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Private Equity and Venture Capital in SMEs in Developing Countries

The Role for Technical Assistance

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Abstract

This paper discusses the constraints for private equity financing of small and medium enterprises in developing economies. In addition to capital, private equity investors bring knowledge and expertise to the companies in which they invest. Through active participation on the board of directors or in partnership with management, private equity investors equip companies with critical improvements in governance, financial accounting, access to markets, technology, and other drivers of business success. Although private equity investors could help to create, deepen, and expand growth of small and medium enterprises in developing economies, the vast majority of private equity in such markets targets larger or more established enterprises. Technical assistance, when partnered with private equity, can unlock more investor commitments and considerably enhance the ability of small and medium enterprises in emerging markets to raise private equity capital. Technical assistance provides funding that allows private equity funds to extend their reach to smaller companies. Technical assistance can mitigate some level of risk and increase the probability of successful investments by funding targeted operational improvements of investee companies. Dedicated technical assistance facilities financed by third parties, such as development finance institutions, governments, or other parties, have emerged to fill this critical need. The paper discusses the provision of investment capital twinned with technical assistance, which is now more accepted by limited partners and general partners or fund managers and is becoming more of a market model for private equity finance focused on small and medium enterprises.

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List of Abbreviations

AECID	Agencia Española de Cooperación Internacional
AFD	Agence Française de Développement
AfDB	African Development Bank
BIO	Belgian Development Corporation
CAF	Corporación Andino de Fomento
CDC	Commonwealth Development Corp
CI	Conservation International
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EU	European Union
FdeF	Fondo de Fondos
Finnfund	Finnish Fund for Industrial Development Cooperation
FMO	Financieringsmaatschappij voor Ontwikkelingslanden
FOMIN	Fondo Multilateral de Inversiones/Multilateral Investment Fund
GBMF	Gordon and Betty Moore Foundation
GDP	Gross Domestic Product
GP	General Partner/Fund Manager
HNW	High-Net-Worth Individual or Investor
IADB	Inter-American Development Bank
IC	Investment Committee
IFC	International Finance Corporation
IPO	Initial Public Offering
IRR	Internal Rate of Return
LAVCA	Latin America Venture Capital Association
LP	Limited Partner
Norfund	Norwegian Investment Fund for Developing Countries
OPIC	Overseas Private Investment Corporation
PE	Private Equity
SEDF	Soros Economic Development Fund
SIFEM	Swiss Investment Fund for Emerging Markets
SME	Small and Medium Enterprise
TA	Technical Assistance
TAF	Technical Assistance Facility or Fund
USAID	U.S. Agency for International Development
VC	Venture Capital

A. Introduction: Private Equity, Venture Capital, and Technical Assistance

Private equity (PE) refers to an asset class in which investors purchase the illiquid equity (or equity-like) securities of operating companies. This equity is not publicly traded, but instead held in private hands. In exchange for their capital, PE firms take ownership stakes that range from a concentrated minority through to majority ownership in a company. PE investors typically hold these securities for a period of three to seven years with the expectation of generating attractive risk-adjusted financial returns upon exiting the investment. For more details on the PE industry refer to Annex 1.

Like PE firms, VC firms also invest in the private securities of operating companies. VC firms are known for investing in early-stage companies that are typically riskier in nature than the investments made by their PE counterparts. (See the life cycle of financing for a typical company in Table 1.) Often VC firms invest in companies in sectors that are related to technology or innovation, although they may also back businesses in other verticals. In developed markets, VCs also source ideas and build new companies from proprietary networks of proven entrepreneurs. This seeding of investment ideas into the market is less common in developing markets, but will likely become more common as these markets become more robust.

Table 1 Typical Stages of Financing a Company

Company stage	Uses of financing	Typical sources of financing	Financing stage
Concept: Idea is created, initial business model is conceptualized, but there is limited management in place, no product ready, and no track record	Assess/prove business feasibility and qualify for start-up capital: • Develop business plan • Conduct market research • Build and test prototype • File patents	• Personal savings • Microcredit • Friends/Family • Angel investors[a] • Seed-stage VC firms • Grants	Seed capital
Product development: Business model investigated, product prototype in place, but needs to be finalized and introduced to market	Converting concept into product: • Develop product • Conduct initial marketing • Establish product facility • Recruit key management	• Bootstrap financing • Angel investors • Microcredit • VC firms (seed/series A investor)[b]	Start-up capital
Initial revenue: Have proven product, delivered proof of concept, but cash flow is negative	• Expand sales and distribution • Improve productivity • Enhance team and operations	• Microcredit • Angel investors • VC firms	Early stage
Established company: Sustained positive cash flow; customer base is growing, and the business is viable	• Working capital • Trade credit, factoring, leasing • Expansion: grow sales and assets, ramp up existing operations, capital expenditures, launch new products, or enter new markets	• Cash-flow–based financing: line of credit (working capital), short-term unsecured financing/ long-term debt • Asset-based financing: accounts receivable, inventory, equipment, real estate • Suppliers (trade credit) • Factoring/Leasing • Private/growth equity	Growth equity/debt financing
Corporate: Strong sales/revenue, stable cash flows	• To support growth • Finance acquisition/ management buyout • Optimize capital structure	• Private equity • Initial public offering • Mezzanine financing • Corporate debt	Private equity/debt financing/public equity

	• Provide exit path for existing investors or owners		

Source: Authors' research.

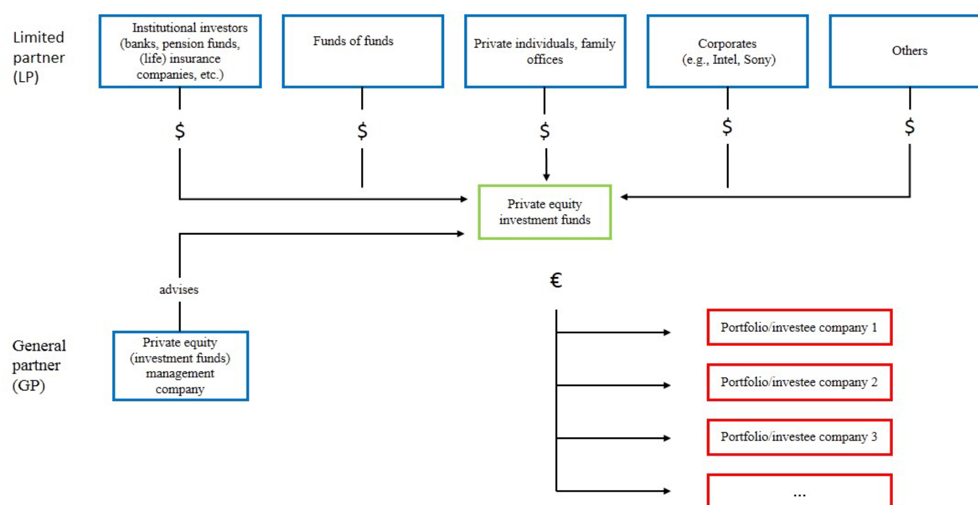
a. Angels refer to established entrepreneurs or HNWs who may be interested in financing startups for reasons that are not just financial (e.g., altruistic).

b. A series A investor participates in a first round of funding for a startup.

PE and VC firms are investment managers that typically raise fixed pools of capital that are then invested in a diversified set of companies, often across many industries. Both PE and VC firms source deals by working with a network of intermediaries,[1] developing business linkages and competencies in specific sectors, and by scouring a given market for investment opportunities. Apart from providing financing, PE funds typically take a "capital plus" approach, in that they help the companies in their portfolios to enhance management capacity, improve market focus and presence, strengthen governance, and manage growth. Although PE investment styles may vary considerably, many firms seek financial returns by supporting and financing the growth of the companies in their portfolios. As such, these firms are widely linked to job creation.[2]

PE and VC funds usually employ a partnership structure. A fund management company, or general partner (GP), raises capital from a limited number of qualified investors that become limited partners (LPs) of a fund. Typically LPs consist of pension funds, insurance companies, foundations, endowments, high-net-worth individuals (HNWs), sovereign wealth funds, or development finance institutions (DFIs). The fund manager receives two types of compensation from the investors. First, the fund charges a management fee—approximately 2 percent of the capital in the fund—to cover operating expenses. Additionally, the GP receives a share of the gains generated on its investments—typically 20 percent of profits—which is known as carried interest. Carried interest seeks to align the incentives of the GP with those of the LP investors in the fund. See Figure 1 for a typical PE structure and business model.

Figure 1 Standard PE Business Model



Source: European Private Equity and Capital Association.

[1] Such intermediaries include accelerators, incubators, accounting firms, advisory and consulting firms, investment advisors, investment banks, lawyers, business associations, and banks.

[2] IFC Job Study, www.ifc.org.

Within the VC and angel investor network, incubators and accelerators are intermediaries that help companies to grow by providing a combination of capital, mentorship, technical support, infrastructure, and other critical resources. Their ultimate goal is to prepare companies for growth and eventual investment from VC firms. Unlike VC firms, however, incubators and accelerators are not funds per se and generally provide only small amounts of financing. Often the capital invested by such intermediaries is start-up capital and is less than $25,000–50,000. Rather than providing significant cash, these intermediaries "invest" largely through in-kind contributions such as workspace, basic infrastructure, advice, technical resources, mentorship, sector expertise, and other types of capacity building.

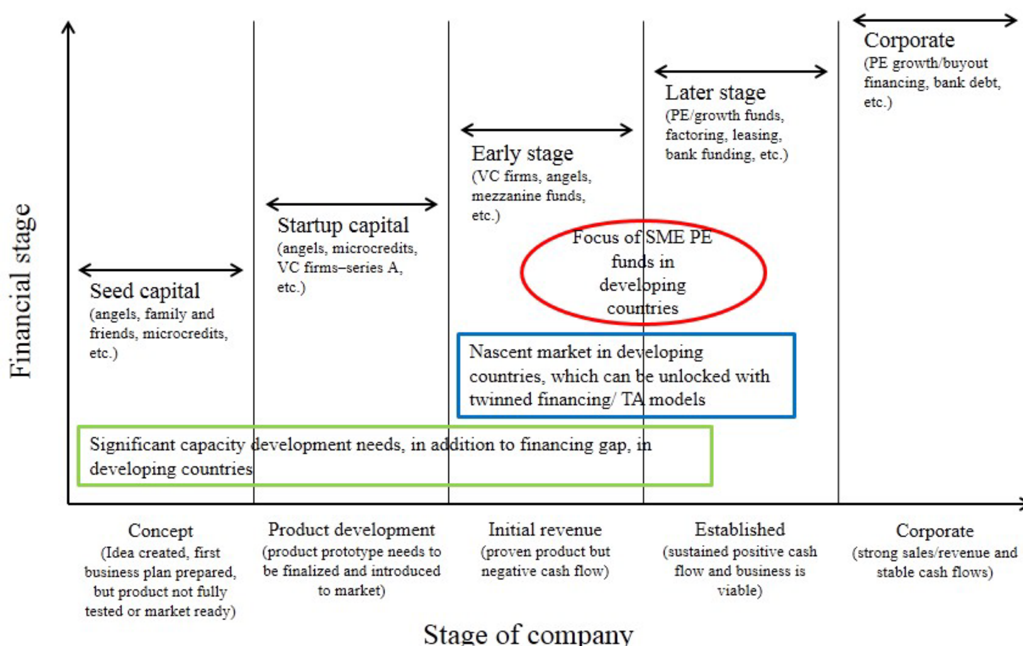
In developing countries, technical assistance (TA) has proven to be an important tool for fund managers and investors in the PE and VC industries. In such markets, entrepreneurs and the businesses that they manage are held back by deficiencies in business training and operational expertise. These challenges are not limited to start-up businesses, but can also be seen in established small and medium enterprises (SMEs) or family-owned businesses in a wide variety of industries. Such capacity gaps often translate into missed opportunities and broadly impede the ability of businesses to access financing. Moreover, TA can improve critical business functions such as governance and financial planning, which are essential for attracting new sources of capital. In the context of this report, TA refers to a set of services provided to the types of companies in which PE and VC funds invest, also known as portfolio companies or investee companies. Such services build skills or capacity for the investee companies in diverse areas such as finance, management, technology, and strategic planning.

Technical assistance can considerably enhance the effectiveness of fund managers' investments in SMEs. TA mitigates risk and increases the probability that investments will perform successfully by funding targeted operational improvements within these companies. Although this type of capacity building creates value for companies independent of their size, it can be most impactful for smaller businesses that inherently lack the resources to make such investments on their own. Thus, in this context, TA provides funding that allows funds to extend their reach to smaller and less sophisticated companies. For a detailed definition of the SME segment, refer to Annex 1.

B. Private Equity, Venture Capital, and SMEs in Emerging Markets

Despite the vast number of SMEs operating in developing countries, the overall market for risk and growth capital available to these types of businesses remains small and fragmented. Small and medium enterprises encompass a variety of businesses and sectors, ranging from relatively stable businesses looking to expand, to companies that leverage innovation to transform an existing market. The persistence of an "equity financing gap" is not surprising given that sourcing any external capital, even debt, is challenging for these companies. Yet unlike developed economies, where the equity-financing gap is most likely to affect new and innovative companies, in developing economies this phenomenon affects larger and more established enterprises as well. Although overall figures for the equity gap are difficult to determine, the World Economic Forum has identified a persistent gap in financing for businesses that require between $50,000 and $2 million in external capital. Figure 2 provides an analysis of the financing cycle and associated financing gaps.

Figure 2 Start-up Financing Cycle



Source: Authors' research.
Note: PE = private equity; SME = small and medium enterprise; TA = technical assistance; VC = venture capital.

The market for SME PE and VC in many developing countries represents a small fraction of the overall quantity of fund investment. In the two years ended December 31, 2011, SME investing in Latin America exceeded $600 million but represented less than 5 percent of overall capital invested by VC and PE firms in the region. Similarly, LAVCA has reported that investments in SMEs represented just 10 percent of overall PE investment in Colombia, Mexico, and Peru (LAVCA 2012a, b). In 2011 there were about 16 active funds dedicated to East Africa, and, according to a survey by Deloitte (2012), there were 20 deals representing a total investment of $188 million. However, the average transaction value per deal was more than $10 million, meaning that SMEs that were seeking less than $3 million to support their first stage of growth or expansion were largely overlooked.

The lack of PE and VC for SMEs in developing economies has a secondary effect beyond simply limiting companies' access to capital. In addition to capital, investors bring knowledge and know-how to the companies in which they invest. They actively manage their investments by implementing enhanced governance structures and by introducing rigorous management practices. Through active participation on the Board of Directors or in partnership with management, investors equip companies with tools to improve critical ingredients of business success such as governance, financial accounting, access to markets, and other operational areas. Still, a paradox is at play since companies that lack access to these types of skills are often unable to seek PE and VC financing in the first place.

Although increased flows of PE investment could help to create, deepen, and expand SME growth in developing economies, the vast majority of PE firms in such markets targets larger or more established enterprises. Several reasons can be identified for this phenomenon. First, PE is a relatively new financing source in many emerging markets, and investors do not lack for opportunities to invest in large and established companies with lower risk profiles. Second, investing in SMEs is more challenging than investing in established companies because of higher execution risk, elevated transaction costs, and greater information barriers. Finally, although the pool of investment management talent in these markets is growing, one still finds a finite number of professionals capable of operating PEFs. This means that the

overall pool of PE firms remains shallow relative to the potential size of these markets. In effect, while the number of funds and fund managers is evolving, the fund management industry in emerging market regions such as Latin America and East Africa remains nascent.

Technical assistance, when partnered with PE and VC, can deepen investor commitment and enhance the ability of SMEs in emerging markets to raise capital. Investors, typically those with development aims, and donors have been working to create a viable SME investment market through targeted TA efforts. Two main benefits of TA can be seen. First, TA provides funding that allows fund managers to extend their reach to smaller companies. Second, TA mitigates risk and increases the probability for successful investments for both PE and VC funds by funding targeted operational improvements. Although the potential benefits of TA are clear, many funds investing in SMEs in developing countries are small and lack the scale and financial resources to fund TA projects themselves. Thus, dedicated TA facilities financed by third parties such as DFIs, governments, or other donors have emerged to fill this critical need. Given the benefits provided by such TA facilities, PE, and VC funds can also improve their chances of raising capital from potential LPs by highlighting prospective or current relationships with TA facilities. Moreover, funds can derive a competitive advantage in relation to other market actors by leveraging their access to TA funding when seeking to convince target investee companies to partner with their firm. Overall, TA serves to strengthen the case for PE and VC in the emerging markets. As a result, the notion of TA facilities working with PE and VC funds is now more accepted by LPs and GPs and is becoming a more common market model in the SME segment in developing countries. For a list of funding sources for select dedicated TA funds and for profiles of TA donors, see Annex 2 and Annex 3.

C. Constraints to SME PE and VC

Constraints to SME PE and VC in developing markets may be categorized under several general themes. First, despite the vast differences in the operating environment between developed and emerging markets, fund structures that were developed in advanced economies have been transplanted to emerging markets without making adjustments to reflect these differences. Although these structures seek to implement industry best practices, they do not contemplate the specific needs of funds operating in places such as Latin America, Asia, and Africa. Second, environmental factors, ranging from shallow capital markets to fundraising challenges, inhibit the development of robust local PE markets. In a most basic sense, companies in emerging markets may have limited insight into the PE asset class and can be apprehensive about taking an equity investment from a fund manager. Finally, persistent capacity constraints, herein referred to as an "advisory gap," ensure that many promising candidates for PE investment remain ill-prepared to seek such investment.

1. Fund Structures

DFIs and impact investors dominate mainstream PE and VC fundraising in many developing countries. Given the limited number of local institutional investors that can commit large amounts of capital to funds in developing countries, DFIs have tended to dominate the LP landscape. Impact investors, defined as investors that aim for measureable social impact as well as a financial return,[3] also regularly participate as LPs in developing country funds, specifically in funds with social aims. This

[3] A recent JPMorgan report argued that impact investments must be considered a separate asset class because such investments require a specialized investment skills, metrics, benchmarks ratings, etc.

impact-investing segment includes philanthropic institutions, corporate and family foundations, and HNWs.

DFIs, in a quest for demonstration effect, often exert multiple (and perhaps untenable) requirements on fund managers. For example, they may expect PE funds to simultaneously adopt traditional-style economic models that generate internal rates of return (IRRs) in excess of 20 to 30 percent, while at the same time requiring these firms to move downstream to invest in SMEs, which inherently involve greater investment challenges and risks. For example, PE funds that count DFIs within their LPs tend to follow the traditional LP/GP business model that is employed in developed markets, although they may not always charge the industry-standard fee structures (2 percent management fee and 20 percent carried interest).[4] In many East Africa–based SME funds, for instance, the management fee ranges from 2.5 to 4 percent, and carried interest ranges from 15 to 20 percent. Most DFI-sponsored funds aim for market-based returns with target IRRs in excess of 20 percent, which are higher than the IRRs of 8 to 15 percent expected by impact investors. This differentiation is driven by the fact that DFI-sponsored funds seek to also attract co-investors who are purely market driven to develop the local LP market and, ideally, set the stage for other managers to fundraise from these investors. In contrast, impact funds cater to a specific subset of investors who prioritize the impact of their investment alongside, or even above, financial return. Thus, the difference in financial expectations between these two types of funds reflects the long-term objectives of each type of investor. It is important to note, however, that the distinction between impact funds and traditional PE funds entails more than the just a fund's stated mission or investment thesis. Rather, impact funds must operate under specific established operational standards, such as approaches to deal structures or reporting, that are tailored to the impact sector.

This DFI-encouraged model can impose structural constraints that affect the flow of investment capital to early-stage SMEs while inhibiting the creation of a "feeder" for future high-quality deal flow for funds that invest in more mature companies. This "traditional" fund structure model ensures a match with PE and VC industry fund structure standards, meets the requirements of most of the current set of DFI investors, and aims to appropriately align fees and incentives for managers. However, such traditional fund structures may limit capital flows to a growing pool of new entrepreneurs, early-stage SMEs, and seed-stage companies. Such companies require significant support both pre- and post-investment. Even when fund management fees are slightly above the industry standard, the restriction of the management fee to about 2 or 3 percent of what are typically small average fund sizes results in limited streams of operational capital. This often compels the GP to restrict team composition and in turn impedes the ability of a firm to attract talent.

Without sufficient capital to fund operations, PE and VC firms struggle to establish a strong local presence and to build the networks, relationships, and sector know-how that drive pipeline and investment quality. Most domestic funds have small locally based teams to support their activities. In part, low management revenues (as a result of fund size, fee structure, and the overall pool of funds under management across multiple funds) and inadequate internal funding to develop fund management capacity limit the size of the teams and their ability to recruit experienced investment managers. Anecdotal evidence in East Africa and Latin America, for instance, indicates that many fund managers and investment teams are relatively new to the field of SME investing. Discussions with DFIs corroborate that the breadth and scope of regionally based fund managers is suboptimal and that local fund management experience and competency requires further development. Given this capacity constraint, the GP is somewhat limited in its ability to add transformative value to the companies in which it invests, especially in smaller companies that require greater management resources.

[4] Carried interest refers to the share of profit paid to the manager of a PE fund.

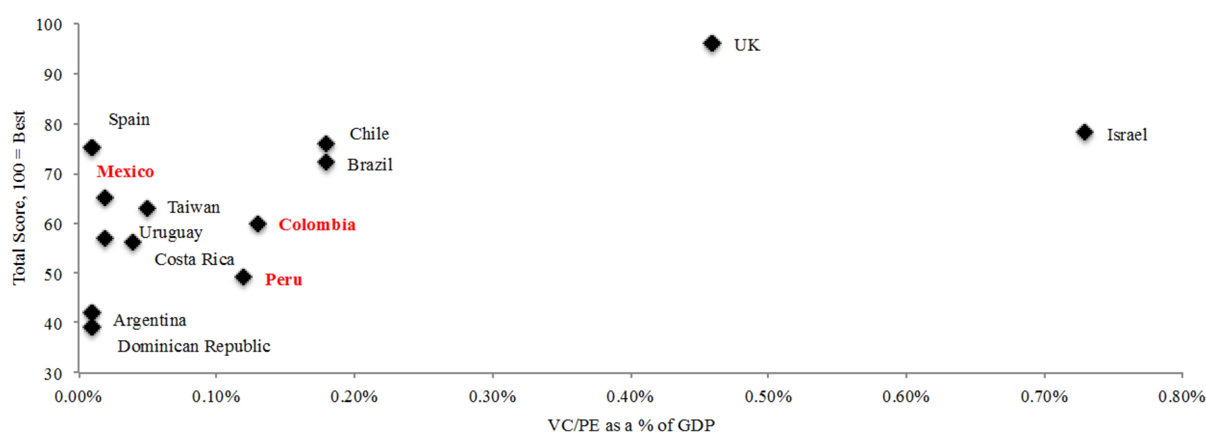
Given investor expectations and fund structures, a concerted move is being made by many SME funds in developing countries to invest in large, established companies. Moreover, firms may collaborate to cofinance large deals. Follow-on investments are also common, thus reducing the need to source new deals or increase the population of investable companies. These factors combine to further exacerbate the financing gap for SMEs while creating incentives for fund managers in developing markets to seek less risky deals in more established companies. Simply put, even those firms that raise capital to invest in SMEs may eventually invest that capital in larger businesses. This tendency not only crowds out the capital available for SMEs, but also inhibits the development of a high-quality pipeline of smaller companies that will eventually serve as deal flow for the subset of PE funds that invest in larger companies.

Moreover, the tendency for PE funds to prefer larger deals in more established companies is structural. The investment of time in conducting due diligence, negotiating deal terms, and managing an investment is independent of the size of the investment. Smaller transactions can take as much time, or even more time, than larger transactions. Thus, a clear incentive is seen for PE firms to invest in larger deals and deploy more capital per opportunity while expending the same amount of time and energy. Investors who choose to invest in SMEs have to believe that there are dynamics at play—whether they are advantages with regards to fundraising, competition for transactions, or deal terms—that justify their decision to target these types of companies.

2. Market and Environmental Challenges

Despite the growth prospects for PE and VC in emerging markets, structural issues continue to limit the expansion of these asset classes. A direct correlation exists between the regulatory environment for alternative investments and the size and vibrancy of the industry in a given country. Developing nations that seek to build robust PE and VC sectors must implement structural reforms in the regulatory and legal systems to make the market attractive to financial investors. The situation in Latin America is demonstrative of how the regulatory environment in a particular nation will directly impact private fund activity. This relationship is relatively straightforward: the more attractive the overall regulatory and operating environment for fund mangers—in this case as determined by a scoring mechanism developed by LAVCA—the greater the size of the industry as a percentage of gross domestic product (GDP). It is worth noting that most of the deficiencies are related to the legal and regulatory environment, such as the strength of laws protecting minority shareholder rights. Figure 3 maps the size of the PE and VC industry versus the regulatory and legal environment in a variety of countries in Latin America and several developed nations.

Figure 3 PE and VC Environment Score versus PE and VC as Percentage of GDP—Global



Source: LAVCA 2012a, b.
Note: GDP = gross domestic product; PE = private equity; VC = venture capital.

On the demand side of the equation, funds in developing countries note significant interest in growth financing for SMEs. For instance, in East Africa, both SME fund managers and advisors noted healthy demand for financing. Field interviews in Africa show that some funds have evaluated more than 200 agribusiness business proposals, and others have reviewed more than 150 SME deals in other sectors over the last three or four years. In Latin America, managers of SME-focused funds note that the equity gap extends from start-up financing through to PE for growing SMEs that require up to $5 million–$7 million of capital.

Despite the need for financing, feedback from stakeholders suggests that SMEs (mainly family-owned businesses) in developing countries are typically apprehensive about equity investments and have limited knowledge or awareness about the fund management industry and the firms operating in their market. Many SMEs are owner-managed or family-owned businesses and are unwilling to dilute their ownership and decision-making authority. These companies are often unaccustomed to how PE transactions are structured and are not always able to retain external advisors that can provide adequate counsel on such matters. The nascent state of this segment and a persistence of information barriers also make valuation of SMEs difficult, which leads to gaps in perceived valuation between investors and their potential partners. Many entrepreneurs therefore shy away from equity financing because of a lack of familiarity with equity and exit mechanisms, differing views on valuation, resistance to governance structures, an unwillingness to cede control to external partners, and a reluctance to change the owner-manager culture at their firm. All of these factors combine to make sourcing quality SME investments far more challenging than in developed markets. Moreover, some SME business owners may opt for debt financing over equity, given that they understand the risks associated with bank financing and do not have to accept externally instituted changes in management culture and control. Of course, such debt financing would not be available for higher risk start-up companies.

Generating exit events serves as another constraint to attracting capital in the SME space. Initial public offering (IPO) opportunities in developing countries remain tenuous for investment funds—even those operating in the mid- and large-cap segment of the market—because local capital markets are not well developed. Without access to IPOs, fund managers have to rely on strategic buyers, trade sales, or buyouts by other investment firms to achieve exits. For this reason, numerous PE players on the smaller end of the investment spectrum tend to favor investing through self-liquidating instruments such as subordinated debt, as this helps to mitigate exit risk. Exiting via a sale to a PE firm or strategic acquirer is

certainly achievable, but such pathways require investors to think carefully about exit paths prior to consummating a deal. In general, PE investors in these markets have observed that it is more difficult to sell small assets than large investments, and thus SME investors are disadvantaged in this respect.

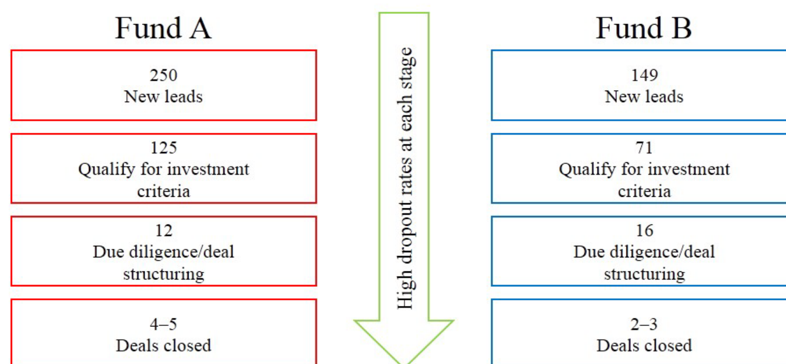
Although local investors such as pension funds can serve as cornerstone investors in alternative asset funds in many emerging market regions, these firms are averse to participating in VC or SME-focused funds. Although the local pension funds will consider opportunities related to VC or SMEs, they also look to deploy large amounts of capital per investment and are often limited by market regulators from taking more than a fixed portion of any particular fund. Given the sheer amount of capital that these funds wish to deploy, they view smaller investments as expensive to manage relative to the size of the opportunity. At the same time, regulatory restrictions may hinder investment. Although the capital that such funds could provide is important, the validation that their support of a given fund provides to the market is potentially even more beneficial during fundraising. International investors often look to the actions of local investors when deciding whether to invest in a given firm.

Given the difficulties related to achieving exits in the SME segment, investors opt for other types of financing to participate in this sector of the market. As mentioned above, this includes substituting equity capital for alternative forms of either short-term (factoring) or long-term (subordinated debt) financing. Often this lower end of the market focuses on building businesses that serve the bottom of the pyramid and can be financed by impact investors, who are willing to work with riskier credits and will accept lower than market returns. Many global impact investment funds that offer subordinated debt have offices in Latin America and East Africa, including Grassroots Business Fund, responsAbility, and Root Capital. In the VC market, companies that are seeking to raise capital will turn to angel investors, accelerators, or incubators in search of growth financing.

For those funds that do focus on SME financing, fund managers indicate a robust pipeline of SMEs, but a high proportion of firms that are not yet investment ready. Much of the core business of investment firms centers on sourcing large pipelines of deals and then selecting the best deals in the pipeline for due diligence and potential investment. It is natural for firms to discard deals as they narrow the funnel of the deal pipeline, but fund mangers in developing countries report that a significant portion of the companies that are culled from the pipeline suffer from basic capacity constraints. For example, as many as half of the companies in a given pipeline lack basic due diligence materials such as coherent financial statements and a comprehensive business plan. Many of these companies are impaired by a variety of operational weaknesses that range from weak governance to underdeveloped management and financial systems. Fund managers believe that if companies had access to targeted TA to address these deficiencies, the universe of funds operating would be far more likely to invest, thereby accelerating capital flows to SMEs.

Specifically, dropout rates at each stage of the investment process remain high. (Figure 4 illustrates sample deal flow dynamics in two East Africa funds.) Only about 5 to 10 percent of proposals graduate to the due diligence and deal structuring stages, and just 2 to 4 percent of proposals move forward to term sheets and agreements. For example, one fund manager in East Africa indicated reviewing more than 150 investment proposals over the last four years, but closing just four transactions. SME-focused fund managers in Latin America see a similar dynamic at play across that region. The fact that these companies proceed forward with a small number of transactions is not directly a concern. A reputable fund has an incentive to source as many deals as possible and wishes to invest only in the very best. In the case of the funds operating in East Africa and Latin America, however, the high dropout rates are largely a function of the target firms not being investment ready. Thus, the asset class itself is constrained by the scarce number of businesses that are functionally prepared to raise capital from professional investors.

Figure 4 Comparison of Deal Flow Dropout Rates for Two SME Funds



Source: Authors' research and interviews.

Even in markets where a history exists of PE investment in the SME segment, many of these firms have now moved upmarket, thus creating a "brain drain" in the SME space. Even though both the Latin America and East Africa markets include firms that have invested in SMEs for close to a decade, these funds have generally migrated from smaller deals to larger deals as they have raised larger funds. In both regions one finds a tendency for fund mangers that are successful to raise larger follow-on funds, which, in turn, allows them to make larger investments. As a result, fund mangers abandon the SME segment, taking with them both the equity capital and human capital that they have amassed over their operating history.

3. The "Advisory Gap" and Capacity Constraints

Although some boutique firms and business advisory service providers cater to SMEs in developing countries, the industry remains both nascent and fragmented. SMEs that wish to raise capital often find a significant gap between the expectations of funds that could provide them with capital and their own level of preparedness for the due diligence process. At the same time, SMEs typically cannot afford to contract financial and transaction advisors. Moreover, given the small size of SME transactions and limited fees available to advisors for such transactions, the pool of specialized firms providing such services is limited. The end result of the fee and affordability challenge is that many of these smaller firms and service providers remain subscale. The "advisory gap" for SMEs acts as a barrier that may limit the evolution of the SME investment and financing markets in the short to medium term.

Fund managers note the need for TA to address both pre-investment and post-investment SME capacity deficiencies. Such TA serves to improve pipeline entry, increase the quality of the deal flow, and enhance the quality of investments. Typically, pre-investment deficiencies include weak governance and management structures, poor financial management and accounting functions, inadequate market assessments, incomplete financial records and information, and inadequate financial planning. Many fund managers also indicate that following an investment, portfolio companies often continue to face capacity and operational challenges in areas such as governance, organizational structure, change management, marketing capacity, access to technical expertise, and succession planning. This phenomenon highlights the critical importance of pairing TA with investment in SMEs. Box 1 provides a summary of the most common capacity constraints identified by SME investment firms.

Box 1 Capacity Constraints to SMEs

Investors in emerging markets face challenges that their counterparts in developed markets rarely encounter. In developing markets, even established businesses often lack critical business tools, from management and financial planning to technology, that are common in developed market businesses. These issues are even greater for SMEs, many of which lack the resources or the know-how to develop required technical skills. Access to technical support services also remains limited, and even when support services are available, they may be expensive and difficult to procure. Specifically, the range of projects, both pre- and post-investment, that can be considered under the rubric of TA include the following:

- Financial literacy training
- Resource planning and budgeting
- Business plan development
- Finance and accounting training
- Marketing support and market studies
- Strategic planning
- Legal support
- Operational and process improvement
- Facilitating access to international supply chains
- Information technology

Given this range of needs, TA has become an essential tool for funds investing in SMEs in developing economies. For example, a 2009 study by the World Resources Institute titled "On the Frontiers of Finance" found that of the 18 emerging markets funds it interviewed, every one of the firms offered TA in one form or another.

Source: Authors.

D. Pairing Technical Assistance with PE and VC Investment in SMEs

Although the model of pairing TA with PE and VC is still embryonic, DFIs and GPs have recognized that a "capital plus" model, which factors in TA alongside capital, is essential in many developing countries and is applicable across the spectrum of both early-stage and more mature SMEs. Investment capital, paired with TA support, although still limited in its application, is now gaining acceptance and is regarded as critical to support the viability and financial success of portfolio companies. Table 2 highlights typical sources of TA funding.

Table 2 Funding Sources for Dedicated TA Facilities by Geography and Type

Multi-Regional & Global Funds	Latin America-Focused Funds	Africa-Focused Funds
DFI/Government	**DFI/Government**	**DFI/Government**
Agence Française de Développement	AECID	African Development Bank
Bio	CAF	AGRA
COFIDE	Fondo de Fondos de Mexico	CDC
EIB	Government of Colombia	DEG
EBRD	IFC	EIB
Finnfund	IABD/FOMIN	FMO
FMO		International Finance Corporation
IFC	**Foundations**	IFAD
KfW/DEG	The Nature Conservancy	Italian Development Corporation
OPIC	Omidyar Network	Norfund
Swedfund	The Rockefeller Foundation	Proparco
USAID	Soros	SIFEM
Omidyar Network		USAID
	Corporate-Related Institutions	UNIDO
Foundations	JP Morgan	
Conservation International		**Foundations**
Ford Foundation		Bill & Melinda Gates Foundation
Gordon and Betty Moore Foundation		Elma Foundation
The Rockefeller Foundation		Gatsby Charitable Foundation
		Maria Wrigley Trust
Corporate-Related Institutions		Rockefeller Foundation
Accion International		Shell Foundation
Triodos-Doen		
		Corporate-Related Institutions
		ASN Bank
		Doen Foundation
		JP Morgan Social Finance

Source: Authors' research and interviews.

Technical assistance, usually delivered through a designated TAF, is typically categorized as either pre- or post-investment TA. Pre-investment TA finances support for SMEs that have been identified as attractive investment targets yet require additional preparation before a deal can be finalized. This could include targeted support to improve financial reporting, operations, or legal and governance concerns. Post-investment TA, on the other hand, finances support for portfolio companies that develop capacity needs during the life cycle of the investment. Such support can include governance improvements, training, access to expert technical advice and mentorship, and business strategy or operational improvements. This targeted support can, in turn, help both to improve the quality of the investments and to prepare the company for exit.

Post-investment TA is the most prevalent model. Currently TA paired with investment in developing countries is largely restricted to post-investment support for portfolio companies. In some limited cases, however, TA is provided pre-investment, or support is extended directly to an investment firm as part of its efforts to explore a particular investment thesis and to build a pipeline of potential target companies within a specific theme. Such cases are far less likely, however, given donor preference to support portfolio companies.

Box 2 Global Models of TA

Although TA is recognized as an important tool for funds investing in SMEs, the models used for implementing TA vary widely based on the type of fund, the profile of the investors and donors, and the stage of development of the market and the fund. These models include the following:

- *VC model:* In this model the VC fund takes an active and hands-on approach in the style of Silicon Valley VCs. No dedicated TA facility or fund (TAF) is used, but rather the fund managers provide these services directly to their portfolio companies. Any required services can be covered from management fees paid by investors because of the "pure profit" nature of the VC industry, whereby funds invest only in the strongest companies. Examples of this model include Stratus, China Environmental Fund, Latin Idea Ventures, and Alta Ventures.
- *Standalone TAF:* In such a model, a PE or VC fund will raise a standalone TAF from donors that will fund

various projects related to its investment activities. This can range from paying for the cost of due diligence or covering fund legal expenses to supporting specific TA projects at portfolio companies. Dedicated TAFs work well for funds that are profit driven, but as part of their mission also support a broader economic development and range of companies that are more than purely profit-driven firms. Moreover, the small size of many funds investing in SMEs means that management fees (typically 2 to 3 percent of funds under management) are insufficient to fund TA initiatives in the absence of a TAF. Examples of this model include the African Agriculture Fund, LeapFrog Investments, Fanisi Venture Capital Fund, Africap Microfinance Fund, and Leopard Haiti Fund.

- *Market development TA grant:* These types of grants from donors are not used directly by a PE or VC fund, but rather are used to develop the market by dispersing knowledge learned from the fund's activities or by providing funds for the PE or VC firm to educate other potential market players. These types of grants are included in PE-related TA, however, as they are made concurrent with an equity commitment to a fund in the relevant market. Thus, this type of grant serves to amplify the impact of an LP investment by strengthening the overall investment environment. Examples are C-Primus and Angel Ventures Mexico.
- *One-off TA grants:* These grants are not associated with a specific TAF, but rather are made on a per-project basis depending on donor objectives. These grants may also be facilitated by the relevant GP in each instance. Examples include AfricInvest-FMO and Aavishkaar Group.
- *Shared services arrangement/fee-funded TA:* In this model a fund provides services to its portfolio companies such as shared accounting, legal, or other services, as part of its investment operations. There is no dedicated facility. Rather, TA is funded either from management fees charged to investors in the fund or by fees charged to portfolio companies. Examples include IGNIA and GroFin.

Source: Authors.

The combination of pre- and post-investment TAF needs during the life cycle of the investment is widely recognized to be about 7 to 15 percent of the value of a given investment. Usually, a TAF ranges between 6 and 20 percent (average around 10 percent) of the size of an associated investment fund. Table 3 includes a sample of global TAF sizes relative to fund sizes.

Table 3 Dedicated TAF Size versus PE Assets under Management
dollars (millions)

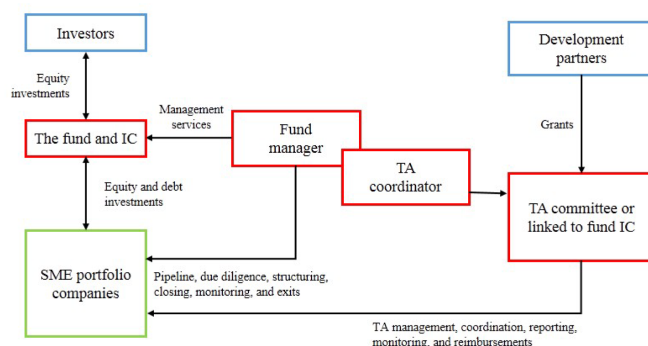
		US$MM		
	Year	Fund Size	TA Facility Size	TA as % of Fund
Leopard Haiti Fund	2011	75	3 to 5	4% to 7%
Africa Agricultural Capital	2011	25	1.5	6%
African Agriculture Fund	2011	151	13.3	9%
Aureos's Africa Health Fund	2011	105	8.4	8%
Fanisi Venture Capital Fund S.C.A.	2010	50	2.0	4%
LeapFrog Investments	2008	135	5.0	4%
Business Partners Lt.	2006	85	8.0	9%
Africap Microfinance Fund	2001	15	3.8	26%
			Average	*9%*
			Median	*7%*

Source: World Resource Institute, proprietary research.

Given that SMEs often face constraints and cannot financing their own TA, zero-interest loans (or a matching grant mechanism) may be used to provide TA for SMEs. Although the TAF pays for TA service providers, funding is usually deemed a nonrecourse loan to the portfolio company. This may be structured as a non-interest-bearing loan with a grace period and is repayable over an agreed-upon period that takes into account the company's cash flows and its ability to pay. Typically at least 60 to 70 percent of the total TA funding can be expected to be reimbursed. In limited cases the TA services is simply a grant or a matching grant, where the beneficiary company matches on the order of 25 percent of the TA cost.

It is generally considered most efficient when the TAF or the designated TA pool is managed directly by the fund manager under predetermined disbursement criteria, as well as agreed-upon governance and reporting requirements. The provision of TA is linked to the investment process and the fund manager's portfolio management and monitoring responsibilities, given the manager's close working relationship with its portfolio companies. As long as the policies, processes, criteria, governance, and reporting requirements are predetermined and well defined, this structure is deemed an effective, responsive, and efficient mechanism. Figure 5 provides a high-level outline and example of the governance and management of a paired PE and TAF model.

Figure 5 Governance Model of a Typical Paired PE and TAF



Source: Authors' research.
Note: IC = investment committee; PE = private equity; SME = small and medium enterprise; TA = technical assistance.

Other potential alternatives to a TAF that is directly managed by a fund manager can be identified, such as an independent TAF that works with multiple funds. Such a model would seek to increase the scale of TA available in the market and to cater to various types of businesses and funds that require TA. Moroever, this model may offer some economies of scale while avoiding some of the conflicts of interests associated with a model in which a single fund operates a TA. At the same time, governance arrangements for a TAF available to multiple fund managers may be more onerous and may increase bureaucracy. As such, such a structure would require careful design and implementation.

To drive both accountability and transparency, the TAF is structured in some form of trust (fund or separate escrow account) for accountability and transparency. Decision-making authority for the TAF lies with a TA committee that usually comprises external members (e.g., donors) and one or two representatives of the fund's investment committee. Alternately, the PE fund's investment committee is charged with additional oversight and decision-making authority regarding the TA. Typically, the fund manager appoints a TA coordinator (whose costs are reimbursed from the TAF), who is empowered to manage the TAF, assess TA requests and proposals, identify and coordinate with TA service providers, monitor TA provision, and oversee reporting.

E. Lessons Learned: Technical Assistance Paired with PE

Technical assistance can directly support investment firms in nascent PE and VC environments where investing in SMEs is not yet proven to be a financially attractive investment strategy. On a long-term basis, positive financial returns are a requirement to successfully create a robust PE and VC

environment in any country or region. Without these returns, there will be no follow-on funds, and those businesses seeking to drive positive economic, social, or environmental impact will not receive ongoing support from the financial sector. For investment approaches that aim to deepen access to patient capital in underserved markets, such as SME investing, TA can help to create an environment where such returns are more likely to be achieved, thus helping to build long-term investor interest in the industry. Once these firms can generate sufficient returns, they should no longer require TA resources to support their management capacity.

A fund's track record and competence as well as the viability of the investment strategy in a given market is critical to success and must augment any TA. Even with the assistance of TA, a fund will not succeed if the firm cannot demonstrate a viable strategy, evidence of a track record, local knowledge, and the capacity to develop a leadership presence in a given market or market segment. When selecting funds with which to partner for a TAF, donors must assess the professional qualifications of the funds to determine whether they have the requisite experience to build an investment portfolio, generate returns for investors, and raise capital from LPs. Moreover, fund managers must be able to present a coherent investment thesis for the SME market in their geography. This is the responsibility of the fund rather than the TAF.

Dedicated TAFs should seek to impact and support portfolio companies over the life of the associated fund. Relative to one-off grants, these dedicated TAFs should allow a fund and a TAF to work together to support an portfolio company over the investment life, because capacity development needs for a SME are not one-off events in a developing market environment. Depending on the structure of the TAF, its donor period should be coordinated with the investment life of the PE or VC fund to allow for more tailored and flexible support to portfolio companies.

A TAF requires clear disbursement criteria, governance, and coordination. Although the TAF can be more efficiently and effectively managed by a firm, clear guidelines, policies, and procedures should be established to ensure good governance and alignment with the TAF's mission and its objectives. Depending on the size of the TAF, a dedicated TAF coordinator should be employed by the fund manager to ensure effective management, accountability, and reporting. Such a role also ensures continuity of knowledge and sustained relationships with a pool of business advisors and third-party services providers.

Alignment of governance and objectives of the TAF is critical to achieve development goals. At times, tensions may exist between the commercial motivations of the fund and the development goals of the TAF. For example, the fund might prefer that the TAF be used to mitigate investment risks, but that is not usually the primary mission of the TAF and its funders. Rather, the TAF is intended to achieve development goals. Such tensions can be managed by having clear but aligned objectives and strong governance arrangements.

Under well-defined criteria and conditions, a TAF can also enable a fund manager to augment capacity and build the competency needed to support portfolio companies and in turn to further support the market for SME investment. New SME fund managers aiming to enter the market, especially to invest in early- or seed-stage companies, often face shortfalls with respect to track records, internal capabilities, and capacity to nurture portfolio companies. In such instances, business advisory and mentorship is best housed as part of the overall fund management thesis (taking a VC or angel investor approach), with such skills and capacity maintained in house by the fund manager to support and build capacity at portfolio companies on an ongoing basis. If appropriately designed and under the right conditions and criteria, access to TA resources can support such fund management capabilities.

Given fee structures and market dynamics, fund size is an important consideration of the "economics" of managing a fund. Interviews with fund managers and DFIs indicate that a SME fund size

must be at least \$20–30 million, but ideally at least \$50 million (given the traditional fund and fee structures discussed previously) to support the resources needed to appropriately manage a fund. Although this is an important benchmark to consider, it must be weighed against the funds' expected market target (financing SMEs versus midsize companies) and expected investment amount per deal. A fund size of about \$50 million, targeting larger SMEs or midcap companies with an investment average of \$3 million to \$10 million, requires the manager to target 10 to 12 deals over a standard four-to-five-year investment period. Assuming a deal strike rate of around 10 percent, this would require the manager to fully assess more than 100 targets. Even at an average ticket of around \$5 million per deal, it may prove a challenge to generate a reasonable quality deal flow in developing countries. The challenge of quality deal flow and investment targets is even greater if the fund is targeting earlier-stage SMEs and seed-stage companies and targeting deals between \$500,000 and \$2 million. A \$50 million fund size within an "industry standard" fund structure would require the manager to generate a deal flow of roughly 500 SMEs and invest in approximately 30 companies over a four-to-five-year period. This would be a significant challenge given the discussions about pipeline quality, dropout rates, and management capacity and competencies found in this report. Tailoring the fund structure and size, managing expectations, providing capacity funding to new managers, and customizing or increasing the fee structure could potentially resolve this challenge.

Donors should also dedicate long-term resources to overseeing the TAF. With fund lives ranging from 8 to 10 years and a difficult exit environment, PE in emerging markets requires a long-term perspective. As a result, managing a TA program from the perspective of a TA donor requires dedication of long-term resources and the development of a structured management process. Furthermore, donors must acknowledge the reality that PE and VC investors measure their success in terms of financial returns, while donors measure success in terms of impact (e.g., job creation). To align these models and reconcile donors' goals with those of investors, donors need to be prepared to tailor impact assessments and reporting to address their development objectives, while ensuring that fund managers do not have to significantly alter their processes and reporting structures from industry best practices.

The size of the TAF varies depending on context. A TAF size ranges from as little as 4 to 5 percent up to nearly 30 percent of the size of the investment fund. This range is driven by factors including the following: (1) the capacity and maturity of the partner funds, (2) the maturity of the market, (3) the investment thesis and investment objectives of the fund, (4) the discretion of donor institutions, and (5) and the expected operating costs of the TAF. In general, the size of the TAF relative to the investment fund will be larger in new market segments that lack existing PEFs. Furthermore, funds operating in nascent markets or market segments often require additional assistance. In such instances, new funds face significant start-up costs as they open offices, undertake fundraising, and build deal pipelines and internal capacity.

Although oversight is important, fund managers are wary of bureaucracy. Funds operating in developing countries understand the value provided by TAFs and ascribe value to the resources offered by a model that pairs PE with TA. In fact, access to a TAF can be a competitive advantage for a fund manager in terms of raising funds, sourcing investments, and managing the portfolio successfully. Still, some firms are concerned about the potential "catch" associated with taking TA funds. Past interactions with DFIs have exposed them to confusing bureaucracy and significant reporting requirements. They would prefer to work with TAFs that allow for a degree of flexibility that will make these partnerships user friendly and will ensure stronger alignment with the standard fund operating model and investment perspective.

TA should require "investment" by the recipients of TAFs, thus helping to ensure that all parties value the services while helping to support the long-term viability of the TAFs. TA recipients typically repay all or most of the TA funding (through mechanisms such as zero-interest loan models) or match some percentage of the TA funding received to ensure that all parties have "skin in the game." The level

of "investment" by a company or firm receiving TA funding may depend on the stage of the business, the type of TA, and the ownership structure of the company. When TA can be charged as a zero-interest loan, funds can be recycled and redeployed to impact a larger group of firms or portfolio companies.

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Annex 1 Definitions: Micro-, Small, and Medium Enterprises, Technical Assistance, and Private Equity

a). Definition of Micro-, Small, and Medium Enterprises

SMEs lack a universally accepted definition among stakeholders in the SME PE market, and so this study relies upon the definition put forward by the IFC in the *Interpretation Note on Small and Medium Enterprises and Environmental and Social Risk Management,* dated January 1, 2012. This note defines SME in terms of three variables: revenue, size of the labor force, and total assets. In order to qualify as an MSME, an enterprise must demonstrate two of three indicators in Table A1.

Table A1 Definition of SMEs

Indicator	Micro-enterprise	Small enterprise	Medium enterprise
Employees	<10	10–50	50–300
Total assets	<$100,000	<$100,000–3,000,000	$3,000,000–15,000,000
Total annual sales	<$100,000	<$100,000–3,000,000	$3,000,000–15,000,000

Source: IFC.

b). Definition of Technical Assistance

In developing markets, specifically among businesses operating in the SME space, entrepreneurs are held back by a lack of business training, expertise, and market networks, which translates into missed opportunities and deficient financing. TA refers to a set of services provided to businesses, including for the purposes of this study, the companies in which PE firms invest, also known as portfolio or investee companies. Such services, whether provided by either the PE or VC firm or third-party service providers (technical experts or financial/transaction advisors), essentially serve to accelerate the investment and enhance the commercial viability of the business.

c). Definitions of Terms Specific to the VC and PE Industry

The following terms are helpful to understanding the PE and VC industry in the markets discussed in this study:

- *Private equity (PE):* PE refers to investments in established, often medium or large, companies. Frequently, however, the term "private equity" is used to generally refer to all private capital investments (inclusive of PE and VC).
- *Venture capital (VC):* VC refers to investments made in start-up and very early stage companies. In developed markets, VC typically refers to technology-related investments, but in developing markets, the definition often includes any early-stage or start-up enterprise.
- *General partner (GP):* VC and PE firm structures differ depending on geographic and other considerations, but a fund manager is typically known as a general partner.
- *Limited partner (LP):* Investors in VC or PE firms, whether they be foundations, endowments, HNWs, medium-net-worth individuals, or DFIs.
- *Management fee:* A fee charged by a VC fund or PE firm to compensate the manager for its expertise and role and to cover other items such as investor relations, operations, and administration costs of the fund. In developed markets, this fee is usually equal to 2 percent of funds under management, but for smaller funds in developing markets, it may be higher.
- *Carried interest:* A share of profits that the GP receives if the fund yields a positive financial return. Typically, managers receive 20 percent of fund profits in excess of a minimum hurdle rate (such as 8 percent). Some impact or funds in developing markets do not have hurdle rates, so the GP shares in all profits. Funds also may be structured so that their carry is partially determined by predetermined social impact measures and targets (e.g., job creation).

Annex 2 Survey of Funding Sources for Select Dedicated TA Funds

1. Multiregional and Global Funds

a). LeapFrog Investments

- *Fund objective:* Micro-insurance in Africa and Asia
- *Fund size:* $125 million, €5 million dedicated TA Fund
- *Investors and funders include the following:*
  - Accion International
  - EIB
  - FMO
  - Omidyar Network
  - Triodos-Doen Foundation

b). SEAF (Small Enterprise Assistance Funds)

- *Fund objective:* MSME entrepreneurs in emerging markets
- *Fund size:* More than $600 million in more 20 funds since inception
- *Investment size:* Between $1 million and $5 million and other higher amounts
- *Investors and funders include the following:*
  - BIO
  - COFIDE (the Peruvian national development bank)
  - European Bank for Reconstruction and Development
  - Finnfund
  - FMO
  - Ford Foundation
  - IFC
  - KfW/DEG
  - Omidyar Network
  - OPIC
  - Rockefeller Foundation
  - Swedfund
  - USAID

c). Verde Ventures

- *Fund objective:* Invest in SMEs that contribute to healthy ecosystems in Africa, Latin America, and Asia
- *Fund size:* $17.5 million (first fund); currently raising a new fund with a goal of $50 million
- *Investment size:* Between $30,000 and $5 million
- *Investors and funders include the following.*[5]
  - AFD
  - Conservation International
  - GBMF
  - KfW/DEG

2. Latin America-Focused Funds

a). Adobe Capital

- *Fund objective:* Invest in SMEs that positively contribute to society
- *Fund size:* $20,000,000 with TA provided by new ventures
- *Investment size:* Between $100,000 and $3 million

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[5] See Annex 3 for acronyms used in these lists of investors and funders.

- *Investors and funders include the following:*
    - CAF
    - Promotora Social Mexico

b). Angel Ventures Mexico

Fund objective: Invest in Mexican MSMEs

- *Fund size:* $20,000,000 (target)
- *Investment size:* Between $500,000 and $3 million
- *Investors and funders include the following:*
    - Bancóldex
    - IABD/FOMIN

c). Corporacion Inversor

Fund objective: Invest in Colombian MSMEs, with focus on innovation

- *Fund size:* $22,000,000
- *Investment size:* Between $500,000 and $2 million
- *Investors and funders include the following:*
    - Bancóldex
    - BanColombia
    - Bavaria Foundation
    - Grupo Bolivar
    - IABD/FOMIN
    - JPMorgan
    - Latin America Enterprise Fund Managers

d). EcoEnterprises

- *Fund objective:* Invest in environmentally sustainable SMEs
- *Fund size:* $30,000,000 (target for second fund)
- *Investment size:* Between $500,000 and $3 million with a dedicated TAF (size to be determined)
- *Investors and funders include the following:*
    - FOMIN
    - Nature Conservancy
    - Rockefeller Foundation

e). Fondo de Capital Privado Inversor

Fund objective: Invest in Colombian MSMEs

- *Fund size:* $20,000,000 (target)
- *Investment size:* Between $1 million and $3 million
- *Investors and funders include the following:*
    - Government of Colombia
    - IABD/FOMIN

f). Grassroots Business Fund

- *Fund objective:* Invest in Latin American MSMEs
- *Fund size:* $40,000,000 (global)
- *Investment size:* Between $500,000 and $2 million
- *Investors and funders include the following:*
    - IFC
    - Other DFIs

g). IGNIA

Fund objective: Private equity focusing on SMEs in Mexico

- *Fund size:* $102,000,000
- *Investment size:* Between $1 million and $10 million
- *Investors and funders include the folowing:*
  - CAF
  - Fondo de Fondos
  - IADB/FOMIN
  - IFC
  - JPMorgan
  - Omidyar Network
  - Rockefeller Foundation
  - SEDF

h). Progresa Capital

- *Fund objective:* Invest in Colombian MSMEs
- *Fund size:* $21,000,000
- *Investment size:* Between $1 million and $3 million
- *Investors and funders include the following:*
  - Bancóldex
  - Cajasan
  - Colinversiones
  - Comfama
  - Grupo Bancolombia
  - Grupo de Inversiones Suramericana
  - Grupo Nacional de Chocolates
  - IABD/MIF
  - Inversiones Argos
  - Promisión
  - Promotora
  - Secretaría de Estado de Cooperación Internacional de España

i). SEAF Peru and SEAF Colombia

See SEAF Global

3. Africa-Focused Funds

a). African Agricultural Capital

- *Fund objective:* Invest in SMEs that contribute to healthy ecosystems in Africa, Latin America, and Asia.
- *Fund size:* $17.5 million (first fund); currently raising a new fund with a goal of $50 million
- *Investment size:* Between $30,000 and $5 million
- *Investors and funders include the following:*
  - Bill & Melinda Gates Foundation
  - Gatsby Charitable Foundation
  - J. P. Morgan Social Finance (senior debt investor 50 percent guaranteed by USAID)
  - Rockefeller Foundation
  - USAID (TA Fund)

b). African Agricultural Fund

- *Fund objective:* Invest panregionally in Africa to provide greater regional food security
- *Fund size:* $150 million with dedicated TA fund of €10 million managed by TechnoServe
- *Investment size:* Between $500,000 million and $2 million
- *Investors and funders include the following:*

  - Alliance for a Green Revolution in Africa
  - International Fund for Agricultural Development
  - Italian Development Corporation
  - United Nations Industrial Development Organization

c). Aureos Africa Health Fund

- *Fund objective:* Access to affordable, high-quality health products and services through targeted investments in private health companies to scale up sustainable businesses
- *Fund size:* $105 million with $8.4 million TA fund
- *Investment size:* Between $250,000 and $5 million
- *Investors and funders include the following:*
  - AfDB
  - ASN Bank
  - Bill & Melinda Gates Foundation
  - DEG
  - Elma Foundation
  - IFC
  - Norfund

d). Business Partners Ltd.

- *Fund objective:* Africa-focused investor in small and medium SMEs
- *Fund size:* $85 million (in five funds)
- *Investment size:* Between $50,000 and $250,000
- *Investors and funders include the following:*
  - CDC
  - Doen Foundation
  - EIB
  - IFC
  - Norfund
  - SIFEM

e). GroFin

Fund objective: Multinational financier and advisor to small and medium SMEs in Africa
Fund size: $170 million
Investment size: Between $30,000 and $5 million
Investors and funders include the following:

  - AfDB
  - CDC
  - EIB
  - FMO
  - IFC
  - Norfund
  - Proparco
  - Shell Foundation

Annex 3 Profiles of Funding Sources for Dedicated TA Funds

1. Development Finance Institutions

a). African Development Bank (AfDB)

AfDB is a development bank established in 1964 with the intention of promoting economic and social development in Africa. The Group comprises the African Development Bank, the African Development Fund, and the Nigeria Trust Fund. AfDB provides loans and grants to African governments and private companies investing in the regional member countries in Africa. It is owned and funded by member governments and has a public-interest mandate to reduce poverty and promote sustainable development.

b). Agence Française de Développement (AFD/Proparco)

AFD is a bilateral financial institution and the main implementing agency for France's official development assistance to developing countries. AFD's activities are aimed at reducing poverty and inequalities, promoting sustainable economic growth, and protecting "Global Public Goods" of benefit to all humanity. Proparco is a development financial institution partly held by AFD and private shareholders. Its mission is to be a catalyst for private investment in developing countries, and its activities target growth, sustainable development, and reaching the Millennium Development Goals. It finances operations that are economically viable, socially equitable, environmentally sustainable, and financially profitable. The group invested nearly €1 billion in loans, equity, and other securities in 2010.

c). Agencia Española de Cooperación Internacional (AECID)

AECID is a public entity within the Ministry of Foreign Affairs and Cooperation, responsible to the Secretary of State for International Cooperation and for Latin America. AECID is the governing body for Spanish policy on international development cooperation, and its fundamental aim, according to the AECID statutes, is to promote, manage, and implement public policies for international development cooperation, with particular emphasis on reducing poverty and achieving sustainable human development in developing countries. Combating poverty is the ultimate goal of Spanish policy for international development cooperation, as part of Spain's overall foreign policy, and AECID's actions are based on the belief that interdependence and solidarity are essential elements of international society.

d). Belgian Development Corporation (BIO)

BIO is a private company whose capital is held by the Belgian government (Ministry for Development Cooperation) and the SBI/BMI (Société Belge d'Investissement International [Belgian Corporation for International Investment]), each holding 50 percent. Its early-stage capital amounts to €5,000,000, and it makes investments using additional equity granted by the Ministry for Development Cooperation.

e). Commonwealth Development Corporation (CDC)

CDC is the United Kingdom's DFI. Wholly owned by the U.K. government's Department for International Development, it is the world's oldest DFI. CDC's mission is to be a pioneering investor, stimulating the private sector, and demonstrating the power of enterprise and private capital to reduce poverty in the poorest places in the world (Africa and Asia). CDC is a self-financing organization that reinvests its profits into the business and its operations. The organization has received no new money from government since 1995. It currently has capital invested in more than 1,126 companies in 74 countries, working with 80 different fund managers.

f). Corporacion Andino de Fomento (CAF)

CAF is a development bank established in 1970 comprising 18 nations in Latin America, the Caribbean, and Europe, as well as 14 private banks from the Andean region. The organization promotes a model of sustainable development through credit operations, grants, and technical support and offers financial structuring to public and private sector projects in Latin America. Based in Caracas, Venezuela, CAF has

offices in Buenos Aires, La Paz, Brasilia, Bogota, Quito, Madrid, Panama City, Lima, and Montevideo.

g). European Investment Bank (EIB)

The EIB is the EU Bank. Its shareholders are the 27 member states of the Union, which have jointly subscribed its capital. The EIB furthers the objectives of the EU by making long-term finance available for sound investment. In Latin America, EIB can support viable public and private sector projects in infrastructure, industry, agro-industry, mining, and services. Special emphasis is given to projects that contribute to environmental sustainability (including climate change mitigation) and to the security of the EU energy supply. The EIB is authorized to lend up to €2.8 billion in the region.

h). Financieringsmaatschappij voor Ontwikkelingslanden (FMO)

FMO, the Dutch development bank, supports sustainable private sector growth in developing and emerging markets by investing in ambitious companies. In March 2008, FMO achieved bank status; the bank is officially under the supervision of the Dutch Central Bank. As of December 2009, FMO was present as a development finance partner in more than 80 different developing countries and emerging markets. As of December 2011, the total asset valuation of the bank was €5.06 billion.

i). Finnfund (Finnish Fund for Industrial Development Cooperation)

Finnfund is a Finnish development finance company that provides long-term risk capital for private projects in developing countries. Apart from co-investing with Finnish companies, Finnfund can finance ventures that use Finnish technology, cooperate with Finnish partners on a long-term basis, or generate major environmental or social benefits. It has assets of approximately €300 million.

j). Fondo de Fondos (FdeF)

Fund of Funds is a specialized institution that invests in PE and VC funds. The funds promote medium- and long-term productive investment in Mexico, on behalf of SMEs. FdeF is a strategic partner in SME development and competiveness via investments made in PE and VC investment funds, both national and international.

k). Inter-American Development Bank (IADB)/ Multilateral Investment Fund (FOMIN)

Established in 1959, the IADB is a multilateral finance institution that supports the efforts of Latin America and Caribbean countries to reduce poverty and inequality. The IADB is the largest source of development financing in the region and has 48 member countries, including 26 Latin American and Caribbean borrowing members. It serves national, provincial, and municipal governments, as well as nongovernmental organizations and private sector companies primarily through loans, grants, and TA. The IADB's funding is primarily raised through borrowings from international capital markets and through contributions from its member countries. Historically, the most active investor in MSMEs in Latin America by far has been FOMIN, which is a division of the IADB with more than $2 billion at its disposal. Since FOMIN was established in 1996, it has invested in 66 seed and VC funds.

l). International Finance Corporation (IFC)

IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector in developing countries. Established in 1956, IFC is owned by 184 member countries.

m). Italian Development Corporation

The Development Cooperation, an integral part of Italy's foreign policy, stands on two priority pillars. The first is represented by the need for solidarity in ensuring all the inhabitants of the planet protection of their lives and human dignity. The second sees in cooperation a method for establishing, improving, and strengthening relations among the world's various and diverse nations and communities. This exchange among equals, in addition to increasing that mutual understanding necessary for identifying the real needs

of the local communities on the receiving end, fosters relations aimed at economic, as well as social and human, growth, respectful of the environment and the various cultures and capable of safeguarding common assets such as water, food, and energy, so as to ensure the growth and well-being of populations and the pursuit of peace among peoples. Italian development cooperation policy offers to pursue these objectives along with economic, cultural, and security diplomacy, strengthening Italy's role and image around the world.

n). KfW/DEG

Owned by the German government and established in 1948, KfW finances sustainable investments in Germany and Europe and developing and transformation countries by supporting and applying a broad array of financial instruments. KfW is one of the world's leading financial institutions in supporting environmental, climate, and biodiversity projects. DEG, a subsidiary of KfW, has been financing private sector investments in developing countries since 1962. By promoting private sector development, DEG contributes to the creation of jobs and income and to better living conditions in the partner countries.

o). Norwegian Investment Fund for Developing Countries (Norfund)

Norfund is an investment company intended to develop and establish profitable and sustainable enterprises in poor countries. The objective is to promote business development and contribute to economic growth and poverty alleviation. Norfund's investments are divided into four investment areas: financial institutions, SME funds, renewable energy, and industrial partnerships. The organization currently has 47 employees distributed between the main office in Oslo and regional offices in Bangkok, Johannesburg, Nairobi, and San José (Costa Rica). As of mid-2011Norfund had a committed portfolio of about $1.4 billion. Norfund's main regions of activity are eastern and southern Africa. In addition, Norfund invests in Central America and selected countries in Southeast Asia (Bangladesh, Cambodia, Laos, and Vietnam).

p). Overseas Private Investment Corporation (OPIC)

OPIC mobilizes private capital to help solve critical development challenges and in doing so advances U.S. foreign policy. Because OPIC works with the U.S. private sector, it helps U.S. businesses gain footholds in emerging markets, catalyzing revenues, jobs, and growth opportunities both at home and abroad. OPIC achieves its mission by providing investors with financing, guarantees, political risk insurance, and support for PE investment funds. As a DFI, OPIC makes investments that other private investors would not make, paving the way for other private sector capital to successfully enter emerging markets. OPIC's instruments are also more flexible than those of traditional investors, with loan tenors up to 20 years and transaction sizes ranging from $100,000 to $250 million. Since 1971, OPIC has supported $188 billion of investment across nearly 4,000 projects in developing countries.

q). Swedfund

Swedfund provides risk capital, expertise, and financial support for investments in the emerging markets of Africa, Asia, Latin America, and Eastern Europe. It has assets of approximately $300 million.

r). Swiss Investment Fund for Emerging Markets (SIFEM)

SIFEM is the Swiss Development Finance Institution. It provides long-term finance to PE funds and financial institutions in emerging markets. SIFEM's primary focus is on institutions investing in the SME sector. On a selective basis, SIFEM also invests in microfinance. SIFEM's investment philosophy is guided by the belief that by investing in commercially viable emerging market SMEs can provide investors with risk-adjusted returns, as well as generate sustainable, long-term development effects in local communities. SIFEM is fully owned by the Swiss Confederation and managed by Obviam, a privately owned management advisory group.

s). U.S. Agency for International Development (USAID)

USAID is an independent agency that provides economic, development, and humanitarian assistance around the world in support of the foreign policy goals of the United States.

2. Foundations

a). Bill & Melinda Gates Foundation

Guided by the belief that every life has equal value, the Bill & Melinda Gates Foundation works to help all people lead healthy, productive lives. In developing countries, it focuses on improving people's health and giving them the chance to lift themselves out of hunger and extreme poverty. In the United States, it seeks to ensure that all people—especially those with the fewest resources—have access to the opportunities they need to succeed in school and life. It is based in Seattle, Washington, and has awarded grants exceeding $26 billion since 1994.

b). Conservation International (CI)

Building upon a strong foundation of science, partnership and field demonstration, CI empowers societies to responsibly and sustainably care for nature, our global biodiversity, for the long-term well-being of people. Founded in 1987, CI has headquarters in the Washington, DC, area and 900 employees working in nearly 25 countries on four continents, plus more than 1,000 partners around the world.

c). Elma Foundation

The ELMA Foundation's mission is to improve the lives of Africa's children and youth through the support of sustainable efforts to relieve poverty, advance education, and promote health.

d). Gatsby Charitable Foundation

The Gatsby Charitable Foundation, endowed by Lord David Sainsbury in the United Kingdom, has more than 40 years of grant-making history. Gatsby has funded programs in Africa since the mid-1980s with the aim of stimulating economic growth. The foundation's work is focused on promoting economic development that benefits the poor through support to key sectors and markets in East Africa

e). Gordon and Betty Moore Foundation (GBMF)

GBMF seeks to advance environmental conservation and scientific research around the world and improve the quality of life in the San Francisco Bay Area. The foundation is dedicated to advancing environmental conservation and scientific research around the world.

f). Omidyar Network

The Omidyar Network is a philanthropic investment firm dedicated to harnessing the power of markets to create opportunity for people to improve their lives. It invests in and helps scale innovative organizations to catalyze economic and social change. The network has committed approximately $500 million since its inception

g). Rockefeller Foundation

The Rockefeller Foundation supports work that expands opportunity and strengthens resilience to social, economic, health, and environmental challenges to promote the well-being of humanity. The foundation has assets in excess of $3.5 billion.

h). Soros Economic Development Fund (SEDF)

SEDF supports economic development in postconflict countries and in nations transitioning to democracy. The fund promotes economic opportunities and access to information, products, and services for underserved populations. It invests in sustainable businesses or initiatives that strive to alleviate poverty by creating jobs and revitalizing deteriorating communities. SEDF is a nonprofit private foundation that is part of the Open Society Foundations, a network of charitable foundations created by investor and philanthropist George Soros. Established in 1997, SEDF has more than $200 million in investment capital.

3. Corporate-Related Institutions

a). Accion International

Accion International is a microfinance and microlending organization, giving people the financial tools they need to work their way out of poverty. Accion has more than $200 million of impact investment capital and seeks to support microfinance institutions sustainably while building a financial market that will radically enhance the efficiency, reach, and scope of financial services at the base of the economic pyramid.

b). ASN Bank

ASN Bank is a Dutch bank, part of SNS Reaal. ASN focuses on social responsible and sustainable investments. ASN Bank is currently the largest sustainability-driven bank in the Netherlands.

c). JPMorgan/J. P. Morgan Social Finance

JPMorgan Chase & Co. is a global financial services firm with assets of $2 trillion. J. P. Morgan Social Finance was launched in 2007 to service the growing market for impact investments, meaning those investments intended to generate positive impact alongside financial return. Recognition is growing that innovative business models can complement limited public sector and philanthropic resources by delivering market-based solutions to low-income and excluded communities in a sustainable and scalable way. The Social Finance business is dedicated to servicing and growing this nascent market through principal investment, thought leadership, and client advisory.

d). Triodos-Doen Foundation

Triodos-Doen was founded by Triodos Bank and the DOEN Foundation in 1994. Triodos-Doen's vision is to develop microfinance into a full-fledged and integral part of the financial sector in developing countries. The creation of an inclusive financial sector, a sector where the majority of people have access to financial services, will provide a sustainable basis for balanced socioeconomic development. Triodos Bank is a bank based in the Netherlands with branches in Belgium, Germany, Spain, and the United Kingdom. It is a pioneer in ethical banking. Triodos Bank finances companies that it thinks add cultural value and benefit to people and the environment.