On 28 April 2021, the Global Distributors Collective (GDC) and Acumen co-hosted a Forum for donors and investors interested in improving access to finance for last mile distributors (LMDs). 91 attendees representing 59 funders attended the event.

The key objectives of the Forum were to build a shared understanding of the LMD sector; and co-create solutions to tackle the top barriers to finance in the sector. This snapshot highlights the Forum’s key takeaways and emerging ideas.

1. Purpose and participants

The event was divided in two parts. Part 1 focused on understanding the LMD landscape and the financing challenge. It included presentations from the GDC and Acumen, as well as a panel discussion featuring four financing models (SIMA/Angaza Distributor Financing Fund, Aceli Africa, Lendahand/Energise Africa and Persistent), and discussing lessons learned about how to support LMDs. Part 2 focused on designing solutions to access to finance challenges, in breakout groups.

2. Key insights

**Why are LMDs important?**

- To meet the Sustainable Development Goals, last mile populations need access to beneficial products and financing to afford them. **LMDs have a crucial role to play in delivering these products to the hardest-to-reach consumers.** The GDC’s membership alone has reached more than 35 million people to date with products including solar lights and productive appliances, improved cooking solutions, water filters and agri inputs.

- To unlock the full potential of the LMD sector, all types of funding are needed. But even though the importance of last mile distribution is increasingly recognised, capital is still not flowing into the space - and the capital that is flowing is not sufficiently inclusive or tailored to the sector’s needs.

**Is a mind shift needed regarding investment in LMDs? “It’s not all about scale!”**

- The traditional VC model does not work for LMDs due to the 'boom or bust' mentality of VC instruments and returns, misaligned incentives between investors and LMDs, and the exclusionary nature of traditional investment tools. To quote Leslie Labruto from Acumen, "LMDs are never going to be the next Uber, and that’s OK".

- Investors can think differently about how capital is deployed by aiming for ‘replication’ rather than scale. This involves blending traditional types of capital - grant, debt and equity - in new ways, supporting LMDs to revolve their capital eg. through revenue-based loans, demand dividends, profit-sharing models, and social impact bonds.
Attaining profitability in the sector is not easy – but it is possible. Companies are more likely to be profitable early if they focus not on scale but on building efficient sales and customer service systems tailored to their market. As Mia von Koschitzky-Kimani from Persistent puts it, "It's not all about scale". A degree of scale is important, but growth at any cost is typically a poor indicator of a sustainable business - and scale presents its own challenges.

The growth and fundraising journey of LMDs: GDC research based on interviews with 21 leading LMDs

See the full research here. Highlights include:

- **LMDs can achieve substantial impact**, with those in our sample having reached on average 42,000 new customers and achieving on average $3m sales revenue in 2020.

- **Faster-growth LMDs have funded growth primarily with equity at all stages**. They have struggled to access working capital of appropriate tenor and terms, including due to the debt-to-equity requirements of investors, and so have had to use equity to finance inventory and operations. Moreover, growth equity is increasingly hard to access as VCs are looking for fast, sometimes unrealistic growth.

- **Slower-growth LMDs have funded growth primarily with debt**. However, raising loans has been a huge challenge for these companies, given the need to demonstrate substantial track record and turnover.

- **Slower-growth and local LMDs¹ have achieved more sales per $ of capital raised**, suggesting that while they may be slower to deliver impact they may be more ‘efficient’ at doing so. Without an equity cushion, local and slower-growth LMDs may be more driven to achieve profitability quickly. In addition, local LMDs are likely to have lower overheads due to more localised teams.

- **Early fundraising challenges are similar for all LMDs, with a dearth of start-up capital and smaller working capital loans. Challenges then vary depending on growth trajectory**. For LMDs focusing on geographic expansion, it is increasingly difficult to find equity investors and growth is constrained by the availability of working capital financing. For LMDs focusing on profitability, access to loans is limited by their balance sheet.

- **There are three forms of finance needed for LMDs:**
  1. Between $100-400k of grant or equity in their first 2-3 years of operations - and support to raise it
  2. Equity for faster-growth LMDs (from $500k-5m+) to expand rapidly, or as a means to access more debt
  3. For all LMDs, rapid, continuous and growing access to working capital debt (from $50k-2m+) - with reduced collateral requirements, and improved terms.

**What are funders already doing? A few examples from our panellists...**

- Consumer financing is a huge challenge for LMDs and makes assessing loan eligibility and due diligence difficult. **Using standardised measures around asset quality** enables gains in terms of underwriting and monitoring (seen, eg. in SIMA’s experience leveraging data from the Angaza platform).

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¹ ‘Local’ LMD defined as one with majority local ownership and local leadership.
• **Smart subsidies** (in the form of SIINC plus first-loss cover) are being used in the agri sector by the Aceli Africa model, and proving to be effective in increasing the risk appetite of lenders and enabling them to provide small loans to SMEs.

• **Co-financing partnerships** (eg. between Lendahand and SIMA) are a valuable way for investors to share information, build pipeline and become familiar with LMDs at an earlier stage.

• A number of investors are exploring **data-driven approaches to reduce transaction costs** and offer small ticket sizes (eg. the existing SIMA/Angaza Distributor Financing Fund, and Lendahand’s development of an automated credit scoring system).

• **Focusing on the cost side of LMDs and developing simple metrics to understand overheads** is useful to assess their potential for profitability. SIMA Funds looks at the operating expenses:revenue ratio of LMDs, and has found that a ratio of 20-25% is a good benchmark for a local LMD in East Africa.

• **Subsidy seems to be the only possible solution to challenges around local currency financing.** Lendahand is about to release a local currency platform in partnership with TCX, but without subsidy this will still generate an additional hedging cost for the investee.

3. **Financing challenges and emerging ideas**

Breakout groups at the event discussed specific financing challenges and potential solutions. Participants demonstrated a shared enthusiasm for better understanding the sector and for more collaboration among funders. The challenges and solutions are summarised below.

### LMD financing challenges

- **Start-up capital of all kinds**, particularly equity and flexible grant funding, especially for local LMDs who have less developed networks.

- **Capital-raising support**, especially for small and local LMDs who have limited bandwidth, do not speak the language of funders, struggle to set up strong finance and governance structures, and have limited connections.

- **Smaller working capital loans** for early-stage LMDs who typically need to borrow under $100k, but struggle to borrow anything without substantial track record and turnover.

- **Growth equity** with realistic growth and return expectations, particularly for fast-growth LMDs.

- **Larger working capital loans** of longer tenures, to ensure a continuous supply of financing and reduce the frequency of fundraising for larger LMDs.

- **Local currency loans** to reduce currency risk exposure, especially for LMDs providing consumer financing who have long cash conversion cycles.

- **Improved working capital terms** with longer tenures, lower interest rates, reduced collateral requirements, lending at higher debt:equity ratios and including ways to show more attractive balance sheets.

- **Improved funding processes** for all types of capital to minimise bureaucracy and disbursement delays, which create significant stress for LMDs and endangers their operations.

#### a) Data, evidence and insights

- Build a clearer picture of the capital continuum, to help LMDs identify funders at each stage of growth, and help funders understand the gaps in financing available.
- Create benchmarks to help investors compare LMDs’ performance, and help LMDs compare potential investments with deals closed to date and their respective terms.
- Undertake research to better understand what profitability looks like and better align LMD/investor expectations, as well as to build a shared understanding of how impact can be achieved through replication of slower-growth business models, as well as scale.

**b) Sector collaboration**

- Create spaces for LMDs, funders and technical assistance (TA) providers to network, exchange information, and identify opportunities to collaborate.
- Build an alliance of funders, to streamline the process for LMDs as they move along the capital continuum and help early investors to exit.
- Explore ways to increase participation of local investors, eg. by having local banks join syndicated deals led by specialist intermediaries. This could help to provide local currency financing.
- Explore opportunities for investors to finance end-users directly, eg. by helping LMDs build partnerships with MFIs.

**c) Capacity building**

- Accelerate capacity building efforts. The sector needs TA bundled with finance as well as unbundled TA. Capacity building should include skills training for junior and middle management staff, temporary embedding of key staff (eg. CFOs), peer learning opportunities and mentoring, sector-wide tools and templates, fundraising support and match-making, and transfer of learnings/best practices. This could be best delivered through a holistic TA facility for LMDs.
- Provide support to funders to design financing mechanisms and capacity building interventions that are fit for LMD needs.

**d) Blended finance, incentives and risk mitigation**

- Scale up incentives/subsidies, guarantees and technical assistance, to both international investors as well as local banks at country level, to support LMDs. Explore the Social Impact Incentives (SIINC) model in the LMD sector, topping up lenders’ returns when investees achieve high impact.
- Grant funders to increase their risk appetite and embrace the ‘numbers game’, providing small amounts of unrestricted funding to a large portfolio of start-ups, accepting a high failure rate (eg. D-Prize model).
- Develop standardised ways to collateralise receivables (eg. African Frontier Capital receivables facility), that local financial institutions could replicate.
- Establish a blended growth equity vehicle for LMDs that mixes public and private capital to build a ‘fund of funds’, where each fund targets different return expectations and has its own fund manager. The goal is to provide different flavours of financing and spread the risk across the fund of funds.

**e) Improved funding processes**

- Funders to set clear and achievable milestones for disbursements, in particular to help smaller companies that cannot meet initial investor requirements. Funders could consider a revenue- or profit-based repayment mechanism to align incentives, ensure flexibility and build resilience (eg. Untapped).
- Investors to be more upfront about due diligence processes, including by providing a check-list to companies before they start and holding comprehensive kick-off calls to align expectations.

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4. Next steps

- Some of the solutions identified are ‘quick wins’ while others are bold, long-term ideas that will take time and funding to develop. Over the coming years, the GDC hopes to work alongside funders, LMDs and service providers to lead and/or support many of the above solutions.

- Pending donor approval, in the next six months the GDC aims to drive the following:
  1. Data, evidence and advocacy: Building on the GDC’s existing LMD funding database, create a clearer and up-to-date picture of the capital continuum; and continue to build sector understanding of what growth and impact look like in the LMD sector.
  2. Sector collaboration: Create more spaces for LMDs, funders and TA providers to cooperate, network and exchange information.
  3. Capacity building: Broker pro-bono or low-bono TA and mentoring partnerships for LMDs; support funders to design and tailor financing mechanisms and capacity building interventions for LMDs; and develop a set of tools for LMDs to increase investment readiness and ease the due diligence process.

- Acumen commits to host a follow-up funders call in June to share innovative instruments for supporting and investing in LMDs. On the call, Acumen will share more with interested funders about its design of an impact-indexed loan instrument, with annual disbursements based on financial and impact evaluation. Interest rates would be based on impact: the higher the percentage of first-time access customers or customers served below the poverty line, the lower the interest rate.

If, like us, you are inspired to take action and explore one or more of these solutions, we invite you to take a look at our full research piece on the growth and fundraising journeys of LMDs, and contact us at GDC@practicalaction.org.uk