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RECOMMENDATIONS FOR A SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

FINAL REPORT

Bureau for Global Programs, Field Support and Research
U.S. Agency for International Development

Prepared for: *Office of Operations & New Initiatives, Bureau for Africa*

Prepared by: *The Services Group*
and
Coopers & Lybrand

Sponsored by: *Private Enterprise Development Support Project II*
Project Number 940-2028.03
Contract Number PDC-2028-Z-00-7186-00
Prime Contractor: Coopers & Lybrand

June 1994

Coopers
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Prepared for: *Office of Operations & New Initiatives, Bureau for Africa*

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Southern Africa Enterprise Development Fund

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ACRONYMS

ADELA	Atlantic Development Group for Latin America
ANC	African National Congress
BPED	Botswana Private Enterprise Development
CDC	Commonwealth Development Corporation
EDESA	Economic Development for Equatorial and Southern Africa
LAAD	Latin America Agribusiness Development
NAFCOC	National African Federated Chamber of Commerce
NAIC	National Association of Investment Companies
NIS	Newly Independent States
PID	Project Identification Document
SAEDF	Southern Africa Enterprise Development Fund
SBIC	Small Business Investment Company
SIFIDA	Societe Internationale Financiere pour les Investissements et le Developpement en Afrique
SME	small- and medium-size enterprise
TOR	terms of reference

D

Southern Africa Enterprise Development Fund
(SAEDF)

Definition of Terms

<u>Carried interest</u>: An incentive compensation tool used by U.S. venture capital funds wherein an ownership stake in investments made by the fund is allocated to fund management. Typically results in cash compensation only if investment is successful. Often represents more than 75 percent of Management's total compensation. Typically vests over time that management works with fund.

<u>Cross-border investment</u>: A joint venture between investors from more than one country in the region, in a production or service facility in one of the countries of the region.

<u>Equity</u>: Basic risk capital of a business, exposed to all the risks and rewards involved in ownership. There is no obligation to repay capital invested as equity.

<u>Financial sustainability</u>: Beyond its initial capitalization, the Fund pays its own way, i.e., it is commercially viable and does not require ongoing subsidy to continue operations.

<u>Franchising</u>: Franchisor develops business concept and standardized operating procedures. Sells or leases license to replicate concept and provides management support services to individual franchise owners.

<u>Fund</u>: Southern Africa Enterprise Development Fund, or SAEDF. The Fund region encompasses Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

<u>Debt</u>: An obligation to repay a stated amount plus a fixed amount of interest over a given period under agreed upon conditions.

<u>Direct investment</u>: Investing in a target group firm or company, without going through an intermediary.

<u>Hurdle rate</u>: The minimum projected rate of return an investment opportunity must meet to qualify financially as a possible portfolio investment. Also called threshold.

<u>Indirect investment</u>: Investing in an intermediary financial institution (e.g., leasing company; commercial, merchant, or development bank; venture capital fund, etc.), which in turn invests in the target group.

<u>Leasing</u>: A method whereby enterprises gain access to expensive equipment difficult to finance through banks and other traditional means. Lessor retains ownership to equipment and receives periodic payments for its use from lessees. Equipment can be re-possessed quickly in case of non-payment, reducing creditor's risk, thereby improving access for entrepreneurs.

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Leverage: At least three types of leverage -- financial, technical, management.

Financial leverage is using one pot of money to attract additional money. Such leverage could occur at three levels with a regionally managed Fund -- at the Fund level, the financial intermediary level (indirect investment), and the operating company level (direct investment).

Technical leverage is using the Fund's structure, expertise, management network, and financial participation to attract additional skills to the investees operation. Such leverage could result in no- or reduced-cost technical assistance.

Management leverage is using management's expertise and success to attract additional risk money through the creation of parallel funds that are managed by existing management or those trained by them.

Quasi-equity: Loan that gives the lender the potential to share in equity gains or an equity instrument that involves a fixed return.

Return on investment: For purposes of the SAEDF, it is measured as a combination of financial sustainability and development impact.

Technical assistance: Could take two forms -- 1) Targeted, deal specific training, the cost of which is part of the initial investment; 2) general training that enhances the potential deal flow for the Fund, i.e., it serves to further develop the investment market for the Fund.

Treasury funds: Liquid assets owned by a fund temporarily held in passive, income-generating investments while awaiting placement in active portfolio investments.

Unbundling: The selling-off by a company of certain functions. Often such sales are to the existing management group of the function in question, in which case the unbundling is also called a management buy-out.

Venture capital: Growth-oriented, long-term risk money that can take a variety of forms, e.g., equity, quasi-equity, and debt are all part of the investment tool kit. It provides long-term financing and tailored, intensive management support to increase the likelihood that the investees potential is realized. To succeed as a business, venture capital must bring both financial and human capital to the process of business development. As a business, it is a fairly specialized area of the financial services industry.

EXECUTIVE SUMMARY

Southern Africa Enterprise Development Fund

In March 1994, USAID requested a team of consultants to recommend a structure for an enterprise fund to provide a range of financial services to 11 countries of Southern Africa. The recommended structure was to possess certain attributes. First, it should support the development of private enterprise, in general, and it should help provide business skills and business ownership to people previously lacking these things. Second, the fund should be financially self-sustaining. Third, it should help to foster regional economic integration.

In response, the team recommends an independent, non-profit entity, structured to emulate an American-style venture capital fund and similar, in many respects, to the enterprise funds supported by the U.S. government pursuant to the Support for Eastern European Democracies Act of 1989.[1] Venture capital, by its very nature, provides both capital and technical assistance, and can be extremely flexible in providing a range of services to a range of countries. At the same time, venture capital, is structured to be financially self-sustaining -- all of its activities are focused on the objectives and efficient in the use of funds.

Three important principles will likely determine the success of the proposed fund:

- A fund must be independent, able to make its own investment decisions and to determine the nature of its own operations without undue external regulation and constraints.
- A fund must be managed by experienced venture capital investors with a commitment to economic development.
- The capitalization of a fund must be unconditional to ensure its independence and longevity. The amount of unconditional funding must be enough to enable financial self-sufficiency.

Given these attributes, an enterprise fund in Southern Africa can be expected, over time, to have a development impact, contribute to increased intra-regional economic relationships, and become financially self-sustaining.

Project Environment: Southern Africa represents the brightest potential for an enterprise fund on the African continent. The region is changing fundamentally -- for the better. Democratic elections, including the historic one in South Africa, are taking place across the region. Monetary and fiscal management have improved due to structural adjustment programs. Socialism is generally on the wane, and investment regulations and incentives have been reformed to better

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[1] The team understands that there is interest in standardizing the structure of the existing Eastern European and NIS funds. The team is not aware that this standardization would necessarily apply to all funds established with USAID assistance. Given this, the team sought to design a fund for Southern Africa that encompassed basic features and tenets of U.S. funds, while balancing development impact with financial self-sustainability. However, certain features may not mirror the standard structure under consideration.

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support private enterprise. Currency exchange and trade restrictions have been greatly liberalized. Most countries in the region share the English language and English law.

The need for an enterprise fund is real. The region varies from the very poor economies of Mozambique to the relatively wealthy ones of Zimbabwe and South Africa, with many in-between like Swaziland and Tanzania. Even the wealthier countries, however, have large segments of the population without access to capital and business expertise. The region's economic output is dominated by South Africa, and concerns are growing that, absent economic growth throughout the region, South Africa could become the new colonialist. An even larger concern exists that without economic improvement in the lives of the majority of the population, the progress made to date may be reversed.

<u>Constraints</u>: Many of the business conditions that exist today in Southern Africa have roots in either apartheid or socialist economies -- and before that, in colonialism or traditional, agrarian societies. These systems have created a web of practices and conditions that restrict access to financial capital and business know-how among large segments of the population. Among the constraints retarding growth of the private sector are:

- Limited capital or limited access to the capital that does exist.
- Limited human resource/management capacity.
- Inappropriate business regulations and policy environments.
- Poor physical and business service infrastructures.
- Lack of market-driven mentality.
- Poor competitive positions and low productivity.

While donor agencies are working to address these constraints, few donor interventions have taken a regional perspective in so doing. Yet, on a regional basis, the four basic elements of entrepreneurship exist -- i.e., people, markets, capital, and support organizations. The latter two elements, however, are frequently not attracted to the first two; thereby, not creating the right conditions for successful and sustained entrepreneurship. By supplying venture capital and venture capitalists, the SAEDF will be able to bring the capital and support organization elements of entrepreneurship together with people and markets to establish the right conditions, on a selected basis, for entrepreneurship to develop and grow.

<u>Objectives</u>: An opportunity for innovation exists in providing capital and management services through a regional venture capital or enterprise fund model. Venture capital is the business of developing businesses. Its financial sustainability -- its success -- depends wholly upon the success of its investment efforts. As such, it is an ideal mechanism for delivering financial services tailored to a country's and an enterprise's particular needs.

The proposed Southern Africa Enterprise Development Fund (SAEDF) would invest financial and human capital in business opportunities throughout the region. Its mission is as follows:

> Through the innovative and sustainable provision of long-term risk capital and management assistance to those previously lacking access to such, the SAEDF will increase and broaden throughout Southern Africa: 1) private sector participation in the economy; 2) business ownership; 3) employment opportunities; and 4) business development skills.

The Fund's objectives are threefold:

- To have development impact, defined as increasing business ownership, skills, and employment opportunities, within a target group characterized by a lack of access to capital and expertise.
- To be financially self-sustaining wherein beyond its initial capitalization the fund may reasonably be expected to generate sufficient profits to continually re-invest and cover its operating costs for the foreseeable future.
- To promote intra-regional economic activity and inter-dependence.

Guiding Design Principles: To accomplish these objectives the proposed model customizes critical aspects of a U.S. venture capital structure to address the development objectives of the Fund, without undermining the basic tenets of private enterprise investing. The Fund's guiding principles are based on lessons learned from a study of USAID and other enterprise funds throughout the world, as well as the team's more than 60 years of combined investment and development experience. They are:

- Independence of the Fund to make investment and operational decisions with a minimum of regulations and oversight.
- Non-conditional capital in an amount sufficient to achieve, after a minimum of five years, financial self-sustainability and a noticeable development impact.
- Management experienced in risk capital investing and economic development, and demonstrating commitment to the objectives of the Fund.
- Local presence in order to know the investment environment, make sound investments, and manage these investments.
- Flexibility to respond to varied and changing business conditions and needs of the target group.
- Patience to stay the course through a long-term commitment and reasonable expectations as to the impact of a fund.

Proposed Structure: These design principles guided the team in crafting a structure which includes the following:

- A U.S. non-profit corporation, with an independent Board of Directors.
- A selection process and selection criteria for the Board and for management that includes private venture capitalists with knowledge of and commitment to development issues.
- Non-conditional funding of $100 million over five years.
- A regional presence, with the ability to achieve a local presence as needed.

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- Return to investment criteria that considers the need for a positive financial return and real development impact.

- USAID non-voting participation on the Board of Directors and a Mission-derived list of development objectives.

Hypothetical financial projections indicate that the Fund can be sustainable while contributing significantly to private sector development and intra-regional trade. At a $100 million capitalization, the Fund will be a prominent example of private enterprise support. Properly structured, the Fund could become an innovative and successful model, guiding the future course of private sector development agencies for years to come and encouraging private investment capital in Southern Africa.

I. INITIATIVE FOR SOUTHERN AFRICA -- REGIONAL FINANCIAL SERVICES

A. Background

USAID's Initiative for Southern Africa seeks to address a broad range of development concerns. Its objectives include strengthening individual economies and working to enhance regional cooperation and integration. Under the broader heading of regional economic integration are such supplemental goals as assisting the growth of small and medium sized enterprises (SMEs), creating jobs, empowering local entrepreneurs who have historically lacked access to investment capital, and building a private sector capable of serving as the engine of growth.

During the months of October to January 1994, USAID consultants carried out a prefeasibility study to examine the American Enterprise Fund structure as a model for addressing these needs in the southern African region. This model, as developed in Eastern Europe and the Newly Independent States (NIS), creates a venture capital fund which works in conjunction with local financial institutions to make available long-term capital to indigenous SMEs on a profit-driven basis.

These consultants reviewed the experience with the design and early implementation of the Eastern European, NIS, and African venture capital funds, as well as the experience of the Specialized Small Business Investment Companies (formerly Minority Enterprise Small Business Investment Companies) in the United States; assessed the appropriateness of these models for Southern Africa; and, in November 1993, conducted a brief, two week field assessment in six selected countries -- South Africa, Zimbabwe, Zambia, Botswana, Mozambique, and Swaziland.

The study concluded that, while the experience with the Eastern European and NIS funds was still limited, the funds were having an important development impact in the countries where they had been established, and that an enterprise fund in southern Africa could have similar development potential were the basic model appropriately adapted to the needs and economic conditions of the countries in the region. Specifically, the study recommended a regional fund -- as opposed to country-specific funds -- to serve the eleven countries of the region, and that the fund encompass a training and technical assistance component for African-owned SMEs.[1]

B. Terms of Reference

The consensus TOR, for this the second stage of the design effort, incorporates field and USAID/ Washington reviews and critiques of the aforementioned pre-feasibility study. The final TOR is shown in Annex A, while Annex B presents a one-page summary of the design team's experience. The essence of the TOR focuses on the "design [of] a regional umbrella [financial services] program which would allow for the development of tailored country programs responsive to the unique constraints and opportunities in each country."

The team was asked to design a regional fund structure that would have the <u>flexibility to adapt the delivery of financial services to the particular nuances of eleven different countries</u> in order to promote and invest in enterprise development in these countries. In addition, the same fund would need to <u>be self-sustainable</u> and should be open to the possibilities of <u>leveraging U.S. government</u>

[1] See the document titled "Report on Proposal for Southern Africa-American Enterprise Fund," prepared for USAID by Harvey & Company, January, 1994.

funds. In short, the team was requested to design a fund that balanced profitability with development impact.

C. Methodology

This technical report is the output of the engagement. It is intended to provide input to USAID/Washington in writing the Project Paper. The team's approach to designing a regional financial services project incorporated the following elements:

- Build on previously completed work.
- Review past experience with risk capital funds operating in developing countries.
- Undertake a field mission to meet with USAID representatives, investors, entrepreneurs, bankers, etc. from South Africa, Swaziland, Tanzania, and Zimbabwe.
- Meet with USAID private sector officers, or their representatives, from USAID Missions in Southern Africa.
- Bring to bear the team's own significant experience with risk capital management both in the U.S. and in developing countries.

A list of people contacted is included in Annex C. Annex D contains a bibliography of documents reviewed.

II. THE PROJECT ENVIRONMENT

The existence and appropriateness of various broad, business climate conditions (external factors) and a proper mixing of business elements (internal factors) are necessary to stimulate and support private enterprise development. This section reviews these factors, at a general level, and then relates them to the particular case of Southern Africa.

A. Precipitating and Sustaining Conditions for Private Enterprise Development

Entrepreneurs and the enterprises they form are at the center of the economic development process in industrialized and developing countries alike. In the United States, researchers have found that venture capital-backed companies have made a disproportionately large contribution to local, regional, and national economic development not only in terms of new services and technologies but also in terms of jobs created, corporate and individual tax revenues, employee income, and export sales. These findings have contributed to the growing focus on venture capital as a potential tool for achieving development objectives in developing countries, where financial markets and sources of capital to back entrepreneurial ventures are very limited.

The basic factors in the enterprise development process may be organized into two groups: external and internal. Government policies, societal values, institutions and location/infrastructure are the external factors that determine the environment, within which people, capital, market opportunities, and support organizations -- the internal factors -- interact to create and develop new ventures and to extend existing lines of business.

1. External Factors

External factors define the parameters in which internal factors combine, mix, and operate. Factors such as government policies and regulations, societal values, supportive institutions, and access to and ease of acquiring resources help define the nature of and impact on the ultimate cost of doing business in a given country.

a. Government Policies

At one level, national and local government policies and regulations influence the enterprise development process on several fronts: e.g., the support for basic research at colleges and universities; the provision of effective primary and secondary education, job-skills training and re-training; tax policies and laws conducive to investment in business; rules and regulations governing capital formation and organized capital markets; trade tariffs and foreign exchange controls. The effectiveness, consistency, and transparency of government agencies in implementing these and other policies and regulations also determines their impact on the economic development process.

b. Societal Values

Societal values establish the extent to which entrepreneurship is accepted or encouraged. An entrepreneurial society has investors, bankers, lawyers, accountants, suppliers, and customers that know the importance of entrepreneurs. Successful entrepreneurs must be visible so that they can be role models. While success should be lauded, failure must not be condemned -- indeed, it must be socially acceptable. Positive societal values lessen the blow of failure and make it possible for an entrepreneur to rejoin the workforce at an appropriate experienced-based level, or to try again.

c. Institutions

Institutions play a significant role in the development process as the locus for research and innovation. Included in this group are universities, research institutes and large companies. All act as spawning grounds for innovation.

d. Location and Infrastructure

Proximity and ease of access to critical resources such as suppliers, educated workers, customers and institutions are the lifelines of successful businesses. Therefore, the condition of the transportation, road, electrical, water, and telecommunications infrastructure are of tremendous importance to entrepreneurs. For specific industries, business infrastructure in the sense of networks of suppliers and/or technical services can also be critical to the creation of new businesses.

2. Internal Factors

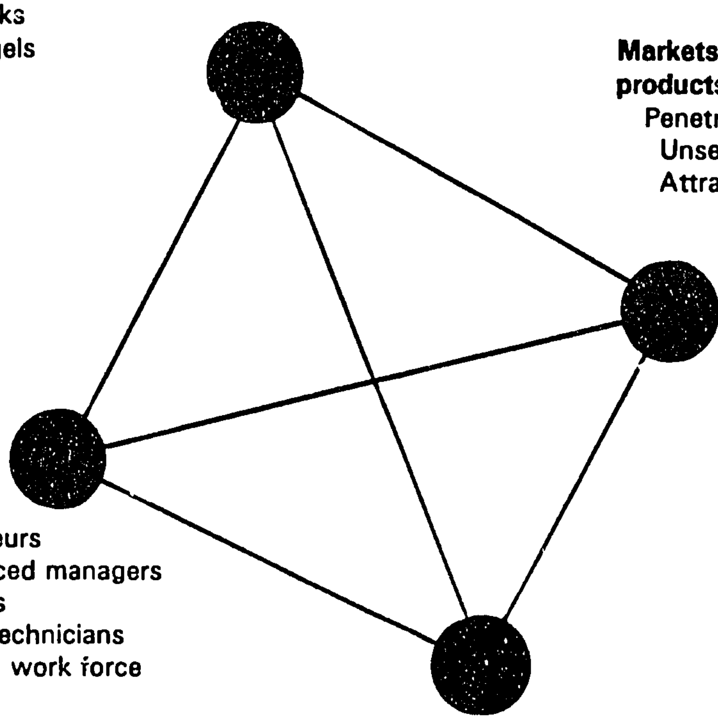
The nucleus of the enterprise development process is entrepreneurship, which is comprised of four basic building blocks -- people, capital, market opportunities, and support organizations. Figure II-1 depicts these building blocks bonded together. When external conditions are right, entrepreneurship occurs. New companies are formed. They create employment. In time, a few ambitious employees leave jobs to start their own companies. Investors finance start-ups, harvest their successful investments, and finance additional start-ups. Support organizations such as venture capitalists, accountants, attorneys, and consultants become skilled at meeting the needs of entrepreneurial companies. Over time, a region becomes a self-sustaining generator of entrepreneurial activity.

Venture capital and venture capitalists are essential elements of two of the building blocks comprising entrepreneurship. Venture capital provides the long-term risk capital and venture capitalists provide the long-term human capital support necessary to foster entrepreneurship.

B. Southern Africa

Southern Africa is more developed than other regions in sub-Saharan Africa. Within southern Africa though, there are wide discrepancies from one country to another. Essentially, the region can be divided into four development blocks: 1) South Africa and Zimbabwe, 2) Swaziland, Namibia, Botswana, and Lesotho; 3) Tanzania, Malawi, and Zambia; and 4) Mozambique and Angola, countries recovering, or trying to, from the ravages of war and not sharing the region's common language.

FIGURE II-1. Elements of the Entrepreneurship Support Nucleus



Source: Adapted from, "Venture Capital and Regional Economic Development", Chapter 10 in Venture Capital at the Crossroads, by William D. Bygrave and Jeffry A. Timmons, Harvard Business School Press, Boston, MA, copyright 1992.

Southern Africa offers significant potential for economic growth. Moreover, the extensive use of English and English law throughout most of the region provides a foundation for a supportive institutional environment, and makes the region more accessible than elsewhere in Africa to U.S. investment, as well as facilitating cross-border investments. The region enjoys a market with a combined population in excess of 130 million people and an infrastructure that, though less than perfect, effectively connects many of the countries and supports interdependence.

On the negative side, inappropriate policies, low productivity, commodity-based economies, political conflict, corruption, HIV, and capital flight, coupled with worldwide recession and deteriorating commodity markets, have all combined to stall economic development. Many outsiders, and increasingly regional economic actors, believe that regional economic integration offers one means to overcome some of these constraints and to exploit some of the regional advantages.

1. <u>Political Environment</u>

The political environment in Southern Africa is changing rapidly and fundamentally. In general, these changes are towards openness and greater democratic participation, and are positive. Compared with other regions, southern Africa appears, at this time, to be more successful in implementing democratic processes and institutions than other parts of the continent.

This is evidenced by the national elections held in virtually all the countries of the region in the past four years. In many cases, these were the first free elections for national leaders or representatives to constituent assemblies in a country's history, effectively ending the dictatorships which had prevailed since independence. The following countries have all undertaken elections for national political leadership in the past few years: Namibia (completing the independence process under U.N. guidance); Tanzania (inaugurating a new government and ending Socialist rule); Zambia (leading to the defeat of Kaunda); Malawi (upcoming in May 1994); Angola (leading to a standoff and resumption of hostilities between the parties); and Mozambique (incorporating the peace process, with additional elections planned for 1994).

South Africa has completed its first all-race elections ever, ushering in the transitional government of national unity headed by the African National Congress (ANC). This remarkable transition has changed the political face of the region. Although the elections were preceded by extensive political violence, there is little doubt as to the mandate earned in the elections by the new majority government. The political debate will now shift to the ability of the new government to deliver benefits to the non-white populations, and the use of power by the ANC. The inclusion of most groups, including at the last minute Zulu-based organizations, has laid the foundation for the utilization of political channels rather than violence and/or civil disorder.

Botswana and Zimbabwe have enjoyed longer democratic traditions, although each has been dominated by one political party in spite of an active opposition. Lesotho and Swaziland are effectively monarchies, with little in the way of open democratic participation in spite of the existence of participatory assemblies or other representative institutions.

Beyond the spread of democracy and open elections for national leadership which has occurred, there are other elements of the political environment which will affect each country's ability to engender sustained private investment and economic growth. These are the questions of whether a country's leadership can create a stable policy environment, provide essential services, develop the capacity of public sector institutions, and take the lead in sectors such as education and health where the government is often the sole provider. In these areas many countries have been less successful, and the recent transition to democracy will not necessarily improve an elected leader's ability to govern. These countries should, however, have some additional legitimacy bestowed on them by virtue of their mandates.

The problems of widespread corruption, a lack of technical capacity, bloated payrolls, and inefficient organizational structures which have characterized many countries' public institutions may be harder to reform than the political process itself, as they involve entrenched interests and deeply ingrained behaviors. Many countries have been stymied by institutional problems in implementing reforms and improving services. Here again, Southern Africa is perhaps better off than other parts of the continent, but still faces real problems in developing governing and public administration capacity.

2. Economic Environment

The regional economic environment is varied, and influenced to a great degree by South Africa. The contrasts are stark: Mozambique is one of the poorest countries on the continent, with a virtual breakdown of basic economic institutions and functions, including even subsistence agriculture, resulting from the civil war which has plagued the country since independence. South Africa, on the other hand, has a dualistic economy in which the formal business sector, dominated by whites, places it more on a par with the developed countries of the Organization for Economic Cooperation and Development than with the rest of Africa. While the overall economic policy environment and performance will determine a large part of the attractiveness of any country for investments by the Fund, there are a number of specific areas which are of particular concern. These include macroeconomic stability, (foreign and domestic) investment regulations, foreign exchange regulation, and the characteristics of the financial sector.

Three of the countries visited by the team -- South Africa, Tanzania, and Zimbabwe -- are examined more closely in Annex E to provide concrete illustrations of these specific areas. Though conditions vary among the other countries in the region as well, these three provide a broad cross-section for comparative purposes.

a. Macroeconomic Stability

Macroeconomic stability is important for the general investment environment facing the Fund. Sound monetary and fiscal management, as well as balance of payments stability, deeply influence the financial sector and the ability of its institutions to provide effective intermediation and, ultimately, capital to new and expanding enterprises. While these financial functions and institutions can adapt to unstable environments, the overall development of the financial sector is constrained. The principal impact of macroeconomic instability manifests itself in several ways, of which the most obvious are inflation, exchange rate instability or lack of foreign exchange, and inefficiencies in domestic credit markets either through liquidity problems or crowding out due to extensive deficit financing requirements. Table II-1, next page, summarizes basic economic indicators for the countries of the region.

Table II-1
Comparative Data and Information
(Annual Data from 1992)

		South Africa	Zimbabwe	Botswana	Namibia	Swaziland	Lesotho	Malawi	Zambia	Mozambique	Tanzania
GDP (millions of US$)		$107,130.04	$5,755.50	$3,375.09	$2,301.61	$879.80	$663.58	$1,517.08	$2,283.90	$920.31	$2,409.96
Population (millions)		39.82	10.58	1.37	1.53	0.82	1.84	10.36	8.64	14.87	27.83
GDP per Capita		$2,690	$614	$2,500	$1,504	$1,143	$361	$146	$272	$64	$87
Growth in Real GDP		-2.08%	3.36%	8.83%	3.48%	16.47%	n/a	-7.92%	-1.78%	-2.30%	3.60%
Inflation rate (Consumer Prices)		13.91%	42.09%	16.17%	17.69%	8.24%	17.20%	22.68%	191.34%	35.16%	22.07%
Implicit GDP Deflator (a)		n/a	34.6	n/a	n/a	-4.8	13.2	15.3	67.4	35	28.2
Prime Interest Rate (Lending Rate)		18.91%	31.00%	14.25%	20.21%	15.00%	18.30%	22.00%	54.57%	n/a	31.00%
Literacy (a)		n/a	66.90%	n/a	n/a	67.90%	73.60%	58.80%	72.80%	32.90%	n/a
Exchange Rate											
	Nominal (per US$)	3.053	5.48	2.257	3.053	2.743	3.053	4.3958	357.1428	2951.4	335
	REER (1985=100)	109.5	n/a	n/a	n/a	n/a	97.4	91.1	83.5	n/a	n/a
Balance of Payments (millions of US$)											
	Trade Balance	$5,429	$48	$147	$110	-$90	-$823	$44	$420	-$659	-$426
	Current Account	$1,388	-489.4	137.5	142	25.3	37.6	-53.1	-307	-381	-778.5

Source: All data from The International Monetary Fund's International Financial Statistics April 1994 unless noted below.
(a) From The World Bank's Trends in Developing Economies 1993

In general, macroeconomic management in the region has improved in recent years. This is due largely to the structural adjustment or reform programs initiated in a number of countries under the aegis of the international financial institutions. These programs, particularly in the early stages, have concentrated on macroeconomic policy as a prerequisite for balance of payments support and extension of new international credits. South Africa, again, is a special case, where sound macroeconomic management was necessary in order to survive the impact of sanctions, particularly in disinvestment and lack of international lending. This extended to the Rand currency area as well, encompassing Swaziland, Lesotho, and Namibia.

In a general sense, the following points stand out in the region concerning macroeconomic policy and stability:

- South Africa, Botswana, Angola, and Zambia have relied on mineral export earnings, with varying implications in each country.
- The region as a whole runs a trade surplus, with Mozambique, Lesotho, and Tanzania running large deficits, South Africa with large surpluses, and the others near balance.
- Tanzania, Zimbabwe, Zambia, and Malawi have undertaken vital structural adjustment programs involving macroeconomic stabilization and reform. These countries, plagued by instability (of varying types) in the recent past, now appear to be steadily improving.
- South Africa and the countries of the Common Monetary Area and South African Customs Union -- Botswana, Lesotho, Swaziland, Namibia -- have all enjoyed relative macroeconomic stability.
- Mozambique and Angola lack even the basic institutions and instruments for effective macroeconomic management, and continue in a crisis-management mode.

b. Investment Regulation, Protection, and Incentives

The specific regulations governing Fund investment in companies in each country can be an important determinant of the viability of those investments. Suitable conditions will be, indeed, a pre-condition for undertaking any investments, whether direct or indirect. Beyond how these regulations affect the actual investments of the Fund, they also determine in part the attractiveness of the overall investment climate of a country. In this respect, most countries have reformed their investment regulations and incentives in the recent past to more explicitly promote private investment, particularly foreign direct investment. Table II-2, next page, summarizes some investment factors for a number of the countries in the region. Many countries have adopted particular investment incentive programs or laws granting favorable tax or other treatment for qualifying investments. These have met with mixed success, but in many cases these investment laws are the major mechanism for establishing basic rights of equal treatment, guarantees against nationalization, assurances of repatriation, and stability of tax treatment for new projects. Therefore, they have an importance beyond the tax incentives often accorded.

Table II-2
Investment Factors

	Tanzania	Zimbabwe	South Africa	Botswana
Profit Tax Rate	35% for residents; 40% for non residents	40%	40%; (48% if distributed)	40%
Tax Incentives	Corporate tax holiday up to 5 years then 50% for non-residents & 40% for residents	Special initial allowance for capital costs; 50% investment allowance on training capital expenditures	Accelerated depreciation for approved beneficiary projects	Corporate tax holiday up to 100% for the first 2 years, 75%, 50% and 25% in the following 3 years
Duty Exemption for Capital Goods	Customs duty-free imports; Refund of duty and import tax on certain goods; Refund of domestic sales tax and excise duty	Duty Exemption for Approved Projects	Low tariff rating for Capital Goods. No specific duty exemption provisions	Duty exemption not available, but capital grants are given
Regional Development Incentives	None; except for mining	Lower taxation at "growth points"	Cash grant of up to 10.5% of assets outside of major population centers for up to 5 years	Selebi-Phikwe corporate tax rate of 15% for 20 years & 10 year exemption from dividend withholding tax; Capital grants also based on location
Foreign Investment Restrictions	Extensive sectoral restrictions and reserved activities; minimum investment of $250,000 to qualify for incentives	Complex set of restrictions on capital & dividends; Joint ventures with local firms encouraged	Domestic borrowing restricted pro rata with foreign equity share	Administrative approval; Domestic borrowing limit; Land ownership; Some sectors off-limits for incentives
Business Establishment Procedures	Slow investment approval process; additional steps for licensing, etc. increase time substantially.	Investment Centre approvals still slow; complex registration and licensing provisions	Simple business establishment procedures; additional steps to access incentives	Average for the region
Time Required and/or Steps to Get Incentives	60-90 days	Historically, 60 - 90 days for project approval. 45 days under new law.	60 days	4 institutions
Other	Mining incentives: Free customs, duty & sales tax for imported equipment, retention of forex for exporters in offshore accounts up to 70%	Tax incentives in "growth points"; Facilitated foreign exchange access; Freedom to repatriate for new investment	Low interest long-term loans for export oriented projects; Relocation grants for foreign investors	Cash grant up to $600/worker; Grant of up to 80% of unskilled and semi-skilled workers, for 2 years then diminishing for next 3 years; Grant of up to 8% of sales revenue for same period as above; Grant of up to 50% of "off the-job training cost for 5 yrs

Table II-2
Investment Factors

	Namibia	Malawi	Mozambique	Zambia
Profit Tax Rate	32%; 15% additional tax on dividends	35%; 15% additional tax on dividends	50% 68% if distributed	15% on dividends
Tax Incentives	None; incentives under consideration	40% investment allowance	2 to 8 year tax holiday by negotiation	3 year holiday, followed by 75% holiday for 2 years; 7 years for dividends
Duty Exemption for Capital Goods	Sales tax exemption	Only for bonded warehouse or export operations	For export oriented projects only	Full exemption for all projects
Regional Development Incentives	Limited EPZ program in Arandis	n/a	n/a	limited
Foreign Investment Restrictions	Discretionary power to reserve sectors for nationals	Limited sectoral restrictions	Case by Case approval; must demonstrate economic contributions	Largely open with lifting of protective restrictions and privatizations
Business Establishment Procedures	Cumbersome investment approval process	Relatively straightforward; assistance from MIPA	Cumbersome and unpredictable	Simplified procedures with default period; 5% tax on capital
Time Required and/or Steps to Get Incentives	4 institutions	Up to 1 month	n/a	30 days
Other	EPZ and additional incentives under consideration	Training deductions	Various initiatives underway for EPZ's; reform of investment laws	Additional sectoral incentives for agriculture, tourism, and other priorities

c. Foreign Exchange

Controls on foreign exchange constitute a major issue for the Fund and its investments. First of all, in countries with overvalued exchange rates, import licensing, exchange controls, or some other means of rationing the resulting scarcities were a necessity. These administrative controls have been a major disincentive to business development, particularly export-oriented companies, and are among the most frequent complaints of local business organizations. The imposition of a market-based mechanism for determining exchange rates was therefore a necessary first step to dismantling or liberalizing the complex network of administrative controls that many countries in the region had built up over the years.

With the introduction of more realistic exchange rate determination mechanisms, the opening was made for liberalization of trade, services, and capital transactions. Most countries have, to a large degree, liberalized trade transactions. Some have liberalized other current transactions such as service payments. Very few have liberalized capital movements, although most now grant explicit repatriation guarantees for new foreign investment. None of the countries currently has anything close to full convertability of its currency, though this may change, as all employ some controls and restrictions, and the exchange risk will vary in each country and over time. Basic characteristics of the foreign exchange regime of selected countries are shown in Table II-3, next page. The foreign exchange risks which the Fund will be subjected to are, to a limited extent, manageable with traditional instruments of hedging, pass-through, etc. However, this will not be the case in all, or even most, of the Fund's transactions if it is to meet the other objectives of broadening access to risk capital.

d. Financial Sector

The financial sectors in the countries of southern Africa range from highly developed (South Africa and Zimbabwe) to rudimentary (Mozambique.) They also vary in terms of their openness, with South Africa and Zimbabwe historically closed: South Africa due to sanctions and Zimbabwe due to exchange controls. In these cases, there has been a situation of an excess of investible funds, due to the limitations on investment opportunities and controls on capital exports. Nevertheless, this has not led to more open financial systems characterized by risk taking and support for new business ventures. Instead, as in the other countries with less developed financial sectors, there are the same problems which have tended to limit access to all but the established business community. These include:

- A lack of long term capital.
- Underdeveloped public (listed) stock exchanges, which could provide liquidity to equity investments.
- A focus on short term trade and/or inventory finance.
- A reliance (in the less developed countries) on donor-supported external financing for capital goods.

Table II-3
Foreign Exchange Regimes

	Tanzania	Zimbabwe	South Africa /1	Botswana	Malawi	Mozambique	Zambia
Export Retention Accounts	Partial	Yes, 60%	No	No	Foreign Exchange Accounts available	No	50-75 percent
Controls on Imports	Liberalized	Liberalized under OGIL system	Foreign exchange available through banks with no prior authorization required	Import permits required for goods imported from outside SACU	OGL system covers most imports	Import Licensing; granted liberally	OGIL system; 15% discount if donor funded
Exports Proceeds Repatriation Period	60 days	90 days	180 days	180 days	5 days after payment	n/a	n/a
Foreign Investment Repatriation	Guaranteed, but requires clearance by the Bank of Tanzania	Complex system of controls for existing investment; allowed for new foreign investments after May 1993.	Via Financial Rand market at a premium, currently 25%	Up to $20 million may be repatriated immediately & the remainder in installments not to exceed 3 years	With Reserve Bank approval	Guaranteed for registered projects; subject to scheduled payouts	Guaranteed
Dividend Remittance	Guaranteed under Investment law, requires clearance.	Limits of 50% for existing investment; 100% allowed for new foreign investments after May 1993.	Via Financial Rand market at a premium, currently 25%	Peg to a basket of currencies	With Reserve Bank approval	Guaranteed for registered projects; within 3 months	50 percent of net income
Exchange Rate Mechanism	Interbank market	Interbank market; Official rates for export earnings converted	Interbank market	Interbank market	Pegged to basket of currencies	Interbank market	Interbank market
Other Capital Controls	Extensive controls service and capital transactions	Extensive controls service and capital transactions	Extensive controls on service & capital transactions by nationals	Difficult for citizens to invest outside of Botswana	Capital and services transfers controlled	Controls on service and capital transfers	Controls on service and capital transfers

1/ Namibia, Lesotho, and Swaziland are members of the Common Monetary Area with South Africa, or have their currencies tied to the Rand and follow foreign exchange prescriptions.

- Excessive collateralization requirements, limiting financing to those with substantial assets outside of their business venture or otherwise unencumbered, i.e. to established wealthy individuals or corporations.

- Higher perceived risks to lending for industrial or agro-industrial projects with longer payoffs.

- A history of subsidized government finance programs which placed a premium on political influence to gain access to capital.

- Higher perceived risk in lending to "fringe" groups not dealing with major market sectors.

- Lack of effective institutional mechanisms to reach smaller scale enterprises cost-effectively.

- Macroeconomic instability leading to volatile, at times negative, real interest rates.

To varying degrees these factors are found in all countries. In this environment, the development of access to equity finance instruments for previously disenfranchised groups is very difficult, as well as for developing access to more traditional sources such as bank lending. The problem of access, then, cuts across all countries, even those with well developed and dynamic financial sectors. In the less developed countries this is compounded by lack of depth in financial markets and lack of capacity in financial institutions.

3. Infrastructure & Services

The level of infrastructure development is a handicap for all the countries in the region. The only exception is South Africa, where the level of basic infrastructure and public services, largely or completely oriented to whites, rivals that of developed countries, with services to black townships and rural areas nowhere near the same levels. Here the major issue will be the extension of these services to the whole population. This is likely to be more important with "social infrastructure" such as schools, housing, and social services. With utilities such as electricity, transportation, communications, etc., discrimination has been maintained on economic grounds.

In most countries parastatal companies or regulated monopolies have a lock on public services, restricting access and potential competition in sectors such as telecommunications, electric power, and transport (except for road). Until these restrictions are dropped, most countries will be forced to suffer through inadequate levels of service which constitute a disincentive to new investment. However, the relatively low level of infrastructure development also creates investment opportunities, to the degree that these sectors are open for private investment.

4. Social and Cultural Conditions Affecting Business

Social and cultural conditions in Southern Africa today are mostly generated out of centrally planned economies and the practice of apartheid. These systems have diffused certain beliefs into all spheres of everyday life through social institutions and organizations including families, schools, churches, voluntary associations, trade unions, political parties, cultural and sporting organizations and the communications media. These systems have created a web of values, beliefs, meanings, understandings and political practices that often restrict or deny the access of capital markets to certain groups. This in turn stifles the growth of SMEs in the formal sector, and creates certain social conditions which affect both national and regional economic growth The following paragraphs summarize these conditions.

First and foremost, the indigenous African entrepreneurial spirit requires rekindling in many Southern African countries. Because certain groups, primarily blacks, have had restricted property ownership rights and marginal access to financial institutions, there is a dearth of experienced and educated blacks in the formal sector. Of these, most have little or no experience in the formal capital market. Entrepreneurs seeking to start or expand their SMEs have rarely been successful in accessing the capital they require for at least two reasons:

- They lack the business "know how" to prepare proper business plans and the appropriate contacts for presenting ideas for financing.

- Most financial institutions in southern Africa are very conservative, requiring substantial collateral. Minus land, these entrepreneurs are forced to offer their limited personal wealth as collateral, that is, funds from family, friends and business associations. Often, this is insufficient to secure financing from a formal institution.

The rekindling of indigenous entrepreneurial growth may lie in at least three distinct groups: managers working in large corporations, young people, and women of all ages. First, indigenous Africans who currently work as managers in foreign-owned enterprises have skill-sets necessary to effectively manage small- and medium-sized businesses. With access to capital, they could become community-level role models.

Second, young southern Africans can often identify good business opportunities, but may not have the skills or access to capital to expand the enterprise or make it profitable. For example, a 1993 World Bank survey noted that black, South African micro-enterprise owners are predominantly young (35 percent are less than 30 years old) and have a median educational level of six years of formal schooling. Few have worked in the formal sector and, therefore, lack supervisory or management experience.[2] In brief, business opportunities often do not match the young entrepreneur's skill-set. However, through a variety of programs -- often donor sponsored -- these young entrepreneurs increasingly have access to, and are taking advantage of, education, an improved policy environment, and new sources of capital that were unavailable to their parents and grandparents.

Third, women of all ages have the potential to increase national and regional economic growth. For example, in South Africa, women operate approximately 50 percent of all informal enterprises. The World Bank has put the figure as high as 62 percent. However, women tend to be concentrated in those sectors with the lowest levels of profitability, such as food, textiles and garments, and retail. Throughout most of southern Africa in general, women most likely have private sector capabilities above and beyond those of men, mainly because they have been denied

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[2] Riley, Thyra, "Characteristics of and Constraints Facing Black Businesses in South Africa: Survey Results," World Bank, November 1993.

access to public sector work. Current changes in education, licensing and tax policies as well as access to capital could be the incentives these women, and their male counterparts, need to move from the informal to the formal sector, and from local to national and regional markets.

With access to working capital, equity capital and long-term credit, these three groups, among others, have the potential to increase national and regional economic growth through SME development. Indigenous Africans, among others, have had restricted access to capital within the formal sector because of the risk averse nature of most existing financial institutions. Fortunately, as government policies become more business-friendly. and the education and experience of indigenous Africans increases, so are the financial institutions slowly adjusting their principles and their perceptions of risk. For example, Nedbank in South Africa is structuring loans to suit the needs of indigenous entrepreneurs. Meridien Bank in Tanzania offers internships to indigenous Africans from throughout southern Africa. Most of these interns have direct contacts in the indigenous-owned business sector, and inform bank management about investment opportunities therein.

These contacts are important for indigenous entrepreneurs, because there is currently no regional network for indigenous-owned, formal sector SMEs in southern Africa. On a national level, steps are being taken towards this end in some countries, including South Africa and Tanzania. In South Africa, the National African Federated Chamber of Commerce and Industry (NAFCOC), and its 2,000 business members, could become a pivotal link between potential indigenous joint venture partners, though it currently lacks the means to do so. In Zimbabwe, the Indigenous Business Development Council has some 1700 members. In Tanzania, the Chamber of Commerce in Dar es Salaam maintains a data base with 2,200 annotated business listings. It is their hope to expand this service to include 25,000 SMEs throughout the country.

The development of these and other local support institutions is an important first step to developing a regional network that will boost growth. Such regional linkages between SMEs could contribute significantly to the creation of jobs and wealth while beginning to align quality and productivity in the formal and informal sectors across the region. In addition, real investments resulting from these linkages should increase as many countries in the region promulgate structural reforms that make their countries -- and the region -- more inviting to foreign, including cross-border, investors.

C. Review of Enterprise Development-Related Donor Activity

Each USAID Mission in Africa develops a strategy focusing on up to four critical development pillars. These pillars include Building Democracy, Stabilizing Population Growth, Protecting the Environment, and Broad-Based Economic Growth. The eleven countries of USAID's Southern Africa region have a varied focus to their programs, as indicated in Table II-4, next page. Mission activities in democracy, economic growth, and environmental protection could provide possible support for the SAEDF.

Building Democracy portfolios tend to promote activities that encourage full participation in development, government effectiveness, and the emergence of private advocacy groups. Missions that emphasize **Protection of the Environment** support education and training for sustainable agricultural practices, vegetation and tropical forestry preservation, and conservation of biological diversity. **Stabilizing Population Growth** tends to focus on four basic areas:

- Supporting family planning programs.
- Supporting education, information, and communication.
- Developing channels for contraceptive distribution.
- Educating senior policy makers on the impact of continued high population growth.

Table II-4. Southern Africa USAID Mission Program Pillars

COUNTRY	BUILDING DEMOCRACY	STABILIZING POPULATION GROWTH	PROTECTING THE ENVIRONMENT	BROAD-BASED ECONOMIC GROWTH
ANGOLA				
BOTSWANA		X		X
LESOTHO				X
MALAWI		X	X	X
MOZAMBIQUE	X			X
NAMIBIA	X			X
SOUTH AFRICA	X			X
SWAZILAND				X
TANZANIA		X	X	X
ZAMBIA		X		X
ZIMBABWE		X	X	X

All ten of the active missions in the region include **Broad-Based Economic Growth** as a pillar of their development programs. Activities in this area address the alleviation of poverty and improvement of the quality of life for African people by supporting initiatives that seek to increase agricultural output, improve individual productivity through education and health, and expand access to productive resources and markets. Individual Mission activities under this objective include:

- Botswana: The Mission is working to enhance the enabling environment to increase private investment and enterprise growth in the non-mineral sectors of the economy. It also is seeking to increase the level and relevance of what students learn, their receptivity to additional training, and their preparedness for further education. Its major business development activity is the Botswana Private Enterprise Development (BPED) project. BPED has three primary components. First, it works through a local business group to strengthen the policy-related dialogue between the private sector and the government. Second, BPED assists entrepreneurs through training in technical and business skills and provides technical assistance for the writing of bankable business plans, which are used to facilitate access to credit through a government business promotion group. Finally, the project is involved in investment promotion, facilitation, and the privatization of companies.

- Lesotho: In the area of broad based economic growth the Mission is striving to improve the quality and efficiency of primary education. The Mission also has activities which look to sustain and improve output and productivity in selected agricultural sub-sectors.

- Malawi: Currently the Mission is reconsidering its private sector strategy and activities, which have declined from previous levels. At one time, the Mission had a number of activities supporting SMEs, e.g., loans, business advisory services, parastatal privatization, etc. Presently the mission is working to increase agricultural activity, among other efforts.

- Mozambique: USAID in Mozambique supports private sector development principally through improvements to the policy environment, especially for private agriculture. It supports market-based, private sector-led, and agriculture-led increases in productivity and production, and assists in the rehabilitation and recovery of the social infrastructure.

- Namibia: For the moment, USAID/Namibia does not have any explicit enterprise development/support activities. The mission's emphasis is on basic education reform. However, the Mission is planning an initiative that would provide a bridge between specific enterprise personnel requirements and individuals who, with training, could meet those needs.

- South Africa: The Mission's private sector portfolio seeks to promote and contribute to a fully-integrated market-driven economy. Its activities work to develop and facilitate linkages between U.S. and South Africa by focusing on both the business sector and the enabling environment to increase broad-based black ownership, employment and participation at all levels of the economy.

- Swaziland: USAID has three basic means to support/promote SMEs. These efforts include: a training program, grant financing, and the Swazi Business Growth Trust which provides a variety of services and training. The objective of these activities is to increase the number of Swazis who direct, manage and participate in national development and increase the number and size of Swazi-owned businesses.

- Tanzania: The Mission is working toward the delivery of more effective infrastructure services and is seeking to increase formal private sector participation in the economy. Its administrative support to the Tanzania Venture Capital Fund is one such example.

- Zambia: The Mission's support for SME development has principally come through the Zambia Agricultural Marketing Support project. The Mission is also assisting with privatization efforts by providing technical assistance to the Zambia Privatization Agency.

- Zimbabwe: In Zimbabwe, USAID is extensively involved in policy reform activities which support the expansion of private businesses. The Mission works to increase household food security for communal areas and supports activities to increase black ownership and investment at all levels of Zimbabwe's economy.

On a regional level, the USAID-backed Africa Growth Fund has a charter that permits it to invest anywhere in sub-Saharan Africa and has one investment in the region. Other donor enterprise development activity on a regional level is very limited. The International Finance Corporation is establishing the Zambezi Fund to provide financing for privatization mainly in Zambia, and possibly Zimbabwe. The Commonwealth Development Corporation is currently managing two funds, supported in part by USAID, one in Ghana and the other in Tanzania, and has expressed interest in doing so elsewhere on the continent, especially Southern Africa.

The World Bank is in the early stages of a "fund of funds" venture capital project for its Eastern Africa region, which includes Tanzania. Though still probably a year away from funding, the concept is receiving a favorable review within the Bank and there is interest in the possibility of establishing a similar fund for its southern Africa region. The Bank has also undertaken an effort to encourage and incentivize countries in southern Africa to expedite certain economic policies aimed at opening up their economies, especially to regional trade and investment.

At a country level, numerous donors, development finance institutions, and private banks -- e.g., the German, Canadian, Swedish development agencies; Standard Charter and Meridien banks; Kwazulu Finance Corporation; etc. -- are addressing such issues as the enabling environment; business development; training; privatization; and possible investment vehicles. However, financial initiatives in places like Zimbabwe and South Africa -- including USAID's own -- appear to be dwarfed by the potential.

D. Demand

It was not possible during a three week sprint through four of eleven countries to develop a clear picture of demand. Nonetheless, the technical team's informed opinion, after talking with private and public sector participants, is that US $100 million is not beyond the absorptive capacity of the region if it is patient capital and, especially, if the regional trend to removing barriers to cross-border trading continues. The proposed level of SAEDF funding of US $100 million would appear to strike a good balance between being so little that it negatively impacts on the Fund's effectiveness and being so much that it unduly raises expectations.

The proposed level of funding, when spread across eleven countries, is not significant. Even if investments occur in only half of the regional countries, the Fund as proposed should be capable of making developmental and financially sound investments.

For example, even though tens of millions of dollars are headed toward South Africa, much of this will be invested in the stock exchange and not directly in private enterprises, especially those previously lacking access to such long-term capital. According to one merchant banker, South Africa alone would be capable of absorbing the bulk of the Fund's total capitalization in relatively good investment opportunities in operating businesses. Institutions like NED Enterprices, which is moving heavily into franchise financing, are currently seeking sources of long-term risk capital.

Even in Mozambique, investment opportunities exist now. Mozambique's three major ports -- Maputo, Beira, and Nacala -- are the closest outlets for Zimbabwe, Malawi and parts of Zambia, Botswana, and South Africa. Investments are already occurring in refurbishing this infrastructure and these projects can represent cross-border investment. For example, an association of Zimbabwean orange growers has invested in the refurbishment and management of a cool storage facility in Beira to more competitively export its output.

Moreover, previously completed work which estimates the unmet requirements for long-term risk capital in the region to be in excess of US $800 million. Assuming a leverage factor of four to one, the Fund would need to be capitalized at US $200 million to meet the projected demand. The Fund capitalization would increase to US $266 million at a more conservative leverage ratio of three to one.

Previous work also estimated demand by projecting a desired portfolio mix. Using this approach, but the design team's average investment size by type of investment (see section five, page 15), Table II-5 shows an estimated need of US $225 million over five years, or more than 65% greater than the proposed initial capitalization of US $100 million.

Table II-5. Estimating Demand Based on Possible Portfolio Mix

Investment Class	Number of Investments	Avg.Financing per Client (US$ millions)	Total Financing (US$ millions)
Indirect	30	5.5	165
Direct	20	1.5	30
Cross-border direct	10	3	30
		TOTAL	225

E. Constraints and the Opportunity to Promote Enterprise Development

The constraints confronting the small and medium sized business sector are many and varied across the region. They include:

- New democracies, still struggling with legitimacy and stability, which has retarded improvements in other areas, resulting in:

* Continued outdated and discriminatory business statutes/regulations.
* Still evolving and often inappropriate policy environments.
* Continued poor infrastructure.
* Continued high-cost, poorly provided services such as utilities and transport.
* Reinforcement of the general climate of uncertainty as to their ability to survive, and with respect to their ability to maintain avowed policies.

- Limited or, in the case of previously protected markets, underdeveloped human resource capacity, especially in managerial and financial skills. This results in:
  * Restricting the pool of potential emerging businesses.
  * Inability to present ideas in bankable form.
  * Low productivity.

- Conservative, risk averse financial system, leading to:
  * Limited access to financing, even in countries with reported available capital.
  * Lack of long-term financing, especially equity.

- Small domestic market, resulting in:
  * Poor ability to compete on price and quality.
  * Diseconomies of scale.
  * Limitations on growth, other than through exports.
  * Pressures to maintain tariff and other means of protection for local industry.

- Lack of market information, resulting in:
  * Inability to compete effectively in export markets.
  * Marketing of makeable products rather than the making of marketable products.

Some of these constraints are being addressed by USAID and other donors at a country-level, although very little exists at a regional level that attempts to address these obstacles to SME development. While some debt and equity financing is available through various donor initiatives, a financing "shortage" still exists for both types of capital. In a few countries this takes the form of limited available capital. In others, it is the inaccessibility of available capital that creates a shortage for indigenous SMEs. In either instance, the opportunity exists for the creative use of limited but long-term investment capital to leverage additional capital from other sources within and outside a country for use by SMEs. However, the successful use of long-term investment capital will by its very nature require the provision of long-term human capital as well.

There are initiatives that seek to provide training and technical assistance to the SME sector. Such assistance, however, is typically of a short-term nature, e.g., workshops, seminars, consultancies -- and often general in content. Even in the case of consultancies provided by well-intentioned, competent specialists, the consultants have little long-term control in following through with recipients of their services.

While a need exists for financial services that address the financial and technical shortfall, the form of such service is difficult to impossible to predict across 11 countries. That is to say, one size will not fit all; flexibility is paramount. The mechanism for delivering financial services must be capable of delivering a variety of long-term financial instruments and technical assistance. Moreover, it must deliver such in a cost efficient manner given increasingly limited donor funding and in order to attract private capital.

Venture capital is an ideal mechanism, given the regional circumstances, for efficiently delivering a variety of financial services. As defined, venture capital is long-term, growth oriented risk capital that can take a variety of forms -- equity, debt, and any number of quasi-equity or debt instruments in-between. Where preference share equity might work in one country for one SME or one financial intermediary, a credit guarantee may be required for another in the same or different country.

Just as important, venture capital is the business of developing businesses. A critical component of this is the provision of flexible and tailored long-term management and technical assistance to the investee. Where one situation may call for a complete overhaul of management, another may require targeted training in only a few specialized areas. In short, to succeed, venture capital must bring both financial and human capital to the business development process.

On a regional level all four elements of the entrepreneurship nucleus exist -- i.e., people, markets, capital, and support organizations. The latter two elements are frequently not attracted to the first two, thereby not creating the right conditions for successful and sustained entrepreneurship. By supplying venture capital and venture capitalists, the SAEDF will be able to bring the capital and support organization elements of the nucleus together with people and markets to establish the right conditions, on a selected basis, for the entrepreneurship nucleus to develop and grow.

III. LESSONS LEARNED FROM PREDECESSOR ENTERPRISE FUNDS

The past forty years have seen a number of development-oriented investment experiments designed to stimulate private sector growth in various parts of the developing world. These experiments include CDC, LAAD, SIFIDA, ADELA and EDESA in the early years and, more recently, funds in Eastern Europe, the Thailand Fund in Asia, the Africa Growth Fund, and donor-backed funds in Ghana, Tanzania, Kenya, and Cote d' Ivoire.[3] These investment funds are the precedents from which critical factors leading to their success or failure can be extracted.

The design of the SAEDF can benefit greatly from these established investment activities. The hard lessons learned from these experiences can enable the SAEDF to prepare for the realities of risk capital investing in Southern Africa and thus avoid the same pitfalls encountered by other funds.

To this end, the team reviewed, to the extent possible given the information available, ten currently operating enterprise funds.[4] Three of these -- LAAD, SIFIDA and EDESA -- are sufficiently mature to provide important guidance to the SAEDF design. The others, three from Eastern Europe and four from Africa, are less than five years old and their performance is not conclusive. Nonetheless, lessons can also be drawn from these newer funds. Annex F looks more closely at each of these funds.

An additional source of applicable lessons is the more than 60 years of combined risk capital and development experience of the technical team itself. Team members have experienced investment successes and failures alike, often in a development context, and have developed their own well-founded body of knowledge regarding the ingredients of success.

The design of the SAEDF is based on fifteen guiding principles. These principles are directly related to the lessons learned which are outlined below. They are divided into four sections: Expectations, Management, Relationship with Financier, and Capitalization.

A. Expectations

1. Difficult Investment Environment

Investing in developing countries, even if purely for profit, is no easy task. Free market principles tell us that the rate of return should be commensurate with the risk level of each investment. In developing countries, however, a multitude of conditions increases risk, without necessarily a concomitant increase in the prospective investment returns.

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[3] LAAD -- Latin America Agribusiness Development; SIFIDA -- Societe Internationale Financiere pour les Investissements et le Developpement en Afrique; ADELA -- Atlantic Development Group for Latin America; EDESA -- Economic Development for Equatorial and Southern Africa.

[4] Due to the limited time allotted to the investigation of these predecessor funds, we are limited to broad impressions and general lessons. Information in many cases is derived only from written reports, principally annual reports written by the funds themselves, without benefit of follow-up questions and clarifications. In depth investigations would doubtless reveal additional important lessons and, possibly, revisions of earlier impressions.

Every fund manager interviewed, and every annual report studied, attested to the constraints inherent to the investment environment of developing countries. These constraints include:

- Unreliable or insufficient financial and market information upon which sound investment decisions are based.
- Insufficient quantity of capable, experienced local business managers.
- Legal and regulatory structures insufficient to protect investors' rights or which obstruct investments.
- Droughts, wars, unstable governments, corruption, and population pressures.
- Unreliable, insufficient physical infrastructures or business service infrastructures.
- Small, undeveloped markets for products and services.
- Lack of market awareness of the role and requirements of private investors.
- Discomfort with taking on non-family business partners.

These constraints have led three of the oldest funds -- LAAD, SIFIDA and EDESA -- to experience periods of extreme turmoil whereby their continued existence was called into question. Only one of the ten funds studied -- LAAD -- can be considered profitable.[5] For the others, it is too soon to tell.

Guiding Principle: *Because the investment environment is already difficult, an enterprise fund should be carefully structured and managed so as not to give rise to additional and extraneous obstacles to success. Expectations should be tempered.*

2. Market Development/Patience

In most developing countries, private risk capital is not well understood. Investees often expect to easily acquire low-cost capital from established enterprise funds since these funds are associated with development agencies whose history speaks of donations rather than investment. Therefore, significant effort is required to educate the investment marketplace as to the role of risk capital and its investment parameters.

Several Eastern European Funds, in particular Bulgaria and Czechoslovakia, report that a surprising degree of market development is required. This appears true for both Ghana and Tanzania as well.[6] Such market development extends the period from start-up to first investment as well as

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[5] EDESA appears to be currently profitable but has suffered some erosion of equity over the years.

[6] The Tanzania fund undertook more than a year of fund development and market education prior to capitalization. Thus, although the first investment was made within months of capitalization, pre-investment research and preparation took many months.

increases a fund's operating costs. Therefore, enterprise funds must be financially structured to allow for this longer gestation period.

Guiding Principle: *A fund should include sufficient allowance for start-up costs. Expectations or requirements regarding the pace at which investments will be placed should be tempered.*

3. Careful Investing versus Fast Investing

An axiom of successful risk capitalists is "slow is good". U.S. venture capital companies commonly take at least one year to complete their first investment -- and this in a conducive environment with experienced managers. The odds of success are improved by careful due diligence and waiting for the right deal -- avoiding those investments where the risk/return relationship is not optimal.

Pressure to place funds often results in investing in sub-optimal deals, which jeopardizes the sustainability of the fund. For example, the Bulgaria and Czechoslovakia enterprise funds were pressured to invest after a slow start in placing investments. These funds later experienced a high level of write-offs fairly early in their lives, possibly due to this pressure.

Guiding Principle: *A fund's design should not incorporate any pressures regarding investment timing.*

4. Flexibility

EDESA is one of the most successful of the funds reviewed by this technical team. EDESA has fundamentally changed its business several times in its 20 year history. Originally lending frequently to government enterprises, EDESA shifted to equity investments in private ventures. More recently, EDESA has re-focused much of its business on establishing leasing and factoring companies. As Africa has changed, EDESA, to enable its own survival, also changed. By way of contrast, SIFIDA's poor health results from, in part, changing too slowly. This could possibly be attributed to the distance between SIFIDA's operating office and investment environment.

One of the cardinal rules of risk capital investing is to be able to act quickly, to respond to opportunities and cut losses quickly. In this regard, when contemplating possible product/service offerings, it is less important to specify the precise product/service menu a fund will provide than it is that a fund be structured in such a manner as to allow management the flexibility to develop the product/service offerings demanded by the specific marketplace.

Guiding Principle: *The design of a fund should not be so constrained as to preclude or slow the adjustment of its business (i.e., its product/service offerings) to suit changing market conditions.*

B. Management

The following paragraphs speak to the issues related to management, including experience, compensation, and locale.

1. Experienced Management

The skills required for successful risk capital investing are highly specialized. A risk capitalist must combine the mental approach of a principal and the integrity of a fiduciary. An instinct for understanding all aspects of a business and the ability to lead a business are required. Past experience with failed and successful investments alike seasons the manager.

For example, Robert Ross, President of LAAD, worked with ADELA, the failed Latin America private development finance firm of the 1960's, for over ten years prior to joining LAAD. From that unsuccessful experience, Ross acquired investment judgement and experience. LAAD's success is the result. In contrast, Kenya Equity Management's investment record has disappointed in part due to inexperienced management.

Previous investment experiments have often attracted as managers individuals who, although trained finance professionals, lack significant experience in risk capital investing as well as an understanding and appreciation of the particularities and nuances of attempting to provide risk capital in a development context. (A context in which the very notion of taking on an institutional -- as opposed to family -- "partner" in one's business may be considered quite "foreign".) Should the SAEDF not attract highly motivated individuals with the appropriate experience base, the likelihood of success will be greatly diminished. Bluntly speaking, the success of the Fund will depend on the calibre of the management team.

ADELA's staff was largely inexperienced in both equity investing and managing small companies. This lack of experience was one of several factors contributing to its demise.[7]

Guiding Principle: *The management of a fund should -- must -- be highly experienced in making private investments as principal. Ideally, the experience base should include knowledge of investing in a development context.*

2. Motivated Management

An objective of enterprise funds is to encourage private sector development. Paradoxically, few development fund managers are compensated in a private-sector manner, but rather as salaried, government employees. This compensation structure is inconsistent with the objectives and tasks of fund managers.

A capital fund manager must behave as an owner -- deeply committed to the success of the venture -- and must therefore be compensated as an owner, sharing in the firm's profits. Venture capitalists' compensation, beyond a base level, is usually a percentage of the long-term gains realized when an investment is liquidated. The rewards for success therefore can be substantial and highly motivating. The rewards for simply putting in time -- base salary -- are moderate.

Part of attracting the right team is compensating them appropriately. It is important that management have the opportunity to share in the returns of a successful investment. Moreover, success need not be defined in financial terms only, but can incorporate measures of development

[7] See Tessler & Cloherty, Inc., "Lessons Learned from the Experience of ADELA, CDC, and SIFIDA", 1985.

impact. These indicators must be pertinent and measurable, at an acceptable cost, or they will serve to de-motivate rather than motivate management.

CDC's Ghana and Tanzania funds incorporate compensation based on twenty percent of the realized gains of the portfolio. This is typical of U.S. venture capital firms in that the potential compensation is unlimited. By way of contrast, the Eastern European enterprise funds are under heavy criticism for paying high current salaries. As a result, new funds are being designed with strict salary caps. While high current income does not encourage investment success, salary caps are highly de-motivating.

Guiding Principle: *The compensation package for fund management should include a moderate base salary with the potential for additional gain based upon long-term investment success. Investment success can be defined in monetary and non-monetary terms.*

3. Close Monitoring

More than half of the investment manager's work occurs subsequent to the investment of capital. Successful investing is a constant process of reducing risk and increasing potential return, trying always to "beat the odds". Therefore, the investment manager must be on constant look-out for ways to prevent the investment from moving off-course and, if off-course, ways to steer the investment back on-course. In this respect, equity or long-term debt investing is often compared to a good marriage, requiring a constant process of interaction and adjustment.

In the modern, fast-changing, and competitive business environment, many opportunities exist for an investment to move off-course, since the course itself is ever-changing. The investment manager, having both deep and broad experience with many different businesses, is in an ideal position to "work" the investment -- i.e., advise and assist the enterprise managers as they adjust to changes within the environment. If the investment manager fails to "work" the investment, the odds of failure are greatly increased.

Most successful investment managers require consistent and frequent, usually monthly, reports from their portfolio investments. Such reports include income statements, balance sheets, cash flow statements, management discussion and analysis of these financial statements and additional information. These reports inform both the business managers and the investment managers as to the condition and trends of the enterprise. Investors in closely-held businesses also regularly meet with the business managers, visit the business premises, attend Board of Directors' meetings, attend industry conventions and other events. This close monitoring is essential to successfully managing a business or an investment.

Guiding Principle: *Structured, intensive requirements for reporting by investee companies should be mandated by fund management.*

4. Location Close to Investments

There are two main reasons why the Fund should have a local presence. First, the process of successful investing requires an intensely intimate knowledge of the business in which the investment is made, as well as the economic, social, and political environment of which the business is a part. An investment depends upon literally thousands of variables; the more variables known and understood prior to investing money, the greater the likelihood of a successful investment. The only way to acquire the intimate knowledge necessary is to invest substantial amounts of time experiencing the environment as a whole. The most efficient way, generally the only way, to invest this time is simply to live within the environment. If sufficient time is not invested, potential risks will remain unidentified and uncalculated prior to making the investment, heightening the chance that significant problems will arise.

A second reason for local presence relates to the monitoring and, if conditions warrant, the management of the business in which the investment is made. An essential ingredient of successful investing is intimate interaction between the investor and the investee. Without local presence, such interaction would be impossible, directly jeopardizing investment success.

a. Regional-Level

To be self-sustaining and effective in its objective of stimulating greater regional economic and social interdependence, the Fund must be established as a regional entity, located in the region. A regional fund can provide greater flexibility for investment management and a broader-based opportunity for deal flows. In an atmosphere where increasing access is a primary goal, cross-border collaboration and joint ventures are essential for overall financial success of the fund, but these opportunities would be difficult to ferret out from the U.S.

b. Country-Level

As nearly all of the USAID Private Sector Officers in the region pointed out, the Fund's profitability and impact will depend in large part on its effective on-the-ground reputation in individual countries. As a regional fund, local partnerships, individual investments, and close collaboration with USAID and others, combined with frequent visits by regional Fund management, will be necessary if the Fund is to acquire the taste, smell, and feel for the investment opportunities in a country.

Guiding Principle: *Fund management should be located within the region in which investments are placed.*

5. Principal versus Agent Mentality

Investing funds for capital appreciation is a different business from arranging financing for a fee -- the mind set, the disciplines, the risks, and the time horizons are all distinct. Investment bankers are agents, paid a fee for arranging transactions, regardless of long-term success of the transaction. Risk capitalists are investors, paid through the actual capital appreciation of a business over time.

This difference in compensation and mentality is fundamental in driving investment success for two reasons. First, the level of due diligence by a risk capitalist is significantly deeper and long-term oriented. Second, the ability and desire of a risk capitalist to monitor and influence the operations of a business is much more intense. Both due diligence and monitoring are critical ingredients to investment success.

Consider ADELA, for example, Tessler and Cloherty note that the Board was far too large and institutionally mismatched for the purpose. In addition, no one had a real and personal stake in ADELA's success. Both of these were contributing factors to ADELA's misfortunes.

Guiding Principle: *Managers of enterprise funds should have substantial, successful experience as principals or owners in risk capital funds.*

C. Relationship with Fund Investor

1. Government versus Investment Manager Orientation

A fundamental difference in orientation exists between government financiers of enterprise funds and the private-sector fund officers engaged to manage them. This can lead to misunderstandings and conflict, ultimately affecting fund performance.

Government is highly sensitive to political hot-buttons such as potential conflicts of interest, compensation levels, and other issues of the day, like "exporting jobs". Often, because of the sensitivity to public reaction, these issues take on a greater importance than the fund's objectives themselves. Private-sector managers are oriented to the objectives of the fund and are trained to stay focused on the ends. As a result, managers are often perceived by the government as not being sufficiently responsive to its needs as a key investor.

Guiding Principle: *Fund structures must incorporate sufficient rules such that U.S. government sensitivities are satisfied. On the other hand, funds must be free of the cost and uncertainties inherent in excessive reporting, review and evaluations, and the consequent uncertainty of continued funding.*

2. Independence with a Minimum of Investment Constraints

The investment environment in developing countries is extremely challenging. Investment success and long-term development impact depend upon guiding investments through a mine field of potential problems. So many things can and do go wrong in business, that without agile and correct adjustments a fund and its portfolio businesses could easily fail. The addition of U.S. government rules and procedures can easily impact on sustainability by restricting a fund's agility and increasing its operating expenses through attendant costs of complying with regulations, reviews, and procedures. The investment manager's task is complicated further by the need to allocate valuable staff time to meeting these requirements.

LAAD's President speaks eloquently of the expense and distraction from his mission due to USAID's rules and regulations. During the period in which LAAD received USAID funding, high level personnel spent considerable time with USAID staff to ensure their satisfaction with LAAD's activities. CDC management advises, in definitive terms, to limit the amount of oversight to which a fund is subjected and to clearly define development objectives.

Independence in financial and management decision making, unconstrained by excessive rules and regulations, is a necessity if managers are to nimbly respond to changing business conditions with appropriate actions. Independence allows a fund to:

- Respond quickly to investment proposals using simple and direct investment criteria. This responsiveness is critical if a fund is to build a favorable reputation with potential investees and investors, alike.

- Avoid most of the expensive and time-consuming procurement processes generally required by government bureaucracies. A fund designed to be financially self-sustaining and commercially viable can ill-afford such cumbersome processes.

- Assure potential investees that a fund can readily access investment capital. This is essential if a fund is to convince potential investees to submit to the pre-investment analysis process, which requires expenditure of time and money by the investee.

- Maintain continuity of investment objectives and to credibly communicate this to the marketplace. Fund managers will not be undermined or discredited in the eyes of investees due to sudden changes in objectives or requirements.

- Respond in a rapid and straight-forward manner to investment proposals brought to it by USAID Missions and other parties. This is in clear contrast to the complex and time-consuming procedures required under a deal-by-deal pass-through allocation system, wherein each proposal would be "vetted" by many -- all with varying requirements.

USAID's need for monitoring and oversight need not be incompatible with cost effective portfolio management, provided USAID's requirements and guidelines for reporting are spelled out from the outset, are realistic, and, to the extent possible, are part of normal fund monitoring and management. Anything less will prove costly and debilitating to a fund's management, with potentially disastrous impact on the overall commitment of a fund's personnel and on it's investment decisions. In a similar vein, broad or unfocused development objectives may cause otherwise good investments to be rejected, or unprofitable investments to be accepted. CDC management advises that development objectives be clearly defined and attainable through direct action on the part of a fund.

Guiding Principle: *Fund documents -- charter, by-laws, grant agreement -- should recognize and support the need for fund independence by incorporating clearly defined development objectives and operating rules and regulations up-front that are not subjective or changeable.*

D. Capitalization

1. Management Costs versus Transaction Size

Donor-backed funds often target small and medium investments as a way to distribute wealth and create employment. However, an inherent conflict exists between the goals of investing in SMEs and fund financial sustainability. Fund management costs are largely fixed, regardless of the nature of the transactions. Therefore, the costs of making and monitoring an investment are higher, on a relative basis, for smaller transactions than for larger transactions.

The Ghana Risk Capital Fund has adjusted its focus to larger transactions as it became apparent that its management costs were otherwise unsustainable. The Polish-American Enterprise Fund, as well as EDESA, have invested in locally-managed, lower cost financial intermediaries in order to make smaller investments economically sound.

Guiding Principle: *If a fund's target group is SMEs, then the fund's capitalization and on-going financial support should be structured to support the high cost of smaller investments. Alternatively, a fund should use financial intermediaries to place and monitor investments in SMEs.*

2. Management Costs versus Fund Size

Management costs are relatively fixed regardless of the size of the Fund. To achieve financial viability, a fund's asset base and consequent earning power must be large enough to support these fixed costs. If a fund's capitalization is too small, then management costs can overwhelm the fund and eventually erode its capital base.

Many of the smaller funds have encountered -- or soon may encounter -- substantial diminution of their investment base due to relatively high management costs. The Ghana Fund ($2.1 million), the Tanzania Fund ($5.0 million), the Africa Growth Fund ($5.2 million) all have management costs disproportional to their capital base. Even EDESA and SIFIDA, with approximately $20 million of equity base, state that management costs are a significant problem.

Guiding Principle: *A fund should be sufficiently capitalized so as to have the reasonable prospect that income earned on investments may support on-going management costs.*

3. Dependable, Non-conditional Capital

In order to perform effectively, fund managers must be confident of consistent, assured access to capital for two reasons. First, the intensity of effort needed for effective due diligence and negotiations requires a high degree of motivation, which is undermined without assured access to funds for the investment. Second, the investee also requires a high degree of motivation to undergo the work required in attracting the investment. If the investees are not confident that funds are available, then they will be reluctant to seek investment partners.

If additional funding is conditional upon the performance of the fund as evaluated by the funding agency, then management will be motivated to satisfy the demands of the agency. Such demands can change over time depending upon the current orientation and politics of the agency, and may be inconsistent with or disruptive of the stated objectives of the fund.

The new Russian American Enterprise Fund is authorized for US $300 million, but granted only US $20 million initially. Because US $20 million is insufficient to attract public attention and investment opportunities, this fund may announce that its capitalization is much larger than US $20 million. When the fund's true committed capital becomes known, the credibility of fund management may suffer. Also, management could be inclined to conduct its affairs in order to maintain USAID's comfort level, whether or not such conduct is effective and efficient in pursuing the fund's ultimate objectives.

Guiding Principle: *Sufficient capital to finance a fund reliably for a reasonable length of time should be committed up-front. Conditions to further financing should be minimized and clearly stated with quantitative benchmarks.*

4. Leveraging

The European and NIS Enterprise Funds serve as a stimulus to increased capital and technical assistance directed to SMEs in areas where none previously existed. Likewise, the SAEDF can play a catalytic role in leveraging and redirecting the flow of capital that already exists toward the indigenous and black African entrepreneur, who generally has no or limited access to financial and management resources for SME and inter-regional business development.

Leverage is the use of other peoples' resources -- whether financial, managerial, or technical -- to advance ones own objectives. Several of the eastern European and NIS funds have been successful at establishing parallel funds that their management teams invest. Likewise, there has been some success at working through intermediaries, even in establishing such. Leverage could be used in nearly every undertaking to achieve potential as fully as possible. However, as demonstrated by the experience of minority-focused venture capital funds in the U.S., leverage at any level and of any type does not happen overnight nor occur spontaneously. It is based on a fund's success.

Guiding Principle: *A fund should encourage financial, management, and technical leverage.*

E. Summary

A number of lessons can be drawn from the experience of predecessor funds and applied to the design of a regional, Southern African fund. Among these principles are:

- Because the investment environment is already difficult, an enterprise fund should be carefully structured and managed so as not to give rise to additional and extraneous obstacles to success. Expectations should be tempered.
- A fund should include sufficient allowance for start-up costs. Expectations or requirements regarding the pace at which investments will be placed should be tempered.
- A fund's design should not incorporate any pressures regarding investment timing.
- The design of a fund should not be so constrained as to preclude or slow the adjustment of its business to suit changing market conditions.

- The management of a fund should -- must -- be highly experienced in making private investments as principals. Ideally, the experience base should include knowledge of investing in a development context.

- The compensation package for fund management should include a moderate base salary with the potential for additional gain based upon long-term investment success. Investment success can be defined in monetary and non-monetary terms.

- Structured, intensive requirements for reporting by investee companies should be mandated by fund management.

- Fund management should be located within the region in which investments are placed.

- Managers of enterprise funds should have substantial, successful experience as principals or owners in risk capital funds.

- Fund structures must incorporate sufficient rules such that U.S. government sensitivities are satisfied. On the other hand, funds must be free of the cost and uncertainties inherent in excessive reporting, review and evaluations, and the consequent uncertainty of continued funding.

- Fund documents should recognize and support the need for fund independence by incorporating clearly defined development objectives and operating rules and regulations up-front that are not subjective or changeable.

- If a fund's target group is SMEs, then the capitalization and on-going financial support should be structured to support the high cost of smaller investments. Alternatively, a fund should use financial intermediaries to place and monitor investments in SMEs.

- A fund should be sufficiently capitalized so as to have the reasonable prospect that income earned on investments may support on-going management costs.

- Sufficient capital to finance the fund reliably for a reasonable length of time should be committed up-front. Conditions to further financing should be minimized and clearly stated with quantitative benchmarks.

- A fund should encourage financial, management, and technical leverage.

IV. DEFINING OBJECTIVES

The constraints and principles outlined in the preceding sections helped frame the objectives of the Fund. This section reviews these proposed objectives and offers for consideration a mission statement for the Fund.

A. Fund Objectives

Most of the countries in southern Africa are in transition from single party, centrally managed economies to pluralistic democracies with market driven, private enterprise economies. These fragile democratic experiments, as well as the more established democracies of the region, are all dependent on achieving real economic improvement in the daily lives of their citizens in order to maintain their legitimacy. The SAEDF is designed to contribute to the process of generating sustainable economic development of the region, and the consequent improvement in the economic and social well-being of its citizens, by accomplishing objectives in three areas: (1) Business Development; (2) Financial Sustainability; and (3) Regional Economic Integration.

1. Business Development

a. Objective

The SAEDF will contribute to accelerating the pace of sustainable private sector development in the region by increasing business development, ownership and management skills among indigenous African entrepreneurs. It will accomplish this by providing long-term risk capital and business management assistance, and by leveraging existing long-term debt and equity capital from indigenous and foreign sources.

b. Rationale

Profitable businesses create wealth, employment, higher per capita incomes and thereby the means for a better quality of life for owners, employees and their families. Business formation and expansion, in turn, requires capital and business development expertise or "know how". In the countries the design team visited, and in those visited by the pre-feasibility study team, it is the lack of access to long-term risk capital suitable for small and medium scale business development by indigenous African and aspiring entrepreneurs which has stifled business formation and growth, as well as the acquisition of business management experience. The problem persists for several reasons:

- Limited personal "wealth", which is the principal source of business start-up capital. Owner equity capital is commonly created through long-term savings, earnings, and capital gains from other successful investments, and most frequently from gains in the value of real estate. However, in several of the countries of the region, until recently, ownership of real estate by black Africans was prohibited by law. In others, the necessary policies, regulations, and land registry systems which encourage the creation of private capital are of recent vintage. These conditions are improving. However, creation of adequate entrepreneurial equity capital from existing sources will take decades. In the interim, traditional financial institutions will not lend or invest funds with an entrepreneur who can not provide an appropriate level of owner equity capital in order to share the highest business risks.

- Lack of significant social interaction between decision makers in the financial community and indigenous African entrepreneurs leading to a form of business "red-lining". In Zimbabwe and South Africa in particular, where there is no general scarcity of capital, the perceived risk of investing in companies started or managed by black African entrepreneurs may in fact be greater than the actual risk of doing so. Nevertheless, to a large extent, these perceptions influence the lending and investment practices of decision makers in the financial community, the overwhelming majority of whom are white. While the racial composition of the lending corps as well as the extent to which racially-biased perceptions and attitudes inform investment and lending practices are both likely to change as these societies achieve greater openness, this will happen over decades. In the interim, releasing or leveraging existing local debt and equity capital to finance business opportunities sponsored by black African entrepreneurs will require altering the risk perceptions of decision makers in the local financial community.

- Lack of business management expertise among many indigenous African entrepreneurs. While there exists no lack of talent, drive and interest in business ownership among African entrepreneurs and aspiring entrepreneurs, it is generally recognized throughout the region that, for historical and political reasons, such entrepreneurs often lack the levels of technical and managerial experience normally required by investors and lenders. Lowering the risk levels generally perceived by potential investors and lenders will require augmenting the managerial and technical capacity of indigenous African entrepreneurs.

In sum, accelerating the pace of business development -- and by extension sustainable private sector development -- in the region, will require greater access to long-term risk capital and business development expertise by indigenous African entrepreneurs.

2. Financial Sustainability

a. Objective

Objective: *The SAEDF shall seek to become financially self-sustaining, without grant support beyond initial capitalization, in order to serve as a long-term, dependable source of risk capital and business development expertise in the region. In practice, this will mean that the Fund shall not permit its inflation-adjusted principal balance to be eroded; that the Fund shall attempt, at minimum, to generate an inflation-adjusted break-even, i.e. zero percent (0%), rate of return on its portfolio, after operating costs and investment losses.*

b. Rationale

In order to accomplish financial self-sustainability so defined, the SAEDF will perforce be required to seek a reasonable rate of return on each individual investment. The successful accomplishment of its objective will mean that the SAEDF, over time, has invested more capital in "winners" than "losers" and has in fact invested in enough successful businesses, responding to real demand in the region, to insure its continued existence.

Finally, it should be noted that there is an implicit subsidy in this approach to financial self-sustainability, consistent with the SAEDF's development orientation. By setting its minimum acceptable inflation-adjusted portfolio rate of return target at zero percent, in markets where private investors do not exist or require rates of return on investment in the range of forty to fifty percent and more, the SAEDF effectively lowers the price of otherwise scarce, very expensive risk capital; at the same time, it broadens the opportunity set of entrepreneurs and businesses capable of profitably utilizing risk capital in the marketplace.

3. Regional Economic Integration

a. Objective

To the extent possible, without jeopardizing its financial sustainability or business development objectives, the SAEDF will attempt to promote greater regional economic interdependence by investing in businesses of a regional character.

b. Rationale

As the USAID "Initiative for Southern Africa" policy document points out, southern Africa offers greater potential for economic growth than any other area of the continent. The predominance of English as a common language and English law as the basis of its countries legal systems; the relatively strong and sophisticated economies of Namibia, Zimbabwe, Botswana and South Africa; the abundance of essential minerals, fertile agriculture, and a regional population exceeding 125 million, all position the region as an area offering tremendous opportunity for entrepreneurial business activity and private sector development.

At the same time, the recent worldwide recession and unfavorable terms of trade for raw materials and agricultural products, as well as the continued existence of inappropriate policies, low worker skills and productivity, narrow productive bases, corruption, and high population growth rates, combine to generate poor overall economic performance for the region.

A consensus appears to have emerged among aid specialists that the way to solve many of the region's problems, and take advantage of its enormous natural potential, is through increased regional economic integration. Moreover, it is thought that generating sustained economic growth in the region would have spill over effects on the rest of Africa in terms of trade, the growth of service industries, and the power of successful examples.

As an active investor, with a regional focus, the Fund may be expected to see and, from time to time, invest in business opportunities of a regional nature, either by way of shareholder group composition, productive capacity, markets, or some combination thereof. However, given the complexity and scale of many of the region's problems and the broad field over which the SAEDF is expected to generate business activity, the Fund alone will not change the economic make-up of the region.

B. Mission Statement

> Through the innovative and sustainable provision of long-term risk capital and management assistance to those previously lacking access to such, the SAEDF will increase and broaden throughout Southern Africa: 1) private sector participation in the economy; 2) business ownership; 3) employment opportunities; and 4) business development skills.

The above statement endeavors to recognize the regional nature of the Fund and to capture the dual developmental and financial self-sustaining objectives of the Fund. For the Fund to be sustainable, it must -- by extension -- invest in companies and entities that are profitable. The statement attempts to focus on those previously without access to such long-term resources, while leaving the door open to innovative uses of funds and talent to achieve the objectives. It also recognizes that more than money is needed to achieve the Fund's objectives.

V. RECOMMENDED MODEL FOR SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

The structure for a Southern Africa enterprise development fund presented in this section represents the consulting team's recommendations to USAID. This recommended design follows from the constraints, the lessons learned, and the objectives. A few of the guiding principles are summarized below.

The design team recognizes that certain political or regulatory constraints may cause the actual fund structure to differ from this recommended design. However, the team has chosen to present the structure it believes would be most effective in achieving the objectives outlined in Section IV, without regard to external design constraints.

Three alternative fund structures are presented in Annex G. These include:

- A design patterned closely after the current Eastern European - American Enterprise Funds and known to be acceptable to the U.S. government.

- A fund of funds design similar to the Project Identification Document (PID) proposal, which was patterned after the Small Business Investment Company (SBIC) model.

- A pass-through option, wherein funds would be passed through to individual USAID country missions and managed by those missions.

A summary and comparative analysis of all four designs is presented in Section VII.

A. Design Principles

In order to maximize its effectiveness, the Fund's design should incorporate:

- Independence to make investment, management, and all other decisions with a minimum of rules and regulations, investment constraints, and oversight which can be costly and constraining.

- Regional and local presence of the fund's management group to maximize knowledge of the investment and development environment, deal flow, due diligence, and investment monitoring.

- Flexibility to adjust the Fund's product or service offerings in response to the changing needs of the target group, without a cumbersome approval process.

- Focus on a simple set of clearly defined objectives, not attempting to be all things to all people.

- Reasonable expectations of the fund's power to make visible changes in Southern Africa and to become financially self-sustaining, in light of the inherent constraints in the investment environment.

- Patient capital which recognizes the long-term nature of the fund's mission and the time required to consummate optimal transactions.

- Experienced management, with substantial history as a successful principal investor and a sensitivity to development issues.

- Incentive compensation, that will attract and motivate highly capable management.

- Close monitoring of investments, that identifies needed management assistance to enhance the chances of investment success.

- Leverage, that accesses additional financing and needed management assistance for its investees.

B. Recommended Fund Model

The discussion of the recommended model for the SAEDF is presented in two parts. The first looks at topics related to the organization of the Fund and the second considers subject matter related to the operation of the Fund.

1. Fund Organization

Four topics are of particular interest when discussing the organization of the Fund -- its legal structure, its Board of Directors and management team, its initial capitalization, and its location.

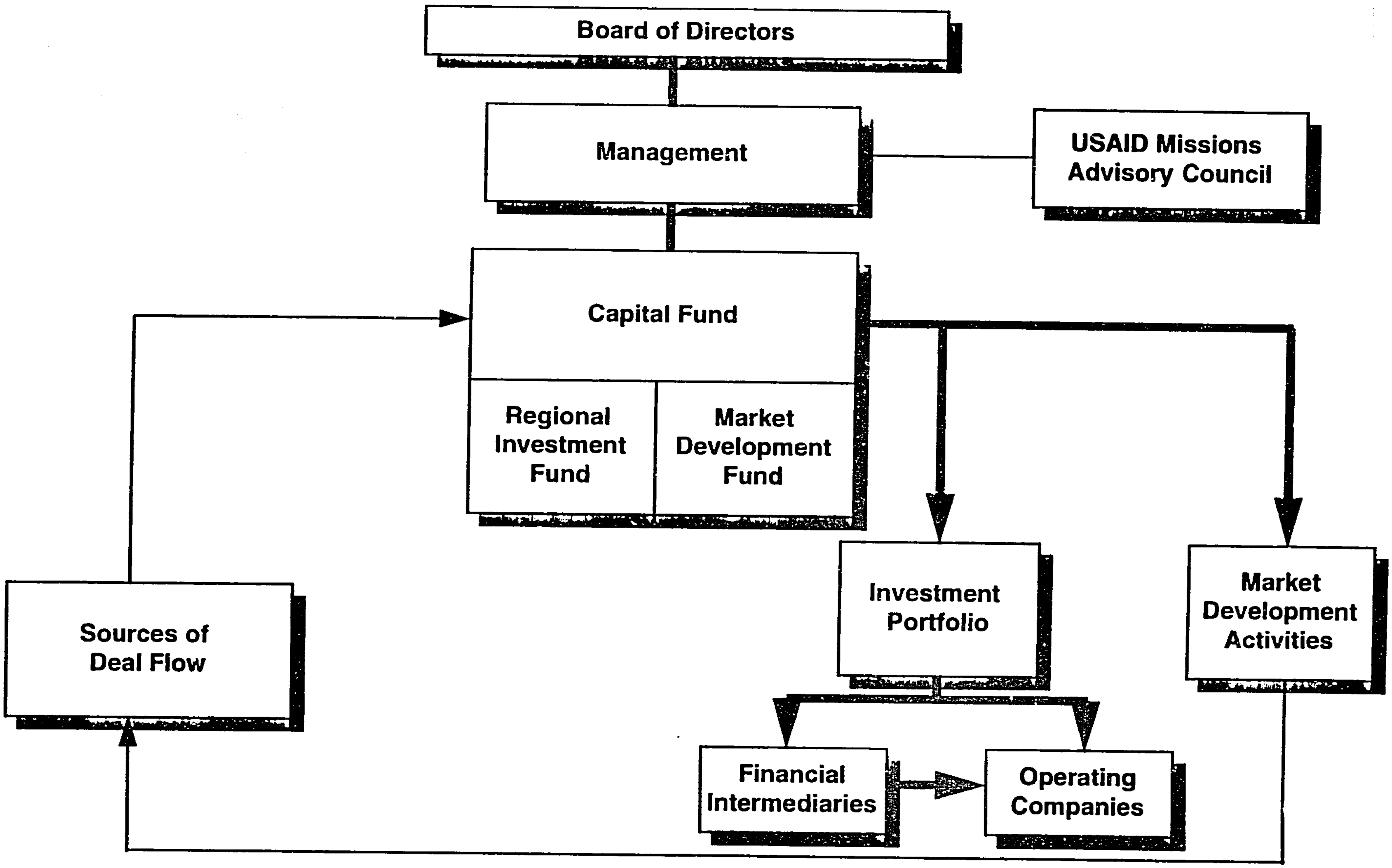
a. Legal Structure

The Fund should be established as a not-for-profit, (501)c3 U.S. corporation -- that is to say, the Fund would not have shareholders and would not distribute dividends. This legal structure avoids the need to create a Trust and a separate management entity (an oft-used arrangement on other USAID-funded venture capital initiatives, e.g., Kenya Investment Trust). In addition, it facilitates the use and management of an endowment and/or grant funds, and provides for certain tax advantages.

A not-for-profit does not restrict the Fund's ability to leverage capital from interested third-party investors such as another donor agency or private interests. It is not solely, nor even principally, the Fund's money that attracts such investors; rather, it is management's performance. If Fund management demonstrates success, the Fund could attract: 1) donor capital as a direct investment in the Fund and 2) donor and private capital through the creation of parallel funds specifically managed by the SAEDF management team.

Because it is a not-for-profit, will potential investors, partners, and investees take the Fund seriously, or will it be viewed as another soft-money institution? The answer rests with the Board of Directors and Fund management, for it will be their actions that establish the Fund's demeanor. In this regard, the independence of the Board and of management in decision making is paramount.

Figure V-1
Fund Model



The charter, by-laws, articles of incorporation, and grant agreement (if applicable) of the fund will necessarily specify certain legal and policy operating parameters. One objective of such parameters is to enhance USAID's level of comfort that its funds are not misappropriated and are used for development purposes. USAID, in turn, should limit its oversight responsibility, thereby giving the Fund's Board and management the independence required to successfully manage the Fund.

Members of the Board and the managing director should work with USAID in drafting the Fund's charter and by-laws and negotiating the grant agreement. Their participation would benefit both USAID and the Fund. Directors and management would thereby take greater ownership and responsibility for achieving the Fund's objectives. USAID would learn first-hand, rather than after the fact, the concerns of management regarding various USAID oversight requirements.

Even though legally structured as a U.S. not-for-profit corporation, the Fund would operate across the southern African region, i.e., it would be a regional fund, and as such should have its office in the region. There are several reasons at an operational level that point to a regional fund approach:

- It provides a mechanism to invest in close-out missions.
- It will be more attractive to top quality managers than single country funds or deal-by-deal investment schemes. A regional fund is larger and higher profile, representing a more interesting challenge to potential managers. In addition, with $100 million, a regional fund can afford a higher level of compensation and can create a more meaningful "carried interest" package than smaller funds.
- It achieves economies of scale. For example, a single regional fund will enable management costs, a major component of transaction costs, to be spread over a larger volume of transactions, thereby enhancing the viability of the Fund. At the same time, this enables a regional fund to attract top quality, highly experienced risk capital managers, who would be unaffordable for smaller, single country funds.[8] Moreover, the cost of and approval process for a regional fund will like be less expensive and time consuming than the cost of and approval for a series of funds at the country level.
- A large-scale regional fund can afford permanent-hire, top quality investment managers who, over time, will develop a depth of experience and investment judgement in the southern Africa region. Such leadership provides consistency, constancy, and continuity.

b. Selection and Composition of Board of Directors and Management

The Board and management, together, constitute an important determinant of Fund success. For the most part, they will determine the Fund's ultimate structure, set its investment parameters,

[8] A regional fund will require a single USAID approval, while country funds might require 11 approvals, not to mention PIDs and Project Papers. From a transaction cost perspective, a regional fund also offers USAID certain economies of scale.

and establish its operating procedures. Therefore, the selection process and the criteria for selection are critical components of the Fund design.

1) Board of Directors

Selection Process: A selection committee consisting of USAID's Administrator, or designee, and two individuals from the venture capital community[9] would propose a slate of candidates to the President of the United States, who would select four of the proposed five initial board members. The fifth board member will be the Fund's managing director as an *ex-officio*, voting member. It is suggested that the President of the United States make the initial Board selection from the slate of proposed candidates in order to raise the profile of the Fund's Board of Directors to that of the European funds.

Selection Criteria: The Board should represent a set of diverse and relevant skills and experience. The Board should be characterized by ethnic and gender diversity, and include among its voting members the following attributes:

- At least two members who are US citizens who exhibit significant skills and expertise as risk capital investors with demonstrated knowledge of the political and economic realities of "doing business" in Southern Africa.
- At least two members who are citizens of Southern Africa who exhibit a deep understanding and commitment to private enterprise development throughout the region and demonstrate experience and expertise in the legal, financial, and banking practices of the region. The intent should be for the Board to eventually have a Southern African majority.
- At least two members who have demonstrated understanding of and experience with development of disadvantaged communities in the U.S. or Southern Africa.

Composition: The initial board size should be small -- perhaps totalling five directors -- in order to establish the tenor and style of the Fund. A five member board will enhance interaction and promote timely decision making. Other board defining recommendations include:

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[9] By way of example only, (these individuals have not expressed an interest nor been approached): **Patricia Clogherty** is President of Patricoff & Co., one of the most successful private venture capital investment companies in the U.S. She brings over twenty years experience as a venture capitalist and many years of international economic development experience. Ms. Clogherty is a former Peace Corps volunteer and, in recent years, under official auspices, has helped set up venture capital funds in Brazil, Peru, Kenya, and Cote d'Ivoire. She has also conducted thorough evaluations of LAAD, ADELA, and the U.S. Small Business Investment Companies program. **Terry Jones** is co-founder and President of Syndicated Communications (SYNCOM) and general partner of Syndicated Communications II, L.P., the largest and one of the most successful minority-oriented venture capital family of funds in the U.S. A Harvard MBA, he spent many years living in Africa pursuing private entrepreneurial interests before returning to the U.S. to co-found SYNCOM. He is a former member and chairman of the board of the National Association of Investment Companies (NAIC). For the last decade, he chaired the NAIC's International Economic Development Committee and in that capacity conducted numerous business development seminars and workshops in African countries on behalf of USAID and the U.S. State Department.

- A maximum board size of nine, excluding non-voting participants. This provides ample freedom to include others who would want board representation if they invested in the Fund, yet not become too unwieldy.

- A term of three years at which time board members may be reappointed or replaced at the discretion of the President.

- A limit of no more than two consecutive terms.

- Meetings held semi-annually, at a minimum, or as deemed necessary by the Board.

- Rotating Board meetings throughout the region.

To provide additional perspective at the Board level and to further balance financial self-sustainability and development impact objectives, it is recommended that the USAID Regional Director for Southern Africa (or designee) serve as an *ex-officio*, non-voting director. The position is non-voting in order to avoid certain USAID oversight requirements that a voting position would necessitate.

2) Management

Selection Process: The Board of Directors should have responsibility for selecting three senior members of management. The managing director should be hired first, and then participate in the selection of other senior management personnel. In selecting the managing director, the Board would rely on its contacts within the venture capital industry.

Selection Criteria: Management should be selected based on --

- A substantial track record of successful risk capital investing.
- Appreciation for the nuances of stimulating private enterprise in a development context.
- Personal commitment to the values and objectives of the Fund.
- Willingness to commit to minimum of five years on-site.

In order to give the Fund local contacts and knowledge, a southern African should be sought to fill one senior manager position. However, in no case should other management qualifications be sacrificed.

In the past, an RFP selection process has often been utilized by USAID. It is strongly recommended that this process not be used in this case in order to ensure that top quality, experienced risk capital investors are enlisted. Foregoing the RFP process will enlarge the pool of potential candidates from which to find those with the desired characteristics.

Composition: A total of three senior investment officers should be engaged, including a managing director and an experienced Chief Financial Officer. Additional junior officers may be hired by senior fund management as and when needed. Ideally, the Fund would eventually have an all Southern African management. Initially, it is likely that one of three senior and possibly all three junior officers will be from Southern Africa.

3) Rationale

The Board and management selection process recommended here is not typical for USAID. The process seeks to ensure a management team that demonstrates substantial, successful experience in venture capital investing.

The approach also strives to engender a sense of "esprit de corps" among the executive management team by including the managing director in the selection of the other senior Fund managers. The dynamics of the executive management team are critical, requiring a team of dedicated individuals who share a common purpose, values, and investment philosophy. As individuals, they must bring to the team a complementary mix of strengths, abilities, talents, and biases, all or most of which are known by the other team members.

Creating an effective senior management team is as much an art as a science. Without a common purpose, shared values, and investment philosophy, the management team is unlikely to cohere. Without a complementary mix of strengths, abilities, talents, and biases, the team is unlikely to possess sufficient depth and breadth to make superior investment decisions.

The Board will establish the Fund's investment philosophy and operating policies. Tasking the Board with selecting senior the management team helps ensure that the Board and management share the same investment philosophy. Why is this important? Though the Board, especially initially, may make the investment decisions, it is management that finds, packages, and presents the investment opportunities to the Board. A Board and management out of sync at a very basic, philosophical level will be hard pressed to assemble a portfolio that successfully achieves the dual objectives of self-sustainability and development impact.

4) Compensation

Members of the Board of Directors will serve on a volunteer basis. There should be no directorship compensation made by the Fund to any member of the Board. Travel expenses (travel plus M&IE) would be covered by individual directors, or by the Fund at published per diem rates upon request of each director.

Management compensation should be determined by the Board of Directors. It is recommended that compensation for senior management mirror the proven, free-market compensation package typical of U.S. venture capital funds. This package includes three components; 1) salary and benefits, 2) annual bonus, and 3) carried interest.

- Salary and benefits: Annual salary should approximate that received by Senior Foreign Service officers, currently about $100,000 to $128,000. Benefits should include those usually accorded a Senior Foreign Service officer including medical, housing, schooling, shipment, etc.

- Annual Bonus: Up to $150,000 per year during the first five years of the fund should be allocated for annual performance-based bonuses. This amount is for the entire Fund staff, including senior and junior investment officers and administrative staff. Bonuses should be distributed at the discretion of the Board, in consultation with the managing director.

- Carried Interest: In order to motivate management to behave as owners of the Fund, an ownership stake in the realized gains from each investment should be distributed to Fund management. Parameters to be determined by the Board of Directors include the percentage of realized gains to be distributed, the provisions under which the carried interest would be vested, and the allocation of carried interest among individual managers. The return earned on passive treasury fund management should not be considered for purposes of establishing management's carried interest.

To ensure that management is not incentivized to emphasize financial performance over development objectives, total cash compensation should be limited. No individual's average annual compensation (salary plus performance incentives) at any time during the period of employment at the fund should exceed a given amount to be established by the Board.

The team recognizes that the proposed compensation scheme potentially exceeds the US $150,000 limit in the newer Eastern European fund agreements. The importance of instilling a sense of ownership should be weighed against the U.S. government's desire to respect this limit. It may be useful to note that as carried interest pays off only if an investment is profitably sold at an appropriate return on investment, no U.S. government funds will be used to pay this management incentive.

c. Capitalization

USAID should capitalize the Fund in the total amount of $101.5 million according to the following schedule:

FY1994	$21.5 million	(August 1994)
FY1995	$20.0 million	(March 1995)
FY1996	$20.0 million	(March 1996)
FY1997	$20.0 million	(March 1997)
FY1998	$20.0 million	(March 1998)

To provide Fund management with confidence, financial continuity, and credibility in the marketplace, it is recommended that funding up to the $100 million level, and under no circumstances less than US $50 million, be provided on a unconditional basis, except for "cause". Cause is defined as acts of corruption or crime by principal members of the Fund's management or Board.

Funding of any tranche should not be conditional on the expenditure of previously received funding. Managers should not be under pressure to close transactions quickly, as the quality of transactions might thereby suffer. Moreover, to a significant degree, operating expenses can be funded by interest earned on the passive investment of money received but not yet invested in Southern Africa.

In the case that USAID funding must be conditional, clear and objective benchmarks should be established. The possibility of arbitrary or subjective withholding of funding can seriously undermine management's morale and the overall success of the Fund. The following benchmarks are suggested as indicators of satisfactory results justifying a further tranche:

- Year one --
  - Management submission and approval by the Board of:
    - Statement of Corporate Policies and Procedures
    - Personnel compensation policy
    - Environmental protection policies and procedures
  - At least four visits to all participating countries
  - Development of appropriate databases
  - Establishment of a monitoring system that captures investment performance as defined in financial and development terms

- Years two through five --
  - At least two annual visits to all participating countries
  - Unqualified audit opinions
  - Fund has not realized a loss of more than 50% of the value of its investments

d. Location

The Fund's location should be determined by the Board, but that location should be within the region. In making the site selection it is recommended that the Board consider the following characteristics:

- Infrastructure
- Telecommunications
- Ease of regional travel
- Freedom from exchange controls
- Security & livability for management
- Type of operating structures legally permissible
- Tax and other investment promotion incentives
- Perception of promoting regional integration

This last criterion is deemed important enough to exclude South Africa from consideration as the Fund headquarters. However, the Fund at the discretion of the Board could open satellite offices as justified by demand and the Fund's exposure in any given country. A suggested short-list for the Fund's location, in alphabetical order: Botswana, Swaziland, Zambia, Zimbabwe. Ideally, Fund management as well as the Board and USAID would participate in making this decision.

2. Fund Operations

In discussing the operating parameters of the Fund, several topics are of interest: sources and uses of resources, investment parameters, market development support, technical assistance, monitoring of investments, investment exits, and termination of the Fund.

a. Fund Resources

The Fund's sources and uses of funds can be divided among four categories -- treasury funds, operating budget, market development funds, and investment funds. Technical assistance is incorporated within investment funds, as all technical assistance is assumed to be deal-specific.

1) Treasury Funds Management

Treasury funds represent those monies held by the Fund which are not invested in Southern Africa enterprises or otherwise expended. The income earned from treasury investments will in large measure support the Fund's operating costs.

Treasury funds would initially be sourced solely from USAID grants to the Fund. Additional sources of treasury funds include other investors, interest earned on passive treasury investments, and all income earned, but not yet reinvested, by the Fund on its Southern Africa investments including interest, dividends, and capital gains. Any income received by the Fund should be placed in Treasury, i.e., no idle funds.

Treasury funds should be invested in highly conservative, U.S. income-producing investments, e.g., U.S. government obligations. To relieve management from the burden of treasury fund management, a fiduciary investment manager, or perhaps two, of good repute should be retained to manage the treasury funds. This can be accomplished easily and at low cost.

2) Operating Budget

The operating budget represents the cost side of the Fund. It includes all salaries and compensation, office and travel expenses, and due diligence, legal, accounting and other investment expenses. On an annual basis, management should submit a proposed operating budget to the Board for review and approval. Moreover, the Fund should be audited annually by an independent, internationally recognized audit firm selected by the Board.

At no time should annual operating costs exceed two and one half percent (2.5%) of Fund's anticipated total capitalization. This rate compares quite favorably to that of those funds reviewed in Annex F, all of which are in excess of three percent, and is comparable to the two to two and one half percent typical of a U.S. fund.

Operating costs should be funded initially by a USAID grant, included in the first tranche, to cover start-up costs and the first months of Fund operations, estimated at US $1.5 to $2.5 million. Thereafter, operating costs should be paid out of income on treasury funds or other current income.

Annex H presents a hypothetical operating budget. It is presented as an illustration of the type of information Fund management should be responsible for presenting to the Board in its annual operating budget and reporting on a quarterly basis.

3) Market Development Support

In order to develop a flow of potential transactions in an environment where venture capital is unknown, a substantial amount of time and money is required to educate the marketplace as to the Fund's existence, benefits, and requirements. Therefore, it is recommended that US $5 million of the Fund's capitalization be expended to develop a flow of potential transactions which meet the Fund's dual objectives. These funds could play an especially important role in countries without USAID missions or where other such donor support is dwindling. Market development and education support activities might include:

* Bringing business people together on a regional level, developing a regional network of entrepreneurs and encouraging the cross-border flow of capital, labor, and expertise.

* Working with local banks to help them better understand what to look for in a good risk capital investment opportunity and how the Fund's activities could complement the bank's business.

* Educating entrepreneurs as to the advantages, the rights, and responsibilities of a venture capital partner.

* Providing management assistance to entrepreneurs and enterprises in order to create investable enterprises.

* Conducting workshops in conjunction with existing enterprise development entities, e.g., Black Integrated Commercial Support Network, Swazi Growth Trust, Tanzania Business Service Center.

* Establishing a database of potential investment opportunities and technical support across the region and incorporating industry research capabilities, e.g., contacts, investment leads, joint venture partners, technology development/transfer data bank, accountants and attorneys, etc.

Funds for market development and education support could be taken from the total pool of investment capital and limited to US $5 million over the life of the Fund at a rate of US $1 million per year in the first five years of the Fund's life. Unused market development funds will be invested as treasury funds.

Return on investment would still be based on the total initial US $100 million investment capitalization. This brings some discipline to directing the use of market development money towards activities that potentially would enhance deal flow.

4) Investment Funds

Sources of Funds: After deducting market support, US $95 million of the total US $100 million investment capitalization will be allocated to investments in Southern Africa. All investment funds are sourced from treasury funds, the "bank account" of the Fund. Over time, as capital gains and other income is realized, an amount greater than $95 million is expected to be available for investment. In time, the bulk of the Fund's appreciation will come through capital gains. Hypothetical projections presented in Appendix H show nearly $200 million available for investment after 20 years.

Uses of Funds: Investment funds should be used to assist southern African enterprises in terms of both provision of risk capital and technical/management assistance. All technical assistance provided by the Fund should be dedicated to enterprises in which the Fund has invested or expects to invest. To maintain financial sustainability, the investment of technical assistance should be added to the capital investment in determining whether an enterprise will be able to repay the investment plus provide a return on the investment to the Fund. It should be anticipated that the majority of the Fund's investments will likely require seven to ten years before any gains can be realized. The bases upon which the Fund should decide to invest in a particular enterprise are described below.

Leverage: The Fund is designed to potentially achieve three different types of leverage which contribute to fund and investee financial and technical strength.

- The Fund will practice financial leverage at possibly three levels -- the Fund level, the level of financial intermediaries, and the operating company level -- by using other peoples' money to help finance its investment.

- The Fund will practice technical leverage by applying other peoples' technical skills to its investments. For instance, the Fund will hire regional chartered accountants to assist in the analysis of potential investments and will hire other professionals as required by its business. In some cases the Fund may leverage off of donor-funded technical assistance providers such as the International Executive Service Corps or other programs supported by USAID or other donors.

- Management leverage will occur when the Fund's success leads others -- private or donor -- to invest in it or establish parallel funds managed by the Fund's management team. In addition, Fund management will leverage its network of contacts -- both in the region and outside -- to advance Fund objectives. For example, the Fund may identify cross-border market opportunities for an in-country business, joint venture partners, or a mutually beneficial trade in technical skills and financing sources.

b. Investment Guidelines

The exact nature of the Fund's investment philosophy and parameters should be established by the Fund's Board of Directors and executive management. Recommended guidelines are presented here.

1) Investment Philosophy

A clear investment philosophy is necessary if the Fund is to achieve financial self-sustainability with development impact. The philosophy will be largely dictated by the mission statement, the Fund's charter and by-laws, and the Fund's Board. Recommended guidelines include:

- The Fund should make sound investments under market driven principles, without any subsidies and seeking a reasonable return on its investments.
- Each investment made by the Fund should have a definable development impact, according to the development objectives set out in Section IV. That is, for a specified target group, an investment might serve: to enhance business development through improved skills, management, or access to capital; to promote regional economic integration; to support diversified ownership; etc.
- The Fund should seek to invest as an active partner, providing targeted financial and management assistance as required to achieve the necessary return on investment. The cost of such assistance should be included in the expected return on investment calculations.
- To the extent that Fund's active participation with an enterprise can be otherwise assured, then investing as a minority owner should be encouraged.
- The Fund should invest in those enterprises with competent, committed management that have above average growth and profitability potential due to increasing management skills, promising markets and products or services.
- The Fund should avoid investments which would be profitable only because of the existence of serious economic policy distortions, such as artificial monopolies or other preferential treatment.
- The Fund should avoid investments which are contrary to U.S. government policies, including investments in military industries, investments which may cause the export of jobs from the U.S., investments which may cause social or environmental degradation, and investments which might be embarrassing to the U.S. government.

2) Return on Investment

Financial Return: The Fund should seek to preserve its inflation-adjusted principal balance. Therefore, each investment must have an expected positive rate of return so that with losses, the Fund will be in a net positive position in real U.S. dollar terms. The hypothetical projections in Annex H indicate that a ten percent (10%) rate of return in capital gains plus a four percent (4%) current income return may be sufficient to preserve the Fund's inflation-adjusted principal balance.

This 14 percent combined rate of return is substantially less than would be required by a profit-seeking, private sector investor. Such investors might require an inflation adjusted 30 to 50 percent annual return on investment to compensate for the level of risk encountered in developing countries.

Development Return: Return on investment can also be measured in development returns. The Board should establish development impact indicators consistent with the development objectives outlined in Section IV. These indicators would be used to measure the Fund's development impact and to measure expected impact in initially deciding whether to make a particular investment. Every investment will not be expected to impact on each indicator. Indicators might include favorable changes in/to:

- Ethnic and gender composition of labor force, management, and ownership.
- Socioeconomic composition of labor force, management, and ownership.
- Employment generation, direct and indirect, over time.
- Employee productivity.
- Financial leverage attained on each investment.
- Distribution and increase in business management and vocational skills.
- Compensation and income levels for employees.
- Transfer of technology.
- Tax revenues for local government.
- Regional trade and investment linkages.
- Development of capital markets.
- Establishment, strengthening, and/or expansion of a wide-array of enterprises across a variety of sectors.

3) Investment Parameters

The Board should determine the appropriate investment guidelines for the Fund in terms of defining the target groups, investment by country, types of investment, size of investments, investment instruments, and other parameters. Recommended parameters are suggested here.

a) Target Groups

A development objective of the Fund is to increase the level of business ownership and skills among those segments of the population previously lacking access to such. Each investment, therefore, should help to distribute ownership and skills. Several types of investment opportunities that can be used to reach this target group are described under Types of Investments, below.

b) Country

For the Fund to make an investment, the country in which the enterprise operates must have undertaken economic and political liberalization, and must be politically acceptable to the U.S. Government. At the time of this technical report all but Angola are eligible. The need for stricter country eligibility criteria must be balanced against the negative impact that external constraints can place on the Fund's sustainability. Given these eligibility criteria, it is recommended that:

- To ensure appropriate diversification of investments, no more than 30 percent of the Fund's capital should be invested in any one country.

- To ensure fair access by each country to the Fund's benefits, no less than five percent (5%) of the Fund's capital should be invested in any one country.

- Should no investment opportunities meeting the Fund's investment criteria be forthcoming from a given country during the first five years, the Fund may allocate that country's five percent (5%) minimum to investment opportunities in other countries.

- Funds invested in a cross-border opportunity should not count against the countries participating in the cross-border investment.. Cross-border is defined as a joint venture between investors from more than one country in the region, in a production or service facility in one of the countries of the region.

If, as has been proposed within USAID, 50 percent of the Fund's capital were invested in South Africa, then the remaining 50 percent would be divided among ten other countries. This could have a fund-threatening impact by limiting the Fund's ability to diversify its portfolio and, hence, jeopardizing its sustainability.

In addition, it all but eliminates fair access to funds for the other ten countries in the region. For example, if, to ensure fair access, a minimum of five percent (5%) of total capital were allocated for each country, then management would be compelled to invest no more than and no less than 5% of capital in each of the remaining countries.

Finally, allocating more than 30 percent to any one country jeopardizes the regional integration objective and could likely engender negative political fall-out from the ten slighted countries. Nelson Mandela recognizes the importance of promoting regional economic harmony when he stated, "It would be a tragedy if the new government tries to use its superiority economically and financially and politically to dominate the region around."[10]

c) Types of Investments

The Fund should not be constrained as to the allowable types of investments, beyond the requirement that investments address the Fund's basic development and financial objectives. Given this, investment types fall into three general categories:

- Indirect Investments: Investments in financial intermediaries or other enterprises which invest in or service smaller enterprises. Several types of indirect investments are outlined in Annex I. These include small enterprise banks, mortgage banks, leasing companies, franchise operations, and subsidiary venture capital companies.

- Direct Investments: Investments made directly into operating companies by the Fund. These may be expansions of existing companies or start-ups. Direct

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[10] Clow, Simon, "New S. African Government Expected to put Spotlight on Regional Ties," Journal of Commerce, 27 April 1994.

investments may also include buy-outs, privatizations and spin-offs where a transfer of ownership and management to previously disenfranchised people may take place.

- Cross-border Investments: Direct investments made in operating companies whose business involves cross-border operations.

d) Individual Investment Size

The Fund should establish different minimum and maximum investment limits for the three types of investments. Minimums ensure that investments are scaled appropriately to the Fund's transaction costs and overhead. Maximums ensure that the Fund is appropriately diversified and protected against the failure of any particular deal. Recommended ranges of investment size are:

- Indirect investments: $1 million to $10 million.
- Direct investments: $.5 million to $2 million.
- Cross-border investments: $1 million to $5 million.

To avoid the risks of overly constraining Fund operations, no allocations regarding amounts to be invested in each investment type should be permanently established. The Fund's Board may choose to establish allocations, which may be adjusted to suit changing investment conditions.

To the extent possible, through direct or indirect investments, the Fund should support small and medium sized African enterprises (SME), the definition of which will necessarily change from country to country and should be determined by the Board in consultation with USAID Missions. Investments in financial intermediaries (indirect investments) will be predicated on, in part, the intermediaries' ability to reach the target group.

The Fund should have the flexibility to invest in opportunities that fall outside the SME definition provided the investment has positive development impact. Privatization, management buyouts, and spinoffs are examples of direct investment opportunities which may exceed the upper end of the SME definition, but that offer excellent prospects to increase ownership among people previously excluded.

e) Types of Investment Instruments

No specific recommendations are made regarding the types of instruments the Fund may employ. The particular form of investment is best determined by the specifics of the investment opportunity. However, all instruments should provide long-term, risk capital. Senior debt, short-term bridge financing, and lines of credit are not the business of the Fund. These kinds of financing can quite often be provided by others and represent potential leveraged capital for the Fund.

f) Investment by Sector

As with investment limits per country, it is recommended that no more than 30 percent of the Fund's portfolio in a particular country be invested in a particular sector, excluding those countries with only one investment.

4) Investment Monitoring and Management

The Fund should expect that approximately half of the investment managers' time will be spent "working" the investment. Managers should constantly seek to identify problems before they grow and manage those risks in order to enhance the prospects of a favorable return.

The Fund should determine the frequency, type of information, and form of presentation required of each enterprise in which it invests. Venture capital funds in the U.S. typically require monthly financial statements from their investee companies as well as non-financial statistics representing critical success factors. Given the riskiness of the Fund's investment environment, the Fund should consider requiring no less than this level of information.

The Fund should produce a comprehensive annual report detailing the Fund's operations, activities, financial condition, and accomplishments -- financial and developmental. In addition, semi-annual and quarterly reports should be provided to the Board.

During its first year of operation, the Fund should establish a standardized reporting module to be used by each investee. Standardized reporting will greatly simplify the overall evaluation of the portfolio.

5) Foreign Exchange Risk

An important aspect of investment monitoring and management will be the foreign exchange risk. The Fund will be investing on a regional basis, and therefore will be exposed to the risks associated with currency fluctuations and foreign exchange controls in each of the countries of operation. This exposure consists of two separate risks: the risk of depreciation or devaluation of the currency, and the risk of controls or other constraints which will prevent realization of investments.

The currency risk associated with devaluation has been a tremendous source of uncertainty and hesitancy among investors in the past. A devaluation, for example, would immediately erode the dollar value of equity or local currency-denominated debt invested in companies. However, this risk has been the greatest in countries which have maintained overvalued currencies for extended periods of time. The resulting adjustments, once the overvaluation could no longer be sustained, was severe in its impact, in effect making up all at once for past years of adjustments never made.

Currently, most countries in the region are no longer at this point, and therefore the risk of precipitous devaluation is lessened. Most countries have market-based exchange rate determination systems in place, so that structural payments imbalances cannot be perpetuated as in the past. There are many, however, which still suffer relatively high rates of inflation and, consequently, can expect to depreciate relative to the dollar. This is a more manageable situation, as prices will be constantly adjusting more or less in step with changes in currency values. Continued inflation/depreciation does, however, still erode the principal balance of equity or any local-currency denominated loans.

The second aspect of foreign exchange risk is that none of these countries have convertible currencies, and all have exchange controls over capital transactions. While most have guaranteed profits remittance and repatriation of capital for approved and registered foreign investors, even in this case there are requirements for Central Bank approval, and the rights are not automatic. In periods of balance of payments crises, dividend remittances or repatriation of capital following a sale or liquidation always ranks low on a Central Bank' s priority list. In addition, many countries require approval of financial statements to demonstrate that the money being taken out is in fact profits, and may limit the amounts based on their interpretation of the company's financial results, even with foreign investment laws that guarantee repatriation. These restrictions on paper have improved substantially with the passage of new foreign investment promotion legislation; however, there is still uncertainty and risk given the ability of the Central banking authority or government to influence and control capital transactions.

These risks will pose a part of the project risk for each investment made by the Fund, to varying degrees depending on the country and the specific economic situation. Over the long term, it is impossible to predict and plan for these types of risk. There are some means of limiting exposure in the short term, but the options for hedging, loan swaps, etc., are limited. Passing the risk on to an intermediary or the investee is likely to make the funds undesirable unless there is an export orientation to the project. While this is one explicit target type of project, it is not likely to be characteristic of most of the target group SME's. Therefore, the Fund will have to accept and manage foreign exchange risk as part of its overall country and project exposure. In doing so, the potential impact of exchange controls may be less than on other types of investors, given the political profile of the fund, and its role as a catalyst for new investment. The major source of risk will continue to be macroeconomic instability and inflation, rather than the impact of exchange controls.

6) Investment Exits

The financial objective of the Fund is to liquidate each investment after significant value has been added to the enterprise. To successfully exit an investment, the Fund should evaluate potential exit strategies before placing its investment in the particular enterprise. Exit strategies may include:

- Sale to the management or original owners of the enterprise.
- Sale to another third party investor, possibly one who has co-invested with the Fund originally.
- Sale to the public through local stock exchanges.

The Fund should not be pressured to liquidate its investments according to a pre-established time schedule. Liquidation should be performed when conditions are optimal, regardless of time. The time required before liquidation may be significantly longer than normal in developed countries. The Fund should be structured to accommodate extended investment holding periods. Moreover, given the risk inherent in relying on the investee to purchase the Fund's equity position the Fund should negotiate the terms of managements' repurchase prior to investing.

If possible, Funds earned from liquidation of investments should be converted to U.S. dollars and repatriated to the Fund's U.S.-based, treasury investments. However, the Fund must recognize that significant convertibility or currency devaluations may prevent repatriation on an economically sound basis. These foreign currency risks should be factored into the initial investment risk versus return decision. The Fund may opt at times to make investments denominated in U.S. dollars or may attempt to hedge its currency risks. If repatriation is not economically appropriate, funds may remain blocked in the local country. In such a case, funds should be re-invested in that country.

7) Fund Termination

The Fund should be structured as a perpetual entity, without termination. As a U.S. government capitalized, not-for profit entity, nobody "owns" the Fund. Therefore, there is no constituency requiring termination.

However, termination should be required if, after ample time, the Fund has proven itself unsuccessful. The Fund should be terminated or reduced in size no earlier than year ten under either of the following conditions:

- The Fund has not invested more than 50% of its capitalization, or

- The total value of the Fund's current investments in enterprises decreases to less than 50% of total capital invested in those enterprises.

C. Fund Start-up Activities

Start-up covers that period of time from selection of the Board selection committee through the first year of operations. The Board and management are the first important elements of an effective start-up since many of the activities, e.g., writing the charter or negotiating the grant agreement, can not be performed by consultants. During the first year of operations, the Fund management team, working with the board or the executive committee, will:

- Establish management and financial systems.
- Hire staff.
- Develop and present the first operating budget.
- Visit each USAID mission at least quarterly.
- Define the target group and establish a development agenda for each country.
- Establish investment parameters.
- Draft due diligence guidelines.
- Define demand profile and devise marketing strategy.
- Establish investment proposal criteria and format.
- Develop guidelines for use of Market Development Support funds.
- Develop standard reporting formats.
- Develop and coordinate with deal flow contacts.
- Seek out investment opportunities.

- Establish systematic procedures for monitoring and reporting financial and developmental changes and results that satisfy both SAEDF board and USAID.

VI. Relationship With USAID

The very nature of the Fund will demand that management develop a broad and deep network of contacts in both public and private sectors. But, given the initial special relationship between the Fund and USAID as its sole source of capitalization, it is expected that the Fund's Board and management will seek to develop the mechanisms to communicate with USAID.

A. USAID Oversight and Fund Independence

Over the years, USAID has taken the lead on enterprise development. It has very often "pushed the envelope," in terms of what can be accomplished through a government entity. The adaptation and use of risk capital funds in a developing country context is an excellent example of this pioneering. Seeing the need for long-term risk capital in developing countries, USAID has massaged, adapted, and applied the concept in developing countries.

These past experiences with venture capital investing have also highlighted the difficulties of breaking new ground within a government agency. A major lesson learned from predecessor projects is that USAID, the bureaucracy, must be taken out of the day-to-day decision making loop. But as experience with the European and NIS funds teaches, doing so also creates its own problems in terms of oversight and psychic ownership of both the financial results and development impact.

There is ample precedent for disengaging USAID from the decision process through the inclusion of "Notwithstanding" articles, and thereby mitigating the negative impact of certain bureaucratic incumberances. Through the SEED Act, Congress provided the European and NIS funds with "maximum flexibility and minimum government oversight", wereas in other funds, waivers have been sought on a case by case basis, as required. Neither of these approaches is ideal.

A balance needs to be reached between too little and too much oversight. It is a balance that must be struck up front in the Fund's charter and grant agreement so as to be properly addressed in the development of Fund systems and procedures. LAAD, funded in large part by USAID, speaks eloquently of the difficulties in maintaining commercial viability because of USAID's rules and constraints, but also demonstrates that it is possible to strike a workable balance.

B. USAID Proposed Oversight

Experience with the funds the design team reviewed demonstrates that balancing the need for independence and freedom with the needs of USAID for financial and development accountability is a delicate and difficult process. It is a process that should be entered into by all parties from the outset and spelled out in detail up front. Given the Fund's independent nature, several mechanisms are proposed to assure a sense of responsibility and partnership on the part of USAID in the Fund's portfolio development:

- Assuming the USAID grant funds are provided <u>unconditionally</u>, USAID would participate on the Fund's Board in an *ex-officio*, non-voting capacity. We recommend that the Regional Director for Southern Africa serve as this representative.

- USAID's representative would advise regarding USAID-specific legal and policy matters and, within USAID, would be the agency's point of contact on Fund-related topics. Participation on the Board would also provide the means by which USAID and the Fund can directly communicate on other matters, e.g., policy constraints that USAID may want to take up with governments in the region.

- If the funds are provided conditionally, then the need for an *ex-officio*, non-voting position on the Board is not recommended as USAID can draw its comfort from the ability to withhold further funding. The team recommends the former option of unconditional funding with USAID representation on the Board because it allows USAID greater access to Fund management while, at the same time, providing management with greater independence and flexibility.

- USAID would establish an Executive Advisory Council (see Fund Model pg. V-3) comprised of a mix of Mission Directors from the region and Southern Africans. This advisory council, or preferably a smaller executive committee of the council, would meet annually with Fund management to review progress toward financial and development objectives and ways to advance such efforts.

- USAID's level of comfort would be addressed through a rigorous Board and management selection process, management compensation based on attainment of development and financial objectives, monitoring and reporting requirements (e.g., annual visit, two evaluations, development impact assessment as discussed) developed in conjunction with Fund management, and the notation of such in the appropriate document -- charter, by-laws, and/or grant agreement.

- An important concern for USAID is seeing that financial profitability does not overshadow development impact. The foundation for addressing this concern must be laid-out in the SAEDF's charter and by-laws. A short, but broad, list of development objectives would be included in the Fund's charter. Fund management and USAID Missions would customize this list particularly in terms of the target group to fit the particular nuances of the country.

Aside from its seat on the Board, through which USAID will receive various reports, the proposed Advisory Council will be encouraged to meet with the Fund's management once a year to discuss Fund activities and ways to promote and further development impact. While USAID has a need to know, excessive oversight visits interfere with proper fund management; in the end, such interference furthers neither USAID's development interest nor the Fund's financial viability.

The information needs of USAID regarding development impact must be determined up front in consultation with Fund management and changed infrequently. The reason for consulting with Fund management is that the gathering of the information should not be a burden to either Fund management or investees. Otherwise the collection, analysis, and dissemination of this information becomes a distraction that can negatively affect performance. Information that might prove useful on the development side has previously been outlined under "Return on Investment" in section five, page 13. To assist with such monitoring, during its first year of operation, the Fund should invest in a monitoring data base to better manage the financial and development performance of its portfolio.

Finally, USAID should evaluate the Fund at the end of years four and ten. The purpose of the first evaluation would be to review the Fund's progress over the first four years and, of the second, to determine the Fund's development impact.

C. USAID As Partner

There will be important interaction between Fund management and USAID field personnel at the Mission-level. Although it will be a new and independent entity, the Fund will not begin its investment activity in a vacuum. In a number of cases, USAID Missions have sponsored private sector initiatives including micro-loan programs, loan guarantee programs, and business services projects, which could provide the Fund with a source of potential deal flow. Fund management could regularly look to the USAID Missions for:

- Economic information.
- Contacts.
- Facilitation of government discussions.
- Potential deals and technical assistance through existing or planned Mission-funded bi-lateral projects.

Beyond this, several Missions have played or are contemplating undertaking active or lead roles in structuring and/or establishing independent financial intermediaries in the form of trusts or venture funds which could represent appropriate or potential investment opportunities for the Fund, e.g., the proposed South Africa Trust. While the Fund shall be under no obligation to invest in Mission sponsored or initiated vehicles, the greater the degree to which the Missions choose to funnel high quality Mission and non-Mission sponsored investment opportunities to the Fund, the greater the likelihood of additional USAID dollars being invested in the Mission's host country.

VII. COMPARISON OF MODELS

Table VII-1, below, summarizes certain attributes of the organization and operation of the proposed SAEDF and three other fund models profiled in Annex G. While there are similarities among the four approaches, there are some important distinctions. Some of the most important differences are in Board and management selection and composition, capitalization, role of USAID, operating budget, type of investments, and investment instruments. Advantages and disadvantages of the various models are presented in Table VII-2, page four.

Board and Management: All funds look for the most competent Board and management possible, but the selection process impacts on the available pool of candidates. In the past, some Boards have lacked the necessary venture capital experience because venture capitalists were not part of the process that nominated a slate of candidates.

Hiring management through an RFP often results in individuals with insufficient exposure to venture capital investing. This RFP process also can result in difficult communications between the Board (appointed by the President or in other instances the local USAID Mission) and the management team, who feel a greater responsibility to their contractor, USAID, than they do the Board. Moreover, a locally appointed Board -- comprised of accountants, bankers, lawyers -- naturally has significant local knowledge, but tends to be overly conservative, having no venture capital experience.

The proposed SAEDF model recommends that the President select the Board from a slate of candidates prepared by a three person committee, including two from the venture capital industry. This process is more likely to uncover individuals who are experienced risk capital investors, with knowledge of investing in a developing country. In turn, a Board comprised of seasoned venture capitalists is more likely to engage a management team with the appropriate skills set.

Capitalization: Placing conditions on infusions of investment capital complicates fund management's task as potential investees may become reluctant to invest the time and money to work with management to prepare an investment plan. Likewise, Fund management is not certain it should invest the time and money either, and could find itself overly pre-occupied with assuring the next tranche then with assuring the financial and development value of its investments. The timing of the capitalization also impacts on the Fund's ability to earn sufficient income from Treasury monies to cover its operating costs. The proposed SAEDF recommends unconditional tranches of US $20 million a year for five years.

Role of USAID: In many of the predecessor funds or in the other models, USAID draws comfort from an active oversight role. This can prove to be distracting and costly. The proposed SAEDF model suggests achieving that comfort through a Board and management selection process that results in a highly qualified and balanced Board and management team, provision of a non-voting Board seat, and active interaction between management and USAID Missions in Southern Africa on a regular basis and in establishing development objectives.

Operating Budget: The necessarily smaller, Mission managed funds would require additional grant funding to cover operating costs. Because many of the predecessor funds received installments as needed for investment purposes, they did not have sufficient treasury funds on which to earn interest to cover operating costs. These too required additional grant funding for such.

Table VII-1. Model Comparison

Fund Organization	Proposed SAEDF	Mission Managed Pass Through	PID/ SBIC-like	Predecessor Funds
Legal Structure	Not-for-profit U.S. corporation	Local Trust w/ private management arm	Not-for-profit U.S. corporation	Not-for-profit U.S. corporation or local Trust
Board Selection	Mixed committee of venture capitalists and USAID select slate for President to appoint	At regional level, *ad hoc* committee. At country level, USAID appointed	USAID appointed	President or USAID appointed
Board Composition	Mix of U.S. and regional, venture capitalists and development expertise	USAID personnel on *ad-hoc* committee and local expertise at country level	Unclear	Mix of U.S. and local expertise
Management Selection	Board selects	RFP	Board selects or RFP	Board selects or RFP
Management Composition	Mix of U.S. and regional venture capital expertise	Determined by Missions	U.S. expertise in banking, accounting, investment banking	Mix of U.S. investment bankers etc. and local expertise
Management Compensation	Moderate current salary with carried interest	USAID-scale salary	USAID-scale salary	Capped, high current salary, with no carried interest
Capitalization	US $20mm/year for five years, unconditional	Varies according to the number and size of country funds established	US $20mm/year over five years, conditional	US $20mm/year over five years, conditional and paid as needed
Location	Southern Africa	Country specific	U.S.	U.S. and regional or country specific
Fund Operation				
Treasury Funds	Safe investments in U.S. securities	No treasury funds	Safe investments in U.S. securities	Limited or no treasury funds
Operating Budget	Derived from interest earned on treasury funds and current income	Grant funding	Derived from interest earned on treasury funds and current income	Grant funding
Investment Parameters:				
Type	Direct and indirect	Direct and indirect	Indirect, fund of funds	Direct and indirect
Target	Disadvantaged and intermediaries serving disadvantaged	Disadvantaged	Intermediaries serving disadvantaged	Disadvantaged or SME
Instruments	Equity, debt, and quasi-equity/debt	Equity	Debt	Equity, debt, and quasi-equity/debt
Market Development	Yes	Possible	No	Yes
Role of USAID	Non-voting member of Board, passive over-sight	Non-voting member of Board, active oversight	Non-voting member of Board, active oversight	No Board representation, active oversight

The proposed SAEDF model recommends annual investment fund installments sufficient to throw off interest income from treasury funds management to avoid annual operating grant funding. This approach also enhances management independence and flexibility and, over the life of the Fund, is less expensive.

Type of Investments and Investment Instruments: The SAEDF would have the flexibility to make both direct and indirect investments. Indirect investments offer the Fund the opportunity to achieve greater leverage as well as reach a larger number of disadvantaged entrepreneurs and enterprises with a wider variety of tailored investment instruments, e.g., debt and equity, as well as hybrids of each. Yet, it has the freedom as designed to make direct investments, particularly those that encourage greater regional economic integration.

Though local funds can also invest in intermediaries, they have in the past principally invested directly in operating companies, reducing the potential impact among the target group and eliminating a point of possible leverage. And while the focus of a fund of funds approach is on indirect investments, it typically is through debt-only instruments and eliminates the possibilities of direct investment.

Table VII-2. Advantages and Disadvantages of the Models

Model	Advantages	Disadvantages
Proposed SAEDF	Greater potential regional impact Increased likelihood of attracting qualified Board and management Greater independence and flexibility Increased opportunities for leverage Provides for greater portfolio diversification Enhanced prospects of sustainability	Change in organization from many predecessor funds requiring more up-front work Not all Missions may benefit from fund Potential for imbalance between sustainability and development impact
Mission Managed	Intimate local knowledge and presence Very responsive to country-specific development objectives Ease of monitoring for USAID All countries can participate assuming they meet USAID's political and economic guidelines	Limited regional impact potential Sustainability more problematic Higher costs Limited independence Limited investment funds Difficult to attract needed expertise Limited portfolio diversification, putting capital at potentially greater risk Need for operational grant funding
PID/SBIC-like	Limits loss potential as primarily debt instruments Easier for USAID/Washington to monitor fund as Washington based Greater potential regional impact on financial sector	Limited portfolio diversification No direct control over impact on target group No local or regional on-going management presence Difficulty in monitoring investment portfolio in Southern Africa Less flexibility
Predecessor Funds	Local presence Provides for greater portfolio diversification	Conditional funding Less independence Need for additional operational grant funding Difficult to attract needed expertise

PN-ABT-334

ANNEXES: RECOMMENDATIONS FOR A SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

FINAL REPORT

Bureau for Global Programs, Field Support and Research
U.S. Agency for International Development

Prepared for: *Office of Operations & New Initiatives, Bureau for Africa*

Prepared by: *The Services Group*
and
Coopers & Lybrand

Sponsored by: *Private Enterprise Development Support Project II*
Project Number 940-2028.03
Contract Number PDC-2028-Z-00-7186-00
Prime Contractor: Coopers & Lybrand

June 1994

Coopers
&Lybrand

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June 1994

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ANNEX A

Terms of Reference

Terms of Reference
Southern Africa Enterprise Development (SAED) Project

1. Goals and Objectives of the Assignment

Summarized below are the goals and objectives that should guide the contract team in its preparation of the feasibility study/Project Paper for the Southern Africa Regional Enterprise Program. These are presented as the most desirable characteristics that should be incorporated in the design of the program. They represent the consensus conclusions derived from the following reviews/critiques of the pre-feasibility study and the initial draft terms of reference:

*January 12, 1994-- Africa Bureau Review of the Pre-Feasibility Report;

*February 16, 1994-- CLancaster's Meeting with JHicks and CPeasley;

*February 28, 1994-- USAID Southern Africa Mission Directors Meeting With KBrown and BKaschak; and

*February 28 and March 1, 1994-- ISA Task Force Meeting of Private Sector Officers from Eight USAID Missions.

1.1. Scope of the Program--The EUR and NIS Enterprise Fund models, and the Fund of Funds model proposed in the AFR/ONI reports are too restrictive to effectively achieve the goal of promoting the development of the indigenous private sector and small and medium enterprises in the region. Therefore AID's goal (and the specific assignment of the feasibility team) is to design a regional umbrella program which would allow for the development of tailored country programs responsive to the unique constraints and opportunities in each country.

1.2. Target Group and Constraints to be addressed--There are a wide range of constraints, varying by country, hindering indigenous ownership of productive assets and the development of disadvantaged small and medium enterprises in the region. In most countries the most pressing constraint is not the lack of capital, per se. This target group is more constrained by the lack of general management skills, lack of specific technical skills and access to technology required in specific enterprises/industries, very conservative banking and financial systems skewed against their getting fair access to locally available financing, as well as policy and regulatory environments which mitigate against the creation and/or expansion of small and medium sized enterprise. Therefore the regional umbrella program should provide for an appropriate mix of technical assistance, training, policy reform interventions, and financial leveraging mechanisms to facilitate access to local sources of private and governmental capital.

1.3. Participation of Other Donors and Investors-- The program should be designed in a manner to attract other donors, and if feasible other sources of private capital. However careful attention must be paid to assuring that the above purposes are not undermined by desires and efforts to have the program be a remunerative investment for private participants.

1.4. Sustainability-- The program should be designed to maximize the sustainability of the major components, and where feasible to maximize the self-financing potential of any elements that involve leveraging debt or equity financing.

1.5. Maximizing African Participation, leadership and Ownership-- Most of the enterprise funds and venture capital models referenced in the pre-feasibility study are organized as 501 (c) 3 organizations based in the U.S. Given the goals and objectives noted in the preceding paragraphs it is highly unlikely that an organization based in the U.S. could maintain the necessary interaction with the key regional stakeholder and provide services in the most cost effective manner. Moreover maximizing African participation and leadership is a major thrusts of all segments of the Initiative for Southern Africa, under which this regional enterprise program is included. Therefore our objective is to establish the umbrella program as an independent trust or non-profit entity based in Southern Africa with an appropriate mix of southern African and American participation in the governing body and the management of the trust.

2. <u>Feasibility Study Issues To Be Addressed Recommendations:</u>

In carrying out its work the feasibility study team will take into account the regional umbrella and country specific issues enumerated by the PSOs in the reporting cable from the recent mini-conference in Harare. At the regional level this will include, but will not be limited to, project sustainability; criteria for country participation and resource allocation across participating countries; structure including Board of Directors and operational management and functions of the umbrella; services to be provided by the umbrella; location of the umbrella; legal questions related to establishment of the umbrella; flow of funds from the umbrella to the country level programs; lessons learned from other capital intermediation activities and lessons learned from prior attempts at orchestrating provision of capitals, TA/training and attention to policy matters in promoting enterprise development; market information requirements of the stake-holders; relationship between regional and country level management structures; and the play of market forces in determining discrete investments. At the country level, issues to be addressed will include: country eligibility criteria, definition of target groups and strategies for accessing the identified end-line participants; approaches for identifying and serving the training and technical assistance needs of the participants, identification of intermediaries with special attention to the relationship between the intermediaries and the end-line participants; threshold criteria concerning individual country enabling environment and political situation; social cultural constraints to target group participation with particular attention to the participation of women, and relationship of the project to country/mission strategy and management capacity.

3. <u>Design Model:</u>

The Southern Africa Enterprise Development project (SAED) will be designed in two phases. Phase I, the regional umbrella structure, will be developed over the next few months on the basis of the recommendations supplied by the feasibility study team. Phase I will result in the authorization, and initial obligation, of the SAED in FY 94. Phase II will consist of the formulation of the country specific components to be developed in the field after the regional umbrella is authorized.

4. __Feasibility Team Itinerary:__

The proposed itinerary of the feasibility team is as follows:

a. Johannesburg March 20 to March 25

b. Manzini March 25 to March 26

c. Dar Es Salaam March 26 to April 2

d. Harare April 2 to April 12

5. __Field Participation:__

The team will hold a 1-2 day wrap-up reviews conference with Mission Directors and/or PSO's in Harare on April 11-12. USAID/W would welcome participation of a PSO from the region to work with team throughout the field work period; depending on availability, either Don Greenberg or Mike Klesh would be ideally suited to join the effort.

Given that the team will concentrate on recommendations for Phase I, Coopers and Lybrand has identified business specialists from the region, one from each country to be visited, to be sufficient to assure inclusion of the "local" which appears perspective.

6. __Consultation:__

USAID/W will share feasibility recommendations, as well as the draft subsequent project paper with field missions for comment before proceeding to an authorization.

7. __Logistics:__

USAID/W appreciates field offer to assist with logistics Team members have been instructed to check with PSO's immediately upon arrival in each country for assistance with scheduling.

8. __Communications:__

Feasibility Team will be headed by Bill Kaschak, Director, AFR/ONI. Please direct all communications to him with copies to Nate Fields and Keith Brown of AFR/SA.

ANNEX B

Summary of Team's Experience

Deanna Madvin: Started her career as an executive manager and board member of a Los Angeles based financial services company. She worked as a small business advisor for the Peace Corps in Guinea and, subsequent to her service, was retained by the USAID mission there. Most recently, Ms. Madvin has undertaken assignments in West Africa and Russia, focusing on small business and NGO development. She has degrees in finance and anthropology.

Michaela Walsh: Began her career at Merrill Lynch. Served in its New York-International, Beirut and London offices. Became a partner of Boettcher & Co., a New York Stock Exchange member firm. Joined Rockefeller Brothers Fund as a program officer and led a study at OTA on alternative, local and appropriate technologies. In 1980, she became founding President of Women's World Banking. Currently she is President of Women's Asset Management Ltd.

Peter Michaelson: Peter Michaelson has more than 10 years experience as a venture capital investor. As a Managing Director of AEA Investors in New York City, he participated in several $30 to $100 million acquisitions of family-owned businesses as well as more traditional venture capital investments. More recently, he has turned toward socially responsible investments such as conversion of a historic warehouse into artist lofts, low-income housing development, helping establish a minority-owned tree-planting cooperative and international private sector development consulting. Peter has spent three years working and travelling in developing countries, principally in South Asia.

Larry Morse: Began his professional career as an economist with Mathematic Policy Research, followed by a number of years with The Urban Institute's Employment and Labor Policy Group. Seeking more direct involvement in employment creation, he joined UNC Ventures, a private minority-focused venture capital firms as an analyst , leaving the firm after five years as an investment officer. In 1988, he joined EQUICO Capital Corporation, a wholly-owned venture capital subsidiary of The Equitable, as a Vice President, subsequently participating in the buy-out of EQUICO to create TSG Ventures Inc. As a venture capital investor, he has served on the boards of director of numerous private companies. On completion of this project, he will be joining a new risk capital fund as a general partner.

Mehlo Ndiwieni: An economist by training, he works with C&L's Financial Services Division in Harare, with emphasis on cross-border trade and investment issues. He has also worked for the Confederation of Zimbabwe Industries as Chief Economist, the Zimbabwe Development Bank, the International Food Policy Research Institute, and the Zimbabwe Ministry of Finance Economic Planning and Development.

Bill Kedrock: After leaving Peace Corps, he received his Masters in Business Administration and has applied this schooling over the last ten years to enterprise development issues throughout Africa and the Caribbean, in both long- and short-term positions. He worked over four years on USAID's experiment with the use of agribusiness venture capital in the Caribbean as an investment officer and project advisor.

ANNEX C

Contacts

United States

CARE Small Business Assistance Corporation (CARESBAC)
Tom Gibson, President
Agnes Dasewicz, Assistant

EQUATOR
Steve Cashin, Vice President and Washington Representative

Harvey & Company
Barron Harvey, Chief Executive Officer
Douglas Leavens, Vice President International Division
Steve Psaledakis

International Finance Corporation (IFC)
Vincent Rague, Sr. Investment Officer, Capital Mkt., Africa
Richard Rutherford, Sr. Invest. Off., Capital Mkt., Africa

Latin American Agribusiness Development Corporation (LAAD)
Robert Ross, President

Minority Enterprise Small Business Investment Companies
Phyllis Dawson

USAID/Washington
Africa: Bill Kaschak, Director, ONI
Mike Unger
Ray Solem
Nate Fields

PRE: Dale Sarro, Director, Office of Investment

GC: Pauline Johnson

World Bank
Henri A. Aka, Consultant, Agriculture Operations Division
Loyd McKay,
Stefano Migliorisi, Public and Private Enterprise Division, Eastern Africa Department

U.K. Contacts

Commonwealth Development Corporation
- Alistair Boyd, Deputy Chief Executive
- Chris Orman, Portfolio Management
- Jose Cattani T., Executive, CDC Costa Rica

Switzerland

Economic Development for Equatorial and Southern Africa
- Rene Gerber, President
- Claude Bachmann, Director

Societe Internationale Financiere pour les Investissements et le Developpement en Afrique
- Philippe Sechaud, Managing Director
- George Mills, Directeur Adjoint

South Africa

Black Integrated Commercial Support Network (BICSN)
- Jethro Mbau, General Manager, Corporate Finance
- Fernando Bertoli, Chief Operating Officer

Coopers & Lybrand
- Reginald T. Muzariri (Johannesburg)
- Colin Gooden (Cape Town)
- Andre Labuschaigne (Cape Town)
- Michael Purcell (Cape Town)
- David Lermer (Cape Town)

Ebony Financial Services (Ebony Management Service, Ebony Brokers Consultants, Ntaluba & Co. - Chartered Accountants (SA) Auditors)
- Juneas Lekgetha
- Sango Ntsaluba

Economic Development for Equatorial and Southern Africa
- Victor Viseu, Group Coordinator

(The) Ford Foundation
- Ellen Brown, Programme Officer for South Africa and Namibia

Frankel Pollack Vinderine Inc.
- Simon Oliver, Director - Corporate

Harvey & Company
- Gregory Boyd, Sr. Venture Capital Specialist, International Division

Investment Development Unit
- Errol Benvie, Executive Director

Inyanda Chamber of Commerce (Affiliate of NAFCOC)
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Lincoln Shembe, Umlazi Tyre & Exhaust Centre

Kilimanjaro Bottling (Pty) Ltd.
Gibson Thula, Director and Vice-Chairman

Kwacha (PTY) Ltd.
Dr. Nthato Motlana
Fred Ndlovu

KwaZulu Finance & Investment Corporation Ltd.
Alfred Markwat, Divisional Manager, Small Business

KwaZulu Technical Training Centre
Brian Stewart, Managing Director

Management & Marketing Renaissance C.C.
Don Mkhwanazi, Chief Executive

Mortgage Installment Guarantee
Billy Mthembu, Managing Director

National African Federated Chamber of Commerce & Industry
Archie Nkonyeni, President
Moss Leoka, Moss Leoka Communications (Pty) Ltd.
W.A. Mckenzie, Partner, Aiken & Peat (KPMG)

Nedbank
Mutle C. Mogase, Manager Corporate Division

NED Enterprise (Div. of NEDCOR)
Neville Edwards, General Manager
Thomas Hammon, Senior Manager

New Africa Advisors (Pty) Ltd. (Sloan Financial Group)
Charles H. Allison, Jr., Executive Director
Elizabeth Edwards, General Manager

Sizwe and Company, Chartered Accountants (S.A.)
Sizwe E. Nxasana

Small Business Development Corporation Ltd.
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Trudi Hartzenberg, Senior Lecturer
Alistair Ruiters, Senior Lecturer

Tanzania

Association of Tanzania Employers
Sylvester Jaja Lugiko Sengerama, Advisor

Bank of Tanzania
Mr. Kitomary, Deputy Governor

Business Services Center
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Laurel Druben, Consultant

Commonwealth Development Corporation
Derek Pierson, General Manager

Coopers & Lybrand
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Employers Association
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Equity Investment Management Ltd. (Tanzania Venture Capital Fund)
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Dominic Pallangyo

Industrial Promotion Services
Kabir Hyderally

Institute of Finance Management
Kassim Hussein, Director of Studies & Sr. Lecture in Finance

Meridian BIAO Bank
P.S. Thomas, General Manager

Planning Commission, Human Resources Planning, GOT
Silvery Balili Buberwa, Director

Population Services International
Timothy Manchester, Director

Tanganyika Development Finance Limited
Hatibu Senkoro, General Manager

Tanzania Chamber of Commerce Industries and Agriculture
Mrs. Soma Goonetilleke, Chief Technical Advisor (U.N.)
Mr. Kaloalje, Director
Lawrence Mmasi, Finance Officer

Standard Merchant Bank
- Vincent Langlois, Manager, Corporate Finance Division
- David Polkinghorne, Manager
- Frank Kilbourn, Manager, Corporate Finance Division
- Phuthuma Nhleko, Corporate Finance

Standard Bank of South Africa
- Brian Bentley, Manager, Financial Institutions
- Leon Morton, Senior Manager, Business Services

Sunnyside Group
- Chris Darroll, Executive Director

USAID/South Africa
- Cap Dean, Director
- Harry Johnson, GDO
- Karl Jensen, Private Sector Specialist
- Rick Harbor, Economist

(The) Urban Foundation
- D.L. van Coller, CEO

Webber Wentzel (Attorneys, Notaries, and Conveyancers)
- Peter Arthur

Swaziland

Business Management Extension Programme
- Mrs. Gamedze

Central Bank
- James Nxumalo, Governor

Ministry of Finance, Kingdom of Swaziland
- Jeffrey Jackson, Director (Public Enterprises Unit)

Small Business Growth Trust (SGBT)
- Eddie Litchfield, Board Member
- Don Henri, General Manager
- Dan Maseko, Board Member
- Doug McLean, Deputy Manager
- Henry Mnisi, Financial Services Manager

USAID/Swaziland
- Ed Baker, PDO
- Valerie Dickson-Horton, Director
- Joseph Murrie, Consultant, SBGT Evaluator
- Jamie Raile, Project Manager

Tanzania Industrial Studies and Consulting Organization
E.L. Kamuzora, Director General

Tanzania Investment Bank
A.W. Mosille, Director of Project Appraisal
Mr. Mpogolo, Director of Finance
Gibbons Mwaikambo

United Nations Development Program
John Tucker, Programme Officer

USAID/Tanzania
Dale Pfeiffer, Director
Joel Schlessinger, Deputy Director
Pat Fleuret, Program Development Officer
Tom Tengg, Private Sector Officer

World Bank
Mr. Konish, Director

Zimbabwe

Africa Project Development Facility
Anil Sinha, Investment Officer
Jack Thompson, Regional Manager

Anglo American Corporation/Hawk Ventures
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BARD Discount House
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ANNEX E

Economic Summary of South Africa, Tanzania, and Zimbabwe

To gain a better appreciation for the problems and promises with in the region, the team visited three countries -- South Africa, Tanzania, and Zimbabwe. The economic information on these three countries which follows is presented not as a definitive piece but rather to illustrate the problems and promises which create the regional potential. As noted previously, specific conditions vary among all the countries in the region. Nonetheless, these three provide an interesting cross-section for comparative purposes.

A. Macroeconomic Stability

Table E-1, on the following pages, presents some of the basic indicators for Tanzania, South Africa, and Zimbabwe.

1. Tanzania

Since independence in 1961, the Government of Tanzania (GOT) has strongly favored state-owned enterprises engaged in capital-intensive activities over private firms, a policy formalized under the socialist tenets of the 1967 Arusha Declaration. Private enterprise and individual entrepreneurship has been limited, channeled into smaller scale activities of lesser interest to the government. As a result, existing private firms consist of a handful of large-scale commercial entities and numerous small and medium enterprises engaged in the production and trade of consumer goods and agricultural products.

Since 1986 the Government of Tanzania has been pursuing a Structural Adjustment Program with the World Bank aimed at restoring the basis for sustainable growth of the economy. These programs emphasized increases in incentives to agricultural producers, the rationalization of state industry and a general reduction in state intervention in the economy. The reforms have led to renewed growth in the economy. Average GDP growth between 1986 and 1992 was 3.8 percent.

However, private businesses remain constrained by a legacy of adverse economic policies, attitudes of mistrust and derision of individual entrepreneurship, restrictive and debilitating regulatory requirements, and the lack of appropriate skills, information, and resources.

Total official exports from Tanzania in 1992 were valued at US$413 million, in contrast to a total import bill of US$1.5 billion. Out of this total, traditional exports (coffee, tea, cotton, sisal, tobacco and cashews) account for US$239 million and non-traditional exports US$174 million (minerals, petroleum products, manufactured products and other miscellaneous products). The fastest growing non-traditional exports are minerals and horticulture products. The manufacturing sector, previously heavily protected, is currently not very export competitive. In fact, exports of manufactured products have declined from US$103 million in 1990 to approximately US$66 million in 1992.

Table E-1
Macroeconomic Indicators
Time Series 1987-1993

	1987	1988	1989	1990	1991	1992	1993
Real GDP Growth							
Tanzania	NA	4.23%	4.00%	4.77%	3.89%	3.60%	NA
Zimbabwe	NA	9.16%	5.05%	3.36%	NA	NA	NA
South Africa	NA	4.20%	2.30%	-0.46%	-0.39%	-2.08%	0.37%
Inflation							
Tanzania	NA	31.20%	25.82%	19.71%	22.29%	22.07%	19.86% (a)
Zimbabwe	NA	7.39%	12.89%	17.38%	39.73%	25.42%	27.56%
South Africa	NA	NA	14.67%	14.37%	15.31%	13.91%	9.68%
Interest Rates (Prime Lending Rate)							
Tanzania	27.50%	29.63%	31.00%	NA	NA	NA	NA
Zimbabwe	13.00%	13.00%	13.00%	11.71%	15.50%	19.69% (b)	36.33%
South Africa	12.50%	15.33%	19.83%	21.00%	20.31%	18.91%	16.26% (c)
Government Deficit (%of GDP)							
Tanzania (d)	6.80%	7.60%	8.06%	8.51%	10.06%	6.12%	NA
Zimbabwe	10.54%	9.20%	8.42%	7.50%	NA	NA	NA
South Africa	5.69%	4.43%	5.26%	5.14%	6.11%	9.03%	NA
Import Cover (Reserves/Imports)							
Tanzania	3.18%	7.52%	5.06%	16.25%	NA	NA	NA
Zimbabwe	15.51%	15.35%	7.18%	9.91%	9.10%	NA	NA
South Africa	4.60%	4.53%	5.71%	5.91%	5.15%	5.45%	NA

a) Inflation figures for 1993 are based on the first three quarters.

b) 1992 Lending rate was calculated on the first three quarters.

c) Exlcudes December.

d) Deficit figures for Tanzania exclude Lending Minus Repayments figures which were not available.

Tanzania's ability to manage its economy effectively has still to be demonstrated at the Macroeconomic level. To date, progress with the structural adjustment program has been adequate and has laid a reasonable foundation for a transition to a stable economy with greater private sector participation. The sustainability of this will need to be demonstrated consistently as the initial period of compliance with mandated measures gives way to the need for independent macroeconomic management.

2. Zimbabwe

Zimbabwe has for many years enjoyed a position of comparative macroeconomic stability, however in a highly restrictive and closed policy framework. It has exploited its pre-existing advantages in industrialization and minerals, however with decreasing effectiveness over the past decade. In particular, private investment has dropped due in part to uncertainty over government policy and restrictive regulations on the business sector, particularly regarding foreign exchange.

To address these issues, Zimbabwe embarked on a Structural Adjustment Program (SAP) of trade liberalization and public sector reform in 1991. As the SAP began, the extended drought in Southern Africa (1991-92) was a major setback to economic development in Zimbabwe, which suffered a fall in GDP of nearly 8 percent in 1992. Import of foodstuffs and the decline in exports have had a severe impact on the balance of payments. The drought also depleted energy supplies, forcing the government to import power from Zaire, and electricity rates skyrocketed.

However, the recent agricultural season was solid, and the economic situation is rapidly improving. There are still problems in some key agricultural sectors, such as tobacco, but production of basic foodstuffs is returning to pre-drought levels. The sector was projected to grow by 22 percent in real terms in 1993. In manufacturing, the textile industry was hit particularly hard, having to rely on imports of cotton lint just to meet domestic supply. Likewise, the viability of energy-intensive industries was threatened, leading to retrenchment. Finally, domestic consumption of manufactured goods dropped significantly in 1992, with sector-wide effects on demand and profitability. Early 1993 figures show a 22 percent fall in production; no growth is expected for 1993.

The drought has slowed the process, but the government has taken steps in 1993 to move fast to try to meet the SAP conditionality requirements. Inflation is now estimated at 23 percent (down from nearly 50 percent), and is slowly dropping due to the tight monetary policies pursued over the past year. Interest rates have fallen to 30-35 percent, after peaking at 47 percent earlier in 1993. Money supply growth was 23 percent in January 1993, but declined dramatically to 15 percent in June 1993. Key government measures affecting private business include: relaxing of foreign exchange controls; liberalization of investment regulations and procedures; and initiation of a new export support program.

Among exporters, key sectors are rebounding, and new leaders emerging. Zimbabwe has a healthy and diverse agricultural sector, with tobacco as the leading export industry, and cotton/textiles also important in international trade. Horticulture exports have risen dramatically, with the export of a broad range of cut flowers to the European Community (EC). Zimbabwe is also rich in gold, ferrochrome, and nickel -- major foreign exchange earners -- but local processing is limited. Intermediate goods are readily available, but quality and cost are not competitive with the global market in inputs such as packaging. The bulk of Zimbabwe's non-traditional exports have historically been to the region, but new opportunities are opening and Zimbabwe is gaining ground in the EC (and to a lesser extent, the United States and Pacific) in apparel, cut flowers, citrus, and pine furniture.

Zimbabwe has faced a number of crises, and now appears to be serious about substantial liberalization. This should increase the attractiveness of the country as an investment location, and improve the prospects for new investment by both foreign and domestic firms.

3. South Africa

The political change sweeping the country in the buildup to the April 1994 general elections is perhaps the strongest influence on the overall macroeconomic environment. While political enfranchisement of non-whites will have positive effects on the country's economy by bringing about an end to international sanctions, it has also created a climate of uncertainty which has dominated business decisions.

Although the end to sanctions has brought renewed interest from foreign investors, few actual deals have been consummated. (In some countries, particularly the United States, vestigial elements of sanctions, such as those imposed by states, have not yet been fully dismantled.) This hesitancy from foreign investors is mirrored by South African firms as well. The principal elements of the uncertainty surrounding the political transfer of power to the black majority, as they affect the economy, can be summarized as follows:

- fears of escalation of the political and civil violence;
- uncertainty over the economic policy of the formerly marxist African National Congress (ANC), with the potential for nationalization of private firms in key sectors or other means of increased government intervention in the economy;
- demands on government spending to create jobs and improve the social infrastructure for blacks, and the effect on an already strained fiscal policy;
- uncertainty over the nature and extent of affirmative action laws and programs, and their effect on employment and shareholdings;
- the possibility of accelerated expatriation of skilled whites moving overseas;
- unions, which have been key in the democratization movement, gained economic power and are highly politicized; and,
- the legacy of heavy state intervention in the economy, and the assumption by the ANC of the key regulatory and administrative functions, as well as management of the extensive network of parastatal companies in key sectors.

In this climate of major political change and economic uncertainty, the recent improvement in macroeconomic indicators has received little notice. Inflation is down under 10 percent for the first time since the early 1980's; and the prolonged recession shows signs of ending, with GDP growth positive in 1993, the first growth since 1989. The Rand has steadily depreciated so that the real effective exchange rate has remained roughly constant.

South Africa has, by necessity, generated a trade surplus since 1986, in order to offset the net capital outflow resulting from the shut off of new international loans. However, South Africa's exports remain dominated by gold and minerals, with a strong contribution from agricultural products. The share of manufactured goods has remained relatively constant at around 24 percent of total exports.

Even with the current uncertainty, there is some optimism that an economic turnaround is underway. As with all else, this is hedged by the outcome in the transfer of power following the April elections. While the previous Marxist orientation of the ANC has clearly been replaced by a new pragmatism, the concrete actions facing the new government will tell the real story. While there are mostly fears of runaway deficits charged by social spending, there are also opportunities for improved macro management. For example, there should be savings associated with an ending of apartheid, particularly in defense and "hidden" costs of covert activities, such as support for RENAMO in Mozambique. Additionally, there may be possibilities for elimination of the two-tier exchange rate system, by allowing capital transactions via the commercial Rand market. In general, there are few indications at this stage whether the ANC will continue to utilize many of the interventionist tools of economic management implemented by the National Party, or whether as part of a break with the past they will dismantle them and the extensive system of regulation which accompanied apartheid.

B. Investment Regulation, Protection, and Incentives

1. Foreign Investment

a. Tanzania

Tanzania revamped its investment policy in 1990 with the passage of the National Investment Promotion and Protection Act. This act established the Investment Promotion Centre, with responsibilities both to promote and regulate investments. All foreign investments must be approved by the Centre. The Act does provide guarantees against expropriation and for remittance of profits and repatriation of investments in hard currency. In addition, to qualify for the incentives available under the Act, the investment must qualify for a certificate indicating approved enterprise status. For foreign investments, this means be a minimum of US$250,000 equivalent for any project.

Foreign investments are restricted extensively by sector in Tanzania. Certain strategic sectors are reserved for government investment only, such as utilities, railways, communications and insurance. This list extends to other areas such as airlines, steel, chemicals, etc. in which the government must be a joint venture partner. Other sectors, including all wholesale and retail trade and a number of basic business services are reserved for Tanzanian nationals. Still others may include foreign investment, but they must have a certificate, meaning a $250,000 minimum and other criteria.

These sectoral restrictions are extensive and complicated. Their impact goes further in establishing the IPC as a major arbiter of foreign investment approval and licensing. To date, the response has been limited, with some investment from Kenya, and some others in Tourism. The framework represented by the 1990 act is restrictive, more so than many other countries in the region. While it represents a major liberalization for Tanzania, it poses problems for the introduction of the Fund, as it is still a restrictive and bureaucratic approach to private investment.

b. Zimbabwe

Zimbabwe also has a complex policy framework governing foreign investment. The principal obstacle is the byzantine system that has been developed to regulate foreign exchange and the disposition of profits and dividends of foreign-owned firms. Distinctions are drawn between the treatment and allowable uses of pre-1979, post-1979, and now, post-May 93 funds, creating a number of separate regimes for investment. Although the government has plans to rationalize and unify these regulations, they still act to discourage new investment, especially when compared to more transparent investment regimes in other countries.

In 1993, the government has taken several major steps to increase foreign investor confidence in Zimbabwe. Restrictions on foreign investment have been relaxed, including increases in dividend remittances and relaxation of capital controls. The introduction of the Export Retention Scheme and Foreign Currency Denominated Accounts has freed up foreign exchange access, and foreign investors are also now permitted to invest in the stock exchange for the first time. New inflows of foreign funds are subject to a limitation of 5 percent per investor and overall 25 percent limit on foreign investment in any single counter. These new investments qualify for 100-percent dividend remittance and full repatriation of capital on disinvestment. The initial response has been positive, yielding Z$70 million (US$10.77 million) in foreign inflows of funds into the stock exchange between June and November 1993.

Nevertheless, recent events have made apparent the disillusionment of foreign investors with the Zimbabwe business environment. The Zimbabwe/U.S. Business Council was suspended in November 1993, with its administration citing lack of progress in the development of competitive investment incentives, the need for an investment code, and the generally unhelpful bureaucracy which believes that "foreign investment is not politically correct," and considers "foreign investors a nuisance to be tolerated because of the need for foreign exchange." Such perceptions are likely to remain until the government truly dismantles the complex framework it has erected to control the use of foreign funds and resolves the land tenure issue that has plagued the country for years.

c. South Africa

Foreign investment is widely encouraged in South Africa, and there are few restrictions. Foreign firms may own land and other real assets, and are not restricted in the form of investment. Firms are limited in the amount that they may borrow locally by a formula tied to the amount of foreign equity. There are, however, currency restrictions on repatriation, which must be effected via the financial rand. For new investors, however, investment into South Africa also is via the financial rand, giving an effective premium of 20-30 percent.

2. Investment Registration and Licensing

a. Tanzania

All Tanzanian businesses are required to obtain a number of "one time" licenses in the process of business formation including: a certificate of approval from the Investment Promotion Centre

(IPC); a Certificate of Incorporation from the Registrar of Companies; and, an Industrial License and a Certificate of Registration from the Registrar of Industries. Annual business licenses are also required. Other sector-specific licenses are issued for various businesses, e.g., commercial fishing operations, travel agents, etc. The licensing procedures are extremely complex and time consuming given the large number of "one time," annual, and transaction-based licenses and permits required, and the equally large number of authorities involved.

All foreign investors in Tanzania are required to obtain a certificate of approval from the Investment Promotion Centre. Although intended to streamline the licensing process for both local and foreign investors, the IPC "Certificate of Approval" has become just another addition to the other permits and licenses already required by various GOT entities. The benefits accorded by the IPC are not automatically provided to the qualifying investor. Instead, each benefit has to be specifically requested from the Ministry of Finance and other GOT authorities. As a result, the licensing process is very bureaucratic and time consuming. Even though the IPC is supposed to approve a project in 60 days they have so far been unable to meet this target. One foreign investor cited the Tanzanian bureaucracy as a major constraint to investment, stating that unless you have a local partner to take you through the process it would take "ten years" to set up a project in Tanzania.

b. Zimbabwe

Investment procedures in Zimbabwe have historically been complex and problematic. The government has been criticized for the lack of transparency in investment requirements and the time-consuming process of obtaining approval for both foreign and domestic projects. In this context, the Zimbabwe Investment Centre (ZIC) was reconstituted in 1992 as an autonomous investment authority, with a mandate to move from investment evaluation to investment registration. Over the past year, considerable progress has been made in this regard, and is hoped that the ZIC will further simplify and streamline the investment process. The investment application form has been reduced to six pages, and the ZIC has been granted substantial autonomy for decision making by its Board of Directors, of which the majority are from the private sector. An Investment Committee meets weekly to review investment applications, which by law must be evaluated within 45 days.

At present, the ZIC staff maintains that the average project takes only ten days to process. However, businesses contacted estimated that a minimum of two months has been the norm, and some initiatives have been held up for far longer periods in the past. Under the new provisions, projects with a value of US$10 million or more require the approval of the ZIC Board, which meets once a month, so review can also fall within the 45-day maximum.

c. South Africa

In South Africa, registration of a company is relatively straightforward. The corporate documents must be deposited with the registrar of companies; this also often involves attorneys and/or chartered accountants as advisors. All companies must be registered with the Department of Finance's tax authorities for sales and income tax purposes. Firms also normally will register with the Department of Manpower as an employer, and finally with the municipal authorities. These steps can be accomplished in a matter of days, as there is no waiting for approvals or licenses.

Foreign investments must also be registered with the Reserve Bank, in order to ensure their repatriation in the future. The major accounting firms often act as advisors and facilitators to foreign firms, and report that the necessary formalities can literally be accomplished in one day. However, certain additional steps are often required as well, such as securing expatriate work permits, building permits, etc.

In order to qualify for investment incentives, application must be made to the Department of Trade and Industry's Industrial Development and Investment Center. This additional step can be complicated for large projects, but normally will take less time for straightforward applications for the regional incentives described below.

3. Investment Incentives

a. Tanzania

Investment incentives in Tanzania are set forth in the National Investment Promotion and Protection Act. Across the board, Tanzania provides favorable tax treatment for new investment, without the requirement of application for special incentives in such areas of depreciation allowances and special deductions on capital equipment and facilities. Additional incentives may be extended to all types of enterprises outside the mining industry, upon application through the IPC, and can include both new investments and expansions to existing businesses. They include:

- A 5-year tax holiday in which the investing enterprise pays no income tax on its profits; and no withholding tax on its dividends, interest payments and royalty payments. After the tax holiday, enterprises pay corporation tax as follows: Residents 35 percent; Non-residents 40 percent; and Joint Ventures 35 percent.

- Full exemption from import duties and sales tax for all imports that are needed to establish the enterprises including equipment, machinery, spare parts raw materials and supplies.

- When the investing enterprise earns foreign exchange it is entitled to retain a portion of its foreign exchange earnings (minimum 50 percent) in an external account. These funds can be used not only to buy essential inputs, but also for dividend remittance, debt servicing, and loan repayments.

In addition, with effect from the 1992-1993 financial year, the excise tax has been eliminated on many locally produced commodities; provision has been made for total remission of taxes on all raw materials used for the local production of various goods; customs duty and sales tax have been eliminated on commercial trucks and buses; and, the tax on share capital has been abolished.

b. Zimbabwe

To encourage productive investment, the government has established the Special Initial Allowance, a capital allowance allowable on the cost of construction, buildings, and equipment. The "SIA" is calculated on a straight-line basis at 25 percent. An Investment Allowance of 50 percent is also provided on the cost of any training establishments and/or equipment for employee training. In an effort to encourage decentralization of economic activity, the Government has designated special "growth point" areas, wherein, targeted tax incentives are offered to investors including: SIA of 100 percent on construction costs, and an additional investment allowance of 15 percent on such construction; and, a 10 percent corporate tax rate for five years on manufacturing operations (normal rate applicable thereafter). Finally, the government provides duty exemptions on capital goods for import duties and surtaxes via the ZIC for qualified projects.

c. South Africa

Investment incentives and other means of conferring special incentives to favored investments in South Africa are limited. The chief ones operational are the Regional Industrial Development Incentives, and various preferential financing schemes. The Regional Industrial Development Incentive consists of three separate components:

- the **Establishment Grant**, a cash grant, equivalent to 10.5 percent of the operational assets of the company, payable in the initial two years of operation;
- a **Profit-based incentive** payable in the following three years, based on a formula of profitability, but not exceeding the amount of the establishment grant;
- a **Relocation incentive**, to partially reimburse the relocation costs for foreign investors, up to R1 million per project.

These incentives are not taxable, and are paid upon submission of audited financial statements and other information required by the Department of Trade and Industry. They are not available for projects located within the main centers of Johannesburg/Pretoria (PWV) and Durban. For other population centers, they are available at a 60 percent rate; and for undeveloped areas at the full rate. Other tax measures are intended to encourage investment, such as the treatment of R&D expenses, equipment leases, etc.

C. Foreign Exchange

1. Tanzania

The Bank of Tanzania manages the exchange rate, and all regulations governing foreign exchange transactions are covered under the Foreign Exchange Act and its subsidiary legislation. The GOT over the years has made substantial progress in maintaining a relatively constant real effective exchange rate and ensuring that there was sufficient foreign exchange to meet import requirements. Up until July 1993 there were three exchange rates: the official central bank rate, the parallel rate and the Bureau or market determined rate. In July, all three rates were effectively unified when the official rate was abolished and the parallel rate moved closer to the bureau rate.

Foreign exchange transactions through the private bureaus amounted to approximately US$300 million which is a substantial portion of all for-ex transactions and implies that the bureau rate is a good reflection of the prevailing market rate. Almost all current transactions can be done using the bureaus. The BOT operates an open market auction system selling approximately \$5 million a week to the bureaus. BOT monitors all bureau transactions to ensure that there is no excessive capital flight or collusion between bureaus to set artificial rates. Access to foreign exchange for imports is unlimited, provided appropriate documentation is furnished.

Repatriation of foreign exchange earned by foreign investors is permitted under the incentives offered by the Investment Promotion Centre. Remittance of dividends/profits or repatriation of capital by Tanzanian companies to non-resident shareholders abroad is made through the bureaus after verification of the accounts and the declared profits/dividends, and authentication of tax payments. The Bank of Tanzania must clear all such remittances.

2. Zimbabwe

The Government of Zimbabwe has recently picked up the pace of steps to liberalize the foreign exchange regime. Now mid-way through a 5-year Economic Structural Adjustment Programme, although the drought has slowed the liberalization process, the Government is trying to make up for lost ground and meet conditionality requirements.

The Zimbabwe exchange rate had been determined on the basis of a trade-weighted basket of currencies, with the U.S. dollar as the currency of intervention. At the onset of the ESAP in 1991, the exchange rate was US\$1 to Z\$2.64. A 100 percent devaluation followed shortly thereafter and at the end of 1993, after multiple devaluations the exchange rate is at US\$1 to Z\$6.5, a decline of nearly 250 percent.

In early 1994 the government announced a series of additional liberalizations, substantially improving access to foreign exchange and eliminating what had been an extensive network of administrative controls. The key elements of this new foreign exchange regime include:

- Expansion of the **Open General Import License** (OGIL), introduced in 1991, which now covers approximately 33 percent of all imports. The OGIL was originally intended to be the principal means to liberalize foreign exchange access, but this strategy has altered to embrace two new schemes:

- **Expanded Export Retention Scheme**, whereby exporters now retain 60 percent of their export proceeds for their import requirements, with the exception of a "negative list" of prohibited goods. The direct holding of foreign currency accounts replaced the earlier retention scheme of entitlements. The balance must be converted at a Reserve Bank-determined rate, said to be equal to market rates.

- **Foreign Currency Accounts** are now available for exporters, foreign-owned firms, or any firm which earns foreign exchange. These may be subject to retention restrictions, as for exporters, however it represents a dramatic shift in policy for Zimbabwe.

- A **Market Determined Exchange Rate** will apply to most currency transactions, as set by the inter-bank buying and selling.

Exchange control is administered by the Reserve Bank of Zimbabwe, as specified in the Exchange Control Act. As noted above, the complexity of the exchange control regime is viewed by foreign firms, in particular, as one of the principal constraints on both new investment and expansion of existing operations. While, in principal, foreign investors are allowed to remit between 50 and 100 percent of after-tax profits, subject to certain conditions, the regulations governing "blocked funds," "switched blocked funds," "surplus funds," and their variations as they apply to pre-1979, post-1979, and post-May 1993 investments, have been so complex as to discourage investment altogether. A simplified and transparent foreign exchange regime will be critical if Zimbabwe is to vie for export investment with its liberalizing neighbors. While there has been substantial progress with the latest round of liberalizations, it will undoubtedly take some time for the business community to respond to the new rules, having been bound for so long by such extensive restrictions. While new investments are generally allowed full repatriation, the lingering affect of these other limitations serves to stifle potential investor interest.

3. South Africa

Gold currently accounts for approximately one third of South African exports. This is down substantially from approximately 60 percent little more than a decade ago, reflecting mostly the increased contribution of other mineral exports. However, the foreign exchange earning power of gold exports has resulted in a higher exchange rate than would otherwise have prevailed without the contribution of gold. This has led to a modified example of the "Dutch Disease" in which the competitiveness of manufactured goods is lessened by the overvaluation of exchange rates due to commodity exports. The extent of this overvaluation has been offset by the net capital outflows from disinvestment and sanctions on new international loans, however most analysts feel it has contributed to the lack of export competitiveness, and reinforced the calls for protection for local industry.

South Africa has extensive exchange controls, a legacy of the effect of sanctions and the need to manage capital outflows. There are, however, no restrictions on trade transactions, which are effected by commercial banks without Reserve Bank approval. Export proceeds must be repatriated within 180 days, and there are no retention accounts for exporters. For other current account transactions, there are guidelines and/or set amounts such as for overseas travel. Other services require authorization from the Reserve Bank.

South Africa has a two-tier exchange rate system. The Commercial Rand is used for all current transactions, and there is open trading in the interbank markets. Other than its role in approving non-trade transactions, the Reserve Bank in theory intervenes only to "smooth out" short-term fluctuations, rather than to fundamentally influence the determination of the exchange rate. In practice, there does appear to be some attempt at exchange rate management. At the end of 1993 Reserves were at the relatively low level of five weeks of imports.

The Financial Rand is a separately determined exchange market for capital transactions by non-residents, and by residents in some cases. Initiated in 1960 to stem capital outflows, the financial rand market covers all capital transactions, essentially equilibrating external supply and demand for Rands by non-residents for investment/disinvestment in South Africa. The Financial Rand market is relatively thin and volatile. The discount compared to the commercial Rand was recently around 25 percent; and fluctuates between 20-30 percent.

Outward direct investment by residents is strictly controlled by the Reserve Bank. The Bank reviews all applications, for which there must be offsetting balance of payments effects through South African exports. Outward FDI is also usually via the financial rand, placing an additional penalty on South African firms expanding overseas.

While there appears to be relatively little interference with trade transactions from the extensive network of exchange controls, other transactions are hindered by controls, cumbersome procedures, and the financial penalty associated with the financial rand. This has led the business community to be critical of the system of exchange controls. The degree of evasion of controls was impossible to determine. However, it is clear that the major business groups have substantial overseas assets which they may utilize when confronted with exchange restrictions.

D. Infrastructure & Services

Table E-2 summarizes the costs of some basic infrastructure services for the three countries.

1. Power

a. Tanzania

Installation procedures are quite cumbersome and can take up to six months particularly if the industry is outside of major towns, as in horticulture. Firms are sometimes forced to buy a generator to standby until power is installed or to ensure a smooth power supply. Generators can cost up to US$5000. Electricity tariffs in Tanzania are nearly seven times as high as those in Kenya. Power supply tends to be very erratic and is affected by water shortages. One firm in Dar's industrial area complained that in 1992 power cuts affected production by 50 percent. Rates are extremely high at US$0.15/kwh, among the highest in the region.

b. Zimbabwe

Zimbabwe relies on hydroelectric power as a major supplier of its energy needs and was hit hard by the 1991-92 drought during which electricity rationing was imposed. Output from the Hwange coal fields has also been constrained by lack of spare parts to repair its aging plant and equipment. While energy costs escalated dramatically across the board, the Zimbabwe Electricity Supply Authority is still not charging economic rates and is failing to generate sufficient revenues to cover costs and upgrade and expand the system. A Zimbabwe business group estimated 1993 production would fall 30 percent short of demand. Charges for electricity for industrial use average US$0.048/kwh -- below the norm for Southern Africa.

In 1993, agreement was reached with South Africa to set-up a back-up system for sourcing, should such a situation recur in the future. In addition, investigations have been initiated with Zambia to undertake a joint hydro-electric project on the Zambezi river over the long term. These supply increases, together with refurbishments of existing facilities will ameliorate, but not eliminate the structural flaws in the energy supply chain.

Table E-2
Infrastructure
(All Costs in U.S. Dollars)

	Tanzania	Zimbabwe	South Africa
Electricity Rates ($/KwH)	$0.150	$0.048	$0.064
Water Rates ($/M3)	$0.210	$0.246	$0.298
Telecommunication Costs to EC ($/min.)	$7.00	$2.58	$1.50
Installation Costs for:			
Water	Minimal	Minimal	Minimal
Electricity	Minimal	Minimal	Minimal
Telephone	$3300 "unofficial expediting cost"	> $100; substantial delays	Minimal
Standard Factory Building Construction Costs ($/sq.m.)	$325	$160	$230
Standard Factory Building Rental Costs ($/sq.m./month)	$3	$2.13	$1.64
Office Rental Costs ($/sq.m./month)	$18	$5 - $15	$9.00
Typical Delays for Utility Hook-Up			
Water	1 to 2 months	12 months or own supply	1 month or less
Electricity	6 to 15 months	Extensive	1 month or less
Telecomunications	Up to several months	2-3 years	1 month or less

c. South Africa

By either European or African standards, infrastructure in South Africa is well developed. This includes transportation, communications, and utilities. Electricity cost is low (US$.06 per KwH), with mostly coal generation. South Africa accounts for approximately 60 percent of the total electricity produced on the African continent. The national electric utility, ESCOM, supplies over 90 percent of the electricity consumed in the country. There is a national grid of over 202,000 km, and there are no significant delays in hookups in areas with regular service.

2. Water & Sewerage

a. Zimbabwe

The severe drought in Southern Africa vastly depleted Zimbabwe's water supply over the 1991-92 period. While the return of the normal rain patterns has replenished the reserves, delays in obtaining water hook-ups are extensive, and many industrial users have opted to drill their own wells. The cost of water, when it is available, is highly competitive within the region, at US$0.246/cubic meter, but as is the norm with public services, the tariff falls far short of economic levels and has served to obstruct new investment and capital expenditures required to upgrade the national system.

b. South Africa

Water service is readily available in most developed areas. Although water shortage is a problem for the country overall, siting of plants requiring water can be accomplished. The cost varies upon the location, but is generally available for R 1,00-1.50 per kiloliter (US$0.298/m3).

3. Telecommunications

a. Tanzania

Telephone communications are still very poor particularly for calls within Tanzania. Costs to Europe and the PTA are US$7.00/minute including sales tax. Installations of new telephone service can take months or years. To "speed up" installation of a telephone, firms report payoff requirements of US$4,000.

b. Zimbabwe

Telecommunications service is perhaps the most frequently cited shortcoming of Zimbabwe's otherwise well-developed infrastructure system. Operated by the government's Posts & Telecommunications Corporation (PTC), the telecommunications network has long been inadequate to meet rising demand for basic services as well as for upgrading of lines for new types of uses. Delays of four to five years in receiving phones are not uncommon among businesses. The number of firms awaiting phones was estimated at 19,000 at year-end 1992, out of a total of 88,000 total requests for service.

The PTC's plans to expand the system have been held up by bureaucratic delays, and its is now more than five years overdue in an initiative to install new digital exchanges and transmission systems. During 1986-90, direct exchange lines grew at a rate of 2 percent per annum, compared to demand increases of 6 percent annually. As with electricity and water service, tariffs are below economic levels and there is insufficient foreign exchange to cover the needed capital expenditures for spare parts and new equipment. Charges for international calls are roughly half those of Kenya. The World Bank has been examining options for a project to rationalize the structure and operations of the PTC, including implementing an economic rate schedule and allowing for alternative suppliers of telecommunications service to enter the market.

c. South Africa

South Africa has a developed telephone system, with digital switching networks and direct international connections. There are virtually no delays in installations of new telephones, at least for businesses in established areas. Extension of services to black townships and rural areas is likely to be a priority in the new administration. Costs are moderate compared to other African countries, but still expensive by global standards. The typical cost for a direct-dial call to the UK, for example, is US$1.50 per minute -- less than other countries in the region.

4. Transport

Basic transport costs are summarized for the three countries in Table E-3, next page.

a. Tanzania

Air freight. The two major airports are Dar es Salaam International Airport and Kilimanjaro International airport in Arusha. An average of 28 flights per month leave Kilimanjaro International Airport. Approximately 50 flights leave Dar es Salaam each month. Capacity is limited however because a number of flights already have cargo from Nairobi which airlines consider more reliable. Cold storage facilities at the airport are not adequate and investors currently have had to put up their own facilities at the airport. Plans are underway however to construct better facilities in addition to the private facilities that are being constructed. Airfreight rates average from US$1.50-1.70/ kg. to the EC. Rates to Singapore are US$6.33/kg.

Sea. The major port in Tanzania is the Dar es Salaam port. Port capacity for dry cargo is 4 million tons a year. The port is currently handling 2 million tons a year. Including liquid cargo the port capacity is 7 million tons. Shipping rates to the EC range from US$1500-3000/TEU (twenty-foot equivalent unit). Port charges average about US$450/TEU. At least two container ships leave for Europe each week.

Table E-3
Transportation
(All Costs in U.S. Dollars)

	Tanzania	Zimbabwe	South Africa
Air Freight Costs ($/Kg)	$1.50 - $1.70	$2.00	$1.70
Number of Passenger Flights to Europe/Week	10	10	32
Sea Freight Rates to Europe Including Ground Transport & Fees ($/20 ft. Container)	$1,500	$2,200	$1,000
Road Carriage to Port Including All Fees ($/20 ft. Container)	$16/100 Km	$1035 Harare to Durban	NA
Rail Carriage to Port Including All Fees ($/20 ft. Container)	$110/ton Intra PTA Rate	$1250 Harare to Durban	$360 Johannesburg to Durban

Overland. Road transportation is improving considerably under the government's road rehabilitation program. There is a need however, to improve feeder roads as they are currently a hindrance to the development of the horticultural sub-sector. The cost of road transport is quite high ranging from US$50-60/ton within Tanzania and US$110 within the PTA. Rail transportation in Tanzania is very inefficient. It takes three weeks for example to transport goods to Uganda. Transportation to Zambia is much more efficient however taking only 2-3 days. Domestic inter-city train rates are US$110 per ton.

b. Zimbabwe

Air Freight. Zimbabwe has daily air service between the international airport in Harare and Europe and the major cities of Africa. The national airline, Air Zimbabwe, provides domestic air links to Bulawayo and other tourist and population centers. Air cargo rates are considerably higher than the regional average at US$2.15/kg. for basic exports, although high-volume shippers are able to negotiate lower rates. There have been complaints of a shortage of cargo space on Affretaire, the Government-owned cargo airliner, which are being investigated.

Sea. As a landlocked country, the door-to-door cost of ocean transport is higher in Zimbabwe than for regional competitors. Zimbabwe is reliant on the ports of Beira (Mozambique) and Durban (South Africa) for its sea cargo. Because of the civil unrest in Mozambique, most Harare-based exporters have relied on Durban as the principal port, despite the fact that port charges at Durban run 30 percent higher, and the rail charges are more than three times as high for general exports (US$282 vs. US$984).

Overland. National Railways of Zimbabwe (NRZ) is the largest employer in the country with over 20,000 workers, Under the structural adjustment program, the NRZ has come under pressure to rationalize its service while upgrading its equipment and facilities through a US$10 million-World Bank/USAID modernization project. Over 3,000 km of rail cross Zimbabwe, linking the country to the ports of Beira, Durban, and Maputo and to the transport systems of its neighbors in Zambia, Botswana, and Tanzania.

The economy is heavily reliant on rail transport for commodity exports -- tobacco, maize (historically), minerals, and cotton. Likewise, the major roads are well-maintained and there is a well-developed trucking industry. A significant percentage of businesses, nearly 30 percent, have opted for road transport, despite the higher tariffs, because the delivery time is cut by half. However, the differential between road and rail rates is narrowing as railroad charges rise. Problems with the clearance of trucks at Beitbridge, at the South African border, have lessened the attractiveness of that route for exporters. The Beitbridge bottleneck has slowed the flow of goods considerably, doubling the amount of time to reach the port from two to four days. Trucking costs for a 20 ft. container between Harare and Durban are an estimated US$769.

c. South Africa

Transportation infrastructure is extensive for road and rail internally, and for air and sea internationally. There are daily flights to Europe and Asia, and direct flights to New York have also been resumed. Air cargo is at average costs for the region, with the benchmark figure of $1.70 per kg to Europe being commensurate with rates from East Africa.

Ocean freight is very competitive for Africa, with basic rates for a 20-foot container to Europe at US$1,000. This compares favorably with East Africa. There are sailings on conference liners every 10-12 days; with outsiders on a weekly or more frequent basis. Port handling charges are R 229 (US$68) for a standard 20-foot container, plus a wharfage fee of 0.9 percent of FOB value (1.8 percent on import.) Delivery charges are another R99 (US$30) within Durban. Shipment onwards by rail to Johannesburg area adds R900 (US$269) and can be accomplished within 36 hours. Durban, the major port, has a modern container facility and also handles bulk cargoes (grain, sugar, coal, oil, petrochemicals, etc.) Overland transport is either by rail or road, and is well developed, given the major population centers inland in the PWV area.

ANNEX F

Synopsis of Predecessor Enterprise Development Funds

The pages that follow review the performance of several enterprise development funds across some common parameters. Note that consistent and comparable data was not available for all funds so there are gaps. The funds reviewed include: The Africa Growth Fund, The Czech and Slovak American Enterprise Fund, The Ghana Venture Capital Fund, Latin America Agribusiness Development Corporation S.A., Bulgarian American Enterprise Fund, SIFIDA, Polish American Enterprise Fund, EDESA, Kenya Trust for Enterprise Development, and Tanzania Venture Capital Fund.

THE AFRICA GROWTH FUND L.P.

Developed by Overseas Private Investment Corporation (OPIC). Commenced operations March 1989.

STRUCTURE

A. Legal Structure

Delaware Limited Partnership. General Partner is Equator Overseas Services Limited, Bahamas corporation. Managed by Equator Investment Services Limited, an affiliate of Equator Bank.

B. Board of Directors

Limited Partnership, not corporation.

1. **Selection Process:**
2. **Characteristics:**
3. **Size:**

C. Management

1. **Selection Process:**
2. **Characteristics:**
3. **Size:**
4. **Compensation**
   $750,000 annual fee paid quarterly in advance, reduced to $625,000 in 1992 when syndication efforts were suspended at $5.0 million.
5. **Operating Expenses**
   Supported by USAID through 1991, now dipping into capital.

D. Capitalization

1. **Sources of Capital**
   Paid in as of 1990 - Citicorp Sub-Sahara Investments, Inc. ($1.0mm); Coca-Cola Export Corporation ($1.0mm); Kellogg Development Corporation ($1.0mm); Lummus African Development Co., Inc. ($1.0mm); Odyssey Fund ($.5mm); Pioneer Holdings Societe Anonyme ($.5mm); Pioneer II Fund Limited Partnership ($.25mm); Equator Overseas Services Limited ($.15mm).
2. **Amounts of Capital**
   $2.7 million equity paid-in 1989. $2.5 in 1990. $6 million debt at 12/92.
3. **On-going Support**
   Grants from OPIC and USAID. OPIC guarantees $20 million of Notes for Fund capital from institutional investors.

E. Location

Headquartered in Hartford, Connecticut. Offices in Washington, D.C., London, Nairobi, Lusaka.

G. Objectives

1. **Financial sustainability**
   Yes
2. **Development objectives**
   Private sector development, broadly.

THE AFRICA GROWTH FUND L.P.

FUNCTION

A. Fund Resources

1. **Treasury Management**
   U.S. Govt. and U.S. bank securities.
2. **Allocation**
   $8.3 million invested at 12/92; $.35 equity in Ghana merchant bank; $.74 equity and $3.5 debt in Botswana tourism; $2.5 equity in Ivory Coast mining; $.5 equity in Ghana transport; $.05 equity and .65 debt in Cameroon manufacturing. 1993 $1.5 debt in Kenya.

B. Investment Parameters

1. **Return on Investment**
2. **Investment Criteria**
   a. **Target Group**
      Private new businesses or expansions; management quality; U.S. interest.
   b. **Country**
      Sub-saharan Africa where OPIC is authorized to do business. OPIC insurance is used.
   c. **Investment instruments**
      Provides 20% to 45% of project's equity capital, hard currency investments.
   d. **Direct vs. indirect**
      Direct
   e. **Sectoral**
      Full range of industries, focus on hard currency earners. No real estate, commodities, military or government controlled enterprises.
   f. **Size**
      AGF investment $500,000 to $3 million; total project size $5 million to $50 million

C. Market Development Support
Necessary

D. Monitoring

1. **Financial objectives**
   Audited by Price Waterhouse
2. **Development objectives**

E. Investment Exits/Fund Termination
3 to 15 year investment horizons. 20 year life of partnership.

EVALUATION

A. Management Comments

B. Performance
Too early to tell. Management fees high for $5 million fund - over 10% - depending on use of $20 million OPIC notes. Rumored to have large gain in Ivory Coast.

LESSONS LEARNED

1. **Management costs.** Transaction costs and management costs must be proportional to fund size or fund will de-capitalize over time.

2. **Attractiveness of larger investments.** Larger investments often imply better management, lower risk, lower proportional transaction costs and other benefits.

THE CZECH AND SLOVAK AMERICAN ENTERPRISE FUND

Established March 1991 pursuant to the 1989 Support for Eastern European Democracy (SEED) Act of the U.S. Congress. Opened for business in July 1991

STRUCTURE

A. Legal Structure

501(c)(3) U.S. non-profit corporation. Two wholly owned subsidiaries - one Czech and the other Slovak.

B. Board of Directors

1. **Selection Process:**
2. **Characteristics**
   U.S. business and law; Czechoslovakian
3. **Size**
   7 members

C. Management

1. **Selection Process**
2. **Characteristics**
3. **Size**
4. **Compensation**
5. **Operating Expenses**
   In 1993, $2.3 million, of which $1.3 million is employee compensation.

D. Capitalization

1. **Sources of Capital**
   US. Government
2. **Amounts of Capital**
   $65 million committed to date; $60 million investment capital, $5 million Technical Assistance funding
3. **On-going Support**
   Dependent upon continued compliance with AID grant agreement.

E. Location

Washington, D.C.; Prague; Bratislava

G. Objectives

1. **Financial sustainability**
   Yes, but secondary
2. **Development objectives**
   Small and medium business support; export oriented businesses; energy efficiency; agricultural food processing

THE CZECH AND SLOVAK AMERICAN ENTERPRISE FUND

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**

   $32 million committed to date - $22 million in direct investments, $8 million in indirect investing through joint lending agreements with local banks, $2 million in technical assistance grants.

B. Investment Parameters

1. **Return on Investment**
2. **Investment Criteria**
   - a. **Target Group**

     Growth companies with management in place, particularly spin-offs and privatizations. Must have local ownership component.
   - b. **Country**
   - c. **Investment instruments**

     Equity and loans
   - d. **Direct vs. indirect**

     Joint ventures with U.S. manager residing in-country are attractive. $8 million to joint lending programs in order to address small business loans of $25,000 to $125,000.
   - e. **Sectoral**

     Exports are 65% of total revenues of portfolio companies
   - f. **Size**

     Average size of deal in portfolio is $472,000. 47 investments totalling $22 million. Stated range $300,000 to $1.5 million per investment.

C. Market Development Support

D. Monitoring

1. **Financial objectives**
2. **Development objectives**

E. Investment Exits/Fund Termination

Two sales of investments are scheduled to occur 1994.

EVALUATION

A. Management Comments

Management was surprised by the extent of resources required to be spent in educating the marketplace about the Fund's business. This resulted in delays in placing investments.

Legal infrastructure constraints and business ethics make investing difficult.

B. Performance

Too early to judge success of investments. $30 million placed in 2.5 years at a cost of approximately $6 million in transaction costs. Write-offs of $633,000 in 1993 are high on average investment base of approximately $10,000,000 - 6.5%.

LESSONS LEARNED

1. **Patience & Management Costs.** Market development education is necessary and substantial.

2. Investment environment. Regulatory, legal and business environment constraints are significant.

THE GHANA VENTURE CAPITAL FUND

Established in July 1992 with $2.1 million principally by Commonwealth Development Corporation. Additional funding in Spring 1994.

STRUCTURE

A. Legal Structure

Management company, Venture Fund Management Company Ltd. (VFMC), separate from Fund, (GVCF). VFMC incorporated in Ghana to manage GVCF and other funds. GVCF incorporated in Ghana. Special tax and regulatory provisions negotiated with Government of Ghana

B. Board of Directors

1. **Selection Process**

   Each investor with 16% appoints one board member.
2. **Characteristics**
3. **Size**

   Fund - 8 directors.

C. Management

1. **Selection Process**

   VFMC manager appointed by CDC
2. **Characteristics**

   General Manager is former CDC officer, Chartered Accountant. 2nd manager is Chartered Accountant. 3rd is Ghanaian, formerly of Africa Development Bank and SIFIDA.
3. **Size**
4. **Compensation**

   VFMC receives 3% of assets per year plus a share of profits, if any through ownership of Fund's capital shares.
5. **Operating Expenses**

   Funded by USAID's Africa Venture Capital Project grant to CDC for management support through 1994.

D. Capitalization

1. **Sources of Capital**

   CDC initially underwrote not less than 40% or $2 million; investment in form of non-interest bearing, subordinated Shareholder Loans and Capital Shares; initial funding 1992 $2.1 million. Additional funding sought 1994 $4.9 million. Total $7.0. Shareholders: Barclay's Bank of Ghana, CDC, Continental Acceptances (Ghana), Ecobank Ghana, Inter-Afrique Holdings (Ghana), Merchant Bank (Ghana), Social Security and National Insurance Trust (Ghana).
2. **Amounts of Capital**

   $2 million to $5 million
3. **On-going Support**

   USAID grants to support management costs

E. Location

Accra

G. Objectives

1. **Financial sustainability**

   Seeks returns commensurate with risks involved
2. **Development objectives**

   Broadly - to support private enterprise development.

THE GHANA VENTURE CAPITAL FUND

FUNCTION

A. Fund Resources

1. Treasury Management

2. Allocation

B. Investment Parameters

1. Return on Investment

20% in cedis, net of inflation

2. Investment Criteria

a. Target Group

Balance between expansions and start-ups, no turn-arounds or buy-outs/buy-ins initially. Changing to privatizations and re-structurings to meet realities of marketplace.

b. Country

Ghana

c. Investment instruments

Equity & quasi-equity, minority only. Some loans.

d. Direct vs. indirect

Direct investments infusing capital into operations

e. Sectoral

Agriculture, fisheries, mining, industrial, utilities, transport, communications, hotel, tourism

f. Size

Transaction size $100,000 to $500,000, no more than 25% of capital in one deal, 35% in one sector

C. Market Development Support

Highly necessary.

D. Monitoring

1. Financial objectives

Quarterly operating reports from management company to Fund.

2. Development objectives

E. Investment Exits/Fund Termination

Aims to realize its gains and distribute all proceeds within 10 years; no re-investment of proceeds from sale of investments. Exit from investments at first reasonable opportunity.

EVALUATION

A. Management Comments

Poor quality financial information in most proposals, particularly from smaller deals. Potential investees surprised and deterred by financial return requirements of Fund. Fund fights perception in marketplace as 'development agency' with easy money.

B. Performance

Too early to tell. Trust management costs can not be supported by the small size of this fund. No increase in value of capital shares between 7/92 and 2/94. One deal made - $370,000 in cardboard box manufacturer. Approved 1 deal and 3 possible of 144 proposals reviewed to date.

LESSONS LEARNED

1. **Patience.** 1 deal approved of 144 reviewed to date.
2. **Flexibility.** Changing business orientation to privatizations and restructurings because of shortage of investable opportunities.
3. Dependable Capital. Who will fund management costs after 1994?
4. **Focus.** Management advises to have few development objectives in order to enhance focus on the difficult business of sustainability in a risky environment.

BULGARIAN AMERICAN ENTERPRISE FUND

Funded in January 1992 pursuant to the Support for Eastern European Democracy (SEED) Act of 1989 by U.S. Congress.

STRUCTURE

A. Legal Structure

501(c)(3) non-profit, U.S. Corporation

B. Board of Directors

1. **Selection Process**
2. **Characteristics**
   American business people
3. **Size**
   6 directors, all volunteers.

C. Management

1. **Selection Process**
2. **Characteristics**
3. **Size**
   3 top managers
4. **Compensation**
5. **Operating Expenses**
   Operating expenses in 1993 $1.8 million, compensation $800,000

D. Capitalization

1. **Sources of Capital**
   U.S. Government (USAID)
2. **Amounts of Capital**
   Up to $55 million, $50 investment, $5 technical assistance
3. **On-going Support**
   Dependent upon compliance with grant agreement; $8.2 million disbursed through 9/93.

E. Location

Chicago and Sofia

G. Objectives

1. **Financial sustainability**
   Yes
2. **Development objectives**
   Promote free enterprise, generate employment and hard currency.

BULGARIAN AMERICAN ENTERPRISE FUND

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**

   Investments to date $5.1 million, $300,000 technical assistance; %5 million of $55 million commitment for technical assistance

B. Investment Parameters

1. **Return on Investment**

   Positive return sought
2. **Investment Criteria**
   - a. **Target Group**

     Small businesses - large businesses remain state controlled. Hard currency generators, competent management at risk.
   - b. **Country**
   - c. **Investment instruments**

     Equity and loans
   - d. **Direct vs. indirect**

     Seeks joint ventures
   - e. **Sectoral**

     Micro-lending with Opportunity International $1000 to $25,000 size; Small and medium lending with South Shore Bank $25,000 to $250,000 transaction size; Small Hotels.
   - f. **Size**

C. Market Development Support

Considered necessary in Bulgarian environment.

D. Monitoring

1. **Financial objectives**

   GAO considers financial monitoring to be insufficient.
2. **Development objectives**

E. Investment Exits/Fund Termination

Proceeds from exits to be re-invested in Bulgaria.

EVALUATION

A. Management Comments

Investments are difficult to find, due principally to slow changes in government policies. Shortage of experienced local business partners. To create deal flow, focused effort on particular industries is required. Activity has been disappointingly slow to start.

B. Performance

Major loss of $1.7 million already on total investment base of $8 million. Operating expenses of $1.8 million on $8 million investment base. Poor financial performer.

LESSONS LEARNED

1. **Investment Environment.** Constraints in economy are high - lack of business partners, govt. policy.
2. **Patience.** Must be capitalized to afford slow start and expect no fast start.
3. **Compensation.** GAO critical.

LATIN AMERICA AGRIBUSINESS DEVELOPMENT CORPORATION S.A.

Established in early 1970's by a group of American agribusinesses.

STRUCTURE

A. Legal Structure

Private investment company incorporated in Panama, pays no income taxes.

B. Board of Directors

1. **Selection Process**
   Each shareholder may sit on board.
2. **Characteristics**
   American agribusiness and banking executives
3. **Size**
   11

C. Management

1. **Selection Process**
   Selected by Board of Directors
2. **Characteristics**
   Formerly at ADELA, experienced in private development finance.
3. **Size**
   8 professional managers
4. **Compensation**
   Total 1993, $1.3 million.
5. **Operating Expenses**
   Total 1993, $2.4 million.

D. Capitalization

1. **Sources of Capital**
   Equity and debt. Equity from agribusiness shareholders - $2.6mm. Retained earnings = $18.3 million. Debt from AID ($26mm), Banks ($8mm), Development banks ($8.5mm), Public bond ($5mm)
2. **Amounts of Capital**
   $49 million debt. $20 million equity and retained earnings.
3. **On-going Support**
   No further subsidies other than low-cost loans.

E. Location

Headquarters in Miami - 4 regional offices in Latin America.

G. Objectives

1. **Financial sustainability**
   Yes, and achieved.
2. **Development objectives**
   Agribusiness development, hard currency and employment generation.

LATIN AMERICA AGRIBUSINESS DEVELOPMENT CORPORATION S.A.

FUNCTION

A. Fund Resources

1. Treasury Management

Managed by LAAD

2. Allocation

100% Latin America medium term agribusiness loans.

B. Investment Parameters

1. Return on Investment

7.5% spread over cost of funds.

2. Investment Criteria

a. Target Group

Latin America agribusiness, family operations

b. Country

All Latin America, 85% Central America and Caribbean.

c. Investment instruments

100% medium term, secured loans.

d. Direct vs. indirect

100% direct.

e. Sectoral

Agribusiness.

f. Size

Over time, has made 465 loans totalling $190 million - average $450,000. 1993 disbursed $20 million in 67 loans -average $300,000.

C. Market Development Support

D. Monitoring

1. Financial objectives

Annual audits by Price Waterhouse.

2. Development objectives

AID evaluations. 67 projects financed in 1993 will generate 3700 new jobs and $51 million in export earnings.

E. Investment Exits/Fund Termination

No termination. Average life of loans is five years.

F. Relationships

EVALUATION

A. Management Comments

Investment success depends upon judging character of borrowers. Judgment can be gained only through experience. One must know one's customers. Working under AID agreements is extremely expensive and cumbersome. Lending environment becoming more competitive as Latin America business conditions improve. Must be business-like to survive.

B. Performance

Accessed public markets for $10 million of additional financing underwritten by Barclay's Bank - the ultimate test of financial viability. Positive income and return on investment. Real development impact on $190 million in loans made. Return on equity approximately 11% over life of fund. Best of all funds.

LESSONS LEARNED

1. **Focus.** Management is highly focused on maintaining profitability while achieving its development goals.
2. **Experienced managers.** Meeting with Robert Ross revealed him to be a highly experienced, hard-nosed and pragmatic businessman, concerned about development issues.
3. **Independence.** Ross states that AID constraints make business success difficult.

POLISH AMERICAN ENTERPRISE FUND

Established May 1990 pursuant to the Support for Eastern European Democracy (SEED) Act of 1989 of the U.S. Congress.

STRUCTURE

A. Legal Structure

501(c)(3) non-profit U.S. Corporation; Polish offices exempt from local taxes.

B. Board of Directors

1. **Selection Process**
2. **Characteristics**

   Chmn. Dillon Read, Brzenzinski, 2 professors, Chmn. Ford Motor, Lane Kirkland (AFL-CIO), 2 Poles
3. **Size**

   8 directors.

C. Management

1. **Selection Process**
2. **Characteristics**
3. **Size**
4. **Compensation**

   $1.6 million PAEF compensation; $900,000 ECC compensation.
5. **Operating Expenses**

   1993 operating expenses $4.2 million including Enterprise Credit Corporation.

D. Capitalization

1. **Sources of Capital**

   $240 million authorized by U.S. Government; 11/92 $101 million from European development finance institutions and private investors.
2. **Amounts of Capital**

   $134 million received from U.S. to date in addition to some PL480 funds.
3. **On-going Support**

   U.S. support depends upon compliance with grant agreement.

E. Location

6 staff in New York City; 35 in Warsaw.

G. Objectives

1. **Financial sustainability**

   Yes
2. **Development objectives**

   Small and large private sector enterprises

POLISH AMERICAN ENTERPRISE FUND

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**

   To date, $142 million in equity and loan investments, $8 million in technical assistance, $66 million in additional unfunded commitments.

B. Investment Parameters

1. **Return on Investment**

   Positive

2. **Investment Criteria**

   a. **Target Group**

      Small and medium enterprises

   b. **Country**

      Poland

   c. **Investment instruments**

   d. **Direct vs. indirect**

      ECC established in 1990 to address smaller enterprises, 2500 loans for total $60 million, average $24,000.; Polish-American Mortgage Bank established in 1992.

   e. **Sectoral**

   f. **Size**

      Investment spread over 2500 businesses, including ECC investments.

C. Market Development Support

D. Monitoring

1. **Financial objectives**
2. **Development objectives**

E. Investment Exits/Fund Termination

EVALUATION

A. Management Comments

B. Performance

$4.2 million in 1993 operating expenses to place approximately $45 million. Investment write-offs $1.2 million on total base of $107 million. GAO critical of compensation levels and inadequate financial reporting.

LESSONS LEARNED

1. **Compensation.** Sensitive issue with government funded projects.
2. **Use of Intermediaries.** Cost effective method of addressing small and medium target group.
3. **Management costs.** Costs can get out of control, particularly relative to fund size.
4. **Reporting.** Improved focus on reporting is needed, particularly in context of government funding.

SIFIDA

Established in 1970.

STRUCTURE

A. Legal Structure

Luxembourg corporation. Taxable.

B. Board of Directors

1. **Selection Process**
2. **Characteristics**

   Shareholders
3. **Size**

   26 directors

C. Management

1. **Selection Process**
2. **Characteristics**
3. **Size**

   15 staff all told
4. **Compensation**
5. **Operating Expenses**

   $2.4 million (reduced to $.7 when subtracting fee income) in 1992 to manage $23 million portfolio. Down from $3.3 millon in 1990.

D. Capitalization

1. **Sources of Capital**

   125 industrial and financial corporate shareholders including Africa Development Bank and International Finance Corp. Uses shareholders as merchant banking business leads.
2. **Amounts of Capital**

   $21 million equity invested. Equity 49% of capital in 1992. Reduced borrowings 32% in 1992 to $17 million, commensurate with reduced investment activity.
3. **On-going Donor Support**

E. Location

Geneva. No field offices.

G. Objectives

1. **Financial sustainability**

   Yes
2. **Development objectives**

   Creation, modernization or expansion of productive industries, export earnings, promote financial expertise, encourage private enterprise.

SIFIDA

FUNCTION

A. Fund Resources

1. Treasury Management

2. Allocation

$7.2 million equity, $28 million loans (reduced by $7 million reserve for losses).

B. Investment Parameters

1. Return on Investment

2. Investment Criteria

a. Target Group

b. Country

Has invested in over 100 projects in 30 African countries, including North Africa. Investment focus currently on southern Africa.

c. Investment instruments

Project finance, trade finance, pre-export finance, letters of credit, debt conversion, bridge financing, services. Income from fees 2/3 of gross revenue in 1992.

d. Direct vs. indirect

e. Sectoral

Has developed focus on advisory services regarding hotel investments.

f. Size

At 12/92 in 50 projects total investment $26.3 million. Average $525,000.

C. Market Development Support

D. Monitoring

1. Financial objectives

Serious problems with loan losses. Pulling way back from investing its own capital. Non-performing loans are $15.1 million. Provision for losses is 18% of portfolio. Audited by Peat Marwick.

2. Development objectives

E. Investment Exits/Fund Termination

Medium and long term investments. No termination intended.

EVALUATION

A. Management Comments

Moving to increase services for fee income as a result of poor investment performance.

B. Performance

Survivability is questionable. Rumored to be discussing sale of business to Edesa. Over 20 years, value of equity investment reduced by approximately 70%.

LESSONS LEARNED

1. **Location.** Should be in region close to investments.
2. **Experienced management.** Must have quality investors as managers.
3. **Expectations/Investment Environment.** High level of risk in African investments.

TANZANIA VENTURE CAPITAL FUND

Established in Fall 1993, principally by Commonwealth Development Corporation

STRUCTURE

A. Legal Structure

Private limited liability Tanzania Corporation; Special tax and financial provision negotiated with government; no capital gains tax or tax on interest or dividends from investments placed

B. Board of Directors

One board for Fund and another for Management Company

1. **Selection Process**
2. **Characteristics**

    Fund board represents shareholders; Management board all Tanzania residents
3. **Size**

C. Management

Separate management company; Equity Investment Management, Ltd. (EIM); 5 year management agreement

1. **Selection Process**

    Former CDC officer heads EIM
2. **Characteristics**
3. **Size**

    1 expatriate general manager; 2 Tanzanian professionals
4. **Compensation**

    3% of assets + 20% of realized profits measured in US dollars
5. **Operating Expenses**

    Supported by USAID and ODA grants; paid out of Fund's capital if earnings insufficient

D. Capitalization

1. **Sources of Capital**

    CDC, USAID, ODA; no borrowing or leveraging of capital; per government's special approval, blocked funds may be invested in Fund
2. **Amounts of Capital**

    $5 million to $10 million; 50% at subscription and 50% within 18 months upon call by Fund
3. **On-going Support**

    AID support of management expenses for limited time period.

E. Location

Dar es Salaam

G. Objectives

1. **Financial sustainability**

    A rate of return commensurate with the risks involved in equity investments in Tanzania - minimum 25% annually after-inflation
2. **Development objectives**

    Support development of private enterprise

TANZANIA VENTURE CAPITAL FUND

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**

   No investments placed to date.

B. Investment Parameters

1. **Return on Investment**
2. **Investment Criteria**
   - a. **Target Group**

     New and expanding private sector businesses; small and medium
   - b. **Country**

     Tanzania only
   - c. **Investment instruments**

     Equity & quasi-equity
   - d. **Direct vs. indirect**

     Mainly direct investments; no majority interests
   - e. **Sectoral**

     Across all business sectors
   - f. **Size**

     $200 average; $50,000 to $500,000 range; no more than 25% of Fund's capital in any one investment

C. Market Development Support

D. Monitoring

1. **Financial objectives**
2. **Development objectives**

E. Investment Exits/Fund Termination

Plans 15 year life of Fund, at which time investment liquidated and proceeds distributed to shareholders; no re-investment of proceeds from old projects into new projects; all distributions are freely convertible per special government approval

F. Relationships

EVALUATION

A. Management Comments

B. Performance

Too early to tell. No prospect of management expenses wholly supported by operations of Fund. Hope for additional Funds managed by same group to achieve self-sufficiency.

LESSONS LEARNED

1. **Management expenses.** Must be structured to allow for small fund size and slow start.
2. **Focus.** Management states that list of objectives should be limited as investment success is difficult enough without additional constraints.
3. **Incentive Compensation.** Management company's profit derived only from realized gains on portfolio as is typical of free-market investment managers.

EDESA

Founded 1972 by Dr. A.E. Rupert, a South African, in conjunction with major Swiss, German, South African, American, British and other business and finance institutions.

STRUCTURE

A. Legal Structure

Luxembourg corporation. Subsidiaries in Liberia, South Africa, Swaziland, Zimbabwe, Germany and Switzerland.

B. Board of Directors

1. **Selection Process**
2. **Characteristics**
   Shareholders
3. **Size**
   16 members

C. Management

1. **Selection Process**
   Selected by Board of Directors
2. **Characteristics**
   Rene Garber managing director since inception.
3. **Size**
   5 senior managers.
4. **Compensation**
   $1.6 million in 1992.
5. **Operating Expenses**
   $2.5 million in 1992, to manage $44 in total assets.

D. Capitalization:

1. **Sources of Capital**
   Equity from 24 Swiss, German, South African, Dutch, U.K., U.S. and other business and finance institutions. Debt is 42% of total capital.
2. **Amounts of Capital**
   Paid up capital $20.5 million. Retained earnings $3.0 million. Debt = $17.3 million.
3. **On-going Support**
   Self-financing.

E. Location

Headquarters in Zurich. Offices in Nairobi, Harare, Johannesburg, Monrovia.

G. Objectives

1. **Financial sustainability**
   Yes
2. **Development objectives**
   Economic development in Equatorial and Southern Africa by stimulating private enterprise through the provision of finance and know-how.

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**
   Equity investments of $12.9 million - 47% of portfolio in 1992.

B. Investment Parameters

1. **Return on Investment**

   Positive, market-rate returns sought.

2. **Investment Criteria**

   a. **Target Group**

   b. **Country**

      Active in Botswana, Kenya, Lesotho, Malawi, Swaziland, Tanzania, Zambia, Zimbabwe.

   c. **Investment instruments**

      Equity (47%) and loans (53%). Equity portion increasing annually. Medium term loans, with currency protection.

   d. **Direct vs. indirect**

      Takes active role in working with investees. Investments in leasing, hire-purchase, and factoring.

   e. **Sectoral**

   f. **Size**

C. Market Development Support

D. Monitoring

1. **Financial objectives**

   Annual audits by independent Luxembourg accounting firm.

2. **Development objectives**

E. Investment Exits/Fund Termination

No termination contemplated.

EVALUATION

A. Management Comments

Very difficult task, which has become no easier over 20 years. Negatives are government interference, oil and commodity prices, inadequate governance, droughts, wars, population growth, desertfication and increasing tendency of industrial countries to look inward. Pluses are reduced government involvement, structural adjustment, democratization, opening of South Africa. Difficult to find willing investors to enhance EDESA's size.

B. Performance

Only two shareholders have sold out. Significant losses in project financing, mainly due to devaluation. ROI on shareholders equity approximately 0.5% annually over life of Fund. However, EDESA is one of the very few survivors and is self-financing its management costs, earning a net profit in 1991 and 1992. Investments in leasing companies of Zimbabwe, Malawi and Botswana appear successful, developmentally and financially.

LESSONS LEARNED

1. **Flexibility**. EDESA began lending to governments, changed to venture capital in 1980's.
2. **Transaction costs/Management capacity**. Small size inhibits management capacity.
3. **Investment Environment**. Governments sometimes interfere with the successful investments. Investment exits are problematic.
4. **Patience**. EDESA has survived over 20 years, through several low points.
5. **Experienced Managers**. Knowledge of business and African environment critical in surviving.
6. **Intermediaries**. Use of financial intermediaries can be successful, low-cost method of reaching small and medium enterprises.

KENYA TRUST FOR ENTERPRISE DEVELOPMENT

Authorized in May 1987 by USAID. First investments disbursed in June 1988.

STRUCTURE

A. Legal Structure

Independent trust managed by Standard Chartered Bank, Ltd. (Trustee). Trustee channels money to Industrial Promotion Services, Ltd. (IPS), a pre-existing company and Kenya Equity Management Ltd. (KEM), a new company designed to operate as fund manager for Kenya Equity Capital Ltd.

B. Board of Directors

1. **Selection Process**
2. **Characteristics**
3. **Size**

C. Management

1. **Selection Process**
2. **Characteristics**

   IPS pre-established, successful holding company. KEM new, unseasoned investment manager hired by Equator Advisory Services, Ltd. and International Resources Group Ltd.
3. **Size**
4. **Compensation**

   KEM to receive 3% of loans committed.
5. **Operating Expenses**

D. Capitalization

1. **Sources of Capital**

   USAID, to IPS and KEM in form of Trust Loans to fund sub-loans which IPS originates in conjunction with its own equity investments. Total $9.6 million in Trust Loans through 1993.
2. **Amounts of Capital**

   $3.0 million to IPS.
3. **On-going Support**

   Expense support to KEM of 1.35 million over 3 years.

E. Location

Nairobi

G. Objectives

1. **Financial sustainability**

   Yes.
2. **Development objectives**

   Increased investment, employment, foreign exchange and tax revenue.

KENYA TRUST FOR ENTERPRISE DEVELOPMENT

FUNCTION

A. Fund Resources

1. **Treasury Management**
2. **Allocation**

B. Investment Parameters

1. **Return on Investment**
   Not specified
2. **Investment Criteria**
   a. **Target Group**
   b. **Country**
      Kenya
   c. **Investment instruments**
      Equity (minority positions) and debt.
   d. **Direct vs. indirect**
      Direct
   e. **Sectoral**
      Unlimited
   f. **Size**
      Target $200,000 for IPS, $300,000 for KEM.

C. Market Development Support

D. Monitoring

1. **Financial objectives**
2. **Development objectives**
   1994 evaluation states program has achieved quantified development goals of total employment, output, foreign exchange and taxes.

E. Investment Exits/Fund Termination

No exits to date.

EVALUATION

A. Management Comments

B. Performance

KEM invested in 6 companies. Financial performance considered poor by AID evaluation. KEM manager terminated due to lack of experience and performance. KEM terminated investment activities in order to generate merchant banking fee income.

IPS invested in 6 companies. Ultimate financial performance unknown. Development objectives are being met. IPS is a holding company, with substantial management involvement - not a traditional investment company.

LESSONS LEARNED

1. **Transaction Costs.** Size of funds and transactions too small to support management costs. Not financially sustainable.
2. **Focused & experienced management.** KEM suffered. IPS prospered.
3. **Investment Environment.** Insufficient and unreliable financial and market information, exit strategies, lack of management - substantial shortcomings in investment environment

ANNEX G

Profiles of Alternative Fund Models

The following briefly considers three alternatives to the proposed SAEDF model. The first is fund of funds approach based on the structure the SBIC uses in the U.S. The second considers a pass through option, that would in essence create many separate, smaller, and country-specific funds. The third follows the current structure of the Eastern-European Enterprise Funds.

A. SBIC Model

1. Fund Organization

a. Legal Structure

- Non-profit U. S. Corporation; 501, c(30).
- Charter, by-laws, policies and directors determined by USAID.

b. Board of Directors

- Selection Process:
  * All members of the initial Board of Directors appointed by the A/USAID.
  * A/USAID serves on the Board as a non-voting Alternate Chairman.

- Characteristics -- Not specified.

- Size -- Not specified.

c. Management

- Selection Process:
  * Board hires management staff directly, subject to USAID specified guidelines; or
  * Contract team selected by request for proposal (RFP) process, the RFP process to be managed by USAID staff; or
  * Co-promoter selected to manage the SAEDF based on commitment of substantial amount of its own funds, with USAID capitalization offered as additional leverage.

- Characteristics -- Vary according to selection process. However, since the SBIC Model envisions the SAEDF purely as a "wholesaler" of leverage to a net-work of private venture investment companies ("retailers") in the region, its staff will be primarily responsible for negotiating contracts the Associate Venture Capital Companies and monitoring their performance. Therefore, the background characteristics of SAEDF management would be expected to mirror those of the professionals who staff the Investment Division within the U.S. Small Business Administration, i.e. primarily banking, investment banking, accounting or law.

- Size -- Not specified, but would be expected to grow as the network of Associate Venture Capital Companies expands.

d. Capitalization

- Sole initial funding for the SAEDF will be a US $100 million grant from USAID, made available in US $20 million tranche per year over five years, all installments after year one contingent upon the success of SAEDF in negotiating commitments to Associate Venture Capital Companies for at least 75 percent of funds provided to it by USAID, and having placed at least 25 percent of such funds through draw-downs by Associates.

- SAEDF will not be limited to accepting financing solely from USAID, as diversification of funding sources is a long-term objective. To the extent that funding is generated from other sources for management through the SAEDF system, the source of such funds would be expected to negotiate its own conditions for its use. The SAEDF, as an "independent" non-profit corporation, would enjoy complete latitude in such negotiations for alternative funding so long as agreements reached do not interfere with its ability to accomplish USAID objectives with USAID funds.

e. Location

Headquartered in Washington, D.C. Field representation in regions where affiliate growth and support needs are greatest.

2. Fund Operations

a. Fund Resources

- Treasury Management -- Safe Investments, i.e. U.S. Government securities. Interest to be applied to meeting SAEDF overhead costs.

- Allocation -- SAEDF shall be a "wholesaler" of long-term debt to a southern Africa-wide network of independently owned and operated venture capital companies, providing additional capital to such companies to match funds of their own which are at "first risk" in any investment. The Associate Venture Capital Companies (AVCCs) would be expected to each, in turn, develop a portfolio of investments in small and medium size businesses in their respective market areas by "retailing" long-term debt and equity financing to such businesses.

b. Investment Parameters

- Return on investment -- SAEDF will endeavor to be competitive in the marketplace for money. It must charge enough on its long-term debt capital to pay its costs of operating; and the AVCCs must be able to live on the spread between what they can charge investees and what they must pay the SAEDF for its money. All transactions with Associates are envisioned as loans at, say, 20 years, with interest derived from a formula including the T-bill rate as a proxy for cost of money + assessment of risk + operating cost.

- Parameters:
    - Target group -- Candidates for Associate status shall be private business entities or individuals engaged in small and medium-size business development in Africa. This would include qualified African businessmen and women, international private voluntary organizations (PVOs) engaged in small enterprise

development throughout Africa, as well as established investment firms engaged in business development in Africa such as EDESA, SIFIDA and the Africa Growth Fund.

* Country -- Potential "retailers" in all countries of the region would be eligible.
* Type of investment instrument(s) -- SAEDF would provide financing to retailers in the form of long-term debt. Retailers, in turn, would provide financing to enterprises in a variety of forms depending on their market focus and/or area of specialization.
* Type of investment -- Indirect, solely through intermediaries.
* Sectoral -- None specified.
* Size -- The SAEDF would provide leverage to Associates at ratios of 7:1, 5:1, and 3:1, based on minimum equity requirements of US $100,000, US $500,000 and US $2,000,000 for Associates that are PVOs, LDC-owned/ domiciled and U.S.-owned/domiciled respectively.

<u>c. Market Development Support</u>

None envisioned. However, modest grant support (up to $50,000 per Associate) might be made available to Associates which are PVOs or LDC-owned/domiciled, to partially defray start-up and/or initial operating costs.

<u>d. Monitoring</u>

- Portfolio:
  * In the SAEDF relationship with its Associates, there would be no interference with investment placement, management or liquidation. Associates would have free rein within the sole constraints of their negotiated agreement with the SAEDF.
  * Monthly financial and management reports would be required.

- Development -- A SAEDF reporting system which emphasizes USAID development objectives would be established; and annual USAID evaluations would be conducted with a view toward assessing the SAEDF's progress toward achievement of its objectives.

<u>e. Investment Exits/Fund Termination</u>

- Investment Exits -- Since SAEDF provides financial leverage to Associates in the form of long-term debt, the terms of the financing -- including repayment of principal -- are codified in the agreements with the particular Associate.

- Fund Termination:
  * Because the SAEDF is a non-profit corporation with an objective of achieving self-sustainability, it is expected to operate in perpetuity. Therefore, no wind-down, liquidation or USAID reimbursement would be expected.
  * However, three years from the date of the original grant to the SAEDF, USAID would sponsor a comprehensive evaluation of the Fund's progress toward meeting USAID's development objectives. If, in the opinion of the evaluators, the SAEDF has not achieved reasonable progress, and prospects of improvement are not good, USAID would have the option to cease further commitment to the Fund and all monies not yet advanced would be made available for reprogramming.

f. Relationships

- USAID -- Control over all USAID funds granted to the SAEDF will be accomplished through:
  * Development of its corporate charter, bylaws and procedures at the outset;
  * Appointment by the A/USAID of its initial Board of Directors;
  * Participation of the A/USAID on the Board of Directors as a non-voting Alternate Chairman;
  * Establishment of an SAEDF reporting system which emphasizes USAID development objectives; and
  * Plans for annual Project evaluations with a view toward assessing progress toward Goal and Purpose achievement.

- Other -- To the extent that funding is generated from sources other than USAID, such sources would be expected to negotiate their own conditions for its use.

B. Mission Managed (Pass Through)

This model represents a program that addresses individual country needs through regional allocation of funds but country-level management and coordination through the Mission.

1. Fund Organization

a. Legal Structure

Trusts are created in every participating country, separate and distinct from USAID.

b. Board of Directors

- Each bilateral fund has an *ad hoc* Board of Directors selected by USAID Mission and Washington personnel.

- USAID has at least one seat on the Board of the Trust, along with host country entrepreneurs and cooperating partners.

c. Management

- At the regional level, an "USAID Coordination Committee" is responsible for allocating funds, reporting, and coordinating with other donors. This committee is comprised of the Regional Director for Southern Africa, designees from USAID Missions, and Washington personnel.

- At the country level, each USAID Mission decides how to select bilateral fund management for their respective country. Options for selecting management include, but are not limited to:
  * An RFP process
  * By selectively choosing managers via resumes and open competition
  * Through a personal services contractor that works within the Mission itself.

d. Capitalization

Any organization or group may invest in the independent bilateral trusts created in each of the participating countries. However, these investments are made with the full knowledge that the Fund seeks regional and bilateral SME development as well as financial returns. Because of its development orientation, this Fund's anticipated returns on investment are less than those with purely profit-motivated objectives.

e. Location

- The regional coordinating office is based in the USAID Regional Office for Southern Africa.

- Independent trusts are created in each of the participating countries.

2. Fund Operations

a. Fund Resources

- Treasury Management -- Country management decides whether to invest the funds in government securities of that country or in U.S. government securities. They are responsible for the management of these funds.

- Allocation:
  * The total amount available is US$100 million, at US $20 million a year for five years.

  * Allocation is determined by the regional Coordinating Committee, which would meet annually over the life of the installments from USAID/Washington.

  * For phase-out countries, the regional Mission manages allocated funds as recommended by the USAID Coordination Committee.

  * Operating budgets are provided by country Missions or other donors, though uninvested funds should be allowed to earn interest towards such costs.

b. Investment Parameters

- Return on Investment -- All bilateral Funds must work towards a positive rate of return so that, with losses, the fund is in a net positive position. The bilateral Funds must preserve the inflation adjusted principle balance. Bilateral Missions, including small and phase-out Missions, may leverage other program resources (i.e. HRD) and personnel to support enterprise development on a national and regional basis.

- Parameters:
  * Target Group guidelines are not specified because of the diversity of views and needs within the Southern Africa region. Therefore, target groups are determined on a country-by-country basis by the USAID Missions and their coordinating partners (other donors, NGOs).
  * Missions are not restricted to investing in enterprises of a certain size, number of employees, or revenues generated.

* There is no allocation criteria in terms of the type of investee. Financial intermediaries, direct investments, and industry allocations are all appropriate investments, providing they meet established (Mission generated) development guidelines and (regional fund generated) financial returns.
* There are no specific allocations by **type of investment instrument** - debt, equity, leasing etc. Products are driven by the investment opportunity and the market.

c. Market Development Support

The training component is designed on a country-by-country basis by the individual Missions and their cooperating partners using appropriate regional, Washington, and international assistance. Management of this component could be selected during the initial, bilateral management selection process. Or, management for this component could be selected through a separate, distinct process.

d. Monitoring

- Each country fund is responsible for monitoring its activities as it requires from both a financial and development point of view.

- All funds would be formally evaluated during the fourth year of the fund's life for both financial and development achievements.

- The USAID Regional Director's office will receive regular reports on the progress of the various country funds. The form, frequency, and content of such will be determined in conjunction with the Missions and fund management.

e. Investment Exits/Fund Termination

- The Coordinating Committee would remain active at least until the annual AID/Washington installments are finished. Beyond that would be determined by need and the Regional Director. The life of this committee could be relatively short since bilateral Missions create their own mechanisms for investing funds allocated to them.

- The country trusts are meant to be financially self-sustaining. Therefore, they have an indefinite term. Should the trusts be dissolved, the remaining funds will be returned to the U.S. Treasury.

C. AID Standard Model for Eastern Europe

1. Fund Organization

a. Legal Structure

- Non-profit U. S. Corporation; 501, c(3).
- Charter, by-laws, policies and directors determined by negotiation between USAID and Board.

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b. Board of Directors

- Selection Process:
  * All members of the initial Board of Directors appointed by the President of the United States.

- Characteristics:
  * Mix of U.S. financial professional, high-profile citizens and local V.I.P.'s.

- Size -- Five to ten.

c. Management

- Selection Process:
  * Board hires management staff directly

- Characteristics -- Financial professionals, generally American, with experience in investment banking, venture capital or operating companies. Local staff added and trained over time.

- Size -- Five to 35.

- Compensation - Limited to maximum of $150,000 per year. No carried interest.

d. Capitalization

- Funds authorized by SEED Act in the amount of $50 million to $250 million per fund. Specific grants per USAID grants agreements of approximately $20 million. Actual funding on as-needed basis. Each transfer of funds conditioned on USAID's satisfaction with Fund's continued compliance with Grant Agreement and Fund's ability to meet overall objectives.

- New grant agreements negotiated and new terms established by USAID after expiration of former agreement. Each draw-down subject to AID's satisfaction with Fund's compliance with current grant agreement. Subjective terms and conditions included in grant agreements.

e. Location

Headquartered in U.S., not necessarily Washington, D.C. Most operations conducted out of office established in capitol of subject country and provincial offices.

2. Fund Operations

a. Fund Resources

- Treasury Management -- Highly conservative, highly liquid investments. Treasury fund balance remains limited due to method of capitalization.

- Allocation -- Determined by Board of Directors. Allocation to operating costs, technical assistance and long-term investments in such a way that Fund may become financially self-sustaining.

b. Investment Parameters

- Return on investment -- no specific financial return parameters established except that Fund should endeavor to become self-sustaining. Development impact measured in terms of private sector growth and employment generation.

- Parameters:
  * Target group -- Private enterprises including joint ventures with American and other partners. Focus on increasing local management of businesses. Focus on small and medium enterprises.
  * Country -- One country funds including Poland, Czech Republic, Slovakia, Hungary and Bulgaria.
  * Type of investment instrument(s) -- Flexible.
  * Type of investment -- Direct and indirect. Indirect involves financial intermediaries who provide capital or services to smaller enterprises.
  * Sectoral -- None specified.
  * Size -- Typical individual direct investment from $250,000 to $2,500,000.

c. Market Development Support

Provided by Fund management. Need for market development sometimes unanticipated, representing additional cost to Fund.

d. Monitoring

- Portfolio:
  * Quarterly financial and management reports. Occasionally non-existent or late.

- Development -- Basic statistics on employment generation and economic growth in private sector.

e. Investment Exits/Fund Termination

- Investment Exits -- Flexible - sometimes structured in initial investment but often left open. Potential exits include sale to management, sale to co-investors, sale to third parties and sale through public stock exchanges.
- Fund Termination -- None contemplated.

f. Relationships

- USAID -- Control over USAID funds granted are accomplished through:
  * Participation in development of corporate charter, bylaws and grant agreement at the outset;
  * Grant agreement for only part of total authorization;
  * Monthly disbursement reports;
  * Three year time limit to expend all granted funds;
  * Right to receive any information requested;
  * Semi-annual progress reviews;

* Visits by AID Project Officer to home and field offices and to sampling of investees three time per year;
* AID approval of each investment in intermediary.

- Other -- To the extent that funding is generated from sources other than USAID, such sources would be expected to negotiate their own conditions for its use. Relationships with other non-profits or progressive finance institutions such as IESC, South Shore Bank. Relationships with financial intermediaries.

· **ANNEX H**

SAEDF
Hypothetical Financial Projections

These hypothetical financial projections address only the financial sustainability goal of the Fund. The purpose of these financial projections is:

- To illustrate in financial terms the operations of the SAEDF and describe the various sources and uses of SAEDF's funding. That is, the anticipated real-life operations of the Fund, including where money comes from and where it goes.

- To specify the independent operating and financial variables most critical in determining the ultimate success of the Fund. That is, the projections specify the level of performance required of the Fund's operations, investments, and environment in order to achieve financial sustainability.

The net result of the attached projections is captured in a break-even analysis. This analysis demonstrates, dependent upon a variety of operating assumptions input into the model, whether the value of the Fund's investments may exceed the total investment made into the Fund, adjusted to reflect inflation.

The attached hypothetical projections, which are determined by the specific assumptions described below, result in the following overall performance of the Fund:

Year: [Fund Year	**1999** 5th	**2004** 10th	**2009** 15th	**2014** 20th]
Total Value of Fund	$99.7	$120.8	$161.2	$217.0
Break-even Point	$106.2	$128.0	$155.7	$189.4
Net Gain	($6.5)	($7.1)	$5.5	$27.6

Based on the assumptions described below, during the first eight years of operations the Fund's income is expected to produce net negative returns -- on an inflation-adjusted basis. This is due primarily to the prolonged time required for investments to be placed and for resulting returns to be earned. This is a phenomenon common to investment funds and expected in the case of SAEDF. After this period, the Fund's income exceeds its investment losses, operating expenses and inflation effect. At that time, the Fund's net financial position begins its return to a positive position.

It is worth noting, that an inflation-adjusted break-even point presents a formidable standard of financial self-sustainability. While the Fund awaits the placement and subsequent returns from its investments, the break-even point continues to increase with annual inflation, nearly doubling over the 20 year period.

Therefore, assuming the validity of several critical assumptions, the Fund is projected to become financially self-sustaining and modestly profitable over an extended, twenty year lifetime. The critical assumptions used in determining this financial sustainability are:

- Capitalization: Assumed that USAID makes annual installments of US $20 million a year over five years.

- Operating Expenses: Operating expenses include all employee compensation, office, travel, investment and all other expenses required to operate the Fund as designed. For purposes of these projections, operating expenses are projected at approximately $1.7 million in 1996, the first full year of operations, and to increase at a 4 percent rate of annual inflation.

- Treasury Income: Treasury income is income earned on treasury funds -- money received from USAID but not yet invested or money returned to the Fund from its investments. Treasury funds are assumed to be invested by an independent investment manager in U.S. Government securities of varying maturities, the income from which would support the operating expenses of the Fund. For purposes of these projections, the average rate of return on treasury investments is assumed to be 5 percent.

- Investment Portfolio Capital Gains ROI: Investment portfolio capital gains ROI refers to the average compounded annual rate of return earned by the Fund's long-term investments in southern-African businesses. This projected ROI applies only to those portfolio investments that are not written off and it does not include any current interest or dividends earned from portfolio investments. For purposes of these projections, the ROI is assumed to be ten (10) percent per annum in U.S. dollar terms, over and above any local currency devaluations.

- Investment Portfolio Write-offs: The Fund may be expected to incur substantial losses on a portion of the investments it makes in Southern African businesses. That is, a certain percentage of investments may be completely lost, with no investment return expected. For purposes of these projections, the portion of investments which are assumed to be written off is twenty (20) percent.

- Investment Portfolio Current Income: A portion of the Fund's investments in Southern African businesses may include provisions for regular, current payments of interest or dividends to the Fund. This income would support the operating expenses of the Fund. For purposes of these projections, the current income overall on the portfolio investments is assumed to be (4) percent per annum in U.S. dollar terms, over and above any local currency devaluations.

- Inflation: Inflation refers to the change in purchasing power of the U.S. dollar. Although the Fund will be investing in various currencies of Southern Africa, it is presumed that these investments will be translated into dollar terms for valuation purposes. For purposes of these projections, U.S. dollar inflation is assumed to be 4 percent per annum.

The modest profitability shown in the attached financial projections result from several critical assumptions. To the extent that these assumptions are not borne out in actual operations, financial results will vary. The table below attempts to demonstrate the variability of financial results as critical assumptions are changed.

	Operating Expenses	Treasury Income	Write-off Percent	Portfolio Income	Capital Gains	Inflation Percent	Year 10 Acc. Profit	Change fm Base Case	Year 20 Acc. Profit	Change fm Base Case
Base Case	flat	5.0%	20.0%	4.0%	10.0%	4.0%	(7.1)	0.0	27.6	0.0
Low Operating Expense	(250,000)						(3.6)	3.5	39.9	12.3
High Operating Expense	250,000						(10.6)	(3.5)	14.3	(13.3)
Low Treasury Income		3.0%					(12.5)	(5.4)	9.7	(17.9)
High Treasury Income		7.0%					(1.3)	5.8	47.3	19.7
Low Write-offs			15.0%				(0.6)	6.5	63.5	35.9
High Write-offs			25.0%				(13.5)	(6.4)	(5.3)	(32.9)
Low Portfolio Income				2.0%			(18.1)	(11.0)	(19.5)	(47.1)
High Portfolio Income				6.0%			4.5	11.6	83.1	55.5
Low Capital Gains					8.0%		(13.8)	(6.7)	(13.3)	(40.9)
High Capital Gains					12.0%		0.0	7.1	74.7	47.1
Low Inflation						2.0%	12.3	19.4	94.5	66.9
High Inflation						6.0%	(29.3)	(22.2)	(63.3)	(90.9)

Blank box indicates Base Case assumption.

As would be expected, even minor adjustments in assumptions have major cumulative impacts when compounded over 20 years. This is natural and expected in modelling any business, particularly an investment fund. Such sensitivities highlight the importance of experienced and capable Fund managers, who must intensively manage the Fund's operating determinants in the face of ever-changing market conditions. Even slight improvements in the underlying determinants resulting from superior management will have major positive impacts.

The most powerful variables in determining the projected success of the Fund are the annual Return on Investment, whether in terms of current income or capital gains, and the rate of inflation. For each 1.0% change over or under the base case assumption in the Return on Investment percentage, whether in terms of current income or capital gains, the equity of the Fund after twenty years changes by approximately $25 million. For each 1.0% change in the rate of inflation over or under the base case assumption, the break-even hurdle point used to define self-sustainability changes by approximately $40 million. Although all assumptions have a major impacts, these are particularly significant.

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND – PROJECTED FINANCIAL STATEMENTS

26-Apr-94

Income Statement

Year:	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
In-flow from USAID	$1,500,000	$0	$0	$0	$0	$0	$0	$0	$0	$0
Treasury income	500,000	1,273,599	1,641,637	1,725,520	1,762,040	1,447,012	791,550	638,193	908,682	1,153,299
Current income on portfolio investments	0	200,000	700,000	1,392,000	2,132,000	2,764,000	3,285,963	3,447,203	3,332,398	3,327,222
Capital gains on portfolio investments	0	0	0	0	529,600	1,536,960	3,149,856	5,244,042	7,667,646	9,333,803
Total income	2,000,000	1,473,599	2,341,637	3,117,520	4,423,640	5,747,972	7,227,369	9,329,437	12,108,726	13,814,323
Operating expenses	(1,056,033)	(1,696,048)	(1,763,890)	(1,834,446)	(1,907,823)	(1,984,136)	(2,063,502)	(2,146,042)	(2,231,883)	(2,321,159)
Provision for investment losses	0	0	0	(400,000)	(1,000,000)	(1,800,000)	(2,600,000)	(3,400,000)	(3,867,926)	(3,666,480)
Market development – program support	0	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	(1,000,000)	0	0	0	0
Net income	$943,967	($1,222,449)	($422,253)	($116,926)	$515,817	$963,636	$2,563,867	$3,783,395	$6,008,916	$7,826,684

Statement of Assets, Liabilities & Equity

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Assets										
Treasury investments	$20,943,967	$29,721,518	$34,299,265	$34,582,339	$37,698,156	$24,461,992	$15,127,703	$22,747,263	$30,660,238	$36,841,711
Portfolio investments	0	10,000,000	25,000,000	44,600,000	62,000,000	76,200,000	88,098,156	84,261,992	82,357,933	84,003,144
Total Assets	$20,943,967	$39,721,518	$59,299,265	$79,182,339	$99,698,156	$100,661,992	$103,225,859	$107,009,254	$113,018,171	$120,844,855
Liabilities & Equity										
Liabilities:										
	none									
Equity:										
USAID investment	$20,000,000	$40,000,000	$60,000,000	$80,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Retained earnings	943,967	(278,482)	(700,735)	(817,661)	(301,844)	661,992	3,225,859	7,009,254	13,018,171	20,844,855
Total Equity	$20,943,967	$39,721,518	$59,299,265	$79,182,339	$99,698,156	$100,661,992	$103,225,859	$107,009,254	$113,018,171	$120,844,855

Statement of Cash Flows

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Net income	$943,967	($1,222,449)	($422,253)	($116,926)	$515,817	$963,836	$2,563,867	$3,783,395	$6,008,916	$7,826,684
Add back provision for losses	0	0	0	400,000	1,000,000	1,800,000	2,600,000	3,400,000	3,867,926	3,666,480
Cash from operations	943,967	(1,222,449)	(422,253)	283,074	1,515,817	2,763,836	5,163,867	7,183,395	9,876,842	11,493,164
In-flow from USAID	20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	0	0	0	0	0
Investments made	0	(10,000,000)	(15,000,000)	(20,000,000)	(20,000,000)	(20,000,000)	(21,698,156)	(2,963,836)	(15,563,867)	(20,783,395)
Investment return of principle	0	0	0	0	1,600,000	4,000,000	7,200,000	10,400,000	13,600,000	15,471,705
	$20,943,967	$8,777,551	$4,577,747	$283,074	$3,115,817	($13,236,164)	($9,334,289)	$7,619,559	$7,912,975	$6,181,473
Treasury balance at End of Year	$20,943,967	$29,721,518	$34,299,265	$34,582,339	$37,698,156	$24,461,992	$15,127,703	$22,747,263	$30,660,238	$36,841,711
Treasury balance at Beginning of Year	0	20,943,967	29,721,518	34,299,265	34,582,339	37,698,156	24,461,992	15,127,703	22,747,263	30,660,238
Change in Treasury Balance	$20,943,967	$8,777,551	$4,577,747	$283,074	$3,115,817	($13,236,164)	($9,334,289)	$7,619,559	$7,912,975	$6,181,473

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND – PROJECTED FINANCIAL STATEMENTS

26–Apr–94

Year:	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Income Statement										
In–flow from USAID	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Treasury income	1,287,691	1,302,258	1,295,362	1,315,164	1,359,106	1,446,124	1,606,037	1,766,891	1,868,879	1,935,404
Current income on portfolio investments	3,503,998	3,821,521	4,157,482	4,460,455	4,731,537	4,951,374	5,143,699	5,405,339	5,764,249	6,174,749
Capital gains on portfolio investments	9,597,425	9,188,538	8,944,209	8,929,753	8,731,636	10,720,093	12,135,670	12,947,366	13,148,563	13,393,992
Total income	14,389,113	14,312,317	14,397,053	14,705,372	14,822,279	17,117,590	18,885,406	20,119,596	20,781,691	21,504,146
Operating expenses	(2,414,005)	(2,510,565)	(2,610,988)	(2,715,427)	(2,824,045)	(2,937,006)	(3,054,487)	(3,176,666)	(3,303,733)	(3,435,882)
Provision for investment losses	(3,489,034)	(3,520,370)	(3,734,312)	(3,912,749)	(4,551,446)	(4,964,220)	(5,201,817)	(5,293,513)	(5,455,310)	(5,779,559)
Market development – program support	0	0	0	0	0	0	0	0	0	0
Net income	$8,486,074	$8,281,381	$8,051,753	$8,077,196	$7,446,789	$9,216,364	$10,629,102	$11,649,417	$12,022,649	$12,288,705
Statement of Assets, Liabilities & Equity										
Assets										
Treasury investments	$38,134,191	$37,732,997	$37,669,297	$38,713,258	$39,639,176	$44,384,601	$49,868,383	$53,581,116	$55,594,939	$57,367,462
Portfolio investments	91,196,738	99,879,313	107,994,766	115,028,000	121,548,871	126,019,811	131,165,130	139,101,815	149,110,640	159,626,822
Total Assets	$129,330,929	$137,612,310	$145,664,063	$153,741,258	$161,188,048	$170,404,411	$181,033,513	$192,682,931	$204,705,580	$216,994,284
Liabilites & Equity										
Liabilities:										
Equity:										
USAID investment	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000	$100,000,000
Retained earnings	29,330,929	37,612,310	45,664,063	53,741,258	61,188,048	70,404,411	81,033,513	92,682,931	104,705,580	116,994,284
Total Equity	$129,330,929	$137,612,310	$145,664,063	$153,741,258	$161,188,048	$170,404,411	$181,033,513	$192,682,931	$204,705,580	$216,994,284
Statement of Cash Flows										
Net income	$8,486,074	$8,281,381	$8,051,753	$8,077,196	$7,446,789	$9,216,364	$10,629,102	$11,649,417	$12,022,649	$12,288,705
Add back provision for losses	3,489,034	3,520,370	3,734,312	3,912,749	4,551,446	4,964,220	5,201,817	5,293,513	5,455,310	5,779,559
Cash from operations	11,975,108	11,801,751	11,786,065	11,989,945	11,998,235	14,180,584	15,830,919	16,942,930	17,477,959	18,068,264
In–flow from USAID	0	0	0	0	0	0	0	0	0	0
Investments made	(25,348,547)	(26,159,083)	(25,931,246)	(25,883,232)	(26,723,313)	(27,640,941)	(30,204,017)	(34,037,464)	(36,638,186)	(38,116,980)
Investment return of principle	14,665,919	13,956,137	14,081,481	14,937,248	15,650,997	18,205,782	19,856,880	20,807,267	21,174,050	21,821,240
	$1,292,480	($401,194)	($63,700)	$1,043,961	$925,918	$4,745,424	$5,483,782	$3,712,733	$2,013,823	$1,772,523
Treasury balance at End of Year	$38,134,191	$37,732,997	$37,669,297	$38,713,258	$39,639,176	$44,384,601	$49,868,383	$53,581,116	$55,594,939	$57,367,462
Treasury balance at Beginning of Year	36,841,711	38,134,191	37,732,997	37,669,297	38,713,258	39,639,176	44,384,601	49,868,383	53,581,116	55,594,939
Change in Treasury Balance	$1,292,480	($401,194)	($63,700)	$1,043,961	$925,918	$4,745,424	$5,483,782	$3,712,733	$2,013,823	$1,772,523

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND – OPERATING EXPENSES

	Unit Cost	Units	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Personnel												
Senior Management												
Salary	$100,000	3 people	$200,000	$312,000	$324,480	$337,459	$350,958	$364,996	$379,596	$394,780	$410,571	$426,994
Benefits	50,000	3 people	100,000	156,000	162,240	168,730	175,479	182,498	189,798	197,390	205,285	213,497
Other Professional Staff												
Salary	40,000	3 people	80,000	124,800	129,792	134,984	140,383	145,998	151,838	157,912	164,228	170,797
Benefits	20,000	3 people	40,000	62,400	64,896	67,492	70,192	72,999	75,919	78,956	82,114	85,399
Other Personnel												
Salary	7,500	5 people	25,000	39,000	40,560	42,182	43,870	45,624	47,449	49,347	51,321	53,374
Benefits	2,500	5 people	8,333	13,000	13,520	14,061	14,623	15,208	15,816	16,449	17,107	17,791
Relocation costs			50,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Bonus Program		25% of salary	76,250	118,950	123,708	128,656	133,803	139,155	144,721	150,510	156,530	162,791
Total Personnel Expense		11 people	453,333	707,200	735,488	764,908	795,504	827,324	860,417	894,834	930,627	967,852
Travel												
Airfare out of region	4,000	10 trips	40,000	41,600	43,264	44,995	46,794	48,666	50,613	52,637	54,743	56,932
Airfare in region	1,000	72 trips	72,000	74,880	77,875	00,990	84,230	87,599	91,103	94,747	98,537	102,478
Accomodation	100	330 nights	33,000	34,320	35,693	37,121	38,605	40,150	41,756	43,426	45,163	46,969
M&IE	100	330 days	33,000	34,320	35,693	37,121	38,605	40,150	41,756	43,426	45,163	46,969
Other			25,000	26,000	27,040	28,122	29,246	30,416	31,633	32,898	34,214	35,583
Total Travel Expense			203,000	211,120	219,565	228,347	237,481	246,981	256,860	267,134	277,820	288,932
Office												
Rent	3,000	12 months	36,000	37,440	38,938	40,495	42,115	43,800	45,551	47,374	49,268	51,239
Telephone	2,000	12 months	24,000	24,960	25,958	26,997	28,077	29,200	30,368	31,582	32,848	34,159
Insurance	250	12 months	3,000	3,120	3,245	3,375	3,510	3,650	3,796	3,948	4,106	4,270
Utilities	100	12 months	1,200	1,248	1,298	1,350	1,404	1,460	1,518	1,579	1,642	1,708
Office Supplies	250	12 months	3,000	3,120	3,245	3,375	3,510	3,650	3,796	3,948	4,106	4,270
Security	250	12 months	3,000	3,120	3,245	3,375	3,510	3,650	3,796	3,948	4,106	4,270
Equipment purchases	500	12 months	30,000	6,240	6,490	6,749	7,019	7,300	7,592	7,896	8,211	8,540
Vehicles			50,000	10,000	10,400	10,816	11,249	11,699	12,167	12,653	13,159	13,686
Other	1,000	12 months	12,000	12,480	12,979	13,498	14,038	14,600	15,184	15,791	16,423	17,080
Total Office Expense			162,200	101,728	105,797	110,029	114,430	119,007	123,768	128,718	133,867	139,222
Investment expense												
Accounting due diligence	20,000	10 deals	50,000	208,000	216,320	224,973	233,972	243,331	253,064	263,186	273,714	284,662
Legal due diligence	10,000	10 deals	25,000	104,000	108,160	112,486	116,986	121,665	126,532	131,593	136,857	142,331
Legal – contracts & agre	30,000	5 deals	37,500	156,000	162,240	168,730	175,479	182,498	189,798	197,390	205,285	213,497
Other professional servic	10,000	10 deals	25,000	104,000	108,160	112,486	116,986	121,665	126,532	131,593	136,857	142,331
Total investment expense			137,500	572,000	594,880	618,675	643,422	669,159	695,925	723,762	752,713	782,821
Technical assistance			TA is paid out of funds allocated for investments – not an operating expense									
Miscellaneous & contingency			100,000	104,000	108,160	112,486	116,986	121,665	126,532	131,593	136,857	142,331
Total operating expense			$1,056,033	$1,696,048	$1,763,890	$1,834,446	$1,907,823	$1,984,136	$2,063,502	$2,146,042	$2,231,883	$2,321,159

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SOUTHERN AFRICA ENTERPRISE FUND – OPERATING EXPENSES

	Unit Cost	Units	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Personnel												
Senior Management												
Salary	$100,000	3 people	$444,073	$461,836	$480,310	$499,522	$519,503	$540,283	$561,894	$584,370	$607,745	$632,055
Benefits	50,000	3 people	222,037	230,918	240,155	249,761	259,751	270,142	280,947	292,185	303,872	316,027
Other Professional Staff												
Salary	40,000	3 people	177,629	184,734	192,124	199,809	207,801	216,113	224,758	233,748	243,098	252,822
Benefits	20,000	3 people	88,815	92,367	96,062	99,904	103,901	108,057	112,379	116,874	121,549	126,411
Other Personnel												
Salary	7,500	5 people	55,509	57,730	60,039	62,440	64,938	67,535	70,237	73,046	75,968	79,007
Benefits	2,500	5 people	18,503	19,243	20,013	20,813	21,646	22,512	23,412	24,349	25,323	26,336
Relocation costs			10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000	10,000
Bonus Program		25% of salary	169,303	176,075	183,118	190,443	198,060	205,983	214,222	222,791	231,703	240,971
Total Personnel Expense		11 people	1,006,566	1,046,829	1,088,702	1,132,250	1,177,540	1,224,642	1,273,627	1,324,572	1,377,555	1,432,657
Travel												
Airfare out of region	4,000	10 trips	59,210	61,578	64,041	66,603	69,267	72,038	74,919	77,916	81,033	84,274
Airfare in region	1,000	72 trips	106,578	110,841	115,274	119,885	124,681	129,668	134,855	140,249	145,859	151,693
Accomodation	100	330 nights	48,848	50,802	52,834	54,947	57,145	59,431	61,808	64,281	66,852	69,526
M&IE	100	330 days	48,848	50,802	52,834	54,947	57,145	59,431	61,808	64,281	66,852	69,526
Other			37,006	38,486	40,026	41,627	43,292	45,024	46,825	48,698	50,645	52,671
Total Travel Expense			300,490	312,509	325,010	338,010	351,530	365,592	380,215	395,424	411,241	427,690
Office												
Rent	3,000	12 months	53,289	55,420	57,637	59,943	62,340	64,834	67,427	70,124	72,929	75,847
Telephone	2,000	12 months	35,526	36,947	39,425	39,962	41,560	43,223	44,952	46,750	48,620	50,564
Insurance	250	12 months	4,441	4,618	4,803	4,995	5,195	5,403	5,619	5,844	6,077	6,321
Utilities	100	12 months	1,776	1,847	1,921	1,998	2,078	2,161	2,248	2,337	2,431	2,528
Office Supplies	250	12 months	4,441	4,618	4,803	4,995	5,195	5,403	5,619	5,844	6,077	6,321
Security	250	12 months	4,441	4,618	4,803	4,995	5,195	5,403	5,619	5,844	6,077	6,321
Equipment purchases	500	12 months	8,881	9,237	9,606	9,990	10,390	10,806	11,238	11,687	12,155	12,641
Vehicles			14,233	14,802	15,395	16,010	16,651	17,317	18,009	18,730	19,479	20,258
Other	1,000	12 months	17,763	18,473	19,212	19,981	20,780	21,611	22,476	23,375	24,310	25,282
Total Office Expense			144,791	150,582	156,606	162,870	169,385	176,160	183,206	190,535	198,156	206,082
Investment expense												
Accounting due diligence	20,000	10 deals	296,049	307,891	320,206	333,015	346,335	360,189	374,596	389,580	405,163	421,370
Legal due diligence	10,000	10 deals	148,024	153,945	160,103	166,507	173,168	180,094	187,298	194,790	202,582	210,685
Legal – contracts & agre	30,000	5 deals	222,037	230,918	240,155	249,761	259,751	270,142	280,947	292,185	303,872	316,027
Other professional servic	10,000	10 deals	148,024	153,945	160,103	166,507	173,168	180,094	187,298	194,790	202,582	210,685
Total investment expense			814,134	846,700	880,568	915,790	952,422	990,519	1,030,140	1,071,345	1,114,199	1,158,767
Technical assistance												
Miscellaneous & contingency			148,024	153,945	160,103	166,507	173,168	180,094	187,298	194,790	202,582	210,685
Total operating expense			$2,414,005	$2,510,565	$2,610,988	$2,715,427	$2,824,045	$2,937,006	$3,054,487	$3,176,666	$3,303,733	$3,435,882

TREASURY, PORTFOLIO AND BREAK-EVEN CALCULATIONS

26-Apr-94		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Treasury Balance											
Balance at beginning of year			$20,000,000	$30,943,967	$34,721,518	$34,299,265	$36,182,339	$21,698,156	$9,963,836	$15,563,867	$20,783,395
In-flow from USAID		20,000,000	20,000,000	20,000,000	20,000,000	20,000,000	0	0	0	0	0
Cash from fund operations		0	943,967	(1,222,449)	(422,253)	283,074	1,515,817	2,763,836	5,163,867	7,183,395	9,876,842
Investment out-flow to portfolio		0	(10,000,000)	(15,000,000)	(20,000,000)	(20,000,000)	(20,000,000)	(21,698,156)	(9,963,836)	(15,563,867)	(20,783,395)
Investment in-flow from portfolio		0	0	0	0	1,600,000	4,000,000	7,200,000	10,400,000	13,600,000	15,471,705
Balance at end of year		$20,000,000	$30,943,967	$34,721,518	$34,299,265	$36,182,339	$21,698,156	$9,963,836	$15,563,867	$20,783,395	$25,348,547
Average Balance		$10,000,000	$25,471,983	$32,832,742	$34,510,391	$35,240,802	$28,940,247	$15,830,996	$12,763,852	$18,173,631	$23,065,971
Income on Balance (US Govt. Securities)	5.0%	$500,000	$1,273,599	$1,641,637	$1,725,520	$1,762,040	$1,447,012	$791,550	$638,193	$908,682	$1,153,299

Portfolio Balance (valued at cost)		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Portfolio balance (beginning of year)		$0	$0	$10,000,000	$25,000,000	$44,600,000	$62,000,000	$76,200,000	$88,098,156	84,261,992	82,357,933
Investments made		0	10,000,000	15,000,000	20,000,000	20,000,000	20,000,000	21,698,156	9,963,836	15,563,867	20,783,395
Realized loss of principle	20% write-offs	0	0	0	(400,000)	(1,000,000)	(1,800,000)	(2,600,000)	(3,400,000)	(3,867,926)	(3,666,480)
Investment return of principle only	5 years	0	0	0	0	(1,600,000)	(4,000,000)	(7,200,000)	(10,400,000)	(13,600,000)	(15,471,705)
Portfolio balance (end of year)		$0	$10,000,000	$25,000,000	$44,600,000	$62,000,000	$76,200,000	$88,098,156	$84,261,992	82,357,933	84,003,144
Average Balance		$0	$5,000,000	$17,500,000	$34,800,000	$53,300,000	$69,100,000	$82,149,078	$86,180,074	$83,309,962	$83,180,538
Current income %	4.0%	$0	$200,000	$700,000	$1,392,000	$2,132,000	$2,764,000	$3,285,963	$3,447,203	$3,332,398	$3,327,222
Investment return of principle only	5 year average life; years		0	0	0	1,600,000	4,000,000	7,200,000	10,400,000	13,600,000	15,471,705
Realized gain ROI =	10% annualized capital gain		0	0	0	529,600	1,536,960	3,149,856	5,244,042	7,867,646	9,333,803
Investments returned to treasury			0	0	0	2,129,600	5,536,960	10,349,856	15,644,042	21,467,646	24,805,508

Break-even Point (inflation adjusted)		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Beginning of year		$0	$20,400,000	$40,596,000	$61,599,840	$83,443,834	$106,161,587	$109,388,050	$113,763,572	$118,314,115	$123,046,680
Total inflow		20,000,000	19,000,000	19,000,000	19,000,000	19,000,000	(1,000,000)	0	0	0	0
Inflation adjustment	4.0%	400,000	1,196,000	2,003,840	2,843,994	3,717,753	4,226,463	4,375,522	4,550,543	4,732,565	4,921,867
Break-even point (end of year)		$20,400,000	$40,596,000	$61,599,840	$83,443,834	$106,161,587	$109,388,050	$113,763,572	$118,314,115	$123,046,680	$127,968,547
Fund Equity (assets less liabilities)		$20,943,967	$39,721,518	$59,299,265	$79,182,339	$99,698,156	$100,661,992	$103,225,859	$107,009,254	$113,018,171	$120,844,855
Equity in excess of break-even		$543,967	($874,482)	($2,300,575)	($4,261,495)	($6,463,431)	($8,726,058)	($10,537,713)	($11,304,861)	($10,028,509)	($7,123,692)
Present Value of Excess		$543,967	($840,848)	($2,127,011)	($3,788,453)	($5,524,968)	($7,172,184)	($8,328,108)	($8,590,765)	($7,327,734)	($5,005,012)

TREASURY, PORTFOLIO AND BREAK-EVEN CALCULATIONS

26-Apr-94

		2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Treasury Balance											
Balance at beginning of year		$25,348,547	$26,159,083	$25,931,246	$25,883,232	$26,723,313	$27,640,941	$30,204,017	$34,037,464	$36,638,186	$38,116,980
In-flow from USAID		0	0	0	0	0	0	C	0	0	0
Cash from fund operations		11,493,164	11,975,108	11,801,751	11,786,065	11,989,945	11,998,235	14,180,584	15,830,919	16,942,930	17,477,959
Investment out-flow to portfolio		(25,348,547)	(26,159,083)	(25,931,246)	(25,883,232)	(26,723,313)	(27,640,941)	(30,204,017)	(34,037,464)	(36,638,186)	(38,116,980)
Investment in-flow from portfolio		14,665,919	13,956,137	14,081,481	14,937,248	15,650,997	18,205,782	19,856,880	20,807,267	21,174,050	21,821,240
Balance at end of year		$26,159,083	$25,931,246	$25,883,232	$26,723,313	$27,640,941	$30,204,017	$34,037,464	$36,638,186	$38,116,980	$39,299,199
Average Balance		$25,753,815	$26,045,164	$25,907,239	$26,303,273	$27,182,127	$28,922,479	$32,120,741	$35,337,825	$37,377,583	$38,708,090
Income on Balance (US Govt. Securities)	5.0%	$1,287,691	$1,302,258	$1,295,362	$1,315,164	$1,359,106	$1,446,124	$1,606,037	$1,766,891	$1,868,879	$1,935,404
Portfolio Balance (valued at cost)											
Portfolio balance (beginning of year)		84,003,144	91,196,738	99,879,313	107,994,766	115,028,000	121,548,871	126,019,811	131,165,130	139,101,815	149,110,640
Investments made		25,348,547	26,159,083	25,931,246	25,883,232	26,723,313	27,640,941	30,204,017	34,037,464	36,638,186	38,116,980
Realized loss of principle	20% write-offs	(3,489,034)	(3,520,370)	(3,734,312)	(3,912,749)	(4,551,446)	(4,964,220)	(5,201,817)	(5,293,513)	(5,455,310)	(5,779,559)
Investment return of principle only	5 years	(14,665,919)	(13,956,137)	(14,081,481)	(14,937,248)	(15,650,997)	(18,205,782)	(19,856,880)	(20,807,267)	(21,174,050)	(21,821,240)
Portfolio balance (end of year)		91,196,738	99,879,313	107,994,766	115,028,000	121,548,871	126,019,811	131,165,130	139,101,815	149,110,640	159,626,822
Average Balance		$87,599,941	$95,538,025	$103,937,039	$111,5[illegible]1,383	$118,288,436	$123,784,341	$128,592,470	$135,133,472	$144,106,227	$154,368,731
Current income %	4.0%	$3,503,998	$3,821,521	$4,157,482	$4,460,455	$4,731,537	$4,951,374	$5,143,699	$5,405,339	$5,764,249	$6,174,749
Investment return of principle only	5 year ave	14,665,919	13,956,137	14,081,481	14,937,248	15,650,997	18,205,782	19,856,880	20,807,267	21,174,050	21,821,240
Realized gain ROI =	10% annualiz	9,597,425	9,188,538	8,944,209	8,929,753	8,731,636	10,720,093	12,135,670	12,947,366	13,148,563	13,393,992
Investments returned to treasury		24,263,344	23,144,675	23,025,690	23,867,002	24,382,632	28,925,875	31,992,550	33,754,633	34,322,614	35,215,232
Break-even Point (inflation adjusted)											
Beginning of year		$127,968,547	$133,087,289	$138,410,781	$143,947,212	$149,705,100	$155,693,304	$161,921,036	$168,397,878	$175,133,793	$182,139,145
Total inflow		0	0	0	0	0	0	0	0	0	0
Inflation adjustment	4.0%	5,118,742	5,323,492	5,536,431	5,757,888	5,988,204	6,227,732	6,476,841	6,735,915	7,005,352	7,285,566
Break-even point (end of year)		$133,087,289	$138,410,781	$143,947,212	$149,705,100	$155,693,304	$161,921,036	$168,397,878	$175,133,793	$182,139,145	$189,424,711
Fund Equity (assets less liabilities)		$129,330,929	$137,612,310	$145,664,063	$153,741,258	$161,188,048	$170,404,411	$181,033,513	$192,682,931	$204,705,580	$216,994,284
Equity in excess of break-even		($3,756,360)	($798,471)	$1,716,851	$4,036,158	$5,494,743	$8,483,375	$12,635,635	$17,549,138	$22,566,435	$27,569,574
Present Value of Excess		($2,537,663)	($518,671)	$1,072,340	$2,424,012	$3,173,077	$4,710,517	$6,746,269	$9,009,258	$11,139,427	(7,123,692) $13,085,689

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

26-Apr-94	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Return of principle		0	0	0	1,600,000	4,000,000	7,200,000	10,400,000	13,600,000	15,471,705
1995	0									
1996		(10,000,000)			1,600,000	1,600,000	1,600,000	1,600,000	1,600,000	
1997			(15,000,000)			2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
1998				(20,000,000)			3,200,000	3,200,000	3,200,000	3,200,000
1999					(20,000,000)			3,200,000	3,200,000	3,200,000
2000						(20,000,000)			3,200,000	3,200,000
2001							(21,698,156)			3,471,705
2002								(9,963,836)		
2003									(15,563,867)	
2004										(20,783,395)
2005										
2006										
2007										
2008										
2009										
2010										
2011										
2012										
2013										
2014										

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

26-Apr-94

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Return of principle	14,665,919	13,956,137	14,081,481	14,9[illegible]7,248	15,650,997	18,205,782	19,856,880	20,807,267	[illegible]1,174,050	21,821,240
1995										
1996										
1997										
1998	3,200,000									
1999	3,200,000	3,200,000								
2000	3,200,000	3,200,000	3,200,000							
2001	3,471,705	3,471,705	3,471,705	3,471,705						
2002	1,594,214	1,594,214	1,594,214	1,594,214	1,594,214					
2003		2,490,219	2,490,219	2,490,219	2,490,219	2,490,219				
2004			3,325,343	3,325,343	3,325,343	3,325,343	3,325,343			
2005	(25,348,547)			4,055,768	4,055,768	4,055,768	4,055,768	4,055,768		
2006		(26,159,083)			4,185,453	4,185,453	4,185,453	4,185,453	4,185,453	
2007			(25,931,246)			4,148,999	4,148,999	4,148,999	4,148,999	4,148,999
2008				(25,883,232)			4,141,317	4,141,317	4,141,317	4,141,317
2009					(26,723,313)			4,275,730	4,275,730	4,275,730
2010						(27,640,941)			4,422,551	4,422,551
2011							(30,204,017)			4,832,643
2012								(34,037,464)		
2013									(36,638,186)	
2014										(38,116,980)

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

26-Apr-94	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Write-offs		0	0	(400,000)	(1,000,000)	(1,800,000)	(2,600,000)	(3,400,000)	(3,867,926)	(3,666,480)
1995	0									
1996		(10,000,000)		(400,000)	(400,000)	(400,000)	(400,000)	(400,000)	0	0
1997			(15,000,000)		(600,000)	(600,000)	(600,000)	(600,000)	(600,000)	0
1998				(20,000,000)		(800,000)	(800,000)	(800,000)	(800,000)	(800,000)
1999					(20,000,000)		(800,000)	(800,000)	(800,000)	(800,000)
2000						(20,000,000)		(800,000)	(800,000)	(800,000)
2001							(21,698,156)		(867,926)	(867,926)
2002								(9,963,836)		(398,553)
2003									(15,563,867)	
2004										(20,783,395)
2005										
2006										
2007										
2008										
2009										
2010										
2011										
2012										
2013										
2014										
Capital gains		0	0	0	529,600	1,536,960	3,149,856	5,244,042	7,867,646	9,333,803
1995	0									
1996		(10,000,000)			529,600	742,560	976,816	1,234,498	1,517,947	
1997			(15,000,000)			794,400	1,113,840	1,465,224	1,851,746	2,276,921
1998				(20,000,000)	.		1,059,200	1,485,120	1,953,632	2,468,995
1999					(20,000,000)			1,059,200	1,485,120	1,953,632
2000						(20,000,000)			1,059,200	1,485,120
2001							(21,698,156)			1,149,134
2002								(9,963,836)		
2003									(15,563,867)	
2004										(20,783,395)
2005										
2006										
2007										
2008										
2009										
2010										
2011										
2012										
2013										
2014										

SOUTHERN AFRICA ENTERPRISE DEVELOPMENT FUND

26-Apr-94

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Write-offs	(3,489,034)	(3,520,370)	(3,734,312)	(3,912,749)	(4,551,446)	(4,964,220)	(5,201,817)	(5,293,513)	(5,455,310)	(5,779,559)
1995										
1996										
1997										
1998	0	0	0	0	0	0	0	0	0	0
1999	0	0	0	0	0	0	0	0	0	0
2000	(800,000)	0	0	0	0	0	0	0	0	0
2001	(800,000)	(800,000)	0	0	0	0	0	0	0	0
2002	(867,926)	(867,926)	(867,926)	0	0	0	0	0	0	0
2003	(398,553)	(398,553)	(398,553)	(398,553)	0	0	0	0	0	0
2004	(622,555)	(622,555)	(622,555)	(622,555)	(622,555)	0	0	0	0	0
2005		(831,336)	(831,336)	(831,336)	(831,336)	(831,336)	0	0	0	0
2006	(25,348,547)		(1,013,942)	(1,013,942)	(1,013,942)	(1,013,942)	(1,013,942)	0	0	0
2007		(26,159,083)		(1,046,363)	(1,046,363)	(1,046,363)	(1,046,363)	(1,046,363)	0	0
2008			(25,931,246)		(1,037,250)	(1,037,250)	(1,037,250)	(1,037,250)	(1,037,250)	0
2009				(25,883,232)		(1,035,329)	(1,035,329)	(1,035,329)	(1,035,329)	(1,035,329)
2010					(26,723,313)		(1,068,933)	(1,068,933)	(1,068,933)	(1,068,933)
2011						(27,640,941)		(1,105,638)	(1,105,638)	(1,105,638)
2012							(30,204,017)		(1,208,161)	(1,208,161)
2013								(34,037,464)		(1,361,499)
2014									(36,638,186)	
										(38,116,980)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Capital gains	9,597,425	9,188,538	8,944,209	8,929,753	8,731,636	10,720,093	12,135,670	12,947,366	13,148,563	13,393,992
1995										
1996										
1997										
1998										
1999	3,035,895									
2000	2,468,995	3,035,895								
2001	1,953,632	2,468,995	3,035,895							
2002	1,611,218	2,119,511	2,678,632	3,293,666						
2003	527,685	739,875	973,283	1,230,033	1,512,458					
2004		824,262	1,155,711	1,520,303	1,921,356	2,362,513				
2005			1,100,689	1,543,292	2,030,155	2,565,705	3,154,810			
2006	(25,348,547)			1,342,459	1,882,282	2,476,087	3,129,272	3,847,776		
2007		(26,159,083)			1,385,385	1,942,469	2,555,261	3,229,332	3,970,811	
2008			(25,931,246)			1,373,319	1,925,551	2,533,006	3,201,206	3,936,227
2009				(25,883,232)			1,370,776	1,921,985	2,528,316	3,195,279
2010					(26,723,313)			1,415,267	1,984,366	2,610,376
2011						(27,640,941)			1,463,864	2,052,506
2012							(30,204,017)			1,599,605
2013								(34,037,464)		
2014									(36,638,186)	
										(38,116,980)

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ANNEX I

Indirect Investments

A. Advantages

The SAEDF will provide a wide range of financial products and services directly to private enterprises via direct and indirect investments to suit the varying needs of the different country economies within Southern Africa. Harking back to the lessons learned, it is imperative to have an in-country presence to invest wisely and successfully. Though the Fund should have the liberty to make direct investments, it should be expected that a large portion of its portfolio will be in indirect investments in individual country financial institutions; thereby achieving the necessary in-country presence. In this way, the Fund will also increase the number of private enterprises it reaches. Other advantages of investing with financial intermediaries include:

- Leverage: The Fund can increase the possibilities of leveraging its investment with financing from other sources. In most cases, whether direct or indirect investments, the Fund will provide equity or other forms of risk-capital -- e.g., subordinated debt or credit guarantees. The presence of such financing by its nature will enable the recipient company to seek additional financing. With indirect investments, such leverage can therefore be obtained at the intermediary level and, once again, at the level of the operating enterprise each time the intermediary itself invests.

- Low Cost Structure: The Fund can address its development objectives while maintaining financial self-sustainability by making investments in lower-cost, locally-managed financial intermediaries,. The Fund's cost structure, as with any organization staffed with expatriate professionals, renders direct support to a significant number of the lower-end SMEs prohibitive from a cost point of view. However, by investing in locally owned and managed financial intermediaries, service delivery costs can be substantially reduced increasing the Fund's ability to reach the smaller SMEs.

- Access to Expertise: The Fund's access to the considerable financial and business skills of the experienced venture capitalists who are expected to manage the Fund is highly desirable in addressing the development needs of the private sector in Southern Africa. These skills are expensive. By using intermediaries, the Fund will leverage and transfer these expensive skills across a variety of players. Because their success and compensation depends upon it, Fund managers will be motivated to intensively monitor, advise and, when advisable, provide technical assistance to the intermediaries in which they have invested.

- Range of Services: The Fund is to support private sector activity in 11 countries of Southern Africa, each likely to have a continually evolving range of needs. To address these needs would require a large, multi-faceted organization, which would inevitably produce high costs and insufficient focus. By investing in locally-based financial intermediaries, delivering targeted financial products and services to address a country's specific private sector demands, the Fund's ability to offer a wider range of financial services becomes much greater. At the same time, the Fund will only invest in an intermediary that has positive prospects for financial success and commercial viability - which will automatically ensure that actual needs in the marketplace are addressed.

B. Types of Financial Intermediaries

The range of financial services in which the Fund can invest is unlimited. Only two restrictions apply: first, investments in intermediaries must be expected to yield a net positive financial rate of return and, second, the intermediary must be operated to support the target groups of the Fund. Within those restrictions, the following are exemplary of the range of potential financial services investments.

1. Small Enterprise Banks

Small enterprise banks specialize in providing debt financing to small businesses. While such institutions are commonplace in Southern Africa, there remains a perceived need for additional institutional capacity. Small enterprises in the region lament that most small enterprise banks are owned and managed by either governments or large banks, and are therefore neither structured nor highly motivated to meet small business' needs for flexibility and responsiveness.

An opportunity may exist in the region for the Fund to establish or expand existing privately-held, specialized small enterprise banks. These banks would be specifically structured and managed to target the small business market. The cost structure and management tools of the bank would be designed around the small business market, increasing the chances of the banks' commercial viability.

An example is the Enterprise Credit Corporation (ECC), which was established and financed by the Polish-American Enterprise Fund (PAEF). The ECC, owned by the PAEF, operates as an independent entity in separate offices in Warsaw with a staff of more than 30. The ECC is the largest and most accessible lender to small business in Poland, having made more than 2500 small business loans totaling nearly $60 million. The ECC's average loan size is approximately $25,000. While the SAEDF could not economically make loans of this size, it could establish and support a separate organization such as the ECC with a substantially lower cost structure.

2. Leasing Companies

Leasing companies provide businesses with access to critical, expensive equipment. Equipment is often necessary to enhance the productivity of enterprises or simply to produce goods and services. In many cases, businesses can not establish sufficient lines of credit to acquire expensive equipment directly, due to lack of credit history or collateral. Leasing companies purchase and continue to own the equipment, but provide businesses with the use of that equipment for a fee.

In regions, such as Southern Africa, where loan default rates are high, leasing can substantially reduce the level of risk in providing financing by maintaining direct ownership of the equipment. The equipment can be more easily seized in the event of non-payment, in contrast to collecting on

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a defaulted loan. As a result of decreased risk, availability of financing is increased. Therefore, businesses gain access to critical equipment which would otherwise be unavailable.

The Fund will be in position to establish or invest in the expansion of existing locally-managed, low-cost leasing companies in Southern Africa. The Fund, by virtue of its access to highly competent financial management, will lend considerable technical assistance to ensure and improve the financial viability of leasing companies in which it invests. Additionally, a leasing company could obtain additional financing based upon the equity or quasi-equity investment of the Fund.

An example is udc Limited (UDC) of Zimbabwe. EDESA S.A., the Swiss-based private international development financial institution acquired UDC in 1984 and transformed it into a successful leasing company. UDC is now the largest finance house in Zimbabwe. Its principle business is hire purchase and leasing for assistance to industry, mining commerce and agriculture in the procurement of vehicles, equipment, plant and machinery. As a private institution, UDC has been successful in adjusting to changing market conditions to ensure its commercial viability. With the 1992 drought and high interest rates produced by the Economic Structural Adjustment Program, UDC was forced to substantially reduce its cost structure while maintaining its support to private enterprise. At the end of 1992, UDC had over 7500 customer accounts with an average value of US$12,000. UDC has recently established private leasing companies in Botswana and Mozambique.

3. Franchise Companies

Franchises are generally the least risky type of start-up business. The franchisor, if it is reputable, has developed a template for replication of a proven business concept and provides on-going business support services to its franchisees. The franchisor's success, similar to the venture capitalist, depends upon the success of its franchisees and therefore takes whatever actions are required to ensure the success of the franchisee. The franchisee is a type of small or medium sized business of which it is one of the Fund's development objectives to support.

The Fund may invest in and support franchisees in a number of ways; the Fund may directly invest in franchisors who then invest in individual franchisees, the Fund may provide a financing facility for a franchisor's franchisees to access, or the Fund may invest directly in franchisees.

As an example, Ned Enterprise, a division of NedBank, a major bank in South Africa, has been established to support and profit from franchise activity in South Africa. Ned Enterprise provides consulting services to international franchisors as to business opportunities in South Africa, identifies capable potential franchisees and master franchisees, for a fee, to the franchisors, and finances the acquisition of franchises and master franchises.

4. Venture Capital Companies

Venture capital companies provide higher-risk financing to businesses for start-up, expansion or acquisition. In many respects, the Fund itself is a venture capital company. In order to target smaller scale businesses than those achievable by the Fund, with its high, American-style cost structure, the Fund could finance new, locally managed venture capital companies in Southern

Africa. The Fund could also co-invest with existing regional venture capital companies supported by international development finance institutions.

A commonly-cited obstacle to private enterprise growth in the region is the lack of available equity capital, which is essential in obtaining any additional debt financing. Locally managed and owned small-scale private venture capital companies could provide this equity capital to small businesses, at substantially lower transaction costs than are achievable through the Fund's direct investment activity.

Examples of verture capital firms which the Fund could establish are a particular black-owned South African accounting firm or particular individual Chartered Accountants in Tanzania. These principals are highly entrepreneurial and have pre-established potential investment opportunities with long-term, in-depth business relationships with locally-owned businesses and managers. While it is unusual in the United States for accountants to successfully transfer their consulting skills and agent mentality to that of owner and investor, these principals appear to exhibit the necessary entrepreneurial mentality and desire. The cost structure of a venture capital firm operated by these accountants might allow equity investments as low as $25,000.

5. Mortgage Banks

The Fund may invest in existing or new mortgage banking companies which would assist in financing home ownership in Southern Africa. The mortgage banks would be locally managed, calling on the Fund's or other expatriate technical expertise as needed. Support of mortgage banks in Southern Africa could substantially increase the incidence of home ownership, which is a critical under-pinning of a healthy private sector.

In the United States and Europe home ownership is a common means for small business-people to accumulate the capital necessary to build businesses. The scarcity of home ownership in Southern Africa is a significant obstacle to the spread of small and medium business ownership.

While mortgage banking expertise, in particular, is not widespread in Southern Africa, a sufficient supply of general banking expertise does exist. With some technical inputs, locally managed mortgage banks could flourish. For example, the Polish-American Enterprise Fund in 1992 established the Polish-American Mortgage Bank which has begun to make construction and mortgage loans for single-family housing.

6. Investment Trusts

A variation on several of the above financial intermediaries is the independent investment trust. The Fund would be well-structured and effectively staffed to invest in locally-managed trusts the purpose of which would be to invest in and provide technical support to locally owned and managed operating companies. The trust could leverage the Fund's investment by accessing, on the strength of the Fund's underlying equity, institutional debt financing and public and private sector equity capital.

An example of a trust is the South Africa Enterprise Development Trust proposed by the USAID South Africa Mission. This Trust could be established and funded with US$3 million from the Fund

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in addition to a loan guarantee facility. As proposed, the Trust could then access an additional US$15 million of South African institutional direct investment into the Trust. Each investment made by the Trust could then, as conceived, access an additional $3 of private sector debt and equity investment for every $1 invested by the trust. As a locally-managed investment trust, supported on an as-needed basis by the Fund, the trust could maintain a cost structure low enough to afford investments in small or medium sized businesses.

ANNEX J

Review of USAID Technical Report Issues

On May 24, 1994, USAID/Washington held an issues discussion on the technical report. Most of the issues raised are presented here and where appropriate, i.e., it is not an issue internal to USAID, a response is offered. The issues covered the following topics: demand, legal, policy, structure, USAID relationship, resource allocation, and obligating mechanism.

A. Demand

1. *Has the feasibility study adequately determined if sufficient demand exists on a per-country and regional basis? For example, Table II-5, "Estimating Demand Based on Possible Portfolio Mix" cites no sources of reference.*

Given the limited time spent in four of eleven countries, the Team's opinion is largely anecdotal, but it does corroborate previous work that estimated a need for capital in the region of about US $800 million, justifying an initial Fund capitalization of US $200 million, at a 4:1 gearing ratio. Based on this, the design team feels that the proposed US $100 million capitalization strikes an appropriate balance between too little and too much. More money can be added based on Fund success, plus the Fund will seek to leverage its capital to increase its total capitalization.

An important first year activity for Fund management will be to undertake a more precise analysis of demand by country and sectors within a country. This is a task best performed by management rather than outside consultants, as management will have the responsibility for servicing that demand.

A portion of the information in Table II-5 is taken from the pre-feasibility report titled "Report on Proposal for Southern Africa-American Enterprise Fund," dated January 1994. As another means of estimating required capital, the team combined its investment classes and its average investment size per class, with the pre-feasibility team's projected portfolio composition. This approach results in an estimated required capitalization of US $225 million. The pre-feasibility team's estimate using this methodology was US $280 million. In short, at US $100 million, the Fund would not appear to be over capitalized.

2. *Does targeting direct investments of $1.5 million per client not restrict fund access to a small section of the population?*

The fund will reach a larger section of the target population through indirect investments, i.e., investments by the Fund in financial intermediaries that can then invest capital in the target group more cost effectively. In this manner the Fund "indirectly" reaches a larger portion of its target group. Such indirect investments could range from US $1 to $10 million but the companies the intermediary then invests in could be as small as US $50,000 in total assets, or smaller depending on the working definition of SMEs for a particular country. (Again, this definition would be determined by individual Missions and Fund management.)

It is worth re-emphasizing that for portfolio diversification and sustainability, the Fund should have the flexibility to make "direct" investments in operating companies and/or cross-border deals that offer other forms of development impact, such as broadening productive asset ownership or the transfer of technology. These types of investments must be of a sufficient scale to justify the transaction and oversight costs -- pre- and post-investment.

3. *The study itself notes, first, that the resources proposed are "not significant," and second, that capital is not the most pressing constraint.*

If spread across ten or eleven countries, US $100 million is not a great deal of money. However, the Fund is not likely to invest in every country, so the capital available to those countries that it does investment in will be greater. Moreover, the Fund will very likely achieve a degree of financial leverage. Indeed, the French and the Japanese apparently are interested in a regional fund and in investing in one with USAID. In addition, there will be leverage achieved on each individual investment made by the Fund. Assuming a gearing ratio of three to one, the Fund would attract an additional US $300 million in investment capital -- debt and equity. This combined US $400 million is substantially more significant.

In some countries, the existence of capital is not the problem. The problem is an inability by a majority to access that capital. As a result, for this group, despite available capital, there is a shortfall of capital. This "contrived shortfall" exists in part because the perceived risks of investing in the excluded group are considered too high. The Fund's participation can reduce the perceived risks and simultaneously raise the potential return of investing in a presently excluded group. In turn, this should attract existing but risk averse capital to this target group. To the extent it does, the Fund achieves leverage.

4. *The benefits from the program are likely to be narrowly focused, as opposed to, say, the impact of $100m on a less capital-intensive, more people-oriented, and perhaps more productive mix of policy reform, small farm-based agricultural development, basic education for women or microenterprise credit.*

The Fund will bring access to capital to women, youth, small entrepreneurs, expanding businesses, and others who currently lack such access. Besides financial capital, the Fund brings to each investment technical and management assistance. Moreover, management will have first-hand experience with and knowledge of the policy and regulatory environment in which its investees must operate. This can be valuable information for USAID's policy dialogue efforts. In these and other ways, the Fund complements existing, on-going bi-lateral programs. The Fund does not replace these efforts but is in addition to, and in fact could service and benefit from many existing or planned bi-laterally funded projects.

B. Legal

1. *Is the fund established as a for profit or a not-for-profit organization?*

Considered a determination internal to USAID. The team recommends for reasons stated in the paper that the Fund be established as a U.S. not-for-profit corporation.

2. *What are the legal implications of creating an endowment with DFA funds?*

Considered a determination internal to USAID.

3. *Does the fund fall within the bounds of Appropriations Acts 599 and 547a: Impact on Jobs in the United States.*

Considered a determination internal to USAID.

4. *Can USAID establish dollar endowments?*

Considered a determination internal to USAID.

C. Policies

1. *Are waivers needed in order to comply with USAID Handbook 13 which deals with grant and procurement issues?*

Considered a determination internal to USAID.

2. *Will the Enterprise Fund fall within the guidelines of USAID's Policy Determination 20, issued on January 3, 1994.*

Considered a determination internal to USAID.

3. *Is USAID prepared to allow market based financial compensation for the fund managers? This may exceed the $150,000 maximum as determined by USAID policy.*

Considered a determination internal to USAID. The team recommends a base salary in the range of $100,000 to $128,000, comparable to Senior Foreign Service officers, with a carried interest incentive plan. Such a plan would not benefit Fund management unless the Fund was financially and developmentally successfully and would compensate management from net positive return on investment, i.e., would not use U.S. government grant funds.

4. *What will the selection process be for the Fund's Board of Directors and management -- competitive RFP process or other?*

The team recommends a non-RFP process that brings USAID together with proven, successful venture capitalist to nominate a slate of possible Board members for the President of the United States to select from. The President's participation places this Fund on par with predecessor funds in Eastern Europe and the NIS. The Board would then select a management team.

D. Structure

1. *How will the internal management of the fund be determined in light of the proposed independent structure of an organization operating on a regional platform?*

Fund management should be independent of outside control. Management would be responsible to the Board, which USAID would have had a hand in selecting and on which USAID would have an *ex-officio*, non-voting member -- assuming investment funds are provided unconditionally.

2. *How does this model compare with past examples?*

This model differs from past examples in several important ways:

- The selection process for the Board is designed to pro-actively include USAID and to deliver a Board with significant, successful venture capital experience as principals balanced by an awareness and knowledge of the difficulties of doing so in a developing country.

- The design seeks to include USAID throughout in a participatory and passive role so as to keep the agency informed, to better balance sustainability and development impact, to balance monitoring with time and costs, and to better leverage USAID's strengths within a given country.

- Funds are sought on an unconditional basis over a five year period, based on which the Fund and its investees can confidently pursue opportunities and on which the Fund would generate treasury income to cover its operating costs.

- The design is for a regional rather than a country fund.

3. *Should the legal structure of the Fund be not-for-profit?*

The team has suggested a not-for-profit because it is cleaner to establish, one company rather than two (a Trust and an management company); carries with it some tax benefits; and can still attract private capital.

4. *What qualifications should the Board of Directors and management have?*

Basically, both the Board and management require a mix of proven venture capital experience as a principal, knowledge of the complexities of investing risk capital in developing countries, and knowledge of Southern Africa. Overtime, the Board should acquire a Southern African majority and management should be completely Southern African.

5. *What kind of in-country presence should the Fund have?*

The team feels that a critical success factor is having a local presence. For this reason, the Fund should be located in the region. At a country level, the Fund would manage the need for local presence by investing directly in companies and intermediaries where the investment size and potential payoff justify the cost of close Fund oversight. Investments in intermediaries will give the Fund the intimate, local knowledge necessary to cost effectively find and manage a number of smaller investments in the target group. The Fund could also establish satellite offices in other countries when the number or amount of investments in any country justifies it.

6. *As to Fund management, the team makes the valid point that top managers act like "principals" in the venture capital business, rather than employees, and elects to meet this need by hiring individuals who have been principals in past undertakings as employees of the Fund, and allowing for some profit participation. It would be far more straightforward to make the Fund's resources available to true principals who have their own money at risk..*

   As to planning for meeting overhead costs, the Fund has come a long way by indicating plans for a small, mostly local staff, and use of local professionals for *business consulting services. More appropriate, however, is to accomplish low overhead the natural way; by putting local owner-operators at the helm of small, niche funds, and allowing them to contain costs as they will naturally when their own funds are at first-risk.*

Generally speaking, the team would agree with the above statements. However, as this Fund is not out to maximize return but in fact lower return in favor of increased development impact, the team felt it would be difficult to find those willing to invest their own funds. Moreover, some of the advantages of a not-for-profit status would be lost. A properly structured incentive plan, that includes budget as well as financial and development objectives, should achieve the desired result of managing the Fund as an invested principal. In addition, the Fund can achieve some "natural" cost advantages by investing in the owner-operator, niche funds, with money at risk, i.e., financial intermediaries.

7. *...Bringing top managers into a region does not provide for anywhere near the market intimacy that is achieved by hiring from within the region. ...Defining an investment market as comprising an eleven-country region is a too-broad definition. The safest investment to make, and manage, is one that is within a few minutes of where one works and lives, with the same people one works and lives with.*

As proposed the Fund would from the outset be composed of a Board and management with Southern Africa representation. Eventually the Board would be controlled by members from the region, with management completely comprised of Southern Africans.

The need for "presence" is defined by the characteristics of an investment, e.g., its size, the perceived risk/return relationship, management skills, market strength, the ease and cost of regular communications and travel, and other factors. Some investments will support a long, physical distance between a fund and investee; others will not. In the U.S. some funds specialize in a particular geographic area or industrial sector; others are quite open, investing regularly in opportunities across the country, near and far. However, the characteristics of such investments justify the time and cost of managing them from a distance. There will be "long-distance" investments in Southern Africa that will justify such cost as well.

The Fund, however, could not rely on these investments only and have the desired development impact. For this, the Fund must be able to reach the smaller of the SMEs. The characteristics of such investments are likely to be such that they will require a local presence that a regional Fund would be hard pressed to cost effectively achieve. Therefore, the Fund will have to find local intermediaries in which to invest that justify the transaction and management costs, pre- and post-investment. These parochial, perhaps niche intermediaries, will have the knowledge and intimacy required of the local marketplace to make investments and support their investees in a cost efficient manner.

E. The Fund's Relationship With USAID

Has the right balance been struck between fund independence and USAID controls? As construed, will the project impact upon USAID's target group as defined by the DFA?

The team believes that this balance has been struck. USAID would participate in the Board selection process; would have an *ex-officio*, non-voting seat on the Board; would participate on an advisory council; and would establish development impact indicators and define the target group on a country-by-country basis in conjunction with Fund management. The idea is for USAID to take its comfort up-front, in a positive participatory and on-going manner, rather than through the use of a stick, such as conditional funding.

As the Missions must work within the DFA and they Missions would have a partnership role in defining the target group, it is assumed that the Fund would impact upon this group in a positive manner.

F. Allocation of Resources

1. *How will the funds be allocated and what determines that distribution?*

If the Fund is independent, the Board ultimately defines the investment parameters. The team has suggested several parameters for the Board's consideration:

- Target group. In general, the Fund should invest only in those businesses that assist the target group in one of several developmental ways.
- Types of investment. Basically three -- indirect, direct, and cross-border. The team does not suggest a percentage breakdown as this should evolve according to market demand.
- Investment size. The team has suggested a range of US $1 to $10 million for indirect; US $0.5 to $2 million for direct; and US $1 to $5 million for cross-border direct.
- Type of investment instruments. Determined by market/investee needs, always emphasizing long-term risk capital over senior debt or short-term instruments.
- Investment by sector. A suggested limitation of no more than 30 percent of the Fund's portfolio in a particular country be invested in a particular sector, excluding those countries with only one investment.
- Country. No more than 30 percent of the Fund's capital should be invested in any on country.

2. *Because market development is very important to this fund, these activities should not eat into the already limited $100 million to be used in 11 countries. The proposal calls for $5 million to be allocated for the market development/education component. Will the fund be willing to commit greater resources in order to promote sustainable market development?*

The team has suggested that US $5 million dollars of the US $100 million proposed capitalization be used to prime the deal flow pump through market development. This would be a Board decision though. To encourage responsible management of market development funds and more closely tie its use to potential deal flow, it is suggested that the return on USAID's investment be calculated on the total US $100 million and not US $95 million.

The team is not recommending more than five million dollars in the first instance. Experience and need, balanced by the impact on Fund sustainability, will determine if additional money should be allocated to this activity from investment funds.

3. *Should there be parameters on the percentage of capital invested in any one country?*

To not do so jeopardizes Fund viability by limiting diversification. From a development perspective, not doing so could greatly limit the Fund's region-wide development impact. Moreover, politically speaking, not doing so could raise the possibility of negative political fallout from those countries that might then be excluded.

The team has recommended that no more than 30 percent of the Fund's capital be invested in any one country and that no less than five percent be invested in any one country. With respect to the latter guideline, should no viable investment opportunities be forthcoming in any particular country during the first five years, the Fund could allocate that country's five percent to investment opportunities in other countries. Like other investment parameters, country allocation is ultimately the Board's decision.

4. *The study addresses sustainability issues but does not provide guidance as to the appropriate size of a sustainable fund. Based on the European Funds, the size should be in the area $120 - $150 million. How does the SAEDF address this issue?*

The team recommends an initial, unconditional capitalization of US $100 million provided in five equal annual installments, with an additional US $1.5 to $2.5 million in start-up and initial operating grant funds. With this infusion, and given a inflation-adjusted return on investment of ten percent, the Fund can be sustainable.

G. Obligating Mechanism

1. *How does USAID obligate the funds and with whom? For example, if we are to sign a grant agreement with the Fund, what steps are needed to get the Fund established so that we can execute such an agreement?*

Considered a determination internal to USAID.

2. *Are there alternative obligating mechanisms, e.g., establishment of an endowment, SADC?*

Considered a determination internal to USAID. The team would prefer an endowment over the SADC, provided the endowment money was in addition to, and not part of, the proposed US $100 million initial capitalization.

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