How can African SME funds mobilise more capital?

Data and lessons from pioneering LPs and GPs

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INVESTISSEURS & PARTENAIRES

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Foreword

NICHOLAS COLLOFF, ARGIDIUS FOUNDATION

The fabled ‘’missing middle” was so characterized to entice people with an opportunity, as this report makes clear, decades after its coinage, it can often feel like a ‘’void”, something that is actually, simply missing.

So, it needs a re-brand, maybe as the “transforming middle” because as this excellent report also makes clear a growing number of SME funds are successfully entering this space, finding growing SMEs to successfully invest in, and slowly helping transform their local economies and communities. As we know from our own work on the business support side of our engagement, there is no shortage of demand for finance from SMEs with real potential for growth.

Slowly though, because as this report highlights, they still face strong headwinds. These headwinds are both internal to the funds themselves, their own capacity constraints and developing experience; and, external embedded in the regulatory, financing landscapes they must navigate. But every challenge, as this report demonstrates, is being met somewhere by a corresponding successful response.

The *Economist* recently reported that if Africa was to win more investment, it needed better and more reliable data, and this report is a valuable contribution to this need. Data that is not only quantitative, on fund performance, for example, but qualitative as what are the characteristics that are needed to build a flourishing SME financing ecosystem from the perspective of SME Funds.

The Argidius Foundation is delighted to have helped bring this report to market, and look forward to utilizing it widely in our own efforts to help advocate for a transformed middle of flourishing SMEs linked to appropriate financing in a successful investment landscape fuelled in part by profitable SME Funds.

Foreword

SÉBASTIEN BOYÉ AND JÉRÉMY HAJDENBERG
MANAGING PARTNERS, I&P

Over the past two decades, the cause of African small and medium-sized enterprises (SMEs) has witnessed remarkable progress in international and national policy discourses as well as in investments made. Development aid and private sector investors have developed mandates to support entrepreneurship and build a growing track record in supporting SMEs, fostering a greater understanding of their importance to job creation and innovation on the continent.

Yet the lack of access to finance continues to be the foremost concern expressed by entrepreneurs. It not only hampers their growth potential but stifles the broader economic development of the continent. The current and potential impacts of African SMEs are still only partially identified and measured, and lessons of successes and failures insufficiently shared. The SME funds operating on the continent are not immune to these challenges, as they often face the same problems as the entrepreneurs they wish to finance. Though they are the essential link in the chain, they struggle to raise capital in a complex landscape.

In many regards, I&P's journey is a small-scale reproduction of the SME funding industry's evolutions. We began as first-time fund managers, grappling with the challenges of raising capital in a nascent landscape fraught with obstacles. Our first pilot fundraise in 2002 taught us early that networks and 'skin in the game' are gamechangers.

As I&P grew into a more experienced fund manager, we encountered firsthand the complexities that many navigate today: the challenge of balancing the fund model whilst targeting impact and additionality, as well as the hazards of attracting and retaining talent, managing a portfolio of SMEs, and exiting them in environments where SME investing does not always benefit from favourable regulatory environments. We have had our share of both successful and failed investments and have seen our peers face the same problems, being forced to increase their ticket sizes more often than not.

To grow our impact, we leveraged this experience to assist new fund managers in designing, fundraising, and managing their first funds. This path led us to create the first sponsor fund of its kind, IPDEV, in 2015, and then to become fund-of-funds' advisors and managers, evolving in the realm of donor-funded initiatives to foster investments. Progressively learning about the 'other side' of the negotiations, we became a limited partner (LP) as well and witnessed the emergence of a new generation of African first-time and emerging fund managers who are revolutionizing the sector with innovative strategies and, at times, ingeniously circumventing systemic obstacles.

Along the way, I&P was fortunate enough to meet equally committed funders, without whom many initiatives would have never emerged. In particular, we can't thank the Argidius Foundation enough for having played a decisive role in the launch of the IPDEV sponsor fund. After years of supporting catalytic initiatives, the Argidius Foundation called on the SME investment sector in 2023 to embark on a collective learning agenda and build a unified voice to amplify the cause of SMEs through data-based and scalable examples. We have responded to this call with joy and conviction, fully aware that our positioning at the crossroads between LPs and GPs allows us to advocate from a place of experience. This commitment will be reflected in a number of publications on SMEs and SME funds in 2025 and 2026, with the goal of providing data for first-time LPs.

The SME investment asset class cruelly lacks data and lags behind other asset classes: venture capital (VC), although it is a newer asset class, has worked and collaborated from early on to build a good foundation of data. Building on other catalytic initiatives such as the Collaborative for Frontier Finance (CFF), our first publication assesses the fundraising landscape for SME funds, providing up-to-date data and key lessons from LPs and GPs on how to design and raise SME funds. This is one step towards a hopefully growing body of data aggregated by the sector over time. We hope it will offer useful benchmarking information for GPs who fundraise; we also hope it will increase LPs' exposure to the realities SME fund managers face and the solutions they are implementing. We trust that this advocacy will transform evidence and case studies into impactful policies and new investment mandates, ensuring more much-needed capital can be catalysed for SMEs across Africa.

Content

EXECUTIVE SUMMARY

How can African SME funds mobilise more capital? Data and lessons from pioneering LPs and GPs

Enriching current research with aggregated fund economics data and highlighting key lessons from GPs and LPs.

Despite its potential to deliver on the Sustainable Development Goals, particularly those targeting ‘No poverty’ (SDG 1), ‘Decent work and economic growth’ (SDG 8) and ‘Industry, innovation, and infrastructure’ (SDG 9), SME investing remains an overlooked segment of the private capital landscape in Africa. Decades after the term was coined, there is still a ‘missing middle’ in private capital finance on the continent and an unmet funding need estimated at a staggering $140bn*.

This report contributes to the learning agenda on improving access to finance for African SMEs, by highlighting solutions for SME funds to mobilise more capital. Pioneering practitioners and industry organisations, such as African Venture Capital Association (AVCA), Collaborative for Frontier Finance (CFF), Convergence, Dalberg, Dutch Good Growth Fund (DGGF), and Omidyar Network, among others, have done considerable work to segment SMEs and the funds that invest in them, document the challenges they face, and highlight the case for a more robust funding ecosystem.

However, there is still very limited aggregated and publicly available data when it comes to the fundraising performance and financial returns of African SME funds. This report documents the economics of SME funds; it provides data, often challenging existing preconceptions, to help ground current debates in the sector and generate new insights on the drivers of performance.

This report is only one step, and its conclusions need to be challenged and refined with an expanded sample of data, and in response to more direct input from GPs and LPs. We call for feedback on this first version from all players in the sector and envision a collaborative process leading to a subsequent report with more insight and data and with strengthened conclusions and recommendations.

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* Convergences. 2024. R. Ivory., E. Pullela. How can blended finance help improve African SME’s access to finance? [Consulted online]

Key findings

The past decade has seen the emergence of a growing and denser SME fund ecosystem.

The SME fund ecosystem has become geographically more diverse, now spans across asset classes, and above all is attracting more talent exponentially. In stark contrast to 15 years ago, it has become an African-led ecosystem: the vast majority of fund managers are now based in Africa, 80% are led by African GPs (66%) or mixed African-foreign GPs (13%), and 69% have raised capital from African public and private investors. This includes not only established SME funds (pioneers 15 to 20 years ago) who are mobilising more capital and diversifying their instruments for SMEs but also many first-time and emerging fund managers who are entering the space. The diversification of LPs has supported this growth with African sovereign and private capital, private foundations, international family offices, and other catalytic funders complementing the pioneering role of DFIs.

This SME fund ecosystem growth remains tenuous in relation to the needs of SMEs and their role in the development trajectory of the continent.

The unmet funding need for African SMEs remains estimated at $140bn*. SMEs are the fastest providers of decent formal jobs, and they drive value-adding economic growth and innovation. Most are neglected by the traditional financial sector, as they typically have little collateral, and innovative business models. SME funds can provide risk capital to these companies in the form of equity, quasi-equity, mezzanine, or straight debt, alongside management support and technical assistance; this support can unlock SME potential for developmental outcomes and financial returns.

Starting and running a SME fund is a journey plagued with challenges.

SME funds are most often pioneers in their market, operating with considerable additionality and being the first investors in the companies they target. They support SMEs with investment readiness (p.114), build investment talent from the ground up (p.132), and play a key advocacy role to attract African capital (p.114) and support enabling regulatory environments (p.127). In this context, they face numerous trade-offs.

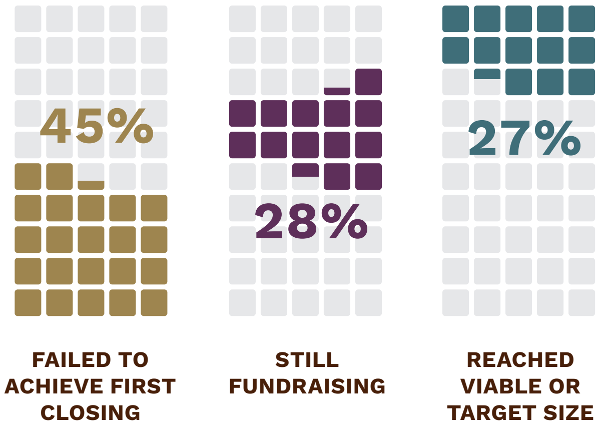
> It is structurally difficult for SME fund managers to deliver market-rate returns to LPs due to high relative transaction costs, lower liquidity, and exposure to country or macroeconomic risk (p.109). They must vastly outperform larger funds in terms of gross returns in order to deliver the same net returns. Most SME funds have historically delivered below-market returns for LPs (to Omidyar data) with challenging liquidity (link).

> It is structurally difficult for SME fund managers to sustain their own economics and retain a team. The very tight model of running a SME fund has forced most of the pioneering SME fund managers to abandon investment in SMEs as they increase their ticket size and fund size, with only a minority remaining focused on this space (p114). Today, most SME funds are led by first-time and emerging fund managers raising small fund sizes and struggling to attract and retain talent (p.20).

> Emerging fund managers face very challenging fundraising odds. Indeed, 45% fail to achieve first close, and those who do achieve it take two years on average and then additional time to reach their final target fund size.

GLOBAL SAMPLE

FIRST-TIME AND EMERGIGNG FUND MANAGERS



Historically, most LPs in the sector have built criteria that focus on reducing risk and end up excluding most emerging fund managers (p.38): these LPs typically do not back small fund sizes, first-time and emerging fund managers with non-traditional track records, solo GPs, country-specific funds, etc. These restrictions make it very difficult for first-time and emerging fund managers, where female and African fund managers are most highly represented, to raise capital from international investors.

SME fund managers are implementing solutions to these challenges.

> Their fund returns are improving: SME funds launched since 2015 have been delivering higher average gross returns than the previous generation of funds (p.109) thanks to a combination of an improving environment, strong market positioning, fast organic growth, and deep management support. These gross returns translate to positive net returns reached earlier than by the previous generation of funds (p.114).

SME funds from the sample (early-stage growth and debt SME funds)

22 funds in the sample
Average age of 7.5 years

MOIC	1.55x
TVPI	1.15x

Within our sample of SME funds, first-time and emerging fund managers with non-traditional backgrounds are performing very well (p.38), as are solo GPs (p.38). They are challenging conventional LP criteria and suggesting that a traditional track record is not a reliable proxy for fund performance.

	AVERAGE MOIC
Fund managers with non-traditional background* Average age of the funds: 6-7 years	1.58x
Fund managers with traditional background* Average age of the funds: 7-8 years	1.21x
Solo GPs* Average age of the funds: 6.1 years	1.88x
Two GPs* Average age of the funds: 8.1 years	1.12x

* All types of funds (early debt, early SME, and growth SME funds)

> They better match liquidity with investor constraints by incorporating self-liquidating instruments in their strategy and by designing innovative fund structures such as longer-term closed-ended funds, permanent capital vehicles, and hybrid funds (p.99). They tailor their fund structure, currency, and country risk management to their fundraising strategy and investor base (p.88), including by domiciling their funds in new locations. Such strategies create a diverse panorama of fund structures with real success in raising capital.

> They design more robust fund management companies by challenging traditional fund terms on management fee and hurdle rates (p.109), building alternative models for investment readiness and portfolio support, reaching economies of scale via horizontal growth (p.116), and finding pragmatic ways to retain key talent (p.131).

In a difficult fundraising landscape, SME fund managers leverage new opportunities to mobilise more capital.

> Emerging fund managers triple the odds of achieving their target fund size by raising progressively or partnering with sponsors and platforms. Raising progressively (p.88) implies setting up pilot funds, mobilising personal, angel, and warehousing capital to build track record, and leveraging catalytic and philanthropic initiatives to design a fund and build a team.

	FAILED TO ACHIEVE FIRST CLOSING	STILL FUNDRAISING	REACHED VIABLE OR TARGET SIZE
EMERGING FUND MANAGERS WHO STARTED SMALL WITH A FUND SIZE < $5M	13%	35%	52%
EMERGING FUND MANAGERS WHO STARTED WITH A TARGET FUND SIZE > $5M	60%	24%	17%

Partnering with fund platforms and sponsors (p.88) accelerates the fundraise and triples the odds of reaching the target size.

	FAILED TO ACHIEVE FIRST CLOSING	STILL FUNDRAISING	REACHED VIABLE OR TARGET SIZE
EMERGING FUND MANAGERS **BACKED** BY A SPONSOR	22%	17%	61%
EMERGING FUND MANAGERS **NOT BACKED** BY A SPONSOR	50%	30%	20%

> They focus their fundraising efforts on specific pools of capital.

- Impact funding windows from international DFIs (p.55) have anchored several emerging managers; their investment criteria (fund size, terms, etc.) focus them on growth SME funds and VC funds.
- In order to reach first close, SME fund managers raise private capital from African corporates (p.60) and individual investors (p.60).
- African sovereign investors have grown to become a critical element of the funding space, with the example of VCTF in Ghana leading the way (p.67) and a multiplication of sovereign funds, public pension funds, and domestic and regional DFIs allocating capital to SME funds.
- Pan-African funds-of-funds (p.73) with a catalytic and/or impact mandate have become critical enablers of emerging fund managers, especially early-stage SME funds and SME debt funds, by playing an essential anchoring role and providing fundraising and fund design support. Some have also provided catalytic capital in the form of working capital, warehousing capital, and junior tranches.

There is **much more research to be done on the performance of African SME investing**, which can be achieved thanks to stronger collaboration in the sector, including:

- Expanding the understanding of African SME fund returns by including more funds and more asset classes and geographies.
- Exploring the trade-offs between impact performance and additionality on the one hand, and the profitability of SME fund models on the other by cross-analysing impact and returns data.
- Assessing how catalytic capital instruments influence fundraising performance and fund returns, as well as the additionality and impact of investment strategies, to determine how they can support the growth of the sector.
- Exploring the opportunities and constraints for African private and sovereign capital to unlock more allocation to the SME investing sector.
- Researching the mainstreaming of gender-lens investing within SME funds, including gender-diversity in fund management companies, representation of women in SME portfolios as owners, managers and employees, and adoption of gender-inclusive best practices in SMEs.

Key recommendations

Combining the lessons learned by practitioners in the space with recent data has helped identify the recommendations below for LPs, GPs, and ecosystem funders ("E").

PART 1

TREND #1: A multiplication and diversification of Africa-based funds over the past 30 years

The three segments of early-stage SME funds, growth SME funds, and SME debt funds remain under-researched; more data and sharing of lessons will build understanding of these segments for LPs and new GPs.

1. A data-sharing initiative will improve LPs' knowledge of fund performance in the sector and support new GPs in designing their fund; this requires collaboration. E
2. New LPs can be attracted to the asset class by receiveing more aggregated data and lessons on fund performance and fund models. LP
3. A particular research focus on funding models for early-stage SMEs is necessary to highlight how catalytic capital can solve some of the particular constraints faced in this segment. E

TREND #2: Raising a SME fund remains very challenging, especially for newcomers in the space

LPs can adjust their assessment criteria in order to back strong performing teams, including first-time and emerging fund managers with non-traditional backgrounds.

1. Assessing a first-time and emerging fund manager requires a more granular approach than looking at track record. LP
2. LPs can back lean teams, including solo GPs, to benefit from their advantages while mitigating some of the risks. LP
3. Creating equitable opportunities for women can take multiple approaches. E
4. There is a need for a flexible approach with respect to a GP's skin in the game. LP

TREND #3: International DFIs are still the leading players in SME fund investment – today, they invest mainly in larger funds

DFIs can continue building the market of African funds by complementing their existing range of instruments.

1. Increasing investments in SME funds and adapting terms is key. LP
2. Collaborating more closely with non-DFI investors could increase DFI allocation to SME funds. LP
3. Data shows that African private capital is more likely to invest in African SME funds than international commercial capital to; DFIs can find solutions to promote this trend. LP
4. DFIs can invest in funds-of-funds to target the smaller fund sizes that they are not able to fund directly, particularly SME debt funds and early-stage SME funds. LP

TREND #4: African private and sovereign capital is increasing its allocation to the sector, but there is still significant room to grow

Unlocking the pools of domestic capital will build a more resilient fundraising environment.

1. Engaging African/domestic capital in fundraising is a strategic priority for GPs. GP
2. Investing in African funds can be attractive for domestic investors. LP
3. Catalytic funders will be essential to unlock these domestic pools of capital. E

TREND #5: New catalytic capital funders have been decisive in building the market, but there is much more to be done

Increasing the amount of catalytic capital will speed up the mobilisation of capital for African SME funds.

1. A range of catalytic tools are key to empower a new generation of fund managers: working capital, warehousing capital, junior tranches, direct opex support. E
2. Funds-of-funds can scale with the right support. E

PART 2

TREND #1: Emerging fund managers are adapting their fundraising strategy to navigate LP dynamics

Successful emerging fund managers have taken a progressive road to fundraising; an enabling environment is needed to facilitate the launch of new funds.

1. In the absence of a strong enabling environment, emerging fund managers should plan for a 2 to 4-year step-by-step fundraising sequence. GP

2. There is a strong opportunity for new GPs to partner with other GPs or sponsors/ platforms and improve their odds on the fundraising market. GP

3. Catalytic funders can facilitate the emergence of new SME funds by filling the most glaring gaps: availability of launch working capital, warehousing capital, anchor investment, and junior tranches. E

TREND #2: Better matching the liquidity profile of SME funds with the horizon of SME investments

Fund structures can better match SME investment horizon constraints with LP liquidity objectives.

1. Raising open-ended hybrid funds or permanent capital vehicles can be the right option for raising a new SME fund. GP

2. Adapting the liquidity requirements to the longer cycle of SME investing can improve fund returns while mitigating liquidity risk. LP

3. Developing a secondary liquidity market for fund investments is an important next step for the ecosystem. E

TREND #3: The return profile of SME funds is showing improvement

Recent data provides novel insights into SME fund performance.

1. Acknowledging the structural challenges of SME investing is a first step towards finding solutions to improve the returns of GPs and LPs. E

2. Available data shows how certain LP perceptions (track record, first time manager risk, etc.) are not in line with the reality of returns achieved. LP

3. SME investing is an impact choice; GPs must demonstrate how their approach and background enables them to overcome important structural challenges to provide returns; they can pursue alternative ways to grow as fund managers, in order to avoid creeping up and neglecting SMEs. GP

TREND #4: Options for fund domiciliation are multiplying but many markets are yet to design enabling environments

Enabling environments are necessary to promote the growth of private equity and SME investment in key African markets.

1. GPs can adapt the domiciliation of their fund to their fundraising strategy, with an increasing number of options at their disposal. GP

2. Advocacy from SME investors and LPs is necessary to promote enabling tax and regulatory environments across African markets and to develop domestic private equity markets. E

TREND #5: Currency and political risk cannot be overlooked by GPs

Fund managers manage currency and country risks; ecosystem initiatives can help mitigate exogenous shocks.

1. Expanding access to and subsidizing currency hedging for SME fund managers will increase local currency financing. E

2. Providing risk-sharing mechanisms for country and political risk will enable international investors to commit to emerging funds. E

TREND #6: Building and retaining talent against all odds is key

Moving towards a new generation of African fund managers and investment teams.

1. Adequate support for new fund managers helps navigate the challenges of fund design and should be combined with working/warehousing capital. E

2. Training investment teams and not only fund managers will grow the talent pool for SME funds. E

INTRODUCTION

The continent needs more SME investment, but the lack of data is an obstacle to mobilising capital.

The context: African private capital in shifting sands

Africa's economic growth between the 1990s and 2010s built positive momentum for the rise of its private capital markets. This period was marked by optimism on the part of global investors, who viewed the continent as a future economic powerhouse, often comparing it to the 'next China' due to its rapid population growth, expected economic acceleration, and wealth of natural resources. During these twenty years, Africa attracted private and public investors for its immense growth potential, as reflected in key publications, from 1998 TIME magazine's 'Africa is Rising' cover to the McKinsey Global Industry's 2010 'Lions on the move' report. The first billion-dollar fund raised in 2013 was seen as a positive signal for the industry.

Many countries have continued to perform well. Some are still among the fastest growing economies in the world. However, the global economic landscape has undergone significant shifts in recent years, marked by a series of shocks (COVID, Russia-Ukraine war, world inflation…) that have severely impacted the African continent, given the macroeconomic fragility of many African markets. The considerable foreign financing that had supported Africa's growth since the early 2000s and which peaked at around $1 trillion in 2016-17, has since declined to an estimated $400 billion. This decline raises concerns, in a context of ever-growing needs for capital and public debt crises accumulating in many key markets. The evolution of Chinese investments is a case in point: China has long been the largest bilateral lender to Africa, having contributed a net $786 billion in debt over the past two decades—amounting to about 13% of Africa's total debt. This influx of funding, averaging approximately $40 billion annually, represented about 2% of sub-Saharan Africa's GDP. A shift is currently happening, with China announcing at the 2024 Forum on China–Africa Cooperation (FOCAC) that it is scaling back funding to around $15 billion a year. The current trajectory suggests that without strategic intervention, the continent could face negative net capital flows from China, compounding existing deficits and exacerbating balance of payments issues. The continent's ability to sustain its growth trajectory depends on increasing investment rates and fostering stability in regions afflicted by conflict or macroeconomic uncertainty.

SME funds face an unfavourable fundraising environment.

The SME investment industry is inevitably swayed by these macroeconomic shifts. Whilst capital inflows and heightened interest from international investors along with promising reforms of regulatory frameworks enabled the rise of SME fund pioneers backed by development finance institutions (DFIs) twenty years ago, the current situation is much more contrasted.

Today, many aspiring African fund managers seek to get started and face a limited supply of Limited Partners (LP) capital, strong regional disparities, and a host of challenges stemming from the shocks of the COVID-19 pandemic, currency volatility, and political unrest. Whilst their potential to be catalysts for innovation and job-intensive growth is proven, their success rate in raising funds remains unfortunately low.

The data gathered by I&P (see research methodology, p.14) shows that in the last eight years, out of a sample of 135 SME fund managers, 38% have achieved a viable fund size, 25% are still fundraising, and 37% have failed to fundraise. The figures are much bleaker for first-time and emerging fund managers: 27% have achieved a viable fund size, 28% are still fundraising, and 45% have failed their fundraise. It is worth noting that these figures incorporate a survivor bias, where the fund managers who have tried and given up are not all known, meaning that the true fundraising success rate is probably lower.

This low success rate stems from a mismatch between the demand and supply of LP capital, both in quantity (volume of capital) and quality (horizon, risk aversion, etc.). Those who succeed in raising capital take an average of 25 months for early-stage SME funds and 16.5 months for SME growth funds to reach their first close and longer to reach a final close and viable size. This timeline is even longer for first-time fund managers, who face high barriers to entry into this industry.

This report is a step towards improving data for SME fund managers and their investors; it must now be enriched by more information.

The report does not cover the considerable research already led on how SMEs promote inclusive growth and job-creation. Plenty of key materials have been written by I&P and many other sources on this topic[1], including from I&P and many other sources, and the consensus is that investing in SMEs is key to bridge the rising employment gap in Africa's growth trajectory.

Compared to the venture capital asset class, current data on SME investing remains rare and fragmented, especially for the SME funds investing

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[1] AGRA. 2018. Independent Review of the African Seed Investment Fund (ASIF)
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ticket sizes below $5m. Whilst VC is inherently data-driven and collaborative, SME investing has been built around deal exclusivity and confidentiality.

Despite the need for new General Partners (GPs) and LPs to access relevant market information and learnings, **there is a glaring gap in available aggregated data on SME fund returns and on the relative success of various SME fund models and fundraising strategies**. This report provides a first step in providing such data, building on the existing segmentation and focusing on SME funds targeting the lower segment of the 'missing middle', that is, funds making investments under $5m. Our goal has been to focus on depth of information, often at the expense of breadth.

The aggregated data and learnings in this report generate a first set of conclusions on the financial performance and current fundraising landscape for African SME funds, analysing key dynamics between LPs and GPs and highlighting both the challenges encountered and solutions implemented by LPs and GPs to overcome these challenges.

This is only a first step, based on a partial sample that must be expanded in terms of geography (North Africa and South Africa are not well represented in our sample) and number of funds. We call on GPs, LPs, and ecosystem organisations in the sector to contribute to this effort by highlighting gaps in this publication, **with the objective to achieve a more ambitious and participative version of this report next year.**

Finally, the report aims to contribute to the aggregation of data in this field by offering an in-depth analysis of a carefully selected sample, as outlined in the research methodology. This analysis will help deepen understanding of the challenges faced by SME funds, ultimately supporting efforts to unlock capital for this crucial segment. I&P will seek to **collaborate with other funders and ecosystem organisations in a data-sharing effort that augment existing samples and target exhaustivity** whilst enforcing strict confidentiality of individual fund-level data.

Research methodology

In comparison to its peers in banking and microfinance, there is very little research focused on the key provider of risk capital for SMEs: SME funds.

A segmentation of SME funds based on both instruments and ticket size.

Key industry organisations[2] have led the necessary effort of segmenting the market and differentiating different types of SME funds that encounter specific structural challenges and providing important information on these fund managers. The report ***The Missing Middles: Segmenting Enterprises to Better Understand Their Financial Needs***[3] by Omidyar Network clarifies the various categories of 'missing middles' associated with different types of SMEs. Through segmentation criteria[4] such as growth and scale potential, product profile, and entrepreneur attitude, these categories divide SMEs into groups that face similar financing needs.

SME funds across the continent have developed

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2. AVCA, CFF, Omidyar, etc.
3. K. Hornbergen, V. Chau. "The Missing Middles. Segmenting Enterprises to better understand their financial needs". Summary Report. Omidyar Network. Ministry of Foreign Affairs of the Netherlands. Collaborative for Frontier Finance.
4. K. Hornbergen, V. Chau. "The Missing Middles. Segmenting Enterprises to better understand their financial needs". Summary Report. Omidyar Network. Ministry of Foreign Affairs of the Netherlands. Collaborative for Frontier Finance.
5. Shell Foundation. Omidyar Network. Deloitte. 2019. Insights on SME fund performance. Generating learnings with the potential to catalyse interest and action in SME investing.

diverse strategies to address the specific financial requirements of these different missing middles. These differentiated strategies lead to distinct ticket sizes tailored to each category's precise financing needs. These varying ticket sizes, in turn, influence the key factors of fund size, transaction cost, fund models, organisational structures, and in the end, the fundraising strategy they pursue to attract certain types of LPs.

In keeping with the important groundwork already laid out on the segmentation of SME and VC funds[5], we will present the different fund categories, as shown in the diagram that follows.

Early stage, small and growing businesses

Fund size <$20m

Early-stage SME funds

- **Domiciliation** In-country or Mauritius
- **Structure** All types, including many open-ended/PCVs
- **Potential LPs** HNWIs, domestic capital, funds-of-funds
- **Strategy** Strong impact and additionality; high gross returns compensating high relative transaction costs

Investment ticket size generally $100k to $1m

Medium-sized growth-oriented SMEs

Fund size $20m to $100m

Growth SME funds

- **Domiciliation** Primarily in Mauritius
- **Structure** Closed-ended structures
- **Potential LPs** DFIs (impact windows), foundations, family offices
- **Strategy** Seeking risk-adjusted market rate returns (in line with PE benchmarks or below for some impact strategies)

Investment ticket size generally $1m to $5m

Wide array of SMEs from early to growth stage

Fund size $10m to $80m

SME debt funds

- **Domiciliation** Varied
- **Structure** All types, including many open-ended/PCVs
- **Potential LPs** DFIs (impact windows), foundations, family offices
- **Strategy** Strong impact and reach, moderate returns

Investment ticket size generally $100k to $5m

Later stage growth-oriented companies (typically larger than most SMEs)

Fund size >$100m

Large equity funds

- **Domiciliation** Mauritius, Europe
- **Structure** Closed-ended structures
- **Potential LPs** DFIs (commercial windows), international corporates
- **Strategy** Seeking risk-adjusted market rate returns (in line with PE benchmarks)

Investment ticket size generally >$10m+

Early-stage, high growth tech-enabled ventures

Fund size $20m to $100m

VC funds

- **Domiciliation** Delaware, Mauritius mainly
- **Structure** Closed-ended structures
- **Potential LPs** HNWIs, DFIs, Funds-of-Funds
- **Strategy** Seeking returns in line with global VC benchmarks

Investment ticket size seed to Series A, $200k to $5m

The present report will focus on three segments: early-stage SME funds, growth SME funds, and debt funds.

The **large equity funds** are the legacy players of the private equity landscape in Africa: ACA, Verod, Amethis Finance, AfricInvest, Adenia Partners, DPI, etc. They have now built established teams and are on their way to raising their third or additional funds in a territory mainly funded by DFIs and international capital. Most had initial positioning in the Growth SME funds segment but gradually increased their ticket size (generally above $10m) to improve returns. We do not address large funds in this study, as they have radically different challenges than SME funds and are better covered by industry publications.

Furthermore, AVCA described very precisely the newfound attractiveness of **VC funds** in their 2023

Africa Report[6] and show how they are positioned to assume an ever-increasing proportion of private capital deal activity. Although the attractiveness of the VC[7] is well established, and although many SME funds incorporate some investments in tech-enabled companies into their strategy, the present report does not focus on this category, which is already well-documented and whose fund models and investment strategies are very different than SME funds.

In our study, we also segment the **different types of fund managers**, as they face distinct challenges and obstacles in their fundraising journeys. Here, we identify two categories of fund managers:

> **First-time and emerging fund managers** are defined as those raising either their first or second fund, without any prior experience in raising other funds.

> **Experienced fund managers** are those who have previously raised two or more funds and are now raising an additional fund.

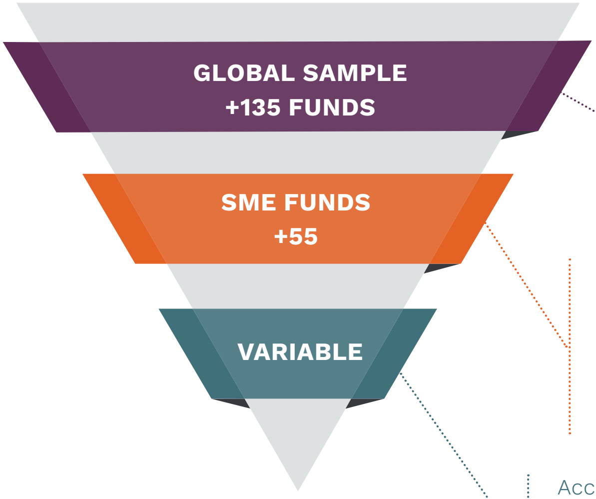
Sampling and data analysis.

This report uses three data sources to collect accurate information on SME funds, and to reflect with acuity the outlooks and challenges of both GPs and LPs.

a. First, we relied on an **in-depth analysis of I&P's track record** and conducted a literature review, that included ecosystem publications as well as former I&P publications.[8]

b. Next, we conducted **interviews and surveys with key LPs, GPs, and ecosystem players** representative of the SME investing landscape (37 interviews and survey responses targeting respondents with fund sizes ranging from <$10m to $120m operating in various regions on the continent).

c. Last, we analysed a **135-strong sample of African funds**, including some that have successfully raised capital and others that have never achieved first close. Reducing the scope to funds focused exclusively on SME financing throughout the report, this large sample was narrowed down to a **sub-sample of 55 SME funds for which more detailed data is available**, including data on fund manager profile (*track record, gender, GP composition, etc.*), fund terms (*size, domiciliation, structure, etc.*), and performance *(financial returns, fundraising composition, etc.).*



The global sample was used mainly to analyse basic information on fund managers having raised or achieved closing (breakdown of men / women, breakdown of experienced / emerging fund managers / breakdown of sponsored funds / non-sponsored funds, fundraising approaches…) with data available online. We included in this sample all asset classes having SME or impact exposure (VC, debt, growth SME, early SME funds) to gain a broad overview on the trends of funds and fund managers on the continent.

We classified 55 representative funds from this sample (here focusing only on growth SME (30%), early SME (44%) and SME debt (26%) funds. We gathered fund terms for this sample (fund size, fund structure, domiciliation, fees, currency raised, former backgrounds of fund managers, etc.). We gathered detailed financial results data and LP composition for 22 of these funds for an in-depth financial analysis.

According to the granularity of the analysis and scope, our total sample for each analysis changes (e.g. differentiation on women or emerging fund managers, closed or open-ended vehicles, funds having achieved viable fund size, etc.). The total sample analysed will be provided for each snapshot realised.

Caveat and call for feedback and data collaboration.

To date, there is very little aggregate data covering fund returns and other key metrics for SME funds. The contribution of data shared in this report reflects a picture of an investment landscape at a given time, and has no claim of being fully representative or exhaustive of the asset class. In fact, there are key gaps to be filled (lack of data for many key funds in the sector as well as for important geographies).

Building useful benchmarks for the sector on fund returns and impact requires more collaborative data and research that can be made available publicly to strengthen GPs' fundraising arguments and LPs' exposure to the sector.

This first report is also a call to action for key LPs, GPs, and ecosystem players to provide feedback and engage in collaborative data-sharing. This participative process will culminate in a second version of the report which will be published in 2026 and will target a more refined and representative landscape of SME funds.

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6. AVCA. 2023. African Private Capital Activity Report
7. Venture capital investments accounted for 70% of the total volume of private capital deals reported between 2020 to 2022 H1, up from an average of just 37% between 2017 and 2019. The expansion of Africa's venture ecosystem, particularly in the last two years, has seen the asset class account for 75% (equivalent to US$6.7bn) of the entirety of private capital deal value that occurred within the period. AVCA, 2023 Venture Capital Report in Africa
8. I&P, OIF. February 2024. Guide du financement des entreprises en croissance en Afrique francophone.
I&P. October 2023. Using catalytic capital to foster the emergence of African entrepreneurs in underserved markets.
I&P. October 2019. Formalisation des PME en Afrique subsaharienne.
I&P. IPDEV, a pioneering initiative to promote African SMEs.
I&P, INSEAD, ANDE. Investir dans les Petites et Moyennes Entreprises en Afrique.

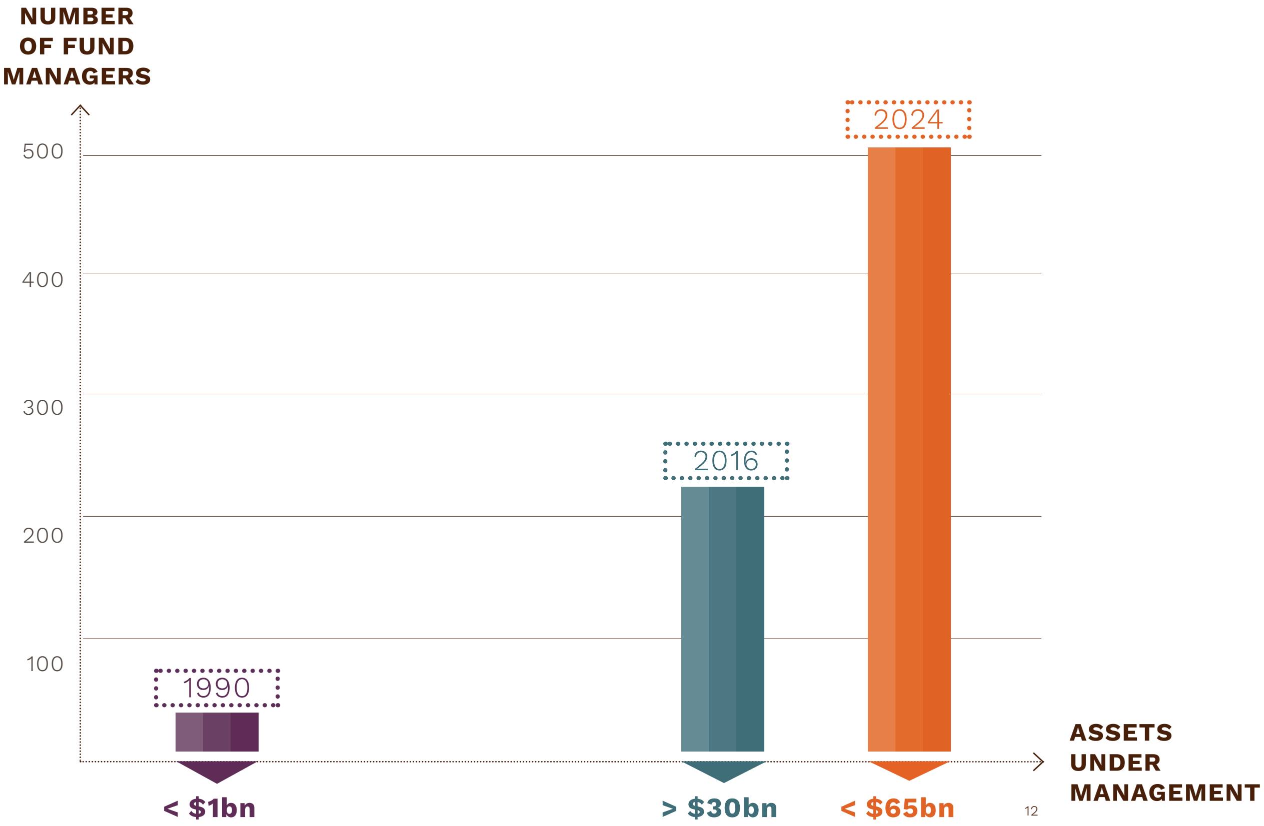
PART

01

There are many new SME funds, and they struggle to raise

1.

A multiplication and diversification of Africa-based funds over the past 30 years



The industry has not just grown, it has also diversified. The new funds that have emerged target new geographies, finance new business segments, develop increasingly innovative solutions and attract new pools of capital. The AVCA 2023 Private Capital Report highlights that the $33.1bn raised by African funds between 2012 and 2023 now encompass a wide range of funds: infrastructure funds, debt funds, early-stage SME funds, growth SME funds, venture capital funds, and more. I&P has mapped 135 SME and VC funds active in Africa, either already deploying capital or currently raising. Together **they seek to raise and deploy a total of $9.3bn**, which compares to an estimated funding gap of $140bn for African SMEs[13].

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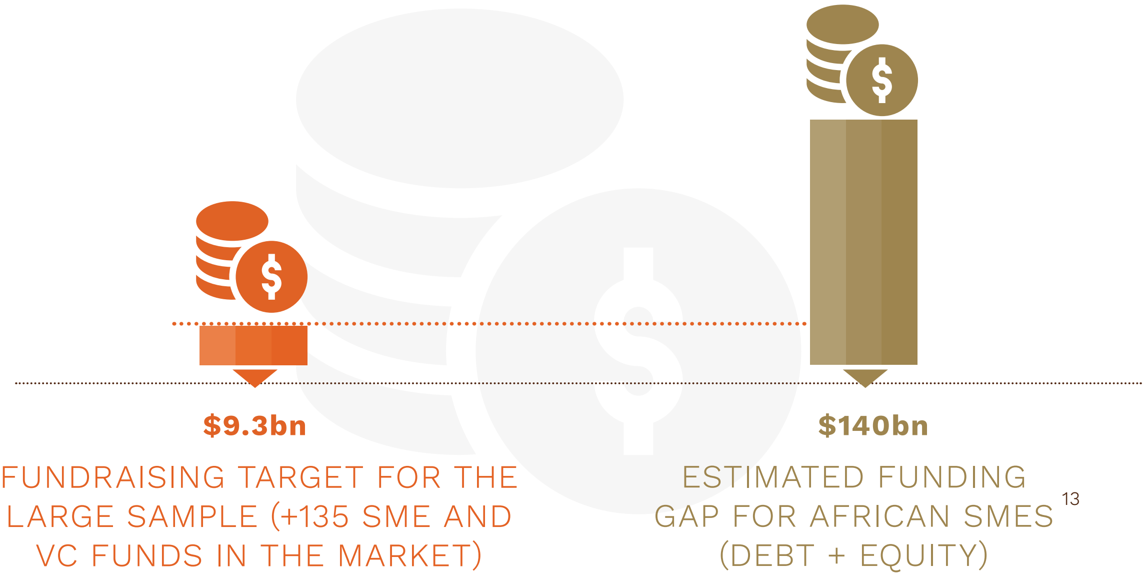
9. BCG. 2016. P. Dupoux., T. Hammoud., S. El Fihri. Why Africa Remains Ripe for Private Equity.
10. The Africa Report. Rob Withagen. 2021. African Investments. What does Africa's private equity landscape look like in 2021? [Consulted online]
11. Briter Bridges. 2023. H1 Africa Investment Report 2023.
12. Estimation drawn from PwC AWM Research Centre Analysis Paper.
13. Convergences. 2024. R. Ivory., E. Pullela. How can blended finance help improve African SME's access to finance? [Consulted online]



We can identify several archetypes within this list of SME funds (see 'Methodology focus', page 14), which must be assessed separately, as they face different fundraising situations.

Some of these archetypes are well documented today (large PE, venture capital funds), but data availability remains very poor for early-stage SME funds, growth SME funds and SME debt funds. These three categories will therefore be our focus.

Early-stage SME funds are raised by first-time fund managers.

STORIES

Kim Kamarebe moved back to Uganda in 2009 to finance SMEs after her education at Princeton and Harvard Business School and a few years in investment banking at Goldman Sachs. Working with nascent British fund TLG Capital at the time, she led a landmark pharmaceutical deal in the country which went on to become a certified HIV and TB medicine manufacturer and among the most successful IPOs in East Africa. She went on to try and setup her own single country SME equity fund. Despite the high quality of her profile as an investment professional and her knowledge of the market, she faced many struggles. She first spent a year trying to raise, approaching DFIs and institutional investors not interested in backing a local fund manager and finally resorted to managing a small-scale facility financed by HNIs, through which she made a handful of investments in the country whilst simultaneously doing advisory work for corporates. Kim's efforts did attract the attention of potential funders, but she had to turn down their request that she move to Europe to set up a team and a bigger fund there. Kim was determined not to give up her goal of locally supporting and financing early-stage SMEs. **It was only 12 years after returning to Uganda and finally finding a sponsor and an anchor investor as well as two other very aligned LPs that Inua Capital was finally able to reach a final close in May 2023.**

This is the story of many women and men who have taken on the arduous challenge of setting up early-stage SME funds in an environment where first-time fund managers who succeed in raising remain the exception.

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13. Convergences. 2024. R. Ivory., E. Pullela. How can blended finance help improve African SME's access to finance? [Consulted online]

Early-stage SME funds often act as trailblazers in their respective countries: they are the first institutional investors in the SMEs they target, and they invest with strong additionality. The early-stage SME segment is strategic to creating jobs and sustainable growth and to preparing a strong pipeline for later-stage funds, but it often lacks structure and investment-readiness, needing substantial technical support.

> **Early-stage SME funds invest tickets ranging from $100k to $1m** in equity and quasi-equity. In addition to capital, they also offer significant non-financial support, such as mentorship, technical assistance, and capacity building;

> **They raise small fund sizes ($3-$20m)** but achieve very strong capital efficiency (impact per USD) and additionality.

> Apart from certain large economies (Kenya, Nigeria etc.), **the continent is characterised by small, fragmented economies which require locally-based funds** and favour, as much as they limit, small size funds. This is why early-stage SME funds are locally-based and often country-specific, managed by teams with deep knowledge and networks of their target market.

The overwhelming majority of early-stage SME funds are set-up by first-time and emerging fund managers. Out of our sample of 55+ SME funds, 25 funds are early SME funds. Among them, we found that:

92% of early-stage equity fund managers are emerging fund managers

Their lower fund sizes are more accessible for first-time fund managers to raise. Most experienced fund managers, on the other hand, find it hard to maintain a focus on this segment, as they are progressively pushed to increase their ticket size. Currently, very few funds provide equity and quasi-equity to this segment, for which the investment needs are very high; addressing the demand of risk capital of early-stage SMEs must be done by regularly backing new generations of emerging and first-time fund managers.

These early-stage funds face challenges of their own, which compound with the challenges already faced by first-time and emerging fund managers as new entrants in the space (see Part 1, #2 'Raising a SME fund remains very challenging, especially for newcomers in the space', p.38).

Mapping of early-stage SME funds in Africa and their LPs.

INVESTORS (LPS)

Funds of funds: IPDEV, The Mastercard Foundation Africa Growth Fund, Nyala Ventures, DGGF, Agri-Fi

Domestic private investors; domestic companies or multinational subsidiaries including corporates, banks, insurance companies: Orange, Sonatel, Askia, Axian, Eurofind, Groupe NSIA, Sonar, Société Générale...

Domestic pension funds (especially in Ghana)

Domestic public stakeholders: FONSIS (Senegal), CDC Côte d'Ivoire...

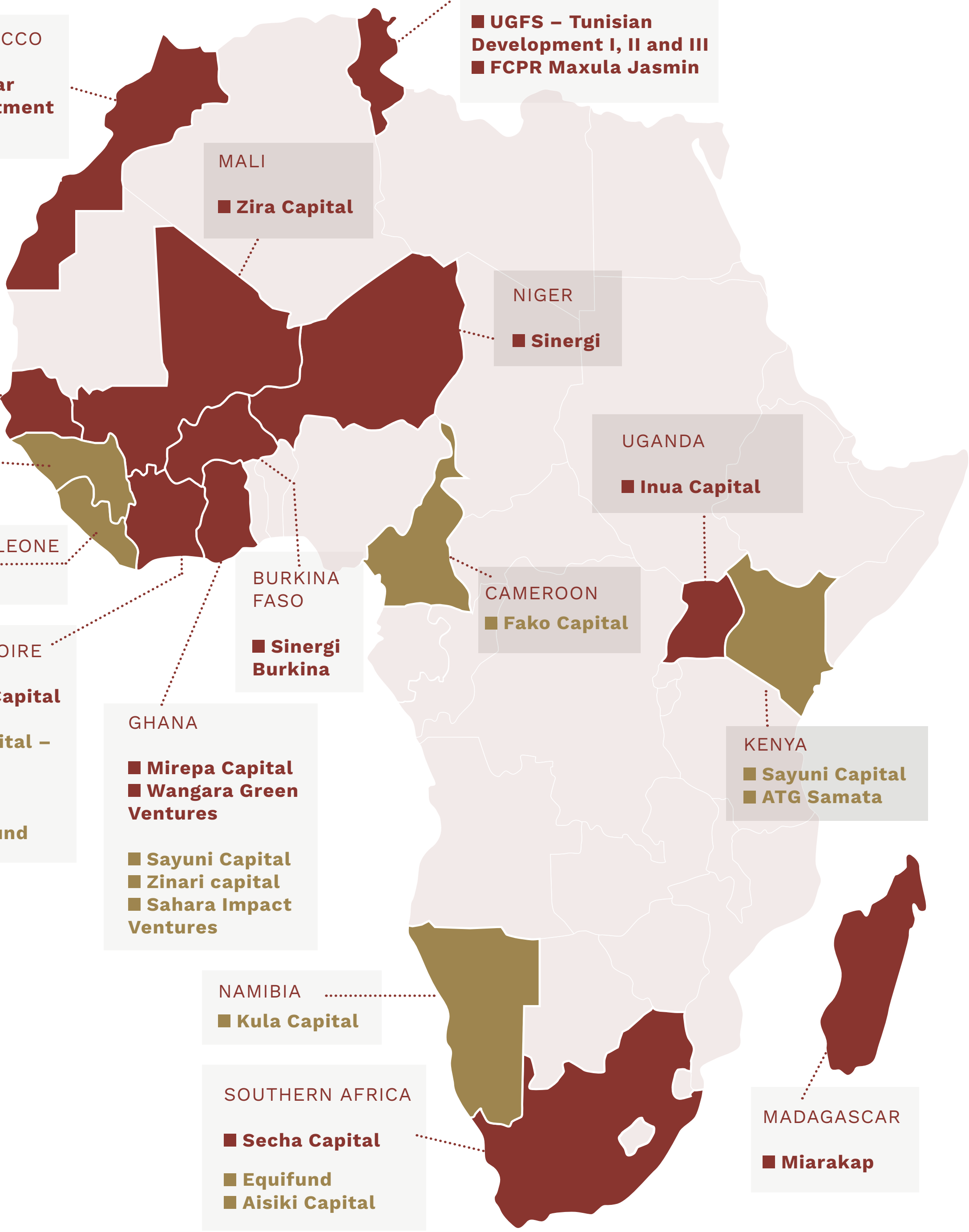
Foundations and Donors: Small Foundation, SIDI

HNWIs: Individuals, entrepreneurs, diasporas

INVESTEES (FUND MANAGERS)

🟥 **Existing funds that have completed their fundraise**

🟫 **Funds currently raising**



TUNISIA

🟥 **UGFS – Tunisian Development I, II and III**
🟥 **FCPR Maxula Jasmin**

MOROCCO

🟥 **Athar Investment Fund**

MALI

🟥 **Zira Capital**

SENEGAL

🟥 **WIC Capital**
🟥 **Teranga Capital**

NIGER

🟥 **Sinergi**

GUINEA

🟫 **Gola Capital**

UGANDA

🟥 **Inua Capital**

LIBERIA, SIERRA LEONE

🟫 **Gemini**

BURKINA FASO

🟥 **Sinergi Burkina**

CAMEROON

🟫 **Fako Capital**

CÔTE D'IVOIRE

🟥 **Comoé Capital**

🟫 **WIC Capital – Fund II**
🟫 **NEPER Ventures**
🟫 **Barka Fund**

GHANA

🟥 **Mirepa Capital**
🟥 **Wangara Green Ventures**

🟫 **Sayuni Capital**
🟫 **Zinari capital**
🟫 **Sahara Impact Ventures**

KENYA

🟫 **Sayuni Capital**
🟫 **ATG Samata**

NAMIBIA

🟫 **Kula Capital**

SOUTHERN AFRICA

🟥 **Secha Capital**

🟫 **Equifund**
🟫 **Aisiki Capital**

MADAGASCAR

🟥 **Miarakap**

*This mapping is not exhaustive.

Snapshot of our sample of early-stage SME funds

EARLY-STAGE SME FUNDS

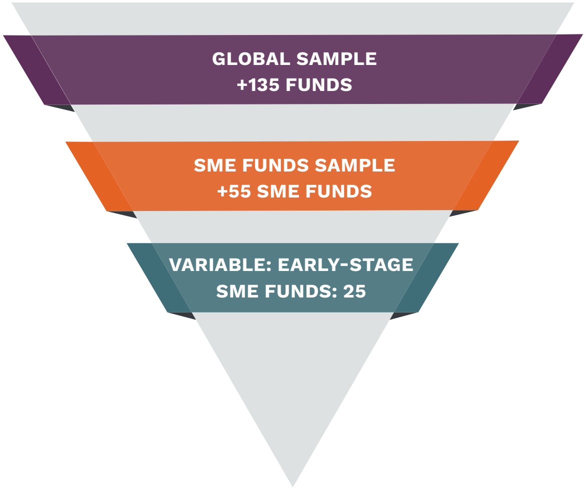
$7m

AVERAGE FUND SIZE OF THE SAMPLE

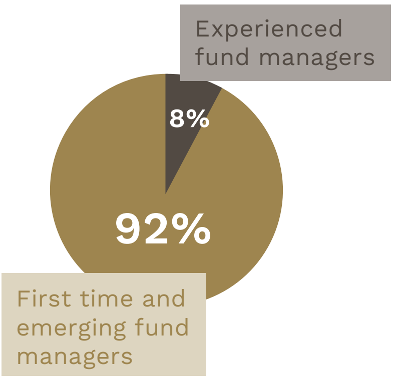
$100k - $1m

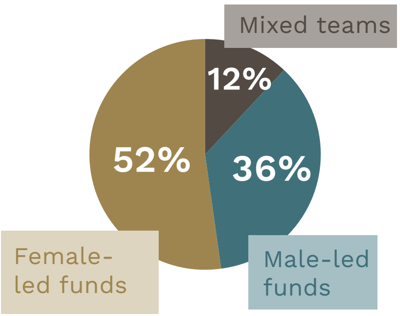
TYPICAL RANGE OF TICKET SIZE

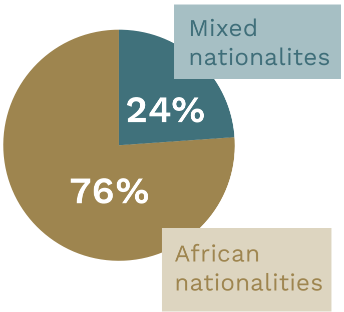
72% ARE COUNTRY SPECIFIC FUNDS



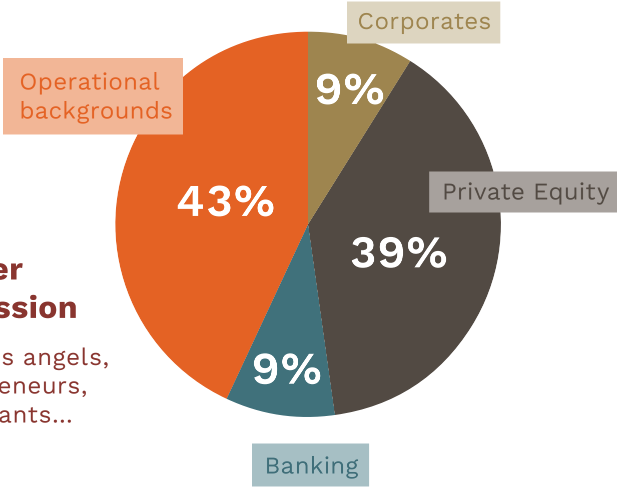
FUND MANAGERS PROFILES







TRACK RECORD OF FUND MANAGERS



Former profession

Business angels, entrepreneurs, consultants...

Traditional track-record

37% 10+ YEARS INVESTMENT TRACK RECORD

Non Traditional track-record

63% WORKING AS OPERATORS, BANKERS, ADVISORS

SPOTLIGHT | ACTAWA:
How a promising first-time fund manager failed to raise due to misalignment with LPs.

In 2021, Wiem Abdeljaouad and her business partner began fundraising for Actawa, a €10m impact seed fund in Tunisia targeting scalable start-ups positively impacting women and youth. As aspiring fund managers in a small yet promising market, the pair initially concentrated their efforts to secure an anchor investor. Leveraging their extensive network, deep local anchorage, and strong investment and professional track records, they successfully convinced IPDEV to sponsor them whilst refining their investment strategy, business plan, and marketing materials. With IPDEV's support, they continued adjusting their investment approach to further build their pipeline and bring in a fund as their primary investor. This allowed them to reach more than half of their target fund size, after which they sought additional LPs among Tunisian individuals, family offices, banks, and insurance companies.

However, their fundraising efforts stalled due to two major challenges: Wiem's partner stepping back for unforeseen personal reasons, and a misalignment with a key potential anchor, whose standard conditions conflicted with the proposed SME-focused model. This situation highlights a central question for fund managers: to what extent should they adapt their investment strategy to attract new LPs? LPs often have their own priorities and expectations, which may clash with each other or with practical realities on the ground, especially when it comes to small SME impact funds dedicated to growing businesses that still require a lot of close post-investment support and heavy lifting. Fund managers must skilfully navigate these constraints whilst remaining resilient, both financially and mentally, throughout the lengthy discussions and negotiations.

In the case of Actawa, LP demands based on global standards did not match the realities faced by the GPs, most notably a management fee formula better adapted to the venture capital market than to the early-stage SME sector. This turned a tough fund model into an impossible one for the GPs, who had already been personally incurring most of the fundraising and setup costs for almost two years without any interim compensation and also had to manage additional capital injections expected by the Tunisian regulator to establish the management company.

Despite their complementary profiles, their unique positioning, their strong pipeline, the fundraising traction they achieved, and the backing of an experienced sponsor that had already backed seven funds across the continent, Actawa's partners, like many other first-time and emerging fund managers, were unable to reach a successful first close.

SPOTLIGHT | WIC CAPITAL:
How an emerging fund manager grew out of an angel network by investing in early-stage businesses and then launching an institutional fund.

On March 8, 2019 (International Women's Day), the Women's Investment Club – Senegal took another step toward its commitment to support female entrepreneurs in Senegal by launching WIC Capital, the first impact investment fund with a single focus on women-led or founded SMEs in the country, investing tickets between €50k and €500k.

Initially self-financed by the 130+ women (executives, entrepreneurs, etc.) of the network and led by Ms. Evelyne Dioh, the locally-domiciled fund progressively grew its size, one fundraising opportunity at a time, raising up to €5m from donors, insurance companies, and impact investors. Today, WIC Capital has invested risk capital into 10 SMEs in Senegal and Côte d'Ivoire, managed a financial inclusion program to support another 13 entrepreneurs. As a complement to WIC Capital, the Women's Investment Club set-up a technical assistance activity, WIC Académie, which leverages the members' expertise to support Senegalese women-led businesses with finance / strategic / operational support and capacity building. Based on this pilot, the fund manager plans to scale in Senegal and Côte d'Ivoire, looking to raise a €30m closed-ended fund and reaching out to a new class of LPs.

WIC Capital presents a case of a fund management firm, sponsored by an angel club and donors, that progressively built a track record over 4 years, leading to the launch of a SME fund at scale.

Growth SME funds are a small crowd of pioneers with few newcomers.

Most of the pioneering funds targeting SMEs could be found in the Growth SME funds' space until 2020. Whilst some managed to retain this SME focus through somewhat small tickets despite high pressures to move up above, it is now a limited pool, as **most of them increased their ticket size (>$5m) to focus on larger investments and balance their model** (See Part 2, section 2/3). Most of these pioneers are no longer active as standalone funds: for example in East Africa, Catalyst has been absorbed by Metier and Fanisi by Ascent Capital.

> Growth SME funds invest in equity and quasi equity with **investment tickets ranging from $1m to $5m** targeting medium-sized and growing SMEs and Series A-stage tech-enabled businesses

> Although they target a more mature segment of SMEs than early-stage SME funds (see research methodology page 14), growth SME funds still need risk capital as well as substantial technical assistance to support their portfolios

> Historically backed by African *(AfDB or BOAD)* or international *(IFC, Proparco, EIB, etc.)* DFIs, this asset class is typically managed by more experienced fund managers able to raise larger

funds ($40m-$150m) from a combination of DFIs as well as from foreign foundations, corporates, and family offices. Some have also mobilised significant African capital, particularly in Ghana, where pension fund regulation reform has unlocked capital (*Oasis Capital, Injaro Ghana Venture Capital Fund*).

The barriers to entry are high in this space as raising a minimum fund size of $30-$50m is often a prerequisite; this is why few newcomers manage to enter this market.

A few new players have managed to emerge in recent years (Aruwa Capital raised $20m in 2019-2022, Adiwale Partners raised €60m in 2021); they are led by partners with very considerable private equity experience and deep LP networks.

SPOTLIGHT ADIWALE CAPITAL

In 2016, Jean Marc Savi de Tové and Vissého Gnassounou, two experienced private equity professionals with decades of experience, went from Cauris Management (a pioneer growth equity fund in WAEMU) to launching Adiwale Partners, a private equity fund management company with a focus on high growth potential SMEs in Francophone West Africa.

Vissého worked for 14 years at Cauris Management, where he actively worked on the fundraising of two funds totaling €75m in commitments and executed/monitored more than 15 transactions in Francophone West Africa.

Prior to Cauris Management, Jean Marc Savi de Tové was a portfolio director at CDC Group (now BII) where over 6 years he contributed to over $600m in up to 32 funds managed by fund managers such as AFIG Funds, Africa Capital Alliance, AfricInvest, Aureos, Catalyst, ECP, Helios, etc.

This combination of an established track record stemming from 40 years of combined work experience (including 20 SME transactions, 14 exits returning 2.4x Capital[14]), solid LP networks and an understanding of both the target markets and investors' needs was instrumental in their success raising Adiwale Capital Fund I, a €60m private equity fund with commitments from BII, AFDB, etc.

These fund managers are under pressure to develop financial instruments tailored to their SME targets whilst meeting the usual parameters expected by DFIs. They seek to attract new pools of capital (pension funds, local capital) to diversify their investor universe and strengthen their bargaining power to improve the terms of their funds and better adapt them to their targets.

This is a scattered space. In frontier markets in particular, the lack of Growth SME funds prevents many businesses from scaling up and reaching their maximal potential.

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14. African Development Bank. 2019, March. A project Summary Note - Adiwale fund I – Multinational https://www.afdb.org/fr/documents/document/project-summary-note-adiwale-fund-i-multinational-109760

Mapping of growth SME funds in Africa and their LPs.

INVESTORS (LPS)

Funds of funds: Mastercard Foundation Africa Growth Fund, DGGF

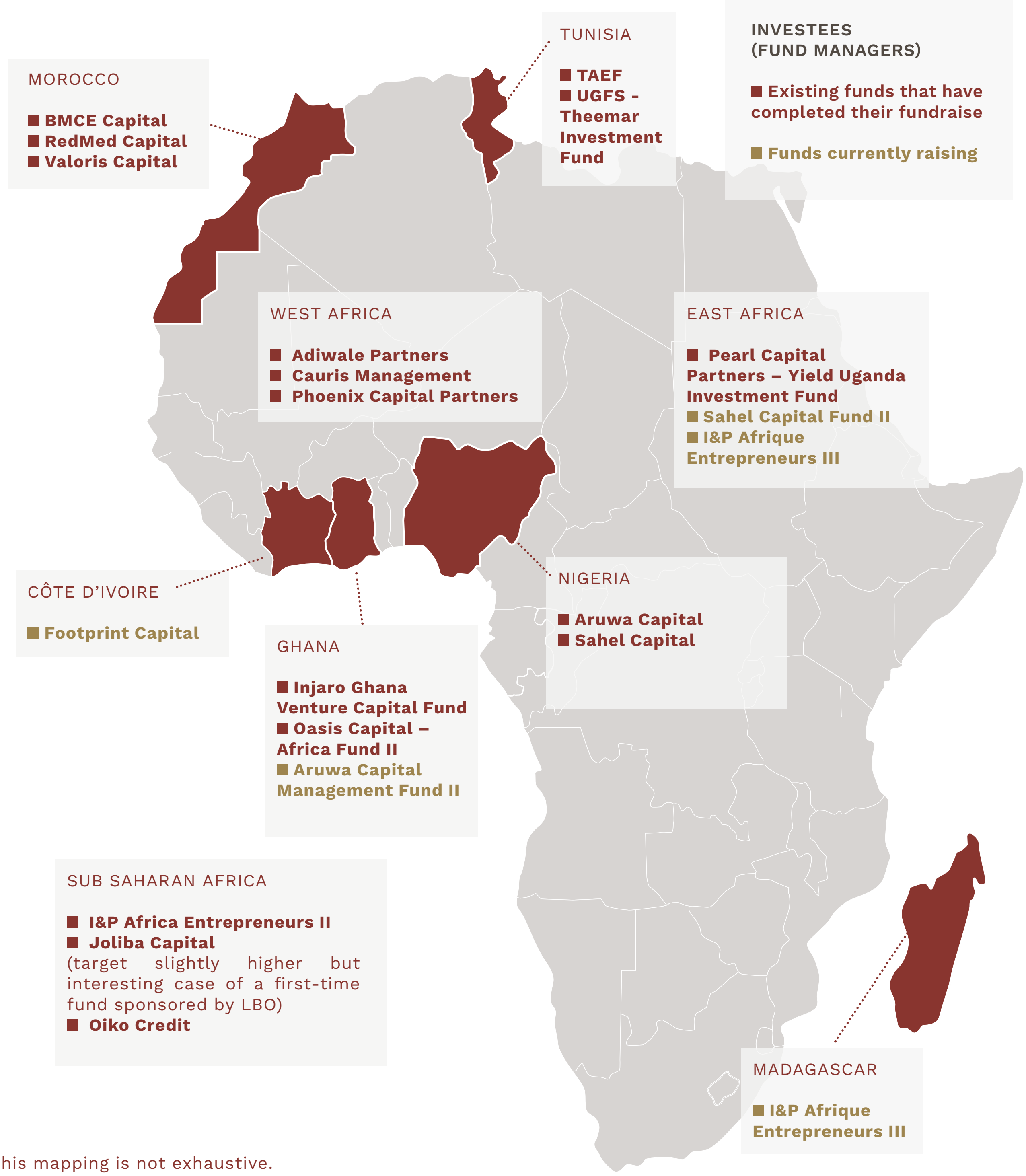
DFIs: IFC, AfDB, FMO, Proparco, BOAD, DFC, Swedfund, BII, Bpifrance, BIO, EIB ...

Both African and foreign corporates: Africa Re, GTA C2A Vie, BOA Group, Societe Generale, Danone, etc.

Domestic public stakeholders:
VCTF (Ghana), CNPS (Côte d'Ivoire), Development Bank of Ghana, NSIA (Nigeria), Bank of Industry (Nigeria)

Pension funds (mostly in Ghana due to the favourable environment): GCB Capital, Stanbic Investment Management Services, ENO International, Investcorp Asset Management, CAL Asset Management, PETRA Advantage, PETRA Opportunity, Databank Asset Management, and Standard Pensions Trust

Foundations: Visa Foundation



MOROCCO

🟥 **BMCE Capital**
🟥 **RedMed Capital**
🟥 **Valoris Capital**

TUNISIA

🟥 **TAEF**
🟥 **UGFS - Theemar Investment Fund**

INVESTEES (FUND MANAGERS)

🟥 **Existing funds that have completed their fundraise**

🟨 **Funds currently raising**

WEST AFRICA

🟥 **Adiwale Partners**
🟥 **Cauris Management**
🟥 **Phoenix Capital Partners**

EAST AFRICA

🟥 **Pearl Capital Partners – Yield Uganda Investment Fund**
🟨 **Sahel Capital Fund II**
🟨 **I&P Afrique Entrepreneurs III**

CÔTE D'IVOIRE

🟨 **Footprint Capital**

NIGERIA

🟥 **Aruwa Capital**
🟥 **Sahel Capital**

GHANA

🟥 **Injaro Ghana Venture Capital Fund**
🟥 **Oasis Capital – Africa Fund II**
🟨 **Aruwa Capital Management Fund II**

SUB SAHARAN AFRICA

🟥 **I&P Africa Entrepreneurs II**
🟥 **Joliba Capital**
(target slightly higher but interesting case of a first-time fund sponsored by LBO)
🟥 **Oiko Credit**

MADAGASCAR

🟨 **I&P Afrique Entrepreneurs III**

*This mapping is not exhaustive.

Snapshot – Growth SME funds & fund managers - Analysed sample

GROWTH SME FUNDS

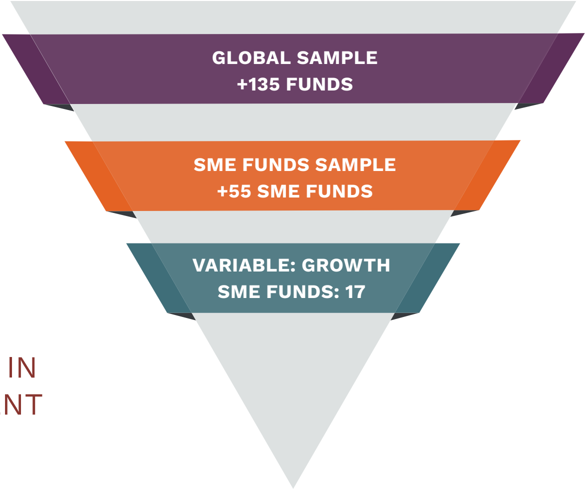
$54m

AVERAGE FUND SIZE OF THE SAMPLE

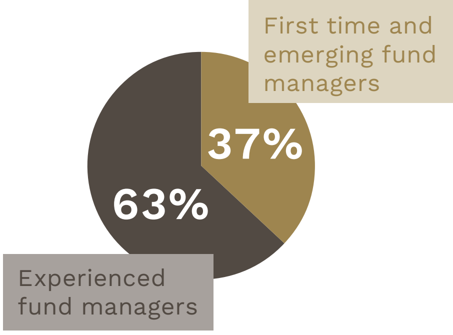
$1m - $6m

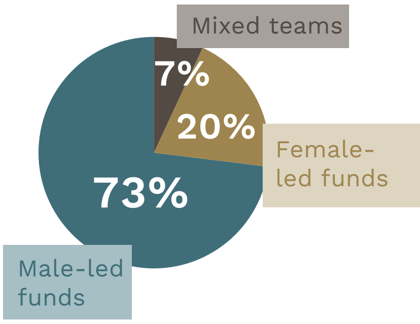
TYPICAL RANGE OF TICKET SIZE

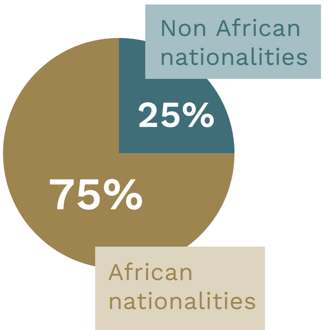
18% ONLY ARE COUNTRY-SPECIFIC FUNDS; 82% OF THEM INVEST IN REGIONS OR ON THE CONTINENT



FUND MANAGER PROFILES

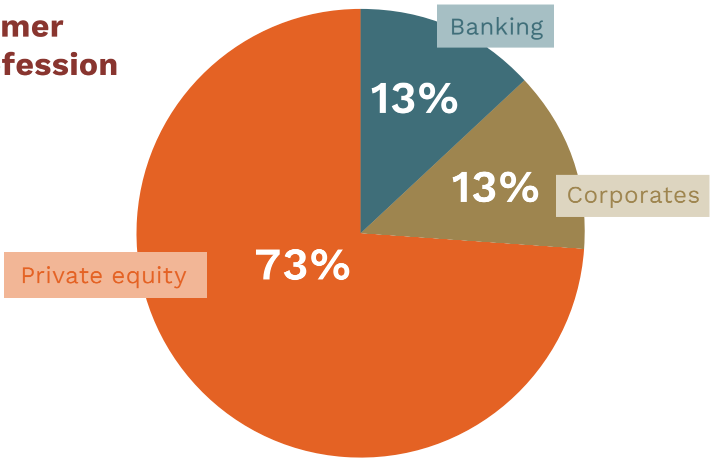






TRACK RECORD OF FUND MANAGERS

Former profession



SPOTLIGHT | INJARO INVESTMENTS:

From a DFI-funded impact fund to unlocking domestic pools of capital.

Injaro Investments was co-founded in 2009 by Jerry Parkes and Dadié Tayoraud, who met at the Wharton School, University of Pennsylvania, and shared a vision of leveraging their expertise to contribute to Africa's development. The team initiated its activities by investing in SMEs across the agricultural value chain and deploying capital to seed and input businesses in Ghana and West Africa, with funding from AGRA and Lundin Foundation.

By September 2014, the team closed its institutional fund Injaro Agricultural Capital Holdings Limited (IACHL) with total capital commitments of $49.2m, sourced from several DFIs, including CDC Group, FMO via its MASSIF Fund, and Proparco through FISEA. These investments through the specific impact windows of DFIs, aimed to support SMEs in countries such as Ghana, Côte d'Ivoire, and Mali and enhance food security and income for smallholder farmers and low-income producers.

After 10 years running IACHL, Injaro Investments switched its focus to raise a new fund from domestic investors, the Injaro Ghana Venture Capital Fund (IGVCF), closing in 2022 at GHS 216m and attracting capital from Ghana's domestic fund-of-funds, the Venture Capital Trust Fund, and Ghanaian pension funds and institutional investors, including Stanbic Investment Management Services, Petra, Databank Group, CAL Asset Management Company, and Ghana's Minerals Income Investment Fund. IGVCF is designed to invest as a commercial growth fund in high-potential SMEs within Ghana and Côte d'Ivoire, targeting a diversity of sectors not restricted to agribusinesses.

SME debt funds fill a key gap for self-liquidating risk capital.

Debt funds are answering the limited access to working capital and medium-term debt that SMEs experience, especially in certain segments underserved by the local banking sector (local currency value chains, women-owned businesses, rural businesses, innovative models, and early-stage businesses). They provide both short-to-medium term working capital products and longer-term mezzanine finance to growing SMEs that are not candidates for equity. Most of these debt funds are the first institutions to invest short-to-medium term financing in the SMEs they target, and in this regard, they play a vital role to complement bank offerings by:

> Lending with more flexible and lower collateral requirements than banks and thus including SMEs that are not bankable, thanks to a risk management approach

> Offering longer and/or more flexible tenors, which allows for:

> In some cases, participating in SME governance and/or providing technical assistance and management support that further de-risk SMEs and promote their growth.

> Leveraging more bank lending thanks to the support provided.

These SME debt funds usually operate with two types of positioning:

> Highly additional funds operating in the lower end of the missing middle, with tickets below $2m for SMEs that are too big for microfinance institutions

but too disorganized or unsecured for traditional banks. These funds are sometimes structured as permanent capital vehicles (PCVs) at a modest size (under $30m), providing working capital facilities with a capital recycling effect.

> Funds providing larger tickets ($2m to $10m) to larger businesses that have insufficient access to banking facilities and sizable financing needs for working capital or growth. These funds can be structured as open-ended or closed-ended.

Interestingly, **a large number of regional and homegrown SME debt funds are found in East Africa as opposed to West Africa** where mostly international players (*Oikocredit, Grofin*) that have led the sector operate. Our analysis exclusively covers SME debt funds and excludes funds with large ticket sizes whether sector-specific (infrastructure debt funds, large corporate, etc.) or large mezzanine funds targeting larger companies (*BluePeak, Ethos, Vantage, Helios, etc.*), as their model is fundamentally different and they do not invest in SMEs.

DGGF's 2016 report **The Case for Mezzanine Finance**[15] provides a good overview of the mechanics of SME debt funds, highlighting the **difficulty of sustaining economics for funds investing tickets below $1m due to the unfavourable ratio of transaction costs to ticket sizes** and to high failure rates. This is illustrated in the **USAID's 2018 CSAF**[16] financial benchmarking presentation which, though focused on agriculture loans, notes that loans in Africa are twice as likely to end up in recovery compared to other emerging markets, that operating costs are 22% higher, and that there are issues around the reliability of data needed to assess credit risks of these SMEs.

In this environment, the economics of running SME debt funds are challenging, but several players (*XSML in Central, East and Southern Africa*) have now built scalable solutions for loans between $2m and $5m, and others (iungo capital in East Africa) have achieved strong milestones in smaller loan sizes (as low as $50k-$1m) with innovative instruments. This category is led mostly by experienced fund managers, as the risk-adverse nature of LPs in the debt space puts the bar high for a fund manager's track record. These fund managers achieve very significant reach in terms of the number of SMEs accessing funding and the number of jobs created and maintained.

These **debt funds often raise debt themselves;** when they do, they typically need a strong equity layer (25% to 50%, depending on fund models) to cover for their senior debt fundraise. In the current market, they struggle to raise this equity, as the historical performance of debt funds has reportedly been challenging. They also find **innovative solutions to address other complexities**, including currency risk (notably for funds raising in hard currency and investing in local currency) and sometimes regulation.

Ultimately, SME debt funds are a small but important segment in the SME finance landscape, in need of more investor backing.

> *'There is a pressing need to see more debt funds, as working capital still remains a challenge for SMEs, especially short-term working capital.'*
>
> *An LP*

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[15] DGGF. E. Benink, R. Winters. 2016. New perspectives on financing small cap SME in emerging markets. The case for mezzanine finance.

[16] USAID CSAF. 2018. CSAF Financial benchmarking presentation. Summary presentation. https://pdf.usaid.gov/pdf_docs/PA00TK8G.pdf

Mapping of debt SME funds in Africa and their LPs.

INVESTORS (LPS)

List of investors:
DFIs: FMO, BII, DFC, IFC, DEG, DGGF, etc.

Foundations and family offices:
Calvert Foundation, Ceniarth, Lundin Foundation, Small Foundations, etc.

INVESTEES (FUND MANAGERS)

🟥 **Existing funds that have completed their fundraise**

🟫 **Funds currently raising**

WEST AFRICA

- 🟥 **Sahel Capital SEFAA**

EAST AFRICA

- 🟥 **iungo Capital**
- 🟥 **SME Impact Fund**
- 🟥 **Business Partners International**
- 🟥 **Sahel Capital SEFAA**

- 🟫 **iungo capital**
- 🟫 **SME Impact Fund II**
- 🟫 **East Africa Plus Fund**
- 🟫 **Balloon Ventures**

SUB SAHARAN AFRICA

- 🟥 **AgDevCo**
- 🟥 **Bamboo Capital – ABC Fund**
- 🟥 **Grofin**
- 🟥 **Oiko Credit**
- 🟥 **Incofin**
- 🟥 **ResponsAbility**
- 🟥 **TLG Capital**
- 🟥 **Uncap**
- 🟥 **XSML**
- 🟫 **Uncap**
- 🟫 **Untapped Global**

- 🟥 **SIDI**

SOUTH AFRICA

- 🟥 **Linea Capital**

*This mapping is not exhaustive.

Snapshot – Debt funds & Fund Managers – Analysed sample

DEBT SME FUNDS

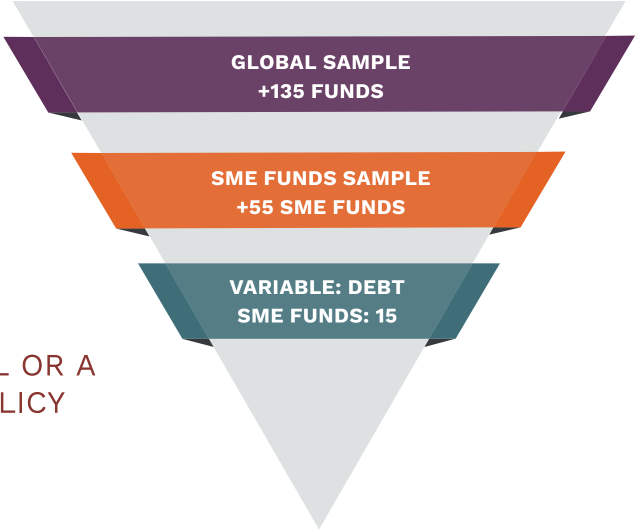
$48m

AVERAGE FUND SIZE OF THE SAMPLE

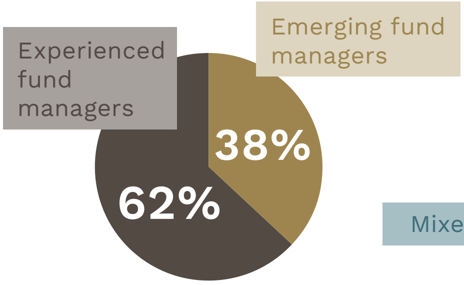
$100k - $3m

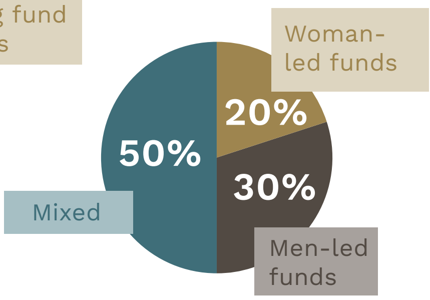
TYPICAL RANGE OF TICKET SIZE

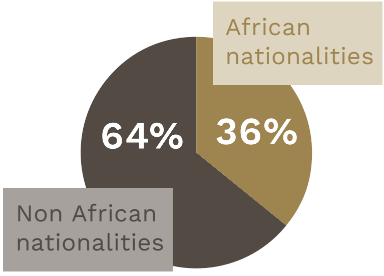
15% ONLY ARE COUNTRY SPECIFIC FUNDS; 85% HAVE A REGIONAL OR A PAN AFRICAN INVESTMENT POLICY



FUND MANAGER PROFILES







SPOTLIGHT | XSML

XSML is an Africa-focused Dutch-founded investment firm, launched in 2008 by two former FMO executives to help entrepreneurs in frontier markets in Africa grow their businesses into sustainable medium and large companies. XSML mainly provides debt and mezzanine financing (and equity, potentially) to SMEs with investments needs ranging from $300k to $10m.

XSML began as a frontier market investor whose first fund focused on DR Congo and the Central African Republic, which granted them the support of IFC in the pilot phase of its SME Ventures programme as well as the support of other LPs. Based on the track record of this first fund, XSML has gone on to raise successive generations of new funds with DFIs (IFC and FMO being repeat investors) and new LPs, expanding their geographic footprint.

They have proven the viability of a model where risk capital provided in the form of self-liquidating instruments can find an additional and scalable positioning, more flexible than bank funding and more accessible than equity financing.

Fund	Vintage	Fund size	Status	Countries
Central Africa SME Fund	2010	US$ 19m	Fully exited	DRC, Central African Republic
African Rivers Fund II	2016	US$ 50m	Exiting	DRC, Uganda
African Rivers Fund III	2020	US$ 85m	Investing	DRC, Uganda, Angola
African Rivers Fund IV	2023	US$ 135m	1st close at US$ 97.5m	DRC, Uganda, Angola, Zambia, Kenya

SPOTLIGHT | IUNGO CAPITAL:

iungo Capital is an East African debt provider, looking to bridge the missing middle finance gap in East Africa by investing mezzanine debt in small, traditional SMEs across the region.

Thanks to $1m seed debt funding from DGGF and 2 individual investors, iungo capital was able to launch its pilot phase in 2017 to test its model of provided $100k- $500k mezzanine debt to Ugandan small and growing businesses. The initiative continued to grow and expanded to Kenya, Rwanda and Tanzania, having attracted additional funding from foundations, impact investors and one DFI, and investing (thanks to capital recycling) over $22m in 51 SMEs in East Africa.

At the inception of iungo capital seven years ago, founders Steven Lee and Roeland Donckers took an unorthodox approach by creating a permanent capital vehicle to fill the financing gap for SMEs they had observed on the Ugandan market they were both working in. Their investment thesis is to provide $100k-$500k loans, with an average ticket size of $250k, where each investment is done in collaboration with a local angel investor. Through their efforts, they were able to demonstrate that the model works and that iungo's product provides much-needed capital to SMEs, in addition to strong technical assistance support.

The company's fund manager is looking to scale its permanent capital vehicle model, as it is actively fundraising to continue to address the strong demand from the market.

Iungo presents the interesting case of a fund manager with the following features:

> Has built a strong local team across East Africa.

> Has a unique positioning in East Africa with no to low competition for short- to mid-term debt funding.

> Made the PCV/blended finance model work through a closely monitored debt/mezzanine offering with regularity of cashflows.

RECOMMENDATION 1#1

The three segments of early-stage SME funds, growth SME funds, and SME debt funds remain under-researched; more data and sharing of lessons will build understanding of these segments for LPs and new GPs.

1) A data-sharing initiative will improve LPs knowledge of fund performance in the sector and support new GPs to design their fund; it requires collaboration.

E

In order to improve transparency on returns and viable models across segments of SME funds, a **common aggregated database managed by a trusted third-party repository of data** can be set-up for some of the main LPs in the sector (DFIs, Fund-of-funds) to share fund portfolio data, while protecting the confidentiality of any individual level fund data. The CSAF benchmarking report for agri-SME[17] lenders exemplifies this approach by providing data on returns and risk, thanks to deep collaboration by practitioners. Extending a similar initiative to cover SME investments in diverse sectors, including SME debt funds, early-stage SMEs, and growth SME funds, would address information gaps that currently hinder investor confidence and capital flow. Other important examples of data-sharing initiatives in our sector are the AVCA's African PE/VC benchmark publications, Convergence's new Market Data Explorer or the Collaborative for Frontier Finance (CFF) publications on local capital providers (LCPs).

By sharing aggregated data on gross and net investment returns as well as fund and GP economics, the SME fund sector can not only mobilise more capital but also help **new fund managers design models and strategies, learn from the lessons of their peers and ultimately improve performance**, as well as provide data-based evidence to support these fund models. In the case of CSAF, the 2018 data benchmarking report led to the creation of Aceli Africa, an ecosystem initiative dedicated to providing incentive payments to support small ticket size investments across the agri-lending sector.

This report serves as a **step in a broader agenda to foster data-driven decision-making in this asset class.**

2) New LPs can be attracted to the asset class by sharing more aggregated data and lessons on fund performance and fund models.

LP

The practice of information-sharing has become far more widespread in recent years, and today there are numerous existing collaborations, particularly among DFIs. However, this must be made **accessible for new LPs entering the space**, as GPs must often invest significant time explaining how funds operate, the challenges they face, and the returns LPs can expect. Given the nascency of the industry, **this educational work is crucial to facilitate investment from new LPs**.

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[17] USAID CSAF. 2018. CSAF Financial benchmarking presentation. Summary presentation.

> *‘There is close collaboration between DFIs now. We frequently compare pipelines and have ongoing informal discussions about markets, sharing investment pitches, etc. Everyone needs to align their efforts to achieve a first close, making it in everyone’s interest to collaborate and ensure success.’*
>
> *A DFI*

To this end, Argidius Foundation is currently supporting I&P in launching a **community of first-time LPs**. Its goal will be to lower the barriers to entry for new LPs to invest in African SME and VC funds. Other initiatives, such as CFF working groups, also exist, that aim to **bridge the knowledge gap and engage with LPs less exposed to the sector** (smaller family offices and HNIs, sovereign investors, private domestic capital, etc.). LPs can continue pushing for enhanced collaboration, greater pipeline-sharing, and more co-investment opportunities. This would not only foster a **stronger understanding of fund investment processes among LPs** but would help them build confidence in our industry and facilitate the engagement of new pools of capital.

3) A particular research focus on funding models for early-stage SMEs is necessary, to highlight how catalytic capital can solve some of the particular constraints faced in this segment.

E

Early-stage SMEs requiring investments between $100k and $2m represent the bulk of SMEs on the continent; they are also the most neglected by traditional players, including the banking sector. The challenges of addressing this segment, either via equity and quasi-equity (early-stage SME funds) or debt (SME debt funds) are highest. A particular focus on this segment and the lessons of the first players can help assess the range of catalytic capital tools that can be deployed to grow it.

2.

Raising a SME fund remains very challenging, especially for newcomers in the space

2023 and 2024, the start of a 'funding winter' affected by unfavourable macroeconomics?

Despite the recent multiplication of funds, the fundraising landscape has been marked since 2023 by significant difficulties, collectively referred to within the VC community[18] as a **"funding winter"**, an expression just as apt for the SME fund ecosystem. This trend is reflective of **a broader downturn affecting fundraising for private risk capital worldwide.** According to the 2023 African Private Capital Activity Report[19], global private capital fundraising experienced a **17% year-on-year decline in 2023.** In Africa, the situation has worsened, with numbers declining for the second consecutive year. In 2023, the total fundraising value in Africa amounted to only $1.9bn, a 9% year-on-year decrease from 2022 and the second-lowest figure since 2012, surpassed only by the exceptional year of 2020, which was heavily affected by the COVID-19 pandemic (see FERDI Report 2024: Impact Investing in Africa).

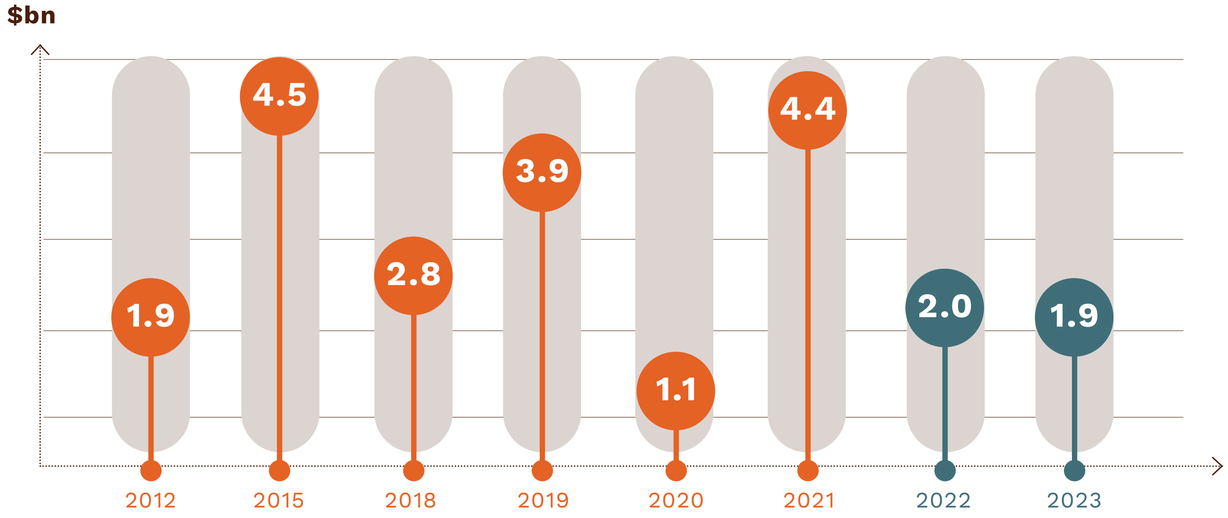

Figure: Total value (in $bn) of African private capital fundraising by year of final close

This downward trend has continued into 2024[20]: **commitments reached only $0.3bn in the first half of the year—a staggering 80% year-on-year decline.** Indeed, 2024 has been a very difficult year for fundraising in the African investment industry.

Several factors may have contributed to this decline:

> Recent years have witnessed a significant shift in the previously described perception of Africa as the continent of economic promise. The international outlook on the continent has become more cautious, influenced by a combination of political and economic challenges in a context marked by geopolitical tensions worldwide. Some countries have experienced the outbreak of conflicts, increasing a perception of political instability. Public debt in other countries has surged, raising concerns about long-term fiscal sustainability. Currency crises in some have hurt foreign investors. And the global economic disruption caused by COVID-19 has undermined investor confidence, leading to a progressive reduction from international private capital inflows to the continent.

> Higher inflation and rising interest rates have reduced the global appetite for risk: the rise of the risk-free rate prompted investors to seek safer havens and discouraged investment in regions perceived as riskier. The U.S. Federal Reserve's policy of increasing interest rates ended the era of abundant liquidity that fuelled the growth of private equity and venture capital globally and in Africa. The flight to safety also strengthened the US dollar[21,] adversely impacting emerging market currencies and intensifying inflationary pressures.

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[18] AVCA. 2024. Venture Capital in Africa Report 2023. Public version.
[19] AVCA. 2024. African Private Capital Activity Report 2023. Public Version.
[20] AVCA. 2024. African Private Capital Activity Report 2023. Public Version.
[21] World Bank Group. 2022. C. Arteta., S. Kamin., F. Ulrich. Policy Research Working Paper 10258. How do rising U.S. Interest Rate affect emerging and developing economies?

> Most of the capital flight comes from international private investors, who have played an important role in the growth of the industry, particularly for SME growth funds. Interviewed SME growth fund managers reported that **international private investors accounted for at least 50% of their investor base a decade ago but have largely withdrawn today**. Such 'risk-off' behaviour is sometimes compounded by the growing complexity of compliance and regulatory requirements for these private investors, especially for international banks. Many calculate that potential losses due to even minor compliance breaches now far exceed the potential returns, given the small scale of these investments.

Fundraising has become harder for all fund managers, and the riskier a fund manager is perceived, the more tortuous the path to fundraise. The following sections focus in more detail on the experience of emerging fund managers, but more **experienced fund managers also face their set of challenges.** When raising a fund II and even a fund III, one can of course demonstrate its capacity to deploy capital, but it is often **too early for the manager to show significant traction with exits in the current liquidity environment**.

'I have never seen a worse fundraising environment for first-time fund managers in Africa'

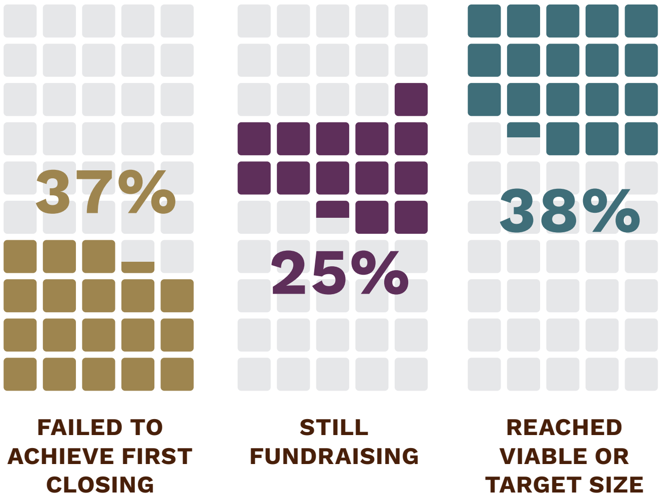
a DFI manager

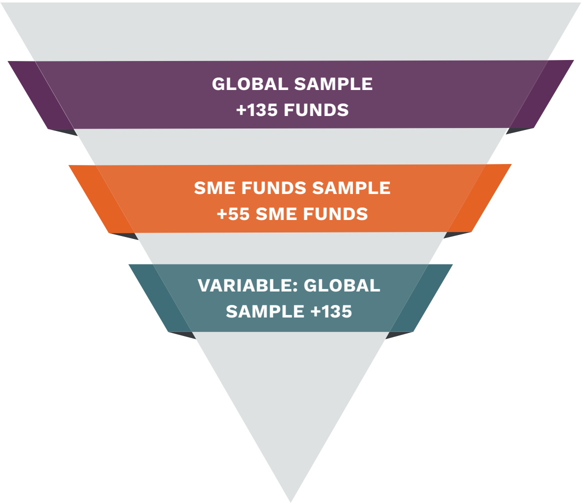
There is a scissor effect between more fund managers seeking to raise and limited pools of new capital unlocked.

There is **no public data on the fundraising success rate of first-time fund managers on the continent**; instead, we notice a 'survivor bias', where the success stories of GPs who do manage to raise hide the stories of the many who have given up.

Of course, many aspiring fund managers fail to raise for intrinsic reasons (lack of the team's focus, poor fund design, inadequate fundraising strategy, etc.). However, there is a larger trend at play, with a **'scissor effect' whereby a growing number of fund managers are competing for the limited pool of capital available.** This dynamic affects all fund categories, including the higher bracket of the SME-funding space, but is even more detrimental to first-time fund managers.

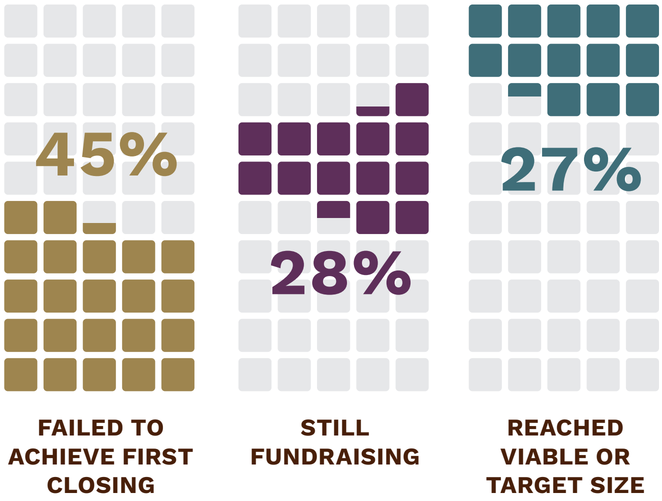
GLOBAL SAMPLE ALL FUNDS

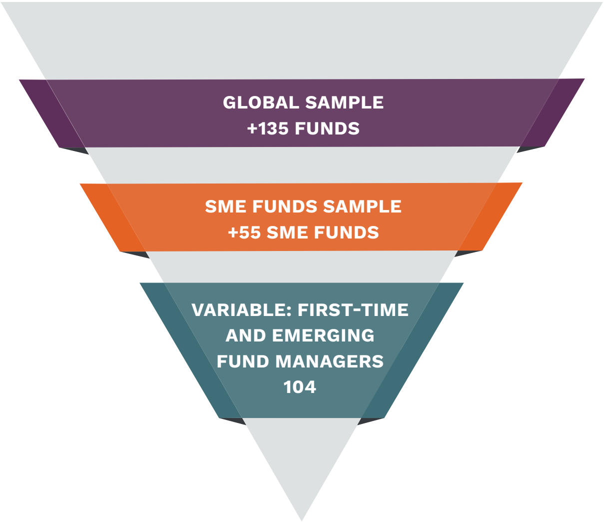




Out of our global sample of 135 funds, only 38% have reached viable or target size, 37% of them have failed to achieve first closing, and 25% are still fundraising. This picture becomes even bleaker when focusing on first-time and emerging fund managers.

GLOBAL SAMPLE FIRST-TIME AND EMERGIGNG FUND MANAGERS

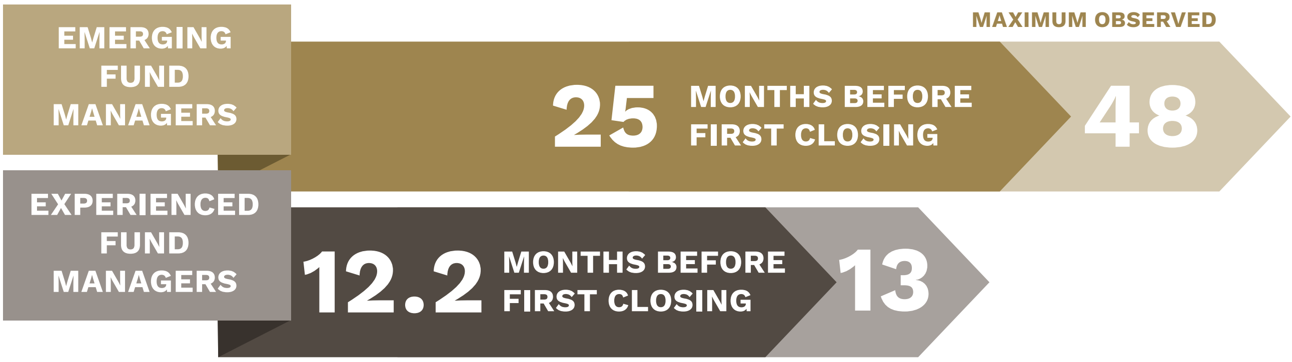




Out of our global sample of 135+ funds, 104 were founded by first-time and emerging fund managers on the continent (in this sample, we have only considered fund managers that have completed their fund design and have been raising for six months or more). **Only a quarter of these first-time or emerging fund managers have managed to reach their target or viable size.** Within this group, many promising fund managers give up despite having a relevant track record and differentiated strategies.

Even when they succeed in their fundraise, it is a very long process: **first-time fund managers typically take between one to four years to achieve first close**, and three to six years to achieve their target fund size. Many of them must find ways to start investing before they even reach their first close[22]. Once they have deployed and managed a first fund, experienced managers take a year on average to reach first close for their successor fund.

Out of our 55+ SME fund sample, we analysed the fundraising trajectories of 22 funds, of which 15 are emerging funds managers and 8 experienced fund managers. **On average, emerging fund managers take 25 months before first closing, whilst experienced fund managers take 12 months.**



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[22] CFF. 2023. Annual Local Capital Provider Survey 2023. Small business finance in African and in the Middle East.

The fundraising environment is particularly hard for early-stage SME funds, emerging fund managers, and female GPs.

Within this difficult landscape, first-time and emerging fund managers raising smaller sized funds (early-stage SME funds and SME debt funds) face compounded challenges due to perceptions of risk in their team structure (solo GPs, non-traditional track records, and backgrounds perceived with biases), their risky fund model, the lack of established networks with LPs, etc.

First-time and emerging fund managers are measured against benchmarks they cannot meet.

First-time and emerging fund managers are key to building a resilient, innovative SME investment ecosystem and to addressing neglected segments of SMEs and new geographies. Yet they face the highest barriers for fundraising.

> *'A lot of these emerging fund managers do not have the traditional track record associated with private equity, making it difficult for LPs to assess them. However, they are often the only ones to target the missing middle, which is not addressed by traditional private equity, banks or microfinance.'*
>
> *A fund-of-fund manager*

Their **perceived lack of track record** is the main pitfall. In a context of uncertainty, where there is very limited historical return data from SME funds across vintages on the continent, the bar is higher for first-time African fund managers to demonstrate that they can achieve returns than for their peers in more mature markets. For **most LPs, a solid track record is often a non-negotiable criterion** for consideration. It is defined, in the traditional sense, as circa 10-years of prior investment experience across the entire investment cycle, from sourcing to exit, within a segment of companies that fit with their fund's investment strategy. It is used as a proxy for a fund manager's ability to generate returns and manage risks for many LPs. LPs look not only at the individual track record but at the **track record of GPs investing together**, using it to assess the strength of a partnership and alignment on the investment strategy. This leads to a situation where only one type of background is rewarded in a fundraise and to a vicious circle where only the managers with a prior track record raise funds and are therefore able to further increase their track record.

> *''DFIs have demands that are very heavy for newcomers. The track record often requested by DFIs cannot be built during fundraising; either you have it or you don't' '*
>
> *A GP*

ZOOM

According to AVCA's 2023 African Private Capital Industry Survey[23], **89% of LPs consider track record crucial when assessing fund managers in Africa.** After that (for 54% of LPs) comes the ability of a GP's network to source, manage, and support target companies and the operational expertise in target sectors (for 46% of LPs). According to this survey, of those who prioritise the performance track record, a significant majority (64%) admit to not having invested in a first-time fund manager in Africa in recent years.

Women are evolving in an industry still characterized by gender imbalances and structural inequalities

According to the Sagana and Chemonics report Unlocking Opportunities for Women Fund Managers (2024)[24], despite strong and growing evidence of higher returns and greater impact from gender-diverse teams, women are still severely underrepresented in the SME investment sector:

> Only 2%-3% of total capital flows to women-led fund managers across both PE and VC[25]

> Only 11% of team members in PE/VC within emerging markets are women[26]

> Only 10% of all fund managers globally are women[27]

Global awareness of the role of women in PE and VC has significantly increased, leading to a near quadrupling of women-led funds in the last five years.[28] The strengthening of global standards and definitions of gender-lens investing with 2X Global[29], fully incorporated by DFIs and many other leading LPs, as well as demonstration of the impact created[30], have pushed the industry forward. However, several challenges remain:

> **Lack of representation** of women in the PE/VC space, especially in senior investment and GP positions.

> **Limited networks:** Women often face challenges in accessing established networks which are critical in the PE sector.

> **Capital constraints:** Raising a fund can require significant resources, and women often have less capital at their disposal than do men.

> **Investor mismatches:** Most women-led funds are led by first-time and emerging fund managers and often do not align with traditional LPs (DFIs, commercial investors). They are more likely to be supported by mission-oriented private investors (HNWIs, family offices, foundations, etc.)[31]

> **Gender biases:** Biases about women's capabilities in fund management still exist, including within the LP community.

ZOOM

Women-led and gender-diverse fund managers are heavily represented in the SME funds category, especially as first-time and emerging fund managers.

According to the CFF's Annual Local Capital Provider Survey 2023 (based on a sample of 60 fund managers addressing small growing businesses in Africa and the Middle East).

> 60% of respondents are women-owned fund managers, compared to 12% in PE and 5% in VC globally.

> 2X Criteria are being applied more broadly across the board.

This is coherent with the sample we analysed. Out of our sample of 55+ SME funds, we found that:

> 55% of SME fund managers are women-owned.

However, of these female-owned fund managers, **only 39% have reached a first close**. Financing women in raising and reaching first close is thus key to supporting the overall growth of the early SME sector.

Out of the 55+ SME fund sample, **35 are female-led or gender-diverse funds**. Data confirms that:

> They are **mostly first-time and emerging fund managers**, raising their first fund.

81% of women fund managers in our SME fund sample are **first-time and emerging fund managers**

> They are largely set up by **new GPs with non-traditional backgrounds**.

74% of women-led and gender-diverse fund managers have **non-traditional backgrounds** (entrepreneurs, consultants, engineers…)

> Those with an investment track record as private equity or VC professionals **launched their fund after holding senior investment positions in other funds**.

100% of female fund managers with a traditional PE background previously **had high ranking positions in an investment company**

Groundbreaking initiatives to support more women-led fund managers have been designed in the past five years and work best when they can incorporate the main structural constraints that emerging fund managers face. One example is the Mastercard Foundation Africa Growth Fund which is a fund-of-funds initiative dedicated to backing women-led and gender-lens emerging African fund managers, managed by a consortium of partners led by Mennonite Economic Development Associates (MEDA) as fund manager, including I&P as fund advisor, ES Partners as BDS partner, Criterion Institute as GDEI partner, Genesis Analytics as learning partner and ACG as communications partner. By combining (i) investment criteria that adapt to the realities of emerging fund managers, (ii) a range of catalytic instruments including warehousing capital, working capital and anchor investment, and (iii) an intentional approach to financing women, the Mastercard Foundation Africa Growth Fund has committed capital to many women-led invetsment vehicles.

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23. AVCA. 2023. African Private Capital Industry Survey. Behind the Scenes: LP and GP perspectives unveiled.
24. Chemonics International, Sagana Consulting. 2024. Unlocking opportunities for women fund managers. Technical brief.
25. IFC. RockCreek. Oliver Wyman. 2019. Moving Toward Gender Balance in Private Equity and Venture Capital.
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27. Women in VC, "The Untapped Potential of Women-led Funds," October 2020
28. Chemonics International, Sagana Consulting. 2024. Unlocking opportunities for women fund managers. Technical brief.
39. The inception of 2X Global leading the work on the 2X Challenge is the main example
30. Global Impact Investing Network (GIIN). 2024. In focus. Gender and Impact Investing in 2024.
31. Chemonics International, Sagana Consulting. 2024. Unlocking opportunities for women fund managers. Technical brief.

Fund return data suggests that first-time and emerging fund managers with non-traditional backgrounds and lean teams perform well.

Prior investment track record is not a reliable proxy for financial performance.

Of course, the historical investment track-record of a fund manager does not guarantee future performance. But beyond this, it is a particularly weak and hasty proxy for performance when it comes to SME funds run by first-time and emerging fund managers. This is especially true as they often operate in **untapped markets**, acting as the first investors to launch funds in their segments or countries, which makes it even more **difficult to rely on similar track records** in their country of operation. There are many cases where the LP focus on investment track record has favoured (often foreign) investors with experience in other markets, and often completely different asset classes (investment banking, large cap PE), compared to domestic investors with non-traditional but **highly relevant backgrounds in building and supporting SMEs** as well as angel investing.

The data seems to challenge the perceptions that first-time fund managers with non-traditional backgrounds perform poorly. In small sample of SME funds, which would need to be expanded, we find many cases where first-time fund managers with non-traditional backgrounds have performed very well and better than more experienced fund managers with an investment track record in the same market.

Out of our 55+ SME fund sample, we have analysed financial data for 22 funds (debt, early SME, and growth SME funds), of which 14 are emerging fund managers and 8 are experienced fund managers. It shows that despite a younger age of portfolio, **emerging fund managers** (raising their first institutional fund) **tend to achieve a higher MOIC than experienced fund managers** (raising their fund 2 or beyond).

	Emerging fund managers* Average age of the funds: 7.3 years	**Experienced fund managers*** Average age of the funds: 9.3 years
AVERAGE MOIC	**1.49x**	**1.28x**

* All types of funds (early debt, early SME, and growth SME funds)

Out of the same sample, there are 10 fund managers with non-traditional backgrounds and 12 fund managers with traditional backgrounds.

The data shows a similar trend of **non-traditional backgrounds outperforming traditional backgrounds**, despite a younger portfolio age:

Fund managers with non-traditional background*
Average age of the funds: 6-7 years

Fund managers with traditional background*
Average age of the funds: 7-8 years

AVERAGE MOIC

1.58x

1.21x

* All types of funds (early debt, early SME, and growth SME funds)

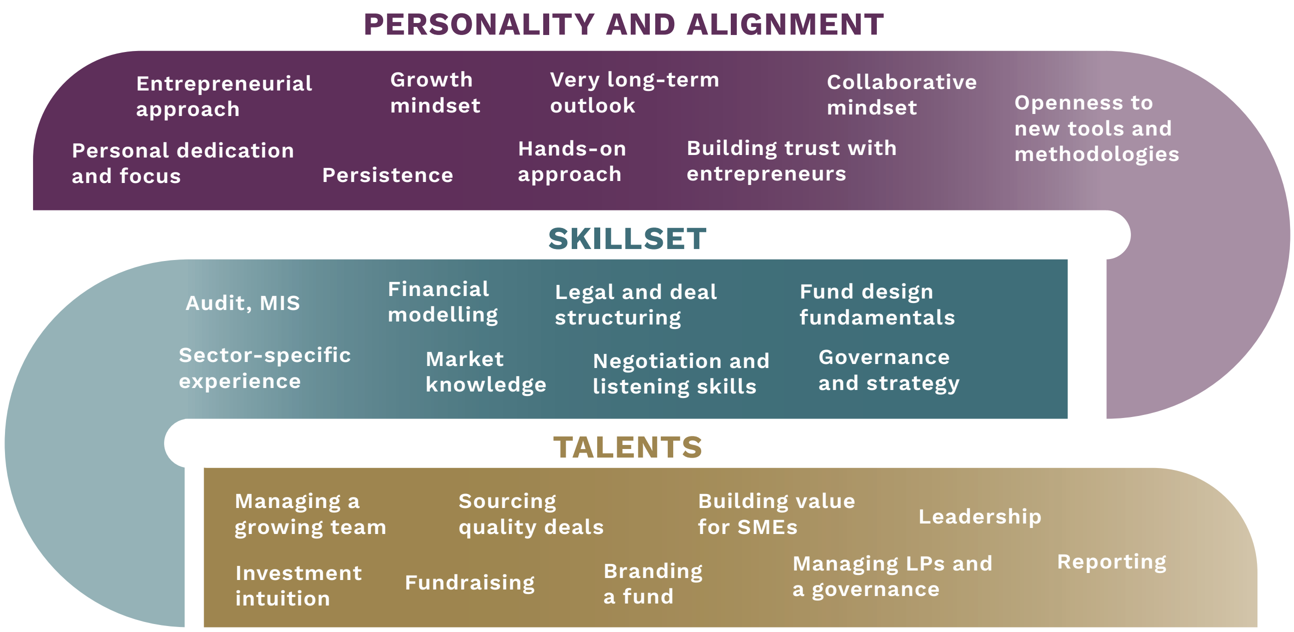
This MOIC data is also reflected in the total value to paid-in (TVPI) achieved by these funds. Several factors can lead to these conclusions:

> First-time fund managers do not have a legacy portfolio with portfolio crises and exits to manage; the GPs can be solely focused on deploying their first fund, and do not face the same level of complexity in fund management.

> First-time fund managers tend to address key gaps in the market where their positioning gives them a clear competitive edge.

> First-time fund managers tend to invest in earlier-stage SMEs, with better gross investment performance.

Of course, this sample must be widened to build more robust data; however, it is coherent with similar data in mature markets where **first-time fund managers running small funds can over-perform in some segments**. It also suggests that LPs can take a broader view of what track record is, while assessing fund managers. Taking the time to unpack the key success factors for their fund and **testing the fund manager's capacity** on each of them is a more granular approach: sourcing in a particular market, negotiating, adding value to SMEs and helping them grow, exiting, managing a team, etc. This set of skills can certainly be found in fund managers with heterodox backgrounds (entrepreneurial, consulting, etc.). As an example, the following diagram shows **some of the main criteria I&P has identified over the years to assess new fund manager** (each with sub-criteria of varying degrees of importance):

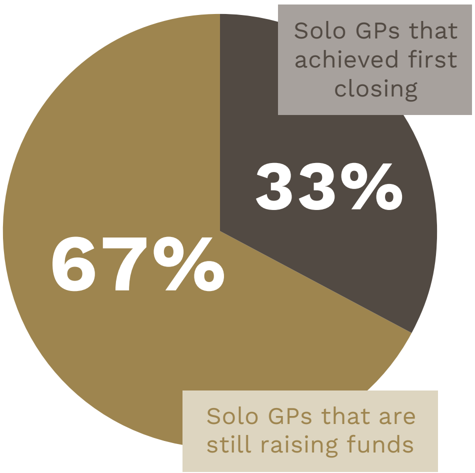


A new fund manager builds their team progressively and often starts out as a solo GP

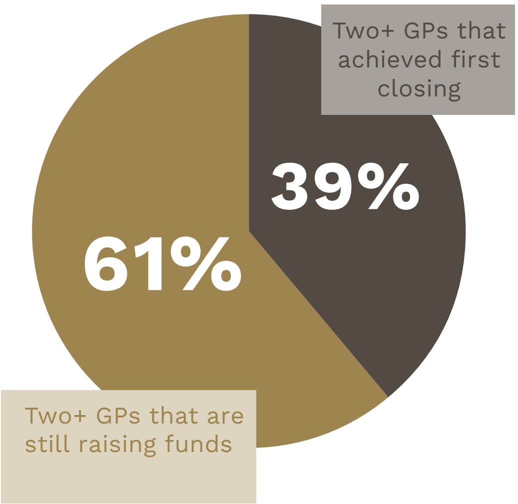
First-time and emerging fund managers **lack the resources to pay for a full team before they raise capital**, whilst second or third funds already have established teams. Unless there is working capital available (see section 1#5, p.73), the team can only be recruited at first close. Solo GPs, which are teams with one sole founder supported by more junior team members, are common in the first-time fund manager landscape; they bring both advantages and challenges.

Our sample of 55+ SME funds (early SME funds, growth SME funds, debt funds) shows that there is a majority of 'two+' GPs trying to raise but that on average **they tend to achieve closing at the same rate as do solo GPs.**

SOLO GPs: 40% OF THE SME FUNDS SAMPLE



TWO+ GPs: 60% OF THE SME FUNDS SAMPLE



Out of our sample of 55+ SME funds, we have analysed financial data for 22 funds (debt, early SME, and growth SME funds), **among which 13 are 'two+' GPs and seven solo GPs** (two in the sample are not relevant for this data). Our sample would need to be expanded, but shows how on average **solo GPs can perform better than partnerships**, despite the younger age of their portfolio:

SOLO GPs: AVERAGE TVPI OF 1.28

Average age of the funds: 6.14 years

TWO+ GPs: AVERAGE TVPI OF 0.90

Average age of the funds: 9 years

Solo GPs bring some advantages: they avoid partnership conflicts, retain full control over decision-making, and create lean teams. However, they also face drawbacks: heightened key-person risk, lack of sparring partners, potential skillset gaps, and narrower networks.

RECOMMENDATION 1#2

LPs can adjust their assessment criteria in order to back strong performing teams, including first-time and emerging fund managers with non-traditional backgrounds.

1) Assessing a first-time and emerging fund manager requires a more granular approach than looking at track record; first time fund managers with non-traditional backgrounds tend to perform well.

LP

Return data shows that emerging fund managers, including those with non-traditional backgrounds, can outperform fund managers that more traditionally fit the criteria of most LPs. Adapting the assessment criteria of LPs, by including a more granular approach than the focus on track record, can help LPs access new types of fund managers that deliver returns whilst building a more inclusive fund management ecosystem that makes space for non-traditional backgrounds.

2) LPs can back lean teams, including solo GPs, to benefit from their advantages while mitigating some of the risks.

LP

Rather than rejecting solo GPs outright, which is often an exclusionary criterion for many LPs, these risks should be carefully assessed and, when needed, mitigated by interventions that can include strengthening the investment committee and board, offering targeted technical assistance, bringing in a senior professional on a partnership track, engaging a senior advisor, or identifying a sponsor to back the GP. By addressing specific needs, these measures can help build a resilient, well-rounded fund management structure and in some cases may be more stable than partnerships between two GPs. Indeed, succession crises at fund II or fund III have plagued many of the pioneering SME funds in the market, affecting returns for all LPs.

Backing solo GPs can help LPs unlock new segments of companies; fund models and fund return data suggest that this can lead to strong returns.

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32. Gender Smart. 2021. A Guide to investing in first-time women and diverse fund managers. The XX factor: Unlocking opportunity, impact and alpha.
33. Global Impact Investing Network (GIIN). 2024. In focus. Gender and Impact Investing in 2024.

E

3) Creating equitable opportunities for women can take multiple approaches.

There are significant imbalances in the SME fund management sector, particularly when it comes to the representation of women as GPs and senior investment professionals. Significant research has already demonstrated that gender-equal funds lead to better performance[32]. Providing opportunities for women fund managers requires both taking action in established funds and simultaneously and proactively encouraging new fund managers to emerge:

> Promoting women to senior positions (as directors and partners) in established funds helps them build the track record that enables them to raise funds in the future.

> Promoting the **adoption of deep GLI policies** in established funds, even when it is not their direct mandate, also supports outcomes over time for women, and this is driven mostly by LPs. The GIIN's last report on GLI[33] shows that gender-lens investors had the highest average rates of women representation at every leadership level: 47% at the senior management level, 42% at the board level, and 39% at investment committee level. Intentional LPs can invite fund managers to develop ambitious GLI policies that go beyond the minimum criteria.

> Backing more **first-time and emerging fund managers with non-traditional backgrounds** whilst embedding a gender lens approach is a key intervention, as this group disproportionately includes women fund managers.

LP

4) There is a need for a flexible approach with respect to a GP's skin in the game.

> LPs ask GPs to invest cash into their own fund, **with a benchmark of 1% of the fund size**: this is known as skin in the game, which is used as a proxy for GP alignment with LPs.

> LPs can recognize the context-specific aspect: since launching a new fund takes two to four years, aspiring GPs already show dedication and take considerable personal risk.

> **Investing significant cash is very challenging for fund managers**, especially after spending two to four years to raise a fund without pay. In addition to cash investment, LPs should consider all aspects of skin in the game, including the time GPs have spent to raise a fund, and, in the case of smaller fund size, the compensation that GPs must forego to charge their LPs reasonable fees.

> When it comes to the cash amount, a more useful proxy for GP alignment with LPs would be an assessment of their skin-in-the-game investment as compared to their net personal wealth rather than of their fund size.

3.

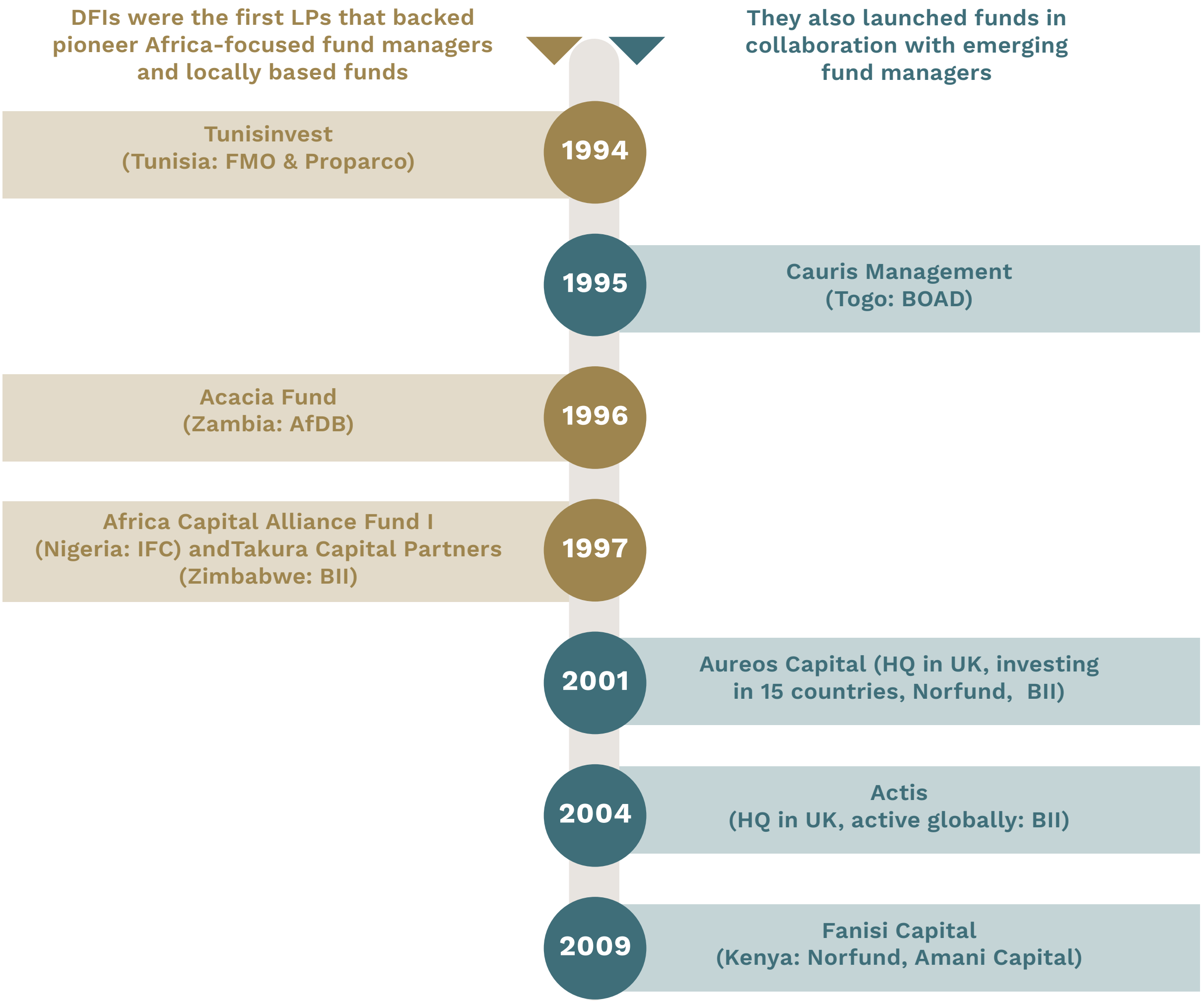
International DFIs are still the leading players in SME fund investment – today, they invest mainly in larger funds

DFIs' historical objective was to attract international capital into emerging markets, mainly by backing large funds.

Initially established in the 1940s to support emerging market governments through loans[34], bilateral and multilateral development banks also started in the 1990s to invest in private companies (AfdB, AsDB, JICA later...). Some specialized public institutions, now called DFIs, were created (Proparco, DEG...). They were seeking to mobilise additional private capital for these markets by demonstrating to international investors that they could deliver returns. They began investing directly in large corporates, financial institutions and infrastructure. They targeted emerging markets with strong growth potential, such as China, Indonesia, Mexico, South Africa and Nigeria, aiming at increasing competitiveness and productivity. Opportunities of this scale were fewer in 'frontier markets' like Senegal, Tanzania, and Burkina Faso. For these, DFIs thus developed a new strategy and began investing in intermediaries such as funds.

Their primary objective in financing funds was to reach new segments of companies in untapped and riskier markets[35]. This enabled them to diversify their risk-exposure, benefit from fund managers' expertise in specific regions and sectors, and grow their pipeline with co-investment opportunities. Direct investing also showed its limits for DFIs: it required extensive internal capacities which were difficult to set up in smaller economies.

A second objective was to contribute to the **development of investment ecosystems** in emerging economies. DFIs provided funding to first-time and emerging fund managers in Africa and helped establish a PE industry in many of markets.



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[34] AVCA. African Private Equity and VC Association. Guide to PE in Africa. 2016

[35] Michelitsch, R., Soriano, A., Cuestas, E. (et al). Inter-American Development Bank. Inter-American investment Corporation. 2017. Comparative study of equity investing in Development Finance Institutions (DFIs).

However, **financial returns did not meet expectations** for most of the SME funds in emerging markets. From the 2010s onwards, DFIs faced significant political incentive to find ways to address SME needs as part of their development mandates but also pressure to generate higher returns. They kept investing but often **under the condition of blended finance mechanisms to achieve financial returns.** Direct investments proved to be more profitable for DFIs; however, they have maintained their fund investment strategy for the reasons mentioned above.

INVESTMENT IN COMPANIES

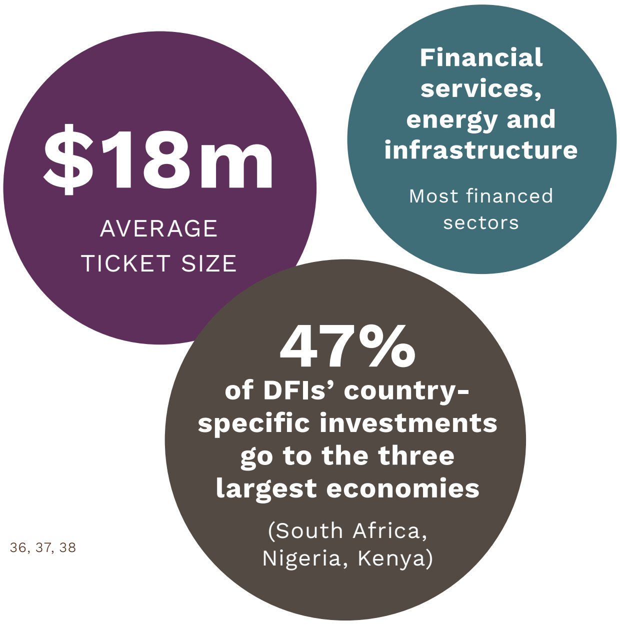
⊕ Impactful lever for developing ESG, climate, and gender standards directly with companies and advocating for these topics
⊕ Direct investments are often more financially successful than indirect investments (due to fund costs)
⊕ Political interest: Direct investments offer more public visibility

⊖ Extensive costs of managing all investment stages in-house, especially for untapped markets
⊖ Investments that cannot go below a certain threshold (e.g. $10 million) and therefore do not reach SMEs

INVESTMENT IN FUNDS

⊕ Cost-efficient way to reach investees in markets where DFIs may not have a presence or experience
⊕ Learning from fund managers' expertise and knowledge on a country or a sector
⊕ Bringing interesting co-investment opportunities
⊕ Diversifying risks
⊕ Contributing to the development of a PE SME industry in countries where the industry is nascent

⊖ Additional external costs to finance funds: management fees, forms of compensations have to be paid
⊖ Less control over investment decisions and fund terms
⊖ Less liquidity

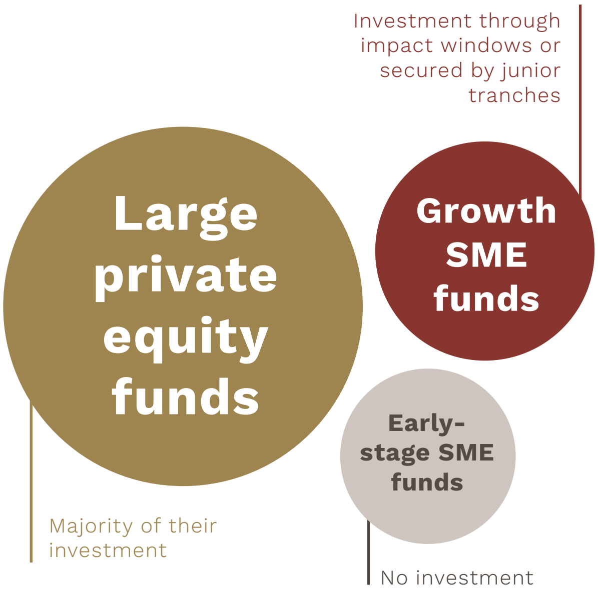


$18m
AVERAGE TICKET SIZE

Financial services, energy and infrastructure
Most financed sectors

47%
of DFIs' country-specific investments go to the three largest economies
(South Africa, Nigeria, Kenya)

36, 37, 38



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36. Michelitsch, R., Soriano, A., Cuestas, E. (et al). Inter-American Development Bank. Inter-American investment Corporation. 2017. Comparative study of equity investing in Development Finance Institutions (DFIs).
37. African Resilience Investment Accelerator (ARIA). Foundations of Growth. June 2024. DFI investments in frontier markets: Activities, lessons learned, approaches to fostering investment. BII, FMO.
38. FERDI. Severino, J.M. 2023. « Des millions pour des milliards : Accélérer l'émergence entrepreneuriale africaine pour une croissance accélérée, durable et riche en emplois »
39. British International Investment. Carter, P., Ayres, S. 2024. Investing for impact in African private equity funds. Practical thinking on investing for development.

‘Although DFIs have historically backed many first-time and emerging fund managers to help create the African PE industry, they are now in a new phase of market development, that puts more emphasis on successor funds from established GPs’ [39].

The bulk of capital goes to **back established fund managers** with **large investment tickets** (typically a minimum of $5m), and DFIs are especially interested by funds with a **pan African/regional strategy** in a sector-specific (infrastructure, energy, etc.), innovation (VC), or generalist approach. Of course, they do not automatically back successor funds of a given fund manager (although there is a common perception in ecosystems that once the relationship with DFIs is solidified with a first investment, it continues with successor funds), as the **financial returns expectations** remains the main criteria. DFI investment in African funds has mostly focused on growth equity or debt/mezzanine funds of a certain size (usually above $80m) with a regional or pan African focus, the rationale being that these funds would allow economic sustainability of both the fund and the fund managers, allowing the GPs to recruit and maintain an experienced team with the depth of expertise to provide strong value and support to their investee companies.

‘DFIs are inherently risk-adverse. We certainly have a development and market-building mandate but our internal risk department also has a strong say.’

A DFI

In a context where even the more mature fund managers in the African PE ecosystem are not able to raise exclusively from private commercial investors, they still depend on DFI capital for their fundraises, and it becomes a key strategic priority for DFIs to support the fund IV, fund V etc. of these successful fund managers to ensure their survival and continued growth. This leads to significant DFI capital being deployed in the most mature funds.

‘Most DFIs have told us they would not invest in funds below $100m.’

A GP

There are several examples of recent announcements of DFI investments; most have gone to larger private equity funds and VC

IFC

> March 2024: $10.5m commitment to 4DX Ventures Fund III (managed by New-York based VC firm and focused on SSA)

> March 2024: $5m commitment to P1 Ventures, pan-African VC fund

> October 2024: $5m commitment to Equator Africa Fund I (final close at $54m) – first-time and emerging fund manager focused on climate VC investment

> January 2024: Commitment to two infrastructure funds: $20m in Africa50 IAF Fund (at $222.5m first close) and $30m commitment to AIIF 4 (exceeding $500m target)

BII

> August 2024: Commitment alongside seven other institutions (EIB, FMO, SIFEM, etc.) for the $200m first close of Helios CLEAR Fund

AfDB

> August 2024: $10m junior equity commitment to KawaSafi Fund II, a $200m target clean energy fund in SSA

Proparco

> August 2024: €20m commitment to Amethis Fund III (large PE fund in SSA). This follows the announcement of a €25m commitment from EIB in May. These two commitments come after the first close of the fund in July 2023 at $140m (IFC, Swedfund, family offices, private institutions), contributing to the target of €450m

> Final closing of the Transform Health Fund at $111m, managed by AfricInvest in partnership with the Health Finance Coalition (HFC). In addition to Proparco, other investors include DFC, FSD Africa Investments, Ceniarth, UBS Optimus Foundation, Skoll Foundation, USAID, etc.

SIFEM

> April 2024: $15m commitment to Adenia V at final close, contributing to the fund reaching $470m, alongside other DFIs (DFC, FinDev Canada, Norfund, DEG, EIB, FMO, IFC, Proparco), impact investors (Blue Earth), Kenyan, Ghanaian, and South African pension funds, as well as other foundations, family offices, etc.

There are reasons why the bulk of DFI capital does not go to SME funds.

On their own balance sheets, **DFIs would typically not consider investing in funds below a $80-$100m target size**, which is mostly due to low historical returns in SME funds. Research and interviews indicate why:

Low historical profitability of SME funds in DFI portfolios

> DFIs have commercial return expectations, and their **historic SME fund portfolio has suffered from low returns**.

> One DFI mentions the lacklustre returns of SME funds in its portfolio, with most funds returning below 1x and an average TVPI at 1.1x driven by outlier performers; another mentioned that 90% of their SME funds delivered returns below 1x.

> In its annual report, Norfund unveiled that the IRR of its fund portfolio reached -0.6% in 2023. Since inception, IRR is 0.3% in investment currency[40]. Though this is the return of its overall fund portfolio, Africa represents 66% of this portfolio.

> The *2019 Deloitte, Omidyar Network, and Shell Foundation report Insights on SME Fund Performance* aggregated data on the performance of SME funds in DFI portfolios, with an average investment ticket size of $2.9m (fitting the category of SME growth funds) and with vintages up to 2015. They achieved an average TVPI of 0.84x and reported a negative net IRR (USD) of -6.69%.

Structural organisational constraints

> DFIs often have small teams dedicated to SME funds investment, which also cover other segments as well; they must deploy considerable time to get investments to the finish line, in process-intensive and bureaucratic organisations where several layers of approvals are necessary. This is even more challenging in a context where DFI capital deployment targets are set in volume, leading DFIs to prioritise large tickets to be invested in large funds.

> This leads to a prudent approach where small-sized funds, or funds that are at **risk of being rejected by the risk department**, are filtered out of the investment process. This risk department is empowered to contradict propositions by the DFI's own investment teams.

Positioning in the ecosystems

> DFIs often contend that it is the role of the local financial systems (microfinance, banks, etc.) to address the funding needs of early stage/small enterprises; DFIs provide direct financing lines to these financial institutions and therefore reach SMEs indirectly.

> There is a **shift of several DFIs towards increasing direct investment into SMEs and startups, instead of intermediating their investments** through SME funds, in part due to strategic priorities and to the under-performance of the SME funds asset class.

- BII launching in 2023 a new platform, Growth Investment Partners (GIP) Ghana with an anchor commitment of up to $50m to provide long-term flexible capital to SMEs in Ghana, with tickets of $500k to $5m primarily in local currency equivalent. The company aims to support up to 150 Ghanaian SMEs within the next 15 years.
- Proparco increasing its allocation of direct investments to venture capital investments as part of a mandate to back innovation from seed to series B.

To cater the SME segment, most DFIs thus developed specific windows to support Growth SME funds as part of their impact mandates.

Several first-time and emerging fund managers have managed to access DFI capital in the past three years, in particular VC funds and a limited number of growth SME funds (e.g. Joliba, Adiwale), with fund sizes ranging from $60-$90m.

60% of funds raised by growth SME funds in our sample come from DFIs

As a matter of fact, growth SME funds are mostly funded by DFI capital. Out of our sample of 55+ SME funds, 17 of them are Growth SME funds. Among them, we found that DFIs make up the majority of sources of capital. It represents a limited number of investments for DFIs for relatively modest volumes.

The minimum fund size considered is $30 – $50m. Considering that a single DFI is able to invest up to a maximum of 20% – 25% of the fund size, a fund can only exist if attracting at least three to four DFIs. This dynamic generates a **'winner-takes-all' situation** where a small number of fund managers succeed in attracting three to four DFIs in a fundraise, whilst other fund managers, though generating interest from one or two DFIs but struggling to secure a third one, fail to raise any capital at all.

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40. Norfund. 2023. Annual report.

> *'There is a tough fundraising environment in Africa today. It is very DFI-heavy, and each DFI has a specific mandate; they may not converge together for many fund managers.'*
>
> *a LP*

Smaller-size SME funds, in particular early-stage SME funds and SME debt funds, have not recently raised capital from DFIs, with the significant exception of the DFC deploying debt capital into several SME debt funds which can provide coverage with an equity tranche[41].

Due to the limited wriggle room on their own balance sheets, **DFIs have created special impact pockets**, **most often off-balance sheet**, to allocate capital to these growth SME funds and to take more risks:

DFIs	SME programme	Key features	Examples of vehicles funded
IFC	**SME Ventures Programme**	> Launched in 2010, off balance sheet > Invests in private equity funds focusing on SMEs and operating in World Bank IDA - FCS countries > First pilot in 2010-2015, focused on key countries (Sierra Leone, Liberia, DRC, Nepal, Bangladesh), invested in four funds, two of which were African funds > As of 2023, a total of $273m invested in 24 fund managers across the globe, many in Africa > Invests preferably in closed-ended funds with minimum size of $50m	2023: €15m commitment to Joliba Capital Fund I (€88m final fund size) of which 50% were SME Ventures and 50% IDA-PSW Repeat commitment: XSML Fund I: $12.5m IFC commitment for a fund size of $19m XSML Fund II: $15m commitment for a fund size of $50m XSML Fund III: $15 commitment for a fund size of $85m
Proparco	**FISEA**	> Proparco's SME support fund, managed on behalf of AFD Group > First vehicle launched in 2009, with €250m deployed in 41 projects, 30 of which were funds in Africa > Second vehicle launched in 2020 with €210m raised and currently being deployed > Investment tickets of €5 to €15m in funds of $50–$100m size	2022: $12m investment in Maris Africa 2022: Commitment in FEFISOL II (1st closing at €22.5m) 2018: $4.4m commitment in FEFISOL I 2013: €5m commitment in Moringa 2017: €7m commitment to IPAE2
FMO	**MASSIF**	> FMO's financial inclusion fund, set up in 2006 and managed on behalf of the Dutch government (off balance sheet). Direct and indirect (funds) investments > $493m committed portfolio as of FY 2023, including $196m in Africa	2023: €10m commitment to Joliba Capital Fund I (€88m final fund size 2024: $12.5m commitment to ARF IV (XSML's fourth fund, with first close at $97.5m and target size of $135m)
EIB/ AFDB	**Boost Africa**	> EIB – AFDB joint venture in 2016 to support innovation and the emergence of new scalable VC funds in Africa > Focus on funds with minimum fund size of $50m	2023: Commitment to Seedstars Africa Ventures 2022: Commitment to Janngo Capital 2022: Commitment to Atlantica Ventures 2018: Commitment to Partech Africa I
BIO	**SDG Frontier Fund**	> Set up in 2020 with a €36m fund size thanks to the participation of 14 Belgian institutional and private investors, including BIO > Co-invest with BIO in private equity funds in Asia and Africa, with tickets below $10m > Due to this pure co-investment strategy with BIO, this facility ends up investing in large-sized PE funds	2022: $2.5m commitment to Uhuru Growth Fund I 2022: $2.5m commitment to TIDA Africa II Fund 2021: €4m commitment to Cathay AfricInvest Innovation Fund
DFC	**Social Enterprise Finance/ Portfolio for Impact and Innovation (PI²)**	> DFC does not have a specific funding pocket addressing the SME fund segments. However, under its PI² programme, the institution seeks to address the financing gap for small-scale, high impact projects through direct and indirect investments > For the SME segment in Africa, preference seems to go to providing loans to investment vehicles	2020: $4m direct loan to iungo capital BV (PCV providing debt to African SMEs) 2024: $7m direct loan to Barka Capital Debt SPV

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41. CFF. 2023. Annual Local Capital Provider Survey 2023. Small business finance in African and in the Middle East.

> As DFIs are still the predominant players for growth SME funds, they have a **significant influence and responsibility over the segment**.

> *'Not many investors are actively seeking out African funds. The market depends on DFIs, so you have to apply their terms and conditions.'*
>
> *A DFI*

SPOTLIGHT | BEYOND THE QUANTUM OF CAPITAL, DFIS LEAD THE NORMATIVE PROGRESS OF THE SECTOR.

DFIs are still the undisputed leaders in the normative progress of the sector today, supporting fund managers to improve practices and standards with each new generation of funds.

In the early 2010s, DFIs focused primarily on developing robust ESG strategies and impact management frameworks ('Impact Operating Principles'). By the 2020s, the DFI-led 2X Global initiative had elevated standards in gender-lens investing and gender equity among fund managers. Today, a climate-lens approach is no longer a differentiator but often a baseline requirement for gaining traction in fundraising.

This focus on climate, gender, and other impact components undoubtedly improves practices and is important for our ecosystems. It is consistent with the provision of concessionary funding (meant to generate social impact) and limits 'impact-washing' behaviours thanks to the use of measurable standards.

However, this raising of standards also raises the bar for first-time and emerging fund managers. They often must realign their investment strategies to meet the expectations of LPs. The level of complexity, standards, and expertise that a new fund manager is expected to meet on these specific topics (climate, gender) is often perceived as a hidden barrier to entry and can be perceived as a 'trend' driven by DFIs and followed by ecosystems. It also raises costs for funds, requiring them to dedicate resources for the topics (ESG officer, climate risk assessments, GDEI policy, etc.).

Overall, there is a dilemma here, and it is important for the DFI community to assess both where to put the needle in setting expectations from SME funds and how to be inclusive by providing support alongside standards.

RECOMMENDATION 1#3

DFIs can continue building the market of African funds by complementing their existing range of instruments.

1) Increasing investments in SME funds, and adapting terms.

LP

To truly enable the growth of the SME investment ecosystem, it is vital that DFIs prioritise investing in African funds led by Africa-based fund managers. **Moving beyond the under-performance of SME funds** launched 15 to 20 years ago is key to grasp the opportunity brought by an emerging generation of fund managers that is operating in a more mature market, with considerably more talent, and beginning to deliver real returns. DFIs can pursue their market-building role by funding and building the capacity of the new generations of fund managers, equipping them to attract and manage domestic and international capital, and leveraging their key assets of proximity, market knowledge, and efficiency.

Investing in SME debt funds and early-stage funds will require more flexibility on ticket size, terms, and liquidity constraints.

Providing long-term co-investments into SMEs alongside fund managers is also important due to the lack of patient capital available on the market. Such co-investments also enable LPs to get a more direct grasp of the realities of some portfolio companies, increase proximity with fund managers through the life of the co-investment, and deploy more capital in selected portfolio companies that fit well with their strategy.

2) Collaborate more closely with emerging institutional investors could increase DFI allocation to SME funds.

LP

In order to lessen the frequency of cases where many DFIs invest in the same funds and enable them, as a group, to back a larger number of SME funds, DFIs could further increase coordination and co-investment with other institutional investors able to anchor SME funds, such as the rising number of funds-of-funds and African sovereign investors that can deploy significant capital.

There is already a positive trend in that regard, that can be enhanced with more collaboration on pipeline and data-sharing. This will multiply the opportunities for SME fund managers to raise capital from individual DFIs as they can do so without necessarily needing to attract three DFIs, but instead a combination of DFI, funds-of-funds and sovereign players.

3) Data shows that African private capital is more likely to invest in African SME funds than international commercial capital; DFIs can find solutions to promote this trend.

LP

The performance of historical SME funds has been undermined by foreign exchange risks and country risks, which DFIs and international commercial investors struggle to control. Today, international investors are a very limited source of capital for African SME funds. Instead, African private capital is emerging as a major source of funding, and a reliable one (see p.60).

To date, only very few sovereign domestic actors in Africa are able to commit enough capital to anchor

SME funds, which means that fund managers looking to raise African private capital struggle to find an anchor investor. In markets where such an anchor is active, such as in Ghana with VCTF, fund managers improve their success rate in raising domestic private capital dramatically, as shown in page 69; however, anchors such as VCTF remain an exception in the landscape.

DFIs can leverage their development mandate to plug this gap in many markets where domestic anchors are not active, and fuel the promising trend of African private investors investing into African SME funds.

4) DFIs can invest in funds-of-funds to target the smaller fund sizes that they are not able to fund directly, particularly SME debt funds and early-stage SME funds.

LP

DFIs currently have limited tools to continue building the market of SME fund managers: they are limited to backing growth SME funds and are not able to deploy capital to early-stage SME funds and SME debt funds, although they cater to most of the SME market.

Investing in funds-of-funds dedicated to anchoring and investing in emerging African fund managers is a useful way for DFIs to complement their existing offering whilst overcoming their constraints on ticket size and risk management. This has been exemplified by the investments of Proparco and African Development Bank into sponsor fund IPDEV: via IPDEV, they have contributed to building nine new PCVs in frontier markets that they would not have been able to fund directly.

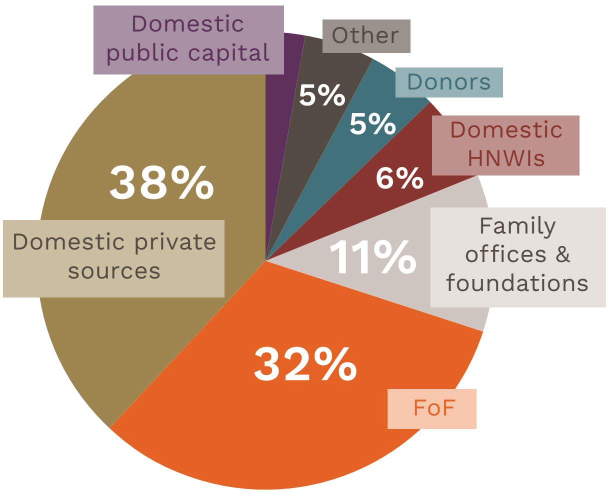
Although funds-of-funds can create an additional layer of fees, experience suggests they are a key instrument to back emerging fund managers who go on to raise from DFIs for their second fund, making this an investment into a future pipeline (see part.1 trend #5, p.73). Funds-of-funds can also help DFIs target new asset classes (early-stage SME funds, SME debt funds) and countries and diversify risks over several funds.

4.

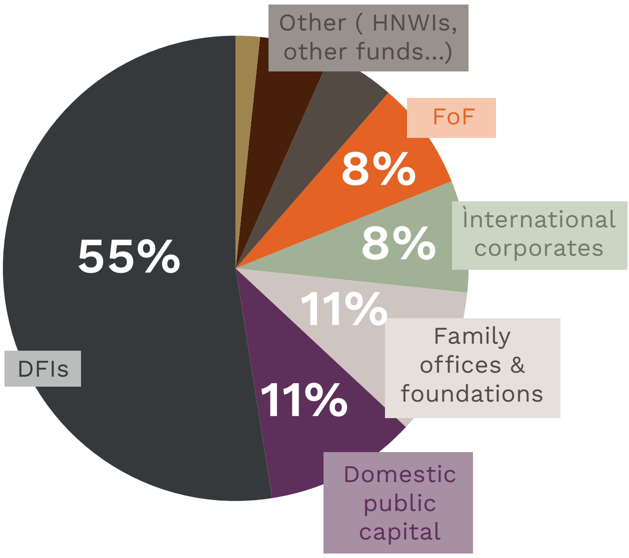
African private and sovereign capital is increasing its allocation to the sector, but there is still significant room to grow

African pools of capital are yet to be unlocked at scale for SME investment and represent the greatest fundraising opportunity for fund managers. A gradually improving sentiment of African investors is being felt across the continent. This includes increasing commitments of **domestic private corporates in early-stage SME funds**, particularly corporates willing to explore PE and SME fund investment as a viable asset class in their markets along with an increasing surge of interest from **domestic public capital,** particularly with the development of sovereign funds or sovereign agencies with fund-of-funds mandates to support the SME fabric.

LP COMPOSITION
EARLY-STAGE SME FUNDS



LP COMPOSITION
GROWTH SME & DEBT FUNDS



From our sample of 55+ SME funds, we analysed the LP composition of 22 funds for which data was available, among which 10 early-stage SME funds, 10 growth SME funds and 2 debt funds.[42]

Strikingly, whilst DFIs constitute more than half of the funding raised by growth and debt funds, early-stage funds rely on funds-of-funds and domestic private capital.

Domestic commercial capital has already begun investing in SME funds.

Investment from the domestic private sector is essential to building a resilient, sustainable, and locally grounded investment ecosystem. Domestic investors are valuable long-term partners for fund managers, with a strong understanding of the local environment that international investors often lack. Their local presence provides stability to funds, as they are less likely to withdraw during periods of political unrest—a risk more prevalent with international stakeholders, who may be influenced by broader geopolitical factors. The private capital markets in other emerging markets, such as India, have grown tremendously with the involvement of domestic capital.

There is growing evidence that this is a key source of capital, especially for first-time fund managers. **Domestic private investors predominantly commit to early-stage SMEs, country-specific funds, and regional funds** with a strong focus on one key market. Local domiciliation and operation can sometimes be key for these LPs when they

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[42] We decided to merge for this analysis growth SME and early debt funds as they have the same LP composition's patterns.

invest in local currency and prefer to operate within familiar regulatory frameworks. Whilst DFIs and international institutional investors deploy large ticket sizes that exclude small fund sizes, domestic investors are well-positioned to provide appropriately sized investment for SME funds. For the seven SME funds sponsored by IPDEV (see trend #5, p.73), domestic investor ticket sizes range from $30k to $1.3m with an average investment ticket of $400k (mainly in Francophone countries).

SPOTLIGHT | AFRICAN LPS INVESTING IN EARLY-STAGE SME FUNDS AND FIRST-TIME FUND MANAGERS

A dedicated sample of 18 early-stage SME funds, all of whom are first-time and emerging fund managers, have raised capital altogether from 195 African investors including 10 pension funds, 123 individuals, 58 corporates, three domestic sovereign institutions and one DFI (AfDB).

From our sample of 55+ SME funds, we analysed the LP composition of 22 funds, among which 10 are early-stage SME funds and 10 growth SME funds[43]. We found that **domestic private sources account for almost the half of capital raised by early-stage SME funds**, whilst this represents only 2% of funds raised by growth SME funds.

38% of funds raised by early stage SME funds come from **domestic private sources**

2% of funds raised by **growth SME funds** come from these same stakeholders

This trend is driven mainly by corporates and financial institutions.

Corporates with significant resources often show a commitment to supporting the economic growth of the countries in which they operate. **Their involvement is driven by various interests**.

> Large corporates have a **strategic long-term interest in contributing to the development of a robust SME-market** and overall economic growth; moreover, investing in a SME fund can satisfy direct strategic objectives such as providing external growth opportunities and building an ecosystem of local reliable providers, key market insights and complementary networks in a rapidly changing environment.

> Their **perception of country or currency risk** is completely different than that of international investors, as corporates operate every day in this environment, know its risks and opportunities intimately, and most often they have their assets and liabilities in local currency.

> SME funds can also provide more **short-term synergies,** such as cofinancing opportunities for a banking group, acquisition targets for a corporate group, etc.

> The largest corporates in these markets are frequently expected by their ecosystem to support local entrepreneurship and implement corporate social responsibility (CSR) initiatives. Investing in SME funds can be an innovative way to do so.

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43. And two debt funds

Corporates, banks and insurance companies are playing a critical role.

It is often overlooked by fund managers but companies, banks, insurance companies etc. can and do invest in funds. Among the investors in the funds supported by **the IPDEV sponsor fund,** domestic corporates constitute a significant portion of the LPs, **averaging 39% of the total funds raised**. This contribution is broken down as follows: 20% from corporates, 14% from banks, and 5% from insurance firms (often life insurance as its liabilities include longer-term capital).

INSURANCE COMPANIES

Domestic insurance companies primarily seek to diversify their assets beyond traditional treasury bonds. However, they frequently encounter difficulties due to regulatory constraints, which often require them to achieve rapid returns on their investments.

Example: SONAR, the leading insurance company in Burkina Faso, has invested in Néré Capital.

CORPORATES

Domestic companies investing in early-stage SME funds often come from the telecommunication or the agro-industries, thus having a strong interest in observing entrepreneurial and business dynamics and in identifying potential clients, suppliers, and acquisition targets. These companies generally seek to secure positions on boards and audit committees and thus tend to invest significant amounts through large ticket sizes to gain strategic influence.

Example: Sonatel, a Senegalese telecom company, has invested in Teranga Capital, demonstrating its strategic involvement in local SME funds.

NATIONAL BANKS

National banks frequently serve as recurring co-investors in early-stage SME funds, driven by their interest in building a pipeline of potential clients within the funds' portfolio to generate annual revenue from loans. Having clients that have raised funds also reassures banks about the robustness of the SMEs they lend to. Banks benefit from gaining deeper insights into the entrepreneurial environment in order to create financial tools tailored to the specific needs of local SMEs.

Example: The banking sector accounts for 20% of Comoé Capital's shareholders. Among them is NSIA, the leading bank-insurance group in Côte d'Ivoire.

Commitments by domestic corporate and financial institutions depend first and foremost on the strategic vision of their senior management. **Many corporates are first-time fund investors** unfamiliar with the long-term investment cycles of private equity or traditional fund structures. Fundraising is therefore based on trust and relationships and requires considerable advocacy from fund managers to convert interests into commitments.

> *'These investors are not willing to take a loss, and as first-time fund investors they are risk-adverse; so first-loss protection or guarantees will be attractive to them.'*
>
> *A GP*

SPOTLIGHT | AXIAN

Based in Madagascar, Axian exemplifies a large domestic conglomerate dedicated to supporting its national ecosystem and beyond. The group operates in five sectors: energy, telecom, financial services, real estate, and innovation. Originally a family business, Axian has expanded over the years to become a key player in Madagascar and, ultimately, across Africa and the Pacific.

Axian[44] is recognized as an impact-generating company, although it is not classified as an impact investor. Since 2017, the group has launched initiatives to invest in entrepreneurship through private equity and venture capital via Axian Investment. Initially, Axian focused on fund managers with teams based in Madagascar, such as Adenia Partners and Miarakap, and in a second stage broadened its investment strategy to the African continent with investments in Development Partners International (DPI), Emerging Capital Partners (ECP), and to date a total of around 20 funds.

Individual investors, including high net worth individuals (HNWI), are also getting involved.

Many SME funds that manage to reach a final close at their target fund size have collected **capital from individuals at their first close by leveraging their personal network**. These individual investors, sometimes North American or European, but mainly African or from the African diaspora, have taken on an important role in financing SME funds, especially supporting first-time and emerging fund managers raising small fund sizes.

There are many examples in the industry: WIC Capital gathered its first investment capacity with the WIC network angels, Zira Capital in Mali raised from the West-African diaspora (see Ciwara Capital page 66), Aruwa Capital first closed its fund 1 thanks to some participation from Nigerian HNWI (executives, CEOs, partners of other large PE funds, sometimes from the diaspora), as well as HNWIs and family offices from Europe and the US, this HNWI pool made up 30% of Aruwa Fund I.

From our sample of 55+ SME funds, we analysed the LP composition of 22 funds, 10 of which are early SME funds and 10 SME growth funds. In this sample, **HNWIs provide 6% of the funds raised by early SME funds and 6% of growth SME funds as well**, but these 6% are very impactful, as they are often the first checks in, that is, those that help fund managers build credibility and make their first investments.

Many of these individual investors are successful entrepreneurs and executives who have built large businesses and are now motivated by supporting other entrepreneurs. They are often willing to ‘give back’ to the country where they have built their success, and many seek to be useful in mentoring other entrepreneurs. They are driven by a strong sense of impact, choosing to join funds when deeply aligned with the fund manager’s vision.

The African diasporas are awakening to new ways of contributing to the continent’s development.

Europe’s African diaspora, with over 9 million members, including 5 million in France, is renowned for its active commitment to Africa’s development. In 2024, remittances from sub-Saharan Africa’s diaspora to their countries of origin are estimated at $55bn. These remittances, mainly intended for family and community support, are supplemented by a transfer of skills and the mobilisation of networks. Part of this diaspora is characterised by highly skilled socio-professional profiles and has significant potential to invest in projects combining returns and high impact in Africa. **This source of capital and expertise offers an invaluable opportunity to stimulate the financing of African SMEs.**

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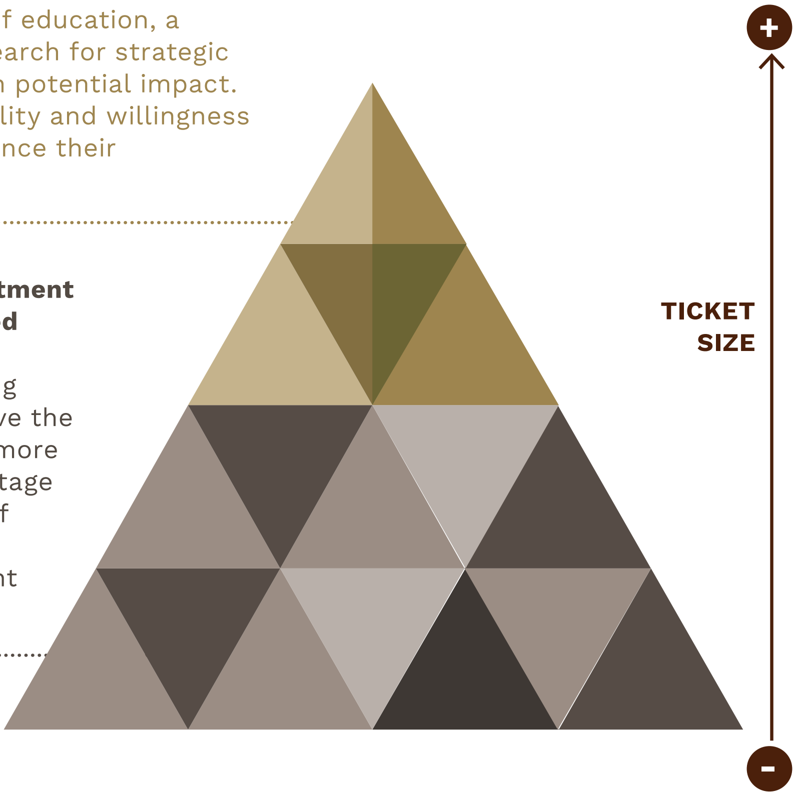
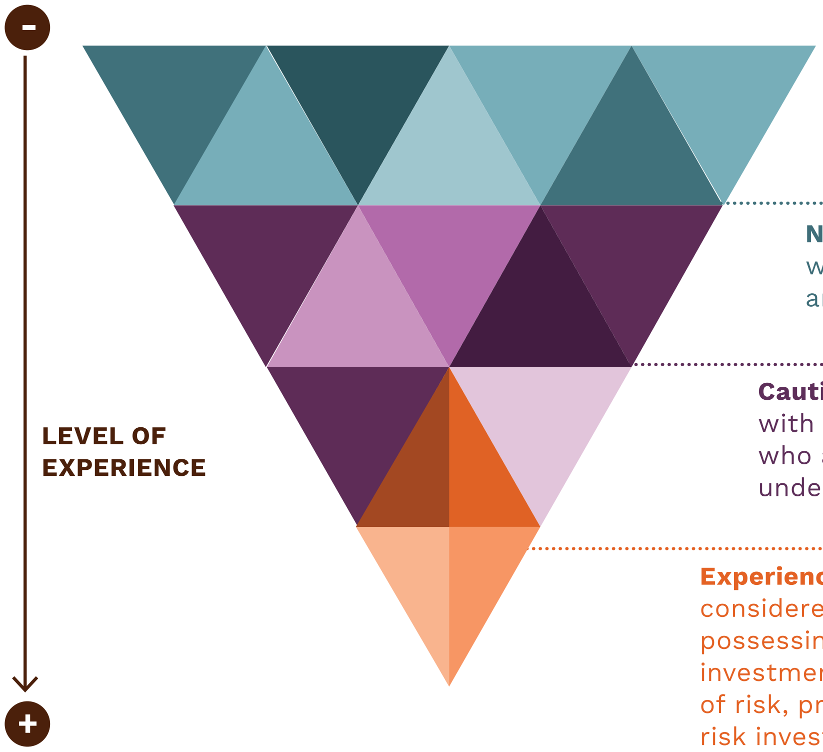
[44] FERDI. 2024. Impact investing in Africa: a 2024 analytical map

I&P and IFAD collaborated on a white paper that analysed key profiles of diaspora investors, and led to the creation of an investment company led by diaspora members, Ciwara Capital[45]. It is at this stage still an initiative with limited funding and in the early phases of fundraising.



Profiles with good investment capacity (priority target): these are ‘highly skilled professionals’ and ‘entrepreneurs and business leaders’ who are distinguished by an advanced level of education, a significant savings capacity, and a search for strategic investment opportunities with a high potential impact. They are described as having the ability and willingness to use their skills to positively influence their investments.

Profiles with moderate or low investment capacity but who can invest provided they have investment knowledge ‘intermediate professions’ and ‘young professionals and students’ who have the potential to invest but require more training or knowledge to take advantage of their investment capacity. Each of these profiles can be distinguished according to their level of investment knowledge and risk appetite.



Novice investors with limited investment knowledge and a low risk appetite.

Cautious investors with moderate investment knowledge who are looking for secure and easy-to-understand investments.

Experienced investors considered to be ‘highly informed’ and possessing in-depth knowledge diversified investment experience and an understanding of risk, predisposing them to accept high-risk investments with the potential for high returns.

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45. Mobilising the diaspora via private equity: the case of Ciwara Capital in Mali [not published yet]

SPOTLIGHT | CIWARA CAPITAL

Ciwara Capital is an investment company initiated by the African diaspora. Launched in 2022, this investment fund was born out of the interest of individual investors, most of them Malians, in financing the Zira Capital fund in Mali. Their desire to go further by setting up a standalone initiative that would finance SMEs directly has led to the creation of one of the only structured and operational financing facilities of the West African diaspora. Ciwara makes minority equity investments in the early-stage SME funds space, with investment tickets ranging from €50k to €300k, but also supports its portfolio by mobilising skills and networks from its shareholders.
The profiles of the co-founders are very representative of the trends observed above around individual investors and HNWIs:

> The four founding shareholders are graduates of prestigious international schools and hold senior management, CEO, and partner positions.

> Two are successful and renowned entrepreneurs respectively working in energy transition and FinTech; whilst the other two are financial sector experts, notably in the banking sector.

> All had previously faced the challenges inherent in investing in Mali and, in some cases, had acquired local entrepreneurial experience. Their experiences convinced them that their impact on the continent's development could be amplified through investment and support for local businesses, all within an appropriate investment vehicle.

The involvement of pension funds is largely driven by country-specific regulation.

Assets under management by African pension funds have surged over the past two decades. Both public and private pension funds have become essential collectors of long-term savings. They are poised to **continue growing due to the continent's rapid demographic growth**. For instance, the CFF report *Unlocking Local Pension Fund Capital for Small Business Finance* highlights that Ghana's Pensions Industry Collaborative, which controls 66% of the $5.5bn in total pension funds in Ghana, grows at an average annual rate of over 30%. **The investment potential of pension funds is immense**; today, they mostly invest in traditional risk-free assets such as government bonds.

Recent developments, however, indicate an **emerging trend among these funds to diversify and invest in a growing category of 'alternative' assets,** thereby adding private equity, venture capital, and infrastructure to the historical categories of public markets and real estate. This includes both public pension funds, which manage the bulk of pensions in certain markets, and private pension funds in deregulated markets. Although the total amount remains an insignificant proportion of total pension fund assets, **some SME funds have successfully raised from pension funds**:

> East Africa: Fanisi Capital and Catalyst are raising funds from Kenya Power Pension Fund
> Ghana: Both Injaro and Mirepa Capital SME Fund have raised cedi-denominated funds with commitments from pension funds and schemes
> Côte d'Ivoire: CNPS, Côte d'Ivoire's social security fund, invested in funds managed by Amethis Finance, Cauris (Yeleen), AfricInvest, and AFIG Funds
> Uganda: NSSF (National Social Security Fund) has invested in Yield Fund by Pearl Capital Partners
> Rwanda: RSSB (Rwanda Social Security Board) is committing capital to funds that are domiciled in the country.

The involvement of pension funds largely depends on domestic regulations. Kenya, Ghana, and Rwanda have benefited from regulatory reforms to foster pension funds investments in alternative asset classes. The example of Ghana is undoubtedly the most telling to date: in 2008, the government of Ghana established the National Pensions Regulatory Authority (NPRA) and then the National Pension Act in 2018, which introduced the private sector into the pension industry and enabled allocation to PE and VC funds. Most notably, in 2021 the NPRA increased the maximum exposure limit for pensions to alternative investments to 25%. This is higher than peer jurisdictions (Kenya: 10%, South Africa: 15%, Nigeria: 5%) and is comparable to developed markets. Since then, several new locally domiciled funds have emerged in the country (Injaro Ghana Venture Capital Fund, Mirepa Capital SME Fund, Oasis Africa Fund), all of which have raised significant capital from pension funds and schemes.

SPOTLIGHT | PENSION FUND ADMINISTRATORS (PFA) IN NIGERIA

As of October 2024, Nigerian pension funds cumulatively hold assets amounting to $22bn ($13bn) across all fund types and have recently grown exponentially in size and value in the local currency. The 5% limit allocation on pension fund investments in private equity in Nigeria could potentially represent over $1.1bn for the sector. However, the Nigerian pension industry's commitment to PE funds has averaged at 0.4% of total pension fund assets over the past decade. Current allocation of 0.5% as of October 2024 represents $60mn, compared to $13.5bn in PE assets for South Africa pension funds. Several factors can explain this situation: The regulatory environment, although one of the most advanced on the continent, remains insufficiently favourable. This is combined with the government's lack of familiarity with the private equity asset class, as well as concerns regarding liquidity and risk; but regulation plays a crucial role as some examples below show:

> A prerequisite for pension fund investments in private equity is that at least 60% of the selected fund must be allocated in Nigeria. This restricts Nigerian pension funds from allocating capital to PE funds that might have a regional or pan-African focus.

> Pension funds may only invest in funds where the fund manager is registered with the Nigerian Securities and Exchange Commission (SEC). In practice, this can end up contradicting the guidance of international investors who seek domiciliation in Mauritius or territories outside the continent.

African DFIs and sovereign investors will be key to drive more investment into the sector.

African multilateral institutions were instrumental in the launch and expansion of the private capital industry in Africa. The African Development Bank (AfDB) has been investing in private equity since 1997, helping build the asset class from initial investments in Acacia Fund and South Africa Infrastructure Fund in 1997 to most recently committing to funds such as KawiSafi Fund II. The AfDB has invested in many of the renowned names of the African private equity industry: ECP, Cauris Management, Vantage, Grofin, AfricInvest, Aureos, etc. Its committed portfolio of equity investments has grown from $90m in 1997 to $1.9bn in 2022, with 27 direct investments and 68 fund investments. Of note, 51% of the funds committed to are first-time funds[46].

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[46] African Development Bank Group. 2024. Private Equity in Africa. The role of the African Development Bank. A key player in the development of equity markets in Africa.

The West African Development Bank (BOAD) has also contributed to the industry in Francophone West Africa:

> BOAD was at the heart of the creation of Cauris Management in 1995, the first homegrown PE fund in Francophone Africa to develop the PE industry in the WAEMU region and helped syndicate other institutional investors, DFIs, and regional institutional capital (banks, insurance companies, pension funds) for the launch of Cauris Investissement at €7.6m.

> BOAD has also been a repeat investor in Cauris' successor funds, which have grown significantly in size.

> BOAD launched the Yeelen Financial Fund LP, a €50.6m financial services, sector-specific fund managed by a consortium that includes Cauris Management.

> Has invested in other private equity funds such as AFIG Fund II and I&P Afrique Entrepreneurs and contributed to the creation of new locally domiciled investment vehicles in WAEMU through a commitment to IPDEV.

Beyond these examples of multilateral African DFIs, **sovereign funding by national players is key to de-risk funds and build the markets**. In other ecosystems such as Europe, which had to build a VC industry and try to catch up after many years lagging behind the US, sovereign funding was a determining factor in the emergence of a dynamic fund management ecosystem. It is very difficult today to find EU-based fund managers who have never received investment from the EIB-funded European Investment Fund, French-based fund managers who have not attracted investment from public bank Bpifrance, or UK-based impact fund managers without Better Society Capital on their LP list. These sovereign actors are not only funding but anchoring and often de-risking such investment funds and played a major market-building role at a time when few domestic investors were familiar with the asset class.

This trend is now visible in many African markets. In recent years, **a new wave of sovereign initiatives has risen**, aimed at supporting SMEs with dedicated resources and often with backing from key players such as the World Bank, AFD, KFW, etc. The support has come in many forms, including public sector agencies, sovereign wealth funds, public sector pension funds, caisses des dépôts, public funds-of-funds, etc., which have often come with new regulations designed to improve business environments in which SME funds operate. DFIs (see Part 1, #3 'International DFIs are still the leading players in SME fund investment – today, they invest mainly in larger funds', p.50) have long tried to play this role directly, but experience shows that domestic players can go where DFIs may not risk going due to their developmental mandate in a single country or region. These initiatives have been praised in the SME investment community, as they demonstrate intentional public support for the development of the SME private sector.

Of course, this is a work in progress: **regulatory challenges consistently emerged in our interviews as a significant barrier to fundraising and industry growth on the continent**. There is a disconnect between the launch of ambitious public initiatives and their regulatory environment, where local tax frameworks and business-friendly regulations are often not yet in place, hindering the impact potential on the industry. whilst it is still early to draw conclusions, our interviewees have identified critical factors that have made some of these programmes genuinely transformative for local ecosystems: a threefold combination of **financing, capacity building, and regulatory development.**

PROGRAMME[47]: **VCTF[48] (2009 and recapitalized in 2023)** | COUNTRY: **GHANA**

I. FINANCING

Fund size: $40m, aims at investing in closed-ended funds investing only in SMEs through equity and quasi-equity

> Ticket size: $1m to $5m per fund as an anchor investor
> VCTF has invested in most of the Ghana-based funds (Oasis, Injaro, Mirepa, Wangara, etc.)

II. INVESTMENT REGULATIONS

Example:

Collaboration of the VCTF with the Ghana Stock Exchange (GSE) to create a dedicated junior stock market for SMEs (Ghana Alternative Exchange) to facilitate the exits

III. CAPACITY BUILDING

Technical assistance for funds for a total of GHC 5m;

Ghana Angel Investor Network (GAIN), a platform for business angels to invest in early-stage companies

PROGRAMME: **FONSIS[49] (2012)** | COUNTRY: **SENEGAL**

I. FINANCING

FY 2022:
> Sovereign Wealth Fund managing projects worth €900m.
> Ecosystem objective to contribute to the growth of the private equity industry in Senegal, with minimum ticket of $500k
> In 2016, FONSIS invested €1.3m in Teranga Capital, the first early-stage SME fund operating in Senegal
> Leveraging this experience, it incubated four SME new funds: Fonds Agri, We! fund, FIR, and Oyass Capital
> Currently working on a KFW-funded initiative to seed/back emerging locally-based fund managers

II. INVESTMENT REGULATIONS

2022:
The securities exchange commission in the WAEMU region (CREPMF), with support from the World Bank, issues a new regulatory framework allowing for the creation of local PE/VC funds

Implementation and harmonization of legal frameworks within the eight-state region is underway

III. CAPACITY BUILDING

2023:
Launch of PROCAP, a new subsidiary to provide back office/outsourced services support to the local PE industry
Activities are yet to start

PROGRAMME: **SA SME Fund[50] (2015)** | COUNTRY: **SOUTH AFRICA**

I. FINANCING

> Fund size: 240bn ($71m)
> Via fund investments, aims to invest 50% of its capital in companies owned by black entrepreneurs and 25% in entrepreneurs from the Indian and coloured communities
> Invested in:
- Venture capital: Knife Capital, OneBio, Savant, 4Di, University Technology Fund, Digital Africa Ventures, Grindstone Ventures
- Growth: PAPE, SummerPlace, Spartan, Masisizane, A2Pay

Industry building initiatives: Grindstone, SAVCA Fund Manager Development Programme

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[47] Non exhaustive list
[48] VCTF website - https://vctf.com.gh/about-us/ [Consulted in November 2024]
[49] Fonsis website - https://www.fonsis.org/fr/ [Consulted in November 2024]
[50] SA SME Fund Website - https://sasmefund.co.za/ [Consulted in November 2024]

PROGRAMME: **ANAVA[51] (2020)** | COUNTRY**: TUNISIA**

I. FINANCING

Fund size: €200m aims at investing in 13 funds (seed stage, early stage, and late stage)

Ticket size: Between €7.5m ($8.2m) and €15m ($16.3m) in funds, with an equity stake from 20% to 75%, depending on the maturity stage

II. INVESTMENT REGULATIONS

Startup Act
New legal framework aims to encourage the launch of startups and investments:
> Label for startups, bank accounts in foreign currency, exemption of taxes
For investment:
> Tax rebate on investment in startups, exemption from capital gains tax for the sale of titles related to participation in startups

III. CAPACITY BUILDING

Flywheel fund
Two financial instruments for ESOs:
> A grant for the conception of new support programmes (DEAL)
> A subsidy to ensure the continuity of certified ESOs (SAIL)

PROGRAMME: **MSMEDA[52] (1991 BUT INVESTMENTS IN 2023)** | COUNTRY**: EGYPT**

I. FINANCING

> Fund size: EGP 36bn ($734m)

> Able to invest up to 20% of a fund size

> Ticket size between €500k and €7m

48% of beneficiaries being women, promoting gender equality and inclusivity

II. INVESTMENT REGULATIONS

> Egypt's National Strategy for the Development of Organic Clusters: 2019–2030, in partnership with AfDB
> The establishment of the MSEDA is part of 2020 Law No. 152 establishing MSME definitions, launching tax incentives, and an enabling environment for entrepreneurs d to participation in startups

III. CAPACITY BUILDING

One-stop-shop entrepreneurship awareness programmes

> Training and mentoring programmes

PROGRAMME: **FONDS MOHAMED VI[53] (2021)** | COUNTRY**: MOROCCO**

I. FINANCING

> Fund size: MAD 15bn ($1.5bn) aiming at catalysing investments in the country, mainly in infrastructure, SME and startup support, industry, agriculture, innovation, and tourism

Direct investment, indirect investment (PE and VC), subordinated debt (CapAccess)

II. INVESTMENT REGULATIONS

Partnership with AfDB to reinforce investment environment

> Partnership with IFC to strengthen sustainable infrastructure
> Partnership with AFD to stimulate investment, development of infrastructure, and the creation of a joint venture dedicated to sustainable infrastructure

III. CAPACITY BUILDING

> Pipeline PME programme to help companies raise capital
> Project preparation structure to help entrepreneurs in legal and financial structuration

PROGRAMME: **CDCI CI CAPITAL[54] (2024)** | COUNTRY**: CÔTE D'IVOIRE**

I. FINANCING

> Launched in 2023 with a $70m fund size (World Bank facility) to invest directly and indirectly (fund-of-fund capacity) in SMEs

> Fund-of-funds ticket: $1.5m

Requirement to invest in locally-domiciled vehicles, and for the funds to be invested in Ivorian SMEs

II. INVESTMENT REGULATIONS

Same as above (FONSIS)

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[51] Anava website - https://smartcapital.tn/anava/ [Consulted in November 2024]
[52] MSMEDA website - HYPERLINK «https://www.msmeda.org.eg/»https://www.msmeda.org.eg/ [Consulted in November 2024]
[53] FM6 website - https://www.fm6i.ma/ [Consulted in November 2024]
[54] CDCI CI Capital website - https://cdccapital.ci/ [Consulted in November 2024]

RECOMMENDATION 1#4

Unlocking domestic capital pools.

1) Engaging African/domestic capital in fundraising is a strategic priority for GPs.

GP

> When embarking on the journey of raising a first fund, it is crucial for GPs to focus on their existing networks. Engaging with individuals, corporates, family offices, and foundations that are already familiar with their work and values can provide a supportive foundation of investors who trust the GPs and understand their vision. Connecting with those who know them personally can lead to quicker commitments and a more collaborative fundraising experience.

> Whilst there may be concerns about managing a larger group of investors, this approach has proven to be the most successful strategy for first-time and emerging fund managers in the current fundraising landscape. A **diverse investor base** can offer not only financial support but also valuable insights and resources. Embracing the complexity of managing multiple stakeholders can ultimately strengthen the fund's resilience and adaptability.

> Domestic investors bring vast networks that help fund managers in deal selection, but above all, they are a game-changer for the support provided to portfolio companies: they unlock new capital and contracts, make the right introductions, and can support in lobbying efforts. This is often a **game changer for portfolio support**, not at all a mere marginal benefit.

> They can invest in local currency and in fund managers that are domiciled in-country, thereby widening the types of fund structures that a manger can design, and they do not perceive country risk in the same way as do international investors.

> As GPs design their fund structure, it is essential to **prioritise the motivations and interests of this initial group of investors** rather than rigidly adhering to industry benchmarks. Understanding what drives these early backers will enable GPs to create a fund that aligns with their expectations and risk appetite. Notably, DFIs are often less inclined to invest in a first-time fund, so focusing on the unique needs of early supporters will create a more compelling value proposition and enhance the chances of securing commitments.

Key success factors to attract African domestic capital include:

> Attracting capital into new fund managers is largely a **game of trust which can be approached like concentric circles**, beginning with a first circle of trusted professional relationships and then expanding with the relationships they themselves can bring.

> Showing a **clear path to liquidity** (pension funds) or the strategic benefits of a long-term patient capital vehicle.

> Providing rights to enable investors to gain insights and strategic advantages from their investment in this fund, which may include representation at an IC or board and/or capacity to coinvest flexibly alongside the fund.

> **Domiciliation** in a favourable environment, often in-country.

2) Investing in African funds can be attractive for African capital.

> For private capital, investing in African funds combines strategic advantages with a diversifier

Investing in SME funds can be a **diversifier and stabilizer for domestic portfolios** that are often heavily skewed to fixed income and where alternative investments are limited to a very narrow and risk-prone stock-market and heavily cyclical real estate market. Domestic investors, due to the narrow financial markets they operate in, have a very different set of constraints than do global institutional players who would seek a 'super return' in the PE asset class.

Beyond the potential financial return, whether you are a bank that seeks to cofinance SMEs, an insurance company that seeks to diversify its portfolio and build fundamental experience on private equity investment, or a corporate that looks for external growth opportunities and market insights, SME funds are a very impactful way to support entrepreneurship in a given country, to learn about key emerging trends in the market, and to do so with high potential synergies with the core business.

> Investing in African funds promotes key national developmental goals for sovereign funders

Establishing a supportive environment for SME funds to emerge is essential **to foster economic growth and sustainability in countries, as well as to improve their tax base**. Setting up catalytic programmes to **support SME environments is therefore a common public policy** around the world. Lessons learnt from sovereign-funded investment funds suggest that the best performers are (i) either independently managed or managed by embedded investment teams with strong investment professional experience, (ii) focus on supporting intermediaries (such as funds and other financial institutions) rather than beneficiaries (such as entrepreneurs directly), (iii) use their flexible capital to de-risk funds and therefore leverage additional private capital from the local capital markets56, and (iv) combine their action with significant lobbying for an enabling tax and regulatory environment for the domestic SME fund sector.

The example of Ghana has shown how combining VCTF's catalytic capital with pension fund regulatory reform triggered an acceleration of domestic investments into Ghana-specific SME funds.

3) Catalytic funders will be essential to unlock these domestic capital pools.

> The asset class of SME investing is rightly perceived as completely new by domestic investors, who are often themselves first time fund investors (see part 2 of the report).

> Catalytic capital in the form of junior tranches, guarantees or first-loss protections can play a very significant role in de-risking these new investors and over time unlocking new pools of capital for SME fund managers.

5.

New catalytic capital funders have been decisive to build the market, but there is much more to be done

Catalytic capital is defined by the Catalytic Capital Consortium (C3) as a type of investment that "accepts disproportionate risk and/or concessionary returns relative to a conventional investment in order to generate positive impact and enable third-party investment that otherwise would not be possible"[55]. When it comes to SME fund investment, catalytic capital refers to a **form of capital that assumes higher risk or lower returns to enable fund managers to achieve their fundraise**.

Catalytic initiatives have progressively emerged to bridge the gap for early-stage SME funds and first-time and emerging fund managers.

As stated in I&P's study for C3[56] there is a twofold challenge for catalytic capital to reach SME funds, including in frontier markets and with high additionality: increasing the volume of catalytic capital (quantitative) and improving the characteristics of deployed catalytic capital (qualitative).

Catalytic capital and blended finance funders deploy a range of instruments to answer the needs of SME fund managers.

Emerging fund managers follow a lifecycle with major obstacles along the way.

In the long journey from fund launch to final close, emerging fund managers must design their fund, build their team and track record, gain fundraising traction, and achieve viable fund size. Today, the obstacles are such that most fail to reach this end goal (see Part 1, #2: 'Raising a SME fund remains very challenging, especially for newcomers in the space', p.38). Funders have recognized this as the main structural factor hampering the growth of the SME investment sector and have begun to piece together a continuum of support in order to lift the main barriers along this lifecycle.

The graph below maps some of the **key supporters and funders of African emerging fund managers**, from acceleration programmes to LPs with significant allocations:

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[55] Tideline. 2019. Catalytic Capital. Unlocking more investment and impact. – Cited by C3 online

[56] Investisseurs & Partenaires. Catalytic Capital Consortium. 2023. Using catalytic capital to foster the emergence of African entrepreneurs in under-served markets.

During the launch phase, fund managers must design their fund and build industry networks: **cohort-based acceleration programmes** have been designed to provide them with training and exposure, help them on-board the learnings of peers in their sector, and provide templates for fund design. These acceleration programmes include Africa-specific programmes described above and global programmes (such as VC Lab), which include cohorts of African fund managers. First-time fund managers have gained from this but also share how funding is their main hurdle to date.

> *'The acceleration programme helped me build a network of allies and gain insights. But we tend to be over-mentored and under-funded'.*
>
> *An emerging GP*

To date, working capital (which can go hand in hand with fund design support), warehousing capital and junior capital are the **most unmet needs of emerging fund managers.**

INSTRUMENT	MAIN FINDINGS
WORKING CAPITAL **Funding to build a team and cover launch costs during the long launch phase** In a context where final closes are reached only after two to five years, grants and concessional loans can provide fund managers with the runway they need to cover basic expenses, without relying on distracting sources of income or compromising on their vision. Working capital helps fund managers focus on the fundraise thanks to a stipend, but also as well as attract senior talent early on to strengthen their team and make a stronger case to LPs in a context where they compete with more experienced teams. Working capital can also cover legal and domiciliation costs as well as operational expenses and travel. When there is a loan component to working capital, it is often repaid partly at final close and partly over time from the management fees.	Working capital is a highly capital-efficient intervention with strong externalities in terms of ecosystem building; most interventions are in the $100-$300k range. Working capital shortens launch phases considerably. Regarding instruments, a combination of grant and soft loan is optimal to avoid loading the fund manager with too much debt. For first-time fund managers, working capital should be combined with tailored fund design support to maximise chances of success.
WAREHOUSING CAPITAL **Pre-close investment capital to build a demonstration portfolio** Warehousing capital allows fund managers to demonstrate track record as a team for potential investors and validate their investment thesis. It also allows fund managers to on-board a portfolio quickly at fund close and shorten their investment period. It can take many forms, including commercial or concessional loans, repayable grants, or equity. LPs must decide whether to on-board this portfolio at fund close.	Warehousing capital most often accelerates fundraising traction and refines a fund's investment strategy; needs can range around 5%-10% of a fund's target size. Negotiating the takeover of a warehoused portfolio with LPs at first close is difficult when a premium is expected; this supports either a model where warehousing capital is highly concessional as opposed to commercial or loan investments as opposed to equity investments.
JUNIOR CAPITAL By investing junior capital in a fund, a catalytic funder improves the risk-return profile of the fund and unlocks capital from LPs that otherwise would not have participated. Junior capital can be incorporated into a capital structure of a fund via different instruments, including junior equity, subordinated debt, or guarantees.	Junior capital is particularly decisive to unlock new pools of capital (e.g. pension funds) but is also becoming a common ingredient of raising impact funds in certain segments of the market (climate, agri, frontier markets, etc.) where DFIs and international investors demand de-risking. Junior capital tranches typically cover around 20% of a fund's size and are most often invested at first close.

In addition to improving fundraising outcomes for individual fund managers, catalytic capital tools play a key system-level role for the sector:

> They **democratise access to fundraising,** enabling outstanding profiles to take their chance where financial constraints might otherwise have prevented them; they lower barriers to entry for profiles perceived as heterodox or with bias, and solve the 'chicken-and-egg' problem on track record. All things being equal, a more meritocratic sector leads to stronger performance.

> They **build a more diverse and resilient fund management system** by empowering fund managers to take chances on alternative fund structures or additional investment strategies that address segments and geographies of the market that are currently untouched. In a context where some segments are crowded whilst others are neglected, catalytic capital builds resilience into the system by increasing the overall pipeline universe and decorrelating investment strategies.

> They **prepare the long-term supply of new capital for the sector** by helping first-time fund investors and new pools of capital to overcome initial inertia, build comfort with the asset class with a first investment, and continue investing over time in the next generations of funds to follow.

Catalytic capital and blended finance flows originate from impact-first funders, including donors and philanthropy.

Catalytic capital and blended finance has been promoted by development banks and DFIs via specific windows.

DFIs and development banks have invested equity into many funds on the continent: the European Investment Bank and AfDB window of Boost Africa (for first-time VC funds such as Janngo Capital, Atlantica Ventures and Seedstars Africa Ventures) and Green Climate Fund (for climate funds such as Acumen Resilient Agriculture Fund) are examples that have deployed junior capital into new fund managers, with strong success in terms of leveraging additional capital.

Foundations have also taken on a very active role in providing catalytic capital in the SME fund space.

Private foundations have been an important investor in early SME funds. From our sample of 55+ SME funds, we analysed the LP composition of 22 funds, of which 10 are early SME funds and 10 growth SME funds. In this sample, private foundations account for 11% of the direct investment for early SME funds and 8% for growth SME funds.

Their mandate can vary (livelihoods, impact in a specific sector, etc.) but is driven by impact first; they have traditionally used grants, and now some also deploy equity instruments to mobilise more capital towards this objective. Their mandate is often explicitly catalytic and focused on backing pioneering pilots that can leverage more capital; they typically look for interventions with the highest leverage and additionality. Examples of foundations that have supported African investment funds with catalytic capital, either in the form of grants or equity, include Argidius Foundation, Small Foundation, Visa Foundation, and Lemelson Foundation. Many of them are active C3 members and funders. For instance, Argidius Foundation has supported several funds with grants to cover launch costs or BDS/investment-readiness for SMEs, including funds in the IPDEV portfolio, iungo capital, and SME Impact Fund in East Africa, among others. The Mastercard Foundation, via its grant-making activity, has also provided capital to fund managers post-COVID to deploy entrepreneurship funding programmes and sustain jobs in their key markets: for instance, the Suqali programme in Senegal (managed by Teranga

Capital) has deployed capital to several SME funds in the market (WIC Capital, Brightmore Capital, etc.) to support entrepreneurship. Other similar programmes have been managed by impact fund managers in Kenya and in Ghana.

Beyond grants, several pioneers of the SME investment landscape have raised their first fund with equity capital from foundations, often taking a de-risking role for other LPs: this is particularly striking in the agri-SME investment landscape, where foundations are very active (e.g. Pearl Capital Partners, funded by Rockefeller Foundation, Gatsby Charitable Foundation, and others and SME Impact Fund funded by Hivos and Cordaid), but similar trends can be found in healthcare, access to energy, gender-lens investing, and other sectors driving significant impact.

Bilateral and multilateral donors are increasingly active in the catalytic capital landscape.

Donors do not have a financial return objective but primarily look to foster SDGs by leveraging the transformative potential of SMEs. To date, they have mostly invested in funds via programme-specific grants, as that of the Netherlands-funded and Palladium-managed Challenge For Youth Employment (CFYE), which has provided grant capital to be used as investment capital by impact funds such as WIC Capital in Senegal, Balloon Ventures in Uganda, and Acumen Fund in Kenya; or the 2X Global-managed Climate Gender Equity Fund (CGEF), which has provided warehousing capital to emerging funds such as ATG Samata (Kenya, South Africa), Altree Capital (South Africa), and wCap (Zambia); or the World Bank InfoDev programme, which has provided anchoring capital to Kenya Climate Ventures and Wangara Green Ventures. Such donor programmes work through requests for proposals for which fund managers can compete, and individual grants range from several hundred thousand dollars to multi-million-dollar awards. Such programmes create opportunities to build a track record and cover team costs whilst a fundraise is ongoing; of course, alignment with fund goals is crucial to avoid distraction from the main goal of raising the fund.

Notable exceptions to these programme-specific grants are funds-of-funds that were capitalised by donors.

A promising trend: new pan-African funds-of-funds deploying catalytic capital.

Over the past 10 years there has been a trend towards the development of new pan-African funds-of-funds with a catalytic capital mandate that are funded by bilateral donors and private foundations. This trend comes in the context of **growing interest from traditional grant-making players in impact investment tools** and in the role the private sector is playing in achieving the development goals these grant makers pursue. Many catalytic funds-of-funds were in fact initiated and established by these funders, as in the cases of DGGF, Mastercard Foundation Africa Growth Fund, and FASA. The funders have created or funded a concept and then selected a team or consortium to manage the fund.

Importantly, the donors that have initiated new catalytic funds-of-funds have elected to **choose managers other than their typical investment team** (DFIs) to deploy targeted capital for early-stage SME funds: DGGF (funded by the Dutch Cooperation Ministry) is managed by Triple Jump, an independent fund manager; similarly, FASA (funded by NORAD and USAID), is managed by I&P which is also an independent fund manager. This trend suggests that **independent funds-of-fund managers can in some cases be additional to DFIs** and help serve complementary mandates.

Less frequently, **new funds-of-funds are initiated by fund managers that embark on a fundraise**, such as IPDEV, Nyala Ventures, Ci-Gaba, or Oryx Impact. These funds-of-funds are active on a spectrum of catalytic capital, with some taking a strong market-building mandate and others putting a higher priority on commercial returns and liquidity. Launching a fund-of-funds is very challenging, for a combination of reasons: (i) the risk/return/liquidity profile of a fund-of-funds targeting SME funds is typically not optimal, and becomes very challenging when its strategy is to invest catalytic capital, and (ii) the minimum viable size for a fund-of-fund is high, putting a high bar on the fundraise. At a time when funds-of-funds were still rare in Africa, it took a full **four years for IPDEV to reach a modest fund size of €24m in 2018**, and many funds-of-funds are currently raising. Nevertheless, funds-of-funds are a promising tool to increase mobilisation of capital to the continent:

> **Funds-of-funds raise the existing barriers LPs face in financing SME funds**: in a context where most SME funds are small-sized and launched by emerging fund managers, most LPs lack the resources and tools needed to invest directly in such funds (deep market knowledge, dedicated teams able to lead due diligence and anchor new funds, in-country footprint, low enough minimum ticket size, etc.).

> The **portfolio approach of funds-of-funds mitigates the risks** usually attributed to investing directly in SME funds. By investing in multiple funds (typically between 10 and 15), funds-of-funds diversify well and mitigate manager risk, country risk, etc.

> **Funds of funds de-risk new fund managers thanks to the in-depth support they provide**. They refine their fund design, support their fundraise and legal documentation, and give access to networks, tools, grant-funded technical assistance, resources, etc. These prove crucial for fund managers as they navigate their fundraising journey to achieve first close and are generally not provided by other types of LPs.

> **From an ecosystem perspective, funds-of-funds contribute to building an African investment industry** with local funds, local teams, and local currency investments.

Of course, funds-of-funds come with their own constraints:

> They add a layer of fees for the LPs, who are charged fees by the fund-of-funds manager, on top of the fees already charged to the fund-of-funds vehicle by SME fund managers. In some cases, this additional layer enables LPs to invest in new segments of the market, otherwise neglected, and therefore generate more returns and impact.

> They add a layer of intermediation between LPs and the SME fund managers, which can lead to more indirect control over investments. This can be mitigated via governance provisions, flow-through clauses and transparent reporting.

Launch date	**2014**	**2015**	**2022**		**2024**
Name of the FoF	**Dutch Good Growth Fund (DGGF)**	**IPDEV**	**Mastercard Foundation Africa Growth Fund**	**Nyala Ventures**	**FASA**
Investors	Launched and capitalised by the Dutch Ministry of Foreign Affairs	Various LPs, DFIs (AfDB, Proparco), private foundations (Small Foundation, SEDF), corporates	Launched and capitalised by the Mastercard Foundation	FSD Africa Investments	Launched and capitalised by USAID, NORAD, FCDO, KOICA
Fund Manager	Triple Jump	I&P	MEDA as Fund Manager, I&P as Fund Advisor and ESP as BDS partner, along with Genesis Analytics, Criterion Institute, and Africa Communications Media Group	Initially Cardano and Total Impact Capital in partnership with CFF, more recently FSDAi	I&P
Size of the fund	**€175m ($191m)**	**€24m ($26m)**	**$150m**	**£10m ($13m)**	**$80m (Target: $200m)**
Funds supported	**35**	**9**	**Undisclosed**	**4**	

FUNDRAISING

Moremi Fund	Ci-Gaba	AWIF (African Women Impact Fund)	Oryx Impact Fund
N/A	N/A	N/A	N/A
Kuramo Capital Management	Savannah Impact Advisory	Riscura	Oryx Impact
Target: $150m	**Target: 75m**	**Target: $1b**	**Target: $250m**

The pan-African funds-of-funds listed in the above table are highly successful in their use of catalytic capital. They complement domestic funds-of-funds with a mandate on a single market (VCTF, SA SME Fund, Anava, FM6 being exceptions).

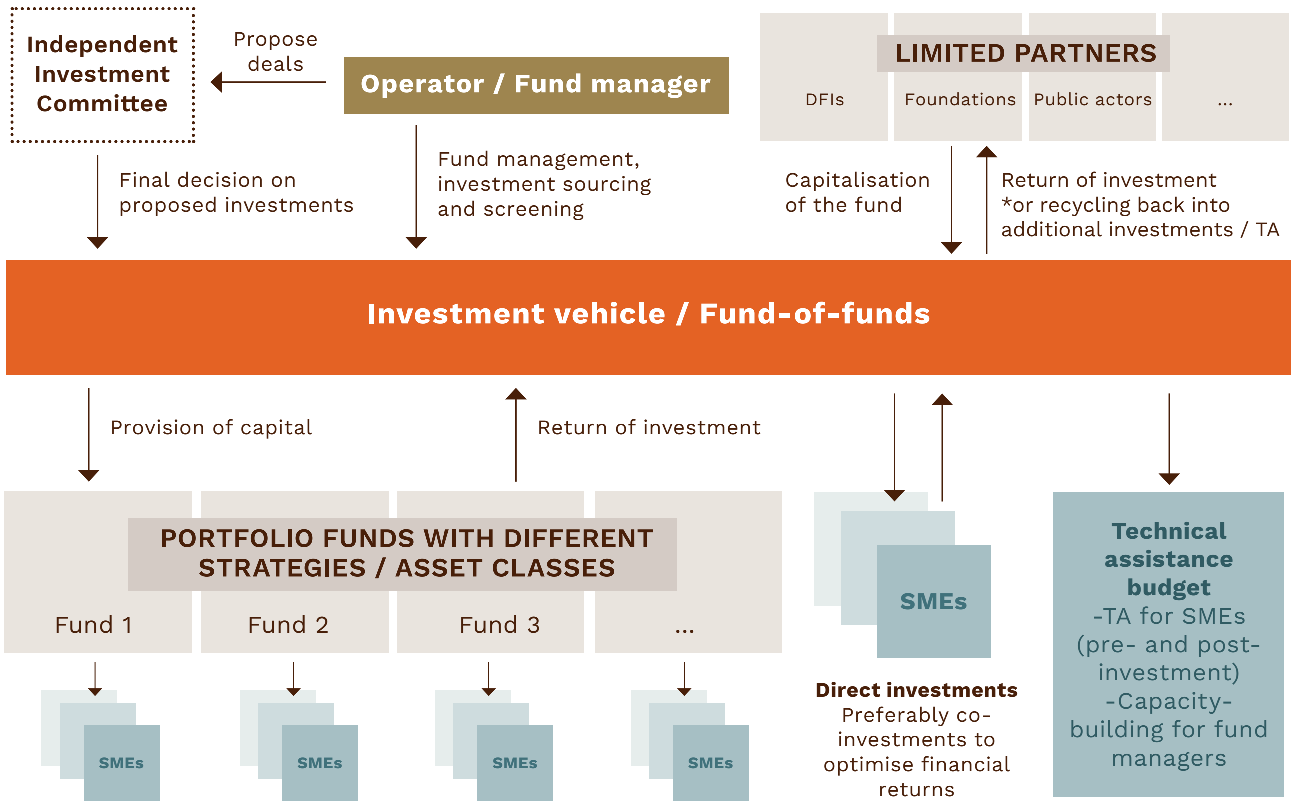
> *‘We can provide the catalytic capital to emerging fund managers. However, we need more commercial capital, as it is the only way to achieve economic impact and returns – and for that, we need actors that share the risks’.*
>
> *Manager of a catalytic capital funder*

They deploy various forms including **working capital** (IPDEV, Mastercard Foundation Africa Growth Fund), **warehousing capital** (Mastercard Foundation Africa Growth Fund), **anchor capital** (all) and **junior capital** (FASA). In our sample of 55+ SME funds, we have 20 first-time and emerging fund managers that have reached first close. Among these 20 funds, we found that 68% of them have been backed by one of these pan-African fund-of-funds. This demonstrates their nearly inevitable role in a first-time fund manager’s fundraising strategy.

68% of first-time and emerging managers have reached a first close on the continent in the past 10 years thanks to one of the four funds-of-funds listed above.

The exception to this trend is Ghana, where a domestic fund-of-fund (VCTF) has played this catalytic role and leveraged domestic capital from pension funds (see page 69).

Figure: Typical fund of funds structure



SPOTLIGHT I THE DUTCH GOOD GROWTH FUND (DGGF) SCBD PROGRAMME

Launched in 2014, the Dutch Good Growth Fund (DGGF) aims to improve financing for the missing middle in emerging markets, including those in fragile countries. Mainly financed by the Dutch Ministry of Foreign Affairs and managed by a consortium of impact investment managers Triple Jump and PwC, DGGF creates impact through a fund of funds approach, investing in emerging markets funds and financial institutions that have the expertise and connections to support local SMEs. DGGF is designed in several different layers which include: the intermediary investment fund portfolio (financial institutions that include upscaling MFIs, banks with a SME product and digital lenders, mezzanine vehicles, venture capital funds and private equity funds), and a catalytic sub-facility called the Seed Capital and Business Development programme (SCBD).

The seed capital window of the SCBD programme supports a broad spectrum of SME financing initiatives: e.g. first-time and pilot SME funds (debt or equity), new digital lenders, and non-bank financial institutions, etc., which all have the common goal of enhancing access to finance for female and young entrepreneurs notably operating in fragile states. Thanks to financial support of on average €1.5m per initiative, along with technical assistance and business development support, the SCBD programme seeks to overcome the usual challenges of new SME finance providers (low fundraising traction, transaction costs, limited deal flow and track record, etc.). The ability to scale up is still the main challenge preventing some of the seed-capital-financed initiatives to graduate to follow-on funders, including the intermediary investment fund portfolio. Certain models (solo GPs, fly-in models which proved unsustainable notably during the COVID crisis, unsustainable model economics) prevent DGGF and its peers from investing.

The SCBD facility also provides technical assistance and business development support to the fund-of-fund investees and companies in the underlying portfolio. It also supports local entrepreneur support organisations (ESOs) such as accelerators and incubators and angel networks dedicated to facilitating early-stage investments.

Finally, the facility captures lessons learnt, insights, success factors and failures into knowledge products across the sector. The SCBD programme's experience shows that layers of fragility build on each other and threaten even the best conceived SME funding initiatives, leading to a variety of endogenous and exogenous reasons for success or failure. The SCBD programme has successfully filled a gap by taking a very additional approach. Ultimately, SBCD's unique positioning enables them to test a number of different models and advances information-sharing in the sector.

DGGF impact report 2024: DGGF Impact Report 2024 | Publication | DGGF

SPOTLIGHT I THE IPDEV SPONSOR FUND

In 2013, I&P saw the need for a catalytic sponsor fund to promote the emergence of fund managers on the continent that would be dedicated to making early-stage SME investments. I&P later launched IPDEV, which co-creates new African SME funds in partnership with first-time fund managers. IPDEV raised €24m between 2015 and 2018 from a wide range of investors, including DFIs (Proparco, AfDB), foundations (Small Foundation, Lundin Foundation, SEDF), corporates, and individuals. Ten years later, IPDEV is still the only sponsor fund of its kind and recently published an independent evaluation.

IPDEV's model relies upon:

> Identifying individual fund managers through a selection process that looks beyond an applicant's track record and values entrepreneurial and operator experience.
> Co-designing the funds from inception (investment strategy, team and governance, ESG & impact strategy, fundraising, fund model, legal documentation, tax structure).
> Financing two years of launch for the fund manager.
> Acting as co-GP with a high holding percentage in the management companies.
> Anchoring the funds with 20%-40% of the fund size and actively raising the rest from local first-time fund investors.
> Deploying operational support to each fund manager, supporting their investments, setting up and participating in their governance, building their capacity, and networking with them as peers to share data practices, HR, etc.
> Acting as a fundraiser and business developer by bringing additional opportunities to fund managers, including donor-funded acceleration and seed programmes, technical assistance facilities, etc.

IPDEV's unique model has set a strong precedent:

> To date, seven funds have raised capital (Teranga Capital in Senegal, Sinergi Niger in Niger, Sinergi Burkina in Burkina Faso, Miarakap in Madagascar, Inua Capital in Uganda, Comoé Capital in Côte d'Ivoire, Zira Capital in Mali). Two more have been launched and are fundraising in Cameroon and Guinea. All are early-stage SME funds, structured as permanent capital vehicles with fund sizes between €2m and €8m and ticket sizes ranging from €100k to €500k. All funds have completed their target fund size and have deployed capital in equity or quasi equity.
> They have succeeded in raising from domestic investors, with 71+ African investors mobilised, leveraging 6.3x IPDEV's initial commitment.
> They have invested in 200 early-stage SMEs with equity, quasi-equity, and seed funding instruments, in the vast majority of cases as the first institutional investor in these SMEs.
> They are proving that SME funds investing equity and quasi-equity tickets of €50-€500k in early-stage SMEs can perform whilst generating high impact. The funds are performing very well, in line with or above expectations, and without reliance on grants to cover their fund management expenses.
> Together they have built a common team of 103 investment professionals, often playing a key role in building the talent pool in markets considered to be 'frontier'.

RECOMMENDATION 1#5

Increasing the amount of catalytic capital and blended finance will speed up the mobilization of capital for African SME funds.

1) A range of catalytic tools are key to empower a new generation of fund managers

E

- There are many segments of the market that still lack capital, and can only be targeted by new fund managers: frontier markets, early-stage SMEs, etc.

- **Working capital** is key to cover launch costs and legal fees for GPs as they design their fund, build their team, fundraise. This can be a combination of grant and soft loans that are repaid over time if they manage to raise a minimum viable fund size. The objective is not to cover all costs at market rate, but to lower the financial risk that new fund managers take and ultimately allow professionals without personal wealth to achieve final close without compromising on their vision or pursuing other sources of income that distract from and jeopardize raising the fund.

- **Warehousing capital** is key to enable first-time fund managers to build track record as a team and validate their investment thesis.

- **Junior catalytic capital**, especially when deployed as anchor investment, can dramatically improve the chances of fundraising by de-risking and unlocking more risk-adverse pools of capital. It can not only cover first losses, but also improve returns across the waterfall for LPs.

- **Direct operational grant support** to fund managers that address highly additional segments of the market but operate on fee budgets too small to maximize their impact or sustain a fund. This is particularly relevant when structural barriers (such as the lack of investment-readiness of a particular SME segment) can be overcome by simple interventions (such as covering part of the cost of an additional team member focused on pipeline development and investment-readiness in order to build a critical mass of SMEs eligible for funding).

2) Funds-of-funds can scale with the right support

E

Though they unlock new segments of the market, only very few fund-of-funds are currently deploying capital to SME fund managers. Many others are currently being raised and can be supported to increase the number of players:

- Fund-of-funds with a thematic or pan-African approach can mobilise large amounts of capital and deploy fast into a pipeline of ready fund managers.

- Country-focused fund-of-funds play a transformative role in building their investment ecosystem and are being raised in key markets.

- The fund model for such funds-of-funds is itself challenging both on liquidity and return; supporting them with blended finance interventions is a very high-leverage intervention for ecosystem funders.

CONCLUSION

In a challenging fundraising landscape, more catalytic solutions are arriving for emerging fund managers

There are **many new fund managers entering the fundraising market in Africa**, with an exponentially growing pool of talent and diversification of strategies and segments. However, they must **navigate a complex fundraising landscape**, with scarce LP capital, high barriers to entry, and extended fundraising timelines, which often jeopardizes their chance to raise.

The rise of catalytic capital funders, whilst promising, is far from responding to the size of the need. Only a handful are able to deploy catalytic capital at scale, compared to 250+ SME fund managers raising on the continent. In particular, anchor/junior capital, warehousing capital, and working capital remain very limited. Filling these gaps will be key to ensuring that new talent is able to arise and achieve its impact, that new pools of long-term capital can be unlocked, and that a **more diverse and resilient SME investment ecosystem emerges**.

Finally, the learning agenda of the sector is still at a nascent stage and requires more coordination and data-sharing to address the concerns of LPs, many of which have faced real challenges to invest in African SME funds. It is important to fully acknowledge the challenges that African SME funds have faced in the past and assess the new solutions being implemented by fund managers. Sharing more data and drawing more robust lessons from the experiences of fund managers will provide LPs valuable reference points and help mobilise more much-needed capital.

This is the objective of Part 2.

PART

02

GPs are finding solutions to the challenges of SME investing

1.

Emerging fund managers adapt their fundraising strategy to navigate LP dynamics

SME fund managers must navigate the complex fundraising environment described in Part One. All SME fund managers, including the most established, experience long fundraising timelines.

Emerging fund managers bear the brunt of this tough fundraising environment.

Most first-time and emerging fund managers take two to four years to reach final close and struggle to attract institutional capital for their first fund. *(We expand on this on Part 1, #2 'Raising an SME fund remains very challenging, especially for newcomers in the space', p38*). This is a major hurdle to the growth of the SME investment sector, as most established fund managers tend to walk away and leave the SME segment, and this gap must be filled by new managers.

For this reason, LP/GP power dynamics are tilted in favour of LPs, **who can afford to take a 'wait-and-see' approach** and watch progress from the sidelines. On the contrary, **fund managers don't have the luxury of time** and strive to progress step by step and need positive momentum from all LPs to create a virtuous circle and continue on their fundraising journey.

Many first-time and emerging fund managers quickly come to the realization that raising a $30m fund, let alone a $50m fund, from scratch is unlikely.

> *'Number one thing to do as an emerging fund manager: get a launch grant, with an institution paying the launch process. It is impossible not to be paid for five years.'*
>
> *A GP*

Instead, most successful fund managers are pursuing **progressive or heterodox fundraising strategies to achieve a faster close** with less uncertainty:

They raise progressively to build track record and credibility

They partner with a sponsor to access resources and funding

They team up to strengthen their case and raise more easily

They raise progressively to build track record and credibility.

The typical journey of an emerging fund manager entails four stages:

FUND DESIGN AND TEAM BUILDING	PILOT FUND OR SMALL FIRST CLOSE FOR TRACK RECORD	ANCHOR INVESTOR/ CATALYTIC CAPITAL	FINAL CLOSE WITH LPs
As an emerging fund manager, working on the right positioning for the fund and for the team is the most crucial first step in any fundraising.	Once the fund's thesis and vision have been set up, the next step of a phased fundraising is the raising of a pilot fund. This is a common strategy to be able to begin investing and build credibility and track record.	After having raised small fund sizes, fund managers usually seek anchor investors that bring a badge of credibility and strategic support for their fundraising journey.	Following these steps considerably increases the chances of reaching a first or final close with LPs.

First-time and emerging fund managers start by building a track record with limited amounts of capital.

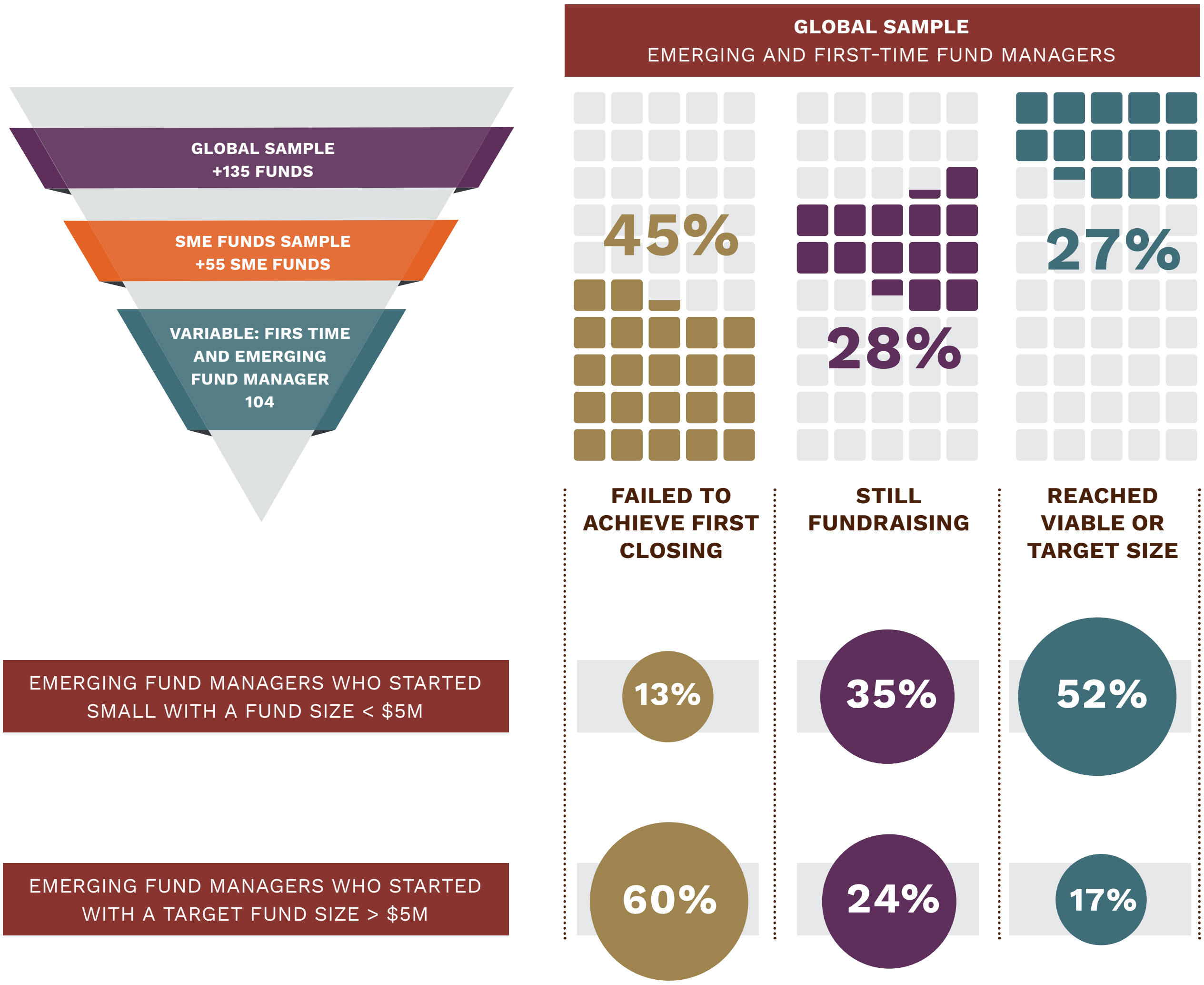
They use their own capital, leverage warehousing capital or angels. Next, they go on to raise a pilot fund or a first close far below a minimum viable fund size to keep investing. Such a first close most often includes individuals, foundations with a catalytic mandate, or other investors who already know and trust the fund manager. They take a bet on the fund manager's capacity to deploy this first close and grow the fund to a viable size in a second stage. Fund managers also take a risk in that set up, as with very limited fees, they must find other ways to support their team costs (personal funds, consulting, grants).

> *'Leverage your local networks. Start small with what you have, do your first small deals and keep on building.'*
>
> *A GP*

SPOTLIGHT

Several successful fund managers have deployed this strategy, such as Janngo Capital, the largest female-led VC fund in West Africa, which began its fundraising journey in 2017, managed to raise a permanent capital vehicle (PCV) with initial seed funding of $1m, used it to prove its investment acumen by making 10+ deals, and ended up raising its institutional vehicle with a final close at €73m in 2024, mostly from DFIs, a full seven years after the early design of Janngo as a project. Similarly, Secha Capital in South Africa started with a $5m first permanent capital vehicle in 2017 and invested in 10 South African companies, growing each company between 3x and 37x. Its Fund II is a Southern Africa fund, looking to scale its operator-investor model with a target size of $35m. Secha Capital achieved a first close at $16m in September 2023 and has now raised $20m.

Out of this report's sample of 135 funds, 104 are led by emerging and first-time fund managers, **30% of whom adopted a progressive fundraising strategy to raise, whilst 70% did not**. Their experience suggests that the former approach leads to dramatically increased chances of success:



This is consistent with the CFF *2023 Annual LCP Survey* covering 60 fund managers, which shows that most emerging fund managers use the so-called **'demonstration effect'** in order to increase their chances to reach a target fund size. 60% of their surveyed funds have either started investing individual deals or setting up pioneer funds of ≤$10m to prove their investment thesis and reach the target fund size.

To facilitate a phased fundraising, fund managers sometimes create alternative fund structures. Janngo started out with a pilot fund that was structured as a PCV and only raised a traditional closed-ended fund in a second phase once their track record had been proven. Aruwa Capital and iungo capital, which both managed to successfully close viable fund sizes, took similar approaches, structuring their first vehicles as investment companies with **flexible fundraising deadlines** and beginning their investing journeys with assets under management (AUM) below $5m. Others create dedicated special-purpose vehicles (SPVs) to house warehoused investments or collect capital from angels.

The recent development of **warehousing and working capital facilities** facilitates this progressive approach. Catalytic funders use such tools to help first-time fund managers cover some of their costs and make their first transactions whilst fundraising (*see Part 1, #5 'New catalytic capital funders have been decisive to build the market, but there is much more to be done', p.73*).

They first seek an anchor investor that can bring support and credibility. Once a small first close or pilot fund has been deployed, the next step for emerging fund managers is often to find an anchor investor.

LPs are indeed concerned about fundraising risk. Fund managers **typically need to raise capital from four to 10 significant LPs in order to achieve a viable size,** so even if one LP takes the risk to fully conduct due diligence and commit capital to a new fund, there is no guarantee that other LPs will follow suit. This is one of the main reasons why DFIs typically like to look at investments in groups of two or three. As the review and due diligence of a first-time fund is time-consuming, **very few LPs will take the risk to commit without a clear anchor investor** bringing a sizable chunk of the needed capital, which can lead to fund managers feeling frustrated that most LPs congregate around a small number of successful funds and create a **'winner-takes-all' dynamic in fundraising**.

An anchor investor that typically provides around 20%-40% of the size of a fund provides a fund manager a **badge of credibility** and sends the signal that an institutional investor has conducted due diligence and is satisfied. This lowers the fundraising and due diligence risks for other LPs. **Mobilising a junior tranche/catalytic capital can also be a strategic priority for first-time fund managers.** Although such capital is still limited, there is growing interest within the donor and philanthropic community in investing catalytic capital (*e.g. Green Climate Fund for climate funds, FASA for agri-SME funds, Boost Africa for VC – see Part 1, #5 'New catalytic capital funders have been decisive to build the market, but there is much more to be done', p.73*) Whilst not always necessary, this approach can significantly accelerate fundraising by de-risking the fund. This is particularly key in some sectors considered riskier (agri-SME funds) or operating in more nascent segments (frontier markets, climate funds). Fund managers can also follow more heterodox approaches to raise their first fund.

Fund managers can also follow more heterodox approaches to raise their first fund.

> Answering donor or DFI requests for proposals can be an effective strategy for raising a first fund.

This approach was successfully employed by Wangara Green Ventures in Ghana with the World Bank Infodev Ghana Venture Capital Facility and by XSML, which raised its first investment capacity in the Democratic Republic of Congo and Central African Republic with an IFC call for funding that was focused on frontier markets.

> Building a track record with a search fund instead of raising a traditional fund.

A search fund is an investment vehicle typically set up by an entrepreneur/operator, with the primary purpose of finding, acquiring, and managing a single existing company. In the initial ('search') phase, investors provide the **'searcher' capital to cover the costs associated with identifying and evaluating a target company**. This phase typically lasts one to two years. Once a target company is identified, the searcher raises additional capital (often from the same investors who funded the search stage) to acquire the company. After the acquisition, the searcher often takes an active management role, operating and growing the business to increase its value over time. This allows them to **build both the investment and operating track record whilst limiting the initial fundraise to the amount necessary to search for** and then purchase a single company. One such example is the successful acquisition by a search fund in Africa which occurred in 2021 in Francophone West Africa when Africa Search Capital (ASC) acquired a majority stake in Falcon Security Hub, a pioneering electronic surveillance company in Côte d'Ivoire. There are still very few examples of this approach in Africa compared to other emerging markets.

They team up to strengthen their case and raise more easily.

Today there is a **multiplication of talented investment professionals aspiring to manage new funds**. Many set out on this journey alone; however, most see very quickly how being a solo GP compounds the challenges already faced as a first-time and emerging fund manager.

> *'There are too many aspiring fund managers, too many solo GPs looking to raise a fund. The king-in-a-castle approach often does not work; people need to regroup and partner.'*
>
> *A GP*

An increasing number of GPs have decided to team up in reaction to this tough environment.

In our sample of 55+ SME funds (for early-stage SME funds, growth SME funds, and debt funds), we found that a higher percentage of funds has more than one GP:

41% are solo GPs

59% are co-GPs (Two+ fund managers)

This trend appears more pronounced among debt funds (82% with two+ GPs) and growth SME funds (60% with two+ GPs) compared to early SME funds (only 48% with two+ GPs) in the sample.

Teaming up as GPs offers numerous advantages and enhances the likelihood of successfully raising a fund:

- It brings a **broader reach in terms of geography, sectors, and skillset** that builds a clear rationale for raising a larger fund size with a larger universe of potential investors. In a context where small fund sizes are so hard to raise, the whole often becomes larger than its parts.
- It **combines LP networks and existing pools of capital**, thereby shortening the road to first close and facilitating the building of a track record.
- It reduces pressure on and cost of recruiting the right senior talent, since GPs tend to take an entrepreneurial long-term view and forego short-term remuneration for long-term upside.

There are, of course, **success factors to consider, as new partnerships among GPs** can bring additional risks that LPs readily identify:

- Building and **showing alignment early is important**, not only on vision and investment strategy but also on partnership terms, allocation of responsibilities, personal constraints, and challenges.
- Demonstrating that 'partnership risk' is mitigated through substantial common experience is also necessary: GPs need to show that they have executed transactions together, collaborated for a substantial period of time, sat together on an IC, etc.

SPOTLIGHT

ATG Samata was launched by partners Lelemba Phiri and Lisa G. Thomas. It is the merger of two fund management companies: Africa Trust Group and Samata Capital, which partnered in October 2023 to form ATG Samata. Lelemba was the founder of Africa Trust Group, the fund manager for the $10m Enygma Ventures (GLI fund focused on Southern Africa) and the Empress Fund, an angel syndicate pilot fund. Prior to becoming an investor, Lelemba was part of a company that expanded across five countries in Africa. Lisa was the founder of Samata Capital, an early-stage gender-lens investor with a focus on East and West Africa. Before founding Samata, she held several senior investment roles in other funds and worked in more than 20 emerging market countries. Across their combined 35+ years of investing and operating in Africa, Lelemba and Lisa have done many co-investments and built a shared vision around creating access to capital and opportunity for talented entrepreneurs. Their complementary backgrounds of investment and entrepreneurship will drive high quality investment decisions and deep support for their portfolio companies.

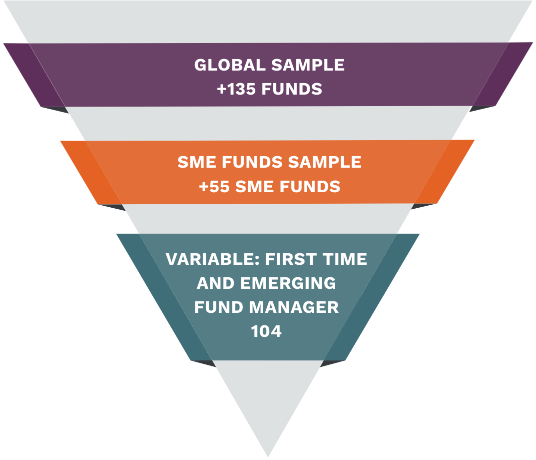
Such partnerships can be structured on an equal basis or as junior-senior partnerships. For aspiring fund managers, the fastest path to become a GP is to join a fund that has recently achieved or is on track to achieve first close, as a partner or on a partner track. Joining an emerging fund management company (raising fund I or fund II) can be a particularly strong opportunity to access responsibilities and build a track record.

Acceleration cohorts and training programmes for fund managers such as 2Xignite, Obuntu Foundation and Moremi Accelerator, as well as networks such as African Women in Investment (AWI), can be propitious spaces for these partnerships to emerge.

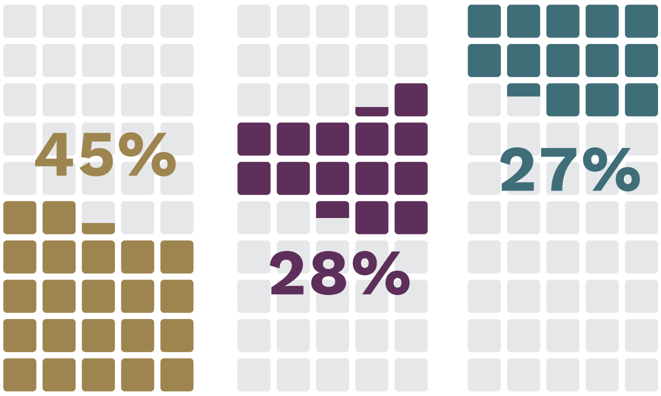
Fund managers partner with a sponsor or fund platform to access resources and anchor funding.

Teaming up with another GP helps build a strong team but most often does not solve the question of anchor investment. This is why an increasing number of new fund managers are opting to partner with experienced fund managers as sponsors. A sponsor is an **institutional or strategic investor that plays a catalytic role** in the establishment and growth of a new fund (See Part 1, #5 'New catalytic capital funders have been decisive to build the market, but there is much more to be done', p.73).

Out of our global sample of 135+ funds, 104 are emerging and first-time fund managers, and 17% of them were backed by a sponsor or platform during their fundraise. **Their experience shows that sponsorship has tripled their chances of fundraising success**:



GLOBAL SAMPLE
EMERGING AND FIRST-TIME FUND MANAGERS



	FAILED TO ACHIEVE FIRST CLOSING	STILL FUNDRAISING	REACHED VIABLE OR TARGET SIZE
EMERGING FUND MANAGERS BACKED BY A SPONSOR	22%	17%	61%
EMERGING FUND MANAGERS NOT BACKED BY A SPONSOR	50%	30%	20%

Sponsorship agreements can bring fund managers significant value.

> Sponsorship arrangements first and foremost bring capital into the fund, with the sponsor either investing themselves or leveraging their network of LPs. This shortens the time to reach first close.

> A sponsor typically provides **financial and non-financial support to the fund manager** in the form of direct funding for the GP, an established track record and investment know-how, a ready-made fund structure, tried-and-tested processes and DFI-level standards, an existing fund manager license in regulated markets, etc.

> Sponsors can also bring a **network of other sponsored fund managers,** business development opportunities, and fund management services (ESG, investor relations, back office, etc.) at reduced costs via a platform approach.

> Sponsors also help **mitigate key-person risk for LPs**, as they secure the continuity of a fund manager should a key-person risk materialize with the main GP.

'Having a co-GP is the way to go, but it does not necessarily mean partnering with an individual. Not everyone is able to build a business, a fund. To scale and be credible with institutional investors, partnering with an established platform is of incredible value.'

A fund managing partner

Key success factors for a sponsor in the current environment include:

> A real **capacity to invest capital,** not only into the fund but also into the GP/management company in the context of a long fundraise.
> A long-term financial model that can **back first-time fund managers** without charging considerable fees.
> **Credibility as an investor** and a relevant track record of boosting fundraising outcomes.
> The capacity to support the fund manager during both the **fundraise and the investment period** and to continue bringing value on an as-needed basis.

In return for their capital and time, sponsors typically acquire a GP stake or shareholding in the management company, receive a portion of the fund's fees, and/or a share of the potential carried interest earned by the GPs. Specific arrangements vary widely, with as many models as there are sponsors.

SPOTLIGHT I EAST AFRICA GROWTH IMPACT FUND (EAGIF)
A SPONSORED FUND IN FUNDRAISING

Amanda Kabagambe is currently fundraising for EAGIF, a $50m private credit fund whose objective is to address the growth capital needs of East Africa SMEs. She is a transaction advisor and management consultant with over 14 years' experience providing cross-cutting advisory services and advising institutions including the World Bank, the Government of Uganda, and regional DFIs and has structured and arranged over $150m of direct investments. EAGIF was launched in partnership with TLG Capital, which provides both anchor capital and technical support. The new fund will capitalise on TLG's 10+ year track record investing successfully in Africa.

Sponsorship options remain limited for first-time and emerging fund managers.

In 2014-15, IPDEV and Capria Ventures (which later pivoted to a different model) **tested two sponsorship models for new fund managers**. Recently, there has been an increase in sponsorships, such as LBO France backing Seedstars Africa Ventures and Joliba; Verod Capital sponsoring Verod Kepple Africa Ventures; and at least seven other such cases of sponsored fund managers currently raising capital.

Such partnerships can fail due to misalignment on partnership terms or vision, insufficient support from the sponsor, or diverging paths as a result of prolonged and ultimately unsuccessful fundraising efforts. IPDEV has experienced some failures of this kind first-hand and witnessed a dozen more in the ecosystem. Emerging fund managers can mitigate this risk by doing their own due diligence on the sponsor to ensure that the sponsor can provide enough value to boost their fundraise.

RECOMMENDATION 2#1

Successful emerging fund managers have taken a progressive road to fundraising; an enabling environment is needed to facilitate the launch of new funds.

1) In the absence of a strong enabling environment, emerging fund managers should plan for a two-to four-year step-by-step fundraising sequence.

GP

Experience shows that successful fundraises for emerging managers tend to be those that are **progressive and that start with a very low investment capacity to prove track record**. This creates a long sequence with many steps (*fund design, raising initial capital or warehousing, building a team, building a track record, finding an anchor investor, completing the fundraise*) lasting two to four years on average.

Emerging fund managers should plan accordingly for what is truly an entrepreneurial journey. Key steps include carefully mapping the relevant funders for each stage of the launch and prioritising relationships in a context of limited time and resources and leveraging pro bono support both on the investment cycle and on legal, domiciliation, and fund management processes.

This process often requires planning financially for a minimum of two years without income by identifying other sources of income and funding. Grants are one option, as there is very significant interest on the part of donors and foundations in supporting the entrepreneurship ecosystem. Also, former consultants transitioning to becoming emerging fund managers tend to rely financially on their consulting background to pay the bills during the fundraising phase and continue to take on advisory projects, whether or not they are directly tied to their fundraising. There are often synergies between their consulting activity and their ongoing fundraising, particularly via building a track record by managing entrepreneurship financing programmes or by accessing new LP networks. This can be time-consuming and distract from a fundraise phase that is very demanding.

2) There is a strong opportunity for new GPs to partner with other GPs or with sponsors/platforms and improve their odds on the fundraising market.

GP

The exponential growth of talent and interest in the sector creates opportunities for partnerships between individuals and/or organisations. This is not an obvious path, as **partnerships need to be deep and solid enough to be convincing in a fundraise**; however, finding the right sponsor, platform, or partner can both accelerate the fundraise and increase chances that a viable size is reached.

The combination of (i) a greater number of aspiring fund managers facing a limited supply of capital, and (ii) strict LP criteria, rising standards, norms, and complexity for fund managers, puts a significant premium on accessing fundraising capacity, networks, credibility, and operational support to convince both international and domestic investors. This makes **fund platform solutions, GP-stake funds[1]/sponsor funds, or anchor funds** with strong embedded support a key piece of the growing ecosystem going forward.

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1. https://www.ey.com/en_lu/insights/private-equity/the-rise-of-gp-stakes-investing

3) Catalytic funders can facilitate the emergence of new SME funds by filling the most glaring gaps: availability of launch working capital, warehousing capital, anchor investment, and catalytic capital.

Behind the inspiring stories that are shared when a fund finally reaches its last close, many fund managers have gone through an obstacle course, which highlights their persistence and resilience. Staying the course for two to four years before reaching a viable fund size sometimes requires fund managers to compromise or weaken their vision. This underscores the fragile nature of the investment ecosystem in African countries, where the necessary elements to help fund managers thrive are only nascent.

Fund managers face an ecosystem where launch and anchor funding remain anecdotal and where most acceleration programmes come without the necessary funding for operational expenses and building track record. The challenges in navigating this ecosystem create a situation where very few fund managers make it to raise their fund and where many deserving teams give up.

The set-up of such working capital, warehousing facilities, and junior capital/anchor investment is a **prerequisite to the growth of the sector** and, in the end, to more capital being driven to SMEs.

2.

Better matching the liquidity profile of SME funds with the horizon of SME investments

The prevailing model in the global investment landscape is a closed-end fund structure, typically set for a 10-year term with two optional one-year extensions, paired with the traditional 2&20 standard: 2% management fees and 20% carried interest (most often with an 8% hurdle rate). This standard has become entrenched in the investment industry in the United States, particularly in private equity and public markets and then subsequently adopted globally. **Whilst growing evidence suggests that this model is not optimal for maximizing returns in African SME funds, LPs are often hesitant to explore alternative structures**, which are perceived as less liquid or too favourable to fund managers.

Among our sample of 55+ SME funds, we analysed fund structures for 51 of them and found that 94% of the growth SME funds are structured as closed-ended funds, whilst only half of early-stage SME funds are structured as closed-ended funds:

56% of the early-stage funds are structured as closed-ended funds

94% of the growth SME funds are structured as closed-ended funds

67% of debt funds are structured as closed-ended funds

Liquidity is the top priority for most LPs.

For most LPs active in the African ecosystem, liquidity comes first and comes before the return target.

LPs are significantly more comfortable with closed-ended funds with clear time horizons, and this is for several reasons. First, LPs face a principal-agent problem where they must put pressure on exits in order to avoid misalignments where GPs over-extend the life of a fund to earn (certain) fees with the goal to achieve an (uncertain) return. Then LPs themselves need to demonstrate to their asset owners that they can redeem capital in order to mobilise more capital for a market that is still perceived as risky. **Recycling capital into new transactions is often crucial to the business model and impact of these LPs**.

Beyond the closed-ended nature itself, the global time horizon standard for a closed-ended fund (10-year), with a 5-year investment period and a 5-year exit period, has been replicated **in a market for which it is most often not the ideal holding period** (definitely when it comes to equity transactions). Indeed, the implication of this model is that investments made at the end of the investment period need to be sold after only five to six years.

An investment fund typically operates as a **two-sided market agent[2], as its model depends on both (i) attracting LPs and (ii) investing in SMEs**. A defining feature of two-sided markets is rigidity, as one market determines the set of constraints for the other market, and both sides do not evolve in a correlated manner. Investment funds must first raise their capital with LPs, then lock the terms in a 10-year fund (or more), and only then invest in SMEs. Bridging the two sides of this market is a key success factor for a fund manager, and liquidity may be the most challenging aspect of it.

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[2] Jean-Charles Rochet et Jean Tirole, « Platform Competition in Two-Sided Markets », *Journal of the European Economic Association*, vol. 1, no 4, 2003, p. 990-1029.

Historical data suggests that the global standard does not lead to optimal returns for African SME funds.

Operational realities are substantially different between mature and nascent markets, making it unrealistic to expect that identical fund terms can deliver comparable results.

Insights from interviewees converge to reveal that the problem of SME fund performance most often does not stem from the performance of African SME investments themselves, but rather from the time constraints imposed by traditional fund structures, which fail to align with the realities of SME investing. Funds indeed face two principal challenges when trying to match the timeline of closed-ended fund standards: (i) the **limited exit options which delay the realisation of investments**, and (ii) the **longer time needed for value creation within a SME**.

SME equity investments are less liquid, with limited exit opportunities.

Investing equity into SMEs poses a considerable challenge compared to mid- and large-cap private equity: as ticket sizes decrease, exit options become more and more limited, with fewer secondary players positioned and limited options for financial engineering. At the same time, debt cannot be the only instrument invested into SMEs, as they require long-term capital to grow, have limited cash flows, and require considerable management and governance support. Equity can be a powerful solution for fast-growing SMEs.

> Stock exchanges are not yet a reliable exit route.

Illiquid financial markets do not enable IPOs (initial public offerings) as a viable exit option for African SMEs. Whilst there have been successful private equity exits via stock markets, they are **mostly confined to large companies** in the more developed financial markets of the continent, such as those of Morocco and South Africa. To date, the establishment of SME compartments within stock exchanges has mostly not yet translated into substantial exit opportunities for SME investors. For instance, in 2017 the WAEMU region's regional stock market BRVM launched 'BRVM Small Capitalisations', an alternative compartment designed for SMEs. A technical assistance support programme aimed at preparing SMEs for their IPOs was also initiated, and several growth SME funds active in the region committed to participating with the stock exchange; however, to date:

> Secondary and trade sales represent a large proportion of exits but remain challenging.

Secondary and trade sales represent one of the most frequently used exit strategies in the private equity sector. Shares can indeed be sold to secondary funds, other financial institutions, or corporations with a strategic interest. **Opportunities to sell to strategic players or corporations are more limited in the SME space**, as SME funds typically hold minority stakes in their portfolio companies. Very few African SME investors have a control strategy (*Adenia Partners, which started out in 2003 managing a €10m fund, went on to raise four additional funds and as of 2024 is managing an €800m AUM, is a notable exception*), because most entrepreneurs seek first and foremost minority investors. Corporate buyers pursue strategic goals and seek to secure majority ownership.

Similarly, opportunities to sell to larger funds are lower than in mature markets due to the underdevelopment of the later-stage ecosystem; this is particularly true in more 'frontier' markets within the continent.

This means that instead of lining up an auction process with several buyers, SME funds face a less liquid environment whilst exiting even well-performing companies and have only a handful of credible likely buyers. **This delays exits and reduces potential returns**.

Nevertheless, SME investors are able to exit. **Out of 58 exits made by I&P in 10+ countries:**

59% were exits sponsor

41% were secondary or trade sales

Longer holding periods lead to positive exits for SME funds, which would not have been possible with shorter holding periods.

2024: Injaro Agricultural Holdings Ltd exited its stake in Agricare Limited, Ghana's oldest animal feed producer, to Flour Mills of Ghana. This strategic sale represents a full exit from Agricare, after an **eight-year holding period.**

2021: I&P exited Normat, a Beninese company active in building materials, to EPC, the world leader in manufacturing and distribution of explosives for civil use. This exit, which led to a very good equity multiple, took place **after a 12-year holding period.** During this period, the company faced very significant challenges and pivots which would not have allowed a good exit in a five-to-seven-year period.

2015: Cauris Management sold its stake in Eau Technologie Environment (ETE) to Moroccan company Les Eaux Minérales d'Oulmès, **for a 3.4x return**. This exit happened after an eight-year holding period.

> Selling back to the founders is often necessary for SMEs: For most SME funds, sales back to the sponsor or activation of the 'put' option is often a major exit route. Whilst there are successes, selling back to the entrepreneur (and often to their network) often requires to capping the equity return of the fund, leading to lower returns even in the case of strong performance of the companies.

SMEs, especially when early-stage, require more time to maximize exit outcomes. Beyond liquidity, it takes time for a SME investment to grow up-to a stage where it can be attractive to a buyer. When investing in an early-stage SME, fund managers know that the first two to three years will often be dedicated to structuring and solidifying the business, only then followed by an exponential growth phase. Investors observe that the majority of **returns begin to materialize around years six and seven**, once the SME has had sufficient time to stabilize and expand (or seven to nine years if the companies have faced strong headwinds along the way).

> *'If you find a small young fragile company with four employees and you're trying to get your return in three years and exit in year five, you're misaligned.'*
>
> *A GP*

Data from Omidyar's report 2019 *Insights on SME fund performance* supports this timeline: an analysis of the financial returns of 100 SME funds[3] revealed that SMEs typically need six to 10 years post-investment to deliver substantial financial returns so that fund returns are maximized in the 15-20-year range[4]. Of note: this research dates back to 2019 and only covers SME funds with vintages older than 2015.

There has been clear improvement in recent years, with SME funds reaching positive gross and net returns much more quickly than previously. Out of our sample of 55+ SME funds, we analysed financial data for 22 of them (growth SME, early SME, and debt funds), 18 of which had vintages more recent than 2015. This sample complements Omidyar's research well, as it is made of more recent funds. Our analysis shows on average that **gross returns (MOIC) become positive for funds with an average age of four years, and net returns (TVPI) reach 1x for funds with an average age of 6.7 years.** This data needs to be made more robust by a larger sample, but it is promising; it suggests that an improving environment has led to earlier positive returns for SME portfolios and makes the case for a more exhaustive update of data on this topic.

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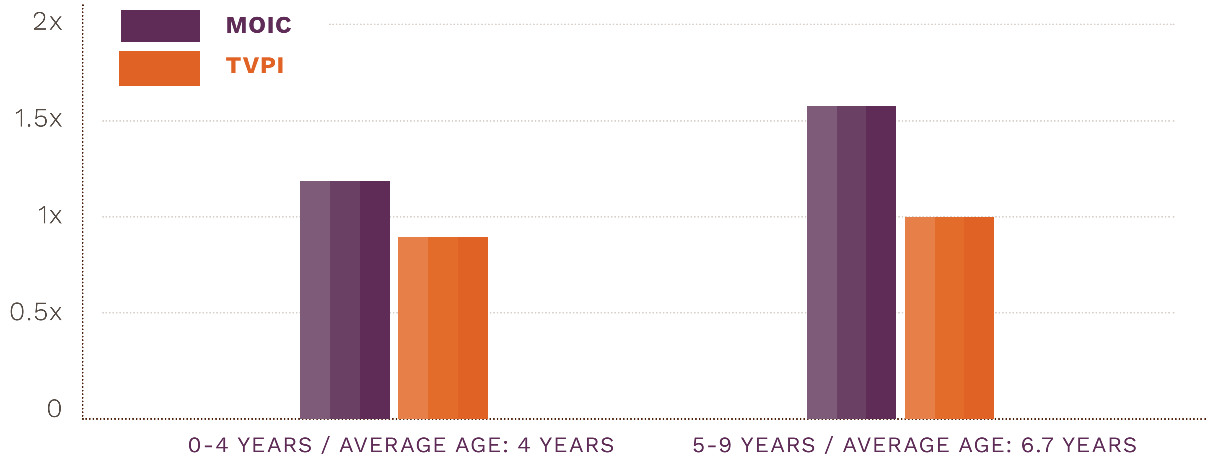
[3] The report characterizes SME funds as funds with investment tickets ranging from $100k to $2m.

[4] Shell Foundation. Omidyar Network. Deloitte. 2019. Insights on SME fund performance. Generating learnings with the potential to catalyse interest and action in SME investing.

Average time needed for SME funds to achieve returns (MOIC and TVPI)



Of course, the main point remains that the lower liquidity of the SME investing market places considerable exit pressure on closed-end SME equity funds, often with counterproductive effects: exiting a SME too early to return capital and demonstrate exit experience to potential LPs for the next fund means leaving most of the value on the table at a time when the portfolio company has been de-risked and often prevents reinvestment in a company that is on a growth path, therefore harming the returns of the LPs in the current fund.

Reality check: In practice, SME equity funds are rarely liquidated in 10 years, but rather in 15 years. The combination of the extended time required for value creation and the limited exit options in the African SME context hinders closed-end SME funds from achieving full liquidation within the typical 10+2-year timeframe. LPs with a long history of funding African SME funds have shared that in practice, SME funds tend to be liquidated in 15 years rather than in 10 to 12.

Cauris Management's first fund was launched in 1995 and was fully liquidated only in 2013, after 18 years. This €7.6m SME fund invested in 30 SMEs and realized a net return of 2.5x. Their second fund, Cauris Croissance was launched in 2006 with a €15.2m size and is yet to be fully liquidated after 18 years. The case of Cauris demonstrates that positive and attractive financial returns for LPs are achievable, though after sufficient time is allowed for SMEs to reach maturity.

SME fund managers now develop solutions to better match their liquidity structure and their investment strategy.

Many design a strategy to invest heavily in self-liquidating investments to reduce reliance on delayed equity exits.

> They invest with mezzanine or straight debt instruments.

In the absence of a liquid market for equity exits, investing mezzanine or debt has become a strategy for fund managers to finance SMEs whilst providing more liquidity to LPs. Theoretically, this limits upside compared to equity, but reduces risk and improves liquidity. Some funds have built their expertise on investing such capital with attractive gross returns (iungo capital, XSML), and some others have gradually moved from providing equity and quasi-equity to a straight debt and mezzanine model (AgDevCo being an example).

> They combine equity with quasi equity instruments.

Today, there are very few SME funds that invest only pure equity. Funds that present themselves as equity funds actually use a blend of equity, quasi-equity, and self-liquidating instruments to invest in SMEs. This approach enables **self-liquidating mechanisms that reduce reliance on traditional exits** whilst also allowing for capital recycling, which helps lower relative fees and improves net returns.

They improve their fund structures to extend the time horizon.

> Some funds keep a **closed-ended structure but raise longer-term funds** (often 12-year funds + two one-year extensions)

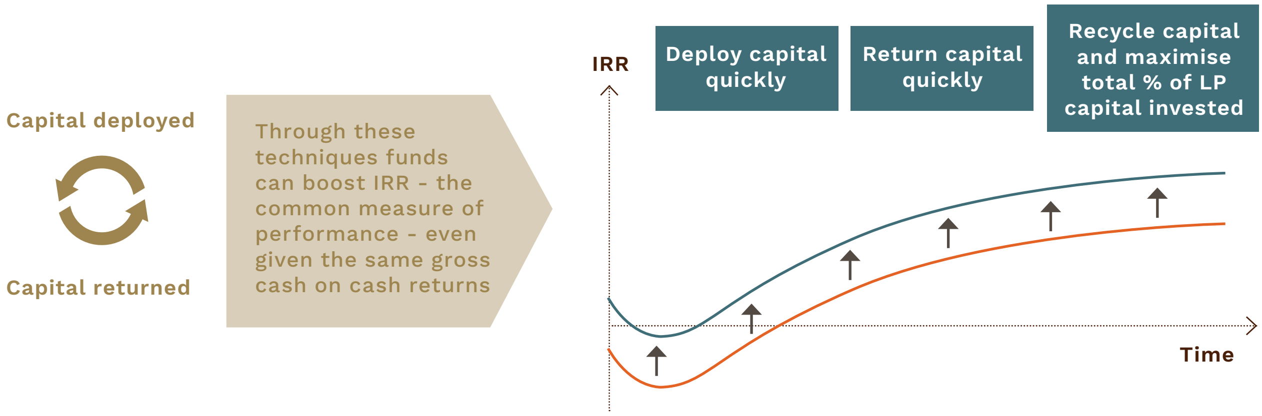
In some contexts, LPs can accept a longer horizon for a closed-ended fund. This is often combined with a **steep cliff on the management fees after year 10**, in order to remove the incentive for the GPs to extend the life of the fund. However, this report found that this remains a rare case: only three of the 38 emerging fund managers that structured their funds as closed-ended made the choice of horizons longer than 10 + 2 years (10 + 3; 10 + 4; 10 + 5, respectively).

> They demonstrate that they can **deploy capital more quickly to avoid deepening the ‘J curve’.**

The standard investment period for closed-ended funds is usually five years (+ 1). Some SME fund managers find ways to **shorten these investment periods without compromising deal quality**, for instance, by bringing warehoused transactions into the portfolio from the start of the fund to which follow-on capital can also be provided. This is another advantage of finding ways to make a few first transactions before a first close, and it empowers fund managers to focus more on value creation and shorten the path to exit.

Increasing the velocity with which capital is deployed and then returned or recycled improves liquidity and IRR but raises questions on pipeline readiness, maturity of the investment team, and transaction costs within the first few years. This approach can be combined with a tiered fee structure that begins with higher fees in the first years to enable this big push and fast deployment and portfolio support in the first years of the fund.

Velocity of capital... drives fund performance J-Curve. From the report *Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations,* IFC, 2018. [5]



Through these techniques funds can boost IRR - the common measure of performance - even given the same gross cash on cash returns

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5. International Finance Corporation (IFC). 2018. IFC SME Ventures. Investing in Private Equity in Sub-Saharan African Fragile and Conflict-Affected Situations.

A growing number of fund managers structure their fund as open-ended or permanent capital vehicles.

In the sample of 55+ SME funds analysed, growth SME funds are mainly structured as closed-ended funds (only 6% of them are structured as PCVs, whilst almost half of early-stage SME funds tend to be structured as PCVs.)

44% of early-stage funds structured as PCVs

94% of growth SME funds are structured as traditional closed-ended funds

PCVs are often better suited to the realities of investing equity into early-stage SMEs.

They remain a minority of funds on the continent but present numerous advantages for investing in the early-stage SME segment:

Patient capital improves gross returns: PCVs allow **SME funds to hold investments over longer periods**, capturing the full benefits of value creation efforts without the pressure to exit prematurely. This structure aligns well with the growth trajectories of African SMEs. Extended holding periods can result in stronger gross financial returns. This advantage is compounded when working in uncertain environments: for single-country funds, PCVs offer critical flexibility during periods of political or economic instability, such as political upheavals or currency depreciations.

The average MOIC of the four PCVs in the IPDEV portfolio older than five years is 2.48x. This is due to a combination of early-stage investing and patient capital.

> Capital recycling and flexible fee structures enable net returns: Due to their open-ended nature, PCVs operate outside the standard '2-and-20' fee model. Instead, PCVs typically implement a **flexible budget model, often based on a 10-year forecast** with annual board-approved budgets that include investor representatives. This adaptive approach promotes transparency and aligns management fees more closely with the fund's evolving needs. Since PCVs recycle their capital multiple times, they are able to achieve higher cost efficiency over time.

According to Palladium's IPDEV Fund Evaluation 2023 report, the average net return (TVPI) of the IPDEV portfolio's four PCVs older than five years is 1.82x, thanks to higher gross returns and capital recycling. This places them in the 85th percentile of funds operating despite the fact that these PCVs have a fund size below $10m and higher relative management fees than average.

> Investors can exit PCVs at premiums to the book value: PCVs are structured as investment companies with shares that can be sold to third parties. When they achieve capital increases, new investors set a new valuation. Existing investors can decide to **sell shares upon this occasion and create liquidity.** PCVs are not a purely financial vehicle but also add strategic value as a long-term funder of SMEs in their market; they allow investors to earn additional value and exit at a premium to the book value (similar to bank or MFI shareholders). This secondary sale option completely transforms the liquidity dynamics compared to closed-end funds, where LPs are required to wait until the end of the divestment period to redeem their capital in the absence of secondary markets. Finally, PCVs are structured in a manner such that a supermajority of shareholders can decide to liquidate the PCV, forcing the fund manager to exit the portfolio and return the proceeds over a certain period; this provides liquidity in the worst-case scenario.

Two of the IPDEV-sponsored funds have achieved capital increases at a significant premium to the nominal share price that have materialised the value increase in line with the TVPI achieved. At the occasion of these capital increases, existing and new investors purchase shares, and existing investors have an opportunity to sell part or all of their shares to new investors.

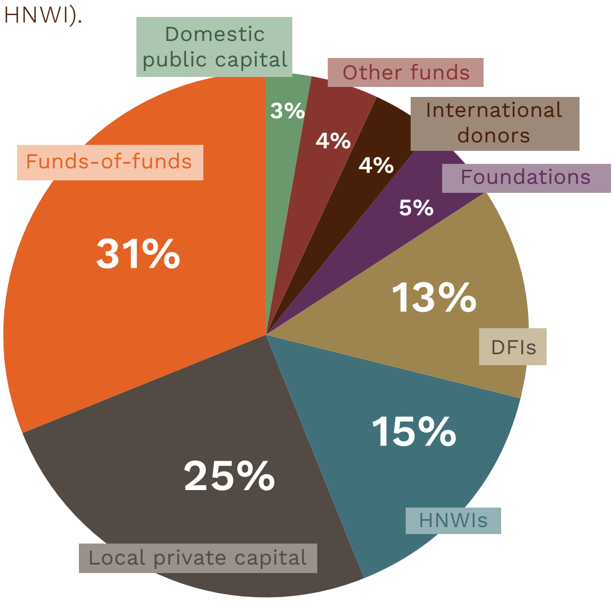
> **Adaptability to first time investors:** PCVs structured as investment companies are often attractive for domestic capital sources such as financial institutions, individuals, and corporates, which may be first-time fund investors and more comfortable with investing in investment companies with a familiar governance.

Miarakap (Madagascar) is structured as a PCV and has managed to raise capital with many first-time and domestic LPs – 45% of its total fund size was raised with more than 10 domestic private corporate groups, including banks, telecom, and industrial groups. Miarakap also managed to raise a significant amount of its fund (9%) from more than 10 HNWIs who are key entrepreneurs in the country. Miarakap's final close was achieved with more than 25 domestic LPs, proving their interest in investing in locally-domiciled PCVs.

> **Focus on investment and lower reliance on fundraising:** PCVs recycle their capital, which softens the imperative for closed ended funds to continue fundraising every five years. This **removes a major uncertainty in the life of a fund manager** and improves focus on the investment cycle. Fundraises for PCVs can still grow the impact or ambition of the PCV, but they are more flexible. PCVs can also stack debt over their equity capital base, thereby achieving a leverage effect, something LPs in a typical closed-ended fund generally forbid.

Beginning with $1m in seed funding in 2017, iungo capital has since invested in 51 SMEs whilst continuously fundraising and recycling capital, gradually growing its PCV fund size to $11m by blending debt and equity investments. Today, the fund manager is looking to scale-up its activities across four countries in East Africa by further increasing its AUM.

PCVs struggle to attract international pools of capital. Out of our sample of 55+ SME funds, 17 funds are structured as PCVs. They raise from a diversity of investors, with a high proportion of African/often domestic capital (public, private, HNWI).



Whilst historically DFIs have shied away from such structures, the two examples below demonstrate that PCVs are increasingly funded by DFIs.

AgDevCo is a pioneering agri-SME investor in Africa, with 80 agribusinesses funded already across the continent. AgDevCo is structured as a Permanent Capital Vehicle. Established in 2009 and funded initially by the UK government, AgDevCo achieved a closing of $90m with three DFIs in 2021: the CDC Group (later renamed BII) with a $50m equity investment, Norfund with a $20m equity investment, and $20m of senior debt from DFC . AgDevCo, which is in the process of a further debt and equity funding round, which will take its total capital to above $400m. is a pioneering agri-SME investor in Africa, with 80 agribusinesses already funded across the continent. AgDevCo is structured as a PCV, and in 2022 AgDevCo achieved a closing of $90m with three DFIs: the CDC Group (later renamed BII) with a $50m equity investment, Norfund with a $20m equity investment, and $20m of senior debt from DFC.[6]

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6. AgDevCo. 2022. Funding Press Notice. 'AgDevCo secures $90m of DFI funding to further invest in African agribusinesses to deliver jobs, incomes, and food'.
7. AIMA. Saksena, D. Vermeylen, C. Pointer, T. Simmons. 2023. The rise of hybrid funds 2023. AIMA Journal, Edition 136.

SPOTLIGHT I MARIS CAPITAL

Maris Capital is the example of a team that started out as a typical fund structure and subsequently made the choice to transform into a PCV/holding company.

> In 2010: Maris Capital achieved a first close of a $26m Maris Africa Fund with 70% from private investors and 30% from DFIs such as FMO and Proparco. In 2011–13, Maris Capital made a total of 14 investments in seven countries in Eastern and Southern Africa. The team then felt that the typical private equity fund cycle was working against their long-term objectives and restricting their potential for greater synergy across the portfolio.

> In 2014: They restructured the fund to a PCV called Maris Limited. They raised $36m and exited their initial LPs, who received up to 2x their original investment and achieved a net IRR of 24%. Today, Maris continues to grow its platform of operating companies with a majority investment strategy and the latitude of time-for-value creation given the PCV structure. The firm has built a portfolio of 20 SMEs across 11 East and Southern African countries. They continue to benefit from strong support from FMO.

> In 2022, Proparco, which exited the first vehicle (Maris Africa Fund) in 2014, decided to partner again with the investment manager and invested $12m (through FISEA+) in Maris Limited to support the financing of five additional SMEs.

Despite these very positive signals, it remains a major challenge to raise PCVs, and many fund managers currently raising 10-year structures began by attempting to raise a PCV and switched to closed-ended funds after receiving LP feedback.

The hybrid fund structure: a very promising option offering 'the best of both worlds'.

Hybrid funds are open-ended vehicles that **blend permanent capital investors together with closed-ended investors** into the same fund structure[7]. They are designed as open-ended vehicles but comprise two different classes of shares: one for patient equity and one for institutions willing to exit in the traditional '10 + 1 + 1-year' window that can do so without jeopardizing the capacity for the vehicle to continue operating and recycling the permanent capital. This fund structure rewards patience, as mechanisms can be created so that the longer an investor remains, the more value they accumulate.

Hybrid funds are advantageous for SME fund managers, as they can both (i) **address a large universe of investors**, both permanent investors and LPs on a fixed timeline, and (ii) maintain the advantages of a PCV that recycles capital and **safeguards the fund's sustainability**. Hybrid funds also allow for more flexibility over how to structure management and performance fees.

It is important to acknowledge that such structures are legally more complex, often extending negotiation and fund structuring timelines. Moreover, ecosystems still lack significant long-term experience to fully assess their advantages. The IPDEV fundraising experience demonstrates that a hybrid financing vehicle can be structured without the need for multiple share classes. In any case, the exit of LPs weakens the investment and holding capacity of the vehicle, unless a new fundraising effort is undertaken simultaneously.

Inua Capital is a Uganda-domiciled $8m permanent capital vehicle launched by emerging fund manager Kim Kamarebe and sponsored by IPDEV. It is structured as a hybrid fund: whilst 75% of its capital is permanent equity provided by IPDEV and the Mastercard Foundation Africa Growth Fund, the remaining 25% is an equity layer structured with preferential liquidity over 10 to 12 years. This enabled Inua Capital to attract Agri-Fi EDFI, a DFI focused on agri-SME investing, into a permanent capital fund structure. The fund structure is designed to reward patient capital and creates a virtuous circle where investors are incentivised to continue recycling their capital instead of redeeming it.

RECOMMENDATION 2#2

Fund structures can better match SME investment horizon constraints with LP liquidity objectives.

1) Raising open-ended hybrid funds or permanent capital vehicles can be the right option for raising a new SME fund.

GP

Data shows how **the strengths of PCVs can mitigate some of the challenges of SME investing** and lead to improved returns. Whilst institutional investors (including DFIs) typically shy away from such structures, there are now several exceptions to this rule. PCVs have attracted other pools of capital as well (*domestic private and sovereign capital, HNWIs, foundations, funds-of-funds*) and showed that they enable GPs to raise smaller fund sizes without reliance on international institutional investors.

In the interest of expanding the investor universe, hybrid funds are a promising structure that uses a blended finance model to combine permanent capital with closed-ended investors within the same vehicle.

There is a greater need to disseminate lessons from **alternative fund structures** in order for ecosystem players to better understand their advantages and limits.

2) Adapting the liquidity requirements to the longer cycle of SME investing can improve fund returns whilst mitigating liquidity risk.

LP

The priority given to liquidity by most LPs currently hampers investment into the early-stage SME segment. This segment is key to supporting the long-term growth of the sector and requires considerable capacity-building and patient capital. LPs can adapt their liquidity requirements to the investment strategies of the SME funds they seek to support:

> Longer-term closed-ended funds are often more in line with the requirements of investing equity into early-stage SMEs than are the typical 10 + 2 structure.

> Permanent capital and open-ended vehicles have benefits that are particularly salient for SME investing and have already proven they can provide **alternative paths to liquidity** which, although less programmed, can be more flexible than the redemptions of a closed-ended structure.

> Catalytic funders can solve the **liquidity mismatch between SME needs and LP constraints** by taking junior positions in longer-term closed-ended funds or permanent capital positions in hybrid open-ended funds. LPs can leverage this opportunity by being open to joining such blended structures.

3) Developing a secondary liquidity market for fund investments is an important next step for the ecosystem.

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It is critical to develop the secondary liquidity market for fund investments in order to **improve liquidity in the SME-fund, private-equity** and venture-capital ecosystems on the continent. Such markets exist in other regions, whereby LPs in closed-ended funds and investors in PCVs can sell their equity share to new investors, achieving liquidity before redemptions occur, and whereby GPs can seek support from continuation funds to extend the holding period of key portfolio companies.

New ecosystem initiatives focused on secondary transactions would unlock capital by removing one of the main obstacles LPs have faced to date: the requirement to block funds for 10+ years.

3.

The return profile of SME funds shows improvement

We must acknowledge an inconvenient truth in our sector: although this report's sample of SME fund performance shows promise for funds with more recent vintages, the **average historical financial return of SME funds in Africa has been poor**, and very few SME fund managers currently achieve their hurdle rate.

Of course, fund manager underperformance or misalignment can explain some of the more spectacular failures in the sector. However, it would be disingenuous to blame this average lacklustre performance solely on fund managers who would need 'more mentoring'. A closer analysis shows that African SME investors face **substantial structural challenges in achieving market-rate returns** that their peers in other markets or asset classes do not face and that in many cases, those that reach better returns are precisely the ones who adjust the rules of the game.

In order to highlight solutions, one first needs to recognise the specific challenges of this asset class.

The challenges of SME investing can seem daunting; they are the reason why investing in SMEs is additional and drives impact.

SME investors are not dealt the same hand of cards as their peers that make larger investments (mid- or large-cap or private equity) or that are active in more mature markets. Instead, they face challenges at **every level of the investment value chain**, irrespective of the financial performance of the SMEs they invest in. The I&P report '*Using catalytic capital to foster the emergence of Africa entrepreneurs in underserved markets*'[8] provides an analysis of the economics behind small SME funds, which is summarised here.

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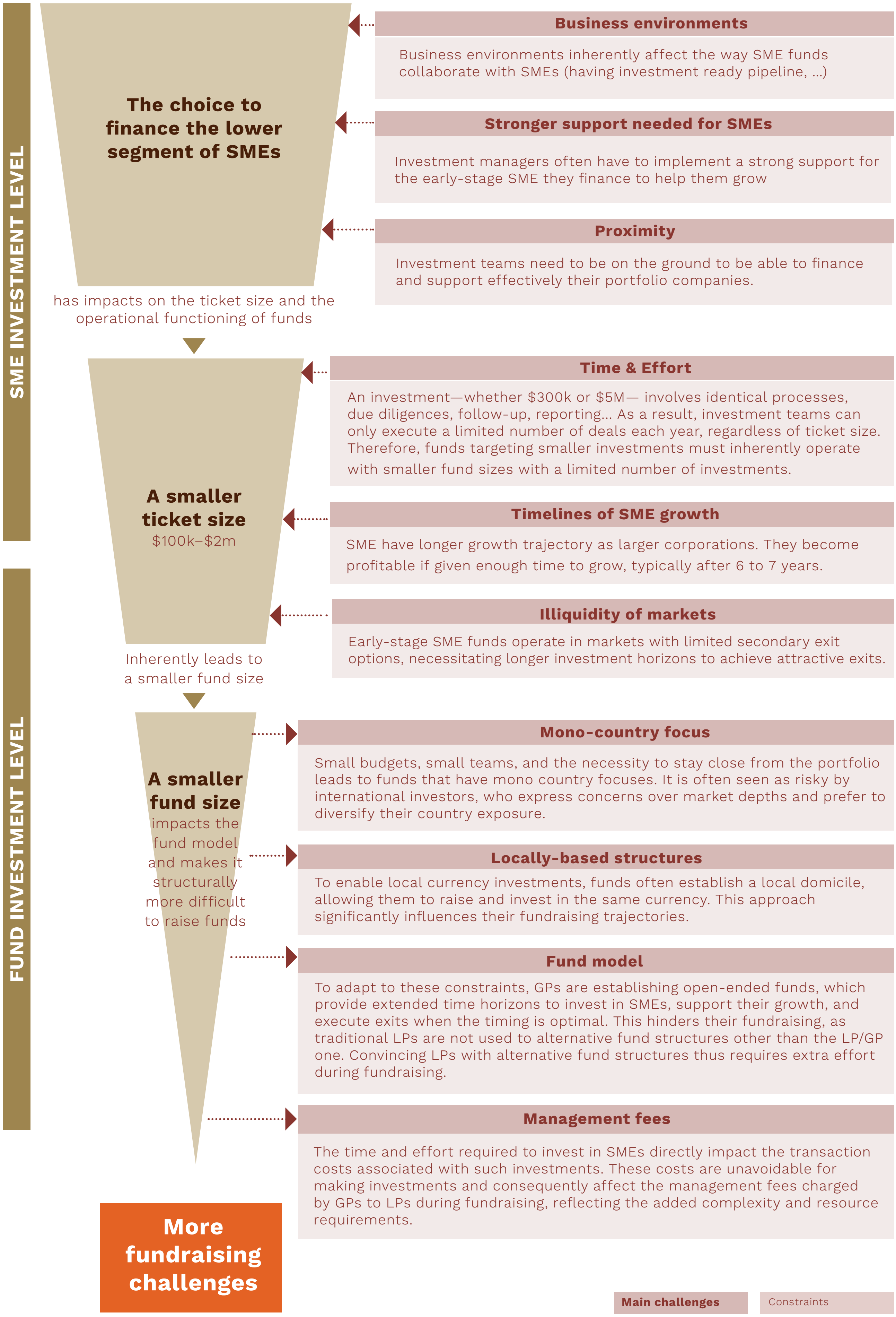
[8] Investisseurs & Partenaires. Catalytic Capital Consortium. (2023) Using catalytic capital to foster the emergence of African entrepreneurs in underserved markets.

[9] Investisseurs & Partenaires. Catalytic Capital Consortium. (2023) Using catalytic capital to foster the emergence of African entrepreneurs in underserved markets.



SME INVESTMENT LEVEL

The choice to finance the lower segment of SMEs

has impacts on the ticket size and the operational functioning of funds

Business environments

Business environments inherently affect the way SME funds collaborate with SMEs (having investment ready pipeline, ...)

Stronger support needed for SMEs

Investment managers often have to implement a strong support for the early-stage SME they finance to help them grow

Proximity

Investment teams need to be on the ground to be able to finance and support effectively their portfolio companies.

A smaller ticket size
$100k–$2m

Inherently leads to a smaller fund size

Time & Effort

An investment—whether $300k or $5M— involves identical processes, due diligences, follow-up, reporting... As a result, investment teams can only execute a limited number of deals each year, regardless of ticket size. Therefore, funds targeting smaller investments must inherently operate with smaller fund sizes with a limited number of investments.

Timelines of SME growth

SME have longer growth trajectory as larger corporations. They become profitable if given enough time to grow, typically after 6 to 7 years.

Illiquidity of markets

Early-stage SME funds operate in markets with limited secondary exit options, necessitating longer investment horizons to achieve attractive exits.

FUND INVESTMENT LEVEL

A smaller fund size
impacts the fund model and makes it structurally more difficult to raise funds

Mono-country focus

Small budgets, small teams, and the necessity to stay close from the portfolio leads to funds that have mono country focuses. It is often seen as risky by international investors, who express concerns over market depths and prefer to diversify their country exposure.

Locally-based structures

To enable local currency investments, funds often establish a local domicile, allowing them to raise and invest in the same currency. This approach significantly influences their fundraising trajectories.

Fund model

To adapt to these constraints, GPs are establishing open-ended funds, which provide extended time horizons to invest in SMEs, support their growth, and execute exits when the timing is optimal. This hinders their fundraising, as traditional LPs are not used to alternative fund structures other than the LP/GP one. Convincing LPs with alternative fund structures thus requires extra effort during fundraising.

Management fees

The time and effort required to invest in SMEs directly impact the transaction costs associated with such investments. These costs are unavoidable for making investments and consequently affect the management fees charged by GPs to LPs during fundraising, reflecting the added complexity and resource requirements.

More fundraising challenges

Main challenges Constraints

First, the gross performance of SME investments suffers from structural challenges. For an asset's given growth and profitability performance, the investment into a SME asset will yield lower returns than will an investment in a larger private equity asset since:

> SME investments cannot mobilise two of the five traditional drivers of return in private equity, which are financial leverage and inorganic growth, as SMEs typically borrow at a higher cost and with more difficulty and cannot acquire other companies. They can only build value by organic growth, improved profitability, and multiple expansion.

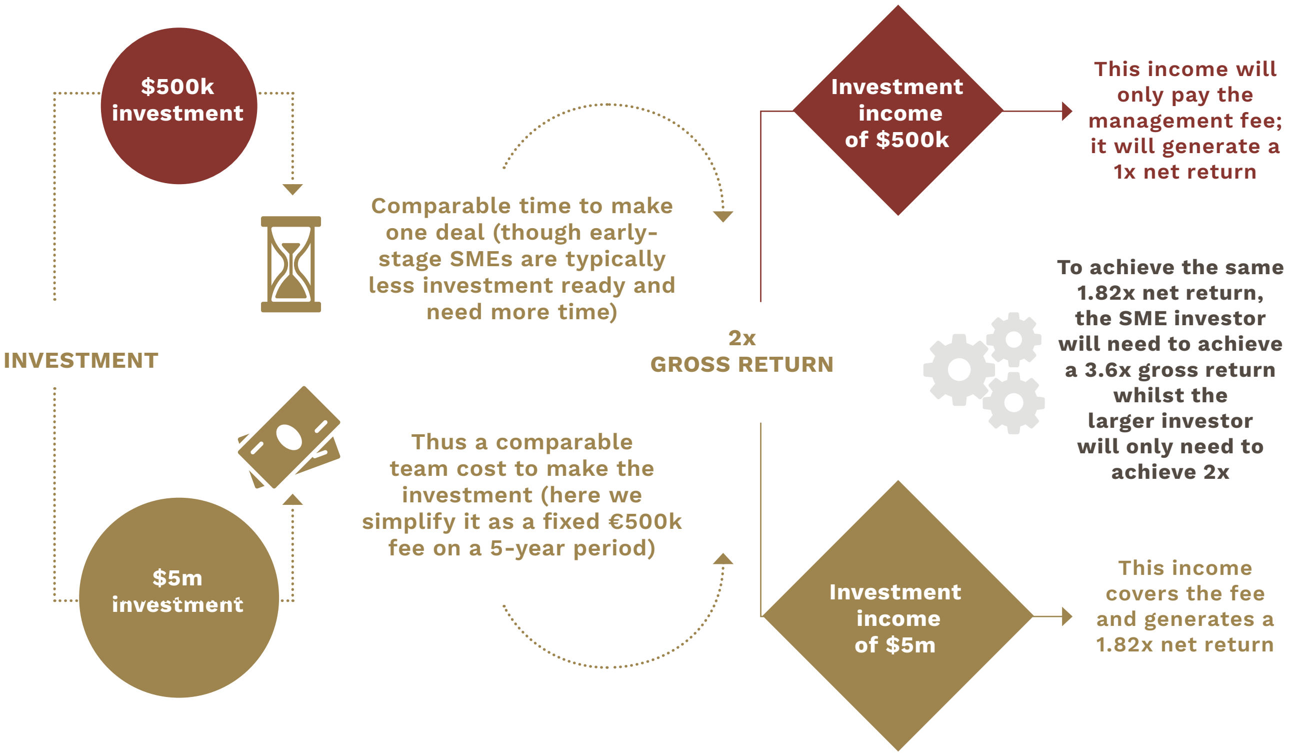
> SME investments are typically minority stakes which create less value at exit.

> SME investments are more exposed to exchange rate risk and tax frictions, since financial engineering is costly and less available to SME investors.

> Their lower liquidity leads to longer holding periods and lower materialisation of value at exit due to more limited exit options and a higher prevalence of exits on sponsors.

This is compounded by the challenging fund economics of SME funds, whose small size undermine their net returns.

> On the one hand, the iron law of ticket size and transaction costs puts a much higher bar for a SME fund to achieve net returns. To understand this, we must forget internal rates of return and focus on **absolute numbers as in this simplified exercise**:



Comparable time to make one deal (though early-stage SMEs are typically less investment ready and need more time)

Thus a comparable team cost to make the investment (here we simplify it as a fixed €500k fee on a 5-year period)

This income will only pay the management fee; it will generate a 1x net return

To achieve the same 1.82x net return, the SME investor will need to achieve a 3.6x gross return whilst the larger investor will only need to achieve 2x

This income covers the fee and generates a 1.82x net return

> A SME fund therefore has **higher relative transaction costs compared to a fund investing larger ticket sizes;** this translates to a higher management fee percentage for SME funds, which often earn fees between **2.25%-3.25% over 10 years** as opposed to the 2% global standard. This generates a higher fee load relative to the fund size, which pulls the rug out under the feet of the fund by reducing the amount of capital available to be invested and generate returns. Therefore, a SME fund will consume 25%-30% of fees over 10 years and will only have 70%-75% of its fund to generate the income to cover these fees and earn returns, whilst a larger fund will be able to invest 80% of its fund size, giving more firepower to cover the fees and earn returns.

The report's sample of 55+ SME funds (early-stage funds, growth SME funds, debt funds) demonstrates that **management fees for SME funds are higher than global standards:**[10]

3.9% in average management fees for early-stage equity funds

2.4% in average management fees for growth SME funds

2.4% in average management fees for debt funds

This data directly contradicts the notion that the global standard of 2% is the right benchmark for new SME funds coming to the market. Challenging the global standard for 2% management fees is a necessary step to raise an Africa-focused SME fund. The 2% threshold should not be seen as a gold standard, but rather as the result of a compromise that reflects power dynamics in the sector between GPs and LPs. In Silicon Valley, the most coveted fund managers such as Sequoia Capital and Accel famously charge higher fees, well above 2%, on their very large funds under management, whilst emerging VCs cannot hope to attract more than 2%.

Instead of replicating this global standard, fund managers and LPs need to find the best fit for a given fund size and investment strategy.

All things being equal, this set of constraints can generate lower returns for LPs and creates an even more dire challenge for GPs. A $30m SME fund and a $200m private equity fund will both make 15 investments and require a total team of 10-15 people[11]. However, a 3% yearly management fee on a $30m fund will generate only $900k in yearly fees to pay for that team and all the costs of the fund manager, whilst a 2% fee on a $200m fund will generate $4m in yearly fees, more than 4x the income for a similar team size. In this context, where the ratio of AUM over team size is key, SME fund managers struggle to offer competitive compensation and maintain team stability, particularly when competing with larger funds in more mature markets.

SME fund managers are under very strong pressure to raise larger fund sizes and when they increase their investment ticket size often end up neglecting the SME segment they started out to support. This trend has been replicated time and again: most of the pioneering SME investment firms that started out making $100k-$2m investments in the 2000s and early 2010s either stopped raising new SME funds as a team (*Fanisi Capital, Cauris Management, Grassroots Business Fund, etc.*) or **increased their ticket size above $5m or $10m to continue growing their AUM** and improve returns for their LPs and the sustainability of their team *(Adenia Partners, AfricInvest, Aureos, Ascent, etc.*). The pioneering teams that have remained focused on SME ticket sizes *(Acumen Fund, Injaro Investments, I&P, XSML, Oasis Capital, Pearl Capital Partners, etc.*) are few, and over time even they tend to neglect the segment of early-stage SMEs with investment needs between $100k-$2m to focus on growth-stage companies with investment needs between $2-$5m.

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[10] Importantly, the average management fee number for early-stage equity funds is increased by the large number of PCVs that charge higher fees compared to fund size, due to higher recycling of their capital base.

[11] International Finance Corporation (IFC). (2018) IFC SME Ventures. Investing in Private Equity in Sub Saharan African Fragile and Conflict-Affected Situations. Figure 24.

It is often therefore a choice motivated by the impact created by backing SMEs on job creation and livelihoods and by a mandate of additionality that leads teams to continue investing in the SME segment over the long term.

The challenges faced by SME funds creates a trap where **SME funds are inherently disadvantaged compared to larger private equity funds.** With lower historical returns, most LPs see more risk in SME funds and show limited willingness to consider alternative structures, even those that could improve return potential. Instead, they tend to favour conservative, familiar fund structures, effectively reinforcing the constraints on return generation. A common perception among LPs is that 'those who ask for a low hurdle and high fees are often the worst fund managers'. This myth needs to be debunked.

Fund managers find solutions to address inherent structural imbalances and improve returns.

SME investors have been mobilising several levers, not only to **increase returns for LPs** but also to improve their **own economics and sustainability as fund managers.**

First, they prove that they can reach higher gross returns (MOIC) to balance out the transaction costs and risks inherent to SME investment. Out of our sample of 55+ SME funds, we analysed the financial data of 22 funds, including eight growth SME funds and seven early-stage SME funds[12]. We find that the MOIC for early-stage SME funds averages 1.88x, higher than the 1.66x average for growth SME funds, despite a younger average age of the early-stage SME fund portfolios.

	Growth SME funds	**Early SME funds**
	8 funds in the sample Average age of 7.2 years	7 funds in the sample Average age of 5.8 years
MOIC	**1.54x**	**1.88x**
TVPI	**1.23x**	**1.25x**

Higher fee load of early SME funds

Due to the **higher fee load of early-stage SME funds**, they reach a similar net return (TVPI) as growth SME funds. This data must be refined with a broader sample but suggests that the higher gross returns achieved by early-stage SME funds compensate for the higher fee load, leading to a similar net return as growth SME funds. This is driven by:

> Proprietary pipeline with low competition and favourable terms at entry, as early-stage SME funds are often the only players in their market.

> Much faster **organic growth** of SMEs than of other asset classes.

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[12] And seven debt funds.

> Well-managed risks due to high selectivity and favourable investment terms.

> Potential for high portfolio income for loan and mezzanine investments, due to the risk-adverse nature of commercial banks that neglect important segments of the markets and openness for entrepreneurs to accept profit-shares with risk capital lenders.

> Potential for strong multiple expansion for equity investors due to the additional work done in formalising and strengthening the SMEs over the holding period.

Second, they improve their fund structure to lower the relative fee load.

> **Higher recycling** by incorporating self-liquidating instruments and medium-term finance alongside long-term risk capital helps increase the proportion of the fund's capital that is deployed into SMEs and earning income, and therefore balance out the higher fee level.

> **Leveraging alternative resources for investment-readiness and portfolio support:** SME fund managers are finding creative ways to make pipeline SMEs investment-ready and to provide high-impact portfolio support without relying solely on fees. This increases efficiency and enables them to provide game-changing support to unlock SME growth, whilst keeping the fee level manageable.

- Most fund managers mobilise **traditional 'technical assistance' budgets** with donors that allow them to cover the cost of third-party experts to build capacity and unlock growth and impact for the SMEs in portfolio.

- Some implement **innovative HR models to build lean teams**. For instance, Secha Capital in South Africa has pioneered an operator-investor model which places management professionals in portfolio SMEs to provide them with high-powered support[13], funded not by management fees but by the investments made by the fund and therefore as a shared cost with the SMEs. Others implement shared services such as 'CFO as a service', whose costs are mostly covered by portfolio SMEs. Most SME funds rely on building teams made of young and promising talented members who are keen to learn and who are given responsibilities and coached closely by the GPs, as shown in the talent section (see Part 2, #6 'Building and retaining talent against all odds', p.131).

- Other SME funds **outsource a significant amount of investment-readiness and capacity-building work** to dedicated teams that are funded partly by the SMEs and partly by donors and philanthropy. For instance, iungo capital provides its pipeline and portfolio companies with a technical assistance package *(finance, accounting, strategy, HR, ESG, GDEI, Impact*) carried by a dedicated team co-funded by grants through a separate subsidised non-profit technical assistance provider, iungo xl[14]. For this packaged support, companies pay fees-for-service. Other funds build programmes with donors to provide seed funding and management support to companies in their pipeline (e.g. Comoé Capital with the EU-funded IPAS programme).

- Finally, SME funds typically leverage **very high-value experts for their portfolio SMEs**: funds with a very strong impact mandate can achieve find pro bono resources, such as WIC Capital in Senegal, which mobilised a network of close to 100 experienced female management professionals to mentor and support entrepreneurs in its portfolio. Others can replicate the venture partner arrangements implemented in VC, where such experts are remunerated with carried interest, a cut in the general partnership, or other forms of incentives.

Third, they improve the sustainability of their fund management company.

> **Flexible fee models:** During the investment phase SME funds often require higher fees to cover the operational demands of sourcing and managing smaller, more demanding investments. Most SME and impact funds charge LPs between 2.25% and 3.25% in average yearly fees, which helps fund managers sustain their team and operations. Some adopt a tiered-fee structure

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[13] African Tech Roundup. Masuku, A. (2024) 'OP-ED: Secha Capital's Operator-Investor Model—An African VC alternative breaking the tech-first mould'.
[14] Moellenbrock, B. (2020) Angel Network Spotlight. Angel Networks in Emerging Markets: A Guide for Development Institutions. Iungo Capital.

with higher fees during the investment period and a significant reduction afterwards, reducing the long-term cost for LPs whilst ensuring sufficient resources upfront. This is particularly achievable when the fund's model can credibly show how follow-on investors will take on part of the burden of supporting companies after a few years. When charging higher fees than benchmarks, some funds, particularly PCVs, take a **budget approach**, where annual budgets are reviewed and approved by investor representatives, offering LPs transparency and oversight over management expenses to improve acceptability.

> Hurdle rates lower or at 0%: In a context where few SME funds have historically reached their 8% hurdle rate, maintaining such a threshold for the GPs to earn any return creates a misalignment, where GPs become disincentivised in the case of medium performance. Lowering hurdle rates in this asset class is therefore **a rational compromise** that ensures that GPs are incentivised in all scenarios. Out of the report's sample of 55+ SME funds, hurdle rate is available for 19:

7.1% is the average hurdle rate from the sample of funds we analysed

More radically, **several SME funds do not have any hurdle rates** but allow GPs to participate in returns as soon as investors recoup their investment. In the case of very small fund sizes (<$20m), such an approach can compensate the low absolute fee levels and promote an entrepreneurial approach by GPs (e.g. Teranga Capital, Miarakap). This is typically advocated for small funds in the venture capital world as well (VC Lab). Some fund managers also advocate 'American' waterfalls to quicken the path to carried interest, but with limited success with LPs.

> Horizontal growth to avoid mission drift: Many SME fund managers seek to avoid a mission drift whereby they would grow 'vertically', increasing their fund size generation after generation, up to a point where they would no longer be able to invest in SMEs. Instead, they diversify their activities by designing and raising additional vehicles and programmes that complement their offer. They therefore end up managing several vehicles at once, building economies of scale and synergies and reducing the risk of any given vehicle under-performing or facing delays. Examples include Sahel Capital (Pan-African team), which is managing both an equity fund (FAFIN) and a debt fund (SEFAA) with complementary mandates; Teranga Capital in Senegal, which has set up seed funding and ecosystem programmes (such as $30m Suqali, funded by the Mastercard Foundation) to address gaps that their commercial equity fund is not tackling, and many others. A horizontal growth approach diversifies the universe of funders for SME investors, adding donors and foundations to the typical LPs in a fund. It also helps team retention by multiplying the opportunities for team members to grow and take on additional responsibilities. Of course, this growth model brings a high degree of complexity.

Breaking the mould to create a promising path for sub-$10m funds should be the way forward. The IPDEV network of funds provides examples of smaller-sized SME funds achieving promising returns. They combine all the factors perceived as challenges by traditional LPs: permanent capital, first-time managers often working as solo GPs, non-traditional track record, early-stage equity investing equity in small ticket sizes, frontier markets, and above all, a fund size below $10m.

To overcome these challenges, they have innovated on **fund structure** (permanent capital vehicles, higher fees, no hurdle), leveraged a network of peers and the support of a sponsor, and diversified their activities to increase their footprint and reach economies of scale.

After six years on average, they have achieved their first exits with very successful MOICs and are reaching **average TVPIs of 1.62x**, underscoring that, with the right structure, even the smallest funds can deliver meaningful returns in African SME markets. Two of them have raised additional capital at a significant premium to their share price. IPDEV's 10-year fund evaluation, conducted independently by Palladium, shares more detail.

RECOMMENDATION 2#3

Recent data provides novel insights into SME fund performance.

1) Available data shows how certain perceptions held by LPs (re: track record, emerging fund manager risk, etc.) are not in line with the reality of returns achieved.

LP

> New data shows how SME funds have improved gross and net performance over the past 10 years; key LPs in the ecosystem can collaborate to further share data and improve understanding of the sector.

The lack of context-specific data and lessons on SME fund returns on the continent heightens the risk perception of LPs and leads to both misunderstanding of GPs' realities and immobilism. A data-sharing initiative among the main LPs in the ecosystem with large SME fund portfolios (DFIs, funds-of-funds) can support this agenda whilst maintaining the confidentiality of individual fund-level data. This can improve the understanding of the drivers of returns of SME investors and attract new LPs to the space by removing uncertainty and barriers to entry.

> **Adapting elements of fund structuring away from the traditional benchmarks** can promote better returns for LPs that invest in SME funds.

SME funds that adapt key terms (fee level, fee structure, hurdle rate) to the realities of SME investing can lead to better incentivisation of the GPs that align them with LP interests and unlock new segments. In particular, this allows fund models to work for SMEs that would otherwise remain neglected and therefore unearths promising investment opportunities whilst expanding the scope of SME finance on the continent.

2) SME investing is an impact choice and a space where trade-offs between impact and returns are real; GPs must demonstrate how their approach and background enables them to overcome important structural challenges to provide returns; they can pursue alternative ways to grow as fund managers in order to avoid "creeping up" and neglecting SMEs.

GP

> **SME investors generate impact with high additionality**; this leads to trade-offs on return and liquidity that must be acknowledged, but it also provides opportunities for returns.

In a space where they are often pioneers, GPs must demonstrate how **their approach and background enable them to overcome important structural challenges to providing returns**. Many SME investors are already showing the way, and the positive trend on SME fund returns can provide benchmarks to SME funds currently fundraising. **Retaining a long-term focus on SME investing is an impact choice for a fund manager**; it requires elaborating a robust impact thesis and impact management framework in order to build a convincing case to LPs.

> **Horizontal growth via new vehicles and building grant-funded projects** is an alternative path for SME investors to growth in ticket sizes.

In order to retain a focus on SMEs over the long term and avoid the 'creeping up' dynamic towards ever larger fund sizes and ticket sizes, fund managers can leverage their SME investment expertise to start new offers that are complementary to their initial fund. These are new vehicles with different investment strategies or projects funded by donors or philanthropy. They create synergies and economies of scale, which support otherwise challenging SME fund models.

3) Acknowledging the structural challenges of SME investing is a first step towards finding solutions to improve the returns of GPs and LPs.

> **Catalytic capital remains necessary to de-risk SME fund models** that address particularly impactful and additional segments of the market and that cannot provide market risk-adjusted returns.

Blended finance models are often the principal way in which LPs can invest into frontier markets, riskier sectors (such as agriculture), and nascent industries (such as climate adaptation funds). Recognising that some fund models face such trade-offs that they cannot meet market rate returns is important, and junior capital can help unlock capital for such funds.

> Beyond junior capital, there is an important space for **direct grant support to SME fund managers** in the form of incentives or intervention-based financing.

Incentives can support some of the additional structural costs of SME fund models that make it impossible to otherwise invest into certain segments of SMEs (*as Aceli Africa has demonstrated in the East African agri-SME space*); this can leverage significant capital for neglected segments with additionality. Similarly, donors and foundations can support interventions that maximise the impact of SME funds but cannot be funded due to very low management budgets (*positions dedicated to ESG and impact, investment-readiness, portfolio capacity-building)*. Pioneering funders such as the Argidius Foundation have shown that supporting mission-aligned fund managers can generate considerable additional impact.

The process of raising such grants is time-consuming, requires access to networks and experience in grant-writing, and excludes many deserving fund managers; a more level playing field can be created by supporting ecosystem organisations that build the capacity and networks of first-time fund managers (CFF, Advancing Women in Investing, etc.).

4.

Options for fund domiciliation are multiplying but many markets are yet to build enabling environments

The fund domiciliation is a key decision factor for LPs.

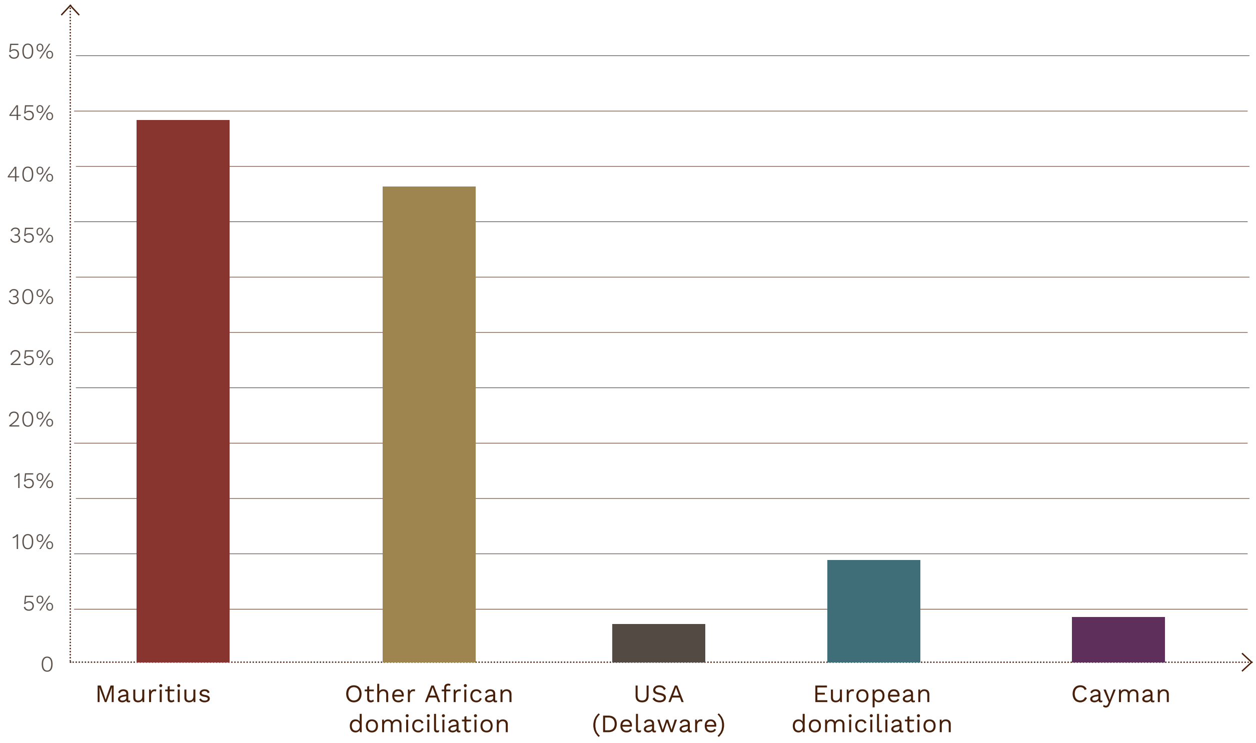
In 2019, Mauritius found itself under international scrutiny due to deficiencies in their AML/CFT frameworks. Evaluations resulted in the country being placed on the Financial Action Task Force (FATF)'s 'grey list' (list of jurisdictions under increased monitoring) in February 2020 and subsequently added to the European Union's blacklist in[15]. This event sent shock waves throughout the African private equity sector, which had dubbed Mauritius as the 'Mecca' for the industry. After a series of measures and corrective actions, the country was removed from the list of high-risk countries in January 2022. In the meantime, fund managers that had begun raising in 2019 and had spent considerable legal costs to domicile in Mauritius were considerably impacted, as they had to switch to other jurisdictions such as France or Luxembourg when Mauritius joined this list.

This sequence underscores the importance of fund managers making the right choice of domiciliation as they seek to attract international investors and private capital. The choice of a jurisdiction is often a function of the availability of (i) an **enabling ecosystem of service providers in the investment industry**, (ii) a **flexible legal environment enabling the set-up of various structures,** and (iii) a **favourable regulatory framework reducing risk for investors.**

> *'You can't compromise on the quality of the financial centre you are part of, because you need an infrastructure that meets the criteria of your LPs.'* *A GP*

Out of our sample of 55+ SME funds (early SME funds, growth SME funds, and debt funds), we found that most SME funds are domiciled in Mauritius, but also other African jurisdictions (e.g. Ghana, WAMEU, Uganda, Kenya, etc.) have been selected as domicile.

FUND DOMICILIATION OF OUR SAMPLE



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15. Calculettea, S. (2021) "Mauritius removed from the FATF grey list". Bowmans.

From the perspective of international institutional LPs, the choice of domiciliation for Africa-focused fund investments is driven first by risk management.

> Institutional investors are assessing all risks, including the breadth of financial regulation, political stability and legal framework stability, the ease of repatriation of funds, legal and tax efficient structuring options, and good corporate governance and AML/CFT frameworks.

> To mitigate reputational and AML/CFT risks, a key element is the status of the country of domiciliation on the FATF list. As some African countries are being removed and added to the list regularly (at the time of writing, the grey list includes key markets such as Nigeria, Kenya, South Africa, Côte d'Ivoire, Cameroon, DRC, and Tanzania), institutional investors might favour locations perceived by international LPs as more stable, such as Luxembourg, France, the Netherlands, and the US, even for African-led vehicles.

> A prevalent market practice for VC funds is to domicile in Delaware, US, in a context where many African tech ventures are also domiciled in this jurisdiction.

> For Africa-based GPs a heavily regulated domiciliation such as Luxembourg or France can increase complexity and costs to an unsustainable level.

> Some LPs have strict mandates when it comes to domiciliation, and it can become difficult to align all constraints.

Mauritius has historically been the most favoured location for African private equity domiciliation.

Ranked number one in Africa by the World Bank for Ease of Doing Business[16], Mauritius has established itself as the go-to jurisdiction for Africa private equity at scale, notably for funds with a regional or pan-African investment strategy, thanks to its supportive infrastructure:

> Strong regulatory framework with the Mauritius Financial Services Commission (FSC) catered to private equity/venture capital, combined with very good flexibility in terms of options to design investment vehicles and fund structures whilst maintaining tax efficiency.

> Good fund administration and service provider environment, with qualified professionals, offering strong middle-office, legal, and administration support.

> Political and economic stability and a bilingual work environment.

> Substantial network of double taxation agreements, both with African and European countries.

> Trusted financial centre for DFIs making investments into Africa, despite the grey list episode, which ultimately helped the country strengthen its AML/CFT framework.

For all the reasons above, most international institutional investors, notably DFIs, are more comfortable investing in Mauritius domiciliated funds. The average cost of incorporating a fund vehicle and management company in Mauritius (including starting legal costs) is $25k, to be provided up front by the fund manager (incorporation of Limited Partnership and acquisition of a Global Business License).

With a view to lower the barriers to entry further, including with respect to licensing, Mauritius launched the Variable Capital Company in 2022 as a new cost-effective fund structure to enhance its competitiveness as a domicile for investment funds, including small-sized funds.

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[16] World Bank Group. Ease of Doing Business rankings. (Available online: https://archive.doingbusiness.org/en/rankings).

The recent advent of new Africa-based financial centres can increase options for fund managers.

To contribute to the development of a strong private capital industry in Africa, **there is a case to be made for capital to be domiciled and regulated on the continent,** allowing African LPs to have options that fit their currency and regulatory constraints and contributing to building a resilient financial sector less affected by global trends. Countries like South Africa saw very early the need of an enabling legal and operating framework for private capital investments and created specific fund structures linked to investor incentives. Most funds operating in the country are incorporated there.

In this regard, the 2023 AVCA report *Funds and Fund Management Services* in Africa provides a good overview of the different initiatives to establish new African financial centres as a credible alternative to the offshoring of fund vehicles dedicated to Africa[17]. This report was prepared in partnership with the Kigali International Financial Centre (KIFC) in Rwanda, which in recent years has made strides to position Kigali as a modern international financial centre and financial services hub for East Africa and the entire continent.

SPOTLIGHT I KIGALI INTERNATIONAL FINANCIAL CENTRE (KIFC), RWANDA[18]

KIFC offers one of the most attractive tax regimes in Africa, specifically for fund management activities. The centre is the second onshore jurisdiction (after Casablanca), offering the lowest preferential corporate tax rate (3%) for fund managers, fund administrators, and fund vehicles. It also offers tax exemption on corporate tax rates for partners in a limited partnership (under conditions), capital gains, dividends, and interests and VAT for fund managers, fund administrators, and fund vehicles. Finally, the centre has a five-year tax holiday for family offices, a captive insurance scheme, private banks, and mortgage institutions.

Moreover, KIFC positions itself as a strong enabler for sustainable and green investing. This has been backed by the Rwandan government through the establishment of a fund under the Ministry of Environment to give grants for green projects that will make them scalable. In addition, KIFC has joined the Financial Centres for Sustainability (FC4S) and the Sustainable Stock Exchange, which respectively aim to accelerate the shift to sustainable finance and encourage sustainable investment.

Moreover, KIFC's initiatives to attract talent include a five-year work visa and an income tax exemption for contractual foreign professionals, under conditions. Professionals also can work for an international company whilst simultaneously working for a local firm.

When it comes to unique features of its legal and regulatory framework, KIFC has a licensing exemption for fund managers licensed under financial regulators in other jurisdictions. Finally, it should be noted that one of KIFC's priorities is to support fintech through regulation. As a result, the centre has put in place a regulatory sandbox, through the National Bank of Rwanda, which promotes fintech and innovation.

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[17] AVCA. Kigali International Financial Centre. (2023) Funds and Fund Management Services in Africa. Part 2.

[18] AVCA. Kigali International Financial Centre. (2023) Funds and Fund Management Services in Africa. Part 2.

First-time and emerging fund managers explore in-country domiciliation when running a country-specific fund, and this is where progress is needed.

First-time and emerging fund managers often raise **country-specific funds of a small fund size that raises mostly domestic capital**. They typically seek to domicile their fund in their country of operation, in order to easily attract domestic investors and keep costs low, as domiciling in Mauritius, let alone outside the continent, creates additional complexity and cost, which can be prohibitive for fund sizes below $10m.

Out of our sample of 55+ SME funds, 25 funds are early-stage SME funds; they raise small fund sizes typically with domestic investors. By analysing their domiciliation closely, we found that:

60% of early SME funds are domiciled in their country of operation

40% of early SME funds are domiciled internationally (mainly in Mauritius)

Our sample also shows that domiciling locally can be a winning option when fundraising for early-stage SME funds. Out of the same sample of 25 early-stage SME funds, 14 have achieved first close; the vast majority of which were domiciled in their country of operation:

93% of early-stage SME funds that achieved first close are domiciled in their country of operation

The other 11 are still in the process of trying to fundraise, and only 30% were domiciled locally. A key reason why in-country domiciliation can support fundraising is that early-stage SME funds tend to **raise more easily from domestic pools of capital,** as explained in Part 1, #4 'African private and sovereign capital is increasing its allocation to the sector, but there is still significant room to grow', p.60. **Funds are often more attractive for domestic capital when they themselves are domiciled locally.**

Supporting the growth of new fund managers and the development of domestic capital markets that can channel capital into SMEs therefore **requires promoting a conducive regulatory and tax environment** across the continent and addressing remaining bottlenecks such as:

> The lack of appropriate fund structures in many legal frameworks.

> The need for adequate regulations specific to private equity funds in terms of licensing, capital requirements, trainings, etc.

> The double taxation of fund returns (as corporate income tax and capital gains tax) and the VAT taxation of management fees.

Some countries have already created enabling environments for the growth of the domestic private equity industry (Ghana, Rwanda, as previously mentioned, Togo, and other markets in the WAEMU zone).

SPOTLIGHT I GHANA – A CASE IN POINT ON HOW MORE CAPITAL CAN BE MOBILISED VIA POLICY REFORM.

Efforts to build a resilient PE/VC environment started in 1992 in Ghana with the creation of the Ghana Venture Capital Fund and followed-up in 2004 with the Ghana Venture Capital Trust Act, designed to lay the foundational blocks for the emergence of a PE/VC industry in the country.

As of FY 2023, AUM of the local private equity funds stood at around $166m with local, cedi-denominated currency funds at around $97m. The *State of Venture Capital and Private Equity in Ghana 1991–2023* report provides some interesting insights[19]:

> The Venture Capital Trust Fund (VCTF) has consistently been the anchor of local funds, committing about $29m to 11 funds since its creation in 2004, for an estimated funding gap at $145m. A new fund-of-fund initiative, Ci-Gaba, is being launched today.

> Locally-domiciled pensions funds are following in the VCTF's footsteps and have recently resumed their interest in supplying capital of local funds. Between 2022 and 2023, local pension funds committed significant capital to locally-domiciled funds: Injaro Ghana Venture Capital Fund (IGVCF) is among the latest examples.

Whilst efforts are being made to unlock constraints for local private capital, the country still needs to establish a framework for the incorporation of adequate vehicles. Currently, funds must be registered as limited liability companies (LLCs) or external companies, which reduces flexibility and generates tax burdens. Efforts are underway to create a limited partnership structure in the country.

The regulation framework through the SEC also needs to be streamlined for more efficiency, as the process to licensing and registration for new fund managers is said to last between five months and up to one year. Cumbersome regulatory requirements have been a deterrent to fund managers domiciling in the country.

Other markets are now improving their enabling environment. The case of Uganda shows how a high-potential market in terms of SME investing has not yet tapped into domestic capital markets due to the lack of an enabling environment for SME funds. In a striking contrast with Ghana, in Uganda only two funds have domiciled in-country, with a total AUM of $30m, but out of which only $2m has been raised from domestic investors. However, recent progress is very promising and could lead to much more capital mobilisation.

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[19] Adongo, C. A., Antwi-Asimeng, S. N., Tong, S. N., and Bressey, M. K. (2024). The state of venture capital and private equity in Ghana, 1991–2023. Accra: Ghana Venture Capital and Private Equity Association (GVCA) and Impact Investing Ghana (IIGh).

SPOTLIGHT I UGANDA – THE BIRTH OF A SPECIAL STATUS FOR PE AND VC FUNDS IMPLEMENTING TAX EXEMPTIONS[20].

Ugandan private equity funds are to be registered as a company as per the Capital Markets Authority Act. Until 2024, these funds faced triple taxation on their investments, making them unattractive for investors. Due to Uganda's absence of legal and tax status for venture and early-stage funds, investors in Uganda-domiciled funds were subject to the 30% capital gains tax, 15% dividend tax, and the 30% corporate income tax. Specifically, this high capital gains tax was a strong disincentive for investors, including domestic investors such as the NSSF, to investing in Ugandan funds.

Lobbying from the industry has been leading to promising steps in 2024, with efforts to enhance the regulatory regime applicable to private equity and venture capital funds, led by the East African Venture Capital Association (EAVCA) with the support of the European Union, IFAD (International Fund for Agricultural Development), industry regulators such as Uganda's Capital Markets Authority (CMA), and of course the domestic investment industry. As a result, in 2024 Uganda introduced proposed amendments to the Income Tax Act, aimed at exempting income derived from PE/VC funds regulated in Uganda. This is a first step towards enabling more funds to domicile in Uganda and raise domestic capital.

SPOTLIGHT I THE WAEMU – IN A PROCESS TO CREATE REGULATIONS, WITH VARIABLE PROGRESS DEPENDING ON THE MARKETS.

The WAEMU zone comprises eight countries (Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo) which share a common currency, the CFA Franc (XOF), which is issued by the Central Bank, BCEAO.

For the most part, the region lags behind in the development of the PE/VC industry, accentuated by the absence of regulations encouraging the local domiciliation of private equity funds. Efforts were made in 2003 with the adoption of the 2003 WAEMU Uniform Law on Fixed-Capital Investment Companies, which was the first attempt at providing an adapted legal structure to PE funds. Since then, only a few countries have transposed the Uniform Law into their in-country legal framework, and even for the ones who have done so, efforts to provide the industry with the relevant tax status to encourage domestic investors to fund the asset class have been scarce, leading to double taxation on fund income and taxation of management fees. As a result, if we take the example of Senegal, where the law was transposed, only one SME fund, Teranga Capital, has been registered under this law.

With the support of the World Bank, in 2019 the WAEMU financial market authority AMF-UMOA (formerly CREPMF) worked on establishing a more appropriate legal framework to organise private equity activities in the region, including a proposal for new legal fund structures. The framework was issued in December 2021. Some 30 prospective funds have reportedly filed license applications with the AMF-UMOA[21]; however, the new funds are yet to emerge under this framework.

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20. European Union. IFAD. (2021). Policy Brief. Creating an enabling environment for PE funds in Uganda. Policy proposals for public policymakers
21. Atwood R. (2022) 'A New Lifeline for West Africa's Smaller Enterprises'. International Finance Corporation.

RECOMMENDATION 2#4

Enabling environments are necessary to promote the growth of domestic private equity and SME investment industries.

1) GPs can adapt the domiciliation of their fund to their fundraising strategy, with an increasing number of options at their disposal.

GP

> GPs have a growing number of options to match their fund domiciliation with LP criteria, with an increasing number of options at their disposal, including affordable options in Mauritius and other budding financial centres on the continent.

> First-time fund managers, particularly when they raise small-sized funds from domestic investors, can domicile in-country to optimise their fundraising outcome.

> Parallel funds and feeder funds, though they create additional complexity and remain a second-best option, can reliably solve diverging demands of LPs.

> When LP criteria on domiciliation lead to increased complexity and costs for fund managers, LPs can make sure to remain inclusive to emerging fund managers and SME funds by considering flexible arrangements (parallel or feeder funds) and providing financial or legal support.

2) Advocacy from SME investors and LPs is necessary to promote enabling tax and regulatory environments across African markets and to develop domestic private equity markets.

E

For the ecosystems:

> Policy advocacy from SME investors, LPs, and key ecosystem actors is necessary to **promote enabling tax and regulatory environments**.

Such enabling environments promote the growth of domestic private equity and venture capital markets and ultimately stimulate economic growth and increase tax revenues for public authorities. Close attention should be paid, among others, to alleviating:

- Double (and sometimes triple) taxation on fund income.
- VAT on management fees, which often cannot be recuperated.
- Management company registration costs (notably as some countries have a minimum capital requirement on the management company itself).

> Fund managers can lead this effort by organising into domestic industry organisations and lobbying as an industry group with regulators and income tax authorities. International institutions play an important role as enablers to help drive this change.

5.

Currency and political risk are not overlooked by GPs, whether setting up country-specific or pan-African funds

Recent depreciation events in key African PE markets materialised currency risk for international LPs.

Exchange rates fluctuations are significant risks for SME funds, sometimes compounded by their long investment horizons. International LPs have experienced considerable losses due to FX risk which has been among the main reasons for the historical underperformance of African private equity funds.

For instance, the steep depreciation of the Nigerian Naira against the dollar by 4x over the past four years *(USD: NGN from 361 in 2019 to 1,500 in June 2024)* has significantly eroded the value created by pan-African large private equity funds that have invested in Nigeria, affecting fund valuations and even likelihoods of exits. A similar scenario in Ghana *(USD: GHS – from 5.65 in 2019 to 15.25 in June 2024*) has affected funds with a Ghana exposure. **Depreciating currency makes it challenging for GPs to pass on the value created by SMEs to LPs** expecting USD returns. In addition, it can trigger stricter capital market controls and currency illiquidity, for example, in the heavily CBN-regulated FX markets in Nigeria, which impedes LPs' repatriation proceeds.

Beyond currency, fund managers face major exogenous risks that impact fund performance and, therefore, investor interest, particularly political country risk and macroeconomic risk. Based on the *2023 AVCA Annual Private Equity Survey*, 57% of LPs and 85% of GPs cite macroeconomic risks, including currency volatility and political uncertainty, as significant challenges to fundraising.

The combination of political instability and currency volatility has caused many DFIs and international investors to avoid **country-specific funds**. This aversion is based on a risk management approach emphasizing macro risk above all; it is also based on data from a limited sample of funds and neglects some of the advantages of country-specific funds.

Many country-specific funds have achieved above-average performance (in hard currency) despite significant instability thanks to strong local networks, proprietary pipelines driving better entry valuations, and a deeper capacity to add value to SME growth – leading to higher gross returns.

	Country-specific Early stage growth and debt SME funds **Average age of 7.1 years**	**Regional and panafrican funds** Early stage, growth and debt SME funds **Average age of 7.9 years**
MOIC	**1.61x**	**1.23x**
TVPI	**1.09x**	**0.95x**

Many have a strong enough positioning in their market to design investment strategies with strong (though not foolproof) hedges against exogenous risks, including in frontier markets. An example is Sinergi Burkina, an early-stage SME PCV launched in 2015 in Burkina Faso. Despite significant political upheaval in the country, the PCV has achieved positive fund returns to date, including by **exiting its second SME investment in 2022 at an 8x equity multiple** via a $12m fundraise with DFIs and international impact investors.

Fund managers adapt to manage currency and country risks.

Fund managers navigate these challenges by:

> **Adapting their geographical scope to align with their fundraising strategy:** To attract DFI and international investor interest, many fund managers are keen to expand their focus beyond a single country or region, often stretching resources thin in an attempt to achieve pan-African reach. Whilst this broader scope can help diversify risks, it also reduces the fund's ability to provide high-value support to SMEs and drive returns. Fund managers who opt to diversify geographically demonstrate that they can build a footprint in several markets whilst keeping costs manageable, or that their investment strategy allows them to forego on the ground presence in some markets thanks to ad hoc arrangements such as co-investments and local partnerships.

> **Raising country-specific funds with domestic investors:** Fund managers with a single-country focus target domestic investors and have limited access to DFI and international capital: examples such as Injaro Ghana Venture Capital Fund (IGVCF) and Mirepa Capital SME Fund in Ghana, Teranga Capital and Comoé Capital in the WAEMU zone, and Miarakap in Madagascar, demonstrate that raising country-specific funds is feasible; these funds bypass most international investors but still manage to secure the capital they need, mostly from domestic sources. Domestic investors typically do not share the same country or currency risk aversion as international investors and have been seen to back SME funds despite macroeconomic challenges *(e.g. Injaro and Mirepa achieving close in 2023 despite the economic situation in Ghana*) and political uncertainties (*e.g. the fundraise of Sinergi Burkina in Burkina Faso or Zira Capital in Mali)* – see Part 1, #4 'African private and sovereign capital is increasing its allocation to the sector, but there is still significant room to grow', p.60. Country-specific funds may raise capital exclusively in local currency from domestic investors or in USD/EUR from a blend of domestic and foreign investors.

> **Beyond the fundraising strategy, SME funds that raise USD/EUR funds demonstrate that they can incorporate currency and country risk management into their investment strategy.**

> They invest in SMEs with natural hedges against depreciation, such as exporters with revenues in hard currency, dollarized sectors, or to a lesser extent companies active in import substitution and essential goods and services with limited price elasticity. Whilst this approach mitigates currency risk, it narrows the investable universe and leads to questions around pipeline depth.

> They avoid companies dependent on public procurement and invest in those that can grow regionally and diversify their income in other currencies.

> They seek hedging options where possible.

Hedging remains costly and very limited in most African currencies and is often unsuited to risk capital investments with uncertain payouts. Funds typically hedge only when absolutely essential, given the high costs, limited access, and mostly debt investments. Innovative facilities exist to make this possible, such as the technical assistance facility provided by LP KfW to SEFAA (Sahel Capital), which can be used to hedge currencies on some specific transactions.

> They design dual-currency fund structures, with both USD and local currency tranches for LPs, to balance their exposure to currency risk whilst expanding local currency investments. This structure can also be achieved through parallel USD/local currency funds.

> *‘African markets have experienced a lot of macroeconomic shocks, currency depreciations that have put pressure on fund managers to prioritise export-oriented sectors or sectors where the pricing is pegged to hard currency. It demands an alternative approach, either more local funds being raised or innovative financial products to give more flexibility to fund managers.’*
>
> *A Donor*

RECOMMENDATION 2#5

Fund managers manage currency and country risks; ecosystem initiatives can help mitigate exogenous shocks.

1) Expand access to and subsidising currency hedging for fund managers will increase local currency financing.

E

SME fund managers have limited influence over exogenous factors such as currency and political risk which hamper their capacity to fundraise. Donor and philanthropic funding can help lower some of these structural barriers they face.

Currently, SME investors cannot access affordable hedging options. New initiatives to provide such hedging would expand the pool of investable SMEs across the continent, promote investment into local value chains and key sectors geared to the local demand, and significantly improve fundraising outcomes for fund managers. This could be done via:

\> Donors subsidising hedging costs on transactions.

\> Catalytic funders investing junior equity tranches that absorb currency losses beyond a certain threshold.

\> Ecosystem players designing a scalable pan-African hedging facility that diversifies currency risk across multiple currencies and is adapted to risk capital funds.

2) Provide risk-sharing mechanisms for country and political risk will enable international investors to commit to emerging funds.

E

These mechanisms would support the growth of the SME investing sector by enabling emerging fund managers, who disproportionately launch country-specific funds, to access more international capital. International LPs would benefit from the deep local rooting of such investors, whilst managing country risk. Since emerging fund managers tend to disproportionately invest in early-stage SMEs, this would be a key intervention to support a more inclusive SME finance sector.

6.

Building and retaining talent against all odds

First-time and emerging fund managers face un unfair environment when it comes to building and retaining teams.

Attracting talent whilst building a fund is the first challenge. Raising a first fund demands a significant amount of effort over a long time for a highly uncertain outcome. Fund managers hire staff very progressively to keep expenses down, which delays building a cohesive senior team. It also blocks them from building the track record they need to convince LPs that they have experience doing deals as a team and that 'partnership risk' is mitigated. Both senior and junior professionals take high risks when joining fund managers who have not yet achieved a final close and who can only give limited visibility (and often a lower pay than what larger fund managers can afford). In this context, attracting talent, especially senior investment talent, is very tough.

> *'It took me a year to find my Investment Principal, after some trial and error, despite my offer to provide a quick path to partnership. This is a competitive market, and he is paid more than I am!'*
>
> *An emerging GP*

After the final close is reached, retention becomes increasingly harder over the years.

> SME funds are caught between a hammer and an anvil: on the one hand SME investing requires time-intensive work (from preparing SMEs for investment to ongoing value creation in the portfolio), which puts pressure on bandwidth and creates stretched investment teams. On the other hand, the SME fund's small size generates low fees which cannot cover compensation for senior or junior hires that is competitive with that of larger funds.

> Solo GPs need to secure a **strong 'number two'** position early on, not just to meet LP requests but to distribute the workload and increase bandwidth as the fund cycle matures. They must also **build a track record together** to prepare future fundraises. Senior investment professionals with the right experience are scarce, coveted by larger funds with higher packages, and challenging to retain.

> **Junior team members** are more available; however, once they are trained and build their track record, many look for less strenuous and/or more lucrative opportunities in larger funds with strong brands. Inflation and macro/currency issues can make it worse in some countries that suffer from brain drain.

This creates a situation where **turnover is hard to mitigate**, and GPs must often 'start over' by re-training new team members constantly, capping a team's efficiency gains over time.

> *'We need to be able to retain talent, but our SME focus often makes it hard to offer competitive packages, so we have lost key people to larger funds.'*
>
> *An emerging GP*

They implement a combination of solutions to attract and retain talent.

Fund managers pursue different team models. Many funds managing under $30 million adopt a team structure with two GPs, or one GP and one principal/investment director with quick access to partnership, and a **'grow-from-within'** approach. They rely on a team of junior hires who gain hands-on experience, have direct access to mentorship from the GPs and above all work with higher responsibilities and learning opportunities than in a larger fund where they are 'cogs in the machine'. This approach builds loyalty and helps identify future leaders who can join the partnership as the fund scales; it also accepts that many team members will turn over.

> *'As an emerging fund manager and in the current market, you can't retain more than one or two staff members over the long term. So build your HR strategy around this.'*
>
> *An emerging GP*

Others take a **'top-heavy' approach** from day one as an entrepreneurial bet, creating a team of three to four senior partners who accept comparatively low pay for a few years and hope for higher rewards over the long term. This brings very high execution capacity, networks, and value provided to the portfolio and lowers risk of turnover. The partners are those taking the risk that the fund manager may not scale fast enough to satisfy their ambition.

Regardless, most fund managers offer quicker paths to partnership compared to larger funds in order to compensate for lower pay and higher risk.

They work on culture and efficiency:

> Building a positive work environment: In the world of private equity and finance, on the continent just as elsewhere in the world, we cannot underestimate how much a positive and ethical work environment can provide a strong competitive edge. Fund managers that foster an inclusive, supportive environment can attract and retain professionals who feel safer, more valued, and more stimulated than in other organizations.

> *'I joined this team also because it is female-led and has a healthy work culture; I've known too many hostile workplaces in the past.'*
>
> *A female investment manager*

> Becoming better managers and leaders: GPs who make it a priority can become inspiring leaders and excellent team managers. This tends to often be neglected by many fund management companies and a major reason for turnover. Many GPs come from a deal-making rather than a management background. In this context, management coaching has proven to be a highly impactful technical assistance intervention.

> Building a robust training methodology for new hires is key to manage team turnover and increase efficiency; intensive on-boarding trainings can be used as important moments to build foundational skills, as well as loyalty and team culture. They can be supported by existing fellowships and trainings that are often subsidized (e.g. the Africa Private Equity Fellowship).

> In the context of stretched teams, **back-office, reporting, and data and pipeline management software programmes** are game-changers, allowing teams to maximize efficiency. Providing technical assistance specifically for implementing these tools is a high-value intervention and can be done early in the life of a fund manager to avoid switching costs.

> Finally, **utilizing third-party services or fractional resources** for some functions (accounting, compliance, reporting,

communications, ESG) can optimize costs. There is a movement towards pooling resources among fund managers to drive down costs of shared services; however, in practice this can create complexities.

Some recognize the limits of their model and look for additional resources:

> **Pro bono and performance-based support:** Fund managers round out their capabilities by leveraging pro bono (or performance-based) participation from investment committee members, venture partners, advisors, and independent board members to build value in their portfolio or help source investments. This expands their expertise and network without overextending budgets.

> **Working capital:** Securing working capital is critical for early-stage fund managers often during their fundraising phase and sometimes during the first years of the investment period (until a larger fund II can be raised). Grants and soft loans earmarked for team development allow fund managers to build core teams earlier and therefore build the right partnership dynamic, culture, and organisational set-up from the get-go. Several ecosystem players include such working capital facilities in their offering for fund managers, including sponsor fund IPDEV and fund-of-funds Mastercard Foundation Africa Growth Fund.

RECOMMENDATION 2#6

Towards a new generation of African fund managers and investment teams.

Enabling a new generation of African fund managers to sustainably address the financing needs of SMEs on the continent requires initiatives to support the talent pool, especially in nascent markets. This will lower barriers to launching and managing funds.

1) Adequate support for new fund managers helps navigate the challenges of fund design, and should be combined with working/warehousing capital:

E

Key interventions include:

> Incubation programmes for first-time fund managers, in particular cohort-based programmes, to bring training and exposure.

> Tailor-made acceleration services to support fund design and fundraising over six to 12 months. Coupled with working capital for fund managers, this can help accelerate fundraising and reduce failure rates.

> Senior mentorship from experienced investors for first-time GPs who struggle to access the knowledge of the sector in a context where to date data and lessons are poorly shared.

> Management coaching for GPs to support them in becoming strong managers and leaders.

> Capacity-building on the main standards demanded from fund managers (ESG, impact, GDEI, climate, etc.), making not only training but also templates and frameworks available to fund managers, in order to ensure that this welcome raising of standards does not become exclusionary.

2) Training investment teams and not only fund managers will grow the talent pool for SME funds

E

> Preparing a talent pool for SME investors requires trainings for mid- and junior-level professionals, including both theoretical training and concrete case studies taught by experienced investors.

Industry fellowships, internship placements, and training programmes for junior investment professionals to learn not only the fundamentals of investment methodology but lessons from real-life cases in the sector.

CONCLUSION

From Insights to Action: Suggestions for next steps

This report was developed by the I&P team as part of a **larger advocacy initiative launched in April 2024 with the support and funding of the Argidius Foundation**. This initiative originated from the frustration shared by many fund managers with regard to the lack of existing research and data on SME funds. Publicly available financial returns data on SME funds, for example, continues to be strikingly limited, preventing SME fund managers from raising awareness about their distinct asset class, its opportunities as well as its constraints. This dearth of data also prevents SME fund managers from learning from the fund models, benchmarks, and achievements of their peers and from demonstrating their own potential to attract investment. The SME funds asset class thus remains obscure to many limited partners; this is a key contributing factor to the mismatch between the expectations and standard terms of LPs, on the one hand, and the needs of SME funds, on the other.

Improving the quality and availability of data on SME funds can pave the way to catalysing greater flows of capital toward SMEs.

This report is merely another step on a path that has already been forged by many other players and which must continue to be forged. The report's findings require refinement through a broader and more diverse dataset, as well as through additional contributions from GPs and LPs. **We welcome feedback from all stakeholders in the sector and envision a collaborative process that will culminate in a subsequent and enriched report containing deeper insights and more robust data on the SME fund asset class.**

Our key next steps toward advancing awareness of SME investing as an asset class include:

> Launching the LPs Invest in Africa (LPIA) Initiative: In March 2025, we will introduce the LPIA initiative, designed to unlock investment capital for Africa's SME funds by addressing pain points for first-time LPs who seek to increase their allocation to African SME funds.

> Performing in-depth SME fund case studies: We plan to conduct a comprehensive study of five SME funds, identifying best practices and key lessons. The findings will be published and shared widely to enrich the conversation.

> Publishing an update of this report: In early 2026, we will release an enhanced version of the current report, incorporating new data and analysis thanks to the feedback gathered from ecosystem stakeholders throughout 2025.

Since its creation, I&P has been committed to a policy of proactive advocacy for the recognition of African SMEs as vectors of change and to the promotion of adapted financing solutions in Africa. There is still much more research to be done on the financing of SME funds in our ecosystems. We believe much progress can be achieved through enhanced collaboration across the sector, addressing critical topics such as:

> Expanding the understanding of African SME fund returns by including more funds and more asset classes and geographies.

> Exploring the trade-offs between impact performance and additionality, on the one hand, and the profitability of SME fund models, on the other, through cross-analysing impact and returns data.

> Assessing how catalytic capital instruments influence fundraising performance and fund returns, as well as the additionality and impact of investment strategies, to determine how they can support the growth of the sector.

> Exploring opportunities for unlocking the allocation of more African private and sovereign capital to the SME investing sector.

> Researching the mainstreaming of gender-lens investing within SME funds, including gender-diversity in fund management companies, representation of women in SME portfolios as owners, managers, and employees, and adoption of gender-inclusive best practices in SMEs.

The research efforts undertaken for this report in the previous months were made possible solely thanks to collaboration with ecosystem stakeholders who generously provided information, data, and insights, for which we are grateful. Continuing this collective effort and collaboration among all ecosystem stakeholders is essential to elevating the SME asset class to a level more commensurate with the continent’s current needs.

Key recommendations

Combining the lessons learned by practitioners in the space with recent data has helped identify the recommendations below for LPs, GPs, and ecosystem funders (“E”).

PART 1

TREND #1: A multiplication and diversification of Africa-based funds over the past 30 years

The three segments of early-stage SME funds, growth SME funds, and SME debt funds remain under-researched; more data and sharing of lessons will build understanding of these segments for LPs and new GPs.

1. A data-sharing initiative will improve LPs’ knowledge of fund performance in the sector and support new GPs in designing their fund; this requires collaboration. E
2. New LPs can be attracted to the asset class by receiveing more aggregated data and lessons on fund performance and fund models. LP
3. A particular research focus on funding models for early-stage SMEs is necessary to highlight how catalytic capital can solve some of the particular constraints faced in this segment. E

TREND #2: Raising a SME fund remains very challenging, especially for newcomers in the space

LPs can adjust their assessment criteria in order to back strong performing teams, including first-time and emerging fund managers with non-traditional backgrounds.

1. Assessing a first-time and emerging fund manager requires a more granular approach than looking at track record. LP
2. LPs can back lean teams, including solo GPs, to benefit from their advantages while mitigating some of the risks. LP
3. Creating equitable opportunities for women can take multiple approaches. E
4. There is a need for a flexible approach with respect to a GP’s skin in the game. LP

TREND #3: International DFIs are still the leading players in SME fund investment – today, they invest mainly in larger funds

DFIs can continue building the market of African funds by complementing their existing range of instruments.

1. Increasing investments in SME funds and adapting terms is key. LP
2. Collaborating more closely with non-DFI investors could increase DFI allocation to SME funds. LP
3. Data shows that African private capital is more likely to invest in African SME funds than international commercial capitalto; DFIs can find solutions to promote this trend. LP
4. DFIs can invest in funds-of-funds to target the smaller fund sizes that they are not able to fund directly, particularly SME debt funds and early-stage SME funds. LP

TREND #4: African private and sovereign capital is increasing its allocation to the sector, but there is still significant room to grow

Unlocking the pools of domestic capital will build a more resilient fundraising environment.

1. Engaging African/domestic capital in fundraising is a strategic priority for GPs. GP
2. Investing in African funds can be attractive for domestic investors. LP
3. Catalytic funders will be essential to unlock these domestic pools of capital. E

TREND #5: New catalytic capital funders have been decisive in building the market, but there is much more to be done

Increasing the amount of catalytic capital will speed up the mobilisation of capital for African SME funds.

1. A range of catalytic tools are key to empower a new generation of fund managers: working capital, warehousing capital, junior tranches, direct opex support. E
2. Funds-of-funds can scale with the right support. E

PART 2

TREND #1: Emerging fund managers are adapting their fundraising strategy to navigate LP dynamics

Successful emerging fund managers have taken a progressive road to fundraising; an enabling environment is needed to facilitate the launch of new funds.

1. In the absence of a strong enabling environment, emerging fund managers should plan for a 2 to 4-year step-by-step fundraising sequence. GP

2. There is a strong opportunity for new GPs to partner with other GPs or sponsors/platforms and improve their odds on the fundraising market. GP

3. Catalytic funders can facilitate the emergence of new SME funds by filling the most glaring gaps: availability of launch working capital, warehousing capital, anchor investment, and junior tranches. E

TREND #2: Better matching the liquidity profile of SME funds with the horizon of SME investments

Fund structures can better match SME investment horizon constraints with LP liquidity objectives.

1. Raising open-ended hybrid funds or permanent capital vehicles can be the right option for raising a new SME fund. GP

2. Adapting the liquidity requirements to the longer cycle of SME investing can improve fund returns while mitigating liquidity risk. LP

3. Developing a secondary liquidity market for fund investments is an important next step for the ecosystem. E

TREND #3: The return profile of SME funds is showing improvement

Recent data provides novel insights into SME fund performance.

1. Acknowledging the structural challenges of SME investing is a first step towards finding solutions to improve the returns of GPs and LPs. E

2. Available data shows how certain LP perceptions (track record, first time manager risk, etc.) are not in line with the reality of returns achieved. LP

3. SME investing is an impact choice; GPs must demonstrate how their approach and background enables them to overcome important structural challenges to provide returns; they can pursue alternative ways to grow as fund managers, in order to avoid creeping up and neglecting SMEs. GP

TREND #4: Options for fund domiciliation are multiplying but many markets are yet to design enabling environments

Enabling environments are necessary to promote the growth of private equity and SME investment in key African markets.

1. GPs can adapt the domiciliation of their fund to their fundraising strategy, with an increasing number of options at their disposal. GP

2. Advocacy from SME investors and LPs is necessary to promote enabling tax and regulatory environments across African markets and to develop domestic private equity markets. E

TREND #5: Currency and political risk cannot be overlooked by GPs

Fund managers manage currency and country risks; ecosystem initiatives can help mitigate exogenous shocks.

1. Expanding access to and subsidizing currency hedging for SME fund managers will increase local currency financing. E

2. Providing risk-sharing mechanisms for country and political risk will enable international investors to commit to emerging funds. E

TREND #6: Building and retaining talent against all odds is key

Moving towards a new generation of African fund managers and investment teams.

1. Adequate support for new fund managers helps navigate the challenges of fund design and should be combined with working/warehousing capital. E

2. Training investment teams and not only fund managers will grow the talent pool for SME funds. E

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