06/09/2019

Hon. J Maswanganyi, MP
Chairperson: Standing Committee on Finance (National Assembly)

Hon. Y Carrim, MP
Chairperson: Select Committee on Finance (National Council of Provinces)

For attention: Mr Arico Kotze
Per email: akotze@parliament.gov.za

Mr Allen Wicomb
Per email: awicomb@parliament.gov.za

Dear Hon. Maswanganyi and Hon. Carrim

WRITTEN SUBMISSIONS ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2019

We thank you for the opportunity to comment on the Draft Taxation Laws Amendment Bill published on 21 July 2019 ("the Draft Bill").

Kingson Capital (Pty) Ltd ("Kingson") is a Venture Capital firm and also a company approved in terms of section 12J of the Income Tax Act, 1962 ("section 12J of the ITA"). Kingson will be directly affected by the proposed amendments to section 12J of the ITA as set out in section 17 of the Draft Bill. We hereby take this opportunity to make submissions on these proposed amendments.

We welcome National Treasury's intent to end abuse within the VCC tax incentive regime and also recognise the importance of taking measures to protect the fiscus and the South African tax base. We are pleased that National Treasury acknowledges the role the VCC tax incentive regime has had as an incentive for true venture capitalists; acting as a catalyst for equity funding for small businesses that otherwise would not have had access to market funding due to either both their size and inherent risk.

However, we are concerned that the proposed amendments to section 12J of the ITA are broad and will adversely affect our ability and the ability of the South African Venture Capital industry to raise capital in terms of the VCC tax incentive regime. This will have an adverse effect on the pool of capital so eagerly sought after for the express purpose of providing access to equity funding for small businesses, and facilitating much needed job creation, for amongst others, the unemployed youth.

Our submission, which includes research publically available, also includes certain information which up to this point has not been publically available. This information is provided for the express purpose of providing this Committee with a high-level view of our business strategy, future plans and the impact that the proposed amendments will have on our ability to fundraise in the future.

Global Venture Capital Ecosystem

1. In creating an environment conducive for true venture capitalists, it's important to understand the global VC ecosystem and the framework in which they operate. This enables South African VC's to model themselves accordingly in order to connect into more sophisticated VC markets.

2. Global Venture Capital (VC) activities are at a record high. A recent report published by the Center for American Entrepreneurship titled _Rise of the Global Startup City: The New Map of Entrepreneurship and Venture Capital_ details the global VC ecosystem with some pertinent highlights:

    2.1. Global VC investment surged from $52 billion in 2010 to $171 billion in 2017

    2.2. Global venture deals grew from 8,600 deals in 2010 to 14,800 in 2017

    2.3. The report distinguishes between two main types of Global Startup Hubs: Established and Emerging Hubs. The classification is made purely based on the amount of VC investment and the number of venture deals. In total, 92 cities are categorised across both. Of the Emerging Hubs, only two African cities are included: Nairobi and Lagos.

3. The above information highlights the growth in venture investment globally. It also provides a backdrop to the scale and possible extent of growth to which the South Africa venture ecosystem could benefit. Of concern though is that the growth rate in which South Africa has benefitted is not enough to keep pace with the rest of Africa, to the extent that not one South African city is included. Instead, both Nairobi and Lagos have surpassed all South African cities as Emerging Hubs.

4. Below is table of some of the more prominent early stage VC investors. The purpose of the information (extracted from PitchBook[1]) is to provide high level information relating to the quantum of investor investment sizes from sophisticated VC markets into Venture Capital funds. These investors are commonly referred to as Limited Partners; Total AUM represents Total Assets Under Management:

Name of firm	Founded	Total AUM (USD millions)	Number of Limited Partners
Andreessen Horowitz	2009	9,990	30
Benchmark	1995	2,050	42
Bessemer Venture Partners	1911	7,020	21
Founder Collective	2009	185	7
Founders Fund	2005	3,270	17
Index Ventures	1996	6,100	54
Kleiner Perkins	1972	5,450	61
Sequoia Capital	1972	18,350	109
Y Combinator*	2005	772	9
500 Startups*	2010	503	16

* Represent Accelerators/Incubators

5. The above information is important as it provides context of the scale of investment into venture capital markets, at least in more mature markets. This is concentrated amongst a relatively few number of investors.

[1] PitchBook Data Inc. is a globally recognised research and data technology platform that covers the private capital markets including venture capital.

6. In addition, the above information supports the view that VC funds are dependent on fewer, very large or anchor investors to raise a fund.

7. In our view, true Venture Capitalists are, and will continue to be supported by a relatively smaller number of local investors. The VCC tax incentive has been critical in supporting the emerging Venture Capital industry in South Africa and remains an important tool by government to invest and encourage the private sector into this inherently high risk asset class..

Overview of Kingson

8. Kingson is a Venture Capital Firm and an approved Venture Capital Company (VCC) in terms of S12J of the ITA. The below salient points provide context for and relevance to the impact of the proposed amendments on our business strategy and future plans in accelerating a digital economy in South Africa.

    8.1. On the 27th of September 2018 the Kingson Accelerate Fund (Pty) Ltd ("Kingson Accelerate"), a related company to Kingson, secured a USD 10 million loan portfolio guarantee facility from the United States Agency for International Development ("USAID"). The guarantee facility is a risk sharing facility providing for a 50% guarantee on any debt issued by Kingson Accelerate, supported by the US Treasury.

    8.2. Kingson launched its Fund Two, a ZAR 400 million fund (c. USD 30 million) in Q1 of 2019. The launch was supported by a signing ceremony and investor meeting with the theme: *How to Scale the Startup Ecosystem in South Africa.* The event was co-hosted by the Chargé d'Affaires of the US Mission to South Africa, Ms Jessica Lapenn, and included other notable individuals from both the private and public sector.

    8.3. At the event, the Fund Manager to Kingson was gifted with a special award in recognition of playing its role in unlocking private capital for small-and medium-sized enterprises and technology companies, and catalysing the local venture capital industry in South Africa.

    8.4. Recognising the importance of connecting South African startups and creating a viable venture ecosystem in South Africa, the Fund Manager has committed resources and time in the United States garnering investment support and building investor networks into Washington DC, New York City, San Francisco and Silicon Valley.

    8.5. As a result of time spent in the US building these investor networks and introducing startups to US investors, Kingson started to garner US investment support for its Fund Two.

    8.6. In early July 2019, prior to the publication of the Draft Bill, Kingson had signed two multi-million dollar commitments from international investors.

    8.7. The above commitments were made on the basis that we will continue to fundraise and garner local investment support from South African investors.

    8.8. On the local front, Kingson has been engaging with South African based investors, which include large companies and family offices, all of which will be investing amounts greater than the proposed cap.

8.9. Kingson is currently running two pilot projects with large local companies showcasing the potential value enhancement, using technology and innovation within their supply chain from Kingson's current portfolio.

Revised Fund Two size

9. Due to investment commitments already made and the investment appetite mentioned above, Kingson is in the process of revising its Fund Two size to USD 100 million.

10. Kingson envisages the fund will comprise

    10.1. International investors: 75-80% of the capital

    10.2. Local investors: 20-25% of the capital

Investment into South African Technology Companies

11. Kingson is of the view that tremendous opportunities exist for South African technology companies to provide solutions that are scalable in the rest of Africa and into other developed markets.

12. Kingson supports the view that South Africa should be positioned as the financial hub of Africa. The role of technology in positioning the country and future knock-on effects for youth employment, skills transfer and small business creation is significant.

13. In our endeavours to scale and grow the South African technology landscape, we have learnt from other US-based investors, that in order for a startup business to progress further in the digital economy and attract foreign funding, the following are prerequisites:

    13.1. The start-up business must have obtained investment from local investors;

    13.2. The start-up business must achieve local product market fit (which means a business must commercialise its product locally first); and

    13.3. The start-up business must gain sufficient traction in its local context first, with growing Annual Recurring Revenue (ARR), before it can scale into other markets.

14. Because of the concentration of the South African market, largely dominated and controlled by big companies, it is virtually impossible for a startup to grow and achieve the required level of ARR, without rubbing shoulders with one or several large companies.

15. Kingson has witnessed first-hand how large companies in South Africa often adopt the approach to bypass innovative start-ups to in-source the technology, often attempting to replicate it.

16. For the sake of creating high performing start-ups that can compete with larger South African companies, start-up businesses need investors with bigger pools of capital to drive a more locally competitive market and increase the number of growing small-and-medium sized companies, thus helping address and solve large scale unemployment and create jobs.

17. To raise a fund, it is common practice that there are one or two significantly large investors that help anchor the fund, and other investors then invest off the back of capital committed.

18. It is also common practice that in VC funds, there are relatively few very large investors.

19. The focus on local technology companies is a long-term investment that adds revenue to the national fiscus in the form of corporate tax and VAT. In addition, their growth will increase the South African GDP and contribute to PAYE.

Developing policy aligned with the President's call for action

20. When President Ramaphosa calls on investors to join the "new momentum", as he did on the 4th of September 2019, referring to South Africa as "an economy that is fertile ground for companies and businesses who are prepared to invest in human capital" referencing opportunities presented by the 4th Industrial Revolution, and then calls on all investors, "particularly local investors, to be part of this new momentum" it is of paramount importance that we have a framework that can facilitate that investment by local investors.

21. Similarly, when President Ramaphosa, opened the inaugural South African Digital Economy Summit on July 5, 2019 with the below emphasis:

    "The digital revolution is an opportunity to build an entrepreneurial state, where government's own appetite for risk and innovation inspires large-scale entrepreneurship and unlocks economic potential. An entrepreneurial state should have strong venture capital as one of its elements."

    We view S12J of the ITA as part of government's "own appetite for risk and innovation" that is helping inspire large-scale entrepreneurship.

22. This requires policy that supports and continues to enable the digital revolution, and the creation of the entrepreneurial state that the President envisions for this nation.

Why is S12J of the ITA important to Kingson's future business plan?

23. South African based investors, historically and continually, show a reluctance to invest in early stage businesses.

24. S12J of the ITA affords VCC's the opportunity to engage with investors. It is unfortunate that S12J of the ITA has largely, up to this point, been utilised for purposes other than its intended use.

25. S12J of the ITA is important to help facilitate and on-board investors who otherwise would not invest into early stage businesses.

26. It is of significant importance to Kingson to garner investment support from large South African based companies to invest alongside international investors. This is important for two main reasons:

    26.1. International investors want to see local investment and commitment in the fund;

    26.2. Local investors are strategically important in providing market access and distribution channels for revenue growth, a key aspect of reaching critical ARR metrics for further foreign direct investment and significant follow-on funding.

27. Local investors are very important players in helping to develop a thriving venture capital industry in South Africa.

The impact of the Draft Bill on Kingson at present

28. The Draft Bill proposes to cap the investment amount, available as a deduction, to ZAR 2,500,000.

29. The proposed cap will prohibit investment from large companies with whom we are already engaging, and working with, as detailed above in sections 8.8 and 8.9.

30. The proposed cap seriously impedes Kingson's ability to execute on its business strategy, not only placing at risk local capital earmarked for small business, but may also jeopardise current investment committed by our international investors.

31. Kingson's inability to garner investment from local investors will prejudice its ability to fundraise further in international markets.

32. Should the Draft Bill be promulgated in its current form, there is no incentive for Kingson to continue to fundraise from local investors. Instead, international investors, seeing opportunities in South African technology companies, have no incentive to assist in retaining talent within South Africa. This will further contribute to South Africa's brain drain and loss of skilled talent to more investor friendly markets.

Proposed recommendations

33. Understanding that the primary reason proposed in the Draft Bill is to protect the fiscus, we believe there are other more appropriate mechanisms that can be used to achieve this outcome.

34. We propose that an accelerated allowance be introduced over a 3 (three) year period on the following basis:
    34.1. Year 1: 60% allowance, and
    34.2. Year 2: 20% allowance, and
    34.3. Year 3: 20% allowance.

35. We believe this will have the desired impact of "spreading" the impact on the fiscus while still proving a mechanism to attract investment by local investors into this all-to-important SME sector.

36. We implore this Committee to intervene the promulgation of this Draft Bill, as the introduction of a proposed cap in its current format, no matter the size, will have a detrimental impact on the ability of VCC's to fundraise.

Presenting to the Committee

I respectfully request an opportunity to appear before the Committee to give an oral presentation.

Yours Faithfully

Gavin Reardon
Director