Angel Networks in Emerging Markets: A Guide for Development Institutions

ANGEL NETWORK SPOTLIGHT | 2020

iungo capital

Credit: iungo capital

Status as of May 2020

FOUNDED: 2016

BASED: Kampala, Uganda

INVESTMENT GEOGRAPHY: Uganda, Kenya, Rwanda

FORM: Hybrid for-profit fund with nonprofit technical assistance affiliate

NUMBER OF ANGELS: 50; 20 active

NUMBER OF DEALS: 20

TOTAL FUNDING: $4.5M USD from fund and angels combined

INVESTMENT FOCUS: Small and Medium Enterprises; sector agnostic (core to date in light manufacturing and agriculture)

WHAT MAKES THIS NETWORK SPECIAL

iungo capital's innovative approach aligns the motivations of a for-profit fund, non-profit technical assistance provider, and local angel investors to meet the finance and support needs of East African Small and Medium Enterprises (SMEs). Although it does not manage a formal angel network, the iungo capital fund only invests in companies for which it has identified a local angel investor willing to co-invest and serve as a mentor.

BUSINESS MODEL

- iungo capital's evergreen fund structure relies on investment returns to support its work. At the end of 2019 it was close to operational break-even, three years after its first investment.
- iungo xl, the nonprofit technical assistance provider, receives success fees for its services from assisted companies that progress and receive investment from iungo capital. After three years of grants to subsidize the working capital gap, it is expected to operate on a break-even basis.
- iungo capital's angel engagement is integral to its model and does not require additional financial support.

KEY ANGEL ENGAGEMENT STRATEGIES

- iungo capital identifies potential angel investors and engages them one-on-one to mentor and invest in a specific business that can benefit from the angel's particular expertise.
- With iungo capital managing deal structuring and ongoing administration, the angel investors focus on mentoring and supporting the company – the "fun" and rewarding part of angel investing.
- iungo capital coaches the angel investors, most of whom are new to angel investing, on the entrepreneurial investment process.

KEY ENTREPRENEUR ENGAGEMENT STRATEGIES

- The fund and its informal business network identify promising SMEs that have financing and assistance needs, then the nonprofit iungo xl provides customized technical assistance to selected SMEs.
- SMEs that make the necessary progress and get approved by iungo capital's investment committee receive investment from the fund and the co-investing angel, and ongoing technical assistance from iungo xl.
- Entrepreneurs benefit from the mentorship and connections of a local angel investor with relevant business expertise.

Bonny Moellenbrock is the lead author of this case. This angel network spotlight is part of Angel Networks in Emerging Markets: A Guide for Development Institutions, a USAID-funded study of angel networks in Latin America, Middle East/North Africa, and Sub-Saharan Africa. This project is a collaboration between Center for the Advancement of Social Entrepreneurship at The Fuqua School of Business at Duke University, Millbrook Impact, and the Bertha Centre for Social Innovation and Entrepreneurship at the Graduate School of Business at the University of Cape Town. This case study reflects the status of the network as of May 2020. Find other cases from this project as well as the full guide at http://bit.ly/EmergingAngels

Development History and Model

FOUNDING STORY AND LEADERSHIP

> When I'm asked why I do this, part of my answer is always to prove a point – that it is possible to have a fund structure that can successfully address small investment tickets. That's part of the challenge, part of the fun.
> **Roeland Donckers**
> Co-founder

iungo capital was co-founded in 2016 by Steven Lee and Roeland Donckers, serial entrepreneurs and investors with over 25 years of global investment experience in emerging markets, including 10 years in Sub-Saharan Africa. They have extensive experience in building startups, scaling up growth-stage businesses, conducting turnarounds of non-performing businesses, and structuring investments. Through their work, Lee and Donckers found that the Small and Medium Enterprises (SMEs) often operating in traditional industries tended to have relatively higher employment generation than the early stage technology companies that often attract more investor attention. Seeking to have a positive economic impact in East Africa, they designed the iungo model specifically to address the financing and business needs of SMEs in the region.

Their goal was to address the "missing middle" – SMEs with a $50,000 to $500,000 USD working capital need that is too large for microfinance to address and too small or risky for venture funds or banks. They sought to provide investment capital as well as technical assistance services to address the companies' business development or other operational needs to maximize growth and impact potential. iungo launched in Uganda, a market that was less mature and crowded than Kenya, with unmet demand for this type of support and financing. They have since expanded to Rwanda and Kenya.

In addition to Lee and Donckers, from the United States and Belgium respectively, iungo now has nine team members from East Africa with business or financing education and experience to provide technical assistance and investment services to the target SMEs. iungo is sector-agnostic, focusing on SMEs that are at least two years old with at least $100,000 USD in revenue. They look for companies with strong founders, an interesting growth plan and market, and a need for financing and technical assistance to meet their growth goals. Most of their investments to date have been in labor-intensive "backbone" sectors and industries, including agricultural processing, food processing, light manufacturing, transport, and construction.

THE IUNGO SERVICE MODEL

> The impact of capacity building is longer term. We get hands-on involved and solve problems for the companies.
> **Roeland Donckers**
> Co-founder

The iungo 3-part service model is a unique combination of investment fund, technical assistance provider, and angel engagement specifically designed to reduce the cost and risk of investing in SMEs while addressing their capital and business needs. This approach creates a win-win-win scenario for all three parts of the model, in addition to the supported companies (see Figure 1).

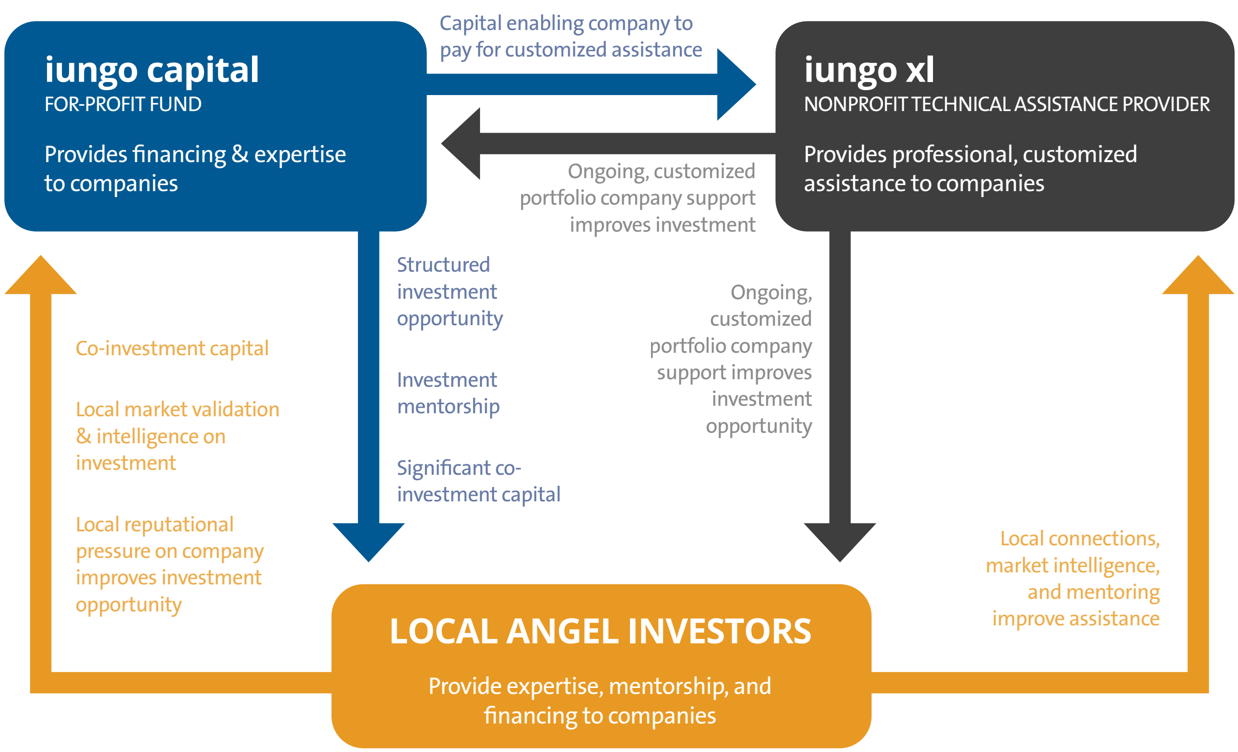
Part 1: iungo capital is an investment fund which sources, screens, and invests in SMEs. iungo invests primarily with debt and revenue share vehicles because these are a better fit for the SMEs, which have usually been in business for at least two years, are generating revenue, are familiar with debt instruments, and may not be interested in giving up ownership in return for an equity investment. In addition, debt and revenue share are self-liquidating structures that eliminate the need for an equity exit event such as a public offering or acquisition, which are less likely scenarios in these local markets.

Part 2: iungo xl is a separate, nonprofit entity that provides pre-investment and post-investment support to companies identified or invested in by iungo capital. Unlike an accelerator, it does not have cohorts of companies or a set curriculum. Rather, it identifies the individual needs of each company and provides customized assistance over a maximum 6-month period to address those needs. Companies that make progress on their milestones move forward with investment from iungo capital and continue to receive growth-oriented technical assistance from iungo xl; those that underperform and do not receive investment are dropped from the iungo xl program.

Part 3: While iungo does not directly manage an angel network, **local business angels** are key strategic partners along the entire investment and technical assistance process. Angels assist in sourcing and screening enterprises, and no investment is made by iungo capital unless the fund has identified a local professional with business expertise relevant to the company willing to co-invest and serve as a mentor to the company. Beyond committing financial capital and customized expertise to the enterprise, angel participation signals local validation of the business model and introduces a level of peer pressure and reputational risk that keeps entrepreneurs focused.

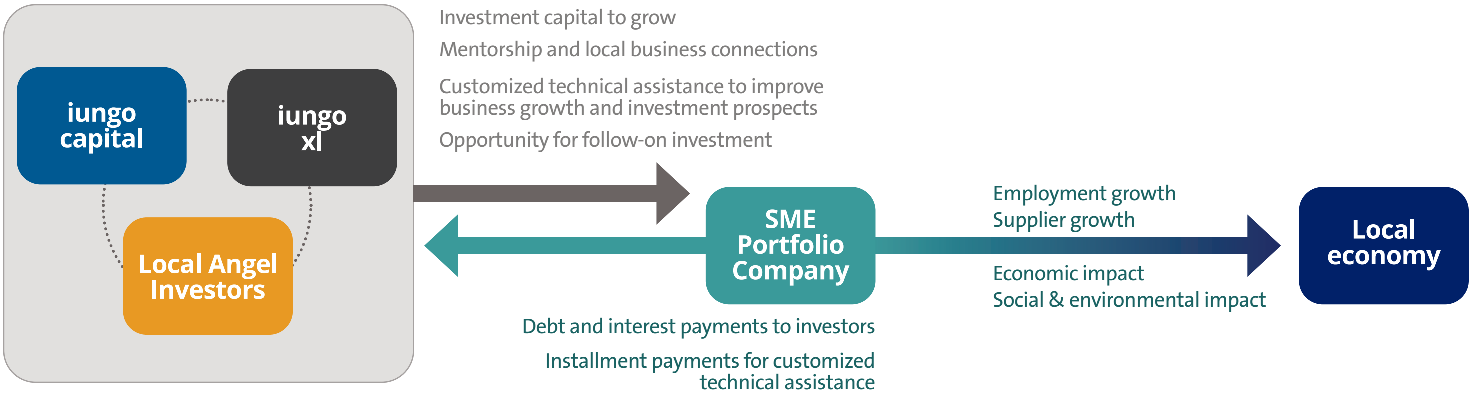
The participating angel investors benefit as well. iungo capital mentors the angels, allowing less experienced business angels to learn about direct investing, and structures the investments, allowing angels of all experience levels to focus on mentoring the entrepreneur, rather than administration.

FIGURE 1: iungo's risk- and cost-reducing virtuous cycle



A virtuous cycle: By aligning the needs and motivations of each stakeholder with iungo's mission, this 3-part model effectively serves the needs of the target SMEs, as shown in Figure 2. The SMEs receive customized technical assistance from iungo xl which positions them for investment. iungo capital identifies a local business angel to co-invest alongside the fund. The financing fuels the company's growth, with the angel mentor and iungo xl team dedicated to providing ongoing assistance along the way. In return, the growing company provides debt payments and financial return to iungo capital and the angel investor, and pays iungo xl for its services. Finally, the company generates positive economic and employment impacts, as well as any social or environmental benefits of its products or services.

FIGURE 2: iungo model benefits to companies and the economy



As of early 2020, iungo capital has facilitated $4.5M USD of investment into 20 SMEs, activating 20 angel investors who each made 5-20% of the total investment into the company. There is clear evidence that iungo plays a key role in activating new capital in this market; the majority of the local angels made their very first investment alongside iungo, and the majority of investees received their first external financing from iungo. Across portfolio companies, revenue has increased 94% after investment, and jobs have increased 15%.

Business Model & Path To Sustainability

EXAMPLE INVESTMENT:
ONE TO FISH

Portfolio company One to Fish, a fish processing and export company in Uganda with a staff that is 60% women, received investment from iungo in 2019. Prior to investment, iungo xl provided assistance with finance and accounting systems, supply chain management, and ESG practices. The participating angel investor is a founder of two businesses himself and has experience in the logistics, marketing, and exporting of fish products. iungo's mezzanine debt investment provided working capital for raw material, and led to a 70% increase in revenue in the six months post-investment. After a three-month grace period, One to Fish began making fixed monthly repayments and quarterly revenue share payments.

iungo capital launched and began investing with a $1M USD debt investment from the Dutch Good Growth Fund and individual high-net worth investors. Additional debt and equity capital followed from European and American impact-oriented funds including DOEN Participaties, Schooner Foundation, and Ceniarth, to a fund size of approximately $7M USD in 2019. The fund's structure and vehicle choices have been instrumental to its growth and ability to achieve sustainability:

- **Structure**. iungo capital chose an open-ended, or "evergreen," holding company structure, with an operating budget approved by investors, rather than the typical General Partner/Limited Partner structure supported by a percentage management fee (see "Missing Middle" box on the next page). This allowed iungo capital to begin investing immediately with a small fund and generate a track record to attract additional capital. Avoiding the traditional GP/LP structure's inherent pressure to do fewer, larger deals also allows iungo to make right-size investments for SMEs in East Africa.
- **Investment vehicles**. iungo capital invests in portfolio companies with debt and revenue share instruments rather than equity instruments. In addition to being a better fit for the target SME's needs, these instruments generate earlier returns for the fund than equity; iungo's investments are paid back over an average of three years, with payments beginning as soon as three months after the deal closes. The payments support iungo capital operations, pay returns to investors, and can be recycled into additional investments, while allowing iungo capital to avoid charging a management fee.

At the end of 2019, three years after its first investment, iungo capital was operating close to breakeven, achieving a 5% return to debt investors over a 4.5-6-year term, and on track to achieve a target 8-9% return for its equity investors.

The nonprofit technical assistance provider, iungo xl, received $780,000 USD in grants from several of their investors as well as the Argidius Foundation to support the first five years of operations in Uganda. iungo xl is on schedule to operate at breakeven based on success-based fees-for-service paid by the companies after they receive investment. The success fees, up to $15,000 USD per company, are paid in installments over two years. The founders consider efficient use of staff time to be a key component of the sustainability of iungo xl services. Whereas traditional accelerators spend staff time on cohort-wide training and work with companies for a set length of time, the iungo xl team only spends time on customized needs that will directly assist each enterprise in reaching the next milestone. Companies that do not progress towards milestones are dropped from the assistance, so resources are continuously directed to enterprises most likely to receive an investment, and generate the desired business growth and impacts afterwards.

"Missing Middle" Challenges of the Limited Partnership/General Partnership Structure

The typical venture fund structure has multiple capital providers putting money into a Limited Partnership (LP) that then pays a management fee to a General Partner (GP) entity to manage the fund. For example, a $20M venture fund LP would typically pay a 2% per year management fee (or $400,000) to the GP to source opportunities, conduct due diligence, structure deals, and manage the portfolio of investments. Under this structure, GPs generally do not find it feasible to manage a fund smaller than $20M, unless the management fee is higher than the 2% market standard. In addition, making small investments takes just as much GP management time as large investments, and there is simply a limit to the number of portfolio companies a GP can manage. Thus, the typical LP/GP structure incentivizes fund managers to 1) raise larger funds to have a higher management fee as compensation, and 2) make fewer, larger investments. Both of these factors contribute to the "missing middle" challenge – there are fewer funds willing to make relatively "small" $50,000 to $500,000 investments.

Angel Engagement

> It's not about building a network. It's about having people that are doing deals, and then the network will come out of that.
> **Roeland Donckers**
> Co-founder

Credit: iungo capital

While iungo capital does not consider itself an angel network, it is deliberately and successfully engaging and activating angels to invest alongside the fund and provide mentorship to entrepreneurs. Potential angels are recruited on a one-by-one basis through local business networks and investment clubs. iungo currently has relationships with fifty potential business angels; twenty of those have now co-invested with iungo capital, and most for the first time.

Pre-investment, iungo capital focuses on identifying an angel with relevant business expertise and interest in mentoring the entrepreneur and co-investing with the fund. Identifying a suitable angel is a prerequisite for iungo capital to proceed with a deal. Once an angel signs on, iungo capital staff manage the investment process, deal structuring, and negotiation with the entrepreneur, and the angel invests alongside the fund with the same terms. Post-investment, iungo capital helps the angel manage the ups and downs of the relationship with the enterprise and provides additional direct support to the company.

This approach to working with the angel and portfolio company frees the angel to focus on their unique value-add – mentoring the enterprise – and minimizes the time the angel has to spend on less enjoyable administrative aspects of an investment. It also addresses some of the key barriers for new angels, who may not have sufficient knowledge or time to structure their own deals. From iungo capital's perspective, rather than spending significant staff time engaging with angel investors as a group or managing meetings and pitch events, staff time is spent crafting one-on-one relationships between the enterprise and an angel that can provide specific value to the business.

Strategies In Practice

Angel Networks in Emerging Markets: A Guide for Development Institutions identifies common context and business model challenges that angel networks face, as well as the strategies they use to address those challenges. While iungo capital is not truly an angel network, the model incorporates many of these strategies, highlighted below.

		STRATEGIES TO ADDRESS CHALLENGES
ECONOMIC CONTEXT CHALLENGES	**Relatively small markets** **Lack of investment awareness, experience, & skill** **Bias against local early-stage investing** **Regulatory barriers to angel investing**	**Expand the local market through partnerships** • Develop ecosystem partnerships for deal flow • Participate in regional/cross border partnerships for deal flow/additional angels • Engage foreign/diaspora investors alongside local investors to increase capital available **Attract new angels through broader definition and awareness** • Expand the angel definition beyond high net worth individuals, to include mid-level professionals, friends and family, and others in the local market • Produce events that raise awareness of angel investing • Engage local business influencers in events to enhance attractiveness • Amplify success stories to generate interest and excitement **Activate capital through education, facilitation, and risk reduction** • Provide angel education and mentoring to build skills and confidence • Cultivate peer engagement to build trust • Facilitate the investment process to reduce transaction costs and friction • Use pooled capital models to shorten the learning curve • Develop fund models or hybrid funds to activate additional capital • Pursue investment guarantees or investment matches to reduce risk • Experiment with innovative workarounds to local regulatory constraints
BUSINESS MODEL CHALLENGES	**Achieving a sustainable business model** **Retaining skilled network leadership** **Lack of participation by key influencers** **Unsuitability of traditional equity in some cases**	**Diversify revenue and share costs** • Charge fees for services to investors or entrepreneurs • Charge transaction-based fees • Generate revenue from sponsorships or consulting engagements • Structure investment upside participation for the organization • Be embedded in another institution to share costs • Secure grants/government support **Attract and retain staff and membership talent** • Structure investment upside participation for the manager • Host networking events attractive to key investors • Alleviate deal management burden on the most active members **Use innovative financing structures in addition to equity** • Use alternative financing structures that match local expectations around ownership, business success, exit, and return

Looking Ahead

Now that iungo capital has demonstrated its model and is close to breakeven, it is raising additional debt and equity capital as it expands geographically. The fund is in the process of closing its first debt investment from a development finance institution, and will then focus on raising $10M USD in equity, which will bring the evergreen fund's total capitalization to $20M USD.

iungo capital leadership believes that its model, despite being customized for its region, is scalable and replicable in new markets. While the "missing middle" might span a different range of capital in different locations, it is an issue for any emerging market. They note that a critical component for success is adequate launch capital both for investment and for technical assistance.

SUCCESS MEASURES

iungo capital aims to achieve impact in three ways:

1. **Financial inclusion:** Providing necessary financial capital and assistance to companies in the missing middle not otherwise able to access it, improving both their economic impact and social and environmental impact. This is measured in investments made and company revenue growth. As of early 2020, iungo capital has facilitated $4.5M USD of investment into 20 SMEs. For over 50% of investees, iungo capital's investment was their first external financing.
2. **Job and income generation:** Measured in the company, along its value chain, and with an added gender lens. This is measured by overall jobs in the companies, number of youth and women employed, and women in ownership and management positions. iungo uses its portfolio companies' sourcing volume as a proxy for income generation along the value chain. Across portfolio companies, revenue has increased 94% after investment, and jobs have increased by 15%. To date, 37% of portfolio companies have women in ownership positions, 74% have women in senior management positions, and women hold 50% of the total jobs across portfolio companies.
3. **Development of local angel capital market:** Stimulating business angels' involvement in sectors they traditionally have avoided with investment amounts that they would not be able to achieve alone, and facilitating the development of their angel investing skills. This is measured by the number of angels investing and the amount of capital they invest. Twenty angel investors have co-invested with iungo capital, the majority of whom were making their first angel investment.

At an individual company level, iungo capital uses the B Corporation assessment to evaluate explicit Environmental, Social, and Governance criteria. Mutually agreed upon financial and impact milestones are an integral part of the investment contract with each company, and additional investment is contingent upon financial and impact milestones being met.

Lessons From This Network

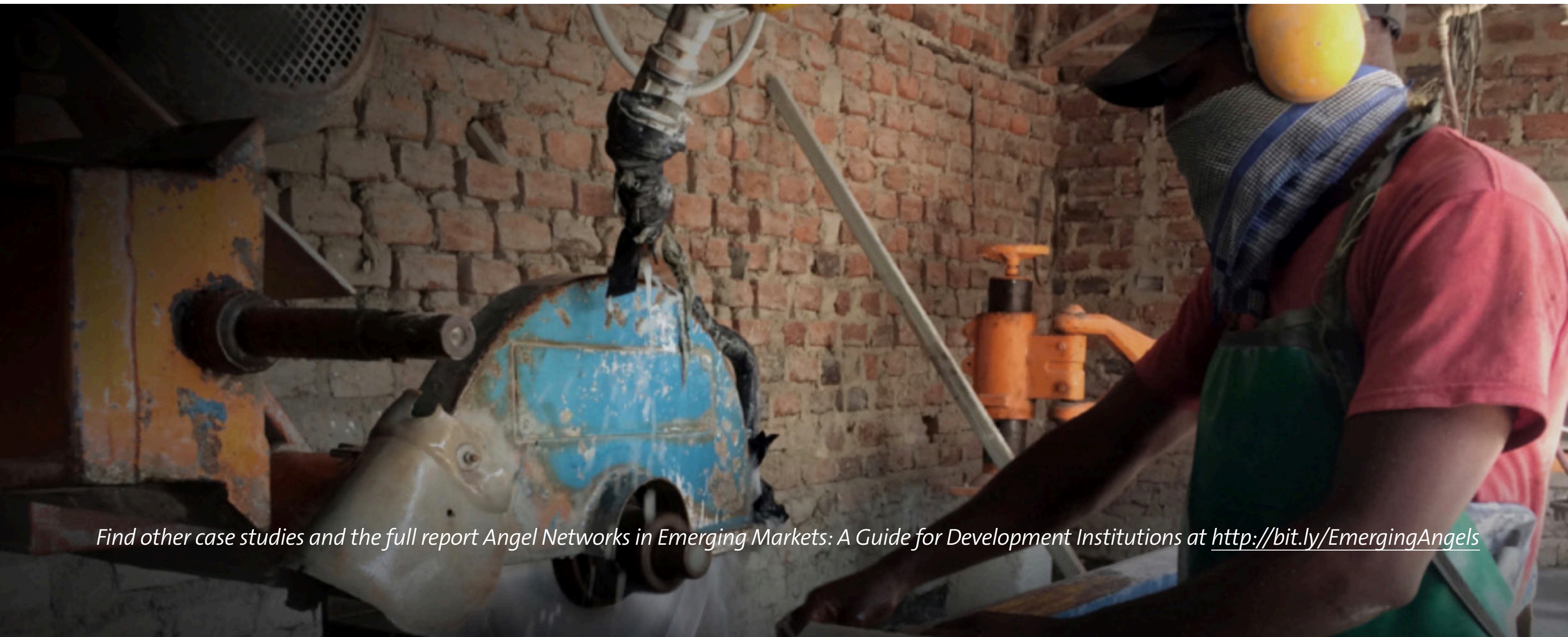
A well-aligned hybrid service and business model maximizes mission impact while meeting the needs of all stakeholders. iungo developed a hybrid model to align three stakeholder groups with a common mission – meeting the finance and support needs of SMEs in the "missing middle" in East Africa. The mission defined the operating parameters, and then iungo focused on the particular needs, motivations, and value-add of each stakeholder to create a win-win-win approach.

Innovative models can be designed to meet the specific financing needs of target companies, rather than the expectations of developed market capital providers. iungo capital resisted "typical" investment fund structures because they did not align with the capital needs and constraints of their target SMEs. iungo's evergreen fund structure and investment vehicles are a better match for the financing needs and return prospects of the target companies.

Customized services are an efficient use of staff time and are highly valuable to companies and angels. On the investor side, iungo spends time recruiting individual angels with specific expertise that matches a potential portfolio company's needs, rather than delivering group services to a network of angels that may or may not ever invest. On the company side, iungo provides highly customized technical assistance, rather than cohort-based support like most accelerators, and drops companies that do not meet progress milestones. While this customized approach may initially appear less scalable, iungo believes this approach provides a better return on their investment of staff time and resources.

Local angels can play a key role in ensuring the most productive and appropriate use of foreign capital. Local angels play an integral role in iungo capital's model, providing local business community insight and market understanding as well as positive peer pressure and assistance for the entrepreneur. This angel investor element, together with the extensive local market experience of the fund managers and the building of a local team, helps to ensure that the foreign investors' impact capital is invested appropriately and in a manner that maximizes the likelihood of impact and financial success.

Credit: iungo capital



Find other case studies and the full report Angel Networks in Emerging Markets: A Guide for Development Institutions at http://bit.ly/EmergingAngels