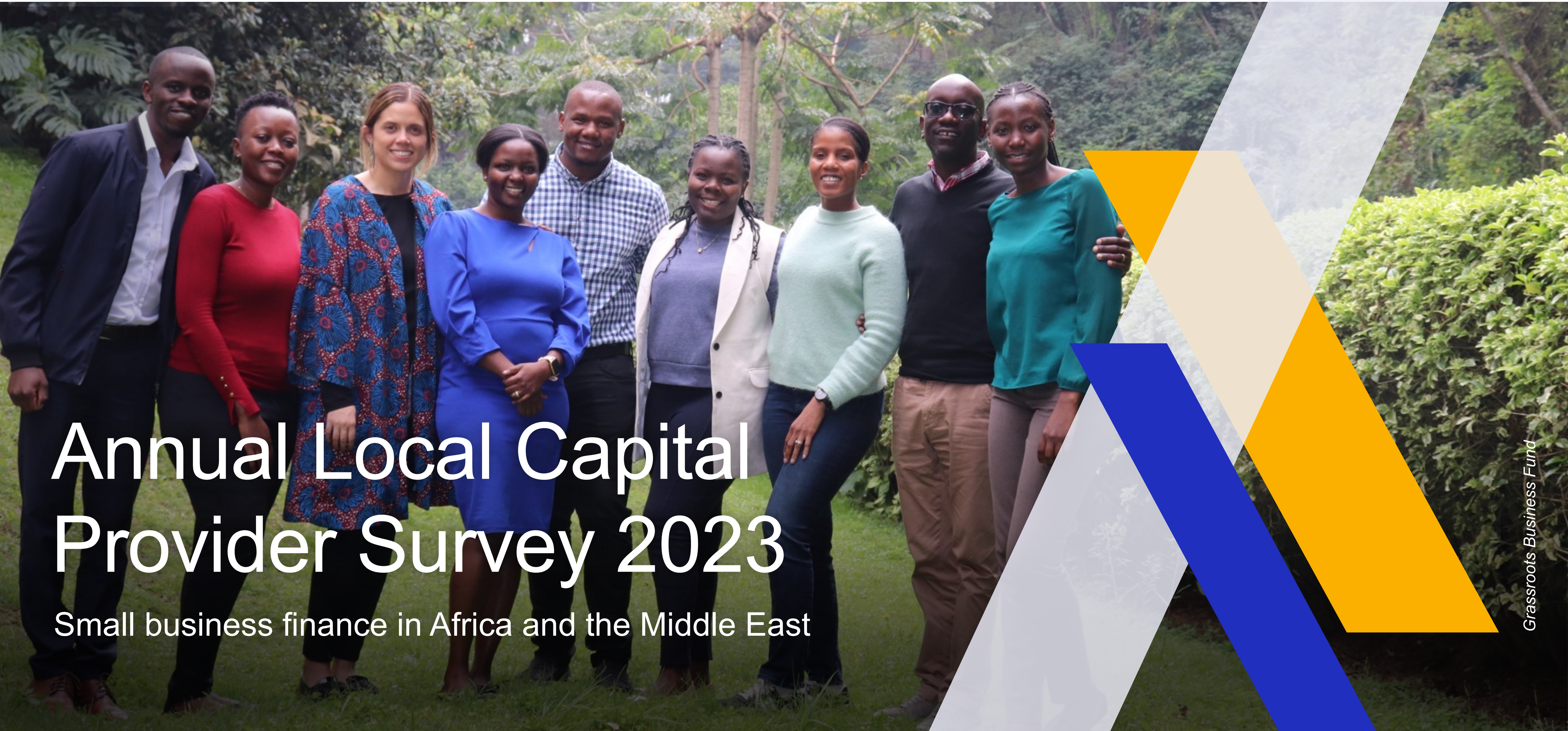
COLLABORATIVE
FOR FRONTIER FINANCE



Annual Local Capital Provider Survey 2023

Small business finance in Africa and the Middle East

Grassroots Business Fund

Foreword

Small businesses in emerging markets play a significant role in promoting inclusive growth and building resilience in the face of macroeconomic shocks. Small businesses need investment capital, yet the traditional banking systems in emerging markets have struggled to meet their financing needs.

Meanwhile, an emerging asset class of nonbank financial players have stepped in. Local capital providers (LCPs) are part of the growing private fund landscape. They are fund vehicles based in market by providing smaller ticket, growth-oriented impact capital into small businesses across Africa and the Middle East. They are often the first formal investors in these businesses.

With a few notable exceptions, the global developmental institutions and local government agencies have traditionally backed programmes that focus on regulated banks, larger-scale private equity (PE) funds and tech-oriented venture capital (VC) funds. While noteworthy, these programmes have struggled to reach small and growing businesses in these economies. As such, these critical institutions currently observe the innovations and outcomes of LCPs from the side lines.

In this 3rd annual survey, we provide a state-of-play for these LCPs. We explore the characteristics that distinguish them from existing investment models, focussing on 60 LCPs who, collectively, are looking to provide $1.5bn in capital to small businesses and, to date, have financed 1 200 enterprises.

Having observed these fund managers for the last five years, we are witnessing traction on a number of fronts. As pioneers, they have developed multifaceted approaches and investment models to reach and fund finance small businesses. As field-builders, they have contributed to this report by providing insights and shared learnings. With their innovative approaches, they can inform the broader market on how small businesses finance can be done in the toughest markets.

That said, as this report will indicate, to reach scaled impact, these LCPs themselves need support and investment capital from the development community, institutional capital holders and national small business finance programs. Hopefully, this report can begin to address the information asymmetry that has limited the flow of institutional and patient catalytic capital that is requisite in order to ensure a more resilient small enterprise ecosystem across these regions.

Regards
CFF team

Authored by

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Acknowledgements

Thank you to the local capital providers (LCPs), particularly those in the growing Early-Stage Capital Provider Network, as well as those in CFF' sister networks of 2X Global, Women in Africa Investments and I&P.
The generosity and candidness of the fund managers are major accelerants of the growth of this asset class.

Thank you to our funders, Argidius Foundation and FSD Africa Investments whose ongoing support makes this type of systematic data collection possible.

Abbreviations

AUM	assets under management
BDS	business development support
bn	billion
CFF	Collaborative for Frontier Finance
DFI	development finance institution
FMCG	fast-moving consumer goods
FoF	fund of funds
FTE	full-time equivalent
FX	foreign exchange
GLI	gender lens investing
GP	general partner
HNWI	high net worth individual
k	thousand
LCP	local capital provider
LP	limited partner
m	million
MENA	Middle East and North Africa
mezz	mezzanine
PE	private equity
SAFE	simple agreement for future equity
SDG	sustainable development goals
SGB	small and growing business
SME	small and medium-sized enterprises
TA	technical assistance
USD	United States dollar
VC	venture capital

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Introduction

Purpose of survey

- Further elucidates the distinctive attributes of the SGB finance asset class
- Tracks specific trends and growth momentum of asset class
- Provides deep insights into how small business finance needs are being met by fund managers
- Explores how fund managers are innovating to raise capital, addressing their own track record and sustainability
- Illustrates the business and impact case for these intermediaries considering the early stage of fund lifecycle
- Builds value proposition for LP investors and market builders to engage

Audience

- Commercial and concessionary LP investors: To raise awareness of innovation and investment opportunity in asset class to increase quantum of capital into LCPs.
- Fund managers: To benchmark practice against peers in order to improve effectiveness, sustainability and scalability.
- Policymakers and market builders: To encourage development of mechanisms to leverage capital and continue to evidence business case in order to build sustainable market.

Framing of SGB finance market

- SGBs are crucial contributors to local socioeconomic development and employment in Africa and the Middle East, particularly in the face of macroeconomic shocks and the climate crisis.
- SGBs are chronically under-funded as well-established financial paradigms from banks/microfinanciers/PE/VC funds cannot adequately address their risk and size to be able to offer affordable finance. There has been insufficient recent progress to suggest these financial institutions are heading in this direction.
- LCPs are shaping a new funding paradigm from the ground up. They are using a variety of fund models, investment theses and value creation approaches to not only address specific SGB financing needs, but also address funding vehicle sustainability and scale.

Methodology

Context

This is the 3rd annual CFF Local Capital Provider Survey, following on from the 2020 and 2022 editions. It tracks the progress of an emerging class of fund managers addressing SGB finance in Africa and the Middle East. It is designed to better understand how fund managers are innovating in order to address challenges in this notoriously tricky market segment. Through the years it demonstrates how the market is evolving and SGB finance asset class is taking shape.

Circulation

49-question survey shared with CFF's Early-Stage Capital Provider network, partner networks, regional industry associations and market builders, and posted publicly on social media channels.

Respondents

60 Fund managers investing ticket sizes of between $20k and $2m into SGBs in Africa and the Middle East. All fund managers answered all of the questions.

Survey design

- Organisational Background and Team
- Vehicle's Legal Construct
- Investment Thesis
- Pipeline Sourcing and Portfolio Construction
- Portfolio Value Creation and Exits
- Performance-to-Date and Current Environment/Outlook
- Future Research

Taxonomy

This market segment is emerging along with more precise terminology. Below is some guidance on the choices CFF has made in this report.

Small and growing business (SGB)

SGBs are a subsegment of SMEs whose common characteristics include commercially viable businesses with opportunity for growth, five to 250 direct employees creating new jobs, demand driven business models in real economy, and typically seeking growth capital from $20k to $2m. CFF uses the term SGB as SME definitions are too broad and often context specific.

Fund manager, general partner (GP) and local capital provider (LCP)

These terms are used interchangeably to describe the respondents in this survey. They are a group of financial intermediaries that LPs would routinely refer to as fund mangers or GPs. CFF generally prefers the term 'local capital provider' because they are based in the market they are investing, using a wide variety of fund models, investment theses and operational practices.

SGB finance asset class

SGB finance behaves differently from more established asset classes such as PE, VC and private debt. It has a unique mix of characteristics, which are continuing to be defined through this research, for the purpose of informing LP risk, return, impact, liquidity and correlative preferences. See slide x to explore emerging distinguishing characteristics. Ongoing research will track financial and impact performance of SGBs and funds.

Self liquidating and equity investment models

For the purposes of a comparative analysis between self-liquidating and equity investment models, we have categorised secured/unsecured senior debt, mezz debt, shared revenue and convertibles as self-liquidating, and common/preferred equity and SAFEs as equity.

Commercial, catalytic and concessionary funding

Commercial investment seeks market-rate financial returns and is usually provided by traditional financial institutions. Concessionary funding offers more favourable terms than market rates either in terms of risk appetite, return expectation, length of tenor or a combination of these factors. Catalytic funding aims to drive positive social or economic impact and attract additional investment – it is return seeking but willing to take more risk than commercial funding.

Pioneer fund

For this report, a pioneer fund is ≥$10m in size, set up as first fund or proof of concept to test investment thesis and build track record.

Currency

Figures are quoted in USD and depicted as $(x).

Summary

Amam Ventures. Photographer Tariq Orani

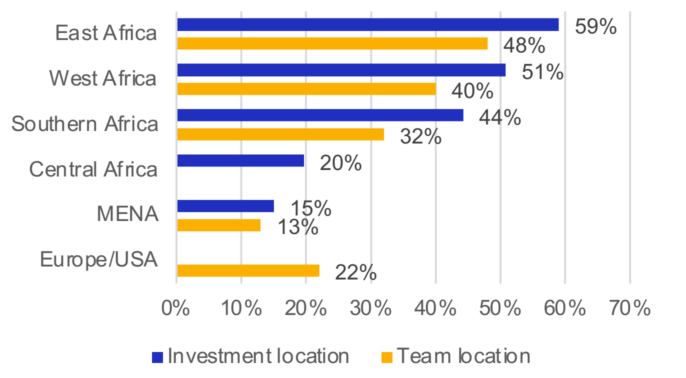
Small business finance as an emerging asset class

Despite operating in different markets with varying investment vehicles, these fund managers share many common features

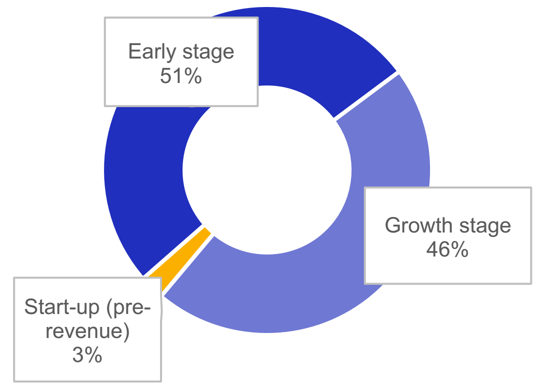
Observations

- **Finance the 'missing middle'**. Write cheques of $200k to $2m
- **SGB-oriented portfolios**. Funds tend to be sector agnostic and target small, growth-oriented enterprises that meet local market needs. While not usually VC type investments, most businesses are tech-enabled.
- **Leverage local business knowledge.** GP teams operating in market include seasoned business executives with extensive understanding of local markets, customer needs, supply chains etc.
- **Balancing fund economics and small business finance**. Emerging evidence suggests sustainability at smaller size than the traditional $30m.
- **Provide the funding *needed* by small businesses**. Working capital, as well as the 'soft' and intangible investments required for growth
- **Innovative approaches**. Cashflow-oriented, with minimal or alternative collateral-based protections.
- **Post-investment value-add**. Investment thesis calls for supporting their portfolios' business and growth requirements.
- **Impact-oriented.** Focusing on job creation and the SDGs.
- **Focus on diversity and inclusivity** among the team and their portfolio businesses, with a strong focus on gender and youth opportunities.

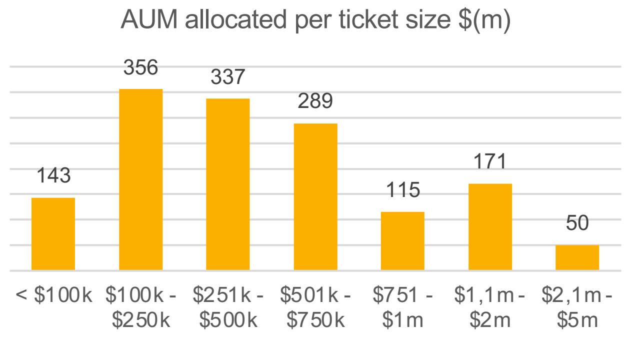
There is a trend towards localisation growing year-on-year



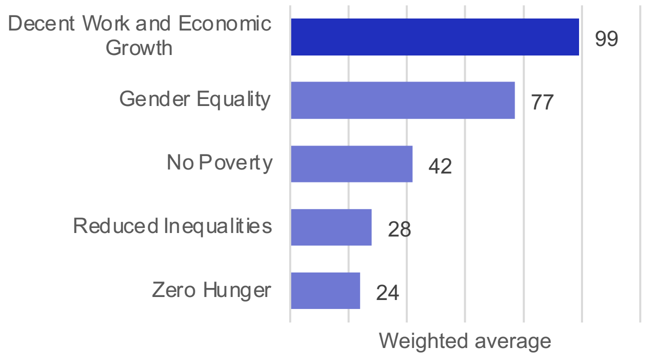
Investing in post revenue companies demonstrating growth potential



75% of fund managers report an average ticket size of <$500k. The majority of AUM overall is allocated to investments ≤$750k



Employment, inclusivity and food are most important SDGs

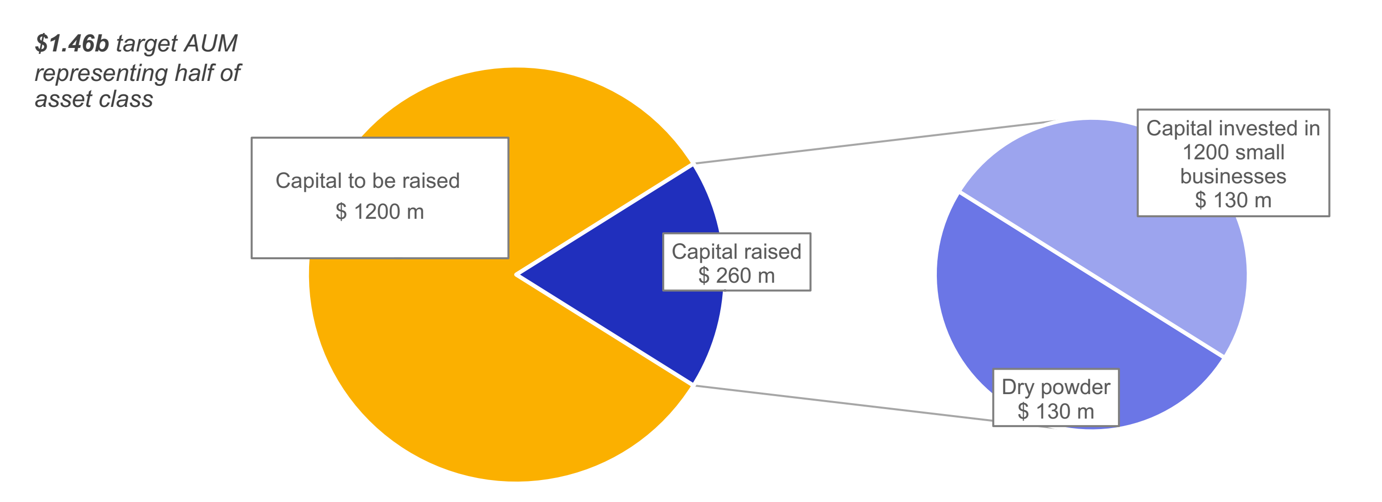


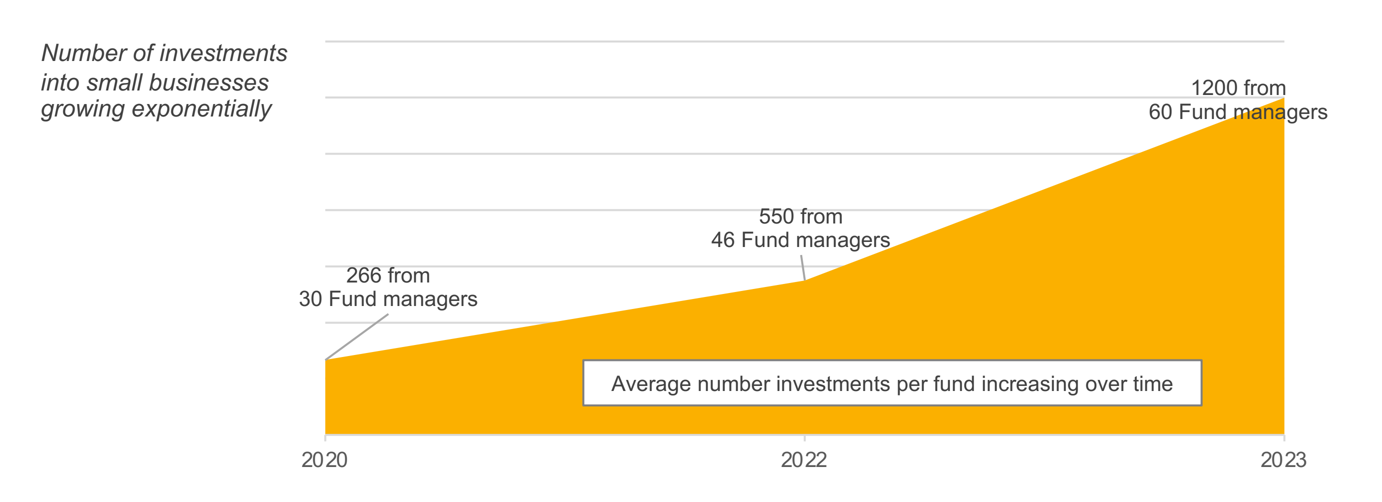
Visible traction of this growing asset class

See Section 1

Observations

- **Emerging asset class.** This emerging asset class of small business finance fund managers has continued to grow. AUM is now $260m. Nine funds have reached first close over 2022/23 vs. three in the prior year with almost half now achieving formal first close.
- **Demand exceeding inflow of LP capital**. Learning curve for LP investors continues to lag demand for capital. Fund managers have reported closing at a smaller size than intended to meet the needs of their pipeline. 40% of funds have started investing despite not having reached first close.
- **Financial and impact performance**. 1 200 small businesses have been funded. We can now track performance as 90% were financed more than a year ago and 30% have a five-year track record.
- **Scaled potential is real**. We estimate that the 60 respondents approximate half of small business-oriented funds across the SSA/MENA regions. Cumulatively this group is targeting $1.46bn in AUM – implying a potential in the near term for the sector to achieve approximately $3bn AUM.





Considerations

- Demand continues to outstrip supply of capital for Africa and Middle East's SGBs. **Yet growth is happening.**
- **Improve understanding of the sector** by institutional and development agency LP's regarding the investment case to accelerate investment
- Begin **benchmarking financial and impact performance** of portfolio companies.

Investment thesis designed to address the needs of small business

See Section 3

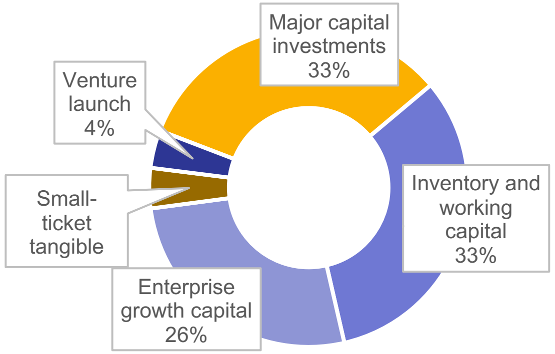
Observations

- **<u>Financing Needs</u>**. 80% of fund managers allocate growth capital for intangible investments – the type of finance small businesses find impossible to raise from banks.
- **<u>Diverse instruments and constructs.</u>** 60% of managers can use either debt or equity, flexibly managing business needs while better managing the risk/ reward balance.
- **<u>Minimise exit challenges of equity</u>**. 60% prioritise debt or self-liquidating instruments – allowing cash flows to cover capital funding needs. Self-liquidating instruments address cultural ownership preferences, allow businesses to prioritise growing their business and cash flow in the early part of financing lifecycle, providing higher degree of liquidity for the enterprises.
- **<u>Technical assistance (TA)</u>**. All funds provide or have intent to provide TA to portfolio companies. Most use a tailored as opposed to standardised approach. This is indicative of business need and is applied despite tight margins.

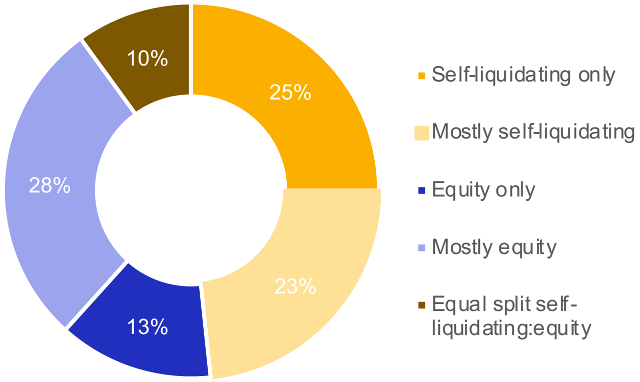
Considerations

- **<u>Fund Managers are innovating</u>** on the traditional investment and finance models – ensuring that they can provide the appropriate capital for small and growing businesses
- **<u>Segment and profile fund management models</u>** according to how they address small businesses finance.
- **<u>Provision of TA is a core offering</u>** to portfolio enterprises. Explore how best Institutional funders/donors can support manager's' ongoing capacity to provide these critical services.

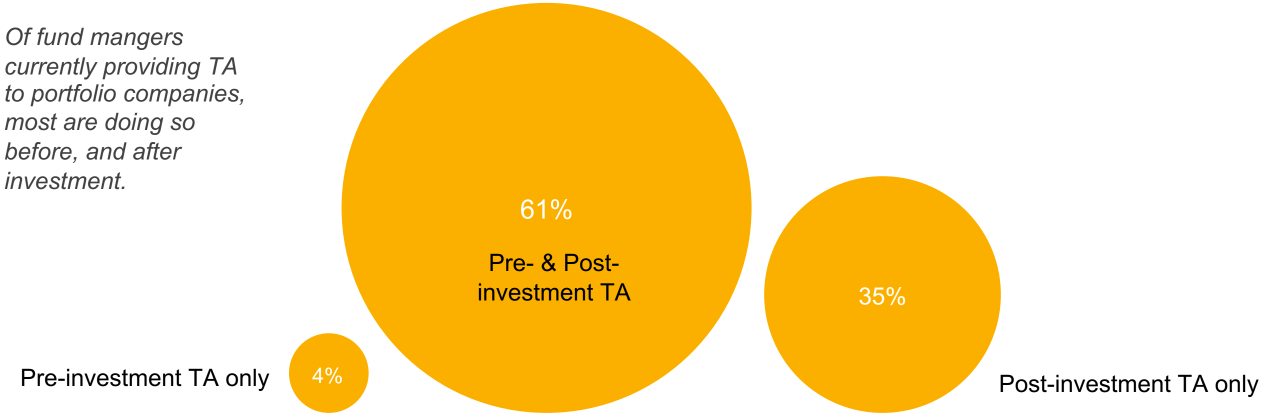
Use of proceeds mainly used to finance working capital, large asset investments and intangible growth investments



60% of fund managers are using a mix of self-liquidating and equity instruments in their portfolio



Of fund mangers currently providing TA to portfolio companies, most are doing so before, and after investment.



Driving an impact thesis of job creation, business sustainability, and inclusivity – while driving financial performance

See Section 3 and 6

Observations

- **<u>Driving employment</u>**. 80% of fund managers are targeting job growth. 100% have achieved stable or positive employment growth in their portfolio companies in last year. Almost all consider the impact of women representation in the workforce.
- **<u>Principal SDGs</u>**. All target at least three SDGs.
- **<u>Inclusiveness</u>**. Women-led funds make up 60% of this asset class compared to 12% in PE and 5% in VC globally.[1] The principals in women-led funds have 2x more direct investment experience than in men-led funds both in terms of deal execution and documented exits.

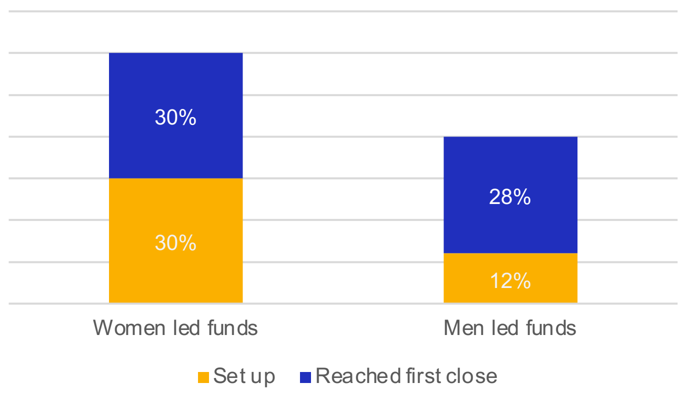
  Women bring other women into investment decision making structures. Women owned funds are 2x as likely to have majority women representation on boards and 1.5x more likely to have majority female management teams.
- **<u>Financial Performance:</u>** Although too early to determine return profiles most fund are reporting positive revenue and operating cashflow growth over the last 12 months.[2]

[1] The State Of Diversity In Global Private Markets: (McKinsey & Co, 2022)
[2] Small and growing businesses are the key to inclusive development. (von Glahn, 2023)

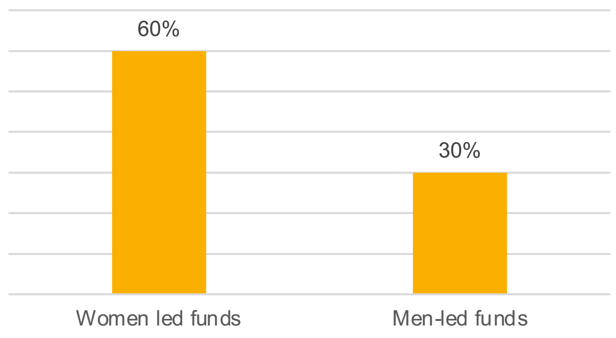
Considerations

- **<u>Develop impact methodologies</u>** that are cost efficient and timely.
- Develop appropriate methods for **<u>portfolios valuation and tracking performance</u>** of small businesses funds.
- Apply **<u>disciplined portfolio valuation</u>** methodologies.

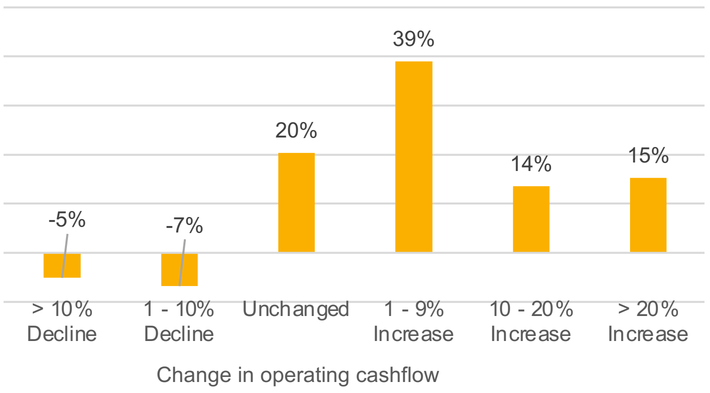
60% Funds are women-led and 100% of all funds are reporting against 2x criteria



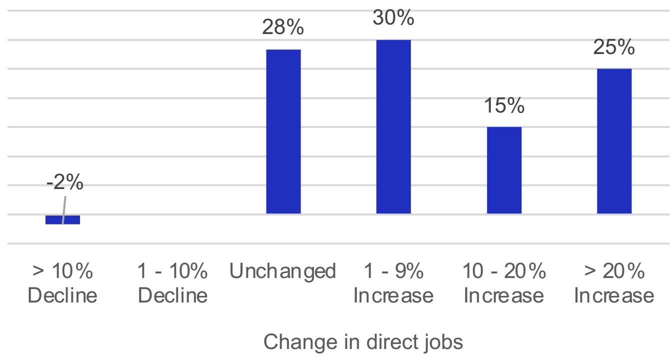
% funds with least two investment principals with well documented exits



70% fund managers are reporting positive change in operating cashflow in the last 12 months



70% fund managers are reporting positive job growth in the last 12 months despite tough macroeconomic conditions



Navigating the twin hurdles of track record due diligence norms and perceived risk of small business finance

See Section 2

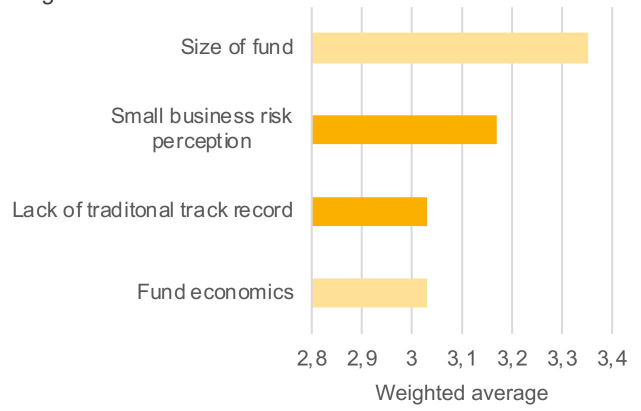
Observations

- **<u>Team track record</u>**. 90% of GPs have direct investment experience (although often as angel investor and not a fund) although only ~50% have documented exits.
- **<u>LP biases</u>**. LPs do not seem to 'value' the GPs' deep local knowledge and business experience
- **<u>Enhanced portfolio selection and value creation</u>**: 50% of funds have their own accelerators and many are integral to angel networks. This approach enhances pipeline quality and leverages market knowledge
- **<u>Demonstration effect</u>**. ~35% of funds are open ended, putting monies to work without delay; ~30% have set up pioneer funds of ≤$10m to test investment thesis; and 30% are investing before first close
- **<u>Information asymmetry of small business finance</u>.** The perceived risk associated with small businesses is considered a significant hurdle to attracting LP investments.
- **<u>Avoid unproven business models</u>**. Only 5% of funding goes towards higher risk, unproven venture type businesses.

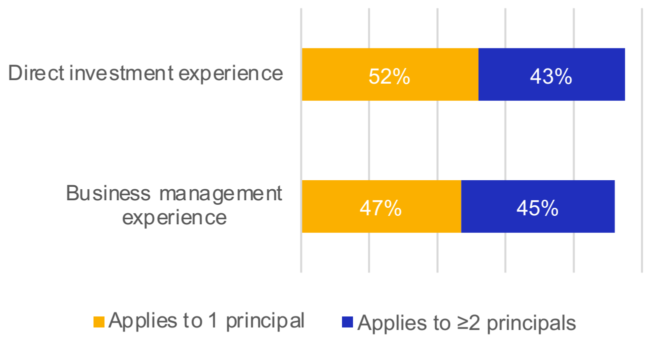
Considerations

- By any metric, this sector needs a **<u>substantial boost in engagement</u>** from development community and better alignment with national leaders
- Embed **<u>appropriate GP incentive constructs</u>** to align team interests and retain talent.
- Increase **<u>availability of warehousing capital</u>** to accelerate 'demonstration effect'.
- **<u>Distinguish the lower risk profile of this asset class</u>** compared to VC/PE investing models.

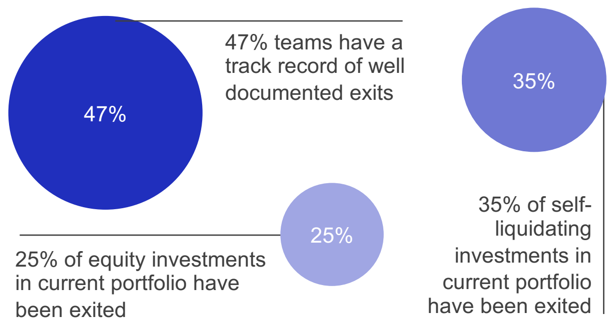
Track record and business risk some of top challenges to fund raising



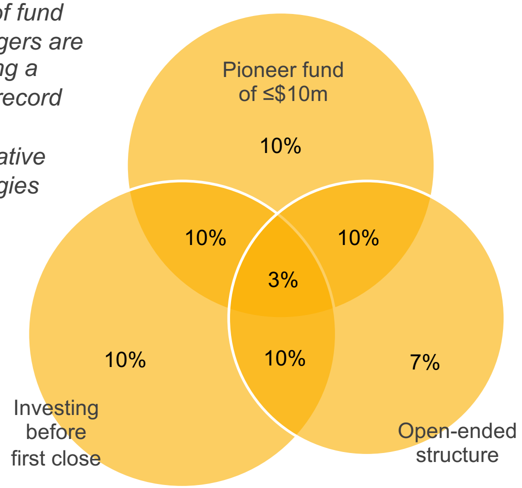
Fund managers have a relevant combination of experience to address small business risk



Historic and current portfolio exits



60% of fund managers are building a track record using alternative strategies



Heading towards making fund economics work …

See Section 1 and 4

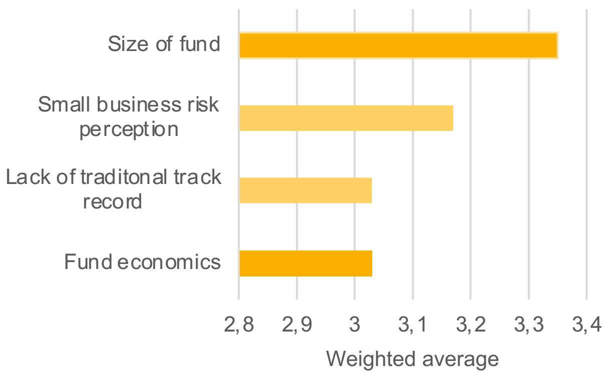
Observations

- **Alternative fee models**. ~ 60% funds use alternative fee structures. ~30% access concessionary funding to set up and cover part of running costs.
- **Managing smaller funds**. 60% of the funds are <$30m, requiring alternative approach to the traditional 2&20 fee model.
- **Open-ended fund models**. ~ 30% launch with open-ended constructs, allowing them to earn fees immediately.
- **Self-liquidating & debt instruments**. 85% of fund managers use at least some self-liquidating investment constructs, allowing for generation of cash flows throughout the investment period vs. waiting for exits. 60% of AUM is invested in self-liquidating instruments.
- **'Value' of market knowledge**. 90% of funds are comprised of highly experienced executives allowing for smaller teams and lower staffing costs.
- **Efficient pipeline development**. 50% have their own accelerator programme or other efficient models of assessing pipeline opportunities – lowering due diligence time and costs.

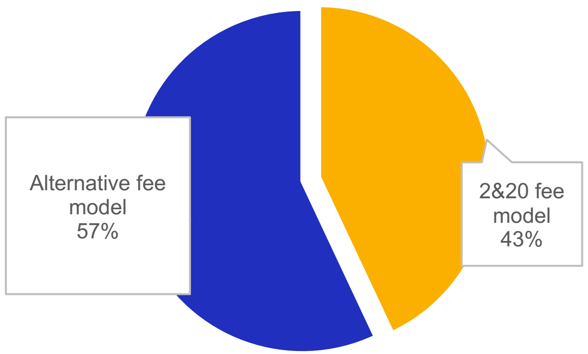
Considerations

- **Shared services** would allow GPs to lower operating costs.
- Sector would benefit from **use of 'smart subsidies'** to support fund managers in early stages of fund lifecycle.
- As ecosystem builders, **DFIs may need to consider greater flexibility** regarding management fees given the economic impact of a resilient small business financing sector.

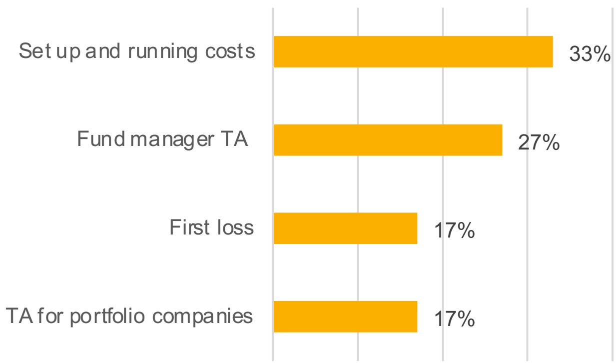
Perception of fund size & related economics are key constraints to fund raising



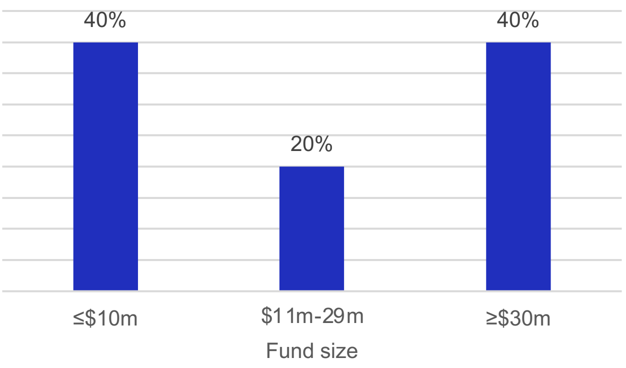
Many LPs appear willing to pay only the 'traditional' fund management fees.



60% of fund managers are accessing concessionary capital in one or other form



Emerging evidence to suggest sustainability at fund sizes <$30m



Where are the those that espouse private sector development?

See Section 4

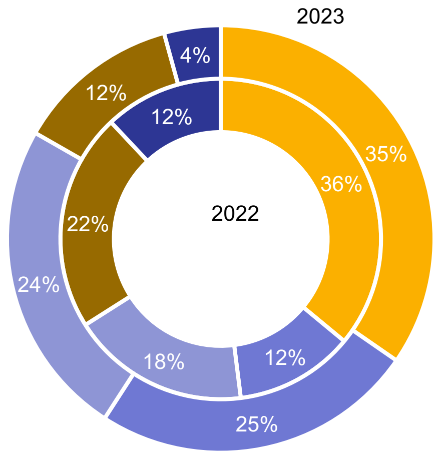
Observations

- **<u>Critical role of local HNWIs</u>**. For the last two years, fund managers have been highly dependent upon the funding support of local HNWIs/family offices.
- **<u>Material support of local institutional investors</u>**. 2023 saw a doubling in the percentage that have tapped these investors.
- **<u>Non-relevance of DFIs</u>**. Despite the development role that such funds play, DFIs have not been compelled to directly support this sector.
- **<u>Shift from donors to market-oriented Investor</u>**. As noted in this report, while concessionary funding can play an important role in launching these funds, managers are increasingly relying on more commercial type capital.
- **<u>Increasing role of fund-of-fund LPs</u>**. FoF are taking on a bigger role.

Considerations

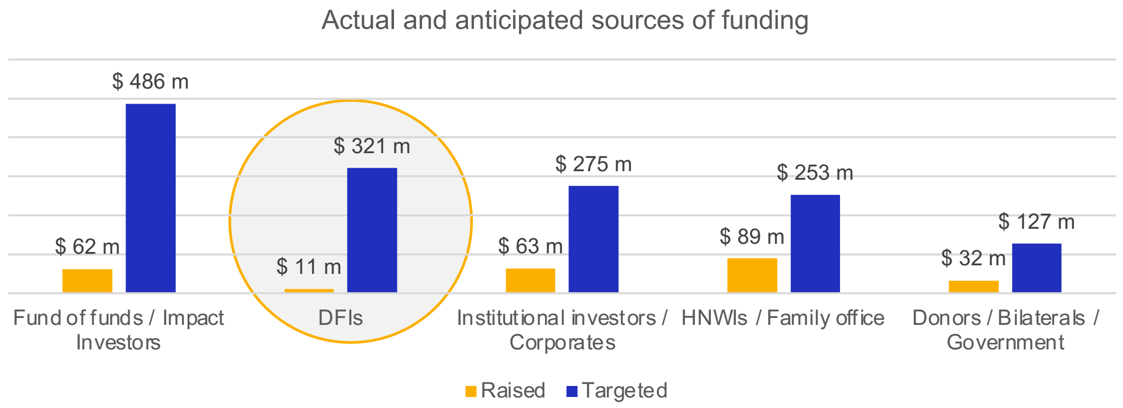
- DFIs played a critical role in the establishment of the microfinance sector. Similarly, **<u>DFIs should play catalytic role</u>** for this emerging asset class.
- Importantly, **<u>local institutional capital</u>** could provide local currency and longer-term funding (e.g., pension funds, asset managers and sovereign wealth funds).
- **<u>FoF vehicles</u>** offer DFIs/institutional investors opportunity to commit larger sums while diversifying across a spectrum of local funds.

Shift in existing sources of LP capital over the last two years



Catalytic role of HNWI/family offices as they have been able to perceive the value proposition of this emerging asset class, nimbly seizing the opportunity to kickstart the sector.

DFIs report large increases in funds invested in 2023. However, with regards to small business finance, they are not prioritising the role of local capital managers.



Concessionary capital key to unlocking an emerging asset class

See Section 5 and 6

Observations

The 'smart' use of concessionary capital is critical in the creation of new industries and asset classes. Principal application of concessionary funding has assisted these funds to launch and support initial operating capacity.

- **Set-up costs**. ~30% have received funding for set-up and initial operating overhead costs.
- **Fund TA Support**. A similar percentage have accessed funding for their own TA needs.

Other uses include:

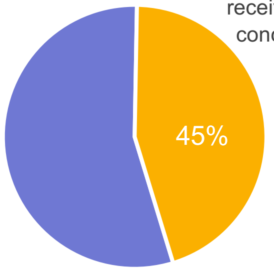
- **Portfolio company TA**. Fund managers provide critical post-investment support to accelerate the growth of their portfolio enterprises. 25% of the funds have received concessionary funding to cover this TA need.
- **Risk mitigation**. The ~20% of managers who have raised first loss have raised ~20% of targeted fund size, which is marginally more than the average of 17%.

Considerations

- **"Smart Subsidies"**. Development funders have overly focused on LP risk mitigation in financial intermediary sector, which, while relevant, is not the exclusive 'smart' use of subsidies and subsidised capital.
- Recognise the need for **'catalytic and patient capital"** to build this ecosystem and asset class by developing a 'suite of subsidies' to meet the different needs and stages of funds.
- **Capture and disseminate learning** from capital facilities and FoFs that support early-stage funds and emerging managers to accelerate pipeline development.

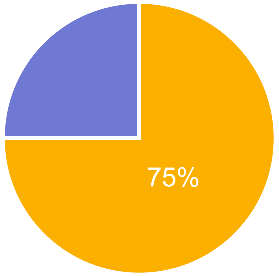
Structured systematic concessionary funding support can be used to accelerate capital raising in early stage of market building

32% of funds have received **single type** of concessionary funding



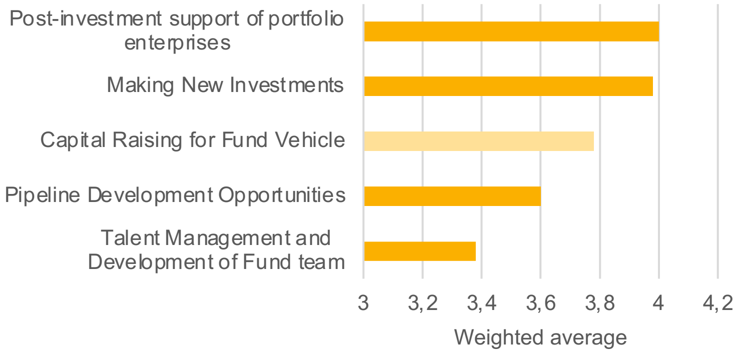
45% have reached first close

28% of funds have received **multiple types** of concessionary funding

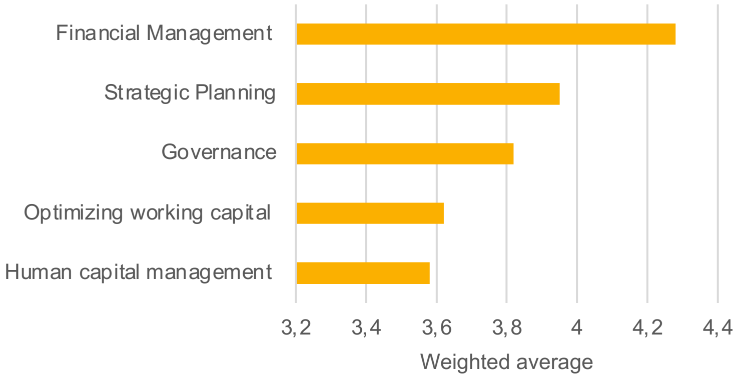


75% have reached first close

Fund team priorities in next 12 months – grant funding supports TA, capital raising and team retention



~40% of TA for portfolio companies is covered by donor funding supporting mainly finance, strategy and governance



Investors and ecosystem builders need to take a stewardship role in building the small business finance market

See Section 5

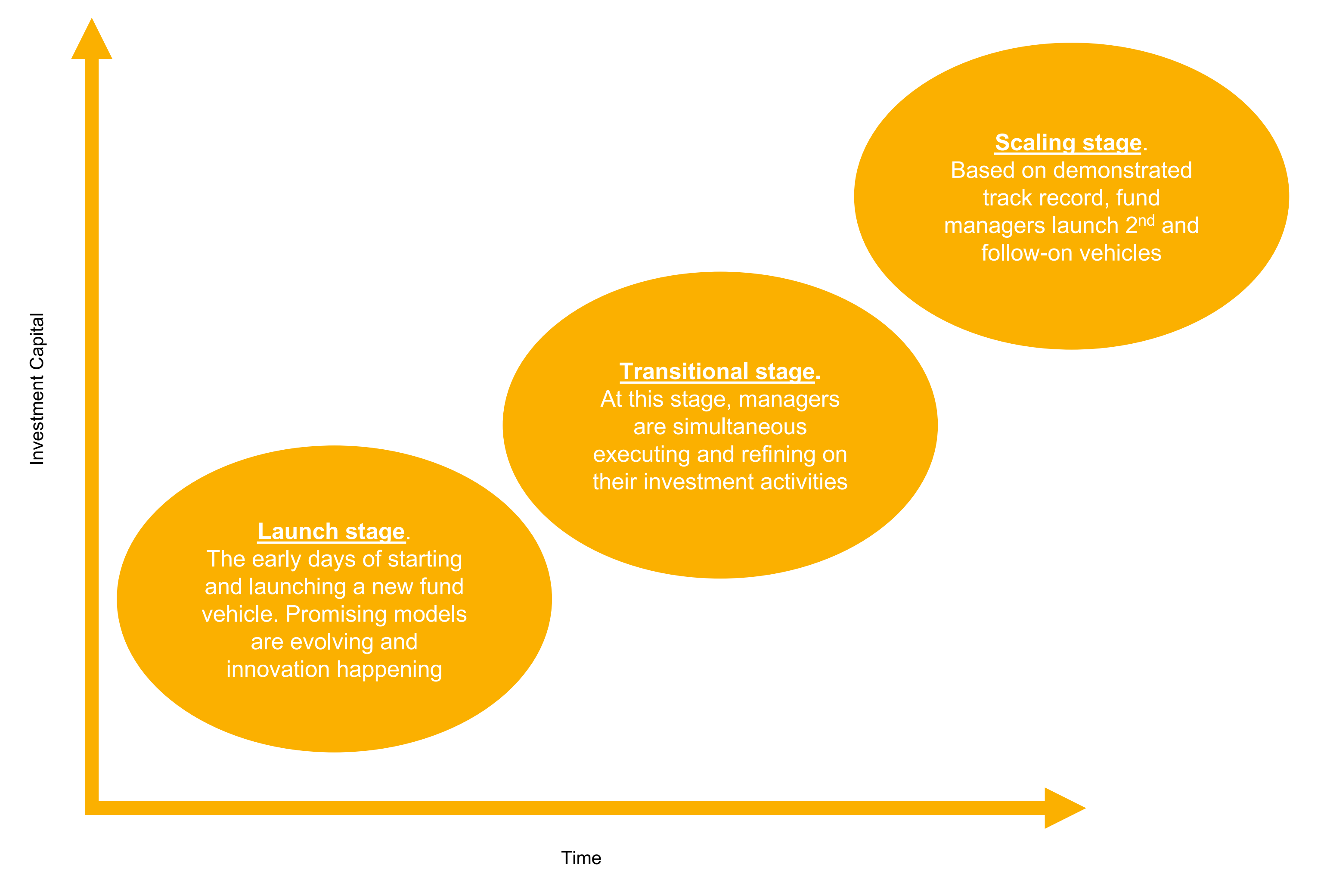
Observations

Three stages in fund development requiring different types of subsidised capital support.

- **Launch stage**. Promising models are evolving and innovation happening . However, this '*R&D*' phase requires ecosystem building capital that is the domain of bilaterals, local development agencies, donors and DFIs (out of TA or subsidised divestment pots).
- **Transitional stage.** Require disciplined capital to provide the monies, confidence and time to play out their investment thesis and capabilities. Fund managers benefit from 'anchor capital' commitments from ecosystem builders that leverage other LPs. Stakeholders include transitional FoF, impact investors and DFIs, local institutional, sovereign agencies, HNWIs and family offices.
- **Scaling stage**. Having demonstrated their investment thesis and capabilities, fund managers move onto achieving scale (e.g., follow-on funds and/or follow-on capital)– while attracting mainstream institutional LPs. At this stage, concessionary monies are highly beneficial to assist in developing impact metric methodologies, post-investment TA.

Considerations

- **Strategically allocate catalytic capital** to each stage of the development and scaling of this asset class



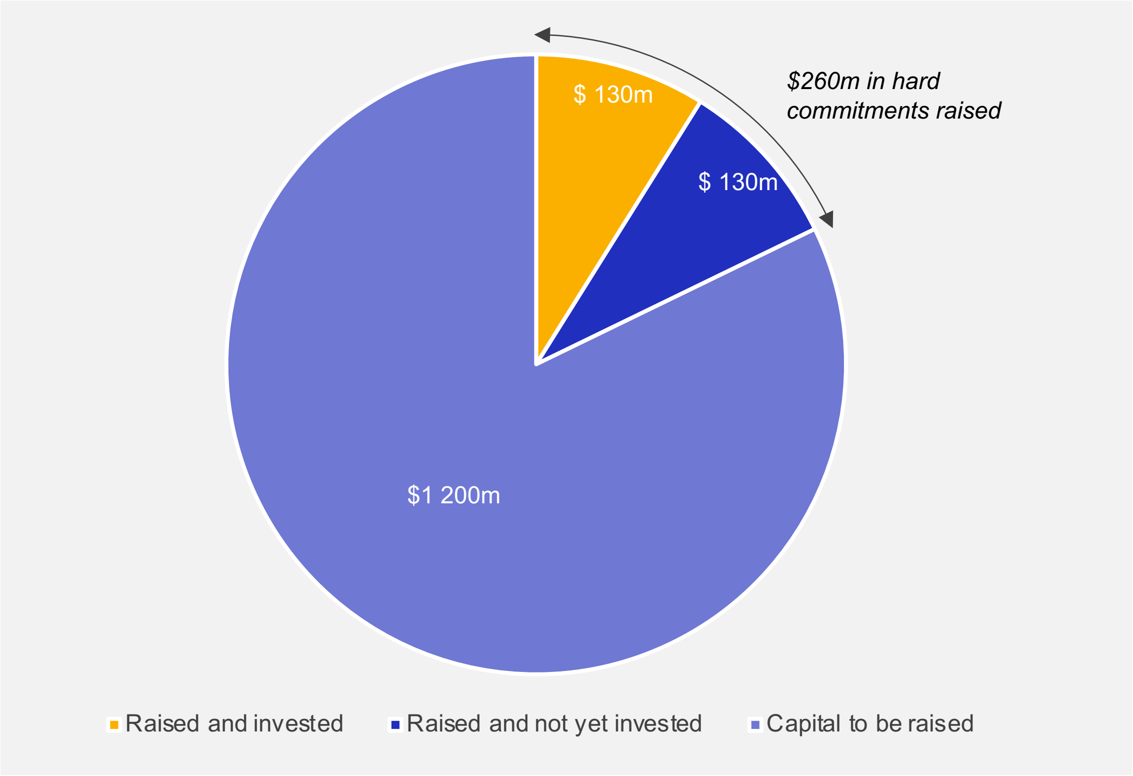
Sections

1. Vehicle construct
2. Team and track record
3. Investment thesis and process
4. Capital raising
5. Value creation
6. Performance and outlook

Kenya Climate Ventures

1 Vehicle construct

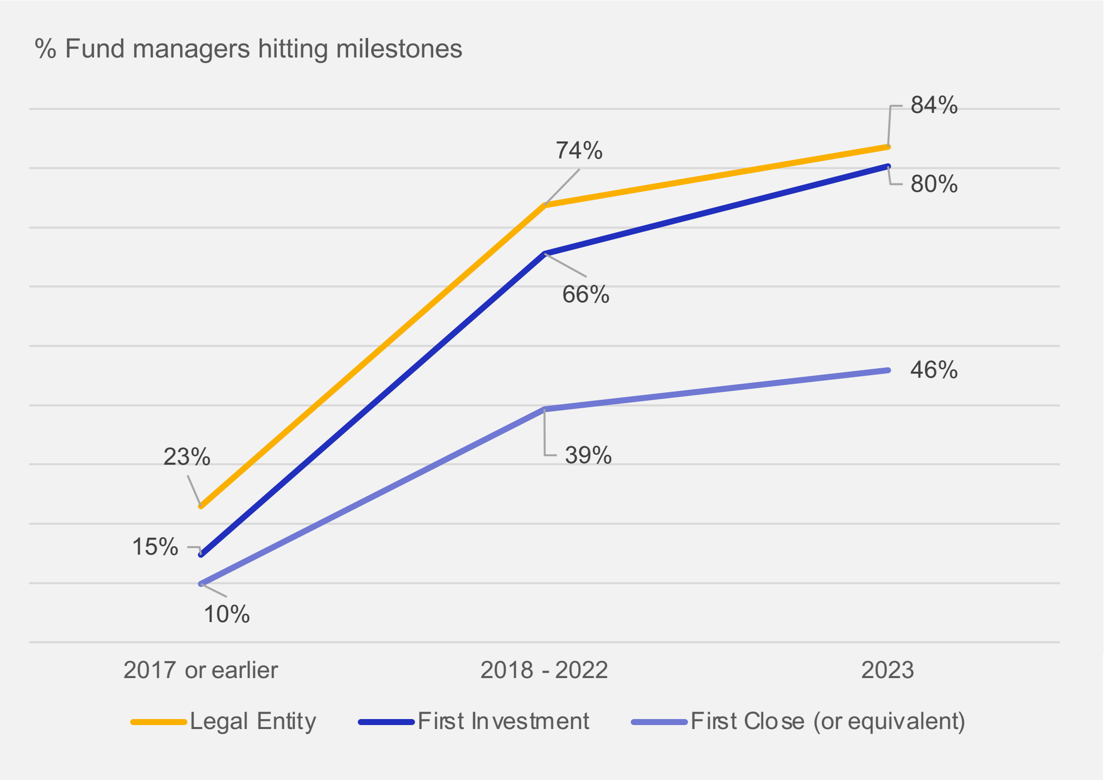
Fund managers targeting a capital raise of $1.4bn



- The actual and prospective size of asset class is demonstrably increasing year on year. Fund managers have raised ~20% of the $1.46 bn they are targeting over the next 2 years.
- Total fund raising in private capital markets across Africa was $2bn down from $4.4bn in 2021 due to macroeconomic shocks.[3]
- 2022 survey showed target capital raise range between $900k–$1.5bn with 15 fewer survey respondents.

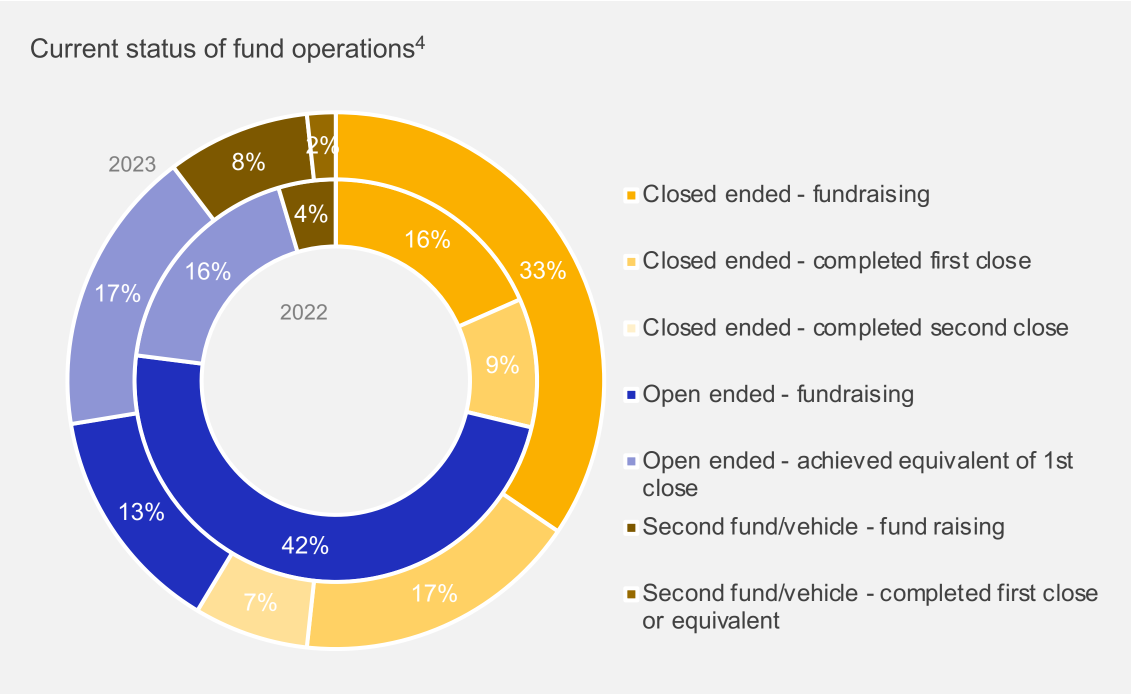
[3] *2022 African Private Capital Activity Report (AVCA, 2023)*

The trajectory of funds reaching first close has slowed



- Fund managers are having to demonstrate track record in order to raise capital to reach first close.
- 80% Funds managers investing despite only ~45% having reached first close or equivalent thereof.
- Of the funds that set up in 2017 or earlier, ~85% have achieved first close.
- ~65% have made investments that are more than a year old.

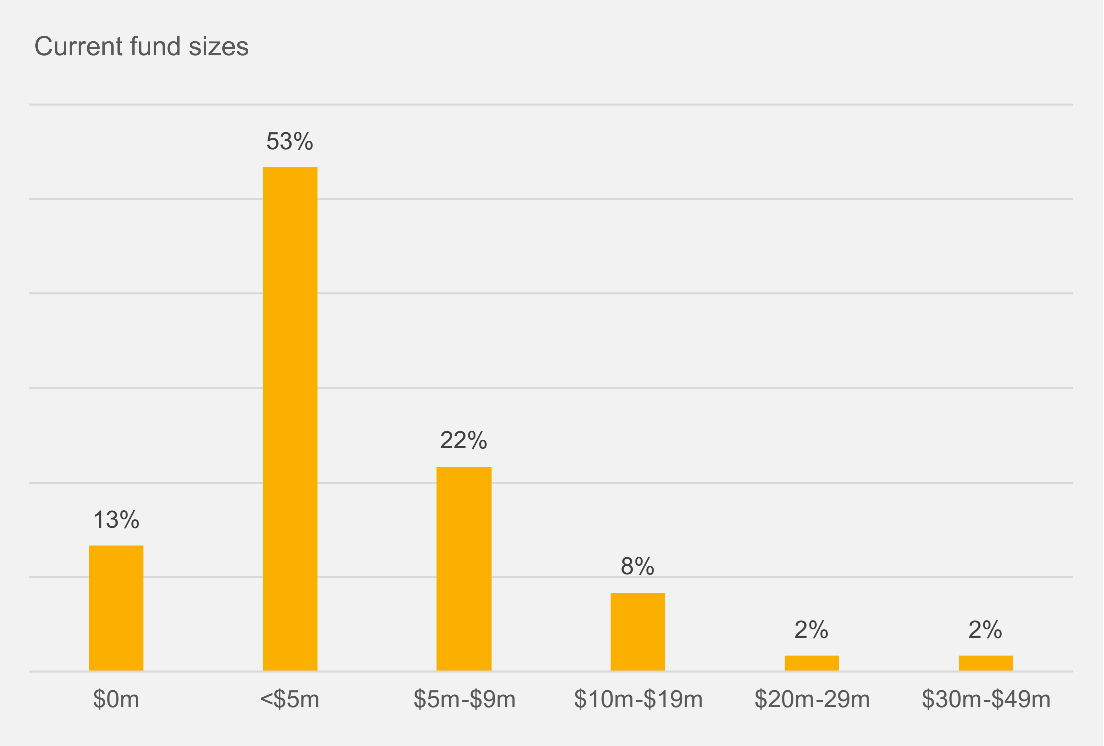
There is a shift to close-ended funds



- ~60% of funds are closed ended.
- The increase in close-ended funds can be explained through enlarged sample and speculatively, by fund managers responding to LP preferences for closed-ended vanilla structures.[5]
- ~45% of funds have reached first close, a marginal increase from 2022.

[4] The number of second funds in this question does not accord with earlier statements because not all funds have submitted data on second fund.
[5] The additional 15 survey respondents are closed-ended funds and four funds reported as open-ended in 2022 survey are reported as closed-ended this year.

Small funds are reaching first close quicker

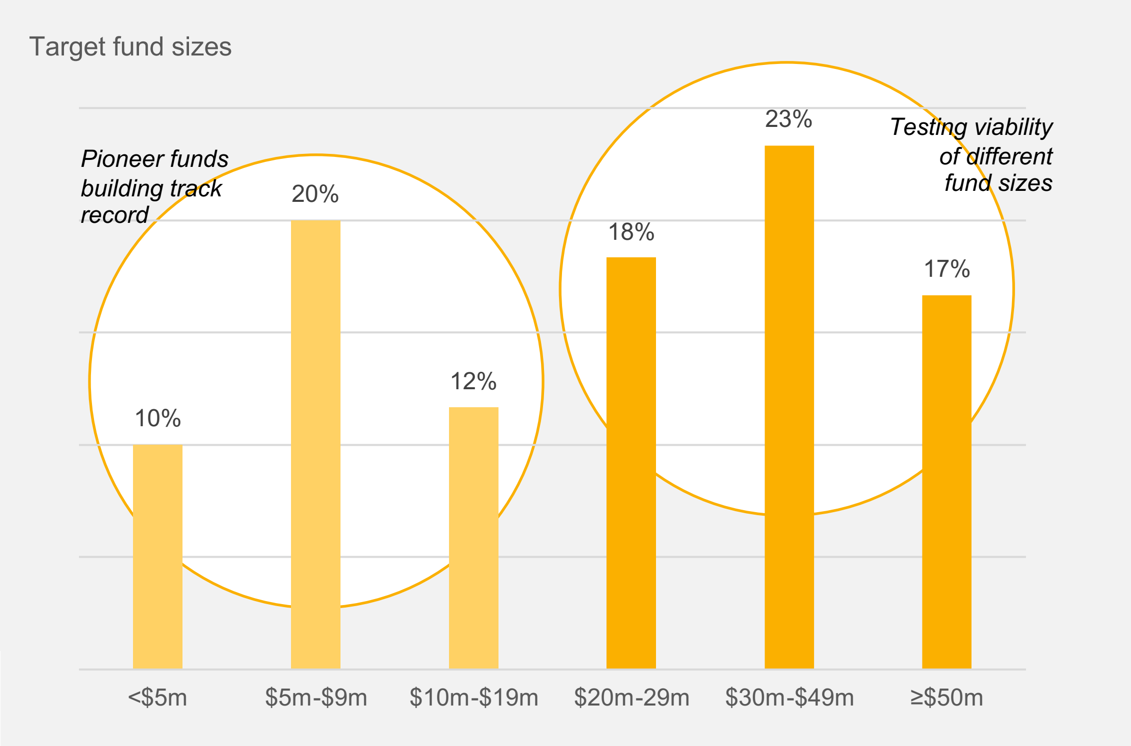


Those targeting small fund sizes are more likely to have made first close. [6]

- Those targeting fund size of ≥$20m have raised ~15% of capital in aggregate. 30% of these funds have made first close.
- Those targeting fund size of <$20m have raised ~50% of capital in aggregate. 65% of these funds have made first close.

[6] *We do not know the size of first close from this data.*

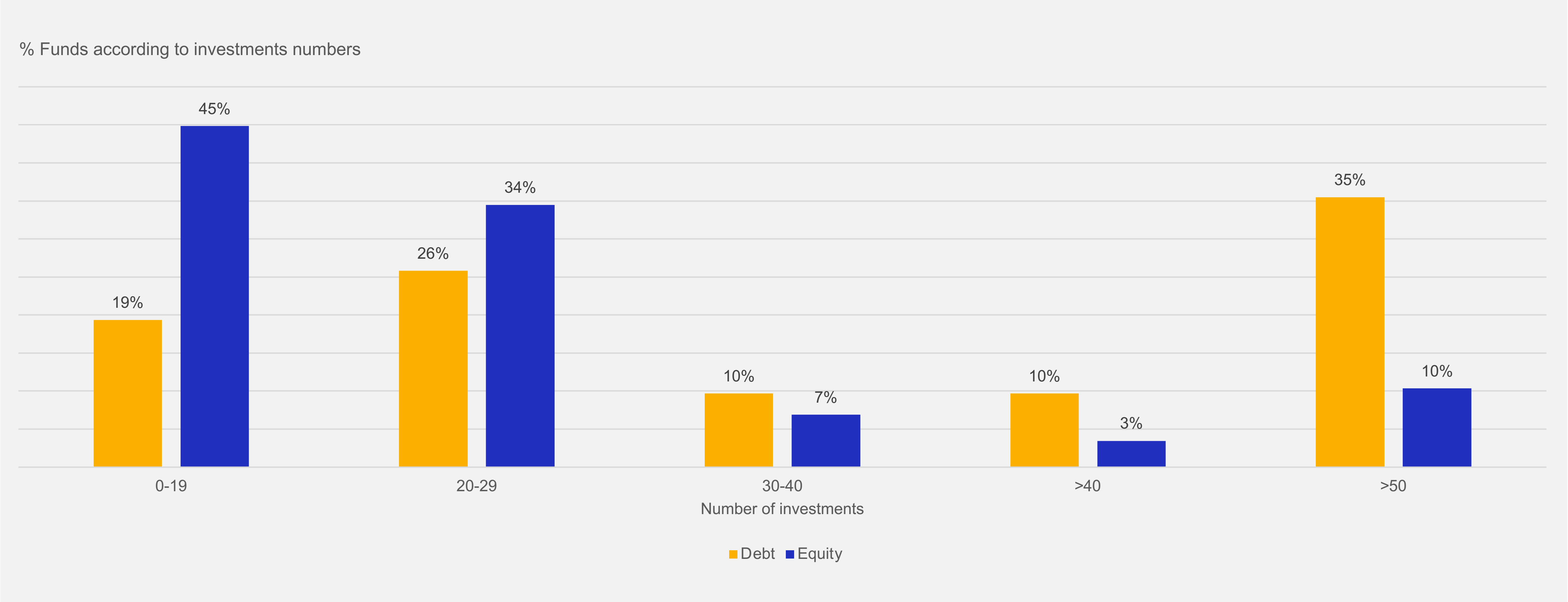
At least 40% of funds deliberately targeting what has traditionally thought of as unsustainably sized funds



- ~60% Funds targeting fund size of $20m or more. This trend has remained stable from 2022.[7] Those targeting smaller sizes are often doing so as pioneer funds building track record.

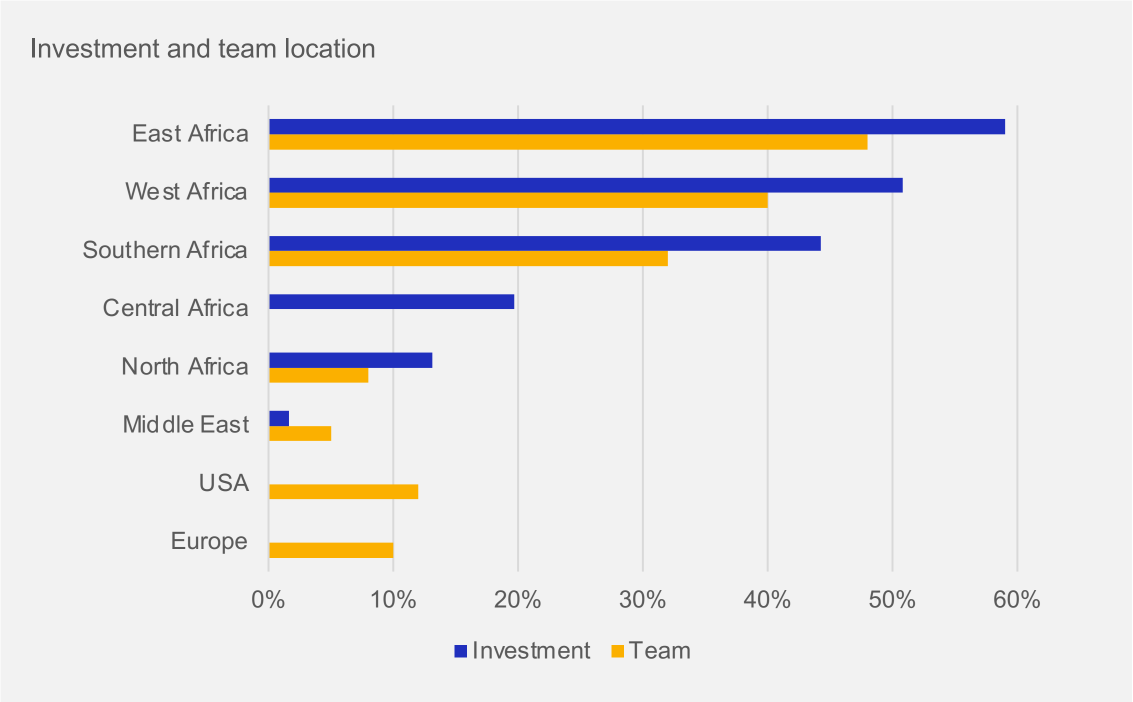
[7] *$30m is often cited by LPs as minimum viable size although fund managers and FoF are reporting viable fund sizes at $20m considering local cost structures.*

Equity funds tend to have fewer investments as expected



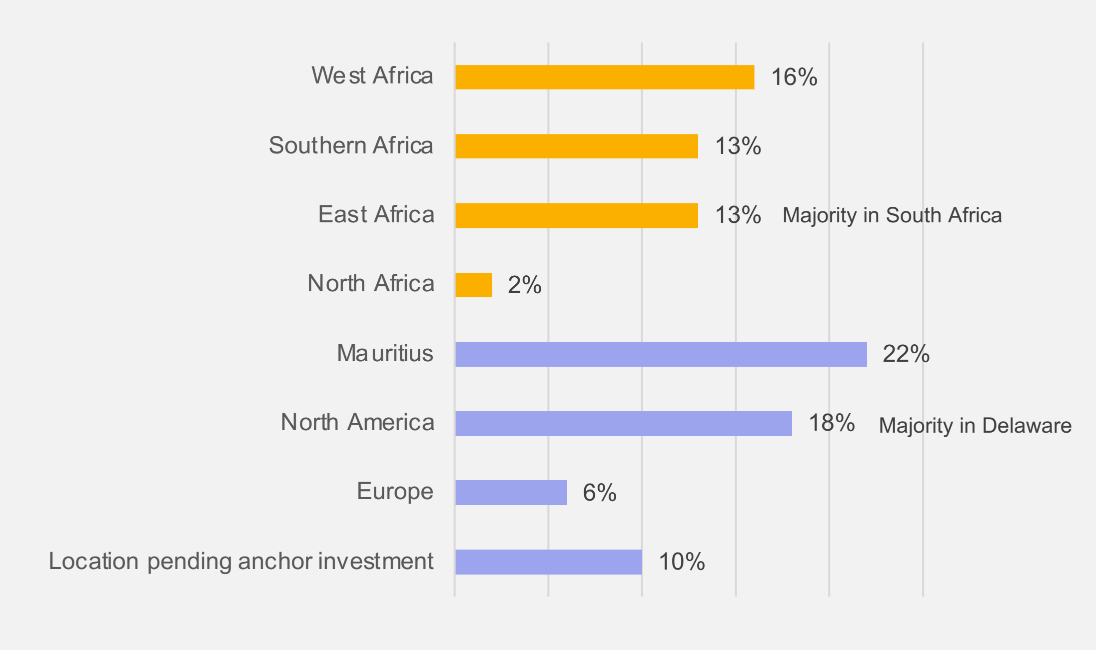
- Equity funds tend to make smaller number of deals although a few fund managers have high volume strategies.
- ⅓ self-liquidating investment models are using more standardised approaches to lending and thus able to do higher volume, some making hundreds of deals.

There is a trend towards localisation growing year on year



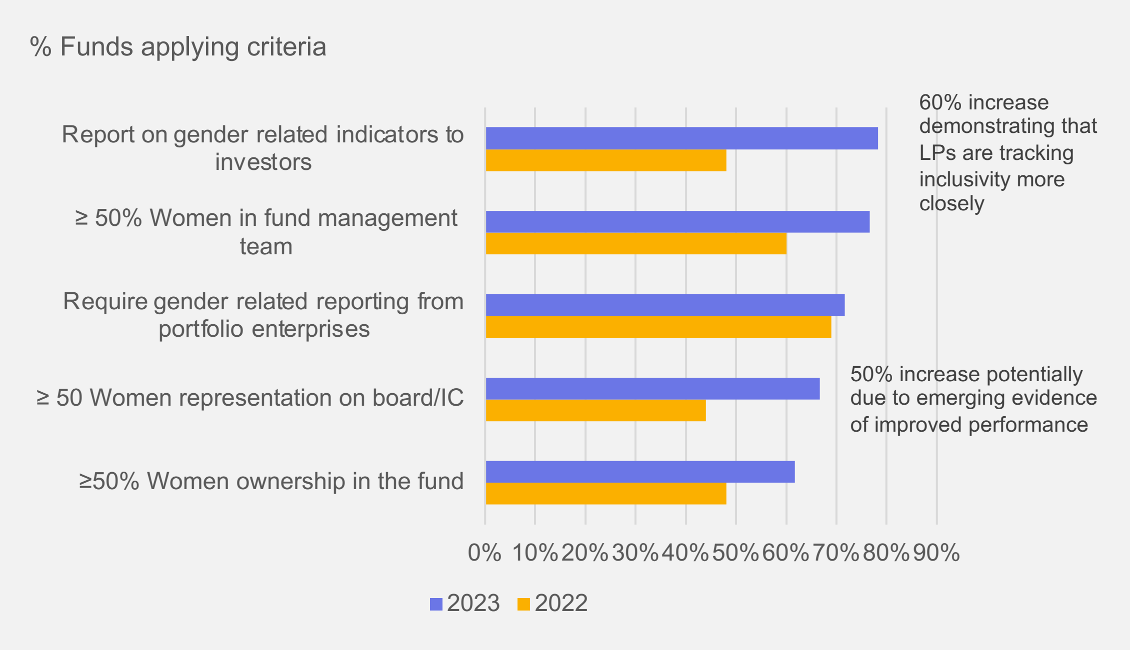
- 35% of funds are investing in at least two African regions, although only 15% of funds are based across multiple regions.
- Of the ~15% funds that are pan-African, half are tech focused or VC funds.
- Every fund, bar one, has a team based in Africa even if they are headquartered in Europe or USA.
- The percentage of teams based in global north is decreasing over time with a 50% decrease between 2022 and 2023.

Fund are domiciled in jurisdictions that LPs prefer be they international or local



- Half of funds are domiciled in jurisdictions that international institutional LPs prefer. The remaining funds are largely domiciled in the country in which they are located.
- 7 out of 8 funds that have domiciled 2022/23 have done so in internationally preferred jurisdictions.
- 90% of internationally domiciled funds are raising foreign currency. 100% of locally domiciled funds are raising local currency with ¼ of those targeting foreign currency as well.
- ~10% Fund managers are domiciled in two places. This includes their country of origin and recognised offshore domicile.

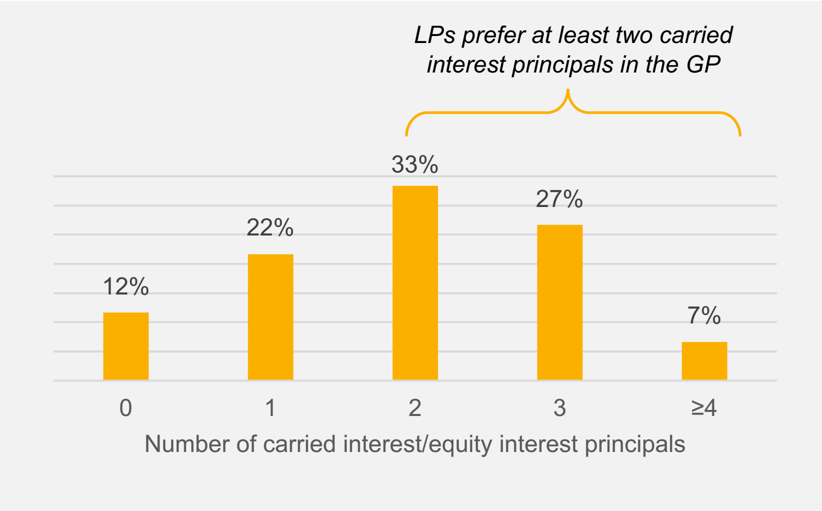
Women bring women into investment decision making structures



- Intentional inclusive gender representation continues to grow. Women make up ~60% of partners in this market segment compared to 12% in PE and 5% in VC globally.
- Women-owned funds are 2x as likely to have majority women representation on boards and 1.5x more likely to have majority female management teams. On reporting female and male led teams are about the same.

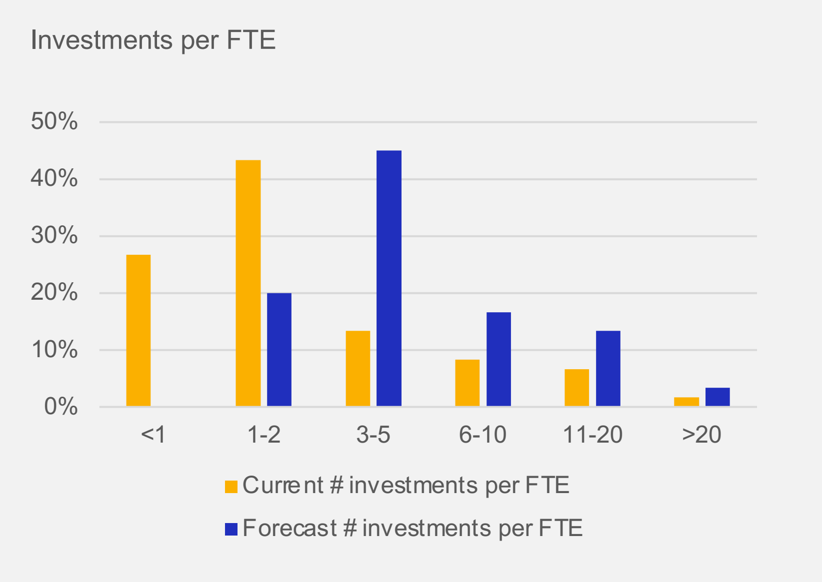
Funds recognise need for shared ownership at senior level despite pressure that puts on the bottom line

- Most solo GPs report that they are looking for suitable partners. Solo GPs are split almost evenly between women- and men-owned funds.
- Most of the funds without carried interest principals are open-ended debt funds.

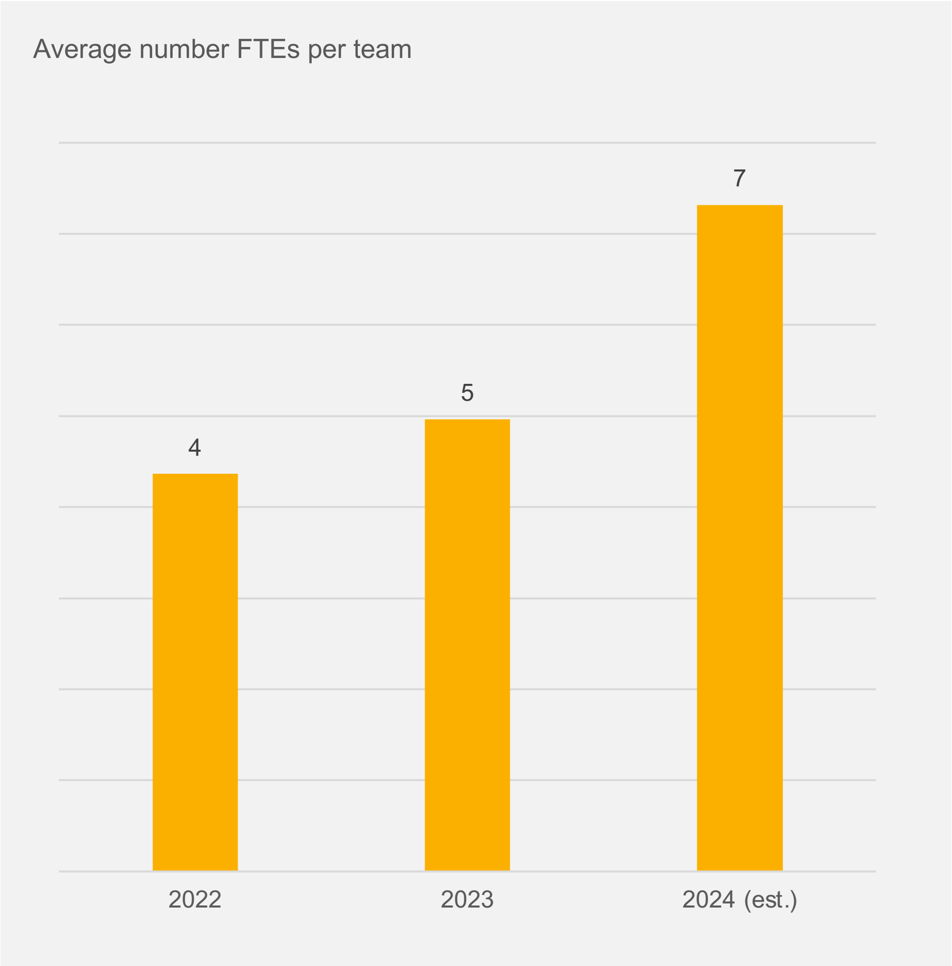


Funds are moving towards market norms with regards to team size

- Equity investment models forecast ~5 investments per full time equivalent (FTE) on average. This accords with the PE model of fund management.
- Self-liquidating investment models forecast ~7 investments per FTE on average. This is slightly lower than what might ordinarily be expected of debt funds but is perhaps an indication of complexity of financing smaller businesses and/or applying mixed funding types.



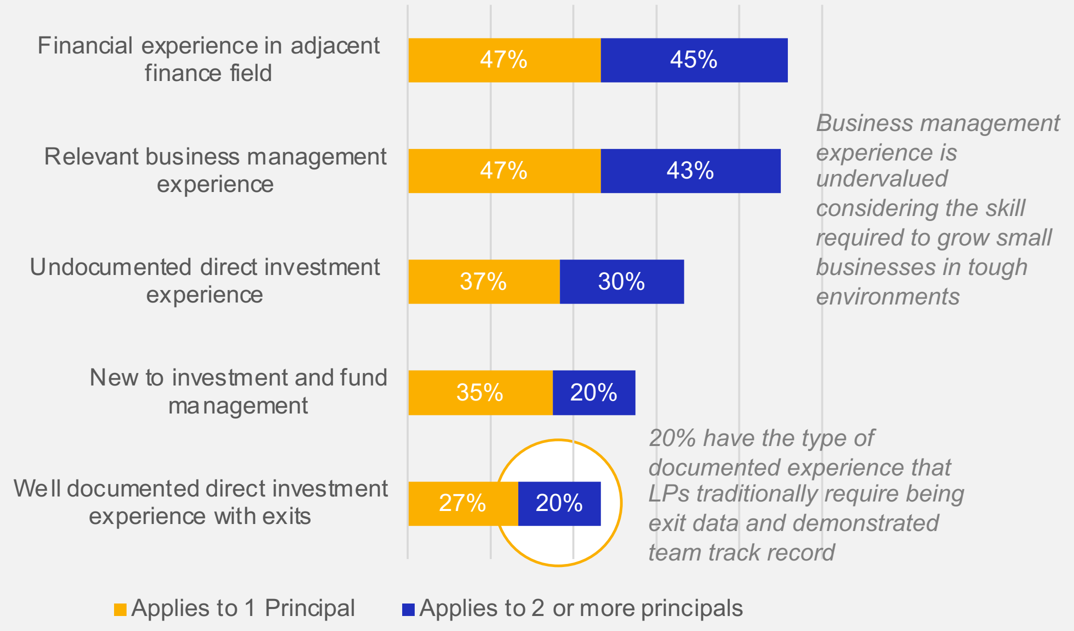
Growing teams are indicative of growing AUM



- Team size growing year on year indicative of support required for deployment as well as capital raising

Most emerging managers have direct investment experience

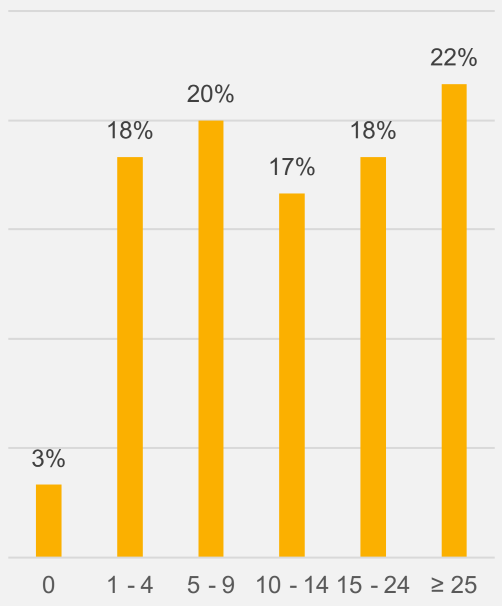
% Funds with work experience within GP leadership team



- 97% of GP leadership teams have at least one principals with some type of direct investment experience. This may not equate with what LPs consider traditional fund experience in traditional funds having exit data
- 90% of GP leadership teams have business management experience.

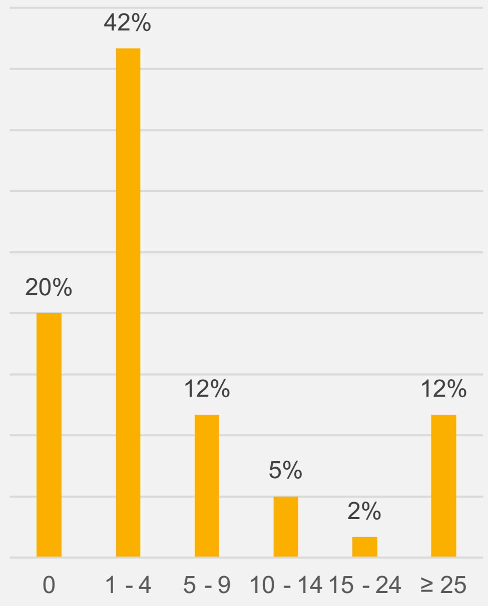
Funds managers have direct investment experience with exits lagging

Number of investments completed by principals prior to current fund



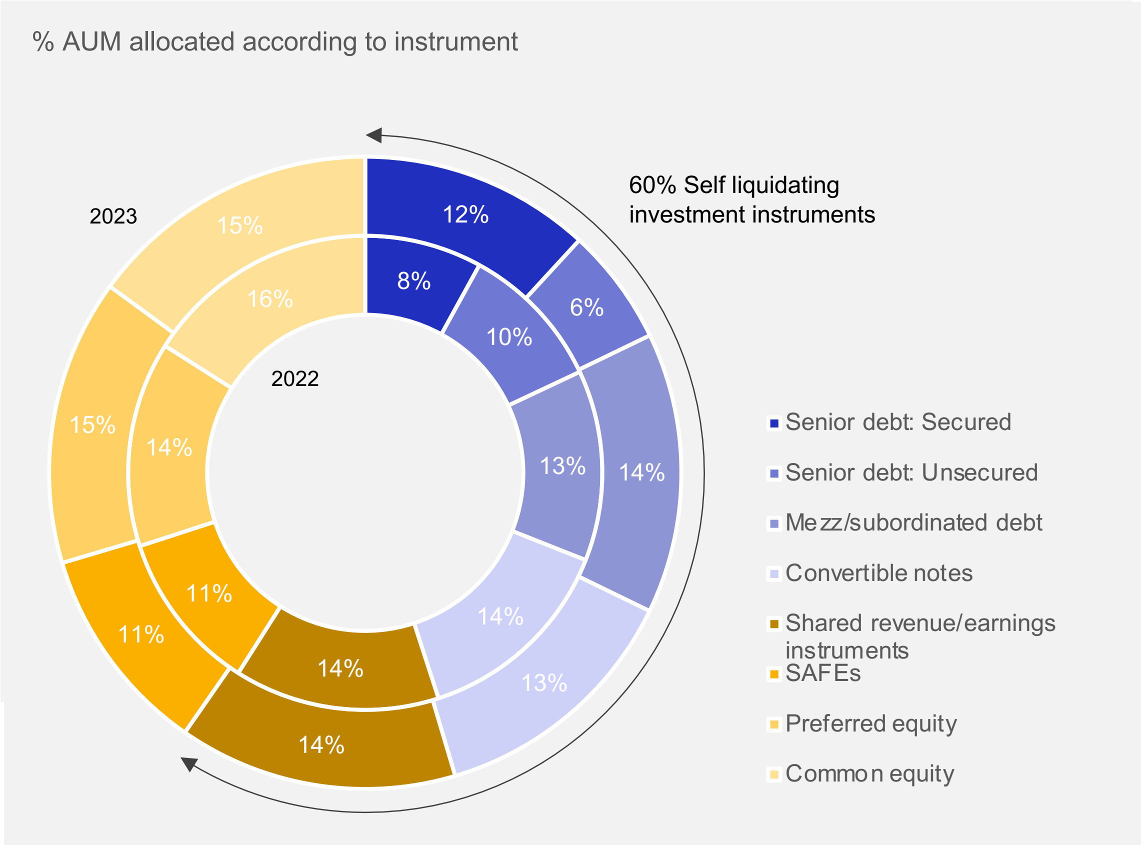
- Fund managers can demonstrate that they can deploy capital. 80% have done in excess of 4 investments

Number of exits/monetisations completed by principals prior to current fund



- 80% of principals report some type of exit, whether it is well documented or not.

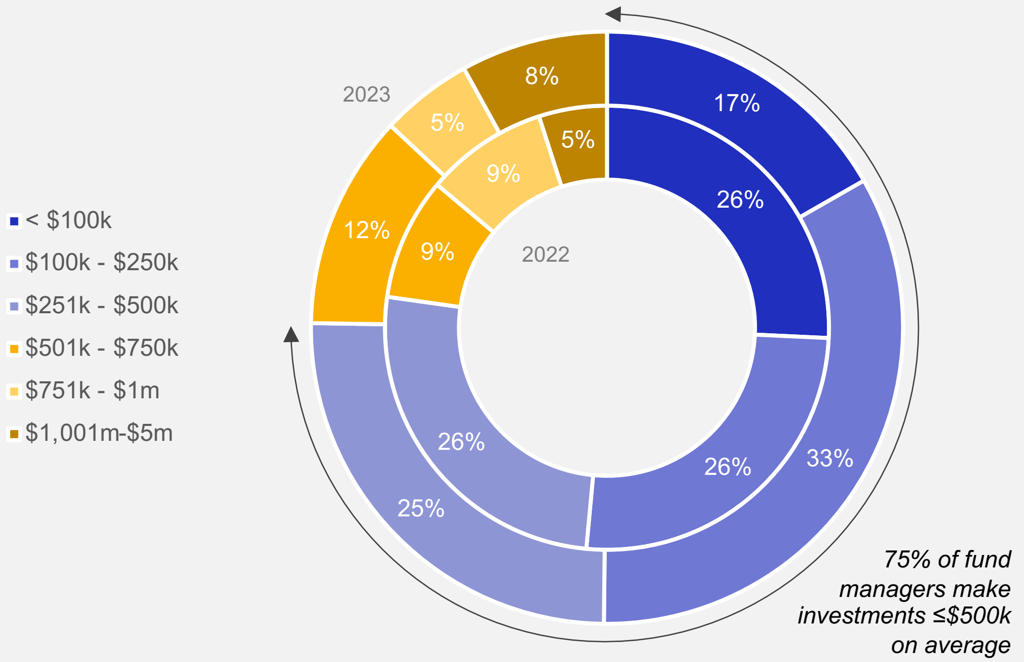
Self liquidating instruments used for marginal majority of investments



- No significant change in instrument mix since last year.
- Self liquidating instruments are still most widely used, which accords with challenge of exit environment and fund manager preference for cashflow throughout fund lifecycle.

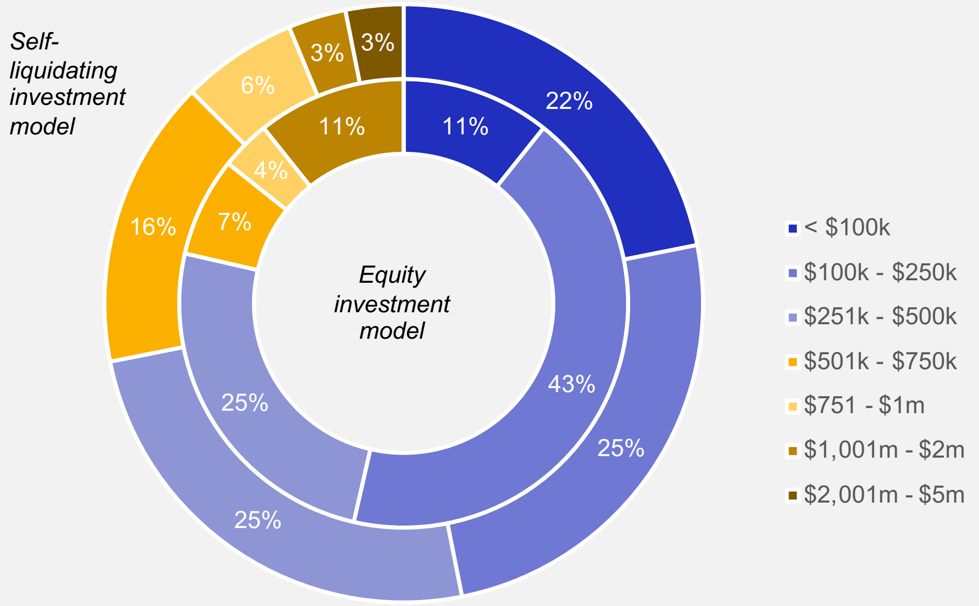
Ticket sizes generally less than $1m

% Funds with average ticket size – comparison between 2022 and 2023



- % fund manager portfolio allocation skewing slightly towards larger ticket sizes year-on-year.

% Funds with average ticket size – comparison between self-liquidating and equity investment models

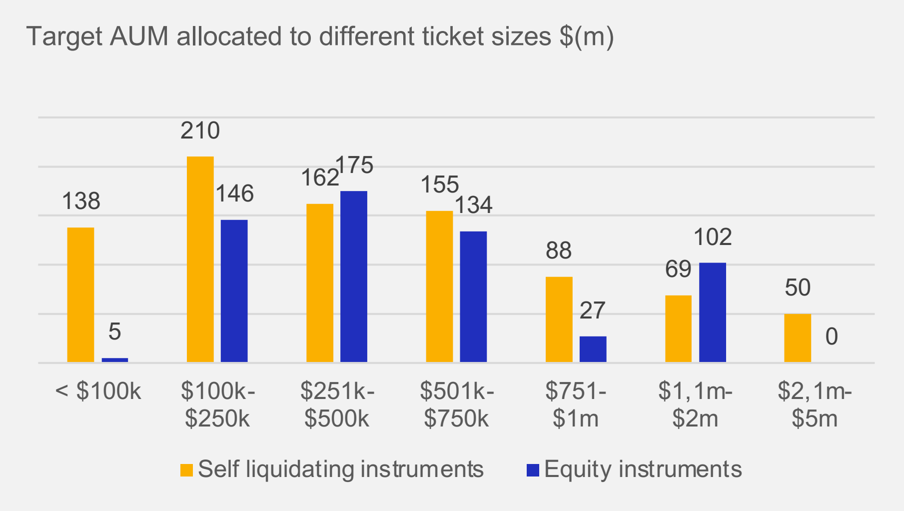


- Self liquidating investment models better suited to smaller tickets although equity investments concentrated between $100k and $500k.

Significant injection of growth capital at smaller ticket sizes

- $1.3bn of aggregate portfolios allocated to ticket size ≤$1m.
- By comparison, average private capital deal size in Africa in 2022 was $17m with $3.4m as median.[8] The median VC deal size is $2m and median venture debt deal size is $5.6m.[9]

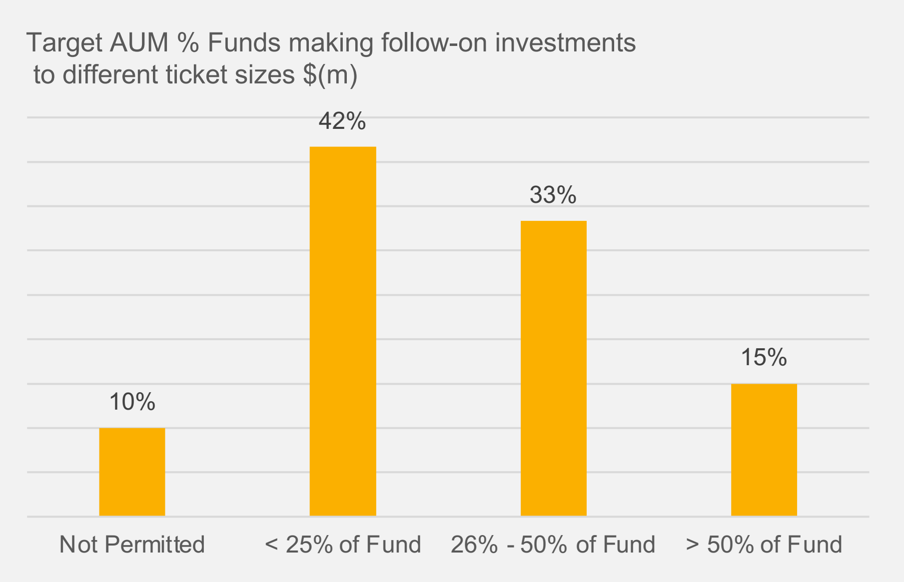
[8] *2022 African Private Capital Activity Report (AVCA, 2023)*
[9] *2022 Venture Capital in Africa Report (AVCA, 2023)*



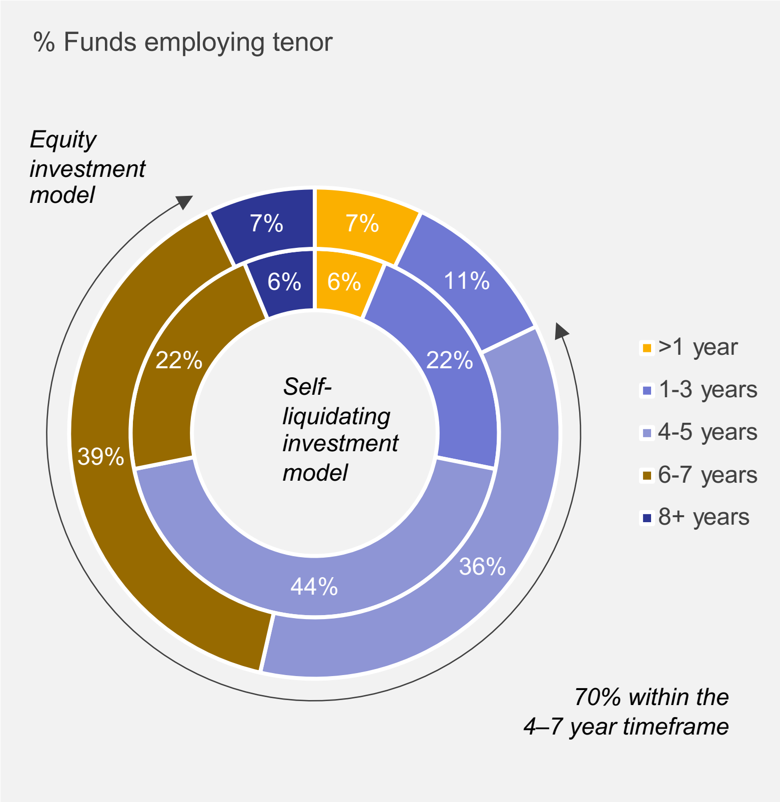
Most funds permit follow on investments

- Follow on investments are important because fund managers are supporting businesses in the early stages of their capital raising journey and they often require additional investment to scale. Fund managers can benefit from early bets and value-add of their initial investment.
- To provide context, it's worth noting that 63% of venture funding in 2022 was directed towards follow-on financing.[10] Several factors affect more limited follow-on investments. Including, size of funds with follow-on often entailing larger amounts, investment thesis and concentration risk.

[10] *2022 Venture Capital in Africa Report (AVCA, 2023)*

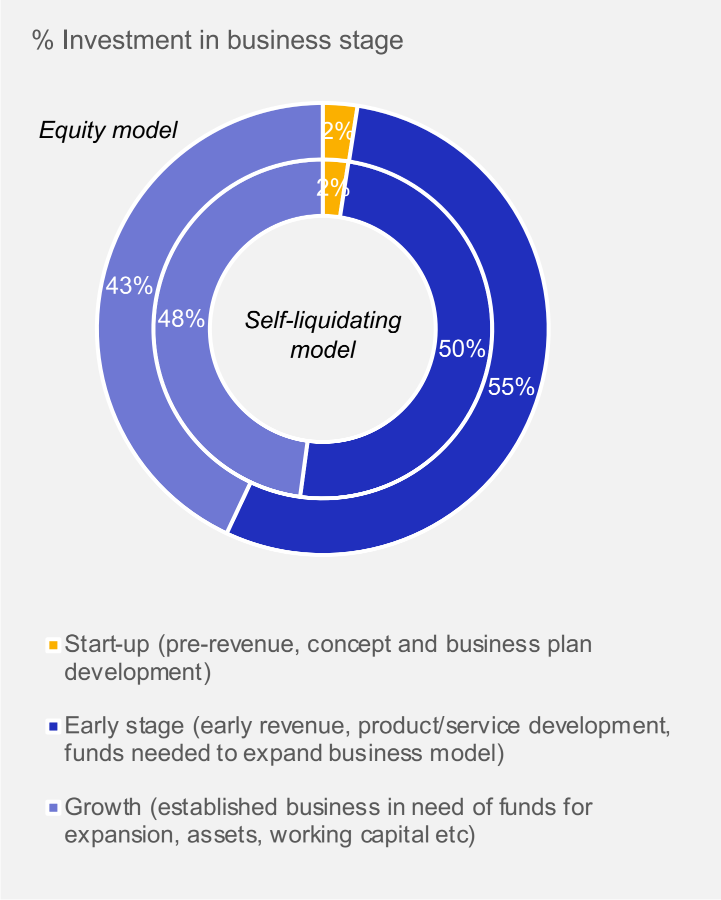


Majority of investments | have 4–7 year tenor



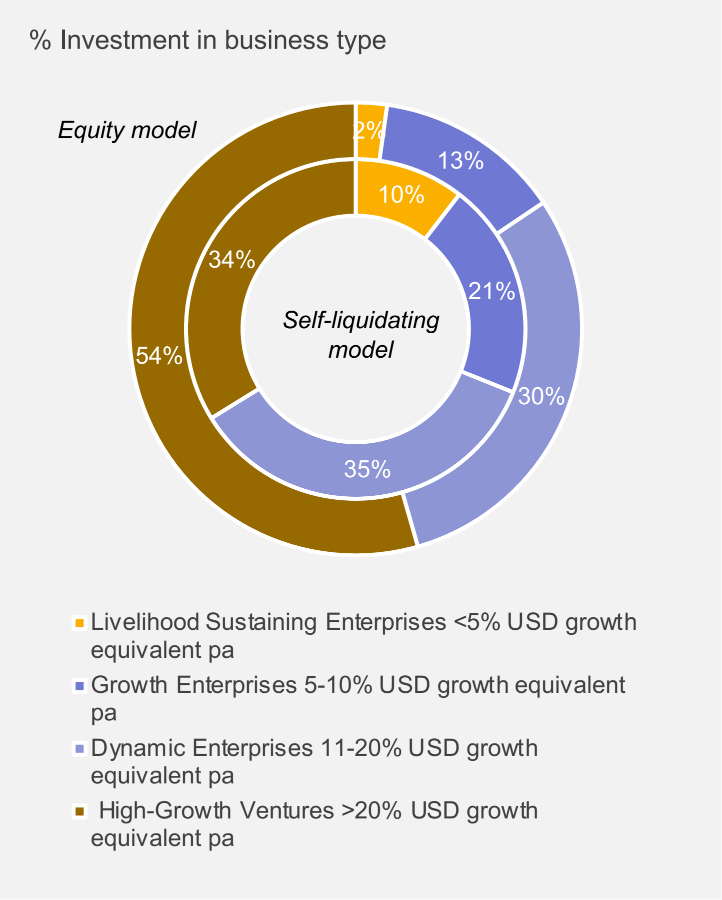
- Half of equity investments are ≥6 years which fits global market norms.
- There is no survey data on fund term of closed-ended vehicles but anecdotally 10+1+1 is usually targeted. At >8 years, 40% of exits in equity investment model are longer than LPs would ideally expect.

Early stage preferred over start-ups



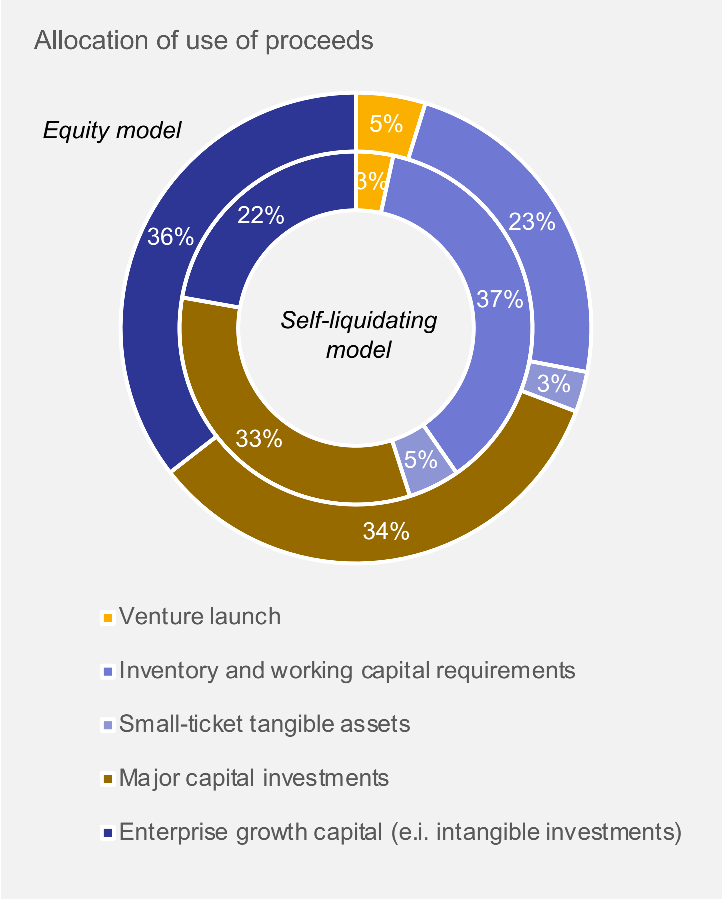
- Regardless of investment model, fund managers are investing in post revenue enterprises with demonstrated growth.

Most investment into businesses targeting >10% growth pa



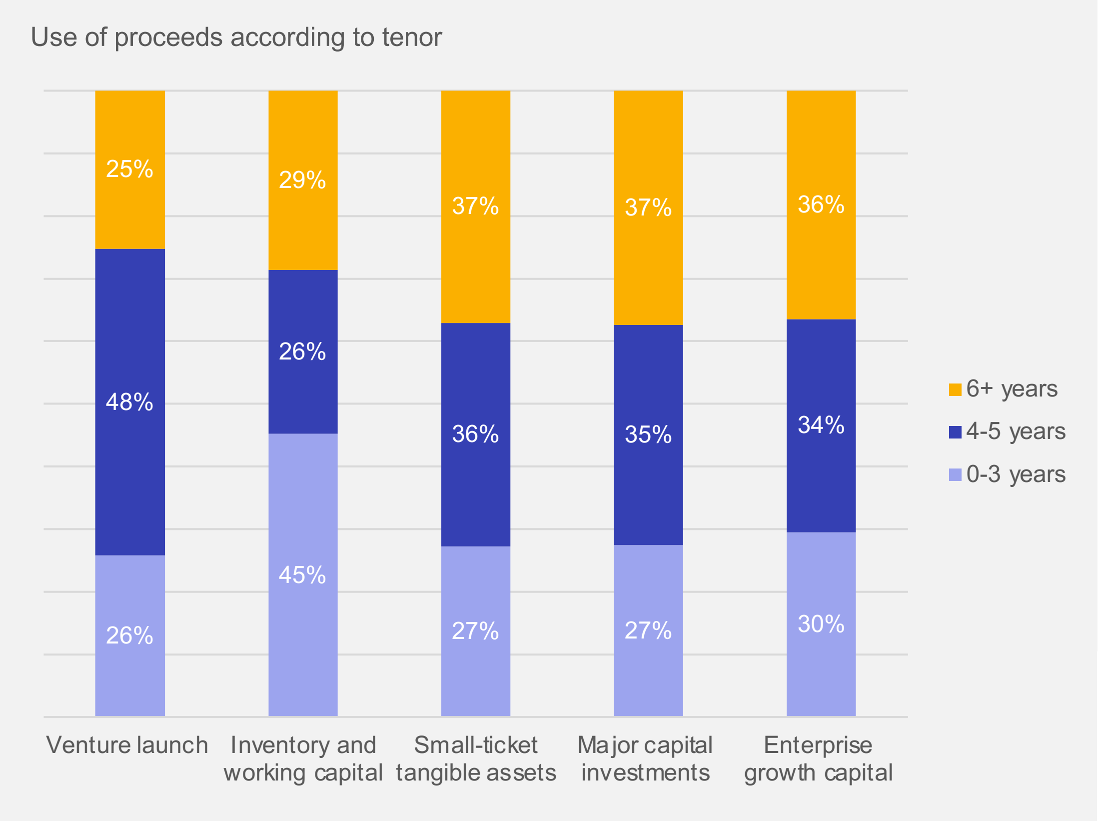
- Equity investment models are more likely to be seeking high growth ventures.

Working capital, major capital assets and intangibles financed



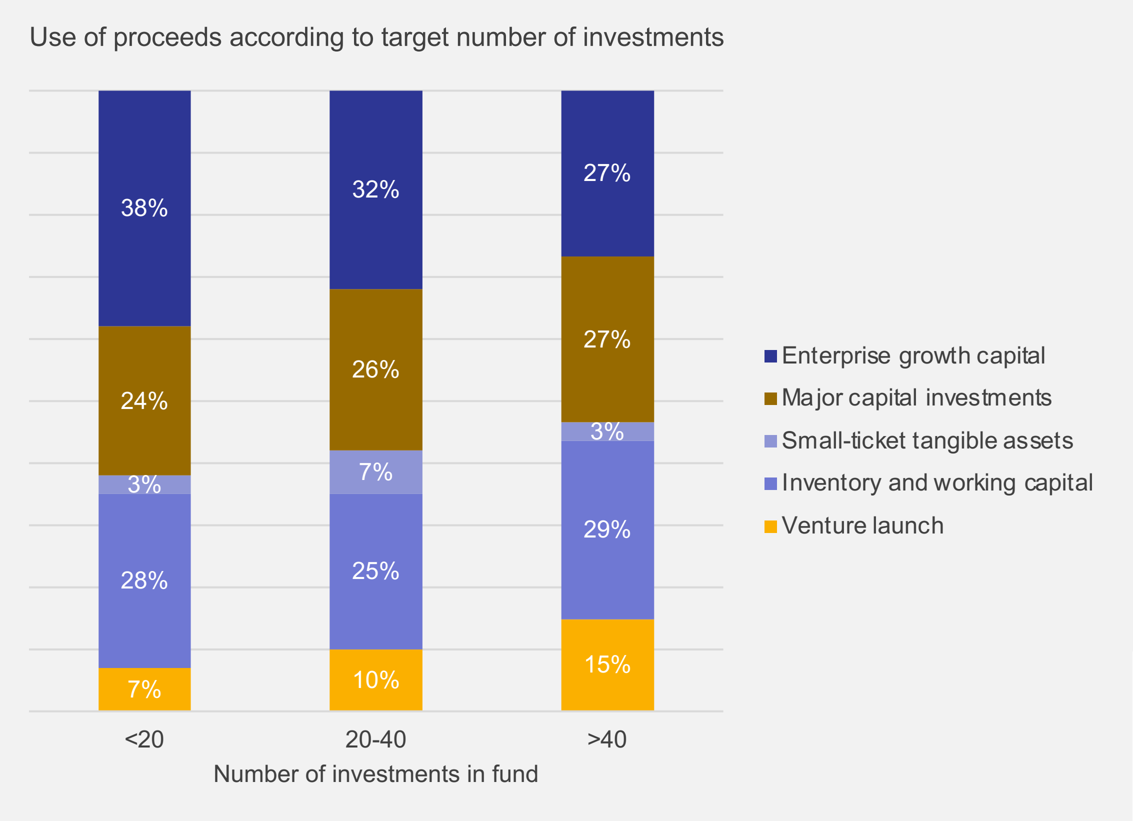
- The focus on intangible investments (such as staff build-out, expanded sales & marketing capabilities, operating systems etc.) is in line with global trends.

Tenor of investment is tailored to business need



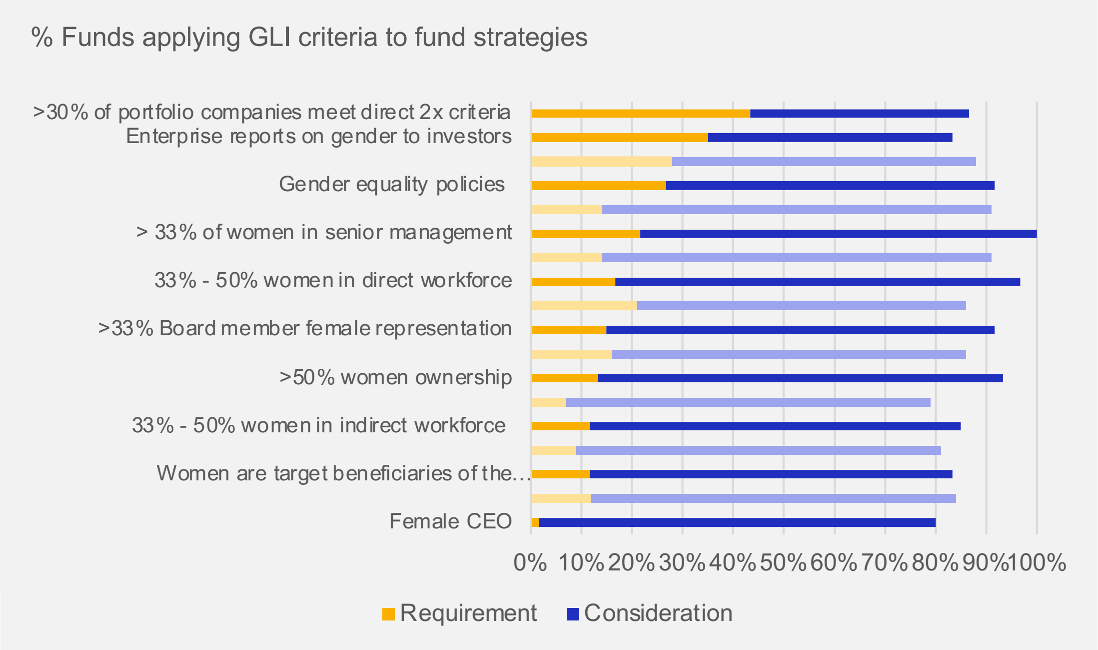
- Working capital investments tend to be of shorter tenor than major capital or enterprise capital investments as expected.
- Equal % across tenor for all other investment types.

No significant difference in use of proceeds according to number of investments



- Funds making fewer investments are more likely to make enterprise growth capital investments. This is likely as result of increased size and longer tenor of investment.
- Funds making more investments are more likely to make venture launch investments. This is likely related to smaller size of investment.

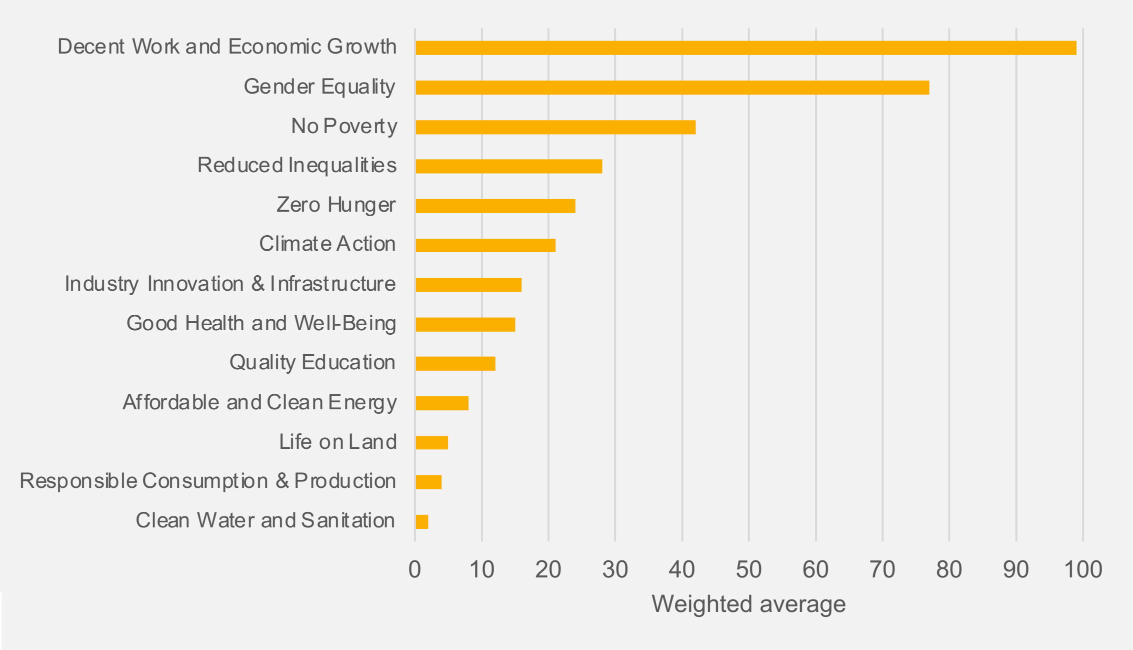
Gender lens investment is major impact area for most fund managers



- 2x Criteria are being applied more broadly across the board.
- Regardless of female ownership, funds are considering GLI in investment decision-making.
- 2x Global reported raising $16.3bn over the last 2 years for GLI across Asia, Africa, Central and Eastern Europe, Latin America and the Caribbean.[11] AVCA reports that 26% of VC investment in Africa in 2022 had at least one female founder.[12]

[11] *https://www.2xglobal.org/news-media-stories/2xchallenge-raises-16-billion-in-two-years*
[12] *2022 Venture Capital in Africa Report (AVCA, 2023)*

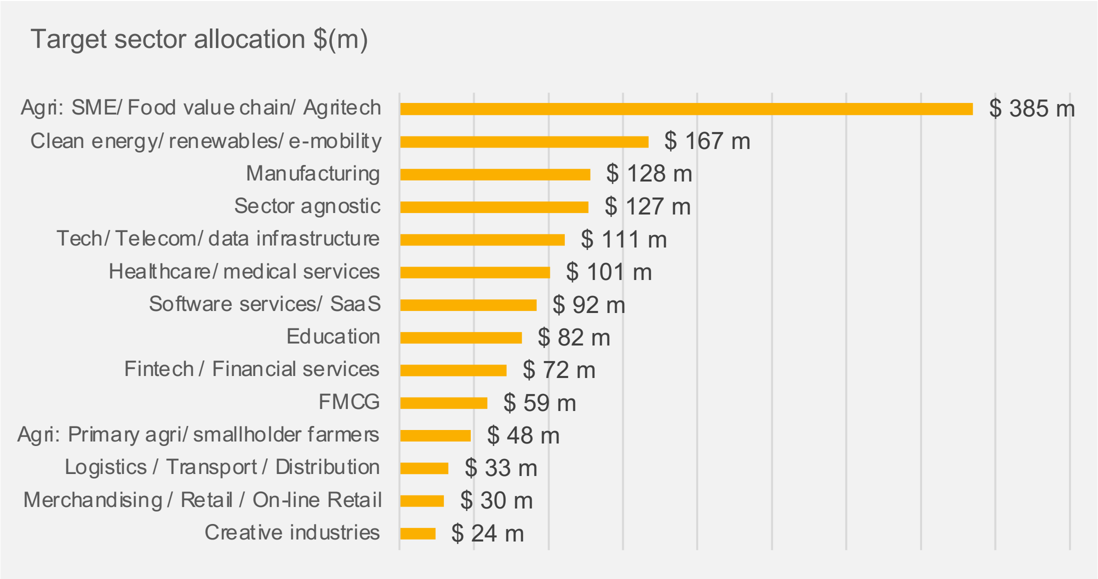
All fund managers report against UN SDGs



- Fund managers are aligning fund impact strategies with the SDGs. The 2x Criteria for GLI and IRIS+ are also commonly used tools.
- Millions are unemployed having a direct and devastating effect on livelihoods and well-being. For example employment rates range from 77% in East Africa to 57% in Southern Africa.13 Decent work is critical to all managers in this sample.
- Inclusivity and poverty alleviation are consistently relevant cross cutting themes.

[13] *Report on employment in Africa (Re-Africa) (ILO, 2020)*

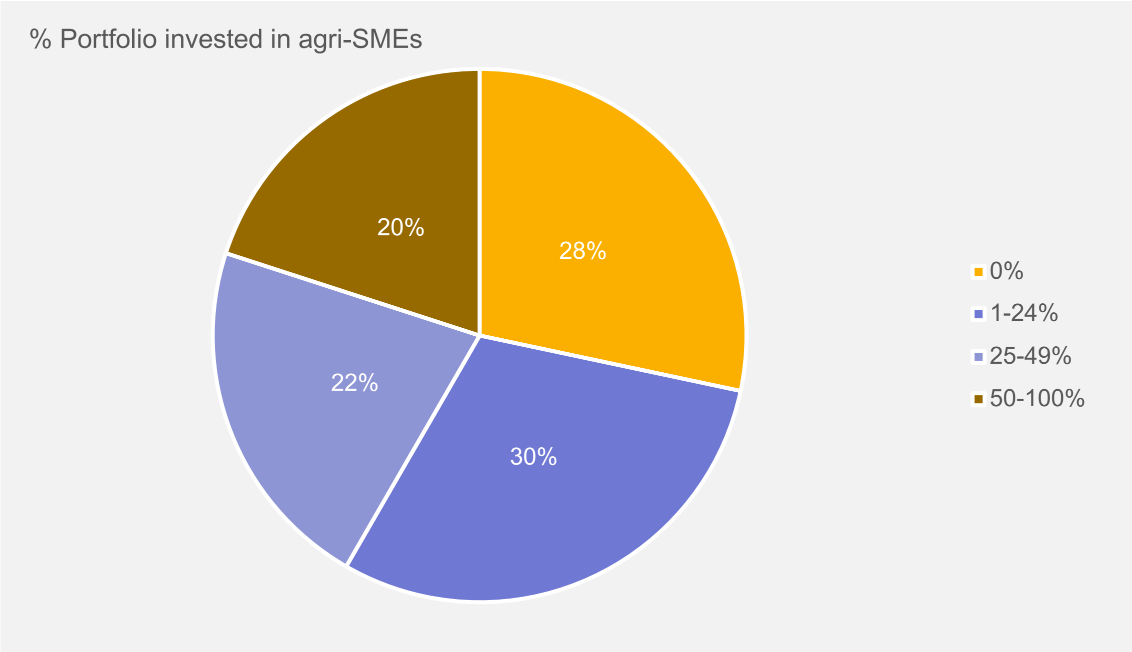
Investment into Agri-SMEs dominates AUM, although most funds investing across multiple sectors



- Agriculture is the dominant sector, although most funds are multi-sectoral, pursuing the most investable local business opportunities. Agriculture employs just over half of the people in Africa, so this distribution is not surprising.
- 55% of funds report having a sector focus where at least half of the fund is allocated to a single sector.
- 25% of funds either identify as sector agnostic or have equal mix of investments across at least five sectors.
- By comparison, a third of VC deals in Africa are in the financials sector.[14]

[14] *2022 Venture Capital in Africa Report (AVCA, 2023)*

Agri-SME investment core part of opportunity mix in local context

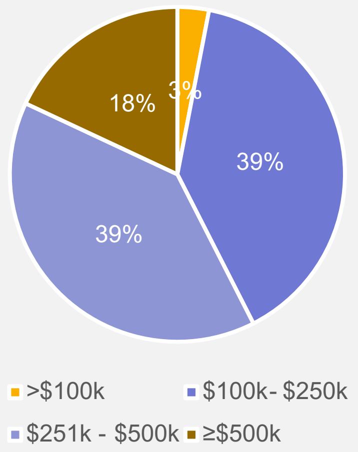


- 75% of funds have at least some agri-SME in their portfolio.
- 40% of funds have Agri SME/food value chain/agri-tech as the dominant sector in the fund.
- 15% of funds are investing in primary agriculture and smallholder farmers. None of those prioritise primary agri funds but rather include as a minority of portfolio generally in conjunction with agri-SMEs.

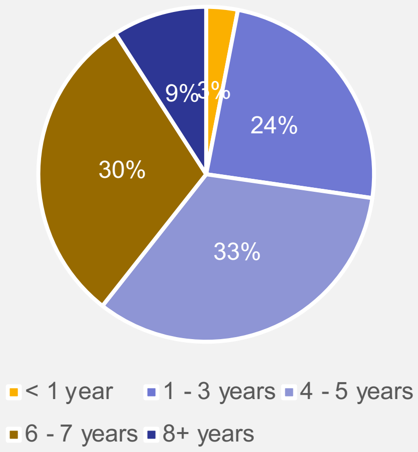
Agri-SME finance differs marginally from the full sample[15]

- Fund managers expect to invest similar ticket sizes, tenor and instrument mix into agri-SMEs as compared to full sample.
- By comparison, Aceli Africa reports unmet demand in smaller sized loans with their own incentive programme stimulating loans of $162k on average.[16]

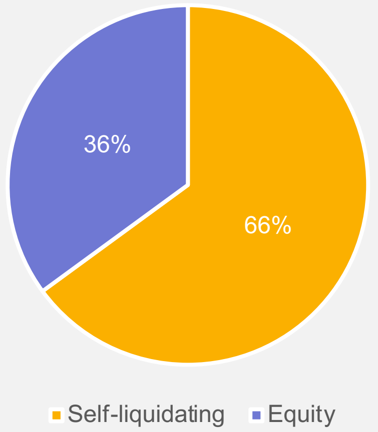
% AUM invested according to ticket size



% AUM invested according to tenor

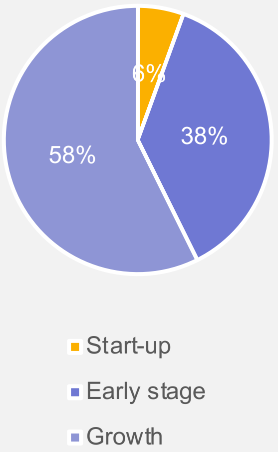


% Allocation according to instrument

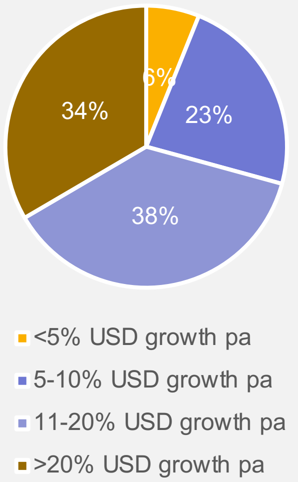


- Compared to full sample, agri-SME lending skews towards growth stage businesses and greater working capital allocation.

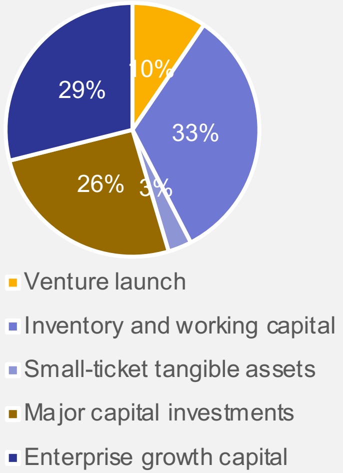
% AUM invested in business stage



% AUM invested in business type

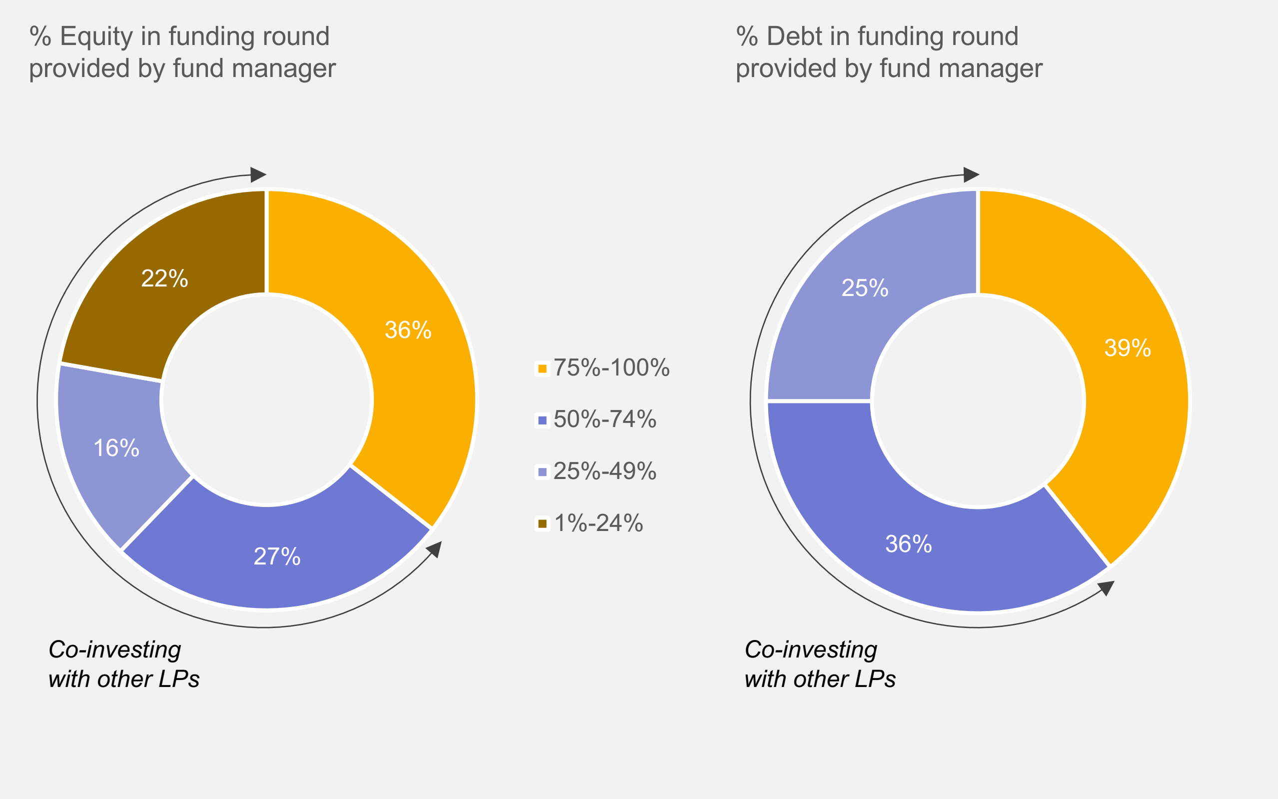


% Allocated to financing need



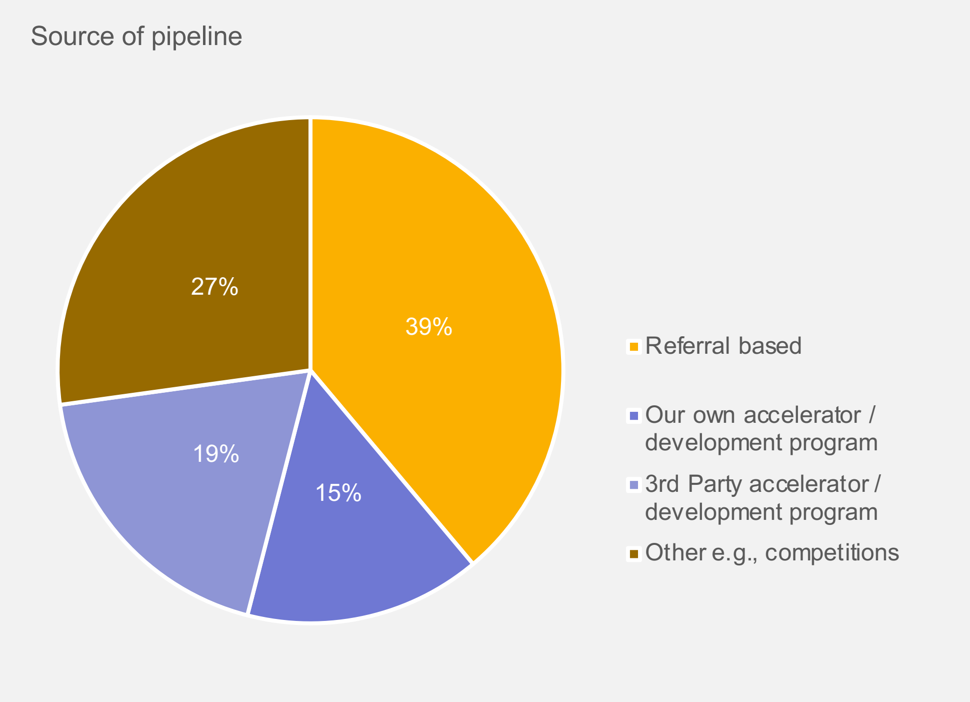
[15] These figures apply to funds where Agri-SMEs one of the dominant sectors targeted in portfolio mix.
[16] Aceli Africa Year 2 Learning Report (Aceli Africa, 2023)

A third of fund managers are the sole financier in the companies they are investing in



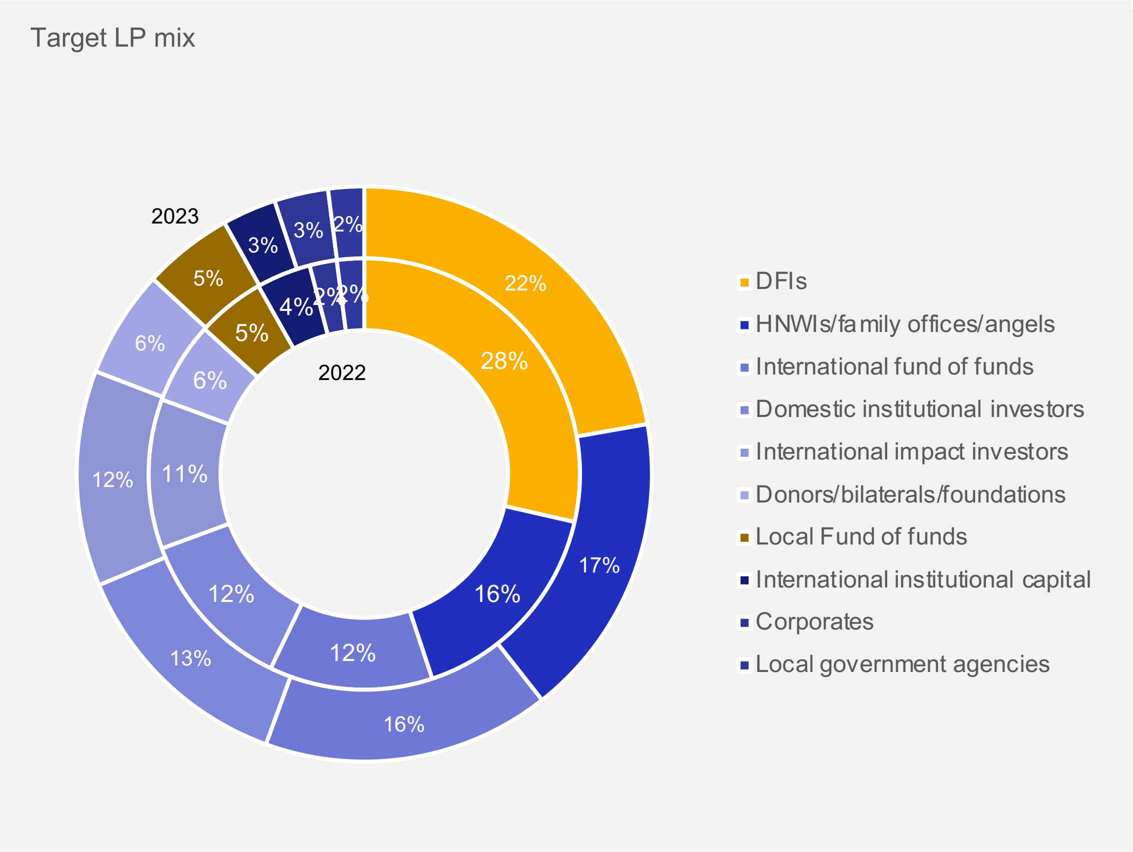
- The main distinction is between fund managers that are sole financiers and those co-investing, who make up the majority. This question does not tell us the equity/debt funding mix.
- One of the consequences of being a sole financier might be that post-investment TA engagement might be slightly higher. The only difference that bears out in this respect from the full sample would be that equity investors are marginally more likely to deliver TA themselves rather than outsource.

Half of fund managers have their own accelerators



- Half of fund managers have their own accelerators although tend to source about 15% of their pipeline from these programmes.
- In many cases the incubator/accelerator/entrepreneur network has preceded the fund and the ecosystem quite often includes angel investor networks particularly in the GLI sector.
- These ecosystems provide ongoing support to the fund in the form of anchor funding, deal sourcing, portfolio company development and co-investment.
- LPs thus often benefit from this established self-sufficient system.

The target LP mix has not changed significantly since last year despite increase in sample size

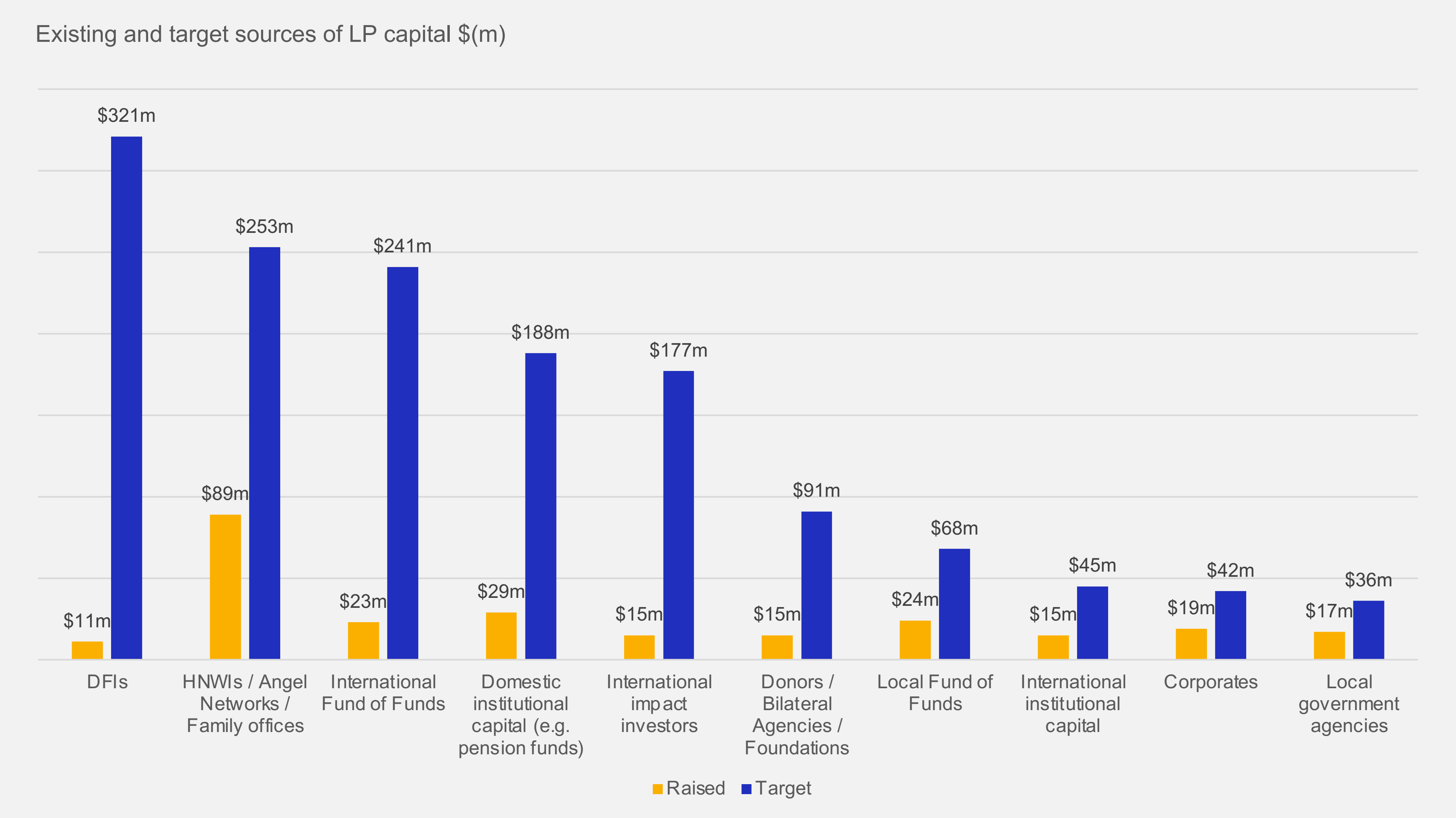


- Expectation of raising funding from the DFIs has reduced by ~20%.
- Marginally more funding is expected from FoF, which is not surprising considering the number of such vehicles that have started deploying in the last year.

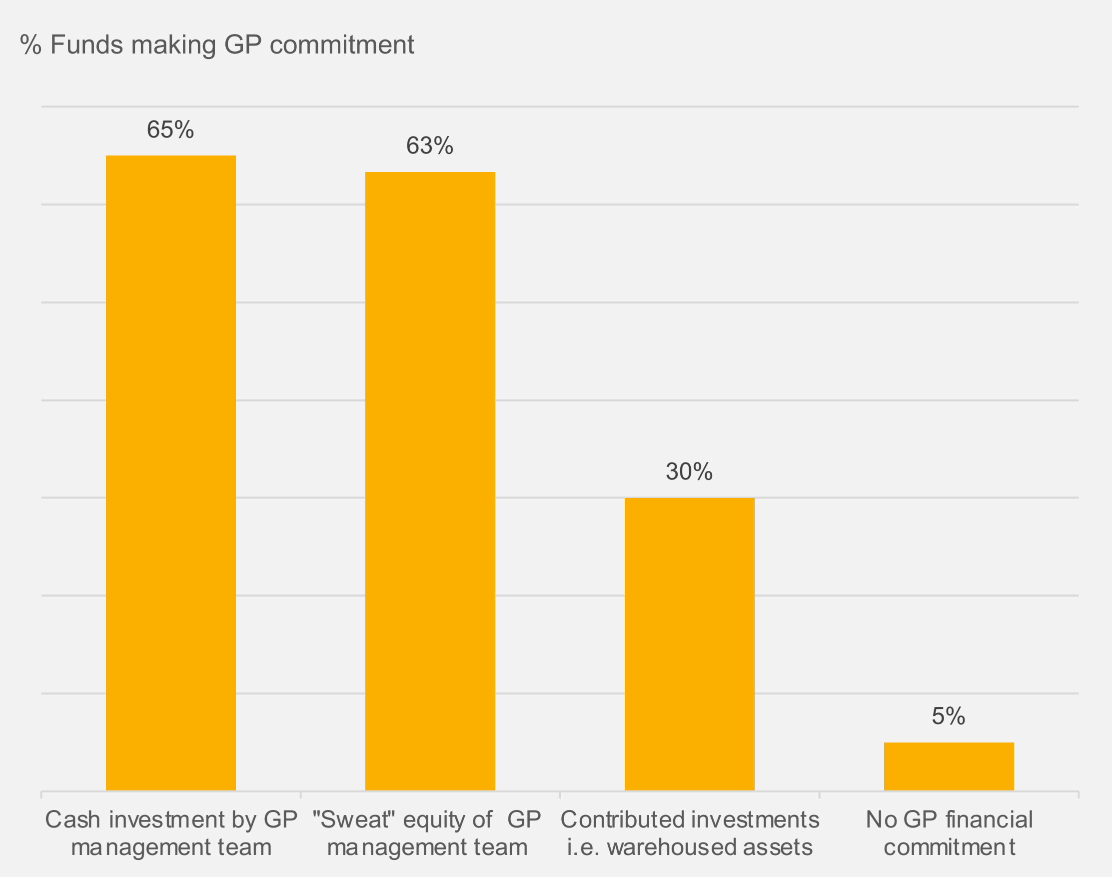
HNWIs and family offices are key source of funding but need to crowd in other capital to grow asset class

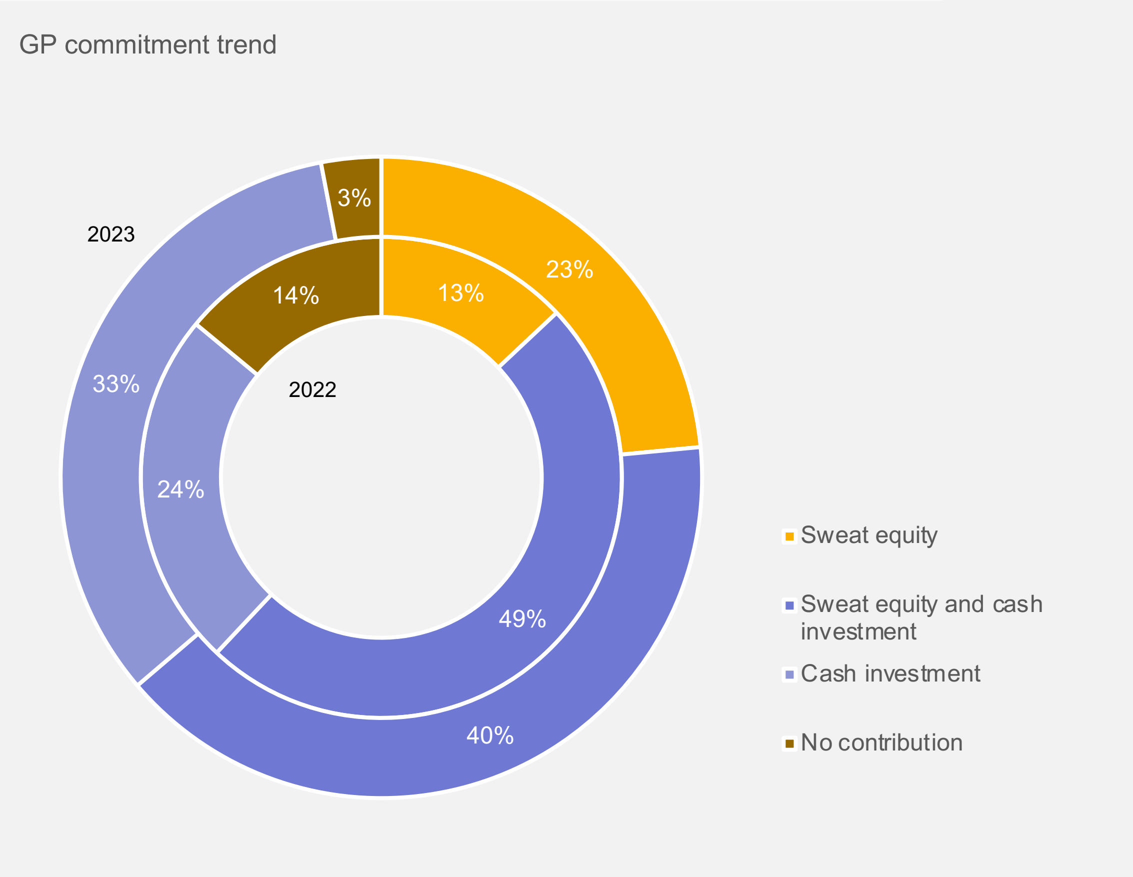
- HNWIs/family offices: Private capital is funding the small business finance private fund market in Africa currently. Anecdotally many of these LPs are local or from the diaspora.
- DFIs: Generally, DFIs only come into the picture for the second fund and, even then, are proving extremely challenging to access funding from. In contrast DFIs invested 60% of the $2bn going into private capital funds in Africa last year.[17]
- Local capital: Local currency investment is much better suited to small business investments as neither small businesses not fund managers can adequately absorb currency risk.
- ¼ of target capital raise is expected from local LPs including a mix of domestic sources like funds of funds, institutional investors, corporates and government (excl HNWIs). Fund managers have raised ⅓ or $90m of that amount thus far.
- FoF: ~20% of target capital raise is expected from local and international FoF. 15% or ~$50m of that raised thus far.
- Grant capital: This capital from donors, bilaterals and governments is the only potential source of de-risking or first loss capital.

[17] *2022 African Private Capital Activity Report (AVCA, 2023)*



GPs are putting skin in the game under tough circumstances



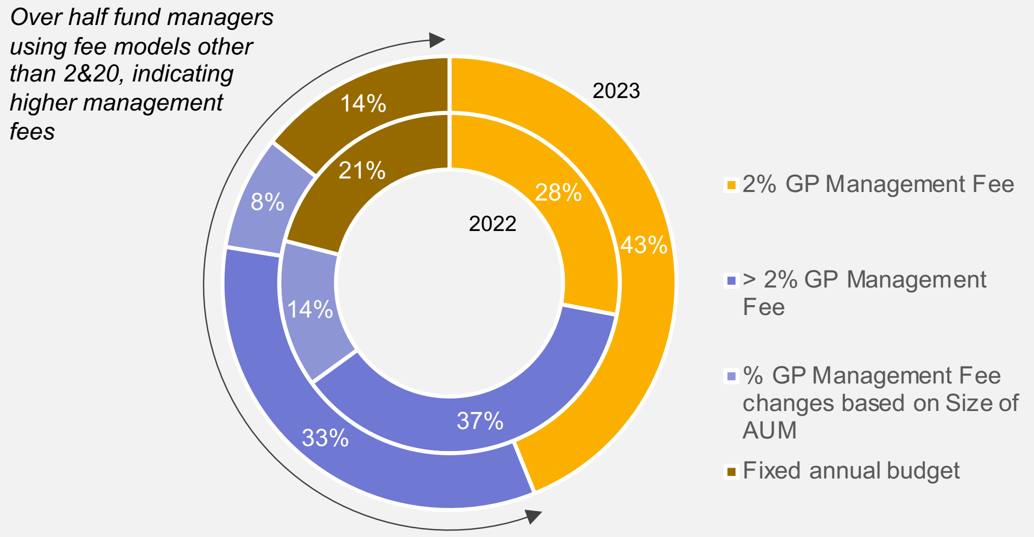


- ¾ of GPs have made a cash contribution This is generally as a requirement of LPs and often under circumstances where the GP does not have access to personal wealth.
- Of the 30% who have contributed warehouse investment capital, 40% have reached first close.

- The percentage funds raising capital despite no cash contribution, has increased from last year. Of those funds where only sweat equity required, the split between equity and self-liquidating was 50:50. Anecdotally most fund mangers are taking below market remuneration in early stages of fund raising.

Funds are applying traditional fee structures despite tough fund economics

% Funds using GP management fee model

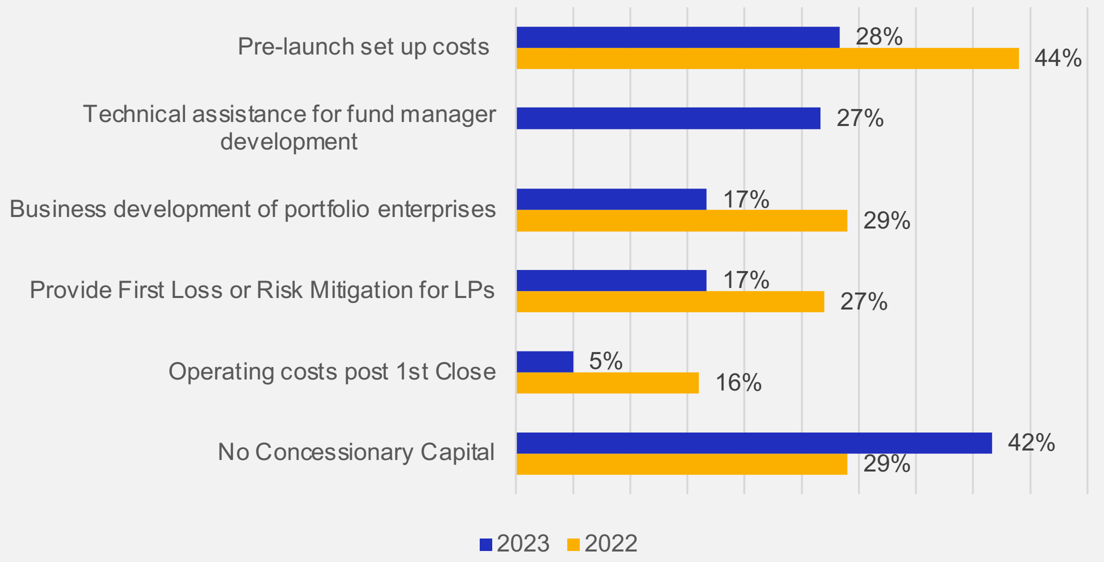


- The increase in funds using 2&20 model could imply that managers are being forced into more vanilla structures in order to attract LPs.[18]
- The 2&20 fee model is more prevalent in larger funds:
  - 55% of funds ≥$20m use 2&20 fee models
  - 40% of funds <$20m use 2&20 fee models.
- All funds using fixed fee models are open ended. 40% of open-ended funds have fixed fee models.

[18] *There are more closed-ended funds in sample this year*

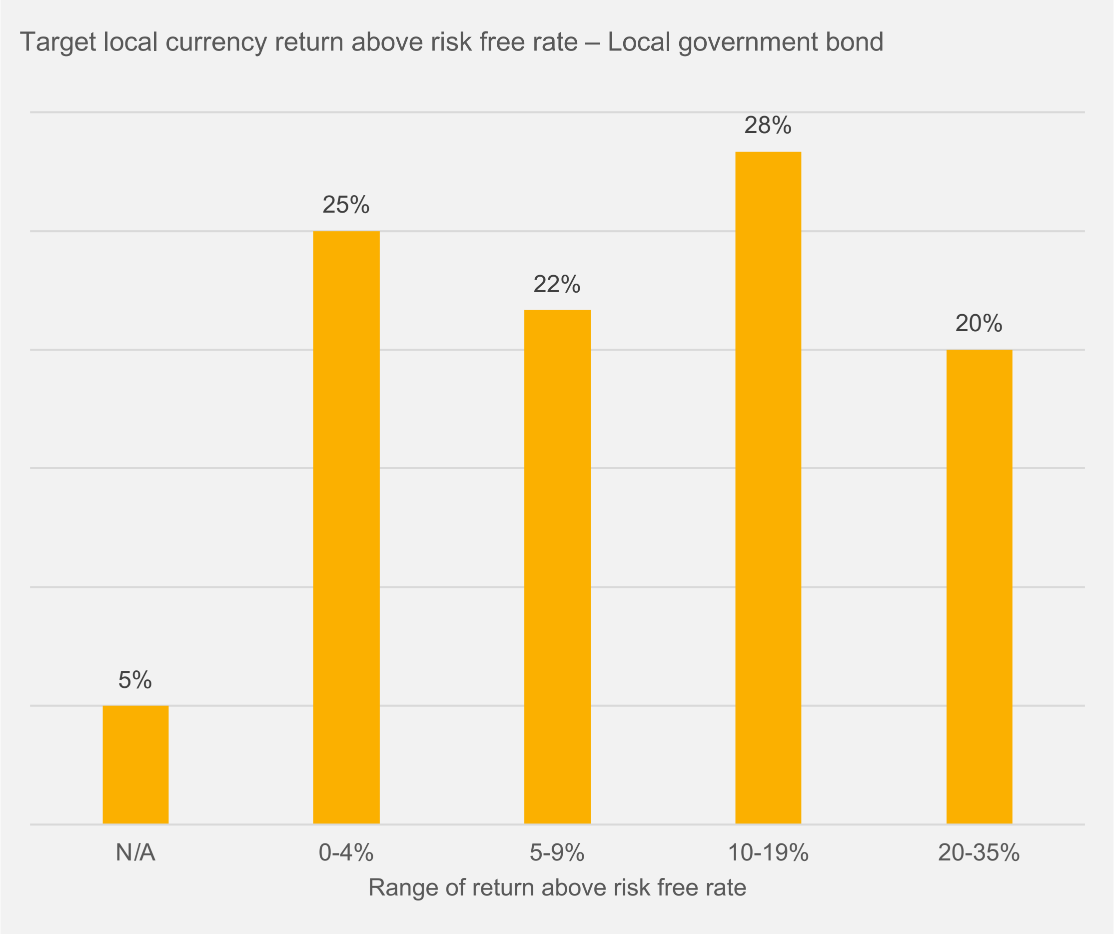
A small majority of fund managers receive concessionary capital

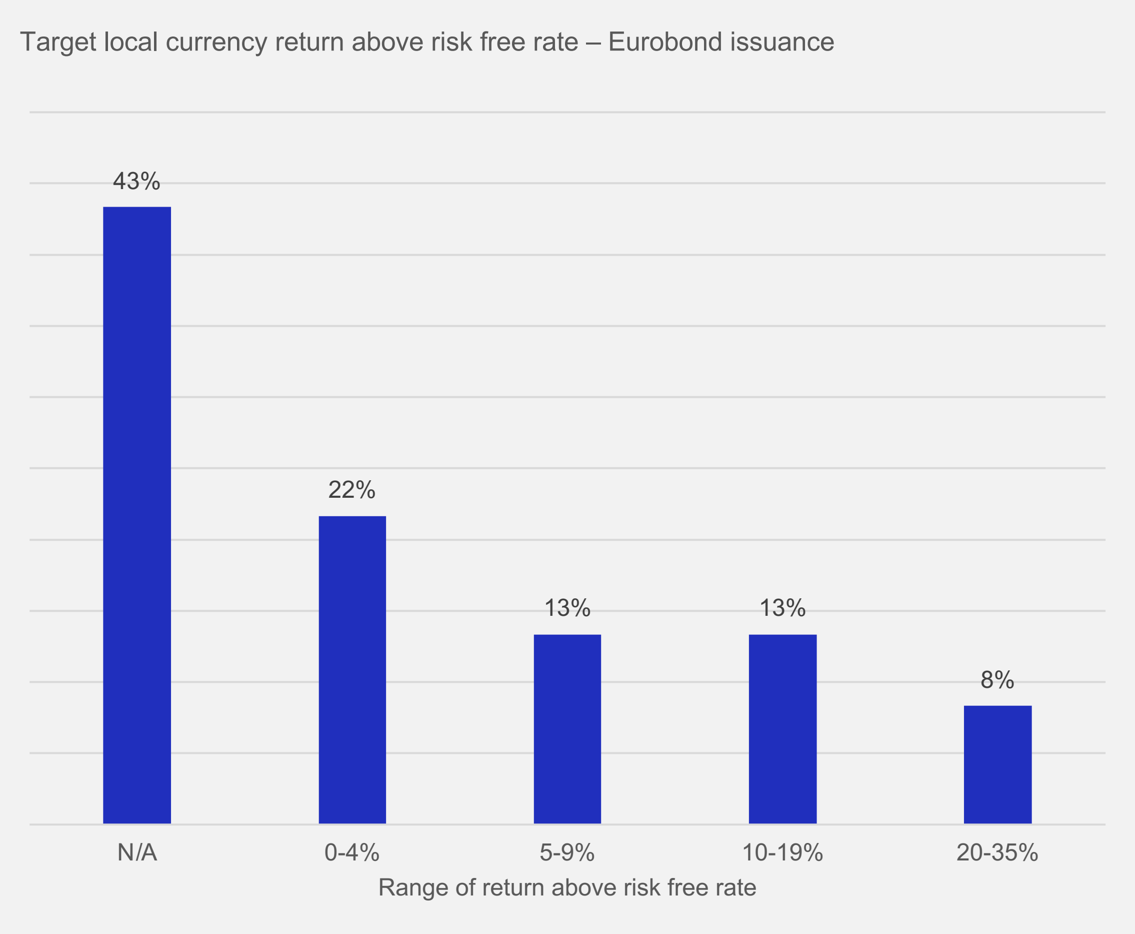
% Funds receiving concessionary funding



- Set-up cost remains biggest area of support. A minority of fund managers are accessing first-loss capital on a case-by-case basis.
- Fund managers are equally likely to have achieved first close whether they have received concessionary funding or not. That is ~45% have achieved first close in each group.
- Just over half of those who have received concessionary funding are closed-ended funds.
- 50% of funds accessing concessionary funding have received support in multiple areas. 75% of these funds have achieved first close.
- Those fund mangers who have raised first loss have raised ~20% of targeted amount, which is marginally more than the average.

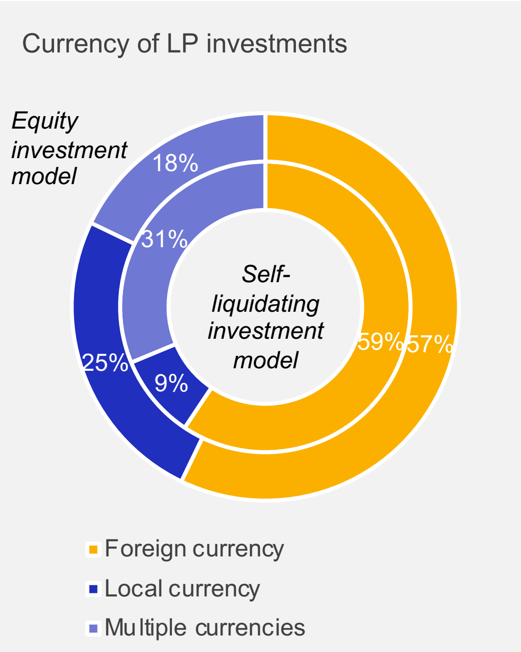
More funds reporting target returns against local currency benchmarks

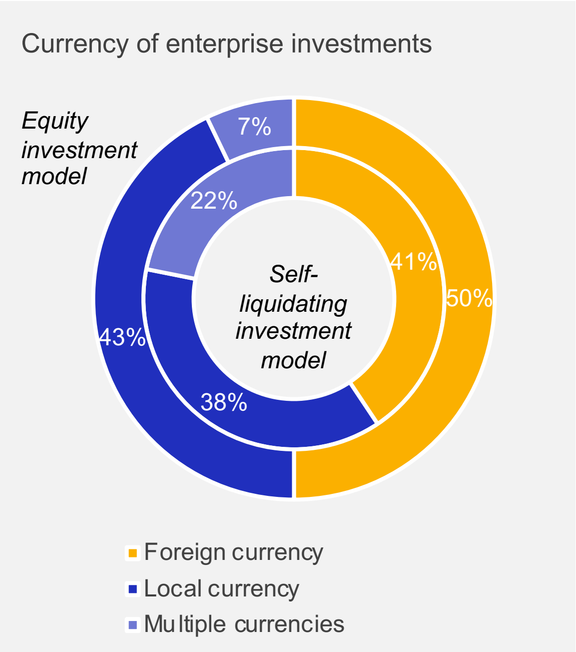




- 95% of fund managers price finance against local currency risk free rate, while 57% do so against international debt. Almost all fund managers who reported against the Eurobond did so also against local government bond.

Currency mismatch and concomitant risk continues

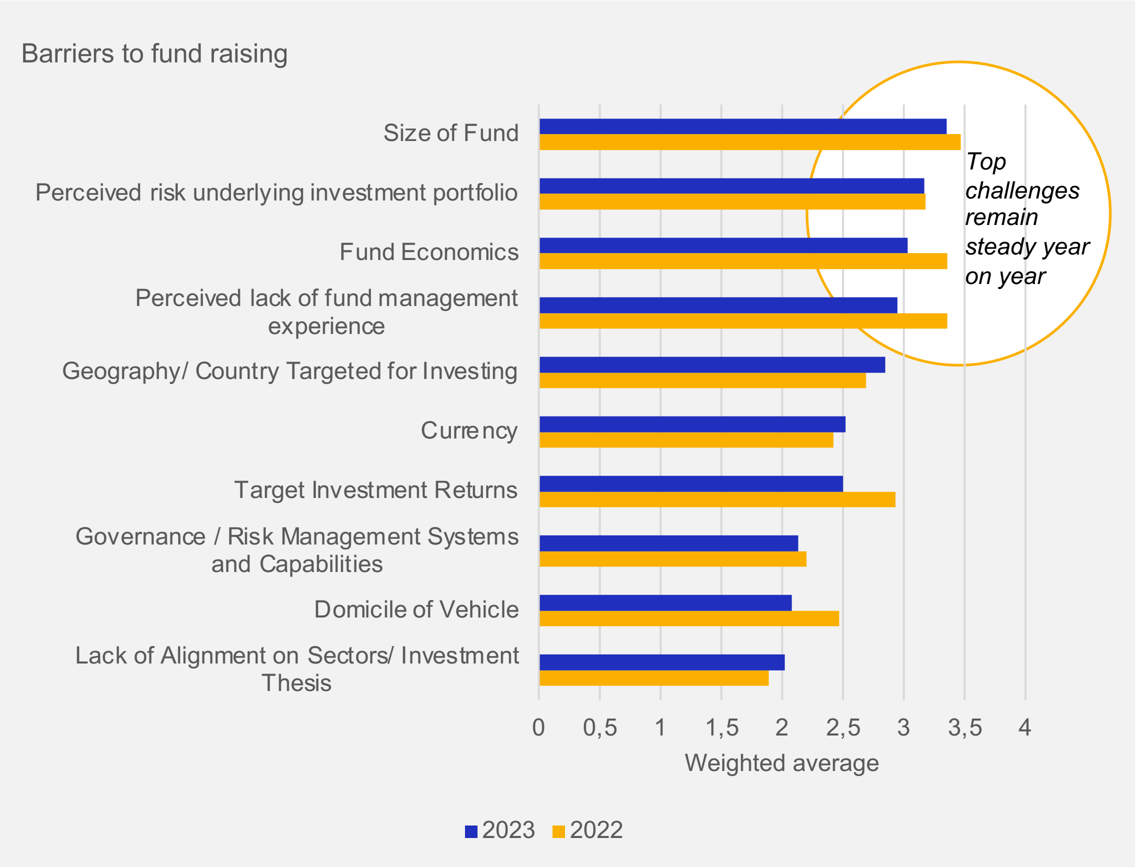




- Forex mismatch continues with at least 60% of LP commitments in hard currencies.
- This continues anecdotally to push fund managers towards export- or commodity-orientated businesses that can provide a natural hedge against the currency risk.
- For equity funds: If LCPs raise hard currency, they invest hard currency with risk priced into deal terms with small businesses.
- For self-liquidating funds: If LCPs raise hard or multiple currencies, 30% of the time they invest in local currency. The rest of the time small businesses are taking risk of currency fluctuations.
- This is a pervasive issue across asset classes. For example, 73% of active in investors in Africa's VC landscape are international.[19]

[19] 2022 *Venture Capital in Africa Report (AVCA, 2023)*

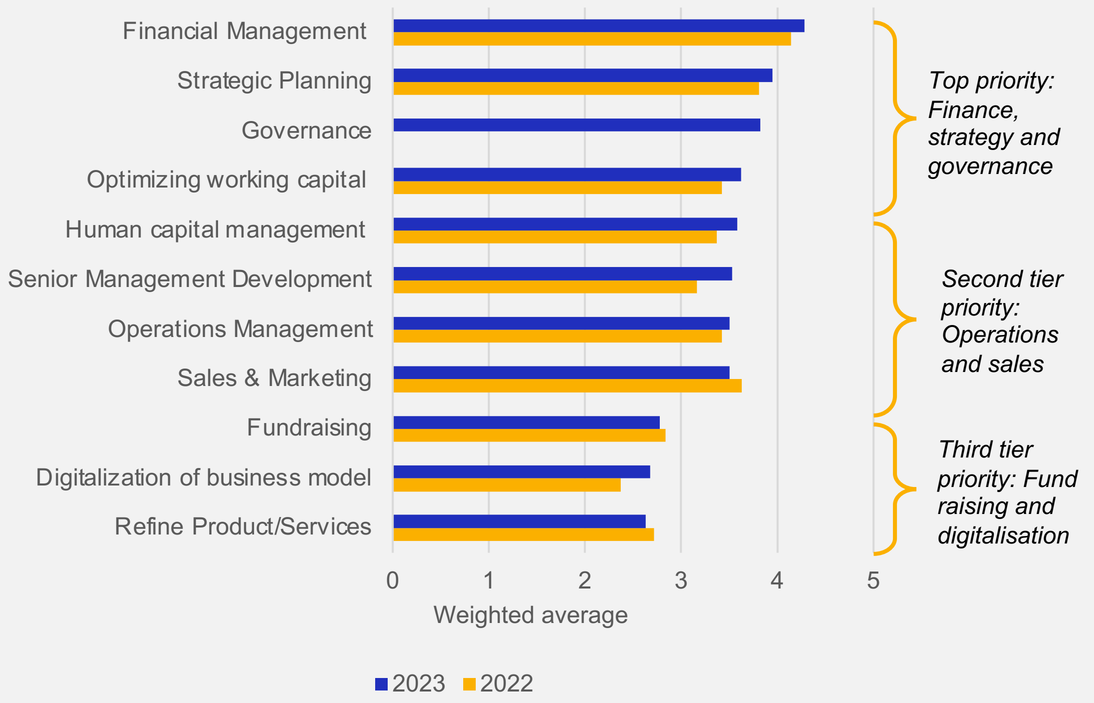
Fund economics, business risk and track record continue to deter LPs



- More evidence is required to determine whether these risks are mitigated through innovative approaches applied by fund managers in this sector. Small business finance is unique asset class that requires a different approach to what exists in banking and private market funds to date, so should be evaluated differently.

Financial management, strategy and governance top priorities

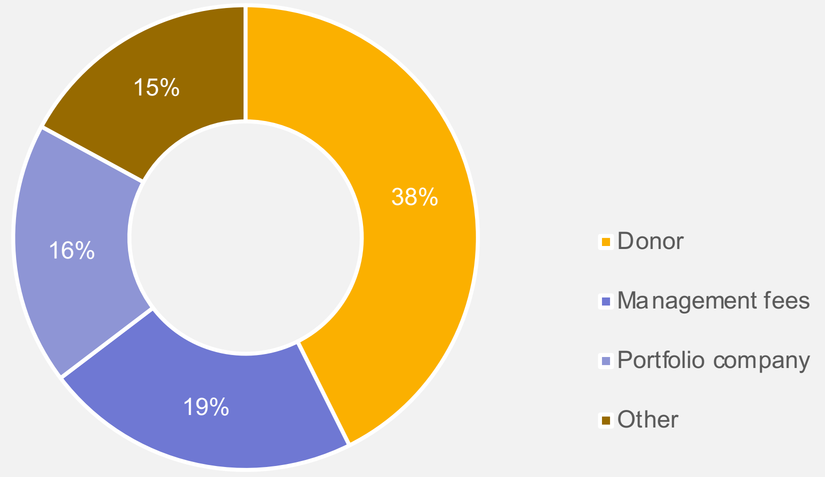
Key business development areas in 12 months after closing investment



- The type of support offered by mangers is consistent with this financing usually being the first that portfolio companies receive and, thus, financial management, governance and strategy are key.
- Once again, digitalization is lower on list of priorities than anticipated, although fund managers report integrating software to support business functions such as financial management and sales etc.

Fund mangers are accessing donor funding to support TA for portfolio companies if they can

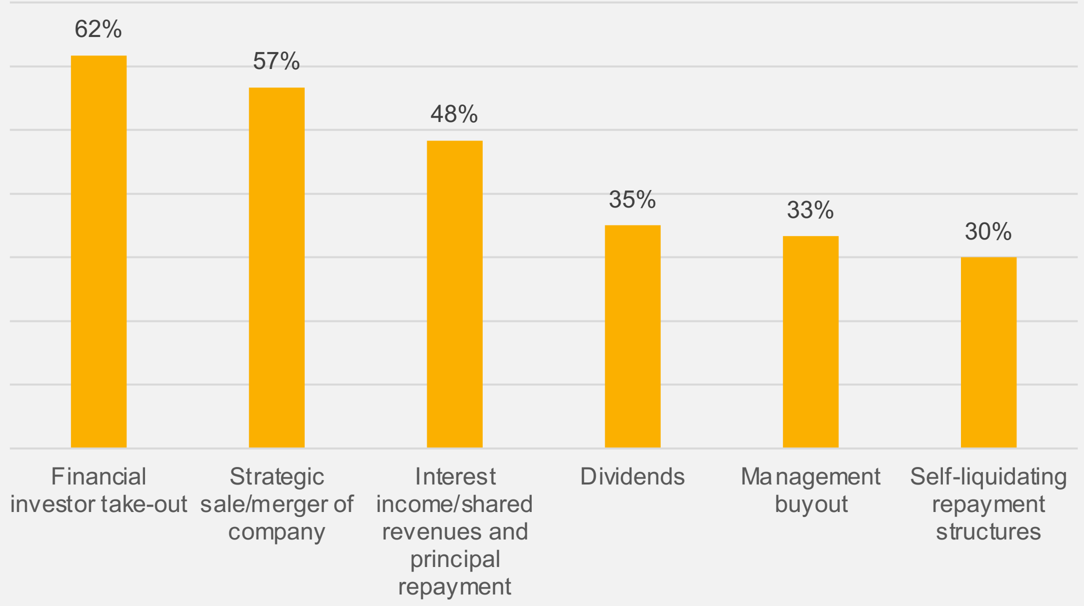
TA funding sources



- Fund managers universally believe TA is essential to small business growth, although they too are bootstrapping in order to survive. Thus the 'optional' activity around TA is often funded outside of management fees where there are other obvious income streams from donors and the investees themselves.
- 40% of fund managers allocate at least some of their management fees to TA. Although, across the full sample, management fees cover only 19% of funding required to offer the service.
- 50% of fund managers are raising funding from donors. These fund managers cover the majority of their TA costs from donor funding.
- 40% fund managers require portfolio companies to contribute to TA costs. The majority of those recover less than half of TA costs form the portfolio company the rest coming from other sources.

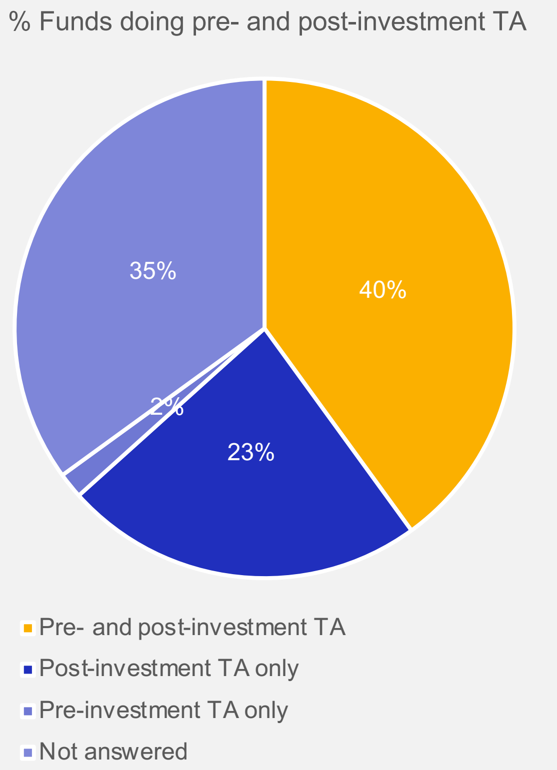
Fund managers have employed a range of exit strategies

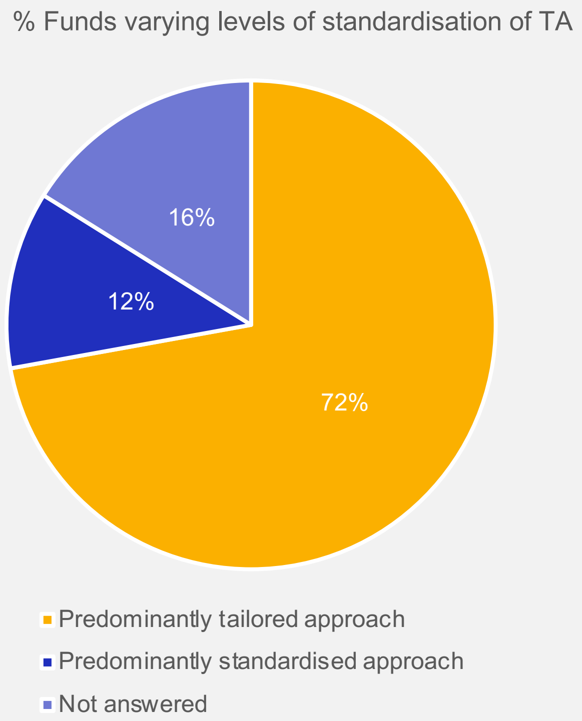
% Funds using form of monetisation or exit

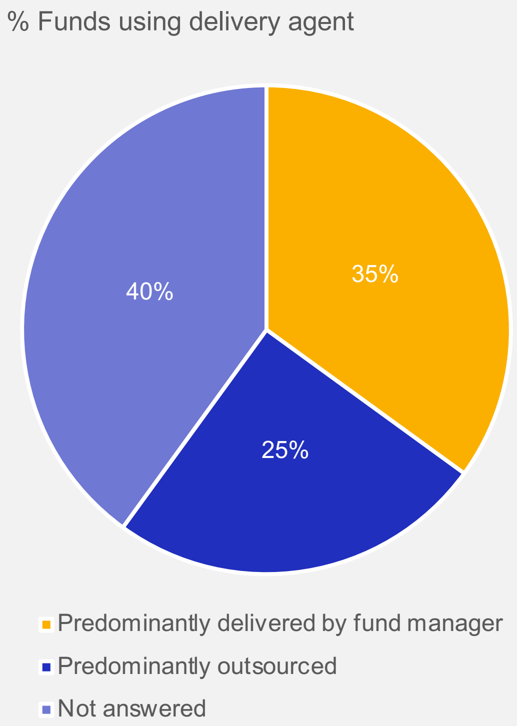


- Those fund managers who have exited equity investments in their current funds have done so through investor take-outs and strategic sales. They are not relying on management buy-outs to exit.
- Those fund managers who have monetised debts investments have done so conventionally through interest income and principal repayment but also through shared revenue.

Fund managers are using a variety of models to deliver TA



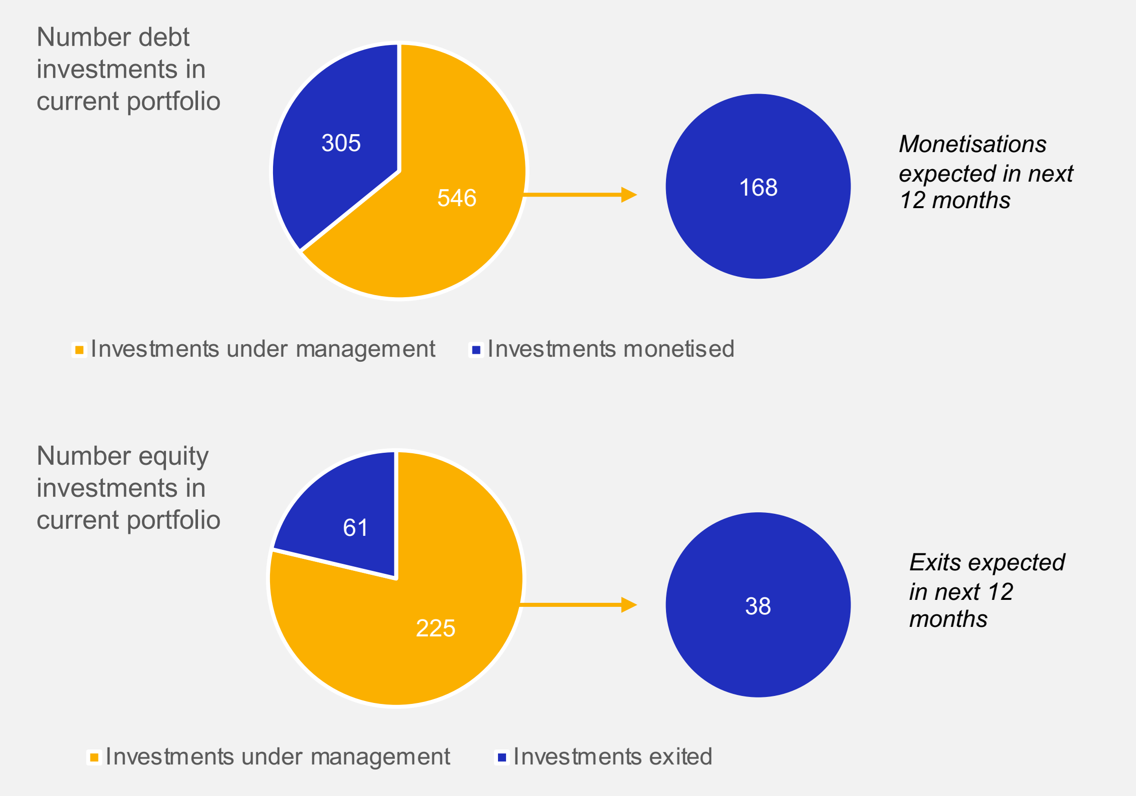




- All fund managers provide or have intent to provide some BDS to portfolio enterprises. This is one of the key differentiators these intermediaries and not something generally provided by banks or digital lending platforms who may be also financing small businesses.
- The proportion managers offering pre-investment support is significant considering risk. This is where ‘own accelerator development programmers’ are often at work.
- Fund managers report wanting to streamline TA but only a minority have been able to standardise.
- TA tends to be provided ‘in house’ considering the the alignment of incentives and significant depth of business management and entrepreneurial experience within this group of fund managers.

6 Performance and outlook

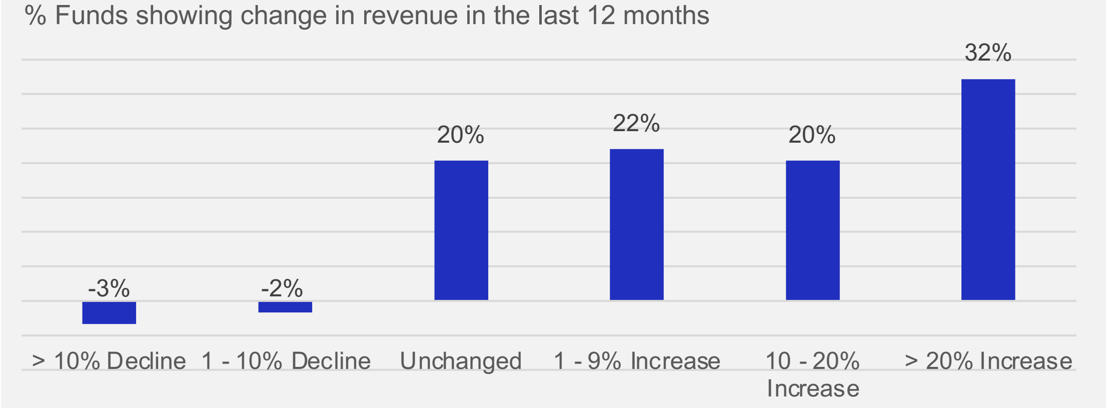
Fund managers are monetising debt investments early and in significant quantities

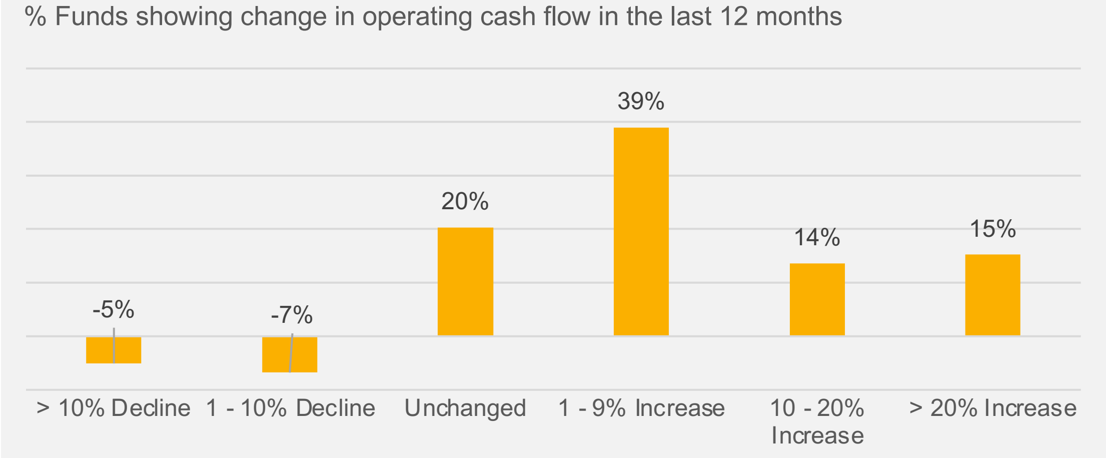


- 1 140 investments made in current portfolios, a third of which have been monetised or exited. Equity exits relatively fewer than debt monetisations considering longer average tenor.
- By comparison, 786 VC and 67 in venture debt deals were done.[20]

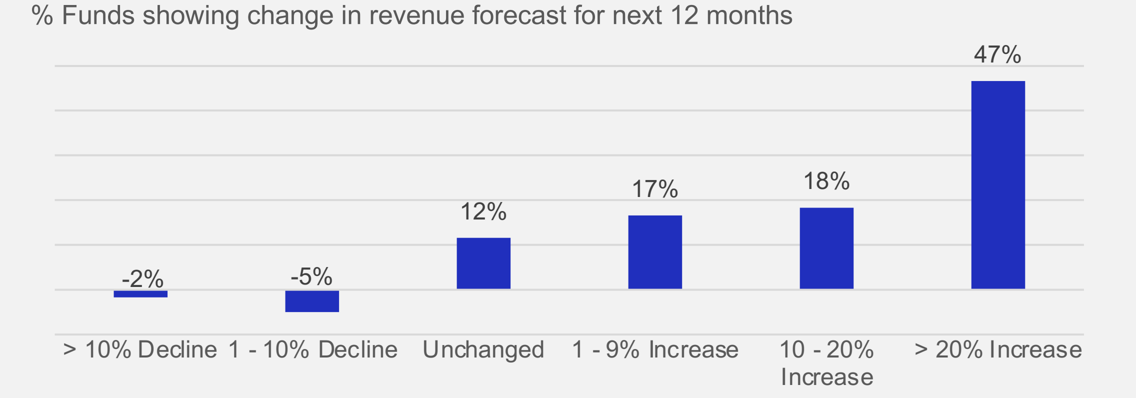
[20] *2022 Venture Capital in Africa Report (AVCA, 2023)*

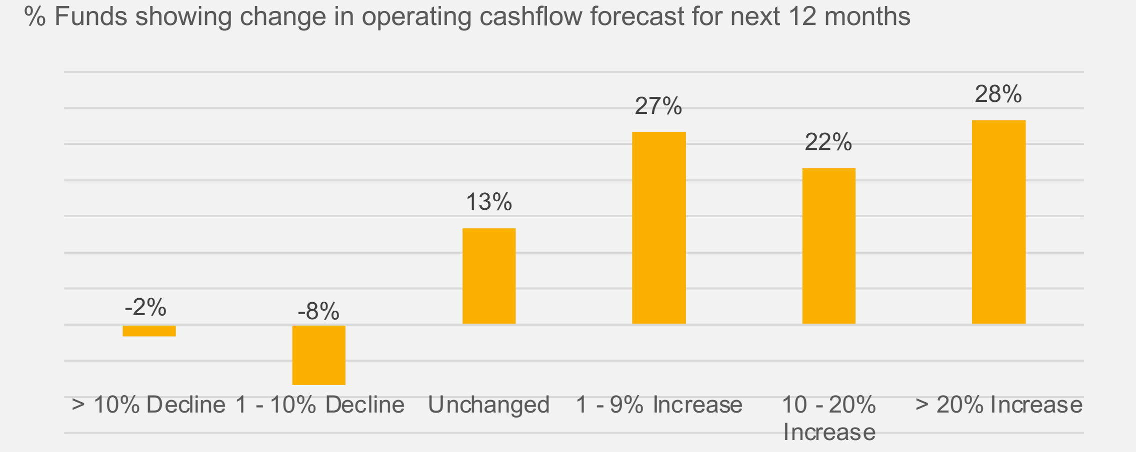
Reported financial metrics generally positive in the last 12 months





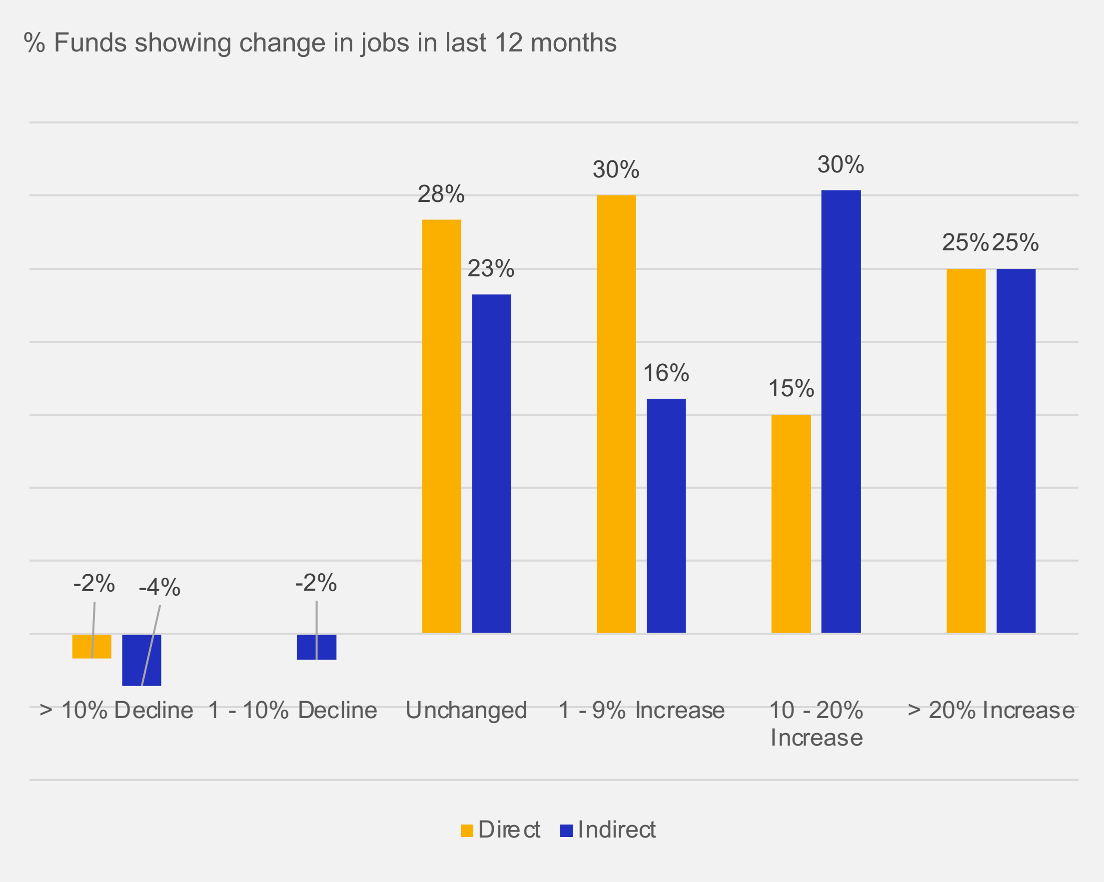
Buoyant forecast in revenue and operating cashflow for next 12 months

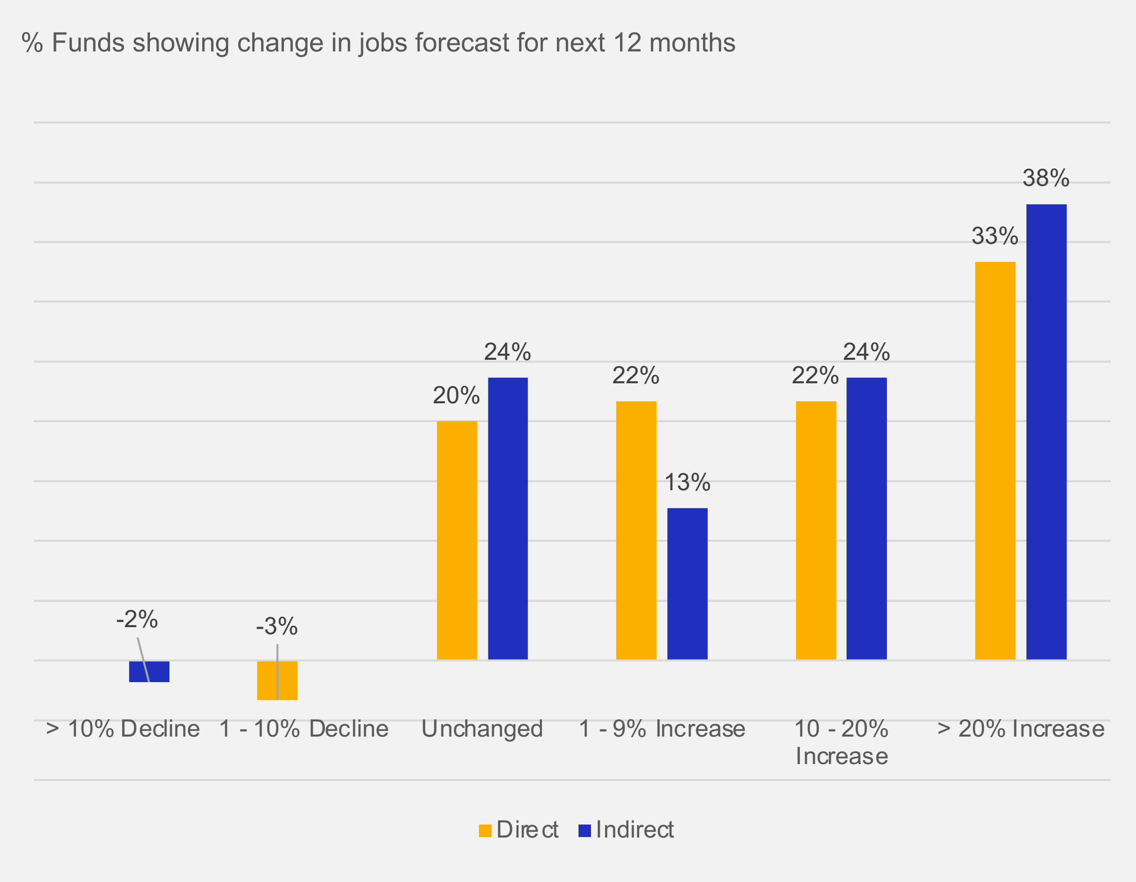




- The majority of fund managers report healthy revenue and operating cashflow growth in the last year despite turbulent macroeconomic conditions.

70% of funds reporting an increase in jobs over last 12 months



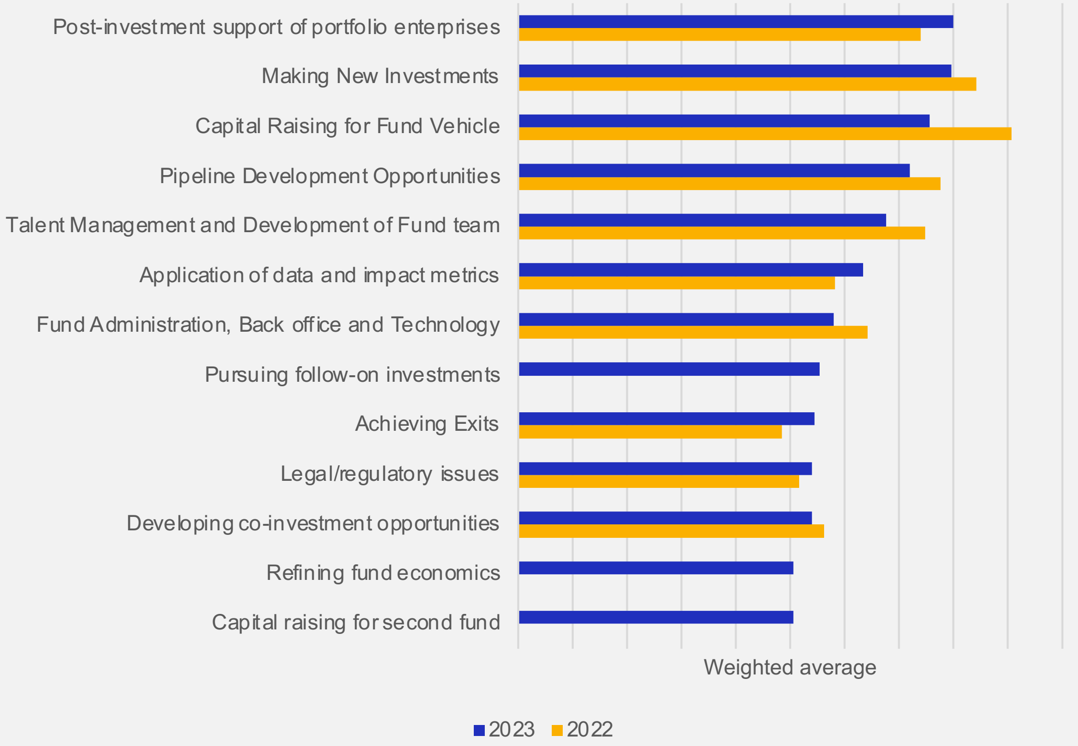


- All managers track job sustainability and growth, considering the high demand in these markets.
- When it comes to jobs, some fund, managers are moving beyond simple employment to incentivising entrepreneurs to provide 'good jobs' offering contracts, a living wage and learning opportunities.[21]

[21] *Balloon Ventures: Insights from small and growing business employees in Kenya and Uganda (60 Decibels, 2022)*

Slight shift in focus to deployment as funds reach first close although capital raising still a priority area

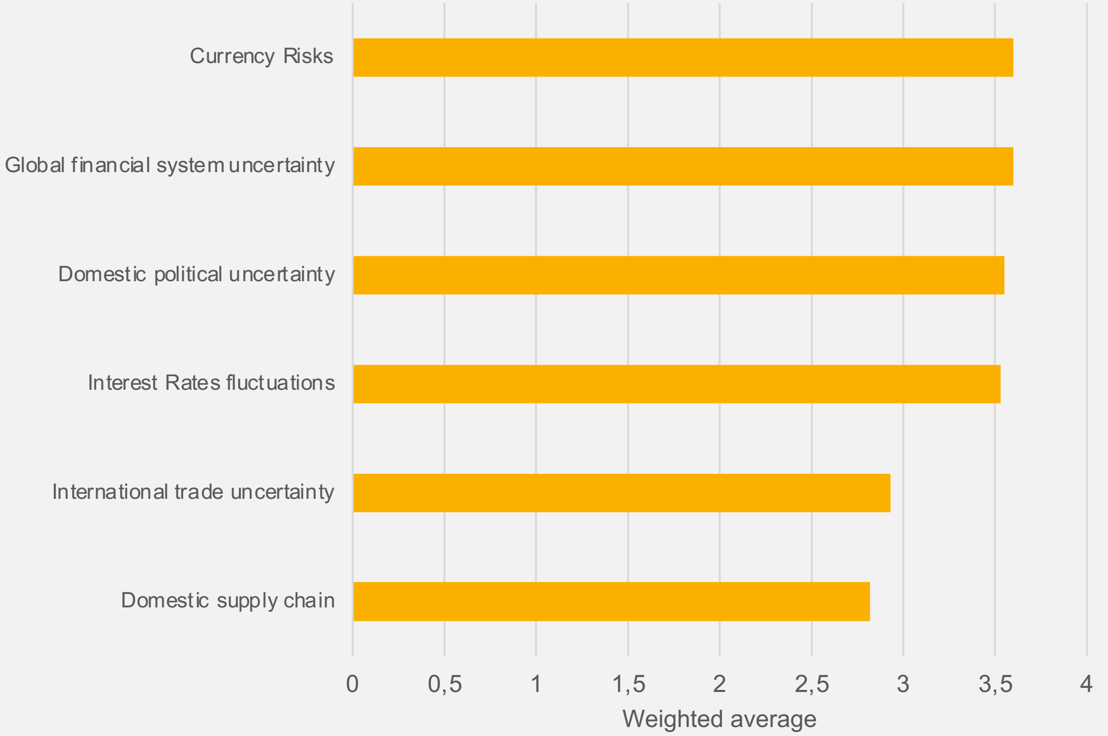
Areas of highest priority over the next 12 months for funds



- As fund managers start investing so there is slightly less emphasis placed on capital raising. This shift from last year is indicative of a a slight maturing of the market.

Macroeconomics continue to dominate list of concerns

International and domestic concerns over next 12 months



- Currency is an ongoing concern for fund mangers especially considering that 60% of LP commitments are in hard currency.

Survey questions

1. Name of organisation
2. How many funds are you currently raising and/or investing?
3. Name of Fund to which this survey applies
4. Timeline. When did your fund/investment vehicle achieve each of the following? (Please provide a date for each of three points in your fund's evolution)
5. In what geographic markets do you invest? (select as many as applicable)
6. Where is your Team based? (select as many as applicable)
7. Number of current and forecasted Full Time Equivalent staff members (FTEs) including principals
8. Number of carried-interest/equity-interest principals currently in your Fund management team
9. Gender Inclusion: Do any of the following apply to your fund?(select as many as applicable)
10. What is the prior work experience within the GP leadership team / fund principals, as it relates to fund management?
11. Team Experience: Please specify cumulative number of investment/financing transactions completed by your principal(s) prior to this current fund/vehicle? (Please provide answer for both columns)
12. Where is the legal domicile of your fund? Select as many as apply
13. Currency Management. What currency do you make investments? What currency is your fund LP vehicle? (Please answer for both as appropriate)
14. What is the fund type and current status of your most recent fund vehicle’s operations? (Please select appropriate response)
15. What are the current hard commitments raised, current amount invested/outstanding portfolio and target size of your fund vehicle? (USD Equivalent)
16. What is target number of investments for your fund?
17. Does your LP agreement/governance permit "follow-on" investments?
18. Has your fund/vehicle received concessionary capital for any of the following needs? (select as many as appropriate)
19. Existing sources of LP capital. Please indicate the percentage committed investment by each LP category into fund. (Please provide responses summing up to 100%)
20. Target sources of LP capital. Please indicate the percentage Targeted/Anticipated investment by each LP category into fund at full fund closing. (Please provide responses summing up to 100%)
21. In determining the capital contribution by the fund management team into the vehicle, what is the form of GP financial commitment? (Please select as many as apply)
22. What is the GP Management Fee? (Please select the appropriate description)
23. In what currency is your hurdle rate determined?
24. For your carried interest, what is your hurdle rate (%)?
25. Based on your investment thesis, what is your target local currency return (%) above domestic risk free return rate?

Survey questions

26. In raising funds for your vehicle, what are the factors that you perceive as the most consequential barriers/constraints in raising funds from potential investors?
27. Stage of the businesses that you finance / invest in. (Please provide responses summing up to 100%)
28. Mix in growth expectations of portfolio enterprises you finance / invest in? (Please provide responses summing up to 100%)
29. Describe the Key Financing Needs of your Portfolio Enterprises at the time of initial investment/funding. (Please provide responses summing up to 100%)
30. Target Investment Activities by Sector. Provide sector mix according to target outlined in investment thesis.
31. Financial Instruments to be applied in target portfolio (Please provide responses summing up to 100%)
32. Please list the top 3 Sustainable Development Goals that you target (or as many as apply):
33. Gender Lens Investing. Are any of the following either considerations or requirements when making investment/financing considerations? (Please provide a response for each row)
34. How do you source your pipeline? (Please provide responses summing up to 100%)
35. What is the average size of investments/financing per portfolio company?
36. What percentage of current capital raise are you funding for your portfolio companies (on average)?
37. In the first 12 months after closing on an investment, what are the key areas that you prioritise with regards to your portfolio enterprises?
38. How is your pre and post technical assistance to portfolio companies funded? (Please provide responses summing up to 100%)
39. Which of the following apply to your business development support to portfolio companies? (Select as many as apply)
40. Typical investment timeframe?
41. What is the typical form of investment monetisation/exit?(select as many as applicable)
42. List the number of investments made to date by your current vehicle.
43. List number of exits/monetisations achieved to date in current vehicle
44. List number of exits/monetisations anticipated in next 12 months
45. Please specify if you have made any other type of investment with funds raised that relate to your intended fund (such as warehoused investments). (Please provide form of investment and number of investments)
46. Please provide, across your portfolio, both the historical and expected average change in revenues and operating cash flow of your portfolio.
47. What is the total impact on employment/jobs associated with your portfolio? What has been the average impact since date of investments and what is the expected impact over the next 12 months on direct and indirect jobs?
48. What will be your fund's areas of priority over the next 12 months?
49. Over the next 12 months, what international and domestic factors are you most concerned that could impact your activities?

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