Investment Supply for Small and Medium Enterprises

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**Acronyms**

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<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>AAF</td>
<td>African Agriculture Fund</td>
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<tr>
<td>AECID</td>
<td>Agency for International Development Cooperation from Spain</td>
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<td>AFD</td>
<td>Agence Française de Développement</td>
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<td>AfDF</td>
<td>African Development Bank</td>
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<td>AGF</td>
<td>African Guarantee Fund</td>
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<td>AGRA</td>
<td>Alliance for a Green Revolution in Africa</td>
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<td>ANDE</td>
<td>Aspen Network for Development Entrepreneurs</td>
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<tr>
<td>BADEA</td>
<td>Arab Bank for Economic Development in Africa</td>
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<td>BOP</td>
<td>Bottom of Pyramid</td>
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<tr>
<td>CADFUND</td>
<td>China Africa Development Fund</td>
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<tr>
<td>CDB</td>
<td>China Development Bank</td>
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<tr>
<td>CDC</td>
<td>Commonwealth Development Corporation</td>
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<td>CGS</td>
<td>Credit Guarantee Schemes</td>
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<td>DBSA</td>
<td>Development Bank of Southern Africa</td>
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<td>DFIs</td>
<td>Development Finance Institutions</td>
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<td>EADB</td>
<td>East African Development Bank</td>
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<td>EGS</td>
<td>Environmental Governance Standards</td>
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<td>EIF</td>
<td>European Investment Bank</td>
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<td>EIF</td>
<td>European Investment Fund</td>
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<td>EU</td>
<td>European Union</td>
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<td>FAST</td>
<td>Finance Alliance for Sustainable Trade</td>
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<td>FFFs</td>
<td>Founder, Family and Friends</td>
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<tr>
<td>GERREF</td>
<td>Global Energy Efficiency and Renewable Energy Fund</td>
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<tr>
<td>IDC</td>
<td>Industrial Development Corporation of South Africa</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IFAD</td>
<td>International Fund for Agricultural Development</td>
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<tr>
<td>M &amp; A</td>
<td>Mergers and Acquisitions</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<tr>
<td>NGO</td>
<td>Non-Governmental Organisation</td>
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<tr>
<td>NRI</td>
<td>Natural Resources Institute</td>
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<tr>
<td>NEPAD</td>
<td>New Partnership for Africa’s Development</td>
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<td>PC</td>
<td>Portfolio companies</td>
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<tr>
<td>PEF</td>
<td>Private Equity Fund</td>
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<tr>
<td>PPF</td>
<td>Project Preparation Facility</td>
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<tr>
<td>Proparco</td>
<td>Promotion et Participation pour la Coopération économique</td>
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<tr>
<td>PTA Bank</td>
<td>Eastern and Southern Trade and Development Bank</td>
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<td>SCAF</td>
<td>Seed Capital Assistance Facility</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Description</td>
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<td>SIF</td>
<td>Sierra Investment Fund</td>
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<td>SME</td>
<td>Small and Medium Enterprise</td>
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<td>TAF</td>
<td>Technical Assistance Facility</td>
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<td>VC</td>
<td>Venture Capital</td>
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Executive Summary

The Development Bank of Southern Africa (DBSA), in partnership with the Natural Resources Institute (NRI), is undertaking a study on finance for the fisheries sector for the New Partnership for Africa’s Development’s (NEPAD) Establishing a Fisheries and Aquaculture Investment Partnership Programme. This report presents the results of a study of the supply of financial services to small and medium enterprises (SMEs).

A major objective of the study is to document the experiences of providers of financial services to SMEs worldwide, with particular emphasis on identifying innovative business models that can generate financial and social returns. The methodology employed follows the ‘value chain’ approach in that investment processes are analysed and factors facilitating or constraining the fluidity of the chain are identified.

The underlying barriers to financing SMEs in Africa can be classified into four types related to: (1) risks involved; (2) institutional development; (3) policy and regulatory frameworks; and (4) skills and training needs. Particular difficulties’ in the fisheries sector include: Information Asymmetry i.e. promoters lack business acumen to fully articulate their ventures to funders; but financiers lack expertise in appraising fisheries projects. Establishing a venture fund is challenging and lengthy; as is accessing local capital. Limited incubation and lack of project preparation facilities that assist fisheries and aquaculture entrepreneurs to develop their ideas into bankable deals limit the pool from which investors can mine potential fisheries and aquaculture investments.

Global financiers in SMEs are currently implementing innovative financial models for sustainable enterprises. One key characteristic of investment funds specialising in SMEs in Africa is that they combine investment funds with business development funds in order to ensure the economic growth of SMEs as well as the likelihood of prompt loan repayment. Innovative financial models for SMEs seek to fill the gap between traditional banking and grant-based donor finance. Hybrid business models that can leverage the best aspects of philanthropy and business can help build sustainable, scalable enterprises. The delivery of investment and business development for SMEs can be done directly or through intermediaries. Other forms of innovation include utilizing SME purchase agreements as collateral; specialised financial intermediaries and multilateral agencies acting as co-lenders and risk-sharing of loans to SMEs; and industry partners assisting to develop the economic growth of SMEs and ensuring market access.

Lending institutions and investment funds by and large follow a process which can be likened to that of a value chain. The importance of identifying key steps in the lending or investment process and the associated facilitating or constraining factors becomes evident when dealing with SMEs particularly in Africa. Lending institutions, Credit Guarantee Schemes (CGSs) and Private Equity Funds (PEFs) follow pre-determined cycles. This is highlighted in the cases studies in the report.
Numerous challenges in finance for SMEs exist. Bureaucracy, actual or perceived, and a lack of awareness about SMEs have been identified as serious barriers to the successful reaching of SMEs. Existing relations are crucial to the lending relationship between SMEs and local financial intermediaries, especially when new products are introduced or for speedy approvals. Appropriate monitoring and performance measurement metrics, which are important in a social business model such as a Fund for SMEs in the fisheries sector are lacking. Country-specific legal regulations are cumbersome for regional funds. In a rapidly changing environment, maintaining the alignment of stakeholders’ interests is critical. Business development support from a group of talented management professionals with knowledge of financial accountability, operations, and international/national markets in the fisheries sector – in order to serve as advisors and talent-enablers to SMEs is crucial. Financial returns and exact exit structure are rarely known or guaranteed.

Key interventions to help increase financial access by companies in the sector include: (1) Exit strategies; (2) Incubation facilities; (3) Business Angels; (4) Funds of funds; and (5) Policy and regulatory reforms. The key intervention is to promote financial market growth in Africa to address exit strategy challenges such as small African capital exchanges, Restriction on Listing of Foreign Companies, Share Buyback Restriction and Inadequate Double Taxation Agreements. The business incubation sphere in Africa is very young and underdeveloped compared to other developing countries in the world. SMEs in Africa can also benefit from the formation of business angel networks in combination with the establishment of incubators and investment funds. Amendments to stringent policies that hinder access to key sources of local capital in Africa today are essential e.g. restrictions on illiquid investments by pension funds and insurance companies, which can serve as investment vehicles targeting SMEs.
1. **INTRODUCTION**

The present study of the supply of financial services to SMEs is part of a wider programme entitled ‘Establishing a Fisheries and Aquaculture Investment Partnership’, which is being undertaken by the Development Bank of Southern Africa (DBSA), in partnership with the Natural Resources Institute (NRI), for the New Partnership for Africa’s Development (NEPAD).

A major objective of the study is to document experiences of providers of financial services to SMEs worldwide, with particular emphasis on identifying innovative business models that can generate financial and social returns. The methodology employed follows the ‘value chain’ approach in that investment processes are analysed and factors facilitating or constraining the fluidity of the chain are identified.

The structure of the study is comprised by six sections. After this introduction, section 2 outlines the underlying barriers to financing SMEs in Africa. Section 3 presents major global investment funds worldwide, while section 4 discusses key innovative financial models. Section 5, meanwhile, takes the value chain approach to identify several case studies; section 6 briefly lists remaining challenges in finance for SMEs; and section 7 presents some possible solutions to overcome them.

2. **PERPETUAL BARRIERS TO FINANCING SMEs IN AFRICA**

The UNEP\(^1\) identifies some long-standing constraints to investment for SMEs in Africa. These can be classified into four types related to: (1) risks involved; (2) institutional development; (3) policy and regulatory frameworks; and (4) skills and training needs.

**Risks Barriers**

- SMEs that form the ‘missing middle’ in demand-side financing landscape in African countries are generally perceived by local banks and financial institutions as risky and therefore unprofitable.
- Small entrepreneurs do not appear to have the skills and specialised capacity to run successful businesses.
- Differing incentives, expectations and motivations between investors and fund managers with regard to investing in the SME sector results in misalignment of financial strategy of fund managers, also becoming a reason of an incorrect perception about the sector’s profitability.

• Perception of equity amongst entrepreneurs as giving away stake in their businesses to outsiders hinders them from accessing equity type financing.
• Enforcing environmental sustainability as a pre-condition to financing hinders the SME’s chances of accessing affordable finance.
• The cost of doing business with banks in Africa is high, while the professional attitude appears to be low.
• Difficulties in modeling cash flows and revenue streams of a project.

Institutional Barriers

• Development finance institutions are crowding out private sector investment in SMEs. Philanthropic funds for example, need to be wary of setting interest rates too low as to not crowd out private sources of capital.
• Institutions that generate data, distribute reliable information and create relevant knowledge that could benefit SMEs are missing. For example, SMEs could benefit from gaining access to market data about African countries, or information about opportunities in international markets.
• The costs of identifying and developing promising investment opportunities is prohibitive for most off-shore investors - some successful private equity/venture capital funds have overcome this by establishing dedicated technical assistance/business development facilities funded by donor aid.
• Local banks and financial institutions could be instrumental in serving the SME sector but are generally under-capacity and unskilled to deal with such clients.
• The majority of enterprises operate in the informal sector, therefore making it difficult to identify their capital and training needs.

Policy and Regulatory Barriers

• Many countries in Africa, especially in Sub-Saharan Africa, do not yet have a regulatory framework conducive for the SME sector and especially one that encourages sustainable development. For example, there is no regulatory framework in place in which an SME financing firm can be recognised and licensed as a venture capital firm. Therefore the SME cannot access the associated benefits linked with being a venture capital firm. Because the firm’s status may not be clear, this can further discourage inward investment.
• Variance in regulatory regimes from one country to another exacerbates the problems faced by fund managers in serving SMEs.
• Well-meaning yet misdirected public policy may distort the market and adversely affect the chances of private players entering the financing market. For example, in Uganda, the government sets limits for interest rates (e.g. 6%, 2007 data) for financing to rural sector based enterprises, which might be lower than the transaction costs of providing financial services to such enterprises.
Skills, Knowledge, Information and Training Barriers

- Most fund managers, local banks, or financial institutions are not skilled to deal with the SME sector, let alone sustainable SMEs. Most investment officers do not have knowledge of these sectors and are therefore unable to serve these SMEs appropriately.
- In many cases banks are not using the right credit technology that can be useful for reducing transaction costs.
- It is difficult to understand and identify the specific training needs of the African entrepreneur.
- Knowledge transfer is needed such that SMEs understand what relevant standards must be met to access international markets (e.g. for organics, health centers, etc.)
- There is a lack of convergence in the needs of SMEs and investment / fund managers. The former needs finance so they can go advance their businesses. The latter needs assurance in the form of business plans, sound financial sustainability, credit ratings and skills that prove the money invested will not be lost.
- Lack of standardised reporting is a barrier for investors trying to understand the landscape.
- Lack of adaptation to local/regional/national needs.

Particular difficulties in the fisheries sector

- Information Asymmetries in the Fisheries Sector: The specialised expertise required to appraise fisheries projects is usually not available to traditional banks in Africa. This problem is further exacerbated because most fisheries and aquaculture entrepreneurs lack the business acumen to express their concept articulately to traditional providers of finance.

- Venture Fund related challenges: the process of starting a fund and raising capital is challenging and lengthy. The funds also face difficulty in accessing local capital into funds e.g. pension, insurance sectors. Funds in the region also face double taxation challenges.

- Limited Incubation/ Project Preparation Facility (PPF): There are potential deals in the market but many are not presented in a bankable format. Lack of a project preparation facility that assists fisheries and aquaculture entrepreneurs to develop their ideas into bankable deals limits the pool from which investors can mine potential fisheries and aquaculture investments.
3. GLOBAL INVESTMENT FUNDS FOR SMEs

Global investors in SMEs are currently implementing innovative financial models for sustainable enterprise. Table 1 presents six major global investment funds. In Europe, the European Investment Bank (EIB) and the European Investment Fund (EIF) are active in most of the EU member states. In Africa, the 8 Miles Fund promoted by Bob Geldof, Acumen Fund, Grofin, and Root Capital are all working to support SMEs in Africa.

While the EIB provides loans, EIF and the 8 Miles Fund specialise in private equity and venture capital for SMEs. All work through local financial intermediaries – whereby EIF is a fund of funds – and their investment levels for SMEs tend to be large. The Acumen Fund, Grofin, and Root Capital, on the other hand, disburse smaller amounts directly to SMEs although some work in partnership with strategic stakeholders such as buyers of SMEs’ products, NGOs, multilateral agencies and industry partners.

One key characteristic of investment funds specialising in SMEs in Africa is that they combine investment funds with business development funds in order to ensure the economic growth of SMEs as well as the likelihood of prompt loan repayment.
Table 1: Key characteristics of funding for SMEs

<table>
<thead>
<tr>
<th>Investor</th>
<th>Type of product</th>
<th>Total amount available</th>
<th>Individual amount per SME project</th>
<th>Target group</th>
<th>Investment purpose of SMEs</th>
<th>Intermediary</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Investment Bank</td>
<td>EIB Loans for SMEs</td>
<td>Euros 30 billion (over 2008-2011)</td>
<td>From very small to a maximum €12.5m</td>
<td>SMEs &lt; 250 employees in the 27 EU member states</td>
<td>Tangible (e.g. equipment) and intangible (e.g. distribution networks)</td>
<td>Local commercial banks, guarantee funds, mutual guarantee institutions, microcredit organisations. For some, EIB provides guarantee to reduce risk.</td>
</tr>
<tr>
<td>European Investment Fund</td>
<td>Private equity and venture capital funds investing in SMEs</td>
<td>EUR 409 million in 2008</td>
<td>n.a.</td>
<td>SMEs</td>
<td>Seed capital; build-up strategy; internationalisation; mezzanine finance.</td>
<td>The EIF is a fund of funds. In 2008, it worked with 32 venture capital funds in Europe.</td>
</tr>
<tr>
<td>8 miles – Bob Geldof</td>
<td>Private equity fund for Africa</td>
<td>US$750 million to be raised</td>
<td>Investments worth between $15m and $80m</td>
<td>Africa</td>
<td>Agribusinesses, financial services and telecommunications.</td>
<td>Secured backing from the African Development Bank and the International Finance Corporation. Other investors are set to sign up.</td>
</tr>
<tr>
<td>GroFin East Africa SME Finance Facility</td>
<td>Finance and business development</td>
<td>n.a.</td>
<td>Up to US$ 1 million</td>
<td>SMEs in East Africa</td>
<td>start-ups, through all the phases of business growth, up to established businesses</td>
<td>n.a.</td>
</tr>
<tr>
<td>Acumen Fund</td>
<td>Finance plus management support, talent, technology, and access to a global network of advisors</td>
<td>US$20 to US$100 million</td>
<td>Loans and equities. Investments: US$300,000 to US$3m. Equity: typically between 10% and 33% of the capitalization</td>
<td>SMEs in Africa</td>
<td>SMEs that can generate a return on capital, grow by a factor of 10 and work in the fields of health, water, housing, and energy</td>
<td>n.a.</td>
</tr>
<tr>
<td>Root Capital</td>
<td>Loans, training and supply chains to tap into global markets</td>
<td>US$17 million</td>
<td>US$25,000 to US$750,000</td>
<td>SMEs in Africa</td>
<td>Rural businesses where small-scale producers are organized into cooperatives and associations</td>
<td>Strategic partners include: buyers, NGOs, specialized financial intermediaries, multilateral agencies, commercial financial institutions and industry alliances.</td>
</tr>
</tbody>
</table>

Source: Elaborated by author from EIB, EIF, GroFin, Acumen and Root Capital websites.
4. INNOVATIVE FINANCIAL MODELS

Innovative financial models for SMEs seek to fill the gap between traditional banking and grant-based donor finance. In this sense, innovative financial models aim at providing products that are financially sound and can create positive impacts on social development. This dual purpose of innovative financial models makes them unique and increases the likelihood of stimulating an overall positive effect on SMEs development.

One of the characteristics of innovative financial models for SMEs is their ability to device hybrid business models for the design and delivery of financial products.

Hybrid Business Models

Business models that can leverage the best aspects of philanthropy and business can help build sustainable, scalable enterprises. Figure 1 shows a typical hybrid business model, which combines an investment fund with a business development fund, both of which supported by innovative structures that help track the performance of fund investments in terms of their financial and social returns.

The Investment Fund for SMEs requires patient capital that can provide the flexibility to invest in volatile environments such as the fisheries sector in Africa, while applying financial discipline in the delivery and recovery of loans and equity investments. The Talent and Business Development Fund, meanwhile, is oriented at building capacity within the SMEs in order for their business to develop sustainably and consequently for investments to be recovered on time. Both funds feed into each other supported by innovative structures that ensure that financial and social yields are generated. The supportive structures include a Portfolio Database Management System, which tracks the financial and social performance of each investment. Tracking and measuring investments is especially important for a social venture model such as investment in the fisheries sector in Africa. For instance, Acumen Fund has developed a methodology called Best Available Charitable Option which measures their investments against other charitable options to evaluate opportunity costs for each investment. More generally, tools such as this can assist any investment fund to identify best available investment options in the fisheries sector in Africa.
Figure 1. Hybrid Business Model of Innovative Finance for SMEs

Innovative Structures

- Portfolio Database Management System
- Best Available Investment Option
- Professional, experienced team to assess SMEs needs
- Supply chain analysis
Potentially, the Fund can provide SMEs with talent, management support, technology and access to a global network of advisors. In addition, a professional group of experienced experts can facilitate ongoing SMEs business success by providing advice on business planning, cash flow analysis and financial forecasting. In the case of GroFin Fund, this enables the Fund to tailor financial solutions to SMEs reflecting both the cash flow and risk profile of the business.

Capability support for SMEs, such as those mentioned above, is a strategy that helps ensure business development and investment returns. This is also essential when traditional collateral are not requested from SMEs. Acumen Fund, for example, assesses the viability of the project rather than relying on collateral. For Root Capital, on the other hand, the main security is future supply chain commitments, such as purchase contracts from companies like Green Mountain Coffee Roasters, Starbucks, Whole Foods, Marks & Spencer and The Body Shop. The Fund makes loans based on producers’ future sales rather than their existing assets, using cash flows tied to consumer demand as security rather than any traditional asset-backed collateral. In other words, loans are made against signed purchase agreements between the SME and their buyers. The purchase agreement, in effect, becomes the collateral, which is in fact a discrete, future revenue stream pledged to repay the loan.

The delivery of investment and business development for SMEs can be done directly or indirectly. Figure 1 shows that the investment fund can be disbursed through financial institutions (FIs) and the talent and business development fund through non-governmental organisations (NGOs). The European Investment Bank, for instance, delivers loans for SMEs via local commercial banks, guarantee funds, mutual guarantee institutions, and microcredit organisations. The European Investment Fund, on the other hand, is a fund of funds, which in 2008 worked with 32 venture capital funds in Europe.

Other specialised funds for Africa work with key strategic partners including buyers of SMEs produce who can bring prospective clients to the Fund as well as provide their own purchase agreements as collateral; NGOs that can train SMEs and therefore enable them to grow; specialised financial intermediaries and multilateral agencies to act as co-lenders and risk-sharing of loans to SMEs; commercial financial institutions to which growing SMEs can graduate to; and industry partners who can help develop the economic growth of SMEs and ensure market access.
As mentioned before, the European Investment Bank (EIB) offers finance for SMEs through local commercial banks. In the UK, these include Barclays, Lloyds TSB, NatWest, HBOS, Royal Bank of Scotland and Ulster Bank.
Table 2: Features of EIB loans for SMEs

<table>
<thead>
<tr>
<th>Investor</th>
<th>Type of product</th>
<th>Total amount available</th>
<th>Individual loan conditions per SME</th>
<th>Target group 1/</th>
<th>Loan purpose</th>
<th>Intermediary</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>European Investment Bank</strong></td>
<td>EIB Loans for SMEs</td>
<td>Euros 30 billion (over 2008-2011)</td>
<td>From very small to a maximum €12.5m</td>
<td>SMEs &lt; 250 employees in the 27 EU member states</td>
<td>Tangible (e.g. equipment) and intangible (e.g. distribution networks)</td>
<td>Local commercial banks, guarantee funds, mutual guarantee institutions, microcredit organisations. For some, EIB provides guarantee to reduce risk.</td>
</tr>
<tr>
<td><strong>NatWest Bank, UK</strong></td>
<td>EIB Loan Scheme for SMEs</td>
<td>n.a.</td>
<td>From £26,000 to £10m. For 2-25 year at preferential interest rates.</td>
<td>As above plus: Borrowers must permit EIB inspections.</td>
<td>Multi-purpose including asset purchase, working capital or R&amp;D costs.</td>
<td>NatWest is an intermediary of EIB loans. NatWest’ eligibility for SMEs states that the lending decision rests with them – i.e. The EIB is unable to intervene.</td>
</tr>
<tr>
<td><strong>The Royal Bank of Scotland</strong></td>
<td>EIB Loan Scheme for SMEs</td>
<td>£250 million.</td>
<td>£26,000-£500,000 (higher can be considered). For 2-25 years at preferential rates.</td>
<td>SMEs &lt; 250 employees</td>
<td>As above</td>
<td>As above</td>
</tr>
<tr>
<td><strong>Ulster Bank Ireland Limited</strong></td>
<td>EIB Loan Scheme for SMEs</td>
<td>n.a.</td>
<td>€30,000-€2m (higher can be considered). For minimum of 2 years</td>
<td>As above plus: Borrowers must permit EIB inspections.</td>
<td>As above</td>
<td>As above</td>
</tr>
<tr>
<td><strong>Barclays</strong></td>
<td>EIB Loan Scheme for SMEs</td>
<td>£150 million.</td>
<td>£5,000-£22m. One off 2.5% cash back payment when the loan is drawn.</td>
<td>SMEs &lt; 250 employees</td>
<td>Not for working capital and refinancing purposes.</td>
<td>As above</td>
</tr>
</tbody>
</table>


1/ Loans can be granted to businesses in most sectors (except those associated with property development for sale, property investment, the purchase of farm land, weapons & ammunition, gambling & related equipment, tobacco-related businesses, use of live animals for scientific purposes, or any business which is considered morally or ethically controversial).
Table 2 shows the main features of the EIB loan scheme and that of its UK partner banks with the aim to apply a ‘value-chain’ approach to the analysis. A major attraction for SMEs about the loan scheme is that lending is received at reduced interest rates and for a loan term of a minimum of two years. Loan amounts start at about £25,000 with differing upper limits across commercial banks. Barclays Bank, for instance, offers the wider range, covering from £5,000 up to £22 million. The loan purpose is common in all banks, i.e. loans for investment in asset purchase, working capital, and research and development costs.

5. VALUE CHAIN APPROACH

Investment funds by and large follow a process which can be likened to that of a value chain. The importance of identifying key steps in the investment process and the associated facilitating or constraining factors becomes evident when dealing with SMEs particularly in Africa. This section highlights some specific cases of investment or ‘value chain’ processes in Africa and in Europe.

5.1. The case of SME finance in Africa

A relatively general investment process begins with due diligence of the applicant’s proposal. Acumen Fund (see Figure 2) follows four key stages: (1) Due diligence, which includes a business model, financial analysis and site visits; (2) Development of structuring options and presentation to the investment committee for approval; (3) Management assistance; and (4) Exit.

[Figure 2. The Acumen Fund investment process]

Source: Elaboration by author based on www.acumenfund.org/
The due diligence stage involves initial entrepreneur skill evaluation and testing of mission alignment, which is then followed by a business model analysis – in which an assessment of the business plan and financial models is made. In the second stage, fund managers construct a term sheet outlining the potential investment structure, conduct a site visit and consult the legal counsel in order to move to the next process stage. The result of the second step in the process is an investment report to be presented to the investment committee, a body composed by the executive managers and board members with experience particularly in private equity and venture capital.

Once the investment is approved, the Fund provides ongoing management assistance throughout the life of the investment. This is often carried out via various channels: (1) by participation in the SME’s board of directors; (2) provision of funds for business development and the encouragement of talent within the SME; (3) support from a network of consultant and advisors; and (4) advice from legal and marketing experts. The advantage of adding business development support to financial investment is that it ensures not only the SME sustainability but also it assists the Fund’s own investment model by adjusting to clients’ needs accurately.

At the end of the investment term, the Fund generally exits the investment in one of the following ways: (1) Debt, via payments of principal and interests over the term of the loan; and (2) Equity, via sale of shares to strategic investors, management buybacks or initial public offerings.

5.2. The case of EIB in Europe

Loans from the European Investment Bank (EIB) to SMEs follow a pre-determined cycle, which is depicted in Figure 3. Key steps are the following:

(a) EIB selection of financial intermediaries

The EIB disburses funds to SMEs through local financial intermediaries. These include local commercial banks, guarantee funds, mutual guarantee institutions, and microcredit organisations. The EIB already works with over a hundred banks in the 27 EU member states. Through its Fund for SMEs, the EIB offers the intermediary banks sophisticated risk-sharing products designed to reach market segments that commercial banks have difficulty penetrating, i.e. SMEs for which the risk is considered too great or the security provided is judged insufficient. Three types of measures are developed:
Loans where risks are shared with the banks, with the EIB guaranteeing part of the total risk taken on by the intermediary bank;

Loans where the EIB takes a risk on the beneficiary SME directly, in parallel with the intermediary bank; and

Mezzanine products for high-growth SMEs or ‘gazelles’. Through its subsidiary the European Investment Fund (EIF), the EIB Group provides participating loans, which are like quasi-equity and enable ‘gazelles’ to increase their ability to obtain bank credit without necessarily having to open up their capital or provide substantial security.

**Figure 3: The European Investment Bank project cycle**

![The EIB project cycle](http://www.eib.org/projects/cycle/index.htm) (Accessed on 04.10.10)

**(b) EIB eligibility criteria of SMEs**

All autonomous firms with fewer than 250 employees are eligible. Subsidiaries and holding companies of industrial groups are not eligible as these EIB loans are reserved for small and medium-sized enterprises.

**(c) Banking criteria for loan approval**

The financial intermediaries of EIB loans for SMEs evaluate and review the SME projects being funded and retain the credit risk against the SME final beneficiaries. Therefore, the SME
projects are evaluated by the financial intermediaries using normal commercial banking criteria. The EIB, in principle, is not involved in lending outside those normal criteria.

As seen in Figure 3, the process for loan approval involves staff teams from a diverse expertise, a management committee and the board of directors. All these three groups of experts interact with one another to assess fully the application before approval. The legal team is then involved in the contract negotiation, which if approved, leads to the disbursement of the loan to the SME. The last stage of the process is the monitoring control of SME projects in order to ensure that loan repayments are made promptly.

5.3. The case of Private Equity Funds

A Private Equity Fund (PEF) is a privately-managed investment pooling² vehicle that investments in equity and quasi-equity³ securities predominantly⁴ in private companies. PEFs generally fall into two sub-categories:

1. Venture Capital (VC) or Early Stage – which target start-ups (with limited funding options) launch, early development and expansion. The VC funds typically acquire minority shareholding, and have board representation to assist management.
2. Buyouts or Later Stage/Development – which target established companies, and seek majority/controlling shareholding.

Figure 4 below illustrates the financing cycle of a new enterprise.

(a) Financing cycle

The valley of death⁵ is a conceptual gap (in time and money) between commencement of a venture and generating positive cash flow. If funders are unable to cover negative cash flow, then the enterprise risks going out of business. Potential investors of seed capital required at this stage include Angels⁷, VCs and FFFs (i.e. Founder, Family and Friends).

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² Differ from Collective Investment Schemes such as Mutual Funds or Unit Trusts which invest in liquid investments such as equity in listed companies. Legislation prohibits investment in private companies.
³ These are securities with equity features such as Preference Shares and convertible debt instruments.
⁴ Subject to its mandate, a PEF is permitted to invest in listed companies.
⁶ See Annex 2.
⁷ According to Cardullo (2003), in the USA, Angel investors 5 year returns are expected to be over 500%, whilst VCs are around 400%. This tends to be practical in ground-breaking knowledge sectors such as IT and Biotech, hence funding in these sectors usually emerge. Food, on the hand, is ‘defensive’, producing low, stable returns. Annex 2 shows the return expectations of Angels and VCs.
Upon breaking-even⁸ (cash flow), the Emerging Growth Company will seek VC for early stage finance to address its capital structure, as well as SME bank facilities. Strategic Alliances with stakeholders e.g. suppliers and customers are established, based on product offering and emerging business relationships. These include supplier contracts after having proven reliability as a supplier, market acceptance of product, and demand for product. Scoping for potential synergetic Mergers and Acquisitions (M&A) are sought henceforth, over the life of the enterprise. As the enterprise’s revenues increase and capital requirements increase, Investment and Merchant Banks are engaged to offer corporate finance solutions. These include, but not limited to going public, M&A and PE buyouts.

**Figure 4: New venture financing cycle**

The figure below highlights the number of PEFs in Africa in 2009. According to PSR (2010), VCs are the largest number of PEFs. However, Buyout PEFs account for over 50% of invested capital; with VCs accounting for less than 14% of PEF investments in Africa (Hoppenot 2009).

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⁸ In aquaculture, this about 2 years.
(b) **Private Equity Life Cycle**

The life of a close-ended PEF is about 10 years (see figure 6 below). The first year is intended for the fundraising. Success of the fundraising exercise is dependent on among other factors including but not limited to: market conditions, reputation of team and focus i.e. portfolio companies (PCs) geographical location, sector, size and stage in business cycle.

**Figure 6: Private Equity Life Cycle**

Cash draw downs are expected during the investment period i.e. over the next four to five years of initialing the fundraising. This, however, is a function of the PC’s circumstances, and market dynamics.
The realisation period is over the following four to five years. The fund will be liquidated in about 10 years. There is a potential extension period (here 2 years) which could be related to poor market conditions e.g. for stock market listing or acquisition by competitor or other PEF.

Private equity is an alternative asset class. Investments are generally illiquid, as the underlying portfolios consist of unquoted companies. Funds typically have a valuation committee, as valuation of portfolio companies can be contentious.

(c) Private Equity Investment Process

The investment process commences with the fundraising (see illustration below); follows with three stylized steps (i.e. selection, structuring and monitoring); and ends with exit strategies.

Figure 7: Private Equity Investment Process

Source: Adapted from Müller (2008).

Selecting
PEF will leverage the expertise and knowledge of its industry specific team (including former operating executives) and contacts in the sector and financial communities to identify, and analyse companies for the PEF. The focus will be on opportunities across the aquaculture and fisheries value chain in Africa. Discussions with promoters, management and boards of companies which fit the fund’s focus will then be pursued. Companies can also approach PEF for potential tie-ups.

Structuring
Upon a target PC agreeing to pursue the transaction, PEF will undertake a valuation and comprehensive financial, tax, legal, operational, management and industry due diligence exercise. The due diligence exercise will also identify:

- opportunities for growth,
- areas for operational improvement, and
- risks.
Upon satisfaction with due diligence, and agreement on valuations, PEF will structure the transaction, based on the financial requirements, and plans for real value enhancement and risk mitigation of the potential PC for the PEF Investment Committee’s consideration.

**Monitoring**

The consummation of a transaction marks the beginning of the process of active value management focussed on boosting revenue of the portfolio company. PEF will be actively involved within portfolio companies, cultivating and nurturing them by working with PC management:

- to build a successful business by driving growth, enhancing profitability and optimising long term growth,
- ongoing support and clear monitoring guidelines for financial and operating results and strategic priorities,
- assistance in challenging situations,
- pursuing aggressive debt repayments, and
- representation on Board.

**Divesting / exiting**

PEF hold the investment in a PC over the medium term i.e. over 5-10 years. It will exit at the optimal time i.e. extracting maximum value for investors, and minimal impact to the portfolio company. Possible exit strategies will include:

- Direct sale to new investors;
- Listing on stock exchange;
- Secondary buy-out by other private equity firms;
- Dividend payments to investors through debt recapitalisation.
(d) Impact Investing

Impact investing can be defined as ‘investments intended to create a positive impact beyond financial returns’. 9

**Figure 8: Defining Impact Investing**

![Diagram of Impact Investing]

*Source: The Rockefeller Foundation, J.P. Morgan.*

The Impact Investing approach generally targets at the Bottom of Pyramid (BOP) i.e. people earning less than $3 000 per annum per capita (World Resources Institute definition). Although the term is new, it has existed for over 60 years e.g. the Commonwealth Development Corporation (CDC) (established in 1948) and the International Finance Corporation (IFC) (established in 1956) investing in business to provide solutions (O’Donohue et al 2010). Traditionally the forte of Development Finance Institutions (DFIs), the investor base is expanding to include financial, institutional and private investors. Corporations are making impact investments through diversifying supply chains by seeking fair trade and Environmental Governance Standards (EGS) compliant suppliers.

Impact Investing is two-dimensional i.e. business sector and impact objectives, (see table 3 below) e.g. investing in aquaculture to create employment, food security and sustainable use of resources. The impact is in addition to upholding EGS policies (O’Donohue et al 2010).

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Table 3: Impact objectives in detail

<table>
<thead>
<tr>
<th>Increase incomes and assets for the poor (from IRIS’s social impact objectives)</th>
<th>Improve basic welfare for people in need (from IRIS’s social impact objectives)</th>
<th>Mitigate climate change (from IRIS’s environmental impact objectives)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment generation</td>
<td>Conflict resolution</td>
<td>Biodiversity conservation</td>
</tr>
<tr>
<td>Access to energy</td>
<td>Disease-specific prevention and mitigation</td>
<td>Energy and fuel efficiency</td>
</tr>
<tr>
<td>Access to financial services</td>
<td>Access to clean water</td>
<td>Natural resources conservation</td>
</tr>
<tr>
<td>Access to education</td>
<td>Affordable housing</td>
<td>Pollution prevention and waste management</td>
</tr>
<tr>
<td>Income/productivity growth</td>
<td>Food security</td>
<td>Sustainable energy</td>
</tr>
<tr>
<td>Agricultural productivity</td>
<td>Generate funds for charitable giving</td>
<td>Sustainable land use</td>
</tr>
<tr>
<td>Capacity-building</td>
<td>Health improvement</td>
<td>Water resources management</td>
</tr>
<tr>
<td>Community development</td>
<td>Equality and empowerment</td>
<td></td>
</tr>
</tbody>
</table>

Source: RIS. As defined at irs.tregin.org.

Source: Table extracted from O’Donohue et al 2010.

The investment options are exactly the same as other investments, i.e. debt, equity and guarantees. Investors’ return expectations vary from competitive to concessionary. The main challenge is deal sourcing is difficult as deals are generally under $1m (i.e. SMEs).

The Gatsby Charitable Trust and the Bill & Melinda Gates Foundation fund smallholder farmers in sub-Saharan Africa (O’Donohue et al 2010).

5.4. The case of Credit Guarantee Schemes

Information asymmetry i.e. promoters knowing more of venture, but lenders understanding less, results in low allocation of SME finance by lenders. Solutions for addressing SME financing challenges require:

1. An enabling environment encouraging entrepreneurship
2. Addressing market failures that limit successful enterprises

Credit Guarantee Schemes (CGS) have been used to address the challenges above, by governments in developing countries and developed countries respectively. Credit guarantee is an insurance product a SME can purchase as a substitute for collateral. The guarantor promises to repay the outstanding (in full or part) loan, should borrower (SME) default.

Proponents of CGSs argue that:

1. Lenders build relations with customers, who in future would not depend on guarantees.
2. In terms of banking regulations, European guarantee schemes leverage is set at 12.5 times of capital\(^{10}\). Banks also partially guarantee loans, increasing leverage of the CGS. This makes CGSs more efficient than concessionary loans.\(^{11}\)

3. Can be self-sustaining i.e. premiums plus return on unused funds.

Critics however claim CGSs

1. Are a moral hazard i.e. borrowers disincentive to repay loans, and lenders finance riskier loans
2. Have a ‘crowding out’ effect, making loans more expensive for credit worthy customers.

\((a)\) Operation of a CGS

The flowchart below illustrates the process for a SME to obtain a loan (Figure 7.1 as in original source).

The borrower approaches the lender with the loan application (with the relevant supporting documents/information). The lender then appraises the loan application against set criteria e.g. viability and risks. If the application does not meet requirements, it is declined. If it meets requirements, and sufficient collateral is provided by the borrower, the loan is approved and disbursed (subject to the borrower agreeing to the lender’s term sheet i.e. contract). If the collateral is insufficient, the lender approaches the Guarantee Fund (GF) which vets the applications for consideration. If application does not meet the GF’s requirements, the loan is declined. If requirements are met, an agreement is made with the borrower, who is issued a guarantee certificate and invoice (for premium), which are both sent to the lender.

The lender draws the loan contract, which, if the borrower accepts, is disbursed net of fees and premium (for GF); otherwise application is declined.

Alternatively, the borrower approaches the GF, and if application meets requirements, is forwarded to lender. The above process follows. However, lenders are likely to have wider distribution networks than a GF; and multiple lenders would generally be participating with the Guarantee Fund.

\(^{11}\) However, some African countries do not have the capital to leverage.
Figure 7.1 Flowchart individual guarantee scheme

Source: Deelen and Molenaar (2004). 12

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5.5. **African Guarantee Fund for Small and Medium-sized Enterprises**

The African Development Bank (AfDB), in partnership with the Danish and Spanish Governments led the initiative to develop the African Guarantee Fund (AGF) to support SMEs in Africa.\(^\text{13}\) The AGF is domiciled in Mauritius and expected to commence in 2011 with initial capital of US$50m, and intended to grow to US$300-500m in the long term. Initially, the AGF will be funded by donors and DFIs; and subsequently private capital when viability proven to be sustainable. The AGF services will be limited to:

1. Providing financial guarantees
2. Capacity development of client institutions’ SME banking (outsourced).

5.6. **Multilateral Investment Guarantee Agency**

The Multilateral Investment Guarantee Agency (MIGA) is a member of the World Bank Group and provides political risk cover for investments. MIGA issued three Master Contract Guarantee for Funds.

In 2009, MIGA\(^\text{14}\) issued a 10-year US$4.5m political risk guarantee to Sierra Investment Fund (SIF –via fund manager Manocap), for SIF’s the acquisition and recapitalisation (fleet, new processing facility and cold storage to increase monthly catch from 3 000mt to 9 000mt) of Sierra Fishing Company (SFC).\(^\text{15}\) SFC is a commercial fishing and processing enterprise in Sierra Leone and reportedly operated for over 50 years, and is the country’s largest seafood supplier. The fund focus is Sierra Leone.

In 2010, MIGA\(^\text{16}\) issued Chayton Atlas Investments (part of the Chayton Atlas Agricultural Fund, an agri-business fund) political cover for US$50m, being US$10m for farm acquired in Zambia, and US$40 for other acquisitions and expansions in Zambia and Botswana. Chayton focus on achieving scale economies from vertical integration across the agri-business value chain.\(^\text{17}\) It intends to develop production hubs, with small-scale farmers feeding in. It is seeking opportunities in Malawi, Tanzania and Mozambique.

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\(^{15}\) See [http://www.sierrafishingcompany.com/background.php](http://www.sierrafishingcompany.com/background.php)


5.7. Islamic Banking

Ascertaining religious statistics in Africa is a challenge. Various estimates for extent of Muslim population range between 30%-47% of Africa’s total population. Therefore, the emergence of Sharia finance could unlock potential funding for Muslim entrepreneurs in aquaculture and fisheries in Africa, as Western/traditional funding mechanisms are generally not necessarily supportive of religious-based finance.

The basic principles of Islamic (or Sharia) finance is the prohibition of riba (usury); sharing in profit and loss; certainty of contracts; and investments conflicting with principles e.g. gambling, alcohol and pork.

Table 4: Islamic finance

<table>
<thead>
<tr>
<th>Type of Financing&lt;sup&gt;18&lt;/sup&gt;</th>
<th>How it works</th>
<th>Application</th>
<th>Similar to:</th>
</tr>
</thead>
</table>
| **Mudarabah**                 | profit sharing | • one party gives the other party money to invest/manage.  
• profits share predetermined ratio. | Venture Capital |
| **Marabaha**                  | financing transaction i.e. cost plus agreement | • lender mark-ups asset required by client, and ownership transferred when fully-paid.  
• No penalties for late penalties for late payments; thus higher collateral | • Rent-to-buy  
• Asset finance |
| **Musharaka**                 | Joint-venture (JV) financing | • client purchase banks portion of asset over time; bank and client share risk  
• Bank profit on loan equal to % of the JV  
• profit sharing ceases when capital repaid.  
• In default, property sold and proceeds split on the basis of current equity.  
• rental paid by borrower to JV shared | • Mortgage Finance  
• Floating rate loans – rent can be linked to market rate e.g. LIBOR |

Debt ratios below 33% are considered to be Sharia-compliant. Sharia compliance has the potential to offer broader financial intervention in Africa.

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### 5.8. Funds in Africa

The following provides a brief description of current funds for SMEs in Africa.

<table>
<thead>
<tr>
<th>Fund/ Manager</th>
<th>Type</th>
<th>Focus</th>
<th>Fund Size</th>
<th>Limits</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIF; and Manocap Soros Fund/ Monacap</td>
<td>SMEs</td>
<td>Agri-business</td>
<td>n/a</td>
<td>$500 000 - $5m, minimum IRR of 30%</td>
<td>Focus on Sierra Leone; Liberia and Ghana. Investors include CDC and the Soros Foundation</td>
</tr>
<tr>
<td>African Development Corporation (ADC)</td>
<td>SMEs</td>
<td>Agriculture</td>
<td>n/a</td>
<td>MIGA cover of US$150m for 20 projects in financial services and IT, telecommunication, real estate and agriculture</td>
<td>German-based development company. Outside of the financial services sector, focus on high margin projects.</td>
</tr>
</tbody>
</table>
| Silver Street Capital | Buyout | Agriculture, in particular, maize, wheat, fruit, tea and aquaculture. | US$100m | n/a | - Investing in South Africa; Malawi, Tanzania, Mozambique, Uganda and Zambia.  
- Use competitive advantage of large commercial farms to increase productivity of small-scale farmers i.e. capital, market and know-how. Increases throughout from out-growers for its processing facilities.  
- Impact investing partnership with NGO Foundations for Farming to assist in training small scale farmers. |
| African Agriculture Fund (AAF) Managed by Phatisa. AF SME Fund managed by separate fund manager | Buyout; SME | the agriculture value chain | Buyout: first close US$135m, target $300m. SME initially US$30m (target US$60m), | Buyout: US$5-US$20m. SME: maximum investment $4m. | The focus is to increase and diversify food production and distribution.  
Investing in full agricultural spectrum:  
1. Primary agriculture, including aquaculture  
2. Secondary i.e. processing  
3. Tertiary i.e. distribution  
Investors include:  
- AFD, AECID, IFAD, (AfDB), DBSA, |
<table>
<thead>
<tr>
<th>Africa Agribusiness Investments (Agri Vie)/SP Fund Managers</th>
<th>food and agribusiness in Sub Saharan Africa</th>
<th>protein products, including aquaculture</th>
<th>Average transaction: ZAR 40m/ US$6m 25-75% of equity</th>
<th>US$110M</th>
<th>Oversubscribed in 2010 by 10%. It was initiated by SP-aktiv and Sanlam (a leading South African financial institution. It focussed on track record i.e. financial reports, competent management, good governance, growth prospects (local and exports), vertical integration in supply chain and sustainable competitive advantage. Also, on social and environmental sustainability. Investors include Norfund, IFC, EIB, IDC, DBSA, ADB, Kellogg Foundation and Sanlam) thus Impact Investor.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial Development Corporation (IDC)</td>
<td>agro-business</td>
<td>Minimum loan: ZAR1m (US$142 860). Minimum equity of ZAR5m (US$714 300); 8% real after tax</td>
<td>N/a</td>
<td>IDC’s interventions seek to ‘develop and implement’ new technologies in agri-business. Financing primary Agriculture limited to high value intensive agricultural or aquaculture production. Promoter’s contribution - 35% of total assets for existing enterprises, and 45-50% for start-ups. IDC funded Abagold, an Abalone farm in South Africa: ZAR19m ($2,7m). Acquisition of 10% equity by BEE group.</td>
<td></td>
</tr>
<tr>
<td>Inspired Evolution</td>
<td>including agribusiness</td>
<td></td>
<td>US$94m</td>
<td>Focusing on proven technology and management; clean technology investments Investors include: Seed Capital Assistance Facility (SCAF), Global Energy Efficiency and Renewable Energy</td>
<td></td>
</tr>
</tbody>
</table>


Private Infrastructure Development Group (PIDG), Infraco, Infrastructural 

Private Infrastructure Development Group (PIDG), Infraco, a PIDG programme assisted in developing the Antara Cold Storage (in partnership with local firm Antara Holdings Ltd). Antara Cold Storage is a warehouse and cold storage distribution facility in Ho Chi Min City (Vietnam). It serves the aquaculture farmers of the Mekong Delta. The US$16m facility is expected to address spoilage (reportedly some 30% of production), inspection services (in line with export market requirements) and scope for increased value addition. A TAF grants for capacity building in the fisheries sector to ensure maximisation of the facility will be availed.

Members include UK Department for International Development (DFID), Swiss State Secretariat for Economic Affairs (SECO), Netherlands Ministry of Foreign Affairs (DGIS), Swedish International Development Cooperation Agency (Sida), International Finance Corporation (IFC)/World Bank, Austrian Development Agency (ADA), Irish Aid and KfW.

Box 2. China Africa Development Fund
The China Africa Development Fund (CADFund), a subsidiary of China Development Bank (CDB) was established in 2007 with initial funding of US$1bn and expected to grow to US$5bn. A sovereign fund, CAD Fund supports Chinese enterprises pursing the ‘go out’ strategy and investing in Africa. It promotes and co-invests in equities or quasi-equity instruments with China enterprises investing in Africa. CAD Fund operates independently of CDB.

CAD Fund provides market intelligence for African/Chinese enterprises seeking strategic partnerships. Social and environmental assessments are undertaken for all projects to international best practices.

As with Private Equity vehicles, investments in projects do not exceed 10 years. Investments range between US$ 5m and US$50 million. Exit strategies include IPOs or to existing shareholders. CAD Fund does not require majority stake, but active participation through board and management appointments. Countries are split into 5 regions for investment purposes; i.e. Southern Africa (9 countries), Eastern Africa (10 countries), Central Africa (7 countries), West Africa (14 countries), North Africa (6 countries)

CAD Fund’s mandate focuses on four key areas:
- Agriculture: including primary agriculture (including contract farming e.g. cotton farmers in Zambia, Malawi and Mozambique) and agro-processing e.g.
stockbreeding for leather products in Ethiopia;
- Infrastructure: key for Africa’s development i.e. power, ports, rail, roads.
- Manufacturing: leveraging Chinese expertise and transferring skills.
- Industrial Parks: US$250m committed for industrial parks in Zambia, Egypt (Suez Park), Mauritius (Tianli Park), Nigeria (Lachish Trade Zone, a free trade zone in Lagos) and Ethiopia for Chinese enterprises.

The private equity vehicle invests in most industries and projects except typical ‘unethical’ enterprises such as gambling and alcohol. Whilst CAD Fund provides equity; other Chinese institutions (including China Development Bank, the Funder) can be approached to offer other finance e.g. debt.

Source: www.cadfund.com/en

### 5.9 Multilateral Development Banks

<table>
<thead>
<tr>
<th>Financier</th>
<th>Type of product</th>
<th>Individual amount per SME project</th>
<th>Target group</th>
<th>Investment purpose of SMEs</th>
<th>Intermediary</th>
</tr>
</thead>
<tbody>
<tr>
<td>AfDB</td>
<td>Equity, Debt, Guarantees and TAF grants</td>
<td>Minimum AU 50 000, maximum equity of 25%</td>
<td>SME Facilities</td>
<td>Agriculture</td>
<td>Directly, Lines of credit to financial institutions, Investing in PEFs</td>
</tr>
<tr>
<td>Arab Bank for Economic Development in Africa (BADEA)</td>
<td>Debt, TAF grants</td>
<td>n/a</td>
<td>SMEs</td>
<td>Agriculture, Manufacturing and Rural development</td>
<td>Directly, Lines of credit to financial institutions</td>
</tr>
<tr>
<td>DBSA</td>
<td>Equity, Debt, Guarantees, TAF grants</td>
<td>Minimum US$10 m</td>
<td>Infrastructure, medium to large enterprises</td>
<td>Excludes primary agriculture and gambling, alcohol, tobacco</td>
<td>Directly, Lines of credit to financial institutions, Investing in PEFs</td>
</tr>
<tr>
<td>East African Development Bank (EADB)</td>
<td>Equity, Debt, Guarantees</td>
<td>Loan US$50 000 - US$10m, Equity maximum $500 000</td>
<td>SMEs</td>
<td>Agriculture, Agro-processing</td>
<td>Direct</td>
</tr>
<tr>
<td>Eastern and Southern Trade and Development Bank (PTA Bank)</td>
<td>Trade Finance</td>
<td>n/a</td>
<td>SMEs</td>
<td>Import/Export financing; support agriculture</td>
<td>Directly, Lines of credit to financial institutions</td>
</tr>
</tbody>
</table>
6. **KEY CONSTRAINTS IN THE INVESTMENT CHAIN**

(a) **Bureaucracy**

In the lending chain, some evidence suggests that the weakest link is in the loan approval process particularly when intermediaries are involved such as in the case of the EIB fund for SMEs via local financial institutions.

Bureaucracy, actual or perceived, and a lack of awareness about SMEs have been identified as serious barriers to the successful reaching of SMEs.\(^{25}\) Constraints arising from bureaucratic reasons are reported to exist in the UK and explained the slow uptake of EIB loans. However, red tape issues are most particularly relevant in some African countries where lack of information prevails about processes and actions.

(b) **Lack of closeness**

In recent months, it has been reported\(^{26}\) that SMEs in the UK are opting to take out overdrafts instead of loans despite high interest rates of the former (of about 30%). One of the reasons given is that SMEs may feel an affinity with their current account providers, and therefore would prefer to seek an overdraft from them rather than to request for a loan from another provider.

This suggests that closeness of banks to SMEs and knowledge about this type of enterprises is crucial to the lending relationship between SMEs and local financial intermediaries, especially when new products are introduced. Another aspect of overdraft preference over loan might be the speed of approval and the fact that is short-term. For instance, in the current financial crisis, Irish SMEs are in need of short-term working capital that the EIB loan is not designed for as the minimum loan maturity for these loans is two years.\(^{27}\)

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(c) Performance measurement

Monitoring and measuring investments is especially important in a social business model such as a Fund for SMEs in the fisheries sector. Metrics are not necessarily readily available but some methodologies are being devised for example that of the Portfolio Database Management System developed by Acumen Fund in partnership with Google. This system tracks the social and financial performance of each investment.

(d) Legal constraints

Investment Funds can face legal challenges when working in various countries. In this context, the terms of specific investments would relate to country-specific legal regulations and therefore a team of legal professionals would be needed, adding to the cost of running an effective investment fund.

(e) Exit strategies

Exit strategies are best to be developed from the time of investment. Overarching exit goals depend on the type of investment:

- Grants: When the Fund involves grants acquired from donors – for example to partly run the business development fund – exit strategies are usually defined and structured at the time of investment by the donor. A crucial management decision would be to exit these grants with the same diligence and rigour than that applied to private investment.
- Debt investment: This type of investment involves a clear timeline and exit upon the final principal and interest payments.
- Equity investments: These often involve the most challenging exits. Despite detailed planning upfront, the returns and exact exit structure are rarely known or guaranteed. Some common exit strategies include: initial public offering, sale to strategic investor, and promoter buyback.

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28 www.acumenfund.org/
Alignment of stakeholders’ interests

Investment Funds in Africa are particularly reliant on the alignment of stakeholders’ interests. In a rapidly changing environment whereby the African region is affected by internal and external changes, it is crucially important to ensure that the interests that initially brought the stakeholders together to form the Fund are aligned and in place.

Key facilitating factors in the alignment of stakeholders’ interests include: (1) regular communication; (2) transparency; and (3) constant adjustment to accommodate individual and collective interests.

Business development support

Pre- and post-investment services and technical assistance for SME development help secure the largest returns on investment and the largest double bottom line benefit (i.e. social and financial yields). To achieve this, Investment Funds, such as E+Co, emphasises cash flow over pure dividends and capital recovery over long-term exit.  

A particular challenge is the design of innovative business development services that the Fund can provide. For this, the requirement would be to attract a group of talented management professionals with knowledge of financial accountability, operations, and international/national markets in the fisheries sector – in order to serve as advisors and talent enablers to SMEs.

7. POSSIBLE SOLUTIONS

A recent study of the ICT sector in East Africa identifies possible interventions to help increase financial access by companies in the sector. Given that the majority of the companies analysed are SMEs, the findings are relevant to the present study of finance to SMEs in Africa.

Table 5 presents some of the recommended interventions to promote equity investment in SMEs in Africa. Key interventions include: (1) Exit strategies; (2) Incubation facilities; (3) Business Angels; (4) Funds of funds; and (5) Policy and regulatory reforms.

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Table 5. Possible interventions for increasing equity investment in SMEs in Africa

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Intervention</th>
<th>Specific Interventions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited number of equity finance providers</td>
<td>Increase number of equity finance providers</td>
<td>Ensure ease of exit&lt;br&gt;Ensure ease of access to&lt;br&gt;investment opportunities&lt;br&gt;Create a Fund of funds&lt;br&gt;Reform policy and regulations to attract local registration</td>
</tr>
<tr>
<td>Equity financing gap in early stage SME companies</td>
<td>Increase number of equity finance providers financing early stage SME companies</td>
<td>Create a business angel network&lt;br&gt;Increase pool of local capital through introduction of appropriate investment vehicles</td>
</tr>
<tr>
<td>Lack of understanding of equity financing by entrepreneurs as well as poor financial and business planning practices.</td>
<td>Promote business incubation</td>
<td>Support existing incubation facilities&lt;br&gt;Develop new incubation facilities</td>
</tr>
</tbody>
</table>

Source: Adapted from CMA (2010)

Exit Strategies

The African capital exchanges are generally very small and unable to absorb new firms quickly hence the lengthy period of time before initial public offerings (IPOs). This makes it very difficult for venture capital to plan exit strategies through IPOs. Other challenges with regard to exit strategies include: Restriction on Listing of Foreign Companies on the Exchanges; Share Buyback Restriction and Inadequate Double Taxation Agreements. The key intervention is to promote financial market growth in Africa.

Incubation

The business incubation sphere in Africa is very young and underdeveloped compared to other developing countries in the world. East Africa’s academic institutions have begun setting up centres of innovation. In addition, few incubation facilities with the adequate business development services are available.

Business Angel Network

According to the CMA (2010) report, business angel networks have been key investors in ICT in other parts of the world, e.g. 68% of all business angel networks in Europe invested in ICT in 2008. In Africa, there are no formalised angel networks. However, pseudo angel networks exist in the form of investment groups e.g. Transcentury. More generally, SMEs in Africa can benefit
from the formation of business angel networks in combination with the establishment of incubators and investment funds.

**Fund of Funds**

As mentioned in previous sections, the EIF operates as a fund of funds to stimulate the SME market in Europe. This approach could be one option for Africa; alternatively domestic capital sources can be unlocked as an investment vehicle for funds.

**Policy & Regulatory Reform**

There are stringent policies hindering access to key sources of local capital in Africa today. Two potential sources of capital in this context include pension funds and insurance companies, which can serve as investment vehicles targeting SMEs.
References and sources consulted


External web links consulted

International Financial Institutions

Dutch Development Finance Company (FMO)
European Investment Bank
Export-Import Bank of Japan
EXIM Bank ( USA )
Finnish Fund for Industrial Cooperation (FINNFUND)
Industrialization Fund for Developing Countries (IFU, Denmark )
International Development Association (IDA -World Bank Group)
International Finance Corporation (IFC - World Bank Group)
International Fund for Agricultural Development (IFAD)
Japan Bank for International Cooperation (JBIC)
Kreditanstalt fur Wiederaufbau (KfW, Germany)
Multilateral Investment Guarantee Agency (MIGA - World Bank Group)
Overseas Private Investment Corporation (OPIC, US)
PROPARCO (France)
Saudi Fund for Development
Swedfund International AB (Sweden)
The Islamic Development Bank (IDB)
The Nordic Development Fund (NDF)
The Nordic Investment Bank (NIB)
The OPEC Fund for International Development (OPEC Fund)

Development Agencies
Aga Khan Development Network (AKDN)
Agency for Technical Cooperation and Development (ACTED)
Agence Francaise de Development (AFD, France)
Australian Agency for International Development (AusAID)
Austrian Development Cooperation
Commonwealth Development Corporation (CDC, UK)
Canadian International Development Agency (CIDA)
Department for International Development (DFID, UK)
Dept. for Intl. Development Cooperation, Ministry of Foreign Affairs - Finland
Deutsche Gesellschaft fuer Technische Zusammenarbeit (GTZ - Germany)
French Development Agency (AfD)
Icelandic International Development Agency (ICEIDA)
Japan International Cooperation Agency (JICA)
Korean International Cooperation Agency
Luxembourg Agency for Development Cooperation
New Zealand Agency for International Development (NZAID)
Norwegian Agency for Development Cooperation (NORAD)
Spanish Agency for International Cooperation (AECI)
Swiss Agency for Development and Cooperation (SDC)
United Nations Industrial Development Organization (UNIDO)
United Nations Development Programme (UNDP)
U.S. Department of Agriculture - Foreign Agricultural Service
U.S. Trade and Development Agency (TDA)
United States Agency for International Development (USAID)

Multilateral Development Banks
African Development Bank Group (AfDB)
Arab Bank for Economic Development in Africa (BADEA)
Development Bank of Southern Africa (DBSA)
East African Development Bank (EADB)
Eastern and Southern African Trade and Development Bank (PTA Bank)
Industrial Development Corporation of South Africa (IDC)

Venture Capital & Private Equity

Actis
Africa Agricultural Capital
Africa Capital Alliance
Africa Finance Corporation (AFC)
Africa Catalyst Fund
Africa Lion Fund 2 (AFL2)
AfriCap Microfinance Fund (AfriCap)
Africa Venture Partners
AfrInvest Limited
Agelos Social Ventures GmbH
Andromeda Fund B.V. (Bid Network)
Anglo Khula Mining Fund
Argil Venture Capital Fund
Averroes Finance
Aureos Capital
Belgian Investment Company for Developing Countries (BIO)
Brait
Business Partners International (BPI)
Capital Alliance Private Equity (CAPE)
Cauris Investissement
Central Africa Growth Sicar (CAGS)
Central Africa Invest Fund
Cordiant Capital
DEG (Germany)
Emerging Africa Infrastructure Fund
Emerging Capital Partners
Emerging Markets Partnership
Equity Africa
Ethos Private Equity
GloFin Capital (Aspire Funds)
Investec Private Equity
Kingdom Zephyr Management Africa
Millennium Global
OIKOCREDIT
Pan African Capital Group
Pryme Private Equity
Shanduka Fund Managers
Sigefi Private Equity (Siparex)
Southern Africa Enterprise Development Fund (SAEDF)
SOVEC Social Venture Capital
Swiss Investment Fund for Emerging Markets (Sifem)
The Belgian Corporation for International Development (BMI-SBI)
Verde Ventures
Virgin Entrepreneurs Unite SME Fund

Go to http://www.cdcgroup.com/list-fund-managers.aspx:
Actis www.act.is
Aureos www.aureos.com
Cordiant Capital www.cordiantcap.com

Africa
Adlevo Capital www.adlevocapital.com
Advanced Finance and Investment Group www.afigfunds.com
African Capital Alliance www.aca-web.com
African Lion www.afl.co.za
Business Partners www.businesspartners.co.za
Cauris Capital Partners www.caurismanagement.com
Citigroup Venture Capital International www.citicapitaladvisors.com
Development Partners International www.dpi-llp.com
ECP Africa www.ecpinvestments.com
Ethos Private Equity www.ethos.org.za
GroFin www.grofin.com
Helios Investment Partners www.heliosinvestment.com
Horizon Equity www.horizonequity.co.za
I&P Management www.ip-mngt.com
Manocap www.manocap.com
Medu Capital www.meducapital.co.za
Amundi www.amundi.com
Seed Fund Advisory www.seedfund.in
Sphere Holdings www.sphereholdings.co.za
Travant Capital www.travantcapital.com
Tuninvest www.tuninvest.com
Vantage Capital www.vantagecapital.co.za
ANNEX 1:

Successful case studies of innovative financing models investing in sustainable SMEs in Africa

Note to readers: This section presents four case studies of innovative investment models.

Providing finance to SMEs in Africa is a complicated affair. Adding the criteria of sustainability in assessment of such enterprises further increases the challenge. Nevertheless, few innovative business models have emerged that show to the larger investment community that it is possible to create value for the environment as well as larger development goals without sacrificing financial returns. With the aim of bringing such examples to the attention of mainstream investors seeking avenues for investment with multiple objectives, this annex highlights case studies of the following SME investment funds: Acumen Fund, Grofin, E+Co, and Root Capital.

Acumen Fund
Acumen Fund is a global nonprofit venture fund founded in 2001. It fills a niche between traditional capital markets and grant-based philanthropy by investing in enterprises that bring critical goods and services to low-income markets. In addition to investing, Acumen Fund provides these enterprises with talent, management support, technology, alternative financing, and access to a global network of advisors.

Over the past six years, Acumen Fund refined its investment model and built a world-class global team with offices in four countries. The enterprises in which Acumen Fund has invested have created more than 20,000 jobs, with the enterprises generating approximately $8 million of annual income. In Africa, Acumen’s investments have protected 7 million East Africans from malaria and delivered medical care to 800,000 Kenyans to reduce preventable diseases. Over the next five years, Acumen Fund plans to scale its model by a factor of five, growing the investment portfolio from $20 to $100 million with the goal of serving more than 50 million people by 2011.

Business model
The keys to Acumen Fund’s business model are flexible philanthropic dollars and patient capital. Acumen Fund uses philanthropic capital to make disciplined investments – loans or equity, not grants – that yield financial and social returns. The patient capital provides the flexibility to invest in very difficult environments, while helping market-oriented solutions move towards financial sustainability. Any financial returns are recycled into new investments.

Acumen Fund’s typical investment is a company with a 2-3 year operating history with an established business model and revenue stream. Investments are in the $300,000 to $3 million range. Acumen Fund generally takes a minority stake in its investments, typically between 10% and 33% of the capitalization. Acumen Fund’s expected payback period is 5-7 years. While Acumen Fund’s model is similar to that of venture capital firms, the investment criteria are somewhat different. Acumen Fund invests in enterprises that can generate a return on capital, grow by a factor of 10 over the life of the investment, and provide breakthrough insights in the fields of health, water, housing, and energy.
**Investment process**

Acumen’s investment process has four key stages: 1.) due diligence, which includes business model and financial analysis and site visits; 2.) development of structuring options and presentation to the investment committee for approval; 3.) management assistance; and 4.) exit.

The due diligence stage involves initial sourcing, entrepreneur skill evaluation and mission alignment testing. If an enterprise passes the initial due diligence stage, it moves to the business model analysis, which evaluates the business plan, and often expands and builds the organization’ financial models. Once this stage is complete, Acumen Fund constructs a term sheet outlining the potential investment structure, conducts a site visit, and consults legal counsel to move the investment process forward. During this process an investment memo is developed to present to the investment committee, a body comprising Acumen Fund’s executive management and three board members with extensive experience in private equity and venture capital.

Once an investment has been approved, Acumen Fund provides ongoing management assistance through the life of the investment, often through participation on the board, provision of an Acumen Fund Fellow, or targeted support from a network of consultants and advisors as well as legal and marketing support. Acumen Fund tracks each investment’s progress against its objectives, using these metrics to assess the support that is needed and to inform Acumen’s own investment model. At the end of the investment term, Acumen Fund exits the investment in one of the following ways: debt via principal and interest payments over the term of the loan or equity via sale to strategic investors, management buybacks, or initial public offerings.

Since its inception, Acumen Fund has not experienced a default on a loan and has exited one investment through a complete loan repayment.

**Challenges**

The key challenges faced by Acumen Fund are deal flow, metrics and evaluation, legal constraints, exiting investments, and talent. These issues are addressed in more detail below:

1. **Deal flow**

   Acumen Fund seeks not just good ideas, but innovative business models that have the potential to be sustainable and scalable, leadership with management skill and aligned values, and clear opportunities to provide significant social impact in the issue areas and geographies where Acumen Fund works. Many enterprises need to be evaluated to find the few that meet Acumen Fund’s criteria for funding, so identifying and assessing potential investments is a labor- and time-intensive exercise.

2. **Metrics**

   Tracking and measuring investments is especially important for a social venture model. Acumen Fund has focused on developing efficient tools with which to assess its investments. For example, Acumen Fund has developed a methodology, known internally as the Best Available Charitable Option (BACO). BACO is used to measure Acumen’s investments against other charitable options delivering comparable products and services – in essence, evaluating the opportunity costs of each investment.

   Acumen Fund also uses an innovative Portfolio Database Management System (PDMS) developed in partnership with Google, which tracks the social and financial performance of each investment.
This tool allows for more efficient performance management and reporting across the portfolio, as well as for better sharing of information across Acumen’s global portfolio team in its four offices. Acumen Fund is exploring the potential to share this tool with other social investors in the sector.

3. Legal Constraints
Investing in and building operations in multiple countries has been a key challenge to Acumen Fund’s development. Acumen Fund has faced challenges surrounding the terms of specific investments related to country-specific legal regulations.

4. Exiting Investments
Acumen Fund’s exit strategy is developed from the time of investment. While each investment has a unique set of financial, operational and social impact objectives, overarching goals apply across portfolios and geographies. During the investment term, Acumen provides strategic management support to help investees reach expected exit targets. The formal completion of an investment depends on the following parameters defined by financing type:

– While Acumen Fund no longer provides grants, several of its initial exits involved legacy grants, which had exit dates that were defined by a timeline structured at the time of investment. Acumen Fund exited these grants with the same diligence and rigor as was applied to its debt and equity investments, documenting milestones and lessons learned.
– Debt investments involve a clear timeline and exit upon the final principal and interest payment.
– Equity investments are often the most challenging exits; despite detailed planning upfront, the returns and exact exit structure are rarely known or guaranteed. Acumen Fund anticipates the following exits within its existing portfolio: initial public offering (IPO), sale to strategic investor, and promoter buy-back. The intricacies of exiting investments will continue to evolve as Acumen grows and learns from each investment.

5. Talent
Acumen Fund has learned that financial capital is not enough to support the growth of sustainable bottom of the pyramid businesses. Entrepreneurs, especially those working to meet the basic needs of low-income people, need support beyond financing to grow their businesses. In particular, as they scale their enterprises, they require talented management professionals with knowledge of financial accountability, operations, and local markets. As a result, Acumen Fund is thinking of innovative ways to fill this gap.

Conclusion
While markets are creating tremendous wealth in the world, the same markets are leaving behind the majority of the world’s population, creating a growing gap between rich and poor. Hybrid models that leverage the best aspects of philanthropy and business can help build sustainable, scalable enterprises that provide critical goods and services at affordable prices.

By focusing on three critical areas – capital, talent and knowledge – Acumen Fund is working to transform the development paradigm from a top-down approach to one that is focused on the needs of low-income people as customers. The focus on capital means investing in enterprises that deliver water, housing, healthcare and energy to low-income communities, using patient capital and innovative structures to build businesses and deliver financial and social returns. To support these organizations, Acumen Fund is developing a pipeline of talent – young leaders and managers with the combination of vision and practical skill to fight poverty using market-based approaches.
And by capturing the insights learned in its investing work, Acumen Fund seeks to prove that entrepreneurial approaches have a central place in unleashing potential for the four billion people living in poverty. The ultimate measures of success will be the replication of these models to serve even more of the world’s poor and increased flows of capital to such enterprises.

*For more information visit www.acumenfund.org*

**Grofin**

Introduction

GroFin is a specialist finance company that serves the needs of businesses. Its finance solution includes business development making it a ‘one-stop-shop’ for committed entrepreneurs with viable business ideas – from start-ups, through all the phases of business growth, up to and including established businesses that need up to a $1 million in finance. They enhance the probability of success for entrepreneurs through the provision of appropriate finance and business development.

Rationale

*Why a combination of finance and business development?*

Business statistics worldwide reveal that the majority of business failures are a direct result of management performance or the poor administration of financial activities. This is where GroFin’s expertise in business development plays an important role in growing and maximizing the success of an entrepreneurial enterprise. Appropriate interventions and the transfer of skills and knowledge enable more and more small and medium enterprises (SMEs) to become successful. They help entrepreneurs maximize the profitability of their businesses as well as assisting them through the challenging times and growth phases. They offer much more than just money – they offer a complete solution.

*Why GroFin and not a bank?*

Banks can be inflexible, expecting high levels of security for all their lending, without a specialized understanding of their entrepreneurial customers. A bank seldom allocates resources to account for the entrepreneur’s business needs.

Unlike banks, GroFin considers finance applications on the basis of viability, not collateral. It ensures that they understand the entrepreneur’s business and its needs. GroFin sees the relationship as a long-term partnership, taking ownership in the entrepreneur’s success.

Business model

At GroFin, the entrepreneur will get a tailored solution in line with needs. Each tailored solution consists of finance in the form of debt, performance based incentives and in some cases equity.

With the finance the entrepreneur will receive professional support from an experienced team of committed people to facilitate ongoing business success. Detail business planning, cash flow analysis and financial forecasting will not only enable the entrepreneur to prepare for certain business risks, it will also enable GroFin to tailor a finance solution reflecting both the cash flow and risk profiles of the business. Because each business is vastly different from the next, GroFin does not use a standard interest rate that can be quoted. Instead, each unique need will be matched with a unique finance solution.

Challenges faced

1. Growth management
A major challenge, for any growing organization in the region, is to allocate sufficient resources to managing that growth, and securing the associated benefits of scale, whilst avoiding ceilings of complexity.

2. Building capacity
As an organization grows, sustainability is ensured only through developing capacity at all levels of the organization. This is a slow, expensive task, which requires careful planning and significant effort to secure.

3. Keeping interests aligned
The African region not only changes domestically; the external environment, which exerts significant influence through policy, trade and development initiatives, also changes rapidly. GroFin’s stakeholders are affected by these changes, and it is important to maintain regular communication to ensure that interests that initially brought those stakeholders to GroFin are still in place.

Opportunities leveraged
1. Stakeholder support
Numerous stakeholders are interested in developing Africa through SME development. GroFin regularly listens to their needs to understand where opportunities lie to achieve mutual interests. In this regard, GroFin constantly develops new approaches that facilitate effective delivery of these interests.

2. GroFin example investment: GroFin assists high school teacher to provide fresh water to local community

Investment Information
Investment Fund ETEF
Investment Type Profit Share
Investment Purpose Working Capital & Equipment
Investment Amount US$ 410,000

Specialist financier GroFin and a former high school teacher are bringing fresh water to thousands of South Africans, one bore hole at a time. Jacob Mapaila, a 44-year-old grandfather who taught for 15 years, chanced upon a new calling one day in the 1990s when he watched women and children in his village in Limpopo struggling to haul heavy buckets of water from a communal tap back to their homes several kilometers away.

With crucial financial support and invaluable business guidance from GroFin, Jacob and his wife are today running a thriving company – ‘Borameetse’, a name that combines an Afrikaans word with a Sesotho language word and means ‘drill for water’. The company drills bore holes deep underground and supplies homes, farms and even whole communities in rural South Africa with fresh water, pumps, tanks and pipes.

“I never could have imagined where I would be now when I think of the day I realized how difficult it was for people to get something as important as water,” said Jacob. “So much has changed for me because of the GroFin partnership...I was calling myself a businessman, but I wasn’t. They loaned me money, but they also gave me knowledge and that knowledge will always be with me,” he added.
Before Jacob teamed up with GroFin, he was relying on other companies to do the actual drilling for his customers. Jacob lacked the capital to purchase his own drill rig – the heavy machine that digs for water – and also needed expertise to manage a growing business. He went to the banks for money, but they all turned him down. They said his plans were ‘too risky’, something small businessmen like Jacob often hear.

Jacob’s hopes of buying his own rig were fading until Peter Atkins, an English-born friend who had offered business advice, introduced him to GroFin. GroFin saw Jacob’s personal potential and also realized the long-term viability of Borameetse. They loaned him 2.5 million rand (about US$ 410,000) for the purchase of a brand-new drill rig mounted on the back of a 16-ton truck.

Jacob’s business has thrived since he partnered with GroFin. Borameetse’s gross profit has increased from a modest 272,000 rand in 2005 to an estimated 5 million rand for 2007. Jacob recently hired four full-time staff and plans to employ several more. His wide array of clients include both rural and urban households, farmers fighting the ravages of drought, villages (including his own) where water resources are scarce, municipalities, schools and even hospitals, all in desperate need of reliable water supplies. “Without the loan GroFin gave us, I don’t know how I would have bought the truck” Jacob said. “I guess I would have bought a second-hand rig, but it would have worn out already with all the business I have.”

But GroFin’s partnership with Jacob went far beyond lending capital for the drill rig.

GroFin’s experts and a dedicated development manager helped Jacob find a better quote on the truck he purchased, helped him with marketing his business in local newspapers, helped him better understand the nature of his market and honed his overall business plan, even teaching him how to better manage his accounts. GroFin also inspired Jacob to begin using the internet and email – invaluable tools for any 21st century business. Providing both capital and hands-on guidance and support is what makes GroFin’s approach to business development unique. “I definitely have a healthy relationship with GroFin and I will want to work with them again,” Jacob said.

For more information visit www.grofin.com

E+Co

In 2000, Mona Mwanza was a small electrical appliance and engineering shop in northern Tanzania. In 2001, it began discussions with E+Co about expanding its business to include selling solar home systems to un-electrified households and businesses that used kerosene lanterns, candles and the occasional diesel motor. E+Co helped the entrepreneur first develop a business plan and financing strategy, providing a $50,000 working capital loan (2001; 9%; 2 years) to acquire inventory. This loan was repaid on time. E+Co followed up with a $100,000 (2004) and $200,000 (2006) loan and assistance in structuring the business expansion.

The enterprise is now in multiple rural locations and has established a new company, Zara Solar, focused exclusively on the sale and installation of solar systems. Zara will reach 1000 new households - about 6,000 people - per year. E+Co investment to date totals $350,000; 2500 households are already served with modern energy (15,000 people), which translates to more than twelve thousand tons of carbon dioxide made possible through E+Co’s investment and additional services. Some of these climate enhancing “CO2 offsets” have been sold as Verified Emission Reductions. E+Co identified an international award opportunity for the company and then jointly prepared a successful application with the entrepreneur that garnered the entrepreneur with international recognition and prize money: Zara Solar was the winner of the 2007 Ashden Award for Sustainable Energy, presented by Al Gore.
In this case, E+Co acted where others, including local financial institutions, perceived the risks as too high. Solar technology was unknown to traditional lenders and investors. Serving rural markets and local communities was considered too risky and dismissed with a familiar litany: non-repayment by the poor, distances and logistics making transactions impossible; transactions as too small and too disaggregated; insufficient collateral and track record; with, criteria not meeting the standards of neither project finance nor corporate finance. In addition, the transactions were too big and too heterogeneous for the growing, less formal, yet vibrant pro-poor microfinance sector.

Providing Enterprise Development Services (EDS), prior to its investment and during the investment period has helped build the skills of the entrepreneur. This included guidance on how to legally structure the company in the most beneficial way to allow for growth and providing advice on how to improve accounting systems of the company, including suggestions on equipment, software packages and the structure of its chart of accounts. At the same time, EDS helped E+Co to better understand the entrepreneur, his business concept and the business case, thus reducing the perceived risk of the investment. Similarly during the investment period, E+Co worked together with the entrepreneur to assist in the growth of the company, providing services where needed and, again, as a consequence optimize the monitoring and management of its investment.

What E+Co did in these transactions (and over one hundred others) was to fill the gap in the market. This led to modest but positive financial returns on investments and impressive positive impacts for people and the planet. E+Co’s investment strategy focuses on two complementary investment stages and the provision of pre- and post-investment services:

1. Economically focused, growth oriented investments E+Co invests in economically focused, more mature investment opportunities. More established enterprises, solid partners, and more familiar construction, operations, off-take, supply and financing arrangements characterize these opportunities.
2. Developmentally focused, early stage investments E+Co invests in developmentally focused, less mature investment opportunities. These opportunities are characterized by less experienced entrepreneurs bringing technologies to relatively immature markets. There are fewer features of conventional project or corporate finance. Investments are smaller, involve multiple disbursements and are more oriented towards milestones achieved.
3. Pre- and post-investment services and technical assistance window E+Co provides specialized services, pre and post investment. In its investment approach, E+Co’s three priorities are to realize company performance first, cash flow and profitability second and capital appreciation third. With an eye on the early stage of the private clean energy sector, and the only nascent status of capital markets in most target countries, E+Co believes this approach leads to the largest return on investment and the largest triple bottom line (TBL) benefit. Thus E+Co’s investment instruments emphasize cash flow over pure dividends; capital recovery over long-term “maybe” exits.

As a mission-driven but business oriented company, E+Co offers investors global outreach (with options for geographical focus) plus a unique TBL return. In this TBL return, the financial return determines the ultimate sustainability of its invested companies and of E+Co, while the socio-economic and environmental bottom line justifies the contribution of public resources.

E+Co’s solid performance on this hybrid return structure for over 14 years reflects the ‘fiduciary’ character of managing the assets as well as the other interests of its investors. To date, E+Co supported enterprises are serving 3.6 million people in Africa, Asia and Latin America with clean energy. Over their lives, these enterprises will offset more than 13 million tons of carbon and achieve a leverage of about
$10 for every $1 invested by E+Co. As a result E+Co has shown over its 14 years of operations that for an E+Co investment of about 7USD, local businesses can bring clean energy to a poor person. Through this investment, one achieves business creation, energy delivery and environmental improvements. For more information visit http://www.eandco.net/index.php

**Root Capital**

Root Capital is a nonprofit 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. Its innovative lending model responds to a gap in the capital markets and empowers poor rural producers to compete in the international marketplace. To date, Root Capital has disbursed more than 400 loans with a gross value in excess of $80 million to 182 sustainable grassroots businesses representing over 250,000 small farmers, fishermen, and artisans in 24 developing countries. Serving remote rural businesses traditionally ignored by commercial financial institutions, Root Capital’s 99% repayment rate is a testament to the financial viability of this underserved market.

**Business model**

Root Capital manages a $17 million portfolio of loans ranging from $25,000 to $750,000 directed at the rural poor, who account for an estimated two-thirds of the more than 4 billion people living on less than $4 per day. It targets rural businesses where small-scale producers have organized themselves into cooperatives and associations to achieve the economies of scale required to side-step local intermediaries and export their products more directly. Surging consumer demand for natural products has left buyers in North America, Europe and Japan scrambling to find developing country suppliers who can fulfill their social and environmental standards and their quality and volume requirements.

Root Capital’s model is based on providing grassroots businesses with access to credit, training, and supply chains so that they can tap into global markets. When Root Capital makes a loan, the main security is future supply chain commitments — such as purchase contracts — from companies like Green Mountain Coffee Roasters, Starbucks, Whole Foods, Marks & Spencer and The Body Shop. It makes loans based on producers’ future sales rather than their existing assets, using cash flows tied to consumer demand for ethically and sustainably sourced goods, as security against the credit it provides to grassroots businesses, local processors, exporters and other supply chain actors.

**Strategy**

Root Capital’s approach redefines risk in a way that places value on ethical supply chains, which emphasize product quality and long-term relationships, not just price. It uses factoring, a form of cash flow lending, as a risk mitigation strategy for 80% of its portfolio, including both short-term and long-term loans. The remaining 20% of the portfolio consists of more traditional asset-backed loans, where equipment and/or land serve as collateral. In a factoring arrangement, Root Capital lends against signed purchase agreements between grassroots producer businesses and their buyers. The purchase agreement, in effect, becomes the collateral — a discrete, future revenue stream pledged to repay the loan. When the product is shipped, the buyer pays Root Capital directly for interest and principal payments due on the loan. Short of weather issues or other unforeseen circumstances such as a strike at port, Root Capital can be confident that a loan will be repaid.

Root Capital offers five credit products including:

**Short-term loans**

**Trade credit / export credit** (up to 12 months) is used by borrowers to purchase product from their farmer and artisan members and to cover costs during the months between purchasing raw product and
receiving payment from buyers. During this period, goods are processed, stored and shipped. Trade credit is Root Capital’s most common product, comprising 80% of its loan portfolio in 2007.

**Pre-harvest finance** (one harvest cycle; up to 18 months) supports individual farmers with loans that act as pre-harvest income. This financing enables farmers to invest in their production and cover their daily expenses (e.g., their families’ educational and health needs).

**Buyer inventory financing** (up to one year) provides funds for importers to purchase goods from grassroots suppliers and to fund their operations until they sell the goods and receive payment from their customers.

**Long-term loans**

- **Capital goods financing** (typically three to five years) pays for infrastructure that can significantly improve the quality and quantity of production.
- **Long-term working capital facilities** (three to five years) enable producer enterprises to address long-term working capital needs, such as a three-year organic conversion.

Root Capital is continually exploring new opportunities that may require specialized financial instruments. For example in 2006, it issued a seven-year pilot loan to a farmer cooperative in Nicaragua to purchase plots of land whose title will be transferred to individual members over a period of cultivation, production and repayment.

**Challenges faced**

The prime challenge in Root Capital’s arena is the lack of financial skills needed by borrowers to properly manage their enterprises and interact effectively with buyers and financial institutions.

Rural producer businesses are generally not familiar with how to report, analyze, and interpret financial information about assets, liabilities, equity, revenues, expenses, and cash flows. To address this critical need for basic business training and financial education among grassroots businesses, Root Capital launched a new initiative in early 2006 called Root Capacity.

Root Capacity complements and deepens the impact of Root Capital’s core lending activities by equipping leaders of farmer and artisan cooperatives with financial and managerial skills to build their businesses and work effectively with suppliers, clients, and commercial financial institutions. Root Capital is uniquely positioned to develop specialized curriculum, training methodology, and technical assistance for this type of financial education because it understands the needs of and has formed trusting relationships with rural businesses and their buyers. Since 2000, it has already provided a limited amount of this type of technical assistance as part of its lending program. Root Capacity offers assistance systematically and on a larger scale through a comprehensive, multi-pronged approach designed to:

- Strengthen the financial management and entrepreneurial capacity of rural grassroots businesses;
- Bolster the financial literacy of their elected leaders and individual members;
- Create awareness among local financial service providers of effective ways to serve this market; and
- Document and disseminate lessons learned.

For more information visit [http://www.rootcapital.org/](http://www.rootcapital.org/)
ANNEX 2:

THE ENTREPRENEUR VALLEY OF DEATH

Angel Risk-Return Space
Venture Capitalist Risk-Return Space

Source: Cardullo (2003)