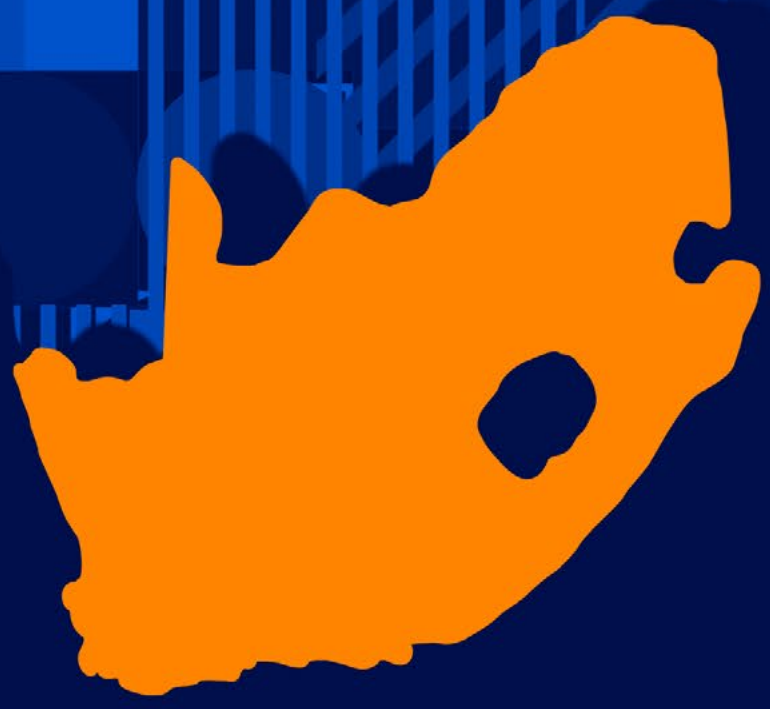
Legal Syndication Primer

South Africa



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African Angel Academy

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Legal Syndication Primer

South Africa

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African Angel Academy

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Introduction

About the African Angel Academy

The African Angel Academy (AAA) is an online programme and knowledge community, which was established in 2020 by Viridian and ViKtoria Ventures, supported by the African Business Angel Network (ABAN), to grow the number of active angel investors on the continent. Drawing on the expertise of early-stage investors from across Africa, the Academy offers virtual learning and networking courses for those looking to start or grow their angel investing portfolio. As of 2022, AAA's alumni network comprises close to 400 (and counting) individuals representing more than 18 angel investing groups in 11 countries.

The AAA course is available for anyone to purchase and start learning at their own pace or to learn as part of cohort programmes AAA runs with partners throughout the year. In the cohort format, the online course is offered to selected participants along with live masterclasses, Q&As, networking and mentorship opportunities, and showcases spotlighting promising local startups.

To find out more about AAA's programme and course offerings, visit africanangelacademy.com/programmes.

The African Angel Academy is endorsed by the African Business Angel Network (ABAN).

About Viridian

Viridian is an impact agency that designs and delivers programmes for early-stage entrepreneurs, investors and entrepreneur support organisations across Africa's entrepreneurial ecosystem. Our programmes act as a catalyst for these key economic actors, ultimately growing shared prosperity across Sub-Saharan Africa.

www.viridian.africa

About ViKtoria Ventures

ViKtoria Ventures is a consulting and fund management firm with a focus on entrepreneurial finance in East Africa.

www.viktoria.co.ke

About the International Tech Hub Network

These guides were developed with support from the UK–South Africa Tech Hub, UK–Kenya Tech Hub, and UK–Nigeria Tech Hub. These hubs are part of the International Tech Hub network delivered by DCMS (Department for Digital, Culture, Media, and Sport), under a UK government initiative designed to promote inclusive growth of digital ecosystems in partner countries. Over the past two years, the Tech Hubs have partnered with the African Angel Academy to train, network, and mentor emerging angel investors and groups, connecting them to promising local startups and supporting them through an alumni network.

About the authors

This document was authored by Dommisse Attorneys through the contributions of:

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Dommisse Attorneys was established in 2009 for the purpose of working with growth companies. They deliver legal services required to:

- establish these businesses,
- negotiate their funding,
- build their legal structures and products to maximise their value to owners and future buyers, and
- negotiate and structure their exit.

The firm's most prominent skills are fund raising/private equity, (international and local) structuring, and exit transactions, all of which are typically the highest-profile moments in their clients' lives. They have also developed an increased focus on international structuring work, where the aim is to systematically build and develop an offshore/onshore legal structure for our clients that demonstrates value to a potential purchaser or investor. This is done in compliance with local and international laws. Lastly, Dommisse's transactional team also has extensive experience in structuring private equity funds, venture capital funds, and other investment vehicles.

Dommisse Attorneys is a service provider partner to the African Angel Academy. For more guidance on what to consider when establishing and running syndicates, please contact Dommisse Attorneys at info@dommisseattorneys.co.za.

Dommisseattorneys.co.za.

About the South Africa Syndication Legal Primer

This short guide was developed as a resource for a new supplementary AAA module, the AAA Active Angel Series Syndication Module. This module builds on the AAA foundational online course and aims to equip programme alumni with the knowledge and confidence to participate in syndicated deals, and to promote collaboration within the angel investing ecosystem. The guide outlines common syndication and angel deal structures available to angels in South Africa as of January 2023. For further detail on each structure and the suitability of using a specific structure for your deal or syndicate, please feel please contact Dommisse Attorneys at info@dommisseattorneys.co.za.

This guide comprises the following sections:

Part 1: Syndication structures

Part one of this guide provides an overview of the various syndication structures available to you in South Africa. It explores the advantages and disadvantages of each structure, and any tax or legal implications or compliance requirements when using the structure.

According to research conducted by Briter and ABAN in 2021, there were more than 58 active angel syndicates on the African continent, and this number is expected to be higher in the new report which was released in November 2022 in partnership with the African Angel Academy.

AAA strongly encourages programme participants to either join or form a syndicate, depending on their experience level. Not only does syndication have significant benefits for the participating angels but it can have a significant impact on start-up success. For angels, syndicating is a great way to learn more about the investing process from more experienced leads, access greater deal flows, access larger deals (by pooling capital) and, of course, to decrease their risk by building a diversified portfolio with access to a diversified pool of expertise.

For a syndicate to be successful in the long run, it is important to ensure it is set up and governed in the most efficient and transparent manner, and this section lays out the common considerations with regard to this.

Part 2: Angel transaction structures

The second section of the guide looks at the available structures for angel investment deals in South Africa. It also outlines the advantages and disadvantages of each structure, and any tax or legal implications or compliance requirements.

The 2021 *Analysing Africa's Angel Investment Landscape* survey also discovered that 58% of investors were using multiple or mixed structures when making deals, although the use of SAFEs and convertible notes is growing in popularity.

The selection of transaction structure(s) will impact an investment's management and returns, and it is worth considering the implications.

A note from the authors

This guidance note follows from a request from the African Angel Academy (AAA) that we provide guidance to prospective angel investors in the AAA network regarding i) available legal structures to facilitate syndication by angel investors and ii) the legal structures associated with typical investment transactions in a South African context.

This guidance note summarises the most important considerations on the above topics and enables the angel investors in the AAA network to formalise their investment strategies in accordance with their personal preferences. We see this as preliminary guidance only. The details of each investment and the syndications formed by angel investors need to be considered carefully to ensure that the legal structure and transaction type is appropriate for the circumstances under which the investors are operating.

It is not our intention to provide advice, and any observations or comments as to the interpretation or application of law will be subject to refinement in discussion, research, and formal opinion (if we are engaged to provide such opinion). We expect the proposals to evolve and develop further in discussion, and specific risks to be discussed prior to implementation of any final proposals. Therefore, this document should not be relied on for any purpose other than to explore potential structuring options.

Please note that fee structures in this primer are generally subject to assessment in the context of actual transactions. These fees could vary from transaction to transaction, and from law firm to law firm, and will ultimately be subject to the engagement terms of the law firm in question.

Timothy Kelly, Associate, Dommisse Attorneys
Adrian Dommisse, Director, Dommisse Attorneys

Please note that the content of this guide cannot be considered to be legal advice, and AAA or Dommisse Attorneys is not responsible for any consequences arising from the selection of any of the structures outlined in this guide.

These course notes serve as an introduction to the legal structures angel investors in South Africa can employ when making an investment and structuring a syndicate.

These notes have been developed by Dommisse Attorneys for the African Angel Academy as part of the African Angel Academy's Syndication Module. The content developed for this module was funded by the UK Government's International Tech Hub Network via its UK–South Africa Tech Hub.

Part 1

Syndication legal structures

Introduction to the South African landscape

From a South African perspective, aggregated investments can take various legal forms. The choice between these structures is largely driven by tax efficiency, regulatory requirements, whether the vehicle is independently managed and, ultimately, the investors' investment strategy. There are no special syndication vehicles available for angel investing in South Africa, and investors are entitled to use the most appropriate "conventional" legal entity for the investment in question. The structure can then be tailored to an extent to fit the needs of the group of investors involved in an investment. Importantly, if investors wish to fund their investment through debt financing or similar funding mechanisms, the terms of the financing in question will determine, to a large degree, the most appropriate vehicle and structure to be used, and how they should be structured to meet the requirements of those funding terms.

Private company (incorporated in South Africa)

South African private companies are regularly used as investment vehicles by South African and foreign investors. These entities are similar in nature to private limited liability companies in other countries and are essentially private companies. This means there are at least some basic restrictions on the transferability of private company shares and the shares can't be offered to the public through public offerings or similar mechanisms. Shareholders in private companies have limited liability for a company's debts.

Issue	Notes
Liability of investors	One of the main reasons for using private limited liability companies is that the investors (shareholders) in these entities would have limited liability for the company's debts. This has the effect that a shareholder can only stand to lose the funds invested to acquire shares in the company, and are not liable for any debts incurred by the company (unless the shareholders provide surety or guarantees for the company's debts, but this needs to be agreed to explicitly as it deviates from the default legal position of limited liability).
Tax treatment	The tax treatment of shares held in an investment company is probably the biggest drawback of the company as an investment vehicle. **Exits:** If investors hold their investments through an investment company, and the shares in the ultimate investee company are disposed of, the investment company will first pay capital gains tax on the difference between the acquisition cost (called "base cost") and the price at which the shares are disposed of. Then, when the investee distributes the proceeds of that disposal to the investors (i.e., its shareholders), that distribution will be subject to a further dividend withholding tax of 20% for South African tax resident investors. The tax treatment of any dividend by a South African investment company to shareholders who are not tax residents in South Africa will depend on the tax treaty between South Africa and the country in which the investor is tax resident. **Dividends:** The tax treatment of dividends paid by the ultimate investee company to the investment company will likely result in less tax leakage than in the case of disposals on exits (as described above). The reason for this is that a dividend from a South African-based investee company to a South African based investment company will not be subject to dividend withholding tax. The dividend withholding tax described under Exits will however still apply for dividends that the investment company pays to its foreign investors.

Issue	Notes
Regulatory considerations	The South African Companies Act is the main regulatory structure governing private companies, regulating the entity and the relationship between its shareholders and directors. Importantly, if the entity is managed by its board and not by an independent entity fulfilling a management function, the entity does not need any special regulatory licenses as the affairs of the board are governed by the Companies Act, which imposes various fiduciary duties on the directors. By its nature as a private company, the company is prohibited from making public investment offerings. If the company does not fulfil an intermediary role (other than merely being an investment holding company) or financial advisory role, the regulatory requirements are less burdensome than most other vehicles.
Specific South African requirements for foreign investors	There is a process under South African exchange control regulations that require shares held by a non-resident shareholder to be submitted to an authorised dealer (being the resident company's bank) to request the bank to endorse their share certificates. The bank will require confirmation from an independent valuer such as an auditing firm that the shares were issued at fair value and that payment was received from the non-resident shareholder.
Suitability of vehicle for investments outside of South Africa	South African companies are permitted to make foreign direct investments of up to R5 billion per calendar year but are required to submit the details of the investment to an authorised dealer (being the resident company's bank) to request the bank to approve the application for the foreign direct investment. The bank will require various details of the investment transaction, including the shareholding and other corporate information of both the investment company and the investee company, details of how the investment will be funded, the proposed structure through which the interest in the foreign company will be held, and a description of the business of the foreign investee company.
Disadvantages	The biggest disadvantage of using an investment company is the lack of tax transparency that applies to this entity, resulting in exit proceeds to be taxed on both the investment company and shareholder level, as described above.
Advantages	The entity can be structured with fewer regulatory license requirements than some of the other entities, given that it is managed by its board and not by an independent manager. The fact that the liability of shareholders for company debts are limited also provides the option to fund investments through debt financing.
Ideal use case for this option	This vehicle is ideal for scenarios where the value of having a lower level of regulatory license requirements outweighs the lack of tax transparency. It is also ideal for scenarios where various investments are held by the same entity, of which some are intended to be made outside of South Africa. Importantly, an entity set up in South Africa is restricted under South African exchange control regulations when making convertible note or SAFE investments into foreign entities, unless the investment company already holds shares in an investee company. This is because the rule is that South African companies or investors are only allowed to advance loan funding or SAFE investments to foreign entities if that funding is provided as a shareholder loan.
Scope and cost of legal work needed to set up structure	• Company Incorporation (including issuance of shares, appointment of directors: R5,000 • Memorandum of Incorporation: R18,000–20,000 • Subscription Agreement: R15,000–17,000 • Shareholders' Agreement (optional and can be combined with subscription agreement): R18,000–20,000

Private company (incorporated in foreign jurisdiction)

The structure and form of private companies in most countries are similar to that of private companies in South Africa. A notable exception, and indeed an entity type which may be useful to facilitate syndicated investments, is a limited liability company set up in the United States. These entities enjoy some characteristics of private companies whilst also having certain characteristics similar to those of partnerships.

Issue	Notes
Liability of investors	In most countries, the liability of shareholders for company debt is limited to their investment, as is the case for South African private companies, as described earlier.
Tax treatment	**Tax transparency:** The same issue as described for South African companies will typically apply to private companies in most jurisdictions. A notable exception to this is a limited liability company (LLC) set up under United States law (particularly in Delaware), which is an attractive option because it is seen as transparent for US tax purposes. Unlike in the case of South African private companies, any profits (including dividends and exit proceeds received from investee companies) generated by the LLC are not recognised by the company but are instead taxed as income on the members of the LLC, achieving a similar outcome as is the case for partnerships as described below. **Special tax regime:** Importantly, if South African tax residents hold the majority of shares in the LLC, the LLC will be regarded as a controlled foreign company (CFC) under South African tax laws. This can have various unintended tax consequences and must be managed carefully with the advice of tax specialists. One example is that, if the LLC is majority owned by South African tax residents, the South African shareholders may be taxed in South Africa on their proportionate share of the profits of the LLC – even if those profits are retained in the LLC. This is known as "imputing" profit to South African entities. In addition, if the LLC is a CFC by reason of it being majority owned by a South African, and then later ceases to be a CFC (for example, by reason of dilution of the South African shareholders through investment), the LLC may be deemed to have exited South Africa, and any South African shareholder owning 10% or more of the CFC may be liable to pay capital gains tax on the value of their shares.
Regulatory considerations	The regulatory requirements for foreign entities depend on the country (and in the case of the US, the state) in which the company is incorporated. Dommisse Attorneys is unable to advise on the laws of other countries, but the understanding is that the regulatory burden of managing an LLC set up in the United States is relatively low.
Specific South African requirements for foreign investors	As an investment by a foreign investor into a foreign company would fall outside of the scope of the application for South African law, there are no notable South African requirements that would apply to foreign investors acquiring shares in the entity. Notably, when an LLC set up in the United States invests into South Africa, the shares issued by the South African investee company will need to be submitted to an authorised dealer (being the bank of the resident company) to request the bank to endorse their share certificates. The bank will require confirmation from an independent valuer such as an auditing firm that the shares were issued at fair value and that payment was received from the non-resident shareholder.

Issue	Notes
Suitability of vehicle for investments outside of South Africa	This vehicle is ideally suited for investments outside of South Africa, but can also be used for investments into South African entities as described above.
Disadvantages	Given that legal, tax, and financial advisory cost will be provided from a foreign country such as the United States, the cost of setting up the entity with the desired legal structure and ongoing advisory cost can be expensive.
Advantages	Due to the combined value of tax transparency, limited liability of members, and the low level of special requirements for foreign investors, this entity could be an ideal option in most cases.
Ideal use case for this option	The ideal use case for this entity is where the investment company is formed predominantly for investment outside of South Africa, although South African investments are also possible. This entity is not the ideal option if the ownership will be majority held by South African tax residents.
Scope and cost of legal work needed to set up structure	The parties would need to consult with legal counsel in the United States to obtain cost estimates for setting up the entity. Investors have reported an easy and cost-effective set-up process through SWIFT. The conclusion of legal agreements to regulate the relationship between the investors and the entity would be managed by US counsel.

Bewind trust (incorporated in South Africa)

A bewind trust (also called a "vested trust") is a unique type of legal entity in which the beneficiaries of the trust have a vested right on the assets. This differs from the typical "inter vivos" family trust, in which the beneficiaries only obtain vested rights over assets if the trustees of the trust make distributions to beneficiaries based on the terms of the trust deed. If a bewind trust is used, the investors would be beneficiaries of the trust, having a vested right over the assets of the trust in proportion to their capital contributions to the trust. The trust is managed by the trustees, who may also be trust beneficiaries. The trustees do not own the trust assets, but merely fulfil an administrative function and control the assets on this basis.

Issue	Notes
Liability of investors	Liability of investors as beneficiaries of a bewind trust can be limited to their capital contributions by means of the trust deed. Liability of trustees can be excluded completely (provided that trustees cannot be indemnified for gross negligence or wilful misconduct).
Tax treatment	**Tax transparency:** As the beneficiaries' rights to assets of the trust are vested, this means that profits (including dividends and exit proceeds received from investee companies) generated by the trust are not recognised by the trust, but are instead taxed as income on the beneficiaries of the trust, thus also achieving a similar outcome as is the case for partnerships.
Regulatory considerations	In terms of the South African Financial Advisory and Intermediary Services Act, any person or entity fulfilling a financial service to another person is required to be registered as a financial service provider. Financial services are defined broadly to include investment and divestment decisions and processes, which may apply to the trustees of a bewind trust in certain cases. Trustees should not be required to be Category I (discretionary services) financial service providers as an important characteristic of a bewind trust is that trustees do not have a discretion in dealing with trust assets but are rather given limited administrative control over the assets, with ownership of the assets residing in the beneficiaries. Further, the trust can be structured so that the beneficiaries are all trustees. This way, if the trust is structured correctly, none of the trustees fulfil an investment management function on behalf of any other beneficiaries, but only in respect of their own assets, meaning that a Category II (intermediary services) license should also not be required. Alternatively, the trust can appoint a registered financial service provider to fulfil any intermediary services on behalf of the trust.
Specific requirements for foreign investors	Foreign persons are permitted to act as trustees and beneficiaries of a South African trust, but the trust's bank may impose further compliance requirements on payments the trust receives from and makes to foreign investors. As the requirements are updated regularly, the parties considering the use of a bewind trust should liaise with their South African bank of choice to understand the process of foreign investments into the trust as well as payments to foreign persons from the trust to ensure that this entity choice is appropriate and is structured correctly.

Issue	Notes
Suitability of vehicle for investments outside of South Africa	This entity will not be suitable for investments outside of South Africa. As of the time of writing this primer, South African exchange control regulations do not permit South African trusts to make foreign investments. Foreign direct investment allowances are reserved for companies and private individuals only.
Disadvantages	The South African system of forming and managing trusts is regulated by the Master of the High Court in South Africa. The requirements are strict and onerous, which may frustrate the day-to-day functioning of the trust. The registration of the trust, addition and removal of trustees, any changes to the trust deed, or any other similar actions need to be channelled through the Master, which may result in delays. Further to this, cross-border investment activity can be expected to have various challenges.
Advantages	The tax transparency and the ability to structure the entity with a relatively low level of regulatory licensing requirements may be attractive to some investors.
Ideal use case for this option	South African investors seeking a long-term vehicle to syndicate their investments into various South African investees may find this to be a viable option. This vehicle may not be suitable for cross-border investment or for single investments, for the reasons described earlier.
Scope and cost of legal work needed to set up structure	• Trust Deed: R25,000–30,000 • Appointment of the trustees, nomination of the beneficiaries for the trust, and lodgement of the trust deed and the various required forms with the Master's office: R15,000–20,000

En commandite partnership – independently managed fund (incorporated in South Africa)

Arguably, the limited liability (*en commandite*) fund structure could be the most common and tax-efficient fund structure for venture capital and private equity investments. However, fund structures have extensive regulatory requirements and higher formation cost than the other entity types. For sake of completion, brief notes on typical fund structuring requirements are added here, but the scope and strategy of each fund should best be scoped and structured on a case-by-case basis.

Issue	Notes
Liability of investors	Investors in a typical fund structure are referred to as "limited partners", predominantly because they have limited liability and do not participate in the fund's day-to-day management. The general partner fulfils the management function and represents the fund in its dealings with third parties, and therefore has unlimited liability towards third parties.
Tax treatment	Tax transparency: en commandite partnerships are seen as an attractive option because, for tax purposes, the vehicle is seen to not have its own legal personality and is therefore transparent for tax purposes. Any profits (including dividends and exit proceeds received from investee companies) generated by the fund are not recognised by the fund on the partnership level, but are instead taxed as income on the partners in the same manner that they would have been taxed had they held the assets directly.
Regulatory considerations	As indicated above, the typical fund structure has limited partners who fulfil a limited role in the day-to-day management of the fund, and the general partner who fulfils the management function. The management function is typically outsourced to an entity acting as fund manager. The fund manager's functions are regulated under South African law, and the fund manager is required to either have a Category I or II financial service provider license (see "regulatory requirements" under bewind trusts for more details). These funds are also required to register with the South African Venture Capital Association (SAVCA) as members, which is offered as an alternative to registering as Collective Investment Schemes – a much more cumbersome regulatory regime.
Specific requirements for foreign investors	Foreign persons are permitted to invest in South African funds, but the fund's bank may impose further compliance requirements on payments received from foreign investors and payments made to foreign investors from the fund bank account. As these requirements are updated regularly, parties involved in such an entity should liaise with their South African bank of choice to understand the process of investments and payments to foreign persons from the trust, to ensure that this entity choice is appropriate and structured correctly.
Suitability of vehicle for investments outside of South Africa	South African funds are only permitted to make foreign investments if they are members of SAVCA and mandated to invest outside of the common monetary area (CMA) of Lesotho, Namibia, South Africa, and eSwatini, and, importantly, only if the fund has successfully applied to the SARB to invest outside of the CMA. The application submitted to the SARB must include, at the very least, the partnership agreement, a 36-month cash flow projection, an indication of the expected capital to be used for foreign investment, and the percentage of shares that will be acquired in foreign entities.

Issue	Notes
Disadvantages	Extensive regulatory requirements, which are even more cumbersome if foreign investments are made by the fund, which require SARB approval. The cost of setting up and mainlining a fund structure is higher than any of the other entities.
Advantages	Robust vehicle once set up, with limited liability to investors and with tax transparency.
Ideal use case for this option	Best to use where angel investments are structured through a fund with the goal to invest and reinvest funds over a long-term period in a pool of investments to spread risk, and when using the management function of an independent fund manager.
Scope and cost of legal work needed to set up structure	• Main Limited Partnership Agreement to form the main partnership in respect of the fund: R50,000–60,000 • Investment Management Agreement: R20,000–25,000 • Deed of Adherence to be signed by LPs to bind themselves to the terms of the main partnership agreement when investing: R5,000–10,000 **These fees do not include the cost of setting up and regulating any general partner (GP) entities, as this will need to be scoped based on the nature of the GP entity.*

Normal partnership – not managed independently (incorporated in South Africa)

A normal partnership is a relatively niche option that has not been used as often as the other vehicles in a South African context. In this structure, the partnership is managed by its partners, who each control and manage their own assets. The partnership is merely used to aggregate investment and the separate legal personality of the partnership is therefore limited to this purpose only.

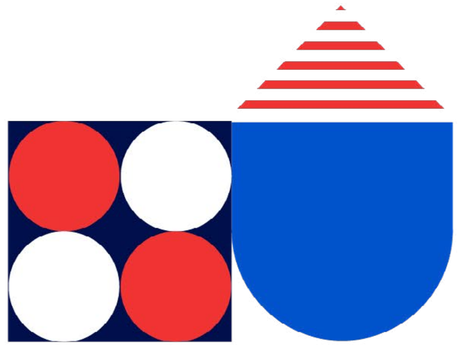
Issue	Notes
Liability of investors	As all partners participate in the management of the partnership, the liability of partners for partnership debts are joint and several. This means that each partner has unlimited liability for the debts of the partnership towards third parties. This can be limited by restricting the partnership from incurring any debts as it is merely used to syndicate investments and not to incur any liabilities. Further to this, partners can indemnify one another from liability for the actions of other partners, although this will only be enforceable between partners and not to third parties. In other words, if a partner does incur liability as the result of the actions of another partner, the "innocent" partner may be held liable by the third party, but will then have recourse against the "defaulting" partner.
Tax treatment	Tax transparency: as the partnership seen to not have its own legal personality, it is transparent for tax purposes and a similar outcome is achieved to that of en commandite partnerships.
Regulatory considerations	If the partnership is structured correctly, none of the partners will fulfil a management function in respect of the assets of the other partners, and there should therefore not be any regulatory license requirements.
Bespoke characteristics of vehicle	It is recommended that the partnership agreement sets out the following provisions: • **Beneficial shareholding:** the partners each nominate the partnership as their nominee shareholder (which is permissible in terms of the South African Companies Act), so that the partnership holds any shares on behalf of the syndicate investors (as beneficial shareholders). • **No management:** each partner controls their assets independently and may exit the partnership at any point by terminating the partnership's nomination as nominee shareholder and require that the shares are issued to the partner in their own name. • **Investee company documents:** documents concluded with investee companies must allow the partnership to assign rights and shares to its ultimate partners without restriction, as long as the effective ownership does not change. • **Voting pool arrangement and proxy:** to ensure that the partners act as a collective in respect of each investee, the partnership agreement should include a voting pool agreement in terms of which the partners are required to conduct an internal vote before voting on investee company matters. Following this, one of the partners represents the other partners by proxy and is bound to cast the vote in accordance with the result of the partner vote.

Issue	Notes
Specific requirements for foreign investors	Foreign investors may act as partners in the partnership, but as their investment is only structured through the partnership for purposes of aggregating the investment in the investee company, they will still be legally seen as the holders of shares and other rights towards investee companies. Any foreign investor investing in South African companies through the partnership will still be required to complete the share endorsement process through a South African authorised dealer (being the bank of the resident investee company) to request the bank to endorse the share certificate issued to the partnership. The bank will require confirmation from an independent valuer such as an auditing firm that the shares were issued at fair value and that payment was received from the non-resident shareholder. As the partnership will hold a single share certificate in the investee company, that share certificate will require endorsement as a result of the foreign investment in the partnership. This is a relatively untested area with South African banks, and further clarity should be obtained from the bank in question to understand the bank's process and requirements in this regard.
Suitability of vehicle for investments outside of South Africa	South African individuals who are taxpayers in good standing and 18 years and older may transfer, as a foreign capital allowance, up to a total of R10 million per calendar for investment purposes abroad. As individual investors are merely structuring their partnership to aggregate the investment, the normal rules for foreign direct investments for individuals will apply. This process is also conducted through an authorised dealer (a South African commercial bank) and, as in the other cases, each bank may have their own requirements and processes for these outward investments.
Disadvantages	The fact that partners will be jointly and severally liable for partnership debts may be a problem for some, although the risk in this regard can be mitigated through the correct structuring of the partnership agreement. The requirements for cross-border investment and interaction with authorised dealers (South African banks) may delay the investment process due to the unique nature of the investment vehicle. The vehicle will also have limitations regarding partners fulfilling a "lead investor" or managerial function as some of these functions may be regulated, requiring further regulatory licenses.
Advantages	The vehicles should be fairly easy and cost-effective to form as they do not result in the formation of a legal entity with a separate legal personality, but rather comprises investors syndicating their investment through the partnership.
Ideal use case for this option	This vehicle will be fairly flexible and can be used in most scenarios. It will be ideal for syndications formed on a case-by-case basis.
Scope and cost of legal work needed to set up structure	*Partnership Agreement:* R25,000–30,000 (including provision for the bespoke characteristics listed earlier in this section)

Syndication Structures in Summary

Syndication structure	Investment structure most suited?			Cost	Time	Tax Efficiency	Influence of excon in the case of investments in South African investees*
	SAFE	Convertible note	Equity				
Individual investment	X	X	X	SAFE – lowest cost	Fastest – individual simply signs SAFE/other investment document.	Individual taxed in home country.	Lowest – approval for initial investment
SA-based simple partnership		X	X	Medium	Fast – requires only partnership agreement; however, convertible note and equity arrangements are more complex than a SAFE and may increase the timing.	Tax transparent (only taxed on investor level)	Approval of initial investment, specific processes with banks due to nature of partnership
SA-based LLP		X	X	Highest	Slow – LLP partnership documents and appointment of GP, regulatory requirements all contribute to slow process. Convertible note and equity arrangements are more complex than a SAFE and may increase the timing.	Tax transparent (only taxed on investor level)	Approval of initial investment, specific processes with banks due to nature of partnership
SA-based company		X	X	Medium – company constitutional documents and regulatory licenses only if independently managed	Medium – South African company documentation to be created. Investments are typically in the form of convertible loan (convertible note) or equity, so more complex.	Not ideal: CGT plus DWT	Approval of initial investment into investment company
Offshore-based entity	X	X	X	Offshore costs typically the highest	South African leg is quick and only needs to negotiate investment terms, which will depend on the kind of instrument.	Tax transparency can be achieved with Delaware LLC (Individual is taxed in country of tax residence).	Target company needs to get approval for the investment. South African resident investors need approval for their investment in the offshore company. If South African entity has an interest in offshore company, a “loop structure” is created, which requires additional approvals.
SA-based vested trust		X	X	High – trust formation documents	Slow – trust to be formed and registered with Master of High Court in SA.	Tax transparent (only taxed on investor level)	Approval of initial investment, specific processes with banks due to nature of trust

*Investments into investee companies outside of South Africa by entities formed in South Africa have additional exchange control requirements as further detailed in the primer. It should be noted that South African resident persons or entities are restricted from making SAFE and debt investments into offshore entities unless they are shareholders of those entities.



Part 2

Angel transaction legal structures

THIS SECTION DISCUSSES three different investment mechanisms which can be used to invest in private companies based in South Africa.

These are:

- Simple agreement for future equity - SAFEs
- Convertible notes (loans)
- Equity investments

A note on foreign investments into South Africa

This section briefly sets out the regulatory process which should be complied with when investing foreign currency into a South African private company, thus giving a general overview of the investment landscape in South Africa from a foreign investor's point of view. First, before a foreign investor can invest foreign currency into a South African company, they must comply with the Exchange Control Regulations, 1961 (Regulations), read with the Currency and Exchanges Manual for Authorised Dealers (the Manual). The Regulations are enforced by the South African Reserve Bank (SARB), which also delegates the authority to approve certain transactions under the Regulations read with the Manual to authorised dealers.

Authorised dealers are generally commercial banks that can interpret and apply the Manual. If a certain type of transaction is categorised as pre-approved in the Manual, the authorised dealer can give the stamp of approval. Any transactions which don't fall under the "pre-approved" category must be approved by the SARB.

When a foreign investor acquires shares in a South African company, the Regulations provide that the shares must be endorsed as "non-resident". Under the Regulations, shares held in a South African company by a foreign investor are called "controlled securities". In practice, the physical endorsement (which is undertaken by the authorised dealer) is only a requirement for a private company which is not listed on the South African exchange. Annexure A lists the information typically required by authorised dealers to motivate a non-resident endorsement.

Simple agreement for future equity (SAFE)

The simple agreement for future equity (the "SAFE Agreement") was developed as a Y-Combinator structure, and has been adopted worldwide. However, Dommisse Attorneys has created a "South Africanised" version, which is adjusted so that it is applicable within the South African investment and legal context. A deeper exploration of these adaptations can be found at the Digital Collective Africa website. Dommisse Attorneys' equity investment structure essentially tracks the same terms that one would expect on open-source, international Series Seed and Series A (NVCA) investments.

In practice, a SAFE works by providing a framework for an investor to invest money on transparent terms. This facilitates the immediate payment of the investment amount to the investee while leaving the ultimate terms and amount of equity or cash to be returned on the investment until the occurrence of any of the following three events:

- **An equity financing event**, meaning the investee company takes on further investment (likely on a formal basis) where the terms are negotiated in detail. At this point, the SAFE holder's investment amount will convert into shares in the company (either at the SAFE price or at a discount, as applicable) on the same terms that are negotiated for the new Investors.
- **A liquidity event**, where the investee company is either listed or acquired, or the ultimate control of the entity is changing. At such point, the SAFE holder will have the option to either receive a payment equal to the cash amount which they originally invested, or a number of shares with a value equal to the investment converted at the liquidity price.
- **A dissolution event**, which includes the voluntary termination of business operations, an assignment of assets for the benefit of the company's creditors, or any other liquidation, dissolution, or winding up of the investee company. At this point, the SAFE holder will have the option to get their money back (if there are sufficient funds remaining in the company after creditors have been paid).

In essence, once an investor funds a company through a SAFE agreement, the investment amount will either convert into shares at a predetermined value (the post-money valuation cap) or at a discounted rate (if a discount has been agreed to) at an equity financing event. Otherwise, an investor will have the option to convert their SAFE into shares or get their investment back on the occurrence of a liquidity event, or to simply get their investment back on the occurrence of a dissolution event. The remainder of this section discusses key features which can be negotiated when appropriate under a SAFE.

Firstly, **the post-money valuation cap** is the company's anticipated value after the investment (including all other SAFE investments) as well as any other convertible instruments are concluded. The post-money valuation cap is anticipated to be the closing value of the "SAFE round". This amount therefore naturally coincides as closely as possible with the pre-money valuation of the next round of financing. On this basis, the parties to the SAFE agreement are essentially agreeing to a hypothetical valuation cap which will apply in a conversion event. This amount should reflect an acceptable proportionate equity percentage in the company. Therefore, if the company is worth more than the valuation cap, the SAFE investor shareholding won't be diluted by the excess value as the post-money valuation cap limits the company's value for the purpose of the investment conversion. This is valuable as it provides certainty to the investor that their shareholding can't dilute below a certain level. It's important for the company that this value isn't set too low as that could result in the investor receiving more equity than the parties anticipated. If this were to happen, the investment amount would account for a disproportionately large percentage of the total shareholding post shareholding.

From the founder's perspective, it is advantageous to set the post-money valuation cap as high as is possible while still being reasonable. The valuation cap has come to be interpreted as a de facto valuation at the time of the SAFE investment, but this goes exactly counter to the desired effect of a SAFE, which is to set the valuation of the SAFE round based on the first priced round – i.e. the equity financing event post-SAFE investment. If the valuation cap is set too low, the founder will have given up too much equity. The best way to think about the valuation cap is that it protects the investor from a scenario where the company scales rapidly and their investment becomes too small. In other words, it serves as an upper bound on the valuation when the time comes to convert their investments to shares.

The discount rate is the second key feature that can be agreed to under a SAFE. If this is agreed to between an investor and investee, it will give the investor the opportunity to convert the investment amount into shares at a discounted rate relative to the amount paid by other investors in the priced financing round. Effectively, the SAFE holder will receive more shares for their investment as recognition for taking additional risk. The discount rate rewards the SAFE holder for investing earlier than the subsequent investors who invest during the formal round.

Third is the concept of **pro-rata rights**, which refers to a written side agreement between the investee company and the investor (and holders of other SAFEs, as appropriate) giving the investor a right to purchase its pro-rata share of equity being offered by the company in the subsequent financing. This allows the investor to subscribe for additional shares in the company during a future financing round in order to maintain their ownership stake implied by the initial investment amount.

Lastly, SAFEs can include **a most favoured nation (MFN) provision**, which in short allows the investor the option to substitute their SAFE's terms for the terms of any subsequent SAFE. So, if a subsequent SAFE offers the next investor a lower valuation cap, or a greater discount rate, the original investor can claim those terms. The MFN provision is also covered in an article that deals with the commercial considerations behind the MFN provision.

Issue	Notes
Investor risk	The investor's risk is limited to the amount invested in the company.
Tax treatment	Investor expected to be taxed in their tax jurisdiction (if a direct investment), unless investing through a South African resident entity (see discussion of taxation of syndicated entities in Section 1).
Regulatory considerations	This investment will require the SARB's approval only if it is made from a foreign jurisdiction in a foreign currency. The SARB will likely treat the SAFE as a subscription for shares, but foreign resident endorsement would only be required on conversion.
Key terms and characteristics	• Investment amount • Post-money valuation cap • Discount rate • Pro rata rights • Most favoured nation provision (MFN) – optional
Scope and cost of legal work needed to set up structure	Minimal, due to SAFEs' standard nature. Terms are generally understood to be non-negotiable so that efficient and affordable investment is facilitated. There are no costs applicable if there are no lawyers involved. Legal costs can total up to R20,000 if lawyers manage term sheet, negotiations, and drafting process.
Disadvantages	SAFE holders are not shareholders, and therefore would not have any equity (or debt) rights until conversion of the investment amount into equity.
Advantages	It is a very quick, low-cost process of funding. The "post-conversion" shareholding is immediately transparent.
Ideal use case for this option	The ideal use case for SAFEs is during the early investment stages, pre-empting an eventual equity financing event.

Convertible loan

Similar to a SAFE, a convertible loan or note is a pre-equity funding mechanism. This allows for the immediate funding of an investee company. This mechanism is a hybrid instrument, where the funding amount can either convert into shares or be repaid to the investor, generally at the election of the investor. The big difference to the SAFE lies in the fact that convertible loans create a liability for the funding company to the investor. The investor is a creditor of the company, with an associated level of debt seniority; whereas investors under a SAFE agreement have, at best, an equity-type investment, and will only become a creditor (subordinated to debt creditors) on the occurrence of a dissolution event with no election in this regard.

With a convertible loan, conversion can either be at the investor's discretion or take place automatically. If not converted, the loan will accrue interest and be repayable (as capital and accrued interest) to the investor – possibly on a defined repayment schedule. The company may also be restricted from making any distributions to shareholders until such time that the investor has been repaid the loan amount.

The following are the key features for negotiation under a convertible loan agreement:

Loan facility and milestones or single tranche

An investor can either agree to the convertible loan amount being provided to the company in one single tranche, or by way of a loan facility which is disbursed upon the occurrence of certain milestones or conditions being met. This is generally dependent on the context of the investment, as well as the company's growth plan and the intended use of the proceeds.

Conditions for disbursements if multiple tranche

If it is agreed that the investment will be by way of a loan facility whereby the company has access to several tranches, investors generally impose certain milestones or conditions on the company. Each milestone/condition must be met before the company can access the subsequent investment tranche.

Security

In some cases, investors may insist on being provided with real security for their loan (e.g., the company's assets or even guarantees from other shareholders secured by pledges of their shares).

Conversion and conversion shares

Conversion can either be at the investor's discretion or take place automatically. On conversion of the loan facility, the investor will typically receive a number of shares calculated with reference to the outstanding loan facility plus accrued interest, divided by the applicable share price. For example, the share price may be the lower of:

- the price at which other investors subscribe for such shares in the course of a qualified equity financing, reduced by any conversion discount that may be negotiated; or
- the price implied by the post-money valuation cap. Examples of conversion triggers include an equity financing event in which the company raises a minimum amount (and perhaps at a minimum valuation), a defined date being reached, a liquidity event (merger, sale, bankruptcy). Investors may also build in discretionary conversion rights as well as the discretion not to convert even where a conversion trigger occurs.

Interest

The amount of interest, and when that interest starts accruing, is to be negotiated. These repayment terms are crucial and are typically related to the anticipated timing for an equity fund raise or conversion event.

Governance, control, and insight

An investor may negotiate certain control and insights into the company as well as the decisions which are being taken in respect of the company. This includes the right to appoint a director to the company board, placing certain restrictions on the company's ability to make certain decisions (e.g. future funding terms), and imposing reporting obligations on the company.

Right of follow-on investment

Unless specifically negotiated, the investor won't have pro rata rights to invest into the company until the loan has been converted. If the investor wants the right to participate in an equity funding round that triggers conversion, this should be specifically negotiated.

Equity arrangement upon conversion

Although the immediate concern at the point of investment is around the amount of money and repayment provisions, the parties involved could go further to anticipate the minimum rights which will govern the equity arrangement upon conversion of the loan amount into shares.

Issue	Notes
Investor risk	Risk is limited to the value of the loan.
Tax treatment	The investor expected to be taxed in their tax jurisdiction (if a direct investment), unless investing through a South African resident entity (see discussion of taxation of syndicated entities in Section 1).
Regulatory considerations	The SARB's approval will be required if the loan is made from a foreign jurisdiction in a foreign currency. In this case, it is necessary to comply with conditions set down by the SARB for foreign loans. These are provided on the SARB's website under "Inward Loans".
Key terms and characteristics	• Investment amount • Conversion mechanism • Repayment • Interest terms • Governance and control • Equity arrangement post conversion
Scope and cost of legal work needed to set up structure	Given that this investment centres around one agreement (Investment Agreement dealing with loan terms and equity arrangements) this is usually relatively low-cost, subject to complexities around conversion terms, governance and control rights, and equity arrangements post-conversion: R30,000–60,000. Depending on whether conversion is imminent, the parties may decide to revise the Memorandum of Incorporation and Shareholders Agreement at the date of the investment to reflect the agreed governance and control.
Disadvantages	Can be highly negotiated and therefore take longer to conclude an agreement. It is also not standard like the SAFE, therefore the agreement will likely need to be drafted by a commercial lawyer. For these reasons, SAFEs are considered to be more early-stage investment mechanisms, and convertible notes are more appropriate for mature-stage funding.
Advantages	Investors retain senior creditor rights prior to conversion, so they are able to wait for a while before they decide whether they wish to convert the loans to equity, using the intimate knowledge about the company and its prospects of success that they glean during the loan period.
Ideal use case for this option	Higher-value funding, funding more mature companies pre-equity, or in higher-risk scenarios are ideal use cases for convertible notes. The convertible note is valuable for investors where companies are looking for funding to bridge them ahead of a funding round, or where there is a higher-risk scenario. The former (pre-funding round investment) can reward the investor through valuation caps, discounts, and/or preferential rights. In a high-risk scenario, a convertible note is also valuable as it facilities a high-risk-high-reward scenario, allowing the investor to convert into equity if the company does well, but to also to be repaid their investment funds (plus interest) otherwise.

Equity investments

An equity funding arrangement is where an investor invests money into a company, and in exchange, receives shares proportionate to the value of the investment measured against the company's "pre-money" value. Equity funding gives rise to a direct ownership interest in the company and, depending on the size of the ownership, the investor may be able to justify certain rights in the company. These might include the right to appoint a director, the right to restrict the company from taking certain decisions or actions without the investor's approval, the right to determine whether certain forced sale or vesting arrangements should apply in respect of the founders, and other considerations which are discussed in this section.

Valuation and capitalisation

It's important to understand both the company's pre- and post-money valuation as well as its capitalisation before subscribing for shares in a company. Valuation refers to the value ascribed to the company for the purpose of the investment, which can be calculated using several methods. The proportion of the investment's value to the company's value determines the investor's ownership stake and therefore the number of shares they can purchase. The company's capitalisation refers to the shareholding in the company (both pre-investment and post-investment), as well as the "fully diluted" cap table – which means all the shares in issuance and also all the shares which the company is obliged to issue, for any reason whatsoever, prior to the closing of the investment deal. The pre-investment fully diluted cap table should explain every actual, potential, or contingent obligation which the company may have to issue shares at the date of signature of the investment's term sheet. This includes share warrants, options, convertible loans, and all other convertible instruments (including SAFEs) which, upon exercise/conversion into shares, will dilute existing and future shareholders' stakes in the company.

Governance and control (i.e., director appointment, resolution thresholds, protected matters, quorum)

The Company's Act 71 of 2008 (the "Act") automatically confers certain rights on shareholders. These include, amongst others, the right to vote at shareholder meetings, the right to dividends, and to remaining assets of the company on winding up after creditors have been paid. The Act also creates basic minority protections (special resolution thresholds), pre-emptive rights on issuance of new shares, and the right to vote with the other shareholders on who the company's directors will be.

Ordinary resolutions require a majority vote of more than 50% and special resolutions require a majority vote of more than 75% (although these can be changed in the company's constitutional documents). The distinction between ordinary and special resolutions relate to the importance of their subject matter. For example, any transaction involving the sale of the company's material assets requires a special resolution. For shareholders to take a vote on a certain matter by resolution, a quorum must be achieved. In other words, at least a certain proportion of shareholders must be at a meeting in order for the resulting decision to be valid. It is not uncommon to see investors negotiating for the right to appoint directors to the board, as well as veto rights over certain "restricted matters" (i.e., annual budget, determination of salaries, funding terms, etc.).

These are all general points which an investor should consider before taking equity in a company as they relate to the amount of control which the investor can exercise in relation to the company's actions and decisions. It's important also to respect and acknowledge the control which the founders are relinquishing to take on investment. This must reflect in an objectively fair transaction, otherwise resentment and de-motivation might follow, which ultimately affects the company's prospects of success.

Shareholder arrangements

When investing in a company, it is often appropriate for the shareholders to agree to certain arrangements which should apply amongst themselves. This is generally captured in a shareholder's agreement. The principle underpinning these arrangements should fundamentally be to promote growth, transparency, fair decision-making, and to protect the investors' investment. These can be achieved through certain mechanisms, which are summarised below:

Compulsory sales

These provisions require a shareholder to sell all or some of their shares back to the company/the other shareholders on the occurrence of certain events, such as a termination of employment, death, insolvency, etc. The value at which these shares are sold may track the reason for the compulsory sale.

Founder vesting and lock-up

Founder's own shares can vested over time to encourage retention. Founders can also be restricted from selling their vested shares to incentivise retention but also to create value.

Tag along and come along rights

Tag along and come along rights are essentially exit provisions which facilitate alignment on certain exit opportunities. Tag along rights apply when one or more shareholders sell their shares, requiring the purchaser to make an offer to all the other shareholders at the same price and on the same terms. Come along rights allow a defined percentage of the shareholders to force 100% of shareholders to agree to a bona fide offer for the company. This avoids a scenario of a single minority shareholder holding up a potential exit transaction.

Pre-emptive rights on sale and transfer of shares

The pro rata right (based on percentage shareholding) to participate in new issuances of shares by the target company is automatic, and conventionally, all shareholders also have the right to purchase any shares sold by any other shareholder. In both cases, should any shareholder choose not to purchase their full pro rata shares to maintain their stake in the company, the remaining shareholders shall have the right to purchase the remaining shares.

Anti-dilution rights

Investors might negotiate the inclusion of anti-dilution rights, which protect their percentage shareholding if the company raises funds at a lower valuation in future.

Liquidation preference

A liquidation preference allows the investor to get at least their investment amount back (or even a multiple) upon a liquidity event in preference to other shareholders (but not in preference to creditors). A liquidity event typically includes a change of control, a merger, consolidation, or a sale as well as the lease, transfer, or exclusive licencing of all or substantially all of the company's assets.

Management and information rights

Shareholders are automatically given access to certain information, including financial statements and company documentation. However, this is often extended by agreement to include (i) monthly financial statements (including management accounts); (ii) operating budgets, forecasts, and other information reasonably requested by the investor.

Representations and warranties

The company will typically give reasonable warranties that verify the nature of the business and company assets which form the basis for the investment decision. These warranties can be extensive, and may be qualified to one degree or another, provided that is in writing.

Issue	Notes
Investor risk	The investor's risk is limited to the amount invested in the company.
Tax treatment	Investor expected to be taxed in its tax jurisdiction (if a direct investment), unless investing through a South African resident entity (see discussion on taxation of syndicated entities in Section 1).
Regulatory considerations	The exchange control regulations provide that shares must be endorsed as "non-resident" if they relate to an investment from a foreign jurisdiction in a foreign currency.
Key terms and characteristics	• Pre-money and post-money valuation, share price, aggregate investment amount, pre-and post-money cap table • Control and governance considerations • Founder restrictions/lock-up/vesting • Shareholder protections: anti-dilution rights, liquidation preference • Pre-emptive rights
Scope and cost of legal work needed to set up structure	Costs are quite variable, based on complexity of the transaction. The typical range is R50,000 to R200,000 for: • Subscription Agreement • Supporting Resolutions • Deed of Adherence • New Memorandum of Incorporation and Shareholders Agreement (optional)
Disadvantages	Not considered a creditor of the company and only entitled to distributions after the company's creditors are paid. This type of investment is generally more detailed and therefore costly and slower.
Advantages	Shareholders in the company are entitled to distributions and dividends declared by the company for as long as the company is in existence and profitable. Given the long-term nature of an equity investment, this arrangement has the potential for more carefully structured equity rights, which maximise control and minimises risk through liquidation preferences and anti-dilution provisions.
Ideal use case for this option	To be used where the company needs investment, and when the investor expects the company to succeed and intends to be involved to a degree through voting or otherwise.

Annexure A

Information typically required by authorised dealers to motivate a non-resident endorsement

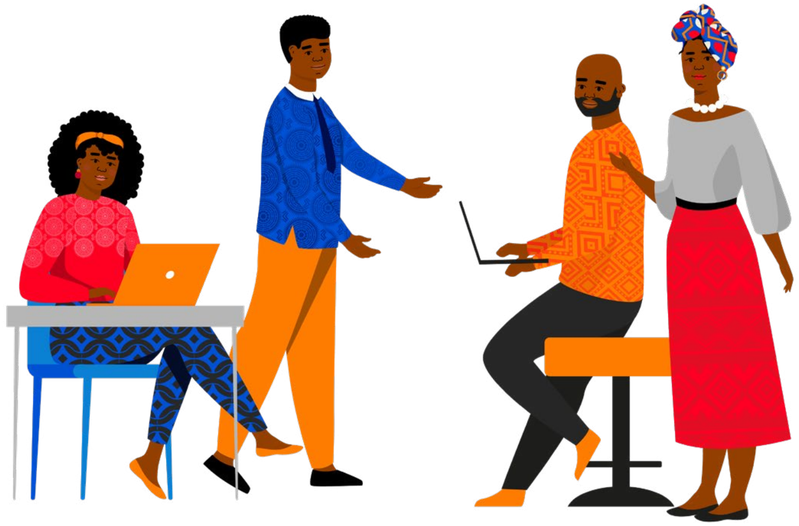
For the authorised dealer to complete an endorsement, they need to be supplied with the relevant share certificates, as well as the following:

- The full name and country of residence of the non-resident who owns or is interested in the shares, together with a declaration as to non-residency
- The name of the resident company in which the shares are held
- The total number of shares held by the non-resident in the resident company
- The full name and residential address of the non-resident in possession of the shares
- A company declaration which provides that the owner of the shares is a permanent resident outside of the common monetary area (CMA), or alternatively confirming emigrant status. The declaration should also confirm that the funds being introduced into South Africa do not form part of a resident's foreign investment allowance, foreign earnings, foreign inheritances, or funds for which amnesty has been granted or in respect of a voluntary disclosure programme, and that there is no South African interest in the non-resident.
- Investor company organogram
- Passports of all non-resident individuals must be obtained and submitted
- Where the foreign investor is a non-resident individual, an individual declaration must be provided.
- Written resolutions of the board of directors of the resident company authorising the equity investment transaction for the foreign investor shareholders
- The subscription agreement/sale of shares agreement, which gives effect to the acquisition of shares in the company.
- An auditor's letter which confirms that the transaction was concluded at arm's length and at a fair and market-related price, illustrating the basis on which the value of the transaction was determined.
- The latest financial statements of the company
- Proof of inward SWIFTs received into the resident company's business bank account for the payment of shares
- The resident company's organogram.
- The share certificates and share register
- Registration certificate and incorporation documents of the resident company

Back Cover

Additional Resources

- ABAN African Investment Survey 2022
- Understanding SAFEs and Priced Equity Rounds: Fundraising + Investors, Legal, Safes | Y Combinator
- How to Invest in Startups with Angel Syndicates
- Syndication: Overview, Examples Reasons for Syndication
- Angel Networks in Emerging Markets
- How Venture Capitalists and Angel Investors Can Benefit from Investing in African Startups
- From Supa Strikas to Startups, Tomi Davies' Approach to Angel Investing
- Digital Collective Africa



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