EMCompass Quick Take

Fresh Ideas about Business in Emerging Markets

Note 2 | **April 2016**

CASE STUDY: BAYPORT FINANCIAL SERVICES

How Can Businesses Tap Local Capital Markets to Expand?

Bond markets, though still underdeveloped in Africa, are beginning to emerge as a realistic financing option for private companies looking to invest or expand their operations on the continent. Multilateral development banks can play a critical role in that process by issuing bonds in local currencies and providing risk guarantees and anchor investments to companies looking to issue their own bonds.

Less than one quarter of adults in Sub-Saharan Africa had an account at a formal financial institution in 2012, compared with about half of adults worldwide, according to IFC research. The absence of a financial infrastructure that enables secure and efficient saving and money transfers, as well as access to credit and insurance, bars many Africans from making productive investments in their families and businesses.

Access to financial services and credit is slightly greater in Zambia, where the banking sector is better developed than many African nations. Still, a large portion of the Zambian populace, especially in rural areas, remains unbanked and vulnerable to unscrupulous or unregulated loan activities, according to KPMG. Even in countries with fairly developed financial sectors, services are often directed toward established businesses and higher income households. And small firms are particularly underserved: Only 16.4 percent in Sub-Saharan Africa have a bank loan or line of credit, compared with 29.5 percent in developing countries across the globe. In Zambia it is only 5.2 percent.

Bayport Financial Services Ltd., Zambia's largest microfinance lender and its market leader in payroll based lending, wanted to expand lending to low and middle income borrowers and small businesses, unlocking the credit market for ordinary Zambian citizens while tapping a large new customer base.

Capital markets are a traditional source of funds for an expansion of bank lending, yet debt and equity markets are underdeveloped and illiquid in many African countries—if they exist at all. Domestic debt markets are typically dominated by government securities in Africa, and Zambia is no exception: As of 2014, there hadn't been a Zambian kwacha (ZMW) corporate bond issuance in five years.

Cooperation with multilateral development banks enabled Bayport to end that dry spell and tap capital markets for the funds it needed to expand lending. IFC first developed a constructive dialogue with Zambian capital market regulators through a *Zambezi* bond issuance in 2013. The development bank then used its extensive experience with capital markets transactions—both in Zambia and more broadly—to help Bayport plan an issuance that could be appropriately structured and launched in a timely manner.

CATALYTIC INVESTMENTS

IFC and African Local Currency Bond Fund, a unit of the German government owned development finance institution KfW, also made funding commitments: IFC committed to purchase 35 percent of the Bayport issue as an anchor investment and ALCB Fund promised to buy 13 percent. Those investments were catalytic, enhancing the issuer's profile and creating a comfort level for other investors, and attracted pension funds and insurance companies to the transaction.

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Investor interest in the issue was robust enough that Bayport increased the offering by ZMW 21 million, from the initial 150 million planned. In the end, the company was able to issue its first medium-term note, raising ZMW 172 million, or about $26.5 million. Not only did the issue break a long dry spell for the market, it was the largest corporate bond issuance in Zambian history.

Bayport used the proceeds to expand credit access to many more low and middle-income workers as well as small businesses, which will lead to investments in new business ventures, small scale agriculture, education and home improvement. Those investments in turn will generate economic growth and new sources of profits for other private enterprises.

In addition to expanding Bayport's lending base, raising its profit potential, and encouraging the firm's efforts to strengthen responsible finance practices, the Bayport bond project helped deepen Zambia's domestic capital market, a critical ingredient to financing the country's economy. It also had a positive impact on the private sector by establishing strong financial practices and demonstrating the possibilities for tapping capital markets to fund new business ventures in Africa. Bayport's example is expected to spur other enterprises in the region to issue bonds to broaden their investor base and lower their funding costs.

Of course Bayport's successful bond issuance needs to be viewed in context. The firm possessed a strong business model and a sound loan portfolio and its cofounders were experienced executives with a wealth of domestic experience and relationships in banking, government, and information technology. They had worked closely with IFC prior to founding Bayport. Additionally, IFC's *Zambezi* experience provided valuable insights and relationships that helped Bayport navigate the issuance process.

These factors highlight the level of risk-aversion toward shallow, underdeveloped capital markets and the strong credentials that are required—and can be provided by development banks—to succeed in such settings. ■

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