

Chasing Outliers

Why context matters for
early-stage investing
in Africa



Authors:



Tayo Akinyemi: Lead Researcher, Writer, and Co-Publisher

**the
subtext**

Osarumen Osamuyi: Writer and Co-Publisher

Contributors:

Tony Chen: Co-Publisher

Mia Smith: Research Assistant

This research was made possible by funding from Kinyungu Ventures



Kinyungu Ventures is an East African venture firm on a mission to catalyze resilient businesses for local intergenerational prosperity. Based in Nairobi and Chicago, Kinyungu Ventures strives to do three things well:

- Context: Provide wisdom in crucial moments
- Connects: Leverage trusted relationships
- Capital: Invest in great businesses

Table of Contents

Acknowledgements	6
Foreword	7
Abbreviations	8
Executive Summary	10
Why Silicon Valley VC clashes with African realities and how funds and startups respond	10
Why people, execution, and alignment matter	12
Founder, team, and investor characteristics	12
Execution, relationships, communication, and alignment	12
The Case for Context	13
Introduction	17
Part I: Why Silicon Valley venture capital is a bad fit for Africa	18
Key characteristics of the Silicon Valley–style investing model	18
African markets don't match VC expectations	20
African market characteristics	20
Return expectations and performance	23
Capital scarcity	23
Deal flow scarcity	25
Fund structures	26
How startups navigate mismatches	29
Building businesses to solve big problems and create big impact	29
Building infrastructure and fixing supply chains	29
Targeting mass markets	30
Leveraging local presence and knowledge	30
How funds navigate mismatches	31
Investing in businesses to solve big problems and create big impact	31
Leveraging local presence and knowledge	32
Assessing and mitigating risk	34
Making strategic investment decisions	35
Return expectations and time horizons	37
The time horizon conundrum	37

African VC and PE performance and expectations	37
African VC and PE performance	38
VC returns expectations	38
Why lower returns are still compelling	39
Founder exit expectations	40
Part II: Why people, strategy, and alignment matter	41
Founder, team, and investor characteristics that drive success	41
Founder characteristics	41
Team characteristics and behaviors	43
Why a great team is important and what makes a strong team	44
Why attracting and retaining human capital is difficult	44
Investor characteristics	44
Entrepreneurial experience, market familiarity, and flexibility	45
Leading deals	46
Passive investors: How investors add value to startups	47
Active investors: How investors offer advisory and operational support	47
Self-interested investor behavior	48
Relationships between founders and investors	49
Communication	51
Consistent and transparent conversation	51
One size doesn't fit all	52
Using formal and informal methods	53
Barriers to communication for founders	53
Execution and business metrics	54
Execution	54
Business metrics	54
Alignment	55
Alignment, and misalignment, for investors	57
Alignment, and misalignment, for entrepreneurs	59
Part III: Build what works here	61
Adapt investment structures	65
Pursue focused investment strategies	66
	66
Methodology	69
Research motivation and key question	69
Responsive interviewing	69

Preliminary hypothesis	69
Interview guide development and interviewing	69
Respondents and sampling	70
Analysis	71
Limitations	71
Bibliography	72
Endnotes	75

Acknowledgements

Chasing Outliers is the product of people connecting with those of like mind to create something new and useful. This report joins a river of information about digital startup and early-stage investing activity that has been shaped by a historical lack of data on fundraising, exits, and venture life cycles. This data gap has inspired entrepreneurial attempts to quantify this activity by sharing information on how much money has been raised and, to a lesser degree, how much value has been created (or lost) through venture capital exits.

This report is unique because it explores the precursors to those outcomes and seeks to explain the structural challenges that affect and potentially constrain the survival, profitability, and exit potential of African startups. As with any novel endeavor, this work is buttressed by the contributions of many people who have offered their support, insight, and skills.

We would like to extend our sincere gratitude to the 100 founders, investors, and limited partnership representatives who graciously shared their time and knowledge with us. Our research would have been impossible without their generosity and candor. In celebration of the power of networks, we would also like to thank Josiah Mugambi and Andile Masuku for bringing the report team together. Josiah astutely determined that two Chicago-based, Africa-focused question-askers should connect. Similarly, Andile recognized that a deep-thinking, Lagos-based puzzle-solver would be an excellent co-conspirator.

Although this report represents a practical search for answers rather than an academic undertaking, we are indebted to Nicolas Friederici and Tim Weiss for their invaluable advice (and book recommendations) as we sought to understand and apply qualitative research methods to our inquiry. We are also grateful to Mia Smith for her research assistance.

Finally, we would like to thank Digital Divide Data for providing transcription services, Carol J. Anderson for copy editing this report, and Skyline Design for designing the report.

Foreword

When I began the journey to become a fund manager for early-stage African ventures, I was excited and anxious to tackle the complicated problem of getting the “right” capital to the right companies in the right way. As an entrepreneur at heart, I embrace the marvelous chaos, the impossible trade-offs, and the crafty experiments required to find product/market fit.

Along the way, though, a wise mentor warned me that “venture fund product/market fit” is different. I can’t just run a few experiments, get quick market feedback, and pivot the way a tech company does in five weeks. As a fund, the quality of your investment decisions is often revealed slowly. Deciding to pivot a fund doesn’t take five weeks—it might take five years. What if I deployed large amounts of misdirected money today? In five years, I’d be very wise—and very broke.

I realized that while my thinking isn’t restricted by history, I am also very keen to learn from its lessons. How do I squeeze 15 years of learning into one? This desire to learn from those who have gone before me is the genesis of this research. And my hope is that the lessons learned from the first chapter of African venture capital will lead to more resilient, stronger start-ups, venture funds, ecosystems, and economies across the continent. While the challenges are many, I believe that humans always rise to the occasion with resourcefulness and ingenuity.

A handwritten signature in black ink that reads "Tony Chen". The signature is fluid and cursive, with the first name "Tony" written in a larger, more prominent script than the last name "Chen".

Tony Chen
Co-Founder, Kinyungu Ventures

Abbreviations

AVCA	African Private Equity and Venture Capital Association
B2B	business-to-business
B2C	business-to-consumer
CAPEX	capital expenditures
DFI	development finance institution
GP	general partner
HNI	high-net-worth individual
IPO	initial public offering
KPI	key performance indicator
LP	limited partner
OPEX	operating expenditures
PCV	permanent capital vehicle
PE	private equity
SME	small and medium-sized enterprise
VC	venture capital



Executive Summary



There are multiple mismatches between key characteristics of Silicon Valley VC and African markets.

Chasing Outliers: Why Context Matters for Early Stage Investing in Africa explores what drives outcomes for early-stage startups and investors in Africa. The first section tackles the assumptions that drive venture capital (VC) investing norms and how well they apply in Africa, while the second section addresses how founder, team, and investor behavior; communication; execution; and alignment influence startup success or failure.

This report makes a case for why African market realities (which are distinct from other markets' realities), and startup characteristics (in which key variables may be similar but context affects how they're experienced on the ground) create a set of operational norms that influence how startups and funds behave. The existence of this unique "operational code" should inform how early-stage investing is practiced in Africa.

WHY SILICON VALLEY VC CLASHES WITH AFRICAN REALITIES AND HOW FUNDS AND STARTUPS RESPOND

There are multiple mismatches between key characteristics of Silicon Valley VC and African markets. These mismatches influence how startups and funds maneuver as well as what results they expect and produce.

- **African market characteristics.** African markets are large, but also fragmented. They comprise consumers with limited purchasing power who are likely to be utility- and price-sensitive. Additionally, these consumers are difficult and expensive to acquire and retain, partially because they don't tolerate fully digital modes of distribution.
- **Returns potential.** Silicon Valley VC, which is designed to support high-growth companies, requires outsized returns that African markets can't necessarily provide at the same scale due to the market dynamics described above. Yet founders and investors seek strong growth, and returns can still be compelling.
- **Capital availability.** Funding hypergrowth companies requires a lot of capital, particularly when the costs of building infrastructure and navigating external conditions are considered. Capital in Africa is scarce, however. Because of this, pursuing a "growth at all costs" strategy where capital pools are shallow can endanger companies.
- **Deal-flow availability.** To the extent that a "spray and pray" strategy characterizes the volume of opportunities required to find unicorns, deal flow scarcity can make them harder to find. Investors who hold unrealistically high returns expectations, crowd into deals that meet those expectations, or focus on specific sectors may reduce their deal flows.

- **Fund structures.** African startups take a long time to generate returns due in no small part to challenging market conditions. As a result, general partners (GPs) may benefit from flexibly structured funds that limited partners (LPs) are unlikely to support without strong business cases and compelling results.

Because of these incongruencies, startups and funds have adjusted their operating models to better align with market realities. More specifically, startups have done this by tackling problems in foundational sectors such as agriculture, building infrastructure, pursuing mass markets, and leveraging their local knowledge and presence.

- **Tackling big problems.** Africa-focused founders are often trying to solve large, foundational problems that could improve the lives of countless people. In many cases, this means that they are motivated not only to stimulate economic development, but to use technology to increase value creation for agricultural producers, improve education, and create access to finance, health services, and jobs.
- **Building infrastructure.** To deliver a product or service, a venture often has to build the infrastructure or fix the supply chains required to do so. As well, sometimes, a company may also set out to fix one element of a supply chain, such as providing affordable internet service, only to realize that it also has to build towers and generate power.
- **Pursuing mass markets.** In the African context, small and fragmented markets, poor and difficult-to-reach consumers, and hefty infrastructure costs all constrain returns. Serving the majority of African consumers represents a massive opportunity under certain conditions, however: Although African consumers have limited purchasing power, they are numerous. Consequently, startups can build robust businesses that are based on high volumes, small margins, and lean operations.
- **Leveraging local presence and knowledge.** Nuances in consumer behavior, cultural norms, and business practices affect how startups operate. As a result, it's critically important for founders to live where their businesses are based and to truly understand the environment.

Funds have responded similarly to startups in terms of investing in solutions to big problems and prioritizing local presence and knowledge. They have also focused on risk assessment and mitigation, as well as strategic decision-making.

- **Solving big problems through investing in solutions.** Many investors see massive, profitable opportunities in creating the backbones of African economies, which means investing in building blocks such as human capital, financial services, infrastructure, and real assets. Technology can be used to reach customers more cheaply and easily by defragmenting and organizing markets, reducing customer acquisition and distribution costs, and increasing efficiency. In other words, delivering products and services that fix market failures in largely uncontested markets can be a lucrative opportunity.
- **Prioritizing local presence and knowledge.** Generally speaking, VC is a local business where investors fund startups in relatively close proximity because they want to understand the problems and markets involved. In Africa, the need for such understanding is more acute given the challenging conditions and fragmented markets. As a result, fund managers

acknowledge the benefits of having an on-the-ground presence and context familiarity.

- **Assessing and mitigating risk.** Given the lack of data on startups, consumers, and markets, investors try to assess and mitigate risk by tracking multiple types of risk, using the due diligence process to understand founders, and charging premiums to compensate for the risk they assume.
- **Making strategic investment decisions.** To navigate tough terrain, investors seek to make strategic investing decisions that improve outcomes, such as investing in companies after product-market fit has been achieved, investing primarily in business-to-business (B2B) companies, re-investing in companies that are performing well, and diversifying their portfolios geographically as well as by sector, stage, and age of investment.

WHY PEOPLE, EXECUTION, AND ALIGNMENT MATTER

While the first part of this report outlines characteristics of early stage investing in Africa that are distinct from those that define Silicon Valley VC, a number of other factors that aren't explicitly Africa-specific also affect startups. These factors include how founders, teams, and investors behave, create relationships with one another, execute and measure performance, and contribute to success (or failure), irrespective of where the founders and investors are operating.

Founder, Team, and Investor Characteristics

Although founders drive company success, the “ideal entrepreneur” archetype is nuanced. Investors seek founders who can execute and who are passionate, committed, and highly intelligent. These founders possess unique insight into the problems they're solving, communicate transparently, and are deeply experienced.

Strong founders must also be supported by a strong team. Funds invest in visionary CEOs as well as their ability to attract other talented people who co-own the execution of that vision. Good teams are analytical, determining how and when to take action as well as what worked, what didn't, and how to create value going forward. Despite the importance of strong teams, however, it can be very difficult to hire, cultivate, and retain top talent.

Investors also have an impact; founders appreciate investors who have built businesses, understand markets, and adapt well to the inevitable shifts in a startup's trajectory. They also seek investors who will lead investments, provide good advice, actively support their business, or remain supportive yet passive. Ultimately, founders prefer investors who prioritize their interests as well as their own.

Execution, Relationships, Communication, and Alignment

The challenging market conditions in Africa make superior execution indispensable. In fact, execution quality can distinguish teams with comparable resources, separate novice teams from mature ones, and transform mediocre ideas into successful businesses. For founders and investors alike, execution is about translating strategy into actions that produce results for the company. It involves determining what steps are required to achieve a goal, using data to determine what is or isn't working, learning from failure, and using insights to change the business model or strategy. To assess the quality of their execution, companies use a variety of key metrics. However, unit economics are often emphasized, because strong unit econom-



Despite the diversity of funding sources, the investor ecosystem remains immature, undifferentiated, and saturated, with investors not yet coalescing around specific niches.

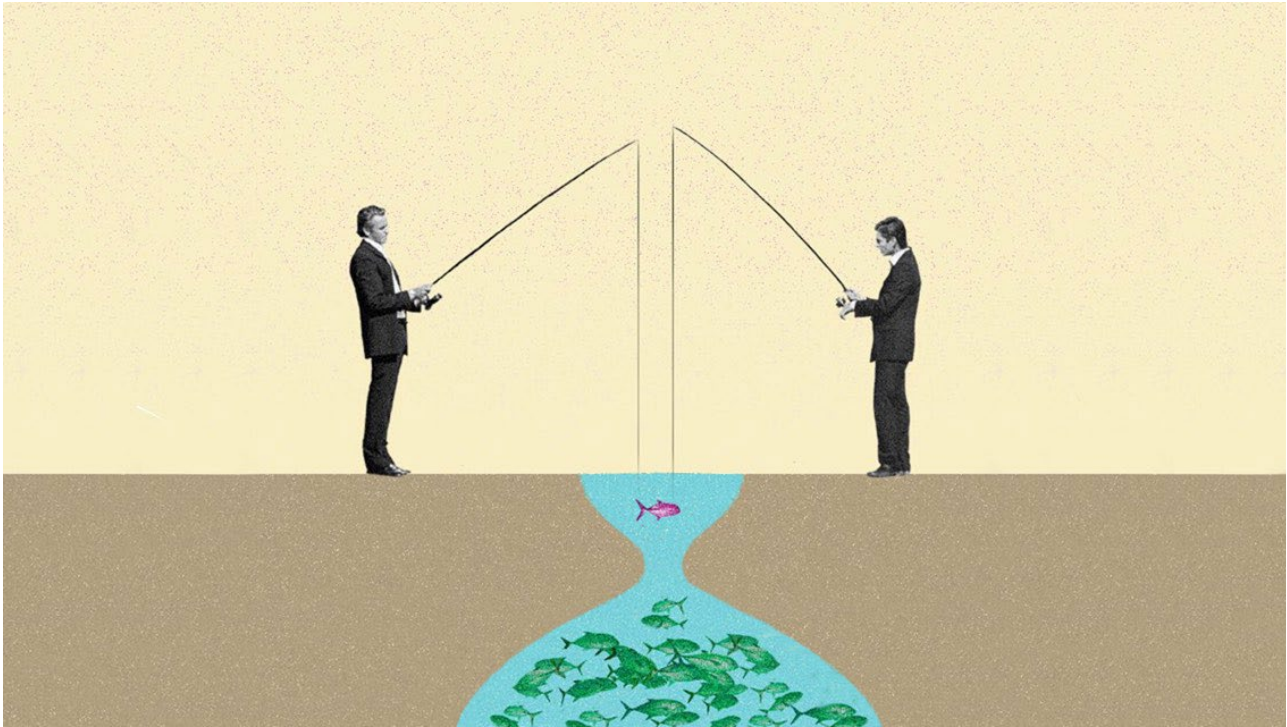
ics increase the margin for error, while poor unit economics are difficult to correct. As a result, many African companies prioritize profitability at earlier stages in their life cycles.

Again, although execution is a key driver of outcomes for African startups, the ways in which founders and investors interact is also critical. Founders and investors build healthy relationships by cultivating trust, openness, and transparency. Similarly, strong communication characterized by transparency and openness contributes to strong relationships. Notably, communication approaches often reflect founder and investor preferences as well as the needs and stages of the companies involved. Good communication and relationship building also create a foundation for alignment, or owning shared goals and processes. From an investors' perspective, alignment can be achieved by sharing goals and building relationships, and agreeing on deal structure and desired outcome expectations. Similarly, entrepreneurs try to achieve alignment by agreeing on goals and strategy, as well as through fostering good relationships and communication.

The Case for Context

Reflecting on the mismatches and adaptations identified earlier alongside the intensive people, relationship, and execution dynamics, one could erroneously conclude that the case for investing in Africa is tenuous and fraught with caveats. However, a more measured perspective is that significant, profitable opportunities exist despite, and arguably *because*, of the challenges previously highlighted, for three reasons:

1. **There are still large, unexploited markets to serve in Africa.** Despite conditions that seemingly limit the size of addressable markets, key indicators of robust consumer markets and enabling startup environments, including a growing, young, middle-class population; increasing mobile and smartphone penetration; high-tech adoption; and an increase in entrepreneurship activity, talent, and support structures are still valid. Additionally, the same challenging conditions that increase friction also reduce competition and increase the size of unserved populations.
2. **Many of these opportunities will be discovered through experimentation and exploited through stellar execution.** In many cases, large, profitable opportunities in Africa are more likely to be created by deploying well-understood business models in poorly understood markets, rather than relying on frontier technology and innovation. As well, many African startup ecosystems are at the stage of development in which companies whose models reflect deep market knowledge, and whose operators possess the muscle to execute them, will enjoy a larger opportunity space.
3. **African startups are building infrastructure to create new markets while digitizing analog use cases.** Leveraging technology to defragment big markets and serve consumers better sounds like a typical VC opportunity. In African markets, however,



For those who know how to go deeper, there are still large, unexploited opportunities within African markets.

companies are leveraging mobile infrastructure and nuanced local knowledge to digitize and organize analog markets.

In essence, the core message from this discussion is that African startup ecosystems should adopt norms, structures, and processes that reflect the realities of operating in Africa. As highlighted in the alignment discussion above, goals, priorities, expectations, and strategy all need to coincide to drive the desired outcome: cultivating African startups in a way that is rooted in, and respectful of, context.

Arguably, multiple points of leverage can stimulate change, including markets, ventures, funds, LPs, and startup ecosystems. Markets will evolve and startups will adapt out of necessity, which leaves funds and LPs as a potentially rich area of focus.

This research suggests that funds should consider adopting other structures and pursue focused investment strategies. General partners need flexible structures that better enable them to respond to market-level changes. Using alternative instruments and structures, such as debt or permanent capital vehicles (PCVs), is one approach. The open-ended time frame that characterizes PCVs is a notable benefit, allowing companies to fully realize their growth potential. Nonetheless, some would argue that time horizon and liquidity preferences are difficult to reconcile within PCVs. Limited partners want to see a return of capital within a defined period of time, usually 10–15 years within a typical fund structure.

Using focused investment approaches is another way to circumvent the challenges of African markets. As with alternative investment structures, there are a number of options for funds, including focusing on B2B investments, moving upmarket to invest in more mature companies, and cross-subsidizing a portfolio. A fundamental enabler of these and other shifts is the willingness of more LPs to reconsider their assumptions, norms, and preferences, however.

Time will tell which investing structures and operational variables matter most. What is clear now is the need to respect the context in which funds and startups operate and use it as a foundation to develop appropriate fund and company building norms.



Introduction



The pressure to find cash might motivate founders to select the first investor(s) willing to commit rather than those who represent the best values and strategy fit.

When we first embarked on this inquiry, we wanted to answer a high-priority question for any first-time fund manager: What factors drive outcomes for early-stage startups? We needed to understand what made deals and startups do well or badly.

To some extent, we have accomplished that goal. This report offers insight into the ways in which founder and team characteristics, as well as a path to execution, contribute to startup success.¹

Extolling the virtues of teams and execution is a response one might expect from any venture capitalist anywhere in the world. What may be less typical is an exploration of the structural components of African early-stage investing and how well (or poorly) core elements such as markets, venture business models, and funding models fit together to affect African startups.

In pursuing the former, we had hoped to clarify which specific variables—e.g., founder capabilities and startup expansion capacity—would have outsized effects. Instead, we identified structural mismatches between key assumptions within the Silicon Valley venture capital (VC) and African market realities and their implications for how African startups are created, funded, and perform.

Since the first wave of innovation-driven enterprises began on the continent 15-odd years ago, we have seen massive improvements along the vectors that are easy to quantify: more tech hubs, more developers, more companies growing larger and raising more money, etc. However, today's reality requires a deeper/more structural look, and thus this research effort is best viewed as a “check-in” on the development of the ecosystem: a critical perspective to provide clarity on where we are and a map to help entrepreneurs, investors, and others navigate this operating environment.

This report is divided into three parts. Part I describes the Silicon Valley model, key mismatches with African markets, and how startups and funds respond to these mismatches, as well as return expectations. Part II describes key variables that affect not only African startups, but likely most startups in most places. This part explores founder, team, and investor characteristics; approaches to execution and performance measurement; and alignment between founders and investors.

Finally, Part III offers our perspective on the implications of these findings, and suggestions on finding the way forward.

Part I: Why Silicon Valley VC is a bad fit for Africa

KEY CHARACTERISTICS OF THE SILICON VALLEY–STYLE INVESTING MODEL

To properly examine the disconnect between African market realities and Silicon Valley–style investing, it’s important to begin with a brief summary of the model’s core assumptions. Venture capital is a strategic input that enables companies with unproven business models to scale rapidly and exponentially beyond the confines of organic growth so that they can achieve outsized returns with a comparably outsized risk of failure. The four core assumptions that emerged from our conversations with investors and founders are:

1. **A startup is a venture that can achieve high variable growth with low fixed inputs.** A VC-backed startup’s capacity for exponential growth is what motivates investors’ risk tolerance. Rapid growth signals the opportunity size and, as a company grows, its margins increase and costs to deploy products and services decrease. A startup can achieve zero marginal costs through the use of technology, readily accessible infrastructure, and low asset ownership. As a result, investors and founders emphasize growing rapidly, rather than achieving profitability. Venture capital stimulates this growth in the pursuit of the market-capturing, semi-monopolistic conditions that yield massive returns.
2. **The consumer markets that VC–funded startups seek to capture are broad, deep, and composed of digitally literate consumers with high purchasing power.** The US market comprises 331,000,000 people² with a per-capita GDP of \$24,342.³ Additionally, three-quarters of American adults have home broadband internet access.⁴ A large market of consumers with disposable income has enabled familiar growth stories. As a founder explained, “Amazon is successful in America because Americans have money to buy things. Nigerians don’t have that type of money to buy things.”
3. **Venture capital investing is a high-risk, high-reward approach in which a small number of exponentially successful “winners” compensate for a larger number of “losers.”** Within a prototypical portfolio of 10 companies, one or two are expected to become as or more valuable than the other nine that return value equal to the initial investment, or that lose money. In other words, investors must seek incredibly large returns (20-100x the initial investment), to cover these losses. A company that produces these types of returns and is valued at \$1 billion or more is called a “unicorn.”⁵
4. **Venture capital investing involves using increasingly large amounts of capital quickly to create the exponential increase in value that drives return expectations.** Investors select companies with VC–level return potential and provide capital across multiple rounds of fundraising that correspond with startups’ life cycles until they can exit their investments within the previously described range of returns. This risk/return dynamic is commonly called the “power law” of VC investing. Investors fund startups across multiple rounds of fundraising over



But it worked there. Why can't it work here?

many years so that they can dominate the market, as was the case with Facebook.⁶ This is made possible by a robust pool of venture and private equity capital from pre-revenue and seed to series D in the US, as well as robust secondary markets in which later-stage investors can purchase share ownership from earlier-stage investors.

Together, these four assumptions represent an approximation of what drives Silicon Valley-style VC investing. But do these same conditions apply to African venture formation and investing?

The next section tackles this query by detailing the mismatches that exist between Silicon Valley model orthodoxy and African realities. However, it is important to highlight why Africa-focused investors cannot simply “copy and paste” Silicon Valley investing models and apply them to African contexts.

First, VC is appropriate for a very small number of companies, anywhere in the world, for the reasons described above. According to CB insights, there are just under 500 unicorns globally,⁷ which calls into question whether their pursuit should fuel an entire industry in Africa or elsewhere.⁸ As well, the high-profile failures of companies such as WeWork have increased the level of skepticism surrounding hypergrowth companies.⁹ Although it is common for startups to lose money as they develop products and seek customers, the trough of loss is deeper for unicorns because they tend to spend large amounts of capital to fuel growth and subsidize their cost of service.¹⁰ Ideally, revenue growth accelerates enough for the company to become profitable. If it doesn't, a company could be forced to raise more and more money to drive growth, until the company eventually collapses.¹¹

Venture capital also needs addressable markets that are massive, infrastructure-rich, prime for digital disruption, and have deep capital pools. In Africa, markets are potentially large but fragmented, contain limited infrastructure, are costly and time-consuming to digitally enable,



A core challenge of tackling a big problem in Africa is the many other big problems that startups have to address in order to solve the first one.

and lack sufficiently broad and deep pools of investment capital. In other words, it's difficult to apply cash-burning, "blitz-scaling"¹² models that pursue growth over profitability in this type of environment. Given VC's relatively short tenure in Africa, there is still much to learn, but as an investor explains it, the incongruity is stark:

I don't think the venture model will work in Africa because we're never going to grow big enough or fast enough. We're not like the US, where you can sell a lip gloss to 300 million people every month and make a billion dollars. So, if a typical venture model is one out of 10 wins, that one covers the losses plus all your instrumental gains. If you're never going to win that big, you might have to be a little less risk tolerant and maybe aim for three or four.

AFRICAN MARKETS DON'T MATCH VC EXPECTATIONS

To fully explore the mismatches that exist between Silicon Valley investing conditions and African market realities, this section will cover market characteristics, capital availability, deal flow volume, fund structures, return expectations, and return performance.

African market characteristics

There is a disconnect between startup ambitions and market realities. The 10- or 20-year-old African VC thesis predicated on a growing, young, tech-savvy, middle class has yet to be proven, notes one investor:

Earlier this year I was in the AVCA [African Private Equity and Venture Capital Association] meeting and one investor asked, "what thesis should we have for Africa, given everything that has happened?" You know the thesis: Africa has a huge population, young demography, rising middle class, etc. It's the same thesis that was there over ten years ago. Have we unlocked any of them? No. So we know this is going to happen, but we have not unlocked whatever potential everyone has been talking about, over 10 years or 20 years ago, so why are we just fooling ourselves? Let us build to survive. When we get to the point where we are okay, then we will build for returns or for scale.

As described by this investor, a fundamental premise underlying the argument for venture-backed opportunities in Africa is the growth of its middle class, as a proxy for large consumer markets. This segment is smaller, however, and holds less purchasing power than assumed. In a 2018 report, the Brookings Institute projected that more than half of African households would have discretionary income by 2020 and noted that consumer expenditure had grown by a compound annual rate of 3.9% between 2015 and 2019.¹³ Despite this, household spending trails incomes.¹⁴ Additionally, BMI Research's dependency index shows that having dependents reduces economic power for African middle-class consumers. For example, the average Nigerian consumer might be responsible for up to eight people.¹⁵

Along with having limited purchasing power, African consumers are utility- and price-



African startups may suffer from diseconomies of scale, whereby unit economics worsen as the companies grow.

sensitive. They primarily spend their limited incomes on products or services that add value (i.e., “painkillers”). Yet African consumers may still not pay for a service with a seemingly obvious value, such as a solar home system, if the value proposition isn’t compelling. Consumers also make purchasing decisions based on prioritizing cost over loyalty and ease of purchase (where making change isn’t required). As a result, startups’ products have to be affordable and accessible, despite limited access to consumer finance.

African consumers are also expensive to acquire (so there are high consumer acquisition costs) and difficult to retain, as indicated by the low lifetime value of the customer. These consumers are also difficult and costly to reach for a number of reasons, but a lack of access to far-reaching digitally enabled distribution networks¹⁶ figures prominently.

What contributes to this situation? First, consumers are rarely amenable to fully digital distribution methods, preferring “tech touch” approaches that create trust by embedding human interaction.¹⁷ For example, African e-commerce businesses were initially challenged to reconcile African human interaction-heavy shopping norms with shopping cart-oriented Western practices, which were digitized and used as a template for e-commerce. As one investor explains:

People can’t run with tech. For example, for a telemedicine platform, in Western markets, access is at your fingertips. In African markets, you have to solve for trust. You don’t assume that the doctor has been vetted and is available; you have to solve for issues around how much data is needed to have this consultation. There are so many softer elements that people don’t think through. So, we really need to look at a tech-touch model. If you were to launch a telemedicine platform, how would you solve for that trust? What are the touchpoints with the doctor that people still want?

Second, startups may overestimate the degree to which their customers may be digitally literate, particularly if they live in rural areas. They may also fail to account for resistance caused by the level of risk these consumers assume when trying new products, especially when they have experienced past disappointments. However, some founders still expect technology adoption to increase as they educate consumers and deliver value-adding solutions digitally.

Finally, because of how difficult and expensive it is to reach consumer markets,¹⁸ multinational corporations such as telecom companies and banks are more likely to have the capital to invest in building large, mass market distribution networks than startups do.

More generally, African markets are fragmented, comprising many markets instead of just one. This makes it more difficult to expand outside home markets, a challenge that will be discussed later in this report. As well, the lack of infrastructure makes it more expensive than expected to build African startups because of the costs associated with building distribution networks and supply chains. As a founder lamented:

You think about this company, who raised 30 million dollars. They’re doing a

Concessionary capital is funding that can be deployed with lower return expectations, often in exchange for increased social or environmental impact. Grants and low-interest loans are types of concessionary capital. This type of funding can be used to subsidize the cost of offering a product or service that is expensive to deliver. For example, a startup delivering water and sanitation services might have high capital expenditures to build factories and waste-treatment plants as well as educate customers. Funding such a startup might mean supporting a loss-making business model until it's ready for VC.

Although some investors argue that it's possible to generate both impact and financial returns, trying to balance the two effectively can prove challenging. The case for collinearity (as this phenomenon is called) is that there can be alignment between a company's business model and its social impact, such that more business translates into more impact. This is true in a sense, but in certain cases, friction can occur between the incentives of impact-driven and purely commercial capital.

Consequently, founders and investors need to ensure that they share the same vision and strategy for the company so that the correct capital reaches the right business at the right stage. When a venture starts its journey with concessionary capital, the motivations and metrics prioritized by the impact-focused investors can clash with those of the more profit-oriented commercial investors that follow. As one investor notes:

Sidebar 01

THE ROLE OF CONCESSIONARY CAPITAL

Another aspect is alignment around impact. We are impact-first with a focus on social impact at the base of the economic pyramid. We want to create opportunity for people who are very low income. This company has a broad mass-market business model that has a customer base that we're focused on, but it also includes middle-income people. We actually have an impact team and we identify and track impact risks. For the company, as they grow and take on commercial-oriented capital, investors will be pushing for a focus on upmarket customers, which can lead to pressure on the impact front where our goals may be out of alignment with more commercial investors on that side where there might be problems.

Part of the conflict may be due to the lack of collaboration that can occur among grant providers, impact investors, and commercial investors. Prioritizing impact goals or financial performance can constrain a company's growth and performance, making it less attractive to commercial investors. Blending capital or injecting different types of capital into the same deal while matching their incentives, time horizons, and return expectations, could help more companies transition successfully.



While concessionary capital can be instrumental, it can also cause create tension with commercial capital.

multiple country expansion that's been really good. That would be a \$150 million raise easy in the US or Europe for the same expansion in the market. You can't solve continent-wide problems with country-level money. You need continent-level money. We need companies that do continent-wide scale.

For example, e-commerce giant Amazon benefits from a public postal service in the US and affordable internet access, both of which are largely absent in Africa. As a result, African startups may suffer from diseconomies of scale, whereby unit economics worsen as the companies grow due to increasing infrastructure costs. An investor describes this dynamic:

I am talking about a situation where our lack of infrastructure, our infrastructure deficit, the failure of leadership over the last 50 years since independence, has created a situation where we don't have an environment that allows you to scale effectively. We have what I call a diseconomy of scale, so when we need to go from two outlets, or whatever your business is, to 10, your unit economics are worse, because you need to hire more people. You actually have worse unit economics as you scale because it has become so expensive to check all that stuff and because we just don't have the infrastructure in place.

Arguably, these same challenges make up the valuable, scalable opportunities in sectors such as logistics and payments that companies such as Kobo360 and Paystack are cultivating.

Return expectations and performance

What constitutes achievable returns represents another clear mismatch between the VC model and African market realities. Venture capital requires exponential returns that are hard to generate in Africa due to market dynamics that are expensive and difficult to navigate. Arguably, the VC model doesn't fully account for these realities, given that it requires big returns in a short amount of time and is expensive to operate due to personnel and deal structuring costs. For example, a fund that has earned 3x returns in local currency might see those returns dwindle to 1x as a result of currency devaluation. As a result, African investors and founders are likely to require profitability from their companies sooner.

Even so, African VCs seek strong growth, and founders who are fundraising are advised to grow consistently. As well, although returns may be more conservative than what is desirable for VC, they can still be compelling. For example, fund portfolios may consist of a few smaller wins rather than one or two outsized ones. (Additional insight can be found in the "Return expectations and time horizons" section of this report.)

Capital scarcity

To say that capital is scarce in Africa is an oversimplification. Although it's true that the pool of available capital is too shallow to fund hypergrowth companies, this scarcity has multiple dimensions: market depth, fund size and capacity, the availability of local funds and working capital, and the influence of networks. A fundamental assumption established earlier is that very large amounts of capital are required to build infrastructure and scale businesses that achieve diminishing marginal costs and exponential returns. For example, Konga has raised US\$79.5 million,¹⁹ while Jumia has raised \$824 million.²⁰ As well, generous amounts of funding are needed to navigate unexpected events that are more common in Africa, such as bank closures or regulation changes.



Many investors see massive, profitable opportunities in creating the backbones of African economies.

These market-exogenous factors can not only increase a startup's capital requirements, but also the time required to scale. Consequently, a blitz-scaling approach without sufficient capital can lead to a company's insolvency and death—in other words, founders can't build unicorns with too little funding. Even if unicorns are possible in Africa, as the progress of companies such as Interswitch suggests,²¹ capital scarcity renders a “growth at all costs” approach infeasible. As a result, African companies are more concerned about profitability earlier than are other companies. Ironically, this aggressive growth dynamic is a concern in Silicon Valley as well. Venture capitalists there are also starting to note the risks associated with this approach, and how it can damage companies.²²

With this foundation, we can explore the multiple dimensions of capital scarcity:

- **Market depth.** Compared with the US and Europe, Africa's capital markets are small and shallow, which makes it difficult to finance heavily loss-making businesses. Secondary markets are underdeveloped and there is no continuous pipeline of capital from pre-seed to series E. In some markets, however, there are several different types of investors with different priorities and returns expectations. Unfortunately, despite the diversity of funding sources, the investor ecosystem remains immature, undifferentiated, and saturated, with investors not yet coalescing around specific niches. Despite this, some funding gaps are viewed as more acute. There is a dearth of funding for companies in the “missing middle” with a goal to raise \$75,000 to \$2 million, for example, and many will argue that seed and/or pre-revenue capital between \$50,000 and \$100,000 is also lacking.²³ In contrast, private equity funds such as Carlye, KKR, and TPG raised \$18.7 billion between 2014 and 2019.²⁴
- **Fund capacity.** Few Africa-focused funds have enough capital to properly finance consumer-facing businesses. Given the cost and difficulty of acquiring and retaining customers, funds need tens of millions of dollars to fund these businesses. As a result, small funds might struggle to do follow-on investments in well-performing businesses, constraining their capacity to optimize returns. In other words, funds that can't reinvest in performing companies will have their ownership stakes diluted as additional capital enters. Some funds have responded by attempting to raise funds to support series A and B investments in such companies.
- **Local capital.** As many have lamented, the pool of active local investors in Africa is small. Many investors remain uncomfortable with the dynamics of investing in technology businesses, preferring to invest in primary economic activity such as oil and land. In many other countries, high-net-worth individuals fund startups, but this is not the standard in Africa yet. However, although more than half the countries in Africa lack angel networks,²⁵ new groups are emerging. Attitudes have also begun to change and should continue to do so as exits increase and success stories proliferate.
- **Capital via networks.** The fundraising privilege enjoyed by white, expatriate founders has been the source of much conversation, as evidenced by research from *The Guardian*, Viktoria

Ventures, and Village Capital, indicating that venture capital goes predominantly to white founders.²⁶ Well-networked expatriate founders with elite credentials seem to find funds more easily than local founders with limited networks:

What you see in Europe and the US, you have friends and family and a lot of angels, and sometimes the government assists in funding early initiatives. Those channels are less accessible in sub-Saharan Africa. If you are an expat, you might have friends and family money. Or, you could access angels from Europe and the US. If you're a local founder, I think it's really tough to find that kind of early-stage money, which makes it a bit difficult to just make it through the idea stage where you develop the first prototype or first iteration of your service and go out and try to build a small team.

- **Working capital.** As with local capital, working, debt, and emergency capital can all be difficult to find. Accessing these types of capital is important, given how expensive equity is. To address this challenge, one fund leverages its equity investment to open lines of credit for its companies so that they don't use equity to finance operating expenses.

Because capital scarcity is a multi-dimensional challenge, it has a variety of effects on founders' ability to raise money and partner with well-matched investors, navigate relationships with them, and plan for future capital requirements. Most importantly, a lack of capital makes it difficult for founders, even the best ones, to raise money for their startups. The pressure to find cash might motivate founders to select the first investor(s) willing to commit rather than someone who represents the best values and strategy fit.

Similarly, founders may make short-term pragmatic decisions to sustain their businesses, which could have negative effects later. For example, a founder may opt to partner with an investor who conducts less stringent diligence, take on a large number of individual investors, or choose an accessible but ill-fitting structure for the company, such as one designed for small businesses.

The power asymmetry between founders and investors may also cause investors to take founders' time for granted by, for example, changing or adding to due diligence information requests or conducting a slow-moving diligence process.

Despite these challenges, founders and investors can combat capital scarcity by planning ahead. It's important to begin the capital planning process in advance of funding needs and beyond the current round of fundraising. By identifying capital requirements, the milestones needed to unlock more capital, and the pool of investor prospects, founders have a better chance of securing funds. Investors can work with founders to map a capital pipeline and build relationships with follow-on investors because they need to attract more capital to build the company while preserving the ownership levels required to secure profitable exits.

Deal flow scarcity

Deal flow isn't necessarily a function of capital scarcity, although it's reasonable to expect that less capital will result in fewer deals. Deal scarcity seems to be a common challenge in African VC, however.²⁷ While not solely responsible, returns expectations, sector focus, and investor crowding can contribute to deal scarcity. Although opportunities are abundant in Africa, fundamental market conditions render VC-level returns difficult to achieve.

As previously noted, the difficulty and expense associated with acquiring customers, their

limited purchasing power, and infrastructure building costs constrain value creation. Consequently, some fund managers may reject larger limited partner (LP) injections due to the lack of investable startups available to absorb the extra capital. As well, there may be too few investable deals to support sector-focused theses. Investors' ability to identify investments is partially dependent on having a sufficiently large pool of prospects; having a sector focus reduces the volume of leads. Some funds focus on opportunities that exist at the intersection of different sectors, however, such as agriculture and technology.

Finally, because investable deals are scarce, investors tend to crowd into winning deals with investors with whom they have built relationships. As noted above, funds may have an abundance of capital with too few startups in which to invest. To address this challenge, investors may eschew their theses to enter existing deals, rather than sourcing their own. Unfortunately, when early-stage deals are underfunded, startups are less likely to survive to complete subsequent fundraising rounds, which further exacerbates the deal scarcity.

Fund structures

Ideally, fund structures should fit the needs of the entrepreneurs, general partners (GPs), LPs, and the markets they are built to support. Even Silicon Valley VC was invented to enable investing in early-stage American companies.²⁸ Nonetheless, very few businesses are truly venture businesses—in Africa or anywhere else. African ventures can generate attractive returns, but they may take a long time to do so because of the challenging market characteristics described above. These conditions require adaptation not only from startups, but from the funds that finance them. In other words, GPs may need the flexibility to change fund structures to respond to market realities.

Unfortunately, GPs are unlikely to secure investment from LPs if they don't use the preferred vehicle, primarily the LP/GP structure. This preference is at least partially a function of pre-existing norms and switching costs. For example, there are funds that experiment with permanent capital vehicles, or investment entities created for managing capital with an unlimited time horizon.²⁹ These remain in the minority, however. Perhaps more importantly, LPs may confront internal bureaucratic constraints as well as resistance to an option that seems less accessible. As one fund manager explains, choosing a permanent capital vehicle reduced the amount of money the team was able to raise:

We said, let's do a permanent capital vehicle. But I think we underestimated the LP resistance to differentiated structures, i.e., the DFIs [development finance institutions] hated it and wouldn't fund it. And so we raised less money than we would have and, at some point, we stopped fundraising because unless we were willing to really make fundamental changes to structure, there wasn't going to be a fund to write. Anytime you do something different, it distracts from the normal processes. In some cases, the new structure has too many cons that may not outweigh the pros in their estimation. So, if it gets complicated, if the LP's eyes glaze over, or I need to pull out a calculator to explain the hypothetical profits, I've lost them.

Limited partners are sometimes also constrained by the amount of capital they can deploy. For example, some of the DFIs that invest in many African funds need to deploy a minimum amount, such as \$10–20 million, which in turn incentivizes the funds to invest larger amounts of money in later-stage companies that have the capacity to absorb it. Is the African environment different enough to require structures that reflect its uniqueness? It probably is. But until you have LPs funding it, you have a practical choice: You



VC is like a sports car - it requires smooth roads, good weather, and a pit crew. However, if most of the local terrain requires off-roading, why do we still spend all our time talking about pit crew efficiency?

can either be right and have less money, or you can raise funds and make it work. And the reality is that people don't necessarily make it work, but that's what you have to do.

If this is true, first-time fund managers may be less likely to propose novel structures; the GP will do better by pitching a thesis that the LP will buy. However, an LP might take a risk on an innovative fund vehicle if it is pitched by an experienced investor who has delivered VC-level returns and who presents a compelling business case for the structure's use. According to one LP:

It's very, very hard to raise a fund no matter what the strength of the team; it takes a lot of time, and it costs a lot of money. And if you add to that the fact that you would love to innovate on the fund structure and terms or actually do something even more innovative, it's a big additional challenge that most GPs maybe are not well equipped or funded to do. You need to be really, really good, have a very strong team, maybe have an anchor investor that believes in you, and then you have a chance, but that diminishes the chances that we're ever going to see an innovative structure.

From this perspective, LPs may be more receptive to novel structures than is assumed—fund structure selection is technically a negotiation between GPs and LPs. Given the risk, however, potential GPs may not opt to propose such structures, even if some DFI LPs consider them:

So, it's maybe the chicken and the egg, because the DFIs would like to have other models but when these models come, they don't get funded. There's very little innovation; everyone is coming up with the GP/LP fee structures, that is, 10-year term life, plus two times one-year extension, 80% hurdle and 20% carry share, and so on.

Limited partners play pivotal roles in early-stage investing ecosystems because they invest in the funds that invest in startups. There are many different types of LPs, including pension funds, family offices, private-impact organizations, and public-impact organizations. Development finance institutions, which fund the majority of African funds, belong to the last category.³⁰

Development finance institutions usually have broad, development-oriented mandates, which sometimes include a specific focus on supporting funds. Within a general social and economic development agenda, DFIs focus on specific areas or problems in Africa, such as creating jobs; increasing access to goods and services in education, health, energy, and finance; and fixing market failures such as the provision of investment capital. They typically deploy different types of funding, including debt, risk-sharing capital, capital for funds, and direct equity such as venture capital and growth equity. They represent the first stage of the capital deployment pipeline, so any constraints or restrictions on their ability to capitalize funds will adversely affect GPs seeking to raise money.

Whether they are supporting funds or directly investing in startups, DFIs seek profitable opportunities. However, they may opt out of investments that are not returns-optimized in an effort to strike a balance between profit and impact. For example, with direct investments, some DFIs will forego opportunities, to avoid “crowding out” other investors. In other cases, they will invest so that needed services are provided to underserved customers, such as the provision of working capital to smallholder farmers.

Similarly, some DFIs support first-time fund managers, but their appetite for accepting such risk varies. When they do, it’s likely aligned with their mandate and/or facilitated by a pool of capital earmarked for higher-risk investments. Nonetheless, the due diligence process can be rigorous. Limited partners try to establish trust in the fund management team by assessing its strategy (as well as its fit to their own), the team’s skills, their investing track records individually and as a team, the proposed pipeline of investments, and the interest of their fellow LPs. Ideally, this assessment process should take 3 to 6 months for a single LP, although the fund manager will probably need 18 to 24 months to raise the full fund. However, sometimes a fund is very slow to close, or doesn’t close at all. When this happens, DFIs suggest the following possible contributing factors:

- **Use of a non-standard fund structure.** As noted in the previous section, raising a fund

Sidebar 02

DEVELOPMENT FINANCE INSTITUTIONS AND CAPITAL SCARCITY

is a difficult, expensive, and time-consuming task for most GPs, and introducing complexity can make the task even harder. For example, proposing a non-standard structure such as a permanent capital vehicle may weaken a GP’s case for support. This holds true even if the structure is a better fit for the fund and its portfolio startups.

- **Too few anchor LPs.** Even if a “lead” anchor—an investor who inspires the confidence of other investors and creates momentum—is on board, a fund often needs multiple anchors in order to close. For example, a fund may struggle to attract other investors if it has a low “first close,” which is the first tranche of capital invested into the fund and which represents a percentage of the total. Typically, a higher first-close percentage signals to other investors that the fund is likely to close.
- **Limited investing track record.** A first-time GP may lack a robust track record of investment. However, LPs will consider the individual track record of each team member in terms of deal closes and exits as well as how long the team has worked together and what they have achieved as investing partners.
- **Opportunistic strategy change.** General partners seek LPs that match their goals and strategy (and vice versa). However, LPs have so many different priorities that it may be hard to create a thesis that accommodates this diversity. If GPs opt to change their strategies, they may inadvertently reduce their chances of finding a genuine fit.
- **Team competence.** If an LP doubts a team’s skills, experience, or ability to return capital, that team will struggle to secure the LPs investment. Similarly, a team that is poor at fundraising will also struggle.

Inasmuch as some DFIs have a mandate to support African venture capital, there are clearly conditions under which funding GPs, particularly first-time fund managers, is challenging.

There is very little innovation on the part of the GPs, and some GPs will lished player that has already proven that they can deliver returns so that the VC and the DFIs take a bet on them. Don't know which one's going to come first, but it will not come by itself

HOW STARTUPS NAVIGATE MISMATCHES

This section focuses on how startups operate in light of the mismatches that exist between the Silicon Valley VC model and African market realities. Founders tackle large, foundational problems; build missing infrastructure; serve mass markets; and leverage local presence and knowledge.

Building businesses to solve big problems and create big impact

African businesses must solve real problems: it's a common refrain among founders, investors, and ecosystem builders. There is little patience for convenience-based innovations serving rich people's problems, such as the much-maligned Juicero's attempt to automate home juicing.³¹ As a result, Africa-focused founders often try to solve large, foundational problems that could improve the lives of countless people. In many cases, this means that they are motivated to stimulate economic development, but also to use technology to increase value creation for agricultural producers, improve education, and create access to finance, health services, and jobs. As one founder aptly described it:

In a diverse continent like Africa, you're looking for large, foundational problems in the areas of education, finance, and healthcare—foundational substrate problems. I was looking for a business with good characteristics to leverage code or media to solve a large problem for a number of people, which means better gross margins.

At their core, African startups build businesses to stimulate change, serve people, and make money.

Building infrastructure and fixing supply chains

Unfortunately, a core challenge of tackling a big problem in Africa is the many other big problems that startups have to address in order to solve the first one. To deliver a product or service, a venture often has to first build the infrastructure or fix the supply chains required to do so.³² This is why diseconomies of scale exist: companies have to absorb more infrastructure costs as they grow. For example, a home internet provider will have to build towers very cheaply in order to have a chance at amortizing costs. In many cases, these startups can't find partners who can provide high-quality inputs, so they supply those inputs themselves.

A company may also set out to fix one element of a supply chain, such as replenishing inventory for small retailers, only to realize that they also have to build the order fulfillment and delivery infrastructure. Perhaps obviously, this logistics infrastructure enables the distribution of products to customers, which can be a significant challenge for many companies..

In fact, as the activities of companies such as Sendy and Flutterwave suggest, many of the most valuable opportunities are in building infrastructure that enables business to be done. However, the costs of doing so are high, not only in terms of CAPEX (capital expenditures) and OPEX (operating expenses), but also in terms of what is called "first-mover disadvantage." Similar to the logic underlying diseconomies of scale, first-mover disadvantage accrues when sector pioneers

invest in building or fixing infrastructure, educating consumers, and influencing policy. As one investor shared when describing the market building process:

I think some really simple language is what I personally like to call first mover disadvantage...because the companies that start out have to build so much of the ecosystem around them, which later-stage players can then take advantage of.

For example, the first solar home system company M-Kopa had to educate all their customers on how to use mobile money, sometimes having to hire or recruit agents or recruit on behalf of the mobile network operator. And then the next companies that come in, they benefit from that infrastructure or that behavior change or those that have been done. Often, it's payments, it's financial inclusion, it's behavior change, it's agreements with government, it's recognition on the policy side that your business model is viable and should be included in that country's strategic thinking.

Consequently, African startups may resemble traditional small and medium-sized enterprises (SMEs) that leverage technology, rather than typical asset-light, software-driven ventures.

Targeting mass markets

Typically, billion-dollar companies (or unicorns) are business-to-consumer (B2C) businesses. The startup uses venture capital to fuel the exponential growth and performance that derives from huge markets that contain consumers with healthy purchasing power. As we have reiterated, potentially large but fragmented markets, low-income and difficult-to-reach consumers, and hefty infrastructure costs all constrain returns.

Yet serving the majority of African consumers represents a massive opportunity under certain conditions. Although these consumers have limited purchasing power, they are numerous. Consequently, startups can build robust businesses that are based on high volumes, small margins, and lean operations. In a business such as internet provision, where the volume of consumption drives the business model, a company has to attract enough customers to pay for the infrastructure, minimize CAPEX and OPEX to match low prices, and raise enough capital to acquire customers and build the network. However, as noted earlier, consumers prefer tech touch to fully digital products and services. To reach these customers, startups must test their readiness to adopt technical solutions and conduct digital transactions.

One founder, for example, described the process of testing customers' ability to make online purchases:

What I didn't know necessarily is whether people are going to use e-commerce to order their products. I mean, does it work for high- and middle-income folks but not for low-income people? And so those were the things I was testing. The first thing we tested it with was the website, just to see people's reaction to it, since e-commerce is much more recent here than in any other parts of the world. So we learned through that. It was really about the user: Would people use it? Would people pay for these products over this channel?

Notably, the COVID-19 pandemic seems to have accelerated technology adoption, as evidenced by increases in cashless payments and online shopping. It remains to be seen,

however, if these changes in consumer behavior will be permanent.³³

If customers adopt the solution (and are willing to pay for it), then startups can begin to focus on growth and scale. But what happens when customers can't or won't pay? In some cases, companies are forced to pivot from B2C models to business-to-business (B2B) models in order to survive. Despite the challenges of cultivating business relationships and the length of sales cycles, serving business customers has advantages. As a founder who pivoted from B2C to B2B described it:

It became apparent within six months or so after we'd gotten that initial money, that the clients weren't coming knocking nearly as much as we anticipated. The decision of exploring other avenues was driven by the necessity of the initial business expectations not going anywhere close to planned.

Perhaps obviously, business customers have the ability to pay, potentially leading to quicker revenue generation.

Leveraging local presence and knowledge

Beyond simplifying generalizations about African market characteristics, nuances in consumer behavior, cultural norms, and business practices can also affect how startups operate. This is why it's important for founders to live where their businesses are based and to truly understand the environment. Being locally present and knowledgeable is even more important for expats and returning members of the diaspora. Expat founders, particularly if their in-country tenure has been brief, will have to invest in learning markets, and may eventually decide to return to their home countries. Diasporan founders have "returned home," but they may also confront a learning curve when it comes to market knowledge.

For example, one founder was temporarily based in Europe to raise money, while the rest of the leadership team was on the continent. Although the company faced overwhelming external conditions, the founder's time away also contributed to their difficulties.

Similarly, an investor recounted how a founder tried to run a business in Ghana from Nigeria, traveling back and forth before the fund intervened. Despite the advantages of local-embeddedness, some East Africa-focused investors lamented the lack of funding directed toward local founders. They acknowledged the disadvantages that local founders suffer due to lack of access to networks and knowledge of how to present a company to investors and prepare for the diligence process. These investors also recognized the impact of building the capacity of local teams and seeding future generations of experienced founders.

HOW FUNDS NAVIGATE MISMATCHES

This section focuses on funds and how they opt to solve big problems, be locally based and knowledgeable, mitigate risk, and invest strategically.

Investing in businesses to solve big problems and create big impact

Like Africa-focused startups, Africa-focused funds aim to solve large, fundamental problems. Many investors see massive, profitable opportunities in creating the backbones of African economies through investing in building blocks such as human capital, financial services,

infrastructure (e.g., power and roads), and real assets, such as real estate and manufacturing. This investment also involves using technology to make it cheaper and easier to reach customers by defragmenting and organizing markets, reducing customer acquisition and distribution costs, and increasing efficiency.

By fixing supply chains in, for example, health, education, and logistics, tech-enabled startups reduce friction and create the infrastructure for the digital economy. By doing this, these companies pave the way for inclusive economic growth that melds profit and impact, creates jobs, and increases household wealth. Investors understand that delivering basic products and services that fix market failures in largely uncontested markets is a lucrative opportunity

Leveraging local presence and knowledge

Being locally based and knowledgeable about local markets is as important for funds as it is for startups. Fund managers acknowledge the benefits of having an on-the-ground presence and context familiarity. For example, one investor relocated temporarily to support a founder in another country. Another explained how intuition developed over time and how exposure to local conditions helps investors to interpret and reconcile unexpected changes. Not surprisingly, founders extoll the benefits of partnering with such investors, appreciating how they understand business models, operating conditions, and market dynamics. As one founder put it:

One of the lessons learned was that it's not even worth talking to people who haven't had an African experience. That could even be a safari 10 years ago to South Africa. Cool, we can talk. There has to be at least some type of context that matters. Otherwise, it's a waste of time.

Foreign founders and investors also acknowledge the problems that emerge when investors are based outside of Africa and don't understand African markets. Fundamentally, VC is a local business where investors fund startups in relatively close proximity because they want to understand the problems and markets involved. In Africa, the need for such understanding is more acute given the challenging conditions and fragmented markets.

In such environments, ignorance is costly. For example, "helicopter" investors may make inaccurate business model assumptions, such as how easy it is to convert "freemium" models into paid ones. They may also miss nuances in customer behavior that can lead to poor service delivery. For example, one investor described how a service failed her security guard:

I had another company that did delivery of products and was supposed to be supporting low-income people. But my security guard waited at the bus stop for three hours; he was waiting for the driver to deliver a product that he could have purchased sitting adjacent to the bus stop. It's easy to think that delivery is good. Nuances of customer behavior and user experience are infinite, though, so it's really hard to get that type of intel.

Ultimately, this lack of knowledge can result in missed opportunities for local founders and investors. According to an expat founder, many investors in Africa don't understand African markets and culture. These investors harbor a bias that enables them to bypass local founders who can execute in favor of expat founders with elite degrees who present themselves well:

The ability to expand geographically is an important success strategy in terms of scale potential and risk diversification. Given the fragmented nature of African markets, there are few individual countries and/or sectors, such as financial technology (“fintech”) in Nigeria, which will enable a big business to scale. As a result, companies often need to expand outside of their home markets to grow.

How they scale is a function of the strategy, business needs, available resources, and product and market characteristics, however. For example, a company may expand by deepening its reach within a single country or expand to other countries within Africa or internationally. Some companies, such as Paga and Lidya, are expanding globally into specific countries, while others, such as Lulalend, are going deep in a single market.

Resistance to regulatory changes and other external shocks is another benefit of operating in multiple countries. A company can weather a ban on its activity in one country if it operates in others. In the words of one founder, “even if something crazy happens here, like the government bans delivery trucks, we’d be fine because the company operates in three other markets.” Investors also seek the benefits of geographic diversification from a portfolio perspective, opting to spread exposure across multiple countries.

Again, because of fragmented markets with unique characteristics, deciding where and how to expand can be a complex decision-making process. To determine whether expanding makes sense, companies have to consider how deep their home markets are, how easy it is to expand, and what their customers gain from the expanded footprint. For example, truck drivers within a logistics company network may benefit when those companies enter new countries, but digital bank customers in Ghana may not benefit when the service moves to Nigeria.

Ventures also need to consider what operational leverage they have, because the regulatory landscape, competitive environment, marketing outlets, and distribution channels may be quite different in different countries. Fundamentally, expansion teams need to find a match between their core business, a market gap, and consumer characteristics that suggest an ability and willingness to pay for that gap to be filled.

An infectious disease diagnostics company described its decision-making processes:

We would go to countries where the cost of analog diagnostics is extremely high and there is a very clear value proposition. We can serve you on the cloud, same turnaround, 24 hours, at half the cost. So that is a very straightforward

Sidebar 03

HOW STARTUPS THINK ABOUT EXPANSION

value proposition when it comes to economics and cost. The other criteria which is also very straightforward is going to countries where there is a scarcity of clinics to start with and that is measured worldwide by the number of clinics per inhabitants. So, we immediately found, particularly in Africa, many countries where the ratio of clinics to inhabitants is way below international norms. When it comes to Africa, we added a layer of general political stability. It needs to be a country where we can do business in a straightforward way, no corruption, and have stability; and where we can sign contracts, receive our money, repatriation of any money that we generate in that country.

Companies can determine the size of the addressable market from the perspective of overall population size, urban density, income levels, smartphone penetration, internet access and affordability, cost and availability of substitutes, and the quality of the business environment, including regulatory conditions. Scaling can be difficult and expensive, however, especially for brick-and-mortar operations. From that perspective, it makes sense to partner with corporates and leverage their infrastructure to reduce customer acquisition costs and expand more aggressively. According to a founder who worked with a corporate to scale broadly:

We had a corporate partner. This company is our biggest client. We have a roadmap with them to deploy their solution in 40 countries. For us, it’s much simpler to rely on them for deployment; when we go into a country and launch, they cover all the costs and allow us to aggregate all the partners in the country. It’s like a pilot program with no risk.

It’s clear that there are still many unanswered questions about how best to expand in Africa. For example, in retrospect, an aggressive pan-African rollout, such as what Jumia pursued, could be considered capital-intensive, risky, and unsustainable. As one investor explained, the unit economics of a business like Jumia’s should be negative due to its infrastructure building costs. Notably, within a few months of its initial public offering (IPO), Jumia closed or downsized operations in four countries.³⁴

Examples like this make it clear that as African ventures continue to expand into other markets, important best practices and lessons learned will emerge.



Many of the opportunities in Africa are problems in need of a reframing.

Most of the investors are coming from the West, and increasingly from the East, and don't know the African markets well and don't know African culture well. They're used to receiving pitches from Harvard and Stanford graduates. You definitely have bias. You see again very strong entrepreneurs that figure out the execution part and don't do the best job at selling themselves.

Assessing and mitigating risk

Another factor that makes investing and operating in Africa challenging is the lack of data—on markets, consumers, and startups themselves. As an angel investor explained, “It's equally important whenever you're making investments to know who you're dealing with, especially in Africa where you don't have access to the same reliable data as in the US or in Europe.”

In light of that reality, investors assess many different types of risk, use the due diligence process to really get to know founders, and charge premiums to compensate for risk:

- **Categories of risk.** Investors assess risk related to markets, execution, and external dynamics such as macroeconomic, political, and country conditions; and currency. Market risk is a foundational concern that reflects how durable the market need is, as well as how vulnerable it is to external factors. It involves deeply understanding customers, business model defensibility, and competition. (For example, private, high-quality education will always be a need because of governments' inability to provide it and parents' willingness to pay for it.) Execution is also a significant factor, given how commonly investors cite it as key to startup success. Of course, savvy local investors leverage their market knowledge to assess risk properly and compensate themselves through deal terms. Macroeconomic, political, and currency risk, among other risks, represent external conditions that may significantly affect a startup.
- **Due diligence as risk mitigation.** As noted, it's critically important for investors to get to know founders well and invest the time to do so. Some investors take six months to a year (or more) to get to know founders thoroughly—by examining values, company culture, hiring practices, interpersonal dynamics, conflict management, family background, and reputation. Of course, the due diligence process is meant to help founders and investors get to know each other; it should be a two-way assessment. Although the burden may be on founders to “pitch” their companies, it's also an opportunity to seek understanding, test chemistry, and ask questions. After many calls, meetings, meals, financial model dissections and mutual reference checks, both founders and investors should know whether they have found the right partners. As a founder summarizes it:

Our lead investor spent six months getting to know us and our model; the questions they ask reveal as much about who they are as you do to them. Due diligence—that is, the getting-to-know-you process—brings a huge amount of understanding. Deals have broken apart not because we failed due diligence, but because you understand the people you're dealing with and have a point of view about whether it fits.

Some investors are more thorough and engaged than others, however, and thus require very little in terms of diligence.

- **Risk compensation and how it affects startups.** Another way that investors compensate for risk is by charging African startups comparatively higher premiums, offering lower valuations and higher interest rates (on convertible notes) for more ownership. The rationale is that although African markets may be less risky than prices suggest, a credible amount of risk related to uncertainty and external conditions remains. A founder describes how external factors affect costs, scalability, and risk:

There's the whole exogenous factor. Africa is not as risky as some markets will price it. But it's still damn risky. So many exogenous factors—we had locusts, too much rain, and droughts. So many exogenous factors that delay that exponential growth, which means that more capital is needed, so if your capital requirements with those types of business models is exponential because of the time to get to scale, your valuation won't catch up. I can't see, in the long term, that people coming in doing a VC play are going to make money; they're going to be beat on the time value of money.

Other variables may also contribute to negative risk perception and a desire to receive compensation. A lack of market familiarity (as discussed in the previous section) and a dearth of success stories may worsen risk perception.

Unfortunately, arguably self-interested decisions by investors may have serious consequences for founders. In some cases, investors may try to optimize return multiples while reducing time to delivery beyond what the market can bear. For example, investors can increase interest rates on debt or convertible notes in order to achieve desirable returns, while saddling startups with effective interest rates as high as 40%–50%. As described by a founder, investors may adjust terms to match their returns expectations.

They don't put as much money in because they think you should be able to do it for less. When they put the money in they take 20 or 25 instead of 15. Instead of taking 15% in Chicago, people will, for the same company, take 20 or 25% equity for their money instead.

In some cases, investors will try to retroactively worsen the terms of early investors by trying to buy their shares at a steep discount or reducing the valuation in order to increase their holdings and reduce their share price. In one instance, for example, an investor introduced non-negotiable operational milestones just before the deal closed.

Making strategic investment decisions

Alongside assessing and mitigating risk, investors seek to make strategic investing decisions that involve investing post-product/market fit, focusing on B2B companies, re-investing in strong performers, and diversifying their portfolios.

- **Investing post-product/market fit.** Many investors eliminate business model risk by investing in later-stage companies, post-revenue and –proof of concept, after product/market fit has been proven with recurring revenue. As one investor explains:

So we are what we call the scale-up stage. And that's important because we are



Founders value investors who have entrepreneurial experience.

already eliminating business model risk in some senses. We invest past the proof of concept once that's already been established; it has actually proven product/market fit through recurring revenue. Typically, you see at least a million in top-line revenue. So you can already tell by those numbers that we are eliminating a lot of the business model risk.

- **Focusing on B2B businesses.** Because consumers are difficult to aggregate, expensive to acquire, and have limited purchasing power, many investors focus on B2B businesses. According to some, these types of businesses are easier to scale than B2C businesses and are more capital efficient. The enterprise sales cycle is lengthy, however, and closing these sales requires distinct relationship-building skills. Although some businesses start as B2C companies based on assumptions about market capture, poor customer retention may stimulate a B2B pivot. In the words of an entrepreneur who built a B2C business and then pivoted to B2B:

B2B markets are easier; it's easier to find your clients and to speak to them. B2C markets require quite a significant marketing budget over a sustained period of time. And I don't know that one can realistically tackle them without a very long runway or significant venture capital. So the only way to get revenue to at least break even quicker might be in the B2B space because the market is easier to access. And I just don't think it's as well organized as the B2C market in more developed markets of the US and Europe, where if you have a great app, it'll go up in the app store and people will pull out the credit card and buy, or through Google ads. So it's easier to find and communicate to the customer. It's easier to collect money with your customer; and if you deal in physical goods, logistics and delivery options are smoother and cheaper there, too.

- **Reinvesting in strong performers.** For early-stage investors to achieve a sustainable business model, they need to invest in multiple fundraising rounds for winning companies and limit losses. Investors who seek billion-dollar companies must also deploy large amounts of capital over time. The goal is to invest the maximum allocation per company in a small number of potential unicorns and then reinvest to avoid dilution and optimize returns at exit. However, funds (whether or not they're hunting unicorns) need to have enough money to invest in multiple companies across multiple rounds.

Early-stage investors who lack capital may attempt to raise funds to enable follow-on investing, which helps founders by signaling viability to the investor market and shortening their search for new investors. Ideally, an early-stage fund may focus on seed round investments in response to the lack of institutional investors at that stage. If so, its strategy might be to maximize its per-company allocation for winners, follow on to series A, and exit one or two rounds later. Funds may also opt to invest earlier or later in order to capture promising opportunities and maximize fund economies.

For example, a series A investor described how her fund captures earlier opportunities:

While we're focused on series A, we have increasingly moved toward seed, just because we recognize that we want to maintain and build an early relationship, and maybe create option value early on and have the ability to come in at series A with a sizable check; and then also, in other cases, we'll have certain hypotheses about where the market is and what the pain points are.

- **Portfolio diversification.** Some investors seek to balance their portfolios geographically as well as by sector, stage, and age of investment. Geographic diversification can be achieved either by expanding within the same country or by entering other countries as market opportunities dictate.

RETURN EXPECTATIONS AND TIME HORIZONS

Although there is much incongruence between African markets and Silicon Valley investing assumptions, the crux of the difference is the size of returns and how long it takes to achieve them. Many of the other factors discussed above reduce returns and/or elongate timelines. As a result, it's helpful to examine how time horizon, returns expectations, and performance differ in African markets.

The time horizon conundrum

Time horizon, or the amount of time it takes for a startup (or the fund invested in it) to increase the value of its investment, is a source of friction within the VC investing model in Africa. It is generally agreed that African companies take a long time to return value. Generally speaking, founders and investors reference a 5–10-year time commitment. Opinions vary, however, about how much time is sufficient.

One argument is that 10 years (plus two one-year extensions), which is the time horizon associated with a standard LP/GP VC fund, is too little time and a poor fit for the needs of ventures and GPs. From this perspective, LP preferences and constraints are prioritized over those of funds and startups. It's useful to clarify, however, what LPs want and what GPs and ventures want. Limited partnerships simply want good returns in a “reasonable” amount of time. However, they may be more concerned with the illiquidity caused by open-ended investment periods than the strength of the returns.

In contrast, both funds and startups may accept that longer time horizons are more realistic. Funds might seek investing structures with more flexibility, which would enable them to exit according to the startup's life cycle rather than a fixed time frame.

African VC and PE performance and expectations

With time-zone friction as a backdrop, the next obvious question is: What do return expectations and performance look like in Africa thus far? Without robust exit data, it's difficult to definitively answer this question. Some early indicators, though, which are described in more detail below, suggest that VC and private equity (PE) fund returns are lower than expected. The same could be said for VC firms in general, however. According to Alex Lazarow, “after fees, half of all venture capital firms don't return their capital (a zero or negative rate of return), and only 5% return more than three times the capital (the equivalent of 12% annualized return over ten years).”³⁵

Nonetheless, some Africa-focused investors have VC-type expectations and have seen signals that are commensurate with future exponential returns.

African VC and PE performance

At the end of 2016, the Africa Private Equity & Venture Capital Index and Benchmark indicated that returns over a 10-year horizon were 4.51% (5.53% excluding South Africa-focused funds), compared with 9.39% for the US VC index and 10.02% for the PE index.³⁶ Similarly, DFS Lab shared in an August 2020 webinar that Compuscan, Jumia, and DPO exited for \$263 million via acquisition, \$190 million via IPO, and \$288 million via acquisition. Similarly, some investors also assert that PE funds are returning about 2x, struggling to secure exits, and underperforming DFIs' mezzanine and debt assets. As one investor describes it:

There's also now what I call a rush to exit funds, especially for PE guys. They're struggling to find exit opportunities for their companies. If you have a 10-year fund life and you've reached year 11, what do you do? Business performance expectations did not go as expected, especially in the last five years. There's been a burst of capital coming into the market. It's so saturated that anyone and everyone can say they've raised money from whomever and it's way more difficult to see exits early on and even at 2x or 3x your money, it's quite rare.

One LP suggested that funds don't meet the hurdle rate because they are unable to find or access deals, because currency devaluations erase returns, and because the PE model is expensive due to personnel and deal-making costs. Difficulty reaching carry could be exacerbated by the use of European structures, in which carry is earned on a fund basis, versus American structures, in which carry accrues on a deal-by-deal basis.

Although these returns statistics are arguably lower than what is preferred in VC, they can still be compelling. For example, the VC exit values described above are consistent with the expectations of investors who believe that strong returns in Africa will be tens or hundreds of millions of dollars, as will be explored in more detail shortly.

VC returns expectations

Because DFIs seem to have conservative returns expectations, some investors have tempered their returns expectations. Generally speaking, fund managers expressed returns expectations ranging from 2–20x, with 3x and 10x returns seeming more common.³⁷ These expectations seem to rest on the basis of companies that will be worth tens of millions to hundreds of millions of dollars.

There are many possible contributors to this outlook. One variable is the fundamental character of African markets, which has been highlighted previously. The prevalence of these market conditions suggests that Africa will need large amounts of capital to build the capacity to produce sizable returns. Others highlight current performance—i.e., fund managers struggling to exit or companies that have raised large amounts of money but aren't growing exponentially. Finally, there is the divergence of narrative and reality. For example, LPs may believe that companies can grow but don't believe that exits will occur at the valuations proposed.

Why lower returns are still compelling

As one investor elegantly puts it, the “power law” holds to some extent in Africa; i.e., it's



Limited partnerships are often stuck between global LP expectations and entrepreneurial realities on the ground

still important for investors to appreciate how scarce outstanding outcomes are. However, the distribution of outcomes is different. Whereas in Western markets an outlier can achieve billion-dollar unicorn status, a similar performance in African markets may be in the \$150–300 million range. The rationale is that African opportunities are based not on pure innovation, but on executing and localizing well-understood business models that have been deployed elsewhere, such as digital payments, to address pain points based on infrastructural gaps.

Hypothetically, if power law logic suggests that one company in a 20-company portfolio generates 60% of returns, then in the African context, 50% of the portfolio would deliver 80% of the returns. Even in cases where investors find very strong performers, they may not find enough to float the whole portfolio, especially when returns are smaller and time horizons are longer. Expressed differently, if African markets won't support a 1/10 outcome to cover all the losses and generate all of the fund's returns, a portfolio might require three to four more conservative successes instead. This logic also seems to apply to emerging markets more generally, where VC performance is based on a portfolio of outsized but not exponential returns.³⁸ Nevertheless, there are investors (and founders) who have VC-level returns expectations, some of whom have experienced valuation increases on existing investments from 3x to 150x.

Of course, there are caveats. First, investors make money in these markets based on their price at entry, so they have to be mindful of the price and valuation of the company. Second, although markups signal progress, exits still must be achieved as a signal of long-term success. Third, as noted earlier, capital markets must be deep and broad enough for investors to select their risk and roles, and to be compensated accordingly. For example, series A investors can pay more and take less risk when pre-seed and seed investors pay less and take more risk *and* sufficiently large exits are achieved to compensate everyone appropriately.

What can one conclude from this? Probably not much—yet. African PE is about 30 years old as an asset class, and some DFIs have only recently started deploying capital within the last few years.³⁹ For example, in 2016, the African Development Bank and the European Investment Bank launched Boost Africa, a joint initiative to encourage African innovation and entrepreneurship by investing in funds, in addition to other⁴⁰ support activities.⁴¹ As a result, although performance might be worse than expected, African VC and PE are still quite young and the “bill” has not yet come due.

Founder exit expectations

There are six primary founder exit strategies in Africa:

1. **Secondary sale or fund acquisition**, in which a fund buys the shares of another investor such as a later-stage venture firm.
2. **Trade acquisition** (also called a strategic sale, trade sale, or M&A [mergers and acquisitions]), in which an acquiring company pays cash to an investor for an ownership stake.
3. **Initial public offering**, when a company enters the public markets by listing its shares on an exchange where they are traded. The investor can sell shares to the public.
4. **Management buyout**, when a company’s leadership buys some or all of the company back from investors.
5. **Earn-out structure**, in which a new investor pays a portion of the value of the shares owned by the initial investor, and then pays the remainder over time.
6. **Buyback**, through which the company buys back shares from an investor.⁴²

Of the six options, founders and investors spoke most frequently about three: a strategic sale to another company, a secondary sale to a financial buyer, and an IPO. The first option seems to be the most common; the third one, the least, although the share buyback was seldom mentioned. Historically, IPOs in Africa have been constrained by the low trading volume of stocks on exchanges and high transaction costs. Initiatives such as the African Exchanges Linkage Project, which intends to connect the trading and information systems of exchanges in Egypt, Kenya, Mauritius, Morocco, and Nigeria, may help turn the tide, however.⁴³

Compared with investors, few founders expressed specific exit expectations. The consensus seemed to be on focusing on executing and building a solid business; the exit opportunities will follow. Founders seem to be aware of all of the options but didn’t articulate a path toward a specific one.

Part II: Why people, strategy, and alignment matter

FOUNDER, TEAM, AND INVESTOR CHARACTERISTICS THAT DRIVE SUCCESS

The first part of this report outlined characteristics of early-stage investing in Africa that are distinct from those that define Silicon Valley VC. Other factors that are not Africa-specific also affect startups in Africa, however. How founders, teams, and investors behave, and how they create relationships with one another, are significant components of success (or failure). Execution is another key success driver, and how startups measure performance and remain in sync with other stakeholders matters, too.

Founder characteristics

From the perspective of investors, founders drive company success. Investors rely on founders to commit to the problem and work around obstacles toward a profitable solution. As one investor put it:

I mean, it takes a certain type of entrepreneur, and the reality is, for our market and the difficulties it has, the average entrepreneur needs to be an absolute superstar relative to the rest of the world, because if most of the other entrepreneurs in the rest of the world come here, they will be destroyed.

Beyond this, the “ideal entrepreneur” archetype is nuanced and layered. Investors seek founders who can execute their vision and who are passionate, committed, and highly intelligent. These ideal entrepreneurs possess unique insight into the problems they’re solving, communicate transparently, and are deeply experienced. Finally, they understand when their companies need skills and expertise beyond what they can provide.

- **Execution ability.** The key aspects of excellent execution will be examined in more detail in Part III. Put simply, though, “execution is everything.” Fundamentally, a founder’s ability to execute is rooted in what they know, what they do, and what they can figure out. Because entrepreneurship involves resolving unanswered questions, a founder needs to fully understand their markets and make reasonable assumptions about what they don’t know. This ability requires deep domain expertise and operating experience. It also calls for analytical skills—the ability to synthesize on-the-ground realities while recognizing larger patterns. When goals aren’t met, founders need to understand what went wrong and then learn from their mistakes.
- **Passion and motivation.** Investors need to know that founders are deeply passionate about the problems they want to solve. They believe that these types of entrepreneurs give off an “energy” that signals their motivation and commitment to their mission. As one investor said, “She came in to visit us, and she was there for two-and-a-half hours. It was like a tornado hit the office. I mean, she left, and people were just standing there, looking at her, speechless!”

Venture capital funds are typically structured as a partnership between GPs and LPs. The LPs in this arrangement put up most of the capital but are not involved in the day-to-day administration of the fund. The GPs, on the other hand, are responsible for managing the fund in accordance with the limited partnership agreement.

For the LPs, the investment in VC is usually a small part of a more diverse portfolio, due to its high-risk, high-return property. Funds typically have a duration of 7 to 10 years (with the possibility of an extension), but tend to invest capital in the first 5 to 6 years.

The most common revenue model is colloquially referred to as the 2/20, where the GP charges a fixed annual fee of 2% of assets under management to cover operational expenses and a 20% “carry” charge (their share of the net profits after the initial invested capital has been distributed/returned to the LPs). Particularly for smaller, more experimental funds and for GPs who have historically delivered superior returns, there is some leeway for deviation from these norms. The incentive structure at play varies depending on the fund size. For smaller funds, most of the compensation is expected to come from the 20% carry; for larger funds, the 2% fixed fee may be significant enough to cause misaligned interests between the GPs and LPs. To track performance, VCs typically measure/report returns in terms of their IRR (internal rate of return), which is the annualized percentage return one “expects to generate on the money they have invested.”⁴⁴

Most funds focused on Africa approach investing by deploying capital against a thesis. These are intended to help guide investment decisions along vectors like company stage, sector, geography, market trends, etc. One investor, however, makes the case for the opposite approach:

No one has the answers or a script in nascent markets. The direction is being built as it flows. That translates into investing in things that look disconnected and unrelated. It’s a function of the deal flow that we’re getting and what we’ve been able to deduce while vigorously refusing to fall into the trap of “this is where the world is heading, so this where we’re going.” This is a philosophical view for us. You won’t hear much of our investment thesis. If you go to our website, you won’t hear or see proclamations about specific industries or trends. We think that those emerge as you go, especially if you’re

Sidebar 04

FUND ECONOMICS AND PORTFOLIO CONSTRUCTION

an early-stage investor. There are little dots on the horizon, not monumental towers defining history.

Investors consider a number of factors when constructing and managing their portfolios, including mitigating risk, potential synergies (and competition) between investee companies, learning opportunities, asset types, return expectations, and per-company capital allocation, among others. To mitigate government and currency risk, investors often invest across geographies; within a country, they might invest across sectors; and within a sector, they might either invest across product types or along different parts of the value chain. In certain cases within a sector, investors may try to avoid investing in multiple businesses that end up being in competition with one another. Instead, investing in complementary businesses allows them to explore value-accretive partnerships between companies in the portfolio.

In order to secure fund viability, investors may consider balancing riskier deals that have high return potential with deals that have a more modest profile but more solid, predictable returns. They may also take advantage of other asset classes (e.g., debt) to cross-subsidize their portfolios and provide non-dilutive capital to businesses that can absorb it. In addition, some investors try to conserve capital to double down on, or maintain ownership in, winners without destabilizing the fund. Venture capital funds typically don’t hold cash; instead, they make “capital calls” against LPs’ commitments, as needed. This means that when deploying capital, a GP must also consider the rare possibility of LPs defaulting on their commitments somewhere down the line.

Ultimately, the investor has to decide where to direct limited capital and advisory resources, whether or not to deploy the full amount allocated for a company, and when to exit, based on a) the company’s progress, b) the return profile, and c) their determination of the company’s growth potential. Understanding why certain investments succeed or fail, as well as what tends to work across sectors and geographies, can help GPs make this call.

- **Commitment to the entrepreneurial journey.** Entrepreneurship is a difficult endeavor that requires commitment, flexibility, and sacrifice. Not only must founders stay the course over time, they must also navigate challenges and adapt their approaches in response to the market. One investor characterized the hard-won path to success this way:

It's so important for the entrepreneur and founder to understand this is a marathon, not a sprint. To find someone who will be willing to do an uphill battle for 10 years. To sacrifice a lot of the other things in life and to put a lot of time into work needs dedication. I'm trying to figure out the level of dedication and if they're aware of how hard it's going to be. It's hard to be an entrepreneur.

- **Intelligence, insight, and expertise.** “Best in class” intelligence and domain expertise in a founder is a distinguishing factor for many investors. Indeed, unique insight into a problem is a strong identification of “founder/market” fit, and a founder’s ability to solve it. As one investor described it, “if someone is going to dedicate—conservatively—12 years of their lives to building a company to turn it into a rocket ship, by the time they come and talk to us, they better be the smartest people in the domain or demonstrate an ability to become the smartest people in that domain, or they will fail.”
- **Transparent communication and coachability.** Throughout the relationship (and perhaps especially during due diligence), investors want founders who will be honest about their shortcomings and challenges. Founders should also be willing to learn, open to feedback, and able to ask for help. A willingness to listen should not, however, preclude a founder’s ability to disagree and advocate for their position.
- **Maturity and experience.** Research published in the *Harvard Business Review* revealed that the average age of founders who built the highest-growth companies is 45. This suggests that a seasoned entrepreneur with decades of experience is more likely to succeed than the stereotypical college drop-out.⁴⁵ Despite Africa’s predominantly young population, Africa-focused investors value experienced founders. Perhaps not surprisingly, they cite the importance of work experience, domain expertise, exposure to tech startups, and experience with both building and exiting businesses.
- **Willingness to transition.** When a company enters a growth stage, it may require a different set of skills and experience. As a result, the founding chief executive officer (CEO) may need to transition to another role or leave the company. A founder’s ability to recognize the arrival of this transition point, and/or respond to feedback about its necessity, can have a significant impact on the company.

Team characteristics and behaviors

Although the founder is obviously critical to a startup’s success, they must also be surrounded by a strong team.

This success is likely attributable to a number of factors, but the team’s quality and ability to execute may be *the* determining factor. As an investor highlighted, “You can have a mediocre idea, but if you have a brilliant team that executes it, it can be a very successful business. The weakest link will be execution of the business plan.” As a result, we focus next on why a great team is important, what behaviors and characteristics a great team has, and what challenges accompany attracting and retaining human capital.

Why a great team is important and what makes a strong team

Inasmuch as funds invest in a visionary CEO, they also bet on the leader's ability to attract other talented people who co-own the execution of that vision. This is a signal of potential success, because when capable people fulfill key roles, companies can grow and scale. Personnel requirements change as companies grow, and more mature ones will need a strong C-suite (i.e., chief financial officer [CFO], chief operating officer, and chief technology officer), middle managers, and a strong technical and sales team.

As with founders, teams have a variety of desirable characteristics, many of which are rooted in an ability to solve problems, learn, evolve, and persevere.

Great teams are also analytical, determining how and when to take action. When it comes to failure, being analytical helps determine what worked, what didn't, what went wrong, and how to create value going forward. This is particularly important in low-resource environments in which it's necessary to execute efficiently—prioritizing the action that will create the most value.

Finally, the best high-performing teams work collaboratively and implement good processes. These teams are adept at creating processes to make data-informed decisions and determine how to order the steps in a process to achieve the desired result. Although they may also compete for the best ideas, they defend their decisions both internally and externally and rally around the agreed-upon course of actions.

Why attracting and retaining human capital is difficult

Generally speaking, it's difficult to attract people with the right skill sets and experience. Not only can it be difficult to hire the type of talent that will evolve with the company, it can also be challenging to cultivate talent and then lose it to large companies that pay more. More specifically, companies may struggle to hire middle managers and tech talent.

Senior-level management and tech resources are expensive because the market for these skill sets is competitive and the pool is relatively small. By contrast, hiring too aggressively can also be a challenge. For example, one founder grew his company's headcount quickly after raising money, hired the wrong people, and then subsequently fired them all. In the future, the founder resolved to clearly define roles and hire the fewest, best people with the closest fit to values, abilities, and culture, rather than rushing the process and hiring ahead of the curve.

Investor characteristics

Understanding what makes founders and teams work well is a key component of understanding startup success. It's equally important, however, to understand what founders seek in investors.

First, founders appreciate investors who have built businesses, understand markets, and adapt well to the inevitable shifts in a startup's trajectory. Second, they seek investors who will lead investments. Third, founders want investors who provide good advice and actively support the business, or who remain supportive yet passive. Ultimately, founders prefer investors who prioritize their interests as well as their own.

Entrepreneurial experience, market familiarity, and flexibility

Among other things, founders value investors who have entrepreneurial experience, familiarity with their markets, and embrace flexibility.



Founders appreciate investors who have built businesses, understand markets, and adapt well to the inevitable shifts in a startup's trajectory.

- **Entrepreneurial experience.** Founders value investors who have built businesses because it enables them to truly understand their experiences. Many fund managers, though, are employees, perhaps with backgrounds in consulting, finance, or law, and who are potentially running their first funds. Those with entrepreneurial experience may perceive risk differently, having weathered the process of building a business. These types of investors know what matters, what to focus on, and which questions to ask. They may also be more sympathetic to founder challenges and more inclined to help resolve them. For example, one founder explained how the seed investors who followed her into her second startup were entrepreneurs who had built their own businesses—people who had “done the work, gotten their hands dirty, and solved hard problems.” As another founder recounts:

We met with many potential investors when we decided to raise money. We had some choice; we shortlisted three funds that were interested in investing. The reason why we selected this one? They were really entrepreneurially minded, which was quite important to us. We believe if you invest in a company and you don't understand the reality of entrepreneurs, it can be a bit complicated. It's very important to us.

Yet another investor noted that founder success is the foundation of entrepreneurial ecosystems—the first generation of founders builds and exits successful businesses, and then invests in the next generation as angels, then as fund managers.⁴⁶ The challenging and long-term nature of the entrepreneurial journey requires mutual understanding between founders and investors. For example, according to analysis from Amadeus Capital based on CB Insights data, 78% of top investors in the US have entrepreneurial or scale up experience.⁴⁷ As such, founders seek investors with the experience to contribute to this understanding and create alignment, a topic that will be explored in more detail below.

- **Market familiarity.** In an environment with large unserved or underserved populations and broken or missing infrastructure, there are countless opportunities to deliver new products and services. Given the newness of the spaces these innovations occupy, however, founders may struggle to find investors who have experience in these areas and who understand the markets and the ventures themselves. As a result, founders may waste time explaining their businesses to investors who can't comprehend the opportunity, or to those who are unable to offer meaningful guidance due to their lack of experience. As one founder described it:

There are a couple places where we've run into challenges with investor expectations. Because of the area we operate in, they're just learning about it and there's no interest in investing. Because it's a new business and somewhat complicated, it takes a while to understand. That can be very time-consuming, to get people to understand who don't have any experience. So, we're trying to do more match-making upfront.

Valuing a business, both literally and philosophically, is a fundamental part of an investor's job. As this founder's comment illustrates, it's quite difficult to value and purchase something that someone doesn't actually understand.

- **Flexibility.** Founders, particularly African founders, must be able to adapt in response to market conditions. The same holds true for investors. An investor should not expect a startup to adhere strictly to the plans and projections they were initially pitched, because market characteristics or customer needs might change or new, unexpected opportunities may emerge that the company should exploit. Significant challenges can also arise. In all cases, though, the company may need to change course or even fundamentally change the business. As a result, investors need to be open-minded and flexible enough to support founders as they respond to these dynamics. As one investor shared, “the biggest mistake that investors make is that they expect that the plan they sign off is going to be the plan. It's definitely not.”

Leading deals

A popular video from 2010 depicts a man at a festival who leaps up and starts dancing alone, until another person joins him, and another, until a crowd of dancing people forms.⁴⁸ This clip is sometimes used to illustrate the quest of a founder to declare their vision and persuade others to contribute. This same dynamic applies to attracting investors, particularly a lead investor, who are willing to write the first check and corral other funders. When a lead investor writes a check and offers a term sheet, they create momentum for the funding round.

Typically, when a known and respected investor expresses interest in or invests in a company, other investors will also engage. If a high-quality lead investor who is aligned with the company's goals and values encourages their contacts to consider the venture, they will probably bring investors of a similar caliber and level of alignment into the investment. In some cases, lead investors already have a network of co-investors whose process and values align. A founder who closed a round after other deals collapsed unexpectedly explained:

If you look at the rest of that seed round, the investor signed a term sheet and put in 700K for the total round. By no means was the round finished, but they assembled the rest of the investors. Once they decided to lead, they called up everyone and said, this is what we're doing. Within three to four weeks, we had the rest of the round closed and were ready to close. Mobilizing other investors is extremely critical.

A lead investor is particularly useful when the company needs money to weather a challenging situation, such as when it's preparing to raise a round of capital, has to fund a pivot or push for traction, or just needs enough runway to keep running. Additionally, a lead investor will often manage the due diligence and coordination for the deal. In some cases, an investor may “anchor” an investment—that is, commit funding without taking the lead role.

Unfortunately, founders may have a difficult time securing lead investors, because many funds prefer not to lead. Given the importance of a lead investor's role, it's useful to examine why investors don't lead. While the motivations for this preference are multi-faceted, the nature of the relationship between the founder and investor could play a role. For example, one investor took a lead role in the funding round of someone he had known for many years. And as one investor quoting a common VC saying expressed it, “you can't borrow conviction.”

The few founders who tried to explain why investors don't lead argued that few people, including investors, think independently. It's much more difficult to take a position before anyone else

because human nature leans toward risk evasion. Investors, many of whom are also employees, may not be incentivized to lead given the time and expense it requires to coordinate the deal and to conduct due diligence.

Passive investors: How investors add value to startups

Although investors can add value to their portfolio companies in a variety of ways, value may not strictly be a matter of being actively or passively involved. Both founders and investors uphold the utility of being strategically passive. For example, one venture capitalist argued that “the hidden superpower of VCs is the ability to get out of the way,” while a founder declared, “I don’t need to be helped by an investor. Eighty percent of the value an investor brings to me is about the capital.” The underlying assertion here is that the founder is the domain expert whose job it is to run the business.

As a result, an investor should remain in the background if and until they can contribute concretely. For example, some investors will invest, but will stay away from operations and only request occasional updates. Even in these scenarios, though, investors can monitor and offer advice on areas in which they have expertise. In fact, both founders and investors affirm the value of listening to and supporting founders, respecting their ability to lead and operate, helping them problem-solve, and making introductions.

Investors’ ability to add value may change as companies enter and exit different stages. They may also be able to help founders navigate rare decisions, such as product launches or acquisitions, because they will have seen many more instances of these than founders have. Where expertise, technical knowledge, or specific value addition is lacking, however, a “hands-off” approach is preferred. This is partially because updating a large number of active investors is time-consuming for founders. There are circumstances, however, in which founders welcome active support and seek value beyond just capital.

Active investors: How investors offer advisory and operational support

Investors can offer valuable support to founders without making operational decisions. This type of advisory support falls into three broad categories: 1) general advice, soundboarding, and strategy; 2) functional expertise; and 3) peer-based support.

At a very basic level, investors provide support beyond capital in the form of network access and a sympathetic ear. What investors can offer varies by the company’s stage, industry, and venture-specific characteristics. However, many founders can benefit from having investors who are willing to think through problems, offer advice, and help the founder grow as an executive. Investors who can leverage their networks to help founders find customers, partners, and other investors, or access markets, are also valuable.

As well, although investors might lack expertise that is germane to a company’s business model, they may be able share their functional knowledge. In other words, investors can help founders with finance, legal, or strategy-related challenges. For example, investors with banking or financial advisory experience can help founders build financial models or optimize their fundraising efforts. Those with legal backgrounds can help founders understand deal terms, cap tables, financing instruments, and governance structures.

Investors can encourage peer mentoring. Those who have portfolio companies in the same sector can connect them to learn from each other’s experiences.

Of course, there are also scenarios in which founders need or want more operational support. This type of engagement might involve working alongside founders in the business, deploying portfolio management services, or offering general operations support.

- **Investors as operators.** When investors have identified operational experience as their core value-add and/or a primary need in the market, investors will serve as “full-time” partners in the business. Operator-investors will take executive roles at these companies (i.e., serving as CFO), or deploy team members to work with founders on their business models and supply chains. For example, one investor assesses companies to determine how to improve operations and works with them to set and achieve milestones, while others take on C-level roles.
- **Portfolio services.** Some investors who offer robust operational support have a fullpost-investment support platform. These investors often tackle areas identified during due diligence, such as product and geographic expansion; financial controlling; business intelligence; and legal, recruiting, and organizational structuring. Many of these areas are also addressed by funds that offer general operations support (see below). For example, some firms offer accounting and marketing services to their portfolio companies.
- **General operations support.** Other investors are not fully embedded in their portfolio companies but still work on problems such as product development, financial model building and fundraising, recruiting, strategy, key performance indicator (KPI) tracking, and board development and management. For example, some investors help with recruiting tasks, such as screening and interviewing, and leverage their processes and platforms to recruit for multiple companies.

Self-interested investor behavior

Although investors can provide significant value through advice and operational contributions, they can also cause harm during the fundraising process. Sometimes, founders have to negotiate with investors who lack experience and who don’t know how to properly evaluate a startup or lead an investment. In other cases, they aren’t transparent about the status of their own operations.

For example, funds may fail to disclose that they cannot issue term sheets because they haven’t yet structured their funds, or that their funds are in legal or financial trouble. Investors may also offer unfair terms—issuing high premiums to compensate for uncertainty, trying to exit angel investors at low multiples, or introducing tranching conditions in the late stages of negotiation. As one founder described his experience with an abruptly cancelled deal:

Everything was going fine and then the third week of June, I remember it clearly. I get a call from my point of contact: “Hey sorry to tell you this, but it looks like we can’t move forward with the closing.” I said, “What the hell are you talking about? We’re supposed to close in three weeks! You’ve done the due diligence. What do you mean we’re not going to close?” I hung up the phone and thought, what is going on here? You don’t sign a term sheet. They must have been out here five or six times and to not follow through on this deal? I had no clue what was going on. The thing that was worse was I had to go back to the existing investors, and say the deal is off. And for when people asked why the deal was off, I had no good answer for them.

Such incidents can not only waste valuable time for a founder but may also destroy deals and leave companies in need of cash. The antidote to such problematic experiences is arguably self-interest, but of the longer-term variety—with an emphasis on cultivating strong, trust-based relationships.

Relationships between founders and investors

The crux of healthy relationships between founders and investors is building and sustaining trust, openness, and transparency. Investors need to trust and support their founders and their decision-making, in return for good capital stewardship. One founder explains the nature of this exchange this way:

The other thing too is the relationship you build. If your investor puts in money and they don't trust you, if you're going to put money into anyone's company, that implies trust. You should believe in the founders. All too often you have funds put money in and then they don't come in strongly supporting the founder. It's about building that trust and making sure people have trust or respect and believing you're the right person. They might not always agree with your methods, but if an investor says they trust you, it's also the founder's job to preserve that trust. You have to be disciplined, work hard, and show these people you respect their money. You have to be ambitious and show that their trust in you is deserved. That's how that relationship is built; you have to be a good steward.

To accomplish this, investors need to firmly position themselves as partners to their founders, and not simply exploit the power dynamic and lead with demands. Investors need to establish early on in the relationship that their aim is to support their founders, help them achieve their goals, and deploy their resources to assist them to solve whatever problems may arise. As a result, when things go wrong, they want to be the first to hear bad news and work with their founders toward finding a solution. Not surprisingly, investors expect to have intense disagreements, but they also expect to compromise and do what's best for the company.

Arguably, this level of honesty and transparency is particularly important when there are cultural differences to navigate. Investors may need to invest in getting to know founders slowly, building trust and confirming shared goals and values over time.

For many investors, the foundation of this type of relationship is created before, during, and after the due diligence process. As noted above, investors try to understand founders, where they need help, and what value the fund can provide. To that end, investors appreciate founders who are honest about their needs and shortcomings. Being dishonest during the due diligence process is a warning sign for investors, and damages trust.

Similarly, investors seek to be forthcoming about their requirements, such as regular reporting. This also applies to the closing process, during which investors who work expediently and are clear about the timeline to close differentiate themselves. Finally, some investors support two-sided diligence, encouraging founders to speak to their portfolio companies to understand what it's like to work with them.

Despite investors' intentions, however, founders may find it difficult to manage relationships with investors. First, managing individual investor relationships can be time-consuming, especially if the investors are highly engaged. Second, there are times when investors abuse their power, for example, by advocating for deal terms that benefit them rather than the

For entrepreneurs, the success of the fundraising effort often relies on the size and depth of their network, experience with the fundraising process, ability to tell a compelling story, and leverage in negotiations, among other factors. Initial investors are usually found via immediate connections (i.e., through other founders and investors), and securing a lead investor makes the process smoother further down the line. The ideal case for founders is to attract interest from multiple investors, because it gives them leverage during the due diligence process. In the same vein, the privilege some founders derive from either being expatriates or having gone to school or worked in other countries may aid their ability to raise more money and at better terms than their local counterparts.

Because fundraising is a labor-intensive, time-consuming process, founders may have to divert attention from the business for long periods of time to find investors who are a good fit, and to navigate their due diligence processes. Despite this requirement, however, founders need to maintain a focus on growth even as their funds run low, because slow growth tends to cool investor interest. Considering all this, investors who are unprofessional, dishonest, and lack empathy through this process may negatively affect a company's trajectory. One founder, for example, described how an investor cancelled a deal at the last minute without sufficient warning or explanation, leaving them stranded with little runway.

Accounting for slight differences in investment criteria, investors tend to have similar considerations

Sidebar 05

FUNDRAISING AND DUE DILIGENCE

when evaluating companies: market size and growth potential, unit economics, product, structure, competition, team, etc. There are some differences between how due diligence processes are conducted with companies at different stages by the investors that invest at those stages, however. Early-stage investments, e.g., are usually not assessed in strictly quantitative terms, while later-stage (PE-type) investments tend to be. Consequently, founders who are raising smaller amounts of money at seed stage often do so off of a compelling story. For a series A round, although the narrative matters, companies are largely raising based on product/market fit. From series B onward, however, founders are required to show strong revenue traction and a model/trajec-tory that makes it possible to predict the impact of additional capital injections.

Investors value founders who have a unique, informed perspective about market opportunities—what makes them tick, their motivations, commitment to the vision, etc., as well as the inner workings of the business—and typically want to spend time getting to know them. One of the ways some investors make this determination is through extensive reference-checking before investment. They also value transparency and vulnerability during the due diligence process, as well as receptivity to feedback.



Fundraising, particularly the “first money in,” is all about trusted networks.



Investors need to firmly position themselves as partners to their founders, and not simply exploit the power dynamic and lead with demands.

entrepreneur (especially when that entrepreneur lacks the knowledge, experience, and networks to protect her interests). From a founder's perspective,

You have all the leverage when you have the money in a market where you have a lack of capital, especially. What you say versus what you do is really the culture of your organization. It's the truth, always. I had an investor who didn't even look at the deck. She hadn't looked at it before the call. Really? Do you know what your job is? If you've asked for it, it means you need to look at it. If you want to talk for 30 minutes, you need to take a look at it. Making smart decisions with money is your job. Small signals about time and the value of the other person is what actually set the relationship apart from the pure power leverage you have on money.

Although the desire to create trusting relationships is a valuable starting point, partnerships are also cultivated through action and good communication.

Communication

Communication is a seldom-explored topic in VC, both in Africa and elsewhere. Investors often say that investing is a people business, and communication is quite literally the way in which people relate and relay information. Although the tenets of good communication and the impact of poor communication seem obvious, exploring how certain characteristics, such as consistency and transparency, affect founder and investor relationships is instructive. Additionally, understanding how communication approaches are tailored, how informal and formal methods are used, and what challenges emerge offers insight into relationship-building.

Consistent and transparent conversation

Two of the most important characteristics of effective communication between founders and investors are consistent and transparent communication. What constitutes consistent communication is probably self-evident. Many investors prefer to be in touch regularly—daily, every other day, weekly, or twice a month. Constant communication keeps everyone informed, accountable, and aligned on goals and progress. It also gives founders and investors the opportunity to discuss challenges and problem-solve together.

For investors, transparent communication is rooted in frequency and openness, as noted above. Investors want to cultivate honest, direct conversation; this requires that founders are comfortable enough to be straightforward. If they are, investors can identify areas of weakness and help founders find solutions to problems. Again, this often begins during the due diligence process through which founders share their goals and strategy (and investors share their thoughts and expectations), and continues post-investment with open information-sharing. Founders aim to share good and bad news and have intense but respectful disagreements, as one would with a trusted partner.

Sharing the thought processes behind decisions is also a form of transparency and helps



“Click the link!” “What? Brick the sink?”

investors contextualize the actions described in updates. Of course, there are times when neither investors nor founders are forthcoming. For example, investors don’t always state their lack of interest in a company directly, which can be confusing for an entrepreneur. Similarly, founders may not share the nature of their discussions and negotiations with other investors (when it’s appropriate to do so), which may also lead to mismatched expectations and conflict. As one investor noted:

It’s make-or-break, that communication and that engagement. I’ll give you an example. I came into a deal but they did not need to go through existing investors to share that they were taking on this investment. And they told me that they would take me onto this investment because their existing investors screwed them over, because they didn’t go back and have that conversation when I came in. Then the existing investors started to get hostile, and I said, “Look, you know I’m happy to get on a call with everybody.” I was open to working out the terms, but them giving me my terms had nothing to do with me because I wasn’t in the deal yet. It’s you and your communication with the company now.

One size doesn’t fit all

Although investors use open communication to build trust, they need to take a tailored approach.

Communication approaches vary by founder preferences, the needs and stage of the company, and investor preferences. Founders have different personalities, strengths, and weaknesses; they also have differing communication styles. For example, some reach out in the face of difficulty, while others remain silent.

Companies also have different communication needs and preferences as they enter and leave different stages of development.

With earlier-stage companies, founders may communicate with investors frequently about operational challenges, while later-stage companies with more internal capacity may communicate less frequently, but about weighty strategic issues.

Young companies may also communicate informally initially, but later incorporate more formal methods such as sending monthly or quarterly updates. As well, companies that are refining their products and pricing may want to discuss technology, while those that are growing will focus on branding, partnerships, and business development.

Finally, investors also have different preferences. Some request a lot of information, such as updates about financials, fundraising, and product development, while others want quick, informal updates over lunch. Ultimately, communication approaches vary and evolve with each company and fund.

Using formal and informal methods

Formal methods that founders commonly use to inform investors and other stakeholders include reports on financial and operational KPIs that are delivered monthly or quarterly, regular shareholder emails that provide similar information (usually monthly), and regular in-person or virtual board of director calls and meetings, held monthly or quarterly. Additionally, many founders engage in more consistent emails or calls to provide a steady stream of information, or host special sessions for special topics or challenges.

By contrast, most informal communication between founders and investors happens on WhatsApp. It's used to answer questions and share advice. Additionally, founders, investors, and board members will sometimes have sensitive conversations outside formal channels through face-to-face conversations. Of course, "real world" communication is dynamic, and a startup will use whatever method best addresses its needs and those of its stakeholders. For example, a company might host quarterly board meetings but also have individual conversations with investors or board members as needed.

Barriers to communication for founders

Although there are many different causes of poor communication, lack of capacity, either in terms of knowledge or time to deliver, is a contributor. Some investors find that founders (particularly less experienced ones) may not fully understand what they expect in terms of information sharing, or how to deliver it. Founders may struggle to determine what is important to share, leaving investors feeling ill-informed. For example, one investor helped a founder understand the connection between poor communication and bad relationship management, while another chose to account for a founder's capacity gaps. As this investor explained:

When you have an agreement on how much reporting is happening and the quality, at an early stage, it's hard to get your house in order. Take it from the perspective of, why we aren't receiving the level we expect: Is it lack of capacity or lack of understanding? At the early stages, it's a lack of understanding or a lack of capacity. We help them to tighten screws or ensure that they hire specific people to take on those roles.

In other instances, the mechanism chosen by the investor is value-subtracting for the entrepreneur—for example, managing and sharing a spreadsheet of sales leads. Similarly, one founder may have many investors with very different reporting and information requirements and might struggle to reconcile them all. When capability isn't the issue, bandwidth might be. Given how demanding entrepreneurship is, founders have to carefully balance

their communication responsibilities and operational duties. For example, a founder could prioritize which investors they communicate with, and at what level of intensity, based on the percentage of ownership.

Hype is another challenge to communication, albeit a unique one. When companies have the skills and resources to persuasively tell their stories (irrespective of whether their performance supports the narrative), they may create a virtuous cycle in which the funding, talent, and connections they attract may potentially make them better companies. There are heavy costs, however, for other companies and the startup ecosystem as a whole. Companies that are strong performers but poor storytellers garner less support, while what constitutes ecosystem resources may be incentivized to flow in low-impact directions, such as pitch training and competitions. As a result, what represents success metrics may be skewed toward vanity metrics such as the ability to pitch, instead of focusing on meaningful ones, such as the ability to operate.

EXECUTION AND BUSINESS METRICS

The previous section explored the defining characteristics of startups operating in Africa, with a particular emphasis on founder, team, and investor attributes, as well as the importance of communication and relationship dynamics. A key theme throughout that discussion is how much team and founder traits and behavior shape startup success. In this section, the emphasis shifts to execution as a critical success factor and differentiator by defining the term and exploring why it's a key differentiator.

Execution

Founders and investors agree that execution is about translating strategy into actions that produce results for the company. It also involves determining what steps are required to achieve a goal, using data to determine what is or isn't working, learning from failure, and using insights to change the business model or strategy. Notably, decisions are made with imperfect, incomplete information and limited resources. Within this context, it's easy to understand why execution differentiates startup performance. One investor described what execution looks like in unforgiving markets:

Execution is everything. I can't overstate that: it's that much more important in Lagos or Nairobi when everything is against you. There's no "let me pick up the phone and talk to someone who's done it before," because no one *has* done it before. Speaking to Jack Dorsey won't help. It's about showing us how this is a person who thinks and builds their knowledge base and has a grip of the fundamentals of the market.

Africa's challenging market conditions make superior execution even more important. Quality of execution distinguishes teams that have raised the same amount of money, separates new teams from mature teams, and can turn mediocre ideas into successful businesses. As another investor stated:

So much of building a great company in this part of the world is about sheer grit and willingness to just demolish every obstacle in your path, and I can tell you from first-hand experience that building a company here is a far more challenging endeavor than doing so in Western markets. You may have far more competition in those markets, but in some ways here, the system is stacked against you and you have to fight through so many different types of issues on a daily basis, everything from the legal



Execution is everything. It's that much more important in Lagos or Nairobi when everything is against you.

landscape often being vague, stuff being unenforceable, and other parties not necessarily always operating at the highest level of professionalism. And also educating customers on your value proposition is sometimes an uphill battle. So there are pros and cons but you just tend to have to power through certain types of issues that make execution a more important asset to have.

Business metrics

Although there are many different indicators that companies can track to monitor business performance, unit economics are emphasized for several different reasons. First, large margins allow companies to maneuver and make mistakes. For example, telecom companies can afford to pay for diesel, security, infrastructure, and expatriate employees because their margins are big enough to absorb the costs. Companies with big margins are also resilient in the face of external shocks such as bank closures and policy changes.

Second, negative unit economics are difficult to fix once established, but good economics can be challenging to achieve. Ideally, the amount of invested capital needed to generate a dollar of income should decrease over time—unit economics should improve, and unit spending should decrease. This requires startups to understand their cost of sales, however—that is, how expensive it is to produce \$1 of revenue. This figure is difficult to determine without earning recurring revenue, which also drives growth. Inasmuch as high margins offer forgiveness, smart cost management does as well. This is why having costs in local currency and revenue in dollars, pounds, or euros can help preserve margins.

Ultimately, companies want to overcome diseconomies of scale, in which their marginal costs increase as they expand; however, the costs associated with building infrastructure make this difficult. Yet companies that manage to do this are on the path to becoming scalable businesses that benefit from network effects, lower capital expenditures and operating expenses than competitors, decreasing marginal costs, and increasing margins. As noted above, companies in Africa tend to be resilient because they think about profitability earlier in their life cycles—generating cash, spending less, and lasting longer between funding rounds and cash infusions.

ALIGNMENT

This report began with an examination of the incongruencies between the assumptions underlying Silicon Valley-style investing and the characteristics of African markets, as well as how startups and funds were navigating those realities. What has been revealed through this exercise is an understanding of where expectations and reality were structurally misaligned. However, alignments and misalignments are also possible on an operational level when investors and founders interact. By examining opportunities where these emerge between investors and founders, insights about where to focus dialogue and negotiation are revealed.

Founders of and investors in African startups must pay close attention to—and try to anticipate—the ways in which governance, regulation, and other external factors can affect their ventures. The quality and stability of the regulatory environment can, and often do, affect a company’s outcomes. As one investor put it:

Outcomes are highly influenced by external factors. Regulatory environments change, market opportunities change, the competitive landscape changes, customer preferences change, and everything is influenced by external forces in some way, shape, or form. One thing to generally remember is that regulators catch up with tech. If you think you’re operating in an environment where policy is weak or not there, they will catch up with you.

These cases, in which companies initially move faster than regulators but see their progress stymied when regulators catch up, were found to be common, especially in highly regulated sectors such as fintech. Unfortunately, these challenges often have a disproportionately negative impact. One entrepreneur argued that policy-related challenges such as random product bans and interest rate changes, are “much more stressful” for entrepreneurs than poor road infrastructure and other challenges with the business environment. In addition, companies must navigate antitrust regulation, manage currency and interest rate changes or devaluation, and secure work visas and licenses. These challenges can be mitigated through investment in regulator engagement and education; investors can drive these conversations by organizing via VC associations, contributing to the regulatory process, and helping regulators better understand the follow-on effects of laws and

Sidebar 06

REGULATION AND EXTERNAL CONDITIONS

statutes being considered.

A portion of the risk premium assigned to African businesses stems from the instability of the regulatory and macroeconomic environment. Beyond regulation, however, other events outside a company’s control can become existential threats early on. In the words of one founder, “the reality of being an early-stage startup is that in that pre-seed stage, your fate is not your own.” Macroeconomic disruptions, elections, public health crises, weather, and shifts in the market for talent are some examples of these kinds of conditions. Although the impacts of these elements vary in kind and degree, they all seem to reduce the amount of autonomy that founders have over their businesses. Similarly, a survey conducted by the UK-Nigeria Tech Hub⁴⁹ found that 80% of Nigerian startups have pivoted or are considering pivoting as a result of market disruptions due to COVID-19.

Day to day, it can be difficult for founders to predict how a startup’s operations will interact with external conditions. As such, the opportunity for a company comes from resolving the tension between its aims and the external environment. In a sense, a company’s fate may be intertwined with external shocks until it reaches the stage at which it has built enough muscle to absorb them.



The next (regulatory) storm is often hard to predict.



Companies in Africa tend to be resilient because they think about profitability earlier in their life cycles.

Alignment, and misalignment, for investors

From an investor's perspective, alignment is achieved with respect to goals, deal structure, relationship building, and outcome expectations.

- **Goals.** Creating a shared sense of purpose seems like an obvious element on which to seek alignment. There are many different dimensions to consider, however. First, companies and capital both have objectives and expectations, such as the pursuit of profit or impact. As a result, it's important for these goals to match; if they don't, the wrong capital could be deployed to the wrong company. For example, the growth objectives for a lifestyle business, from the perspective of the founder and the investor, are very different from those of a venture-backed business. To that end, investors should align with founders on the types of businesses they want to build and structure the deals and compensation accordingly, bearing their own requirements such as return hurdles and impact in mind. General partners should also seek a values match and ensure that a shared understanding of the vision, goals, and returns with founders also extends to LPs.
- **Deal structure.** From a systemic perspective, the LP/GP structure may not adequately reconcile the time horizon preferences of GPs and LPs, as has been reiterated throughout this report. From a deal-level perspective, though, investors aim to set expectations around mission and terms such as employee compensation and investing. However, they also use governance structures such as board seats (or board observer seats) to guide and influence quarterly strategic decisions.
- **Relationship building.** Many investors seek to establish mutual trust with founders early on as the foundation for a long-term partnership. They endeavor to empathize with their founders' needs while also being clear about their own. Cultivating respect for one another's perspectives makes it easier to disagree productively and defer to whomever has the best knowledge of the subject, while acknowledging that running the business is the founder's role. It's important for investors to take a service-oriented rather than antagonistic approach to engaging with founders, given the embedded power dynamic. These relationships are built over time and maintained by regular communication, healthy disagreements, and compromise.
- **Outcome expectations.** In addition to clarifying with a founder what type of business they are building, an investor should also establish exit expectations, or what level of incentive is commensurate with the 10 to 20 years of hard work an entrepreneur will invest in growing the business. Beyond that, alignment on outcome expectations is particularly important for impact investors, who may have to balance profit and impact. Of course, finding common ground is a bit easier when investors seek both. For example, one impact investor invests in companies with high growth potential that they want to help scale. As a result, they work with commercial investors to fulfill the

large capital needs that this trajectory requires. In contrast, another investor had to shift their focus away from development-oriented capital that preferred investing in direct impact, such as a newly built school building, versus helping to improve how children are educated.

Misalignments, however, occur through investing structures, conflicting priorities among investors, incongruent values, and founder dilution.

- **Investing structures.** Sometimes, the incentives embedded in a structure direct behavior away from desired outcomes. For example, when fund managers don't invest their own capital in the funds they manage, there is significant potential for misalignment. For closed-end funds, there is pressure to deploy capital as quickly as possible, because the fund's life is limited. There's no guarantee, however, that the fund manager will remain with the fund for its duration, or raise a second fund. Beyond that, with no invested capital, fund managers rely on intrinsic motivation to push for returns, support their portfolio companies, and earn carry.

In contrast, no matter how their funds perform, if fund managers raise more money, they make more in fees. The challenge, however, with maximizing fund size is finding enough companies to invest sufficiently large amounts of capital into. This disconnect between structure and desired outcomes also emerges in the previously discussed misalignment between aspects of the LP/GP structure and the needs of GPs and their portfolio companies. Inasmuch as time horizon constraints don't necessarily mesh with the amount of time it takes to generate returns, GPs fear that proposing alternatives will hinder their ability to raise money from LPs, who are concerned about the liquidity of their capital. Investors who want to remain in their careers need to raise a first and second fund (and beyond) and have performing assets.

- **Conflicting priorities.** Impact-focused companies that also raise money from commercial investors may experience friction that is caused by the divergent goals and priorities of these investors. For example, impact investors may favor deepening impact in a region more than commercial investors do, who might emphasize expanding into other countries. Similarly, companies that start with impact capital and raise commercial capital at a later stage may experience pressure to reach profitability more quickly. As one investor shared:

We have an investment in a company where there are two co-leads that came in after us and there's one that's trying to push the company from his board seat role to focus on a B2C model and prove the supply chain even though eventually they'll probably outsource and focus on key value-add. Another co-lead is pushing for straight B2B and not focus on aspects of the value chain that the other investor wants. This company went through an existential crisis when the boardroom dynamic has deteriorated, which led to burnout and hurt feelings and discord that have damaged the company.

Companies can suffer when founders and investors don't agree on its vision and strategy.

- **Incongruent values.** Investors may interact with founders who prefer a more "pragmatic" approach to business norms around compliance, corruption, and staff management, for example. When they adhere to such standards (and the founders

in question don't), there's a risk that these founders will seek funders who are a better fit in terms of expedience. Founders may also choose convenience in terms of raising money because of capital scarcity; they're inclined to partner with the first investor willing to commit, rather than relying on whether the values fit exists.

- **Founder dilution.** If founders sell too much equity early on or can't raise a large enough late-stage round, they may end up diluted and disincentivized. This is a problem for early-stage investors, because they'll have to rely on later-stage investors to shepherd the vision:

If the valuation is really low and you do an equity round early on, then as a founder, you'll see yourself being diluted heavily before you reach series A. That's bad for a number of reasons, including that the investor who invested in a series A or B wants to see a founder be in charge or be able to pull through their vision and make decisions. Otherwise, they have to put their trust into other investors who are bigger shareholders than entrepreneurs.

Alignment, and misalignment, for entrepreneurs

Like investors, entrepreneurs secure alignment by agreeing on goals and strategy, as well as fostering good relationships and communication. Misalignments occur when founders and investors have different priorities and expectations.

- **Goals and strategy.** When founders find investors with complementary perspectives on goals and strategy, it's an indicator of a good match. According to a founder who selected an investor based on a shared strategic perspective:

In the beginning, we wanted to make sure that they understood what we wanted to do. That they got us right, not wrong. You have things you write on decks and papers. But you need to spend time with investors so that they get what you're building, your vision and strategy, what you want for your company. That was something that was very, very important. The reason why we didn't move forward with most of the investors we met with was because most of them really believed only in tech or only on a platform where everything was automated, and that's it. From the very beginning, our strategy was a combination of human and digital. And this is also one of the main reasons we moved forward with the investor we chose. They really believed in this.

It's important for startups to share growth plans, goals, and targets early in the fundraising process, and potentially work with investors to develop operational plans. Post-investment, founders should continue to communicate consistently

- **Relationships and communication.** As alluded to above, the overall engagement process, including due diligence, helps founders and investors get to know each other. Between calls, socializing, and due diligence, they begin to determine whether or not there's a fit. After the deal, founders need to consistently update investors.
- **Divergent priorities and expectations.** When founders and investors have different perspectives on markets and deal terms, misalignments emerge. For example, one founder was pursuing a B2B target market because it was generating more cash than the B2C retail focus that the investor preferred, and the

business was cash-constrained. With respect to deal terms, founders have faced dilution and loss of operational control over investors' desire to drive competitive returns. A founder shared his perspective on how his later-stage investors felt about earlier-stage ones: "The people who invested in the SAFE [simple agreement for future equity]⁵⁰ have more than tripled their money; they are happy. Our series A investors were really unhappy because they felt the SAFE investors were stealing value. But I wouldn't have been able to start the company without them."

Clearly, lack of alignment can cause friction within deals for founders and investors alike.

Part III: Build what works here

The curiously anthropomorphic search for creatures both mythical and mundane began in 2013, when Aileen Lee, founder and managing partner of Cowboy Ventures, coined the term “unicorn” to describe startups that achieve valuations of \$1 billion or more.⁵¹ At least since then, Silicon Valley seems to have focused on catching unicorns.⁵² As we explored at the beginning of this report, unicorns are companies that perform well enough to absorb an entire portfolio’s worth of losses, and, as fund sizes increase, the search intensifies.

Why, however, in a discussion focused on African early stage investing, are we concerned with the nomenclature assigned to another region’s startups? The answer is clear, if not entirely satisfying: For better or worse, Silicon Valley has defined how startups should be built and funded. Unfortunately, many of these stipulations don’t quite fit much of the rest of the world,⁵³ and their utility is being questioned in Silicon Valley as well. Perhaps more importantly, it’s worth questioning whether an entire funding ecosystem should be built to serve unicorns, its rarest and most fragile members.

As we’ve illustrated throughout this report, there are multiple mismatches between key characteristics of Silicon Valley VC and African markets that contribute to the poor fit. These dissimilarities in turn influence how startups and funds maneuver, and the results they expect and produce. To recap:

- **African market characteristics.** African markets are large, but fragmented. They comprise consumers with limited purchasing power who are likely to be utility and price sensitive. Additionally, these consumers are difficult and expensive to acquire and retain because they don’t accept fully digital modes of distribution.
- **Returns potential.** Silicon Valley VC, which is exclusively designed to support high-growth companies, requires outsized returns that African markets can’t necessarily provide at the same scale due to the market dynamics described above. Founders and investors seek strong growth, and returns can still be compelling.
- **Capital availability.** As noted, funding hyper-growth companies requires a lot of capital, particularly when the costs of building infrastructure and navigating external conditions are taken into account. Capital in Africa is quite scarce, however. As such, pursuing a “growth at all costs” strategy where capital pools are shallow could endanger companies.
- **Deal-flow availability.** To the extent that a “spray and pray” strategy characterizes the volume of opportunities required to find unicorns, deal-flow scarcity can make them harder to find. In Africa, investors who hold unrealistically high returns expectations, crowd into deals that meet or approximate those expectations, or focus on specific sectors may reduce their deal flows.
- **Fund structures.** African startups take a long time to generate returns due in no small part to challenging market conditions. As a result, GPs can benefit from flexibly structured funds that LPs are unlikely to support without strong business cases and compelling results.



Significant, profitable opportunities exist despite, and arguably because of, the challenges.

As a result of these incongruencies, startups and funds on the continent have adjusted their operating models to better align with the realities of the market: startups, by tackling problems in foundational sectors such as agriculture, running lean operations, and expanding earlier than their peers⁵⁴ in other regions; and funds, by favoring B2B companies and established use cases, investing post product/market fit, and aiming to build a portfolio of modest winners, rather than a few absolute home runs.

Reflecting on the above, one could conclude that the case for investing in and on the continent is slimmer than previously imagined. That view would be incomplete, however. We would argue instead that significant, profitable opportunities exist despite, and arguably because, the challenges highlighted.

Three major pillars support this argument:

1. **There are still large, unexploited markets to serve in Africa.** Despite conditions that seemingly limit the size of addressable markets, key indicators of robust consumer markets and enabling startup environments—a growing, young, middle-class population; increasing mobile and smartphone penetration; high tech adoption; and an increase in entrepreneurship activity, talent, and support structures (such as accelerators)—are still valid. Although the size, influence, and growth trajectory of these factors are unclear, it stands to reason that markets will continue to develop if startups continue to develop them (as this report has argued they must, in order to operate), and other stakeholders play their part.

However, the same challenging conditions that increase friction also reduce competition and increase the size of unserved populations. For example, more than 80% of Kenyans lack health insurance⁵⁵—a stark example of an unserved market. Of course, there are many more opportunities in areas such as education and access to finance to be cultivated. An investor vividly describes the size of such opportunities:

We also realized that a lot of these markets are still there for the taking. They're completely just unserved.... Look at a company like Andela: fantastic platform; but you realize that the per-unit cost to touch 3,000 or 4,000 or 5,000 people is quite high, right? That's an opportunity! How do you reduce that cost? And how do you expand it? What's great about sub-Saharan Africa markets is that you could invest in 15 of these companies and they will all do well, or you might have addressed 3% of the need. So when people ask me why I am bullish about Africa, it's like, let me walk you through an example of unserved opportunities that are just looming.

In other words, many of the opportunities in Africa are problems in need of a reframing.

2. **Many of these opportunities will be exploited by using stellar execution to address pain points by building or fixing infrastructure.** As some of our interviewees argued, large,

profitable opportunities in Africa are more likely to be created by deploying well-understood business models in poorly understood markets, rather than relying on frontier technology and innovation. A cursory scan of the most prominent tech companies in the ecosystem suggests that, in a sense, this is accurate. We would take the argument even further, however.

In his 2014 publication *The End of Copycat China*, Shaun Rein⁵⁶ proposes a more robust model for the spread and commercialization of innovation in emerging markets. According to his view, emerging markets' innovation happens in three stages

- **In stage 1**, companies copy validated business models from more developed markets and apply them locally, with minimal adaptation. This is also called business model innovation, an example of which is Amazon-style ecommerce adapted to a developing market with cash payments on delivery.
- **In stage 2**, companies apply technological innovation to solve uniquely local problems that “proven” models from elsewhere are neither equipped to spot nor solve.
- Finally, **in stage 3**, models developed for the local context are applied globally to other markets, both by the aforementioned “local” companies but also by global companies taking inspiration from them.

We believe that African markets are at an inflection point between stages 1 and 2, and that the opportunity space is fundamentally larger for companies whose models reflect deep market knowledge and whose operators possess the muscle to execute them. The mechanisms by which this will happen are (1) the creative-destructive force of company building and (2) the resultant deepening of the collective knowledge base.

In its October 2018 report *Fostering Productive Entrepreneurship Communities*,⁵⁷ Endeavor found that the most successful ecosystems become so by generating a relatively small number of companies that reach scale. Entrepreneurs who had been involved with successful firms (including receiving capital, support, and mentorship from the leaders of those firms) were more likely to build successful firms of their own.

This view, taken alongside Shaun Rein's model, suggests that each successive generation of founders learns directly or indirectly from the successes (and failures) that precede them. The performance of present-day companies relative to their counterparts founded 5–10 years ago seems to support this theory.

3. **African startups are leveraging mobile technology to reach customers more cheaply and easily and to increase efficiency and scale while digitizing analog markets.** In African markets, companies are leveraging mobile infrastructure to reach customers and using nuanced local knowledge to digitize and organize analog markets. First, technology can be used to automate people- and paper-intensive processes and reduce the friction caused by the high cost of acquiring and distributing to customers, thereby allowing the business to be run more cheaply. Second, this technology is delivered through/enabled by mobile infrastructure, because most people have phones. According to the GSMA, in 2018, the mobile penetration rate for unique mobile subscribers was 44%, and 23% for mobile internet users, while 39% of connections were for smartphones.

An instructive example is PiggyVest. The Nigerian company automated savings and investments app debuted in 2016 after the founders came across a social media post whose author saved 1000 naira every day for 365 days in a physical piggybank. The team built software to digitize this process and make it more seamless. They have leveraged this venture into a business with over \$80 million managed for more than a million customers. Crucially, though, for PiggyVest to exist, payment processors such as Paystack and Flutterwave must have first built the infrastructure that made recurring debits possible.

Similarly, all across the continent there are opportunities to provide basic products and services such as access to consumer finance that have not yet been offered but that enable pre-existing consumer behavior. Products that enable consumers to put their limited income to productive use in the ways *they* deem fit, as opposed to trying to change their behavior, create opportunities for investors to take advantage of.

Companies in this category can overcome the diseconomies of scale (increasing rather than decreasing marginal costs as companies grow) caused by infrastructure gaps through the use of mobile infrastructure. These companies more closely adhere to technology-enabled scale logic, where the business costs less and grows more the bigger it gets. Large amounts of capital are deployed to generate revenue and build the infrastructure and network required to sustain competitive advantage.

The hitch is that fixing friction may be insufficient to sustain a moat.⁵⁸ Organizing a local analog market such as a commodity exchange and *then* adding a digital layer, however, may be more difficult for larger, better-capitalized competitors to replicate. This may, in turn, contribute to the development of digital economies that create more opportunity for everyone. When a company braves first mover disadvantage to build infrastructure, educate customers, and digitize markets, subsequent generations of companies benefit. One founder describes this dynamic in terms of digital blue oceans:

You can't fish for a whale in a pond. You can only fish for a whale in an ocean. The African market for digital services are rivers, not the Indian Ocean. One of the things that baffles me is investor expectations, when they are operating in markets that have only produced only one or two unicorns in almost 20 years. We all have huge expectations, but this doesn't make any sense when it comes to digital services. There's a disconnect between the ambition of startups and business from what the market realities are.

With these opportunity spaces defined, we can plainly state what may have been obvious from the start of this discussion: African startup ecosystems should define terms and chart paths that reflect the realities of operating in Africa. As highlighted in our discussion of alignment, goals, priorities, expectations, and strategy all need to coincide in order to drive desired outcomes. This is not to suggest, by any means, that Africa-focused founders, GPs, or LPs should abandon venture capital and unicorn hunting. However, there is enough evidence to propose that cultivating cash-hungry growth businesses in exchange for rare but exponential returns is largely incongruent with African market dynamics *as they currently exist*.

Just as founders expect consumers' acceptance of tech-enabled solutions to increase, however, so do we expect African markets to grow and change. In the meantime, investors both

inside and outside of Africa have already begun to rename and define African startups and their expected performance. At TechCrunch Disrupt SF in 2019, Marième Diop, VC investor at Orange Ventures argued, “It might be a better option to set lower revenue expectations and have startups list on local exchanges to raise capital from IPOs when they’re ready. We may be able to create more gazelles at home than unicorns abroad.”⁵⁹ A gazelle, a term coined by American economist David Birch, has been repurposed to describe African startups that exhibit at least 20% revenue growth year on year for 3-4 years.⁶⁰ Gazelles solve real problems and provide basic services,⁶¹ as we’ve asserted African startups do in this report.

Similarly, camels, as defined by Alex Lazarow in his book *Out-Innovate: How Global Entrepreneurs—from Delhi to Detroit—Are Rewriting the Rules of Silicon Valley*, conserve cash, manage costs, preserve unit economics, and are much more resilient to shocks than unicorns.⁶² These companies are born out of ecosystems with harsh conditions, external shocks and fewer resources.⁶³ As a result, they spend less cash as they build and sell, ultimately reaching profitability sooner, surviving longer, and producing compelling, if not exponential, returns.⁶⁴

Surely the names we give to startups here and elsewhere are symbolic of intent, strategy, and results. Consequently, it’s useful to discuss how best to cultivate African startups in a way that is rooted in context. Arguably, there are multiple points of leverage from which to stimulate change: markets, ventures, funds, LPs, and startup ecosystems. Markets will evolve, as argued above, and startups will adapt out of necessity, as described in this report. This leaves GPs and LPs as potential areas of focus. As such, our research suggests that funds and GPs should consider adopting other structures and pursuing focused investment strategies.



Like camels, resilient businesses can withstand the heat and the cold.

ADAPT INVESTMENT STRUCTURES

Ideally, investments should be structured to reflect investors’ risk appetite and returns expectations as well as companies’ needs. In light of the mismatch between LPs’ requirements and those of GPs and their portfolios, there should be room to re-examine how well traditional structures accommodate ever-changing market realities. For example, as was

previously suggested, GPs need flexible structures that better enable them to respond to market-level changes. Using alternative instruments and structures, such as debt or PCVs, is one approach. With the former, however, it's important for investors to consider the fit of an instrument to a company's needs. For example, debt is useful for purchasing assets such as a vehicle fleet or for building supply chains. Similarly, revenue sharing, in which a company pays back principal with interest via a portion of revenue until a threshold is reached, could be an option for investors. However, the interest rate should be capped at a reasonable level—e.g., 10%–15%—so as not to burden the company.

With PCVs, a notable benefit is that their open-ended time frames allow companies to fully realize their growth potential. As a result, investors can avoid exiting in duress during a down cycle or pandemic. Arguably, this is a better match for GPs and startups given the challenging and dynamic conditions of African markets. This is why some investors create holding companies that allow them to invest off their balance sheets and follow their companies' growth trajectory without exit pressure.

Nonetheless, some people would argue that time horizon and liquidity preferences are difficult to reconcile within PCVs. Limited partners want to see a return of capital within a defined period of time, which is 10–15 years within a typical fund structure. According to a DFI LP:

So chances are, you've significantly reduced your probability to raise capital if you come with an evergreen structure, because most people want an exit or potential exits. That's clearly the biggest challenge: making sure there's sufficient liquidity in due time if you want to exit. People can actually buy you out or give you the liquidity to get out. Sometimes you do accept it because you believe that a more permanent structure makes sense, because it takes a lot of time for that particular investment space to raise capital; but in general, people don't like evergreen structures.

Within a PCV, an archetypal exit scenario requires an LP to remain in an investment for a longer period of time (e.g., 20 years), possibly even after the founders have departed. Hypothetically, this scenario would require these LPs to manage the business as board members, not observe and advise as investment committee members. As well, an exit creates a feedback loop, demonstrating (to some extent) whether or not a venture created value. Committing capital "indefinitely" to a PCV structure disrupts that loop, as well as the principle of revolving capital, in which exits enable capital to be recycled into the market.

One investor also argued that PCVs could be used to subsidize VC as an asset. In this scenario, DFIs could fund a 20-year permanent capital vehicle similar to AgDevCo, which is backed by the UK government and the CDC. High-net-worth funds from family offices and foundations could also be deployed to shepherd the investments after the founding teams have departed, addressing a common LP concern about PCV time horizons. Novel structures need progressive, aligned investors to support them, however.

PURSUE FOCUSED INVESTMENT STRATEGIES

Using focused investment approaches is another way to circumvent the challenges of African markets. As with alternative investment structures, there are a number of options for funds, including focusing on B2B investments, moving upmarket to invest in more mature companies, and cross-subsidizing a portfolio.

As one founder explained it, the archetype of a successful company in Africa may be one that grows slowly and rewards investors with dividends after 15 years:

The alternative is to build a really hard business that grows, breaks even in year 5, and grows kind of profitably for 10 more years. And after 15 years maybe they pay back off of dividends. What VC would raise based on that? Even when you have world-class leaders to start complicated, scalable businesses and do most things right, it's a hard, long slog.

In other words, success in Africa may look different than it does in Silicon Valley. For example, it's possible that Africa's best-performing companies will be B2B businesses, even if B2C ventures eventually overcome market and capital constraints to become blockbusters. For example, Interswitch has both B2B and B2C businesses. According to an investor observing the patterns of African success stories, B2B business are certainly part of the equation, even if growing them is challenging:

I think the majority of what we've seen so far has either been B2C, or B2B with a focus on very small margins. There's actually a dearth of great B2B companies, partially because they're harder to build; you're competing with potentially a global suite of products that do the exact same thing, so you need to figure out a way to escape the "plain vanilla" effect. So while they're harder to build, I think they're also potentially very rewarding because you get somewhat lower risk, you have recurring revenue dynamics, it's easier to scale, and they're just as a function of being that more capital efficient, but harder to get product/market fit with consumers. The pain point is often glaring.

As well, to the extent that target shifting is good for portfolio returns, investors may also opt to move upmarket. Some pre-seed and seed investors who are struggling to exit their investments have opted to shift their focus to later-stage companies or companies that are more like SMEs, both of which have lower risk and higher return potential. Unfortunately, this means that many early-stage companies won't get the funding they need to mature, which will ultimately damage the ecosystem.

Finally, some funds are experimenting with adding fixed income, debt assets, and PE-type SMEs, which have lower risk profiles and more predictable return patterns, to cross-subsidize their direct equity investments. For example, Collins Onuegbu of the Lagos Angel Network described the utility of creating a portfolio composed of revenue-generating companies as well as those using revenue to scale.⁶⁵

Will we find unicorns in Africa? Time will tell, but for now we hope that founders, GPs, LPs, and ecosystem builders across the continent can agree to support African startups in a way that respects markets and gives these intrepid ventures the best possible chance of success.



Methodology

RESEARCH MOTIVATION AND KEY QUESTION

This project began with an aspiring fund manager's desire to understand what makes early-stage venture deals in Africa successful. Due to the exploratory, novel nature of the question, we chose to use a qualitative research method to answer it. In contrast, quantitative research is more appropriate for inquiries in which the general nature of the problem and specific areas of concern are fairly well known.⁶⁶ However, in this case, the slate was relatively blank and the way forward fairly open.

Our goal was not to conduct an academic study; we simply sought to answer a practical question in a credible manner. Absent a deliberate decision to properly research this topic, Tony Chen would have had informal conversations with his peers to garner insights and learn best practices. This approach echoes that organic process, but also benefits from the credibility of following a generally accepted research methodology.

RESPONSIVE INTERVIEWING

From the many qualitative research techniques available, we chose a method called responsive interviewing. Responsive interviewing is a flexible form of qualitative interviewing that allows the researcher to change questions in response to what they are hearing.⁶⁷ It's framed as a partnership between a researcher and a respondent in which the researcher gains insights from the respondent through non-confrontational conversation. We chose responsive interviewing for three main reasons: 1) its flexible ethos fit the exploratory nature of our central question; 2) the process mimicked an organic approach for obtaining actionable insights; and 3) the collaborative nature of the conversation style was appropriate for our inquiry, which involved asking people with whom we had limited relationships to share potentially sensitive information.

PRELIMINARY HYPOTHESIS

As noted above, the initial framing of the key question was rooted in the notion of the deal as the primary unit of analysis. More specifically, we were interested in tipping points—that is, what made good deals bad and vice versa. Our preliminary hypothesis was that the *culture* of the deal—communication, values, and alignment, as well as the *structure* of the deal—terms, instrument, timing, etc., would most significantly affect deal outcomes. In consultation with our advisors in academia, however, we decided to focus instead on a “static” question: What variables drive outcomes for early-stage venture deals in Africa? This is the question that ultimately guided our research.

INTERVIEW GUIDE DEVELOPMENT AND INTERVIEWING

Based on this revised question, we created a semi-structured interview guide with open-ended questions. A semi-structured guide enables a researcher to prepare questions that address specific topics, while using open-ended questions gives the respondent the latitude to respond how they see fit—that is, through elaborating, asking new questions, challenging the inquiry, etc.⁶⁸ We structured the guide to explore our hypothesis by posing questions in four main areas: deal structure, alignment between founders and investors, communication, and

other considerations.

We finalized the interview guide after piloting it with a small number of respondents, and continued to revise it throughout the interview process in response to what we were learning. Overall, we asked questions about thesis and motivation, deal structure and history, fundraising and the due diligence process, indicators of business health, communication, external conditions, team and culture characteristics, portfolio construction, success factors, use of funds, and the VC model fit. Questions about the latter four areas were added in response to interviewee insights or feedback.

Interviews ranged from 30 to 90 minutes on average and were conducted virtually via Zoom, WhatsApp, or Skype. Interviews were transcribed in real-time by the interviewer, or recorded and transcribed based on the audio recordings. All interviews were conducted under conditions of anonymity and non-attribution, as way to encourage respondents to speak freely. As such, any details that could potentially identify respondents have been removed or altered.

Respondents and sampling

With quantitative research, and some forms of qualitative research, it's important to select a randomly selected sample that represents a larger population. In this case, it wasn't feasible to create randomly selected samples of founders and investors, given the constraints on our access to data, our ability to attract willing respondents, and the existence of sufficiently large populations.

Although there are databases of African startups, they are hosted on private platforms such as WeeTracker and VC4Africa. An open database of investors is maintained by TLcom Capital, however, which we used to collect email addresses for many investors. As a result, our method of sourcing respondents combined convenience sampling, or approaching who we knew or could reach through our networks; and snowball sampling, or asking respondents for referrals. We did bear in mind, however, the utility of purposive sampling for range, or including dissimilar or infrequent representatives of a population.⁶⁹ Practically speaking, this meant we attempted to balance geographic spread and gender representation while also including different types of investors (by thesis, sector focus, and instrument type) and founders (by sector).

To garner a holistic perspective, we set out to speak to the founders and investors involved in a specific deal. Our aim was to examine at least 40 early-stage deals. Unfortunately, we were unable to reliably secure referrals from one party to the other, and/or interview founders and investors from the same deal. As a result, we refocused on interviewing founders and investors in unrelated deals.

Through the interview process, the unit of analysis shifted from an initial focus on the deal to a focus on the venture itself. This focus was retained through the conclusion of the study. Toward the end of the interviewing process, however, it became clear that the LP perspective was missing, and needed. In response, we spoke to a small number of DFI representatives. In total, we interviewed 100 founders, investors, and LPs. Of that number 38 were founders, 56 were investors, and 6 were LPs.

ANALYSIS

After the interviews were completed and transcribed, we coded them according to the themes that reflected our main questions. We compiled and summarized our learnings by code in order to identify insights, organize those insights into summary statements, and then combine those statements into an explanatory theory that addressed our core questions.

LIMITATIONS

Investors were over-represented in this study by a ratio of 3:2, and only a small number of LPs were interviewed, as noted above. This is largely attributable to response rate differences between interviewees, as well as the limits of the team's network. We deliberately sought diversity across geography and gender, however.

Additionally, although the scope of this research is pan-African, the majority of respondents are active in Kenya, Nigeria, or South Africa, where most startup and investing activity on the continent is concentrated.

Finally, despite this pan-African emphasis, the research team is well aware how heterogeneous the continent is, and consequently, how tenuous it is to make generalized, pan-African claims. We feel that while there is likely to be variation across the continent, however, many of the key assertions hold to a large extent due to the systemic nature of the insights.

Bibliography

- African Development Bank Group. "African Development Bank, Partners Meet over Securities Exchanges Linkage Project." April 26, 2019. <https://www.afdb.org/en/news-and-events/african-development-bank-partners-meet-over-securities-exchanges-linkage-project-19240>
- African Development Bank Group. "Boost Africa Initiative – Frequently Asked Questions." Retrieved September 14, 2020, from https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/Boost_Africa_FAQ_AfDB.pdf
- African Private Equity and Venture Capital Association (AVCA). *2019 Annual African Private Equity Data Tracker*. March 2020. <https://www.avca-africa.org/research-publications/data-reports/2019-annual-african-pe-data-tracker/>
- Ashworth, Michelle. "What Role Can DFIs Play in Promoting the Development of the African Venture Capital Ecosystem?" *Private Sector & Development* (blog). September 10, 2018. <https://blog.private-sector-and-development.com/2018/09/10/what-role-can-dfis-play-in-promoting-the-development-of-the-african-venture-capital-ecosystem/>
- Azoulay, Pierre, Benjamin F. Jones, J. Daniel Kim, and Javier Miranda. "Research: The average age of a successful startup founder is 45." *Harvard Business Review* online. July 11, 2018. <https://hbr.org/2018/07/research-the-average-age-of-a-successful-startup-founder-is-45>
- Barry, Kenneth. "Private Equity in Africa: Emerging Trends." AVCA, January 29, 2020. <https://www.avca-africa.org/newsroom/afri-spective-an-inside-look-at-private-equity-in-africa/2020/private-equity-in-africa-emerging-trends/>
- Bright, Jake. "Africa Can List More Gazelles at Home than Unicorn IPOs Abroad." TechCrunch, October 21, 2019. <https://techcrunch.com/2019/10/21/africa-more-gazelles-at-home-than-unicorn-ipos-abroad/>
- Bright, Jake. "Africa Roundup: Nigerian Fintech Gets \$360M, Mints Unicorn, Draws Chinese VC." TechCrunch, December 2, 2019. <https://techcrunch.com/2019/12/01/africa-roundup-nigerian-fintech-gets-360m-mints-unicorn-draws-chinese-vc/>
- Cambridge Associates and AVCA. *Africa Private Equity & Venture Capital Index and Benchmark Statistics*. Data as of December 31, 2016. Published June 29, 2017. <https://www.avca-africa.org/media/1745/2016-q4-cambridge-associates-africa-pe-vc-benchmark-for-avca-june-2017.pdf>
- Chen, James. "Permanent Capital Vehicle (PCV)." Investopedia. January 16, 2020, from <https://www.investopedia.com/terms/p/pcv.asp#:~:text=A%20permanent%20capital%20vehicle%20>
- Colin, Nicolas. "A Brief History of the World (of Venture Capital)." *The Family Papers* 19, Medium, May 4, 2016. <https://salon.thefamily.co/a-brief-history-of-the-world-of-venture-capital-65a8610e-7dc2>.
- Cowan, Matthew. "Why Startups Should Become 'Camels'—Not Unicorns—During COVID-19." *Crunchbase News*, <https://news.crunchbase.com/news/why-startups-should-become-camels-not-unicorns-during-covid-19/>
- Fox, Benjamin. "Venture Capital with a Difference: Targeting Africa's 'Missing Middle'." EURACTIV.com, October 5, 2018. <https://www.euractiv.com/section/africa/news/venture-capital-with-a-difference-targeting-africas-missing-middle/>
- Ganti, Akhilesh. "Economic Moat." Investopedia. Accessed September 16, 2020, from <https://www.investopedia.com/terms/e/economicmoat.asp>.

- GSMA. *The Mobile Economy Sub-Saharan Africa 2019*. 2020. https://www.gsma.com/mobileeconomy/wp-content/uploads/2020/03/GSMA_MobileEconomy2020_SSA_Eng.pdf
- Hayes, Adam. "Last Mile." Investopedia. July 16, 2019, <https://www.investopedia.com/terms/l/lastmile.asp>
- Hoffman, R., & Yeh, C. (2018). *Blitzscaling: The lightning-fast path to building massively valuable companies*. Penguin Random House.
- Hundeyin, David. "Jumia: What went wrong at 'Africa's First Unicorn?'" *The Africa Report*, December 11, 2019. <https://www.theafricareport.com/21124/jumia-what-went-wrong-at-africas-first-unicorn/>
- Jackson, Tom. "How Angel Networks Are Filling Startup Funding Gaps in Africa." *Disrupt Africa*, August 27, 2019. <https://disrupt-africa.com/2019/08/how-angel-networks-are-filling-startup-funding-gaps-in-africa/>
- Juetten, Mary. "Failed Startups: Juicero." *Forbes*, November 27, 2018. <https://www.forbes.com/sites/mary-juetten/2018/11/27/failed-startups-juicero/#3bf87128166e>
- "Jumia Group." Crunchbase, accessed August 28, 2020 <https://www.crunchbase.com/organization/jumia-group>
- Kazungu, Jacob S., and Edwine W. Barasa. "Examining Levels, Distribution and Correlates of Health Insurance Coverage in Kenya." *Tropical Medicine & International Health* 22, no. 9: 1175–85. <https://onlinelibrary.wiley.com/doi/full/10.1111/tmi.12912>
- Kendall, Jake. "Why are African startups launching in multiple countries before they even hit seed stage funding?" Medium, January 5m, 2019, <https://medium.com/dfs-lab/why-are-african-startups-launching-in-multiple-countries-before-they-even-hit-seed-stage-funding-94354a89c43f>
- "Konga Online Shopping." Crunchbase, accessed August 28, 2020 <https://www.crunchbase.com/organization/konga-online-shopping-limited>
- Lazarow, Alexandre. *Out-Innovate: How Global Entrepreneurs—from Delhi to Detroit—Are Rewriting the Rules of Silicon Valley*. Massachusetts: Harvard Business Review Press, April 2020.
- Lazarow, Alexandre. "The New Hot Startups Will Be Camels, Not Unicorns." *Marker* (Medium), April 27, 2020. <https://marker.medium.com/the-new-hot-startups-will-be-camels-not-unicorns-53d480535916>
- Lazarow, Alexandre. "The Case for Camels." *Kauffman Fellows*, July 23, 2020. https://www.kauffmanfellows.org/journal_posts/the-case-for-camels
- Lee, Aileen. "Welcome to the Unicorn Club: Learning from Billion-Dollar Startups." *TechCrunch*, November 2, 2013. <https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/>
- Levy, Carolyn, "Safe Financing Documents," *YCombinator*, September 2018, <https://www.ycombinator.com/documents/>
- "Logistics Update Africa: Getting Past the Hurdles to the Last Mile." *eTrade for All*, accessed August 28, 2020. <https://etradeforall.org/logistics-update-africa-getting-past-the-hurdles-to-the-last-mile/>
- Madowo, Larry. "Silicon Valley Has Deep Pockets for African Startups—If You're Not African." *The Guardian*, July 17, 2020. <https://www.theguardian.com/business/2020/jul/17/african-business-es-black-entrepreneurs-us-investors>
- Morris, Rhett, et al., "Fostering Productive Entrepreneurship Communities," *Endeavor*, October 2018, <https://endeavor.org/content/uploads/2015/03/Fostering-Productive-Entrepreneurship-Communities.pdf>

- Olubodun, Feyi. *The Villager : How Africans Consume Brands*. Lagos, Nigeria: Ouida Books, 2018.
- Onuegbu, Collins. "African Startups. Of Unicorns, Gazelles and Corporate Breakfasts." Medium, March 11, 2018. <https://medium.com/@collinsonuegbu/african-startups-of-unicorns-gazelles-and-corporate-breakfasts-9ca2a0020247>
- Pasti, Francesco. *State of the Industry Report on Mobile Money 2018*. GMSA, 2019. <https://www.gsma.com/r/wp-content/uploads/2019/05/GSMA-State-of-the-Industry-Report-on-Mobile-Money-2018-1.pdf>
- Pew Research Center. "Internet/Broadband Fact Sheet." Pew Research Center: Internet & Technology, June 12, 2019. <https://www.pewresearch.org/internet/fact-sheet/internet-broadband/>
- Rein, Shain. *The End of Copycat China*. New Jersey: Wiley, October 20, 2014
- Rice, Mae. "Zebras, Camels, Gazelles, Oh My! What Animal Is Your Startup?" Built In, June 22, 2020. <https://builtin.com/growth-hacking/startup-animals-zebras-camels-gazelles>
- Signé, Landry (with Chelsea Johnson). *Africa's Consumer Market Potential: Trends, Drivers, Opportunities, and Strategies*. Brookings Institution, December 2018. <https://www.brookings.edu/wp-content/uploads/2018/12/Africas-consumer-market-potential.pdf>
- Sivers, Derek. *First Follower: Leadership Lessons from Dancing Guy*. YouTube video, 2:57. Posted February 11, 2010. <https://www.youtube.com/watch?v=fW8amMCVAJQ>
- Sloet, Boldewijn. "The African VC funding paradox." *African Tech Ventures*, 8, Feb., 2019, <https://www.africatechventures.co/bx/african-vc-funding-paradox/>
- Socha, Pierre. "Entrepreneurs Make The Best Tech VCs—Or Do They?" Amadeus Capital Partners blog, December 18, 2019. <https://www.amadeuscapital.com/entrepreneurs-make-the-best-tech-vc-or-do-they/>
- Taylor, Liam. "Covid-19 Accelerates Africa's Digital Transformation." *African Business Magazine*, July 9, 2020. <https://africanbusinessmagazine.com/sectors/technology/covid-19-could-accelerate-africas-digital-transformation/>
- Viktoria Ventures, et al., "Angels in the Silicon Savannah: A Practical Guide for Early-stage Investors," August 2020, <https://www.viktoria.co.ke/wp-content/uploads/2020/09/Investors-Guide-2021.pdf#wpcf7-f18-o1>
- Weiss, Robert S. *Learning from Strangers: The Art and Method of Qualitative Interview Studies*. New York: Free Press, 1994.
- World Bank. "GDP per Capita (Current US\$)." (n.d.). World Bank Open Data. <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=US>
- Worldometer. "United States population (live)." Accessed September 8, 2020. Worldometers.info. <https://www.worldometers.info/world-population/us-population/>

Endnotes

¹ For the purposes of this discussion, success for a startup means that it achieves product/market fit, grows, and eventually returns capital to its investors.

² “United States Population (LIVE),” Worldometer, accessed, August 28, 2020, <https://www.worldometers.info/world-population/us-population/>

³ World Bank, “GDP per Capita (Current US\$) – United States.” World Bank Open Data, 2020, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=US>

⁴ Pew Research Center, “Internet/Broadband Fact Sheet,” Pew Research Center: Internet, & Technology, June 12, 2019, <https://www.pewresearch.org/internet/fact-sheet/internet-broadband/>

⁵ Aileen Lee, “Welcome to the Unicorn Club: Learning from Billion-Dollar Startups,” TechCrunch, November 2, 2013, <https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/>

⁶ Alexandre Lazarow, “The Case for Camels,” Kauffman Fellows, July 23, 2020, https://www.kauffmanfellows.org/journal_posts/the-case-for-camels

⁷ Matthew Cowan, “Why Startups Should Become ‘Camels’—Not Unicorns—During COVID-19,” Crunchbase News, <https://news.crunchbase.com/news/why-startups-should-become-camels-not-unicorns-during-covid-19/>

⁸ Mae Rice, “Zebras, Camels, Gazelles, Oh My! What Animal Is Your Startup?” Built In, June 22, 2020, <https://builtin.com/growth-hacking/startup-animals-zebras-camels-gazelles>

⁹ Alexandre Lazarow, “The New Hot Startups Will Be Camels, Not Unicorns.” Marker (Medium), April 27, 2020, <https://marker.medium.com/archive/2020/04/27>

¹⁰ Ibid.

¹¹ Ibid.

¹² Blitzscaling, 2020, www.blitzscaling.com/

¹³ Landry Signé with Chelsea Johnson, Africa’s Consumer Market Potential: Trends, Drivers, Opportunities, and Strategies, Brookings Institution, December 2018, <https://www.brookings.edu/wp-content/uploads/2018/12/Africas-consumer-market-potential.pdf>

¹⁴ Ibid.

¹⁵ Feyi Olubodun, *The Villager: How Africans Consume Brands* (Lagos, Nigeria: Ouida Books, 2018).

¹⁶ Adam Hayes, “Last Mile,” Investopedia, accessed August 28, 2020, <https://www.investopedia.com/terms/l/lastmile.asp>

¹⁷ A preference for human-digital synergy is only one aspect of consumer behavior in Africa. However, a full discussion of the nuances of consumer behavior is beyond the scope of this report

¹⁸ “Logistics Update Africa: Getting Past the Hurdles to the Last Mile,” eTrade for All, accessed August 28, 2020, <https://etradeforall.org/logistics-update-africa-getting-past-the-hurdles-to-the-last-mile/>. Reaching the last mile within a manageable cost structure is an ongoing challenge. While the average costs internationally to reach the last mile is 28% of the product costs, it’s 35-55% in Africa due to poor infrastructure, supply chain analytics, etc.

¹⁹ “Konga Online Shopping,” Crunchbase, accessed August 28, 2020, <https://www.crunchbase.com/organization/konga-online-shopping-limited>

- ²⁰ “Jumia Group,” Crunchbase, accessed August 28, 2020, <https://www.crunchbase.com/organization/jumia-group>.
- ²¹ Jake Bright, “Africa Roundup: Nigerian Fintech Gets \$360M, Mints Unicorn, Draws Chinese VC,” TechCrunch, December 2, 2019, <https://techcrunch.com/2019/12/01/africa-roundup-nigerian-fintech-gets-360m-mints-unicorn-draws-chinese-vc/>
- ²² Rice, “Zebras, Camels, Gazelles, Oh My!”
- ²³ Benjamin Fox, “Venture Capital with a Difference: Targeting Africa’s ‘Missing Middle.’” EURACTIV.com, October 5, 2018, <https://www.euractiv.com/section/africa/news/venture-capital-with-a-difference-targeting-africas-missing-middle/>
- ²⁴ AVCA, 2019 Annual African Private Equity Data Tracker, March 2020, <https://www.avca-africa.org/research-publications/data-reports/2019-annual-african-pe-data-tracker/>
- ²⁵ Tom Jackson, “How Angel Networks Are Filling Startup Funding Gaps in Africa,” Disrupt Africa, August 27, 2019, <https://disrupt-africa.com/2019/08/how-angel-networks-are-filling-startup-funding-gaps-in-africa/>
- ²⁶ Larry Madawo, “Silicon Valley Has Deep Pockets for African Startups—If You’re Not African,” The Guardian, July 17, 2020, <https://www.theguardian.com/business/2020/jul/17/african-businesses-black-entrepreneurs-us-investors>
- ²⁷ Boldewijn Sloet. “The African VC funding paradox.” African Tech Ventures, 8, Feb., 2019, <https://www.africatechventures.co/bx/african-vc-funding-paradox/>
- ²⁸ Nicolas Colin, “A Brief History of the World (of Venture Capital),” The Family Papers 19, Medium, May 4, 2016, <https://salon.thefamily.co/a-brief-history-of-the-world-of-venture-capital-65a8610e7dc2>
- ²⁹ James Chen, “Permanent Capital Vehicle (PCV),” Investopedia, August 29, 2020, <https://www.investopedia.com/terms/p/pcv.asp>
- ³⁰ Ibid.
- ³¹ Mary Juetten, “Failed Startups: Juicero,” Forbes online, November 27, 2018, <https://www.forbes.com/sites/maryjuetten/2018/11/27/failed-startups-juicero/>
- ³² In the context of this discussion, infrastructure refers to foundational investments in logistics networks, for example, that benefit multiple companies in the same industry.
- ³³ Liam Taylor, “Covid-19 Accelerates Africa’s Digital Transformation,” African Business Magazine, July 9, 2020, <https://africanbusinessmagazine.com/sectors/technology/covid-19-could-accelerate-africas-digital-transformation/>
- ³⁴ David Hundeyin, “Jumia: What Went Wrong at ‘Africa’s First Unicorn’?,” The Africa Report, December 11, 2019, <https://www.theafricareport.com/21124/jumia-what-went-wrong-at-africas-first-unicorn/>
- ³⁵ Lazarow, “The Case for Camels.”
- ³⁶ Cambridge Associates and AVCA, Africa Private Equity & Venture Capital Index and Benchmark Statistics, data as of December 31, 2016, published June 29, 2017, <https://www.avca-africa.org/media/1745/2016-q4-cambridge-associates-africa-pe-vc-benchmark-for-avca-june-2017.pdf>
- ³⁷ These ranges reflect information provided by interviewees, and do not represent independent data collection by the researchers.
- ³⁸ Lazarow, “The Case for Camels.”

- ³⁹ Kenneth Barry, “Private Equity in Africa: Emerging Trends,” AVCA, January 29, 2020, <https://www.avca-africa.org/newsroom/afri-spective-an-inside-look-at-private-equity-in-africa/2020/private-equity-in-africa-emerging-trends/>
- ⁴⁰ Africa Development Bank Group, “Boost Africa Initiative - Frequently Asked Questions,” accessed September 14, 2020, <https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/Boost-Africa-FAQ-AfDB.pdf>
- ⁴¹ Michelle Ashworth, “What Role Can DFIs Play in Promoting the Development of the African Venture Capital Ecosystem?” Private Sector & Development (blog), September 10, 2018, <https://blog.private-sector-and-development.com/2018/09/10/what-role-can-dfis-play-in-promoting-the-development-of-the-african-venture-capital-ecosystem/>
- ⁴² Viktoria Ventures, et al., “Angels in the Silicon Savannah: A Practical Guide for Early-stage Investors,” August 2020, <https://www.viktoria.co.ke/wp-content/uploads/2020/09/Investors-Guide-2021.pdf#wpcf7-fl8-o1>
- ⁴³ African Development Bank Group, “African Development Bank, Partners Meet over Securities Exchanges Linkage Project,” April 26, 2019, <https://www.afdb.org/en/news-and-events/african-development-bank-partners-meet-over-securities-exchanges-linkage-project-19240>
- ⁴⁴ Aaron Kellner, “IRR IRL: What You Need to Know About Internal Rate of Return,” SeedInvest, May 8, 2018, <https://www.seedinvest.com/blog/startup-investing/irr-irl-what-you-need-to-know-about-internal-rate-of-return>
- ⁴⁵ Pierre Azoulay et al., “Research: The Average Age of a Successful Startup Founder Is 45.” Harvard Business Review online, July 11, 2018, <https://hbr.org/2018/07/research-the-average-age-of-a-successful-startup-founder-is-45>
- ⁴⁶ Pierre Socha, “Entrepreneurs Make The Best Tech VCs—Or Do They?,” Amadeus Capital Partners blog, December 18, 2019, <https://www.amadeuscapital.com/entrepreneurs-make-the-best-tech-vcs-or-do-they/>
- ⁴⁷ Ibid
- ⁴⁸ Derek Sivers, “First Follower: Leadership Lessons from Dancing Guy,” YouTube video, February 11, 2010, <https://www.youtube.com/watch?v=fW8amMCVAJQ>
- ⁴⁹ UK-Nigeria Tech Hub, “COVID Impact Survey,” April 2020, <https://www.google.com/url?q=http://covid-impactsurvey.com&sa=D&ust=1603922230690000&usg=AOvVaw3o2-358LaPjRijbFlaQ6Z7>
- ⁵⁰ Carolyn Levy, “Safe Financing Documents,” YCombinator, September 2018, <https://www.ycombinator.com/documents/>
- ⁵¹ Lee, “Welcome to the Unicorn Club: Learning from Billion-Dollar Startups.”
- ⁵² Lazarow, “The Case for Camels.”
- ⁵³ Ibid.
- ⁵⁴ Jake Kendell, “Why are African startups launching in multiple countries before they even hit seed stage funding?” Medium, January 5, 2019 <https://medium.com/dfs-lab/why-are-african-startups-launching-in-multiple-countries-before-they-even-hit-seed-stage-funding-94354a89c43f>
- ⁵⁵ Jacob S. Kazungu and Edwine W. Barasa, “Examining Levels, Distribution and Correlates of Health Insurance Coverage in Kenya,” *Tropical Medicine & International Health* 22, no. 9: 1175–85, <https://onlinelibrary.wiley.com/doi/full/10.1111/tmi.12912>
- ⁵⁶ Shain Rein. *The End of Copycat China* (New Jersey: Wiley, October 20, 2014)
- ⁵⁷ Rhett Morris, et al., “Fostering Productive Entrepreneurship Communities,” *Endeavor*, October 2018, <https://endeavor.org/content/uploads/2015/03/Fostering-Productive-Entrepreneurship-Communities.pdf>

⁵⁸ Akhilesh Ganti, "Economic Moat Definition." Investopedia, accessed September 16, 2020, <https://www.investopedia.com/terms/e/economicmoat.asp>

⁵⁹ Jake Bright, "Africa Can List More Gazelles at Home than Unicorn IPOs Abroad," TechCrunch, October 21, 2019, <https://techcrunch.com/2019/10/21/africa-more-gazelles-at-home-than-unicorn-ipos-abroad/>

⁶⁰ Rice, "Zebras, Camels, Gazelles, Oh My!"

⁶¹ Collins Onuegbu, "African Startups. Of Unicorns, Gazelles and Corporate Breakfasts," Medium, March 11, 2018, <https://medium.com/@collinsonuegbu/african-startups-of-unicorns-gazelles-and-corporate-breakfasts-9ca2a0020247>

⁶² Alexandre Lazarow. *Out-Innovate: How Global Entrepreneurs—from Delhi to Detroit—Are Rewriting the Rules of Silicon Valley*. Massachusetts: Harvard Business Review Press, April 2020.

⁶³ Ibid.

⁶⁴ Lazarow, "The Case for Camels."

⁶⁵ Onuegbu, "African Startups. Of Unicorns, Gazelles and Corporate Breakfasts."

⁶⁶ Rubin, H. J., & Rubin, I. *Qualitative interviewing: The art of hearing data*. Thousand Oaks, Calif: Sage Publications, 2005.

⁶⁷ Ibid, 7.

⁶⁸ Ibid, 29-31

⁶⁹ Robert S. Weiss. *Learning from Strangers: The Art and Method of Qualitative Interview Studies*. New York: Free Press, 1994.

