Competitive Industries and Innovation Program (CIIP) Roundtable

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Access to Enterprise Finance
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The challenge: moving beyond early stage stagnation

- According to 2013 Enterprise Survey limited access to credit is the most significant constraint to doing business in Uganda.

- Providing funding to SMEs with some track-record and growth potential, but lacking data on which to base investment decisions:
  - Incomplete or non-existent financial records
  - Insufficient business plans
  - Understated revenues/tax avoidance
Will bank financing save the day?

- Lack of ‘bankable’ projects
- Are banks in a position to address relatively high SME failure rates?
- Will reforms credit infrastructure, such as collateral registries, property rights, credit bureaus, insolvency regimes, do enough to support early-stage financing?
- Large number of credit lines and credit guarantee schemes coupled with capacity building, but how sustainable is their impact? Do they reach early-stage enterprises?
Disappointing track-record: bank credit to the private sector (percent of GDP)
Traditional PE funds unlikely to reach SMEs

- Investments gravitate towards funding larger enterprises due to high search and monitoring costs
- Considerable disclosure and transparency required of SMEs: financial records & business plans
- SME owners required to give up equity stake and potential return upside
- Provide investors provided with high, but uncertain/delayed returns
East African PE deals 2012–2017

Uganda: 34 deals worth $40 million (equivalent to 3.5% of African volume and 1.6% of African value)

EAST AFRICA KEY FINDINGS: 2012-2017

180
Number of reported PE deals

US$2.4 bn
Value of reported PE deals

US$5 mn
Median deal size

Share of number and value of PE deals in East Africa, by country, 2012–2017
Potential alternative models

- IFC’s SME Ventures program
  - Provides funding for technical assistance to defray extra costs associated with SME-focus
  - Accepts reduced return expectations (5 to 8 %) [Significantly lower than required PE returns: multiplying equity by a factor of 2.5 over 5 years]
  - Retains PE market conformity: 2 % management fee and 20 % carried interest (GP’s share of capital appreciation) to support private participation
  - Initially specifically targeted at fragile states
Potential alternative models

- **Business Partners Ltd**
  - Active in Southern and East Africa (incl. Uganda)
  - Royalty payments (0.5% to 3% of turnover) complement low interest rate loans
  - Facilitates business development by providing space to SMEs (rent paid as part of royalty)
  - Decentralized business mentoring, entrepreneurial support services & networks
  - Proven consistently sustainable business model, although challenges replicating & reaching scale
Potential alternative models

- **GroFin**
  - Preferred instrument is a self-liquidating term loan with market-related interest rate plus percentage of business revenues
  - Terms customized to each SME (may combine equity, mezzanine and debt instruments)
  - Collateral required depends on borrower’s business prospects, expertise and track-record
  - Business model may be “too bank-like”? Has run into sustainability/incentive problems
Key characteristics of subordinated debt fund: combining debt and equity elements

- Equity in the SME remains with entrepreneur
- Steady return to investors makes it easier to attract long-term resources, initially from impact investors
- Once model demonstrated to be financially self-sustainable could be attractive to institutional investors
- Governance crucial to disassociate from quasi-public status and to leverage/build on expertise in the PE sector
Structure: mezzanine debt fund (1)

- Domiciled in Mauritius – parallel on-shore registration, if feasible
- Funding to be in UG shillings
- Fully-transparent and competitive fund manager selection
- Investment committee includes fund staff and private sector professionals
- Once a credible track record is established seek other impact investors and institutional investors
Structure: mezzanine debt fund (2)

- Target SMEs – investment size < $2 million
- Management fees and expenses to reflect size and cost of managing fund (rather than fixed 2% of committed capital)
- Known amortization schedule – ‘self-liquidating’, regular income stream provides regular income to investors
- Reinvestment of repayments – permanent capital vehicle (no fixed life as in PE funds)
- Carried interest replaced by percent of dividends paid to investors, but only after x number of years in operation; after gains exceed x% of commitments; after fund has positive net income etc.