Business case for a new SME financing fund in DRC

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1. Executive summary

SME's in DRC struggle to find financing. In fact, 92% of SME's rely on internal financing according to the World Bank enterprise survey in 2013. This is much higher than the Sub Sahara average of 74%. Financing is needed by SME's to grow their business and to invest in working capital and assets needed for value creation. Relying on internal financing slows down this growth considerably.

This creates a big problem for the DRC economy, as SME's are responsible for the bulk of job creation and, as a result, economic growth, stability and prosperity.

Reasons cited by entrepreneurs as well as commercial banks for this failure to secure loans are:

- SME's don't have enough collateral
- Entrepreneurs do not understand the procedures for applying and do not have the documentation and systems in place to successfully apply
- There is a mutual lack of trust
- The terms offered by banks do not meet the requirements of entrepreneurs, especially if they need to invest in assets (short tenure and no grace period)

There are very few alternatives available for SME's, especially those looking for USD 100k-1m: FPI, the government development bank seems ineffective; the African Rivers private equity fund of XSML focusses on large (>USD 2m) deals; foreign investment funds are not active in DRC.

More than finance, SME's are ill prepared to attract and make effective use of financing. Extensive pre- and post-investment technical and managerial support is needed to guarantee returns to investors as well as sustained growth of the SME's

This funding and support gap can be addressed in 2 ways:

1. Creation of new investment funds, coupled with support structures, that target the lower end of the SME requirement
2. New donor funded programs that target SME development and growth

Given that donor enthusiasm for SME development is low in DRC, we believe that the introduction of new investment funds is the best alternative. Because local fund management talent is not available the fastest way to do this is:

1. New fund managers starting investment holding structures that allow for gradual increase in investment portfolio, giving them time to build a track record
2. Inviting existing investment funds active outside DRC to enter the DRC market

Unfortunately, interest of foreign funds in the DRC is low, leading us to the conclusion that the creation of smaller, local investment funds is the best alternative.

Pre- and post-investment support, which is currently not available in DRC, can best be organised in separate entities that are funded by investors active in this field and that will accept lower financial returns.

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2. Introduction

2.1 The Elan RDC programme

Elan RDC[1] has been working with SME's from a variety of sectors and in 4 zones in DRC since the start of the program in 2014. All in all, Elan RDC partnered with over a 100 entities to introduce new products and services to their markets, especially those involving Congolese at the bottom of the pyramid. The purpose of the program is to increase the disposable income of 1 million poor Congolese by at least GBP 30 per year either through revenue increase or reduction of expenses.

Many of the entities Elan RDC has worked with are local SME's, improving their general management and sales & marketing skills as well as providing linkages to local and international actors seeking DRC business contacts/partners. These business improvement services, also labelled Business Development Services (BDS), are difficult to find, even in Kinshasa. Finding them at affordable rates to make them relevant for small business is even more difficult.

As these local SME's gained traction so did their need for funding to financing investments and working capital. In a few cases this was arranged through loans from local commercial banks or micro finance institutions (MFI). The majority of SME's, however, did not fulfil the demands of banks and are now struggling to maintain momentum. Alternative financing sources (government bank, local investment fund, international investment funds, DFI's) were not available in all but a few cases, for a variety of reasons mentioned in chapter 4 of this document.

This led to the realisation that funding is a problem for a large group of SME's in DRC, especially for those requiring USD 100k - 1m financing.

2.2 SME's are the drivers of growth and stability

It is commonly accepted that the drivers of economic growth, stability as well as employment for emerging markets - even more so in fragile states where government institutional capacity is low - lie in the potential and effective development of the SME sector. Not being able to find sources of financing means that SME's will only grow as fast as their internal sources will allow them to do so, which is significantly slower.

The exact magnitude of the problem is difficult to judge, because there is a lack of statistics about and research into the SME sector in DRC. Even organisations like FEC and COPEMECO (Federation des Entreprises du Congo and Confederation de Petites et Moyennes Entreprises du Congo – the main BMO's for entrepreneurs in DRC) do not have numbers on SME's, let alone on their financing needs and problems. What we do know is that there are approximately 300.000 Micro and SME's in DRC according to the Worldbank/IFC[2] that collectively have a finance gap of USD 6.8 billion. Many of these are informal and are in

[1] For more information: www.elanrdc.com

[2] www.smefinanceforum.org/data-sites/msme-finance-gap

need of financing of much lower amounts than USD 100k, but the fact remains that many of them, also the larger ones, are unserved when it comes to financing. 35% of these are estimated to be “fully constrained”. Fully credit-constrained firms are defined as those that find it challenging to obtain credit. These are firms that have no source of external financing. They typically fall into two categories: those that applied for a loan and were rejected; and those that were discouraged from applying either because of unfavourable terms and conditions, or because they did not think the application would be approved. The terms and conditions that discourage firms include complex application procedures, unfavourable interest rates, high collateral requirements, insufficient loan size and maturity.

According to another World Bank report[3], SME’s represent nearly 90% of all DRC businesses, and employ over 50% of the workforce, but their contribution to GDP is less than 20%, compared to 60% in countries with high incomes. This points to a severe lack of effectiveness on the part of SME’s.

2.3 Elan RDC key learnings on SME finance

Elan RDC key learnings with relation to its SME partners is in line with the studies mentioned above. Financing is a limiting factor in growth, but equally important is that the majority of SME’s are not able to effectively apply for financing due to a lack in general management skills (strategy, governance) as well as more specialised skills such as sales & marketing, accounting and human resource management. This lack of skills leads to a lack of trust by financial institutions and, as a result, high rejection rates. When they do successfully apply for financing the terms offered by banks (short loan tenure, high collateral, no grace period) are not suitable, especially for partners that need to invest in assets.

1	2	3
There are few sources of finance other than banks & own funds	SME’s lack the skills and understanding to successfully apply for loans	Loan terms are not suitable for asset finance

The following chapters will elaborate on the financing options currently available to SME’s and why these are not sufficient for SME’s to grow and thrive in DRC. The final chapter lists a number of solutions for this gap as well as recommendations for solutions most suitable in our opinion.

The purpose of this document is to prove that there is a real need for new investment options in DRC, especially in the range of USD 100k – 1m, and thus to stimulate parties interested in providing financing to SME’s in DRC to act on those interests, be it through the creation of investment vehicles or through providing funding to them.

[3] documents.worldbank.org/curated/en/610151502304081524/pdf/ITM00184-P160806-08-09-2017-1502304076949.pdf

3. Finance: only one of the problems facing SME's in DRC

Although statistical data on SME's in DRC is lacking, 3 studies, one in 2011 in Kinshasa among 21 SME's (by KfW[4]), one by the World Bank in 2013[5] among 529 SME's nationwide and a third in 2018 in Bukavu among 109 SME's (by researchers of the University of South Wales, UK[6]) point to similar issues that SME's are facing on their path to growth:

- No access to finance
- Lack of managerial and technical skills
- Infrastructural issues (energy, physical access to markets)
- Corruption related delays, hindrance and cost

This document focuses on the first two points only.

3.1 SME's rarely use external financing

Only 7% and 9% of firms use banks to finance investment or working capital respectively. These averages are significantly lower than the averages for all sub Saharan countries (19% and 22%). 92% of SME's are financed internally, compared to 74% in Sub Saharan countries. DRC firms' limited access to financial services is also confirmed when looking at deposits (as opposed to credit). The percent of firms with a checking or saving account dropped from 71% to 57% between 2010 and 2013, remarkably below the global average of 88%. Accordingly, firms in DRC report access to finance as the second biggest obstacle to their operations after lack of electricity.

The numbers above illustrate that SME's are either not willing or not able to get loans from banks. The KfW study shows that there is a combination of factors contributing to this:

- Banks are not trusted (2 banks went bankrupt in the past years, "they steal ideas", "they do not support me in difficulties – are out to get the collateral")
- Interest on loans are perceived to be excessive (15-25%) and therefor SME's prefer to use own funds
- SME's seeking external financing don't fulfil the requirements for loans and are turned down. Main reasons given are:
    - SME's are ill prepared for successful applications
    - not having enough collateral
    - not having (audited) financial statements
    - not having sufficient traction and track record

Other sources of finance, such as investment funds and the government development fund "Fonds de Promotion de l'Industrie" (FPI) are not well known and are thus not frequently

[4] www.kfw-entwicklungsbank.de/Download-Center/PDF-Dokumente-Sektoren-Berichte/2011_01_Congo-Unternehmer_E.pdf

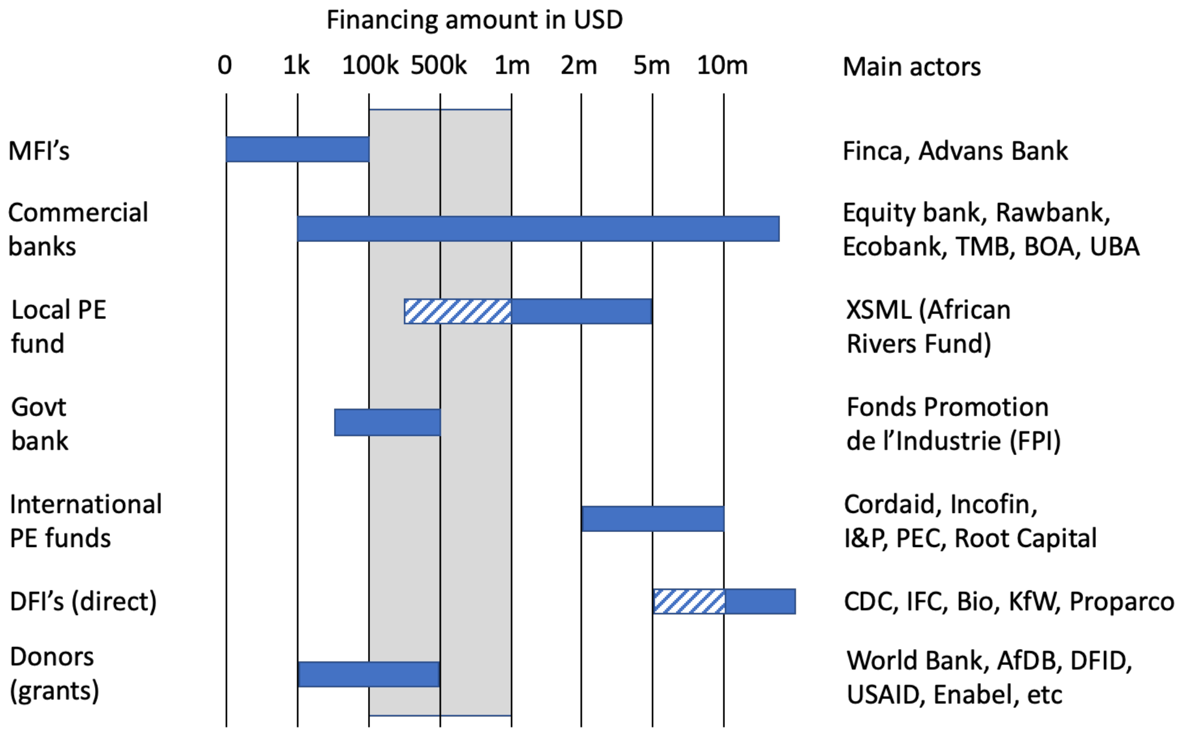
[5] World Bank 2013 Enterprise Survey: www.enterprisesurveys.org/data/exploreeconomies/2013/congo-dem-rep#firm-characteristics--size

[6] pdfs.semanticscholar.org/8500/559d2c12b6fb54cb1aad59bc3dbd7b81a6bb.pdf

used. Additionally, if SME's are not based in Kinshasa, their chances of successfully applying for financing will be limited.

3.2 What options do SME's have for financing in DRC?

The schematic below shows the current financing options that SME's have at their disposal in DRC, with more details below it.



Micro Finance Institutions (MFI's)

+ MFI's are well known in the market and easily accessible, with branches in many cities
- the amounts that can be borrowed are limited (less than USD 100k)
- MFI's charge high interest (>20% per annum)
- no support for SME's after getting loans

Commercial banks

+ Banks, like MFI's, are well known in the market and easily accessible, with branches in many cities
+ Even with all the issues listed below Equity Bank and Rawbank issued approximately 1500 loans of more than USD 100k in 2017[7]
- Unfavourable terms, especially when financing investments:
  - 150% or more of the loan required in collateral
  - Maximum 3 years loan maturity, which is prohibitive for asset financing
  - 15-18% interest per annum

[7] Information collected by Elan RDC

    - No grace periods, which puts huge strains on cash flows and is prohibitive for asset financing
- credit conditions are perceived as extremely strict. Clearly the image of commercial banks is more negative than positive [8]
- the procedures for getting loans are not well understood
- the number of banks active in SME loans has reduced in 2018 (BIAC and FI Bank folded, Rawbank and Bank of Africa reportedly no longer provide SME loans)
- loans only (no equity or mezzanine finance)
- no support for SME's after getting loans

Local private equity fund (XSML[9])

+ Grace periods up to 12 months and tenures up to 6 years offered
+ Loans, equity and royalty-based schemes (or a combination thereof) possible
+ African Rivers Fund (USD 50m, focusing on Uganda and DRC) is the follow-on fund of the Central African SME Fund (USD 19m, focusing on USD 100k-500k in DRC and Central African Republic, fully invested in 2015)
+ Technical Assistance available (not in-house), supported by (partial) grants
+ International and thus perceived as trustworthy
+ After getting financed by XSML SME's find it easier to get bank loans
- On paper starting at USD 250k, but in practice financing below USD 1m is rarely given
- Small number of SME's serviced (35 in the past 8 years)

Government bank (Fonds Promotion de l'Industrie)[10]

+ Grace periods up to 12 months and tenures up to 5 years offered
+ 9% interest, with a 2% discount for female entrepreneurs
+ Can also award (partial) grants, which helps to reduce cost of financing
- On paper a good option, but perceived as less trustworthy[11] because run by the government, has a large portfolio of bad debt due to wrong decisions in the past
- very little support for SME's after getting loans

International private equity funds

+ International funds interested in investing in DRC (Cordaid, Incofin, Persistent Energy Capital, Root Capital, Investisseurs & Partenaires)
- Because they do not have local offices they struggle to find and analyse investment requests
- Sourcing of deals is difficult and expensive, so they focus on larger deals (> USD 2m) only

Development Finance Institutions (DFI's)

+ KfW has a local office and Proparco is intending to open an office in 2019. CDC has investments in DRC

[8] www.kfw-entwicklungsbank.de/Download-Center/PDF-Dokumente-Sektoren-Berichte/2011_01_Congo-Unternehmer_E.pdf
[9] www.xsmlcapital.com
[10] www.fpi-rdc.cd/
[11] There are unconfirmed rumours that SME's are asked to "split" the interest advantage with employees of FPI

- Due to large ticket size these are generally out of reach for SME's, although most (IFC, FMO, CDC, Proparco, Bio, DGGF) are indirectly active as investors in the African Rivers Fund of XSML

Donors

+ Elan RDC had the possibility of giving (matching) grants until USD 500k in specific sectors, combined with mainly inhouse management support but is a programme with a limited time horizon and it is active in a limited number of sectors
+ the World Bank recently announced a USD 100m entrepreneurship support programme[12] (with USD 42m for SME's in a broad range of sectors) in DRC, offering maximum USD 200k matching grants to 500 SME's
- There is a danger that grants will distort the financing market as they are basically "free money" in an environment that due to its risk profile should demand a risk premium for capital
- There are few organisations active locally that can support SME's to become investment ready or that can help them post-investment

3.3 What financing terms do SME's need?

Current sources of financing are limited and those that are available do not always offer terms that are suitable for SME's, especially those that need financing for the purchase of assets. The terms that SME's generally require are:

- Flexible on collateral: many SME's cannot meet current collateral requirements (market average is currently 150% of the loan amount, preferably in real estate). Options to use guarantee funds or to be able to pledge shares are not available, nor are there providers willing to take more risk by reducing the collateral percentage
- Long tenures: SME's operating in sectors other than trade cannot repay investments in the short periods currently required in DRC. Short tenures put very high stress on cash flows
- Grace periods: these are crucial in instances where cash flows lag behind investment such as in equipment
- Low interest: viable SME's, that generally make healthy returns in USD, should be able to pay the current market rates. Partial grants could help reduce those rates but this is not a priority in our opinion

3.4 How is the market for equity investment?

Due to the lack of capital markets in DRC entrepreneurs are not familiar with equity investments and generally do not trust outside investors enough to allow them to become shareholders. This is beside the discussion on valuation, with which there is very little experience with. Scepticism against equity more prevalent in smaller SME's than in the larger ones.

[12] documents.worldbank.org/curated/en/741111531107037545/pdf/DRC-SME-PAD-06122018.pdf

Convincing SME's to accept equity investment in DRC is also time consuming, sometimes delaying signing of deals for six months or more. This time is valuable: with a loan the investor could have started receiving returns.

Finally, again due to the lack of a capital market, selling an equity stake is difficult.

These 3 factors lead us to the conclusion that equity investment, especially in smaller sized SME's, does not seem suitable in DRC.

3.5 What investment readiness and/or post-investment support is there for SME's?

Although the KfW report shows that SME's are willing to pay up to 10% of the loan amount for investment readiness support, Elan RDC's experience shows that it is not easy to be realised and this also does not solve the SME capacity gap to effectively use funds. In 2015 Elan RDC did a trial whereby 2 SME's were supported by external consultants in getting loans from local banks. The intention was that the consultants would be paid a success fee upon approval of the loan. SME's nor banks saw the added value and in the end the consultants were not paid. Although it isn't possible to generalise based on this small trial, further research by Elan RDC has shown that there are a number of restrictions in the BDS market in DRC:

- Consultants are perceived as expensive and not adding value
- Banks prefer to work with SME's directly instead of through intermediaries, as it allows them to analyse their risk more easily
- Business Development Services available in DRC are superficial, mostly limited to business plan writing, less on improving SME capacity, nor linking SME's to alternative/less well-known sources of financing

Having said this, fund manager XSML has proven that being close to investees and supporting them with advice and, if needed, technical support (at 0% interest and sometimes with partial grants) not only provides value, but more importantly still, increases the propensity of entrepreneurs to repay loans and interest that is due.

For true SME growth in DRC, intensive pre- as well as post-investment involvement is required, combined with sources of finance that are tailored to the needs of the SME's.

3.6 Conclusion

SME finance in DRC is currently at an impasse:

- Most financial institutions operating in DRC mention that they have funds available but complain of a lack of "good" SME's to invest in
- At the same time SME's that require funding, especially for investments, complain that there are no viable funding options available to them. This is particularly acute in the USD 100k-1m bracket
- Most SME's are ill equipped/prepared to attract financing. As a result, they are being refused loans
- Local and international investors (PE funds, DFI's) that could possibly assist SME's with capacity building currently focus on larger (>USD 1-2m) ticket sizes

As a result, smaller SME’s that could, with the right support, become interesting companies to invest in later (by funds and/or DFI’s) are not being served. For them, being able to access USD 100k-1m is crucial in order to grow and become eligible for the larger deals that international investors offer. These SME’s are faced with 2 problems:

1. There are no financing options that support especially investments in assets (which require longer maturities and possibly grace periods in order to be applicable for them)
2. Even if financing options would be available most SME’s would need technical and managerial assistance to become investment ready

4. Financing solutions for SMEs in DRC

As we have shown in the previous chapter, SME's in DRC are in need of 3 things in order to grow:

- More sources of finance, especially in the USD 100k-1m range
- Financing terms that are conducive to SME's seeking funds for investment in assets (longer tenures, grace periods, flexible collateral)
- Technical and managerial assistance pre- and post-investment

This combination currently does not exist in DRC and will need to be created in order to become available.

4.1 What is the DRC government doing to address this need?

The DRC government has no programmes targeting SME financing. Its development bank, FPI, seems to be operating independently to the SME ministry (Office de Promotion des Petites et Moyennes Entreprises Congolaises OPEC), which has no funds at its disposal. It isn't clear if there is enough political will to make FPI and OPEC more effective.

The cabinet of the new president is still under formation, so it is still not clear what policy changes will be made, although with the large number of issues on the administration's plate chances that SME finance will be a focus area are slim. Having said that, there are signs that Congolese diaspora with fund management experience are in discussion with the new president on the creation of new investment funds. Nothing concrete has been announced as yet.

Currently all hope seems to be pinned on the new World Bank project (see previous chapter under donors), although it remains to be seen how effective this will be. A 5 year project can hardly be enough to transform SME financing in the long run.

4.2 What about industry bodies?

There are 2 industry bodies that have critical mass and national presence in DRC: the Federation de Entreprises du Congo (FEC) and Confederation de Petites et Moyennes Entreprises du Congo (COPEMECO). FEC has been criticised for focusing too much on the needs of large corporates and charging annual fees that are too high for SME's (USD 500). COPEMECO on the other hand misses clout, seems politicised and is not perceived as being effective for its members.

Neither FEC nor COPEMECO were able to provide Elan with statistics on SME's in DRC, nor analyses of their needs. It is not realistic in our opinion to expect these bodies to push for solutions, although they could assist new fund managers in reaching out to entrepreneurs.

4.3 The role of commercial banks

Commercial banks are ideally placed to provide solutions for SME’s in DRC. Some have received capital injections from DFI’s for this reason, however they are notoriously risk averse. Recent bad experiences of BOA and Rawbank in SME financing as well as the bankruptcy of FI Bank and BIAC have made banks even more wary.

It is possible that the election of the new president could open up the finance market, but that remains to be seen and most probably will not give SME’s the conditions they need.

4.4 Regional focus or national?

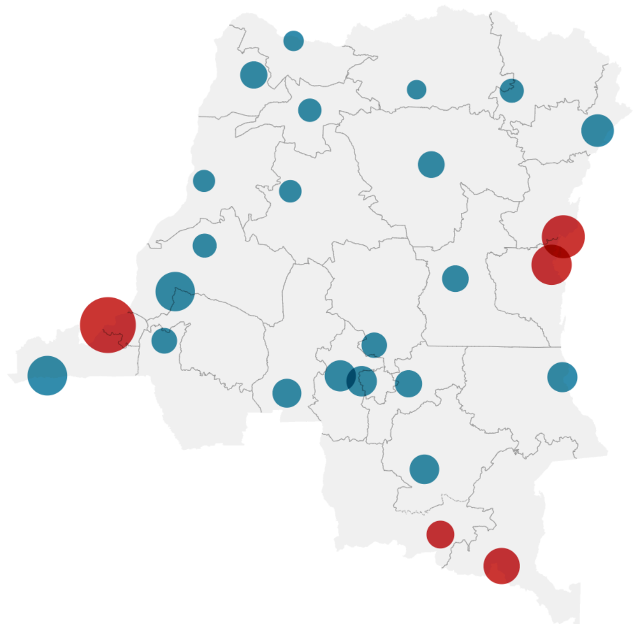
One of the aspects to consider is if a new investment vehicle should have a regional or national focus.

As we have explained before there are 3 economic zones in DRC, where most of the population is also concentrated:

- Kinshasa and surrounds (Kinshasa province: 13% of the total)
- The mining region of Old Katanga (Lubumbashi and Kolwezi: 8% of total)
- North and South Kivu (Goma and Bukavu: 15% of total)

DRC population 2015 by province

in red centres of high economic activity



Province	Population 2015	%
Kinshasa	11,575,000	13%
Nord-Kivu	6,655,000	8%
Sud-Kivu	5,772,000	7%
Kongo Central	5,575,000	6%
Kwilu	5,490,000	6%
Haut-Katanga	4,617,000	5%
Ituri	3,650,000	4%
Kasaï-Central	3,317,000	4%
Kasaï-Oriental	3,145,000	4%
Tanganyika	3,062,000	4%
Haut-Lomami	2,957,000	3%
Kasaï	2,801,000	3%
Lualaba	2,570,000	3%
Sud-Ubangi	2,458,000	3%
Lomami	2,443,000	3%
Tshopo	2,352,000	3%
Maniema	2,333,000	3%
Kwango	2,152,000	3%
Sankuru	2,110,000	2%
Haut-Uele	1,864,000	2%
Maï-Ndombe	1,852,000	2%
Mongala	1,740,000	2%
Tshuapa	1,600,000	2%
Équateur	1,528,000	2%
Nord-Ubangi	1,269,000	1%
Bas-Uele	1,138,000	1%
TOTAL	86,025,000	

Map: B. Zuidberg • Source: INS RDC • Get the data • Created with Datawrapper

SME investment, especially in smaller ticket sizes, requires intensive collaboration in the preparation phase. Maintaining close relations with entrepreneurs after signing deals is equally critical.

Sourcing deals and maintaining close relations with SME entrepreneurs in all 3 economic zones will require either local offices, or frequent travel from a central office (which would be in Kinshasa). Disregarding whether it will be possible to find staffing for local offices, significant costs will be incurred either way[13]. Whether these costs can be recuperated from clients will depend on two factors:

- Whether the costs can be reduced as much as possible through standardisation
- The size of fund and its agreement with investors on compensation

If the fund is small (less than USD 20m) it seems sensible to limit operational expenses by focusing on Kinshasa province and acting opportunistically on leads from other zones.

4.5 How to organise investment readiness and post-investment support?

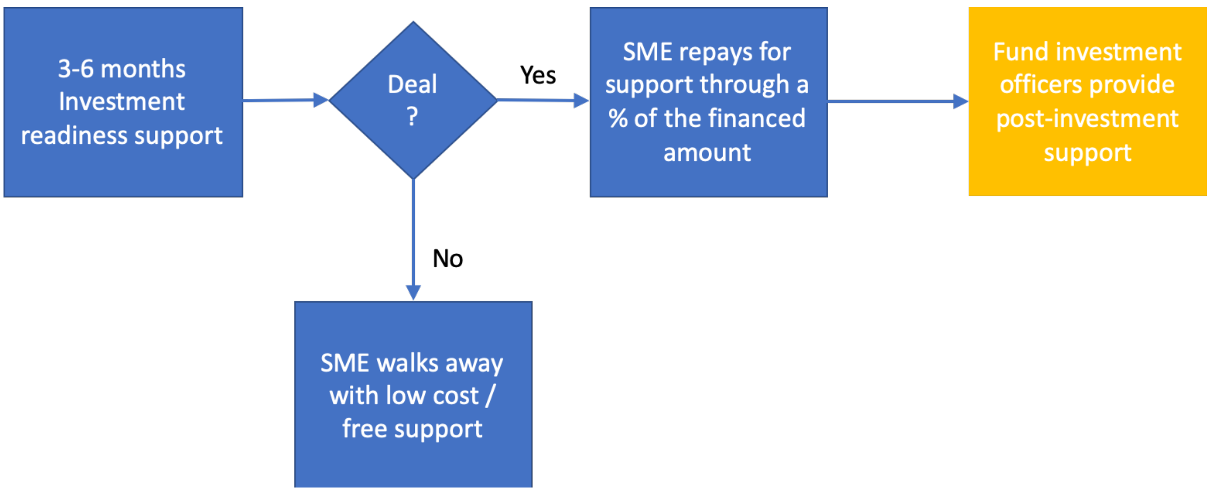
As illustrated in the previous chapter, SME's in DRC need substantial investment readiness as well as intensive post-investment support.

It is to be expected that a fund will be responsible for delivering the necessary assistance post-investment, with a focus on accounting & finance, strategy, and governance, providing the necessary support for companies to reach their milestones and projected growth.

Most investee companies, however, will need substantial pre-investment support to get to the point of being investment ready. This process can take anywhere between 3 and 9 months depending on the maturity of the SME and requires a wider range of skills than the typical investment team is capable of, also adding marketing, operations, HR, and ESG standards.

Pre-investment support will not always guarantee that an investment will be made (success rates of 25-50% are normal in the industry, depending on the effectiveness of the selection process), so arrangements must be made for the event of a no-deal. It will be difficult to recuperate all costs incurred, but a portion could be. This is a matter of negotiation.

If the SME is accepted by the fund, the pre-investment work must be paid for. This could be through a deduction of a pre-determined sum from the investment amount, or by a payment over the course of the investment tenure.



[13] A economy return flight from Kinshasa to either Lubumbashi or Goma is 700 USD

If the SME is not accepted by the fund it walks away at no cost, with a due diligence report in hand that it can use to prepare itself for future financing.

In any case, because the nature of pre- and post-investment support is so different, as well as to clearly separate duties, it would be good create separate entities for both activities:

1. The investment readiness activity could be formalised as a non-profit activity, that can provide services to the fund as well as for other clients if needed. Being a separate entity will possibly allow for separate funding, by funders that are not necessarily interested in the investment fund itself
2. The fund, which has financial as well as non-financial (impact) goals, can then focus on companies that have actually received financing

In order to reduce expenses for investment readiness support as much as possible, standardisation of methods will be needed, while avoiding a "cookie-cutter" approach.

Doesn't this support already exist?

Investment readiness support is scarce in DRC:

- Congo Invest Consulting in Kinshasa[14] is mainly focused on larger deals and assisting foreign companies to enter the DRC and find local partners / start their operations
- Elan partner Ensemble Pour la Difference[15] has a similar setup to the one described above but is based in Bukavu and has a local focus

Support along the lines as described in the previous paragraph does not exist in Kinshasa and Lubumbashi.

4.6 Solution 1: creation of a DRC based investment fund

The first solution is the creation of a DRC based investment fund, much like the original CASF fund of XSML:

- Fund size approx. USD 20m (it is unlikely that the market can currently absorb larger amounts)
- Broad sectorial portfolio
- Focus on main economic zones (Kinshasa, old-Katanga, North and South Kivu provinces)
- USD 100k-1m ticket size
- Primarily loans, revenue share and equity on the basis of opportunity and entrepreneurs' maturity
- Tenure: 3-5 years
- Grace periods up to 12 months
- Commercial interest rates (similar to commercial banks)
- Local office(s) for deal sourcing, monitoring, relationship management and (possibly) technical and managerial assistance

[14] http://www.congo-invest.com/
[15]

There are, however, a few problems associated with this model:

1. *Fund management*: there are no experienced fund managers available locally and finding local *first fund managers* that are credible enough and able to raise USD 20m is unlikely
2. *Investors*:
   a. local investors are impatient and used to high returns, which they normally achieve in real estate (>30% per annum).
   b. International private investors have not shown interest in DRC and recent downgrades in investment rating for DRC will not help.
   c. DFI's (as described in the previous chapter) require multi country approaches, minimum investments of USD 10m and max 20% share (effectively requiring a USD 50m fund).
   d. Family offices and foundations generally limit their investments to lower (USD 0.5-2m) amounts, making a USD 20m fund difficult.

   In short, finding USD 20m is difficult
3. *Returns*: using traditional fund structures with fixed horizons and management fees for a small fund in the DRC does not make sense financially for either the fund managers or the investors. Having a local office covering the 3 economic zones is expensive, having 3 offices is even more expensive, with the added complication of finding qualified staff. Loan default rates > 10% should be expected. XSML management confirmed that their first fund CASF did not create high enough returns for XSML to continue being active in the lower end of the market. In order to satisfy the return requirements of their investors XSML have increased their deal sizes
4. *Technical and managerial assistance*: providing this is expensive, especially at small scale in a market lacking service providers and with a wide portfolio and large geographic footprint

We see two solutions to this address these 4 problems, which were also suggested in the IFC report[16] of November 2018 on their experiences investing in fragile states:

- The Iungo Capital model
  Move towards a permanent capital vehicle (a holding) with a separate entity for investment readiness support, with focus on one economic region only.
  This allows first fund managers to approach family offices and foundations for smaller investments or loans and build track record with the smaller amount. Possibly, donors or other investors would be willing to support the investment readiness entity.
  As they prove that they are capable, the permanent structure allows the fund managers to approach additional investors, gradually increasing the fund size and possibly the territorial focus. This gradual increase relieves them of the pressure to raise a lot of funds which must then be invested very quickly. It also allows for a yearly discussion with investors on the budget of the organisation, depending on the actual activity of the holding. Discussions on the budget of the investment readiness support can be separated from those of the fund

[16] https://www.ifc.org/wps/wcm/connect/f086c783-0f7d-4d53-b5d0-73c7492a4230/IFC+SME+Ventures+in+African+FCS_21+Nov+2018_low+res+FINAL.pdf?MOD=AJPERES

- The Grofin / BPI model
  Convince an existing pan-african investment fund to include the DRC in their operations. The fund could open a local office and gradually increase its local portfolio, using existing back office and technical + managerial assistance tools that it is already using elsewhere to reduce cost. Examples of this are Grofin and BPI. The fact, however, that these players have chosen to stay away from DRC, even after the heralded success of XSML[17], is an indicator that as yet they are not ready for a DRC entry

4.7 Solution 2: Donor programs targeting SME finance

An alternative to the creation of an impact investment fund would be the creation of a donor advised fund (DAF) that supports SME growth in DRC through a double-sided approach: an investment readiness program, coupled with a returnable capital vehicle that gives out loans/takes equity in businesses in regions and sectors that form the focus of the contributing donor group. Generally, DAF's are more focused on non-financial impact, which would be a good fit with DRC, where financial returns of small funds will be difficult (for reasons previously mentioned).

This is a growing field of interest for donor organisations (family offices, foundations and government donor organisations alike) as they move away for charity and grants towards returnable grants and impact investment[18].

The involvement of donor organisations seems a promising prospect, however during the research of this study international government donors active in DRC (DFID, AFD, GIZ, Enabel, JICA) have not indicated that they will be moving in this direction, leading us to believe that it is not realistic this will happen anytime soon.

[17] https://peafricaevents.com/2018-winners/
[18] https://thegiin.org/assets/2018_GIIN_Annual_Impact_Investor_Survey_webfile.pdf

5. Glossary

BDS Business Development Services

BMO Business Member Organisation

COPEMECO Confederation de Petites et Moyennes Entreprises du Congo

DFI Development Finance Institution

FEC Federation de Entreprises du Congo (industry BMO)

FPI Fond de Promotion de l'Industrie (DRC government development bank)

PE Private Equity

SME Small and Medium Enterprise, having 11-250 employees and … annual turnover, in this document specifically those that have been formalised and that seek financing of USD 100k-1m