UNEP Finance Initiative
Innovative financing for sustainability

WWF for a living planet

UNEP FI and WWF Workshop:

Innovative Financing for Sustainable Small & Medium Enterprises (SMEs) in Africa

International Environment House, Geneva, Switzerland
Wednesday 26th September 2007,
0900 – 1630 hrs

Background Note

Introduction and Objective:

WWF and UNEP Finance Initiative welcome you to the international workshop on *'Innovative Financing for Sustainable SMEs in Africa'.* The workshop is an invitation-only event for experts and investment professionals focused on the small and medium enterprise sectors[1] in emerging markets.

The objective of this workshop is to provide participants with a platform of interactive exchange to better understand opportunities and risks related to investing in sustainable SMEs in Africa. In addition we will identify potential areas for collaborative action to promote financing for sustainable SMEs.

The event will operate in the following framework:

- Focus will be on finance & risk mitigation - two key aspects related to investment in *small to medium* enterprises; while the importance of policy and regulation is recognized, these aspects will not form the focus of discussions.
- Core stakeholders participating at the event are investment professionals and strategic managers from the private financial sector (banks, fund managers), public (development finance) institutions and philanthropic foundations. A limited number of participants from SME supporting organizations have also been invited.
- Participants are assumed to have basic knowledge of financing and development of SMEs in emerging markets.
- With the aim of encouraging frank dialogue, the event will be held under the Chatham House Rule (participants are free to use the information received, but neither the identity nor the affiliation of the speakers, nor that of any other participant, may be revealed)

This document contains key questions and a set of hypotheses that will form the focus of discussions during the event. It also points to corresponding relevant background reading, included in the workshop pack.

[1] A large number of sources, including World Bank, use employment as main indicator, with enterprises employing up to 250 people termed as SME. Other useful indicators include revenue and financing need.

Key Guiding Questions for the Day

These key questions cover the overarching themes of the day and are aim to provide delegates with a context of discussions that are expected to take place.

1. Where are the most significant gaps in the SME financing landscape in Africa? To name a few:
   - In-country flows v/s cross-border flows
   - Missing viable exit strategies
   - Financial infrastructure

2. What is the role of public/philanthropic finance in creating vibrant private capital markets for "sustainable" SMEs?

3. On which particular aspects related to investing in sustainable SMEs is there a need for new knowledge? Some suggestions include:
   - Market data & intelligence
   - Missing project data
   - Cultural norms
   - Stakeholder perceptions
   - Type and size of capital
   - Interest and expertise of local financial institutions
   - On-the-ground SME expertise: can they articulate what they need?

4. How can existing resources and infrastructure in UN organizations, Bi/Multi-lateral development agencies, governments, NGOs etc., related to investing in SMEs be turned into actionable knowledge for investors[2]?

5. What is best-practice in financing SMEs in Africa and what success stories and/or learning from failures can you share?

6. Do different regions in Africa require different investment approaches?

7. What are the competitive advantages of your respective organizations with regards to investing in or supporting SMEs in Africa? Towards this end, what are your key objectives and success criteria?

8. What concrete actions would you consider supporting (focusing on knowledge, networks, and capital)?

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[2] Example Idea: Developing a meta-platform that is set up by a country to provide an overview of all projects/themes being currently addressed, e.g. HIV/AIDS projects in S. Africa (what organizations are active, how long have they been active, what do they focus on (education, treatment etc.), what their funding structure is, etc. This is analogous to Hans Rosling's presentation at TED Conference where he proposes to develop search methodology to drill down on data stored in government databases. Video Link: "Hans Rosling – No more boring data", http://www.youtube.com/watch?v=hVimVzgtD6w.

Lay of the Land: Business Environment in Africa

For a meaningful discussion on investing in African SMEs, it is important to keep in mind the larger context within which enterprises in African countries have to operate. While the general business climate could considerably vary from one region to another, it can be useful to keep following points in consideration:

1. General market characteristics, risks and hurdles
   a. Regulation
   b. Market infrastructure
   c. Split between formal and informal sector (particularly relevant to SMEs)
2. Project related or sector specific risks
3. Objectives and constraints of participating organizations

Suggested Background Reading:

- *Africa Competitiveness Report 2007 by World Economic Forum, World Bank, and Africa Development Bank.*
  - *Ch 1.1, "Assessing Africa's Competitiveness in a Global Context*
  - *Ch1.2,* "*From Benchmarking to Impact: Identifying Which Dimensions Matter"*

Abstract:

Recently, there has been considerable optimism in the media with regards to the improving economic climate of Africa. After many years of economic stagnation, Africa is experiencing an economic resurgence. While most of this growth has been driven by a confluence of external circumstances, genuine sustainable growth must be based on solid domestic foundations. At the outset, it is important to take a look at the larger context within which SMEs in Africa have to operate.

Hypotheses for Discussion

During the event, several key hypotheses will be presented by various speakers. Delegates are expected to challenges these hypotheses. Suggested background reading corresponding to these hypotheses is also included in the workshop pack.

Hypotheses 1: The financing gap is most acute for *small to medium* enterprises (employing 10 to 100 and needing from $100,000 up to $500,000), as this segment is most challenging for policy makers to understand, and for investors (both public & private) to serve.

Key questions for consideration:

- What is the nature of the financing gap faced by the *small to medium* enterprises in Africa?
- What barriers do high-potential, high-risk, growth-oriented small enterprises face in gaining access to finance?
- Why is a one-size-fits-all approach inadequate to serving the financing needs of *small to medium* enterprises?
- Why is there need for innovation in terms of financing instruments and institutional arrangements, in order to serve this complex sector?
- How does this need vary depending on characteristics such as sector, geography, landscape (urban v/s rural), and availability of infrastructure?

Suggested Background Reading:

- *"From Walk to Talk: Ideas to optimize development impact",* a Report on the Task Force of Capacity for Program Delivery, Clinton Global Initaitive
    - *Section 2.4, "Improving Delivery in Enterprise Financing: Driving Growth Home"*
- *Financing SMEs in Africa* by Celine Kaufman, OECD Paper

Abstract:

Africa's private sector consists of largely informal micro-enterprises, operating alongside large firms. Most companies are small due to legal and financial obstacles to capital accumulation. Between these large and small firms, SMEs form a "missing middle" in many African countries.

Hypotheses 2: Investing in "sustainable" SMEs can deliver market returns sought by mainstream investors as well as environmental and social value sought by public and philanthropic investors.

Key questions for consideration:

- What do we mean by "sustainable" SME? This question points to the need for two-tier sustainability of SMEs, a) financial sustainablity and b) sustainability by the virtue of the sector SMEs operate in, for e.g., renewable energy services, or organic agriculture, or in business practices that minimize SMEs' environmental impact.

- What does this mean in the African context?
- Why should sustainability and profitability be considered concurrently when investing in African SMEs?

Suggested Background Reading:

- *"Sustainable SMEs: Creating value within planetary limits",* Paper by Jenni Inglis
- *"Blended Value Investing: Capital Opportunities for Social & Environmental Impact"* by World Economic Forum. Sections:
  - *'Innovations in Private Equity Investing'*
  - *'Variations on Traditional Venture Capital'*

Abstract:

Sustainable Small & Medium Enterprises, enterprises that create financial as well as environmental and social value by virtue of their business, offer a viable vehicle for achieving sustainable economic growth in emerging markets. Successful blended value investment vehicles based on the above principle can have successful application for the SME sectors in African countries.

Hypotheses 3: A vibrant capital market for "sustainable" SMEs in Africa cannot exist without "smart" subsidy and relevant structural innovations and platforms. (e.g. stock exchanges)

Key questions for consideration:

- What are the key market imperfections that lead to a financing gap for sustainable SMEs and therefore require development/philanthropic finance intervention?
- What forms can such interventions take in order to create a vibrant capital market for "sustainable" SMEs?
- How can public / philanthropic interventions make investing in sustainable SMEs attractive to mainstream investors?
- What is the right capital mix necessary to meet the financing needs of sustainable *small to medium* enterprises?
- What kinds of institutional arrangements / partnerships can effectively deliver "smart subsidy" or "blended capital"?

Suggested Background Reading:

- *On the Frontiers of Finance: Investing in Sustainable SMEs in Emerging Markets,* by Belinda Hoff & Mareike Hussels
- *Venture Capital for Development* by Alan J. Patricof, APAX Partners

Hypotheses 4: As commercial investors in Africa and abroad migrate towards larger deals, they will need new incentives to put their capital in "sustainable SMEs".

Suggested Background Reading:
- Why doesn't Africa get more equity investment? Frontier Stock Markets, Firm Size, and Asset Allocations of Global Emerging Market Funds

Abstract:
The paper makes an argument as to 1/ why efforts to encourage greater private investment in Africa should concentrate on domestic audiences, and regional specialized funds, 2/ how the depth and success of the Johannesberg Stock Exchange can be better utilized for other regions, and 3/ any long-term strategy should concentrate on underlying barriers to firm entry and growth.

Hypotheses 5: Risk – namely country, market & business risk – is a significant factor that makes investing in sustainable, particularly growth-oriented SMEs, difficult. However, effective mitigation of these risks can lead to increased investment in SMEs.

Suggested Background Reading:
- *Risk Mitigation Mechanisms for Investment in Sustainable SMEs, Paper by DeRisk Advisory Services*

Abstract:
Considerable number of the reasons investors give as to why they do not finance SMEs is directly related to the risk – perceived and real – associate with investment. The ability to mitigate these risks more effectively should allow investors to place more capital in SMEs.

Hypotheses 6: Collaborative action that combines the rigor of market discipline, the capital of private investors, and smart subsidy of public and philanthropic investors is key to success for investing in sustainable SMEs.

Suggested Background Reading:
- *"Blended Value Investing: Capital Opportunities for Social & Environmental Impact"* by Jed Emerson, Sections:
    - A Cautionary Conclusion: Maximizing Blended Value Returns by Embracing Market Fundamentals

Workshop Session 1:

Challenges and barriers to scaling financial innovations targeting Sustainable SMEs

Knowledge Generating Objectives:

1. What are the biggest challenges to sustainable SME development?
2. What are the biggest challenges to scaling the innovative approaches heard?
3. What could be the solutions to either set of challenges?
4. Who needs to be involved?
5. What can the group of 8 to 10 agree as the 3 most important challenges and 3 stakeholder groups that must be involved?

Workshop Session 2:

Current and Future Actions, support needs to be active partners in Innovative Financing for Sustainable SMEs

Knowledge generating objectives:

1. What is your organization doing to address the challenges (as defined in session 1) / create solutions?
2. What could you do in relation to the key mechanisms just presented?
3. What would be their incentive to do so?
4. What's stopping you from doing it i.e. what do you need before you can become partners?
5. What would your involvement ideally look like? (partnerships, projects, conferences, capacity building, research, financing etc.)
6. What other networks could be tapped into, e.g. business schools, existing initiatives, industry bodies, think-tanks, industry associations?
7. What existing/new technologies could be deployed, e.g. mobile telephony?