COLLABORATIVE
FOR FRONTIER FINANCE

SGB Fund of Funds Vehicles

ROLE, OPPORTUNITY, AND DESIGN CONSIDERATIONS

Accelerating Access to Capital for Small and Growing Businesses **June 2022**

Table of Contents

Developed in partnership with

- World Economic Forum Global Alliance for Social Entrepreneurship (Global Alliance)
- Collaborative for Frontier Finance (CFF)
- The Global Steering Group for Impact Investment (GSG)
- Impact Investing Ghana (IIGh)
- Sustainable Development Investment Partnership (SDIP)

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Abbreviations

AfDB	African Development Bank
AUM	assets under management
BDS	business development services
CFF	Collaborative for Frontier Finance
DCA	Development Credit Authority
DDQ	due diligence questionnaire
DFI	development finance institution
FI	financial institution
FoF	fund of funds
GDP	gross domestic product
GP	general partner
GSG	The Global Steering Group for Impact Investment
I&P	Investisseurs & Partenaires
IC	Investment committee
IFC	International Finance Corporation
IMM	impact measurement and management
IRR	internal rate of return
LCP	local capital providers
LP	limited partner
MDB	multilateral development banks
MFI	microfinance institution
NAB	National advisory board
PE	private equity
PIC	Public Investment Corporation
ROI	return on investment
SA	South Africa
SDG	Sustainable Development Goals
SDIP	Sustainable Development Investment Partnership
SGB	small and growing businesses
SME	small and medium-sized enterprises
TA	technical assistance
VE	venture capital
VCTF	venture capital trust fund
WEF	World Economic Forum

Definitions of Stakeholder Groups

Definitions and examples of stakeholder groups referred to in this document are presented in the table below. These terms mirror how the market refers to this ecosystem.

Table 1: Definitions of stakeholder groups

Stakeholder group	Definition in this context	Interchangeable terminology and examples
Local capital provider (LCP)	An investment intermediary investing between USD50k and USD500k into small and growing businesses (SBGs), using diverse investment theses, tool and instruments and having deep local knowledge.	• Fintech platforms • Fund managers • General partners (GPs) • Intermediary • Investors in “missing middle” • Non-banking financial institutions (NBFIs) • Private funds (private-equity fund; private debt fund) • SGB Fund • SME funds • Sub-fund • Venture capital (VC) funds
Fund of funds (FoF)	A pooled investment facility that invests in LCPs which are investing in SGBs.	• FoF vehicle (including the 10 FoFs profiled in this report) • Multi-manager investment • Pooled investment facility • SGB fund of funds • Transitional FoF[1] • Wholesale investment vehicle • Wholesaler
Investor	A person or organisation investing money into an FoF expecting to assume a certain level of risk in order to achieve a financial and impact return.	• Bilateral agencies • Development finance institution (DFI) • Institutional capital • Institutional capital holder • Institutional investor • Limited partner • Local pension fund • Multilateral development bank (MDB)
Small and growing business (SGB)	Commercially viable businesses that have five to 250 employees that and significant potential and ambition for growth, typically seeking growth capital from USD20k to USD2m.	• Enterprises • Small and medium-sized enterprise • Small business

[1] *Emerging terminology referring to role FoF can play in market development, enabling LCPs to transition from raising FoF capital to raising institutional investor capital.*

Wilfred Njagi (Villgro Africa)

Amos Gachuiri (FSDAi)

1 Executive Summary

1.1 What did we set out to do and why?

Small and medium-sized enterprises (SMEs) are one of the key growth engines of emerging-market economies, absorbing up to 70% of the labour market, generating 40% of gross domestic product (GDP) and unlocking sustainable development. Access to finance is biggest constraint to growth, with a USD3.7 trillion funding gap (excluding micro-enterprises).

The biggest source of credit is working capital through local banking systems, with allocation limited by fixed-asset collateral requirements. Growth capital is available mostly through private funds, vehicles and platforms which are capitalised predominantly by international investors such as development finance institutions (DFIs) or multilateral development banks. But there are limitations on the market-building capabilities of international development capital: lack of proximity to market and preference for debt and direct deals.

In some emerging economies, development funding is being used to leverage local institutional capital to provide local-currency investment to entrepreneurs and businesses. And, indeed, to leverage additional international capital which complements the existing, deep knowledge of local investors with technical, sustainable and innovative finance skills.

It is with this in mind that a consortium of partners, initiated by the World Economic Forum Global Alliance for Social Entrepreneurship (WEF) and including the Collaborative for Frontier Finance (CFF), The Global Steering Group for Impact Investing (GSG) and the Sustainable Development Investment Partnership (SDIP), has been working with Impact Investing Ghana (IIGh) to accelerate the design and implementation of Ci Gaba Fund of Funds, an investment vehicle, that could address some of the key barriers to growth finance for small and growing businesses (SGBs)[2] in Ghana.

[2] *Commercially viable businesses with five to 250 employees that have significant potential and ambition for growth, typically seeking growth capital from USD20k to USD2m.*

1.2 The current situation in Ghana and other African markets

In 2021, 429 private capital investments totalling USD7.4 billion were reported on the continent, with 259 exits reported between 2016 and 2021. This record-level growth has been driven by large deals in infrastructure over the last year, although early-stage companies attracted 54% of the total amount invested.[3]

Ghana is consistently ranked as one of the top 10 private equity and venture capital (PE/VC) destinations on the continent and has attracted over 35% of PE/VC investment in West Africa over the last five years. Most of that capital (70%) is from international investors, mainly DFIs. The local capital that has been raised has been mainly through a government-funded fund of funds, the Venture Capital Trust Fund (VCTF), which has successfully provided first-loss capital to enable local venture funds to raise further financing. The VCTF has recently been recapitalised by the government of Ghana, through a World Bank facility, to invest in additional funds and implement an innovative emerging fund manager programme. This, as well as other FoF initiatives, will provide a critical mass of co-investors focused on local funds that could partner with a pension-funded fund of funds.

The potential of private pension-fund capital in Ghana into private-equity and debt funds has yet to be tapped. These funds control 66% of the more than USD5.5 billion pension-fund assets under management (AUM), growing at a rate of approximately 30% per year. Despite an investment limit of 15% in alternative assets, there is currently only a ±0.03% exposure.[4]

The opportunity for a private-sector-led vehicle to complement the existing initiatives, attracting capital from an alternative segment of investors and focusing on emerging private fund managers, is significant – on paper. Translating that potential into a compelling investable proposition has been the work of the last six months. This took the form of designing and structuring an FoF to unlock pension funding and forming a Pensions Industry Collaborative that brought the industry together to develop a broad action plan to unlock pension funding for alternative assets.

3 AVCA. (2020). Private Equity & Venture Capital in Africa Covid-19 Response Report. https://doi.org/10.1177/1403494812457731.

4 Ghana National Pensions Regulatory Authority. (2020). Annual report.

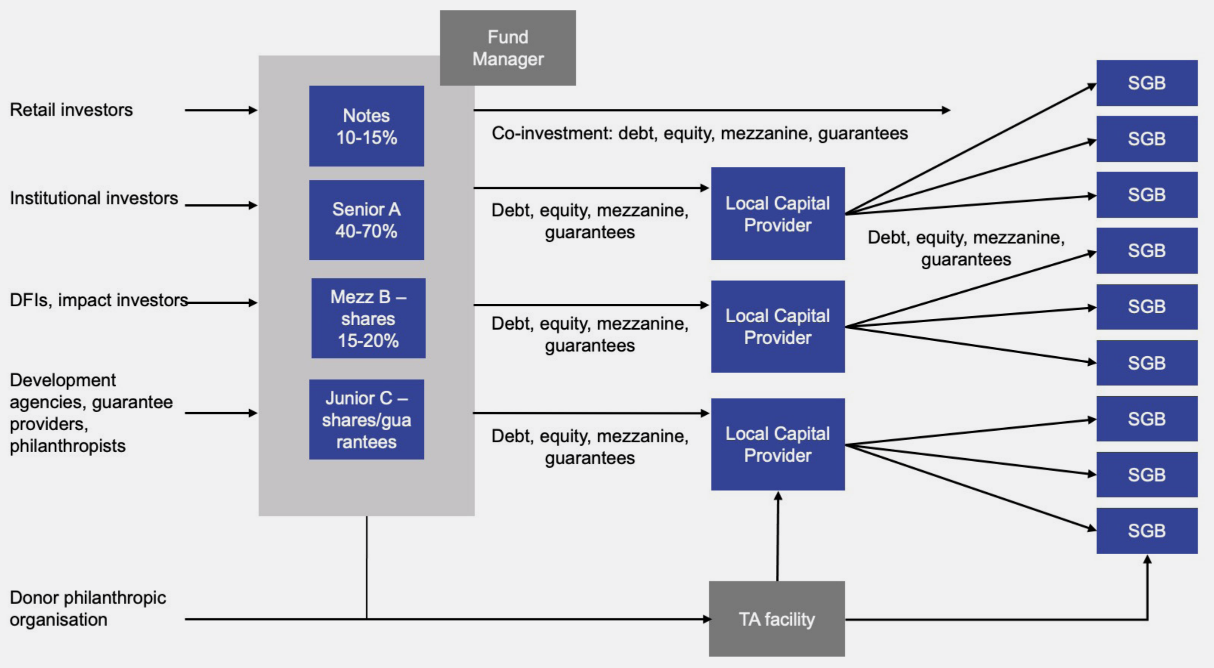
Lelemba Phiri (Africa Trust Group), Leila Charfi (Actawa Ventures) and Dmitry Fotiyev (Brightmore Capital)

1.3 The opportunity to build on and apply our learnings

This research and market review is intended to inform the broader ecosystem on the need for, value of and key construct considerations in the development of new intermediary vehicles to accelerate the flow of capital to SGBs in emerging markets. We have documented our learnings and look forward to working with the ecosystem builders to further both the adaptation of vehicles such as FoFs and an understanding of the role they can play in private-sector development.

We have termed these vehicles SGB FoFs, referring to the underlying asset, or transitional FoFs, referring to the vehicle's role in asset-class development.

Figure 1: Typical Fund of Funds structure[5]



1.4 System-level change: a catalytic opportunity

Fund of funds vehicles for SGB finance offer the potential to address certain market gaps, as described below.

1 Efficient capital mechanisms

These FoF vehicles allow institutional capital holders to "reach down" into the underserved missing-middle market segment, aligning institutional-scale capital with the financing needs of SGBs.

The International Finance Corporation (IFC) and others have long documented that emerging enterprises across Africa are starved for capital in the USD50,000 to USD500,000 range: the "missing middle".[6] To date, it has been a challenge for institutional capital, DFIs and multilateral development banks (MDBs) to addresses SGB finance consistently and at scale. As a result, we have seen a market phenomenon in which "SME" funds are generally between USD30 million and USD50 million in size, driving fund managers to target investment activities above the needs of the missing middle. By supporting a pool of smaller capital vehicles

[5] *Adapted from König, A.-N., Club, C., & Apampa, A. (2020). Innovative Development Finance Toolbox. October. https://www.kfw-entwicklungsbank.de/PDF/Download-Center/PDF-Dokumente-Broschüren/2020_Innovative_Development_Finance_Toolbox.pdf*

[6] *Dalberg & Collaborative for Frontier Finance. (2019). Closing the gaps: Finance pathways for serving the missing middles. Collaborative for Frontier Finance. https://www.frontierfinance.org/closingthegaps*

that meet the funding needs of the missing middle, FoFs address the mismatch in ticket size.

Further, FoFs address the economies-of-scale conundrum that institutional capital holders confront when considering supporting smaller local capital providers[7] that prioritise SGBs (i.e., local fund managers that operate vehicles below USD30 million). Such large institutional capital holders have found that the operational cost of assessing, underwriting and monitoring smaller capital vehicle is prohibitively expensive.

2 Standardisation and simplicity

Over the past two decades, institutional capital and DFIs flowing into local banks and microfinance institutions (MFIs) has benefited from the homogenous nature – and often regulated operating environment – of these intermediaries. Key terms and constructs can be adapted easily from one financial institution (FI) or MFI transaction to the next.

However, local funds or investment vehicles that serve the missing middle are a heterogeneous group. Their capital managers have developed investment models that benefit from the managers' unique skills and experience to meet the capital needs of the emerging enterprises in their markets.

By tapping an FoF, institutional capital and DFIs benefit from the FoF vehicle managers' ability to aggregate such diversified models. Applying standardised underwriting terms, FoFs are able to pool these heterogeneous models under one umbrella, simplifying the investment process for DFIs.

3 Risk diversification

Underwriting SGB missing-middle capital in emerging economies is inherently high-risk. A portfolio of local capital providers provides the requisite pooled diversification.

As demonstrated across all markets, experienced LCPs are in a position to best underwrite and manage local business finance. FoFs are able to pool together a portfolio of such LCPs. This allows for risk diversification, as FoF invests across multiple funds, fund structures and regions – and, thus, underlying small businesses.

4 Enabling market transition

Initial SGB-oriented FoF vehicles offer a pathway to scaled market capital.

We anticipate that these initial FoF models, while immediately achieving a level of scale and addressing market gaps, are a step towards increasing capital flow to the missing-middle sector. Learnings will drive further innovation, thereby enabling access to even larger pools of institutional capital.

In order for these FoF vehicles to play this informing and catalytic role, it will be necessary to obtain as much data as possible from their implementation. This includes information on the types of local funds (the "who"), instruments and investment approaches (the "how"), financial performance and Sustainable Development Goals (SDG) impact (the "why").

The term "transitional" is used in the context of the stage of market development. These "transitional" FoFs enable LCPs to develop a track record with a view to raising institutional monies in the future, providing a staging platform for capital to flow to LCPs through pooled vehicles in the short to medium term, and directly from institutional investors in the long term.

[7] *Investment intermediaries such as funds, vehicles, platforms, non-bank finance intermediaries, etc., investing between USD50k and USD500k into small and growing businesses, using diverse investment theses/tool/instruments having deep local knowledge*

5 Building local SGB financing ecosystems

The FoF structure is required as a developmental step to building the market for private, local SGB-oriented fund vehicles.

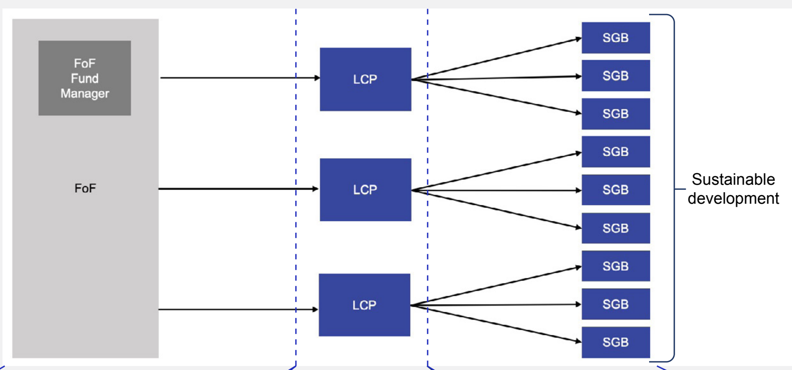
In the past, it has been the orientation of DFIs, MDBs, bilateral agencies and other “ecosystem builders” to prioritise direct investments[8] into SMEs, “soonicorns*” and high-growth small business. However, in doing so, such development-oriented organisations are failing to support the LCPs that better understand the small-business operating environment. It is these local managers who can best underwrite and manage local business finance.

An FoF vehicle allows field-building organisations to support such local intermediaries and, in doing so, build local teams, skills and experience for establishing a more consistent and resilient SME-financing sector in emerging markets.

[8] CEM Benchmarking. (2015). Value added by large institutional investors between 1992-2013.

* Soonicorns” – “A recently launched business that has the potential to become a “unicorn” (valued at more than one billion dollars)

Figure 2: Potential Theory of Change at the FoF, LCP and the SGB levels



Investor

Providing flexible or additional capital to LCP’s

Leveraging additional commercial, local institutional or private capital

Sharing data to enable transparency on financial and non financial performance

Driving impact integrity by sharing data, frameworks and benchmarks

Advocating with policy makers for regulatory change

LCP

Building capacity

- Emerging and existing fund manager capacity development
- Impact measurement and management support
- Network activation
- Working capital facilities
- Negotiate and set up opportunity for Shared services

Providing anchor funding

- First time fund managers
- Minority or underserved fund managers
- Fund managers source funding from other investors as a result
- Warehouse facilities for fund managers

Replicating fund structures in alterative geographies, sectors or market segments

SGB

Investing on suitable and affordable terms

Providing technical assistance to SGBs

Achieving impact in the lives of entrepreneurs, employees and customers at SGB level

Developing sub-sectoral pipeline through advocacy, regulation or project development funding

Increasing capital supply to SGB sector by building investment case and reducing information asymmetry

Accelerating the implementation process - critical issues to be considered

This project has had the benefit of input and guidance from a number of experts across the ecosystem. Recognising the value proposition of FoFs for SGB finance, our goal was to lay out the key issues for accelerating the market's acceptance, design and implementation of such catalytic vehicles.

In this review, the following major considerations arose:

Establishing the purpose

1 Clarity of purpose is critical in establishing the investment thesis and operational model

FoFs offer the opportunity to develop a diverse portfolio of fund vehicles - and therefore, presumably, can address multiple market failures. However an overly broad investment and theory of change focus runs the risk of creating too much uncertainty or novelty for investors.

Considerations for establishing the investment approach and operating model

2 FoF economics is challenging

The economics of small - business finance in emerging markets is inherently difficult. The key to system - level change is demons trating that the FoF's portfolio of LCPs can indeed make market - based investments in SGBs. Although at this catalytic stage, it is not a necessity for the FoF itself to obtain market - based returns for all its LP capital investors. Rather, a "blended" return approach may most likely be required, in which a portion of its capital or funding is subsidised. Alternative approaches to remuneration can also be considered in the early stages of market development.

3 Desired flexibility does not necessarily equate to open - ended models

FoF form should reflect core investment objectives whilst meeting the often - complex objectives of LPs and addressing any perceived potential risk imbalances. While SGB FoFs are not automatically candidates for open - ended vehicles, the flexibility afforded by an open - capital vehicle implies that such vehicle is suitable for system informing FoF vehicles.

Accessing appropriate limited partners (LP) and institutional capital

4 Local LP capital

FoFs offer local institutional investors, particularly local pension funds (LPF), an interesting "play" in small - business finance by addressing need for diversification and long - dated assets. FoF vehicles and teams can and have addressed capacity, regulatory and risk - return constraints.

5 International development capital

DFI's consider themselves FoFs so are reluctant to invest into an additional intermediary layer, yet they rarely access the type of LCP highlighted in this report. Perhaps most convincing, is the role FoFs that can play in accessing local institutional capital but the authors consider it is also incumbent on development funders to innovate around risk/return/impact expectations and enhancing their respective contributions to better - informed market data in SGB finance.

6 Blended capital for transitional FoF vehicles.

There is an important role for concessionary capital at this time with regard to risk mitigation, management fees, technical support and data analytics. There is evidence to suggest that, once precedent for fund models is achieved Expanded critical insights.gdoc in a market, fundraising for similar structures becomes much easier with both the original investors and a wider group.

Risk management – unbundling and managing the risk profile is critical

7 Governance

A well - articulated governance framework is required for aligning with the value proposition of the investment vehicle.

8 Portfolio

The ability to diversify investment risk across a portfolio of local fund managers, different investment strategies, differing underlying SGB portfolios, and return and investment mechanisms will be key.

9 Team capabilities and experience

Even with emerging data and risk management tools, SGB finance requires a nuanced understanding of the local markets. The knowledge and experience of these LCPs is therefore critical. FoF teams may be augmented by tapping experienced FoF managers or IC members who may have operated outside the local markets.

Design process and implementation

10 Resources and mandate

The complexity and technical factors to be considered in the design of an FoF require material resources. The FoF design process is driven – and influenced – by several foundational factors, including development funding, anchor funding and vehicle mandates.

Roeland Donckers (Iungo Capital) and Wiem Abdeljaouad (Actawa Ventures)

1.5. Using the Ci Gaba Fund of Funds design process to anchor the learnings

The Ci Gaba Fund of Funds has been designed by a group of investment professionals associated with Impact Investing Ghana. The key terms are captured below, and the fund management team is in the process of capital-raising.

Of the remaining nine operational FoFs and wholesaler vehicles summarised in the table below:

- They hold a total of over USD875 million in AUM and all are currently deploying.
- All are focused on addressing constraints at a fund-manager level (mostly first-time or underserved fund managers).
- Four have either targeted or have managed to raise local institutional capital from pension funds.
- The single-funding-source wholesalers have created funds of ±USD150 million to USD200 million in size; the size of FoFs pooling investments tends to range from ±USD25million to USD100 million.
- Ticket sizes range from USD5 million to USD20 million.
- Fees range between 1-2% of AUM, with two offering performance-based incentives to FoF management teams.
- Only one FoF does not offer technical assistance to fund managers.

Lillian Mramba (Grassroots Business Fund)

Table 2: Fund of funds profiles (funds 1 – 5)

Fund	Ci Gaba	Nyala Venture	I&P IPDEV2	Seed capital and Business Development Facility	FMO Ventures
Geography	**Ghana and West Africa**	**Sub-Saharan Africa**	**Francophone Africa**	**Africa**	**Africa**
Goal	Designed to address lack of investment in early-stage funds providing equity investment in SGBs	Designed to promote investment readiness of funds seeking institutional capital	Designed to share methodology of equity investment and sponsor first-time fund managers addressing early-stage capital gap in SGBs in Africa	Designed to address lack of anchor investment in first-time fund managers	Designed to support business using technology to enable affordable access to goods and services
Construct	• USD85m • Senior tier for pension funds • 30% first loss • Ghana domicile • Open-capital vehicle	• GBP8m from FSD Africa • Kenya domicile • Limited liability company (LLC)	• EUR24m sponsor fund • Investors include DFIs and private foundations • EUR15m leveraged from mainly African investors thus far	• EUR 40m from Ministry of Foreign Affairs of Netherlands	• EUR200m from Dutch government • First-loss guarantee from European Commission
Portfolio	• 10 to 15 funds • 40% emerging funds • Flexible capital - debt or equity • 50:50 Ghana/regional • 20% co-investments	• 6 to 8 LCPs (funds) • Flexible capital – debt or equity (+ working capital loans) • USD25k - USD2m ticket size	• Targeting 10 first-time fund managers (invested in 5 so far) • Anchor investor up to 20% fund size	• Demonstration of sub-scale funds of ±EUR7m-15m in size • EUR1m – 1.5m ticket size • Loan, equity or mezz with results-based instrument linked to socio-economic outcomes	• 60% Africa • 50% indirect • 14 investments in VC funds • EUR515m ticket size
Management	• 1% AUM management fee • Investment team based in West Africa • Independent Investment Committee (IC)	• 4-person investment team based in Europe and Africa	• No data on IPDEV2 specifically • I&P 100-person team across 10 countries	• Managed by four-person team from Triple Jump	• Netherlands-based team
Value creation	• Target return on investment (ROI) of 20% per annum (local currency) • 5% technical assistance (TA) facility to support emerging fund managers	• USD300k TA facility • USD270K Learning Lab • Both manged by CFF	• EUR3.50m facility • Funds pre-close costs • GP TA • Supports TA fundraising • Access to I&P network	• Some shared capacity building for fund managers • Loan/grant for portfolio company TA distributed through GP	• Co-investment with qualified lead investor • Ventures programme TA facility focus on environmental, social and governance (ESG)/impact/ inclusive business

Table 3: Fund of funds profiles (funds 5 – 10)

Fund	Capria Fund 1	Black Business Growth Fund	SA SME Fund 1	Thuso Incubation Partners	Public Investment Corporation (PIC)
Geography	**Africa, Latin America, and Asia**	**South Africa**	**South Africa**	**South Africa**	**Africa**
Goal	Designed to address lack of early-stage and early-growth risk capital required to scale	Designed to invest in emerging black-owned and -managed private-equity funds	Designed to address lack of economic growth due to lack of capital into SMEs	Designed to support emerging black fund managers in low mid-cap funds	Designed to increase PIC exposure to alternative investments across Africa
Construct	• ±USD60m • Closed-ended 13(+2)-year fund	• USD80m • Senior tier includes local PFs • USD13m first loss from government • Closed-ended fund	Fund 1: • USD100m • Open capital vehicle Fund 2: • Target USD35m with 20% first loss • Closed-ended fund	• USD165m AUM • Instigated and anchored by Eskom Pension and Provident Fund	• USD200m • Part of 5% strategic asset allocation from Government Employees Pension Fund
Portfolio	• 50:50 between emerging and experienced fund managers • Fund size: USD20m – 100m • USD500k – 3m ticket size • Debt or equity	• 5 to 7 funds • Focus on growth capital investments rather than buyout	Fund 1: • 7VCs + 5 growth funds (private equity and debt) • 5 first-time fund managers	• 9 funds • Underlying investment in low mid-cap companies	• 10 Investments (1 FoF) • ±USD20m ticket size • 20% emerging; 50% developmental, 20% established
Management	• 10 people in investment team • 5 people in operations and finance	• 1% AUM management fee • Performance fee: 10% above 8% hurdle	Fund 1: • 2% AUM management fee • Performance bonuses in lieu of carry	• Fees % AUM in line with FoF precedent and no carry • Team of 2 FTEs; ±8 for ad hoc support	• 2% AUM management fee
Value creation	• Long-term GP partnering & CEO support • Access to Capria network	• Target return: CPI+10% net internal rate of return (IRR) in ZAR • Supported funds during COVID • Shared IMM system	• Fund manager support • TA to support pipeline development	• Shared services platform (compliance, audit, legal)	• Exits for direct investments require auction process • No TA offered

2

Background and Context

Amos Guchuiri (FSDAi) and Lelemba Phiri (Africa Trust Group)

A consortium of partners, initiated through the World Economic Forum Global Alliance for Social Entrepreneurship and including Collaborative for Frontier Finance (CFF), The Global Steering Group for Impact Investing and the Sustainable Development Investment Partnership (SDIP), has been working with Impact Investing Ghana (IIGh) to develop an investment vehicle to unlock finance for LCPs and SGBs on a sustained basis in Ghana.

- The CFF facilitates a network of approximately 100 SGB fund managers across Africa with the purpose of supporting investment readiness and making linkages to capital. The most recent CFF survey[9] calculated a USD1 billion funding opportunity in this cohort alone, based on the fund investment and technical assistance requirements of LCPs. By "demystifying" frontier finance for a widening group of international institutional investors, CFF can expand the capital pool for these LCPs.[10]
- Global Alliance/SDIP is a global platform of public, private and philanthropic institutions with the ambition to scale and accelerate sustainable investments in developing countries. Over half its members are specifically interested in SME and SGB finance as a means to achieve this. This report builds on the Country Finance Roadmap for SDGs, aligning with the report's recommendations on the development of innovative financial instruments to improve small-business finance.[11]
- The GSG aims to embed impact at the heart of investment, business and policy decision making, so that significantly more capital can flow to create social and environmental impact. One of the ways it drives change is by disseminating best practices and leading market building initiatives with its National Advisory Boards (NAB), currently operating in 35 countries.[12]
- IIGh is the National Advisory Board for Impact Investing in Ghana. It hosts the Ghana Pension Industry Collaborative, which brings the pensions industry together in order to collaborate to unlock pension funding for alternative assets and is championing a number of initiatives to unlock local funding for LCPs. These include the design and setup of an FoF to unlock local pension funding.

This report is intended for investment and market-building teams developing FoF and wholesale capital structures. The purpose of this report is to share key learnings from an FoF design process, and general insights and tools drawn from a wider group of FoFs. This report is not intended to provide a systematic methodology on FoF design but rather highlights some key pain points for practitioners to address when designing or investing in an FoF.

[9] *Due for publication in Q3 2022.*
[10] *Collaborative for Frontier Finance. (2020). Emerging Market Small and Growing Business Capital Provider's Survey Results.*
[11] *World Economic Forum & Sustainable Development Investment Partnership. (2021). Country Financing Roadmap for the SDGs: Ghana.*
[12] *GSG. (2018). Building an impact investment wholesaler. October.*

2.1 Fund of funds

A fund of funds (FoF), also known as a multi-manager investment, is a pooled investment facility that invests in other types of funds or investment vehicles. This investment approach is in lieu of investing directly in bonds, stocks and other types of securities or assets.[13] The terms "wholesaler" and "wholesale investment vehicle" are often used interchangeably with "FoF" to describe a vehicle that makes both indirect and direct investments.

For this report, we focused on FoFs that invest in LCPs which operate across Africa. These LCPs in turn provide capital to SGBs with funding needs typically in the USD50,000 to USD500,000 range – the "missing middle". For further discussion on the types of enterprises and capital vehicles, see CFF's reports on the missing middle.[14]

To address the needs of SGBs in their local markets while leveraging their unique value proposition, LCPs across Africa have adapted from the traditional Silicon Valley and PE fund models. The vehicles may be closed-ended or open-ended. Their investment instruments range across the spectrum and include equity, simple agreements for future equity (SAFEs), revenue share, convertibles, mezzanine, and senior debt.

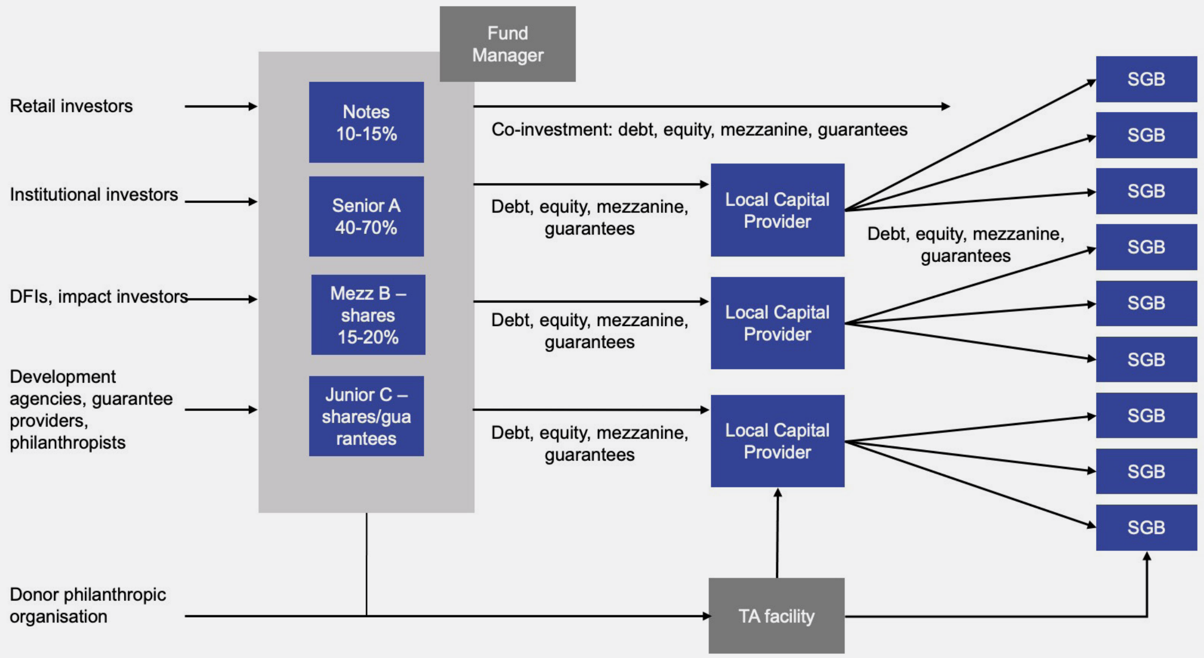
Figure 3 shows a typical construct of an FoF where investments are made into intermediaries or LCPs.

[13] *Chen, James; Investopedia, April 12, 2022; Fund of Funds (FOF) Definition (investopedia.com)*

[14] *Dalberg & Collaborative for Frontier Finance. (2019). Closing the gaps: Finance pathways for serving the missing middles. Collaborative for Frontier Finance, January. https://www.frontierfinance.org/closingthegaps*

[15] *Adapted from König, A.-N., Club, C., & Apampa, A. (2020). Innovative Development Finance Toolbox. October. https://www.kfw-entwicklungsbank.de/PDF/Download-Center/PDF-Dokumente-Broschüren/2020_Innovative_Development_Finance_Toolbox.pdf*

Figure 3: Typical Fund of Funds structure[15]



Ebenezer Arthur (Wangara Green Ventures)

3
Report Methodology

This report has been developed principally as part of a programme funded by the World Economic Forum Global Alliance for Social Entrepreneurship to review access-to-capital considerations for social enterprises and SGBs.

The methodology followed included:

- a "deep dive" into the development of the Ci-Gaba FoF design team, over two months;[16]
- an investor round table with 16 participating foundations and DFIs hosted by the Global Alliance;[17]
- interviews with representatives from nine established FoF vehicles operating in emerging economies that have SGBs as the underlying asset; and[18]
- engaging in the design processes of 2X Collaborative (driving gender-lens investing), the South African impact investment wholesale vehicle (through South African NAB) and the GSG Pension Fund working group..[19]

16 Hamdiya Ismaila and Amma Lartey as well as engagement with Pension Industry Collaborative

17 Organisational representatives from BII, Ford Foundation, DFC, UNCDF, Small Foundation, SECO, 2x, EDFI, Open Value Foundation, FMO Ventures, FCDO, SIFEM, Cornerstone Partners, Sustainable Market Initiative, Green Square Ventures and DEG

18 See Section 6 for full FoF profiles

19 Tshikululu Social Investments. (2021). Impact Investing Wholesale Vehicle: Learning Outcomes Report. October.

Enyonam Kakane (Mirepa Capital)

4 Learnings

4.1. Ten critical issues to be considered regarding FoF design

Establishing the purpose

1 Clarity of purpose is critical in establishing the investment thesis and operational model

Rationalising a focused investment opportunity

FoFs offer the opportunity to develop a diverse portfolio of fund vehicles - and therefore, presumably, can address multiple market failures. However, as with all investment opportunities, FoFs are best if focused within certain boundaries regarding their investment thesis.

Clarity as to the purpose and objectives or the vehicle is critical for the success of the vehicle, as well as its ability to attract institutional capital. Considerations include:

- What is the investment opportunity?
- How will the vehicle drive market-based investments?
- What are the areas of SDG impact being targeted?
- What is the investment horizon – its form, and timing of exits and investment monetisation?

FoF can have a direct effect on the local capital marketplace. They exert a direct influence over the intermediary layer in which they invest, the outcome of which would hopefully include financially sustainable sub-funds.

By demonstrating viable investment opportunities, FoFs are in a position to attract additional capital, and at rates and terms that are viable for SGBs. Investors require FoF vehicles to have a clear investment theory. Investors need to see the value of operating via an intermediary model such as an FoF compared with investing directly in local SGB funds. Therefore, it is an imperative for FoFs to have a credible and achievable investment proposition. An overly broad investment focus runs the risk of creating too much uncertainty or novelty for investors.

For example, Thuso Incubation Partners have focused primarily on growing first-time black fund managers. The underlying investments are weighted to real assets which are considered less of a "blind pool" than PE in SMEs. This means that the anchor investor can restrict the unknown risk to fewer variables.

Defining the impact Theory of Change

As noted, FoFs can drive systemic change in the field of SGB finance in emerging economies. They can address the misalignment of institutional capital and the information asymmetry related to risk/return opportunities in SGB finance. It is therefore beneficial for the FoF manager to clearly articulate the development role the FoF plays.

- How does this vehicle better inform the marketplace as to the risk/return metrics?
- How does the vehicle drive incremental capital into the sector (or at least inform upon that shift)?
- What is the additionality of the vehicle?

FoFs can exert a systemic effect through, amongst other things, the development of shared market infrastructure (such as impact measurement and management systems), the sharing of data, and stakeholder advocacy. As an example, "additionality" can be achieved at several levels:

- At the FoF level, by de-risking investment opportunity for institutional investors
- At the LCP level, by providing the anchor investment and TA support to these emerging fund managers
- At the SGB level, by supporting business development.

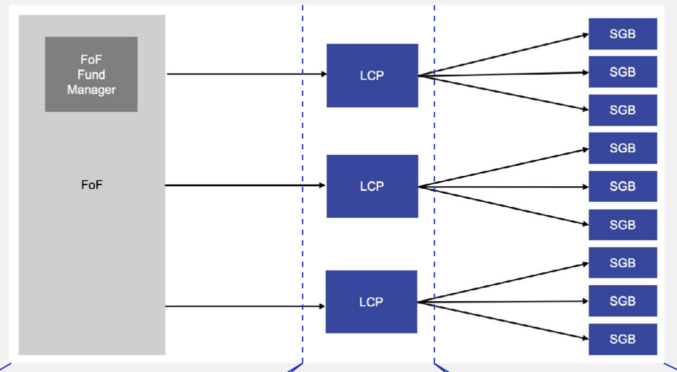
See Figure 4 below.

Given the multiple dimensions of driving systemic impact, development institutions require FoF vehicles to have a clear Theory of Change alongside a solid investment thesis.
However, targeting an overly broad range of SDGs raises questions as to capacity to achieve. Such development-oriented institutions have demonstrated a preference for a vehicle to address a restricted set of market failures within a core fund design.[20] One could also add market-building components to the fund activities over time, as funding allows.

For example, the Dutch Good Growth Fund (DGGF) Seed Capital and Business Development facility is working primarily at the intermediary level by providing warehousing and anchor capital to support track-record development and seed demonstration funds. One of the key aspects of the IPDEV2 Theory of Change is the ability of LCPs to raise co-investment from local investors on the back of their contribution of 20% of fund size.

[20] *Feedback from Global Alliance Ci Gaba FoF investor round table*

Figure 4: Potential Theory of Change at the FoF, LCP and the SGB levels



Investor

Providing flexible or additional capital to LCPs

Leveraging additional commercial, local institutional or private capital

Sharing data to enable transparency on financial and non-financial performance

Driving impact integrity by sharing data, frameworks and benchmarks

Advocating with policymakers for regulatory change

LCP

Building capacity
- Emerging and existing fund manager capacity development
- Impact measurement and management support
- Network activation
- Working capital facilities
- Negotiate and set up opportunity for Shared services

Providing anchor funding
- First time fund managers
- Minority or underserved fund managers
- Fund managers source funding from other investors as a result
- Warehouse facilities for fund managers

Replicating fund structures in alterative geographies, sectors or market segments

SGB

Investing on suitable and affordable terms

Providing technical assistance to SGBs

Achieving impact in the lives of entrepreneurs, employees and customers at SGB level

Developing sub-sectoral pipeline through advocacy, regulation or project development funding

Increasing capital supply to SGB sector by building investment case and reducing information asymmetry

Considerations for establishing the investment approach and operating model

2 FoF economics is challenging

The economics of small-business finance in emerging markets is inherently difficult. Adding an additional intermediary level such as an FoF places additional pressure on achieving the traditional return expectations for SGB finance. Several considerations arise:

Development role of FoFs in SGB finance

The key to system-level change is demonstrating that the FoF's portfolio of LCPs can indeed make market-based investments in SGBs.

As noted above, FoFs can address the market information asymmetry associated with the SGB finance risk/reward perception and the appropriate financing constructs and tools. As a catalytic vehicle, an FoF should theoretically unlock more impact and simultaneously drive system-level change.

At this catalytic stage, it is not a necessity for the FoF itself to obtain market-based returns for all its LP capital investors.
Rather, a "blended" return approach may most likely be required, in which a portion of its capital or funding is subsidised. The logic behind this is that, at this stage, it is unlikely that an FoF can drive catalytic impact while extracting an additional layer of fees from the investment value chain.

FoFs investing in equity-focused local fund managers

FoF fund economics will track those of underlying investments.
As part of their operating model, these FoFs often invest in local funds that themselves use primarily equity instruments to invest in the SGBs in their portfolio. Such investments do not have a current carry such as debt and debt-like instruments. As a result, they do not generate material cash over the early investment cycle (first three to five years). Such cash is required to pay the compensation of the FoF manager team. Meanwhile, most Africa-based PE funds have had limited exits and can require an expected fund life cycle of 10 years or more to achieve full exit.[21] It is wishful thinking to expect SGB FoFs to outperform these statistics, especially in inexperienced markets, under current macro-economic conditions. Therefore, one can anticipate that, with SGB FoFs, the life cycle would be similar, or potentially more prolonged.

Applying a commercial, self-sustaining lens to SGB-oriented FoFs

The private finance-development sector seeks to balance "catalytic" contributions and avoid "market distortion". To achieve the latter, any vehicles or instruments are required to be based fundamentally on commercial or near-commercial terms and instrument constructs.[22] For FoFs, this is reflected in the risk/reward construction. FoF vehicles that are prioritising a commercial-oriented construct, while not necessarily being "return-first", are seeking "self-sustaining" vehicles. This often requires the FoF manager to ensure that rate of return on fund investments both covers the FoF's management fees and provides a market-based return for its LPs.

An interesting conundrum arises. The current information asymmetry regarding risk-based pricing for SGBs makes it inherently difficult for an FoF to achieve this balance of "market-based" returns.[23] Seeking such returns has resulted in FoFs migrating up the risk spectrum by focusing on more established, medium-sized enterprises, or setting unrealistic return expectations for LPs.

Therefore, the authors caution that SGB-oriented FoFs at this stage will require measured expectations of LP returns and/or a blended LP capital approach to provide tiered returns based on the LP's development or market orientation.

Practicalities and realities related to manager fees in transitional FoFs

FoF vehicles, as an additional layer in the intermediation of capital, are inherently challenged to achieve market-based returns for their LPs.
Hence, SGB FoF fees are not well positioned to be modelled on the precedent set by the PE FoF asset class. While FoFs offer risk diversification and ease of investment, institutional investors are usually cautious about the ability of FoFs to achieve market-based returns. While familiar with these benefits, institutional investors have yet to adjust expectations at a structural level and instead prefer to search for market segments that will satisfy their mandates. These structural expectations and norms can result in FoF managers presenting unrealistic fee scenarios to the investor, only for the investor to be disappointed later.

For example, a recent study demonstrated that SME funds in emerging markets return mid-to-low single-digit returns, which does not fit with LP expectations of double-digit dollar returns.[24]

21 *AVCA. (2020). Private Equity & Venture Capital in Africa Covid-19 Response Report. https://doi.org/10.1177/1403494812457731*

22 *Certain development agencies explicitly cannot provide "subsidised" terms for private sector investment activities, regardless of the development impact and/or information asymmetry.*

23 *Along with impact due to the lack of data on portfolio performance, SGB finance pricing in many emerging markets suffers from the substantial crowding-out effect of the significant amounts of local borrowings by government treasuries and agencies,*

Another challenge is the need for the FoF manager to have sufficient financial resources to cover the cost of a capable team. In the case of an SGB FoF, such managers play an "outsized" role in engaging with and supporting their portfolio. With pressure to obtain "market-based" returns, such support and the related staffing creates additional stress on the need for sufficient management fees for the FoF.

Alternative approaches to how FoF GP/manager remuneration are structured

Grant-supported management costs

At this time, given the catalytic nature of SGB-oriented FoFs, we anticipate that such vehicles will require grant capital to mitigate the need to increase investment return requirements at the SGB level in order to cover the FoF management fees.

For example, Nyala Venture facilities has taken an approach that differs from the traditional 2-and-20 type of compensation. In the case of Nyala Venture a portion of the management costs is being covered directly by grants. To properly align and incentivise managers, they do include performance fees based on achieving financial and impact goals over the life of the FoF.

We do note that, from our discussions with LP-level investors in this sector as well as traditional grant-providers, while the catalytic nature of an SGB FoF is recognised, the preference is for the FoF manager to target and achieve compensation without grant subsidies. This is due to the perspective that for such an FoF to be sustainable over time, it needs to be "self-sufficient". Additionally, such a market-based approach for the management fee, the vehicle would be able to provide sufficient compensation to attract the right calibre of team. The authors applaud such intentions but at this time do not believe there is an opportunity to extract such rates without placing usury rates upon the SGBs – a concept that is counter to the goals of these vehicles.

Negotiating fees can result in additional approaches that move away from the established precedent of fees as a percentage of AUM and incentive fees based on return-sharing above a watermark level. This can include setting fees on a pre-agreed based on covering staffing and operational costs.

For example, the SA SME Fund 1 negotiated a pre-agreed FoF management fee over the life of the FoF that was fixed upfront and loosely correlated with 2% of AUM. More importantly, the calculation of the fee reflected the size and calibre of the team that was required to successfully execute the GP mandate.

Cross-subsidy of management fees

To address the challenges of obtaining sufficient funding for their management fees related to an SGB-oriented FoF, asset management firms often rely on the cross subsidisation from other funds.

For example, 27four Black Business Growth Fund and SA SME Fund 2 were able to take advantage of these circumstances.

Fees should be calculated differently based on whether the Fund is open or closed. For example, open-ended funds may not calculate fees based on a percentage of AUM considering they could start investing prior to first close. Thus, one could argue that fees might be greater to begin with in an open-ended vehicle, but staff and cost structures could be reduced over time.

[24] *Shell Foundation, Deloitte, & Network, O. (2019). Insights from SME fund performance. December.*

3 Desired flexibility does not legitimise complexity

FoFs offer the opportunity to address the marketplace information asymmetry regarding potential approaches to successfully funding SGBs. This includes whether to adopt an open-ended vehicle construct for an FoF vehicle.

While SGB FoFs are not automatically candidates for open-ended vehicles, the flexibility afforded by an open-capital vehicle implies that such vehicle is suitable for system informing FoF vehicles.

However, the construct of an FoF needs to address the full spectrum of design considerations in order to be “fit for purpose”. For instance, given their role as catalytic and informing vehicles, transitional FoFs may not be best served by building in many of the traditional fund-vehicle design components. These mechanisms, while meeting the often-complex objectives of LPs and addressing any perceived potential risk imbalances, may not reflect the core objectives of the FoF vehicle. These traditional components include legal constructs such as highwater mechanisms, tag-along rights and co-investment terms, and portfolio reinvestment and follow-on investment underwriting requirements.

Form follows vehicle objectives and function

Factors driving the vehicle operating model include demonstrating the validity of the investment thesis of local fund managers and informing about risk and risk mitigants associated with SGB finance.

As catalytic initiatives, transitional FoFs will be prioritising these objectives. These factors should be reflected in the FoF’s financial and operational model. Targeting these outputs will allow the development of a robust data and analytical set to inform the broader marketplace.

Form needs to consider institutional investor preferences

If an open-ended structure is being considered to achieve the FoF’s objectives, then it makes good strategic sense to co-create terms alongside anchor LPs This would be a useful principle to follow.

Open-ended vehicles add another “unknown” to the investment thesis. DFIs, in particular, have focused on time-defined closed-end vehicles. This allows them to meet their mandate of demonstrating both financial returns and impact within a defined period. While development funders should be building a track record for these structures to address this issue, it has not been a priority, given the other risk and impact considerations.

Transitional FoFs that have applied evergreen constructs have tended to have an extremely flexible anchor funder. For example, the SA SME Fund 1 is more focused on demonstrating the importance of SGB finance than time-defined fund economics. Not only is it applying an FoF construct, it is also recycling returns back into the vehicle and anchoring a second fund.

Transparency is key to the success of a market-informing FoF vehicle. Any vehicle construct must therefore look to inform how the FoF vehicle would perform under a standard FoF construct. For example, PE exits are typically targeted in a three-to-seven-year timeframe. For SGB funds, it stands to reason that similar or additional time is required to realise the investment (i.e., achieve exits). Therefore, a construct may be needed that allows LP investors to exit and not be constrained by excessively long hold periods.

Figure 5: Open-capital vehicle design considerations

- What constitutes a liquidity event?
    - (i) Dividends (with flexibility to hold or reinvest)
    - (ii) Listing of holding company
    - (iii) Selling of assets
    - (iv) Transfer of stakes internally or new investors (after set holding period). Etc.
- What is the minimum holding or lock-up period? How is this linked to the return profile of the FoF?[25]
- Is there a liquidity cap or redemption constraints?
- How often and how much/what percentage of the portfolio can be liquidated? Would this differ depending on class of share?
- How will the portfolio be valued considering early exit of some investors? How frequently and what methodology will be used?[26]
- When and where are dividends taxed?
- Will funds be returned to investors or recycled?
- Where and when are dividends taxed?
- How will fundraising work?
- At what intervals can new investors enter the fund?
- Is there a limit on new funds being used for the redemption of current investors at the prevailing valuation?[27]
- What fund structure is most suitable?[28]
- How will terms of carry be structured to ensure that investment managers are adequately incentivised in the absence of a clearly defined term expiration date?[29]

Accessing appropriate limited partners (LP) and institutional capital

4 Local LP capital

FoFs offer local institutional investors an interesting "play" in small-business finance. Funds should ideally be locally sourced, but the biggest pools of capital, like pension funds, are often not yet fully equipped to invest in this market segment.

Opportunity

Local pension funds (LPFs) are cited as one of best sources of local capital available, for multiple reasons:

- LPFs are looking to diversify investment portfolios in order to increase returns. An OECD annual survey of large pension funds and public pension reserve funds found that funds have been, on average, lowering equity and fixed-income exposure in favour of increasing alternative investment allocations.[30]
- LPFs are outgrowing local asset pools, particularly in lower- and middle-income countries where public equities markets are limited, and governments bond yields are decreasing. For example, at ±30% growth per annum, the Ghanaian Pension Fund appears to have increasing appetite to explore new asset classes.
- LPFs, with local currency and long-term time horizons or long-dated liabilities, have profiles that are well aligned to the capital needs of FoF vehicles.
- LPFs are generally concerned with local economic development as a sustainability strategy for their investments. Local capital is needed to grow and strengthen the pipeline of investments and improve the socio-economic conditions into which their members will be retiring. For example, improving local economic development is explicitly stated as the overriding impact objective of Asset Owners Forum South Africa.
- FoF solves multiple issues for LPFs, including ticket size, diversification and, importantly, specialist skills in this market segment.

[25] *PE funds typically have fund life cycles of 10 years or more, resulting in an average target holding period of three to seven years for a deal. Globally, long-dated investing is thus defined as the willingness and ability of an investor to hold an investment for more than seven years and, in some cases, forever.*

[26] *In the case of equity investment, valuations may be carried out and audited on an annual basis according to NAV (International Private Equity and Venture Capital Valuation guidelines). The FoF may consider doing a liquidation valuation during a major exit (this is the most conservative approach and is calculated by subtracting the company's liabilities from its assets, with receivables valued at 80% to 90% of book value).*

[27] *This would enable the new investment to grow the size of the FoF rather than simply buying out old investors.*

[28] *Evergreen funds are permanent capital funds that assume an indefinite term to better align with investment opportunities. Legal forms may vary by jurisdiction. Holding companies are long-lived investment companies that have no core operations other than investing in financial securities. The holding structure's distinguishing feature is incorporation in terms of the Companies Act and the creation of a limited liability structure. Unlike with evergreen funds, holding companies need not be subject to jurisdictional qualified-investor regulations.*

[29] *For example, deal-by-deal carry.*

[30] *The survey covers more than 100 public and private pension funds from 46 countries. Brazil, India, Indonesia, Malaysia, Nigeria, Russia and South Africa are among the non-OECD countries included in the survey report. The survey is based on a qualitative and quantitative questionnaire sent directly to large pension funds and public pension reserve funds.*

LPFs – realities and considerations

While there are numerous positive alignments with LPFs, as noted above, there are several constraining considerations:

- LPFs in emerging markets often have capacity, regulatory and risk-return constraints that preclude them from investing directly into SGB funds. Given their fiduciary responsibility to pensioners, pension funds are often tightly controlled on the regulatory side.
- LPFs look to after-fee returns (including the effect of risk mitigation) to make investment decisions rather than applying a blanket restriction on investment vehicles.[31]
- Although barriers to investment tend to be multi-factorial, some– such as regulatory limits on certain asset classes – can be binding constraints to significant growth in allocation.
- While LPFs have expressed interest in SGB finance, they have very little experience in assessing, structuring and underwriting such financings.
- Even in relatively advanced markets, the alternative investment activity tends to be concentrated in a few, larger LPFs, predominantly in the public sector.[32] These first- movers tend to have internal investment teams, and deals are less likely to be screened out by asset consultants before they see can be evaluated by trustees. Identifying such funds and building a relationship can often be more rewarding than trying to engage a wider group of nascent LPFs. For example, all the South African private-sector-led FoFs represented in the report have raised or are looking to raise local institutional capital in either the first or follow-on fund. Indeed, it has been one of the main selling points to concessionary funders.

In summary, while there is underlying logic for LPFs to engage in SGB FoF vehicles, it is important to understand the major constraints upfront.[33]

5 International development capital

In most African markets, international DFIs are key contributors to private-sector investment.[34]

Opportunity

DFIs come with specific mandates which dictate sector, geography and development impact. IFC SME Ventures, EIB/African Development Bank (AfDB) Boost Africa programmes and FMO ventures, for example, have driven capital into early-stage fund managers. However, as an institutional capital sector, the quantum into SGB funds is de minimis when compared to the current need.

FoF vehicles address several limiting factors:

- **Aggregation versus minimum deal size:** FoFs enable DFIs to reach smaller funds, despite restrictions on minimum deal sizes, by investing across a portfolio via a pooled fund.
- **Risk diversification:** By identifying a cohort of investable LCPs, FoFs enable diversification across sectors and geographies and, thus, underlying SGBs.
- **Technical support:** FoFs provide on-the-ground support to fund managers, particularly emerging fund managers, based in-country – particularly FoFs with a market-building mandate in geographies where the LCP intermediary layer is not well developed.
- **Scale of impact:** FoFs enable LPs to not only anchor or grow a wider cohort of LCPs but also support the market-building mandate of the transitional FoF.
- **Legal domicile and compliance due diligence:** FoFs limit the legal requirements to a single vehicle that would then have the responsibility of underlying LCP compliance.

[31] *Three LPFs invested in FoF vehicles in South Africa reported applying this principle.*
[32] *For example, the large public pension fund tends to be developmentally minded, defined-benefit in structure and large enough to take illiquid and slightly riskier positions.*
[33] *See the upcoming Doing Small Business Finance Framework (CFF, 2022) for a breakdown of major relevant characteristics.*
[34] *In 2018, total DFI commitments to Africa amounted to USD80bn (https://brightafrica.riscura.com/sources-of-capital-on-the-continent/development-finance-institutions/total-dfi-commitments/#scroll).*

DFIs - realities and considerations

While the above highlights addresses several key operational limitations of DFIs, there are constraining considerations. These would be in achieving returns (financial and impact) in line with public mandates. DFIs have clear mandates to ensure they are not "market distorting" and to support the building of robust and resilient private sectors. Given current risk perceptions related to SGB finance, this often equates to double-digit dollar-returns targets.

Building the case for revised return expectations and increased focus on impact*

Performance data on SGB funds is limited, but a recent study has illustrated that SME/VC funds have underperformed the mark generally set by DFIs.[35]

Can expectations be reset based on such historical performance and, if so, how could they be framed?

Despite statements on impact, most DFI risk underwriting committees do not balance impact to risk in extending their financing. If this cannot be addressed in the short term within the existing investment mandate, there are other mechanisms that can be brought to bear.

DFIs could consider tapping into internal or associated soft capital (e.g., first-loss funds) to redress the imbalance. For example, the US DFC has access to the USAID-funded Development Credit Authority (DCA) guarantee support mechanism. Similar alternatives exist across most DFIs and their associated development agencies.

Building the case for an additional intermediary layer of FoF in order to leverage local institutional capital

DFIs have been instrumental in providing support to the corporate and FI sectors in emerging markets. This support has tended to focus on the operational efficiency of larger-scale borrowers, which encourages the prioritisation of larger ticket sizes and more established growth prospects, rather than focusing on development impact.

- DFIs would be well advised to leverage local institutional capital as the means of driving SGB finance. FoF vehicles would allow them to support such financial actors without burdening themselves with small transactions. In addition, they would benefit from the risk diversification associated with such vehicles.
- For example, although FMO Ventures and DGGF have set up large wholesale vehicles, neither has sought to leverage local investment or co-investment – and this could be viewed as a missed opportunity.
- Of the larger local wholesalers, the PIC intends to invest part of its portfolio in SGB FoFs with the intent of reaching small businesses, knowing that the transaction size at that level does not make sense for them.

Building the case for contributing to better-informed market data and thought leadership in SGB finance

DFIs are reticent about sharing detailed, aggregated and anonymous performance data. This is a missed opportunity, considering that they have been the biggest investors in this market segment to date. The authors would urge a collective drive to do so and acknowledge the work of these organisations in supporting the market more generally. For example:

- FMO Ventures Program actively supports the SGB finance ecosystem for example through the CFF LAUNCH Capital Provider Programme. Increased participation by DFIs along these lines, and in particular in gathering data on local fund manager performance, would have immeasurable benefit to the sector.
- IFC Ventures provides direct support to local fund managers through an online portal of shared resources for local fund managers.

[35] Shell Foundation, Deloitte, & Network, O. (2019). Insights from SME fund performance. December.

** This directly aligns with recommendations from "G7 ITF Impact Taskforce. (2021). Time to deliver: mobilising private capital at scale for people and planet.*

Complementary alignment of LPFs and DFIs

The role of co-investing alongside each other in stimulating investment is under-explored.

- LPFs provide local-currency financing solutions at suitable scale and tenor. Meanwhile, international DFIs can contribute their risk assessment and structuring expertise.
- By mandate, DFIs target the additionality related to their investment capital. This can be achieved by partnering with LPFs. Similarly, given the lack of familiarity with SGB finance, LPFs require support in addressing risk assessment and mitigation.
- There are a few examples where cross-border partnerships have played a catalytic role. DFIs are doing this at scale, but not in the SGB market segment. For example, MiDA is a USAID-funded organisation supporting LPFs in South Africa and Kenya to co-invest with guarantors and US pension funds. And the Emerging Markets Loans Fund enables European institutional investors to co-invest, alongside the FMO, in loans to financial institutions, renewable-energy projects and agribusiness companies in frontier markets.

6 Blended capital for transitional FoF vehicles

FoFs offer substantial opportunity to address the SGB finance conundrum. There is, however, an important role for concessionary or catalytic capital at this time.

Opportunity

In the case of transitional FoFs, concessionary or catalytic capital can be applied in several specific ways. These are discussed below.

Risk mitigation

Risk capital can be invested as first-loss or subordinated tranches. In order to attract commercial capital, Ci Gaba, SA SME Fund 2 and 2X Ignite[39] each have (or are considering) the application of concessionary capital to address the uncertainties associated with the underlying SGB portfolio. As noted, at this time there is substantial information asymmetry related to small-business finance in Africa. Each FoF is applying some form of a "back of the envelope" calculated risk capital cushion. For example, Ci Gaba is looking to apply a 30% first-loss component. This range was established by applying a material increase in the subordinated capital above the multi-year performance experience of local banks' SGB-lending portfolio performance. SA SME has raised most of a 20% first-loss tranche for its second fund from development agencies and their previous fund. The first loss has been calculated and raised to attract LPFs where there is existing precedent.

36 CFF and IFC SME Ventures Fund Manager Portal. https://www.fundmanagerportal.org

37 Capital willing to take additional risk or a below-market-rate return in general in order to accelerate development objectives.

38 Capital seeking risk-adjusted returns but willing to take a higher risk than commercial investors.

39 Although still under development, 2X Ignite is seeking a first-loss mechanism for its targeted FoF for first-time women-led local funds in emerging markets.

40 On average, leverage – the volume of commercial capital catalysed by USD1 of concessional capital – across these funds has been 2.6, with a minimum leverage ratio of 0.32 and a maximum leverage ratio of 24" Convergence. (2020b). How to mobilise private investment at scale in blended finance

41 The indicative price of a guarantee is a facility fee of 0.75% and utilisation fee of 2%. For equity capital financing for SMEs, a guarantee covers a known equity investor or venture capital fund for up to USD500,000. An indicative price of a guarantee as taken from Africa Guarantee Fund is a facility fee of 1% and utilisation fee of 5%

42 For example, would it be at 10 years after the lock-in period of an open-ended fund or at 15 years, when VC/SME funds are expected to realise returns?

Figure 6: First-loss guarantee: design considerations

- Why first loss and not a grant or subordinated debt or equity?
- Does the guarantee sit within the capital stack?
- Does the guarantor seek risk-adjusted returns on the investment in case of successful performance?
- How is the guarantee treated in the capital stack and waterfall distribution?
- What size of first loss is required and on what basis is that amount calculated?[40]
- How would the guarantee work in case of debt vs equity investors/vehicle?
- What level of fees would you (or your LPs) be willing to pay for a guarantee?[41]
- When will the guarantee kick in?[42]
- Will the guarantee be paid when the FoF is wound down or on a deal-by-deal basis?
- What happens after the guarantee has been spent down and there are investors who have chosen not to exit?
- What amounts are guaranteed? Principal and return? What level of return?
- Do guarantors need to be rated and, if so, what rating would be used?
- What is level of familiarity of local institutional funders with first-loss guarantees and other blended-finance structures? What information would they need to do to be able to make an informed decision?

Underwrite management fees

As noted, transitional FoFs are under pressure to cover full management fees without placing usury financing costs upon the underlying SGB portfolios. The Nyala Venture and IPDEV2 FoFs provide concessionary funding to mitigate the potential burden of management-related fees. To ensure alignment with targeting a quality portfolio, both facilities provide performance incentives to the managers or fund advisers. These incentives are based on the financial and impact metrics of the FoF vehicle.

Technical support and business development services

IPDEV2 and Nyala Venture both provide technical support. Each, however, has taken a different approach. The I&P vehicle looks to use business development services to support and strengthen the operational and financial capacity of the underlying SGBs. Nyala Venture is providing technical assistance to the local fund managers in its portfolio.

Share learning and data analytics

One of the greatest areas of impact for transitional FoFs is their ability to inform the broader marketplace. To achieve this, a transitional FoF requires funding to implement data-gathering and data-monitoring processes and systems. This data would be both financial and impact data, and would be assessable at the SGB, fund and FoF levels. Nyala Venture will allocate funds for this to the Frontier Capital Learning Lab. Not only will this enable the tracking and monitoring of financial and impact performance, the Learning Lab will also develop case studies to provide greater context to the opportunities and challenges related to local SGB capital managers.

Concessionary capital - realities and considerations

Concessional funding is scarce and slow to arrive – and when it does, it comes with many strings attached. The following points illustrate how the general distribution of concessionary capital compares with that in the FoFs profiled:

- About half of blended-finance transactions in sub-Saharan Africa (SSA) are between USD10 million and USD100 million in size, with 22% between USD10 million and USD25 million. The median size of transactions targeting funds is USD67.3 million and facilities is USD150 million. This is actually on the small side, considering the size of the FoFs profiled in this report.
- Further, 34% of deals are structured with guarantees (the largest median deal size is USD136 million) and 63% are structured as concessional equity/debt. Transactions with design-stage grants have the smallest median transaction size, USD25 million. FoFs profiled have used concessionary funding across the spectrum.
- Almost two-thirds of investment comes from public and philanthropic sources, with DFIs and MDBs making up 35% of that number. The rest comes from the private sector. USAID is the most active donor, and IFC, AfDB and FMO are the most active investors. Because the DFIs are currently less interested in investing into FoF structures, these figures would not necessarily hold for these structures – although the majority of first loss in the FoF profiled has come from local public sources.
- To date, the blended capital facilities in West Africa have prioritised financial services, while in East Africa the focus has been on energy. Therefore, there has been little focus on and application of such capital in the broader and very heterogenous SGB sector across SSA.[43]

Designing on the basis of precedent, context and opportunity

Although there are some principles on which a blended FoF can be designed, there are no standardised, prescriptive approaches. This enables teams to build highly contextual structures, which can result in a slow and cautious process as investors familiarise themselves with purpose and concessional funding approaches.

There is limited aggregated deal information on market precedent apart from Convergence's work on blended finance. While some of Convergence's high-level findings are universally

[43] *Convergence. (2020). Blended finance in Sub Saharan Africa. February.*

available, many of the investment term details, including things like leverage ratios[44] and SSA-specific information[45] are not. This means local fund teams who want to learn from previous experiences would need to do so on case-by-case basis through investors or emerging-market counterparts.

For example, a recent study on private-sector funders has indicated a leverage ratio of 2.6:1, and ranging from 0.32 to 24 depending on structure, size, sector and country.[46] The FoFs profiled in this report that have raised concessional capital were structuring mainly as first-loss guarantees at a leverage ratio of between 5:1 and 10:1. For example although IFC is leveraging similar ratios of private capital into climate finance, they are managing only 2:1 in International Development Association countries. So, the supporting calculations behind leverage ratios based on precedent are not as robust as they could be.

With regard to first-loss mechanisms and achieving alignment with LP investors, the application of de-risking mechanisms and level of de-risking required are based on imperfect local datapoints and therefore become the foundation of extensive investor negotiations.
Since most LPF investors have limited experienced with these structures, it falls to the design team to establish the parameters for negotiations.

The application of de-risking mechanisms and level of de-risking required at this time is usually a function of credible proxies such as bank SME lending performance and DFI portfolio data as well as local regulatory guidelines.
LPs also take into account risk factors such as macro-economic factors, liquidity of assets and fund manager experience. These are imperfect local datapoints yet have become the foundation of investor negotiations. Commercial investors, especially pension funds, have not tended to indicate preferred guarantee size because most do not have ability to assess, and it would thus fall to the FoF design team to establish the parameters for evaluation.

There is evidence to suggest that, once precedent for funding models is achieved in a market, fundraising for similar structures becomes much easier with both the original investors and a wider group.
For example, the Ashburton Credit Enhancement Fund 1 pioneered a government guarantee mechanism to attract pension-fund investment in the SGB sector in South Africa. Once achieved, it opened the gate for a second fund as well as the 27four Black Business Growth Fund and SA SME Fund, where fundraising was faster and investors had quantitative data points on credit enhancement

Quantifying impact

Impact marketplace mechanisms such as impact bonds or social success notes may be used to address the gap in returns, even to the point of market sustainability.
Most fund design teams would agree that the need for concessionary capital should reduce over time as information asymmetry decreases and markets strengthen. While this is indeed happening, many agree that the SGB market segment may require flexible funding on a perpetual basis. Since these enterprises are no less important to the economy than larger, less risky ones, it is incumbent on the financial ecosystem to accommodate this.

Market-builders have been considering how the quantification of impact could provide the underlying principle on which to fill this gap – in other words, including social return in performance reporting and "selling" that impact to concessional funders on a market-determined basis. Although this is not a tactic that has been used by the FoFs profiled below, it may indeed prove valuable in fundraising in future.

In conclusion, concessionary capital has been instrumental in supporting the FoFs profiled in this report. As a result, they have been able to anchor and grow an intermediary layer that has, to date, not managed to raise capital at scale.

[44] *Convergence. (2018). Leverage of concessional capital.*
[45] *Convergence. (2020). Blended finance in Sub Saharan Africa. February.*
[46] *Convergence. (2020). How to mobilise private investment at scale in blended finance https://assets.ctfassets.net/4cgql-wde6qy0/5O3FEqDOdXz-f2rkEu5XRaP/eb29a9c1237f-f439320358a1764fa585/How_to_Mobilize_Private_Sector__Final_Final_.pdf*

Risk management – and managing the risk profile – is critical

As noted, beyond local banks' loan portfolio performance there is limited data on the performance of SGBs. While we develop a clearer picture of the risk/reward situation, there are necessary risk management principles that should be applied alongside risk mitigants mentioned previously.

The risk associated with FoF vehicles falls into three principal buckets - governance & compliance; portfolio; and relevant team experience. Each needs to be assessed and addressed appropriately, as required, in the structuring of an FoF."

7 Governance

A well-articulated governance framework is required for aligning with value proposition.

Several considerations arise:
(i) domicile;
(ii) GP management rights and economic interests;
(iii) LP rights within the construct;
(iv) investment committee/underwriting decision making; and
(v) management policies and procedures.

One of the key factors to be considered within the governance context is whether the FoF has a purely commercial mandate rather than a market-building mandate. Historically, FoFs, particularly those investing in PE funds, have been set up as purely commercial vehicles with little focus on impact. Transitional FoFs are market-builders. As such, they often include direct and indirect market-support mechanisms into the design and budget, often requiring development partners to execute. For example, Ci Gaba will provide TA to emerging fund managers alongside anchor investment. This is very much in line with the government-funded equivalent FoF in Ghana, the VCTF, which has demonstrated the need for this type of assistance over and above anchor investment. The governance structure would align with the market-building mandate in these cases.

8 Portfolio

The attraction of FoFs is the ability to diversify investment risk across a portfolio of local fund managers, different investment strategies, differing underlying SGB portfolios and return/investment mechanisms.

For example, most of the FoFs profiled in this report, are investing across regions or continents. There are sometimes restrictions on FoF hoping to attract local pension fund capita where there is an imperative to invest at home.

9 Team capabilities and experience

Many emerging markets lack extensive FoF vehicles in the more established asset classes of PE or VC.

Therefore, for SGB finance, the pool of experienced managers and teams is even more limited. Yet, as is true with SGB investing and lending, strong knowledge of and experience in the local ecosystem, markets, business communities and consumer behaviour and orientation are critical. Hence, strong local teams are essential to creating value and mitigating risk in these vehicles. That said, such teams may be augmented by tapping experienced FoF managers who may have operated outside the local markets. This can be achieved either at the team or IC level.

Design process and implementation

10 Resources and mandate

The complexity and technical factors to be considered in the design of an FoF require material resources.

The **strategy origination and driving force behind the establishment of an FoF is** influenced by several foundational factors. The source of development funding, anchor funding and vehicle mandate affect the design of the FoF. Often, these three elements are interlinked:

- **Funded vs unfunded development process:** Design teams may be self-funded, through sweat equity, have access to core funding from a parent organisation, or raise donor finding from development partners. There is a clear benefit to having some design funding to support dedicated, expert resources, as this may shorten the design process and support the robustness of the proposition. For example, the Ghana FoF design process was reliant on the sweat equity of a core group of investment professionals. The design process was restricted to three carefully orchestrated design sprints over a three-month period, ensuring optimal use of precious time. And, by adding a marginal amount to the development budget, donors could shore up their investment by contributing to the implementation runway costs, retaining the right team in crucial early stages.
- **Captive[47] vs Independent anchor funding:** Designing a captive fund comes with the benefit of an anchor funder with the restriction of a tight LP mandate and risk, return and impact preferences. For example, Thuso Incubation Partners was set up through the Eskom Pension and Provident Fund. The GP built a commercial proposition out of an investment mandate dictated by the anchor investor. Independent GPs, on the other hand, are free to design the FoF to best suit the needs of the pipeline but need to convince LPs of the value proposition. For example, Nyala Venture was originally intended to support LCPs during the COVID-19 pandemic, and concessionary funding was sought. As the acute crisis has abated, the funds will instead be used to address some of the structural barriers in the market, funded by the catalytic capital of FSDA Africa Investments.
- **Bottom-up (pipeline/demand for capital) vs top-down (investors/supply of capital) vehicle mandate:** The fund design should account for both investor preferences and pipeline needs, although usually one takes precedence over the other. Ideally, investors should seek to fully understand the market segment they are investing in to ensure that the capital they are providing will be effective – even if de-risking is required. By cultivating realistic return expectations, investors can contribute meaningfully to market-building, even in commercial transactions.

Sourcing alternative income during setup and/or implementation phases

Like fund managers, FoF managers can raise grant funding to cover development costs and initial operating expenses. This can come from third-party donors or from LPs, particularly where they may have separate TA-funding allocations.

- For example, both Nyala Venture's and SA SME Fund's operating expenses have been calculated and covered upfront by LPs as part of a market-building initiative.
- Specific management tasks can be funded by donors. For example, the Jobs Fund[48] covers the impact measurement and management costs of the 27four Black Business Growth Fund. DFIs or MDBs take on specific tasks on behalf of funds such as AfDB, providing governance support during the fund setup phase.
- Donors can cover the TA budget of a fund management team. For example, Thuso Investment Partners raises funding from DFIs to cover analyst support in the first few years of the fund's life to ensure that deal activity happens alongside capital-raising. FoFs can even monetise services, such as a shared back-office, for underlying funds.

[47] *A captive Fund 1s a private pooled investment fund that is managed for a select group of investors or in affiliation with a single investor.*
[48] *Government Fund 1n South Africa.*

Hugues Vincent-Genod (I&P)

5 Setting up a Fund of Funds

5.1. Steps for Fund of Fund setup

FoF design is an iterative process although the following figure provides some indication of sequencing.[49]

[49] Based on Innpact process and CFF conceptual framework

Team	• Track record of investment in market segment • Track record of successful exits in market segment • Track record of working together as a team • Meaningful presence in market where investments will take place • Equitable GP ownership
Design	**Investment thesis** • Developing a credible theory as to how financial and impact returns can be generated • Concept and market analysis which informs investment thesis • Reasoned argument for particular investment strategy, including Theory of Change, pipeline, investment timelines etc. **Investment strategy** • Set of rules, behaviours or procedures guiding selection of portfolio, differentiating from competitors in market
	Fund economics – the business model that will support the generation of returns • Financial model
	Pre-establishment of vehicle • Design structure and select domicile • Legal feasibility – assessment of whether proposed system/structure conflicts with legal requirements • Term sheet
	Source of capital • Qualified LP pipeline (selected according to financial and impact return expectations) • LP engagement and relationship building
Implementation	**Business plan** – to inform/convince would-be investors of value proposition • Thesis and strategy • Financial projections • Funding requirements, use and repayment
	Legal documentation • PPM • LP agreement
	• Selection of service providers and software for front, middle and back offices
	Policies, processes and procedures • Portfolio construction Investment profile and allocation Target funds Investment instrument Pipeline development approach Investment terms and deal structuring • Vehicle and investment management/operations Investment process Team management Back-office operations • Portfolio development and value creation Technical assistance Portfolio monitoring and reporting Impact measurement and management Exits and return achievement
Closing	• Establish vehicle • Onboard investors • First close • First board meeting

5.2. Key questions when designing a Fund of Funds

Figure 7: Key FoF design questions

1. What is the investment thesis? In other words, why should potential investors care about the targeted market segment?
2. What is the unique value proposition offered by the investment thesis and investment team?
3. What does the current investment pipeline look like at both sub-fund and SME level?
4. How will proceeds be used?
5. What is the risk, return and impact expectation of potential commercial and concessionary funders?
6. What de-risking or blended-finance mechanism would need to be considered if there is a mismatch in investor expectations and how would it be structured?
7. What are the minimum requirements for the FoF manager to successfully raise capital?
8. What legal structure would best address both investor and investee requirements?
9. How would the portfolio be constructed to support financial and impact return requirements?
10. What is process for portfolio development and investment selection criteria?
11. What investment/financing instruments are being applied?
12. What governance and oversight mechanisms are in place?
13. What is the investment team and operational construct of the vehicle?
14. What are the costs associated with managing the fund and how has the fee structure been set up to accommodate this?
15. How does the investment instrument speak to the risk management and monetisation of returns?
16. How will the FoF realise a return, and over what time period?
17. What is the hypothesis regarding ongoing and post-investment engagement and support of the portfolio and how can the FoF support that?

Shiluba Mawela (Tshiamo Impact Partners) and Sewu-Steve Tawia (Jaza Rift Ventures)

Jessica Spinoza (2X Collaborative)

6

Fund of Funds Profiles

6.1. Ci Gaba Fund of Funds

Ci GABA VENTURE CAPITAL LIMITED

Designed to unlock local capital for local fund managers who make equity and debt investments into SGBs, as well as providing an intermediation layer that can unlock local pension funding by de-risking the investment opportunity for LPFs and enabling them to diversify across multiple funds.

Ghana and West Africa

Pre-investment

Vehicle construct	• Target fund size: USD85m (GHS500m) • Two tiers of capital: - Senior tier from LPFs[50] structured as preference shares with return expectation based on 10-year government bond rate. - 30% first loss from donors or development funders seeking impact return. • Potential additional de-risking from co-investment with the VCTF[51]. This could be structured as a direct investment into the FoF or as a co-investment into sub-funds offering an additional first-loss facility, effectively de-risking overall investment for senior investors. • Domiciled in Ghana • Open-capital vehicle proposed to be better suited to the longer investment realisation periods in emerging markets. Ten-year lock-in period with regulation prohibiting >25% equity holdings sale per annum, so effectively draw down over four years. Repayments to investors to occur as soon as cashflow allows. • Limited liability company, as there is no LP option in Ghana.
Portfolio construction	• 10 to 15 equity and debt investments into sub-funds investing in SGBs, with ticket sizes ranging from USD50k - USD2m. • 50% country-specific and 50% regional. • 60% established growth funds (including start-up and expansion) and 40% emerging funds. • 20% into co-investments.
Management and operations	• Encourage sub-fund managers to take predominantly minority equity positions in SGBs with some quasi-equity and a small amount of debt. • Management fee restricted to 1%, based on market precedent and expectation, not fund expenses.
Portfolio development and value creation	• Target ROI of 20% per year (local currency). • 5% TA facility to support emerging fund managers.

50 *The largest potential pool of local investment capital for this segment sits with local pension funds that currently control USD5.6bn in AUM with minimal exposure to alternative investments and 90% exposure to government and bank securities.*

51 *Newly capitalised by the government through the Ghana Economic Transformation Project with USD40m.*

6.2. FMO Ventures

FMO Entrepreneurial Development Bank	Designed to address the need for early-stage capital in businesses with innovative business models applying disruptive technology to enable affordable access to goods and services to the un(der)served in emerging markets. Investing either directly in businesses or through VC funds investing in these businesses. **Africa** **Investing**
Vehicle construct	• EUR200m from Ministry of Foreign Affairs of the Netherlands, expecting risk-adjusted, market-related returns. • First-loss guarantee from European Commission. • Five-year investment period.
Portfolio construction	• 60% Africa: 40% Asia. • 50% direct with follow-on – fintech, energy access, agritech. • 50% indirect : - 14 investments - VC Fund 1 in early and late-growth stage (i.e., Series A/B/C) - EUR5 to EUR15m investment size. - Focus on co-investment opportunities potentially in fintech, energy access, agritech and sector-agnostic funds - (Preferred) equity, convertible (bridge) notes and technical assistance - VC funds management teams based in Africa/Asia
Management and operations	• FMO team supporting, based in Netherlands
Portfolio development and value creation	• FMO Ventures team currently building internal expertise and knowledge in fintech, energy access, agritech. • Focus on co-investment with qualified lead investors and/or help to find qualified lead investor if necessary. • Ventures programme TA facility focus on ESG, impact, inclusive business. • Complementary to the programme, FMO offers debt financing, guarantees and private-equity financing.

6.3. DGGF Seed capital and Business Development Facility

Dutch Good Growth Fund	Designed to address lack of anchor investment in early-stage or first-time fund/vehicle managers. Looking to a create track record in order to attract additional funding. These funds/vehicles are of strategic interest to DGGF but are too young, small or risky to form part of the main DGGF investment portfolio as yet. **Africa** **Investing**
Vehicle construct	• EUR40m from Ministry of Foreign Affairs in the Netherlands. • 15-year mandate starting 2014 – no restricted investment period. • Ongoing investment.
Portfolio construction	• Invests in demonstration or sub-scale funds, vehicles or financial intermediaries of ±EUR7m to EUR15m in size. - Average ticket size of EUR1m to EUR1.5m using loans or equity participation (maximum 20% share)/mezzanine. • Most investments structured as results-based instruments, with tranches released based on milestones reached. - Outcomes include number of enterprises receiving finance, type of entrepreneur (youth and women), growth in turnover and jobs, and additional investment raised. • Tend to be the only investor with the purpose of leveraging further capital. • 19 investments in financial intermediaries by 2020. - 57% underlying SME investments are female-led. - 39% underlying SME investments are youth-led. - 40% capital committed to fragile countries.
Management and operations	• Managed by Triple Jump in cooperation with PwC. • 4 team members and support staff.
Portfolio development and value creation	• Capacity-building for fund managers, e.g., mezzanine finance, GLI, ESG, reporting. • Loan or grant for portfolio company TA, extended to fund manager for distribution.

6.4. I&P IPDEV2

Designed to share methodology of equity investment and sponsor first-time fund managers addressing the early-stage capital gap in SGBs in Africa.

Francophone Africa

Investing

Vehicle construct	• EUR24m sponsor fund. • Investors include DFIs (AfDB, Proparco) and private foundations (Ceniarth, Small Foundation, Lundin, Soros). • Tracking jobs, gender, livelihoods, suppliers and small producers.
Portfolio construction	• Targeting 10 first-time fund managers; aimed at investing in 500 early-stage SMEs in 10 countries in 10 years. • Equity funds. • Approach: - Partners with fund managers, funds pre-close costs and contributes to fund design. - Creates permanent capital vehicles (PCVs) domiciled locally with adapted incentive structures. - Anchors each PCV with 20% of the capital and raises the rest from local and international investors. • By 2021 IPDEV2 had invested in five funds in five countries. These funds have gone on to raise EUR15m from an additional 45 African (87%) and international investors. • 34 investments made and 47 team members recruited and trained.
Management and operations	• No data on specific team and fee structure.
Portfolio development and value creation	• EUR3.50m from AfDB, Argidius, Proparco, Principality of Monaco and IFAD. • Supports funds closely throughout their investment cycle and operations. • Raises TA and designs partnerships to help funds operate and scale. • Creates networks among the fund managers to build value and synergies.

6.5. Thuso Incubation Partners

Instigated by major LPF in line with development mandate, supporting new black fund managers in private market funds. Thuso Incubation Partners ("Thuso"), a majority black-owned and -managed company, spun out from Ke Nako, which is an established PE FoF manager. Thuso is the only transformed team in South Africa undertaking fund manager incubation.

South Africa

Investing

Vehicle construct	• USD165m AUM • Major LP is Eskom Pension and Provident Fund,[58] which selected Thuso as a FoF manager (through a request for proposal) to deploy dedicated development funding. • Some interest from other pension funds through asset consultant. • Invests seed and anchor funding as well as specialist incubation support as part of investment. • Commercial return expectations.
Portfolio construction	• Invested in nine new black-fund-management teams. • Underlying investment in low- to mid-cap companies.
Management and operations	• Fees charged as a percentage of AUM in line with FoF precedent and no carry, • Team of two people with additional eight in ad hoc support.
Portfolio development and value creation	• Do not take position on manco. • Most fund managers require technical assistance with running business (i.e., fund) rather than dealmaking. Nevertheless, because most managers are usually raising capital, not dealmaking, in the first two years, a significant part of TA comes in the form of analyst support to the team (often funded through donors sourced by the FoF manager). • Introduced to investment opportunities in Ke Nako pipeline (and vice versa) with Thuso sub-funds bringing empowerment credentials.[59] • Shared services platform including compliance, audit and legal, with preferential rates negotiated (no margin for FoF manager).

[58] *Second-largest pension Fund in South Africa with USD11.1bn AUM, 3.6% of which is in private equity.*
[59] *Certain deals available only with minimum representation of black management/capital, under Black Economic Empowerment regulations.*

6.6. Nyala Venture

NYALA VENTURE

- A catalytic financing and support facility with a priority for gender-lens focused investments, designed to provide capital and support to LCPs in SSA who finance SGBs.
- The facility was created in partnership with CFF, Cardano Development, and Total Impact Capital (Nyala Venture), and with funding support from FSD Africa Investments.
- The facility targets LCPs rooted in local markets who have a deep understanding of the financing and capacity-strengthening needs of their target SGBs and often utilise innovative investment vehicles and capacity-support structures to invest in SGBs (i.e., alternative capital providers).
- The goal of the facility is to assist LCPs to become investable for local and international concessionary and commercial funders. The facility aims to demonstrate investment readiness through:
  i) the provision of catalytic capital;
  ii) providing capacity-strengthening support and technical assistance; and
  iii) by sharing learnings with the institutional funding market through the CFF Frontier Capital Learning Lab.

Pan African

Launched and investing

Vehicle construct	• GBP8 million from FSDAi for Nyala Venture to deploy through a facility established by FSDAi. • Dutch BV. • USD270k for Learning Lab/Demystifying Frontier Finance for institutional investors. Mechanisms to share the Nyala learnings with institutional market to improve the design of future ALCP/ LCP investment facilities.
Portfolio construction	• 6-8 ALCPs investments. • Flexible capital to the LCP investment vehicle in the form of debt or equity. • Ticket sizes between USD250k and USD2m. • Working capital loan to the LCP manager to support operations, where applicable. • Maximum loan size USD100k. • Technical assistance and capacity-strengthening support.
Management and operations	• Four-person investment team, including a Europe-based senior investment professional and Africa-based senior investment professional. • Set management fee; not calculated on AUM. • Capacity-strengthening TA facility managed by CFF. • Learning Lab/Demystifying Frontier Finance managed by CFF.
Portfolio development and value creation	• Catalytic capital to finance LCPs' investment activities and working capital. • Anchor funding has been provided to Nyala Venture to facilitate follow-on LCP commitments, multiple instruments and tailor-made to best meet LCP needs. • USD300k capacity-strengthening TA facility • TA and support: facilitated peer and expert support as part of the CFF Early-stage Capital Provider Network and the CFF Nyala cohort; in addition, focused fund manager support determined by the LCP/s individual needs. • CFF Frontier Learning Lab tracks developments and outcomes of the Nyala Venture investments and TA activities. Gathering data for institutional investors, informing other market FoFs through direct relationships with initiatives such as 2XIgnite.

6.7. Capria Fund 1

	Designed to address lack of early-stage and early-growth risk capital required for small businesses to achieve scale. Achieved through capitalising small-business finance institutions across emerging markets. **Emerging markets** **Fully invested**
Vehicle construct	• Capria Fund 1 - nearly fully committed - FoF size: ~USD60m - Investment from mix of DFIs, institutional investors, family offices and high-net-worth individuals - Targeting market-rate returns with distribution waterfall variable by investment type - Measuring impact on "low-income lives" - Structured as LLC: closed-end 13-year fund, with an additional two years of optional extensions (LP investments) - Domicile: Delaware
Portfolio construction	• Invests in small-business finance institutions ("SBFIs" or "fund managers") • Investing in Africa, Latin America, and Asia (allocated roughly equally across each region) • Invests in GPs, funds, and directly in companies through co-investment programme. Investment breakdown: - GP Investments (loans to fund managers + warehousing): USD50,000 - USD1M - Fund investments: USD500,000 - USD3M - Co-investments: USD1M - USD1.5M • Investment profile and target funds: - Funds: ~50/50 between first-time managers and those with existing AUM; emphasis on early-stage equity funds (typically those investing in companies at the pre-seed through Series A); experienced on-the-ground teams; typical fund sizes are USD20m to USD100m. - Companies: Product-market fit, ready to scale, early-growth, typically Series B or mature A; strong growth trajectory. • Investment instrument: - Equity - Debt (loans to fund managers, warehouse deals)
Vehicle and investment management and operations	• 10-person investment team supported by five-person operations and finance team. • Fees and expenses variable by investment strategy. • Investment process includes a combination of data requests divided in two DDQs, meetings with the team, deal reviews or shadowing, and in-person due diligence (when possible).
Portfolio development and value creation	• Long-term GP partnering & CEO support: Work with each fund on all aspects of business, using the proprietary Capria Quantum assessment to develop a bespoke plan. Engage directly with CEOs on strategic topics and facilitate workshops among founders on key topics. • Capria Network: Facilitate sharing of insights, best practices, tools, templates, investment opportunities, sector knowledge, and connections through network of funds/CEOs.

6.8. 27four Black Business Growth Fund

27four Investment Managers

Designed to support the transformation of the financial services sector by addressing the lack of institutional investment in emerging black-owned and -managed private-equity funds who are investing in SMEs for growth, with intermediation required to diversify underlying investments and de-risk through first-loss guarantee.

South Africa

Reached final close and investing

Vehicle construct	• Target size: USD80m (ZAR1.2bn). • Risk-adjusted returns for senior investors, including LPFs, Consolidated Retirement Fund for Local Government and Rand Water Provident Fund. - USD46m (ZAR710m) raised by second close in March 2020 - An additional USD50m raised subsequently, to slightly exceed fund target size. • USD13m (ZAR200m) first loss from National Treasury's Jobs Fund. • Closed-vehicle structure, 12+1+1 to accommodate underlying fund lives. • Set up as an LP.
Portfolio construction	• 5 to 7 funds with 50+ underlying portfolio companies in mid-market range; highly diversified. • Black-managed private equity in SA with small allowance for outside SA to allow for SA companies expanding out. • Primary and secondary commitments, as well as co- investments. • Focus on growth capital investments rather than buyout.
Management and operations	• Management fee: 1% on committed capital. • Performance fee: 10% of gains above the hurdle (8% IRR) for funds' investments, 20% on direct investments. • Underlying funds typically have up to 2% management fee and 20% carry above hurdle.
Portfolio development and value creation	• Target return: CPI+10% net IRR in ZAR • Supported funds during the pandemic when deal flow was there but not capital, as institutional investors were delaying investment decisions. This included: (i) warehousing transactions; (ii) identifying co-investments; and (iii) negotiating bridging finance from banks.[52] • Shared impact measurement and management system created to track impact across sub-funds, made possible through Jobs Fund allocation[53]. Baseline data collected and managed against transformation plan annually to create rolling annualised indicators that can be aggregated to an FoF level. • Four core SDGs selected: 1 (No poverty), 2 (Zero hunger), 5 (Gender equality) and 8 (Decent work and economic growth), with explicit Jobs Fund requirement of creating over 3,500 jobs over fund lifecycle.[54]

[52] *Rand Merchant Bank and Investec offered bridging finance on terms 50% higher than the average loan transaction.*

[53] *High fidelity in system due to Jobs Fund 1nvestment, which is unusual in the market,*

[54] *IISA. (2020). Impact Measurement Management Report. 1–59. https://res.cloudinary.com/do95jfmcf/image/upload/v1601543911/website/publications/iisa_imm_report_web_kh-fuw4.pdf*

6.9. SA SME Fund 1

sa sme FUND	Designed to address lack of economic growth due to lack of capital in SMEs (note: our current fund was not designed to focus on early-stage only). Initiated by business in partnership with government at the request of the Minister of Finance as part of a series of measures by big business to promote growth.[55] Fund I has been structured to support Fund 2 (in terms of fees and first loss capital) both with a significant market-building mandate. **South Africa** **Fully invested**
Vehicle construct	• Fund 1 SME FoF. • USD100m (R1.4bn) fully committed. • Permanent capital vehicle (company). • Fund 2 VC FoF (pre-investment). • Structured as a limited partnership (LP-GP). • Proven track record of deployment. • Currently fundraising for a target size of USD35m (ZAR500m). • Up to 20% first-loss equity tranche from SA SME Fund and others.[56] • USD6.5m to USD9.8m from local pension fund. • USD6.5m from government, invested on commercial basis.
Portfolio construction	• Fund 1 - Seven VC vehicles and five growth funds (including private equity and debt) - Five first-time fund managers in cohort (at least three likely to go on to raise second fund)
Management and operations	• Fund 1 operating costs set at a level to ensure they do not exceed what they would have been had SA SME used a 2% fee typical of funds. • Fund 2 management fees cross-subsidised by Fund 1 so LPs will not pay fees to the FoF manager in Fund 2. • Performance fees[57] • Lean team with significant FoF experience • Investment professionals remunerated on market-related terms with performance bonuses in lieu of carry.
Portfolio development and value creation	**Fund 1** • Target return 2x multiple • Fund manager development in partnership with Southern Africa Venture Capital Association, including programmes for emerging fund managers and VC fund managers • Biggest risks identified are lack of a quality SME pipeline and a weak incubation landscape: - 3 funds received earmarked funding from government source, Technology Innovation Agency, to support aligned sectors - 2 funds received pipeline development grants attached to accelerators - 2 funds received returnable seed funding for high-potential startups that were unlikely to make it through IC.

[55] *Most corporates abide by voluntary regulation, part of which stipulates 3% of NPAT is to be allocated to SMEs on concessional rates.*
[56] *No precedent in first loss in venture capital in South Africa.*
[57] *SA SME waives the management fee to lower the costs of managing the fund and is rather remunerated through the holding company that owns some of the AUM.*

6.10. Public Investment Corporation

PUBLIC INVESTMENT CORPORATION	Designed to expand the Government Employees Pension Fund's exposure to the African continent, with a relatively small allocation to SMEs specifically. Moved to an indirect investment strategy, with increased activity across the continent. **Africa** **Funding allocated and pre-investment**
Vehicle construct	• Asset manager of Government Employees Pension Fund (GEPF) - Strategic asset allocation target of GEPF[60] in Africa (excluding SA) is 5%, but currently underinvested. - Allocation every two years based on SSA, deployment rate and returns (plus developmental, political and exchange control imperatives). - USD200m of current USD6bn allocation earmarked for SME investment. • Return expectation across USD6bn portfolio: ±10%. • No concessional funding and no plan to raise.
Portfolio construction	• 10 Investments of ±USD20m each • Indirect investments: - 20% to first-time fund managers (80% max shareholding) - Developmental fund managers (50% max shareholding) - Established fund managers (20% max shareholding) - Likely one FoF (only if no possibility of co-investments into other investees) • Predominantly credit funds or NBFIs but also PE, VC and mezzanine funds. • Commercial investment terms. • Significantly increased its indirect investment allocation over the last 10 years. The strategic focus in the medium term is on credit funds to reduce risk, given the forecasted economic performance, although equity funds will continue to form an important part of the portfolio. • Sectors include economic infrastructure, energy (especially renewable energy), SME priority sectors (manufacturing, tourism, agri and agro-processing, beneficiation), social infrastructure, consumer and financial services.
Management and operations	• Fee charged by fund managers is typically 2% of total commitments. PIC fee to GEPF is not market-related and significantly below the 2% market rate. • Four-member team, increasing to seven people in deployment phase. • Specific tasks undertaken by multiple cross-functional teams within PIC, including legal, ESG, risk, etc. – benefit from economies of scale but not necessarily familiar with asset class and means investment team loses degree of control.
Portfolio development and value creation	• Exits for direct investments require auction process for transparency purposes. • Before the significant allocation to PIC from GEPF in 2006, yet to return capital, although valuation is positive (90% direct PE investments, 10% indirect) with no exits (partly because of performance but also because of level of effort required for auction of ±100 assets). • No technical assistance offered to fund managers.

[60] *Does no fall under Pension Funds Act, so no investment limit.*

COLLABORATIVE
FOR FRONTIER FINANCE

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