Dutch Good Growth Fund

- enhance access to finance for SME segment in developing countries -

('spoor 2')

strategic advise by:

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Bernadette Blom/Bob Assenberg

Contents

1. EXECUTIVE SUMMARY 3

2. OBJECTIVES AND SCOPE OF THIS STUDY 9

3. THE SME LANDSCAPE IN DEVELOPING COUNTRIES 12

3.1 A KEY ROLE FOR SMEs IN ECONOMIC DEVELOPMENT 12

3.2 ACCESS TO FINANCE, A KEY CONSTRAINT FOR SMEs 13

3.3 WHAT IS NEEDED TO ENHANCE ACCESS TO FINANCE TO SMEs 16

3.4 INNOVATIVE BUSINESS MODELS FOR IMPACT- MARKET BASED SOLUTIONS 17

3.5 INVESTOR'S VIEW ON SME AND IMPACT INVESTMENTS 18

3.6 THE ROLE OF DUTCH GOOD GROWTH FUND- RATIONALE 19

4. ROLE AND POSITIONING OF THE FUND FOR THE 'MISSING MIDDLE' IN DEVELOPING COUNTRIES 21

4.1 THE ROLE OF THE GOVERNMENT 21

4.2 POTENTIAL TARGET AREAS RELEVANT TO LOCAL SME SEGMENT WHERE THE MARKET IS FAILING 22

4.3 WHAT IS NEEDED FROM THE FUND TO CATALYZE PRIVATE CAPITAL? 25

4.4 FOCUS ON THE SME SECTOR IN 66 LOW AND MIDDLE INCOME COUNTRIES 26

4.5 ADDITIONALITY- COORDINATION WITH OTHER PROGRAMS 28

5. INVESTMENT STRATEGY, INSTRUMENTS AND CRITERIA 30

5.1 FUND OBJECTIVE AND STRATEGY 30

5.2 INVESTMENT APPROACH 30

5.3 INVESTMENT GUIDELINES AND CRITERIA 32

5.4 INVESTMENTS INSTRUMENTS AND PRODUCTS & SERVICES OFFERING 34

5.4.1. Investment Instruments – Investment Capital facility 35

5.4.2. Seed capital+ Capacity Development Support 37

5.5 PORTFOLIO ALLOCATION AND EXAMPLES 39

5.6. STRUCTURAL ELEMENTS OF THE FUND 42

5.7 BLUEPRINT FOR SOCIAL IMPACT MEASUREMENT AND IMVO 45

5.9 FINANCIALS 50

ANNEXES

1. Executive Summary

Objectives and scope of this study

In the Dutch coalition agreement of October 2012 the intention for a revolving fund was presented. The policy document *A World to Gain: A new Agenda for Aid, Trade and Investment* of Minister Ploumen, states that the Dutch Government seeks to synergise trade and development policy and has the intention in its development co-operation policy to transition from an aid to a trade relationship with more and more countries.

In the context of the current government policy, the Dutch government wishes to establish The Dutch Good Growth Fund ('DGGF'). The DGGF (€750 million in total) is a revolving fund which offers tailored funding arrangements for entrepreneurs (particularly small and medium-sized enterprises) that have solid business or investment plans and relevance to development, and whose business practices are sustainable and socially responsible. Part of the available funds will be targeted at the SME segment in developing countries.

The main objective of the 'local SME segment' within the DGGF is:

To enhance access to financing for the SME-segment in developing countries (the so-called 'missing middle') by supporting the development and financing of innovative, financially sustainable investment funds and -vehicles that have the potential to generate a significant development impact and catalyse private investment for the local SME sector. To the extent possible, investments will be considered for impact sectors like agriculture, water and sanitation, SRGR and gender as well as for fragile states.

It is assumed that BZ considers to contribute an estimated total investment capital of EURO [200-250] million to this local SME segment (spoor 2) to be made available in subsequent tranches. On top of this it is anticipated that an estimated amount of EURO [40 to 50] million (20% of spoor 2's fund size) of business development capital will be made available to the Fund Manager ("FM") from sources outside the DGGF

The Dutch Ministry of Foreign Affairs ("BZ") has appointed Goodwell Investments B.V. ('Goodwell') to advise on the possible investment strategy and investment criteria of the local SME segment of DGGF.

Rationale for the Fund and role of the government

SMEs are the backbone of every economy: they are engines of employment, income generation and growth. Studies indicate that SME's account for around 80% of job creation and over 55% of employment in developing countries [1]. Emerging economies are no exception here. A number of complex constraints are keeping SMEs in developing countries from realizing their full potential: skills shortages, inadequate infrastructure, but also very importantly a lack of financial resources. Insufficient access to finance is often seen as the key obstacle to growth. Lack of finance for smaller-sized SMEs is often labeled as 'the missing middle'. The SME finance gap is the result of a mismatch between the needs of the

[1] According to research by IFC-McKinsey, 2010

small and medium-sized firms and the restrictions and requirements of the investors and financiers, which typically are more tailored for larger public and private firms. SMEs need capital and long-term finance for growing their business combined with hands-on support to develop managerial skills, financial skills, technical skills, IT systems and business linkages.

The Dutch Good Growth Fund can play an important role in addressing this market failure, create/stimulate innovative partnerships and offer risk mitigation mechanisms so that investment and other financing initiatives with sustainable financial and social returns can be enhanced.

Private sector investors and businesses are willing to invest in developing countries. However, they are kept out of certain difficult countries, sectors or client segments because their perceived risk of investing in these segments is too high and they are not able or willing to absorb it, whilst investments could ultimately prove sustainable and have a significant development impact. They demand instruments that can partially mitigate these risks. By enabling development of initiatives in these 'difficult' segments (by f.i. providing first loss capital or a guarantee for certain risks like country risks, default risks, SME's in rural areas etc.), a track record can be built so that the dynamics and the risks of the SME segment/geography can be better understood and trust enhanced.

The involvement of the government should be temporarily and the role is to correct for a market failure, reducing the perceived risk needed to enable private investors to step in.

Another important rationale for the Fund is its catalysing effect, mobilizing private capital to the local SME investment sector and reducing the perceived risk of certain sectors/countries/segments.

Key areas where the market is failing relevant to the local SME sector in developing countries

We have interviewed several parties and received the following feedback on where the market is failing and the Fund could play an important role:

- Lack of support for early stage SME's/innovators: A significant funding gap exists for early-stage innovators. There are very few impact-oriented investors willing to assume the high risks and uncertain and/or low returns associated with investing in socially impactful early-stage businesses and business concepts, particularly in geographies and industries where sector risk is perceived to be high. It is the common view of market parties that if we wish to build an impact investing industry that successfully delivers on the promise of bringing market-based solutions to disadvantaged populations, the success depends on the support for these early-stage innovators. It is today's fledgling innovator who sets the stage for tomorrow's next great scalable innovation that can also produce strong financial returns.
- Innovative ways to reduce costs/make assessment process more efficient: One of the additional reasons why investors shy away from financing SMEs are the high transaction costs involved compared to the invested amounts. New efficient, innovative mechanisms to reduce costs are needed

- Lack of support for SMEs in certain 'difficult' remote locations or sectors or facing gender issues (SME's managed/owned by women)

By enabling initiatives in a certain 'difficult' geography or sector to build up a track record, the dynamics and the risks of this market/sector can be better understood and trust can be enhanced.

- Unlocking of local capital: pension funds and banks in developing countries tend to keep more than half of their deposits in liquid assets and provide minimal credit to the local private sector (USAID). Innovative ways to unlock these resources such as local currency bond programs/LC loan guarantees are needed
- Long term local currency funding: SMEs with long-term assets need long term local currency funding, however, international long-term debt financiers are unable to assume currency or interest rate risks. Long-term hedging products are scarce and often expensive. Local financiers are unable to provide long-term debt. Local Borrower faced with currency and or tenor mismatch. More innovative solutions are needed.
- Value chain: to generate significant impact, the whole value chain needs to be developed, some parts of which are not acceptable to private investors (f.i. small holder/farmers default risk in agriculture). Innovative financing structures should catalyse capital.
- Fragile States-:investors are reluctant to enter into 'difficult' countries as the perceived risk is too high. Whilst in these countries often a high development impact can be generated and investments are needed.

Investment strategy, instruments and criteria

With the Fund BZ aims to enhance access to financing for the SME-segment in developing countries (the so-called 'missing middle') by (i) supporting the development and financing of innovative, financially sustainable investment funds and vehicles that have the potential to generate a significant development impact and have no or limited access to private capital and (ii) to catalyse private investment for the local SME sector in up to 67 low and middle income countries.
To achieve this objective, the Fund provides various types of investment capital (such as guarantees, first loss, debt, mezzanine capital, equity) in combination with business development support and non financial support to innovative initiatives, DGGF will invest, indirectly via investment vehicles/funds or – in specific cases- local banks. Therefore no direct investments will be made into SMEs.

Leverage (by means of attracting private capital) will take place at the underlying investee fund/vehicle level and ultimately at the underlying SME-level.

The Fund aims to be additional which means it wishes to bridge the current financial gap between availability of private capital (including capital from development finance institutions) and the finance needs of promising investment initiatives that support the SME sector. It also aims to expand the existing range of financial instruments that can be used to support the local SME sector in emerging economies.

The Fund intends to create a balanced, diversified portfolio of investments in investment funds, other investment vehicles and, in specific cases, investments via local financial institutions. Investments should stimulate local employment, knowledge transfer, and strengthening of the local SME sector.

The following investment guidelines will apply:

- Investments are indirect, i.e. through investment vehicles/funds and – in specific cases - other financial intermediaries
- All investments are assessed on (i) additionality, (ii) innovative character, (iii) financial viability, (iv) development impact (at SME-and sector level), (v) ability to catalyse private investments, (vi) ability and willingness to adopt an ESG reporting framework, (vii) track record of management team
- At DGGF-level the portfolio should be revolving, within the portfolio different investments will have different scoring on the assessment indicators above; this requires a diversified portfolio approach by the Fund Manager
- Single Investment Exposure: max 10% of total Investment Capital
- Country Limit : 15%, Regional Limit 40% of total Investment Capital

Based on the assumptions (fund size of EUR 200m, fund maturity of 15 years, expected market-based returns for investments, majority of investments in funds, 16 investments of which for 6 investments none or only part of the investments will be recovered) used within the simplified financial model, DGGF can be revolving with an expected single digit-return.

Set-up and structure

The Fund consists of an Investment Facility and an aligned Business / Capacity Development Fund for support.

DGGF will have a separate Investment Committee. A key to success of DGGF is that approval processes and reporting requirements need to be appropriate, simple and fast. Furthermore, in order to be relevant for innovative solutions, the allowed investment instruments need to flexible and tailor-made to the investment proposition. Innovation requires a flexible approach in terms of financial structuring and DGGF should be market-driven. The Fund Manager should be well placed to assess risks and required risk mitigation instruments and to structure and price accordingly.

DGGF is an open-end fund which means that returning funds can be re-invested on a continuous basis. In an open-end structure DGGF is less pressed to exit within a certain set timeframe. Naturally a rigorous investment and monitoring process with a clear focus on exits remains critical.

A realistic time period in which the Fund Manager could invest an assumed amount of EUR 200 – 250 million is five years. The investment period is therefore set at five years, a time period which is required to build up a diversified portfolio and at the same time comply with requirements on financial returns, development impact, catalyzing private investments and investment restrictions.

The Fund Manager should have a pro-active approach, identify opportunities and link potential partners, apply and share cross-learnings amongst the investees and other stakeholders, liaise with other SME finance programs and providers, and provide active support and monitoring to the investee vehicles. Furthermore standardized frameworks and reporting need to be developed, implemented and regularly updated.

The EU definition for SMEs is not applicable in many of the developing countries and applying this definition would seriously hamper opportunities to invest. Therefore the definition for SMEs need to be flexible and tailored to the countries and sectors invested.

Investee vehicles need to have an Environmental, Social and Governance Framework and should apply relevant standards of IFC Performance Standards as well as the World Bank Exclusion List. Investees/intermediaries should scan and establish development plans for most critical improvements in E&S-issues for underlying SMEs.

Comparison and coordination with other Programs

DGGF is different in its set-up from other government grants and financial instruments programs because of the focus on innovative structures, required revolving financial character and flexibility in terms of usage and allowed financial instruments.

Compared with the MASSIF-programme, DGGF (i) is allowed to take higher risks (f.i. first-time partnerships, innovative business models, new - smaller, specialized funds with limited/no track record), (ii) primarily invests in funds and vehicles whereas MASSIF invests in primarily in financial institutions / banks directly, (iii) has a broader mandate and more flexibility in applying instruments, (iv) is managed by a pro-active manager (which is not FMO's role in MASSIF, as they state themselves).

Most important distinguishing feature of the Dutch Good Growth Fund is it's openness for innovative, financially sustainable, investment funds/vehicles and –initiatives that enhance financing for the 'missing middle', difficult countries, certain segments that need to be developed etc. with a significant development impact and which have no access to private capital. Additionally an important element of the Fund is its catalysing effect, mobilizing private capital to the SME sector and reducing the perceived risk of certain sectors/countries/segments adding an important value. It is the combination of characteristics that makes the Fund unique, although we would like to note that some overlap with other initiatives cannot be completely avoided

Other government programmes or multilateral initiatives (DFID funds, IFC Blended Finance) could occasionally provide opportunities for co-investment in order to increase scale and derive at a critical mass for risk mitigation. More generally, the Fund Manager should work closely with aligned programmes and initiatives, focused on cooperation but also for exit opportunities for DGGF (by a sale / transfer to other aligned parties that have a different risk appetite).

Success Factors and Challenges

The biggest selling points for the Fund would be (a) the aspect of risk mitigating capital in combination with business capacity development capital and 'hands on' support available for high risk innovative initiatives targeting the SME sector in developing countries under a single independent management and (b) its openness for: (i) innovative, scalable, new investment funds-/vehicles and initiatives that that (indirectly) increase financing for the local SME sector, (ii) difficult countries, (iii) certain untapped SME market segments that need to be developed (f.i. smaller enterprises, unserved remote/rural regions, SME's owned/managed by women, SME's in post conflict/fragile states etc.), all with a significant development impact and which have no or limited access to private capital. Much emphasis should be placed on structuring the governance and internal processes of the Fund such that it can effectively deliver faster and more nimble solutions for the SME sector in emerging economies. Speed and flexibility are essential to the success of the Fund.

Success in building up a quality, high risk, revolving portfolio of exposures at the scale and within the timelines envisaged by the DGGF cannot be taken for granted, however. A common theme in the feedback of market parties is that for investing in local SME sector more than investment capital alone is needed, specifically TA for capacity building, 'hand holding' and building of the local SME sector including its enabling environment is of key importance. The high level market study succeeds in identifying a set of differentiated interventions and investment targets, where the Fund will indeed find a ready market for its product offering at the necessary scale maintaining a plausible delineation from existing programs that will minimize potential duplication and overlap. The selected FM should have (and continue to maintain) long term working relationships with (local) managers (maximizing local market intelligence) and pro-actively establish other relevant partnerships, initiate and support the set up of dedicated funds and actively pursue investment pipeline opportunities. Only then, the Fund will be able to scale up exposures quickly enough to meet the high political expectations vested in the project.

2. Objectives and scope of this study

In the Dutch coalition agreement of October 2012 the intention for a revolving fund was presented. The policy document *A World to Gain: A new Agenda for Aid, Trade and Investment* of Minister Ploumen, states that the Dutch Government seeks to synergise trade and development policy and has the intention in its development co-operation policy to transition from an aid to a trade relationship with more and more countries.

In the context of the current government policy, the Dutch government wishes to establish The Dutch Good Growth Fund ('DGGF'). The DGGF (€750 million in total) is a revolving fund which offers tailored funding arrangements for entrepreneurs (particularly small and medium-sized enterprises) that have solid business or investment plans and relevance to development, and whose business practices are sustainable and socially responsible.

Small and Medium Enterprises (SMEs) play a major role in economic development, particularly in emerging countries. Studies indicate that SME's account for around 80% of job creation and over 55% of employment in developing countries[2]. Access to finance remains a key constraint to SME development in emerging economies. There is an estimated trillion dollar financing gap for SMEs in the formal sector in emerging economies, with the biggest gap in Africa, where SMEs require 300% more funding than is currently provided in the market.

Private sector investors and businesses are willing to invest in developing countries but demand instruments that can mitigate certain risks which the private sector is not able and willing to absorb. In some cases private investors are kept out of certain difficult countries or sectors because their perceived risk of investing in these segments is too high and they are not able or willing to take it, whilst investments could ultimately prove sustainable and have a significant development impact. One of these segments is the SME segment in developing countries, also called 'the missing middle'. The government could play an important role in addressing this segment, create/stimulate innovative partnerships and offer risk sharing mechanisms so that networks can be enhanced to support a track record with sustainable financial and social returns. Part of the means of the DGGF will be used for this local SME segment.

The main objective of 'local SME segment' within the DGGF (spoor 2) is:

To enhance access to financing for the SME-segment in developing countries (the so-called 'missing middle') by supporting the development and financing of innovative, financially sustainable investment funds and -vehicles that have the potential to generate a significant development impact and catalyse private investment for the local SME sector. To the extent possible, investments will be considered for impact sectors like agriculture, water and sanitation, SRGR as well as for fragile states.

[2] According to research by IFC-McKinsey, 2010

A rough first estimate of contribution from the DGGF to this local SME segment is in the range of [€ 200 to 250] million. The intended investment approach is to create a balanced, diversified portfolio of investments in investment funds and other investment vehicles

The Dutch Ministry of Foreign Affairs ("BZ") has appointed Goodwell Investments B.V. ('Goodwell') to advise on the possible investment strategy and investment criteria of the local SME segment of DGGF (when we refer in the document to 'the Fund' or "DGGF" we refer to the local SME segment of DGGF-spoor 2-) in its pre-incorporation phase. BZ has composed a Terms of Reference document referring to the consultancy services requested. The objective of the assignment is to provide comprehensive consultancy services and advise BZ on the following:

A.
Further specification of :
- The potential investment strategy for the Fund
- Possible investment guidelines, including restrictions and terms
- Prepare an example of portfolio investments and allocation
- Prepare a related financial model

B.
Preparation of selection of Fund Manager

In this context, the Dutch Government, initiator and sponsor of the Fund set out a few essential features that should guide the design of the Fund's investment activities, strategy and product offering with regard to this local SME investment segment. These guiding principles are:

- The Fund should be designed to attract **innovative, financially sustainable, scalable** activities that **enhance access to finance for 'the missing middle' in developing countries and** have the potential to generate **substantial development impact**
- **Additionality**: The Fund should target initiatives that would not otherwise be capitalized by private investors (including DFI's) because the 'perceived' or actual risk is too high and private investors are not willing or unable to take this risk
- The **involvement** of the government should be **temporarily** and the role is to correct for a market failure, enabling private investors to step in
- **Avoiding market disturbance**: The Fund should avoid in any case to disturb the market or to 'crowd out' private capital
- **Revolving nature:** DGGF means will be returned and used multiple times (100% revolving on a nominal basis)
- **Create a substantial multiplier effect:** Every euro invested by the Dutch government creates a multiple of private investments, at least two times the amount provided

- The Fund should offer products that **stimulate financing to local SME's and/or strengthen the SME sector in developing countries and catalyze private capital**
- Investments should **comply with international IMVO guidelines** (OESO guidelines for multinational enterprises and IFC Performance Standards)
- The Fund will have an **indirect investment approach**, it will not directly invest in SME's itself but rather reach the SMEs and the SME sector through a wide range of intermediaries
- The Fund should be **complementary to existing Dutch government programs**

Approach and Methodology

The research has been done on the basis of desk research, and interviews with market parties, including donors, investors, Fund managers, etc (see also Annex X.. for a list of parties and persons interviewed). Interviews focused on how this Fund can contribute to enhance financing for the local SME sector, where within the SME segment the market is failing, what the market needs in terms of risk mitigation instruments and non financial support and what are the key elements that should be included in the investment strategy for the Fund.
The research had the objective of detailed screening of all available relevant information (including all relevant documentation of BZ, studies, market reports, articles etc.). In addition, the research incorporated findings gathered from an assignment conducted by Goodwell in 2012 related to the Innovative Finance Fund for Development. The focus of this fund was on impact investments in general in developing countries, whereas the focus of the DGGF is on enhancing acess to finance for SME's in general in developing countries. As impact investments tend to be generally at SME-level, a lot of the feedback and conclusions are still valid for the local SME segment of DGGF. DGGF offers an extension of investment opportunities (general SME focus-not only in impact sectors). As a market study is not part of this TOR, the key elements of the 2012 market study, where relevant, are incorporated in this report (and reconfirmed and/or updated with several market parties) mainly in section 4. Main reason for this being that the market study is still very relevant for SMEs in developing countries and provides the necessary background information on the suggested investment strategy for this part of the DGGF.

The research focused on the one hand on the Government policy for development assistance and more specifically with regard to the DGGF and on the other hand market requirements, recent development and trends within the SME landscape in developing countries.

3. The SME landscape in developing countries

3.1 A key role for SMEs in economic development

Defining SMEs

Small and Medium Enterprises ("SMEs") play a major role in economic development, particularly in emerging countries.

The term "SME" typically encompasses a broad spectrum of definitions across countries and regions. Many countries and international organizations set their own guidelines for defining an SME, often based on the number of employees, sales, or assets. For example, the EU defines SMEs as firms with 10 to 250 employees, with less than EURO 50 mln in turnover or less than Euro 43 million in balance sheet total where as IFC uses a turnover threshold of USD 15 mln and a balance sheet total of less than USD 15 mln in its definition. The EU thresholds are very high for most developing countries[3].

The definition of EU and IFC are based on three criteria (i) number of employees, (ii) total assets and (iii) total sales. Enterprises need to meet two out of three criteria to be classified

EU criteria:

TABLE 1.1 EUROPEAN UNION SME DEFINITION

Firm Size	Headcount	Turnover	or	Balance Sheet Total
Medium-sized	< 250	≤ € 50 million		≤ € 43 million
Small	< 50	≤ € 10 million		≤ € 10 million
Micro	< 10	≤ € 2 million		≤ € 2 million

Source: European Commission Recommendation 96/280/EC

IFC criteria:

	Micro Enterprise	Small Enterprise	Medium-size Enterprise
No of employees	<10	10<50	50-300
Total Assets USD	<100k	100k<3mln	3-15 mln
Total Sales USD	<100k	100k<3mln	3m-15m

In general, many countries adopt a definition of SME that covers all firms with fewer than 250 employees, therefore including micro-firms. Under this definition the vast majority of all businesses are SMEs, typically 90 to 99%. The definitional issue is further complicated by the fact that individual banks in the same country use different definitions of SME for their own strategic and risk management purposes.

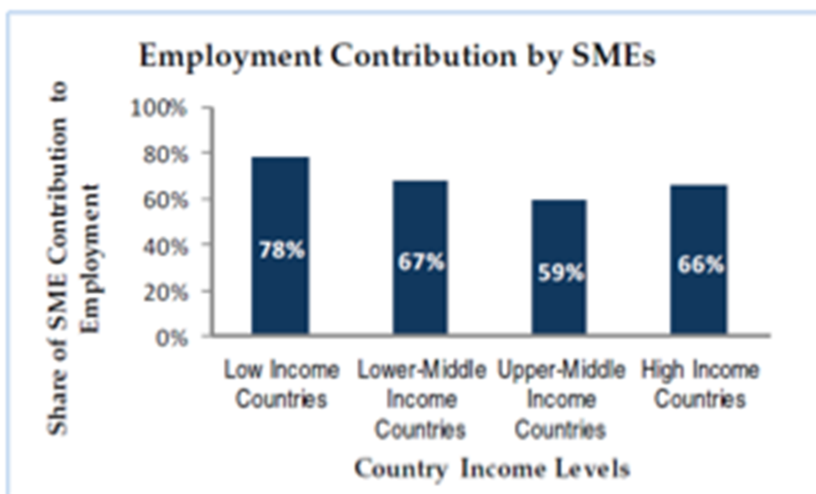
[3] IFC, scaling-up SME access to Financial Services in the Developing World, November 2010

Therefore, the definition of SME is not unambiguous. For each country and sector the definition for a SME needs to be set.

SMEs account for a significant share of employment and GDP

Increased growth in SMEs has a direct effect on GDP growth due to the increase in output and an indirect impact on GDP growth through increased innovation and macro-economic resilience.[4] Smaller firms are often the most dynamic and innovative and can be a testing ground for new business ideas. A number of SMEs will grow to become large firms and cause positive structural changes to the economy.

Additionally SMEs are a key contributor to the employment opportunities in emerging markets[1].



A report by IFC[5] regarding their PE investments indicates that the fastest growth rate in terms of employment comes from smaller companies. Typically as companies get larger, it is more difficult to maintain aggressive growth. The best deployment of funds is in expansion-phase companies, most probably in a service sector or customer-facing operation. IFC states that within the private equity space, development impact and financial returns appear to be correlated.

3.2 Access to finance, a key constraint for SMEs

Smaller firms are disproportionally restricted by a lack of finance compared to larger firms. This is mainly the case as SMEs do have limited buffers for additional finance and also because a lack of finance and related growth hinders SMEs from taking advantage from the economies of scale (for instance moving from manual to more automated production).

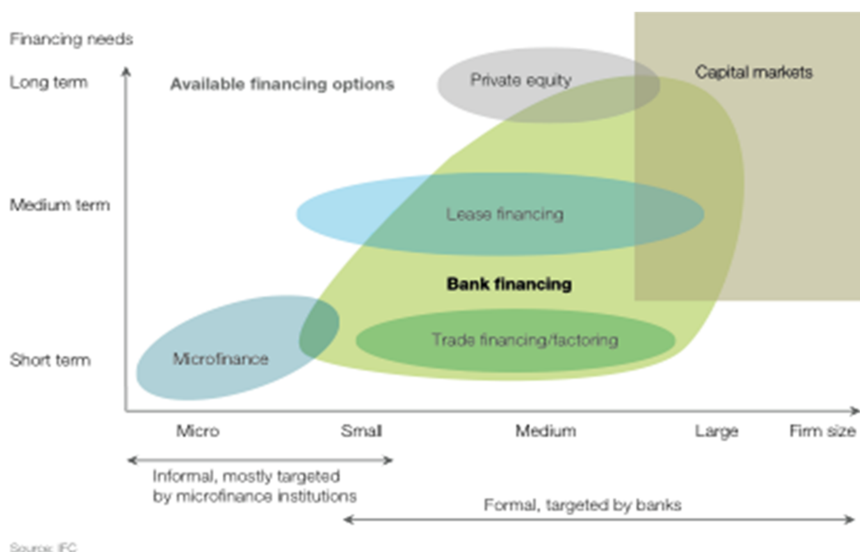
Financial constraints are greatest in low-income countries as indicated by the World Bank Enterprise Survey.

Various data sources and studies indicate that small firms rely on internal financing much more than large firms do, and that the likelihood of a small firm having access to a bank loan

[4] Dalberg , Report on Support to SMEs in Developing Countries Through Financial Intermediaries, Nov 11
[5] IFC, The Keys to Successful Job Creation through Private Equity Investments in SMEs, July 2012

in low-income countries is about a third of what it is for a medium-sized firm, and less than half of what it is for a larger firm. Also other modern and more innovative sources of SME finance, such as leasing and factoring, are also less developed in emerging countries.

Typically lack of finance for smaller-sized SMEs is often labelled as 'the missing middle'. Definitions vary but typically these SMEs are too big for coverage by MFIs and other small-scale lenders& investors and too small for banks and commercially oriented lager investors. A typical range, although varying per country, would be finance amounts of around $ 10k to $ 2-3 million per SME.



The SME finance gap is the result of a mismatch between the needs of the small and medium-sized firms and the restrictions and requirements of the investors and financiers, which typically are more tailored for larger public and private firms. The access to finance for SMEs is limited due to (i) SME intrinsic weaknesses, (ii) stringent requirements and flaws in delivery models of investors and financiers and (iii) lingering deficiencies in the enabling environment for financial services: financial infrastructure (accounting and auditing standards, credit bureaus/reporting systems, and collateral and insolvency regimes), and the legal and regulatory framework for financial institutions and instruments.

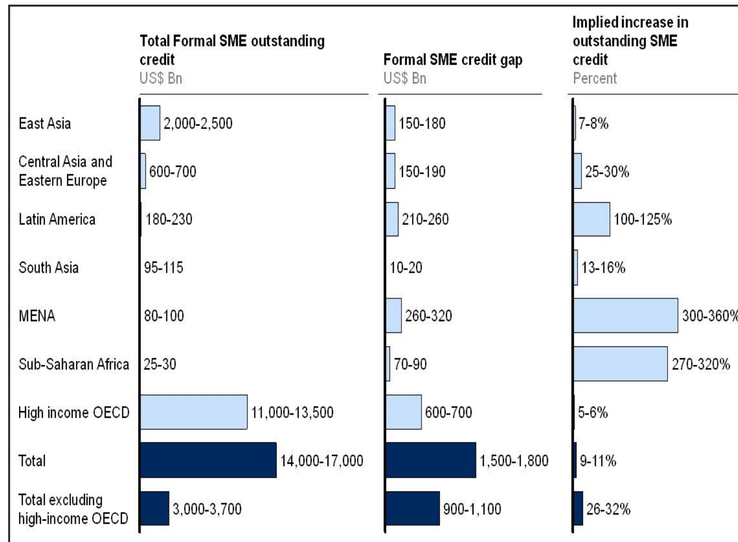
McKinsey states that access to finance is one of the key obstacles to growth and sees lending to SMEs as a potentially profitable segment.[6]

There are close to 365-445 million micro, small, and medium enterprises in emerging markets of which 25-30 million are formal SMEs and 55-70 million are formal micro enterprises, while the rest (285-345 million) are informal enterprises and non-employer firms[7]. According to the same study, close to 45 to 55 percent of the formal SMEs (11-17 million) in the emerging markets do not have access to formal institutional loans or overdrafts despite a need for one. The finance gap is far bigger when considering the micro and informal enterprises –> 65-72 percent of all MSMEs (240-315 million) in emerging markets lack access to credit. The size of the finance gap varies widely across regions but is particularly high in Asia and Africa.

Closing the credit gap for formal SMEs will be relatively easier than for informal SMEs. Close

[6] Mc Kinsey&Company – Micro-, small- and medium-sized enterprises in emerging markets ' - 2012
[7] IFC and McKinsey and Company (McKinsey) "Two trillion and counting", Oct 2010

to 70–76 percent of the formal SMEs (18-22 million) in emerging markets already have some sort of a banking relationship via deposit/checking accounts, while only about 30–35 percent of SMEs (8-10 million) have access to credit.



SMEs are in need of many kinds of financial services, and sometimes limited products and services are provided. What SMEs really need is access to long-term finance. Long-term finance is required in order to invest in long-term assets (machinery, equipment, buildings) and to create a more stable organisation that can develop and implement a longer-term business plan.

Currently a number of categories for private capital providers to SMEs can be identified[8]:

- Commercial banks downscaling towards the SME-segment
- Microfinance institutions upscaling towards the SME-segment
- Community banks
- Dedicated private equity and venture capital funds

In terms of lending, these models share common characteristics: they have an innovative nature to reduce cost through intensive use of technology and/or the adoption of cost-effective client-relationship models.

SME banking and microfinance models are gradually being rolled out in an increasing number of countries and regions, (albeit still providing only limited amounts of financing) however equity/risk capital financing remains a challenge in developing economies. Given that banking and lending services represent the bulk of SME financing in the developing world, especially for small firms equity financing presents an opportunity for the development of a complementary financial product. Especially in their early stage of development SMEs are not ready yet for debt finance and regular repayment schedules and should be supported by risk capital and hands- on support.

Additionally the provision of external equity ("private equity") becomes relevant to facilitating changes in ownership and/or further growth of larger SMEs,

[8] IFC, Scaling up SME Access to Financial Services in the Developing World, Nov 10

Availability of private equity for SMEs

Historically, there were few external equity / capital providers in developing countries. Equity financing is hampered by similar reasons as debt financing (e.g. asymmetric information, lack of reliable financial information), additionally entrepreneurs in developing countries have little familiarity and affinity with the private equity and venture capital model. However, over the last decade a private equity industry for developing countries has surfaced.

Dalberg identified 192 private equity funds supporting SME investment in emerging markets and developing countries with an aggregated capital of US$7 billion. Many of these funds were created in the last five years, and 60% of them focused on Sub- Saharan Africa.[9]

These players focus mainly on large- and medium-sized firms (with financing needs of > USD 5 mln), and would commonly not invest in smaller SMEs. In addition, albeit still at a very small scale, the first local venture capital funds have started to emerge in developing countries.

A report by CGAP[10] estimates that in total more than 300 SME investment vehicles committed at least $ 20 billion to emerging markets. And approximately half of these SME investments is in Sub-Saharan Africa and South Asia (respectively USD 5.3 billion and USD 4.9 billion).
Most investments are made through equity purchases. Only 7% of the vehicles uses only debt, 26% equity only and 67% a mixture of debt, equity and quasi-equity.

Also relatively recent initiatives such as ImpactBase from GIIN show that several funds are currently investing in access to finance for SMEs. However, given the significant current credit gap for SMEs and the tendency for investments in larger SMEs, the currently available initiatives by investors are not sufficient to fill the gap.

3.3 What is needed to enhance access to finance to SMEs

Scalable innovative solutions are needed that establish investment and finance ecosystems in countries and provide support and finance to SMEs.

A key opportunity is to support local banks and financial intermediaries in extending credit facilities to SMEs who already have some sort of banking relationship (typically a deposit/checking account), but do not yet have access to credit. Risk-sharing facilities, innovative partnerships, strengthening of the ecosystem combined with the introduction and implementation of best practice SME lending approaches, are key elements that can help banks provide credit to those SMEs. Additionally support for SMEs to get access to the capital markets (in the form of risk mitigating measures or innovative solutions such as local bond platforms) could be beneficial for the development of the SME markets.

These interventions need to be accompanied by enhancements to the enabling environment for SME lending.

It will be a greater challenge to reach informal SMEs. Informal SMEs are far less likely than formal businesses to have existing deposit relationships with financial institutions, and are

[9] IFC, Scaling up SME Access to Financial Services in the Developing World, Nov 2010
[10] CGAP, Estimating Funder Support for Small and Medium Enterprises , Dec 2011

also far more difficult to serve, especially for commercial banks. Short of comprehensive approaches to move informal businesses into the formal sector, reaching informal businesses will most likely have to build on microfinance approaches, including up-scaling existing microfinance institutions to serve small businesses.

Dedicated active enterprise business support is a key element to develop and professionalise SMEs. Active business support entails but is not limited to support on strategic, business and financial planning, market linkages, fundraising support, organizational development and establishment and management of partnerships. In addition to this, SMEs will generally require specific technical and operational support (IT-systems, specific training etc.). But SMEs also need practical hands-on support to deal with potential providers of finance and capital. SMEs typically do not have the resources, experience and infrastructure to deal with requirements and obligations of finance service providers. Particularly, as SMEs have limited experience and expertise in preparing regular management reporting as well as official accounts, hands-on support is needed.

Furthermore, SMEs will benefit from a stronger surrounding ecosystem, familiar with SMEs and willing to focus on SMEs. In this respect, active sector and ecosystem support is crucial as for instance (i) developing services providers (f.i. admin, legal, fiscal, marketing) targeting and servicing SMEs, (ii) specific associations taking care of rights and opportunities of SMEs (sometimes in specific sector(s)), (iii) improving credit bureaus and collateral and insolvency regimes, (iv) support and training at sector levels as well as with regulators, (i) seminars and other platforms for linking entrepreneurs.

3.4 Innovative Business models for impact- market based solutions

According to research conducted by Monitor[11] the continuance of lack of access to basic goods and services on a massive scale in developing countries indicates a need for alternative ways to move masses of people up the income scale and provide basis access to goods and services at the same time. Typical services and products needed would be related to access to finance, healthcare, water, sanitation, food security, housing, education and energy. Impact investments tend to be generally at SME-level, SMEs are the main drivers of development and growth and are considered to be the backbone of a local economy as they create employment and contribute to social and economic stability.

New scalable and promising business models adjusted for low income markets are needed to address the needs of those living on less than $2 per day. Additionally, investments and development of new business models will generate employment opportunities (particularly for those at the Base of the Pyramid) and increase productivity

During the past fifteen years, interest in private sector alternatives has increased, especially in "market-based solutions". Market-based solutions offer people at the BoP socially beneficial products at prices they can afford, and provide them with improved incomes through means of innovative partnerships as business associates — as suppliers, agents, or distributors.

[11] Promise and Progress, Monitor group, May 2011

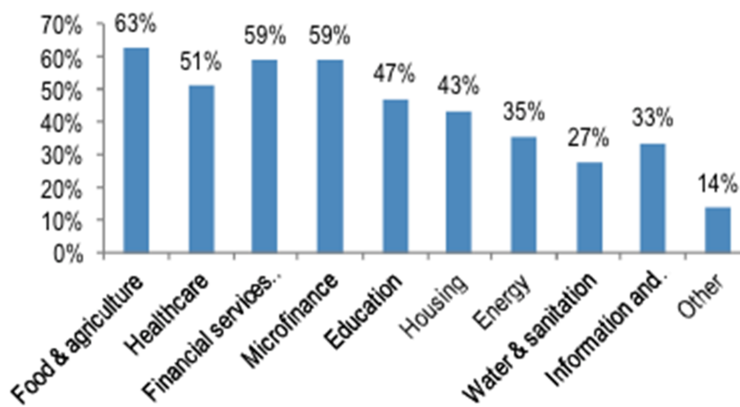
For market-based solutions to succeed, they must operate with business models suited to the extreme conditions of low-income markets. Markets enclosing low-income customers introduce operational challenges to otherwise proven business models requiring innovative approaches to accommodate unreliable income streams or to deliver services to remote rural areas.

In 2009, Monitor Group reported on market based solutions in India[12], investigating more than 270 initiatives; in 2011 Monitor performed similar research in Africa. According to Monitor and also Shell Foundation a strong market based and value chain approach are key to bring ventures to scale. Financial viability is essential for lasting and scalable solutions to be achieved. According to Shell Foundation a disciplined focus on financial return and earned income is critical to ensure sustainability and an end to depending on subsidies"[13].

3.5 Investor's view on SME and impact investments

The JP Morgan report "Perspectives on Progress' was published in January 2013[14]. In total 99 organisations responded to a survey of JP Morgan. These organisations are responsible for a total amount of USD 8 billion of impact investments in 2012. Respondents include Development Finance Institutions, specific microfinance vehicles and funds, impact investments funds, institutional investors as well as foundations. Out of these respondents 51 are investing in emerging markets.
The report demonstrates that there is an increasing focus on sectors outside of microfinance and other financial services, with food & agriculture and healthcare being the main areas of investment.

Figure 9: Sector focus for emerging market investors
Number of respondents = 51; Sector focus reported by any respondent that invests in emerging markets (12 also invest in developed markets)



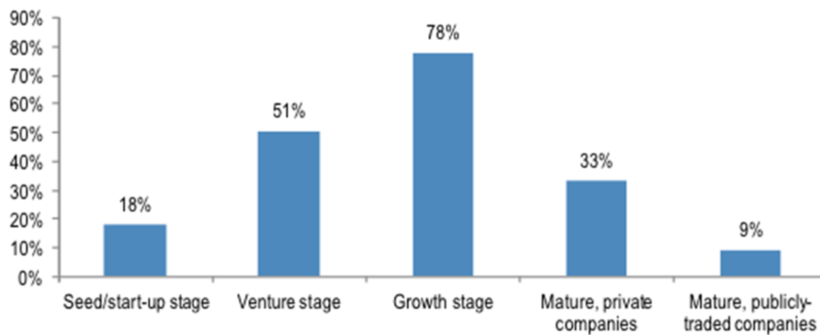
Compared to the results of the survey of 2011, the share of food & agriculture and healthcare has grown significantly. The majority of respondents have a focus on multiple sectors.

The prime geographic focus is on Sub-Saharan Africa (stated by 34% of total of 99 respondents) to be followed by Latin America (32%).

[12] Emerging Markets, Emerging Models : Market-Based Solutions to the Challenge of Global Poverty, 2009
[13] Enterprise solutions to scale, Shell foundation, 2010
[14] JP Morgan , Perspective on Progress, The Impact Investor Survey, January 2013

The survey participants, either investing directly or through intermediaries, were asked to report at what stage of a company they prefer to invest. There is an overwhelming preference for investments in growth stage businesses (78%), and less appetite for venture stage (51%) and mature, private companies (33%). Only a limited percentage for seed/start-up phase.

Figure 11: Stage of company development at which respondents prefer to invest
Number of respondents = 93; Respondents chose all that apply. Those that chose N/A not shown



Source: GIIN, J.P. Morgan.

Definitions used by JP Morgan / GIIN: <u>Seed/Start-up</u>: Business idea exists, but little has been established operationally (pre-revenues); <u>Venture</u>: Operations are established, company may or may not be generating revenues, but not yet positive EBITDA; <u>Growth:</u> Company has positive EBITDA and is scaling output; <u>Mature</u>: Company has stabilized at scale and is operating profitably.

Key barriers for private investors to enter the impact investing space

Respondents of the JP Morgan survey identify the top challenges for growth of the impact investment industry as being 'lack of appropriate capital across the risk/return spectrum", "shortage of high quality investment opportunities with a track record" and "difficulty exiting investments".

Number of respondents = 99; Respondents ranked the top three

Rank	Score	Available answer choices
1	143	Lack of appropriate capital across the risk/return spectrum
2	140	Shortage of high quality investment opportunities with track record
3	76	Difficulty exiting investments
4	58	Lack of common way to talk about impact investing
5	53	Lack of innovative deal/fund structures to accommodate portfolio companies' needs
6	48	Inadequate impact measurement practice
7	44	Lack of research and data on products and performance
8	32	Lack of investment professionals with relevant skill sets

Source: GIIN, J.P. Morgan.

Generally respondents ranked some level of progress of the sector compared to 2011.

3.6 The role of Dutch Good Growth Fund- rationale

The Dutch Good Growth Fund can play an important role in addressing certain barriers that still exist in order for private investors to provide financing to the SME segment in developing countries.

A key challenge to impact industry growth according to JP Morgan is lack of a successful track record. By supporting initiatives with risk mitigating capital and non financial support the Fund mitigates certain risks that private investors are not willing to accept. The Fund will be able it to build up a successful track record and attract private capital. Additionally, if more success stories exist in a certain segment, the 'perceived' risk of private parties with regard to this specific sector will decrease which will lead to more private capital available for the sector. In this way by enabling development of initiatives in certain 'difficult' geography or sectors (by f.i. providing a first loss or guarantee for certain risks like country risks, default risks, SMEs's in rural areas etc.) a track record can be built up and the dynamics and the risks of the SME segment/ geography can be better understood and trust enhanced.

In addition to this an important role of the Fund can be in supporting/enabling innovative business initiatives that indirectly stimulate access to finance for the SME sector (sector development) as a whole but do not necessarily directly provide financing to SMEs themselves (f.i. TCX, weather index initiatives, local bond programs, other capital market initiatives etc). The Fund has an additional role and the Fund Manager ("FM") should, after an initial period of building up a portfolio, actively pursue opportunities to sell part of its investments to private investors or when investing in closed end investment funds build in a phasing out structure which allows the FM to use the capital again to support new initiatives.

4. Role and positioning of the fund for the 'missing middle' in developing countries

4.1 the role of the government

The main role for the government according to private investors is to decrease risk, set standards (f.i. with regard to impact measurement and frameworks) and create the right infrastructure to achieve scale. In this way private new capital flows are unlocked for geographies or sectors where investors in some cases are kept out due to structural barriers even if these investments generate a substantial development relevance and could prove sustainable. Governments need to reduce risks for investors in these markets with guarantees and other support, enabling business models to be tested and hence build up businesses and networks that can subsequently support a track record with sustainable financial and social returns.

Public money can be used to kick-start a private activity where trust and enforcement are lacking. While a donor cannot replicate the enforcement powers of an effective government, it can offer subsidies/soft money/risk capital or support activities that enables private investors to participate in a sector and ultimately accelerate a systemic change.

The government could play an important role in addressing the local SME segment, create/stimulate innovative partnerships and offer risk sharing mechanisms so that networks can be enhanced to support a track record with sustainable financial and social returns.

Multiple layers where multiplier effect will impact

One of the objectives of the Fund is to create a so-called multiplier effect: Every euro invested by the Dutch government creates on average a multiple of private investments, with a minimum of two times the original investment. A direct multiplier effect is created when government funds are used to decrease risks for a specific investment vehicle/fund and catalyze private capital at this investee level. However, the benefits of a donor involvement can extend far beyond the particular financing and local institutions involved. The financed initiatives that build up a successful, robust track record can have a demonstration effect, the perceived risk by private investors of the whole particular (SME) sector or country will decrease and hence investments in this segment as a whole will increase, creating the so called indirect multiplier effect. In the development context, the most powerful impacts will likely be those that affect levels of trust and institutional performance. In financial terms, the leverage or multiplier-effect achieved can be measured at three levels:

- At the DGGF –level (in case additional external funds would be attracted)
- At the underlying fund/vehicle investee level
- At the underlying SME-investee level/ultimate beneficiary

Temporary involvement

The Fund's involvement in transactions may be temporarily necessary to induce private investment, for instance reducing the *perceived* risk necessary to enable private investors to step in. In the best cases the Fund's involvement will disappear over time. In order to ensure additionality, and to avoid market disturbance, the Fund should step out and exit from it's exposure as soon as the private investors are willing and able to accept the risk of a certain investment, and allow the private sector to take over in order for the government means to be used again and be revolving. The role of DGGF should be to catalyse private capital and additionally DGGF's role should be transitional / temporary. Also after a period building up a portfolio, the Fund Manager should actively pursue opportunities to sell part of its investments to private investors. However this may not always be possible when investing in closed end investment funds: in such case private investors are locked in for the whole term of the investment fund and may require government risk mitigating instruments to be committed for this same term.

The Fund Manager should take an active role in this process and should check on a regular basis opportunities to exit or confirm its additionality. Also, when structuring a financing the FM should take into account that it's involvement should ideally be temporary, f.i. by only providing capital/guarantee during investment period or make sure there is a phasing out mechanism in the structure. We recommend the FM to enter into partnerships with private investors (DFI's, other) to transfer transactions when feasible.

4.2 Potential target areas relevant to local SME segment where the market is failing

In its market study of 2012 Goodwell identified a set of differentiated investment target areas, where the government would find a ready market for its product offering at the necessary scale while maintaining a plausible delineation from existing bilateral and multinational programs that will minimize potential duplication and overlap.

We have reconfirmed and updated with a number of market parties and have identified several potential target areas where the market is failing and the Fund could play an important role in order to enhance financing for SMEs in developing countries.

Direct Access to Finance and Investment Support to SME's

Value chain support to generate significant impact in some impact sectors (f.i. agriculture, water and sanitation), it is important that the whole value chain is financed and developed, some parts of which are not acceptable to private investors (f.i. small holder/farmers default risk in agri sector value chain). In order to reach scale, different stakeholders in the value chain need to be included in the financing proposals (f.i. smallholders, manufacturers, cooperatives/associations). An innovative way to do that, for example, is to ensure that once a producer of a certain product is financed, the producer develops an adequate system to either provide pre-financing to suppliers and/or provide deferred payment terms to wholesale or retail distributors, similar to what happens in mainstream (consumer good) supply chains.

A value chain approach is a typical example of establishment of **innovative partnerships**, which can be key to identifying, targeting and servicing currently underserved SMEs

Lack of support for early stage innovators: The biggest funding gap, by a wide margin according to Omidyar network[15], is for early-stage innovators. There are very few impact-oriented investors willing to assume the high risks and uncertain and/or low returns associated with investing behind socially impactful early-stage businesses, particularly in geographies and industries where sector risk is perceived to be high. This deficit was extensively described in the Monitor's Group recent report' From Blueprint to scale.' These businesses and business models can be very promising. In fact the success rate varies between countries and sectors. For example, research by Scott Shane of Case Western Reserve University has shown that start-ups in the health and education sector have a 4-year survival chance of 50% vs 38% for the technology sector. In order to develop and grow, these businesses need some combination of working capital, debt, equity and often business advice.

Businesses
The DGGF should look for Fund Managers or even local financial institutions that play an active role in identifying these market based opportunities with potential for high impact. The Fund can – through its investments and support in investee vehicles- provide early stage and patient capital, business development assistance/TA and market linkages. In this way promising business models can be piloted and achieve financial viability so that opportunities for private investors are accelerated. It should be acknowledged however that supporting these type of early stage businesses comprises a high risk approach but we believe the Fund can play an important role to catalyse and support the growing number of social entrepreneurs until they are ready to source private capital. By means of investment in and support of intermediate investment vehicles, a diversification will take place and cross-learnings can be applied.

Business concepts
Innovative business concepts can be very promising and create systemic change for the SME sector as a whole with a significant development impact entering new areas (for instance online platform for SME bonds, weather index insurance programs, mobile banking initiatives) and in order to attract private capital, need some combination of first loss, guarantees, debt or equity and in some cases non financial support. The demand is there for a pragmatic and creative, hands-on fund manager which is willing to spend time on developing the case, as these opportunities are not 'low hanging fruit' for DFIs and many other financiers.

Lack of support for SMEs in certain 'difficult' remote locations or sectors
By enabling initiatives in a certain 'difficult' geography or sector to build up a track record, the dynamics and the risks of this market/sector can be better understood and trust can be enhanced. For instance investments in deep rural areas in most developing countries reflect these characteristics. One could also think of the water and sanitation, health sector and other impact sectors (that are often dominated by SMEs) that still need more proven business models and track record in order to attract private capital and where a significant development impact can be generated.

[15] Priming the pump: The case for a Sector Based Approach to Impact Investing, Omidyar Network

Indirect Access to Finance and Investment Support to SMEs:

Unlocking of local capital for the 'missing middle': pension funds and banks in developing countries tend to keep more than half of their deposits in liquid assets and provide minimal credit to the local private sector (USAID). Innovative ways to unlock these resources for SME's (such as guarantee schemes for bond programmes) and initiatives to further develop local capital markets such as local currency bond programs/Local Currency loan guarantees are needed.

Long term local currency funding: Local SMEs with long-term assets need long term local currency funding, however, international long-term debt financiers are unable to assume currency or interest rate risks and long-term hedging products are scarce and often expensive. Local financiers are also unable to provide long-term debt. This means that the local borrower (SME) can only borrow short term in local currency or long term in hard currency. In this way the borrower is faced with a currency or a tenor mismatch which makes the SME quite vulnerable for a risk that they are not able to control. This risk can be significant as the local currencies tend to be quite volatile. More innovative solutions for SMEs are needed in addition to initiatives like TCX.
DGGF should make as much as possible funds available in local currency to the local SME sector.
The Dutch Government as provider of a first loss tranche to TCX is entitled to allocate approximately EUR 50 mln in volume per year of local currency hedges with TCX, currently it has allocated this amount to Africa and Micro Finance in general but (as confirmed by TCX) it is possible to amend the allocation. It should be considered to allow the DGGF to use (part of) the TCX allocation to enable it to offer local currency financing.

New financing products and services: Financial services and products which are common in more developed economies like for instance leasing and factoring and insurance, have hardly taken off in developing countries. In addition to financial companies providing these products and services, support will be needed to design and update regulations and liaise with and train relevant authorities as well as financial education on the products and services. (The latter falls outside the scope of the DGGF but can be picked up by embassies/other programmes.)

Innovative ways to reduce costs/make assessment process more efficient: One of the additional reasons why Investors shy away from financing SMEs are the high transaction costs involved compared to the invested amounts. New efficient, innovative mechanisms to reduce costs are needed

Fragile states: investors are reluctant to enter into 'difficult' countries as the perceived risk is too high, whilst in these countries often a high development impact can be generated and investments are needed for the development of the SME segment. Some typical characteristics of fragile countries are[16] :
(a) poor administrative capacity and absence of adequate sector specific policies and regulations for SMEs.

[16] Cordaid-internal presentation

(b) Poor or lack of infrastructure (roads, water, electricity, telecommunication) resulting in high operational costs and disincentives to business and banking operations.
(c) Non-existence of financial services – existing financial institutions have very poor outreach to the poor and to SMEs
(d) Unavailability of support services like market information services, and business development services to provide advice to SMEs ,
(e) Deficient social norms expressed in high levels of corruption, very poor governance systems, poor respect for rule of law, high gender inequality, high levels of distrust.
Political risk cover in the form of guarantees/first loss capital is needed where a risk insurance is not provided by other organizations like MIGA (for instance to cover risk of non enforceability of contracts, nationalization etc.) The Fund can play an important role to enable projects to get kick started, allow Fund Managers to build up a track record of successful initiatives in these countries and in this way decrease the 'perceived' risk so that private capital can be provided. Private Sector development and the creation of SME's in conflict affected environments generate employment, income and food security that strengthen economic resilience of the population. Investing in SMEs in fragile regions has a significant development relevance, TA will be needed in combination with the investment for handholding, building and strengthening the sector etc. Access to financial services is a critical tool for both economic growth and human development. Successful examples of such countries are Cambodia and Mozambique. Both were very dependent on donor money a decade ago but have developed very well. Obviously that development was caused by a broad range of reasons but the fact that DFIs and some other donors have stimulated investments and the development of markets has definitely helped. There is a role for the fund to pick up and kick-start similar cases (in South Sudan or Zimbabwe, for example).

4.3 What is needed from the Fund to catalyze private capital?

Risk sharing mechanisms, capacity development, non financial support and innovative partnerships are needed to attract private capital and catalyze private sector development

Risk sharing mechanisms

It is a challenge to channel institutional investor capital to investments in developing countries. These investors face various structural barriers they are not willing to accept.
Risk sharing instruments such as first loss capital, guarantees and risk insurance will allow the private sector to fund more projects. Also convertible grants (to be returned if the business becomes financially viable) can subsequently be used to finance projects (indirectly through the investment vehicles).

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Capacity Building /TA

SMEs lack access to knowledge. The FM should have access to Capacity building and TA funds for knowledge transfer (bookkeeping/reporting , governance, IT and management systems etc). A common theme in the feedback of market parties is that for investing in local SME sector more than investment capital alone is needed, specifically TA for capacity building is of key importance. The Fund should be able to make TA funds available to their underlying investment vehicles.

Non financial support

The Fund Manager should in addition to the capital provided by the Fund offer it's investees where necessary non financial support which can significantly reduce risks of working in an innovative, challenging environment. This hands-on dedicated support comprises support on structuring of funds and investment vehicles, business skills like business planning and strategy,governance, financial management, impact measurement frameworks, market knowledge as well as linkages to financiers and further fundraising

Innovative partnerships

Most respondents believe that an important role for the Fund Manager should be to facilitate innovative partnerships. Tackling global development challenges is not easy and the collective chances of success will increase if parties active in the field join forces and share learning, experience, networks etcetera. Various interesting impact innovations come from creative partnerships and market linkages among investors, entrepreneurs and sector leaders. The Fund Manager should play an active role in capacity building, facilitating such partnerships, encourage dialogue and enhance networks. A number of such very simple examples can be found in the microfinance field, whereby in each country where the sector developed well it proved essential that associations of institutions were formed, to discuss issues in the sector and undertake joined action. An active Fund Manager can stimulate such partnerships and bring people together if and where needed provided there is a link with a pipeline/investee investment vehicle. The Dutch embassies and partners of BZ such as WB/IFC in the investment region could also play an important role in this respect for the Fund.

4.4 focus on the SME sector in 66 low and middle income countries

SME sector focus

The Fund's focus is to enhance access to finance for SMEs in developing countries.

'SME' typically encompasses a broad spectrum of definitions across countries and regions (and even within countries) many countries and international organizations set their own guidelines for defining an SME, often based on the number of employees, sales, or assets.

A flexible approach for the Fund is recommended by majority of respondents: the FM should assess per country/region what the most appropriate criteria for SMEs are and not work with one overall definition – the Fund should not generalize too much- build in the maximum flexibility to assess per country/region what should be the definition for SMEs not too exclude too many groups.

The Fund should be demand driven and in the end the development relevance should prevail. To the extent possible preference will be given to impact sectors like agri/food security, water and sanitation, SRGR (the priority sectors) and fragile states which enables the FM to build up knowledge, networks and track record necessary to be creative and innovative. However, the Fund's focus will amongst others depend on local demand, market opportunities plus the expertise and network of the selected Fund Manager. Also there are innovative initiatives with a high development relevance (i.e. mobile banking) that are not

covered by one single sector but can be used in multiple sectors and are very relevant for the SME segment as a whole in developing countries.

Geographic focus

BZ has selected the following 66 focus countries for the Dutch Good Growth Fund

Africa				
	Kaapverdië	Somalia		
Benin	Kenia	Senegal	Angola	Sao Tomé
Burkina Faso	Libië	Sudan (Zuid)	Djibouti	Sierra Leone
Burundi	Malawi	Tanzania	Eritrea	Tunesië
Congo Dem. Rep.	Mali	Uganda	Gambia	Zimbabwe
Egypte	Marokko	Zambia	Madagaskar	
Ethiopië	Mozambique	Zuid Afrika	Niger	
Ghana	Rwanda	Algerije	Nigeria	

Asia			
	India	Jordan	Myanmar
Afghanistan	Jemen	Sri Lanka	Cambodja
Bangladesh	Mongolië	Thailand	Laos
Filipijnen	Pakistan	Vietnam	Maldiven
Indonesië	Palestijnse Gebieden	Bhutan	Nepal

Latin America		
Bolivia	Guatemala	Peru
Colombia	Nicaragua	Suriname

Europe		
Albanië	Georgië	Moldavië
Armenië	Kosovo	
Bosnië Herzegovina	Macedonië	

A global fund is good from a diversification standpoint as an important risk in developing countries is the country risk. It is difficult however because the Fund Manager needs to build up regional expertise and know how. The Fund Manager should be able to follow market demand and consider high impact opportunities covering these countries on a case-by-case basis.
However it is highly recommended to choose initially some priority region(s) enabling the Fund Manager to focus, to build up networks, expertise, knowledge, and a track record etc. within focus region(s). Also from a cost and efficiency perspective it makes a lot of sense for the Fund to have some geographic focus as it would be quite a challenge for the Fund Manager to actively build up a pipeline, invest, manage and monitor investments equally in all regions.

The country allocation strategy has important risk management implications for the Fund. Country risk in the sense of a potential deterioration of the economic and regulatory environment must be considered. Also macroeconomic imbalances, inflation and foreign

exchange rate disruptions pose a risk to the Fund, particularly where its exposures will be in local currency. A broad diversification across countries/regions and underlying Fund Managers will be an advantage of the Fund and appropriate currency and country limits need to be defined as part of the overall risk management strategy.
Also in terms of estimated risks and related returns, differences apply between regions and countries. In this respect, also a mixture is needed.

4.5 Additionality- coordination with other programs

The Fund aims to be additional which means it wishes to bridge the current financial gap between availability of private capital (including capital from development finance institutions) to SMEs in developing countries and the finance needs of these companies. To ensure additionality in the long run the FM should on a regular basis (at least once a year) assess if outstandings of the Fund can be transferred to private investors (including DFIs) and should establish a network of partners to whom the investments can be transferred (different ways of transfer are possible f.i. funded/unfunded risk participation, syndication etc.). It also aims to expand the existing range of financial instruments that can be used by the government to support developmentally relevant initiatives.

Other programs

The investments should be additional to the market and to the existing government programs that focus on funds/vehicles that have no or limited access to private capital as the private investors perceive the risk as too high.

As part of the Goodwell 2012 research, various documents and websites providing information about all sorts of government programs to stimulate economic development via investment or subsidy instruments have been studied. Those programs have been mapped and interviews have been held with various people about the use of those instruments (notably PSI and FOM EL&I/FOM-OS. The overall picture of this mapping showed that

a) the Dutch Government already provides various instruments for grants and loans but hardly any for risk capital;
b) most programs, including PSI and FOM, shy away from unproven innovative business concepts;
c) most programs have a very strict set of criteria and leave little room for a tailor-made and entrepreneurial approach.

The overall FMO approach, Massif and to a lesser extent PSI, comes closest to what the Fund aims to achieve. However, the gap between subsidy programs such as PSI on the one hand and FMO-A, including FOM EL&I and FOM-OS on the other hand, is too large. Massif (managed by FMO) also aims to stimulate financing for micro entrepreneurs and SME in developing countries but generally achieves this via local financial institutions and PE funds that do have access to private capital and have a certain track record. Amendment of those programs could be considered but is not recommendable because

1) the teams managing grant programs are unlikely to have the skills or culture to manage investments; and

2) FMO sticks strictly to focus sectors, minimum deal-size and to one standardized approach (with one credit committee, for example). Besides, FMO is not hands-on (as they say themselves) and sees its role primarily as a financier ,
3) The Fund is targeting a different risk segment; it includes the development of innovative financing vehicles managed by potentially new managers and partnerships which have the potential to generate significant development impact.

Another consideration could be that some diversity contributes to market development; projects and investors would like to have a choice and the market for investment projects is huge. Also common feedback is that this Fund needs to be able to work fast, be flexible (criteria not too strict) and have efficient approval processes and governance. The Fund aims to expand the existing range of financial instruments that can be used by the government to support developmentally relevant initiatives.

Compared with the MASSIF-programme, DGGF (i) is allowed to take higher risks (f.i. first-time partnerships, innovative business models), (ii) primarily invests in funds and vehicles whereas MASSIF invests primarily in financial institutions / banks directly, (iii) has a broader mandate and more flexibility in applying instruments, (iv) is managed by a pro-active hands on manager (which is not FMO's role in MASSIF, as they state themselves).

Logically, a new investment fund or program would have to fill the gap between Massif and FMO and focus on opportunities which are outside the FMO focus or which are too small/early for them. Applicable projects financed should be able to migrate to the FMO portfolio or directly to the commercial banking sector down the line. In order to maintain a coherent program of various government instruments, a new Fund would also need to register why projects financed or considered do not fit under existing instruments. Such information would be good input for a mid-term evaluation after 5 years

Other programs:
A lot of initiatives already present in the market are very focused, for instance IFC Blended finance focuses at the moment primarily on climate change projects (but is gradually expanded to include SME and agri business), SME Ventures Fund focuses on a selected number of countries, Acumen Fund focuses on financing SME's in Pakistan/India, East and West Africa in multiple sectors and is venture philantrophy (slightly different focus and investment culture). USAID awards with its initiative Development Innovation Ventures grants to compelling innovative new development solutions - (not revolving, quite a different investment culture) and the grants are allocated to projects by means of a competition.

Most important rationale for the SME segment of the Dutch Good Growth Fund is it's openness for innovative, financially sustainable, business concepts/investment vehicles, difficult countries, certain segments that need to be developed etc. with a significant development impact and which have no access to private capital. Additionally an important rationale for the Fund is its catalysing effect, mobilizing private capital to the SME sector and reducing the perceived risk of certain sectors/countries/segments adding an important value.
It is the combination of characteristics that makes the Fund unique, although we would like to note that some overlap with other initiatives can not be completely avoided.

5. Investment strategy, instruments and criteria

5.1 Fund Objective and Strategy

The Dutch Good Growth Fund ('DGGF) an initiative of the Dutch Ministry of Foreign Affairs (€750 million in total) is a revolving fund which offers tailored funding arrangements for entrepreneurs (particularly small and medium-sized enterprises) that have solid business or investment plans and relevance to development, and whose business practices are sustainable and socially responsible.

Part of the DGGF means will be targeted to enhance access to finance for SMEs in developing economies (the so-called 'missing middle'). BZ considers to contribute an estimated total investment capital of EURO [200-250] million to this local SME segment . On top of this it is anticipated that an estimated amount of EURO [40 to 50] million of business development capital will be made available from sources outside the DGGF to the Fund Manager. With the Fund BZ aims to enhance access to financing for the SME-segment in developing countries (the so-called 'missing middle') by (i) supporting the development and financing of innovative, financially sustainable investment funds and vehicles that have the potential to generate a significant development impact and have no or limited access to private capital and (ii) to catalyse private investment for the local SME sector in up to 67 low and middle income countries. To achieve this objective, the Fund provides various types of investment capital in combination with business development support and non financial support to innovative initiatives, (indirectly via investment vehicles/funds or local banks).

Leverage of private capital (including financing provided by DFIs) will take place primarily at the underlying investee fund/vehicle level. The Fund aims to be additional which means it wishes to bridge the current financial gap between availability of private capital (including capital from development finance institutions) and the finance needs of promising investment initiatives that support the SME sector. It also aims to expand the existing range of financial instruments that can be used by the government to support the local SME sector in emerging economies.

The Fund intends to create a geographically spread, balanced, diversified portfolio of investments in investment funds, other investment vehicles and, in specific cases, investments via local financial institutions. Investments should stimulate local employment, productivity, knowledge transfer, and strengthening of local SME sector.

5.2 Investment Approach

Indirect Investment approach

The Fund will have an indirect investment approach, it will not directly invest in SME's itself but rather reach the SMEs and the SME sector through a wide range of intermediaries. The Fund intends to create a balanced, diversified portfolio of financing instruments to investment vehicles and funds.

The Fund will provide capital, capacity development and 'hands on' support to intermediaries like investment vehicles or holding vehicles. In specific cases local financial institutions can be targeted in case there is clear additionality. For instance this could apply to working with

banks that are moving into untapped market segments for smaller firms (downscaling of commercial banks or upscaling of MFIs) or operate in unserved regions/sectors or fragile states. Also other initiatives with a reasonable size hat enhance access to finance for SME's could apply (for instance working with distributors or manufacturers in the value chain with the aim to finance smallholders and small producers). Especially when investing through local banks the additionality to other government programs (MASSIF) and DFIs has to be ensured (DFI's generally approach the local SME sector via local banks).

Benefits of an indirect investment set-up (i.e. allocation of funds to be invested by local managers based on a strict investment policy) are:

- higher ability for scaling up (more focus / direct monitoring/ better introduction to local networks etc.)

- cross-learnings at national, regional and worldwide level - between investee managers but also between SMEs supported by investee managers

- higher diversification

- more support at micro (SE), meso (sector) and macro (regulations) level due to dedicated operational managers

- lower operational costs compared to direct investments

Disadvantages when compared to direct investments are:

- higher costs for investments in funds (layering of costs)

- difficulties of finding good funds/vehicles and fund managers.

With a view to achieving its targets, the Fund Manager should play an active part in identification and co-creation of initiatives by bringing partners and business concepts together. For instance this could be the case if applicable investments for certain target sectors of for fragile states are not available.

Investing in funds requires relatively less sector knowledge at DGGF-level but does require experience in setting up funds, assesssment of operational management and business plans, building partnerships, arranging reporting, financial management and building and maintaining stakeholder relations.

Arrangements for a specific mandate can be organized efficiently with fund managers that have experience and / or are already managing other investment funds. In order to avoid any conflict of interest or overlapping with existing commitments for these managers, a clear investment policy and possibly specific (different) mandates for the funds that are managed by this manager for specific type of investments need to be established. The benefit of working with existing fund managers is that these people have already access to deals, have done deals in their country and could provide a platform for deal sourcing, co-investments and/or exit opportunities. However as the Fund targets innovative solutions, also business concepts with new managers or partnerships of managers with different and complementary skill sets and experience apply (especially as DFIs / private capital might deem the associated risk too high), naturally combined with appropriate risk mitigation measures by DGGF.

5.3 Investment Guidelines and Criteria

The Fund will invest in funds, vehicles and financial intermediaries focused on providing access to finance for SMEs and delivering significant development impact. No direct financing and/or investments to SMEs are allowed.

The Fund has a rigorous approach in assessing investment opportunities which relates to (i) achievability of delivering financial and development results (ii) effectiveness and efficiency of reaching these SMEs, (iii) strength of the investee, target SMEs and surrounding eco-system and required estimated support.

Each investment opportunity will be reviewed carefully at start of the assessment process to identify the compliance with the objectives of the Fund. In case of an investment, a regular check will be made to define to what extent the investee still fits within the criteria, and if not, how a gradual exit could be made by DGGF.

- To the extent possible, DGGF should provide long term finance in local currency as this is a clear need in the market.
- Where applicable, DGGF could liaise with like-minded funds and organisations to increase the impact and amounts allocated and to gain efficiency and deal-sharing nature

Most important investment guidelines, to be reflected in an assessment in a scorecard (see Annex A for an example of what a scorecard could look like) are:

- ***Additionality-*** the initiative has no or limited access to (new) private capital, including capital from development finance institutions such as FMO and private impact investors
    - The FM will seek evidence that this is the case
    - After an initial period of 5 years to build up the portfolio, the FM will on a regular basis (at least once a year) assess if outstandings of the Fund can be transferred to private investors to ensure additionality in the long run
- ***Innovative character-*** investment in an initiative needs to have an evident innovative character; this can be because for instance the financing instrument is innovative, the sector of investment is innovative, the country is innovative, an innovative concept combining partners etc.

- **Financial viability** –
    - The potential to meet the financial IRR threshold targeted by the investee should be backed by credible projections

    - Investment vehicles need a clear business model that show potential for financial sustainability covering all operational fees by the management fee and to attract private capital
    - Potential for material impact on the development challenge it is trying to solve should be credibly analysed and projected

- ***Management team***- the investment vehicle/fund needs to have a strong and experienced management team that has :
  a. the skills and will to grow a sustainable investment vehicle targeting SME's in developing countries
  b. the requisite skills to execute the business plan and a clear and compelling vision
  c. investment track record – proven ability to generate a financial return
  d. the will to work with the market to achieve the goal of generating a significant development impact
  e. been able to raise funding from other sources as well like local investors , international investors (within a 12 month period) – that will complement the investment from the Fund

- ***Development impact* – SME-level** Investment vehicles/funds need to enhance access to financing for SME's, stimulate local employment, knowledge transfer, and strengthening of the local SME sector. Where applicable when investing in impact sectors the businesses supported by the investment vehicle/Fund should address a critical development need in the priority sectors of the Fund

- ***Development impact – sector level*** In addition to providing access to finance to SMEs, investment vehicles could have a direct impact on development sector (possibly in combination with dedicated support funds). Also, in some cases, investment vehicles are set up to have a demonstrable impact on the sector (like for instance TCX)

- ***Ability and willingness to adopt an E&S reporting framework* –** should be a requirement for each investment in vehicles; assessment of current operations and methodology (if available) and willingness and capability of the underlying investee managers to establish and incorporate an E&S reporting framework that complies with IFC Performance Criteria and OESO IMVO guidelines.

- ***Investment size* –** typical investments between EUR 5 and 25 million with a maximum up to 10 % of the total Investment Capital of the Fund for a fund or investment vehicle investment – typically no majority share or majority of balance sheet/ total funding

- ***Investment concentration* –** up to 20% of the Investment Capital of the Fund to be allocated to one Sponsor/Key Partner in investee vehicles

- ***Leverage* –** expected leverage of private capital (including funds from DFIs) at investee level of a minimum of two times invested capital

- ***Country focus*:** the Fund can only invest in an investment vehicle ultimately targeting initiatives in the 67 target countries

- ***Country limit***: a maximum of 15 % of the aggregate commitments of the Fund may be invested in one single country – applies after three years

- ***Currency limit***: a maximum of 15 % of the aggregate commitments of the Fund may be invested in one single currency (non-USD and EUR) – applies after three years

- ***Sector Limit***: a maximum of 30% of the aggregate commitments of the Fund may be invested in one single sector – applies after three years

- ***Currencies***: the Fund is EUR- denominated, the Fund can make investments in local currencies: FX and local interest rates exposure will be monitored closely and may be hedged, if possible and deemed appropriate by the Fund Manager.

For each new investment, the above criteria should be carefully reviewed and a scoring/assessment should be made in relation to the parameters. The Fund Manager should allocate its investments within a portfolio approach in order to achieve a **revolving nature at Fund level.** This means that a mixture of investments is needed with for instance sometimes a higher financial and lower catalyzing and development impact to be combined with investments with a lower foreseen financial return but high catalyzing impact and high development impact (at level of investee but also potentially the sector).

The investee can be a Dutch as well as a non-Dutch or local initiative, the guiding criteria is that the means ultimately benefit the SME sector in developing countries and that local knowledge and presence that is needed is secured. The FM will work together with IFIs, especially with regard to their pipeline projects and actively using their knowledge and expertise. However, IFIs cannot propose a financing from the DGGF independently, only proposals jointly with other -non IFI related parties- will be considered.

Given the diverse nature of SMEs in different countries / regions and the likely diverse nature of investment vehicles in which the Fund will invest, the overall target of financial sustainability and revolving character as well as achievement of development impact should be achieved at portfolio level.

Any deviations from the investment guidelines need approval from the Board (or alternative governance body) of the Fund.

5.4 Investments Instruments and Products & Services Offering

In order to fulfill its mandate the Fund Manager will provide investment capital, capacity development capital (including seed capital and TA) and non financial support to its investees. The investment capital is funded by the Dutch Good Growth Fund, the seed capital and capacity development tranche is funded by other Government means but tied and available upon request, naturally after approval of the relevant approval committee. The investment capital will be revolving: once loans are repaid or transferred to private investors or equity investments are exited, funds are re-used to provide investment capital. This means that the capital of the Fund will mobilize a multiple of the actual investment capital during the

lifetime of the Fund. BZ aims that at least the nominal amount of the investments should flow back to the Fund after deduction of the management fees of the DGGF.
The capacity development capital will be partially revolving (on a best effort basis) to be able to support high risk investments.
We strongly believe it is possible to achieve both development impact and financial returns in the long run and a trade off between the two is not needed.

5.4.1. Investment Instruments – Investment Capital facility

Risk sharing mechanisms

Private investors face various structural barriers when investing in initiatives supporting local SME's they are not willing to accept. The Fund can play an important catalyzing role by offering *risk sharing instruments* such as first loss capital, guarantees and risk insurance which are needed to make the risk profile of the investment acceptable to private investors, attract private capital and catalyze private sector development. For investments, tailor-made financing solutions could be provided, either by means of funding or guarantees or a combination.

Risk capital – equity and mezzanine

The Fund should provide risk capital to investment vehicles. As DGGF aims to have a catalyzing effect, a likely position would be the position of a 'first loss' junior investor / lender in a structure. However, also the Fund could take a mezzanine position, possibly (i) in combination with a junior tranche, to facilitate a certain minimum size of the initiative and/or to catalyse other mezzanine investors or (ii) as addition to another available junior tranche (provided by a donor) in a 'tiered' structure. Additionally DGGF could take a 'normal' (pari passu) equity position, possibly with an additional guarantee. Other investors could be comforted with DGGF as a normal equity provider, due to the reaching of a nominal minimum size, the strong guiding role of DGGF in establishing the investee vehicle (procedures, standards, reporting) possibly combined with Business / Capacity Development Support made available.

Guarantees structures

International capital from donors, impact investors and even strictly commercial sources cannot be the permanent long-term solution to the funding requirements of local SME lending. Local capital markets, i.e. domestic banks, savers and local institutional investors should be the natural primary sources that fuel the growth of local SMEs.
The Fund can be additional in playing an important role in the 'unlocking of local capital '. Pension funds and banks in developing countries tend to keep more than half of their deposits in liquid assets and provide minimal credit to the local private sector (USAID). The problem of domestic banks in Africa for instance is that they have been rather risk-averse, holding unnecessarily large amounts of liquid assets and have a high preference for off-shore deposits. Guarantees for first loss risks given by the Fund to domestic banks and investment vehicles enhancing access to finance for SME's might be a way to gradually

bridge the gap between overly liquid domestic financial institutions and a local impact SME sector starved for investment. (temporary nature in this case would mean decreasing levels of guarantees over time).
The Fund may also look at how it can support market initiatives that are aiming to unlock local capital.

Finally, financial guarantees or first loss guarantees (compensates the investor up to a pre-agreed limit of default) can be used to reduce default risk, lower cost of capital and potentially increase long term funding. This tool can for instance be used as a type of political risk insurance, allowing investors to enter 'difficult' high risk countries (fragile or post conflict states) and introduce investors to a specific country. In this case it acts as a catalyst to improve the investor climate and increase trust and risk perception. The Fund Manager has to be sure to set the proper first-loss incentives for the participating (local) investor such that it meaningfully engages with the sector on its own merits as part of a strategic commitment rather than lending on the back of an international guarantee alone.
Guarantees can be particularly useful to reduce the deemed layering of risks of investors (for instance a combination of deemed high risks in country risk, currency risk, credit risk, first time fund manager / partnership risk, off-take risks etc).

Guarantee structures can be used on a stand-alone basis, i.e, as an additional risk mitigation to funding provided by other partners. Guarantee structures will often be used in parallel with funding provided by DGGF, i.e capital combined with a guarantee.

Semi- concessional funding

In many cases private investors are not wiling or able to accept the risk of early stage businesses with unproven business models because they are not fully convinced of the business case, or otherwise perceive disproportionate costs or commercial risks in a nascent market. Temporary (partial) guarantees or partly subsidised funds can catalyse private investors to invest. Although investors generally are willing to pay for an insurance/guarantee, actual pricing of covered risk (if available) may be too high for the business case to be sustainable. However in such case the Fund could consider to provide a risk cover for a more attractive price, with a partly concessional character, catalyzing private capital to these countries. The Fund should always aim to avoid market distortion so only provide such an instrument temporarily as long as it is not also provided by a market party. The Blended Finance team of the IFC has very positive experience with using semi concessional financing for financial institutions in relation to SME-financing. In addition to capital/finance, IFC also provides advisory services at sector level (strengthening ecosystem), financial institution level as well as SME-level. DGGF should selectively review opportunities to cooperate with IFC Blended Finance.

Structured investment instruments and returns

A key element of DGGF is the ability to provide capital and support on a tailor-made basis. This means that, depending on the investment proposition, different financing instruments and support mechanisms can be used. At Fund level, there is a requirement for (i) revolvement of funds, (ii) additionality / innovation, (iii) catalyzing private capital and (iv) significant development impact. Within the portfolio, it is clear that not all investments will

contribute in the same manner to the returns and impact with regard to the requirements mentioned. Therefore at portfolio level, subject to the definite investment strategy and investments made, the four requirements need to be fully met. At each individual investment level, a minimum level of compliance for the four elements is required. For instance the Fund Manager can decide to support a particular investment to support a higher development impact and lower financial return, which could then be compensated within the portfolio by another investment with a higher financial return and lower development impact. Balancing of these elements is key. In terms of structuring of investments, the FM should at a best effort basis try to incorporate - to the extent possible - some upside sharing elements which could compensate for lower initial standard returns. Furthermore, the Fund manager should at best effort basis include structures which are amortising or transitional.

In all cases the Fund Manager should at best effort basis try to achieve a balanced estimated risk – return (in which in many cases the estimated risk by the FM can be substantially different from the perceived risk by other investors), but this will not always be possible as sometimes some return reduction might be needed in order to attract other investors.

5.4.2. Seed capital+ Capacity Development Support

Seed capital

In many cases private investors are not wiling or able to accept the risk of early stage businesses with unproven business models. However these businesses can be very promising and can have a significant development relevance if successful. We believe the Fund should focus on these early stage businesses and support investee managers that look for SMEs that have innovative ideas for addressing development challenges more effectively and more cheaply.

These early-stage investments in SMEs bear a high risk profile and lessons from the past have learned that less than half of these businesses will survive, let alone be very successful. Due to the infancy of the sector in the field of impact SME's, there have only been a limited number of success stories so far. Through selectively providing Seed Capital to Investee Managers, one or two first investments could be made by these Managers for building up a track record. This piloting could lead to a subsequent fund structure, which would be in a better position to atrract additional capital due to the already available track record. Additionally the Fund could for instance provide to an existing fund an additional Seed Capital tranche for investments which are deemed still too risky or early stage for the fund itself but with monitoring and support could lead to a pipeline opportunity for this fund.
Also seed capital could be provided for instance for piloting of new services and products (f.i. factoring, insurance, innovative IT applications, etc.) with the intention that this business concepts would become an investee of DGGF at a later stage.

Seed capital focuses on innovative development solutions that have the potential to reach wide-scale and generally need hands on support from the Manager. . Investments are made from the Seed and Business Development Tranche as they are 'high risk' at this stage and the financing can only be revolving on a 'best effort' basis. If the initiative is successful the funds should be returned (possibly with an upside component) as the initiative goes to stage 2 investment from the Investment Capital tranche and/or investments by other investors.

Enterprise Support

The development of the SME sector in developing countries is not only hindered by a lack of investment capital, there are also large gaps in terms of knowledge and capacity. Both businesses as well as the sectors in which they operate need strengthening, and new partnerships and ideas need to be fostered.

The right instruments should be available to make this possible and the justification for the mix of instruments offered always needs to be substantiated extensively in the investment proposals submitted to the Investment Committee, on the basis of a number of broad guidelines only. In this respect, it is advised to focus broadly on the following number of activities which may be supported with 'soft money' from the Business Development Facility. The Fund can provide these funds to the funds/vehicles it invest in (so these investee FM's can use it to support their underlying investees) or to initiate/support new funds/business concepts. Instruments could be used for:

- Feasibility studies
- Deal or capital structuring support or training
- Internal organization like management information systems, processes and procedures, human resources and IT
- Improving corporate governance
- Improving (financial) reporting
- Strategy development and implementation, including in the areas of Environmental and Social management framework/system
- Piloting of (potentially scalable) new products or practices - seed capital/ convertible grants
- Impact measurement

Approval of contributions will be judged on the basis of:

- Development relevance/impact
- Contribution to the long-term sustainability of the project or initiative
- Strategic importance for the sector or the country
- Potential scalability of the business concept and potential for repayment after 3 to 5 years
- Activities which are likely not to take place if there is no financial incentive

Other issues:

- The maximum amount of soft money per investee will typically be up to EUR 1 mln for Business Development and up to EUR 2 mln for Seed Capital, to be conditionally provided during a period of max 5 years
- In order to create alignment, the investee or beneficiaries of any activity will always need to make an own contribution in kind or cash
- In order to enhance recovery of the soft money and maximize the chance of success, every individual case will be tailor-made to the situation in terms of instrument, tenor, pricing, etc.
- The rates charged by external consultants should be compliant with the market and if and where possible various offers should be compared

- The Fund Manager will have a dedicated person within the front-office team specializing in capacity development and technical assistance, so that knowledge is centralized and operations and processes can be streamlined and optimalized
- If applicable, the support funds could be of a 'convertible grant' nature, i.e. (partial) repayment in case the vehicle / initiative is successful

Ecosystem Support *(beyond the scope of DGGF but important to develop local SME sector- DFIs in close cooperation with embassies and other parties should address this)*

It is crucial to develop the ecosystem of SMEs in parallel with the support and development of individual SMEs. Some of the element above can be organized and trained at sector/association level (corporate governance, impact measurement, reporting) and additionally support can be given to develop and strengthen sector associations, partnership buildings and other relevant sector-wide initiatives and best practices. For instance training and implementation of procedures to facilitate and reduce costs for registration of collateral could be a target for support. Another area would be the strengthening of credit registration and credit bureaus.

Additionally surrounding sector providers (auditors, lawyers, fiscal services etc) as well as local banks and financial institutions should be trained and strengthened in the specificities of SMEs and how to deal with them.

Non financial support from the Fund Manager

The Fund Manager should in addition to the capital provided by the Fund offer it's investees where necessary non financial support which can significantly reduce risks of working in an innovative, challenging environment. This hands-on dedicated support comprises business skills like business planning and strategy, management information systems, governance, financial management, impact measurement frameworks, market knowledge as well as linkages to financiers and further fundraising

DGGF needs certain *pragmatic standards* with regard to reporting, processes, procedures and implementation of frameworks for the underlying investee vehicles. The Fund Manager should develop those and implement jointly with the underlying investee managers. The implementation, monitoring and updating of these pragmatic 'best practice' standards (possibly combined with TA-funds made available for this specific purpose) could be of great comfort to other investors and might facilitate in attracting additional capital.

5.5 Portfolio allocation and examples

Asset allocation is an investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to the risk tolerance, goals and investment timeframe. Portfolio asset allocation is based on the principle that different assets perform differently in different market and economic conditions.

A fundamental justification for asset allocation is the notion that different asset classes offer returns that are not perfectly correlated, hence diversification reduces the overall risk in terms of the variability of returns for a given level of expected return. In the case of DGGF,

also a portfolio allocation is needed in order to balance the financial return and development impact.

As also incorporated in the financial model, a diversification in terms of type of capital, regions, sectors, investees/sponsors is required.

It is expected that 15 to 20 investments will be made. In total – assuming a lifetime of 15 years for simplicity sake- 75% to 80% of the allocated funds will be invested, the remainder is paid and reserved for expenses.

Average investments –assuming a fund size between EUR 200 and 250 million - will be between EUR 7.5 and EUR 12.5 million.

The Fund will target the following investment categories:

1. Vast majority will be in investment vehicles / funds in which DGGF will play a subordinated role, either by position in a layered structure or by a mixture of providing capital with a targeted guarantee (either first loss, currency, credit only or target-specific).
   Typically investee funds, in order to be financially viable, will need a minimum final fund size of approximately EUR 20 million. SME-funds can be country-specific (subject to country size) or cover a few (neighboring) countries. Sector-specific funds will more likely require a regional approach, as investment opportunities could otherwise be too limited.

   A number of investments is assumed to be made in innovative business initiatives / vehicles that (indirectly) enhance access to financing for SMEs . (for instance online platform for SME bonds, weather index insurance programs, mobile banking initiatives)
2. Investments (either equity, mezzanine or debt) in banks directly will only cover a relatively small part of the portfolio as additionality needs to be clear and DFIs are other (semi)-private players are active in this area. Straight forward guarantees can be provided, but we assume that this will only happen in exceptional cases as most of the guarantees will be combined and incorporated in a funding contribution by DGGF.

Geographically seen, the portfolio will show a good diversification at the time of full investment. Initially, as the Fund Manager will most likely start to focus on a few regions, there might be some imbalance in terms of geographic diversification. Diversification is needed because risks vary per country and region. Investments in fragile states with relatively high risks but high developmental impact need to be combined and mitigated (by means of risk) with investments in more advanced developing countries (f.i. middle income countries).

There is certainly scope for investments in the impact sectors (and also specifically for BZ's preferred sectors agriculture, water and sanitation).

We expect the Fund to make in some cases some investments with a relatively low –subsidized- return expectation which is needed to catalyse private investments in either difficult countries/regions, sectors and/or for new innovative concepts which could have a deemed layering of risks. For the majority of other investments however the Fund Manager should aim to achieve equity returns in the range of 10% - 20%.

Minimum leverage of private capital of 2 times the DGGF investment should certainly be achievable.

Please find a below a number of potential investment opportunities as provided by BZ and other parties. Please note that no further detailed assessment has been made on these initiatives (as this was also not part of the Terms of Reference). Only 'high level' compliance in terms of additionality, catalyzing private capital, development impact and logics of the business case has been reviewed.

These examples provide a reference basis only for potential investments:

- Private Equity SME Fund in African fragile states – like (Burundi, Central African Republic, Democratic Republic of Congo, Republic of Congo and South-Sudan). Experienced manager to extend to neighboring countries. Need for junior / higher risk tranche to catalyse private investments.

- Innovative data platform – within the agricultural chain all payment data are collected; based on track record and available data, finance to SMEs in the value chain can be provided. Need for additional TA or setting up and Sponsor support and capital.

- Bond issuing platform for SMEs – Pragmatic and simplified bond issue platform for SMEs with standard assessment, forms and legal set-up – TA needed for further development; (temporary) role for supporting purchase of bonds (subordinated capital in fund and/or guarantees)

- African SME Guarantee Fund – Fund is bundling contributions from several parties to provide guarantees (for tenor extension or –partial- credit guarantees) and TA to local banks in relation to SME-lending. Bundling aligned parties delivers higher scale and impact; typically too low returns for DFIs.

- Debt Fund for Sustainable Trade Finance to SMEs in number of developing countries – experienced manager to scale up and further extend current activities. Long-term subordinated capital (which takes small % of potential first loss) needed to catalyse private investments - current fund activities also based on guarantees

- Value Chain Support Fund – in the agricultural chain agreements are established between smallholders and distribution centers / producers – as a pilot the producer will pre-finance the smallholders based on contract – idea to further extend to other food sectors and players and to establish a fund for providing finance. TA needed for further development and capital / (co)sponsor.

- MFI Upscaling Fund targeting various countries – a fund investing in / lending to and providing support to MFIs in their efforts to 'upscale' and include 'the missing middle' SME clients into their client base- TA needed. A first loss guarantee at sufficiently acceptable conditions in order to attract private capital.

- SME Equity Investment Fund with related Advisory Services – experienced sponsor for various of equity SME funds in low-income and fragile economies. Needs catalyzing capital in junior and/or mezzanine tranche in order to facilitate deemed layering of risks by investors

- A multi-country Water Fund providing capital and support to local water SMEs for providing clean and safe drinking water. Core capital / potentially combine with guarantees and key sponsor needed, possibly jointly with TA, clear development impact but hesitant investors (water sector, small-scale, higher risk countries)

- A water and sanitation fund in India, providing capital and support to water and sanitation initiatives in India. Core capital potentially combined with guarantees and TA is needed. Development impact evident but business models need to be proven.

- A Debt fund for supporting and financing low-income housing developers (SMEs) in Southern Africa - with support from experienced housing developer and financier; layered structure -> aim to attract private capital in a sector which has so far been dominated by soft and grant funding

- A fund that covers 'tail end risks' with financing capital assets, i.e. extending on a programmatic base the tenor of loans with financial intermediaries; thereby providing finance for SMEs for capital expansion; in a fund structure a first loss layer would be needed to attract private capital

- A regional agriculture fund with a layered structure investing in and supporting agricultural businesses related to food production and agricultural services

- An innovative platform that connects investors and projects and provides transparent information, by applying innovative technology to create new market infrastructure while providing portfolio management, content and metrics necessary to measure and manage these types of investments

- Trade finance Initiative that will be promoting the inclusion of tier 2 local banks into the global trade finance system by providing guarantees in trade finance transactions such as L/C confirmations, repos and hedging products. As a result the local SME community, primarily banking with the Tier 2 banks, will have cheaper and better access to finance. First loss tranche will act as a risk buffer for the remaining senior funding that is to be provided by development finance institutions

- New financial concept that uses drought index insurance to unlock (micro)finance to smallholder farmers in developing countries. The concept uses satellite evapotranspiration data to insure the repayment of loans provided to farmers, such that the loan is forgiven in case of drought.

5.6. Structural elements of the Fund

Flexible and market-driven

At present, several supporting mechanisms do exist within the Dutch government but also with other governments as well as multilateral and bilateral development-oriented organisations. The success of these mechanisms and pools of funds are mixed. A key element of feedback is that most of the funds are very specific, restrictive in character and bureaucratic in terms of info requirements and processes (quite lengthy). DGGF is looking to support innovative market-driven solutions.

Innovation can't be structured upfront, therefore the Fund should have a significant level of flexibility in order not to rule out opportunities that are not yet identified or developed, i.e. innovative opportunities. Naturally, strict guidelines have to apply to the analysis process and due diligence itself.

In terms of info requirements, the Fund needs to comply with the fact that the key focus is SMEs. In general, SMEs by nature are still developing which is also reflected in the

availability and quality of financial information. This should be accepted and part of the dedicated enterprise support of the Fund should be on developing and professionalizing the finance department and financial information of SMEs.
No stringent requirements are to be set in terms of investment qualifications for SMEs in the underlying investment vehicles. SMEs, particularly in developing countries, are not fully professional yet in many aspects and it should be acknowledged that capital and support are needed to strengthen SMEs. Setting restrictive investment criteria for investments in underlying SMEs undermines the opportunity to make investments.

Open-end fund and investment period

After consultation with BZ it is suggested to re-invest revolving funds in order to create a recurring development impact. Therefore the Fund will have an open-end structure. With the currently assumed EUR 200 to 250 million, the Fund Manager should have an investment period of 5 years and work towards turning around - i.e. selling- all investments within a period of 10-15 years at a 'best effort' basis. However the open-end structure is more in line with the enabling, patient capital approach of the Fund.

Timely and simple approval & reporting processes

Simple and clear approval process with 'lean and mean' Investment Committee (3 to max 5 people) – standardized investment formats should be developed by the Fund Manager and a straight-forward approval process should apply. The Investment Committee should not be too large in size, in order to keep the flexibility to meet up on a regular basis. A pool of independent experts should be available for specific sectors expertise. Approval for Investment Capital should consist of
(i) 'Approval in Principle' by the IC based on a short description of the initiative, compliance with investment criteria and argumentation for investment. On initial approval. the FM can start with commercial due diligence. After successful completion of due diligence->
(ii) Investment Proposal approval by the IC with more detailed analysis of the investment criteria, a full description of the initiative, thorough analysis of the management team/ financials / business plan / development impact / risks and mitigations etc. Certain conditions for commitment and disbursement will be set by the Fund Manager possibly complemented by additional conditions precedent set by the Investment Committee Approvals for the Business / Capacity Development Facility related to an approval for Investment Capital should follow the same two-step approach. Stand-alone proposals for the Facility as well as the Seed Capital Facility could in most cases follow a more simple one-step approach.

In relation to approval of funds for the Business/Capacity Development Support, the Fund Manager should clearly identify and define :

- Enterprise Support – the need for these services within the organization, expected results to be achieved by the support and expected timelines; ability to team up with other initiatives/support given
- Ecosystem Support – what is the purpose of the support provided and how could results possibly be measured, expected timelines
- For the Seed Capital Tranche the argumentation should be clear with regard to reasons for investments, expected nature and results of the piloting as well as the expected progression towards a next step and the potential role of DGGF in this.

Reporting – reporting should include financial, social and environmental reporting parameters with strict guidelines on what needs to be reported. The managers of the underlying vehicles/ funds will very closely monitor their investments and provide support and guidance. Reporting from underlying investments to the Fund should be insightful and timebound. It is suggested to distribute and discuss the management reports (including financial, social and environmental variables) on regular but not too frequent basis, i.e. a 6-months basis. This is a period in which development of underlying investments is clearly visible and meaningful to discuss. Furthermore it should be realized that a three-stage reporting process (DGGF-DGGF investee vehicles- SMEs) takes an enormous amount of time of all parties involved which can't be used on developing, supporting and managing. Due to the triple consolidation, in case of quarterly reports, new reports would only come out towards the end of the next quarter thereby losing its timeliness and effectiveness.

Governance

Analysis of suitable fund structures and related corporate governance as well as a recommendation of the best suitable fund structure and related corporate governance is not part of the Terms of Reference. As part of the mandate for the 'Innovative Finance Fund for Development', some recommendations were made in relation to the corporate governance which in general terms can also be applied to DGGF.

The Fund's operations are governed by a separate Expert Board of Directors that consists of at least a number of independent Directors. The composition of the Board should reflect the required mixture of skills and expertise needed for the innovative fund.

The same applies to the Investment Committee. The IC should be relatively small (3 to 5 people) in order to ensure fast processes and flexibility. Within the Investment Committee, a mixture of different experience and expertise is needed including : (i) investment experience (particularly in Private Equity and Funds), (ii) work and investment experience in development countries, (iii) experiences with working and investing in SMEs, (iv) ability to assess development impact.

In addition to the Board of Directors and Investment Committee, for instance a subcommittee like the Audit and Remuneration Committee could be formed.

The Business / Capacity Development Facility, as indicated by BZ, will not be part of DGGF. This Facility should be a standby facility for which funds are readily available and for which the approval process is in line with the approval process for DGGF.

Two IC-members should be delegated to take decisions on approvals for the Business / Capacity Development Facility. Up to a small amount (let's say EUR 50k per approval) the Fund Manager should be entitled to approve and disburse funds from the B/C DF.

Active aligned Fund Manager

The Fund Manager needs to play an active role in identifying, screening and supporting initiatives and investees. Not only should the Fund Manager play an active role in defining and monitoring uniform guidelines for investees, also the Fund Manager should actively and regularly review the portfolio allocation. In case no applicable opportunities are available for certain sectors or geographies (fragile states), the Fund Manager could link existing

proposals and/or partners. Or alternatively the Fund Manager could also actively provide an initial sponsoring role in developing an investment opportunity, either by own initiative, mandating a partner or via a call for proposal.

The Fund Manager should be remunerated for achieving targets set for financial as well as developmental goals. Thereby a rigorous and targeted management approach of the Fund Manager should be safeguarded. Further details of the remuneration structure are subject to the final investment policy and targets and are to be defined and monitored by the Board of Directors.
A separate additional report will be made with regard to amongst others the pre-qualifications, role and possible set-up of remuneration of the Fund Manager.

Clarity of allocated amount

Based on the allocated amount of capital, the Fund Manager will make a business plan, develop and recruit a team and will have a longer-term focus and strategy for investment of the Fund. As several initiatives still have to be developed or are in different phases of development, the Fund Manager will need several years to invest the funds and provide dedicated support. Uncertainty on the amount of capital available, will mean lack of clarity and resulting less focused plans and will hence decrease the effectiveness of the Fund.

Evaluation

We strongly recommend that an external mid term evaluation of the Fund after a 5-year period will be part of the program. This represents a reasonable time period in which the Fund Manager has been able to build up the investment portfolio and will have some ‘lessons learned’- an interim evaluation is suggested to discuss the status, challenges and possible suggestions for changes or additions going forward. Evaluations should be shared with the Board of Directors.

5.7 Blueprint for social impact measurement and IMVO

Standards

FM should develop a standard social and environmental framework to be used and implemented by all investees. Processes and standards need to be complied with by the investment vehicles and funds in which DGGF invests. The FM should follow the relevant international developments and industry best practices (including IFC Performance Standards, OECD MNE guidelines, World Bank EHS guidelines) and update its ESG framework if needed on a regular basis going forward to make sure its ESG framework and process stays in line with the latest developments. This ESG framework should be integrated in all steps of the credit process (client selection/ DD and approval/ contracting/ monitoring)

Eight performance standards are described in the IFC Performance Standards and are the basis for what the DGGF Investee needs to comply with. As all DGGF’s investees are financial vehicles and funds, a number of standards will not or hardly be applicable to DGGF investees. For each investment an assessment should be made of which elements of IFC Performance Standards are relevant and which are of lesser relevance. Based on this assessment, for the investee managers the focus should be on the standards relevant for the

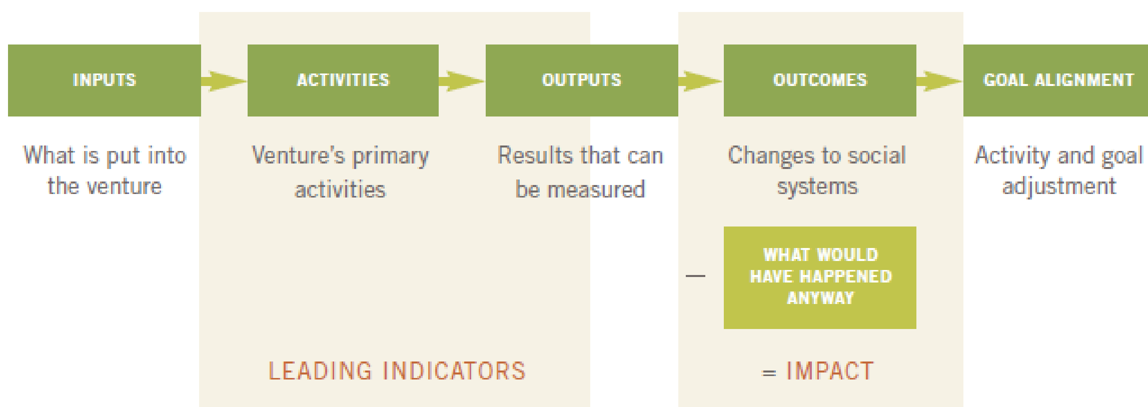
particular investee. Generally this will in most cases at a minimum refer to 'Assessment and Management of Environmental and Social Risks and Impacts' and the related effective Environmental and Social Management System (ESMS), 'Labor and Working Conditions' and 'Community Health, Safety, and Security'.

We recommend a flexible, pragmatic step by step approach, allowing the investee funds and underlying investments time to understand and implement these, in some cases even supported with some training/TA for the FM. It is recommended that agreed milestones to comply with are part of the documentation and relate to commitments and disbursements.
It is recommended by the majority of parties we interviewed that implementation of IFC Performance Standards should be at the DGGF-investee level only. For underlying SME-investments (primarily for bigger investments) a quick scan could be made to assess key risks (if at all). A plan should be made to solve these with a strict monitoring plan. However it is not feasible to request SMEs to comply generally with IFC Performance Standards and to implement an ESMS. These SMEs are not in the position and do not have the time and knowledge to implement these standards and systems. When investing in SMEs , managers should apply to the World Bank Exclusion List.

Impact measurement

Impact measurement should be an integrated part of investment decision, monitoring and reporting. The impact that can be achieved should be an important criteria for investment decisions. Generally, the impact value chain is described as follows (source: GIIN/SVT Group)

Impact Value Chain



As outcomes are generally very difficult to measure and would require complex and expensive tracking systems, our advice is to focus on outputs achieved, also because a lot of general research is already available about the positive correlation between certain outputs and say the Millenium Development Goals (like more jobs lead to more disposable income, which leads to higher spending on sanitation, education and health. Or a better developed financial system leads to more economic growth, leading to better scores on MDGs).
When measuring impact targets, or outputs, there are various existing methodologies that can be used. Below is a summary of a few (source: SVT Group):

Methodology	Pros	Cons
GIIN: IRIS	Standardized; can be tailor-made; accepted by wide community	Subjective if not in combination with independent evaluation
Social Return on Investment	Quantifies / monetizes social impact	Risk of 'creative bookkeeping'
Dalberg approach	Benchmarking against traditional companies	Effects cannot be 'isolated' from what would have happened anyway
Acumen: Portfolio Data Management System	Easy to apply; accepted by handful of companies	Benchmarking against charity
Progress out of poverty index	Measures the real impact on the lives of poor people	For microfinance only

As IRIS is presently developing as the most broadly supported methodology in the impact investing space, we recommended to adopt IRIS. It can also be applied easily across sectors, for a diverse portfolio and the Fund Manager can benefit from further refinement of the methodology by GIIN (the network behind IRIS).

To track impact achieved for the Fund we have developed a draft balanced scorecard that could serve as an example/blue print and which can be made final in consultation with the selected Fund Manager. The scorecard could also serve for yearly evaluation of performance of the Fund and the Fund Manager. The scorecard should consist of short term and long term financial and social targets (both quantitative AND qualitative). Donors and impact investors alike increasingly not only expect impact measurement to be an integrated part of any impact investment initiative, it is also more and more often requested to think about tying remuneration to impact targets achieved. As the Fund wants to play a demonstration role, our advice would be to ty part of the performance related remuneration of the FM to social impact achieved.

Example of a balanced scorecard for impact measurement of the Fund with sector neutral indicators as well as some potential indicators for SME cross sector, for access to water and sanitation, agriculture or health services.

Indicator	Target for the fund over the full time
Countries in which investee funds/vehicles operate have a GDP/capita of more than USD 1,500/year but less than USD 2,500/year at the moment of investing	5 investees
Countries in which investee vehicles operate have a GDP/capita of less than USD 1,500/year at the moment of investing	5 investees
Average annual employment growth in investees/ultimate beneficiaries above average annual national employment growth in country	75% of investees (only for investment funds directly investing in SMEs)
Average annual revenue growth in investees/ultimate beneficiaries above average annual GDP growth in country	75% of investees (only for investment funds directly investing in SMEs)
Number of SMEs reached plus amount of private capital catalysed	1000 Minimum mulltiplier of 2
For specific water initiatives - Number of households reached with access to water and sanitation	100,000
For agricultural investments - Number of farmers reached with access to affordable financing that have an annual revenue of less than USD 5,000 per year	100,000
Number of people served by social infrastructure investments like hospitals or	50,000

schools which have an annual household income of less than USD 2,500/year	

Which targets the Fund will set is dependent on the final choices for geography and sub sectors and it should be realistic given the investment pipeline of the selected Fund Manager (and reflecting the impact of the innovative initiatives). The indicators should be made final in close coordination with the selected Fund Manager, not too many indicators should be used and be measured once a year to the maximum to keep it practicable and workable. We are listing below a few indicators for various sectors, on top of what has been mentioned above in the example balanced scorecard. Efforts such as GIIRS and IRIS give a taxonomy to benchmark how firm level outputs contribute to social impact for various sectors:

SME – cross sector:

- Average revenue growth rate of SMEs in relation to the local GDP growth rate in the country where they operate
- Increase in added value per job created – increase in wages/health-pension benefits.
- Average employment growth rate in relation to the national employment growth in country of operation
- Number of jobs to low skilled workers
- Number of jobs in rural areas
- Number of jobs to female workers
- Number of employees that receive health and/or pension benefits
- Percentage of companies that have provided training to employees
- Impact of growing SMEs on their local economies – for every USD invested, on average, an additional XX in the local economy is generated

Agriculture:

- Sustainable cultivated land area → hectares directly controlled by the investee under sustainable cultivation → number of hectares created
- Number of smallholders associated with the enterprise through purchase contracts
- Number and average wage of people employed above a certain benchmark (say official minimum wage in a country)
- Presence of support programs for small holders like sustainable supply chains, affordable housing programs, access to education for kids, day care for siblings or health programs by the investee

Water:

- Potable Water Production Capacity → Potable water production capacity per unit over the lifetime of the product * number of products sold →reporting on number of liters brought to market
- Number of households with access to a piped water network

Based on the plans of the selected fund manager, appropriate targets for the fund as a whole and annual targets can be set. It would not be appropriate to define them now, without an investment pipeline that underpins validity.

BZ in close coordination with the selected FM should decide which criteria used per focus sector/country. It is important that the criteria are easily measurable (data collection not too difficult, not too many criteria etc.), transparent and clear

All the above indicators measure the impact at firm/fund level and not the positive externalities firms may create for the sector as a whole. Although more difficult to measure, this type of impact is very relevant for the DGGF and represents an important additional impact outcome. For example, a fund may be a first entrant in a market where regulatory structures are weak, management talent scarce, and the business model untested etc. While it may not be able to reach millions of people, the new entrants efforts may develop a new model that lowers the risk and makes possible the entry of others that in turn can reach the people. In assessing the social impact of the Fund both the direct impact of the SMEs plus indirect sector level impact of the Fund should be included (f.i. number of firms/people reached for trainings, number of companies and associations affected).

5.9 Financials

We have developed a high level financial model which provides further insight in the type of investments, returns and costs of DGGF. Naturally the results are fully dependent on the assumptions and input. Therefore this model cannot be seen as a definite blueprint for a model for the Fund but as an insight in a potential set-up and financials of the Fund and a basis for exploring sensitivities.

Most likely the Fund Manager will build and use its own financial model for the Fund.

Some of the important assumptions for the simplified DGGF-model are:

- We have filled in the assumptions sheet based on what we feel is reasonable (on the basis of Goodwel's own experience in fund management) and reflective of what the government has in mind with the Fund;
- Investments are made on an indirect basis, either in funds, vehicles or other applicable financial intermediary structures
- In the model, investments are made by means of a mixture of equity / mezzanine; even in debt vehicles due to the risk mitigating nature of the DGGF funding, an investment is deemed to be risk capital. For simplicity, no straight forward guarantees are included
- The model is multi-sector, multi-instrument and has various return assumptions for different types of investments (on a conservative basis)
- In total 16 investments are included in the model, of which the majority is in fund structures
- The model is for the Investment Capital facility and provides insight in financial returns only.
- Funds related to Business / Capacity Development Support are not included.
- For simplicity sake, a closed-end model has been used with an investment period of five years and a maturity of 15 years. Returning funds, as included in the model, can in practice be used again for investments within an open-end fund structure.
- A number of 6 investments is assumed to be not successful (reflecting approximately a quarter of all investment capital) and nothing or only part of these investments will be recovered

- A Management Fee of 2,5% has been used in the model with a simplified carried interest structure; set-up costs estimated at 1% of the Investment Capital Facility.
- A simplified carried interest calculation has been used, for simplicity sake based on financial returns only

The main conclusion is that for the Investment Facility, DGGF can have a revolving nature with an expected return in lower single digit numbers (expected range 2 to 5%).

ANNEXES

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Annex 1

QUICK ANALYSIS SCORECARD - EXAMPLE

DUTCH GOOD GROWTH FUND - LOCAL SME

Fund size EUR m: 200

INVESTMENT PRINCIPLES AND RESTRICTIONS

NAME INVESTMENT
TARGET GROUP
REQUESTED AMOUNT IN EUR m
TYPE OF CAPITAL
EXPECTED RETURN
TENOR / MATURITY
SPONSOR
COUNTRY
REGION
CURRENCY
SPECIFIC SECTOR
DESCRIPTION
GENERAL CLASSIFICATION (IMPACT AND FINANCIAL)

	Restriction	Current
Single Client Exposure	*10%*	
Threshold for investment		
Single Sponsor Exposure	*20%*	
Regional Exposure	*40%*	
Single Currency Exposure	*15%*	
Single Sector Exposure	*30%*	

Note: Score (1=high, 2= medium, 3 = low)

ADDITIONALITY
- Clarity that no private investor has stepped in and/or will do shortly
- Have similar investments in the region and sector materialised?
- Other - similar - propositions in the planning?

CATALYSING PRIVATE CAPITAL
- Amount of expected private capital to be raised at vehicle level
- Expected leverage at investment vehicle level - final close
- Capital raised at first closing and leverage - first close
- Interest shown so far by private investors

INNOVATION
- Nature of innovation
- Partnerships in place and/or to be established
- Future competiton / other players

FINANCIAL VIABILITY
- Realistic business plan (fianncially viable, realistic growth plans, key risks and impact of sensitity analysis)
- Cost at fund / vehicle level in line / reasonable?

MANAGEMENT
- Commercial investment experience, combining financial and social returns
- Experience in 'hands-on' investing and exits
- Fund management experience
- Diversified team
- Local prsence and network - how assured?
- Ability and willingness to implement ESG-framework
- (if applicable) sector knowledge; if not, how solved (if applicable)

DEVELOPMENT IMPACT
SME-level
Key development returns — *Quantified*
Employment — *new jobs*
Growth investment vs national GDP
……………..

Sector-level
Employment — *new jobs*
……………..

E&S- Framework
Compliance IMVO guidelines
Framework at fund/vehcile level
Applicability to underlying SMEs - foreseen approach

SUPPORT REQUIRED
Type

Funds from TA -facility / other funds for TA

STRENGHTS

KEY RISKS AND MITIGATIONS

GENERAL CONCLUSION

Annex 2

INTERVIEWED PARTIES

INVESTORS

ING – ROY BUDJHAWAN

RABOBANK – HANS BOOGAARD

MARIANNE VAN DUIN

TRIODOS – KOERT JANSEN

CORDAID- HENRI VAN EEGHEN

INNOVATIVE PROJECTS

PHARM ACCESS – ONNO SCHELLEKENS

TCX- JOOST ZUIDBERG

XSML- JARL HEIJSTEE

BID NETWORK- THIERRY SANDERS

DEVELOPMENT FINANCE INSTITUTIONS

FMO – FREEK VAN DEN BOSCH

RUURD BROUWER

MAARTJE HERMANS

IFC (UNIT BLENDED FINANCE) – PEER STEIN, WENDY TELEKI

OTHER

FORMER CEO FMO – ARTHUR ARNOLD

Annex 3

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Annex 4

DGGF - FIN MODEL **ASSUMPTIONS**

The Fund is open-end, i.e. with a continuous process of revolving funds and re-investments.
For simplication purposes, a 15 year time horizon has been used in this financial model

Units per million	1.000.000	EUR		
General assumptions				
Total Fund Target	200.000.000	EUR		
Total invested capital	85%	of total fund	=	170.000.000 EUR
Interest on cash	1%	annually		
Annual drawdown for fees	1	per year		
Cash reserve	100.000	USD		
Expense assumptions				
Administration	0,35%	of total fund size		
Audit	100.000	EUR		
Legal	100.000	EUR		
Pre-operational expenses	1,00%	of total fund size		
Due diligence	20.000	EUR		
Commitment fee to debt investors	0,0%			
Fee assumptions				
Management fee - investment period	2,5%	of committed capital		
Management fee - monitoring period	2,5%	of outstanding invested capital		
Hurdle rate	4%			
Carry to Fund Manager	20%			

Expected return	Vehicles	Fund	High DI
Finance	14%	12%	5%

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DUTCH GOOD GROWTH FUND - LOCAL SME — **SUMMARY SHEET** — *in EUR millions*

	Year 1 2014	Year 2 2015	Year 3 2016	Year 4 2017	Year 5 2018	Year 6 2019	Year 7 2020	Year 8 2021	Year 9 2022	Year 10 2023	Year 11 2024	Year 12 2025	Year 13 2026	Year 14 2027	Year 15 2028	Total
Fund Inflows																
From Investors	30,1	44,9	53,8	41,4	28,8	0,7										**199,7**
From Investees	-	-	-	-	1,9	5,2	12,6	18,2	22,5	39,0	27,8	22,5	22,5	109,4	17,4	299,0
Interest income	-	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,3
Total inflows	30,1	45,0	53,8	41,4	30,7	5,9	12,6	18,2	22,5	39,0	27,8	22,5	22,5	109,4	17,4	499,0
Fund Outflows																
Investments	23,0	39,0	47,8	35,4	24,8	-										170,0
Administration		0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	9,8
Audit expenses		0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	1,4
Legal expenses		0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	1,4
Pre-operational Expenses	2,0															2,0
Due diligence		0,1	0,1	0,1	0,0	-										0,3
Management fee - investment period		5,0	5,0	5,0	5,0	5,0										25,0
Management fee - monitoring period							4,0	3,7	3,4	2,9	2,3	2,0	1,7	0,9	0,3	21,2
Total investment, expenses, and fees	25,0	45,0	53,8	41,4	30,7	5,9	4,9	4,6	4,3	3,8	3,2	2,9	2,6	1,8	1,2	231,1
Beginning balance		5,1	5,1	5,1	5,1	5,1	5,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	
Net inflow (outflow)	5,1	-	-	-	-	-	7,7	13,5	18,2	35,3	24,6	19,6	19,9	107,6	16,3	
Cash available	5,1	5,1	5,1	5,1	5,1	5,1	12,8	13,6	18,3	35,4	24,7	19,7	20,0	107,7	16,4	
Cash reserve	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	-	
Cash available for disbursement	5,0	5,0	5,0	5,0	5,0	5,0	12,7	13,5	18,2	35,3	24,6	19,6	19,9	107,6	16,4	
Equity repayment							12,7	13,5	18,2	35,3	24,6	19,6	19,9	107,6	16,4	
Carry to GP							-	-	-	-	-	-	-	-	-	
Ending cash balance	5,1	5,1	5,1	5,1	5,1	5,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	(0,0)	
Return estimates																**IRR** **3,3%**
Investors																
Cash flows investor	*(30,1)*	*(44,9)*	*(53,8)*	*(41,4)*	*(28,8)*	*(0,7)*	*12,7*	*13,5*	*18,2*	*35,3*	*24,6*	*19,6*	*19,9*	*107,6*	*16,4*	*68,1*

DUTCH GOOD GROWTH FUND - LOCAL SME — **INVESTMENT SHEET**

Fund investment schedule

Business concepts / vehicles		*Year 1*	*Year 2*	*Year 3*	*Year 4*	*Year 5*	*Year 6*	Allocation of total	Amount mio	Number of Repayment	Exit year	Industry	Industry return	Other risk premium	Return assumption	Success investment	Recovery rate
Vehicle 1	-	50%	50%					6,25%	10,6	1	15	Finance	14%	0%	0,0%	**Un-successful**	**25%**
Vehicle 2	-		50%	50%				6,25%	10,6	1	14	Finance	14%	0%	14,0%	Successful	100%
Vehicle 3	-			100%				6,25%	10,6	1	14	Finance	14%	0%	14,0%	Successful	100%
Vehicle 4	-				50%	50%		6,25%	10,6	1	15	Finance	14%	0%	0,0%	**Un-successful**	**25%**
Vehicle 5	-				50%	50%		6,25%	10,6	1	15	Finance	14%	0%	0,0%	**Un-successful**	**0%**
										1	15	Finance	14%	0%	0,0%		
										1	15	Finance	14%	0%	0,0%		
								31%	53,1								

Fund investments										Grace Period	Exit year	Industry	Industry return	Other risk premium	Return assumption	Success investment	Recovery rate
Fund 1	-	33%	33%	33%				6,25%	10,6	3	13	Finance	12%	0%	12,0%	Successful	100%
Fund 2	-	33%	33%	33%				6,25%	10,6	3	13	Finance	12%	0%	12,0%	Successful	100%
Fund 3	-		33%	33%	33%			6,25%	10,6	3	14	Finance	12%	0%	0,0%	**Un-successful**	**50%**
Fund 4	-		33%	33%	33%			6,25%	10,6	3	14	Finance	12%	0%	0,0%	**Un-successful**	**50%**
Fund 5	-		33%	33%	33%			6,25%	10,6	3	14	Finance	12%	0%	12,0%	Successful	100%
Fund 6	-			33%	33%	33%		6,25%	10,6	3	15	Finance	12%	0%	12,0%	Successful	100%
Fund 7	-			33%	33%	33%		6,25%	10,6	3	15	Finance	12%	0%	12,0%	Successful	100%
Fund 8	-			33%	33%	33%		6,25%	10,6	3	15	Finance	12%	0%	12,0%	Successful	100%
Fund 9				33%	33%	33%		6,25%	10,6	3	15	Finance	12%	0%	12,0%	Successful	100%
										3	15	Finance	12%	0%	0,0%		
										3	15	Finance	12%	0%	0,0%		
										3	15	Finance	12%	0%	0,0%		
										3	15	Finance	12%	0%	0,0%		
								56%	95,6								

High developmental investments										Investment horizon	Number of incoming pmt	Payment percentage: 1st pmt	2nd pmt	3rd pmt	4th pmt		Return assumption	Success Investment	Recovery rate
High Dev 1	-	100%						6,25%	10,6	9	1				100%	0%	5,0%	Successful	100%
High Dev 2	-		100%					6,25%	10,6	9	1				100%	0%	0,0%	**Un-successful**	**50%**
								13%	21,3										
TOTAL								**100%**	**170,0**										

goodwell
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DUTCH GOOD GROWTH FUND - MODEL — **MAIN SHEET** — *in EUR millions*

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Investors															
Investor Commitment schedule	100%	0%													
Equity investor	200,0	-	100%												
Capital beginning balance															
Equity	200,0	169,9	124,9	71,2	29,8	1,0									
Commited capital	200,0	169,9	124,9	71,2	29,8	1,0									
Capital required	30,1	44,9	53,8	41,4	28,8	0,7									
Capital disbursed															
Equity investor	30,1	44,9	53,8	41,4	28,8	0,7									
	-	-	-	-	-	-									
Capital disbursed	30,1	44,9	53,8	41,4	28,8	0,7									
Capital ending balance															
Equity	169,9	124,9	71,2	29,8	1,0	0,3									
Commited capital	169,9	124,9	71,2	29,8	1,0	0,3									
DGGF															
Beginning balance		5,1	5,1	5,1	5,1	5,1	5,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Capital inflow from investors	30,1	44,9	53,8	41,4	28,8	0,7									

Outflows to investments	2014	2015	2016	2017	2018	2019	Total
Vehicle 1	5,3	5,3	-	-	-	-	10,6
Vehicle 2	-	5,3	5,3	-	-	-	10,6
Vehicle 3	-	-	10,6	-	-	-	10,6
Vehicle 4	-	-	-	5,3	5,3	-	10,6
Vehicle 5	-	-	-	5,3	5,3	-	10,6
	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
Fund 1	3,5	3,54	3,5	-	-	-	10,6
Fund 2	3,5	3,54	3,5	-	-	-	10,6
Fund 3	-	3,5	3,5	3,5	-	-	10,6
Fund 4	-	3,5	3,5	3,5	-	-	10,6
Fund 5	-	3,5	3,5	3,5	-	-	10,6
Fund 6	-	-	3,5	3,5	3,5	-	10,6
Fund 7	-	-	3,5	3,5	3,5	-	10,6
Fund 8	-	-	3,5	3,5	3,5	-	10,6
Fund 9	-	-	3,5	3,5	3,5	-	10,6
	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
	-	-	-	-	-	-	-
High Dev 1	10,6	-	-	-			10,6
High Dev 2	-	10,6	-	-			10,6
Total outflows	23,02	38,96	47,8	35,4	24,8	-	170,0

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Inflows from investments															
Vehicle 1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,7
Vehicle 2	-	-	-	-	-	-	-	-	-	-	-	-	-	48,0	-
Vehicle 3	-	-	-	-	-	-	-	-	-	-	-	-	-	44,9	-
Vehicle 4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2,7
Vehicle 5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Fund 1	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0	-	-
Fund 2	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0	-	-
Fund 3	-	-	-	-	-	0,2	0,4	0,7	0,7	0,7	0,7	0,7	0,7	0,7	-
Fund 4	-	-	-	-	-	0,2	0,4	0,7	0,7	0,7	0,7	0,7	0,7	0,7	-
Fund 5	-	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0	-
Fund 6	-	-	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0
Fund 7	-	-	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0
Fund 8	-	-	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0
Fund 9	-	-	-	-	-	-	0,9	1,9	3,0	3,0	3,0	3,0	3,0	3,0	3,0
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
High Dev 1	-	-	-	-	-	-	-	-	-	16,5	-	-	-	-	-
High Dev 2	-	-	-	-	-	-	-	-	-	-	5,3	-	-	-	-
Total inflows	-	-	-	-	1,9	5,2	12,6	18,2	22,5	39,0	27,8	22,5	22,5	109,4	17,4
Expense schedule															
Administration		0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7	0,7
Audit expenses		0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Legal expenses		0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Pre-operational Expenses	2,00														
Due diligence		0,1	0,1	0,1	0,0	-									
Total Expense	2,00	1,0	1,0	1,0	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9	0,9
Management fees															
Management fee - investment period	5,0	5,0	5,0	5,0	5,0	5,0									
Carve out High Dev 1		-	-	-											
Carve out High Dev 2		-	-	-											
Management fee - monitoring period							4,0	3,7	3,4	2,9	2,3	2,0	1,7	0,9	0,3
Carve out High Dev 1							-	-	-	-	-	-	-	-	-
Carve out High Dev 2							-	-	-	-	-	-	-	-	-
Net management fee	5,0	5,0	5,0	5,0	5,0	5,0	4,0	3,7	3,4	2,9	2,3	2,0	1,7	0,9	0,3
Other income															
Interest on net management fee		0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Interest on cash reserve		0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Interest income		0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Cash available	5,1	5,1	5,1	5,1	5,1	5,1	12,8	13,6	18,3	35,4	24,7	19,7	20,0	107,7	16,4