Annex 5 Initiative 2: Access to investment finance for SMEs

Description of the initiative and its current state

Initiative

"Almost 50% of African companies identify lack of access to finance as a major constraint to doing business. The cost of finance, including investment finance, is higher in Africa than any other part of the world, and the access for SMEs is particularly limited. Very few commercial banks do small enterprise banking in Africa. Furthermore, the global financial crisis is likely to squeeze access to finance for these enterprises more than for bigger companies for some years to come. Causes of the problem are found in both supply and demand. While the lack of effective business plans and adequate skills within SMEs are a problem on the demand side, the supply is constrained by lack of capacity in the financial sector to do business with smaller companies; inadequate information resulting in high-risk assessments; lack of collateral and collateral registries; poor protection of creditors; and lack of availability of longer-term funds".[1]

"This initiative by the Africa Commission aims to address one of the key constraints to accessing finance faced by African SMEs by creating an African Guarantee Fund that will provide guarantees to African financial institutions lending to SMEs. Financial institutions in Africa typically associate lending to SMEs with high risks and huge administrative costs. The provision of guarantees to African financial institutions will lead to increased access to bank credit for African SMEs.

The African Development Bank has agreed to take the initiative forward and has advanced significantly in the preparation of the facility. The Danish and Spanish governments have joined the process."[2]

The African Guarantee Fund

The African Guarantee Fund for SMEs was initiated in 2010 as a limited shareholding company with registration in Mauritius and operational headquarters in Nairobi. The purpose of the African Guarantee Fund is to contribute to growth and employment in Africa by enhancing SMEs' access to finance through the provision of loan and equity guarantees to financial institutions for their lending to SMEs.

In addition, the African Guarantee Fund supports capacity development both for partner lending institutions to provide financial services to the SME market segment and for SMEs to improve their business management

The Commercial Bank of Africa – Kenya

The Commercial Bank of Africa was originally a corporate bank serving only international organisations and large companies in Kenya. In 2012, the Bank had reviewed its business strategy and was looking to make its first entry into the SME sector: with extreme caution as they regarded the sector as high risk. The availability of the African Guarantee Fund's loan portfolio guarantee products aimed at SME financing persuaded Commercial Bank of Africa to move into SME banking. With a guarantee of USD 2 million from the African Guarantee Fund, Commercial Bank of Africa's SME loan portfolio has grown in three years from less than USD 2 million in 2012 to USD 4.5 million by the end of 2015. The AGF Capacity Building Trust has also financed 50% of the cost of training for Commercial Bank of Africa staff in SME risk assessment and loan portfolio management.
Jeremy Ngunze, Chief Executive Officer of the Commercial Bank of Africa advised that "the *AGF guarantee provided us with confidence to reach out to more SMEs, and faster than we could have ever done, knowing that we have a fall-back, albeit partially, in case of default. We soon realized that SMEs business is good, and the stereotype we had about them changed."*

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1 Realising the Potential of Africa's Youth · Report of the Africa Commission, May 2009.
2 "Growth and Employment: Visions at Work", Africa Commission, August 2010.

skills.

The African Guarantee Fund started operations in 2011 and was officially launched in 2012 with an initial share capital of USD 50 million provided by the three founders:

- African Development Bank with USD 10 million
- AECID (Agencia Española de Cooperación Internacional para el Desarrollo), Spain with USD 20 million
- Government of Denmark with USD 20 million.

In addition, the Government of Denmark provided USD 2.8 million for initial preparatory activities, start-up costs and operational support during the African Guarantee Fund's first year of establishment.

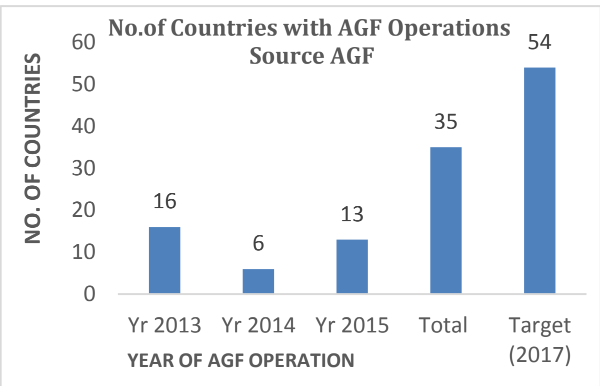
Demark invested a further DKK 96 million in capital in 2014 and provided another DKK 2 million for Danida to conduct/participate in reviews and DKK 2 million for IFU to take over Danida's seat on the Board of Directors of the Fund.

In December 2014 the Swedish International Development Agency approved a re-guaranteed portfolio, which is designed to support the African Guarantee Fund's ability to issue guarantees in support of Partner Lending Institutions' incremental financing of African SMEs. The overall purpose is to catalyse private sector capital for sustainable economic development in Africa. Sida will provide risk coverage of 50% with a ceiling of USD 50 million.

The issued share capital of the African Guarantee Fund was USD 80.5 million by end 2015 whereby the initial Danida investment is more than doubled (see table). The fund is seeking to increase its capital as in negotiations for possible new capital as shown in the table to the right. In 2015, the African Guarantee Fund's income exceeded its expenses by USD 516,913. In December 2015, the African Guarantee Fund took control of the GARI Fund[3] by in West Africa by acquiring 80.56% of GARI Fund's shares, previously owned by the French Development Agency, the European Investment Bank, the Deutsche Investitions- und Entwicklungsgesellschaft and the State Secretariat for Economic Affairs.

Current capital (USD)	
Danida	36,500,001
AECID	20,000,001
African Development Bank	10,000,001
AFD (France)	14,000,000
Total	80,500,003
Possible new capital (USD)	
Canada	13,000,000
Nordic Fund	6,500,000
Total	19,500,000
Grand total	**100,000,003**
Source: AGF	

The African Guarantee Fund has (or will have) 28 staff in 2016.



The African Guarantee Fund plans to originate guarantee deals for USD 200 million in 2016: 50% loan guarantees (individual and portfolio), 10% equity guarantees and 40% bank fund raising guarantees and is expecting a default rate of 1.77%. As can be seen in the table, the portfolio has been steadily growing and now the reached number of SMEs is 850. As at the

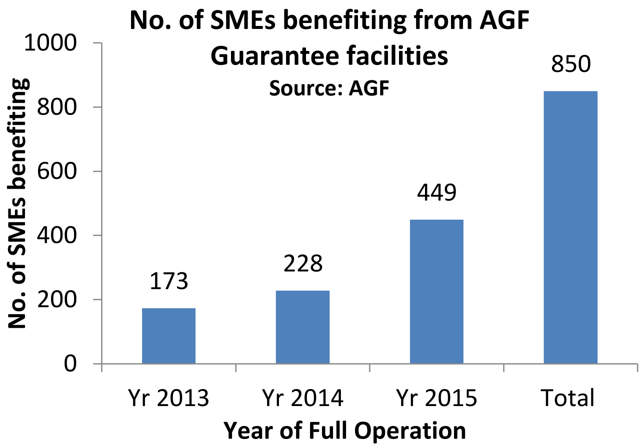
[3] The GARI Fund had a turnover of USD 4.8 million in 2015 and achieved a net result (after cost of credit) of USD 1.7 million.

end of 2015 the African Guarantee Fund had treasury assets of USD 53.8 million and was achieving a return of 2.3%.

"The principal objective of the African Guarantee Fund's treasury management operations is to earn the maximum risk-adjusted return on its capital that is compatible with keeping the capital intact in the medium and long term and being able to settle all obligations in full and as they fall due.

This objective is best met by establishing a portfolio characterized by: (i) Limited risk; Broadly diversified portfolio with a focus on low cost investments; Ensuring necessary access to liquidity at all times; Providing maximum expected returns for the level of risk taken at all times."[4]

The African Guarantee Fund Capacity Development Trust



The African Guarantee Fund operates a Capacity Development Trust, which provides capacity building to participating financial institutions to correctly assess the risk of lending to SMEs, and to effectively manage SME loan portfolio. The Capacity Development Trust also provides support to improve SME business management and governance capability, as this is also critical to the success of the guarantee scheme. The Trust provides capacity building assistance to SME Business Development Support companies and SMEs themselves. Improved business management and governance among the trained SMEs makes them less risky in the eyes of the participating financial institutions. This in turn builds confidence among participating financial institutions to lend to SMEs. The Trust funds up to 50% of the total eligible costs of an approved capacity development project with the beneficiary funding the other half.

The African Guarantee Fund Capacity Development Trust was formally registered under the Mauritius Trust Law 2001 in January 2013 as a non-charitable purpose trust with an initial fund of USD 2.3 million (provided by Danida).

Example of the support provided through an approved Capacity Development Project

- Review and the Development of new SME Products and Services,
- Updating of the SME Customers' Training Manual and undertaking Training of their SME customers,
- Training of bank staff involved in SME lending (Credit, Risk and SME departments), and
- Training and Exposure for Senior Management of the bank involved in policy making in SME lending.

As of April 2016, the Nordic Development Fund has also become a shareholder in AGF, with the establishment of a Green Guarantee Facility. The Nordic Development Fund will contribute EUR 6 million in equity and an additional EUR 1.6 million in grant support for Capacity Development[5]. Discussions are underway with Canada who is considering to provide USD 1.5 million as a contribution to the trust.

The Board of Directors of the African Guarantee Fund has approved 12 projects involving a total fund investment of USD 1,362,764 to date. The anticipated project pipeline for 2016 for the Trust is currently around

[4] African Guarantee Fund, Treasury Management Policy, 2012. For more information on GARI http://fondsgari.org/?lang=en

[5] http://www.africanguaranteefund.com/

USD 4.5 million spread over 12 projects so additional funding is definitely needed.

Relevance of the initiative to the recommendations of the Africa Commission

The establishment of the African Guarantee Fund is in line with the Recommendations 14 and 15 (see table below) of the Africa Commission and is therefore assessed as relevant by the Evaluation.

Initiatives	**Related Africa Commission policy recommendations**
Access to Investment Finance for SMEs	R14: The financial sector in African countries must scale up access to finance, in particular investment finance, for SMEs and develop the necessary capacity. For their part, African governments, supported by international development partners, must provide a predictable regulatory framework, facilitate capacity development of financial institutions and enterprises, and provide effective market based instruments that increase access to investment finance.
	R15: African governments must facilitate a better business environment for small enterprises. This requires basic infrastructure (which may be financed through aid and public-private partnerships), the registration and protection of property rights, a less burdensome regulatory framework, and incentives, rather than punishment in the form of extra costs, for businesses that formalise their operations.

Effectiveness of achievement to date

According to interviewees, the African Guarantee Fund has established itself as a recognised player in the African financial system with competent staff, good financial systems and documented operational procedures and risk management mechanism.

It won the African Banker Award for Financial Inclusion in 2013.[6]

The Fund has grown rapidly and there is significant donor interest in increasing its share capital: however it is unlikely that it will “mobilize a guarantee capital of approximately USD 500 million over a period of five years”[7] as that period ends in 2016.

It is perhaps surprising – as one senior member of the African Development Bank staff advised the Evaluation on terms of anonymity – that the African Development Bank had not lived up to expectations: “it treats the African Guarantee Fund as another project rather than the key partner that it ought to be”.

If the Fund is successful in increasing its share capital to USD 100 million, then the achievement of operational self-sustainability (before tax and cost of credit) in the near future seems realistic.

There is no results monitoring framework in place yet but it is in course of preparation (see 5.4 below). In the absence of quantified baselines and targets for key performance indicators and insufficient evidence from the interviews conducted by the Evaluation, it has been impossible to accurately assess effectiveness at other than the operational level.

Additionality achieved through support to the African Guarantee Fund

“Credit or financial additionality refers to the extra loans that would not have come about without the credit guarantee scheme. Measuring additionality is difficult. In fact, only a few cases of additionality have been “proven”, and thus experts remain sceptical as to whether credit guarantee schemes actually

[6] http://www.africanguaranteefund.com/news/52/191/African-Guarantee-Fund-wins-Financial-Inclusion-award-in-Africa/d,secondpage-EN

[7] “Growth and Employment: Visions at Work”, Africa Commission, August 2010.

cause additionality."[8] In cases where additionality does not occur the credit guarantee is used by banks to provide themselves with increased security for loans that they would anyway have offered: offsetting the cost of the guarantee by increased charges on the borrower.

Whilst not providing evidence of additionality (as a range of other factors come into play) the African Guarantee Fund agreed to provide us with details of changes in the size of the overall SME loan portfolio of some banks supported by a loan portfolio guarantee from the African Guarantee Fund over the period from the award of guarantee to date.

This information is shown in the following table:

All figures in USD	Dec-14	Dec-15	AGF Guarantee
BGFI Madagascar	1,617,900	3,128,969	2,500,000

	Aug-13	Dec-15	AGF Guarantee
Commercial Bank of Africa (CBA) - Kenya	1,900,000	4,500,000	1,000,000

	Dec-12	Dec-15	AGF Guarantee
OIKO Credit - Various Countries in Africa	631,456,000	822,866,000	10,000,000

	Dec-13	Dec-15	AGF Guarantee
Focus Financial Services - Zambia	5,457,800	50,396,800	10,000,000

	Dec-13	Dec-15	AGF Guarantee
Zambia National Commercial Bank (ZANACO)	8,148,230	9,972,590	2,500,000

	Dec-13	Dec-15	AGF Guarantee
Orabank Group - various countries	9,222,570	12,953,479	20,000,000

	Dec-13	Dec-15	AGF Guarantee
Ecobank - Cameroun	27,991,303	31,157,094	7,500,000

Source: AGF

Whilst it is not definitive proof of additionality, it does suggest that this is being achieved with most if not all banks.

Effectiveness of results management system

The African Guarantee Fund has recruited, since July 2015, an experienced staff member to act as Head of its Monitoring and Evaluation Department. Laying a functional M&E system is ongoing, and M&E tools are being developed to facilitate performance measurement of AGF interventions. A monitoring and evaluation framework has been discussed and approved by the Board. The framework shows a set of indicators for each of the two main components of AGF operations: Guarantee Business, and Capacity Development. It also shows planned methods of data collection for the identified indicators, sources, frequency, the type of reports to be produced and their use.

The Key Performance Indicators still do not yet have baseline data and targets. A baseline survey has been launched to obtain the initial values of the indicators, and the plan is to set realistic targets for the indicators once the baselines are known. The baseline survey is reportedly ongoing, and results are expected in May 2016.

An M&E Policies and Procedures Manual has been drafted and will be presented to the Board for approval during the second quarter of 2016.

[8] Discussion Paper on Credit Guarantee Schemes, OECD.

The Evaluation had discussions with the AGF team on the logic implicit in the theory of change and whether the results chain flowed smoothly through the existing logical framework matrix. It was agreed that the impact indicators set for AGF demonstrate a change in banking behaviour throughout Africa (i. Lasting effect on the landscape of financial markets and products and ii. Expansion of resources available for SME financing). These are sensible and logical indicators which would indicate that AGF has been successful in changing the way banks throughout the countries in which the African Guarantee Fund operates lend to SMEs.

At the outcome level two main indicators are given (i. PFIs behavioural changes induced by AGF facilities and ii. Growth of SMEs benefiting from AGF facilities). The first again makes sense: the African Guarantee Fund is attempting to induce changes in the banks with which it works directly, but the second outcome is flawed. The specific indicators for this outcome are an increase in the revenue and jobs of supported SMEs, but banks are not motivated to increase the availability of finance for SMEs by seeing that the enterprises employ more people: banks do not normally even keep records of employment let alone change in employment of their customers. Banks will be motivated to increase the availability of SME financing if they see that such business is profitable and this is the appropriate outcome main indicator.

An entirely separate results chain feeds off how the SME receiving the loan expands its revenue, profitability and employment – but this results chain does not lead to changes in bank behaviour.

The Evaluation has suggested that the M&E Department should plot out the results chains and adjust the theory of change and logical framework matrices accordingly. Similarly, the Capacity Building Trust feeds into the two separate results chains: it supports banks to change their behaviour and it supports SMEs to help them improve their business management capability: again contributions to two separate but linked results chains.

Conclusions

The African Guarantee Fund is expanding rapidly and aggressively: staff of the Fund advised us that AGF has achieved an overall guarantee portfolio in three years, and that it took the GARI fund 20 years to achieve the same size of portfolio.

The Monitoring and Evaluation framework is in place, but lacks indicator baseline values and targets to allow future tracking of the indicators. Target setting awaits the completion of an ongoing baseline survey, which AGF reported will be completed by May, 2016. Data collection for impact level indicators in the AGF Results Framework will be through surveys, which will allow overall impact performance to be judged. However, the operational performance data collected so far is impressive.

The challenge for the African Guarantee Fund will be to maintain its focus on becoming a self-sustaining market-oriented entity whilst gradually expanding its portfolio to embrace banks in the lower performance tiers (with the inherent increased risk) and in countries with an overall greater risk. This is necessary to achieve its impact goals, but will require careful balancing with its self-sustainability goal.