

INTELLECAP & VIKTORIA VENTURES

AN EAST AFRICA GUIDE: ANGEL INVESTING DURING A TIME OF CRISIS

WRITTEN BY

MERCY MANGENI

Intellectap

JASON MUSYOKA

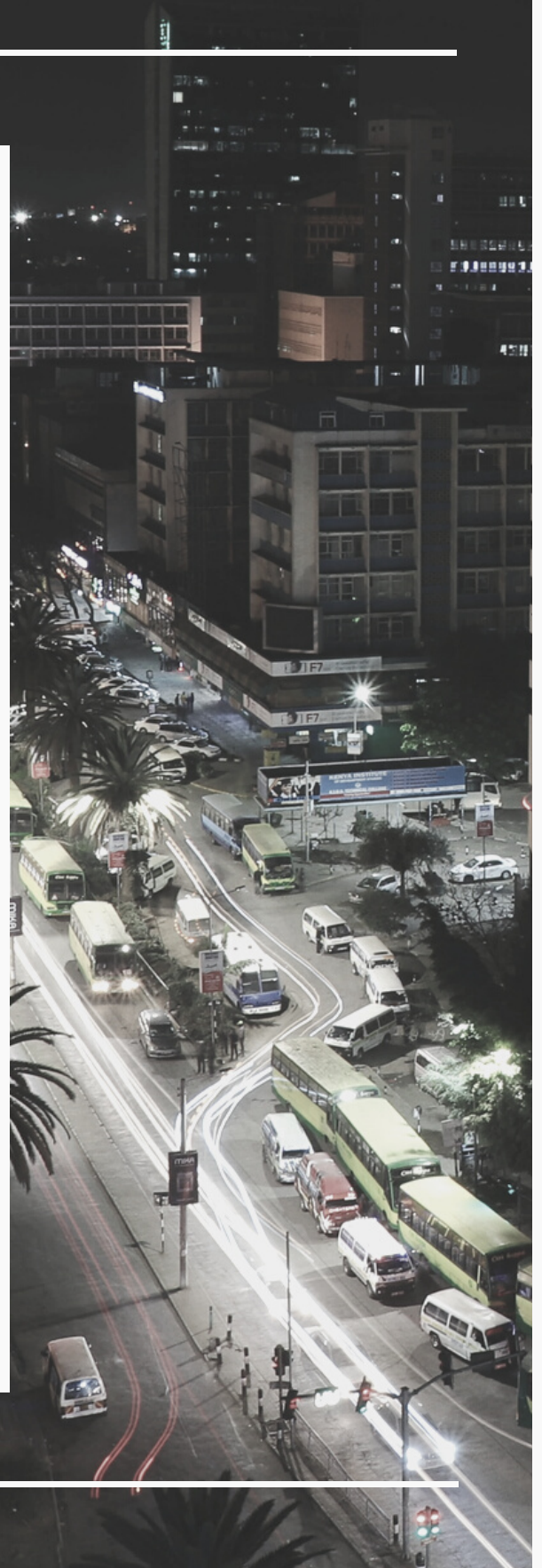
Viktorija Ventures

ARIELLE MOLINO

Intellectap

MAY 2020

Cover Photo by Yonko Kilasi

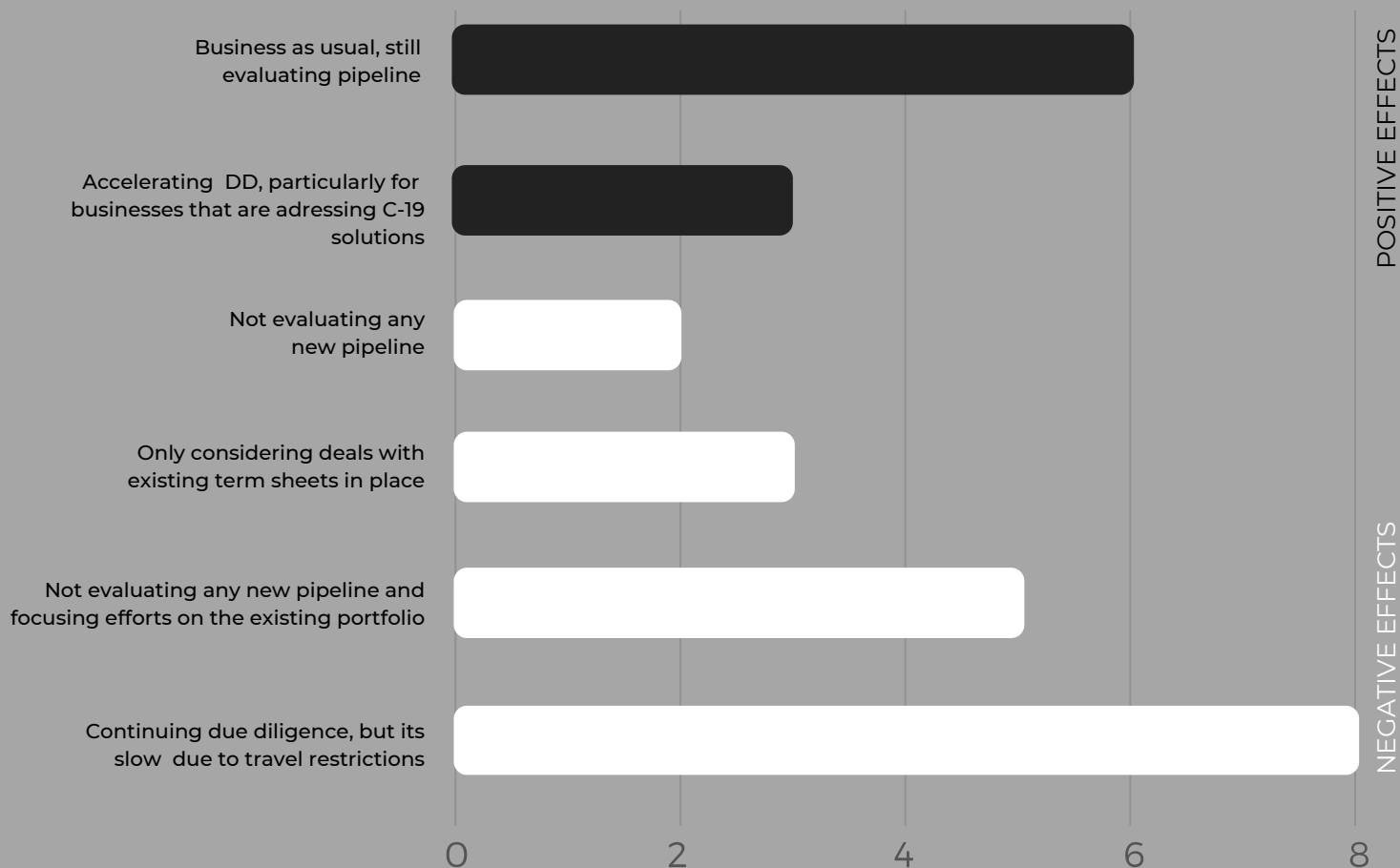


THE CURRENT SITUATION

There has been a lot of focus on how entrepreneurs can survive the Covid-19 pandemic: [InVestia Africa](#) had a webinar on how to navigate this period financially; [Idris Bello](#) has written a great article on survival tips for entrepreneurs; [GS Capital](#) had a webinar on start-up management; and 10X Entrepreneur has launched a [Leadership Field Guide](#) to help entrepreneurs navigate the Covid-19 crisis, just to mention a few.

Let's be honest here: Entrepreneurs will need financing to get through this economic downturn. However, most of the investors that we've asked said that due diligence has been slowed either due to travel restrictions, their focus on supporting their existing portfolio of entrepreneurs, or those which already had term sheets in place. So where is this financing going to come from?

COVID-19'S EFFECT ON DUE DILIGENCE FOR INVESTORS IN EMERGING MARKETS



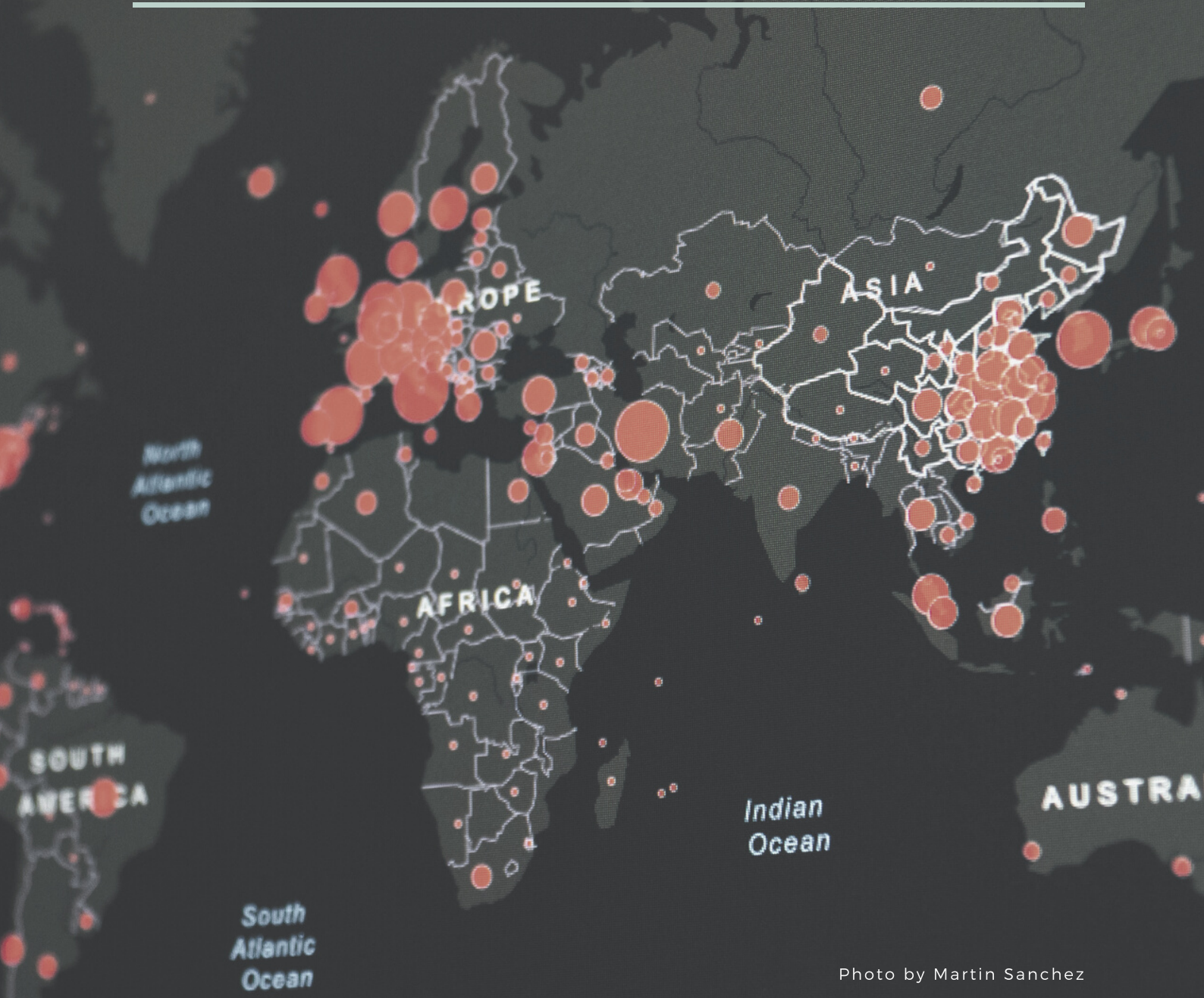


Photo by Martin Sanchez

Our perspective for this article is the investor side of the conversation. What are angel investors thinking about during this global crisis: Is now the perfect opportunity to invest? Is it a time to hold on to your cash and hide it under the bed? It can make sense to halt making any investments all together – and focus on supporting the existing portfolio – given that most angels invest out of pocket. However, this could be an uncommon opportunity to make investments which could generate very good returns, as described in [Jason Calacanis's excellent recent article](#).

While keeping safe and holding back might seem like the obvious thing to do, some level of aggressiveness might be beneficial, especially now when there's a real dearth in financing in the market. We're not advocating for carelessness, but we know entrepreneurs genuinely need financing right now. So we've put together this guide for angel investing in East Africa during a time of crisis, to help provide some considerations and guidance for your investment thesis. As Jason Calacanis says, "Fortunes are made in the down market and collected in the upmarket. Let's get to work."

1. DIVERSIFY YOUR PORTFOLIO

Diversifying your portfolio means that investments are spread out, such that the exposure to risk is reduced. Although diversification does not guarantee against losses, it ensures that risks are minimized and that financial returns are optimally maximized.

Here are some diversification tactics that you can consider:

DIVERSIFY YOUR SECTORS

Unlike commercial investment funds, angel investors are at an advantage because their capital is not limited to specific sectors and they can invest in anything where they see potential returns. During times of crisis, diversifying the sectors you invest in should be increased to ensure that you are covered in case any sectors may not be as lucrative as they previously were. For instance, during the current Covid-19 crisis, some healthcare companies, or technology and technology-enabled startups are thriving due to increased demand of their products or their nature of limited human-to-human interactions. While investments in healthcare companies may be booming now, other sectors requiring large in-person sales forces, distribution networks, or major production lines may be seriously hurting right now. The below infographic adopted from [Dcode](#), summarizes the sectors that are thriving and the potential losers in the crisis. Although it was developed from an Egyptian context, we can draw clear parallels for the East African market.

SECTORAL WINNERS AND LOSERS DURING COVID-19 IN EGYPT



DIVERSIFY YOUR FINANCIAL INSTRUMENTS

Most angel investors in East Africa tend towards equity investments, as the rights given to an equity investor are more lucrative in the early stages. However, entrepreneurs need more than just equity options – particularly during times of crisis. You can use both equity and debt instruments with flexible terms to invest.

Debt instruments ensure a quicker exit within a finite timeline, provided that the company is able to pay off the loan monthly or quarterly. Many young companies can't get financing from banks due to lack of collateral, and have few other options. Especially now during the pandemic, many companies need bridge financing to get them through just the next 6 months, and a simple loan with flexible repayment terms could be just what they're looking for.

If you want to explore more flexible financing instruments, you can consider convertible notes or venture debt, which can give you market interest rate returns (approximately 12% to 14%). You can negotiate similar interest rates (or lower depending on the stage of the company,) which convert to equity shares after a predetermined timeline, or when the company raises additional capital.

WHY

As an investor, you don't want all of your capital tied up for long holding periods because you might need some liquidity in the near future, particularly during these uncertain times. For instance, you are considering a company that can pay back at least the interest (not necessarily the principal) two months after you've invested. Therefore, you are looking for a company that has healthy cash flows, or is EBITDA positive, or is a company whose business is on-lending. Such companies are generally able to service debt instruments immediately because they have consistent cash coming into the business.

WHAT IT MEANS

You have invested about USD 100,000 in two companies in equal halves: one in equity, with a stake of 25%, and the other in debt, which has terms of quarterly interest repayments of 12% on the dollar. You start receiving your interest payment in about four months since your investment, whilst helping the company survive the crisis. How does that make you feel?

DIVERSIFY YOUR GEOGRAPHIC FOCUS

In these times of crisis, the degree and extent to which various locations are affected also varies. Diversifying your investment portfolios across different geographic regions and locations (cities/counties/countries), thus becomes important to reduce overall risk and improve returns. To help you identify promising companies outside of your locale, you can connect with accelerator and incubator spaces in various locations to ensure a rich pipeline of potential investee companies.

WHY

Don't put all your eggs in one basket. Consider this: just before the pandemic you've invested all of your angel investing money of about USD \$20,000 (remember, this is just a small percentage of your total net worth, reference [Jason's article](#) once again) into an energy access company that relies heavily on a door-to-door sales distribution network. Covid-19 hit, and the company is struggling to stay afloat due to social distancing and curfew hours. You've lost your investment with little hope to recover any of it.

WHAT IT MEANS

Instead, you used the same amount of money, but invested smaller amounts of about USD \$5,000 in each of the following: the aforementioned energy company, a health tech company, an agro processing company, and an alternative charcoal briquetting company. The energy company and briquetting companies are severely struggling, while the agro processing company is holding its own. But the health tech company is booming since it has started manufacturing masks and hand sanitizer and soon expects to be supplying Rwanda and South Sudan with these products. By diversifying your portfolio, you still stand to make your money back with a return, despite some of the portfolio companies not performing well. How do you feel?

DIVERSIFY THE STAGES OF YOUR COMPANIES

In this crisis, you should consider diversifying your investments into companies that are both early stage and those that are at a more advanced stage, in comparison to what would otherwise be considered. This will help you cover your risks in case certain more risky early stage companies do not perform as expected during the times of crisis.

WHY

Again, don't put all your eggs in one basket! Consider investing in early stage companies as you usually do, but blend this with investments into growth stage companies. You can achieve this through providing bridge financing for a company that has already raised some equity financing previously and the investor is overexposed.

WHAT IT MEANS

You have already invested USD \$50,000 in an early stage company and are now identifying another company in which to put your other USD \$50,000. There's a company whose equity investor had already previously invested USD \$300,000 for a 40% stake and cannot invest any further. The opportunity for you here is that you provide the bridge financing for this company for the short term and you gain comfort from the investment experience of the larger fund and its incentive for the investee company to succeed. For this to seamlessly work, you would have to build a healthy relationship with the firm, which invested prior. You are able to focus your available energies on the earlier stage company, while relying on the expertise of the investment firm to guide the later stage company.



Photo by Pietro Mattia

2. BET ON THE JOCKEY, NOT ON THE HORSE

In a time of crisis, it is paramount that you look for a team and leader that is not only visionary, but is also agile enough to be flexible and adapt to the current market needs and situations. Most companies that are staying afloat in these times of Covid-19 are companies that have been able to pivot and redesign their businesses to fit the current market needs and work within the confines of what the market requires. This is not a skill that is taught in a business school, but acquired over time through industry experience, and through having an entrepreneurial nose for business opportunities. Investing in an entrepreneur who is able to identify a true customer need and solve a real problem will always be paramount to your success as an investor.

WHY

Often, business mirrors biology. As Darwin said, those who survive “are not the strongest or the most intelligent, but the most adaptable to change.”

WHAT IT MEANS

You invested in an agriculture aggregating company that distributes agriculture products to produce vendors. Covid-19 hit and the produce shops have been closed in order to minimize the spread of the virus and those that are open are not making enough money to cover their costs, as most of their customers are self-quarantined at home. The promoter decided to partner with an e-commerce platform that offers door-to-door food delivery supplies to individual customers, who can purchase the produce directly at affordable prices. They've actually increased margins since they are now selling directly and are able to keep the business afloat. As an investor during an economic downturn, how do you feel?

3. BE SELECTIVE WITH WHERE AND HOW YOU INVEST YOUR MONEY

Startup commercial potential will need a re-analysis. The Covid-19-induced recession will result in a shrinkage or slow-down in the overall economy, not to mention the middle class. Spending patterns will be influenced for the foreseeable future, supply chains will be indefinitely impacted, savings will be depleted, and overall purchasing power significantly reduced. Selecting an investment during these times could make or break your investment portfolio. Therefore, assess potential investee companies more keenly than you might have done before. Consider a few of these factors as you assess:

LOOK AT THE BURN RATE

As a rule of thumb, avoid investing in companies that have had high burn rates pre-crisis. This is because a high burn rate would imply that the company requires a high supply of cash on-hand to meet its expenses, which subsequently implies that the company may need to raise multiple rounds of financing within a short period to cover its costs. Burn rates are relative depending on the sector you're looking at, so be sure to compare companies in similar sectors to get a feel for what an average burn rate should be.

WHY

With a limited supply of capital in the market, it will become harder for companies to raise multiple rounds of financing as the economic crisis deepens. When a company's expenditures are high, the chances of the company raising multiple rounds of financing to ensure survival is low.

WHAT IT MEANS

You have invested USD \$20,000 in a startup whose burn rate is \$5,000 per month, with the objective of bailing them out through this recession. In a period of four months, your investment is depleted and the company needs to raise another round of financing, yet the crisis is far from over and will take another say 6 to 8 months before things are back to normal. You'll either need to finance (or help them raise financing) of another \$40,000, or cut your losses and the company goes belly up. What would you do?

BE CONSCIOUS OF THE CURRENCY YOU'RE INVESTING WITH

If you have an option on whether to invest with local or international currencies, consider why you are investing and what the investment will be used for. For instance, if you want to invest in USD, which you think will hedge you against foreign currency risk, the downside is that the entrepreneur is left exposed to currency fluctuations. However, if the investment will be used to purchase machinery from other geographies, investments in a more universal currency might be preferable. However, if you are a local angel investor and investing in a local company, then investing in local currency may be a good fit for you.

WHY

The dollar may go further for the investor, but not for the entrepreneur, who has to make up lost ground to recover from any currency fluctuation.

WHAT IT MEANS

Let's say you invest USD \$10,000 in debt into a company. At the time of investment, the Kenyan Shilling is at 100. Because you agreed on flexible repayment terms, the entrepreneur has four months until he needs to start paying back the debt. By the time the entrepreneur begins paying back his loan, the Shilling is up to 106. When the entrepreneur converts back to USD, he now owes you an additional KES 60,000 (roughly USD \$600) just on the principal amount to make up for the currency loss. Does that seem fair?

CONSIDER THE COMPANY'S PERFORMANCE PRE-CRISIS

Startups that struggled with high unit economics and low revenues pre-crisis are not suddenly going to turn around and soar (using the same business model). If they were not optimised for growth before, mostly likely they will not have a chance to do so now. Be sure to clearly understand how different revenue streams were performing pre-crisis before you make an investment decision. Especially now, don't waste time and money piloting new revenue streams or investing in new ones. In a Covid-19 free world, some entrepreneurs will raise investment to help them establish product-market fit. During this crisis, you may want to focus on companies that have already established their footing in the market.

WHY

Focus on what's working. Since we don't know how long the crisis will last, and some companies may not have a good runway to weather this storm, give preference for investing in companies that have positive unit economics. The companies need not be profitable initially, but the path to profitability must be demonstrated.

WHAT IT MEANS

You are considering investing into two healthcare companies. Company A is a healthcare company that produces and distributes maternity kits for women in rural areas. It was founded a year before the Covid-19 crisis and it took about nine months to test, pivot, and refine its business model. The company signed exclusive partnerships with four low cost hospitals in rural areas to be able to distribute their products through these hospitals. After the pandemic hit, and international supply chains disrupted, demand for these kits from local producers increased. Company B is a healthcare company that provides tele-medicine solutions. Company B was founded three months ago and were still in their pilot and testing phase when the pandemic hit. They quickly moved into the market, but their system has been very glitchy. Which company would you invest in?

4. DON'T BE A PREDATORY SHARK

Be sure to negotiate fair and reasonable terms with your investee companies, despite the temptation to undervalue companies caused by sharp declines of capital available and desperate entrepreneurs. Although it is prudent to expect higher returns for the higher risk that you are taking by investing during this pandemic, be careful not to value a company so low that it will be a detriment to the company's growth potential. Have an open and honest conversation with the entrepreneur about your returns expectation and the holding periods you expect from your investment, to ensure alignment. You should also consider the fundamental valuation drivers (i.e. a good team, positive cash flows, market validation, accessibility of follow-on capital, and path to profitability) of the company and whether these would survive the crisis, thereby ensuring that your investment is not lost.

WHY

It may be very tempting to take a huge stake in a company that's desperate for funds, but consider the long term impacts on the business. If valued too low, the investor may end up with a large controlling stake, which may reduce the founder's motivation and the perception of the company from other external investors and it may cause challenges in fundraising later on.

WHAT IT MEANS

Let's say your briquetting entrepreneur wanted some investment for cash flow to be able to offer his briquettes on credit to his clientele. Before you invested, the promoter gave 20% of the company to his rich uncle for helping to get the business off the ground. Now, desperate times call for desperate measures and for USD \$10,000, you've taken 50% of the company. After the pandemic is over, a commercial investor is ready to help him expand to neighboring countries, but his share has gone down to less than 15%. He is the one running the company day to day, but he has the least ownership. Very quickly, his incentives for ensuring the success of the company have depleted nearly entirely – he's not much better off than an employee now. What confidence do you have that he'll be putting the same level of effort he was when he was a majority stakeholder?

5. INVEST WITH OTHER ANGELS

During these times of crisis, co-investment is the way to go! As such, affiliating yourself to angel investor networks like Viktoria Angels or the Intellectap Impact Investment Network becomes paramount, in terms of both ensuring a network of angels evaluating similar deals thereby increasing the chances of co-investment, and ensuring sufficient pool of capital and expertise to help companies survive and thrive. When managed properly, co-investing has better potential to generate returns than investing alone.

WHY

You can reap the benefits of co-investments such as lower fees on due diligence, better risk management, increased market experience in evaluating deals, and faster capital deployment.

WHAT IT MEANS

Imagine you're evaluating a tech deal that you're really excited about, but your expertise is not in tech, so you're considering not investing. However an angel you've met on a network is a serial tech investor and agrees that this company has huge potential, but is looking for other angel investors to fill the round, so he's reached out to you. Does this make you reconsider the deal?



6. GET CREATIVE WITH DUE DILIGENCE

A major component of due diligence is the field visits, which help establish trust with promoters and reference check the information shared by the entrepreneurs on written documents. Since movements have now been restricted both internationally and even domestically, due diligence can no longer happen in the way it used to. So how do you as an angel investor establish that trust with the entrepreneur and validate the business numbers without conducting a field visit?

You can adopt technology platforms to speak to various stakeholders such as the management team, customers, and suppliers. You can conduct a virtual field visit, where the entrepreneur virtually provides you with a tour of their facilities, etc. Low cost strategies like collaborating with other partners such as local incubators, accelerators, and legal clinics can be also useful. These partners can conduct due diligence and provide a report based on the assessment performed. You can also talk to other angel investors who have evaluated the same company recently. Desk due diligence should continue without much difference, but ultimately, the decision to invest or not to invest – especially in the early stages of a company – often lies with your gut feeling on that company and the promoter.

WHY

It's incredibly important for you to fully evaluate a business as thoroughly as possible before investing. Just because you might not be able to do your site visits in person doesn't mean you should relax your due diligence standards.

WHAT IT MEANS

Technology makes this easier and cheaper than ever before with WhatsApp, Google Hangouts, Zoom, and Skype. You might have to spend a bit more time on the phone than you prefer, but it could save you some travel costs. If the entrepreneur isn't willing to arrange video calls for you with his suppliers, team, and show you the facility, then maybe he's not the right person to be managing your money right now.

7. PLAN TO PROVIDE MORE THAN JUST MONEY

More than just financial support – especially during a time of crisis – companies require strategic support on ways to save on costs, redesign and pivot business models, target new customer segments, manage cash flows, and stay afloat. Investing in a time of crisis may require more from you as an angel investor in supporting the business. You can contribute your skills, expertise, knowledge, and contacts to the business more than you would otherwise have done, to ensure that the company remains afloat in these turbulent times.

WHY

Money is only one half of the investment equation. If the investment is used inefficiently, you could lose your investment entirely. However, if you're able to help the promoter strategize, open doors, and hire key staff members you may well be able to take the business to a new level.

WHAT IT MEANS

You've invested in a company that collects, sorts and pelletizes single-use plastics, which are then sold to other plastic companies. Due to the pandemic, the company is implementing austerity measures to improve its cash flows and allow them to survive the crisis. Some of these measures include cutting down on electricity expenses as it accounts for over 20% of the companies costs. You sit on the board of directors of Kenya Power and are able to negotiate staggered electricity payment for the company. Due to your efforts, the company is able to save on some of its costs, hence surviving, and it looks like they'll come out of it better.

8. HAVE REALISTIC EXPECTATIONS ON EXITS

With this crisis, we expect that investment-holding periods may be longer than anticipated, which ties up the capital and returns for all investors – not just angels. As such, you may need to consider other exit avenues, while ensuring that they are aligned with the promoter's. This may include timeline and return expectations. You can explore strategic buy-outs from larger corporations as a way to exit the investment, or self-liquidating instruments.

WHY

Many Venture Capital and Private Equity firms, who can normally provide secondary buy-out exits, are focused on supporting their current portfolio companies through the pandemic, rather than investing in new ones. This therefore reduces the avenues of exits available to angels.

WHAT IT MEANS

If you want an exit, you'll need to work on creating it for yourself. Consider what options there might be, and actively work towards them. Don't leave the burden of raising investment solely on the promoter, who is anyway trying to manage the business, the staff, and the finances, among everything else.



IN CLOSING

During times of crisis, there is high uncertainty in the market, so the investment risk and risk of losing money is higher. However, there are companies that need angel investors' support to finance their working capital and generally remain afloat during this crisis. Your support will go a long way and while at it, you might as well benefit from the opportunity that the crisis presents. However, in as much as possible, seek the advice of investment bankers, who have vast experience in investing in times of crisis and have a bird's eye view on the current performing portfolios in the market.

The views expressed in this article are those of the authors. This publication is meant for general information only, and is not a warranty, representation, advice, or solicitation of any nature. Readers are advised in all circumstances to seek the advice of registered investment advisors.



Photo by Yonko Kilasi

MEET THE AUTHORS



**MERCY
MANGENI**



**JASON
MUSYOKA**



**ARIELLE
MOLINO**

Mercy Mangeni has a history of working with early-stage enterprises and startups seeking to raise external commercial capital in East Africa. At Intellectap, she works with enterprises across diverse geographies and sectors in refining their business models and optimizing their operational and marketing strategies, and offers advisory support on fundraising. She is an alumnus of the Cherie Blair Foundation's program for women in business and a fellow through the IDEX Global Fellowship Program, an initiative of Gray Matters Capital.

Jason Musyoka is the Angel Network Manager at Viktoria Ventures, which syndicates local and international investor capital into seed stage investments in tech startups in East Africa. Viktoria Business Angels Network (VBAN) has a member network of 32 angel investors both local and foreign. Currently, they've a portfolio of two companies: Buymore and Livestock Trade Services. Has a degree in Economics from the University of Nairobi and a Chartered Certified Accountants (ACCA) part II professional course qualification.

Arielle Molino is an Associate Vice President at Intellectap and is based in Nairobi, Kenya. Arielle has been a prominent part of the startup ecosystem in East Africa and as a member of Intellectap's founding team in Kenya, Arielle wears many hats executing Intellectap's work. Leading Sankalp in Africa, she develops content, designs the overall event and Sankalp strategy. She has also recruited local high net-worth individuals as angel investors in establishing the East Africa chapter of the Intellectap Impact Investment Network.

ABOUT THE ORGANIZATIONS

INTELLECAP

Intellectap, a part of the Aavishkaar Group, is a pioneer in building enabling ecosystems and channeling capital to create and nurture a sustainable & equitable society. Founded in 2002, Intellectap works across critical sectors like Agriculture, Livelihoods, Climate Change, Clean Energy, Financial Services, Gender & Inclusion, Healthcare, Water and Sanitation, and has delivered over 500 global engagements across 40+ countries and syndicated investments of over USD \$500 million. Intellectap, through its presence in India and Africa, provides a broad range of Consulting, Research and Investment Banking Services, to Multilateral Agencies, Development Finance Institutions, Social Enterprises, Corporations, Investors, Policy Makers and Donors. Our common action platform, Sankalp Forum, one of the largest global inclusive development platforms, brings together the ecosystem to shape the way markets work for delivering the SDGs 2030. Select clients of Intellectap include USAID, Rockefeller Foundation, World Bank, Ford Foundation, The Hans Foundation, Doen Foundation, GIZ, DFID, Hindustan Unilever, P&G, International Finance Corporation, Asian Development Bank and Michael and Susan Dell Foundation.

For more details please visit www.intellecap.com.

AAVISHKAAR GROUP

The Aavishkaar Group are global pioneers in taking an entrepreneurship-based approach towards development. The Group is focused on developing the impact ecosystem in the continents of Asia and Africa. Aavishkaar Group manages assets in excess of USD 1.2 Billion across Equity and Credit, with 7,000+ employees present across India, Indonesia, Bangladesh and Kenya. The Group's ecosystems include Aavishkaar Capital – a pioneer in equity led impact investing, Arohan – one of India's largest Technology led Financial inclusion platform, IntellectGrow – specialized lender to small and growing businesses, Tribe – a fintech player, Intellectap – thought leader and advisory business with a focus on sustainability and Sankalp Forum – one of the world's largest inclusive development led platform. The Group's shareholders include TIAA-Nuveen, Triodos Bank, Shell Foundation, and Dutch Entrepreneurial Development Bank FMO.

VIKTORIA BUSINESS ANGEL NETWORK

ViKtoria Business Angel Network (VBAN) was started in 2017 targeted at investments in early stage tech ventures. VBAN bridges the gap between startups and angel investors by building trust relationships and providing the necessary infrastructure to facilitate investment flow. VBAN syndicates local and international investor capital into seed stage investments in startups in East Africa. The network has a membership of 32 investors and has closed investments in several startups. ViKtoria Ventures acts as the portfolio manager for the network.

If you would like to find out more, please visit <http://www.viktoria.co.ke/vban>.