ISCTE Business School
Instituto Universitário de Lisboa

IS CAPITAL OWNERSHIP A GOOD ALTERNATIVE TO MICROCREDIT? THE CASE OF SÃO TOMÉ AND PRÍNCIPE.

Ana Teresa dos Santos Bento

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Supervisor:
Prof. José Paulo Esperança, Prof. Catedrático, ISCTE Business School, Departamento de Finanças e Contabilidade

Co-Supervisor:
Prof. Rogério Roque Amaro, Prof. Associado, ISCTE, Departamento de Economia

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Abstract

Microcredit, which was been mostly popularized by the Peace Nobel Prize Muhammad Yunus, has been considered an efficient tool to provide poor people from developing countries with basic financial support. However, there has been some criticism regarding these initiatives concerning the high interest rates charged, the lack of financial sustainability, the misuse of microloans among many others. This study proposes an alternative approach based on substituting the credit feature of these initiatives by a capital ownership component in order to accomplish both local development goals and rewarding return on investment.

In order to achieve a more substantial outlook on this theory, a research study was conducted on a Microcredit initiative in São Tomé and Príncipe. It revealed the considerable lack of financial services provided in the country, mainly concerning the lack of initiatives targeting the private sector development. Thus, a Microcredit project like this would enhance the enterprise creation. However, the shortcomings highlighted in the literature were confirmed. This case study suggests that a different financing approach such as angel financing and venture capital could overcome the limitations of micro-credit.

Keywords: Microcredit; Venture Capital; Development; Developing Countries.

JEL Classification: O16; G24.

Resumo

O Microcrédito, que se tornou maioritariamente popularizado por Muhammad Yunus, vencedor do Prémio Nobel da Paz, tem sido considerado uma ferramenta eficaz de providenciar as pessoas mais pobres dos países em desenvolvimento com o apoio financeiros básico. Porém, tem havido alguma crítica sobre estas iniciativas relativamente às elevadas taxas de juro cobradas, à falta de sustentabilidade financeira, ao uso indevido dos micro-empréstimos, entre muitos outros. Aqui será proposta uma abordagem alternativa para atingir ambos os objectivos de desenvolvimento e de gerar retornos sobre o investimento, substituindo a componente do crédito por uma de posse de capital.

De forma a alcançar uma visão mais substancial sobre esta teoria, foi conduzida uma pesquisa sobre uma iniciativa de Microcrédito existente em São Tomé e Príncipe. Foi descoberta uma escassez considerável de serviços financeiros prestados no país, principalmente relativa à inexistência de iniciativas de desenvolvimento do sector privado. Portanto, um projecto de Microcrédito como o estudado viria reforçar a criação de empresas. Contudo, as lacunas evidenciadas na literatura foram confirmadas. Este Estudo de Caso sugere que uma abordagem financeira diferente, como o financiamento por *business* angels ou o de Capital de Risco, poderia ultrapassar as limitações verificadas no Microcrédito.

Palavras-chave: Microcrédito; Capital de Risco; Desenvolvimento; Países em Desenvolvimento.

Classificação JEL: O16; G24.

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"Here we were talking about economic development, about investing billions of dollars in various programs, and I could see it wasn't billions of dollars people needed right away."

Muhammad Yunus

Executive Summary

The Grameen Bank experience by the Nobel Prize Muhammad Yunus bred a massive enthusiasm in the economic spheres. However, in recent years some reservations have emerged concerning different aspects, such as economic growth, sustainability, women empowerment and developmental impact.

A number of studies have tried to prove this "not such a good side" of the Microcredit initiatives. Some more anthropological researches, such as Goetz and Gupta (1996), found that there is a loss of direct control by women concerning their micro-loans in favor to their male relatives. Also, Rahman (1999) investigated the Grameen Bank performance in a Bangladesh village, and it revealed some consequences of the pressure created to ensure timely repayments, such as loan recycling, households members tension and frustration, new ways of dominating women and the increase of violence in society.

From a more economic approach, Buckley (1997) centered his attention on the performance of Microfinance institutions in Africa. He studied Kenya (1992), Malawi (1993) and Ghana (1994). Although the number of Microcredit institutions has risen considerably in Africa in the last years, it was not found evidence that suggests that this kind of programs provide "*significant and sustained positive impacts*" for the new entrepreneurs in terms of the operations sophistication level, increasing income flows or employment levels. His findings were generally consistent with those of Morduch (1998), who studied the social impacts on nearly 1800 households beneficiaries in Bangladesh and showed no significant rise of consumption, school attendance or work reduction comparing to other households.

There are also other issue addressed concerning the restricted effect on enterprise growth; lack of skills and training by the local entrepreneurs; the use of microloans for

other purposes rather than the ventures; pressure to achieve high recovery rates, among many others.

Despite all these apprehensions concerning Microcredit initiatives, its importance in fighting poverty alleviation is incontestable. This research suggests an alternative model, which would mitigate some of these aspects. Therefore, it is suggested that a development Venture Capital (VC) project, meaning both organized VC and a more informal one, such as Business Angels, would generate better results, mainly due to its more involvement character and to investing in Small and Medium Enterprises (SMEs) rather than in micro, informal businesses. There has still been no empirical research on this matter (Venture Capital in developing countries as a means to alleviate poverty), but there have been some findings that relate Venture Capital with economic growth. En-jun and Yu-hang (2004:6), applying the neo-economic growth theory, concluded that "*venture capital is a powerful engine of the growth of economies*", stressing the fact that VC is still undeveloped in China and in other developing countries and that those countries/regions should promote the national venture investment industry. A more empirical approach was applied in order to find evidence on whether VC has significant effects on employment rates. When Belke *et al.* (2003) examined 20 OECD countries, a causal relationship between VC investment and job growth was found, concluding that VCs can significantly generate employment growth and job creation.

More broadly, SMEs, which are the main targets of the VC industry, have a major importance in the economic performance of a country, and can drive developing countries to improve their situation.

But why should anyone risk investing in African SMEs with the lack of infrastructures, politic instability, corruption, among other structural problems? The main reason lies on the theory of declining marginal efficiency of capital. As one of Africa's most imperative problem lies on the lack of resources, mainly capital, it is no surprise that investment there yields some of the highest rates of return. However, it also implies greater risk. Some attractive opportunities have been emerging because of governments' encouragement to create public/private partnership, joint exploitation of natural resources, improved governance and democracy, improved regulation frameworks and reformed investment codes, among many others.

Although there is still a lot of progress to be made, there are great opportunities to be seized in most of the African countries and VC investments could be an efficient mean to achieve both developmental goals and investment returns.

I. Introduction

The aim of this work is to provide an alternative approach to the Microcredit initiatives that, in recent years, have gathered some criticism. Although it is recognized that it has offered a valuable aid to improve people's lives in developing countries, applying some Venture Capital principles in these projects would improve their performance and their impact.

The following chapter will present an insight over this theory, based also on some academic and empirical research on Microcredit, Venture Capital and Small and Medium Enterprises in developing countries. After that it will be exhibited a Case Study over a Microcredit project in São Tomé and Príncipe, where it was applied some conclusions taken before on this matter.

II. The Missing Middle

2.1. Introduction

Today, the private sectors of many developing countries have been lacked a "Missing Middle", which can be defined as the Small and Medium Enterprises (SMEs) and which usually employ 10 to 100 people. These are frequently too large to benefit from NGOs and Microfinance institutions and too small to be considered as significant drivers of economic growth, and therefore undeserving of policy consideration by the governments.

In the following chapters some downsides of the emphasis given to Microfinance by development agencies (mainly their target – informal, micro-businesses) will be described, and it will be suggested an alternative type of finance that would enhance the potential of SMEs, by providing them an easier access to finance by the means of Venture Capital.

A number of studies on SMEs have provided a sense of how important they are for sustainable development in emerging economies. On one hand, by being less mobile than large corporations, they are more likely to have ties of dependence and familiarity to their communities. On the other hand, as they are larger than informal micro-enterprises, they provide more employment, productive activity and public revenues, which contribute to a significant economic growth for these economies.

2.2. General Approach to Microfinance

Developing countries have always faced great challenges at economic, financial, social and human levels. Several initiatives have been held in order to reduce poverty and to improve the living conditions of their inhabitants. However, it is not uncommon that they do not have considerable results due to, for instance, a lack of resources and sustainability, applying occidental patterns to the local communities, macroeconomic mismanagement or faulty regulatory environments.

Pursuing an answer to this, Professor Muhammad Yunus ran an experience starting in 1976, in Bangladesh, where he attempted to improve the living condition of extremely poor people who had a strong motivation to work, but did not have the initial financial resources to begin a subsistence business. These were people who spent their whole life depending on external creditors (*money lenders*), who charged enormous and abusive interest rates, compelled their clients to pay high prices for raw materials or to sell manufactured products at extremely low prices. Yunus decided to lend 27 Dollars to some inhabitants of a village called Jorba, which was distributed as credits to 42 poor people. This experience had the following main characteristics:

- The main costumers were women;
- It was conceded to groups of five people, every member of the group was morally responsible for the others (which turn peer pressure as was a way to substitute collateral, something those people did not have);
- The time between repayments was very short;
- The interest rates were approximately the ones used in the market;
- The businesses should generate profits in the short run (for instance, agriculture, manufacturing, livestock).

This experience was very successful and later on this model was adopted by many developmental organizations and in several countries. After this accomplishment, other devices of financial intermediation to poor people were provided, such as savings, insurance, leasing and others. So, the Microfinance concept emerged as follows: "*provision of financial services to low-income clients, including the self-employed. Financial services generally include savings and credit; however, some microfinance organizations also provide insurance and payment service.*" (Ledgerwood, 1999:1).

Thanks to the success of this experience, and after the creation of the Grameen Bank (which emerged in order to apply this concept), the Microcredit model was spread worldwide and it was considered by many developmental agencies as a very efficient tool to fight poverty. 2005 was declared the International Year of Microcredit by the

U.N. and in 2006 Muhammad Yunus was awarded with the Peace Nobel Prize, shared with the Grameen Bank. It became so popular that celebrities like Natalie Portman and international companies like Benetton have become Microcredit supporters.

Nowadays, Microcredit reaches hundreds of millions of poor people and it has gained the approval of most world leaders. Institutions like Kiva achieved an enormous success: it combines Internet with Microfinance and promises a very easy way to help poor people around the globe. Kiva works with existing Microfinance institutions, which collect data from the loans, information that is published afterwards in Kiva's website. Any person who wants to help can choose who they want to fund and then recover their money.

2.3. Microcredit Drawbacks

Despite the popularity of these initiatives, in recent years some pitfalls of Microcredit performance have been exposed by some academic or less academic studies. There are several reasons, ones that are specific to certain institutions and others that are generic, which will be pointed below:

a) Interest Rates

As it is expected, the interest rates charged in Microcredit loans need to be higher than the ones in the market (commercial banks), as these institutions need to guarantee their subsistence and financial sustainability and assure some independence from extern donations. Their operating costs can be very high, as many small loans require a larger effort than few big loans.

Table 1: Administrative Expenses as Percentage of Loan Portfolio by Region and Portfolio Yield by Scale of Operation

Administrative Expenses as Percentage of Loan Portfolio by Region	
Asia	18.9 %*
Eastern Europe	20.1 %
Latin America	23.3 %
Africa	38.2 %

*All figures for financially self-sufficient MFIs.

Portfolio Yield by Scale of Operation	
Large MFIs	31.6 %*
Medium MFIs	43.4 %
Small MFIs	48.2 %

Source: CGAP, 2002

Moreover, the effective interest rates are higher than the stated ones for the following reasons:

- Use of flat rates of interest
- Collection of security deposit (deducted from the loan amount)
- Compulsory savings collected with loan installments
- Charging insurance premium for the loan
- High penalty for missing a repayment schedule, etc.

(Mitra, 2009)

This matter has been widely discussed because some academics argue that, although these interest rates are, in fact, very high, this does not affect the investors' behavior (Dehejia *et al.*, 2005). However, such high interest rates can deteriorate the debt and the poverty situation of some debtors, as there are many cases when they use new loans to pay the old ones (loan recycling) with higher interest rates. As Boudreaux and Cowen (2008:4) referred, "*How can people in new businesses growing at perhaps 20 percent annually afford to pay interest at rates as high as 100 percent?*"

A further issue utilized to diminish the importance of high interest rates is the fact that in spite of that, people continue to fulfill the repayment of their loans and this rate is extremely high. However, as Buckley (1997) mentioned, this rate cannot be used to measure the impact on enterprise operations and on improvements in living conditions, as it only indicates the borrowers' willingness and capacity to repay.

Particularly in Africa, Microcredit interest rates can be even more problematic because commercial have them already extremely high (due, most of the times, to the inflation rate). These are some examples of African countries' lending interest rates (%):

Table 2: Nominal Lending Interest Rates (%)

Country	2005	2006	2007	2008	2009
Congo, Dem, Rep,		46,4	47	43,2	65,4
Madagascar	27	29,5	45	45	45
Sao Tome and Principe	29,8	29,3	32,4	32,4	32,4
Malawi	33,1	32,3	27,7	25,3	25,3
Zambia	28,2	23,2	18,9	19,1	22,1
Mongolia	30,6	26,9	21,8	20,6	21,7
Uganda	19,6	18,7	19,1	20,5	21
Mauritius	21	21,1	21,9	21,5	19,3
Nigeria	17,9	16,9	16,9	15,5	18,4
Jamaica	17,4	17,6	17,2	16,8	16,4
Mozambique	19,5	18,6	19,5	18,3	15,7
Angola	67,7	19,5	17,7	12,5	15,7
Uruguay	13,6	9,3	8,9	12,4	15,3

Source: World Bank, 2005-2009. (http://data.worldbank.org/).

One should be aware that these high lending interest rates are essentially due to the inflation rate. If the real interest rates are calculated (which take into consideration the inflation rate), the value will be fairly the same as in developed countries.

b) Financial Sustainability

Another underlying concern is the fact that Microcredit institutions face a trade-off between accomplishing their social objectives and being financially sustainable. In order to be self-sufficient from external donations and subsidies, Microfinance Institutions (MFIs) need to:

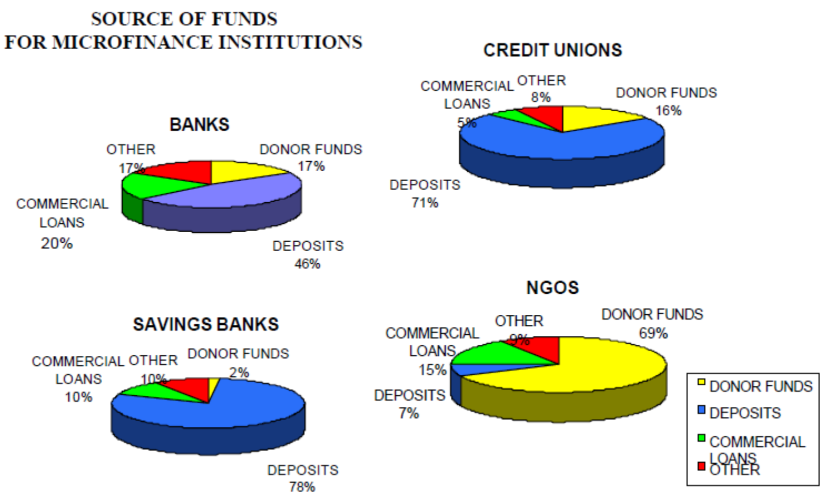
- Charge higher interest rates than the market in order to cover the far above the ground operating costs related to providing many small loans;
- Achieve a large size in order to take advantage of economies of scale;

- Gain some age so they can learn from past initiatives and employ the most efficient management.

The problem is that if MFIs charge high interest rates, they will not be in line with their social objectives and if they have explicitly social objective by targeting the poorest borrowers, they only generate revenue enough to cover 70% of their total costs (Robert and Jennifer, 1998).

Only 10% of MFIs are self-sufficient and independent from donations and subsidies, according to a World Bank study from 2001. As a result, almost all organizations are substantially subsidized, which compromises their long-term viability. Another way to overcome this issue is by trying to use internal sources of funding, by attracting also deposits from their clients as a different financial service. The following graphics show the importance of deposits as a way to guarantee alternative sources of funds, as well as the high dependence of NGOs from donor funds..

Figure 1: Source of Funds for Microfinance Institutions



Source: World Bank, 2001.

The setback of being a donor-subsidize MFI is that funds available are almost always insufficient and that limits on the amount of poor people that can be helped.

c) Pressure to achieve high recovery rates

An indicator that is widely used to provide evidence that MFIs achieve success is the loans recovery rate, which shows that the beneficiaries can and are willing to pay. However, this is not a proof that the loan was used to be invested in a highly profitable business or even that the receivers were pulled out of poverty. The focus on this rate neglects most of the time other crucial indicators such as the improvement of living quality, access to essential goods and services or loan utilization for investment purposes.

This pressure for recovering the loans relates to the economic viability of the MFIs, otherwise it would be impossible for them to maintain their normal activity. The dilemma is that MFIs employees are usually under a lot of pressure and some extreme measures are taken to pressure their clients, sometimes even by using violence.

This usually leads to a pressure to early repayments. One reason hypothesized by Field *et al.* (2009) was the impact of the rigidity of microcredit contracts on this matter, considering the early repayment beginning and the consequent investment behavior. The results of a 845 Microcredit clients survey in India indicated that if it is introduced some more flexibility in those contracts, this will encourage more profitable investments as well as a higher risk of default in repaying the loan, generating a trade-off between banks and clients. Another conciliation that Microfinance institutions need to consider is whether they reach their financial sustainability or if they access the "poorest of the poor". After conducting a study over more than 1300 observations (Hermes *et al.*, 2008), it was found that these two aspects have, indeed, a negative correlation.

d) Skills/Training

One of Muhammad Yunus' lines of thought concerns the assumption that even the poorest people have natural entrepreneurial capacities that are born with them. In a situation of despair, everyone that has access to a small amount of money will do the best in order to achieve the highest profitability so they can improve their situation. Yunus also defends that everyone has a specific talent that can be employed to their self-subsistence.

As a consequence, MFIs only provide some assistance in their regular meetings and most of the time they are used to collect payments, rather than do anything related with the businesses. They rarely provide any formal training. The reality is that it is not always the case that the beneficiaries understand how to succeed and the businesses thrive. Most of the times, the activities that poor people initiate are located in already saturated markets, due to this lack of skill, leading to vulnerability to environmental and economic shocks in that sector. As Hulme (2000:1) referred, "*Because of circumstances beyond their control (sickness, flood, drought, theft and so on), lack of skills and knowledge or taking bad decisions, a proportion of poor borrowers encounter great difficulties in repaying loans.*"

e) The use of microloans

Although Microcredit helps people find a way to improve their living conditions, it rarely creates new jobs for others besides the entrepreneur. Moreover, most of the times the microloan is not fully employed in investing in the business (through expanding operations, increasing inventory, etc.), but rather partially used for consumption purposes.

The consequence is that Microcredit does not contribute significantly to the country's wealth. Basher (2001) explained why the Bangladesh national statistics do not show any significant reduction of poverty, regardless of the Microcredit initiatives that have been carried out there. The national level aggregate statistics do no show robust impact because there is a need for "*an institutional support for the small and medium farmers who are narrowly free from the poverty trap*" (Basher, 2001:12), in a land based rural economy. It is argued that there is a need to ease the productive use of credit, as MFIs programs are designed to focus on repayment rates (as it was mentioned in d)) rather than on making an effort to promote the productivity among the beneficiaries.

As Dichter (2006:4) puts it, "*This is the paradox of microcredit: the poorest people can do little productive with the credit, and the ones who can do the most with it are those who don't really need microcredit, but larger amounts with often longer credit terms.*"

Other reasons remain in MFIs incapacity to succeed in pulling people out of poverty, for instance, providing insufficient economic opportunities for loan recipients to create a profitable business; low understanding of the local factors and economic structures; offering a rigid loan contract, whose payment starts few weeks after; intolerance of some cultures and religions to credit and interest (like the Islam culture); among others.

2.4. An Alternative Solution

Most of these drawbacks are a consequence of both the Microcredit model itself and its target, informal micro-enterprises. Therefore, in this study it is suggested an alternative financing model that it is in vogue in some developed countries: the Venture Capital investments. Similar to the case of some more sophisticated Microcredit institutions, it would not only comprise the purpose of giving a reward to its investors, but it would also have a development intention as it enhances the job creation, the economic growth, the broadening of capital instruments for companies and the attraction for Foreign Direct Investment. These last characteristics were already proved to be some of the consequences of an adequate use of Venture Capital.

Nonetheless, the main feature is that Venture Capital and Business Angels financing would overcome some of Microcredit's problems:

- There are no interest rates charges: instead, it is used an exit strategy, whose return will depend on the enterprises' profit;
- One of its main purposes is to generate profit: so, if it is well managed, financial sustainability would not be a concern;
- The skills and training would not only be from the local partners, but also from the fund managers, as they would have a participation on the enterprise and, therefore, would help on its administration;
- The use of the fund would be exclusively to invest in companies, as it would be spent in their capital participation rather than in credits to the population.

However, it is first required an analysis of the state of the Venture Capital in the African countries, in order to evaluate the risks and opportunities, as this is still an unexplored matter.

2.4.1. General Approach to Venture Capital

According to Megginson (2004:3), Venture Capital can be defined as "*a professional managed pool of money raised for the sole purpose of making actively-managed direct equity investments in rapidly-growing private companies, and with a well-defined exit strategy.*"

This is a very recent concept, as only in the second half of the 20th century it started to be developed in a more formal basis. Before that, it was the domain of wealthy individuals (Business Angels). Its boom was reached in the 60s and 70s in the U.S., where venture capital-backed companies such the ones in the Silicon Valley (for instance Apple, Compaq, Intel and Microsoft) developed innovative technologies and attained a tremendous growth.

The importance of Venture Capital is especially perceptible in the U.S., as it accounts for 21% of its GDP (NVCA, 2009). VC is also associated with job creation, economic growth and with the creation of opportunities for further innovation within an economic sector or geography. As a result, it has been contributing directly and indirectly to an efficient development of the economies involved.

Concerning the developing countries, there is a scarcity of information available there. The amount of venture capital has grown steadily since the 1990s, but this increase has been more relevant in Asia and Central and Eastern Europe. Moreover, the total amount is disappointing comparing to the total value of foreign investment that has been flowing since then. Aylward (1998) also refers that most of the times venture capital in developing countries is, in fact, high-risk debt financing.

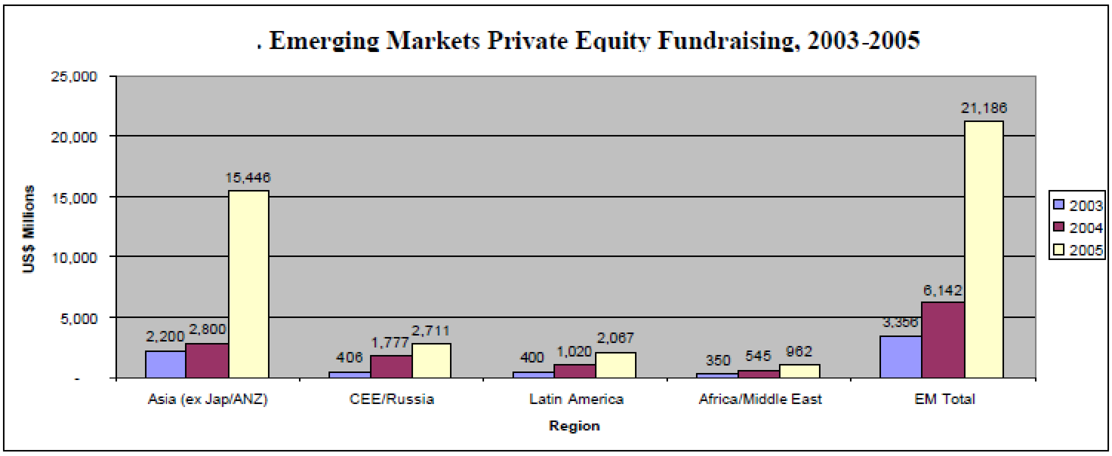
In order to encourage entrepreneurship and private equity financing, Megginson (2004) suggested that some changes have to be carried by these countries, to adopt some features that countries with vibrant VC markets have (U.S.A., Canada, Israel, Great Britain and Switzerlad):

- A tradition of entrepreneurship & risk-taking
- A well-established legal system, with good investor protection
- A supportive, but non-interventionist, government

- A stable regulatory system, that does not penalize start-ups
- A free (and mobile) labor market, rich in engineering talent
- A non-punitive taxation regime that allows use of stock options
- A strong R&D culture - especially in universities or national laboratoriess
- A vibrant IPO market, though this could be a result, rather than a precursor of a strong VC industry.
- A funded pension system, with risk-tolerant institutional investors.

2.4.2. Venture Capital in Africa

Figure 2: Emerging Markets Private Equity Fundraising, 2003-2005



Source: Ernst&Young, 2005, quoted by Ayman Ismail (2009).

If we look more specifically at the African Venture Capital industry, represented in Figure 2, it is still in its early years. Although it has been growing increasingly in the last years, it has the lowest importance in the emerging markets VC industry framework. It does not have transaction types such as Management Buyouts (MBOs) or Leveraged Buyouts (LBOs) yet and even Initial Public Offerings (IPOs) are extremely improbable due to the low capitalization and turnaround of African Stock Exchanges. Only four African stock exchanges have a market capitalization larger than $50 Billion and most of them do not have the liquidity to support an IPO greater than $100 Million (UN, 2000). One of them is the Johannesburg Stock Exchange, which accounts for nearly 90 percent of the total value of sub-Saharan Africa's market capitalization. These stock exchanges face constraints to their growth and development such as few national companies and small average company size. According to UNECA (2007), there are 21 stock exchanges in Africa (in 57 countries), but these markets are characterized by:

- Illiquidity;
- Lack of integration with regional and global markets;
- Range of capacity and technological constraints.

According to the African Venture Capital Association (AVCA), in 2005 the top 3 exit routes were sale to management, sale to other VC company and trade sale. In the same year, only 1 in every 126 exits was made by an IPO. This leads to a still minor importance of the African VC industry compared to the leader VC industry, as it can be observed below:

Table 3: Comparison between the African continent and the U.S.A in terms of Venture Capital industry

	Africa	U.S.A.
Area	30 Million Km2	9 Million Km2
Population	921 Million	296 Million
Capital Under Management	$12-15 Billion	$261 Billion
Fund raised in 2005	$0,55 Billion	$27 Billion
Amount invested	$0,75 Billion	$23 Billion
Contribution to GDP	0,075%	16,6%
Funds raised from Foreign Investors	80%	Less than 5%

Source: NVCA, AVCA and The World Bank (Data from 2005)

Analyzing Table 3, although Africa is over 3 times larger than the U.S., both in population and area, the capital under management, fund raising and amount invested are practically insignificant compared to the American one. Also, the huge amount of funds rose from foreign investors in Africa points to a major lack of funds available in the African territory, which come mostly from Foreign Direct Investment. This indicates that another feature of African venture capital funds is that they are more frequently supported by governmental and multilateral agencies. According to a

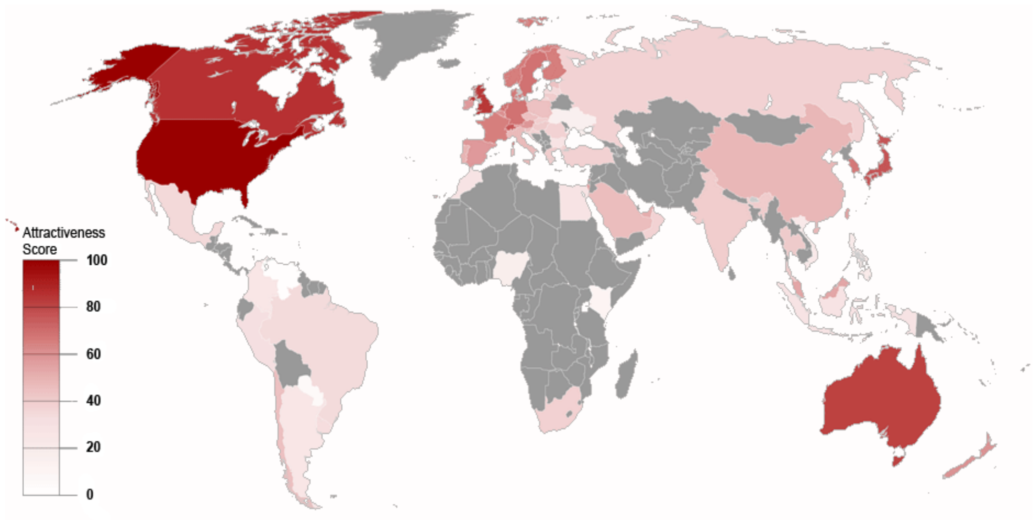
UNCTAD report on Small Businesses in Developing Countries (2001), this kind of activity is supported mainly by:

- World Bank Institutions (IFC – International Finance Cooperation, SEAF – Small Enterprises Assistance Funds);
- Development Banks (ADB - African Development Bank, EIB – European Investment Bank);
- International cooperation agencies (USAID – United States Agency for International Development, CDC – Commonwealth Development Corporation, AFD – Agence Française de Développement).

There are some independent investors, but usually they manage very small funds. Most investments actually made are in tourism or agriculture, sectors with a relatively safe and rapid payback.

To aggravate this situation, Africa attractiveness to Venture Capital is almost inexistent and it is concentrated in a small number of countries, such as South Africa, Nigeria and Egypt.

Figure 3: The Global Venture Capital and Private Equity Country Attractiveness Index



Source: Alexander Groh, Heinrich Liechtenstein and Karsten Lieser, 2011 (http://blog.iese.edu/vcpeindex/)

2.4.2.1. South Africa

According to Inbona (2002), it is probable that the South African Venture Capital market represents at least 50% of the total African market. Although this market has been growing steadily in the last years and it has been well researched by venture capitalists, it is still minimal compared to the American and European VC industry.

According to the South African Venture Capital and Private Equity Association (SAVCA), in 2009 there were about $14 Million under management. These venture capital-backed firms had a major role in the South Africa development:

- Contributed to employment of 5% of South African formal sector employees which equals to around 427 000 jobs;
- Performed a growth in exports of 31% per annum, on average, compared with 24% nationally;
- Achieved an average R&D expenditure growth of 7% compared to 1% for JSE listed businesses.

In social terms, it has been extremely important to the Black Empowerment Enterprise (BEE). Post-investment, the number of BEEs nearly tripled: 72% were black-owned, black-empowered or were community or broad-based enterprises.

2.4.2.2. Nigeria

Due to its large population and market size, Nigeria is one of Africa's most popular choices to employ capital. Although it is still in a very early stage (with only $75 Million under management), there have been some attempts to organize the VC industry as there has been a wide recognition of the potential of VC to the economic growth.

- The Nigerian Venture Capital Exchange has been set up, which is a forum that helps investors and entrepreneurs make the necessary contacts.
- Nigeria's banking industry has established the Small and Medium-Scale Industries Equity Investment Scheme (SMEIS) to fund the country's troubled businesses.

2.4.2.3. Egypt

It is estimated that Egypt's private equity investments are of about $2,6 Billion, which is significantly higher than the surrounding region. The main reasons are its high-growth economy and its well-established stock-market, which is the top five in Africa, according to its market capitalization. The opportunities stand mainly on its physical proximity to the developed countries.

2.4.3. Difficulties and Opportunities in the African Venture Capital Investment

After the analysis of the circumstances of the African Venture Capital, it can be observed that there are some impediments when investing in it. The main weaknesses and threats that justify this reality are portrayed in the following SWOT Analysis:

Table 4: SWOT Analysis of the African Venture Capital industry

Strengths • Continued economic growth across the continent • Increased stability and favorable policies shifted perceptions of the region • Before the financial crisis, investor confidence in Africa was increasing, as was Africa's understanding of the VC/PE offering	**Opportunities** • Historical underinvestment in infrastructure and resources, and growing adoption of PPPs by African governments • Under-banked population with rising incomes, improved access to credit and increasing spending tendencies
Weaknesses • Large geographical region characterized by significant differences in culture, language, legal and regulatory systems across the continent • Small number of pan-African funds competing with larger number of regional specialists • Transaction activity is driven by a few countries, mainly South Africa and Nigeria • VC/PE is dependent on foreign investors who often prefer other emerging markets • Preference of debt and public equity markets over VC/PE funding	**Threats** • A protracted global recovery could limit growth across the continent, and restrict financing and fund raising initiatives • Political risk, lack of transparency and immature regulatory and legal systems are likely to continue to act as barriers to VC/PE activity

Outlook

- Recovery from recession in Africa may lag global recovery
- PE investment activity expected to increase again in 2010

Source: Graham Stokoe, Associate Director, E&Y South Africa, 2011 (http://blog.iese.edu/vcpeindex/africa/)

The main problems that delay Africa's development today are often associated to economic factors (poverty, debt, trade flows, poor infrastructure), political factors (war, lack of democracy, corruption, legislation, institutional capacity), social factors (culture, urbanization, public health, AIDS) and ecological factors (drought, desertification, deforestation, pollution). All these factors lead to an amplified image of high risk for foreign investors to apply their funds.

According to Inbona (2002), the key risks that African venture capitalists face, but if thoroughly understood are critical to ensure attractive returns over time, are the following:

- **Exit Risk**

This problem is the most important risk, due to the absence of liquidity and low market capitalization of stock exchanges. So, an IPO is not yet a viable exit option (except for South Africa, and even there in the last years there has been a lack of this type of operations).

However, the author argues that this risk may not have such a high influence on an investor's decision, when considering the range of other emerging markets. In Latin America (between 1995 and mid-2000) and Asia (in 1998 and 1999), where VC industry is much further developed, only about 7% of the VC investments were exited. Moreover, he suggests that some exit issues should be addressed upfront, in order to prevent this situation, such as:

- To focus on sectors that are more likely to generate an exit (media or telecom, instead of a real estate investment);
- To include the exit clauses in the VC deal structure;
- To prepare the entrepreneur to the reality of the exit;
- To identify all potential buyers in order to generate competition for a deal;

- To be creative (equity-to-debt conversion, royalties/management fees, accelerate interest payments, …)

The consequence is that as there are few possibilities for exits from equity investments, investors have focused on debt instruments that are appropriated only for cash flow generating companies.

- **Country risk**

Before investing in an African country, one should carefully identify the possible political risks. In Africa is not uncommon to find countries where democracy is not yet established (although general environment has improved, with democratic elections and improvements in the national law) and where an ongoing war disrupts the economy.

Figure 4: African Democracy Ratings

Source: The Economist, 2010 (http://www.economist.com/node/16640325)

As figure 4 indicates, there are still few African countries where full democracy can be found, prevailing the authoritarian regimes.

- **Currency risk**

The high inflation and currency depreciation that characterize most of African countries have to be taken into consideration once they can significantly change investment yields over a typical three to five years holding period. However, there are also the CFA block of countries (linked to the Euro) and some others, like Kenya, which experience relative stability.

- **Legal risk**

The law enforcement is sometimes problematic due to the lack of capacity and corruption. Moreover, some African governments do not have an open-market philosophy or regulation that encourage outside investment.

However, Africa also represents a great investment opportunity, mainly because some of its countries' GDP growth has exceeded the world average growth for the past years[1]. After the success of the Asian "tigers" as emerging markets, some support that now it is time for Africa as it is the fastest growing region in the world.

According to the World Bank's 2003 Global Development Finance Report, Africa currently offers "*the highest returns on foreign direct investment of any region in the world*". Together with a 2005 Deloitte survey called "Venture Capital Goes Global", where it is highlighted the fact that European and North-American Venture Capital firms are hunting for opportunities to invest abroad, namely in emerging markets, some conclusions can be attained about the potential of foreign direct investment in Venture Capital in Africa.

Most of African countries benefit from some characteristics that may facilitate the investment in the region (Campbell, 2009), such as:

- The continent benefits from the UK and French law based legal systems;
- There are increasingly sophisticated securities commissions and improved banking oversight;

[1] See Appendix 1

- It has a long history of private ownership;
- Privatization and private sector development policies have considerably improved the opportunities for investment in industrial activities;
- Improved economic policies, monitored by the international community.

In fact, Business Angels and family investors are not a new reality in African countries and have formed the foundation for the Private Equity market. More recently, European and North-American Development Financial Institutions contributed to the first wave of Private Equity/Venture Capital funds across Sub-Saharan Africa (except for South Africa).

Moreover, there are increasingly more opportunities for venture capitalists, as Governments are seeing this kind of investment as a means to promote the private sector development, for instance:

Nigeria

• **SM Industries Equity Investment Scheme**: banks set aside 10% of their PBT annually to invest in SME businesses;

Botswana

• **CEDA Venture Capital Fund** was formed in order to invest in VC and PE transactions. Independent private sector manager, with government pension Fund capital;

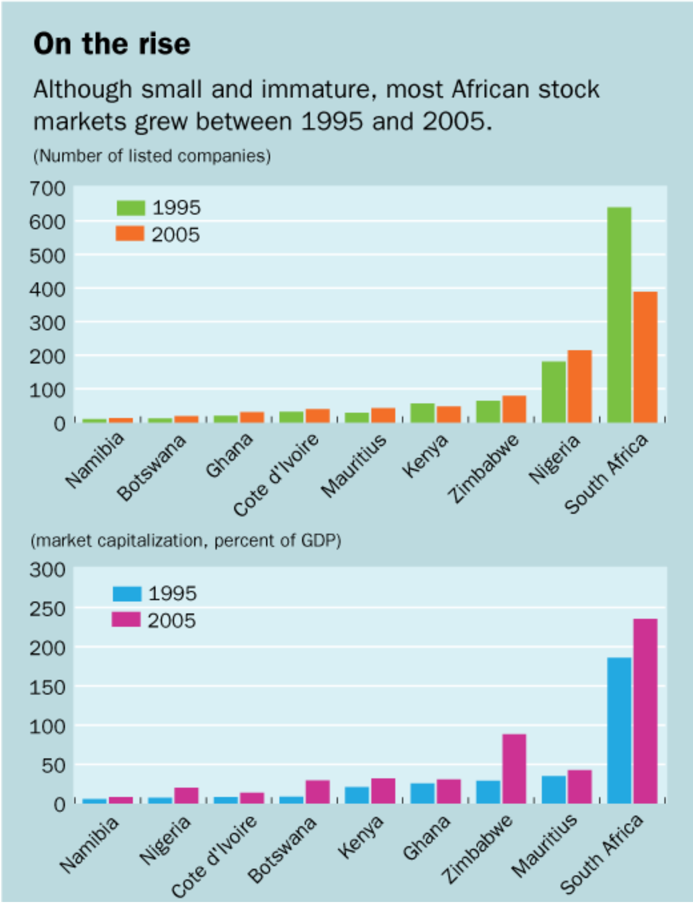
Namibia

• Bank of Namibia conducted study to look into VC/ PE Industry and impact on the economy.

(Moremong, 2006)

Additionally, the rise in the number of African stock exchanges indicates that a number of countries consider them important as a strategy to develop the national economy.

Figure 5: African Stock Markets Growth, 1995-2005



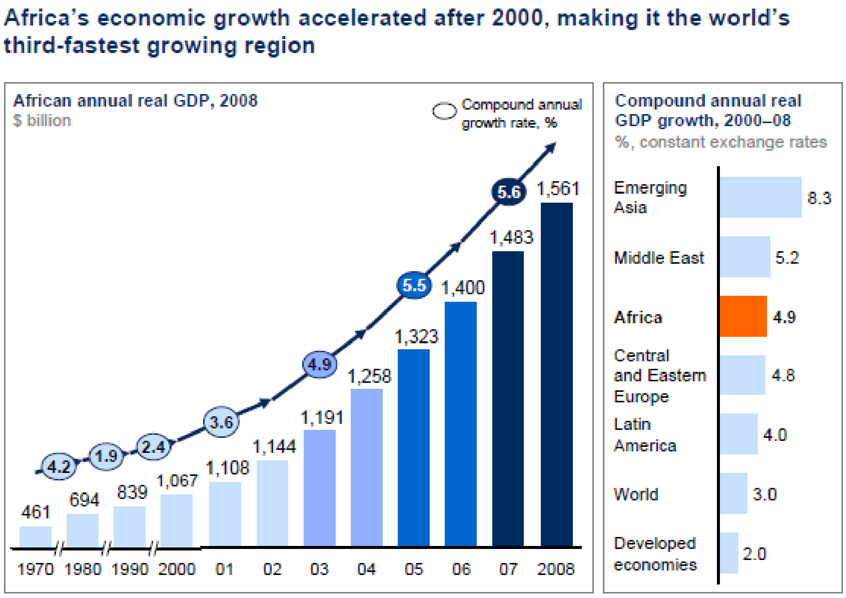
Source: World Development Indicators and staff estimates, quoted by the Charles Amo Yartey (IMF), 2007 (http://www.imf.org/external/pubs/ft/survey/so/2007/car1012a.htm)

According to UNDP, stock markets and other sources of financing (such as Venture Capital) can promote private enterprise expansion, which leads to a stronger national economic growth. A study carried by Paul Collier and Jean-Lois Warnholz of 2002-2007 financial data from all the African-based publicly traded companies (totalizing 954 for which data was available) shows that many of those firms are highly profitable. The main reasons are the low labor costs and gains in operational efficiency, leading to an average return on capital of those companies 65% to 70% higher than that of comparable firms in China, Indonesia, India and Vietnam and a median profit margin of 11%, better that the comparable figures for Asia and South America.

In fact, the political and economic environment in most African countries has changed radically in the last years. As it was mentioned in UNIDO's report on *Venture Capital for Industrial Development*, "*improved economic policies, monitored by the* *international community, privatization and private sector development policies have considerably improved the opportunities for investment in industrial activities*" (2001:3).

In 2010 the McKinsey Global Institute launched a report entitled *Lions on the move: The progress and potential of African economies*, where it was advocated the rise of the African countries and examined the sources behind their economic growth acceleration since 2000. Among the key findings, the fact that Africa's growth resulted from more than a resource boom, but from government actions to end political conflicts, macroeconomic conditions and create better business climates is one of the most relevant because it enabled the broadening of growth across countries and sectors, in a more sustainable and robust way. The continent's growth was so solid that it was one of just two economic regions (along with Asia) where GDP rose during the global recession of 2009.

Figure 6: Africa's economic growth, 1970-2008



Source: International Monetary Fund; World Bank World Development Indicators; Mckinsey Global Institute, quoted by the McKinsey Global Institute, 2010

Moreover, four structural trends that could support continued growth over the long term were predicted to develop:

a) Evolving global economies ties

There will be a global demand for oil, natural gas, minerals, food, arable land (Africa has 60% of the world's total amount of uncultivated, arable land) and other natural resources and this is will play into Africa's favor, as it has an abundance of resource riches. Moreover, it has long-standing commercial ties with Europe and it now conducts half of its total trade with developing economic regions.

b) Growing access to international capital

Africa is gaining increased access to international capital flows: foreign direct investment, bank lending and investor purchases of equity and debt securities from African issuers.

c) The rise of the African urban consumer

The high rise of urbanization, expanding labor force and the rise of the middle-class African consumer will be the new domestic engines of growth, as a consequence of these social and demographic changes. For instance, it was found that the shift from rural to urban employment accounts for 20 to 50 percent of productivity growth.

d) African green revolution

The Africa's agriculture production has an enormous potential to increase significantly through the use of new technologies and infrastructure. It was estimated an increase of the annual agricultural output from $280 billion today to $500 billion by 2020. The continent would benefit greatly from this, as a future worldwide run for agriculture products is expected.

2.4.4. Venture Capital as a Developmental Tool

Summing up, the main question in this study is: so why would anyone prefer to adopt a philosophy of developmental Venture Capital instead of using a normal Microcredit system?

The problem about Microcredit is about how it works. As it was mentioned above, instead of being used to create employment or to expand businesses, it is mostly used to smooth consumption and oriented to generate immediate income. These micro-entrepreneurs are unlikely to reinvest capital in their businesses and to take risks to grow significantly. The consequence is that there is no employment increase, no boost for economic growth (it requires higher investments) or for exploitation of economies of scale and no wealth creation. These are some features that would make the country richer and, consequently, significantly reduce its poverty.

However, micro-enterprises generally get more attention as donors seek to help the very poor. Support for these traditional microfinance models has helped to provide basic financial services to millions of poor people. But to help creating a dynamic and competitive economy, there is a need to pay greater attention to the potential of small and medium-sized firms to promote economic growth and, consequently, development. A traditional micro-loan cannot satisfy the needs of growing enterprises, that is why it was not found so far a correlation between the extent of a country's Microcredit activity and its economic progress.

Furthermore, a standard financial structure requires that part of the enterprise is also funded by equity and only a part can be financed by long and short-term credit. A highly leveraged entrepreneur will barely have capacity to obtain extra long or short-term debt, often required to a start-up or expansion phase, and will start directly to pay interest and amortizations, denying him/her funds in a phase when they are most needed. Private equity or venture capital investments combined with a vigorous support in technical and managerial issues, would be exactly what is needed for local entrepreneurs.

If entrepreneurs are successful in innovating, achieving scale in production, adding value to exports and reinvesting their profits, they can have a multiplier effect on employment (and the income effects associated with it will contribute directly to reduce directly) and overall economic growth, as it happened in the U.S.. Samila and Soreson (2011) studied a panel of U.S. metropolitan areas between 1993 and 2002 and concluded that the local supply of Venture Capital positively affects employment and aggregate income and found empirically that it also leads to economic growth. Quoting Groh (2009) in a study on Private Equity in Emerging Markets, "*What is valid for industrial countries should be even more important for emerging markets. The urgent need for capital especially for financing all kinds of infrastructure and communication* *in emerging markets is evident. The growth potential is enormous and deserves capital to be exploited.*"

Moreover, there are also some indirect effects that Venture Capital can have in a country's development, such as:

- Contribution to Government revenues

In comparison to micro-ventures, which are mostly informal and do not pay taxes, profitable small and medium enterprises generate income for the country. This income will be invested in education, health and infrastructure and will have an essential role, as most developing countries have a negative budget balance.

- Net Foreign Currency effects

The majority of the developing countries face problems connected with their large deficits of trade and current accounts: low foreign currency reserves, debt service incapacity and devaluation risks for the local currency. Therefore, through export revenues and substitution of imports, the enterprises will generate a positive impact in the country's ability to meet its financial obligations and stabilizing the exchange rate.

- Technology Transfer

Technology and know-how transfer occurs if a Venture Capital firms from an industrialized country invests in developing countries. This technology is the basis of improved productivity, which in turn contributes to sustainable poverty reduction by means of growth.

- Infrastructure effects

The establishment of new companies often requires investments into new infrastructure as well, which will have a positive effect on the private sector development.

(Summary report for BIO, 2009)

Venture Capital could help promoting the creation of a strong private sector in African countries and enable them to gain access to sustainable development and lasting social prosperity – thus, reducing poverty.

However, and as it was analyzed before, almost all developing countries lack this risk capital due to several risks that these markets represent. The most active performers are the development finance institutions ("DFIs") which, over the last two decades, have attempted to provide direct investment in the SME sector, venture capital programs and SME loan guarantee programs. For the other investments, potential returns on the SME sector in these countries are not sufficient to overcome professional management and considerable support.

2.4.4.1. The importance of SMEs

What distinguishes the most a Microcredit Project and a Venture Capital alternative in terms of development, is the fact that "The Missing Middle", what lies between informal ventures and Multinationals (SMEs), is probably one of the greatest hopes for the developing countries' economies to be dynamic and competitive. Its importance as job creator in less-developed countries was emphasized by Hu (2010), who found empirical results that supported that the SME sector benefits economic prosperity both in developed and developing countries.

In the developing countries the enterprise landscape is dominated by micro-enterprises and some larger firms, usually Multinationals. These micro ventures are mostly informal (which do not pay any taxes and therefore do not generate any revenue for the government), show very low productivity (because they do not achieve economies of scale), have little capacity to master improved technology and usually do not grow beyond their small scale. This is mainly because they are oriented toward generating immediate income and not to re-invest or to take risks.

In a 2003 World Bank's research on *Small and Medium Enterprises Around the Globe*, it was estimated that SMEs contribute on average to 51,5 percent of high income countries' GDP, contrasting with the low income countries' contribution of 15,6 percent. In contrast, micro-enterprises accounts for only 13 percent in high income countries' GDP and 47,2 percent for the low income countries. So, as income increases, the importance of the informal sector in the economy decreases. Moreover, it was also found a positive correlation between the size of a country's SME sector and the rate of economic growth.

The main reasons that lead to the SMEs' growth constraint in the developing world are related to corruption, infrastructure insufficiencies, difficulties in accessing technology, skills or markets and, mainly, restricted access to finance. According to the World Bank's *World Business Environment Survey*, the second principal global constraint for the worldwide SMEs sampled is financing. The sample was constituted of 10.032 enterprises in 80 countries. Specifically, if we focus on Africa, it would be the Leading Constraint, followed by Corruption and Infrastructure. Globally, while financing is identified as the second-leading constraint by small and medium enterprises, it ranks as fourth for large enterprises.

Table 5: Leading Constraints for the worldwide SMEs

	Leading Constraint	Second constraint	Third constraint	Fourth Constraint
World	Taxes and Regulations	Financing	Policy Instability	Inflation
OECD & Newly Industrialized East Asia (including China)	Taxes and Regulations	Financing	Policy Instability	Inflation
Transition Europe	Taxes and Regulations	Financing	Inflation	Policy Instability
Developing countries (Africa, MENA, East Asia Developing, South Asia, Latin America)	Corruption	Inflation	Financing	Policy Instability/ Infrastructure (tie)
Africa	Financing	Corruption	Infrastructure	Inflation
MENA	Policy Instability	Corruption	Inflation	Exchange Rate
East Asia NIC/China	Financing	Inflation	Anti-competitive practices	Policy Instability
East Asia Developing	Street Crime	Corruption	Inflation/Exchange Rate/Organized Crime (tie)	
South Asia	Corruption/Policy Instability (tie)		Inflation	Infrastructure
Latin America	Taxes and Regulations	Policy Instability	Street Crime	Financing
OECD	Taxes and Regulations	Financing	Policy Instability	Inflation
CIS	Taxes and Regulations	Financing	Policy Instability	Inflation
CEE	Taxes and Regulations/Inflation (tie)		Financing	Policy Instability

Source: Ayyagari, Beck & Demirguc-Kunt, 2003

As it can be observed in Table 6, the main Financing Constraint for the African SMEs is related to the high interest rates, which is a consequence of the soaring inflation existent in those countries. It is followed by the lack of collateral and lack of information to the credit clients. Compared to the other developing countries in Asia and Latin America, the main constraint is broadly the same, but the others vary, as poverty and lack of resources are some of the main characteristics in the African countries, leading to a lack of collateral by most of the firms and incapacity by the bank's staff to provide the accurate information.

Table 6: Financing Constraints (percent of firms rating constraint "major" or "moderate")

Financing Constraints	Africa	MENA	East Africa NIC/China	East Asia Developing	South Asia	Latin America	OECD	CIS	CEE
High interest rates	83.5	67.4	40.3	72.5	83.9	87.6	47.8	80.6	79.5
Lack access to long term loan	n.a.	n.a.	31.2	52.0	65.1	63.1	20.0	58.7	67.0
Collateral requirements	519	45.2	30.1	43.6	58.5	65.1	35.7	49.7	52.2
Bank paperwork	47.1	51.6	29.9	34.6	56.6	63.0	38.9	52.9	48.3
Inadequate credit info on clients	51.7	46.3	27.0	48.4	46.7	46.1	23.5	40.1	41.6
Special connections	38.2	33.3	26.3	39.6	44.5	46.5	26.5	35.1	43.1
Banks lack money to lend	28.4	33.0	20.6	52.2	35.1	39.1	14.3	37.4	46.8
Access to specialized export finance	44.9	39.8	15.1	33.7	36.4	34.7	16.5	35.5	38.8
Access to non-bank equity	43.1	36.2	13.0	32.6	34.9	35.6	18.1	38.3	42.0
Access to lease finance	38.2	29.3	13.1	34.9	32.9	34.1	19.3	32.7	48.9
Access to foreign banks	43.6	29.3	11.7	41.5	33.9	35.0	11.1	35.3	40.4
Corruption of bank officials	23.5	27.4	19.0	45.1	28.9	18.6	5.7	24.3	29.3

Source: Ayyagari, Beck & Demirguc-Kunt, 2003

Further on, it is concluded that the survey findings suggest that key policy, institutional, and governance indicators are linked to important outcomes, including the growth of firms' sales, as well as the growth of investments and the size of the unofficial or informal economy.

To sum up, to make the poor not poor (and not less poor), it is required to create employment sustained by a productive economic activity: a "*vibrant indigenous private sector*" (Patricof and Sunderland, 2005), which, rather than supporting basic income generation, would stimulate the creation of employment and wealth. This is why developing countries, and specially Africa, need to be sustainably pulled out of the poverty trap. If the private sector is effectively developed, then those young businesses must grow to become larger and become the established institutions that can truly make a difference on employment.

2.5. Existent Developmental Venture Capital Funds

The purpose of this chapter is to provide some guidance about how a developmental venture capital fund should function, based on the study and analysis of some successful fund cases.

The first case has been developed in Nicaragua, and it is the only one selected outside the African borders, as it is the single academic study published (in the Journal of Business Research) found that focus specifically on this matter (Venture Capital as means to development in the developing countries).

Subsequently, it is also presented some African funds, which information was found mainly in their official websites and also in a few developmental agencies webpage (such as the IFC and the World Bank).

2.5.1. Agora Partnerships Nicaragua

2.5.1.1. Introduction

This case is almost certainly the one that can teach us more how to deal in a kind of fund in developing countries and with developmental purposes. Agora partnerships is a micro venture capital fund founded in Nicaragua in 2005, with the purpose to "*launch and grow socially-responsible companies in poor countries.*"

What we can learn derives mostly from the fact that the managers are aware that there is a need to adapt the principles of Venture Capital to the context of Nicaragua. What works in the developed world can provide some guidance, but it should not be totally reproduced, mainly taking into consideration the exit strategies.

Another issue that should be bore in mind is the fact that institutions linking economic development and Venture Capital are rare. Consequently, the interdependence between development and venture creation is often ignored, magnifying the financial gap already existent. This access to financing is a major barrier for entrepreneurs in Nicaragua, as formal banking system does not lend to start-ups and hundreds of microfinance institutions serve the "poorest of the poor" in their micro-ventures.

2.5.1.2. The fund's managerial

e) Parent institution: Washington, DC

- It aims to facilitate a more-global reach and future replication in other countries;
- Core responsibilities: establishing global partnerships, matching MBA student groups and entrepreneurs, fundraising, advocacy and improving and replicating the model.

f) Affiliate: Managua, Nicaragua:

- It aims to maximize local participation in Nicaragua;
- Core responsibilities: selecting the Agora entrepreneurs who will receive consulting, managing that process, providing local education and advocacy and managing Agora's incubator services to support the portfolio firms that received investment from the Agora fund.

g) The Agora Fund:

- Raised from private capital, mostly towards foundations, private donors and the Inter-American Development Bank (IADB);
- The managing partners hope to raise $500.000 for the first fund;
- The fund plans on investing $25.000 to $125.000 per venture, which will be employed to support of 5 to 7 new businesses.

2.5.1.3. Some of the main issues

What kind of control should Agora have over its ventures?

One dilemma that Agora faces is the fact that, given Nicaragua's lack of entrepreneurial culture, many entrepreneurs can feel threatened by giving away their ownership and control. This leads to a risk that they will lose incentive to maximize their effort in the star-up phase. However, entrepreneurs are unlikely to reach majority (51%) ownership because they cannot come up with the needed equity. Moreover, entering the investments with a majority stake would guarantee reasonable returns to Agora and complete control over new ventures – for at least the initial period, the entrepreneur will follow the directives set by Agora.

The agreement reached is that, preferably, Agora has a minority position. In case the entrepreneur does not come up with enough capital to reach the majority position, Agora will take a majority stake. But it will always make sure through incentives and shareholders' agreements that "*the entrepreneur feels completely in charge of his operation.*"

What is the most feasible exit strategy?

As it was mentioned before, an IPO is not a viable exit strategy and the companies are not large enough for a MBO or LBO. After analyzing these more traditional exits, including, for instance, wholesalers and distributors looking at vertically integrating their businesses or foreign investors hoping to expand revenues, Agora believes that these strategies are not reliable.

After taking this in consideration, Agora team decided that they will try to look for a dividend-based exit:

- When the cash situation and the forecast for cash requirements in the coming year is good enough the company will pay dividends;
- The amount of dividends disbursed must be a proportion of the cash requirement for the following year (to not cash-starve the business in the first years of development);
- The entrepreneur will receive his shares of dividends and use the money to buy back Agora shares until the entire stake is bought;
- Agora will hold a put option on each of the fund's shares that Agora can exercise every year in an amount equal to the dividends that the entrepreneur receives for that year.

How much should the IRR be?

When evaluating an investment, Agora targets a 25% IRR.

The difficulty about targeting an IRR in this kind of situations is that, on one hand, foundations and private donors usually provide non-for-profit organizations with grants and do not expect to monitor anything but the social impact that their disbursements generates. However, Agora wants to achieve a market-based dynamic to demonstrate the model's financial sustainability and the aspiration to later harness the angel investor community.

On the other hand, committing to a low IRR increases the likelihood for success. However, it also can mean the model's limited capability to deliver commercial returns, which limits future access to the desired investors.

2.5.1.4. Conclusion

The importance of analyzing this case lies on the fact that many conclusions can be employed in other funds of this kind. The IRR, exit strategy and kind of control approaches are quite feasible for other Venture Capital funds with developmental objectives and can be transposed to them. Moreover, there are many issues addressed in Agora fund case that exist in other developing countries that one should be aware of when considering the operating rules.

2.5.2. SOVEC Foundation

sovec
Social Venture Capital Foundation

2.5.2.1. Introduction

SOVEC Foundation was founded by Dutch entrepreneurs to "*stimulate sustainable economic development in developing countries and alleviate poverty*". There are two ways to achieve this purpose: Social Venture Capital Fund I (in which SOVEC Foundation holds a priority share) and direct support of projects that suit its goals.

The main objectives are to finance projects that structurally enhance education and health or other goals that satisfy generally accepted charity, by investing in African SMEs.

2.5.2.2. The SOVEC Fund

This Fund was set up to invest in small and medium sized companies in Africa. As the management team strongly believes that the stimulation of sustainable economic growth in Africa can be best realized by private sector development, the best solution will through SME's investment. All their philosophy is accordingly to what was supported before: "*Venture Capital (VC) fills the gap between micro finance and bank finance. VC is based on a long term and risk-sharing commitment from the investor and reduces the SME's burden of high interest payments. SME's (in developing countries) have no or limited access to growth capital.*"

Like in Agora Partnerships, SOVEC also tries to combine social goals through a business approach, pursuing a normal financial return. In order to SOVEC to be sustainable, there is a need that the projects are economically viable and that should generate enough financial return. As they recognize the huge potential of the African continent and its people, the challenge is how to use this potential in order to benefit both African people and their investors.

SOVEC's first fund is focused on Ghana for its "*political stability and good economic development*". The advantage of canalizing their efforts in Ghana lies on the fact that since 2002 the Ghanaian Government has embarked on a program to encourage the development of a Venture Capital industry in Ghana, in order to stimulate the private sector and to enhance access to long term capital. Moreover, some specific fiscal and legal incentives for Venture Capital funds and investors of such funds have been announced.

2.5.2.3. The Investment Policy

SOVEC not only invests capital, but also shares relevant experience, industrial expertise or business contacts in the international market, by linking an entrepreneur to the local SME. It also cooperates with local investment partners to provide expertise related to doing business in their environment, to have a professional team on the ground and assist in project generation, analysis and monitoring.

When selecting the SMEs in which to invest, the SOVEC team takes the following guiding principles into consideration:

- To invest in SMEs with a track record, that are either profitable, stand alone businesses or have the potential to become one;
- To invest in businesses that have the capacity to stimulate the regional economy and create employment;
- To choose entrepreneurs that combine successful business attitude with a sound social attitude;
- To do not exclude star-ups (if they have an excellent team);
- To invest between €50.000 and €500.000 per company and provide both equity and debt;
- To obtain a (significant) minority stake so the entrepreneur maintains the leading position.

One of the best features of SOVEC's strategy lies on the fact that it combines the expertise of business partners with more experience and important contacts (from the developed countries) with the regional knowledge of local investment partners, who can take an active approach in monitoring and managing the ventures.

2.5.3. BIO – Belgian Investment Company for Developing Countries

2.5.3.1. Introduction

BIO is a private company whose capital is held by the **Belgian State** (Ministry for Development Cooperation) and the **SBI/BMI** (Société Belge d'Investissement International S.A. – Belgian Corporation for International Investment) each holding 50%. Its early stage capital amounts to €5,000,000 and it makes investments using additional equity granted by the **Ministry for Development Cooperation**.

The mission of BIO is to "*promote the creation of a strong private sector in developing and/or emerging countries, to enable them to gain access to sustainable development and lasting social prosperity and thus reduce poverty*."

Although BIO reaches all the developing areas, Africa has remained the most important investment region. In 2009, 14 of the 28 new projects were carried in Africa and the highest commitment volume was also achieved in Africa (€21,8 Million, 34% of total commitments). This is due to the fact that it is where the private sector is still at low scale and the investment climate is especially challenging. BIO is focusing on the Low Income Countries (LICs) because, from a development point of view, these countries are of special importance to fight poverty. One of the main goals is to increase investor's confidence in the economies of LICs, which will help them attract further investment (signaling function for the capital markets).

Similar to the organizations mentioned above, BIO also focuses on SMEs (93% of BIO commitments) rather than micro-enterprises, as catalysts to enhance competition and entrepreneurship, to create jobs and to transfer know-how.

2.5.3.2. Types of finance used

BIO uses a series of financial instruments designed to expand already existing organisations or to help companies to set up in business and which can be adapted according to requirements and the local situation.

1) **Equity and quasi-equity stake**

BIO always takes a minority stake. It also uses quasi-equity (mezzanine capital, subordinated loans, convertible loans, etc.) to strengthen the financial resources of up-and-coming companies, without diluting the position of its shareholders.

2) **Long-term loans**

BIO offers a wide range of direct medium- and long-term loans at both fixed and variable rates. Their term can vary between 3 and 10 years, with a grace period of 3 years maximum.

3) Guarantees

BIO's signature is a guarantee of solvability and facilitates the mobilization of resources by private sector borrowers by guaranteeing certain obligations on their behalf.

4) Local currency

BIO can finance projects in local currency in order to reduce the risks linked to exchange rates and interest rates for its clients.

2.5.3.3. Investment Policy

Although BIO's strategy focuses on 3 sectors (the financial sector, enterprises and infrastructure projects), when focusing on the enterprises' sector, it can be found how the Venture Capital feature of BIO in conducted. It takes into consideration the following guidelines:

- BIO provides financing in EUR, USD or in local currency for a minimum amount of EUR 300,000 per project;
- Loan maturity may vary between 3 to 10 years, with a maximum grace period of 3 years. BIO operates on commercial grounds. Maximum intervention in a project is limited to 50% of the total investment cost;
- In the case of equity investments, BIO is never a majority shareholder. BIO yields its share to other shareholders, to a third party or to the financial market once the company has achieved a sustainable level of maturity, enabling it to strengthen financially and attract funding from other sources;
- The beneficiaries are local SMEs and large companies with local base;
- The institution must be headed by an experienced management; it must be profitable or, in the case of a new business, forecast profit for the near future.

Although BIO's strategy reaches two other sectors, they are also aimed at developing the SME's sector: the financial sector investments aims to allow local SMEs to obtain long-term finance and the infrastructure projects investments intend to fulfill the businesses requirements of a good quality infrastructure to work efficiently and as a result boost local economic growth.

2.5.4. Guidance and Conclusion

After crossing the analysis about Venture Capital in general and in Africa in particular with the examples provided by the funds above, which result has been, so far, extremely positive, some guidelines can be considered about how to run a Venture Capital fund in a developing countries with development purposes:

1. It should be used a combination between Equity and Debt;
2. There is a cooperation between fund managers from developed countries, who bring the know-how, and some local partners, who know the area surrounding;
3. The investments are never below 25.000€;
4. Due to control issues by local entrepreneurs, the organization usually never holds a majority stake;
5. It should be find an alternative exit strategy, which best fits the local context;
6. It should be chosen carefully the enterprises in which to invest, taking into consideration their capacity to stimulate the regional economy and create employment;
7. It should not be forgone profit purposes.

III. The Case Study

3.1. Introduction

Venture Capital as a development tool is still sprouting and it would be almost impossible to test its efficacy and legitimacy based on some already existent funds that are in an initial phase. Therefore, it was considered that a field approach would be more effective, in order to examine its difficulties and opportunities.

For this purpose, there was already a project created in 2009 by an ISCTE Professor, who was also aware of the drawbacks existent in Microcredit schemes, consequence of the high interest rates and the lack of support to the beneficiaries during its execution. The main principle was the possibility to share risks between businesses that achieved a profit above the expected one and the ones which did not have a positive outcome.

3.2. Methodologies

Case studies are a tool that can be used to provide description, test theory or generate theory. They have been defined as "*a research strategy which focuses on understanding the dynamics present within single settings*" (Eisenhardt, 1989:534) or "*research situations where the number of variables of interest far outstrip the number of datapoints*" (Yin, 1994:13). In this case, the project's performance should be analyzed in the light of the context where it is taking place: the culture, the macroeconomic background, the entrepreneurship opportunities and the support given to the enterprises, among others.

Concerning the data collection, it was combined various methods: interviews, direct and participant observation, questionnaires and observations, not only in what is directly linked to the project's beneficiaries, but it was also conducted interviews to members of the local bank, the national bank (BCSTP), a few NGOs and various members of the community, in order to develop a deep detailed characterization of the surrounding environment. The evidence collected was both qualitative (concerning all the context description) and quantitative (the evaluation of the project's performance). Although quantitative data is important to reveal relationships which may not be evident, qualitative evidence may also have a foremost important role in order to understand the rationale underlying these relationships or may indicate directly theory which can after be reinforced by quantitative support.

Furthermore, as suggested by Eisenhardt (1989), the study was conducted by more than one person, in this case two economics master students: Raquel Veiga, focusing on the social impact, and the author focused on the financial sudy. Using multiple investigators can have some advantages, such as to enhance the creative potential of the study and to increase the confidence in the findings. This was especially useful when conducting the interviews, as there was one researcher handling the interview questions, while the other recorded notes and observations: "*the interviewer has the perspective of personal interaction with the informant, while the notetaker retains a different, more distant view*" (Eisenhardt, 1989:538).

3.3. The Entrepreneurship Context in São Tomé and Príncipe

3.3.1. A country's outlook

The Democratic Republic of São Tomé and Príncipe is a Portuguese-speaking African island nation. It is the second-smallest African country in terms of population and one of the smallest countries in the world, with a population of about 150.000 people and an area of around 1.000 Km^2.

Politically, it has worked as a multiparty system since 1990, being a dictatorship before that. There has been some political instability after that, as until now there have been three coups d'état and more than ten different governments.

Concerning its economy, since the 19th century it has been based on plantation agriculture. At the time of independence, in 1975 Portuguese-owned plantations occupied more than 90% of the cultivated area. After that, control of these plantations passed to various state-owned agricultural enterprises. The main product exported is cocoa, representing about 95%. Other exports include copra, palm kernels and coffee.

One of the main economic concerns deals with its enormous debt (resulting from the imports) and its dependence on foreign aid from donors as the World Bank, the UNDP, the European Union, Portugal and other countries and international organizations.

3.3.2. Financial System in STP

The financial sector in STP is still very embryonic and there is not a wide range of financial products provided. The commercial banks only offer the most basic financial services: monetary exchange, deposits and credits. There is a profound lack of investment opportunities, starting with the fact that there is not even a prospect of a Stock Exchange.

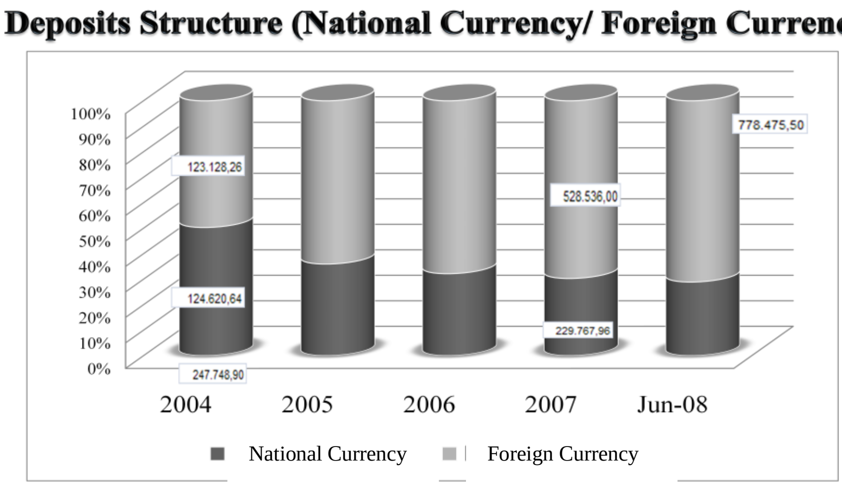
Up to 2003, the Banco Internacional de São Tomé e Príncipe (BISTP) was the only private commercial bank operating in STP. This bank is Portuguese owned (by Caixa Geral de Depósitos) and it is still the prime banking institution. However, in 2003 there was an anticipation of oil revenue and the First Afriland Bank (Cameroonian owned) started operating in the banking sector, followed by Banco Comercial do Equador (Angolan owned), in 2004, which made BISTP monopoly come to an end. Until today, other 6 commercial banks were opened, creating a more competitive banking market. Subsequently, at the moment the financial sector design is composed by the STP Central Bank (BCSTP), 9 commercial banks and 2 insurance companies.

As a consequence, BCSTP has been strengthening the banking supervision, mainly in the application of prudential standards. Especially in the last 2 years, there has been a continuously strong growth in the credit to the economy, along with an increase of the ration of non-performing loans to total outstanding loans (7.9% in December 2008 to 19% in July 2009). In 2010 some reforms have been carried by the Central Bank in order to reduce the risk of distress in the banking system. It was already implemented a regulation to increase the minimum capital of banks and regulation on the intervention of financial institutions, which included a full assessment to all commercial banks. Another accomplishment being carried is to implement the Credit Reference Bureau, which facilitates credit information sharing among banks, in order to increase the financial system efficiency. Finally, other reforms intended to be held by the BCSTP include the introduction of a network of automatic teller machines and debit cards, as well as the preparation of a framework to facilitate mergers and acquisitions among banks. All of this reorganization has been carried with IMF's technical assistance. These last developments intend to "*improve the payments system and the productivity of the banking sector*" (IMF, 2010:7). This was reflected in the slowdown of money circulation and in the renewal of the confidence in the banking system.

Although there is more competition in the financial system, this sector is still not easily reached by all population. The main rationale is connected with the extremely high interest rates applied by the Commercial Banks, which are linked to the inflation rate in the last years. This leads to one of the largest gaps between lending rates and saving rates in sub-Saharan Africa: 31,20% (6 months credits) against 11,29% (6 months deposits) in December 2009. Even though the bank credit has been increasing in the last two years (23% growth rate in 2008 and 40% in 2009), it is still much undeveloped since there is no land ownership law due to a recent privatization land reform, after the end of the socialist regime, which limits the collateralization. Moreover, there is an inappropriate legal framework to the banking and financial sectors, which has been invariable since 1992.

Another important constraint in the banking system is the fact that it is highly dominated by foreign currency (Dollar and Euro), which has been weakening the BCSTP control over the monetary aggregates. As it can be analyzed, deposits in foreign currency advanced from about 40% in 2004 to over 70% in 2008 of commercial banks' deposits liabilities. Hence, BCSTP has made some reforms in order to limit the net open foreign currency positions.

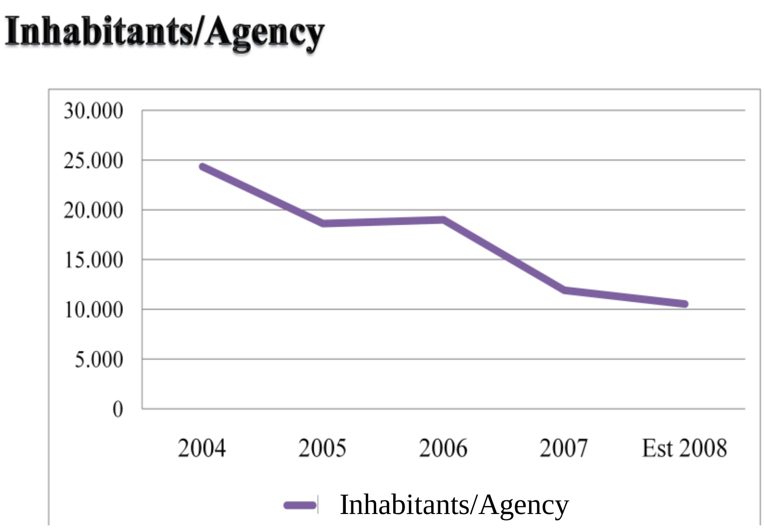
Figure 7: Deposits Structure in STP



Source: Banco Central de São Tomé e Príncipe, 2008

An additional important issue to be considered is the low bancarization level of the national economy (14%), which reflects the banking and financial services penetration level in the country. There are two main indicators: the low "banking net density" in the country and the high quantity of fiduciary currency that circulates. The first one is concerning with the number of inhabitants per bank agency, which was 10.500 in 2008 (whilst the international pattern is about 5.000). However, there is a tendency of improvement in recent years, as it can be analyzed in figure 8.

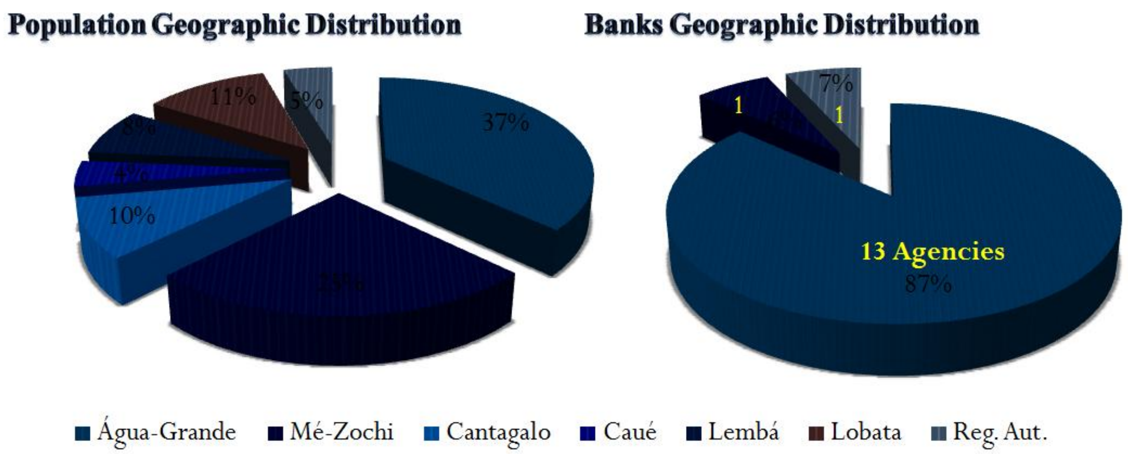
Figure 8: Inhabitants per Bank Agency in STP



Source: Banco Central de São Tomé e Príncipe, 2008

Moreover, these agencies are almost all located in the capital (São Tomé), which indicates an unbalanced geographic distribution because the secondary cities and the rural areas do not benefit from the basic financial services.

Figure 9: Population and Banks Geographic Distribution in STP



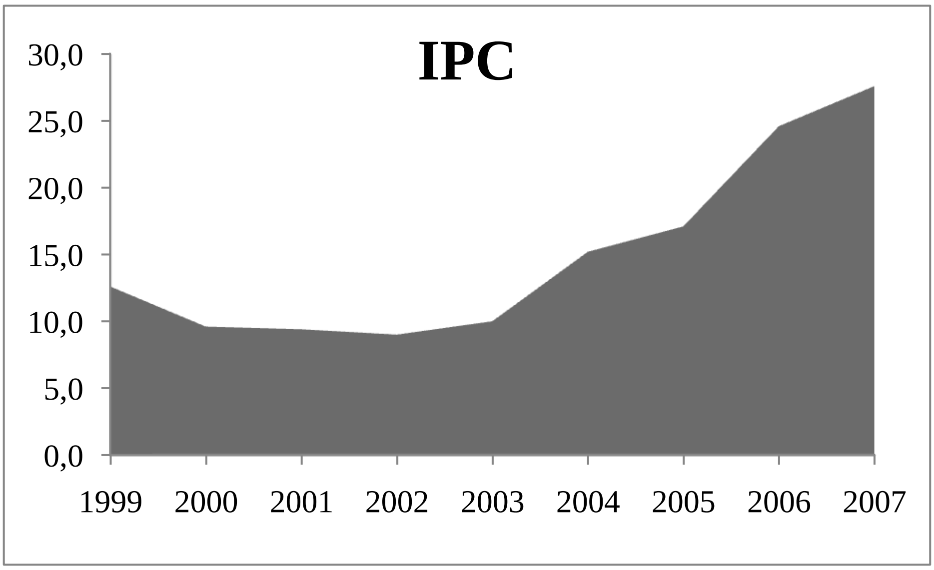
Source: Banco Central de São Tomé e Príncipe, 2008

The Central Bank has dedicated most of its attention in this matter because the banking system developmental stage usually depends on the economic growth of the country. STP, in spite of having an annual economic growth around 6%, does not present a significant increase in its banking system development. One alarming indicator is the monetary multiplier, which is not having a significant growth. Thus, it may confirm that the commercial banks have not been very active as financial intermediates.

However, the scenario is not as dark as it seems to be. There are some signs of evolution, such as the increasing competitiveness in the banking system and some growth in all the monetary aggregates in the last years.

Therefore, what leads to this setting? The main factor is the far above the ground inflation rate, which has been rising sharply since 2003, and derives mostly from the Consumer Price Index evolution. This leads, not only to a high cost of requesting for credit, but mainly to a financial instability that do not allow financial markets to develop in their whole potential.

Figure 10: Consumer Price Index in STP, 1999-2007



Source: Banco Central de São Tomé e Príncipe, 2008

Furthermore, there are other constraints in the country that do not allow the banking system to achieve a regular progress. Firstly, the legal affairs cannot be solved timely because the legal scheme is also undeveloped. Secondly, the banking system infra-structure is insufficient: there are barely alternative paying methods; there is few financial products diversification and the banking services costs are especially high. Both the active interest rates and the minimum amount required to open a bank account are prohibitive for most of the population. At last, but not at least, there is a soaring level of informal economy all over STP, which does not stimulate most of the people of having a bank account or using any kind of financial services. In fact, just recently the public employees started to have their salaries transferred to a bank account, which illustrates the low level of banking services consumption by the major part of the population.

Concerning this low bancarization level, BCSTP is considering some new challenges in order to improve it. One of them is implementing some new technologies to spread the financial services, such as creating ATM's, a platform to link all the financial intermediates' information and electronic paying means mainstreaming. Other initiatives regard providing banking services to rural areas and improving the legal framework.

3.3.3 The case of Neves

It was also important to analyze the financial scheme in Neves to understand why it was essential to provide the population with any vehicle which would promote the entrepreneurship.

There is only one bank established in the city, which provides financial services for all Lembá district. It is a branchy of "Island Bank" and has been in Neves for almost 2 years (although the Island Bank was inaugurated in 2004, in São Tomé). The main reason for its subsistence is due to the existence of a beer production company, which is the second employer in the country.

Due to the lack of financial activity in the country, this bank provides only the basic financial services mentioned above: deposit, credit, transfers and currency exchange. Its portfolio consists of almost 3.000 clients and considering that it ranges a total 15.000 population (the Lembá district), it can be verified that the financial services are not as extensive as in the Developed Countries. It is not common to open a bank account instead of keeping the money at home, mostly because of the lack of savings and information about the financial services.

This bank provides two kinds of deposits gaining interest rate: with a fixed period or not. It also provides two kinds of credit: Microcredit, which ranges from 1 Million Dobras (less than 50€) until 20 Million Dobras and has a period of 2 to 3 months; and Direct Credit, which is for loans over 20 Million Dobras with a period from one until one and half years. Although the first one is called Microcredit, it also requires some kind of collateral or a guarantor and does not have any kind of social purposes. According to the bank director in Neves, it is estimated that about 40% to 50% of credit requests by their clients are refused due mainly to the recent activity of the bank in Neves (which cannot afford a high risk of default) and to the existence of a high rate of defaulted credit. He also referred that it is not provided any kind of credit specifically to support a company creation or expansion since the national banking system does not offer financial services in the long-term. The maximum that can be provided is a 5-year loan and that would not be enough to recover the investment made in Fixed Assets. Additionally, when there is a credit request with a business purpose, it is almost certainly refused.

There is a also a type of informal financing, as the exchange dealers that one can find in the streets provide, as well, credit with a lower interest rate than the one practiced in the commercial banks. This happens because they have some correspondents (family/friends) in Portugal or in other African countries, where interest rates are substantially lower. Therefore, those correspondents ask for credit in their countries and that money is applied in STP, with a considerable gain for both parts. These loans may achieve an amount up to 10.000€ and sometimes they even make mortgages with their clients in the registry to cover those loans.

3.3.4. Alternative schemes to the entrepreneurship promotion

First of all, it is useful to refer the microcredit initiatives that have been developed in STP.

There is no regulation for Microfinance. Various attempts relating to Microfinance, the first in 1997, have not produced the expected results. A World Bank-financed study on micro-finance strategy is being prepared with the objective of assessing the real potential and policy to adopt with respect to Microfinance. This leads to several problems when trying to implement these projects, mainly concerning the installments charge.

One of the first attempts was when the African Development Fund established the Micro-and Small Enterprise Development Fund, which was based on the use of a commercial bank (for the financial intermediary) and an advisory support unit. It establish a new structure called Micondó, which played both the role of financial intermediary and advisory support and was satisfactorily evaluated by the AMINA project of ADB at least for the credit channeled towards the rural environment.

The UNDP also participated in Micondó and it was the only Microcapital initiative that they developed in STP. It was created in 2008, but it was only truly active for about one year and the interest rates were considered “low” (compared to the ones practiced in commercial banks), but still they were above 20% for a 6-months term. The main target was farmers and fishmongers and in the end they had 63 beneficiaries. It was not explicitly mentioned the reason for the failure, but one of the main problems revealed was the fact that, as there was not a specific legislation for Microcredit initiatives, it was difficult to recover the credits conceded. Another difficulty was the inexistent coordinated action concerning all the Microfinance programs.

There are other programs like this, but there is almost every time a direct relationship between Microcredit and genre matters, as a way to promote women. That is the example of Step Up, an American funded NGO, and AMEP-STP (Associação das Mulheres Empresárias e Profissionais). However, according to FONG (NGO's Federation in STP), Microfinance is one of the areas least mentioned by NGOs as their intervention focus.

The IMF recognizes that this is a critical matter, as "*reducing the cost of investing and doing business in São Tomé and Príncipe is crucial for developing our economy's productive and export potential*". The Government has already taken several steps to improve the investment climate, including revising the labor, commercial and customs codes. It has also created a "one-stop window" ("*guichet unico*"), which is a centre that reunites all the procedures to create a company in one place, and the central bank is in the process of establishing a credit reference bureau, as it was mentioned above. This is a consequence of the importance of an easier access to credit and to productive assets, so they can generate revenue and, most importantly, job opportunities to the poor. However, there are no public initiatives to foment the enterprises creation with capital until now. Any projects funded with external resources, including Microcredit, can only be financed by external organizations, such as the IMF, but they can never expect the Government to help them with that.

In fact, the difficult access to credit is one of the major barriers to the enterprises growth in STP. The report *Doing Business* by the World Bank, which investigates regulations that enhance business activity and those that constrain it, has classified STP as the 178th in a range of 183 countries, considering the ease of "doing business" there. For instance, to start a business it is necessary about 10 procedures, to wait around 144 days and cost of 77,3% of income per capita.

In fact, this difficulties can lead to some situations that restrains the country's development, such as the case of dealing with contrauction permits: "*complying with building regulations is so costly in time and money that many builders opt out. Builders* *may pay bribes to pass inspections or simply build illegally, leading to hazardous construction. Where the regulatory burden is large, entrepreneurs may tend to move their activity into the informal economy. There they operate with less concern for safety, leaving everyon worse off*" (World Bank, 2011:18).

Another indicator for Doing Business is the ease of access to credit.

Figure 11: Getting Credit – Global Rank

Source: The World Bank, 2011

This ranking confirms what was mentioned above about the difficulty of accessing credit in STP, mainly concerning credit to initiate/expand business.

3.3.5. Evaluation of the S. Tomé financial infrastructure

After this analysis, some conclusions can be taken about the difficulty of creating enterprises and leading them to a considerable growth in STP's context. Concerning this, it would be very interesting to analyze Venture Capital firms' activity in this country, but they do not exist (not even legislation for them).

In fact, some characteristics such as the economic and financial context, the market dimension, the lack of infra-structure, the extremely low internal savings and the weak credit system have discourage economic agents to invest. But one of the strongest features that retain the STP's private sector from its development is the fact that its financial sector is extremely deficient. According to Beck *et al.* (2005), who used a firm-level survey data base covering 54 countries, concluded that firm growth (especially in small firms) is more affected by constraints in countries with underdeveloped financial and legal systems and higher corruption. In addition to this, Berger *et al.* (2004), after examining data from 1993-2000 on 49 countries, concluded that greater market shares owned by more efficient and national-owned banks are associated with better economic performance (growth). STP is not the case, as there are a lot of small banks and all of them are foreign-owned, suggesting also some lack of efficiency. Some consideration on this matter may lead us to inquire if the development of STP's financial system may lead to the development of the private sector and, consequently, to an improved economic growth.

The fact is that access to credit is very complicated, mainly concerning enterprises creation and growth, as terms are very short and there is not specialized credit to this purpose. Considering that there are barely any other sources of capital, it is very difficult for an enterprise to find external finance. So, it would be of a crucial importance for the private sector's development and for STP's economic growth to create alternatives for this.

3.4. Why Microcredit can be Ineffective in STP

After this description, Microcredit initiatives may seem favorable as an alternative of having access to financing. However, some country's specificities can prevail these projects' inefficiency by amplifying some drawbacks mentioned above.

a) Interest Rates

One of the most preeminent problems in STP's economy is the high inflation rate, which leads to also high lending interest rates. In fact, according to 2009 World Bank's Data (from the countries available), STP was the fourth country with the highest lending interest rate and the eighth country with the highest inflation rate (as GDP deflator).[2]

This inflation rate is due mainly to the import prices of oil and consumer good, as well as the large amount of foreign exchange resulting from foreign aid and oil exploration

[2] See Appendix 2 and 3

activities. However, the inflation rate suffered a decrease from 26,1% in 2008 to 17,3% in 2009.

So, as commercial banks' lending interest rates are always above 30%, in order to be financially sustainable, Microfinance institutions should charge an even higher rate, which makes it almost impossible for any business to repay the loans during its growth course.

b) Financial Sustainability

As it was mentioned before, most Microfinance institutions in STP do not survive due to the lack of repayment by their beneficiaries. The most imperative reason is the lack of specific legislation for these specific organizations and, therefore, it is difficult to recover credit.

However, another important factor that some interviewed people referred is the fact that people in STP (and mainly farmers) are so used to foreign aid, which most of the times is unilateral because its purpose is to make direct investments and so there is not a need to return the money invested, that it is hard to implement a credit philosophy. This means that when the beneficiaries receive the money, most of the times they are not aware that they should save some regularly in order to be returned.

c) Skills/Training

Although there is a relatively high literacy rate among adults (about 88% in 2009) comparing to other African countries, STP lacks people with a technical training or with enough knowledge to drive a firm to success.

In fact, until the Portuguese decolonization, people were used to be employees in "Roças" (huge farms, usually cacao producers), so most of them do not have enough skill and vision to develop sustainable businesses. This also led to a very short-term view and it is hard to find someone that does not give more importance what they need today in favor to what they need tomorrow. Although people do not own many consumer goods, they cannot manage them in order to have some surplus in the future.

A consequence is, for instance, that employers need to make a week payment salary in order to keep their employees working the whole month. So, to keep a sustainable business the situation would be even worse.

d) Differences religion, culture and the role of women

Finally, there is also a difference in the way that Yunus idealized Microcredit, as it was first implemented in the Asian culture.

One of the most evident difference lies on the confidence that Yunus gave to women to raise and maintain new businesses, as they needed to take care of their home and children and did everything possible so their descendents would not starve and have a decent life. However, and based on what I observed when I was living in STP, this is not so linear in African countries. The culture is so different, that many critics that Yunus pointed to men could also be observed in women's behavior:

- They also drink during day and night;
- There is polygamy also among women: they often have children from different men and, as a consequence, their concept of home becomes quite distorted;
- They do not take care of their children so passionately. It was not uncommon to see 2-year old children alone in the street or 7/8-year old girls carrying their younger siblings in their back and taking care of them, instead of their parents.

These differences come, relying on some opinions, from the disparity in their religious attitude. In STP they do not have a fixed religion (it is usually seen people praying in 3 or 4 different churches) as in Bangladesh, for instance, where they are very strict about it. Their more conservative culture is confirmable, as Yunus described it, when women cannot be seen with other men rather than their relatives, when they are expected to dedicate their lives to take care of their homes or when they enjoy every opportunity they have (such as Microcredits) to improve their families' living condition. It is rare in STP to observe such attitude.

Finally, the last difference mentioned is about using Microcredit as a means to survival. Although in STP there is a high degree of poverty (with about 54% of the population below the poverty line, according to CIA's World Factbook), the malnutrition prevalence is not a very serious problem, compared to other developing countries, as the land is very fertile: there is a lot of fruit, fish and it is very easy to breed livestock. The consequence is that people do not have such a strong will to work (most of the European call them "lazy") as it is very difficult to starve.

3.5. A Solidary Micro-Venture Capital Project

3.5.1. Project Brief

In July 2009 it was started a Micro-Venture Capital project in São Tomé and Príncipe. It was created by an ISCTE Professor, whose main field of study is Social Economics, along with some of his students, as an idea of final degree assignment.

This project benefits from a partnership with a Nun's congregation (CONFHIC) established in a small town called Neves, in the Northwest part of the island. This congregation has a major role in the development of the project, once it is operating in the country for 50 years. Therefore, they have a key knowledge about the members of the community and the local economic activity. This can be verified as they developed a substantial number of self-sustained projects amongst the population such as a nursery home, social housing, handcrafts, a kindergartner, a sewing atelier, carpentry and a computer room. All of these activities were developed in order to promote employment in the community and to create a way to satisfy some of the basic social needs in Neves.

The main purpose of this project is to improve the condition of people in a situation of poverty or social exclusion, by financing their micro-venture projects. The fund created to invest is composed by private voluntary donations, mainly from family and friends of the students engaged, but it was also sponsored by a Portuguese voluntary institution called ANIMAR. Due to its experimental character, the fund begun with 2000€ and in 2010 it was increased up to 2700€, but it is expected to grow in the next years. The project was implemented by three students who, voluntarily, traveled to Neves and initiated the first investments. Until now the fund was supervised by the nun's congregation, due to a lack of a permanent group of voluntaries.

Although it is considered a Venture Capital project, some of its characteristics are aligned with a regular Microcredit institution. The main one is the fact that the exit strategy is similar to the repayment of a loan: the first payment (10% of the initial investment) is made 3 months after the money injection and the beneficiary should pay the rest of the investment within a year (in case the venture does not default), which means a monthly 10% repayment in the next 9 months. This tight deadline to start the payment is for the reason that the entrepreneurs were not supposed to invest in infra-structure or any kind of Fixed Asset that would generate enough revenue only in the long-run.

Even though the project was intended to gather a regular venture capital fund, due to the philosophy described above, meaning that the returns when the divestment has been made would be proportional to the venture's profits at that time, this could not be achieved until today due to the impossibility of financing a full-time specialized fund manager, who would engage a complete due diligence and control the management and the final profits of the invested businesses. However, there are also some features that justify describing it as Venture Capital. To begin with, the fact that there is a previous selection of the ventures to invest in. Not every poor person can access the fund, but only the ones whose projects are consistent with the fund's purposes. Secondly, the fact that there is a higher commitment with the investment, in social terms. This means that the investor assumes a higher risk that the ventures do not accomplish a profit, which makes this project special comparing to a regular Microcredit one, which charges a higher interest rate than the market in order to assume this higher risk. In order to achieve this, it was created a reserve fund, which cannot be invested. In case some of the ventures do not succeed, the main fund will reach its initial amount using this reserve fund.

These last characteristics are aligned with the developmental theory of the Microcredit organizational activities (Mezerra, 1993), which supports that those Microcredit institutions should take their efforts towards fighting the structural poverty problems. They should help the micro-entrepreneur achieving his/her social development by providing management technical capacity, commercialization support and/or community experiences. The fact that it is preserved a zero interest rate in the Microcredit feature of the project is also according to a theory which argues that the interest rate should be computed in a philanthropic approach, meaning that it should not exist. The Microcredit institution should only have social purposes and that makes particularly sense when the fund's origin is only donations, which is the case (Psico, 2007).

3.5.2. The Project Launch

In the first branch of the project, there were 28 Million Dobras (around 1100€) available, which could be invested in three different enterprises, and the rest was kept to the reserve fund. There were 7 people interested in investing, so it was chosen 3 of them to enter in August 2009 (one month after the selection process) and 2 of them to start when enough money was return, which was foreseen to be in January 2010. The ongoing project dynamic was kept to when more volunteers would come to decide the new investments.

The identification part was already initiated by the Nun in charge of the Congregation. The three initial enterprises were selected taking into account two main factors: according to a viability study for each case, in which it was considered the future expected profits and the repayments schedule, and the entrepreneurial character of each of the group elements. That was only possible by keeping regular meetings between the fund manager volunteers and the entrepreneurs. As it was already mentioned above, maintaining a business in São Tomé and Príncipe is not simple when taking into account the entrepreneur's will to work hard every day and to be ambitious in order to increase his/her returns. Consequently, the interviews held in the selection part were of a fundamental importance due to the fact that it was essential to understand if the person was capable of dedicating the major part of the investment in the business and if the enterprise would benefit the rest of the community in any way.

The ventures selected were the following:

- A wood adornments manufacturing (10 Million Dobras investment – around 400€)
- A bakery (10 Million Dobras investment – around 400€)
- A sewing atelier (8 Million Dobras investment – around 325€)

At the same time, the two other ventures were kept in standby because of two main reasons: the fund limits and due to the "peer pressure" imposed to the three initial businesses, which would make an extra effort and have an additional motivation to generate returns as soon as possible. The other incentive was the access to a renewal of the investment if they return all the money in time.

The ventures kept in standby and with a subsequent investment in March and June 2010 were the following:

- A beer supply shop (8 Million Dobras investment – around 325€)
- A second-hand clothes shop (7 Million Dobras investment – around 285€)

In the Appendix 4 and 5 it is described the ongoing investments, as well as some financial indicators and the repayments agenda.

3.5.3. Our contribution to the project

In an initial phase, our main mission was to verify the project's condition since its release and its impacts on the beneficiaries and on the society. This first part was not as simple as it was expected, as there was not any kind of record of the businesses' activity. So, since July 2009 the only register was in which business was the fund invested and how much.

Therefore, in the beginning we experienced a great difficulty in evaluating the businesses' performance. We spent some days with every entrepreneur, visited the places where they worked and talked with them regularly in order to estimate where the money was invested, the profit they made and how the businesses developed since they were created. Moreover, we also tried to measure the impact since the investment was made in terms of family, housing, health, food, education, and others.

Afterwards, we also tried to make a difference in the way the project was running. The most urgent issue was to collect the missing repayments, which were significant, in order to redistribute them to the new beneficiaries. To achieve this purpose, we followed the usual Microcredit strategy, where we organized several meetings with the old and new beneficiaries, explaining their difficulties and their ideas to create a sense of solidarity between members.

Other activities included helping the new beneficiaries to formulate a business plan for their future businesses and to teach some accountancy notions so the entrepreneurs could keep a record of their businesses history.

3.5.4. Features to be improved

Although generally the Project was having an acceptable performance, it lacked some social accomplishments and sustainability, due mainly to its Microcredit nature.

There were some features that were not such a success and those could be overcome if it was more a Venture Capital Project than a Microcredit one:

1) **Timely repayments/ Lack of control**

The actual situation: Only once a year there are volunteers that come to verify how the project is running. The consequence is that the beneficiaries, although in general they achieve reasonable profits, do not accomplish the repayments schedule because they do not know how to manage their revenues. So, there is less rotation in the money invested than its potential.

How it could be overcome: If it worked as a Venture Capital project, there would not be the repayment problem. However, the control would have to be ever stricter in order one to be aware of the real profits in the exit strategy. Taking into consideration that in this initial part of the project it would be very difficult to have someone in full-time controlling it, one suggestion would be to teach the beneficiaries how to register their businesses results (which was partially done when we were there) so they could send them back to Portugal. Although Internet is scarce, it exists and it would be a good opportunity to improve their contact with new technologies. After that, it could be decided the best exit strategy, when new volunteers would come.

2) **Lack of individual effects**

The actual situation: Although most of the beneficiaries seemed satisfied with their new businesses, the fact is that it did not appear to have a significant impact in their lives. Most of the time they did not spend their full time trying to grow their businesses and improving them, as it was only one the various activities they had to earn some money.

The consequence is that most of the times their businesses stagnated because it was not put enough effort on them.

How it could be overcome: If small and medium enterprises were created instead of micro-enterprises, more jobs would be generated instead of part-time activities to a have some extra revenue. Having a stable employment with a constant income would improve much more notably these people's lives.

3) Lack of social effects

The actual situation: Not only these businesses should benefit the entrepreneur, but also the people surrounding. There are three main areas where it could have a significant impact: by employing more people who, otherwise, would have no income; by proving goods and services to the population that otherwise could not access to them; and by paying taxes that would generate more revenues for the government to invest in infrastructure (in STP it is one of the only revenues to the government, as there is no VAT or IRS). However, none of that was verified: rarely it was employed anyone else rather than the entrepreneur; the services and goods provided were generally already existent; and the enterprises were all informal, so they do not pay any tax.

How it could be overcome: As it was referred before, a SME would cover all these three areas. Moreover, it would have a higher control by the organization that would finance it and, therefore, there would an interest to diversify the goods and services as they would have a higher demand and would benefit more the population.

4) Lack of sustainability

The actual situation: If it is very difficult to find a financially sustainable Microcredit institution, the situation is even worse for this case in particular, as it is still not charged any interest rate and it is dependent on voluntary students that come to help and on donations from Portugal. Moreover, the inflation in the last years was so harsh in STP that there has been a high devaluation of the money invested.

<u>How it could be overcome:</u> This would be the most difficult problem to solve. However, it was found a reasonable exit strategy (as it happened in the development funds exampled before), this model would be more sustainable as the returns would depend also on the fund managers' skill to grow the enterprises.

IV. Conclusion and Recommendations

Although Microcredit has been considered a powerful tool to reduce poverty, after analyzing some empirical studies it is concluded that sometimes its impact is not significant. In fact, Microcredit has many drawbacks that can substantially reduce its outcomes, such as high interest rates charged, the lack of financial sustainability, the defective use of microloans and many others. So, it is strongly suggested that many international organizations and individual agents should adopt a capital ownership/Venture Capital model when carrying development actions. In fact, not only can it bring economic growth and wealth to the economies, but also it focuses essentially on SMEs, which in terms of development may have more impact in terms of employment, productivity, infrastructure, technology and many others.

In order to have a more sustained insight on this matter, a Case Study over a Microcredit project in São Tomé and Príncipe was carried out. It revealed many features that could be improved, presented before when analyzing the Microcredit drawbacks. After what was concluded before, the solution could be to perform some alterations in the project in order to minimize its Microcredit features and transform it in a more realistic Venture Capital, taking into consideration the examples of successful Venture Capital funds mentioned before:

- Finding an exit strategy, instead of a normal credit repayment, would be the most important, as the current situation is compromising the project's sustainability, mainly due to the high inflation rate existent. Of course it would not be simple, mainly because a regular exit strategy could not be applicable in STP due to the reasons mentioned before. However, there are some alternative and more creative solutions that could provide an interesting approach, such as the dividend-based exit adopted by the Agora Partnerships.
- Another issue would be the Project's dimension. In order for it to assume its Venture Capital role, 400€ investments could never be feasible to create a SME

instead of an informal micro-venture, even in an African country. So, although it would be very laborious, it is needed to raise much more funds in order to make it possible to have normal VC investments as in the other funds exemplified. One suggestion would be, instead of asking for donations from friends and families, this would be also their investment that they could recover, eventually with some gain, which evolution they could behold in a website that the students would create (similar to Kiva). Similar to the other funds, there could also be investments by other development agencies.

- There would be also needed a more frequent and regular project's supervision by the students. There are similar organizations in other Portuguese universities, which regularly organize groups of students who participate in these projects in order to write their Thesis or the degree final assessment, with Professors that supervise their work and give some indications during their stay. There could also be students who would give some support in Portugal, by organizing their trips, making the necessary contacts in STP and raising funds.
- The investment term should be extended to 3 to 5 years, with frequent monitoring, via students supervision (as mentioned above) and by sending regular reports with the businesses' performance.
- The type of businesses should be selected in order to create a more productive activity and more employment.
- It should be targeted an IRR in order to inform the investors and to define goals for the investments.

Venture Capital and Angel financing must be tuned to the specific needs of very small investment projects if they are to succeed in the context of developing nations. They need to reduce the due diligence process to a minimum, to avoid unbearable fixed costs and to involve local investors who have the skills to evaluate local entrepreneurs and provide appropriate support to the governance of the new ventures.

We believe that results obtained with this study should provide valuable headlines for development and financial institutions and NGOs willing to invest in developing countries, as well as local development officers.

However, further research should be directed towards providing a more sustained insight on whether a development Venture Capital fund would have a significant impact on developing countries.

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Appendix 1: GDP Growth (Annual %) > 0

The World Bank Open Data, 2005-2009 (Descending Order from 2009 available data)

Country name	2005	2006	2007	2008	2009
Afghanistan	14,5	11,2	-0,2	2,3	40,8
Comoros	4,2	1,2	0,5	1	12,3
Azerbaijan	26,4	34,5	25	10,8	9,3
China	11,3	12,7	14,2	9,6	9,1
Lebanon	0,9	0,7	7,6	9,3	9
Ethiopia	11,8	10,8	11,5	10,8	8,7
Qatar	7,6	18,6	26,8	25,5	8,6
Uzbekistan	7	7,3	9,5	9	8,1
Turkmenistan	13	11,4	11,8	10,5	8
India	9,3	9,4	9,6	5,1	7,7
Malawi	2,6	8,2	8,6	9,7	7,7
Congo, Rep,	7,8	6,1	-1,6	5,6	7,6
Bhutan	7	6,4	19,7	5	7,4
Uganda	6,3	10,8	8,4	8,7	7,1
Lao PDR	7,1	8,5	7,6	7,3	6,4
Zambia	5,2	6,3	6,2	5,7	6,3
Mozambique	8,4	8,7	7,3	6,7	6,3
Bangladesh	6	6,6	6,4	6,2	5,7
Nigeria	5,4	6,2	6,4	6	5,6
Tanzania	7,4	6,7	7,1	7,4	5,5
Rwanda	7,1	7,3	7,9	11,2	5,3
Vietnam	8,4	8,2	8,5	6,3	5,3
Djibouti	3,2	4,8	5,1	5,8	5
Morocco	3	7,8	2,7	5,6	4,9
Ghana	5,9	6,4	6,5	8,4	4,7
Nepal	3,1	3,7	3,3	5,3	4,7
Liberia	5,3	7,8	9,4	7,1	4,6
Gambia, The	5,1	6,6	6,3	6,1	4,6
Egypt, Arab Rep,	4,5	6,8	7,1	7,2	4,6
Papua New Guinea	3,6	2,6	7,2	6,7	4,5
Sudan	6,3	11,3	10,2	6,8	4,5
Indonesia	5,7	5,5	6,3	6	4,5
Mali	6,1	5,3	4,3	4,9	4,3
Iraq	-0,7	6,2	1,5	9,5	4,2

Sao Tome and Principe	5,7	6,7	6	5,8	4
Kosovo	3,4	4,9	4	5,4	4
Vanuatu	5,1	7,2	6,7	6,3	4
Syrian Arab Republic	4,5	5,1	4,2	5,2	4
Sierra Leone	7,2	7,3	6,4	5,5	4
Yemen, Rep,	5,6	3,2	3,3	3,6	3,8
Benin	2,9	4,1	4,6	5,1	3,8
Cote d'Ivoire	1,3	0,7	1,7	2,2	3,6
Pakistan	7,7	6,2	5,7	1,6	3,6
Dominican Republic	9,3	10,7	8,5	5,3	3,5
Burkina Faso	6,4	5,5	3,6	5	3,5
Burundi	0,9	5,1	3,6	4,5	3,5
Sri Lanka	6,2	7,7	6,8	6	3,5
Bolivia	9,4	4,6	0	6,1	3,4
Tajikistan	6,7	7	7,8	7,9	3,4
Tunisia	4	5,7	6,3	4,6	3,1
Guinea-Bissau	5	2,2	0,3	3,5	3
Uruguay	6,6	4,3	7,5	8,5	2,9
Haiti	1,8	2,3	3,3	0,8	2,9
Cape Verde	11,9	10,1	8,6	6,5	2,8
Congo, Dem, Rep,	6,5	5,1	6,3	6,2	2,7
Kenya	5,9	6,3	7	1,6	2,6
Albania	5,5	5	6	7,5	2,5
Togo	1,2	3,9	1,9	1,8	2,5
Panama	7,2	8,5	12,1	10,7	2,4
Central African Republic	2,4	3,8	3,7	2,2	2,4
Jordan	8,1	7,9	8,5	7,6	2,3
Kyrgyz Republic	-0,2	3,1	8,5	8,4	2,3
Senegal	5,6	2,5	4,9	3,3	2,2
Libya	9,9	5,9	6	3,8	2,1
Algeria	5,1	2	3	2,4	2,1
Mauritius	1,2	3,9	5,5	5,1	2,1
Cameroon	2,3	3,2	3,5	2,9	2
Timor-Leste	6,2	-5,8	7,8	13,2	1,9

Iran, Islamic Rep,	4,6	5,9	7,8	2,3	1,8
Poland	3,6	6,2	6,8	5	1,7
Belarus	7,8	10,5	9,8	11,3	1,4
Australia	2,8	3,1	3,8	3,7	1,3
Swaziland	2,2	2,9	3,5	2,4	1,2
Kazakhstan	9,7	10,7	8,9	3,3	1,2
Philippines	5	5,3	7	3,7	1,1
Niger	7,4	5,8	3,3	9,5	1
Argentina	9,2	8,5	8,7	6,8	0,9
Peru	6,8	7,7	8,9	9,8	0,9
Lesotho	1,1	6,5	2,4	4,5	0,9
Israel	5,1	5,7	5,3	4,3	0,8
Colombia	4,7	6,7	6,9	2,7	0,8
Angola	20,6	18,6	20,3	13,3	0,7
Guatemala	3,3	5,4	6,3	3,3	0,6
Ecuador	6	3,9	4	7,2	0,4
Madagascar	4,6	5	6,2	7,3	0,4
Korea, Rep,	4	5,2	5,1	2,3	0,2
Saudi Arabia	5,6	3,2	2	4,3	0,1
Marshall Islands	0,7	2,4	3,3	-2	0

Appendix 2: Inflation, GDP Deflator

The World Bank Open Data, 2005-2009 (Descending Order from 2009 available data)

Country name	2005	2006	2007	2008	2009
Congo, Dem, Rep,	21,6	13,1	21,1	19,4	30,2
Seychelles	17,5	1,5	17,4	28,5	28,6
Ethiopia	9,9	11,6	17,2	30,5	24,4
Uzbekistan	21,4	21,5	24	19,9	20,8
Maldives	1,3	3,5	7,4	12,5	20,5
Turkmenistan	7,1	11,8	8,5	46,4	20,5
Pakistan	7	10,5	7,7	16,2	20
Sao Tome and Principe	7,6	20,9	19,4	23	17
Ghana	15	80,8	16,3	20,2	16,7
Uganda	-1,7	2,4	7,4	6,5	16,5
Nicaragua	9,9	9,3	8,6	2	16,4
Burundi	16,6	4,4	8,3	25,1	13,6
Ukraine	24,6	14,9	22,8	29,1	13,4
Tajikistan	9,4	20,3	27,9	27,7	13,3
Nepal	6,5	7	7,7	6,7	12,1
Rwanda	9,3	9,4	10,5	17,4	12,1
Egypt, Arab Rep,	6,2	7,4	12,6	12,2	10,8
Timor-Leste	1	4,5	12,9	10,7	10
Argentina	8,8	13,4	14,3	19,1	10
Serbia	15,2	10,8	9,8	12,1	10
Zambia	17,2	13,5	12,8	12,9	9,9
Madagascar	18,3	11,5	9,6	9,5	9,1
Costa Rica	10,6	11	9,3	12,1	8,9
Tanzania	20,2	5,3	9	10,4	8,9
Iceland	2,8	8,8	5,7	11,9	8,6
Malawi	15,3	17,6	7,4	9	8,6
Venezuela, RB	29,6	17,9	14,2	31,1	8,4
Indonesia	14,3	14,1	11,3	18,2	8,4
Jordan	2	15,1	4,7	18,8	8,1
Solomon Islands	5,3	4,3	16,6	4	8,1
Micronesia, Fed, Sts,	1,6	1,5	2,7	4,8	8
Liberia	13,8	8,8	16	10,4	7,4
South Africa	5,4	6,5	8,2	9,2	7,3
Kenya	4,9	7,8	5,3	11,9	6,7
Namibia	5,5	9,3	9	14,3	6,5

Appendix 3: Lending Interest Rates (%)

The World Bank Open Data, 2005-2009 (Descending Order from 2009 available data)

Country name	2005	2006	2007	2008	2009
Congo, Dem, Rep,		46,4	47	43,2	65,4
Madagascar	27	29,5	45	45	45
Brazil	55,4	50,8	43,7	47,3	44,7
Sao Tome and Principe	29,8	29,3	32,4	32,4	32,4
Paraguay	29,9	30,1	25	25,8	28,3
Georgia	21,6	18,8	20,4	21,2	25,5
Malawi	33,1	32,3	27,7	25,3	25,3
Kyrgyz Republic	26,6	23,2	25,3	19,9	23
Tajikistan	23,3	24,4	22,9	23,7	22,9
Zambia	28,2	23,2	18,9	19,1	22,1
Mongolia	30,6	26,9	21,8	20,6	21,7
Uganda	19,6	18,7	19,1	20,5	21
Peru	25,5	23,9	22,9	23,7	21
Ukraine	16,2	15,2	13,9	17,5	20,9
Moldova	19,3	18,1	18,8	21,1	20,5
Azerbaijan	17	17,9	19,1	19,8	20
Venezuela, RB	16,8	15,5	17,1	22,4	19,9
Costa Rica	24,7	22,2	12,8	15,8	19,7
Mauritius	21	21,1	21,9	21,5	19,3
Honduras	18,8	17,4	16,6	17,9	19,2
Iceland	14,8	17,9	19,3	0	19
Armenia	18	16,5	17,5	17	18,8
Nigeria	17,9	16,9	16,9	15,5	18,4
Dominican Republic	24,1	19,5	15,8	19,9	18,1
Yemen, Rep,	18	18	18	18	18
Haiti	25	26,4	23,1	17,8	17,3
Romania	19,6	14	13,3	15	17,3
Myanmar	15	16,1	17	17	17
Jamaica	17,4	17,6	17,2	16,8	16,4
Latvia	6,1	7,3	10,9	11,9	16,2
Argentina	6,2	8,6	11,1	19,5	15,7
Mozambique	19,5	18,6	19,5	18,3	15,7
Angola	67,7	19,5	17,7	12,5	15,7
Iraq	13,7	14,5	19,7	19,5	15,6
Micronesia, Fed, Sts,	16,4	15,6	14	14,4	15,4

Appendix 4: Ventures' Financial Indicators (Balance Sheet, Income Statement and Ratios)

As there was a significant lack of data, it was made the following assumptions in order to perform the balance sheet and income statement:

- In most of the cases, the mensal profit is an approximation based on the time that we spent with the entrepreneurs and their businesses.
- It is only used a one-year term to calculate the IRR [meaning that the Investment = Profit in the first year / (1+ IRR)].
- It is assumed that the entrepreneurs separate their personal expenses from their businesses' capital, which does not happen. It was the only way possible to assume a calculation for the monthly profit and the financial rations, supposing that the entrepreneur never uses the profits for personal expenses and that he/she accumulates it month after month.
- In the sequence of this, in can be concluded that:
    - Cash and Bank deposits in year N = Cash and Bank deposits in year N-1 + Profits in year N – Credit amortization in year N
    - Retained Earnngs in year N = Profits in year N + Profits in the years before
- These are the financial ratios used:
    - Return on Net Assets = PBIT / Net Assets
    - Gross Profit Margin = Gross Profit / Sales
    - PBIT Margin = PBIT / Sales
    - Solvency (Gearing/Leverage) = Total Debt / Capital Employed
    - Liquidity (Current Ratio) = Current Assets / Current Liabilities

      (Capital Employed = Total Assets – Current Liabilities

      Permanent Capital = Total Equity + Long Term Debt)

(The data is in Dobras, where 1€ = 24.500 Dbs)

a) André (Wood adornments manufacturing) – it only lasted 3 months

Balance Sheet:

	October 2009	September 2009	August 2009
Fixed Assets	**2.000.000**	**2.000.000**	**2.000.000**
Intangible Assets			
Tangible Assets	**2.000.000**	**2.000.000**	**2.000.000**
Land			
Freehold Property			
Equipment	2.000.000	2.000.000	2.000.000
Motor Vehicles			
Fixtures & Fittings			
Current Assets	**11.985.000**	**12.015.000**	**10.465.000**
Inventory	2.000.000	2.000.000	2.000.000
Trade Debtors			
Other Debtors			
Cash and Bank Deposits	9.985.000	10.015.000	8.465.000
Accruals			
Total Assets	**13.985.000**	**14.015.000**	**12.465.000**
Share Capital			
Reserves			
Retained Earnings	4.705.000	4.705.000	2.565.000
Total Equity	**4.705.000**	**4.705.000**	**2.565.000**
Long-Term Debt			
Current Liabilities	**9.280.000**	**9.310.000**	**9.900.000**
Bank Loans	9.280.000	9.310.000	9.900.000
Other Short-term Debt			
Trade Creditors			
Taxes and Social Security			
Other Creditors			
Accruals			
Total Liabilities	**9.280.000**	**9.310.000**	**9.900.000**
Total Liabilities and Equity	**13.985.000**	**14.015.000**	**12.465.000**

Income Statement:

	October 2009	September 2009	August 2009
Income:	**0**	**6.600.000**	**7.875.000**
Turnover	0	6.600.000	7.875.000
Other Income			
Interest Revenue			
Expenses:	**0**	**4.460.000**	**5.310.000**
Cost of Sales	0	3.960.000	4.725.000
Administrative expenses			
Wages	0	440.000	525.000
Depreciation and Amortization			
Indirect Taxes			
Other Operating Expenses	0	60.000	60.000

Interest Expense Extraordinary Losses Income Tax			
Net Income	**0**	**2.140.000**	**2.565.000**

b) Mari (Sewing Atelier)

Balance Sheet:

	October 2010	July 2010	July 2009
Fixed Assets	**0**	**0**	**0**
Intangible Assets			
Tangible Assets	**0**	**0**	**0**
Land Freehold Property Equipment Motor Vehicles Fixtures & Fittings			
Current Assets	**3.690.000**	**3.800.000**	**8.000.000**
Inventory	600.000	600.000	2.700.000
Trade Debtors			
Other Debtors			
Cash and Bank Deposits	3.090.000	3.200.000	5.300.000
Accruals			
Total Assets	**3.690.000**	**3.800.000**	**8.000.000**
Share Capital Reserves			
Retained Earnings	3.290.000	2.800.000	
Total Equity	**3.290.000**	**2.800.000**	**0**
Long-Term Debt			
Current Liabilities	**1.000.000**	**1.000.000**	**8.000.000**
Bank Loans	1.000.000	1.000.000	8.000.000
Other Short-term Debt Trade Creditors Taxes and Social Security Other Creditors			
Accruals			
Total Liabilities	**1.000.000**	**1.000.000**	**8.000.000**
Total Liabilities and Equity	**4.290.000**	**3.800.000**	**8.000.000**

Income Statement:

	October 2010	July 2010	July 2009
Income:	**1.430.000**	**18.610.000**	**0**
Turnover	1.430.000	18.610.000	
Other Income Interest Revenue			

Expenses:	**940.000**	**13.710.000**	**0**
Cost of Sales	600.000	13.100.000	
Administrative expenses			
Wages		200.000	
Depreciation and Amortization			
Indirect Taxes			
Other Operating Expenses	340.000	410.000	
Interest Expense			
Extraordinary Losses			
Income Tax			
Net Income	**490.000**	**4.900.000**	**0**

c) Duda (Bakery)

Balance Sheet:

	December 2010	**December 2009**	**December 2008**
Fixed Assets	**982.500.000**	**964.500.000**	**941.500.000**
Intangible Assets			
Tangible Assets	**982.500.000**	**964.500.000**	**941.500.000**
Land	200.000.000	200.000.000	200.000.000
Freehold Property	735.000.000	735.000.000	735.000.000
Equipment	47.500.000	29.500.000	6.500.000
Motor Vehicles			
Fixtures & Fittings			
Current Assets	**733.207.000**	**272.665.000**	**107.440.000**
Inventory			
Trade Debtors			
Other Debtors			
Cash and Bank Deposits	733.207.000	272.665.000	107.440.000
Accruals			
Total Assets	**1.715.707.000**	**1.237.165.000**	**1.048.940.000**
Share Capital	935.000.000	935.000.000	935.000.000
Reserves			
Retained Earnings	780.707.000	293.165.000	113.940.000
Total Equity	**1.715.707.000**	**1.228.165.000**	**1.048.940.000**
Long-Term Debt			
Current Liabilities	**0**	**9.000.000**	**0**
Bank Loans	0	9.000.000	
Other Short-term Debt			
Trade Creditors			
Taxes and Social Security			
Other Creditors			
Accruals			
Total Liabilities	**0**	**9.000.000**	**0**
Total Liabilities and Equity	**1.715.707.000**	**1.237.165.000**	**1.048.940.000**

Income Statement:

	December 2010	December 2009	December 2008
Income:	**1.720.800.000**	**735.000.000**	**540.000.000**
Turnover	1.720.800.000	735.000.000	540.000.000
Other Income			
Interest Revenue			
Expenses:	**1.233.258.000**	**555.775.000**	**426.060.000**
Cost of Sales	973.800.000	379.845.000	279.900.000
Administrative expenses			
Wages	218.058.000	118.330.000	88.560.000
Depreciation and Amortization			
Indirect Taxes			
Other Operating Expenses	41.400.000	57.600.000	57.600.000
Interest Expense			
Extraordinary Losses			
Income Tax			
Net Income	**487.542.000**	**179.225.000**	**113.940.000**

d) Lucas (Beer Supply Shop)

Balance Sheet:

	December 2010	October 2010	December 2009
Fixed Assets	**2.800.000**	**2.800.000**	**2.800.000**
Intangible Assets			
Tangible Assets	**2.800.000**	**2.800.000**	**2.800.000**
Land			
Freehold Property			
Equipment	2.800.000	2.800.000	2.800.000
Motor Vehicles			
Fixtures & Fittings			
Current Assets	**18.190.000**	**11.462.000**	**8.000.000**
Inventory			
Trade Debtors			
Other Debtors			
Cash and Bank Deposits	18.190.000	11.462.000	8.000.000
Accruals			
Total Assets	**20.990.000**	**14.262.000**	**10.800.000**
Share Capital	2.800.000	2.800.000	2.800.000
Reserves			
Retained Earnings	15.190.000	6.962.000	
Total Equity	**17.990.000**	**9.762.000**	**2.800.000**
Long-Term Debt			
Current Liabilities	**3.000.000**	**4.500.000**	**8.000.000**
Bank Loans	3.000.000	4.500.000	8.000.000
Other Short-term Debt			
Trade Creditors			
Taxes and Social Security			

Other Creditors			
Accruals			
Total Liabilities	**3.000.000**	**4.500.000**	**8.000.000**
Total Liabilities and Equity	**20.990.000**	**14.262.000**	**10.800.000**

Income Statement:

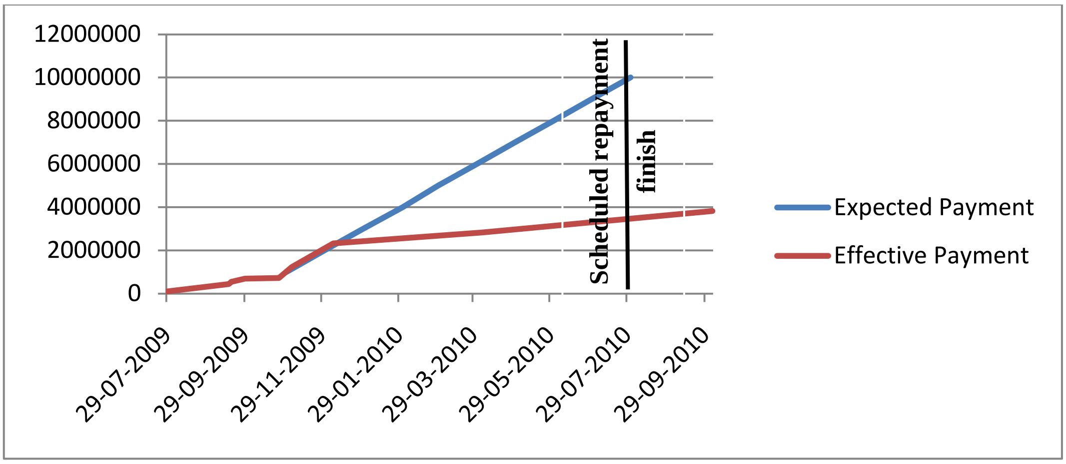
	December 2010	**October 2010**	**December 2009**
Fixed Assets	**2.800.000**	**2.800.000**	**2.800.000**
Intangible Assets			
Tangible Assets	**2.800.000**	**2.800.000**	**2.800.000**
Land			
Freehold Property			
Equipment	2.800.000	2.800.000	2.800.000
Motor Vehicles			
Fixtures & Fittings			
Current Assets	**18.190.000**	**11.462.000**	**8.000.000**
Inventory			
Trade Debtors			
Other Debtors			
Cash and Bank Deposits	18.190.000	11.462.000	8.000.000
Accruals			
Total Assets	**20.990.000**	**14.262.000**	**10.800.000**
Share Capital	2.800.000	2.800.000	2.800.000
Reserves			
Retained Earnings	15.190.000	6.962.000	
Total Equity	**17.990.000**	**9.762.000**	**2.800.000**
Long-Term Debt			
Current Liabilities	**3.000.000**	**4.500.000**	**8.000.000**
Bank Loans	3.000.000	4.500.000	8.000.000
Other Short-term Debt			
Trade Creditors			
Taxes and Social Security			
Other Creditors			
Accruals			
Total Liabilities	**3.000.000**	**4.500.000**	**8.000.000**
Total Liabilities and Equity	**20.990.000**	**14.262.000**	**10.800.000**

October, 2010 (for André there was not annual data)

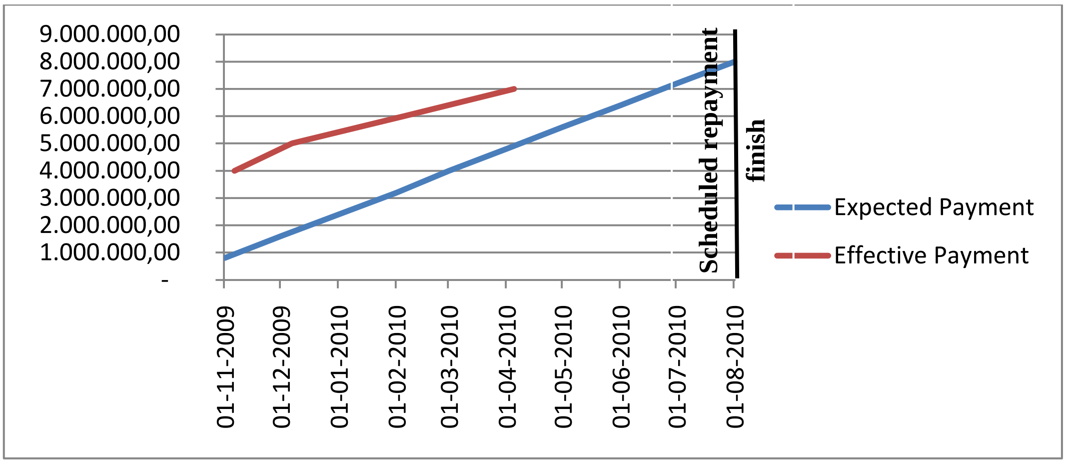
	Return on Net Assets	**Gross Profit Margin**	**PBIT Margin**	**Solvency**	**Liquidity (Current Ratio)**
Mari	13,30%	58%	34,30%	37,20%	3,69
Duda	28,40%	43,40%	28,30%	0,70%	30,30%
Lucas	48,80%	12,20%	9,20%	46,10%	2,55%

Appendix 5: Repayments Schedule in September 2010 (Cumulated)

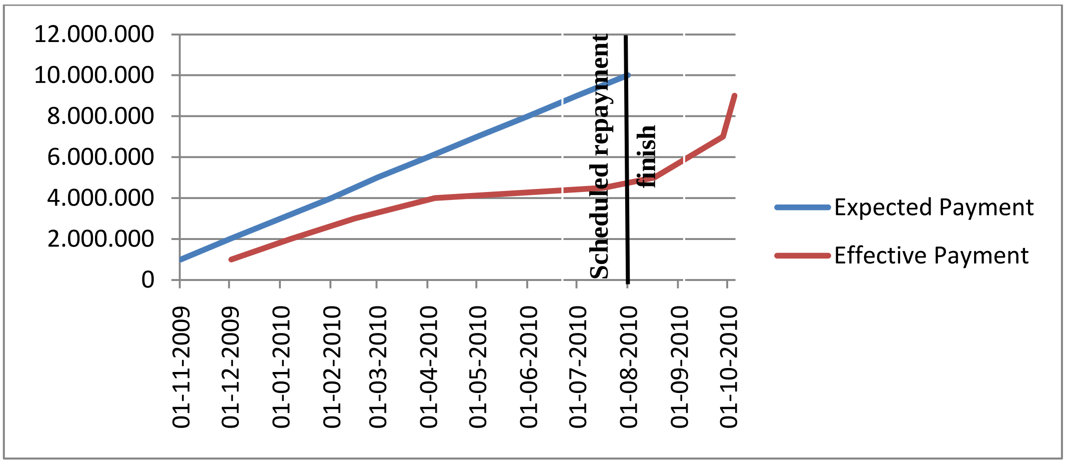
a) André



b) Mari



c) Duda



d) Lucas