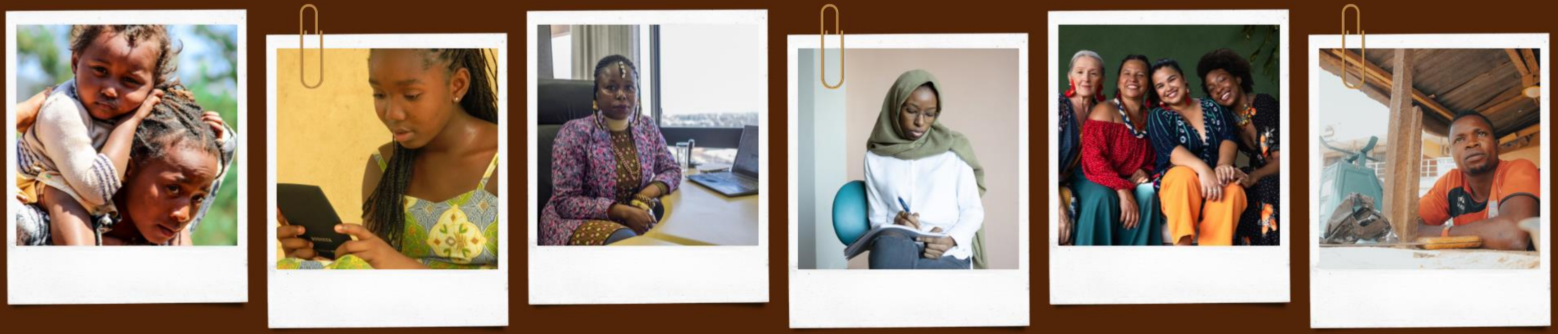
INVESTISSEURS & PARTENAIRES



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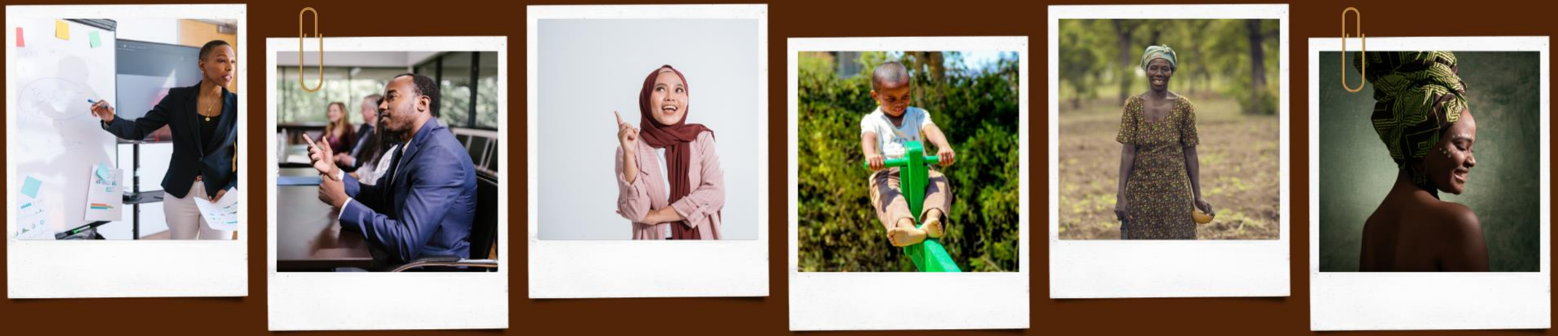


Fund Evaluation
2023

Palladium
MAKE IT POSSIBLE

Table of Contents

1. Glossary

2X Challenge	The “2X Challenge” was launched at the G7 Summit 2018 as a commitment by DFIs and the broader private sector to invest in the world’s women
AFD	Agence française de développement
CFF	Collaborative for Frontier Finance
Country funds/local investment company	Investment funds or investment companies which are launched and anchored by investment from IPDEV2, domiciled in local jurisdictions and deploying equity capital directly to SMEs
Country teams	Staff employed at the local investment and management companies
DFI	Development finance institution
DGGF	Dutch Good Growth Fund
Fund CEO	Fund Manager of the local investment fund or investment company, and Managing Partner of the local management company
HR	Human resources
I&P	Investisseurs & Partenaires, parent organisation
IPDEV2	I&P Développement 2 fund of funds launching and investing in local investment funds
IPDEV2 team	Staff employed by I&P who work on the IPDEV2 fund
IRR	Internal Rate of Return
Local management company	Management companies who are operating the local investment companies
MOIC	Multiple on Invested Capital
SME	Small and medium-sized enterprises
TA	Technical Assistance
YoY	Year over Year

2. Introduction: IPDEV2 Strategy

Investisseurs & Partenaires (I&P) is an impact investment group dedicated to supporting African Small and Medium Enterprises (SMEs). Since its establishment in 2002, I&P has supported over 250 SMEs across fifteen African countries, providing them with long-term financing as well as strategic, managerial, and technical support. As a player in impact investment, I&P is committed to maximising the societal impact of its partner companies and contributing to dynamic and inclusive growth in Africa.

The Strategy

To scale up African private equity and support a growing number of private initiatives, I&P has designed a unique programme to build investment capacity in Africa.

IPDEV2 aims to create, develop and sponsor some 10 impact funds in several sub-Saharan African countries, and thereby finance nearly 300 enterprises and contribute to the creation of 15,000 jobs in sub-Saharan Africa.

The teams supported by IPDEV2 are all first-time fund managers raising and managing their first fund.

Theses impact funds, led by African investment professionals and mainly capitalised by African investors, respond to a key market gap in the region by providing early-stage equity investments ranging between €50,000 and €500,000, with an average ticket size of less than €300,000, to local enterprises.

Current Portfolio

Zira Partners
- Management company
- CEO: Mohamed Keita
- Team size: 5

Zira Capital Investment
- Investment company
- Total capitalisation: €1.5M
- SMEs in Portfolio: 0

Sinergi Niger
- Management & Investment company
- CEO: Maïmouna Baillet
- Team size: 12
- Total capitalisation: €1.0M
- SMEs in Portfolio: 5 (5 exits)

Teranga Gestion
- Management company
- CEO: Olivier Furdelle
- Team size: 19

Zira Capital Investment
- Investment company
- Total capitalisation: €6.1M
- SMEs in Portfolio: 12

Inua Capital Ltd.
- Management company
- CEO: Kim Kamareme
- Team size: 5

Inua Impact Fund
- Investment company
- Total capitalisation: €8.1M
- SMEs in Portfolio: 0

Miarakap
- Management company
- CEO: Emmanuel Cotsoyannis
- Team size: 39

Miarakap Investissement
- Investment company
- Total capitalisation: €5.9M
- SMEs in Portfolio: 10

Comoé Partners
- Management company
- CEO: Djibril Doumbia
- Team size: 13

Comoé Capital
- Investment company
- Total capitalisation: €5.7M
- SMEs in Portfolio: 6

Azmiuth Capital
- Investment company
- Total capitalisation: €1.0M
- SMEs in Portfolio: 5 (1 with Comoé)

Sinergi Burkina
- Management & Investment company
- CEO: Job Zongo
- Team size: 13
- Total capitalisation: €2.5M
- SMEs in Portfolio: 7 (1 exit)

Tunisia, Guinea and Cameroon represent upcoming fund launches

2. Introduction: Objectives of the Evaluation & Acknowledgements

Objectives of the Evaluation

After 7 years of operation, IPDEV2 is nearing the end of its initial investment period and is preparing for the next stage of fundraising and deployment. To that end, Palladium was engaged to analyse IPDEV2's outcomes and results to date, understand the driving forces underlying the programme's current state, assess its achievements and impact generated, explore areas for improvement, and inform the adjustments that will be needed moving ahead.

The goals of this evaluation are to showcase the feasibility and viability of African fund managers, demonstrating that they can be financially viable and be powerful drivers of sustainable impact in Africa through their capacity to assist SMEs and positively influence socio-economic development.

Acknowledgements

We would like to express our gratitude to the Argidius Foundation for providing financial support for this evaluation. We would also like to thank members of IPDEV2 staff and fund teams for participating in the surveys and interviews that were a part of this evaluation.

Finally, we extend our appreciation to the external review committee that has provided valuable insights and feedback on the report. Members of the committee include Mariam Djibo, Pierre Jacquet, Abdou Kane, Philippe Le Houerou, and Martha Stein-Sochas.

3. Key Learnings:

What has worked well?

IPDEV2's critical role in establishing a strong foundation for local managers

Catalytic funding and operational support from IPDEV2 are essential for the launch, fundraising and early stage of local investment companies

Context

Although the situation has been improving, most fund managers struggle to reach a first close[1] with their most common challenges including:

- **Resources and timeline:** Fund managers face limited resources for fundraising and extended fundraising periods, diminishing the likelihood of successful launches
- **Track record and anchor investment:** Fund managers find that securing anchor investments proves challenging due to investors' wariness over their lack of track record
- **Regulation and operation:** Fund managers struggle to navigate complex regulatory processes and operational challenges while also trying to balance the fundraising process.

IPDEV2 Approach & Learnings

Considering these challenges, IPDEV2's approach has been effective in providing:

- **Grants of €100,000** over 18-24 months to support essential workstreams (i.e.: legal fees, fundraising travel), reducing costs and time for Fund CEOs to operationalise their approaches, and doubling their likelihoods of reaching a first close;
- **Anchor investments** of €1M to 2M per vehicle to attract additional investment, give local investors confidence, and reduce their due diligence burden due to IPDEV2's sponsor role.

Across the 7 local investment companies, all the Fund CEOs found IPDEV2's grant funding and anchor investment to be impactful to their fund, and to be the most crucial area of support.

From the local shareholders' perspective, IPDEV2's most impactful contribution was on the governance structure of the local investment companies:

- Providing flexible, hands-on **support in navigating local regulatory framework, operational and legal templates, and access to legal consultants** had a significant benefit to funds in setting up strong governance foundations.

The counterfactual view

All fund teams IPDEV2 invested in, achieved a first closing. This is in stark contrast to the four funds IPDEV2 decided not to invest in, of which three failed to secure a first close and one faces sustainability concerns due to a small first close.

1. Collaborative for Frontier Finance, 2023

African-led initiative and local rooting

IPDEV2 and the local investment companies are led by African stakeholders, aligning with the overarching strategy to empower local economies and benefitting local investors, investment companies, SMEs, and the local ecosystem

Context

Most fund managers investing in Africa use offshore jurisdictions due to challenges in local legal and regulatory frameworks, as well as local economic, political and currency risks.

African leadership: The overarching strategy of IPDEV2 is to empower local economies on the continent and partner with African organisations or individuals.

Critical role of local investors:

- Local investors are critical to developing capital markets and demonstrating the business case for similar funds
- International investors are more likely to withdraw during periods of political and economic uncertainty (i.e. Niger, Burkina Faso and Mali).

IPDEV2 Approach & Learnings

IPDEV2's shareholders have a 35% representation from African-led organisations and individuals, while at the local fund level, the seven investment companies have secured **€28.5M from a pool of 57 investors, of which 84% are from Africa**, reflecting **strong regional support and commitment to empower local economies** on the continent.

- The model demonstrated that locally domiciled funds have been **effective in attracting demand from domestic capital allocators** who have a deeper understanding of local environments, are comfortable with domestic risks and return profiles, and are better aligned with SME needs such as smaller tickets and longer-term investment horizons.

- Local commitments also provide valuable support for local fund managers and SMEs, ensuring **enduring commitment in challenging times**, in contrast to international investors who are more likely to withdraw during periods of uncertainty.

- The model **created a precedent for local domiciliation**, strengthening local capital markets and empowering more fund managers to follow.

Having local shareholders in the investment companies, rather than DFIs or more international investors, was identified as **very important for shareholders at the IPDEV2 level, given the fund's mission of achieving systems transformation.**

> *"The only reason that I partner with IPDEV is the **aligned vision to really, on a continental perspective, make a bold statement for SMEs**. Have local fund managers ethnic to the places in which they operate, resident to the places in which they operate, support local business with capital to get better." (Fund CEO)*

IPDEV2 and the local funds are seen as a validated path to generate impact

IPDEV2 has positioned itself as a true impact-first option for investors as the integrity of the mission has attracted international and local capital and the impact generated has proved to be satisfactory

Context

Operating a fund in untested markets and difficult heterogeneous macroeconomic contexts typically makes it challenging to attract investors but was managed well at each of the programme levels:

- At the **IPDEV2 level**, the fund was marketed from the start as offering single-digit returns due to costs of sponsorship and hands-on support, aligning with the shareholders' agreed-upon goal of capital preservation
- At the **local country level**, investors expected solid financial returns but also placed significant emphasis on achieving a meaningful local impact - 73% of investors at the fund level invested to support the local economy, while 27% invested for the impact, as indicated by survey results
- At the **SME level**, the programme set a precedent for other entities in the region and frontier market funds by pioneering equity investments into SMEs.

IPDEV2 Approach & Learnings

As a result of this approach at each level:

- IPDEV2 **attracted the right investors** that were primarily driven by the impact mission and acknowledged its mission integrity compared to other initiatives in the market. Shareholders commended IPDEV2 for its performance in executing strategies across challenging and diverse markets.
- IPDEV2 has **surpassed expectations in accessing philanthropic and local capital**, enabling it to broaden its impact within country ecosystems through technical assistance for SME formalisation and investment readiness support
- Over **70% of shareholders at the local fund level were very or extremely satisfied** with their investment driven by the impact achieved, while 67% indicated that financial performance of the funds was in alignment with their initial expectations
- On average, **SMEs across the portfolio achieved positive revenue growth**, collectively generating approximately €100M in sales cumulatively since investment, with valuations trending positively over the years.

While IPDEV2 has been active, other fund-of-fund initiatives were launched to focus on Africa. However, they mostly supported a limited number of first-time teams, usually in more mature countries. Some have now altered their strategies towards direct investments, often outside of Africa. This highlights the **unique impact that IPDEV2 brings to the market and the ecosystem.**

Evergreen structure

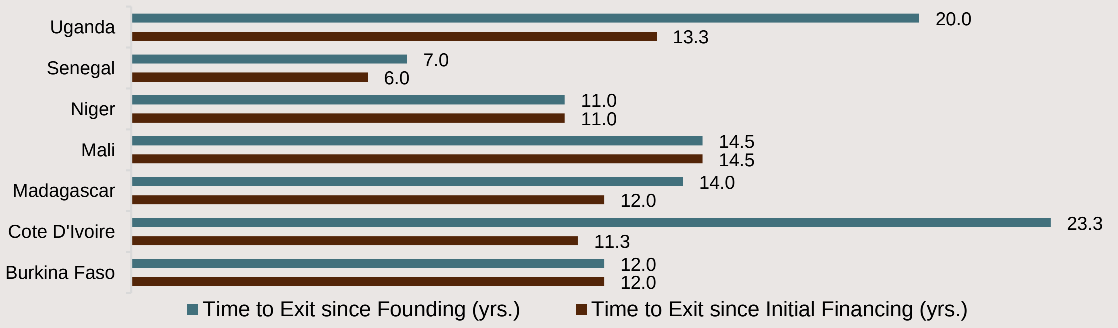
Enables stronger financial and impact outcomes, and aligns with local market needs

Context

Although evergreen structures present challenges around fundraising and liquidity options, they are gaining momentum given that:

- Investments in SMEs in emerging markets require **patient capital as exit pathways are more limited**
- **Formalisation of SMEs and impact in the ecosystem takes time due** to the nature of building early-stage businesses and deploying local funds often taking longer than expected
- In 6 of the 7 IPDEV2 countries, companies required **more than 10 years since their initial financing to secure exits**; broader research into SME funds in emerging markets indicates that they break even after an average of 14.6 years.

Average time to exit since company's founding and since initial financing, by country[1]



Note: Graph represents transactions that have taken place in the IPDEV2 countries since 2015. Eligibility criteria were (1) the company headquartered in an IPDEV2 country, (2) the transaction was an acquisition, public listing, or buyout, (3) the company did not operate in an extractive sector (i.e.: mining, petroleum), (4) Pitchbook data available on the company's year of foundation, and (5) Pitchbook data available on the year company secured a first round of financing. | **Source:** Pitchbook, 2023

IPDEV2 Approach & Learnings

As a result of electing for an evergreen structure, IPDEV2 has seen various positive outcomes:

- Proving appropriate for investing in SMEs in Africa as it allows for **flexibility and patience in achieving financial returns,** aligning with exit timelines
- Empowering fund managers to provide **better aligned long-term support to SMEs** as they grow and achieve positive performance
- Outperformance of IPDEV2 local funds – the collective total value to paid-in capital (TVPI) of four more mature programme funds is 1.82x, placing IPDEV2 in the **85th percentile of funds operating in Africa** and increasing the likelihood of securing exits.

*"We actually think evergreen structure is more appropriate in Africa. We would like to see more of those. I think **it was quite innovative**, even 8 years ago you were not seeing as many funds looking to establish something like that." (IPDEV2 shareholder)*

*"**We need to go much further, even if it means staying longer**, if we sense that the company has the capacity to continue on its growth trajectory. We have a company that performed exceptionally well in 2022-2023, but when we assessed the impact on our balance sheet compared to the growth potential for the company, we decided to wait and support it by investing again. **The goal was to achieve much higher levels of operational performance first and then even higher levels of valuation**." (Fund CEO)*

Product market fit

IPDEV2's strategic impact is bridging the SME financing gap in Africa and fostering growth through aligned equity, crowded-in capital, and comprehensive technical assistance support

Context

Against the backdrop of a $421B financing gap hampering African SMEs' growth,

- **Financing options are often limited to short-term debt** from banks, but remain difficult to access due to perceived high credit risk, high interest rates, demand for collateral or guarantees, and/or cash flow requirements
- **Most SMEs do not receive both technical assistance (TA) and financing**, leaving a crucial capacity-building gap
- There is a persistent **imbalance between demand for capital and supply**, despite growing investment in SMEs through local funds (current AUM of $260M) and fund managers that try to adapt smaller ticket sizes.

IPDEV2 Approach & Learnings

The average ticket sizes of €250,000 provided by IPDEV2's investment companies was highly additional as it responded to a key gap in the market. Investees highly valued the financing and support provided by IPDEV2's investment companies:

- **90% of SMEs found the financial instruments** offered by local investment teams as fully or partially **adapted to their needs**
- Offering a **combination of TA and investment** for for business expansion and operational/governance support was **very important for financial growth** (80%+ of SME survey respondents) and for developing impact measurement tools, adapting intervention strategies, **and generating impact outcomes** (for 70%+ of SMEs)
- The **investment** from IPDEV2 local funds **crowded in additional capital directly to SMEs at a leverage effect of 1.7x**, with over 79% of SMEs that received additional funding affirming that the initial financing and support from IPDEV2 was very or extremely important in securing subsequent investments
- Most SMEs did not have other financing options and those who sought additional financing elsewhere found **IPDEV2 financing was more catalytic for them in achieving objectives**
- **SMEs across the portfolio achieved revenue growth**, collectively generating approximately €100M in sales since investment, with **valuations trending positively** over the years and averaging a 2.18x multiple on funds disbursed.

The **presence of IPDEV2/I&P instils confidence in SMEs for their future** financial sustainability, with 77% expressing they feel very or extremely confident with them as a partner. In contrast, without IPDEV2/I&P support, only 35% of SMEs felt very or extremely confident.

Impact of IPDEV2 on end beneficiaries

IPDEV2 measures comprehensive impact metrics across investee companies, with noteworthy results in SME formalisation, job creation, and inclusion of women

Context

IPDEV2 aims to promote ESG and impact best practises by focusing on several transversal objectives:

- **Formalisation**: IPDEV2 focuses not only on the formalisation jobs, but also in SME operations, such as implementing proper financial reporting and overall investment readiness
- **Inclusion of women**: Women entrepreneurs are well represented in the informal sector, but challenges remain for women to access leadership positions and highly-skilled professions
- **Environment**: Encourage energy-efficiency, renewable energy initiatives, and biodiversity and soil preservation where applicable
- **Governance:** Promoting good governance at the local investment company level and at the SME level.

IPDEV2 Approach & Learnings

IPDEV2 tracks a number of impact metrics across its portfolio and provides a comprehensive annual report on its ESG and Impact results. Below are some highlights:

- IPDEV2 **outperformed job creation benchmarks at 5x,** with 54% YoY growth in number of jobs supported, or 36% growth excluding new investees, as compared to similar funds[1]
- Over **three-quarters of portfolio SME jobs were formal** in 2022, surpassing the national averages of formalised jobs in each country of operation. Nearly all funds, increased the number of formal jobs within 1 year of investment.
- **Aligned with the 2X Challenge for share of female employees** in 6 of 7 investment companies, with local staff generally seeing no gender disparities in career progression or compensation.

1. Collaborative for Frontier Finance, 2023

Impact of IPDEV2 on the ecosystem

IPDEV2 has achieved significant indirect impact in developing entrepreneurship and investment networks by demonstrating a path for others and sponsoring activities that aid the ecosystem's self-sustainability and growth

Context

IPDEV2 aims to build a thriving African entrepreneurship ecosystem by breaking ground in new markets and building fostering collaboration between participants:

- There are ~15 locally-rooted funds focusing on early-stage SMEs across the 7 countries IPDEV2 has presence in, including the IPDEV2-supported funds, but most of these funds are concentrated in more mature markets such as Senegal, Côte d'Ivoire, and Madagascar; **in three out of the seven IPDEV2 countries, particularly those presenting greater challenges, IPDEV2-supported teams are the only entities investing in early-stage SMEs.**

IPDEV2 Approach & Learnings

The indirect impact of IPDEV2's activities on the ecosystem are evident and have been recognized as the catalysing factor for greater investment into the space:

- Anecdotal evidence reveals that other teams explicitly **credit IPDEV2-supported teams for paving the way and demonstrating the feasibility** of such initiatives, and expressed that they would not be operating if not for IPDEV2's local funds doing so first
- Through its programmes, IPDEV2 has **educated stakeholders about impact investing locally,** and **developed investment skillsets and employment**
- **IPDEV2 gained recognition as a leader in equity SME investments in target countries and supported the cultivation of a pan-African SME ecosystem** and stronger connectivity within it by encouraging SMEs to join the I&P entrepreneur network, *Club Africain des Entrepreneurs,* with over 70% of IPDEV2 SMEs participating. The club strengthens entrepreneur capacities by providing workshops and seminars that elevate sector expertise, leadership skills, marketing strategies, resource management and digital integration.

> *"Two or three other funds in Senegal said that **they wouldn't be doing what they're doing now if it wasn't for Teranga Capital**." (IPDEV2 shareholder)*

1. Collaborative for Frontier Finance, 2023

3. Key Learnings:

Challenges of the model and areas for improvement

Tight economic model of IPDEV2 and the underlying funds

While IPDEV2 model requires grant support to provide the catalytic capital and technical assistance that is core to its mission, it must look to address these economic model constraints that may strain its ability to scale and attract a wider range of investors

Challenges

- IPDEV2 generates revenue through grant income, fund set-up and support fees, fair value gains and losses on investments, and dividends
- **Grant funding is critical** for covering operating expenses at the launch phase of local investment companies, but is becoming **increasingly challenging to secure**, as highlighted by the recent freeze of grants in the Sahel region
- **IPDEV2 local funds do not operate on the traditional 2/20 fee model** given the pilot nature of the fund operating in challenging markets, with initially slower deployment, and small transaction sizes relative to costs. **Fees and budgets are negotiated with each fund CEO** based on needs and targets of the local funds
- Tight operating budgets can constrain ability to recruit and retain talent, constrain growth and increase operating risks if staff is at capacity or overextended.

IPDEV2 Approach & Learnings

At the IPDEV2 level:

- **Grant income as a portion of total revenue has steadily declined from 100% in 2016 to only 32% in 2023**, generating an average of 20% income margin which has helped to subsidize some of the operating expenses
- **IPDEV2 reached profitability in 2023** (Y7 of operations), driven by net fair value gains on its investments and demonstrating its path to sustainability.

At the local fund level:

- All IPDEV2 **management companies operate additional programmes** to diversify revenue, facilitate SME investment readiness, and reduce due diligence cost
- Interviews and surveys indicated that **revenue diversification** through these programmes has been **helpful and needed in easing budget constraints**
- However, if not properly resourced and managed, these **programmes can also be time-intensive and take focus away from investment activities.**

Liquidity and performance expectations

The nature of SME investing requires patience from both investors and fund staff, but is causing difficulties as the trade-offs become apparent

Challenges

Conditions inhibiting IPDEV2's liquidity and performance include:

- IPDEV2's **evergreen structure can be challenging to market** to investors due to potential misalignment around the exit timeline
- The nature of SME equity investments and market conditions **prolong timelines to achieving exits**, thereby limiting investors' liquidity options
- **Ambitious business plans and lack of SME investment readiness** caused local funds to miss performance objectives, further extending timelines to achieve targets.

IPDEV2 Approach & Learnings

- Interviews confirmed that **local institutional investors** in IPDEV2 investment companies **target exits after 7-8 years**, while **individual investors consider exit after 10-12 years**
- Although investors are aware of envisioned exit timeline (>10 years), there have been instances of investors requesting an exit before then, due to unexpected changes in their funds
- IPDEV2's limited exits and prolonged fund lifecycles indicate that similar Africa-based, **SME-focused funds may require a comparable or longer life cycle** to achieve robust financial performance
- IPDEV2's local **investment companies may not be as incentivised** to deploy capital rapidly and secure exits to return capital to shareholders due to the investment lifecycle and evergreen fund structure
- Some investors surveyed found the local funds' **financial performance to be below their expectations**, specifically citing a lack of dividends
- Investors suggested that local funds' **investment strategies need some flexibility and adjustments** (i.e.: follow-on investments, larger ticket sizes, larger AUM) to achieve a more sustainable economic model.

Time to launch a local fund and deploy capital has been longer than expected

While the timeframe envisioned by IPDEV2 was thought to be conservative, the actual length of time necessary for launching a local investment company, for it to successfully fundraise, and become operational was greater than anticipated

Challenges

The length of time needed to **launch a local investment company** and to reach first close **has typically taken a minimum of 2 years** due to challenges in:

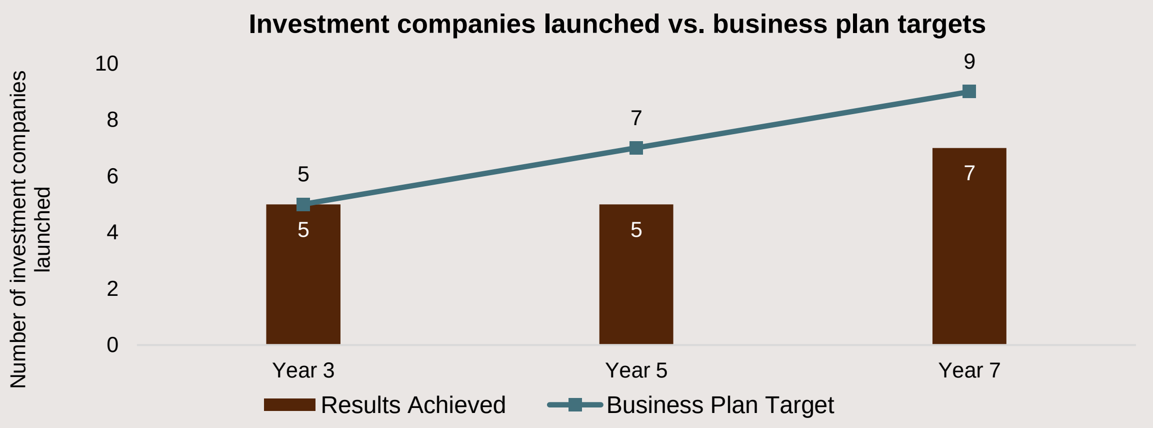
- **Identifying talent**: Significant time and resources are required to identify the right profile for the Fund CEO role, as well as to recruit and train investment teams
- **Fundraising**: Time taken to educate investors on the structure of the fund, impact vision, negotiation of legal documents and receiving approval from decision-making bodies of investors was subject to delays

Once the local fund is launched and operating, it **faces challenges in deploying capital into SMEs**; to date only 50 SMEs have received investments, which is considerably behind the intended pace of deployment (the original target was 500 SMEs over 15 years of IPDEV2, which has been adjusted to 300 SMEs).

IPDEV2 Approach & Learnings

From its experience launching, raising, and deploying funds, IPDEV2 has gained valuable insight that is useful for other ecosystem participants to note:

- **Launching pioneering funds in challenging markets with a less traditional structure slows fundraising**, as legal negotiations and approval from decision-making investors requires increased time and effort
- **SMEs require significant time, education, and effort to become investment ready** for equity, challenges which have been exacerbated by COVID-19
- Although it is unlikely that IPDEV2 will meet its original target investing in 500 SMEs by 2030, it has exceeded other impact targets in job creation, formalisation and ecosystem building.



Professionals with the necessary skills are scarce, difficult to find and to retain

Recruiting and retaining talent has been a significant challenge given budget constraints, specificity of experience needed, and availability of these types of professionals in target markets

Challenges

Attracting and retaining investment professionals is a significant challenge for IPDEV2 as:

- **SMEs require strong hands-on support** and regular monitoring by fund managers
- Investment teams **rely heavily on the leadership and experience of their Fund CEO**
- The economic model of the local investment and management companies **limits their abilities to provide competitive salaries** and benefits (i.e.: medical insurance)
- **Other organisations** (i.e.: international organisations, larger private equity firms, other financial institutions) often **can offer higher salaries.**

IPDEV2 Approach & Learnings

Given this context, IPDEV2 has learned valuable lessons that can help it evolve in the future:

- IPDEV2 had **difficulty identifying people with the necessary investment experience** and who were willing to accept concessions in compensation for the impact mission when launching the funds; however, this has improved over time and **providing employees with greater ownership and other incentives** can further boost talent preservation
- Investment companies experience a key person risk with local Fund CEOs, whose leadership is important to attracting local capital and to managing investment teams; however, IPDEV2 has demonstrated its ability to successfully lead Fund CEO transitions – having been able to **identify new candidates, attract and onboard them smoothly** in three instances (Comoé Capital, Sinergi Niger, and Sinergi Burkina)
- **Improved benefits packages and consistency** across the funds could strengthen staff retention as some countries dealt with high turnover.

Surveys revealed that **a key incentive for staff is IPDEV2's impact** and the ability to support entrepreneurs at a level of responsibility that would not be available elsewhere. In fact, some staff left their roles with IPDEV2 to start their own businesses after being **encouraged to become entrepreneurs themselves** through their work.

Adapting to SME needs while staying on mission

IPDEV2 must evolve as its investees seek larger ticket sizes and more varied capital types, indicating both the programme's nurturing impact and imperative to adapt

Challenges

Portfolio SMEs identified two areas where there still exists a financing gap:

- **Ticket sizes**: IPDEV2 local funds mainly offer tickets ranging from €50K to 500K, with an average ticket size around €250K, but some SMEs have appetites for greater amounts, in the range of €300K to 500K; investment staff have also identified this need for more flexibility and the ability to make follow-on investments in the most promising SMEs

- **Capital types:** After securing equity/quasi-equity, SMEs still face a difficulty securing working capital loans, harming their ability to operate at full capacity and ultimately impacting IPDEV2's financial performance.

"We needed a larger sum of funding to accomplish all our objectives. We had to let go of staff members due to our high cost and the uncertainty to attain our budgeted revenue." (SME Investee)

IPDEV2 Approach & Learnings

To address these financing gaps identified, there is an opportunity for investment companies and IPDEV2 to explore flexibility with ticket sizes and with the capital types provided, which may provide benefits for the economic model:

- **Tapping into SMEs with larger needs above €300K** could unlock opportunities and enable IPDEV2 local funds to better serve the spectrum of SMEs in their target market while improving their economic models

- Investment companies and IPDEV2 can **explore debt vehicles or other instruments to finance working capital requirements** of SMEs at a larger scale than the AFD line currently allows; though the AFD loan allows local investment companies to access lines of credit and on-lend to SMEs in the short-term, there is demand for additional debt instruments

It will be **important to maintain a balance in adapting to SME needs** as there is potential for the core mission to sway from addressing the most important needs of the market.

After 7 years of operation, Teranga Capital is looking to increase its capital from €6M to €10M. Based on learnings, the team is targeting a larger fund with an expanded ticket size range (€500k-1.5M, with an average ticket size of €800K) to **create flexibility for follow-on investments in the most promising companies**. This aligns with the growing trend of companies requiring capital beyond IPDEV2 fund's typical ticket size below €500K

Optimising IPDEV2's support across stages

As the programme evolves and local funds mature, IPDEV2 must adapt its support to their needs

Challenges

At the local fund level:

- As **investment companies mature**, the Fund CEOs and investment teams **require less investment and operational support.**
- However, **without IPDEV2**, 50% of the investment teams surveyed would **not be confident in the financial viability of their funds**.

At the SME level:

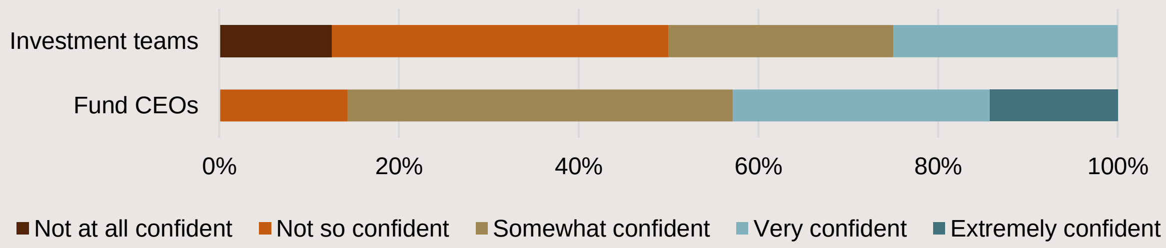
- SMEs still need **support** accessing affordable working capital, and **with internal fiscal and treasury management**
- Relationships between SMEs and local funds have had difficulties
  - Sometimes, partner funds **lacked expertise in the SMEs' sectors**, leading to varied quality and consistency of support across funds
  - SMEs felt **decision-making processes were slow**, disbursements were delayed, and reporting was time-consuming (especially after formalisation)
  - During challenging periods, **communication suffered**, fund partners could become discouraging, and SMEs could become unresponsive.

IPDEV2 Approach & Learnings

IPDEV2 must learn to finetune how it supports its local funds and SMEs:

- **Presence of IPDEV2 instils confidence** for the market, fund staff and investors.
- Practices around knowledge management, CRM, reporting, and pipeline development still **lack standardisation**, slowing the operational efficiency and performance of the funds. IPDEV2 can play a harmonising role across its funds, **leveraging its insight into each local investment company to promote standardisation**
- There is scope and demand from SMEs to involve other ecosystem actors and **increase collaboration at the local level**
- Grant-funded technical assistance would **enhance local investment and management companies' capacity to broaden their scopes** and address a wider range of SME needs.

Investment teams and Fund CEOs' perceptions of financial sustainability of the investment company without the support of IPDEV2



4. Moving forward:

Reflections and recommendations

As IPDEV2 progresses into its next phase, focusing on improving fund economics and liquidity options for investors would balance its commercial viability and impact in building the SME equity investment market

1 Fund Economics

IPDEV2 must balance demonstrating commercial viability with continuing to provide the support that makes it so deeply impactful in building the market for SME investment:

- **Use of grants to further impact and catalyse commercial investment**
  - Grants for fund set-up and operational support directly mobilise local commercial capital into the IPDEV2 investment companies, SMEs, and other investment opportunities in the region
  - I&P must strengthen its fundraising messaging to highlight to impact investors that their support is essential to achieving systems transformation goals regionally and globally.
- **Efficiencies in service delivery to reduce cost**: Capturing lessons learned from existing funds in processes, templates, and hands-on assistance can ensure smoother launches of future funds and reduce operational and TA costs
- **Speed of deployment to increase**: As the market matures and teams gain more experience, future funds will likely have fewer launch challenges and larger pipelines of investment-ready SMEs
- **Economies of scale**: Given the model's efficacy at its current scale, IPDEV2 may look to expand its reach and capacity with larger AUM, which would allow to increase management fees, operational budgets, and allow for follow-on investments.

2 Liquidity Options for Investors

While findings showed that the evergreen structure is beneficial for meeting the needs of SMEs in the region, fundraising and liquidity challenges must be addressed to attract a wider range of investors. Several options may be considered:

- **Alternative instruments**: Utilise alternative instruments at the local fund level such as debt or quasi-equity with structured exits (i.e. revenue share) that create cash flow, partial return of capital to the fund earlier, and partial exits or dividends to investors
- **Stronger incentivisation**: Financial incentives for fund CEOs who can secure earlier exits or secondary sale options; these could be piloted by the more mature funds in the portfolio
- **Secondary transactions**: As IPDEV2 matures and fund performance stabilises, secondary transactions can allow investors seeking liquidity to exit; isolating more mature existing investments in new vehicles to offer liquidity opportunities to near term-minded investors could also be explored
- **Follow-on funds**: Raising follow on funds can provide liquidity for existing LPs as IPDEV2 becomes more attractive to investors given its track record and reputation, compared to when it first launched.

Adapting its investment and support offerings as the local funds and markets gain maturity would ensure that IPDEV2 continues to serve its investee needs; while developing junior talent, leveraging existing networks and considering increased localisation may ease human capital constraints over time

3 Adapting to changing SME needs

While IPDEV2 must continue filling the financing gap for SMEs for early stage equity financing, there is a growing need to provide additional options as some of the companies and markets become more mature:

- **Working capital loans**: Providing flexible short-term loans can be complementary to the equity investment, allowing SMEs to use equity to invest in sales growth (staff, marketing, products) rather than financing working capital needs, which is expected to improve financial performance. This would enable SMEs to build credit history, build business traction to access local capital more effectively, and support IPDEV2's liquidity reserves via repayments
- **Larger tickets and follow-on investment**: Surveys, interviews and market data indicate strong demand for follow on-capital to support investee growth and larger initial investments for the rightly priced opportunities. Availability of such capital will depend on IPDEV2s fundraising success or increasing its AUM to allow for a risk appropriate allocation for follow-on investments and some larger deals.
- **Tailored TA support**: As investees mature, more customised support is needed particularly in growth strategy, new market entry, governance and management, capitalisation strategy, and access to new rounds of financing. Building a network of experts or service providers, and strengthening SME leaders' regional networks would also help address these needs.

4 Building human capital

Given difficulties in recruiting and retaining investment professionals with limited fund budgets, several options can be explored:

- **Investing in junior talent**: Build a recognised fellowship or graduate programme to source and strengthen local talent early in their career. Part of the funding could also be allocated for the remuneration of in-country staff supporting the training efforts; this would also help improve the economic model of the funds
- **Localisation**: Basing staff at the IPDEV2 level in Africa to improve the support they provide, contribute to the local impact story, improve third-party perception in the initiative, and align with market trends of fund managers becoming more localised
- **Leverage existing networks**: There is an opportunity for IPDEV2 to better plug into similar initiatives to source and develop local talent (i.e.: Women in Africa initiative).

I&P has an important role to play not only in knowledge sharing across the fund levels, but also in active ecosystem building – disseminating best practices, advocating for regulatory improvements and educating on impact potential of its programmes

5 I&P's ongoing role in IPDEV2

I&P's international operations and networks give IPDEV2 a unique vantage point compared to its investment companies, who operate at a local level:

- **Best practises**: IPDEV2 should play a role in transferring international best practises and standards down to the local investment company level (i.e.: translating IFC Performance Standards and incorporating them into guides for SMEs)
- **Knowledge sharing**: IPDEV2 can support knowledge-sharing across investment companies by continuing its work on knowledge management tools, which themselves can help scale this function
- **Enhanced centralisation**: There is scope to better coordinate support of processes, automation, and reporting, as standardising these will help scale up IPDEV2's work over time.

6 Improving advocacy and ecosystem building

As a pioneer in locally-rooted SME investing, IPDEV2 plays an important role in advocating for a conducive ecosystem to advance similar activities, and should take a proactive and systemic approach by:

- **Increasing awareness** about equity funding and **disseminating best practises** around meeting objectives in the key impact areas of 1) Job Formalisation, 2) Gender Equity, 3) Environment, and 4) Governance
- Helping to **build the regulatory ecosystem** for local domiciliation of funds in African countries
- **Educating impact investors on importance of job creation and formalisation** in the target markets to strengthen the impact and business case for a greater range of investors.
- **Expand impact goals and indicators** to align with emerging regional priorities and impact interest areas of investors, including a focus on **climate resilience or adaptation** by the SMEs, and potentially an even greater **emphasis on gender-equity**.

5. Sources

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