The Funding Prospects for Nigerian Startups

At the startup phase, access to financing is a major constraint which businesses in every sector in Nigeria must maneuver. For a country bedeviled with a challenging economic and socio-political environment, the fundraising process is extremely tough.

In this article, we will be discussing the prospects for access to startup funding in the current landscape of Nigeria's tech industry.

How Does Fundraising Work?

A start-up or an SME commences after money is raised from personal savings or from friends and family. However, the tech field has its own unique peculiarities. Asides the regular preliminary costs that a founder would have to incur, the costs of building software and product testing through the different stages is quite expensive. Some tech start-up founders have been able to bootstrap the whole process from scratch and slowly grind towards profitability, while the vast majority would require capital to fund and scale their operations. While there is the option of raising funds through either equity or debt instrument, most early-stage start-ups typically prefer equity financing because it puts less pressure on the business's growing revenue.

Understanding Equity Funding Rounds

Every time a start-up raises equity funds from investors, it's called an investing round. But before any of these rounds begin, the business must undergo a valuation process, where the company is ascribed a monetary value based on various factors such as the current and projected financial position of the business, proven strength of its management team, perceived reputation in the industry, etc. The funds provided by investors are in exchange for part-ownership of the company.

Seed funding: This is the first investment in a start-up in exchange for a stake in the company. It can be raised from angel investors or high net worth individuals that invest in start-ups at their early stages. Other avenues to raise a seed round in Nigeria are from Start-up Accelerators, Incubators, Micro-Venture Capital firms, and Venture Capital firms focused on early stage start-ups. The seed funding round usually happens at the pre-revenue stage but there must be an identified Total Addressable Market (TAM). Also, the product/service offering must have gone past its proof-of-concept phase i.e., when there is a Minimum Viable Product, or at least a clear indication of demand for the product/service.

Series A: After the seed round, the business would very likely need more capital to optimize its product offerings. In this case, the founder may need to raise more funds. Series A financing can be made available to start-ups that have a profitable business model. At this round, what the investors are looking out for are start-ups with a great monetization plan, a solid strategy for turning their investment into long-term growth and that will ultimately give them good returns. This funding round will provide just enough leverage for the business to develop its product/service offerings and to execute its go-to-market strategy.

Series B: A Series B round is more focused on financing the growth and expansion phase of the start-up's lifecycle i.e., transitioning the start-up from its development stage into a more established business. Before a start-up is able to successfully raise a series B round from investors, it may not necessarily have started making profits; however, it must have a solid track record and higher bottom-line projections after its previous raises.

Series C: Series C financing rounds are usually raised to achieve significant scale in revenues, or to make a start-up attractive for exit opportunities like an initial public offering or a juicy acquisition deal. Series C and beyond are usually referred to as later-stage investments.

Series D: Start-ups that seek Series D financing are successful ones who want to further their success by introducing new products, acquiring other businesses, or expanding their reach into new markets or locations. After this round, there is no restriction to the number of investments rounds that a company can raise if they wish to. Some businesses go ahead to raise more investments through Series E, F, G, etc.

Challenges with Start-up Funding

The most common challenges that start-ups face during their early financing stage is the inability to keep proper books of account and inability to afford quality professionals for the required external audit, tax compliance and business valuation services. Investors are more trusting of valuations conducted by reputable firms and these services do not come cheap.

Another major challenge that Nigerian tech start-ups face is the uncertain regulatory environment. Most new fintech start-ups have had to innovate around some severe regulations issued by regulatory bodies from time to time. While some have been successful, others have not. So far, these regulations have had an impact on the decisions of both foreign and local investors.

Current and Future Outlook

There are currently over 300 Accelerators, Syndicates, Angel investors, Micro VCs, Venture capital, and private equity funds looking to invest in Nigerian start-ups with ticket sizes ranging from $25k-$25m.

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According to a recent publication by Maxime Bayan, a Senior Venture Builder at BFA Global, Nigerian start-ups raised about $321m in the first half of this year. Worthy of note here is Kuda, a 5-year-old digital retail bank that raised $25m in March 2021 and closed $55m in a Series B round four months later.

Flutterwave, another 5-year-old Nigerian Payments start-up, also achieved its unicorn status this year (Valued at over $1 billion). Coming barely a year after Stripe's acquisition of Paystack, these deals have been perceived as a massive win for the ecosystem and have also set in motion a greater momentum for start-up investment in Nigeria.

Although some skeptics believe that there is an ongoing bubble in the fintech space based on these recent events, we believe that the current traction, larger investments, higher valuation multiples, etc., are justified by the high growth prospects in the tech space and the "higher risk, higher returns" nature of tech investments.

With the enactment of the 2019 Finance Act, a new progressive Company Income Tax (CIT) rate regime was introduced. Under this revised regime, start-ups with annual gross turnover less than N25 million have been completely exempted from paying CIT and charging Value Added Tax (VAT). This tax incentive is a boost for many prospective founders looking to start small.

Conclusion

There have been ongoing discussions about how Covid-19 has changed what the world has considered being normal. We anticipate that the business terrain post-covid will be more conducive to the success of tech start-ups as the new normal is going to be a lot more reliant on digital innovation because the pandemic has significantly changed the way people operate businesses.

We foresee that Nigeria will not be left out of this disruptive trend in the coming decades. It has already been recognized as one of the top 5 emerging markets driving the growth of technology in Africa.

Backed by a rapidly growing and supportive tech ecosystem, smart and visionary start-up founders in Nigeria are now better positioned to access funding that will enable them to continue to build solutions that will meet the continent's increasingly growing demand for digitization.

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