Fisheries and Aquaculture Case Study Synopsis Series

7. Financing for Fisheries SMEs

Teaching people to fish successfully

The West owes a significant historic debt to sub-Saharan Africa but new thinking is that ameliorating poverty and hunger through aid is not the best approach. Using funds to help start and develop sustainable businesses while training and mentoring entrepreneurs will better improve local wealth and bring wider long-term social benefit. Murdoch Mactaggart reports.

Banks, like many other businesses, used to have a sense of social responsibility. There was certainly always a need to make profits, if for no other reason than to ensure the continued survival of the business, but there was typically also an understanding that banks don't operate in a social vacuum and that taking proper account of the long term consequences of particular lending or other decisions on the fabric of the relevant community was both entirely proper and a necessary and desirable approach.

In the mid-1970s, however, corporate greed and the abandoning of any perceived need for social responsibility was given intellectual justification by the theories of the Chicago School of Economics, an unfettered free market approach duly becoming economic orthodoxy. Introduced politically by Pinochet in Chile then by Reagan in the US and Thatcher in the UK, and duly taken up by other political leaders, this argued for transferring economic control from the public to the private sector, liberalising markets, financialising capital, and established the Washington Consensus for development action. In due course the financial sector's enthusiastic embracing of this basically flawed economic approach contributed to critical problems like the food price spikes of 2007/2008 and brought about the recent financial crisis and the consequent global recession, events which had disproportionate impact on Africa and other developing regions.

Also in Africa economic interventions driven by the prevailing orthodoxy saddled countries with considerable debt but brought little economic benefit, in marked contrast to the Asian economies where the approach of both direct state intervention and the establishing of partnerships between the public and private sectors helped drive the region's significant growth. During 1972-2002, for instance, east Asia averaged 5.9% growth, Africa –0.2%.

When African decolonisation began in 1960 South Korea was one of the world's poorest countries. Now the 14th largest economy it's been the world leader in telecomms for a decade, a position directly attributable to targeted state support encouraging business growth, a private sector working with and not against the public sector, and managed access to international markets. Can African countries, many with abundant natural resources and potential for significant agricultural productivity, develop to a comparable state? How can they be helped to do so?

Transforming lives

Fortunately the views of the Chicago School are becoming increasingly discredited, Milton Friedman even acknowledging shortly before his death some errors in his earlier views.

The UK's Trade and Industry minister, Lord Green – who, as Stephen Green, had a 28 year career with the Hong Kong and Shanghai Bank, ending as Group Chief Executive and Group Chairman before joining the UK government - comments "The Chicago School argument that the sole job of business is to create profit for shareholders has proved not just morally insufficient but commercially insufficient as well." adding that "The financial crisis has shown that market fundamentalism cannot serve the community, the business or the shareholder because it does not sustain value. Profit and responsibility are not in conflict but interdependent. Capitalism must adapt and it has to serve everyone, not just the rich and not just the West."

Joseph Stiglitz, Nobel laureate and former World Bank Chief Economist, makes a related point when he writes "Development is about transforming the lives of people, not just economies. And if economic growth is not shared, then development has failed." This resonates with the southern African philosophy of ubuntu, a focussing on peoples' interdependency. "You can't exist as a human being in isolation." commented Archbishop Desmond Tutu. "Ubuntu speaks about our interconnectedness."

SMEs have different needs

It's now widely recognised that small and medium enterprises (SMEs) can be a major engine of economic growth for both local communities and through them for countries. In rural sub-Saharan Africa, for instance, helping people to move beyond subsistence farming has repeatedly been shown to help not only the families and immediate communities directly involved but to trigger the establishment of ancillary businesses so that the community and eventually the local region becomes richer, more educated, healthier, and with reserves enabling them to overcome their fragility and to survive events which might earlier have tipped them into disaster.

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SMEs are also quite distinct from corporates in terms of outlook, processes and working practice. Small, and particularly micro, businesses having perhaps a sole proprietor or only a few employees, are invariably short of time and of resources. They have to be resourceful and innovative to survive. Where corporate staff would specialise in production or analysis or marketing or whatever it might be SME staff need to be Jacks and Jills of all trades. This generalist approach and the need often to learn on the job can bring great benefit but it also can mean that important tasks can be overlooked or ignored. Financial management can seem boring compared with the excitement of making a good catch as a fisherman or seeing your maize crop come up healthy and abundant by practising agroforestry, something you've only recently learned about, or reconditioning old diesel engines for pumping water - unfortunately it's not only a necessary process to improve the business but it's one that banks, not unreasonably, tend to insist on. Drawing up long term business plans and working out how the low season will affect cash flow is something which, it seems, can always be done later, not now, yet work of this kind is essential if a business is to be positively directed and properly managed rather than just lurching around as sales randomly occur.

Despite the increasing focus on social responsibility, however, banks and financial institutions are still pretty poor at understanding the specialist needs of SMEs, taking the default position of doing nothing unless it's pretty safe. It's not unreasonable that a bank ensures that any loans it makes have a good chance of being repaid but banks appear to be poor at evaluating risk properly, apparently preferring to avoid it entirely it if at all possible - even when they are prepared to lend they will often only do so only if their exposure is covered by collateral or third party guarantees, neither of which are easily available to the proprietors of micro businesses.

Barriers to financing SMEs

According to the report Investment Supply for Small and Medium Enterprises, part of a wider project looking at SME finance options in sub-Saharan Africa and particularly at the fisheries sector, there are four main groups of barriers to financing SMEs in Africa: perceived risk; institutional elements; policy and regulations; and skills and training needs. These mirror the four types identified by a 2007 UNEP (UN Environmental Programme) report but add a fifth, that of particular difficulties met in the fishing sector.

In addition to the banks' general view of SME risk they and other financial institutions may also feel that even if risk is covered the returns will be poor and that in consequence investors will be dissatisfied. This may particularly be so if there's a requirement that environmental sustainability be enforced as a condition of funding.

SMEs may also not necessarily present their best case, complete with sufficient information, and hence banks may have difficulty in properly modelling revenue streams and, in consequence, company cash flow in order to judge repayment probabilities.

This issue of lack of good, adequate knowledge runs through many of the identified barriers in different forms. Although aquaculture has been practised for centuries most modern aquaculture takes place in SE Asia and there's a dearth of local, sub-Saharan, knowledge about returns, potential technical problems and similar matters. This gap might be filled by specialist research or other institutions but these again are few and far between. An SME may therefore find it difficult to get information both to present a case for credit and, more generally, to run the business as efficiently as possible; the bank in turn may find it very hard to understand the business model and so properly evaluate the risks.

It's perhaps in the area of policy and regulation that SMEs are particularly badly served. This isn't a peculiarity of African governments, of course, but at least the European Commission has analysed matters in detail and has put in place several policy frameworks and financial support packages – for instance, parts of FP7, the current, seventh, Framework Programme – which are reserved for SME support and intended to encourage innovation and growth. However, corporates have large budgets and relevant trade organisations with which to lobby for particular policies, something which at a particular sectoral level is often supported by unions looking after the interests of their employed members, it's common for legislation to be brought in which not only doesn't help SMEs but may actually hinder their activities, allocation of fishing permits to individuals rather than to communities being a good example.

Private equity

Private equity funds (PEF) take a long term approach and generally fall into two sub-categories: venture capital (VC) funds which target start-ups or provide funding for early development or expansion; and later-stage funds which target established companies and provide mezzanine funding, perhaps for further expansion or to cover mergers or acquisitions.

The period at the very beginning of a company's operations, or sometimes when there's been a major change of focus, can be difficult because there may be no income until products have been developed and begin to sell. It's not uncommon for a business to misjudge the extent of this and it's important for both the VC and for the business itself that there will be access to additional funding as necessary to cover such periods of shortfall as otherwise the company risks going out of business with both parties losing their investment.

A PEF will typically run for at least five years and usually longer, often to ten. As with the approach of some of the newer hybrid funds a PEF will take a proactive role in providing business and development support. This may mean having a representative director on the board but can go beyond that in providing more comprehensive management support and advice. Finally, the PEF will seek to exit the company at the optimal time, that is, at a point when the company has grown sufficiently so that the investment is maximised but the impact on the company itself will be minimal. This exit can take various form including selling shares to new investors, making payments to investors through debt recapitalisation, agreeing a secondary buy-out by another PEF or by floating the company on the stock exchange. However, one of the problems in Africa is that the stock exchanges are both relatively new and fairly small and consequently anticipated share prices, and hence company valuations, may not be that easy to achieve.

A subset of private equity investing with particular relevance to developing countries is impact investing, an approach which has been defined as 'investments intended to create a positive impact beyond financial returns'. Impact investing is fairly new, at least under that name, but is growing rapidly. The research and management consulting firm Monitor Group of Cambridge, MA, for instance, believes that the 2009 level of some $50 billion in asset value among impact investment funds will grown tenfold over the next decade. The Rockefeller Foundation is one of the pioneers of the current approach while funds like the Acumen Fund, Root Capital, E+Co and others support and practice it.

Unlike the situation with many conventional PEFs impact investing generally targets those at the bottom of the heap, people earning less than around $3,000 per annum, for instance. However, although the term itself is new what's a very similar approach is well established. The Commonwealth Development Corporation was established in 1948 and the International Finance Corporation in 1956 and each exists to invest in business to support social returns. Corporations are also making impact investments through diversifying their supply chains by seeking Fairtrade and Environmental Governance Standards compliant suppliers.

Other approaches

A further approach to facilitating funding, also long established, is that of Credit Guarantee Schemes (CGS). These are often used by governments, or the likes of the EC, to encourage entrepreneurs in developing countries or to address market failures that can be limiting to enterprises. Essentially the CGS will guarantee a large proportion of any loan made, thereby reducing a funder's risk.

Two CGS in Africa are the African Guarantee Fund for Small and Medium Enterprises (AGF) and the Multilateral Investment Guarantee Agency (MIGA). AGF was established following an initiative of the Danish and Spanish governments and is based in Mauritius. Its initial capital is $50 million and it's due to begin operating this year (2011). MIGA is a member of the World Bank group and provides political risk cover for investments. The northern part of Africa is substantially Muslim and although this diminishes going south countries like Nigeria in the west or Tanzania in the east, among many others, have sizeable Muslim populations. Different estimates place the Muslim proportion of Africa's population at between 30% and 47% and whatever the true figure there is clearly opportunity for Islamic banking to be a source of preferred funding for many entrepreneurs.

As with its companion Abrahamic religions, although now scarcely honoured in the other two, Islamic banking prohibits usury. There's disagreement about what exactly constitutes 'usury' some authorities holding it to be any levying of interest at all while others argue that it's only excess interest which is prohibited under Sharia. There are also prohibitions on funding activities which conflict with religious principles, such as anything to do with gambling, alcohol or pork.

There's a very wide range of Islamic products which have been or are being developed and it's an important and growing sector which has the potential for offering broader financial intervention in Africa.

Innovative financing models

The report mentioned earlier gives four examples of innovative financing models successfully investing in sustainable SMEs in Africa. These are Acumen Fund, Grofin, E+Co, and Root Capital.

Acumen, founded by former international banker Jacqueline Novogratz in 2001, is a global, non-profit venture fund which invests in enterprises that bring critical goods and services to low-income markets. In addition to investing in companies it provides technology, management support, alternative financing and access to a global network of advisors.

The basic idea behind Novogratz's approach is that traditional aid approaches can't solve the underlying problems faced by people living in poverty because it doesn't allow them to build self-sustaining ways to better their lives. And because Acumen targets companies producing goods or services which can help a large number of people – providing improved irrigation facilities, for instance, or improving health services in some way – it believes that the wider social return on its investments goes well beyond the obvious.

Grofin, established in 2004, is a specialist finance company that makes a point of tailoring its financial and development support to the specific needs of its client companies. Unlike banks, it doesn't ask for security against loans but looks instead at the viability of the business and makes lending decisions on that basis. It now has around $250,000,000 of investment funds under management and has formed strategic partnerships with, among others, the Shell Foundation, the Netherlands Development Finance Company, the Skoll Foundation and the Syngenta Foundation.

E+Co is a New Jersey based NGO with regional offices in Africa, Asia and South America, and which focuses specifically on making clean energy investments in developing countries. It was founded in 1994 with initial investment from the Rockefeller Foundation, Like others already mentioned it's an impact investor, taking a long-term view of its investments, and also providing mentoring and other business support to its clients

Root Capital, founded by William Foote in 1999, in a non-profit social investment fund that provides affordable loan capital and financial training to sustainable grassroots businesses operating in environmentally sensitive areas of Latin America, Africa and Asia. Loans range from $25,000 to $750,000 and its principal market is poor rural producers who can thereby be helped to compete internationally.

It particularly targets rural businesses where small scale producers have organised themselves into cooperatives and associations to achieve the economies of scale required to be able to export their products direct to overseas customers. In this way it values ethical supply chains which emphasise product quality and long-term relationships rather than price. It uses factoring for around 80% of its financial support, so helping with cash flow fluctuations, but also provides conventional asset-backed loans where equipment and/or land can serve as collateral.

Teach a man to fish and he'll knock off early on Friday

Just as the business sector is relatively undeveloped in Africa so also is the business support sector, even though that's starting to change. Business angel networks have been very successful in supporting and helping to grow ICT businesses in many part of the world. In Africa, however, there are no formal business angel networks although there are some investment groups which act in similar fashion.

Similarly, the business incubation approach has had considerable success in the UK and elsewhere but doesn't yet exist in Africa although some academic centres have begun setting up innovation centres. A typical incubation centre will offer business services to innovative start-ups or, on occasion, to established companies moving into an innovative sector which is different from their earlier or core business. These services are often provided free, paid for by government support, although specialist services like legal advice or specialist research work may be chargeable, often at discounted rates. Office premises, typically for between one and perhaps a dozen or so staff, may also be available, typically on a flexible basis and at reasonable rents. The aim is to incubate and duly grow an innovative company to the point where it can move into bigger or more specialised premises, take on more staff and continue to grow under its own steam.

Changes in regulatory practice are also necessary so that SMEs don't fall foul of laws which inhibit their activities or prevent their getting support which they need. This is an area where very much one size doesn't fit everyone and NGOs, fund holders and others need to be alert to proposed changes in laws or regulation.

Impact investing and funds which practice a hybrid approach in providing not just finance but also mentoring, business training and support and other business development services are making a difference in Africa. By taking the approach that a loan needs to be repaid or that there needs to be an exit strategy for investors the funds achieve two things: companies which have succeeded will also have developed an understanding of financial discipline to complement the training and business support given to them and this will in turn help their future activities and, secondly, money leant or invested is recycled and duly reused to help new companies grow.

And, of course, where a company grows successfully it can become sustainable so it not only provides a living to its owners but also provides local employment, contributes to local and national taxation rather than drawing on public funds and helps to create a market for complementary businesses and in time shifts a locality from dependency to self sufficiency.

The key appears to be to provide money not as a means of ameliorating poverty or hunger but using it to kick start or develop businesses which can go on to provide a living to the participants, minimising the risk of failure by providing development, support, mentoring and training as part of the package and generally working closely with all those involved in order to ensure success.

Helping water to flow

Water is a vital necessity yet in South Africa it's also a scarce resource. This is not just because of the shortage of water in general but often because it may only be available from a communal tap and then has to be carried long distances by hand. Carrying a two gallon bucket weighing around 10kg several hundred metres several times a day isn't much fun.

It was seeing women and children in his village in Limpopo, South Africa, regularly struggling with this task that led former high school teacher Jacob Mapaila and his wife to new careers in a business which drills boreholes and then supplies farms and communities with piped water and related infrastructure or equipment such as tanks and pumps. Their company, Borameetse – an Afrikaans/Sesotho compound word meaning 'drill for water' – initially relied on other companies to do the actual drilling. Jacob lacked the capital to buy the necessary heavy machinery and found banks unsympathetic, deeming his proposals 'too risky'.

It was then that he learned of GroFin through an English-born friend who helped Jacob with business advice. GroFin took a much more sympathetic view and, recognising the potential in Borameetse, lent him 2.5 million rand, about $410,000, to allow the company to buy a new drill rig and a 16-ton truck on which to mount and transport it. Importantly, however, GroFin didn't act merely as a supplier of funds but took an active role in helping Jacob and his wife develop their business beginning with helping them evaluate quotes for a truck and so get a better deal right through to showing them how to market the business through local papers. They were also helped to understand how the business really operated and what other opportunities existed. GroFin also got Jacob started on using the internet and Borameetse is now entirely familiar with email and the web.

"I called myself a businessman but I wasn't!" says Jacob. "Grofin loaned me money but they also gave me knowledge and that knowledge will always be with me."

Boorameetse's gross profit was 272,000 rand, about $44,000, in 2005 but in a couple of years had risen to twice what GroFin had leant the company, five million rand or about $820,000. The company now has several employees and is continuing to expand as well as meeting the vital need of bringing reliable water supplies to South African communities.

"So much has changed for me because of the GroFin partnership." he adds. "I definitely have a healthy relationship with GroFin and want to work with them again."

Tim Jackson, Professor of Sustainable Development at the University of Surrey, comments "Is prosperity merely about material possessions or is it about the conditions in which people can flourish, contribute useful work and enjoy respect, participate meaningfully in society?"

African women bear disproportionate burdens, sometimes spending six to eight hours daily gathering firewood and carrying water, perhaps tending to three or four generations of families stricken by AIDS or malnutrition.

Agricultural and trading initiatives are changing women's lives as much as those of men and so having direct impact on communities as a whole. A measure of success is shifting to controlling what one chooses to do rather than being controlled by labour out of dire necessity and this is something which innovative funding approaches are helping to facilitate.

Taming the sun

Moving from dependence on fossil fuel to using renewable energy sources is an urgent and critical route for the world to take. There are also significant benefits for users in that once the infrastructure is in place there are no fuel costs whatever although, of course, maintenance needs to be factored in.

Mona Mwanza, a small electrical appliance and engineering shop in northern Tanzania, wanted to expand into selling solar systems to bring electricity for the first time to homes and businesses which relied on using candles, kerosene, wood fires for cooking, and the occasional diesel-fuelled generator. In 2001 it spoke with E+Co which helped it to draw up a business plan and a financial strategy and lent it $50,000 at 9% per annum to provide working capital to buy stock. Mona Mwanza repaid the loan on time, two years later, and E+Co followed up with further loans of $100,000 in 2004 and $200,000 in 2006, needed to help the business grow. However, an important part of its relationship was also providing advice and support to structure the business expansion well.

Mona Mwanza is now established in several rural locations and has set up a new company, Zara Solar, which focuses purely on supplying and installing solar powered systems and reaches about 1,000 new households – perhaps some 6,000 people – each year. To date E+Co's investment has amounted to $350,000 and the enterprise has supplied 2,500 households, about 15,000 people, with the means to generate their own electricity from the sun and in doing so save an estimated 12,000 tonnes of CO_2 from pouring into the atmosphere. This won the company the Ashden Award for Sustainable Energy, presented by Al Gore in 2007.

As is so often the case with innovative approaches by small businesses banks and traditional financial institutions wrote off Mona Mwanza's proposals as just too risky. Essentially the institutions were ignorant of the potential from a business perspective and were not prepared to help get going something of clear social benefit at both very local and global levels. E+Co, however, filled this major gap in the market both through its loans and by the development advice and the mentoring which it provided as an integral part of the whole package. This approach helped Mona Mwanza and Zara Solar to expand successfully, brought the significant benefits of low-cost electricity generations to thousands of people, and made a modest but important contribution to the need to reduce fossil fuel use.

This case study synopsis has been produced by **Murdoch Mactaggart** and is based on a case study undertaken by **Ana Marr and Charles Chiwara**

The full report is available at www.africanfisheriesinvestment.org and www.africanfisheries.org.

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