to a pitch for a specific investment house, needs to answer three fundamental questions:

- What is the challenge faced by users or customers?
- How do I solve it better than anyone else?
- Why would someone pay me to solve it?

Below are some top tips for successfully winning investment.



Do



Remember the jockey is as important as the horse

Having a strong team is as important as having a strong product in ensuring the success of the business. Demonstrate the business experience and skills in their domain by giving examples of members of the team with other successful inventions, businesses or previous employers in the field. This also shows investors that the business will not place excessive demands on their time. Experienced investors will always focus on the strength of the founders: their attitude, energy, sector knowledge, openness to feedback, and determination combined with flexibility.



Show the inspiration behind the innovation

When pitching angel investors, try to outline a personal story behind the business that is typical of other potential customers. For example: "my relative became ill from contaminated water, a problem common across my country. This inspired me to develop a water purifier for people without water treatment facilities." This demonstrates the potential human 'impact' of the product, the challenge you are solving and your target market. The story can become part of the 'brand narrative' around the product, helping the investor see how you could market the product and build a successful brand.



Use proof points

Offer realistic 'proof points' that show the scalability of the business and the market for the product. These should include: recent revenues and realistic five-year financial projections; any major customers, resellers or licensing partners; the USP or competitive advantage over others in the space; target market size and projected growth.



Do your homework

Every investor is different. Just as they will for you, you must do 'due diligence' on each target investor, including the history and size of their investments, and the industries and types of businesses they invest in. Their interests may only be temporarily aligned with yours but may diverge over time. This ensures you avoid pitching the wrong investor and will help tailor your pitch to their sensibilities and long-term interests, increasing your chance of success.



Demonstrate you're good at handling cash

Provide evidence of good management accountancy, by opening your balance sheet to investors. Give them a top-line summary of your monthly burn rates, margins, customer acquisition costs, inventory and a clear plan for spending investment productively and efficiently. Crucially, explain clearly why you need investment.



Sell the regional market, not just the business

Many investors are still based in Europe or America and might be sceptical of funding African startups because they need to know there is a stable market and demand. Demonstrate that you understand the nuances of different local markets and the ability of your product to scale across Africa. For example, your business strategy could include using Ghana or Nigeria as a 'gateway' to expand into the West African market. Emphasise details like the fact that Africa has a growing middle class and, at a time when Western economies are ageing, Africa is the 'young continent.' This means there is an exciting future opportunity.



Tell your 'impact story'

A significant number of African investors are so-called 'impact investors.' Tell the social and economic impact story of the business from the job creation metrics to the environmental benefits and the number of lives changed. For example: "our solar cooker provides food for XX number of people living off the grid." Businesses without strong sales should also collect positive endorsement from customers to show investors anecdotal evidence of the potential impact.



Don't



Provide fantasy valuations

Be honest and don't exaggerate. Over-inflated valuations based on false figures such as overall market size rather than market share, make you seem untrustworthy and deter investors who might otherwise invest. Even if you win investment at an unrealistic valuation, this will put off other potential investors down the line. Equally, don't undervalue your business. Stress-test your valuation with independent experts or compare it with other businesses at a similar stage. Crucially, be prepared to verify your figures.



Focus too heavily on the tech

Avoid becoming so enveloped in the tech that you cannot explain the real-world challenge it addresses, why it solves that challenge better than others and why a customer would pay for this product to solve it. An investor is more interested in the impact and ROI than the inner workings of the tech.



Use jargon

Pitches filled with buzzwords such as 'AI' or "we are the Uber for solar power/ bikes/ education" will not impress investors. Stick with punchy, concise facts that demonstrate the challenge, how you can address it and how you will make money from addressing it. For example: "XX million rural people each year die of malaria because they are too far from a doctor to get blood tests. Our laser scanner allows local communities to self-test for malaria without a doctor and is cheaper than the alternatives."



Get caught out on the numbers

Ensure you research everything from your market size to your competitors so you understand your business and you can explain the challenges and opportunities clearly to an investor and back your claims with facts. Do not make unsupported claims such as "I believe there is a market of millions for this" or erroneous statements such as "my business has no competitors." Even if your product is the first of its kind, any other businesses competing for your customers' money are your competitors.



Outstay your welcome

When pitching on stage, always imagine you are in an elevator with that investor and have only 90 seconds to communicate your idea and why it deserves investment. Prepare catchy, concise top-line summaries of your invention, its USP and its total addressable market, current and projected revenues and the main competitors in the space. Never overrun your allotted time!

Investment case studies



Equity

Edmand Aijuka, Uganda

Finalist for the 2016 Africa Prize for Engineering Innovation

Innovation: Kamata/Kops Ltd

Kamata, meaning 'to seize', is a prevention system that alerts regional utility centres when power is being tampered with or manipulated.

“ We decided to work with a venture capitalist because their support often comes with mentorship, market connections and business expertise in addition to the funding. This combination of investment and guidance helped us develop our system from a prototype to a commercial product.

The support allowed us to increase our manufacturing output, which meant we could start supplying to customers in industry. These clients make much larger orders, and prefer to pay after the product has been delivered. Without investment, this would have required us to commit a reasonable amount of our own money upfront for the development and supply. Investment helped us meet these costs, and continues to support our efforts to expand the business both locally and across sub-Saharan Africa.

My advice for those looking to attract equity investment is to make sure the company presents the kind of qualities investors are attracted to before approaching them. An organised, coordinated team is one of the things investors look for. Try not to distribute your shares amongst too many individuals; it is easier for an interested investor to deal with fewer, majority shareholders than with multiple parties with small stakes.”



Grant

Brian Bosire, Kenya

Shortlist for the 2016 Africa Prize for Engineering Innovation

Innovation: UjuziKilimo

UjuziKilimo, meaning knowledge farming, measures soil characteristics to help farmers understand and quantify soil qualities.

“ We chose to apply for grants because this type of funding suits our company's profile and current maturity the best. We develop hardware, which needs a huge amount of research and development before we can enter the market. We are also still quite a young company, so do not want to dilute our equity before we have even had a chance to turn a profit. We will be open to other forms of funding once the company has matured more.

Over the past few years we have received grants from Google, KENIA (Kenya National Innovation Agency), and the ASME (American Society for Mechanical Engineers), among others. The funding helped us develop our product and grow the team. Most of the financial help also came with additional support, business networks and partnerships that will aid our growth in the coming years. Our target is to reach one million farmers in five years, and attract venture capital and equity investment.

I would recommend anyone looking for grants to choose carefully. Most application processes are very time-consuming. Select the grants you pursue based on the amount of money available, time spent on the application and programme, and the overall value of the programme to your business. Some grants demand a lot, without providing enough of a support system. A successful startup needs more than just money; you need a whole ecosystem of support and incubation to thrive.”



Authors



Dr John Lazar CBE FEng

John serves on the board of several organisations including What3Words, KindLink, Techfortrade and Technology Trust. He recently stepped down as CEO and Chairman of Metaswitch Networks, a leading provider of communications software. Since then he has launched Enza Capital, which invests in early stage technology companies in sub-Saharan Africa, with its goal being to produce both risk-adjusted financial returns and measurable positive impact. John is a Fellow of the Royal Academy of Engineering and BCS, The Chartered Institute for IT. He was awarded a CBE for services to engineering in HM The Queen's Birthday Honours in June 2016. He is a judge for the Africa Prize for Engineering Innovation.



Sheena Raikundalia

Sheena has over 10 years of experience in the legal, financial services and impact investment sectors in Europe and East Africa and over five years board experience with a non-profit. She is currently a senior advisor with Intelicap's Kenya office providing strategic advisory services to financial institutions, startups, corporates, development agencies and NGOs across the African market. She is also a non-executive director with Inuka Africa, a micro-finance institution with 34 branches spread mainly in agricultural counties in Kenya.