Fifteen years
Fifteen lessons from Africa

INVESTISSEURS
& PARTENAIRES

4 Investment Lessons

10 Lesson n°10: Structuring a deal, but how?

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The African economy is still small, even when including Northern and Southern Africa. The size of its GDP is almost equal to France's but is spread over a billion and a half inhabitants, who are twenty-five times less affluent, on average, than the French. If we subtract the public sector, the state and the informal sector, Africa's formal productive GDP is probably no more than 1,500 billion euros. This indicates that, apart from multinationals and large state-owned enterprises, the number of small or medium-sized enterprises is relatively small. And the majority of bank financing and equity investors are concentrated around large companies. In a context where international liquidity remains abundant, but where African growth has declined, the question therefore is whether the opportunities for large companies in this market will become scarce and/or whether African assets risk growing excessively.

In contrast, as we have detailed in *Entreprenante Afrique*, though difficult to quantify macro-economically, I&P has constantly experienced a powerful entrepreneurial wave surging from the bottom of Africa's economic hierarchy.

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We have seen this with the influx of investment requests reaching our offices, the impressive success of the growing number of business plan competitions on the continent, the multiplication of incubators, etc. We attribute this entrepreneurial emergence to a combination of economic liberalization with demographic and urbanization revolutions, the improvement of the macroeconomic framework, progress in training (and education systems), the return of the diaspora, the renewal of the Lebanese and Indian communities, and the ongoing overall failure of public services (which generates initiatives, particularly in the social sectors) ...

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Nevertheless, this very real entrepreneurial revolution is still insufficient to provide Africa the jobs it needs to absorb the 450 million youths entering the employment market by 2050. Among the numerous barriers needed to accelerate the entrepreneurial movement, the greatest is financing, which is as scarce for start-ups and SMEs as it is relatively abundant for large companies. In order to remove this barrier and respond to this apparently inexhaustible market, one might believe that it suffice to create a sufficiently large number of investment funds of sufficient size. The lack of capital, in the general context of very difficult access for start-ups and SMEs to all forms of finance, is certainly a major obstacle to the development of Africa's entrepreneurial fabric, as all entrepreneurs regularly affirm. However, I&P's experience of leads us to qualify this point, for two reasons.

First, there is a significant difference between investment potential and real bankable investment projects. Every year, I&P's team receives about a thousand investment proposals. Regardless of the type of project, over 75%, are far from ready for investment. The biggest and most frequently encountered reasons are the following: the contractor lacks the required qualifications; the project is conducted or is only possible in the informal sector; the property base of the company is not legal; the business plan is too superficial and demonstrates insufficient analysis and understanding of the business model; the instruments and management methods of the company are weak; the suppliers, service providers and physical environment of the company (access to production site or the market...) are too weak; the entrepreneur is not ready to share capital ownership of the capital and engage in a partnership, mainly due to a lack of understanding of private equity.

Under these conditions, more cases would theoretically fit with "mezzanine" type investing and without equity participation, reducing the legal and association risks. However, this approach would make legal recourse in case of default difficult to exercise. Perhaps more importantly, this approach would make providing management support to the company, which is essential in the vast majority of cases, much more complex to implement. Even with a partnership pact that included co-decision clauses, the investor would be impotent vis-à-vis the major strategic choices of the company.

Nevertheless, it would be beneficial and wise or the stakeholders involved in Africa's development to promote investment readiness of start-ups and young African businesses. Many programs, such as "upgrading programs" for SMEs or pre-investment programs, have already been tested in many countries. Some of them have failed and others have succeeded. Closer cooperation with investors would be very useful. Organizations such as UNIDO, AFD, the European Commission, USAID and the World Bank have undertaken significant efforts in this regard. One of the more promising solutions would consist of providing fund managers the resources and tools (through grants, guarantees, first loss…) to better prepare businesses before an investment.

And of course, on a more general scale, the improvement of the overall business climate in Africa is critical to the success of its SMEs!

This is our twelfth lesson learned in Africa. The acceleration of the African entrepreneurial revolution requires both an increase in the supply of financing, from which entrepreneurs are currently cut off, , as well as a number of structural programs such as capacity building for and direct support to entrepreneurs (possible within investment funds), improvement of the formal environment and in the quality of business plans, etc. In this context, accelerators and incubators should be multiplied and trained in the logic of investment, and "Small Business Acts" systematically implemented to radically transform the operating conditions of start-ups and SMEs and give them greater opportunities to efficiently host investors in their funding rounds. .