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## **The Microfinance of Sustainable Growth Enhancing the Benefits of Investment in Rural Areas of Africa through Social Enterprise Incubation Centers**

### **The key to rural development in Africa: Local Initiative, Control, and Responsibility**

Given long-run national goals of a) food and water security, b) preserving and enhancing natural resources, c) reducing poverty through equitable access to public infrastructure, and d) making rural areas attractive places to live, a “Green Revolution” is essential. A Green Revolution will raise agricultural productivity by turning subsistence living into farming, forestry, and land/water management as businesses creating scope for diverse, balanced growth of the rural economy. The critical human resource for this balanced growth is indigenous leadership: Local Initiative, Control, and Responsibility (LICR). LICR can transform local resources into self-sustaining growth by creating Social Enterprise Incubation Centers (SEICs); SEICs provide micro private equity finance for local high-profit businesses while subsidizing the micro finance of community-based enterprises and social infrastructure.

### **What is an SEIC?**

A Social Enterprise Incubation Center (SEIC) is a business that combines the interests of large corporate investors and community-based organizations, situated in rural Africa or other regions with under-utilized resources and rapidly-rising consumer expenditure. An SEIC invests in micro private equity for comprehensive and sustainable local-area development. The mission of an SEIC is to assist the planning, start-up, and early-stage growth of small private enterprises and community-based social businesses that benefit the residents of this local area through profitable work.

### **Types of small businesses SEICs will incubate**

Small businesses will innovate in various ways, such as:

- new technologies for **processing of foods**, edible oils, and animal feeds serving local and regional markets
- **micro-irrigation** technologies, for changing small subsistence farms into vibrant commercial enterprises
- **fish farming**, scaled and managed for sustained profit as well as for community benefit and protection of natural resources
- technology and logistics for **freezing and cold storage** of fish, meat, juices, other foods and drinks
- **distribution**, such as franchising of aquaculture stores and systems for direct transfer of financial assets such as dividends
- farm-raised, inedible vegetable oil from indigenous plants used as **biofuel for village electrification**
- scalable **solar technologies** for off-grid commercial markets including telecoms, tourism, and farms
- **agricultural waste** for industrial heat, biogas for cooking, and for renewing exhausted soils
- local materials and design for low-cost **construction** of residences and businesses
- **tourist facilities**-- modern in comfort, traditional in culture

### **SEICs improve profitability of small businesses in marginalized rural areas**

SEICs help to build holistic business ecosystems called Sustainable Local Enterprise Networks (SLENs). Enterprises in a SLEN make profits for their owners, while sustaining their growth and benefits to the local area, because they link economically with each other and to larger-scale investments in business infrastructure by governments, large companies, and development finance institutions. Key types of business infrastructure in rural areas include:

- Roads
- ICT
- Electricity
- Water

- Agricultural infrastructure
- Market Centers
- Storage
- Health

## Benefits to local communities

SEICs and small business creation offer many benefits to their host communities. First, consumption goods and services are produced by the private enterprises and by the social businesses that their SEIC incubates. Second, employment income and purchasing power are generated by all this activity. Third, part ownership of these businesses generates profit/income. Finally, the community maintains some measure of responsibility and control of the local business environment, acquired through community ownership of their SEIC.

## Engaging with the SEIC: Community-based organizations

Communities can and should self-organize through Community-Based Organizations (CBOs) such as farm cooperatives, micro-credit banks, savings clubs, etc. These organizations should be certified by their SEIC as being:

- democratically governed
- dedicated to the service of their members
- not corrupt
- legally registered
- financially accountable
- able under local law to own and manage ownership interest in social businesses

Certified community-based organizations acquire equity ownership in social businesses that are incubated by their SEIC. To justify this ownership, they contribute land, security, local knowledge of needs and business opportunities, connections to government, cultural assets, skills, and labor.

## SEIC Governance

An SEIC is structured as a for-profit company issuing shares as a Joint Venture (JV) with a 50-50 split of ownership between local and outside interests:

- **Outside investor(s)** (at least one large national and/or multinational company):
  - Invests cash in portfolios of investments of the Private Equity Account
  - May also make a recoverable grant or low-interest, patient loan for start-up of the Incubation Operations Account
  - owns half of the SEIC's share issue for as long as it does not exit (the working assumption for full repayment of capital being ten years)
- **Local investors** include founders and managers of the SEIC, CBOs and leading individuals and organizations of the SLEN (Sustainable Local Enterprise Network). They provide a minor part of cash requirements and mainly provide:
  - human resources
  - Land and material inputs
  - diverse know-how

Over time, diverse strategic partner companies, contributing expertise that becomes important for the SEIC's portfolios, may also become shareholders, perhaps financing the SEIC's expansion or replication. The 50-50 structure of JV ownership, while awkward from the standpoint of agile management, is vital for underpinning trust and consensus as the basis for decision-making where bridging cultural divides between outside and local interests is a continuing necessity. With this structure, when a contentious issue arises, either side of the JV can in principle forestall decision until a working consensus resolves the issue in favor of forged common ground.

## SEIC Finances

An SEIC is a micro private equity (PE) company that has a developmental purpose. It is structured as a social enterprise having two broad functions:

- to invest for profit in the equity (shares) of the businesses that it assists, for the main purpose of financing the SEIC's operating budget

- to provide comprehensive help for the planning, start-up, and early-stage growth of these businesses (both private and social), while building their autonomy and capacity for sustaining themselves

Correspondingly, the strategic plan for any SEIC has two interdependent accounts: the Private Equity Account and the Incubation Operations Account. A template for projections of these two Accounts is available on the Resources page at [www.wilma.us](http://www.wilma.us). The numbers in this template are purely illustrative and do not correspond to any specific case, nor should this table be interpreted as a forecast. The table (programmed in Excel for convenience) is intended to be a flexible planning tool for local use, using local data.

The Private Equity Account of an SEIC provides for:

- Successive portfolios of investments in groups of businesses whose business plans are prepared and capitalized within a four-year period
- Full repayment of capital to investors through exit (sale of shares) within ten years of initial capitalization
- Annual transfer of net profits to the Incubation Operations Account in amounts sufficient to finance its operating deficit, repay its borrowing, and maintain adequate reserves
- Professional asset management by certified fiduciaries, with investment advice and technical services from both local and international providers

Despite these strengths and the SEIC's services, the expected return on investment of the PE Account, with plausible allowance for capital losses, is below market rates of return, due to its subsidy of the Incubation Operations Account. Moreover, this investment has high risk, and there are no guarantees. Investing in an SEIC should thus be viewed as a social investment, moved by some interest other than profit.

The Incubation Operations Account provides focused help to local enterprises that qualify by meeting the requirements of a checklist, which itself satisfies the checklists of the SEIC's investors. This help extends from refinement of business plans through securing operating capital and good management, and continuing steadily for several years till the investors are in a position to sell their holdings (assumed to occur within ten years). This Account provides for:

- a general manager, staff, and administration
- officers and consultants for locally-relevant industrial sectors, able to provide high-level managerial, technical, and professional assistance
- one-on-one mentoring and coaching support for client (prospective) businesses
- annual entrepreneurial leadership seminars for clients, schools, and local partners
- matching grants to local schools for practical education in entrepreneurship
- A timely contribution of seed capital to each business client
- seconding or other support for technical/professional staff, from interested partners in industry, universities, governments, and non-profits
- Financing from recoverable grants and transfers from the Private Equity Account

On the bottom line of the Account, recoverable grants are fully repaid within ten years, and adequate reserves are acquired and maintained.

### **Why large companies invest in SEICs**

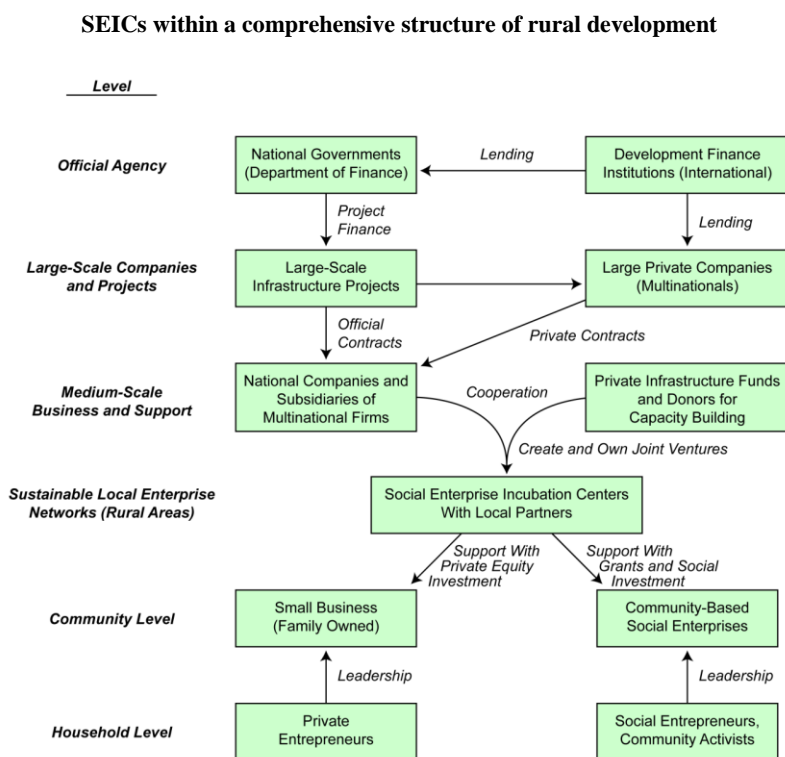
Cash for the PE investments of SEICs come from one or more national or multinational companies (particularly their subsidiaries in or near the given local areas), which are investing or planning to invest in these areas. These companies have a strategic interest in SEICs for one or more of the following reasons, which justify the expected sub-market return and relatively high risk of their investments:

- to build up intangible assets of good will by taking "corporate social responsibility"
- to ensure that locally-owned cash and technical resources are adequate for responding to local business opportunities (linked with new infrastructure, new value chains, new niches for local procurement and/or marketing/distribution)
- to compensate for unavoidable social and/or environmental damages to the local economy resulting from the investing companies' own operations, and thereby to build local support and protection of assets, reducing both costs and risks
- To build local demand for the investors' products through creating growing incomes, and to build local capacity to supply the investors' inputs (both goods and human resources) more reliably and at lower cost than otherwise feasible
- To build political/governmental support for the investors' agenda by being part of the national rural development campaign to achieve long-run development goals, and thereby to induce the government at all levels to reciprocate this support through its policies and regulation

- To gain the approval and support of governments and/or international institutions that may be, now or in future, contracting with the investors and that normally condition their contracts on actions to achieve long-run development goals

## Why private infrastructure funds invest in SEICs

Unlike traditional grants and micro finance, investments in micro PE have significant potential to generate sustainable development. Private infrastructure funds are currently being structured in various ways to invest in profitable companies that embrace sustainable development strategies, particularly companies employing and buying goods and services from marginalized rural communities, and companies investing in rural infrastructure and in projects that thereby become profitable. The return from PE investments may be levered by co-investment with large companies that bring know-how and other capital to these rural communities (as depicted in the diagram below). These funds exploit the power of linkages: they co-invest in partnership not only with providers of relevant industrial technology but also with other entities that locally provide essential capacities in the field of investment. These linkages leverage the impact of the funds' investment with knowledgeable investors in the region, notably banks, private equity funds, and development finance institutions. SEICs provide a convenient and powerful structure to exploit these linkages on a profitable scale, while recognizing the importance of local ownership for security.



## Why donors for capacity building support SEICs

SEICs need and deserve grants for capacity building, institutional development, and the long-run sustainability that comes from strong social infrastructure. More fundamentally, donors will support the founding of SEICs because their concept is based on fundamental truths about development:

- Local Initiative, Control, and Responsibility (LICR) is necessary for bottom-up development that is led by well-educated entrepreneurial energy.
- Autonomy (including freedom of control by donors) is necessary for LICR.
- Successful business is necessary for autonomy (financial self-reliance).
- A structure of finance and support for rural development centered on SEICs is the best way to organize and motivate business at all levels so that the social objectives of development are achieved.
- These objectives are a just, peaceful, and free society that protects and grows the common wealth by empowering the entrepreneurial energy of its citizens.

- This energy is kindled by practical education that builds the values, mindsets and habits of self-reliance through entrepreneurship. This education merits support in the form of grants.

### **Why universities support SEICs**

Universities are a special kind of donor for SEICs, providing research and help in relevant fields of science, technology, training, and business. Both African and offshore universities will provide important resources for the incubation of social enterprises in Africa. Most of the cost of this help will be paid by sources that fund these institutions. Universities will be interested because:

- The Leadership Perspective: Through its work with SEICs the university acquires a new role as incubator of community-based social business, led by its own students, who thereby build their ethical intelligence and social responsibility. This appeals both to liberal arts and technical schools.
- The Faculty Perspective: Diverse university courses acquire links to experiential learning through the conception, planning, and implementation of social businesses, with results that inform these courses and their teachers. Application of leading technologies in lagging economies or sectors adds academic interest.
- The Student Perspective: Students interested in becoming social entrepreneurs themselves acquire, through their participation in the work of SEICs, values, principles, and purposes that frame their academic studies and energize all aspects of their life at university.

### **WILMA's role: Assisting SEIC founders**

A growing network of expertise available to WILMA stands ready to help SEICs to form and grow by providing the following kinds of assistance:

- Help identify underutilized resources that can be used to form SEICs; such resources include personnel (both leaders and residents with many capacities), land, materials, and the capital and know-how of existing enterprises
- Help potential founders of SEICs to organize these resources into SEICs; connect them with sources of knowledge and technical experience including the management of micro PE; help arrange micro-credit loans for individuals with entrepreneurial drive to start local enterprises that potentially qualify for micro PE investment
- Help SEIC founders to attract additional resources for high impact development--a "catalyst," if needed, especially in the field of grants and low-cost patient loans for education in entrepreneurship
- Help to connect these founders with larger-scale regional or national programs for rural development, so as to ensure results on the ground in under-served areas