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Foreign Venture Capital Investments in Sub-Saharan African Technology Startups

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A *McKinsey* report published in February 2014 estimates that *mobile phone ownership* among adults in ***Sub-Saharan Africa (SSA)*** is estimated to be 66 percent. The rapid spread of Internet-enabled mobile phones throughout SSA has created an opportunity for the emergence of tech startups and venture capital firms in economically vibrant cities such as Accra, Lagos, and Nairobi. For many people, mobile phones are more than a communication tool. They are a technology platform that provides access to other services and experiences such as money transfer, entertainment, and education. As a consequence, tech entrepreneurs have seized this opportunity to provide tools and applications relevant to the African context. Their rise is aided in part by relatively low operational capital costs due to inexpensive Internet bandwidth and data storage. This growth offers much needed employment, opens avenues for wealth generation, and increases the role of science and technology in the continuing expansion of Africa's economies. Notable SSA startups include Konga, an ecommerce company in Nigeria, and Ushahidi, a global eyewitness reporting application founded in Kenya.

Naturally, the rise of such startups has attracted foreign venture capitalists (FVCs) from outside Africa such as Intel Capital and Kinnevik, wishing to invest in the startups for profit or social impact. Investing in startups comes with an inherent high risk of failure, which is perhaps higher than that in "traditional" businesses since startups are regarded as entrepreneurial experiments. Thus, FVCs face an elevated risk in addition to what they already face within their broader classification as foreign direct investors.

A pertinent question is how can an FVC effectively participate in the management of a startup in a case where it does not have a local presence? The legal approach to this question is to build watertight contractual provisions in the term sheet and other financing documents that give an FVC sufficient supervision powers in key management affairs such as hiring, capital expenditures, and scaling decisions. The FVC may, for example, require regular reporting and an effective say on technical operations. However, even with comprehensive contractual safeguards, it is challenging to supervise a startup from afar. For example, if the startup founders fail to meet revenue targets and an FVC that has invested in the startup ousts them, will the FVC readily find professionals with the same skill, knowledge, and vision to take the place of the departed startup founders? Equally, any case to enforce terms brought before a court or arbitrator will jeopardize the startup on many fundamental fronts such as shareholder relations and public reputation.

Whereas the scenarios contemplated above may appear gloomy, they should make FVCs better equipped in their approaches to startups in SSA, one of which is to ensure that FVCs cultivate good working relationships with teams that have demonstrated a good chance of success. Also, FVCs may mitigate the risk associated with lack of local presence by investing indirectly in startups through venture capital firms and innovation hubs already on the ground.