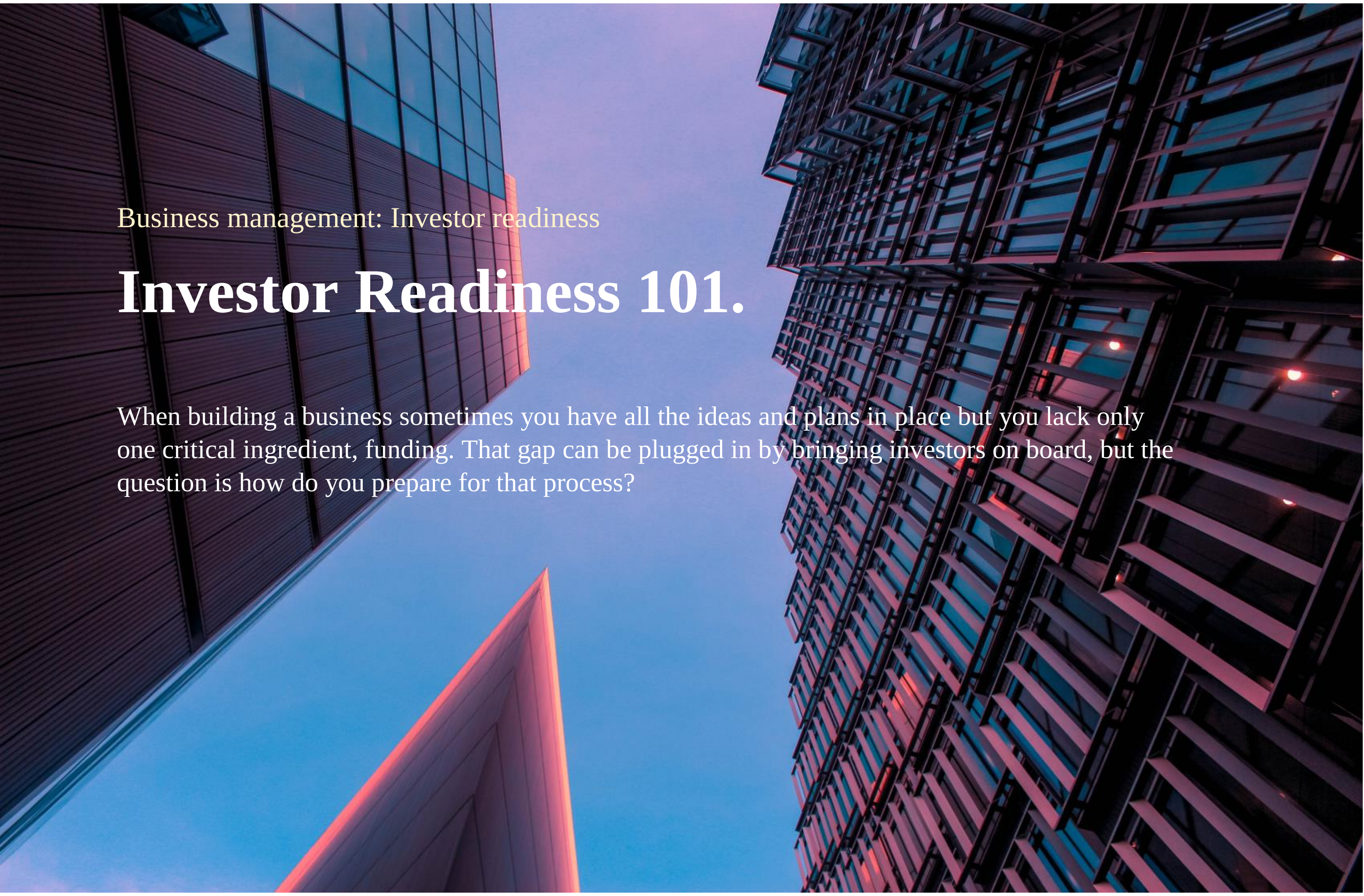
ALGUM AFRICA
CAPITAL LLP



Business management: Investor readiness

Investor Readiness 101.

When building a business sometimes you have all the ideas and plans in place but you lack only one critical ingredient, funding. That gap can be plugged in by bringing investors on board, but the question is how do you prepare for that process?

26 January 2023

www.algumafricacapital.com

The rate at which businesses are started would make you think that starting and running a business is a small fete. Lifting a business from the ground to the 'cruising' level is a humongous task. As the business evolves, so do challenges. One of those challenges is sourcing funds to scale operations.

In our previous note, **<u>Understanding capital structure decisions along business life-cycle transitions: A prelude to investor-readiness</u>**, we discussed the capital structure considerations along the various business life cycles. This note builds up on that by delving deeper into how to prepare for investor readiness. Once an entrepreneur has identified the kind of funding that is appropriate for the business based on its life cycle, the journey of investor readiness begins.

Broadly speaking, the funding may be in form of equity (and its variations) or debt (and its variations). We take a look at equity funding. This is considered to be relatively riskier, more expensive, and is said to be patient capital. The business sells off a stake for capital injection. Before an entrepreneur goes out to raise equity capital, they need to ask themselves whether the business is ready and whether it looks attractive enough to raise the interest of appropriate suitors. This is what we call investor readiness. Investor-readiness is the process of preparing a business to make it investable. It is the process of ensuring that the business has all the critical elements in place-or there is a serious commitment to put in place those critical elements, which ideally would address the concerns of investors, and presenting it in a manner that easily demonstrates the opportunity the potential investors would be getting by taking the risk of becoming equity partners.

When investors are looking to invest in a business, they first assess if it fits within their overall investment philosophy and particular fund objectives. Then they evaluate the three most critical aspects of the investment opportunity – the market, the business opportunity, and the team. Is the market the business is in big enough? Is the problem identified impactful enough and is it worth tackling? Is the team able to capture that market? Some investors are industry agnostic while others are generalists. Some investors are more impact-oriented while others are commercially driven and focus more on superior returns. Geographical location may also form part of the considerations for some investors. A business should ensure that its aware of all these as it prepares to bring on board equity capital investors.

Some of the critical elements of investor readiness include:

1) Legal registration
It is important to ensure that the business is properly registered with all the relevant regulatory bodies. The business should also be compliant, or if there are any compliance gaps, there should be a demonstration that it's in the process of regularising them.

2) Organizational structure
This entails properly depicting how the entire organization is structured. The branches, subsidiaries, and all entities owned by the business or where it has significant stakes.

3) Operational setup
Part of the readiness is about how all the moving operational parts come together as one cohesive value-generating engine. This should be documented, or at least the business should be in the process of doing so. However, there should be a clear sign of how things are handled and the personnel responsible for the critical functions.

4) Corporate governance structures
Corporate governance in any business is very important for investors. They need to be assured that whatever resources they inject into the business will be taken care of. It is therefore important for an entrepreneur to ensure that these structures are properly set up and functioning as required.

5) Defining the problem being solved
What is the business set out to do? This helps investors determine if the business is solving a real problem. Solving real problems provides real markets for businesses which ensures that there will be an uptake of the company's products/services.

6) The business' killer solution
Is the solution being provided by the business the right one for the identified problem? A good product-market fit guarantees business and the building of a loyal customer base. Investors like to use this as a measure of the business's ability to provide a decent return on the capital injected.

It is paramount that the entrepreneur is aware of the process taken by investors when they are evaluating an investment opportunity. Many investors have a **screening criterion** that helps them quickly shortlist potential candidates out of the many deals they come across daily. Another is **investability**. According to the dictionary definition, investability comes from the word investable which means ready for investment, circling us back to our topic of investor-readiness. This goes to show that investors will be keen to evaluate if your business is ready for its investment. Where the business has several issues, investors will not show interest. Issues may include a weak entrepreneur or management team, potentially weak financials, lack of a clear route-market path to capture increasing market share/wide adoption, weak corporate governance structures, and or unclear product-market fit. The other factor is **poor pitching skills.** Understanding what investors are looking for and presenting the business in the best light is an important skill worth learning. Entrepreneurs should be able to develop good pitch decks, investment teasers, and or information memorandums.

The African business environment is ripe for investments and investors continue to flock in to get a share.

According to the 2021 Africa Investment Report, African start-ups raised a total of USD 4.6 billion, 2x what was raised in 2020. In addition, the number of deals grew by 25.0% over the same period. Most of the funding went to start-ups in South Africa, Nigeria, Kenya, and Egypt.

As entrepreneurs consider getting investors they need to think through the entire process. Don't be 'married to the wrong partner'.

About Algum Africa Capital

We are a pan-African Management Consulting and Business Advisory firm. We partner with SMEs and Large Enterprises to help them overcome various business challenges. We position them to achieve success through tailor-made solutions to overcome strategic, financial, organizational, managerial and operational challenges.

Our suite of offerings includes but not limited to strategy, investor readiness, capital raising, mergers and acquisitions, financial modeling, business analytics, business restructuring, business plans, due diligence and operational optimization. We also offer research and analytics services, private equity deal pipeline development and training and capacity building.

Contacts

Please visit www.algumafricacapital.com to learn more about us.

For general inquiries, write to info@algumafricacapital.com

For research and insights write to insights@algumafricacapital.com

For training and capacity building write to training@algumafricacapital.com

For consulting and advisory write to advisory@algumafricacapital.com

If a private equity investor looking for a pipeline write to dealpipeline@algumafricacapital.com