COLLABORATIVE
FOR FRONTIER FINANCE

Africa Fund of Funds Platforms

BUILDING THE SMALL BUSINESS FINANCE ECOSYSTEM

November 2023

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Thank you to the nineteen FoFs who have engaged in peer dialogue over the last year to share lessons learned.

Thank you to small business growth fund managers who are finding new and better ways to invest in small businesses across Africa and the Middle East.

Abbreviations

AUM	assets under management
AFAWA	Affirmative Finance Action for Women in Africa
BBGF	Black Business Growth Fund
BDS	business development support
bn	billion
CPI	consumer price index
DFI	development finance institution
FoF	fund of funds
FM	fund manager
GLI	gender lens investing
GP	general partner
IC	investment committee
IFC	International Finance Corporation
IRR	internal rate of return
m	million
MENA	Middle East and North Africa
MSMEDA	Micro, Small, and Medium Enterprises Development Agency
opex	operating expenses
PE	private equity
SME	small and medium sized enterprises
SSA	sub-Saharan Africa
TA	technical assistance
US	United States
USD	United States Dollar
VC	venture capital
VCFOF	venture capital fund of funds
VCTF	Venture Capital Trust Fund
ZAR	South Africa Rand

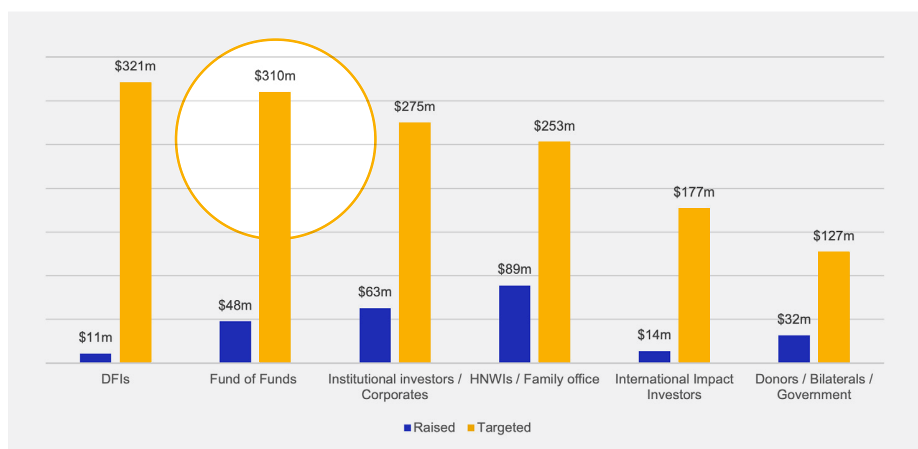
Introduction:

Fund of fund platforms are critical market-builders in small business finance

A new group of fund of funds platforms (FoFs) are achieving system level changes, by efficiently moving institutional capital to local small business investment vehicles in their markets. This means that they are not only focused on the financial returns associated with investing in these funds but also actively triggering a change in the market through investment in innovation, mobilisation of local capital, development of market infrastructure, building of knowledge and engagement with policymakers.

Fund managers investing in small and growing businesses expect to raise approximately USD 310 million of their targeted USD 1.5 billion from international and local FoFs.[1] They have mobilised 17% of that amount thus far. DFIs that function as fund-of-funds, typically focus on the more mature segment of the investment landscape, providing 60% of the USD 2 billion going into private capital funds in Africa last year.[2]

Figure 1: *Actual and anticipated sources of investment capital into local fund managerst*



[1] *CFF Annual Local Capital Provider Survey (Collaborative for Frontier Finance, 2023)*

[2] *2022 African Private Capital Activity Report (AVCA, 2023)*

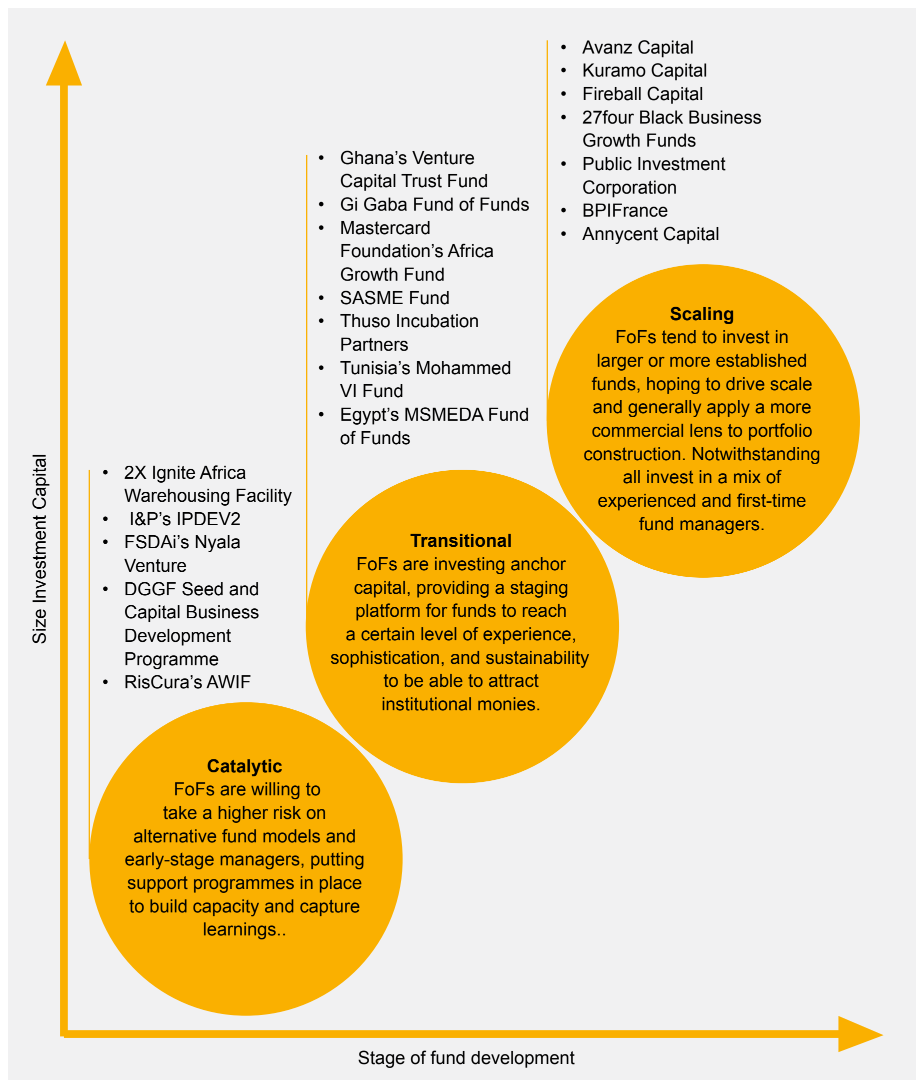
Network of FoF Managers
– Engaged to Inform and build the field

Nineteen public and private FoFs, operating across these markets, have been meeting over the last year to share operational learnings. They are providing a platform to achieve scale by **addressing several key systemic barriers:**

- Funnelling of institutional capital by being able to absorb larger ticket sizes with view to allocating across a set of smaller investments.
- Distributing support capital that can be used to build track record and cover operating costs particularly in advance of a fund manager reaching first close.
- Diversifying risk across a group of funds and their underlying portfolio companies.
- Mentoring, training, and creating opportunities for peer learning.
- Engaging policy makers to create incentives and legal frameworks to attract private investment.
- Sharing and disseminating learning on the financial and impact performance of their portfolios.

The FoFs are a heterogeneous group working at different parts of the continuum of capital and have a depth of experience generously shared in this publication.

***Figure 2:** FoFs investing at varying stages of fund development*



- The **Collaborative for Frontier Finance** outlines the obstacles encountered by emerging fund managers and underscores the transformative potential of support capital, technical assistance and enhanced learning in accelerating fund development.
- **2X Global** introduces the potential inherent in gender lens investing, showcasing how the 2X Ignite Africa Warehousing Facility will actively tackle institutional barriers experienced by female fund managers.
- The **Venture Capital Trust Fund** in Ghana provides insights into how they have attracted private investment into the market through the provision of risk capital, technical assistance and suite of tax incentives.
- **MSMEDA FoF Programme** describes how they are purposefully building an intermediary layer in Egypt that can support start-ups and early-stage businesses, with a view to crowding in private capital.
- **SA SME Fund** shares the de-risking approach they have applied to attract domestic institutional funding into venture capital and small business finance.
- **27four Investment Managers** explains the role of FoFs in encouraging investors to invest in their own country, addressing the dual goals of financial returns and local economic development.

FoF platforms are proving to be a force for small business finance market building in Africa and the Middle East, taking the initiative to build the market alongside their own businesses.

Taking a platform approach to accelerating emerging fund manager development

Susan de Witt and Zee de Gersigny

For decades small business finance in emerging markets has lagged, stifling local economic development and resilience efforts. There is now an emerging understanding of what type of small ticket, growth capital is required to develop small businesses and how to accelerate the scalability and sustainability of intermediaries deploying those investments. These small business growth fund managers[1] (FMs) need access to supportive capital and capacity-building initiatives, to nurture this progress in the short to medium term.

There is a continuum of capital required to support FMs at different stages of development. Opex and warehousing grants and repayable grants tends to be required in the ideation and launch phases of the fund lifecycle, whilst loans and equity can be applied in transition and scaling stages. There is a growing understanding of FM needs, how to address them in tandem and how to ensure sufficient proximity to follow on capital to so FMs are not stranded post investment. Support capital is necessary but has limited value if delivered without commercial rigour or without some type of connection to commercial capital.

Table 1: *Stages of development of FMs*

Phase	Ideation	Launch	Transition	Scaling
Description	Exploring the opportunity and assessing business models, thesis, and strategies. Limited or no funding to date and no established traction	Building track record with team through warehousing, pioneer facility or open-ended fund. Deploying capital into pipeline opportunities	Established legal structure and convinced sufficient catalytic or commercial LPs to make long term commitment into fund	Managing an amount of capital that enables adequate resourcing to be able to retain senior investment management team.
Milestone	Investment thesis	Capital deployed	First close Fund 1	Second/final close or Fund 2

[1] *For purposes of this article the term fund manager refers to group of intermediaries working with a range of investment vehicles and strategies.*

Supporting track record building by investing in warehoused assets

While more than 90% of FMs in this asset class possess direct investment experience, only half have thoroughly documented exits. Moreover, the majority of documented exits occur on a deal-by-deal basis rather than through a structured fund. Consequently, first time FMs often face the expectation from LPs to showcase their competencies before securing long-term investment commitments. To meet this demand, FMs are employing diverse strategies such as making warehouse investments, establishing pilot funds of below USD 10 million in size, and setting up open-ended vehicles.[2]

Given the choice, most FMs would prefer to build early track record between first and second or final close, whilst earning fees on assets under management (AUM). There is an opportunity cost associated with warehousing deals that takes time away from capital raising. But if the general partner (GP) cannot fundraise without validating their specific investment thesis, processes, and team cohesion, then they need warehousing capital, of which there is limited supply.

It was worth the legal and administrative costs because that launch facility was not only important in building track record but in getting us to work together as a team, in building the brand, and in building our business processes. There were a lot of lessons learned in that launch facility that we're taking to the fund itself." Fund manager

Warehouse capital in ideation and launch phases of fund manager lifecycle

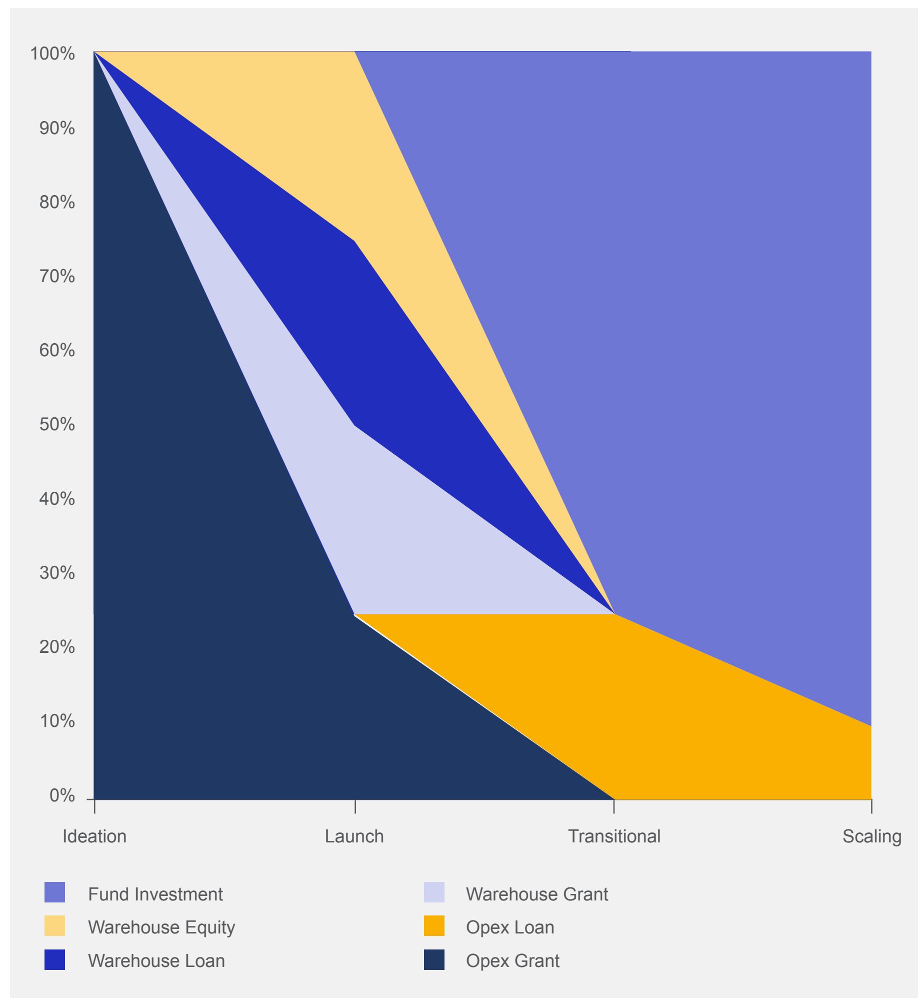
Ideally the warehousing capital raised should be used to prove the investment thesis, but because the warehousing terms often dictate the investment size, type, and tenor this is not always possible. If they cannot prove their thesis, FMs can at least use the capital to validate investment processes, team or they can use the monies to build investment readiness in a future pipeline of investments.

Warehousing investment terms are generally dictated by the capital warehouse facilities are able raise. On the catalytic side, funders extend grants or repayable grants with repayment terms in line with the liquidity of the fund. Or the warehouse facility retains the liability of the investment. Investments can be done on a deal-by-deal basis so LPs coming into Fund 1 can choose the most aligned and best performing warehoused assets and/or those assets can be rolled into the fund at book value in lieu of GP commitment or as first loss.

On the commercial side, funders tend towards loans or convertibles with repayment at time of first close. This strategy works when fund managers are well placed to raise capital from active networks required for a swift first close. Returns are usually capped which means that the risk assumed by the funder is generally not rewarded but it presents a more attractive option for incoming LPs. This means that there would need to other good reasons for funders to engage, be it that they want to establish a long-term relationship with the FM and/or flatten the J curve and reduce drag on fees in Fund 1 to be able to attract commercial LPs. Loans would however still need to be structured with soft terms, paying particular attention to contingencies at time of first close, in order to mitigate risk of non-payment.

[2] Annual Local Capital Provider Survey 2023 (CFF, 2023)

Figure 3: *Capital requirements at different stages of FM development*



There are three noteworthy issues when extending warehousing capital.

- **While experienced warehouse facility ICs can bring discipline, caution is required to ensure delegation of meaningful responsibility to emerging FMs**. Investment decision making can occur at the level of FM investment committee (IC) or at level of the warehouse facility manager IC. These options do not necessarily correlate with where the liability for the investment sits. For example, warehouse facilities extending loans may take investment decisions in house. This decision does however have ramifications for future fund raising as LPs try and discern whether these capabilities lie with the FM or not.

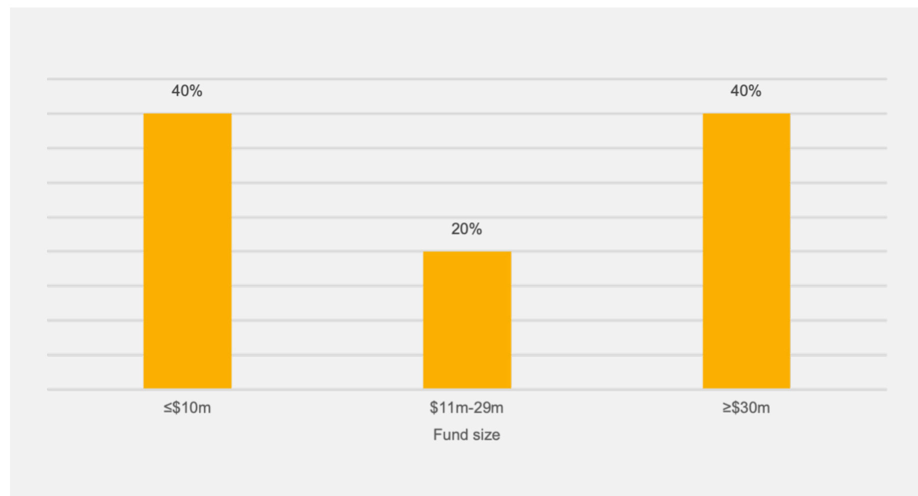
- **Warehousing facilities that are closely associated with investment capital wield a more substantial influence helping to develop FMs.** They can be directly linked, with the platform disbursing both catalytic and commercial funds; or indirectly linked through systematic engagement with co-investors and follow-on investors.

- **Ancillary funding is required to cover operating expenses (opex) during the warehousing investment period.** As FMs do not earn fees on the investment and are generally bootstrapping during this period, the likelihood of error increases, potentially jeopardizing future fundraising efforts. In some instances, incentives (from carry to full profit) have been paid when the asset is transferred or exited, which helps economics of Fund 1 but does not help team during the warehousing investment period.

Supporting fund economics by covering operating expenses

Fund managers experience significant funding constraints in early fund life cycle considering the protracted timeline to first close, ranging upwards from 2 years. Furthermore 60% of funds are below $30m in size, restricted by number of investments at smaller ticket sizes. There is emerging evidence to suggest that funds can be sustainable below this size, but this likely requires additional creative strategies to manage cashflow and supplement income. To this end 60% of fund managers are using alternative feel models to the traditional 2&20, often taking higher fees and/or a higher percentage of fees during the investment period; 85% of managers make at least some self-liquidating investments allowing for generation of cash flows throughout the investment period; and 50% have their own donor-funded, accelerator programmes, generating pipeline and providing business development support.[3]

Figure 4: *Distribution of fund sizes*



Opex support in ideation and launch phases of fund manager lifecycle.

Supplementing opex is one way that catalytic funders can accelerate the fund raising journey with 60% of fund managers currently benefiting in one form or another. Funds that receive a multiple forms of targeted subsidised capital are over twice as likely to reach first close than those who receive a single injection.[4]

Opex is generally used to cover team building and deal making, regulatory set up and the GP commitment to the fund. Considering the outsized time and legal costs associated with fund set up this is a critical area to consider shared services, documentation and platforms. If FMs can speed up governance process this reduces overall costs significantly.

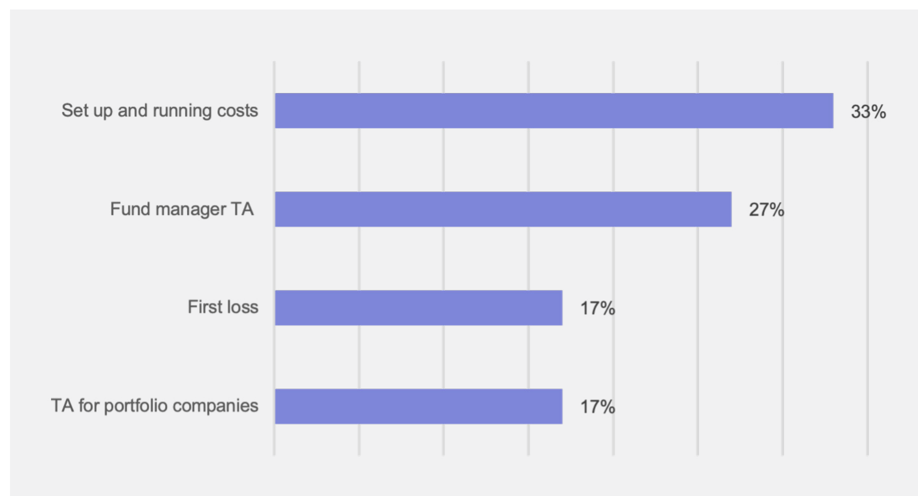
It is generally agreed that FMs in ideation and launch phases can only accept grants or repayable grants. Ideally funding should cover up to 2 years' worth of expenses with disbursements tied to commercially rigorous milestones. Securing licences, strategic team hires and investment funding are credible signals. During later stages FMs could consider low interest loans or impact linked payments internalising the risk but with line of sight to future income streams.

Sustaining an opex facility is tough even when disbursements are repayable and thus it is hard to raise funding from donors to cover those types of expenses. But the market cannot rely on the personal savings of emerging fund managers to carry the early market-building stages of this asset class.

[3] *Annual Local Capital Provider Survey 2023 (CFF, 2023)*
[4] *Ibid*

This is a key piece that's missing in the ecosystem: having somebody able to finance working capital. It would be great if this kind of support was a full grant, but even a reimbursable grant over the lifetime of the fund would be phenomenal if doesn't kill the fund manager." Warehouse facility manager

Figure 5: *Use of donor capital by fund managers*



Taking a platform approach to accelerating fund development

There are two prevailing perspectives on market building: one advocates for allowing the market to evolve organically through the interplay of supply and demand forces, while the other supports government (or donor) intervention. In reality, these viewpoints exist on a spectrum, and practical implementation frequently blends elements of both, particularly in emerging markets where unique societal challenges come into play. By leveraging a platform approach and applying commercial rigour when disbursing soft monies at every stage of the fund lifecycle, it becomes possible to tailor interventions, foster innovation, and attract diverse sources of capital, thereby facilitating a burgeoning and sustainable small business finance market.

Unleashing Africa's Potential:

Driving Economic Growth and Profitability through Gender Lens Investing

Elena Haba and Nike Ogunjimi

In today's dynamic global economy, Africa stands at a pivotal juncture. The continent boasts immense potential for economic growth, with a burgeoning population and a wealth of untapped resources. However, one key asset that often remains underutilized is the substantial potential of women as entrepreneurs, fund managers, employees, and value chain actors. It is essential to recognize that the active participation of women in the financial sector and the broader economy is not only a matter of gender equality but also a strategic imperative for the African continent. At Kuramo Capital Management and 2X Global, we believe that gender lens investing will play a critical role in transforming the African economic landscape and creating more inclusive opportunities on the continent.

Gender lens investing (GLI) has been around for over a decade. It is the integration of gender analysis into a new or existing investment process for better social and financial outcomes. A GLI strategy is defined as an intentional approach to integrating gender into investment decision-making structures and processes, assessing investments for opportunities to support gender equity along the 2X Criteria (leadership, ownership, employment, and consumption), supporting investees to realize these opportunities post-investment through targeted gender value creation and tracking and reporting systematically on gender impact across the portfolio. It involves not only investing in women-led businesses but also evaluating the broader social and environmental implications of investments. Gender-smart investors recognise that financial systems engage with and benefit men and women differently, particularly women of colour, and are actively committed to using finance as a tool to promote gender equality.

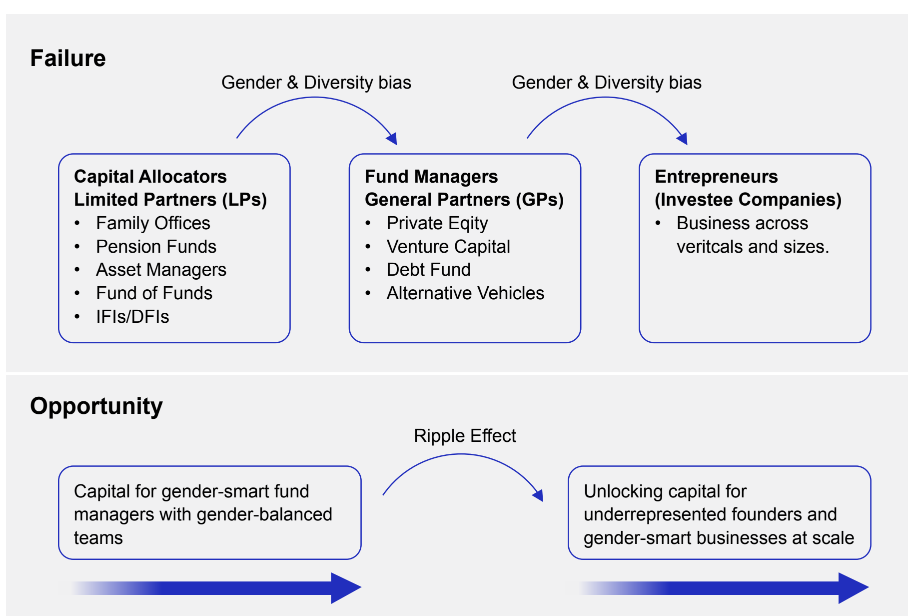
Gender lens investing isn't merely a concept; it's a proven opportunity. According to a 2019 study by the International Finance Corporation (IFC) and Oliver Wyman, private equity (PE) and venture capital (VC) funds with gender-balanced leadership teams enjoy a staggering 20% higher net internal rate of return (IRR) compared to their all-male counterparts. This finding underscores the importance of diversity in investment decision-making. Female fund managers bring diverse perspectives, are twice as likely to invest in female entrepreneurs[1] and are more likely to promote businesses with social and environmental impact. As such, gender lens investing aligns not only with profit-seeking motives but also with the broader goals of sustainability and social impact, making it an essential strategy for Africa's economic development.

Gender lens investing isn't just about addressing gender disparities; it's about harnessing the economic potential that remains untapped."

Despite these compelling arguments for gender lens investing, there is a significant financing gap for African women across various business value chains, amounting to an estimated USD 42 billion. Shockingly, less than 1% of the capital allocated on the African continent goes to female entrepreneurs, as highlighted by the African Development Bank's AFAWA initiative. In Africa in particular, capital allocation is also skewed towards expatriate-run businesses rather than local businesses.[2] Although female entrepreneurs receive significantly less funding than their male counterparts, they generate twice as much revenue per dollar invested.[3] This underscores the immense untapped potential among female entrepreneurs and the profound impact that gender lens investing can have in unlocking this potential. This underinvestment is not unique to Africa but a common thread across emerging markets. Female-led companies receive just 7% of all capital allocated in private equity and venture capital investments. These discrepancies are rooted in the fact that less than 10% of general partners (GPs) in the private equity space and less than 3% of GPs in the venture capital space in emerging markets are female-led.

To be clear, there is not a lack of female-founded and -led PE, VC and debt funds. On the contrary, over the last years, over a hundred funds led by women or diverse teams have come to the African market with gender-smart investment strategies. Yet the majority disproportionately struggle to successfully raise their funds due to persistent bias, inequalities and systemic barriers.

Figure 6: *Market failures and opportunities with regards to gender-smart strategies*



[1] *Moving Toward Gender Balance in Private Equity and Venture Capital (IFC & Oliver Wyman, 2019)*

[2] *Impact investment favours expats over African entrepreneurs. Here's how to fix that (World Economic Forum, 2019)*

[3] *Why women owned start-ups are a better bet (Boston Consulting Group & MassChallenge, 2018)*

In response to some of the key barriers faced by female-led/gender-balanced fund managers with gender lens investing strategies in Africa, we at 2X Global and Kuramo Capital Management have partnered to bring to market the 2X Ignite Africa Warehousing Facility. The Facility will provide investment capital to female-led and gender-smart fund managers to utilize in warehousing deals and enable them to build a track record while fundraising, thereby improving their chances for a successful fundraise. With this, we hope to address financing asymmetries and promote inclusive economic empowerment across the continent. We consider that the smartest way to unlock capital for underrepresented founders and gender-smart businesses at scale is to invest in female-/diverse-led fund managers with gender-smart investment strategies. When women are empowered as entrepreneurs and investors, the African continent stands to benefit in terms of both profitability and social impact.

In sum, gender lens investing isn't just about addressing gender disparities; it's about harnessing the economic potential that remains untapped. We thus urge investors and financial institutions to embrace gender lens investing as a means to drive economic growth, foster innovation, and support women as powerful drivers of change. By aligning financial returns with social and environmental progress, we are confident we can work toward a more inclusive, profitable, and sustainable future for Africa.

2X Global

is a membership and field-building organisation focused on unlocking gender-smart capital at scale. We engage the full spectrum of investment actors, capital providers, and intermediaries working in public and private markets, across both developed and emerging economies towards this mission. Through a broad and diverse set of activities we activate and engage our global community to advance intersectional investment agendas, scale the field, shift mindsets, and facilitate capital deployment. 2X Global has supported capital allocators to invest USD 27.7 billion with a gender lens from 2018 and 2022.

Kuramo Capital

is a leading Sub-Saharan African (SSA) focused investment management firm with a diversified platform that includes investments in primary funds, direct/co-investments, and managed solutions. Over the last decade, the firm has championed the growth and expansion of the private investment landscape in SSA by catalyzing commercial capital to first-time SSA funds and investing in exciting and innovative growth opportunities. To date, Kuramo has catalyzed over USD 3 billion to SSA firms that have a tremendous positive impact on the local communities.

Building Partnerships with the Private Sector

The Case of Venture Capital Trust Fund

Hamdiya Ismaila

Promotion of small and medium sized enterprises (SMEs) remain one of the surest ways to create jobs, improve livelihoods, and ultimately support inclusive growth for the attainment of the sustainable development goals. However, one of the greatest challenges facing SMEs in Africa is access to finance, especially long-term finance to assure sustainability and growth. The African market is very much bank-dominated, and banks usually lend on a short to medium term basis, with businesses needing a consistent cash flow to support the debt repayments.

Most SMEs are highly informal, and their absorption capacity is slow which affects their productivity amongst other things. This means that they need a certain kind of handholding and finance to make them grow and create the jobs that are in dire need. Due to the challenges outlined above, these ventures are deemed too risky for both traditional banking and other forms of financing.

The risk associated with investing in small businesses often hinders this market segment's access to sufficient financing, impeding its ability to grow and contribute to economic development. Whilst some of these risks are perceived, others are actual risks that can be mitigated through strong partnerships between government and the private sector.

Over the years, the government has endeavored to foster the development of the entrepreneurial ecosystem by providing short-term small loans and grants. However, this approach has proven insufficient as these businesses require more comprehensive support to effect meaningful turnaround.

To encourage the private capital inflow into SMEs, two things are required:
- Improving legislation on alternative sources of finance
- Reducing long-term risk of investing

This implies developing risk-sharing partnerships and developing incentives to encourage more private sector actors to support SMEs. This would include activities like providing technical assistance to improve business productivity, customizing financial instruments, and increasing the use of technology, particularly digital payment systems.

VCTF have played a pivotal role in catalysing the real economy of the Ghanaian economy, particularly in alignment with government priorities."

One case study for effective partnerships with the private sector and government is the case of the Venture Capital Trust Fund (VCTF). The VCTF is a creation of the Government of Ghana to support the development of financing to SMEs in Ghana, through different investment structures and technical assistance.

VCTF was deliberate and intentional in growing the VC ecosystem in Ghana by easing access to long-term financing for SMEs. It was set up to operate as a fund of funds (FoF) and uses public money to invest in local fund managers who in turn are investing in SMEs. The VCTF would usually take a first-loss position in the underlying funds and supports local fund managers with their capital raising.

The VCTF was established by legislation, incorporating significant regulatory reforms, notably encompassing tax incentives. These incentives include:
- 10-year tax break on the fund vehicle
- 5-year loss carried forward by the private sector participants in the fund vehicle
- Fund vehicle exemption from all kinds of taxes.
- Technical assistance to support fund managers' internal capacity as well as their investee companies.

  These incentives enabled the VCTF to attract additional private capital at a ratio of 1:5 to support the small business segment over the past 16 years.

In addition to this suite of incentives and de-risking capital, the FoF has made technical assistance funding available to support post investment value creation efforts of fund managers with investees. This has helped the businesses to grow and thrive, created jobs, and improved the livelihoods of employees, clients, and intermediaries.

The operations of the VCTF have played a pivotal role in catalyzing the production of new products and services, providing substantial support to the real sector of the Ghanaian economy, particularly in alignment with government priorities.

The VCTF has attracted financing partners of all kinds to find long-term effective instruments for financing SMEs. These financing partners are mostly co-investors into the investee funds. We have worked with local investors including the Ghana Commercial Bank, Agriculture Development Bank, State Insurance Company, Gold Coast Securities, Ghana Union Assurance, Social Security and National Insurance Trust (public pension fund); and foreign investors including FMO, SIFEM, SOVEC, IFC, DGGF, Proparco, and EIB. There has been an additional USD 109million of private capital invested in these funds.

Key lessons learned and next steps

- *Alignment of interest between parties and having skin in the game as a fund manager, is a must-have and makes all the difference.*
- *Structure matters - the VCTF was structured in a way that it could not raise private investment at FoF level which put us at a disadvantage.*
- *Local institutional investors are key in driving more capital to SMEs but may need to be de-risked. Incentives work well in the early-stage environment so more catalytic capital will go a long way to crowed in more capital.*
- *Local capital providers are needed to help businesses put governance and financial management structures and controls in place to allow better absorption of more capital in the future.*

These lessons have shaped the design of the Ci-Gaba Fund, a new private sector FoF currently fundraising in the Ghanaian market. The FoF was intentionally structured to mobilise local capital for investments in SDG-aligned sectors. The blended nature of the FoF allows both catalytic and commercial LPs to invest with a target raise of USD 75 million. For every dollar invested, the aim is to attract an additional $5 in private investment at sub-fund level.

This FoF was conceived on the back of a booming pension industry that is experiencing exponential growth in assets under management and have yet to invest in the productive sectors of the economy. The pension funds are already over-exposed to government securities and as such would not invest in a government institution like the VCTF. By investing in Ci-Gaba they can get exposure to alternative investments in the real economy through an investment team who have the skills to allocate.

Table 2: *Profile of VCTF*

Current AUM	USD 100m
Team location	Ghana
Investment location	Ghana
LP types	Government of Ghana
Number of investee funds	11
Number first time fund managers	10
Investment size	USD 250k-USD 4m

Egypt Initiatives in Supporting Venture Capital Funding

Douaa Ahmed Yassin

The Micro, Small, and Medium Enterprises Development Agency (MSMEDA) in Egypt is a quasi – governmental organization, committed to the advancement and growth of micro, small, and medium enterprises (MSMEs). It achieves this mission by offering a comprehensive range of financial and non-financial programs designed to aid the establishment and expansion of such projects. These programs are accessible either by direct application to MSMEDA or through its extensive network of financial intermediaries. As well as cultivating and coordinating a culture of entrepreneurship and innovation in the country, MSMEDA has a mandate to support youth-driven enterprises with economic and social objectives ensuring active and meaningful youth participation at the national level.

The genesis of the fund of funds (FoF) programme

Three decades ago, the Social Fund of Development was established with the backing of the United Nations Development Programme. Its primary mission was to mitigate the economic challenges faced by Egyptian workers returning from the Gulf region after the first Gulf War. In the wake of the increasing significance of MSMEs as engines of long-term, sustainable economic growth, the work of SFD was institutionalised into MSMEDA by Decree No. 947 in 2017 and its subsequent amendment, No. 2370 in 2018.

In line with the Egyptian government's ongoing commitment to bolster the economy, foster an entrepreneurial ecosystem, and harness the nation's pool of young innovators and entrepreneurs, MSMEDA initiated a pioneering FoF programme for Venture Capital (VC). The pilot phase kicked off in 2015 followed by a full-fledged program in 2021, in partnership with the World Bank. There was an open call for investors to support start-ups and MSMEs transforming innovative ideas with high growth potential into applications and sustainable projects that could ultimately contribute to Egypt's economic growth.

The structure of the programme

MSMEDA initiated the FoF programme with the primary objective of enhancing the availability of financial support for innovative start-ups and young SMEs demonstrating high potential for economic growth and employment creation. The FoF provides anchor capital into new funds. These would be equity and quasi-equity investments into a range of experienced or emerging, privately-managed investment vehicles including angel funds, accelerators, SME and VC funds and other qualified investment companies. These intermediaries then invest equity or quasi-equity, including venture debt and mezzanine, into early stage enterprises.

Fund mandate

- *Targets first time fund managers with early-stage investing experience, and experienced local, regional & international fund managers.*
- *Accelerators (providing financing), angel funds, seed funds, early-stage VC Funds, growth-stage VC Funds and other SME Funds may benefit from the program*
- *Sector agnostic but may give priority to specific sectors, which represent high sustainable growth or high development impact.*
- *Funds benefitting from the programme may invest into start-ups and high-growth potential SMEs through equity and/or quasi equity instruments.*
- *May invest up to 40% of the fund's capital with a maximum ticket USD 5 million per fund subject to raising at least 50% of fund equity from private sector investors or DFIs.*
- *MSMEDA invests in funds at dollar to x dollar match of MSMEDA's participation in any fund, with regard to investing in Egyptian start-ups.*
- *MSMEDA is also interested in start-ups from Arab, African, and emerging markets, to help Egyptian start-ups to expand and scale in these markets and vice versa.*

Furthermore, MSMEDA is actively working on the implementation of supplementary initiatives designed to boost private sector participation in early-stage financing within Egypt. These initiatives encompass a comprehensive suite of ecosystem-enriching programs tailored to address technical shortcomings in the start-up and entrepreneurial landscape. These will include specialised LP masterclasses, cross border investment facilitation etc.

The programme has leveraged more than twice the initial investment."

Performance to date is exceeding expectations

Out of 40 proposals the FoF has issued 19 soft commitments out of which 8 commitments totalling approximately USD 20.7 million have been transferred to solid commitments. Over 130 enterprises have received investment thus far. The programme aimed to leverage almost two times the USD 50 million allocated. Thus far it has attracted USD 117 million in foreign direct investment and USD 19 million in private sector investment.

And in terms of the start-up ecosystem in Egypt, the current value of the portfolio of investee companies is approximately USD 3 billion representing a substantial segment of the economy.

MSMEDA are currently raising an additional USD 100 million to top up the USD 50 million already raised. We are also looking in the possibility of introducing new financing tools that address market gaps and support the growth plans of the start-ups, such as quasi-equity funds, debt to start-ups, secondaries funds and Series B funds.

Lessons learned thus far

- *Always observe internal and external needs to act proactively especially in severe economic conditions.*
- *Scan market needs to detect signals and identify any threats or opportunities.*
- *Take immediate actions at the correct time without worrying if plans are amended or altered.*

Table 3: *Profile of MSMEDA FoF Programme*

Current AUM	USD 50m
Target capital raise	USD 50m
Team location	Egypt
Investment location	Egypt with possible allocation to Africa, MENA and emerging markets
LP types	Word Bank
Number of investee funds	8
Number first time fund managers	5
Target investee fund size	USD 12m-USD 150m (average USD 30m)
Investment size	USD 1m-USD 5m (average USD 2.5m)
Impact returns	Start-ups and SMEs with particular mandate to support youth-driven enterprises with economic and social objectives

Mobilising Institutional Capital into Alternative Asset Classes

Claudia Manning

The SA SME Fund was initially established as a ZAR 1.4 billion fund (approximately USD 75 million) with capital from 50 corporations and the largest pension fund manager in South Africa, the Public Investment Corporation. It is a fund of funds (FoF) that supports small and medium-sized enterprises (SMEs) in South Africa by partnering with reputable intermediaries who invest either equity or debt into these enterprises; thereby promoting entrepreneurship, growth, innovation, research and development, and employment in the country. The SA SME Fund has subsequently raised two more FoFs; a dedicated SME Debt FoF as well as a Venture Capital FoF.

Venture Capital Fund of Funds (VC FoF) experience

The SA SME Fund has become one of the largest domestic institutional investors in the venture capital (VC) asset class with over ZAR 630 million (approximately USD 35 million) committed to multiple VC fund managers thus far. This position will be cemented with the new VCFoF which has achieved its first close in 2023 with ZAR 800 million (approximately USD 42 million) in commitments. Significantly, the VCFoF has, for the first time in South Africa, succeeded in attracting capital from South African institutional investors including a pension fund, a compensation fund and a university endowment fund.

The role of VC

VC is a key driver of innovation and growth yet remains a relatively underdeveloped and untapped asset class in South Africa. South African institutional investors have, until very recently, shied away from investing in VC, regarding the market as too risky, too illiquid, and not investable.

VC plays a dual role in driving innovation and impact. Global evidence shows that VC has played a critical role in driving innovation in many economies, backing start-ups that are disruptive and offer new solutions to problems. Silicon Valley and Israel, the world's leading VC destinations, are home to the world's most innovative businesses, many of which would not around today be it not for pools of VCs prepared to back them. As an illustration, 42% of US public companies were backed by VC in their early years – these companies now account for 35% of total US employment.

Critically, VC investments in emerging countries are often in high-impact sectors and product markets, with VC-backed entrepreneurs typically focusing on solving problems affecting their communities. This often results in VC having an out-sized development impact in key areas such as low-cost health and housing, affordable education, and small-scale agriculture.

Increasing investment into South African VC

The SA SME Fund has established the VCFoF in order to grow the size and depth of the VC industry in SA The fund has taken proactive steps to lower the risk and create efficiencies to encourage local institutional investors to enter the market.

1 Employing a FoF strategy

- **FoF structure:** A FoF model of capital deployment enables smaller and more diverse fund managers to access capital that may otherwise be out of their reach. In doing so, the VC industry will grow not only in absolute terms but also in geographic, sectoral, and individual fund manager diversity.

- **Risk mitigation through diversification:** The variance in sectors, stage of investment, vintage, and fund manager experience across the portfolio helps to mitigate the concentration and correlation risks that may exist in a sector-specific fund. This can be helpful especially if investors have limited capital to invest, want to limit their exposure to a new asset class, or do not fully understand the market.

- **Access to institutional capital:** A FoF model provides a mechanism for institutional capital to be put to work in a sector and region where most VC funds are too small to receive large allocations of capital.

2 Introduction of a First Loss layer of Capital

- In recognition of the reluctance of institutional investors to invest in VC, a first loss layer of capital was introduced to offer downside protection to private investors in the VCFoF. This capital was sourced SA SME Fund itself (using capital from Fund 1) and USAID. Although the quantum of the first loss capital is relatively small, representing just over 10% of the total Fund size, it provides investors with the comfort that some of their downside is protected in the event that the Fund of Funds does not deliver a stellar performance. The presence of this first loss layer in the capital structure of the VCFoF proved to be instrumental in securing capital from these institutional investors.

3 Waiving Fees at the Fund of Fund level

- Also, in recognition of the fact that investors tend to avoid FoFs because of the 'fees on fees' and 'carry on carry' leakage, the SA SME Fund took the decision to waive fees and carry at the Fund of Funds level. The saving for investors is estimated to be approximately 20% (R200m of a R1 billion fund).

The VCFoF has thus become the first of its kind in securing a new cohort of institutional investors into the sector in South Africa. While these types of investors including a pension fund, a compensation fund and a university endowment fund, are typical VC investors in more mature markets, they have not done so yet in South Africa. At the time of first close institutional investors' commitments comprise approximately 60% of the VCFoF, likely increasing by the final close.

Learnings from SASME Fund's journey

It is important to identify mechanisms to de-risk the asset class when attempting to mainstream it for institutional investors who are wary of investing in new asset classes. The SA SME Fund was fortunate in that it had an established platform that was able to proactively de-risk the opportunity for institutional investors using the mechanisms described above.

- In the absence of relatively unusual vehicles such as the SA SME Fund in other markets, it is DFIs and Foundations that could play this catalytic role to kick-start the market.
- International evidence suggests that the need for these de-risking instruments decreases over time as institutional investors' experience of the asset class grows and they can recognise the benefits of exposure to a more diversified portfolio.
- It is important to take an eco-system approach to building a new asset class – it is not sufficient to simply invest in emerging fund managers and assume the market will develop independently. During its Fund 1, the SASME Fund allocated considerable resources to building the ecosystem, including running first-time fund manager programmes, investing in reputable accelerators that help strengthen the pipeline and creating opportunities for competing fund managers to collaborate.

Table 4: *Profile of SA SME Fund*

	SA SME Fund Limited	Venture Capital FoF
Current AUM	USD 75m (ZAR 1.4bn)	USD 45m (ZAR 800m)
Target capital raise		USD 70m (ZAR 1.3bn)
Team location	South Africa	
Investment location	South Africa	
LP types	• 50 listed companies • Public Investment Corporation	• Pension Fund • Compensation Fund • University Endowment • SA SME Fund • First Loss: • SA SME Fund • USAID • Government
Number of investee funds	9	4
Number first time fund managers	5	0
Target investee fund size	USD 1.6m - 55m ZAR 30m – 1bn	USD 10m - 55m ZAR 200m - 1bn
Investment size	USD 80k - 2.7m ZAR 1.5m - 50m	USD 1m - 3.8m ZAR 20m - 70m

The role of funds of funds in bringing local capital into private companies in Africa

Mardé van Wyk

Most South African retirement funds have historically been invested exclusively in listed instruments including equity, bonds, real estate, and money markets, not following the global trend of investing with confidence in private markets. Retirement funds in the largest global markets routinely have double-digit percentage exposures to unlisted investments and have continued to grow these exposures over the past two decades on the back of strong performance and deepening markets.

This conservatism, and perhaps scepticism, on the part of local retirement funds, has several root causes including concerns around liquidity, high fees, scant evidence of returns in local markets and the perceived lack of experience among local managers. While these apprehensions hold some validity, the imperative remains clear - domestic pools of capital must play a pivotal role in enriching the funding ecosystem for local businesses.

International capital has largely ignored domestic African private equity, on the basis that it is too small, too risky, too foreign, and too unproven to warrant their attention. This apathy accentuates the urgent need for local African investors to take matters into their own hands by investing in their own countries. A key difference between local and global

investors is currency. Global investors are hard currency based and find it hard to stomach the swings in African currencies. Local retirement funds have local currency liabilities and therefore have a natural hedge in investing in local currency denominated investments. This tolerance for local currency exposure makes their investment a critical part of the success of domestic capital markets, particularly in the realm of private markets.

Views of local retirement funds about domestic private markets

When we speak to local retirement funds about their perceptions of private markets, they often express a resolute belief in the transformative impact of channelling capital into domestic businesses. This conviction finds expression in discussions around job creation and the ability to create opportunities in their own countries; and the broader social impact of enhancing access to services and infrastructure for the local population, with an acute focus on solving problems or circumstances faced by retirement fund members thereby creating future pension value to beneficiaries beyond just the commercial angle.

Concessional capital can play a role in sweetening the pot for sceptical retirement funds."

Given the lack of experience of most local institutional investors (and even their investment consultants) in selecting and managing private markets funds, the role of an intermediary such as a fund of funds (FoF) manager is clear. In addition, we know that private market investments have a far higher dispersion of returns than other asset classes, meaning that selection and active management are critical to success, underscoring specialisation as a risk mitigation tool. These factors converge to present a clear market opportunity for professional FoFs to carefully curate and manage these allocations on behalf of local retirement funds. FoFs also offer the advantage of providing proper portfolio diversification, particularly for retirement funds which can only allocate relatively small amounts of capital.

Nevertheless, it is essential to acknowledge that FoFs come with additional costs, which can be a significant hurdle to their adoption. In certain instances, retirement funds may be inclined to take their chances with selection, even in the absence of any prior experience in this realm, rather than incurring the small incremental expense of a FoF.

When attempting to marry the scepticism for the asset class and its vehicles with the clearly identified impact of this kind of investing, at least some retirement funds, who would otherwise commit capital into private markets, come up short and decide not to allocate. This is where concessional capital can play a role in sweetening the pot for sceptical retirement funds and open additional funding into the asset class.

The role of blended finance is to encourage local investors to embrace their own economies

The catalytic role of blended finance in overcoming obstacles for local capital is exemplified by 27four through two pioneering partnerships with the South African government. In both cases, concessional capital was injected to de-risk local investors, thereby stimulating domestic investment in the real economy.

The first such partnership is with the Jobs Fund, a part of South Africa's National Treasury. The Jobs Fund provided grant funding to be used as first-loss capital in a private equity FoF managed by 27four, called the Black Business Growth Fund II (BBGF). By including

a first loss capital tranche in the BBGF which was clearly sufficient to cover all costs of the FoF structure as well as to create a cushion to absorb at least the first part of any losses that may be incurred, local retirement funds were persuaded to invest. Remarkably, the BBGF raised in excess of five times local retirement fund capital for every rand of concessional capital.

In practice, the FoF has delivered the desired results. As a result of the structuring used, investor returns were smoothed, with almost no J-curve through the early period of the fund. Investors soon reached the net return hurdle, and to date, five years into the fund life, net returns for investors are exceeding the target of CPI +10 %. In addition, all the underlying funds in the portfolio are performing at or above expectation, with broad impact being achieved across portfolio companies. Job creation in the portfolio has been consistent even through a time when the South African economy has been shedding jobs and grappling with record levels of unemployment.

We believe that the BBGF should serve as an example of how to encourage local investors to invest in their own economies in a manner that addresses their key concerns. It should also be illustrative to international donors or other impact investors as a highly effective way to drive investment without having to put up all the required capital. This model amplifies concessional funding and lays the foundation for continued investment in the future, fortifying the ecosystem for sustainable economic growth.

When used in this deliberate manner, taking into account the local considerations and partnering with the right institutions, FoFs can be ideal vehicles to meet the dual goals of returns for investors having a clear impact on local economies.

Table 5: *Table 5: Profile of 27four Black Business Growth Fund II*

AUM to date in FoF strategies	USD 82m
Target capital raise	Additional USD 110m for Fund 3
Funds to date	Black Business Growth Fund I & II.
Team location	South Africa
Investment location	South Africa
LPs	South African pension funds / savings pool
	National Treasury Jobs Fund
Number of investee funds	9 funds
Number first time fund managers	Mix of first and second independent fund managers
Target investee fund size	USD30m-135m, average USD 59m
Investment size	USD 4m-11m
Financial and impact return targets	Equity >20%
	Mezz >17%
	Employment focus

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