African Guarantee Fund (AGF)

Development Assistance Committee member: Multiple, submitted by Sweden

Duration: Ongoing since 2012

Budget: USD 66.5 million in 2014, scheduled to increase to USD 500 million between 2015 and 2017

Geographic focus: Africa, except countries challenged by internal strife

Sectoral focus: Banking and SMEs

Offered: Partial financial guarantees and capacity development

Description: The African Guarantee Fund (AGF) is a company limited by shares incorporated under the business laws of Mauritius. The fund aims to unlock the potential of small and medium-sized enterprises (SMEs) to grow, innovate, create jobs and reduce poverty in Africa. The AGF is owned by the African Development Bank (USD 10 million invested), Danish International Development Agency (USD 20 million invested) and Spanish Agency for International Development Co-operation (USD 20 million invested). Plans are underway to expand the shareholding base by bringing on board other bilateral donors, development finance institutions and private investors.

Objectives: The AGF seeks to assist financial institutions to increase their financing to African SMEs through: *1)* the provision of partial financial guarantees to partially cover the risks linked to lending to SMEs, changing institutions' perceptions of bankable SMEs and enabling them to expand their activities and improve their product offerings; and *2)* capacity development assistance to increase their capacities to appraise SMEs and implement growth strategies to bring SMEs to their required scales, lower transaction costs and increase returns on investment.

Partners: The AGF is open to working with any financial institution – banks, non-bank financial institutions and private equity funds – active in financing African SMEs. Institutions should demonstrate a clear commitment to growing their SME portfolios and improving financial product offerings to SMEs and should meet the fund-set facility acceptance criteria as part of overall due diligence. Development partners include the Swedish International Development Cooperation Agency, the African Trade Insurance Agency, the United States Agency for International Development's Development Credit Authority and the Nordic Development Fund. The Swedish International Development Cooperation Agency and AGF signed a re-guarantee partnership agreement in 2014.

How it works: A financial institution that provides financing to SMEs can submit a request for a guarantee. Requests should include: the type and amount of guarantee requested; institution profile, including legal status, key activities, shareholding, directors and management; three-year audited accounts; and a description of the project or product requiring a guarantee. Upon receipt of a request, the AGF carries out a review and then issues an indicative term sheet. Once the indicative term sheet has been accepted, the fund commences detailed due diligence.

Conditions for partial financial guarantees vary according to the products covered. For individual loans to SMEs, the indicative limit is USD 500 000. The indicative price of a guarantee is a facility fee of 0.75% and utilisation fee of 1.75%. For portfolio loans to SMEs (portfolio loans made by an institution to a target borrower segment for which the parameters have been defined but the individual borrowers are not known), the indicative limit is USD 2 500 000. The indicative price of a guarantee is a facility fee of 0.75% and utilisation fee of 2%. For equity capital financing for SMEs, a guarantee covers a known equity investor or venture capital fund for up to USD 500 000. The indicative price of a guarantee is a facility fee of 1% and utilisation fee of 5%. For resource mobilisation to finance SME activities, the AGF guarantees bonds issued by a financial institution to investors for whom the parameters have been defined but the individual investors may not be known. The indicative limit is USD 1 000 000. The indicative price of a guarantee is a facility fee of 1% and utilisation fee of 2.50%.

The standard guarantee maximum coverage rate is 50% of the financing involved. However, the AGF has the capacity to provide guarantee support for amounts higher than this limit – co-guarantee arrangements and resource mobilisation guarantees can go up to 75% and 100%, respectively. Short-term loans of up to two years are covered for the full life of the loan. For longer-term loans, guarantees have tenors not exceeding 80% of the tenor of the underlying financing, subject to a maximum of ten years. To avoid currency exposure, guarantees are issued in the currency of the underlying financing. The actual price may vary across banks depending on the quality of the portfolio as measured by, among other things, the default rate. In the event of a claim, the AGF will provide an advance payment of 50% of the amount of the claim, followed by the balance once procedures outlined in the guarantee agreement have been adhered to.

Capacity development is offered to financial institutions to develop their capacities to appraise and manage SME portfolios. It is also provided to SME business development support companies and SMEs themselves to improve business management capabilities. Capacity development assistance interventions are based on a cost-sharing arrangement with the grantee, where the AGF's share of costs is limited to 50% of total eligible programme costs.

The AGF does not prescribe qualifying characteristics for SMEs other than those defined by the financial service industries of the countries where it operates. The fund targets all African SMEs with a valid operating license regardless of sector, industry, location or ownership. Eligible operations include: start-ups, scale-ups, modernisation, productivity improvement, production capacity improvement, transfer of ownership and restructurings. Transactions in the following sectors are excluded: tobacco or tobacco products; armament productions or where 25% or more of the total production output or turnover of the portfolio company is derived from military-related activities; beverages with an alcoholic content exceeding 15%; casinos or companies where the principal source of income is gambling; speculative investment in real estate or commodities; immoral and illegal activities; production or activities involving harmful or exploitative forms of forced or child labour; trade in wildlife or wildlife products; production or trade in radioactive material, unbounded asbestos fibres and hazardous chemicals. All projects in which the AGF invests must adhere to local and international environmental, social, health and safety standards (e.g. the United Nations Global Compact's Ten Principles and United Nations Principles for Responsible Investment).

Monitoring and evaluation: No monitoring and evaluation documents were found. The AGF's management is developing a monitoring and evaluation system, which will be an ongoing monitoring process within the AGF, focused on the outputs and outcomes of activities. The fund is collaborating with partners to design a system that will be manageable by financial institutions. Indicators are expected to include SMEs' turnover and employment and should thus provide some indication of the development results of the AGF's activities in terms of growth and employment. Information additional to the ongoing monitoring process within the AGF will be collected from surveys, which could include issues such as additionality requirements, the extent to which the AGF benefits young people and women, the fund's social performance, and compliance with the International Labour Organization's Decent Work Agenda.

Results: By July 2013, agreements with ten banks were signed for guarantees amounting to USD 15.8 million, while agreements with five banks amounting to a further USD 33 million were approved and proceeding to signature. Pipeline projects under consideration constituted a further USD 64.8 million of guarantees with 11 banks. Assuming that all approved and pipeline projects are signed, the total portfolio would be USD 113.5 million, representing a leverage of 2.3 on the AGF's capital of USD 50 million invested by its owners.

Insights: The AGF has robust credit risk and due diligence processes that enable it to establish and maintain a quality portfolio, especially when compared to previous national and regional funds that became insolvent and failed to honour their guarantee obligations. Notably, guarantees do not cover existing loans to ensure the additionality of SME financing. Also, the fund tries to solve the problems of fragmentation, duplication and inefficiencies of development assistance for SMEs in Africa, where several donors and development finance institutions implement SME programmes in uncoordinated ways, by pooling resources and offering support at the regional level.

The AGF was able to get off to a quick start owing to leadership and the role of the African Development Bank, which enabled the fund to access its network. The Swedish International Development Cooperation Agency's re-guarantee enhances the fund's capacity to guarantee banks and credit institutions so that they are able to provide debt financing in sufficient volumes, and with adequate tenors and reduced collateral requirements, to meet SMEs' needs. The principal value added of the re-guarantee lies in its function to scale up the AGF's guarantee capacity, which is limited at the AGF's current stage with a constrained capital base. In addition, the Swedish International Development Cooperation Agency's support strengthens the AGF's reputation and standing as a guarantor, which improves the AGF's opportunities to grow its business and ultimately attract capital from the private sector. The latter is important for the AGF to reach the critical mass needed to achieve its long-term goal of phasing out donor support and becoming self-sufficient.

SOURCES:

AGF (22 December 2014), "AGF – Sida Partnership Agreement" (press release), www.africanguaranteefund.com/news/97/160.

AGF (n.d.), African Guarantee Fund website, www.africanguaranteefund.com (accessed 1 July 2016).