Protecting Nigeria’s Entrepreneurial Future

A whitepaper with policy recommendations for Nigeria’s innovation ecosystem as startups and scaleups navigate the fallout of the global pandemic

-endeavor

StearsData
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If you are the founder of a high-growth startup or scaleup in Nigeria, then you have inevitably been affected by the crisis that has tilted the entire world on its axis since early in the year. Necessary measures by governments to mitigate the health impact has had ripple effects on businesses worldwide. Governments have had to very quickly respond to stymie the potential disaster, including providing support programs to keep both large and small businesses afloat. We would like to see more deliberate and concerted action in Nigeria, in light, not only of the crisis, but the generally tougher economic climate that startups and scaleups are facing as our economy goes into a fiscal slump.

This whitepaper presents our “house view” on proactive ideas and measures that the government, policymakers and business community, who understand the importance of protecting the essential high-growth innovation sector of the Nigerian economy, should consider as we work collectively to minimise the impact and protect Nigeria’s economic future.

Our core belief at Endeavor is that high-growth startup and scaleup companies, led by high-impact entrepreneurs, are the key to a vibrant economic future. These companies, making up what we like to call Nigeria’s “innovation ecosystem”, are drivers, not only of economic growth, but also ecosystem development, innovation and high-quality job creation. Thus, it is imperative that this segment is provided with the appropriate support to ensure that these businesses not only survive, but thrive through the economic setback.

Our whitepaper has been developed in collaboration with the fantastic team at Stears Data. It takes two approaches: (1) real-time data collection and measuring the impact of the crisis on startups and scaleups at varying growth stages within different industries, and (2) an analysis of the proposed interventions, business support programs and policy measures by Nigerian government bodies in comparison to similar responses in other regions.

The findings are quite clear, and unfortunately, not surprising: Nigeria’s innovation ecosystem has been mostly negatively impacted by the crisis, due to diminishing cash runways, interrupted fundraising efforts, and limited government support. The support efforts that have been proposed by the government, while directionally promising, have not been tailored specifically with the innovation sector in mind; and as such, many startups and scaleups do not meet the eligibility criteria. The innovation sector will require tailored support for its particular business profiles and needs. We, therefore, propose three main policy recommendations, consisting of financial and non-financial support programs, as well as investment opportunities to bolster funding efforts.

The speed of the post-crisis recovery, and our hope for subsequent economic vibrancy, hinges on the success of entrepreneurship, and specifically, innovation-driven, high-impact entrepreneurship, in Nigeria. Providing the right support to see entrepreneurs through this challenging phase is imperative. We hope that the findings and recommendations laid out in this whitepaper can serve as a guide to enhance the support and implementation of policies that are relevant to the startups and scaleups working to build sustainable, innovative, transformational companies within our innovation ecosystem for the benefit of our wider economy.
The coronavirus pandemic is an economic emergency. The International Monetary Fund expects the Nigerian economy to shrink by 5.4% in 2020, compared to its initial estimate of 2.5% growth at the start of the year. The Nigerian government’s internal forecasts are even bleaker—the pessimistic scenario projects a 9% decline in national output and a recession that lasts until 2023. Nigerian businesses are already feeling the heat as business sentiment indicators have fallen to record lows. Likewise, early innovation ecosystem surveys indicate that many startups have less than one year runway and may struggle to raise funding in the near future.

So far, governments have responded with appropriate earnestness. Germany swiftly passed legislation to temporarily lift annual government spending limits in order to fund its COVID-19 stimulus package; while countries like Australia, Canada and Japan have provided extensive loan guarantees to small businesses. Nigeria has also moved quickly to support businesses despite funding constraints, mainly through a ₦50 billion Targeted Credit Facility (TCF) set up in late March to help individuals and small & medium-sized businesses (SMEs) affected by the crisis.

Given the need to respond urgently to the pandemic, initial policy initiatives have not always been optimally designed. One significant oversight is the failure to distinguish SMEs from the startups and scaleups that form a country’s commercial innovation ecosystem.

This oversight is now being rectified in parts of Europe as a result of the tireless advocacy of key players in the technology ecosystem, most notably in the United Kingdom (UK) where an open letter was sent to the government by local founders and investors. In comparison, Nigeria’s COVID-19 initiatives fall far short of what is needed to support the local innovation ecosystem.

At present, startups and scaleups are likely to benefit the least from measures such as the TCF because they were not designed with the startup business model in mind. This situation poses two problems. The first is that startups and scaleups will struggle and fail without support. This would lead to job losses that would particularly affect the youth workforce in Nigeria. The second is that the innovation ecosystem is the driver of long-term innovation and net job creation at home and abroad. Therefore, the innovation ecosystem is a critical contributor to Nigeria’s post-pandemic economic recovery. This calls for a change in policy approach; key private and public actors must prioritise the innovation ecosystem and design tailored initiatives to support the sector at this time.

The good news is that there are existing frameworks and instruments that can be used as long as the will is there. The government’s main approach must be to leverage existing financial and non-financial ecosystem channels in supporting startups and scaleups. Policymakers must take decisive action to prevent a spate of failures in Nigeria’s innovation ecosystem.
The COVID-19 pandemic and its associated containment measures pose a massive threat to the health and growth of Nigeria’s innovation ecosystem. Public and private sector agents have a responsibility to prevent the deaths of many viable startups that would ordinarily make a considerable contribution to economic and digital transformation over the next decade. On the back of our investigation into the effect of COVID-19 on the sustainability of startups in Nigeria, we urge policymakers to implement tailored support measures to mitigate the cyclical effect of the COVID-19 pandemic on the innovation ecosystem, and use the crisis as an opportunity to create a more symbiotic relationship with local startups.

Between April and July 2020, we gathered evidence and analysed data on the effect of the COVID-19 pandemic on startups and scaleups in Nigeria. We aggregated data from impact surveys conducted by the UK-Nigeria Tech Hub, PwC, FATE Foundation and the Pan-Atlantic University, engaged extensively with startup founders, investors and accelerators, and analysed investment and economic trends from previous recessions.

We also appraised policy measures used to support startups and small businesses; the regions analysed include Nigeria, New Zealand, South Africa, Kazakhstan, Israel, the United States, the United Kingdom and the European Union.

This whitepaper presents our “house view” on proactive ideas and measures that the government, policymakers and business community, who understand the importance of protecting the essential high-growth innovation sector of the Nigerian economy, should consider as we work collectively to minimise the impact and protect Nigeria’s economic future.
Key Findings

1. Cash flow support is the most urgent startup need

Startup revenues have been negatively affected by the pandemic. Nearly eight out of ten startups and scaleups in one survey revealed that they had less than six months runway at the time. The innovation ecosystem relies on frequent funding cycles to finance startup activities and the pandemic has adversely affected that cycle: more than four-fifths of surveyed startups reported disruptions to fundraising.

2. Intervention is urgently needed but there is opportunity in crisis

Like all small businesses, startups need help now. The current situation offers policymakers the opportunity to forge stronger ties with the innovation ecosystem. Therefore, the policies recommended here address a pressing need created by the pandemic, to provide a platform for longer term government support for the innovation ecosystem.

3. Startups need to be treated differently from small businesses

Startups require tailored support as interventions designed for generic small businesses are inappropriate for the innovation ecosystem. Small business relief programs are not conceived with the innovation business model in mind, so startups do not often meet the eligibility criteria for these programs. Even when they do, the support provided is not as useful. Moreover, the rationale for supporting startups is based both on their current and future economic contribution. But the distinct economic potential of a startup exists because innovation and experimentation are baked into the startup business model. Any intervention ought to allow startups and scaleups to retain their freedom to experiment and innovate, which in turn, drives the ecosystem.

4. Startups and investors should retain as much flexibility as possible so that they can do their jobs well

Globally, the best innovation ecosystem models ensure that support mechanisms do not disrupt the unique operating models and incentive structures in the innovation ecosystem. Experimentation and innovation should not be inhibited by policy interventions. The easiest way to ensure this is by allowing startups to remain flexible in how they use the funds provided by intervention programs—this minimises the distortions to startups’ incentive to innovate and experiment.

Nearly eight out of ten startups and scaleups in one survey revealed that they had less than six months runway at the time.
Three Recommendations

We provide the following policy recommendations for how the Nigerian government can better support the innovation ecosystem in this unique moment.

1. Liquidity Support: Create a separate credit facility for startups

The most pressing need for startups at this time is cash. The goal here is to provide financial support to the innovation ecosystem in the quickest and cheapest way: by providing low-interest loans. Liquidity support has been the most common form of support provided to small businesses, given the demand shock that was induced by the COVID-19 pandemic. The primary liquidity support for small businesses in Nigeria is the Targeted Credit Facility and Section 5 highlights why the program is unsuited to startups and scaleups.

We propose a separate liquidity support program that is more suited to firms in the innovation ecosystem, with the following features:

i. The Central Bank should create a credit facility of ₦20 billion with a maximum interest rate of 5% for a period lasting up to two years.

ii. Eligible companies: A startup or scaleup company is eligible for the loan if they meet any of the following conditions:

   a. They have received funding from a VC or any other institutional investor.
   b. They have worked with any ecosystem accelerators e.g. incubators, accelerators, etc.
   c. They have received funding from an angel investor registered with a recognised angel investor network.
   d. A company that does not meet any of the above criteria can obtain a recommendation from vetted VCs or ecosystem accelerators to attest to their high-growth startup business model and growth profile.

iii. A startup can access credit up to 75% of their 6-months costs or ₦40 million if costs exceed that amount. A cost-based scheme is more appropriate for startups as it is a more accurate reflection of their cash flow needs.

iv. The principal and interest are repayable at the end of the two-year period (earlier if a startup opts to do so).

v. A portion of the loan would be forgiven if the funds are used to:

   a. Pay employee salaries and other staff-related costs. This program emulates the United States Paycheck Protection Program by providing some form of wage support while allowing startups retain control over use of fund.
   b. Cover digital investments. This refers to any expenses related to providing a new digital product or supporting the transition to a virtual economy. Startups are better poised to help the Nigerian economy through this period as the digital world is their natural habitat, but many are constrained by cash flow. Loan forgiveness encourages and rewards startups that make significant contributions in this area.
2. Non-financial support: Support existing ecosystem initiatives and include startups in COVID-19 response schemes

Private and public agents should work with existing startups that are pushing digital transformation in priority industries. The Nigeria Centre for Disease Control and other health agencies are currently doing this well in collaboration with health startups in the country, particularly in Lagos State. This approach should be applied to other key sectors.

For example, the CBN currently provides short-term loans to individuals through the Targeted Credit Facility. These loans are disbursed by NIRSAL but are limited in range as they exclude Nigerians not actively engaged in the formal banking system. Individuals accessing the loans must have an active bank account with a Bank Verification Number (BVN), but the latest data from NIBSS shows that just over half of all active bank accounts are BVN-linked. A more effective approach would include Nigeria’s Fintech lending ecosystem, as Fintech lenders have been serving underbanked individuals and SMEs for years and have a wider reach. This approach has worked particularly well in Latin America where Fintech lenders have stepped in to complement limited government lending programs.

Private and public sector actors should identify and support existing ecosystem support initiatives. The key is to boost existing schemes—and help them expand capacity—that connect entrepreneurs to resources, people and tools. The government can do this by providing financial or other support to existing mentorship and capacity-building schemes, pitch events, bridge financing initiatives, and so on. Rather than creating new initiatives, the government should focus its efforts on strengthening existing schemes with experience and a track record of success.

3. Funding support: Inject equity into the innovation ecosystem

Providing funding support to the innovation ecosystem could help the government achieve two goals. The first is that this would address any funding challenges faced by investors and provide additional capital in the medium-term. The second is that the government would turn the crisis into an opportunity by laying the groundwork for catalysing long-term funding into Nigeria’s innovation ecosystem.

The recommendations we have outlined here are:

i. The government should create a fund of funds for investing in the innovation ecosystem for direct equity injection.

ii. The government should provide fiscal incentives to investors in the Nigerian innovation ecosystem.

Create a fund of funds for equity investments

The goal here is to deepen the innovation capital market by sustainably directing public funds to finance private innovation. The government should use an existing fund like the NSIA (or, if necessarily, create a separate entity) to be a fund of funds in Nigeria. Apart from directly providing financing to the ecosystem, this approach would catalyse other investment by encouraging institutional and High-Net-Worth Individuals to bring in their own capital.

This fund would invest in either of the following:

a. Venture capital firms: The fund of funds should act as a Limited Partner by providing capital to local VCs.

b. Ecosystem accelerators: The fund of funds should invest in institutions that support the innovation ecosystem, including incubators, accelerators, and other vehicles for early-stage financing.

c. Angel investors: Beyond funding ecosystem accelerators, the government can support early-stage financing by creating smaller sub-funds (within the fund of funds) aimed at funding early-stage companies. These sub-funds can invest directly into early-stage companies (private investor matching is not required here).

2Startup Genome, COVID-19 Crisis: Global Knowledge Base for Startup Actors, April 27 2020
https://startupgenome.com/reports/covid-19-global-knowledge-base
**Provide fiscal incentives to innovation ecosystem investors**

The goal here is to deepen the innovation capital market by providing tax incentives to individual and institutional investors in innovation companies. Tax incentives alone will not deepen the capital markets and these fiscal recommendations would work best in tandem with the other recommendations outlined.

Tax incentives are aimed at investors (rather than startups) as tax incentives work best when they can directly influence a specific decision (e.g. the decision to invest).

Tax incentives aimed at startups (e.g. deferrals) are less effective and the desired objectives can be met using more potent tools (e.g. low-interest loans for liquidity).

The tax incentives recommended are:

a. A portion of the investor’s losses are tax deductible in the event that a portfolio company goes bankrupt. This provides a partial guarantee to investors and incentivises them to invest in more early-stage companies.

b. Investors can claim partial tax relief (on income and company tax) on investments made in qualifying startups.
## Summary of Recommendations

<table>
<thead>
<tr>
<th>RECOMMENDATION</th>
<th>DETAILS</th>
<th>RATIONALE</th>
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| **Liquidity support**  | i. The Central Bank should create a credit facility of ₦20 billion with a maximum interest rate of 5% for a period lasting up to two years.  
  ii. A startup can access credit up to 75% of their 6-months costs or ₦40 million.  
  iii. A portion of the loan would be forgiven if the funds are used to pay employee salaries or to cover digital investments. | The most pressing need for startups at this time is cash. The goal here is to provide financial support to the innovation ecosystem in the quickest and cheapest way: by providing low-interest loans. |
| **Non-financial support** | i. Private and public agents should work with existing startups that are pushing digital transformation in priority industries.  
  ii. Private and public sector actors should identify and support existing ecosystem support initiatives. | This is a cost-effective way of supporting the innovation ecosystem and leveraging the expertise of the startups and scaleups operating in Nigeria. |
| **Funding support**    | i. The government should create a fund of funds for investing in the innovation ecosystem. This fund of funds would then invest in venture capital firms and ecosystem accelerators.  
  ii. The government should provide fiscal incentives to investors in the innovation ecosystem. | This would address any funding challenges faced by investors and provide additional capital in the medium-term. It would also allow the government to turn the crisis into an opportunity by laying the groundwork for catalysing long-term funding into Nigeria’s innovation ecosystem. |
3. How have startups and scaleups been affected by the pandemic?

While it is still early to gauge the full commercial impact in Nigeria, ecosystem surveys and activity indices (e.g. funding and staffing levels) give preliminary insight into the effect of the COVID-19 pandemic. In the United States, Bloomberg combines these into an index that tracks the health of the private technology industry. Although the index is weighted towards funding indicators like deals and exits, it has been running since 2007 so allows us to put this period in the context of previous economic downturns. The Bloomberg U.S. Startups Barometer was down 50% in late-May compared to the same period in 2019, by far the largest decline in the index since the trough of the 2009 recession. Early-stage financing (Seed or Series A) was down even more—65% year-on-year. This gives a quick snapshot of how the world’s largest technology ecosystem has been affected.

Below, we provide a comprehensive review of how Nigerian startups have been affected by the pandemic, using information gathered from surveys, stakeholder engagement and financial flows.

3.1 The funding environment is tightening

Hyper-growth is at the heart of the startup/scaleup model and achieving this requires companies to experiment and burn through cash more rapidly than traditional businesses. Therefore, fundraising is key to cash flow management in the private technology industry. This funding cycle is the lifeblood of the innovation ecosystem and a good starting point to understand the impact of the COVID-19 outbreak on the innovation ecosystem.

Data from surveys and investment flows abroad strongly suggest that deal size and volume may decline as a result of the COVID-19 pandemic. Given the importance of a liquid funding market to Nigeria’s innovation ecosystem, this likelihood calls for urgent action to support the local funding market to ensure that investment continues to flow to Nigerian startups.

Looking at data from the UK-Nigeria Tech Hub, 84% of surveyed startups reported disruptions to fundraising, with a fifth of all startups highlighting fundraising as the business area most-affected by the viral pandemic. The survey also took the uncommon approach of asking investors how their fundraising plans have changed. Over a third of responding investors expect the pandemic to negatively affect their investment decisions and 14% of investors confirmed they have walked away from live deals, with an additional 21% considering doing the same. This is consistent with the results from a PwC Nigeria survey of 3,000 business leaders in April 2020: more than half planned to delay their investment decision due to the viral pandemic.

14% of investors confirmed they have walked away from live deals

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4See: Bloomberg U.S. Startups Barometer
https://www.bloomberg.com/graphics/startup-barometer/

5UK-Nigeria Tech Hub, COVID-19 Impact Survey on Early Stage Founders & Investors in Nigeria, April 2020
https://www.covidimpactsurvey.com/

6PwC Nigeria, COVID-19 Survey of Business leaders, April 2020
The early conclusion is that Nigeria’s funding market could tighten in the near-term and a similar trend is expected abroad. A global ecosystem survey conducted by Startup Genome found that 72% of startups with outstanding term sheets have experienced a slowdown in negotiations or complete cancellation. In the UK, an investor-led survey of 200 startups found that 40% of imminent fundraises had been delayed.

Survey data is less reliable than tracking financial flows and the best place to look is China, where the pandemic has been raging since late-2019. According to CBInsights, VC-based deals declined 35% year-on-year in China in the first quarter of 2020, with Seed rounds falling 55% year-on-year and 44% quarter-on-quarter as VCs focused on managing portfolio companies.

Meanwhile, Startup Genome data from Asia shows that overall funding in the region took a hit: VC funding in the rest of Asia almost halved due to the situation in China, even though the virus only penetrated countries like South Korea in January. This contagion can partly be explained by China’s outsized funding influence in the region—Chinese VC investment in India rose nearly 10 times between 2016 and 2018 to $5.6 billion. Furthermore, the lockdowns imposed in Chinese cities affected travel plans and led to temporary business closures that interrupted the fundraising process even in places where the virus was less prevalent.

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**Figure 1: Are investors shunning deals due to the pandemic?**

![Pie chart showing investor responses to the pandemic](source)

- Currently considering walking out on a deal
- Have walked away from a deal or partnership
- No impact on deals

*Source: UK-Nigeria Tech Hub Covid Impact Survey*
With this experience in mind, the regional response to the pandemic is crucial for Nigeria’s innovation ecosystem. Many startups are attractive because investors see them as entry points to multiple countries and some startups—most recently, Helium Health—raise funding to expand into other African countries.

The final issue is whether these funding disruptions are temporary. Most ecosystem surveys have focused on short-term investment decisions though it is reasonable to believe that the results hold true as long as economic conditions remain unchanged. The long-term impact of this would be potentially large. Estimates from Startup Genome suggest that global startup investment would be $28 billion less (roughly 10% of 2018 investment) if China’s February-March trend is extrapolated across the globe.

Previous recessions give an indication of how long it may take for investment to recover: it took three years for global VC investment to recover after the dot-com bubble, and a year after the 2009 recession. There are a few reasons to be optimistic that this funding dip would neither be as large nor as persistent. Some of the funding impact can be attributed to the COVID-19 pandemic disrupting VC’s activities, for example by making it more difficult for them to meet with partners or startups. As a result, funding is likely to rebound more sharply as businesses adapt to the enduring presence of COVID-19 in cities.

Figure 2: How will COVID-19 affect investor decisions?

- Slightly positive impact
- Neutral or too early to tell
- Slightly negative impact

Source: UK-Nigeria Tech Hub Covid Impact Survey

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13TechCrunch, Nigeria’s Helium Health raises $10M Series A for Africa expansion, May 6 2020
https://techcrunch.com/2020/05/06/nigerias-helium-health-raises-10m-series-a-for-africa-expansion/
13Ibid. 9
3.2 Many startups will run out of cash within a year

The first place to look at the effect of decreased funding is company runway, which is the number of months a startup can remain liquid at its current cash burn rate. As startups burn cash quicker than traditional companies, the typical funding cycle is shorter, especially at early stages (re-investment is often required within 18-36 months). A slowing funding market is a threat to cash flow sustainability in the ecosystem.

In Nigeria, the UK-Nigeria Tech Hub survey found that 79% of startups have less than 6 months runway and only 6% of startups have enough cash runway for the next 13-25 months. A quarter of the surveyed startups also flagged a lack of financial resources as the biggest threat to survival during this period. Similarly, results from a Pan-Atlantic University survey of over 1,600 Nigerian MSMEs found that cash flow was the second most common business area affected by the pandemic. As a result, 26% of surveyed MSMEs were struggling to pay salaries and 55% were considering job cuts.

At a global level, Startup Genome found that 41% of global startups have less than 3 months runway, up from 29% of startups before COVID-19 hit, and only 15% have cash to tide them over beyond a year. That number is higher in the UK: 40%. Notably, startups that had previously raised money reported better cash positions, as only a third of all startups that had completed at least a Series A round reported less than 6 months runway.

The common theme across surveys and locations is that many viable businesses that would normally survive and become large companies now face a higher failure rate due to the sudden turn in the economic cycle. The government should step in to preserve Nigeria’s economic future by providing liquidity and funding support to ensure that the startup failure rate does not exceed its natural level.

Figure 3: What support do businesses need?

<table>
<thead>
<tr>
<th>Funding for Growth</th>
<th>Business Financing</th>
<th>Working Capital</th>
<th>Market Linkages</th>
<th>Equipment Financing</th>
<th>Business advisory</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>20%</td>
<td>15%</td>
<td>10%</td>
<td>5%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: FATE Foundation MSME Impact Survey

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15Ibid. 7
3.3 Sales & revenues have been significantly affected

Beyond diminishing runway and funding, companies have been worst-hit in terms of sales & revenues. In the UK-Nigeria Tech Hub survey, half of surveyed startups pointed to sales as the most affected area, while a fifth highlighted market assistance (i.e. revenue preserving opportunities) as their main need. These responses tally with global sentiment. 40% of startups in the investor-led UK study reported a revenue drop larger than 25% in March and 68% of startups expect the full-year revenue drop to be similar. Meanwhile, the global ecosystem survey run by Startup Genome found that three-quarters of all startups have experienced revenue declines since the COVID-19 outbreak.

3.4 The lockdown disrupted business operations

Like most companies, local startups have reported some disruptions to their operations, mainly due to social distancing policies implemented by the government. 89% of MSMEs in the Pan-Atlantic University survey reported supply chain issues (e.g. difficulties moving raw materials) and 74% had resorted to technology (e.g. digital marketing, embedding payment systems, etc.) to navigate the period. The effect on business operations reinforces the importance of digital infrastructure and products to cater for the wider economy, and a healthy innovation system is needed to develop these. Nigeria’s infrastructure remains far from what is required in this area: in the PwC business leaders survey, insufficient infrastructure to support remote working was cited as the 3rd most common business concern, only behind liquidity and staff safety.

3.5 Startups have made strategic staffing decisions during this period

Job losses have been ubiquitous during the COVID-19 pandemic. Reliable estimates indicate over 60,000 layoffs in 10 weeks from April to June across more than 450 startups tracked around the world, in line with Startup Genome survey data that shows 75% of startups had laid off workers and as many as 25% laid off more than half of their workforce. Layoffs have been uneven across the world, coming in proportionally higher in the United states (84% of startups) than in Europe (67%) and Asia (59%), likely due to less restrictive labour laws and weaker payroll protection programs in the United States.

Nigeria’s jobs data is much patchier. The official unemployment rate was last recorded at 23% at the end of 2018, but the government anticipates it will rise to 33% at the end of 2020—meaning that nearly 40 million Nigerians will be unemployed.

There have also been notable job cuts in the innovation ecosystem. Big Cabal Media announced salary cuts for all employees, TechAdvance retrenched an undisclosed number of workers, and most significantly, Andela shed about 10% of its global workforce. That said, staffing decisions have been strategic and not only in response to the COVID-19 crisis; for example, RenMoney laid off nearly all its sales agents (50% of its workforce) as it pivots to a digital lending model.

3.6 The focus on innovation makes startups more resilient

Despite the headwinds, startups and scaleups have shown flexibility and resilience, earning their tag as the innovation hub of the economy. Startups in Nigeria and abroad are leveraging opportunities created or expanded by the COVID-19 pandemic. A quick look at the rise of Hopin and Run The World, two virtual events platforms, gives an example of the silver linings in the innovation ecosystem.

Hopin raised $6.5 million in seed funding at the start of 2020 and is being courted by more investors.
Meanwhile, after doubling its workforce as new users increased a hundredfold, Run The World followed up a $4 million seed raise in February with a $10.8 million Series A. Both of these startups were created before the COVID-19 pandemic in anticipation of changes in economies and societies; the pandemic has accelerated these changes.

The same is true for digital payments in Nigeria. Paga announced a 330% quarter-on-quarter growth in mobile wallet sign-ups in the first quarter of 2020. Then the cryptocurrency trading platform BuyCoins revealed that it had hit a ₦100 million transaction target set at launch for a new product “SendCash” with 9 days to spare. And, across the country, many merchants are eschewing cash in favour of digital payments.

These case studies reinforce the belief that Nigeria’s startups are better suited to the future economy; therefore, they should receive much more investment and policy support. As societies adapt to living with COVID-19 and customers and businesses alter their habits, digital firms are better poised to take advantage. In the Startup Genome global survey, 96% of all startups confirmed they could work remotely. This opportunity was captured by Kola Aina, Founding Partner at Ventures Africa: “In fact, they (startups) may benefit from a boost in user adoption and lower customer education costs as people find new ways to live, work, communicate and various sectors take their services online.” However, there are significant obstacles in the way of startups attaining this, primarily in the form of inadequate infrastructure. Nigeria ranked 176 out of 207 countries in the 2018 Worldwide broadband speed league and is ranked second-to-last for electricity supply in the World Economic Forum Global Competitiveness Index (2017-2018).
4. Why we should care about the innovation ecosystem

Reviewing the economic value of startups and scaleups in Nigeria

The rationale for targeted support for the innovation ecosystem is based on its unique role in the economy. The justification for supporting startups and scaleups is based on both their current (realised) and future (potential) economic contribution.

4.1 Scaleups are the most powerful engine of long-term job creation

Saving a scaleup means saving a hundred jobs tomorrow

SMEs account for more than 80% of all jobs in Nigeria. Such a high proportion is typical; employees in small businesses represent 70% of private sector workers in Canada and the World Bank believes that over 50% of global jobs are in SMEs. In the United States, startups and scaleups account for under a tenth of SMEs, and although the data is unavailable in Nigeria, it is fair to assume that startups are responsible for a healthy portion of SME jobs.

But the employment rationale for preserving the innovation ecosystem goes beyond the fact that it provides jobs for many Nigerians. Startups and scaleups are even more valuable because they provide some jobs now and a lot more in the future. An SME today will most likely remain an SME in five years, so saving an SME means saving ten jobs today. In contrast, the appeal of scaleups is that they may provide even more jobs in the future, so saving a scaleup means saving a hundred jobs tomorrow. There is empirical evidence to support this thesis. Data from the United States shows that startups accounted for nearly all net job creation over the last ten years. It turns out that young businesses—rather than small businesses—are the true engine of job creation. Although job losses are more common in the innovation ecosystem (as many startups fail), this is more than compensated for by the millions of jobs created by successful startups. In Nigeria, Paga reportedly has over 400 employees and Flutterwave has about 150. These are young businesses that have quickly grown and created a lot of jobs. Therefore, the most persuasive argument for supporting Nigeria’s innovation ecosystem is that it is the most promising vehicle of job creation in a country desperate for it.

The most recent job creation numbers released by the National Bureau of Statistics (NBS) shows that just over 420,000 jobs were created in the whole of 2016. Disregarding 2016 because it was a recession year, 1.5 million jobs were created in 2015—the highest number stretching back to when NBS data is available from 2012. Meanwhile, Nigeria’s labour force has increased by at least 4 million people in each of the last five years, creating an annual job deficit of over 2.5 million. No surprise then that Nigeria’s unemployment rate has accelerated from 6.4% at the end of 2014 to 23.1% at the last count (third quarter of 2018). The COVID-19 pandemic has surely significantly increased unemployment in Nigeria, and it will remain high until we find more productive sources of job creation. The innovation ecosystem is Nigeria’s best bet and should be preserved as much as possible.

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4.2 Startups bring dynamism to the economy through innovation and competition

Startups and scaleups provide many economic benefits outside job creation. The global startup economy is estimated to be worth $2.8 trillion (about 3.5% of the global economy) and has been growing by over 10% each year, compared to 3% overall global economic growth and the 6%-7% growth witnessed in fast-growing economies like China and India. Yet, these numbers do not fully capture the economic impact of a thriving innovation ecosystem.

Startups bring dynamism to the economy through innovation and competition. For a long time, financial institutions in Nigeria were content to focus on a niche high-income customer base, excluding a large share of the population from financial products. The growing influence of Fintechs in the last ten years has jolted traditional financial institutions into action, putting Nigeria on a path towards greater financial depth and inclusion. Diesel costs have long since been a significant burden for corporates given Nigeria’s unreliable national grid. Now, startups like Daystar Power are embedding solar solutions to drive down energy costs and make businesses more sustainable. Some of the benefits of the innovation ecosystem can only be seen through the transformations it brings, whether in subtle ways like the ease with which a Bolt taxi can be requested in Lagos, or in salient ways like how digital products like Zoom have allowed Nigerians maintain face-to-face interactions during the pandemic.

Startups are also significant contributors to economic growth and productivity. For example, the most valuable company in Argentina is Mercado Libre (market capitalisation: $60 billion), an e-commerce platform seeded during the 1998-2002 Argentine great depression which shrank the economy by a quarter. Mercado Libre and other new technology companies played a significant role in driving Argentina’s economic recovery in the 2000s. More generally, long-run economic growth is ultimately determined by technological progress and the innovation ecosystem is arguably the most important private sector vehicle of technological progress. Research by the United States Centre for Economic Studies shows that economic productivity is disproportionately higher among startups.

More importantly, startups and scaleups contribute significantly to export earnings and Foreign Direct Investment (FDI) in developing economies. Official FDI recorded (by the NBS) in Nigeria has been declining, from $7 billion in 2008 to $1 billion in 2019. This has partly been driven by Nigeria’s waning reputation as an attractive investment destination—the largest economy in Africa is ranked 17th on the EY Africa Attractiveness Index. The trend is the opposite when it comes to startups as Nigeria’s innovation ecosystem has risen to become the most popular destination for venture capital funding in Sub-Saharan Africa.

Figure 4: Venture Capital investment vs. Foreign Direct Investment in Nigeria

![Figure 4: Venture Capital investment vs. Foreign Direct Investment in Nigeria](source: Partech Ventures, National Bureau of Statistics)
The innovation ecosystem is even more important because of how the COVID-19 crisis is likely to change societies. Startups are critical for accelerating Nigeria’s digital transformation. The pace of Nigeria’s economic recovery would depend on how well businesses can adapt to the new status quo created by the viral pandemic and adaptation would depend on how quickly and successfully Nigeria can transition to a digital economy. For example, remote jobs are more resilient but require internet and energy infrastructure that is currently lacking in Nigeria, which is ranked 75th on the Huawei Global Connectivity Index 2019. Startups are born digital so have an important role to play here; we need startups to create solutions and provide the infrastructure, products and services that would enable the Nigerian economy to thrive in the new world.

Finally, there are two important things to remember when looking at the economic value of an innovation ecosystem: size and timing. Work done by Startup Genome shows that the marginal economic value of each startup is positively correlated with the size of the ecosystem. Specific analysis for the United States suggests that ecosystems with three times as many startups produce five times as much economic value. Another way to look at this is that losing a single startup can have a disproportionate impact on the economy and losing two hundred startups is more than twice as bad as losing just a hundred. In short, the number of startups saved today is relevant for preserving the economic potential of Nigeria’s innovation ecosystem.

Timing also matters as it is difficult to make up for losing a startup now just by creating more startups in the future. As startups are most valuable for their future economic contribution, losing startups today has a compounding cost in the future. Studies at the United States Federal Reserve show that when fewer firms than normal are formed in a particular year, there is a knock-on economic cost on subsequent years. The reason is that a portion of these startups would have survived, grown quickly, and gone on to employ lots of people. Losing out on these firms in a given year also means losing out on subsequent years’ economic value—in the United States, as many as 1.7 million extra jobs would have been created in the five years after 2006 if business formation had remained at its average level. The Nigerian government must act now to save startups and preserve the country’s economic future.

24Ibid. 9
25Ibid. 24
26Ibid. 9
5. Why startups and scaleups need tailored support

Policies designed for small businesses are often unsuitable for startups. In the United Kingdom, a separate fund was created to provide liquidity support for startups as the eligibility rules of the government’s flagship small business loan program inadvertently excluded many startups. Likewise, in the United States, many startups and scaleups opted against applying for the national Paycheck Protection Program over concerns that their capital structures run afoul of the United States Small Business Administration rules. Finally, in Nigeria, the maximum loan amount accessible in the TCF is based on an average of 3-years revenue, which penalises startups that have experienced exponential growth in recent years. Broadly speaking, the unique business models used in the innovation ecosystem means that tailored support is required for interventions to be effective. At the same time, policymakers can deploy a wider range of intervention instruments in the innovation ecosystem. For example, the significant financial upside of investing in several late-stage startups encourages the use of equity instruments over simple loans.

5.1 SME relief measures are unsuited to startups and scaleups

Small business relief programs are not designed with the innovation business model in mind, so startups often do not meet the eligibility criteria for these programs. Even when they do, the support provided is not as useful. For example, a Venturelab survey of over 600 startups in Switzerland showed that 70% of startups in the country would not qualify for the CHF 20 billion bridge loan scheme based on the turnover requirements. The results of the survey led the Swiss government to create a separate CHF 150 million credit guarantee scheme for startups. The Swiss experience has been replicated all over the world and reinforces the importance of advocating for support measures that would be appropriate for the innovation ecosystem.

5.2 A different set of intervention instruments can be used in the innovation ecosystem

The common financial instruments used to support small businesses are grants and loans. Grants are more useful but much more expensive, while loans are cheaper and easier to disburse but mainly provide liquidity support, even though a lot of businesses need more than that during this period. These two instruments should still be used as part of intervention policies to support the innovation ecosystem but can be paired with others. For example, a startup is better placed to receive equity investment from the government (e.g. from a fund of funds) than a traditional SME. Moreover, the financial upside of the government acquiring a stake in a startup is significantly greater than an SME. Grouping startups with SMEs would inevitably lead to an under-utilisation of equity instruments in intervention policies. In comparison, governments in Western Europe have acknowledged the uniqueness of startups and scaleups differently, so have deployed quasi-equity instruments in their intervention programs.

It is important that any intervention allows startups and scaleups to retain the same freedom to experiment and innovate that drives the ecosystem model.
Section 3 shows the unique short and long-term benefits of a thriving innovation ecosystem in Nigeria. Startups are valuable for two reasons. Like SMEs, they are important for preserving jobs today. But they are also important to Nigeria’s economic future so supporting them now is an investment in the future. Intervention policies need to account for both principles. In an open letter written to the European Union Commissioner, technology trade hubs in the region warned, “Only taking the current cash flow into account belittles the economic potential of these startups and prevents them from receiving much-needed support.” It is important that any intervention allows startups and scaleups to retain the same freedom to experiment and innovate that drives the ecosystem model.

The goal is not to save all startups but to smoothen out the economic cycle. This means that support initiatives for the innovation ecosystem can be more selective than SME programs, but it is important that it is the market (private capital) that does the selection. Some of the current effects of COVID-19 are structural, but most of the changes startups are experiencing during this period are cyclical and can be compared to a typical recession. It is clear that support for the ecosystem is most useful when it keeps ecosystem features, like funding, as close to normal levels as possible.

Microsoft and Apple, two of the largest companies in the world, were both founded just after the 1973-1975 United States recession. Meanwhile, more than half of all Fortune 500 companies were founded in recessions or bear markets, and the exit multiples of startups seeded during recessions compare favourably to expansion-funded startups. These statistics are sometimes interpreted to show that recessions are good times to start or invest in companies. There may be some merit in that argument but the primary lesson from these statistics is that a startup’s likelihood of success has more to do with its intrinsic features (founding team, business model, etc.) than the economic cycle. These companies succeeded in spite of the hard times they went through and not because of them. It is important that today’s startups are given the same opportunity—to succeed or fail in spite of the economic cycle—and Nigeria avoids missing out on useful startups and scaleups because of the pandemic.
6. How Nigeria is supporting its startups

Analysing existing support initiatives in Nigeria

COVID-19 economic stimulus in Nigeria has mainly been sector-focused. Understandably, the health sector has received the most policy support, but government efforts have also been directed quite strongly towards priority sectors such as agriculture and manufacturing. Stimulus for the wider business environment has largely come in the form of social welfare schemes to stimulate household demand and increased liquidity to drive cheap credit to businesses. The background of this approach is that Nigeria’s public finances are extremely tight following the contraction in oil revenues and historically low tax receipts. Planned federal borrowing of over ₦4 trillion provides some fiscal ammunition, but policymakers still have to lean towards credit facilities and regulatory support in lieu of more robust fiscal packages implemented abroad.

Most of the direct support the government is providing to businesses comes through regulatory measures (e.g. tax filing deferrals) and liquidity. But the liquidity support initiatives rolled out by the Central Bank of Nigeria (CBN) are weighted towards the priority sectors in the economy. The widest credit facility available is the Targeted Credit Facility (TCF), a ₦50 billion fund for households and small businesses. The limitations of the TCF are outlined in detail later in this section.

Overall, the current government initiatives fall short of what small businesses have requested as well as the measures implemented in other countries. For example, the Pan-Atlantic MSME survey indicated that 75% of MSMEs want funding support in the form of grants and loans, while technology support (35% of MSMEs) and mentorship (29% of MSMEs) were other commonly requested types of support. In the PwC business leader survey, nearly a third of respondents believed that government intervention should focus on financial support through tax reliefs and zero-interest loans.

Finally, the existing initiatives only lightly support startups and scaleups. The National Information Technology Development Agency (NITDA) set up a 10-man committee to advise it on ways to support the innovation ecosystem. Although the committee has submitted its recommendations, as at July, no targeted scheme had been implemented.

A comprehensive review of support programs in Nigeria is provided below:

6.1 Health sector initiatives

1. Credit facility: The CBN has provided a ₦100 billion fund for health operators to access low-interest loans. As at the end of May, ₦10 billion had been disbursed to entities that were looking to establish advanced diagnostic centres and expand pharmaceutical plants for essential drugs and intravenous fluids.

2. An import duty waiver on medical equipment was included in the Emergency Economic Stimulus Bill (2020). The duty waiver expires at the end of 2020 and includes medical equipment, medicine, and personal protection equipment.

3. Stakeholders in the health industry have been granted priority access to foreign exchange in the country.

4. A Coalition of Private Sector Against COVID-19 (CACOVID) Fund has been set up by the CBN in liaison with large corporates in the private sector. The fund is focused on expanding Nigeria’s testing and treatment capacity and also contributes to the social welfare program targeted at vulnerable households in the country.
6.2 Fiscal initiatives

1. The Emergency Economic Stimulus Bill (2020) includes a clause that offers businesses a 50% income tax rebate if they do not retrench any staff before the end of 2020. Exemptions to this include: Termination caused by death, voluntary disengagement, and a breach of labour act. The clause does not clarify if the refund will be provided as cash or deducted from future taxes.

2. The Federal Government is initiating a ₦500 billion fiscal package focused on healthcare spending, tax cuts and employee protection programs. No further information has been provided yet and the program needs to be approved by the National Assembly.

3. The National Assembly delayed the implementation of an electricity tariff hike initially scheduled for April 2020 in order to ease the financial burden on households and businesses during the pandemic.

4. A number of state governments in Nigeria have reduced the Right of Way (RoW) charges on laying fibre optic cables along state roads. Ekiti State reduced its RoW charge from ₦5,500 per km to ₦145 per km, Imo State reduced its RoW from ₦4,500 per km to ₦145 per km, Kwara reduced its charges from ₦4,500 per km to ₦1 per km, and Kaduna removed the RoW charges entirely. Plateau and Katsina also reduced their RoW charges. In 2013, the National Economic Council directed states to apply a ₦145 per km cap on RoW charges in the country, and state governors assented to this decision in January. Despite this, fourteen states (none of the six mentioned above) actually increased RoW charges in January 2020.

6.3 Administrative Initiatives

1. The Federal Inland Revenue Service (FIRS) has approved a one-month postponement to Corporate Income Tax (CIT) filings for the 2019 year-end. For companies with a December year-end, the new deadline is July 31st, 2020. The FIRS has also permitted companies to submit their audited accounts up to two months after the initial CIT filing.

2. The FIRS has extended the monthly deadline for filing VAT returns from the 21st of each month to the last working day of each month.

3. The FIRs approved the online submission of all tax returns.

4. The National Agency for Food & Drug Administration and Control (NAFDAC) now allows businesses to e-register products on the Automated Product Administration and Monitoring System. Businesses are also given an 80% discount on the registration fee. Finally, NAFDAC is waiving charges for the late renewal of product licenses for a period of 90 days.

6.4 Small Business Support Program

1. The Economic Sustainability Plan includes specific schemes to support small businesses worst-hit by the pandemic.

2. The government earmarked ₦15 billion to act as a guaranteed off-taker of priority products (e.g. processed food, PPE and pharmaceuticals) to sustain local MSME production during the pandemic.

3. A ₦50 billion grant scheme to provide payroll support to small businesses in the most affected industries, including hospitality, trade and education.
6.5 Credit facilities

1. The Monetary Policy Committee (MPC) of the CBN cut the base interest rate in the country from 13.5% to 12.5% at the end of May in an effort to drive down the cost of borrowing in the country. However, the MPC retained a high Cash Reserve Ratio of 27.5%, which local banks had flagged as an impediment to lending.

2. The CBN has outlined a liquidity boost totalling ₦3.6 trillion. This includes the ₦100 billion health fund, as well as ₦1 trillion each for the manufacturing and agriculture sectors. The ₦50 billion Targeted Credit Facility is also included.

6.6 Targeted Credit Facility

The TCF is the flagship liquidity support program for small businesses not operating in any of the priority sectors of the economy. The ₦50 billion fund is derived from the Micro, Small and Medium Enterprises Development Fund (MSMEDF) and is implemented by NIRSAL Microfinance Bank. The Fund began disbursements at the start of May and the CBN revealed that ₦49 billion had been disbursed by the end of July. Businesses can either apply for a term loan (maximum of 3 years) or working capital financing. The TCF is a welcome initiative for providing liquidity support to small businesses. However, the eligibility requirements and program details are ambiguous and ill-suited to businesses in the innovation ecosystem for a number of reasons.

Eligibility: The TCF guidelines indicate that businesses must provide "clear evidence of the opportunity or adverse impact as a result of COVID-19 pandemic". There is some ambiguity over which businesses would be deemed to be unaffected by the pandemic, particularly as the TCF also lists the activities covered under the program. The listed activities are agriculture, hospitality, aviation, health, manufacturing, and trade. These are all traditional industries. The guidelines leave room for "any other income generating activities as may be prescribed by the CBN" but this does not fully answer the question of which startups are eligible.

Loan size: Businesses can borrow up to ₦25 million for the term loan and as much as 25% of their average turnover in the past 3 years. The latter requirement could penalise the fastest-growing startups whose year 3 revenues are much greater than their year 1 revenues, meaning the maximum loan amount they can secure would be significantly less than what they currently need.

Collateral requirements: The collateral requirements for the TCF may be too strict for startups given the purpose of the loan. The main form of collateral accepted is a title document for land/property (this is the only collateral accepted for loans between ₦15 million and ₦25 million). The TCF also provides the option of moveable collateral, and startups may be permitted to use PPE (plant, property & equipment) in this case. The burden of collateral is a general obstacle to business lending in Nigeria as major financial institutions still consider unsecured lending to be too risky.
7. Lessons from abroad

Using case studies to map out an appropriate innovation ecosystem support scheme

In this section, we analyse a range of initiatives used by policymakers in developed economies to support small businesses and the innovation ecosystem, in particular. The case studies demonstrate that the existing support given to Nigerian startups falls short of what is required in the innovation ecosystem, and provide guidelines for how the Nigerian government can support startups through the current crisis.

7.1 Payroll protection in the United States

Section 2 shows the impact of the COVID-19 pandemic on jobs and startup liquidity; in the Startup Genome global survey, payroll support was listed as the third most helpful policy response. Therefore, it is laudable that many governments have directly addressed this through labour market palliatives, whether by wage guarantees or expanded social safety nets. The UK Government has pledged to pay 80% of the earnings of all furloughed workers (up to £2,500) until October 2020, and, closer to home, the South African Government extended the Unemployment Insurance Fund to cover part of the shortfall in an employee’s wage in the event of a salary cut.

Section 3 highlights the distinction between small businesses as the largest employer of labour, and startups and scaleups as a country’s primary source of long-term net job creation. Meanwhile, Section 4 shows why policies designed for small businesses may be unsuitable for those in the innovation ecosystem. The United States Paycheck Protection Program (PPP) sheds light on how existing payroll support programs do not provide startups and scaleups with the required employment support.

Under the PPP, the United States Small Business administration (SBA) grants businesses a loan which is forgiven if all employees are retained for at least 8 weeks and the funds are used for payroll or overheads (rent, utilities and mortgage payments). The $660 billion fund has been so heavily subscribed that the United States House of Representatives voted to increase the fund’s capacity and extend it to 24 weeks. Although the PPP has its merits, private technology companies in the United States have barely benefited from the scheme as startups’ unconventional structures prevent them from fulfilling the eligibility criteria defined by the SBA.

One significant rule is that eligible businesses must have less than 500 employees (including employees at affiliate companies). Many startups fit this criteria on their own, but the SBA rules would count other startups that share the same investor as affiliates because venture capital and private equity investors tend to retain the sort of control over their portfolio companies that can render the whole group a single company under the rules. This makes most VC-backed startups “too big” for the PPP program and many startups opted against applying for fear of infringing SBA rules. Another eligibility criterion that poses a challenge for startups is that businesses are not allowed to have a minority shareholder that can control the business by wielding the power to block action by the board of directors or shareholders. Based on these guidelines, many investors in startups would be counted as minority shareholders as it is common for startups to sign term sheets that grant investors veto power in strategic decisions. The SBA rules explain that companies are eligible for PPP if minority investors waive those rights, but this alone disincentivises startups from applying.

The failure of the United States PPP to support the innovation ecosystem stems from the tendency to treat startups and scaleups like other small businesses. However, as explained in Section 4, policies must be tailored to the innovation ecosystem and this is equally true for employment protection programs. For example, Nigerian startups should be allowed to retain flexibility in their staffing decisions so that their nimbleness and adaptability are not constrained at this time. In this regard, initiatives like the United States PPP are more appropriate than the provisions in Nigeria’s Emergency Economic Stimulus Bill (2020) because they do not only help the companies that retain workers. Labour market palliatives for the innovation ecosystem should allow startups and scaleups to retain some control over their staffing decisions while policymakers address broader social welfare concerns through more direct unemployment insurance.
7.2 United Kingdom CBILS vs. The Future Fund

The UK is a good case study of how to transition from generic SME policies to those that provide targeted relief to the innovation ecosystem. The UK approach is underpinned by an appreciation of the importance of the ecosystem in a country ready to chart a new growth path outside the European Union. According to the Chancellor of the Exchequer, Rishi Sunak, “These companies provide the growth of tomorrow and they deserve our [UK government] full support.”

However, this support was slow in coming as the flagship COVID-19 support intervention for small businesses—the Coronavirus Business Interruption Loan Scheme (CBILS)—excluded startups and scaleups. The British Business Bank implements the CBILS through 40 accredited lenders who offer different financing options like overdrafts and asset finance to small businesses. All loans are backed by the CBILS fund and the UK government covers the first 12 months of interest payments and charges. But the CBILS criteria excludes companies older than 3 years that have accumulated losses greater than half of their share capital. This requirement excludes a lot of UK private technology companies since the innovation ecosystem prioritises hyper-growth over profits until the business reaches scale. The UK government admitted this fact after the program was rolled out without providing clear measures to address it.

UK policymakers’ improved response can be traced to coordinated pressure from the local innovation ecosystem. This pressure encouraged the government to go back to the drawing board as Alok Sharma, UK Business Secretary, admitted, “We know that young, fast-growing firms require tailored support to see them through.” This tailored support comes mainly through the establishment of the Future Fund, a £250m government co-investment scheme. The fund disburses between £125k and £5m in convertible notes matched by private investors. Only startups that have raised at least £250,000 in the last 5 years are eligible and the note must be repaid within 3 years or converted to equity at the next fundraising round. The Future Fund initiative is a boon to the UK innovation ecosystem as it tackles the economic effects of the COVID-19 pandemic. Moreover, there are a few elements of the scheme worth highlighting:

1. The government uses a convertible note instrument, which fits the capital profile of startups much better than standard loans given to small businesses.

2. The use of convertible notes puts less emphasis on valuing the startup during a crisis, in comparison to a plain equity investment.

3. Private investor matching means that capital would flow to more bankable startups as private investors are much better at assessing startup potential.

Nevertheless, the scheme has its issues:

1. Early-stage companies are excluded even though they are likely to have more cash flow problems. A possible rationale for this is that evidence from previous recessions shows that seed fundraising declined less and recovered quicker than later-stage fundraise.

2. Investment in the scheme is not yet covered by the Enterprise Investment Scheme (EIS) which grants tax breaks on investments in early-stage companies, or the Seed Enterprise Investment Scheme (SEIS). This may reduce investor uptake as 80% of early stage investment in UK companies is carried out through the SEIS and EIS. However, making the Future Fund EIS-compatible would require legislation that would slow down the process so the government has committed to subsequently amending the rules of the EIS to ensure that investors do not miss out on tax relief.
7.3 European Union models

Large European countries have been more active in rolling out schemes to support their innovation ecosystems as they have correctly identified that the COVID-19 pandemic provides an opportunity for them to close the gap with the United States. Some measures have been relatively simple. In France, a €4 billion fund has been created to prop the innovation ecosystem. The fund finances a bundle of palliatives including cash flow guarantees (€2 billion), a short-term refinancing scheme (€160 million), and the accelerated payment of already-planned investments in the sector (€250 million).

Other European countries have gone further by crafting policies closely aligned with the structure of their innovation ecosystem. For example, Portugal’s relief fund is much smaller (€25 million) but includes minimum wage packages for up to ten employees and incubation services for startups. Germany leads the way in this respect, driven by the understanding that a tailored approach is necessary and optimal. As highlighted by Minister of Economic Affairs and Energy, Peter Altmaier, “Classic credit instruments are often a poor fit for young, innovative companies.” In this regard, Germany set up an ambitious €2 billion co-investment fund. The plan is for a government umbrella fund to invest in larger startups with private investors matching between 30% and 50% of the investment. Meanwhile, some funds will be diverted through regional development institutes to invest in smaller startups.

It is important to note that countries in the European Union (EU) have strong experience investing in their innovation ecosystems. The European Investment Fund has been investing in startups for the best part of two decades and the European Innovation Council Accelerator can directly invest up to €15 million (and can do so through convertible notes). Most recently, the EIF began the pilot for ESCALAR, a €300 million scheme that invests in venture capital and private equity companies. EU member states have also habitually co-invested in private funding rounds through national innovation agencies such as Bpifrance and Enterprise Ireland. Despite this history, COVID-19 co-investment programs have hit roadblocks as they fall foul of “undertakings in difficulty” tests in EU Competition Law, which stops countries from using state aid to prop failing businesses. Officials in Brussels have loosened rules to allow equity injections in businesses suffering as a result of the health emergency, but regulatory compliance remains a problem when it comes to startup interventions.
In 2019, around $700 million in VC funding flowed into Nigeria’s startup ecosystem, making it the most popular destination for early-stage financing in Africa. The economic contribution of the innovation ecosystem — startups and scaleups — are readily visible. Fintech platforms drive financial inclusion and introduce new investment opportunities, renewable energy frees households and corporates from the grip of an unreliable national grid, and innovations are being made in a logistics sector previously characterised by mass inefficiency.

The past decade has seen Nigeria’s innovation ecosystem evolve from a handful of companies, into hundreds of startups and scaleups that are competing in local, regional and global markets. Inspiring Nigerian founders continue to innovate towards a better future for us all, searching for sustainable growth models that have the potential to create long-lasting impact and holding the promise of economic and digital transformation. Unfortunately, the pandemic still poses a massive threat to the ecosystem, and we believe that the public and private sectors have a responsibility to support the innovation ecosystem to minimise potential company failures.

The existing shortfall in policy support must be addressed. Sound policies and effective programs need to cater to the high-growth focus of the innovation ecosystem. Tailored support will allow Nigeria’s innovation ecosystem to adapt quickly and continue to contribute to Nigeria’s economy by creating high-quality jobs, driving innovation and capital accumulation, and inspiring millions of entrepreneurs to follow in their footsteps. Our innovation ecosystem requires liquidity and non-financial support.

This whitepaper provides an actionable guide, not just for supporting the innovation ecosystem in the immediate after-effects of the coronavirus pandemic, but also through the subsequent, current economic slowdown. We hope that it will lay the foundation for further collaborative support by the government, targeting startups and scaleups.
About Endeavor

Established in 1997, Endeavor is a mission-driven, global organisation leading the high-impact entrepreneurship movement. Endeavor was founded on the belief that job creation, innovation, and overall prosperity flourish where there is robust support for high-impact entrepreneurs.

Endeavor screens, selects, and accelerates high-impact entrepreneurs building transformative companies in nearly 40 markets globally. Headquartered in New York City, Endeavor operates across underserved ecosystems throughout Africa, Asia, Europe, Latin America, the Middle East, and North America.

Endeavor Entrepreneurs have a significant track record of impact, helping to build sustainable growth models in their home countries by inspiring future generations to innovate and take risks. There are currently 2,083 Endeavor Entrepreneurs leading 1,300 companies across the world. In 2019, Endeavor Entrepreneur-led companies created over 4 million jobs and generated over $24 billion in revenues.

Endeavor launches in markets where there is a vibrant startup ecosystem, lacking in scaleup support. Endeavor Nigeria launched in 2018 to support the best founders of companies at the scale-up stage, who demonstrate the potential to leverage Endeavor’s resources to create large-scale wealth and jobs, and are committed to reinvesting their time and money to help other entrepreneurs in Nigeria’s ecosystem take off.

Endeavor currently supports 16 Endeavor Entrepreneurs leading 10 companies in Nigeria.

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Stears Data is the data collection, analytics and data access division of Stears, a digital information company. Stears was built to help individuals, development organisations, investors, governments and companies cost-effectively access high-quality information on Africa from anywhere in the world. Stears also owns one of Africa’s most analytical business publications - Stears Business.

Our data solutions include providing clients with access to proprietary demographic and economic data, as well as research and advisory services to extract insight from client data.

Data & Economic Advisory

Stears Data provides perspectives and projections on the economy on behalf of our clients. We do this via analysis of trends, risks, and policies in the economy. Our clients include governments and private organisations whose strategic and investment decision making is significantly affected by what is going on in the broader economy.

Surveys & Data Collection

Stears Data designs customised, ground-level data collection projects including surveys, focus groups, polling and market/economic research. We work directly with customers to generate reports and customer insights that address specific business needs in Nigeria at national, state and local levels.

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