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Deconstructing Equity Finance Needs for Medium Sized Firms in Namibia – The Issue of Fit Revisited

Anna T. Kangombe[1],
[1](Graduate School of Economic and Management Sciences, University of Stellenbosch, South Africa)

Abstract : *This paper examined the issue of fit between equity funds and medium sized enterprises in Namibia. The study used data from 71 medium sized enterprises and 18 equity funds. Descriptive statistics were used to analyse the difference between minimum and maximum capital investments required by enterprises and the corresponding amounts offered by equity funds. The results show that, in terms of investment amounts, equity Funds in the country are structured to fit the needs of their target clients.This study opens a dialogue to disaggregate and critically analyse findings on micro and small enterprises before generalising them to medium sized enterprises in Namibia.*

Keywords: *Equity finance, growth capital, Medium size enterprises, Namibia*

I. Introduction And Background

There is limited scholarly research on equity financing for medium sized enterprises in Namibia. The debate on financing is usually general and typically gravitates around Small and Medium Enterprises (SMEs) which most often than not include micro enterprises. This, despite the fact that micro and small enterprises oftentimes have access to other sources of funding; especially state funded enterprise development programs which medium sized enterprises lack (Zaaruka et al, 2007). In Namibia's case for instance, since 1997 until recently, the government through the Ministry of Trade and Industry has had a small and micro enterprise development program by definition, even though by reference, it is called an SME program. Through this program, beneficiaries are defined as enterprises employing between 5 and 10 people with an annual turnover of less than NAD 250 thousand for non-manufacturers and less than NAD 1 million for manufacturers (Ministry of Trade and Industry 1997). Despite the explicit reference to small enterprises only, this definition is used and applied as a generic definition for SMEs in Namibia (see for instance Nashidengo, 2007:11). Resultantly, firms falling within the defined parameters i.e. small enterprises have been the target for most SME programs, leaving out medium sized enterprises. A similar example is that of the then Small Business Credit Guarantee Trust (SBCGT) which provided funding to micro and small enterprises (Zaaruka et al, 2007).

Decoupling the dialogue on financing for medium enterprises from small and micro enterprises in Namibia is peculiar and not convenient for practitioners. For example, most financial institutions in Namibia have MSME lending criteria but they do not differentiate between micro, small and medium enterprises (Enclude, 2014). They are treated as a homogenous group. But, it does not have to be that way. Micro, small and medium enterprises have different needs even though they operate in similar environments. Funding needs are one such example.

SME funding in Namibia has always been an obstacle to growth but strategies to address this constraint only intensified after the country's first Business Investment Climate Survey 2009 highlighted the stunting effects on the sector's ability to create employment and on its overall contribution to the economy (IPPR, 2009). It should be noted that the results of this survey coincided with the 2008 Labour Force Survey which declared that unemployment rates for the country has gone up to 51.2 percent from 34 percent in 2004 (Ministry of Labour and Social Services, 2008). In its results, the Business Investment Climate survey highlighted two important issues regarding financing for SMEs. The first important point is that, the cost of funding is only a major challenge for micro and small enterprises. The second point is that, the most critical concern for medium enterprises is not cost of funding, but, collateral and securities. In Namibia, conventional loans have for long been considered an important source of finance but difficult to access given the country's colonial past which prevented majority of the population from accumulating wealth, a facilitator for raising required collateral (Sherbourne, 2012). As presented in in a study by Sherbourne (2012), 58% of participating SMEs were established using owner's funds (savings) while 10 % were established with funds from friends and families. Only 27 % of the firms were established with funding from the banks. This picture therefore presents an opportunity for alternative funding for medium enterprises given their lack of collateral.

II. Equity Finance As An alternative Source of Funding In Namibia

Although the history of equity finance dates back to the late 18th and 19th centuries, Namibia only got its first 'formally constituted private equity firm' in 2004 (Cull et al, 2006; Shebourne, 2012). Prior to that, direct equity financing investment efforts were tried through Namibia Harvest Investment Limited and the Government Institution Pension Funds' Development Capital Portfolio (DCP) but both failed to the detriment of the industry (ibid). Today, there is an estimated amount of over 18 equity Funds and Fund Managers in Namibia, owing to the government's regulation 28 & 29 of the Pension Funds Act, 1956 (Act No. 24 of 1956) which requires pension funds to invest a minimum of 1.75 percent in local unlisted investments. According to the latest official available data, in 2014, Namibia's pension funds' investments in private equity asset class grew by 46.16% and this figure is expected to be higher following the compliance deadline of June 2015 (Ashiagbor & Vidal, 2016).

Typically, private equity financing is a more optimal source of capital for firms that are seeking substantial growth capital. Investing in firms seeking smaller amounts can be a disadvantage for an equity financing firm as it will incur similar due diligence and management costs but with a comparatively lower return. The advantage of equity financing for medium enterprises in Namibia especially is that, it does not require collateral/securities or a good financial track record which most medium firms often lack. Instead, it focuses on the ability of the investee company to generate future high returns. Thus, medium firms in Namibia are in a potential position to draw and attract equity financing. But, is Namibia's equity finance offering aligned with the needs of the firms?

III. Objective Of The Study

As with any type of financing, equity finance firms have a role to provide quality optimal products and services to meet the demands of their chosen market. Previous studies on SME financing in Namibia have either focused on identifying if there is a need for finance in the industry while few have explored general financial products available for small and medium sized enterprises, with a focus on conventional debt financing. There are limited studies on the extent to which equity financing products are fit for medium enterprises in Namibia. This study aims to explore if Namibia's equity finance (supply side) is structured to meet the needs of medium size enterprises (demand side). The question this study aims to answer is thus, are equity funds' structures in Namibia fit for medium sized enterprises? The study is born out of the need to determine if financing products in Namibia are adequately responding to outcome 4(a) of the Namibia Financial Sector Strategy which aims to 'improve access to financial services and products by eligible Namibians by reducing lack of access from the current baseline of 51.7 percent to 26 percent' (Ministry of Finance, 2012:29). The study is also revisiting a premise submitted by Business Financial Solutions (2013) indicating that equity funds in Namibia are not fit for SMEs.

IV. Theoretical Framework

Equity financing has for years been a source of capital for medium sized enterprise who often lack collateral to raise debt financing or the ability to meet listing requirements for issuing shares through stock exchanges (Gompers & Lerner, 2001). Much of the literature on equity finance use the terms private equity and venture capital interchangeably. Theoretically, the two are not entirely the same because private equity is the entire asset class while venture capital is only one (perhaps the most commonly known) form of private equity. Private equity fund types are determined based on the state and the stage of investee companies. But the investment cycle is similar. Going into these classifications means categorizing equity investments further using all their intricate characteristics which typically often overlap; i.e. mezzanine which carry VC and debt components of buyout transactions, buy outs which prefer taking majority control and distressed investments for firms experiencing difficulties (Metrick & Yasuda, 2010). The overlap between the different types of equity financing are presented in the diagram below. The graph also shows the overlap between private equity funds and hedge funds. However interesting, the discussion about private equity and hedge funds is beyond the scope of this paper.

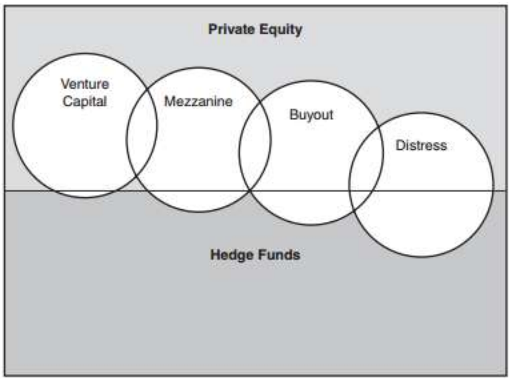

Figure 1 Types of Equity Funds
Source: Metrick & Yasuda (2010:7)

In keeping with international standards, a study by the Bank of Namibia maintained reference to equity funds asset class as private equity and adopted a broader classification by KPMG; namely, venture capital and non-venture capital Funds (Zaaruka *et al*, 2007). These categories are described in the table below.

Table 1: Broad Categories and Descriptions of Equity Funds

Venture Capital	Seed Capital	Funding for research, evaluation and development of a concept or business before the business starts trading.
	Start-up and Early Stage	Funding for new companies being set up or for the development of those which have been in business for a short time
Non Venture Capital	Expansion and Development	Funding for the growth and expansion of a company which is breaking even or trading profitably.
	Management buy-out (MBO) or buy-in (MBI)	Funding to enable a management team and their backers to acquire a business from existing owners.
	Replacement Capital	Funding for the purchase of existing shares in a company from other shareholders.

Source: KPMG as cited in (Zaaruka *et al*, 2007)

The classifications above are not only important for class room learning or boardroom discussions and statistics. Distinguishing different types of investments is essential to understand the relationship between investors and investee firms because in practice, these terms are used interchangeably (Groh *et al.,* 2010). It is also important to understand fund terms and evaluations of portfolio performance. This position is supported by the Southern African Venture Capital and Private Equity Association which instead of using private equity and venture capital interchangeably, distinctively define Venture Capital as ‘a subset of the private equity asset class, which deals with predominantly equity funding of high-tech, high-growth-potential businesses, whose growth is achieved typically through radical global scaling (SAVCA, 2015:5). For the sake of this study, the terms equity funds or equity financing firms are used to refer to providers of the entire private equity asset class.

Theory tells us that equity financing exists because of information asymmetry (Metrick & Yasuda, 2011). This means that investors and investee companies lack information on the opportunities that each presents. Equity finance providers play the intermediary role by collecting funds from institutional investors and wealthy individuals and channel those funds into investments that have growth potential. Some authors such as Wright and Robie (1998) have referred to these types of investments as ‘long term unquoted risky equity financing’. Private equity funds are therefore agents in the economy that facilitate the allocation of investments to opportunities that would otherwise be risky for investors. As Campello & Matta (2010:29) have conceded, the distinct value of equity financing firms is their ability to ‘screen out bad projects from a pool of projects’ to and to develop portfolios that present investors with better returns compared to a situation where they would make direct investments into those projects. This brings a question as to how equity finance firms are able to provide such value.

Unlike conventional debt finance where lenders start harvesting from their investments through instalments almost immediately after such investments are done, equity finance firms do not. They provide what is referred to as ‘patient capital’. This means that equity finance firms do more than just provide capital. They are also responsible for providing expertise and networks for growing those investments because their harvest only takes place at exit (Cuny & Talmor, 2007). Exits usually take place between 5 and 10 years depending on the market and industry. This compels private equity firms to choose their investee projects carefully to ensure that they have winners at the end of the investment period.

V. Methodology

This study used data from three different sources. The first source is a survey that was commissioned by Business Financial Solutions, co-sponsored by Bank Windhoek, the Global Compact Network Namibia (GCNN) and the Gesellschaft für Internationale Zusammenarbeit (GIZ) in 2012 to determine if there is scope for a new private equity fund in Namibia. The survey consisted of 100 medium sized firms defined as enterprises employing between 10 and 100 people. Because there is no database for medium sized enterprises in Namibia, the survey developed the sample using data from the Employment Equity Commission of Namibia (because the current legislation requires all firms employing 25 people or more to register with the commission); data from the Social Security Commission (SSC) where all employers are required to register their employees (used to sieve out those firms that meet the criteria) and lastly, data derived from the development bank of Namibia and commercial Banks.

The second source of data used in the current study is a survey that was commissioned by the Southern Africa Innovation Support Programme on active local providers of Venture Capital, Private Equity and Angle Funding in Namibia in 2013. At the time, only 10 equity funds were identified and they all took part in the study. The study was to take stock of all private equity/venture capital funds and angel firms in the country and present their criterion for funding to SMEs.The third source is an operational database of registered equity funds that Business Financial Solutions has created for their market research purposes. This database was used to augment the data from the Southern Africa Innovation Support Programme survey. This was especially important because the SAIS survey only consists of 12 Funds while in 2015 alone, a number of 9 equity funds were registered.

Together, the two surveys are used to determine the compatibility of equity finance product offering with the needs of medium sized enterprises in Namibia. Specifically, the first source of data (survey commissioned by Business Financial Solutions) is used to present the demand side data while the second and thirds sources (survey by the Southern Africa Innovation Support Programme and the Business Financial Solutions operational database) are used to present the supply side data. Equity funds that had no data on the amounts of funds they provide were omitted. The analysis was done using SPSS.

VI. Results And Discussion

a) Supply Side – Equity Funds

The review of the literature indicates that equity funds prefer to make fewer larger investments than many smaller investments. But how does this serve the needs of medium sized firms in Namibia? The results from the current study shows that equity funds have minimum and maximum amounts of funds that they provide, constituting floor and ceiling amounts. The lowest amount provided by equity funds in Namibia is NAD 100 000 while average lowest amount in the industry is about NAD 10million. On the higher side, the maximum amount provided by equity funds is NAD 200 million while the average highest amounts provided in the industry is about NAD 57.5 million.

Table 2 Investment Ammounts of Equity Funds

		Lowest Amounts Offered	Highest Amounts Offered
	Valid(N)	*18*	*18*
	Mean	10005555	57472222
	Median	6500000	32000000
	Mode	5000000	32000000
	Std. Deviation	11188253	48853464
	Minimum	100000	10500000
	Maximum	50000000	200000000

Of the 18 equity funds assessed in the country, there is only one fund that provides capital to firms requiring less than NAD 1 million. The lowest amount for majority of the Funds (fourteen) is between NAD 1 million and 10 million, while the reminder, four funds only provide funding to enterprises that require an amount starting between NAD 10million and NAD 50 million.

Table 3 Lowest Investment Amounts Offered (ranges)

	Frequency (N)	Percent (%)	Cumulative Percent
below 1million	1	5.6	5.6
between 1 and 10 million	13	72.2	77.8
between 10 and 50 million	4	22.2	100.0

Total	18	100.0	

In terms of the ceilings, about 12 out of the 18 assessed equity funds provide amounts of between NAD 10 and NAD 50 million with 2 Funds providing more than NAD 100 million. The table below shows the maximum amounts provided by equity funds in the industry.

Table 4 Highest Investment Amount Offered (ranges)

		Frequency (N)	Percent (%)	Cumulative Percent
	Between 10 and 50 million	12	66.7	66.7
	between 50 and 100 million	4	22.2	88.9
	over 100 million	2	11.1	100.0
	Total	18	100.0	

Demand Side – Medium Sized EnterpriseOut of the 100 firms that took part in the demand side survey, 71 indicated that they needed growth capital and provided the amount required. The results show that the minimum amount firms require for their growth plans is NAD 150 000 which falls within the minimum amounts offered by equity funds which is NAD 100 000. The maximum amount required is NAD 270 million with an average amount of close to NAD 14 million.

Table 5 Medium Sized Firms Investment Required (Descriptive)- N=71

Descriptive	Amounts
Mean	13,825,352
Median	3,000,000
Mode	2,000,000
Minimum	150,000
Maximum	270,000,000

When compared to equity funds' offerings, only one firm requires an amount of NAD 270 million which is above the NAD 200 million maximum ceiling. With that exception, all required amounts of the reminder of the 70 firms are within the scope of participating Funds as indicated in the table below.

Table 6 Medium Sized Firms Investment Required (ranges)

	Frequency (N)	Percent (%)	Cumulative Percent
below 1 million	10	14.1	14.1
Between 1 and 10 million	45	63.4	77.5
between 10 and 50 million	14	19.7	97.2
over 100 million	2	2.8	100.0
Total	71	100.0	

What is worth noting is that majority of the firms require amounts between NAD 1 and NAD 10 million followed by those requiring between NAD 10 and NAD 50 million. Thus, the overall results show that medium sized firms require amounts that resonates well with the investment amounts offered by equity funds in the industry. This finding extends current knowledge on the issue of fit between equity funds on the market and medium sized firms in Namibia by disaggregating micro and small firms from the debate. Thus, the earlier postulation of Business Financial Solutions (2013) stating that equity funds in Namibia are not fit for SMEs may be true for other aspects that have not been examined by this study but not in terms of the mismatch between investment amounts required and those offered.

VII. Conclusion

The aim of this paper was to explore if Namibia's equity funds structures are fit for medium sized firms, focusing on the minimum and maximum investment amounts offered by the funds against investment amounts required by the firms. Using data from past surveys, the results shows that Fund structures in the country are almost a mirror image of funds required by medium sized firms in the industry. This study therefore concludes that, in terms of investment amounts, equity funds are aligned to capital requirements of medium size enterprises. It should however be noted that, as discussed under the literature reviewed, equity funds availability does not equal fund allocation. This is because fund managers have stringent selection criteria and due diligence processes aimed at identifying and picking high growth oriented firms. Thus, if medium sized firms are not aggressively entrepreneurial and innovative, they may not have access to these funds.

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