Collaborative for Frontier Finance
Annual Gathering of Small Business Local Capital Providers

Objective and Convening Design

Over four days, 27-30 November 2024 in Cape Town, South Africa, CFF convened approximately seventy organizations that are leading players in addressing the capital gap for small businesses in Africa and MENA.

The **objectives** of CFF's annual gathering include:

- Leverage the value of peer-based learning among the emerging asset class of local capital providers (LCPs) that finance and invest in small and growing businesses in these markets.
- Surface and assess market opportunities and constraints.
- Develop an informed dialogue among the LCPs and the broader ecosystem of organizations in the "continuum of capital" for Africa and MENA's small and growing businesses.
- Build "*actionable*" relationships among the participants to address the market opportunities and constraining barriers.

The **approach** of the event was determined based on input from Early-Stage Capital Provider (ESCP) Network Members during a series of "weaving calls" conducted in the months prior to the event. The focus of these calls was primarily on what attendees wanted to learn and accomplish during this year's convening, as well as the potential outcomes of being together as a collective in the same room. Converge, the event facilitator, CFF, and the Event ESCP Members Content Committee worked together to transform the outputs from these weaving calls into discussion topics for the event.

Building upon the approach for our gathering in 2022, we **segmented the event** into three parts, (i) two days of workshops and peer engagement among the ESCP network members, (ii) a day of structured interaction among the ESCP members and the broader community of institutional capital holders and ecosystem builders, and (iii) an additional day for discussions among these critical players in the broader ecosystem.

In addition to determining the content to be discussed at the event, careful thought and design were put into sequencing the conversations and building trust and engagement over the period. This was all done with the goal of fostering closeness and creating an environment conducive to sharing

Link to pre-reading outlining discussion topics including (i) Enhancing existing Fund of Funds structures (ii) Coordinating shared learning and capacity building and (iii) Crowding in domestic capital.

Summarizing comments by two catalytic LPs in attendance:

"The CFF Annual Convening highlight the challenges emerging managers face in raising capital…"

and

"I've engaged with a lot of fund managers, diverse fund managers, female-led diverse teams, and … I'm hearing them and what we can do to improve the way in which we respond … and meet them where they are,
- and that is what we're going to do."

Overview of participants

- 64 organisations and 84 individuals attended.
- Addressing a learning from our Hague gathering of LPs in 2022, we purposely sought out participation of local domestic institutional capital holders and their advisors.
- We noted with over $1.5billlion worth of AUM in demand for capital among FoFs investing in small business finance across Africa, there was approximately $700m represented in the room through FoF vehicles and institutional investors. The transitional funders in attendance manage over $200million in catalytic funds.
- Check out the Lookbook for participant profiles
- YouTube Recap of CFF Annual Convening in Cape Town https://youtu.be/vQmrvp8R2fc

CFF Annual Local Capital Provider Survey 2023

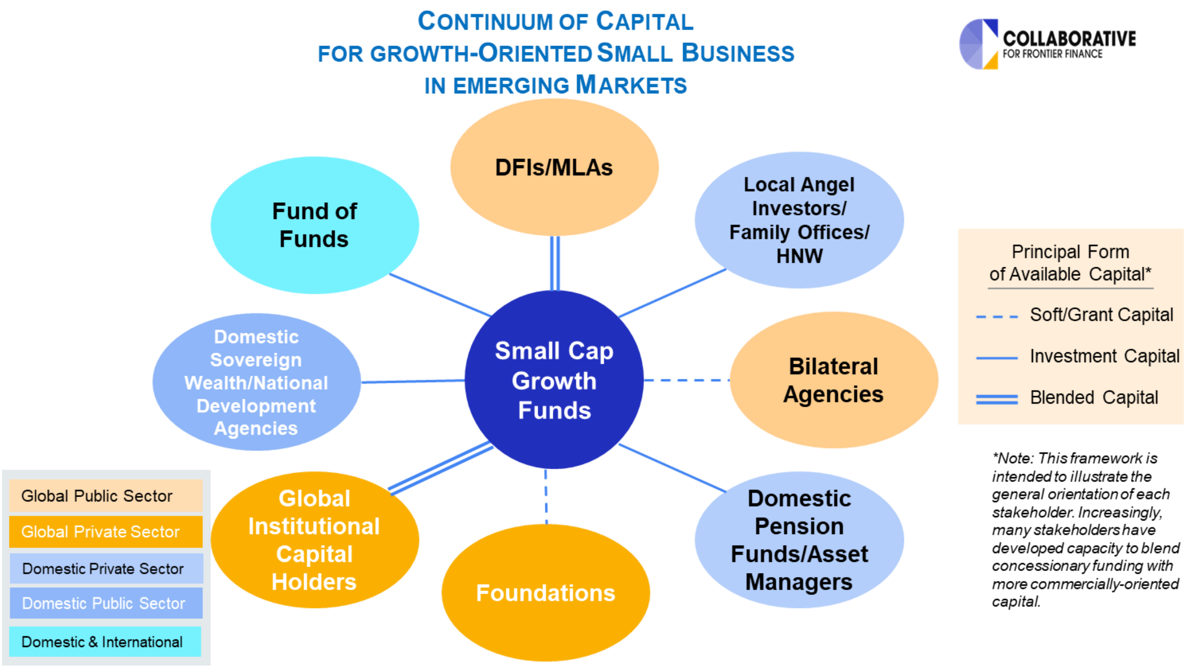
This year's publication highlights the increasing influence of local capital providers throughout Africa and MENA. It categorizes the small business finance asset class, delineating their pivotal role in supply8ing growth capital to businesses and reveals the strategies fund managers are using to build track record, address fund economics and raise capital. The 60 survey respondents aim to secure $1.5billion in capital, following their investments in 1,200 businesses to date.

Discussion Highlights and Key Takeaways

Over the four days, the gathering included more than 50 local capital managers operating across Africa and MENA. In addition, an additional 25 stakeholders from across the broader ecosystem and continuum of capital participated. All are keenly interested in - and are "*invested in*" - the role that capital can play to grow and sustain small businesses operating in Africa and MENA.

The CFF gathering operates under a Chatham House rule. The following notes are representative comments from the participants regarding the key topics and emerging themes from the discussion.

Local Capital Providers are a critical link in the access to capital for small and growing businesses in emerging markets.



Key Issues and Priorities of the ESCP Network and Ecosystem Stakeholders

Building Trust and Raising Capital. *"We are a new asset class."* Given the nascence of this class, a critical consideration is accessing institutional and LP capital. Providing appropriate capital to small businesses in these markets is the principal activity of the network of local capital providers. It is an emerging asset class that differs from traditional private equity, venture capital, microfinance and regulated banking institutions.

Repeatedly, we hear that investment pipeline is not a challenge for small business funds. On the contrary, the leading constraint is access to institutional and LP capital.

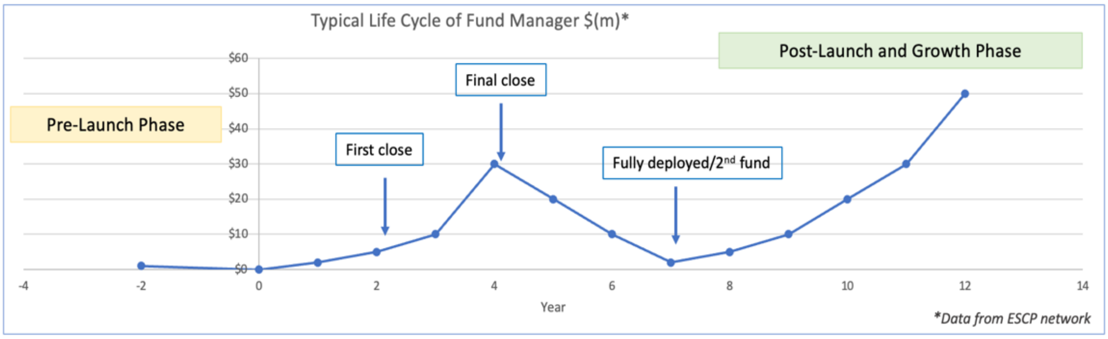
"It has been reported that of the existing DFI investments in Africa, 40-50% are trapped assets, without exits.[1] LPs have these stats in mind when looking at emerging fund managers,

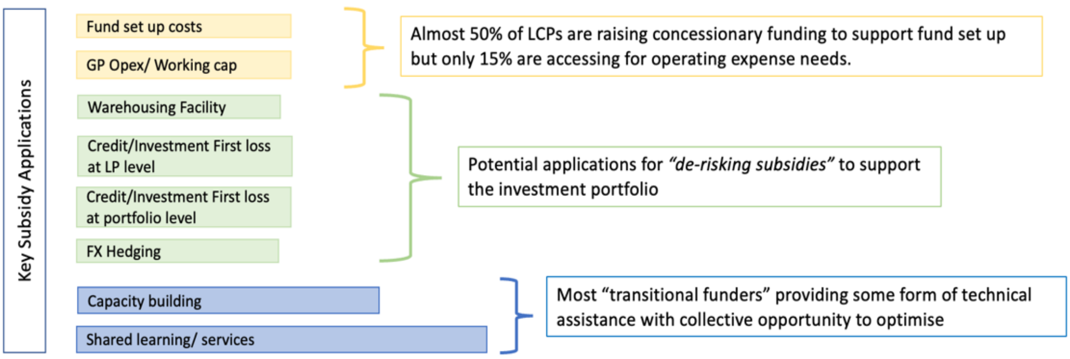
[1] *The Funding Models of Bilateral Development Finance Institutions (OECD, 2023). See p. 40's discussion of the "equity question" and "zombie funds."*

therefore it is a challenge to justify supporting what is new asset class and perceived riskier emerging fund managers. LCPs are working against these statistics and history".

While seeking to develop the SME sector in their markets, a key to success is the focus by LCPs is their ability to assess local value chains, business opportunities, and entrepreneurs. Local LP investors have recognised that LCPs are well placed to can manage risks associated with small businesses in their markets. However, the perception of risk from international [development finance] investors is materially more cautious.

There is the need to *"…build a continuum of capital for emerging fund managers - we need to get to a higher volume through more intentional conversations*."





"Relationship empathy is helpful for both LPs and LCPs. This dynamic is a two-way street - both sides [need to be] winning".

Track Record and Team Development. For first-time fund managers the key barrier placed by institutional capital holders, including DFIs, is capacity to demonstrate portfolio track record. [2]

When discussing track record, LPs not only focus on the traditional metric of "exits". They also look at the history of the team working together, precedents for the stated investment strategy, with data points to support. As such, a fund manager needs to demonstrate (a) their understanding of the drivers of success/failure, (b) sufficient team capacity as GP, and (c)

[2] *Annual Local Capital Provider Survey 2023 (CFF, 2023). See p. 42, "Fund Economics, Business Risk, and Track Record Continue to Deter LPs."*

ability to find, fund, and support portfolio investments within their value chain. All contributes towards the perceived ability of a GP to offer downside protection – and in doing so, provide confidence to institutional investors. Takeaways: Supporting data and in some cases, proxies for traditional fund manager experience need to be considered:

- Demonstrate track record - with narrative and data, , i.e. how long you've worked with entrepreneurs, transferring skill sets from other industries, demonstrating you are a successful entrepreneur who has built their business.
- Leverage the GP team's own prior experiences - which may not simply be exits performance. Rather, LCPs need to provide contextual experience to demonstrate that the team brings relevant, credible expertise, works well together, finds great deals, and executes.
- Credibility of Investment committee – effective means to mitigate risk and build in additional rigour and experience into the investment process.
- Partner with established investor(s) such as angel networks to lend credibility.

Feed innovation, and embrace systemic changes. Small business finance is an emerging asset class. Therefore, *"…market creation requires investment in innovative funding models"*.

"The type of capital that is flowing is not conducive to the needs on the ground. We're still not solving for the entrepreneur. We need to focus on the business."

"New facilities are coming to market. New funds are proving themselves."

Similar to hedge funds and private debt funds in the US, small business funds have varied investment thesis and approaches to their portfolio investments. This diversity increases the challenge for institutional investors to "dive in" at speed, and certainly not with large-size investments into the LCPs. Rather, with this emerging asset class institutional investors raise questions such as *"…how can we be sure you can execute?".*

Innovation and new market opportunities come in multiple forms.

- **Fund constructs and timeframes**. Often LP's expectations are not aligned with the timeframe required to capacitate and build successful businesses. Along these lines, there is a strong sentiment that "…*there is a need for open-ended structures rather than close-ended structures."*
- **Innovations in the functionality and economics** of fund operations has allowed LCPs to finance small businesses with "appropriate" capital. However, institutional investors continue to be largely wed to the 2/20 fund management construct. Instead, "…*management fees mismatch also needs to be addressed*."
- **GP contribution**. *"A percentage should come from GPs, but maybe skin in the game can look differently. Forgone salary can be considered "skin in the game."*
- **Geographic and market segments**. LP's have been cautious on difficult operating environments like Mozambique and Zimbabwe. Yet, with deep local knowledge, LCPs are able to uncover hidden gems that are making these environments investable.

> Similarly, even in more stable economies, "LP's have not relied on local LCP's capacity to navigate small business investment opportunities."

Regarding return expectations, while seeking to drive economic development via supporting small businesses, this asset class is being compared to "*absolute returns strategy, to the S&P returns*". Fundamentally, there is a misconception about small business finance funds – that they inherently achieve inferior returns. Indeed, at this stage of the sector's development, net returns may be affected by the relative cost of managing smaller funds and transaction sizes, the application of impact reporting, and the inherent timeframe for growing businesses to generate free cash flow. Yet, contrary to perception, while staying intentional and accountable to impact, LCPs also target attractive returns as part of their investment thesis.


Samuel Ndonga (Samawati Capital)
Anne Njuki (Sayuni Capital)
Victor Wambua (Mastercard Foundation)

Going to Scale – and strengthening fund economics. As an emerging asset class, small business funds tend to launch with fund sizes that are smaller than the more traditional PE and VC funds. GPs write small ticket sizes therefore the 2-20 model does not work. As such, in their first-time funds, most small business funds are not initially sustainable based on traditional fund management fee economics. This mismatch is perpetuating inequalities. Local fund managers need to be supported systematically, at a large scale.

Means to achieve improved fund economics include:

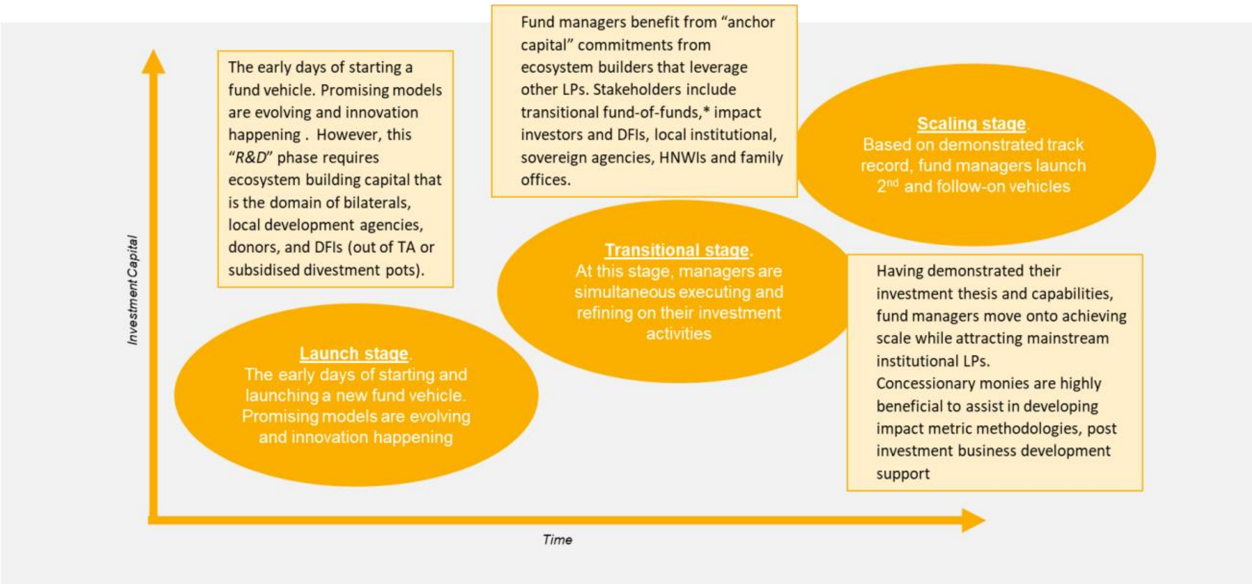
- ✓ Scale; start small–scale–up portfolio while staying focused on their target market.
- ✓ Manage costs - apply standardisation of processes, data gathering, and impact tracking.
- ✓ Impact mix — get "valued" for the impact.

✓ Consider non-traditional fee and fund constructs.

Tapping Fund-of-funds. CFF's annual survey of the small business finance sector has reflected an oft-repeated observation – that DFIs are not well-positioned for a first-time small fund.

➢ **Transitional Funds.** To support the launch of this emerging asset class, over the past two years new intermediary vehicles "transitional funds" have surfaced or are in the final stages of launching. These include the Mastercard Africa Growth Fund, FSDAi's Nyala Facility, USAID's Southern Africa Mobilising Investment Program, 2X Climate Gender Equity Fund, Prosper Africa Catalytic Investment Facility, and the SA SME Venture Capital FoF.

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



"We need 5 to 10 of these transitional funds – supporting LCPs who provide the capital that meet the needs of small businesses."

Reassess how to maximize warehousing FoF models. As an emerging asset class, GPs often struggle to reach first close. To address this challenge many small business funds are benefitting from warehousing programs. *"There needs to be more de-risking to give more people access to the funding. It should be about creating more winners."* Warehoused deals have allowed LCPs to develop relationships, demonstrating:

- ability to apply resources.
- portfolio construction theme and together.
- portfolio performance and embedded growth.

Warehousing deals offer an LCP the opportunity to test and innovate without the burden of fiduciary fund management. Warehousing is intended to demonstrate portfolio strategy, performance and growth. However, as structured today, often this means that a local manager must warehouse for up to five years and then launch their first fund. Meanwhile, over the years, such vehicles have resulted in abandoned assets on the part of the DFIs, as the funds are often not finally launched. Better mechanisms are needed to address both considerations.

Untapped role of local, domestic capital sources. "…*we keep talking about DFIs - private wealth is much bigger than DFI capital. There is a need to be creative about our own funding journeys.*" LCPs noted that the risk perception of someone on the continent differs from that of an institution that is not on the continent. Risk perception from local investors was lower compared to perceptions among internationally based investors as they had greater perspective on the market demand for the small business services/goods. Opportunities to expand locally sourced capital included:

- **Local Institutional Capital**. As a general consensus "…*local pension funds need to be engaged in the conversation and learn from LP's who understand the asset classes*". What is needed is specific programs at the pension fund level to back emerging fund managers. It is tough to deviate from the status quo otherwise for pension fund trustees.
- **Angel Networks and smaller-ticket domestic LP capital**. Build upon the work of Lelapa, the Women in Africa Investment Group, and the African Crowdfunding Association regarding the role of smaller-sized sources of local funding.
- **Regulatory**. Expand regulations to allow retail investment, e.g. in Ghana they changed regulations to allow HNWI to invest.

Need for Advocacy and the role of market-level data. *"We need a robust collective narrative about the importance of LCPs in transforming the communities they serve - the current narrative is not quite there - it needs to be collective and needs to be scaled."*

Clearly, there was one area of universal agreement among those at the gathering – the need for a better understanding of the sector, this emerging asset class, and the role that LCPs play in being part of the solution.

"We need to better profile what small businesses are doing."

To achieve this, we need data. There was a recognition of the current lack of data and market informing analytical work. A recent IGC report specifically noted the need to "*enhance DFIs internal data collection on SMEs: This involves enhancing existing data management systems to collect more nuanced, disaggregated and consistent data on SMEs"*[3]. Yet to achieve this there is a need for market and fund level data. With more market level data in the discussions, we are achieving *"a sectoral view regarding this emerging asset class – [one that engages]*

[3] International Centre for Growth, "Why do SMEs matter?", M. Bertanzetti, S. Mondal, R. Nasir, and M. Teachout, January 2024

the requisite stakeholders, public and private, in order to move beyond the individual transaction level."

Armed with data and analytics we can drive advocacy. *"We need more advocacy to broaden the investors engaged in the field…it is important to bring in ecosystem partners*." And this dialogue needs to be done consistently **"…**we need to have more conversations outside of fundraising".

"Easy for failures to gain prominence - we need to shout about the success."

and

"… evidence-based advocacy is key, consolidate market data for advocacy."

Where do we go from here? Next Steps. As a network of local capital managers, and the highly aligned ecosystem building organizations, a series of recommendations were generated during the convening.

Local Capital Provider Network Priorities. The ESCP network selected a number of key priorities and focus for the coming year, including:

- Steering Group. It is the objective of CFF that increasingly this emerging asset class sets its path to scale and success. To this end, CFF collaborates with the Network Steering group, which consists of Network members. The role of this group is to provide governance and advisory support in coordinating the work, activities, and resources of the Network in partnership with CFF.

In 2024, this group will focus on strategies to increase engagement among members between convenings. This will be accomplished by better segmenting the membership based on regional and thematic needs, and designing engagements that are most relevant to these groups.

- Working Groups. The network of local capital providers is principally a network of peer engagement. At the conclusion of the gathering, the local capital managers selected a series of key areas that they would like to undertake collectively. While the specific list will be posted on CFF's website, the range of joint undertakings include:
    - **Mapping Family Offices/ Investor Education**: The goal is to create a map of foundations and family offices (not DFIs) by compiling an Excel spreadsheet with at least 100 agency names, each with at least 5 characteristics.
    - **Human Resource Management**: This involves conducting a salary questionnaire for different countries, gathering information about training, training documents, recruitment resources, and part-time contracts or support.
    - **Opex for Fund Managers**: The objective is to secure additional OPEX and funding to increase the success rate for grant applications. The plan is to build awareness through peer learning, develop a live database of open calls for funding, and create a database of successful grant applications that can serve as templates.
    - **Climate and Environment**: The focus will be on conducting risk assessments, identifying green financing opportunities, and developing frameworks that managers can use as part of their investment processes.
    - **Geographical Gatherings**. Move towards more local/regional dialogues.
- Continued need to bolster **peer support** around the following:
    - Linkages to capital, i.e. warm intros to capital, keep influencing capital flows for the benefit of the sector as a whole.
    - Shared legal and financial assistance.
    - Entrepreneur support, i.e. opportunity to access group/network discounts, offering office space when people are in town, etc.
    - Peer facilitated conversations across different team functions: CIOs, marketing, analyst role, etc.
    - "Big brother/big sister" peer learning – learning from people who are a little further ahead.

Institutional Capital Holders and Field Builders' Priorities. Several priorities emerged among the institutional capital holders and field building organizations that were in attendance, including:

- **Domestic Institutional Capital** – tapping. In 2024, initiate the first pension fund gathering focused specifically on small business finance and the investment opportunities via the network of LCPs.
- **Continuum of Capital Alignment** – Building knowledge, visibility and trust. Develop the dialogue and engagement with the various segments of the LP community.
    - Expand institutional capital and field builders' participation in the local ESCP events in 2024.
    - Consider the development of a survey for institutional capital holders, DFIs, and field building granting organizations to better understand and track their respective engagement with this emerging class of local capital managers; additionally, need to map the LPs' journey and the small and growing business' journey to identify where mismatches have occurred and what is needed to bridge the gap.
    - Based on findings, chart the continuum of capital to gain greater clarity on what funding needs are being met, where capital is flowing, and where gaps still exist. Provide guidance to the market on what investment needs must still be met.
- **Capital Initiatives**
    - ***LAUNCH+ Capital Provider Programme in Partnership with USAID*** - CFF partnered with USAID Invest to deliver the LAUNCH+ Capital Provider Programme. This is a 12-month capacity-strengthening program for 6 diverse emerging managers in Southern Africa. The intention is to leverage CFF's proven model for strengthening fund managers' fundraising, operational, and investment capabilities to enable these fund managers to scale, achieve commercial sustainability, and ultimately mobilize additional private capital for development across the region. This is done through peer-to-peer learning and networking; accelerated learning modules on topics such as deal structuring, value creation, and financial modelling; mentorship; investor linkages through convening events, and allocation of operational funding.
    - ***Design of LAUNCH+ Integrated Capital Facility*** – CFF with funding support from the Lemelson Foundation and FCDO is designing a facility to address the key capital needs in the early stage of the fund lifecycle of LCPs. The integrated capital facility will include "Investment Readiness"/ Technical Assistance Support, Opex Funding, Track Record Building funding and access to a turnkey legal platform offering with shared services,
- Investigate Specific ***Market Gaps***, including:
    - Need for more catalytic grant funding (can also be first loss) to support fund operations (e.g. set up, legal costs, working capital)
    - Need for more capacity building for funds.

- ○ Need for better data – strengthen collaboration with industry associations. For example, of such initiatives, there has been a study commissioned by Impact Investing Ghana (IIGh) on VC and PE performance in Ghana by research team comprised of empirical researchers and the Ghana Venture Capital Association.

Increased asset class level advocacy.

Advance work to accelerate learnings and knowledge across the spectrum of relevant stakeholders.

- **Mapping Family Offices/Investor Education**. An initial step includes the establishment of this new working group among the ESCP members. The goal is to create a map of foundations and family offices, with data on key characteristics and considerations of these stakeholders. This will allow for improved engagement with this critical community.
- **Data, research – building the case for investing. "…***we are a new asset class; each new deal provides an opportunity to learn more about the asset class and improve on the data*". CFF is in discussions to further "demystify" frontier finance and better inform key stakeholders as to the unique value that local capital providers play. These include several potential initiatives[4]:
  - **Small business segmentation**. Refinement of CFF's 2019 segmentation on small businesses, building upon what we have learned since then, and importantly ensuring the perspective of the LCPs is incorporated.
  - **Local Family Offices, HNW, Angel Networks Engagement**. In compliment with the ESCP working group, there is consideration of a mapping and engagement initiative. Goal is to better understand the current landscape of these capital holders, to develop case studies to better inform them as to the investment opportunities with LCPs, and in doing so establish a network of "*informed*" local LPs to support and invest in LCPs.
  - **Nyala Investment Case Studies**. Building on the catalytic investment activities of FSDAi, develop a series of case studies on their portfolio of early-stage investments.
  - **DFI mapping and engagement on SME finance.** Review with DFIs on where they have been engaged in small business finance, what lessons they can derive, and how it can inform the best means for engaging with the LCP network. Lay groundwork for a working group across the DFIs on small business finance that can engage with the LCPs on a more systemic level.
- **Align with the Growth Firm Alliance**. The Growth Firms Alliance is a small emergent group of funders seeking to harness collective influence to move growth firms up

[4] *These research and analytical initiatives are under consideration, require further refinement, and attract the requisite funding to support the work.*

international and national agendas; encourage the development of a wider array of financial products and institutions; and promote the use of approaches proven to be effective. CFF will look to work alongside the Alliance to advance the critical role that access to finance, and in particular, local capital providers, play.

Andia Chakava (Graca Machel Trust (AfriShela)
Ndeye Thiaw (Brightmore Capital)
Wakiuru Njuguna (HEVA Fund)
Chai Musoni (Vakayi Capital)

"Without SMEs [we will not] see the emergence or development on the continent. The LCP's players are the key link. By investing in local GP's, institutional investors and development agencies will reap long-term benefit."

Gratitude

Thank you to everyone who participated in the event. Thank you to our sponsors whose funding went predominantly towards covering the cost of the LCP attendance. These include Argidius Foundation, FCDO, FSDAfrica, Mastercard Africa Growth Fund, Lemelson Foundation & USAID.