Raising venture capital - is it the right path for your startup?

By Christopher Ball

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Over the last 50 years, venture capital has been a vital source of financing for early-stage high-growth companies that have not yet been listed on any stock exchange. With Africa being put on the map as a tech hub, there will continue to be an increase in the number of entrepreneurs seeking growth capital for their businesses.

Christopher Ball, co-founder of Finch Technologies | image supplied

According to APVCA's *Venture Capital in Africa* report, during 2021 we saw 650 venture capital (VC) deals raising $5.2bn in total, marking a 104% increase from the 319 reported in 2020. These numbers reflect the welcomed evolution in Africa's entrepreneurial space.

With any business' growth plan, timing is everything, so when is the right time to raise venture capital, and when is it time to pull the plug?

Raising venture capital is no easy feat, and you'll need to put in the leg work in order to attract VC firms and investors. Depending on the stage of your business, you will be required to show business traction and an operating model of success.

If there are investors that show interest in your business, traction, and your team, they may well go into full due diligence of the business.

Starting off with a full review of the business operations, the market that the business is playing in, the growth opportunity and whether the unit economics make sense.

There are four vital questions that will guide your decision on whether raising venture capital is the right path:

Will your startup be worth significantly more in five years' time?

VC investors, who are the real risk-holders when investing, want to see the fruits of their labour and will only invest in startups that have the potential to become large profitable businesses.

A typical VC model indicates that in a portfolio of 10 investments, there are likely only two investments that shoot the lights out and succeed. The ones that do succeed are ones with a solid business model and promising profit trajectory.

Venture funds generally have a five–10-year ROI game plan for their limited partners (investors). These investors need to believe your business can be exponentially more profitable in the next five years. So, if you think you'll be able to generate a sizeable revenue, then VC funding can be the ideal growth solution.

Are you prepared to lose full control?

If you go down the route of seeking capital from a VC fund, you'll need to be fully aware and ready to sell. Most venture capitalists will want startups to follow through with an exit strategy either with a sale or IPO. This is likely to happen before they've reached the 10-year mark.

As a startup founder, it's likely that you went down the startup route because you like having control over your business decisions. Raising capital starts with realising you won't have full reigns over your company anymore, and your investors and board members will be crucial members in the decision-making.

According to *Crunchbase*, the median and average level of VC ownership at exit will be 53% and 50% respectively. Meaning, that by the time your company sells, the VC will likely own half of your business.

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Have you found the 'right' strategic VC partner?

As much as you need to impress venture capital investors, you also need to find the right VC firm to help accelerate your startup growth. You'll also need to ensure that the VC firm invests in the stage of funding you are looking for – as investors actively pursuing deals in other stages might not be relevant. Do some digging when it comes to past deals from that specific VC firm, do they share an investment ethos that suits your needs?

When seeking the right venture capitalist, you'll need to know that they will be willing to leverage their own broader professional networks to help you succeed. If you don't find the right fit, it's also okay to pull the plug and take a step back from the capital raising process.

Will you be able to focus on raising capital?

The lure of money often leads founders to drastically underestimate the time, effort, and creative energy required to bring in the dough. If you're already overwhelmed when it comes to creating and getting products into the market, then you might want to give it a couple of months or years before you commit to a venture capital journey.

In current market conditions, it is advised that founders and CEOs raise enough money to get them through the next two years.

Founders will need to spend at least a quarter of their time focused on fundraising and managing their burn rate very well. Part of this will be understanding the ins and outs of your business, putting together a pitch deck and creating valuation terms (how much you need, will use, etc).

When raising venture capital, you need to be prepared for plenty of rejection, and with this comes carving out time for multiple rounds of meetings with potential investors.

Unicorns becoming part of Africa's already rich fauna horizon

Globally there are thousands of successful and lucrative VC firms, some of the best known are A2Z and Sequoia. According to APVCA, 75% of investors active in Africa in 2021 were international and 25% were Africa-based. Africa is one of the fastest growing VC markets globally and this trend shows no sign of slowing down any time soon.

Locally there are a handful of experienced VCs who play across the funding spectrum with 4DI, Nire Capital, Weaver, Crossfin Ventures, PIP invests and Parktown Capital among the top firms leading the way. Crossfin Ventures invests in early-stage businesses, as well as later-stage opportunities, whereas PIP invests in the earlier rounds of business funding cycles.

In 2021, VC deals poured more money into Africa than the seven years prior combined, with fintech dominating as the most active sector by volume at 32%, according to APVCA's *VC in Africa* report.

There has been rapid growth for startups offering practical yet innovative solutions that address challenges for African consumers and this has piqued the interest of VC investors. The continent should brace itself for the influx of unicorns on the horizon.

ABOUT THE AUTHOR

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