



SME Finance in Sub-Saharan Africa: *How do we achieve significant scale and reach?*

Executive Summary & Call to Action

31 August 2017

Shell Foundation | 



Research Methodology & Participants



Enclude, ANDE, and the Shell Foundation have conducted this **research** from late 2016 to mid-2017, with generous participation from **leading providers of SME finance globally**:

Roundtable Discussion – 16 Participants

(November 2016)



Workshop – 11 Participants (March 2017)



Survey and Interviews Conducted – 14 and 10 Participants Respectively (April and May 2017)



Research Reports Reviewed – 30+ Reports



The Approach: From Honest Talk to Action



1. Call for Clarity

- From data points → data sets
- Segmenting this part of the SME universe and understanding the specific pain points

2. Call for Specificity

- Addressing the pain points with effective solutions
- Debunking myths around sources & uses of resources to propel the solutions to scale

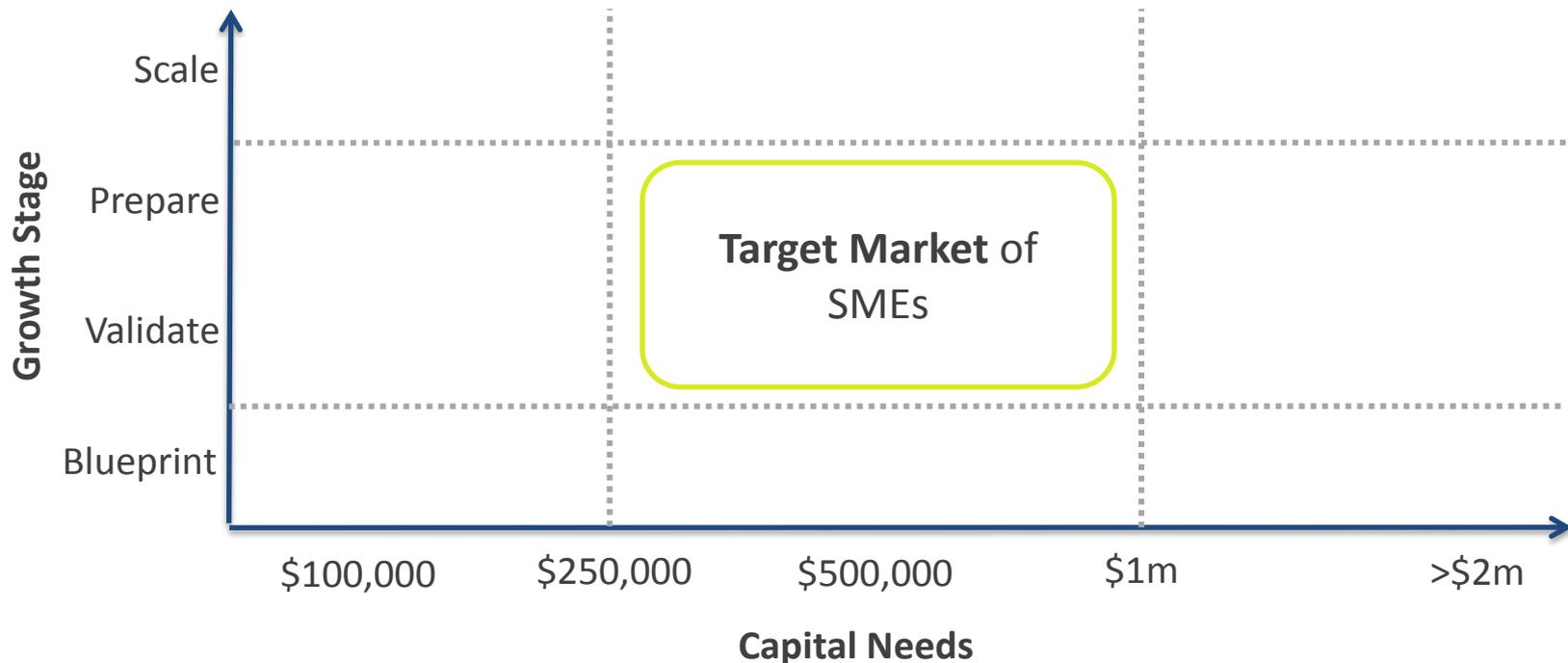
3. Call for Action

- Tackling the data challenge
- Mobilizing the full solution suite to a target location
- Activating domestic capital
- Building sustained and expanding pools of local talent

Call for Clarity: Which SMEs are we talking about?



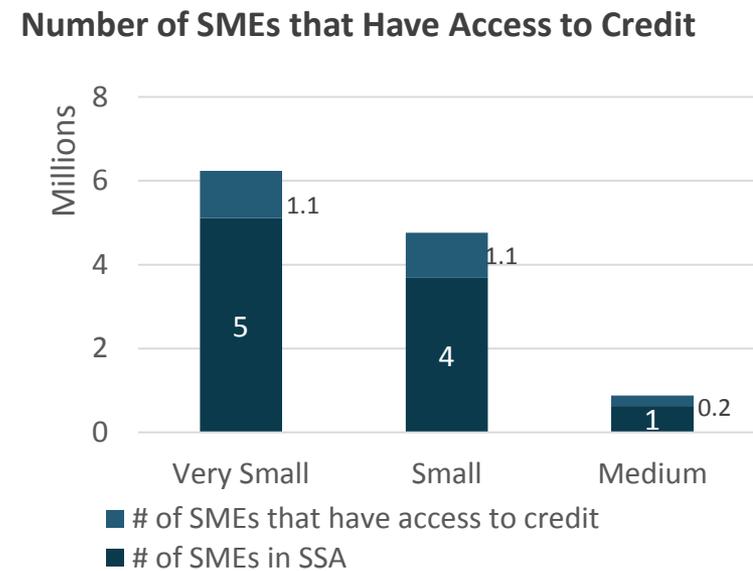
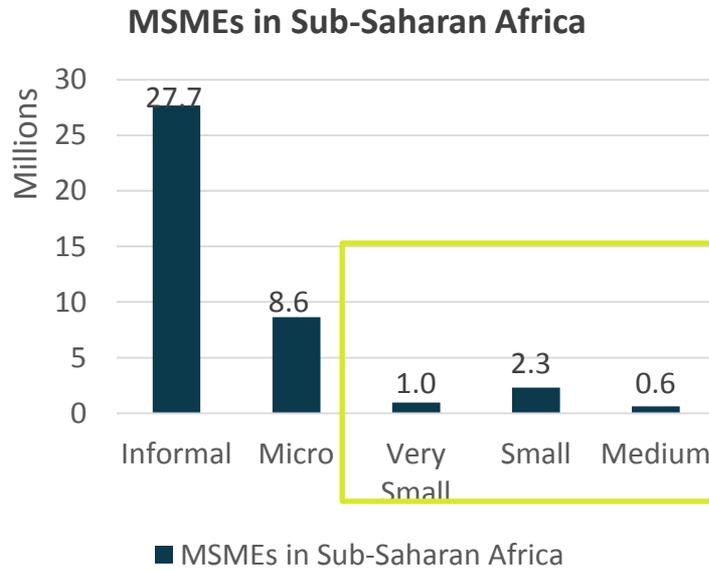
- Focus of this study is on real economy SMEs that are **commercially viable** with **five to 250 employees** and have significant **potential and ambition for growth**
- Within this segment, focus is on businesses in the “**validate**” and “**prepare**” stages seeking **growth and working capital of between \$250,000 and \$1 million** (referred to throughout as our “**Target Market**”)



Call for Clarity: What is the State of the Market Today?



- **Data Gap:** Significant **lack of current data** on SMEs in emerging markets, and specifically for our Target Market. Based on the best available data, we estimate there are **9.4 million formal and informal SMEs in our Target Market** (see Appendix 2)
- **Funding Gap:** We estimate there is currently **\$25.7 to \$30.7 billion** in debt outstanding to these SMEs and around **\$0.53 billion in equity and mezzanine** financing under management targeting those SMEs, creating a gap upwards of **\$70 billion**



Source: Closing the Credit Gap for Formal and Informal Micro, Small, and Medium Enterprises. IFC Advisory Services. 2013

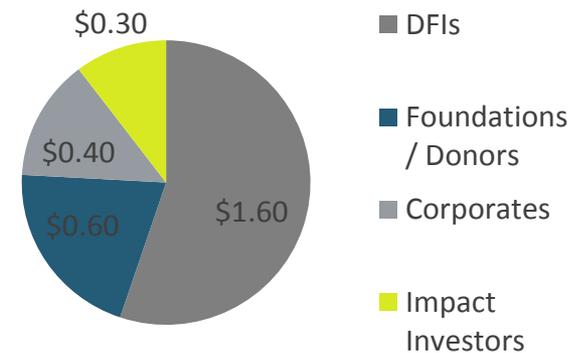
Call for Specificity: How to Increase Both Quantum & Distribution?



- **Quantum:**

- A material increase would require growth in the quantum of financing – targeting an additional **\$3 billion in financing by 2020-2022**
- In the near-term this drive will be led by **Development Finance Institutions** representing just over half of the additional capital sought
- **Donors and foundations** are expected to provide **about a quarter**, with **corporations and impact investors** providing the remaining quarter

Capital to be Deployed (\$3 billion)



- **Distribution:**

- This increase in capital should be coupled with better distribution of financing reaching our Target Market
- By 2020-2022, instead of **1 in 3 SMEs with access to debt, at least 2 in 3 should have access; the amount of equity and mezzanine instruments** available to our Target Market should also increase

Call for Specificity: Which Approaches can Move the Market?



Include evaluated 10 approaches; five were identified as the most promising (listed in order of absorptive capacity and investor appetite); some approaches can be distributed through multiple channels; others through a specific distribution channel:



Commercial Bank with an 'SME Unit' (channel-specific)

Absorptive capacity of 40 – 50% of additional capital



Investment fund providing mezzanine (multi-channel)

Absorptive capacity of 20 – 30% of additional capital



Asset-backed financing (multi-channel)

Absorptive capacity of 10 – 15% of additional capital



Flexible debt instrument (multi-channel)

Absorptive capacity of 5 – 10% of additional capital



Tailored private equity fund (channel specific with design variety)

Absorptive capacity of 5 – 10% of additional capital

Call for Action 1: Building a Current Data Set



Fundamental to achieving scale and reach is having a robust data set that tracks and enables analysis and sharpens insights of size, distribution, trajectory, returns and other data in comparable ways.

To achieve this we must:

- encourage Development Finance Institutions (and other key actors) to **share their data**
- invite ANDE or a similar industry actor, together with academic institution(s), to be the **repository of SME data**, and take ownership of data collection, distribution, and warehousing
- **provide funding**, mainly through Development Finance Institutions and foundations donating \$100,000 per institution per year for collecting, analyzing, and disseminating the data

Call for Action 2: Applying the full suite to a Single Country



Going deep into one country as a community of actors would help demonstrate the viability of the five most promising approaches, and potentially help catalyze quantum steps in capital mobilization.

To achieve this we must:

- build a coalition of funders that **commits to a strategic financing plan for a specific country** (e.g. Uganda as a relevant example) to show what can be done with a density of funders financing promising approaches simultaneously, pursuant to a smart, strategic plan for scale and reach
- encourage a Development Finance Institution or foundation to **fund a 'blue print for action'** of the target country
- provide **incentives and guidance to a diversity of financial and advisory intermediaries** to facilitate capital distribution into existing and new initiatives in the target country

Call for Action 3: Unlocking Domestic Capital



Unlocking domestic capital markets is the only viable solution to foreign exchange (FX) issues. We have seen the consistent and serious effect caused by FX issues, both volatility and depreciation. In the near-term, we need to create structures and solutions using blended finance.

To achieve this we must:

- encourage Development Finance Institutions, impact investors, and foundations to **participate in structures that use different layers of capital** to mitigate FX exposure to keep the cost of capital appropriate for the SME
- encourage Development Finance Institutions to **embolden domestic institutional investors to participate** in structured blended deals, that will be grounded and guided by Development Finance Institutions
- establish a track record through these blended capital structures that will **stimulate domestic investment activity** that is not dependent upon FX mitigation

Call for Action 4: Building Sustained Pools of Local Talent



Ultimately, reliable support for our target SMEs requires local quality resources. We should ensure that every technical assistance program and investment vehicle is structured and managed with an eye to building these local resources.

To achieve this:

- Development Finance Institutions and foundations should **prioritize technical assistance expenditures** that focus on developing local skills, capabilities, and ownership
- all actors should ensure that any **country-level 'blueprint for action'** as proposed in Action 2 connects local organizations that strengthen talent (e.g. universities and accelerators)



- Some models show solid commercial promise, but subsidy will be necessary for many years to come
 - The benefits of those subsidies accrue to cost-effective development impact
 - Substantially scaling the amount of funding and the reach of SME finance should deliver a step-change in impact
 - The sources and purpose for subsidy will also shift
- Grant, sub-commercial, and quasi-commercial capital will all be required in greater proportions in order to leverage more commercial capital
- DFIs will remain as the main investors, but will need to recalibrate and reframe their return expectations, and look to lead and be part of bridging solutions & systemic interventions

Activating Stakeholders in the Right Roles



Each actor has a key role to play in addressing the financing gap:

Investor	Key Action Items
Development Finance Institutions	<ul style="list-style-type: none">• Will need to be the primary financier over the next three to five years, re-calibrating return expectations and strengthening the analysis of impact return• Should lead in making the case for SMEs by (i) sharing data and track record, (ii) increasing investment activity and results, (iii) mobilizing local capital, and (iv) developing local talent, thereby crowding-in other capital providers (v) and demonstrating the case for declining amounts of subsidy as SME investment intermediaries mature and scale
Foundations	<ul style="list-style-type: none">• Should embrace more innovative approaches to SME financing and help finance the building of the SME financing ecosystem• To support the cultivation of the SME finance ecosystem (e.g. grant funding for SME, Intermediaries, and market-level capacity building)
Impact Investors	<ul style="list-style-type: none">• Are encouraged to step up and start providing financing to SMEs through existing approaches, as well as invest in the development of more innovative solutions• Are well-suited to push business development services and technology frontiers
Corporates	<ul style="list-style-type: none">• Need to be engaged through data sharing and performance track record with a particular focus on business cases linked to the Sustainable Development Goals and/or their value chain requirements

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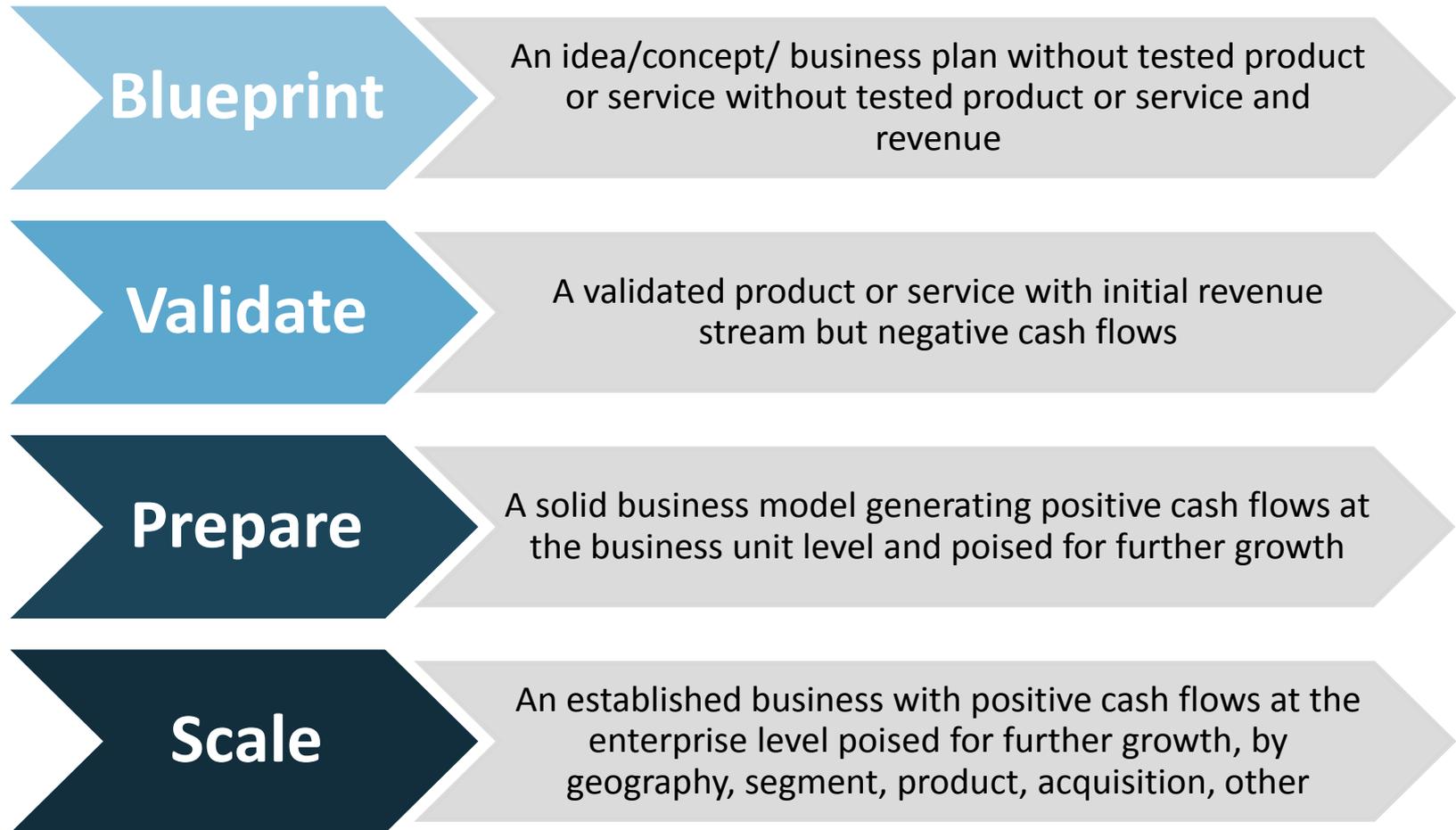
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Appendix 1: SME Segments



Source: From *Blueprint to Scale: The Case for Philanthropy in Impact Investing*, Monitor Report April 2012

Appendix 2: Number of SMEs in Target Market



- There is very limited and often outdated quantitative information on SMEs in emerging markets; the largest scale study was conducted by the IFC in 2010 and 2011
 - Informal SMEs: enterprises that are not registered with the municipality or tax authority
 - Formal micro enterprises: 1 – 4 employees
 - Formal very small enterprises: 5 – 9 employees
 - Formal small enterprises: 10 – 49 employees
 - Formal medium enterprises: 50 – 250 employees
- Based on our definition, we are focused on the very small, small and medium enterprises
- Using this data from 2011, there are about 12.5 million formal MSMEs in SSA, of which 8.6 million are micro enterprises, and thus leaving **3.9 million formal SMEs**
- However, **this data excludes the informal SMEs in our target market**, which are important to include for our study
- In order to arrive at a more informed baseline, we apply a market assumption that within the informal category, the overwhelming majority (80%) is a micro-enterprise with the balance made up of very small (15%) and small (5%) enterprises. Applying this assumption to the set, there would be a total of **9.4 million formal and informal SMEs in our Target Market.**