

REQUEST FOR PROPOSALS FOR THE ESTABLISHMENT AND MANAGEMENT OF THE PROPOSED SME DEBT FUND IN KENYA

1. Introduction

FSD Africa wishes to engage an experienced fund manager who will be responsible for the day-to-day management and administration of a proposed SME Debt Fund in Kenya. FSD Africa will sponsor the proposed fund. In collaboration with FSD Africa, the fund manager will co-design and set up the fund, including fundraising, establishing the investment process, and appropriate legal and governance structures to operationalise the fund effectively and implement the strategy.

2. About FSD Africa

FSD Africa is a specialist development agency working to reduce poverty by strengthening financial markets across sub-Saharan Africa. Based in Nairobi, FSD Africa's financial sector experts work alongside governments, business leaders, regulators, and policymakers to design and build ambitious programmes that make financial markets work better for everyone. Established in 2012, FSD Africa is incorporated as a non-profit company limited by guarantee in Kenya. It is funded by UK International Development from the UK government.

More information on FSD Africa is available [here](#).

3. Background

Micro, Small and Medium Enterprises (MSMEs) have been identified as catalysts for growth in African economies. In Kenya, MSMEs account for 98% of businesses and about 24% of the country's Gross Domestic Product (GDP).

Beyond their economic impact, MSMEs also serve as vital engines of employment generation, particularly for marginalised groups such as youth, women, and persons with disabilities. In Kenya, they account for 14 million (30%) of jobs, and 80% employ up to 10 people. By providing opportunities for entrepreneurship and self-employment, MSMEs help address unemployment challenges and promote inclusive growth within society.

Access to long-term patient capital remains a persistent challenge for many MSMEs. By exploring opportunities to attract MSME finance, leveraging the potential of private markets in Africa, and providing avenues for domestic institutional investors to participate in these markets, we can foster a more robust and inclusive financial ecosystem for MSMEs.

MSME Financing Challenge in Kenya

 <p>MSME financing gap estimated at \$19.3Bn</p> <ul style="list-style-type: none"> • Micro enterprises - \$1.08Bn • Medium enterprises - \$18.22Bn <p>Total Bank lending to MSMEs as of 2022 - \$6Bn</p>	<p>Access to Finance</p>	<p>Availability of Domestic Institutional Capital</p> <ul style="list-style-type: none"> • Africa - \$2.4Trn • Kenyan - \$30Bn • EAC - \$50Bn (can be deployed across the region) <p>Permissible investment (up to 20%) in debt securities</p>
 <p>High cost of MSME financing</p> <ul style="list-style-type: none"> • An average of 27% charged by MFIs as of 2022 when 10-yr treasury was 15% • MFIs are predominantly funded in US\$ with an all-inclusive cost of above 20% in local currency 	<p>Affordability</p>	<p>Relatively cheaper funding from domestic institutional investors remains untapped</p> <ul style="list-style-type: none"> • Target return rate of 10-yr treasury + 150bps • Risk averse – low to moderate risk • Overconcentration on government securities but debt distress concerns • Appetite for investment diversification
 <p>Short Tenor</p> <ul style="list-style-type: none"> • Average tenor - 27 months <p>Collateral value required</p> <ul style="list-style-type: none"> • Commercial banks – 100% • MFIs – 90%. 	<p>Scalability</p>	<p>Long-term financing Opportunity for Growth Tenor</p> <ul style="list-style-type: none"> • Long-term investment horizon – up to 10 years • Relies more on credit quality

FSD Africa is proposing to set up an SME debt fund in Kenya. The fund will be a local currency permanent capital vehicle domiciled in Kenya, targeting investments across East Africa. The fund will be registered and regulated by the Capital Markets Authority (CMA) Kenya under relevant regulations.

The Fund aims to raise USD 300 million, with a first close of USD 100 million and an average ticket size between USD 500,000 and 5 million. It will finance MSMEs through a combination of direct investment (25%) and indirect strategy (75%). The Fund will incorporate a unique blended finance structure to mobilise domestic capital into SME financing.

There has been a unique blend of public and private capital markets using Listed Funds in jurisdictions with highly developed capital markets. Business Development Companies (BDC) in the USA and Venture Capital Trusts in the UK were created to augment efforts to provide funding for SMEs. These entities are usually listed on exchanges to mobilise public funds into private ventures.

In exploring the use of a similar vehicle in the Kenyan market, stakeholders were engaged in deliberating the structuring of an SME Debt Fund/ SME Investment Company in Kenya. Most stakeholders have largely welcomed the introduction of an SME Debt Fund into the market.

The consensus recommendation is to establish an Investment Company under the Alternative Investment Funds (AIF) Regulations in Kenya that will appoint a Fund Manager. It is proposed that the investment company will have a three-tiered capital structure. The first tier of capital will be permanent equity from development agencies, philanthropic investors, foundations, etc. The second tier of capital, which will be junior debt, will be raised from DFIs and other agencies with high-risk appetite. The fund will then leverage the two tiers of capital as per the provisions of the AIF regulations in Kenya to issue senior debt for subscription by local investors, particularly domestic institutional investors. The senior debt will be listed on an exchange in Kenya.

The fund will be supported by a technical assistance facility that will support portfolio companies to improve their performance, support the intermediaries to effectively intermediate funds and support the fund achieve its objectives.

Proposed Structure of the SME Debt Fund in Kenya

The Fund	SME Debt Fund
Legal Structure	Alternative Investment Fund
Incorporation	Kenya
Governance Structure	Board of Directors Independent Fund Manager Investment Committee
Geographical Focus	For investment - Kenya but will also target investments across East Africa. For listing - A recognised exchange in Kenya
Sector Focus	Agnostic and Opportunistic
Investment Strategy	Direct and Indirect debt
Asset Class	Debt
Investment tenor and instrument	Debt Tenor - TBD
Target Raise	\$300 million total fund size - First close of \$100m
Distribution	TBD

4. Objectives and Scope

4.1 Objective

Setting up an SME Debt Fund in Kenya expands the funding opportunity for MSMEs through the public market by tapping into the pool of domestic capital to finance economic growth sectors. The fund will provide avenues for domestic institutional investors to diversify while fostering a robust and inclusive financial ecosystem for MSMEs and powering their job creation potential.

4.2 Scope of work

FSD Africa seeks an experienced fund manager to support establishing an SME-listed fund and managing its day-to-day administration. The scope of the assignment will be two-phased: (i) pre-setup of the Fund and (ii) post-setup.

(i) Pre-set up phase

The successful fund manager will work with the sponsors to design a viable business model, develop and implement a fundraising strategy, develop a pipeline and investment strategy and put in place the necessary processes, policies and procedures to enable successful registration, licensing and launch of the fund. This phase will be contracted through FSD Africa, the fund sponsor. For this phase, the fund manager should include the following in their proposals.

- Preliminary views on the proposed structure of the SME Debt fund and suggested changes/additional input based on market insights and investment strategy for profitable performance.
- A proposal on a viable business model for the proposed fund.
- Brief assessment of a proposed investment strategy, including a strategy for developing a pipeline of investment opportunities for the fund.

- A proposed fundraising strategy, particularly from domestic institutional investors.
- A proposed impact and sustainability metrics for the fund.
- A proposed approach, methodology, next steps, timelines and key milestones for setting up and launching the proposed fund. The fund manager should outline strategic constraints, if any, to be addressed to improve operationalisation.
- A detailed breakdown of the estimated setup costs.
- A proposed governance structure for the fund.
- Detailed and specific description of support required from fund sponsors to successfully set up and operationalise the fund.

(ii) Post-set up phase

Once the fund is set up, the SME Debt fund board would be expected to officially appoint the fund manager to implement an agreed-upon investment strategy. The investment strategy will ensure that the fund continuously meets the conditions of its license and invests in the right people, systems and processes to implement the strategy profitably and deliver on the vision of the sponsors and investors. For this phase, the fund manager should include the following in the proposal.

- An outline of how the fund manager intends to manage the fund and profitably implement the investment strategy proposed above. This should include a proposed fee and compensation structure and a performance/profitability analysis.
- An outline of how the fund manager intends to deploy the technical assistance fund to support the fund to achieve its objectives.
- Description of how the fund manager will embed and implement the proposed sustainability and impact frameworks including periodic impact evaluation and reporting.
- A brief background of the proposed team that will manage the proposed SME debt fund.
- Previous experience in managing an SME or similar funds in Kenya/East Africa - This should include details of the fund, including the investment team and the fund's performance

5. Invitation to tender

FSD Africa is inviting proposals from suitably qualified fund managers to manage the proposed SME Debt Fund.

In addition to the specific requirements indicated or the phases, the proposal should contain the following:

- A description of your firm's history, ownership and organisational structure, including details of relevant regulatory licences to perform fund management functions in your jurisdiction(s) of operation.
- A confirmation that you are licensed to offer the required services in Kenya or have a credible path to obtaining such regulatory approval.
- Any past/ongoing material litigation, regulatory, legal proceedings or sanctions in which your firm or its principals have been involved in the last five years.
- To demonstrate their understanding of this scope, firms may include relevant examples of solutions that inform how this vehicle would be implemented based on experiences in other markets.

The proposals (technical and financial) for the pre-set-up and post-setup phases should be presented separately in the submissions, as this will be the basis of the evaluation. Firms are free to submit a joint proposal.

Your proposals should be emailed to bids@fsdafrica.org with the subject “Kenya SME Debt Fund– Fund Manager” by 1200 East African Time on 02 September 2024.

6. Basis of award

FSD Africa will award a contract to the most economically advantageous tender based on the following requirements and assessment criteria:

Mandatory requirements

The firm must demonstrate experience in undertaking significant and similar assignments of setting up and actively managing fund structures, including fundraising, preferably from domestic institutional investors.

The firm/individuals must have good knowledge of Kenya’s and East Africa’s public and private investment markets, SME financing, credit analysis and valuations and credit portfolio management.

The firm/individuals must have the capacity to engage stakeholders on this assignment, with the appropriate involvement of senior team members.

Assessment criteria

Weighting

Relevant, demonstrated experience and capacity of firm and proposed team in this area	40%
Understanding/interpretation of the task set out in the TORs, methodology, and work plan	30%
Fee basis and total costs (weight will be apportioned to all components of the proposed cost and fee structure)	30%
Total	100%

7. Contact

Questions or comments regarding these terms of reference should be emailed to bids@fsdafrica.org on or before 1200 Eastern African Time on 14 August 2024. Feedback will be provided by 1700 Eastern African Time on 16 August 2024.