Sturgeon Frontier VC Newsletter
(Q4 2020)

INTRO

Sturgeon is pleased to share the first edition of our Frontier VC Newsletter with you. This new quarterly newsletter will cover a broad range of frontier topics and geographies, which we believe will provide a helpful context in which to understand the businesses in Sturgeon's area of focus. We will cover summaries of start-ups that are turning the challenges of frontier markets into opportunities, interviews with the founders of some of these start-ups, and guest content. We hope that these letters will provide you with a unique insight into the dynamic world of frontier market venture capital and the opportunities therein.

In this month's edition:

- We take a look at ShopUp, the Bangladeshi start-up that has just raised $22.5m to expand its B2B platform for SMEs
- 18 months on from its New York IPO, we review the challenges and opportunities facing African e-commerce giant, Jumia
- In our interview with Cameron Goldie-Scot, we learn more about Musoni, a cloud-based digitalisation partner for microfinance institutions
- We feature guest content on the e-commerce market in Africa from *The Baobab Network*, Africa's leading start-up accelerator

SHOPUP (BANGLADESH)

Why has ShopUp been in the news?

In October 2020, ShopUp announced that it had raised a new investment round of $22.5 million, co-led by Sequoia Capital India and Flourish Ventures, with additional participation through VEON Ventures, Speedinvest, and Lonsdale Capital. ShopUp is the first investment by Sequoia Capital India and Flourish Ventures in Bangladesh. The company has raised about $28 million to date from investors and merged with Indian e-commerce platform Voonik earlier in the year as it looks to expand its presence outside of Bangladesh.

ShopUp said it has seen a rise in demand amid COVID-19. Neighbourhood stores' weekly transactions increased by 8.5x between April and August on the platform, and RedX is processing 13x more daily parcel volume than it did in April. The company plans to deploy the capital to strengthen its partnerships with manufacturers and expand its tech infrastructure. "This fresh round of funding will support us in increasing our retail reach, deepening our partnerships with manufacturers, and focusing on building tech-first infrastructure," said Afeef Zaman, CEO of ShopUp.

What opportunity set does ShopUp target?

ShopUp is targeted at the large network of 4.5 million "mom-and-pop shops", known locally as *Mudi Dokaans*, in Bangladesh that account for 98% of the country's retail sector. While it is an extreme example, this sort of fragmentation within retail in frontier markets is common. As in other markets, the vast majority of these small shops have little-to-no digital presence; both for their store, inventory, and order management, and in their relationships with their customers. These issues have been exacerbated by the coronavirus lockdowns.

A research report by the United Nations Capital Development Fund in 2018 highlighted both the importance of these shops for the Bangladeshi economy and the opportunity for businesses that can solve their problems when it comes to digitalisation*. The 1.3 million micro-merchants covered by the report have $18 billion in annual turnover and employ close to 2 million people, with a disproportionally high level of youth employment. Scaled up to include the larger "mom-and-pop shops" that ShopUp targets as well, the opportunity is clearly huge.

However, these businesses face an array of problems. Firstly, ordering from suppliers is most often manual and in cash. Secondly, they struggle to scale their businesses because they do not have access to digital store management tools. Thirdly, they typically do not have access to working capital finance at affordable rates, which, since 73% of their sales rely on credit instead of cash or digital payments, creates a massive liquidity crunch. These problems for small retail stores are practically universal across frontier economies, and yet there has been not nearly as much investor attention given to the SME opportunity as there has to B2C e-commerce and solutions.

What is ShopUp today?

ShopUp has built what it calls a full-stack business-to-business commerce platform to solve some of the key problems outlined above. It provides three core services to neighbourhood stores: a wholesale marketplace to secure inventory, logistics (including last-mile delivery to customers) and working capital.

The marketplace, "Mokam", has over 10,000 products at wholesale prices for SMEs to purchase. The delivery platform, "RedX", caters to the expanding e-commerce sector in Bangladesh by providing tech-first delivery support for both businesses and individuals. RedX delivers across Bangladesh in under 72 hours, with doorstep pickup and delivery and SMS updates. Crucially, it accepts cash on delivery (COD) and bank payment or bKash**.

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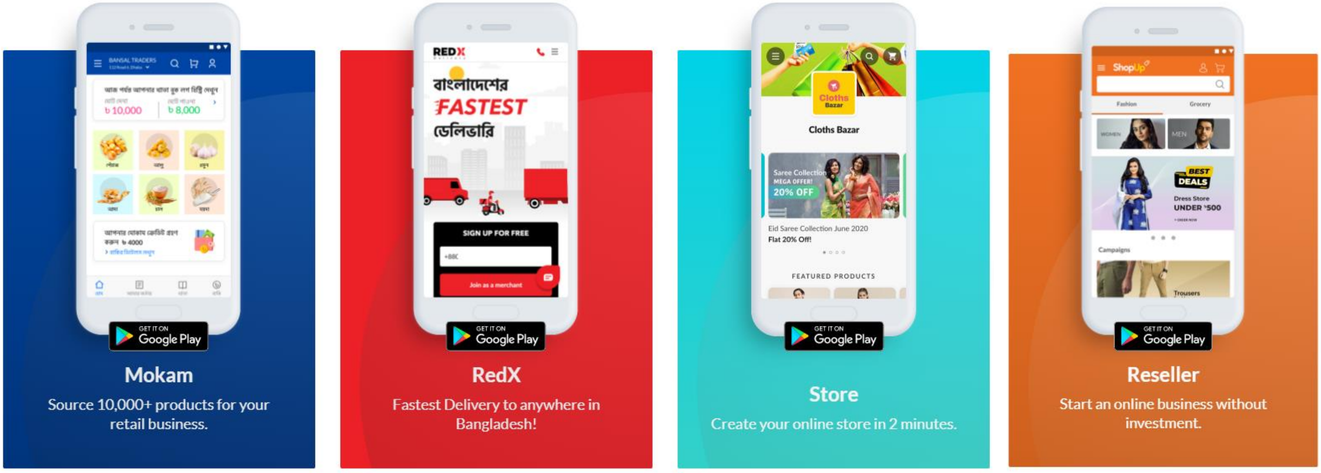
* "LANDSCAPE ASSESSMENT OF RETAIL MICRO-MERCHANTS IN BANGLADESH," *United Nations Capital Development Fund* (2018)

** bKash is a mobile financial service in Bangladesh whose users can deposit money into their mobile accounts and then access a range of services, in particular transferring and receiving money domestically, making payments, recharging prepaid mobiles and paying mobile post-paid bills. Its shareholders include the International Financial Corporation (IFC), the Bill & Melinda Gates Foundation and Ant Financial.

The ShopUp "eLoan" app allows businesses to receive a working capital loan for 3 to 12 months with zero collateral, and interest rates from 7% to 24% maximum, provided by ShopUp's banking partners. The documents required are minimal, and the money is deposited within 7 days of signing the loan agreement. Repayment is possible in multiple different forms, including bKash, automatic deduction, and cash.



ShopUp also enables thousands of SMEs to use their network through social media as a source of additional income. Its "Reseller" app enables individuals to start an online business without any upfront investment in stock, while "Store" allows clients to set up an online store in 2 minutes. This taps into a trend somewhat unique to Bangladesh, where Facebook has become the dominant B2C marketplace in the country. No-one knows exactly how many sellers operate on the platform (some estimate more than 300,000); however, most of them rely on external providers such as ShopUp to manage their inventory, delivery, and payment collection.

ShopUp was founded with the core value of enabling small and medium-sized businesses to succeed, with a principle of technology-first. As it reaches an ever-wider audience in the country of 172 million people, its potential for positive social impact also grows. SMEs in frontier markets such as Bangladesh contribute a larger proportion of GDP and employment than their developed market peers; in Uzbekistan, for example, SMEs generate 50-60% of the GDP and up to 80% of employment. Therefore, businesses which solve the fundamental pain points for these companies through the provision of technology-enabled digital solutions can generate not only outsized financial gains but also social returns.

Key takeaways

- SMEs play a vital role in frontier market economies, supporting both economic growth and employment; however, they are critically underserved by technology-enabled solutions.
- There is a huge opportunity for companies to digitise SME stores, inventory and order management, as well as bringing them online for B2C transactions. This can have an outsized social impact given the number of people employed by SMEs and their economic background.
- Covid-19 has accelerated this shift to digital, and we would expect to see increased investment opportunities in companies such as ShopUp that are solving these key pain points for SMEs.
- Sequoia Capital India and Flourish Ventures' first investment into Bangladesh is indicative of a shift among VC investors to look more at frontier markets where the opportunity to invest at competitive valuations and maximise upside is greater than in more developed markets.

JUMIA (AFRICA)

Why has Jumia been in the news?

In April 2019, Jumia was listed on the New York Stock Exchange, becoming the first African start-up to IPO on a major international exchange. Initially valued at $1.4 billion, by the end of the first day's trading the company's value had soared to over $3 billion. Within a few weeks, however, the company's stock suffered a significant decline, weighed down by allegations of fraud and concealed losses. Just before the anniversary of its IPO, founding investor, Rocket Internet, sold their 11% stake for around $4 per share.

Since the initial turbulence following its IPO, Jumia has refocused on core efficiency and profitability in order to develop a more sustainable business for the long-term. It has exited 14 countries and shifted its product catalogue to a higher turnover and margin products. With the Covid-19 crisis rapidly accelerating retail's shift to digital, globally, and with a renewed focus on profitability, there is a compelling case to review Jumia in a new light. Its share price has certainly reflected changing perceptions of the business, rising to $28 per share at the time of writing (market cap $2.3 billion). The nascent stage of e-commerce in Africa means there are still many opportunities for Jumia to grow, both in terms of its core marketplace and also its payments and logistics as part of a holistic platform.

What opportunity set does Jumia target?

With a population of 1.3 billion, a growing middle class, high GDP growth and high internet and smartphone (77%) penetration, the opportunity for e-commerce in Africa is large. Despite this, there remain fundamental challenges, including poor infrastructure, a lack of locally manufactured goods, and economic instability, that e-commerce players must overcome in order to succeed. These challenges help to explain why the e-commerce market is still so underdeveloped, with penetration less than 1%. However, the development of a core digital infrastructure across the continent has created opportunities for e-commerce players to solve these challenges and meet the needs of consumers, much as Jumia has done.

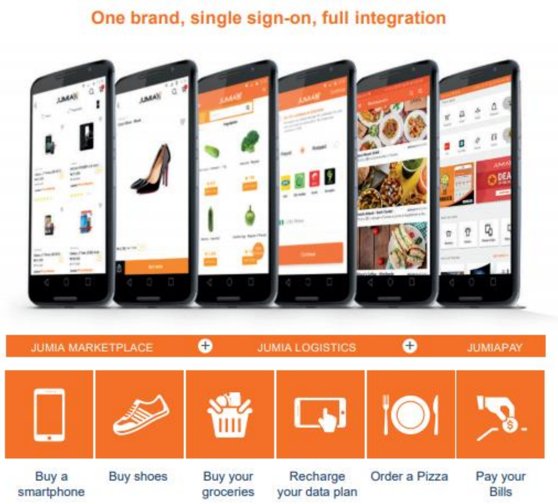
Unlike developed markets where fierce e-commerce competition relies on existing quality infrastructure, in frontier markets such as Africa the responsibility for creating the necessary infrastructure falls on the e-commerce challenger. Once developed, this infrastructure can then become a key point of competitive advantage for the incumbent e-commerce player. To be successful, Jumia had to solve three fundamental problems:

1. **Logistics:** International delivery companies in Nigeria lacked the structure, interest, and capital to scale to meet Jumia's growing requirements. Other issues included severely high traffic volume, theft, and poor-quality roads. As a result, Jumia built its own logistics system, Jumia Logistics, investing in a fleet of delivery vehicles and rented distribution hubs. Customers were able to select home delivery or self-pickup at hundreds of locations. Jumia invested in tech to optimise, track, and notify customers and this data was then used to determine vendor acquisition, drive sales, and persuade international brands to partner with Jumia as a point of entry to Africa.
2. **Payments:** Cash-on-delivery (COD) constituted 85% of Jumia payments in 2015. Given the lack of internet banking, low credit card penetration, and online fraud, most customers preferred to pay cash after receiving and evaluating the purchase. Despite being necessary to bolster sales, cash on delivery still poses a challenge – customers not showing on delivery, or refusing to pay. Jumia has developed its own payments app, JumiaPay, to support its customers to make digital payments. Not only does this reduce the cost and effort of COD, but it also serves as a platform for Jumia to launch new products and services for its users, leveraging the data it gathers through the marketplace.

3. **Customer service:** Customer satisfaction initially fell when Jumia switched to the marketplace model in 2016, mainly as a result of vendors maintaining inadequate stock levels. Jumia responded by making customer satisfaction the main business KPI and investing significant sums in developing a 'first-class' shopping experience that is key to customer retention. Jumia also established J-Force: a series of agents who travel door-to-door to help introduce people to the website. High 'out of stock' vendors were penalised or taken off the platform.

What is Jumia?

When Jumia launched in 2012, backed by Rocket Internet (a European VC), it aspired to become the dominant e-commerce player in Africa. The company initially implemented a business model where it held its own inventory. This inherently has greater capital requirements, but it allowed the company to maintain a certain degree of product and service quality. Despite strong initial growth, an economic downturn and heightened inventory risk led to the decision in 2016 to pivot the business model to that of a capital-light marketplace. Sellers became responsible for inventory, and Jumia was able to focus on marketing, customer service, logistics, tech, and products. As with Sturgeon's portfolio company, Zoodmall, the Jumia team had to solve complex local issues related to delivery, payments (including cash on delivery) and products.



The Jumia platform today consists of its marketplace, which connects sellers with consumers, its logistics service (Jumia Logistics Services), which enables the shipment and delivery of packages from sellers to consumers, and its payment service (JumiaPay), which facilitates transactions among participants active on the platform in selected markets.

Having pulled back and refocused on core profitability, in Q3 2020 the company has – for the first time at group level – achieved a positive gross profit with the majority of countries breaking even. The rebalancing of the business initiated at the end of 2019 has increased Jumia's exposure to faster-selling items and reduced advertising spending, supporting unit economics. Jumia has also begun using its logistics dominance to act as a platform company for deliveries, similar to a company like GrubHub. Operating losses reached a three-year low of €28.0 million, decreasing by 49% year-over-year. With the Covid-19 catalyst increasing demand for e-commerce across Africa, Jumia is still early on its growth journey and now may be its moment to deliver on the promise that many investors saw at IPO.

Key Takeaways:

- Frontier businesses often have to build the ecosystem in order to thrive, rather than relying on existing infrastructure. As Jumia has done with its logistics, these companies are often then able to leverage their ecosystem to reduce costs and develop new revenue streams.
- Choosing the right model is vital when localising a business to frontier markets. The capital intensive, inventory-based model that Jumia started with was less resilient in the face of economic uncertainty than the pure marketplace that they have now become.
- Sustainable growth, positive unit economics and profitability are crucial to the long-term success of frontier market businesses. To use a phrase coined by Alex Lazarow, frontier businesses should be camels not unicorns*. They should be flexible in times of uncertainty, and able to fall back on a profitable core business when their environment requires them to do so. Jumia today is a business better able to do this.

* "Out-Innovate: How Global Entrepreneurs--from Delhi to Detroit--Are Rewriting the Rules of Silicon Valley," Alex Lazarow (2020)

INTERVIEW WITH CAMERON GOLDIE-SCOT: CO-FOUNDER AND CEO OF MUSONI

What is Musoni, who is it for, and what problem are you solving for them?

Musoni is the leading digitalisation partner for microfinance institutions around the world. We provide a multi award winning cloud banking system that is now used by 75 microfinance organisations across 18 countries, predominantly in sub-Saharan Africa and SE Asia. Our solution has been consistently proven to help these organisations to improve efficiency, reduce costs, and grow rapidly. In particular, we specialise in helping organisations to digitalise. By removing the headache of managing technology, we free up time for microfinance organisations to focus on their clients and operations.

There are more than 1.5 billion people around the world who still do not have access to financial services. This means they don't have a safe place to store their money, can't access a loan to invest in their business, and can't safeguard against risks through insurance. One of the reasons so many people are excluded from the financial sector is that financial institutions are stuck using out-dated and expensive technology, or using no technology at all. This is where Musoni comes in.

How and why did you come to found Musoni?

Before starting Musoni, the team founded a microfinance institution in Kenya and were directly involved in operations. As a result, we had first-hand knowledge of what it's like to run a microfinance organisation and quickly saw how transformative the right technology could be. We spent a year researching existing solutions but were not able to find one that helped organisations to easily leverage the latest technology at a reasonable price point. That's why we started Musoni.

We now support organisations around the world and have teams based in the Netherlands, Kenya and Myanmar. The lessons we learnt setting up and running a microfinance institution have been combined with these global experiences. All of this has fed straight back into the solutions we provide.

What do you see to be the main advantages and disadvantages of founding and growing a 'frontier' business?

Working in frontier markets means that it's possible to achieve significant impact quickly. The pace of change is exhilarating. With the right foundations in place (such as a modern cloud banking system), organisations can grow very rapidly in just 12-18 months. One organisation we support in Myanmar grew from zero to 180k clients in just three years.

Frontier markets also come with less standardisation. Every financial organisation we work with is different. To be successful, we choose to approach each project as a partnership, adapting our business and providing extensive support during the implementation and first year of going-live. Over time, this also brings rewards but it's hard work initially. This is why we see ourselves as a digitalisation partner to financial institutions, rather than a software vendor.

Another aspect of growing a frontier business is the number of markets that we're exposed to. This shapes a unique work environment with numerous possibilities for professional development. Equally, individual markets are often not large enough to single handily drive our growth. They can also come with unique, single country risks. For example, in Zimbabwe, many of the financial institutions we support have had a very difficult three years with major political and economic challenges. At Musoni, working across 18 different countries helps to diversify these risks, while also providing a large enough market for growth.

What is the key to successfully managing a team across several geographies?

We have offices in the Netherlands, Kenya and Myanmar and so straddle multiple continents and time zones. We're very lucky to have great people in all of our offices and so have not found growing and managing the different teams to be overly challenging. Before COVID-19, we spent a lot of time travelling between the different regions, and I have lived in both Kenya and Myanmar (recently spending 18 months living in Yangon, setting up our SE Asia office). However, in the last ten months, nobody has been able to travel, and while personally frustrating, the impact on the company has not been too significant. With modern project management and internal communication tools, everyone is connected at all times, and there is a lot of visibility regarding work that's going on which makes it easier to all pull in the same direction.

If you could give young entrepreneurs in frontier markets one piece of business advice, what would it be?

The key to being successful in frontier markets is to involve local knowledge from the start; knowledge of the market and your clients but also of the staff that you will recruit. Everywhere we work, we see highly capable and motivated people that are eager to join the journey of growing a business. Building a successful team and culture requires a true interest in what makes people move, and the exciting challenge of bringing different cultures together in a shared business goal. At Musoni, we have dedicated regional teams with knowledge of each local environment. Our management team have all lived in the countries where we work, and until COVID-19 we spent a large amount of time in the field with our end customers.

The final piece of advice is not specific to only frontier markets; having a strong co-founder is invaluable. Someone to bounce ideas off, share the big decisions with, and navigate the rollercoaster that is growing a company. Musoni was co-founded by Sander (our CTO), and myself. We'd been working closely together for a few years beforehand and there was a natural synergy between Sander's experience working in banking technology, and mine in microfinance. No doubt there are many successful companies with lone founders, but I've always found that starting off as a team makes the journey more enjoyable.

What is the most important source of value-add (aside from capital) you seek from an equity investor?

We look for investors who are always thinking of ways to help the company to grow, and willing to directly support us in doing so. We're fortunate to have some excellent institutional investors and each help us with their networks and expertise. For example, Goodwell arrange an annual CEO summit for the management teams of all of their portfolio companies. It's a great opportunity to share ideas, discuss challenges, and learn about new markets. Alterfin work closely with many MFIs around the world and have supported us with warm introductions to potential clients, advice on the market in general, and connections with their regional teams, making it easier to launch into new markets. Most importantly, we look for engaged investors who are willing to actively share their knowledge and experience to grow the company to new heights.

OPPORTUNITIES AND CHALLENGES FOR AFRICAN ECOMMERCE

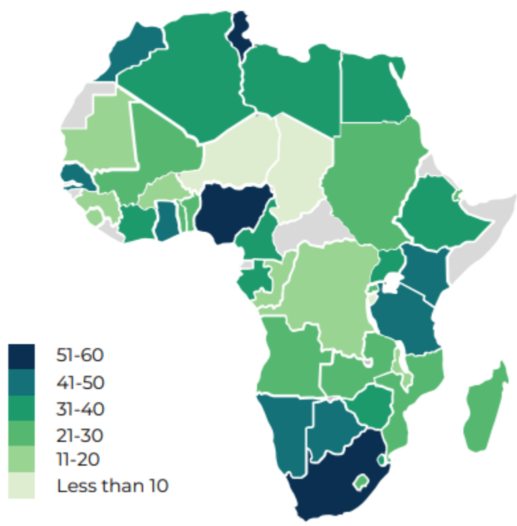
The restrictions imposed as a result of the coronavirus pandemic have thrown e-commerce and online retail into the spotlight across the globe. Compared with well-established digital retail markets such as those in the USA, markets in Africa are still fairly nascent; in 2019, investment into the e-commerce and online retail sector in Africa totalled $116 million USD across 37 deals. While challenges to broad adoption still exist, both in terms of customer preferences and inefficiencies in the market, e-commerce is beginning to generate traction, both because of necessity and the presence of enabling technologies.

African e-commerce overview

It is far from business as usual for the many e-commerce retailers spread across Africa. A recent report published by Reuters describes how the e-commerce sector has been placed under severe strain in South Africa as retailers struggle to cope with hugely increased demand. Existing market inefficiencies, such as informal address systems, are being compounded by the need to introduce physical distancing measures into order fulfilment centres.

In a report published by the UN Conference on Trade and Development (UNCTAD), these market inefficiencies are quantified as an E-Commerce Readiness Index. They cite four main factors required for adoption of e-commerce; the percentage of the population with access to the internet, the percentage of the population with access to a bank account, the availability and security of web-servers, and the reliability of postal services. Mauritius, Tunisia, Nigeria, and South Africa scored highest (with scores of 68.4, 58.1, 54.4 and 53.2, respectively); however, many countries in Africa are still struggling.

Figure 2: UNCTAD E-Commerce Readiness Index Score (out of 100)

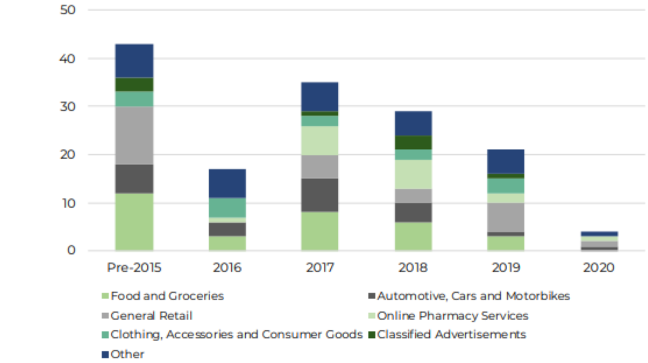


Source: UNCTAD, 2019

The informal address systems used outside of many major towns and cities, and customer preferences such as a preference to pay on receipt of goods, or a mistrust of online retail create barriers for the broader adoption of e-commerce. However, these barriers are fuelling innovation. With lock-down restrictions forcing customers to look online, necessity, as they say, is the mother of invention. For instance, in 2017 the Nigerian post service adopted a service provided by What3Words, a mapping tool which turns approximate addresses into a GPS coordinate. Likewise, e-commerce giant Jumia has long relied on local partnerships to help meet customer needs, while balancing the challenges of multiple distribution partners with its inhouse technology tools.

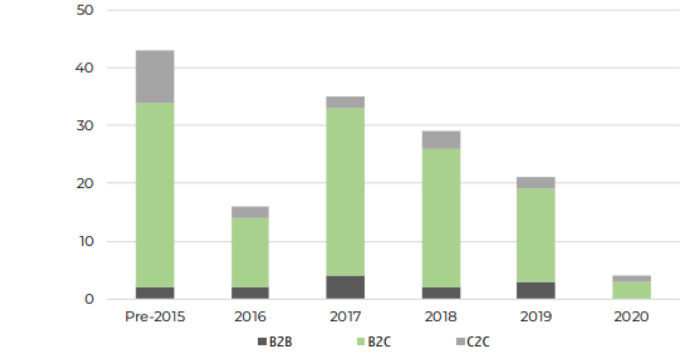
Given the local challenges to expanding e-commerce in Africa, it is perhaps unsurprising that the e-commerce sector is still very much in its infancy. E-commerce accounted for only 1.6%, or $1.2 billion of South African retail sales in 2019, according to London-based market research firm, Euromonitor International. In the United States, the figure is 14.8%. Despite this, the e-commerce sector has long been extremely active. In 2017, there were 35 companies launched, with a further 29 launched in 2018 and 21 in 2019. While food and grocery services and general retail services are common, there has also been an increase in the number of specialist services such as automobile and online pharmacy services. 78% of the e-commerce companies Baobab analysed provided a B2C service, whereas 13% provided a C2C model and 9% operated a B2B model.

Figure 3: Breakdown of e-commerce and retail companies in Africa by service type and year founded



Source: Baobab Insights, 2020 (2020 data taken as of 24th July 2020)

Figure 4: Breakdown of e-commerce and retail companies in Africa by operating model and year founded



Source: Baobab Insights, 2020 (2020 data taken as of 24th July 2020)

Is now the time for e-commerce in Africa?

While short-term trends have indicated increased investor appetite for the e-commerce space in Africa, it is still a fairly nascent industry. Despite the headline grabbing progress made by Jumia in 2019, it is worth reflecting that they also announced that they are pulling out of certain geographies (such as Côte d'Ivoire) in Q1 2020.

E-commerce, particularly B2C online retail, relies on the repeat services of tech-savvy customers. Challenges with infrastructure such as congestion will have an impact on the service provided to online retail customers, but perhaps the real challenge to wholesale adoption is how to service more rural customers in a cost-effective way. This is where the e-commerce and online retail sector has an opportunity to innovate and perhaps partner with companies offering supply chain-management and smart delivery services.

The coronavirus (COVID-19) pandemic is forcing us to rethink our habits and preferences, and perhaps out of necessity is causing consumers to seek out retail options that they previously have not considered. It is too soon to tell if any change in customer behaviour is permanent, but e-commerce companies currently have an ideal opportunity to capitalise upon this change.

The Baobab Network

Based in Nairobi, The Baobab Network is Africa's leading start-up accelerator, providing early stage technology companies across the African continent with funding, support and a global, platform to scale their businesses. In the last three years, VCs in Europe, Asia, the US, and Africa have invested follow-on capital into Baobab portfolio companies. Baobab also works closely with corporate partners around the world that partner with their accelerator for research, innovation, and access to new technologies in Africa.

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