Fifteen years
Fifteen lessons from Africa

INVESTISSEURS
& PARTENAIRES

4 *Investment Lessons*

11 Lesson n°11: Debt is equity's best friend - and vice versa

Even when I&P is willing to bring debt into the investment package, it is rare that the financing need is fully addressed. The operating cycle is generally yet to be funded (it is rarely economically justified to finance the operating cycle with medium and long-term debt, which are expensive) and prudent policy limits or investment ceilings lead to supplementing medium-long-term financing with debt contributions.

In our fifteen years of experience, the African financial system has expanded and improved. In many African countries, however, very few start-ups and SMEs have access to the financial system. Banks are very disparately interested in financing this sector. In many countries, sovereign bonds issued by governments to finance their deficits provide opportunities that banks consider attractive and that absorb most of their liquidity. Some international banks specialize in large accounts or international finance and do not want to invest in the domestic production sector. Finally, SMEs constitute a risky and expensive clientele for banks: claim rates are high, guarantees are often unavailable or difficult to exercise, and the cost of records management is high due to the small size of the loans.

Our experience has led us to build close relationships with banks in the countries in which we operate and to invest significantly in the relationship between banks and our partner companies. We have indeed perceived that our capital contributions, as well as our expertise, have enhanced our partners' bank credit files and facilitated the closure of their loans. Our experience and familiarity with local banks and their practices, the relationships and networks we have developed facilitate the resolution of problems when they arise. Finally, the credit history of our partners is often less than solid and their historical relationship with banks often difficult. I&P teams have often been able to bring expertise and help with building credit scores, and to arrange and conclude agreements that would not have been possible without our assistance.

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However in certain countries, or for example, when we invest in startups or when guarantee provisions are neither possible or desirable, **the use of local commercial bank loans is not possible**. External guarantees provided either by international players (such as ARIZ, AFD Group) or local players (FSA...) often provide important help, but do not solve all problems. This is the case, for example, when the banking sector is confronted with liquidity problems or when the fundamental subject is the cost of records management. In this context, investment funds investing in debt (mezzanine, conventional debt) play a crucial role. Several public development institutions that invest in private equity offer good products with attractive financial conditions. I&P has regularly requested the intervention of these key players in SME financing, but it is rare that the unit amounts offered can be reduced to the size required for small businesses and start-ups. Debt financing of these firms, especially in the poorest countries, remains difficult and solutions sometimes cannot be found. There is, therefore, room for new players in impact funding.

This is our eleventh lesson. A critical success factor for investment is the ability of the equity investor to raise debt from commercial banks, guarantee funds and debt investment funds, as well as to support our partners in their often difficult relationships with these. The limitations of the African financial system and the specificities of the SMEs we support make this mission difficult and require the building of a relationship network based on trust and established over the long-term.