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# Tackling the funding gap to unleash the power of startups in SA

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To build a competitive and fast-growing economy, SA urgently needs to create a much more enabling environment to support entrepreneurship and startups-which is also necessary to foster innovation.

Wrenelle Stander | image supplied

To do this, we need to act now to tackle the yawning funding gap that continues to hamper many small businesses.

Thus, venture capital (VC), a key part of the financial ecosystem that provides entrepreneurs access to capital markets, will become ever more important as we move to rev up all engines of economic growth.

In the Western Cape, a province widely regarded as an innovation hub and the Silicon Valley of Africa, the provincial government has been pushing hard to attract more VC funding into the region to boost the local economy.

VC came under the spotlight recently following the decision by Naspers, Africa's most valuable tech company by market capitalisation, to halt the operations of its R1.4bn SA-focused VC fund.

Furthermore, many have asked whether there is still sufficient appetite to fund startups amid rising interest rates and recession fears across the globe, partly exacerbated by the collapse of startup-focussed lender Silicon Valley Bank.

So, what should we be doing to ensure that we give local startups and SMEs every opportunity to flourish? Could SA's retirement industry, with assets estimated to be worth at least R5-trillion, be the answer?

VC funding, which is generally provided to promising small businesses in exchange for equity, is crucial for the growth of the start-up ecosystem and innovation. Startups, which have become a beacon of hope in recent times, could offer innovative solutions to most of our problems today—from power shortages to tackling climate change.

## Booming startup ecosystem can unlock more investment

Moreover, putting in place all the necessary measures to give startups and SMEs a leg up can help to attract more foreign investment to SA. Investors are generally more inclined to put their money in a country with a booming start-up ecosystem as this invariably suggests that the country is open to innovation and has a high potential for growth. Attracting more foreign investment can accelerate job creation, economic growth, and global competitiveness.

Yet many startups still struggle to access the necessary support and funding needed to propel them to the next level. While other factors can make or break a start-up, a lack of funding is often cited as one of the main reasons why such firms fail to take off. Therefore, we should be doing more to close the funding gap to ensure that our startups succeed. We could do this by offering first-loss guarantees and incentives to encourage more pension funds to invest in VC. As a start, reducing the regulatory burdens on VC investments, and offering lucrative tax breaks or guarantees to support risk taking and to sweeten deals, could boost start-up financing.

Pension funds have traditionally shied away from startups largely because they are regarded as inherently risky business venture.

The SA SME Fund, which invests in funds that support and develop entrepreneurs, highlights that although South African pension funds have been allowed to invest up to 15% of their assets in alternative investments for the last few years, the uptake has been painfully slow—it is estimated that allocations to alternative investments, including VC, are below 2%. Thankfully, this trend is shifting, albeit slowly. According to Ketso Gordhan, CEO of the Fund, more pension funds are beginning to show interest in VC.

"We have a R250m commitment from the Consolidated Retirement Fund and are in Due Diligence with both the PIC and RMA. The Eskom Pension Fund has put out an RFP [request for proposal] for VC funds to apply. All this will begin to change the landscape for VC as far as institutional capital is concerned," Gordhan says.

In the US and Europe, pension funds are a crucial source of capital for the VC industry — the success of some of biggest and well-known global firms today, such as Apple, Facebook, Tesla, and Spotify, can in part be ascribed to VC and the backing by the retirement industry. Estimates suggest that public pension funds contribute at least 65% of the capital in the US VC market, 18% in Europe and 12% in the UK.

Closer to home, Nigeria is a prime example of VfC success. The country's National Pension Commission has encouraged pension funds to invest in VC as part of its efforts to diversify and boost growth. In recent years, Nigerian pension funds have invested in a wide range of VC funds, including those focused on technology, agriculture, and renewable energy. These investments have led to the growth of enterprises such as Paga, a leading mobile payments company. No wonder

Nigeria has established itself as a major start-up hub in recent years.

According to the research firm Disrupt Africa's most recent Tech Startups Funding Report, Nigeria held onto the crown in 2022 as the best funded country in Africa for the second year running, and with the most funded startups. The country saw 180 startups (28.4% of Africa's funded ventures) raise a combined $976m (29.3% of the continent's total) - substantially ahead of all other countries on both counts. Once the wonder child of African start-up funding, SA declined year-on-year, both in the number of startups receiving investment, and in the total amount of funding raised. Seventy-eight startups secured backing in 2022 (12.3% of Africa's funded ventures), together raising $329m (9.9% of Africa's total). These statistics see SA fall to fourth position on both measures, behind Egypt and Kenya. We should be doing better.

## Policy interventions

The relative depth of SA's pension funds and capital markets compared with other African nations should put us in a better position to provide more support to local startups, but this won't happen without targeted policy interventions. To establish SA as a top start-up hub, we need clear policies, incentives, and explicit guidelines—not least those focussed on stimulating pension fund investments in VC.

As the SA Startup Act movement, a collective that represents the local entrepreneurship ecosystem, points out; startups deserve all the backing as they have the potential to become high-growth enterprises underpinned by innovation to achieve above average outputs in terms of growth, job creation and socioeconomic impact.

## The way forward

In the Western Cape, the provincial government has been on a drive to attract more VC funding into the region to boost the local economy and job creation.

Late last year, Western Cape Premier Alan Winde, led a delegation to Europe and one of the main goals was to promote the tech ecosystem in the province and explore closer cooperation with VC funds in London. VC is one of the few financial service sectors dominated by the Western Cape, partly because of the strong tech development ecosystem around the province's leading institutions, such as Stellenbosch University.

Broadly, most VC flows into the technology sector, including fintech and education technology, according to a recent industry report by the Southern African Venture and Private Equity Association (Savca), the industry association and public policy advocate for private equity and venture capital in the region. It correctly emphasises that increasing investment into high-growth early-stage businesses is key to fostering economic growth and innovation, and is imperative to tackle challenges of poverty, inequality, and unemployment.

This is also in line with the National Development Plan (NDP), a government blueprint for eliminating poverty and reducing inequality. The plan has ambitious goals for small firms — including a target of 90% of employment opportunities to be created by this sector by 2030. To get anywhere close to this target, we will need to establish a thriving entrepreneurship and startup ecosystem. For this, we need VC and pension funds more than ever. It's an urgent conversation we should be having as part of efforts to respond to some of the burning questions and challenges we face today.


## ABOUT THE AUTHOR

Stander is CEO of Tourism, Trade, and Investment Promotion Agency Wesgro.