GSG IMPACT | Centre for Development Finance Studies

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A New Lens on SME Mobilisation: How to Maximise Private Capital Flows to SMEs

A guide for DFIs and practitioners wanting to increase the flow of capital to SMEs

A report by GSG Impact, supported by the CDFS
Resulting from a Working Group co-hosted with BII, Norfund and USDFC

About GSG Impact

GSG Impact is a global not-for-profit organisation, established under the 2013 UK G8 presidency, with the goal to create the infrastructure and incentives for capital to flow for measurable, positive social and environmental impact.

We do this by creating, accrediting, and supporting national impact institutions - GSG National Partners. Today we are responsible for over 40 National Partners covering two thirds of the global population. Over half of our National Partners are in emerging markets, with many more in development. Collectively GSG Impact and our National Partners work together as the GSG Impact Partnership.

We are a powerful global movement, developing innovative impact investment solutions and driving national and international policy and regulatory change to enable these solutions to be adopted at scale.

Our mission is to build impact economies across the globe, creating the infrastructure and incentives for capital to flow for the SDGs & climate goals. Our collective efforts have raised over US$ 3 billion in capital and launched more than 15 impact investment vehicles.

We are very focused on mobilising capital for impact in emerging markets. Our current vehicles aim to increase capital flows to the SME sector, which is so essential for a thriving economy. Our solutions include mobilising domestic capital - local pools of capital such as domestic pension funds, usually investing in local currency and thereby reducing the foreign exchange issue. Building up the domestic capital supply ecosystem also leads to better long-term system resilience and less reliance on volatile foreign direct investment.

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About this report

In June 2024, GSG Impact launched a Working Group co-hosted with three Development Finance Institutions (DFIs) British International Investment (BII), Norfund, and the United States International Development Finance Corporation (DFC). The goal of this initiative was to assess DFI success factors to mobilise private capital, for the benefit of small and medium-sized enterprises (SMEs) in emerging markets and developing economies (EMDEs). The project aimed to ensure that DFIs and Public Development Banks (PDBs) have a better understanding of what actions they can take to mobilise additional sources of private capital, especially to benefit SMEs. The initiative was set up to create an evidence-based framework to select and analyse cases of successful capital mobilisation, with demonstrated improvements for SME finance in EMDEs and generate a list of success factors and actionable recommendations that can be implemented by DFIs, PDBs, and other players to increase capital flows to the SMEs in EMDEs.

The project has been carried out by GSG Impact and supported by the Center for Development Finance Studies. An Advisory Group composed of the co-hosting DFIs and selected experts has provided strategic guidance throughout the project.

With generous support from

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From the People of Japan

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Section 1 ***Executive Summary***

Rethinking SME Mobilisation: Key Findings

The context:

Development Finance Institutions (DFIs) - including bilateral DFIs, multilateral development banks (MDBs), and public development banks (PDBs) - are critical enablers of SME finance in emerging markets and developing economies (EMDEs), channelling capital and capacity through local intermediaries to unlock sustainable economic development.

Seventy-five percent of DFI commitments to SMEs are intermediated through domestic commercial banks and local or regional SME funds. These intermediaries then on-lend, invest, or provide non-financial support to SMEs. However, investments by DFIs can never meet the annual US$ 5 trillion SME funding shortfall on their own, given that their total annual commitments are around US$ 140 billion, and only a fraction of that targets SMEs. This is why the role of DFIs acting as catalysts, mobilising domestic and international private capital, is increasingly seen as a primary objective by the development finance community.

Our Working Group set out to describe how DFIs are mobilising private capital for the benefit of SMEs, through the analysis of data provided by the three DFIs co-hosting the Working Group (BII, Norfund and DFC), alongside 13 case studies based on interviews. The definition of private capital mobilisation is evolving, leading to new interpretations of what it includes and how it is measured. Among the recent advances in methodologies, the MDB Task Force[1] distinguishes between private direct mobilisation and private indirect mobilisation.

While both views have their merits, the latter categorisation goes some of the way to considering mobilisation through a more systemic lens. However, it stops short of considering mobilisation that does not occur at the transaction level. As a result, several development actors are considering the question of mobilisation more holistically. The IFC, for example, is soon to publish findings related to its work on conceptualising Private Capital Enabled (PCE) mobilisation, which is anticipated to consider downstream mobilisation effects occurring beyond the transaction level. Meanwhile, BII has highlighted ten pathways in which DFIs mobilise commercial capital, including at the sub-investee level.

Understanding where indirect private capital mobilisation originates will enable practitioners to better target and measure it. In turn, that will allow for the identification of the success factors underpinning it, thereby creating the conditions to scale up the flow of private investment to SMEs.

75%

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[1] The MDB Taskforce is a group of multilateral development banks (MDBs) and Development Finance Institutions (DFIs), collectively known as the "MDB Task Force on Mobilization". It was formed in 2016 to develop the joint mobilisation methodology, and it maintains responsibility for interpretations of and updates to that methodology, and for producing the 'Mobilization of Private Finance' report annually.

Key findings:

This study reveals that private capital mobilisation for SMEs by DFIs is not happening in the way that it is usually accounted for and measured:

• Low mobilisation levels are reported at the point of investment but substantial private capital is being mobilised downstream, through banks and funds supported by DFIs. The report introduces a new concept: "secondary mobilisation", and offers a practical roadmap by which to recognise, track, and scale this phenomenon.

• "Secondary mobilisation" refers to private capital that is catalysed downstream from DFI investments at the intermediary or end-SME level thanks to DFIs' support, but not directly co-invested alongside the DFI. This additional finance, predominantly domestic and commercial, supports SMEs yet goes largely unmeasured under existing OECD or MDB frameworks. For example:

- A bank receives long-term DFI funding, technical assistance, or guarantees to develop SME lending capabilities, and then deploys its own balance sheet capital (through, for an example, local currency deposits) to scale SME loans which will surpass the amount of the initial DFI investment.
- An SME fund supports its portfolio companies in raising additional local private capital, which is neither counted nor systematically tracked by DFIs.

"Secondary mobilisation" is already happening and replicable. Our analysis of 13 case studies of financial intermediaries in emerging markets shows that when certain success factors align, such as strong management buy-in by the intermediary, targeted technical assistance, and supportive DFI engagement, significant local capital is mobilised. These factors are not new, but what is new is recognising their combined effect in driving downstream mobilisation beyond the initial DFI investment. This "secondary mobilisation" is largely unmeasured, but critical for scaling SME finance.

In this paper, we present a provisional framework for thinking more holistically about capital mobilisation through financial intermediaries DFIs use to reach SMEs. We explore how successful models of secondary mobilisation can be scaled to achieve broader impact.

Figure 1:
Mobilisation through Banks – Success Factors

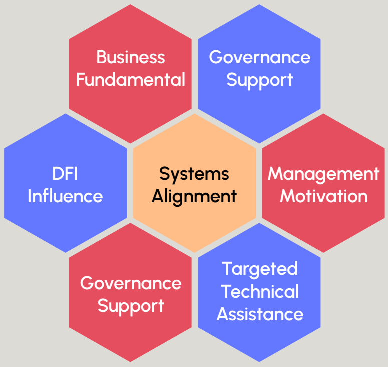
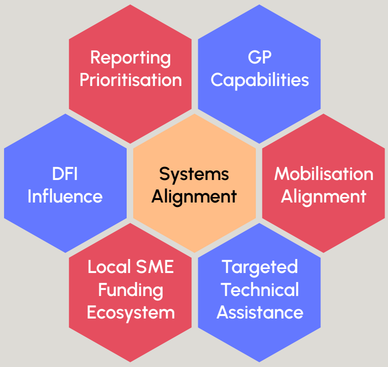


Figure 2:
Mobilisation through Funds – Success Factors



Our Calls To Action:

DFIs, working with the intermediaries they invest in, and in partnership with all ecosystem stakeholders, could drive an increase in the mobilisation of private capital for SMEs by better understanding, tracking, targeting, and intentionally scaling secondary mobilisation.

It starts with recognising that "secondary mobilisation" is a strategy to improve SME finance. While secondary mobilisation is already happening, our goal is to increase its scale and rigour to close the financing gaps.

While "secondary mobilisation" is not a complete solution to filling the SME funding shortfall, this report presents a framework through which to assess the impact of DFI resources for the benefit of small businesses and the communities they support.

Next Steps: The below calls to action are for all stakeholders involved in mobilising SME finance.

"We have looked at private capital mobilisation. We have tried to allocate more capital for SMEs. We haven't optimised for both problems at the same time. Secondary mobilisation is a new concept that we have explored with this Working Group for that purpose."

Working Group Member

1

Understand and track "secondary mobilisation"

· Identify and track examples of where "secondary mobilisation" is happening.

· Extract learnings that will enable the creation of mobilisation strategies at a "secondary" or non-direct level, that could be incorporated into investment decision-making, performance assessments, and TA design.

· Collaborate with selected DFIs, banks, and fund managers to pilot new tracking tools to account for secondary mobilisation in real-time.

2

Develop and incentivise intermediary strategies focused on SME investment via "secondary mobilisation"

· Provide and/or facilitate technical assistance to incentivise and enable sustainable flows of private investment into SMEs:
  · Help banks create sustainable SME lending operations (e.g. by leveraging a bank's balance sheet)
  · Help funds to improve support to portfolio companies in raising capital from private investors.

· Use data to prioritise intermediaries with track records of high mobilisation of capital for SMEs.

3

Scale up ecosystem building and market creation

· Embed ecosystem-building support and market creation more systematically—not just technical assistance to a single partner—to address both demand- and supply-side constraints. This includes fostering the creation of domestic funds that unlock domestic institutional capital.

· Engage with policy-makers to align "secondary mobilisation" strategies with policy incentives.

How Secondary Mobilisation Occurs: Three Case Studies that Inspire

Please go to Annex page 45 for the full list of the 13 case studies and their respective page numbers.

KCB Bank, Kenya: Collaboration Generates Mobilisation

- Technical assistance informed and enabled bank investment in internal systems and customer relationship management, tailored product offerings developed, and non-financial business support to SMEs
- Following the TA starting in 2017, KCB's portfolio started growing from US$ 4M and passed US$ 200M (off their own balance sheet) in 2021, at which point IFC, Sanad and Symbiotics provided a US$ 150M syndicated loan to support the acceleration of KCB's SME portfolio growth.

Mobilisation impact

- KCB's SME loan portfolio grew from US$ 4 million to US$ 900 million over six years, largely funded by KCB's own capital, thanks to an initial grant for technical assistance of around US$ 900 thousand by Argidius Foundation.
- SME lending was established as a core and sustainable revenue and profit driver for the bank. This case demonstrates that DFI lending products can help amplify SME lending but the products and services need to be there in the first place (value of TA).

Sahel Capital, Nigeria: Recognising the Value of Mobilisation at the SME Level

- Investor base including Germany's KfW and the African Development Bank
- Supported by the Nigerian sovereign wealth fund and aligned with Nigerian Government policy priorities
- KfW provides technical assistance facility to funds, including FX hedging and risk management support, de-risking Sahel's portfolio
- Sahel actively supports portfolio companies with due diligence and structuring for subsequent capital raising

Mobilisation impact

- All eight companies in first Sahel fund attracted additional financing from private sources, including local banks
- Additionally, the fund manager has undertaken to assess and report on portfolio company fundraising

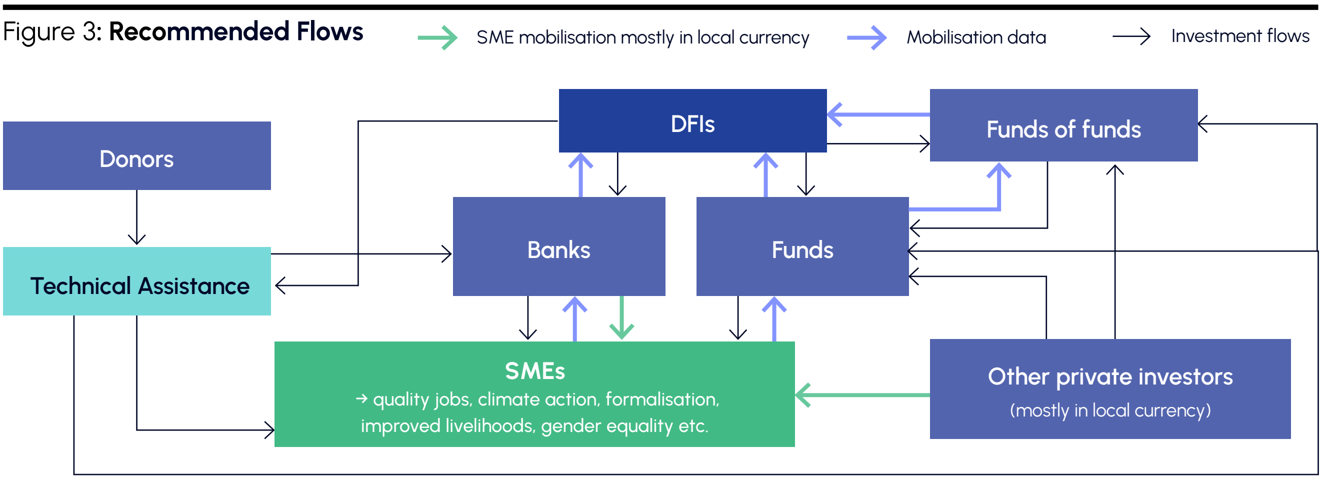
Fondo de Fondos Mexico: Mobilising Domestic Pensions to Build the Market

- Designed as a government-backed fund of funds platform, aimed to anchor emerging private equity and venture capital funds, facilitate infrastructure development, and support SME growth.
- Investors include state development institutions, and development finance partners such as the Inter-American Development Bank (IADB), and also domestic institutional capital providers, especially from Mexican pension funds

Mobilisation impact

- In 2008, in Mexico, there were 12 seed and early-stage funds that invested a total of $3.6 million dollars in only 6 companies. To date, FdF has committed over US$ 1.6 billion across 118 private equity, venture capital, infrastructure, and impact funds, which in turn have backed more than 1400 companies and contributed to the creation of approximately 740 000 jobs across Mexico

Figure 3: **Recommended Flows**



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