SAVCA
SOUTHERN AFRICAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

SAVCA 2015 VENTURE CAPITAL SURVEY

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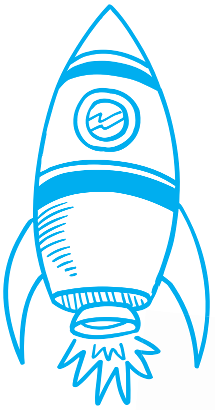
SAVCA and Venture Solutions would like to thank the survey participants, many of whom wish to remain anonymous.

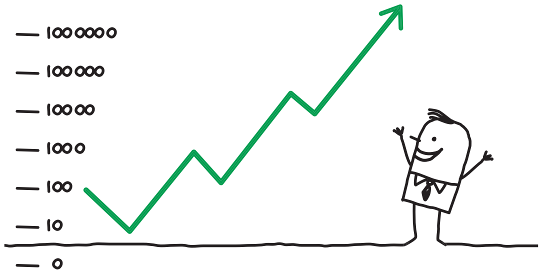
RISING ACTIVITY LEVELS



2012-2015

- Number of VC fund managers up 41%
- More VC professionals
- More deal flow

SOLID RETURNS

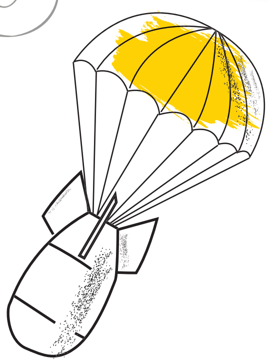


20% ROI

South African VC in 2015

R1.87bn

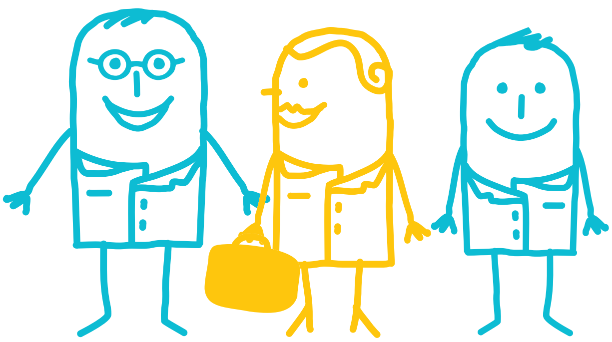
Invested across more than 187 deals



STRONG EXIT PERFORMANCE

More than half of fund managers have done at least one exit

CONFIDENCE IN THE SECTOR

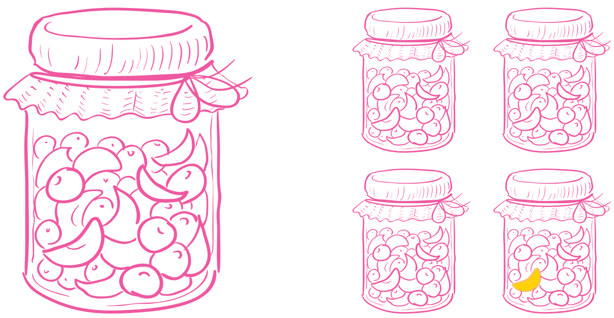


- Two thirds expect profitable exit in next year
- Returns expectations vary from 2 to 5 times money back

AVERAGE DEAL SIZE DOWN 22%

2009-2012
R9.3m

2011-2015
R7.3m



The most common reason for deal failure is poor due diligence.

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Foreword

SAVCA is pleased to present the SAVCA 2015 Venture Capital Industry Survey.

This survey follows similar studies conducted by SAVCA in 2010 and 2012, and is designed to create a more comprehensive understanding of the venture capital (VC) sub-set of the private equity industry in South Africa, covering VC-type deals made by private fund managers as well as by public fund managers and public-funded entities.

This knowledge is essential in ensuring that SAVCA and other organisations working on behalf of the industry target their policy research, lobbying and training initiatives accurately and effectively.

Such activity, in turn, is vital in supporting the development of the VC industry – an industry that is an integral component of a vibrant and healthily functioning economy, and which is considered a critical enabling mechanism for high-tech, high-growth entrepreneurial business activity that has the potential to transform the South African economy.

In 2010, SAVCA commissioned a review of all VC funding of the previous ten years. The survey results pointed towards a significant, albeit emergent, VC asset class in South Africa.

SAVCA published a follow-up survey in 2012, considering transactions between January 2009 and June 2012.

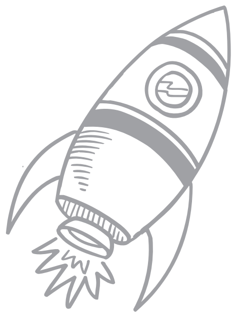
This year, SAVCA commissioned the third in this series of surveys, to cover VC-type transactions that took place between January 2011 and June 2015. As in the first survey, this latest report incorporates angel activity, anecdotally regarded as making up a meaningful portion of total VC activity in South Africa.

We are grateful to Stephan Lamprecht from Venture Solutions for the important role he plays in surveying the VC industry in South Africa. Thank you, also, to all VC fund managers, angel investors and VC-industry stakeholders who provided the information and insights that made this report possible.

Yours sincerely

EvdMerwe

Erika van der Merwe
CEO: SAVCA



1 | About the survey

1.1 Objectives and methodology

The SAVCA 2015 VC survey covers the calendar years 2011 to 2015, with activity measured in 2015 being for the seven months to July. The survey process entailed gathering and processing data through questionnaires and interviews with VC fund managers and other investors conducting VC-type investments. For the purposes of this survey report, investors in the VC asset class are collectively referred to as VC fund managers, regardless of whether or not such investors operate a ring-fenced fund or leverage funds from a draw-down facility, and regardless of the legal format of operations, that may range from operating as private individuals to being structured as investment companies.

The approach to this survey is similar to the bottom-up methodology used in the previous two SAVCA VC surveys covering the periods 2000 to 2010, and 2009 to 2012; verifiable data and information about completed VC transactions were collected and reviewed. A range of data and information sources about transactions and fund managers/operators were used, including information available in the media about transactions concluded, one-on-one interviews with VC fund managers and related stakeholders, and additional referrals from stakeholder interviews.

The approach to this review is objective rather than judgemental. There is no disclosure of per-company information and/or contributions.

1.2 Definitions

For the purpose of this survey, the SAVCA VC definitions employed in previous years were used. Venture capital is considered to be:

A subset of the private equity asset class, which deals with predominantly equity funding of high-tech, high-growth-potential businesses, whose growth is achieved typically through radical global scaling.

The need for VC stems from the specific requirements of such businesses in the start-up and early growth phases, and from the part that experienced VC fund managers can play in structuring and nurturing investments into these businesses.

The following four stages of venture capital were considered for the survey:

Seed funding: The initial capital used to start a business. Seed capital often comes from the company founders' personal assets or from friends and family. Seed money typically is used to pay for preliminary operations such as market research and product development. Seed funding is not usually associated with VC fund managers, especially in South Africa.

Start-up capital: Early funding used for setting up operations (hiring staff, renting office space, equipping the production system, and working capital), commercialising intellectual property, and other activities.

Development capital (mostly pre-revenue deals): Finance used after start-up capital to further launch the business and to support growth in market share, in order to become profitable.

Growth capital (post-revenue deals): Equity-type investments used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/technology lines, accelerating production and/or acquiring competitors.

1.3 Survey scope and attributes

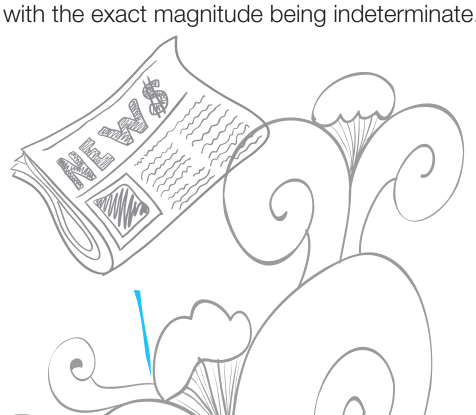
A comprehensive survey questionnaire was used, probing a large number of attributes about:

- VC funds (fund origin, ownership, contributions, location, structure, portfolio details);
- VC fund managers (team, location, mandate, source of funds, funds under management, management fees, experience, fundraising activities, deal flow and investment history, exit strategy and history); and
- Outlook of, and suggestions as to, the development and future of the VC industry in South Africa.

1.4 Information excluded from survey data

Known investors active in the South African VC industry, over and above those listed on the SAVCA Members' Directory, include angel investors, corporate investors, enterprise development initiatives, entities such as the SME loan instruments operated by Business Partners and the conditional grants offered by state-backed institutions such as those falling within the ambit of the Department of Small Business Development, the Department of Trade and Industry, and the Department Science and Technology.

For instance, deals that entail no equity are excluded from the survey. Furthermore, many transactions involving angel investors – typically high-net-worth individuals opting to remain anonymous for privacy reasons – are not captured in this survey, as information about the transactions usually is not announced or recorded in the public domain. Given this, the actual scope of the VC industry in South Africa is broader than that indicated in this report, with the exact magnitude being indeterminate.



2 The state of venture capital in South Africa

2.1 VC transactions: Comparison with previous years

The period of investment between 2006 and 2009 saw a rapid deployment of funds by both private and public sector VC investors, as a result of the formation of new funds (Hasso Plattner Ventures Africa, 4Di Capital), the scaling up of the IDC Venture Capital Fund, and significant ramping up of investment activity by the funds which eventually combined to form the TIA.

The subsequent dropping off of VC investment activity in the years after 2009 is reflective largely of the investment cycle of the VC-type investors captured in this survey, rather than of the impact of the global financial crisis. Investors surveyed typically operate ring-fenced funds or draw from budgets earmarked for VC investments. In such instances, available money will be invested in the first four years (e.g. 2006 to 2009), after which investment activity will move from finding and investing in suitable deals, to maturing such deals for exits. Fund managers attempting to raise new funds reported experiencing the impact of the global recession in the latter part of this period.

Deal trends over time

Year	Total amount invested (R million)	Deals done	Average deal value (R million)
2006	304.1	38	8.0
2007	467.6	47	9.9
2008	551.2	56	9.8
2009	242.3	37	6.5
2010	194.3	25	7.8
2011	210.6	26	8.1
2012	281.9	11	25.6
2013	108.7	18	6.0
2014	141.7	34	4.2
2015[i]	146.3	43	3.4
10 years	2, 581.7	315	8.2
(2015 YTD)	(79.2)	(23)	(3.4)

[i] Year-to-date figures for 2015 are annualised to enable comparison. Note that all survey data, graphs and tables in this report use actual, not annualised data, except where expressly indicated to the contrary, as in this table.

The above table lists actual amounts recorded through all SAVCA VC surveys to date, and the amounts have not been adjusted to show the impact of inflation. The figures for 2015 have been annualised, as survey data for 2015 included deals until mid-July 2015.

The value of new investment activity declined further in the 2011-2015 period, owing in part to VC fund managers taking a more conservative approach to deploying capital in the context of a harsher economic climate. In addition to this, the value of transactions concluded reflected global trends for deals involving digitisation, online enablement and e-commerce, which typically require smaller amounts of funding into businesses that achieve rapid market uptake by using available technologies and adopting lean operations with shorter development cycles.

While per-deal values have been declining in recent years, the number of deals done from 2013 onwards has risen; this mirrors the trend seen during the activity upswing in the 2006-2009 period, but without the commensurate rise in the overall value of deals done. The average deal size in 2012 received a significant upward boost from four individual transactions, three of which were executed by public sector investors into energy and telecommunications infrastructure-type investments.

2 The state of venture capital in South Africa *continued*

During the survey period, 21 fund managers completed 168 new deals amounting to a total of R865 million. Of this total deal flow, 55 transactions (33% of the total number of deals) are categorised as transactions concluded by angel investors, amounting to R42.55 million (5% of the total value of deals).

The deal activity by angels represents a change from previous surveys, where angels did larger deals. Explanations proposed for this shift are two-fold, being firstly that some of the so-called super-angels (individual investors investing amounts similar to formal VC fund managers) formed angel funds that have been reclassified for this survey as Independent Fund Managers (e.g. where the fund manager raises money from different entities on a deal-by-deal basis) or Captive Fund Managers (e.g. where a fund manager represents the same entity throughout the life of the fund) and whose transactions have therefore not been grouped with angel investors. The second contributor to lower deal sizes is the trend outlined above, being that new-media, digitisation and e-commerce deals have reportedly required lower transaction amounts: as reported in survey responses, this has been an area of activity preferred by angel investors.

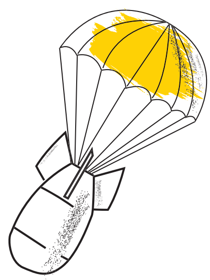
The VC industry has at least R1.87 billion under management invested in active deals at the end of the survey period, after accounting for write-offs and exits that took place during the survey period. The exact amount of dry power or funds available but not yet allocated to transactions is difficult to determine, as the majority of investors polled in this survey operate from drawdown facilities. Although the outright majority of respondents reported a high confidence in obtaining further funds for new transactions, each such deal is subject to scrutiny by respective investment committees (or similar processes involved in approving new funding) and the outcomes and thus total amount of funds available are speculative at best.

Key deal metrics

	2011-2015[i]
Number of VC fund managers invested in period[ii]	31
Number of VC fund managers with new deals in period	21
Number of deals made in period[ii]	112
Total number of deals included in survey period	168
Average transaction value[ii]	R7.34m
Total amount invested in survey period	R865m
Total amount recorded as angel transactions in period	R42.55m
Total invested in VC industry at end of survey period	R1.87bn

[i] 2015 is year to date, that is, January to July

[ii] Excludes angel investors



Number of VC fund managers increased from 22 (in 2012) to 31 (2015).

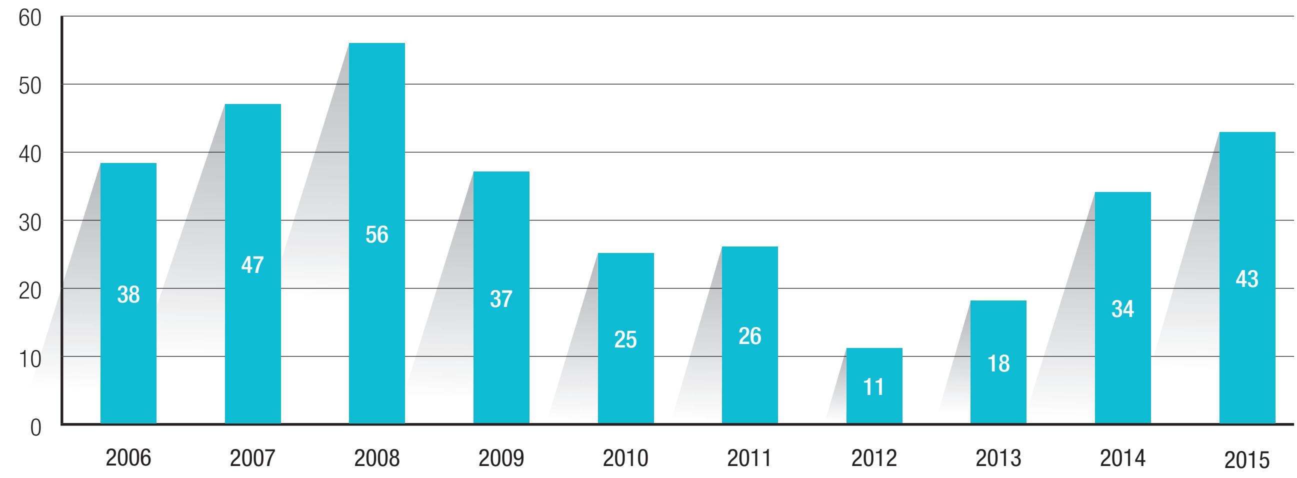
Of respondents, 21 say they did new deals during the survey period.

By 2015, the VC industry accounted for R1.87bn, over more than 187 deals.

2.2 Number of transactions concluded

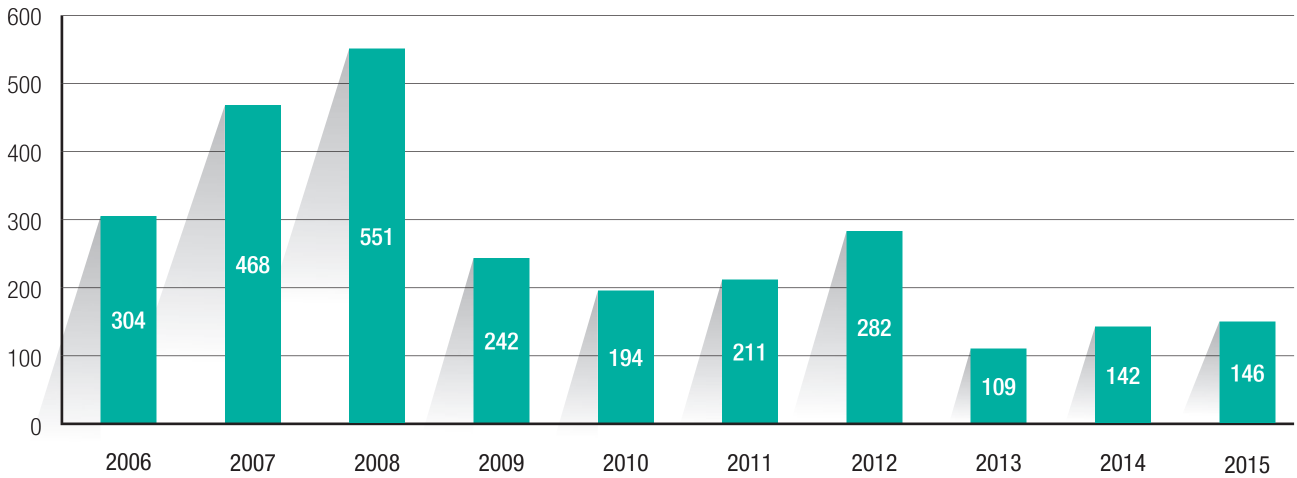
The ten-year profile of the VC asset class in South Africa follows a predictable investment lifecycle, with an upward trend in the number of deals in the latter part of the survey period. Owing to the declining trend in deal size, the average annual value of transactions has predictably edged lower since 2013, the year that saw the first introduction of a number of new fund managers active in the new media, digitisation and e-commerce sector; refer to later section on sector allocation for more information on new media, digitisation and e-commerce deals.

Total number of transactions per year
Number of deals



Figures for 2015 have been annualised

Total value of transactions per year
Average value per year, in R million



Figures for 2015 have been annualised

The number of deals concluded has increased over the past three years.

The average value of deals done in the latest survey period is significantly below the average deal value of previous years.

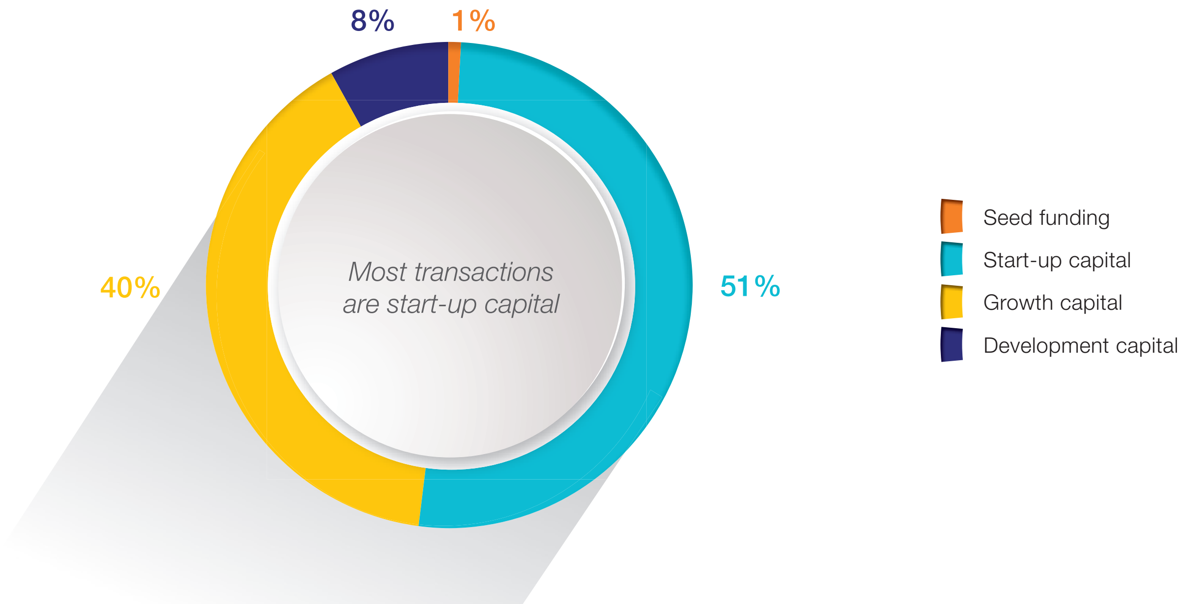
2.3 Contribution by stage of the deal

South African VC investors have continued to demonstrate an appetite for early-stage transactions, as indicated by the below two graphs that show the number of deals done per year across the main stages of VC transactions. Investors typically classified early-stage deals based on the perceived risks and development efforts required, with the vast majority of such deals reported as investments into post-revenue-type businesses.

As in previous surveys, seed funding is not typical amongst South African investors in the VC asset class, being rather the domain of public sector loan-type instruments. Investors active since the previous fund-raising cycle (2006 to 2009) are reporting a preference for development capital in recent years. This preference is in order to balance portfolios and to offset risk; perhaps more importantly, it is based on their ability to find later-stage transactions (e.g. growth and development capital) that enable suitable returns. This can be seen in the increased number of development-stage deals reported in 2014 and 2015.

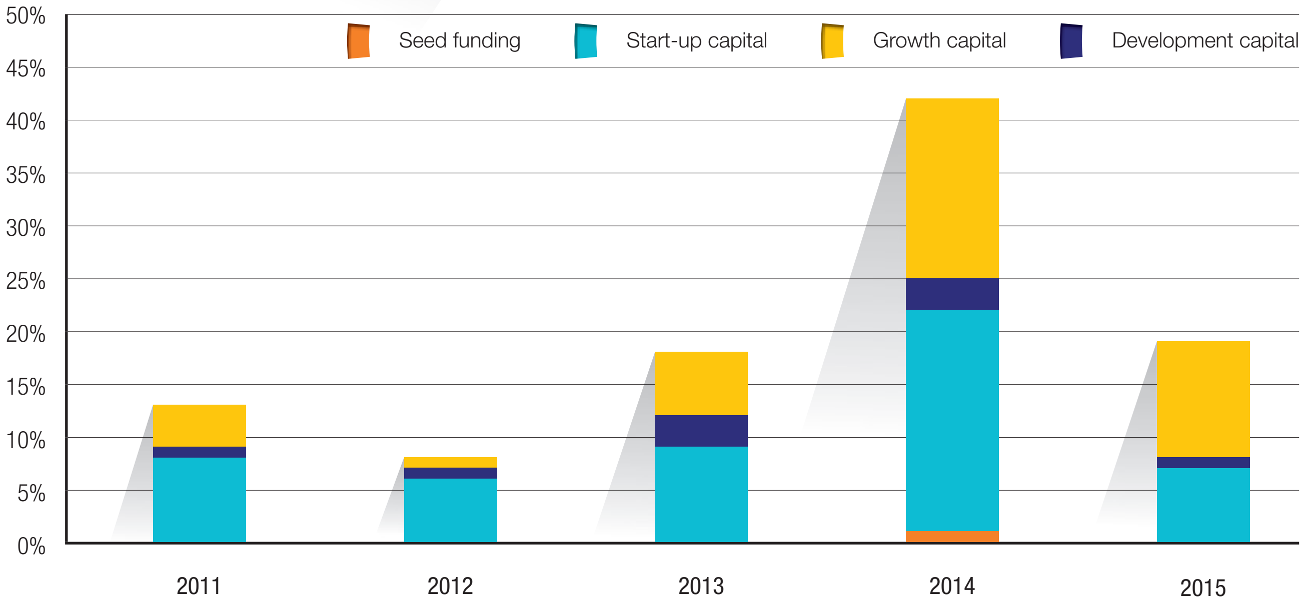
Deal categorisation by stage

Number of deals, as percentage of total



Deal categorisation by stage, per year

Percentage of total

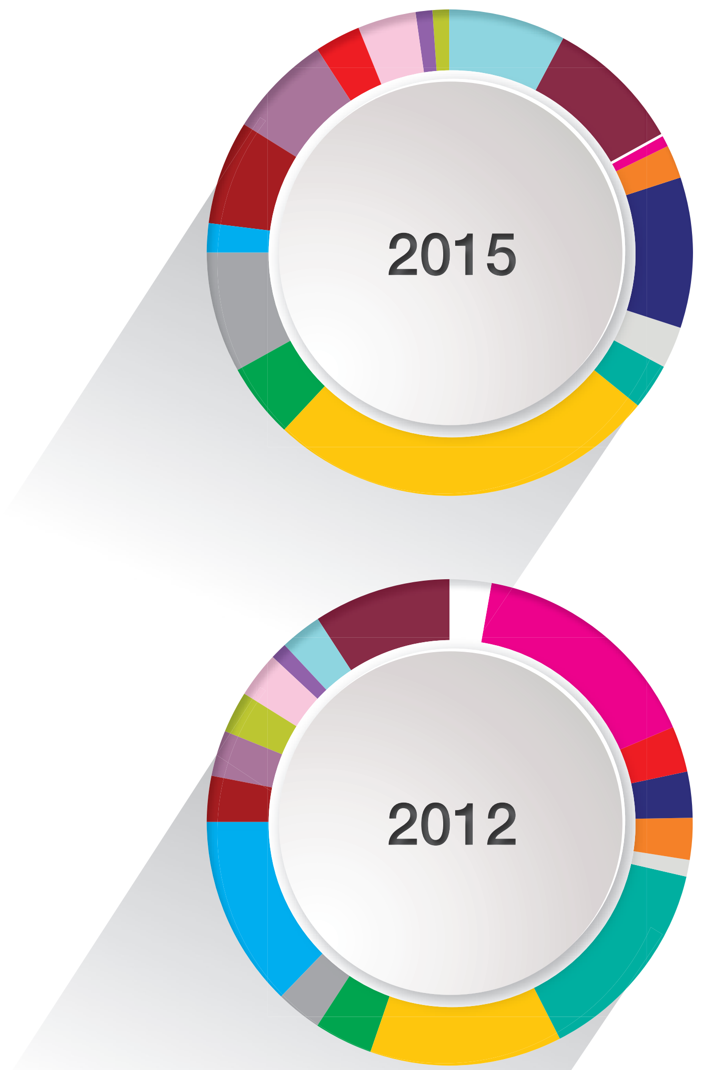


2.4 Sector allocation

The largest number of deals came from ICT-type sectors that include software (26%), e-commerce (10%), electronics (4%) and media/entertainment (7%), together accounting for almost half of all deals reported. This is similar to the previous survey period (2009 to 2012) and mirrors global VC investment activity. The magnitude of high-growth business activity in the ICT sector is even more significant, especially so for policy makers, as many deals categorised by respondents as coming from other sectors (e.g. financial services, and business and consumer services) are also driven by new technologies involving ICT.

The three biggest changes in sector allocation between 2012 and 2015 are software (up from 13% to 26%), telecommunications (down from 16% to less than 1%) and medical devices (down from 13% to 2%). Software, as indicated previously, is receiving a great deal of attention from new fund managers based on the rapid growth in start-up businesses targeting the digitisation opportunity. Telecommunications saw a drastic reduction in number of deals, partially owing to the reintegration by the corporate venture capital unit of one of the large mobile phone operators in South Africa into its mainstream operations; this unit had reported telecoms-type VC deals in the previous survey period. Additionally, the previous survey included deals involving infrastructure and hardware for the rollout of public Wi-Fi services. Medical devices investments are primarily the domain of the public sector fund managers that have reprioritised spending to favour other sectors, but who remain invested in those deals recorded in the previous survey.

Volume of deals by industry sector: comparing 2015 and 2012
Number of deals, as percentage of total

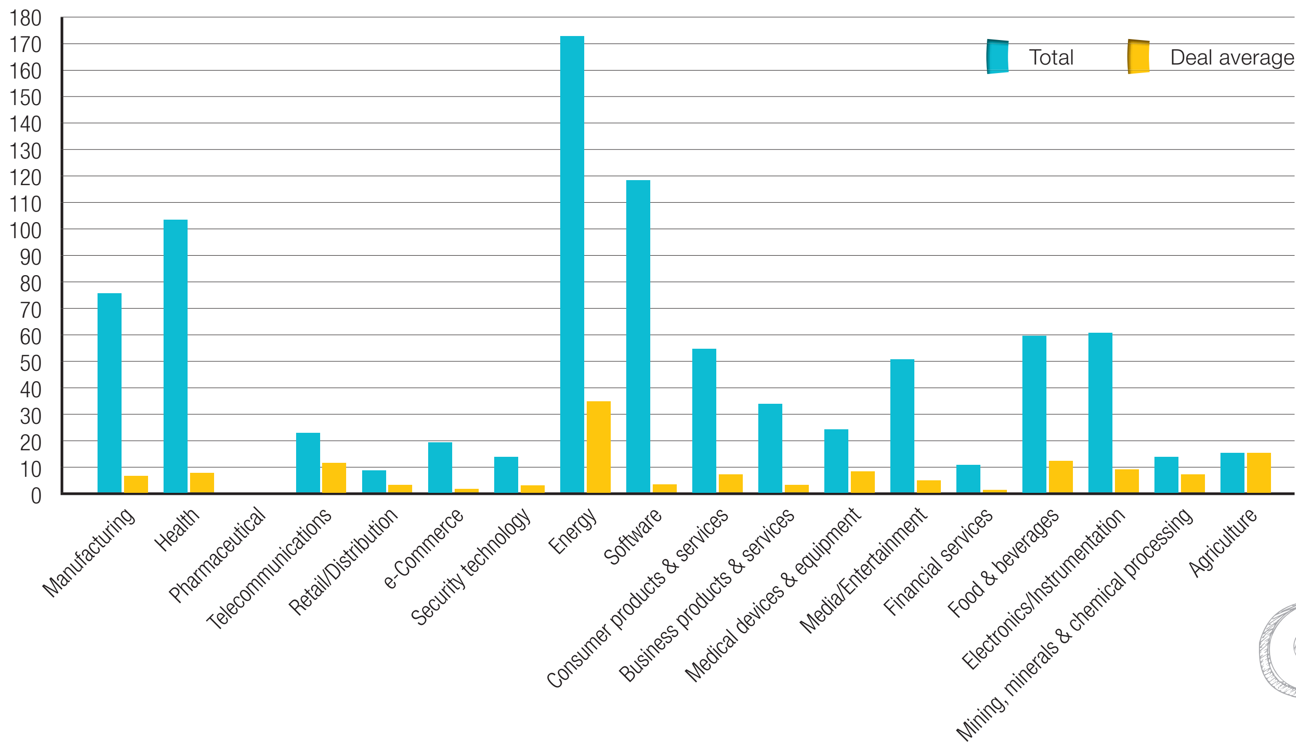


	2015	2012
Manufacturing	8%	3%
Health	9%	9%
Pharmaceutical	0%	3%
Telecommunications	1%	16%
Retail/Distribution	2%	3%
e-Commerce	10%	3%
Security technology	3%	1%
Energy	3%	14%
Software	26%	13%
Consumer products & services	5%	4%
Business products & services	8%	3%
Medical devices & equipment	2%	13%
Media/Entertainment	7%	3%
Financial services	7%	3%
Food & beverages	3%	3%
Electronics/Instrumentation	4%	3%
Mining, mineral & chemical processing	1%	1%
Agriculture	1%	3%

The largest portion of VC deals are done in the early-stage category – with the most popular industry sector being ICT.

Value of deals done by industry sector

Total value vs average value per deal; deals concluded between 2011-2015, in R million



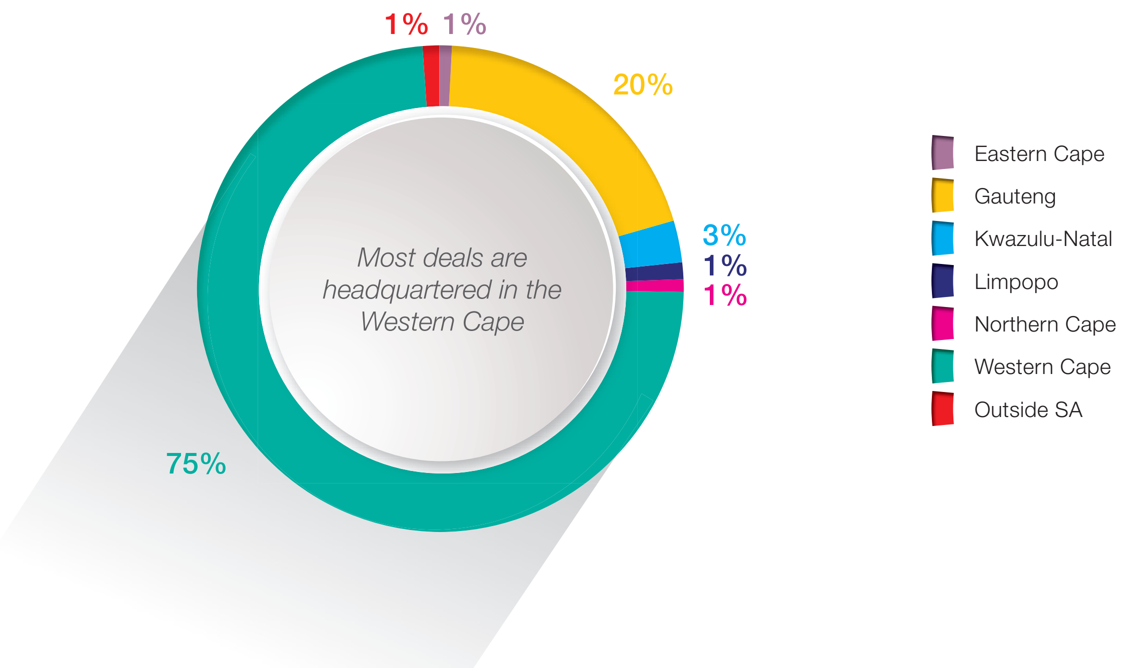
2.5 Location of transactions

The Western Cape has rapidly overtaken Gauteng as the geographic source of the largest number of VC-type deals. This partly is a reflection of the number of entrepreneurs, angel investors and independent fund managers having set up in the Western Cape (see later sections of the report), which is contributing to a preference for, and availability of, suitable deals from Western Cape-based businesses. It is also a reflection of the vacuum left through the TIA restructuring, given that, in previous surveys, TIA-backed businesses represented a significant number of deals based outside of the Western Cape.

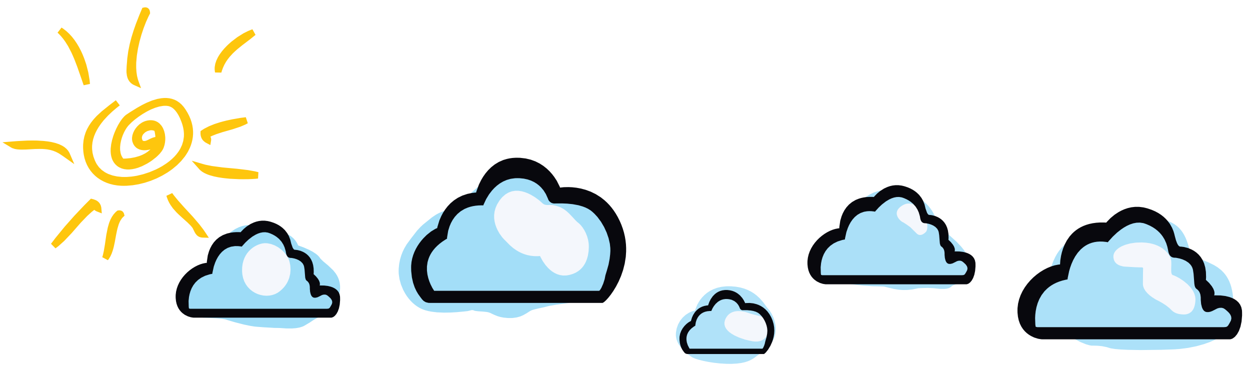
An additional contributor could be that angel investors based in the Western Cape are more forthcoming with data (the majority of angel transactions recorded in this survey were supplied by angel investors based in the Western Cape) compared to their peers based elsewhere in South Africa.

Location of deal

Head office of deal, as percentage of total deals done

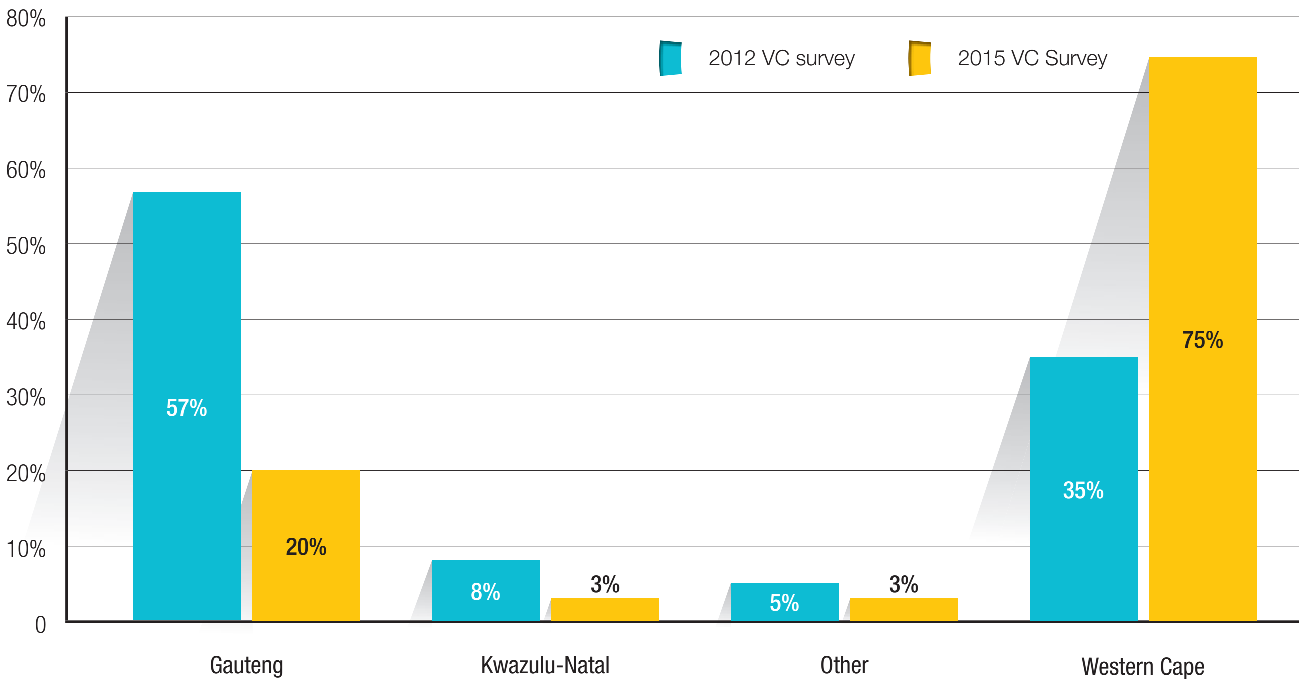


Most VC investment activity takes place in the Western Cape.



Location of deal: comparing 2015 and 2012

Head office of deal, as percentage of total deals done



3 Who invests into South African venture capital?

3.1 Value of transactions by type of fund

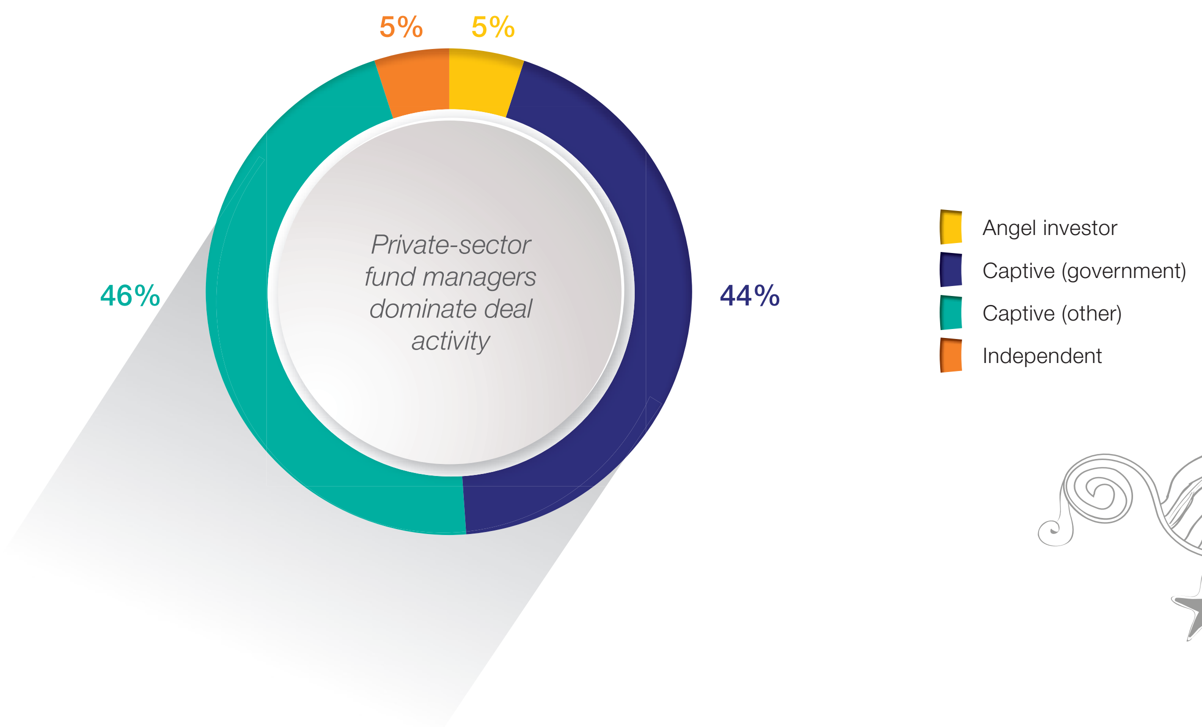
Government-backed investors still represent a significant portion of the value of investment activity, given the magnitude of deals done by such investors. This survey shows that private sector fund managers collectively now have overtaken government as the primary source for VC-type deals, even more so when considering the number of deals: more than 81% of deals recorded in the survey period represented private sector fund managers.

Captive (other) fund managers refer to family offices, single-sponsored funds and corporate venture funds, and have been grouped into one to protect the anonymity of the individual survey respondents.

Angel investors that responded to the survey are typically South African-based individuals (but not limited to South African citizens), on average falling into the age group 35 to 49 years, most with previous investment and/or financial services background. The main reason given by respondents for investing as an angel investor is the pursuit of above-average returns. Further, as was indicated in the previous angel survey conducted in 2010, South African angel investors prefer to invest in syndicates as opposed to investing alone, and invest in deal flow sourced through private networks.

There is still a great need for improved incentives to stimulate increased angel activity, and most angels report a lack of information about deals, deal structuring and follow-on funding as areas for improvement. The sector focus of angel activity follows the same sectors as the majority of fund managers. However, this data may be biased given that angel investors were contacted through existing fund managers (thus, same networks) and through tech-sector industry bodies and associations such as Silicon Cape, SAVCA's own Members' Directory, and technology and investment groups on social media.

Value of deals by fund type
As percentage of total value of deals done



Angel investors and independent VC fund managers have been drivers of new deal activity.

3 | Who invests into South African venture capital? *continued*

3.2 Deal flow reported

Respondents were asked to indicate the origin and suitability of proposals that reach their offices. It was reported that the majority of proposals are rejected owing to these not matching the fund mandate.

Reasons for this vary, but the primary reason reported is that those seeking funding tend to submit proposals without first investigating a fund manager's mandate, preferences and investment activity. The trend nevertheless shows an improvement on previous years.

Across the board, respondents reported unfavourable results from soliciting deal flow through social networks, websites, conferences, media and other arms-length means; the preferred method for obtaining deal flow is through the cultivation of personal networks and referrals from partners, ex-colleagues and personal networks.

Some private fund managers, in an effort to stimulate the pipeline for future investments, have resorted to setting up and/or taking a direct interest in existing private high-growth entrepreneurial incubators and accelerators. These include annual business development programmes, co-funded incubation and mentoring and, in some instances, start-up funding to successful entities following a vetting process. Such funding includes not only money, but in most cases also in-kind contributions to technology infrastructure (i.e. bandwidth, technology development tools and methodologies), mentoring, sharing local and global networks, and assistance in preparing for and completing due diligences.

The pursuit of deal flow through these efforts is clearly distinguished from those involving public-funded incubators, where the consensus view amongst VC survey respondents is that there is not suitable deal flow on offer from public-funded incubators. An interesting observation on one key difference between public and private incubation activities, is the fact that the majority of private incubation and acceleration activities involve post-revenue companies that already have working products and/or service offerings, generating annual turnover figures of between R2 million and R10 million. Public incubators to date are almost entirely focused on assisting start-up entrepreneurs, most of whose entities are pre-revenue and many of which prioritise pre-incubation programmes to assist would-be entrepreneurs with setting up business plans; in short, long before most private fund managers prefer to invest.

The focus of private investors on prioritising early-stage businesses with a trading history, appears to be a potentially successful approach to developing future investment options for those investors with the appetite to do so, and who have the capacity to allocate additional management time to the operations. Some fund managers have secured direct investment opportunities through these ventures, and more than one investor has exited profitably from deals stemming from own incubation activities. Whether or not this becomes a sustainable avenue for deal flow will be one of the pertinent aspects to review in future VC surveys.

Personal networks remain the preferred way to source viable deals.

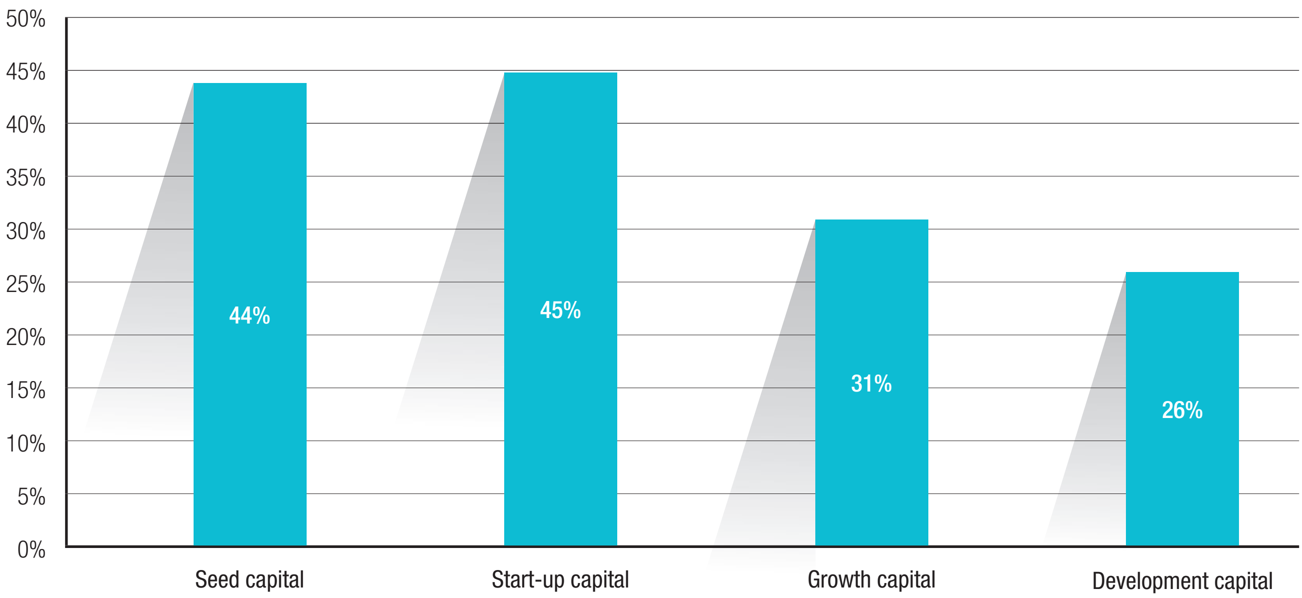
3.3 Equity preferences

Equity invested as declared by fund managers reflects the risk appetite for the particular stage of venture capital, as indicated below. The equity invested by respondents reflects the most recent equity investment figures. One of the drivers of equity value is the limited availability of alternative funders in the market for follow-on investments, which means that the onus is on the first investor to take additional equity over the lifetime of the investment to cater for allocating additional capital to the transaction.

Equity percentage taken by South African VCs are very high by international norms.

Equity preferences

Percentage of equity investment by deal-maker, analysed by deal stage



The quantum of equity invested is influenced primarily by the stage of the deal and secondly by the type of industry. Health (40%), medical devices (47%) and energy (44%) reflect the largest proportion of equity investment by investors, whilst software (31%) and media/entertainment (27%) deals show slightly smaller equity stakes.

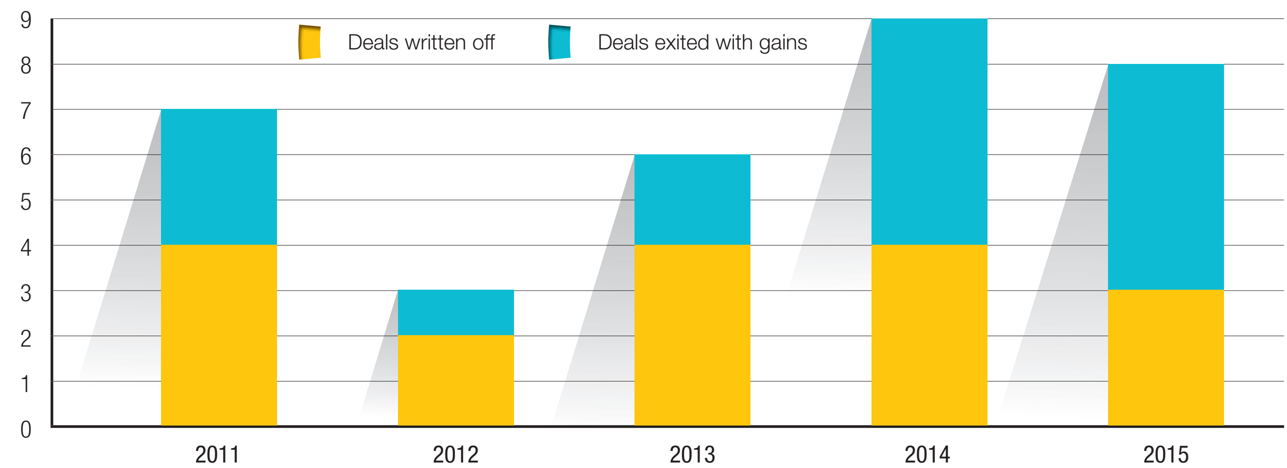
The percentage shareholding taken, where declared, amounts on average to 37% of total equity (based on 109 transactions during the survey period 2011 to 2015). Government investors on average take significantly larger equity stakes than private sector investors (43% compared to 31% across the full sample).

3.4 Exit history and exit mechanisms used

Of the 132 transactions completed since 2011 with declared exit information, the write-off figures (17 of 33 deals in the bar chart below) exclude the substantial number of transactions written off during the survey period by TIA following its restructuring.

Volume of exits

Deals reported, per year



The survey shows that 56% of fund managers with completed VC deals have exited from at least one investment, with only two such fund managers having written off more capital than the amount that they have realised through exits. In both of these instances, the amounts written off are in total less than 15% of the value of all of the transactions undertaken by them to date.

3 | Who invests into South African venture capital? *continued*

The average rate of return on investments (ROI) achieved for all declared deals exited with a gain, amounts to 20% per annum (compound annual growth rate). The total value of declared write-offs during the survey period is R187 million, compared to the total value of declared profitable exits of R438 million.

Trade sales are the preferred way to exit. The second-most common exit method exercised is sale to management.

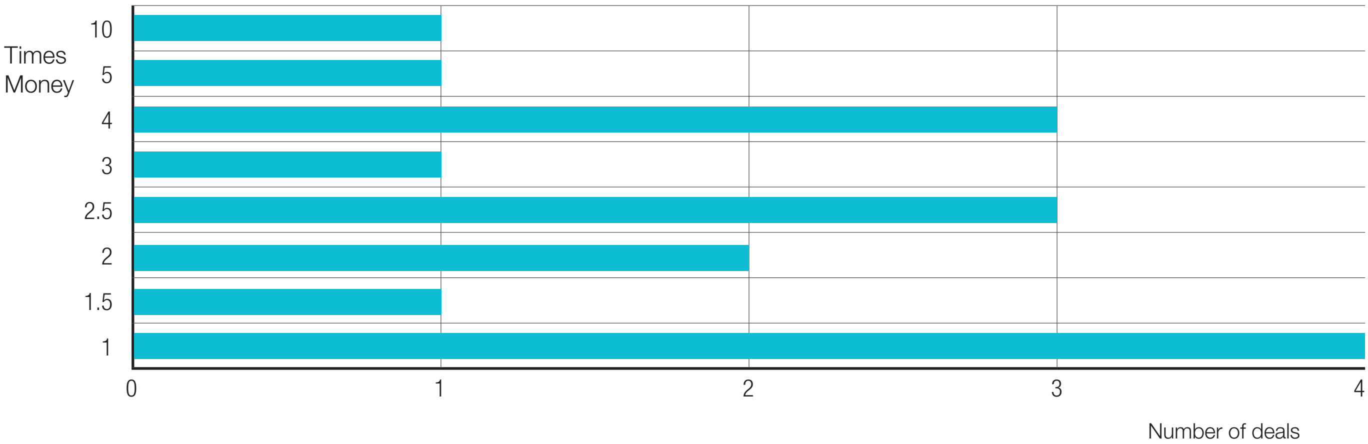
Two thirds of respondents anticipated a profitable exit in the next 12 months, with profitability expectations ranging between two and five times money back. Almost all respondents indicated a willingness to wait up to three years for a profitable exit in the current economic climate.

The average period of investment before exit (including deals that are profitable and deals that are written off) is four years and seven months. Government-backed investors remain invested for longer holding periods compared to private sector fund managers.

Responses to the survey, based on the probability for exits in the near future, indicate that there may be a rapid increase in the number of exits in the next 18 months. This is supported by feedback from responses in so far as rating the probability for exits in the near future. This projection is also consistent with applying the average holding period to the large number of investments held by investors.

Returns performance

Times Money and number of profitable gains



A number of exit transactions were reported anonymously. However two noteworthy recent transactions profiled in the media warrant mention. The first is the acquisition of a Stellenbosch start-up by a global consumer electronics giant. This transaction followed a lengthy and perilous – but not atypical – journey by the start-up team, in their efforts to identify suitable markets for the company's main product, a bicycle radar-enabled safety device. The company is an example of investment activity following from involvement in one of the private VC fund manager's accelerator programmes. The deal itself has resulted in very good public awareness for the South African VC sector as a whole.

In 2015, a global pharmaceutical company announced the acquisition of a Cape Town-based biotech company that was originally funded by one of the public fund managers. The fund manager itself exited prior to the pharma deal. Information about the deal size and particulars involving the transaction are confidential, but early indications are that the transaction itself may have been one of the largest exits in South African high-tech history. This is significant for the VC sector as a whole, but even more so for the role that government played in stimulating business activity in areas of importance to the South African economy (i.e. biotechnology and life sciences as a whole), that may otherwise not attract interest from private fund managers owing to perceived risks, high development costs and long payback periods. This case study should signal a review of public sector funding activities in the early-stage high-tech start-up sector, given alarming trends pointing towards an increasing reluctance by government to play a role in this space; this is an area of discussion featured later in this report.

Both of the above examples point to significant opportunities for achieving above-average returns through developing South African companies and preparing them for global markets. Both examples involve South African companies, and the development of products and services from South Africa, and the attraction of global funding despite often-cited concerns regarding perceived limitations to investing in South African intellectual property.

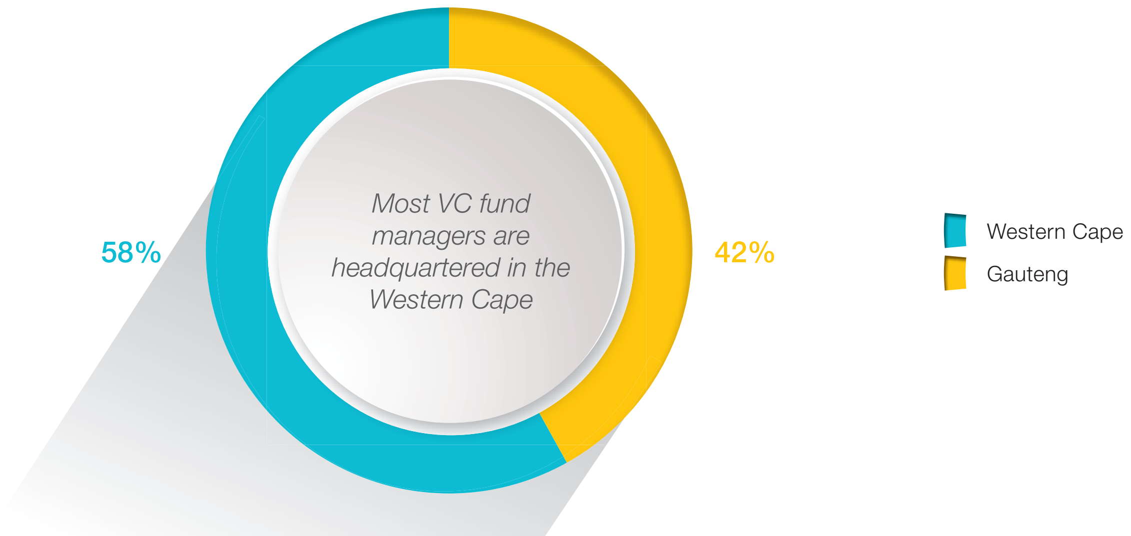
3.5 Fund manager attributes

Fund manager location

The majority of fund managers have their head offices located in the Western Cape. This portion has increased from previous surveys, and has accelerated due to the preference amongst new fund managers – attracted by increased high-tech business activity, a maturing start-up ecosystem, a clustering of early-stage investors, and lifestyle – to establish themselves in the Western Cape.

VC fund managers prefer to be located near their investments to enable easy access and to limit the costs and impact of frequent travelling. Further, the majority of VC fund managers surveyed expressed a preference to be located in the Western Cape, owing to lifestyle choices and given the benefits that they see flowing from being part of a relatively established VC ecosystem. These findings are consistent with the observation that the majority of VC fund managers are headquartered in the Western Cape. Keep in mind, though, that larger fund managers, especially public sector entities, have offices in more than one province in order to have operational support staff in close proximity to portfolio companies.

Location of fund manager
As percentage of total number of fund managers



Fund manager team experience

The majority of fund manager personnel who were employed by VC fund managers at the time of the previous surveys are still involved in the VC asset class, having either remained with the same firms, or having joined other existing or new firms. This points to an increase in the collective VC-specific fund management experience.

New fund managers have set up in the period covered by this survey, many of whom have sector-specific experience: these managers have previous experience in supporting and/or investing in the sectors in which their new funds invest (e.g. e-commerce or media/entertainment), or have experience in running sector-specific business operations.

Fund manager BBBEE classification and BBBEE investment preferences

The majority of fund managers operate small investment companies. Of those, many are classified as Exempted Micro Enterprises in line with the Revised BEE Codes gazetted in 2013.

Of deals declared, 86% are classified as transactions into non-empowered companies, as per the DTI BBBEE classification. Fewer than 7% of transactions involved existing majority-held BBBEE companies.

3.6 Undrawn commitments and new fund management activities

Only two active funds out of 31 reported no capital available for additional or new investments. Most fund managers draw funds on a deal-by-deal basis (thus not operating from ring-fenced time-capped funds) and have confidence that they have the support of fund sponsors to access additional capital for future deals.

4 | The state of the South African VC industry: A comparison with previous SAVCA VC surveys

The following table builds on questions that were asked in previous surveys, where respondents were asked either to rate specific options, or to offer their views. The last column shows the outcome from responses in the 2015 survey, compared with those expressed in previous surveys.

Contributor/focus area	Responses/observations	Change from last survey
Status of the South African VC ecosystem	The consensus outlook amongst respondents is that there has been an increase in the number of viable deals and in the number of investment fund managers. Importantly, there is also a reported improvement in the degree of collaboration amongst investors. The rising number of start-up support entities such as incubators, accelerators and industry bodies are contributing to a more networked, more cohesive and synergistic start-up system.	*Significant improvement*
Impact of government in the VC asset class	The prevalent response points towards a waning impact of government as an early-stage VC investor. Both public sector VC fund managers (TIA and IDC) have already withdrawn, or are in the process of withdrawing, from making direct risk-equity-type VC investments. As expressed by one respondent, "The Innovation Fund used to be an active investor in VC-type deals before being merged into TIA alongside other dedicated funds. TIA is no longer seen as an active investor, having restructured and now focusing on conditional grants and similar non-risk-taking funding activities." Respondents are calling on government to improve the overall business climate in which start-ups and SMEs operate, including through scrapping exchange controls, removing BBBEE as an additional barrier to entry, and exempting small funds from some of the more onerous FAIS licence requirements that are often not applicable to the industry, are costly and place enormous administrative burdens on small teams.	*Marked deterioration*
Exchange control regulation	Exchange control regulation continues to be seen as a substantial impediment to increased VC-type activities, given the additional red tape, delays in obtaining suitable approvals, being generally a deterrent to offshore investors and shutting out South African investors from carrying forward international interests.	*Remains a critical impediment*
Impact of tax incentives	Some independent fund managers and angels have benefited from the Section 12j tax allowance for individuals. There is a view that the incentive ought to include capital gains tax relief for investors. Current tax incentives offer reductions in annual income tax for the investor. VC fund managers aim to achieve returns for the fund based on the profitable growth of assets over the lifetime of VC portfolios (intended to be significant long-term capital gains).	*Incentives remain insufficient*

Contributor/focus area	Responses/observations	Change from last survey
Impact of Intellectual Property from Publicly Financed R&D Act (IPR Act)	Practically none of the deals recorded by private fund managers in this survey involved any publicly financed transactions. The reason for this is varied but the finding arguably points towards insufficient deal flow from public institutions rather than towards the impact of the IPR Act, as those that have engaged with universities cite the IPR Act as an impediment rather than a deterrent. The fact that many fund managers continue to call for certainty in regards to the IPR Act is perhaps an indication that they have not engaged with publicly financed research institutions for the sourcing of deals, as the IPR Act, through the introduction of the National IP Management Office (NIPMO), has made notable strides with regulations and management practices so as to address the areas of uncertainty that existed at the time of promulgating the Act.	***No impact***
Deals from publicly financed institutions such as the CSIR and universities	The dominant view from respondents is that publicly financed institutions do not produce investable transactions, since the R&D from such institutions is not market focused but instead is the result of the pursuit of research and/or academic outcomes. This is exacerbated by a shortage of commercialisation skills at such institutions, where the outputs are at best products (often mostly only patents or technologies) that don't have any clear strategy for becoming businesses, or where the business case is still undetermined. In short, this leaves nothing for VC investors in which to invest. Respondents suggest that Technology Transfer Offices at such institutions ought to serve as a catalyst between the real market needs and the researchers, to inform better and more market-ready outcomes. Arguably, this is unlikely to happen until the research funding instruments (e.g. Department of Science and Technology, Department of Higher Education) emphasise market appeal, contrary to a current emphasis on academic relevance. Of respondents – which include government funders – 88.9% do not expect any future deal flow to come from publicly financed research institutions.	***Remains fundamentally unsuited to VC***
Lack of skilled entrepreneurs	The majority of respondents cited lack of skilled and experienced entrepreneurs as a key inhibitor to increased VC investment activity. This is exacerbated by a competition for scarce resources between start-ups and corporate South Africa, where the latter typically offers better salaries and security.	***Remains an impediment***

VCs are concerned about the negative effect of exchange control on exit performance, as well as about limited entrepreneurial skills.

4 | The state of the South African VC industry: A comparison with previous SAVCA VC surveys *continued*

Contributor/focus area	Responses/observations	Change from last survey
Lack of government seed investment into the VC asset class	Successful government interventions in venture capital markets around the world entail stimulating early-stage deal flow, where the risks are higher, so as to derisk the deal to enable private investors to provide follow-on investment. The latest and previous SAVCA VC surveys suggest that, over the past ten years, VC investors have not invested in follow-on transactions involving government seed investment into the VC asset class. This, despite many early-stage investments by TIA as well as specialised interventions such as the DTI's Support Programme for Industrial Innovation (SPII fund) and the THRIP (a similar DTI fund that incentivises private sector and university collaboration). The outcome is that such public sector investments have not generated follow-on deal-flow activity for private investors, and the majority of public sector VC-type deals still either only have government as the primary shareholder, or receive follow-on investment from the same government investor. Given the above, private sector fund managers reportedly do not see the reductions in government-backed VC, outlined above, as impinging upon the continued viability of the VC industry in its current form. Rather, respondents point out the missed opportunity of supporting rapid growth in the size and therefore impact of the VC industry, as a result of government's failure thus far to find a working public VC model. Ideally, such a model would entail public-backed and enabled deal flow that would stimulate increased private sector deployment of VC funds.	*Continued deterioration*
Lack of exit mechanisms	None of the respondents reported an inability to exit from deals. It is apparent that the industry is pursuing more exit-focused deals, exit-focused entrepreneurs and an improvement in the quality and availability of exit mechanisms as a collective objective.	*Improvement*
Lack of suitable management for VC deals	A shortage of suitable management at VC fund managers and the lack of financial incentives to attract management from corporate opportunities remain a fundamental challenge. This is aggravated by unrealistic expectations of remuneration as well as the fact that stock options are not an attractive incentive to offset the relatively low wages in the sector, different to the frequent use of stock options as a remuneration incentive in developed VC markets such as the USA.	*Remains a key inhibitor*
The VC industry outlook for finding suitable investment deals over the next 12 months	79% of respondents are optimistic about finding suitable deals in the next 12 months.	*Improvement*

4 | The state of the South African VC industry: A comparison with previous SAVCA VC surveys *continued*

Contributor/focus area	Responses/observations	Change from last survey
The VC industry outlook for raising additional funds for investments over the next 12 months	67% of respondents are optimistic about raising additional funds for new deals in the next 12 months, whilst 89% of respondents are optimistic about finding more money for follow-on funding to existing portfolio investments.	***Unchanged***
General outlook, including exits and achieving growth targets	The vast majority of respondents reported having a pipeline of exit-ready transactions in the foreseeable future, and expect moderate to high multiple returns. The overall outlook for starting new funds and finding new deals points towards a positive outlook for the VC asset class as a whole. However, the negative impact of TIA's focus away from risk capital and the IDC's restructuring may hamper the rapid growth of the industry.	***Mixed***

VCs are upbeat about the future prospects for finding suitable deals, exercising profitable exits and continuing to manage profitable funds.

TIA and the VC unit of the IDC are in different phases of drastically reducing investments in VC.

5 | Conclusion

Is venture capital in South Africa a viable industry, with healthy prospects? The answer may depend on the perspective, and in particular on whether the question is viewed by those investors seeking pure financial returns, or by those investors – primarily government-backed entities – seeking to harness the VC asset class as an instrument to increase job creation, to pursue new types of economic activity and ultimately to ensure faster and more sustainable growth in the South African economy.

The following section draws conclusions from this year's SAVCA VC survey to answer the question from both perspectives.

Growth in the number of VC fund managers in South Africa

A number of new fund managers have entered the space during the survey period, attracted to the increase in entrepreneurial high-tech activity (especially so in the Western Cape), but also due to other factors such as lower barriers to entry by way of the decrease in capital needed to participate in VC-type deals, the impact of a weakening exchange rate in rendering local transactions much more appealing to fund managers drawing off foreign-based funds, and an increase in angel investors, some benefiting directly from the Section 12j tax allowance.

Many recent deals involving angels and independent fund managers have targeted the vast digitisation opportunity, while established businesses and public sector entities are embracing technology that will enable them to expand market access (e.g. financial technologies that enable banks to offer services via mobile phones) and to facilitate improved public service delivery (e.g. free Wi-Fi rollout through South African cities based on smart-phone uptake and demand for connectivity in public places).

South Africa is sharing in the global demand for digital-enabled business services and the rollout of fintech incubators by the leading banks, the establishment of innovation centres by the mobile operators, and the footprint created by South African multinational companies' digital expansion throughout the African continent, all collectively stimulating market access for high-growth entrepreneurial ventures, many of which benefited from VC-type investments as recorded through this survey.

This represents a significant improvement in local conditions compared to previous survey periods, as a larger local market for high-growth business ventures is a better launch platform from which to tap into global market opportunities.

Growth in exit activity

The last two years covered in the survey reflect a marked increase in the number of deals involving individuals or funds that have had direct operational experience in the sectors they're targeting for investment. This trend signifies a further deepening of the value provided by VC fund managers, whose offering goes well beyond the provision of capital, to include business acumen and experience, as well as sector-specific know-how, networks and insights. The point is further strengthened through the number of deals that involve entrepreneurs who previously benefited from South African VC investments, and who are now investing as angel investors and fund managers into the South African start-up environment.

The rapid spike in investment activity around 2006 to 2009 and the indicative viability of such deals have resulted in a vast pipeline for VC-type exits expected in the next 18 to 24 months. Fund managers today place more emphasis on exit-ready investments and have had several first-hand opportunities to test local and foreign exit mechanisms. Investments since 2012 demonstrate a faster turn-around time from investment to realisation, and this is expected to continue. Exit returns for investors are generally best of class, but this can only be assessed on a per-deal basis rather than on a portfolio-wide basis, as most funds operate drawdown facilities, making it impossible to assess the ROI on a completed fund life cycle.

The exit outlook is therefore considered positive.

These findings speak to the above-mentioned question from the investor perspective: South African VC fund managers are able to find suitable deals, have sufficient know-how and experience with which to help move deals to a mature and profitable stage from which exits are feasible, and have the track-record of using exits to achieve above-average rates of return.

The SAVCA 2015 VC survey indicates that financial returns in the asset class are achievable and sufficient to justify continued investment in the asset class as a whole.

The role of VC in the socio-economic transformation of the South African economy

VC in South Africa remains a small, niche asset class when compared to other asset classes such as private equity, listed equity, fixed income and property; this is despite a ten-year history of continued public and private investment in high-growth, risk-equity-type transactions. The question of its impact in transforming the South African economy goes beyond VC as an investment activity and touches on the important contribution to the mainstream economy of high-growth scalable business activity. VC is only one part of a more comprehensive system to unlock entrepreneurial activity and to generate globally competitive local business activity.

High-tech VC type businesses are still in short supply in South Africa

VC is a highly specialised investment option that focuses on a specific portion of the economy, namely high-growth scalable business enterprises. This portion of the South African economy is still very small, with the economy historically made up of large companies operating in established markets.

The local VC industry is at best expected to grow organically, until such time as external interventions, including public funds or similar entrepreneurial incentives, are introduced with which to stimulate new economic activity.

A rapid increase in the share of economic activity for high-growth start-ups and similar SME businesses may only materialise through aggressive and appropriate support interventions. Once this happens, the presence of such increased numbers of high-growth SMEs should accelerate VC deal flow from current levels, by ramping up the supply of talented entrepreneurs and high-growth business investment opportunities. This will only succeed in sustainably transforming the economy if additional incentives and support measures are deployed to stimulate the appetite amongst VC investors for increased deal flow activity.

Section 12j and tax incentives to stimulate private VC uptake

The impact of Section 12j, an incentive to stimulate increased fund allocation to the VC asset class, has had tangible impact, evidenced by the formation of specialised fund management teams that participated in this year's survey. The impact is still comparatively small as the incentive has only been in existence for a relatively short period of time – too short to validate its long-term potential as a vehicle to accelerate the overall growth of the VC industry.

Government investment in the VC asset class

Government's two main interventions to speed up increased VC activity in the South African economy over the past ten years revolved around the TIA, and the IDC's VC unit. Both interventions are seemingly disappearing from the industry, either by no longer offering high-risk equity-type and VC-type products, or changing focus to prioritise non-VC-type products and services.

TIA is no longer operating as a risk-equity high-growth fund manager and instead operates a loan book, providing conditional grants as well as institutional grants to support technology transfer offices at public-funded universities, and incubators. During the survey period, this DST-backed public entity allocated upwards of R650 million in conditional grants to South African recipients, many of which were publicly financed institutions such as science councils (e.g. CSIR) and universities.

The impact of this restructure and the ability to perform risk-equity-type transactions is significant, as conditional grants do not involve the same focus, outlook and operating practices typical to risk-equity deals. The negative impact is evident given that deals backed by TIA have not served in any way as deal flow to other fund managers; in fact, VC-type investors have reportedly found it very difficult – if not impossible – to invest in deals that originated from TIA. Reasons offered for this by respondents includes the lack of market access (investments are often into platform technologies, rather than into business products), unfavourable commercial structures, unworkable legal structures in respect of IP involving publicly financed institutions, and difficulty in working with an ever-changing TIA operational team (it has changed CEOs in almost each of the years of existence), to name a few.

The second public fund manager potentially shifting focus away from risk-type VC transactions is the IDC. The IDC previously operated the Support Programme for Industrial Innovation (the SPII Fund). This fund became dormant following its transfer from the IDC back to the DTI and there is no indication as to when this historically successful prototype seed fund will be active again. Lastly, the restructuring of the IDC's own VC unit into an industry- rather than technology-focused fund will leave a notable gap in funding, especially for deals involving publicly funded institutions, as the IDC VC unit has been the dominant VC funder (by number of transactions and size of deals) throughout the last few years.

Disconnect between public-funded deal flow and private sector investment activity

There is no evidence of increased deal flow to private investors in the VC asset class as a result of public sector investment activity: none of the private investors participating in this survey reported any deal flow from publicly funded sources. This needs to be addressed as an urgent and fundamental impediment to experiencing rapid growth in investment activity in high-tech businesses, and to realising socio-economic returns. Failing this, the South African VC asset class will at best continue to grow at average and organically driven rates, subject to market pressures and the high risks associated with being an emergent asset class.

The SAVCA 2015 VC survey shows that government interventions in the VC asset class requires review, as there is little evidence that government-led efforts to date have resulted in ramping up growth of the sector.

The status of the VC ecosystem

Impact figures involving jobs created and the knock-on effect of stimulating the economy are difficult to find. However, considering the measured growth in activity amongst private fund managers, the documented and widely accepted role that early-stage start-up businesses have played in emerging economies, and the role that a functioning VC investment community can play in scaling such start-up activities into mainstream economies, VC in South Africa ought to be harnessed to support improved, more diversified and more sustainable economic growth.

The conclusion from this latest SAVCA VC survey, covering the years 2011 to 2015, is that the VC asset class in South Africa is a functioning albeit niche asset class that remains emergent in nature, and has the fundamental momentum and impact that, through sensible backing and enablement by government, ought to be leveraged as an instrument to accelerate socio-economic transformation.

6 | About

About Venture Solutions

Venture Solutions is an innovation management and commercialisation consultancy active in Sub-Saharan Africa. The focus is developing high-tech start-ups. Know-how and methodologies target commercialisation of new technologies, leveraging intellectual assets for business profits, and structuring start-up businesses for sustainable growth.

The business operates in three key domains as well as the vital overlap and interplay between those domains, being (i) advising corporations, established SMEs and public sector enterprises; (ii) advising universities, research labs and science councils in the management of technology transfer; and (iii) consulting to the start-up ecosystem including business incubators, science parks, VC and angel investors.

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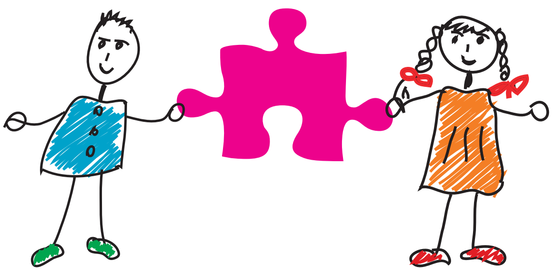
About SAVCA

The Southern African Venture Capital and Private Equity Association (SAVCA) is the industry body and public policy advocate for private equity and venture capital in Southern Africa. It represents around 140 members, accounting for approximately R170 billion in assets under management.

SAVCA promotes Southern African private equity and venture capital by engaging with regulators and legislators on matters affecting the industry, providing relevant and insightful research, offering training and creating meaningful networking opportunities for industry players.

Website: www.savca.co.za
Twitter: SAVCA_news



7 | Abbreviations

BBBEE	Broad based Black Economic Empowerment
BEE	Black Economic Empowerment
CSIR	Council for Scientific and Industrial Research
DST	Department of Science and Technology
DTI	Department of Trade and Industry
FAIS	Financial Advisory and Intermediary Services Act
Fintech	Financial sector technologies
ICT	Information and Communications Technology
IDC	Industrial Development Corporation
IP	Intellectual Property
NIPMO	National Intellectual Property Management Office
ROI	Return on Investment
SAVCA	Southern African Venture Capital and Private Equity Association
SME	Small, Medium and Micro Enterprises
SPII	Support Programme for Industrial Innovation
THRIP	Technology and Human Resources for Industry Programme
TIA	Technology Innovation Agency
VC	Venture capital

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