ON GDI Impact Investing Project

August 19, 2016
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Executive summary: Early stage financing progress

Research Focus and market size
• For the purposes of this study, the GDI team focused on Frontier/Frontier+ businesses. These are for profit companies serving customers that make between $2-8/day; are still in early stages (pre revenue or <$1M rev), and operating in underdeveloped capital markets; F+ businesses are typically more asset intensive. In the latter part of the project
• Further focus on early stage/early venture investors that deploy debt, quasi equity, blended financing to hi growth opportunities
• Of the $85-90 Billion in annual flow to impact investments globally, the approximate annual flow of debt and quasi equity financing for F+/med-to-high growth companies is $0.5-1B in early stage ($50K-$1M average deal size) and $1.5-3B in early venture stage ($1-3M average deal size). The majority of investment flows for F/F+ segments is going into East Africa, India and SE Asia (~90%) and clean energy and financial services (~70%)

Debt fund structures and products
• There are two approaches to investing in Frontier/Frontier+ businesses:
  1) Direct investment by foundations, DFIs, banks, angels, HNW, corporate investors, typically via relatively vanilla tools
  2) Indirect investment in funds, vehicles, facilities that provide a variety of capital options and support
• Characteristics of early stage and early venture debt and quasi equity funds for F/F+ businesses include patient, subsidized, or blended investors with differential returns, IRRs for financial investors average targeted returns of 3-9%, and guarantee and first loss/guarantee structures are often applied at the portfolio level
• A key lever for unleashing more capital for F/F+ investments is to crowd-in large capital pools such as DFIs and pension/sovereign funds that are currently participating in later stage, de-risks investments
• A promising approach is through blended capital investment (including grants for TA, legal and regulatory support) with shares into a Permanent Capital vehicle that overcomes challenges of exits, mismatched time horizons, allows for flexible financing tools
• F/F+ businesses should be segment not just by investment stage, but also by opportunity to scale
• Debt Funds, SME Funds and Financing vehicles that deploy debt and quasi equity are often participating across the board from lifestyle businesses to support for the gazelles and unicorns with a focus on flexible financing to support early stage businesses

Progress by Local players and DFIs
• DFIs typically finance growth for later stage businesses and have onerous requirements, a $1M minimum threshold on investment sizes due to transaction costs (legal, processing, due diligence), and do very few deals per year overall
• Local banks and investors play a small role in providing capital to this segment, and while there are a couple notable examples of catalyzing local bank investment, innovative efforts to leverage local commercial capital are untapped
• Some governments provide direct support, e.g. direct lending/support from governments

6 key success factors of early stage debt
1. Clear identification of investment focus by business type, needs and scale opportunity within Frontier/Frontier+ (lifestyle, low, med-high, breakthrough growth) and matching of tools, investment vehicles, and sufficient institutional capacity and support
2. Appropriate and aligned investment vehicle
3. The right blend of investors, including grants to commercial investors with relevant return expectations
4. Ability to match appropriate products to entrepreneurial needs (working capital, leasing, mezz finance/quasi equity, affordable term loans, etc)
5. Fund manager capacity and on the ground support, expertise was critical and part of activities by fund managers
6. Significant support services for funds at legal/regulatory/structuring and for entrepreneurs to get significant TA
Focus on Frontier and Frontier Plus Segments

Entrepreneur Business Focus

- Serving low- and lower-middle-income (LMI) populations
- The groups situated between the extreme poor/very bottom of the pyramid and the existing middle class
- $2-8 per day

Key Segments to Address Capital Challenges

Frontier

- Unproven business models that are asset light and serve both lower- and middle-income populations
- This segment represents under-tapped opportunity that can be unlocked using conventional VC structures
- Example: Ver de Verdad (eyeglasses), M-PESA (mobile money)

Frontier Plus

- Unproven business models that may be asset intensive, serve only lower-income groups, and/or operate in countries with less-developed capital markets
- Untapped opportunity for investors to be more creative and patient in helping entrepreneurs get to scale.
- Example: d.light (solar energy); EM3 Agri (mechanized agricultural services company)

Sources: ON Frontier Capital
Further focus primarily on early stage/early venture, med-high growth companies and debt/quasi equity investing

<table>
<thead>
<tr>
<th>Investment stage</th>
<th>Type of company</th>
<th>Type of investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Early (and larger seed)</td>
<td>Type of organizations</td>
<td>Grants and guarantees</td>
</tr>
<tr>
<td>$50K-$1M</td>
<td>Social enterprise</td>
<td>Simple grants</td>
</tr>
<tr>
<td></td>
<td>SMEs</td>
<td>Recoverable grants</td>
</tr>
<tr>
<td>Venture</td>
<td>Non-profits with revenue generation</td>
<td>Blended facilities</td>
</tr>
<tr>
<td>Early venture ($1M -3M)</td>
<td>Non-profits with Social enterprise arm with equity stake opportunity</td>
<td>Grants for Technical assistance</td>
</tr>
<tr>
<td>Late Venture ($3-10M)</td>
<td></td>
<td>Guarantees</td>
</tr>
<tr>
<td>Growth ($10-20M)</td>
<td></td>
<td>First loss provisions</td>
</tr>
<tr>
<td>Mature ($20M+)</td>
<td></td>
<td>Liquidity facilities</td>
</tr>
<tr>
<td>Other</td>
<td>Revenue</td>
<td>Debt instruments</td>
</tr>
<tr>
<td>ESG investments</td>
<td>Pre-revenue</td>
<td>Secured debt, collateralized debt</td>
</tr>
<tr>
<td></td>
<td>&lt;$1M p.a.</td>
<td>Working capital, factoring</td>
</tr>
<tr>
<td></td>
<td>Post revenue, &gt;$1M p.a.</td>
<td>Flexible debt (extended grace periods, minimal collateral)</td>
</tr>
<tr>
<td></td>
<td>Scale Opportunity</td>
<td>Debt-like/mezzanine/quasi equity</td>
</tr>
<tr>
<td></td>
<td>Lifestyle</td>
<td>Convertible debt</td>
</tr>
<tr>
<td></td>
<td>Medium growth</td>
<td>Royalty payments</td>
</tr>
<tr>
<td></td>
<td>High growth</td>
<td>Buy-out equity</td>
</tr>
<tr>
<td></td>
<td>Massive growth</td>
<td>Straight equity</td>
</tr>
</tbody>
</table>

• Focus of GDI analysis
• Often discussed as part of interviews/investor mix
Market landscape and GDI survey shows that early stage and early venture stage non-equity, growth flow to be ~$3B in 2016

Global social finance annual investments 2016, USD billion*

- Overall, impact investing is still a small % of the total socially responsible investing market.
- Of the $85-90 billion in impact investing, an estimated 12% goes into early and early venture stage investing [note that GIIN survey only talked to $15B of the total market]
- An estimated $0.5-1B going into early stage and $1.5-3B going to early venture stage F/F+ organizations through debt/mixed products annually

(*) Based on BNY Mellon, GIIN, ImpactAssets, GDI survey (N=30)
Evaluating the market by AUM, early and early venture stage
Frontier/Frontier+ is a small size of the overall market

Impact investing AUM is at least ~$3B in early stage and ~$6B in early venture stage (GIIN 2016); funds vary by equity and equity/debt mixes and often include later stages

STAGING:
- ‘Early Stage’ investment was defined by ticket sizes of $50K-$1M (includes some later “seed”)
- ‘Early Venture Stage’ investment includes ticket sizes of $1M-$3M of a typical venture stage that includes $1M-$10M investment sizes

NOTE: many investors provide follow-on investments at later stages, driving some complexity

EMERGING MARKETS F/F+
- Most funds involved in emerging market F/F+ investing do both debt and equity investments and invest in projects on different stages
- In emerging markets, >90% of progress in East Africa, India and SE Asia and >75% in Financial Services, Energy, Agriculture and Infrastructure (GDI survey)

ASSET/INSTRUMENTS USED
- ~84% of funds are straight debt or mixed debt/equity funds (16% are pure equity); not including DFIs
- Several large debt funds grew out of MFIs

LIABILITIES/TYPICAL INVESTORS AND FUNDS
- Typical LP investors include foundations, investment banks that manage assets, DFIs
- Investments in debt/mixed funds are often through equity investments, grants, loans and guarantees

Source: GDI survey of impact investors (N=30), GIIN, ImpactAssets, BNY Mellon
Overview of flow of impact investing capital to F/F+ businesses

Asset owner / Investors

Investment Vehicle/Asset managers

Frontier/Frontier + businesses
Some investors provide capital directly to F/F+ businesses

<table>
<thead>
<tr>
<th>Direct Investors</th>
<th>Expected returns</th>
<th>Investees</th>
<th>Tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants, smart subsidies or recoverable grants from foundations, HNW</td>
<td>Ranges from full loss, TA facility; principle return or re-invested principle to commercial level returns</td>
<td>SMEs, Growth start-ups</td>
<td>Catalytic grants</td>
</tr>
<tr>
<td>DFI s: fund equity/debt investment</td>
<td>Commercial returns depending on fund</td>
<td></td>
<td>Simple debt instruments (loans, working capital)</td>
</tr>
<tr>
<td>International and Local Banks</td>
<td>Typically high interest rates for SME financing ranging between 20-25% and short time frames</td>
<td></td>
<td>Straight equity</td>
</tr>
<tr>
<td>Local angel networks/Local Funds</td>
<td>Ranges between debt-like returns with added local economy stimulation to VC-like returns depending on investor</td>
<td></td>
<td>SIBs/Pay for Results Facilities</td>
</tr>
<tr>
<td>Corporate investors</td>
<td>Supply chain financing, strategic investor exit option</td>
<td></td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>Governments</td>
<td>Debt-like returns or grant funding with social returns</td>
<td>Other (i.e. project finance)</td>
<td></td>
</tr>
</tbody>
</table>

- **Few opportunities for blended capital structures for direct investments given stage and small ticket sizes of investments**

- **Tools for direct investments are typically simpler capital structures**

- **Difficult to have extensive on the ground presence to conduct DD and support**
Investors primarily deploy capital indirectly to F/F+ businesses through funds and vehicles

<table>
<thead>
<tr>
<th>Indirect investors</th>
<th>Approach/ expected returns</th>
<th>Vehicle</th>
<th>Investees</th>
<th>Tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grants, smart subsidies or recoverable grants from foundations, HNW</td>
<td>Ranges from full loss, TA facility; principle return or re-invested principle to commercial level returns</td>
<td>Fund, non-bank financing vehicle, holding company, MFI, Accelerators/ Incubators</td>
<td>SMEs, Growth start-ups</td>
<td>Typical debt instruments (w/c, trade finance, leasing, factoring, property)</td>
</tr>
<tr>
<td>DFIs: guarantees/first loss</td>
<td>Expectations are to have first loss/guarantees; often 10+% on portfolio/fund overall</td>
<td></td>
<td></td>
<td>Quasi-equity (royalty payments, self liquidating shares)</td>
</tr>
<tr>
<td>DFIs: fund equity/debt investment</td>
<td>Often commercial returns depending on group; Dividend like payments on long term shares or loan</td>
<td></td>
<td></td>
<td>Bridge financing for VCs with straight debt, warrants, convertible debt</td>
</tr>
<tr>
<td>Perpetual equity shares from funds, foundations PRLs, HNW, patient capital from banks</td>
<td>Dividend-like payments; equity never called; 3-9% net returns; potential for liquidity provision (with potential loss)</td>
<td></td>
<td></td>
<td>Long term loans with grace periods</td>
</tr>
<tr>
<td>Commercial long term equity shares</td>
<td>Long term investment with dividend payments; equity called in 15+ years; 5-10% net returns; could be structure as long term loan</td>
<td></td>
<td></td>
<td>Straight equity (not possible with some funds, capital structures)</td>
</tr>
<tr>
<td>Commercial debt market</td>
<td>Short-medium term borrowing; Libor + 3-6% depending on vehicle rating</td>
<td></td>
<td></td>
<td>Technical Assistance</td>
</tr>
<tr>
<td>Crowd sourced debt investment</td>
<td>Dividend like payments on long term shares or loan; 1-5% returns</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Mostly LPs/GPs or debt/wraps for the vehicle

Funds benefit from a variety of investors with differential return expectations and subsidy components

Tools for funds are typically more complex and benefit from more hands on support, business ecosystem building by the in field fund managers
<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>Seed/Early stage</th>
<th>Early Venture stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global foundations, PRIs, HNW</td>
<td>Foundations and high net worth individuals focused on catalyzing sectors and sustainable development</td>
<td>• Shell Foundation</td>
<td>• Heron Foundation</td>
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<tr>
<td></td>
<td></td>
<td>• MacArthur Foundation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lundin Foundation</td>
<td></td>
</tr>
<tr>
<td>DFI</td>
<td>Development finance institutions focused on catalyzing local banks, commercial players and demonstrating successful proof points; focused on job creation and sustainable development</td>
<td></td>
<td>• OPIC</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• IFC</td>
<td>• USAID DCA</td>
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<tr>
<td></td>
<td></td>
<td>• FMO</td>
<td></td>
</tr>
<tr>
<td>International and Local banks</td>
<td>Depository institutions typically constrained to vanilla debt products; investment institutions seeking significant returns</td>
<td>• Capitec</td>
<td>• Atlas Mara</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Mercantile Bank</td>
<td>• Citi</td>
</tr>
<tr>
<td>Angel networks</td>
<td>Local HNWI, business leaders, among others that provide early stage financing, often with a dual purpose of stimulating the local economy</td>
<td>• Ghana Angel Network</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lagos Angel Network</td>
<td></td>
</tr>
<tr>
<td>Corporate</td>
<td>Private actor investing in businesses that support the corporate value chain</td>
<td>• Unilever</td>
<td>• Unilever</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Shell</td>
<td>• Cisco</td>
</tr>
<tr>
<td>Government</td>
<td>Public sector providing grant or affordable capital to stimulate local economy</td>
<td>• USSBA</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• NAFIN</td>
<td></td>
</tr>
<tr>
<td>Sovereign Funds, Pension Funds</td>
<td>Commercial return seekers, but often long term investors and comfortable with lower risk, net high single digits</td>
<td></td>
<td>• MetLife</td>
</tr>
<tr>
<td>Large NGOs</td>
<td>Support local SMEs with TA, access and investment</td>
<td>• FHI360, Save the Children</td>
<td></td>
</tr>
<tr>
<td>P2P/Crowdfunding</td>
<td>Peer2peer lending and crowdfunding are gaining traction in development markets and crowdfunding successful for MFIs</td>
<td>• MFI</td>
<td>• Developed markets</td>
</tr>
</tbody>
</table>
## Progress and challenges highlighted for investors

<table>
<thead>
<tr>
<th>Capital Available</th>
<th>Progress and challenges highlighted for investors</th>
</tr>
</thead>
</table>
| **Global foundations/ HNW** | • Smart subsidies  
• Take risk to catalyze growth and crowding in  
• Willing to partner and take risks  
  - Most products are for later stage organizations, higher ticket size and focused on commercial returns  
  - Often accused of crowding out and not taking enough risk |
| Medium | |
| **DFIs** | • Interest in SMEs, Job creation and catalyzing local banks  
  - Banking model too high cost to serve SMEs and also requires typical collateral/business history |
| High | |
| **Local banks** | • Some changing their model to serve SME customers; no FX risk  
  - Focused on international, higher return  
  - Limited experience in investing |
| Medium | |
| **Angel networks** | • Some local HNW investing small amounts <$50K in local entrepreneurs; no FX risks  
  - Limited experience in supporting social enterprises and SMEs  
  - Investment required to get vendors up to scale and compliance |
| Low | |
| **Corporate** | • Focused on sustainability and responsible supply chains  
  - Limited progress on setting up incentives and take-up of financing programs |
| Medium | |
| **Government** | • Interested in job growth and development  
• Some first loss, guarantee funds  
  - Limited experience in supporting social enterprises and SMEs  
  - Investment required to get vendors up to scale and compliance |
| Low/Medium (in emerging economies) | |
| **Sovereign Funds, Pension Funds** | • Focus on stability as driver of improved returns (New America Foundation)  
  • Interested in investment with proper credit wraps and risk mitigation  
  - Still wary of non-vanilla investments and emerging market risk  
  - Will only work if there is an aggregation method (e.g. funds or securitization) |
| High | |
| **Large NGOs** | • Great source of technical assistance  
  - Limited investment funds |
| Low | |
| **P2P/Crowdfunding** | • Great traction for MFIs and developed markets  
  - Need to develop structures for emerging markets and later stage/larger investments (e.g. dividing deals into investable pieces for crowdfunding) |
| Low | |
Typical fund with blended investors and return expectations

- Blended capital fund
- 1/3 for each group; some cash and some in kind
- EU takes first loss
- $30M grant for capacity building and ecosystem support
- LP structure
- Single digit IRRs (ex $30M grant facility)

- Current plan to deploy to funds investing in early stage and early venture stage business
- Primarily sub-Saharan Africa
- Likely to be equity focused, but currently under discussion (potential to influence)

- Long term limited life fund (15 years)

World Bank Fund to create jobs in Africa $170M

- Blended Capital fund
- Tranch for different risk levels, 3% -11%
- First Loss of 20% by SIDA; can access loan portfolio guarantee
- 2% management fees will support due diligence and travel

- 3 prong industry strategy (BOP financial services, health, energy)
- Early stage, growth
- Fund them through flexible senior secured loans (no equity or quasi-equity)

- Limited life fund

Deutsche’s $50M ECC Fund (Deutsche has many other different funds, e.g. energy access, evergreen)
A key lever is catalyzing large capital pools to move towards F/F+ investments

Illustrative Investor Level Map (to direct or fund level investments)

Working with DFIs to change model/increase risk is biggest bang for the buck

For “commercial” return funds, create structures that support their fiduciary responsibility

Likelihood of movement to higher risk or changing business model (based on interviews):
- High
- Med
- Low

Relative (Current) Risk Tolerance/ Business model that supports smaller F/F+ investments

* Illustrative: further market sizing needs to be done
## Investment facility (funds, vehicles, TA) types

<table>
<thead>
<tr>
<th>Description</th>
<th>Seed/Early Stage</th>
<th>Early Venture Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Deployed</strong></td>
<td></td>
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</tbody>
</table>
| Limited Life Funds | Typically 2-5 year investment cycle, followed by 3-8 year hold. Generally manageable number of investments per fund to provide necessary support (e.g. 8-10 investors per fund) | • Factor(E)  
• Lok, Elevar, Gray Ghost | • New Island Capital (debt) |
| Long-term limited life | Limited partnership with a long-term (15-20 years) fixed term | • Cross Boundary  
• EU/EIB/ADB Fund | |
| Permanent Capital | Evergreen, Holding Company, Perpetual Debt, etc., An open-ended fund structure or one with an indefinite life, typically with one management fee, strong focus on the portfolio business, and no exit expectation | • Anthos, Deutsche Bank  
• GroFin, BPI, I&P | • Deutsche Bank  
• Aspada |
| Non-bank financing institution | A structured investment vehicle providing risk financing for SMEs | • Gazelle Finance  
• MicroVest  
• Finance in Motion | • SPC Finance |
| Merchant banks | A bank that issues shares, local entrepreneurs can create these institutions; provide reasonably priced financing | • Data Bank Ghana, Kenya | |
| MFIs | Organization providing small loans to low income populations | • Accion  
• Oikocredit | |
| Bonds (private placement, public, SIBs) | Bonds or social impact bonds for raising capital in large private placement or listings; requires much larger structures | | • SME Bond Funds |
| Specific Facility (e.g. working capital) | Focused facility on a type of product/deployment, eg. Working capital or factoring | | |
| **Capital at Risk** | | |
| Guarantees/First Loss | Entity provides loss protection/coverage on deal or portfolio, wrap on portfolio | • EU (in process)  
• OPIC, USAID | |
| Liquidity Facility | Market making facility to provide liquidity to investors (similar to investment banking market makers) | • MacArthur (in process) | |
| Insurance/hedges | Insurance for asset heavy and/or cyclical businesses; Hedges for currency or interest rate fluctuations | | • DFIs |
| **Grants** | | |
| TA/legal facilities | Grant funding carved out of a fund to support services for a portfolio or transaction | • VillageCapital  
• Deutsche  
• EU/EIB/ADB | |
| Accelerators/incubators | Early or pre-growth stage investor that runs a program typically providing capital, technical assistance, connections | • Village Capital  
• Kenya accelerators, Echoing Green, etc. | • FMAOffice |
| “Smart” Subsidies | Providing targeted grants to companies that have a clear pathway towards sustainability | • MasterCard Foundation | |

Note: Names in blue indicate additional detail in Case Studies section.
## Investment facilities: deep dive into pros/cons, key success factors, overall prevalence in market (1/2)

<table>
<thead>
<tr>
<th>Capital Deployed</th>
<th>Pros</th>
<th>Challenges</th>
<th>Frequency/Key Success Factors</th>
</tr>
</thead>
</table>
| **Limited life funds (LLF)** | • Generally clear expectations on when fund will pay out and clear expectations of returns going in the investment  
• Well known model that investors are comfortable with, even if returns are risk | • Requires significant hands on support when there are few local managers  
• High due diligence and support costs given small # of investments per fund  
• Limited exit options (also fairly limited pipeline)  
• Funds are relatively small size to date  
• To meet return expectations, many funds moving to later vetted orgs, and larger transaction sizes | • High TA support  
• On the ground presence  
• Limit deals  
• Follow-on capital  
• Ecosystem building  
• Address regulatory & FX |
| **Long-term limited life funds** | • Aligned incentives with business growth due to longer holding time  
• More realistic liquidity/exit options | • Difficult to find patient investors  
• Outside of traditional investor mindsets for risk/return expectations | • Long term hold investors |
| **Permanent Capital** | • Time to build up value in investments  
• Flexibility to make long-term strategic decisions  
• No exit pressures; can go into less liquid assets and even operating businesses; overall patient capital  
• Ability to invest in organizational efficiency required to invest in smaller ticket sizes  
• Opportunity to increase efficiencies over time and reduce grant capital required  
• Minimized fundraising costs in the long term  
• Regular oversight due to reporting/MTM  
• Lends itself well to perpetual equity investment structures with dividend like payments  
• Possible to create larger, flexible portfolios  
• Can buy into the vehicle at any time (rather than closed limited life funds)  
• Depending on investors & regulatory constraints, more flexibility in funding (debt/equity/quasi equity) | • Difficult to find patient investors and investors that would enter a structure with limited liquidity  
• Outside of traditional investor mindsets for risk/return expectations  
• Higher structuring costs at inception; potentially higher costs and challenges for MTMs (market to markets) in illiquid markets  
• Requires fund managers that can manage variety of products  
• Challenges to reach efficiency  
• Need strong governance | • Long term hold investors  
• Blended investors  
• Recognition of the importance of grants in early years for TA/Legal  
• Focus on sustainability and efficiency improvements |
| **Bonds (public, private, SIBs)** | • Liquid and large, gaining traction on SIBs | • Not possible for small size deals, requires structuring/aggregation, e.g. securitization; introduces agency risk | • Requires structuring (securitization) |
## Investment facilities: deep dive into pros/cons, key success factors, overall prevalence in market (2/2)

<table>
<thead>
<tr>
<th>Capital Deployed</th>
<th>Pros</th>
<th>Challenges</th>
<th>Frequency</th>
</tr>
</thead>
</table>
| **Non-bank financial institutions** | • Have more flexible/different business model to serve smaller transaction sizes, mixed models of lifestyle, early and later stage businesses  
• Potential to service riskier/non-bankable customers | • Potential outcome of predatory lending  
• Local regulatory challenges | ![Green] High prevalence |
| **Merchant Banks** | • Could address challenge of lack of correspondent banks and local banking lack of lending; allows for entrepreneurs to own shares depending on type of merchant bank structure | • Archaic structure, needs to be updated for each market and regulatory environment  
• Might have high structuring costs to start  
• Still requires capital to run and lend | ![Red] Little to no prevalence |
| **MFIs** | • Operational infrastructure to lend to non-bankable customers | • Limited ability to lend to later stage organizations  
• Typically debt only | ![Yellow] Moderate prevalence |

<table>
<thead>
<tr>
<th>Capital at Risk</th>
<th>Pros</th>
<th>Challenges</th>
<th>Frequency</th>
</tr>
</thead>
</table>
| **Guarantee/First Loss** | • Crow-in investors worried about risk  
• Strong option for portfolio level wraps  
• Much more accepted type of asset class and gaining traction | • Onerous due diligence on deal by deal basis for small ticket sizes  
• Underlying risk is still a key consideration for most investors  
• Most guarantee/first loss providers invest in later stage organizations  
• Might distort the market, crowd-out other players investing at realistic returns | ![Yellow] Moderate prevalence |
| **Liquidity Facility** | • Crowd-in investors worried about liquidity | • Few investors willing to step up to provide liquidity for illiquid assets | ![Red] Little to no prevalence |
| **Insurance** | • Minimizes input cost and commodity price fluctuations (e.g. crop, FX, steel) | • Often expensive, low availability | ![Red] Little to no prevalence |

<table>
<thead>
<tr>
<th>Grants</th>
<th>Pros</th>
<th>Challenges</th>
<th>Frequency</th>
</tr>
</thead>
</table>
| **TA/Legal facilities** | • Provide critical support to overcome high transactions costs related to smaller and riskier investments  
• Increase likelihood for successful growth and exits | • Full “loss” for investors that only provide grants, negative returns for investors that have a mix of grant and risk capital | ![Red] Little to no prevalence |
| **Smart Subsidies** | • Recognizes the need for real subsidies for high potential businesses | • Might crowd-out investors, needs to be carefully evaluated to ensure long term sustainability of investments | ![Yellow] Moderate prevalence |
Challenges with current typical limited life fund

- Exits and liquidity: Requires sale of assets to realize value (and pay team)
- Subject to exit timing (impacted by FX, almost all strategic buyers, no public exits for F/F+)
- Requires sale of assets to prove performance (and raise another fund)
- Incentivizes larger deals
- Pressure of fund raising cycle
- Due to possibility of redemption, have to hold cash and pass up off-cycle investment opportunities
- Volatile fee income based on risky redemptions

Typical limited life fund structure

- The partnership is usually a fixed-life investment vehicle that is typically 10 years plus some number of extensions.
- An annual payment made by the investors in the fund to the fund's manager to pay for the private equity firm's investment operations—typically 2% of the committed capital of fund
- Minimum 8% rate of return which must be achieved before the General Partner can receive any carried interest (share of the profits paid the General Partner) above the preferred return (typically 20%)
- Typically all investors invest with equal terms but some funds exist with asymmetric returns

Challenges with structures
## Design principles and success factors of Permanent Capital Vehicles

### Permanent Capital Vehicle (Evergreen, Holding Company, Perpetual Equity)

<table>
<thead>
<tr>
<th>Sample Investors and expected returns</th>
<th>Vehicle Type</th>
<th>Investees/Tools</th>
<th>Investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foundation Grants</td>
<td>Permanent Capital Vehicle</td>
<td>Investees/Tools</td>
<td></td>
</tr>
<tr>
<td>Grant capital to cover start-up costs, TA, higher regulatory costs, FX and other risks</td>
<td>Set up as a bond or equity investment structure that return coupons/dividends</td>
<td>Investments</td>
<td></td>
</tr>
<tr>
<td>Foundation PRIs/Other impact investors</td>
<td>Bond or Equity investment or low cost, long term loan/revolving credit structure with low return expectations</td>
<td>• Tools depend on mandate and local regulatory environment</td>
<td></td>
</tr>
<tr>
<td>Bond or Equity investment, coupon/dividend returns expected with net % at commercially competitive rates (meet fiduciary responsibility)</td>
<td></td>
<td>• Flexible products tailored to entrepreneurs: (Short term, e.g. working capital/trade finance/factoring, long term, equity, debt, quasi-equity)</td>
<td></td>
</tr>
<tr>
<td>Commercial Investors</td>
<td>Bond or Equity investment, coupon/dividend returns expected with net % at commercially competitive rates (meet fiduciary responsibility)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>DFIs/Supra Nationals/Agencies</td>
<td>Credit wraps, guarantees, first loss</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Key success factors

1. Clear expectation that grant capital required to get started and expand (smart fund subsidies)
2. Blended investment capital
3. Crowd-in through liquidity facility, TA and/or Legal Facility
4. Move towards sustainable, commercial level returns over time (requires experience, efficiency and scale); grant capital/PRIs sell shares

1. Structure in a flexible fund that does not depend on specific exit and time horizons
2. Strong governance standards, mark-to-markets
3. To reach returns required and provide tailored products, need to have a scaled and efficient vehicle (leveraging technology) that continues to improve performance
4. Products tailored to needs of entrepreneur
Design principles of Securitization to overcome risk and high transaction costs

- **Securitization Structure**
  - **Banks, Funds, SME Financing Vehicles**
    - Investment portfolio 1
    - Investment portfolio 4
    - Investment Portfolio 2
    - Investment Portfolio 5
    - Investment Portfolio 3
    - Investment Portfolio 6
  - **Securitization Vehicle**
    - Aggregation of portfolios and often thousands of underlying loans
    - De-risking through diversification
    - Credit enhancement from DFIs, governments, agencies
  - **Placement**
    - Public (or large private placement)
    - SME Securitization Bond issuance

- **Additional capital unleashed for more lending**

- **Key success factors**
  
  **1.** Strong lending models
  
  **2.** Minimize agency risk (still continue with responsible credit decisions)
  
  **3.** Separate facilities for TA, Legal & regulatory
  
  **4.** Minimize predatory capital provision
  
  **1.** Minimize or subsidize structuring fees
  
  **2.** Ensure zero/low cost credit enhancement

---

*Not for Distribution*
F/F+ businesses should be segmented not just by investment stage, but also by opportunity to scale

**Opportunity for scale (hard to know where each will fall)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Chicken*</th>
<th>Zebra*</th>
<th>Gazelle</th>
<th>Unicorn</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Typical tools</strong></td>
<td>Lifestyle: Set up and run by its founders primarily with the aim of sustaining a particular level of income; do not aim at growth but creates jobs, typically up to 10 employees</td>
<td>Med growth businesses at 5-10%, up to 250 employees; Prime for on-going existence, national acquisition or roll-up strategy; sold for &lt;$3M</td>
<td>High-growth at ~ 20% annually; national or regional scale and span sectors</td>
<td>Scalable Startups: Born to Be Massive</td>
</tr>
<tr>
<td>Debt, leasing, asset based financing products</td>
<td>Debt, leasing, asset based financing products</td>
<td>Equity supported by venture debt/mezz financing between rounds</td>
<td>Equity supported by venture debt between rounds</td>
<td></td>
</tr>
<tr>
<td><strong>Typical investors</strong></td>
<td>Zero VC/PC Interest</td>
<td>Direct investment: Small scale equity</td>
<td>VC/PE</td>
<td>VC/PE</td>
</tr>
<tr>
<td>Efficient lending platforms</td>
<td>Local angels</td>
<td>Venture debt funds</td>
<td>Venture debt funds</td>
<td></td>
</tr>
<tr>
<td>MFIs/GMFI/SME financing vehicles</td>
<td>Foundations grants</td>
<td>Banks</td>
<td>Banks</td>
<td></td>
</tr>
<tr>
<td>Guarantees on portfolios</td>
<td>Efficient lending platforms</td>
<td>DFI</td>
<td>DFI</td>
<td></td>
</tr>
<tr>
<td><strong>Type of vehicle and support required</strong></td>
<td>MFIs/GMFI/SME financing vehicles</td>
<td>SME Financing platforms</td>
<td>Foundations PRI</td>
<td>Foundations PRI</td>
</tr>
<tr>
<td>Need tech driven, scaled program to have efficient execution, thousands of deals</td>
<td>Guarantees on portfolios</td>
<td>Guarantees on portfolios</td>
<td>Guarantees on portfolios</td>
<td></td>
</tr>
<tr>
<td>Need scaled program to have efficient execution, hundreds of deals</td>
<td>Small local investors</td>
<td>Small local investors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business ecosystem development</td>
<td>Small local investors</td>
<td>Business ecosystem development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business ecosystem development</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Light-hearted names, not industry jargon*
Investors focus on scale opportunity (growth) and stage/size of investment

- Most funds optimize scale opportunity for profit and some investors (more impact driven) optimize for job creation (e.g. IFC); although often these are correlated
- Most equity funds are “pure” high scale opportunity/growth stage funds but debt funds vary; some invest in organizations that often started as lifestyle/MFI or micro and small merchant focused
- “SME Financing” investors are not strictly lifestyle org investors or MFIs, most have early venture and scale opportunity investments

- Often in the moderate growth stage company, it is difficult to predict the scale possible and depends on many factors including level of TA support and ecosystem support provided
  - Most successful funds have follow-on investments beyond early stage
  - Some successful funds leverage mixed stage/scale opportunity models to drive returns and mitigate risk
- Trend in the sector towards only high scale and venture stage+; maximizing returns
Profiles of funds involved in early stage investing

- Typical “SME Financing Funds” invest in growth stage businesses as part of their portfolio;
- Many traditional MFI only funds are also moving up the curve to high growth potential businesses focused on employment;
- Given the typical size of these funds, these are relatively significant investments in growth businesses.

Source: company annual reports

Not for Distribution
To evolve from early stage to med-high growth, F/F+ businesses will require a mix of debt and equity

- Over the course of its life, a business with medium to high-growth potential will need both equity and debt products, which will be provided by a variety of investors.
- Also, investors working to support growth stage F/F+ businesses stick with their investments and provide follow-on investment into Series A/B stages

Proportion of external financing

![Diagram showing the proportion of external financing across different stages of business growth, with a breakdown of typical providers and their typical investment types.]

Note: Does not include bootstrapping, which is another key component of financing.
## Deep dive on financing products (1/2)

<table>
<thead>
<tr>
<th>Asset category/ Tool</th>
<th>Examples of products used</th>
<th>Business needs and types</th>
<th>Tools (typical and new trends)</th>
<th>Who is doing it to date</th>
</tr>
</thead>
</table>
| 1. Typical financing products, including debt and asset financing | • Trade finance/credit, working capital, purchase orders  
• Bridge loans no warrants  
• MCAs, factoring  
• CapEx, Leasing, Rent to Own  
• Property/asset finance  
• Flexible loans (grace periods, etc) | • Inventory, inputs  
• Business operations  
• Business growth and investment  
• BizDev/Marketing, hires  
• Inventory, machinery, equipment and real estate, refurbishment  
• Sectors such as agro, medical equipment, WASH, energy | • Connect loans to cashflows (flexible repayment terms)  
• Long grace periods  
• Rent to own  
• Pay as you go models  
• Group lending, peer to peer  
• Credit bureaus  
• Leveraging supply chain financing/credit  
• Cost reduction for responsible supply chain  
• IT/multi-factor based algorithms to identify risk | • Suppliers (e.g. FMCGs)  
• Financing Companies, GMFIs: Root Capital, Finance in Motion, ResponsAbility  
• Smart subsidies from MC Foundation  
• Deutsche for refinancing/bridge loans  
• MicroVest, GroFin for biz operations  
• Island Cap, SPC Finance – Venture |
| 2. Hybrid instrument, mezzanine debt | • Quasi-equity (convertible loans or loans with warrants, bridge loans)  
• Sponsored revenue share/royalty (returns are shared between parties)  
• Impact tied loan  
• Flexible loans | • Financing for tech, education, some health, service  
• Generally less capex and easier bootstrapping, but includes some property/asset finance | • Creative triggers such as revenue milestones or founder salary levels  
• Efficiency in evaluating ideal products | • BPI: Property debt finance with equity shareholding; Specialized equipment 5 year quasi equity with royalty  
• XSML: Income participation loan (royalty based lending) in Congo  
• Gazelle Finance: Royalty based loan  
• GBF, SEAF – convertible loans  
• FRP, GroFin: Convertible debt  
• MacArthur, Heron Group, quasi-equity |
# Deep dive on financing products (2/2)

<table>
<thead>
<tr>
<th>Asset category/ Tool</th>
<th>Examples of products used</th>
<th>Business needs and types</th>
<th>Tools (typical and new trends)</th>
<th>Who is doing it to date</th>
</tr>
</thead>
</table>
| 3. Alternative forms of debt structures and aggregation | • Securitization  
• Crowdfunding  
• Peer2Peer | • Intermediaries, clear loan products  
• Liquidity for banks, finco’s | • Debt Crowdfunding through technology  
• Liquidity and TA facilities | • Not used widely enough  
• MacArthur exploring securitization |
| 4. Credit enhancement       | • Guarantees, convertible guarantees  
• First loss | • Risk perceived to be too high | • Enhancements on portfolios/funds | • DFIs (OPIC, USDCA) for larger deals or portfolio/fund level  
• Deutsche Bank, Anthos |
| 5. Alternative exits       | • Variable Payment Redemptions  
• Post-investment negotiated buyouts  
• Performance incentives | • Exits that are non-traditional with payouts based on revenue/dividends at share value | • Dividend like products that provide liquidity  
• Self-liquidating through revenue sharing | • Maya Mountain Cacao - Demand Dividend investment of $200K  
• MacArthur Foundation on REITs, Chicago Fund to apply to F/F+ |
Summary of venture debt/quasi-equity characteristics (asset light)

Return and time horizon

Key characteristics

Time horizon
• Often, includes a grace period allowing for enterprise to generate cashflow
• Longer term loan structure (10+ years) to provide time to payoff loan; time and capital needed for company to reach market-sustainable level of risk return for commercial capital)

Flexible and/or royalty based payments
• Regular payments to investor tied to financial return such as revenue (capped), cash flow/free cash flow or even entrepreneur’s salary
• Potential reduction in payments/loan forgiveness if performance metric or impact metric is reached
• Potential for balloon payment on loan to put more $ into operations

Risk mitigation
• Conversion to equity (venture debt, quasi equity) if strike price is hit, enterprise is unable to pay
• Loan provided by a 3rd party if guarantee provided by public/foundation/DFI entity

Tied to impact/Guarantees
• If social impact bond or pay for results, 3rd party repays the loan/potentially interest

Need to simplify, develop toolkits and replicable asset structures, train up and drive liquidity

Source: GDI Analysis
Successful deployment of affordable debt for early stage companies is dependent on 6 key factors

1. Clear identification of investment focus and relevant
   - Within F/F+, clear identification of investment focus by business type, needs and scale opportunity (lifestyle; low growth; med-high growth; breakthrough growth) and matching of tools, investment vehicles, institutional capacity to support them

2. Appropriate and aligned investment vehicle
   - Efficient, scaled operational models for debt funds to serve small ticket sizes and achieve high volume/low mix required for returns, over time less grant capital is required
   - Permanent Capital Vehicle cited as most ideal for early stage F/F+ given less focus on liquidity and exits, which is critical due to need for mixed tools (quasi-equity structures)
   - The right fund model (efficient vs high touch) to support the required returns and exits
   - Creative structures from PRIs, e.g. securitization, dividend like product structures from Heron and REIT from MacArthur that provides liquidity (even if not in global space)

3. The right blend of investors
   - Attracts appropriate investors and return expectations (debt returns at ~3-9% vs equity returns at 20%); differential returns by type of investor - grants, patient, subsidized or blended capital
   - Guarantees/first loss capital and grant capital for operating/TA to allow returns/find investors

4. Ability to match tools to SME needs
   - Appropriate use of typical financing structures such as working capital, leasing, trade finance, factoring, term loans, and asset/property backed financing
   - Longer grace periods, multiple financing mechanisms (leasing, working, or growth capital)
   - Creative debt tools (grace periods, royalties) that allow early stage organizations to access debt without revenue and minimize equity dilution
   - Alternative exits like i) dividend like product structures being applied in developed markets that provide liquidity; ii) self-liquidating shares through revenue sharing

5. Fund manager financial and contextual expertise
   - Capacity to creatively structure deals and appropriately match instruments to business needs including both equity and debt
   - Local context to provide the TA and support required to scale and connect with appropriate networks/investors

6. Funds for transaction costs and risks
   - Significant support services for funds at legal/regulatory/structure level; and for entrepreneurs to get significant TA
CASE STUDIES
### Evergreen fund/holding company vehicles for successful early stage debt investing

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION OF VEHICLE</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
<tbody>
<tr>
<td>GroFin</td>
<td><strong>Holding company</strong> with <em>tiered capital structures</em>; objective of attracting institutional capital in the future</td>
<td><strong>Effectiveness:</strong> High for SME-style businesses, with potential to move up the risk curve as a % of total portfolio but currently is low in high-growth debt</td>
</tr>
<tr>
<td></td>
<td>Strategic focus on <em>high volume/low mix</em> comprised of majority lifestyle businesses with smaller percent high-growth</td>
<td><strong>Scalability:</strong> High cost barrier to entry because of organizational structure needed, but significant scale upon investment</td>
</tr>
<tr>
<td></td>
<td>Operationalized by <em>efficient and standardized back end</em> processes and training</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Emphasis on <em>technical assistance</em> combined with financing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Benefitted from <em>heavy subsidy</em> to kick-start operations</td>
<td></td>
</tr>
<tr>
<td>Aspada</td>
<td><em>Focus on “playing the long game” through holding company structure</em> because of the belief that the next Facebook is not “sitting in India’s agricultural value chain”</td>
<td><strong>Effectiveness:</strong> Highly successful to date</td>
</tr>
<tr>
<td></td>
<td><em>Mixed portfolio</em> to allow for risky investment and manage liquidity and include <em>provision of TA / operational support</em> together with capital through HC structure</td>
<td><strong>Scalability:</strong> Dependent on investor appetite</td>
</tr>
<tr>
<td>YUNUS socialbusiness</td>
<td><em>Decentralized office structure</em> to source investments that receive support and preparation</td>
<td><strong>Effectiveness:</strong> N/A</td>
</tr>
<tr>
<td></td>
<td><em>Majority loans below market rate</em> with two year grace periods, with some small equity of up to 25%</td>
<td><strong>Scalability:</strong> N/A</td>
</tr>
<tr>
<td></td>
<td>Provides refinancing for other social businesses and <em>up to nominal value to investors</em></td>
<td></td>
</tr>
<tr>
<td>ANTHOS</td>
<td><em>Holding company</em> capitalized by a single family office with a direct and indirect fund</td>
<td><strong>Effectiveness:</strong> Approach to watch as it grows and returns materialize</td>
</tr>
<tr>
<td></td>
<td>Leverage debt creatively to catalyze other lending, such as <em>underwrite commercial local bank loans</em> to clinics</td>
<td><strong>Scalability:</strong> Opportunity to scale through other family foundations</td>
</tr>
</tbody>
</table>
**Blended investment structures are useful for deploying early stage debt financing**

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION OF STRUCTURE</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
</table>
| **Shell Foundation** | • Tiered capital structures to enable different risk/return profiles as well as bring in philanthropic funding to bridge financing gap to investment-ready  
• Employing structures for investments in both businesses as well as intermediaries | • Effectiveness: High impact based on examples such as GroFin that received over $40M in subsidy to start  
• Scalability: High time and financial investments required |
| **Deutsche Bank** | • Carve-outs for early-stage direct investments within F/F+ funds that target scaled intermediaries like MFIs and non-banks | • Effectiveness: High IRRs  
• Scalability: Opportunity to scale through other family foundations |
| **financeinmotion** | • Public-private partnerships or tiered capital structures to incentivize investors with different risk/return profiles to pool capital  
• Guarantees from grants typically function as a risk cushion, DFIs invest in senior or mezz shares, and private investors invest in fixed-income notes | • Effectiveness: Highly effective with 200 senior loans and 18 mezz loans to intermediaries  
• Scalability: High potential to scale for earlier stage because of existing infrastructure |
Efforts to catalyze local investors and local banks are challenging

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
</table>
| USAID | • First loss guarantees for local banks to increase lending to local businesses through Development Credit Authority  
• Co-guarantees with other DFIs such as SIDA and ADB to support on structuring  
• Example: Agricultural lending stimulation in Ghana through a local bank by using guarantees increased lending to SMEs by 4X | • Effectiveness: Successfully catalyzed new DFIs to leverage capital for guarantees  
• Scalability: Focused on MFIs with potential to scale to other sectors such as household technology |
| IIP | • I&P Development 2 (IPDEV 2) – incubator and sponsor of African investment funds to more efficiently and sustainably support investment into an estimated 550 early-stage  
• I&P invests 20-30% and raises remaining 70-80% capital from corporates, and HNWI that have vested interest in growing the local economy | • Effectiveness: Successfully able to crowd-in local investors, build up local investor ecosystem, eliminate FX and country credit risk  
• Scalability: Focus on equity / quasi-equity; potential application to debt |
| Palladium | • Work with local banks to train on SME lending  
• Support with local agent network | • Effectiveness: Mobilized banks to provide more lending in 2 African countries  
• Scalability: Develop agent networks to support banks to overcome challenging business model |

Despite increased lending to local banks, barriers such as
1) Conservative nature of deposit taking entity and a
2) Business model that does not support small transactions, lending without collateral or credit history suggest challenges to overall scalability of local banks as a solution.
DFI debt provision focused on later stages

- DFI financing trends towards later (growth stage) or larger investments but potentially less scalable (SMEs) businesses
- Portfolio level credit enhancements are showing promise

### OPIC debt investments in 2015 (number of investments)*

<table>
<thead>
<tr>
<th>Range</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1-5M</td>
<td>17</td>
</tr>
<tr>
<td>$5-10M</td>
<td>15</td>
</tr>
<tr>
<td>$11-50M</td>
<td>38</td>
</tr>
<tr>
<td>$51-100M</td>
<td>7</td>
</tr>
<tr>
<td>$100M+</td>
<td>9</td>
</tr>
</tbody>
</table>

### Case studies: DFI activities in early stage debt financing

- **Investments in private funds (e.g. Injaro Ag Cap Holdings)**
- **Focused on later stage, through loans and syndicated loans structured to bring in local capital**
- **Invests in SMEs through 4 funds providing debt, quasi-debt, and equity**
- **Loan portfolio guarantees (e.g. Acumen, Calvert, AlphaMundi) tend to be later organizations; other products are $5M minimum**
- **Portfolio for Impact provides long-term debt for asset-heavy businesses that require longer grace periods and ~$1-5M in debt financing**

- **Debt to direct businesses** tends to target businesses larger in size with proven models working in underdeveloped capital markets and strong management staff and equity investors (no support for <$1M transaction size)
- **Debt to intermediaries** such as BPI and MFIs to redeploy to local businesses
- **Guarantees at the portfolio and loan level** are increasing for both local banks and investors such as Acumen

(*) OPIC annual report 2015
## Other government direct lending initiatives

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
</table>
| **SBA** | • Loans up to $5M with interest from 4-10% for up to 25 years for starting a business, working capital, asset/property financing, and refinancing  
• Businesses can be pre-profit but require some alternative resources (personal assets) and must be small in size  
• Loans cannot be used if the business is primarily engaged in lending, such as banks, payday lenders, or other leasing companies  
• Uses both debt and equity for early stage companies | • Effectiveness: Domestically focused but highly impactful with unique partnerships such as VC firms  
• Scalability: Potential to scale model elsewhere leveraging DFI financing |
| **nacional financiera** | • State-owned bank lends short-term uncollateralized working capital for SMEs against receivables from large buyers through an electronic platform to decrease transactions costs and increase security  
• Financial and technical assistance are provided to strengthen SMEs, and commercial banks are incorporated for further lending | • Effectiveness: High impact reaching over 800K SMEs by 2009 (implemented in 2001)  
• Scalability: Potential to replicate |

Sources: SBA, IFC
Table of contents

• Progress to date
  • Financing available
  • Debt tools and fund structures
  • Progress by leading investors and intermediaries
  • Success factors to affordable debt deployment

• Recommendations for ON
  • Financing gaps and challenges
  • Insights and progress from the field
  • Key recommendations for ON
Executive summary – Gaps and Opportunities

- **Remaining financing gap and challenges**
  - There is estimated to be remains a $10-15B financing gap for F/F+ segments with the biggest sector and location gaps in Africa (except East Africa) and in infrastructure, education, healthcare and agriculture.
  - Biggest ongoing challenges to early stage F/F+ investments include high transaction costs, poor liquidity, lack of business ecosystems and lack of investor capacity.
  - Biggest challenges for debt financing specifically are lack of suppliers, insufficient track records of business, and high perceived risk for debt-level returns.

- **Instruments**: Ideal instruments to overcome barriers to early stage affordable financing differed by organization, with many advocating significantly greater equity products and others focused on additional debt. For debt – more knowledge and use of venture/mezz debt most appropriate. Blended structures that include mixed returns and guarantees/first losses should be moved down the curve to earlier stage businesses. Progress: Impact Terms Project, MacArthur Foundation.

- **Fund structures**: Need larger fund sizes and follow-on funding; investigation into alternative vehicles and structures, holding co working group (limited progress to date); and the development of fund products/structures for commercial capital investors. Progress: MacArthur Foundation, Boost Africa, Deutsche Bank, MicroVest, GIIN.

- **Capacity Building**: Insufficient fund manager and entrepreneur capacity a major theme. Funding needed for i) FM training and ii) TA for entrepreneurs and management teams. Progress: Capria, GIIN, FactorE, Shell Foundation.

- **Ecosystem development**: Catalyze local banks; support and fund legal / regulatory barriers; demonstrate commercial successes / proof points. Progress: USAID, JP Morgan, Goldman Sachs, Heron Foundation, MacArthur Foundation, FMAOffice.

- **Insight and progress from the field on affordable debt financing**

- **Short-listed recommendations**:
  1. Create new Permanent Capital Vehicle for investing in F/F+ segment
  2. Acceleration Facility for successful vehicles/fund managers investing in F/F+ businesses

- **Other high-priority recommendations**:
  3. “Public Good” high tech deal structuring platform for investors, banks, intermediaries and entrepreneurs
  4. Build movement and support creation of community of practice focused on F/F+ investing

- **Lower-priority recommendations** (through discussions with ON):
  5. Catalyze local investors; create impact investing innovation clusters
  6. Information infrastructures for updated credit risk assessment, creation of credit bureaus
  7. Direct structuring of securitization vehicles
  8. Global research on gaps by sector; global research on proof points and mainstream
  9. Fund manager capacity building
  10. Build out the investing ecosystem and organize investors.
There is significant unmet demand for affordable financing for early stage F/F+ businesses

Overall feedback on affordable debt gap

Estimated gap in Frontier/ Frontier plus early stage ($50K-$1M) financing (GDI survey)

<table>
<thead>
<tr>
<th>Gap</th>
<th>No gap</th>
<th>Gap 2 times</th>
<th>Gap 5 times</th>
<th>Gap 10 times</th>
<th>Gap 100 times</th>
<th>Gap 1000 times</th>
</tr>
</thead>
<tbody>
<tr>
<td>Count</td>
<td>1</td>
<td>3</td>
<td>14</td>
<td>2</td>
<td>6</td>
<td>1</td>
</tr>
</tbody>
</table>

Estimated annual need for financing ~$10-15 billion

• Significant financing gap for the ‘missing middle’ to move early-stage businesses that are bootstrapping to growth-stage that are investment ready
• Need to bridge stages between grant and impact investment capital
• Majority of impact investors have floor of 1M due to deal size, transaction costs, and fund structures

Share of unserved / underserved TOTAL SMEs (IFC)

% of SMEs:
- >70%
- 50%-60%
- 40%-50%
- <40%
- No data

Top-down estimation of required financing for early stage F/FP non-lifestyle projects - $5-20 billion (excluding later stage investments and lifestyle businesses)

• Total formal SME credit gap in developing countries is estimated at about $1 trillion (IFC).
• Overall, current financing covers less than 50% of short-term credit needs of formal SMEs and less than 5% of long-term financing needs

Sources: GDI survey (N=30), IFC (World Bank), Dalberg, GIZ India MSME Umbrella Programme, Intellecap, Oliver Wyman, I&M, PwC, etc.
Survey data: Greatest gaps in early stage financing for F/F+ businesses

**Geography focus (% of mentions, N=23)**

<table>
<thead>
<tr>
<th>Region</th>
<th>% of Mentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>West Africa</td>
<td>30%</td>
</tr>
<tr>
<td>Central Africa</td>
<td>26%</td>
</tr>
<tr>
<td>Southern Africa</td>
<td>16%</td>
</tr>
<tr>
<td>South Asia</td>
<td>11%</td>
</tr>
<tr>
<td>Latin America</td>
<td>9%</td>
</tr>
<tr>
<td>Middle East</td>
<td>7%</td>
</tr>
<tr>
<td>China</td>
<td>2%</td>
</tr>
<tr>
<td>India</td>
<td>2%</td>
</tr>
</tbody>
</table>

**Sector focus (% of mentions, N=10)**

<table>
<thead>
<tr>
<th>Sector</th>
<th>% of Mentions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure</td>
<td>26%</td>
</tr>
<tr>
<td>Education</td>
<td>21%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>21%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>16%</td>
</tr>
<tr>
<td>Fin. services</td>
<td>11%</td>
</tr>
<tr>
<td>Construction</td>
<td>5%</td>
</tr>
</tbody>
</table>

- Significant gap across all regions and sectors for early stage affordable debt financing
- Africa (except for Eastern Africa) should be top priority for Frontier/Frontier+ investments
- Infrastructure (including utilities, water, WASH) and healthcare are the most underserved industries

Source: GDI survey of impact investors. Note: Given interviewee challenges in responding specific to debt, question was asked across financing in general (i.e. debt and equity).
Survey data: Barriers restricting early stage investing in F/F+ segments

Supply side barriers for all financing flows to F/F+

- Poor liquidity, exit options: 20%
- High transaction costs: 19%
- Lack of business ecosystems: 12%
- Limited investor capacity: 10%
- Need to build value/supply chains: 9%
- Lack of affordable financing: 8%
- Inflexible fund structures: 7%
- FX risk: 5%
- Mismatched time horizons: 3%
- Regulatory Risk: 3%
- Other: 4%

Challenges specific to debt financing

- Lack of capacity: 29%
- Insufficient track record: 16%
- Insufficient margins (high perceived risk): 16%
- Lack of collateral: 9%
- Inflexible terms: 7%
- High associated costs: 5%
- Lack of knowledge about debt: 5%
- FX risks (lack of local currency debt): 4%
- Regulations: 4%
- No guarantees: 4%
- No benchmarks: 4%
- Exit difficulty: 2%
- Limited upside capacity: 2%

Per this study’s focus, survey included only supply side challenges; however significant demand side/entrepreneur side challenges were raised in nearly all interviews.

Source: GDI survey of impact investors (N=30)
Landscape of recommendations to increase affordable debt flows to this segment

<table>
<thead>
<tr>
<th>Recommendations</th>
<th>Progress to date (mostly debt/quasi equity side)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tool</strong></td>
<td></td>
</tr>
<tr>
<td>Appropriate mix of grant, debt, and equity capital</td>
<td>BPI, GroFin, Heron Foundation, Shell Foundation, LGT Ventures</td>
</tr>
<tr>
<td>Appropriate terms including convertible/recoverable with different triggers, longer-grace periods, or other</td>
<td>Heron Foundation, BPI, GroFin, LGT Ventures</td>
</tr>
<tr>
<td>Use guarantees and first losses at earlier stages on portfolios</td>
<td>OPIC, USDCA, Deutsche</td>
</tr>
<tr>
<td>Overall larger fund sizes and follow-on funding</td>
<td>Microvest, Deutsche Bank, HNW</td>
</tr>
<tr>
<td><strong>Vehicles</strong></td>
<td></td>
</tr>
<tr>
<td>Research on alternative vehicles such as holding companies and evergreen funds</td>
<td>Anthos, MacArthur Foundation, GIIN (but slow progress)</td>
</tr>
<tr>
<td>Develop fund products/structures for commercial capital investors</td>
<td>MacArthur Foundation, Finance in Motion, I&amp;P</td>
</tr>
<tr>
<td><strong>Capacity building</strong></td>
<td></td>
</tr>
<tr>
<td>Fund manager capacity development</td>
<td>Capria, GIIN (limited)</td>
</tr>
<tr>
<td>Financing TA support for entrepreneurs</td>
<td>FactorE, Shell Foundation, Elevar Capital</td>
</tr>
<tr>
<td><strong>Ecosystem development</strong></td>
<td></td>
</tr>
<tr>
<td>Incentivize local banks to provide SME financing at earlier stages</td>
<td>USAID, OPIC, I&amp;P</td>
</tr>
<tr>
<td>Market building efforts</td>
<td>JPM, Goldman Sachs, Heron Foundation, MacArthur Foundation</td>
</tr>
<tr>
<td>Legal/regulatory barrier support and fund</td>
<td>OfficeFMA</td>
</tr>
<tr>
<td>Demonstrating commercial success and proof points</td>
<td>JPM, Goldman Sachs, Lok, Shell Foundation, Heron Foundation</td>
</tr>
</tbody>
</table>

Little to no progress   Some progress   Significant progress

Progress to date includes market leaders within each category and relative success of efforts to date.
Survey data: Solutions to overcome barriers to affordable early stage debt financing for F/F+

- Clear need for capital structures that allow for differentiated returns
- Appetite to increase debt and mixed products for early stage F/F+ businesses
- High demand for alternative structures as opposed to traditional 2/20 VC-like funds

Source: GDI survey of impact investors (N=30)
## Case studies: Progress on general field-building (1/2)

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION OF FIELD BUILDING</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
</table>
| ANTHOS               | • Led holding co working group together with GIIN to mainstream thinking about new structures that do not mirror VC/PE funds and align LP expectations  
• Leveraging family office nature and appetite for risk to build evidence on returns through direct and indirect investing in early stage F/F+ businesses | • **Effectiveness**: Limited progress in working group to date  
• **Scalability**: High potential due to funding capacity and leadership role in market; very interested in collaboration on market building |
| MacArthur Foundation | • Funding research, seeding new vehicles, and managing funds to prove out early stage impact investing  
• Exploring potential for LLC to issue long-term debt with short-term notes to overcome liquidity barrier | • **Effectiveness**: In progress with positive initial outcomes  
• **Scalability**: High potential to replicate and innovate especially domestically; strong partner for ON; though unclear value for early-stage and international specifically |
| Impact Terms Project | • Standardizing term sheets to incorporate impact, ensure founder-friendly nature, and realistically align with expectations on returns and timelines  
• Providing central knowledge hub for terms, entities, measurement and exits | • **Effectiveness**: Limited knowledge of the project  
• **Scalability**: Need to share with others and share term sheets; plan to add vehicle fund structures to the project (in the next 5-6 months) |
## Case studies: Progress on general field-building (2/2)

<table>
<thead>
<tr>
<th>WHO</th>
<th>DESCRIPTION OF FIELD BUILDING</th>
<th>PROGRESS TO DATE</th>
</tr>
</thead>
</table>
| Goldman Sachs | - Focused on educating investors on risk/return realities through rigorous analysis in respect to commercial and social impact  
             - Piloting blended finance structures with small group of ready investors that are interested in building proof points | - Effectiveness: New and currently small  
             - Scalability: Will require a more nimble entity like ON to drive proof points that GS can leverage with clients |
| Deutsche Bank | - Raising and managing major funds around impact including the Future Fund ($500M evergreen fund including pension funds and institutional investors)  
                - Incorporating guarantees and tiered capital structures to bring in commercial investors  
                - Pockets of funds held for TA and early stage to experiment and prove returns | - Effectiveness: Progress in attracting commercial institutional capital; especially interesting structures for debt (but currently unable to engage in equity investing)  
             - Scalability: Steep transaction costs limit ability to lend to earlier stage |
| J.P. Morgan | - Purpose of Social Finance is to prove the market case for impact investing and using business skills to drive impact  
             - Aiming for 10-12% IRR but are content with mixed returns because of demonstration effect | - Effectiveness: Returns unclear, focused on later stage  
             - Scalability: Very interested in funding innovation and leveraging investment as risk capital |
## Interviewee comments on ON’s field building and investment strategies

### Field building strategy
- ON’s thought leadership currently skips important pieces in the investment process such as grant/impact first money that finances small enterprises to make them investment ready. This was left out of the latest thinking in the Frontier Markets report.

- We need ON to push thinking about what we’ve learned to date in order to reset and align expectations. Where are we on the path of becoming proximate to returns that would attract commercial and institutional funding?

### Investment strategy
- ON’s investment strategy should be used as promotion to gather the proof points needed to drive capital from traditional markets.

- ON, along with other philanthropic investors and DFIs, change their minds too quickly, which means there is little follow-on capital to scale what works. They fail to understand the “plumbing pipes” of asset managers and rush to the next shiny asset.

- There are a number of [investors] that support very early stages, but a gap between incubation and growth stage. ON is positioned as a growth stage investor.

- ON has really moved down the curve in investing, often looking for larger stage deals that are already de-risked, often looking like interested in $3+ million minimum.
Interviewee recommendations for investment behavior of key impact capital providers, for early F/F+ segment

**DFIs**
- Reach down to smaller, earlier stage deals
- Provide funds to defray transaction costs of smaller, earlier deals
- Continue advancing proof points around blended finance / tiered structures, to show how to make differentiated returns work together
- Pursue more innovative financing structures (mezz debt, quasi-equity) and support creation/scaling of more flexible financing vehicles (portfolio guarantees on evergreen structures)
- Catalyze local investors and banking
- Need appropriate capital to de-risk at concessionary rates rather than targeting commercial level returns
- Set aside pools of funding for experimentation

**Commercial capital providers**
- Accept more realistic projections around IRR and timelines (accept that not going to be just an “asset allocation” for earlier stage deals)
- Look for proof points
- Realign fixation on “innovation,” which does not inherently drive impact; accept that bread-and-butter business models can generate significant impact
- Accept riskier/earlier stage underlying investments with the right blended finance vehicle/guarantees that support their fiduciary responsibility to investors
- Consider more flexible financing vehicles (e.g. evergreen structures)

**Philanthropic capital providers**
- Act as first mover through providing grant capital/subsidies
- Support investment in TA, Legal, and structuring facilities to increase likelihood of success of investments and overcome small transaction size challenges
- Where relevant, pursue blended finance / tiered structures to de-risk private capital and thus crowd-in commercial capital, increase availability of proof points in the F/F+ segment
- Support investment in business ecosystems
GDI recommends four areas where ON could make a significant impact on the affordable debt financing gap

**Shortlisted recommendations**

1. Create new Permanent Capital Vehicle for investing in F/F+ segment
2. Acceleration Facility for successful vehicles/fund managers investing in F/F+ businesses

**Other high-priority recommendations**

3. “Public Good” high tech deal structuring platform
4. Build movement and support creation of community of practice focused on F/F+ investing

**Lower-priority recommendations for ON** (de-prioritized through discussions with ON team)

5. Catalyze local investors; create impact investing innovation clusters
6. Information infrastructures for updated credit risk assessment, creation of credit bureaus
7. Direct structuring of securitization vehicles
8. Global research on gaps by sector; global research on proof points and mainstream
9. Fund manager capacity building
10. Build out the investing ecosystem and organize investors
## Recap: Current state of play for top 4 recommendations

<table>
<thead>
<tr>
<th>Priority</th>
<th>Recommend-ation</th>
<th>Details</th>
<th>Current progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-listed recommendations</td>
<td>1. Create new Permanent Capital Vehicle</td>
<td>New perpetual structure with value-add TA/Legal/Structuring facility; blended finance approach to catalyze DFIs and flexible tools to demonstrate viability of the model for F/F+ segment</td>
<td>• Anthos, Aspada, GroFin, BPI, and Intellegrow are leading HC/evergreen structures, but are growing slowly and the structure is still perceived as complex or difficult to implement</td>
</tr>
<tr>
<td></td>
<td>2. Acceleration Facility</td>
<td>Evaluate and accelerate/provide significant follow-on funding for successful vehicles and fund managers investing in F/F+ businesses; increase focus on F/F+</td>
<td>• Shell Foundation provides grants to subsidize vehicles providing debt such as GroFin, but is the only major player to date</td>
</tr>
<tr>
<td>Other high priority recommendations</td>
<td>3. Develop deal structuring platform</td>
<td>Deal structuring platform for investors, intermediaries and entrepreneurs</td>
<td>• There are platforms that serve as deal flow listings (Toniic, Convergence, GIIN ImpactBase), but none that provide structuring support for tools and vehicles, with examples of deals and algorithms for choosing the right tools • Impact Terms Project provides terms sheets and some general materials on structures, but nothing customized to specific needs</td>
</tr>
<tr>
<td></td>
<td>4. Focused community of practice</td>
<td>Build movement and support creation of community of practice focused specifically on subset of impact investing (F/F+ and early stage)</td>
<td>• Current conveners advocate for the sector broadly (e.g. ANDE and the GIIN), but do not drill down to the needs of specific segments (e.g. early stage F/F+) • Existing working group efforts on technical topics have progressed slowly (e.g. GIIN holdco group); convenings are one-off (e.g forthcoming ANDE member roundtable on capital aggregation)</td>
</tr>
</tbody>
</table>