

Investisseur et Partenaire pour le Développement (I&P) is a private finance company that provides financial and managerial support to microfinance institutions and SMEs in Africa. I&P operates via private equity investments and, in certain cases, loans. In this article I&P's President, Patrice Hoppenot, presents the main stumbling blocks that a finance company can face when seeking to invest in SMEs in SSA and describes the solutions provided by I&P.

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Patrice Hoppenot graduated from the Mines de Paris executive engineering school as a civil engineer and was awarded an MBA from the University of Chicago. He spent the first part of his career in the industry. In 1988, he founded the European private equity fund BC Partners which went on to become one of the major independent financial investors in Europe specialized in LBO operations. In 2001, he set up Investisseur & Partenaire pour le Développement (I&P), an investment company dedicated to promoting entrepreneurs in Africa and investing in SMEs and microfinance institutions. I&P is today present in over ten African countries. Patrice Hoppenot also serves on the boards of several companies listed on the Paris Stock Exchange.

Private equity investment in Sub-Saharan African SMEs

SME financing cannot be enhanced simply by scaling up volumes of financing. SMEs need to upgrade so that they can meet the eligibility criteria of bankers and other investors. I&P is aware of the difficulties met by promoters and can - subject to certain conditions - provide equity and loan products as well as technical assistance.

By Patrice Hoppenot, Chairman of the board and co-founder of Investisseur et Partenaire pour le Développement

All development players see SME finance in SSA as a key issue: a number of conferences have addressed the topic and new solutions are constantly being sought. Indeed, SMEs create formal employment and help boost the entrepreneurship. They also contribute to the emergence of an industrial fabric that can service the needs of Africa's big corporates which often have to resort to services and products from outside Africa due to the lack of local suppliers. SMEs must have the capacity to boost economic development in SSA, yet SME networks are sadly underdeveloped in many African countries.

Lack of financing may constitute a stumbling block to the development of an SME fabric but unfortunately it cannot be removed simply by scaling up volumes of financing. The issue of SME financing must be addressed in a comprehensive manner and, in particular, by taking into account the needs of these businesses in terms of technical assistance. Indeed, SMEs must be supported so that they can upgrade in order to have access to bank loans and private equity investments by professional investors.

Need to join the formal sector

First of all, SMEs must join the formal sector in order to gain access to financing. Yet formal SMEs in SSA are practically an exception, which is understandable in view of the heavy taxation and costs they are subject to: tax on profits, VAT, social contributions, formal accounting with auditors... They are also a favourite target for tax inspectors which often do not have the most ethical methods. All these costs put a heavy burden on operating accounts. Accounting obligations are an important sign of progress but they are often ill-perceived. These reasons explain why the bulk of SMEs remain in the informal sector where they only have

access to informal finance or limited finance from microfinance institutions. Yet formal legal and accounting frameworks can help SMEs gain easier access to bank credit and can help them do business with big clients or clients similar to themselves. They can consequently finance their growth. Unfortunately only a handful of entrepreneurs join the formal sector.

SMEs must upgrade

The problem of access to finance is obviously not resolved by joining the formal economy. Promoters that want to set up and manage an SME and make it viable must have ambition, a sound project, a clear strategy, sufficient resources (with a sizeable amount in equity) to meet financial needs and real management skills. Since promoters generally lack financial resources and tend to underestimate their needs, there are only very few projects that come to fruition. It is therefore a risky business that few investors or bankers accept to finance, unless the promoter controls a sizeable fortune or has sufficient guarantees. SMEs that are efficient, well established in their markets and managed by professional teams are the only ones able to raise funds through borrowing or equity. The solution to the problem of SME financing consequently lies first and foremost in generally upgrading SMEs. It is indeed very unusual to find SMEs with a level of management that allows banks to lend the amounts required with an acceptable level of risk, even if the business does have interesting potential.

I&P provides solutions to promoters that manage SMEs or wish to set up a company by building partnerships with them. I&P provides equity, while remaining a minority shareholder, loans and technical assistance under a "partnership pact" that sets out the conditions for the partnership. A relationship of trust needs to be built between the ...

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... parties. Indeed, promoters often perceive a capital increase or the introduction of a new shareholder as a loss of control and can consequently take up a defensive position.

The promoter's main undertakings relate to transparency, implementing a rigorous accounting system, the regular transmission of performance indicators, I&P presence on the Board of Directors (if applicable), sharing important or strategic decisions and consultation with I&P for executive recruitment. I&P undertakes to be available to support SMEs in their development, to help define their strategy and organization and, according to its resources, to provide technical assistance and consulting services that may be required for the SME to improve its performance and acquire expertise in its activity. I&P takes a field approach and its investment officers conduct a minimum of three missions a year to each of its partner businesses. They also have regular contacts with pro-

motors via Internet which means they can monitor businesses and quickly step in when required.

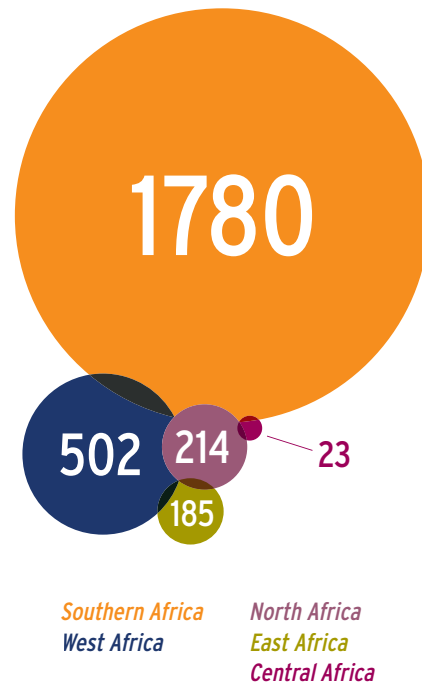
Comprehensive technical assistance

Technical assistance is mainly provided to set up management accounting and performance indicator dashboards that allow the main indicators to be monitored. It is also provided for executive recruitments and the definition of executive positions, industrial management, sales force organization and, more generally, strategy. Technical assistance missions are decided jointly by the investment officer and the promoter. Depending on the type of assistance, missions are conducted by volunteers from "Entrepreneurs & Développement" association (set up by I&P), retired experts and local consultants, particularly for issues relating to accounting and information systems. It is worth noting that I&P's geographical distance from its partners may pose obvious disadvantages, but it does give responsibility to the ...

The rapid growth of private equity in Africa

Private equity investment in Africa is experiencing rapid growth: in 2007, the inflow of private funds in Africa was estimated at USD 3bn (+22% compared to 2006). Yet this amount remains marginal compared to global flows (0.6% of the global total and 7% of the total for emerging countries) and is still focused on certain African countries. South Africa receives the bulk of investments (52%), followed by Nigeria (19%), Zam-

bia (12%), and Morocco (4%). Investments focus on three sectors: distribution (27%), financial services (25%), and telecoms (12%). The main investors, such as ECP, Zephyr Management and Helios Capital, only take positions on mature companies and neglect venture capital and start-up capital activities. Development capital consequently represents 55% of funds raised, while venture capital is only marginal with less than 14% of flows.



Location of Investments (USD millions)

Source: Geiss et Alij, 2008

... promoter and its team. The promoter consequently does not over-rely on I&P and I&P is not tempted to interfere.

Promoting SME autonomy

Once SMEs have upgraded they can refinance themselves via local banks. Working capital finance is often the most needed and the most difficult to finance. The aim of I&P is to allow SMEs to grow, become completely autonomous, profitable and eligible for bank financing. Once they have reached this stage, which can take from a minimum of three years to six or seven years, I&P seeks to sell its shares in agreement with the promoter. This exit strategy may turn out to be a delicate issue in view of the lack of liquidity on these markets. However, I&P can rely on intermediaries that have extensive knowledge of the local market (bankers, businessmen...) and interesting deals always find investors. European firms may even be candidates.

Results from I&P's approach have generally been conclusive since most SMEs that have been partners for over three years have reached profitability. However, it is a costly business (transport, technical assistance, low amounts invested compared to time spent, high risk...). Fortunately, volunteers with extensive experience of SMEs provide support to I&P for business upgrading and the European Union meets part of the cost of technical assistance.

Thanks to these conditions, I&P's approach is sustainable, has an effective impact and its shareholders should receive a small return on their investment. But most importantly, I&P's experience shows how it is possible to finance and promote SMEs in SSA. ●

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Spotlight on an investment in a Nigerien SME

XPharma (name of business undisclosed) is a pharmaceutical distributor with Nigerien capital set up by two local promoters in Niamey in 2001. Two other major pharmaceutical distributors with suppliers in France are also present on the market. I&P contacted XPharma in 2005 at a time when the company was experiencing serious financial difficulties after several years of deficit. The accounts were badly kept due to a lack of skilled staff and the client and supplier accounts were unreliable. Banks had begun to withdraw their financing and the company was finding it increasingly difficult to purchase supplies due to the lack of funds and, consequently, to reach a reasonable level of turnover. However, the promoters were aware of their mistakes and were willing to re-inject capital and review their commercial strategy. I&P had already had a positive experience of a partnership with a pharmaceutical distributor in Mali. It considered that XPharma did have some strong points: an excellent temperature control installation, unexploited commercial potential and, especially, open-minded managers who were willing to benefit from technical assistance and had the capacity to bring in financing. Finally, there was potential to build synergies with the two independent distributors. A full audit conducted by a competent Nigerien accounting firm gave a clear assessment of the financial situation, treasury requirements and the outstanding client debts to be recovered. In 2006 the parties agreed to subscribe to a FCFA 130 million capital increase with a 50% share for the promoters and 50% for I&P which then held 21% of the capital. I&P also allocated a FCFA 65 million subordinated loan with a 3-year maturity that could be converted into shares at I&P's sole discretion. Finally, the promoters managed to mobilize loans from local banks by providing personal guarantees. The company was gradually restructured in agreement with the promoters: an experienced financial director was hired; reliable information and management systems were implemented; the commercial strategy was reviewed to focus more on Niger's underserved interior while continuing to deliver to Niamey's pharmacies; client payments and financial margins were closely monitored. 2006 was still a difficult year due to a few remaining accounting errors and a slower start than expected for activities. I&P decided to convert its loan in 2007 which meant its shareholding rose to 26%. Local banks accepted to finance XPharma's working capital requirements. In 2007 turnover rose by 40% and in 2008 it rose by 30% and reached FCFA 1.75 billion. XPharma's net income for 2008 topped the FCFA 40 million mark. The company today employs around ten people and has become profitable and sustainable.