Accelerating Improvements in Health Product Distribution

EXAMINING OPPORTUNITIES FOR BLENDED FINANCING IN SUB-SAHARAN AFRICA

March 2021

SALIENT | SOUTHBRIDGE

CONTENTS

3 DISCLAIMER

4 ACKNOWLEDGMENTS

5 ADVISORS

6 EXECUTIVE SUMMARY

7 PROBLEM, SCOPE AND PROCESS

11 KEY FINDINGS

23 SOLUTIONS IDEATION

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This work examined how blended financing approaches can accelerate the growth and impact of start-ups and mid-sized distributors of health products in sub-Saharan Africa (Nigeria, Kenya, Ghana and Uganda) to improve the availability, affordability, access and quality of essential medicines.

Findings suggest that for start-ups and distributors to grow and scale efficiently, they need:

1. Risk-tolerant capital to develop and deploy technology-driven innovations
2. Access to timely, affordable foreign currency to optimize product importation
3. Affordable working capital in local currency to ease cash conversion cycles
4. The ability to secure affordable debt
5. Regulatory approaches that enable start-ups to expand scale and scope, while maintaining patient safety

Over the past 20 years, blended finance initiatives to improve health in Africa have traditionally focused more heavily on product development (e.g. through product development partnerships), product pricing (e.g. through volume guarantees), and clinical service delivery (e.g. through joint programs for investment paired with technical assistance).

In comparison, **opportunities to blend highly risk-tolerant grant capital with debt and equity to address market failures in health product distribution appear under-explored. Ambitious, rigorous and action-oriented approaches are required.**

To jump start thinking on potential action, early ideation in two areas was undertaken:

- First, to better deploy risk-tolerant financing and professionalized support for tech-enabled start-ups in health product distribution and delivery, a state-of-the-art initiative to scale data-driven innovations through small grant funds and professionalized acceleration was described.
- Second, to enable better access to debt, with a focus on affordable working capital, an effort to build a best-in-class, scalable risk assessment mechanism was outlined. This capacity could power a working capital facility for health, where funding would be raised in local currencies, to further decrease debt prices for small- and medium health enterprises in distribution and delivery.

The early ideas outlined are by no means comprehensively described or evaluated. Instead, we hope to sharpen understanding of the needs, thus inspiring more ambitious design, action and commitments. **Investing to help improve the efficiency, effectiveness and sustainability of health product distribution is critical.**

- **Problem, Scope and Process**

Key Findings

Solutions Ideation

In many countries in Africa, a large proportion of people depend on private distribution systems for access to essential medicines. However, highly fragmented, private supply chains often fail to provide regular access to low-cost, high-quality essential medications. In fragmented markets, start-ups and mid-sized distributors are often operating at a smaller scale, unable to leverage technologies and economies of scale or scope to better deliver for their customers.

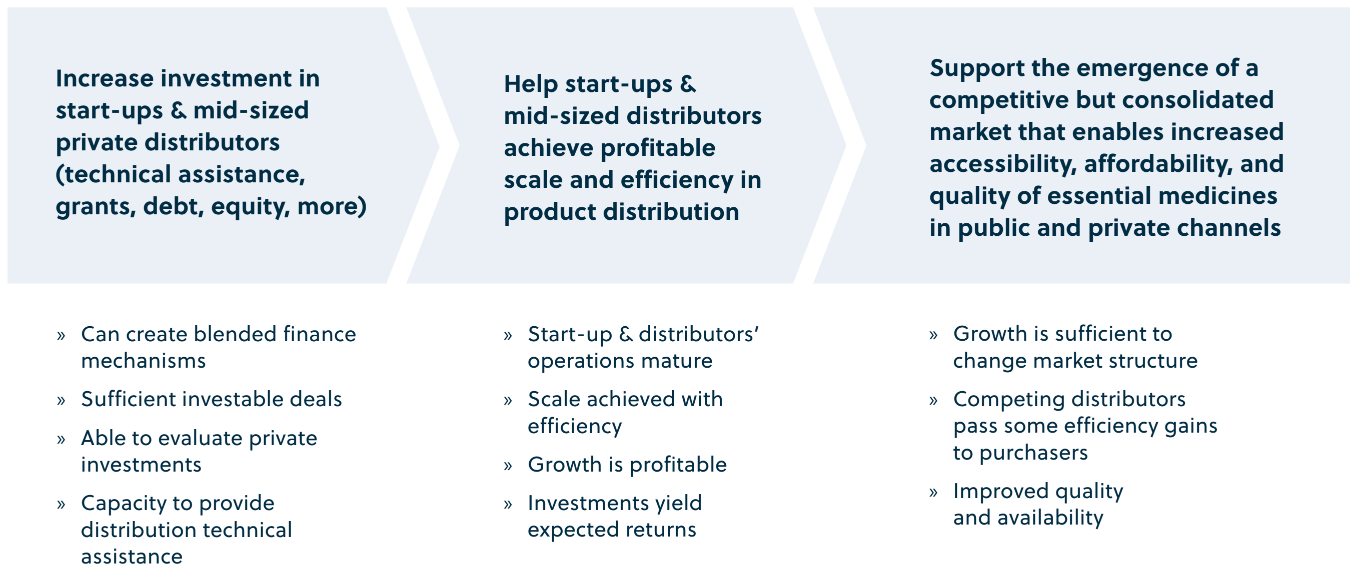
This project asks "How might blended financing be leveraged to accelerate the growth and impact of start-ups and distributors in sub-Saharan Africa to improve the availability, affordability and quality of essential health products?"

This project focuses on mechanisms that can drive the growth and efficiency of private sector distributors by increasing investments of grant, debt and equity.

PROBLEM

Many people in focus geographies obtain health products by way of private distribution systems that suffer from inaccessibility, lack of affordability, and poor quality.

THEORY OF CHANGE & KEY ASSUMPTIONS

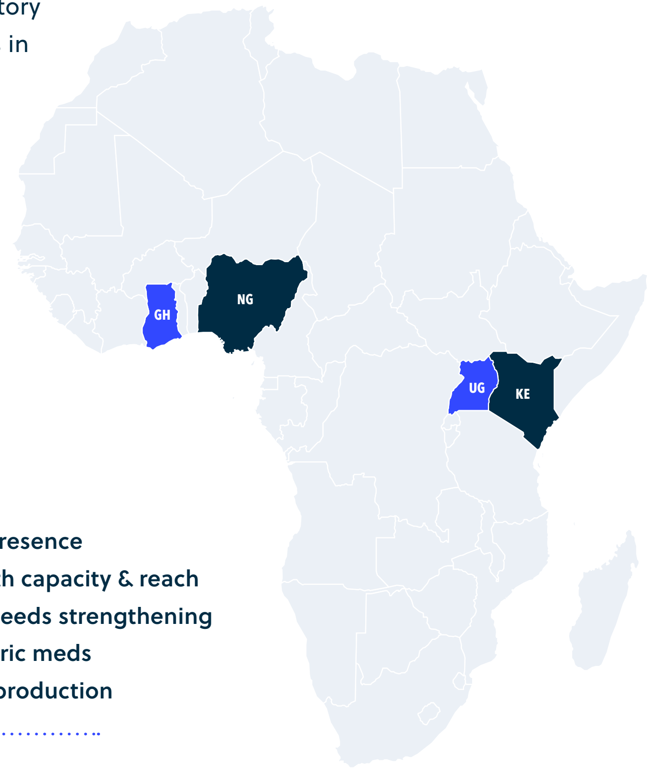


This path is not the only way to drive a more competitive, consolidated, efficient and effective market—there are others. Though health impact is a downstream effect, investments should carefully consider alignment of incentives to achieve this upfront.

This project operates under the assumption that financing investments to improve growth trajectory and operational efficiencies will help drive the scale of some businesses, eventually helping the market move towards consolidation. Of course, such investment would only be one part of a larger effort required to achieve changes in market structure and dynamics. This project does not examine what other changes might be required. Increasing blended financing is likely a necessary step, but it is not sufficient.

GEOGRAPHIC SCOPE

The study focused on four countries: Kenya, Nigeria, Ghana and Uganda. Kenya and Nigeria boast large, private sectors, a maturing regulatory environment, higher quality management systems and standards in distribution, consolidation in importations, with high levels of fragmentation in last mile delivery, and emerging local manufacturing capacity. In contrast, Uganda and Ghana represent emerging markets with higher GDP growth but sustained donor presence. In these contexts we see lower levels of local production, some distributors demonstrating maturity and reach, but a continued need for strong talent to strengthen supply chain management.



Kenya & Nigeria

- Large, private sector markets
- High QMS standards & scale
- Generics highly fragmented
- Maturing regulatory environment
- Higher levels of local production

Uganda & Ghana

- Emerging markets
- GDP growth, donor presence
- Some distributors with capacity & reach
- HR for supply chain needs strengthening
- Higher levels of generic meds
- Lower levels of local production

Private sector distribution is complex, with many players including retailers/merchants, start-ups, small- medium- and large-scale distributors, manufacturers and more. Actors often play multiple roles, and relate to one another as customers, competitors or partners. This work focuses on the potential for blended financing to improve the growth and efficiency of **start-ups and mid-sized distributors**—others are out-of-scope.

Scope	Actor	Description	Revenue	Examples
area of focus	**Start-ups**	Increasing number of tech-enabled companies, many poised for growth	$0.5-10M annual revenue	*DrugStoc, my-medicines.com, RxAll, MedRX, more*
area of focus	**Mid-size distributors**	Many medium-sized, family-owned companies, most import and have physical assets	$10-100M annual revenue	*Global Health, Abacus, Osons, Konga, Zolon Healthcare, Medical Access, Omaera*
*out of scope**	**Incumbent distributors**	Few large-scale incumbents, growing through acquisition; have different financing structure due to scale, profits, banking relationships	>$100M annual revenue	*Imperial, Eurapharma (Laborex)*
*out of scope**	**Manufacturers**	Largely foreign, based in India, China, Malaysia, Europe and more		*Cipla, GSK, Pfizer, Mylan, Teva, many, many more*

**Potentially high impact but engagement requires different theory of change and approach*

WHAT DO WE MEAN BY 'BLENDED FINANCE'?

In this context, "blended finance" refers to approaches that leverage a combination of grants, debt and/or equity funds. The use of this capital can take several forms including but not limited to: grant investments in technical assistance or policy/advocacy, debt for working capital or asset financing, mezzanine debt for companies or projects, equity investments in seed-, venture- or growth-stage companies or in projects, debt and equity for funds or investment vehicles, and more.

technical assistance	*working capital loans*	*seed*
policy & advocacy	*asset financing loans*	*venture*
	mezzanine debt	*growth*

PROCESS

The learning exercise was completed over 16 weeks and entailed a rapid review of existing data, key informant interviews with nearly 50 experts, analysis to identify a set of key challenges, and early ideation on solutions.

Through key informant interviews, we collected new data on companies' business operations and related payment and supply terms, import mechanics, OPEX and CAPEX needs, existing sources of financing, access to and use of debt/equity financing and more. Data on other pain points impacting operational efficiency or market entry (such as regulatory challenges) were also collected and evaluated. Five key challenges were identified, and early solution spaces described with a focus on two.

Problem, Scope and Process

Key Findings

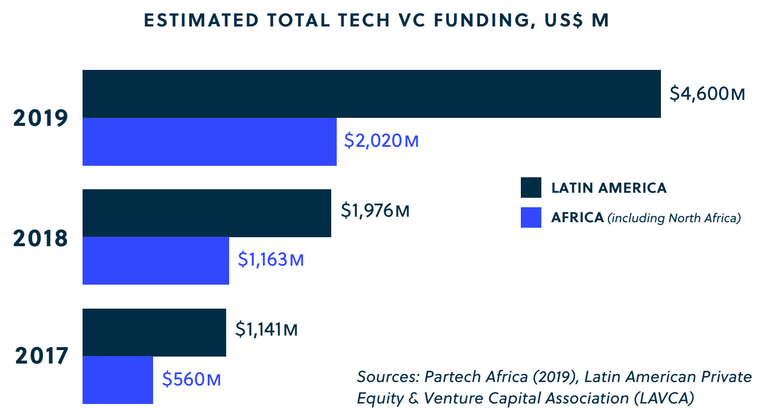
Solutions Ideation

There are three types of capital available to health product distribution companies in Africa: equity, grant and debt financing. However, access is shaped by the broader context of financing across the continent.

EQUITY & GRANTS

Access to equity financing in Africa is constrained because the amount of total available funding is limited and concentrated in terms of geographies, industries, and beneficiaries.

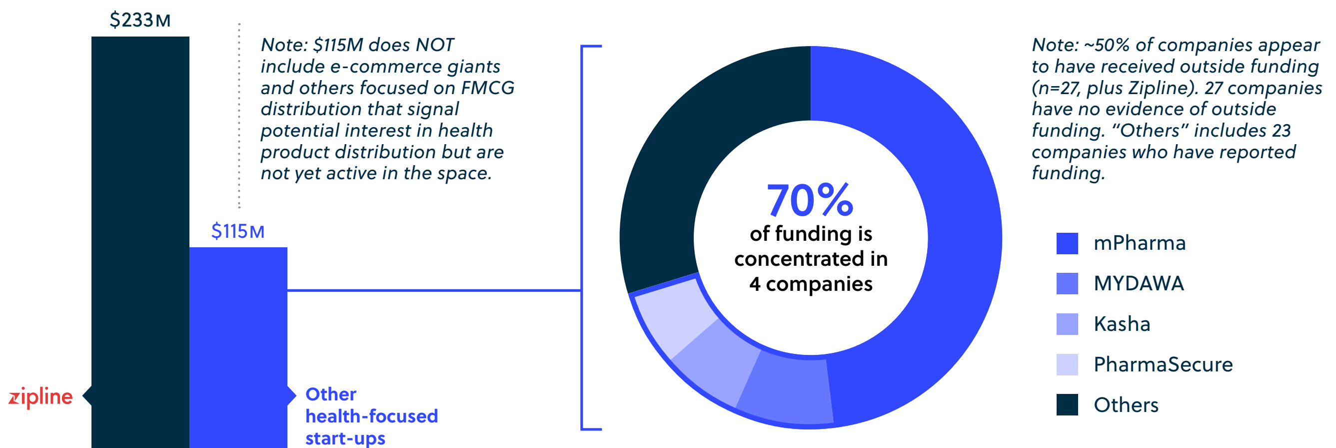
Venture capital and private equity funding, while growing, is still underdeveloped and concentrated.



Though it's showing recent growth, the African market for venture capital is still small. Only $2B was raised in 2019 by African start-ups, compared to around $4B raised in Latin America; and $14B raised in India. Plus, the African venture capital market is concentrated. Industry-wise, venture capital is largely focused on Fintech (40%), energy and agriculture. Geography-wise, 85% of funding is concentrated in Nigeria, Kenya, Egypt, and South Africa. Thus the health sector, and companies in many priority geographies, are still under-served.

Why is the African investment market concentrated with a limited number of transactions? For private equity investors, investment tickets are often too small to cover high transaction costs. Plus, private equity investors often seek multi-country distributors and are limited to a small pipeline. For venture capital investors, there are a limited number of innovative business models with proven traction, and investment entails high transaction costs.

Given this context, it's no surprise that start-ups operating in health product distribution have challenges raising funds. Salient tracks 54 start-ups in health product distribution operating in the focus geographies, and only 50% appear to have received external funding of any kind over the lifetime of the business. Zipline is the largest fundraiser, though unmanned aerial vehicles are out-of-scope for the purposes of this project. Excluding Zipline, 27 companies appear to have received external funding, totaling a little over $100M. However, 70% of the funding appears to be concentrated in only 4 companies, with the bulk of the financing going to mPharma.



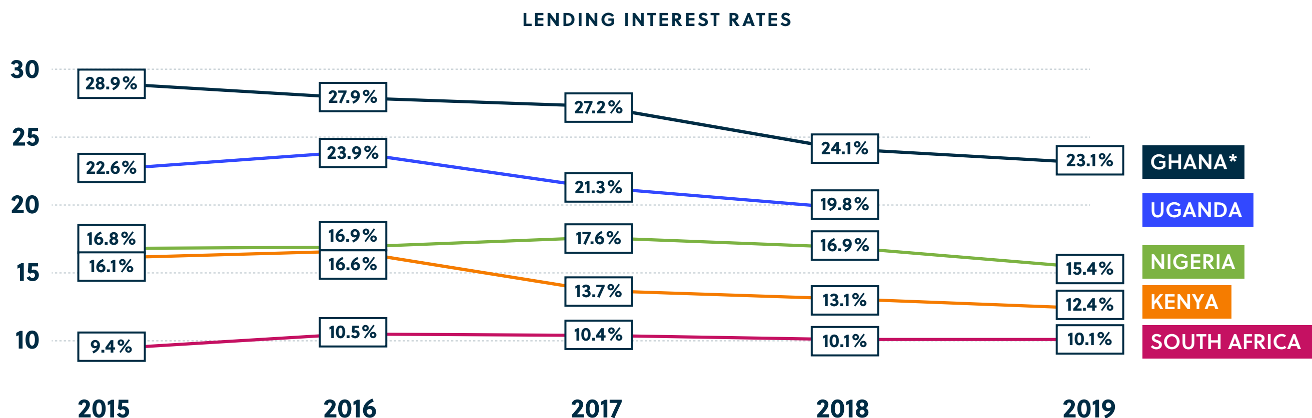
Source: Salient analysis of start-ups in health product distribution in Africa. Not all data have been validated, may not be entirely comprehensive.

DEBT

Contrary to equity, debt capital is more highly available but remains expensive and inaccessible. Banks remain the first financial provider for African businesses, including distributors. However, issues with the cost of debt and access appear to be primarily driven by structural constraints set outside of the health sector.

Lending interest rates are high in focus countries, ranging on average from approximately 12% in Kenya to 23% in Ghana, making financing working capital and investments too costly for many companies. High interest rates are caused by structural factors such as underdeveloped banking sectors, high inflation rates, medium to high levels of country risks and high refinancing costs.

Challenges with local debt capital are shaped by forces *beyond* the health sector.



*Source: World Bank | *Source: Central Bank of Ghana*

Unfortunately, most start-ups and distributors we spoke with borrow at even higher rates than the market averages. The difference between actual rates and market rates can be up to 500-700 basis points (5-7%). For example, in Nigeria, a distributor might borrow at 20% instead of the 15.4% average rate. Interviewees reported receiving higher rates primarily because they're considered small or medium enterprises (SMEs), for which banking in Africa is not well-developed. Higher rates for these businesses reflect perceived risks by banks who are not well-equipped to asses and manage risk for SMEs generally and in the health sector specifically.

If you want to do business for 25M UGX, then the bank will require collateral worth 75% equivalent. Even if you have the collateral, they will still ask you for a personal guarantee.

– Distributor

Bank of Ghana only considers tangible assets as valid collaterals. They will always prefer land or machinery over other types of securities.

– Distributor

Even if a SME distributor is ready to assume the high cost of debt, collateral requirements make accessing the loan very difficult. Most interviewees cited collateral requirements as one of the main barriers to accessing debt; one interviewee reported being asked to provide collateral worth 75% of the value of the loan. Unfortunately, what qualifies as collateral is very limited; often banks will only accept titled land or buildings. The exact definitions are sometimes set by law (Ghana), other times set by internal credit policies. **Due to the high cost and/or difficulty in access, most start-ups and many small distributors avoid bank loans.**

Financing solutions for international transactions (including imports) are generally more expensive and scarce in Africa.

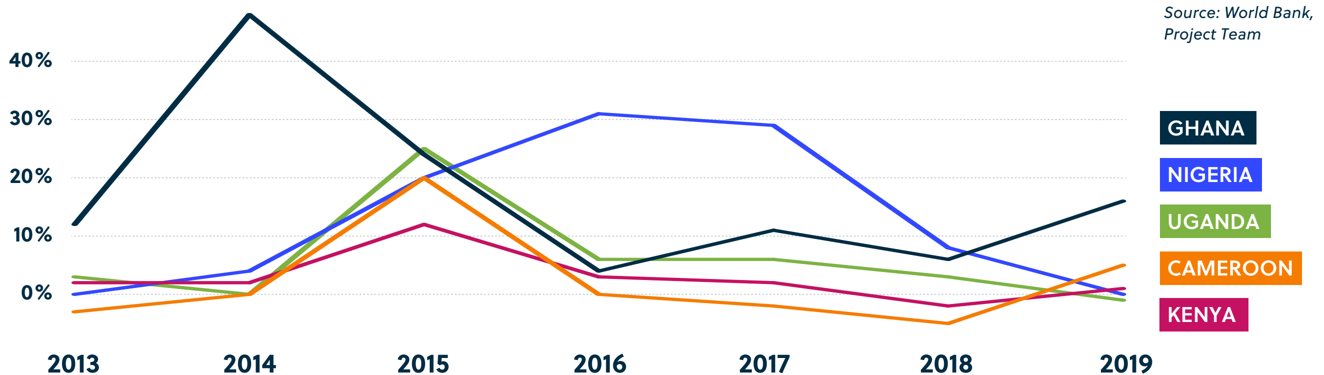
FOREIGN EXCHANGE & TRADE

Many distributors import medications, thus need to be able to finance international transactions. Importing challenges businesses in two key ways: 1) it's difficult to access foreign currency and trade finance tools to secure an international transaction, and 2) it costs more in Africa than elsewhere to access foreign liquidity and trade tools.

Cost of foreign currency can be high because of scarcity of liquidity and/or country risks. In Nigeria for example, limitations in access to foreign currency often causes mid-sized distributors to obtain foreign currency through parallel markets, where the foreign exchange rate is ~30% more expensive than the official rate. In 2020, due in part to falling oil revenues, Nigeria restricted access to foreign currency and its S&P Credit rating downgraded from B to B-. In turn, black market rates surged.

In some countries, high foreign exchange risks increase the cost of international transactions because of hedging costs. Ghanaian and Nigerian currencies have fluctuated drastically against the dollar. Thus when financing imports, distributors need to hedge to protect themselves from currency fluctuations, which adds to the cost of already expensive trade credits or trade insurance.

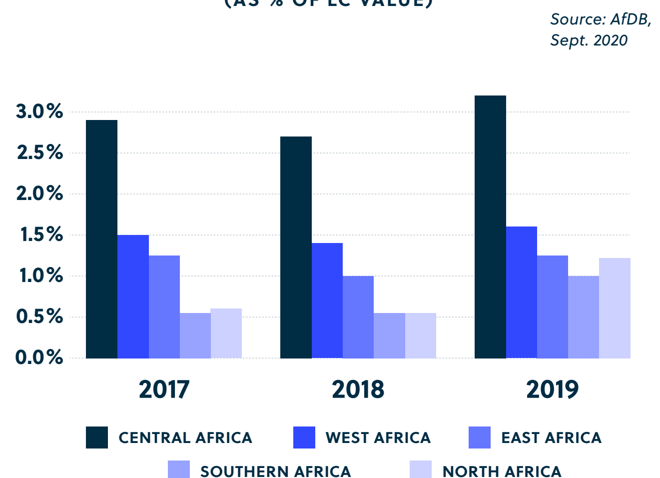
FLUCTUATION OF THE LCU/USD EXCHANGE RATES (% CHANGE Y-O-Y)



Trade finance is still developing. Only 40% of total African trade was intermediated by banks in 2019, against 80% on average in the world. It means African banks are more likely to reject a SME distributor request to secure an import. African banks face structural barriers, including inadequate FX liquidity, growing competition, increasing lack of international partners (correspondent banks), and regulatory restrictions.

Trade instruments are more expensive in focus regions. Letters of Credit remain the most used trade instruments for African importers. Their cost is higher in focus countries compared to other parts of Africa and the world. This is another example of how international transactions can be more expensive in focus regions.

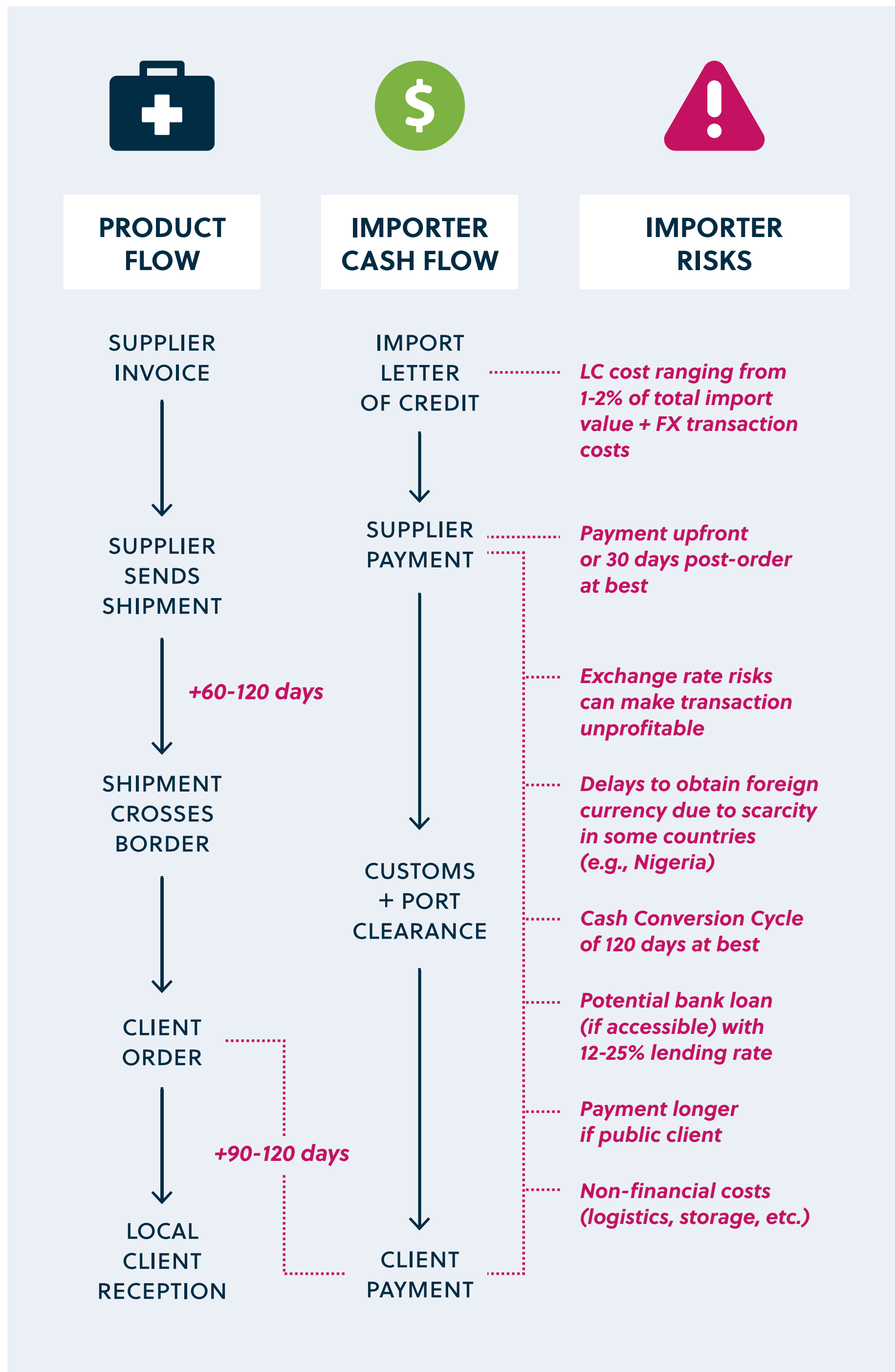
AVERAGE LETTER OF CREDIT OPENING FEE (AS % OF LC VALUE)



AN INSIDE LOOK: CHALLENGES FOR MID-SIZED DISTRIBUTORS

Importing distributors face a myriad of challenges in financing their business operations, which are compounded by protracted cash conversion cycles.

Product availability is impacted significantly by a range of challenges including: long import lead times (ranging from 60 to 120 days); a need to pay upfront and in cash for imports, resorting to the use of expensive lines of credit; the requirement to pay for imports in hard currencies, in contexts where access is limited and expensive, parallel market exchanges may drive up the price; minimum shelf life requirements which constrain purchasing further; and long product registration timelines.



Access to credit is exceptionally challenging. Suppliers do not appear to offer credit to customers, often requiring upfront cash payments for products. When supplier credit is offered (usually 30 day terms) the mismatch between the local currency sale and foreign currency payable can be very difficult to manage. For banks to provide letters of credit, the transaction often needs to be fully backed with cash or titled property as collateral, which is very challenging to fulfill. Customer repayment cycles are very long (90 to 120 days) and can be longer for government purchasers. Very few sales are in cash, and the businesses have essentially no recourse for customers non-payment.

As a result of these challenges, product prices suffer. Distributors must build these costs into the commodity prices as they sell onward, posing challenges to affordability.

Some local banks offer products like working capital, but it is often costly. Banks have difficulty assessing distributors when they can't meet collateral requirements such as titled property or guarantees. Private equity investment exists, but only the largest companies are aware of these actors.

Most mid-sized distributors struggle to obtain foreign currency, investment and to overcome regulatory barriers for product registration. Key informants highlighted four problem areas:

1 Cash payments and pre-payments are commonly required.

"Most suppliers require cash payments upfront. Some (multinationals) can provide credit terms for ~90 days."

– Distributor

"If you want to buy commodities from pharma, you need to do pre-payment. Which then means you have to buy the fastest moving commodities."

– Distributor

2 Selling to government can decrease financial institutions' willingness to engage.

"We try to enforce payment terms based on the size of the client: 30 days for medium-sized, 60 days for large customers. With institutions and the State, it takes minimum 3 to 6 months to get paid."

– Bank

"We offer invoice discounting at 70% of the book value of the debt. But if it's public sector, likely not to offer product due to the timelines involved in Government's payments."

– Bank

"For us [in Private Equity], distributors relying heavily on public clients (due to corruption risks) or imports (FX risks) would be more challenging to address."

– Investor

3 Access to foreign currency is challenging; letters of credit have high collateral requirements.

"LC is in hard currency. It is a challenge to get foreign currencies to pay your supplier in time: there is an issue of availability and timing of availability. A lot of importers must turn to the black market."

– Distributor

"We have had issues where we let go of customers because we couldn't get access to dollars to pay in advance to suppliers."

– Distributor

"Letters of Credit need to be fully funded which ties up Working Capital further."

– Distributor

4 Regulatory harmonization to hasten product registration is still seen as a critical need for growth.

"Imports are 70% of all products sold in the EAC. Need harmonization, need local manufacturing. Product approval is taking 18 months to 24+ months. Need to get exemptions and fast-tracking. ... Regulatory harmonization would also be transformative to create a single market."

– Distributor

"Product registration takes 6 months to 2 years. [There is] corruption in approvals."

– Distributor

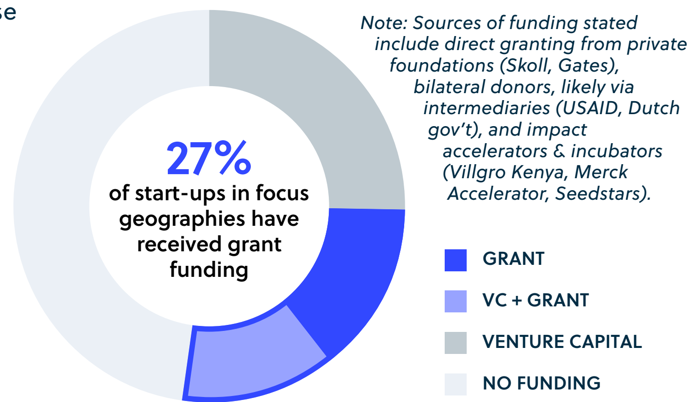
AN INSIDE LOOK: CHALLENGES FOR START-UPS

There is an active and growing ecosystem of innovators operating in tech-enabled health product distribution in countries of interest.

Source: Salient analysis of start-ups in health product distribution in Africa. Some data from secondary sources, and has not been validated independently with companies.

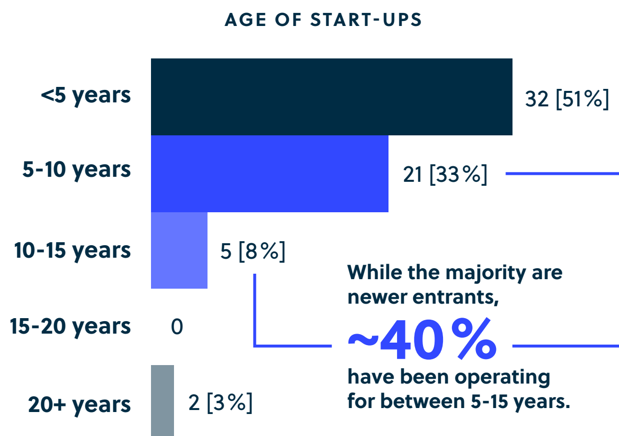
Nearly 30% of the relevant companies in Salient's database appear to have received some grant funding over the course of their businesses life, suggesting that grant funding is available. However, findings suggest that grant funding remains inaccessible for some, especially founders without ties to high-income countries.

Grants appear small, ranging between $50K to $2.5M. Transaction costs for both investors and companies are often untenable. Some grants are "vertical specific"—focused only on contraceptives, or malaria, which may not holistically support business growth. Only ~12% (1/8) of founders without high-income countries experience appear to have received grants, compared to ~36% (15/42) of founders with ties to high-income countries. Female founders are rare, but appear to have received grants at approximately the same rate as their male co-founders.



Source: Salient analysis of start-ups in health product distribution in Africa. Some data from secondary sources, and has not been validated independently with companies.

The structures for deploying grant funding appear poorly suited to encourage growth for a number of reasons. Coming from a range of sources, the investments appear small and uncoordinated; joint learning is rare. Donors and companies report untenably high transaction costs to execute grant sizes that are appropriate for small businesses, and all note that the common practice of tying grant funding to disease-specific efforts can hamper the development of the businesses as a whole.



Grants are available—for some—but may not be structured to support business growth.

However, the market may be well-poised for growth. Analyses suggest that many start-ups have now been operating in markets for between 5-15 years, and thus may be well-positioned to access growth-financing. Notably, valuations of these companies may be shifting. While these companies once were largely considered "asset light," this categorization may not strictly hold as companies adopt hybrid approaches.

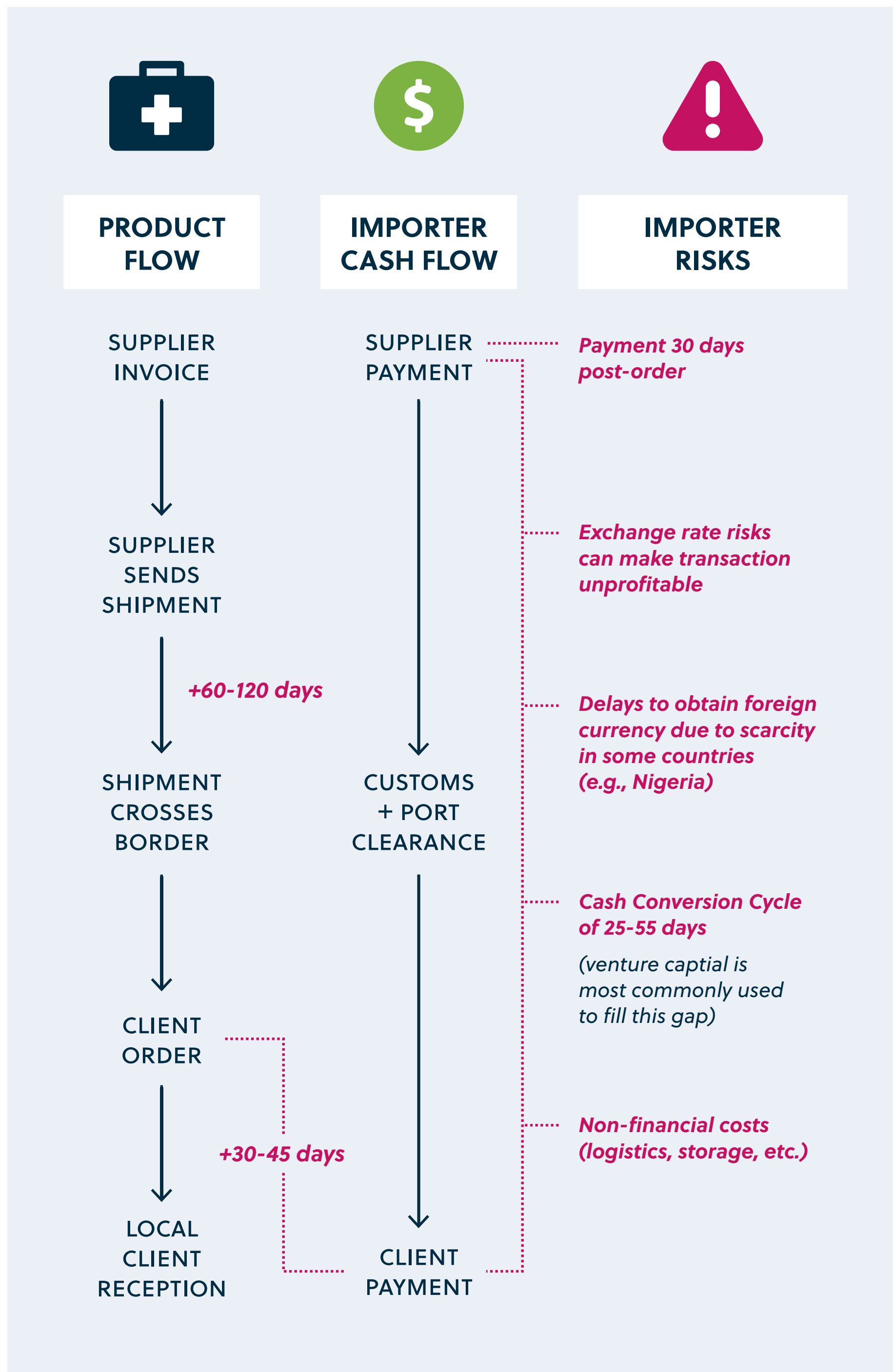
As an intermediary, we do not stock medicines for long periods and rely on other facilities: largely have been an "asset light" model... To [scale], we likely need a very good warehousing structure. Currently, if suppliers' warehouses are closed, we are forced to wait for it to open to meet our customers' need ... [We're] looking to invest in a warehouse to hold stocks for when wholesalers are closed/demand is too high.

– Start-up

We've received tech-based valuations. This year a VC came back and valued us as a local distribution company.

– Start-up

Like mid-sized distributors, start-ups also face challenges with importation, though customer repayment is much quicker and venture capital provides liquidity.



Most start-ups are focused on disintermediating supply chains by interfacing directly with suppliers and offering their customers lower or more reliable prices. Thus, many aspire to import medicines. Like mid-sized distributors, start-ups also report needing to pay suppliers within 30 days of ordering, but unlike mid-sized distributors, do not report needing to pay suppliers upfront with cash. Nevertheless, upon importation they need to execute payments in foreign currencies. While some companies have venture capital investments in foreign currencies that can fund the transaction, those without struggle to access affordable hard currencies in a timely fashion.

Interestingly, start-ups report much shorter customer payment times than mid-sized distributors—between 30-45 days, versus 90-120 days. Thus, they appear to have much shorter cash conversion cycles with 25-55 days between when start-ups pay their suppliers and when their customers pay them.

Key informants of start-ups report reasonable supplier terms and customer repayment cycles, with liquidity from venture capital, yet access to local lending and regulatory consistency are barriers to growth:

1 Start-ups generally report 30 day terms from suppliers, but lack access to volume-based pricing.

"Supplier-side terms are the most challenging. We have >160 manufacturers and supplier partners we've been working with since 2017. We have 30 day terms with the majority, but the pricing fluctuations are hard [to manage]. At this stage [we are] not large enough to unlock the best pricing with big manufacturers."

– Start-up

2 Repayment from customers is less of a challenge, though start-ups are generally avoiding government.

"Repayment from our customers is strong. We have a sticky service, open receivables [for B2B service] are in at about 45 days."

– CEO, Medsaf

"[For B2B service] most repay suppliers in 14-28 days, and pharmacies are expected to repay in 30 days. But delays mean they're often repaying in 60-90 days. [For B2C business] there are fewer cash constraints here. We have 1 week to repay their suppliers, but this works fine because they're paid by customers immediately on delivery. [Health insurance] is a new business line that began in January of 2020 and is growing the most rapidly of any businesses... Only 2-3 of them can pay in 30 days. The rest are repaying in 45-60 days, or longer."

– Start-up

3 Start-ups do not access local banks for capital, they utilize venture capital to fill their needs.

"Any bank you go to will tell you to provide [physical] collateral and they don't accept inventory as collateral. When you go to banks, they don't advance you capital to do anything. You can park cash somewhere and borrow money against that cash."

– Start-up

"We operate on equity financing which is significantly cheaper compared to market alternatives which are banks with high interest rates (24-26%)."

– Start-up

4 Inconsistent or unpublished regulations are seen as a barrier for investors, and for the largest start-ups.

"Regulation is an important issue [for investors]. Tech-related regulations are either: non-existent (data storage rules in Kenya), not clear / inconsistent (not clear what one is allowed do with telemedicine in several countries). This is compounded by inconsistencies between neighboring countries."

– Investor

"[We] considered Benin and Togo for expansion but they have severe regulations. Ghana and the French countries are not as bad ... [These countries] prefer that foreign companies have a local partner on the ground."

– Start-up

Several grant makers, bankers and investors provided input on ways to ease access to finance for health distributors. All financing partners express eagerness to engage more with the health industry, in light of the COVID-19 pandemic. In particular, venture capital and private equity investors see the health industry as an attractive segment. They cited encouraging macroeconomic trends, and felt that in spite of broader economic strains the health sector was resilient.

Financial partners generally see the health industry as attractive, but limited knowledge, high risks and high transaction costs limit their engagements.

However, each type of financing partner faces challenges in serving health product distributors, which limits their engagement. Three common barriers include:

- lack of data or little knowledge of markets, actors and dynamics
- high perceived risks engaging with SMEs, particularly among actors dealing with public clients or imports
- high transaction costs in Africa

GRANT MAKERS

While grants are generally available, they appear inaccessible to most African founders who lack ties to US/Europe. Furthermore, grants are often tied to outcomes for specific health verticals (ex. Malaria, contraceptives) and thus are not structured to align with broader plans for business growth. Finally, the transaction costs for both the start-up and the donor are often untenably high, as the processes for grantmaking have been designed to move larger amounts of capital with high degrees of control.

BANKS

While banks have no issues financing large distributors, there is a low affinity and engagement with SMEs in any sector. Because most start-ups and mid-sized distributors are considered SMEs, banks' key barriers to engagement include: a perception that SMEs carry a high risk of default; imprecise application of traditional risk analysis methods to assess credit requests in this sector; and low incentives for banks to develop new products that more effectively serve SME segments.

VENTURE CAPITAL & PRIVATE EQUITY

On the investor side, venture capital and private equity investors generally see African markets as fragmented, with nascent ecosystems, and regulatory frameworks that hamper growth. More specifically, venture capital investors worry about: a lack of innovative yet solid business models, variations in quality of their deal pipelines, lack of data and "winner-takes-all" mentality. Private equity investors are typically looking for companies with around $40M in annual revenues. However, companies of that size are scarce, and thus the pipeline is limited. Sometimes, the challenge with private equity investment can be cultural as distributors are often family-owned businesses and not familiar with private equity models, or reluctant to accept external investments.

In summary, informants affirmed a willingness to engage more with the health industry as a whole but structural barriers limit engagement. To date, efforts to address these issues in the health sector (let alone the distribution sub-sector) have been very limited.

FINDINGS SUMMARY

In summary, we find five key areas where blended financing solutions could help accelerate the impact and scale of businesses in health product distribution:

To grow, start-ups and distributors need to...	However, start-ups and distributors are faced with...	Solutions are required to...
INNOVATE FOR SCALE *test transformative, tech-driven models for product-market fit*	limited amounts of risk-tolerant grant financing available, and these are largely inaccessible to most companies—especially to those without strong HIC ties. Funding is not strategically deployed to drive growth.	**1** **more strategically and efficiently co-deploy grant capital**
IMPORT *purchase more products abroad to respond to demand*	lack of access to foreign currency... - with reasonable terms - without substantive delay	**2** **enable access to foreign currency for imports**
IMPROVE CASH CONVERSION CYCLES *increase sales* *(more sales = more credit to existing or new clients)*	limited supplier credit (30-day terms at best) non-accessible bank loans (collateral requirements + other documentation constraints) expensive bank loans (interest + other fees)	**3** **ensure better access to working capital in local currency**
SECURE INVESTMENT *increase distribution capacity (tech, warehouses, vehicles)* *increase sales workforce* *grow externally (M&A)*	high cost of debt low interest from private equity investors in small actors (e.g., with revenues roughly <$40M USD)	**4** **structure collaterals to reduce costs of debt**
SAFELY AND LEGALLY EXPAND *reach economies of scale* *reach economies of scope*	challenges with facility licensure, product registration, market entry and minimum shelf-life requirements inhibit expansion by scope & scale	**5** **strengthen regulatory approaches**

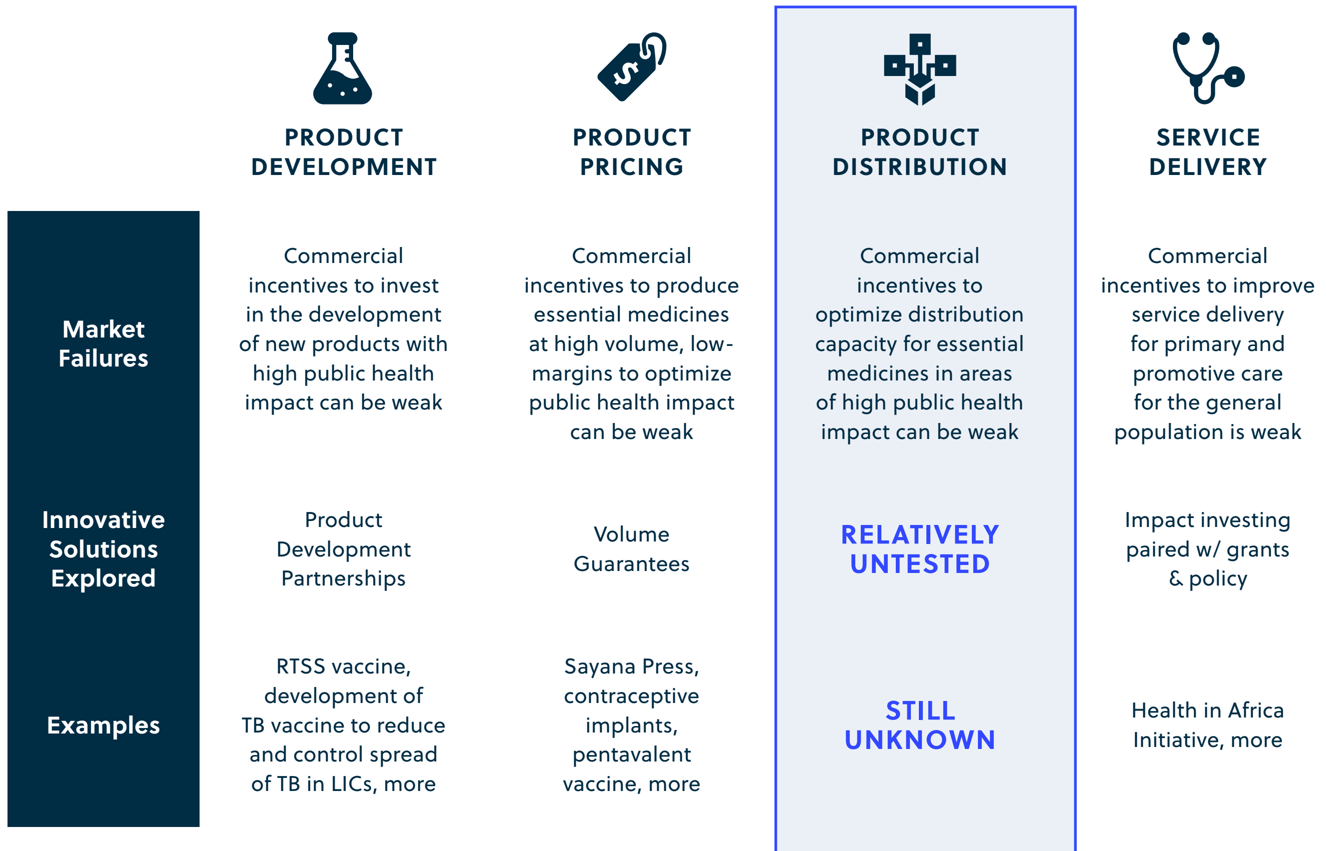
Problem, Scope and Process

Key Findings

Solutions Ideation

PREVIOUS EFFORTS

Previous efforts to leverage blended financing approaches in the sub-Saharan Africa health market have largely focused on product development, product pricing and service delivery. **Attention and action in product distribution has been limited,** to the detriment of markets and consumers.



	PRODUCT DEVELOPMENT	PRODUCT PRICING	PRODUCT DISTRIBUTION	SERVICE DELIVERY
Market Failures	Commercial incentives to invest in the development of new products with high public health impact can be weak	Commercial incentives to produce essential medicines at high volume, low-margins to optimize public health impact can be weak	Commercial incentives to optimize distribution capacity for essential medicines in areas of high public health impact can be weak	Commercial incentives to improve service delivery for primary and promotive care for the general population is weak
Innovative Solutions Explored	Product Development Partnerships	Volume Guarantees	RELATIVELY UNTESTED	Impact investing paired w/ grants & policy
Examples	RTSS vaccine, development of TB vaccine to reduce and control spread of TB in LICs, more	Sayana Press, contraceptive implants, pentavalent vaccine, more	STILL UNKNOWN	Health in Africa Initiative, more

EARLY IDEAS

To jump start thinking on potential action, five ideas to address the challenges with grant, debt and equity financing arose. The ideas were not comprehensively described or evaluated, but are meant to spark more creative discussion on opportunities for action.

To improve access of start-ups to funding to drive scale and growth...

1 SUPPORT START-UPS WITH COORDINATED SMALL GRANTS + PROFESSIONALIZED ACCELERATION

Launch a Pan-African network to support early and growth-stage start-ups with small grants and professionalized acceleration, respectively. Deploy small grants to encourage ecosystem development, targeting traditionally excluded companies. To support growth-stage companies, partner with 4-5 high-quality and specialized accelerators, with complementary capacities and locations.

To improve access to foreign currency for imports...

2 DEPLOY SME-FOCUSED IMPORT GUARANTEE

Develop a scalable, efficient risk assessment model for health distributors to decrease the price of lending for imports. Provide guarantees on SMEs' payment risks for small import transactions (e.g., guarantees of letter of credits or import loans).

To improve access to working capital...

3 LAUNCH PAN-AFRICAN DEBT FUND FOR AFFORDABLE LOCAL CURRENCY LOANS

Develop a scalable, efficient risk assessment model for health distributors to decrease the price of working capital loans. The new debt fund would be funded with local currencies, to decrease hedging costs and further improve the affordability of loans.

To reduce the high costs of debt...

4 START A SME-DEDICATED QUASI-EQUITY FUND

Develop a scalable, efficient risk assessment model for health distributors. Deployed participatory loans can be assimilated to equity within a SME balance sheet because they are long-term (8-10 years) and subordinated to all other debts.

To strengthen regulatory frameworks...

5 SUPPORT THE HARMONIZATION OF E-PHARMACY GUIDELINES

In partnership with national, regional and continental regulatory actors, undertake a rapid review of e-pharmacy guidelines in-development across Africa. Jointly identify potential opportunities to support guideline development and/or harmonization (including the potential development of a model guideline).

To jump start thinking on potential action, rapid ideation on solutions for #1 (coordinated small grants and professionalized acceleration) and #3 (a scalable risk-assessment mechanism to power a debt fund for working capital loans in local currency) was undertaken.

If established effectively, a risk assessment process might also enable action in areas #2 and #4. Work to support the development of e-pharmacy guidelines (#5) is being pursued, and thus further description was not required at this time.

POTENTIAL SOLUTION #1: INNOVATING FOR IMPACT

Recent research on the needs of start-ups in health in emerging markets, funded by USAID,[1] suggests that start-ups at different stages of maturity require different types of support. In health generally, start-ups in the **idea stages** need local talent, technical talent, and the ability to test prototypes. This often requires small grant support, which seems inaccessible to founders in health product distribution who lack strong ties to the US and Europe. This appears especially true of founders in French-speaking geographies. Thus, mechanisms that better enable access to small grant funds for local founders could help build innovation ecosystems. In the **early stage,** broader research suggests health start-ups require monetization strategies to transition to a commercially viable model, including the development of customer acquisition strategies. They often need access to investors who will tolerate lower rates of return, or offer patient debt products. In health product distribution, these findings are also consistent. Finally, at **growth-stages,** health start-ups require support to enter new markets, establish partnerships to enable scale, attract executive talent and implement professionalized business processes. They likely require equity investment and working capital. Again, these needs were confirmed in our research on health product distribution.

A small grant mechanism *and* professionalized acceleration would meet the specific needs of innovators in health product distribution.

The support required by businesses at the early- and growth-stages are often provided through programs traditionally referred to as 'accelerators'. **While many health product distribution start-ups have participated in accelerator programs, the quality of support provided in this context is often poor.** In fact, socially-driven acceleration may have exacerbated the quality issue, by assembling support teams focused more heavily on improving business' social impact than addressing practical commercial needs. Furthermore, in contrast to commercial accelerators, where investors and mentors have commercial stakes in the businesses success, the incentives of social acceleration efforts may not be as tightly aligned with the companies broader goals. As one venture capital investor stated, *"Grant funding [without co-design and inputs from the commercial sector] has "muddied the waters" and created more businesses that do not scale."* Grant funding combined with professionalized, high-quality support, in alignment with commercial investors, is required to help businesses scale.

CHALLENGE: Poor access to risk-tolerant financing and professionalized support limits the emergence & growth of start-ups in health product distribution and delivery.

ENVISIONED SOLUTION: Launch a state-of-the-art, Pan-African initiative to scale data-driven innovations in health product distribution & delivery.

This solution aims to improve access to highly risk-tolerant financing and *professionalized* support for start-ups in health product distribution and delivery. Research confirms that small grants are inaccessible to many start-ups, especially those in Francophone Africa, those whose founders lack ties to HICs, and female founders. Furthermore, grant capital is not deployed strategically, alongside equity and debt, to support business growth. Lastly, it has become more challenging for public health investors to engage with start-ups at any stage. Deploying the right size of support, at the right time, with properly aligned incentives, and joint-learning is nearly impossible.

1 USAID's Center for Innovation and Impact. *Unleashing Private Capital for Global Health Innovation: Innovator and Investor Support Opportunities.* Washington DC: USAID, 2019.

There is therefore a need to strategically and efficiently co-invest grant capital in start-ups, blending with investment capital and support, to accelerate growth and health impact.

The envisioned solution is to launch a state-of-the-art, Pan-African initiative to scale data-driven innovations in health product distribution and delivery. Primarily, the solution seeks to create a facility to ease small grant investments in early-stage companies and to better align grant capital with commercial efforts to support start-up growth. A second but critical goal is to create onward funding mechanisms to ease the ability of donor agencies to engage with both early- and growth-stage companies.

It is expected that this solution could provide best-in-class support to >40 start-ups across Africa's five economic communities each year and ensure that >25% secure follow-on investment to drive sustainable growth and accelerate health impact.

Overview of the solution:

- Assemble savvy group of investors to catalyze the health tech ecosystem in an efficient, nimble and professionalized manner. Structure governance to ease small grant investments, structure grant funding to better support business growth and impact, and enable efficient joint learning.
- Select and partner with 4-5 excellent, specialized accelerators, with complementary capacities (1 partner per sub-region)
- Build initiatives focused on health distribution & delivery within partner programs
- Small grants would be given to seed the ecosystem & enable experimentation
- Acceleration aims to help grow the most promising start-ups through specialized technical support, peer-to-peer learning, connection to public health entities, governments, major corporates and donor customers, follow-on investment

Coordination needs:

- **Strategic planning:** assemble co-sponsors (a mix of donors and corporates), design program governance for co-sponsors, assess & benchmark existing programs and accelerators, identify key needs and capacities, design target features
- **Implement the program:** source & select partners, co-build small grants & acceleration programs, negotiate contractual requirements
- **Spearhead & coordinate** partners and the life-cycle of the programs (sourcing, selection, acceleration, and exits of start-ups)
- **Evaluate** partners, **participate** in the investment process for start-ups
- **Facilitate** joint program governance & joint learning and coordinated investment between co-sponsors

For this solution to be robust and well grounded, it is important to address several design concerns, including but not limited to:

DESIGN ITEMS	OBJECTIVE / NEEDS	DESIGN CONSIDERATIONS
Small Grant Deployment	‣ Small ticket sizes, with low transaction costs ‣ Highly risk-tolerant ‣ Preference for founders who are traditionally excluded ‣ Ability for funders to create bespoke investments	‣ Programs like Grand Challenges Explorations enable small investments, with follow-on funding. There are likely others. ‣ The ability to more nimbly structure small grants in real-time may be better served by bespoke programs, but coordination costs could be quite high
Accelerator Incentive & Capacity Alignment	‣ The structures, incentives, capacities of accelerators vary, aligning all in one organization will be impossible	‣ Balancing ROI, social impact and in-market presence may be best achieved through a portfolio approach ‣ Higher coordination costs, but may be better fit-for-purpose and more sustainable approach to build local ecosystems
Scope, Scale & Deal Flow	‣ Narrow scope or small scale would constrain deal flow & threaten success ‣ Broadening scope / scale may diffuse measurable impact on specific sectors & geographies, be harder to launch	‣ Accelerators available are often more generalized by sector and open geographically to enable deal flow, so this will likely align ‣ Should the scope be just logistics; broaden to health tech; or take a SDG approach and accelerate businesses in health / ag / fintech / logistics / more?
Connections to Key Customers & Investors	‣ Help ensure support to start-ups includes connections to customers (e.g., pharma corporates, governments, donors, others) and follow-on investors who can help drive scale	‣ Select accelerator partners who have strong experience partnering with corporates, governments and strong connections to follow-on investors within and beyond the continent
Program Management & Coordination	‣ Ensure start-ups get maximum benefit from the capabilities across the network ‣ Determine the best way to structure network functions, IP, operations, communications, investor/donor/gov't relations and more	‣ Begin practical work designing the alliance with partners as soon as possible, to think through the real synergies, constraints and structure ‣ Do not under-fund strong coordination and clear, honest and timely communication, to enable the group to become more than the sum-of-its-parts
Ties to Health Outcomes	‣ Notoriously difficult to measure the public health impact of social or commercial enterprise efforts in the short-term	‣ Require thoughtful M&E – including a clear theory of change, articulation of assumptions, a realistic timeline for impact measurement, and learning and growth approach
Lessons Learned	‣ Avoid pitfalls of previous efforts, both within & beyond health sector	‣ Review similar efforts and extract key lessons learned in design & implementation

POTENTIAL SOLUTION #2: AFRICAN WORKING CAPITAL FACILITY

As noted in the findings, health product distributors (like many SMEs) have poor access to affordable debt. Working capital loans are particularly difficult for distributors to access. Banks often associate SMEs with high solvency risks and therefore require extensive collateral and higher-than-market interest rates, which decrease the accessibility of loans. The high costs of debt are passed to customers, often decreasing the affordability and availability of products to the end consumer.

We assume the risks are over-estimated for two major reasons: first, banks lack appropriate tools to assess SMEs' credit requests and secondly, recent efforts pioneered by the Medical Credit Fund suggest that SMEs in the health sector are bankable. However, without specific interventions, banks are unlikely to develop or sustain health- or SME-specific debt products because markets are small and other safer, more profitable opportunities exist.

CHALLENGE: Health distributors have poor access to debt, and critical needs for affordable working capital. Risk assessment capabilities in the sector are limited, and hedging costs increase the price of loans.

ENVISIONED SOLUTION: Build best-in-class, scalable risk assessment mechanism to power a Pan-African working capital facility in health. Raise funding in local currencies to further decrease debt prices for health SMEs.

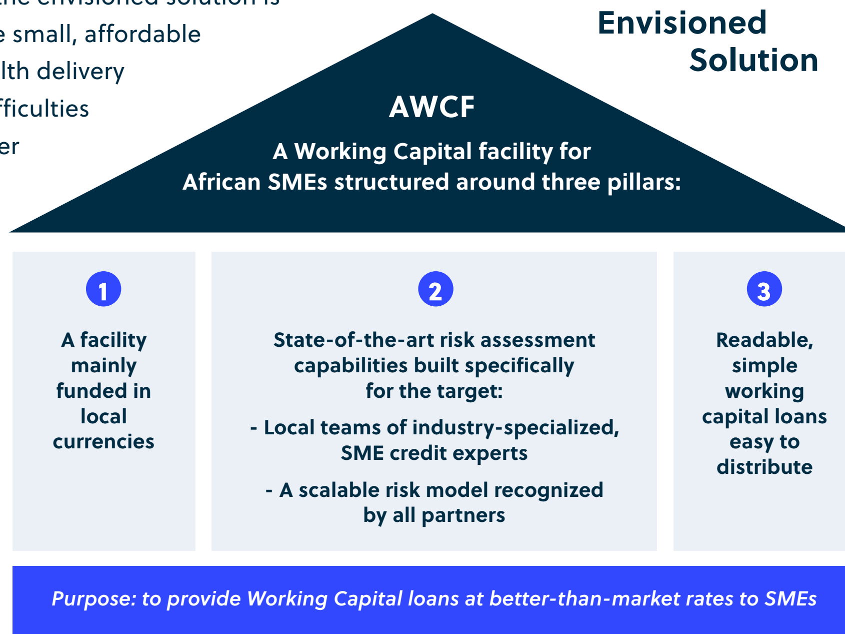
Efforts to scale access to working capital can build on the work of innovative organizations working to extend debt in the health and distribution sectors in Africa, such as the Medical Credit Fund, IMFact, Kountable and more. In particular, it's worth examining the progress of the Medical Credit Fund, which is operating the only health-specific debt fund on the continent. This effort, launched in 2009, provides small loans to health SMEs to fund care improvement through direct (pen-and-paper or digital) and indirect lending (by co-financing or guaranteeing loans by financial partners). MCF uses a layered capital structure, deploying debt, first-loss guarantees, and grant funding for technical assistance. MCF's average loan size is 20K USD, though loans can range from 1K to 2,500K USD. To date, the fund has dispersed more than 5,000 local currency loans, totaling more than $US 100M, with a repayment rate above 95%.

MCF lends directly through its digital, automated solution called 'Cash Advance.' They also directly execute larger loans on a case-by-case basis. Indirect lending, which account for the majority of their activity today, are executed through partnerships with local financial institutions. To foster more lending to health SMEs, MCF co-finances (50%) or partially guarantees bank loans, while providing support for technical assistance.

The success of the Medical Credit Fund (MCF) model illustrates that health SMEs are bankable in Africa.

The success of the model illustrates that health SMEs are bankable. However, several key limitations remain. First, while MCF has improved access to debt for health SMEs, the cost of debt available remains very high (20-22% APR). To date, concessional funding for MCF has been provided in foreign currency, which requires MCF to hedge against foreign exchange risks. The hedging costs are significant, totaling around 10% of the total cost of debt. Thus, raising funds in local currency for this model has the potential to drastically reduce the cost of debt, while expanding access. Second, the incentive to continue lending to health SMEs once MCF programming has concluded is not clear. Banks have more profitable, lower-risk business lines to pursue. To date, no financial institution has maintained a healthcare portfolio without MCF support. Finally, MCF's new approach to offer direct lending may be constrained by regulation in some contexts.

With these challenges and learnings in mind, the envisioned solution is focused on creating a mechanism to distribute small, affordable loans to small and medium-enterprises in health delivery and distribution who would otherwise have difficulties accessing debt. If SMEs are able to obtain lower financing costs, they will be able to decrease prices and fuel their growth, ultimately improving availability and affordability of health products. The solution has three core functions: 1) raise funds in local currency to decrease hedging costs and lower the overall costs of debt; 2) develop a scalable, state-of-the-art risk assessment process for deployment by local teams to enable more efficient lending; and 3) the risk assessment process would power lending of simple working capital loans to distributors.



KEY ASSUMPTION ON IMPACT: All other factors being equal, access to more affordable working capital loans will allow distributors to: 1) finance more client credits, resulting in an increase in sales and an improvement of availability of health products, and/or 2) lower margins, resulting in an increase in sales and an improvement of availability and affordability of products.

An international mechanism funded in local currency with internalized, scalable risk assessment capabilities could help address distributors' need for debt.

The first core function highlights the need for the mechanism to be funded at least partially in local currency to lower the cost of hedging and lower the final cost of debt for SMEs. The second core function states the need for the facility to be equipped with state-of-the-art risk assessment capabilities that are built specifically for the target SMEs, their geographies and industries. Here, a tool alone is likely to be insufficient. A robust process is likely to require both a credit specialist team and an adapted credit process, and is critical to success. While important experimentation and learning is underway in this space by actors such as MCF, Kountable, IMFact and more, the capabilities don't yet exist at scale. The third core function is to craft and deploy a handful of simple and standardized debt products, direct loans, co-financing or guarantees. We believe simplicity is key to helping achieve sustained scale.

Design and prototyping of the risk assessment mechanism is a first step, while work proceeds to assess interest in the design and launch of a facility.

Overview of the solution:

- Distribute accessible and affordable small working capital loans to SMEs through a continental facility (unearmarked loans, loans against receivables, invoice factoring, ...)
- Build/strengthen innovative risk assessment processes focused on small actors in health space
- Structure the mechanism around three pillars:
  1. A mechanism mainly funded in local currencies
  2. State-of-the-art risk assessment capabilities built for the target
  3. Readable, simple products easy to distribute
- Test the mechanism through one of the following operational approaches:
  1. Build from scratch a standalone fund
  2. Scale an existing solution (ex: MCF)
  3. Merge 2-3 existing initiatives

Operational needs:

- **Deepening diagnostics (step 1):** Map ongoing initiatives and actors, present solution to potential sponsors / funders, and gather needs
- **Designing of the strategic blueprint (steps 2, 3, and 4):** Recommend strategic options, size the mechanism, define the products, and build the detailed strategic model
- **Supporting and facilitating the operational roll-out (step 5):** facilitate and coordinate discussions between stakeholders, assist formalization of partnerships, coach implementing partners

KEY QUESTIONS: Which scope is most appropriate? How to ensure the number of tickets is sufficient to justify the cost of the risk assessment team?

The recommended mechanism needs to create and maintain a team of senior, specialized credit analysts with in-depth knowledge of SMEs, industries, and different markets to provide undisputable risk assessments. This team represents one of the main costs of operating. The mechanism needs to deal with sufficient demand to be economically sound, i.e., to generate enough revenue to cover the associated costs.

THREE SCOPES TO DETERMINE IN ORDER TO ENSURE SOUND ECONOMICS

Health scope

Distributors only?

Small and medium manufacturers?

Small and medium providers?

Industry scope

Whole distribution industry (ex. e-commerce)?

Other social industries (education, culture, ...)?

Other priority industries (agriculture, energy, ...)?

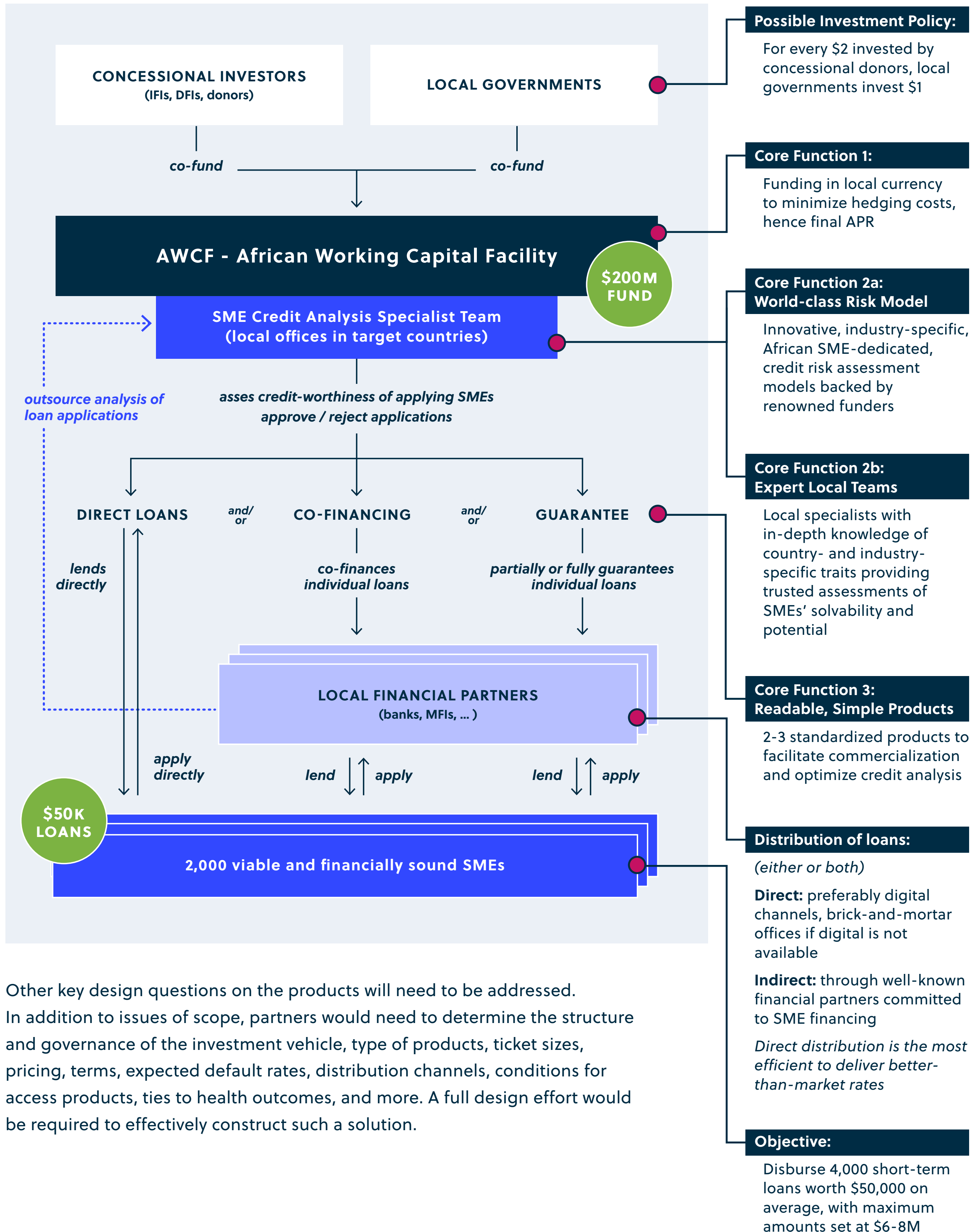
Geographic scope

Countries of focus (Nigeria, Ghana, Kenya, Uganda, Cameroon)?

sub-Saharan Africa / Africa?

Low- and Middle-Income countries in Africa, Latin America, Asia?

POSSIBLE GLOBAL ARCHITECTURE



Other key design questions on the products will need to be addressed. In addition to issues of scope, partners would need to determine the structure and governance of the investment vehicle, type of products, ticket sizes, pricing, terms, expected default rates, distribution channels, conditions for access products, ties to health outcomes, and more. A full design effort would be required to effectively construct such a solution.

IN SUMMARY

Findings suggest that for start-ups and distributors to grow and scale efficiently, they need:

1. **Risk-tolerant capital to develop and deploy technology-driven innovations**
2. **Access to timely, affordable foreign currency to optimize product importation**
3. **Affordable working capital in local currency to ease cash conversion cycles**
4. **The ability to secure affordable debt**
5. **Regulatory approaches that enable start-ups to expand scale and scope, while maintaining patient safety**

The challenges are far from simple, and need is urgent.

Completed over 16 weeks, this effort intended to jump start learning, discussion and action.

To date, efforts to leverage blended financing to improve access to health in Africa have largely been focused on product development or clinical service delivery. Ambitious efforts to improve the markets for health product distribution are lacking—and the need is urgent. Robust, creative and action-oriented approaches are required.

Early thinking on new ways is meant to help spur a new conversation—the ideas are by no means comprehensively described or evaluated. Instead, we hope the findings help inspire ambitious design thinking, urgent action and long-term commitments from global partners to act boldly in the pursuit of more highly functional markets for health product distribution.

INTERESTED IN CONTINUING THE CONVERSATION?

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