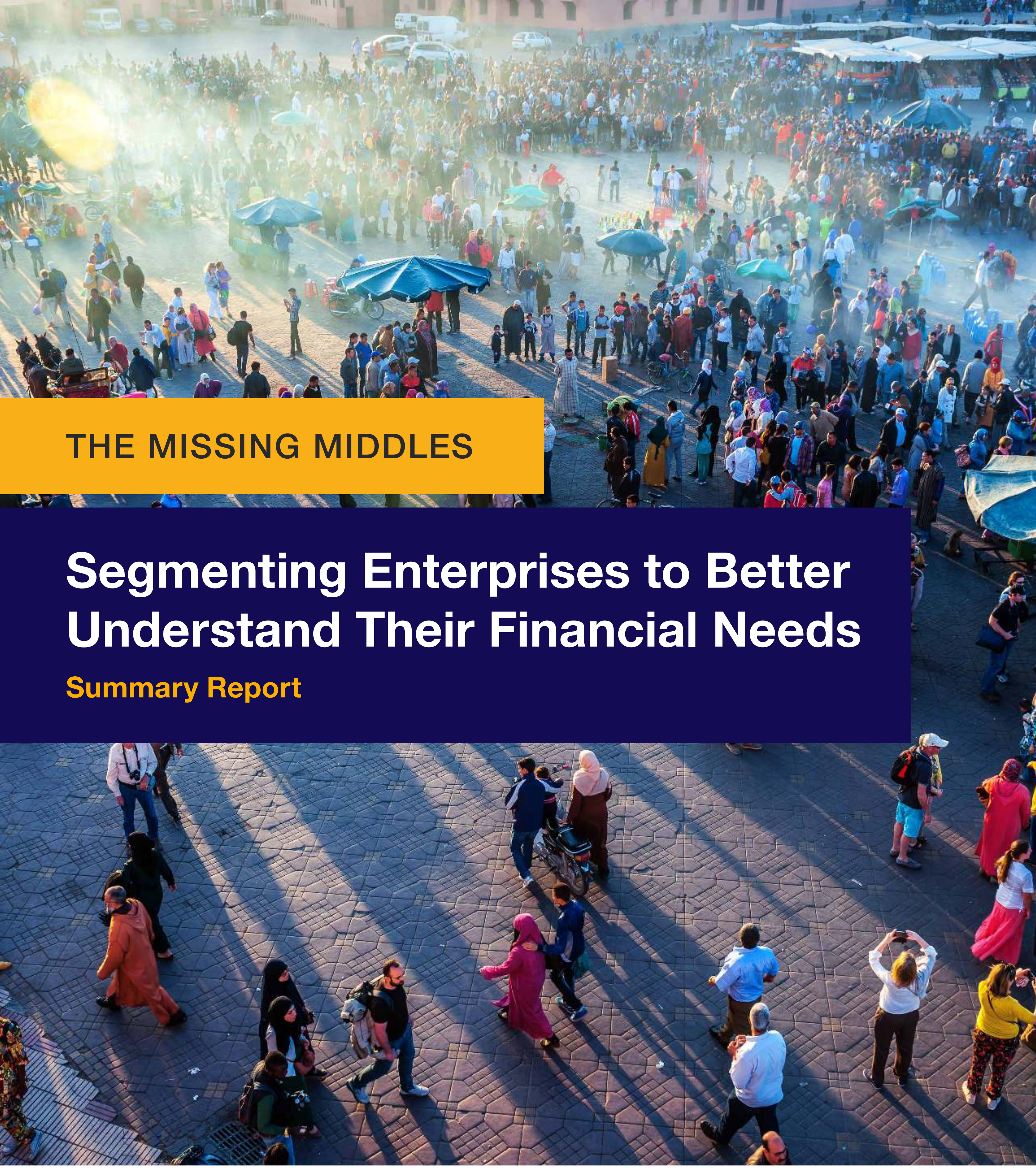

THE MISSING MIDDLES

Segmenting Enterprises to Better Understand Their Financial Needs

Summary Report

OMIDYAR NETWORK
A WORLD OF POSITIVE RETURNS

Ministry of Foreign Affairs of the Netherlands

COLLABORATIVE
FOR FRONTIER FINANCE

COMMISSIONED ON BEHALF OF:

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

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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 multigenerational small family businesses in sectors like retail, trading, and manufacturing—and are managed by an equally diverse range of entrepreneurs.

SGBs typically seek external financing in the range of $20,000 to $2 million 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 (see “Enterprise credit gap” graphic on page 5).[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. Such businesses often face a fundamental mismatch between available financing and their specific needs.

Addressing the SGB financing challenge is critical to promoting robust, broad-based economic growth and to unlocking the potential of entrepreneurs to positively impact their customers, employees, and communities.

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.

A primary cause for the SGB financing gap is that small and/or early stage businesses are inherently hard to serve. Financial service providers[2] 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 (e.g., 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. This, in turn, contributes to inefficiency in matching enterprises with the right sources of funding and financial instruments (on appropriate terms and at the right time according to their business development stage).

This report focuses on Small and Growing Businesses (SGBs) operating in emerging and frontier markets.

This report proposes a segmentation framework that aims to help financial service providers, enterprises, donors, limited partners (LPs), and field-building organizations[3] better understand and navigate the complex landscape of SGB investment in frontier and emerging markets. By putting forward common language and terminology for different types of SGBs, this report ultimately aims to contribute to a better-functioning financing market that can generate more efficient matching between enterprises and financial service providers. The hope is that this effort will contribute to wider efforts to unlock greater amounts of appropriate capital for SGBs.

SCOPE AND RESEARCH METHODOLOGY

Scope

This report focuses on Small and Growing Businesses (SGBs) operating in emerging and frontier markets. As defined by the Aspen Network of Development Entrepreneurs (ANDE), SGBs are commercially viable businesses with five to 250 employees that have significant potential, and ambition, for growth.[4] SGBs typically have financing needs ranging from $20,000 to $2 million. They are a subset of the wider universe of micro, small, and medium-sized enterprises (MSMEs).

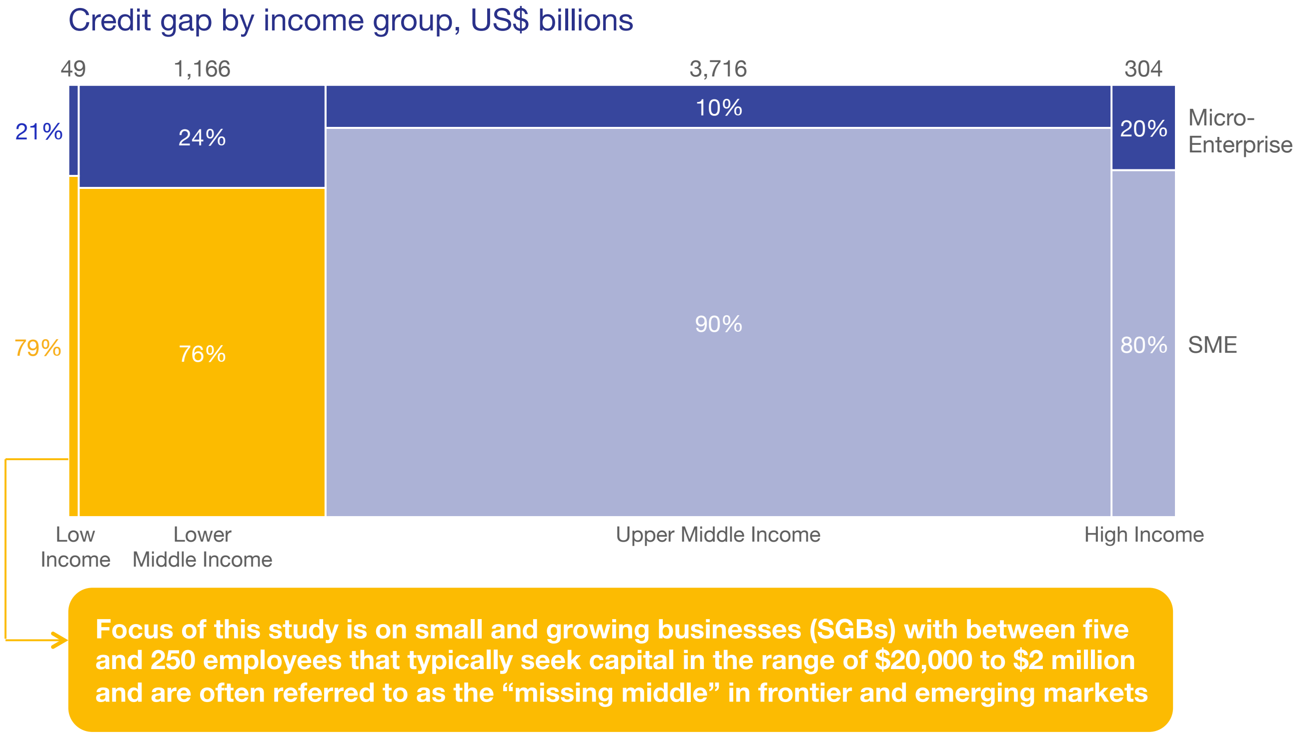
This study includes both impact-oriented enterprises and traditional enterprises; we also explicitly include both early stage startups and well-established small businesses that have been operating for decades. However, this study does not focus on those microenterprises that are informal and are unlikely 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.

2 *Financial service provider* is an umbrella term for financial intermediaries and investors (local and international, traditional and impact-oriented) that directly invest in enterprises. Examples include venture capital funds; debt, mezzanine, and private equity funds; commercial banks; non-banking financial institutions; and microfinance institutions.

3 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 research organizations, academic institutions, or training institutes, produce thought pieces, convene stakeholders, develop curricula, and otherwise have a positive effect on the broader frontier and emerging market investment space.

4 "What is a Small and Growing Business (SGB)?" ANDE.

Enterprise credit 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)

Research Methodology

This segmentation is distinct from existing frameworks in that it integrates several 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. Our research included the following components:

- **Literature review:** We conducted a comprehensive review of existing studies focused on enterprise segmentation, as well as assessments of appropriate financing for SGBs.
- **Stakeholder interviews:** We interviewed representatives from more than 50 SGB investors and intermediaries (e.g., accelerators and technical assistance providers) to understand how they target and segment the SGB market, and what variables are most important to them in assessing the financing needs of SGBs.
- **Quantitative analysis:** We also collected portfolio data from five financial service providers[5] that specifically focus on our target market. We asked each of these organizations to select a randomized cross section of companies currently within its portfolio and to report on this sample using a template that included 38 unique quantitative and qualitative data points[6] across five main areas of interest: entrepreneur characteristics, business demographics, financial performance, type of external financing received, and outcomes and impact.
- **Human-centered design research:** Finally, we employed human-centered design research via in-depth behavioral interviews with individual entrepreneurs to better understand their experiences and attitudes with respect to financing their businesses.

5 GroFin, Santa Clara University's Miller Center for Social Entrepreneurship, IntelleGrow, Investisseurs & Partenaires (I&P), and Root Capital.

6 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.

THE FOUR FAMILIES OF SGBS

Multiple classes of SGBs inhabit the missing middle. Our research sorts the universe of SGBs with financing needs between $20,000 and $2 million into four distinct segments—which we call “families.” 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 has distinct financing needs, and faces different gaps or mismatches in the market between available investment options and the solutions that are best suited to enterprise needs.

Our research sorts the universe of SGBs with financing needs between $20,000 and $2 million into four distinct segments—which we call “families.”

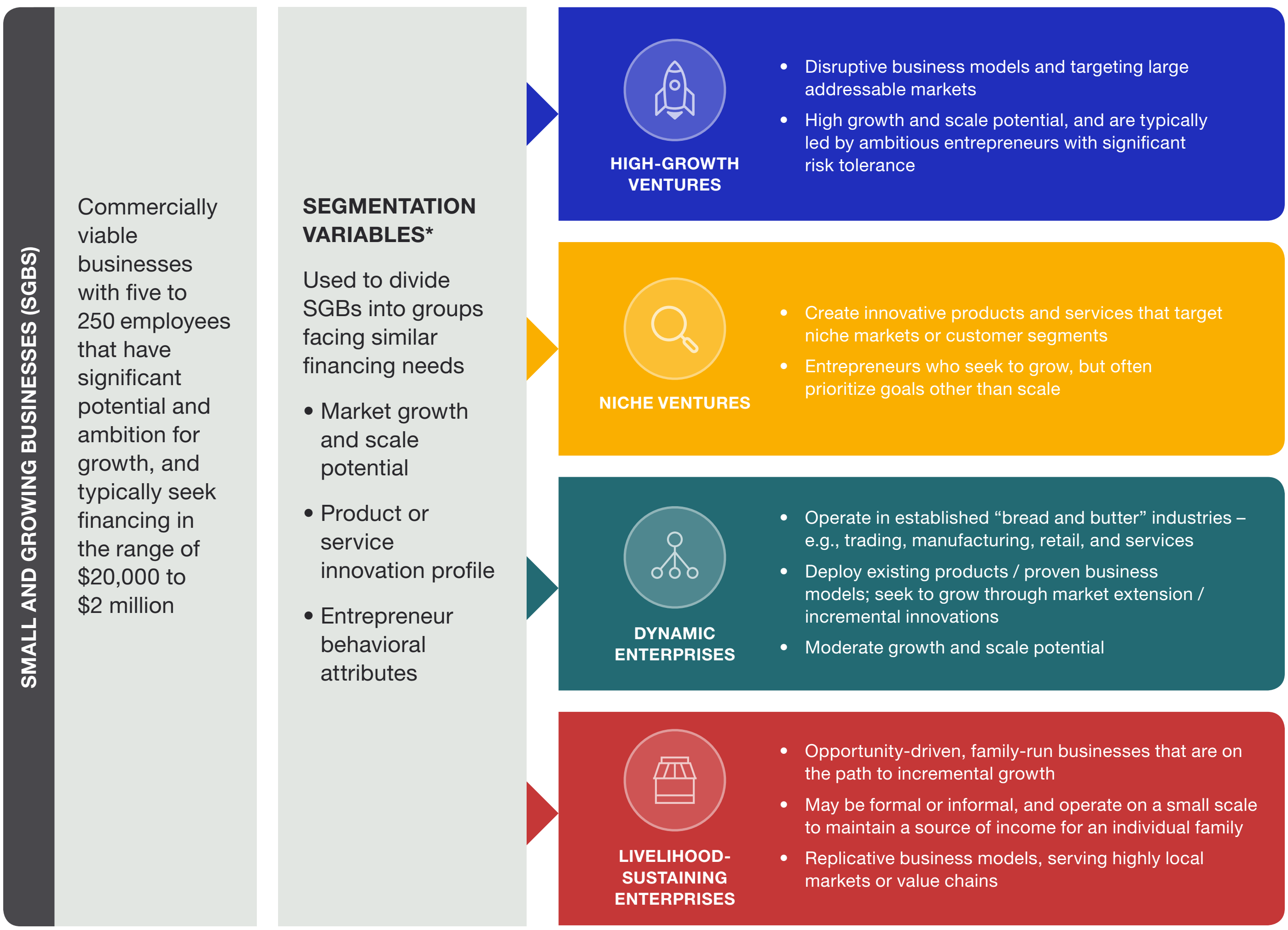
These four families come into focus when we look at SGBs using three distinct variables:

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.**



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

Enterprise Segmentation Framework: Four Families of Small and Growing Businesses

HIGH-GROWTH VENTURES

High-growth Ventures, the first enterprise family, 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 through digital technology (e.g., social media platforms, mobile money transfer, etc.) but also through durable or hardware-based products (e.g., off-grid solar, cookstoves, or medical diagnostic equipment, etc.), and business model innovations.[7] Due to their steep growth trajectory, High-growth Ventures typically have significant need for external financing. While they make up just a small percentage of SGBs in an economy, High-growth Ventures have outsized impact in driving innovation, spurring productivity, and creating new jobs. Example archetypes are high-tech startups and impact-oriented enterprises focused on pioneering scalable business models for reaching low-income customers.

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

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

High-growth Ventures, the first enterprise family, 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.

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

NICHE VENTURES

Niche Ventures create innovative products and services that 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 this family of businesses are creative economy enterprises, such as artists and businesses with a specific focus on unique artistic value-add in niche markets, or locally focused social enterprises, which seek deep impact at the local level. Niche Ventures play a role in meeting increasingly diverse customer needs as economies mature and in serving as laboratories for social innovation.

These are businesses like Bombay Atelier, a small company in Mumbai that designs and produces unique, artistic furniture and targets a high-end local market. Bombay Atelier's founder, a designer by trade, is seeking to grow the business while preserving the unique, customized aesthetic of its products.

Another example of the Niche Venture family is Nazava, a small business in Indonesia which sells affordable water filters with a social mission of improving consumers' health and well-being. Nazava focuses on achieving impact on specific communities primarily in Sabu Island, through the resale of affordable water filters and bundling them with education about the importance of clean water delivered by local health workers.

Niche Ventures create innovative products and services that target niche markets or customer segments whose total addressable market is limited.

DYNAMIC ENTERPRISES

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. 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.

Multigenerational, family-owned 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. They have a range of external financing needs, from short- and long-term lending to growth capital in the form of equity or mezzanine financing.

One example of a Dynamic Enterprise is Stick Pack, a flexible packaging and sticker products manufacturer in Egypt founded in 1987. Stick Pack, which now employs several hundred people, has grown over time by introducing new product lines, sourcing locally, reducing costs, and gaining local market share in its core product lines. The company has benefited from external finance, notably a debt working capital loan from GroFin that enabled the company to develop a new production line.

Another example is CAC Chirinos, Peruvian coffee cooperative that works with over 700 smallholder farmers to bring their product to market. The company has grown thanks to access to trade finance from Root Capital and other agricultural SME lenders, which has enabled the company to work on the ground with coffee farmers to improve crop productivity and quality.

Dynamic Enterprises, the third enterprise family, are medium sized and operate in established "bread and butter" industries—such as trading, manufacturing, retail, and services—and deploy proven business models with steady but moderate rates of growth.

LIVELIHOOD-SUSTAINING ENTERPRISES

Finally, Livelihood-sustaining Enterprises are small businesses selling traditional products and services. These SGBs are driven by opportunity and not necessity, employ a small number of people, and are already formal or soon to be formalized. They tend to operate on a small scale, with low growth potential, and serve local markets or value chains, often in sectors such as retail and services. Livelihood-sustaining Enterprises can create value for finance providers as their activities generate returns above local rates of inflation.

An archetype of this enterprise profile is a small lifestyle enterprise that is growing and has "graduated" from traditional microfinance, and now seeks a larger sum of capital to support operations. Enterprises in this family are particularly important for sustaining livelihoods for rural and vulnerable populations. Their needs for external finance are small in scale, but many can benefit from products that enable them to manage working capital.

These are businesses like Prime Auto Garage, a small woman-owned business in Kigali, Rwanda, that provides motor vehicle repair services. Started it 2001, it has grown over time to employ over 20 people, and has received a $54,000 loan from Business Partners International to finance the purchase of additional garage equipment.

Livelihood-sustaining Enterprises are small businesses selling traditional products and services. These SGBs are driven by opportunity and not necessity, employ a small number of people, and are already formal or soon to be formalized.

Archetypes and Examples of the Four Segment Families of SGBs

ARCHETYPES

HIGH-GROWTH VENTURES

- Startup tech ventures
- Asset-intensive physical product-based ventures targeting significant scale
- SGBs pioneering or transforming a sector*

NICHE VENTURES

- Artisans and companies in the creative economy
- SGBs with a focus on serving a specific local community or target population

DYNAMIC ENTERPRISES

- Multigenerational family businesses
- Traditional businesses operating on "core" sectors for many emerging economies – i.e., agriculture, manufacturing, services, and retail

LIVELIHOOD-SUSTAINING ENTERPRISES

- Microenterprises that are successful and 'graduate' from microfinance to hire additional employees

EXAMPLES

High-growth ventures

- **Freight Tiger** – a young tech-based logistics company in India seeking to transform transportation
- **PEG Africa** – a young Ghanaian-based solar company providing pay-as-you-go financing, with rapid growth into multiple African markets

Niche ventures

- **Vega Coffee** – a social enterprise utilizing a direct-to-consumer business model to sell roasted coffee beans as a premium product in the US
- **Bombay Atelier** – a high-end furniture company in Mumbai with unique, customized designs
- **Nazava** – an Indonesian social enterprise that sells affordable water filters coupled with education about importance of clean water from local health workers to communities on Sabu Island

Dynamic enterprises

- **Stick Pack** – a sticker products manufacturer in Egypt founded in 1987 with slow growth through new product lines and gaining local markets
- **CAC Chirinos** – Peruvian coffee cooperative supporting smallholder farmers gain access to higher markets
- **La Laiterie du Berger** – a dairy processor sourcing fresh milk collected from 800 farmers in Senegal

Livelihood-sustaining enterprises

- **Prime Auto Garage** – a small business in Rwanda founded in 2001 that provides car repair services, which has slowly grown to over 20 employees
- **W&R Shoes** – a small business in Nicaragua which after 27 years grew to a workshop of 15 people

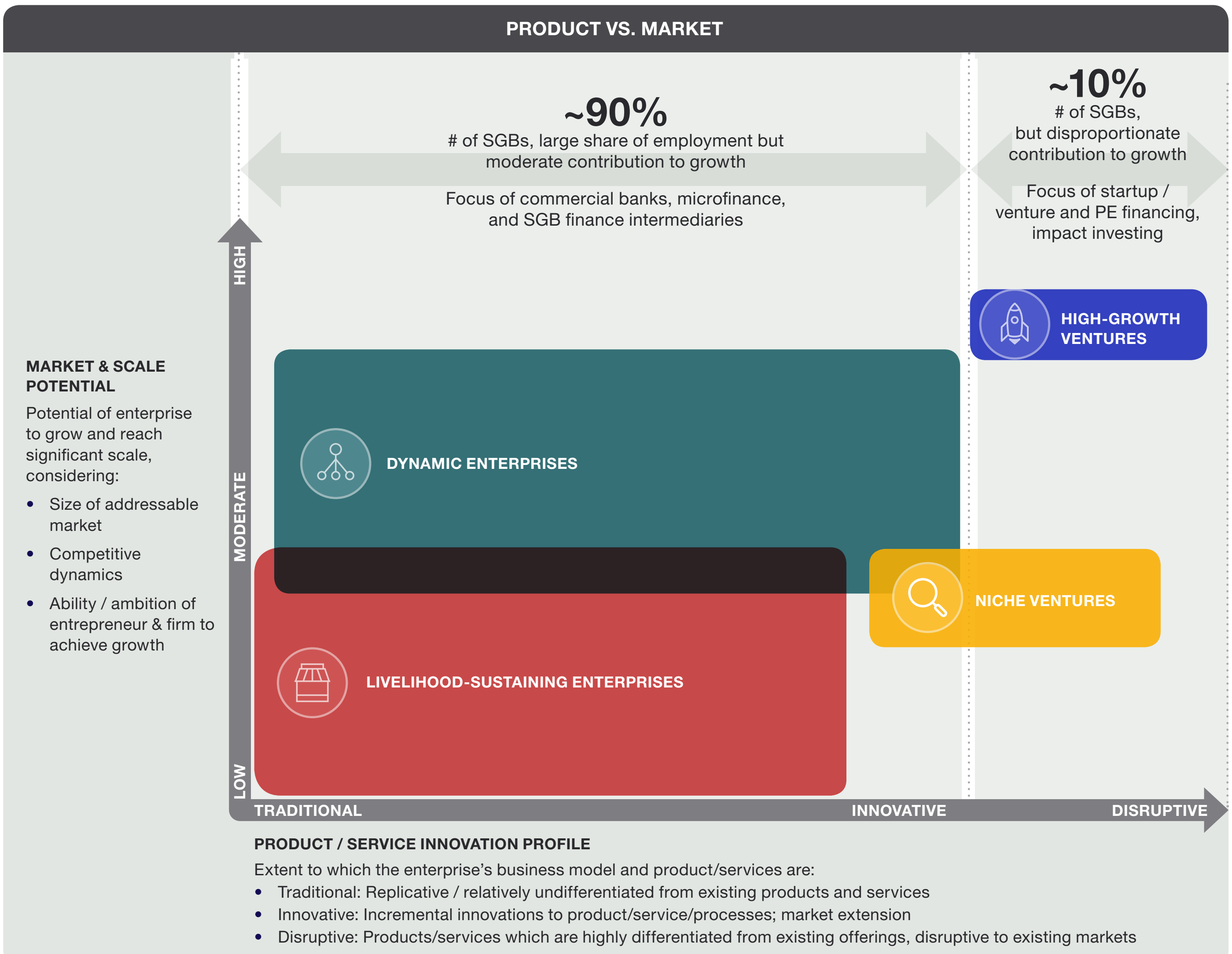
*Source: SGBs addressing the pioneer gap as discussed in Monitor/Acumen Fund, "From Blueprint to Scale: The Case for Philanthropy in Impact Investing," 2012.

DIFFERENTIATING THE FOUR FAMILIES OF SGBS: THREE LENSES

To highlight the distinguishing characteristics of each of the four families of SGBs, we apply three "lenses" to our analysis. Each of these lenses provides a unique way of comparing these distinct categories of SGBs and helps to call out differences in their financing needs.

Lens 1: Product vs. Market Matrix

We use a product-market matrix (see below) to differentiate families by the type of product or service an enterprise is seeking to offer 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 to be innovative in their core product and service offerings or to disrupt the markets in which they operate. Traditional businesses provide mainly existing products to existing customers. Innovative enterprises pursue incremental innovations to products and services and market extension strategies to reach adjacent customer segments. Disruptive enterprises seek to create or pioneer new markets that meet new, unmet customer needs. On the y-axis, we plot growth and scale potential, which maps the extent to which an enterprise has the potential to scale beyond the size of an SGB and serve larger markets and customer bases.

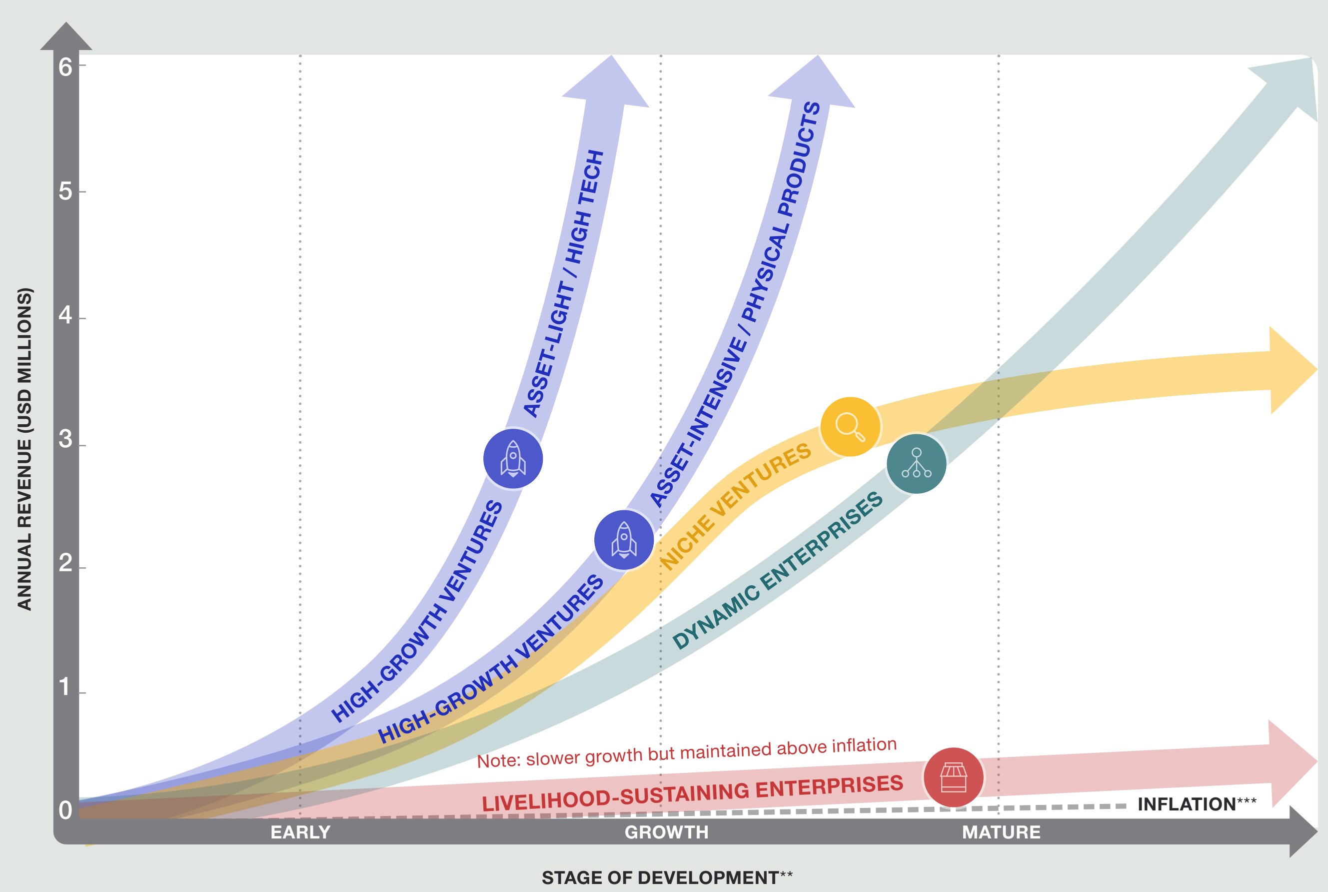


Using this framework, High-growth Ventures and Niche Ventures both have a high focus on innovation, but High-growth Ventures are differentiated in having very high-scale potential and their ambition and ability to serve large addressable markets. Dynamic Enterprises and Livelihood-sustaining Enterprises typically pursue more traditional business models in established industries and differ primarily in their size, complexity, and ambition and potential for growth.

Lens 2: Growth Curves

Growth curves can be used to understand the paths of development and approximate size of the financing need of each of the four families over time. Drawing on quantitative portfolio data from five SGB investors, we used gross revenue and age of enterprise as proxies to see how the average enterprises in each family evolved over time. Since annual revenue growth is a highly contextual variable that depends on geography, sectors, and inflation levels, among other factors, we have instead opted for a simple depiction of broad growth trajectories over a set period (see the figure below). These trajectories and time periods are illustrative and are primarily meant to show key differences in each segment family's respective growth trajectories.

ENTERPRISE FAMILY GROWTH CURVES*



* 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.

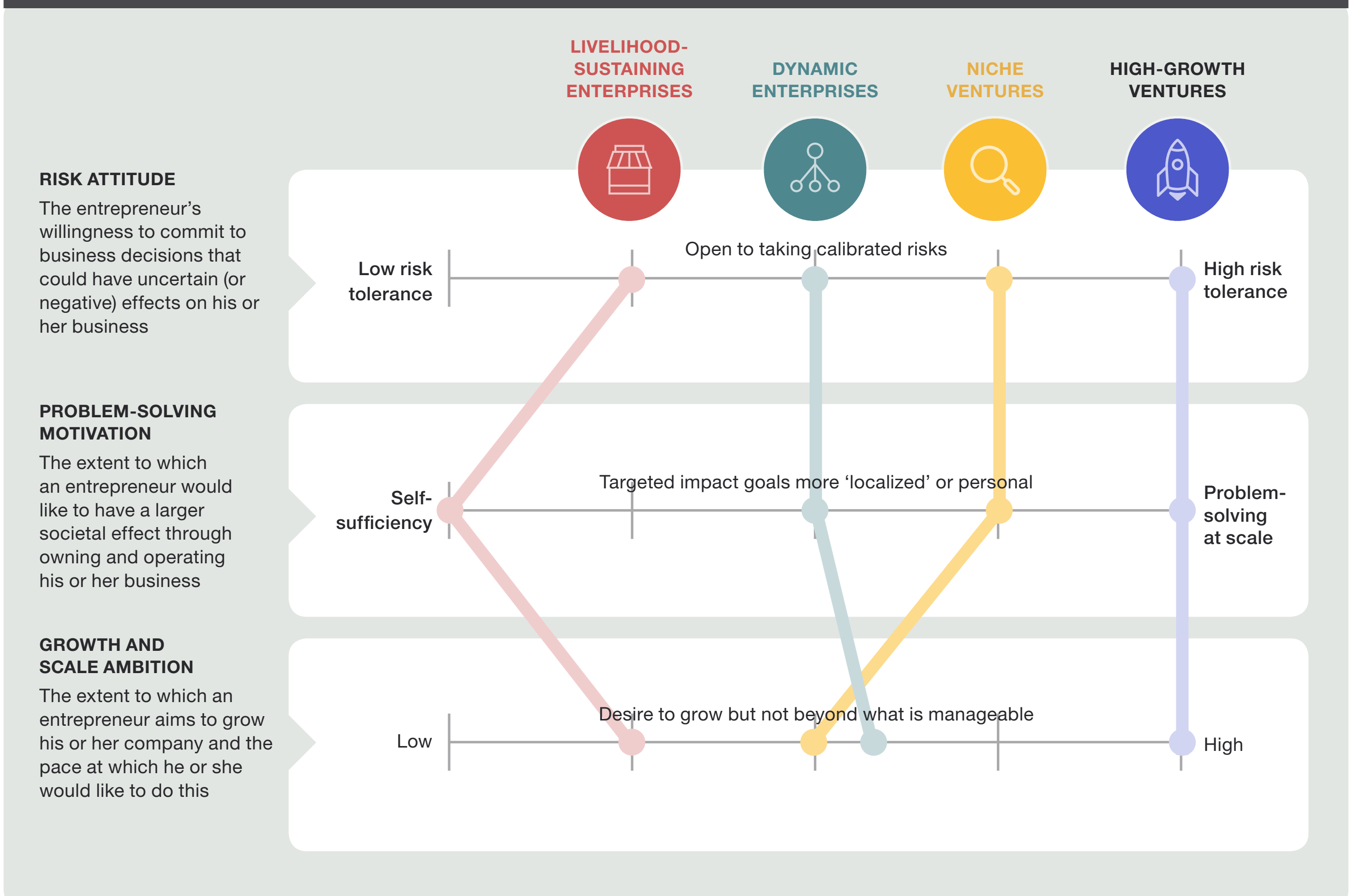
*** Local markets' rate of inflation

The illustrative growth paths of each segment family over time reveal some telling difference in financial needs. High-growth Ventures is the segment that, if successful, must leverage early stage risk capital and subsequent growth capital to scale beyond "SGB status" in a relatively short period of time, although the trajectory of growth is often different for asset-light or tech businesses from that of asset-intensive or physical product-based businesses. Niche Venture businesses enjoy early stage growth but differ in not reaching an inflection point of scaling; they thus typically do not need larger tranches of growth capital. Dynamic Enterprises tend to demonstrate more modest growth over a longer time horizon, while Livelihood-sustaining Enterprises start and remain small, and therefore require only limited, basic types of external finance.

Lens 3: Entrepreneur Behavioral Profiles

Finally, we examined the behavioral attributes of entrepreneurs, via human-centered design research, as a final lens to describe and differentiate the four families. We focused on behavioral traits that significantly influenced an entrepreneur's attitudes toward external financing—particularly their attitude toward risk, problem-solving motivation, and growth and scale ambition. In the figure below, we define illustrative "personas" for common management behavioral profiles in each of the enterprise families. These personas are not definitive, as entrepreneurs' behavioral attributes will of course vary person-to-person and across demographic and cultural contexts. Rather, the personas are intended to illustrate attitudes we observed in our human-centered design research that are common among entrepreneurs and management teams in these families.

ENTREPRENEUR BEHAVIORAL DIMENSIONS*



* 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 con 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.

For High-growth Ventures, we've described the persona of an entrepreneur that has high growth and scale ambition, the desire to problem-solve at scale, and the willingness to take risks to achieve this vision.

The example behavioral profile for a Niche Venture management team or founder is notable, as attitudinal factors are central to what defines this family. In this example, the persona is a founder who is willing to take risks (e.g., create a startup with an "innovative" product offering) and is seeking to achieve a specific vision of how to solve a problem or serve a particular customer segment. This founder has a specific vision for his or her business (achieving a specific kind of impact or designing a product that targets a specific niche market or customer segment) and prioritizes fidelity to that specific vision of success more highly than maximizing scale.

For Dynamic Enterprises, we observed a persona characterized by calibrated risk-taking to achieve success in the long term. And finally, for Livelihood-sustaining Enterprises, we illustrate the persona as a business owner or management team that has a low risk tolerance and is likely to weigh factors such as stability and security (i.e., of the family's livelihood and immediate financial needs) significantly in his or her decision-making.

THE FOUR FAMILIES OF SGBS: FINANCING NEEDS, MARKET GAPS, AND PROMISING SOLUTIONS

Having defined the enterprise families, our research turned to understanding enterprises' financing needs, identifying important variables for sub-segmenting each of these families according to those needs, and highlighting the financing gaps and mismatches that are most prevalent across SGB investing in emerging and frontier markets. We also highlight areas of progress in advancing financing solutions that address these gaps and mismatches.

Summary of the SGB Families

		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; Promising venture; Poised for growth
	Digital technology based Small number of high growth and disruption-driven businesses in a large and growing market		Exponential growth with fast development phase			
NICHE VENTURES	Small, high ambition niche businesses in modest-sized markets	Moderate scale potential, disruptive business model	High initial growth which tappers off as addressable market has limited upside	"Cross-trainer" – designing new approaches to difficult problems	Business model as relates to financing needs	**Service innovator**; **Product 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	"Treadmiller" – keeping small business afloat	Collateral availability & financial performance	**Fully credit constrained small enterprise**; **Partially credit constrained small enterprise**

High-growth Ventures

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.

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 lens 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.

High-growth Ventures are most distinct in their financing needs in that they need staged "risk capital" to fuel their growth journey.

However, we found that 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 distinguish between asset-light tech ventures and asset-intensive physical product-based ventures.

We define digital technology ventures as asset-light 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 physical product ventures as asset intensive businesses that produce "physical things" and need to prototype and/or build bricks-and-mortar infrastructure to scale—and thus face a particularly serious challenge in securing early stage risk capital to bridge the "pioneer gap."

Market Gaps: 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, and thus there is a corresponding need for the SGB finance community to support the expansion of venture investing in these markets.

In addition, there is a need to expand access to early stage risk capital for physical product ventures and other High-growth Ventures that are not a fit for traditional venture capital financing structures. This means moving beyond using closed-ended venture capital fund structures deploying straight equity to using a broader array of vehicle structures and financial instruments that enable the use of more flexible time horizons (such as evergreen funds and holding companies) and of financial instruments that allow for structured exits.

Promising Solutions: We are already seeing significant momentum in this direction, with a growing number of funds adopting alternative structures and instruments. For example, Adobe Capital in Mexico uses primarily mezzanine instruments (e.g., revenue-share structures) to finance innovative businesses with significant growth potential but uncertain exit prospects. In addition, a range of investment funds—including Bridges Ventures and GSB Impact Fund—have created evergreen or permanent capital vehicles that provide more flexibility on time horizons.

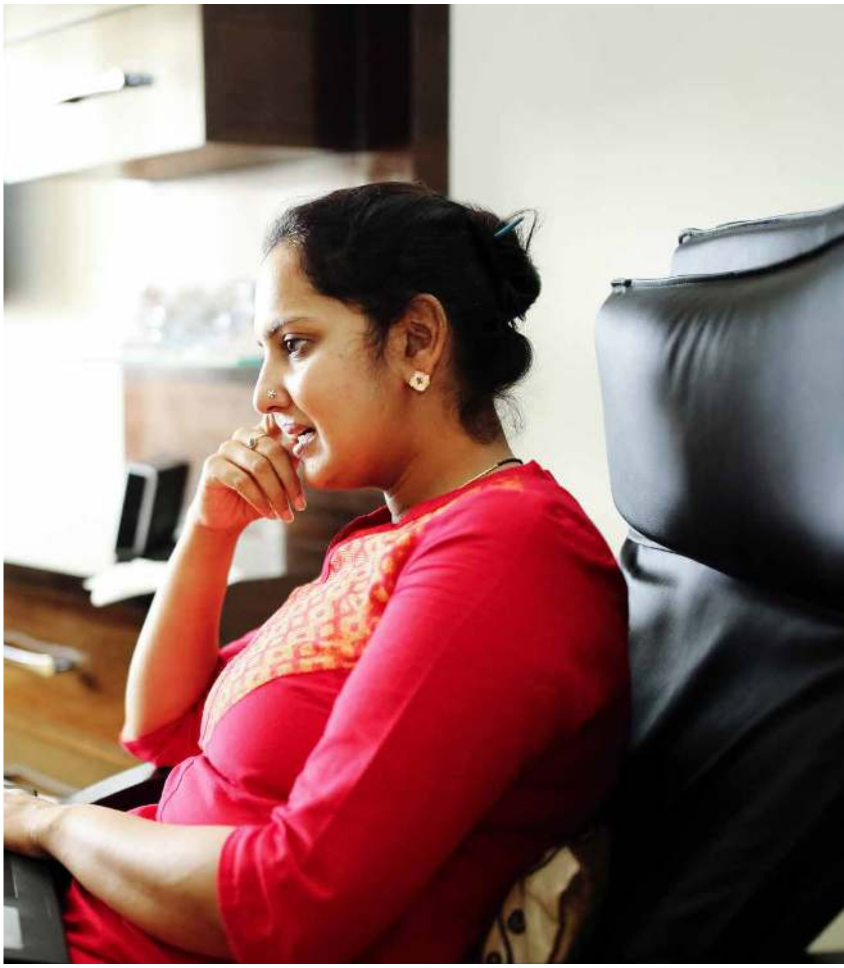
Niche Ventures

Financing Needs: Niche Ventures, like High-growth Ventures, often require risk capital early in their journey in the process of launching an innovative product or service. However, their capital requirements are often more modest in size.

For Niche Ventures, we distinguish between *Product-based Innovators*, which tend to have higher costs related to product R&D, getting products to market, and scaling, and *Service-based Innovators*, which tend to have more limited financing needs and shorter working capital cycles.

Once they have proven their business models and established a track record of performance, Niche Venture enterprises can benefit from a wider array of financial services from mainstream financial institutions—such as lines of credit, asset financing, and other lending products.

Market Gaps: In many emerging and frontier markets, a prevalent financial needs mismatch impacting Niche Ventures is the lack of early stage financing for innovators with promising products and services that don't have large ambition to scale and have limited exit prospects. In more mature markets, early stage funding for Niche Ventures often comes from sources such as friends and family, personal bank loans, angel investors, and equity crowdfunding. In less developed markets, these sources can be scarce. As such, we see a situation in which Niche Ventures have very few options for risk capital at all. This sometimes leads niche business entrepreneurs to seek out venture capital in the absence of other viable sources of risk capital, and can lead to wasted time and effort—enterprises pitching to investors with quite different expectations for risk, return, and impact.



Promising Solutions: A promising solution for Niche Ventures is the development of more robust ecosystems of local investors. 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. Organizations like the Global Business Angels Network (GBAN) and the African Business Angels Network (ABAN) have helped build an ecosystem for angel investing and strengthened linkages among local financial service providers.

Niche Ventures can also benefit greatly from the support and connections provided by business networks and accelerators (e.g., Alterna, Enabilis, etc.). 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.

Dynamic Enterprises

Financing Needs: Dynamic Enterprises face significant financing gaps—in many ways, they are squarely "in the center of the missing middle." Many of these businesses are well-established and large enough to have complex operations, and thus have financing needs distinct from those of startups. They can benefit from working capital solutions to meet short-term financing needs; lending that can enable capital expenditure for specific assets or investments that can fuel incremental growth; trade finance for relevant sub-segments; and, potentially, equity or equity-like capital to strengthen balance sheets and enable expansion opportunities.

Because Dynamic Enterprises often have diverse operating and capital expenditure financing needs, we use *business activity*—e.g., manufacturing, trading, services, and financing—as the variable for further sub-segmenting this family. Business activity is a variable that is strongly correlated to several key drivers of external financing needs, such as capital intensity and cash conversion cycle. For example, *manufacturing* enterprises often require high capital expenditure (due to high plant, property, and equipment requirements) and have long working capital cycles (due to the need to fulfill orders of physical products, deliver them to customers, and collect or finance customer purchases). In contrast, many services-based SGBs have more modest financing needs, as they have more limited capital expenditure requirements and shorter working capital cycles.

Dynamic Enterprises face significant financing gaps—in many ways, they are squarely "in the center of the missing middle."

Market Gaps: 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.

As such, we also see important roles for specialized SGB-focused financial service providers that offer mezzanine financing and flexible debt to meet the needs of Dynamic Enterprises. 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 redeemable equity 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.

Promising Solutions: 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.

Specialized debt providers focused on SGBs—such as Business Partners International and GroFin—present an alternative to collateralized bank lending, offering debt on more flexible terms for SGBs and more customized to the dynamics of the industries and markets in which they operate. Specialized agricultural lenders, such as Root Capital, are another important source of capital for Dynamic Enterprises in rural areas, having raised blended finance and developed specialized underwriting capabilities and lending products to meet the distinct need of this sub-segment of dynamic enterprises.

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.

Livelihood-sustaining Enterprises

Financing Needs: Livelihood-sustaining Enterprises have basic financial needs centered on short-term working capital. Across the board, the primary challenge for members of this enterprise family is ensuring that they can continue operating at full capacity during their cash conversion cycles, as the enterprise may have "lumpy" cash flows or might want a safeguard against any unplanned events (e.g., customer default) that could affect it.

We sub-segment Livelihood-Sustaining Enterprises based on their level of financial performance. *Partially Credit-constrained* businesses are characterized by a demonstrable track record of performance and profitability, the presence of some moveable or non-moveable assets to collateralize, and a threshold level of internal financial controls. These attributes provide the foundations to enable financial service providers to underwrite lending to these businesses. *Fully Credit-constrained* businesses, however, are far riskier due the lack of track record of financial performance, absence of moveable or non-moveable assets to collateralize, and low level of financial management capabilities. Such enterprises are among the most difficult to finance and require the highest levels of technical assistance.

Market Gaps: Critical constraints to financing Livelihood-sustaining Enterprises relate to transaction costs, the perceived risks of serving this segment family, and the challenges of cost effectively obtaining assessment data to be able to efficiently underwrite small-ticket-size loans.

Promising Solutions: A promising solution lies in driving down the cost of credit assessment and of servicing these enterprises 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. An example is ZineOne, a digital hub that enables banks and retailers to aggregate data streams from digital sources to build contextual insights and improve customer engagement. Another example is Liwwa, which is a digital lending platform that offers affordable, unsecured loans between $7,000 and $70,000 (in local currency equivalent) that are tenured between three and 36 months for trade and asset financing. These business models offer the prospect of radically reducing the cost of servicing loans for Livelihood-sustaining Enterprises and making the economics of serving this family viable and scalable.

Other cost-saving improvements like standardizing bundled lending and nonfinancial support services as well as using shared services platforms like what Business Partners International (BPI) is doing in South Africa should also be explored as well.

A ROADMAP 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	• **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	• **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	• **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	• **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

Looking at the SGB financing sector in terms of the four enterprise families helps provide a roadmap for what we need to do in order to address the $930 billion SGB financing gap. For each family, there are clear financing gaps—but also clear examples of promising solutions being developed to address those gaps. This report highlights ideas for action—many of which innovative investors and intermediaries are already advancing—that we think will be critical to implement and scale in order to unleash the potential of SGBs to drive economic growth and impact.

SGB Families Risk-Return Mismatches and Gaps and Ideas for Action

To address the “time horizon mismatch” faced by asset-intensive High-growth Ventures, we need to accelerate the uptake of alternatives to closed-ended fund structures (e.g., open ended and evergreen funds, and holding companies) and use of financial instruments that allow for structured exits.

Niche ventures often face a “scale potential mismatch,” as they offer products and services to local or niche markets, and thus don’t have the return and exit prospects sought by VCs. Expanding local sources of very early stage finance—such as angel investors and local seed funds—offers greater promise to provide niche ventures with both appropriate capital and local expertise and networks.

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) or commercial banks. 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 this 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 operational performance to bolster fund economics.

Finally, the “transaction cost” gap refers to the cost of small ticket working capital lending relative to the return a financial provider can achieve. Here, we see use of digital technology to radically reduce the cost of assessment and delivery as key to scaling solutions that can serve both Livelihood-sustaining Enterprises and other SGB families.

HOW TO USE THIS FRAMEWORK

We hope this framework can be used and further developed by stakeholders in the SGB finance ecosystem to help move the field forward. Ideas for action to build on this research include the following:

- **Mapping and opportunity identification:** We hope individual investors and fund managers will use this framework to articulate what types of SGBs they serve and—equally important—what types of SGBs are not their focus. We do not expect investors to have a singular focus on one SGB segment family, but we do anticipate that different investors’ portfolios will be concentrated in different families. Using this framework to create a common vocabulary will allow ecosystem actors to more effectively communicate who is playing where in a specific market and offers the potential to improve the process of matching enterprises and investors.

- **Market sizing:** We also see an opportunity to use this segmentation framework to create more nuanced mappings of the SGB investing landscape in specific sectors and geographies. A more granular analysis would help identify where the need—and opportunity—is greatest to scale up promising SGB financing models. Based on lessons from this research, we have a hypothesis about which families face the most significant financing gaps (e.g., Dynamic Enterprises in many markets), but a more robust follow-on analysis is necessary to validate this.
- **Aligning financing solutions to segments:** We hope this segmentation framework can serve as a basis for better aligning expectations for risk, return, and impact for different segments of the SGB market. This research highlights some promising SGB financing solutions that are emerging to meet the needs of different enterprise families. However, there is an opportunity to conduct a more thorough analysis and categorization of these financing solutions, and to test their applicability across enterprise families.

We also see opportunities for specific types of SGB finance actors to use this segmentation framework. Commercial banks can use segmentation to build and test better financial products and service delivery models to serve different families of SGBs in local markets. Venture capital firms and impact investors can better identify what types of high-growth businesses may require alternative financing to traditional venture capital instruments. Financial technology firms can use the segmentation to identify and size underserved market segments, where tech-driven solutions can generate efficiencies that make financing small businesses more profitable. These are a few examples but there are many other applications that should be explored.

CONCLUSION

We acknowledge the constraints of this segmentation approach—notably its high reliance on qualitative and conceptual factors rather than quantitative thresholds—but we hope this research can serve as a starting point for future action. The intent is to provide a common vocabulary so that industry stakeholders across the value chain—from entrepreneurs to financial intermediaries to technical assistance providers to investors—can better communicate with one another.

We also hope this framework provides a roadmap for those who are addressing SGB financing gaps and a structure to accelerate promising solutions in the sector. Indeed, the Collaborative for Frontier Finance, the multistakeholder alliance co-sponsoring this effort, is one such platform focused on bringing together stakeholders across the ecosystem to more effectively collaborate on SGB financing solutions.

We hope this segmentation framework adds a strong foundation to efforts already underway to help these entrepreneurs find the financial and technical support they need to transform their communities and societies.

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. This segmentation helps reveal the tremendous diversity of SGBs, as well as the corresponding diversity of their financing needs. In such a context, there is no silver bullet for scaling access to SGB finance. Rather, what is needed is 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 segmentation framework adds a strong foundation to efforts already underway to help these entrepreneurs find the financial and technical support they need to transform their communities and societies.