ECONJB 011-23: Venture Capital Market Review and Recommendations

Consolidated Final Report

Prepared for the Department of Economic Development and Tourism

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Executive Summary

The Western Cape Government (WCG) is seeking ways to diversity the provincial economy and to achieve break-out growth. It aims to entrench the province as the technology, financial, innovation and design capital of South Africa and the continent. With the growing adoption of technology to provide solutions to global problems, the opportunities for this industry are endless. By supporting new and growing businesses within this sector it is hoping to foster entrepreneurship and thereby contribute to the sustainable development of the province. These new and growing businesses are on a fast-track path to growth but are cash-hungry and require the support of venture capital (VC).

This report is in response to a Terms of Reference issued by the WCG to gain insights into the state of VC in the Western Cape. It describes the global and African VC ecosystems, followed by a focus on South Africa and the Western Cape. The key points of an international literature case study are highlighted. This is then followed by a regulatory impact assessment and a review of some private sector institutions operating in the VC landscape. This considers their mandates and their barriers to increased investment. Finally, the barriers to increasing VC activity in the province are considered and potential solutions available to the WCG are presented.

African Venture Capital Ecosystems

In 2022 Africa recorded 786 deals with a US$5.2bn value, representing 3% of the total volume and 1.2% of the total value of global venture funding in 2022 (AVCA, 2023b)). The African VC market therefore remains relatively underfunded compared to its demographic and economic potential. This could be explained by a combination of macroeconomic factors – lack of consistent or material economic growth across the continent, political instability, infrastructure gaps, regulatory uncertainties, uncertainty and unpredictability in financial markets, often challenging business environments, and ecosystem immaturity – allied with international investor's traditional wariness of Africa and the VC industry on the continent being in its infancy stage.

Despite its comparative lack of size, VC activity on the continent has shown strong growth and in 2021 reached record levels, which were maintained through 2022. Africa lags America and Europe in terms of trends and so experienced the start of the current "funding winter" about six months after it started impacting the rest of the world. This decrease in global VC activity is

ascribed to geopolitical impacts like the Ukraine/Russia war, cuts in funding to development finance institutions (DFIs) and economic headwinds.

The prominence of seed-stage deals in Africa's VC landscape lies partially in the surge in entrepreneurial activity being seen across the continent and the growth in angel investing activity. There are an increasing number of active angel groups and more angels being trained across the continent. With over 900 000 new business registrations in Africa in 2020 alone, this early-stage investment seems set to continue.

West Africa has dominated the VC landscape on the continent with Nigeria most prominent in terms of deal volume and value. However, this prominence has declined over the last two years with Kenya, Egypt and South Africa overtaking Nigeria. These four (referred to as the Big Four) are currently the dominant ecosystems in the VC landscape. In terms of economic sectors, South Africa and Nigeria stand out as the most diversified markets, with VC investments spread across multiple sectors, reflecting their status as more mature markets within the African tech ecosystem. These two markets boast a higher concentration of tech talent and a history of entrepreneurial success and exits, which attracts a wider range of investors (Team, 2023, p. 32).

Doing business in many African countries remains challenging despite efforts by some governments to create attractive investment destinations. Many investors are seeking a more active role from governments in shaping policies that provide supportive measures for investors and businesses within the tech ecosystem (ABAN, Briter Bridges, & AAA, 2022).

South African Venture Capital Landscape

According to the South African Venture Capital and Private Equity Association (SAVCA), over 9.1bn was invested by its members in 1 205 deals in 2022. At 60% most deals were less than R5m. The average deal size in 2022 was R7.54m, down 4.9% from the 2021 average of R7.93m (by comparison, the median deal size in the UK is £7.1m – approximately R170m). Most of the 2022 investment occurred in pre-series A, series A and series B stages of start-up development. These three stages accounted for 90% of all VC investment by value. However, angel funding in South Africa, which mostly occurs at the pre-seed and seed stages, often goes unreported. Most VC investment in 2022 was into the ICT (information & communication technology) sector. Other sectors that benefitted were products & services and health care.

The peak value of VC capital raised and deal value in South Africa occurred in the year after covid struck, with $832m of venture capital raised and $1.07bn invested in deals in 2021. The value dropped to around $600m for both venture capital raised and deal value in 2022 and 2023. Collectively over the five years from 2019 to 2023 R2.6bn was both raised and invested (Africa: The Big Deal, 2024). This excludes deals less than $100 000.

Exits in South Africa remain problematic. They totalled 38 in 2019 and 43 in 2020. They then dropped to 24 in 2021 and eleven in 2022. Compounding this low number is that only around 40% of all exits were profitable.

Western Cape Venture Capital Ecosystem

The Western Cape is the premier location for the venture capital industry in South Africa and received the lion's share of VC deals and investment by South African VC investors in 2022. According to the SAVCA survey of its members slightly more than half of all deals and investment occurred in the province. This is corroborated by the Africa: The Big Deal database which indicated that 48% of all SA VC deals that it registered (excluding those less than $100 000) occurred in the Western Cape. Adding to this, more than half the head offices of the firms that received funding are in the Western Cape.

The number of VC deals in the province increased from seventeen in 2019 to a peak of 58 in 2021 and 57 in 2022. The number then dropped to 34 in 2023. There were 195 deals in the Western Cape between 2019 and January 2024. The value of the deals also peaked in 2021, at $616m. This then reduced to $218m in 2022 and $214m in 2023.

The fintech industry attracted over half the deal value since 2019, with healthcare a distant second. Telecom, Media & Entertainment (telecoms) sector was third in terms of value.

Most deals, in terms of both value and number, occurred during the Venture Round, a catch-all phrase for venture capital funding that can refer to multiple stages or series. This was followed by Series A for both value and number. Mergers & Acquisitions (M&As) have the third highest value but only 10% of the deal numbers. This reflects the growth in average company value as it matures through the various venture capital phases, with M&A being the final stage for a firm VC deal. M&A firms are also the oldest at 8.6 years. The youngest are the pre-seed firms at 3.0 years. Then, as to be expected, the average age of the firms increases with the next levels of funding all the way to Series C.

Fintech had the most exits in the Western Cape, with nine exits but valued at $7m only. Telecoms had four exits but these were valued at $30m each. There were two exits in retail, valued at $25m each. The average value of all exits was $21m. As a general observation, the fact that there were only 195 deals in the Western Cape over the five-year period 2019-2023 and only nineteen exits for that same period, is indicative of both the infancy and lack of size of the VC industry in South Africa. The nascent nature of the industry is also evident from the stakeholder interviews.

The number of employees increases with firm maturity. The average number of employees at the pre-seed stage is 11.4, increasing to 132 at Series C. The average employment in the Western Cape across all stages is 45.9, which is slightly lower than the 49.3 of South Africa. Expressed differently, the Western Cape has 6.0 employees per $1m of VC investment. The average across South Africa is 5.7.

Western Cape and South African VC Potential

South Africa's VC industry as a percentage of GDP is the same as the average for Africa, at 0.2%, but is 2.9 times less than the global average of 0.5%. The clear international leaders are Israel (3.7%), India (1.6%), the UK (1.1%) and the United States (0.9%). If South Africa had to address the structural impediments and could increase its VC industry as a % of GDP to the global average of 0.5%, then it would need to increase by 2.9 times (i.e. almost triple). If this were to be attained and the VC activity distribution within the provinces were to remain the same, then the Western Cape VC industry could increase from its current $350m a year to $1.0bn. At current exchange rates this would see the industry grow by R12bn.

Venture Capital in Other Countries

A literature review was conducted on three African countries (Kenya, Tunisia and Mauritius) and two non-African countries (The UK and India). A case study on the Israeli VC industry was also conducted. Some of the more salient points provided below.

Ease of Doing Business (EODB) and a friendly business environment, while helpful, does not automatically translate into an active VC industry. While this does encourage investment, what is ultimately required for successful VC activity is both a business-friendly environment, allied with certain macroeconomic factors (such as a large, young population quickly adopting technology, a growing middle class and the availability of a skilled labour force), and a dynamic start-up environment in certain industry sectors (like fintech).

Macroeconomic risks such as currency volatility and uncertainty regarding government / economic policy, are key concerns for overseas investors in Africa, both for LPs and GPs. Coupled with this, a low-tax jurisdiction, government incentives and a light regulatory touch are all factors that can bolster or attract VC activity. Start-up acts tend to improve the attractiveness of a country.

The number of exits in any given year is an indicator of the strength of VC activity in a jurisdiction and is often a key factor for LP investors when considering whether to invest in VC funds, or for international or local VCs when investing in similar sectors or startups locally.

A busy, particularly innovative and successful industry sector can catalyse investment in a country as there are sufficient supporting structures, follow-on investors and pools of talent and skills which support the sector's growth. Established markets attract more investment and are trusted more as investors can focus on business risk without having to worry about country risk and government-related uncertainties.

YOZMA Case Study

Faced with triple-digit inflation and imminent bankruptcy in the 1980s, the Israeli government resolved to shift from a socialist economy to a capitalist one. An economic stabilization plan was set into motion and Project Yozma was born. One goal was to unleash the potential of the private sector by encouraging companies to take risks and experiment with new ideas. Project Yozma kick-started innovative industries by investing in new venture capital funds and early-stage Israeli start-ups. It was able to provide the funding needed to bring their products to market.

Yozma raised $100m and co-invested 40% of the capital required by start-ups. It took an equity stake, rather than provide grants. And the private partners could buy out Yozma's shares at cost after five years if successful. This reduced the risk of the industry and the influx of capital and foreign expertise kickstarted Israel's startup ecosystem. It led to the development of a globally competitive and innovative high-tech industry.

Four key lessons emerge from this case study:

1. The first is the involvement of government in reducing the risk of the VC industry. This de-risking was not only confined to Israeli investors but was extended to international ones too.

2. The value of a fund-of-funds model and how, if used correctly, it can incentivise and de-risk the formation of new funds.

3. The ongoing support from early stage to late-stage funding and particularly for under-represented communities.

4. The establishment of offices in offshore jurisdictions, in Singapore and South Korea, to facilitate cross-border transactions.

Regulatory Impact Assessment

The three main problematic regulatory areas pertinent to the South African VC industry are exchange controls, intellectual property and the lack of tax incentives.

Exchange Controls

Exchange controls exist to manage and regulate the flow of money in and out of a country and are used by many governments to restrict the movement of capital, currency, or financial assets across national borders.

Replacing SARB approval with post-transaction notification would benefit start-ups by reducing the potential delays and disruptions associated with transaction approval times. It would make South Africa's foreign exchange regime more competitive with other countries and so assist in making the country a more attractive destination for overseas investors.

Reporting rather than pre-transaction approval could be achieved through the release of an exchange control circular. Reporting offshore payments would still help the government maintain control over capital flows. Certain types of transactions could be excluded so they still retain the requirement for pre-approval.

Intellectual Property

Intellectual property (IP) usually refers to a start-up's unique idea, software or product, including patents, trademarks, copyrights, trade secrets and other proprietary knowledge, that gives it a competitive advantage or makes it unique.

SARB could consider an amendment to its Currency and Exchanges Guidelines for Business Entities. The amendment would allow qualifying start-ups to receive automatic approval of

offshore IP sales, subject to reporting the transaction (South Africa Startup Act Movement, 2023). With a retention of SARB approval, the monitoring of the inflow and outflow of capital assets is maintained, as well as the valuation and taxation of those assets.

This change would allow IP transfers to related non-resident parties and remove the administrative burden and potential delays associated with getting SARB approval. This in turn would remove the concern or uncertainty for international investors that exchange controls could prevent IP housed in South Africa from being transferred offshore.

Tax Incentives

Generally, government incentives for start-ups and for promoting early-stage investment in small business is usually either directly into start-ups; by creating business incubators and accelerators, training and skills development programmes; or though incentives such as tax relief to investors and to start-ups themselves.

Stakeholder engagement showed almost universal support for the previously scrapped Section 12J incentive that encouraged individuals to invest in the VC industry. Unfortunately, the incentive was abused but it could have been amended rather than scrapped.

An improved tax incentive for investors would allow investors to invest directly in qualifying start-ups or indirectly through VCCs to encourage greater angel investment. While tax incentives for investors make sense, in the South African context it has been shown that there would be a net loss to society if tax incentives are extended to the start-ups themselves (Genesis Analytics, 2022, pp. 86, 87).

Economic Viability of Regulatory Reform

There are two areas where the impact of the regulations could be quantified. Lifting exchange controls has the potential to increase international start-up funding by R127.4bn and tax incentives for investors by R927m over five years (Genesis Analytics, 2022, pp. 40, 75). These two international investment amounts translate into an annal increase in Western Cape Start-up revenue of R11.6bn and R84m respectively. This translates into a direct contribution to GDP in the province of R5.7bn and a total contribution to Western Cape GDP, which includes all indirect and induced effects in the province, of R12.7bn. The contribution to the South African economy, from the Western Cape start-ups only, is R15.7bn.

It is estimated that 3 900 direct jobs and 15 900 total jobs would be created in the Western Cape. There would be approximately 19 000 jobs created across the country from the Western Cape start-ups alone. Job creation is not necessarily the focus of high growth tech start-ups. However, these businesses have the potential to create a substantial number of indirect and induced jobs through their supply chains and employee expenditure. Out of the 15 900 total jobs in the Western Cape only 3 900 are direct, with the remainder indirect and induced. This means these firms create three indirect and induced jobs in the province for every direct job.

Analysis of Private Sector Institutions

The investment mandates of the private sector financing institutions are all similar in philosophy but there are differences in the specific areas of focus and lifecycle of the start-ups. Most, however, invest in firms that already have some traction in the marketplace and the very early stages, such as pre-seed and seed, are considered too risky in what is already a risky industry.

Furthermore, the VC industry is young and does not yet have an established track record. This, with its inherent risk, does not always align with the investment mandate of pension funds. However, the local pension fund industry is large in comparison and if only 1% of pension funds could find their way into VC funding then it has the ability to quadruple in size.

Mechanisms do exist to de-risk the VC industry and this is where the WCG can assist. These mechanisms are:

1. To establish a first loss fund. This can be done for any stage of funding. While the WCG might not get a return on its investment, it should see this as promoting an industry with longer term economic benefits.

2. To directly fund pre-seed and seed stage start-ups. It is not necessary for the WCG to duplicate the measures that have already been established by industry. It is therefore recommended that it either finance existing funds-of-funds or create a catalytic match funding process which could be used by any early-stage investor to leverage additional grant funding.

3. Improved support of existing incubators and accelerators through very specific funding mechanisms. What is important at this early stage is to not just provide generalised SME support services or ESD programmes but to work with organisations that have a

track record of making start-ups “investor-friendly” or “investable” as well as those who have a track record of assisting startups to secure early-stage funding.

These mechanisms potentially have the dual effect of refocussing the attention of the funding institutions on earlier stages of the start-ups as well as attracting more pension fund investments. The full impact of any mechanism, though, extends beyond its direct intervention. Targeting interventions may help showcase the VC industry and assist it to develop a track record. This in turn has a catalysing effect, which means that more funds become available for VC investment, further rounds of investment become easier and more exits occur.

Barriers and Remedial Options

There are several barriers to increasing VC activity in the Western Cape that were identified. The WCG has access to several options to address these barriers.

Barriers to VC Activity in the Western Cape

The four biggest barriers facing the South African and Western Cape VC industry are restrictive exchange controls, rigid IP legislation, the burdensome tax regime and international investors’ negative perceptions about the country (some of which are directly as a result of the first two barriers). Restrictive exchange controls was almost unanimously referred to across all stakeholders. These four are followed by currency risk, a lack of exits, a lack of pension fund investment, length of time for regulatory approval and the local industry still being small. Rounding off the top ten is the problem of getting skilled / nomad visas. A further twenty barriers were identified. These are shown in table ES1.

The top five barriers are particularly pertinent to international investors and are seen as country risks that add to the business risk of the VC asset class. International investors therefore look at other international VC destinations where these additional country risks are not prevalent.

Many of the top ten issues are either systemic or within the remit of the national government and hence there is very little that the WCG can do. This is reflected by their score of 2 in their ability to deal with the barrier. The WCG can influence international investor perceptions of the Western Cape and may be able to intervene with issues like the skilled visa issue, and hence these score a 3. There is nothing the WCG can do about currency risk.

The WCG can address some of the barriers lower on the list, such as the lack of early-stage funding and the start-up fragmentation of the VC industry. Others where it may have influence are international competitiveness (functioning provincial infrastructure, quality of life, integrated digital and telecommunications network, etc); the lack of appropriate incubation / early-stage start-up support; a lack of tech talent; the risk of the VC asset class; VC fragmentation; diversified markets; lack of air connectivity; and the need for a certain level of entrepreneurial activity.

Table ES1: Barriers to Western Cape VC Activity

	Barriers	Source	Severity	WCG Ability to Address
1	Exchange controls	Stakeholder	5	2
2	Intellectual Property controls	Stakeholder	5	2
3	Burdensome/restrictive tax regime	Stakeholder	5	2
4	International funders wary of SA/negative perceptions	Stakeholder	5	3
5	Currency risk	Stakeholder	4	1
6	Lack of exits	International/Stakeholder	4	2
7	Lack of pension fund/institutional investment	Stakeholder	4	2
8	Length of time of regulatory approval	Stakeholder	4	2
9	Local industry still small	International Review	4	2
10	Problems getting visas	Stakeholder	3.5	3
11	Corporate SA is conservative	Stakeholder	3	2
12	Geopolitical trends	International Review	3	1
13	International competition	International Review	3	4
14	Lack of early stage funding (majority follow-on funding)	International/Stakeholder	3	5
15	Lack of incubation/early stage support	Stakeholder	3	4
16	Local industry still young	Stakeholder	3	2
17	Local VC funders too small	Stakeholder	3	2
18	Strategic geographic position	International Review	3	2
19	Lack of air connectivity	Stakeholder	2	4
20	Lack of tech talent	International Review	2	4
21	Mandate limitations	Stakeholder	2	2
22	Public sector too conservative and cumbersome	Stakeholder	2	2
23	Risky class of asset	International/Stakeholder	2	4
24	Areas of expertise attracted to VC funding	International Review	1	2
25	Declining local economy	International Review	1	2
26	Diversified markets	International Review	1	4
27	Limited investment opportunities	International Review	1	2
28	Need for certain level of entrepeneurial activity	International Review	1	4
29	Overseas funders too big	Stakeholder	1	1
30	VC sector fragmented	Stakeholder	1	5

Key to Barrier Score

5 Major impediment constraining industry
3 Barrier to growth but not major constraint
1 Minor barrier

Key to WCG Ability Score

5 Able to directly address
3 Indirectly address
2 Limited ability
1 No ability

Remedial Options

The list of remedial options available to the WCG is given in Table ES2. The overall aim of these remedial options is not only to address impediments to the VC industry, but also to catalyse the industry. The general philosophy gleaned from the stakeholder interviews is that it is not necessary for the WCG to start new initiatives (and in many cases, the Western Cape is praised for already doing a lot of the right things). This philosophy can be summarised as: government should create the space for the industry, let industry do itself. Where local government can play a role is to support the VC space locally and collaborate with the private sector to add impetus to VC industry momentum.

Table ES2. Remedial Options Addressing Barriers

	Options	Source	Impact	WCG Ability to Address	Timeframe
1	Address exchange controls (including IP legislation)	Stakeholder	5	2	Long
2	Address tax incentives	International Review	5	2	Long
3	Facilitate skilled visas	Stakeholder	4.5	3	Medium
4	Lobby government for incentives	Stakeholder	4	5	Long
5	Develop a Startup Act	International Review	4	2	Long
6	Create a One Stop Shop / VC unit	Stakeholder	3.5	5	Medium
7	Create supportive environment - incubators, innovation zones	Stakeholder	3	5	Short
8	Facilitate interaction between innovators and industry	Stakeholder	3	5	Short
9	Host roadshows	Stakeholder	3	5	Short
10	Continued good provincial governance	Stakeholder	3	4	Long
11	De-risk VC funding as an asset class	Stakeholder	3	4	Short
12	Establish free trade zones / special economic zones	Stakeholder	3	3	Long
13	Make Cape Town attractive - lifestyle, weather etc.	Stakeholder	3	3	Long
14	Pursue public/private partnerships	Stakeholder	3	3	Short
15	Promote macroeconomic stability	International Review	3	1	Long
16	Improve air access/ease of access	Stakeholder	2	4	Short
17	Focus on certain sectors	International Review	2	3	Medium
18	Foster entrepreneurial innovation	International Review	2	2	Medium
19	Establish a VC industry central database	Stakeholder	1	3	Short

Key to Impact Score

5 Remove major impediment constraining industry
3 Remove a barrier to growth but not major constraint
1 Remove a minor barrier

Key to WCG Ability Score

5 Able to directly address
3 Indirectly address
2 Limited ability
1 No ability

The two most important options that the WCG can address are exchange controls including rigid IP legislation; and addressing tax incentives for the industry. These are closely followed by facilitating skilled visas. However, the WCG's ability to address the top two is very limited because this lies within the ambit of national government. While their impact is big, these are unfortunately not quick solutions. The WCG may have marginally more ability to motivate for the relaxing of skilled and nomad visa conditions over the medium term.

There next three options are to lobby national government for incentives, to develop a Startup Act and to create a One Stop Shop. The WCG has a direct ability to lobby government and to develop the One Stop Shop but less ability to develop a Startup Act. Some of the less important options where the WCG has a direct ability to influence are to create a supportive environment such as incubators and innovation zones; to facilitate access between innovators and industry; to host roadshows; continued good provincial governance; to de-risk VC funding as an asset class; and to Improve air access.

Each option available to the WCG was analysed to determine a key intent, high-level programmes and governance and the potential impact on procurement.

Summary to WCG Options Analysis

In summary, the study identified 30 barriers to VC activity in the Western Cape and nineteen interventions available to the WCG to address these barriers. Not all options, however, were directly within the WCG's sphere of influence.

While all nineteen interventions are fundamentally aimed at increasing VC activity in the province, fifteen are aimed at increasing funding. Twelve of them are aimed at supporting start-ups and five are regulatory reforms.

Conclusion

VC activity in South Africa is still a young industry that needs to demonstrate a track record. The Western Cape is the premier VC location in the country but there are several major impediments to unlocking its potential. The four biggest are restrictive exchange controls, rigid IP legislation, the burdensome tax regime and international investors' negative perceptions about the country. The WCG's ability to address these barriers is limited but options do exist. Options also exist for the WCG to address some of the less restrictive barriers as well as where it can support the industry. In doing this, the WCG should work with the VC industry and use existing mechanisms to ensure efficiency. This would be a catalysing effect and unlocking the true potential of the VC industry in the Western Cape can contribute to economic growth and lead to substantial job creation.

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Abbreviations

AAA	African Angel Academy
ABAN	African Business Angel Network
AI	Artificial Intelligence
AVCA	African Private Capital Association
CMA	Capital Markets Authority
CVC	Corporate Venture Company
DBT	Department for Business and Trade
DTA	Double Tax Agreement
EAC	East African Community
EAVCA	East Africa Venture Capital Association
EIS	Enterprise Investment Scheme
ESG	Environmental, Social and Governance
FATF	Financial Action Task Force
FDI	Foreign Direct Investment
FSC	Financial Services Commission (of Mauritius)
GBC	Global Business Corporation
GBL	Global Business Licence
GDP	Gross Domestic Product
GP	General Partner
ICT	Information and Communication Technology

IPPA	Investment Promotion and Protection Agreement
KIC	Knowledge Intensive Company
LP	Limited Partner
M&A	Merger and Acquisition
PCC	Protected Cell Companies
SAVCA	South African Venture Capital and Private Equity Association
SAFE	Simple Agreement for Future Equity
SARB	South Africa Reserve Bank
SARS	South Africa Revenue Services
SDGs	Sustainable Development Goals
SEIS	Seed Enterprise Investment Scheme
SPV	Special Purpose Vehicles
VC	Venture Capital
VCC	Venture Capital Company
VCC	Variable Capital Companies
WCG	Western Cape Government

Glossary of Terms

The following definitions have been borrowed from the South African Venture Capital and Private Equity Association (SAVCA, 2023, p. 9). They are used extensively by the industry.

Capital:

Pre-Seed	Funding mostly in the form of grant money. This earliest stage of funding comes so early in the process that it is not generally included among the rounds of funding at all.
Pre- Series A	A mid-round between Seed and Series A, provided to a company that has achieved some traction in the market, and now needs capital to prove that the business fulfils a specific market need. In South Africa, Pre-Series A involves deals where the start-up is not yet big enough to enable a Series A round and typically involves a 10% to 25% equity stake. Also referred to as Start-up capital.
Private Equity	The main difference between private equity and venture capital is the age of the company. Private equity will typically invest in a mature company which has proven revenue and been in operation for several years, whereas venture capital concentrates on start-ups and early stage investing. Another important distinction is that VC funders often take a role in managing entrepreneurial companies at an early stage, adding skills (technological and strategic support, and mentoring) as well as capital.
Seed Capital	Funding provided before the investee company has started mass production/distribution with the aim to complete research, product definition, or product design, also including market tests and creating prototypes. This funding would not be used to start mass production/distribution. Many angels invest at the seed stage once a company has been set-up but not generated significant revenues or traction. This could be in the form of convertible debt or equity (including SAFEs).

Series A	Post-revenue, companies with proven market relevance that need capital to take a strong strategy for turning the business into a successful, profitable enterprise. Also referred to as Later-stage capital. Equity ranges between 10% and 15%.
Series B	A type of private equity investment (often a minority investment involving less than 10% equity) in relatively mature companies that are primarily looking for capital to expand and improve operations or enter new markets to accelerate the growth of the business. Also referred to as growth capital.
VC Funds	Firms that have raised, or are currently raising, third-party funds from institutional investors.
Venture Capital	Term used for funding provided by investors to start-up firms and small businesses that need funding and support to get an idea off the ground, develop a business model or launch into the market. This funding is often deployed to companies in a series of "rounds" of funding as pre-agreed milestones are met.
Venture Debt	Loans offered to early-stage, high-growth companies with existing venture capital backing by venture debt providers (typically banks or private capital funds) to provide liquidity to a business for the period between equity funding rounds, to cover working capital requirements or asset financing.
Venture Round	Term used as a catch-all phrase for venture capital funding that is not classified as a particular round within the venture capital funding process.

Investor Classifications:

Angel Investors	High-net-worth individuals who inject funding for start-ups in exchange for ownership equity or convertible debt. Many angels in Africa and South Africa converse with one another through groups or syndicate structures allowing them to spread their risk and invest smaller ticket

	sizes. There is no formal definition or requirement for being considered an angel investor in SA or Africa unlike the US and other markets.
Captive Funds	Funds in which one shareholder contributes most of the funding, typically where a corporate or parent organisation allocates funds to the Captive Fund from its own internal resources. Captive Funds may be subsidiaries of, or divisions within, financial institutions or industrial companies.
Captive Government	Funds primarily sourced from a government department or public body / sector.
Captive Corporate	Funds primarily sourced from a corporate entity such as a listed company.
Captive Other	Funds sourced from other sources such as family offices.
General Partners	Invest in a fund and also assist with its management.
Independent Funds	Funds managed by fund managers in which third party investors are the main source of capital and no investor holds a majority stake.
Limited Partners	Invest in a fund and but do not assist with its management.
VC Firms	Firms that are not known to be investing through a fund structure, making mainly direct investments.

Early-stage investment involves funding the first three stages of a company's development, being seed capital (money to help an entrepreneur post setting up the business but where capital is needed to find product market fit), start-up funding (for product development, manufacturing, sales, marketing and growth), and early-growth funding (scaling to boost manufacturing and sales).

A start-up is a company in the first stages of operations. Start-ups are founded by entrepreneurs who want to develop a product or service they believe will disrupt the market and for which there will be significant demand.

Introduction

The Western Cape Government (WCG) is seeking ways to diversity the provincial economy and to achieve break-out growth. It aims to entrench the province as the technology, financial, innovation and design capital of South Africa and the continent. With the growing adoption of technology to provide solutions to global problems, the opportunities for this industry are endless. By supporting new and growing businesses within this sector it is hoping to foster entrepreneurship and thereby contribute to the sustainable development of the province. These new and growing businesses are on a fast-track path to growth but are cash-hungry and require the support of venture capital (VC).

The Department of Economic Development and Tourism (DEDAT) issued a Terms of Reference (ToR) to appoint a professional service provider to conduct research into the state of VC in the Western Cape. The primary focus is to gain insights into the current state of the VC ecosystem, to identify key players, to assess the regulatory environment and to benchmark the province against national and global standards. The goal is to provide analysis of options and recommendations to increase VC activity in the Western Cape. This report is in response to the ToR and is the third and final one of the study. It combines the previous two reports and includes additional information. There are several sections to this report as well as a series of appendices.

The first section lists the ToR and indicates where the specific deliverables are dealt with in the report. The actual investigation commences with the second section, a description of the global and African VC ecosystems. This is then followed by a section focusing on the South African and Western Cape VC landscapes. This includes sketching the industry ecosystems. The fourth section highlights the key points of an international literature review of the VC industry in five countries. The detail of this literature review is contained in Appendix A.

The fifth and sixth sections are a regulatory impact assessment and a review of some private sector institutions operating in the VC landscape. This considers their mandates and their barriers to increased investment. Section seven is the final section in the body of the report. It consolidates the literature review and stakeholder engagements and presents options for the WCG to consider to increase VC activity in the province. This section considers the barriers faced by the VC industry, potential solutions and the ability of the WCG to intervene.

Appendix B reports the main input from stakeholder interviews. Appendices C and D contain supplementary information on skilled and nomad visas and the functions of the UK VC unit.

1 Addressing the Terms of Reference

The ToR requires a report covering the following components:

4.1 An overall analysis of the venture capital players and activity in Africa and South Africa. This is addressed throughout the report but with specific focus in sections 2, 3 and 4.

4.2 Benchmark the venture capital industry (inclusive angel investors) and its performance in South Africa against three other African countries (including Mauritius), and two non-African best practice countries against the following:

i. Performance and intensity of venture capital activity.

ii. Incentives and government support provided to the venture capital industry.

iii. Most pertinent legislation and regulations governing or directly impacting on the venture capital industry.

This is addressed in section 4. An assessment of angel investors is given in section 2.6 and a description of the UK VC Unit is given in Appendix D.

4.3 An analysis of venture capital players in South Africa, including the source of their funding, criteria for investing, key areas of focus (e.g. sectors, size, maturity, etc) and support offered (incubation, market access, etc). This is covered in sections 3.1 and 6.1.

4.4 An analysis of the venture capital activity in the Western Cape, including the size, scope and diversity of investments, investment stages and deal stages (where applicable). Refer to section 3.2.

4.5 An analysis of 6 to 8 South African private sector finance institutions (e.g. long-term insurance corporations) to understand their investment mandates and detail under what circumstances they would increase their allocation to start-ups and scale-ups. This is addressed in section 6.

4.6 An analysis of international funding and detail under what circumstances they would allocate more funding towards the Western Cape. This is one of the main issues highlighted by stakeholders and is addressed in section 5 (the regulatory impact assessment) and section 7 (the analysis of barriers and remedial options).

4.7 Develop an ecosystem map illustrating the relationships between the various stakeholders. This is sketched out in sections 3.3 and 3.4.

4.8 An analysis of the challenges (including regulatory constraints) faced by the different types of venture capital funders (e.g. institutional, angel, funds) and their proposed solutions. This is addressed in sections 2.6, 3.4, 4.1, 4.2 and 5 as well as sections 7.1 and 7.2.

4.9 Evaluate the impact of the barriers on the venture capital landscape. This is covered in section 7.1.

4.10 Identify regulatory best practices and propose recommendations for regulatory enhancements. See section 5.

4.11 Assess the economic viability of initiating / implementing regulatory reforms. This is covered in section 5.6.

4.12 To inform the above assessments, the service provider will be required to:

1. Conduct interviews and surveys with key stakeholders, including venture capital firms, entrepreneurs, government departments / entities / officials, institutional investors and industry experts, etc, to gather insights into the venture capital landscape.

2. Engage at least two (2) industry associations or representative bodies.

Fourteen stakeholder interviews were conducted with all categories of stakeholders described above. Refer to the acknowledgements section at the start of this report for a list of the stakeholders. Appendix B summarises the key points raised by the different stakeholder groups.

Three industry associations were interviewed. These were SAVCA, the Startup Act Movement and ABAN.

4.13 Make suitable recommendations based on the work caried out in sections 4.1 – 4.11 above to crowd in more Venture Capital investment to the Western Cape, and to address any identified systemic barriers. Differentiate the role of provincial government versus other stakeholders (private sector, banking fraternity, regulators and government) in order to unlock opportunities and address challenges facing VC in the Western Cape. This is covered in section 7.2.

4.14 Provide recommended options on the following:

1. How to increase venture capital activity and supply in the Western Cape

2. How to increase the volume and supply of venture capital funding for Western Cape based business.

Each option must include proposed high-level programme design, governance design, options analysis and procurement approach.

The recommended options are covered in section 7.2. The programme design, governance design and procurement approach are given for each option in Table 9 in section 7.3. The first two columns of Table 10 in Section 7.4 summarises the identified remedial options for each of the two bullet points above. This is how to increase VC activity and supply in the Western Cape and how to increase the volume and supply of capital funding.

4.15 Provide recommended options to increase demand through support to start-ups and scale-ups. Each option must include proposed high-level programme design, governance design, options analysis and procurement approach.

The recommended options are covered in section 7.2. The programme design, governance design and procurement approach are given for each option in Table 9 in section 7.3. The second last column of Table 10 in Section 7.4 summarises those identified remedial options that support start-ups and scale-ups.

4.16 Provide recommended options with respect to addressing regulatory constraints, detailing what regulations need to be changed, as well as the impact that the change would provide in terms of investment and jobs (amongst others).

The recommended options are covered in section 7.2. The programme design, governance design and procurement approach are given for each option in Table 9 in section 7.3. The right-hand column of Table 10 in Section 7.4 summarises those identified remedial options that specifically address regulatory constraints. Section 5.6 quantifies the jobs associated with the regulatory changes.

2 African Venture Capital Ecosystems

The African VC market is small in comparison to other global markets, despite its growth over the past few years. In 2022 Africa recorded 786 deals with a US$5.2bn value, representing 3% of the total volume and 1.2% of the total value of global venture funding in 2022 (AVCA, 2023b)). The comparison between Africa and other jurisdictions is presented in Table 1.

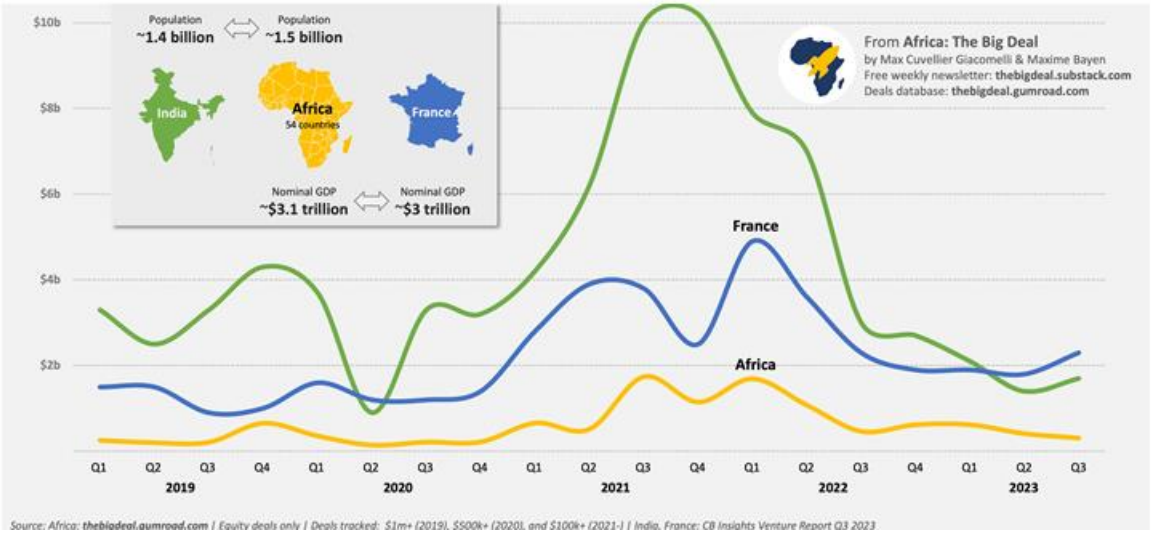
Table 1: Global Venture Capital 2022

Area	Number Deals	Deal Value
Africa	786	$5.2bn
North America	13 251	$225.5bn
Europe	7 619	$89.5bn
Asia	6 860	$108.0bn
Global	30 977	$445.0bn

Source: (AVCA, 2023b)

India and France are comparable in terms of markets with a population and nominal GDP equivalent to that of Africa. However, since 2019 $11.5bn was invested in start-ups in Africa (equity only), compared to $42bn in France (3.6x) and $81bn in India (7x) (Africa: The Big Deal, 2024). Figure 1 shows the quarterly equity funding raised by start-ups in Africa, India and France (for deals exceeding $100k).

Figure 1: Funding Raised by Start-ups in Africa, India and France



Source: (Africa: The Big Deal, 2024)

The African VC market therefore remains relatively underfunded compared to its demographic and economic potential. This could be explained by a combination of macroeconomic factors – lack of consistent or material economic growth across the continent, political instability,

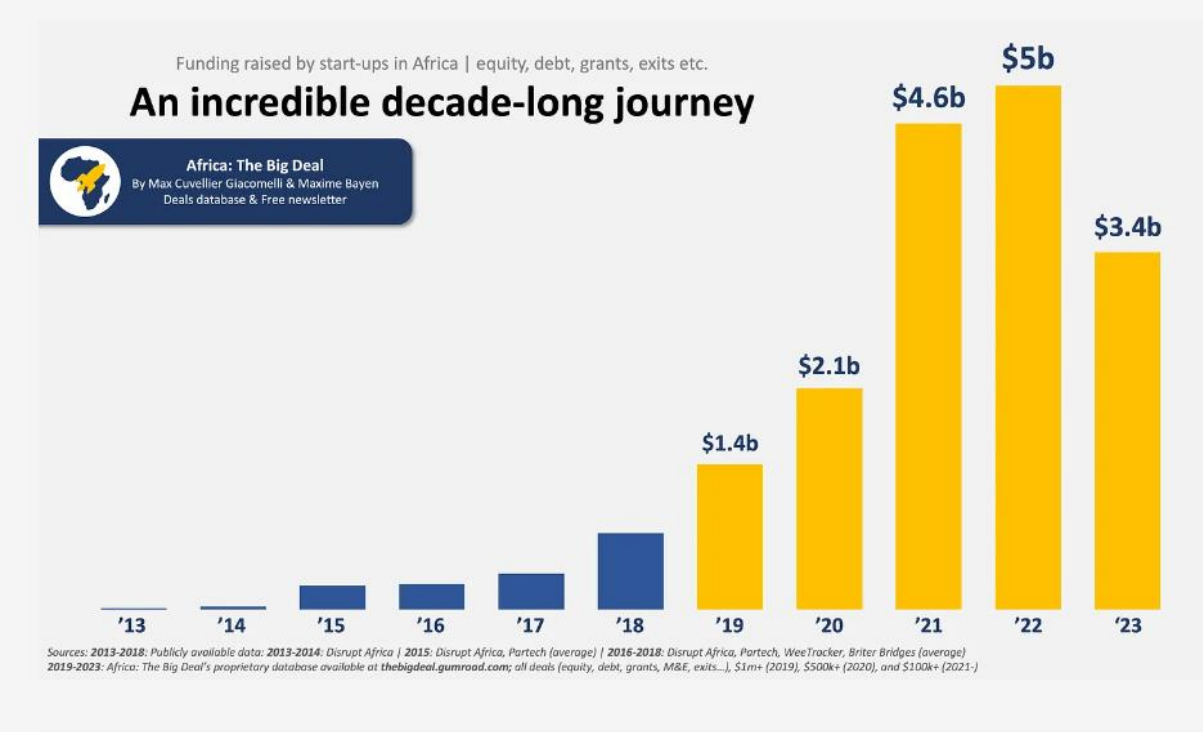
infrastructure gaps, regulatory uncertainties, uncertainty and unpredictability in financial markets, often challenging business environments, and ecosystem immaturity – allied with international investor's traditional wariness of Africa and the VC industry on the continent being in its infancy stage.

While information on the sector has become more readily available and there is increased coordination and cooperation between data collection and reporting, there are still gaps in the data and information available as well as differing definitions of VC funding, sectors and level of data collected which makes data analysis difficult, especially for early-stage deals.

2.1 Growth in Africa

Despite its comparative lack of size, VC activity on the continent has shown strong growth and in 2021 reached record levels, which were maintained through 2022, as reflected in Figure 2.

Figure 2: Growth in VC Activity in Africa



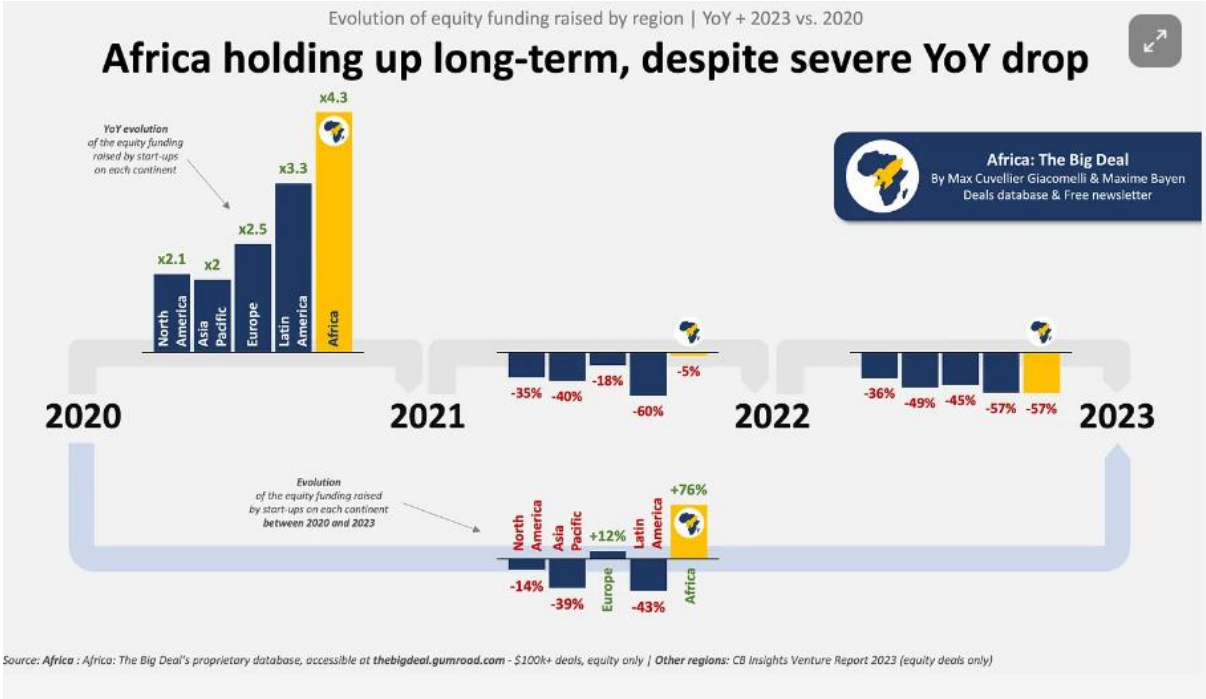
Source: (Africa: The Big Deal, 2024)

African entrepreneurs closed out Q3 2023 having raised 28% more capital than they did during the same period in 2022 – making it the only region to witness positive year-on-year growth that quarter, outside of Europe (AVCA, Venture Capital Activity in Africa Q3 2023, 2023).

VC funding to Africa throughout 2020 to 2023 has consistently outpaced Latin America, the continent's closest socio-economic comparator (AVCA, Venture Capital Activity in Africa Q3

2023, 2023). Figure 3 also indicates that the African VC industry is much bigger in 2023 compared to 2020, unlike all other regions shown in the diagram which have contracted recently. Africa and Europe are the only regions to have shown positive growth over that time frame.

Figure 3: Annual VC Growth 2020 to 2023



Source: (Africa: The Big Deal, 2024)

Some of the key differences between Africa and Latin America are:

1. Africa being perceived as having greater untapped potential for growth.

2. Africa's rapid population growth and its large and youthful demographic that is becoming increasingly urbanized and tech-savvy.

3. Africa’s surge in tech innovation, particularly in mobile technology and fintech solutions. This innovation is driven by factors such as the widespread adoption of smartphones, improving internet connectivity, and the emergence of tech hubs and incubators across the continent.

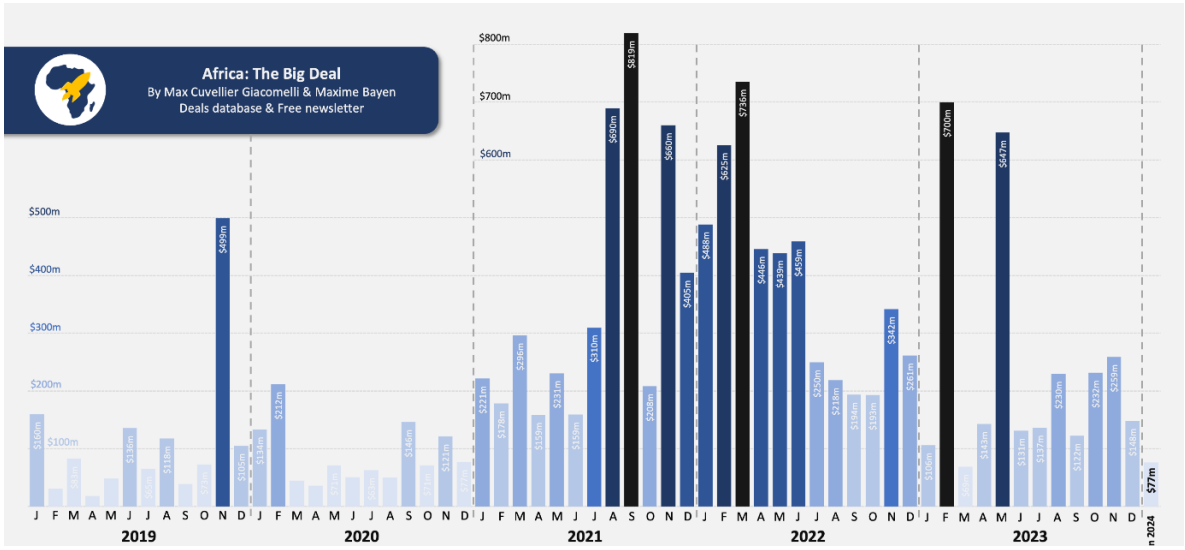
4. Easing of government policies and some relaxation in regulatory environments in Africa. Efforts to promote entrepreneurship and VC funding such as Startup Acts, by some African governments have provided impetus in this regard.

5. Increasing international VC firms and angel investor networks across Africa.

6. Differences in sectoral focus. For example, Africa is experiencing more investment in sectors like agritech, renewable energy, and e-commerce.

Africa lags America and Europe in terms of trends and so experienced the start of the current "funding winter" about six months after it started impacting the rest of the world. This decrease in global VC activity, ascribed to geopolitical impacts like the Ukraine/Russia war, cuts in funding to development finance institutions (DFIs) and economic headwinds, has impacted VC funding in Africa as shown in Figure 4. This has resulted in more debt funding than before and which has become more attractive to start-ups.

Figure 4: Monthly Funding Raised by Start-ups in Africa



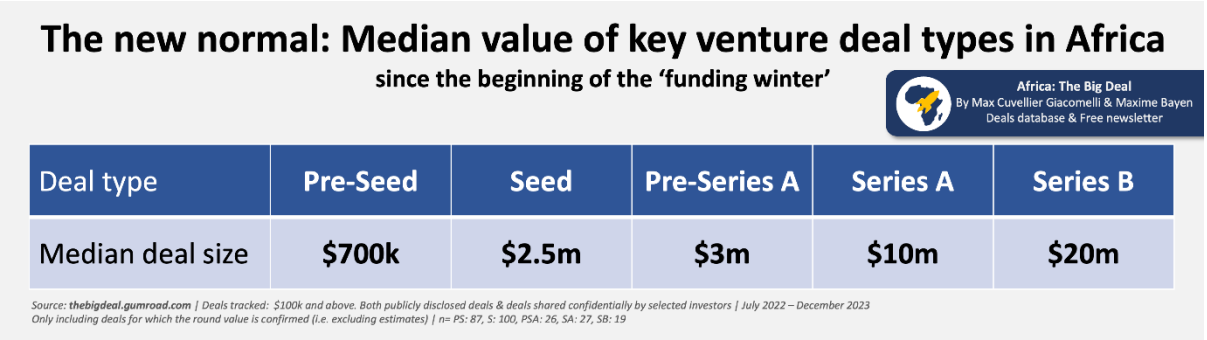
Source: (Africa: The Big Deal, 2024)

Industry layoffs in portfolio companies which have raised large funding rounds in the past, made headlines in 2022 because of market instability and declining revenue, together with the streamlining of workforces after inflated hiring during the Covid-19 pandemic. However, the nature of staff being dismissed in the African context differs from its North American and European counterparts. A large percentage of layoffs amongst Africa's tech firms were in the business support and not tech-related roles. Overall, the need for, and relative scarcity of, tech talent across Africa remains a more pressing concern than broad global layoffs (CIO, 2023).

Although the highest deal value in Africa does not compare with deal maximums in other regions, Africa remains competitive by median deal values. At the seed stage, in 2022 Africa's median deal value fell slightly short of the global average of $2.0m. However, Africa's median deal value significantly exceeded the global average at both the early stage (at $10m compared to the global $5m) and also at the late stage (standing at $45m compared to the global $7.9m) (KPMG, 2023).

Figure 5 shows the median deal size values (Africa: The Big Deal, 2024), which have dropped primarily post seed stage, with early stage deals still maintaining their value.

Figure 5: Median Deal Size in Africa



Source: (Africa: The Big Deal, 2024)

VC industry in Africa grew at a Compound Annual Growth Rate (CAGR) of 31% between 2014 and 2022. This growth is in line with the historic evolution of the industry, which has been one of steady, incremental maturation (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 11).

2.2 Stage of Funding

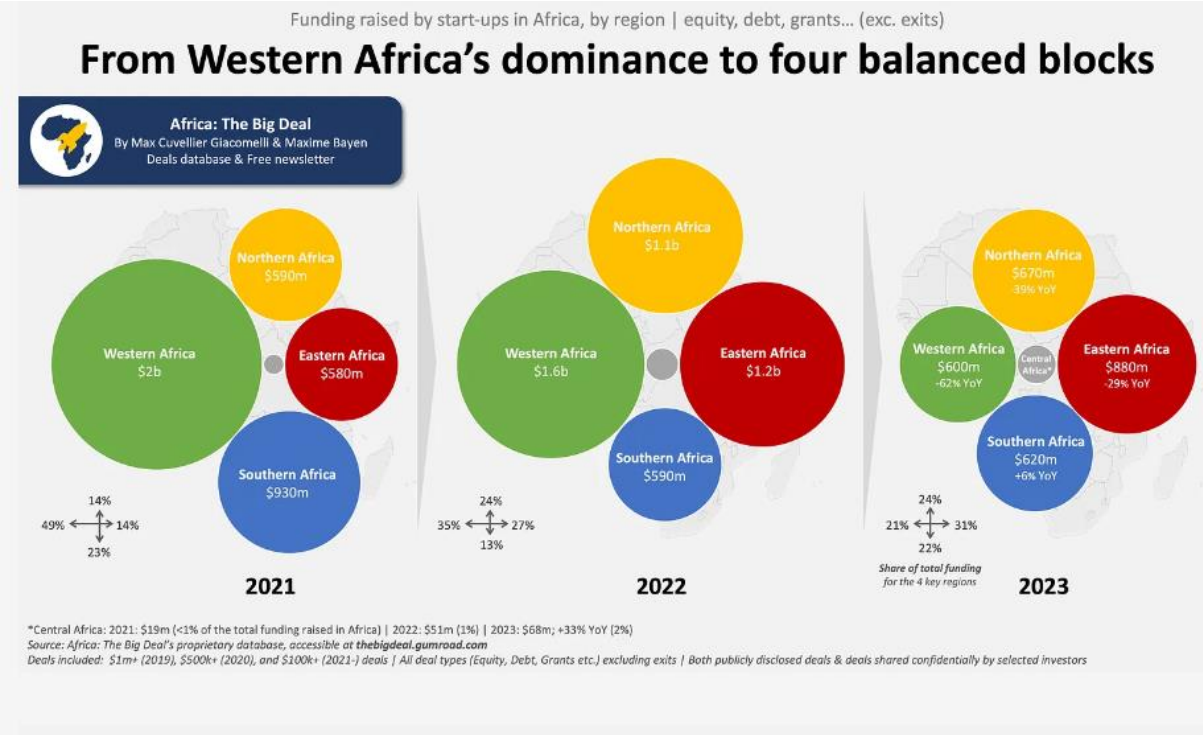
The majority of dealmaking in 2022 was follow-on funding, i.e. repeat or subsequent financing of existing portfolio companies, rather than first-time financing. Amongst first time recipients of capital, 52% of transactions were at the seed stage, with only a small percentage (4%) of first-time capital recipients doing so at the early-stage (i.e. pre-series A or series A transactions) (AVCA, 2023b, p. 13). It should be noted that early-stage activity is historically under-reported because angel deals and those less than $100k are not generally captured by industry associations.

The prominence of seed-stage deals in Africa's VC landscape lies partially in the surge in entrepreneurial activity being seen across the continent and the growth in angel investing activity. There are an increasing number of active angel groups and more angels being trained across the continent. The African Angel Academy has trained over 600 angels in 24 African countries over the past four years (including over 90 angels based in SA). While the fact that over 900 000 new business registrations in Africa were reported in 2020 alone (Bank), would indicate that this early stage investment seems set to continue strongly, not all such new businesses are suitable for VC or angel investment and many high growth businesses in Africa are not even registered as they are based offshore, despite operating in the African market.

2.3 Regional Ecosystems

West Africa has dominated the VC landscape on the continent with Nigeria most prominent in terms of deal volume and value. However, this prominence has declined over the last two years with Kenya, Egypt and South Africa overtaking Nigeria. These four (referred to as the Big Four) are currently the dominant ecosystems in the African VC landscape, as shown in Figure 6.

Figure 6: Dominant African VC Regions 2021 to 2023



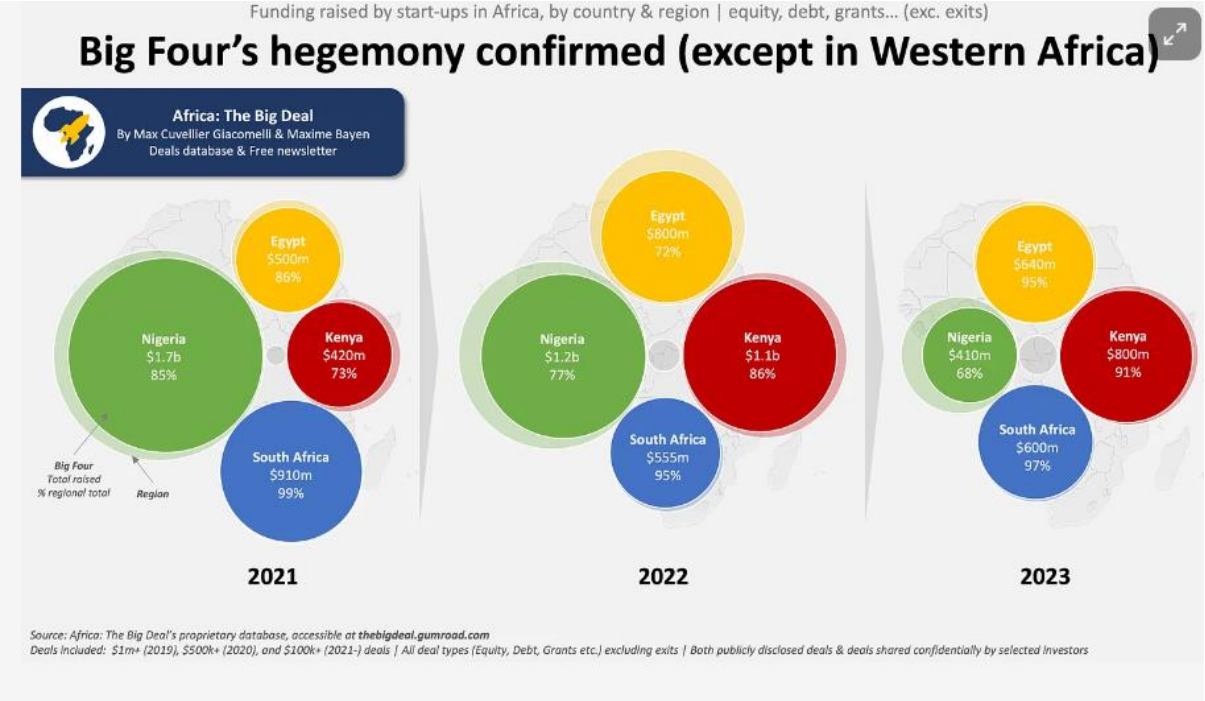
Source: (Africa: The Big Deal, 2024)

According to The African Private Capital Association (AVCA), Venture Capital in Africa 2022 Report (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 17), Southern Africa's longstanding predominance between 2014 and 2020 as the region which saw the most deal activity, has declined, coming in fourth place by both deal volume (15%) and value (9%), in 2022. The report attributes this decline to South Africa's worsening economy in recent years (an unemployment rate of 35%, a projected highest jobless rate globally in 2023 (Forum, 2023), GDP per capita in 2021 lower than it stood a decade prior, and consumer inflation at its highest level in thirteen years during 2022). In addition, the report suggests that South Africa's grip on the VC ecosystem has loosened in the face of increased macroeconomic stability, policy reforms and competition, entrepreneurial innovation, and investment

elsewhere on the continent, with the result being a drop in regional deal activity for Southern Africa (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 17).

Figure 7 confirms the Big Four status, compared to their regions, for funding raised by start-ups, in Africa and how this has changed over time (Africa: The Big Deal, 2024):

Figure 7: Dominant African Countries 2021 to 2023



Source: (Africa: The Big Deal, 2024)

Venture debt, as a component of VC funding (or defined as such when a VC deal that includes venture debt is part of a larger transaction that also involves equity), has grown to be a more significant part of the African investment ecosystem in recent years. It involves loans offered to early-stage, high-growth companies with existing VC backing by venture debt providers (typically banks or private capital funds) to provide liquidity to a business for the period between equity funding rounds. The combination of a lower cost of capital and flexible repayment terms have led to the increasing popularity of venture debt as an asset class and as an attractive alternative to traditional equity financing, enabling start-ups to scale their businesses without sacrificing their ownership stake. Venture debt is largest by both deal value and volume across multiple regions in Africa. East (25%) and West Africa (21%) were particular hubs for venture debt deal activity in 2022. This was driven by start-ups headquartered in Kenya and Uganda in the East, while start-ups headquartered in Nigeria, Senegal and Cote d'Ivoire led the charge of venture debt deal activity in the West (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 18).

In terms of economic sectors, South Africa and Nigeria stand out as the most diversified markets, with VC investments spread across multiple sectors, reflecting their status as more mature markets within the African tech ecosystem. These two markets boast a higher concentration of tech talent and a history of entrepreneurial success and exits, which attracts a wider range of investors (Team, 2023, p. 32). Nigeria's large market provides a fertile testing ground for a variety of tech solutions, from fintech to healthtech and beyond, catering to a range of consumer and business needs. South Africa's established financial and legal systems, along with its strategic position as a gateway to the African continent, have fostered a conducive environment for start-ups across multiple sectors, not just fintech. This maturity in the market dynamics allows for a more balanced distribution of venture capital, which is less skewed towards a single sector, and encourages a more general development of the tech sector (Team, 2023, p. 32).

According to a 2023 Africa Tech Venture Capital report by Partech VC Partners (Team, 2023), writing about the African tech ecosystem for 2023[1]:

- South Africa became the top VC investment destination in Africa in 2023, leading in equity funding amount while its top four peers all saw sharper declines in deal counts and volumes.

- Despite a 34% decline in equity funding amount, South Africa took the top position with $548m. The country also recorded 83 deals with the lowest year-on-year decline among the top four at 13%, resisting the global downturn extremely well and ranking second.

- Nigeria, however, kept the lead in the number of equity deals with a total of 112 deals (-41% year-on-year), and moved to second in equity funding amount at $468m with the largest decline among the top four at 59%.

- Kenya holds the third spot on deal count with 67 equity rounds (-35% year-on-year) but experienced a steep decline in equity funding amount (-56% year-on-year) to reach $335m.

[1] *The Partech VC Partners report only looks at equity funding across the region and so figures differ from those reported by Africa: The Big Deal listed above. The methodology of the Partech Report includes only equity or debt rounds that are $200K or above. This means that the focus is on Late Seed (Seed+) to Growth stage equity & debt rounds.*

- Egypt is the most drastically impacted of the top four. The deal count dropped by 58% (highest decline in top four) to just 60 equity deals. On the funding volume, the 45% decline that kept Egypt in third spot with $432m is hiding an even steeper decline because 60% of that amount went into a single deal.

- Beyond these leading countries, Morocco and Ghana were the only other countries surpassing the $50m funding threshold, with Morocco reaching $93m (+252% year-on-year) and Ghana securing $75m (despite -63% year-on-year decline), making Morocco part of the top five for the first time, both in total funding and deal count (17 deals, -11% year-on-year).

This report identifies the increasing representation of Francophone countries in the top countries of African tech investment as a significant trend. In 2023, five Francophone countries – Morocco ($93m), Congo ($42m), Rwanda ($38m), Tunisia ($33m), and Senegal ($27m) – secured their spots in the top ten of African tech funding, highlighting the growing appeal and potential of these markets in the tech sector. In 2023, 52% of all African countries that recorded a transaction were Francophone (14 out of 27), a rise from 46% in the previous year. Since 2014, 18 out of the 21 countries in Francophone Africa have received equity funding.

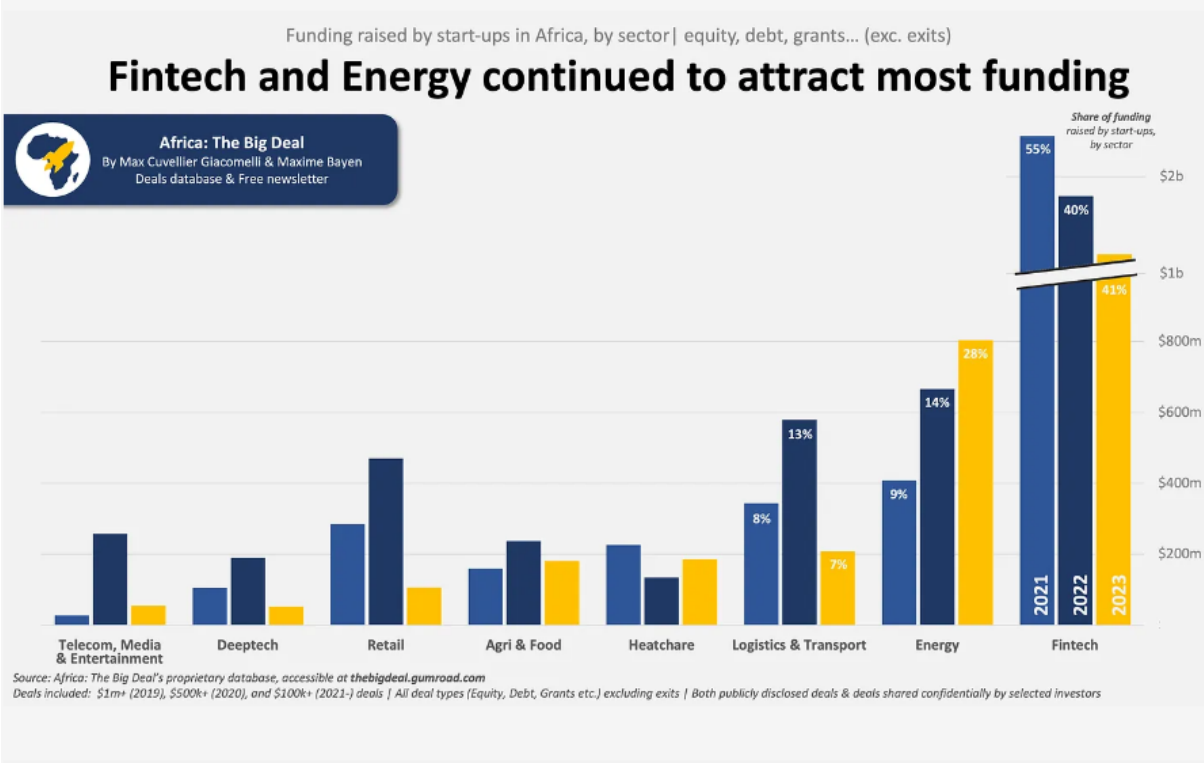
This shift not only reflects the region's active participation in tech ventures, but the report suggests, also highlights a broader change in the landscape of African tech investment. Some of the contributing factors are that six of the ten fastest-growing economies in emerging markets are in Francophone countries; the concentration of global VC funding is shifting from the US and the UK, reducing the impact of the language barrier-and providing opportunity for investors from other countries to invest in non-English speaking destinations; and more VC firms have Francophone Africa mandates. From an intervention perspective, Senegal and Tunisia both have Startup Acts that support the development of start-ups and innovation ecosystems. In addition, one legal framework (OHADA) which covers seventeen countries (many of which make up Francophone Africa) makes transacting as well as scaling across the region for portfolio companies easy. While Morocco does not yet have one, it too has established start-up incubators, accelerators, and investment funds to support the growth of start-ups and promote innovation.

2.4 Sectors

In 2022, the three most active sectors by volume for VC funding for the third year running, were Financials (financial services, including activities such as banking, insurance, investment management, real estate, and other financial services, and including financial technology also

known as fintech) (31%), Information Technology (15%) and Consumer Discretionary (15%) (goods and services that are considered non-essential and are often driven by consumer demand, for example, retailers, food chains, luxury goods and entertainment) (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 22). These three sectors collectively accounted for just under two thirds of the total number of venture capital deals struck on the continent on that year. The dominance of these three sectors reflects Africa's evolving demography and the changing nature of African consumerism; not only are African entrepreneurs bringing new goods and services to market, but the innovative use of technology is also modernising the distribution and accessibility of these entities beyond the upper-middle class to Africa's growing band of young, urban and connected workforce. Given that Africa's economic growth prospects are linked to its accelerating urbanisation, a growing middle class with more discretionary income, and improvements in digital infrastructure deepening both internet and mobile penetration across the continent, indications are that the popularity of these three sectors amongst investors is likely to persist in the long term (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 22).

Figure 8: Most Active Sectors 2021 to 2023



Source: (Africa: The Big Deal, 2024)

Fintech also plays a critical role in addressing infrastructural challenges in Africa. Beyond just being payment applications, these solutions are essential in enabling a wide range of ventures and traditional businesses. By establishing both local and cross-border solutions, and

fostering key connections between individuals, businesses, and financial institutions, fintech's role remains integral to the ecosystem (Team, 2023, p. 30). A sizable portion of Africa's population and business sector remains either unserved or underserved, particularly in the informal sector, a gap that presents a persistent challenge and an ongoing opportunity for innovation and investment, and making the continent a fertile ground for entrepreneurs and investors (Team, 2023, p. 30). However, African markets remain fragmented and the number of middle-class Africans is still relatively small compared to the overall population.

While fintech leads the way as the sector attracting the most funding, around $1 of every $3 invested into start-ups in Africa in 2023 went to climate tech start-ups, reaching over $1bn in total) (Africa: The Big Deal, 2024). While energy and water start-ups attract the most funding in this sector, agritech dominates the early-stage funding (Africa: The Big Deal, 2024). This reflects the increased funding dedicated to mitigating climate change across Africa.

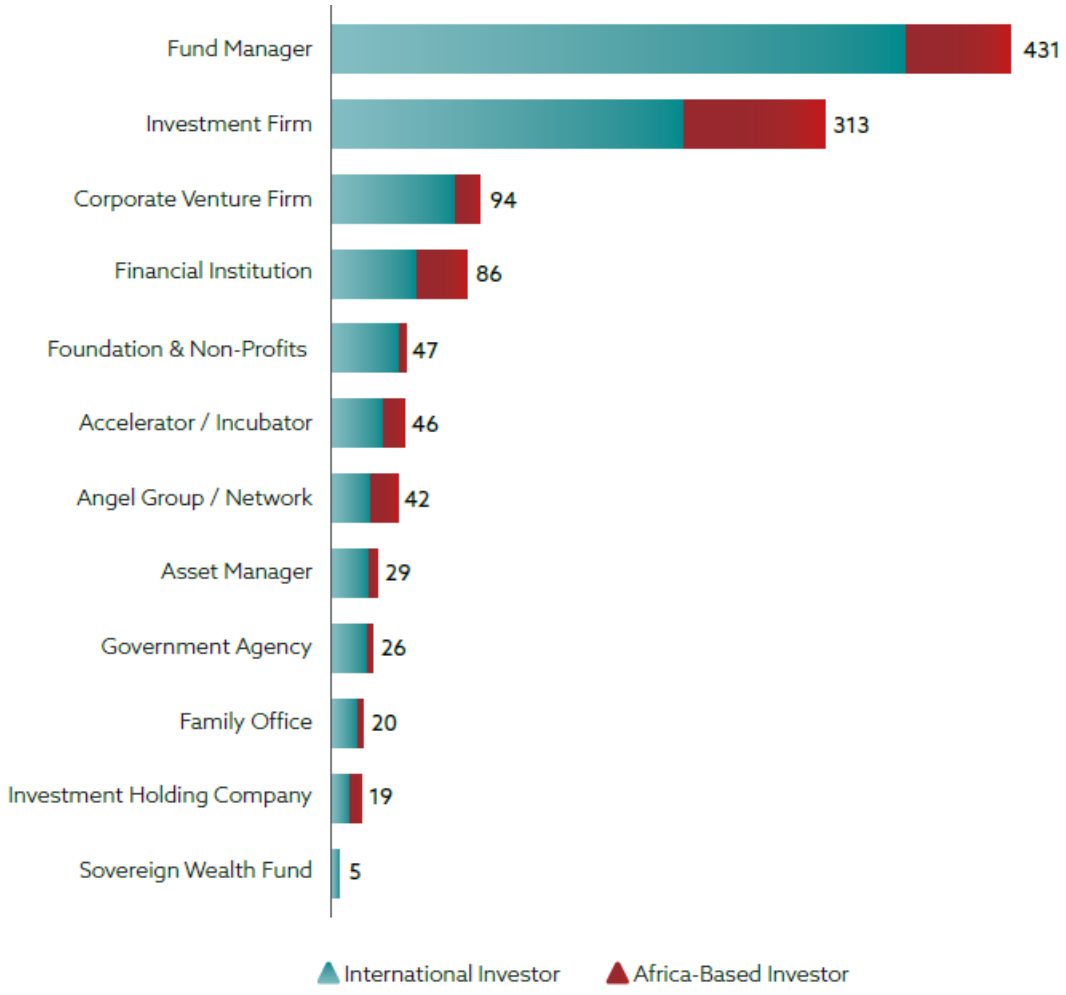
2.5 Investor Profile

According to the African Private Capital Association (AVCA), a pan-African industry body which promotes and enables private investment in Africa, Private Equity (PE) / Venture Capital (VC) Fund Managers, which are firms that raise third-party funds from institutional investors, were the most active investors by type in Africa in 2022. They were closely followed by PE / VC Investment Firms (firms that mainly make direct investments) (AVCA, 2023b, p. 35). An increasing number of African fund managers that traditionally focused on private equity investments on the continent are now concurrently raising VC funds, enabling them to invest in earlier stage businesses as well as build a potential PE pipeline. These are illustrated in Figure 9 but should only be treated as indicative because stakeholder engagement shows that angel investments, for example, may be considerably higher than reported in the graph. Angels and angel groups do not typically belong to industry PE / VC associations or report their deal data to these organisations.

Corporate Venture Capital (CVC) investors, which include venture capital arms or subsidiaries of corporate companies as well as individual companies making unique investments outside of a formal firm or fund structure, were the third most prominent investor type funding VC deals on the continent. Global corporations such as Visa, Mastercard, Yamaha and Shell actively supported new entrepreneurial ventures in Africa last year. They join CVC firms Accenture Ventures, Mobility54, Orange Digital Ventures and PayPal Ventures, which made their first foray into Africa's venture capital industry in 2021 and made repeat investments on the continent last year (AVCA, 2023b, p. 36).

Financial Institutions accounted for 7% of venture capital investors active on the continent in 2022. These investors are a broad cross-section of financial services operators including banks, trust companies, insurance companies and brokerage firms. An interesting trend in this category is the increasing number of fintech start-ups, which themselves received VC funding earlier in their development lifecycle, that are beginning to finance other entrepreneurs emerging on the continent (AVCA, 2023b, p. 36).

Figure 9: African VC Investors



Source: (AVCA, 2023b, pp. 35-36)

Industry reports vary but indications are that African investors make up the largest group of investors by region in Africa in 2023 (Africa: The Big Deal, 2024). Of the international investors, North American investors represent the largest investor by region that allocated capital to the continent in 2022, followed by European investors (mostly from the United Kingdom, France and the Netherlands) (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 37).

South Africa, Nigeria and Egypt continue to be the main sources of VC funding amongst African investors, featuring in the top five of the country-based breakdown of investor participation in 2022. These three countries accounted for a combined 15% share of the total number of investors that participated in VC deals on the continent in 2022, slightly lower than the proportion they commanded in 2021 (AVCA, Venture Capital in Africa Report 2022, 2023a, p. 37).

2.6 Angel Investors

Angel investors are typically professionals, entrepreneurs or high-net-worth individuals who invest their own money in start-ups in a personal and increasingly formal but less structured process when compared to VC investments. When tracking the activity of angels, it should be noted that most angel investments are private and not publicly disclosed, and this class of investing is underreported.

While there are high-net-worth individuals who invest their money in start-ups, many angel investors use their savings or salaries to make investments. Findings from the 2022 African Business Angel Network (ABAN) African Angel Investment Survey reveal that more than half of surveyed angel investors are entrepreneurs and investment professionals whose source of investment capital is their salaries (ABAN, Briter Bridges, & AAA, 2022). A small minority of angels (17%) invest other people's money, but this is most likely other angels' capital as they syndicate and lead deals.

Many angel investors play a hands-on role in the start-ups they choose to invest in, providing mentorship and other non-financial support as with any other VC funder. Personal relationships play an important role with most angels sourcing deals through their networks. Family and friends can sometimes act as angels, but professionals who work with start-ups, know the founders and what they do are increasingly becoming angels. In addition, angels in the investment sector, often invest in deals which are too early stage or not aligned to their fund or vehicle mandates. Apart from their personal networks, angels also find deals through accelerator cohorts, angel groups and syndicates. Technical experience is the most important quality that angels look for in founding teams, followed by strong managerial experience, being a second-time founder, and having good interpersonal skills. Nearly half of surveyed angels (45%) said they prioritise economic impact, such as job creation, in their investments (ABAN, Briter Bridges, & AAA, 2022).

Some angel investors belong to investor networks and data from ABAN shows there are 68 angel networks spread across more than 34 African countries and the diaspora. Angel

networks or groups may themselves be investment vehicles apart from offering their members access to deal-flow information, opportunities to participate in large funding rounds, training and support, and risk-sharing. Nigeria, Egypt, and South Africa are home to the most angel networks on the continent. Angel groups and their legal structure vary from being informal to being a legally registered investment vehicle.

Estimates from ABAN's network of angels indicate that 2 058 angel investors invested more than $22.5m across 408 deals, out of 5 743 applications received, at an average ticket size of $55.2k in the first and second quarter of 2023.

Table 2 gives an overview of angel investor activity in Africa in the first six months of 2023:

Table 2: Angel Investing Activity

Indicators	**Q1&Q2 2023**
Number of active angel investors	2058
Number of active female angel investors	576 (28% share)
Number of transactions closed	408
Total amount invested by angels (disclosed)	$22,521.723.00
Average amount invested per startup	$55.200.30
Startup engagement	
Number of member events organised?	260
Number of mentorship sessions with portfolio startups?	270
Number of startup applications received	5743
Number of startups shared with angel network members?	1509
Number of female founders or co-founders?	287(19% share)
Number of transactions closed	408 (27% share)
Impact indicators	
Estimated decent job created by portfolio companies (disclosed)	6,280
Estimated total revenue generated by portfolio companies	$15,700,000
Data source: *ABAN affiliated members quarterly reports (23 networks out of 68 participated) + Catalytic Africa data. Timeline: Q1 and Q2 2023*	

Source: (ABAN, Briter Bridges, & AAA, 2022, p. 4)

Demographics of angel investors are summarised as follows (ABAN, Briter Bridges, & AAA, 2022)**:**

- Age: The majority (over 70%) of angel investors are between the ages of 30 and 50. The age distribution of the respondents suggests angels are typically successful and established in their careers.

- Gender: Survey results show that angel investors are predominantly male, standing at 69% of total respondents. Entrepreneurs and investment professionals make up most male angels (56%).

- Ethnicity: Most angels writing cheques are black (68%).

- Education: Angels come from different academic backgrounds with business administration (38%) and accounting and finance (21%) being the two most common fields of expertise. Many angels have a university degree (76%) and have received foreign education (54%).

- Occupation: Founders or entrepreneurs make up the largest group of angels (30%), followed by investment professionals (24%) and C-level managers (24%). Entrepreneurs back local founders to solve local and global challenges after experiencing success in their own ventures.

- Location: Most of the surveyed angels are based in Africa's top investment destinations, with Nigeria leading (19%), followed by South Africa (10%), and Kenya (8%).

The takeaway from the above is that angel investors in African start-ups are predominantly male (although this is steadily changing with more and more women angels and groups being established), university-educated, and have achieved some level of success in their career. This accords with global trends, except that globally, the US remains the primary location of angels and business executives make up the largest group of angels.

Equity is the preferred investment type among angels (60%), followed by blended finance (20%), and debt (18%). Angels use a combination of investment instruments to deploy capital. Equity/shareholders agreement are the preferred instrument (32%) followed by Simple Agreement for Future Equity **(**SAFE) deals (29%), and convertible notes (debt) (19%). However, the choice of instrument is also influenced by what is legally possible in the jurisdiction of the investment. Fewer than 20% of angels use loan agreements and grants. Close to half of angels use two or more methods to deploy capital including on their own, investing with other angels and through angel networks. Fewer than 25% of investors invest independently.

The majority (53%) of angels invest between $1 000 and $10 000 per round into a start-up. Investing in groups, allows angels to more effectively deploy smaller investment amounts in to a greater number of deals, spreading their risk. Two-thirds of angel investors (66%) offer

follow-on investments to their portfolio companies. Over 50% of angel investors have at least 10% of their portfolio companies having raised new rounds of funding from other investors. Many angels focus on two or more sectors, with around a quarter taking an agnostic approach when investing in start-ups. Fintech is the most popular sector.

Most angels prefer to back start-ups that are in the very early stages of development and at the pre-product market fit stage (75%). At this stage, many companies struggle to raise funding from institutional investors who require certain milestones to be reached before making an investment. Investing at this stage can be difficult because of lack of data to make decisions. As a result, angels typically adopt less formal approaches, compared to VC funds when deciding which companies to invest in. This is where the personal relationships are important and trust is key, as with so many factors likely to change including the business model, the market segment, the product features etc, the ability for the team to execute and grow the business in response to the market becomes key. Given the relatively small ticket size, there is also typically less stringent criteria required for the start-ups to meet, and the due diligence process is less extensive than that needed at later stage rounds. However, this is considered relatively easier but riskier than investing at the later stages. Angels can provide and gain huge value by helping start-ups in this category to build solutions that people need.

While a third of surveyed angel investors are open to investing in start-ups regardless of their domiciliation, US incorporation is still preferred by angels (24%). Ease of business, tax benefits, privacy, intellectual property protection, and predictable outcomes in legal disputes are some of the reasons why angels require start-ups to domicile in particular financial centres. Only a minority of African angels (less than 30%) have achieved an exit of 10% or more on their portfolio investments, highlighting the early nature of their investments.

Doing business in many African countries remains challenging despite efforts by some governments to create attractive investment destinations. Creating a conducive environment for investors helps new angels enter the space, providing more avenues for early-stage businesses to access capital. Regulatory frameworks that protect angel investors and tax incentives that encourage angel investing are a good starting point, but investors are looking for other factors to rationalise investments, including certainty and predictability in the financial market, reduced risks of investments in unstable economies, and ease of compliance. Many investors are seeking a more active role from governments in shaping policies that provide supportive measures for investors and businesses within the tech ecosystem (ABAN, Briter Bridges, & AAA, 2022).

ABAN's 2022 survey revealed that ecosystem immaturity is a major barrier faced by angels when investing in Africa. Nascent markets are characterised by mostly early-stage companies, limited support organisations and structures, and low availability of capital to scale. This limits an angel's ability to realise returns and achieve exits from portfolio companies in these markets. In some countries, there is also a lack of necessary regulatory frameworks to protect angels along with limited exit opportunities.

The incentives that angels need to increase their investments in African ventures are directly linked to the challenges they face when investing. Maturing ecosystems, access to quality deals and high-potential innovators, investment incentives to compensate them from the relatively high risk and strong macroeconomic conditions are some of the key requirements to be able to increase their frequency and size of capital injection into African start-ups.

3 South African Venture Capital Landscape

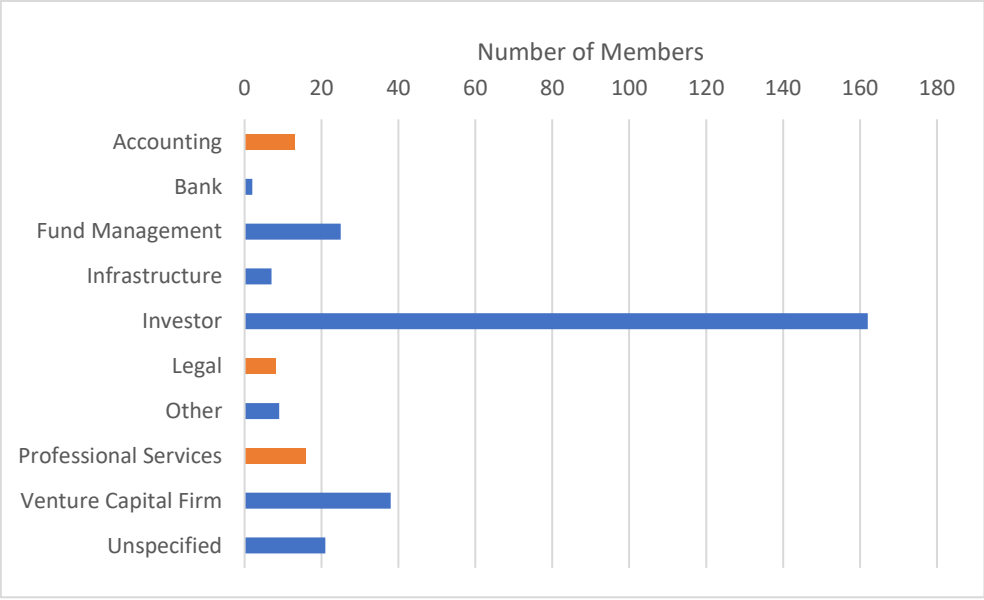
This section of the report focuses on the national and Western Cape VC industries. It then goes on to sketch the industry ecosystems and concludes by estimating the potential of the South African and Western Cape VC industry.

It is necessary to commence this section by highlighting data discrepancies that exist in the VC industry. While data collection has improved over recent years, inconsistencies do still exist and different sources might not always align. This report makes extensive use of the South African Venture Capital and Private Equity Association (SAVCA) data and that published by Africa: The Big Deal. Both acknowledge limitations to their data sets, however. SAVCA does not represent all VC players in the country and Africa: The Big Deal only includes VC deals greater than $100 000. While both datasets might not comprehensively cover the VC industry, they are sufficiently robust to show trends and to draw conclusions.

3.1 National Overview

The current membership list of (SAVCA) by profession is presented in Figure 10. The largest category by far is investors, at 54% (this is disaggregated in Figure 11). This is then followed by the VCCs (13%) and fund managers (8%). Accounting, legal and other professional services are shown separately by the orange bars but collectively would form 12% as professional support services.

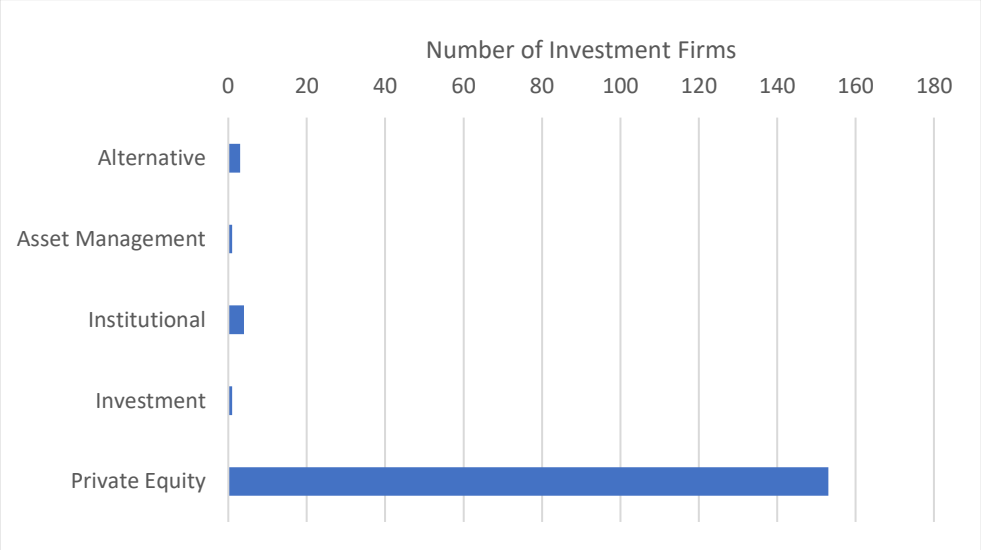
Figure 10: SAVCA Members by Profession



Source: (SAVCA, 2024)

Figure 11 provides some detail to investors, who were the biggest category of members shown in Figure 10. Private Equity investors form the largest category of investors at 94%.

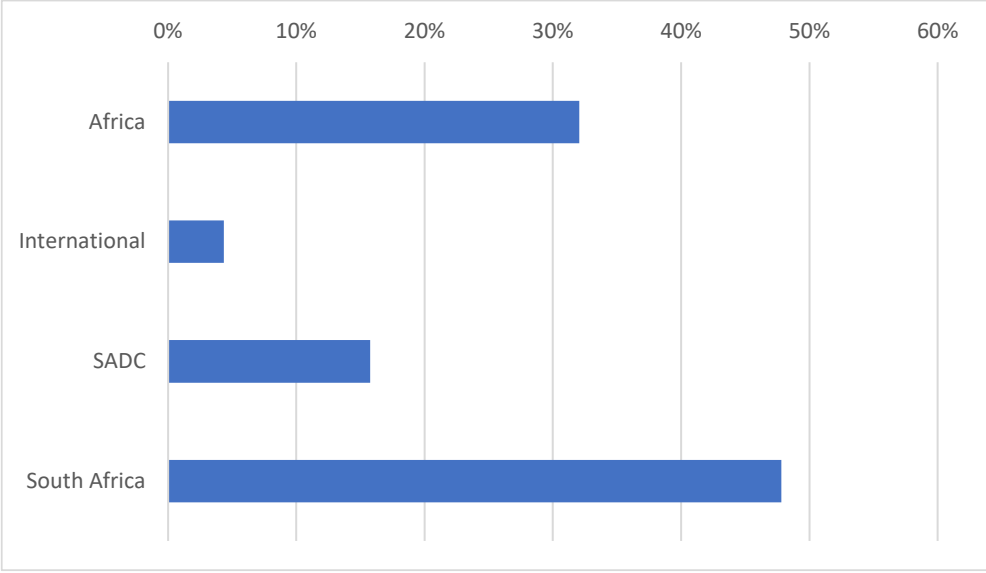
Figure 11: SAVCA Investor Member Details



Source: (SAVCA, 2024)

The geographic footprint of members is illustrated in Figure 12. Slightly more than half those who disclosed their business location are active only in South Africa, with a further 16% active in other SADC countries. Almost a third are active throughout Africa and only 4% active outside of the continent.

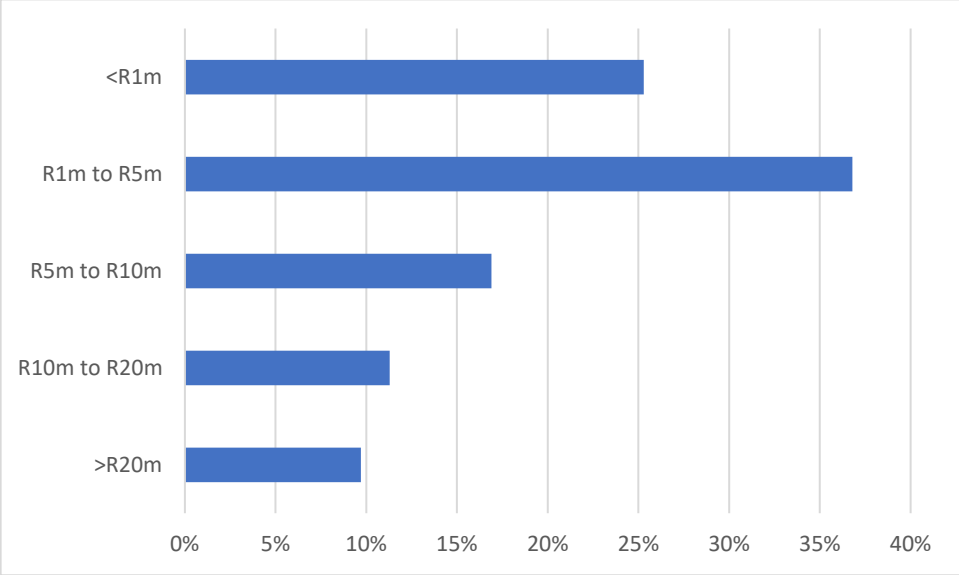
Figure 12: Member Geographic Footprint



Source: (SAVCA, 2024)

Most of the next graphs are based on the 2022 SAVCA survey of its members. The size of VC deals in 2022 is illustrated in Figure 13. Over a third of the deals were in the R1m to R5m range while a quarter were less than R1m. This means that 60% of all deals were less than R5m.

Figure 13: Deal Size Distribution of All Active Deals in 2022

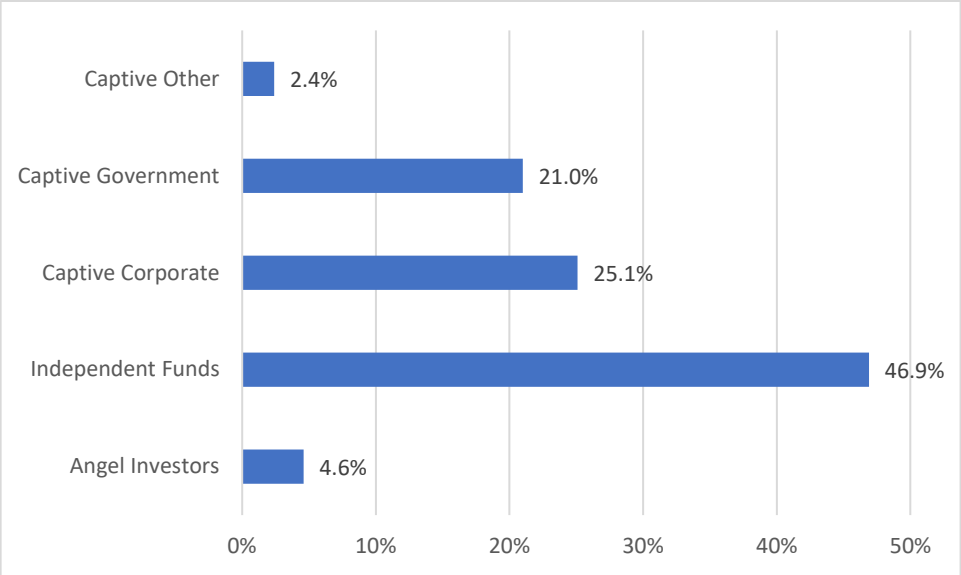


Source: (SAVCA, 2023, p. 11)

By the end of 2022 over R9.1bn had been invested in 1 205 deals. The average deal size in 2022 was R7.54m, down 4.9% from the 2021 average of R7.93m (by comparison, the median deal size in the UK is £7.1m – approximately R170m at an exchange rate of R24:1£). Although this average is down in 2022, the overall portfolio of deals increased by 18% over 2021. A total of 195 investment rounds were declared for 2022 with eleven exits (SAVCA, 2023, p. 11).

Almost a half of all active deals in 2022 were from independent funds. A quarter were captive corporate (i.e. the fund was primarily sourced from a private company) and slightly more than a fifth were captive government (primarily sourced from a government department or public body). The remainder was split 4.6% angel investors (high net-worth individuals) and captive other (such as primarily sourced through family offices).

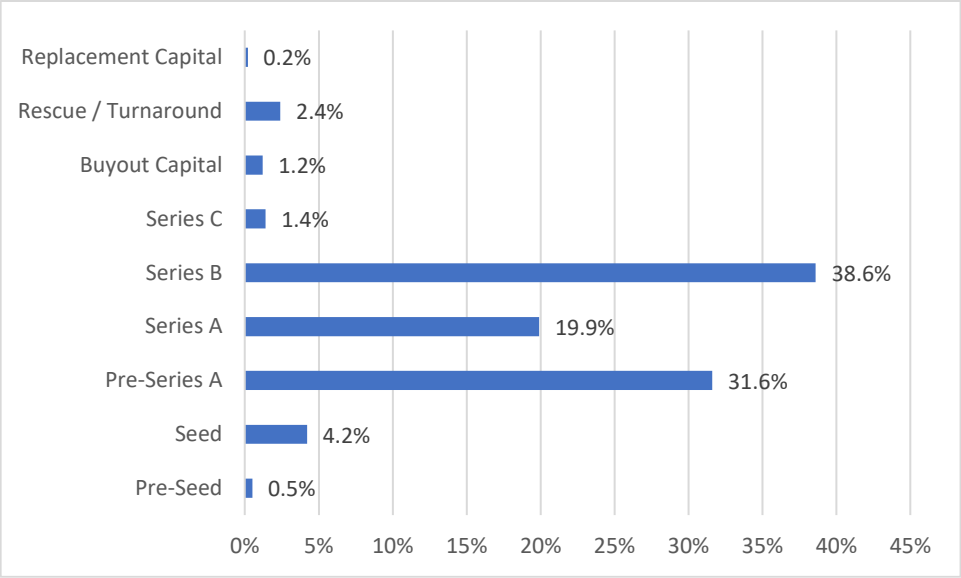
Figure 14: Source of Funding in 2022



Source: (SAVCA, 2023, p. 12)

Figure 15 indicates that most of the 2022 investment occurred in pre-series A, series A and series B stages of start-up development. These three stages accounted for 90% of all VC investment by value. Pre-series A investment is mid-round between seed (before the start-up begins mass production or distribution) and Series A (post revenue and entering into rapid growth and scale). In this pre-series A stage the company will have achieved some traction in the market, and now needs a relatively smaller amount of capital to prove that the business fulfils a specific market need in South Africa. This round typically involves a 10% to 25% equity stake because these businesses are still very high risk, even though the value of the rounds is much less.

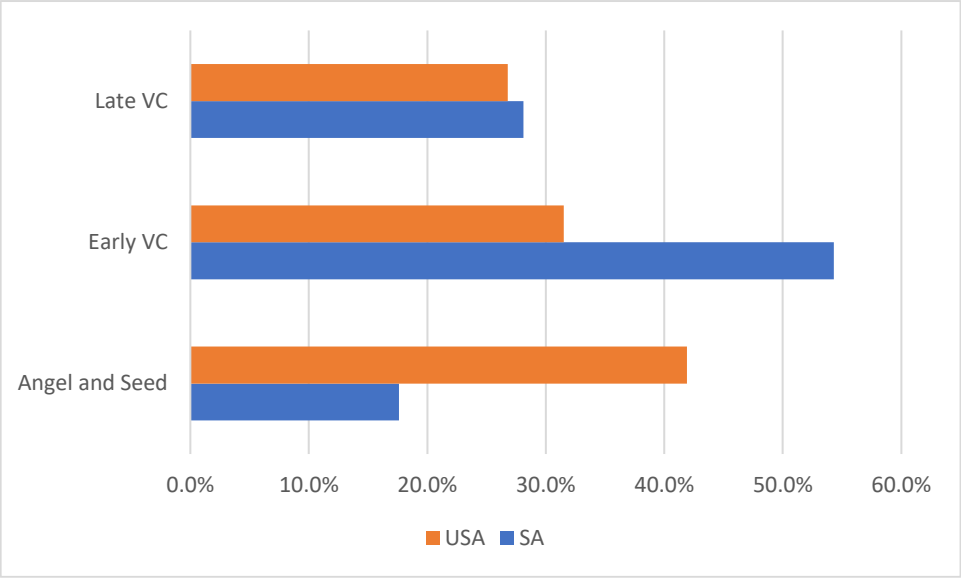
Figure 15: Value of Investment by Stage in 2022



Source: (SAVCA, 2023, p. 13)

Series A and series B stages are investment rounds into companies with proven market relevance. Series A is capital to turn the business into a successful, profitable enterprise and equity typically ranges between 10% and 15%. Series B usually involves less than 10% equity in relatively mature companies that are primarily looking for capital to expand and improve operations or enter new markets to accelerate the growth of the business (SAVCA, 2023, p. 9). Both Series A and B investors could also exit earlier seed and angel funders, acquiring this equity directly from these investors, as well as providing capital to the business for growth.

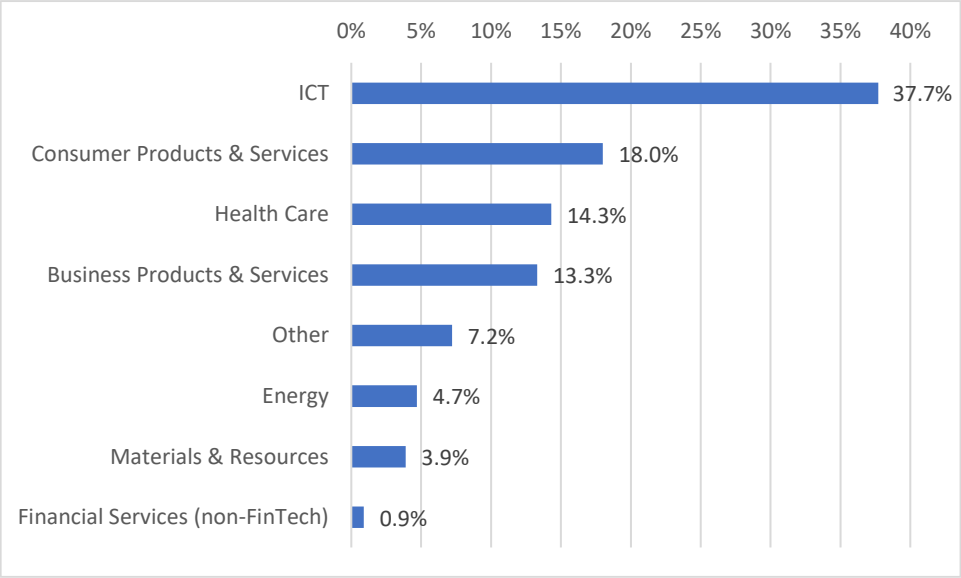
Figure 16: Proportions of VC Deals by Stage



Source: (SAVCA, 2023, p. 14)

In South Africa most deals take place in the early VC stage (54%), followed by late VC (28%) and with little in angel and seed (18%). Angel funding, however, often goes unreported. The proportion of deals in the USA is shown by the orange bars for comparison in Figure 16. The proportion of late VC deals is similar to South Africa but there are substantially more angel and seed deals (42%) reported in the USA.

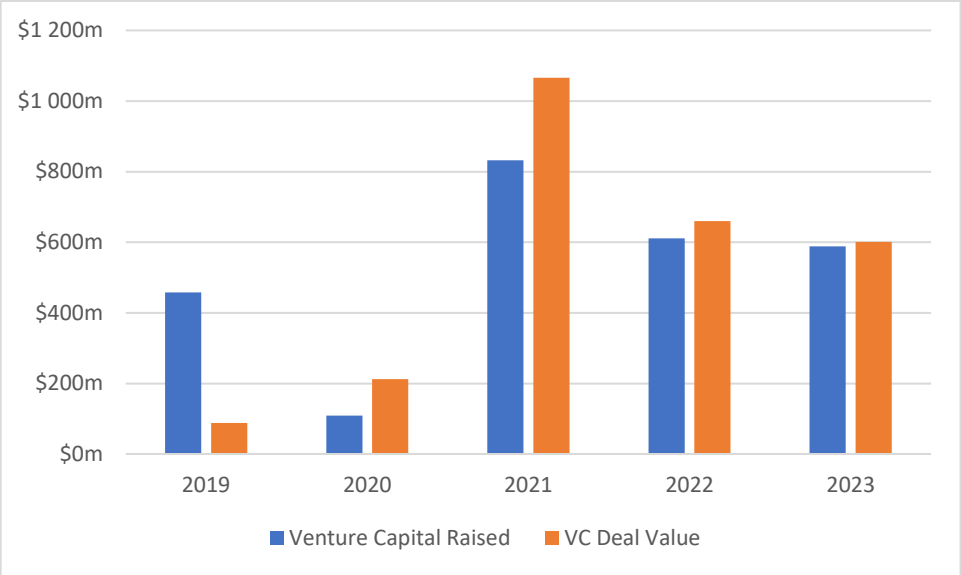
Figure 17: Investment Sectors by Value



Source: (SAVCA, 2023, p. 17)

Most VC investment in 2022 was into the ICT (information & communication technology) sector. This is shown as 38% in Figure 17. Other sectors that benefitted from VC investment were the products & services sectors, where consumer products & services attracted 18% and business products & services 13%, for a total of 31%, and the health care sector with 14%. According to SAVCA research, the proportion of deals in the USA was similar to South Africa in the ICT and business products & services sectors but differed in the health care and consumer products & services sectors (SAVCA, 2023, p. 18). The USA VC industry invested more in health care but less in consumer products & services and less in energy.

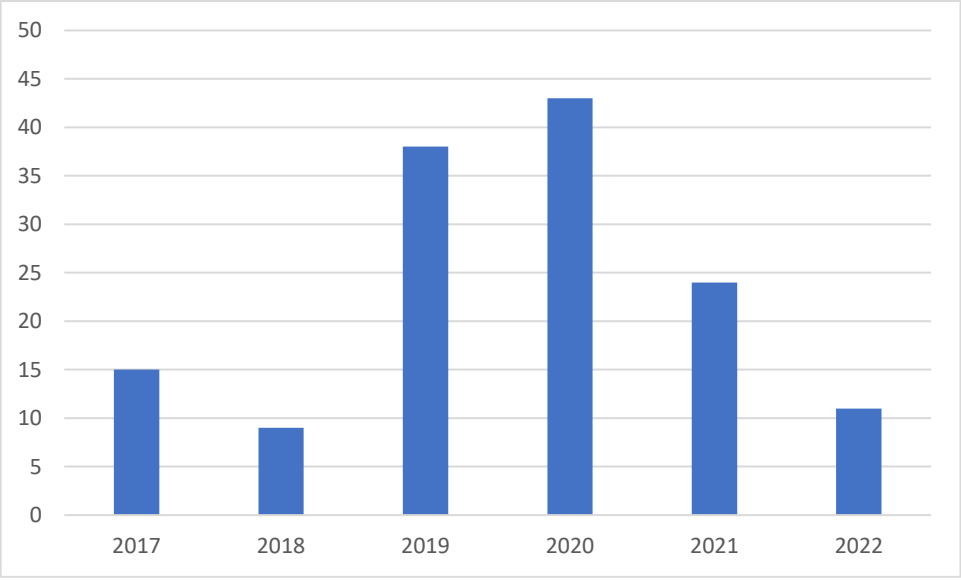
Figure 18: Value of VC Investment



Source: (Insights, 2023), (Africa: The Big Deal, 2024)

The peak value of VC capital raised and deal value in South Africa occurred in the year after covid struck, with $832m of venture capital raised and $1.07bn invested in deals in 2021. The value dropped to around $600m for both venture capital raised and deal value in 2022 and 2023. Collectively over the five years R2.6bn has been both raised and invested. In 2020 there were 167 deals, whereas 2021 attracted 186 and 2022 195 (SAVCA, 2023, p. 22). This means that the average deal has increased in value between 2020 and 2021 but then decreased in 2022.

Figure 19: Number of Exits



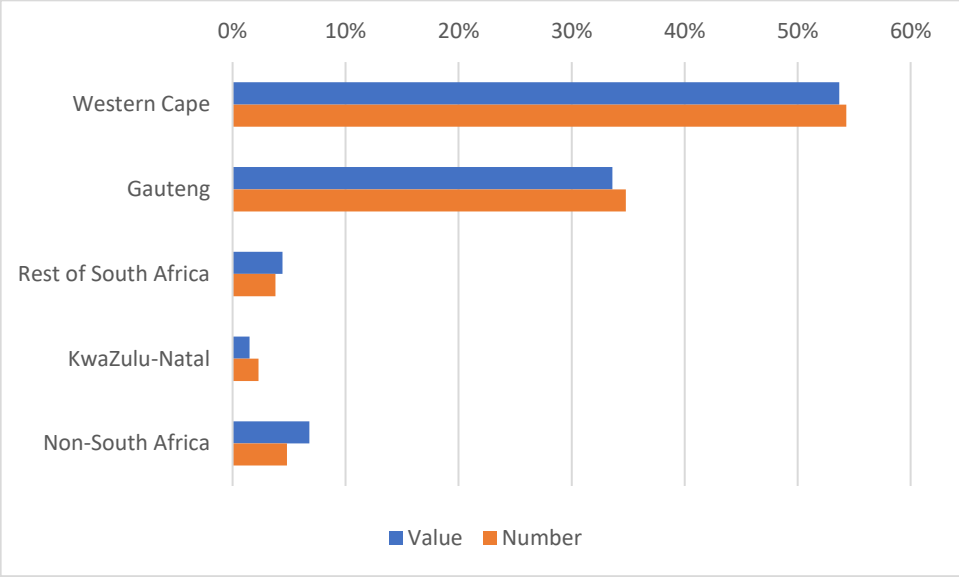
Source: (SAVCA, 2023, p. 31)

The number of exits between 2017 and 2022 is shown in Figure 19. These dropped from fifteen in 2017 to nine in 2018, before increasing to 38 in 2019 and peaking at 43 in 2020. The number of exits has since dropped, to 24 in 2021 and eleven in 2022. Not all exits are profitable, however, and in most years the number of loss-making exits has exceeded the profitable ones. The exceptions are in 2019 when there were an equal number of loss-making and profitable exits and in 2022 when there were six profitable and five loss-making exits. Over the six years shown in Figure 19 only 40% of exits were profitable. This underscores the risky nature of investing in start-up businesses.

3.2 Western Cape Venture Capital Ecosystem

The Western Cape is the premier location for the venture capital industry in South Africa. This can be seen by the geographic distribution of the value and number of venture capital deals in the country and the location of the investee firm head offices (SAVCA, 2023, pp. 18, 29). Figure 20 displays the geographic location of the 2022 venture capital deals, both in terms of value and number of deals, while Figure 21 shows the location of the investee (entrepreneurial firms) head office between 2018 and 2022.

Figure 20: Geographic Location of South African Venture Capital Deals - 2022

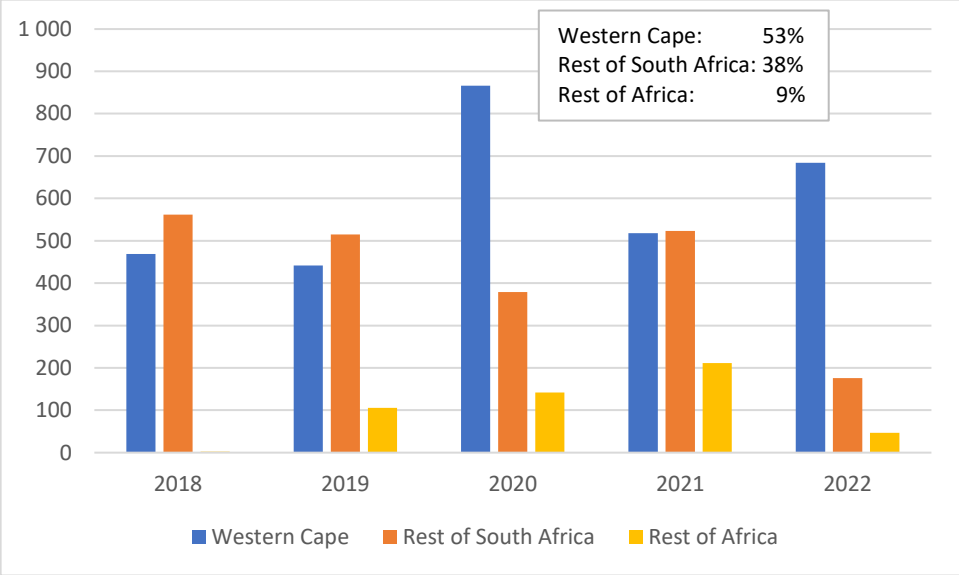


Source: (SAVCA, 2023, p. 18)

Figure 20 illustrates how the Western Cape received the lion's share of VC deals and investment by South African VC investors in 2022. More than half of all deals and investment occur in the province. This is followed by Gauteng with approximately 20% less of the total share of all deals and investment.

A similar perspective is offered by Figure 21. More than half of all head offices of the firms that received funding are in the Western Cape. These proportions approximately align with the value of deals analysed in the Africa: The Big Deal database between 2019 and 2023. In this database, 48% of the value of all SA VC deals are associated with companies headquartered in the Western Cape and with 42% headquartered elsewhere in South Africa. The proportion of companies with headquarters outside of South Africa is 10% and 1% were unknown.

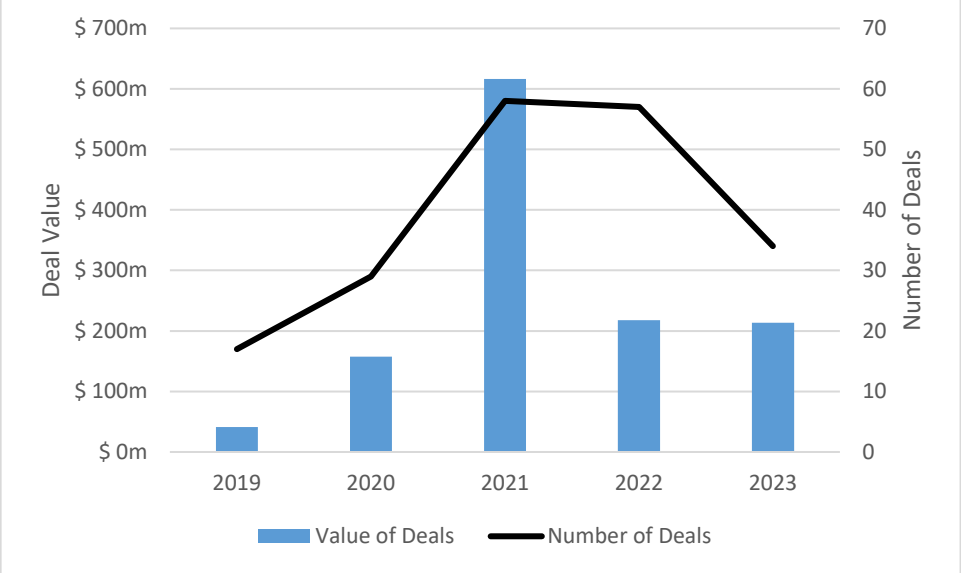
Figure 21: Investee Head Office Location by Value of Deals



Source: (SAVCA, 2023, p. 29)

This section on the Western Cape venture capital ecosystem draws mostly from the 'Africa The Big Deal' database (Africa: The Big Deal, 2024). The South African data has been segmented by province, based on start-up and scale-up company location. Once again, the data limitations highlighted at the start of this section must be emphasised.

Figure 22: Number and Value of Western Cape Deals 2019 to 2023



Source: (Africa: The Big Deal, 2024)

Figure 22 shows how the number of VC deals in the province increased from 17 in 2019 to a peak of 58 in 2021 and 57 in 2022 (read off the right-hand axis). The number then dropped to 34 in 2023. There were 195 deals in the Western Cape over the five years shown in the diagram and with a further two registered in January 2024. The value of the deals also peaked in 2021, at $616m. This then reduced to $218m in 2022 and $214m in 2023. This is in line with the national trends presented in Figure 18.

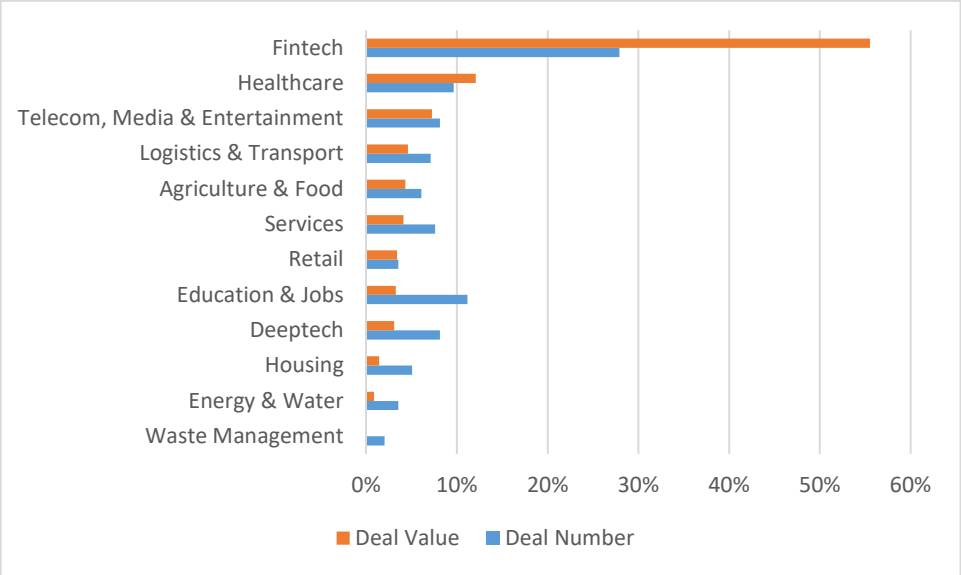
The average deal value in the Western Cape increased from $2.4m to $10.6m in 2021. It then dropped to $3.8m in 2022 but rose again to $6.3m in 2023. The two deals registered so far in 2024 average at $2.7m. The average deal value for all 197 deals in the Western Cape since 2019 is $6.4m. This provincial average is 8% less than the $6.9m average for South Africa (Africa: The Big Deal, 2024).

The fintech industry[2] attracted over half the deal value since 2019 and at 28% also has the highest number of deals. This is clearly illustrated in Figure 23. Healthcare is a distant second in value (12%) and third in deal number (10%). Education & Jobs has the second highest number of deals at 11% but its value at 3% means it is only eighth on the list. The Telecom, Media & Entertainment (telecoms) sector is third in terms of value (7%) and number of deals

[2] *Fintech is new technology that seeks to improve and automate the delivery and use of financial services - https://www.investopedia.com/terms/f/fintech.asp*

(8%). Deeptech[3] is joint third with telecoms in number of deals. Deeptech has been increasing in popularity of late, with two deals in 2020, increasing to four in 2021 and nine in 2022. It then lost traction in 2023 and dropped down to a singular deal that year.

Figure 23: Western Cape Venture Capital Sectors



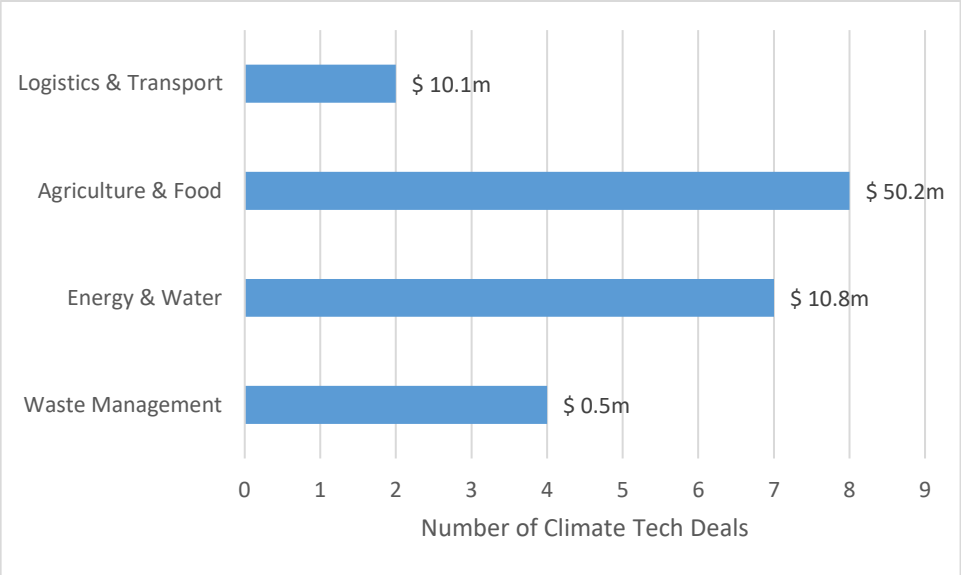
Source: (Africa: The Big Deal, 2024)

Climate tech is not a defined VC sector. Rather, it refers to refers to technologies and services that enable decarbonization of the global economy[4] and could be prevalent in any sector. Figure 24 shows that there were 21 VC deals in the Western Cape between 2019 and 2023 that included climate tech. The total value of these climate tech deals was $71.6m. Most were in Agriculture & Food with eight deals valued at $50.2m, followed by Energy & Water with seven deals valued at $10.8m. The other sectors encompassing climate tech were Logistics & Transport and Waste Management.

[3] *Deeptech involves using advanced science and technology, such as artificial intelligence, blockchain, or advances in biotechnology, to provide solutions to complicated problems - https://dictionary.cambridge.org/dictionary/english/deep-tech*

[4] *https://www.nasdaq.com/solutions/listings/resources/blogs/what-is-climate-tech*

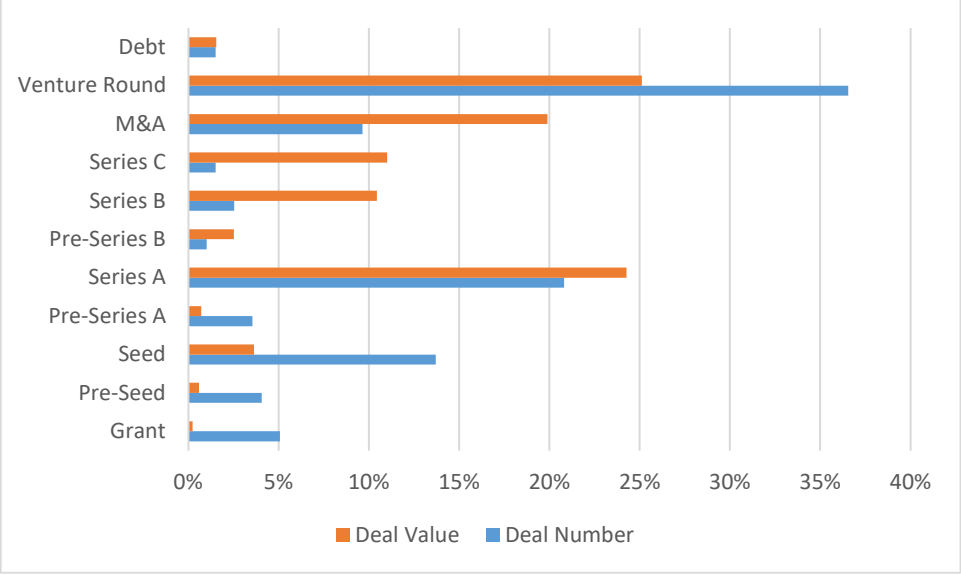
Figure 24: Number and Value of Climate Tech Deals



Source: (Africa: The Big Deal, 2024)

The average climate tech deal was valued at $3.4m, which is approximately half the provincial VC deal average.

Figure 25: Stage of VC Investment



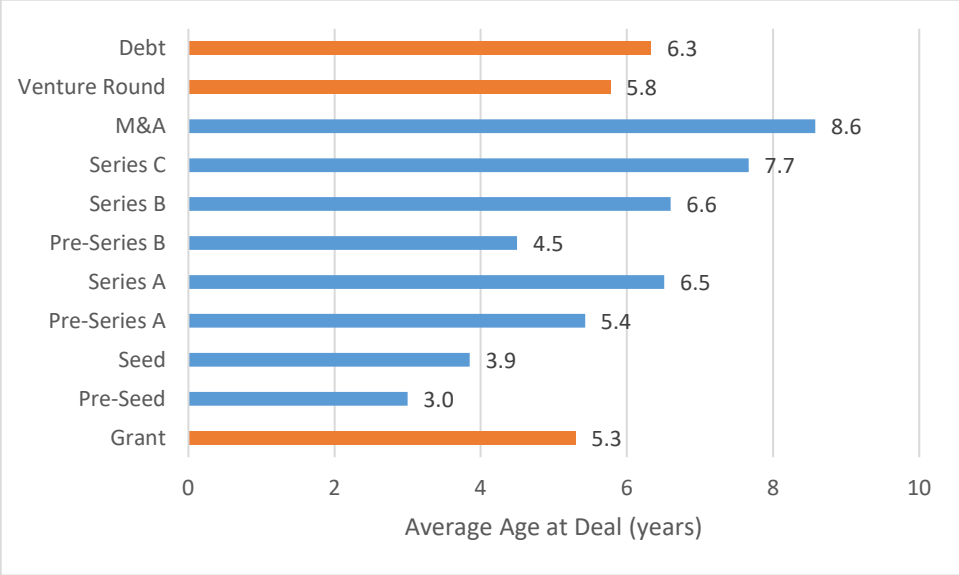
Source: (Africa: The Big Deal, 2024)

Figure 25 shows that the Venture Round, which is a catch-all phrase for venture capital funding that is not classified anywhere else and can refer to multiple stages or series, attracted the most deals (25%) as well as the highest value (37%). This is followed by Series A for both value (24%) and number (21%). At 20% Mergers & Acquisitions (M&As) have the third highest value but only 10% of the deal numbers. This reflects the growth in average company value

as it matures through the various venture capital phases, with M&A being the final stage for a firm VC deal. This is also reflected in Figure 26, which indicates the average age of a firm at the various stages of funding. The blue bars in the diagram show progressing rounds of funding for start-ups and scale-ups. The orange bars refer to any stage of funding. The blue bars commence at pre-seed, near the bottom of the diagram, and mature through the various stages to M&As towards the top.

At 8.6 years, M&A firms are the oldest in all the funding stages. The youngest are the pre-seed firms at 3.0 years. Then, as to be expected, the average age of the firms increases with the next levels of funding all the way to Series C. The exception is pre-Series B. A possible explanation is that there are relatively few firms that required this level of funding and have moved quickly through the various phases to reach this funding requirement.

Figure 26: Company Age at Stage of Investment

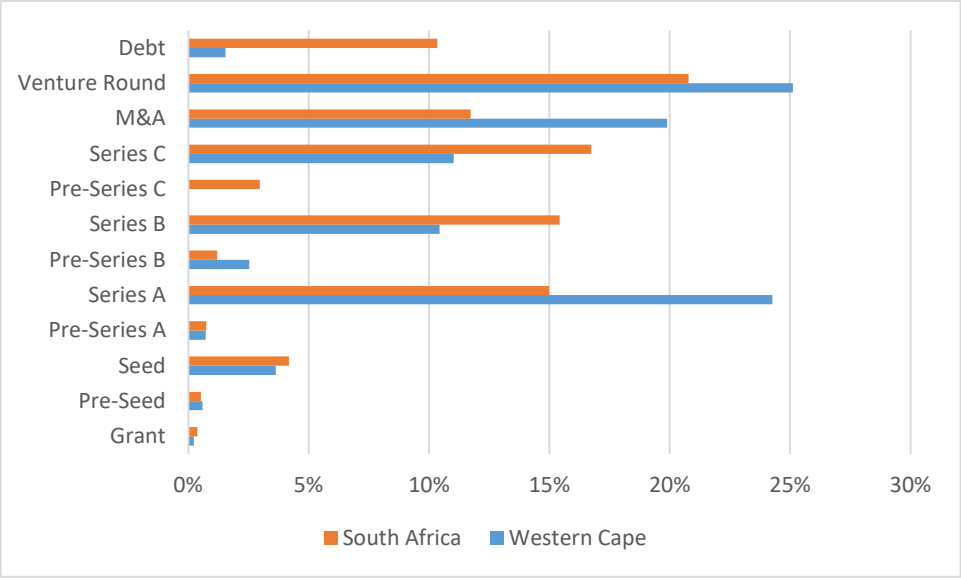


Source: (Africa: The Big Deal, 2024)

Figure 27 highlights the differences between funding at various stages of the VC journey in the Western Cape compared to South Africa. The proportions of funding are similar in the very early stages, from grant to pre-seed and seed funding. The Western Cape attracts more financing in the early stages (Series A) and exits (M&As) as well as the general Venture Round[5] funding stages. VC firms in South Africa, in general, have higher portions of funding in the middle Series B, pre-Series C and Series C stages, as well as debt.

[5] *general catch-all for all stages*

Figure 27: Deal Value - Western Cape versus South Africa



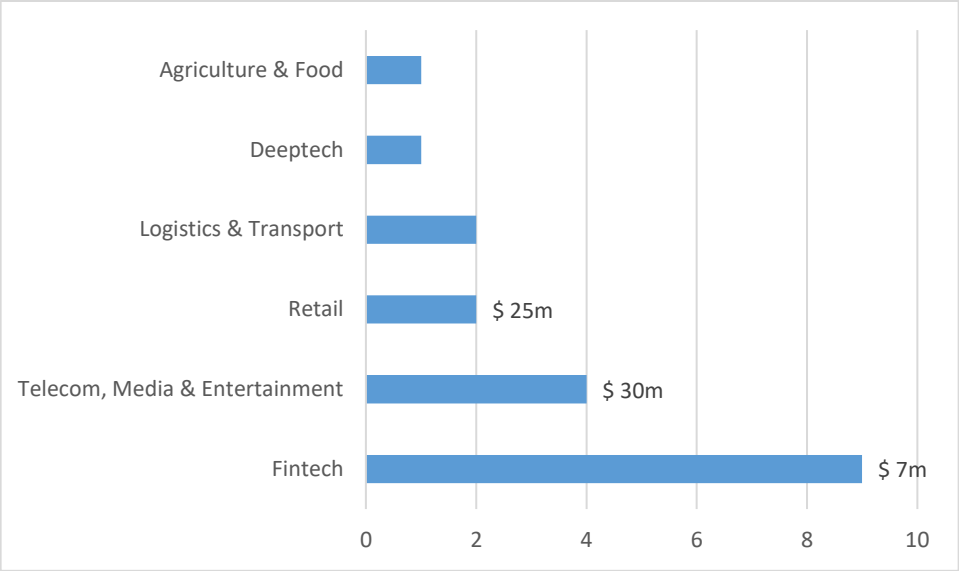
Source: (Africa: The Big Deal, 2024)

There were nineteen exits between 2019 and 2023, as shown in Figure 28. All exits occurred through M&As. The most exits occurred in fintech but this is to be expected, given the popularity of this sector as indicated earlier in Figure 23. This was followed by four exits in telecoms, two each in retail and in logistics & transport, and one each in deeptech and agriculture & food.

Also shown in Figure 28 is the average value of an exit, where available. Although fintech had the most exits, the average value was only $7m, compared to $30m for the four in Telecoms and $25m for the two in Retail. The average value of all exits was $21m.

As a general observation, the fact that there were only 195 deals in the Western Cape over the five-year period 2019-2023 and only nineteen exits for that same period, is indicative of both the infancy and lack of size of the VC industry in South Africa. The nascent nature of the industry is also evident from the stakeholder interviews.

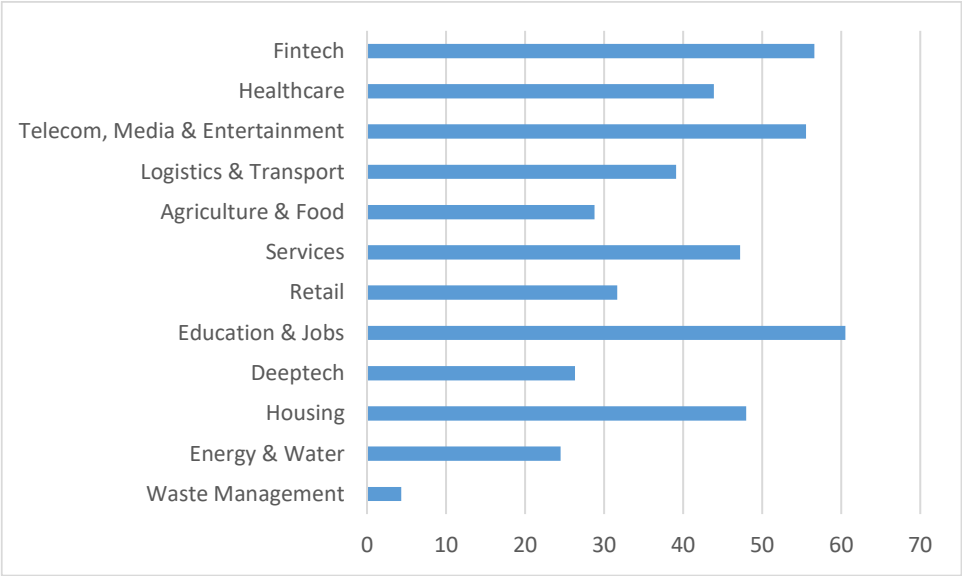
Figure 28: Number of Exits by Sector



Source: (Africa: The Big Deal, 2024)

Figure 29 indicates the average employees by sector. The three highest employers are education & jobs, fintech and telecoms. These three sectors employ between 55.6 and 60.5 employees on average. At the other end of the scale is waste management (4.3 employees), energy & water (24.5) and deeptech (26.3). The average across all sectors was 45.9 employees.

Figure 29: Company Employees by Sector

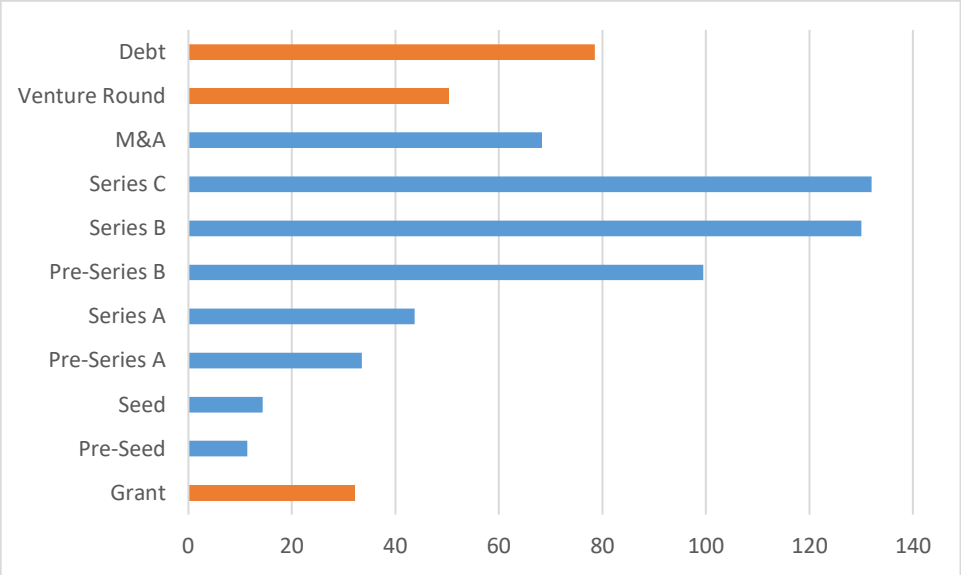


Source: (Africa: The Big Deal, 2024)

If one considers the maturity of a firm to be represented from the pre-seed stage to the series C stage, then Figure 30 clearly shows the number of employees increasing with maturity. The

average number of employees at the pre-seed stage is 11.4, increasing to 132 at Series C. The average employment in the Western Cape across all stages is 45.9, which is slightly lower than the 49.3 of South Africa.

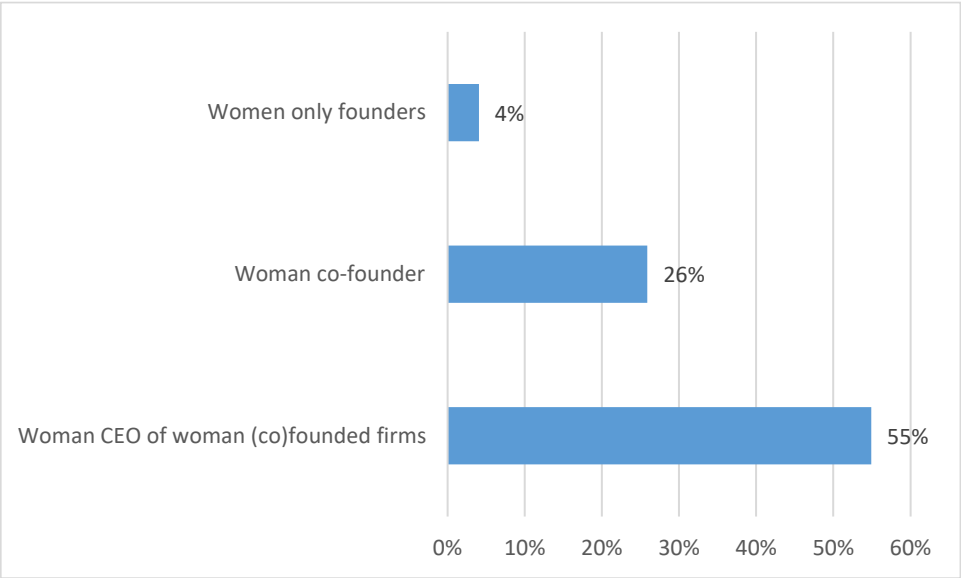
Figure 30: Company Employees by Stage of Investment



Source: (Africa: The Big Deal, 2024)

Combining Figure 30 with Figure 22 allows one to determine the number of employees per $1m at each stage of investment. The average for the Western Cape is 6.0 employees per $1m. The average across South Africa is 5.7.

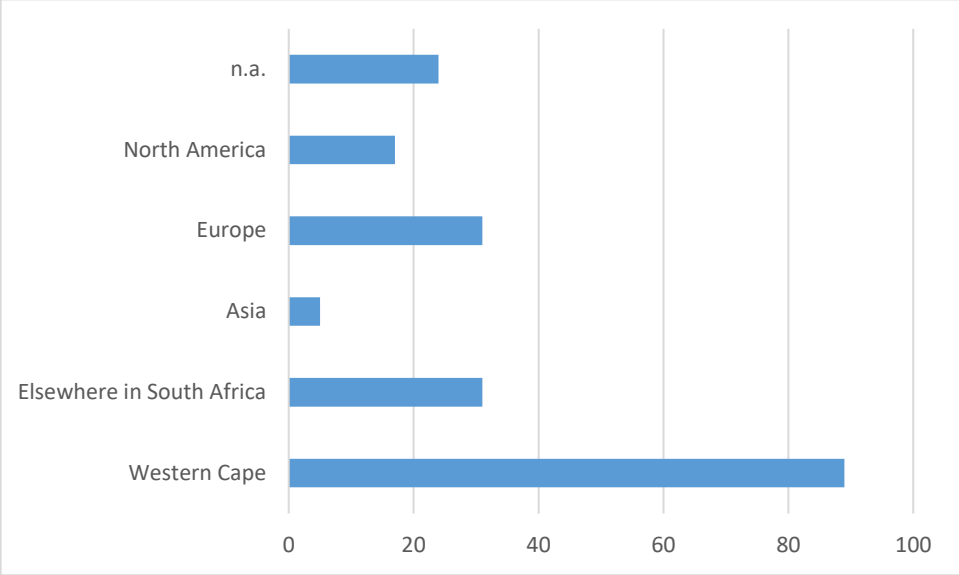
Figure 31: Female Representation



Source: (Africa: The Big Deal, 2024)

Female representation is shown in Figure 31. Only 4% of firms have female only founders, but this increases to one-quarter (26%) when jointly co-founded with males. This means that approximately a third of all firms have female founder representation and of these firms slightly more than half have female CEOs.

Figure 32: CEO University Location



Source: (Africa: The Big Deal, 2024)

The final metric presented in this section is shown in Figure 32. This shows the location of where the CEOs received their tertiary education, if applicable. It has relevance because stakeholders often allude to the contribution of the Western Cape universities to the province's VC attractiveness. It also allows for a corroboration between business, government and academia.

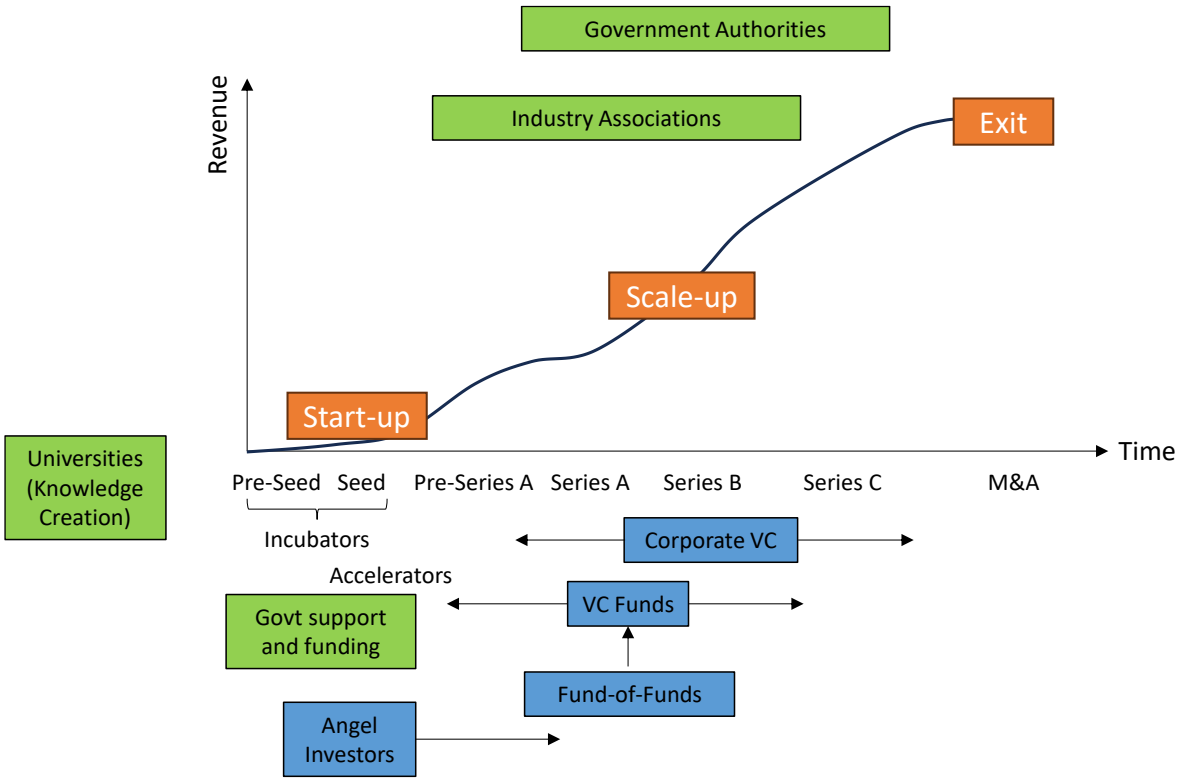
Almost half (45%) of the CEOs received their education from an institution in the Western Cape. Another 16% received their education from institutions located elsewhere in South Africa, while 12% either did not disclose their location or did not receive a tertiary education. At 27%, slightly more than a quarter received their education from overseas institutions, of which those located in Europe form the majority (16%).

3.3 The VC Ecosystem

The VC ecosystem looks at the different stakeholders involved in the industry, at different stages of the start-up lifecycle. Two perspectives are presented. The first, in Figure 33, illustrates the ecosystem by maturity. The second, in Figure 34, looks specifically at the VC fund ecosystem.

Figure 33 shows the revenue lifecycle of a start-up / scale-up, which should theoretically increase with maturity, in conjunction with the different stakeholders at the various stages from start-up to successful commercialisation. Different stakeholders might be involved at different stages while others are involved across the full life cycle. The latter include government authorities as regulators and the industry associations. The start-up, if successful, would morph from founder to scale-up to maturity across all stages.

Figure 33: South African Venture Capital Ecosystem



Universities can be important role players early on as knowledge creators and research hubs. It is at this early stage that a supportive start-up and entrepreneurial environment can be beneficial, with programmes, networks and incubation or innovation zones as well as accelerator programmes that foster entrepreneurial innovation, educate start-ups and facilitate start-up and industry collaboration, playing a decisive role. Business services provided by service providers such as lawyers and accountants, that facilitate and guide founders through the regulatory and commercial landscape, are part of the process of bringing ideas to fruition. Government plays an obvious secondary role in the ecosystem as a regulator, and is often the main reason for lawyers and accountants. However, outside of ordinary regulation, it can play a more primary role of contributing directly to the start-up and entrepreneurial environment by providing grant funding as well as instigating directly supportive regulatory

programmes, that incentivise both start-up and investor, or implement policy that promotes an ease-of-doing-business environment.

The most risk is at the pre-seed and seed stage of start-up funding, where the start-ups have no or very little track record or revenue, and the research shows that this is an obvious gap in the funding lifecycle of most local start-ups. Most VC funds only consider investment in the post revenue stage of a start-up, which occurs at pre-Series A, and this is when more funding options become available to the start-up. Angel investors tend to invest in the earlier funding stages and in lessor amounts (than the later stages) but can invest in later rounds, as they follow their rights or their equity converts. So, government involvement in initiatives such as first-loss or catalytic matching funding, at the early, pre-seed funding stage can significantly reduce investment risk and spur investor activity at this stage.

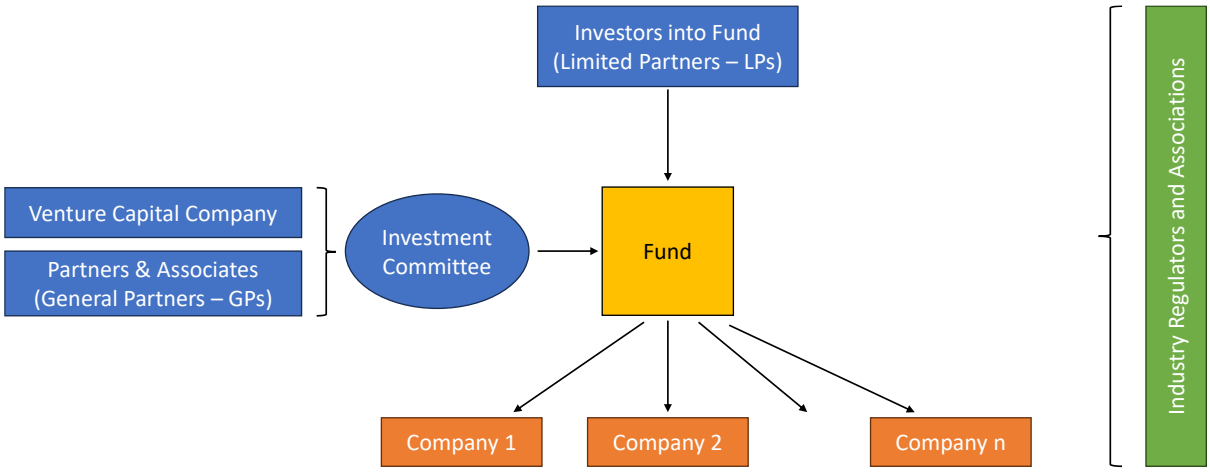
Funds-of-funds invest in VC funds that align with their mandates, while corporate VC investors tend to prefer slightly more mature firms than typical early stage VC funds. Private equity and captive government tend to be conservative, which is reflected in their investment mandates, and prefer the mature company that has a proven track record, with an established market share and customer base and is at the post-revenue stage.

Most VC and angel investors offer the start-ups in their portfolios additional resources, apart from money, like mentorship, skills development, networking resources and infrastructure. This is beneficial for both the start-up and the investor as it makes the start-up more “investable”, i.e. able to attract more funding as required and ultimately to achieve a successful exit. What is key to the ecosystem, and which defines a mature VC landscape or early-stage funding ecosystem, are the number of exits. As more exits happen, so more funds become available for re-investment, the VC and angel investors gain a track record and the whole early-stage ecosystem grows.

The typical South African venture capital (VC) fund structure is illustrated in Figure 34. The VC fund lies at the heart of the structure because it is funds that invest directly into the start-ups and scale-ups. The fund is managed by the Venture Capital Company (VCC), which also raises the funds through its limited partners (LPs) and general partners (GPs). While GPs may also invest in the fund they manage, the LPs make up most of the investors into the VC fund and consist of institutional, angel, independent or family office investors. The GPs differ from LPs by being active in the management of the fund. Typically, VCCs operate on what is known as the 2:20 business model; they take 2% commission annually from the fund to cover operating costs and the profit is split 20% to the GPs (referred to as the ‘carry’) and 80% to the LPs after the initial capital with a predetermined interest rate (hurdle rate) has been

achieved. Stakeholders have indicated that for small funds the 2% management fee is unsustainable and that they migrate to a 2.5% management fee, until a certain threshold fund size is reached (approximately R700m) especially as a there are a lot of operational costs to cover at the start of a VCC's establishment.

Figure 34: Typical Venture Capital Fund Structure



Source: Adapted from (Viridian, 2024)

The VC fund invests in qualifying start-ups and scale-ups for a share of equity, assists the businesses to scale and grow through active management of their investment portfolio and then looks for opportunities to exit. Qualifying firms would need to be a match to the VCC's investment mandate, be in the start-up or early-stage growth phases with the potential to exhibit long-term high growth, i.e. businesses that are scalable. The goal for the VCCs is to make as much of a return on its investment as possible within a certain defined period (usually 5-7 years) and it then "exits" the investment. An exit occurs when the VCC sells its shares in the start-up, which can happen in a variety of ways: the management of the start-up buys out the VCC, the start-up is sold to a later stage acquiring company through an M&A transaction (the most common exit option), early stage VCCs exit in later rounds when new investors (such as later stage VCCs or PE investors) buy them out, or through an initial public offering (IPO).

The ecosystem is completed by industry and government regulators.

Since only some of the VC-backed companies develop into successful and highly profitable businesses, this type of investing is high risk and a core skill within VCCs is the ability to identify novel or disruptive technologies or business models that have the potential to generate high commercial returns at an early stage. This means that VC funders often take an active role in managing their investments into entrepreneurial companies at an early stage, adding

skills (technological and strategic support, and mentoring) as well as capital, and so differentiating VC funding from buy-out private equity, which typically invests in companies with proven revenue and provides no other support than financing. Inherent in realizing abnormally high rates of returns is the risk of losing all of one's investment in a given start-up company. Consequently, most LP investments are done in a pool format, where several investors combine their investments into one large VC fund that invests in many different start-up companies. By investing via a VC fund, the investors spread their risk to many different investments[6].

VC funding has become an important source of early-stage, risk tolerant capital for entrepreneurs, who often cannot source funding from (risk-averse) banks. Venture capital is also a way in which the private and public sectors can participate in as well as support structures that systematically creates business networks for new firms and industries so that they can progress and develop. This helps identify promising new firms and provide them with finance, technical expertise, mentoring, talent acquisition, strategic partnership, market access and business models.

Apart from the obvious goal of venture capitalists to maximise the returns on their investments for themselves and their LPs, the end goal is for investment capital to flow to businesses with the highest growth potential. This brings financial benefits for the start-up founders and their employees, the VC investors, but also often to society at large, who gain access to a new product or service that enhances their quality of life[7].

The need for high returns makes venture funding an expensive capital source for companies, as they take equity and is most suitable for businesses that have large up-front capital requirements, which cannot be financed by cheaper alternatives. That is most commonly the case for intangible assets such as technology development, software and other intellectual property, whose value is unproven. If these intangible assets are accepted and find traction in the market, this enables the start-up to scale exponentially. This is why venture capital is most prevalent in the fast-growing technology and life sciences or biotechnology fields, where businesses have the potential for exponential growth and returns.

3.4 Offshore Structures

While the previous section illustrated a standard VC ecosystem, this is not always the case in South Africa, which offers a level of complexity not experienced in most other countries. In

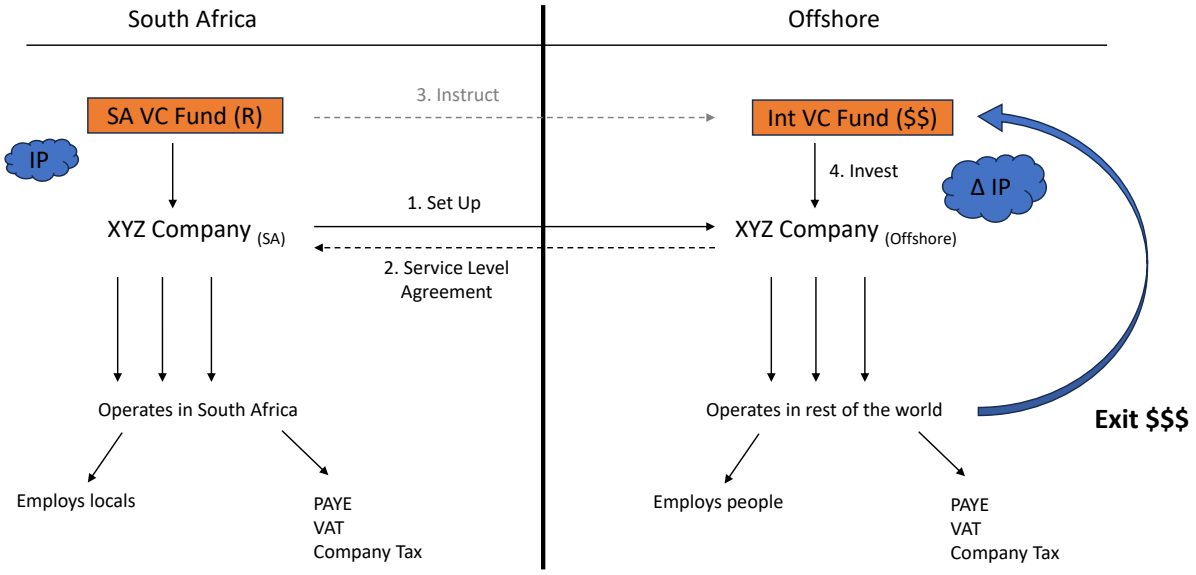
[6] *https://en.wikipedia.org/wiki/Venture_capital*

[7] *https://dealroom.net/blog/top-venture-capital-firms*

many instances, when South African companies want to expand globally, they need to set up an offshore structure. The reason for this offshore structure is to be able to access international funding, which often avoids investing in South Africa because of its tight exchange controls, rigid Intellectual Property (IP) laws, depreciating currency and governance concerns. The offshore structure is set up as depicted in Figure 35.

As an example, a South African start-up company, XYZ_{SA}, operates in its infancy in the mostly local market. It then seeks to grow and expand globally, but to do this needs to attract international funding. The international VC funder does not want its money to go directly into South Africa nor does it want to invest in IP that will be stuck in South Africa. So, XYZ_{SA} sets up an offshore company, $XYZ_{Offshore}$, as its head office and any *new* IP associated with its new products for the global expansion is housed there. A Service Level Agreement between XYZ_{SA} and $XYZ_{Offshore}$ places XYZ_{SA} as the local subsidiary. All head office functions would move offshore. The IP for the original product is still housed in South Africa and this cannot leave the country without exchange control approval. XYZ_{SA} would still be earning income and employing people, but only for revenue associated with the original product. IP developed as the company expands is housed by $XYZ_{Offshore}$ and any global revenue associated with the new product would be earned offshore.

Figure 35: Local and Offshore Structure



The implications are that the global revenue would be much higher than the local revenue and, despite XYZ_{SA} still employing people and paying taxes in South Africa, this is on a lesser scale than in $XYZ_{Offshore}$. South Africa therefore loses out on the incremental revenue associated with the global expansion. When the VC funder exits, if $XYZ_{Offshore}$ has grown as hoped, then the value of the company would be captured offshore, in $XYZ_{Offshore}$, and the VC

funding would be reinvested into the offshore fund. In addition, founders who hold shares offshore, would exit their businesses internationally and many successful SA entrepreneurs have financially emigrated along with any capital gains from successfully exiting their businesses. Once again this is lost capital to South Africa.

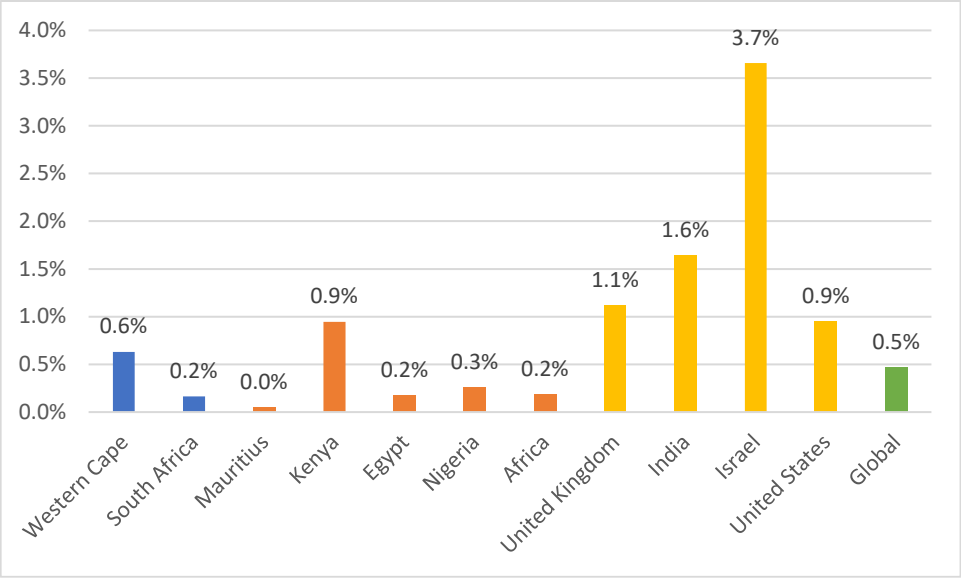
This offshore structure comes with its own unique challenges. It increases the cost of doing business because dual companies need to be set up, service level agreements need to be drawn up, dual operations conducted and board meetings need to be held offshore. The IP for the new product and all decisions relating to this IP need to occur in the offshore jurisdiction. However, this is seen as usually the only viable solution to accessing international funding for local entrepreneurs building companies that want to scale and exit internationally.

The above situation is a single example, but many variations exist. In some instances, the IP leaves the country before local operations are even set-up, in order to avoid falling foul of the South African Reserve Bank regulations and to be able to access international funding from early on in the life of the start-up. This means that no local operations occur, with no local employment or taxes paid.

3.5 Western Cape and South African VC Potential

The size of the Western Cape and South African VC industries relative to its GDP and compared to other jurisdictions in 2022 is shown in Figure 36. Looking at the country comparisons, South Africa's VC industry as a percentage of GDP is the same as the average for Africa. Within Africa, Kenya is the clear leader, followed by some distance by Nigeria and then South Africa and Egypt. South Africa is 2.9 times less than the global average of 0.5%. The clear international leaders are Israel (3.7%), India (1.6%), the UK (1.1%) and the United States (0.9%). A case study on the development of the Israeli VC industry is provided in section 4.3.

Figure 36: Venture Capital Industry as % of GDP



Although strict comparisons between regions and countries should not be made, the Western Cape performs better than South Africa and exceeds the global average when looking at VC as a percentage of GDP. This now allows for a benchmarking exercise. If South Africa had to address the structural impediments to its VC industry, to be discussed later, and could increase its VC industry as a % of GDP to the global average of 0.5%, then it would need to increase by 2.9 times (i.e. almost triple). If this were to be attained and the VC activity distribution within the provinces were to remain the same, then the Western Cape VC industry could increase from its current $350m a year to $1.0bn. At current exchange rates[8] this would see the industry grow by R12bn.

[8] *R19.00 per $1*

4 Venture Capital in Other Countries

This section summarises the key points of the literature review of five countries and Africa in general. The five countries reviewed are Mauritius, Kenya and Tunisia in Africa and the United Kingdom and India as two non-African counties. The three African case studies are supported by VC insights across Africa. This section then concludes with a case study on the development of the Israeli VC industry.

The detailed reviews can be found in Appendix A (section 9).

4.1 Summary of International Perspectives

The salient points of the international case studies presented above are summarised.

Ease of Doing Business (EODB) and a friendly business environment, while helpful, does not automatically translate into an active VC industry. While this does encourage investment, what is ultimately required for successful VC activity is both a business-friendly (or in particular, a VC-friendly) environment, allied with certain macroeconomic factors (see below), and a dynamic start-up environment in certain industry sectors (like fintech). However, the lack of a business-friendly environment will hamper the growth of the industry.

Helpful macroeconomic factors, such as:

- large populations which create demand
- growing middle class with higher purchasing power
- fast technological adoption
- availability of skilled labour force.

These factors are particularly attractive and important to overseas investors, who may not understand the micro issues within a country or region but look for certain macroeconomic indicators.

Macroeconomic risks: for example, currency volatility and uncertainty regarding government / economic policy, are key concerns for overseas investors in Africa, both for LPs and GPs.

Government support: low-tax jurisdiction, government incentives and a light regulatory touch are all factors that can bolster or attract VC activity.

The importance of regions: investors, particularly overseas investors, often consider a potential investment location within its geographical context, i.e. as a gateway to Africa or central to a particular region of Africa.

The importance of exits: the number of exits in any given year is an indicator of the strength of VC activity in a jurisdiction and is often a key factor for LP investors when considering whether to invest in VC funds, or for international or local VCs when investing in similar sectors or start-ups locally.

The importance of certain (attractive) sectors: a busy / particularly innovative / successful industry sector can catalyse investment in a country as there are sufficient supporting structures, follow-on investors and pools of talent and skills which support the sector's growth.

Startup Acts:

- provide start-ups with targeted incentives aimed at addressing the actual challenges they face.
- need an ecosystem approach (or recognise interdependence of multiple factors): the interaction between the components in the ecosystem is critical to understanding the challenges that may impede entrepreneurship and potential solutions. For example, if a policy increases access to finance but entrepreneurial skills are lacking, the financing might be difficult to disburse and financiers might complain about the lack of pipeline. It is also helpful to avoid fragmented and overlapping programmes.
- a participatory design process is essential, bringing together policy makers and all other stakeholders.
- acts as a reference document for other government programmes and policies.
- the need for a clear and objective selection process to target the right beneficiaries and a solid understanding of what a start-up is and is not by all stakeholders.
- public/private partnerships: to efficiently ascertain whether a company meets the criteria for a start-up under the Act, there may be a need to use private sector resources and expertise because it is generally better equipped to identify potential businesses.
- provide a monitoring and evaluation mechanism: there should be a monitoring body composed of members from the public and the private sectors, that evaluates

beneficiaries, and to establish a clear methodology, including regular and relevant surveys to gather the perceptions of benefiting firms.

Established markets: attract more investment and are trusted more as investors can focus on business risk without having to worry about country risk and government-related uncertainties.

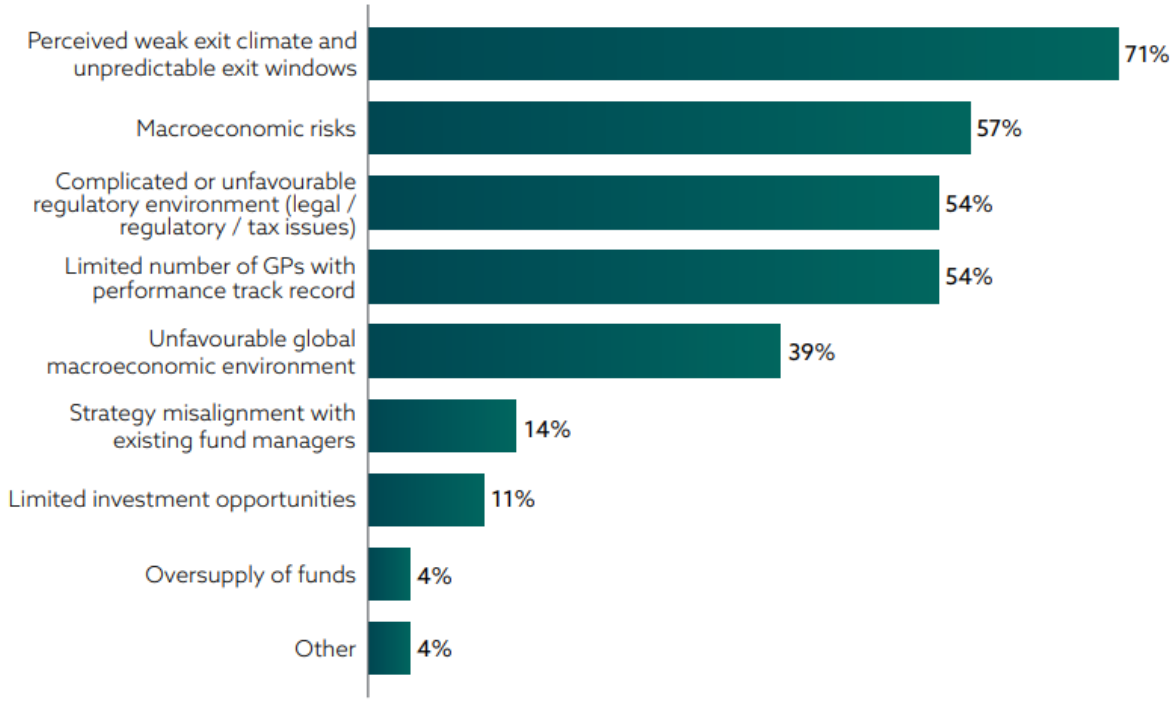
4.2 Africa General

Figure 37 lists the biggest challenges for LPs investing in private capital in Africa.

Over two thirds of LPs (71%) view the perceived exit climate and unpredictable exit window as a significant challenge when investing in private capital in Africa (AVCA, 2023). Despite the record high of 82 full exits on the continent in 2022, which indicated the potential for successful exits in the region, the exit environment in 2023 was down due to prevailing macroeconomic uncertainties. Fund managers are struggling to exit investments and distribute cash to investors, leading to longer asset holding periods, lower returns and are exploring alternative liquidity options.

Another significant proportion of LPs (57%) identified macroeconomic risks as an important challenge when investing in African private capital. (AVCA, 2023). Among these risks, currency volatility and uncertainty remain a key concern for investors.

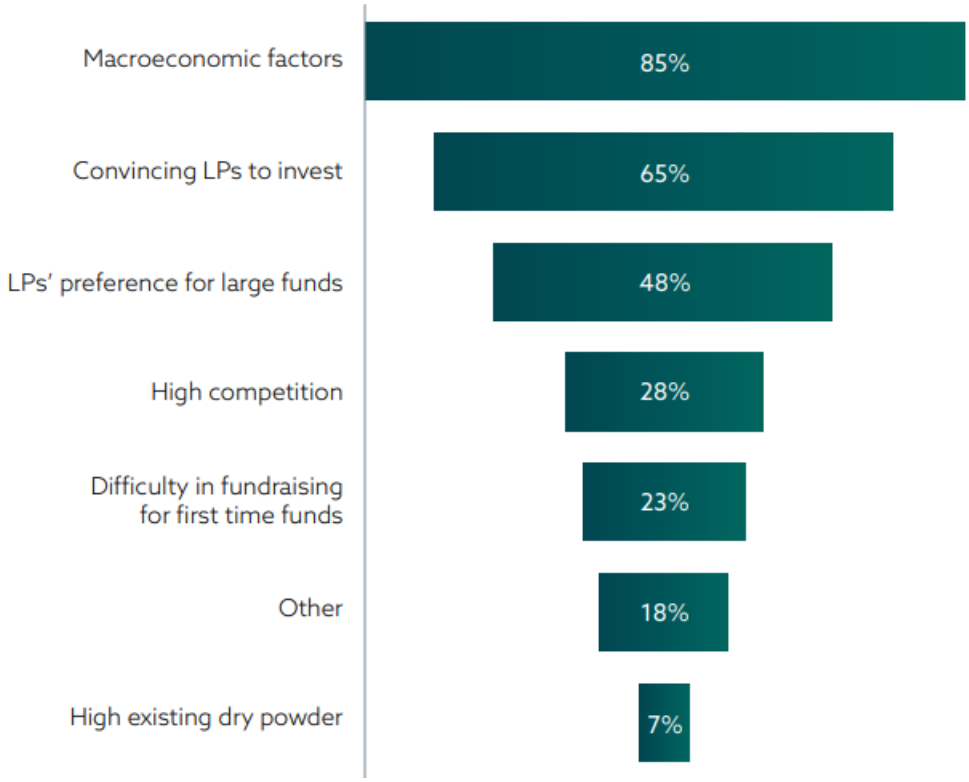
Figure 37: Biggest Challenges for LPs Investing in Private Capital in Africa



Source: (AVCA, 2023b, p. 15)

Figure 38 demonstrates the same challenges as Figure 37 but focuses on GPs. For GPs the majority (85%) identify challenging macroeconomic factors as a significant obstacle to fundraising. These factors include current economic uncertainty, the escalating currency volatility, supply chain disruptions resulting from covid and the ongoing war in Ukraine, along with increasing levels of geopolitical instability. An additional challenge that a substantial percentage (65%) of GPs face is the challenge of convincing LPs to invest in their funds as they struggle to close funds.

Figure 38: Key Challenges for GPs in Fundraising in 2023

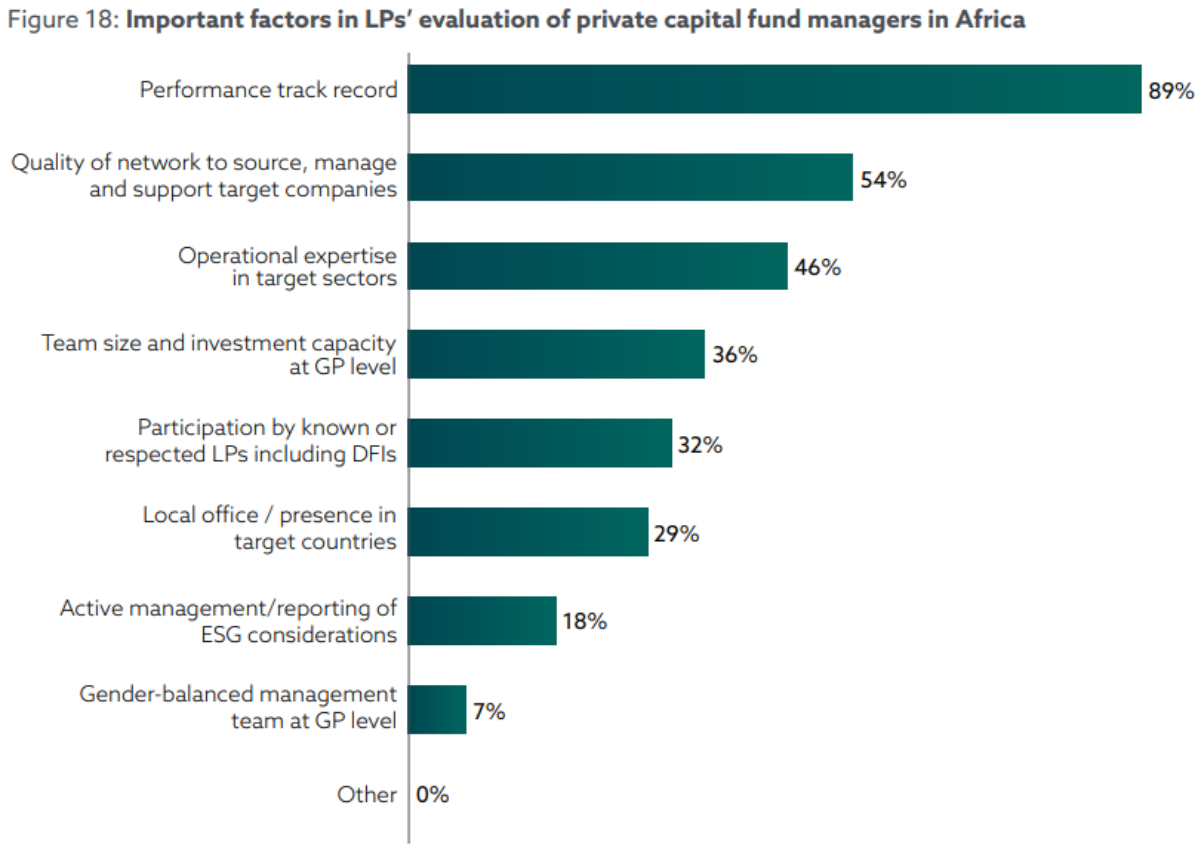


Source: (AVCA, 2023b, p. 16)

Under the "other" category, GPs identify additional obstacles to fundraising in 2023, which include unfamiliarity of LPs with new investment strategies, LPs' preference for more established markets in Africa, difficulty in meeting reporting requirements for smaller teams, the struggle to convince new LPs to invest in the continent, and scepticism arising from negative perceptions about Africa. 7% of GPs have identified high existing dry powder as a challenge. Dry powder in the venture capital and start-up world means cash on hand to either invest in a new opportunity or provide additional funding to portfolio companies to fuel growth. When venture capitalists have a high existing dry powder, it means they have a significant amount of unallocated funds that they can deploy into new investment opportunities and which are not at work to produce returns for the fund.

Most LPs (89%) emphasize the significance of a strong performance track record when evaluating fund managers in Africa; a history of successful investments and profitable exits stands as the paramount factor for LPs considering potential investments in fund managers (AVCA, 2023). However, of those who prioritize the performance track record, a significant majority (64%) admit to not having invested in a first-time fund manager in Africa in recent years and 44% say they would not consider such an investment, citing the lack of a robust performance track record as a critical concern. This is a concern as there are a number of first-time, female led funds with a gender lens mandate, working to close the gender funding gap in Africa, and key to enabling this are LPs investing into these GPs. In the main, the VC industry has been very male dominated (both by GPs and LPs) which has resulted in gender bias in sourcing, evaluating and making investment decisions.

Figure 39: Important Private Capital Fund Manager Evaluation Factors by LPs



Source: (AVCA, 2023b, p. 18)

Apart from the performance track record, over half of LPs (54%) identify the quality of a fund manager's network as another crucial element in their evaluation process. Research has indicated that, particularly in Africa, access to a private capital firm's network can substantially contribute to value creation for investee companies; access to a VC or PE firm's network, including support with mergers and acquisitions, connections to industry specialists, suppliers,

and customers, plays a pivotal role in the growth of African portfolio companies. Figure 39 shows the factors that LPs consider when evaluating private capital fund managers in Africa.

4.3 YOZMA Case Study

It was shown in Figure 36 how Israel is the clear global leader in VC relative to the size of its economy (VC as a percentage of GDP). This case study explores how this came about.

Faced with triple-digit inflation and imminent bankruptcy in the 1980s, the Israeli government resolved to shift from a socialist economy to a capitalist one. An economic stabilization plan was set into motion and Project Yozma (“initiative” in Hebrew) was born. One goal of the stabilization plan was to unleash the potential of the private sector by encouraging companies to take risks and experiment with new ideas. The establishment of Yozma by the Israeli government in the early 90s was meant to kick-start innovative industries by investing in new venture capital funds, in addition to directly investing in early-stage Israeli start-ups. It was able to provide the funding they needed to bring their products to market.

Yozma mandated several conditions for participating funds (Cole, 2023):

- Include a foreign VC firm as limited partner, to bring investment expertise into the space.
- Partner with an Israeli investment company for local connections.
- Focus on early-stage Israeli start-ups.
- Raise at least $20M with about 40% from Yozma's capital.

If a fund met these criteria, Yozma invested 40% of the capital (up to $8M). This was matched by at least 60% from private investors. Yozma took an equity stake, rather than provide grants. And the private partners could buy out Yozma's shares at cost after five years if successful. This gave upside potential through ownership of valuable start-up stakes.

Yozma raised $100M from the Israeli government. This attracted $150M in private foreign capital. Ten new Israeli VC funds were established with Yozma incentives between 1993-1997 and Yozma backed funds invested in over 200 start-ups between 1993-1998 (Cole, 2023). Yozma "follow up" funds grew to nearly $6b in capital. VC investments jumped from $58m to $3.3bn (Social Impact Israel, n.d.). The number of companies launched using Israeli venture funds rose from 100 to 800 and Israel's information-technology revenues rose from $1.6 billion to $12.5 billion (wikipedia, n.d.). By 1999, Israel led the world in the share of its growth

attributable to high-tech ventures (70%) (Social Impact Israel, n.d.). According to the OECD, Israel is ranked first in the world in expenditure on Research and Development (R&D) as a percentage of GDP (wikipedia, n.d.)

The influx of capital and foreign expertise kickstarted Israel's start-up ecosystem. It led to the development of a globally competitive and innovative high-tech industry (Cole, 2023).

Yozma succeeded due to several interlinked factors. First, the funds were designed so that incentives aligned all stakeholders to build profitable funds and start-ups: rather than protect against downside, the funds were designed to incentivize upside for investors. The fund-of-funds model brought discipline and oversight but avoided government intervention. Finally, the investment was for a limited five-year program with clear exit path for government stakes.

Israel currently has more than 276 active VC funds of which 71 are international VCs with Israeli offices (wikipedia, n.d.). According to a report from Start-Up Nation Central (SNC) the three largest earning sectors in Israel were Enterprise IT & Data Infrastructure (which raised just under $6b), Cybersecurity-dominated Security Technologies ($5.9b), and Fintech ($4.2b) (wikipedia, n.d.). In 2021, VC investment in Israel stood at $25.6 billion – a leap of almost 150% from 2020 (wikipedia, n.d.).

Since its inception, Yozma has managed more than $220 million in its three funds: Yozma I – formed in 1993; Yozma II in 1998, and Yozma III in 2002, with direct investments in about 50 portfolio companies (Social Impact Israel, n.d.). It has helped a significant number of its portfolio companies go public on major stock exchanges in the US and Europe. In addition, it has positioned some of its portfolio companies for acquisition or an investment by leading international corporations.

The Yozma funds also engage in the development and financing of social businesses and programs for employment of disadvantaged populations. In 2015, with the cooperation of the Ministry of Finance and the National Economic Council at the Prime Minister’s Office, two funds for the encouragement and development of social businesses (Yozma funds) were launched. These funds provide professional backing for social businesses which employ disadvantaged groups – handicapped people, adults entitled to an income supplement, youth and young adults at risk, released prisoners and single-parent families receiving income support. The Yozma funds are financed by the government, donations and other investors, and are operated by means of concessionaires.

Yozma positions itself not only as the creator of the VC industry in Israel but ongoingly as a source contributing to the VC deal flow by (Yozma, n.d.):

- Building its own brand awareness: Yozma's contribution to the creation of a professionally managed VC industry in Israel has generated a strong brand recognition for Yozma as a top-tier, value-added, and dominant player. As a result of Yozma's activities, there is a substantial network of angel investors, industry-insiders, lawyers, consultants, government agencies, press, and academia that recognize Yozma's unique standing in Israel.

- Formal and informal links to Israel's leading technological academic institutions: Yozma has developed close working relationships with several of the leading academic institutions in Israel. Some of the most promising companies in the portfolio of Yozma have come directly from these institutions.

- Working relationships with top-tier international venture funds: a key part of Yozma's strategy is to strengthen its network of peer venture funds in the US and Europe. In particular, the network of peer funds supports portfolio companies in their effort to establish presence outside Israel.

- A network of technology incubators: Yozma has developed tight links with a wide network of more than twenty technology incubators spread throughout Israel. As a result, Yozma has been able to scan the incubators on an ongoing basis and cherry-pick promising business opportunities.

Yozma has established offices in Singapore and South Korea to strengthen its ability to facilitate cross-border transactions.

Yozma's industry focus is primarily on companies in the fields of Communications, IT and Medical Technologies. Emphasis is placed on companies that develop infrastructure and enabling technologies, that have a depth of technology, have a multiple stream of products, and that place their main target markets outside Israel (Yozma, n.d.).

The focus is on Israeli and Israeli-related companies that target international markets, and on Singapore, South Korea, and other Asian companies that target international markets. Yozma invests in all stages of company development with a primary focus on early stage. Initial individual investments typically range between $1m and $6m. Additional capital is reserved for follow-on investments.

Israel's government is very supportive of its high-tech economy. When it noticed seed-stage start-ups were flagging, the Israel Innovation Authority announced the launch of a new funding program to help seed-stage and early-stage start-ups, earmarking $25m for the project

(Butcher, 2021). This program offers participating companies grants worth 40% of an investment round up to $1.1m and 50% of a total investment round for start-ups in the country or whose founders come from under-represented communities — Arab Israeli, ultra-Orthodox and women — in the high-tech industry (Butcher, 2021).

Four key lessons emerge from this case study:

1. The first is the involvement of government in reducing the risk of the VC industry. This de-risking was not only confined to Israeli investors but was extended to international ones too.

2. The value of a fund-of-funds model and how, if used correctly, it can incentivise and de-risk the formation of new funds.

3. The ongoing support from early stage to late-stage funding and particularly for under-represented communities.

4. The establishment of offices in offshore jurisdictions, in Singapore and South Korea, to facilitate cross-border transactions.

5 Regulatory Impact Assessment

This chapter investigates the impact of South Africa's regulations on the growth of its VC industry. It commences by looking at regulatory best practice internationally. It then focuses on South Africa's regulations that are pertinent to the VC industry. The three main problematic regulatory areas are exchange controls, intellectual property and the lack of tax incentives. The issues pertaining to each problematic regulatory area are discussed and reforms suggested.

5.1 Regulatory Best Practices and Proposals

From a regulatory perspective, the research shows that countries that score highly on ease of doing business indices, whose governments are business friendly and/or who provide targeted incentives to both start-ups and investors, tend to encourage VC activity. Startup Acts and skilled or nomad visa programs are examples of regulatory activities that VC friendly countries have in place, often together with targeted tax incentives. Accordingly, bearing in mind the barriers to VC activity in South Africa indicated by the research, the following key regulatory reforms are identified: relaxation of exchange controls; IP reform (which also involves a form of exchange control change); and tax incentives.

While a Startup Act has proven of significant help in many countries in Africa – chiefly because it achieves a legislative focus on and framework for small business in one instrument, which also makes it easier for firms to be aware of the benefits – it is often complemented with other regulations, policies and programmes. And the research indicates that, at least until South Africa has a Startup Act, focusing on exchange controls and tax incentives should take priority. In any event, Startup Acts and start-up programmes like those offered in the UK contain tax incentives as part of the start-up- and investor-friendly narrative. What all of these regulatory inputs demonstrate, however, is an ease-of-doing-business impetus and an "open for business" mentality. These are overarching stimuli for all business, never mind start-ups and small business in particular. While South Africa does not have a Startup Act, the VC industry has initiated the Startup Act Movement, to actively engage authorities on such a development.

5.2 Relevant Regulatory Authorities

In South Africa, VC funding and start-ups are regulated primarily through the following authorities:

- The Companies and Intellectual Property Commission (CIPC) – this maintains a register of companies and regulates them in terms of the Companies Act 71 of 2008.

- The South African Revenue Service (SARS) collects PAYE and VAT from start-ups and capital gains tax from investors and any shareholders that exit.

- The South African Reserve Bank (SARB) implements exchange controls (on behalf of National Treasury) related to the purchase/sale of foreign exchange and cross-border movement of funds by investors and start-ups.

- The Department of Trade, Industry and Competition (the dtic) promotes economic competitiveness and investment through legislation like the Protection of Investment Act.

- The Financial Sector Conduct Authority which regulates VC funds in terms of the Financial Advisory and Intermediaries Services Act (FAIS Act).

5.3 Exchange Controls

Exchange controls exist to manage and regulate the flow of money in and out of a country and are used by many governments to restrict the movement of capital, currency, or financial assets across national borders.

5.3.1 Context

Most developed countries have relatively open foreign exchange regimes and require reporting rather than approval for offshore payments or currency conversions, except for certain types of transactions. In Mauritius, for example, there are no foreign exchange controls. In other words, free repatriation of funds is allowed and there is no regulatory consent needed for the repatriation of funds, which can be in the form of profits, dividends, fees earned from consultancy services, etc., earned by a foreign investor in Mauritius. Apart from complying to standard anti-money laundering laws and regulations, a foreign investor does not have to seek any authority`s consent for the free movement of funds abroad and within Mauritius.

However, in South Africa, there are significant controls relating to the offshore movement of money, creating barriers for start-ups aiming to expand overseas and/or to access international finance. This was cited by almost every stakeholder interviewed, as a reason for international investors not investing in South Africa (whether in a fund or in a start-up) and for these same investors being either wary of South Africa as an investment destination or actively distrusting the country as a potential target for their funds. Investors see exchange controls both as a contradiction of global open market policies and as a threat to their ability to earn

and receive profit from the South African start-up (South Africa Startup Act Movement, 2023, p. 13). It was also cited as a major headache for start-ups who do business outside the common monetary area (of South Africa, Namibia, Lesotho and Eswatini) and who have to pay overseas suppliers.

While a more open regulatory environment may be attractive, particularly in relation to attracting overseas investors, this is not an option that is currently considered for South Africa. Most countries at least have some form of reporting requirement for offshore payments and the few countries that have lax reporting requirements or none at all (for example, the Cayman Islands, the British Virgin Islands, Bermuda, Monaco, Andorra, San Marino and Liechtenstein) are typically considered tax havens and are regarded with some suspicion. Moreover, South Africa's 2023 grey listing by the Financial Action Task Force (FATF), indicating that South Africa does not comply with the FATF's International Standards for Anti-Money Laundering/Combating the Financial Terrorism (AML/CFT) and other safety measures, would also seem to indicate that lifting exchange controls too much or too quickly, may be counterproductive.

The Exchange Control Regulations of 1961, as amended in 2012, promulgated in terms of Section 9 of the Currency and Exchanges Act No. 9 of 1933, provide the founding legislative authority. These are supplemented by the Currency and Exchange Guidelines released annually by SARB and it is their Financial Surveillance Department that manages and implements the regulations on behalf of the National Treasury. Although the National Treasury has gradually loosened exchange controls since 1993, they remain prohibitively restrictive for start-ups and investors. Start-ups are required to obtain approval from SARB (through an Authorised Dealer, usually a bank) before making foreign payments, such as paying foreign employees or to cover offshore office costs. Requiring prior approval enables the SARB to monitor cross-border payments but creates payment delays and additional red tape for start-ups. This pre-transaction approval is more stringent than the post-transaction reporting required by most developed countries.

The offshore movement of money for the purpose of expanding a South African start-up overseas (such as paying foreign employees or covering capital costs) is seen as goods and services purchased from "non-residents" (foreign entities) and are considered "imports" by SARB's Balance of Payment codes, even if no physical import will take place. The exchange controls related to "goods purchased outside the Republic" are dealt with by Regulation 12 of the Exchange Control Regulations read with specific details for offshore payments for imports as provided in SARB's Currency and Exchanges Guidelines. For a transaction of less than R50 000, start-ups may make offshore payments directly via credit and/or debit card, and for

larger transactions, via an authorised dealer or first via an authorised dealer into a foreign bank account and then from the foreign bank account. As shown in the stakeholder interviews, the administrative burden for start-ups to understand the regulations, complete the required paperwork and then to wait for the necessary SARB approval creates a material impact on their business. In some cases, this can either delay a funding transaction or even scupper it.

5.3.2 Exchange Control Recommendations

Replacing SARB approval with post-transaction notification would benefit start-ups by reducing the potential delays and disruptions associated with transaction approval times. It would make South Africa's foreign exchange regime more competitive with other countries and so assist in making South Africa a more attractive destination for overseas investors to do business and invest in.

Reporting rather than pre-transaction approval could be achieved through the release of an exchange control circular by the Financial Surveillance Department that would amend the provisions related to import payments in SARB's Currency and Exchange guidelines for business entities (Section 6), authorised dealers (Section B.1), and authorised dealers in foreign exchange with limited authority. Reporting offshore payments would still help the government maintain control over capital flows and so complement the need to comply with the FATF recommendations. Certain types of transactions could be excluded, i.e. could retain the requirement for pre-approval.

5.4 Intellectual Property

In the context of a start-up, intellectual property (IP) usually refers to the start-up's unique idea, software or product, including patents, trademarks, copyrights, trade secrets and other proprietary knowledge, that gives it a competitive advantage or makes it unique. For example, and particularly pertinent to the VC industry where technology is an obvious focus, the source code for a new software programme would be considered IP. It is the IP of a start-up that the VC investor is ultimately investing in and which will fundamentally comprise the value of the start-up as it scales up and expands into a fully-fledged business. It follows that the profitable sale (or "exit") of a start-up by a founder/investor is dependent on being able to transfer the IP, being the start-up's primary capital asset, to a buyer. In the context of South African start-ups being able to access investment, overseas investors want certainty that IP held in South Africa can be easily transferred offshore for the purpose of expanding the business internationally or selling the business upon exit to a foreign buyer.

5.4.1 Background

In South Africa, IP rights are governed under the Exchange Control Regulations as capital assets that generate revenue over time by virtue of owners being able to sell or licence access to the IP. Regulation 10(1)(c) of the Exchange Control Regulations states that "no person shall, except with permission granted by the Treasury and in accordance with such conditions as the Treasury may impose, enter into any transaction whereby capital or any right to capital is directly or indirectly exported from the Republic". Section 4.1(g) of SARB's Currency and Exchanges Guidelines for Business Entities states as follows (selected extracts):

"The transfer of South African owned intellectual property by way of sale, assignment, or cession and/or the waiver of rights in favour of non-residents in whatever form, directly or indirectly, is not allowed without the prior approval of the Financial Surveillance Department. This restriction does not apply to technology, media, telecommunications, exploration and other research and development companies, who for capital raising purposes may assign intellectual property offshore provided that the registration remains in South Africa.

South African residents may license intellectual property to non-resident parties at an arm's length and a fair and market related price for the term of the agreement, provided that they present Authorised Dealers with the licence agreement and an auditor's letter confirming the basis for calculating the royalty or licence fee.

All royalties and/or fees emanating from such transactions must be repatriated to South Africa within a period of 30 days from the date of becoming entitled thereto and reported under category 201 on the FinSurv Reporting System.

The sale, transfer, assignment and/or licensing of intellectual property is subject to appropriate tax treatment."

Accordingly, start-ups may not transfer IP to related non-resident parties, such as subsidiaries or associated companies, making it difficult for start-ups to expand overseas in order to access international markets and funding. This makes South Africa uncompetitive in relation to other countries (including Nigeria, Egypt and Kenya) where IP transactions with related non-resident parties are permitted, provided that they are conducted at arm's length and at fair and market-related prices. In addition, while start-ups may transfer IP to *unrelated* non-resident parties, doing so requires lengthy approval by SARB and the expensive creation of offshore structures. Specifically, if entrepreneurs and investors want to maintain ownership over the IP, instead of exiting early, they need to transfer IP to the unrelated non-resident party in return for shares

(a “non-cash-settled share swap”) through the use of an expensive and complex loop structure.

The legal costs of setting up an offshore structure (typically through a loop transaction with an unrelated non-resident party) and accurately valuing the IP for the purpose of the share swap are substantial. Moreover, to ensure that future IP developed by the offshore structure using the foreign investor’s capital is owned by that offshore structure instead of the South African entity, the foreign structure cannot simply be a legal entity or shelf company; it needs to have a physical foreign presence from which business activity is conducted, or else future IP created will still be considered by SARB and SARS as being held in South Africa. If the offshore structure is considered to be a South African controlled company, the company will need to pay taxes on its profits to SARS and will still have to comply with SARB’s exchange controls.

Prior to 2019, the challenge for start-ups only being permitted to sell IP to unrelated non-resident parties in order to expand offshore (and usually receive investment) was that local entrepreneurs and investors had to give up ownership of their IP rights. Since local entrepreneurs and investors could not own shares in the non-resident party purchasing the IP rights at the time of the purchase (or else the party would be considered “related”), the entrepreneurs/investors had to give up ownership of the IP rights to sell the IP offshore. A related party is “a party to a transaction that has a direct or indirect interest in the other party and has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or both parties are under common control… [which] includes transactions between parties that belong to the same group of companies such as parent, subsidiary, fellow subsidiary and/or an associate company.” (South African Reserve Bank, 2024).

Losing ownership over IP rights means giving up entitlement to the revenues generated by the IP and so has the effect of an early exit from the start-up by the local entrepreneur and early investors, before the potential value of the IP has been realised. Local entrepreneurs or investors not wanting to exit early either had to stay in South Africa without expanding overseas or create, at great cost, an offshore vehicle to develop IP abroad.

With this in mind SARB eased the loop structure restrictions in 2019 and lifted them entirely for resident individuals and companies. A loop structure is a type of transaction that involves a loop or circular flow of funds among multiple entities or accounts. The circular manner of the transaction results in a net zero transfer of funds and can be difficult to detect by regulators and tax authorities who want to ensure funds are moving for legitimate purposes. This is why SARB originally prohibited loop structures. However, loop structures benefit local

entrepreneurs and investors by allowing them to sell IP rights to unrelated non-resident parties in return for shares in the non-resident party. Doing so enables the local entrepreneurs and investors to retain some (or all) ownership over the IP rights because they then own shares in the entity that holds the IP rights. This transaction is also referred to as a "non-cash-settled share swap" since the non-resident party is swapping an asset (the IP rights) for shares and no money changes hands.

While permissible loop structures have enabled start-ups to transfer IP offshore to *unrelated* parties without having to exit early, start-ups in South Africa still face the problem of not being able to transfer IP to *related non-resident* parties. In other words, entrepreneurs cannot transfer IP to a parent company, subsidiary, fellow subsidiary and/or an associate company. Additionally, after the share swap, the unrelated non-resident party with whom the share swap has occurred would become a related non-resident party, meaning no future IP created in South Africa can be transferred to that entity. And both the IP sale and share swap with an unrelated non-resident party require SARB approval, which can be onerous. One stakeholder reported that SARB took three months to provide approval and this almost cost them the investment.

Due to the exchange control restrictions and the associated tax on the offshore movement of IP, international investors are disinclined to invest in South African domiciled start-ups**.** Instead, investors typically insist that founders create offshore structures to house existing and future IP rights, usually in jurisdictions where investors are based and/or where there are stronger investor protections, which is an expensive undertaking for cash strapped start-ups. This means that when investors exit, they can avoid time- and resource-consuming exchange controls, and there will be less risk that the IP cannot be transferred to the buyer. This concern by international investors regarding local IP restrictions and the creation of the offshore structures to avoid these, has been confirmed in the stakeholder interviews. This is viewed as the single most important barrier to international VC investment in South Africa.

5.4.2 IP reforms

SARB could consider an amendment to subsection 4.1(g) of the SARB's Currency and Exchanges Guidelines for Business Entities (2023). The amendment would allow qualifying start-ups to receive automatic approval of offshore IP sales, subject to reporting the transaction to SARB within a specified timeframe or only to SARS for taxation purposes (South Africa Startup Act Movement, 2023). With a retention of SARB approval, the monitoring of the inflow and outflow of capital assets is maintained, as well as the valuation and taxation of those assets.

This change would allow IP transfers to related non-resident parties and remove the administrative burden and potential delays associated with getting SARB approval. This in turn would remove the concern or uncertainty for international investors that exchange controls could prevent IP housed in South Africa from being transferred offshore.

5.5 Tax Incentives

Government incentives for start-ups and for promoting early-stage investment in small business is usually in the form of the following:

- Government can provide investment directly to start-ups through public investment funds or public-private partnerships. For example, the South African Government provides a range of loan, equity finance and quasi-equity funding to businesses (including start-ups) through the Small Enterprise Finance Agency (SEFA) and the Industrial Development Corporation (IDC). The Technology Innovation Agency (TIA), a state-owned entity, invests in technology development and commercialisation projects.

- Government can reduce the risk associated with investing in start-ups by creating business incubators and accelerators, training and skills development programmes, and/or other support initiatives targeted at start-ups. For example, the Small Enterprise Development Agency (SEDA), the Department of Small Business Development (DSBD) Enterprise Incubation Programme (EIP) and TIA all target small business and offer programmes that assist this sector. However, it should be noted that many of the government's initiatives target small businesses more broadly instead of innovative, scalable start-ups that fall within the target businesses of angels or VC funders.

- Government can offer incentives (typically through tax relief) to investors to make investments more attractive and/or less risky, and to start-ups themselves as many founding teams are often self-funded ventures in the very early stages.

5.5.1 The South African Context

Limited funding for start-ups in South Africa can be attributed to the high risk associated with investing in young companies with limited (or no) track records. Allied to this is the absence of tax incentives for investors or for start-ups (compared to the UK, for example, where there is an extensive programme for qualifying start-ups and their investors to realise various benefits). Early-stage companies require significant amounts of capital to develop and bring products or services to market and such investments tend to be illiquid, meaning that investors

cannot easily buy or sell their shares in a company. This is often cited as a reason why effectively no South African institutional investors, such as pension funds or insurance companies, invest in the VC asset class. Local VCCs also tend to have a risk averse investment profile, usually investing at series A round and beyond, and requiring start-ups to be at post-revenue stage, leaving a large gap in the pre-series A funding space.

Investors in start-ups are also subject to the same taxes on capital gains and dividends as investors in more traditional assets, thereby providing no additional incentive to invest in significantly riskier start-up investments. Upon the sale of shares, CGT is payable at a rate of 18% for individuals and special trust investors, 21.6% for corporate investors, and 36% for other trusts in accordance with Section 26A of the Income Tax Act (South African Revenue Service, n.d.). While South Africa's CGT rate for individuals at 18% is not unusually high, other popular start-up investment destinations in Africa have more competitive CGT rates for individuals, including Nigeria (10%), Kenya (5%) and Mauritius (0%). Many angels are investing earnings into start-ups, where they will have already paid relatively high personal tax on their earnings (40% upwards), and then this capital competes with other less risky and more certain investment options, providing little or no financial incentive for individuals to invest into start-ups.

Start-ups are required to register with SARS and pay Value-Added Tax (VAT), Pay-As-You-Earn (PAYE) and Corporate Income Tax (CIT). The Income Tax Act provides for two tax concessions for small businesses, namely Section 12E which enables small business corporations (with a gross annual income less than R20 million) to pay a reduced CIT, and Section 48 which exempts small and micro enterprises from CIT, VAT, CGT and dividends tax in favour of paying a single progressive turnover tax. However, a recent study found that while many start-ups are unable to take advantage of existing small business tax benefits due to the low annual income tax thresholds, taxes for start-ups are not the abiding barrier when compared to more significant challenges, such as a lack of funding, to warrant introducing additional tax incentives (Genesis Analytics, 2022). The study states that introducing a tax incentive for start-ups, such as exempting start-ups from VAT, CIT and/or PAYE in the first five years of operating, would come at more cost to SARS in terms of lost revenue (R2.4 billion over a five-year period) than it would benefit society from start-ups that succeed because of the reform. This is because the number of start-ups that fail due to the burden of taxes is minimal.

National Treasury did provide upfront tax relief (via Section 12J of the Income Tax Act No. 58 of 1962) to VC investors between 2009 and 2021 but decided to scrap this incentive after June 2021 as a result of perceived poor performance and abuse. Section 12J allowed taxpayers to

deduct the full amount invested in an approved VCC from their taxable income, subject to certain limitations. The VCC had to invest at least 80% of funds into qualifying SMEs, and could not invest in certain restricted sectors. Investors had to hold their shares for a minimum of five years to retain the tax deduction, and there were limits on the total annual amount that could be invested in a VCC. While Section12J was a very useful mechanism for VC funds, the cost of compliance and need for an FSB license made the legislation unsuitable for most angel investors.

5.5.2 Tax Reforms

Stakeholder engagement showed almost universal support for the Section 12J incentive and it was expressed that, rather than scrapping this incentive, it should be refined and reintroduced.

Section 12J was introduced as a tax incentive to encourage equity investment through VCCs in small and medium-sized businesses and junior mining companies. The Section allows a holder of shares to claim a 100% deduction of the cost of the shares issued by the VCC, provided certain requirements are met. For a VCC to qualify:

- it must be a South African resident entity, and unlisted,
- the sole object of the company is the management of investments in qualifying companies,
- the tax affairs of the company must be in order and the company must have complied with all the relevant provisions of the laws administered by the Commissioner,
- its “investment income” must not exceeds 20% of its gross income,
- no person who holds a share in a VCC can hold more than 50% of the shares in any company in which the VCC has invested,
- the company is licensed under section 8(5) of the Financial Advisory and Intermediary Services Act,
- the company is not carrying on any impermissible trade.

The maximum cap on any investment in s12J funds was R2.5 million per annum per individual and R5 million per company. The section was effective for venture capital shares acquired on or after 1 July 2009 but on or before 30 June 2021.

What is also apparent from the research and specifically from other countries that offer this type of tax incentive is that the criteria for companies qualifying for the benefits of the incentive must be clear. These criteria could include business age, financial size and metrics of innovation, with a clear list of excluded sectors and investment types (including low-risk immovable property and other asset classes that would still attract investment even in the absence of the tax incentive). Government should ensure that qualifying start-ups are adequately identified and/or labelled, and that regular monitoring and evaluation of the tax incentive keeps track of which start-ups are receiving investment, updating the investee company criteria where needed. Table 3 below shows a comparison of qualifying company criteria in Section 12J, the UK's Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) and the Nigeria Startup Act.

Targeting business-size metrics (like asset value, turnover and/or number of employees) encourages investment into smaller firms but can disincentivise growth because start-ups are incentivised to remain small to qualify for investment. Examples are that start-ups might not hire more people or increase the company's asset base. However, an EU Commission report indicates that the positive impact of investments is greater for smaller companies, irrespective of age (European Commission, 2017). To strike a balance, potential tax incentives in South Africa could target financially smaller businesses to increase the impact of investments, while ensuring that the financial size limit is reasonably high so that start-ups are not incentivised to stay small (Genesis Analytics, 2022).

Business age requirements are common and ensure that early-stage start-ups in need of VC, rather than SMEs in general, are targeted. This can however negatively impact sectors where innovations typically take significant time to get to market and generate revenues due to regulatory requirements e.g. medical devices or pharmaceuticals. Startup Acts in Africa typically target companies younger than eight years (Senegal and Tunisia) or ten years (Nigeria), while the most common business age criteria in the EU Commission's study of developed countries' incentives was less than three years (Genesis Analytics, 2022).

Business sector requirements are essential for targeting impactful investments and were one of the main downfalls of Section 12J. It can also be more effective to couple sector exclusions with some target business features. For instance, the Nigeria Startup Act requires that qualifying companies have the company objective of "innovation, development, production, improvement, and commercialisation of a digital technology innovative product or process." Combining the need for innovation with a list of excluded sectors could ensure that innovative, higher-risk start-ups receive investment from the incentive (Genesis Analytics, 2022).

Table 3: Qualifying VC Company Criteria in South Africa, the UK and Nigeria

Criterion	South Africa: Section 12J	UK: SEIS and EIS	Nigeria Startup Act, 2022
Residency	Resident in SA	Has a permanent establishment in the UK	N/A
Business age	N/A	SEIS: <2 years old EIS: <7 years since first commercial sale	<10 years old
Gross asset value	<R50 million	SEIS: <£200,000 EIS: <£15 million	N/A
Full-time equivalent employee size	N/A	SEIS: <25 EIS: <250	N/A
Business sectors	Excluded sectors: trade of immovable property (except as a hotel keeper[172]), banking, financial or advisory services, gambling, liquor, tobacco, arms or ammunition, and more.	More than 20% of trade cannot include leasing activities, legal or financial services, property development, running a hotel or nursing home, coal or steel production, banking, insurance, debt or financing services, and more Did not previously carry out a different trade	Targeted sectors: The company's objectives are innovation, development, production, improvement, and commercialisation of a digital technology innovative product or process. The company is a holder or repository of a product or process of digital technology, or the owner or author of a registered software
Listing requirements	Unlisted or a junior mining company	Independent and unlisted	N/A
Other requirements	Not a controlled group company Tax affairs are in order	Ability to demonstrate real risk to capital for investors rather than merely aiming to preserve capital asset values	Has at least one-third local shareholding held by one or more Nigerians as founder or co-founder of the startup Not a holding company or subsidiary of an existing company which is not registered as a startup

Source: (Genesis Analytics, 2022, p. 64)

However, while 12J has been spoken about favourably, reinstating 12J is not enough; several start-ups turned down 12J funding as they ultimately decided to register themselves and their IP offshore, and 12J funds also has some investment limitations, e.g. they were not able to invest in fintech companies.

Tax incentives for investors usually offer one or more of the following: (i) upfront tax relief on the initial investment, (ii) relief on income generated over the investment period, and (iii) relief on capital gains realised upon disposal of the investment. For example, while Section 12J provided a larger reduction in total taxable income in the year of making the Section 12J investment (100% of the investment value relative to 50% for SEIS investments and 30% for EIS investments), the UK's incentives also include CGT relief upon disposing the VC shares at the end of the investment period. Many tax incentives in developed countries take a similar upfront tax relief only approach to Section 12J (Genesis Analytics, 2022).

Dividend tax relief during the investment lifecycle is less relevant to VC equity investments because start-ups typically do not generate an income from which to pay dividends in their earlier stages of operations. Where start-ups do generate an income, they are likely to retain the profits for reinvestment and growth rather than pay dividends.

CGT relief should ensure that investors continue to support the start-ups throughout the investment period because theoretically mentoring and supporting start-ups provides a greater success of the start-up, which in turn would increase the capital gains on the investment that investors could earn tax-free. The EIS and Nigeria Startup Act all provide CGT relief to investors in addition to upfront relief.

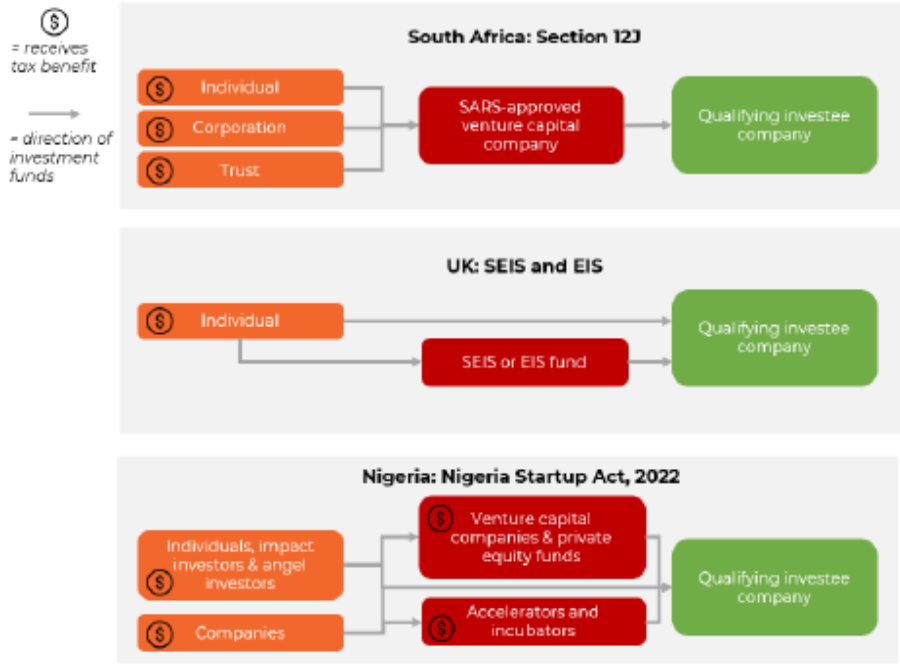
Loss relief on the disposal of an investment against taxable income or capital gains reduces the downside risk associated with VC investments by compensating investors for losses incurred when the investee start-up fails. The SEIS provides loss relief to investors, but not CGT relief. Given that capital losses are more likely than capital gains in South Africa, where only one-third of VC exits were profitable in 2021, the fiscal cost of loss relief would outweigh the cost of CGT relief (Genesis Analytics, 2022). With the government taking on most of the risk of the VC investment, VCCs and other investors could also be riskier in their investments and less incentivised to support investee start-up growth. Upfront and disposal relief are likely to increase the quantity of investment by compensating risk, but upfront relief only or loss relief could reduce the incentive that investors have to ensure that the investee start-up succeeds given that the government provides compensation irrespective of investment's success.

Some countries allow investors to invest directly in qualifying start-ups or indirectly through VCCs to encourage greater angel investment. International best practice determines certain restrictions, such as: restricting the level of interest that investors can have in the investee company; restricting investment benefits to new investments instead of providing windfall gains to existing investors; limiting the value of investments by investor or investee company to limit the potential fiscal cost of the initiative; and requiring that investments are held for a minimum duration.

Section 12J, the UK's SEIS and EIS, and the Nigeria Startup Act allow different types of investors to qualify for tax relief, as shown in Figure 40. Section 12J provided tax relief to individuals, corporations and trusts that invested in start-ups indirectly through a SARS-approved VCC. The VCC received no tax relief through Section 12J. The UK's SEIS and EIS provide tax relief only to individual investors who may invest directly or indirectly through a managed SEIS or EIS fund. The Nigeria Startup Act is vaguer, but states under subsection 29(1), that tax incentives are for "individuals, impact investors, angel investors, companies,

venture capitalists, private equity funds, accelerators or incubators which invest in a labelled start-up or in the start-up ecosystem."

Figure 40: South Africa, UK and Nigeria Incentive Models



Source: (Genesis Analytics, 2022, p. 69)

Not allowing investors to invest directly in start-ups means that angel investors (and crowdfunding contributors) are not included in the tax incentive. Often the compliance costs of setting up an intermediate structure like a 12J vehicle for angel or seed stage investors becomes prohibitive This narrows the net of potential investors who invest in VCCs and/or directly in start-ups, whereas incentivising more of these types of investors (who traditionally invest in early-stage start-ups) can help fill the seed/early-stage funding gap and would bring South Africa in line with most other countries' tax incentives for investors. However, the National Treasury's analysis of Section 12J shows that it was high net worth individuals in South Africa who benefited from the tax incentives (Wasserman, 2021), and this is not viewed favourably by government.

Overall, an improved tax incentive for investors should allow investors to invest directly in qualifying start-ups or indirectly through VCCs to encourage greater angel investment. This should be coupled with government reducing public VC investment by the equivalent value of the tax revenue lost each year, targeted support for start-ups by government, VCCs and investors, and regular monitoring and evaluation.

While tax incentives to start-ups in other countries are a feature of their VC programmes and could offer substantial impetus to local VC funders, it should be noted that the research shows that other reforms related to lifting exchange controls and providing tax relief for investors, discussed above, would be more effective at solving South African start-ups' cash flow challenges and attracting international VC funding into the country.

5.6 Economic Viability of Regulatory Reform

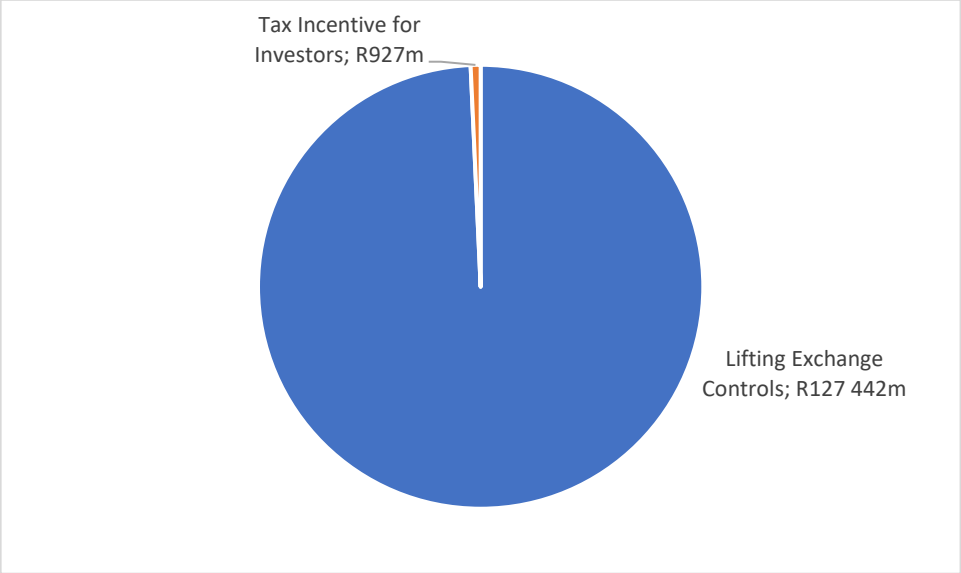
There are two areas where the impact of the regulations can be quantified. These are on the lifting of exchange controls and the impact of a tax incentive. Both have been quantified in a report commissioned by the WCG into creating an enabling regulatory environment for start-ups in South Africa (Genesis Analytics, 2022).

Lifting exchange controls has the potential to increase international start-up funding by R127.4bn and tax incentives for investors would increase international funding by R927m over five years (Genesis Analytics, 2022, pp. 40, 75). The same report does not recommend providing tax incentives for start-ups, because the benefits are relatively minor and outweigh the potential fiscal costs (Genesis Analytics, 2022, p. 87)[9]. This section therefore concentrates only on the economic viability on lifting exchange controls and providing tax incentives for investors.

Figure 41 illustrates the contribution of the two regulatory changes to start-up funding. Lifting exchange controls is the game changer, with 99% of the impact.

[9] *Tax incentives for start-ups could incentivise the formation of high growth businesses, especially for potential founders who are mid-career and who provide initial capital to start the business.*

Figure 41: Potential Start-up Funding from Regulatory Changes



Combining the two regulatory changes has the potential to increase international start-up funding by R128.4bn over five years. This is for South Africa. It was discussed in section 3.2 that 48% of all South African VC activity occurs in the Western Cape. Therefore R12.2bn of this R128.4bn would find its way into the Western Cape VC ecosystem each year. It will be recalled from section 3.5 that if South Africa were to achieve the global VC benchmark of 0.5% of GDP that this would translate to an additional R12bn of activity in the Western Cape. The amounts presented in Figure 41 therefore align with that benchmark. Stakeholders have also indicated that unlocking regulatory barriers could result in South Africa's VC industry growing substantially and that the potential could increase to half that of Israel, or 1.8% of GDP. The amounts presented in Figure 41 are within these perceived industry limits.

The macroeconomic contribution, which is expressed as the contribution to direct and total GDP and the creation of jobs, is based on the increased turnover of the start-ups[10]. Input output multipliers are applied to the turnover to quantify the direct, indirect and indirect contribution. The direct contribution is the immediate contribution from the expenditure. The indirect contribution is felt from supply chain effects and the induced contribution when employees at all points along the supply chain spend their salaries and wages.

[10] *The report by Genesis Analytics indicates savings of R411m for not having to set up offshore business structures, not having to conduct offshore operations and by not having to relocate families offshore. Not incurring these costs would contribute to the efficiency of the start-ups but they only represent 0.3% of the potential turnover of the firms remaining in South Africa.*

The starting point of quantifying the macroeconomic contribution is therefore to estimate the turnover of the start-ups associated with the increased international expenditure presented in Figure 41. The Africa: The Big Deal Database indicated that 6.0 jobs were associated with each $1m of deal activity in the Western Cape (refer to Figure 30 in section 3.2). Table 4 indicates that an additional 3 800 direct jobs would be created in start-ups in the province with the lifting of exchange controls and 28 with the investor tax incentive.

Table 4: Turnover and Employment from Regulatory Changes

	Lifting Exchange Controls	Investor Tax Incentive
Annual international start-up investment	R12 152m	R88m
Converted to US Dollars at R19:$	$640m	$5m
Number of tech start-up jobs	3 827	28
Salaries & Wages	R2 411m	R18m
Annual start-up turnover	R11 555m	R84m

The median after-tax salary for a tech employee is indicated as R483 564 (Genesis Analytics, 2022, pp. 40, 75, 86). This is R630 000 before tax when the relevant SARS tax rates for individuals are applied. This translates into a salary bill of R2.4bn for lifting exchange controls and R18m for the investor tax incentive.

According to the South African Social Accounting Matrix (SAM) developed by the National Treasury (van Seventer, Bold, Gabriel, & Davies, 2019) salaries and wages are an average of 20.9% of turnover for the communication technology; finance & insurance; and business services sectors. These three sectors are the most likely to encompass the tech start-up businesses receiving the funding. Dividing the salary bill by this ratio leads to an estimated annual start-up turnover of R11.6bn for lifting exchange controls and R84m for the investor tax incentive.

The contribution to GDP is given in Figure 42. The direct contribution of the two reforms is R5.7bn. Total GDP in the Western Cape would increase by another R7.0bn to R12.7bn when all indirect and induced effects are included. This is 1.2% of provincial GDP. The contribution to South African GDP is R15.7bn and is only the contribution from the Western Cape start-ups.

Figure 42: Contribution to GDP

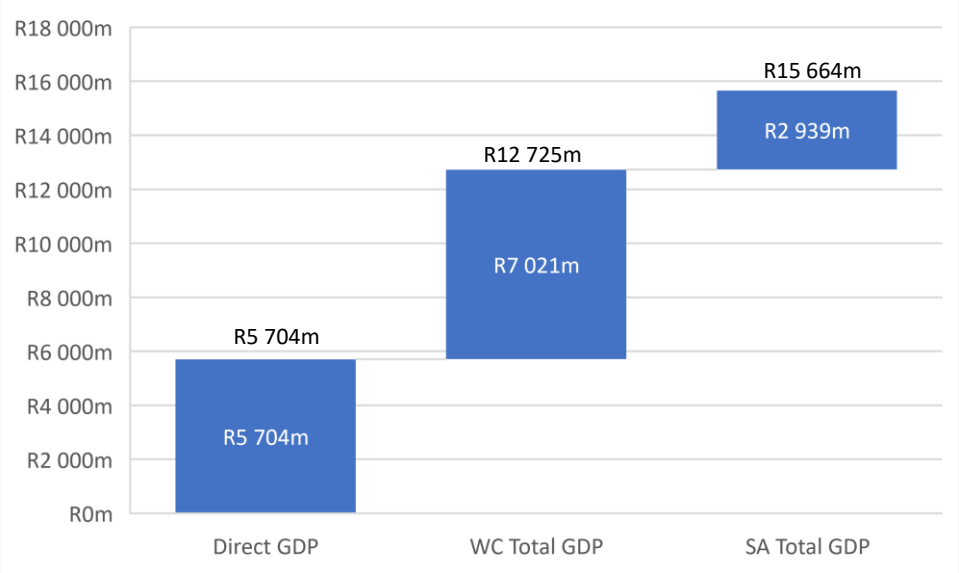
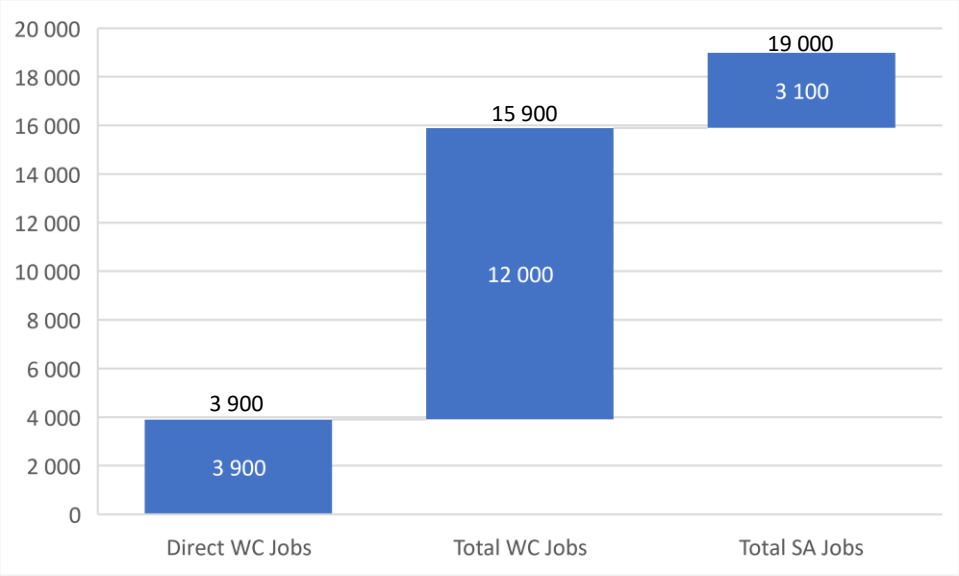


Figure 43 shows the potential job creation associated with the regulatory changes. It is estimated that 3 900 direct jobs and 15 900 total jobs would be created in the Western Cape. There would be approximately 19 000 jobs created across the country from the impact on the Western Cape start-ups alone. This excludes the contribution of the start-ups elsewhere in the country.

Figure 43: Job Creation



Job creation is not necessarily the focus of high growth tech start-ups. However, Figure 43 illustrates that these businesses have the potential to create a substantial number of indirect and induced jobs through their supply chains and employee expenditure. Out of the 15 900

total jobs in the Western Cape only 3 900, approximately a quarter, are direct. The remaining 12 000 are indirect and induced. This shows that these firms have the potential to create three indirect and induced jobs in the province for every one direct job.

Beyond these direct benefits to GDP and job creation in the relative short-term, creating a favourable investment environment will have the impact of retaining exit capital locally, allowing VCs, founders and key staff who have capital gains to keep investing locally either in new funds as angels or by starting new companies. A stronger sector starts creating a stronger pool of experienced entrepreneurs, mentors, technical staff and associated service providers. More internationally owned VC firms and start-up acceleration programmes would establish African offices in South Africa. Successes and exits also positively contribute to the overall entrepreneurial culture of a country, further driving innovation, risk taking and the establishment of new industries and sectors.

6 Analysis of Private Sector Institutions

The investment mandates of a selection of private sector funding institutions were assessed to understand under what conditions or factors they would increase their funding to start-ups and scale-ups. The private sector funding institutions were a combination of VC firms, banks and the SA SME fund, which is a fund-of-funds and has invested as an LP into a number of SA based VC funds.

The following private sector institutions were interviewed:

- Savant
- Hlayisani
- Launch Africa
- Endeavor
- NEXT176 (funded by Old Mutual).
- Nedbank Venture Capital
- The SA SME Fund

In addition to the above seven institutions, the Standard Bank and Sanlam websites were examined for their VC funding mandates, philosophies and case studies.

6.1 Mandates

Most private sector institutions, whether investors, funds or corporates, have similar over-arching mandates and investment philosophies. They all conform to Environmental, Social and Governance (ESG) frameworks that are generally aligned with internationally accepted standards, such as the IFC Performance Standards, the World Bank Group ES Guidelines, King IV Report on Corporate Governance or the United Nations Sustainability Development Goals. These are to ensure social responsibility, environmental sustainability and good governance. Some also include transformation targets in their mandates[11].

[11] *The SA SME fund, which is a fund-of-funds and does not invest directly into businesses, includes transformation in its mandate. This is to invest 50% of capital into black-African owned and managed businesses, a further 25% being dedicated to Indian and Coloured -owned and managed businesses, and with the remaining 25% being at the discretion of the fund manager - https://sasmefund.co.za/*

Within these investment philosophies, all mandates are broadly similar in that they consider growing businesses with disruptive technologies, solving a problem for large addressable markets, visionary leadership and good exit opportunities. Some firms might have more of a local focus while others are pan-African.

While the mandates are all similar in the type of firms targeted (scalable, high-growth, disruptive), there is considerable variation in the sectors and the stage of funding:

- Some firms are sector agnostic while others look for sector-specific opportunities in science and engineering, ICT, manufacturing, agriculture, education or healthcare industries. While the sectors might vary, the common thread is the use of technology to solve sector-specific problems and which will ideally allow the business to easily scale.

- There is a wide range of growth stages that the funds invest in, but generally these range from pre-Series A to Series B. Some funds do provide seed funding, but most are interested in the post-revenue growth stages. Corporates tend to look at funding later-stage businesses at Series B and Series C. While some funding does go to the seed stage, very little finds its way into pre-seed. There is a feeling amongst some of the stakeholders interviewed that the corporate and investment funds are moving away from pre-seed and seed towards the later stages of funding in order to de-risk, so that they can attract additional private sector capital and because there is a lot more work and resources required to support early-stage start-ups. The economics of deal flows incentivises larger deals rather than smaller ones - investing R1m requires the same due diligence and deal-structuring costs as investing R10m. Complementing this, the fund managers and corporates who were interviewed consider the pre-seed and seed stages too risky and believe that this is where government should intervene, either by supporting incubators or accelerator programmes, by funding the start-ups directly or by providing guarantees to reduce risk.

From the above, the only part of the mandates of private sector institutions identified as offering meaningful change for the local VC industry, particularly because it is so young, is if they focused more on the earlier stages of funding required by start-ups rather than the later stages. However, these early, pre-revenue stages would need to be extensively de-risked by government before private sector financiers would consider shifting their focus there. As an asset class, and a young and risky one at that, the local VC industry suffers from a lack of track record. This includes a lack of exits. Consequently, the industry requires some de-risking

in the short term in order to attract more private sector funding. This is also why angel investors are essential for a well-functioning ecosystem, but more are needed to plug this gap.

6.2 Pension Funds and Insurance Companies

The pension fund industry is risk averse. The VC industry is a risky industry, so the two do not automatically align. Liquidity compounds this issue. Typical VCC investments are five to seven years, but this could be longer because of the lack of exits in South Africa. Pension funds prefer more liquid investments than those offered by the VC industry. In addition, pension funds typically consider large investment amounts (in tens of millions), have cumbersome internal processes and lack sector-specific expertise. Start-ups, on the other hand, in their early stages require smaller investment amounts (typically well below that of any large corporate/institutional investor), nimble investor decision-making and sector-specific expertise. While there are substantial returns to be made by investing in the VC industry, its lack of track record, allied with its inherent risk and the characteristics that define it as an asset class, make it an atypical and unfamiliar asset class for pension funds.

Enticing the pension fund industry to invest in VC funds is an exciting prospect. Table 5 indicates that the SA pension fund industry in 2020 was valued at $157bn. This is R2.6trn. According to the Startup Act Movement there was a combined portfolio of R8bn amongst VC fund managers invested in SA in 2021 (South Africa Startup Act Movement, 2023, p. 2). To put this in perspective, the R8bn represents 4% of the R200bn South African Private Equity asset value in 2022 and only 0.3% of the pension funds. If 1% of the SA Pension Fund Industry (R26bn) were to be invested in the VC industry it would quadruple in size.

Table 5: Comparative Size of VC Fund Portfolio

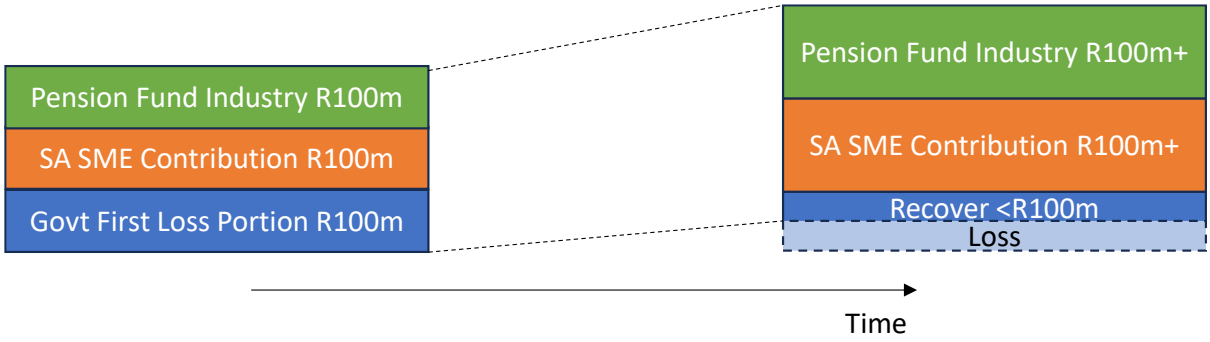
	Size (Rbn)	VC Fund as %
2021 VC Fund Portfolio	R8bn	100%
2020 SA PE Assets	R200bn	4%
2020 $157bn SA Pension Fund Industry	R2 584bn	0.3%

Source: (South Africa Startup Act Movement, 2023, p. 2)

Potential solutions include pension funds reducing their risk by spreading their investments across a portfolio of VC investments. They could also reduce their risk by investing in a fund-of-funds, such as the SA SME fund set up precisely for this purpose. The fund-of-funds invests in a wide variety of VC funds, all managed by seasoned fund managers. Investing across a diverse portfolio of start-ups and scale-ups reduces overall risk. Including a first-loss contribution by government further reduces industry investment risk.

Figure 44 illustrates how a first loss contribution could work. The SA SME fund is raising R300m for a specific fund-of-funds investment, which includes a R100m government first loss portion. The SA SME fund invested R100m of its own capital into this fund and raised a further R100m from the private sector on the back of the R100m government first loss injection. The way this specific first loss contribution works is that the R300m is invested in early-stage start-ups. Due to the risky nature of these businesses, the full R300m plus interest might not be returned. However, the private sector would get its R100m investment returned with some predetermined interest amount. The same could apply to the SA SME contribution. Government gets the balance. This might be less than their R100m initially invested but it might also be more. Government absorbs most of the risk and the investment becomes more attractive to industry, although not totally without risk. Government's incentive for contributing the first loss is that it has stimulated a growing sector of the economy.

Figure 44: Mechanics of a First Loss Fund



The WCG could reduce the pension fund risk by establishing a first loss fund for the Western Cape. The SA SME fund has indicated that it has already been in talks with the WCG about developing such a fund specifically for the province. If funds are leveraged to the same extent as previously demonstrated, then an additional R2 would be raised and invested in the Western Cape VC industry for every R1 of WCG spending. The benefit continues, however. This round of spending helps the young VC industry develop a track record, something that it currently lacks. An established track record could further attract pension fund investment.

6.3 Summary of Private Sector Funding Institutions

The investment mandates of the private sector financing institutions are all similar in philosophy but there are differences in the specific areas of focus and lifecycle of the start-ups. Most, however, invest in firms that already have some traction in the marketplace and the very early stages, such as pre-seed and seed, are considered too risky in what is already a risky industry.

Furthermore, the VC industry is young and does not yet have an established track record. This, with its inherent risk, does not always align with the investment mandate of pension funds. However, the local pension fund industry is large in comparison and if only 1% of pension funds could find their way into VC funding then it has the ability to quadruple in size.

Mechanisms do exist to de-risk the VC industry and this is where the WCG can assist. These mechanisms are:

1. To establish a first loss fund. This can be done for any stage of funding. While the WCG might not get a return on its investment, it should see this as promoting an industry with longer term economic benefits.

2. To directly fund pre-seed and seed stage start-ups. It is not necessary for the WCG to duplicate the measures that have already been established by industry. It is therefore recommended that it either finance existing funds-of-funds or create a catalytic match funding process which could be used by any early-stage investor to leverage additional grant funding for a start-up to match their risk capital up to a threshold limit (e.g. R500K per start-up).

3. Improved support of existing incubators and accelerators through very specific funding mechanisms. These could include catalytic matching funding by early-stage investors, results or outcomes-based grants so as to ensure a greater chance of success for the start-ups at the pre-revenue stage. What is important at this early stage is to not just provide generalised SME support services or ESD programmes but to work with organisations that have a track record of making start-ups “investor-friendly” or “investable” as well as those who have a track record of assisting start-ups to secure early-stage funding. This would include identifying which start-ups are genuine “start-ups” as defined by the VCCs, as against small businesses that are simply not scalable, high-growth or disruptive enough to ever fall within the VCC target category. Using results-based grants or financing instruments are a good way to keep programme providers accountable.

These mechanisms potentially have the dual effect of refocussing the attention of the funding institutions on earlier stages of the start-ups as well as attracting more pension fund investments. The full impact of any mechanism, though, extends beyond its direct intervention. Targeting interventions may help showcase the VC industry and assist it to develop a track record. This in turn has a catalysing effect, which means that more funds become available for VC investment, further rounds of investment become easier and more exits occur.

7 Analysis of Barriers and Remedial Options

This section focuses on the barriers faced by the VC industry in the Western Cape and remedial options for the WCG to address them. These options include high-level programmes, governance and procurement issues.

7.1 Barriers to VC Activity in the Western Cape

Table 6 lists the barriers to venture capital activity in the Western Cape, based on stakeholder interviews and international case studies. They are ranked and sorted on a scale of 1 to 5, where 5 is the most severe and 1 the least. A score of 5 has been defined as a major impediment constraining the industry, while 3 is seen as a barrier to growth but not a major constraint. A score of 1 would indicate only a minor barrier. Intermediate scores between the limits defined above are possible. The most severe barriers are shown at the top of the table.

Table 6: Barriers to Western Cape VC Activity

	Barriers	Source	Severity	WCG Ability to Address
1	Exchange controls	Stakeholder	5	2
2	Intellectual Property controls	Stakeholder	5	2
3	Burdensome/restrictive tax regime	Stakeholder	5	2
4	International funders wary of SA/negative perceptions	Stakeholder	5	3
5	Currency risk	Stakeholder	4	1
6	Lack of exits	International/Stakeholder	4	2
7	Lack of pension fund/institutional investment	Stakeholder	4	2
8	Length of time of regulatory approval	Stakeholder	4	2
9	Local industry still small	International Review	4	2
10	Problems getting visas	Stakeholder	3.5	3
11	Corporate SA is conservative	Stakeholder	3	2
12	Geopolitical trends	International Review	3	1
13	International competition	International Review	3	4
14	Lack of early stage funding (majority follow-on funding)	International/Stakeholder	3	5
15	Lack of incubation/early stage support	Stakeholder	3	4
16	Local industry still young	Stakeholder	3	2
17	Local VC funders too small	Stakeholder	3	2
18	Strategic geographic position	International Review	3	2
19	Lack of air connectivity	Stakeholder	2	4
20	Lack of tech talent	International Review	2	4
21	Mandate limitations	Stakeholder	2	2
22	Public sector too conservative and cumbersome	Stakeholder	2	2
23	Risky class of asset	International/Stakeholder	2	4
24	Areas of expertise attracted to VC funding	International Review	1	2
25	Declining local economy	International Review	1	2
26	Diversified markets	International Review	1	4
27	Limited investment opportunities	International Review	1	2
28	Need for certain level of entrepeneurial activity	International Review	1	4
29	Overseas funders too big	Stakeholder	1	1
30	VC sector fragmented	Stakeholder	1	5

Key to Barrier Score

5 Major impediment constraining industry
3 Barrier to growth but not major constraint
1 Minor barrier

Key to WCG Ability Score

5 Able to directly address
3 Indirectly address
2 Limited ability
1 No ability

The four biggest barriers facing the South African and Western Cape VC industry are restrictive exchange controls, rigid IP legislation, the burdensome tax regime and international investors' negative perceptions about the country (some of which are directly as a result of the first two barriers). Restrictive exchange controls (which directly affects the ability to move capital, which includes IP, out of the country) was almost unanimously referred to across all stakeholders and, along with the burdensome tax regime and negative country perceptions, have each been scored a 5. These are followed by currency risk, a lack of exits, a lack of pension fund investment, length of time for regulatory approval (which refers to exchange control restrictions) and the local industry still being small. These each scored a four. Rounding off the top ten is the problem of getting skilled / nomad visas. The top five barriers indicated in the table are particularly pertinent to international investors (seen as country risks), which add to the business risk of the VC asset class (investing in start-up companies). International investors therefore look at other international VC destinations where these additional (country) risks are not prevalent.

It should be noted that some of the barriers identified in the table do present an element of double counting. For example, negative perceptions of SA are because of factors such as exchange controls and IP concerns, currency risk and lack of exits. Similarly, length of time for regulatory approval is linked to exchange controls and IP. However, not only have all these barriers been identified as "separate" in the stakeholder interviews and so listing all of them maintains the accuracy of the research data, but identifying distinct barriers allows for a more nuanced and distinct response to them. For example, while exchange controls and problems with IP transfer may remain, the ability to change outsiders' perceptions of South Africa (or the Western Cape) remains a possible outcome.

The ability of the WCG to address these barriers, also ranked on a scale of 1 to 5, is shown in the last column of Table 6. The WCG would score a 5 if it can directly address an issue. It would score a 3 if it can indirectly address an issue (such as by lobbying national government). Limited ability scores a 2 and no ability scores a 1. Once again, intermediate scores between the defined limits are possible.

Many of the top ten issues are either systemic or within the remit of the national government and hence there is very little that the WCG can do. Most top ten issues therefore score a 2 in terms of their ability. The WCG can influence international investor perceptions of the Western Cape and may be able to intervene with issues like the skilled visa issue, and hence these score a 3. There is nothing the WCG can do about currency risk and this barrier scores a 1.

The WCG can address some of the more minor issues. Barriers it can directly address are the lack of early-stage funding and the start-up fragmentation of the VC industry. Other areas where it may have influence are international competitiveness (functioning infrastructure, quality of life, integrated digital and telecommunications network, etc); the lack of appropriate incubation / early-stage start-up support; a lack of tech talent; the risk of the VC asset class; VC fragmentation with diversified markets; lack of air connectivity; and the need for a certain level of entrepreneurial activity.

7.2 Remedial Options Addressing Barriers

The literature and stakeholders suggest several options to addressing many of the barriers identified. Table 7 ranks nineteen remedial options for addressing barriers, in order of impact. The options are scored on a scale of 1 to 5. If an option has the potential to remove a major impediment to the industry it scores a 5. An option scores a 3 if it removes a barrier to growth but one that is not a major constraint. It scores a 1 if the option only removes a minor barrier. The right-hand column of the table indicates the WCG's ability to address these options.

Table 7: Remedial Options Addressing Barriers

	Options	Source	Impact	WCG Ability to Address	Timeframe
1	Address exchange controls (including IP legislation)	Stakeholder	5	2	Long
2	Address tax incentives	International Review	5	2	Long
3	Facilitate skilled visas	Stakeholder	4.5	3	Medium
4	Lobby government for incentives	Stakeholder	4	5	Long
5	Develop a Startup Act	International Review	4	2	Long
6	Create a One Stop Shop / VC unit	Stakeholder	3.5	5	Medium
7	Create supportive environment - incubators, innovation zones	Stakeholder	3	5	Short
8	Facilitate interaction between innovators and industry	Stakeholder	3	5	Short
9	Host roadshows	Stakeholder	3	5	Short
10	Continued good provincial governance	Stakeholder	3	4	Long
11	De-risk VC funding as an asset class	Stakeholder	3	4	Short
12	Establish free trade zones / special economic zones	Stakeholder	3	3	Long
13	Make Cape Town attractive - lifestyle, weather etc.	Stakeholder	3	3	Long
14	Pursue public/private partnerships	Stakeholder	3	3	Short
15	Promote macroeconomic stability	International Review	3	1	Long
16	Improve air access/ease of access	Stakeholder	2	4	Short
17	Focus on certain sectors	International Review	2	3	Medium
18	Foster entrepreneurial innovation	International Review	2	2	Medium
19	Establish a VC industry central database	Stakeholder	1	3	Short

Key to Impact Score

5 Remove major impediment constraining industry
3 Remove a barrier to growth but not major constraint
1 Remove a minor barrier

Key to WCG Ability Score

5 Able to directly address
3 Indirectly address
2 Limited ability
1 No ability

The overall aim of these remedial options is not only to address impediments to the VC industry, but also to catalyse the industry (this catalysing effect, referred to above, was mentioned in several of the stakeholder engagements. For example, as more financial institutions enter the VC industry so other institutions will follow. Or, as more exits occur, there is more funding, and more funders, to reinvest in the VC class). The VC industry in South

Africa is young and small and needs time to grow. On their own, these barriers, while identified as such, are characteristics of the local VC industry and start-up industry maturity, and are not within the direct responsibility of government, but addressing some of them could allow the industry not only to grow but could offer it a kick-start.

The general philosophy gleaned from the stakeholder interviews is that it is not necessary for the WCG to start new initiatives (and in many cases, the Western Cape is praised for already doing a lot of the right things). This philosophy can be summarised as: government should create the space for the industry, let industry do itself. Where local government can play a role is to support the VC space locally and collaborate with the private sector to add impetus to VC industry momentum.

There are three options of greatest impact and that score either a 5 or a 4.5. The two most important are addressing exchange controls including the rigid IP legislation; and addressing tax incentives for the industry. These are closely followed by facilitating skilled visas. However, the WCG's ability to address the top two is very limited because this lies within the ambit of national government. They are also not quick solutions. The WCG may have marginally more ability to motivate for the relaxing of skilled and nomad visa conditions over the medium term. Appendix A provides an overview of skilled and nomad visas.

There are two options that score a 4 in importance:

1. Lobby national government for incentives: While the WCG cannot provide tax or nationally legislated incentives, it can lobby national government on behalf of industry. As such, it could collaborate with industry organizations and facilitate discussions with the national authorities. As with most of the other legislative interventions, this is a long-term solution.

2. Developing a Startup Act. Although a Startup Act has been shown to be beneficial in many jurisdictions, others (such as the UK with extensive start-up and small business programmes and incentives) function well without them. Startup Acts have the overriding impact of focusing regulatory benefits on start-ups and generally include tax and related incentives, so the impetus provided by a Startup Act is seen as important and particularly in a country such as South Africa that currently lacks these incentives.

   The WCG ability to develop a Startup Act is limited, however. It could support the Startup Act Movement, a private sector lobby that is already engaging with the national government on a variety of VC issues. Joining this group would add weight and impetus to their initiatives. Wesgro already have some traction with this group and

have facilitated meetings between the movement and national government. This should be continued but unfortunately this is seen as a solution developed in the long-term.

Creating a One Stop Shop scores a 3.5 and stands on its own as an intervention of slightly less importance than the top five but also of greater importance than the rest to come. The South African VC landscape is complex and international investors are wary of country risks and unaware of the challenges of the local regulatory landscape. Local entrepreneurs are focussed on their business, are unprepared for SARB, SARS and other compliance requirements, and need advice on funding options, business structures and potential offshore solutions. This is an area where the WCG could be directly involved by offering a facilitative and education service, which could be set up in the medium term. This could include, for example, a concierge service, putting (large) international investors and local VCs or angel groups in touch, or directing international investors to a directory of local, relevant service providers or accelerator programmes.

Specifically, a VC One Stop Shop, possibly housed within Wesgro or the EoDB unit within DEDAT, could:

- Provide the advice required by industry stakeholders. Such a unit would calm jittery international investor nerves by mapping out the local landscape and add credibility to the industry solutions that are already in place to address the (barriers presented by) exchange control and IP regulations.

- Foster relationships with international VC hubs, such as in Amsterdam or the UK. By fostering these relationships, the WCG could look to develop an international hub for Western Cape industries wanting to move offshore, creating a ‘soft landing’ for them in foreign jurisdictions as well as partnering with international programmes i.e. the UK’s Global Entrepreneurship Programme (GEP) which assists international start-ups to register entities in the UK. While these businesses might previously have been lost to South Africa because of exchange controls or conditions prescribed by international investors, locating them in an international hub funded or facilitated by the government would keep them linked to South Africa. Conditions for relocating to this international hub could be that the start-up outsources some of its functions to South Africa and even a condition to repatriate part of its profits back to the country. This ensures financial and physical continuity with the Western Cape rather than a total loss of business as is currently happening.

- Assist international companies locating to South Africa, as has been suggested by stakeholders, with potential Broad-Based Black Economic Empowerment (B-BBEE) requirements. Advice can be provided to these international firms on where to channel investment opportunities in order to garner B-BBEE credits.

- Assist with or complement several of the other options: creating a supportive environment (accelerators, etc.), establishing free trade zones, facilitating interaction between innovators and industry, public/private partnerships, hosting roadshows, and establishing a VC central data base.

An overview of the UK VC Unit is presented in Appendix D. This operates like a One Stop Shop and could be used as a model for the Western Cape.

Of the remaining options, a number have the likely impact of removing a barrier to growth and are directly within the WCG's ability to address:

1. Create a supportive environment such as incubators and innovation zones: Several incubators already exist in Cape Town and where local and provincial government are already involved. The WCG can continue its work here and could consider ramping up its support in the short-term for specific interventions designed to support start-ups and catalyse early-stage investment locally. Industry stakeholders have criticised some of the incubators or accelerators as no more than glorified shared-office space. The WCG could review the incubators/programmes and the support they offer to ensure that this aspect of the VC industry is adequately catered for or assisted.

   Accelerators, incubators and innovation zones are important because they have the capacity to nurture early-stage enterprises with limited market traction into solid businesses. This stage is also very risky and one that is largely avoided by the VC Funds. It is a stage that seems to offer limited, meaningful support to entrepreneurs (who may require longer term programmes than are currently on offer, to make them investor-friendly), as well as being under-funded. The WCG can be directly involved in this option and would reduce this start-up risk either by redesigning the mechanisms used to support accelerators and incubators (e.g. results-based grants or forgivable debt), or through additional funding initiatives e.g. catalytic match funding to angels or seed funders. The provision of direct start-up funding or contributing to a first loss fund operated by a third-party manager would reduce the risk of the start-ups and open doors to more private sector investment including angels.

2. Facilitate access between innovators and industry: The WCG is uniquely positioned with its various departments and contacts throughout the Western Cape economic landscape to put innovators in touch with potential clients (for example, start-ups in the agritech space with farmers/agricultural cooperatives). This facilitative service could be via the One Stop Shop, roadshows or through incubators, accelerators and innovative zones, all mentioned above. By facilitating contact, it would not only market products to potential clients but could also spark further ideas and development for a particular sector and for the VC industry as a whole.

3. Hosting roadshows: This is the first short-term option available to the WCG. Stakeholders have indicated the importance of roadshows, both in South Africa and abroad. Roadshows, as part of a facilitative/educative initiative, make potential international investors aware of the opportunities in the Western Cape and introduce local VC actors to international investors. Wesgro has hosted a number of international roadshows in the past with positive results e.g. to Silicon Valley in 2015 and Singapore and Japan in 2016, which included representation by the start-up sectors. By arranging and/or hosting more of these roadshows, the WCG can showcase Cape Town as well as the local VC industry, and so address the negative perceptions of investors, which industry considers to be very important. These roadshows need to be carefully planned along themes and consideration given to which investors and which entrepreneurs to invite. They might require a careful matching to optimise outcomes.

   It is not only investors who could be targeted by the roadshows but also international start-ups. They could outsource some of their processes, such as software development, to the Western Cape, where skilled service providers at competitive prices are already on offer. In addition, these could be co-hosted and coordinated by international embassies who are tasked with building relationships and economic ties between SA and the country they represent.

4. Continued good provincial governance: The Western Cape is identified as currently the premier VC destination in South Africa and reasons for this include the good governance of the province and the generally good functioning of infrastructure.

   The Western Cape needs to continue to be seen as the best governed province in the country. While the Western Cape does not exist in a vacuum and is dependent on the broader state for support, the province and Cape Town in particular, are viewed as both attractive hubs of industry and of good governance. The WCG is encouraged to maintain and build on this aspect. This is an on-going, long-term solution.

5. De-risk VC funding as an asset class: Although this risk is fundamental to the industry, the WCG could alleviate some of this risk by providing financial guarantees (specifically to international investors) and/or could contribute to a first loss fund.

6. Improve air access: Wesgro already has an Air Access unit. The unit needs continued support to ensure regular flights between Cape Town and the rest of Africa and West Africa in particular.

Table 8 indicates how the remedial options described above address the barriers raised earlier. The table distinguishes between primary and secondary remedial interventions. Primary interventions include those options that directly address a barrier, while secondary interventions include the options that indirectly affect a barrier. The numbers shown in the primary and secondary intervention column relate to the numbering of the remedial options presented in Table 7.

Table 8: Barriers Addressed by Remedial Options

No	Barriers	Primary Intervention	Secondary Intervention
1	Exchange controls	1	
2	Intellectual Property controls	1	
3	Burdensome/restrictive tax regime	2 & 4	
4	International funders wary of SA/negative perceptions	1,2,3,5,6,9,10,12,13,15,16	
5	Currency risk		4
6	Lack of exits		1,2
7	Lack of pension fund/institutional investment	11,14	
8	Length of time of regulatory approval	1	
9	Local industry still small	5	
10	Problems getting visas	3	
11	Corporate SA is conservative	8,9	
12	Geopolitical trends		15
13	International competition	1,2,3,4,5,6,7,8,10,12,19	13
14	Lack of early stage funding (majority follow-on funding)	11,14	7
15	Lack of incubation/early stage support	7	
16	Local industry still young	5	
17	Local VC funders too small	14	11
18	Strategic geographic position	13	10
19	Lack of air connectivity	16	
20	Lack of tech talent	18	
21	Mandate limitations	14	
22	Public sector too conservative and cumbersome	14	
23	Risky class of asset	11	
24	Areas of expertise attracted to VC funding	17	
25	Declining local economy	15	
26	Diversified markets	18	
27	Limited investment opportunities	18	17
28	Need for certain level of entrepeneurial activity	18	17
29	Overseas funders too big		6
30	VC sector fragmented	19	14

There are some barriers that cannot be directly addressed by the WCG. These are currency risk, lack of exits, geopolitical trends and overseas funders being too big. There are some

options available to the WCG that could indirectly address these barriers. These options are to lobby the national government to address exchange controls (including IP legislation); lobbying national government for tax incentives; lobbying government for non-tax incentives; creating a One Stop Shop; and promoting macroeconomic stability.

There are some barriers that require multiple interventions by the WCG. These are international funders being wary of South Africa and having negative perceptions; and addressing international competition. In these instances, each remedial option undertaken by the WCG would help to address the barrier, but it requires a full suite of options to make significant progress.

7.3 Options Analysis

Table 9 assesses all nineteen remedial options discussed above, to increase VC activity and supply in the Western Cape, as well as funding where possible. The table refers to individual programmes for each option, high-level governance and potential procurement issues. In some cases, a comprehensive programme, governance or procurement may not be required or relevant.

Table 9: Recommended WCG Options

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
1	Address exchange controls (including IP legislation)	5	WCG to articulate the key areas within the legislation requiring unblocking and develop a proposition to NT & SARB.	Meet with National Treasury / SARB quarterly. Liaise with industry bodies such as the Startup Act Movement, SAVCA, Wesgro.	High-level WCG officials with ability to argue industry issues, spearheaded by MEC responsible for Economic Development. Intergovernmental protocols and forums will dictate the relevant process.	None required
2	Address tax incentives	5	WCG to propose alternatives to NT regarding incentives, such as a re-visited S12J.	Meet with National Treasury / SARS quarterly. Liaise with industry bodies such as the Startup Act Movement, SAVCA, Wesgro.	PT Economic Development 10x10 (HoD, DEDAT, HoT) PT Technical Committee on Finance (HoT) High-level WCG officials with ability to argue industry issues, spearheaded by MEC responsible for Economic Development Intergovernmental protocols and forums.	None required
3	Facilitate skilled visas	4.5	Develop a sustained advocacy agenda plan. Present to DoHA a proposition to address critical skills and business visa challenges.	Meet with Dept of Home Affairs Quarterly. Liaise with industry bodies such as the Startup Act Movement, SAVCA, Wesgro.	Appropriate WCG officials. Intergovernmental protocols and forums.	None required

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
4	Lobby government for incentives	4	To support start-ups and improve the enabling environment. Link specific outcomes, such as job creation, to trigger the incentives.	Meet with National Treasury and National Govt Depts (e.g. DTIC, DSBD, DST, DCTC) WCG to propose alternatives to NT regarding incentives, such as refunding R&D expenditure and grant funding	High-level / mid-level WCG officials with ability to argue industry issues. Intergovernmental protocols and forums.	None required
5	Develop a Startup Act	4	To provide impetus for a focused programme that supports start-ups and incentivises VC investors	Collaborate with Startup Act Movement. Meet twice yearly. WCG to explore the regulatory tools available at provincial level.	High-level / mid-level WCG officials and Wesgro, in consultation with the Startup Act Movement.	Some for Startup Act research
6	Create a One Stop Shop / VC unit	3.5	Facilitate a vehicle to increase information and reduce regulatory friction to VC investors, angels and start-ups. Identify additional features which could be added to the InvestSA facility.	Identify mandate, personnel, skills and appropriate space for the unit. Liaise with industry and industry bodies, in particular, Wesgro	DEDAT and Wesgro officials Establish strategic focus, budget, reporting lines, KPIs, etc.	Internal budget processes/private sector collaboration. Possible HR, skills and personnel planning research.
				Establish unit	DEDAT and Wesgro, City and other relevant municipality officials. Reporting lines and KPIs.	Budget required for staffing, training, marketing the unit, and for unit activities. Private sector collaboration.
				Operations and marketing the unit	Unit staff – reporting to WCG and to industry. Private sector collaboration.	Budget as above.

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
7	Create supportive environment - incubators, innovation zones	3	To help fill the gap between early stage start-up and seed stage and generally to support start-ups	Identify current initiatives and results to date	DEDAT or Wesgro personnel	DEDAT and Wesgro to advise or otherwise appropriate research budget
				SWOT analysis	DEDAT or Wesgro personnel	As above
				Redesign initiatives and programmes to achieve the desired results and outcomes including private sector funds raised etc. Fund more investment readiness initiates, matching grants and technical assistance programmes for start-ups with potential to grow and the ability to create jobs.	DEDAT or Wesgro personnel	Internal budget process / private sector collaboration
				Appoint service providers to deliver on programme objectives	DEDAT or Wesgro personnel	Training or programme budget / private sector collaboration. Results based grants could be deployed effectively.
8	Facilitate interaction between innovators and industry	3	Establish coalitions with private sector and other relevant stakeholders to promote collaboration and support growth opportunities.	Engage industry	Identified WCG officials (VC Unit), Wesgro, SAVCA, industry	To be determined
				Roadshows, events, round tables, industry forums, innovation zone activities	DEDAT, Wesgro, industry, universities	Entertainment and marketing budget

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
9	Host roadshows	3	Showcase the excellent facilities the Western Cape has to offer VC, and act as a facilitator between investors and entrepreneurs	Discussion with VC industry, Wesgro as well as international embassies. Part of VC Unit (if one)	High-level / mid-level WCG officials and Wesgro. Industry and private sector collaboration. Ensure appropriate strategic focus, within mandate.	May require internal budgeting/private sector collaboration.
				Plan roadshows	High-level / mid-level WCG officials in conjunction with Wesgro and industry. VC Unit (if one)	Marketing budget, sponsorship possibilities, industry collaboration
				Host roadshows	Wesgro, SAVCA, VC Unit (if one). DEDAT representatives.	Marketing, travel exhibition and entertainment budget. Sponsorship / private sector collaboration
10	Continued good provincial governance	3	To keep the Western Cape attractive to investors	Various	Political and Administrative leaders in WCG and Wesgro	As per current budget
11	De-risk VC funding as an asset class	3	WCG to offer first loss and other support, especially for early-stage investment.	Develop innovation fund and invest in existing structures	Provincial Treasury	Innovation fund - SCM approval to invest quickly in firms
				Develop a catalytic matching fund aimed at early-stage start-ups and supporting angel investors	Provincial Treasury	Early-stage matching fund – SCM approval to invest quickly in firms
				First loss fund invested in existing structures	Provincial Treasury	First loss fund - invest circa R100m in Funds

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
12	Establish free trade zones / special economic zones	3	Develop a methodology for identification of property, facilities, and partnering with the private sector for specialised infrastructure and zones to support tech and innovation start-ups.	Investigate viability of zones	DEDAT, Wesgro, industry participation	Research budget / private sector collaboration
				Establish location (e.g. Freeport Saldanha or Atlantis SEZ)	DEDAT, Wesgro, industry participation. Town planning, treasury and transport officials	Research and planning budget
				Discussion with IDZ / SEZ officials	DEDAT and high-level WCG officials (e.g. DG, DDG)	To be determined. Planning budget
				Establish / expand innovation unit	DEDAT, Wesgro, industry participation	Expansion budget
				Market unit	DEDAT, Wesgro, industry participation	Marketing budget
				Monitor and evaluate with quarterly meetings	DEDAT, Wesgro, industry participation	Internal budget required
13	Make Cape Town attractive - lifestyle, weather etc.	3	Ongoing Wesgro activities with more nuanced packaging for VCs	Events promotion, roadshows	Wesgro, CoCT	To be determined / internal budget / sponsorships / industry collaboration
				Engage with CoCT officials regarding City plans	WCG Office of the Premier	None identified
14	Pursue public/private partnerships	3	To help public funds work with VCCs and other intermediaries and make the VC asset class more accessible	Meet with industry associations to understand support needed	DEDAT, Wesgro, industry participation	None required
				Implement as required	DEDAT, Wesgro, industry participation	To be determined

No	Option	Importance	Key Intent	Programme	Governance	Procurement Approach
15	Promote macroeconomic stability	3	Develop a tactical and sagacious advocacy approach, substantiated by research to engage with national policy-makers regarding strategic policy and regulatory areas.	Not applicable at a national level. At a provincial level, as for option 13	Political and Administrative leaders in WCG and Wesgro	To be determined / internal budget / sponsorships / industry collaboration
16	Improve air access / ease of access	2	Ongoing Wesgro activities	Monitor Wesgro Air Access Unit	Mid-level WCG officials, Wesgro.	None required
17	Focus on certain sectors	2	Make the Western Cape a leader in certain tech industries	Industry liaison – government and industry	DEDAT, Wesgro, DTIC, DST, TIA, universities	Research budget
18	Foster entrepreneurial innovation	2	To ensure a diverse and mature start-up landscape that includes a nursery for innovation	Engage industry and universities, innovation zones, early-stage funding. Highlight success stories, release annual stats and results.	DEDAT, Wesgro, industry, universities	Budget as required for innovation zones and early-stage funding/collaboration with private sector. Marketing and promotions budget
19	Establish a VC industry central database	1	To facilitate/ educate VC industry actors and reduce perceived fragmentation	Engage with industry, part of VC Unit (if one)	DEDAT, Wesgro, SAVCA, industry participation	To be determined
				Provide more training and educations to both SMEs and Start-ups on the array of financing options not just angels and VC funds. Contribute to developing database or partner with other existing databases.	DEDAT, Wesgro, SAVCA, industry participation	To be determined

7.4 Summary of WCG Intervention

Table 10 summarises the options available to the WCG for intervening in the VC industry. These options are summarised according to whether they would increase VC activity in the Western Cape, whether they would increase funding, whether they support start-ups or whether they are regulatory reforms. It should be emphasised that these recommendations are based on the WCG working with other stakeholders in the VC industry and not replicating their efforts.

Table 10 should be viewed from the perspective of whether an intervention is specifically implemented to increase VC or angel activity, funding, support start-ups or is regulatory. It should not be viewed as whether the ***outcome*** of the intervention might affect any of those four categories, i.e. the table focuses on the intention of the intervention, not the outcome (which may be uncertain).

There are nineteen interventions. While all of them are fundamentally aimed at increasing VC activity in the province, sixteen are aimed at increasing funding. Twelve of them are aimed at supporting start-ups and five are regulatory reforms.

Table 10: Summary of WCG Options

No	Option	Increase VC Activity in WC	Increase VC Funding for WC business	Support to Start-ups	Regulatory Reforms
1	Address exchange controls (including IP legislation)	Yes	Yes		Yes
2	Address tax incentives	Yes	Yes	Yes	Yes
3	Facilitate skilled visas	Yes	Yes		Yes
4	Lobby government for incentives	Yes	Yes	Yes	Yes
5	Develop a Startup Act	Yes	Yes	Yes	Yes
6	Create a One Stop Shop / VC unit	Yes	Yes	Yes	
7	Create supportive environment - incubators, innovation zones	Yes	Yes	Yes	
8	Facilitate interaction between innovators and industry	Yes		Yes	
9	Host roadshows	Yes	Yes	Yes	
10	Continued good provincial governance	Yes	Yes		
11	De-risk VC funding as an asset class	Yes	Yes		
12	Establish free trade zones / special economic zones	Yes	Yes	Yes	
13	Make Cape Town attractive - lifestyle, weather etc.	Yes	Yes		
14	Pursue public/private partnerships	Yes	Yes	Yes	
15	Promote macroeconomic stability	Yes	Yes		
16	Improve air access/ease of access	Yes			
17	Focus on certain sectors	Yes	Yes	Yes	
18	Foster entrepreneurial innovation	Yes		Yes	
19	Establish a VC industry central database	Yes	Yes	Yes	

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9 Appendix A: International Literature Review

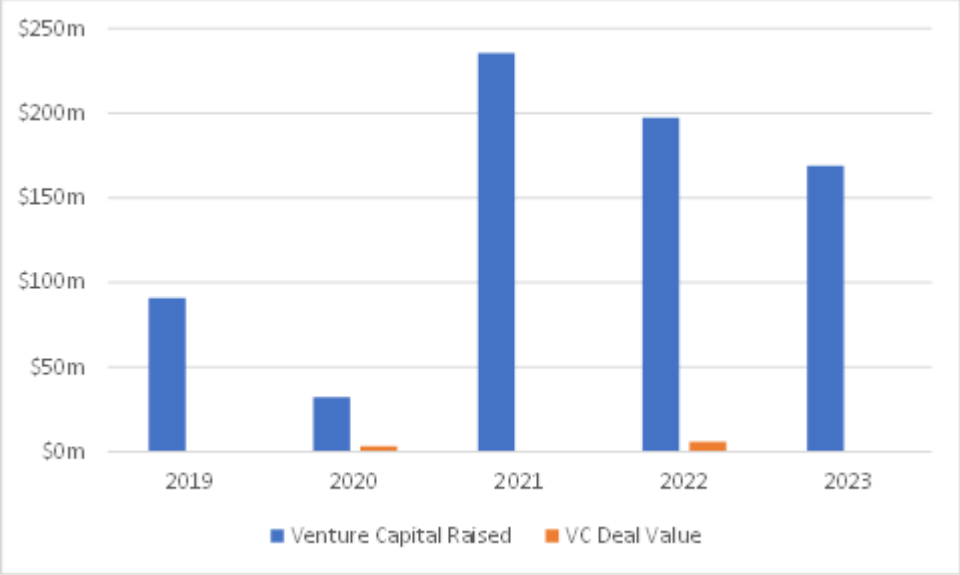
Five countries were reviewed. These are Mauritius, Kenya and Tunisia in Africa and the United Kingdom and India as outside of Africa. Furthermore, some general African issues have been included.

9.1 Mauritius

9.1.1 Performance and Intensity

The VC market in Mauritius has undergone significant growth and development, driven by several factors. The country has a favourable regulatory environment for VC with supportive policies and incentives in place, which has created a conducive ecosystem for start-ups and VC funds, attracting both local and foreign investors. Mauritius serves as a both a bridge between Asia and Africa, and a gateway for investment into Africa, with many VC funds using the country as a base for their operations in the region. This has led to an increase in the number of VC firms and funds in Mauritius, further fuelling the growth of the market. Underlying macroeconomic factors also play a role with a stable and well-regulated financial system, a strong entrepreneurial culture and a skilled workforce.

Figure 45: Mauritius Venture Capital Raised and Deal Value



Source: (Insights, 2023), (Africa: The Big Deal, 2024)

It is clear in Figure 45, which shows VC funding raised and VC deal values for the period from 2019-2023 that while Mauritius attracts venture capital, there is very little VC activity in the

country itself. In other words, it is seen as an attractive jurisdiction to set up an offshore company, but the economy does not attract much VC investment.

Mauritius is an easy place to do business and was ranked number one in 2019 in Africa by the World Bank in ease of doing business and 13th globally out of 190 countries. It is the 19th freest globally in the 2024 Index of Economic Freedom but is ranked first out of 47 Sub-Sahara African countries and its economic freedom score is higher than the world and regional averages) (Foundation, 2024). According to the Global Peace and Democracy Index of 2023, Mauritius ranked first in Africa and 23rd overall (Peace, 2023). The Bertelsmann Transformation Index (Stiftung, 2022), which measures political transformation, economic transformation and governance performance for 137 countries, ranked Mauritius twelfth in its 2022 edition. The Index notes that "14 democracies have been consistently classified as consolidating and stable over the past twenty years in addition to being able to maintain their high level of democracy despite myriad transformation challenges. This group includes: Botswana and Mauritius in Africa" (Stiftung, 2022, p. 7). The World Economic Forum's Global Competitiveness Report (GCR) 2019 ranked Mauritius as the most competitive country in Africa, at the 52nd place worldwide (out of 141 countries).

Mauritius is therefore an easy jurisdiction in which to do business, is stable, has an open economy and is considered as having good governance.

9.1.2 Incentives and Government Support

Mauritius has a tax system that makes doing business attractive. This system includes:

- Corporate and personal tax rate of 15%. Funds structured with a Global Business Corporation (GBC) Licence are entitled to benefits alongside the partial 80 per cent tax exemption, resulting in a maximum effective tax rate of 3 per cent.

- A GBC may be locally incorporated or as a branch of a foreign company. It can engage in certain global business activities such as asset and fund management, ICT services and consultancy. GBCs also benefit from Mauritius' network of Double Taxation Agreements (DTAs), making it a cost-effective structure for international tax planning.

- No foreign exchange controls: in other words, free repatriation of funds is allowed, no regulatory consent is needed for the repatriation of funds earned by a foreign investor in Mauritius. Apart from complying to standard anti-money laundering laws and regulations, a foreign investor does not have to seek any authority`s consent for the free movement of funds abroad and in the country.

- No Capital Gains Tax, no property tax and no inheritance tax.
- Rebate schemes for some specific types of exports.
- No customs duty on specific equipment, such as machinery manufacturing solar water heaters, used in the agriculture and agri-based industry, and prefabricated building materials, for example.
- Dividends are not subject to tax.
- Free repatriation of profits, dividends and capital.

The country has long-standing cooperation agreements with most African and international bodies, including the Africa Union, the Southern African Development Community and the Common Market for Eastern and Southern Africa (COMESA), making it an ideal platform between Africa and Asia. Its social infrastructure is also amongst the most developed globally, with high-standard boarding schools and universities, and a modern healthcare system.

Many multinationals choose the Mauritius International Financial Centre to establish their Headquarters. Introduced in 2016, the Global Headquarters Administration licence is a strategic move by the Mauritian government to establish and strengthen the position of Mauritius as the leading regional financial and business hub for multinational companies doing business in Africa. With this licence, multinational companies are allowed to set up their regional administration, procurement and accounting offices in Mauritius. Companies holding this licence have to employ ten Mauritius-resident full-time professionals with at least two at managerial level. The professional can be an expatriate who is based in Mauritius and is any person who is involved in the main activities of the company. It allows multinational companies to provide headquarter services, namely business planning, development and coordination, general organisation and administration; and economic research and analysis.

Moreover, companies holding a Global Headquarters Administration licence are eligible to an eight-year tax holiday on all income generated by the company from its headquarter activities, provided it satisfies the licencing requirements.

As a low-tax jurisdiction, with numerous DTAs, the absence of exchange controls, low corporate tax, no capital gains tax and no withholding tax, Mauritius provides an attractive environment for the establishment of offshore trusts.

9.1.3 Legislation and Regulations

Mauritius offers a diverse range of options and familiarity as a jurisdiction of choice for fund structures and investment vehicles, particularly those which permit the segregation of assets and liabilities, such as protected cell companies (PCCs) and variable capital companies (VCCs).

A PCC is a special purpose vehicle (SPV) that separates assets owned by each cell within the company. It operates as a single legal entity that can be divided into multiple cells, ensuring the distinct separation of assets and liabilities among these cells (i.e. ringfencing). This separation is governed by the Protected Cell Companies Act (the PCC Act) and the Companies Act (the Companies Act). In addition, it is a corporate structure, limited by shares, that consists of a core (non-cellular) and an indefinite number of cells (cellular).

PCCs are often structured to meet the commercial objectives of asset managers and investors and are typically used for prescribed activities such as investment funds, asset holding or structured finance business. These activities may require the PCC to hold a Global Business Licence (GBL). Under the Financial Services Act, where the majority of shares, voting rights or legal or beneficial interest in a resident corporation (other than a bank licensed by the Bank of Mauritius) is held or controlled by a person who is not a citizen of Mauritius and that corporation proposes to conduct or already conducts business principally outside Mauritius, an application for a GBL should be made to the Financial Services Commission of Mauritius (the FSC).

A PCC may be incorporated in Mauritius as a Global Business Company (GBC), and existing foreign or Mauritian companies may also be converted to PCCs. Approval from the FSC is typically required for the creation of each cell. The board of directors of a PCC is responsible for maintaining the separation of cellular assets from non-cellular assets. The board is also required to maintain this level of distinction from cell to cell.

The benefits of PCCs also include reduced administrative costs, a secure investment environment, and the opportunity to improve returns for investors, making them an attractive option for life insurance companies, general insurance companies, mutual funds, and other collective investment schemes.

The Variable Capital Company Act (the VCC Act) of 2022 introduced VCCs which expanded Mauritius' investment fund structures. A VCC is a corporate vehicle designated to provide flexibility in capital management, primarily for collective investment schemes such as mutual funds or hedge funds. A VCC can be structured as an open-ended or closed-ended fund, and

it does not have a minimum capital requirement. VCCs can be used to create sub-funds and special purpose vehicles that fall within the same category, while offering the same level of protection (i.e. ringfencing). The VCC is a company incorporated under the Companies Act which carries out its activities through its sub-funds and SPVs. The Mauritius Minister of Finance expressed the need to supplement the competitiveness of the Mauritian financial services sector, introducing VCCs as a part of such efforts. VCCs provide more flexibility and efficiency by using a single entity for the management and operations of a fund.

SPVs, with approval from the FSC, can also have separate legal personalities and are increasingly used by family offices. A VCC can be incorporated in Mauritius under the Companies Act or as a continuation of an existing foreign company. Like PCCs, VCCs offer several advantages to investors, including flexibility in capital management, no minimum capital requirement, no restrictions on investment policies and no restrictions on distribution policies.

Both PCCs and VCCs are popular investment vehicle options that provide investors with flexibility and security. While PCCs and VCCs share similarities in terms of segregating assets and liabilities within their structures, the distinguishing feature lies in the separate and distinct legal identity that sub-funds of VCCs can have. In contrast to PCCs, where the cells remain part of the same legal entity, VCC sub-funds can potentially attain a unique and distinct legal identity separate from that of the overarching VCC.

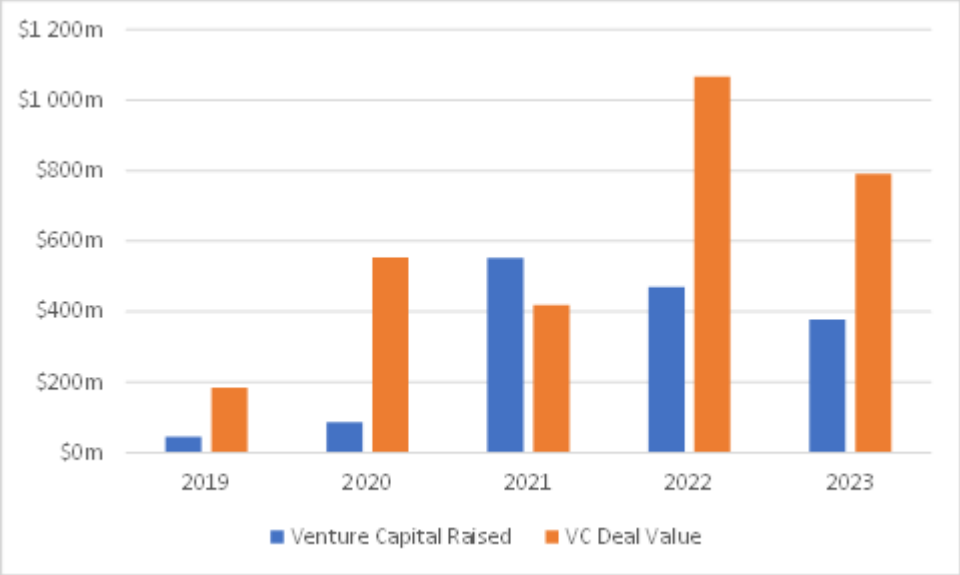
Aside from the country's numerous DTAs, Mauritius has signed Investment Promotion and Protection Agreements (IPPAs) with 29 countries and awaits ratification with fifteen other countries in Asia and EMEA as of 2022. IPPAs promote and protect investments by reducing possible risks concerning nationalisation or expropriation in the participating countries. It also creates access to a broader market of millions of consumers in other regions. An IPPA can benefit investors through the fee repatriation of investment capital and returns; guaranteeing against expropriation; implementing the most favoured nation rule for the treatment of investment; compensation for losses in the case of war, armed conflict or riot; and arrangements for the settlement of disputes between investors and the contracting states.

9.2 Kenya

9.2.1 Performance and Intensity

Kenya, as one of the Big Four VC countries in Africa holds the third spot in Africa in 2023 on deal count with 67 equity rounds (-35% YoY), but experienced a steep decline in equity funding amount (-56% YoY) to reach $335m in 2023 (Partechpartners, 2023, p. 20).

Figure 46: Kenya Venture Capital Raised and Deal Value



Source: (Insights, 2023), (Africa: The Big Deal, 2024)

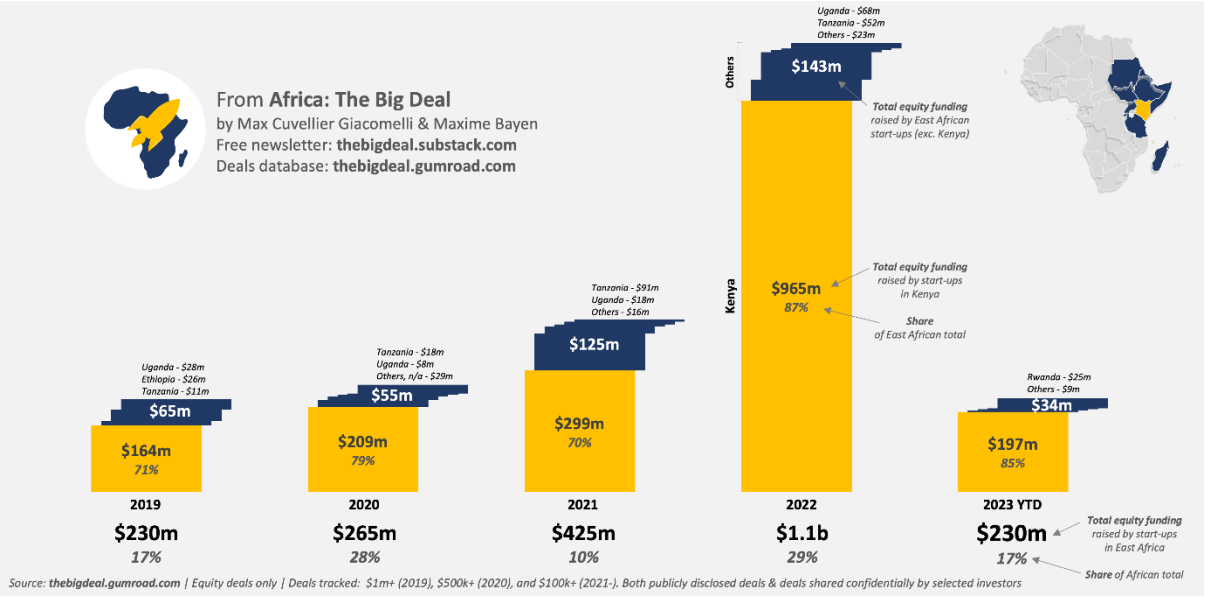
Figure 46 shows that Kenya attracts both capital (more than Mauritius) and extensive VC activity. Some of its VC activity is funded by venture debt. It has low funding levels in Fintech and is mostly led by E/M/S/Commerce (e-commerce, mobile commerce and social commerce) at $74m (25% of total sector funding) followed by Agritech with $70m (49% of sector funding) and Cleantech with $69m (23% of sector funding) (Partechpartners, 2023).

In an industry survey of LP and GP perspectives (AVCA, 2023), while LPs chose West Africa as an attractive region, most GPs (83%) consider East Africa the most appealing region for private capital investment, closely followed by West Africa (78% of GPs). Kenya and Nigeria, the largest private capital markets in East and West Africa, were chosen as the most attractive countries among most GPs.

Figure 47 shows Kenya as the clear leader in the region when it comes to funding raised by start-ups in East Africa with Kenya the clear leader in the region. 84% of all the funding raised in East Africa since 2019 was raised by start-ups in Kenya and no other East African market has ever claimed more than $100m in funding in any given calendar year (Africa: The Big Deal, 2023). An interesting observation is that CEOs of start-ups in Kenya are much more likely to have studied in Europe or in the US than in Africa[12].

[12] *https://thebigdeal.substack.com/p/-a-closer-look-at-kenyas-success*

Figure 47: Funding Raised by Start-Ups in East Africa 2019 to 2023



Source: (Insights, 2023), (Africa: The Big Deal, 2024)

Kenya has implemented significant political, structural and economic reforms that have driven sustained economic growth, social development and political gains over the past decade. Kenya's macroeconomic indicators are among the strongest in Africa, with 5% - 6% GDP growth over the past five years, 6% - 8% inflation, proved infrastructure, and strong consumer demand from a growing middle class. It also has the largest and most diversified economy within the East African Community (EAC), which comprises of Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda. A once restrictive regulatory framework has undergone liberalising reforms and eased the market entry for new actors and improved the attraction for foreign direct investment (FDI) (Stiftung, 2022). It also serves as a launch pad for investors to execute cross-border investments in companies that operate within the EAC and has pursued legal and trade harmonization to support regional commerce and cross-border expansion by businesses in these markets. Given Kenya's membership in the EAC, basing an investment firm in the country offers a fund manager the possibility of "regionalizing" local businesses and taking advantage of the EAC's cross-border regulations and commercial policies (World Bank, 2018). But this also means that funds operating in Kenya must take regional legal and regulatory factors into account in addition to navigating those in Kenya. In this sense, Kenyan fund managers often operate within a regional legal and regulatory context.

Kenya is the second-best African country in terms of regional integration policies within the EAC and Common Market for Eastern and Southern Africa (COMESA) regional blocs, according to the Africa Regional Integration Index Report 2019. Kenya's performance on regional infrastructure, productive integration, free movement of people, and financial and

macroeconomic integration is high (Stiftung, Bertelsmann Stiftung's Transformation Index (BTI) 2022 Kenya, 2022).

The country's capital, Nairobi, is viewed as an attractive location in East Africa from which investors can establish offices and cover the region, a de facto alternative investment hub of East Africa, which places it alongside Johannesburg and Lagos as the investment capitals of Sub-Saharan Africa. Nairobi is also home to the East Africa Venture Capital Association (EAVCA), an organization that was set up in March 2013 to advocate on behalf of VC and PE investors (World Bank, 2018).

9.2.2 Incentives and Government Support

The Kenyan Government introduced the Start-up Bill 2020, creating several tax-related incentives and protection for intellectual property for new businesses in the "Silicon Savannah" that are majority-Kenyan owned.

The EAVCA announced a collaboration with the State Department of Investment Promotion and the Kenya Development Corporation in September 2023 (Ministry of Investments, 2023). Their joint effort aims to establish a framework for co-investing and mitigating risks associated with private investments in County Aggregation and Industrial Parks (CAIPs), set up by government across the country to assist farmers and the light manufacturing sector, with the goal of driving bottom-up economic transformation through venture capital investment. The collaboration aims to foster economic growth and development in the region by facilitating private investments in CAIPs.

9.2.3 Legislation and Regulations

Capital markets in Kenya are governed by the Capital Markets Act, Chapter 485A, Laws of Kenya. This Act of Parliament establishes the Capital Markets Authority (CMA), whose purpose is to promote, regulate and facilitate the development of an orderly, fair and efficient capital market in Kenya. Section 12 of the Act gives the CMA powers to formulate rules, regulations and guidelines required for the purpose of carrying out its objectives. Among the capital market players to be regulated by the CMA include registered VC companies (Riro, 2022).

In exercise of its powers, the CMA issued regulations that provide a framework to govern operations of the VC firms in Kenya as well as enhance the visibility of their activities to the regulator. Further regulations in 2020 give the CMA powers to license, approve and regulate private equity and VC companies that have access to public funds with the aim of safeguarding

funds that private equity (PE) and VC firms access from public institutions such as pension schemes, who invest in the PE or VC funds as limited partners.

Other regulatory authorities that impact the private equity market in Kenya include the Retirement Benefits Authority (RBA), which regulates all licensed pension schemes; and restricts the assets under management (AUM) that they can invest in PE and VC funds (currently capped at 10% of the AUM for all pension schemes licensed and regulated by the RBA). The Competition Authority of Kenya (CAK) regulates the merger notification and approval processes for all M&A deals happening within Kenya; and which result to a change of control in the businesses involved. For cross-border deals within the Common Market for Eastern and Southern Africa (COMESA), the COMESA Competition Commission reviews and approves proposed mergers and acquisitions.

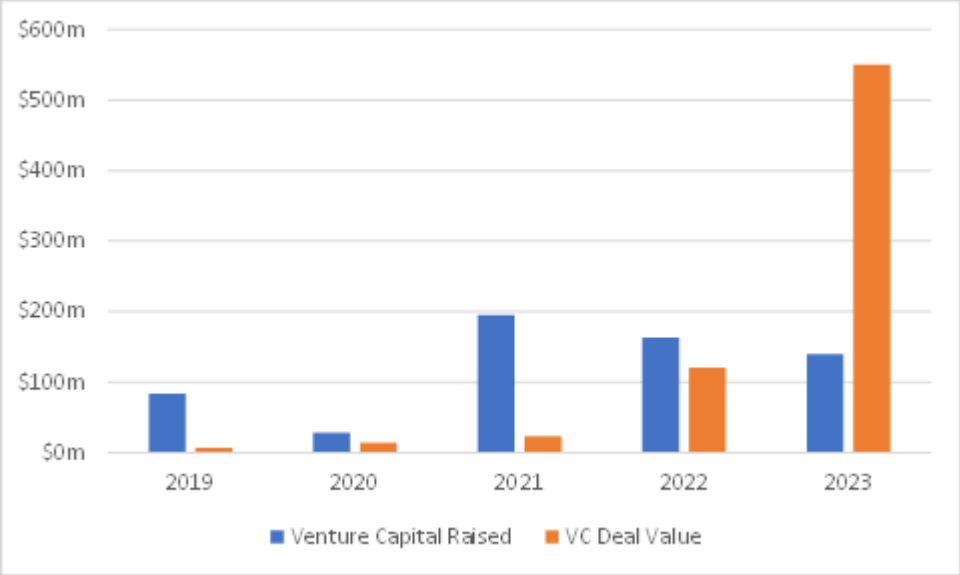
While the above regulations override all sectors, there are regulations that apply to specific sectors of interest within the economy. For example, in the ICT sector, each prospective licensee must have a minimum shareholding by Kenyan citizens of 30%; in the mining sector, Kenyan citizens must own at least a 35% shareholding in the target business for it to be issued with a mining license; the threshold for local equity participation in corporate private security providers is set at 25%. And within the banking sector, no single person is allowed to own more than 25% of the shares of a licensed bank (with some exceptions) (Riro, 2022).

9.3 Tunisia

9.3.1 Performance and Intensity

Information Technology (34%), Consumer Discretionary (21%), and Industrials (14%) were Tunisia's most active sectors for venture capital investment between 2017 and 2022. Innovation in Tunisia's IT sector has attracted international attention to this small country, particularly in the fields of artificial intelligence (AI) and biotech. One of the most striking trends is the representation of Francophone countries in the lead countries of African tech investment. In 2023, five Francophone countries – Morocco ($93m), Congo ($42m), Rwanda ($38m), Tunisia ($33m), and Senegal ($27m) – secured their spots in the top ten of African tech funding, highlighting the growing appeal and potential of these markets in the tech sector (Partechpartners, 2023).

Figure 48: Tunisia Venture Capital Raised and Deal Value



Source: (Insights, 2023), (Africa: The Big Deal, 2024)

Figure 48 shows VC funding raised and VC deal values for the period from 2019-2023. Start-ups headquartered in Tunisia that raised capital in 2022 include SmartBee, a remote beehive monitoring system using infrared technology to prevent excess bee mortality and optimize honey production, the only one of its kind in North Africa. Another example is Deepera.AI, a financial management platform for the stock market using AI.

Start-ups founded by the Tunisian diaspora are also adoptive of disruptive AI-enabled solutions. Initially founded in Tunisia but now headquartered in the United Kingdom, deep tech start-up Instadeep was acquired by a German biotech company in early 2023 in a deal with a long-term value of $684m (Disrupt Africa, 2023. Tunisia-Founded AI Start-up Instadeep Acquired In $684m Deal). The success of Instadeep, which delivers AI products and solutions for the enterprise sector, positions Tunisia to become a leading deep tech hub in Africa and the Middle East (Massachusetts Institute of Technology, 2023. Legatum Center For Development & Entrepreneurship Blog). So too does Expensya, an expense management SaaS start-up and another Tunisian success story – now operational in over 90 countries and serving almost 6 000 corporate businesses (TechCabal, 2022. How this Tunisian start-up won big in Europe).

9.3.2 Incentives and Government Support

Tunisia was the first African country to pass a Startup Act in 2018, a landmark legislation that has since been implemented or worked towards in several other countries across the continent (including Senegal, Mali and Ghana). The Startup Act aimed to position Tunisia as an

innovative business hub for start-ups at the crossroads of the Mediterranean, Europe and Africa, and successfully jolted the start-up ecosystem in Tunisia which previously saw only a handful of venture capital deal activity take place prior to 2019 (Africa, 2022).

A crowdfunding law was passed in 2020, recognising this mode of financing for companies and projects.

9.3.3 Legislation and Regulations

The Startup Act is a comprehensive targeted legislative framework codified in one main instrument, that is often complemented with other regulations, policies and programmes. Having most provisions in one main document make it easier for firms to be aware of the benefits they may be granted. Also, Startup Acts are passed through bills of parliament or ministerial decrees and therefore are more significant than simple policies. And when they have been adopted through a participatory process involving grassroot entrepreneurs, this can impulse a positive dynamic at national level and boost investors' trust (Facility, 2021).

The Tunisian Startup Act (Act) was adopted in 2018 and provides incentives to three types of beneficiaries: entrepreneurs, start-ups and investors. The objective of the law is to set up an incentive framework for the creation and development of start-ups based, in particular, on creativity, innovation and the use of new technologies and achieving a strong added value and competitiveness at the national and international level. The Act sets certain conditions to be considered as a start-up, classified into two categories: those related to the company's characteristics (e.g. years of existence, number of employees, annual income, etc.) and those related to the company's potential of high growth or innovation.

To be eligible to benefit from the Act, the company cannot exceed one hundred employees, its total balance sheet and its annual turnover cannot exceed $5.3m and more than two-thirds of its capital should be held by individuals, VC investment companies, collective investment schemes, seed funds, any other investment body or by foreign start-ups. The Act requires two cumulative criteria: a business model with a strong innovative dimension, particularly technological, and an activity with strong growth potential.

The granting of incentives provided by Startup Acts often depends on the ability of firms to meet the abovementioned criteria and to go through a labelling process. The selection process of firms receiving grants and / or incentives can be either objective or discretionary. In an objective selection process or entitlement-based labelling process, firms are expected to apply to a designated institution and submit proof that they meet stated objective criteria. In a discretionary selection process companies applying for start-up status must go through a

selection process managed by a committee (often composed of public and private actors) responsible for determining whether a company is innovative or has the required growth potential in accordance with the provisions of the Act. This latter process is called "discretionary" because it is left to the committee to determine if a start-up complies with the requirements through an analysis of the company's individual situation. The Tunisian Startup Act has this kind of selection process. The start-up label is awarded by the Ministry in charge of the digital economy based on input from the Technical Committee, which is responsible for checking that the company meets the cumulative conditions.

The Act provides financing tools to three types of actors: entrepreneurs, through the provision of an allowance given to the co-founder and shareholder to cover living expenses for one year; start-ups, via the creation of a €200m fund of funds; and investors, who benefit from tax deductible start-up investment as well as capital gains tax exemption of profits from the sale of shares in start-ups.

Most recently, in July 2020, Smart Capital announced new financial support for Tunisian start-ups. This includes: a fund of $84m to finance innovation projects, up to $1m to support labelled start-ups impacted by COVID-19, support funding of $7m to finance research and innovation, and a state innovation laboratory with funding of $3.5m (Facility, 2021).

In terms of governance, the Ministry in charge of the digital economy assumes the direct and indirect costs of intellectual property registration for start-ups to facilitate access to IP registration. As a form of business support, all public agents and employees of a private company benefit from a Start-up Leave to create a start-up for a period of a year, renewable once. From a fiscal point of view, the following are fully deductible and within the limit of income or profit subject to tax:

- Income and profits reinvested in the underwriting of the initial capital or increased capital of start-ups.
- Income or profits reinvested in the capital subscription of VC companies, or placed with them in the form of VC funds, seed funds or any other investment body.
- The profits from the sale of shares in start-ups are exempt from the capital gains tax.
- Exemption from corporation tax and the assumption by the State of employers' and employees' contributions to the statutory social security scheme.

From a labour perspective, any young graduate legally eligible for the employment programs, and who creates a start-up, retains the right to benefit from these programs for a maximum period of three years.

Financially, the following benefits are also available:

- Start-ups are legally entitled to issue convertible bonds, and are authorized to issue multiple convertible bonds, regardless of the option periods for conversion.
- The right to open a special account in foreign currency with approved intermediaries, without capital controls on funds raised.
- Any promoter of a start-up may benefit from a start-up scholarship for a year.
- Tax exemption on profits for investors.
- A Start-up Guarantee Fund (yet to be created) aims to guarantee the participation of private equity firms, venture capital funds, seed funds and any other investment body (Facility, 2021).

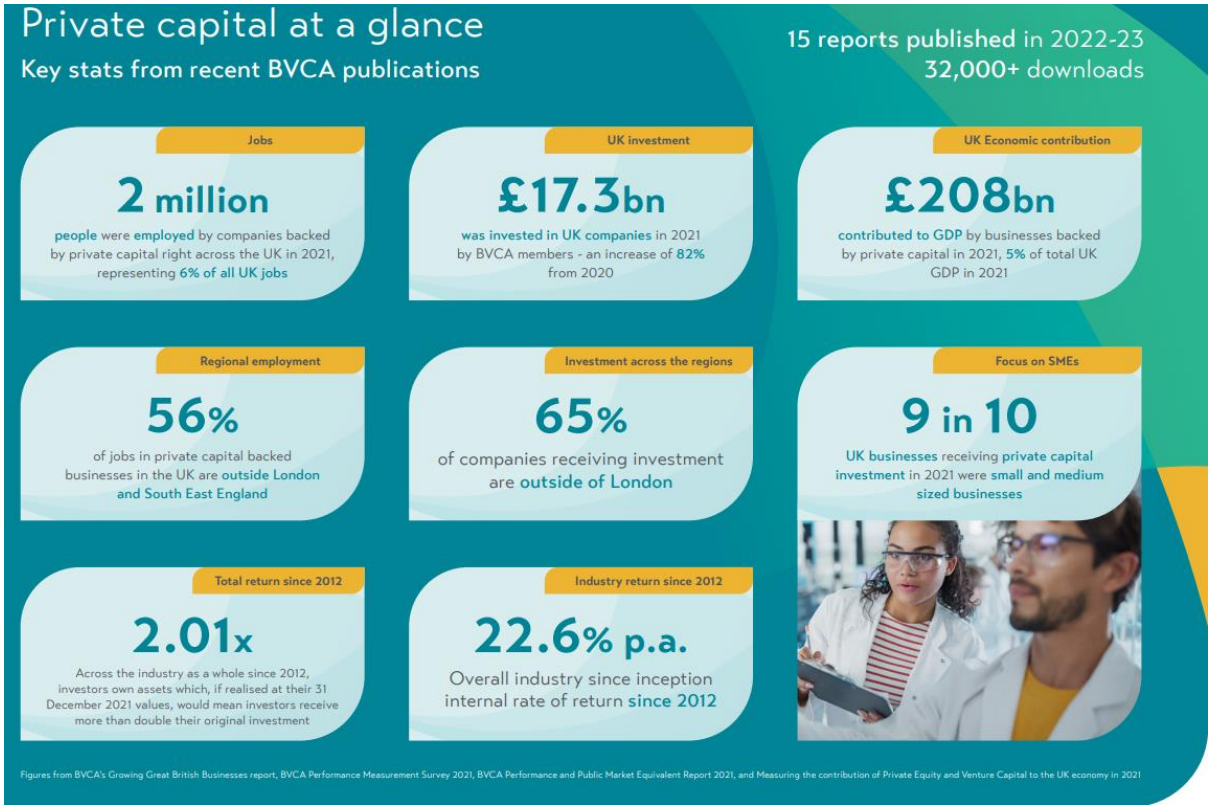
9.4 United Kingdom

9.4.1 Performance and Intensity

The UK has the second most active and capital-intensive VC market in the world with £22b of VC deployed in 2022. In 2021, UK VC companies raised some £16b of additional capital, 80% of which was raised from international investors, predominantly from North America, Europe and Asia. In 2022, there were over 3 900 VC Deals in the UK, the median valuation per deal being £7.1m and the largest individual deal being £745.2m. A snapshot of the VC industry is shown in Figure 49.

The UK is home to a growing concentration of companies in Life Sciences, FinTech and DeepTech – Artificial Intelligence, Robotics, Semi-Conductors and Quantum Technologies. It is home to four of the top ten universities in the world and between 2012 to 2017, the UK had five universities in the global top ten for raising capital for companies that have been spun out of academic research. In 2022, the UK was ranked 4th from 132 economies that featured in the 2022 Global Innovation Index (Trade, n.d.).

Figure 49: UK Private Capital Industry



Source: (British Private Equity & Venture Capital Association, 2023)

The UK has a vibrant and growing VC ecosystem, with a significant presence in London, followed by other major cities like Manchester, Edinburgh, and Bristol. London, in particular, is considered a major hub for fintech, biotech, and other innovative sectors. The VC scene covers a wide range of sectors, including technology, life sciences, fintech, clean energy, and more. Fintech has been a particularly strong focus, with the UK being a global leader in financial technology innovation.

Brexit has had an impact and added complexity to cross-border investments, but London remains an important global financial centre and a key player in the start-up ecosystem. In addition to London, other cities like Manchester, Edinburgh, and Cambridge have emerged as strong start-up hubs. These cities benefit from a mix of universities, research institutions, and a supportive entrepreneurial environment.

9.4.2 Incentives and Government Support

The UK government has initiatives to support the start-up ecosystem and attract investment. Various programs provide tax incentives to investors, encouraging them to invest in early-stage companies. The following are key interventions that support VC investment:

- Enterprise Investment Scheme (EIS): The Enterprise Investment Scheme is a government program that provides tax incentives to individual investors who invest in qualifying early-stage companies. Investors can benefit from income tax relief, capital gains tax relief, and inheritance tax relief. EIS is designed to encourage private investment in start-ups and small businesses.

- Seed Enterprise Investment Scheme (SEIS): SEIS is a more focused version of the EIS, specifically designed for start-ups in their early stages. It provides even greater tax incentives to investors who support very early-stage companies, making it an attractive option for those looking to invest in high-risk ventures.

- Venture Capital Trusts (VCTs): VCTs are investment vehicles listed on the London Stock Exchange that pool funds to invest in a portfolio of small, high-risk trading companies. Investors in VCTs receive tax incentives, including income tax relief and tax-free dividends.

- British Business Bank: The British Business Bank is a government-owned development bank that plays a crucial role in supporting SMEs in the UK. It operates various programs and funds to facilitate access to finance for start-ups and growing businesses. The bank works with private sector partners to provide funding and investment support.

- Innovation Grants and Competitions: The government, through various departments and agencies, offers grants and runs competitions to encourage innovation in specific sectors. These grants can provide crucial funding for research and development activities and help start-ups bring innovative products and services to market.

- Research and Development (R&D) Tax Credits: The government provides tax incentives for companies engaging in qualifying R&D activities. This can be especially beneficial for technology and innovation-driven start-ups, allowing them to reduce their tax liabilities and reinvest in further research and development.

- Tech Nation Visa Scheme: The Tech Nation Visa Scheme is designed to attract international talent to the UK's technology sector. It allows skilled individuals, including entrepreneurs and tech professionals, to work and develop their businesses in the UK.

- Regulatory Support: The government works to create a supportive regulatory environment for start-ups and venture capital investment. Efforts are made to streamline processes, reduce red tape, and facilitate innovation. It has a dedicated

Venture Capital Unit that seeks to connect UK early-stage and growth-stage companies with investors.

9.4.3 Legislation and Regulations

As many as two-thirds of UK angel investors only consider SEIS/EIS-eligible companies and according to the UK Business Angels Association, 90% of angel investors have invested through EIS or SEIS, and 80% of the total investments in angels' portfolios are SEIS or EIS (Association, n.d.).

EIS is designed for medium-sized businesses and a company can raise up to £12m in EIS funding. To qualify for the scheme, the company must:

- Be established in the UK.
- Have under 250 employees.
- Have under £15m in gross assets.
- Have started trading less than seven years ago (unless one qualifies as a Knowledge Intensive Company).
- Not be listed on a stock exchange.
- Not be owned or controlled by another company.

There are several conditions for eligibility for EIS:

- The investor must be a UK taxpayer and at the time of investment, they cannot be an employee of the company.
- The investor cannot hold more than 30% of the company's overall shares and the company cannot carry on business in certain (non-qualifying) activities, like property development, banking and other financial activities, legal / accounting services, farming, shipbuilding, hotel operations or nursing homes.
- The Risk to Capital Condition requires evidence that: the company's objective must be to grow over the long term and this growth will be a direct result of the EIS investment; and by investing in the company, investors will be putting their capital at 'significant' risk.

- The money raised with each new issue of EIS shares must:
    - Be used to grow or develop the business.
    - Present an actual risk of loss of capital for the investor.
    - Not be used to buy all / part of another business.
    - Be spent within two years of the investment or the date started trading (if later).

EIS makes investing in young companies attractive to investors because their investment (max. £1m per tax year) comes with the following benefits:

- A 30% income tax break against the amount invested.
- No Capital Gains Tax (CGT) is owed on profit arising from the sale of the shares, as long as they are held for at least three years before sale.
- Investors can defer payment of CGT owed on the sale of other assets by investing through EIS.
- No Inheritance Tax is payable provided the EIS shares have been held for at least two years.
- If the EIS shares are sold at a loss, this loss can be offset against any income tax in that year or the previous year.

A Knowledge Intensive Company (KIC) is one in which the creation of IP is used as part of the main business for the next ten years, at least 20% of full-time employees have a higher education qualification and their work is in the same academic field, and sufficient operating costs include expenditure on research, development/innovation. If one can demonstrate that that a company fulfils HMRC's (His Majesty's Revenue and Customs) criteria for a KIC extra benefits are available under EIS. These include being able to raise up to £20m in total and up to £10m per year, a 10-year fundraising window, allowing up to 500 full-time employees and investors allowed to claim tax relief on up to £2m, as long as at least £1m is invested in a KIC.

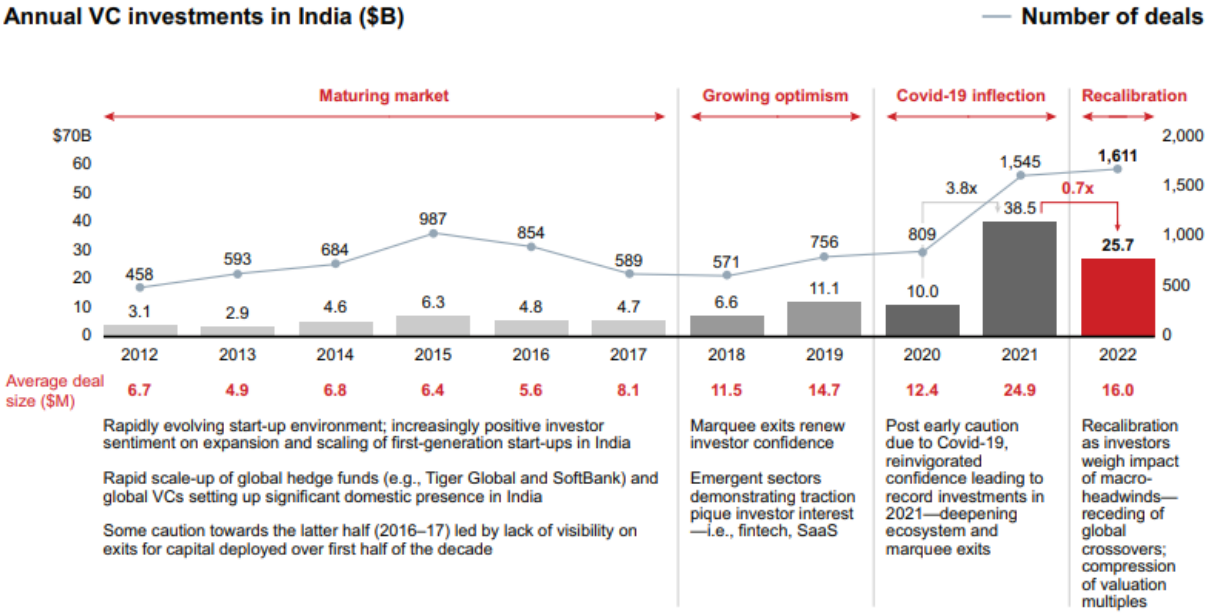
HMRC introduced the SEIS in 2012 as a sister scheme to the EIS, designed for even earlier-stage businesses. It offers investors greater tax relief to compensate for the extra risk involved in investing in very young businesses.

9.5 India

9.5.1 Performance and Intensity

In India VC investment in the final quarter of 2023 remained down on record 2021 levels. This was despite positive macroeconomic factors (the economy continued to grow, GDP growth remained strong, and stock markets were at an all-time high) and a general sense of positivity in the market. This continued after the global fall-off of VC investment in 2022, where the challenging global investment environment occasioned by factors such as the Ukraine/Russia war and conflict in the Middle East, made investors more cautious. However, it should be noted that within Asia-Pacific, the share of India-focused VC investments reached 20% for the first time in 2022, and India continued to account for 5% of global VC funding in line with 2021. For the second time in a row, the number of unicorns (a start-up company with a value over $1bn) added in India (23) outpaced China (11), and India marked the addition of its 100th unicorn in May 2022 (only the third country globally, after USA and China, to have created 100+ unicorns) (Bain and Company, 2023). The number of deals and deal value in India for the period 2012-2022 is shown in Figure 50.

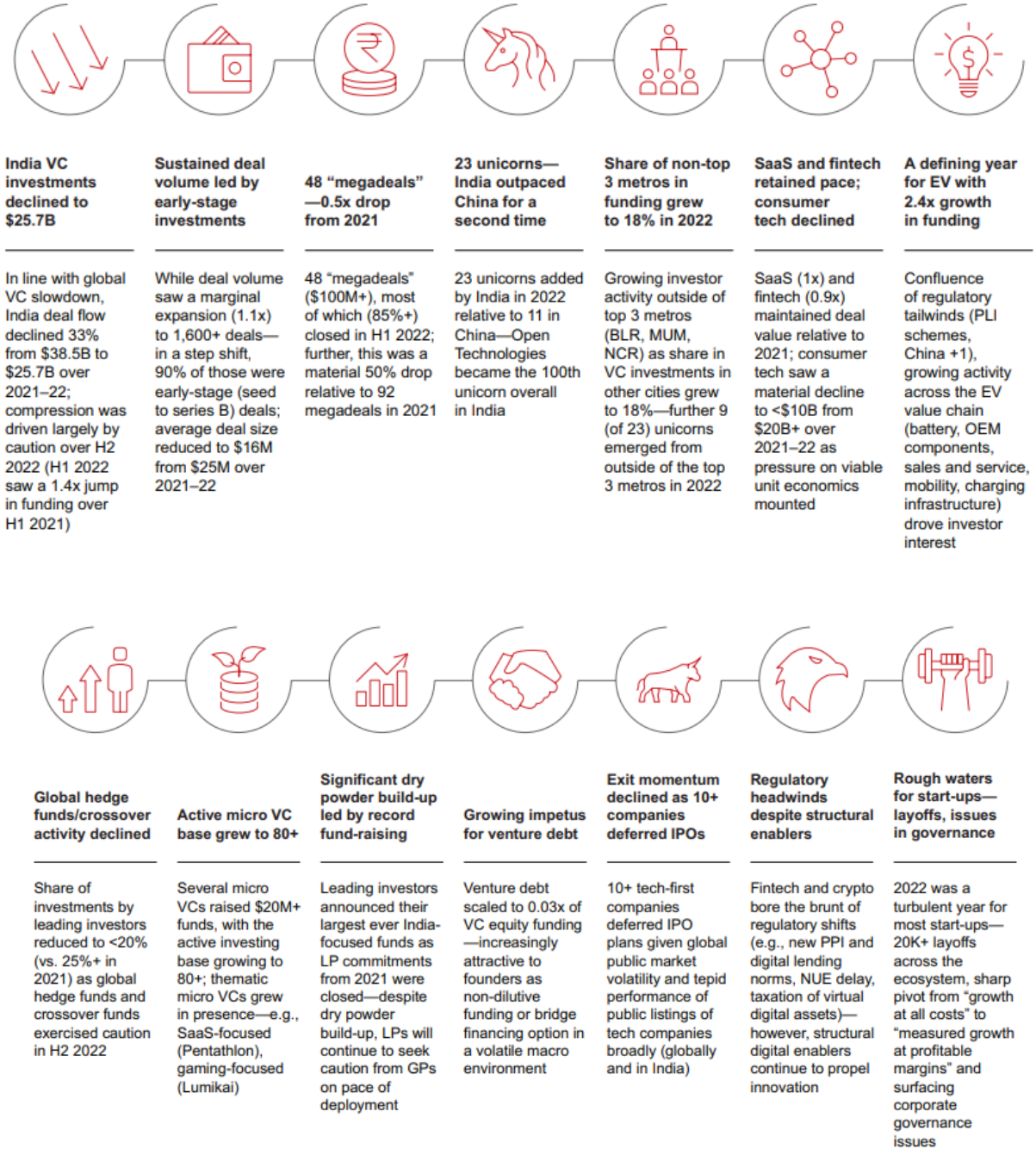
Figure 50: Annual VC Investments in India



Source: (Bain and Company, 2023)

As an overview of VC activity for 2022, Bain and Company's report "India Venture Capital Report 2023" highlights the Indian VC ecosystem as presented in Figure 51.

Figure 51: 2022 VC Ecosystem in India – A Year of Recalibration



Source: (Bain and Company, 2023)

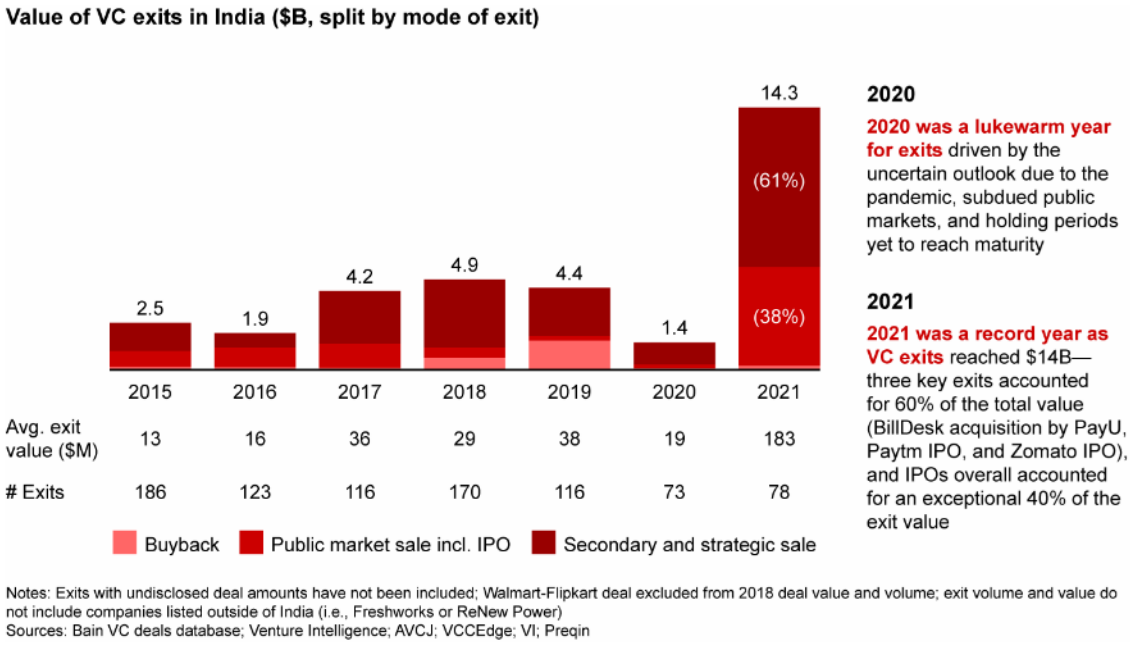
Consumer tech, fintech, and SaaS (software as a service) continued to dominate VC investments, accounting for ~70% of funding in 2022. A few emergent sectors came to the fore in 2022: electric vehicles, agritech and emergent deep tech segments, such as generative AI, space tech and climate tech (Bain and Company, 2023).

When it comes to exits:

- There was a decline from $14.3b to $3.9b over 2021–22; public market exits continued to account for 40% of total exits, in line with 2021.
- Decline in public market exits from $5b+ to $1.5b was largely driven by a slowdown in tech listings in 2022; more than ten firms paused IPOs in light of the global rout on public tech listings. However, 2022 did see six IPOs with VC exits, but these were relatively small compared to 2021.
- While total strategic/secondary exits remained consistent in volume (63 in 2021 vs. 59 in 2022), large exits declined significantly; 2022 saw eleven $50m+ exits relative to nineteen in 2021.

The average exit value over the period 2015-2021 is shown in Figure 52.

Figure 52: Value of VC Exits in India



Source: (Bain and Company, 2023)

With 40% of 2022 unicorns added outside the top three metros, 15% of unicorns in India now having a female founder or co-founder, and 50% of start-ups registered with the Department for Promotion of Industry and Internal Trade (DPIIT) outside the top three metros (Mumbai, Bengaluru, and NCR), indications are of a deeper and more mature VC ecosystem in 2022 in India. Foreign venture capitalists have played a unique strategic role in the growth and development of venture capital in India, particularly in larger deals and late-stage growth

deals, which is a global trend. The recent regulatory turmoil in China with several cancelled IPOs including that of Jack Ma's Ant Financial, which would have been one of the largest in history valuing the company at over $300bn. In other words, global VCs are looking to diversify their risk in Asia and India is well-positioned to benefit from this strategy.

India has one of the top five start-up ecosystems in the world, which looks to continue to grow rapidly in the future. In 2020, some of the key metrics underpinning VC investment, in comparison to the other big VC countries/economies, are shown in Table 11.

Table 11: Top Five International VC Ecosystems - 2020

	US	China	India	UK	Israel
Total number of unicorns	203	206	27	13	7
Average time to unicorn (years)	6-8	4-6	6-8	7-9	5-7
Average valuation per unicorn ($bn)	3.5	3.8	3.2	2.4	1.3
Total number of funded start-ups	57k	9k	6.4k	10k	2k
Ratio of unicorns to funded start-ups	36	22.9	42	13	35
Total engineering graduates	0.26m	4.6m	1m	0.07m	0.01m
Total number of internet users	270m	800m	560m	59m	7m
% internet users of population	82%	57%	41%	89%	78%
Total number of incubators and accelerators	1 500	11 800	400	370	91
Ease of doing business rank (World Bank 2019 (2018)	6 (8)	31 (46)	63 (77)	8 (9)	35 (49)

Source: (Bain and Company, 2023)

In the longer term, it seems that global investors are likely to remain positive about India; with solid macro-fundamentals, a large economy (with a sizeable middle class with large working-age population, services-driven economy, and an expanding manufacturing base), a sizeable workforce entering the formal economy, a digitally enabled population, and a deepening innovation ecosystem, there remain key foundational drivers underlying India's promise in the next decade.

An important but subtle contributing factor in the ability of Indian entrepreneurs to successfully attract VC investment is cultural. Increasingly, Indian entrepreneurs many of whom have been trained abroad in the United States and the United Kingdom, have been willing to cede more control to venture capitalists and embrace them as true partners.

Increased VC investment in India is also driven by several social, economic, and industrial factors. India is maturing and it is now the 5th largest economy in the world with a GDP of $3.5tr and a per capita GDP of $2k. The World Bank estimates that the Indian economy will increase by more than a third to $5tr over the next ten years. The other attractive aspect of the Indian economy is its scale: India is a highly diverse nation of 1.4bn people and it is rapidly overtaking China to become the most populous country in the world (Sable, 2022).

Not only is this population large, but it is young. Unlike China, which is ageing rapidly due to the one-child policy, almost 30% of India's population is under the age of fourteen and 50% of the country's population is below the age of 25. This young Indian population represents a gargantuan-sized consumer market that will be among the first to adopt the latest cultural and technological trends. They also form the basis for the 1.5m new engineering graduates that India produces annually (second only to China). These graduates will provide the human capital required to build the technological innovations that VCs invest in.

India's information technology services industry has served as a catalyst to attract venture capital to the country. India has built an internationally competitive IT services industry, which accounted for 8% of Indian GDP in 2020 and is projected to contribute 10% of Indian GDP by 2025 (Sable, 2022). This industry is a leading source of R&D and having established themselves in IT services Indian entrepreneurs are increasingly branching into software development.

This has attracted increasing foreign investment as the computer software and hardware sector garnered $85.5bn in FDI between April 2000 and March 2022, which is the second largest foreign direct investment amount in India and accounts for 14.5% of cumulative FDI inflows. The IT services are reinforced by an extensive 4G mobile network that is capable of providing connectivity to India's 1.1bn smartphone users, an infrastructural backbone that is enabling the delivery of myriad ecommerce and fintech services to India's vast population by the country's burgeoning digital start-ups (Sable, 2022).

Part of the attractiveness of India as a VC destination is the wide variety of investors who can effectively function within the country. The number of active VC funds has grown to 665 and this increasingly includes micro-VCs, family offices as well as larger investors (Sable, 2022).

9.5.2 Incentives and Government Support

Key initiatives by the government of India are as follows (Bain and Company, 2021):

- Start-up India: Regulatory program simplifies processes for start-ups; procedural simplifications to set up companies; tax waivers incentivise start-ups and provide incubation assistance and funding to start-ups.

- Digital India: Developing digital infrastructure to support digital services to increase penetration of mobile, data and information.

- Securities and Exchange Board of India (SEBI): Alternative Investment Policy Advisory Committee (AIPAC) eases financial regulations for alternative investment funds (which includes VC funds); tax benefits such as pass-through and TDS (Tax Deducted at Source) waivers for VC funds, less stringent angel fund regulations such as reduced lock-in period, permitting up to 25% investment overseas.

- Launch by government of a mobile app and a website for easy start-up registration. Anyone wanting to launch a start-up can fill out a simple form on the website and upload the required documents. The entire process is completely digital.

- Government provides lists of facilitators of patents and trademarks, which provide high quality Intellectual Property Right Services including fast examination of patents at lower fees. The government will bear all facilitator fees and the start-up will bear only the statutory fees.

- A fund was set up by government to provide funds to start-ups as venture capital. The government also gives guarantees to lenders to encourage banks and other financial institutions to provide venture capital.

- Start-ups are exempted from the income tax for three years, provided they get a certification from the applicable regulatory authority.

- Start-ups can apply for government tenders. They are exempted from the “prior experience/turnover” criteria applicable for normal companies answering to government tenders.

- Research Parks are set up to provide facilities to start-ups in the R&D sector.

- Various compliances have been simplified for start-ups to save time and money. Start-ups are allowed to self-certify compliance (through the Start-up mobile app) with certain labour and environmental laws.

- No capital gains in venture funds set up by government when investors exit.

- Banks are permitted to invest in VCs.

- Various other tax exemptions and incentives.

- Regulatory or compliance requirements are relaxed in certain cases, for example, the requirement to inform Competition Commission of India if the acquirer has >5% stake in similar enterprises, has been repealed.

9.5.3 Legislation and Regulations

These are largely listed in the section above.

10 Appendix B: Stakeholder Engagement

This section on the stakeholder engagement distils the key issues from the interviews. The issues are categorised into the interviews with the VCCs, Investors, Industry Experts, Associations and Entrepreneurs themselves.

10.1 Venture Capital Companies

The Venture Capital Companies that were consulted were Savant, Hlayisani, Launch Africa and Endeavour.

Venture Capital Companies (VCCs) indicate that raising money for the investment funds is their biggest issue. This was unanimous across all interviewees. While they have had local success in collecting fund money, international money is more difficult to access. There are several reasons why international investors are wary of South Africa, with the two main ones being the country's tight exchange control laws and intellectual property (IP) legislation. Confidence in the national government is low, with perceptions of corruption, and inconsistency amongst policies and government departments being of most concern. While not mentioned unanimously by all VCCs interviewed, currency depreciation/risk is another factor. These risk factors were then followed by the lack of investment by pension funds and then, by some distance, skilled or nomad visas. While the visa issue was a hindrance, there were ways of addressing them albeit at a cost to the start-ups.

International investors, being more sophisticated and more exposed to mature VC markets across the world, are more conscious of "brand SA" and country risks, whereas local investors are less sophisticated and less concerned with the macroeconomic risks associated with South Africa. Investing in start-ups is considered a risky enough endeavour. Adding country and currency risk to this raises the stakes. There are many other international VC destinations that do not have the country or currency risk of South Africa, hence very little international funding finds its way into the country. Allied to these challenges is the fact that the local VC industry is still in its infancy so there is a lack of track record for local VC funds and a lack of exits. Overseas LPs want to see evidence of success. They also have amounts in the millions of US Dollars to invest and, in most cases, the local VC market is not easily able to handle such amounts. However, despite these barriers, South Africa is still a cheaper location to build global businesses than elsewhere in the world and there is huge potential for the VC industry in SA to grow.

Innovative South African firms have found ways to work around the exchange controls and rigid intellectual property laws, by registering offshore companies and conducting their headquarter operations (offshore) from there. This adds to the complexity and cost of running a business because consultants must be employed to assist with this process and effectively two (parallel) offices are operated. Alternatively, the business emigrates offshore and is lost totally to South Africa.

Some VCCs are headquartered in the Western Cape and operate their funds out of South Africa. Their main focus is on start-ups and scale-ups in the country and while there is no shortage of local start-up firms, local VCCs are beginning to look north of South Africa's borders for new investments. The lack of exits in South Africa is one of the drivers for this decision allied to the fact that, to be genuinely scalable, local firms must expand into overseas or African markets.

One VCC was headquartered in the Western Cape but had located its investment fund in Mauritius. The reason for this was to avoid the South African exchange controls so that the fund would attract more international investors and then more easily expand into markets across Africa. This fund is also different from the ones based in South Africa in that it was funded by high net-worth individuals and not institutions.

The VCCs consider pre-seed and seed capital as too risky and concentrate on pre-Series A, Series A and Series B funding. They believe that this (early stage) funding is an area where the government can assist, by investing and providing support at the pre-seed and seed stage of a start-up. One solution provided by a VCC was that the government start a first loss fund. This means the government would absorb the first losses at this stage of funding, thereby reducing the risk and making pre-seed and seed investment more attractive to private sector investors. An additional mechanism would be for government to provide revenue guarantees.

Pension funds are not attracted to the VC industry largely, at this stage, because VC funding as an asset class is relatively new (and these funds are not well educated in this asset class of investment), the pension funds have internal processes that are both conservative by nature and often cumbersome (start-ups have immediate funding requirements that cannot wait for financial quarters or traditional investment timing disbursements) and sector specific start-ups require specialist evaluation, which expertise a pension fund does not have. While corporate governance in South Africa is seen as strong, which is a beneficial characteristic and represents a mature economy, corporate South Africa is viewed as conservative; there are rigid procurement lines and a lack of understanding and knowledge of the VC asset class.

Investment by SA companies in VC through a fund-of-funds would make sense, because these offer more liquidity and a wider spread of investments.

Several of the VCC funds were invested in by the SA SME fund, which as a fund-of-funds, stakeholders indicated had catalysed the industry. This also presented a potential solution to reducing risk associated with the industry, and in particular the early stages of the start-ups, and could start attracting pension fund investment. Pension funds would reduce their risk by investing in a fund-of-funds that then diversified its investment across a portfolio of VC funds operated by skilled managers. Risk would be further reduced if government contributed to a first loss fund, managed by the fund-of-funds. The VCCs saw this as an attractive solution because it would have the added benefit of not having to report directly to several pension fund investors, which tend to have more onerous reporting procedures than a fund-of-funds. There was some preference for government not to fund start-ups directly, but to rather work with VCCs, i.e. in public/private partnerships, so that the VCCs have more capital to invest and the investment process is managed by people whose business it is to make the credible investment decisions.

In general, anything that contributes to EoDB and support for the VC industry, is welcome. There is a need to "catalyse" the industry, i.e. to grow it from its current nascent stage by increasing available investment capital, increasing the number of VC funds and achieving more exits. All this has a multiplier effect and helps to "legitimise" VC investment as an asset class. Government can facilitate this in various ways: by bringing start-ups and industry together, for example, in agritech, bringing entrepreneurs together with farming groups; by helping to speed up regulatory approval in areas like the biotech industry; by preventing issues like greylisting; and by "educating" start-ups and investors on the VC industry.

Section 12J of the Income Tax Act was hugely beneficial to the industry. This allowed private individuals to offset their investments in the VC industry against their income and to reduce their tax bill. Unfortunately, this incentive was abused, mostly by individuals investing in property, and was shut down by SARS. The collective feeling amongst the VC industry is that the loophole could have been closed rather than cancelling the incentive. Despite this incentive having been shut down in 2021, its beneficial effect is still being felt by the industry.

From an international investor perspective, the Western Cape is seen as separate from the rest of South Africa[13]. While the exchange control and IP regulations remain as per the rest of

[13] *One VCC went so far as to say that they only mention Cape Town and the Western Cape to potential international investors and do not mention South Africa.*

South Africa, VC entrepreneurs and investors like the potential lifestyle that Cape Town and the province can offer. It is felt that VC entrepreneurs are attracted to dynamic and liberal cities, such as San Francisco, Berlin and Cape Town, that can provide an attractive work-life balance. The feeling amongst the VCCs is that the Western Cape Government (WCG) could assist with hosting both local and international roadshows, showcasing the potential of the Western Cape. These roadshows would need to be carefully planned to ensure that the correct investors and start-ups are aligned with each other. The WCG could also assist by facilitating access to nomad (skilled) visas. These visas would allow highly qualified and skilled international software developers and business managers to live and work in the Western Cape, which would help build the local VC landscape. Stakeholders acknowledged the input of the WCG and Wesgro in particular and lauded the provincial government for its holistic approach to supporting the VC industry.

A stakeholder indicated that it is not possible to differentiate between the VC industry and the broader economy within which it operates. The two are interlinked. Although the start-ups are disruptors and their revenue is not necessarily linked to regional or global economic growth, the supporting ecosystem is. Economic growth would ensure more funds available for investment in start-ups. Higher economic growth would also improve the chances of successful exits. So, the VC industry would assist in growing the economy and a growing economy would advance the VC industry.

While the world is becoming increasingly digital with meetings conducted on virtual platforms, there is still a need for investors to have face-to-face meetings with firms and to view their premises. Air access and ease of location is therefore important, and having direct flights and being in the same time zone are all factors that impact investors, VCCs and entrepreneurs. Organisations like Wesgro could assist by investigating additional direct air routes into Cape Town.

10.2 Investors

Investors are separated into private and public sector institutions. The investors interviewed were the Public Investment Corporation (PIC), the SA SME fund, Nedbank and NEXT176.

10.2.1 Private Sector Institutions

The institutions interviewed ranged from a fund-of-funds to corporate VC companies (CVCs).

The CVC indicated that one of the main differences to a VC Fund is that the CVC tended to provide debt funding rather than equity, although it would take on minority equity in certain

instances. The CVC did not have a separate fund but rather its investments were all on the parent company balance sheet. There was no specific sector as part of its investment mandate, but scalable, digital and disruptive technology was its focus. It also focussed on post-revenue companies because it needed to protect the business integrity of its investment choice. It might relax its investment focus to seed stage if the start-up was identified as strategically critical but, in this instance, would prefer to co-fund so that others could complement its due diligence. At the pre-seed and seed stage, investments were generally too small and the "churn", or failure rate, was too high. It is at this stage that there should be more support, ensuring effective incubation programmes and processes that help start-ups through the proto-type stage to landing first client and beyond. There is a gap between identification of talent and nurturing it through to series-A, and a focus on this gap would help the start-up industry.

Another difference to a VC fund is the timing of the exit. While positive returns were still important, the CVC was its own investor, reporting requirements were less onerous and there was less pressure to exit an investment within a specific time frame. While the investment mandate was to achieve good returns, it included to strategically assess whether the product offered by the start-up could be incorporated within the institution's operating network or that of the institution's clients. The mandate was to fund start-ups throughout Africa but, practically, the investments were concentrated in South Africa.

The SA SME fund is a fund-of-funds that has raised R1.4bn for its first fund. This was invested in nine VC funds, two private equity funds and five debt intermediaries. One of the VC funds is the University Technology Fund, a university IP commercialisation fund, that works to invest in and commercialise valuable South African IP originating from universities.

The SA SME fund is now raising capital for a second fund, which mandate would be more conservative than the first because it is trying to attract pension funds. This would be the first time that pension funds invest in VC in South Africa. Most of the fund, at 85%, would be invested in Series A and B businesses and the rest in a seed fund-of-funds. The seed fund-of-funds would include a substantial contribution from government. The time horizon is ten to twelve years to achieve a return on investment, there would be no fees (these are funded by USAID and other revenue sources) and at least R90m would operate as a first loss portion. Its attempts at raising capital from foreign investors have been unsuccessful and it has given up on this source of funds.

One of the biggest challenges facing the industry is track record. The VC industry is young and there a few VC investors who have made real money. A lack of track record is inhibiting

private sector investment, who view half the decision to invest as being about returns and the other half about experience. However, progress is being made and the private sector is becoming more interested in VC.

The biggest challenge to the VC industry according to investors are the exchange controls and rigid IP laws. Complementing this is the ability to raise finance and then a lack of skills and understanding of the industry. Stakeholders indicated that there is insufficient support to start-ups and believed that the WCG could offer more support at the incubator and post incubator level. Many incubators were seen as glorified shared desk-space locations with little business support. Incubator businesses were typically supported for six weeks but they needed support for longer than that. This was also an area where angel investors performed a vital role.

Some government departments are progressive and supportive of the VC industry, but most lack an understanding of the industry and it would be more productive for them to invest in a fund-of-funds rather than operate a parallel investment vehicle themselves. They can then offer non-financial support to the industry.

10.2.2 Public Sector Institutions

A single public sector institution was interviewed. It is the biggest asset manager on the continent but has only recently begun investing in VC.

Its mandate is to invest in unlisted South African entities and to focus on Series A to C rounds, with some investment in pre-Series A if the technology is proven. While the institution is sector agnostic (meaning it would invest in any sector if necessary), its preference is for agriculture, mining, manufacturing, financial services and financial inclusion. It does not invest in gambling, ammunition or in sin industries.

Its VC unit is still young and was only launched in 2018. While it only has two clients, momentum has been building over the last eighteen months. They invest directly in firms and also in VC intermediaries (VCCs). Their investment mandate for firms is in the R15m/R20m to R100m range, while their investment in VC intermediaries ranges from R50m to R150m.

The public sector institution admits that its onerous supply chain and due diligence processes do not fit well with the more nimble requirements of a VC industry, hence their willingness to work with private sector funds. This is a good example of a public-private sector partnership, where they support the private sector with funds, rather than competing against them. They therefore invest in intermediaries as limited partners. This means that they are not involved in

the administration of the VC fund, but would only invest in the fund if it aligns with their mandate.

It is their experience that the industry is very fragmented. Entrepreneurs would apply to them for funding but without knowing the type of funding or the stage of their businesses. Government departments are also disparate and do not work together in allocating funds. They therefore advocate the development of a database, housed by one of the industry associations, containing the details of VC funds, the stage and type of funding provided, the details of entrepreneurs and government assistance, and those who can provide advice.

10.3 Industry Experts

Like the VCCs, the biggest issue raised by industry experts is that international investors are wary of South Africa (and these foreign investors supposedly make up over 90% of the investors into technology in South Africa). There is a trust deficit in the South African government, which could be addressed, as a start, by relaxing exchange control and IP regulations and by introducing nomad visas. While the introduction of nomad visas could be a first, easier step, it is the exchange control and IP regulations that are the biggest barriers to investment. They would need to be addressed jointly, however, because removing the one without the other would not make sense. 'A wall of international investment could be unleashed' if these barriers are removed.

Currently South African firms are finding innovative, but costly, ways of working around these barriers to access international investors. These include migrating offshore. The start-up maintains its South African offices as a subsidiary of the offshore company, but all new IP and strategic decisions are made offshore. Most of the revenue is generated offshore and the exit occurs there as well. The benefit of this process is that an entrepreneur can legally work around the current regulatory barriers, but for most start-ups this is an expensive and frustrating process. It also means that raising VC funding in South Africa is expensive in comparison to many other countries where exchange controls are less rigid and onerous.

IP is important because it is the commercial asset that can be sold by the start-up. Currently, even if exchange controls were scrapped, capital gains tax (CGT) applies to the sale of IP and this can be prohibitive for a founder. For example, if local IP is "sold" to an offshore entity (set up by the founder), it has to be valued at a genuine market-related amount, which could be millions of Rand. The offshore entity does not actually pay the founder anything, but the founder is liable for CGT, which will be large because the base cost will in most cases be zero.

S12J helped to incentive the VC industry locally, but it was very restrictively applied. This is in contrast to incentive programmes in places like the United Kingdom, where if a start-up qualifies for the programme, anyone can invest and both investors and start-ups reap the benefits of the programme.

The next big issue in the industry is that of exits. Investors struggle to sell their investments because of a lack of investment by private equity firms, and initial public offerings (IPOs) are simply not a viable option for exit in this country (as they may be for other jurisdictions like USA and Europe). VCC funds therefore have to hold onto their investments for longer than ideal, which ties up funds that could be reinvested into the industry.

The WCG assists the industry with its good governance of the province. As long as the province's infrastructure is maintained and it is seen as the premier province in South Africa, then it will continue to attract entrepreneurs. The WCG could provide additional assistance by lobbying government on the issues of exchange controls, IP regulations and nomad visas. It could also establish a one-stop shop for international investors, educating them on the unique South African regulatory environment and its solutions. This would provide credibility to the current solutions of creating offshore companies, thereby placating international investor fears and potentially attracting more investment. This one-stop shop could then showcase the benefits of the Western Cape and put investors in touch with VC firms and entrepreneurs.

10.4 Associations

Three associations were interviewed. These are SAVCA, The Startup Act Movement and ABAN.

The big issues, in order of impact, are IP, exchange controls, pension fund investments and skilled visas. The regulatory barriers are seen by industry as encouraging businesses to remain local and not to expand globally, which should be the essence of a start-up (as defined by the VC industry). Markets, at least for scalable start-ups, essentially are global and not local, and with these restrictive laws businesses are being incentivised to leave rather than to expand within South Africa.

If pension funds start investing into a fund-of-funds this would bring welcome liquidity into the industry. The impact, however, would not be as great as the relaxation of IP regulations and exchange controls. The skilled visa issue is small but remains a hindrance and incurs unnecessary costs by having to fly international skilled personnel in and out of the country every few months.

If these barriers are removed then South Africa could have a VC industry as big as Chile or Argentina or even half as big as Israel relative to its GDP. However, South Africa is already behind the rest of Africa in terms of a Startup Act. The Startup Act movement was established seven years ago but it is only in the last three years that it has started making any progress. Members of the movement actively speak with the National Treasury and SARB officials to address issues facing the industry.

Unfortunately trust issues are hampering progress and some officials do not have the skills to understand the VC industry or to adequately engage with the movement. Government officials distrust the VC industry and believe it is trying to move profit offshore. They do not understand that by removing barriers and by providing incentives, they will increase overall turnover, thereby increasing tax revenues and employment (a similar sentiment was shared by an entrepreneur who engaged with SARB regarding the negative impact of exchange controls). SARB is slowly starting to listen and has asked the industry to assist with drafting its latest circular, rather than just comment on it. If the WCG wants to be involved in the VC industry it should work with the VC industry rather than in isolation. The WCG can facilitate and steer conversations between industry and the national government.

Understanding of the VC industry by government and its relevant officials is key. There should be an understanding that VC funds are not focused on, or even beneficial for, job creation and that start-ups in the VC sense are not your average SMME. Township entrepreneurs are primarily state funded and, unless they fit the VC target of scalable disruptor, or government provides first-loss funding, these entrepreneurs will not attract VC investment. Not all start-ups are “investable” and if they are genuinely scalable, they have to go global as South Africa is not big enough.

Most Western Cape VC Funds have sufficient deals. It is funding that is an issue. This could change if pension funds would invest in the industry, but they would only do so if the funds are de-risked. They also need the VC industry to establish a track record. A means of de-risking the industry is to encourage the pension funds to invest in funds-of-funds. Funds-of-funds such as Fireball and the SA SME fund, have been major catalysts for the VC industry and more must be done to encourage investing in them. Investing in the funds-of-funds rather than directly in VC funds might be more attractive for the pension funds because they are more liquid and certainly carry less risk because of the diversity of investment. The VC funds themselves would also welcome the pension fund industry investing in funds-of-funds because the reporting structures for pension funds are much more onerous than funds-of-funds. The VC funds would consequently only need to report to the fund-of-funds, rather than many disparate pension funds each with their own requirements.

The Western Cape ecosystem is working well and if the WCG is to assist the industry it should assist the full ecosystem. It should consider creating clusters and bringing universities, an important part of the ecosystem, on board to plan for them. The WCG could then further assist by marketing the clusters and hosting focussed roadshows. These roadshows must be carefully planned, however, and should not be a shot-gun approach. The correct mix of entrepreneurs and fund managers must be present to meet the relevant international investors.

The WCG could consider setting up a hub in an offshore jurisdiction, such as Amsterdam. This would be attractive for WC firms who are considering leaving the country because of the exchange control and IP laws. While this might be viewed as encouraging firms to leave the country, they would retain links with South Africa. Conditions could be attached to their settlement in such an offshore hub, such as outsourcing aspects of their business processes to South Africa or even having to repatriate a portion of their profits upon exit. This would at least have some benefit for South Africa rather than losing the full business.

A One Stop Shop would facilitate investment in the VC industry. Such a VC unit or facility could offer a concierge service and guide international investors through the South African VC landscape. This service could even be expanded to provide firms leaving the country with a soft landing offshore, such as settling in an offshore hub. This would encourage firms to retain ties with South Africa.

Some issues specifically facing the associations is that they do not fully represent the industry. Data collection is hence problematic.

Angel investors are a category of VC investors that are often underreported. Some are members of angel networks, but not necessarily a member of any formal industry association. They use strong personal networks and word of mouth to source deals, and often know the founder of the start-up or work closely with that person, before they invest in them. For this reason, angel deals often happen at pre-seed or seed stage and go unreported. They are typically in the R20 000 to R200 000 range and are in the form of debt that needs to be repaid.

Many angels are single investors but there are opportunities to co-invest. In some cases they even operate in syndicates. In whatever form, investments by angels are at a very risky stage in an already risky asset class. Many small investments can be difficult to manage and require the same amount of work or due diligence as later stage investment for more funding. Accordingly, it follows that the incentives that angels need to increase their investments are directly linked to the challenges they face when investing; navigating difficult regulatory

environments, securing investment incentives or tax breaks in countries that offer none, and managing negative macroeconomic factors. A mature ecosystem, access to quality deals and high-potential innovators, and strong macroeconomic conditions are some of the key requirements for angels to become more active.

10.5 Entrepreneurs

The entrepreneurs are separated into those who operate from South Africa and those who have left the country. This has been done to provide as diverse an opinion as possible.

10.5.1 South Africa Based Entrepreneurs

Local entrepreneurs struggle to find sufficient capital for business expansion, particularly if they are looking at expanding globally. The local cheque size is too small and too expensive. They are therefore forced to look at international funders. The dynamic with international funders is different to local VCC firms in that the international funders are looking for entrepreneurs to fund, whereas in South Africa there are insufficient funds and it is the entrepreneurs who are looking for investors.

Investing in SA decreases the likely number of exits because the buyer pool is smaller. As one goes through the funding process, the rounds get larger so the investment becomes greater and the number of potential exits decreases. However, the VC industry needs as many exits as possible so that there is more capital in the VC landscape.

Foreign investors in technology, particularly from the USA, often understand the tech industry better than local investors because the foreign investor has a history of tech development and they represent a second generation of tech developers and investors. Locally, however, this is not the case where many VC investors are conservative and do not understand many of the start-up technologies. International investors also tend to have large client bases and/or strong embedded networks, and so offer extensive leverage for an SA start-up looking to go global.

To expand globally and to secure international funding, offshore companies with new IP need to be set up. This is costly. Even if the exchange control and IP regulations do not frighten potential overseas investors away, the time taken for the authorities to assess each deal is too long. This causes hesitancy amongst investors and while almost scuppering one deal, it resulted in another one being lost because the international investor walked away. After losing its first cohort of investors, this company set up operations in Mauritius and moved its data science and software engineering divisions offshore, and was able to secure funding as well

as an exit. At the height of its operations the company employed 200 people in Cape Town. It now no longer has a local presence but employs 400 people worldwide.

The feeling amongst local entrepreneurs is that local regulations force South Africans into building local firms, rather than global ones. SARB is seen as protectionist and contributing to an anti-competitive local VC environment. This requires radical re-thinking by officials as they obsess over retaining capital in SA, but as a result of their actions, it never arrives in the country in the first place.

The Mauritius financial regime is suitable for offshore transactions and it is extremely easy to conduct business there. There are no IP or exchange control issues. Rwanda or Tanzania were also considered as alternatives to Mauritius and both were considered as better jurisdictions than South Africa. A low tax jurisdiction is not always beneficial as this may lead to perceptions of dodgy tax havens, but lower CGT and tax incentives for investors does help.

A VC unit within the WCG would add credibility to the industry. It could be used to walk potential investors through the landscape, as well as to market the region, educate, provide information, collect data and provide alternatives to both investors and start-ups. This would also reduce the cost to local entrepreneurs if the VC unit could advise on how to set up offshore structures, rather than each one having to pay lawyers to understand and advise on the regulatory environment.

The Western Cape is a good location for international firms to outsource some of their business processes. There is a risk though of external IP being deemed South African if software is developed here, so this is frightening off international investors. The Western Cape is very attractive to founders: there are very good service providers (such as lawyers and accountants) who are cheap compared to international rates, there are good schools, infrastructure is generally good and the weather is appealing. It is difficult to find a similar location elsewhere on the continent.

10.5.2 UK Based Entrepreneurs

One entrepreneur is developing a mobile app in a niche game-viewing industry. The entrepreneur left South Africa before starting the business, but decided to do so because accessing international finance is cheaper than local finance. The entrepreneur would have had to give away 20% equity in his company for R1m in local funding, whereas in the UK this same equity transfer was done for £1m. The local start-up finance would have been too little for his business to go global.

Supporting this decision to leave was the unstable outlook for South Africa and the potential cost to leave after his business was developed (and assuming it became successful). The IP would have had to remain in South Africa and with the tight exchange controls, the founder would not have been able to extract his funds. Furthermore, South Africa has one of the highest tax regimes in the world. Selling his company and starting overseas at a future date would have triggered a large CGT event and would not have made the move worthwhile, effectively trapping the business and him in SA. This scenario frightens off international investors.

The UK provides continued practical and financial support. This includes the Enterprise Investment Scheme (EIS – which provides tax breaks for both tech companies and investors) and incentives such as claiming back one third of research and development costs. This has provided an additional capital injection to the entrepreneur. It has been four years since he migrated his business to the UK and the start-up is not yet at breakeven, so it needs all the support it can get.

It is currently employing twelve people, plus interns.

11 Appendix C: Skilled and Nomad Visas

One of the more frequently mentioned barriers by stakeholders is the difficulty in obtaining skilled or nomad visas and the onerous conditions associated with them. Skilled visas are marginally different from nomad visas.

A skilled visa program is typically designed by a country's government to attract skilled workers from around the world to fill specific labour market needs. The specific details of skilled visa programs can vary widely between countries, but there are some common elements that are often found in these programs.

1. Governments usually identify specific occupations that are in high demand. These lists often include professions where there is a shortage of skilled workers.

2. Skilled visa programs have eligibility criteria that applicants must meet. This may include educational qualifications, work experience, language proficiency, and other relevant skills.

3. Many countries use a points-based system to assess the eligibility of skilled visa applicants. Points are awarded based on factors such as age, education, work experience, language proficiency, and sometimes additional criteria like job offers or ties to the country.

4. Applicants may be required to submit an Expression of Interest, expressing an interest in migrating and providing information about their skills and background. Some countries use this as a preliminary step before allowing applicants to submit a formal visa application.

5. Based on the points system and other criteria, eligible candidates may receive an Invitation to Apply for a visa. This is the formal invitation to submit a visa application.

6. Applicants who receive an Invitation to Apply can then submit a formal visa application. This involves providing detailed documentation, undergoing health and character assessments, and paying relevant fees.

7. If the visa application is successful, the applicant is granted a skilled visa, allowing them to live and work in the country for a specified period. Some visas may have pathways to permanent residency or citizenship.

8. In some cases, skilled visa programs may require applicants to secure a job offer from a local employer or have sponsorship from an eligible entity in the host country.

Nomad visas, also known as digital nomad visas or remote work visas, are designed to accommodate individuals who work remotely and wish to live in a country temporarily. These visas have gained popularity as more people adopt flexible work arrangements and choose to work from different locations around the world. The specific details of nomad visas can vary between countries, but there are some general features:

1. Nomad visas typically have eligibility criteria that applicants must meet. These criteria may include having a steady income from remote work, proof of employment, health insurance coverage and a clean criminal record.

2. Applicants are generally required to demonstrate that they work for a foreign employer or that they are self-employed and can sustain themselves financially while residing in the host country.

3. Nomad visas often involve a straightforward application process. Applicants may need to submit documentation such as proof of employment, income statements, a valid passport and other required forms.

4. The duration of nomad visas varies by country. Some visas are issued for a few months, while others may allow stays of a year or more. Extensions or renewals might be possible in some cases.

5. Nomad visas typically allow holders to live and work from various locations within the host country, providing flexibility to explore different regions.

6. Some countries may require applicants to have health insurance coverage for the duration of their stay. Others may offer a combination of health insurance and other benefits as part of the visa package.

7. Nomad visa programs may offer additional services, such as co-working spaces, networking events, or other resources to support remote workers settling in the country.

8. Nomads are often expected to comply with tax regulations in their home country and may need to address any tax implications associated with their temporary residence in the host country.

12 Appendix D: UK VC Unit

The Venture Capital Unit in the United Kingdom falls under the Department for Business and Trade (DBT). It provides a dedicated, concierge style support for high value (£100m+) investments through the Office for Investment (OfI). This unit prioritises projects that have the greatest impact on the UK economy and aims to improve business confidence in the UK as an investment destination for high value, strategic investments.

With a wide network of industry experts and leaders, DBT and the Venture Capital Unit:

- Introduce international institutional investors, such as pension funds, sovereign wealth funds, and asset managers, to capital projects that are seeking equity investment – giving quick access to experts to take their interest forward.
- Provide VC funds a landing point and make introductions to British start-ups that are fund-raising.
- Provide support after a business has invested in the UK – providing account managers to assist with expansion and where necessary, resolve investment environment issues.
- Support invested companies to export, including through a dedicated export credit agency, UK Export Finance.
- Navigate the investment environment by providing specialist advice directly to investors about the business environment in the UK, including tax, access to finance, banking, research and development (R&D), visas and skills.
- Identify potential sites for business expansion, especially where there are large or complex site requirements.
- Provide financial modelling to consider quality, risk and profit after tax.
- Enable an understanding of and access to the UK's broad spectrum of financial and tax incentives available to investors, including through the Free Ports programme.
- Provide bespoke support to international entrepreneurs through a network of mentors, helping make a commercial success of early-stage companies.
- Locate a service provider or business partner to suit the international investors' specialist requirements, using the UK's Investment Support Directory.

The Venture Capital Unit works with international investors and connects them with vetted UK companies. The UK government aids overseas investors to establish UK based venture funds and supports them with introductions to UK based Limited Partners and receptive corporates.

The Venture Capital Unit collaborates with international and UK VC funds, Corporate Venture Capital, innovation hubs, university spin-outs, incubators and accelerators, to identify and review high growth potential companies that are seeking venture capital investment. If the conditions are met, the unit works directly in support of the company to provide introductions to international investors and help develop relationships. It produces and shares sector specific and investor-only “Lookbooks”, which are curated portfolios of some of the most innovative and exciting UK companies seeking funding in a particular sector.

The Unit organises invitation-only, sector-specific showcase events, where international VC funds are introduced to the UK scale-up eco-system and are provided opportunities for presentations from leading UK companies which are pursuing funding.

As part of the DBT, businesses looking to move to the UK are assisted with:

- Establishing a UK business base.
- Getting support to move a tech business to the UK.
- Registering a company in the UK.
- Opening a UK bank account.
- Accessing finance.
- R&D support.
- UK visas and migration.
- Hiring skilled workers.
- UK tax and incentives.
- Checking if an acquisition requires government approval.
- Finding a UK specialist - the UK Investment Support Directory is a collection of companies that have skills and experience in helping overseas businesses set up or expand in the UK.