REALIZING THE POTENTIAL FOR PROFITABLE INVESTMENT IN AFRICA
High-Level Seminar organized by the IMF Institute and the Joint Africa Institute
TUNIS, TUNISIA, FEBRUARY 28–MARCH 1, 2006

Realizing the Potential for Profitable Investment in Africa

A case study

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Paper presented at the high-level seminar: *Realizing the Potential for Profitable Investment in Africa*
Organized by the IMF Institute and the Joint Africa Institute
Tunis, Tunisia, February 28 – March 1, 2006

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www.businesspartners.co.za

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Investing in Entrepreneurs

Business Partners Ltd

Business Partners Limited is a specialist investment group, providing customised and integrated investment, mentorship and property management services for small and medium enterprises in South Africa.

Vision, mission, goal

- Our **vision** is to be a world-class, added-value investor in small and medium enterprises, thereby facilitating wealth generation, job creation and economic development in South Africa.
- Our **mission** is to fulfill our vision by investing capital, skill and knowledge into viable entrepreneurial enterprises.
- Our **goal** is to be one of the most internationally respected successful and profitable investors in small and medium enterprises.

Corporate Profile

- South Africa's leading SME (small and medium enterprise) investment company
- Unlisted public company — ISO 9001:2000 certified
- Offers a wide range of investment, property, venture capital and equity products tailored for SME's, as well as post-investment mentorship services
- Focus on enterprises requiring between R250 000 and R15 million to finance a start-up phase, expansion or development
- Approved 538 investments to the value of R660,5 million during 2004/2005, facilitating more than 7550 employment opportunities

± R6 = US $1

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Corporate Profile (cont'd)

- Since inception in 1981, the company has invested R6,8 billion into 30 100 SME investments, facilitating the creating or maintaining of 480 472 jobs
- Current investment portfolio — R1,1 billion
- Four Equity Funds country-wide (incl UYF Franchise Fund), as well as a Property Fund, based in Johannesburg
- 22 offices servicing the SME sector countrywide
- Business Partners operates under the non-executive Chairmanship of Mr. Johann Rupert and is managed by Jo' Schwenke, Managing Director, since 1996

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Business Partners is *the* specialist in SME risk financing

We usually structure a deal for the entrepreneur consisting of a loan, and for the risk we carry, we will take a combination of minority equity and royalties

All loan repayments (capital and interest) and royalty payments are carefully planned against the available cash flow analysis which we have prepared.

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Consider the following mini case study

How do we solve this problem?

a competent person with good "doing" skills, business skills and much entrepreneurship approaches a financier with a viable business plan — (requiring R1 000 000), but with little own contribution (say R100 000) and no further security

note $1 = R6

A possibility

We acknowledge R100 000 equity from our partner;

put in R900 000 as equity; and

split shareholding 10 - 20% for entrepreneur and 80 - 90% for us

Shareholding %

- We are at risk for R900 000 (total capital investment)
- *less* security value (assumption) R250 000
- therefore, risk = R650 000
- entrepreneur's contribution R100 000
- this is 13,3% of risk capital (100/750)
- therefore a shareholding of 20% would be fair

Problems

While the business is small — particularly "Lifestyle"—
and when business develops problems, the entrepreneur is likely to act like an employee.

When times get tough he will probably walk away and take a job

The Alternative

- Calculate IRR of business based on previous scenario
- assume 5 years to exit
- 80% for Business Partners/ 20% for entrepreneur
- business is worth R2,5 million in month 60
- IRR is, say, 27 %

Then *RESTRUCTURE!*

how?...

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Restructure

- We restructure with a combination of:
  - term loan
  - royalty
  - minority shareholding! (25% to 45%)

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Royalty

An interest rate will kick in
in a straight line right away,
thus causing cash flow problems;

while the royalty is payable as
a % of the activity of the business
and will therefore mirror the ability to pay

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The royalty is always linked to the performance of the business, ie

- % of turnover
- cents per liter sold / units sold
- R per transaction
- free cash flow

Considerations that affect structuring

- fairness to both entrepreneur and Business Partners
- motivation of entrepreneur is paramount, particularly when things do not go too well
  - *get entrepreneur's commitment using a stick and carrot*
- Insolvency Act will play a role as to whether ordinary shares, preference shares, loans or other instruments are used
- taxation concerns
  - *normal tax & capital gains tax will inform our choice of instruments*
- exit mechanisms

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- different exit routes will place completely different stresses on the relationship with the entrepreneur
- the options involving sales to a 3rd party will usually have the entrepreneur and Business Partners cooperating to get the highest price

the sale back to the entrepreneur

— *particularly as per the case study scenario* —

can present major challenges

to the investment professional

Advantages to Business Partners particularly with small entrepreneurs

- cash is returned regularly – less temptation to entrepreneur
- a lower capital amount is required by entrepreneur to buy out Business Partners in month 60
  - R2m would be required on 80/20 split
  - only R625 000 is required per the restructured model

But most important of all

the structure we choose and the proposal we agree on MUST be fair to all the parties in the venture

Because of our methodology we:

- like risk financing

    provided

- we get a fair deal

So COLLATERAL is not a pre-requisite for us, but it does affect our price

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Our financing depends on the skills,

- doing
- business (can be bridged with mentoring)
- entrepreneurship,

of the entrepreneur – not his collateral

So PROVIDED the entrepreneur has sufficient skills for the venture

FINANCE IS ACCESSIBLE

Remember

CAPITAL, ***SKILL*** and ***KNOWLEDGE***

are required for a successful business