



South Africa Siyasebenza

Learning Series

NOVEMBER 2019

A Credit Guarantee Scheme for Job Creation Ashburton Credit Enhancement Fund (ACEF)



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The Jobs Fund is a R9 billion fund established by the Government of South Africa in 2011. It was established to encourage innovation and give greater impetus to initiatives with potential to generate sustainable employment. The Fund aims to catalyze innovation in job creation through structured partnerships with private and public sector and NPOs by awarding once-off grants to organisations through a competitive process. The Jobs Fund operates on challenge fund principles and aims to act as a catalyst for innovation and investment in new business approaches that directly contribute to long term sustainable employment creation.

www.jobsfund.org.za

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Implemented by:

The Government Technical Advisory Centre, National Treasury



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This paper was prepared by the JF Learning Team based on work done for the Jobs Fund by **Greater Impact**

Abstract

This paper presents the results of the evaluation of the implementation of a Credit Guarantee facility by Ashburton Investments with respect to the Ashburton Credit Enhanced Fund (ACEF) in partnership with the Jobs Fund to support job creation in the SME sector in South Africa. The purpose of the facility was to stimulate job creation in the Small and Medium Enterprise (SME) sector by extending financial services to SMEs through intermediaries who would otherwise not get funding from conventional finance houses in the country because of the risk associated with investing in SMEs. A R68 million guarantee provided by the Jobs Fund was used by ACEF to raise R679 million from pension funds. **These are funds that only became accessible for investment in unlisted private assets after the amendment of regulation 28 of the Pension Funds Act of 1956.** This resulted in a matched funding ratio of 1:10 with Ashburton releasing these funds to financial intermediaries who in turn lent to SMEs. Over 9000 new permanent jobs in the process. The lessons learnt from this evaluation are presented in this paper.

1. Introduction

The issue of access to finance for SMEs remains one of the main barriers to starting a

business. This has been attributed to the highly conservative nature of South African banks and most lenders being more likely to finance small businesses in their later stages of development rather than at start-up. The most common barriers to SMEs' securing financial assistance include:

- inadequate collateral on the part of the entrepreneur;
- a lack of credit history and/or;
- the inability to produce an acceptable business plan required by financial institutions.

The Ashburton Credit Enhanced Fund (ACEF) was developed within this context, to provide an innovative solution to unlocking private sector capital for SMEs by using a Guarantee Mechanism. It was envisaged that the Fund would encourage the flow of capital to growing businesses that find it difficult to access funding through traditional channels due to the perception of inherent risk associated with SMEs.

In the case of ACEF, Ashburton raised capital by pooling financial resources from investors forming a single investment vehicle known as an en commandite partnership¹. Ashburton then invested the capital raised into growing businesses as debt funding

be invested. The general partner has full discretion, within the bounds of the contract, in terms of how and where to invest the funds.

¹En commandite partnership is one of the commonly used legal structures to pool investors' funds. It is a limited liability partnership where the contract is between a general partner, Ashburton in this case, and investors who provide capital to

either directly or via an intermediary seeking expansion capital.

The ACEF investors were all retirement fund organizations. Ashburton manages funds invested in ACEF on behalf of the investors by selecting investment opportunities which, when combined, target a stable investment return of at least CPI (Consumer Price Inflation) plus 3% per annum. ACEF seeks to provide a measurable positive impact on society by ensuring that the investments also deliver a high social impact, primarily through job creation. The investments within ACEF are backed by a 50% first loss capital guarantee from the Jobs Fund which means that investors are protected from investment losses up to a maximum of 50% due to credit defaults.

Figure 1 illustrates the ACEF’s business model. ACEF does not invest directly into SMEs but rather funds intermediaries and large corporations (investees), who further

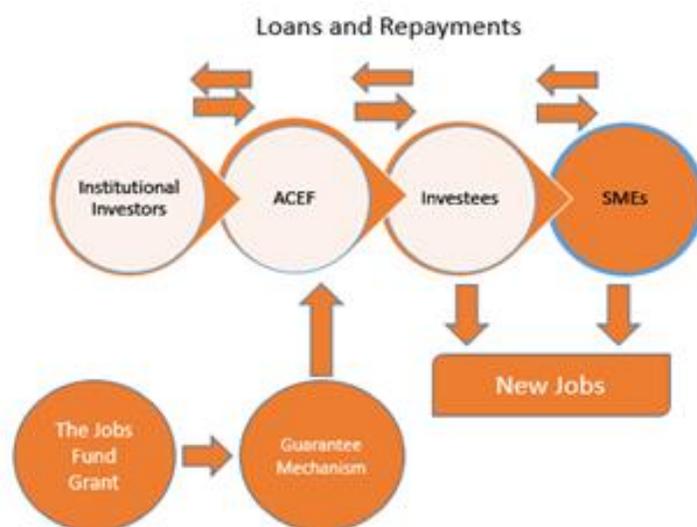
invest in SMEs. The jobs are created at both the investee and the SME level.

It should also be noted that Ashburton’s target market of intermediaries, i.e. the pool from which it selects investees is not considered high risk since these firms would have displayed some track record before Ashburton's decision to invest in them.

These firms are typically medium-to-large corporates and on-lenders who are able to provide a good level of security for their investments. The intermediaries would then invest in SMEs in the country, where there is a considerable risk of failure, hence the need for a guarantee scheme to protect the investment.

This paper presents the results and lessons learnt from the evaluation of the implementation of the ACEF fund. The evaluation was completed in June 2018.

Figure 1 ACEF Guarantee Mechanism Model



2. Objectives

The following were the objectives of the ACEF project evaluation:

1. Determine the performance with respect to anticipated outcomes (being measurable changes or benefits that happen as a result of services and activities provided by the project).
2. Document noteworthy accomplishments, shortfalls, discrepancies and opportunities for improvement based on the experiences of project stakeholders with a focus on lessons learned.
3. Aid in interpreting the successes and failures of the project in order to develop recommendations, tools and processes that improve and promote the success of current and future projects whilst recognizing the unique constraints and limitations of the project.
4. Deepen understanding of the feasibility and scalability of the project as well as the underlying assumptions and limitations and how these may be overcome in the future.

Section 3 describes the methodology that was followed in the evaluation for the Ashburton ACEF fund, while section 4 discusses the results of the evaluation. The recommendations and conclusions are given in sections 5 and 6 respectively.

3. Method and Approach

The methodology used to evaluate the ACEF implementation included a desktop review, an on-line survey and face to face interviews.

Desktop Review

The following documents were reviewed for the evaluation: the project concept and strategy documents; investee agreements; monitoring and tracking plans; Project Implementation and Monitoring Plans (PIMPs); Year End Review (YER) reports; job creation spreadsheets; letters from investors; memoranda for job creation definitions; and communication between Ashburton and the Jobs Fund.

The intention of the desktop review was to provide evidence to support and triangulate the findings of the fieldwork. The desk review process also provided insight into the project in context, landscape, evolving good practice, and industry benchmarks of performance.

On-line Survey

An online survey was administered to both investors and investees. The survey aimed to show how investor perspectives were changing since the initiation of the project. The survey also sought to uncover the

factors affecting investment into the ACEF fund.

The investee survey used various questioning techniques to understand Ashburton's offering to the broader funding market as it relates to the appropriateness and sustainability of the project. The insights from these surveys helped formulate the subsequent in-depth interview questions.

In-depth Interviews

Face-to-face in-depth interviews were undertaken with investees and the Ashburton team. Each investee was visited in their place of work for the interviews. Interviews with investees were used to complement the insights drawn from their survey responses and gain a deeper understanding of key areas highlighted through the survey results. Interviews with the entire project implementation team from Ashburton were completed in January 2018. The interviews sought to provide a comparative perspective and view to the responses of the investors and investees, as well as to get some insights into conceptualization and implementation aspects of the project.

4. Results

The Guarantee Mechanism proved a very successful fund raising mechanism by attracting R679 million in committed capital from the private sector – more than double the minimum that was initially expected. The capital was raised primarily from pension funds who typically have a low appetite for risk and often wait for positive investment lessons learnt before investing. This was made possible by the amendment to Regulation 28 of the Pension Funds Act of 1956². This amendment made it easier for Pension Funds to invest in unlisted asset classes. The guarantee acted as an appropriate incentive to entice these investors to invest into the fund.

In terms of access to expansion capital for SMEs, approximately 71% of the investees credited the diversification of their organisation's sources of funding to the receipt of the loan from Ashburton. The majority of the investees (86%) indicated that it is harder to raise capital due to the current socio-political and economic climate in the country.

Encouraging investors to invest in unlisted corporate debt for SMEs without the backing of a guarantee has a longer time horizon than the scope of this project. However, these

² National Treasury (2011) 'Pension Funds Act 1956, (Act 24 of 1956): Amendment of Regulation 28 of the regulations

made under Section 36', No. R. 183 in Government Gazette 34070: 3–72

early results suggest a positive contribution towards this goal, with 60% of investors indicating that they would invest in a similar fund without a guarantee, but that the fund would have to meet certain conditions. This suggests there is further room to improve confidence to the point where many investors will be willing to invest in SMEs without the backing of a guarantee.

ACEF reported 9 635 new permanent jobs as per the JF report for the quarter ending June 2018. 97% of the jobs went to previously disadvantaged individuals in the Eastern Cape, Limpopo and Kwa Zulu Natal provinces.

81% of these jobs were created in the Micro Enterprise and Solutions Finance sector.

The impact of the project on its direct beneficiaries is seen in the ability of the beneficiaries to earn an income and become more independent. The investee's beneficiaries utilise loans afforded to them to start their own businesses from which they derive an income through self-employment. As some of these businesses grow, indirect jobs are also created, thus increasing the indirect impact of the fund.

The formal employment created, equally contributes towards the economic independence and participation of those employed. The benefits of economic independence and participation yield

multiple indirect returns, such as the ability to improve household living standards, improve access to health care and improve access to good quality education. These outcomes were not directly measured by the evaluation.

In terms of change of perceptions about investing in social investment projects and SMEs, the evaluation found that retrospectively, 60% of investors believed that social impact investments were highly risky before investing in the fund. These perceptions have now shifted towards a more positive outlook and risk perception with 80% of investors now believing that such investments are not as high risk as they thought.

5. Recommendations

5.1 Attracting private sector investment

- a) The guarantee has been effective and needs to be in place for the foreseeable future.
- b) It is important to know how the investment opportunities help contribute towards meeting investors' objectives.
- c) Ability to raise funds within the targeted investors' market is also key (a strong marketing team is critical to success). It will also be important to promote these types of funds at investor conferences.

Other fund managers have introduced similar funds. This indicates initial successes in terms of replicability of the model.

5.2 Structure for managing investors' funds

- a) Awareness of the general economic, commercial and regulatory environment affecting the targeted private investors is required e.g. structuring investments in a way that is permissible for the targeted investors.
- b) It is important for lenders to recognize their competitive advantage in the market by identifying a stage, or stages, along the lending value chain at which to operate. ACEF realised that they didn't have the competitive advantage of lending to the SMEs directly so they focused on investing in intermediaries with capacity and expertise to, in turn, invest in SMEs.

5.3 Identifying good investees (intermediaries)

- a) Experience in impact investing i.e. investing to influence systemic change or create jobs is critical.
- b) The team managing investor's funds should demonstrate expertise in key areas of the investment environment. The team's investment philosophy and

processes need to be clearly articulated for increased investor confidence.

5.4 Operating costs

- a) Managing investment portfolios with an impact mandate can be costly depending on the level of screening and reporting required. It is normal for the cost of operations to be between 4% and 6% p.a. It is recommended that fund managers find innovative ways to reduce these fees. Subsidisation of operating costs may be required especially where investors are not willing to cover the high operating costs.

5.5 Sustainability

- a) The guarantee should be in place until sufficient track record has been developed by ACEF. The positive business case can then be used to get investors involved in the SME sector without necessarily needing a guarantee mechanism to back their investment.

5.6 Jobs Fund Partner Mandate

It is recommended that the Jobs Fund adopt a portfolio approach in monitoring financial and impact performance of funds similar to ACEF. These funds may select investment opportunities which may yield very different financial and impact returns.



6. Conclusions

ACEF was successful in raising awareness and investment into a new asset class of unlisted credit. Indications are that investor behaviour and attitudes towards this asset class are changing and institutional investors are more open to seeking out impact investment opportunities. It is likely that ACEF's continued work in this space will crowd-in further investors and have a very real and positive impact on job creation.

The Jobs Fund grant, being utilised as a guarantee, was a key catalyst in crowding in pension fund investment.

There is evidence that other fund managers have launched similar funds which suggests that the model is being adopted in the industry. This will further crowd-in investor funds and contribute to job creation in the country. It is crucial that the positive business models that have been developed in the process be widely disseminated in the industry to boost and maintain investor confidence.