Why African startups are now on the acquisition trail

By Tom Jackson

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Investments in African startups are on the up year-on-year, with funding flooding into a variety of countries and a large selection of sectors.

The annual Disrupt Africa African Tech Startups Funding Report tracks the growing investor interest in the continent's tech scene, but it also tracks acquisitions and exits each year. This tells a less coherent story.

There were only five acquisitions of African tech startups in 2017, the same as in 2015, and for less than in 2016. Acquirers are certainly interested in the space, but it seems that it is not yet mature enough for it to be recording multiple exits on a regular basis. This is surely something that will change over time.

When startups buy startups

What is happening, however, is African startups becoming acquirers themselves. In February, Lenya's BitPesa, which raised two funding rounds last year to take its total secured investment to around the $10 million mark, bought Spain-based online money transfer platform TransferZero.

Ghanaian marketing startup Kudobuzz has made two acquisitions this year, buying e-commerce product RetailTower and advert creation tool AdGeek. This was a process begun by Nigerian on-demand delivery startup Metro Africa Express (MAX) late in 2016 when it acquired Lagos-based Easyappetite.

But why is this happening, even before the African tech startup space has matured to the point where startups are serious targets for more major acquirers. BitPesa chief executive officer (CEO) Elizabeth Rossiello says the TransferZero acquisition came about as the Spanish firm was a BitPesa customer and the two teams had a strong working relationship.

“The acquisition came out of the realisation that we could be more successful working together and combining our assets,” she said.

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That said, it was still a very big deal for an African tech startup to buy out a European one.

“I’m not sure what the numbers are, but there are very few small African startups that have grown in the last few years to purchase a European payments company. It takes a lot of corporate governance, financing, compliance and legal work to complete an acquisition,” says Rossiello.

“There is a lot of operational execution required in the months afterwards to ensure optimisation of the new assets. We are really proud of our team’s work and achieving this milestone event.”

She says she sees a number of such consolidations occurring over the next few years as certain sectors slim down. Spaces such as fintech, for example, are crying out for consolidation, with significant stakeholders preaching its necessity. The Finnovating for Africa report released last year by Disrupt Africa, for example, found there were 125 payments and remittances startups active across Africa, and 31 in Nigeria alone. Mergers, acquisitions and – alas – closures are necessary and inevitable as the space evolves.

“There has been a long period of innovation and entrepreneurship, but there is a lot of overlap that is not efficient,” Rossiello said.

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“As companies grow or specialise, there is a need to work together for better customer service. There has been some incredibly successful innovation over the past years in the fintech space, and the complementary models that have proven traction should be working together, either through mergers or strong partnerships.”

The need to embrace complementary models in order to grow was also behind the 2016 acquisition made by MAX, according to the startup’s director of marketing and communication Ized Uanikhehi.

“MAX decided to expand its food delivery service, so we decided to acquire Easyappetite. We also brought the founder on board,” she said. “This allowed MAX to expand rapidly in the food delivery space in Lagos.”

Uanikhehi said acquisitions were a big deal for any tech startup as they are a sign of liquidity, and agreed with Rossiello that consolidation in the startup space was a good thing as excessive competition destroys value.

"Consolidations mean people are working together to solve big problems," she said, adding that she expected more acquisitions across the sector in the coming years, especially in fintech and logistics.

Can we expect more acquisitions?

Startups may be buying startups, but can we expect more activity on the part of major acquirers in the coming years? Successful exits would certainly help with attracting more investment to the space.

Last month saw South African restaurant technology company orderTalk get acquired by Uber Eats, in the latest successful exit for local VC firm Knife Capital. Knife Capital partner and co-founder Keet van Zyl says he expects to see more such deals occurring with greater frequency over the coming years.

"It is just a matter of time. Collectively some of the VC investors in Africa have enviable portfolio companies that will mature and attract interest from strategic acquirers. And our entrepreneurs and supporting ecosystems are gaining momentum," he said.

Paul Cook is managing director of South African firm Silvertree Internet Holdings, which has been on the acquisition trail itself over the last couple of years, buying the likes of TopCheck and DealDey in Nigeria. He also expects more successful exits in the coming years.

"Many of the transactions seem to be in classifieds and e-commerce. At the moment, most are still driven by value-add that the acquirer can bring on top of the current business. I think the market is still perhaps too early-stage for deals driven by the value of the startup as a self-standing entity. Hopefully, that will start to change," he says.

Cook did, however, have a qualifier about deals that have taken place to date, saying unless you are on the inside it is hard to know when a transaction is a success and a real opportunity-driven acquisition, or rather a distressed sale due to shareholders needing liquidity or the underperformance of the company.

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"I would say that we are starting to see a few more "secondary" – sale of shares versus investment – transactions, but at least some of these are distressed sales," he said.

"Also, there was a wave of investments in spaces like e-commerce that happened several years ago, and it's now come time for those investors to seek liquidity, so that's driving some transactions."

A how-to guide to exits

How have the exits that have taken place come about? Van Zyl said each of Knife Capital's exits – it also successfully exited its investment in Kubu to Garmin, for example – have been unique in their own way. In orderTalk's case, the business was highly scalable, had a recurring revenue model, had seen aggressive growth, and was generating sustainable cash flows.

"Each startup had some key differentiators and was innovation-driven. The entrepreneurs focused on business development and were engaging and coachable. Business models were scalable and target markets mostly B2B. They had an Investment team behind them that always thought about the exit," he said.

"Every strategic choice we made was considered from many angles, but one of those angles always included the impact it would have on the attractiveness to potential acquirers. And we always knew who they could be. From as early on as the due diligence exercise we built out a so-called ‘Partner Universe’ of preferred market access partners and potential acquirers to get closer to through our networks during the growth journey.”

During this journey, Van Zyl said, Knife Capital prioritised value drivers and always had a realistic sense of what the financial and strategic valuation ranges of the companies could be.

“Then we ensured that the companies systematically built out a comprehensive sell-side data room as interesting things happen to interesting companies – and they were ready to pounce when the opportunities presented themselves,” he said.

ABOUT TOM JACKSON

Co-founder @DisruptAfrica. Tech and business journalist in Africa. Passionate about the vibrant tech startups scene in Africa, Tom can usually be found sniffing out the continent's most exciting new companies and entrepreneurs, funding rounds and any other developments within the growing ecosystem.

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