Fifteen years
Fifteen lessons from Africa

INVESTISSEURS & PARTENAIRES

3 *Lessons from Enterprises and Entrepreneurs*

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?

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

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.

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.


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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.