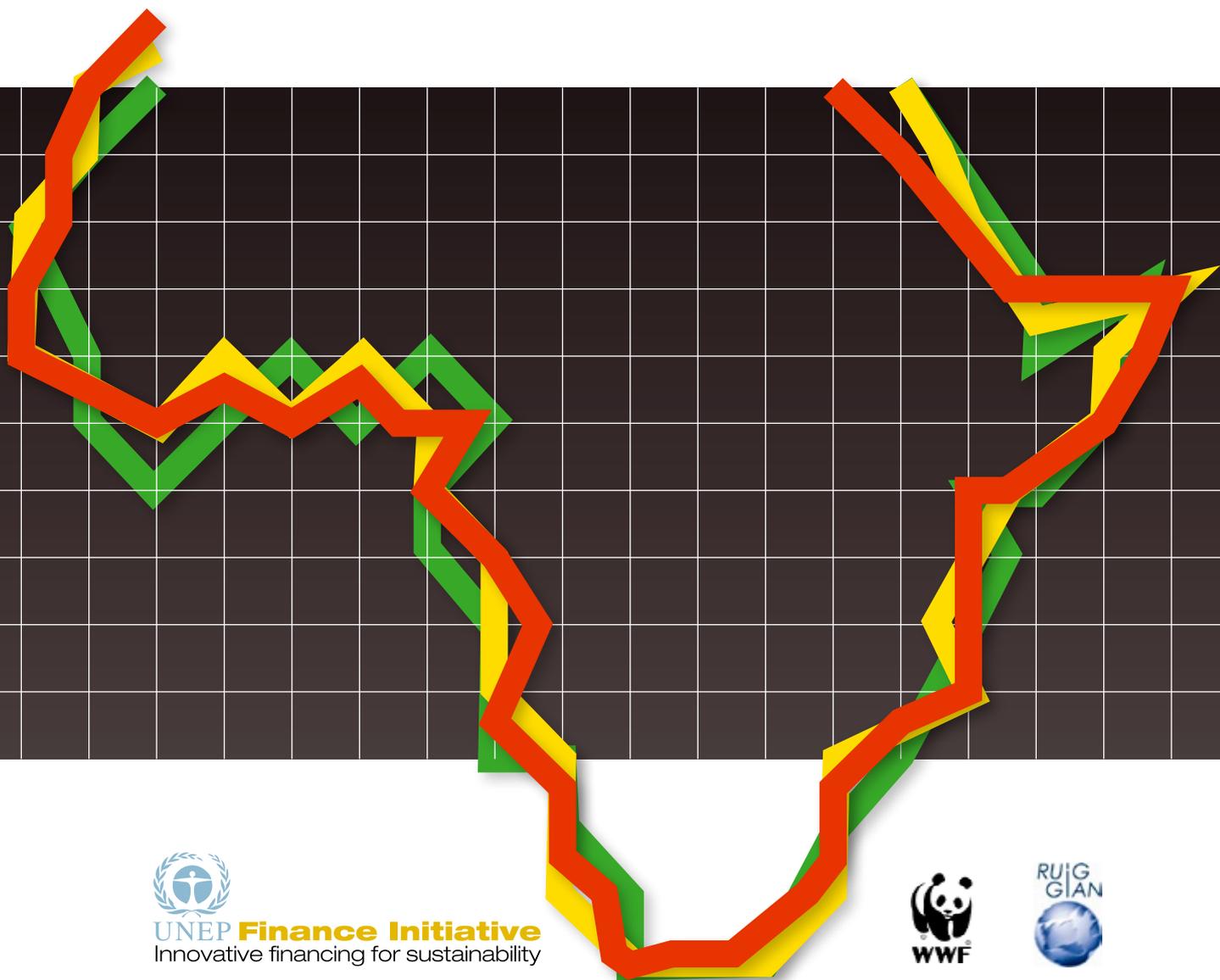


Innovative financing

for sustainable
small and medium
enterprises
in Africa



UNEP Finance Initiative
Innovative financing for sustainability



Innovative financing for sustainable small and medium enterprises in Africa

International Workshop
Geneva, Switzerland

2007 Meeting Report

Event organized by:

UNEP FI African Task Force (ATF)

WWF (the global conservation organization)

Geneva International Academic Network (RUIG-GIAN)

International Organizations MBA, University of Geneva



UNEP Finance Initiative
Innovative financing for sustainability

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Foreword



Few debate the view that a vibrant Small and Medium Enterprise (SME) sector can form the bedrock on which all economic activity is built, and that SMEs can be the mainstay of an economy, particularly in terms of employment. In many emerging markets the SME sector is one of the principal driving forces for economic growth and job creation. And this holds particularly true for many countries in Africa where SMEs and the informal sector represent over 90% of businesses, contribute to over 50% of GDP, and account for about 63% of employment in low income countries. However, inadequate access to financing continues to be one of the most significant impediments to creation, survival, and growth of SMEs in Africa.

As part of our mandate to support sustainable financial practices in Africa, the United Nations Environment Programme Finance Initiative (UNEP FI) African Task Force (ATF) commissioned this report to explore the issue of SMEs in Africa. The report looks at reasons for the lack of investment and suggests drivers that could spur interest in this critical area. Its aim is to provide practical guidance to SMEs, investors and supporting stakeholders to attract and facilitate an environment for sustainable economic growth in Africa.

This report is the result of research, discussions with experts, gathering case-studies, and an International Workshop on Innovative Financing for Sustainable Small & Medium Enterprises co-hosted by WWF and UNEP Finance Initiative. We are convinced this report will be an important addition to the excellent efforts by numerous stakeholders to gain a better understanding of the supply side barriers to increased investment in sustainable SMEs as well as identify concrete actions to advance this sector. We trust this contribution will add value to the efforts of those committed to creating sustainable livelihoods in Africa and for the protection of the continent's rich and diverse environment.

Paul Clements-Hunt

Head of Unit
UNEP FI

Objectives

Note to readers: This section outlines the objectives, structure and intended audience of this report.

This report is the result of an international workshop on 'Innovative Financing for Sustainable Small and Medium Enterprises in Africa', jointly undertaken by the United Nations Environment Programme Finance Initiative (UNEPFI) and the WWF, with support from the Geneva International Academic Network (RUIG-GIAN) and the International Organizations MBA at the University of Geneva. This workshop convened experts in small and medium enterprise (SME) financing and sustainability coming from public, private and philanthropic investment communities, as well as Africa-based organizations working on SME financing. Parallel research was conducted on the topics of 'Financing Mechanisms for Sustainable SMEs', 'What is a Sustainable SME?' and 'Risk Mitigation Mechanisms for Investing in Sustainable SMEs' conducted respectively by UNEPFI, WWF and DeRisk advisory Services, a development finance intermediary. Drawing on the research of WWF and DeRisk, aims of this report are three-fold:

- Draw the attention of development, philanthropic and private finance communities to the opportunities in investing in sustainable SMEs, and provide them with a better understanding of the issues surrounding this subject.
- Highlight innovative financing models, through illustrative case-studies of funds investing in sustainable SMEs in Africa.
- Present the inputs received from the workshop participants on how to best scale innovative models and create an environment conducive for increased private investment.

The report is intended for investors, fund managers, financial institutions, SMEs and policy makers and is structured in the following manner:

- Sustainable SMEs: This section gives a definition on sustainable SMEs and highlights the importance of SMEs for sustainable economic growth in Africa. Page 6
- Methodology: This section details the methodology used to identify the barriers and opportunities to financing SMEs in Africa. Pages 7–8
- Challenges to financing SMEs in Africa: This section highlights challenges faced on the demand side, by SMEs accessing finance. And, challenges faced on the supply side, by current investors in reaching out to SMEs, and barriers that keep potential investors from investing in SMEs. Pages 9–11
- Recommendations and current financing options for SMEs: Based on the barriers and challenges previously highlighted, this section provides recommendations. Pages 12–13
- Successful case studies of innovative financing models investing in sustainable SMEs in Africa: This section presents the following four case studies of innovative investment models. Pages 14–23. These examples were derived from the following companies:
 - Acumen
 - GroFin
 - E+Co
 - Root Capital

Sustainable SMEs

Note to readers: This section gives a definition on sustainable SMEs and highlights the importance of SMEs for sustainable economic growth in Africa.

Small and medium enterprises (SMEs) have become the focus of attention for development stakeholders interested in market-oriented solutions to poverty and economic development. While the definition of SMEs varies from one country or continent to another, most of these organizations have been using the definition of the SME sector as provided by the World Bank or International Finance Corporation (IFC). In terms of need for finance, the IFC defines an SME as:

- Small Enterprises: Loan Size of \$10,000 to \$100,000
- Medium Enterprise: Loan Size of \$100,000 to \$1 million

Further, a number of organizations are actively striving to promote the role of SMEs as vehicles for sustainable development. However, there has been a noticeable gap in defining the term 'sustainable SMEs'. Acknowledging this gap, the WWF commissioned research to define the term 'sustainable SME'.¹ As a starting point for the coherent definition of the field, two categories of sustainable SMEs have been identified:

- 1 SMEs that are internally driven to contribute to sustainable development to the maximum extent possible, and
- 2 SMEs that happen to support sustainable development in some way that is appropriate to the context within which they operate (including social and economic development)²

In many emerging markets, the SME sector is one of the principal driving forces for economic growth and job creation. And this holds particularly true for many countries in Africa where SMEs and the informal sector represent over 90% of businesses, contribute to over 50% of GDP, and account for about 63% of employment in low income countries³. Despite these opportunities, SMEs in Africa face many obstacles including corrupt governance structures, unfavorable macroeconomic environment, debilitating physical infrastructure, and administrative challenges. However, inadequate access to financing continues to be one of the most significant impediments to creation, survival, and growth of SMEs in Africa.

Further owing to their high risk profile, SMEs in Africa largely remain an unattractive investment for mainstream investors. Of particular concern to investors are the country, currency, and credit risks, characteristic of many African countries in which SMEs operate. However, recent years have seen an upsurge of interest in this sector from various types of investors, namely, development finance institutions and philanthropic investors that envision a double value in their investments in SMEs – they are spurring sustainable economic development, while at the same time, earning reasonable financial returns.

Few SME investment models however, have emerged that have managed to turn the risk/return profile of SMEs in favor of increased investment. Successful SME financing models have been seen in some regions of Africa and are highlighted in this report. Therefore, the aim of this report is to present opportunities in financing SMEs as a vehicle for creation of sustainable economies throughout Africa.

1 For details on the term 'sustainable SMEs', please refer to the WWF report called 'Sustainable Small and Medium Enterprises: Creating Value within Planetary Limits', which was prepared as research input to the workshop.

2 The focus of the UNEP FI and WWF workshop focused on sustainable SMEs that employ between 10 and 100 people and with financing needs anywhere from USD 50,000 to 500,000 for early stage, high potential, high growth sustainable enterprises. It is for this segment within the larger SME sector spectrum where the financing gap is most acute, where interventions are difficult and therefore call for innovation.

3 Annual Report 2005, UN Economic Commission of Africa (UNECA)

Methodology

Note to readers: This section details the methodology used to identify the barriers to SME financing models in Africa and potential measures for more investment.

Our findings are mostly based on an International Workshop held on Sept 26, 2007. UNEP FI and WWF in Geneva organized this workshop, which brought together experts from the investment communities in the public, private and philanthropic finance sectors, fund managers, and SME support organizations, to gain a better understanding of the supply side barriers to increased investment in sustainable SMEs as well as identify concrete actions to advance this sector.

The workshop was divided into two parts. The morning session focused on innovative SME financing models and barriers to their scale, followed by presentations on successful models for financing. The theme of the afternoon session was on mitigating risk and actions and next steps. This session went into further depth on SME financing related issues and was opened by a presentation on risk in SME investing and mitigation mechanisms, by DeRisk. This presentation engaged stakeholders in identifying practical solutions keeping in view the barriers and challenges identified earlier in the day, as well as concrete recommendations. Participants were divided into groups of 8-10 during the entire day and were asked to brainstorm on a specific set of questions relating to the identified themes for the respective workshop sessions.

Case studies were invited from public, private, and philanthropic investment sectors of successful models that provide financing to SMEs in Africa. Case studies highlighted in this report include: Acumen Fund, E+Co, Grofin, RootCapital, and FMO. Participants in this workshop are listed below.

Participant Name	Position	Organization
Alberic Pater	CSR Consultant	Triodos FACET
Aleem Walji	Head of Global Development Initiatives	Google Foundation
Andrew Gaines	Managing Partner	DeRisk Advisory Services
Andu Alem Tegegne	Former Secretary General	Ethiopian Chamber of Commerce
Angela de Wolff	Director of Investments	ConSer Responsible Investments
Ayodele Aderinwale	Executive Director	Africa Leadership Forum
Barbara James	Executive Director and Founder	Africa Venture Capital Association (AVCA) and Henshaw Capital Partners
Bernd Balkenhol	Director of Social Finance Programme	ILO
Bruno Wenn	Senior Vice President, Sub-Saharan Africa	KfW
Chris Venter	COO	Grofin
Christina Adams	Independent Consultant	
Christoph Achini	Senior Investment Manager	Swiss Investment Fund for Emerging Markets (SIFEM)
Corinne Proske	Manager, CSR	National Australia Bank
Cristina Gueco	Project Manager	UNEP Finance Initiative
Daniel Magallon	Acting Managing Director / Project Manager	Basel Agency for Sustainable Energy (BASE)
Dorothee Teichmann	Intern	UNEP Finance Initiative
Dupe Adelaja	Director General	SME Development Agency of Nigeria
Elodie Dewarlincourt	Africa Programme Manager	State Secretariat for Economic Affairs (SECO)
Elsie Enniful Adu	General Manager	Fidelity Capital Partners Limited
George Ocora	Finance Consultant	Finance Consultant
Henry Morgan	Senior Vice President	de Pury Pictet Turretini & Co. Ltd
Inderpreet Chawla	Project Manager	UNEP Finance Initiative

Jan Kappen	Program Manager, Energy Finance	UNEP
Jean Altounian	Partner	Courvoisier & Associates SA
Jem Bendell	Independent Consultant / Associate Professor	Lifeworth Consulting / Griffith Business School
Jen Morgan	Manager, Sustainable Finance	WWF
Jennifer Inglis	Consultant	WWF
Jim Bunch	Director of Investments	Omidyar Foundation
Jo Schwenke	Managing Director	Business Partners South Africa
Johannes Majewski	Project Manager	GTZ
John Karuri	MBA Candidate	IOMBA, University of Geneva
Judy Im	MBA Candidate	IOMBA, University of Geneva
Julie Greene	MBA Candidate	IOMBA, University of Geneva
Kimberly Ochs	Researcher	London School of Economics
Marc Pfitzer	Managing Director	FSG Social Impact Advisors
Marieke Hussels	Associate	World Resources Institute
Marina Krawczyk	MBA Candidate	IOMBA, University of Geneva
Michal Bruck	MBA Candidate	IOMBA, University of Geneva
Milton Lore	Managing Director	Bridgeworks Africa Limited
Natalie Ryan	Project Manager	UNEP Finance Initiative
Nate Schaffran	Investment Officer, Africa	Root Capital
Oliver Karius	Managing Director	Vantage Point Global
Paul Clements-Hunt	Head	UNEP Finance Initiative
Paul Van Aalst	Director of Europe	E+Co
Pipien Hakizabera	Director	Center for Support to SMEs in Rwanda
Preeti Sinha	Finance for Development Initiative	World Economic Forum
Roland Hunzicker	Programme Manager, Development Development (WBCSD)	World Business Council for Sustainable
Smita Sircar	MBA Candidate	IOMBA, University of Geneva
Stephen Antwi-Asimeng	Managing Director	Fidelity Capital Partners Limited
Sylvaine Herold	Economist	Regional Sustainable Energy Group
Thomas Abraham	MBA Candidate	IOMBA, University of Geneva
Tracy K. Lloyd	Investment Officer	Mozambique SME Initiative, International Finance Corporation (IFC)

Challenges to financing sustainable SMEs in Africa

“If the financial world is a casino, SMEs are not even getting to the slot machines.”

Paul Clements-Hunt, Head of Secretariat, UNEP Finance Initiative

Note to readers: This section highlights challenges faced on the demand side, by African SMEs accessing finance. And, challenges faced on the supply side – by current investors reaching out to SMEs, and by potential investors considering investing in SMEs. At the workshop, we asked participants in separate groups to identify the biggest challenges to scaling innovative financing mechanisms for sustainable SMEs. Barriers are classified by the following type:

- Perceptual Barriers
- Institutional Barriers
- Policy and Regulatory Barriers
- Skills, Knowledge, Information and Training Barriers

The most commonly cited barriers were:

Perceptual Barriers

“Small is risky. Small does not have the skills to successfully run a business. This perception becomes a barrier for SMEs in getting finance.”

Andu Alem Tegegne, former Secretary General of the Ethiopian Chamber of Commerce, Partner at Goh Capital Partners

- 1 SMEs that form the ‘missing middle’⁴ in demand-side financing landscape in African countries are generally perceived by local banks and financial institutions as risky and therefore unprofitable.
- 2 Small entrepreneurs do not have the skills/capacity to run successful businesses.
- 3 Differing incentives, expectations and motivations between investors and fund managers with regards 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.
- 4 Perception of equity amongst entrepreneurs as giving away stake in their businesses to outsiders hinders them from accessing equity type financing.
- 5 Enforcing environmental sustainability as a pre-condition to financing hinders the SME’s chances of accessing affordable finance.
- 6 The cost of doing business with banks in Africa is high, while the professional attitude is low.

⁴ The focus of the UNEP FI and WWF workshop focused on sustainable SMEs that employ between 10 and 100 people and with financing needs anywhere from USD 50,000 to 500,000 for early stage, high potential, high growth sustainable enterprises. It is for this segment within the larger SME sector spectrum where the financing gap is most acute, where interventions are difficult and therefore call for innovation.

Institutional Barriers

“There is a need to tap the global financial stock, and reflecting on this we have to rethink the role of the development finance institution.”

Bruno Wenn, Senior Vice President, Subsaharan Africa, KfW

- 1 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.
- 2 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.
- 3 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.
- 4 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.
- 5 The majority of enterprises operate in the informal sector, therefore making it difficult to identify their capital and training needs.

Policy and Regulatory Barriers

“We are seeing a trend throughout the world of investment size going up, rather than down, to address the SME sector.”

Barbara James, Executive Director, Africa Venture Capital Association (AVCA) and Founder, Henshaw Capital Partners

- 1 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 recognized 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.
- 2 Variance in regulatory regimes from one country to another exacerbates the problems faced by fund managers in serving SMEs.
- 3 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%) 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

- 1 Most fund managers, local banks, or financial institutions are not skilled to deal with the SME sector, let alone sustainable SMEs. There is an added challenge for sustainable SMEs, who operate in more niche sectors such as renewable energy or organic agriculture, etc. Most investment officers do not have knowledge of these sectors and are therefore unable to serve these SMEs appropriately.
- 2 In many cases banks are not using the right credit technology that can be useful for reducing transaction costs.
- 3 It is difficult to understand and identify the specific training needs of the African entrepreneur.
- 4 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.)
- 5 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.
- 6 Lack of standardized reporting is a barrier for investors trying to understand the landscape.
- 7 Lack of adaptation to local/regional/national needs.

Recommendations and current financing options for SMEs

Note to readers: Participating experts at the workshop were asked for recommendations on various aspects related to SME financing in Africa. This section presents the key recommendations offered:

1. Educate investors about blended value approaches to financing

It was widely acknowledged at the workshop that aside from the challenges faced, sustainable SMEs clearly offer an opportunity to create financial as well as environmental value. While this has resulted in tremendous interest in SMEs amongst development finance and philanthropic investment sectors, private sector participation is a must. Towards this end, it is a crucial prerequisite to educate mainstream investors about various blended value investment approaches. Further, coordinated efforts should be spent in developing credible blended value approaches that could work in African countries.

2. Build local / regional groups to strengthen local institutions and banks

Without local participation, the long-term success of any initiative, especially in the field of SME financing, cannot be assured. It was recommended that capacity building and engagement of local banks while building new regional institutions that serve the needs of SMEs is a must. Such institutions could become integrated platforms or centers for skills, knowledge, and training that would not only impart relevant skills and training to SMEs but would also help them identify opportunities in broader markets.

3. Train African fund managers in identifying, investing in, and promoting sustainable SMEs

African fund managers are on a steep learning curve when it comes to engaging international investors, and can benefit from increased exposure to international finance.

4. Conduct research to generate more knowledge on SME financing

Defining sustainable SMEs continues to be a work in progress. Further research is needed to refine and standardize the definition of sustainable SMEs. For different stakeholders to effectively collaborate with each other there is a need to share a common language.

5. Explore mechanisms to align investor incentives

Investors from the public, private and philanthropic institutions approach SME financing with differing, yet at many times complimentary incentives. With increased coordination amongst players from these categories, their efforts can bear greater fruit. On these lines, a need for an honest broker was expressed – such as, an institute that would serve as an intermediary body between different levels of organizations within the SME investment value chain. There is a need to connect different stakeholders allowing for a transparent information flow from local fund managers to global investors and vice-versa.

6. Organize a focused workshop in each region of Africa

In particular, invite more stakeholders from the demand side of SME financing, namely entrepreneurs, business associations and trade groups. Needs of SMEs, fund managers, and the context within which they operate vary tremendously from one region of Africa to another. Regular regional workshops focusing on sustainable SME financing and bringing together respective key players would be beneficial for the sector.

7. Partnering or tapping into existing institutions and networks to deliver the objectives

Following some of the recommendations pointing to the need for increased coordination amongst various, and often disconnected, stakeholders interested in sustainable SME financing, institutions with objectives to stimulate and promote private capital in Africa to alleviate poverty and promote sustainable development could be used as platforms to act as an 'honest broker' - a coordination mechanism for various stakeholders including investors from public, private and philanthropic institutions, active in SME financing and seeking synergies with players from complimentary sectors.

Existing institutions and networks could also act as a knowledge center conducting latest research into issues associated with SME financing, generating knowledge relevant to multiple stakeholders interested in SME financing as well as for distributing this knowledge to relevant stakeholders. These institutions include amongst others, the African Venture Capital Association, Financial Sector Deepening Kenya, FinMark Trust, country banking associations, etc.

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 clearly possible to create value for the environment as well as larger development goals without sacrificing financial returns. The workshop invited senior level experts from three such organizations that have developed precisely such a model and are operating quite successfully not only in African countries but in other parts of the world as well. With the aim of bringing such examples to the attention of mainstream investors seeking avenues for investment with multiple objectives, this report 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's 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)⁵ 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,

⁵ The idea behind TBL investments is to not only improve profits (the economic aspect) but to also improve environmental and social performance, thus the goal is to achieve these three pillars.

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.⁶ 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.

⁶ It is estimated that rural population accounts for an even greater proportion (75%) of the 1 billion people living in extreme poverty under \$1 per day ("Global Monitoring Report 2007," World Bank).

■ 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.

Opportunities leveraged

Central to Root Capital's lending model are the strong relationships it fosters with a growing network of partner organizations. Key strategic partners include:

1. Buyers

Root Capital works with an array of buyers, from alternative trade organizations engaged in 100 percent fair trade practices (e.g., Cooperative Coffees, Equal Exchange, Twin Trading) to more mainstream companies for whom sustainable natural products represent a profitable and growing segment of their business (e.g., Green Mountain Coffee Roasters, Starbucks, Whole Foods). Buyers serve the important role of bringing prospective clients to Root Capital's attention and providing their own purchase contracts as collateral to mitigate Root Capital's risk. In return, Root Capital's loans offer a critical service to buyers by strengthening the operations of their suppliers, thus stabilizing their supply chains.

2. Nongovernmental organizations (NGOs)

NGOs engaged in eco-labeling and fair trade certification, such as Rainforest Alliance and

TransFair USA, help Root Capital identify prospective clients and reduce its client acquisition and monitoring costs by conducting independent assessments of the social and environmental impacts of potential borrowers. Furthermore, NGOs working in grassroots business development and environmental stewardship provide technical assistance to Root Capital's clients, enabling them to successfully grow their businesses with the loan capital they receive.

3. Specialized financial intermediaries

Root Capital has structured co-lending deals with other like-minded social investment funds, such as Calvert Social Investment Foundation and RSF Social Finance (formerly Rudolph Steiner Foundation), that may not otherwise work in rural markets in the developing world. In such an arrangement, Root Capital conducts credit reviews on behalf of these partners while leveraging their capital and core competencies.

4. Multilateral agencies

Root Capital has piloted a limited guarantee facility with the United States Agency for International Development's (USAID) Development Credit Authority (DCA) that provides a 50 percent guarantee on cumulative loan disbursements of up to \$4 million in Latin America and up to \$2 million in East Africa. That is, for each loan Root Capital places under the DCA guarantee, the U.S. government provides 50 percent risk-sharing on the loan.

5. Commercial financial institutions

Root Capital aims to create an SME finance asset class and graduate its clients to be served by local commercial banks. For example in Rwanda, local banks began lending to smallholder coffee farmer cooperatives in response to Root Capital's initial financing activity. In southern Mexico, Fondo Accion/ Banamex, a public/private financing venture of Citibank, leveraged Root Capital's factoring methodology to finance several former borrowers.

6. Industry Alliances

Root Capital has played a leading role in launching two new alliances: Finance Alliance for Sustainable Trade (FAST), a trade association of socially- and environmentally-minded SME financiers, and the Aspen Network for Development Entrepreneurs (ANDE). FAST aims to play an advocacy role by raising awareness within the investor and policy-making communities of the opportunities and development benefits associated with sustainable trade SMEs. Speaking in a unified voice will improve the ability of SME-focused organizations to access investors, governments and key decision makers. FAST also advances the SME sector by coordinating efforts and sharing best practices in areas such as technical assistance, impact assessment, due diligence and financial training. ANDE is an industry alliance convened by The Aspen Institute to support SMEs and entrepreneurs in developing countries that create jobs, build assets, lift household incomes, and generate public goods such as landscape stewardship and better access to primary healthcare.

For more information visit <http://www.rootcapital.org/>

Project partners

United Nations Environment Programme Finance Initiative (UNEP FI)

The United Nations Environment Programme Finance Initiative (UNEP FI) is a global partnership between the United Nations Environment Programme and the private financial sector. UNEP FI works closely with 170 financial institutions that are signatories to the UNEP FI Statements, and a range of partner organisations, to develop and promote linkages between the environment, sustainability and financial performance. Through regional activities, a comprehensive work programme, training activities and research, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

UNEP FI African Task Force (ATF)

The African Task Force is UNEP FI's platform in Africa. ATF members are financial institutions that collaborate to drive sustainable development, and address the critical environmental and social issues in Africa. The group has a mission of supporting and expanding sustainable financial practice throughout the continent. The ATF consists of the following members:

Africa Investor
African Institute for Corporate Citizenship
Citi South Africa
Development Bank of South Africa
Industrial Development Corporation
Nedbank
Standard Bank Group
Societe Generale
Standard Chartered Bank
Swaziland Development & Savings Bank
The Banking Association South Africa
The Netherlands Finance Corporation (FMO)
University of South Africa (UNISA)

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World Wide Fund for Nature (WWF)

WWF is one of the world's largest and most experienced independent conservation organizations, with almost 5 million supporters and a global network active in more than 100 countries. WWF's mission is to stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature, by: a) conserving the world's biological diversity, b) ensuring that the use of renewable natural resources is sustainable, c) promoting the reduction of pollution and wasteful consumption.

For more information visit <http://www.wwf.org/>

Geneva International Academic Network (GIAN)

The GIAN is an international research network founded by the University of Geneva, the Graduate Institute of International Studies (GIIS) and the Graduate Institute of Development Studies (GIDS). Its main objective is to create synergies among various entities, principally academic institutions and international organizations - governmental or non-governmental - to further the role of Geneva and Switzerland in the service of peace and justice.

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