Project Update

2019 Insights

balloon VENTURES

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Summary of progress

- In total, across Kenya and Uganda we are currently supporting **39 small and growing businesses**.
- We are seeing **good demand and impact for business consulting in 5 core areas** (planning and management, financial management and accounting, human resources, sales and marketing, and production).
- Creating good jobs is currently going well. **Businesses are treating staff as assets** rather than costs which is leading to **greater legal protections and salary increases** (in some cases 2x baseline numbers).
- We understand much better the **value proposition for entrepreneurs** who are now paying directly for consultancy support.
- We see **impact occurring through regular and consistent engagement**. Weekly, monthly, quarterly meetings with clear goals and accountability create a rhythm that drives behavior change.
- A **consistency of challenges across businesses** is positive as it allows us to standardize our work. We need to continue our focus on delivering support more efficiently.
- Getting **accurate financial data** is still a challenge. Solving this problem will create huge efficiencies across the whole journey (e.g. recruitment, due diligence, post investment).
- There has been a significant improvement in loan repayments due to various learnings and changes we implemented in early 2019. **We received 98% of all monies owed in Q4/19**.
- Project sustainability continues to improve with **profits for Q4/19 covering 25% of all branch costs (37% in Uganda)**. We project that **sustainability will be achieved with £580,000 of live investments** per branch.
- **Pipeline is challenging, however we are still hitting our numbers** and portfolio quality is improving every quarter.
- **We have started offering more diverse financial products** (e.g. short term and long term investment)**.** This is because we've found that one product does not respond to the diverse needs, capabilities and aspirations of SGBs in our target market.

Key Insights

Standardisation

Our goal this year is to fully productise our business support services, so all businesses go through a standardised journey using the same core set of tools and methods to improve their management. We are building:

1. A SGB Diagnostic to evaluate the relative strengths and weaknesses of a business. The Diagnostic is split across the 5 sections described above: Planning and Management, Financial Management and Accounting, Human Resources, Sales and Marketing, Production/Operations.
2. From this Diagnostic, we score and prioritise current practices to identify the critical areas to work on and build a plan for our support.
3. With the plan defined, we then have a Toolkit with guides, templates and case studies that our staff use with the businesses according to need. For example:
    a. Guides to build a sales force, introduce financial controls, or manage working capital
    b. Templates for job descriptions, performance management and tracking credit
    c. Case studies that show how all this has been applied successfully in the past.

    The Diagnostic identifies the key area of focus, and our Toolkit gives staff and businesses the resources to fix the related issues.
4. This Diagnostic/Toolkit also serves as the basis for staff training, meaning impactful work can be done by junior staff on modest wages.
5. We are also building out guidance about building trust, influencing entrepreneurs, creating a strong working relationship, running good sessions as we are seeing this as a key driver of success.

Financial analysis and reporting

The financial accounting of SGBs is generally poor. As discussed below we spend a disproportionate amount of time during due diligence recreating financial accounts. After making an investment, the challenge usually continues. Our Investment Managers spend up to 50% of their time on improving financial processes and collecting financial data. Progress is often very slow and some entrepreneurs are resistant to change. Having tighter systems and controls inhibits the ability to take large drawings from the business. In addition, more accurate financial information may increase the business's tax obligations, for example taking them over the VAT threshold and/or increasing corporation tax.

In response, we are testing various approaches with the goal of having a single process that we implement as standard in every portfolio company. This will also free up a more staff time for other work. We are trying:

1. Extending Buymore trial (PoS software), after positive early results in some SGBs.
2. Reviewing other technology solutions. For example, a cohort of clients in Kenya will be trialling Quickbooks.

3. Introducing rewards for compliance with key aspects of good financial management. For example, reducing repayment obligations where SGBs can demonstrate progress against pre-agreed criteria.

Peer groups

Various evaluations have recently highlighted the potential of utilizing **peer groups** to grow businesses. Reports from Togo to China have shown that small groups of entrepreneurs working together can lead to strong business growth. We also see several other areas where peer groups can improve our model. Initial thoughts include:

- **Behaviour change** - Sometimes driving change in the most difficult areas (lack of commitment to good record keeping, a preference for informal labour and operations) is better overcome through lessons from peers than from Balloon. Peer advice can be more authentic and convincing for the toughest challenges. Businesses owner also have specific and deep experience that they can share e.g. importing, KEBS etc
- **Recruitment** - Businesses that are performing well typically surround themselves with other good businesses. Therefore these networks can become valuable recruitment networks thus bringing down our recruitment costs.
- **Security** - Traditional forms of security are sometimes not available for the businesses we target. Peers may represent another means through which to take security, e.g. acting as a guarantor for other clients.

We have begun piloting monthly peer group sessions and will report on progress in our next report.

Investments

In recent months there has been a big improvement is repayments from entrepreneurs. **This quarter we collected 98% of all money owed.**

This drop in bad loans has also coincided with an increase in the number of investments. Therefore we are making more investments and better investments. We introduced various changes in the second half of 2019 which have markedly improved repayment rates. These include:

- **Better security**. Previously we weren't taking good enough security on loans. For example, we found that securing an investment only with an asset purchased using that investment wasn't good enough. Entrepreneurs need to provide additional security so they are risking something already in their possession. We've also introduced more personal guarantees, witnessing from local community leaders, and spousal consent requirements.
- **Better due diligence**. We have learnt for what business types our programme works (e.g. we now avoid startups and turnarounds). We make sure businesses can pay off the investment based on their existing performance (i.e. even if they do not reach growth goals). We are much more conservative in financial projections. We also have a stronger focus on the entrepreneur profile and set hurdles to test their commitment and willingness to partner. We only invest in a business's core (i.e. what they are already doing successfully), building out from there.

- **More cautious**. Where we're unsure about an investment, we start with a smaller, short-term arrangement to assess suitability at lower risk (discussed further below)
- **Less Flexibility**. By removing revenue shares and flexibility from investment contracts, there are now fixed repayment dates for all entrepreneurs. This allows us to identify and act on problem clients sooner.

Improvements in repayment may also be linked to improvements in the effectiveness of business support services.

We have started offering more diverse financial products. This is because we've found that one product does not respond to the diverse needs, capabilities and aspirations of SGBs in our target market. This is because:

- **The challenges and opportunities that SGBs face vary significantly based on several factors, such as industry, size, maturity, ambition.** For example, SGBs operating in industries with high levels of demand seasonality require short-term working capital injections at strategic points in the year. Similarly, SGBs with large B2B clients often need short-term financing to service big orders backed by LPOs. SGBs investing in assets and/or infrastructure usually require a longer-term more patient approach. Responding to this diversity requires more products than our initial proposition suggested.
- SGBs are cautious about entering into long-term investment agreements. When given the option between shorter-term and longer-term repayment plans, SGBs will typically go for the shorter-term option, even if it means putting strain on the business. The longer term partnership model is treated with caution by most SGBs, most of whom are new to concepts such as growth support and technical assistance.
- In response, we are **trialing a range of shorter term products** for SGBs, including LPO financing, working capital loans, and standard fixed-term consultancy, alongside the core long-term product that is the focus of this project. Short term products are only offered to SGBs that we believe will eventually qualify for a long-term product, and in many cases shorter arrangements provide scope, at lower risk, to do "extended due diligence".

To **increase the efficiency and speed of investment due diligence**, we are exploring several innovations:

- **Industry benchmarks**. By focusing on poverty reducing sectors and making a high volume of similar investments, we are creating rules of thumb for different sectors that quickly identify attractive businesses. For example, for schools we know the number of students, the fees, the land ownership, and the teacher-student ratios required for a school to be viable. As we invest in more, these rules of thumb improve.
- **Proxies.** Proxies for a successful business are number of full time employees, staff salaries, the output of employees, the assets owned, mobile money and bank account activity. We use these proxies to quickly if a business is doing well and generating profit.
- **Extended due diligence.** We've learnt that you only really understand an entrepreneur and the business once you start working with them. Areas like trustworthiness and commitment are very hard to ascertain before an investment. We are piloting making smaller short term investments in order to learn and work with the entrepreneur. From this we have excellent data

to make the next investment decision. The other approach would be to get paid for Growth Support, before investing, but this is challenging to sell.
- **Peer to peer** due diligence, credit scoring is another idea being explored, for example by asking existing clients to act as guarantors, or offering bonuses to the peer group for good repayment.

Financial sustainability

- **Financial sustainability for the most recent quarter was 25%**. This is very positive and is due to a higher volume and size of investments repaying well. Assuming that we maintain the same cost base through finding efficiencies as investment numbers grow, we project that we need £580,000 of capital invested per branch to break even.
- Of note this last quarter, we have **sold consultancy support to 5 businesses at between £160 and £300 per month.** This is a very positive development as previously businesses have been cautious about paying for this support. This suggests that our value and brand is going as people learn of the impact.
- **We have stopped using the revenue share model.** We found that it incentivised inaccurate reporting, it created a difficult relationship between Balloon and the investee where we were perceived as auditors rather than partners, and administering it was expensive. Therefore we have moved all investments to straight debt contracts. The challenge of this is there is no upside if a business flies.
- The challenge with making this model financially sustainable is a) that the businesses and ticket sizes are small, so profit from investments and/or consulting is limited, and b) the majority of investment funds have a separate grant funding facility for their TA. **If our TA was grant funded we believe we offer an annual return of 8-10%** in local currency which is what a typical SME investor targeting larger ticket sizes might achieve.
- Assuming our assumptions hold true, to reach sustainability we need £1.16m as described in point 1. We are continuing to build more track record before going out to raise the additional investment capital.

Final reflections

- Given the poor record keeping, we think that revenue is a challenging metric. We believe good jobs is a more accurate and objective measure of business performance.
- Growth work with most businesses is starting with HR. Without a capable team to train and support, sustained impact is difficult. Therefore, at pre investment, we have introduced new requirements to evaluate teams and their capabilities, and to predict emerging HR gaps for SGBs as they implement growth plans. At post investment, all new businesses will undergo a HR audit to uncover and prioritise strengths and weaknesses. The results are used to inform next steps. We are also having good success using the Good Jobs Framework scores in a peer setting as a jumping off point to discuss and address poor staff conditions and the effect this can have on SGB performance.
- We are developing a staff training programme for Balloon staff. This is delivered in-house and was designed based on the needs of our teams

(built around the core consulting toolbox). When the more complete Diagnostic has been built, we will link staff training to this.