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Working Paper Series¹

Crowdfunding's potential in the South African entrepreneurial ecosystem: Is there a role to play in catalysing Venture Capital?

by

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No DEFWPS0015/September, 2016

¹ **Note:** The findings from this working paper does not in any way reflect the views of the Development Finance Centre (DEFIC). The views are only representative of the authors.





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Published by:

The Development Finance Centre (DEFIC),
Graduation School of Business, University of Cape Town,
9 Portwood Rd, V & A Waterfront, Cape Town, 8002
Centre webpage: <http://www.gsb.uct.ac.za/s.asp?p=791>

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Adam Bennot and Stephanie Giamporcaro

Abstract

Like many emerging economies, South Africa faces numerous economic, social and political challenges, of which a key problem is the considerable and growing unemployment. Entrepreneurship is an important driver of economic driver, job creation and innovation. Despite, government efforts and interventions, South Africa is plagued by a low level of entrepreneurial activity and high failure rates of start-ups. One of the reasons why South African start-ups continue to struggle appears to be a lack of access to finance, particularly early-stage seed capital. Recently, crowdfunding, an online ecosystem of venture funding, has emerged as a novel way for entrepreneurs and early stage ventures to secure financing through formal and informal networks without having to turn to more traditional sources of new venture finance.

The purpose of this research is to investigate the potential influence crowdfunding could have on the early-stage financing ecosystem in South Africa, particularly, how it could affect entrepreneurial deal flow as well as inform the venture capital decision-making process, and to what extent it can be used as a viable source of entrepreneurial seed capital.

The research findings suggest that the reward-based crowdfunding may be able to help solve the funding gap problem in South Africa in three important ways. Firstly, given the significant funding holes in the life cycle of early stage ventures, crowdfunding has the potential to increase the amount of available capital at the seed stages of a start-up Secondly, crowdfunding can be used for market validation and proving a consumer base, which offers a reliable signal quality to investors, therefore improving screening and due diligence. Thirdly, crowdfunding will not directly increase the VC deal flow but rather it could complement the broader VC ecosystem.

Keywords: Crowd funding | Venture Capital | Entrepreneurship | South Africa |