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Risk capital funds formed with host country bank/NBFI partners

Mongolia
Lawrence Camp
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Project Summary

Elevator Pitch

Concise Summary: Help us pitch this solution! Provide an explanation within 3-4 short sentences.

Provide a source of domestic risk capital in partnership with host-country banks/NBFIs. Senior debt for SMEs is available, but maturities remain short and interest rates and collateral requirements high – a constraint to longer-term productivity investments. We provide low-coupon, longer-term financing to augment senior bank debt for capital investment

About Project

Solution: What is the proposed solution? Please be specific!

The Growth Capital Funds provides a holistic approach to the financing requirements of start-up businesses and fast growing SMEs. There is a dearth of longer-term local currency risk capital and corporate finance capability in developing countries, and thus it is extremely challenging for entrepreneurs and rapidly growing SMEs to access financing for productivity investments – investments which typically have longer-term repayment requirements. On the supply-side, the Fund will establish financing facilities in developing countries to provide longer-term, low-coupon, and (when and as needed) subordinated debt to high-potential entrepreneurs and rapidly-growing SMEs. These financing facilities will be established in partnership with and largely capitalized by host-country banks and NBFIs. It will build their capacity to provide a wider range of financing instruments and corporate finance services targeted to entrepreneurs and SMEs. On the demand-side, it will utilize its participating bank and NBFI client bases to identify high-potential clients. It will ensure that these enterprises are supported with business advisory services and specialized technical assistance to ensure their successful growth. The Fund will incorporate best practices for high-potential SME financing, including introduction of competitions and prizes, use of longer-term financing instruments with the repayment/returns back-ended, and monthly reporting through a simplified financial management system. It will network its clients internally and externally. Internally the network provides B2B opportunities, domestic advisory support from other local businesses, and a voice for advocacy on entrepreneurship/SME issues. Externally clients will be able to access a network of investors and non-investor volunteer mentors with industry specific expertise.

Impact: How does it Work

Example: Walk us through a specific example(s) of how this solution makes a difference; include its primary activities.

Each $5 million financial facility will generate a total of $66 million in additional investment (investment which would not have occurred otherwise) over 10 years. Assuming that $15,000 of investment results in one job created, each $5 million facility will directly create 4,402 jobs. Assuming one job improves the livelihood of a five person family, each $5 million facility will have a direct impact on 22,000 people. Of course, the real impact will be significantly larger due to: (i) the multiplier effect of $66 million in investment, and (ii) the skills transfer which will take place and the demonstration effect which will launch similar funds.

About You

About You

First Name

Lawrence

Last Name

Camp

Website
Your Organization
Country

About Your Organization

Organization Name
Organization Phone
Organization Address

Organization Country
Organization Type

The information you provide here will be used to fill in any parts of your profile that have been left blank, such as interests, organization information, and website. No contact information will be made public. Please uncheck here if you do not want this to happen..

Your solution

Country your work focuses on
If multiple countries, please list them here. If your solution targets an entire region, please select it below
Region(s) your solution focuses on:

Africa, Europe and Central Asia, Latin America and the Caribbean, Middle East and North Africa, South Asia.

Range of turnover in your target firms, in USD

Less than $1 Million, $1-5 Million.

Average turnover in USD of your target firm

$2 million

Number of employees in your target firms

5-24, 25-49.

Average number of employees of your target firm

25

Specify the size, average and range of expected loans or investments in each target firm

The average size loan would be $100,000 and the range would be from $50,000 to $300,000.

What stage is your solution in?

Idea phase

Innovation

How does your proposed innovation leverage public intervention in catalyzing private SME finance?

While the Growth Capital Fund will predominately be funded by host-county bank and NBFI partners, its impact will be significantly greater and can be brought up to scale more rapidly with public support, which could include:

- A small level of grant funding to support launch and first two years of the financing facility until it becomes fully self-funding.

- The ability to access partial guarantees and other risk mitigation measures in order to increase the willingness of investors and host-country banks and NBFIs to participate.

- Support from donor and IFI funded business development services (BDS) providers to prospective clients in: (i) developing business plans and loan request packages; and (ii) implementing the financial management system.

- Support from volunteer organizations such as the International Executive Service Corps (IESC) to link experienced business professionals and industry specialists with client companies.

- Support from trade development organizations to new domestic, cross-border and global markets for client businesses.

What barriers does your proposed solution address?

Asymmetry of information, Lack of collateral, Lack of financial capacity, Lack of SME access to skills / knowledge / markets, Unavailability of financial products tailored to SME needs, Lack of institutional capacity of financial intermediaries, High transaction costs for financial intermediaries to serve SMEs, Underdeveloped local capital markets (term local currency funding, exit options for SME equity).

If you checked any of these barriers, describe how your solution addresses them

It addresses all of the barriers which developing country entrepreneurs and SMEs face in accessing the financing needed to longer-term capital investment.

It addresses the barrier of collateral and insufficient capital which constrains otherwise viable investment projects from being developed. Banks are often willing to extend credit for what they consider to be a viable investment, but generally limited to not greater than 50% of the fair market value of the collateral – for example, on a $200,000 cold storage unit, a bank might lend $100,000 collateralized by the unit. However few farmers or small rural entrepreneurs have cash to fund the additional $100,000, or the sufficient additional collateral to pledge for that amount. The Growth Capital Fund will provide subordinated debt to bridge the gap between what the project developer can contribute and the bank can lend and on terms which will allow for bank repayment first.

It addresses the tenor barrier of lack of access to longer term financing. Assuming the cold storage unit will take a year to start cash flowing and has a repayment projection of six years; it requires a source of patient, longer-term financing.

It addresses the pricing barrier. Spreads on senior secured bank loans tend to be high in developing countries, and the spread on junior unsecured debt (if available) would be excessively high (beyond the capacity of most capital investments to service). The Growth Capital Fund provides for a low coupon in the early stages (when the bank debt is being serviced and repaid), and rising in line with the cash flows and capacity to service.

It addresses the capacity barrier of limited corporate finance skills. Participating banks and NBFIs would be encouraged to rotate their best and brightest officers to the Growth Capital Fund where they would receive training and hands-on support with transaction structuring.

It addresses the capacity barrier of limited formal business education and skills among entrepreneurs and small business people, but ensuring access to business skills training, BDS providers, and mentoring by senior experienced businesspeople and industry specialists.

It addresses the information asymmetry and financial literacy barrier faced in developing country businesses (and in privately owned and operated firms in general) though introducing a standard template for financial and managerial reporting which has been specifically developed for SMEs. This template provides a financial management tool (actually a rudimentary MIS) as well as a monthly, quarterly and annual financial reporting system.

Impact

Provide empirical evidence of your proposed solution's success/impact at present. If your project is in the idea phase, please provide evidence that speaks to its potential impact

There is a strong track record of success in providing subordinated/mezzanine debt to developing country medium size businesses on the part of entities such as Business Partners and SEAF. A key innovation of the Growth Capital Fund is to engage host-country banks and NBFIs as the investors, fund managers and intermediaries (thereby driving down the transaction costs) and to serve SMEs. A number of projects have proven successful in developing local domestic capacity to intermediate and manage funds, including USAID's American Bank of Kosovo, Khan and Xas Bank in Mongolia, and any number of on-lending facilities in which donor/IFI funds have been channeled through domestic banks. The Growth Capital Fund builds upon the experience of developing banking capacity for on-lending of funds, and extends it to developing corporate finance capability for more sophisticated financial transactions at the SME level.

How many firms do you expect to reach?

The approach is scalable. $5 million in the financing facility (primarily funded by participating banks and NBFIs) will produce $19.8 million in risk capital loans over 10 years and assuming an average risk capital loan size of $50,000 this equates to almost 400 firms.

What is the volume of private SME finance you aim to catalyze?

The $5 million will leverage $33 million in senior bank financing (assuming bank debt 50% of the investment) and $13 million of equity. Again the $5 million would be predominately provided by host country bank and NBFI investors. The seed investment is small and resulting leverage much greater.

What time frame will be required to reach these targets?

The financing facility (the local in-country operating unit under the Growth Capital Fund) would be operational within 3 months of launch. Each financing facility is expected to have a life of 10 years but could be extended.

Does your solution seek to have an impact on public policy?

Yes

What would prevent your solution from being a success?

Lack of seed funding. Poor execution.

Sustainability

List all the funding sources that are required for the sustainability of this solution

Funding will come primarily from investors and from participating host-country banks and NBFIs. Initial grant funds would be required to support launch and first two years of operating expenses of each financing facility.

Demonstrate how your proposed solution has the capacity to graduate from dependence on public finance. What is the time frame?

Public finance would be utilized only for launch and start-up costs and each facility would be expected to be fully self-sustaining within two years.

Demonstrate how your proposed solution will survive a potential loss of its largest private funding source

The proposed approach has elicited strong commit for investment by developing country banks and NBFIs as well as local national investors. We believe that there are numerous potential investors and accordingly will limit participation with the objective of engaging a broad number of investors and funding sources. As such, the loss of one funding source would not be an issue.

Please tell us what kind of partnerships, if any, could be critical to the greater success and sustainability of your innovation

The Growth Capital Fund hinges upon partnerships with developing country banks and NBFIs (who will be the primary investors in the financial facilities. Also important will be partnerships with donors, IFIs and foundations which can provide support through risk mitigation instruments and innovation grant. Finally, partnerships with NGOs and volunteer organizations such as MBA Corp, FSVC and IESC which can provide advisory services to the financial facilities and to clients.

Are there non-financial issues that could threaten the sustainability of your proposed solution?

Approximately 300 words left (2400 characters).

Please tell us if your proposed solution aims to scale up through a high growth sector, expand immediately to multiple sectors, and/or scale up geographically

The proposed solution would seek to scale up geographically. Financing facilities would initially be established in five countries as pilots, each with a slightly different business model. At the close of the first year and assessment would be conducted, and based upon to findings and lessons learned of that assessment, the model would be refined. The target would be to roll out five new financing facilities annually for the first three years.