5 factors to look out for before investing in a VC

By Philani Sangweni

8 Dec 2020

Many entrepreneurs rely on investments from venture capitalists (VCs) to fund their growth. These are usually firms that rely on outside investors for the money they put into startups.

Philani Sangweni

But not all VC firms are equal. Just as they would for other investment vehicles, investors need to do their homework before committing cash to a fund.

Here are some of the things they should look for.

1. Entrepreneurial experience

The more entrepreneurial experience that a VC team has, the more likely they are to understand what's needed to make a startup successful. Higher success rates and more exits ultimately mean better returns for your investment.

Unfortunately, many traditional VC firms are made up of former accountants and corporate analysts. While they might be good at financial analysis, they don't always have intimate knowledge of the struggles that entrepreneurs face on a daily basis.

That means that when a company in which they've invested is struggling, they may not always have the requisite knowledge to step in with any necessary interventions. Given that most VCs expect only a small percentage of the companies in which they invest to exit and succeed, it'd be fair to assume that wouldn't be too much of a problem.

But as an investor, you want to ensure that your money has the best possible chance of making good returns. A VC team with a strong entrepreneurial experience is therefore pivotal.

2. International backgrounds

While there are a handful of startups that have done well while exclusively serving the South African market, this does come with constraints.

If you want real returns, rather look for VCs that aim to take the startups in their portfolios global. But ambition and ability are two different things. Before investing in a VC fund, examine the team's credentials. Do they have experience doing business in multiple markets? Have they previously helped businesses to expand globally?

You also shouldn't be afraid to inquire about their access to international networks as these will play a large role in how they go about ensuring that the startups in their portfolio can expand globally, and even achieve an international exit.

3. Who else backs them?

You can learn a lot about a VC by finding out about its other backers. What kind of track record do they have? Do they have a history of making smart investments?

A good indicator will be backing from different kinds of respected investors, including other successful entrepreneurs, and the most respected private investors in a particular ecosystem. This variety shows that the VC has a good prospectus and that the buy-in to its investment philosophy isn't limited.

4. More than just returns

A good VC won't just offer investors returns in the shape of successful startup exits; but also the opportunity to be part of businesses that build the future of South Africa.

In South Africa, a number of VCs have made use of the Section 12J tax provision, which offers individuals, trusts and companies resident in South Africa a tax rebate on investments (up to 45% for individuals and trusts, and 28% for companies) - if made through an approved venture capital company (VCC).

It's an important regulation, which has helped jumpstart the South African VC space. If you're an investor, you want to ensure that any VC in which you're considering investing understands how the mechanism works, and is able to get the most out of it for you.

5. Local nous

With record low interest rates pushing developed market investors into the startup space, VCs have been forced to look elsewhere for high-return/low-cost investments. South Africa, with its relatively established tech sector, has been a natural target.

Occasionally, however, that can mean overseas VCs entering the country without any real knowledge of the local business environment. Unless they find good local collaborators, this can lead to bad business advice and a higher rate of failed startups.

As important as it is that you invest in a VC that can take its startups global, it's equally critical that it has local nous necessary to identify the startups that stand a chance both here and abroad.

Embracing VC

Once considered the realm of mavericks, VC today is a much more consolidated blend of art and science. But even as it becomes more accessible, investors should still make sure they do their homework in order to identify the right VC - one that'll put their money to work growing startups, and generating real returns.

ABOUT THE AUTHOR

Philani Sangweni is the managing partner at Entrepreneurs for Entrepreneurs (E4E) Africa. an entrepreneur-led startup investment fund. Prior to the fund's formation, Philani was a senior manager at Accenture and COO at Fundi. After exiting Fundi in 2017, he co-founded a boutique technology consultancy and Akro while completing his EMBA at Insead.