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NZZ Monday, 5th March 2018

Millions for new jobs

Impact investing means investing money in a way that has a positive social impact. Just how much time and expertise this requires is demonstrated by the example of a successful young company in Cape Town.

Eugen Stamm

The invisible hand brings capital to the foot of Table Mountain in Cape Town,



(Illustration: Karsten Petrat)

Trevor Gosling and Neil Welman want to get things moving in South Africa. That's why they launched Lulalend in 2015. In the spartanly-furnished offices of the start-up company, we see a few young employees concentrating on their laptops in front of them, the colourful seating area remains empty. Lulalend grants online loans to small and micro-enterprises nationwide, pioneering the way in South Africa. Over recent years, start-ups with a similar business model have also been established in many other countries, including Switzerland. However, the example of Lulalend shows that it is sometimes necessary for various players to interact together in order to advance an idea. It also illustrates the

challenge of finding ways for capital to flow from the north to the south in order to generate a return on capital whilst simultaneously social progress at the same time.

Cape Town as a start-up city

Their appointments calendar is full yet the two founders are laid back, like so many other people in Cape Town. It must be the sun and the sea that encourages the relaxed approach of the city's inhabitants. Nevertheless, they are both ambitious. Gosling worked for the investment bank Goldman Sachs and has already sold a first e-commerce start-up to the media group Naspers; Welman spent ten years in London gaining experience working as an expert in credit risks. According to Gosling, Cape Town has since established itself as a centre for start-ups. Today, the young generation is no longer forced to leave the city in order to pursue a career with a major company in Johannesburg.

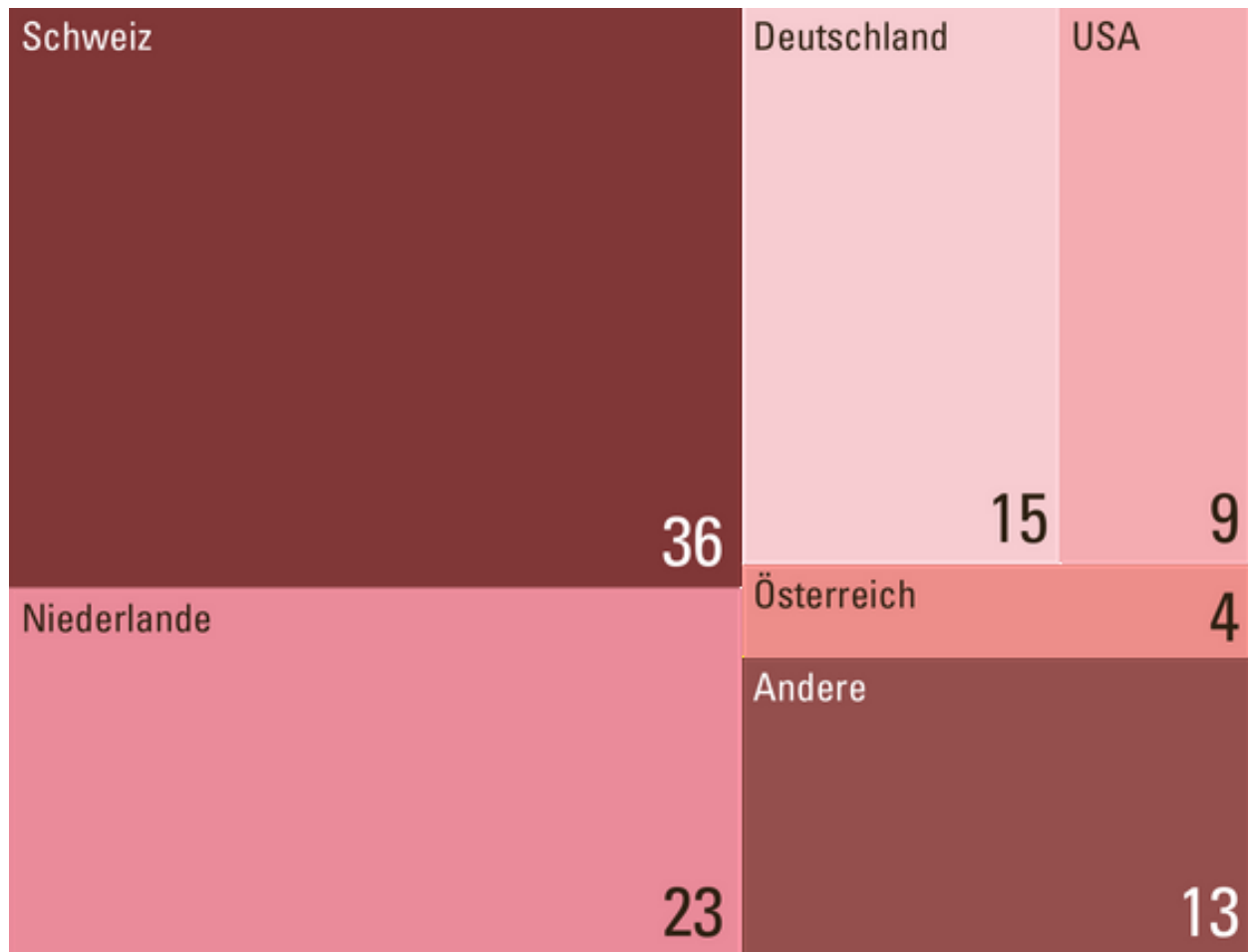
"Promoting the growth of SMEs is one of the goals for achieving sustainable development."

In order to set up a company you need money; raising capital is rarely easy. When the idea consists of making unsecured loans in a country like South Africa to companies whose owners you haven't even seen yet and which include for example beauty salons in the poor townships, or the operator of a dinosaur exhibition who wants to finance the purchase of a new exhibit, a Tyrannosaurus Rex, then you've got a serious problem. In South Africa, Gosling and Welman were unable to find anyone willing to get involved in something like this. A number of investors in the country had apparently already had their fingers burned with unsecured personal loans.

Most investors consider two categories: Risk and return. Some also consider a third, namely the difference that an investment makes. If you buy a government bond and consequently lends money to the Swiss Confederation you have no risk or return and make no noticeable difference to the world. By contrast, financing SMEs in emerging countries is not without risk but does bring a return and does have a certain amount of impact as well. Because, according to a study by the World Bank, small companies create four out five jobs in these countries. In South Africa there is a dire shortage of jobs; youth unemployment is 51%. The IFC Enterprise Finance Gap Database shows that throughout the continent, the banks either fail to lend any money to 32 million SMEs, or the amounts they lend are insufficient. Seen on a global basis, the shortfall in lending to these drivers of job growth is said to be a colossal \$ 2,600 billion.

Microfinance Switzerland

Assets under management in the microfinance sector worldwide, by country of domicile, in %.



Source: Symbiotics MIV Survey (2017) – Graph: jok

The United Nations has announced targets for sustainable development, one of these being to promote the growth of SMEs. This doesn't call for charity but specialist investors to pave the way, with a whole band of investors following in their path.

In Cambridge USA, pioneers like these can be found at the head office of Accion. The non-profit organisation, founded in 1961, works in conjunction with fin-tech and micro-finance companies all over the world in order to facilitate access to the financial system for everyone. Accion also manages a number of investment funds. One of these, Accion Venture Lab, invests amounts of up to \$500,000 in the early-phase financing of start-ups whose business model is aimed at poor sections of the population. Michael Schlein, the CEO of Accion, brims with optimism. This is to be the start of a golden age of financial inclusion. Mobile phones and the digital revolution would blaze new trails in order to bring financial services to three billion people who are still excluded. Lulalend in Cape Town is one of more than 30 start-ups in which the Fund has invested by taking equity. The portfolio also includes for example First Circle in the Philippines, Konfio in Mexico and Lydia in Nigeria, all young companies which also grant loans to SMEs.

Nearly as good is good enough

To date, Lulalend has granted loans totalling the equivalent of more than CHF10 million to small construction and transport companies, restaurants, garages, hairdressing salons etc. The unsecured loans range between CHF1,600 and CHF 40,000, with terms of six or twelve months. The loans are granted automatically and within just a few minutes. The decision is based on transaction data from business accounts of the potential clients, credit card data and data from on-line accounting platforms. With traditional banks, a decision which is based on a paper credit file takes several weeks says Neil. To be successful, the Lulalend algorithm doesn't have to be better than a bank's lending process. Nearly as good is good enough. Up to now, the default rate for the loans has been less than 5%, with an average interest rate of 20%. That sounds a lot. However, South African government bonds also yield 8 to 10%.

"The apparent financing shortfall for SMEs in emerging countries is said to be \$2,600 billion."

The money which Lulalend lends has to come from somewhere – in this case from Lake Geneva. It's here that Petra Zeier works at the headquarters of Symbiotics, an asset manager specialising in microfinance investments. Zeier is responsible for the Regmifa Fund, the aim of which is to make finance available for SMEs and microenterprises in Southern Africa. This investment vehicle was launched in 2010 at the initiative of various European development banks. The Fund has since grown to more than \$ 100 million. The Regmifa Fund is the first institutional investor to have granted Lulalend a loan. As a start-up, it is an atypical investment for the Fund, explains Fund Manager Zeier. Normally, it is established banks that focus on the promotion of small companies or microfinance institutions who would receive loans from the Fund.

So why the exception? The fact that Accion had invested in the start-up was a positive sign. It was through discussions with Accion that the Head of the Symbiotics South African Office, Duncan Frayne, first learned about Lulalend. In addition, the development banks have issued so-called first-loss guarantees for the Fund. In other words, they will meet the initial losses that are incurred, the aim being that the Fund should also make risky but promising investments.

Currency as a problem

Last but not least, there was also the problem of the currency risk. The South African rand fluctuates significantly against the Fund currency of the US dollar, as well as against the Kenyan shilling, the Zambian kwacha or the Ghanaian cedi. Hedging against currency risks like these is either very costly or even impossible as no bank offers this option. The Fund doesn't want to simply saddle the loan recipient with the risk - it's just too great.

This is where another innovative actor, domiciled in Amsterdam, gets involved. The Currency Exchange Fund, TCX for short. The Fund was established in 2007 by development banks, the German and Dutch governments and other institutions. The Fund's task is to provide hedging for these currency risks at acceptable terms and consequently to facilitate and promote capital flows from the north to the south. With the support of TCX, Fund Manager Zeier was able to finance the growth of Lulalend's credit portfolio with a loan.

Invisible pipelines

Cambridge, Geneva, Amsterdam, Cape Town: The example of Lulalend is just one of many but it does show the complexity of the task of building the invisible pipeline through which impact investment flows. Swiss companies are world leaders in this field. They manage more than a third of the global

microfinance investments which totalled \$13.5 billion at the end of 2016. In Zurich, the firms participating in this area are Responsibility and Blue Orchard. Over the last 15 years, the latter alone has granted loans in the sum of more than \$4 billion to SMEs in emerging countries. Impact investments, in other words investments which have a measurable, positive social impact, have also become an issue for the major banks. As such, for example Credit Suisse, which has more than 15 years experience in this field, wants to ensure that the impact industry will continue to grow and become part of the mainstream so that private capital can be efficiently directed towards this area, says Laura Hemrika, Global Head Corporate Citizenship and Foundations at Credit Suisse. She adds however, that this issue is not just about money. For example, within the framework of partnerships with visionaries such as Accion, employees of the bank offer their know-how in support of microfinance organisation throughout the world on a voluntary basis.

In the meantime, Gosling and Welman are creating jobs, directly and indirectly. Their aim is to expand their team to 30 employees by the end of the year. To this end, they are looking for investors to raise around \$5 million in a second round of financing. South Africa has a new President; that gives them confidence. The very first client to whom they granted a loan runs an online shop for coffee. It has since already succeed in increasing its sales five-fold and is also looking for employees as it will shortly be opening its first store in Cape Town.