



THE MISSING MIDDLES

Segmenting Enterprises to Better Understand Their Financial Needs



COMMISSIONED ON BEHALF OF:

Collaborative for Frontier Finance (Omidyar Network / Dutch Good Growth Fund [DGGF])

AUTHORED BY:

Kusi Hornberger and Veronica Chau with support from Robert Colvin and Mackenzie Welch from Dalberg Advisors as well as Priti Rao, Michael Mori, Sanjukta Das, and Nishita Kavadia from Dalberg Design which led the human-centered design research in India

COORDINATED BY:

- **Chris Jurgens** [Omidyar Network, Director – Impact Investing]
- **Julia Kho** [Dutch Good Growth Fund, Knowledge Manager]
- **McKenzie Smith** [Omidyar Network, Program Manager – Impact Investing]
- **Marnix Mulder** [Triple Jump, Director – Market Development]

EXPERT ADVISORS

- **Peter Tropper** – Managing Partner, Peter Tropper LLC, Formerly: Chief Investment Officer in International Finance Corporation's Private Equity Group
- **Michael Barth** – Managing Partner, Barth & Associates LLC, Formerly: Chief Executive Officer of Dutch Development Bank (FMO), Director, International Finance Corporation (IFC) Capital Markets, Managing Director, Darby Overseas Investments Ltd

ACKNOWLEDGEMENTS

We wish to thank the many people who contributed to this report. A special thanks goes to the Technical Advisory Group who served as a source of feedback and guidance on this study. Representatives from investors and financial intermediaries, field-building organizations, and donors and LPs who were interviewed for this project include: Alberto Gomez-Obregon and Kate Montgomery (Acumen Fund); Genevieve Edens and Randall Kempner (ANDE); Nicholas Colloff and Harry Devonshire (Argidius Foundation); Stephanie Kimber and Matt Steine (Australian Department of Foreign Affairs and Trade); Brian Trelstad and Olivia Prentice (Bridges Fund Management/Impact Management Project); Mark Paper (Business Partners International); Alice Gugelev and Erika Boll (Global Development Incubator); Akbar Khan (IntelleGrow); Matt Gamser, Wendy Teleki, Shruti Chandrasekhar, and Dipta Shah (International Finance Corporation); David Munnich and Elodie Nocquet (Investisseurs et Partenaires); Carol Dahl, Philip Varnum, and Rob Schneider (Lemelson Foundation); Michael McCreless (Root Capital); Sam Parker (Shell Foundation); Sally Walkerman and Anna Brosnan (Small Foundation); Natasha Suchecki (UCT Bertha Centre); Liz Chacko (USAID); and Dustin Shay, Rachel Crawford, and Allie Burns (Village Capital).

Additional thanks to all of the many organizations that participated in our stakeholder interviews, including: Tahira Dosani (Accion Venture Lab); Alejandra Revueltas (Adobe Capital); Ben Powell (Agora); Daniel Buchbinder (Alternia); Ritu Verma (Ankur Capital); Thomas Hyland (Aspada); Lauren Cochran (Blue Haven Initiative); Songbae Lee (Calvert Impact Capital); Dan Kranzler (Capria); Harry Davies (Ceniarth); Jake Cusack and Matt Tilleard (Cross Boundary); Min Pease (Echoing Green); Richard Rose (Edge Growth); Francois Ritchot (Enclude); Paola Ravacchioli (European Investment Bank); Jorrit Dingemans and Jeroen Harteveld (FMO); Rakesh Apte and Jocelyn Cheng (Global Innovation Fund); Jim Villanueva, Karishma Menon, and Aaron Nasurutia (Global Partnerships' Social Venture Fund); Jaime Ramirez (Grassroots Business Fund); Guido Boysen (GroFin); Praveen Trivedi (ICICI Bank); Jaime Garcia Alba (Inter-American Development Bank); Roeland Donckers (iungo capital); Caleb Dagenhart (Kabbage); Ahmed Moor and David Asker (Liwwa); Chris Walker (Mercy Corps' Social Venture Fund); Nicole Etchart (NESsT); Michael Grossman (New Island Capital); Annie Roberts (Open Capital Advisors); James Mitchell (Orkidstudio); Dia Martin (Overseas Private Investment Corporation); Amy Wang (PG Investments); Jorge Castillo (Pyme Capital); Ahmed El Alfi (Sawari Ventures); Philip Myburgh (Standard Bank); and Chris West (Sumerian Partners)

With special thanks to our contributing data partners:



Table of Contents

EXECUTIVE SUMMARY	4
1. INTRODUCTION	11
2. APPROACH	14
2.1 Scope and definitions	14
2.2 Methodology	15
3. KEY FINDINGS	20
3.1 Three lenses	22
3.2 The four “families” of SGBs	27
High-growth Ventures	28
Niche Ventures	36
Dynamic Enterprises	42
Livelihood-sustaining Enterprises	50
3.3 Summary of the segment families	56
4. CONCLUSION	57
Annex 1: Summary of demand-side literature review	62
Annex 2: Summary of supply-side literature review	64
Annex 3: Summary of portfolio data analysis output	66
Annex 4: Summary of human-centered design behavioral research	71
Annex 5: Bibliography and stakeholders consulted	75

Executive Summary



Small and growing businesses (SGBs) have significant and positive impact on emerging and frontier markets. They create jobs, contribute to inclusive economic growth, provide access to essential goods and services to underserved populations, and spark innovative technologies and business models. These enterprises span a diverse range of sectors and business models—from rural agricultural cooperatives to innovation-driven startups to well established, multigenerational small family businesses in sectors like retail, trading, and manufacturing—and are managed by an equally diverse range of entrepreneurs.

SGBs seek external financing for a range of purposes—to support early stage growth, expand operations, finance working capital, and acquire new assets—but struggle to access forms of capital that meet their needs. According to the International Finance Corporation (IFC), small and medium enterprises in low- and lower-middle-income countries face a \$930 billion financing gap.¹ Accessing financing is particularly challenging for certain types of SGBs, such as early stage ventures and businesses with moderate growth prospects, that are stuck squarely in the “missing middle” of enterprise finance: They are too big for microfinance, too small or risky for traditional bank lending, and lack the growth, return, and exit potential sought by venture capitalists.

This report proposes a new segmentation framework to help financial service providers, enterprises, donors, limited partners (LPs), and field-building organizations² understand and navigate the complex landscape of SGB investment in frontier and emerging markets. We focus on

The Collaborative for Frontier Finance (CFF) is a group of fund managers, funders, and field-building organizations committed to increasing the amount of appropriate capital available for small and growing businesses in frontier and emerging markets. To this end, CFF 1) designs and accelerates promising, scalable models that address SGB financing needs; 2) defines an action agenda and common vision to increase appropriate capital for SGBs; and, 3) connects, pools, and facilitates the flow of capital to SGBs and the intermediaries that support their growth. Omidyar Network and Dutch Good Growth fund have partnered with CFF to sponsor this report as a first step toward realizing this broader vision.

¹ Based on the Collaborative for Frontier Finance's analysis of the “MSME Finance Gap” (IFC 2017). This analysis focuses on the credit gap only in lower- and lower-middle-income countries and excludes microenterprises. We believe this is a good proxy for SGBs in emerging markets as the SMEs in those markets share many characteristics with SGBs.

² Donors / LPs consist primarily of the owners of financial assets that fund or invest in financial service providers; examples can include development finance institutions, foundations, bilateral donors, and individuals. Field-building organizations, such as networks, research organizations, academic institutions, or training institutes produce research and thought leadership, convene stakeholders, promote peer learning, develop training curricula, and otherwise have a positive effect on the broader frontier and emerging market investment space.

enterprises³ with five to 250 employees and financing needs ranging from \$20,000 to \$2 million. These enterprises must be operated by opportunity-driven (as opposed to necessity-driven) entrepreneurs, be commercially viable, have some potential for growth, and employ non-family members. We include both impact-oriented and traditional, “bread-and-butter” enterprises within the scope of this study. We do not include enterprises that are informal or are unlikely to embark on a path of formalization, due to their limited growth prospects and the major difficulties financial service providers face in serving them. However, we do include high-performance microenterprises and startups that are on the path to formalization and growth.

THE SGB FINANCING GAP HAS MULTIPLE CAUSES

A primary cause for the financing gap is that SGBs are inherently hard to serve. Financial service providers often have difficulty assessing the risk-return profile of enterprises in this space due to the companies’ lack of track records, their inconsistent or weak financial performance, and a general lack of information about their operations and management. Even when risks are well understood, cost relative to investment return (i.e., high transaction costs and small ticket sizes) may prevent traditional financial service providers from seeing a strong business case for serving these segments of the market.

Another factor contributing to the financing gap is the lack of an effective, widely adopted segmentation approach that can be applied to a highly heterogeneous population of SGBs. More nuanced segmentation would allow for better and more meaningful differentiation among enterprises and their financing needs. The lack of such an approach instead contributes to confusion in the market and misaligned expectations around risk, financial returns, exit prospects, and impact potential for SGBs.

A NEW WAY OF UNDERSTANDING THE MARKET FOR SMALL AND GROWING BUSINESS FINANCING

The segmentation framework presented in this report offers a new way to understand the financing needs of SGBs in frontier and emerging markets. In contrast to previous segmentation efforts that have focused on a subsegment of SGBs (e.g., social enterprises serving low-income populations, or enterprises in a particular market or sector), this framework covers full universe of impact- and traditionally oriented enterprises that have strong prospects for growth and job creation. Moreover, it segments these enterprises using a mix of quantitative and qualitative characteristics that cut across both observable enterprise attributes and behavioral traits of entrepreneurs.

The segmentation framework we propose uniquely integrates a number of approaches often used independently, but rarely in concert with each other. Our methodology combined *perspectives from leading SGB investors* on how they segment the market; analysis of enterprise-level *quantitative data* from multiple SGB investors; and *behavioral analysis of entrepreneurs* using human-centered design techniques.

We believe the common language and SGB terminology we propose can meaningfully contribute to a more efficient financing market that better matches enterprises to the financial service providers that can help them. The hope is that this effort will support wider efforts to unlock greater amounts of appropriate capital for SGBs.

DEFINING THE FOUR FAMILIES OF SGBS

Our research identifies four relatively broad SGB “families” that occupy the missing middle, differentiated according to several variables that impact their financing needs as well as their attitudes to external finance. Each of these enterprise families tends to play a distinct role in driving inclusive economic growth and job creation in emerging and frontier economies. Each family also faces different gaps or mismatches in the market between available investment options and the solutions that are best suited to enterprise needs.

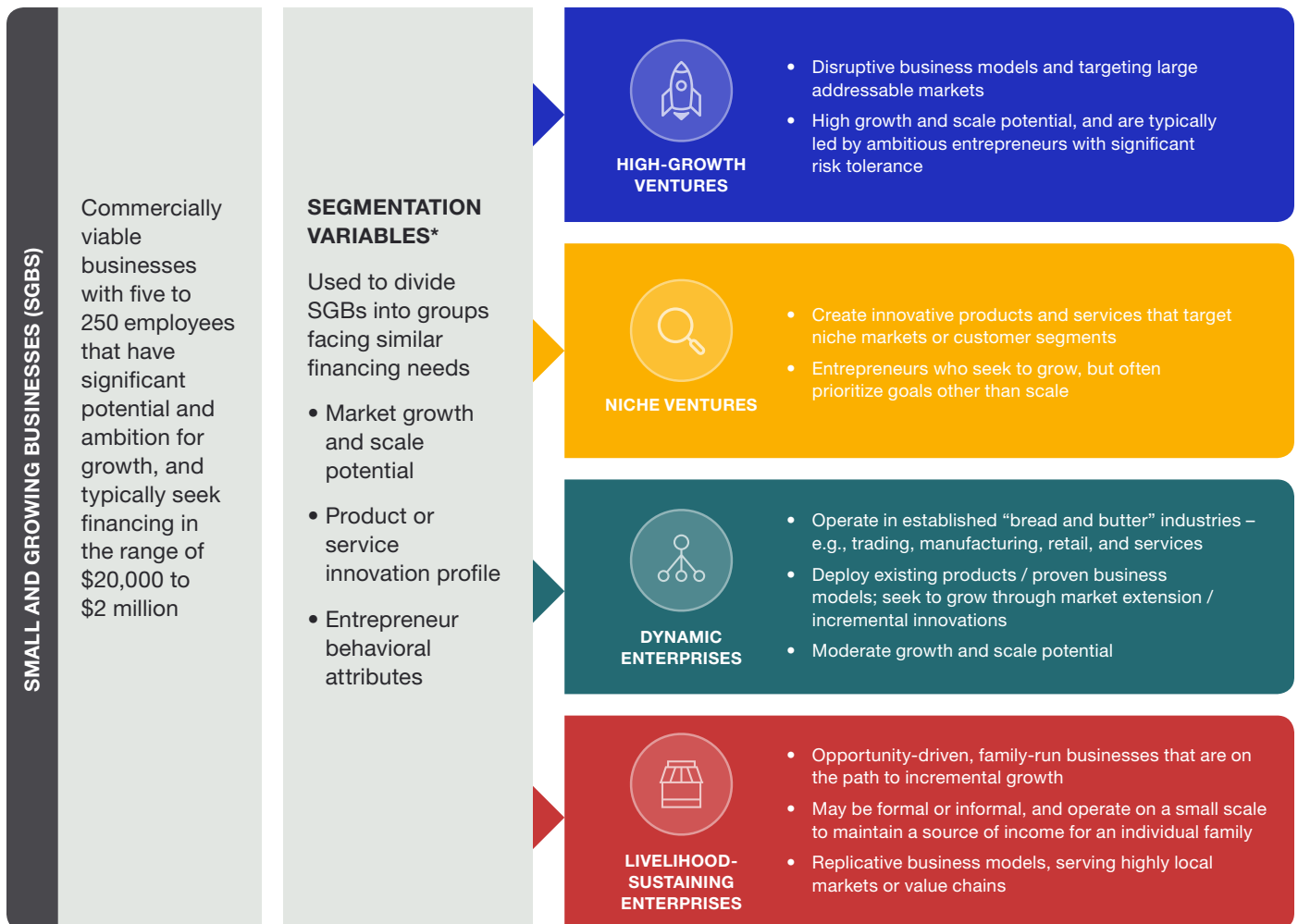
³ We use “SGBs” or “enterprises” as shorthand terms to refer to both small and growing businesses (SGBs), as coined by ANDE, and formal or formalizing small- and medium-sized enterprises (SMEs) that have financing needs between \$20,000 and \$2 million.

These four families come into focus when we look at the universe of SGBs through three distinct variables:

1. **Growth and scale potential:** An enterprise's prospects for future growth, potential to reach significant scale, and the pace/trajectory of growth
2. **Product/service innovation profile:** The degree to which an enterprise is seeking to innovate in its core product or service offering or to disrupt the market in which it operates
3. **Entrepreneur behavioral profile:** Attitudes of the entrepreneur with respect to key dimensions that impact decisions on external finance—notably, risk tolerance, impact motivation, and growth ambition

The four families that form the top-level division of our segmentation framework are **High-growth Ventures, Niche Ventures, Dynamic Enterprises, and Livelihood-sustaining Enterprises.**

Figure 1: Enterprise segmentation framework: four families of small and growing businesses



(*) Variables identified, prioritized, and validated through stakeholder interviews with ~80 SGB-focused investors operating in frontier markets



High-growth Ventures are SGBs that pursue disruptive business models and target large addressable markets. These enterprises have high growth and scale potential and tend to feature the strong leadership and talent needed to manage a scalable business that pioneers completely new products, services, and business models.

Often led by ambitious entrepreneurs with significant risk tolerance and a desire to achieve outsized impact, these firms begin as startups and due to their rapid growth, soon “graduate” from SGB status to become larger firms. High-growth Ventures innovate by leveraging digital technology (e.g., social media platforms, mobile money transfer, etc.) but also by creating new hardware-based products and pursuing business model innovations (e.g., off-grid solar, cookstoves, or medical diagnostic equipment, etc.).⁴ Due to their steep growth trajectory, High-growth Ventures typically have significant need for external financing. While SGBs make up a small percentage of an economy, High-growth Ventures have outsized impact in driving innovation, spurring productivity, and creating new jobs.

Archetypes⁵ of High-growth Ventures include high-tech ventures (i.e., asset-light startups that are often software-based or digital and have favorable economies of scale); innovative businesses in established industries with “disruptive” potential (they may be tech-enabled but have a significant physical product or asset-intensive, brick-and-mortar component); and impact-focused companies that are pioneering new markets (e.g., serving the base of the pyramid) with the intent to achieve impact at scale.

An example of a High-growth Venture is Freight Tiger, a logistics tech company based in Mumbai that seeks to transform India’s large transportation and freight industry through software that improves the end-to-end supply chain. The company has secured multiple rounds of equity investment from top-tier venture capital firms in India.



Niche Ventures also create innovative products and services, but they target niche markets or customer segments. They seek to grow but often prioritize goals other than massive scale—such as solving a specific social or environmental problem, serving a specific customer segment or local community, or maintaining a product/service that is particularly unique or bespoke. Example archetypes of such businesses are creative economy enterprises that specifically focus on adding unique artistic value in niche markets and locally focused social enterprises dedicated to having deep social impact at a local level.

Vega Coffee is a Niche Venture social enterprise in Nicaragua that sells roasted coffee beans, sourced from smallholder farmers, directly to customers in the United States. A Kickstarter campaign helped the company achieve growth by providing initial seed funding to conduct pilot tests of its model. The size and saturation of the mail-order specialty / fair trade segment within the coffee market will limit Vega’s model, but the company is well positioned to continue its steady growth and increase the incomes of its smallholder partners.



Dynamic Enterprises, the third enterprise family, operate in established “bread and butter”⁶ industries—such as trading, manufacturing, retail, and services—and deploy proven business models. Many are well established and medium-sized, having steadily expanded over a number of years. They seek to grow by increasing market share, reaching new customers and markets, and making incremental innovations and efficiency improvements—but their rate of growth is typically moderate and tempered by the dynamics of mature, competitive industries. Multi-generational family businesses are a common archetype of this segment, and entrepreneurs’ behaviors are often influenced by the family members’ attitudes toward growth, risk, and innovation. Dynamic Enterprises are often the backbone of local economies and are important sources of jobs for low- and moderate-skilled workers.

⁴ *Hardware Pioneers: Harnessing the Impact Potential of Technology Entrepreneurs*, Lemelson Foundation/FSG (2016).

⁵ Archetypes are distinct from sub-segments discussed later in the report. They represent commonly seen types of business frequently identified by investors interviewed as inhabiting the SGB segment families. A sub-segment, in contrast, is defined based on the additional financing needs segmentation variables most relevant for each SGB family. For example, we sub-segment High-growth Ventures based on stage of development, as discussed below.

⁶ “Bread and butter” meaning essential industries that provide the basic necessities of life and form the backbone of business activity in developing markets.

Dynamic Enterprise archetypes include local manufacturers with a strong local presence but limited reach into larger markets, or established agricultural cooperatives that have export contracts with international buyers, or family-run restaurants with multiple chain outlets across a local or regional market.

For example, La Laiterie du Berger is a Dynamic Enterprise that manufactures dairy products from fresh milk collected from over 800 farmers in northern Senegal. The company has seen steady growth since 2005 when it started and supports the growth of the local dairy sector by collecting milk locally and providing producers with access to high-quality cattle feed, technical assistance, and credit to ~6,000 small dairy farmers.



Finally, **Livelihood-sustaining Enterprises** are small businesses selling traditional products and services. These businesses may be either formal or ready to formalize; they tend to operate on a small scale to serve local markets or value chains, often in sectors such as retail and services, and deploy well-established business models. Such businesses often start out as “mom and pop” shops at microenterprise scale, but subsequently grow incrementally to hire additional employees. Enterprises in this family are particularly important for sustaining livelihoods in rural and vulnerable populations. Their needs for external finance are small in scale, but many Livelihood-sustaining Enterprises can benefit from products that enable them to manage working capital.

Multigenerational small family businesses are a common archetype of Livelihood-sustaining Enterprises. These businesses have steady but modest upward growth and a few core employees outside of the immediate family. A second archetype is a microenterprise that grows to hire employees beyond immediate family members, moves from informality to increasing formality, and seeks out capital beyond the scale of what most microfinance institutions can provide.

An example is Prime Auto Care Garage, a small, woman-owned business based in Kigali, Rwanda that provides motor vehicle repair services. It has been in operation since 2001, has 27 employees, and received a loan from Business Partners International for additional garage equipment to help it grow.

Each SGB family has distinct financing needs, and faces gaps in being able to access financing that meets their needs over the course of their growth and evolution.

FINANCING NEEDS AND MARKET GAPS

Each enterprise family has distinct financing needs, and faces gaps in being able to access financing that meets their needs over the course of their growth and evolution. Figure 2 on page 10 highlights these financing gaps for each SGB family, as well as areas of progress in advancing promising financing solutions to address these gaps.

For **High-growth Ventures** that are tech-based and that otherwise have clear pathways to scale and exit prospects, traditional venture capital and private equity—complemented by venture debt where appropriate—provide the needed risk capital and growth finance. In frontier markets where venture capital and private equity are underdeveloped, there is important work to be done to build out such sources of finance.

However, there is a mismatch in applying traditional venture capital expectations to enterprises whose growth trajectories and pathways to scale are fundamentally different from software-based tech companies. This includes many “hardware-based” and asset-heavy businesses, as well as innovative impact enterprises that are pioneering new business models in frontier markets.

To meet the needs and unlock the potential of High-growth Ventures that are not a fit for tech-oriented VC financing, several shifts must take place. First, we need to see greater use of financing structures that allow for longer-time horizons to realize profitability, scale, and exits—such as a shift from closed-ended funds to permanent capital, evergreen structures, or fund structures with lower management fees, higher carried interest, and longer time horizons for exits. Second, in some cases, there is a need for greater sums of flexible capital to help pioneering ventures bridge the “pioneer

gap.” Third, we need to see a larger and more diverse range of follow-on investors who can buy out initial investors after initial seed or Series A funding and help clean up the cap table of companies that are reaching larger scale.

We are seeing a range of promising developments in alternative financing vehicles and instruments for High-growth Ventures beyond traditional VC funds using straight equity. For example, High-growth Ventures are beginning to benefit from the rise of new fund structures serving seed and early stage enterprises in frontier and emerging markets, such as Mercy Corps’ Social Venture Fund and Global Partnerships’ Social Venture Fund.

Niche Ventures, like High-growth Ventures, often need modest amounts of startup capital to test their innovations and get their businesses off the ground, but are unlikely to generate the scale and returns that would yield a profitable exit for a venture capitalist—and in many cases the entrepreneurs behind these businesses have no desire to exit, given the business is often closely tied to their identity and community.

Such enterprises need an alternative to venture capital to support their early growth. In countries with well-developed financial sectors and robust entrepreneurial ecosystems, Niche Ventures often turn to friends and family, angel investors, local enterprise accelerators, and newer sources like equity crowdfunding. In many emerging markets, such sources are rare, and enterprises have often turned to international impact investors or to donor-funded and business plan competitions. Such sources of capital fill a critical gap, but are limited in how far they can reach. The more promising solution is to cultivate robust local ecosystems and local investors—such as local angel investors and locally managed seed-stage funds—that can help niche entrepreneurs launch startups and grow.

Dynamic Enterprises face a critical mismatch between what they can offer and what most financial service providers seek on the risk-return continuum. Dynamic Enterprises are considered too small and risky for commercial banks, too large for microfinance, and not sufficiently scalable or profitable for venture capitalists. At the same time, there is a clear shortage of specialized local market financial intermediaries or fund managers who are taking on the challenge of building the appropriate financial tools and product offerings that fit the needs of enterprises in this family. While some specialized local financial intermediaries including non-banking financial institutions (NBFIs⁷) are emerging, they are still few and small in scale. As a result, this segment remains significantly underserved.





Dynamic Enterprises need more flexible debt providers, additional mezzanine-focused fund managers in local markets, and new ways to lower transaction costs. A promising development for Dynamic Enterprises is the growing uptake of models that pair mezzanine financing products with technical assistance, as provided by financial intermediaries such as Business Partners International and iungo capital. In addition, new data- and technology-driven solutions are enabling SGB-focused lenders to serve Dynamic Enterprises more efficiently by enabling more efficient risk assessment and underwriting.

Livelihood-sustaining Enterprises face a critical mismatch between their financial needs and financial service providers’ transaction costs to serve them. Their expected risk-return profile is not attractive to most traditional commercial banks or NBFIs and the cost to serve these enterprises is too high for fund structures, leaving these enterprises with constrained access to capital and unfavorable terms (e.g., short tenure, low capital limits, high interest rates, etc.).

To fill this gap, more debt and nonfinancial support is needed, in addition to continued innovation. Technology, data, and machine learning solutions offer the potential to dramatically lower transaction costs, improve credit-risk scoring, and eventually allow this segment to be served at scale by both traditional credit and nonfinancial services. Innovations by tech-enabled financial service providers such as ZineOne, NeoGrowth, and Indifi, among others, have the potential to radically transform finance for Livelihood-sustaining Enterprises; the investor community should seek ways to scale up and learn from these models. Expanding the scale and effectiveness of NBFIs that serve this segment will be critical, as will be the bundling of financial and nonfinancial services.

7 Non-banking financial institutions.

Figure 2: Financing gaps and ideas for action

	KEY FINANCING GAPS AND RISK-RETURN MISMATCHES	IDEAS FOR ACTION
 HIGH-GROWTH VENTURES	“Time-horizon” mismatch – Applying “Silicon Valley” venture capital growth and timeline expectations to “asset-heavy” ventures	<ul style="list-style-type: none"> • Increase use of longer-term fund structures – structuring alternatives to the closed-end fund structures that allow flexibility for longer investment periods and exit time horizons • Increase use of alternative financing structures that allow for more flexible time horizons and exits – such as self-liquidating equity and revenue-based loan instruments such as demand dividends
 NICHE VENTURES	“Scale potential” mismatch – Applying venture capital scale expectations to businesses with smaller addressable markets to grow into	<ul style="list-style-type: none"> • Stimulate local sources of risk capital in frontier markets where venture investing remains limited • Increase use of innovative funding mechanisms such as recoverable grants and pay for success convertible notes
 DYNAMIC ENTERPRISES	“Financial intermediary” gap – Considered too risky for commercial banks; growth profile not aligned to venture capital expectations; and too small for most PE growth funds	<ul style="list-style-type: none"> • Increase commercial bank understanding of SGB market opportunities, support SGB tailored product development, and provide technical assistance on tailored financial instruments for different segment families • Expand and strengthen specialized financial intermediaries providing flexible debt and mezzanine financing instruments • Explore opportunities to use blended finance facilities to provide SGBs with pre- and post-investment technical assistance and other types of support
 LIVELIHOOD-SUSTAINING ENTERPRISES	“Transaction cost” gap – Transaction costs for very small ticket financing often exceed the income that financial service providers can obtain	<ul style="list-style-type: none"> • Expand digital financial services and data-driven tech solutions (e.g., for credit and risk assessment) that drive down cost to serve • Standardize products and procedures to achieve economies of scale and increase efficiencies, particularly for debt-like mezzanine fund managers • Improve unit economics through hiring talented local staff and providing training to new graduates for lower average salary costs

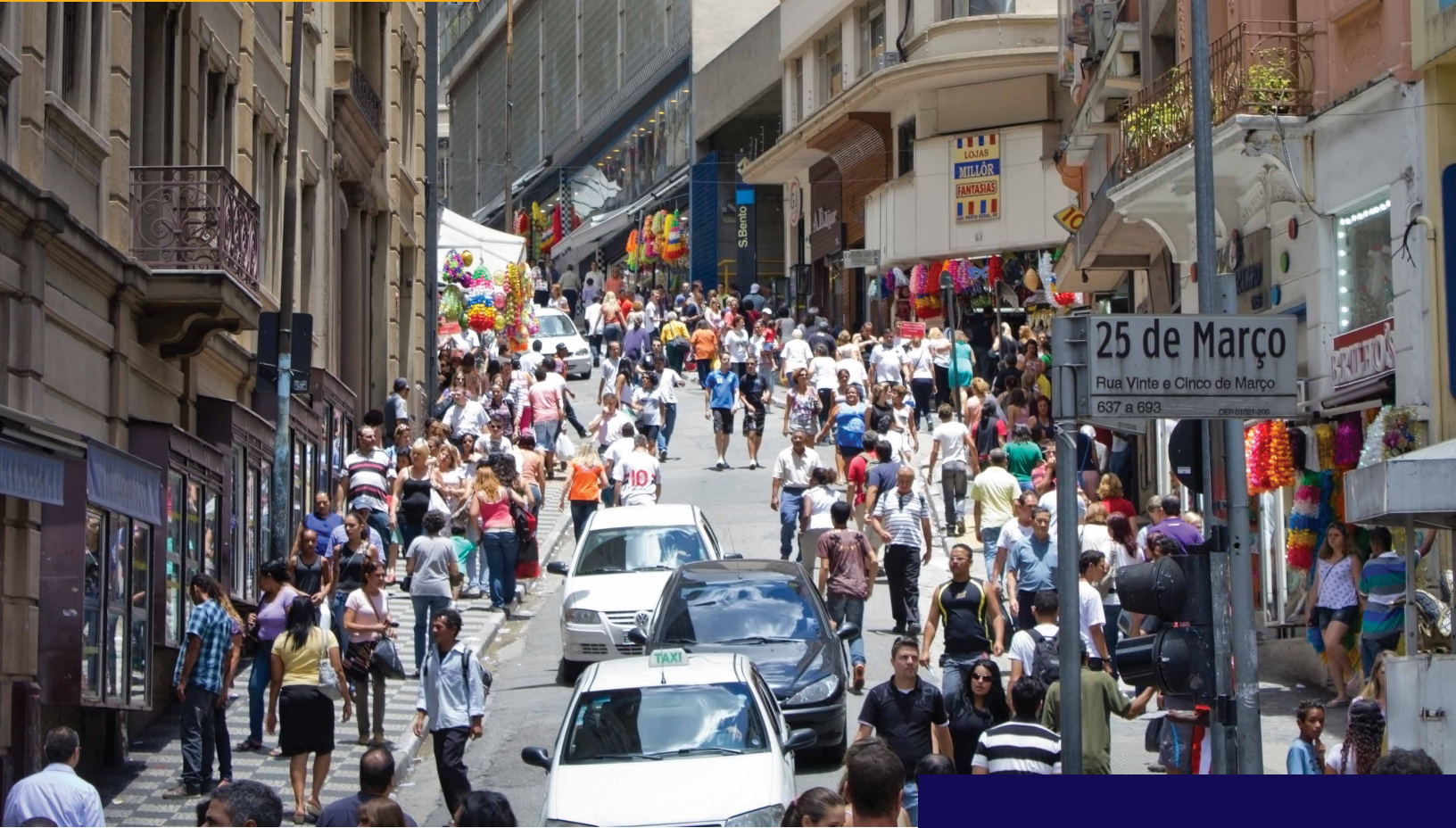
A ROADMAP FOR ACTION

This segmentation exercise helps reveal the tremendous diversity of SGBs, and the corresponding diversity of their financing needs. It also helps clarify what needs to be done in order to address the \$930 billion SGB financing gap. Each of the four enterprise families faces distinct financing shortfalls, but clear examples of promising solutions are being developed to address those gaps.

To unleash the potential of SGBs to drive inclusive economic growth, we need to continue to experiment, iterate, refine, and scale a wide variety of financing solutions. There is no silver bullet for scaling access to SGB finance. Rather, the solution lies in creating a diverse, robust ecosystem of SGB finance providers that can meet the needs of different families of SGBs at different stages of their growth journeys.

We hope this framework can be a starting point for future action by providing a roadmap for those who are addressing SGB financing gaps and by accelerating promising solutions in the sector. Indeed, *The Collaborative for Frontier Finance*, the multistakeholder alliance sponsoring this effort, is one such platform focused on bringing together stakeholders across the ecosystem to more effectively collaborate on SGB financing solutions.

1. Introduction

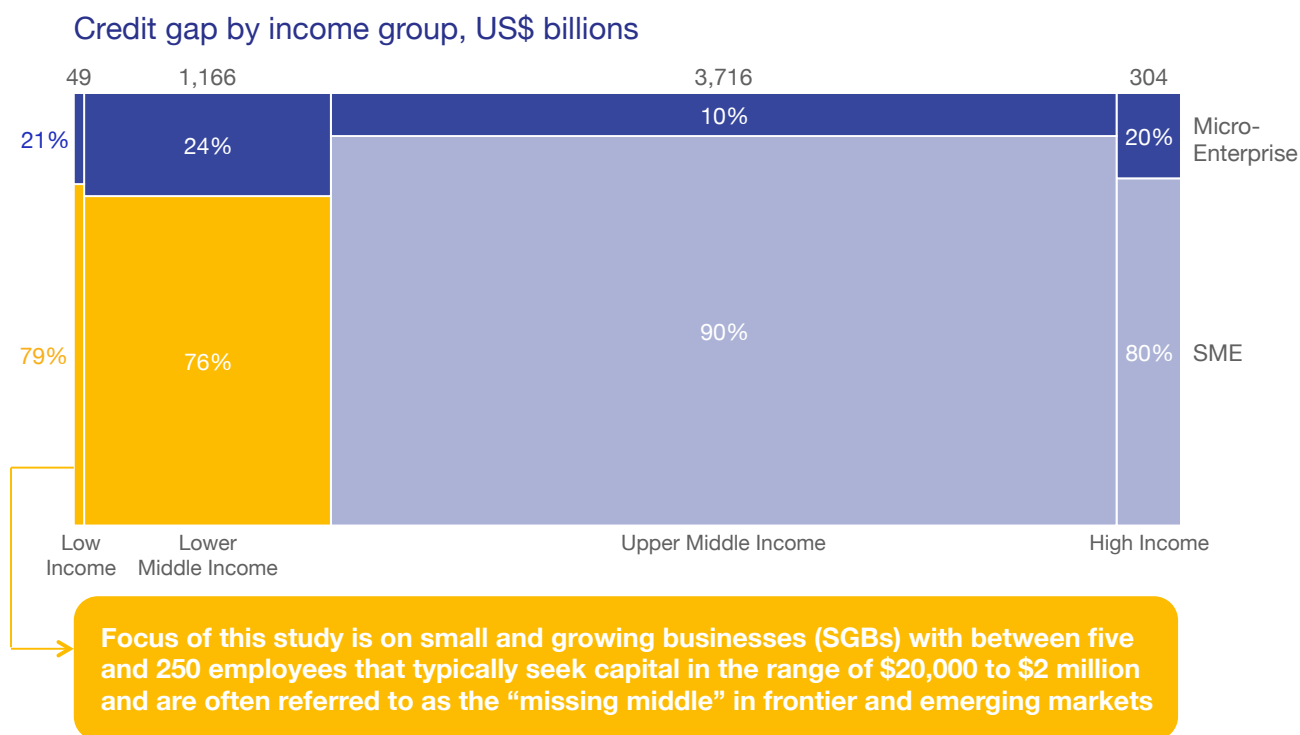


Small and Growing Businesses (SGBs) in emerging and frontier markets face a \$930 billion financing gap that fundamentally challenges their ability to grow and sustain their businesses. While many efforts are underway to close this gap, one persistent challenge has been the inconsistency with which stakeholders define this category of business.

Small and Growing Businesses (SGBs) in emerging and frontier markets face a \$930 billion financing gap that fundamentally challenges their ability to grow and sustain their businesses. While many efforts are underway to close this gap, one persistent challenge has been the inconsistency with which stakeholders define this category of business. The current definitions of SGBs and small and medium-sized businesses (SMEs) are based more on descriptive elements—e.g., number of employees, size, stage—than on the key drivers of their actual financing needs.⁸ Similarly, the definition of SME—even within the same country or market—can vary across financial service providers, investors, and regulators. Without a common language and understanding of what these terms mean, difficulties arise in advancing the conversations between financial service providers, enterprises, donors and LPs, and field-building organizations.

⁸ This terminology is further defined in Section 2.

Figure 3: Emerging markets SGB finance gap relative to the overall global MSME financing gap



- Notes: Microenterprises are defined as those with less than 10 employees and SMEs as those with 11-250 employees
- Source: IFC MSME Finance Gap Database (2017)

Beyond this challenge, financial service providers have divergent expectations related to risk, return, and impact. Traditional venture capitalists may apply standard venture capital growth models to enterprises with very different paths to maturity. Private equity and venture capital financiers usually prioritize investment exit, but in many developing and emerging market contexts, exit prospects are often limited. Traditional debt providers, meanwhile, are less concerned with returns or exit prospects than they are with the likelihood of loan repayment for businesses that lack collateralizable assets. These challenges can hinder the effective matching of appropriate financial service providers with clients and, more broadly, sow confusion about the frontier and emerging market investment space, inhibiting progress in closing the financing gap.

Largely separate conversations are taking place among impact investors and traditional financial service providers; more might be accomplished if these two worlds were brought together. The vast majority of the current literature on the field focuses separately on impact-oriented enterprises or more traditional, “bread-and-butter” businesses.⁹ This bifurcation between traditional SME finance players and impact investors limits the opportunity to unlock the full potential of commercial capital sources. A language that can more effectively appeal to and unite the two worlds has the potential to foster strategic collaboration toward addressing the financing gap.

With these challenges in mind, Omidyar Network, DGGF, the World Bank’s infoDev, and the Global Development Incubator (GDI) formed the Collaborative for Frontier Finance (CFF) with the aim of building a sustainable, diverse, and robust financing ecosystem for small and growing businesses in frontier and emerging markets. CFF is a group of fund managers, funders, and field-builders committed to increasing access to appropriate capital for SGBs by scaling relevant financing solutions and supporting enabling interventions. This report has been developed in partnership with CFF and a broad range of partner organizations, with the goal of helping to build a collective understanding around SGB financing in emerging and frontier markets. It is meant to help organize and clarify a complex, heterogeneous space, so that a range of stakeholders can better operate within it, and to serve as a starting point for those wishing to:

⁹ “Bread and butter” meaning essential industries that provide the basic necessities of life.

- Build a common vocabulary around small and growing-stage enterprises across the SGB and impact investing sectors to improve sector-wide communication and collaboration
- Create a foundation for building better data to inform expectations on risk, return, and impact for the segments of SGBs and to help target appropriate investment instruments as well as subsidized concessional finance
- Improve mapping of how a range of financial service providers and financial instruments can meet the varying needs of different SGB segment families
- Identify the greatest capital gaps within the SGB finance space in specific sectoral or geographical contexts
- Create a better functioning market and ecosystem by generating more efficient matching between enterprises and financial service providers

This report also has specific benefits for financial service providers, enterprises, donors and LPs, and field-building organizations. For financial service providers, we hope the report provides better language and descriptions of the segments of businesses that you are targeting as an investor. Moreover, we hope this report provides a strategic framework that investors (and others) can use to begin focusing on the enterprise families that have the greatest needs for financing beyond traditional structures. Similarly, we hope this report will help enterprises better target appropriate investors and better understand the range of SGB financing solutions that exist. For donors and LPs, we hope this report will provide a strategic framework to use in channeling assistance, resources, and funding.

This report also has specific benefits for financial service providers, enterprises, donors and LPs, and field-building organizations. For financial service providers, we hope the report provides better language and descriptions of the segments of businesses that you are targeting as an investor.





2. Approach

This report focuses on SGBs and formal (or formalizing) SMEs, which we broadly term “enterprises,” whose financing needs range from \$20,000 to \$2 million. We include both impact-oriented and traditional, “bread-and-butter” enterprises within the scope of this study.

2.1 SCOPE AND DEFINITIONS

What is in scope?

This report focuses on SGBs and formal (or formalizing) SMEs, which we broadly term “enterprises,” whose financing needs range from \$20,000 to \$2 million. We include both impact-oriented and traditional, “bread-and-butter” enterprises within the scope of this study. Using the definition provided by ANDE, SGBs are commercially viable businesses with five to 250 employees that have significant potential, and ambition, for growth.¹⁰ An SME, on the other hand, meets at least two of these three criteria: 10 – 49 employees and \$100,000 – \$3 million in assets and/or annual sales.¹¹

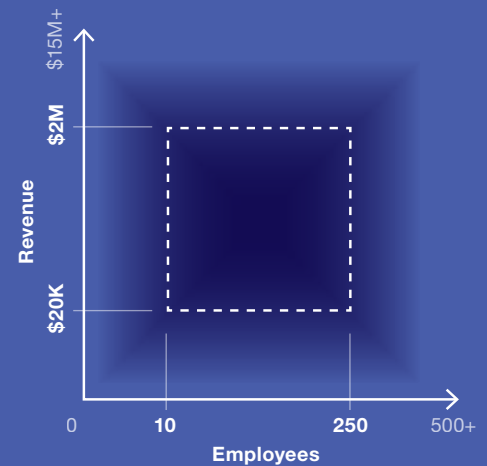
Indicator	Microenterprise	Small enterprise	Medium enterprise
Employees	<10	10 – 49	50 – 299
Total assets	<\$100,000	\$100,000 < \$3 million	\$3 million < \$15 million
Total annual sales	<\$100,000	\$100,000 < \$3 million	\$3 million < \$15 million

We define SGBs as a subset of SMEs that have growth potential and ambition. In addition, we intentionally exclude from our definition of SGBs those SMEs that are necessity-driven microenterprises that tend to be informal and have limited capacity or intent to grow.

¹⁰ “What is a Small and Growing Business (SGB)?” ANDE (2012).

¹¹ “Interpretation Note on Small and Medium Enterprises and Environmental and Social Risk Management,” IFC (2012).

Figure 4: Scope of this study



Using the IFC’s definitions as a starting point, the vast majority of enterprises within this study are post-revenue and have annual revenues somewhere between \$20,000 and \$2 million. Similarly, enterprises within scope will likely have more than 10 but less than 250 employees (outside of the owner’s family). However, as Figure 4 depicts, these boundaries are not always fixed, and there are occasionally “borderline” cases that may well be incorporated.

What is out of scope?

On the lower end, our intention is to filter out enterprises that will be unlikely to meet even minimum standards imposed by financial service providers and those that have little chance of substantive growth. We therefore do not include microenterprises that are operated by necessity-driven entrepreneurs who have very little potential or desire to move beyond employing immediate family members (in addition, perhaps, to one or two non-family members). Moreover, we do not include enterprises that are informal or are unlikely to embark on a path of formalization,¹² as they have such limited growth prospects and financial service providers face major difficulties in serving them. However, we do include “high performance” microenterprises and startups that are on the path to formalization and growth.

On the upper boundary, we have chosen to exclude businesses that have finance needs of more than approximately \$2 million. Enterprises reaching this size and maturity typically start to have greater access to traditional sources of capital, such as commercial banks and private equity funds, although the level of accessibility varies considerably by country and sector. While these larger businesses are important drivers of economic growth and job creation, they do not necessarily constitute the “missing middle” that is the focus of this report, and so are not included here.

2.2 METHODOLOGY

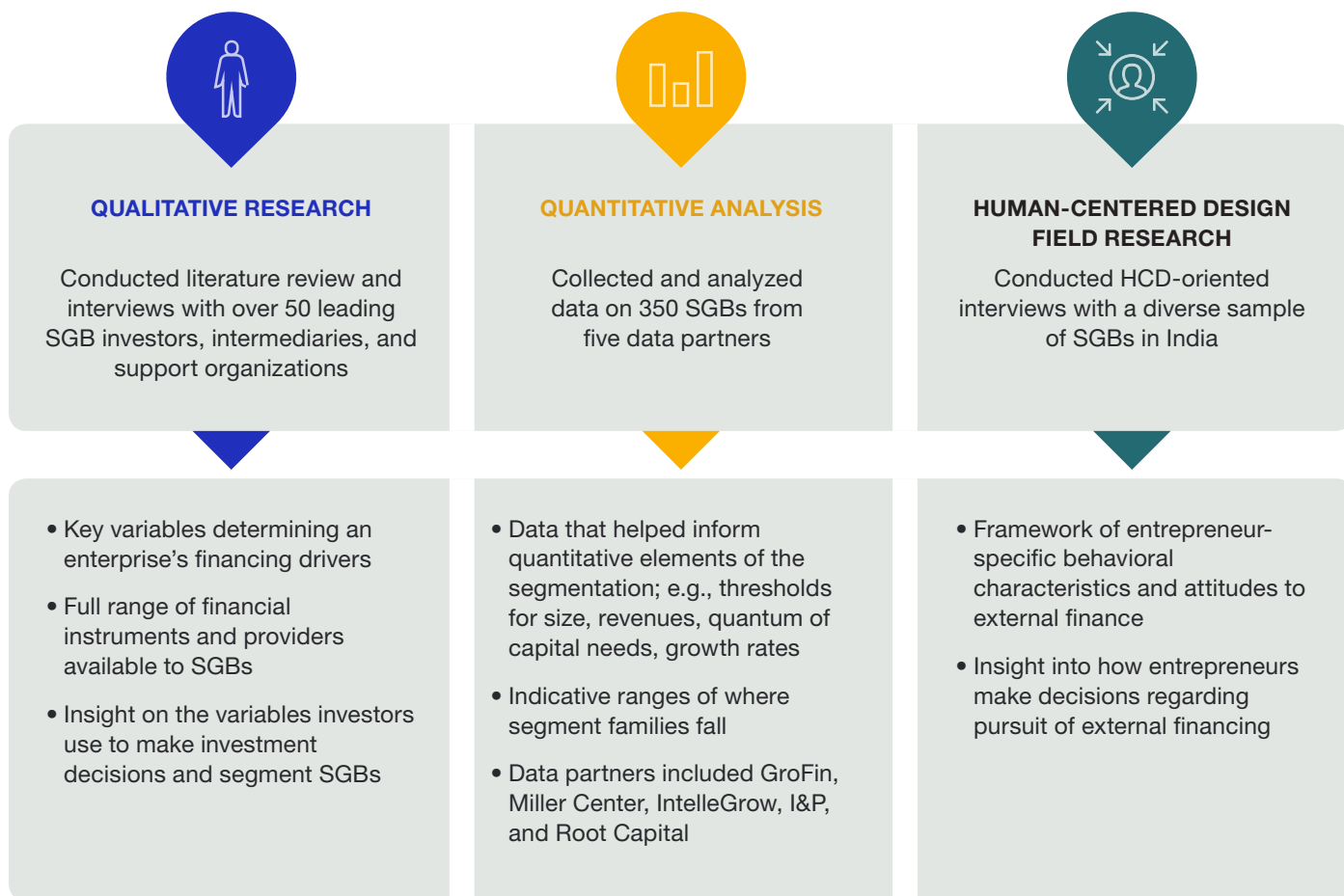
To help ensure that our research remained grounded in the realities of small enterprises and financial service providers, we adopted four principles to underpin our methodology:

- 1. Focus on fundamental enterprise financing needs** by adopting an enterprise viewpoint as the key criterion for the selection of analytical variables and segment archetypes
- 2. Ensure appropriate market grounding** by relying on real-world experiences of financial service providers to identify the types of financial products used to support SMEs and SGBs
- 3. Build on existing approaches and work** by identifying common approaches and synthesizing best practices
- 4. Emphasize practical utility** by ensuring that this product is useful for investors and other practitioners within this space and is not overly technical

Given the ambition of this project, we deliberately chose to use a variety of analytical approaches (both quantitative and qualitative) to design a practical and usable enterprise segmentation framework. Figure 5 summarizes the three overarching areas around which we based our research and analysis.

¹² Alternatively, according to DGGF, we can define the lower boundary as businesses that have outgrown (or soon will outgrow) microfinancing services but do not yet have access to regular financial services.

Figure 5: Summary of analytical approach, activities, and outputs



Qualitative research – literature review

To inform the starting point for this work, and to avoid duplication of existing analyses, we conducted literature reviews that focused on understanding pre-existing segmentation approaches (i.e., the demand side) as well as financial instruments and providers (i.e., the supply side).

On the demand side, we conducted a review of 19 publications (see Annex 1 for more information) that spanned impact investors, development finance institutions, traditional commercial financiers, and other ecosystem players. In surveying the landscape, we found Argidius’ segmentation framework¹³ to be particularly insightful and applicable to our study. Additionally, Village Capital’s VIRAL framework¹⁴ and FSG and Acumen’s *From Blueprint to Scale*¹⁵ publications provide welcome depth and valuable ways of describing the development of a business in a largely sector- and geography-agnostic manner. We also identified several datasets from the World Bank and ANDE’s Global Accelerator Learning Initiative that helped shape our quantitative understanding of the demand side.

On the supply side, we identified 19 sources (see Annex 2 for more information) that focused on identifying and describing financial instruments and providers potentially appropriate for SGBs and SMEs. In particular, we drew on OECD’s *New Approaches to SME and Entrepreneurship Financing*¹⁶ and Duke University’s “Impact 101: Supply and Demand.”¹⁷

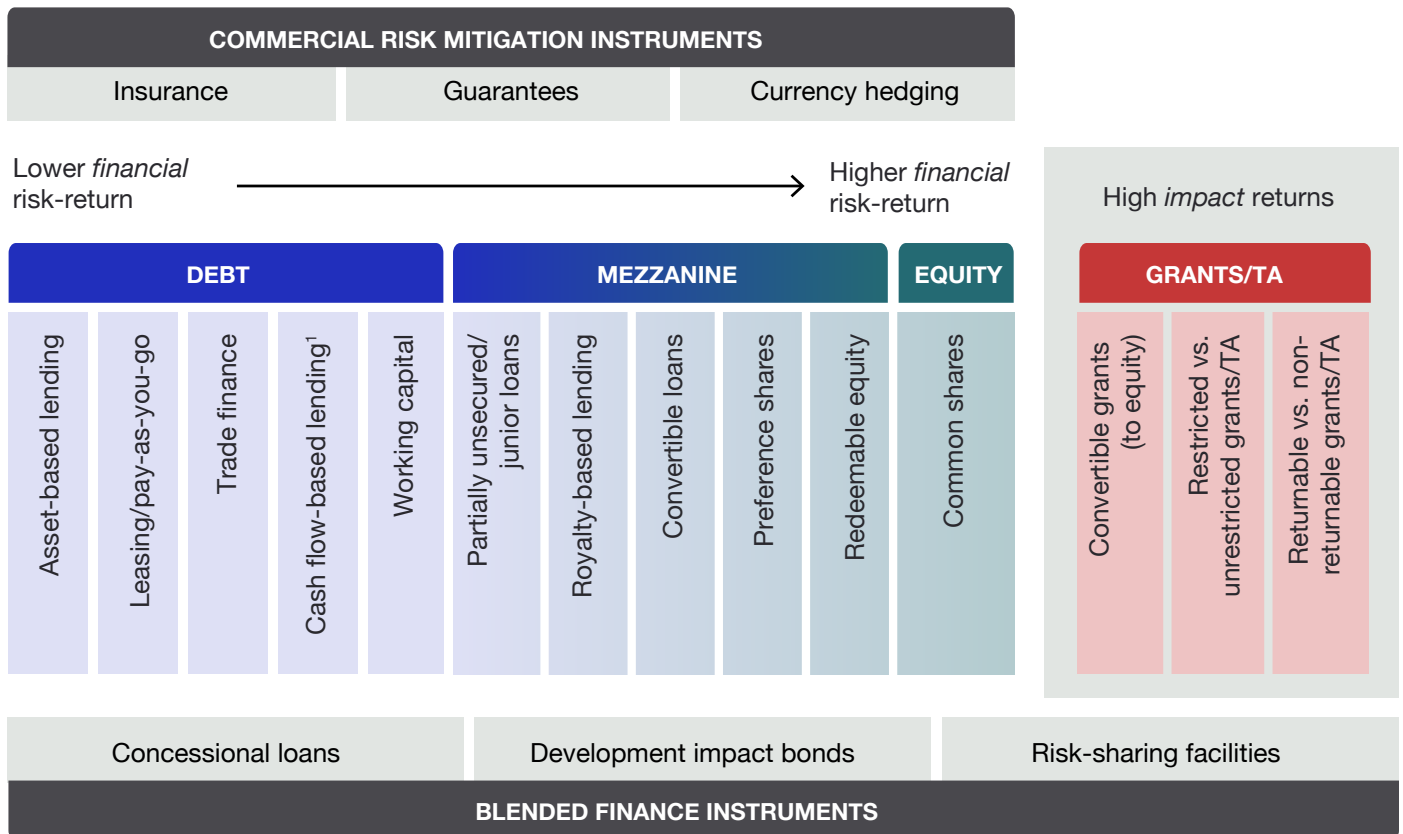
¹³ “Annex 3: Argidius segmentation of SMEs into Venture, Dynamic, and Formalizing,” Argidius.
¹⁴ VIRAL Framework, Village Capital.
¹⁵ *From Blueprint to Scale: The Case for Philanthropy in Impact Investing*, Monitor Group & Acumen Fund (2012).
¹⁶ *New Approaches to SME and Entrepreneurship Financing*, OECD (2015).
¹⁷ “Impact Capital 101: Supply and Demand,” Duke University (2013).

While each source we identified has its own value and adds to the knowledge base of the field, we noted several broad information gaps that need to be addressed in order to meet the objectives of this study.

On the demand side, we found that none of the existing segmentation approaches aspires to be truly global in its reach and ambition. The vast majority of the segmentation frameworks we identified tended to focus either on an investor’s specific portfolio or a specific geographic and/or sectoral context. These frameworks have limited applicability to a study that is global and sector-agnostic in scope. Most of the remaining segmentation approaches we identified tended to focus on distinctive enterprise traits (e.g., number of employees, size, stage, etc.); very few, however, gave equal weight to the behavioral traits of entrepreneurs. Not only is this latter lens critical for very early stage investors, such as venture capital funds, but it also reveals key attributes affecting external financing needs. In other words, we saw a need for new research that factors both qualitative and quantitative variables into different segmentation schemes.

On the supply side, we found that most of the publications that focus on financial instruments and providers typically do not meet the standard of being mutually exclusive and collectively exhaustive. Specifically, many of the publications tend to focus on a particular subset of instruments (e.g., only equity or debt) or providers (e.g., only impact investors). While these reports provide a strong in-depth analysis of certain topics, they do not provide the full range of possibilities that are available to enterprises. Moreover, we found that some of these publications tend to mix terminology (e.g., referring to mezzanine and convertible loans as distinct instruments), which can create confusion. In order for readers to fully comprehend the range of possibilities and accompanying descriptions, we have articulated a financial instrument framework (below) that synthesizes what we found in our research (see Annex 2 for further detail on instrument definitions).

Figure 6: Financial instrument framework



Notes: (1) this includes factoring, purchase order finance, and warehouse receipts

Sources: based upon “New Approaches to SME and Entrepreneurship Financing: Broadening the Range of Financial Instruments,” OECD (2015) and “New Perspectives on Financing Small Cap SMEs in Emerging Markets,” DGGF

With these gaps in mind, our goal is to articulate a segmentation approach that is truly global in scope, yet that still possesses enough specificity to be informative and useful to readers. Unlike other segmentation frameworks, the one articulated in this report includes—regardless of geography or sector—the full universe of impact- and traditionally oriented enterprises that have strong prospects for growth and job creation. Moreover, it intends to segment these enterprises using a mix of quantitative and qualitative characteristics that cut across both observable enterprise attributes and behavioral traits of entrepreneurs.

Qualitative research – stakeholder interviews

Stakeholder consultations helped us prioritize among the full range of segmentation variables we generated through the literature review. We further validated these external financing drivers and priorities through discussions with individual expert advisers as well as at our Sankalp workshop in Nairobi, April 2018. Figure 7 offers more detail on these categories and how we prioritized them.

Figure 7: External financing drivers

	External finance driver	Definition	Example metrics
FAMILY SEGMENTATION VARIABLES	Market growth and scale potential	Management's ambition and ability to pursue growth and scale	<ul style="list-style-type: none"> • Size of addressable market • Competitive dynamics • Growth trends and prospects
	Product/service innovation profile	Characterization of product/service innovation level	<ul style="list-style-type: none"> • Degree of disruption and innovation vs. traditional models • Level of R&D-based product/svcs
	Entrepreneur behavioral attributes	Full range of management's behavioral and demographic characteristics	<ul style="list-style-type: none"> • Growth and scale ambition • Appetite for risk • Desire for control
SUB-SEGMENTATION VARIABLES	Stage of development	Maturity stage as determined by the size of capital needs	<ul style="list-style-type: none"> • Seed (\$20,000 - \$250,000) • Early stage (\$250,000 – 1M) • Early growth (\$1M – 2M) • Mature (\$2M – 10M)
	Capital intensity	Size and intensity of finance needs for enterprise to operate	<ul style="list-style-type: none"> • Business activity/sector • Number of employees • Asset intensity
	Financial performance/structure	Characteristics of recent financial performance and debt structure	<ul style="list-style-type: none"> • Sources/uses of cash • Profitability trends

Quantitative analysis

Finally, we collected portfolio data from five financial service providers that specifically focus on different segments of our target market: GroFin, Santa Clara University's Miller Center for Social Entrepreneurship, IntelleGrow, Investisseurs & Partenaires (I&P), and Root Capital. While we partially based this selection on the availability and willingness of partners to contribute, we felt that these financial service providers represented a sufficiently robust cross-section of different types of investors that focus on a range of investee stages, business sectors, instrument types, geographical regions, product/service profiles, and other relevant factors.

We asked each contributing data partner to select a randomized cross-section of companies currently within its portfolio and to report on this sample, to the extent possible, within a data template we provided. This data template included a combination of 38 unique quantitative and qualitative data points¹⁸ across five main areas of interest:

¹⁸ We developed these 38 unique variables using definitions from several widely consulted sources, including GIIN's IRIS, Impact Management Project's "The Investor's Perspective," and DGGF's categorization of mezzanine products.

1. Entrepreneur characteristics (e.g., CEO’s attitude toward risk, gender and age of CEO, strength of leadership, education of CEO)
2. Business demographics (e.g., age of business, stage of lifecycle, number of full-time employees, business activity)
3. Financial performance (e.g., three-period revenue growth, cash flows, liabilities/assets)
4. Type of external financing received (e.g., amount of debt, equity, or mezzanine finance—and who provided it)
5. Outcomes and impact (e.g., type of financing, purpose of finance, total investment amount, maturity/tenure)

At the end of this process, we succeeded in collecting data (of varying degrees of comprehensiveness) on 355 individual portfolio companies spanning 55 countries. To complement the anonymized database we created from the five portfolio data partners, we also consulted and referenced data from the Global Accelerator Learning Initiative (GALI) and World Bank Group’s Enterprise Surveys datasets. These datasets contained less detail on entrepreneur characteristics but helped flesh out our data on business demographics and types of external financing received.

Although the dataset we collected represents a robust cross-section of SGBs in frontier and emerging markets, it has three main limitations in terms of extrapolation to the full universe of SGBs and SMEs. First, this sample size is too small to be representative of the entire population of SGBs in frontier and emerging markets. Moreover, data partners themselves might not have applied sufficiently robust sampling methods to obtain representative data. Second, partners did not report on a number of fields or sets of data, primarily due to confidentiality concerns or lack of internal data. Third, some of the data we requested—especially related to behavioral characteristics—were difficult to categorize and involved a certain amount of individual subjectivity. Recognizing these limitations, we created a logic tree that outlined a series of binary questions that served as proxies for key segment family characteristics (see Annex 3 for further details).

Human-centered design (HCD) research

The second stage of our analysis involved conducting HCD research to learn more about various behavioral characteristics that underpin external financing needs. We began by brainstorming the full range of behavioral attributes that can have strong explanatory power in determining an entrepreneur’s finance-seeking behavior. Based on our HCD team’s experience, and further informed by our stakeholder interviews, we identified a range of relevant behavioral characteristics:

- **Growth ambition:** the extent to which an entrepreneur aims to grow his or her company and the pace at which he or she would like to do this
- **Impact motivation:** the extent to which an entrepreneur would like to have a larger societal effect through owning and operating his or her business
- **Risk attitude:** the entrepreneur’s willingness to commit to business actions and decisions that could have uncertain (or negative) effects on his or her business

We then conducted an HCD “design sprint” in Mumbai, involving in-depth interviews with eight enterprises of highly varying profiles. We probed the origin stories of these entrepreneurs and sought to learn how their enterprises have developed over time, as well as how the behavioral characteristics mentioned above informed certain financing decisions. We then used the insights gained from the entrepreneurs to develop examples of “leadership personas”—profiles of entrepreneurs focused on key behavioral attributes that impact how they manage their business, and how they approach external financing. Annex 4 details each of these leadership personas.

The second stage of our analysis involved conducting HCD research to learn more about various behavioral characteristics that underpin external financing needs.

3. Key Findings

Our research identifies four relatively broad SGB “families” that occupy the missing middle.

families tends to play a distinct role in driving inclusive economic growth and job creation in emerging and frontier economies. Each family has distinct financing needs, and each also faces different gaps or mismatches in the market between available investment options and the solutions that are best suited to enterprise needs.

These four families come into focus when we look at the universe of SGBs through three distinct variables:

- 1. Growth and scale potential:** an enterprise’s prospects for future growth, potential to reach significant scale, and the pace/trajectory of growth
- 2. Product/service innovation profile:** the degree to which an enterprise is seeking to innovate in its core product or service offering or to disrupt the market in which it operates
- 3. Entrepreneur behavioral profile:** attitudes of the entrepreneur with respect to key dimensions that impact decisions on external finance— notably, risk tolerance, impact motivation, and growth ambition

Using these variables, we identified four SGB families: **High-growth Ventures; Niche Ventures; Dynamic Enterprises; and Livelihood-sustaining Enterprises.** These families are most helpful in identifying the broad classes of financing needed to address a business’s core needs.

Our research identifies four relatively broad SGB “families” that occupy the missing middle.

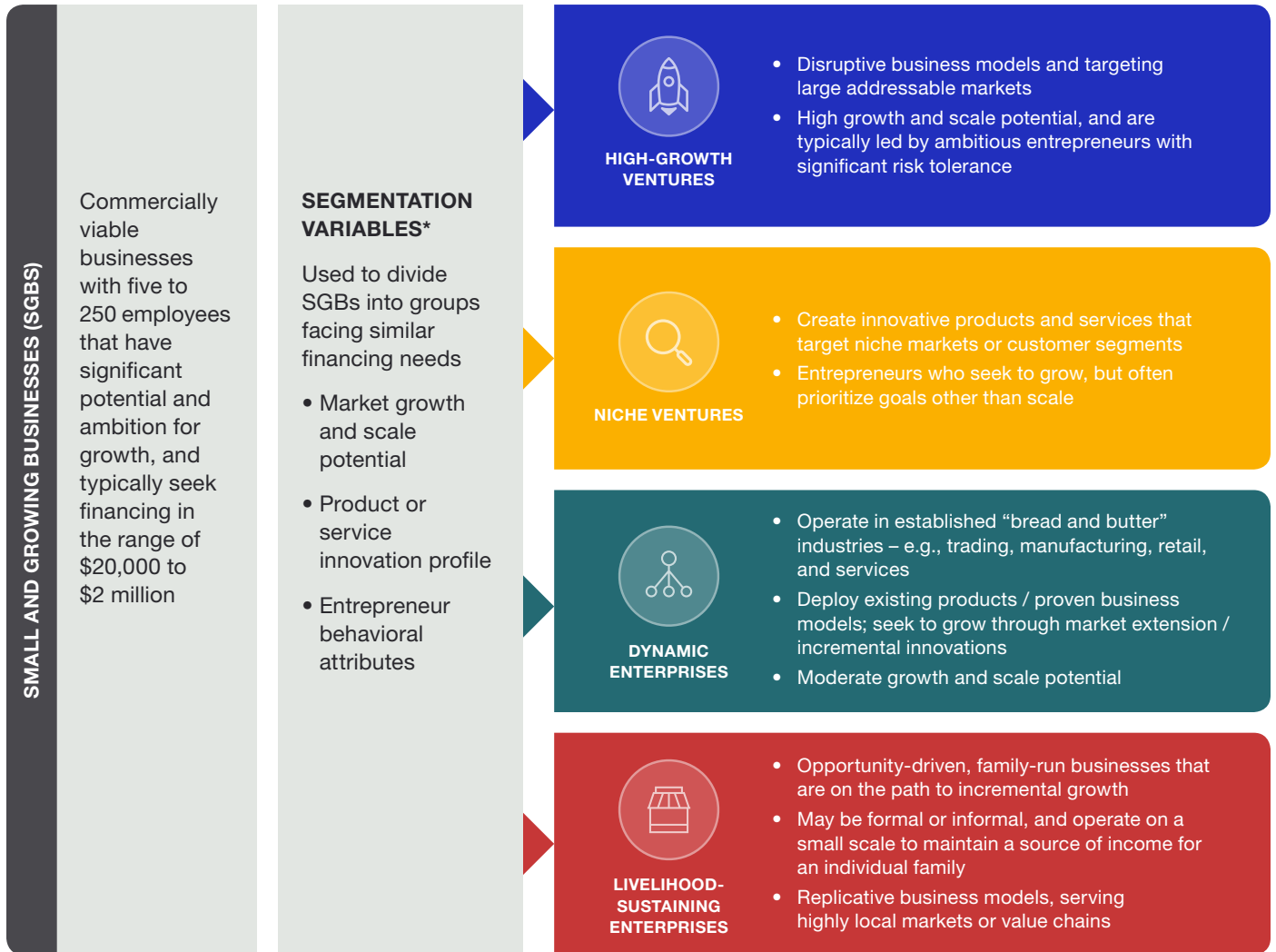
Each of these enterprise

A Note on SGB Family Nomenclature

In line with our focus on making this as useful a tool as possible, we have tried to give each segment a name that is intuitive and easy to understand. However, some of the segment families do include value-laden naming that may bias readers’ views about where they or other enterprises might fit within the landscape.

It was not our intention to implicitly rank or judge any of the segment families. As this report will make plain, the segment families have unique and important roles to play in the economies in which they operate. Moreover, entrepreneurs (regardless of their segment family) in general should be celebrated for their willingness to take risks and provide benefits to others.

Figure 8: Four segment families of the “missing middle”



(*) Variables identified, prioritized, and validated through stakeholder interviews with ~80 SGB-focused investors operating in frontier markets

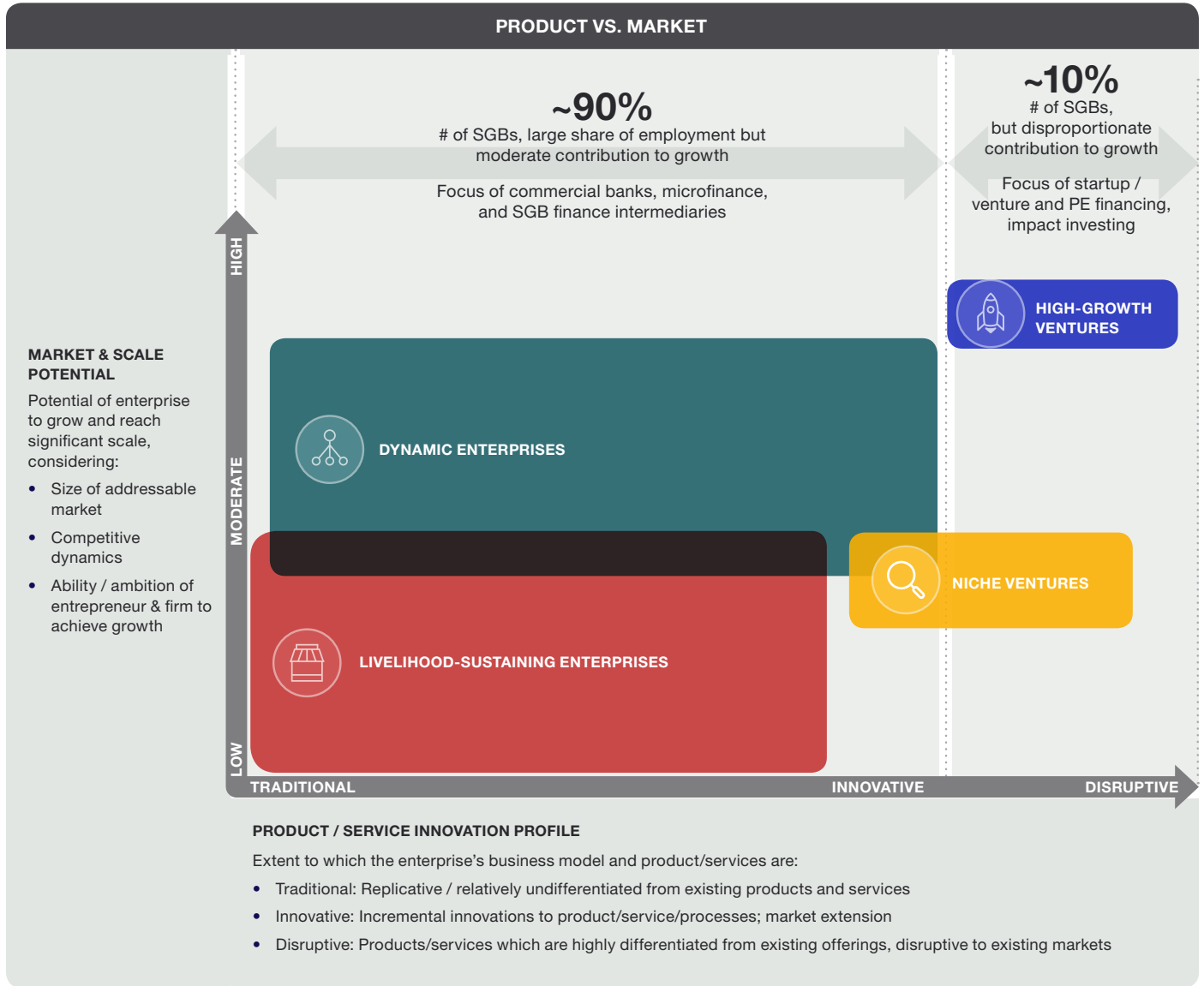


3.1 THREE LENSES

We used the variables above to derive three “lenses” for comparing and differentiating the key attributes of each enterprise family. Each lens provides a unique way of looking at the four SGB families; together the lenses give us a holistic picture of the families’ potential external financing needs.

Lens 1: Product-market matrix

Figure 9: Product-market matrix



We use a product-market matrix to differentiate families by the type of product or service an enterprise offers to a set of target customers. On the x-axis, we describe the “product innovation profile” in terms of the extent to which enterprises are seeking either to innovate in their core products and services or to disrupt the markets in which they operate. We characterize “traditional” businesses as those that largely seek to serve existing customers with existing products, and largely through proven business models. “Innovative” businesses are those that seek to innovate by expanding into adjacent markets and customer segments or driving incremental innovations in their product and service offerings. We describe as “disruptive” those businesses seeking to create or pioneer new markets that meet new, unmet customer needs, or to develop new products and services that are markedly different from existing offerings.

The y-axis represents market growth and scale potential. Enterprises in each of the families vary in their prospects for future growth, their potential to reach significant scale, and the pace / trajectory of their growth. Multiple underlying factors impact growth and scale potential, including the fundamentals of their business model, size of the addressable market being targeted, and the capabilities and behavioral attributes of the entrepreneur.

Quantitative markers for growth and scale potential will vary significantly by industry, geography, stage, and other variables. We generally classify as “low growth and scale” those businesses that are small and likely to stay small. We expect SGBs in this category to generally stay below ~50 employees, even at maturity. We generally describe “moderate growth” as having the potential for sustained periods of above-market growth, and use double-digit growth as a broad proxy. Finally, “high growth” rates refer to steep growth curves—and in some cases, the proverbial “hockey stick” growth curve sought by venture capital investors. These enterprises tend to rapidly outgrow the SGB category to become a larger growing business that is seeking millions or tens of millions in external financing from mainstream financial service providers such as banks and private equity funds, and generating tens of millions in revenue (with revenue thresholds varying significantly by industry).

This framework highlights the first of many key differences among SGB enterprise families. High-growth Ventures and Niche Ventures both focus on innovation, but High-growth Ventures target and grow in large addressable markets so that their products and services can be potentially rolled out to millions of people. Niche Ventures, in contrast, focus on far more limited markets. It is worth pointing out that this distinction is not always intentional. Niche Ventures may begin with the expectation that they are entering a large addressable market, only to discover that market is far more limited

than projected. Conversely, an entrepreneur may launch what he or she believes will be a Niche Venture, only to discover that the market is much larger and the business’s growth much faster than anticipated.¹⁹

Dynamic and Livelihood-sustaining Enterprises, in turn, pursue more traditional business models. Rather than developing new, highly disruptive products or services, Dynamic Enterprises strive toward continuous improvement through incremental innovation of existing products, services, and businesses processes. Livelihood-sustaining Enterprises largely provide traditional products and services through business models that are highly replicative.

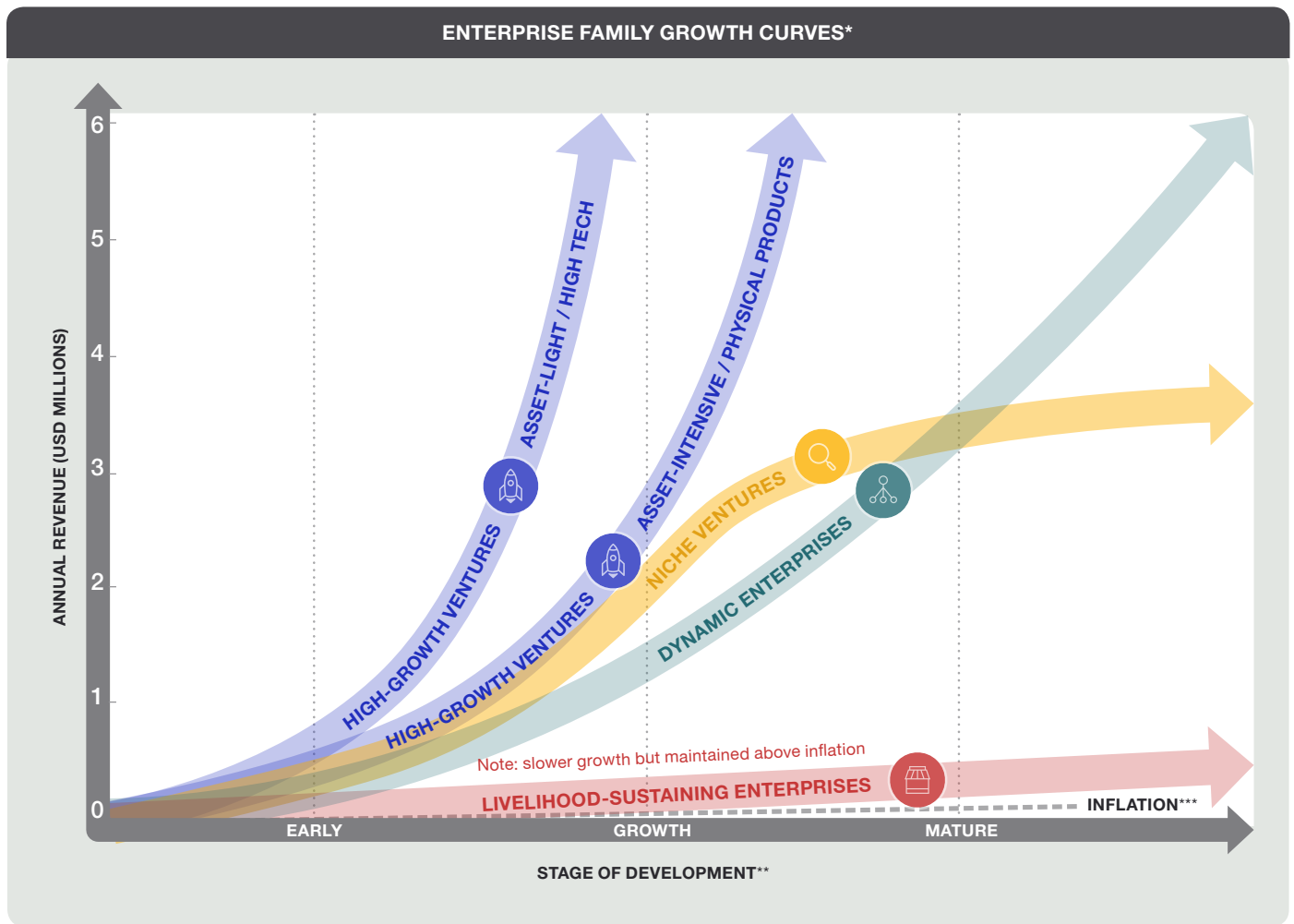
With respect to target markets, Livelihood-sustaining Enterprises are limited in scope and capacity to serving highly localized markets, and thus remain small. Dynamic Enterprises, in contrast, have greater potential to serve larger markets and wider groups of customers as they grow. While there are some blurred boundaries between High-growth Ventures and Dynamic Enterprises in their target markets, very few Dynamic Enterprises (as opposed to High-growth Ventures) succeed at moving into large regional or even global markets.

SGBs in each of the families vary in their prospects for future growth, their potential to reach significant scale, and the pace / trajectory of their growth. Multiple underlying factors impact growth and scale potential, including the fundamentals of their business model, size of the addressable market being targeted, and the capabilities and behavioral attributes of the entrepreneur.

¹⁹ The notable exception is the niche market that starts small but expands many times over—to the point that Niche Ventures could potentially serve millions of people. This, however, is a long-term process.

Lens 2: Growth curves

Figure 10: Growth curves of the four families



* Growth curves are illustrative-based enterprise data collected from five fund managers and classified on their characteristics using average annual revenues and age of enterprise for each family. Curves are stylized and do not represent individual SGBs.

** Stage of development closely correlates with Village Capital's VIRAL framework. For example, early stage High-growth Ventures most closely align with VIRAL Levels 1-4, growth aligns with Levels 5-6, and mature most closely aligns with Levels 7-8.

*** Local markets' rate of inflation

We use growth curves as a second “lens” through which we can better understand and differentiate the development path and size of financing need of each of the four families over time. Drawing on data from SGB investor portfolios (described in greater detail below), we used gross revenue and age of enterprise as proxies in order to see how the average enterprises evolved in each family. Since annual revenue growth is a highly contextual variable—dependent on geography, sector, and inflation, among other factors—we instead opted for a simple depiction of broad growth trajectories over a set period. These trajectories and time periods are purely illustrative and are primarily meant to depict key differences in each segment family’s respective growth trajectories.

The illustrative growth paths of each segment family over time reveal some telling differences. High-growth Ventures display rapid “hockey stick” growth, particularly when they reach growth stage, while Niche Ventures never reach that inflection point. Within the High-growth Venture family, asset-intensive, physical product-based ventures follow a slower timeline than do asset-light, high tech ventures. Other SGB enterprise families have their own distinctive, though more gradual growth curves. Dynamic Enterprises maintain moderate-to-strong growth over a long period of time. Livelihood-sustaining Enterprises have modest growth rates but do tend to grow at rates slightly above local rates of inflation and thus are still viable investment opportunities.



Entrepreneurs' behavioral profiles—and their attitudes and behaviors toward risk, growth, and problem solving—are the final lens through which we compared and differentiated the four families of SGBs.

There are, of course, instances in which enterprises may move between families. A family-run business might, for example, go through a change of ownership that alters its entrepreneurial profile, which could potentially result in a move from Livelihood-sustaining Enterprise to Dynamic Enterprise. Or a specific target market that a Niche Venture is operating in could grow dramatically over a brief period, which would afford this enterprise family the opportunity to scale and become a High-growth Venture. Ultimately, these lenses should be viewed as heuristic—they are meant to illustrate common characteristics, not stake out rigid categories.

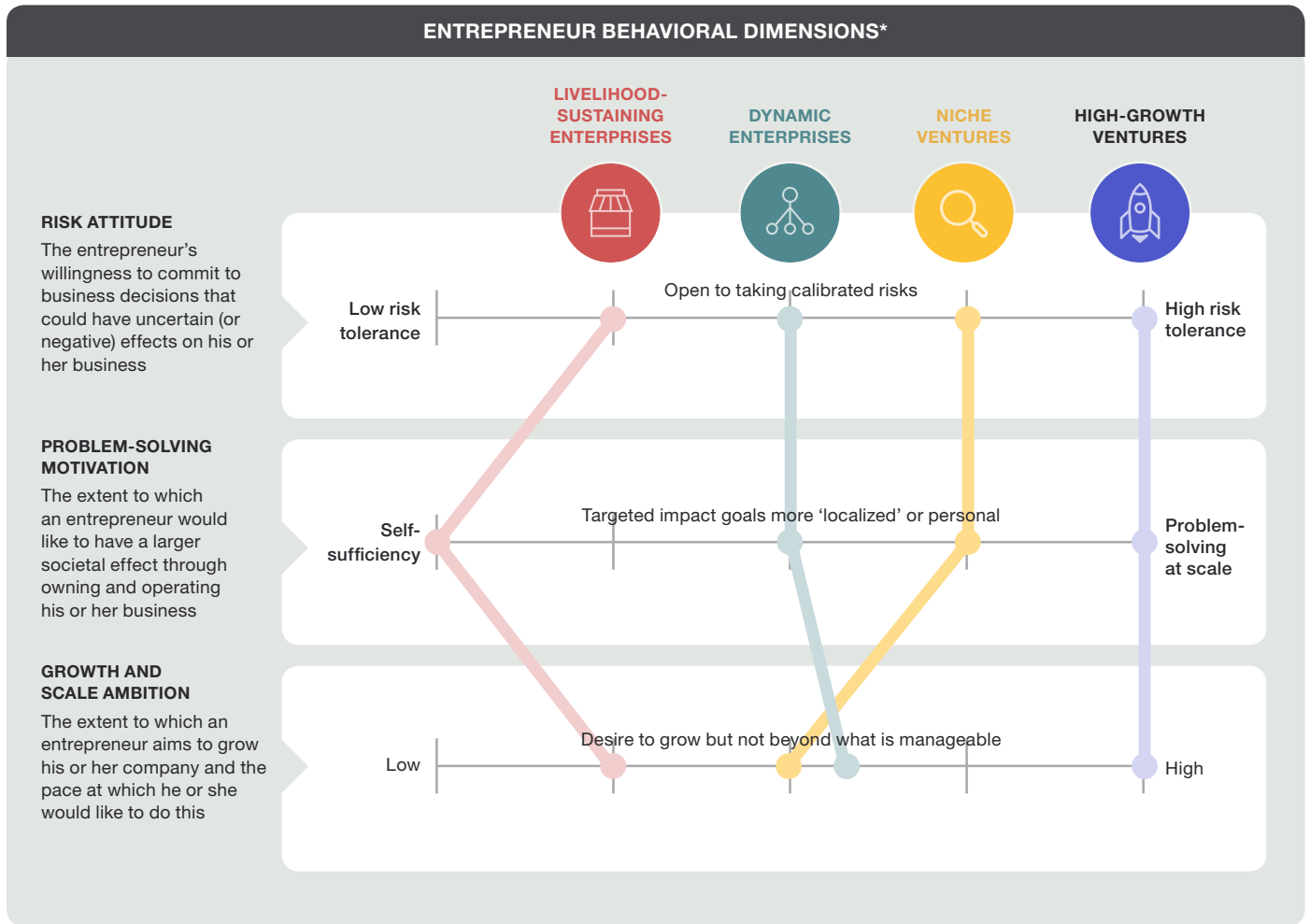
Lens 3: Entrepreneur behavioral profile

Entrepreneurs' behavioral profiles—and their attitudes and behaviors toward risk, growth, and problem solving—are the final lens through which we compared and differentiated the four families of SGBs.

Through our human-centered design research, we found that certain behavioral variables significantly drive not only enterprise performance but also an entrepreneur's approach to external financing. Certainly, an entrepreneur's level of business acumen, technical expertise, and social capital are important variables. But in this analysis, we particularly call out several attitudinal factors pertaining to growth ambition, problem solving motivation, and risk attitude. High levels of ambition toward growth and scale, desire for problem-solving at scale, and greater risk tolerance among entrepreneurs are all associated with higher-growth enterprises.

In the figure on page 26, we summarize the key differences of those variables within the four families. Here again, it is important to note that this model is merely indicative of a predominant behavioral profile of entrepreneurs in these families.

Figure 11: Entrepreneurs' attitudes and behaviors toward risk, growth, and problem solving



* Behavioral dimensions are illustrative and it is important to note that an individual entrepreneur within these families could have much more variation to this simplification of behavior patterns. However, this model is indicative of a 'predominant' behavioral profile of entrepreneurs in these families. Additionally, entrepreneur willingness to problem solve and take risks can be constrained by ability to do so, such as limited access to finance.

Note: Research found further variables such as control and openness to feedback are particularly useful to distinguish between Niche and High-growth Ventures to determine where financing tools such as equity could be a good fit.

Entrepreneurs leading High-growth Ventures—particularly successful ones—tend to be highly ambitious about the growth and scale of their enterprise. They strive to have a transformative impact through their business and are willing to take risks to achieve this vision. At the other end of the spectrum, entrepreneurs leading Livelihood-sustaining Enterprises often have lower levels of risk tolerance and growth ambition.

Niche Venture entrepreneurs often have motivations that lead them to focus on serving more limited or targeted markets rather than rapidly scaling. They can be willing to take risks (for example, create a startup with an innovative product offering), but Niche Venture entrepreneurs with a strong aesthetic or impact-related motivations may actively choose to limit the scale of their production or set prices in such a way that preserves quality and distinctiveness, but also limits the size of their market. This may make it difficult for Niche Venture entrepreneurs to share decision-making power with investors or other stakeholders.

3.2 THE FOUR “FAMILIES” OF SGBS

The four “families” are relatively broad categories of SGBs that differ, among other ways, in growth trajectory and scale potential, target market and customers, product / service profile, and the behavioral attributes of the typical entrepreneur. In emerging and frontier economies, each of these enterprise families tends to play a distinct role with respect to factors such as job creation, economic growth, and innovation. Defining these families can help differentiate the range of needs for which different classes of financing (e.g., venture capital, private equity, mezzanine, bank lending) are relevant. We found that each of these families tends to face distinct sets of challenges in accessing financing appropriate to its needs.

We derived these families using the three “lenses” (discussed above in 3.1) by integrating insights from stakeholder interviews, behavioral analysis of individual entrepreneurs, and analysis of enterprise-level data (described in section 2). Stakeholder interviews provided a window into how investors integrate both qualitative and quantitative factors in assessing an enterprise’s investment readiness, financial needs, and fit for their investment strategies. Behavioral analysis gave us a view into how entrepreneurs think about their own financing needs, and how their attitudes toward factors such as growth and risk impact their preferences and decisions with respect to external financing. Finally, the quantitative analysis helped validate key parameters of the segmentation with respect to factors such as business size, stage of development, and sector.

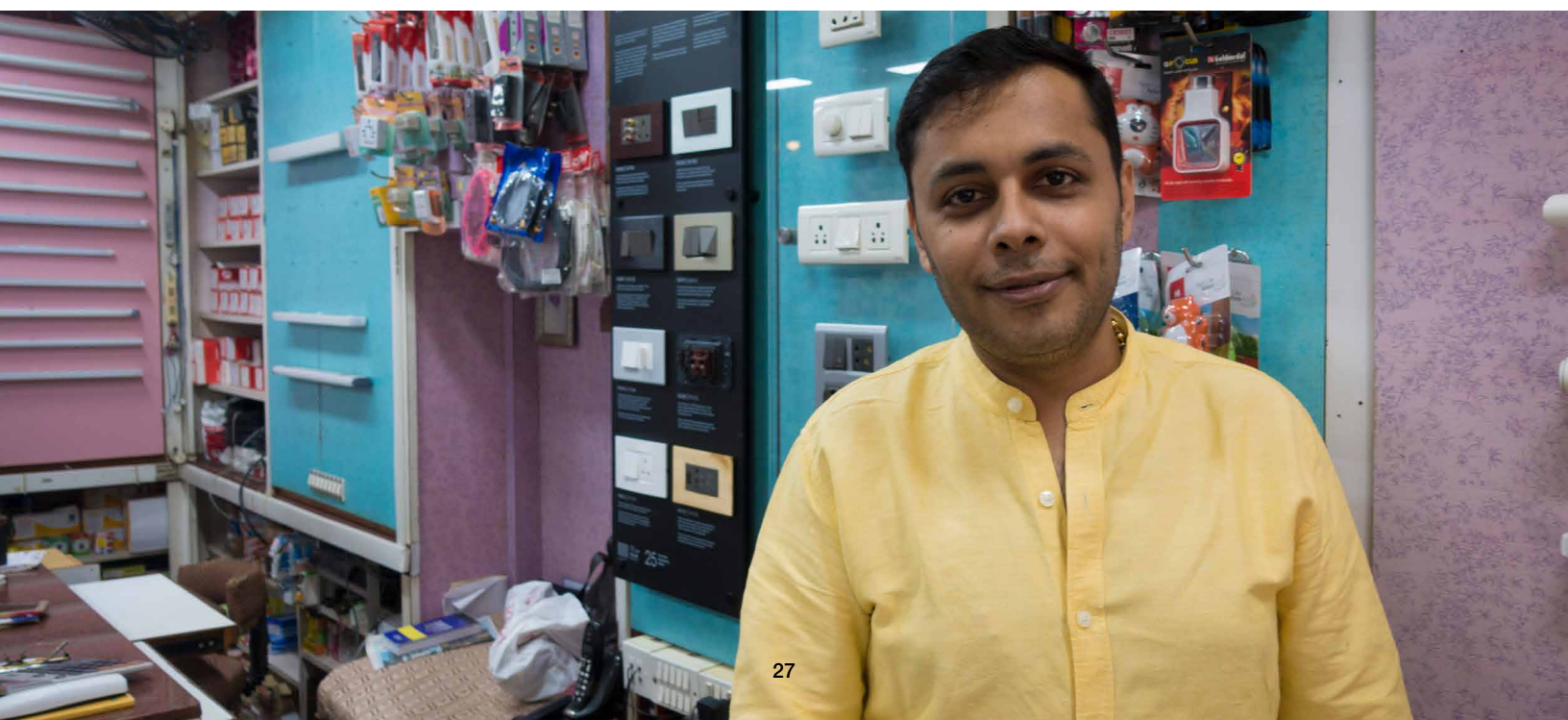
Below we provide a “portrait” of each segment family in terms of:

- Overview – role in economy, leadership personas, and example enterprises
- Financing needs, further sub-segmentation, market gaps, and mismatches
- Potential solutions and promising developments in the field

A Note on Impact Enterprises

In seeking to increase the flow of finance to all types of SGBs, we have developed this framework with an agnostic view toward social enterprises. Social enterprises, as defined by the Social Enterprise Alliance, are organizations that address a basic unmet need or solve a social problem through a market-driven approach. Using this working definition, it is important to highlight that social enterprises can exist in all segment families, though certain segment families may have a higher concentration of businesses that self-brand as social enterprises.

Given that the financial needs of social enterprises generally do not vary greatly from those of other enterprises, social impact did not factor into the segmentation.





Highly innovative business models serving large addressable markets with a rapid growth trajectory, though the pace of growth is impacted by industry, market, and asset intensity. High-growth Ventures are expected to scale beyond “SGB” status and graduate to capital needs of >\$2m.



PRODUCT VS. MARKET

Large-scale potential and disruptive business model due to focus on large market with innovative product or service



GROWTH CURVES

Hockey-stick growth (slope varies by enterprise); successful enterprises ‘graduate’ from SGB status to >\$2m in financing needs within a few years



MANAGEMENT BEHAVIORS

“Sprinter” – entrepreneur seeks to be recognized for achieving disruption at scale. Often higher risk tolerance due to growth ambition and financial safety net

ROLE IN ECONOMY

- **Size:** Small proportion of the total # of SGBs (~1%), but due to scale have disproportionate economic impact
- **Impact:** Engines of innovation – can deliver marked improvements in productivity for economic growth and job creation

ARCHETYPES

- **High-tech Venture:** Asset-light startup, often software-based, with favorable economies of scale
- **Impact Pioneer:** Company pioneering a new market, defining new payment models, or operating in very low resource environments with impact intent (e.g., base of pyramid markets)
- **Physical Product Venture:** Asset-intensive business that is engaged in R&D, manufacturing and distribution of physical products. These ventures often require setting up ongoing technical support/maintenance to customers. They also often must deal with regulatory or policy issues that increase their costs and slow their readiness for production and scale.

EXAMPLES

- **Freight Tiger:** A young logistics tech company seeking to transform India’s large transportation and freight industry through software that improves the end-to-end supply chain
- **PEG Africa:** A young Ghanaian-based solar company providing PAYGO financing, which has grown rapidly and expanded into multiple African markets



Overview

High-growth Ventures are SGBs that pursue disruptive business models and target large addressable markets. They represent a very small percentage of the total SGB population²⁰ and typically feature very innovative and market-disruptive business models.²¹ These businesses have a clear ambition and pathway to graduate from their SGB status in a matter of several years. Our portfolio data suggests the median age of a High-growth Venture is seven years and three-year growth rate is 66 percent per year (more details in Annex 3). As they mature from the initial seed stage, High-growth Ventures are typically targeted by venture capital funds that see significant potential returns through exponential growth and scale—which could mean rapid expansion within the High-growth Venture’s region or could mean serving millions of consumers.

Using growth equity and advice provided by venture capital funds, High-growth Ventures typically seek to move beyond merely proving a profitable business model; they seek to achieve product-market fit and begin scaling up. Once High-growth Ventures achieve these major milestones, private equity funds or other strategic investors will often look to acquire an equity stake to further grow the business.

Role in economy

High-growth Ventures play a significant role in promoting job creation. China, for instance, has seen the creation of 10 million new jobs specifically in the e-commerce sector, which is still largely absent in many countries.²²

Beyond their role in job creation, High-growth Ventures are a major driver of “disruptive progress”—that is, the creation of new markets and ways of doing business that fundamentally advance an economy’s productivity and competitiveness. As the originators of innovative and disruptive products and services, High-growth Ventures play a key role in piloting, validating, and de-risking different business models that can be adopted and more broadly applied by other businesses. In turn, since these products and services are transformative and disruptive by nature, High-growth Ventures can have a broad sectoral influence on other companies and how they conduct business over both the short and long term.²³

Leadership persona

Founders of High-growth Ventures typically have high levels of human and social capital along with the ambition to grow and high levels of risk tolerance. They tend to be more open to outside feedback and new ideas to help grow their business. To meet these high ambitions, founders are often willing to consider ceding some ownership through minority shareholder partners to secure financing, expertise, and other non-financial resources (more details on leadership personas in Annex 4).

Example enterprises

Freight Tiger is a young, Mumbai-based logistics tech company that is seeking to transform India’s large transportation and freight industry through software that improves the end-to-end supply chain. The company has secured multiple rounds of equity investment from top-tier venture capital firms in India.

High-growth Ventures are SGBs that pursue disruptive business models and target large addressable markets. They represent a very small percentage of the total SGB population.

²⁰ We rely on internal estimates (based on our knowledge of the field) for each segment family’s size relative to the overall population of SGBs. These figures will need to be further validated with data on the overall population.

²¹ We consider a company’s efforts and aspirations along any of three distinct (but sometimes overlapping) paths of innovation: (1) technical innovation, (2) business model innovation (e.g., disrupting incumbent industries), and (3) market extension and innovation (e.g., pioneering a new market).

²² “Disruptive innovations and new business models: The role of competition policy advocacy,” World Bank (2016).

²³ *Disruptive Technologies: Advances That Will Transform Life, Business, and the Global Economy*, McKinsey Global Institute (2013).



HIGH-GROWTH VENTURES

Another example of a High-growth Venture is **PEG Africa**, a Ghana-based company founded in 2013 that sells innovative solar products through pay-as-you-go financing. PEG Africa has grown rapidly, expanded into multiple African markets, and attracted a range of external growth-focused impact investors, including Acumen Fund and Investisseurs & Partenaires.

Financing needs, further sub-segmentation, market gaps, and mismatches

FINANCING NEEDS

High-growth Ventures are most distinct in their financing needs in that they need staged “risk capital” to fuel their growth journey. Certain types of High-growth Ventures—such as asset-light tech companies—are well served by conventional venture capital investing structures, with staged venture capital equity rounds that, in markets with more sophisticated venture investing sectors, are increasingly complemented by venture debt. As High-growth Ventures mature, they often seek larger sums of growth capital from private equity investors and are able to tap into a more sophisticated range of financial product offerings from banks and other mainstream financial service providers.

SUB-SEGMENTS

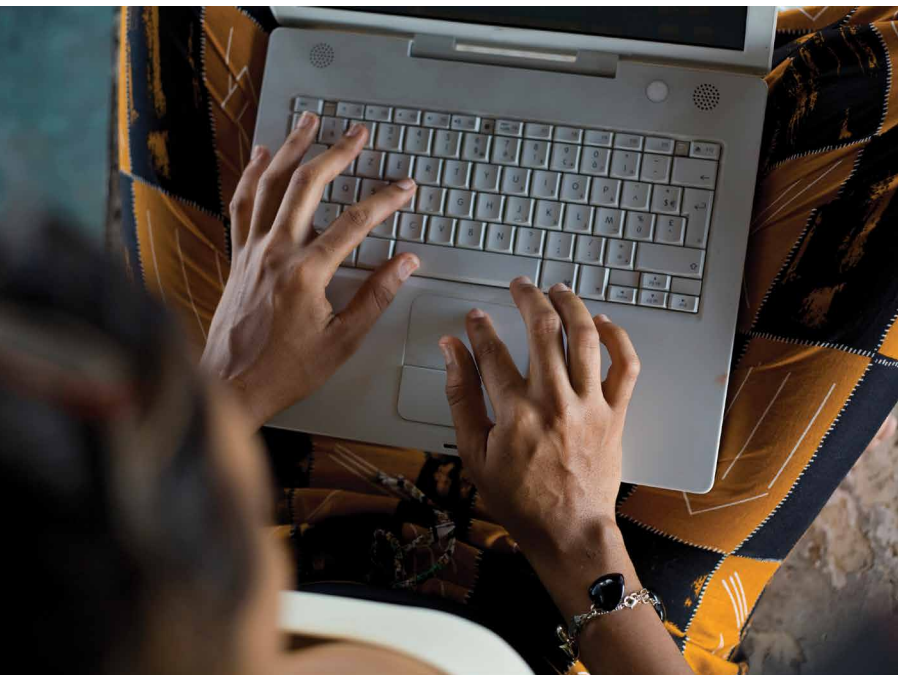
Given this context, we think sub-segmenting enterprises in this family by stage of development—as is done in multiple existing frameworks (e.g., FSG and Acumen’s *From Blueprint to Scale*, Village Capital’s VIRAL Framework)—is an important perspective for determining an enterprise’s capital needs. In this report, we define three sub-segments—Startup, Poised for Growth, and Promising Venture—according to indicators of enterprise maturity in scale. We define three stages of growth that are most predictive of the financing needs of High-growth Ventures:

Startup Ventures are building an initial team, setting the company’s vision, solidifying its value proposition, and validating an investable market, aligning closely with Village Capital’s VIRAL framework Levels 1 – 4²⁴ or the *From Blueprint to Scale* “blueprint stage.”²⁵ As nascent enterprises, Startup Ventures are typically small and pre-profit, but

demonstrate a strong likelihood of being able to scale rapidly and address a large market—which distinguishes this sub-segment from Niche Ventures.

Promising Ventures are slightly more mature enterprises that have successfully deployed their product or service and proven the viability of their business models. As these ventures move beyond being early adopters, this stage aligns most closely with the VIRAL framework Levels 5 – 6 or the *From Blueprint to Scale* “prepare stage.”²⁶ At this point in their evolution, Promising Ventures have typically reached, or are near, their break-even point.

Poised-for-growth Ventures have found effective product-market fit and have started to scale up their operations as well as product / service offerings. These activities most closely



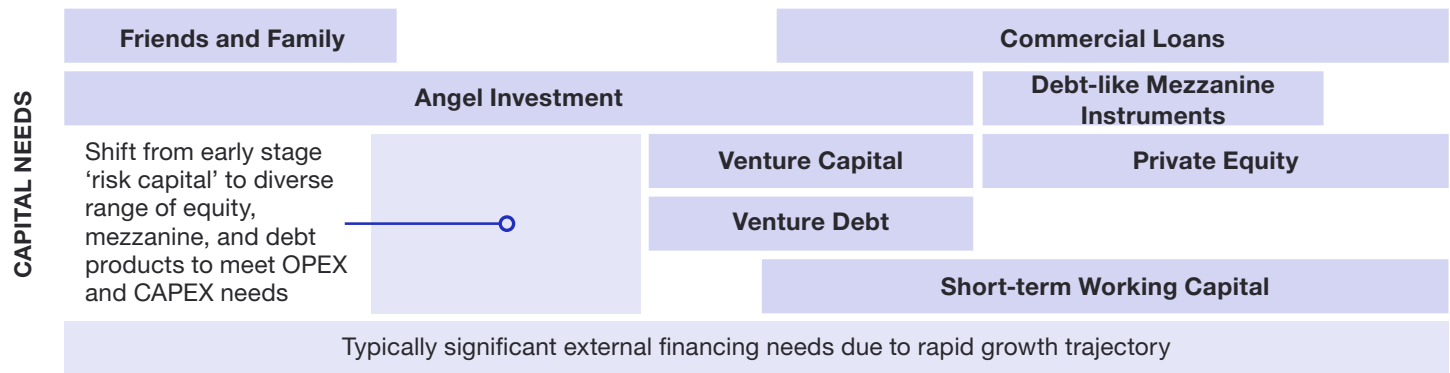
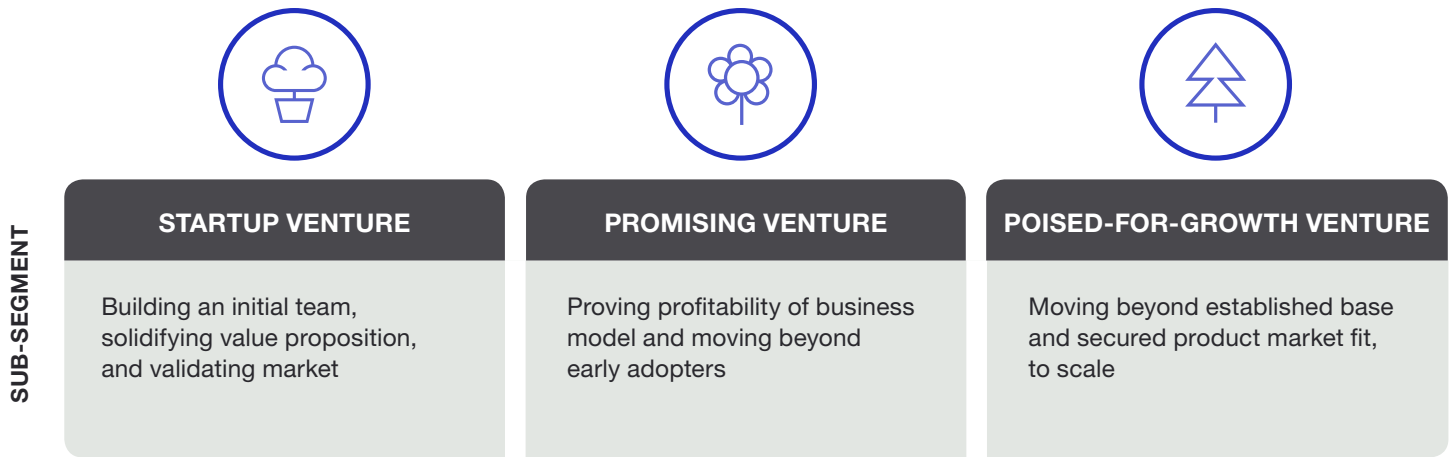
²⁴ VIRAL Framework, Village Capital.

²⁵ *From Blueprint to Scale: The Case for Philanthropy in Impact Investing*, Monitor Group & Acumen Fund (2012).

²⁶ *Ibid.*



Figure 12: High-growth Ventures – sub-segment capital needs



- DESCRIPTORS
- **Friends and family:** Friends, family, and highly risk-tolerant investors provide finance to startups to establish core operating infrastructure and build a basic product design to bring to market for first time
 - **Angel investment:** Investments at high-risk startup stage support growth before entry of other financial service providers with lower risk tolerance
 - **Mezzanine:** With some positive cash flow or solidified business model, mezzanine finance becomes available
 - **Venture capital:** After demonstration of potential for growth and product market fit, VC enters to propel growth
 - **Venture debt:** Given more established business models and VC support, ventures can access debt finance from specialized financial service providers to fund working capital or capital expenses
 - **Private equity:** Having reached promising venture stage growth equity in the form of common shares issued to VC funds become a common way for High-growth Ventures to meet OPEX and CAPEX needs
 - **Commercial loans:** As established ventures, businesses gain access to large amounts of commercial debt
 - **Short-term working capital:** After reaching threshold levels of turnover and profitability short-term working capital becomes available to fuel growth stage



align with the VIRAL framework Levels 7 – 8 (scaling up and seeking an exit) and the From Blueprint to Scale stage in which enterprises seek to expand to reach significantly more customers and markets.

However, we found that in order to distinguish the financial needs of different types of High-growth Ventures, we needed not only to sub-segment this family by stage of development, but also to differentiate between asset-light tech ventures and asset-intensive physical-product-based ventures. “Asset-light” refers to high-tech / IT companies that have the potential for “hockey stick” growth due to the economics of scaling software-oriented solutions to reach sizable addressable markets. We define asset-intensive ventures as those that produce “physical things” and need to prototype and/or build bricks-and-mortar infrastructure to distribute and scale—and thus face a particularly serious challenge in securing early stage risk capital to bridge the “pioneer gap.”

Market gaps and mismatches

With respect to accessing appropriate finance, High-growth Tech Ventures are the segment of SGBs that are typically the best served by investors, particularly in economies where venture capital and private equity investing are established and growing. However, there are numerous frontier markets where venture investing remains quite nascent,²⁷ and thus there is a corresponding need for the SGB finance community to support the expansion of venture investing in these markets.

Another major challenge that High-growth Ventures face is what is known as the “pioneer gap”—an all-too-common financing gap (as described by *From Blueprint to Scale*) between the initial seed stage and later stages when venture capital or private equity firms would typically invest. High-growth Ventures can seek seed funding from multiple sources, including friends and family, angel investors, and business plan competitions or seed funding from accelerators. However, as the ventures grow and their capital needs increase, fewer financial service providers are willing to invest larger amounts of capital in a company that has yet to prove commercial viability and scale.

The pioneer gap is especially acute for High-growth Ventures working in emerging and frontier markets, where risks are already high and the costs of scaling can be significant. It is usually only once this barrier is overcome that venture capital and private equity funds will be willing to invest, but the question remains as to how High-growth Ventures can get to this stage without sustained investment and needed technical assistance.

A Note on Asset Intensity

An enterprise’s asset intensity is one of the key determinants of its external financing needs and need for capital. Asset intensity is a ratio between the total value of an enterprise’s assets and the revenue it generates over a specific period of time.

Deloitte’s report, *Reaching Deep in Low-income Markets*, cites three primary factors that affect asset intensity and determine if a firm is “asset heavy” or “asset light.” First is the size of fixed costs related to property, plant, and equipment (PPE) and labor. More specifically, enterprises that produce physical products will be more asset intense compared to digital products or services. The second factor relates to the “lumpiness” of variable costs as the enterprise scales. This specifically refers to the regularity (and, to an extent, predictability) of an enterprise’s cash conversion cycle. Finally, there is the marginal cost involved in serving each additional customer. Some products or services, for instance, may require a larger sales force, which increases the marginal cost of serving each new customer.

²⁷ Omidyar Network’s publication *Frontier Capital: Early Stage Investing for Financial Returns and Social Impact in Emerging Markets* (2016) adds further color to the varying levels of challenges that enterprises and financial service providers face in different frontier and emerging market contexts. It also highlights the tremendous impact and financial opportunity that can be realized.



The last prevalent financing mismatch we see among High-growth Ventures is the application of “Silicon Valley” venture capital expectations on time horizons, returns, and exits to High-growth Ventures that don’t have the growth trajectory, scale potential, and exit prospects of a software-based tech firm. As pointed out in Omidyar Network’s *Frontier Capital* and Lemelson Foundation/FSG’s *Hardware Pioneers*, this includes physical-product-based businesses that require time and capital for the expensive process of prototyping and market testing physical products; asset-heavy businesses that have capital-intensive growth paths; and pioneering businesses operating in frontier markets with limited to no venture investing infrastructure, thin capital markets, and limited exit prospects. Such ventures face a particularly acute challenge in accessing the early stage risk capital to refine their products and business models.²⁸

Potential solutions and promising developments in the field

POTENTIAL SOLUTIONS

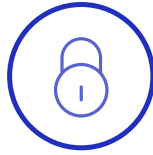
Increasing the use of alternative financing instruments can help address the time-horizon gap. Mezzanine instruments such as self-liquidating equity or loans with revenue-based upside features allow for more flexible time horizons and exits—and better match investors’ expectations with SGB needs.

In addition, there is a need to move beyond closed-ended venture capital fund structures, and instead begin to embrace the use of vehicle structures with more flexible time horizons (such as evergreen funds and holding companies) and of financial instruments that allow for exits structured to support the financing needs of asset-intensive and physical-product-based High-growth Ventures.

²⁸ *Hardware Pioneers: Harnessing the impact potential of technology entrepreneurs*, FSG (2016).



Figure 13: High-growth Ventures – constraints, promising developments, potential providers



KEY CONSTRAINTS

- Real and perceived risks and lack of exit prospects
- Financing gaps at pre-series A funding stage, as well as between Series A and next round financing opportunities
- Overly rapid growth expectations for hardware-based ventures: Asset-heavy/hardware-based ventures have different costs, economics of scale, and time horizons than asset-lite / tech-enabled / digital ventures



PROMISING DEVELOPMENTS

- New fund structures focusing on SGBs straddling the pioneer gap (e.g., Omnivore Fund II focus on seed and Series A ventures)
- Increasing number of funds focusing on seed and early stage (e.g., Mercy Corps’ Social Venture Fund, Global Partnerships’ Social Venture Fund)
- Research on best practices to support innovative, hardware-based ventures (e.g., Lemelson Foundation)

POTENTIAL FINANCIAL SERVICE PROVIDERS

ANGEL INVESTORS AND NETWORKS

COMMERCIAL BANKS

VENTURE CAPITAL FUNDS

PRIVATE EQUITY FUNDS

DEVELOPMENT FINANCE INSTITUTIONS





PROMISING DEVELOPMENTS

The venture capital and early stage private equity sectors are growing in a larger range of emerging markets. Development finance institutions have played a key role in anchoring emerging markets SGB-focused funds as part of their mandates to stimulate private sector development and financial markets development, particularly in frontier contexts. Capria is another example of an entity that's seeking to strengthen local fund managers—particularly those serving High-growth Ventures—by deploying a model that combines a fund of funds to invest in first- and second-time fund managers with an accelerator program that provides GP principals with access to best practices in fund management, access to investors, and peer networking opportunities.

A further sign of progress is the rise of funds focusing on closing the pioneer gap. Omnivore Fund II, a DGGF investee, is a prime example of a fund that addresses the pioneer gap and provides more appropriate capital to hardware-based ventures. The fund focuses on providing a steady stream of capital and technical assistance to seed and Series A enterprises as they develop. It focuses explicitly on companies offering technology for agriculture and the rural economy, offering comprehensive technical assistance on human resources, governance, strategy, and market access.

There are also promising efforts underway to solve the challenges faced by physical-product-based ventures. The Lemelson Foundation, for example, has been particularly active in promoting new approaches to investing in and supporting innovative, hardware-based technologies. Greater levels of patience, flexibility, and support from financial service providers and other ecosystem actors are key to these approaches. Hardware-based technologies and solutions typically involve greater development costs, require longer timelines, and necessitate greater resources for delivery as well as scaling up.

Mercy Corps' Social Venture Fund and Global Partnerships' Social Venture Fund are additional examples of funds that aim to address constraints facing High-growth Ventures by focusing on seed and early stage enterprises. Mercy Corps' Social Venture fund provides \$50,000 – \$250,000 to innovative startups in financial services, agriculture, last-mile distribution, and youth training; it also provides comprehensive technical assistance and market access support. Global Partnerships' Social Venture Fund provides funding and advisory support to founders of early stage, impact-oriented enterprises in education, energy, health, sanitation and water, and rural livelihoods.

The use of more flexible fund structures—such as through permanent capital vehicles like holding companies or open-ended funds—has begun to create more flexible funding for earlier-stage High-growth Ventures.

Finally, the emergence of alternatives to closed-end funds is promising. The use of more flexible fund structures—such as through permanent capital vehicles like holding companies or open-ended funds—has begun to create more flexible funding for earlier-stage High-growth Ventures. NESST's open-ended Evergreen Social Enterprise Loan Fund, for instance, provides loans ranging from \$50,000 to \$1 million that are not tied to a specific exit date and can couple with up to three years of grants with technical assistance.²⁹ As another example, the structure of a permanent capital vehicle such as Pacific Agri Capital's holding company allows it to invest in long-term agricultural development projects that don't align with most investors' time-horizon expectations—and to invest in and capture value by driving operational improvements throughout the investment period. We are already seeing significant momentum, but more attention is needed.

²⁹ Armeni, Andrea and Ferreyra de Bone, Miguel, "Innovations in Financing Structures for Impact Enterprises: Spotlight on Latin America," Multilateral Investment Fund with support from the Rockefeller Foundation (2017).



Business models creating innovative products and services that target niche markets or customer segments, such as high-end premium markets or, conversely, small customer bases at the bottom of the pyramid. Niche ventures have steady growth over time.



PRODUCT VS. MARKET

Moderate scale potential, disruptive business model



GROWTH CURVES

High but steady growth with limited upside



MANAGEMENT BEHAVIORS

“Cross-trainer” - designing new approaches to difficult problems

ROLE IN ECONOMY

- **Size:** Small fraction of all SGBs but meet the needs of a rising middle class in frontier and emerging markets through high-value-add products and services, or niche markets in developed markets.
- **Impact:** Laboratories of social innovation – meet the increasingly diverse and varied needs of consumers, workers, and communities and support the creation and growth of local supply chains.

ARCHETYPES

- **Creative Economy SGBs:** Artists and businesses in the creative economy, with specific focus on unique artistic value-add in niche markets
- **Locally Focused Social SGBs:** Socially conscious SGBs focused on deep impact at a local level – e.g., impacting a specific community or producer or customer group.

EXAMPLES

- **Bombay Atelier**, a small company in Mumbai that designs and produces artistic furniture and targets a high-end local market. The founder, a designer by trade, seeks to grow the business while preserving its unique designs
- **Vega Coffee**, a social enterprise utilizing a direct-to-consumer model to sell coffee from Nicaragua as a premium product to US customers. Vega focuses on achieving impact in specific low-income communities



Overview

The result of our study's unique methodology of blending quantitative analysis of the firm's financing needs with qualitative insights into the entrepreneur's overall mindset and aspirations, we identified a segment of firms that has not yet formally been recognized in the existing literature or market practice. They often get mistaken as part of one of the other segments—either High-growth Ventures or Dynamic Enterprises. Yet, after spending significant time understanding both the key motivations of the entrepreneurs who are operating these firms and examining their distinctive financing and growth pathways, we are convinced that this truly is a distinct segment of firms, whose financing needs are not very well understood nor adequately met.



Niche Ventures create innovative products and services that target niche markets or customer segments. Some of the businesses in this category focus on a specific customer segment, such as high-end premium markets or serving specific local communities. Niche Ventures may also choose to conceive of their impact in terms of depth rather than scale. For example, some enterprises choose to provide a larger range of higher-quality products / services locally instead of seeking to expand into new markets with a limited range of products / services. Finally, some Niche Ventures may be

fundamentally constrained by the volume of products or services they can provide; specialty artisans, for instance, may face fundamental limits in how many products they can create. Taken together, these factors fundamentally limit the ability of these enterprises to achieve scale and confine them to limited markets (at least in the short- to medium-term future).

Niche Ventures create innovative products and services that target niche markets or customer segments.

Role in the economy

While the overall economic effect of Niche Ventures is limited—we estimate that they make up a small fraction of all SGBs—they nonetheless can meet the desires of a rising middle class in frontier and emerging markets to obtain differentiated, high-quality products. Our portfolio data showed that Niche Ventures have a median of 49 employees and a median revenue of \$1 million (more details in Annex 3). Niche Ventures can compete with more expensive imported goods due to their lower cost and ability to tap into unique tastes in a given marketplace. By shifting a portion of consumers away from imported goods and toward domestically produced ones, Niche Ventures indirectly support the creation and growth of local supply chains, with benefits related to job creation and income generation.

Niche Ventures play another important indirect role in economies: They can function as laboratories for social innovation. Some Niche Ventures choose to target bottom of the pyramid markets (or vulnerable populations more generally) with specialized products and services that help fulfill unique needs. Given the difficulty in reaching and serving the bottom of the pyramid profitably, this market often has few commercial options available, and pilots of affordable, potentially impactful products and services can be rare. Because they are not solely motivated by financial factors, Niche Ventures can invest resources in piloting and rolling out products and services for these markets, directly impacting vulnerable populations and supplying lessons for other commercial players.



Leadership persona

Niche Ventures are led by management teams looking to remain true to the company's original purpose and vision, which typically have deep personal meaning to the owner (e.g., a dedication to the aesthetics of product design or to social impact). Therefore, the founders are often highly motivated to grow without sacrificing the desire to meaningfully impact certain markets. These founders are cautious about taking on finance or partners who may not share or understand the original vision of the founding team, but they do recognize the opportunities that could result from obtaining external finance, as well as how their products and services could be further refined.

Example enterprises

An example of a Niche Venture is **Bombay Atelier**, a small company in Mumbai that designs and produces furniture with unique artistic style and targets a high-end local market. Bombay Atelier's founder, a designer by trade, is seeking to grow the business while preserving the signature aesthetic of its products. Another example is **Nazava Water Filters**, a water filter manufacturer in Indonesia that focuses on creating tangible products customized to niche local consumer demand.

Financing needs, further sub-segmentation, market gaps, and mismatches

FINANCING NEEDS

Given their focus on creating high-quality products and services, Niche Ventures have a strong need for financing to support product or service development. Creating, piloting, validating, and refining an innovative product or service can be a costly and time-consuming process that requires long-term, patient capital. Moreover, since these enterprises target niche markets, they lack economies of scale and can face higher transaction costs in selling goods and services to a small number of customers—which creates a pressing need for working capital financing to decrease uncertainty during the cash conversion cycle.

SUB-SEGMENTS

While there are many ways to better understand the financing needs of Niche Ventures, we found that the most important trait to consider was the nature of the product or service that they are creating. **Product-based Innovators**, which tend to be more asset-intense (given their need for more R&D and the costs associated with getting a product to market), and **Service-based Innovators**, which tend to be more asset-light (since innovation tends to be in the delivery model) each have their distinctive financing needs. Additional sub-segmentation variables to consider are type of business activity and financial performance. We found that stage of maturity was relevant to Niche Ventures in early stage startup mode, but less critical after this phase, as the more measured pace of growth of these firms creates less distinctive financing needs over time.

Product-based Innovators focus on creating tangible products customized to niche markets. Examples of this sub-segment include specialty manufacturing, specialty food processors, and other activities tending toward higher capital expenditure needs. Compared to Service-based Innovators, these enterprises tend to have higher asset intensity, given the higher costs related to product R&D, getting products to market, and scaling.

Service-based Innovators focus on providing intangible services to niche markets and consumers. These enterprises are often specialty service providers less oriented toward capital expenditures, since these enterprises likely rent or lease their spaces. This sub-segment, compared to Product-based Innovators, tends to have low asset intensity, since the innovation is primarily in these businesses' delivery models and their needs are primarily related to staff and payroll.



Figure 14: Niche Ventures – sub-segment capital needs



SUB-SEGMENT

SERVICE-BASED INNOVATOR

Focus on providing services to niche markets and consumers, such as retail, education, restaurants. More asset-light due to focus on innovation in delivery model

PRODUCT-BASED INNOVATOR

Focus on creating products customized to niche markets, such as specialty manufacturing, food processing, etc. More asset intense given need for more R&D

CAPITAL NEEDS

OPEX: High OPEX needs for staff, payroll, and other operational expenses

CAPEX

OPEX

CAPEX: High CAPEX needs for R&D, inventory, getting products to market, and scaling

DESCRIPTIONS

High OPEX needs: Can be provided through

- (1) working capital from commercial banks, foundations, nonprofits, or NBFIs;
- (2) cash-flow based lending through commercial banks or corporates; or
- (3) trade finance from commercial banks

High CAPEX needs: Can be provided through

- (1) asset-backed loans from commercial banks or angels;
- (2) grants/TA through foundations, nonprofits, or NBFIs; or
- (3) leasing through nonprofits



MARKET GAPS AND MISMATCHES

We highlight two market gaps that inhibit a more efficient matching between appropriate capital and Niche Ventures. First, Niche Ventures' lack of a track record, lack of collateral, and unique business models means that traditional financiers—especially commercial banks—face significant risks in serving this segment. Traditional financial service providers are often simply unwilling to supply the product or service development financing Niche Ventures need in order to fully refine their products / services.

Second, in some market contexts, a lack of early stage financing options can push Niche Venture entrepreneurs to actively pursue investors, such as venture capitalists, whose expectations for returns and exits make them more suited to High-growth Ventures. This can lead investors and enterprises alike to devote time and resources to efforts that are unlikely to produce satisfactory outcomes.

As a consequence, Niche Ventures are typically misunderstood and underserved by existing financing markets. When they are treated like High-growth Ventures, they underperform venture capital fund expectations; when they are viewed as being more similar to Dynamic Enterprises, their ability to produce social impact often goes overlooked, and they tend not to get financed. The result is that many Niche Ventures never have the opportunity to maximize their potential.

Potential solutions and promising developments in the field

POTENTIAL SOLUTIONS

Overall, as Niche Ventures are often more local in scope and scale, we view local investors as being particularly critical and well suited to meeting their financing needs. International venture capital firms or impact investors may need to see large-scale potential to generate desired profitability and/or impact in order for an investment to be attractive. Local investors—including angel investor networks, local funds, and even commercial banks or NBFIs—may well be better placed to serve Niche Ventures, as they are more closely embedded in the local markets and customer bases that Niche Ventures are serving. International funders looking to support this category of enterprise should look to find ways to partner with and scale these local financial providers.

Niche Ventures can also benefit greatly from the support and connections provided by business networks and accelerators. These platforms have shown success in referring Niche Ventures to financial intermediaries more aligned with their scale and growth trajectory.

Finally, Niche Ventures would likely benefit from an increase in the supply of innovative funding mechanisms such as recoverable grants, pay-for-success convertible notes, and crowd-sourcing platforms (e.g., Kickstarter, Broota, etc.), which can efficiently pool capital from consumers who value their niche innovations.

PROMISING DEVELOPMENTS

Ecosystems of local investors are becoming more robust across a number of emerging and frontier markets. In recent years, the field has witnessed the emergence of more localized angel investors and investment syndicates that can more effectively mobilize local sources of capital. While the emergence of these actors has been partially organic, it has also been supported by select field-building organizations that have begun specifically to focus on this set of constraints inhibiting the growth of local financial markets.

Overall, as Niche Ventures are often more local in scope and scale, we view local investors as being particularly critical and well suited to meeting their financing needs.



Figure 15: Niche Ventures – constraints, promising developments, potential providers



KEY CONSTRAINTS

- Mismatch between applying High-growth Venture expectations on scale and exit potential, leading to wasted time for investors and SGBs alike
- Mismatch between financing needed to refine products/ services and traditional financial providers’ willingness to supply, due to lack of track record, lack of collateral, and unique business model



PROMISING DEVELOPMENTS

- More robust local investor ecosystems in emerging and frontier markets (e.g., African Business Angel Network’s efforts to create new angel groups across the continent)
- Increased training and awareness around angel investing in emerging markets (e.g., Global Business Angel Network’s convenings and investment guides for established and new angel investors)
- Expand use of longer-term fund structures – Open-ended funds or permanent capital vehicles can allow for longer investment periods required

POTENTIAL FINANCIAL SERVICE PROVIDERS

COMMERCIAL BANKS

ANGEL INVESTORS

FOUNDATIONS

NON-BANK FINANCIAL INTERMEDIARIES (NBFIS)

Another promising development is the increased training and awareness raising for angel investing in particular. The Global Business Angels Network (GBAN), for example, brings together entrepreneurs, policymakers, and other early stage finance actors to help local financial ecosystems recruit more investors and build stronger networks. In addition to sponsoring convenings and meetings, it also produces research and investment guides for established and newcomer angel investors.



Businesses in stable ‘bread and butter’ industries deploying established business models for producing goods and services, with moderate growth paths over sustained periods of time



PRODUCT VS. MARKET

Moderate scale potential, with traditional business models focused on incremental innovation



GROWTH CURVES

Low to moderate but steady growth



MANAGEMENT BEHAVIORS

“Treadmiller” – Keep small business running and maintain a stable source of income

ROLE IN ECONOMY

- **Size:** High proportion of the total # of SGBs but a higher proportion of SGB revenue and employment, with an ability to create high volume of jobs, generally unskilled or semi-skilled
- **Impact:** Mainstay of a healthy economy – Dynamic Enterprises are a large source and driver of job creation, particularly given their size and the labor-intensive nature of many Dynamic Enterprises’ work

ARCHETYPES

- **Local Manufacturer:** Established T-shirt manufacturer employing 75 workers with strong presence in one city and surrounding hubs, but limited reach into larger markets
- **Agricultural Cooperative:** A long-standing cocoa co-op with 200 members and four small export contracts with well-known international buyers
- **Medium-sized, Family-run Restaurant:** A successful chain restaurant with eight outlets across three neighboring cities, run by an extended family of entrepreneurs

EXAMPLES

- **CAC Chirinos,** a Peruvian coffee cooperative selling coffee locally and internationally. Founded in the 1960s, Chirinos had 100 members and has experienced gradual stable growth within its local market
- **Stick Pack,** a medium-sized business in Cairo, provides bulk quantities of flexible packing and adhesive materials with printing. In operation since 1987, the company has several hundred employees but seeks to steadily grow



Overview

Dynamic Enterprises, the third enterprise family, operate in established “bread and butter” industries—such as trading, manufacturing, retail, and services—and deploy proven business models. Many are well established and medium-sized, having grown steadily over a substantial period. Our portfolio data analysis shows that the median number of employees is 69 and the median annual revenue is \$2.2 million (additional data in Annex 3). Dynamic Enterprises seek to grow by increasing market share, reaching new customers and markets, and making incremental innovations and efficiency improvements—but their rate of growth is typically moderate and tempered by the dynamics of mature, competitive industries.

Dynamic Enterprises, the third enterprise family, operate in established “bread and butter” industries—such as trading, manufacturing, retail, and services—and deploy proven business models. Many are well established and medium-sized, having grown steadily over a substantial period.

Dynamic Enterprises may start as a small family business, with initial financing coming from personal savings or friends and family. Often they follow relatively steady growth paths, meaning that their growth is characterized by incremental reinvestment of earnings over time; they typically do not raise large rounds of growth equity (even if they could benefit from it). Dynamic Enterprises may remain “small and growing” businesses for a prolonged period of time—many are unlikely ever to “graduate” from SGB status. However, they have growth potential that could be unlocked by receiving the right type of financing and supporting forms of assistance to build the capacity of their management and operations at the right time.

Role in economy

Dynamic Enterprises focus on industries such as manufacturing, agribusiness, retail, and services—mainstays of most economies—making them responsible for a large proportion of total SGB revenue and employment. Within many emerging and frontier market economies there is a high demand for unskilled and semi-skilled jobs; Dynamic Enterprises are well positioned to provide a high volume of these types of jobs due to their size and the labor-intensive nature of much of their work.

Given the necessity of these enterprises’ products and services, the presence of a vibrant population of Dynamic Enterprises is crucial to building an economy’s self-sufficiency and reducing the need for costly imports. The health and vibrancy of Dynamic Enterprises is also critically important for other small and growing enterprises, as they create a significant demand for products and services as inputs into their production, and because Dynamic Enterprise employees drive consumer purchases and local demand.

Leadership persona

Management teams that lead Dynamic Enterprises often provide incomes for extended families and their surrounding communities, so owners can tend to be relatively risk-averse, given the impact of any potential miscalculation on the communities’ livelihoods. At the same time, owners want to stably and steadily grow beyond their local markets into regional ones; however, this process can often take decades given the nature of competition in well-established markets and the risks of growing the size of operations.



Example enterprises

C.A.C. Chirinos, a coffee cooperative based in Chirinos, Peru, is a Dynamic Enterprise that sells coffee locally and internationally in public markets. Founded in the 1960s, C.A.C. Chirinos had about 100 member farmers and experienced stable growth within its local market up until about a decade ago, when its expansion into local markets corresponded with increased growth rates. C.A.C. Chirinos has received some debt financing in the past, including an investment from Root Capital, to pay for such improvements as the creation of an on-premises organic fertilizer plant. C.A.C. Chirinos seeks to achieve high but stable growth as it works to increase its market share and potentially expand into additional crops such as cacao.

La Laiterie du Berger, started in Senegal in 2005, manufactures dairy products from fresh milk collected from over 800 farmers in northern Senegal. After the company's consistent growth, La Laiterie du Berger products are now distributed in more than 6,000 outlets and its reach continues to expand within Senegal. The company has supported the growth of the local dairy sector by collecting milk locally and providing producers with access to high-quality cattle feed, technical assistance, and credit. La Laiterie du Berger has received financing from Investisseurs & Partenaires and the Danone Group, among others.

Another example of a Dynamic Enterprise is **Stick Pack**, a medium-sized business based in Cairo, Egypt that provides customers bulk quantities of custom-printed, flexible packing and self-adhesive materials. The company has operated stably in Egypt since 1987 and has several hundred employees, but seeks to steadily grow within Egypt and the Middle East. It received an investment from Grofin in 2015 to develop a polypropylene production line to more efficiently manufacture packaging products.

Financing needs, further sub-segmentation, market gaps, and mismatches

FINANCING NEEDS

Dynamic Enterprises are stuck squarely in the missing middle of enterprise finance: They are too big for microfinance, too small or risky for traditional bank lending, and lack the growth, return, and exit potential sought by venture capitalists. By the standards of SGBs, mature Dynamic Enterprises tend to have larger, more complex operations (e.g., high payrolls,



marketing and advertisement expenses, substantial plant / equipment costs, and costly raw materials and inputs) and ongoing relationships with both suppliers and customers that necessitate a stable source of short-term working capital. They may also need CAPEX financing if they are seeking a specific growth target in the medium to long term (e.g., entering a new geographic region or constructing a new facility or factory). Yet many Dynamic Enterprises lack sufficient cash flow or liquidity to finance their operations or capital expenditure investments on their own.

SUB-SEGMENTS

Our analysis revealed that the best way to understand Dynamic Enterprises' financing needs is to further segment this category by sector. The sector in which an enterprise operates serves as a good predictor of its level of asset intensity (listed on page 46 in order of increasing asset intensity) and "thirstiness for capital."

Stage and size are clearly important variables for the financing needs of Dynamic Enterprises as well. However, since the majority of dynamic enterprises are well-established businesses, operating in established markets, most have matured beyond the startup or early stage of growth, and now face critical financing gaps in their ongoing operations and desire to grow in scale.

Service Enterprises are typically asset-light, predominantly small- to medium-sized businesses in urban locations that primarily provide services rather than producing tangible products. Merchandising / trading Enterprises, which typically have moderate asset intensity, buy goods wholesale and resell them in different markets. They are usually medium-sized businesses based in rural locations. Financing Enterprises typically have moderate to high capital intensity,³⁰ since they are primarily focused on building the size of their portfolios. Finally, Manufacturing/processing Enterprises, which use raw materials to produce finished goods, are comparatively larger, typically asset-heavy businesses.

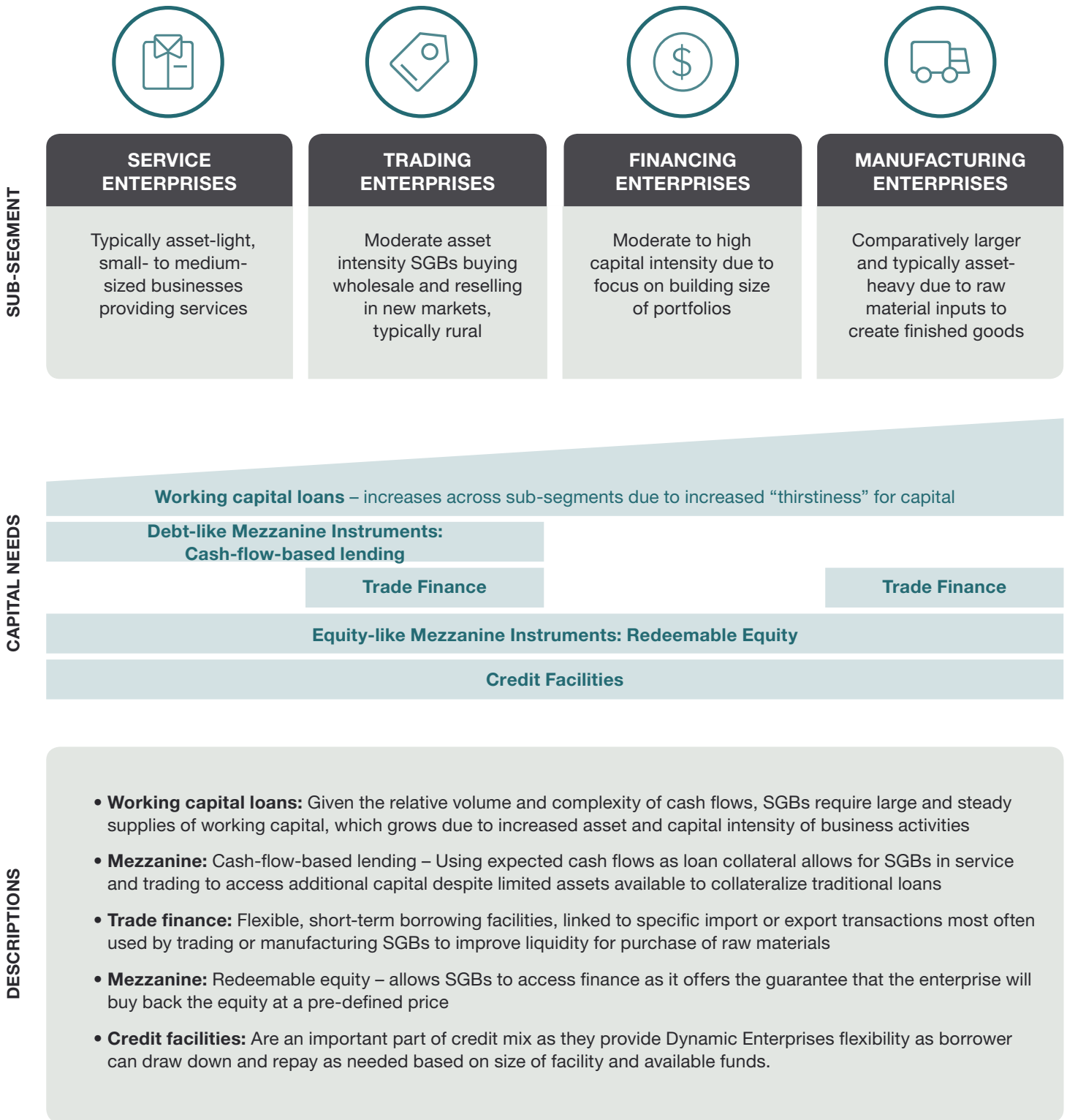
Our analysis revealed that the best way to understand Dynamic Enterprises' financing needs is to further segment this category by sector. The sector in which an enterprise operates serves as a good predictor of its level of asset intensity and "thirstiness for capital."



³⁰ This is similar to "asset intensity" – see the discussion on page 33.



Figure 16: Dynamic Enterprises – sub-segment capital needs





MARKET GAPS AND MISMATCHES

In many countries, very few financial service providers are focused on serving this large family of businesses. Many Dynamic Enterprises are simply not large enough or sufficiently high-yielding to justify the transaction costs or assuage the concerns of risk-averse commercial banks that prefer to serve larger businesses. However, particularly once they mature, Dynamic Enterprises are too large for the core product offerings of most MFIs and NBFIs. And finally, most Dynamic Enterprises do not attract the impact investors, accelerators, or innovation-minded venture investors that in many countries tend to focus on innovative startups.

Thus, a key priority for Dynamic Enterprises is drawing in more financial service providers to serve this segment. Local and regional commercial banks are by far the largest player with potential to serve this family, and indeed an increasing number of banks are developing specialized SME banking capabilities and products. The IFC's SME Finance Forum plays a valuable role in promoting innovation and knowledge sharing among banks focused on the SGB sector.

However, the risk profile of some Dynamic Enterprises, and the direct cost and opportunity cost of serving them (relative to serving lower-risk segments, such as corporates), means that many commercial banks lack incentive to focus on Dynamic Enterprises—particularly those that are smaller and earlier stage.

Potential solutions and promising developments in the field

POTENTIAL SOLUTIONS

Increasing the number of specialized SGB-focused financial service providers that offer mezzanine financing and specifically more flexible debt to meet the needs of Dynamic Enterprises is a key priority. Specialized mezzanine funds take a private equity approach to investing in high-potential Dynamic Enterprises, providing flexible growth capital, but via instruments that allow for a “structured exit” (e.g., revenue share or royalty arrangements). Mezzanine instruments as an alternative to straight equity can be a helpful alternative structure for businesses where prospects for exits are limited or where entrepreneurs prefer not to exit.

Self-liquidating instruments that allow businesses to generate revenue to repay their lenders, along with innovations like invoice financing, show promise in serving Dynamic Enterprises. In addition, alternative financing structures such as evergreen funds—which are not tied to the constraints of their LPs, and thus have more flexibility, patience, and risk tolerance—can be appropriate sources of capital for Dynamic Enterprises.

Finally, many commercial banks are beginning to understand that Dynamic Enterprises often need not only financing but also technical assistance. They are starting to partner with technical assistance providers or build their own teams in order to bundle post-investment technical assistance with the financing they provide to Dynamic Enterprises.

A key priority for Dynamic Enterprises is drawing in more financial service providers to serve this segment.





Figure 17: Dynamic Enterprises – constraints, promising developments, potential providers



KEY CONSTRAINTS

- Squarely “in the middle of the missing middle” – considered too small and risky for commercial banks but too large for core products offered by MFIs, NBFIs, and tech MSME lenders
- Further challenges due to frequent lack of established governance, lack of internal financial controls, and lack of a strong financial track record



PROMISING DEVELOPMENTS

- Flexible solutions such as self-liquidating instruments, often mezzanine instruments (e.g., Business Partners International)
- Innovation through provision of mezzanine finance to local angel investors (e.g., iungo capital)
- Customizable solutions such as working capital loans or invoice financing through mobile application (e.g., Kabbage)

POTENTIAL FINANCIAL SERVICE PROVIDERS

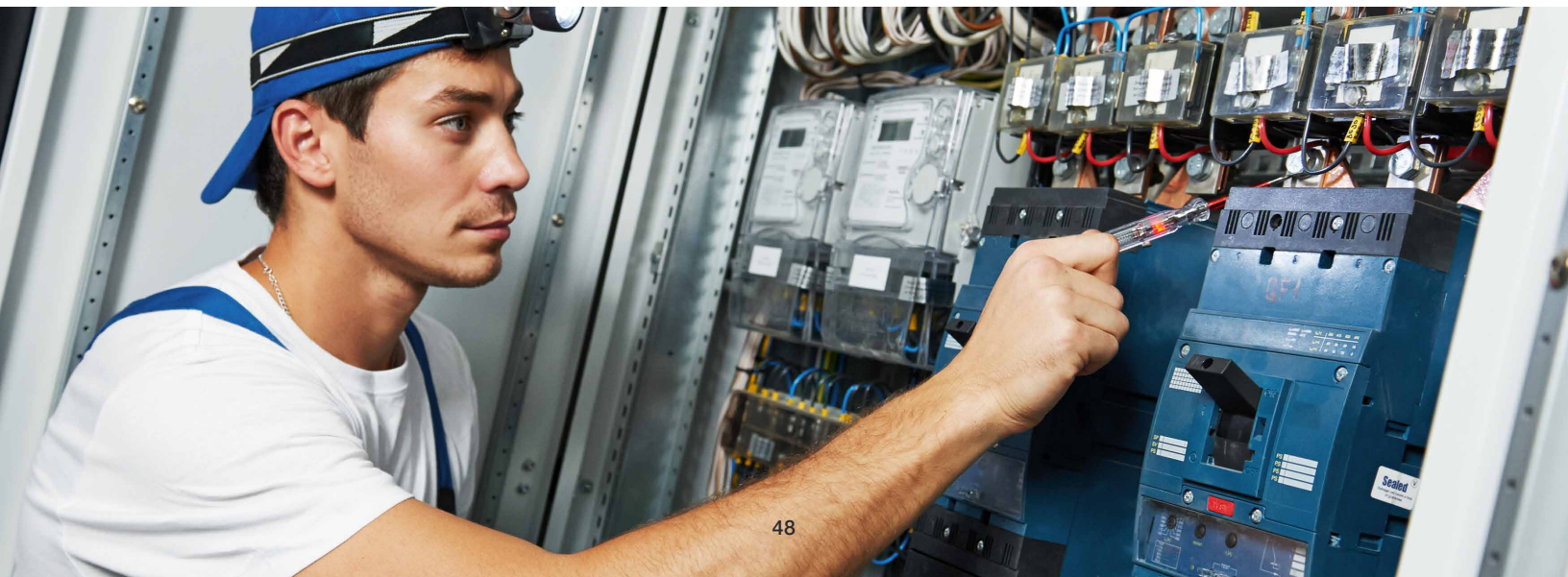
COMMERCIAL BANKS

DEBT FUNDS

MEZZANINE AND PRIVATE EQUITY FUNDS

DEVELOPMENT FINANCE INSTITUTIONS (DFIS)

CORPORATES AND OTHER VALUE CHAIN ACTORS





PROMISING DEVELOPMENTS

Promising Solutions: While still limited in overall use, flexible, debt-like mezzanine instruments that are tailored to the needs of Dynamic Enterprises offer significant potential to support businesses that aren't able to access bank lending or growth equity finance. **Business Partners International (BPI)**, for example, has been quite successful in applying this model in South Africa and several other markets into which it has recently expanded. Through the use of self-liquidating instruments, efficient due diligence processes, and the offering of nonfinancial support (e.g., mentorship, technical assistance, or property management), BPI has been able to serve thousands of businesses.

XSML is an example of a financial service provider that targets the Dynamic Enterprise family in several frontier markets in Central and East Africa. Through two funds, XSML provides growth capital to Dynamic Enterprises using a range of instruments—equity, mezzanine structures, and longer-term debt—and pairs this with providing technical assistance and management expertise.

Another promising development is the increased use of mezzanine financing instruments by fund managers. **iungo capital**, for example, has successfully provided mezzanine finance to SGBs in Uganda, where it engages local angels through a co-investment structure in which the angel investor provides 5 – 10% of the total capital needed.

New digital lending services have also shown promise for small businesses. **Tienda Pago**, another innovator in small business loans, provides invoice financing for SGBs in Mexico and Peru. The loans are administered through a mobile application; the only requirements are that the loans be used to purchase inventory, invest in new equipment, cover payroll, hire staff, or launch marketing campaigns.

We have also seen promise in the growing role of specialized agricultural lenders, particularly in trade and asset financing. For example, through pre-competitive alliances like the **Council for Smallholder Agricultural Finance (CSAF)**, Root

Capital and 11 fellow member organizations have collaborated to increase trade and asset financing to Dynamic Enterprises such as agricultural co-ops, out-grower schemes, and agro-processors. CSAF's lending activity has more than doubled over the past five years, reaching \$716 million disbursed in 2017 to 794 agricultural Dynamic Enterprises across 64 countries.

In the thought leadership space, **DGGF** has been particularly active in promoting the use of flexible mezzanine instruments. Specifically, DGGF's *New Perspectives on Financing Small Cap SMEs in Emerging Markets: The Case for Mezzanine Finance* has helped advance the field's thinking and broadened its understanding of this set of financial products.

However, all of these financial service providers face challenges with respect to the fundamental risk-return profile and cost of serving the Dynamic Enterprise segment. As a result, while they are growing and reaching an increasing number of previously unfinanced SGBs, their collective portfolios remain small relative to the very large addressable market of Dynamic Enterprises.

All of these financial service providers face challenges with respect to the fundamental risk-return profile and cost of serving the Dynamic Enterprise segment. As a result, while they are growing and reaching an increasing number of previously unfinanced SGBs, their collective portfolios remain small relative to the very large addressable market of Dynamic Enterprises.



Small, family-run businesses that are opportunity driven and on the path to increased formalization. These businesses operate to maintain an income for an individual family and have slow and steady growth as they incrementally prove their product or service through traditional business models.



PRODUCT VS. MARKET

Small scale potential and traditional business model



GROWTH CURVES

Low but steady growth



MANAGEMENT BEHAVIORS

“Treadmiller” – Keep small business running and maintain a stable source of income

ROLE IN ECONOMY

- **Size:** Collectively estimated to be 60 to 70 percent of total SGBs
- **Impact:** Primary source of basic services and jobs especially for rural and vulnerable populations. However, given the replicative nature of products and high competition, Livelihood-sustaining Enterprises are not a major engine of new job growth or improved productivity.

ARCHETYPES

- **Small Family Business:** Multigeneration small family business, with steady but modest upward growth and a few core employees outside of the immediate family
- **Graduated Micro-enterprise:** Small business that has moved from initial informality to established products and additional employees, both full and part time. Unlikely to grow significantly, but will maintain consistent operations

EXAMPLES

- **Prime Auto Care Garage,** a small, woman-owned business based in Kigali, Rwanda providing vehicle repair services. In operation since 2010, the enterprise has achieved robust but limited growth and currently has 27 employees
- **W&R Shoes,** a small family-owned business in Masaya, Nicaragua started by an independent shoemaker. After 27 years, the workshop has grown to include 15 employees



Overview

Livelihood-sustaining Enterprises are small, opportunity-driven, family-run businesses that are on the path to increased formalization and incremental growth. These businesses typically start out as a source of income for an individual or a family, but grow incrementally (typically modestly above the rate of inflation) to hire more employees and expand their product and service offerings. Their growth plans often involve incremental improvements in their product, service, and/or delivery and largely concentrate on the provision of replicative products and services, using simple and traditional business models.

While such enterprises are unlikely ever to become large enough to “graduate” from SGB status, they are capable of achieving moderate growth with the right opportunities and support (financial and nonfinancial). Our portfolio data analysis shows that the median number of employees for a Livelihood-sustaining Enterprise is 16 and the median annual revenue is \$170,000 (more details in Annex 3).



Livelihood-sustaining Enterprises are small, opportunity-driven, family-run businesses that are on the path to increased formalization and incremental growth.

For the purposes of this study, we differentiate Livelihood-sustaining Enterprises from the broader category of microenterprises. We do not include microenterprises that are operated by necessity-driven entrepreneurs who have very little desire (or potential) to move beyond employing immediate family members and a few individuals. Additionally, we do not include microenterprises that are informal and have limited near-term prospects of embarking on the path of formalization—these businesses are minimally relevant to a study that focuses on the missing middle, as they have more limited financing needs or are better served by MFIs.

Role in economy

Our internal estimates have Livelihood-sustaining Enterprises making up 60 to 70 percent of the total SGB population. They are one of the most job-rich segments in developing economies,³¹ yet they are not a major engine of new job growth, improved productivity, or incremental economic growth. Given the absence of a formal private sector in most developing economies, and the corresponding lack of jobs and a market for basic goods and services, livelihood-sustaining small businesses are a necessity for most individuals seeking livelihoods—particularly in rural economies and vulnerable populations—and provide the simple goods and services needed in local markets. The replicative nature of the products and the high levels of competition, however, mean that Livelihood-sustaining Enterprises provide primarily lower-wage jobs for unskilled and semi-skilled labor.

Leadership persona

Livelihood-sustaining Enterprise owners are focused on running their businesses to provide sustainable income and livelihoods for their families and their employees. They often value the security and predictability of a business model and customer base they know well. While as entrepreneurs they are comfortable taking risks within certain parameters, they are unlikely to venture into business models and markets with which they are wholly unfamiliar.

³¹ In many economies, informal, necessity-driven SMEs likely hold the largest number of jobs collectively but do not meaningfully contribute to economic growth or drive job creation.



Example enterprises

Prime Auto Care Garage is a small, woman-owned business based in Kigali, Rwanda that primarily provides limited motor vehicle repair services. It has been in operation since 2001, has 27 employees, and has achieved robust but limited growth. Prime Auto Care Garage was able to receive a loan from Business Partners International for \$54,000 for additional garage equipment to help it moderately grow.

W&R Shoes, a small business in Nicaragua, is another example. The founder of W&R began making shoes at age 10 and started an independent workshop out of his home after decades of working for other craftsmen. After 27 years of operation, that workshop has grown to 15 employees, including three family members. The workshop is well known in the shoe-making center of Nicaragua and has partnerships with regional shoe stores to send school shoes to nearby cities.

Financing needs, further sub-segmentation, market gaps, and mismatches

FINANCING NEEDS

The financing needs of Livelihood-sustaining Enterprises are fairly basic and are heavily weighted toward working capital to finance operations. For many businesses in this category, the primary challenge is in obtaining short-term capital to continue operating at full capacity during their cash conversion cycles and to provide more predictability. Other critical costs relate to maintaining a basic level of operation, such as payroll, utility payments, and space rental. Given the segment's modest growth profile, capital expenditure needs are limited but could extend to small acquisitions of land, production facilities, equipment, machinery, and similar needs.

SUB-SEGMENTS

In line with a recent IFC study,³² we identified financial performance as the primary sub-segmentation variable for Livelihood-sustaining Enterprises. Given the lack of growth prospects, relative informality of the businesses, and simple financing needs, the quantity and variety of finance providers as well as the types of available instruments are all significantly limited. To determine a meaningful distinction between providers and instruments, we used financial performance to create two segments: Partially Credit Constrained and Fully Credit Constrained.

Partially Credit-constrained businesses are characterized by a demonstrable track record of marginal profitability and, generally, lower risk for a financier, given the presence of some assets to collateralize and at least a degree of formality in internal financial controls. These enterprises have ambition to grow and have successfully managed to employ people outside of the owner's family for an extended period of time. These enterprises are often among an MFI's top performers and may have accumulated some small non-moveable assets.

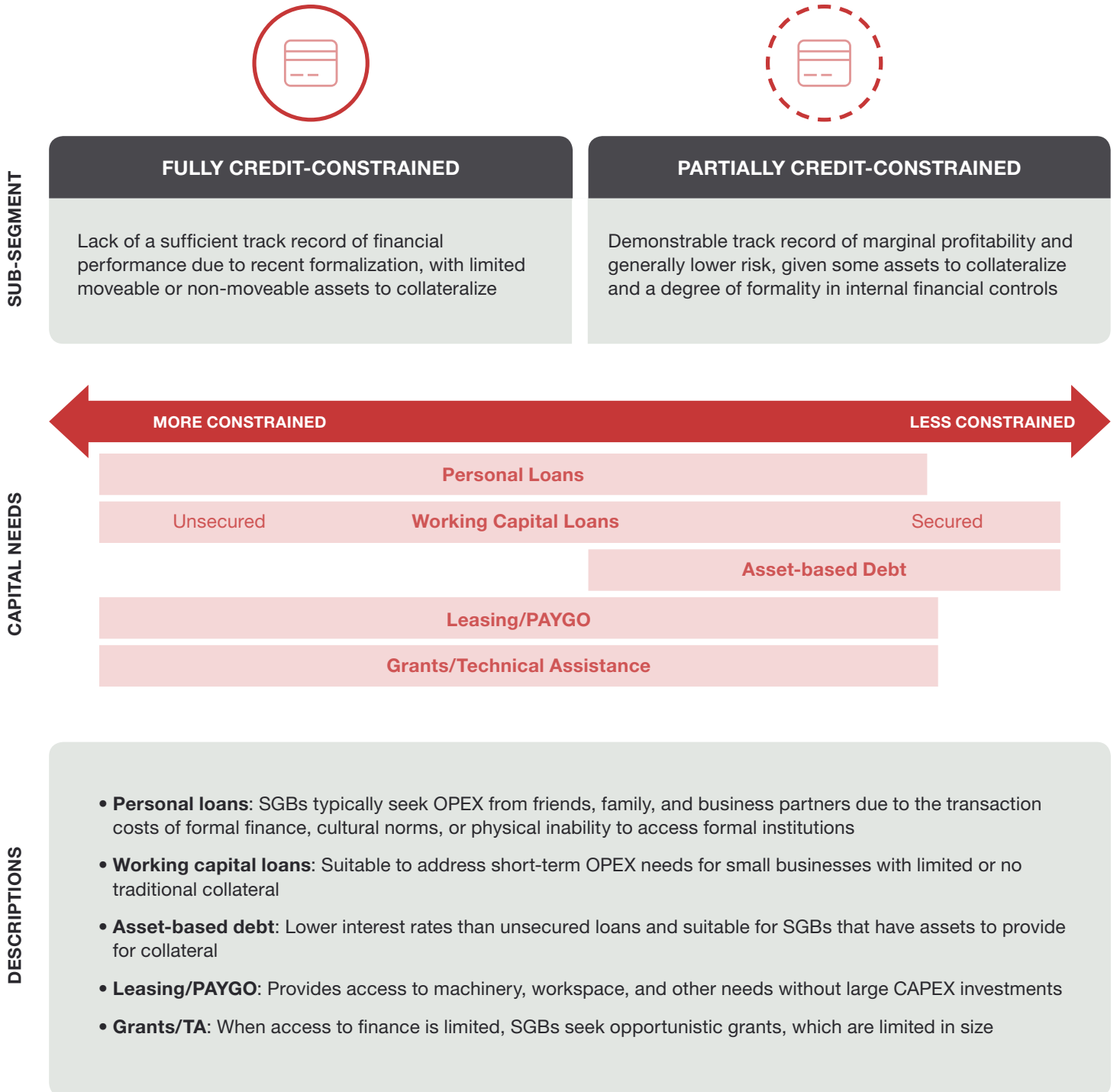
Fully Credit-constrained businesses, however, are far riskier due to a variety of reasons. These enterprises may lack a sufficient track record of financial performance, since the entrepreneur may have only recently decided to grow his or her business or begin the process of business formalization. Additionally, these enterprises may have no moveable or non-moveable assets to collateralize. These and other factors fundamentally limit the appetite of financial service providers to engage with this sub-segment given the high risks but very limited growth prospects.

The financing needs of Livelihood-sustaining Enterprises are fairly basic and are heavily weighted toward working capital to finance operations. For many businesses in this category, the primary challenge is in obtaining short-term capital to continue operating at full capacity during their cash conversion cycles and to provide more predictability.

³² "MSME Finance Gap: Assessment of the shortfalls and opportunities in financing micro, small and medium enterprises in emerging markets," International Finance Corporation, World Bank Group (2017).



Figure 18: Livelihood-sustaining Enterprises – sub-segment capital needs





MARKET GAPS AND MISMATCHES

The primary constraints for Livelihood-sustaining Enterprises relate to the transaction costs and perceived risks of serving this family of SGBs. Generally, these enterprises lack collateralizable assets, possess limited financial management capacity, and likely have weak or mixed financial performance. These factors deter traditional finance service providers, especially commercial banks, from lending to this segment. Further compounding this challenge is the general lack of moveable and non-moveable asset registries in emerging and frontier markets, which prevent banks from using asset-based lending at scale.

Similarly, outside of MFIs, few finance service providers exist that can lend small increments of long-term capital (between \$20,000 and \$100,000, depending on the country) at large volumes to meet the needs of millions of Livelihood-sustaining Enterprises, given the challenges of efficiently and cost-effectively assessing risk. In the absence of these sources and community sources of finance, Livelihood-sustaining Enterprises are left with the option of seeking opportunistic grants from foundations and nonprofits / social enterprises, which are limited in size and reach.

Potential solutions and promising developments in the field

POTENTIAL SOLUTIONS

In recent years, MFIs have become increasingly important and successful providers of short-term, microcredit working capital facilities. They are uniquely positioned to do this given their local roots and innovative risk-mitigation measures, particularly if transaction costs can be kept low. Similarly, certain nonbank financial institutions, such as community development finance institutions and credit unions, are major providers of working capital.

In some countries and in very specific circumstances, commercial banks may be a source of capital, but they do not ordinarily serve or target this SGB segment family. Trade or supply chain finance can also be pursued through business partners or large corporates with well-established supply chains.

Finally, perhaps the most promising solution lies in driving down the cost of credit assessment and of servicing these SGBs through technology. There has been an explosion of tech-enabled lending models for micro-, small-, and medium-sized enterprises (MSMEs) that are driving down the cost of providing small loans and meeting working-capital needs.





Figure 19: Livelihood-sustaining Enterprises – constraints, promising developments, potential providers



KEY CONSTRAINTS

- Lack of collateralizable assets and mixed financial performance
- High transaction costs for financial service providers due to small loan sizes and difficult risk assessment
- Lack of moveable and non-moveable asset registries prevents banks from using asset-based lending at scale

PROMISING DEVELOPMENTS

- MSME-focused loan platforms address cashflow challenges for non-banked retailers (e.g., NeoGrowth)
- Digital lending platforms (e.g., Liwwa)
- Multiple lender matching (e.g., Indifi)
- Peer-to-peer networks, low-cost risk assessment tech, and better data (e.g., World Bank’s Personal Property Security Registry for asset registry)

POTENTIAL FINANCIAL SERVICE PROVIDERS

MICROFINANCE INSTITUTIONS (MFIS)

NON-BANK FINANCIAL INTERMEDIARIES (NFBIS)

COMMERCIAL BANKS

PUBLIC/ GOVERNMENT BANKS

NON-GOVERNMENTAL ORGANIZATIONS (NGOS)

PROMISING DEVELOPMENTS IN THE FIELD




In recent years, NBFIs have emerged that use digitally based platforms to reduce the transaction costs involved in serving Livelihood-sustaining Enterprises. Through the use of peer-to-peer networks, low-cost risk assessment processes and alternative credit scoring methodologies, and better data, NBFIs can dramatically change how this segment family is served. For example, NeoGrowth, one of Omidyar Network’s investees, is a short-term loan platform that helps small- and micro-sized retailers in India who lack access to traditional bank credit address everyday business cash-flow challenges. Indifi Technologies is another investee that seeks to match small businesses with multiple lenders. Liwwa, an investee in DGGF’s portfolio, is a digital lending platform that primarily operates in Jordan, where it uses advanced data analytics to assess the creditworthiness of enterprises.

3.3 SUMMARY OF THE SEGMENT FAMILIES

Synthesizing the full range of segment family core characteristics

This report lays out a set of segment families defined through a series of quantitative, qualitative, and behavioral lenses, with further detail provided by a series of sub-segments. Distilling and synthesizing the full universe of SGBs is a complex undertaking—one that requires a holistic lens that can be adapted based upon situational needs and contexts. In order to summarize the full range of these core characteristics, Figure 20 depicts the core characteristics of each of the four SGB segment families.

Figure 20: Synthesis of the four segment families and their core characteristics

		LENS 1: PRODUCT VS. MARKET	LENS 2: GROWTH CURVES	LENS 3: MANAGEMENT BEHAVIORS	FURTHER SEGMENTATION DRIVER	ENTERPRISE SUB-SEGMENTS
 HIGH-GROWTH VENTURES	Physical product based Small number of high ambition invention-based businesses in high growth potential markets	Large scale potential and intentionally distributive business model	Exponential growth with longer development phase	“Sprinter” – seeks to be recognized for achieving disruption at scale through product/service innovation	Stage of development	Startup venture
	Digital technology based Small number of high growth and disruption-driven businesses in a large and growing market		Exponential growth with fast development phase			Promising venture
 NICHE VENTURES	Small, high ambition niche businesses in modest-sized markets	Moderate scale potential, disruptive business model	High initial growth which tapers off as addressable market has limited upside	“Cross-trainer” – designing new approaches to difficult problems	Business model as relates to financing needs	Service innovator
 DYNAMIC ENTERPRISES	Mostly mature, medium sized and growing in “bread and butter” business activities	Moderate scale potential and traditional but also sometimes innovative business models	Moderate growth with variation year to year but steady upward trajectory	“Marathoner” – building a steady and profitable business for the long term	Business activity as relates to differing levels of financing requirements	Services enterprise
						Trading /merchandising enterprise
						Financing enterprise
						Manufacturing/ processing enterprise
 LIVELIHOOD- SUSTAINING ENTERPRISES	Small, often family run in low-growth traditional business	Small scale potential and traditional business	Low but steady growth above local rates of inflation	“Treadmill” – keeping small business afloat	Collateral availability & financial performance	Fully credit constrained small enterprise
						Partially credit constrained small enterprise

4. Conclusion



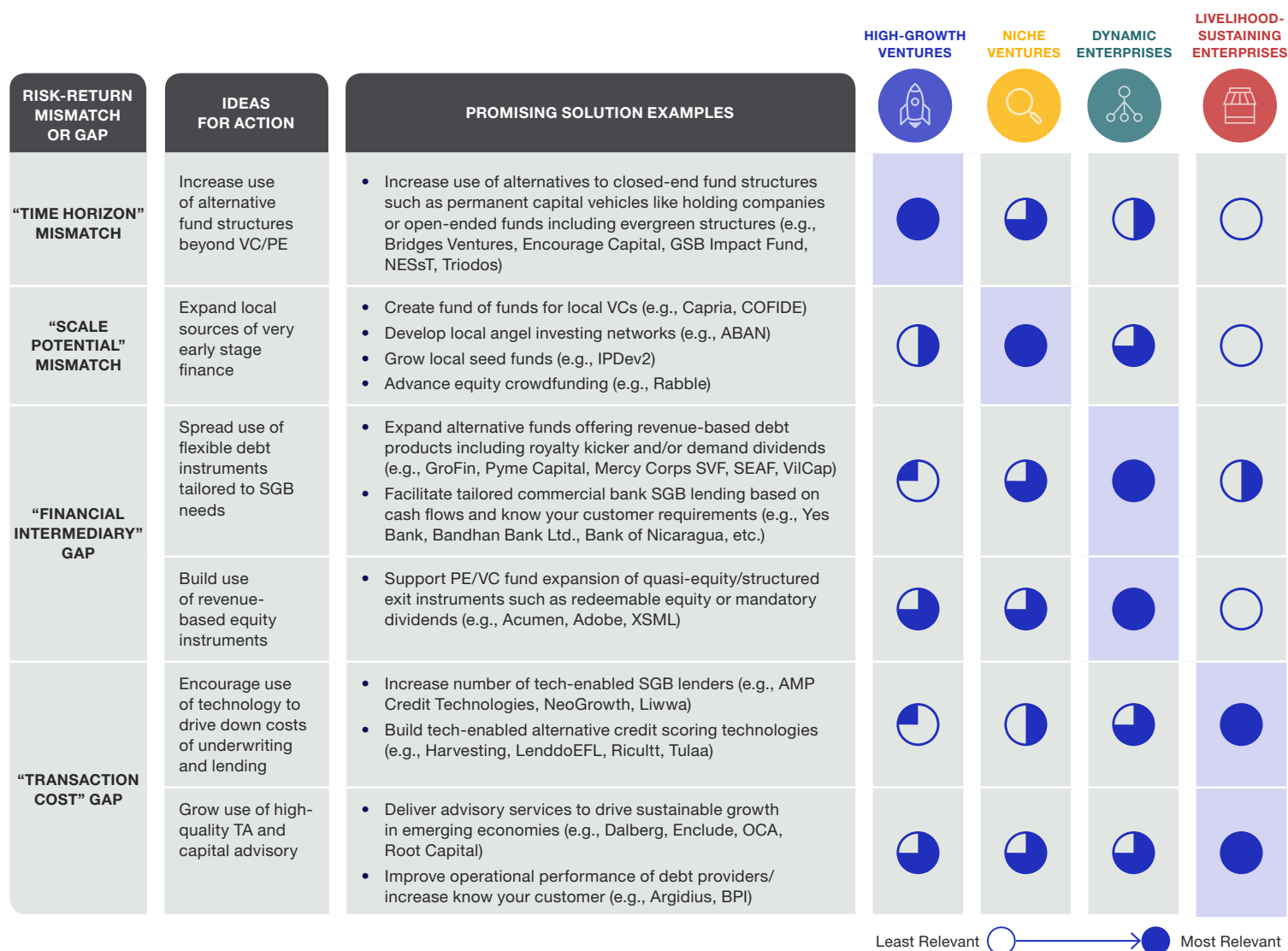
Multiple families of SGBs inhabit the “missing middle.” Our research identified four segment families occupying the universe of enterprises with financing needs between \$20,000 and \$2 million. These families of enterprises are differentiated by their growth trajectory and scale potential, the types of products and services they offer to their customers, and the behavioral attributes of the entrepreneurs and management teams that run them. These variables, in turn, influence the type of external financing that is appropriate to each family’s needs. Each of these families also faces distinct challenges in accessing appropriate finance.

Small and growing enterprises are inherently hard to serve. Financial service providers have difficulty assessing the risk-return profile of enterprises in this space due to their lack of track record, inconsistent or weak financial performance, and limited information about operations and management. Providing financing to the missing middle typically involves high transaction costs for limited ticket sizes, making the economics of doing a deal less attractive. Regulatory stipulations, such as liquidity or collateral requirements, can also deter financial service providers from serving customers perceived as higher risk.

While progress is being made to increase access to appropriate capital for SGBs, our segmentation analysis and exploration of appropriate finance instruments and providers has revealed critical financing gaps or risk-return mismatches (summarized in Figure 21) across all four of the SGB families identified in this report. These gaps and mismatches will necessitate action.

Our research identified four segment families occupying the universe of enterprises with financing needs between \$20,000 and \$2 million. These families of enterprises are differentiated by their growth trajectory and scale potential, the types of products and services they offer to their customers, and the behavioral attributes of the entrepreneurs and management teams that run them.

Figure 21: Summary of SGB family risk-return mismatches or gaps, ideas for action, and promising solution examples



Our research reinforced the importance of addressing the SGB **“time horizon” mismatch**—applying scale and exit timescales more relevant to asset-light high tech companies to SGBs with more moderate growth trajectories and uncertain exit prospects. This gap is particularly acute for High-growth Ventures that are asset-intensive, but also impacts dynamic and niche enterprises.

To address the time horizon mismatch, alternatives must be embraced to complement the traditional closed-end venture capital and private equity fund structures. Holding company, open-ended and evergreen investment funds are all models that allow investors to offer their investees greater flexibility and longer time horizons. Holding company structures like Encourage Capital or Pacific Agri Capital act like a parent company holding subsidiary investments; this structure is flexible in its ability to liquidate or hold investments as long as necessary to realize returns. Open-ended evergreen funds like NESsT Loan Fund or GSB Impact Fund have no time limit for fundraising or liquidation, giving fund managers greater flexibility to be patient with their investments.³³

The **“scale potential” mismatch** refers to companies with more moderate growth prospects, or targeting limited addressable markets, seeking out investors and sources of financing that are geared toward companies with rapid

³³ Andrea Armeni and Miguel Ferreyra de Bone, “Innovations in Financing Structures for Impact Enterprises: Spotlight on Latin America,” (2017).

growth and exit prospects. This mismatch is particularly acute for Niche Ventures. Expanding local sources of very early stage finance can help address the “scale potential” mismatch. We see multiple promising approaches for stimulating local sources of early stage finance. For example, COFIDE, the bilateral development bank of Peru, has recently created a fund of funds to seed local early stage investors to support its local market. In addition, there are several promising efforts to foster the expansion of local angel investment networks to build capacity and accelerate angel investment, as the African Business Angel Network (ABAN) is doing across the African continent. Another approach is to support the development of local seed funds through investments made by external fund of fund structures, such as the Investisseurs et Partenaires IPDEV2 fund focused on West Africa.

The “**financial intermediary**” gap refers to the dearth of financial services providers that have developed specialized capabilities to serve SGBs that aren’t a fit for traditional growth equity (VC, PE) and yet remain too risky for banks to lend to using traditional loan products. This gap is particularly acute for Dynamic Enterprises, but is relevant to Niche Ventures and certain types of High-growth Ventures as well. To close the “financial intermediary” gap, we think it will be important to expand the number of financial intermediaries deploying mezzanine instruments (both flexible debt and quasi-equity) and to help existing mezzanine-focused financial service providers drive improved performance. We see promising opportunities to help improve the performance of existing fund managers through benchmarking performance across multiple mezzanine providers, exploring opportunities for “shared services” for mezzanine providers to increase efficiency, and offering training to increase fund managers’ familiarity with mezzanine instruments and use cases. Capria’s work to invest in and build the capacity of a range of emerging market fund managers—and develop tools to benchmark performance—is another promising development to note.

To close the “financial intermediary” gap, we think it will be important to expand the number of financial intermediaries deploying mezzanine instruments (both flexible debt and quasi-equity) and to help existing mezzanine-focused financial service providers drive improved performance.

In addition, we see opportunities to support commercial banks’ participation in the space, via platforms such as the IFC’s SME Finance Forum. Commercial banks such as Bandhan Bank, BBVA, Equity Bank, and others are increasingly willing to expand tailored lending products, as well as support the growing number of financial intermediaries—such as GroFin, PYME Capital, SEAF, and Village Capital—that are deploying variants of mezzanine financing. Those players that are pioneering new markets and approaches for deploying alternative mezzanine instruments will need continued support to experiment and refine their use of specific products—such as royalty kickers³⁴ or demand dividends³⁵ that offer flexible repayment terms and the opportunity to participate in the upside.



³⁴ A structure which combines a traditional loan with a revenue-based “kicker” to compensate for the added risk. Instead of owning a percentage of the business (as would be the case with an equity investor), the royalty investor takes a percentage of the company’s revenue for a fixed period to increase its return potential.

³⁵ A variation on debt royalty structured but modified to fit the realities of investing in emerging or frontier markets by adding four key features: (1) payments tied to cash flow; (2) a “honeymoon” or grace period to allow capital to go to work typically 6-18 months; (3) a fixed payoff amount at end of investment period to increase upside on loan and; (4) term sheet covenants to align payment terms with cash flow cycle of the business.

The “**transaction cost**” gap refers to the fact that the cost of small ticket working capital lending to small SGBs is high relative to the income that such products can provide for lenders, while remaining affordable to SGBs. To reduce this gap, technology and pre- and post-investment technical assistance can both play important roles. Technology players like Apollo Agriculture, Liwwa, NeoGrowth, and YAPU solutions can lower customer acquisition and monitoring costs, while innovators like Harvesting, LenddoEFL, Ricultt, and Tulaa and their alternative credit-scoring tools have already significantly lowered credit-scoring costs for traditional lenders. Meanwhile, the pre- and post-investment advisory services that players like Root Capital provide to their borrowers can help fund managers de-risk and maximize the impact of their investments.

All of these actions are needed. As the paragraph above illustrates, some the solutions cited above are most relevant for specific SGB families, but most are relevant for multiple families and benefit the broader SGB finance ecosystem. For example, supporting local sources of early stage capital will be most useful to Niche Ventures and Dynamic Enterprises, but it will also help High-growth Ventures succeed. Similarly, the most dramatic effect of lowering transaction costs will be to allow many financial intermediaries to access and serve Livelihood-sustaining Enterprises for the first time—but all the SGB families will ultimately benefit.

FUTURE RESEARCH

This segmentation exercise has revealed a great deal about the key differences and unique financing needs among the different enterprise families that make up the “missing middle,” but it has inherent limitations and more work is needed. This initial phase of work was global in scope and aimed at identifying families of enterprises broadly applicable across sectors and geographies. This approach was an intentional choice and an important starting point. However, the global scope meant that it was not feasible to size the segments. It also limited our ability to narrow down our discussion to specific actors and interventions that might provide more appropriate finance to each segment. We see an opportunity to build on the foundations of this initial report to make the segmentation framework more specific and actionable by augmenting it with further data or by drilling down to a more focused level of a sector or market.

Looking forward, we see five areas of potential future research:

- 1. Further validate the segments and provide more quantitative markers by analyzing a broader, more representative set of enterprise data.** This study started the process by gathering a meaningful but relatively modest dataset. Future phases of research could tap into larger data sources—e.g., those of multilateral development finance institutions such as the World Bank and IFC—to validate both the segments and their parameters. This could include accessing quantitative data from major data sources or further deepening qualitative data through additional behavioral research.
- 2. Apply the segmentation framework to a given market or sector.** The size and characteristics of each enterprise family will vary significantly by market and industry. In addition, the quantitative markers between segments will vary significantly, particularly by industry. Applying the four enterprise families framework to a given market—e.g., Kenyan SGBs or Bangladeshi agricultural SGBs—can help refine the overall framework and make it more actionable (e.g., as a means of identifying the most significant market gaps).
- 3. Conduct more in-depth analysis of the characteristics and financial needs of a given enterprise segment family.** Additional study of a specific segment family and its needs would further refine our understanding of the key financing gaps and how to best address them.
- 4. Deepen the analysis with respect to matching investors and investment instruments with specific segment families and their respective sub-segments.** Drawing upon this report’s work, supply-side research could provide a more nuanced and detailed mapping of how specific financial and nonfinancial instruments could meet the needs of specific enterprise segments at different stages of their evolution, and address identified financing gaps.

5. Overlay other behavioral or entrepreneurial characteristics onto this framework, with a specific focus on youth, women, and inclusivity (i.e., the most vulnerable populations). Our portfolio data analysis revealed a high degree of under-representation of youth and women entrepreneurs. A critical next step is to understand what kinds of segment-level challenges these entrepreneurs face.

Efforts that build on this foundational research are needed immediately. The segmentation project has revealed not only how difficult it is to understand the diverse financing needs of enterprises operating in the missing middle—and how best to help them—but also how essential this knowledge is to building more sustainable and vibrant enterprise ecosystems across frontier markets. Missing middle enterprises are true engines of healthy economies; the constraints on their growth have broad implications for societies as a whole. Closing the \$930 billion SGB financing gap is critical to unleashing the power of entrepreneurs to contribute to more robust, equitable, and resilient economies.

While the SGB financing gap is formidable and persistent, we see encouraging progress on a range of innovative solutions that meet the needs of entrepreneurs across the enterprise families described in this report. It is clear that there is no silver bullet for addressing the financing gap. The diverse entrepreneurs of emerging and frontier markets need a wide range of solutions to meet their distinct needs. We hope this segmentation framework provides a roadmap for galvanizing new action and can help advance efforts already underway to help these entrepreneurs find the financial and technical support they need to transform their communities and societies.



ANNEX 1: SUMMARY OF DEMAND-SIDE LITERATURE REVIEW

Objectives & methodology

The objective of this review was to inform the design of an enterprise segmentation framework by learning more about existing approaches to segmenting SMEs in emerging markets. Rather than attempting a comprehensive review of all existing methodologies and frameworks, the research team instead conducted a highly targeted study of the approaches taken by leading financial service providers and other experts. However, in order to capture a range of perspectives on the leading approaches, we cast a wide net over existing practitioner, academic, and donor literature.

The following are the main sources we ultimately used in this targeted research process:

1. ANDE, “State of Measurement in the SGB Sector” (2017).
2. AT Kearney, “SME Clients: Do It Smart, Win Their Hearts” (2011).
3. BDRG Continental, “SME Finance Monitor: Q2 2016” (2016).
4. Dutch Good Growth Fund, *#ClosingTheGapKenya: Update on Key Challenges for the “Missing Middle” in Kenya* (2015).
5. Dutch Good Growth Fund, *Guinea: Key Challenges for the “Missing Middle”* (2017).
6. Dutch Good Growth Fund, *#ClosingTheGapTogo: Key Challenges for the “Missing Middle”* (2017).
7. Dutch Good Growth Fund, *#ClosingTheGapSenegal: Key Challenges for the “Missing Middle”* (2017).
8. Enclude, “Echoing Green Portfolio Segmentation: Accelerating Capital to For-profit and Hybrid Enterprises” (2017).
9. Foundation for Small and Medium Enterprise Development (University of Durham), “Segmenting Support for Small and Medium Enterprises: Identifying and Dissemination Best Practices” (2001).
10. Omidyar Network, *Frontier Capital* (2015).
11. Village Capital, “Why Most Entrepreneurs Hate Fundraising—And How to Fix It” (2017).
12. World Bank, “What’s Happening in the Missing Middle?” (2017).
13. Acumen Fund & Monitor Group, *From Blueprint to Scale: The Case for Philanthropy in Impact Investing* (2012).
14. IFC, “High Growth SMEs Thematic Review: Presentation to the SME and Jobs Committee” (2013).
15. Impact Management Project, *The Investor’s Perspective* (2017).
16. Argidius Foundation, “Annex 3: Argidius Segmentation of SMEs into Venture, Dynamic, and Formalizing.”
17. Capria, “Critical Success Factors: Support Intermediaries” (2018).
18. Capria, “Critical Success Factors: Entrepreneurs” (2018).
19. ANDE, Shell Foundation & Enclude, “SME Finance in Sub-Saharan Africa: How Do We Achieve Significant Scale and Reach?” (2017).

Main findings

The segmentation framework we provide in this report fills several gaps that emerged in our review of the literature. First, our framework is designed to be agnostic in terms of geography, sector, or type of funder, which makes it broadly applicable and relevant. Second, the framework is based on an understanding of the fundamental external financing needs of SGBs. Third, we combine different research methodologies—qualitative, quantitative, and behavioral—not often used to develop different lenses to understand the differences in SGB financing needs. And fourth, we use segment-specific descriptions and language that are already employed by our target audience, thereby increasing the likelihood of adoption and alignment with users' key areas of interest.

Overall, most segmentation frameworks tend to focus on specific geographies, sectors, or types of funders. Given the wide variations in local economic contexts, developing a framework with both global universality and relevance to diverse local contexts can be challenging. Similarly, a segmentation framework based wholly on specific stages of the business lifecycle will better suit some types of industries than others, just as a segmentation that tracks the interests of a single funder will likely have limited relevance across a broad spectrum of financial service providers.

The few segmentation frameworks that do focus on larger global contexts yield few insights into how differences among segments relate to appropriate financial instruments and providers. While some studies shed light on the broad trends around formal finance for each segment, most of the literature reviewed does not include detailed data on SME financing needs or key risks for investors at the segment-specific level—which limits the extent to which the studies can substantively inform investors' decision-making processes.

In addition, the studies we looked at also tended to rely on a single methodology to explore a limited number of variables, the three most common being size of business (typically defined as number of employees), growth (typically defined as growth in revenue), and lifecycle stage (based on different definitions). Each framework applied these variables differently, however, with little overlap—and none of the frameworks considered the behavioral characteristics of the entrepreneur as a factor in determining an SGB's financing needs. SGB financing analysis would benefit from the addition of attitudinal, behavioral, and demographic considerations—all of which we believe are essential to understanding SGB trajectories and determining SGB needs.

Exceptions to this broader trend are Echoing Green's portfolio segmentation and DGGF's *Closing the Gap* (Guinea) report. Echoing Green provides a broad range of specific indicators and areas of information that shed light on the needs of each of the segments addressed, including annual revenue, annual profit, cash flow patterns, number of paying customers, number of firms with full-time financial professionals, number of firms with audited financials, expected returns, fundraising success rates, and so on. In addition, for each segment, Echoing Green examined current and anticipated funding sources as well as instrument type. DGGF's *Closing the Gap* (Guinea), while not going into the same depth, offers interesting perspectives on relevant types of segment-specific data, such as financing patterns, specific business challenges, and appropriate financial products.

Finally, a number of publications, including DGGF's report *Closing the Gap* (Kenya) and the World Bank study *What's Happening in the Missing Middle*, specifically mention the need for a common definition of an SME. This is but one of a number of essential terms and concepts whose definitions vary considerably across the literature. Some studies do heed the call for a common language. The Omidyar Network report, for example, not only seeks to articulate the business opportunity in low- and middle-income (LMI) countries, but it also puts forward a market opportunity segmentation. Similarly, Village Capital sets out a detailed taxonomy of the business lifecycle. Our framework attempts to bridge all those definitions and set out a clear and usable common language for the different segments of SGBs.

A key to any proposed universal language of SGB finance is the likelihood of its adoption. ANDE's report on SGB measurement practices is useful, in this regard, for its comprehensive overview of the types of segment-specific data likely to be available from project stakeholders. ANDE's report is based on a survey of organizations operating in the SGB investment space, which directly overlaps with the target users of this project's emerging segmentation framework. By

tying our segment-specific descriptions to metrics known to be employed by our target users, we have a better chance of obtaining a rich cross-selection of SME data, aligning the outputs of this report to users' key areas of interest, and advancing a set of terms and definitions that have clear utility in the world of SGB/SME finance.

ANNEX 2: SUMMARY OF SUPPLY-SIDE LITERATURE REVIEW

This research relied, in part, on a targeted review of existing literature on financial products and finance providers in the emerging and frontier market investment landscape in order to answer the following questions:

- What is the full range of **financial instruments** that investors deploy in emerging and frontier market contexts, and how are these categorized or segmented?
- What is the full range of **finance providers** investing in and lending to SGBs/SMEs in emerging and frontier market contexts?

Our research process identified 19 publications; on the basis of relevance and additionality, we chose to prioritize 12. These sources are listed below.

No.	Name of source	Focus on instruments or financiers?
1	“In Search of Gamma: An Unconventional Perspective on Impact Investing,” IESE Business School & Family Office Circle Foundation	Financiers
2	“Impact Investing: A Problem-Driven Approach,” New World Capital Group	Financiers
3	“Impact Investing in West Africa,” Dalberg Advisors	Financiers
4	“Innovative Finance in Africa,” UCT Bertha Centre	Financiers
5	“New Approaches to SME and Entrepreneurship Financing,” OECD	Instruments
6	“Policy Levers and Objectives: Explanatory Note for Governments,” Social Impact Investment Taskforce	Instruments / Financiers
7	“Investing for Impact,” Bridges Ventures	Instruments / Financiers
8	“New Perspectives on Financing Small Cap SMEs in Emerging Markets,” DGGF	Instruments
9	“Structuring Exits for Competitive Returns,” Angel Capital Association	Instruments / Financiers
10	“The Investor’s Perspective,” UBS	Instruments
11	“The State of Impact Investing in Latin America,” Bain	Financiers
12	“The Impact Investing Landscape in Latin America,” ANDE, LAVCA, LGT Venture Philanthropy	Financiers
13	“SME Finance in Sub-Saharan Africa,” Shell Foundation, Enclude, ANDE	N/A
14	“Market for Social Impact Investing by Private Equity Funds Stands at \$4 Billion in the United States,” Pacific Community Ventures	N/A
15	“The Impact Investment Market in South and Southeast Asia,” Palladium	N/A
16	“Supply and Demand Side Assessment of Impact Investment within the Caribbean,” Multilateral Investment Fund (IDB) & Compete Caribbean	N/A
17	“The Navigating Impact Investing Project,” Tideline & Omidyar Network	N/A
18	“Mapping the Impact Investing Sector in Brazil,” ANDE, LGT Venture Philanthropy, Quintessa	N/A
19	“The Landscape for Impact Investing in East Africa,” GIIN, Open Capital Advisors	N/A

Based on the literature review, we identified the following main types of financial instruments:

Debt:

- **Asset-based lending:** any form of lending that is secured by a non-current asset
- **Leasing / pay-as-you-go:** an agreement whereby the owner of the asset (lessor) provides a customer (lessee) with the right to use the asset for a specified period of time in exchange for a series of payments
- **Trade financing:** a short-term instrument involving a lender, buyer, and seller that is issued in financing trade flows between a buyer, who wants to ensure he or she is buying the correct good, and a seller, who wants to make sure he or she is paid as per the agreement
- **Cash-flow-based lending:** a loan that is backed by the recipient's business cash flows (e.g., factoring, warehouse receipts, purchase order finance)
- **Working capital:** a credit facility made available to a borrower that can be tapped at the borrower's discretion and according to set rules governing the facility (e.g., overdraft protection, demand loans, and revolving credit lines)

Mezzanine:

- **Partially unsecured / junior loan:** a loan with tailored repayment structure and flexibility regarding collateralization requirements
- **Royalty-based lending:** a loan that provides the investor with a base interest plus royalties, which are payments that depend on the performance of the company—usually a percentage of revenue of EBIT(DA)
- **Convertible loan:** typically a loan with a maturity date and a regular payment schedule, as well as an option to convert the loan into shares
- **Preference shares:** shares that are given preference over ordinary shares, including priority in receipt of dividends and upon liquidation, often with a fixed annual dividend
- **Redeemable equity:** largely similar to ordinary shares, but with a right to sell the shares back to the entrepreneur (put option), typically using a predetermined price or a formula

Equity:

- **Common shares:** shares of common stock provide an ownership interest in the company, along with voting rights and possible dividends; dividends are not guarantees and may be suspended if the company struggles financially; holders of common stock are the last to be paid if the company liquidates

Grants:

- **Convertible grant:** a grant that is provided to an investee that can be converted into debt or equity based upon success
- **Unrestricted vs. restricted grant / TA:** the distinction between a grant that can be used for general use free from external restrictions (unrestricted) and one that comes with stipulations or requirements (restricted)
- **Refundable vs. non-refundable grant / TA:** the distinction between a grant that can be paid back to the original provider of the grant (refundable) and one that cannot be paid back (non-refundable)

Commercial risk mitigation instruments:

- **Insurance:** a contract, represented by a policy, in which an entity receives financial protection or reimbursement from an insurance company against losses (e.g., weather, political risk, etc.)
- **Guarantee:** a non-cancellable indemnity bond backed by an insurer to guarantee investors that principal and interest payments will be made
- **Currency hedging:** a contract that protects against unexpected, expected, or anticipated changes in currency exchange rates

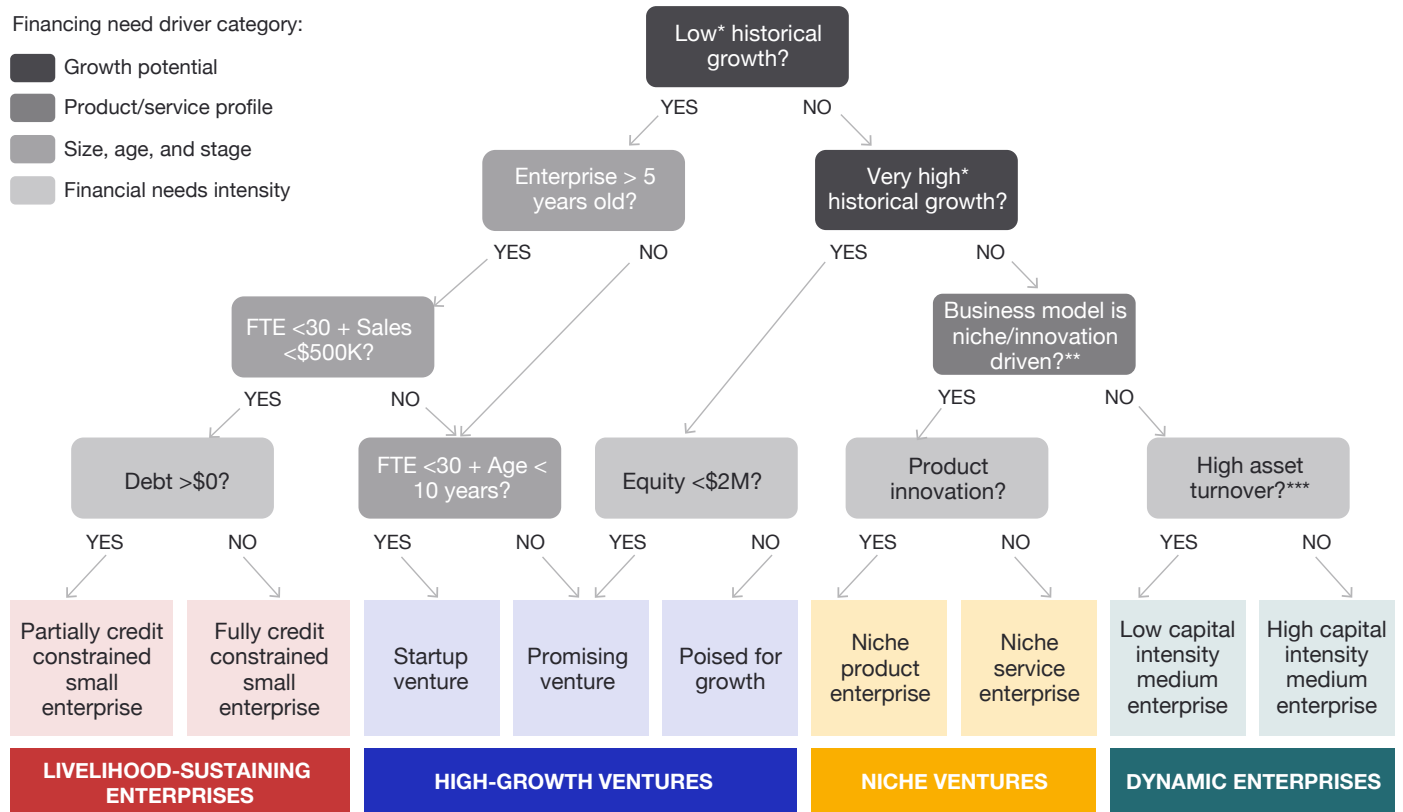
Blended finance instruments:

- **Concessional loan:** a loan that is provided on more favorable terms than the borrower could obtain in the marketplace
- **Development impact bond:** an outcome-based contract whereby private investors provide upfront funding for social development interventions and are remunerated by public sector agencies at a commercial rate of return if evidence shows that the intended outcomes were achieved
- **Risk-sharing facility:** a loss-sharing agreement between an entity (typically a multilateral development bank) and an originator of assets in which the multilateral development bank reimburses the originator for a portion of the principal losses incurred on a portfolio of eligible assets

ANNEX 3: SUMMARY OF PORTFOLIO DATA ANALYSIS OUTPUT

In order to analyze the quantitative characteristics of the four SGB segment families, we chose a process that allowed us to segment and sub-segment a dataset of 350 SGBs from anonymized data shared by five data partners: GroFin, Intellegrow, Investisseurs et Partenaires, Root Capital, and Santa Clara/Miller Center. Figure 22 illustrates this process.

Figure 22: Segmenting and sub-segmenting the dataset of SGBs



Notes: * Exact numbers and ranges vary by market.

** The orientation of a business model or product / service toward innovation / disruption or traditional / replication may not be observable through portfolio data and thus requires additional qualitative analysis, such as a review of product / service / business model description.

*** In cases for which no asset data were provided, qualitative descriptions of business activity/sector were used to segment.

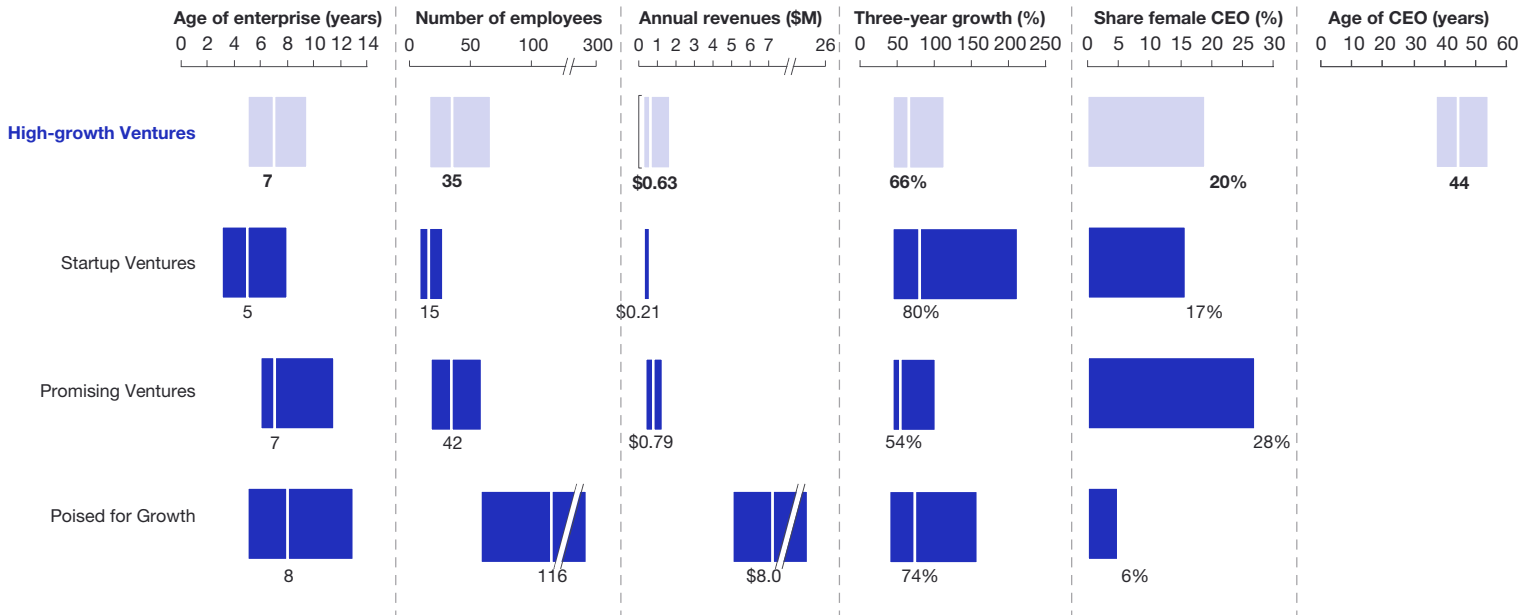
The figures below lay out several of the quantifiable characteristics that emerged from our portfolio data analysis for each of the four SGB families and sub-segments.

High-growth Ventures

High-growth Ventures have a median age of seven years and a median of 15 employees. Annual revenue has reached \$0.63 million and the three-year growth is 66%. Twenty percent of High-growth Venture CEOs are female; the average CEO age is 44. Within our sub-segments, Startup Enterprises have a median age of three years and a median of 15 employees while Promising Ventures have a median age of seven years and 42 employees. Poised-for-growth Enterprises, in turn, have a median age of eight years and 116 employees. The three-year growth rates and accelerating annual revenues indicated in our portfolio data reflect rapid growth (ranging from 54% to 80%) across all three of these sub-segments.

Figure 23: Indicative quantitative characteristics of High-growth Ventures and sub-segments³⁶

Number indicated is the median of sample and range represents the 25th to 75th percentile of the same sample except for share female CEO, which is indicated as sample average



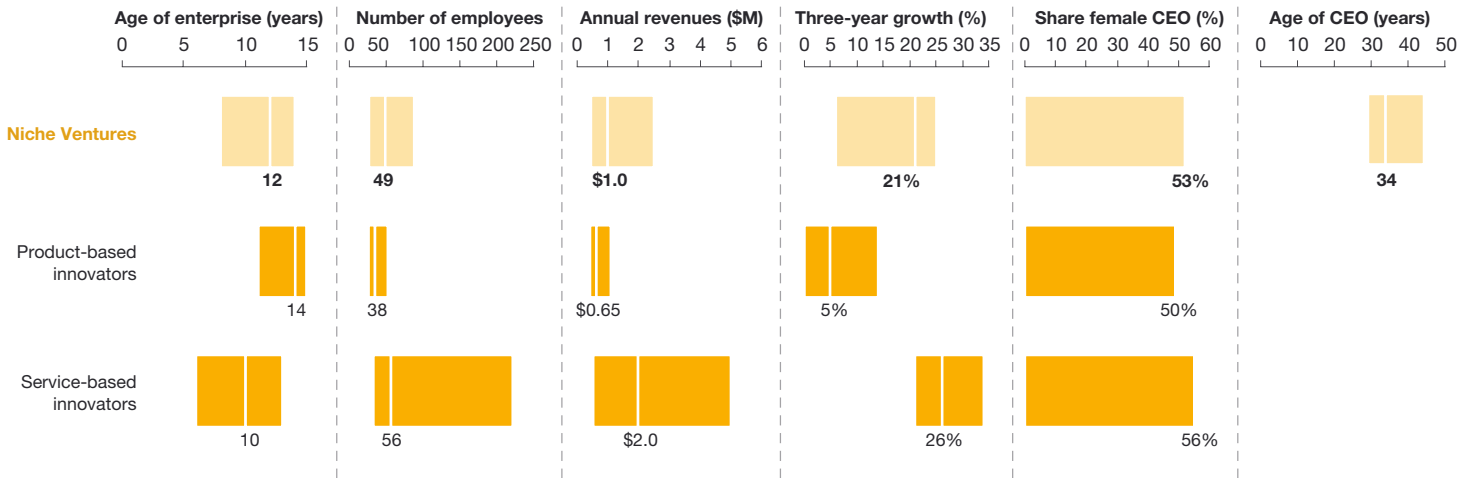
³⁶ The data presented in this report come from sample portfolio data collected from five organizations. These data are meant to illustrate the quantitative characteristics that typify each family, but more study and analysis are needed before a truly representative picture can emerge.

Niche Ventures

Within our dataset, the median age of a Niche Venture is 12 years and the median number of employees is 49. Annual revenue has reached a median of \$1.0 million and median three-year growth is at 21%. Over half (53%) of Niche Venture CEOs are female and the average median CEO age is 34 years old. At the sub-segment level, Product-based Innovators have a median age of 14 years and median of 38 employees while Service-based Innovators have a median age of 10 years and 56 employees. Within our data pool, Product-based Innovators have lower revenues and three-year growth (a median of \$0.65 million and 5%, respectively) than do Service-based Innovators (\$2.0 million and 26%, respectively). Fifty percent of Product-based Innovators have a female CEO; the percentage is even higher (56%) for Service-based Innovators.

Figure 24: Indicative quantitative ranges for Niche Ventures and sub-segments

Number indicated is the median of sample and range represents the 25th to 75th percentile of the same sample except for share female CEO, which is indicated as sample average



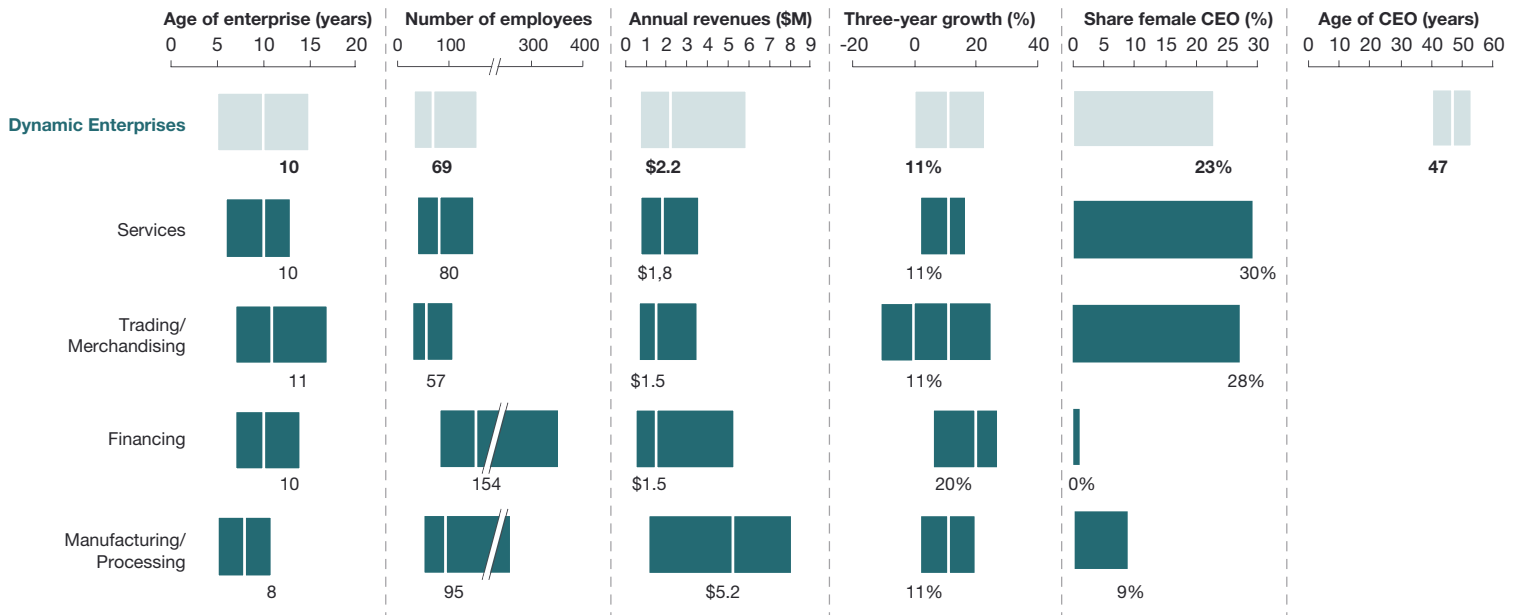
Dynamic Enterprises

Within our dataset, the median age of Dynamic Enterprises is 10 years and size is 69 employees. At \$2.2 million, median annual revenues are higher than those of both High-growth and Niche Ventures, but the upward trajectory is slower at a median of 11% three-year growth. Female entrepreneurs lead 23% of Dynamic Enterprises within our dataset; the median age of CEOs in this enterprise family is 47 years.

Median enterprise age hovers around 10 years across all four sub-segments. The variation is much more noticeable in median number of employees, ranging from 57 to 154. Financing Enterprises have the highest median three-year growth among the sub-segments, at 20%, while all other sub-segments share a median three-year growth of 11%. Female CEOs are best represented within Services (30%) and Trading/Merchandising (28%) but are severely underrepresented within Financing (0%) and Manufacturing/Processing (9%).

Figure 25: Indicative quantitative characteristics of Dynamic Enterprises and sub-segments

Number indicated is the median of sample and range represents the 25th to 75th percentile of the same sample except for share female CEO, which is indicated as sample average



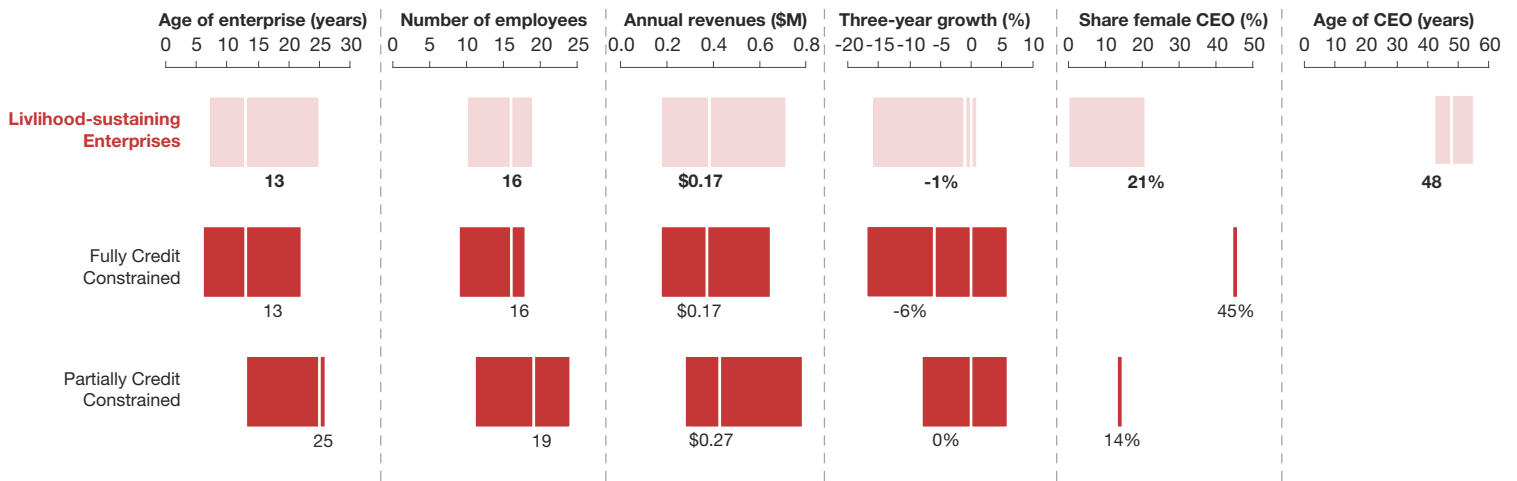
Livelihood-sustaining Enterprises

With a median age of 13 years, the Livelihood-sustaining Enterprises in our sample are the oldest of any enterprise family (see Figure 26). Enterprises within this family have a median of 16 employees and median annual revenue of \$0.17 million, the lowest among all segment families. Growth is stagnant: The median three-year growth is -1% for this family. Twenty-one percent of Livelihood-sustaining Enterprises in our dataset are run by female CEOs; the median CEO age is 48 years.

Fully Credit-constrained Enterprises have a considerably lower median age than Partially Credit-constrained Enterprises (13 and 25 years, respectively). They also have a slightly lower median number of employees (16 employees versus 19 employees) and lower median annual revenue (\$0.17 million versus \$0.27 million). While growth is limited across all Livelihood-sustaining Enterprises, the 0% median three-year growth rate of Partially Credit-constrained Enterprises is still higher than that of Fully Credit-constrained businesses (-6% median growth rate). Forty-five percent of Fully Credit-constrained Enterprises and 14% of Partially Credit-constrained Enterprises have female CEOs.

Figure 26: Indicative quantitative ranges for Livelihood-sustaining Enterprises and sub-segments

Number indicated is the median of sample and range represents the 25th to 75th percentile of the same sample except for share female CEO, which is indicated as sample average



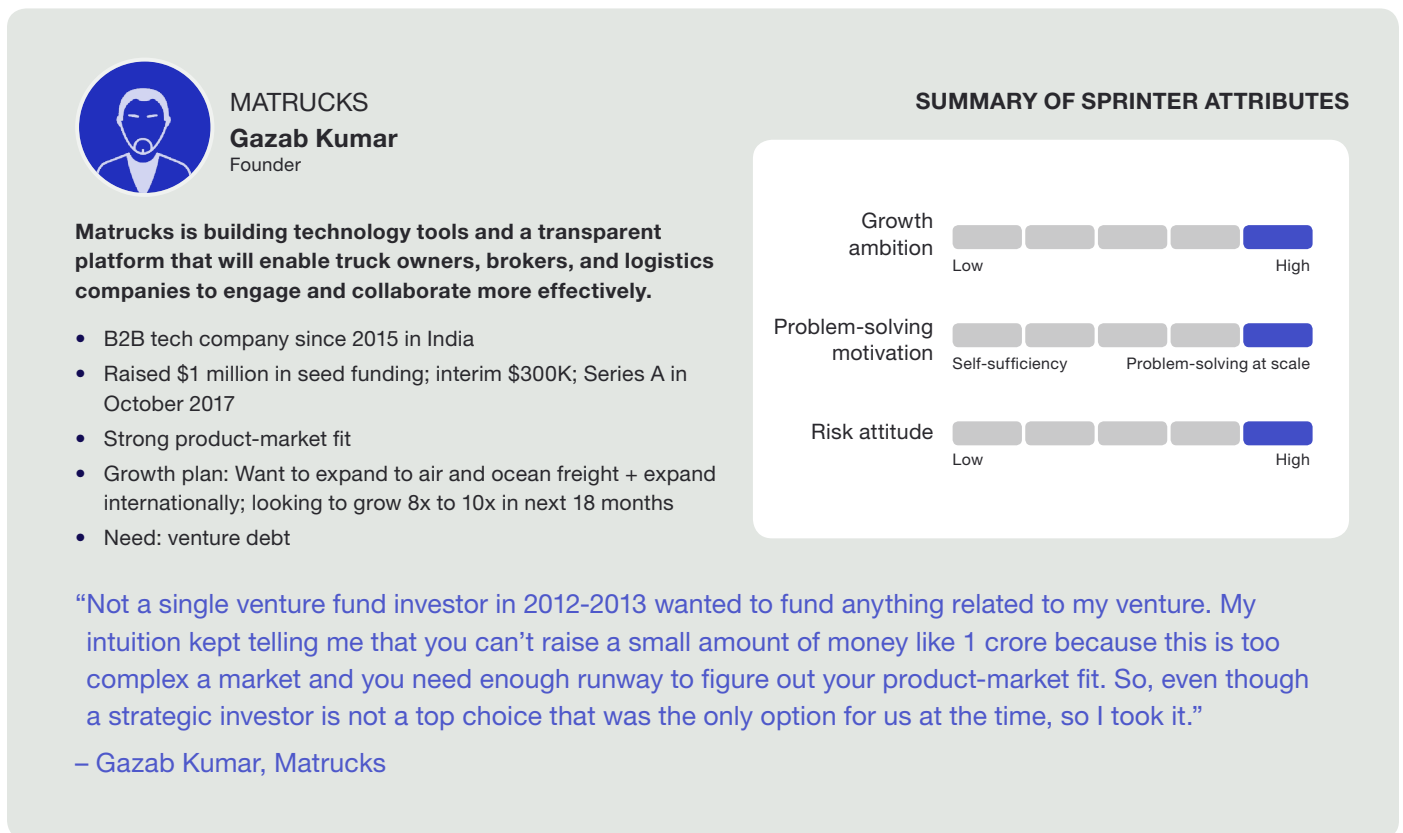
ANNEX 4: SUMMARY OF HUMAN-CENTERED DESIGN BEHAVIORAL RESEARCH

Below we provide the details of each of the four SGB families’ leadership personas, which have been anonymized for confidentiality, and insight into how these behavioral characteristics help define each segment family. Each persona describes the behavioral characteristics of the management team or founder of an SGB. These personas are not definitive—management’s behavioral attributes will, of course, vary person-to-person and across demographic and cultural contexts. Rather, the persona is intended to illustrate attitudes that are typical or common to management in these families, and which we observed in our human-centered design research.

High-growth Ventures

Leaders of High-growth Ventures share a set of behavioral characteristics that together form the persona we call the “**Sprinter**.” High-growth Ventures typically have high levels of human and social capital along with the ambition to grow (and eventually achieve scale). To meet these high ambitions, Sprinters are often willing to consider ceding some ownership through minority shareholder partners to secure financing, expertise, and other nonfinancial resources. Similarly, Sprinters—especially high-performing ones—tend to be more open (compared to other segment families) to outside feedback and new ideas that can help grow their business. Finally, Sprinters also tend to have a higher risk tolerance. The figure below provides an example of a Sprinter from a Mumbai-based High-growth Venture.

Figure 27: Sprinter leadership profile – Matrucks³⁷

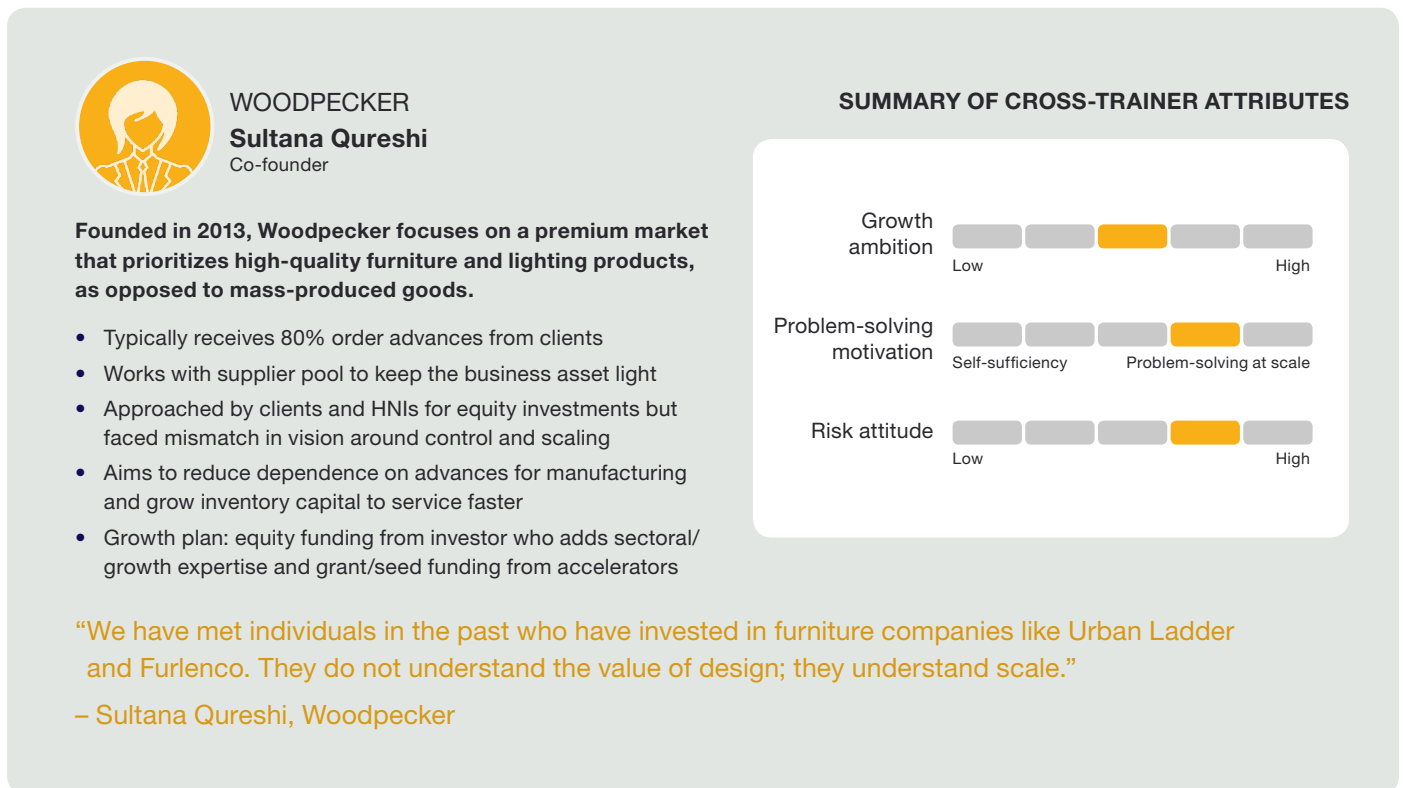


³⁷ Collected from half-day in-person management behavioral interviews conducted in India between March 5 – 13, 2018; anonymized to maintain confidentiality.

Niche Ventures

Our HCD research uncovered a set of distinct behavioral characteristics largely driven by the Niche Venture management team's desire to remain true to its original purpose and vision—we call this persona the “**Cross-trainer.**” Since these businesses typically have deep personal significance to the owner (e.g., a dedication to the aesthetics of product design or to social impact), entrepreneurs are often highly motivated to grow without sacrificing the desire to meaningfully impact certain markets. Cross-trainers are cautious about taking on finance or partners who may not share or understand the original vision of the founding team, but they do recognize the opportunities that could result from obtaining external finance, as well as how their products and services could be further refined. The figure below provides an example of a Cross-trainer persona based on our HCD research in Mumbai.

Figure 28: Cross-trainer leadership profile – Woodpecker³⁸



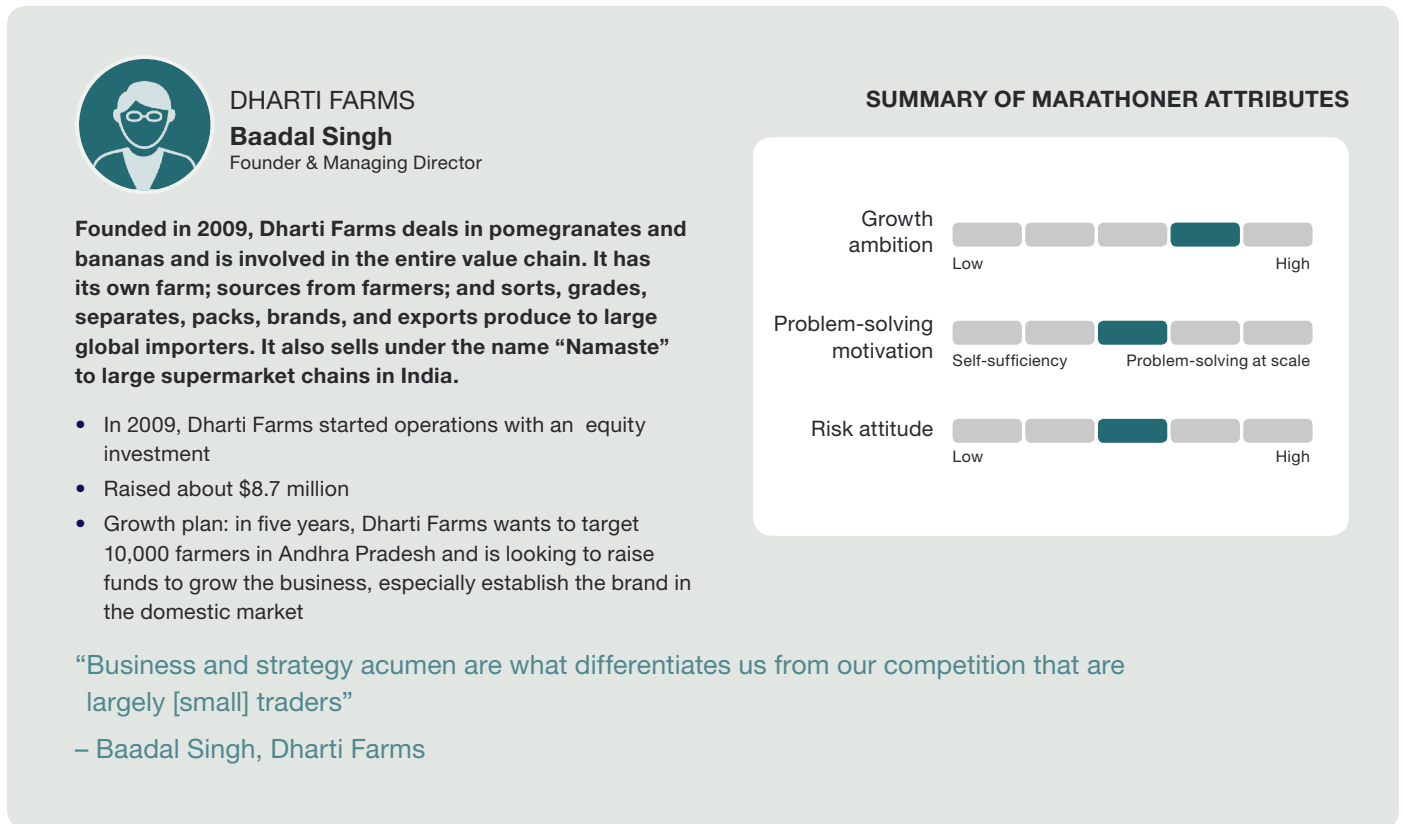
³⁸ Collected from half-day in-person management behavioral interviews conducted in India between March 5 – 13, 2018; anonymized to maintain confidentiality.

Dynamic Enterprises

Corresponding to Dynamic Enterprises’ aspirations for stable growth, leaders within this family display behavioral characteristics that form the persona we call the “**Marathoner**.” Dynamic Enterprises often provide incomes for extended families and their surrounding communities, so owners tend to be relatively risk-averse, given the impact of any potential miscalculation on the communities’ livelihood. At the same time, owners want to stably and steadily grow beyond their local markets into regional ones. However, given the nature of competition in well-established markets and the risks of growing the size of operations, this process can often take decades.

The figure below provides an example of a Mumbai-based Dynamic Enterprise.

Figure 29: Marathoner leadership profile – Dharti Farms³⁹

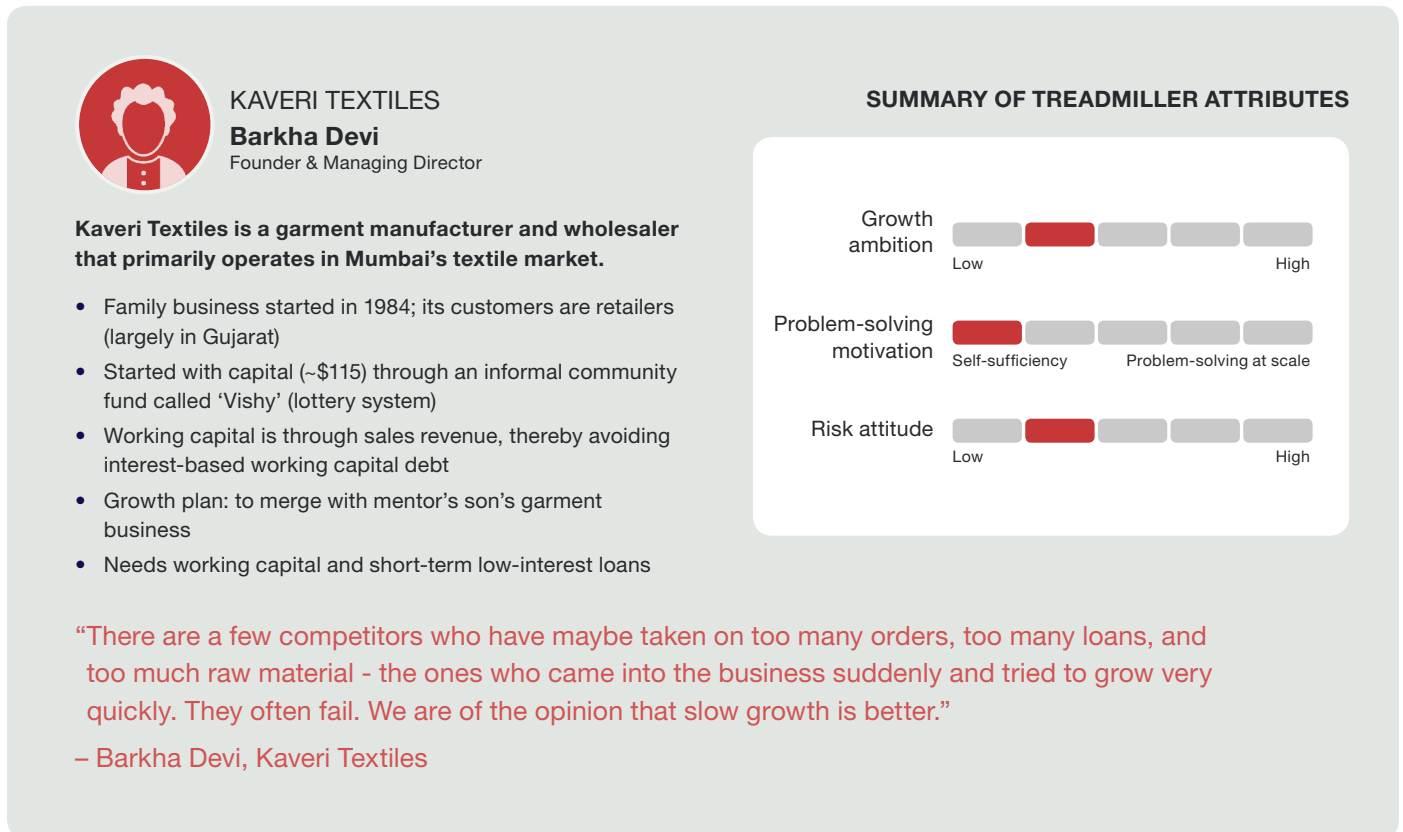


³⁹ Collected from half-day in-person management behavioral interviews conducted in India between March 5-13, 2018; anonymized to maintain confidentiality.

Livelihood-sustaining Enterprises

Leaders of Livelihood-sustaining Enterprises have a unique blend of behavioral characteristics we call the “**Treadmiller.**” These entrepreneurs are focused on running their businesses to provide sustainable income and livelihoods for their families and their employees. They often value the security and predictability of a business model and customer base they know well. While as entrepreneurs they are comfortable taking risks within certain parameters, they are unlikely to venture into business models and markets with which they are wholly unfamiliar. Treadmillers harbor some ambitions to grow, yet they are wary of the uncertainties involved in doing so and the potential effects this could have on immediate family members. The figure below provides an example of a Mumbai-based Livelihood-sustaining Enterprise:

Figure 30: Example Treadmiller leadership profile – Kaveri Textiles⁴⁰



⁴⁰ Collected from half-day in-person management behavioral interviews conducted in India between March 5 – 13, 2018; anonymized to maintain confidentiality.

ANNEX 5: BIBLIOGRAPHY AND STAKEHOLDERS CONSULTED

Bibliography

“Annex 3: Argidius segmentation of SMEs into Venture, Dynamic, and Formalizing,” Argidius.

“Business model innovation vs replication: financial performance implications of strategic emphases,” *Journal of Strategic Marketing* (2009).

“Disruptive innovations and new business models: The role of competition policy advocacy,” World Bank (2016).

Disruptive technologies: advances that will transform life, business, and the global economy, McKinsey Global Institute (2013).

Frontier Capital: Early Stage Investing for Financial Returns and Social Impact in Emerging Markets, Omidyar Network (2016).

From Blueprint to Scale: The Case for Philanthropy in Impact Investing, Monitor Group & Acumen Fund (2012).

“Hardware Pioneers: Harnessing the impact potential of technology entrepreneurs,” FSG (2016).

“How Do Economies Define Micro, Small, and Medium Enterprises (MSMEs)?” IFC (2006).

New Approaches to SME and Entrepreneurship Financing, OECD (2015).

New Perspectives on Financing Small Cap SMEs in Emerging Markets: The Case for Mezzanine Finance, Dutch Good Growth Fund (2016).

“Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises,” IFC (2013).

“Reaching Deep in Low-Income Markets: Enterprises Achieving Impact, Sustainability, and Scale at the Base of the Pyramid,” Monitor Deloitte (2017).

“Segmenting support for small and medium enterprises: identifying and disseminating best practice,” Atherton & Lyon (2001).

“What is a Small and Growing Business?” Aspen Network of Development Entrepreneurs (ANDE) (2013).

“What Platforms Do Differently than Traditional Businesses,” *Harvard Business Review* (2016)

“VIRAL Framework,” Village Capital. Available online at: <https://vilcap.com/entrepreneurs-landing/viral/>

Stakeholders Consulted

List of organizations interviewed		
Accion / Venture Lab	Deutsche Bank	iungo capital
Acumen	Diamond Bank	Lemelson Foundation
AfDB	Echoing Green	Liwwa
Agora	Edge Growth	Mercy Corps
Alterna	Enclude	NESsT
Alterna	Equity Bank	New Island Capital
Ankur Capital	European Investment Bank	Open Capital Advisors
Aspada	Factor E	OPIC
BBVA	FINCA	Pyme Capital
Blue Haven Initiative	FinDev	Root Capital
BNP Paribas	FMO	Sawari Ventures
Bridges Ventures	Gazelle Finance	Small Foundation
Business Partners Intl	GIIN	SME Finance Forum
Calvert	Global Innovation Fund	GP/Eleos Social Venture Fund
Capria	Grofin	Standard Bank
CDC Group	IntelleGrow	UCT Bertha Centre
Ceniarth	International Finance Corporation	USAID
CrossBoundary	Investisseurs & Partenaires	

List of stakeholders participating in Sankalp Workshop		
Omdiyar Network (co-sponsor)	Dutch Good Growth Fund (co-sponsor)	Orkid Studio
Acumen Fund	Grofin	Oxfam International
ANDE	iungo capital	Small Foundation
CrossBoundary	Lemelson Foundation	University of Zurich
Global Innovation Fund	Open Capital Advisors	Village Capital
Global Partnerships		

List of technical advisory group members		
Omdiyar Network (co-sponsor)	Dutch Good Growth Fund (co-sponsor)	OPIC
Acumen Fund	InfoDev (World Bank Group)	Root Capital
Argidius	International Finance Corporation	Shell Foundation
Bridges Fund Management	Investisseurs & Partenaires	Small Foundation
Business Partners International	Lemelson Foundation	UCT/Bertha Centre
DFAT	MacArthur Foundation	USAID
Global Development Incubator	Miller Center/Santa Clara University	Village Capital