ISSN 1977-6411

European Commission

Tools and Methods Series
Reference Document Nº 22

Blending and support to private sector development

November 2015

Directorate-General for International Cooperation and Development

How to obtain EU publications

Free publications:

- via EU Bookshop (http://bookshop.europa.eu);
- at the European Union's representations or delegations. You can obtain their contact details on the Internet (http://ec.europa.eu) or by sending a fax to +352 2929-42758.

Priced publications and subscriptions:

- via EU Bookshop (http://bookshop.europa.eu).

Tools and Methods Series

Reference Document Nº 22

Blending and support to private sector development

Directorate-General for International Cooperation and Development
European Commission

Brussels • Luxembourg, November 2015

Disclaimer: The contents of this publication do not necessarily reflect the official position or opinion of the European Commission.

Print	ISBN 978-92-79-57521-1	doi: 10.2841/592713	MN-BB-16-004-EN-C
PDF	ISBN 978-92-79-57520-4	doi: 10.2841/643146	MN-BB-16-004-EN-N

Luxembourg: Publications Office of the European Union, 2015

Preface

Blending is an instrument for achieving European Union (EU) external policy objectives, complementary to other aid modalities and pursuing the relevant regional, national and overarching policy priorities. Blending is the combination of EU grants with loans, risk capital or guarantees from public and private financiers. The idea behind the instrument is that the EU grant element can be used strategically to attract additional financing for important investments for development in EU partner countries.

This and three other sector reference documents provide basic information on the main supported sectors in EU partner countries and on how potential support can be provided by EU blending operations in:

- energy;
- transport;
- water and sanitation;
- private sector development.

The four sector reference documents complement the *Guidelines on EU blending operations*, which is the central guidance document on blending operations and which summarises the key features, modalities and operational aspects of blending applicable to all sectors.

The main audience for these documents is the staff of the EU Delegations and of the Directorate-General for International Cooperation and Development (DG DEVCO) and the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR).

Abbreviations and acronyms

AFD	Agence Française de Développement
BAS	Business Advisory Services
DFI	development finance institution
EC	European Commission
EBRD	European Bank for Reconstruction and Development
EFSE	European Fund for South-East Europe
EGP	Enterprise Growth Programme
EIB	European Investment Bank
EU	European Union
IFC	International Finance Corporation
IFI	international financial institution
LFI	local financial institution
MSME	micro, small and medium enterprise
NIF	Neighbourhood Investment Facility
OECD	Organisation for Economic Co-operation and Development
PSD	private sector development
SME	small and medium-sized enterprise

Table of contents

List of boxes

List of figures

CHAPTER 1
Sector overview

The European Union (EU) is a significant player in providing support to private sector development (PSD) in the context of its external aid programmes; this support covers a wide range of activities including regulatory reforms, capacity building and the provision of business development services. On average, the EU has provided EUR 350 million annually. Over the period 2004–2010, the EU provided substantial grant funding for PSD at EUR 2.4 billion — comparing favourably with several other well-recognised PSD donors such as France, Sweden and Denmark.

In this sector, the EU adds value by its capacity to leverage grant resources for PSD through investment and blending facilities, its ability to link PSD with trade liberalisation matters, and through the transfer of EU good practices and knowledge.

PSD encompasses a wide variety of grant-funded technical (non-investment) and financial (investment) interventions and activities. In May 2014, the Commission adopted the communication 'A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries' (EC, 2014), outlining a renewed EU strategic framework for strengthening the role of the private sector in achieving inclusive and sustainable growth as called for in the Agenda for Change (EC, 2011).

In December 2014, the Council welcomed this new strategic framework and encouraged the Commission to translate it into the programming process along with the concrete actions set out in the communication (EU Council, 2014).

The communication includes 12 actions, 2 of which directly call for a stronger role for blending in small and medium-sized enterprise (SME) support (EC, 2014: 8–9):

> *Action 2:* Co-finance market-based schemes for micro, small and medium-sized enterprises to access business support services from local providers including business intermediary organisations, incubators, informal self-help organisations and cooperatives to increase management skills, technological know-how and market linkages for micro, small and medium-sized enterprises in the formal and informal sector.

> *Action 4:* Make strategic use of EU grants, including through blending mechanisms, to improve access to loans, equity finance, guarantees and patient capital for micro, small and medium-sized enterprises also in high-risk countries and through impact financing of social enterprises.

The communication also sets out seven principles which shall be observed in all PSD activities:

1. Focus on employment creation, inclusiveness and poverty reduction.
2. A differentiated approach to the private sector.
3. Create opportunities through market-based solutions.
4. Follow clear criteria in the provision of direct support to private sector actors.
5. Account for different local contexts and fragile situations.
6. Put strong emphasis on results.

7. Observe policy coherence in areas affecting the private sector in partner countries.

In relation to Principle 4, the communication identifies the following six criteria (EC, 2014: 5):

(1) **Measurable development impact:** Support given to a private enterprise or financial intermediary has to contribute in a cost-effective way to the achievement of development goals such as job creation, green and inclusive growth or broader poverty reduction. This requires transparency as regards objectives and results, along with appropriate monitoring, evaluation and results measurement arrangements.

(2) **Additionality:** Without public support the private enterprise would not undertake the action or investment, or would not do so on the same scale, at the same time, in the same location or to the same standard. The supported action should not crowd out the private sector or replace other private financing.

(3) **Neutrality:** The support given should not distort the market and should be awarded through an open, transparent and fair system. It should be temporary in nature with a clearly defined exit strategy. Support justified by market failures and consequent risks should not have the effect of discouraging regulatory reform efforts addressing the causes of market failure.

(4) **Shared interest and co-financing:** Partnerships with the private sector have to be based on cost-effectiveness, shared interest and mutual accountability for results. The risks, costs and rewards of a joint project have to be shared fairly.

(5) **Demonstration effect:** A supported action should aim to have a clear demonstration effect that catalyses market development by crowding in other private sector actors for the replication and scaling-up of development results.

(6) **Adherence to social, environmental and fiscal standards:** Private enterprises receiving support have to demonstrate that their operations are compliant with environmental, social and fiscal standards, including respect for human and indigenous rights, decent work, good corporate governance and sector-specific norms.

The EU has positioned itself as a generalist in providing PSD support in developing and partner countries. According to a recent evaluation, the EU has deliberately maintained a nearly 'all-encompassing' portfolio of activities, without defining a specific niche or role in terms of PSD support (ADE, 2013). The EU's capacity to build partnerships has thereby increased by being able to respond to diverse country needs and align with partner government priorities across a range of areas.

The rationale for PSD is to provide the poor with the capacity to find jobs and improve their incomes, laying the foundation for their exit from poverty. In addition, a growing private sector enables governments to generate sufficient tax revenues to provide essential public services such as health care and education. In this respect, SMEs are an important focus for PSD support due to their large contribution to employment creation and poverty reduction.

SMEs encompass a broad range of businesses which differ widely in their size, development stage, business strategy, specialisation, innovation potential, technology level, growth prospects and risk attitude. They can range from small retailers with only a few employees to fast-growing and innovative high-tech companies with more than 100 employees.

All firms — but especially SMEs — face a variety of **challenges** in developing countries in securing finance, accessing market information, establishing business linkages to meet demand for their products and services, and finding talented employees to manage their business. In addition, the business environment in which firms are operating is not always conducive to business entry, growth or exit.

EU support mainly focuses on micro and small enterprises operating in the formal and informal sectors, as interventions in these segments have the potential to yield large development impacts such as job creation, increased productivity and accelerated investment formation.

There is a strong link between the business environment and the country's regulatory framework, depth of financial markets, level of economic development, and political and macroeconomic stability.

The financial and technical assistance/advisory service needs of SMEs depend critically on the **development stage** and specific challenges faced by small enterprises. In the **early stages** of SME development (seed phase, business start-up), a different mix of financing and advisory services is needed than during the **growth and expansion phase**.

Within the EU, the Small Business Act for Europe (adopted in 2008 and reviewed in 2011) reflects the Commission's political will to recognise the central role of SMEs in the economy. The act provides a comprehensive **SME policy framework** for the EU and its Member States. Based on this policy framework, the Organisation for Economic Co-operation and Development (OECD) — together with the European Commission (EC) and the European Bank for Reconstruction and Development (EBRD) — has developed the Small and Medium-Sized Enterprises (SME) Policy Index. It is a benchmarking tool to monitor and evaluate progress in implementing this policy framework for SMEs along the following 10 business dimensions:

- education and training for entrepreneurship
- cheaper and faster start-up
- better legislation and regulation
- availability of skills
- improving online access for tax filing and company registration
- getting more out of the Single Market
- taxation and financial matters
- strengthening the technological capacity of small enterprises
- successful e-business models and top class business support
- developing stronger, more effective representation of small enterprises

Guidance for EC operational activities in the field of PSD in external cooperation are included in 'Trade and Private Sector Policy and Development' (EC, 2010). This document provides an overall context for private sector policy and development and its inter-linkages with broader aspects of development cooperation. It also includes 10 specific thematic reviews covering all major PSD themes — trade policy, trade facilitation, quality infrastructure, intellectual property rights, business enabling environment, investment promotion, access to finance, competitiveness, business development services and doing business with the poor. Note that the information provided in the present reference document mainly focuses on **access to finance**.

1.1 Sub-sectors

EU interventions regarding PSD in developing countries are conducted at three different levels:

- macro level — the overall policy and regulatory framework;
- meso level — market-enhancing institutions and organisations;
- micro level — individual SMEs and financial institutions.

Typical examples of EC-funded projects at each of these three levels are described below.

MACRO LEVEL

- Improving the business enabling environment and investment climate through review and reform of policy, legal and regulatory frameworks and through developing the capacity of relevant public institutions and agencies
- Improving the financial services environment for micro, small and medium enterprises (MSMEs)
- Improving the trade-related environment through assistance on trade policy, facilitation and quality systems

MESO LEVEL

- Enhancing access of local enterprises to advocacy functions and business development services through support to business intermediary organisations

- Improving MSME access to finance by strengthening local institutions, including through development of appropriate financial products, building financial infrastructure or specific financial instruments

- Supporting investment promotion agencies and facilitating investments by brokering and matchmaking

- Enhancing private sector capability to meet trade-related requirements by disseminating and capacity building and by assisting compliance bodies, businesses and consumer associations

MICRO LEVEL

- Increasing capacities of MSMEs and value chain actors concerning productivity, innovation, competitiveness and market access through technical assistance at the firm/cluster level

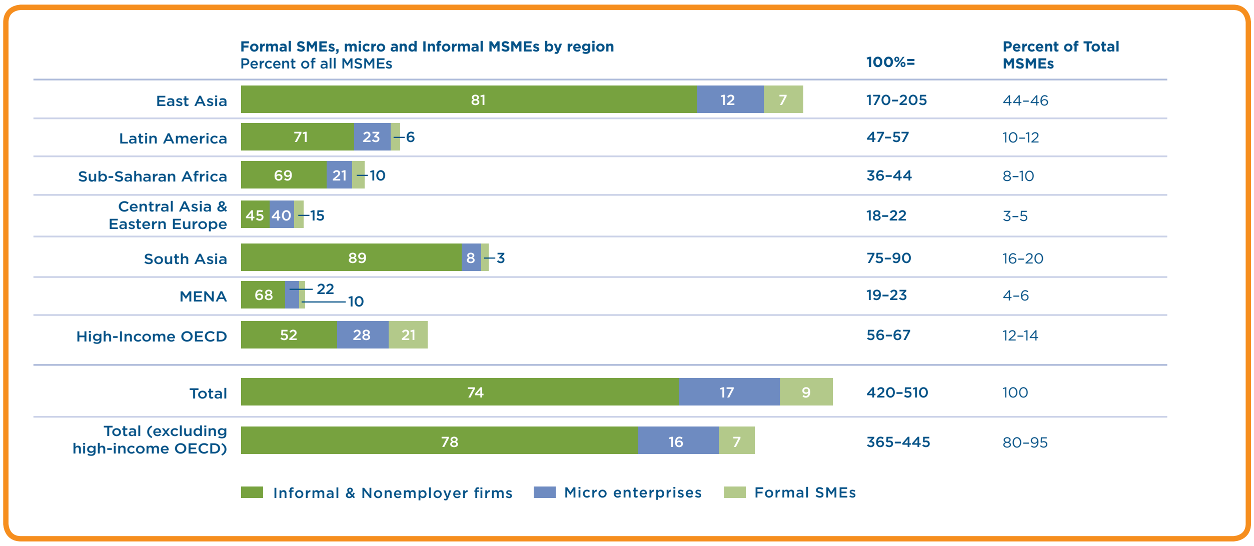
- Facilitating MSME access to finance through specific financial instruments, dissemination of information among companies, helping firms prepare bankable business plans, and conducting pre-investment feasibility studies and due diligence assessments

1.2 Regional overview

It is estimated that 99% of all firms in developing countries are SMEs. A 2010 study suggests that there are close to 365–445 million MSMEs in developing and emerging markets, of which 25–30 million are formal SMEs and 55–70 million are formal micro enterprises; the rest (285–345 million) are informal enterprises and non-employer firms (Stein, Goland and Schiff, 2010).

Figure 1.1 shows the estimated number of formal and informal SMEs per region, revealing important differences at the regional level and the significant share of the informal sector in the total targeted population. This confirms the need to adopt an approach in line with the type of private sector actor to be supported. It is also essential to set priorities in terms of stage of development and degree of vulnerability of the partner countries.

FIGURE 1.1 Formal SMEs, micro and informal MSMEs by region



Source: IFC, 2010.

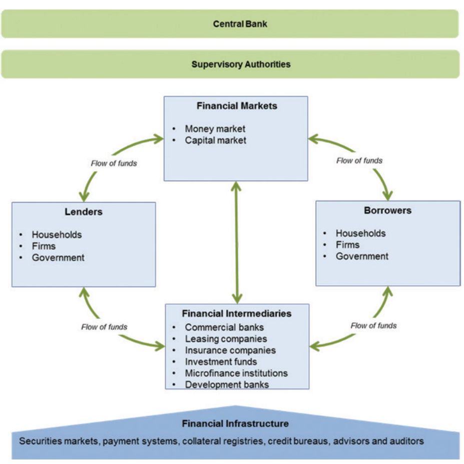
1.3 Main actors

The level of SME access to finance is the result of a complex interaction between different actors in the financial system and of the overall economic, legal and regulatory framework of a given country.

Figure 1.2 provides a simplified structure of a financial system. The main function of any financial system is to channel funds from those that are net savers (spend less than their income, 'lenders') to those that are net spenders (spend more than their income, 'borrowers'). These functions are provided by the financial markets and by financial intermediaries.

The main types of lenders and borrowers are households (individuals), firms (including SMEs) and the government. Thus, the original business model of a commercial bank is to collect deposits from customers and transform them into loans to borrowers.

FIGURE 1.2 Simplified structure of financial system



Commercial banks can also borrow on the financial markets, e.g. by issuing bonds.

This financial system is based upon institutions and firms which provide the basic financial infrastructure such as securities exchanges, payment system operators, credit bureaus or service providers (such as financial advisors and auditors).

- The **central bank** is the highest financial authority in every country, implementing the monetary policy and promoting price stability.

- **Financial supervisory authorities** supervise the different financial actors.

More recent phenomena — such as peer-to-peer lending and crowd-funding, where private borrowers and lenders interact directly without any financial intermediaries — are not included in the figure, as they are not considered an official market participant supervised by the relevant authorities.

Development financing is most often provided (either directly or indirectly) to SMEs via development finance institutions (DFIs). A brief profile of the main multilateral, bilateral and regional DFIs active in the PSD field is provided in Annex 1 of the *Guidelines on EU blending operations*.

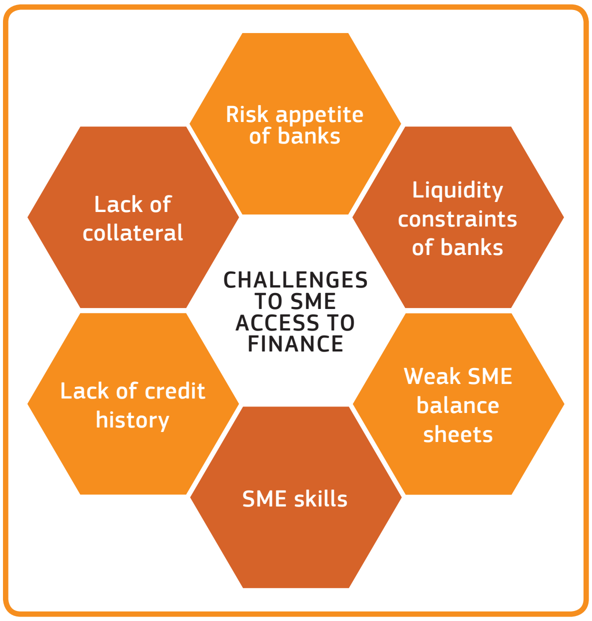
CHAPTER 2

Project financing structures

Access to finance is an important factor in countries' overall competitiveness and greatly influences the ease of doing business. Smaller firms are highly affected by a lack of finance, which hinders their creation and growth. Access to finance is a major challenge in many developing countries for a variety of factors (see Figure 2.1).

- SMEs are regarded by banks as **high-risk borrowers** mainly because of insufficient collateral (or lack of enforceability), low level of equity (thus a weak balance sheet) and vulnerability to the business cycle. Furthermore, banks' appetite to finance SMEs may be hampered by external business environment factors such as bankruptcy and collateral regulations.

FIGURE 2.1 Challenges to SME access to financing



- Information asymmetries exist due to unreliable accounting and financial reporting information and a **lack of credit history**.

- SME lending is often not a profitable business activity for banks because of the level of **transaction costs**.

- Local financial markets sometimes constrain refinancing and thus the **liquidity situation** of banks, limiting their ability to provide loans in local currency and with tenors acceptable for SMEs.

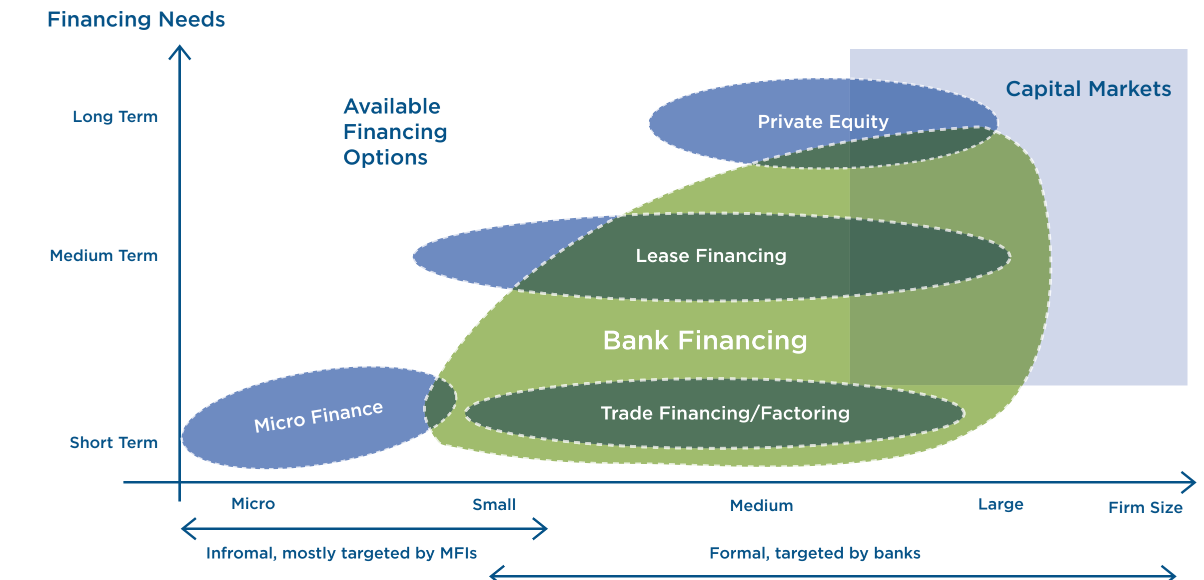
- Rural and agricultural SMEs and other companies located in remote areas are particular vulnerable to a **lack of adequate finance**. This is not only due to their perceived credit risk but also because the branch networks of most banks do not reach such remote locations.

- In most cases, SMEs have **weak internal business planning capacities** and no experience in preparing and presenting convincing business plans, project proposals or funding applications. This in turn contributes to the negative perception of banks that SMEs are not creditworthy clients.

SME finance can be conceptualised as a continuum ranging between microfinance and capital market financing of large firms (see Figure 2.2). Research suggests that developing countries have a smaller number of SMEs than developed countries, a situation often described as the 'missing middle'[1]. One explanation for this situation is the persistent obstacle for

[1] See also Entrepreneurial Finance Lab Research Initiative, Center for International Development at Harvard University, 'The missing middle'.

FIGURE 2.2 SME finance continuum

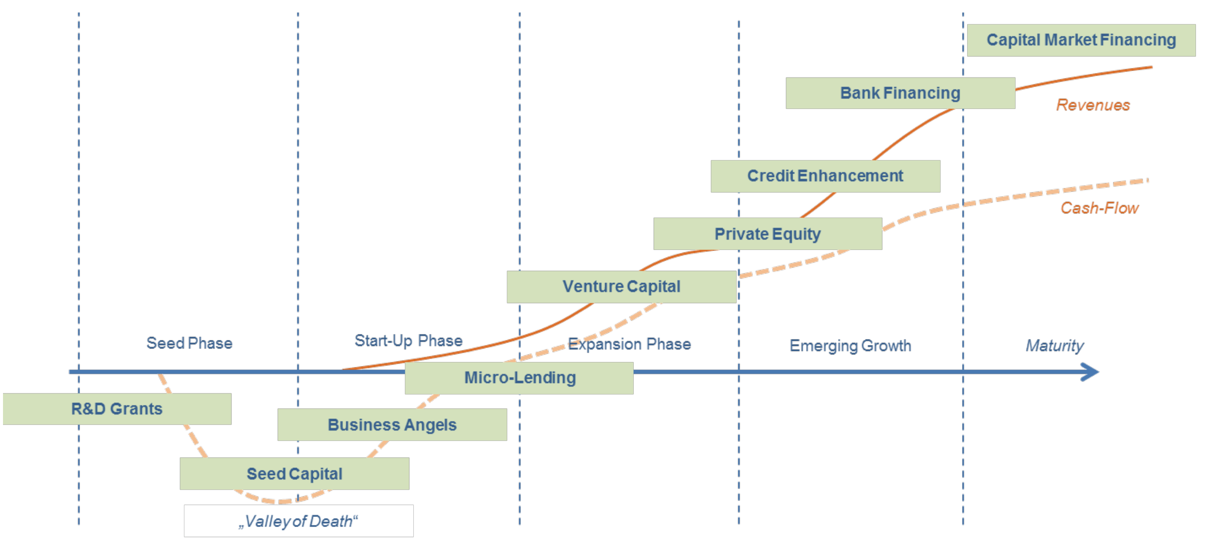


Source: IFC

SMEs of access to finance, which limits the growth of the SME sector.

SME financing needs differ greatly depending on the respective **development stage** of an enterprise. Figure 2.3 depicts the typical enterprise development phases, from seed to emerging growth and maturity, and the corresponding potential financing sources at each stage. The risk/return combination, commercial prospects and perceived credit risk are very different at each stage, as are the available and appropriate financing sources and financial structure.

FIGURE 2.3 SME financing needs by stage



In the **early phases** of enterprise research and development grants, seed capital and business 'angels' are the most appropriate funding sources to overcome the so-called 'valley of death'[(2)]. As the enterprise matures and grows venture capital, bank financing/leasing and eventually private equity (in case of enterprises with high growth potential) are available.

A distinction must be made between venture capital and seed capital. **Seed capital** refers to equity capital provided in start-ups in the initial rounds of finance. **Venture capital** refers to the next round of finance in companies that have achieved stability and have strong growth potential. Venture capital can be seen as a subset of private equity, which includes all sorts of investments in companies and securities which are not traded publicly on a stock exchange.

It is important to recognise the differences in **equity and debt financing**. Equity constitutes an ownership title in a company and fully shares both the upside and downside potential of the venture. Debt constitutes a creditor claim on the company, can be provided on a short- to long-term basis, and its repayment (according to pre-agreed schedule) has priority over the disbursement of net earning to the owners (equity capital). Debt financing (e.g. bank loans, microfinance, leasing) and informal equity (by family and friends) is much more common for SMEs than formal external equity financing (e.g. venture capital). This is not only due to the traditional reliance of many economies on bank financing, but also the reluctance of entrepreneurs to give up ownership and control in their companies to venture and private capital investors. More information on debt versus equity can be found in Annex 2.

The **approach of DFIs to SME financing** varies. While all DFIs have programmes addressing the SME access to finance barrier, they differ in risk appetite, geographical focus, instruments (debt, equity and guarantees) and financing strategies (direct investment in enterprises versus financial intermediation).

(2) The 'valley of death' is a commonly used term among early stage investors describing the dangerous combination of high cash needs, limited revenues and uncertain ability to raise capital.

Credit lines (with or without technical assistance support) are a comparatively simple instrument, but they essentially address only the liquidity barrier of the banking sector. More innovative financial risk-sharing instruments such as equity, structured funds, guarantees and other risk-sharing instruments can be used in the framework of the EU blending facilities.

The use of **financial instruments** is recommended when market participants do not provide funding in sufficient amounts or at suitable terms to otherwise financially viable projects or enterprises due to market failures and sub-optimal investment situations. It is important to distinguish financial instruments from purely concessional/subsidised financing ('soft loans'); see Box 2.1 for more on concessional financing.

BOX 2.1 Concessional finance and official development assistance reporting

In its broadest sense, concessional finance comprises financial products — including grants, loans, guarantees and equity investments — provided on terms that are clearly more favourable than those explicitly available from the market. According to the OECD/International Monetary Fund definition, concessional loans are loans extended on terms substantially more generous than market loans.

Concessionality is achieved either through interest rates below those available on the market, the impact of which can be further enhanced through a favourable, tenor or repayment profile. Other structural aspects may also make a loan concessional. For example, unless it is reflected in the pricing, lower seniority or a weaker security package of a loan would be considered concessional if commercial financial institutions would normally not accept it for a particular client in a particular market environment. 'DFI Guidance for Using Investment Concessional Finance in Private Sector Operations' further details rationale, forms and potential risks.

The level of concessionality in loans provided by international financial institutions has a direct influence on official development assistance statistics. As of the end f 2014, the OECD was reviewing its methodology on the treatment of loans, concessionality levels and grant equivalents. For more on this topic, see OECD's 'Note on the treatment of loan concessionality in DAC statistics'.

Because of their shareholder structure and credit rating (mostly triple A), DFIs are able to refinance their operations on the capital markets (e.g. via the issue of bonds) on highly favourable terms[3]. They can pass on this comparative funding advantage to their clients, although DFIs do apply sound banking principles and thus charge interest rates on their loans which are commensurate with the credit risk of each borrower.

The EC has vast experience with SME access to finance in EU Member Countries. SME access to finance support was and is provided under various initiatives, including as the Entrepreneurship and Innovation Programme (2007–2013), the Competitiveness of Enterprises and Small and Medium-Sized Enterprises (COSME) 2014–2020, Horizon 2020 and the Joint European Resources for Micro to Medium Enterprises (JEREMIE).

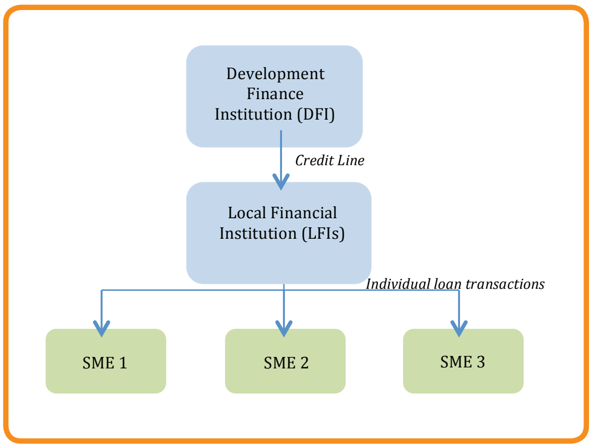
The traditional instrument and starting point for international financial institutions (IFIs) worldwide to address the SME finance gap is the use of **SME credit lines** to local financial institutions (LFIs). However, credit lines alone only address the issue of a constrained liquidity, not the issue of real or perceived risk.

The basic model of a SME credit line is presented in Figure 2.4. A DFI selects LFIs which are dedicated to financing SMEs. It then concludes a credit line agreement with those LFIs. The LFIs disburse sub-loans to **eligible and creditworthy SMEs** at market conditions, applying their own normal due diligence procedures.

An important aspect of SME credit lines is that they should not distort the local funding market, and LFIs should apply their own internal banking and lending criteria. This means that it should be the sole decision of each LFI to decide which SME to finance. The terms and conditions of each loan transaction should be determined case by case, based on the results of the due diligence and creditworthiness analysis carried out by the LFI.

[3] Commercial banks with a lower credit rating have to pay higher interest rates on their bonds in order to provide investors with a return in line with credit risk.

FIGURE 2.4 Model of a SME credit line



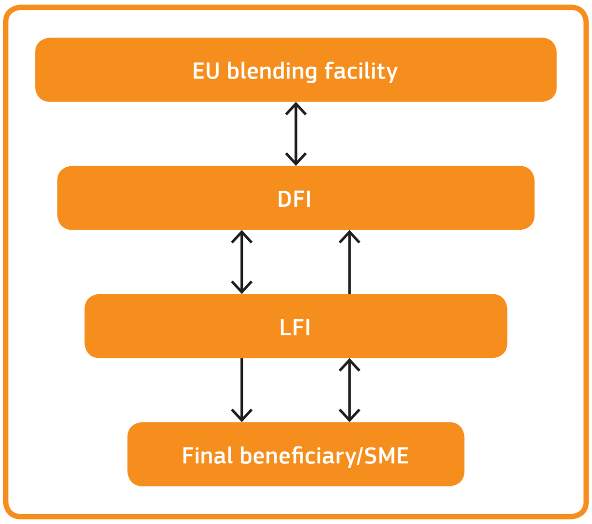
Such a credit line is often complemented by grant-funded **technical assistance** in order to maximise impact. In most cases, a broad range of support services are needed to ensure the success of a credit line. For example, LFIs could be supported in further developing and refining their internal SME credit screening, due diligence and risk management procedures to become more efficient. Support in developing dedicated SME loan products and distribution channels are also common areas for technical assistance, such as development of innovative products to increase outreach to vulnerable populations and capacity development measures for bank staff. A credit line and the accompanying technical assistance should ultimately demonstrate to the local banking market that SMEs are a potentially profitable customer group worth serving.

When speaking about financial instruments in the context of EU blending facilities, it is useful to differentiate between the various levels at which financial instruments can be applied; see Figure 2.5 for a simplified structure.

Although the legal/financial relationship between the blending facilities, DFIs and LFIs can be quite complex (e.g. as in risk-sharing mechanisms such as first loss; this is discussed further in Section 3.2), the financial products emerging at the end of this chain are in most cases quite simple (e.g. a loan from a commercial bank to a SME).

As noted earlier, the characteristics and funding needs of enterprises differ; this requires a differentiated approach on the part of donors and DFIs.

FIGURE 2.5 Levels of financial instrument application



There is a clear trade-off between strategies and approaches for supporting a large number of smaller companies in multiple sectors (e.g. via a credit line) or targeting a small number of companies to unlock their high growth potential[4].

In this respect, it is important to note that only a few already existing or newly established SMEs are high-growth ventures with the potential to disrupt the market with an innovative business model, reaping huge benefits in terms of growth, profits and market share. More frequently, SMEs are replicative companies providing basic services and products by mimicking predecessors[5]. Many of these replicative companies stay small and do not become active outside the boundaries of their communities. At the other end of the spectrum are microenterprises, which are simple businesses with no employees other than the entrepreneur producing only subsistence-level earnings.

SME-specific and affordable financial products must therefore be created; this might also include risk-management products such as micro-insurance.

(4) For example, see the experiences and results of publicly supported SME equity funds such as SEAF. In a 2007 report, SEAF presents its business case on the financial and development benefits of investing in high-growth SMEs. Clearly, these high-growth-potential companies run by ambitious entrepreneurs constitute only a very small sub-set of the SME sector, and identifying such companies requires an experienced private equity fund manager.

(5) The distinction between replicative and innovative entrepreneurship was defined by Baumol (2010).

CHAPTER 3

Types of blending projects

3.1 Sector blending portfolio

To date, the Neighbourhood Investment Facility (NIF) has supported the largest number of SME (private sector) projects.

An analysis of the average share of support to SME projects among all approved blending projects reveals that they account for approximately 11 %. The sectors with the largest number of approved projects are energy (44 %), transport (23 %) and environment and water (18 %).

Looking more broadly at projects with some form of private sector engagement and private financing (regardless of sector), 23 % of all EU grants have been committed to such projects.

3.2 Uses of EU grants to support SME projects

Support to SMEs through blending can be provided as:

- **technical assistance** aimed at supporting the development and implementation of financial instruments, and building demand- and supply-side capacity for borrowers, service providers and LFIs;
- **incentive payments (investment grants**, which are contributions which can finance part of the total investment and reward specific types of investments, such as specific energy-saving systems;
- **risk capital**, e.g. subordinated equity in structured funds such as the European Fund for Southeast Europe (EFSE), the Green for Growth Fund and the SANAD Fund for MSME to attract investment in SMEs;
- **guarantees** such as the SME Guarantee Facility (Neighbourhood South) to unlock commercial finance to SMEs by sharing part of the (perceived) risk.

The following sub-sections describe each of these aid modalities in more detail.

TECHNICAL ASSISTANCE

Technical assistance is instrumental in providing a broad variety of support services at different levels, such as

- capacity development;
- policy advice;
- preparation/facilitation of programmes/projects;
- Implementation support.

As in all other thematic areas, technical assistance is an integral part of PSD at the macro, meso and micro levels. Technical assistance provided in the context of blending is a powerful tool, as it is closely delivered alongside DFI investment and lending activities. As this technical assistance is generally linked to financing, it usually addresses barriers at the micro level.

Credit lines provided by DFIs to LFIs are often complemented by EU-funded technical assistance providing the following support services.

- **Support and capacity building to LFIs:** These services include creating awareness among loan officers of the new credit line, support in refining internal credit risk and SME assessment procedures, support in marketing and loan origination, social performance management tools, responsible finance and results measurement.

- **Support in the development of a project pipeline:** Project development support services include preparation of business plans, consultations with prospective borrowers, financial structuring of more complex transactions and support in improving financial reporting capacities for first-time borrowers.

- **Support of DFIs:** This includes development of standard tools such as operating manuals, marketing plans and facility websites; and reconciliation of disbursement data.

- **Verification of completed investment projects:** This is performed by an external verification consultant and is only necessary in the case of an investment subsidy.

While in most cases, the EU covers 100% of the cost of technical assistance, cost-sharing modalities should be encouraged. Cost-sharing could be agreed on especially where technical assistance provides direct support to LFIs and their borrowers. In this way, LFIs could also contribute part of the cost, which may increase their ownership in the provision of technical assistance.

Technical assistance is a necessary complement to **risk-sharing** mechanisms. The EU Platform for Blending in External Cooperation concluded that guarantees and risk-sharing products are often more effective when combined with technical assistance to support financial institution expansion into new MSME-oriented business, specific loans such as green loans or fragile political and economic contexts. Skills development in the financial sector, together with work towards creating a proper regulatory framework in the partner country's financial sector, should be the first stage of any intervention seeking to introduce guarantees.

Layered investment funds such as the EFSE or SANAD are complemented by a separate technical assistance facility which provides various tailored support services on an as-needed basis primarily to the funds' partner financial institutions. For example, SANAD provides support in the following areas:

- market and feasibility studies;
- strategy design and business model development;
- development of MSME financial operating models;
- product development;
- lending methodology;
- middle management organisation;
- delinquency and credit risk management;
- financial and asset liability management;
- institutional transformation.

The prospects of closely aligning investment and/or lending with technical assistance are very promising, as can be seen with the EFSE and SANAD. If technical assistance can be utilised in a flexible way, targeted at the specific needs of investment operations, a high level of development impact can be generated.

INVESTMENT GRANTS AND INCENTIVE PAYMENTS

Investment grants can cover part of the total project cost and, consequently, reduce the amount borrowed by the entrepreneur. Investment grants are less widely used in the private sector context, but can be used, notably, to support investments in innovative or green technologies. As with all other forms of support, this should be in line with the principles and criteria defined in the Commission's communication on the private sector.

Examples supported under the facilities include schemes whereby SMEs are incentivised to invest in sustainable energy projects (e.g. purchase of a new, more efficient production facility). Along with the loan from a participating bank, SMEs have access to a subsidy if their investment meets selected eligibility criteria.

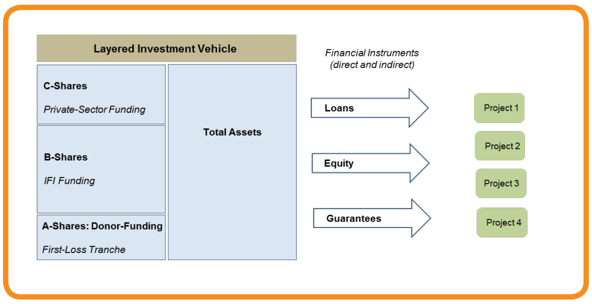
RISK CAPITAL

Risk capital is a broad term comprising **equity investments**, **structured financing** solutions such as first-loss and subordinated capital as well as other risk-sharing instruments such as local currency financing programmes. An important component of private sector–related risk capital operations via blending is carried out through layered (or structured) investment funds. These can help mobilise additional public and private investors to provide debt and equity finance for MSMEs in countries with an under-developed financial infrastructure and a riskier operating environment.

In such structures, the EU contribution is **subordinated** to or shares risk on equal terms (*pari passu*) with the capital provided by other, more commercially oriented, investors. The subordinated EU contribution can act as a first-loss cover for all other providers of finance[1]. The lower risk to other investors as a consequence of the first-loss tranche can either reduce the level of returns expected by other investors (lowering the overall cost of capital) or expand the amount and volume of investment relative to the capital (achieving higher impact through financial leverage).

A structured fund consists of three different layers of capital, each having a different risk/return characteristic (see Figure 3.1):

FIGURE 3.1 Financial structure of a structured fund



(1) An equity investment in an enterprise or investment vehicle is the classic form of first-loss capital, as the equity has the main function of absorbing losses; also see Annex 2. Only if the losses are larger than the equity are other capital providers, e.g. lenders (debt capital), affected. The terms and conditions of a first-loss contribution in structured investment vehicles are clearly defined at the outset, and include such vital parameters as type of losses and maximum (capped) amounts. Second-loss denotes a structure whereby other investors bear an unexpected loss up to an agreed amount, and the EU contribution only (partly) covers any losses exceeding this amount.

- **C shares:** first-loss tranche, subordinated contribution provided by donors;
- **B shares:** mezzanine tranche, provided by DFIs/IFIs;
- **A shares:** senior tranche, provided by private sector investors.

The risk sharing among these three classes of investors is contractually regulated by a so-called 'cash-flow waterfall', meaning the hierarchy and order in the distribution of any returns generated by the fund investments. In the (unlikely) event of losses, the donor grant funds constituting the first-loss tranche (C shares) are affected first. Only when these are depleted up to the agreed percentage of losses, is the mezzanine capital affected (B shares), followed by holders of senior capital (A shares).

The specific terms and conditions for the provision of risk capital are negotiated on a case-by-case basis between the EU and the respective DFIs.

Based on this capital structure, these investment funds provide investments in the form of loans (debt), junior or senior equity, mezzanine finance or guarantees to sub-projects. For example, the EFSE (presented in more detail in Case Study 1 in Annex 1) provides mostly loans to financial intermediaries that then on-lend the funds as loans to micro and small enterprises and low-income households.

GUARANTEES

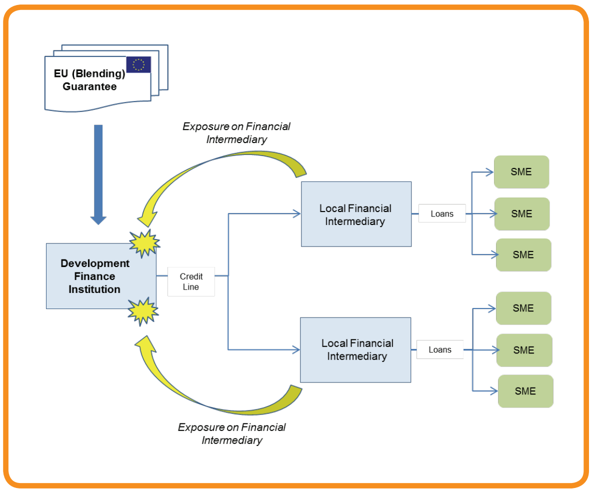
There is a wide variety of guarantees available, covering different losses from well-defined risk events. In the framework of SME finance credit, guarantees which cover losses from loan defaults are relevant. A credit guarantee is a commitment by a third party (the guarantor) to pay the debt of a borrower when the latter cannot repay it itself (in the event of debt service default). The guarantor is liable to cover any shortfall or default on the borrower's debt under the terms and conditions stipulated in the agreement between the guarantor, the lender and/or the borrower.

In large infrastructure projects or export transactions, individual guarantees (tailored to the individual transaction) are common; in the SME finance field, **portfolio guarantees** are more common. Such portfolio guarantees cover losses not from individual SME loans but from a whole portfolio of aggregated loans originated by LFIs.

Conceptually, in the framework of SME finance facilities, two different types of guarantees must be distinguished.

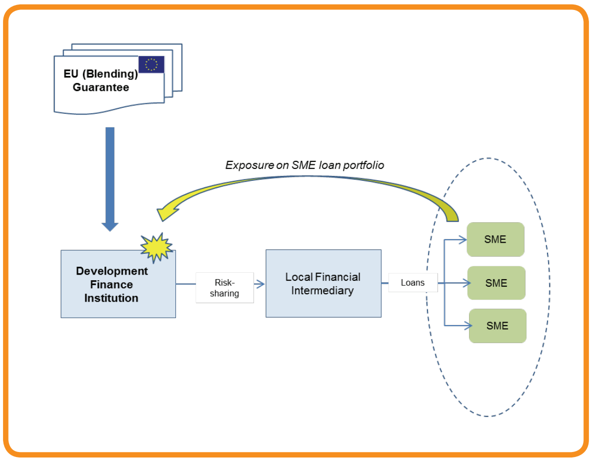
- **Guarantees covering the risk exposure of DFIs to LFIs:** In this case, the DFI provides a SME credit line (normally on an unsecured basis) to an LFI. If there are any loan defaults, this risk is fully absorbed by the LFI. However, the financing possibilities of the DFI are limited by the overall credit risk of the LFI. The EU guarantee mitigates this risk, enabling the DFI to increase total financing; in the example below, it can provide a credit line to a second financial institution (see Figure 3.2).

FIGURE 3.2 Guarantees covering risk exposure of DFIs to LFIs



- **Guarantees covering the risk exposure of DFIs to the SME lending portfolio of LFIs:** In this case, the DFI provides the LFI a portfolio of risk-sharing mechanisms (a credit line can also be provided, but not necessarily). This will enable the financial institution to expand its lending portfolio to SMEs. The guarantee of the DFI to the financial institution is either a 'funded guarantee' or an 'unfunded guarantee', depending on whether it is accompanied by a credit line. This is the most common use of guarantees via blending. The EU guarantee acts as a counter-guarantee to the portfolio guarantee provided by the DFI to the LFI (see Figure 3.3).

FIGURE 3.3 Guarantees covering risk exposure of DFIs to the SME lending portfolio of LFIs



For example, in the case of the SME Guarantee Facility covering Jordan, Egypt, Lebanon, Tunisia and Morocco, the involved IFIs — the European Investment Bank (EIB), the Agence Française de Développement (AFD) and the International Finance Corporation (IFC) will provide a partial risk guarantee to the LFIs. These risk guarantees are contingent upon actual losses being incurred in the SME lending portfolio of the local banks. On the other hand, at the level agreed between the EU and the IFIs, the NIF will provide a junior tranche to the EIB, which will absorb the first losses incurred by the DFIs.

The rationale for risk mitigation instruments such as guarantees is to overcome an initially real or perceived risk barrier and help lenders build experience in the SME sector. Thus, donors can reduce perceived risk to a level closer to actual risk — and in this way significantly increase the availability of affordable financing.

CHAPTER 4

Key issues in project development

Because financial instruments are comparatively complex products, their design needs to be adapted to the **operating environment** of individual partner countries. Many financial instruments require a degree of certainty in the host country's legal and regulatory environment (e.g. where they form part of a public-private partnership) or the presence of a local financial infrastructure (e.g. SME instruments).

In fact, a key objective of these instruments, beyond the immediate financing they provide, is to help develop beneficiary countries' **financial and economic infrastructure** and thus help them achieve sustainable development.

4.1 Ensuring development impact

SME support interventions should be targeted and accessible. This objective can be achieved through a **demand-driven approach** in designing donor interventions. Interventions based on the actual needs and requirements of enterprises are much more likely to be successful and to be accepted by the client companies. A high-quality assessment in the form of a **robust diagnostic** of the nature of the market failure is clearly an important precondition for a well-designed intervention.

Development practitioners often justify assistance to SMEs by the **special contributions they make** (jobs and investment) or the unique challenges they face. Still, there is only limited research evidence on the actual contribution of SMEs to employment generation and economic growth. Some facts from the existing literature include the following (IFC, 2013; World Bank, 2011).

- Small firms create more jobs than large firms, but they have a lower productivity growth. On average, formal SMEs account for 45 % of total employment in developing countries; this is mostly in the service and manufacturing sector. It is safe to assume that if informal SMEs are added, this figure is well above 50 %.

- Firm growth is dependent on size and age. Unlike in developed countries where firms are born small and then grow bigger, surviving firms in developing countries are either born large and do not grow much or even decline in size.

- In low-income countries, small firms have the highest share of total employment and job creation. This circumstance should spur action in the formalisation of firms and in removing constraints that prevent small and young firms from growing and maturing.

SME support schemes have the highest development impact if they are based on clear evidence of market failures and sub-optimal investment situations in the SME sector and embedded in the activities of other donors and national support schemes. Measuring the development impact of SME support schemes is important, and is strongly recommended by the 2014 private sector communication:

> **Measurable development impact:** Support given to a private enterprise or financial intermediary has to contribute in a cost-effective way to the achievement of development goals such as job creation, green and inclusive growth or broader poverty reduction. This requires transparency as regards objectives and results, along with appropriate monitoring, evaluation and results measurements arrangements (EC, 2014:5).

Besides providing technical and financial support and leveraging private investment into SMEs, the EU can also promote **responsible business practices** among SMEs via blending. For example, Client Protection Principles have been developed by a broad coalition of microfinance institutions, DFIs and practitioners to define the minimum protection microfinance clients may expect from microfinance institutions. These principles cover aspects such as appropriate product design and delivery, prevention of over-indebtedness, transparency, responsible pricing, fair and respectful treatment of clients, privacy of client data and mechanisms for complaint resolution.

Annex 3 provides a brief overview of other globally accepted responsible investment principles which can serve as guidance when designing and programming SME support schemes in partnership with DFIs and LFIs.

4.2 Avoiding market distortions

Besides achieving a measurable development impact, the avoidance of market distortions is an important aspect when supporting private sector actors. This premise is also clearly set out in the neutrality principle of the 2014 private sector communication:

> **Neutrality:** The support given should not distort the market and should be awarded through an open, transparent and fair system. It should be temporary in nature with a clearly defined exit strategy. Support justified by market failures and consequent risks should not have the effect of discouraging regulatory reform efforts addressing the causes of market failures (EC, 2014: 5).

In addition to the criteria set out by the 2014 private sector communication, the Principles to Support Sustainable Private Sector Operations offer similar guidance on key aspects of PSD support (Heads of MDBs, 2012). These principles, endorsed by several DFIs in 2012, set out the following **five principles** for private sector (and thus also for SME support interventions) from the point of view of DFIs.

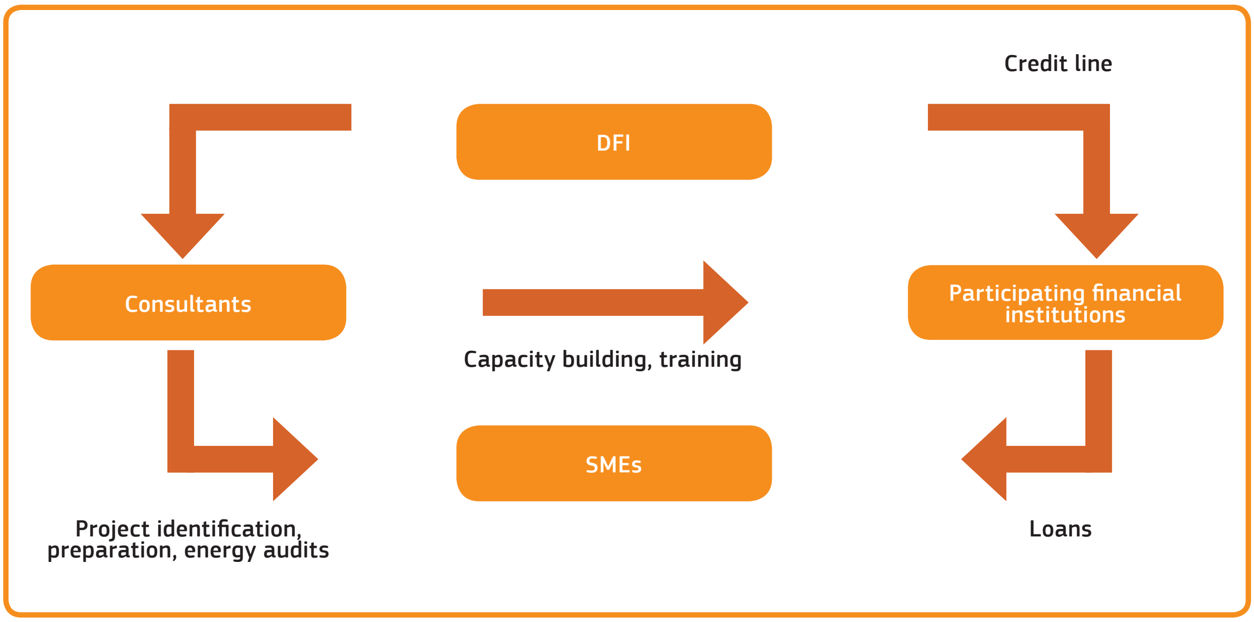
- **Additionality:** DFI support of the private sector should make a contribution beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector.
- **Crowding-in:** DFI support to the private sector should, to the extent possible, catalyse market development and the mobilisation of private sector resources.
- **Commercial sustainability:** DFI support of the private sector and the impact achieved by each operation should be sustainable, both during and after involvement. Multilateral development bank support must therefore be expected to contribute to client commercial viability.
- **Reinforcing markets:** DFI assistance to the private sector should be structured to effectively and efficiently address market failures, and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.
- **Promoting high standards:** DFI private sector operations should seek to promote adherence to high standards of client conduct.

4.3 Climate aspects

Climate change aspects are not, with some exceptions, the main motivation behind designing and delivering SME support programmes. However, the SME sector is an important sub-sector from the perspective of climate change and carbon dioxide emissions, and climate aspects are important when considering sustainable growth. Globally, the industry sector (of which SMEs are a sub-set) is responsible for around 20% of carbon dioxide emissions.

The most advanced method of integrating climate change mitigation aspects into SME support schemes is via **energy efficiency credit lines**. All major DFIs have wide experience in designing and managing such dedicated credit lines. For example, the EBRD has mainstreamed Sustainable Energy Financing Facilities into its operations; in most, but not all, cases, SMEs are eligible. The basic structure of a typical SME energy efficiency credit line is shown in Figure 4.1.

FIGURE 4.1 Basic structure of typical SME energy efficiency credit line



These energy efficiency credit lines focus on SMEs which plan to implement sustainable energy projects (e.g. purchase a new, more efficient production facility) and which want to borrow from a participating bank for this purpose. Depending on the availability of investment grants, DFIs may consider the introduction of stricter eligibility criteria (e.g. a minimum energy saving threshold of 10 % or 15 %) and to incentivise SMEs to go beyond current practice (e.g. SMEs might receive an extra incentive in the form of a grant if they also introduce an energy management system).

The consultant hired by the DFI has the important role of supporting SMEs in identifying and developing viable energy efficiency projects, e.g. by carrying out energy audits. Depending on individual experience, the same consultant could also support participating banks in introducing tailored SME loan products and in their marketing campaigns.

CHAPTER 5

Risks and risk mitigation

In the context of SME access to finance support schemes, two different levels of risk must be differentiated.

- **Programme-level risk:** This refers to uncertainty on the suitability, additionality and demand for a SME support intervention.
- **Micro-level risk:** The credit risk of individual sub-projects financed by blending facilities depends on factors specific to each enterprise: size, age and development stage, diversification, quality of management staff, debt level, rate of technological change, number of customers, etc.

As the identification, assessment and management of micro-level risks is the responsibility of DFIs and their partner financial institutions, only programme-related risks are discussed here.

For all financial SME support programmes, sound analytical and empirical evidence on a SME financing gap in a specific market or country is an important risk mitigation tool.

So far, no standardised and generally accepted methodology exists to evaluate ex ante SME access to finance. However, the European Investment Fund has published 'Guidelines for SME Access to Finance Market Assessments' (EIF, 2014) which provide guiding principles and a set of tools based on its experience with the Joint European Resources for Micro to Medium Enterprises instrument in EU Member States. However, the European Investment Fund notes that: 'Against the background of an environment of imperfect information and uncertainty, there is *no* perfect solution to assess (ex-ante) SME finance market gaps and the correct quantification of these gaps is *impossible*' (EIF, 2014: 6).

While these guidelines are primarily designed to be applied in EU Member States, the proposed market assessment analytics can also be adapted for application in diagnostic studies outside the EU as well.

In view of these key issues and the methodological difficulties, EC staff should critically analyse and challenge each new intervention proposal or contribution request from DFIs. Despite the sophisticated terminology used in the banking sector, common sense is the best approach in critically assessing new intervention proposals.

By way of guidance, a few typical questions are presented below based on common-sense rather than scientific scrutiny. This guidance should be seen as complementing the already established approval procedures in each blending facility. Also, the aim of these questions is not to create any dispute between the EC and the lead financial institution, nor to question the lead financial institution's due diligence quality and project development efforts[1].

The main questions concern principles and criteria.

- What is the underlying **evidence of the justification** of the intervention? Has a feasibility study or market assessment been carried out in advance

(1) A lead financial institution is an accredited (eligible) financial institution which may submit project proposals to blending facilities. Upon approval of the project proposal by the governing body of the blending facility, the EC delegates implementation of the EU grant to the lead financial institution.

(analytical underpinning)? Has the lead financial institution carried out any appraisal missions on site; if yes, which stakeholders have been met?

- Is a **market failure** specified and defined? What evidence (beyond mere statements or general observations) is provided on the existence of the market failure which is being addressed by the project?

- Is there a clear definition and understanding of the **target group** (final beneficiaries) and their specific needs and constraints? Was there any direct interaction with major local stakeholders (e.g. individual SMEs, business or SME associations, government agencies) outside the financial sector during the design of the intervention?

- Have concrete results in terms of **development impact** been clearly identified?

- Has a careful consideration of **alternatives** been carried out?

- If the intervention includes **technical assistance for the LFIs**, has the scope of this technical assistance been discussed during the negotiations between the lead financial institution and the LFIs? Have the LFIs (if already selected or at an advanced stage of negotiations) had the opportunity to review and comment on the technical assistance terms of reference? Were the LFIs invited as observers in the procurement of the technical assistance, including participating in interviews with key experts?

ANNEX 1
Case studies

Case Study 1: European Fund for Southeast Europe

The EFSE provides sustainable funding to micro and small enterprises to help them grow, generate additional income and create employment; it also provides funding to low-income families to assist them in improving their housing conditions. It does so with a strong commitment to responsible finance.

The EFSE was initiated and launched in 2005 by the KfW Development Bank. It was established as the successor fund of the four European funds in Bosnia and Herzegovina, Kosovo, Montenegro and Serbia. The result was the successful transfer of various preceding development finance initiatives, supported by several donor agencies and their integration into a new sustainable institutional structure.

The fund's initial outstanding loan portfolio of EUR 122 million, transferred from the preceding European funds, has increased by 200% to EUR 244.5 million after the first year of operation, making it one of the world's largest microfinance investment vehicles.

The initial fund advisor was Frankfurt School of Finance (Bankakademie); currently, it is Finance in Motion, which also manages the Green for Growth Fund and SANAD.

ORGANISATION AND GOVERNANCE

The fund is governed by a general shareholder assembly, a board of directors, an investment committee and a development facility committee; Box A1.1 details their governance functions. The overall organisational structure of the fund is shown in Figure A1.1.

CAPITAL STRUCTURE AND INVESTORS

The advantage of the EFSE funding strategy is to use donor funds to leverage additional funds at a large scale for development purposes. This is achieved by issuing different share tranches bearing different risks (see Figure A1.2):

- public donors invest in the junior tranche (first-loss piece);
- DFIs and IFIs invest in the mezzanine tranche;
- private investors invest in the senior tranche.

While mezzanine and senior investors invest at the regional level, donor funds can either be earmarked to a specific country or to the region at large. Country-specific donor funds are exclusively used for investments in a particular country, facilitating a possible later transfer of ownership to local stakeholders. Regionally earmarked donor funds allow for flexible use of funds and can therefore best accommodate changing development finance needs in the target region.

The following donors have contributed grants as first-loss capital (C shares): the EU, the German Federal Ministry for Economic Cooperation and Development (BMZ), the Swiss Agency for Development and Cooperation, the Austrian Development Agency, the Danish International Development Agency (Danida), the Government of the Republic of Albania and the Small and Medium Business Credit Support CJSC (subsidiary of the Central Bank of Armenia).

BOX A1.1 EFSE governance structure

The **General Assembly of Shareholders** is the highest level of authority. The main decision-making powers lie with the Board of Directors supported by its technical committees: the Investment Committee and the EFSE Development Facility Committee.

The **Board of Directors** comprises representatives from IFIs and donors, provides access to a wealth of diverse knowledge and experiences, and has decision-making authority.

The **Investment Committee** is appointed by the Board. It is a specialist body that supports the Board in key decisions on investment transactions.

The Development Facility is operated separately alongside the fund. All activities financed by the EFSE Development Facility require the prior authorisation of the **EFSE Development Facility Committee**, which is made up of representatives from donor agencies that contribute grant funding to the facility. The Investment Committee and the Development Facility Committee have delegated decision-making powers.

The final, crucial link in the fund's organisational structure is the **Advisory Group**. Formed by the governors and other high-level representatives from central banks in the target countries, this body provides the EFSE with better linkages to local realities, concerns and needs, shares local experiences, and makes policy and operational recommendations to the fund management and the Board of Directors.

Day-to-day management of both the Investment Fund and the EFSE Development Facility is entrusted to a group of professional service providers.

FIGURE A1.1 Fund organisational structure

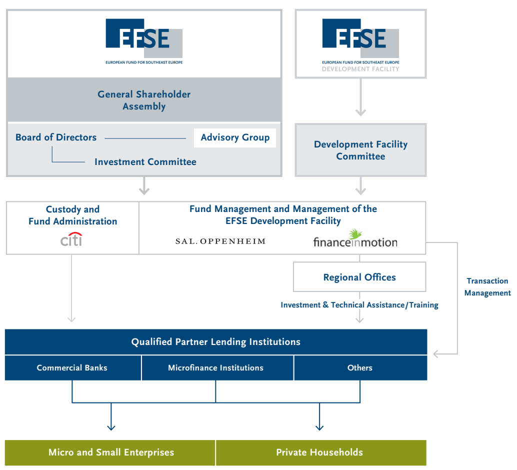
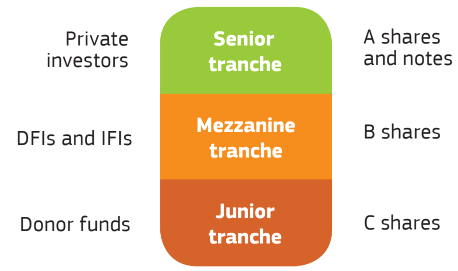


FIGURE A1.2 Share tranches



The IFIs that have invested in the mezzanine tranche (B shares) are the IFC, the EBRD, KfW, the Netherlands Development Finance Company, the Oesterreichische Entwicklungsbank and the EIB.

INVESTMENT STRATEGY

The investment objectives of the fund are:

- the provision of development finance in South East Europe through qualified financial institutions to the target group of micro and small enterprises in urban and rural areas and low-income private households;
- strengthening of local financial markets to better serve the financing needs of micro and small enterprises and private households,

- the provision of long-term funds, in addition and complementary to other financing initiatives in the region.

The EFSE provides the following financial instruments:

- medium- to long-term senior loans;
- syndicated loans;
- subordinated loans;
- term deposits;
- subscriptions to bond issues;
- guarantees;
- equity/quasi-equity participations.

The investment focus of the fund is on micro and small enterprises, rural micro and small enterprise loans (particularly for agriculture, livestock and agro-processing), housing and home improvements for private households.

The EFSE does not directly lend to end borrowers (micro and small enterprises and low-income private households). It provides commercial long-term funds to carefully selected qualified LFIs — its partner lending institutions — after strict due diligence for refinancing of business and rural/agricultural loans to micro and small enterprises and private individuals; as well as housing loans to private households, including housing energy efficiency loans.

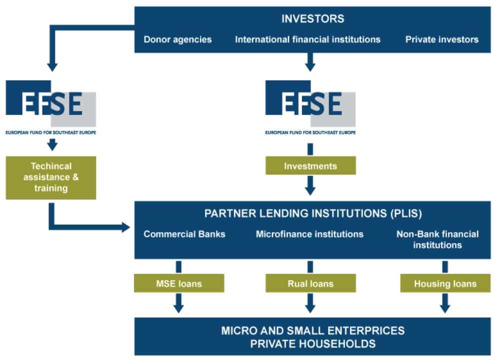
FINANCIAL INTERMEDIARIES

The EFSE operates through LFIs in South East Europe and the European Eastern Neighbourhood Region. These intermediaries include commercial banks, microfinance banks, microcredit organisations and non-bank financial institutions such as leasing companies. They on-lend funds received from the EFSE to the fund's ultimate target group: micro and small enterprises and low-income private households.

The fund only invests in financial intermediaries that fulfil a comprehensive set of eligibility criteria (e.g. sound financial performance, good governance, prudent management and clear target group orientation). The level of fulfilment of these criteria is rigorously analysed and monitored as part of the fund's overall risk management strategy.

The partner lending institutions bear the full risk associated with the disbursed sub-loans and, in principle, are free to define final terms and conditions to their sub-borrowers. To a limited extent, the fund's instruments bear some minimum conditions to ensure target group orientation as specified below. The maximum loan amount of the underlying sub-loans for all three products is EUR 100 000. During the entire credit cycle, the fund requires partner lending institutions to comply with minimum environmental and social standards that represent international best practices (see Figure A1.3).

FIGURE A1.3



As of the end of 2013, the EFSE had worked with more than 70 financial intermediaries.

- **Albania:** Credins Bank, Banka Kombetare Tregtare, ProCredit Bank, Opportunity Albania
- **Armenia:** Ararat Bank, Converse Bank, Byblos Bank, Inecobank
- **Azerbaijan:** Bank Respublika, AccessBank
- **Belarus:** Belgazprombank
- **Bosnia and Herzegovina:** Intesa Sanpaolo Banka, NLB Tuzlanska Banka, NLB Razvojna Banka, Nova Banka Banja Luka, Raiffeisen Bank, ProCredit Bank, EKI, MI-BOSPO, Mikrofin, Partner, Sunrise, MF Banka
- **Bulgaria:** Raiffeisen Bank, ProCredit Bank

- **Croatia:** Zagrebacka Banka
- **Georgia:** Bank of Georgia, ProCredit Bank Georgia, Bank Republic
- **Kosovo:** NLB Prishtina, ProCredit Bank, KEP Trust, KRK
- **FYR Macedonia:** Halkbank, NLB Tutunska Banka, ProCredit Bank
- **Moldova:** Moldova Agroindbank, ProCredit Bank, Microinvest
- **Montenegro:** Crnogorska Komercijalna Banka, Erste Bank Podgorica, NLB Montenegrobanka, Hipotekarna Banka, Alter Modus
- **Romania:** Banca Transilvania, Opportunity Microcredit, Patria Credit, ProCredit Bank, Agricover Credit
- **Serbia:** Cacanska Banka, Komercijalna Banka, Privredna Banka, Banca Intesa Beograd, Opportunity Bank, ProCredit Bank, ProCredit Leasing, Raiffeisen Bank, Sberbank
- **Turkey:** Alternatifbank, Fibabanka, Sekerbank, Garanti Leasing
- **Ukraine:** Megabank

RISK MANAGEMENT

During the lifetime of the EFSE, no losses have ever been recorded and no asset impairment reported. External audit reports have always been unqualified. This high level of security is the result of robust risk management, entailing a number of core features such as:

- **credit risk management**, including an internal rating system to measure the financial strength of partner lending institutions as well as regular monitoring through on-site visits by the local offices run by the fund advisor;
- **management of market and asset/liability risks** through an asset-liability committee, jointly operated by the fund manager and the fund advisor;
- **operational risk management**, comprising frequent training of fund staff, among other actions.

TECHNICAL ASSISTANCE

The financing activities of the fund are complemented by a technical assistance facility — the EFSE Development Facility — aimed at enhancing the long-term development impact of EFSE investments and maximising outreach with MSMEs and low-income households.

The EFSE Development Facility provides the following support services, implemented by qualified consultants:

- **tailored, hands-on consulting and training** to support the fund's partner lending institutions in building internal capacities and optimising their processes (individual technical assistance);
- **support to the broader financial sector** in the fund's target countries by working with sector organisations to promote growth and responsible financial practices (sector technical assistance);
- **applied research** on a wide spectrum of topics to gain insight into the drivers of and obstacles to development (applied research).

The EFSE Development Facility contracts specialised consultants through competitive bidding processes overseen by the Development Facility Committee (constituted of representatives from KfW, the Swiss Agency for Development and Cooperation, and the Netherlands Development Finance Company). The selection of an appropriate consultant is carried out in close collaboration with the partner institution(s) to ensure strong commitment from local counterparts. In addition, the EFSE Development Facility requests cost sharing from the institution.

RESULTS AND IMPACTS

Since the inception of the fund, EUR 1.5 billion has been committed; the current investment portfolio (as of year end 2013) stands at EUR 826 million. The majority of this investment portfolio is comprised of micro and small enterprise loans (78 %); the remainder are housing loans (22 %). The average loan size is EUR 5 700.

The four most active countries — accounting for more than half of the total investment portfolio — are Serbia (24 %), Bosnia and Herzegovina (12 %), Turkey (9 %) and Georgia (9 %).

The EFSE has not only had a positive impact on funding to its target group, but has also demonstrated the viability of the structured fund business model. The EFSE was the first fund supported by the EU via a first-loss donor contribution.

Based on the success of this model, several subsequent investment funds have been created replicating the fund structure; these include the Green for Growth Fund and SANAD.

Case Study 2: SME Guarantee Finance Facility

The overall objective of the regional Euro-Mediterranean Investment Partnership SME Guarantee Facility is an increase in local banks' lending to SMEs, improving access to finance for SMEs on a sustainable basis and — ultimately — job creation. The facility targets Jordan, Lebanon, Egypt, Tunisia and Morocco. It is designed as a EUR 320 million unfunded risk-sharing facility implemented by the following IFIs:

- EIB — EUR 120 million;
- IFC — EUR 120 million;
- AFD — EUR 40 million;
- Organization of the Petroleum Exporting Countries (OPEC) Fund for International Development — EUR 40 million.

The NIF grant of EUR 24 million, to be managed by the EIB, will serve as a risk cushion for the facility that brings the necessary credit enhancement to provide an incentive to LFIs to scale up lending to SMEs.

Under the facility, the IFI partners will enter into individual guarantee operations with selected local banks (partner financial institutions). The facility will provide these partner financial institutions with a partial credit risk guarantee for covering up to 50 % of the losses of the principal amount (not automatically accrued interest) incurred under their portfolios of eligible loans to SMEs.

The purpose of the loans will be to finance business operations, including working capital, equipment and machinery financing. Thus, partner financial institutions shall retain at least 50 % of the credit risk and not be entitled to transfer this remaining risk to any third party without the consent of the IFI. Furthermore, partner financial institutions will have to pay a guarantee fee to be negotiated on a case-by-case basis.

To be eligible as partner financial institutions, the selected bank will have to meet the eligibility criteria set up by the IFI partners.

The recent Arab Spring highlighted the fact that economic growth led by PSD remains the cornerstone of any equitable growth strategy and job creation in the region. Indeed, most businesses in the Mediterranean partner countries are SMEs and micro-enterprises representing between 80 % and 95 % of all local enterprises (depending on the country) and accounting for between 20 % and 40 % of all private sector employment.

SMEs in the Mediterranean partner countries are severely constrained by lack of access to finance. For example, less than 20 % of these SMEs have a loan or line of credit from a financial institution, and only about 10 % of banks' total investment finance goes to the SME sector.

The facility is designed as an instrument to help bridge this financial services gap for SMEs and make a meaningful contribution towards greater financial inclusion in the region. It will provide an effective risk management tool aiming to encourage local commercial banks to increase their financing to SMEs, by deploying local currency resources mobilised from their domestic market. Portfolio guarantees provided on a large scale are not common in the region.

Each of the five targeted countries has at least one national partial credit guarantee scheme in place. The most important of these in each country are the Credit Guarantee Company in Egypt (majority owned by banks), the Jordanian Loan Guarantee Corporation (60 % state owned), Kafalat in Lebanon (37.5 % state owned), the Caisse Centrale de Garantie in Morocco (100 % state owned) and Sotugar in Tunisia (100 % state owned). The performance of these credit guarantee schemes paints a rather mixed picture, as not all of them appear to reach a significant number of SMEs. The SME guarantee facility will complement those schemes; potential overlaps will be assessed and cooperation sought where possible.

The facility will complement risk-sharing instruments set up by other European DFIs/IFIs (such KfW and the AFD), and is part of the Arab World Initiative developed by the World Bank.

- KfW fully supports the project and appreciates the complementarity with its existing SANAD initiative that has received a NIF contribution of EUR 10 million.
- AFD has developed a partial credit risk guarantee mechanism for the Mediterranean partner countries (ARIZ MED) for both individual loans and loan portfolios. With the risk-sharing facility in place, ARIZ MED will focus on single SME loan guarantees.

In addition, and to complement the facility, a USD 30 million technical assistance programme is being set up and managed by the World Bank Group as part of its Arab World Initiative. This technical assistance will contribute to the long-run success of the facility and to improvement of know-how of both banks (on the supply side) and SMEs (on the demand side) to achieve an increase in bank lending to SMEs.

Case Study 3: EBRD Enterprise Growth Programme and Business Advisory Services in Eastern Partnership Countries

The SME sector in Eastern Partnership countries face structural problems due to the legacy of state ownership and control, an adverse business environment and — sometimes — the existence of a cash-based shadow economy.

The overall objective of this initiative is to support economic transition and support enterprises in adapting to the demands of a market economy and to build capacity for innovation and growth. The specific objectives include:

- improve access to finance for SMEs and help attract public and private investments;
- enhance the competitiveness of assisted SMEs;
- disseminate best practice examples and models;
- strengthen the sustainability of local business advisory services to SMEs.

The programme builds on the EBRD's successful Turnaround Management — now the Enterprise Growth Programme (EGP) — and Business Advisory Services (BAS) programme. Today, both initiatives are managed by the EBRD as part of its Small Business Support programme.

While the EGP helps enterprises transform themselves and implement structural changes by providing the advice of experienced international experts (e.g. former chief executive officers and directors), the BAS enables SMEs to access qualified local consultants.

The rationale for both programmes is the nascent business consultancy market in many Eastern Partnership countries. Many local business consultants only offer a limited scope of advisory services. Limited expertise is available in the fields of strategic planning, restructuring, computerised manufacturing systems, and energy efficiency and environmental management.

ENTERPRISE GROWTH PROGRAMME

The scope of the EGP involves the following support services.

- Industry-specific management expertise is introduced by providing the advisory services of experienced senior executives from economically developed countries.

- A focus is maintained on substantial managerial and structural changes and support to the introduction of international best practices to SMEs by engaging highly experienced international senior executives and industry experts as advisors, working directly with the management of assisted SMEs. Projects involve extensive restructuring, usually encompassing all aspects of an enterprise's activities. The EGP has an extensive database with senior advisors from a large range of industry sectors and countries. Enterprises are matched with advisors from the same industry sectors.

- To increase client commitment and ownership of EGP projects, the EGP has introduced cost sharing. This requires clients to make a financial contribution towards project costs, based on a predefined matrix. In addition, all EGP beneficiaries are expected to cover all local transport and translation services related to each individual project.

- Assistance is provided to emerging mid-sized companies to help them become more creditworthy and, therefore, bankable. The EGP will work closely with the organisation's banking team to identify promising projects.

- Seminar and training activities are conducted to disseminate successful case studies, lessons leaned and best practices to a wider audience.

BUSINESS ADVISORY SERVICES

The scope of the BAS involves the following support services.

- Assistance is provided to individual enterprises to engage with local consultants on a cost-sharing basis through narrowly based, specific projects with a rapid payback. Support provided by the BAS includes project development, monitoring during project implementation, followed by evaluation one year after completion and flexible grants (up to 75 % of net project cost capped at EUR 10 000) based on country-specific grant guideline matrices, which determine the grant percentage for each project based on size, location and type of advisory service.

- Projects supported by the BAS will include market analysis and planning, development planning, feasibility studies, reorganisation/restructuring; computerised financial/management information systems; computerised manufacturing systems; engineering studies; quality management and certification systems; environmental management and energy efficiency–related projects. Special attention will be given to support projects that assist local SMEs in improving their access to finance.

- Cooperation with the EFSE and its partner lending institutions as well as with the organisation's partner banks in the Eastern Partnership countries will improve access to finance for BAS clients and facilitate the engagement of consultancy services by MSMEs receiving external financing.

- Market development activities include MSME and consultancy training to enhance access to local consulting as well as improve professionalism and supply of services; visibility and dissemination of best practices as well as promotion of consultancy benefits to a wide audience of MSMEs to promote the use of business advisory services as well as stimulate demand for more sophisticated consultancy services; support to and development of existing local institutions to consolidate and promote long-term sustainability of the local consultant industry and local institutions supporting MSMEs; informed contribution to policy dialogue with national agencies in partnership with other stakeholders to promote the development of the MSME sector.

The EBRD selects interested local consultants to work under the BAS by checking their track record and, if pre-selected, providing opportunities for continuous professional development.

The EBRD has offered this programme since 1995; therefore, it is helpful to look at experiences so far. In 2007, the EBRD prepared a mid-term review on BAS management and its impact at the enterprise, consultant and market development levels (EBRD, 2007). The review confirmed the need for an instrument like the BAS at the operational (field) level, encouraging enterprises to use consultancy services within a managed environment (accreditation of consultants and review of their performance), thus to break the ice, especially for first-time users of consultancy services.

The rather loose definition of BAS strategic objectives and indicators was noted by the, which only covered the period 2000–2005. Furthermore, expected sustainability impacts such as project benefits and skills transfer could not be measured, as no data existed on the proportion of enterprises which have experienced a permanent change in attitude and behaviour to pay for external consultancy services.

The review also highlighted the difficulties of translating a successful pipeline of projects into a sustainable consultancy market development. This could be achieved by selecting projects with non-standard (innovative) consultancy needs (rather than applying the first-come first-served principle) and disseminating such cases to encourage other firms to work with consultants.

ANNEX 2

Debt versus equity

Equity constitutes an ownership title in a legal entity such as a company or an investment vehicle and fully shares both the upside and downside potential of the venture. Equity is a long-term funding source, absorbs losses and shares the net earnings once all other claims (such as wages, taxes and debt service) are remunerated.

On the other side, **debt** constitutes a creditor claim on the company, can be provided on a short- to long-term basis, and its repayment (according to pre-agreed schedule) has priority over the disbursement of net earnings to the owners (equity capital).

The **loss-absorbing** and **long-term** nature of equity makes it the dominant source of finance for SMEs in the early stages of development, characterised by negative cash flows and untried business models.

Traditionally bank (loan) financing of young or newly set-up companies with a lack of commercial history (especially innovative companies which employ new or untested technologies) is severely constrained, partly because of a weak balance sheet due to a lack of equity. Therefore, as SMEs grow, they tend to complement equity with debt once cash flows become positive and collateral becomes available to lenders.

Growing companies can generate equity internally by **retained earnings** (i.e. earnings not disbursed to shareholders but which are by purpose re-invested in the company). However, during the seed and start-up phases, this is not possible. During these initial phases, the most common sources of equity capital come from the personal savings of the founding entrepreneur and **informal sources** (family and friends). **Formal equity providers** such as 'angel' investors, venture or private capital — especially in developing countries and countries in transition — are rare. The main reason for this situation is the perception that equity investors cannot achieve the type of risk-adjusted returns deemed necessary or can exit investments within a reasonable time frame, especially for investment in SMEs. The situation is further impaired by well-known principal-agent problems such as information asymmetries, adverse selection and high monitoring costs.

The importance of venture and private equity goes well beyond the funding itself. Besides taking an ownership stake in the company alongside the entrepreneurs, these private equity funds provide substantial **managerial and business development support**, business contacts and counselling of owners and senior managers. This ensures that the investee companies adopt state-of-the-art management, operational, accounting and marketing procedures (which is especially important if the founders are e.g. engineers who are rightly focused on the product of the company). Furthermore, through marketing support and brokering valuable business contacts, they support expansion of the company. Finally, private equity firms demand and support execution of a highly ambitious growth strategy, ensuring a profitable exit after some years. Such targeted assistance can be a very powerful instrument for further developing SMEs; it can also be more effective than stand-alone technical assistance or business advisory services.

However, it must be mentioned that not all business owners want external equity investors such as private equity firms because this also means selling a substantial (sometimes a majority) stake in the company — thus giving up ownership and control.

This clearly constitutes a case for donor-, government or DFI-backed venture capital and private equity vehicles or SME stock exchanges. More information and policy recommendations can be found in the *SME Finance Policy Guide* (IFC, 2011).

Investment risk associated with equity investors is higher than that of lenders. The returns of an equity investment can have high variability and uncertainty, depending on the commercial success of the company. Therefore, the expected return for equity investments is also higher than corresponding debt financing, if compared for the same company. External equity providers (such as angel investors, venture and private equity funds) perform a rigorous and intensive due diligence and screening process before committing to invest in any company.

All financing instruments can be categorised along the debt-equity continuum. For example, **leasing** has essentially the same debt characteristics as a straightforward bank loan (besides, depending on the jurisdiction, the tax treatment). Financing instruments such as **mezzanine finance** lie between debt and equity. **Junior loans** are an example of a mezzanine finance instrument; these are technically loans, but the priority rank of repayment is after that of senior loans, making them more risky.

The weighted average of cost of capital of a company (of both the equity and debt) is an important determining factor in business and investment planning. In theory, each new investment the company undertakes should at least earn the cost of capital.

ANNEX 3

Responsible investment principles

The EU private sector communication (EC, 2014) and related Council conclusions call for increased attention to promoting responsible business practices through EU external development policy.

It is widely acknowledged that private investments in low- and middle-income countries have increased significantly in recent decades, far exceeding official development assistance. Figure A3.1 shows the composition of private international investment flows to developing countries between 1990 and 2011[1]. As shown in the figure, the level of foreign direct investments, remittances and long-term loans and bond investments all exceed official development assistance. Thus the importance of **institutional investors** (such as investment funds, pension funds, insurance companies) has significantly increased, as has as their potential role as facilitators and enablers for sustainable and responsible investment.

The three broad areas which responsible finance principles address are:

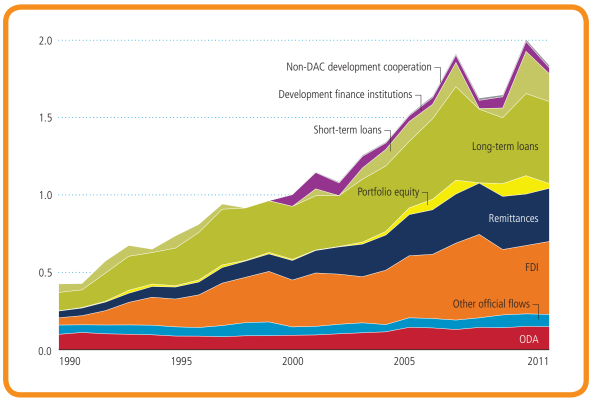
- financial institution self-regulation;
- consumer protection;
- financial education (literacy).

The following presents some globally accepted principles in dealing with the investment activities of DFIs and financial intermediaries; these go beyond SME finance.

The Principles for Responsible Investment initiative was launched by the United Nations in 2006 after former Secretary-General Kofi Annan brought together a group of the world's largest institutional investors, academics and financial advisors to draft a set of six sustainable investment principles:

- We will incorporate environmental, social and governance issues into investment analysis and decision-making process.
- We will be active owners and incorporate environmental, social and governance issues into our ownership policies and practices.
- We will seek appropriate disclosure on environmental, social and governance issues by the entities in which we invest.
- We will promote acceptance and implementation of the Principles within the investment industry.

FIGURE A3.1 International resource flows to developing countries, 1990–2011



Note: FDI = foreign direct investment; ODA = official development assistance. Data for some flows do not cover the entire period; see source. Excludes flows with no historic data.

Source: Development Initiatives, 2013.

(1) The composition of aid and private capital flows, along with the issue of aid fragmentation, is discussed in OECD Development Centre (2008).

- We will work together to enhance our effectiveness in implementing the Principles.

- We will each report on our activities and progress towards implementing the Principles.

There are currently 1 200 signatories to these principles, representing over USD 34 trillion under management. More information can be found at the Principles for Responsible Investment website.

These principles may be high level and voluntary, but the mainstreaming of sustainable and responsible investment practices into the financial sector and by institutional investment managers has substantial potential to create a lasting impact in both developed and developing countries.

The United Nations Environment Programme Finance Initiative (UNEP FI) and the Equator Principles are other global initiatives; while the Carbon Disclosure Project, the Climate Principles, the Principles for Investors in Inclusive Finance and the Natural Capital Declaration are examples of more thematically oriented initiatives.

Integrating environmental, social and governance aspects into investment decisions is not only about 'doing good' but is becoming an increasingly important risk management tool, helping investors mitigate potential negative outcomes of the business operations of their investee companies. Clearly, there is a spectrum of investment models and associated risk/return combinations, as shown Figure A3.2.

FIGURE A3.2 Spectrum of investment models

				Impact investing		
		Responsible investment				
	Traditional	Screening	ESG integration	Themed	Impact-first	Philanthropy
	Competitive returns					
				Targeted social and/or environmental impact		
FOCUS	Limited or no focus on ESG factors of underlying investments	Negative or exclusionary screening and positive or best-in-class screening, based on criteria defined in a variety of ways (i.e. by product, activity, sector, international norms.)	The use of qualitative and quantitative ESG information in investment processes, at the portfolio level, by taking into account ESG-related trends, or at the stock, issuer or investee level.	The selection of assets that contribute to addressing sustainability challenges such as climate change or water scarcity.	Environmental or social issues which create investment opportunities with some financial trade-off.	Focus on one or a cluster of issues where social and environmental need requires 100% trade-off.
EXAMPLES		▪ Ethically-screened investment fund ▪ Best-in-class SRI fund	▪ Long-only public equity fund using ESG integration to create additional value	▪ Clean energy mutual fund ▪ Emerging markets healthcare fund ▪ Microfinance structured debt fund	▪ Fund providing debt or equity to social enterprise or trading charity	

Source: PRI, 2013 (adapted from Bridges Ventures, 'Sustainable & Impact Investment — How We Define the Market', 2012.

References and further reading

Private sector development

Development Initiatives, 2013. *Investments to End Poverty*. http://devinit.org/wp-content/uploads/2013/09/Investments_to_End_Poverty_full_report.pdf

Donor Committee for Enterprise Development, 2008. *Supporting Business Environment Reforms — Practical Guidance for Development Agencies*. http://www.enterprise-development.org/page/business-environment-reform#database

Donor Committee for Enterprise Development, 2013. 'Private Sector Development Synthesis Note: Member Agency PSD Strategies'. http://www.enterprise-development.org/page/strategies-overview

EC (European Commission), 2010. 'Trade and private sector policy and development: support programmes financed by EU external assistance', Reference Document Nº 10. EC, Luxembourg. http://capacity4dev.ec.europa.eu/t-and-m-series/document/reference-document-nr-10-trade-and-private-sector-policy-and-development

EC (European Commission), 2011. 'Increasing the impact of EU development policy: an agenda for change', Communication, COM(2011) 637 final. EC, Brussels. http://ec.europa.eu/europeaid/news/agenda_for_change_en.htm

EC (European Commission), 2014. 'A stronger role of the private sector in achieving inclusive and sustainable growth in developing countries', Communication, COM(2014) 263 final. EC, Brussels. https://ec.europa.eu/europeaid/european-commission-communication-com2014263-stronger-role-private-sector-achieving-inclusive-and_en

EIB (European Investment Bank), 2013. 'Private sector financing in the Eastern Partnership Countries and the role of risk-bearing Instruments'. http://www.eib.org/attachments/efs/econ_synthesis_report_psf_and_the_role_of_rbi_en.pdf

European Union Council, 2014. 'Council conclusions on a stronger role of the private sector in development cooperation: an action oriented perspective', Summary. http://eu-un.europa.eu/articles/en/article_15857_en.htm

Heads of MDBs (Multilateral Development Banks), 2012. 'Principles to Support Sustainable Private Sector Operations'. http://www.ebrd.com/downloads/news/mdb.pdf

IFC (International Finance Corporation), 2011. *International Finance Institutions and Development through the Private Sector*. http://www.developmentandtheprivatesector.org

IFC (International Finance Corporation), 2013. *IFC Jobs Study — Assessing Private Sector Contributions to Job Creation and Poverty Reduction*. http://www.ifc.org/wps/wcm/connect/0fe6e2804e2c0a8f8d3bad7a9dd66321/IFC_FULL+JOB+STUDY+REPORT_JAN2013_FINAL.pdf?MOD=AJPERES

OECD (Organisation for Economic Co-operation and Development), 2006. *Promoting Pro-Poor Growth: Private Sector Development*. http://www.oecd.org/dac/povertyreduction/promotingpro-poorgrowthprivatesectordevelopment.htm

Private Sector Roundtable, 2013. 'DFI Guidance for Using Investment Concessional Finance in Private Sector Operations'. http://www.ebrd.com/downloads/news/roundtable.pdf

Technical Group 4, n.d. 'Topic 3: Further development of financial instruments and application in practice'. European Union. http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=19082&no=2

World Bank, 2011. 'Small vs. Young Firms across the World — Contribution to Employment, Job Creation, and Growth. Policy Research Working Paper No. 5631. http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2012/11/06/000158349_20121106091157/Rendered/PDF/WPS5631.pdf

SME and entrepreneurship policy tools

OECD (Organisation for Economic Co-operation and Development), 2006. 'Understanding Entrepreneurship: developing Indicators for International Comparisons and Assessments'. STD/CSTAT(2006)9. http://search.oecd.org/officialdocuments/displaydocumentpdf/?doclanguage=en&cote=STD/CSTAT(2006)9

OECD (Organisation for Economic Co-operation and Development). 'Small and Medium-Sized Enterprises (SME) Policy Index', website. http://www.oecd.org/globalrelations/smallandmedium-sizedenterprisessme-policyindex.htm

OECD (Organisation for Economic Co-operation and Development), 2012. *SME Policy Index: Eastern Partner Countries 2012: Progress in the Implementation of the Small Business Act for Europe.* http://www.oecd-ilibrary.org/finance-and-investment/sme-policy-index-eastern-partner-countries-2012_9789264178847-en

OECD-UNIDO (Organisation for Economic Co-operation and Development and United Nations Industrial Development Organisation), 2004. *Effective Policies for Small Businesses: A Guide for the Policy Review Process and Strategic Plans for Micro, Small and Medium Enterprise Development.* http://www.unido.org/fileadmin/media/documents/pdf/Business_Environment/l5hvghso.pdf.pdf

SEAF (Small Enterprise Assistance Funds), 2007. *From Poverty to Prosperity: Understanding the Impact of Investing in Small and Medium Enterprises.* http://seaf.com/wp-content/uploads/2014/10/From-Poverty-to-Prosperity1.pdf

Small Business Act for Europe, http://ec.europa.eu/growth/smes/business-friendly-environment/small-business-act/index_en.htm

United Nations Conference on Trade and Development, 2012. *UNCTAD Entrepreneurship Policy Framework and Implementation Guidance.* http://unctad.org/en/Pages/DIAE/Entrepreneurship/UNCTAD_Entrepreneurship_Policy_Framework.aspx

SME access to finance

EIB (European Investment Bank), 2014. 'Private Sector Financing in the Eastern Partnership Countries and the Role of Risk-Bearing Instruments'. Synthesis report plus country reports on Armenia, Azerbaijan, Georgia, Moldova and Ukraine. http://www.eib.org/infocentre/events/all/sme-financing-in-enca.htm

Entrepreneurial Finance Lab Research Initiative, Center for International Development at Harvard University, 'The missing middle,' website. http://www.hks.harvard.edu/centers/cid/programs/entrepreneurial-finance-lab-research-initiative/the-missing-middle

IFC (International Finance Corporation), 2010. *Scaling-Up SME Access to Financial Services in the Developing World.* http://www.gpfi.org/sites/default/files/documents/G20_Stocktaking_Report_0.pdf

IFC (International Finance Corporation), 2010. *SME Banking Knowledge Guide.* http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/industries/financial+markets/publications/toolkits/smebknowledge+guide/

IFC (International Finance Corporation), 2011. *Scaling Up Access to Finance for Agricultural SMEs Policy Review and Recommendations.* http://www.ifc.org/wps/wcm/connect/04da89804a02e2e19ce0fdd1a5d13d27/G20_Agrifinance_Report.pdf?MOD=AJPERES

IFC (International Finance Corporation), 2011. *SME Finance Policy Guide.* http://www.gpfi.org/sites/default/files/documents/SME%20Finance%20Policy%20Guide.pdf

IFC (International Finance Corporation), 2012. *Innovative Agricultural SME Finance Models.* http://www.ifc.org/wps/wcm/connect/55301b804ebc5f379f86bf45b400a808/Innovative+Agricultural+SME+Finance+Models.pdf?MOD=AJPERES

Small Enterprise Assistance Funds (SEAF). Development impact reports. http://seaf.com/index.php?option=com_content&view=article&id=163&Itemid=182&lang=en

Stein, Peer, Tony Goland and Robert Schiff, 2010. 'Two trillion and counting: Assessing the credit gap for micro, small, and medium-size enterprises in the developing world', Working paper. International Finance Corporation and McKinsey & Company. http://documents.worldbank.org/curated/en/2010/10/16528328/two-trillion-counting-assessing-credit-gap-micro-small-medium-size-enterprises-developing-world

PSD-related evaluations

ADE, 2013. 'Evaluation of the European Union's support to private sector development in third countries'. http://ec.europa.eu/europeaid/how/evaluation/evaluation_reports/2013/1317_docs_en.htm

Asian Development Bank, 2013. 'Support for Strengthening the Enabling Environment for Private Sector Development. http://www.adb.org/documents/adb-assistance-strengthening-enabling-environment-private-sector-development

World Bank Independent Evaluation Group, 2014. 'The Big Business of Small Enterprises — Evaluation of the World Bank Group Experience with Targeted Support to Small and Medium-Size Enterprises'. https://ieg.worldbankgroup.org/Data/reports/sme_eval1_0.pdf

Environmental, social and governance and responsible investment guidance

CDC Group, 2015. 'ESG Toolkit for Fund Managers'. http://toolkit.cdcgroup.com/

PRI (Principles for Responsible Investment), 2013. 'Understanding the impact of your investments — Measuring environmental and social performance', UNEP Finance Initiative and UN Global Compact. http://d2m27378y09r06.cloudfront.net/viewer/?file=wp-content/uploads/Understandingtheimpactofyourinvestments.pdf

Guidance on EU financial instruments and SME finance assessment

EC-EIB (European Commission and European Investment Bank), 2014. *Ex-ante assessment methodology for financial instruments in the 2014–2020 programming period: General methodology covering all thematic objectives, Volume 1*. http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/ex_ante_vol1.pdf

EC-EIB (European Commission and European Investment Bank), 2014. *Ex-ante assessment methodology for financial instruments in the 2014–2020 programming period, Enhancing the competitiveness of SMEs, including agriculture, microcredit and fisheries (Thematic objective 3), Volume 3*. http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/ex_ante_vol3.pdf

European Court of Auditors, 2012. 'Financial instruments for SMEs co-financed by the European Regional Development Fund', Special Report 2/2012. http://www.europarl.europa.eu/document/activities/cont/201203/20120329ATT42186/20120329ATT42186EN.pdf

European Investment Fund, 2014. 'Guidelines for SME Access to Finance Market Assessments (GAFMA)', EIF Working Paper 2014/22. http://www.eif.org/news_centre/publications/eif_wp_22_gafma_april14_fv.pdf

Other resources

Baumol, William, 2010. *The Microtheory of Innovative Entrepreneurship*. Princeton University Press.

The Smart Campaign. 'Client Protection Principles' website. http://www.smartcampaign.org/about/smart-microfinance-and-the-client-protection-principles

EBRD (European Bank for Reconstruction and Development). 'Sustainable Energy Financing Facilities' website. http://www.ebrdseff.com/en/home.html

EBRD (European Bank for Reconstruction and Development), 2007. 'Special Study" Business Advisory Services Programme'. http://www.ebrd.com/downloads/evaluation/0704-4.pdf

'Equator Principles' website, http://www.equator-principles.com/

OECD (Organisation for Economic Co-operation and Development) Development Centre, 2008. 'Development Aid and Portfolio Funds: Trends, Volatility and Fragmentation', Working Paper No. 275. http://www.oecd.org/development/pgd/41890256.pdf

'Principles for Responsible Investment' website, www.unpri.org

'United Nations Environment Programme Finance Initiative' website, http://www.unepfi.org/

MN-BB-16-004-EN-N

Publications Office