Fifteen years
Fifteen lessons from Africa

INVESTISSEURS & PARTENAIRES

About

Investisseurs & Partenaires is an impact investment group dedicated to African Small and Medium Enterprises. Since its creation in 2002, I&P has invested in about 70 companies, located in 15 African countries and operating in various sectors of activity (health, transport, microfinance...). These enterprises create local added value and long-term employment, and generate important social, environmental and governance impact.

I&P provides capital, technical and strategic support to meet the growth needs of its portfolio companies. The team develops long term partnerships with entrepreneurs, sharing management expertise and knowledge that is useful for improving business strategy, structuring, and success. I&P manages three impact funds, IPDEV, IPDEV2 and IPAE, which represent a total of €75 million.

Created by Patrice Hoppenot in 2002 and headed by Jean-Michel Severino since 2011, the I&P team comprises about thirty collaborators in Paris and in its six African offices in Burkina Faso, Cameroon, Côte d'Ivoire, Ghana, Madagascar, and Senegal.

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Introduction

In 2017 Investisseurs & Partenaires (I&P) is celebrating fifteen years of impact investing in Africa.

2017 is also the year I&P celebrates the fifth and final year of the investment fund I&P Afrique Entrepreneurs (IPAE 1), the group's first "SME" fund after the launch of the venture company I&P Développement 1 in 2002. Two years ago, I&P launched IPDEV2, an innovative project aimed at incubating and developing African investment funds, which has allowed us to further expand our knowledge of African startups and small businesses. More than 70 investments and 20 exits have been effected over the course of these fifteen years by a team comprising about 30 people located in our headquarters in Paris and in seven African offices (Abidjan, Accra, Antananarivo, Dakar, Douala, Niamey, and Ouagadougou).

I&P has met with many great successes and some setbacks over the years and has accumulated unprecedented experience in African SME and startup financing. This experience is certainly quite unique among the investment teams currently operating on the continent, taking into account the number of investments realized (more than 70) and the size of these investments (capital investments between €30,000 and €1.5 million).

Of course, we should put this experience into perspective: we are only one investment group among many and **the African context is constantly evolving, making some of our insights or lessons outdated**. The I&P team has, nevertheless, constantly worked to capitalize on and learn from its endeavors. We have recently conducted a formal evaluation of our first impact fund, IPDEV1, from which we have learned valuable lessons. The book Enterprising Africa (published in 2016) gave us an opportunity to discuss the entrepreneurial revolution taking place on the continent, but we thought it could be useful to share a few highlights of these fifteen years, 75 investments and 20+ exits. These lessons will not only interest equity investors but could also interest any economic actor in Africa, as well as anyone interested in the African economy. Some lessons learned could also be useful for African governments, donors and investment teams willing to create a fund targeting small companies, still so rare today.

This document aims to present some of the lessons our team has learned from our work in Africa. The idea is neither to be exhaustive nor to depict intangible and universal truths about the continent or the entrepreneurial dynamism at stake. We are only reporting on specific insights learned from our investment experience and from which we are trying to draw concrete lessons for our own operations. Nevertheless, **we hope that these highlights, which have been the most striking for us throughout these years, will prove beneficial to all.**

We have classified these lessons into five parts.

Part one is related to strategic issues. Adopting neither an Afro-Optimist nor Afro-Pessimist point of view, we try to show the characteristics of the African context which any investor should consider when defining their investment strategy: how to address the diversity of situations in the 54 countries of Africa? How to invest in a context of precarious governance that poses particular political and integrity issues? And how to support growth models able to capture the extraordinary potential of the development of the middle class, while still supporting the growth of export activities?

Part two relates to the structural changes of Africa's economy and markets. We notably observe that the African economy is evolving from an "imitation economy" to an economy of innovation. We share our hopes and challenges regarding the agriculture and agribusiness sectors, which have the potential to contribute much more to African economic growth. Finally, we share our vision of the considerable transformations that impact market access for all companies, particularly access to consumer goods.

Part three gathers a few lessons learned from our experience as an investor with African entrepreneurs. Considering the size of the companies we invest in, the human dimension is essential and the creation of a long-term relationship of trust between the investor and the entrepreneur is a key success factor. We also share the economic consequences of investing in small-sized, often poorly structured enterprises, which has so far constituted the majority of our operations. We attempt to share insights about key elements characterizing the impact investing sector, including the high follow-up costs required to structure these companies and the frequent need to extend the investment period in order to adapt to the timeframe of development in Africa.

Part four will appeal to professional investors. We expose the fundamental dilemma of financing African SMEs (and SMEs in general) and how we have managed to partially solve it through the financial arrangements we put in place and the partnerships we develop with debt investors. Finally, we are trying to solve one of the key challenges of our business: shortening the maturation time of an investment project and developing a pipeline of companies ready to be financed by relying on increasingly dynamic local ecosystems.

Finally, in part five, we discuss some lessons specifically related to impact. We explain how we set up I&P's impact measurement methodology and why this only make sense if you are actively trying to manage and improve the overall impact of the portfolio. We discuss why developing an ESG strategy is essential to improving the performance and impacts of African SMEs – even though initially it seemed counterintuitive. Finally, we present the new Sustainable Development Goals, which present tremendous opportunities to legitimize and champion impact investing, but also considerable technical challenges.

We conclude by discussing our vision of Africa's future and what it might look like. Finally, we speculate on whether impact investors have a future in Africa, and if so, what role they may have yet to play in it.

1 Lessons of Strategy

1. Lesson n°1: Africa is one continent, but a diverse one
2. Lesson n°2: The business environment is improving, but in a gradual and disparate way, which engenders integrity risks for firms
3. Lesson n°3: The African middle class is shaking up market dynamics but has not closed the debate on growth patterns

2 Market Lessons : (r)evolutions

4. Lesson n°4: The African economy: moving from imitation to innovation
5. Lesson n°5: Meeting the basic needs of the domestic markets is a priority but is feeding Africa financially viable?
6. Lesson n°6: Market access, a path too often overlooked...

3 Lessons from Enterprises and Entrepreneurs

7. Lesson n°7: The African (of French!) SME is a business of men and women
8. Lesson n°8: A small investment requires an impact choice and specific support on the structuring of the company
9. Lesson n°9: Small businesses in Africa need patient capital and time to grow

4 *Investment Lessons*

- 10 Lesson n°10: Structuring a deal, but how?
- 11 Lesson n°11: Debt is equity's best friend – and vice versa
- 12 Lesson n°12: Rely on the entrepreneurial ecosystem to develop business pipelines ready to be financed

5 *Lessons of Impact*

- 13 Lesson n°13: Measuring impact on the ground only makes sense to better manage it
- 14 Lesson n°14: Developing an ESG approach is possible and necessary, even for SMEs in Africa, provided a long-term partnership is established
- 15 Lesson n°15: The Sustainable Development Goals (SDGs) present both a great opportunity to develop the impact investment sector in Africa, and a challenge to measure concrete contributions

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1 *Lessons of strategy*

1 Lesson n°1: Africa is one continent but a diverse one

The African continent is commonly considered as a region of poverty and misery, of war and crises, of corruption and inefficient bureaucracy. Its economic development can be seen as a two-lane road, dividing oil-producing and mining economies from the others, English-speaking countries from French-speaking countries, or countries which have already experienced their demographic transition from the others... At the same time, over the past 10 years, Africa has been increasingly described in the media as a new Eldorado with endless opportunities and where one's success is possible as long as one mimics the methods that are being applied in developed nations.

Africa is all of this: it is diverse. Composed of 54 countries approximately one billion people live on the continent today and this number will double by 2050. Africa's diversity is, in fact, multi-faceted and vast and encompassing geographic, social, political, institutional, not to mention cultural and linguistic diversity (English, French, Portuguese, Swahili, Bambara, Wolof...). This staggering diversity is part of the continent's collectively rich history and **obliges us to be both pragmatic and cautious, while it also offers enormous potential for risk diversification** for investors developing a Pan-African strategy (whether political, macroeconomic or foreign exchange risk exposure).

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Africa is growing, but remains volatile

The first fifteen years of the 21st century have been a period of tremendous growth for Africa. However, during this period, I&P has experienced a macroeconomic crisis in Ghana, a several political crisis in Côte d'Ivoire, an earthquake in Kenya, fifteen coups d'Etat, and the beginning of the Sahelian instability crisis.

There is no reason to believe that the next fifteen years will be any more stable. Oil producing and mining economies remain highly dependent on changing commodity prices. A growing public debt makes macroeconomic equilibriums more unstable. In many countries, social and institutional fragilities frequently lead to political crises. The Sahelian crisis and the multiple security challenges it induces have now become a long-term situation. Internal migratory flows fragilize the balance of local regions. Yet these facts do not render Africa's fantastic foundations invalid. These foundations include disparate and slower than desirable entry into a demographic transition, generating a demographic dividend that will benefit the region in the twenty years to come[1]. They also include the fast-moving urbanization process that is leading to continuous productivity gains, and technological revolutions that are altering the very nature of development (to which we will come back later). Finally they include the role played by China in African growth, not only through imports and investments but also through the very first flows of industrial relocations.

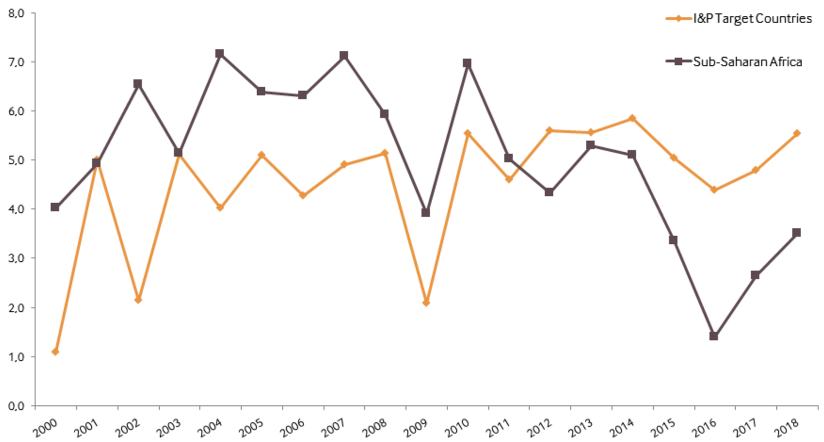
Our direct experience leads us to conclude that Africa's situation will continue to diversify among its countries. We consider four different categories of countries. First, those depending on oil and mining resources and whose middle-class development has been mitigated by the 2008 global financial crisis. Second, the most stable countries, those who rely first and foremost on their domestic growth. Third, those that are entering into the sphere of outsourcing of Chinese manufacturing and that could become part of the new "African miracle." And lastly, the countries experiencing political and military crises. The Sahelian region will play a critical role in this landscape, offering both growth opportunities and security challenges. In fact, each of these categories of countries will experience particular evolutions that will make the term "average" less and less meaningful for Africa.

1. For more information on how Sub-Saharan Africa can harness the demographic dividend: "Regional Economic Outlook: Sub-Saharan Africa", International Monetary Fund, Avril 2015.

Concerning I&P, risk diversification in our fifteen countries has been an important stabilizing factor for our operational performance. We have never renounced investing as long as opportunities were real, even in so-called very fragile countries. Only security threats to our employees and partners have been cause for temporarily closing certain destinations. These constraints will continue to be the biggest challenge to be overcome.

We have also deliberately chosen to invest only marginally, and very selectively, in oil or mining economies. Because of the high volatility of these economies, we do not trust the capacity of an investment fund to "exit" at the optimal time. In addition, we have always been very selective when investing in companies strongly linked to the public sector. Few companies located in oil and mining countries and oriented towards exports or private consumption are competitive enough to present real entrepreneurial potential. The countries in which we have invested are almost exclusively oil-importing countries in the dynamic regions of sub-Saharan Africa. This section of the continent continues to record strong economic performance.

Growth rates of fifteen Sub-Saharan Africa countries in which I&P operates [1], in comparison with the rest of the region



Source: IMF (2017)

1. Benin, Burkina Faso, Cameroon, Comoros, Côte d'Ivoire, Gabon, Ghana, Madagascar, Mali, Mauritania, Namibia, Niger, Uganda, DRC, Senegal.

Foreign exchange risk is not going to decrease anytime soon

In the case of equity investments in our region of operations, it is not possible to be protected from this foreign exchange risk

The foreign exchange risk is particularly harrowing for an international investor over the long term. Volatility remains high in Africa. Though contraction periods have become less frequent, their magnitude in Africa is unique – reaching 10 points of growth on average – and may explain the convergence of both weak economic diversification and macro management that remains pro-cyclical and susceptible to external shocks. In the case of equity investments in our region of operations, it is not possible to be protected from this foreign exchange risk. Currency hedging is either nonexistent or very costly, and the ascent of currency flows is hardly predictable and for amounts that remain hazardous. There is no alternative than to fully accept this foreign exchange risk.

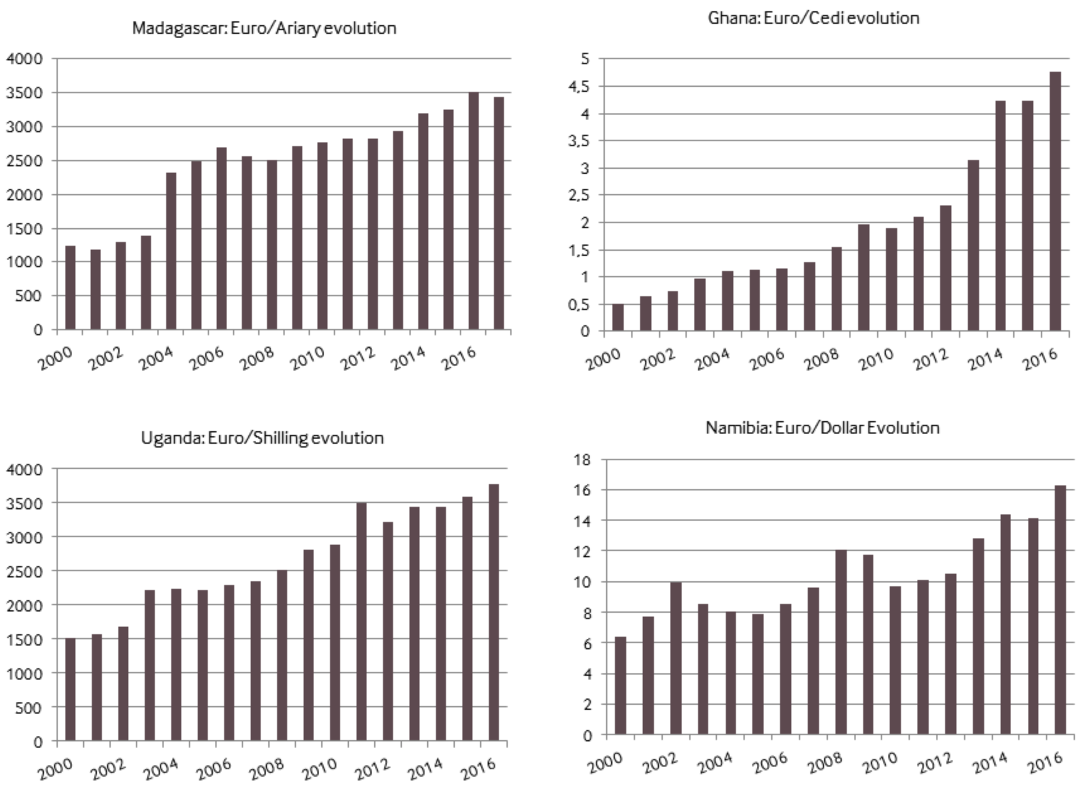
Nevertheless, several factors should help mitigate the perception of foreign exchange risk.

The first one concerns the CFA franc zone. For European investors, this zone represents an important option for foreign exchange risk reduction. Since the 1994 devaluation, such risk has been almost entirely eliminated. An adjustment could occur in the future, or even a modification of the regime, either in one of the sub-regions or throughout the entire zone, but the extent of the changes is unlikely to be comparable to 1994.

The second factor concerns the nature and magnitude of parity changes over the middle term in the countries we operate. The negative tensions affecting the foreign exchange market of the various countries where I&P has operated in recent years began to diminish in 2017.
This was due to various factors. The first was the tightening of domestic policies that occurred in Uganda and Namibia. As their currencies are linked to the South African rand, the Ugandan and Namibian Central Banks followed the South African Central Bank's decision to lower bank rates from 7% to 6.75% in August 2017. In Ghana, inflationist tensions have been progressively mitigated with the tightening of monetary policy and exchange rate stabilization. In addition, the inflows of portfolio investments attracted by the issue in bonds of two billion dollars in Ghanaian currency for has led to a decrease of official foreign reserves of imports from 2.6 months to 3.3 months between end of 2016 and June 2017. Finally, the relative political stability in Madagascar in recent years has put an end to major parity shifts in the Ariary seen in recent years.

The average lifetime of a fund like those managed by I&P is ten years maximum or from five to eight years for a specific investment. **At these scales, there is no macroeconomic approach that helps investors foresee the evolution of the exchange rate in a country or a group of countries after the divestment phase**.

Magnitude of parity changes in I&P's countries of operation (outside the the CFA franc zone



Source: IMF , Central Banks (2017)

Only two methods are available to manage the risk.

For both macroeconomic and political risks, the first method consists in allocating investments in a significant number of countries. This simple rule is often little known. It is the same rule, for instance, that explains the severe delusions met during the 2000s and 2010s by those who concentrated their investment flows towards oil-producing and mining economies.

The second method involves looking for "natural" hedging strategies when countries experience substantial fluctuations in exchange rates. In a number of countries, we have focused our investments on exporting firms. Without being excessive, it is possible to select investments in sectors that would benefit from a devaluation (a small part of costs expressed in the strong currency, for example). In these countries, we would avoid sectors with substantive imports or high operational and depreciation costs in foreign currencies, especially where fare modifications are limited (regulated sectors, for instance). In many cases, "natural" hedging can balance financial losses due to the devaluation because of the growth of the extra value created by this devaluation. However, this strategy can work only if the exchange rate fluctuations are not accompanied by capital controls preventing capital flight or by the fixation of artificial exchange rates.

This is our first lesson for investing in Africa. Develop a diversified approach based on sectoral and geographic bases, and allocate political, macroeconomic and exchange rate risks in order to benefit from Africa's diversity of situations and to manage "African risk". Remain aware of security issues and watchful of exchange risks, which are major challenges for international investors that have to integrate these parameters into their investment strategy and constantly adapt them to the continent's volatility and instability.

2 Lesson n°2:
The business environment is improving, but in a gradual and disparate way, which engenders integrity risks for firms

Global rankings such as Doing Business[1] or Mo Ibrahim's Index[2] are a good measure of the constant improvement of what is now called African governance. Among the notable points to recognize, the increasing weight of OHADA[3] regulation in Francophone countries represents a big improvement in the context of business and an important protection for investors. Nevertheless, two important issues for the SMEs and start-ups with which we collaborate are present in this operational context.

First, dealing with the State and public companies remains a risk to consider and accept in a large number of countries. Very few companies can escape the generation of outstanding payments that can lead, in many cases, to bankruptcy for the creditor firms that often lack liquidity and/or have no access to debt refinancing from banks. Despite our precautions, several of the firms we support were trapped in situations where no solution could be found. Alas, in most cases public companies do not represent a lesser risk than the State itself. The situation is even more disturbing because, first, the increasing weight of the public debt in Africa tends to generalize and intensify the challenge, and second, the resolution of a crisis becomes a pretext for corruption. Indeed, public administration agents regularly bribe firms before agreeing to transfer the needed outstanding payments from public firms.

Also, the fight against corruption evolves unevenly between countries. Some countries, like Senegal, have experienced a very positive evolution toward better governance. In many other cases, the situation is stagnant or is becoming worse. In some of our countries of operation, the phenomenon is systemic. It is, of course, a characteristic of the public sector. In such cases, corruption affects all contact opportunities with public administrations (taxation, customs, regulatory agencies, technical ministries) and concerns not only tax management but any situation requiring the delivery of an approval, an authorization or a license.

1. World Bank, "Doing Business Regional Report", updated annually

2. Ibrahim Index of Good Governance: http://mo.ibrahim.foundation/

3. OHADA stands for "Organisation pour l'Harmonisation en Afrique du Droit des Affaires" which means the "Organization for Business Law Harmonization in Africa".

In certain "country/sector" duos, paying taxes has also become counterproductive, generating fiscal sanctions and creating the conditions for powerful unfair informal competition: only informal business can allow economic activity to carry on. This phenomenon also concerns the private sphere: it happens in situations where a firm's employee acts as a prescriber (in insurance companies, for instance) or in purchasing divisions (in tender procedures within construction or retail industries), which generates frequent opportunities for briberies. Such situations are even more dramatic as the possibilities for legal recourse are uncertain. Avoiding a legal dispute is, therefore, a priority, although certain legal courts do function acceptably.

Zoom: I&P portfolio

We observed that companies operating in the financial services sector, specifically in the microfinance space, faced huge pressures from public sector representatives seeking personal gain from unethical and unauthorized transactions. These situations were difficult to handle and generated misunderstandings, delays, as well as significant costs for our portfolio companies. In the majority of the cases, shareholders' coordination, reputation and lobbying capacity were crucial in withstanding these unethical initiatives, to enable their companies maintain good governance principles.

As a result of our experience, analyzing the governance environment has become a priority for all investments. Such analysis can be done in a very concrete manner for a specific "country/sector", duo and even sometimes in "city/sector" duos, depending on what players are involved the institutional configuration. A governance analysis can provide us with information that leads us to renounce very interesting investments that can only be driven if the firm remains informal or that bear substantial financial and legal hazards that cannot be accepted.

Analyzing the governance environment has become a priority for all investments

Despite an increase in public investment for the 2000-2015 period that would be denied after the collapse of public budgets in oil-producing countries, this situation is harmful from a macroeconomic perspective as the collective effort to build equipment to support demographic growth has been largely insufficient. This has led to dramatic deprivations in many sectors, including the energy, water, and transports, as well as health, sanitation and public order, affecting the whole population and the poor in particular. Thus, the state and local governments' legitimacy is often precarious, and constitutes a major flaw in the consolidation of democracy.

Managing integrity, a comprehensive challenge

The African context is characterized by integrity risks that are especially high in comparison to markets in industrialized countries. We have already noted that corruption is widespread, although disparately through the countries and sectors, and affects both public and private business. Fraud risks also concern the inner workings of the firm. In a high-poverty environment, and in a context of social pressure affecting employees that typically have large families to support, temptation is great and so are the risks for the firm. This phenomenon can affect both African and foreign firms. The companies that I&P supports frequently face difficult situations and sometimes have to bear substantial costs due to integrity problems.

With no magic bullet for such situations and risks, we have developed a series of rules during these 15 years to help us better manage these situations.

In the African context, the HR function is key to managing human resources risks, and is as critical as the financial management of a firm

Rule number 1: Prioritize Human Resources above everything else. Indeed, integrity risks inside the firm are first and foremost risks linked to people. Reducing these risks requires maintaining a global vision of the firm, as well as a specific vision for all employees, requires a first-rate human resources policy. In the African context, the HR function is key to managing human resources risks, and is as critical as the financial management of a firm. For big enough firms, the HR Director plays a fundamental role in the enterprise and thus, his or her hiring and control deserve special attention. The HR Director should help the CEO to build a human-resources based policy that will foster employee adhesion to the company, aligning employee interests with the firm's, and that will create transparency. Concerning companies that are not big enough to develop an HR department, the CEO's awareness of and attention to these issues is critical. Where there is mistrust and feelings of exploitation on the part of employees, corruption and fraud are more likely to occur. In addition, HR guidelines must ensure that no clan, based on ethnicity or anything else, manages to create a situation where they would control essential internal processes, or financial functions such as payment or billing.

AgroServ © Béchir Malum

Rule number 2: Always implement strict procedures. The management culture in France is not necessarily strict on procedures. It rather relies on the employee's motivation, through target setting, and, when possible, letting collaborators use their autonomy to define the means to reach the ends. The African context is, so far, less suitable to this method. In some cases, the employee is incentivized by his/her environment to take a steal from the company without this necessarily being perceived as immoral. In any case, it is better for the firm to create situations where, no matter how strong the employee's motivation to commit fraud, it is de facto impossible for it happen. The African managerial context should establish clear, precise and detailed rules, describing both the means and the goals to be fulfilled, and permitting frequent controls and formal audits and limiting decision making at the bottom of the hierarchy. The design of these processes should take into account the fact that not all auditors are trustworthy that collusion between employees and other firms and even the company's bank is also possible. Therefore, it is key to ensure that an effective system of checks and balances over clients, providers and bankers is in place.

Rule number 3: Always monitor cash flows. The need for control over cash flows is more fundamental in Africa than elsewhere. While most documentation and billing systems can be falsified, cash flows -both within revenues and expenses- represent high vulnerability zones that must be eliminated or monitored obsessively. In this regard, the spreading of mobile payment technology is a wonderful opportunity.

Rule number 4: A business must always remain or become formal. Informality is a key component of the African economy. Escaping it is difficult because, for instance, customers want to pay only in cash to avoid VAT. Many suppliers may also want to stay outside of the formal banking system. When it is not possible to do otherwise, cautious controls on cash flows are necessary, as we have just outlined. However, it is important to fight systematically to redirect informal flows into a formal channels, even if this entails certain costs. The use of informal circuits can represent substantial risk in the accounting, integrity or fiscal areas, and reducing these risks is imperative.

Our second lesson for investing in Africa deals with the management of weak governance over the continent and the integrity risks that this situation places on a firm. We have noted that contact with the state and other public entities should be avoided as much as possible in favor of purely private businesses, on the customer side as well as on the supplier side. This general rule may suffer a few exceptions that must be cautiously analyzed and justified before investing. A comparative approach to investment opportunities should include the fiscal and customs situations of the sector. Current and future competition with the informal sector must be carefully assessed, especially when the domestic market is heavily protected with customs barriers or subjected to VAT or various taxations (in particular for B2C businesses). The dependency on customers or providers is also of special interest and requires additional investigation that will clearly establish and measure the integrity risks, which are still relatively high in the African context. Harnessing these risks is a managerial imperative that the entrepreneur shares with the investor. Risk reduction can be achieved following the four rules: prioritizing HR guidelines above everything, imposing strict procedures, closely monitoring cash flows and adhering to or imposing a process of formalization.

3

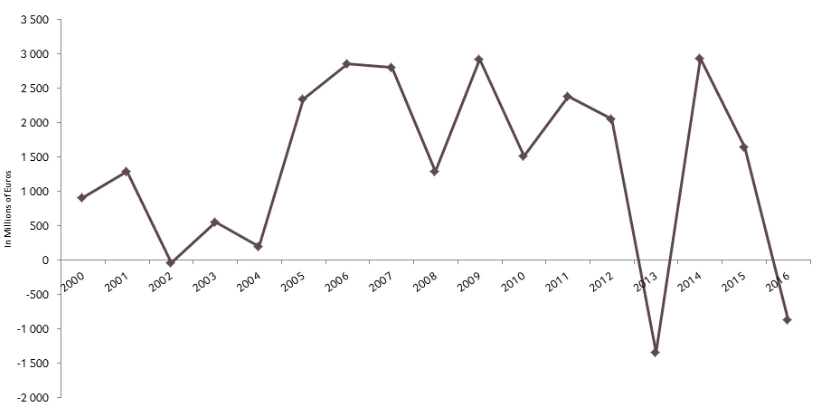
Lesson n°3: The African middle class is shaking up market dynamics but has not closed the debate on growth patterns

At the end of the 2000s/2010s, both African and international investors gradually began to observe a pattern of economic growth based on the emergence of an African middle-class and generated by a growing demographic dividend, population densification and the urbanization process. This economic growth model, grounded on strong macroeconomic parameters, (notably a strong increase in private consumption and substantial budget and trade deficits in countries that do not produce gross materials) has driven a growing number of investment decisions.

Both African and international investors began to observe a pattern of economic growth based on the emergence of an African middle-class

For the first time in history, the African continent has been perceived, not as a vast empty space of natural resources and labor to be extracted, but rather as a densely populated continent where the investment rationale is based on the demographic growth explosion and the emergence of a middle class with a high demand for consumer goods that while sometimes basic or necessitating adaptation for Africa, could also be satisfied by global brands. This consumer trend has begun to affect the manufacturing sector as can be observed in the automotive industries in Nigeria and Kenya. It resulted in a significant growth of international investments, that can exemplified through the investment flows from French multinational firms during the last 15 years.

Net Investment flows from French Multinational firms to Sub-Saharan Africa



Source: Banque de France (2017)

I&P has been involved – in its small way – in Africa's unprecedented social and economic transformation. During the last fifteen years, many large-sized international companies have invested in the production, distribution, and sales of products and services that have benefited the emerging African middle-class, and a myriad of business opportunities have opened up for African entrepreneurs in various industries including local food production, education and health services (health infrastructure, wholesale and retail pharmaceutical production and distribution), construction, modern mass retail, financial services and information technology. There are many entrepreneurial initiatives that have become interesting targets for SME-focused investment funds and larger firms.

This trend will continue to grow. Indeed, it is grounded on a strong foundation of profound demographic and societal transformation whose magnitude will encompass the entire 21st century. Furthermore, the increasing movement of international investment flows toward the consumer sectors of the African economy shows no signs of stopping. We have entered a new period of dynamic African-economic growth based on the development of domestic markets and fueled by local production and distribution.

Zoom: Eden Tree

The vast majority of the companies supported by I&P (90%) directly address local unmet needs, in a wide variety of sectors, ranging from essential goods and services (health, food, education, energy) to construction, equipment... Companies operating in the agribusiness and health sectors – two sectors that are widely represented in the portfolio – are particularly benefitting from the demographic dividend, finding opportunities in the emergence of the middle classes and taking advantage of the development of distribution channels.

This is for example the case with Eden Tree, a company that provides fresh fruits and vegetables in Ghana. Its founder, Catherine Krobo-Edusei, explains the origins of the company: "When I came home to Ghana, I saw there was a need for freshly and safely produced vegetables, herbs and fruits. There was a lot of worry about growing vegetables with contaminated water. I must say I was blown away by the scale of demand that existed!"

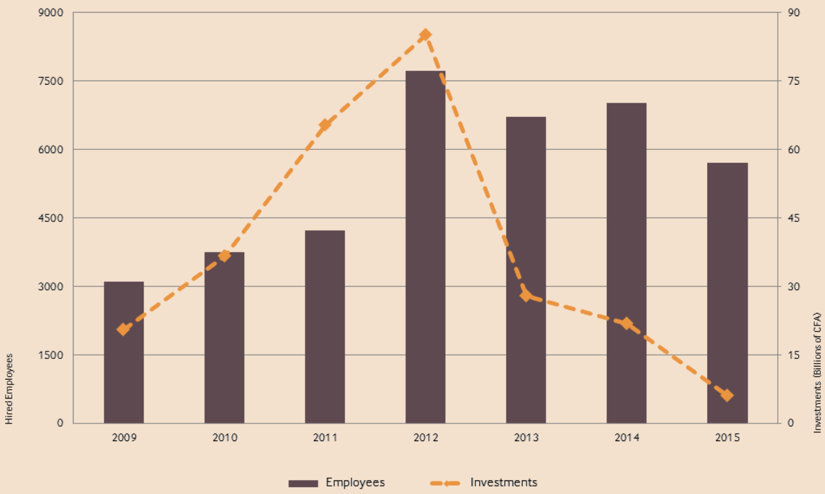
However, three aspects of this growth should be taken into account.

The first aspect refers to the macroeconomic instability in Africa, which has been acutely illustrated by the recent Ghanaian crisis and the financial collapse of the oil-producing countries, which were strong pillars of the emergence of Africa's middle-class. As a result, this middle class has slowed and overly optimistic and even excessive expectations of some investors have not been met. Like Africa's economic growth, this instability is here to stay. The public debt of African governments continues to grow, which will further increase this instability. New macroeconomic adjustments are expected in numerous countries in the coming decade, in oil producing and mining countries, as well as others, whose dependency on commodity prices will continue. These adjustments will also affect the growth rate of African middle-class incomes. In addition, other countries struggling to enter their demographic transition and facing increasing security challenges – as in the Sahelian region – will benefit from Africa's general growth trend to a much lesser extent. The tremendous dynamics of the African domestic market that we have emphasized above will primarily affect the coastal countries in West and Eastern Africa. It will also concern some landlocked countries that are well governed, such as Rwanda today, and to a lesser extent the rest of the continent.

Case Study: Construction Industry in Gabon

Between 2009 and 2014, the Gabonese construction industry experienced tremendous growth at a rate that reached over 150%! Since then, it has been severely affected by a significant decrease in public procurement.

Evolution of investments and jobs in the Construction industry in Gabon



Source: Global Entrepreneurship Monitor (2016)

On a more positive note, a second aspect is linked to a less discussed feature of African growth: the increasing attempts by African investors and entrepreneurs to upgrade channel exports.

These initiatives affect first and foremost agribusiness production (coffee, cocoa, fruits and vegetables) and complement the increasingly abundant supply of food products targeting domestic markets. We will return to this later.

IOT © Joan Bardeletti

Case Study: Madagascar

If we take the example of our investments in Madagascar, out of the six companies that we funded throughout our investment vehicles, four have export-oriented strategies. This is the case of Phileol, a company specializing in the collection and processing of oil seeds in southern Madagascar. The company produces castor oil for export, but also seeds such as jatropha, moringa, prickly pears, marula and baobab. Other agricultural companies have turned to the export market in order to generate greater margins than those available in their domestic market, through the supply of quality products: this is the case of Scrimad, an export and processing company for lychees targeting the European markets, or of the company IOT, which produces sea cucumbers for the Asian market. In another sector, the textile industry, Ultramaille specializes in hosiery, knitting and pullover manufacturing and exports mid-range and high-end knitwear to European markets. The impact of these enterprises is therefore less downstream in the value chain than upstream, through the number of farmers and small producers to whom they provide a stable outlet and provide a regular source of income, in addition to the number of jobs they create and the inflows of foreign exchange that they facilitate.

The third aspect related to Africa's economic transformation is also positive. It refers to the ever-increasing dynamism due to the relocation of Chinese factories to East Africa as well as to some African countries that are not part of East Africa but that have developed dynamic Asian-style manufacturing export sectors, such as Mauritius and Madagascar. The dynamism under way is a result both of the burgeoning working force that Africa previously lacked and the explosive productivity and structural changes occurring in the Chinese economy; it is thus a long-term phenomenon.

Our third lesson is related to the demographic explosion that the continent is currently experiencing and that is generating both countless market opportunities and a productive workforce which is repositioning Africa in international trade. Although investing in this demographic trend will surely be beneficial in the long run, Africa's macroeconomic volatility requires general precaution, common sense and avoidance of any excess optimism. The growing investment opportunities in manufacturing and agribusiness sectors, offered by the world market and domestic public policies should also be considered for their potential benefits in terms of foreign currency risk reduction.

2 Market Lessons: (r)evolutions

4 Lesson n°4: The African economy: moving from imitation to innovation

5 Lesson n°5: Meeting the basic needs of the domestic markets is a priority but is feeding Africa financially viable?

6 Lesson n°6: Market access, a path too often overlooked...

2 *Market Lessons: (r)evolutions*

The last fifteen years have been characterized by profound changes in the sub-Saharan economy. According to the World Bank, sub-Saharan Africa's GDP has increased from $350 billion in 2000 to $1,500 billion in 2016, and the Gross National Income per capita from $485 to $1,500 over the same period. It has been accompanied by dramatic societal transformations (urbanization, the emergence of the middle class, etc.) and cultural and environmental changes (notably in the energy and agriculture sectors). These transformations are shaping new markets and are key determining factors of economic activity. They explain the deadlocks that some companies face, as well as the success of others, regardless of the quality of entrepreneurs.

I&P has experienced and followed developments that have directly impacted transformations the structure of our portfolio. three of them in particular stand out: Africa's shift from an imitation-based to an innovation-based economy; the crucial nature of the issue of nutrition and the strategic development of the agribusiness sector; and questions of market access issues through a reflection on marketing strategies and distribution patterns in the African context.

4 Lesson n°4 : The African economy: Moving from imitation to innovation

In the years 2000 to 2010, the entrepreneurial component of African growth was characterized mainly by the creation and development of companies in traditional sectors. African growth was seen as "catching up" with the industrial and service fabric of so-called advanced countries.

During this decade, the entrepreneurial fabric supported by I&P was characterized both by this perception and this reality: conventional service companies, including microfinance institutions, an under-representation of manufacturing and agribusiness, and a small share of firms engaged in technological innovation. Even the microfinance sector, which is more in which is more specific to poor countries than in industrial countries, could not be claimed as an African innovation. It is difficult to draw specific conclusions on the expected returns of these investments because even these traditional companies, often launched without competition at their onset, brought significant transformations to local economies. They generated significant productivity or quality of life gains for customers, leading to rapid growth in sales and earnings in a sketchy, difficult, and risky economic environment characterized by numerous operational obstacles. Expecting gross actuarial returns above 20%, however, seemed possible albeit difficult.

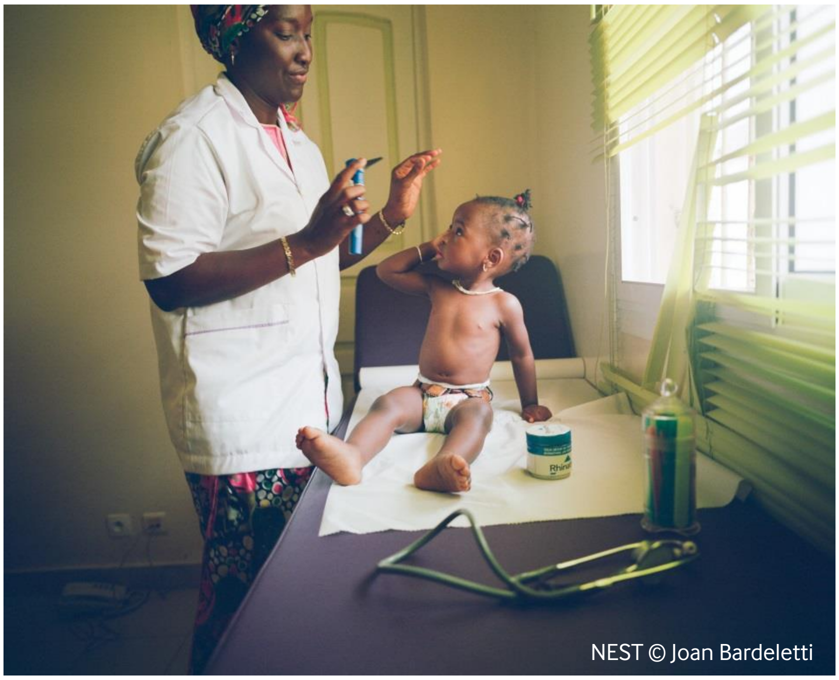
The last few years have seen this situation change in two distinct ways.

"Mobile money" appeared, constituting the first truly African technological revolution

On the one hand, important technological innovations have emerged in the wake of information technology revolution. The widespread use of mobile telephony in itself has generated significant productivity gains and accelerated African growth. This phenomenon has been fueled not only by the major global telecom players (Orange, Vodafone, etc.) but also by African operators (MTN and many local and regional operators that have either been newly created or have emerged from the privatization of former public monopolies, as in Madagascar). As an extension of mobile telephony, "mobile money" appeared, constituting the first truly African technological revolution and radically changing life and business in Africa. New mobile money innovations are multiplying globally and in countless domains, creating unique services throughout the world and specifically adapted to the needs of Africans, the most spectacular of which is in the energy sector, with the creation of SHS or domestic "pay-as-you-go" solar kits.

Many African-owned or expatriate-led start-ups (often created in North America or by people of the African diaspora) are being born across the continent, particularly in East Africa, but also in West Africa, as evidenced by PEG Africa, a company that we invested in and aided when it was founded in Ghana and that now operates in several countries in the sub-region.

At the same time, without involving technological innovation, the social sectors are also attracting investment (above all the healthcare sector) by the African private sector at a heightened scale and pace unique to the African continent. This is also the case for essential services such as energy and water. Our investments in companies such as Enko (private education), Nest (network of care centers dedicated to mother and child in Dakar) and CDS (a Mauritanian company that promotes access to electricity and water in rural areas) perfectly illustrate this trend. We come back to this point, which is linked to the emergence of a middle class in Africa, is the lesson number 3.



NEST © Joan Bardeletti

Africa's economic landscape is in the process of perpetual transformation, resulting in two major consequences for investors.

The first is the partial loss of historical benchmarks and the ability to replicate the experience gained in OECD countries. Until recently, support for enterprise development was perceived to be based on the transfer of technologies, methodologies and capabilities built in industrialized countries and sometimes "adapted" or "tropicalized" for the African context. The new dynamic involves figuring out how to support entrepreneurs who invent their model every day without reference to pre-existing models.

The new dynamic involves figuring out how to support entrepreneurs who invent their model every day without reference to pre-existing models.

Some areas, such as decentralized green energy, are heavily financed by international capital

The second is related to returns. The rapid growth of companies implementing new technologies is multiplied in the African case by the growth rate and the partial relief of physical constraints related to failing infrastructure. Some subsectors can thus generate two-digit gross return-on-investment (IRR) rates. Many new-technology companies also justify a "venture" approach and methodologies rather than "private equity," and many investors have developed a growing interest in this approach. Unlike most of the African SMEs and start-ups we have talked about, some areas, such as decentralized green energy, are heavily financed by international capital, especially from the United States. Nevertheless, all of these technological sectors are inherently risky and sometimes over-valued, as the African context is more difficult than that of OECD countries. Delusions arise and in some country/sector pairs, such as SHS in East Africa, there is reason to fear the appearance of market bubbles, with excessive valuations based on unrealistic assessments of the future performance of companies.

This is our fourth lesson from Africa. Africa's (rapid) evolution towards an innovation economy should not overshadow the basic precautions of capital investment in rudimentary, unstable and vulnerable economies. Nevertheless, a "venture" sector should be established to meet the needs of African technology and innovation companies, particularly in the energy and telecommunications sectors. Such venture capital could reasonably expect high returns, even with small investments, but at the cost of higher risks than in OECD countries. To better reduce these risks, a strong and deeply-rooted local presence seems essential, combined with an excellent knowledge of the technologies being used while investor should be prepared to support the rapid growth of these companies by engaging in numerous, ongoing and important financing rounds.

5 Lesson n°5 : Meeting the basic needs of the domestic market is a priority but is feeding Africa financially viable?

Over the last fifteen years, I&P has invested considerably in the agribusiness sector "from farm to fork" as the Anglo-Saxons say. This sector accounts for 40% of deal flow, one third of GDP in most countries where I&P has invested, and above all plays a key role in food security and job creation in Africa. Indeed, the growth of domestic markets and the international demand for exotic fruits and vegetables, especially those that are certified organic, represent important business opportunities and thus drive growth in the sector.

Few channels are structured and rarely allow for the arrival of products in sufficient quantities or the necessary consistency for the global market

However, it is on the supply side that the difficulties are the most daunting, as very few channels are structured and rarely allow for the arrival of products in sufficient quantities or the necessary consistency for the global market. There are, thus, several methods of supply: (i) supply from intermediate commercial producers (ii) direct supply from the market and (iii) supply from small producers, grouped into cooperatives or led directly by the contractor. This latter configuration is today the most widespread practice of SMEs supported by I&P and the one that seems to generate the greatest impact in terms of the number of families directly supported although we need to qualify this point a bit further. But this approach raises important problems.

The first of many difficulties encountered in the agribusiness sector lies in the relationship between entrepreneurs and small producer networks. These networks are often informal, disorganized, and disconnected, due to poor communications and lack of infrastructure. As a result, entrepreneur very often has to organize the production channels, supply the seeds and other inputs, train small producers in new techniques and enable them to increase their productivity by organizing collection circuits, and formalizing contracts and methods of remuneration. As these small producers now rely on the entrepreneur for a regular income, the entrepreneur must also learn how to manage this dependent relationship that has been established: what happens when the orders are not filled or when the company loses its organic certification and can no longer sell its production? Or, conversely, when climate hazards impact the quality of harvests, limiting the company's supply capacity? Or when opportunistic buyers approach producers who are critical suppliers of the company?

The technical support of NGOs (as in the case of experts who receive funds for technical assistance) is fundamental to small producers in the diversification of their production, the management of seasonality and the improvement of agronomic practices in light of environmental challenges, such as deforestation, desertification and soil depletion.

The under-capitalization of agribusiness and agriculture is striking because they require much more capital than other sectors

The second difficulty in agribusiness arises from the very specific financing method of this sector in terms of the nature (capital, debt), timeframe (long-term capitalization, short-term credits) and size (a seasonal credit may amount to only a few tens of thousands of euros). The under-capitalization of agribusiness and agriculture is striking because they require much more capital than other sectors. From an investor's point of view, therefore, significant ex-ante margins are required to justify the level of risk that one is prepared to take. Every investment in agribusiness requires the development of numerous scenarios to respond to the many uncertainties and risks affecting the development of the company and to anticipate the considerable amount of monitoring time that will be required compared to operations in other sectors. Investors often tend to assume that working capital requirements are mainly a matter of bank financing. Our experience shows that the entrepreneur cannot be left alone to face this problem: banks are often inadequate or unreliable to help because they are unable to offer campaign credits quickly enough or only under terms that are cost-prohibitive. The possibility of financing campaign credits regularly and at a lower cost must therefore be taken into account as soon as the investment is studied. Lastly, with some entrepreneurs, I&P has tested alternative forms of financing, such as crowdfunding, which beyond the very attractive financial conditions they offer, make it possible to raise funds in a few weeks - and even in a few hours! - and offer the company an exceptional communication showcase and platform, instantly exposing its brand to a large number of lenders.


PhiléoL © Zen Design

The third set of difficulties is related to logistical problems and the sometimes misunderstood and poorly anticipated impact of these investments in sociological terms. Logistics aspects are often undervalued. The growth of a company and the increase in production volumes raise many operational questions: they require, for example, an expansion of collection centers, an increase in the truck fleet, increased intermediate storage capacity, etc. A new equity investment leads to a physical scale change that needs to be measured and anticipated, while taking into account the ability of the company and the entrepreneur to adapt to these developments.

This is our fifth lesson from Africa: feeding the continent is a priority, and Africa's agricultural and technological potential are sufficient for it to be implemented. However, agriculture and agribusiness face the same challenges and risks faced by all African SMEs, as well as additional risks specific to agriculture in Africa (climate hazards, rural sociology, fluctuation of agricultural prices, etc.) and where environmental issues play an ever increasing role. Expected financial returns should be carefully measured against these risks, and timelines for return on investments realistically set. Public policies are needed to play an active role in supporting the sector and accelerating private investment.

6 Lesson n°6: Market access, a path too often overlooked...

All managerial functions are important. The financial management of the SMEs in which we invest is crucial for the entire management of the company, as well as for treasury and bank relationship management. We have already mentioned the crucial nature of the human resources department in a context where qualified human resources are scarce, and where employee loyalty is a fundamental and crucial need. **Here, however, we wish to emphasize a dimension that is often underestimated in our business: the commercial and marketing dimensions of investee companies.**

The entrepreneur's focus can thus easily be diverted from customer concerns and methods of market access

Even in high consumer domains, the entrepreneurs we meet tend to focus first and foremost on the technical aspects of their business. In addition, the long list of day-to-day concerns tends to quickly focus the entrepreneurs on production and supply issues and on bank relations when financial issues arise, as they so often do. The entrepreneur's focus can thus easily be diverted from customer concerns and methods of market access. Knowing how to build a brand, being aware of the demands that this entails and appropriating the methods to do so are skills that are often missing in the entrepreneurs with whom I&P works.

Barajii © Béchir Malum

Yet these are fundamental aspects of business and even more challenging in the African context than in industrialized countries: conducting market studies is sometimes not possible and the necessary data may be missing, either partially or totally. Quantitative and qualitative knowledge of the consumer is sometimes only attainable by means of an arduous process that a sole company (particularly a small one) has difficulty implementing on its own. Sales and marketing consultants are rare. Price-quality positioning of a product and the commercial messages to be launched to consumers are sometimes difficult to build, and contain important cultural biases that are identified only too late. Distribution structures can be very complex and can entail a mix of modern distribution, such as the Internet, with traditional methods like door to door sales. The retail sector is itself evolving and subject to major innovations of all kinds. Finally, in a context of scarcity of qualified executives, finding a good sales or marketing manager is no easier than finding a good CFO or HR manager.

Case Study: Barajii

The case of Barajii illustrates the issue of distribution networks. Specialized in the production and marketing of water and fruit juices, the company has set up an efficient distribution system in Burkina Faso and some neighboring countries, based on four channels:

- Sale to wholesalers who buy directly from the factory
- Distribution to small businesses in Ouagadougou and Bobo Dioulasso
- Direct sales to the population thanks to Barajii's points of sale, located in strategic places in Ouagadougou, increasing the visibility of the brand
- Exports to Mali, Togo, Niger, Ghana and Côte d'Ivoire

In total, more than 1 100 points of sale distribute Barajii products in Burkina Faso. With a well-identified brand and a good distribution network on the Burkinabe market, Barajii now seeks to produce and develop its activities in other West African countries (Togo, Ghana, Mali, Niger, Côte d'Ivoire...)

These challenges are another reason to invest in market access, as disregarding marketing issues has often led to considerable problems encountered by our partners, These include : poor marketing, including product name, packaging and format; poor price positioning and poor market segmentation, bad negotiation terms with distributors, errors in identification of distribution channels, lack of motivation on the part of distributors to carry the company's products and failure to effectively identify and analyze the competition. These problems can only be avoided through sufficient investment in time and resources, from project outset, along with the hiring of good marketing and sales employees and a good network/group/supply of providers. The ability of investors and the entrepreneur to react to errors or changes in context and to the competition is essential. Again, this requires a long-term investment that cannot be made the level of the firm alone and requires the involvement of the investment team.

Case Study: NEST

Based on the observation that the capacity to communicate effectively on their activities among various relevant actors lies at the heart of the development strategies of its partner companies, I&P held in 2016 a training seminar on marketing and communication issues, gathering about forty entrepreneurs of the portfolio.

The case of NEST, a network of medical structures launched in 2012 providing quality healthcare for women and children in Senegal, is an interesting example. As a clinic, NEST is not allowed to advertise: a big challenge for a young organization that needs to make itself known!
One of the most effective ways used by NEST is its Facebook page, with over 50 000 followers. It is used as a true information and advocacy tool, on very useful and diverse health topics (pregnancy, breast cancer, etc.) Most of the time, the doctors personally respond to private messages. Thanks to this tool, NEST has developed its credibility and created a special relationship with its current and prospective patients.

This is our sixth lesson from Africa.
Accessing the market, carefully building and developing the brand, and identifying the right marketing and distribution channels are important factors that can determine the ultimate success of the business as much as the ability to raise and manage its finances. Instructing entrepreneurs on the critical nature of sales and marketing and giving this a larger place in the analysis of the investment project is fundamental. This involves investing in the appropriate employee skillsets, as well as adapting marketing to the African local context by understanding and targeting local cultural preferences and taste. In addition, it is crucial to take into account the customer's ability to pay and to diversify distribution to take advantage of all methods available in Africa, from sidewalk distribution to mobile phone and Internet networks.

3 *Lessons from Enterprises and Entrepreneurs*

7. Lesson n°7: The African (of French!) SME is a business of men and women

8. Lesson n°8: A small investment requires an impact choice and specific support on the structuring of the company

9. Lesson n°9: Small businesses in Africa need patient capital and time to grow

3 *Lessons from Enterprises and Entrepreneurs*

In fifteen years, I&P has financed and supported more than 70 companies based in fifteen countries over across West Africa, Central Africa and the Indian Ocean. These companies operate in a wide variety of sectors, ranging from agribusiness, such as a Malagasy aquaculture company breeding sea cucumbers on the banks of Tuléar, to microfinance institution, such as one of I&P's very first partners in Cameroon, to the building materials sector like the only firm that produces terracotta oven tiles in West Africa. Despite their differences, all of these companies fit a profile that I&P has always endeavored to promote: ventures that are often small, generally unstructured, but with strong economic added value and significant social impact.

Additionality, i.e. the will to go where others do not go and to fill a gap, has always been what characterizes I&P most. While we don't pretend to have all of the answers, we can already share some lessons that we have drawn from our operations, where human relations play a key role and where the small scale and timeframe development in Africa require certain adaptations for impact investors.

7 Lesson n°7: The African (or French!) SME is a business of men and women

There is no need for great theories to consider that there is of course such a thing as "African" management style. Its particular characteristics in relation to a "European" management style are, of course, shaped by cultural differences, which vary considerably according to (i) the countries and regions of Africa, (ii) the local conditions, (iii) types of skills and abilities found in the manager's company, as well as among their/his/her customers and suppliers, which may be at odds with Western markets, and finally (iv) different institutional contexts.

Without claiming that there is "a" type or style of African management, we have experienced the fact that management styles in Africa can be very different from Western styles, or that certain universal dimensions of management are particularly important to understand in the African context.

We have tried to outline these African management styles in *Entreprenante Afrique*, a book co-authored by Jean-Michel Severino and Jérémy Hajdenberg and published in 2016 by Odile Jacob Editions. **Despite the sectoral and geographical diversity in our operations, the entrepreneurs we have been supporting for fifteen years do have some common features**, the first being that there is no official data listing them! Our experience, however, allows us to establish that an African SME manager is most often a man or a woman having received higher education and developed solid technical skills. Many have always resided in their home country, but a growing number are from the diaspora and, having studied and / or worked abroad, have returned home to put their new skills at the service of an entrepreneurial project.

These young entrepreneurs start out full of a cheerful optimism, convinced that they can both earn money and contribute to the development of their country

This project may simply entail the takeover or expansion of the family business, or be linked to know-how acquired abroad, or involve a product or service innovation that meets unmet local demands. **In the vast majority of cases, these young entrepreneurs start out full of a cheerful optimism, convinced that they can both earn money and contribute to the development of their country**. However, they must quickly face the reality on the ground and show great resilience, combativeness and agility in light of the many obstacles that stand in their way. We have met more than seventy of these champions of African growth through the investments we have made. These marriages were not all perfect ones, but all those who have succeeded and prospered have done so thanks to a strong and lasting relationship of trust built between the entrepreneur and the investor.

Once this partnership relationship is established, the question of human resources within the company arises. It will come as no surprise that this is the second greatest challenge facing entrepreneurs, after access to finance. SMEs operate in a context of very strong competition from large companies, especially over qualified human resources. Local secondary education is developing but at disparate levels of quality (increasing in Senegal, sometimes decreasing in Côte d'Ivoire). In some countries, technical training is failing: it is difficult, for example, to find craftsmen in the construction industry in Ghana. The recruitment of qualified and loyal personnel, especially in middle management, is one of the major concerns of our entrepreneurs today. Some of the questions our partners ask themselves every day in their business management include: how can I empower middle management and train them to gain efficiency in time management and business operations? What can be done to retain trained talent in a very underdeveloped job market where competition is fierce? And vice versa how to become a manager and not only a leader? Being able to pay decent wages for key positions is naturally part of the solution, but it is also crucial to know how to innovate in this area and retain quality employees through benefit packages that include health insurance, training or even stock options.


Eden Tree © Béchir Malum

Until very recently the private equity industry did not exist in Africa

The human capital challenge does not only exist with our entrepreneurs, but among investors as well. Until very recently the private equity industry did not exist in Africa. When it emerged, it moved towards large transactions with the very few large companies operating in Africa. The phenomenon is growing and over the past five years, several investment teams have been formed. Many of them are still raising funds, but they are growing increasingly interested in SME capital financing, a source of much greater opportunity and which remains under practiced.

However, the recruitment and retention challenges of young investment professionals persist. Private equity skills remain scarce in Africa nowadays. It is therefore essential to train talents over the long term in SME equity financing techniques and in coaching of entrepreneurs, both in the management of their operations, and in the implementation of good social, environmental and governance practices. Quality human resources are scarce in Africa and they are often expensive, which makes it even more difficult for impact funds to compete, since their business models do not allow for high levels of remuneration. It is indeed essential to develop attractive human resources policies and develop a long-term *affectio societatis*.

This is our seventh lesson from Africa. Investing in the men and women who will be the leaders of tomorrow is essential for SMEs, where everything rests on the shoulders of the business owner. However, management in Africa has certain characteristics that it is necessary to understand in order to establish a relationship of mutual trust and define the basis of a strong and balanced partnership: cultural aspects of African management, recent developments, such as the growing number of people returning from the diaspora and the scarcity of skilled workers in Africa, particularly in middle management. I&P advocates and is committed to strengthening the skills of its team and partner companies through the referencing of HR advisory firms anchored in Africa that are able to understand the specificities of the local context and to support companies in the implementation of their HR policies.

8 Lesson n°8:
A small investment requires an impact choice and specific support on the structuring of the company

I&P's choice to focus on small investments led by African entrepreneurs in fragile states is clearly rooted in an impact choice. I&P began investing in the Sahel region in 2002 and continues to invest almost exclusively in fragile countries (85% of IPAE1 investments, 100% of IPDEV2 investments, as of today). These countries are very particular in that they have a fabric of SMEs that are still young (some are even still in the development stages), small in size, and largely operating in the informal sector. These SMEs often have a strong growth potential and, as such, a strong impact potential in terms of job creation and knock-on effect on their local ecosystems. Their environmental, social and governance impacts are colossal. Nonetheless, they are hindered in their development by lack of access to long-term finance and equity. They are all the more fragile as they have to face major local challenges beyond the usual (and substantial) internal and sectoral challenges faced by SMEs. There is, therefore, a real consistency in I&P's impact thesis, the small size of the investments it targets, and its preference for companies with a "fragile country" footprint.

SMEs often have a strong growth potential but are hindered in their development by lack of access to long-term finance and equity.

Since 2002, I&P has progressively learned first-hand about the constraints of the economic model inherent in these choices, which were very well known in theory, but had not yet been fully put into practice. How to identify the right thresholds, know the real costs of investing in a start-up or an SME from sourcing to exit, and assess the legal fees and tax issues ... All of this was a mystery to us.

These past fifteen years have allowed us to answer, however provisionally, two essential questions: are profitability and impact mutually exclusive in our business? Why is providing support to the entrepreneurs so costly, and what should be our primary support priorities, in order to maximize our effectiveness ?

Profitability or Impact? Primarily a question of ticket size!

The smaller the investment, the higher the transaction and monitoring costs, which, in fact, heavily reduces the investor's net profitability

At the risk of disappointing, our answer is categorical: an impact fund dedicated to start-ups and SMEs, whose gross returns can approach or compare with the performance of traditional private equity funds, cannot meet the same level of net returns .

Private Equity professionals know this perfectly well: the smaller the investment, the higher the transaction and monitoring costs, which, in fact, heavily reduces the investor's net profitability. In other words, if an investment of 300,000 euros has been made in a small company that outperforms over the investment period, the margin generated is only likely to cover external and follow-up costs, which are often very high for these poorly structured companies. As a consequence, investors' net profitability will be lower than what they can expect for large investments in more mature and less risky companies. This size criterion determines the economic model of an impact fund and represents a strong impact choice on the part of all investors who have opted to support I&P since 2002.

This impact choice comes with a series of consequences that have considerably changed the way I&P has operated since its creation in 2002. Based on the pioneering experience of I&P Development 1, I&P has changed its business model to offer a wide continuum of equity financing ranging from €30,000 to €3 million for start-ups and small and medium-sized enterprises (SMEs) in Africa. The purpose is to meet the financing needs of companies that are too large to access microfinance institutions and too small to access traditional financing channels, while adapting the financial vehicles' business models to different return profiles for different categories of investors.

In 2015, I&P launched the IPDEV 2 program, which consists of incubating and sponsoring ten impact funds dedicated to very small businesses in ten African countries over the next decade. They are led by local teams and funded up to two-thirds by African investors, in addition to IPDEV2's contribution as a minority stakeholder. These funds are deeply rooted in the fabric of local economies and offer comprehensive and unprecedented support to firms in Africa, relying on a wide range of financial tools (equity, small no-interest, no-collateral loans, grants, coaching, etc.).

The intermediary set up provided by IPDEV2 offers two levels of returns : the holding company gathers investors primarily motivated by development objectives and whose expectations for returns are close to venture philanthropy. Although IPDEV2 needs to be financially sustainable in the long run, the fund does cover the costs of incubation and technical assistance provided to early stage local investment funds. These locally rooted funds gather local investors together to assist IPDEV2 and target higher returns, in the local currency, consistent with local risk/return profiles. IPDEV 2 contributes to financing very small companies, building local capacities and fostering a new generation of African private equity investors.

In line with the investment continuum, impact funds promoted by IPDEV 2 stop where the pan-African IPAE fund begins. Indeed, IPAE invests in companies whose financing needs are greater than €300,000 and go up to €1.5 million. It targets growing companies, but a quarter of the companies in its portfolio are start-ups. The launch of the IPAE fund in 2012 gave I&P the opportunity to create six offices in Africa, including four in West Africa, (historically the most densely operational region), one in Central Africa and one in the Indian Ocean region. These offices are mainly led by African teams who work over the entire investment cycle and support the entrepreneur to meet his needs on the ground. While remaining below the intervention thresholds of typical for-profit investors, the slightly larger size of the companies funded by IPAE1 and 2 allows their investors to hope for better returns, ranging between market returns and the preservation of capital

In line with the investment continuum, impact funds promoted by IPDEV 2 stop where the pan-African IPAE fund begins

Why are the support costs of investee companies so great and what areas should they target in order to get the best return on investment?

Investors ready to make a trade-off between performance and impact and compromise their expectations of return and liquidity to promote small companies remain very few

Indeed small businesses that need only small investments also need intense, multidimensional and long-term support. With I&P coming on board, they must formalize and structure their company, set up reliable management tools and an efficient information system, improve their HR policies, etc. Time spent is also much greater than for higher investment tickets and requires the mobilization of patient and sometimes poorly remunerated capital. Today, investors ready to make a trade-off between performance and impact and compromise their expectations of return and liquidity to promote this category of small companies remain very few. Thus we still face a huge deficit of finance that can allow us to assume the triptych of patient capital / below market-rate returns / high risks, which is key to the growth and success of promising, early stage businesses in Africa and which form the so-called "missing middle".

Steering the company, a more technical mission than it seems

For all of the entrepreneurs we have worked with, their partnership with I&P is their first with an investment fund

Challenges in supporting I&P's investees begin even before the investment. For all of the entrepreneurs we have worked with, their partnership with I&P is their first with an investment fund, and in most cases, I&P is also the company's first private shareholder aside from the entrepreneur and his or her friends or family. The negotiation of the entry of the capital therefore very slow because entrepreneurs need to be educated on 4 topics: (i) the relationship with a private equity investor (including financial and legal discussions, which are often new to the entrepreneur), (ii) the company's formalization, (iii) implementation of new governance (the company often has no board we invest), (iv) definition of a new ESG policy.

Once the investment has been made, supporting the company is tough in many cases. The shareholders' agreement must be implemented, as well as the action plan and the new ESG practices. The company's finances need to be restructured and often call for additional debt financing. Building new facilities, such as a plant or offices, requires close on-site monitoring. A number of technological problems may arise. Strategic and commercial management of the business is time consuming in a context of weak support coming from middle management and a fast evolving environment. Many events happen and require strategic intervention/support on the part of I&P.

Nevertheless, our experience has progressively driven us to focus on the information and management systems of the business, as soon as in the due diligence phase is completed. We continue to devote an increasing number of resources to these business systems, although this weighs ever more heavily on our operational budget, because our experience has proven that this focus is critical to the success of our partners.

The vast majority of companies funded by I&P have experienced major problems with their management and information systems. Accounting is often deficient or inexact and auditors inconsistently competent. Cost accounting often does not exist. Physically rudimentary information systems and a low level of computerization of the company are very common. Yet confronted our partners' immense daily operational challenges in sales, purchasing, production, and HR . Unfortunately, we have frequently been slow to prioritize the set-up of a well-functioning information system to run strategic operations because of the cost , ERP (Enterprise Resource Planning) or not. Indeed, it is not possible to think strategically when the costs and margins of the company's products are not known, or only slightly and approximately, and the economic model is not under control. Nor is it possible to manage production and distribution, monitor the commercial policy and billing process and identify potential fraud in the absence of an effective information system.

In recent years, analysis of the company's management information system (MIS) has become a prerequisite for an investment by I&P. In the vast majority of cases this analysis has led to the definition of an action plan, including audits and new administrative, accounting and financial procedures, software and hardware investments and trainings on how to use business management software tools... These simple action steps should not hide the fact that this is a very complex activity: the engagement of business leaders and employees is not always in place and must be built; suitable software and hardware may be difficult to identify and obtain; good international or African consultants familiar with SMEs are scarce and sometimes difficult to mobilize; the costs of information systems are high compared to the turnover of SMEs and their cash flow problems can make a regular investment process difficult; the use of spreadsheets and their rigorous implementation in the field must be promoted by shareholders. All this means that failures exist and can be expensive. **The translation from intention to reality requires strong determination, as well as the construction of a qualified and specific network to transfer skills and know-how to African SMEs**.

The translation from intention to reality requires strong determination, as well as the construction of a qualified and specific network to transfer skills and know-how to African SMEs

Nevertheless, investing in management and information systems is extremely rewarding and satisfying. Having permanent access to the business margins, costs, economic model, and cash flow and being able to quickly establish solid business plans, etc. represents an invaluable asset for the company. It prevents the entrepreneur and his shareholders from making bad choices or from losing management control, as too often happens in start-ups and SMEs.

This is our eighth lesson from Africa. Choosing to finance small businesses, early stage businesses and start-ups is first and foremost an impact choice. In essence, the lower the investment ticket, the more constrained the economic model of an investment fund, which weighs on the net profitability delivered to investors by over-allocating management costs in relation to the size of the ticket. This is why today, most private equity funds invest more than €5 million per deal where, in reality, there are fewer investment opportunities, perpetuating the phenomenon of the missing middle. For small businesses, and even more so for start-ups, there are very few financing solutions available, even though financing is at the heart of the demand of the African entrepreneurial makeup. At the same time, making an impact choice is not always easy for investors, who have an increasingly wide range of options in the world of "impact" that lead some to believe, often wrongly, that no trade-off between profitability and impact must be made. The impact choice and its consequences on the business model depend on the monitoring costs, which are high for these SMEs. It is possible to reduce costs and make these companies more profitable, thanks to a good information and management system, which does not always appear to be a top priority for the entrepreneurs.

9 Lesson n°9: Small businesses in Africa need patient capital and time to grow

We have often been astonished in industry conferences or events we have attended in recent years, whether in Europe or the United States, to see how omnipresent the notion of "acceleration" is. Many incubators, facilitators and other intermediaries attempt to "accelerate" investment in SMEs, but is this acceleration really desirable?

While the urgency of development is high, while support needs are colossal and while help during the investment preparation stage is very useful, nothing can shorten the time needed to build a relationship of trust between an entrepreneur and an investor, which is a prerequisite for capital sharing. We do try to communicate approximate deadlines on the various stages of our investment process, and in particular a period of 6 months preceding the closing of a deal, but this often takes much more time. In reality, it usually takes 12 to 18 months between the first contact with an entrepreneur and the signature of the shareholders' agreement.

Nothing can shorten the time needed to build a relationship of trust between an entrepreneur and an investor, which is a prerequisite for capital sharing

Similarly, the exit process is lengthy. While exits are indeed possible, contrary to popular belief and as demonstrated by the 23 exits that I&P has made since 2002, the market remains under developed. Discussions are often long and slowed down by requirements to fulfill the impact mandate, especially in this last stage of the investment cycle. Our experience shows that it takes close to 18 months between the first discussions with the entrepreneur on a possible exit plan and the final agreement with him or her or with a third party.

The short investment and disinvestment goals imposed by closed-end funds are hardly compatible with the long period of time required for the development of an African SME

These transaction periods, well known to impact investors that accompany SMEs in Europe, are longer in Africa in the investment monitoring phase, especially when it involves start-ups or early stage companies. The start-up and growth phases of an African enterprise are slowed down by (i) the heavy administrative procedures required in many African jurisdictions, (ii) the market access problems mentioned above, (iii) governance difficulties, (iv) the problems of energy access, (v) the lack of infrastructure, etc. All of these challenges related to the African context inevitably slow down the growth pace of a company and are major constraints for investment teams who struggle to combine them with the hardly compatible short investment and disinvestment goals imposed by closed-end funds, whose terms are typically 10 + 2 years. This closed-end fund model is the most widely used in the private equity industry and the preferred one for investors as it guarantees the liquidity of their investment and sets strict commitment and exit deadlines for fund managers, whose remuneration falls sharply after the first five years of the investment period. However, the long period of time required for the development of an African SME compared to these short investment deadlines, reflects a major disconnect and constraint, which can affect the fund's mid-term performance- because premature exits- and hinder its impact potential. Not to mention that short investment cycles require constant mobilization of the investment teams for fundraising activities and are likely to absorb some of the time they might have devoted to managing their investment portfolio.


Neurotech © Béchir Malum

I&P Développement 1 was set up in 2002 as a financial company under Mauritian law, which allowed I&P to gain considerable experience in this type of "evergreen" structure. The flexibility it provides has given I&P the opportunity to test, innovate, grow and support companies over long periods, with I&P's decreasing involvement over time, but allowing the youngest start-ups to achieve good financial performance and for the team to better negotiate exits. IPDEV2 has followed this evergreen scheme, in order to set up its program of development and building of African capacities over the long term, while providing answers to the liquidity demands of some investors (with liquidity clauses in a reasonable timeline) and imagining innovative compensation and incentive mechanisms for the team.

This is the ninth lesson we have learned from Africa. It is essential to adapt the structure of the financial vehicle to the extended development time necessary for small businesses in Africa, especially for the youngest, smallest and least structured ones. Do not underestimate the time required for the development of these small and medium sized businesses in Africa. Carefully strategizing with donors and investors on the best financial and non-financial instruments that can support these small and medium sized enterprises is a key success factor in maximizing their performance and impact.

4 *Investment Lessons*

4 *Investment Lessons*

Over the last fifteen years, capitalizing on European know-how and methodology, I&P has made 70 direct investments in African startups and SMEs, gaining valuable exposure to the specificities of an emerging economic fabric. This experience has led us to evolve in our expertise as an investor in many ways and we want to share some achievements, as well as some questions on three topics we feel have been important in our work. The first concerns the financial arrangements which raise universal issues that are practically linked to the African situation. The second is related to the management of corporate debt, which leads us to a more specific question on banks in the region. The third concerns the time available for an investor to prepare a business for investment and the significant improvements we have observed over the past years made on the entrepreneurial ecosystem, particularly in East Africa.

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

In I&P's first years in business, operational priority was to focus on the very business of the companies in which we invested. **Over the years, the formalization of investment conditions became increasingly necessary**: the hazards encountered on exits, such as the probability of misunderstanding or disagreement with our partners, and the entry of a growing number of investors in I&P's funds required greater formalization of our funds management and led us to specifying more and more precisely at the time of investment, the conditions of entry, management and exit terms. The financial structure negotiations were becoming increasingly time consuming and tightening on a limited number of options.

For an investor, the choice of legal arrangements in an African SME is dictated by the acceptability of the options it has to offer in the cultures where it operates. We have observed that it is particularly difficult for the SMEs we invest in to accept the entry of third party capital into their business at the maturity stage. In almost all of our investment experiences, our investment funds have been the first capital to be injected into the partner company, necessitating us to train our partners on the methods of equity investment. This leads our partner companies to prefer mezzanine or convertible bonds over more intrusive securities like equity investment, even those appended with clauses allowing participation on the board of directors, consultation or even veto powers on certain strategic decisions made by the board.

In reality, the use of equity-linked debt is neither desirable or systematically possible: the debt is indeed paid back by the company, which can lead to unsustainable financial situations, especially when companies are in strong growth mode and have significant working capital and investment needs. A creditor, even one in equity-linked debt, is also in a less comfortable position than a shareholder to provide support in the management of the company. Lastly, the expectation of return is greater as a shareholder than as a creditor; even for equity-linked debt, entrepreneurs tend to compare the conditions of indebtedness with the conditions offered by the banks, and sometimes have difficulty accepting rate differentials that are perfectly sensible economically. Finally, the tax treatment of the interest on these debts is sometimes very unfavorable.

These considerations have led I&P to prefer to invest capital in partner companies as much as possible when shareholders are in agreement. However, even in these cases, two factors can constrain returns and weigh on the arrangements.

The preservation of their majority position is often a primary concern for our partners

First, our experience has led us to have controlling interest only when it could not be avoided, while the preservation of their majority position is often a primary concern for our partners. This has also led us to put a cap on the amount of capital I&P can bring and once it is reached to use additional funding in the form of debt, sometimes convertible debt, while we would have more appetite for equity.

Secondly, the possibility of buying back our shares at the end of the investment period is often a priority for our partners. This constraint can also lead to putting a cap on the amount of the equity contribution or to making some arrangements that can affect the investment's value.

A complementary difficulty affects numerous arrangements: investing in start-up companies where markets are difficult to predict but highly promising in terms of growth, **it is often challenging for us to value the companies in which we invest**. Typically, the high expectations of entrepreneurs, based on very ambitious business plans, appear to us very excessive, and coming to an agreement can be difficult. Possible negotiated solutions may lead to a delay in the recognition of the value of entry ... At the exit, if the business plan has been followed; mechanisms to upgrade share values or set a minimum guaranteed IRR can be put in place, for example. In all these cases, such clauses, however, make the arrangements and the writing of legal terms more complex.

In addition, arrangements are constrained by the legal specificities of each country and system. Thus, until recently, it had not been possible in OHADA law to use the mechanism of convertible bonds. In practice, the differences between European law and the British common law used in English-speaking Africa, preclude the use of uniform arrangements for all countries and firms, even when fund situations are comparable.

ACEP Madagascar © Zen Design

All of these considerations have led I&P to evolve toward the use of three major types of formula. The first category involves negotiating, at entry, capital multiples for exit, with put and call mechanisms, and the disposal of I&P's shares to a third-party. In the second category, the arrangements are made up of a mix of participating and/or convertible stocks whose accrued yields must provide an IRR target. At maturity, the promoter may redeem the fraction of capital held by I&P on the basis of the targeted IRR. This creates a strong incentive for the promoter to exceed the performance objective. The sale of the capital to a third party is, of course, always possible if both parties agree. Finally, a third category is based on the principles of "venture": based exclusively on capital, with a forecast of successive capital injections in rapid terms; this category offers the early investor "privileges" in subsequent valuations that pay for the risk taken. Around these broader categories, a large number of variations take into account the psychology of our partners, as well as the particular situation of the company and the country concerned.

This is the tenth lesson of Africa: Despite increasing attention to the setting up of investment arrangements and an increasing formalization of the process, there is no standard, "one-size-fits-all" investment arrangement. While general arrangement categories can be distinguished, due to the wide variety of psychological, business and economic profiles of our partners, the disparate but generally weak maturity of the intervention of third-party investors, and the varying laws applicable in different countries, it is impossible to implement standard arrangements , even though the small size of investments in SMEs would seem to justify simple and uniform formulas. The combination of capital contributions and participatory debt in varying proportions, however, would appear necessary in many cases.

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.

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

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.

12 Lesson n°12:
Rely on the entrepreneurial ecosystem to develop business pipelines ready to be financed

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.

Pharmivoire Nouvelle © Béchir Malum

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) ...

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

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. .

5 Lessons of Impact

13 Lesson n°13: Measuring impact on the ground only makes sense to better manage it

14 Lesson n°14: Developing an ESG approach is possible and necessary, even for SMEs in Africa, provided a long-term partnership is established

15 Lesson n°15: The Sustainable Development Goals (SDGs) present both a great opportunity to develop the impact investment sector in Africa, and a challenge to measure concrete contributions

5 *Lessons of Impact*

For years, I&P was doing "impact investment" without knowing it. Created with a dual objective of economic efficiency and contribution to African development, I&P brought together a team and investors deeply committed to the "cause". The many missions in the field were an opportunity for the team to observe the many facets of the impact created by the SMEs we supported: a generation of African entrepreneurs with exemplary careers, offering basic goods and services that are sorely lacking in Africa, the creation of formal jobs, the structuration of economic sectors, and more. Starting in 2012, a more rigorous approach to analyzing and quantifying these impacts was introduced, as the "impact investment" sector was itself coming into being. Over time I&P has become one of the premier actors in Africa involved in a management and impact measurement approach, which has become a sector requirement that remains as vague as it is controversial. After five years of practice, what have we learned?

13 Lesson n°13: Measuring impact on the ground only makes sense to better manage it

The collection of quantified indicators on all of our companies over five years has refined the analysis of impact already well known by the team, but illustrates the role played by SMEs in Africa and professionalizes our communication with investors.

We confirm that SMEs grow faster and create more jobs than other types of companies, especially when they are well financed and supported: I&P's partner companies have average employment growth of 50% over the investment period, which is three times higher than that observed in companies supported by traditional private equity players in Africa. Unsurprisingly, the champions are early stage companies, service companies and microfinance institutions.

SMEs respond to basic needs and have positive domino effects, since they are deeply rooted in their own territories: 90% of them are oriented towards domestic markets. They respond to a whole range of basic needs of local companies and populations and work with, on average, 70% local distributors or suppliers, whose businesses they often help to structure. We find that the majority of African SMEs, as in the rest of the world, are controlled and managed by men: 20% of the entrepreneurs we support are women, compared to 15% on average in African SMEs and 5% in large companies[1].

Our history and experience allow us to define measurable impact objectives for the new funds to be launched and to establish financial incentive mechanisms, allowing team performance bonuses to be linked, not only to financial objectives, but also to extra-financial objectives.

It has been necessary to go out in the field to perform evaluations and to discover a more complex than expected reality

However, aggregated figures alone are not enough: it has been necessary to go out in the field to perform evaluations to meet employees, customers and small producers of these companies, and to discover a more complex than expected reality. These evaluations, carried out each year on one or two companies in I&P's portfolio , have most recently mobilized CIFRE PhD students from I&P and pro-bono HEC students to get out and learn more about our business. These evaluations were conducted by the students at a very reasonable cost, and were co-financed by the technical assistance program and the beneficiary companies. The goal of these studies is not to "measure the impact" from a scientific point of view, but to better understand who the customers, suppliers, and employees of our partner companies are, and to build mutually beneficial relationships.

By interviewing a representative sample of 371 small-scale agricultural producers in Cameroon and Burkina Faso, we confirmed the huge potential impact of agribusiness enterprises, increasing productivity and incomes (+ 40% on average) of hundreds, if not thousands, of local small-scale sub-contractors, most of whom live below the poverty line. We have also gained insight about the responsibility that these companies have taken on: by creating a situation where others depend on them for their livelihood, they sometimes become sources of great vulnerability for producers when struggling to finance their seasonal campaigns or confirm their orders. Not to mention the complexity generated by this model: these SMEs have the difficult task of creating or structuring entire sectors, a service that exceeds their capacity for action and funding. They must combine their strengths with non-profit organizations to train and equip these small producers, and sometimes to help them acquire certifications.

[1] McKinsey, « Women matter Africa », 2016

For many of the SME employees surveyed, access to formal employment has indeed been a tremendous opportunity in countries where only a quarter of the workforce is employed. More than income stability or access to social protections, the main advantage of formal employment is for some, the ability to open a bank account in order to obtain a housing loan. Ensuring greater stability for the employee, formalization is often a guarantee of greater loyalty to the company on the part of employees: at an infant cereal company in Madagascar, the turnover rate of door-to-door saleswomen dropped considerably after they gained access to employee status. However, for other employees and in other contexts, moving to a formal status may mean less freedom and the impossibility of accumulating a number of small and remunerative jobs: the formalization of jobs can thus trigger an unexpected wave of departures, which can destabilize the company, as was the case, to our surprise, in a Beninese company where we recently invested.

In-depth surveys of 534 micro-entrepreneur clients of microfinance institutions in Madagascar and Cameroon have confirmed the importance of access to micro-credit in creating and developing small businesses. At their own level, these small businesses create 2 new jobs per micro-entrepreneur and + 20% turnover growth on average. These micro-entrepreneurs also informed us about the limits and risks of the model. With their ease of access, micro-credits can "lock in" the most promising companies: in the absence of a partnership with local banks, few client companies realize their full development potential and many miss out on the opportunity of bank financing, which can be more suitable and (financially) beneficial after a certain level has been reached.

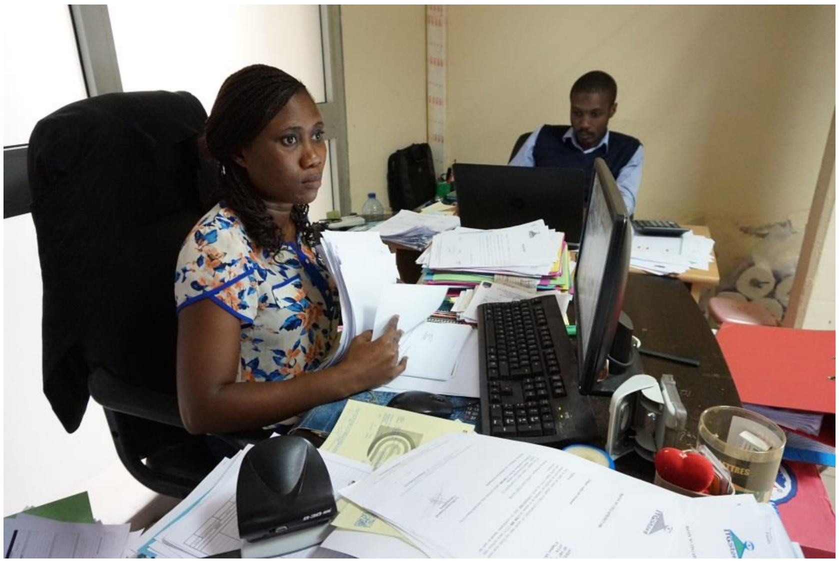
This is our thirteenth lesson in Africa. It is just as difficult to evaluate the impact of an ex-ante company as it is imperative to combine different measurement tools to better understand and know how to optimize it. I&P has put in place an ongoing process to improve its measurement and impact management practices over the years. Experience has shown us that it is necessary, not only to combine quantitative tools (annual collection of cross-sectoral indicators) with qualitative tools (in-depth field study of a given company), but also with a portfolio and individualized approach, by company, according to its geographical, sectorial and market context, in order to better evaluate the positive and negative impacts of our investments and thus manage them as effectively as possible.

14 Lesson n°14: Developing an ESG approach is possible and necessary, even for SMEs in Africa, provided a long-term win-win partnership is established

We see a strong commitment from the entrepreneurs on the issue of social responsibility. They understand its importance in recruiting employees, and in improving their relationships with producers, distributors and local communities

Five years ago, we also strengthened the analysis and monitoring of the social, environmental and governance (ESG) aspects of our investment projects. **This more structured approach has been gradually introduced and has contributed to enriching the work of the investment team - notably because it places human aspects, too often overlooked in the investment decision process, at the heart of the investment process**.

When speaking with entrepreneurs about social responsibility, we have felt a strong commitment from them on this subject. They understand its importance in recruiting and retaining employees, and in improving their relationships with producers, distributors and local communities. A portfolio-wide study on health insurance improvement for company employees has led to the introduction of a support system for SMEs on this subject, which responds to a strong demand from employees and the entrepreneurs who want to retain them. In a context of strong competition for talent, social initiatives have been able to constitute innovative solutions for companies to differentiate themselves as employers.



ITG Store © Béchir Malum

We have also noted the lack of rigor of some SMEs on fundamental issues, such as safety on production lines or roads. In particular, the deplorable situation in Africa in terms of road safety has led to serious and sometimes fatal accidents in our businesses, sometimes where we least expected it, such as with employees of microfinance institutions, where travel between agencies and customers is frequent. Today, one of our number one priorities is fighting to promote road safety, which involves setting up trainings and formal procedures and the installation of a tracking system in the professional vehicles of SMEs. The entrepreneurs we deal with tend to feel less concerned about environmental issues, except when these issues are presented as opportunities that are in their economic interest: energy efficiency or renewable energy solutions are thus of great interest for our partner companies because they work in countries where electricity is extremely expensive and unreliable. If these solutions are identified upstream, the additional investment can quickly become profitable and generate significant cost savings, while promoting independence from local power grids.

This is our fourteenth lesson in Africa. As an investor, we see that performance and impact often go hand-in-hand at the SME level, especially from a long-term perspective. Thus, the first factor of success is for us to choose a committed entrepreneur whose investment project is socially and economically valuable (and beneficial). Experience shows us that the correlation between financial and extra-financial performance is as strong as it is natural, especially over an investment horizon of 5 to 7 years, which makes it possible to reap the full benefits of social or environmental actions in the medium or long term. Therefore, one of our priorities is to evaluate the impact ... before investing. By developing precise criteria or ratings grids , we clarify our impact objectives and commit ourselves to selecting projects based on the expected impact as well as on profitability.

(15) Lesson n°15: The Sustainable Development Goals (SDGs) present both a great opportunity to develop the impact investment sector in Africa, and a challenge to measure concrete contributions

We are seeing an unprecedented mobilization of the private sector, particularly in the international financial community

Since their adoption by the 193 UN Member States in September 2015, the 17 Sustainable Development Goals (SDGs) have become the new benchmark for businesses and investors who want to report on their social and environmental impacts. We are seeing an unprecedented mobilization of the private sector, particularly in the international financial community. Impact investors, who are explicitly seeking to resolve development issues and measure their impact, have a unique position in this new movement. The quantification of the investment needs associated with the SDGs in Africa and this mobilization are therefore a great opportunity for visibility and mobilization of resources for impact investment on the continent, as described in the study we conducted in partnership with Ferdi[1].

At I&P, the SDGs have clearly enriched our reading of our impacts and measurement systems, placing them in a global perspective. Several key objectives are in direct harmony with our investment approach, such as Goal 8 on creating decent jobs and economic growth. Sectoral objectives, such as Goal 3 on "good health and well-being" and Goal 7 on "clean and affordable energy", are linked to several of our investment categories, especially those that meet the basic needs that today constitute 70% of our interventions. However, we also see a real challenge on the ground to measure concrete contributions and avoid impact washing. The 17 SDGs are broken down into 189 targets, which are followed by 230 macroeconomic indicators: their transcription at the level of African SMEs is therefore delicate and requires numerous adjustments. Moreover, a risk of "impact washing" has emerged: as a recent Novethic[2] article points out, some financial players are creating confusion and opportunistically claiming a contribution to the SDGs that is neither intentional or rigorously measured. Measures are limited to calculating the exposure of portfolio companies to "sustainable" or "impact" themes linked to the SDGs (nutrition, health, renewable energies, etc.) in the absence of a real management and measurement system of their impact on the entire investment cycle.

[1] *"Investing in Development in Africa, How impact investment can contribute to meeting the SDGs in Africa", I&P and FERDI, October 2016*

[2] *"Les investisseurs en quête d'impact", Novethic, juillet 2017*

Finally, we find in Africa a tendency towards excessive polarization of impact investors around a limited number of countries and sectoral themes (access to nutrition, credit and energy, in particular) that has been increased by the SDGs and creates a risk of mismatch between the offer of impact funding and the variety of needs on the ground.

This is our fifteenth and final lesson on investment in Africa. The institutional framework is gradually being structured, and the impact investment sector, geared in particular to emerging countries, is receiving renewed attention from political and economic decision-makers. As such, the SDGs represent a tremendous opportunity for institutional recognition in the public and private spheres, paving the way for increased mobilization of funding for impact funds and their beneficiaries in developing countries. This is, of course, to be welcomed, while we must remain vigilant to the drifting "impact washing" that puts discourse before the evidence, and to the difficult application of this generic framework to the multitude and complexity of situations encountered in fragile countries.

Conclusion

Two final questions need to be answered to conclude this document.

First: is there a future for Africa? Our answer is an enthusiastic yes.

The slowdown in the continent's average growth has dampened the enthusiasm of many investors towards the African continent. Fundraising of private equity funds has been less dynamic. Portfolio investments have slowed down, even though Foreign Direct Investments have maintained their same level. The reason behind these recent developments is the collapse of oil prices and of the primary mineral raw materials. Importing countries have continued to grow significantly. This growth is driven by domestic consumption (in other words by demographic growth), as well as by modest but steady productivity gains, and a pace of investment that has been able to keep up – although we would like to see it grow even more.

Raw materials are a poison for many countries, which encounter the greatest difficulty managing them: monetary overvaluation that leads to the collapse of competitiveness, hypertrophy of the public sector and poor governance characterize most oil and mining companies. We should hope that, with the support of their creditors, these economies will take advantage of the collapse of prices to restructure and gain competitiveness, while other net importing economies will continue to improve the efficiency of their investments and control their domestic and external public debt.

This scenario is all the more plausible as African countries, despite their strong differences, will benefit from the demographic dividend in the years to come. Taking into consideration the strategic principles outlined in this document, in our view the African continent carries great investment opportunities, especially for companies working in the consumer goods and equipment sectors, which will particularly benefit from the vast demographic markets. It is an increasingly interesting field for export activities oriented towards European markets (especially the agriculture sector) but also for service activities, thanks to the improving qualifications of the African workforce. Industrial activities are beginning to emerge. Africa has also become an exciting field for observing major sectoral innovations and new economic models, some of which, as in the case of energy and finance, can also be inspiring for industrialized countries. However, in a context of great global competition and high liquidity with low interest rates, the trend followed by multinationals and large investment funds is to value large companies and "fashionable" sectors such as decentralized energy. The question of SMEs and startups financing – and thus the question of impact - remains.

Our second question is: is there a future for impact investing in Africa? Our answer is again yes.

Impact investing consists in contributing to issues of general interest with the use of market instruments. It involves financial and extra-financial performance objectives. Impact investing brings extremely valuable contributions to the challenges facing the African continent, alongside Official Development Aid and traditional profit-making investments, both of which are also decisive. The continent indeed knows a dynamic of general growth without which it would be impossible to develop private investments, including impact investments. However, growth is not enough in itself, and the challenges that countries face are so great that only lucrative investments, with the support of national public budgets fueled by taxes, can respond to the challenges of job creation and the fight against poverty. Public aid and private investments are, despite their volumes, below what would be necessary to contribute to rapid progress. In the specific context in which we operate, impact investing allows for, dealing with most of the crucial issues currently at stake with few public or private funds.

This is particularly true on the employment and entrepreneurship fronts. Africa is currently building the economic fabric of the future, but traditional profit-making investors face profitability constraints that impede them from targeting the SMEs and start-ups that will become, over the years, the larger companies that may interest them. We have mentioned this in this document. We observe a supply shortage compared to the overall investment capacity devoted to the African continent. We must help create the market, support the growth of existing small businesses, and create many more. This will boost formal employment, still so rare on the continent. This is the primary role of impact investors, whose funders can accept lower returns (sometimes going as far as venture-philanthropy), to create this market over the long term, while generating important benefits in terms of employment, and social, environmental and governance impacts.

The impact investing sector, especially in Africa, is still young. Investors are still relatively inexperienced and have realized few exits, and the teams are quite new – I&P is an exception in this respect. Investment cycles, lasting a decade or more, are long, and it's still difficult to recruit new teams. Progress during this period, however, has been striking, both quantitatively and qualitatively, and international interest is clearly growing. More interestingly, we see an equally growing number of private and public African investors turning to this instrument. We believe it is both a profound measure of credibility and sustainability, and a trend that should be followed and supported carefully.

We are willing to bet that in fifteen years there will still be a dynamic, creative, and enthusiastic Africa, and that there will be more impact investors, with bigger capacities, to pursue the greatest adventure of the 21st century, the century of Africa.

IP INVESTISSEURS & PARTENAIRES