

Catalyzing Support for Small and Growing Businesses in Developing Countries:

Mapping the Policies of International Development Donors & Investors



June 2010

Prepared By:
Estera Barbarasa
Harvard Kennedy School
Master in Public Policy 2010

Prepared For: Aspen Network of Development Entrepreneurs
Jenny Everett, Program Manager
Randall Kempner, Executive Director

TABLE OF CONTENTS

List of Acronyms.....	3
List of Charts and Figures.....	4
Acknowledgments.....	5
1. Executive Summary	6
2. Introduction to Report.....	8
3. Background: Challenges SMEs Face in Developing Countries.....	10
4. Methodology.....	12
5. Descriptive Analysis & Findings.....	13
Section 5.1: Range of Program Interventions.....	13
5.1i Macro Level: Business Environment Policies.....	14
5.1ii Meso Level: Sectoral and Industry Level Coordination.....	15
5.1iii Micro Level: Direct Assistance to SME Firms.....	16
Section 5.2: Overview of Development Organizations.....	17
5.2i Multilateral Development Banks.....	18
5.2ii Bilateral Donor Agencies.....	19
5.2iii Development Finance Institutions.....	20
Section 5.3: Comparative Advantage of Development Actors	21
5.3i The Multilaterals – Finance & Knowledge Banks.....	21
5.3ii The Bilaterals – Growth Generators	22
5.3iii The DFIs – Catalyzing Agents.....	24
Section 5.4: Organizational Profiles	25
5.4i International Finance Corporation (Multilateral)	25
5.4ii Inter-American Development Bank (Multilateral)	28
5.4iii United States Agency for International Development (Bilateral)	30
5.4iv FMO, The Netherlands Development Finance Company (Development Finance Institution).....	33
6. Recommendations: Influencing the SME Development Agenda.....	35
7. Appendices.....	39
8. Bibliography.....	49

LIST OF ACRONYMS

AfDB	African Development Bank
ADB	Asian Development Bank
ANDE	Aspen Network of Development Entrepreneurs
BDS	Business Development Services
BGI	Business Growth Initiative
CGAP	Consultative Group to Assist the Poor
DAC	Donor Assistance Committee
DAI	Development Alternatives, Inc.
DCA	Development Credit Authority
DCED	Donor Committee for Enterprise Development
DFI	Development Finance Institutions
DFID	United Kingdom Department for International Development
EBRD	European Bank for Reconstruction and Development
EDFI	European Development Finance Institution
EGAT	Bureau for Economic Growth, Agriculture, and Trade
FI	Financial Institution
FMO	The Netherlands Finance Company
GNI	Gross National Income
GTZ	The German Agency for Technical Co-operation
IDB	Inter-American Development Bank
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IIC	Inter-American Investment Corporation
LAC	Latin America and the Caribbean
MCC	Millennium Challenge Corporation
MENA	Middle East and North Africa
MFI	Microfinance Institution
MIF	Multilateral Investment Fund
MSME	Micro, Small, and Medium Enterprise
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
SEAF	Small Enterprise Assistance Funds
SGB	Small and Growing Business
SME	Small and Medium Enterprise
SME-FI	Small and medium enterprise-oriented financial intermediary
TA	Technical Assistance
USAID	United States Agency for International Development
WBG	World Bank Group

LIST OF CHARTS & FIGURES

CHARTS

Chart 1:	SME Sector's Contribution to Employment and GDP.....	10
Chart 2:	Bilateral ODA Flows, Net Volume and GNI %, 2008.....	19
Chart 3:	EDFI's Investment Portfolios 2008.....	19
Chart 4:	IFC's SME Portfolio by Region 2009	25
Chart 5:	IFC's Micro & SME Commitments in FIs 2003-2007.....	27
Chart 6:	FMO's Committed Global Portfolio 2008	33
Chart 7:	MASSIF's Investment Portfolio 2008.....	33

FIGURES

Figure 1:	Range of Policy Interventions.....	13
Figure 2:	Development Actors.....	17
Figure 3:	SME Financing Strategies of Multilateral Banks.....	18
Figure 4:	USAID's Country Mission Statistics.....	31
Figure 5:	MASSIF's Investment Outputs 2008	34
Figure 6:	Making the Case for SMEs.....	35
Figure 7:	The Donor Committee for Enterprise Development's 2010 Work Plan.....	36

ACKNOWLEDGMENTS

This report has benefitted from extensive review. ANDE staff and select members provided helpful guidance with the research project and important feedback on the report. I would like to extend grateful acknowledgement to Randall Kempner and Jenny Everett for making this policy analysis exercise and report not only possible, but also meaningful. I would especially thank the ANDE members – Mildred Callear from SEAF, Natalie Pinon from Marmanie, and Simon Winter from Technoserve - for their comments and input that informed the recommendations of this report.

I greatly appreciate the time and effort taken by numerous staff of the development organizations included in this report to be interviewed for the research project and to review this report: the International Finance Corporation (Ghada Teima), the Inter-American Development Bank (John Beckham, Fernando Campero, Claudio Cortellese, Sandra Darville, Julie Katzman, and Nobuyuki Otsuka), USAID (Stephen Silcox), the FMO (Henk Nijland), the Donor Committee for Enterprise Development (Jim Tanburn), the Association of European Development Finance Institutions (Jan Rixen), and U.S. Overseas Private Investment Corporation (Mitchell Strauss).

All views expressed, and any errors, remain the authors' sole responsibility.

1. EXECUTIVE SUMMARY

This report depicts the landscape of development organizations that fund and support small and medium enterprises (SMEs) in developing countries: 1) multilateral development banks, 2) bilateral government donor agencies, and 3) development finance institutions (DFIs). The report is a new contribution to both the development community, as well as the Aspen Network of Development Entrepreneurs (ANDE). Advocacy and policy work is a strategic priority for ANDE, and the report's findings will enable the Network to understand the international development community and to be more strategic in its approach as it seeks to influence and shape the international development SME agenda.

Donor Landscape Overview:

The international donor and investor community is highly fragmented, and donor and investor strategies to finance small and medium enterprises vary greatly. Some actors focus on institutional, legal, and regulatory reforms to improve the business environment climate for firms of all sizes. Other actors specifically design interventions to target the challenges faced by small businesses and try to remove their constraints to growth. Even within this approach, development actors vary in their interventions. Some finance SMEs directly, and others finance financial intermediaries and thus indirectly finance SMEs. Typically, donors may not be fully aware of the projects and policies of their peers, and there is minimal coordination in country projects.

Comparative Advantages:

This report identifies the comparative advantage and expertise of each type of development actor to help ANDE gain specialized knowledge and a targeted strategy for each organization as they build relationships and interact with specific development actors.

Based on this report's research and findings from the interviewees, this report concludes that the **multilateral development banks** have the most specialized and innovative SME programs and are the leading funders for SMEs. Their programs are comprehensive and include all of the following components: business environment reform technical assistance, market linkage programs, competitiveness programs, SME equity funds, and debt capital to financial intermediaries lending to SMEs. The banks are typically coined knowledge banks because of their research expertise and capacity to disseminate best practices.

Bilateral donor agencies have a comparative advantage with their expertise in projects that help enterprises build market access and establish market linkages, collaborate in business clusters and industry-wide efforts, and formulate sector-wide competitiveness strategies. This donor group typically focuses on projects that can help firms of all sizes grow and increase their productivity within strategic, high-growth sectors. However, bilateral aid projects are highly fragmented with significant overlap in the same sectors. While aid projects are proliferating, expenditure is primarily focused on education, health, and governance spending and expenditures is decreasing or staying stable for private sector projects.

Development finance institutions (DFIs) have a different business model than other development actors. They work only through the private sector, and they self-define their role as additional to the market. They do not invest in sectors or projects where there is substantial investment from private investors because they do not want to crowd out local markets.

Additionally, they catalyze investments from private sector investors by being the first movers in specific under-served sectors, such as the SME sector, to demonstrate these projects can be profitable.

Summary Recommendations:

ANDE is uniquely positioned to play a strategic role in the development community that few other actors have the legitimacy and capacity to fulfill. This report recommends that ANDE should help bridge the knowledge gap of SME policies among donors, and it should consider how it could coordinate the SME field projects among its member organizations and donors present in the same countries. Additionally, the report recommends ANDE should advocate to increase capital commitments of donors already engaged in SME activities and to motivate select donors without a SME focus to develop these programs.

Recommendation 1: Advocate the Case for SMEs

ANDE should share evidence with the development donors and investors about why it is important to help the SME sector scale and how to develop an approach that can target growth-oriented small businesses, helping them achieve greater productivity. It can document and distribute success stories from its members, and aggregate data and outcomes across its network to demonstrate the impact of investing in SMEs.

Recommendation 2: Coordinate with Other Development Networks and Committees

Natural synergies exist between the ANDE network and international development donor networks: common knowledge of individual investor strategies, ability to monitor sector trends, and scaling impact through collective action. In addition to building bilateral relationships with development organizations, particularly those profiled in this report, ANDE should cultivate multilateral relationships in the development community through key donor networks.

Recommendation 3: Support ANDE Member Existing Partnerships

ANDE member organizations are financing and managing SME support projects in over 140 countries. ANDE should survey its network of 80 plus members to identify which member organizations are financed by the international donors or DFIs and which ones have existing contracts to implement projects. This can help ANDE gain a data-based understanding of existing collaboration with donors and investors, and use this information to better learn how to support existing relationships and how to lobby to increase donor funding or DFI financing of its members.

Recommendation 4: Improve Data Collection and Common Metrics

ANDE should share its best practices from its efforts to build baseline metrics and standard impact accounting methodology in its network with the donor community. Donors could try to model a similar coordination effort to track and measure similar social return on investment metrics.

2. INTRODUCTION

Small and medium enterprises in emerging markets are receiving increasing attention and support from the international development community. Donors and investors are committing more investment dollars and designing programs tailored to helping SMEs in developing countries start-up, increase their competitiveness, and grow to achieve greater scale.

To date, the evidence for the economic and social return on SME investments is mixed. However, there is some evidence that documents the ability of SMEs to generate employment, create pathways out of poverty, and stimulate economic-growth.¹ For example, they are responsible for between 60-70 percent net job creation in OECD countries.² Additionally, small businesses play an important role in contributing goods and services to the \$5 trillion market that serves the four billion people worldwide that live on \$2 a day or less.³

Recognizing the promise of SMEs as engines of growth for developing countries, a group of leading organizations came together four years ago to discuss the need to work in a more concerted effort to build up this sector. In the summer of 2008, the group decided to formally create the Aspen Network of Development Entrepreneurs (ANDE). Officially launched in 2009, ANDE is a member-driven organization housed within the Aspen Institute, an international non-profit that promotes enlightened leadership. ANDE's members are the vanguard of a movement that is focused on small and growing businesses (SGBs) that create economic, environmental, and social benefits for developing countries.

ANDE's goal is to dramatically increase the amount and effectiveness of capital and business assistance for entrepreneurs in developing countries. There are currently around 85 members in the ANDE network working in over 140 countries around the world, including The Bill and Melinda Gates Foundation, The Rockefeller Foundation, Acumen Fund, Agora Partnerships, Root Capital, Technoserve, Small Enterprise Assistance Funds, and many more. See Appendix 1 for a list of current ANDE members.

Since its inception, ANDE has succeeded in the following efforts: administering a \$1 million capacity development fund for member organizations, providing training for investment management professionals to help them understand the investment process cycle (deal sourcing, due diligence, and ongoing business support) in emerging markets, and helping to design a common metrics system for monitoring and evaluating the impact of social enterprises.

From the beginning, ANDE's leadership has made advocacy and policy work a strategic priority for the Network. In order to be more strategic in their approach, they want to better understand the international development donor and investor community and its SME agenda.

This report sets out to depict the landscape of development organizations that fund and support SMEs in developing countries. Particularly, three specific types of organizations are analyzed: **1) multilateral development banks, 2) bilateral government development agencies, and 3) development finance institutions (DFIs)**. ANDE staff or members have not previously conducted

¹ "SMEs, Growth and Poverty: Cross-Country Evidence," Beck, Thorsten et al, World Bank Paper, 2005.

² OECD SME Finance Brief 2006.

³ "The Next Four Billion: Market Size and Business Strategy at the Base of the Pyramid," International Finance Corporation and World Resources Institute, 2007.

this descriptive analysis, and no report currently exists which maps out SME-specific investments in the development community.

Section 5.1 of the report's findings describes and analyzes the range of program interventions and policies that support SME development and growth.

Section 5.2 maps the different development actors under each of the three classifications of development organizations previously mentioned, and it seeks to answer the following questions:

1. Which of the multilaterals, bilaterals, and DFIs are the most significant actors in this SME landscape? (And what are some descriptive statistics about these actors?)
2. Do the donors have programs exclusively focused on SME promotion, or is SME support integrated into a larger framework focused on private sector development?

Section 5.3 analyzes the comparative advantage of each type of organization, identifying the strengths and limitations of their different approaches and investment models.

Section 5.4 profiles four development organizations in-depth: two multilateral development banks (the International Finance Corporation and the Inter-American Development Bank); one bilateral government development agency (the United States Agency for International Development); and one European development finance institution (FMO, the Netherlands Development Finance Company). These particular donors are selected because ANDE specified an interest in better understanding the donors located in Washington DC and Western Europe, since they are headquartered in Washington and can more easily build relationships there. Also, ANDE wants to better understand the European donors as it aims to increase its brand and presence in Europe as part of its growth strategy.

These profiles of the development actors gives ANDE detailed knowledge of each organization as they build relationships and engage in policy work. The analysis for each donor or DFI provides a brief background, examines the organization's SME activities, describes its strategy and impact, and highlights any future organizational priorities for SME programs. Additionally, these profiles can serve as a template for organizations not profiled in this report, so that ANDE staff or interns can develop future profiles on investors that are important to ANDE's advocacy activities.

The report concludes with a set of strategic recommendations for ANDE to help its decision-makers develop its advocacy strategy targeted towards influencing multilateral banks, bilateral agencies, and development finance institutions. With a well-focused strategy, ANDE can be better positioned to influence development organizations to increase investments and policy programs focused on promoting the growth of small and growing businesses in developing countries.

DEFINITIONS

Small and medium enterprises (SMEs): There is a lack of a universal definition for small and medium enterprises. The definition varies from country to country. The World Bank definition for an SME is an enterprise with less than 250 employees.

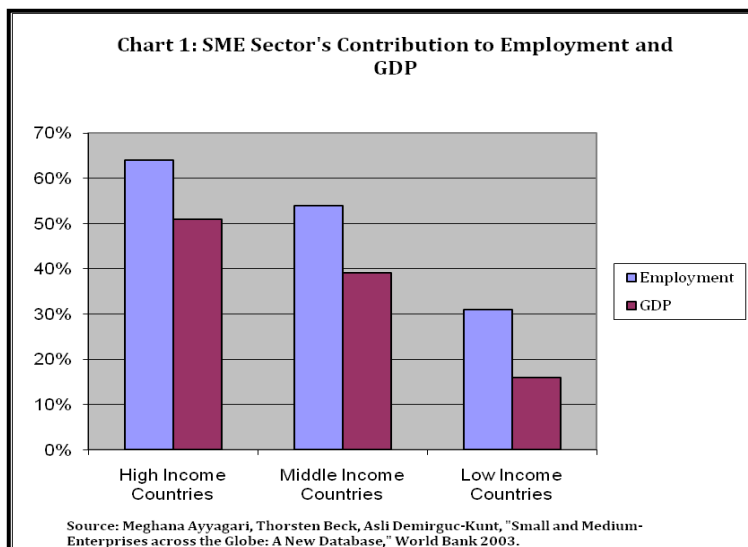
Small and growing businesses (SGBs): ANDE defines SGBs as commercially viable businesses, likely with 5 to 250 employees, which have significant potential for growth but lack access to finance and knowledge resources. Since this report focuses on international donor and investor policies and most development organizations use the SME term and definition, this report will use the language of SMEs, although, ANDE is ultimately interested in promoting SGBs.

3. BACKGROUND: CHALLENGES SMES FACE IN DEVELOPING COUNTRIES

Firms of all sizes – micro, small, medium, and large – in developing countries face challenges in securing financial capital, accessing market information and establishing market linkages to meet product demand, and finding entrepreneurial talent to manage their businesses. Additionally, they operate in a policy environment that is not conducive to business entry, growth or exit -- to varying degrees, depending on the country's regulatory framework, depth of financial markets, level of economic development, and political and macroeconomic stability.

Therefore, many development policies that promote private sector development focus on improving a country's business environment and access to firm inputs for all businesses, regardless of size. Yet, donors also specifically target support to small and medium enterprises within their larger private sector development policies because they recognize that SMEs outnumber large firms in developing countries. SMEs constitute the dominant form of business organization in both developed and developing countries, accounting for up to 99 percent of enterprises depending on the country. However, this report is focused on the SME experience in developing countries.

Chart 1 shows that the contribution to employment and GDP of SMEs in low income countries is smaller than that in middle income and high income countries. Studies have shown that growth in GDP per capita is correlated with enterprises growing in number, size, and type.⁴ In this process, enterprises tend to gain a share of employment and increase their productivity and profitability. However, this transformation process is oftentimes difficult for SMEs to achieve because they are at a greater disadvantage than large firms in gaining access to critical business inputs, and they are more adversely affected by cumbersome government business regulation.



Limited Access to Finance

First, SMEs face gaps in access to debt and equity capital. Debt capital is often difficult for small businesses to secure because it is too expensive and comes with burdensome collateral requirements, sometimes as high as 100 to 120 percent of the loan value. Banks are reluctant to give out loans to SMEs because of the high risk inherent in SME investment projects and the high fixed costs of giving out loans to SMEs as compared to the actual amount of the loan. Small companies lack necessary documentation for the bank's risk assessment process, which could help to alleviate some of the information asymmetry problems. Additionally, there is lack of competition in local banking sectors and lack of innovation to develop financial products for the needs of SMEs.

⁴ "Enterprise Growth Initiatives: Strategic Directions and Options," Development Alternatives Inc., 2004, p 2.

Equity capital is not a strong option for SMEs because their capital needs are less than what private equity firms are interested in. Equity companies face high costs when investing in deals less than \$2 million. SME finance is typically in the range of \$50,000 to \$1 million, but it falls outside lower and higher bounds in some cases. Small investments require significant time to source deals, conduct due diligence and complete transactions. The investees often lack audited financial statements and/or business plans. As a result, SMEs tend to rely on their own capital, loans from family and friends, and angel investors⁵ (if available). This is not sufficient capital to scale and trigger growth.

Limited Market Information

Second, it is commonly difficult to know how to turn entrepreneurial ideas into successful businesses. Entrepreneurs often lack specialized knowledge resources such as technology, market research to identify opportunities where they have a comparative advantage, market access to increase export volume, and a network of supplier and buyer relationships to capitalize on business opportunities. Lack of these important inputs inhibits the ability of SMEs to compete locally, regionally or globally.

Shortage of Business Skills

Third, there is frequently a critical shortage of skilled professionals to efficiently manage and grow SMEs. Educated and high-skill professionals tend to be attracted to opportunities in large companies or jobs abroad. Many emerging countries do not have strong higher education infrastructure or business training programs for those without higher education that is needed to develop the talent and business skill sets to meet the needs of growing companies.

Challenging Business Environment

Finally, in addition to facing barriers in accessing critical inputs, small businesses in developing countries operate in business environments that are not conducive to market entry and business growth, to differing levels depending on the country context. Oftentimes, the macroeconomic situation is unstable, business regulation is burdensome, contracting rules are not enforced, and infrastructure is poorly developed so it is difficult to get products to markets. One example of the challenges in developing countries is that starting a business in low-income countries takes on average 47 days and costs 116.5 percent of per capita gross national income (GNI), as compared to 21 days and 7.3 percent for OECD countries.⁶ In addition, SMEs are subject to greater rent-seeking behavior by tax and other regulatory authorities, since they do not have the political influence to avoid such behavior like larger state-owned or multi-national enterprises.

⁵ An angel investor is an affluent individual who provides capital for a start-up enterprise, usually in exchange for some stake in ownership equity.

⁶ World Bank Group *Doing Business* research.

4. METHODOLOGY

Mapping Analysis

After consulting with ANDE, ANDE partners, and Harvard Kennedy School professors to identify the types of development organizations to be researched and analyzed in this report, we arrived to three classifications: multilateral development bank, bilateral government donor agency, and development finance institution. Once we identified the classifications, I reviewed the websites, annual reports, evaluation studies, and other primary source records publicly available for 5 multilateral development banks, 8 bilateral aid agencies, and 7 development finance institutions. The list of these 20 organizations is listed in Appendix 2.

It was difficult to assemble an ideal dataset because there are data gaps in what donors and DFIs self-report, and the information is not reported consistently across organizations. However, enough information was collected to realize the basic descriptive and analytical goals of the mapping exercise. Data was collected for the following categories: regions, SME programmatic focus, type of investment, total committed portfolio, type of technical assistance, and program outputs and evaluation – when available. This mapping exercise draws out similarities and differences among the development organizations and documents descriptive statistics for the largest actors in this space.

The data guided the selection of the 4 organizations profiled in-depth in this report -- based on the criteria of largest investment volume and widest range of programmatic focus.

Literature Review

Additionally, I conducted a literature review to learn about barriers SMEs face in developing countries and donor policy interventions that address SME and private sector growth constraints. The review also includes an analysis of academic papers that provided evidence for effective SME policy solutions. Finally, the review includes reports that provided an overview of different international development organizations, such as the Organization for Economic Co-operation and Development (OECD) Development Assistance Committee's (DAC) reports on multilateral and bilateral development assistance.

In-Depth Interviews

I interviewed 8 development officials from the International Finance Corporation; Inter-American Development Bank; U.S. Agency for International Development; and FMO, the Netherlands Development Finance Company. I also interviewed 3 officials from the U.S. Overseas Private Investment Corporation, Donor Committee for Enterprise Development, and the Association for European Development Finance Institutions that are not profiled in the report, but the information from these interviewees was used to inform the analysis and recommendations of this report. Appendix 3 includes the list of interviewees, and Appendix 4 includes the interview questions that were standardized for all organizations. The information gathered in the interviews informed the in-depth profile of the four featured donors and investors.

Finally, I interviewed 3 officials from ANDE member organizations – Technoserve, Marmanie, and the Small Enterprise Assistance Funds (See Appendix 8) -- to inform the recommendations for how ANDE can best interact with these development actors.

5. DESCRIPTIVE ANALYSIS & FINDINGS

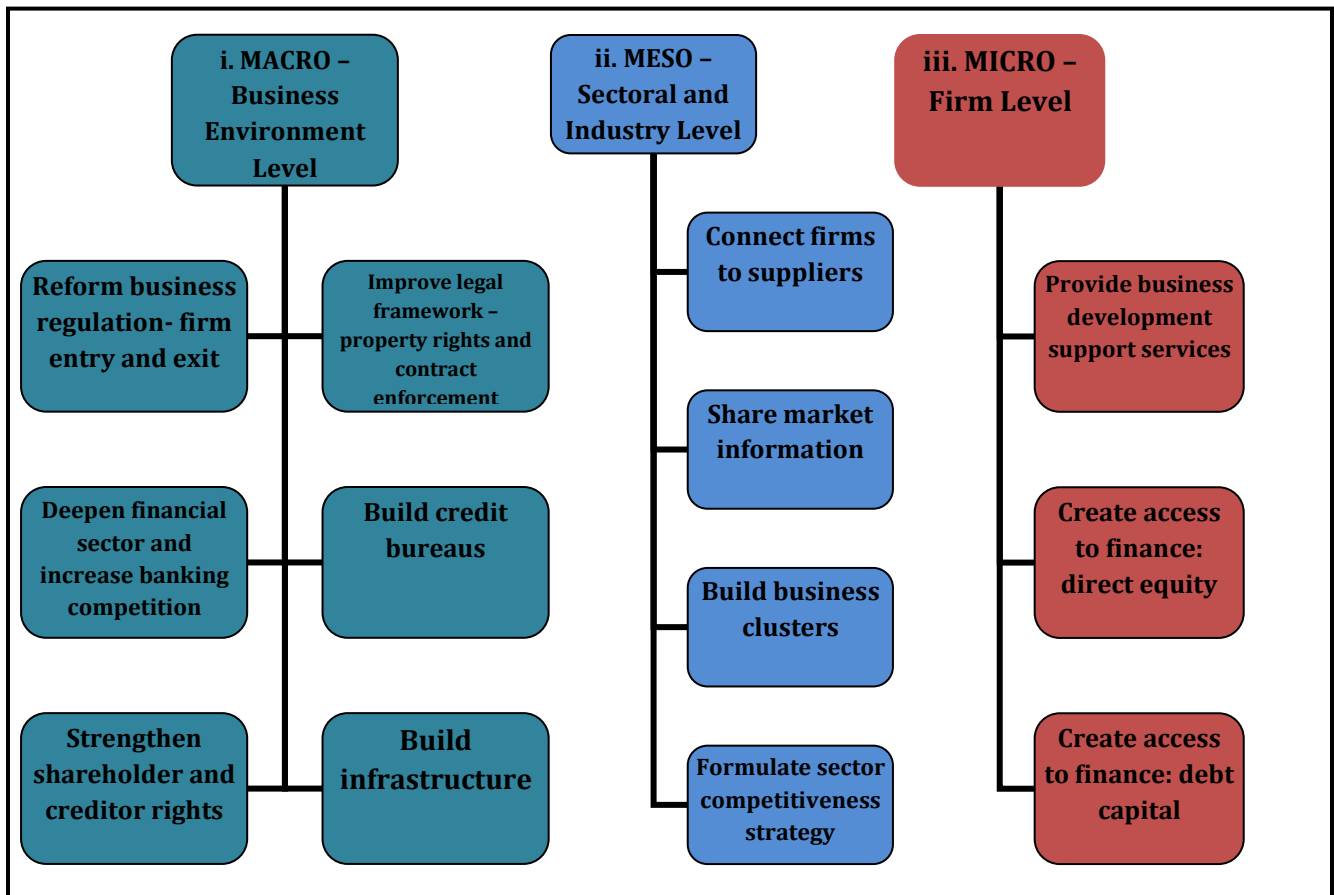
Section 5.1: Range of Program Interventions

This section of the report examines the optimal mix of policy interventions and strategies aimed to promote the growth and competitiveness of SMEs in developing countries. It is important to outline the range of interventions donors and investors can adopt when working to promote SME development before describing the different types of development actors and individual organizations. Each development actor takes its own unique approach to how it supports SMEs, but there are intervention patterns and strategies that can be observed across development actors that promote private sector development and SME growth.

Policies can be integrated as part of a larger, comprehensive private sector development framework. Alternatively, policies can be specialized and implemented in isolation, separate from an integrated organizational strategy.

Policies also intervene at different levels of a country's economy: i) macro-level - focusing on a country's business environment; ii) meso level - focusing on coordination between firms and other actors within a defined sector or industry; or iii) micro level - working with individual firms to help them gain access to finance and improve business management practices. Figure 1 below visually illustrates the different intervention options at these three levels.

Figure 1: Range of Policy Interventions



5.1i – Macro Level: Business Environment Policies

Interventions at the macro level typically focus on reforming a country's business environment. Most donors do not have an official definition they use for "business environment."⁷ This report references the World Bank Group's (WBG's) definition of investment climate (which is the term they use for business environment) in its Private Sector Development Strategy paper:

"Key to effective markets is an investment climate that provides: i) sound rules for the market, ii) the expectation that the rules will be adhered to both by market participants and the state, and iii) physical access to the market. Macro-economic stability, well-defined property rights, a sound judicial and contracting system, a reasonable level of certainty about government policy, functioning financial institutions and a good physical infrastructure, such as a transport system, are all ingredients of a sound investment climate."

Reforming the business environment is a critical policy tool that is needed for any SME reform measure to be effective. It is important to get both the business environment right and to implement programs that can catalyze a response from the private sector in order to create deep economic growth and enterprise development.

The Donor Committee for Enterprise Development (DCED) – a gathering of many funding and inter-governmental agencies that work for poverty alleviation through the development of the private sector– has a business environment working group which includes some of the donors researched in this report, such as Danish International Development Agency (DANIDA), UK Department for International Development (DFID), German Agency for Technical Cooperation (GTZ), Norwegian Agency for Development Cooperation (NORAD), US Agency for International Development (USAID), and the World Bank Group. The objective of the group is to provide expertise and share best practices about how to create a more enabling business environment for enterprises from the direct experiences of the donor members. In 2008, the working group published *Supporting Business Environment Reforms: Practical Guidance for Development Agencies*,⁸ which presents concepts, tools and programs donor groups use to assess and reform the business environment. This serves as a best practices guide to development practitioners working in this specific field.

There are multiple business enabling environment ranking systems developed by different development actors to help development practitioners and policy makers measure and track reforms in regulatory procedures and laws that aim to stimulate private sector growth within countries. The rankings include the following: World Bank's *Doing Business* indicators, the World Economic Forum's *Global Competitiveness Index*, the Economist Intelligence Unit's *Business Environment Rankings*, and the Babson College and London Business School's *Global Entrepreneurship Monitor*. Each use different methodologies, and collectively the data tracked through these indices is useful for identifying and evaluating reformist countries. For example, the U.S.'s Millennium Challenge Corporation (MCC) uses the World Bank's *Doing Business* indicators as part of its criteria for determining which countries receive MCC assistance.

⁷ "Reviewing the Policies and Practice of Donor-Supported Business Environment Reform: Agency Process and Programme Mapping Report," Donor Committee for Enterprise Development, Business Environment Working Group, 2009, p. 4.

⁸ <http://www.enterprise-development.org/page/business-environment-reform>

Macro Policy Example: Financial Sector Policy Interventions

As mentioned in the background section of this report, one of the greatest barriers SMEs face to growth is credit constraint in the banking sector. Reforming the banking sector to incentivize more banks to lend to SMEs is an important example of a macro-level intervention donors and investors currently support. This is an increasingly common approach taken by donors and investors, which is a trend reflected in the interviews conducted for this report.

Development organizations play a role in providing technical support to government reformers to build informational infrastructure in the financial sector to help overcome information asymmetries between banks and SMEs. This includes establishing credit registries and providing regulations so credit bureaus can form. These measures help banks obtain credit information and credit scores on small business owners, and with hard information, lending becomes less risky.

Additionally, donors provide credit lines to banks and attach conditionality that the loans be designated for small business banking. This approach is a good idea in the scenario that banks are agnostic about lending to small enterprises and do not have a history with this. Thus, banks do not know if it would be profitable to lend to SMEs, and if they could generate an acceptable financial return on their lending. In essence, this subsidized finance serves as a demonstration effect to banks. Once the banks see that in fact there is a profit to be earned and that small enterprises are bankable, then donor subsidies could be phased out and the banks could use their own capital for their SME lending portfolios.

Some donors also provide technical assistance (TA) advisory services – at cost – that accompany the loans so that banks are trained in lending practices for SMEs. Loan officers are trained on how to use whatever hard information is available on SMEs or how to look for alternative soft information when making their lending decisions. Therefore, they can screen more carefully and try to ensure lower default rates, so that the demonstration effect period is positive for banks and convinces them that there is a profit to be made in serving the SME sector. Donors have been providing training and TA to assist banks and finance institutions to provide finance to SMEs and microenterprises for over two decades, with success in some settings and less success in others. They have also provided TA to SMEs to prepare bankable proposals. For example, USAID's Development Credit Authority (DCA) office typically looks for a local project that can assist SMEs to prepare bankable proposals in connection with a Loan Portfolio Guarantee, one of the principal products of the DCA.

This is a relatively new approach adopted by donors, and therefore, there have been few evaluation studies conducted to evaluate the effectiveness of this strategy.⁹

5.1ii – Meso Level: Sectoral and Industry Level Coordination

Furthermore, reforms at the sectoral or industry level work to improve coordination and collaboration among firms and other public and private actors to help firms within a particular sector or industry achieve the following: increase access to market information; establish

⁹ Anecdotal evidence from interviews conducted for this report. IFC's study is one of the few evaluations studies measuring this approach: "Financing Micro, Small, and Medium Enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries," Independent Evaluation Group, International Finance Corporation, 2008.

relationships between suppliers, producers, and distributors; share technological transfers; and increase the competitiveness of firms within a particular sector.

Donor groups take some similar approaches and strategies at this level. Strategies include value-chain programs where donors work with large corporations to connect them to small enterprises as suppliers or distributors. In addition, donors work directly with enterprises or through business and trade associations to help build supplier relationships for a particular region, and also to help small businesses gain access to market information to be better able to price their products. Developing and strengthening national and local competition policies also falls under this bucket. This can involve the cluster approach where donors assist governments to actively develop specific sectors. The cluster development approach aims to increase coordination among businesses, suppliers, trade associations, local universities, and local government to promote the growth of a strategic sector; help businesses gain access to inputs; and stimulate greater levels of innovation and technology transfers.

Donors conduct various types of evaluations to assess private sector development projects. Many evaluations focus on program or project impact, however, some concentrate on assessing project design issues, such as good practice, soundness of project design, cost, and efficiency. An USAID-funded study that reviewed donor evaluations of select enterprise development projects found relatively positive outcomes.¹⁰ Evaluations show that many value chain and cluster programs contributed positively to growth of micro and small enterprises; sub-sector programs show mixed results; and market linkage programs show some success in facilitating linkages and effective in improving firms' sales and profits and increasing output.

However, the same study also found flawed methodologies with donor self-evaluations: minimal impact evaluations with randomized control groups, problems with sampling, self-selection problems, and difficulty in attributing change (such as economic growth or poverty reduction) to the program intervention.

5.1iii – Micro Level: Direct Assistance to SME Firms

Direct assistance at the firm level provides either direct equity or debt financing and technical assistance for business support (helping the enterprise improve business practices). Sometimes donors finance enterprises without providing the technical assistance support.

Business development support services are an important component of most donors' private sector development strategies that focus a part of their efforts on interventions at the firm level.¹¹ This includes providing advisory services on a wide range of issues that can help business owners grow their enterprise. Examples include assistance in learning how to write a business plan, conducting a cash flow analysis, understanding and practicing accounting standards, and conducting market research. There is overlap in this area with the work that ANDE members are conducting with their interventions. Additionally, donors take different approaches in whether they provide subsidized advisory services or whether they charge enterprises for these services, although many donors are moving to the approach of charging for these services because this considers long-term

¹⁰ "Review of Evaluations of Selected Enterprise Development Projects," USAID Accelerated Microenterprise Advancement Project, 2004.

¹¹ <http://www.enterprise-development.org/page/business-development-services>

sustainability goals. A key aspect of micro level support is developing the capacity of local organizations (particularly private sector organizations) to provide this support.

In the past, donor programs that focused on direct assistance at the firm level incurred several different problems: a lot of subsidized finance, poorly targeted programs, and hard to measure results.¹² Donors are working to improve these problems by integrating firm assistance programs into a larger framework of private sector development policies and also by using market incentives to avoid market distortions (for example, charging fees for business advisory services).

However, there is a tradeoff between charging fees to secure sustainability as opposed to subsidizing services to create access for smaller enterprises. It is interesting that SME programs in western countries typically subsidize these services, but the sources of subsidy in developing countries is limited, thus charging businesses fees for advisory services is more prevalent in developing countries. However, the problem with charging fees is that this tends to move business service providers upmarket towards firms that can pay the fees and away from many SMEs, especially smaller businesses that cannot afford to pay.

The other critical component of direct firm intervention is providing SMEs with finance. Providing increased financing is an important tool that most development organizations prioritize in their programs. Donor programs in this area include a combination of direct equity and debt capital. Although, as previously mentioned, the trend is for donors to invest debt capital in financial intermediaries that serve SMEs and are moving away from direct equity investments in SMEs.

Finally, donor evaluations show mixed results for firm level program interventions. The USAID-funded study that reviewed donor evaluations of select enterprise development projects found relatively positive outcomes.¹³ Evaluations show that business development services programs generally have helped to remove internal firm constraints and increased enterprise sales, revenues, and profits. However, the same methodological problems previously mentioned apply to these evaluations: minimal impact evaluations with randomized control groups, problems with sampling, self-selection problems, and difficulty in attributing change (such as economic growth or poverty reduction) to the program intervention.

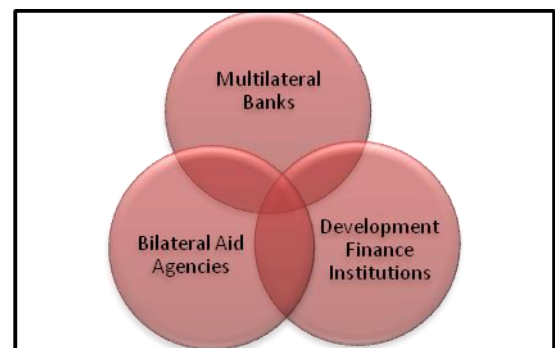
Section 5.2: Overview of Development Organizations

This section provides the overview of three types of development organizations researched for this report: multilateral development banks, bilateral government development agencies, and development finance institutions.

As previously mentioned, this section seeks to answer the following questions:

1. Which of the multilaterals, bilaterals, and DFIs are the most significant actors in this SME landscape? (And

Figure 2: Development Actors



¹² Interview notes with Steve Silcox, Senior Enterprise Development Advisor, USAID.

¹³ "Review of Evaluations of Selected Enterprise Development Projects," USAID Accelerated Microenterprise Advancement Project, 2004.

- what are some descriptive statistics about these actors?)
2. Do the donors have programs exclusively focused on SME promotion, or is SME support integrated into a larger framework of programs focused on private sector development?

5.2i Multilateral Development Banks

First, among all of the multilateral development banks, and even the European development finance institutions (EDFIs), the International Finance Corporation is the largest donor in the area of support for SMEs. In fact, the IFC's portfolio is larger than all of the EDFIs combined. Furthermore, all multilateral banks have programs that address enterprise development, particularly SME promotion, and also policies that promote business environment reforms in the developing countries they finance. See Appendix 5 for a donor grid with details on the multilateral banks.

All multilateral banks have programs to address the SME access to finance barrier, but they implement different approaches. Some donors invest directly in enterprises through loans or equity, whereas, other donors provide loans to financial intermediaries (FIs) – typically commercial banks – which in turn provide direct lending to the enterprises. The latter approach is the more recent trend that is being adopted by the multilateral banks because it can increase the reach and efficiency of investing in SMEs. Figure 3 below illustrates which multilateral development banks are taking what approach.

Figure 3: SME Financing Strategies of Multilateral Banks



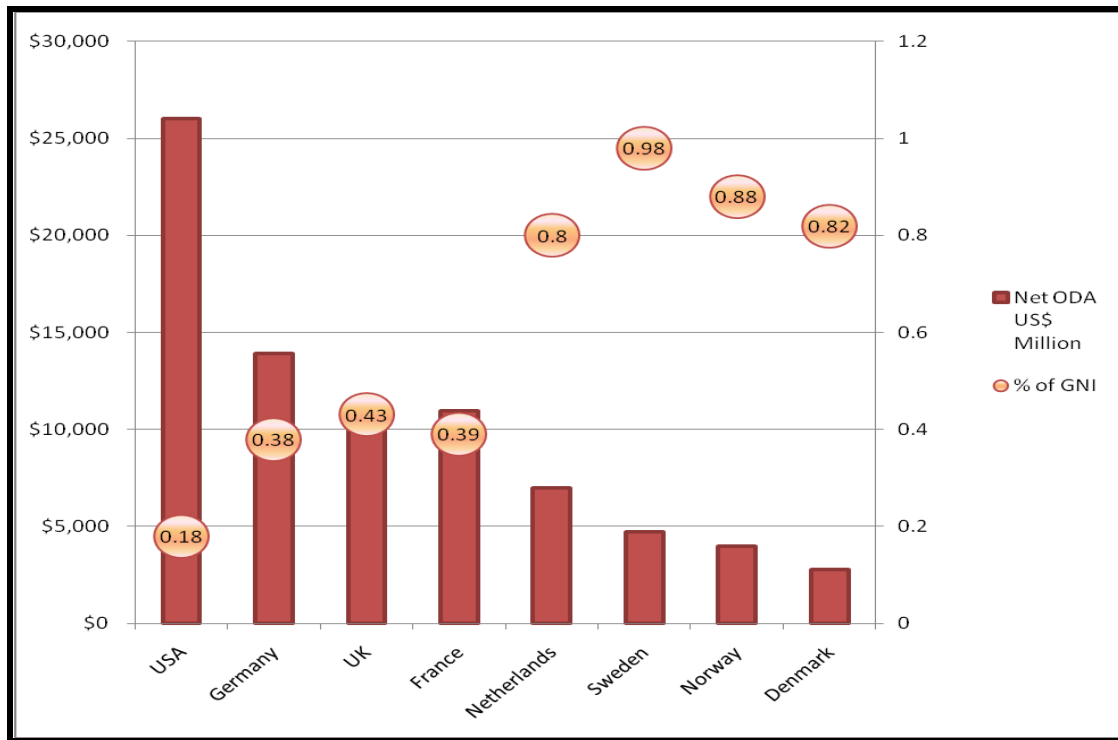
Finally, the majority of multilateral banks provide technical assistance support to governments on a wide range of policies that affect the business environment: business registration, licensing requirements, labor code regulations, contract enforcement, corporate taxation levels, and ease of exporting, to list some examples. The multilateral banks have particularly developed expertise in this area and serve as a convening power to work with different government ministries to provide advice and technical support in designing these policy reforms.

5.2ii Bilateral Aid Agencies

First, in terms of total official development assistance (ODA) flows in 2008, the United States, Germany, the United Kingdom, and France are the largest bilateral aid agencies. An analysis of the data in Chart 2 below draws out three interesting donor patterns.

First, the United States is by far the largest bilateral development actor in terms of ODA volume at \$26 billion, which is almost twice as much as the second largest bilateral donor Germany at \$13.9 billion. Yet, at the same time, the United States also commits the smallest percentage of gross national income (GNI) for ODA disbursements than any other European donor listed below. Furthermore, the donor behavior of Germany, the United Kingdom, and France – the three largest European markets – exhibit striking similarities. Absolute net ODA aid is a similar amount, and they all donate approximately .40% of their GNI. Finally, the Scandinavian countries – Sweden, Norway, and Denmark – also behave in similar ways in terms of net ODA aid volume and percentage of GNI. Interestingly, their aid volume is the smallest amount of all of these donor countries, but they all give a greater proportion of their GNI – close to 1% for Sweden. The Netherlands is the outlier and follows a different pattern. Its net ODA volume is closer to the “big three” European donors, but its GNI % contribution is closer to the Scandinavian countries.

Chart 2: Bilateral ODA Flows, Net Volume and GNI %, 2008



Source: OECD Donor Assistance Committee (DAC) Statistics 2008

A recent OECD report found that donors spend around 20% of their official development assistance on investment programs, in policies ranging from macro-economic reforms, enabling business environment, and enterprise support.¹⁴

¹⁴ “Promoting Private Investment for Development: The Role of ODA,” OECD, 2006.

It is not possible, however, to determine if the same patterns hold for bilateral flows specific to SME programming, and whether the largest bilateral donors in terms of ODA volume are also the largest SME funders. Bilateral donors do not report on SME programs. Instead the investment dollars allocated to enterprise development projects are aggregated into total investment levels for country mission projects.

Furthermore, bilateral government agencies have a history with programs focused on sectoral or industry level interventions, including examples such as GTZ in Germany and USAID. The bilateral donors are the most active organizations in projects that focus on building industry business clusters and working to build value chains between producers, processors, and distributors.

Additionally, similar to multilateral banks, most bilateral donors are very active in business environment reforms. Most of these programs are integrated within the agency's private sector development department, and most of the reform policies are targeted at national levels of developing countries. In a recent mapping report of its member organization, DCED identified the top six common areas of focus of reform among agencies: 1) improving the quality of regulatory governance; 2) broadening public-private dialogue; 3) streamlining business registration and licensing; 4) improving land titling; 5) improving access to commercial justice; and 6) improving labor policies and laws.¹⁵ Most of these agencies have not commissioned evaluation studies to measure the impact of their business environment reform policies; therefore, there is not much evidence available to assess the effectiveness of these interventions.¹⁶

Finally, many of these bilateral ministries have embassies or country offices in beneficiary countries to implement their programs. The donors vary greatly in their geographic targets. Some donors have a presence in most geographic regions, and some such as Danida in Denmark and DFID in the United Kingdom focus primarily on Africa or Asia.

5.2iii European Development Finance Institutions (EDFIs)

The development finance institutions in Europe (EDFIs) are risk capital investment funds owned by the different European governments, and they specialize primarily in making direct investments in enterprises to fuel private sector growth. There are a total of 16 EDFIs and collectively in 2008 they had an investment portfolio of EUR 16.7 billion for a total of 4,221 projects. See Appendix 6 for a detailed breakdown. The European DFIs have substantial expertise in private sector investments and have proven to be effective in their programs.¹⁷

Chart 3 below shows a side-by-side comparison of the volume of investments for each EDFI in 2008. Similar to the bilateral aid flows seen with the bilateral donors, the four largest countries represented are Germany, Netherlands, United Kingdom, and France, with the Scandinavian countries trailing behind. However, net capital allocations to EDFIs from European governments

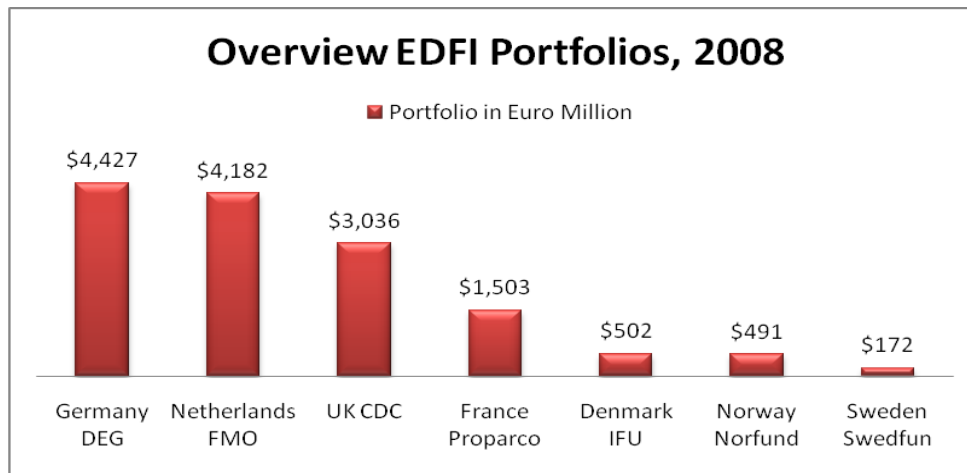
¹⁵ "Reviewing the Policies and Practice of Donor-Supported Business Environment Reform: Agency Process and Programme Mapping Report," Donor Committee for Enterprise Development, Business Environment Working Group, 2009, p. iii.

¹⁶ Ibid.

¹⁷ "The Growing Role of the Development Finance Institutions in International Development Policy," Dalberg Global Development Advisors, 2009.

are negligible. For example, over the past ten years, net capital commitments to the Nordic EDFIs are less than one percent of ODA compared to infusions to the bilateral agencies.¹⁸

Chart 3: EDFI Investment Portfolios 2008



Source: Association of European Development Finance Institutions: “2008 Comparative Analysis of EDFI Members”

EDFIs are different than the other development actors because they work only in the private sector to make investments to firms or financial institutions. Equity (53%) is the most common financing product used by the EDFIs, followed by loans (40%) and then guarantees (7%).¹⁹ The average project size of EDFI’s global portfolio is around EUR 4 million.²⁰

Finally, the geographic investments of each DFI varies among each individual organization depending on partnerships in different countries and the local expertise it has built in its past. However, the EDFIs try to target lower-income countries in their investments and to invest in the least developed countries. In a recent report by the consulting firm Dalberg, they found that collectively the 16 EDFIs’ Africa portfolios grew by 10% from 2007 to 2008.²¹

Section 5.3: Comparative Advantage of Development Actors

This section of the report presents information and analysis about the distinct roles different types of organizations play in promoting SME development and private sector growth and the comparative advantage based on each category of donor or investor organization.

5.3i Multilateral Banks – Finance and Knowledge Banks

Based on this report’s research and findings from interviewees, this report concludes that the multilateral development banks have the most specialized and innovative SME programs and are the leading funders for SMEs.²² Their programs are comprehensive and include all of the following

¹⁸ Ibid.

¹⁹ Ibid, p 9.

²⁰ Ibid, p.9.

²¹ Ibid p. iv.

²² It is possible that bilateral donors spend more indirectly on SMEs, but this data is not possible to disaggregate from their reporting information.

components: business environment reform technical assistance, market linkage programs, competitiveness programs, SME equity funds, and debt capital to financial intermediaries lending to SMEs.

The banks are typically coined knowledge banks because of their research expertise and capacity to disseminate best practices. One classic example is the World Bank's *Doing Business* program which provides research and analysis that reforming countries can use to make changes to business regulations and other laws and regulations that influence a country's business environment. The World Bank frequently works with government officials to provide technical assistance support.

Comparative Advantages

- Make use of global benchmarking for business environment reforms so countries have a standard to peg progress to.
- Serve as convening power for government reforms.
- Adhere to commercial principles and use market-based incentives to ensure sustainability of investments – for example, IFC charges for advisory services.
- Build-in learning and innovation process to test new ideas that can be scaled through larger investments in the future (IDB Multilateral Investment Fund example).
- Subject to independent auditing group.

Limitations

- Have varying capacity to conduct rigorous monitoring and evaluating and use inconsistent year-to-year measures. Difficult to measure and attribute change to policy reform interventions, which involve both political will in a country as well as many donor interventions.
- Commission limited evaluation studies of the strategy that focuses on investing in financial intermediaries. There are not many studies to see if this intervention has proven to be effective.
- Do not engage in extensive bank-client policy dialogue.

5.3ii Bilateral Government Agencies – Growth Generators

Bilateral donor agencies have a comparative advantage with their expertise in projects that help enterprises build market access, collaborate in business clusters and industry-wide efforts, and formulate sector-wide competitiveness strategies. This donor group typically focuses on understanding best practice around projects that can help firms of all sizes grow and increase their productivity within strategic, high-growth sectors. Typically, bilateral donors do not develop specific SME promotion strategies, but focus more on developing the private sector as a whole.

Furthermore, bilateral aid projects are highly fragmented with significant overlap in the same sectors. A recent report from the OECD Development Centre that researched official development assistance (ODA) for all types of development projects found that in 2007 more than 90,000 development projects were running simultaneously, and that developing countries with the largest

number of aid projects had more than 2,000 projects in a single year.²³ However, while aid projects are proliferating, expenditure is primarily focused on education, health, and governance spending and expenditures is decreasing or stable for private sector projects.²⁴

Finally, similar to the multilateral knowledge banks, bilateral donors heavily focus on business environment reform efforts. The most common form of intervention is capacity building, policy development and dialogue, and facilitating dialogue.²⁵ The approach is similar to the multilaterals, but the multilaterals have more of a neutrality advantage in influencing other countries to reform their laws and regulations. These types of reforms have a public legitimacy challenge for bilateral donors as they can be viewed as tied to foreign policy objectives and strategic interests of donor countries.

Comparative Advantages

- Focus on growing strategic product sectors and industry clusters thus helping to generate dynamic economic growth in developing countries.
- Use qualified local staff in local country offices and source local service providers through open, competitive procurement process.
- Possess expertise in business environment reforms, and collaboration is growing among donors in this area through DCED's Business Environment Working Group.
- Disburse large ODA bilateral flows compared to financing volume of other development actors.
- Ability to measure and track outputs of sector-wide projects: track production, exports, imports, and markets in sectors.

Limitations

- Disburse aid through grants, concessional loans and other forms of subsidized aid, thus donor interventions have danger of creating dependency and distortions.
- Skew aid funding toward foreign strategic objectives, and projects can change year to year based on changing foreign policy interests. There is minimal long-term commitment to projects, compared to the other donor groups whose projects can run 5-10 years.
- Design country-focused projects instead of program-focused. This poses a challenge as many enterprise investments are bundled under country-operation projects, and it is difficult to collect this investment data project by project for hundreds of projects.

²³ "Crushed Aid: Fragmentation in Sectoral Aid," OECD Development Centre Working Paper No. 284, January 2010, p. 5.

²⁴ Ibid.

²⁵ "Reviewing the Policies and Practice of Donor-Supported Business Environment Reform: Agency Process and Programme Mapping Report," Donor Committee for Enterprise Development, Business Environment Working Group, 2009.

5.3iii Development Finance Institutions – Catalyzing Agents

Development finance institutions have a different business model than typical development actors. They work primarily through the private sector, and they self-define their role as additional to the market. They do not invest in sectors or projects where there is substantial investment from private investors because they do not want to crowd out local markets. Additionally, they catalyze investments from private sector investors by being the first movers in specific under-served sectors, such as the SME sector, to demonstrate these projects can be profitable.

The recent study conducted by Dalberg consulting firm commissioned by the Nordic governments found similar findings about the value-add role of the EDFIs. According to the report, DFIs add value to development policy in three key areas: 1) investing in under-served project types and settings; 2) investing in undercapitalized sectors; and 3) mobilizing other investors by sharing knowledge and setting standards.²⁶

Comparative Advantages

- Commit to long-term projects (5 to 10 years) to establish credibility, form local partnerships, and make modifications as needed.
- Able to make decisions more quickly than other donors and have less bureaucratic procedures.
- Leverage local investors by co-financing projects with local institutions and channeling investments through local fund managers.
- Do not have foreign objective ties connected to financing decisions. (DFIs used to be linked to national interest and invested in companies from their countries looking to invest in emerging markets of former colonies.)
- Adhere to commercial principles and work with market conditions to ensure sustainability of investments – at cost technical assistance to banks and enterprises.

Limitations

- Isolate equity fund investing for SMEs from other instruments and tools for SMEs, such as business support services. They are not integrated into a broader policy and are not complemented with other services to SMEs.
- In some cases, like FMO, combine their investment activities for microfinance institutions (MFIs) and SMEs together. This does not allow them to tailor their approach to SMEs which have different needs than MFIS. And it bundles the data together and does not separate out outcome data for the SME investments.

²⁶ “The Growing Role of the Development Finance Institutions in International Development Policy,” Dalberg Global Development Advisors, 2009, p. iii.

Section 5.4: Organizational Profiles

5.4i INTERNATIONAL FINANCE CORPORATION

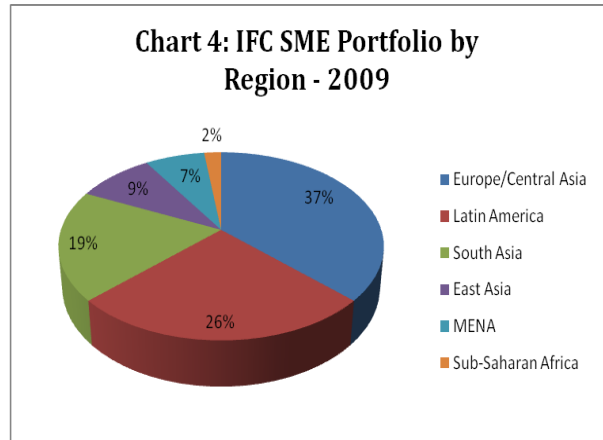
Background

The International Finance Corporation (IFC) is part of the World Bank Group. The World Bank provides loan guarantees and technical assistance grants to national governments, and it provides credits (low-interest loans) to low creditworthy countries. Much of the World Bank’s private sector development activities in developing countries are carried out through loan guarantees and technical assistance grants. The IFC has a different model than the World Bank. It provides debt capital to financial institutions; invests direct equity in private enterprises, including SMEs; and provides technical assistance advisory services to businesses and governments.

SME Activities & Impact

IFC is the largest institutional actor among multilateral banks and DFIs that specifically targets SMEs in their programs. It uses a variety of financial instruments to support SMEs, such as investing in financial intermediaries that give loans to SMEs, as already mentioned. It also uses other instruments such as equity financing, quasi-equity financing, risk management products, and partial credit guarantees.

In 2009, IFC committed \$6.1 billion to its SME finance portfolio, and IFC investee financial intermediaries had an outstanding portfolio of 1.3 million SME loans that totaled \$90.6 billion, demonstrating the power of the multiplier effect. Chart 4 to the right shows how its SME portfolio breaks down geographically. Additionally, IFC’s equity investment portfolio – 77 funds that target SMEs – has committed \$765 million to over 775 SMEs to date. See Appendix 7 for a breakdown of IFC commitments to financial institutions by equity, loan, or loan and equity from 1994 to 2006.



In addition to financial investments, IFC provides a range of advisory services both to enterprises and financial intermediaries. It has developed the SME Toolkit in 2002 and Business Edge for enterprise owners. The SME Toolkit is a free online program which provides resources and use of technology to help business owners learn business skills and management best practices. The Toolkit is currently in use in over 22 countries and has been adapted to over 13 languages. The Business Edge Program is a comprehensive SME management training program that consists of 36 courses on five topics: marketing, human resources, production and operations, finance and accounting, and productivity skills. As of 2007, over 28,000 individuals participated in the program.

Furthermore, IFC’s advisory services help build the capacity of financial institutions (FIs) so it is profitable for them to serve SMEs. IFC works with the individual FIs to build their strategy to reach SMEs, segment the market, develop appropriate financial products, and support operations to deal with SMEs more profitably. IFC first conducts an initial assessment and from that come up with gap analysis to provide recommendations on what the FI needs. Then IFC staff helps in the implementation phase of making those suggested changes.

Bank lending is the number one financing mechanism to reach SMEs, and banks are IFC's largest clients among financial intermediaries. The majority of clients have some sort of SME financing portfolio in place before they begin to work with IFC. However, they do not conduct SME lending in a structured way or do not have a separate unit or separate risk management approach to their work. Therefore, IFC's advisory services help banks with this technical support. IFC provides advisory services to over half of the financial intermediaries they lend to. Its technical support to FIs that focuses on building SME capacity includes the IFC SME Banking Knowledge Guide publication, a training program, and a benchmarking survey.

IFC published the SME Banking Knowledge Guide in 2009 to share IFC's lessons learned and success factors for profitable SME banking operations. This technical guide is being shared with bank directors, managers, and staff in developing countries to help them with their strategy and operations as they approach the SME segment with their banking services. The Guide draws on existing research and many primary interviews with SME banking experts and practitioners worldwide.

IFC's technical assistance also includes the SME Banking Training Program to assist banks working in emerging markets to develop capacity to assess and implement expanded SME business lines. The training is designed for mid-level bank officers and managers, and it provides a comprehensive understanding of SME banking fundamentals, analyzes global best practices, and demonstrates how to adapt these practices to respond to local and regional market conditions.

Furthermore, the IFC has developed an on-line tool to automatically benchmark banking practices. The SME Banking Benchmarking Survey provides valuable information to participating banks and IFC staff on how a specific bank compares to its peers and to best practice banks, and it provides data on key banking operational areas of improvement to efficiently and effectively service SMEs. The tool produces a benchmarking report with tailored recommendations based on the client's needs. Banks can use this tool for new business development and for strengthening existing client relationships.

IFC also provides technical assistance to policy makers and public officials. This type of TA targets the financial infrastructure in countries by helping design leasing laws and financial regulations. IFC works to help build credit information infrastructure, such as credit bureaus. To date, IFC has worked in 40 countries and has helped to establish 10 credit bureaus.

Finally, IFC works with other World Bank agencies to improve the business environment in partner countries. In these policy reforms, IFC's specialization includes regulatory simplification, alternative dispute resolution, and investment policy promotion. IFC is actively working in around 70 countries on investment climate reform projects, and in 40 countries to help governments reform and simplify business start-up programs.

Strategy & Impact

In 2008, the World Bank's Independent Evaluation Group (IEG) conducted an evaluation to assess IFC's investment projects and advisory services operations to support micro, small, and medium enterprises (MSMEs) in frontier countries (or low-income, high risk countries) from 1994 to 2006. During this time, IFC's financial commitment to MSMEs totaled \$1.4 billion, and its advisory services to small and medium enterprise-oriented financial intermediaries (SME-FIs) totaled \$6.5 million. IEG examined 72 SME-FI projects during this time period, and found that 36 were financed primarily with loans, 12 were financed with both loans and equity, and 24 were financed only with

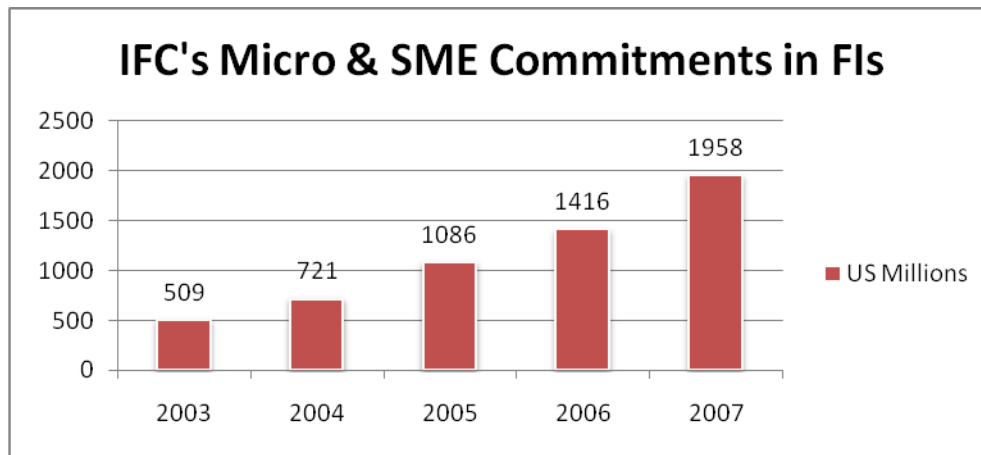
equity.

Of these 72 projects, the IEG more closely examined the operating results and performance of a sub-group of 36 projects. It found that in 2005 this sub-group achieved an annual return on average equity above the 15 percent rate standard for the banking industry in developed countries. Furthermore, it also found a positive impact of its advisory services. The smaller SME-FIs (in terms of total assets) that received advisory services from IFC had an average of 16,115 borrowers per SME-FI in 2005. The larger SME-FIs that did not receive the advisory services had an average of 1,585 borrowers per SME-FI, or almost 10 times less than the ones who did receive advisory services. Since 2001, IFC's strategies to support MSMEs have been the following:

- (i) Offer wide-scale indirect IFC funding through specialized micro-finance intermediaries and SME-oriented financial intermediaries;
- (ii) Provide advisory services to these financial intermediaries to improve their operations, particularly for lending to MSMEs;
- (iii) Invest equity in microfinance intermediaries and SME-FIs when appropriate;
- (iv) Limit IFC's direct loan or equity investment in SMEs;
- (v) Use regional project-development facilities co-financed by donors, to offer non-financial services to SMEs such as institutional capacity building, training, and suggestions for improving local government regulations affecting SMEs; and
- (vi) Broadly support the development of financial markets and the private sector by helping to improve policy and regulatory regimes and business climates.

SME programming is a growing area of focus for IFC, as can be seen in Chart 5 below and the substantial increase in the MSME portfolio since 2003. In the interview with an IFC official, she revealed that IFC has ambitious growth targets in the sector and is expecting to increase outreach.²⁷ IFC's advisory services remain at the forefront of their work. Seven months ago, IFC established a SME task forc to harmonize its strategy at the corporate level. Finally, according to IFC's 2009 Issue Brief on SMEs, IFC officials project that SME lending will double by 2013.

Chart 5: IFC's Micro & SME Commitments in FIs 2003-2007



²⁷ Interview notes with Ghada Teima, Program Manager, IFC Advisory Services – Access to Finance.

5.4ii INTER-AMERICAN DEVELOPMENT BANK (IDB)

Background

Much of the IDB policies of the 1990s were macro-level policies that focused on structural reforms and economic liberalization programs – trade openness, export promotion, financial markets liberalization, and privatization efforts – as the Latin American and Caribbean (LAC) region was changing from a state-centered model of development to a market-based model. The IDB Group provided technical assistance to governments to help them design policies to improve the business environment. It currently still provides technical assistance to governments focused on business environment reform.

SME Activities

The Inter-American Development Bank (IDB) Group has supported SMEs since 1990. From 1990 to 2002, the IDB Group invested \$14.9 billion in direct and indirect support for SMEs.

In recent years from 2003 to 2008, the IDB Group has increased its financial support of SMEs and restructured its SMEs programs under an overarching framework in the 2004 Private Sector Development Strategy. In the context of this framework, the IDB Group has invested more than \$9 billion in loans and more than \$300 million in technical assistance and grants to support SMEs from 2003 to 2008. This support is organized under six programmatic areas:

1. Access to Finance
2. Competitiveness
3. Improving the Business Environment
4. Promoting Entrepreneurship
5. Strengthening the Role of Large Business to Promote Economic Inclusion in a Sustainable Way
6. Innovation and Technology

The table in Appendix 8 summarizes the level of support in each program area.

As can be seen in the table, the largest programs and financial investments are in the financial services sector. The IDB group provides financing to financial institutions through soft loans, direct equity, and loan guarantees. Similar to the IFC, its approach is to primarily help deepen

THE IDB GROUP: The Structure

The IDB consists of three institutions.

1. The Inter-American Development Bank (the Bank):

This is the main body of the three, and provides the most capital to SME financing. Founded in 1959, the Bank is a multilateral development bank that raises capital in financial markets and from donor countries, and it makes financing available to borrowing member countries (governments of countries in Latin America and the Caribbean). In addition to financing, the Bank provides policy advice to governments and technical assistance for preparing and implementing development plans.

2. The Inter-American Investment Corporation (IIC):

The IIC is a multilateral organization created in 1989 with the mission of promoting economic development in LAC by investing in private enterprises. It provides financing – through equity investments, loans, guarantees, and other instruments – and advisory services to enterprises of all sizes, but primarily to SMEs. The IIC also finances financial intermediaries that fund SMEs as a way of scaling the reach of IIC investments.

3. The Multilateral Investment Fund (MIF):

The MIF is the smallest of the three and the youngest (created in 1993). It provides technical assistance grants, loans, and equity to intermediaries to promote SMEs. MIF's projects are pilot initiatives that are innovative.

the financial sector so that more banks and other financial institutions will move downstream to serve more SMEs. From the IDB's experience, it has found that it is more common for microfinance institutions to move upstream and finance SMEs than for commercial banks to move downstream and serve SMEs.

The Multilateral Investment Fund (MIF) Fund at the IDB takes more of an experimental approach in its access to finance programs and uses a variety of financing instruments to meet its objectives. It offers technical assistance and grants, supplies loan and equity to banks and microfinance institutions, and provides equity for seed and venture capital funds. Its Small Enterprise Investment Fund (SEIF) "has undertaken the broadest, most comprehensive approach to the development of the venture capital industry in Latin America of any institutions."²⁸ It is the most significant venture capital investor in the region, and has successfully helped Brazil to build a venture capital industry, although most other Latin American countries have under-developed venture capital industries.

Strategy & Impact

Based on the IDB's evaluation document of its SME programs from 2003 to 2009 and from interviews with a range of IDB officials, it is clear that the SME sector is a top priority for IDB in recent years, and it will continue to grow in upcoming years. All three branches of the IDB group will continue to expand their existing initiatives.

The Bank will develop its existing SME productivity and competitiveness programs through technical assistance support programs to governments. It will help develop labor markets, promote technological innovation, build cooperation among firms, and encourage entrepreneurship.

Currently, most of the Inter-American Investment Corporation's (IIC's) financing is disbursed through loans (90%) to both direct companies as well as financial institutions that lend to SMEs. IIC seeks to work with financial institutions that have sound credit cultures and have a commitment to expanding their portfolio of financing to SMEs. Only about 10% of financing is in the form of direct equity. This has been a shift since 2002 since equity investments did not prove to be profitable in the past. Equity funds were expensive to manage and there were minimal market exits. However, IIC's future strategy will involve moving back towards greater investment through its equity portfolio in the region.²⁹

The IIC's board of directors approved a strategic decision to increase its equity portfolio in Latin America and the Caribbean. It recognizes that equity investments are more developmental in nature than debt for SMEs. It will work to broaden the range of financial products it offers to SMEs and create more flexible products that respond to the specific needs of SMEs.

Finally, the Multilateral Investment Fund will continue to experiment with new ways to finance SMEs and incorporate SMEs into value chains with larger companies. It will also try new business models such as micro franchising at the base of the pyramid. Furthermore, the MIF is increasing its investment for impact evaluations to better assess the causal impact of its programs. This is an important step that many other donors have not committed to.

²⁸ "The IDB Group Support to SMEs in 2003-2008: An Overview." Inter-American Development Bank, 2009, p. 10.

²⁹ Interview notes with John Beckham, Corporate Projects Coordinator, IIC.

5.4iii UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT (USAID)

Background

According to a 2004 report by the consulting firm Development Alternatives Inc. (DAI), USAID is perceived within the donor community as having special interest and expertise in the private sector.³⁰ It has tried many different donor strategies in the past: business environment reforms, micro and small enterprise development, microfinance, business services, export promotion, and other programs. However, the impact of these individual programs or evidence for the optimal mix of program combinations is not known because in many cases rigorous and systematic evaluation was not undertaken. There is minimal consistent, year-to-year outcome data available.

In the 1960s and 1970s, USAID focused on direct firm level assistance, but in recent years has targeted its assistance to develop local institutions that can provide services – both financial and non-financial - to enterprises to develop local capacity. Missions start out by analyzing the economy of a country and conducting a diagnostic to determine what the private sector needs to stimulate growth. It then decides what firms and sectors to target through competitiveness and/or cluster and value chain projects, taking a comprehensive approach. Enterprises benefit directly through an indirect effect from the sector or cluster level projects. USAID projects do not always start out by targeting SMEs.

In the late 1990s, USAID placed greater emphasis on the business development services approach (BDS) advocated by the Donor Committee on Enterprise Development. Within this approach it funded business services that attempted to focus on developing local business service providers, using a facilitation approach to limit distortion of local markets. Some business services were specialized to specific sub-sectors and others supported broad business services that could be used by firms in multiple sectors. Projects often attempted to “embed” business services in commercial relationships, e.g., technical advice provided by a seller of seed or fertilizer. This approach typically works better in agricultural programs than in urban SME products or services.

Additionally, USAID also emphasizes programs that help connect firms to product markets and to connections along the value chain. It finances many projects under the rubric of market linkages and value chain which aim to help firms market their production profitably.

SME Activities

Projects that support SME development are decentralized and implemented by country mission projects. USAID, in general, is very decentralized and most of the money is allocated to the country missions. In 2004, USAID supported enterprise development projects in 36 developing countries. A majority of funding goes to missions in Afghanistan, Pakistan, Iraq, and a few other countries of strategic importance to the U.S. (such as Egypt and Colombia).

In addition to country missions, USAID has two specific initiatives that promote SME support. First, **the Development Credit Authority (DCA)** – established in 1999 - is a tool that USAID missions can use to incentivize financial institutions to lend to underserved small business borrowers. It is USAID’s main finance vehicle for SMEs. These partial credit guarantees cover up to 50 percent of loan defaults made by banks or other financial institutions. Since 1999, DCA has made more than 225 partial credit loan and bond guarantees facilitating close to \$2 billion of private capital to be lent to underserved borrowers in more than 60 countries. There is evidence that this is a cost-

³⁰ “Enterprise Growth Initiatives: Strategic Directions and Options,” Development Alternatives Inc., 2004.

effective tool for USAID. The cost is around \$61 million, and every dollar spent by the U.S. government on this guarantee is matched by \$30 on average by private sector institutions. Claims on the DCA portfolio are just 1 percent.

Second, USAID established **the Business Growth Initiative (BGI)** project through its Office of Economic Growth of the Bureau for Economic Growth, Agriculture and Trade (EGAT) four years ago to provide technical leadership for enterprise development to USAID’s missions and bureaus. It serves as a center of excellence for USAID and the broader enterprise development community of practice and is a clearinghouse for studies and reports and shares best practices with practitioners in this field. The BGI project is managed by a Senior Enterprise Development Advisor, who is assisted by a Presidential Management Fellow. The project is implemented through a small business set-aside contract by a consortium of three consulting firms. The BGI project will end in 2012 and a follow-on project is being planned.

Figure 4: USAID Country Mission Statistics

Average USAID Mission

- Annual program budget \$30 million
- 3 expatriate staff
- Up to 30 local staff, personal services contractors, and fellows

DAI Recommendation 2004:

10% of total program budget, or \$3 million per year, can support an effective strategic Enterprise Growth Initiative multi-faceted component within the USAID country mission

In addition, **Regional USAID Bureaus** have provided enterprise development specialists to assist mission programs in their regions. The Europe and Eurasia (E&E) Bureau, in particular, has provided extensive technical assistance to missions on SME development over the years since its creation after the collapse of the Soviet Union. Since many of the USAID country programs in that region have been closing down, with the “graduation” of those countries from donor programs, this assistance is decreasing proportionally. In fact, the E&E Bureau drafted a strategy for SME development in that region in 2000 that was used to design programs in a number of countries after its adoption. The Africa Bureau and the Latin America and Caribbean Bureau have employed small and microenterprise development specialists in USAID headquarters over the years, but do not currently have specialists in that capacity.

Furthermore, the **Microenterprise Development Office** in USAID has been providing assistance in enterprise development for many years, but with a particular focus on small and microenterprises. Business development programs promoted by that office do try to link microenterprises into value chains that link them to markets that may have larger businesses as key players in those markets.

Strategy & Impact

USAID does not have a separate enterprise development strategy document to provide an integrated framework for its SME activities. It has never had an agency-wide SME development strategy. It does have strategies in place for agriculture and trade. An economic growth strategy was adopted two years ago for the first time. That strategy has aspects that deal with enterprise development, but does not focus on particular sizes of enterprises.

While USAID is mandated by Congress to spend earmarked funds on the development of microenterprises, it does not have a similar mandate to support SMEs which may lead to less of an emphasis on developing SME-specific programs.

This has a number of advantages for microenterprises and disadvantages for SMEs. For microenterprises, it provides clear reporting that is mandated by Congress so that the public knows how much was annually spent on these programs and what results the investments created. For example, in FY 2007, USAID reported that it provided \$193 million in funding for microenterprise development through 184 new and existing grants, cooperative agreements, and contracts in 61 countries. USAID does not have a similar summary statistic for its SME activities in 2007. Furthermore, all missions around the world report on the same indicators related to microenterprise activities because it is a requirement. Again, missions are not required to report on SME activities so there is minimal data available.

In June 2009, President Obama delivered a signature speech in Cairo about the importance of entrepreneurship in the Middle East and hosted a summit on entrepreneurship with participants from more than 50 Muslim-majority countries in Washington this past April. This signals a growing interest in entrepreneurship as a tool for development from the Obama administration, but it remains to be seen if this political rhetoric will be matched by more aid dollars for SME and entrepreneurship programs.

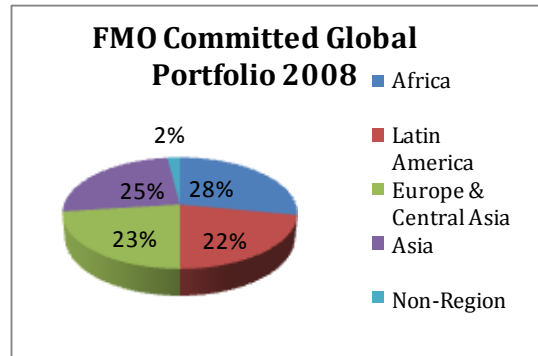
5.4iv FMO – THE NETHERLANDS FINANCE COMPANY

Background

FMO's, the Netherlands Finance Company, mission is to stimulate private sector development through the promotion of entrepreneurship. FMO finances both private companies and financial institutions in order to generate development impact and profit. It is operationally independent from the Dutch government and from the Ministry of Foreign Affairs. There are no government representatives on its board of directors. However, while it is fairly independent in its operations, it consults with the government about its strategy as this is an important relationship.

About 80 percent of FMO's operations are financed by FMO's own capital or capital attracted in the international market, and 20 percent is funded by special funds FMO manages on behalf of the Dutch Ministry of Foreign Affairs. At present, FMO is active in over 80 developing countries and countries in transition and has an investment portfolio of EUR 4.2 billion. Chart 6 shows FMO's geographic priorities.

Chart 6

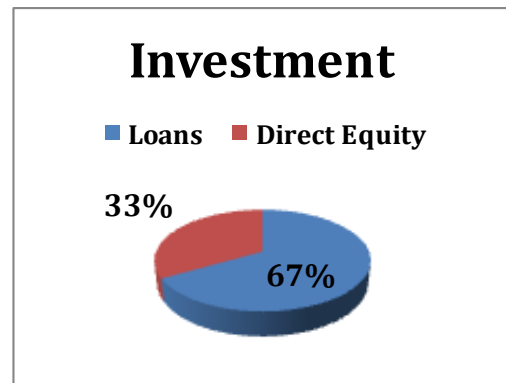


FMO manages a number of specific funds and facilities for the Dutch government that allows it to take more high risk projects than it could take on its own. They include: Access to Energy Fund, MASSIF Fund, Capacity Development program, Infrastructure Development Fund, and Facility Emerging Markets. These funds have greater potential for a development impact.

SME Activities

FMO has around EUR 1.5 billion in financing outstanding to micro, small, and medium enterprises (MSMEs), which is around one third of the total FMO Portfolio. Most of this financing (EUR 1.2 billion) is outstanding in the form of loans to commercial banks with the goal of being lent to MSMEs. Some of FMO's MSME activities are carried out through the Massif Fund, which is EUR 300 million. Co-administered by the Dutch Minister for Development Cooperation, the Massif Fund provides risk capital (through long-term equity and debt) in local currency to financial institutions in developing countries that will use that capital to serve micro-and small-scale entrepreneurs and low-income households. The fund supports commercial banks and microfinance institutions.

Chart 7: MASSIF Investment Portfolio



On the lending side, FMO conducts risk-sharing transactions with commercial banks. As shown in Chart 7, two-thirds of the Massif Fund is dispersed through loans to clients. On the private equity side, it co-invests with locally-based fund managers to build their capacity to serve their SME clients. One-third of the Massif Fund is outstanding in equity: investments in private equity funds and direct investments in financial institutions that target the lower end of the market. Direct lending to SMEs is less of a focus for FMO because it is a time and labor intensive process to provide individual technical assistance to the small businesses to ensure they are successful. Also, FMO does not have local

offices so it is hard to monitor the progress of SME lending from the headquarters in The Hague.

FMO does not specifically target SMEs in its strategy because its approach is a holistic one that aims to develop the financial sector that serves the lower end of the market that traditionally lacks access to finance. Therefore, it combines SMEs, micro-entrepreneurs, and low-income households together. Ultimately, a variety of financial services are offered in greater volume as a result of FMO's backing: savings, cash flow, credit, guarantees, mortgages, leasing, and insurance.

Strategy & Impact

In 2008, FMO prepared a new strategy for 2009-2012, and identified three sectors it believed to have the most positive development impact: finance, energy, and housing. The financial sector is the most important of the three, constituting 50 percent of FMO's portfolio. FMO currently has a financial sector strategy, and the interview with FMO's official revealed that FMO is currently formulating a SME finance organizational strategy, signaling this is a growth target.

FMO's role is to be additional to the market. It makes investments in sectors and projects where commercial investors are risk averse and not willing to invest. In cases where commercial investors are willing to invest, FMO will not take this role as it does not want to crowd out local markets. However, in many underserved sectors, commercial investors are absent. By being the first mover in these high-risk sectors and co-financing with local fund managers, FMO hopes to demonstrate that these investments can be profitable and sustainable -- in turn catalyzing private investments in these sectors in the future. Additionally, it co-finances with local fund managers in equity investments and requires the banks to take a stake in the projects in the case of debt financing to create the right incentive structures that will help maximize financial returns on the projects.

FMO takes a long-term cycle approach in its investments, typically 5 to 10 years. This is quite different than the Ministry of Foreign Affairs, which can change its project and sector priorities every couple of years as the objectives of its foreign strategic interests change. This allows FMO to achieve its long-term economic, social, and environmental impact goals. It uses the Economic Development Impact Score (EDIS) to measure the economic development contribution of a project to its community. Figure 5 shows outputs from its MASSIF portfolio 2008 investments.

Figure 5: 2008 MASSIF Investment Outputs



Finally, FMO values partnership and collaboration. It frequently partners with other DFIs to co-finance projects, typically in 25 percent of its business. Regular partners include Proparco in France and DEG in Germany. Additionally, FMO sees value in engaging with funder networks, and has an ongoing relationship with the Consultative Group to Assist the Poor (CGAP) -- an independent policy and research center dedicated to advancing financial access for the world's poor, supported by over 33 development agencies and private foundations. This is a model that can be replicated for partnership with other donor networks such as ANDE.

6. Recommendations: Influencing the SME Development Agenda

An analysis of the collected data and interviews, in addition to consultation with select ANDE members³¹, produced a number of recommendations to ANDE on how to influence the development agenda promoting SME growth in developing countries.

The international donor and investor community is highly fragmented, and donor and investor strategies to finance small and medium enterprises vary greatly. Some actors focus on institutional, legal, and regulatory reforms to improve the business environment climate for firms of all sizes. Other actors specifically target the challenges faced by small businesses and try to remove their constraints to growth. Even within this approach, development actors vary in their interventions. Some finance SMEs directly, and others finance financial intermediaries and thus indirectly finance SMEs. Typically, donors may not be fully aware of the projects and policies of their peers, and there is minimal coordination in country projects.

Therefore, ANDE is uniquely positioned to play a strategic role in the development community that few other actors have the legitimacy and capacity to fulfill. This report recommends that ANDE should help bridge the knowledge gap of SME policies among donors and investors, and it should consider how it might serve to coordinate the SME field projects among its member organizations and donors and investors present in the same countries. Additionally, the report recommends ANDE should advocate to increase capital commitments of donors already engaged in SME activities and to motivate select donors without a SME focus to develop these programs.

Recommendation 1: ADVOCATE THE CASE FOR SMEs

Figure 6: Making the Case for SMEs

Aggregate ANDE member output and outcome data to demonstrate achievement to date

Commission impact studies

Highlight academic studies and articles that find a correlation between SMEs and economic benefits

Develop case studies of successful member interventions

Development donors differ in their philosophy about the merits of targeting SMEs in their strategies.³² Some are not convinced that investing in SMEs will lead to economic growth, net job creation, or poverty reduction in developing countries. The evidence for the effectiveness of SME development programs is not yet conclusive.³³

However, small businesses do constitute a majority of the private sector in developing countries, and research shows that SMEs do face greater constraints to growth than larger firms.³⁴ Therefore, it is problematic that many small firms in poorer countries are constrained in their ability to expand, leading to a small enterprise sector that is stagnant and not able to scale production as a sector.

ANDE should share evidence with donors about why it is imperative to help the SME sector scale and how to develop an approach that can target growth-oriented small businesses helping them achieve greater productivity. It can continue to document and distribute success

³¹ Please see Appendix 9 for list of interviews with ANDE members.

³² See for example <http://www.enterprise-development.org/page/psdstrategies>

³³ "A market-oriented strategy for small and medium-scale enterprises," IFC Discussion Paper, 2001. And, "Small and medium-size enterprises: Access to finance as a growth constraint," Journal of Banking & Finance 2006.

³⁴ Ibid.

stories from its members, and continue to aggregate data and outcomes across its Network to demonstrate the impact of investing in SMEs. A recent example is the release of ANDE's 2009 Impact Report that shows the successes of ANDE members in 2009 and aggregates sector impact. Another example is ANDE member Small Enterprise Assistance Funds (SEAF), which conducted an impact study that demonstrated that every dollar invested in its SME recipients generated on average an additional \$12 in the local economy.³⁵ ANDE is already doing some of this activity, but it should expand its educational and lobbying activities also to donors who are not convinced about the SME approach in development projects.

One specific example where ANDE can begin its lobbying and educational efforts is in the United States. As mentioned in the report, USAID is mandated by Congress to spend earmarked funds on the development of microenterprises. This is the result of the strong focus on microfinance in the development community, and also because of previous lobbying efforts of microfinance-focused non-governmental organizations and other civic groups to influence Congress to increase US funding for international microfinance support. Congress currently does not have legislation in place to earmark funds for the support of SMEs. ANDE can play a key role in developing a lobbying strategy targeted at Congress to convince US decision-makers that investing in SMEs is critical to triggering economic growth in developing countries, and thus, to convince US Congress officials to earmark funds for SME programs through USAID.

Recommendation 2: COORDINATE WITH OTHER DEVELOPMENT NETWORKS & COMMITTEES

In addition to building bilateral relationships with development organizations, particularly those profiled in this report, ANDE should cultivate multilateral relationships in the development community through key donor and investor networks. Natural synergies exist between the ANDE network and international development networks: common knowledge of individual investor strategies, ability to monitor sector trends, and scaling impact through collective action. Two central bodies are strong candidate for ANDE to target in its advocacy efforts.

Donor Committee for Enterprise Development (DCED).

DCED is a network of both bilateral and multilateral donor agencies working for sustainable poverty alleviation through the development of the private sector in developing countries. It was formed in 1979, and consists of both U.S. and European-based donors and UN agencies. The network's goal is to enhance the effectiveness of members and others in private sector development. This is complementary to ANDE's goal of significantly increasing development donor investments for enterprise development in developing countries, and ANDE should align its advocacy strategy with DCED.

The Association of European Development Finance Institutions (EDFI).

EDFI is a group of 15 bilateral institutions which provide long-term finance for private sector enterprises in developing economies. Its mission is to foster cooperation among its members and to strengthen links with institutions of the

Figure 7 - DCED's 2010 Work Plan outlines several growth-focused objectives, including:

- 1) Becoming widely recognized as the leading source of information and guidance of private sector development;
- 2) Achieving recognition of the importance of private sector development as the solution to key development challenges; and
- 3) Demonstrating that donors have effective approaches to achieve private sector development.

³⁵ "The Development Impact of Small and Medium Enterprises: Lessons Learned from SEAF Investments," Small Enterprise Assistance Funds, 2004.

European Union. The Netherlands' FMO is a member of this group, as well as most other DFIs based in Europe.

As noted earlier in the report, DFIs characteristically co-invest as a financing strategy, and there is opportunity to build these relationships so that the DFIs can co-invest with ANDE members – foundations, investors, and nonprofit intermediaries – in countries with established presence. For example, ANDE members and DFIs could map out where their projects overlap in specific countries and sectors, and work to co-finance those types of projects together in the future, building on their shared local expertise and increasing deal flow.

Additionally, ANDE should develop a strategy to further educate European DFIs about opportunities of SME investing through organizing conferences, roundtables, and workshops for DFI audiences. While many DFI investors are well-informed about the SME sector and investing opportunities, such as the FMO, many other DFI members are not as engaged in the SME sector. ANDE could fill the information gap in this group and gain exposure with this important actor group in the SME financing sector.

Recommendation 3: SUPPORT MEMBER'S EXISTING PARTNERSHIPS

ANDE member organizations are financing and managing SME support projects in over 140 countries. They are conducting due diligence, seeking small businesses that have the will and capacity to grow and increase their competitiveness. And they are financing these businesses from the seed stage to the growth cycle. Through this work, they have accumulated expertise of local businesses and local markets and have a track record of what support services make an impact for businesses.

This expertise and local knowledge is not matched by most other development actors profiled in this report. Many donors and investors indirectly support SMEs by financing financial intermediaries that use that capital to provide loans or equity to SMEs, and therefore, it is the financial intermediaries that possess this expertise and not the donors or DFIs. ANDE members should partner with the development actors to provide guidance and share their local knowledge of the SME landscape in country areas where the donors and DFIs are financing projects.

Additionally, donors such as USAID tend to contract their projects to consulting firms or NGOs, which in some cases, are ANDE members. As a next step, ANDE should survey its network of 80 plus members to identify which member organizations are funded by the international donors and investors and which ones have existing contracts to implement projects. This surveying effort could be integrated into the recent project ANDE is undertaking to 'map' its membership base and understand how projects, initiatives, and investments link its members to each other. This can help ANDE gain a data-based understanding of existing collaboration with donors and investors, and use this information to better learn how to support existing relationships and how to lobby to increase financing of its members.

Finally, as seen in the report's findings, the trend among the multilateral banks and development finance institutions is to decrease direct financing of SMEs through equity instruments and to increase debt financing of financial institutions that serve SMEs. While this is an important trend, it is also important to not abandon equity financing of SMEs, as this has potential for a stronger developmental impact. SMEs need business development support in addition to financing in order to grow their businesses and increase their productivity. They still lack business acumen, and equity investors play an important role in helping SME owners improve business practices.

Therefore, ANDE can help its members lobby donors and DFIs to increase funding for ANDE members. They have a proven track record with their business model, and therefore, it makes sense for donors and investors to help ANDE members build their capacity and scale their existing operations in developing countries.

Recommendation 4: IMPROVE DATA COLLECTION AND COMMON METRICS

As highlighted in this report's findings, collecting consistent data about investment information, average deal size, impact estimates, and other information has been a challenge and the information reported by donors is difficult to disaggregate. Therefore, standardized comparisons cannot be made across donors.

Additionally, there is no centralized international body tracking and collecting donor data about SME investments. The Donor Committee for Enterprise Development recently mapped donor programs for private sector development, but this project did not include a breakdown of SME programs. Additionally, the Organisation for Economic Cooperation and Development (OECD) Donor Assistance Committee's (DAC) aid statistics department measures official and private flows from DAC donors, multilateral organizations and other donors to about 150 developing countries. However, its statistics database does not include a metric for SME or entrepreneurship-focused investments. Both of these bodies are good candidates to start collecting this data, and ANDE could play an instrumental role in advocating for this data collection project.

Finally, ANDE should share its best practices from its own efforts to build baseline metrics and standard impact accounting methodology in its network with the donor community. They should try to model a similar coordination effort so donors are tracking similar social return on investment metrics. Rigorous monitoring and evaluation has been a challenge for the donor community in the past fifty years, and while most donors acknowledge this problem³⁶, little progress has been made to overcome this systemic problem. ANDE's effort should serve as a demonstration effect of how evaluation efforts can be coordinated across diverse and multiple investors.

³⁶ For example, interview notes with Inter-American Development Bank and USAID officials.

APPENDIX 1

LIST OF ANDE MEMBERS

ANDE's Current Members *(as of December 31, 2009)*

Absolute Return for Kids (ARK)	InReturn Capital
Acumen Fund	JCS Investments
African Agricultural Capital	KickStart
Agora Partnerships	The Lemelson Foundation
Alitheia Capital	
Appropriate Infrastructure Development Group (AIDG)	Lundin for Africa
Artemisia Brazil	Marmanie
The Aspen Institute	McKinsey & Company
ATMS Foundation/AMSCO	Media Development Loan Fund
Avantage Ventures	Mennonite Economic Development Associates
Babson College	Mercy Corps
BidNetwork	New Ventures - World Resources Institute
The Bill & Melinda Gates Foundation	OTF Group
Business Council for Peace (Bpeace)	Omidyar Network
CDC Development Solutions	PymeCapital
Calvert Foundation	Rainforest Alliance
CHF International	Rianta Capital
Center for Creative Leadership	The Rockefeller Foundation
Citi Foundation	Root Capital
Dalberg Global Development Advisors	Root Change
E+Co.	RTI International
Endeavor	SA Capital Limited
Energy Access Foundation	Salesforce.com Foundation
Finance Alliance for Sustainable Trade	Santa Clara Global Social Benefit Incubator
Financial Services Volunteer Corps (FSVC)	Serengeti Advisers
FSG-Social Impact Advisors	Shared Interest
Fundacion Bavaria	Shell Foundation
Fundacion Bolivia Exporta	ShoreBank/ShoreCap Exchange
FUNDES	Skoll Foundation
Fusion Venture Partners	Small Enterprise Assistance Funds (SEAF)
Global Business School Network	SNV Netherlands Development Organisation
Goldman Sachs	Social Equity Venture Fund (S.E.VEN Fund)
Google.org	SOLyDES
Grassroots Business Fund	Swisscontact
GrupoEcos	TechnoServe Inc.
Heart Social Investments	Universidad de los Andes
i3 Advisors LLC	VillageReach
IGNIA Partners, LLC	Villgro
ImagineNations	VisionSpring
Innosight Ventures	Vox Capital
	William Davidson Institute

APPENDIX 2

LIST OF DEVELOPMENT ORGANIZATIONS

I. Multilateral Development Banks

1. African Development Bank (AfDB)
2. Asian Development Bank (ADB)
3. European Bank for Reconstruction & Development (EBRD)
4. Inter-American Development Bank (IDB)
5. International Finance Corporation (IFC)

II. Bilateral Government Agencies

6. Denmark's Ministry of Foreign Affairs (including the Danish Development Cooperation Assistance – DANIDA)
7. France's Ministry of Foreign Affairs (including the French Development Agency - AFD)
8. Germany's Ministry for Economic Cooperation and Development (BMZ) [Including the German Development Bank (KfW) & German Agency for Technical Cooperation (GTZ)]
9. Netherlands Ministry of Foreign Affairs
10. Norway's Ministry of Foreign Affairs (including Norwegian Agency for Development Cooperation – NORAD)
11. Sweden's Ministry of Foreign Affairs (including Swedish International Development Cooperation Agency - SIDA)
12. U.K. Department for International Development (DFID)
13. U.S. Agency for International Development (USAID)

III. Development Finance Institutions

14. Denmark IFU
15. France Proparco
16. Germany DEG
17. Netherlands FMO
18. Norway Norfund
19. Sweden Swedfun
20. UK CDC

APPENDIX 3
LIST OF INTERVIEWEES

Included in Donor Profiles:

1. International Finance Corporation

Ghada O. Teima, Program Manager, IFC Advisory Services – Access to Finance. Interviewed January 29, 2010.

2. Inter-American Development Bank

Inter-American Investment Corporation

John Beckham, Corporate Projects Coordinator. Interviewed January 19, 2010.

Multilateral Investment Fund

Fernando Campero, Investment Officer. Interviewed January 19, 2010.

Claudio Cortellese, Principal Project Specialist. Interviewed January 19, 2010.

Sandra Darville, Chief, Access to Finance Unit. Interviewed January 19, 2010.

Julie Katzman, General Manager. Interviewed January 19, 2010.

3. U.S. Agency for International Development

Stephen Silcox, Senior Enterprise Development Advisor, Bureau of Economic Growth, Agriculture, and Trade. Interviewed January 23, 2010.

4. FMO, the Netherlands Finance Corporation

Henk Nijland, Manager Micro & Small Enterprise Finance, Financial Institutions Department. Interviewed March 16, 2010.

Not Included in Donor Profiles (However, interview information used to inform report analysis.)

5. United States Overseas Private Investment Corporation (OPIC)

Mitchell Strauss, Special Advisor SRI Finance. Interviewed January 22, 2010.

6. Donor Committee for Enterprise Development (DCED)

Jim Tanburn, Coordinator. Interviewed March 1, 2010.

7. The Association of European Development Finance Institutions (EDFI)

Jan Rixen, General Manager. Interviewed March 25, 2010.

APPENDIX 4

LIST OF INTERVIEWEE QUESTIONS

SME ACTIVITIES AND PRIVATE SECTOR PROGRAMS

1. For how many years has (* Organization*) supported SME programming and access to finance for small and medium enterprises (SMEs) in developing countries?
2. Is there an (* Organization*) strategic plan for donor strategy to support enterprise development?
3. How many staff members are in (* Organization*) divisions that work on enterprise development?
4. What are donor strategies to support SMEs: direct investment, equity, loan guarantees, technical assistance, and policy advice to governments (what is the mix and breakdown of activity portfolio?) Has this changed over time and how?
5. What are top 5 country recipients in terms of donor volume for enterprise development?
6. What is the average loan size to financial intermediaries from (* Organization*)? Average loan size FIs give to SMEs? What is the average equity investment size directly in SMEs by your (* Organization*)?
7. What was total investment \$\$ to financial intermediaries that support SMEs for 2009? For the past 5 years?
8. What was the total investment \$\$ in direct equity funds to SMEs for 2009? For the past 5 years?
9. Do you project financing to financial intermediaries and/or SMEs will grow in the future for (* Organization*)? Any specifics?
10. What other policies does your (*Organization*) support related to private sector development? Please describe these programs. What was the investment level for these programs in 2009? Past 5 years?

EVALUATION

11. What is the evidence for economic and social impact of your SME and private sector development programs? How do you evaluate (* Organization*) funded projects?
12. What policies in the past have proved to be ineffective, what did you learn from those funding programs and how did you change them? (Lessons Learned)

PARTNERSHIPS/COLLABORATION

13. What is your relationship to bilateral, multilateral organizations, or DFIs funding in the SME space?
14. What is your relationship to US government agencies supporting SMEs internationally?

ANDE CONTACT



















15. What is (* Organization*)'s relationship to ANDE?
16. What role do you think ANDE can play in engaging with (* Organization*)? In what ways could you envision partnering with ANDE in the future?
17. What type of information and research would you like to see from ANDE in the future?

APPENDIX 5 MULTILATERAL BANK DONOR GRID

	Financing Instruments & Focus of Technical Assistance	Total Commitments	Geographic Focus
IFC	<p>Financing: loans, equity investments, and loan guarantees. Financing targets financial intermediaries for SME lending, but some direct support for SMEs distributed through SME equity fund.</p> <p>Advisory services: Access to Finance Investment Climate Corporate Advice Infrastructure</p>	<p>IFC's committed portfolio 2009: \$6.1B in 200 FIs that target SMEs (FIs' outstanding portfolio of \$90.6B for 1.3M SME loans – half of FIs also receive IFC advisory services)</p> <p>(2008) 86 SME banking advisory services projects totaling \$115M</p> <p>As of 2008, IFC's outstanding commitments to private equity funds exceed \$1.9 billion invested in 135 funds. More than half of these funds target SMEs.</p>	<p>Europe/Central Asia: 37% Latin America: 26% South Asia: 19% East Asia: 9% Middle East/N. Africa: 7% Sub-Saharan Africa: 2%</p>
IDB	<p>Financing: loans, equity investments, loan guarantees, and technical assistance grants. Financing targets financial intermediaries for SMEs, but IIC and MIF fund provide direct equity to SMEs as well.</p> <p>Technical assistance: Access to Finance Competitiveness Business Environment Entrepreneurship Economic Inclusion Innovation and Technology</p>	<p>IDB Group has invested more than \$9 billion in loans and more than \$300 million in technical assistance and grants to support SMEs from 2003 to 2008.</p> <p>In 2008, the IIC disbursed over \$19 million in SME lending programs.</p>	<p>Latin America and the Caribbean</p>
ADB	<p>Financing and technical support primarily in the areas of financial services and infrastructure investments</p>	<p>In 2008, ADB committed \$823M in private sector operations (agriculture, finance, and industry and trade). Additionally in committed \$2.9B in infrastructure. Separate information for SME lending is not available.</p> <p>In 2008, about 2.1 million small and medium-sized enterprises (SMEs) benefited from Asian Development Bank (ADB) loans.</p>	<p>Asia</p>
AFDB	<p>Private sector operations in AFDB include: Infrastructure and policy support (financial sector, trade liberalization and legal and regulatory framework). AfDB generally channels its support to MSMEs through financial intermediaries, using lines of credit or guarantee facilities combined with grant resources for technical assistance and capacity building.</p>	<p>In 2008, AfDB committed the following in private sector operations: \$252M agriculture/rural development \$422M industry & mining \$2.17B infrastructure \$458,000 finance Separate information for SME lending is not available.</p>	<p>Africa</p>
EBRD	<p>Credit lines, equity funds, and technical cooperation to support SMES.</p> <p>Providing credit lines to local banks is the main way the EBRD supports small businesses. EBRD also provides equity directly to small companies through the Direct Investment Facility (DIF).</p>	<p>By the end of 2008, the EBRD had directed over EUR 2.5 billion towards small business projects and currently has projects in 24 countries. The Bank's SME portfolio involves over 140 financial intermediaries. Also, in 2008 the Bank signed 28 new projects with local banks totaling EUR 257 million, and it committed EUR 178 million to six new private equity funds.</p>	<p>Eastern Europe</p>

APPENDIX 6

OVERVIEW OF THE EUROPEAN DFIS, 2008

Development Finance Institution	Country	Portfolio in € million ²²	Growth 2007 to 2008, Percent	# of projects	Average project size, € K	Share of portfolio in ACP, Percent
	Austria	627.5	26%	474	1,324	1%
	Belgium	172.9	37%	77	2,246	27%
	The United Kingdom	3,035.6	(20%)	682	4,451	45%
	Spain	431.0	16%	120	3,592	5%
	Germany	4,427.4	24%	675	6,559	13%
	Finland	309.2	29%	106	2,917	29%
	The Netherlands	4,182.1	23%	873	4,791	28%
	Denmark ²³	502.2	2%	303	1,657	19%
	Norway	491.3	2% ²⁴	81	6,065	26%
	Austria	71.5	-	5	14,300	0%
	France	1,503.1	33%	300	5,010	45%
	Belgium	17.8	(18%)	23	775	12%
	Switzerland	250.2	13%	57	4,389	20%
	Italian	521.2	9%	361	1,444	5%
	Portugal	4.0	-	3	1,333	100%
	Sweden	172.4	29%	81	2,128	36%
	European	16,719.7	12%	4,221	3,961	26%
	Global	25,112.1	41%	1,560	16,098	11%

Source: EDFI, (2009): "2008 Comparative analysis of EDFI members," and Swedfund (2009).

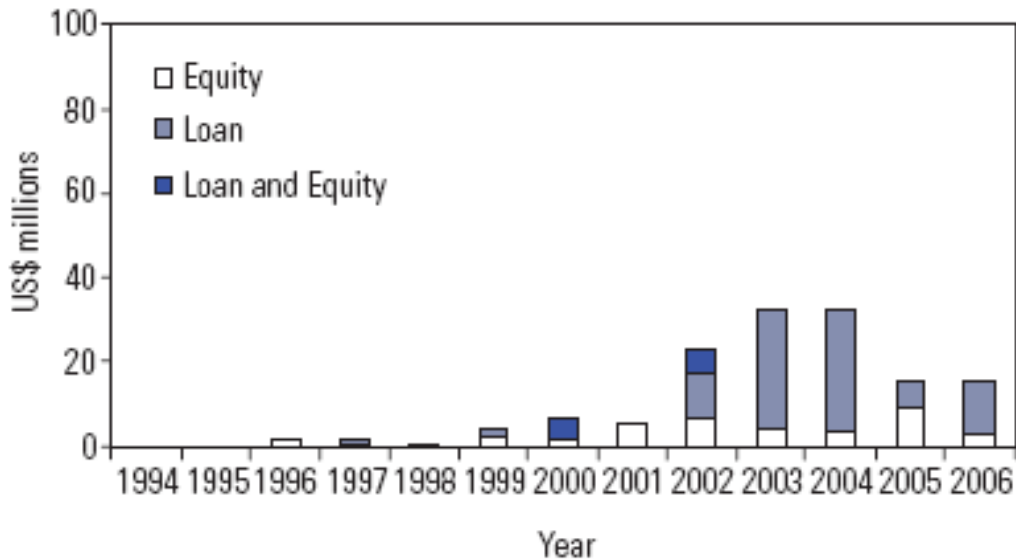
Source: "The Growing Role of the Development Finance Institutions in International Development Policy," Dalberg Global Development Advisors, 2009.

APPENDIX 7

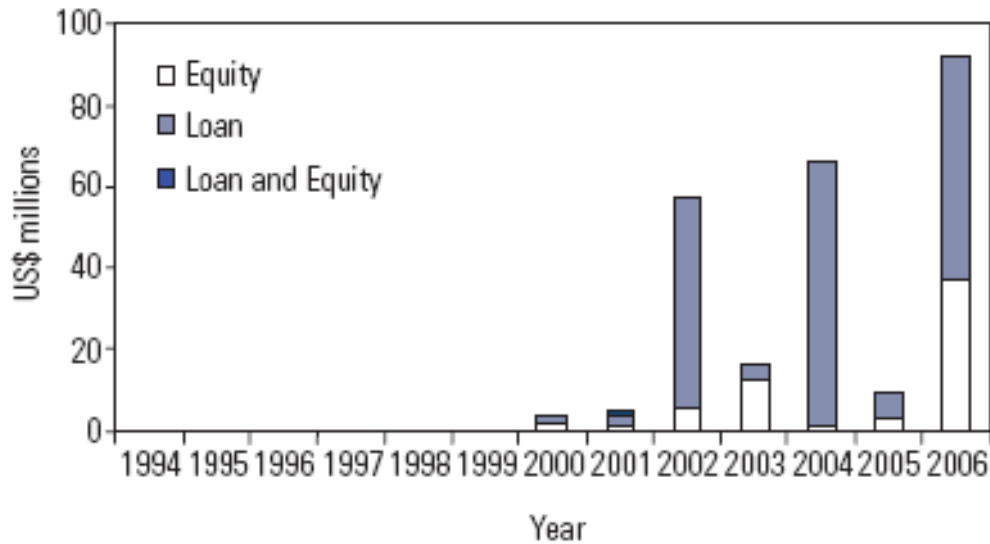
IFC'S ANNUAL NET COMMITMENTS TO SME-FIS 1994 - 2006

EQUITY VERSUS LOAN COMMITMENTS

**In Frontier Countries
Cumulative Commitments = \$137 million**



**In Nonfrontier Countries
Cumulative Commitments = \$251 million**



SOURCE: "Financing Micro, Small, and Medium Enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries," Independent Evaluation Group, International Finance Corporation, 2008.

APPENDIX 8
IDB GROUP SUPPORT TO SMES 2003-2008

Topics and Groups	Loan/Equity		Technical Assistance	
	Amount	N. of Projects	Amount	N. of Projects
Access to Finance				
IDB	\$5,268,100,000	18	\$7,527,000	42
Inter-American Investment Corporation	\$1,731,346,000	264	\$6,038,297	63
MIF	\$68,521,000	14	\$12,072,994	18
TOTAL	\$7,067,967,000	296	\$25,638,291	123
Competitiveness				
IDB	\$1,706,104,000	30	\$39,915,000	84
MIF	-	-	\$14,8894,680	188
IIC Technical Assistance				
TOTAL	\$1,706,104,000	30	\$188,809,680	272
Improving Business Environment				
IDB Business Climate Initiative (BCI)	-	-	-	-
MIF	-	-	\$6,200,800	9
TOTAL	0	0	\$6,200,800	9
Entrepreneurship				
MIF	-	-	\$41,497,875	38
TOTAL	0	0	\$41,497,875	38
Large Businesses as Catalyst of Economic Inclusion				
MIF	-	-	\$23,099,336	20
IIC Supply Chain**				
TOTAL	0	0	\$23,099,336	20
Innovation and Technology				
IDB	\$417,210,000	9	\$11,655,000	66
MIF	-	-	\$16,741,413	37
TOTAL	\$417,210,000	9	\$28,396,413	103

SOURCE: "The IDB Group Support to SMEs in 2003-2008: An Overview," May 2009, Monica Romis et al.

APPENDIX 9
LIST OF ANDE MEMBER INTERVIEWEES

Technoserve

Simon Winter, Senior Vice-President, Development. Interviewed March 12, 2010.

Marmanie

Natalie Pinon, Consultant. Interviewed March 17, 2010.

Small Enterprise Assistance Funds (SEAF)

Mildred Callear, Executive Vice-President and Chief Operating Officer. Interviewed March 18, 2010.

APPENDIX 10
KEY REPORTS THAT INFORMED FINDINGS & ANALYSIS
(RESOURCES FOR ANDE)

1. "2008 Comparative Analysis of EDFI Members," The Association of European Development Finance Institutions.
2. "Enterprise Growth Initiatives: Strategic Directions and Options." Development Alternatives Inc., 2004.
3. "Financing Micro, Small, and Medium Enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries," Independent Evaluation Group, International Finance Corporation, 2008.
4. "The Growing Role of the Development Finance Institutions in International Development Policy," Dalberg Global Development Advisors, 2009.
5. "The IDB Group Support to SMEs in 2003-2008: An Overview." Inter-American Development Bank, 2009.
6. "Inventory and Analysis of Donor-Sponsored MSE Development Programs," Development Alternatives Inc., 2005.
7. "Reviewing the Policies and Practice of Donor-Supported Business Environment Reform: Agency Process and Programme Mapping Report." Donor Committee for Enterprise Development, Business Environment Working Group, 2009.

8. BIBLIOGRAPHY

- Beck, Thorsten, Asli Demirguc-Kunt, and Ross Levine. "SMEs, Growth, and Poverty: Cross-Country Evidence." The World Bank Group, 2005.
- "The Development Impact of Small and Medium Enterprises: Lessons Learned from SEAF Investments," Small Enterprise Assistance Funds, 2004.
- "Financing Micro, Small, and Medium Enterprises: An Independent Evaluation of IFC's Experience with Financial Intermediaries in Frontier Countries," Independent Evaluation Group, International Finance Corporation, 2008.
- Frot, Emmanuel and Javier Santiso, "Crushed Aid: Fragmentation in Sectoral Aid." OECD Development Centre Working Paper No. 284, January 2010.
- "The Growing Role of the Development Finance Institutions in International Development Policy," Dalberg Global Development Advisors, 2009.
- Hallberg, Kristin, "A market-oriented strategy for small and medium-scale enterprises." IFC Discussion Paper, 2001.
- Hammond, Allen, William Kramer, Julia Tran, Rob Katz, and Courtland Walker. "The Next Four Billion: Market Size and Business Strategy at the Base of the Pyramid." International Finance Corporation and World Resources Institute, 2007.
- OECD SME Finance Brief 2006.
- "Promoting Private Investment for Development: The Role of ODA," OECD, 2006.
- Romis, Monica, Claudio Corellese, and Alfredo Giro Quinke. "The IDB Group Support to SMEs in 2003-2008: An Overview." Inter-American Development Bank, 2009.
- Snodgrass, Donald and James Packard Winkler, "Enterprise Growth Initiatives: Strategic Directions and Options." Development Alternatives Inc., 2004.
- White, Simon. "Reviewing the Policies and Practice of Donor-Supported Business Environment Reform: Agency Process and Programme Mapping Report." Donor Committee for Enterprise Development, Business Environment Working Group, 2009.
- Zandniapour, L., J. Sebstad, and D. Snodgrass. "Review of Evaluations of Selected Enterprise Development Projects," Accelerated Microenterprise Advancement Project Business Development Services Knowledge and Practice Research Task Order, 2004.