Enterprise Management

Venture capital could bail you out

Capital still stands out as one of the major challenges to business start-ups in Uganda, but with venture capital, a unique form of financing beginning to take root in Uganda, the challenge of start up financing is being reduced steadily, writes **MICHAEL KANAABI**

Young entrepreneurs brainstorming at a business incubation session in Makerere, a Kampala suburb

Early this year, we ran a story of Lungs Oling, 26, who used to produce fire starter briquettes manually until he beat other applicants to become the first start-up entrepreneur to be funded by Mara Launch Fund, a venture capital scheme.

"The sh8m of equity investment has enabled me acquire a fabrication machine and my production has shot up five-fold," he says.

Like Oling, many young entrepreneurs in Uganda, who would otherwise have been crippled by lack of start-up capital, are getting a second chance at doing business because of the venture capital schemes available; not least of which is the Government's Youth Venture Capital Fund.

WHAT IS VENTURE CAPITAL?

Liz Karungi, an administrator at a venture capital fund, says venture capital is a form of capital offered to high-risk start-up or early stage businesses with high growth potential in exchange for equity in the business.

INDUSTRY OVERVIEW

The venture capital industry in Uganda is still nascent, with the much larger private equity sector where it belongs also just emerging.

Although private equity firms have been investing in some local companies in Uganda like Umeme Limited, Dfcu Bank and Quality Chemical Industries over the years, the investors were based outside the country.

Today, firms like Pearl Capital Partners, which focuses on agriculture financing, and Damascus Capital, which is a generalist private equity firm, have set up locally. Currently, there is over $5b worth of private equity raised to invest in East Africa.

For the venture capital-specific players, we have Grofin, which has been around for a while, the Mara Launch Fund, which started operations in Uganda recently, and the Angel Finance Corporation, among others.

HOW IT WORKS

In most cases, it begins with an entrepreneur pitching their business to a venture capitalist. The venture capitalist will then assess the business, look at its finances, potential to grow and the mid to long-term value it is likely to generate, among other things, then invest in it if they think it is viable and feasible.

"The venture capitalist will inject money into a company and take shares in it generally looking to participate for a period of about five to 10 years. During this period, both the venture capitalist and other shareholders of the business will put together their expertise, their connections and capital to ensure the business becomes a much larger enterprise of significantly higher value," Kim Kamarebe, the managing partner at Damascus Capital, explains.

She says when this period elapses, the venture capitalist will be looking at selling his stake in the company. Often, at this stage, the company is expected to have grown so much that the other shareholders have the capability to buy off the stake of the venture capitalist. The shareholders have the first priority of buying the stake.

Additionally, the company at this stage usually qualifies to take on bank debt so the shareholders can acquire a loan and buy back the stake. Alternatively, the company can sell to a bigger or regional player or even go public and list on the stock exchange if they qualify. This depends on the agreement between the venture capitalist and other shareholders.

BASICS REQUIREMENTS

Karungi says you must be a registered company so that the capital to be invested by the venture capitalists can be equated or turned into an equitable amount of shares that are tradeable and can change hands when required to.

"A detailed business plan is also a must-have. The investor needs to know what your business is aiming at achieving and where exactly you are heading," she says.

"You need to demonstrate your past performance and future projections in terms of expected sales and profit figures, among others."

CONS OF VENTURE CAPITAL

"The fact that you have to let go of a stake in your business in exchange for capital for most hard-headed entrepreneurs is a bitter pill to swallow," says Alfred Kibirige, a young entrepreneur.

He also fears that the strategic direction of the business might have to change when venture capitalists come in because they might want the business to grow faster and target a bigger market as they want the best possible returns for their capital.

Competition for this kind of funding is always tight, putting out most fresh entrepreneurs who might have bright ideas and businesses, but have not fine-tuned them enough to qualify for the funding.

The requirements for venture capitalists to finance one's business are often unrealistic for a young, struggling business.

CHALLENGES

Kamarebe says entrepreneurs are still largely unfamiliar with the concept of venture capital and take long to warm up to it.

Joe Kalema, an investment professional with Damascus Capital in Kampala, says most small and medium enterprises are hesitant to register their businesses formally, professionalise their management, become tax complaint and open up to global scrutiny, which are key in attracting venture capital.

The do-it-yourself mentality is also a major hindrance to the growth of venture capital among small businesses.

"These entrepreneurs would rather own 100% of a business worth sh1m than 50% of a business worth sh50m," Kalema says.

Get funding faster

Joe Kalema, an investment professional with Damascus Capital in Kampala, points out that to position yourself better for the capital injection, you should adopt global standards in the way you do your business in terms of branding, quality, accounting, tax and professionalism.

Venture capitalists would be more inclined to fund a business that thinks regionally in terms of growth and reach since this will guarantee competitiveness, sustainability and better returns in the long run.