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# ON THE FRONTIERS OF FINANCE

Scaling up Investment in Sustainable Small and Medium Enterprises  
in Developing Countries

# Foreword

If the global financial crisis teaches us one thing, it is that the world of investment must adapt to the concept of sustainability. By this, I mean sustainable production and consumption of goods as well as sustainable financial returns.

Thanks to short-sighted financial practices that fueled a bubble in unsustainable consumption built on shaky investments, the global economy is faltering, investment has virtually dried up, and millions of people are sinking into poverty, especially in emerging and developing countries.

When the smoke finally clears, the losses have been written off, and government leaders complete their work to fix the flaws in our global financial system, investment will again begin to flow. But what type of investment paradigm will emerge from the ashes? We hope that the environmental and social dimensions of investment will take their rightful place alongside financial returns.

This is important for all countries, but there is a unique opportunity to make changes in emerging market economies where growth is projected to boom and investment practices and institutions are being established. These economies have been hard hit with the rest of the world in the economic slowdown, which has affected many forms of investment, including the investment capital that is so vital to small, innovative enterprises. These companies are engines of growth and innovation, and the entrepreneurs behind them can bring new technologies and business models to the market that can provide solutions to environmental and social problems.

Fortunately, a number of positive developments suggest a better path forward. First, there is increasing recognition of business as an effective means to achieve social missions. The volume of microfinance loans, for example, has increased significantly in recent years. In 2006 when Bangladeshi banker and economist Muhammad Yunus and his Grameen Bank received the Nobel Peace Prize, the award was a recognition of the power of socially-oriented investments to produce stable financial and social returns. Indeed, social and environmental benefits may enhance financial returns.

The emergence of new socially-focused investment vehicles looking for “triple bottom line” results and a growing social enterprise community with deepening networks is another encouraging sign. Importantly, world demand for environmental goods and services is rising, both from consumers and large businesses looking to “green” their supply chains, resulting in growing and vibrant markets for sustainability-focused entrepreneurs. Nothing better illustrates this phenomenon than the booming growth in demand for, and investment in, clean energy technologies that can help us achieve low carbon economic growth.

Entrepreneurs, private investors, and market-based approaches to development will not solve all of the world’s problems, but together with the public sector, the private sector can play a vital role in providing intellectual and financial capital. In this report we analyze the current landscape and lending practices of financial intermediaries providing capital to entrepreneurs in developing countries. We also describe the key barriers to entrepreneurial growth and success, notably access to finance and business development support. The insights and recommendations in this report are intended to foster greater and more effective investment in this new generation of companies that provide environmental and social benefits while also producing solid financial results.

Jonathan Lash  
President, World Resources Institute

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# Executive Summary

## Sustainable SMEs: The Future for Emerging Economies

Small and medium enterprises (SMEs) play a critical and well documented role in both developing and industrialized economies. They drive innovation, spur economic growth, create jobs, and facilitate the provision of goods and services.

### What Are Sustainable SMEs?

This report defines sustainable SMEs as those whose core business produces a *triple bottom-line* return—that is, social, environmental, and financial gains—and therefore contribute to dynamic, healthy economies and societies. Such enterprises tend to be of two types: those that use natural resources responsibly, such as organic agriculture, sustainable forestry, and ecotourism; and those that offer substitutions or solutions for otherwise resource-intensive products or services, such as clean technology, renewable energy, and new materials. In this report, SMEs refer to enterprises that are legally formed and operate within the formal economy. As defined by the International Finance Corporation (IFC), a small enterprise employs between five and 49 people, and a medium enterprise employs between 50 and 250 people.

Sustainable SMEs are those that manufacture and market environmentally friendly products and/or serve low-income communities and generate additional benefits for society and the environment. Financing such value-added businesses in emerging economies makes sense for both business growth and sustainable development. In developing countries, however, sustainable SMEs face major barriers to growth and success, most notably access to finance and business development support.

Over the past decade, specialized financial intermediaries—generally, those that are international, often with a non-profit organizational structure—have emerged to provide finance and business development support to sustainable SMEs in the developing world. This investment community has grown significantly in recent years, along with the rising interest in green investment, clean technology industries, and market-based approaches to poverty reduction and sustainable development.

“On the Frontiers of Finance” provides an overview of the current landscape, lending practices, and principal challenges of financial intermediaries providing capital to sustainable SMEs in developing countries. The objective is to help stimulate greater and more effective sustainable SME investment by better understanding how the sector can best be supported and expanded.

### INVESTMENT LEADERS SURVEY

In 2007, WRI and Boston College, with support from the International Finance Corporation (IFC), gathered together and interviewed 20 leading sustainable SME investment fund managers from Africa, Asia, Eastern Europe, and Latin America. Our discussions focused on challenges, opportunities, best practices, and pathways to sectoral growth, which forms the basis of this report. Section 3 and the appendix are overviews of these funds and their investment models.<sup>1</sup>

In reporting our findings, we have divided the interviewees into two broad categories:

- *Blended Capital Intermediaries*—investors with a primary focus on creating positive economic, social, and environmental impact by supporting sustainable SMEs and generating financial returns for investors.<sup>2</sup> These are mostly non-profit entities with an international focus, and tend to be based in the U.S. or Europe;



- *Venture Capital Funds (VC Funds)*—investment vehicles that are for-profit, commercial entities that provide market returns. This report examines VC funds in developing countries, those that are tapping into opportunities in green or socially oriented markets, such as cleantech funds.

Our survey revealed the intermediaries face three major challenges: raising funds for what remains an outlying frontier of the finance and development mainstream; justifying to the intermediaries' investors the high costs of technical assistance for businesses; and finding ways to capture the “added value” of positive social and environmental impacts both cost-effectively and consistently across the sector.

### The Aspen Network for Development Entrepreneurs (ANDE)

ANDE is an association of financial intermediaries, technical assistance providers, funders and experts focused on investment in the “small and growing business” sector in developing countries. The members joined forces to create a movement that seeks to spotlight the potential of SMEs in developing countries within both the international development agenda and commercial investment arena. ANDE's vision is to dramatically increase the amount and effectiveness of capital and technical/business assistance for entrepreneurs in developing countries.

Housed in the Aspen Institute, ANDE is a platform through which members can tackle system-wide challenges that can only be addressed through collective action. The member driven group identifies strategic challenges and opportunities in the small and growing business sector and addresses them through concerted action and by creating information and tools that benefit the sector at large.

ANDE's founding funders include The Bill and Melinda Gates Foundation, Citi Foundation, The Lemelson Foundation, Omidyar Network, The Rockefeller Foundation, The Skoll Foundation and Shell Foundation.

## RECOMMENDATIONS

- *Improve Capital Allocation:* Educating commercial investors and grant funders about the business models and performance of SME financial intermediaries, combined with high standards of accounting transparency among the intermediaries would greatly improve the efficiency of the fundraising process. Compiling information about the financial viability and success of different intermediaries and highlighting the growing track record of commercially viable investments is crucial in order to attract further capital to the sector.
- *Promote Financial Innovation:* Long-term approaches and innovative thinking focused on system-wide barriers are needed to move the sector toward the status of both a recognized investment class and a strategic priority area within the development community. Sector-wide initiatives, angel investor networks and experimentation with social stock exchanges are efforts in the right direction that need to be supported and where successful, replicated and scaled.
- *Capture the Triple Bottom Line:* As more investors and donors enter the impact investing space, they will focus even more on demonstrable results and measurable effects. Smart, comparable metrics would facilitate the investment decision-making process by providing a clear picture of which intermediaries' activities are best aligned with the priorities of impact-driven donors and investors. For this reason, comparability is paramount when measuring and communicating impact. Dedicated resources and a collaborative effort among leading intermediaries, investors, donors, and other stakeholders is required to move toward a shared standard methodology for impact measurement and reporting. Over time, aggregate results will help validate and evaluate the efficacy of the enterprise development community's market-based approach to socioeconomic and environmental issues.

Both development and investment trends are leading major advances in sustainable SME financing. The scale and speed of these advances are not, however, meeting either the demand of local entrepreneurs or the urgency of the social and environmental challenges facing the world. Opportunities to achieve development and environmental goals while delivering financial returns are being missed.

We hope this report will inspire investors, financial intermediaries, the philanthropy and donor community, and enterprise development organizations to increase capital flows and improve capital deployment to sustainable SMEs in developing countries.

# 1. Why Invest in Sustainable SMEs?

The number of specialized financial intermediaries providing finance and business development support to sustainable SMEs in the developing world is growing. More than half the funds we examined for this report were established after 2004, with new funds continuing to be created around the world.

This growth is particularly evident in commercial investment firms establishing specialized “cleantech” or “Base of the Pyramid (BoP)” funds<sup>3</sup> and mission-driven organizations experimenting with blended value structures. The growing interest and increase in sustainable SME investment activities are largely due to the following converging trends:

- Greater recognition by the international development community that market-based approaches to poverty alleviation and sustainable development can both work and achieve high leverage for the aid money invested.
- Increasing investment and business interests in emerging and developing countries.<sup>4</sup>
- The emergence of more sophisticated and competitive financial markets in developing countries.
- Growing interest in “green” industries, particularly in energy-related sectors.
- The international development community’s and commercial investment sector’s new interest in enterprises oriented toward social development (a trail blazed by the microfinance sector’s success in connecting to mainstream financial institutions).

## A TRIPLE PAYOFF: ECONOMIC, SOCIAL, ENVIRONMENTAL

*Sustainable SMEs* capitalize on commercial opportunities while generating environmental and social benefits as part of their core business. They help protect the environment, alleviate poverty, and generally improve the quality of life, particularly for rural communities, where the majority of poor people live.<sup>5</sup> Sustainable SMEs also offer innovative business models to shift to more sustainable economic development. The substantial benefits provided can be divided into economic, social and environmental categories:

*Economic benefits:* Monetary benefits like employment and wages, taxes paid, cost savings, and the overall enhancement of the economic environment.<sup>6</sup>

Despite their small size, SMEs have a significant impact on economic development, by employing local, low-skilled labor and investing in their training. SMEs also help formalize local economies by creating companies that, unlike most microenterprises, pay taxes. In addition, they serve as a fundamental link in the supply chain between small-scale producers and urban, national, or export markets. And they often operate in underdeveloped markets—in rural or impoverished urban areas—that lack the infrastructure to support larger-scale public or business activity.

### Box 1. Case Study: Organic Opportunities for Marginalized Communities in Bolivia

Fideos Coronilla, a company based in Bolivia, produces organic, gluten-free snacks made from traditional Andean grain. The company purchases the grains from local farmers' cooperatives, directly benefiting 6,800 farmers and their families. One of Coronilla's inputs, the rare Andean grain cañawa, is grown in isolated areas of the country. These remote regions are inhabited by the poorest of the poor, and the grain sales to Coronilla significantly improve their living standards.

Coronilla provides employment and benefits, such as health care, milk subsidies, and formal education, to more than 30 workers, many of whom are female and have few skills. The company contributes to a local educational organization, coordinates educational meetings on health and hygiene, and sponsors a student award. As a result, Coronilla's employees are healthier than the average local worker, and their children have more opportunities to lead healthier and more productive lives.<sup>1</sup>

1. Small Enterprises Assistance Fund, *The Development Impact of Small and Medium Enterprises: Lessons Learned from SEAF Investments* (Washington DC: Small Enterprises Assistance Fund), July 2004), vol.2, p. 13.

*Social benefits:* Improvements in the quality of life of SME clients and suppliers who gain access to previously unaffordable or inaccessible products and services.

Compared with larger companies and multinationals, small and medium enterprises often rely heavily on their local community for products, employees, and their customer base. As a result, they have a vested interest in the community's well being, so SMEs often invest in local education, health, and infrastructure. Furthermore, such businesses are well placed to understand market opportunities that address unmet local needs, such as access to clean water, health services, and housing or that empower low-income people through such means as microfinancing or affordable telecommunications. SMEs are well positioned to engage low-income communities as producers, for instance, through agricultural cooperatives (see box 1).

*Environmental benefits:* Reduced energy and resource consumption, land and species conservation, improved air and water quality, among others.

In many sectors—clean technology, renewable energy and energy efficiency, organic agriculture, certified forestry, ecotourism, and green construction—market opportunities have emerged based on business solutions to environmental challenges. Sustainable SMEs are flexible market participants with little sunk cost in a particular technology or sector, with, perhaps, the exception of organic or fair-trade certification. SMEs thus are often the first to take advantage of new opportunities and then to drive the market through technology or business model innovations. Often, environmentally sound products are particularly relevant for developing country conditions. For example biomass, solar, small hydro or wind energy can be well suited to provide electricity in rural and off-grid communities and in the process reduce the unhealthy and environmentally damaging use of firewood and charcoal (see box 2).

### Box 2. Case Study: Small Hydro in the Himalayas

Entrepreneur S.K. Sharma and his company provide Small Hydro Power (SHP) hydroelectric power to villages with access to flowing water in the Himalayan Belt of northern India, where more than 50 percent of households have no access to electricity. The quality of grid power, where available, is poor and erratic due to inadequate transmission infrastructure. These mountain communities are rich in water resources, however, making them excellent sites for small hydro projects.

SBA Hydro has designed a number of new turbines that are appropriate for the Indian small hydro environment and have been customized

to reduce cost and raise output efficiency. By tailoring each project to a community's skills, construction practices, and locally available materials, SBA Hydro provides clean and cost-effective hydro energy to rural areas that otherwise wouldn't have electricity. The communities control the power generation and operate the facilities as commercial vendors. After meeting their own energy needs, they supply surplus electricity to the state utility for use by towns and commercial users. The decentralized power plant network ensures a supply of electricity to marginalized communities and offers improvements in education, health facilities, local enterprises, and infrastructure.



## 2. Financing Sustainable SMEs in Developing Countries: An Overview

### 2.1 UNDERSTANDING THE FINANCING GAP

In most countries, SMEs have difficulty securing financing because they often do not have the necessary systems in place to provide transparent information to investors or lenders and cannot supply the high collateral requirements that banks require for the higher risk. In addition, SME financing has a high fixed cost because the deal size is relatively small. In well functioning financial systems, however, SMEs will have a range of financing options and support services as they grow.

For example, a typical SME in the United States starts with a combination of personal savings, contributions from friends and family, and debt from banks, ranging from start-up funds from angel or venture capital investors to traditional bank loans. As the business's needs change, it can draw on additional sources of capital, including trade finance, factoring, leasing arrangements, commercial debt, private equity, and, ultimately, an initial public offering.<sup>7</sup> Each of these options brings firms into contact with different financial actors and sources of capital. The ability to graduate successfully from one form of financing to the next is critical to SME success.

In contrast, SMEs in developing countries typically operate in a much less supportive environment. Entrepreneurs often depend on friends and family (limited availability of capital) and money lenders (charging high interest rates) to get their business started. The opportunities to tap into formal financial services are much fewer than in developed economies. Regarding debt finance, SMEs are often too large for microfinance institutions and too small for commercial lenders in addition to lacking the collateral required by banks. For the large majority of local banks small business finance is regarded as an unattractive business as their perception is characterized by high risk and transaction costs. While not completely inaccurate, this perception results from a mismatch between banks' requirements and the accounting and management practices common among SMEs, as well as a lack of suitable credit scoring mechanisms for small businesses.<sup>8</sup> For sustainable SMEs the hurdles are even higher. Banks are particularly reluctant to support businesses in rural areas, where many sustainable SMEs are located, and in relatively new product sectors such as organic farming or renewable energy generation.

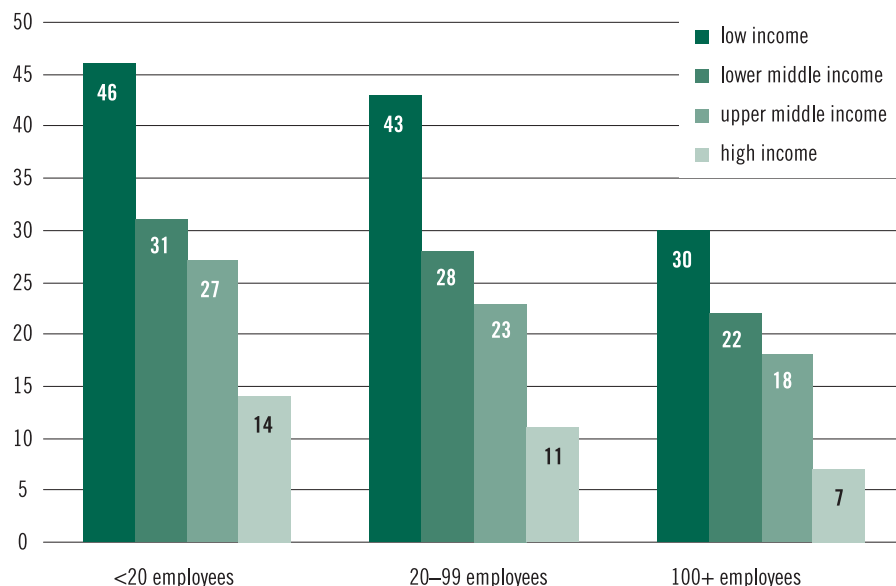
The alternative to bank loans, private equity finance, is seldom available for amounts under US\$2 million and thus is an option only for the largest SMEs in developing countries. Furthermore, most developing countries' capital markets are not developed enough to offer relatively secure exit routes for private equity investments, making this an even less attractive option for financiers.

Exploring opportunities in the SME sector and in emerging “green” and social markets is further discouraged by the investment environment in many developing countries: low competition among local banks, a deficient institutional infrastructure in the finance sector, restrictions on capital allocations to high risk asset classes; high interest rates that emphasize investment in government debt; and low shareholder protection mechanisms. Figure 1 shows the extent to which the lack of access to and the high cost of finance discourage developing countries’ SMEs.

The consequence of this market failure in the supply of capital to SMEs is a “missing middle” in the economic structure of developing countries. As a result, the volume of small and medium businesses remains far below that of developed economies, and existing SMEs cannot realize their full potential.<sup>9</sup>

**FIGURE 1. THE SME FINANCING CONSTRAINT IN LOW-INCOME COUNTRIES**

*Average % of businesses rating access to finance / cost of finance a major constraint to current operations*



Notes: Countries weighted equally within income groups to calculate overall average. As defined by the World Bank, country classifications are defined by gross national income per capita.  
Sources: World Bank Enterprise Surveys; World Bank List of Economies; Dalberg analysis.

### Box 3. Sustainable SME Finance in China: Lessons from Entrepreneurs and Investors

For Chinese entrepreneur Chen He, finding financiers for her Tianjin Lotus Biological Technology Company should have been easy. Her small business, which produces nontoxic seed fertilizers that strengthen crop growth while reducing the use of chemical fertilizers, has doubled its revenues between 2005 and 2007, with annual sales now above US\$95,000.<sup>1</sup> But, says Chen He: “I have not received any loans or any private investment. The banks and venture capitalists say my company is too small and that I have too little collateral to justify the risks.” She has invested more than US\$420,000 of her own money in the company since its founding in 2003 and has received only a municipal government grant of US\$9,9000 in outside help.

Chen He’s predicament reflects the continued financing challenges of China’s more than 4.3 million SMEs, which account for 60 percent of China’s GDP. Despite the country’s booming economy and huge surges in foreign investment, SMEs still find it difficult to raise the necessary capital to grow their businesses. This situation pertains particularly to smaller businesses and those in new sectors, such as the green industries promoted by the government to counter China’s worsening ecological conditions. Of the US\$648 million in venture capital estimated to be invested in the clean technology sector in China in 2006,<sup>2</sup> very little reached SME entrepreneurs. An example is Chen Jing of the Jiangsu Ruikang Organic Food Corporation. With the help of bank loans, her small business has grown into a firm earning US\$1.4 million in gross revenue but still is unable to attract venture capital investment. “How can I grow without the investment? It’s like the old Chinese saying: making the horse run without feeding it grass!” Most Chinese venture capitalists believe that a business should reach the high benchmark of US\$7.0 million in gross revenues before taking it seriously.<sup>3</sup>

The reasons for SMEs’ financing struggles are not just due to size. According to Stephen Guo, director of research and analysis at the China Environment Fund (CEF), venture capital investors also are hesitant because smaller companies often lack proven management and finance skills. “A lot of these businesses are run by people who are technical experts and not managers,” said Mr. Guo, who meets with as many as 80 firms a month.

To make matters worse, China lacks a culture of “angel investors”: affluent individuals willing to cover start-up costs during the difficult phase

of setting up an enterprise. This confines SMEs’ financing options to only banks and government. But banks are reluctant to lend to SMEs because of their lack of collateral and perceived inability to service debt. Institutions that will lend require their borrowers to have debt collateralized through credit guarantee centers, which can be extremely expensive. Ruikang Organic Food Corporation, for example, was able to secure a loan of US\$282,000 from a local bank only after paying the credit guarantee center a fee of US\$70,000. Although this amount was later deducted, as a down payment, from the principal borrowed, for many SMEs it represents a prohibitive proportion of capital requirements.

Liu Zheng of the Shenyang Credit Guarantee Center, which specializes in SMEs, noted that too many lenders inappropriately use the same measures of performance for smaller companies as they do for larger ones and that investment risks often are overestimated. “For SMEs, non-financial factors are comparatively more important than the financial ones,” Liu claimed. The center has provided guarantees for more than 1,000 SME loans worth US\$56.4 million. Bad debts have accounted for less than .001 percent.

On a more positive note, China’s deteriorating environmental problems have created an enormous demand for technologies and services. Deutsche Bank projects environmental investments in China to grow annually by 16 percent and to reach a cumulative US\$230 billion by 2010. With the ability to develop niche and cutting-edge products, smaller firms are in a prime position to capture the demand that could lead them to financial success. “China’s environment needs all the help it can get. The more companies in the sector, the better it is for the environment,” observed CEF’s Guo. Indeed, the belief that they can make a positive contribution to China’s development is driving many of China’s small green entrepreneurs to overcome their struggles. “My product can really help farmers and protect the environment,” says Chen He of the Tianjin Lotus Biological Technology Company. “I know the problems I am facing now are only temporary!”

#### Notes

1. Figures estimated based on a 0.14095 Chinese yuan/1 US\$. See <http://www.oanda.com/> (accessed March 4, 2008).
2. These figures are from *New Energy Finance*.
3. Based on interviews with Chinese investors.

## 2.2 DEFINING THE PLAYERS

Even though investing in sustainable SMEs in developing countries is still a niche occupation, the sector is defined by energetic and innovative players. Recognizing the financial opportunities and potential development impact that sustainable SMEs offer, a number of innovative financial intermediaries have identified ways to channel more capital to the sector. Their non-traditional approach to risk mitigation combines technical assistance and a

**TABLE 1. Survey Results: Defining Characteristics of Sustainable SME Investors**

	VC Funds	Blended Capital Intermediaries
<b>Date of creation (trend)</b>	2002–2007	1998–2001
<b>Size of fund (US\$)</b>	\$10 million to \$35 million (current fundraising up to \$150 million)	\$5 million to \$20 million per fund/entity (N.B.: some managers were operating multiple funds with up to \$100 million in total assets)
<b>Average investment (US\$)</b>	\$1 million to \$5 million; mostly medium-sized companies	\$20,000 to \$1 million
<b>Investment model</b>	<ul style="list-style-type: none"> <li>- Venture capital investments and some convertible debt</li> <li>- Seeking risk-adjusted rates of returns</li> <li>- Locally managed fund</li> <li>- Intensive support of enterprise, including board participation</li> <li>- Limited monitoring of environmental and social impacts</li> </ul>	<ul style="list-style-type: none"> <li>- Mix of debt and equity</li> <li>- Return expectations ranging from proving model to local interest rates</li> <li>- Headquarters often in the U.S. or EU</li> <li>- Provision of technical assistance with varying intensity</li> <li>- Monitoring of social and/or environmental impacts</li> </ul>
<b>Funding model</b>	Patient capital and commercial investment; early investors: mostly family offices and development finance institutions, now increasingly local institutional investors	Combination of risk capital and donor-funded capital; instruments include debt, promissory notes, partnership structures, private investment vehicles limited to accredited investors, combination of separately raised equity and debt pools

close relationship with each entrepreneur. The table in the appendix shows that many financial intermediaries investing below US\$2 million are relatively young and small in size. The data in this table were compiled from interviews with leading investors in sustainable SMEs from Africa, Asia, Eastern Europe, and Latin America. The interviews were conducted by WRI and Boston College, with the support of the IFC, to gain a better understanding of the barriers that intermediaries face and how they have overcome them. We discussed the challenges, opportunities, best practices, and pathways to growing this sector. The table gives details about size, sector focus, funding sources, and investment mechanisms.

All the organizations we interviewed are centered on investing in developing countries' SMEs. Some intermediaries are based within their country of focus, while others are international, based in the United States or Europe, with local offices and investment teams. The various business models are best represented by those at the two ends of the spectrum:

- International blended capital intermediaries with a primary focus on creating positive economic, social, and environmental impacts by supporting sustainable SMEs and generating triple bottom-line returns for investors. Although these groups are often structured as non-profit entities, they operate more like investment firms.<sup>10</sup> Some offer modest to moderate returns, which often are reinvested or returned to investors at a below-market interest rate. We refer to these as *blended capital intermediaries*.
- Locally based, commercially driven funds that realize opportunities for financial and sustainability returns by targeting growth sectors such as clean technology and renewable energy. We refer to these as *venture capital (VC) funds*.<sup>11</sup>

By providing access to the right type of capital, technical assistance, and business development services, financial intermediaries are helping create strong enterprises that deliver tangible environmental, social, and economic impacts. And the approach is finding follow-

ers. The number of sustainability focused, local VC funds, as well as the number of blended capital intermediaries is increasing at a fast pace. Additionally, the concept of venture philanthropy is gaining in popularity, the Base of the Pyramid (BoP) theme is attracting investors looking for new triple bottom line investment opportunities, and some microfinance players are moving into the SME space as they grow alongside their investments.

Our findings (see the appendix) indicate that to date, approximately US\$1 billion in total funding has been committed to sustainability-focused SME funds, with another estimated US\$800 million currently being raised. Other approximations, that include funding committed to technical assistance expenses, are as high as US\$4 billion.<sup>12</sup> Whatever the exact figure, there is no doubt that this sector is growing and that the conversation has shifted from proving the model to scaling it up.

While these are promising developments, to achieve the desired scale, the sector's efficiency, financial viability, and commercial attractiveness must improve. Because the current global economic crisis will add to the existing challenges, the effective utilization of the available capital and the strategic priorities for the sector become even more important.



## 3. Investor Challenges

This section focuses on the three challenges cited by the fund managers interviewed in this study as the most significant barriers to investing in sustainable SMEs: (1) fundraising and coordination of blended capital (2) supplying technical assistance to entrepreneurs and the related costs, and (3) monitoring and evaluating economic, social, and environmental benefits.

Recognition of these challenges should guide investors' and donors' strategic interventions to increase investments in sustainable SMEs, particularly those by mission-driven investors and development finance institutions. Smarter deployment of capital would greatly advance the sector and help unlock investment from additional sources, pushing the sector toward a scale that meets the current entrepreneur demand and global needs.

### 3.1. FUNDRAISING AND COORDINATION OF CAPITAL

#### *CHALLENGES FOR VC FUNDS*

Although private equity investment in many developing countries grew through 2008, it remains a relatively young asset class. For example in Brazil, one of the most vibrant financial markets included in the survey, investors have only recently needed to seek out alternative asset classes beyond government bonds in order to achieve high returns—because of the lowering of Brazil's previously high interest rates. In other countries, such as Colombia and Peru (see box 4), legislative intervention was required to permit local

#### **Box 4. Case Study: Small Enterprise Assistance Funds (SEAF) in Colombia and Peru**

SEAF has a long and successful history of investing in SMEs. To establish a fund in Colombia and Peru, the organization, which is supported by the United States Agency for International Development (USAID), worked closely with the two governments to amend regulations that restricted investment choices available to public pension funds. These restrictions did not permit private equity investment, thus limiting the funds' ability to diversify their portfolios.

Patient capital awarded by USAID enabled SEAF to establish a fund administrator and build local credibility. It also worked with regulators and pension funds in Peru and Colombia to identify regulatory barriers, negotiate and draft the needed legislative modifications, and push them through the various levels of government. SEAF brought in experienced U.S. venture capital and small business investors to make the case to government and regulators. It also demonstrated its capacity to meet the transparency, valuation, fiscal control, and reporting requirements for a regulated fund administrator and lined up a pipeline of potential investments.

With a viable private equity investment vehicle in place and investment commitments from international development finance institutions, including the Swiss State Secretariat for Economic Affairs (SECO), the Belgian Investment Company for Developing Countries (BIO), and USAID, local governments had an incentive to approve the required regulatory amendments and pension funds, and insurance companies were willing to consider investing. The result was groundbreaking. For the first time, pension funds and insurance companies in Peru and Colombia were able to invest in private equity funds. As a result, SMEs in these countries were able to access regulated capital that had previously been off-limits. Although the first fund in Peru did not perform successfully, due to a lack of local fund manager capacity (see section 3.2 on this challenge), opening the door to new sources of capital supplied a critical piece of the development equation, enabling domestic resources to be channeled toward growing the local economy.

### Box 5. New Opportunities to Attract International Investors

Sustainable SME investing is a relatively new field. As a result, fund managers specializing in this have difficulty raising funds in mainstream capital markets. Barriers include lack of track record and no independent information on the funds' historical financial performance, as well as the mainstream investors' ignorance of the SME market. Promising developments in other fields, however, might pave the way for more investment in sustainable SME fund managers.

For example, CalPers, the California Public Employees' Retirement System, Program is targeting "new" fund managers through an External Manager Development Program targeting firms with less than \$2 billion under management (public equity and fixed-income securities). By offering opportunities to these new and emerging money managers, the pro-

gram seeks superior financial returns. In a parallel approach, large asset owners could create an emerging market window where they allocate a certain portion of assets to SME funds in developing and emerging markets.

The Dutch pension funds ABP and PGGM have broken new ground in institutional investing by allocating significant amounts of capital to the microfinance sector. These investments were made possible by the availability of a variety of investment instruments and funds in the more mature microfinance market. If the appropriate financial instruments can be developed to allow pension funds to invest in the SME sector in developing countries, a stream of new capital could be mobilized to grow the large number of enterprises that underpin steady economic growth.

institutional investors to consider private equity as an investment opportunity and achieve greater portfolio diversity.

Even in those regions where investors are comfortable with private equity investments, there remains a lack of familiarity with sustainable business sectors. This creates an additional hurdle for sustainable SMEs seeking funds, as these sectors often demand a longer investment cycle than traditional venture capital and therefore require investors with longer time horizons and patient capital<sup>13</sup>.

However, perhaps the biggest challenge to raising funds is proving that the sustainable SME sector can be profitable in the long-term. Because this sector does not have a track record, investors find it difficult to achieve the required financial comfort level. The local fund managers we interviewed also talked about the difficulty of attracting international investors when they themselves had relatively short track records, as measured by conventional fund management standards. In general, the up-front cost of training local investment teams and creating a pipeline makes it difficult to start a fund and prove the model without the support of patient capital, whether from individuals, foundations, or development finance institutions (see box 5).

#### *CHALLENGES FOR BLENDED CAPITAL INTERMEDIARIES*

Blending capital refers to bringing together providers of commercial and philanthropic capital, who seek different rates of single, double, or triple bottom-line returns. Doing so requires extensive education for both investors and donors and can create tension between maintaining a deal flow that generates attractive financial returns to commercial investors and delivering the non-financial impact sought by philanthropic investors. Blended capital intermediaries must balance this tension between needing to prove the financial viability of the sustainable SME sector as an investment class (the business case) and remaining focused on achieving a positive, non-financial (social, economic, and environmental) impact in line with their non-profit mission.

Although most blended capital intermediaries use some sort of “smart subsidy” in the form of grants or soft loans from government or private donors,<sup>14</sup> they still are an unusual funding target for both the development and donor community used to financing non-business projects.

The blended capital intermediaries interviewed use a range of approaches to bring together diverse sources of capital:

1. Offering investors different levels of risk exposure. For example, different tranches were created within a fund or a range of instruments were combined to raise the diverse sources of capital. Examples of risk-apportioning structures include investors like E+Co, which focuses on clean energy in Africa, Asia, and Latin America; and Root Capital, which funds SMEs working in sustainable agriculture, certified fisheries, and ecotourism in the same regions.
  - E+Co blends public and private capital to support clean energy SMEs in developing countries that generate social, environmental and financial returns. The primary investment vehicles are 1) structured accounts with individually agreed conditions on repayment and interest for professional investors; and 2) promissory notes with pre-determined conditions for smaller investments, made, for example, by high net worth individuals. In addition, grants, donations and income raised through carbon monetization support business development services and impact monitoring and evaluation. E+Co has also established a subsidiary fund management corporation, E+Co Capital Latin America, closely resembling a traditional fund structure. E+Co Capital Latin America manages investment capital from the Inter-American Bank’s Multilateral Investment Fund (IADB-MIF) and other international investors.
  - Root Capital offers short- and long-term loans to producers in rural, low-income communities in Latin America, Africa, and Asia. Using funds from socially minded investors, Root Capital seeks to prove the bankability of sustainable SMEs, such as organic coffee cooperatives, ecotourism enterprises, and lead-free ceramics producers. To mitigate portfolio risk, it uses a three-way “factoring” model in which loans are collateralized with future purchase contracts that SMEs hold with buyers. Contributors to Root Capital’s capital pool include agricultural product importers, international coffee roasters, high net-worth individuals, foundations, religious institutions, and socially responsible investment firms. Some supporters are investors seeking a financial return; others are donors providing grant funding. Root Capital issues promissory notes to investors with interest rates averaging 2.6 percent over one to five years. In the case of a loan default, Root Capital takes the first loss position, followed by investors, who share the risk equally. In addition, for certain Root Capital loans placed under a USAID Development Credit Authority Guarantee, the U.S. government provides 50 percent risk sharing on the loan in case of default.
2. Raising funds explicitly for different purposes and maintaining capital in segregated funds for these purposes. Two examples of segregated funds for blended capital include The Nature Conservancy’s EcoEnterprises Fund and GroFin, an African SME investor.
  - The Nature Conservancy (TNC), a U.S. headquartered non-profit, established EcoEnterprises Fund as a separate entity, in which it co-invested alongside other part-

ners including the IADB-MIF, Corporación Andina de Fomento (Andean Regional Development Bank) and socially responsible investors. TNC purchased its shares with grant-based funds, which allowed a number of smaller donors to contribute to the venture, despite the minimum amount required for direct investment. The total committed risk capital of US\$5.2 million is supplemented by a separate technical assistance facility, managed through TNC. The technical assistance pool was provided by donor grants including the IADB, IFC/Global Environment Facility (GEF), foundations, and TNC donors. Interestingly, TNC found that because of charitable contribution tax benefits, many individuals preferred to support the venture by allowing TNC to purchase shares with their donations or by contributing to the technical assistance facility rather than by direct investment in the fund.

- GroFin, an African SME fund manager, reported that it does not find securing capital difficult, but does pay close attention to the composition of the investor base for its funds. This involves balancing local and international investors as well as considering the non-financial benefits of some investors, for example, multinational companies that play a key role in pipeline development. Investors in GroFin's funds include banks (50 percent), development finance institutions (18 percent), local currency investors (14 percent), and corporations (18 percent), who all participate on equal terms. In order to supplement these equity contributions, GroFin has special finance arrangements with local banks whereby a predetermined pool of capital is available to make loans to portfolio companies. Finance arrangements are done on the same risk-reward basis as fund capital and GroFin is responsible for administering the pool.

#### *A DIFFICULT BALANCING ACT*

Communicating and maintaining the nuances of these blended capital structures presents significant challenges to the intermediaries, with even the most flexible types of capital coming at a cost. Two key challenges identified by interviews were: (1) the high transaction costs associated with coordinating different types of capital due to differing timeframes and priority areas for different investors and donors; and (2) difficulties in explaining the concept of blended capital.

Many intermediaries reported that a disproportionate amount of staff time and resources were required to bring funds to scale and that more streamlined fundraising would allow more time to be spent on assisting entrepreneurs and making investments. Moreover, the different terms and timelines of investment capital and grant funding can affect a fund's ability to provide ongoing technical assistance. The most optimal cycle for SME finance, approximately ten years, is far longer than the typical program cycle for grant-making institutions. Because these grants often fund key components of the intermediaries' pipeline development, due diligence and risk management processes, they are a critical component for financial success and have to be secured for the entire term of the fund. The blended capital intermediaries also reported the importance of finding investors and donors that understood the tension between achieving the greatest possible social, environmental, and economic impacts and the need to manage risk exposure and to deliver acceptable financial returns.

### 3.2 TECHNICAL ASSISTANCE

In many developing countries the number of investment-ready small and medium enterprises is limited. Entrepreneurs often lack skills in business plan development, finance, accounting, market research, and management. In addition, support services are scarce and expensive. As a result, fund managers must provide extensive support to get the enterprise investment. Technical assistance often is required at the outset, to draw up a business plan, to conduct feasibility and technical studies, and to cope with accounting, marketing strategies, and operational problem solving (see box 6). Moreover, many SMEs do not have the correct incorporation documents for investment (especially for equity investments) and thus need help getting the legal documents in order. This not only takes time but can also be very expensive.

#### Box 6. Technical Assistance Case Studies

Financial literacy is an important area of technical assistance, particularly for funds operating in rural areas. After years of providing financial education and management training on an as-needed basis during the due diligence process, Root Capital launched Root Capacity, a formal financial education program, in 2006. The purpose of the program, which is supported with grant funding from the IDB-MIF and private donors, is to strengthen the loan applicant pool and prepare rural SMEs to obtain financing from mainstream banks.

Another strategic area is strengthening the local availability of business support services and creating clusters. Verde Ventures, a fund focused on biodiversity conservation, obtained a grant to increase the local availability of technical assistance from third-party providers, including accountants and marketing consultants. Verde Ventures also works with other business development providers, such as Technoserve, which allows the fund to complement its own technical assistance and build industries around SME value chains, for example, supporting local jewelry and craft manufacturers in ecotourism areas.

All the VC and blended fund managers that we interviewed offer some type of technical assistance and business development to their portfolio companies. The technical assistance for venture capital funds often means working with companies before investing in them, as well as the more traditional strategic planning and management. Support before the investment is even more common for blended capital intermediaries. Technical assistance usually is part of the due diligence process, as this allows investors to examine the viability of both the business and the entrepreneurs (e.g., E+Co and GroFin). Other intermediaries focus on strengthening their investees' operations and facilitating access to international supply chains (e.g., Root Capital, Verde Ventures, and EcoEnterprises Fund). Funds concentrating on clean energy (such as E+Co, Econergy Cleantech Fund, and Continental Wind Partners) also provide technical knowledge and help with the specific market. Although technical assistance could be outsourced, most funds find it more efficient to provide it in-house, as they already have a close relationship with the entrepreneur and, in this way, can avoid an additional layer of management and reporting. Often this technical assistance is combined with the due diligence process.

Overall, the intermediaries report that providing technical assistance is a worthwhile investment, increasing the company's chance of success. But unless the costs of these services are covered by alternative funds, they can reduce the net returns to investors by increasing the intermediary's management fees and cutting into profits.

#### COVERING COSTS

Technical assistance costs can account for 10 to 30 percent of an investment, depending on the region and the project's size. For example, Econergy's CleanTech Fund, which invests in small-scale renewable energy enterprises and alternative technologies in Latin America, needs one to two years of groundwork with businesses before making investments. Without this technical assistance, only one or two of 40 projects that apply for funding would be considered investment grade.

Most VC funds can cover the cost of business development support with their management fee, as the high returns of their investment can compensate for these higher up-front costs. Most blended capital intermediaries, however, cannot cover the cost of technical assistance through returns. The reason is that because of their mission, they tend to support a broader



### Box 7. Seed Capital Assistance Facility (SCAF)

Implemented through the United Nations Environment Programme, and the Asian and African Development Banks, SCAF is designed to help clean energy entrepreneurs access enterprise development support and early stage seed capital financing from private equity, venture capital or special purpose investment funds. For new business ventures there is a lack of available enterprise development support services and seed financing is hard to secure. SCAF addresses the two largest challenges that investors have in providing seed capital financing to early stage projects and companies: the higher transaction costs and insufficient returns offered by these small, less mature and more risky ventures. It offers investment fund managers cost-sharing support for those willing to include a seed investment window within their overall investment strategy.

group of companies—including those that are commercially viable but not financially the most attractive—as opposed to the venture capital’s model of picking likely winners. Some fund managers believe that SMEs should be required to contribute to the cost in order to ensure that the services rendered are valued. For example, GroFin and SEAF charge for the tailor-made business development services they provide. But this often is possible only for the larger SMEs.

Sometimes technical assistance costs can be lowered by investing in an entrepreneur across different growth stages or bundling the assistance with paid-for business development services. Some funds also are beginning to look for co-investment opportunities, as this may allow them to leverage the experience and insights of different investors, including sharing the cost of due diligence. Nonetheless, fundraising for grants to cover the much needed technical assistance requires additional effort by the intermediary. To date, the same international financial institutions usually do not invest in a fund and also provide money for technical assistance, which leads to the fundraising inefficiencies described earlier.

Even though some investors with strong development goals may be both willing and able to underwrite technical assistance along with their investments, the cost of doing so cuts into returns. The lower returns then reduce the chances of attracting more commercial funding sources, which are essential to the growth of the entire sector. Therefore, in order to offer acceptable returns, most intermediaries spend a lot of time raising additional funding to cover the cost of technical assistance. Box 7 describes a new initiative to boost investment in small companies by helping with the higher transaction costs of such seed investments.

#### LOCAL CAPACITY CHALLENGES

In addition to the lack of investment-ready enterprises, private equity / venture capital is a relatively young sector in many developing countries and there are few individuals with the training and experience required for professional fund management. In particular, institutions with a large number of funds in different countries, such as GroFin in Africa and SEAF throughout Eastern Europe, South America, Africa and Asia, cite hiring, training and retaining local staff as principal challenges. The intermediaries to whom we talked underscored the need for investors in their funds to support internal capacity building at the fund level in order to bring the sector to scale.

### 3.3 MONITORING AND EVALUATION

Most intermediaries focusing on sustainable enterprises need proof of positive environmental and social impacts both to fulfill their own mission and to attract capital from mission-driven investors. Without concrete and timely data on the investments’ social and environmental impacts, the intermediaries’ case for investing in these enterprises is weakened. Nonetheless, monitoring and evaluating social and environmental metrics can be complex, costly, and time-intensive. This section discusses the rationale for monitoring and evaluation, the challenges of implementation, examples of current practice, and opportunities to move forward with a sector-wide approach.

### Box 8. Case Study: Environmental Impact Tracking Triggers Additional Financing

E+Co, an investor in clean energy enterprises, has a comprehensive indicators matrix for monitoring financial as well as environmental and social impact with dedicated staff in both headquarters and field offices. The organization monitors its investee enterprises for metrics including the amount of CO<sub>2</sub> emissions offset, the number of households served, the number of jobs created and the amount of firewood displaced. The information E+Co gathers is used not only to feed back positive impacts to investors, but to facilitate the sale of carbon dioxide offsets for selected companies in its portfolio. E+Co estimates that 80 percent of the information needed to monetize the carbon value of its investees is already collected through its monitoring and evaluation program. This places the company in a unique position to access international carbon markets for the benefit of companies in Africa, Asia and Latin America who might otherwise never see financial return from their carbon emission reductions.

#### WHY MONITOR?

1. **Mission alignment:** An objective system that quantifies and analyzes an investment's net social and environmental benefits and impacts helps a mission-driven fund or intermediary to ensure its activities are continuously aligned with its mission. If the enterprise no longer aligns, clear criteria will either help the enterprise improve or—based on explicit evidence of under-performance—be released from the portfolio. This type of information is fundamental for strategic planning, lending organizational credibility, and attracting capital.
2. **Making the case:** In aggregate, a standardized, objective system for quantifying impact aids in evaluation and validation of enterprise development and market-based approaches to poverty alleviation and environmental sustainability. At an organizational level, impact data help determine the effectiveness of a fund's core activities. A credible demonstration of a positive impact also aids in attracting capital from governments and foundations and other sustainability-oriented investors.<sup>15</sup>
3. **Managing risk:** Metrics that capture the enterprise's risk profile—taking into account its activities, inputs, business model, profit model, products, services, and capacity for impact—provide greater insight into the investment's up-front and ongoing viability. Standardized metrics allow for performance comparability within industrial sectors and help with due diligence. They can also help provide a methodology for capturing a company's non-financial aspects, reduce due diligence costs, and contribute to risk management.
4. **Capturing additional value:** Just as monitoring can help a company manage risks, it can also reveal complementary revenue subsidies. For example, an enterprise that monitors its greenhouse gas emissions is technically prepared to explore mechanisms to sell greenhouse gas offsets, a move that would enhance revenues and improve returns to investors. Note, though, that while carbon credit income can be a revenue enhancer, it should not make up the core business proposition.

More than 75 percent of the fund managers we interviewed already measure and report some aspects of their investments' social and environmental impacts. In particular, blended capital intermediaries noted that the demand for monitoring and evaluating their social and environmental impacts is driven by their investors and donors. Venture capital funds are less likely to monitor extra-financial impacts, partly because of their different mandate, which has a stronger emphasis on financial returns, and partly because of stricter cost control at the fund level. Box 8 gives an example of a monitoring and evaluation approach.

#### WHAT AND HOW TO MEASURE?

Monitoring and evaluation starts with the question of what to measure. Taking economic, social and environmental impact as the three main categories of non-financial performance, each presents its particular challenges, especially when trying to capture impacts across a range of different sectors. Whereas socioeconomic benefits, such as job creation, can be relatively easy to measure, environmental and social impact presents greater challenges. Many environmental benefits are quantifiable. In some cases, if accepted market values like the trading price for carbon emissions credits exist, they can even be monetized. Other benefits, such as ecosystem change, involve complex science and, even in

purely qualitative terms, are difficult to convey to a non-expert audience. Social benefits related to quality of life or changes in government policy are difficult to capture as well, so most reporting is qualitative.

Precise measurements for impact evaluation, including control groups and external assurance, are not realistic for SME monitoring. However, the assumptions used to arrive at conclusions about impact need to be transparent and plausible. The critical elements of the impact chain are *outputs* (the results of activities, such the sale of a particular number of biomass cookstoves), *outcomes* (the change achieved, such as saved fuelwood and improved health), and *impact* (the change occurring as a result of the investment). The difficulty of establishing causation has led most funds to track outputs as proxies for quantitative measures of impact and to supplement these measures with a narrative description of the investment's less tangible outcomes.<sup>16</sup>

#### *WHO MEASURES AND WHO PAYS?*

Measurements can be made by entrepreneurs themselves, the fund managers who have invested in them, or third parties.

*Self-reporting:* The least expensive approach for the intermediary is to require portfolio companies to provide information to the investors in preformatted templates along with their quarterly or annual financial updates. The limited capacity of many entrepreneurs makes it extremely difficult for them to gather more complex information. Moreover, emerging market SMEs' constraints on capacity, coupled with a lack of tools, frameworks, and other resources used for self-reporting, can lead to inaccurate and unreliable data. SMEs also have few incentives for self-reporting their impacts. Companies seeking certification to gain a competitive advantage must gather specific and detailed information about the impacts of their inputs and activities. Although this can produce some reliable information, it generally satisfies only a few of the data requirements.

*Fund managers:* A more time-intensive and costly approach is to send fund representatives into the field to work with the entrepreneur to collect or verify data and to improve the business's record keeping. These field representatives visit the portfolio companies, interview the employees and other stakeholders, and, in this way, obtain a more complete picture of outcomes and impacts. For example, the Brazilian fund Axial Par has a dedicated staff person who works with investees to monitor employment, biodiversity preservation, creation of industry clusters, development impact, output/input ratios, product cycles, and other indicators. Axial Par uses the Natural Step method to establish benchmarks and the GRI Guidelines to guide investee companies toward self-reporting their sustainability performance, as well as pursuing independent verification. To date, Axial Par has been able to provide this assistance without external funding. Often, however, a mix of self-reporting and technical assistance from the fund manager is required.

*Third-party:* Third-party research studies can be used to analyze the non-financial impact of investment activities. But because of the high cost of such an approach, it tends to be used only when grant funding is available. The approach is not suitable for widespread monitor-

### Box 9. Small Businesses, Big Development Impacts: Lessons from SEAF Investments

SEAF used a case study approach to analyze the impact of eighteen investee companies from Eastern Europe, Latin America and Asia. Based on IFC methodology, the study measured the incremental effects of each investment over time on stakeholders, such as investors, employees, customers, suppliers, local communities and others. SEAF concluded that every dollar invested in these SMEs generated, on average, an additional \$12 in the local economy.

It took SEAF more than a year to develop the impact assessment and two full-time staff to implement it for the first ten companies. Another year was spent on the second phase study, which added eight companies and a data survey of 30 more. One key lesson learned was that training internal staff, as well as the entrepreneurs, is critical for success, but time consuming.

The results of the impact assessment analysis are available on SEAF's website.<sup>1</sup> In addition, SEAF reported that entrepreneurs and in-country staff felt that the assessment had enabled them to think about the development issues related to their companies and believed that the information could be used for other purposes, such as marketing. In turn, the impact assessment helped SEAF make the case for SME investment with new and existing investors, since the non-financial benefits could be more clearly articulated and quantified alongside the projected financial return.

1. See SEAF, <http://www.seafweb.org/impact.htm> (2007).

ing and evaluation, although it may help construct a credible, standardized, and partially replicable system of measurement.

Even without using comprehensive third-party studies, many funds that systematically monitor impacts rely on grant funding. SEAF, for instance, obtained support from three bilateral donors and one foundation to conduct a comprehensive impact assessment of eighteen portfolio companies in two separate studies, as described in box 9.

#### IMPLEMENTATION CHALLENGES

The benefits of monitoring and evaluation may be compelling, but the challenges of implementation are daunting. Practically, there is an inherent tension between the credibility and the feasibility of a monitoring and evaluation system. The right balance—comprehensive without being cost prohibitive both for the SME and the intermediary—is hard to strike. The key question is devising a monitoring and evaluation system that is cost-effective and applicable to different sectors and funding models and still generates meaningful information.

Socioeconomic benefits like job creation can be relatively straightforward to measure,<sup>17</sup> but environmental and social impacts and benefits are much more complex. Tangible issues, such as “tons solid waste generated,” can be measured on the input/activity side of the equation, thereby making the data gathering fairly basic. But devising credible metrics and feasible data points to quantify these enterprises' intangible benefits is more complicated. Fortunately, steps are being taken to quantify and, in some cases, monetize these benefits. The most successful example is trading carbon emissions credits. Other cases, however, such as threats to biodiversity, require complex scientific modeling. When dealing with these intricate, interdependent biological systems, even anecdotal evidence of benefit is difficult to convey to a non-expert audience. In addition, although social benefits such as quality of life are now being quantified at the national level, demonstrating a direct attribution to any one cause or factor is an immense—and perhaps impossible—undertaking.<sup>18</sup> Because of these challenges, many indicators of social benefits are currently relegated to simple qualitative descriptions of impact.

#### NEXT STEPS

More than two-thirds of the intermediaries we interviewed conduct some form of impact monitoring, and many have invested a lot of time and capital in systems development, staff training, and technical assistance to entrepreneurs. Most funds are motivated to improve their monitoring methodologies even more. New entrants, even in the commercial market, seem to have relatively ambitious goals for monitoring their impacts. However, significant inefficiencies have arisen for the overall sector due to most funds using different methodologies and metrics. Entrepreneurs may have to comply with varying reporting requirements, and it is virtually impossible to make meaningful comparisons of impact across different funds or to aggregate the impacts of the sector. At the same time, the intermediaries themselves feel the lack of common standards as they often face a range of demands from their own investors and donors regarding the type and detail of information required. Despite the investments already made into the current systems, many intermediaries and investors

agreed on the need for standardization, or at least harmonization of what should be measured, who should measure it, and how to verify the information. Not only would this reduce transaction costs, but it also would also help the sector aggregate data in a meaningful way and improve comparability between investments.

ANDE, the Aspen Network for Development Entrepreneurs, is taking initial steps to build consensus among key practitioners toward a common framework, a set of baseline metrics and standard methodology to impact accounting. This approach is being built from input provided by intermediaries, enterprises, and capital providers. An initial set of metrics has already been established (see table 2). Advancing this initiative, a subgroup of ANDE members is currently working on an initial set of environmental indicators.

**Further collaboration will provide a pioneering sector-level standard for impact reporting which would increase the overall visibility of the potential of SME finance.**

Beyond the fund and firm level, a group of European development banks and the IFC have agreed on a set of development indicators with common definitions and consistent tracking methods (currently focusing on investments in private equity funds). The four core indicators—internal rate of return, employment at investee companies, compliance with international environmental and social standards, and compliance with core labor standards—are supplemented by 21 optional indicators that cover economic, social, environmental, governance, capital markets, and private enterprise metrics. The indicators and methodology have been published by EMPEA a) to support fund managers in tracking positive development effects of their investments, b) to harmonize the IFI assessment of development effects of private equity financing, and c) to create data-bases calculated according to a harmonized

**TABLE 2. Impact Metrics Used by the ANDE Network**

Metric	Why Organizations Use It	Data Required from Each Company
Jobs created by each company within a portfolio	Indicator of a growing or catalytic business	Total employment this year and last year, fulltime equivalents
Wage growth by each company within a portfolio	Indicator of benefits passed onto community	Total salary/payroll expenses this year and last year (converted to US\$)
Operating revenue growth by each company within a portfolio	Indicator of a growing or catalytic business	Operating income turnover or revenue from income—this year and last year (converted to US\$) (income from grants/philanthropic donations not included)
Number of customers served by each company within a portfolio	Indicator of reach/scale of a business that seeks to have impact through product or service	Number of individual customers
Amount procured from suppliers by each company within a portfolio	Indicator of company's economic footprint	Total amount spent on equipment, materials, supplies and other inputs
Estimated percent of total procurement from local suppliers by each company within a portfolio	Indicator of impact on local community	Estimated amount spent on procurement from local suppliers as a percent of total procurement
Additional finance mobilized	Indicator of leverage generated by initial investment	Total amount of additional debt and equity (converted to US\$) secured by investee subsequent to initial investment by the fund
Carbon offsets	Indicator of carbon footprint of business	Total carbon offsets generated by the investee

Note: ANDE core metrics are subject to change based on a member consultation process.



methodology<sup>19</sup>. Similarly, the Rockefeller Foundation, through its *Impact Investing initiative*, is working with Acumen Fund and other ANDE members, as well as B Lab, to design and disseminate a set of reporting standards for the broader impact investing sector, as well as a ratings system for social and environmental impact. The aim of these activities is to provide an overall framework for tracking and comparing the non-financial performance of impact investments, to reduce prohibitive transaction costs for impact investors, to increase the efficiency and impact with which impact investment capital is deployed, and, ultimately, to attract more capital to the sector.

These efforts should lead to a better understanding of the benefits of sustainable SMEs and eventually could produce an evolving list of optional metrics. While every fund and donor may monitor and report on only a few metrics, the purpose is to achieve a consensus among the key players on how to measure which impacts in each sector.

## 4. Bridging the Finance Gap: Recommendations

An analysis of our interviews with investment intermediaries produced a number of conclusions for the sector. Sustainable SMEs offer significant economic, social, and environmental benefits that contribute to long-term sustainable growth. They provide employment, link rural communities to markets, stimulate innovation, and can alleviate poverty and protect the environment. However, many barriers exist that prevent the sector from growing as fast as need demands, and that impede sustainable SMEs from realizing their potential and providing large-scale positive societal impact.

SMEs and emerging market investment are often considered as high risk, and the current financial crisis has reduced investors' risk appetite. At the same time, however, the failure of complicated financial instruments has made investments with a tangible value proposition more attractive. In this context, investors may look at SME investment—in real companies and real entrepreneurs—in a more favorable light. Accordingly, we offer the following recommendations to improve and scale investment into the sustainable SMEs in emerging economies.

### Box 10. New Horizons: An Ethical Stock Exchange

A group of financial innovators in London is creating an ethical stock exchange to respond to the increasing appetite for direct ethical investments. The exchange's intention would be to increase liquidity in the market for ethical investment by providing new channels for social enterprises to raise capital through share and bond issues, and for equity investors in social enterprises to disinvest when they need to. The exchange could also raise financial standards among listed companies, thus increasing transparency and investor confidence, as well as providing a focal point for the marketing of new and existing ethical products.

Questions remain, such as the right balance between the need for a flexible, genuine exchange and the need to protect the exchange from exploitation for private benefit through speculation. Other issues to be explored include management, oversight, ownership and financing of the exchange, as well as pricing mechanisms.

### 1. IMPROVE CAPITAL ALLOCATION

A better understanding of blended capital fund requirements is needed to fully tap the potential of this fundraising approach. For blended capital intermediaries, this requires a high level of transparency and accountability. Investors and donors, in turn, need to learn about blended capital models so they can help improve coordination of different types of capital and reduce the related transaction costs. The participation of different players—development banks, foundations, commercial investors, and national and international aid agencies—should be orchestrated in a way that maximizes the effectiveness of the different types of capital that each can provide. This would include investors and donors reviewing the conditions attached to their loans, investments, and grants to ensure they are achieving the desired financial, environmental, and social outcomes. Such efforts could also promote co-investment.

### 2. PROMOTE FINANCIAL INNOVATION

Both long-term approaches and innovation are needed to overcome systemic barriers. Currently, much of the sustainable SME sector is concentrating on developing the enterprise pipeline and creating investment funds. An explicit focus on system-wide barriers, such as the need for large-scale investment in technical assistance, both at SME and fund manager level, and the difficult exit situation for early stage venture investments, is needed. Innovation and collaboration are fundamental here. Such approaches could include, for example: financial structuring that increases the security of investments in intermediaries and breaks down large flows of capital into amounts that can be absorbed by intermediaries; or the creation of a new “social stock exchange” to facilitate exits (see box 10).

### Box 11. Angel Investor Clubs

Although angel investor clubs have been actively supporting entrepreneurs in the United States and Europe for decades—some would say centuries—this business practice is only recently taking hold in emerging economies. These clubs of high net-worth individuals can be instrumental in closing the finance gap for SMEs and start-ups to better enable them to access commercial funding. A good example of a success story is Indonesia's PT. Sosial Entrepreneur (PT SEI). Formed in September 2007 as a collaboration between the IFC's Grassroots Business Initiative and four prominent angel investors from Indonesia, PT SEI was established to support domestic small enterprises, nurturing their social goals while fostering greater commercial rigor in order to increase employment and economic empowerment among the poor and disadvantaged. PT SEI targets promising enterprises that offer a solid combination of commercialization and outreach but that need support to achieve greater scale or replication. The group provides loans, equity investments, and profit sharing, as well as specialized technical assistance, mentoring, and access to networks.

We also must attract new investors. One scale up approach might be that angel investors from emerging economies and regions form investment clubs that exclusively target or prioritize sustainable SMEs. This approach has been successfully implemented in Jakarta (see box 11). Persuading local individuals to invest would go a long way to building a more stable ecosystem of support. Because angel investors tend to be closely involved with their investee enterprises, this approach would not only strengthen and grow the local chain of investment, but it would also create greater recognition for new enterprise models.

Many of the innovations highlighted in this report are already being used to bridge the gap in sustainable SMEs' financing gap. These however need to be evaluated for their potential for replication, and then scaled up to allow local SMEs to drive sustainable development in their countries and shift the current development paradigm.

### 3. DEVELOP INDUSTRY BENCHMARKS AND AGGREGATING DATA

The lack of standardization in monitoring and evaluating the benefits of investment in sustainable SMEs is both hampering the sector's development and harming its credibility. A common methodology and a library of shared metrics would greatly enhance transparency and comparability, reduce transaction costs for different investors, and permit a better understanding of such businesses' positive social and environmental impacts. Standardization would also enable investors to seek out the most effective intermediary in accordance with their priorities regarding financial return and social and environmental impacts.

Ultimately, VC funds targeting environmental or social sectors should also join these efforts, working toward an approach that can be adapted to a variety of financing models, including return-driven funds. A common approach may allow fund managers to satisfy more investors and donors with one reporting template. Common metrics and indicators should focus on all aspects of the enterprise, social, environmental, and financial. Even though not all enterprises and funders may be able or required to report on all three, establishing these common data points would, over time, lead to a better understanding of the sector and, ultimately, better decisions based on its impacts. The main challenge will be reaching a good balance between the depth and substance and the practicality and usability of the metrics and methodology. Efforts should build on current approaches established by groups such as the Global Reporting Initiative (GRI), ANDE and the Rockefeller's Impact Investing program. Through a continuing dialogue, collaboration, and pilot programs, a common and practical approach can be established.

### CONCLUSION

These steps by the sustainable SME investment community, combined with more widespread recognition of the sector as not only a viable tool for sustainable, inclusive growth, but also a solid investment opportunity, would enable developing countries to cultivate vibrant private sectors that could respond more quickly to pressing environmental and social needs. This in turn could help millions of poor and low-income people. We believe that entrepreneurs in developing countries offer solutions to many of the world's most critical social and environmental problems. Investing in and empowering them will help to scale the solutions they provide and construct a new paradigm for both economic growth and sustainable development.

## Appendix – Funds Interviewed

Name	Region	Sector Focus	Year	Size (USD)	Type of Capital	Type of Inv	Avg Inv Size	ROI / IRR	TA	M&E
SEAF	Central & Eastern Europe, Latin America, Asia.	SMEs, some funds have more specific focus	1989 (CARE); 1995 as independent Institution	\$8.5-<30 million per fund. \$180 million AUM in 17 funds (Sept 2007). 400m AUM since 1989.	Development Financial Institutions (DFI), local SME support organizations; Socially Responsible Investors (SRI); local institutional investors; development agencies; foundations.	Risk capital fund (typically equity, also mezzanine and debt financing)	\$1-2 million in earlier funds; Now up to \$5 million.	Net Internal Rate of Return (IRR) to the investors is in high teens.	Technical Assistance (TA) as part of fund management/investment relationship; some via dedicated TA facilities. Includes strategic/operations assistance, BDS; market research; networking; education & training	Ongoing monitoring. Comprehensive development impact case study reports in 2004 and 2007 (economic return per \$ invested). Portfolio-wide development impact survey on annual basis. Ongoing monitoring.
E+Co (incl. E+Co Capital Latin America "CAREC")	Africa, Asia, Latin America	Clean energy production and use	1994	\$45 AUM (\$30 million 'ever-green' facility CAREC -\$15 million)	DFIs, SRI, Private Investors, Foundations, government agencies, religious groups	Mostly debt, with some equity investments	\$50K-<1 million; \$150K average (seed capital focus). CAREC – \$1.5 million	Return after write-offs (excluding TA & services) 8.3% (Debt: 8.6% Equity: 6.4%). CAREC – 10% (Equity); 7.5% (Debt)	Wide range of basic management and financial skills, strategy and clean energy markets. Carbon monetization	Comprehensive Triple Bottom Line (TBL) scorecard including access to energy; efficiency gains; dirty fuel replaced; 3rd party money leveraged
Photovoltaic Market Transformation Initiative (Impax and IT Power)	India, Kenya and Morocco	Photovoltaic retail and market development	1998	\$35m	DFI	loans, equity, guarantee funds	\$1-1.75 million (varies from country to country)		TA varies across countries; services include technical capability, management, and business plan development.	Technical indicators developed in conjunction with the International Finance Corporation (IFC) and additional impact research by IFC
Root Capital (formerly EcoLogic Finance)	Latin America, Africa and Asia	SMEs working in sustainable agriculture, wild-harvested products, handicrafts, certified fisheries, eco-tourism	1999	\$18 m	Debt & grant capital from SRIs, DFIs, individuals, foundations (PRIs), corporations, religious groups	Short term debt secured against purchase agreements; long term debt secured against fixed assets.	\$25,000-750,000; average 180,000	Covering 80% of operating cost	Financial education (grant funded)	Not systematically
Verde Ventures (Conservation International)	High biodiversity risk regions. Current: Latin America, Africa, Asia.	Biodiversity impact: biodiversity hot spots; high biodiversity wilderness areas; & marine priority areas	1999	\$6.75m	Loans from corporation, DFIs, foundations; donors.	Primarily debt (with quasi-equity structure), consider partial equity. Security vs. future cash flows	\$30,000 - 500,000	Target 8% IRR including all operating costs. Investors receive 2.5-5% interest on loans.	Directly and through others (Techoserve) Build industries around investment. Grant funded Technical Assistance (TA) for early stage SMEs.	Triple Bottom Line impact: Environmental - (Hectares/species preserved), financial & social (total beneficiaries). IFC grant for monitoring program.
EcoEnterprises Fund (The Nature Conservancy)	Latin America & Caribbean	Conservation. Sustainable Agriculture, aquaculture, forestry, ecotourism, non-timber forestry.	2000 2009 (EcoEi)	\$6.4m risk capital + \$3.5m TA facility. Eco EI total \$30m	DFIs, SRI, The Nature Conservancy (TNC); Grants from DFIs, foundations, TNC donors.	80% debt; 20% equity; 19% debt & equity interest exp. EcoEI: mezzanine financing and equity	\$325,000	Projected IRR 1% (net of operating costs); Gross IRR 11%	Separate TA facility. Fund pays 3% fee for BDS.	Since inception using fact sheet, scorecard, compare specific follow-ups, local TNC staff verify reports

Appendix – Funds Interviewed

Name	Region	Sector Focus	Year	Size (USD)	Type of Capital	Type of Inv	Avg Inv Size	ROI / IRR	TA	M&E
Triodos Ren. Energy for Development Fund (IT Power India)	South East Asia	Broad renewable energy focus	2000	\$3.5m	Solar Development Corporation, Triodos Bank	Loans and preferred stocks	\$100,000		Technical assistance covered by management fee	
Acumen Fund	South Asia and Africa	Businesses serving BoP across 4 sectors: water, healthcare, housing and energy.	2001	\$20m	Donations from corporations; foundations; individuals.	Primarily debt, but moving towards more equity.	\$500,000-750,000	Revolving fund. For debt, the aim is 10%. For equity aim is debt like returns.	TA in design, marketing, pricing, distribution.	Monthly reporting 4 key criteria: financial sustainability, social impact (BoP customers served), scale, cost effectiveness
Axial Par	Brazil	Health food, forestry, biomaterials, renewable energy, environmental services	2001	\$30m	Private individuals	60% equity, 40% debt	\$5m	Expected IRR 25%	Intensive involvement in management, strategy and sustainability	Environmental / Social benchmarks for each investment; monitoring achievement; independent verification
China Environment Fund (Tsing Capital)	China	Renewables, energy efficiency, recycling, new materials, waste	2002 (CEF1); 2005 (CEF2)	CEF1: 13m; CEF2: 30m; CEF3:250m (raising)	Family office, mutual funds, corporations, DFIs	Equity	\$1-3m, now \$5-20m	Expected IRR: 25%	In the sense of Venture Capital (VC) involvement in company strategy and management	Environmental and social review with company once a year
GroFin	SA, East Africa, Oman, Nigeria.	SMEs: Start-up and growing enterprises All sectors.	2003 (RAPs est. '99)	8 funds 5-30.6m; total \$102m; raising new \$130m Africa fund	Banks; DFIs; Local currency investors; Corporations; Foundations.	Prefer debt/self-liquidating instruments, some equity.	\$50,000-1m per transaction avg 400,000	Target 10% net in USD terms to investors after all costs, write-offs and fees.	Tailor made business development assistance to clients for duration of investment term	Financial monitoring ongoing for duration of transaction as part of business development. Quarterly KPI reporting to investors
Econergy / Clean Tech Fund	Latin America	Small scale renewable energy projects and alternative technologies	2004	\$25.2m	DFIs, local government banks, parent company	Primarily equity	\$ 3m	Target IRR above 18%	Grant funded TA prior to inv. To get the project investment-ready	monitor environmental/social performance of the company and report back to shareholders
EIP II (Environmental Investment Partners)	EU countries in Central Europe	Environmental products and services relating to infrastructure	2005	\$5m	Private individuals, or their foundations and funds	Equity and exceptionally quasi-equity	\$1m	Expected 12%	Ongoing in the sense of VC involvement in company strategy and management	Not in a formal way
Stratus VC III (The Stratus Group)	Brazil	Applied Technology, Cleantech/ Biotech, Environmental Technologies	started investing in 2007	\$28m	Local institutional investors, DFIs	Equity, long-term debt, carbon financing	\$1.2m - 2.8m	30% annual ROI	In the sense of VC involvement in company strategy and management	Requires reports on environmental / social management and performance
Continental Wind Partners (Env. Investment Partners)	EU countries in Central Europe	Wind power infrastructure	2007	\$27m	Private individuals, their foundations and funds	Equity and exceptionally quasi-equity	\$2m	Expected 25%	In the sense of VC involvement in strategy & management	Not in a formal way



## Appendix – Funds Interviewed

Name	Region	Sector Focus	Year	Size (USD)	Type of Capital	Type of Inv	Avg Inv Size	ROI / IRR	TA	M&E
<b>Fundraising Stage</b>										
Gestão Sustentável FIP (Tripod Investimentos)	Brazil	Economically attractive enterprises exerting positive impact on the environment, society or both	2007	\$100m (target)	Local and intern. Institutional investors, DFIs	quasi-equity with conversion; Common and preferred equity.	\$ 10m (target)	Target ROI: 25%	In the sense of VC involvement in company strategy and management	Establishing environmental /social performance indicators to be achieved during the year
Evolution One Fund (Inspired Evolution Investment Management)	Southern Africa	Clean tech and Environmental goods and services sectors and sub-sectors	2007	\$140m	Parent company, corporations, local and international institutions and DFIs	Long-term & quasi-equity; Combinations of senior debt, mezzanine debt & equity carbon financing	\$1.4 - 28.3m	Expected Gross IRR >= 30%	Involvement in management, strategy and sustainability.	Est. environmental / social performance indicators and development of customized sustainability toolkit.
Southern African Cleantech & Sustainability Fund (Inspire South Africa)	Southern Africa (SADC)	Renewable energy non-polluting replacement technology; enterprises serving the BOP	2007	\$25m (target) \$35m	DFIs, Parent company	Equity and Quasi-equity	\$2m	Expected 20% per annum in SA Rand terms	Not formally; exploring funding for more systematic TA from local development organization	Company specific indicators, bi-annual summary reports on environmental and social impact at fund level
<b>Additional Funds (not interviewed for this paper)</b>										
Agora Venture Fund Central America	Central America and Mexico	Value-added manufacturing and agriculture, clean tech, products and services for low income consumers	2006	\$5 m target (still in fundraising stage)	Double bottom line investors, individuals and institutions	Debt, equity, Quasi- equity	\$25,000-500,000; 35-50 projected investments	No specific IRR targets	Strategic/operations assistance, Business Development Services (BDS); market research, etc. Portfolio companies receive strategy and finance consulting and networking assistance from Agora Partnerships, a non profit that sponsors and manages the Fund.	Social impact is monitored across a variety of metrics, including job creation for people earning less than 4 dollars a day. Agora Partnerships publishes a social impact report annually that includes information on the Fund.

Appendix – Funds Interviewed

Name	Region	Sector Focus	Year	Size (USD)	Type of Capital	Type of Inv	Avg Inv Size	ROI / IRR	TA	M&E
IGNIA Fund I, L.P.	Regional Latin America, with an initial focus on Mexico	Companies that serve core needs of the Base of the Pyramid population including but not limited to health, housing, education, basic utilities, entertainment, and nutrition.	2007 (first closing was May 30, 2008)	target \$75 – 100mm total (\$50–75mm in equity commitments and \$25mm in debt)	Institutions (e.g. Omidyar, family foundations in US and Europe); individuals (from US, MX, Europe), multilaterals (IDB provided \$25mm debt facility, MIF made \$5mm equity commitment), in discussions with commercial banks/funds, select endowments, other multilaterals, and individuals.	debt, equity. IGNIA makes equity investments into high growth, for-profit companies.	IGNIA invests between \$2 and \$10mm per portfolio company over the life of the investment. We will consider investing as small as \$500k.	Market rate return target. Approx 25% IRR	Strategic/operations assistance, BDS; market research; etc. IGNIA, as a venture fund, provides traditional venture capital value add to portfolio companies (management expertise, deep and broad network). Also have IGNIA Shared Services company which manages all the administrative and back office functions, enabling the company to scale effectively. (Portfolio company pays for these services, but it is more cost effective and higher quality).	Yes. Quantitative measures of financial performance, with key social metrics integrated into business performance metrics. Also measure impact qualitatively.
LGT Venture Philanthropy Foundation	Latin America, Africa, India, China, South East Asia	Alleviating human suffering, education, sustainable livelihoods	2007	\$ 40m (target)	LGT group companies, employees and clients; High Net Worth Individuals	Grants, loans and equity; “missing-middle type financing”	Up to \$ 1 million	No specific IRR targets	In the sense of VC involvement in management, strategy and sustainability, ongoing mentoring, local TA through fellow-ship program	Organization specific indicators and milestones and bi-annual summary reports, regular update calls and meetings with senior management
Proventus Partners	Latin America	N/A	2008	TBD	High-net worth individuals	Equity and junior debt (mezzanine)	\$1mm – 10mm	15% - 45% (Depends on security)	Technical assistance through the general partnership; Outsource market research needs.	Financial impact primarily and social impact in terms of employment and incremental GDP generated

*The other two institutions interviewed were Shared Interest and Shorebank, but not included in this matrix as they do not make direct investments into SMEs.*

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# Notes

1. Of the 20 funds we investigated, only three target a wider range of sectors.
2. The term *blended value investing* was first coined by Jed Emerson to describe the value from investment returns that incorporated, in a non-divisible manner, “social, ethical, environmental or charitable elements.” For more information, see Jed Emerson, “Blended Value Investing: Capital Opportunities for Social and Environmental Impact,” *World Economic Forum*, March 2006.
3. The BoP community, approximately four billion people worldwide who live on less than US\$ 3,000 per capita per year, is characterized not only by low income but also by significant unmet needs, dependence on informal or subsistence livelihoods, and limited access to markets. BoP business strategies aim to use the power of the private sector to stimulate inclusive growth, by which these communities are integrated into the formal economy and improve their quality of life through enterprise, as either producers or consumers. For more information, see [www.nextbillion.net](http://www.nextbillion.net).
4. Even though the recent financial crisis has changed the parameters of investment decisions and the outlook for fundraising is rather bleak in the short term (see fall 2008 EMPEA survey, [www.empea.org](http://www.empea.org)), it is likely that in the long run, emerging markets and developing countries will continue to become increasingly important investment destinations.
5. Almost 2 billion of the 2.6 billion people living on less than \$2 per day live in rural areas (see World Resources Report 2008: “Roots of Resilience—Growing the Wealth of the Poor,” July 2008, World Resources Institute, in collaboration with UNDP, UNEP, and the World Bank).
6. The view that SMEs make significant contributions to economic growth and employment is not uncontested. While many argue that market failures in developing countries prevent sustainable SMEs from contributing more significantly to development, critics argue that larger firms exploit economies of scale and invest more in research and development. They assert that SMEs are neither inherently more labor-intensive nor better at job creation and thus do not do a better job of alleviating poverty. See Thorsten Beck, “SMEs, Growth, and Poverty: Cross-Country Evidence,” *Journal of Economic Growth* 10, no. 3 (2005):199. This study of developing-country SMEs does not support the conclusion that SMEs exert a causal impact on long-run growth or poverty alleviation. But it also falls short of showing any negative correlation. Please refer to the bibliography for a full reference set of both arguments.
7. B. Hamilton, “How to Write a Business Plan,” in *Financing for the Small Business*, vol. 1, *The SME Financing Gap*, p. 42. Available at [www.ussba.gov](http://www.ussba.gov).
8. Charles B. Wendel and Matthew Harvey, “SME Credit Scoring: Key Initiatives, Opportunities, and Issues,” *Access Finance* (World Bank Group), no. 10 (2006):1, 6.
9. OECD, “OECD Keynote for SME Financing Gap: Theory and Evidence” OECD, 2006).
10. These organizations are most often structured as 501(c)(3) and raise philanthropic funds from a range of donors, including high net-worth individuals, private foundations, and bilateral organizations. They use these funds much as an investment fund would but reinvest any returns into the support services and investments provided for their target SMEs.
11. International VC funds that are active in developing countries tend to focus on the large firms within the SME space and rarely make investments under US\$2 million, which is where the lack of capital is most severe.
12. Figures are based on Dalberg’s analysis of ANDE (Aspen Network for Development Entrepreneurs).
13. *Patient capital* refers to funds invested for the medium or long-term (generally five to ten years).
14. As set out in the UNCDF’s *Blue Book on Inclusive Financial Sectors for Development*, the four broad categories of “smart subsidies” are those seeking to overcome the financing gap for SMEs by (1) improving risk mitigation opportunities; (2) fostering greater transparency among borrowers; (3) increasing efficiency and reducing costs, thereby permitting scale; and (4) enhancing innovation among lenders. See UNCDF, *Building Inclusive Financial Sectors for Development: Executive Summary*. Available at [www.uncdf.org/English/microfinance/pubs/bluebook/index.php](http://www.uncdf.org/English/microfinance/pubs/bluebook/index.php), “The Blue Book,” p. 20.

15. At this point, commercial investors seem less concerned with rigorous proof of non-financial benefits, but this may change as the sustainable investment space becomes more competitive and the credible demonstration of sustainability impact becomes a competitive advantage.
16. Mark Kramer and Sarah Cooch, "Investing for Impact. Managing and Measuring Proactive Social Investments," Foundation Strategy Group, 2006. Available at [www.fsg-impact.org/app/content/ideas/item/287](http://www.fsg-impact.org/app/content/ideas/item/287).
17. Note that just as with financial metrics, clear and standardized definitions are needed for socioeconomic, social, and environmental metrics. The term *job creation*, for example, must clearly define the job created. Does it mean one, full-time equivalent (40 hours per week), direct job,—or does *job creation* refer to indirect jobs for suppliers, transporters, coops, and the like? This distinction is important to give credibility and comparability to a monitoring and evaluation methodology.
18. The most widely used and most credible indicator of quality of life is *infant mortality rates*, which is currently feasible to track at only the national census level. Infant mortality is a term that captures the quality of nutrition, education, and other social metrics.
19. A full list of the indicators can be found at [http://www.empea.net/resources/development\\_indicators.shtml](http://www.empea.net/resources/development_indicators.shtml).







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