Key Financing Policy Reforms and Solutions for the Fourth International Conference on Financing for Development

The Fourth International Conference on Financing for Development (FfD4) represents a pivotal moment for global leaders, financial institutions, and policymakers to address the **long-standing financing challenges faced by Small and Growing Businesses (SGBs)** in emerging markets.

The Collaborative for Frontier Finance (CFF) www.frontierfinance.org/, a consortium of organizations focused on accelerating appropriate capital for the small and growing businesses[1] in emerging markets, is pleased to provide this submission in advance of the proposed Fourth Financing for Development in mid-year 2025 in Seville, Spain.

I. **Global financing framework**. With regards to small business finances, the Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) 2025 laid out a framing as well as actionable items.

The Frameworks called for *"…a new global framework for financing sustainable development that aligns all financing flows and policies with economic, social and environmental priorities…"*

Of the Framework's 19 points, three in particular are applicable to advancing small business finance.

Framework #5 - Incentivizing changes in financing.

Over the years, the discourse around development sector's focus on small business financing has often centered on traditional intermediaries such as banks, microfinance, and private equity (PE) or venture capital (VC) firms. However, despite their relevance, these institutions have struggled to meet the needs of what is often referred to as the "missing middle"—SGBs that are too large for microfinance and too small or risky for PE/VC investments and banks.
Meanwhile, there is a growing body of evidence that indicates that a new asset class of nonbank financial intermediaries has emerged over the past decade. Small Business Funds (SBFs)[2] hold the key to unlocking the potential of these SGBs. These intermediaries are emerging as crucial actors capable of addressing market gaps and failures and ensuring that businesses that would otherwise be overlooked have access to the capital they need. Meanwhile, in a recent survey of 100 of such SBFs across Africa and MENA, should they reach their targeted scale, they **cumulatively represent over $2 - 3 billion**[3] in "*the right kind*" of capital for small and growing businesses.

[1] Small and growing businesses are commercially viable businesses with five to 250 employees that have significant potential and ambition for growth, typically seeking growth capital from USD $20K to $2M.
[2] Small Business Funds target early-stage companies with high growth potential, filling a critical gap in the capital value chain for small and growing businesses (SGBs) that are too large for microfinance, but not suited for venture capital and private equity, and often lack the type of collateral required by regulated banks.
[3] Collaborative for Frontier Finance (2023). 2023 Annual Local Capital Provider Survey. Available at https://static1.squarespace.com/static/59d679428dd0414c16f59855/t/6540bc7cf4c8160e5bc97bf0/1698741389546/CFF+Annual+Local+Capital+Provider+Survey+2023.pdf

- **They purposely target financing for the "missing middle,"** cutting checks of $20,000 to $2 million (though the majority are below $500,000) to small and growing businesses that are too large for microfinance institutions and too small for commercial lenders. With this segment and transaction of this size, most of local capital providers are raising and managing funds of $10 million to $25 million.
- **They provide the types of funding *needed* by small businesses,** such as working capital and growth capital. Their lending and investing is cashflow-oriented, with minimal collateral-based protection.
- **They finance more intangible needs,** including staff build-out, expansion of sales and marketing capabilities, new market entry, product and services development, technology applications and internal management systems. While not tech investors, many of their portfolio companies' business models are underpinned by technology.
- **The fund managers principally consist of business executives** with extensive experience and deep knowledge of their local markets, customer needs, supply chains and overall operating environment.
- **Their investment thesis and the capabilities of the management team look to address the post-investment needs** of their portfolio companies.
- **They're impact-oriented,** focusing on job creation, gender inclusion, climate resilience, green agri, technology for development and the SDGs.
- **The managers and their teams, while small in number, purposely focus on diversity and inclusivity** among the team and their portfolio businesses, with a strong focus on gender opportunities.

However, for these intermediaries to succeed, the global financing system must adapt, and the FfD4 is the right forum to address these challenges through a more holistic and innovative financing framework.

<u>Framework # 5 - Recommendation</u>: To fully incorporate small business finance into the Framework #5, CFF recommends the following be included:

> ***"Opportunity for global and national development stakeholders to incentivize the expansion of an emerging asset class of local capital providers that specifically target small businesses with innovative approaches to small business finance. Development and local government agencies can provide the concessionary capital needed to scale this emerging asset class of Small Business Funds."***

<u>Framework #10 - Multi-stakeholder Partnerships</u>

The FfD3 provided a package of over 100 concrete measures that draw upon all sources of finance, technology, innovation, trade and data in order to support mobilization of the means for a global transformation to sustainable development and achievement of the Sustainable Development Goals.

Yet, in the list of Action Items, there was no specific agenda for tackling the dearth of capital for small businesses. Three action items took a broad brush that do crossover with small business finance. CFF recommends a revision of framework point #10 to be explicit regarding the approach to multi-stakeholder partnerships, CFF proposes the following.

Framework #10 – Recommendation: CFF recommends the following addition to Framework #10.

> ***"To address the insufficient flow of capital that small businesses require to scale and thrive, strategic partnerships led by local actors are needed. These partnerships should build upon the complementary role that each stakeholder can bring and be centered on a shared vision that small businesses are critical to financial inclusion, sustainable development, and gender equality."***

Framework #16 - Generating full and productive employment and decent work for all and promoting micro, small and medium-sized enterprises.

As data has shown, the greatest generator of jobs in emerging markets is through small and growing businesses. Yet, insufficient focus and resources have been applied to addressing the continuum of capital at each stage of their growth. The international development agenda has relied too much upon microfinance and debt financing from commercial banks. These two financial players are currently not able to address the range of needs as an enterprise evolves from micro to small enterprises. By not recognizing this gap, we are failing to develop a robust small business economic sector that in turn is able to create living wage employment at the pace that population growth is occurring in these countries.

CFF recommends a revision of framework point #16 to be explicit regarding decent work and employment, CFF proposes the following.

Framework #16 - Recommendation: CFF recommends the following be included in Framework #16:

> ***"As research has shown, while small business play an important role in creating employment, they face systemic barriers in accessing appropriate capital to grow and thrive. To meaningful address the opportunities for livelihood sustaining and economic opportunities across the emerging markets it is critical to address the capital gap for small businesses."***

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II. Action Areas: Tailored Solutions to Address Financing Gaps.

Reforms across the following action items would yield a material impact on the growth and sustainability of Small Business Funds:

a. Domestic Public Resources

Support local capital providers of small business finance. The global financing landscape must undergo transformative changes to address persistent gaps, particularly for Small and Growing Businesses (SGBs) in emerging markets. CFF's 2023 Annual Survey indicates that this emerging asset class is positioned to provide $2 – 3 billion in financing to the small growth-oriented enterprises in Africa and MENA alone.[4] Local Small Business Funds have emerged as indispensable actors in bridging these gaps, particularly where traditional banks are reluctant to lend due to perceived risk.

Governments must lead the charge in mobilizing domestic resources efficiently. However, inefficiencies and misallocation of public funds continue to stifle progress in many emerging markets. Solutions include:

- Provision of fiscal and concessionary incentives for SBFs: It is incumbent upon local governments to build the foundation of a robust small business finance sector. Governments should offer tax reliefs, subsidies and incentives to LCPs. In doing so, governments will be stimulating investments in high-impact sectors such as agriculture, renewable energy, and infrastructure.
- Engage local central banks and financial regulators for more flexible environment: Enhanced transparency and efficiency in public financial management (PFM) systems are essential to ensuring resources are directed toward development priorities with the highest impact.
- Provide a supportive environment for domestic institutional capital holders to invest in SBFs. In Africa alone domestic pension funds have $1 trillion under management. To date, less than 5% is allocated to productive sectors such as small businesses.

b. Domestic and International Private Business and Finance

Drive capital mobilization by leveraging local and regional fund fund-of-funds vehicles. A critical reality is that global development and private sector capital operate most efficiently at large scale. To reach small business funds, intermediary vehicles such as Fund-of-Funds (FoFs) models offer an important bridging mechanism. The Fund-of-Funds approach allows for the pooling of resources from various actors, including DFIs, donors, private investors, and governments, to support local nonbank financial intermediaries. In addition, this structure by offering a diverse portfolio of local capital funds reduces the perceived risks associated with investing in SGBs and ensuring that capital is deployed efficiently.

Facilitate Accelerator Platforms. Along with risk perception, a critical barrier includes the governance, regulatory and legal compliance requirements of Development Finance Institutions (DFIs) when considering an investment into local small business funds. CFF, in collaboration with key strategic partners, has is developing solutions to address the structural barriers facing DFIs. These solutions include platforms that offer an umbrella fund for emerging fund managers providing access to world class administrative and government services for their funds, warehousing lines of credit to provide demonstration effects as to their capabilities; operating overhead support until reaching sufficient scale, human talent development, knowledge services, and technical assistance for the production of shared learning.

[4] Collaborative for Frontier Finance (2023). 2023 Annual Local Capital Provider Survey. Available at https://static1.squarespace.com/static/59d679428dd0414c16f59855/t/6540bc7cf4c8160e5bc97bf0/1698741389546/CFF+Annual+Local+Capital+Provider+Survey+2023.pdf

c. International Development Cooperation

Development Finance Institutions (DFIs), bilateral agencies and MLAs are uniquely positioned to address the SGB financing gap through catalytic funding and strategic partnerships. Their ability to provide concessional capital, capacity support through technical assistance, de-risk investments, and build strategic alliances with LCPs makes them essential actors in the effort to scale financing solutions in underserved markets.

<u>Support the emerging asset class of small business funds (SBFs)</u>. By investing in high-impact sectors and providing concessional capital to intermediaries like SBFs, DFIs can crowd in private capital that might otherwise be hesitant to enter these markets. DFIs should also focus on building long-term partnerships with SFs, providing both financial resources and technical assistance to ensure that these intermediaries have the capacity to scale and meet the growing demand for SGB financing.

<u>Diversify the types of applications of Concessionary Capital</u>. To date, the substantial majority of concessionary capital has been applied as risk mitigants via guarantees and first loss mechanisms. This approach oversimplifies the complex barriers constraining capital flows to small and growing businesses. Concessionary capital plays an important role in building the foundation of emerging financing sectors such as small business funds. Development players can drive systemic change by providing capacity support to capital managers and their portfolio enterprises that meets Small Business Fund Managers “where they are at.”

<u>Support development of innovative financing approaches, tools and instruments</u>. Private capital is crucial in bridging the financing gap for MSMEs and would benefit from innovations in local financial regulations such as revolving movable collateral to facilitate working capital credit facilities, cash-flow-based lending, trade receivable securitizations, and hybrid equity instruments. Such flexible instruments allow financing to meet the needs of MSMEs as they evolve through their growth cycle.

<u>Incentivize and support funding from local institutional capital holders</u>. One of the most impactful ways DFIs can support SGB financing is by offering catalytic funding that leverages additional private investment. DFIs should explore how they can catalyze and encourage local institutional capital as a way to diversify from foreign capital and mobilize deeper Investor pools (e.g. local Pensions, Insurance and crowdfunding platforms) with long-term, local currency based capital.

<u>Increased collaboration</u>. Strategic partnerships between DFIs, governments, and private investors are critical for creating a robust financing ecosystem that supports the growth of SGBs. These partnerships should be centered on shared goals of financial inclusion, sustainable development, and gender equality. By aligning their efforts, these actors can unlock the capital necessary to drive long-term economic growth in emerging markets.

<u>Development of new FX hedging strategies</u>. DFIs should work closely with LCPs to develop and expand access to currency hedging platforms, which allow businesses to protect themselves from exchange rate fluctuations. The integration of these tools into the global financing system in the immediate term would provide a critical safety net for SGBs and ensure that international capital can be deployed in a way that supports long-term business growth.

d. International Trade as an Engine for Development

International trade is vital for economic development, but MSMEs often face barriers due to financing constraints. The following reforms are necessary:

- Facilitate trade finance for small enterprises and cooperatives: Due to a number of barriers, smaller enterprises have not been included in the global supply chain. The development community and local government agencies should support local capital managers to provide the pre- and post- export working capital and technical support to the enterprises in their portfolios to be positioned for export markets, regionally and globally.
- Combine finance with technical assistance. Too often programs for export assistance do not simultaneously address the financing requirements. Financial assistance programs should be accompanied with technical assistance.
- Simplifying customs regulations. Reduce the administrative burdens to ensure that MSMEs can access regional and global markets more efficiently.

e. Debt and Debt Sustainability

Develop domestic institutional capital capacity to fund small businesses. Debt sustainability is a growing challenge for developing countries. A critical path forward is to strengthen the linkages of domestic institutional capital such as pension funds and domestic savings to finance small businesses – thereby reducing reliance on international capital for economic development.

IMF, World Bank and MLA support. These actors can play a very important role to support favorable regulatory environment, and the local governments' capacity to support small business finance, and in doing so, improve domestic economic resiliency and self-dependency.

Regional harmonization: Aligning financial regulations across regions can facilitate adaptation of new approaches, regulatory regimes and financial innovation.

f. Addressing Systemic Issues

Progress regarding scaling and diversifying Small Business Finance has been materially constrained by information asymmetry and the reliance on the perception that regulated banks are the most effective means of reaching small businesses at scale. As a result, over the past decade, the development sector and local governments have largely focused on risk mitigation programs with regulated banks.

The development community has been focused materially on moving capital at scale, not addressing the systemic barriers that have kept regulated financial institutions from "*making small business finance a core business line.*" Yet, the trends and data tell us that regulated banks are not achieving the outcomes the development sector seeks.

Recognition of system level constraints on regulated banks. Regulated banks in emerging markets face system-level constraints that limit their ability to lend to SMEs. Regulatory requirements, including strict capital adequacy ratios the regulatory frameworks often prioritize safer, larger corporate loans over smaller SME loans. Along with capital adequacy rules, inadequate data and risk analytic tools have resulted in information asymmetry, causing regulated banks to require high levels of collateral and charge high rates.

Alternative financing via small business funds. As noted in this submission, small business funds offer an alternative. These new financing vehicles are able to demonstrate *"how to make small business finance a business line"* – providing the kind of capital and acceptable rates and terms (eg limited to no collateral requirements).

g. Science, Technology, Innovation, and Capacity Building

Investments in science, technology, and innovation are critical to driving financial inclusion and economic growth. Governments and DFIs should:

- Support fintech for small business working capital financing: Fintech solutions offer new approaches for low cost working capital finance for small businesses. However, the broad application of these tools are often constrained by lack of system wide shared data, as well as archaic regulatory barriers.
- Alternative Risk Methodologies. Technology can be better applied to assist in the financing of the growth capital requirements for small businesses. Haskell and Westlake[5] have written extensively that current financing approaches are constrained by information asymmetry as to the needs and repayment capabilities of today's growing enterprise.

III. Emerging Issues

The evolving global financing landscape is shaped by several emerging challenges that require proactive solutions:

a. Climate Change

Climate risks present a formidable challenge to the sustainability of Small and Growing Businesses (SGBs) in Africa and other emerging markets, particularly within the agriculture and energy sectors that are essential to these economies. Most climate challenges are highly localized and contextual, making it crucial to develop new financing facilities specifically designed to help small and growing businesses drive resilience and climate adaptation within their local environments. These businesses, deeply embedded in their communities, are uniquely positioned to respond to local climate challenges.

Small business funds, because of their proximity and deep knowledge of local contexts, are already integrating sustainability and climate resilience into their investment strategies. By directing more financing towards this emerging asset class of fund managers, we can ensure that small businesses have the resources and support needed to effectively mitigate and adapt to the increasing prevalence and severity of climate challenges over the next decade.

b. Digital Transformation

The rapid digital transformation accelerated by the pandemic presents both an opportunity and a challenge for SGBs in Africa and other emerging markets. To avoid widening the digital divide, it is

[5] Haskel, J., & Westlake, S. (2018). Capitalism without capital: the rise of the intangible economy. Princeton, Princeton University Press.

essential to provide not only digital financial services, but also the right type of equity financing to help societies make the switch to digital infrastructure, training, and data analysis.

c. Gender-Inclusive Financing

Women-led Small and Growing Businesses (SGBs) in Africa and other emerging markets continue to face significant barriers to accessing finance, despite their pivotal role in driving economic growth. According to CFF's 2024 Local Capital Provider Survey (forthcoming), out of ~100 respondents, approximately 80% are women-led and 89% apply the 2X Framework. The importance of prioritizing access to finance for women cannot be understated.

The new financing for development agenda must offer tailored financial products that address the unique challenges faced by female Small Business Fund Managers, such as collateral requirements, loan sizes, and flexible repayment structures. These reforms are critical to reducing barriers and expanding access to capital.

IV. Data, Monitoring, and Follow-Up

Effective data collection and monitoring are essential for ensuring that the commitments made at FfD4 translate into tangible outcomes.

a. Data Transparency and Impact Reporting

To track the success of financial interventions, governments and DFIs should:

- Credit bureau modernization. Changes in regulations, metrics and capacity are required. FIs and NBFIs should report on positive and negative performance; expand to include nonfinancial sector metrics, such as rent, utility services, mobile payments, etc.; invest in technology systems to more easily report and simplify access data – thereby improving transparency and applicability of credit bureaus.
- Develop more contextualized impact measurement frameworks across the SDGs: Simply counting number of jobs created in not an indicator of economic development, social progress and national resiliency. Instead, metrics should evaluate the *quality and stability of employment*, *income improvements*, and the *livelihoods supported*, as seen in the Balloon Ventures and 60 Decibels approach, indicators which more accurately reflect economic development, social progress, and national resilience.
- Use real-time data tools: Digital platforms and short form survey data offer mechanisms to better track real-time data collection will allow stakeholders to monitor financial interventions continuously and adjust strategies based on emerging trends.

b. Strengthening Follow-Up Mechanisms

To ensure that commitments are fully realized, FfD4 must institutionalize follow-up mechanisms that include:

- Regular progress evaluations and audits: These will assess the status of financial interventions and provide insights into areas requiring course correction.

- Collaborative monitoring frameworks: DFIs, governments, and private sector actors should jointly monitor progress to ensure accountability across the board.

c. Promoting Open Data and Knowledge Sharing

Fostering collaboration requires open access to data and shared knowledge. DFIs should:

- Establish open data and national level learning lab platforms: Local "labs" on small business finance is an inexpensive and efficient means of documenting and sharing "what works/what doesn't". These platforms will allow financial intermediaries to share insights, lessons learned, and impact data, facilitating continuous improvement in program design and execution. The development community, in partnership with local governments, should support local organizations and research institutions to establish a federation of such labs across the emerging markets. Such "locally owned labs" would provide a forum for convening key stakeholders from across the globe to accelerate cross-border learnings.

V. Overarching Reflections: Building Resilience through Collaboration and Innovation – fostered at the local level

FfD4 provides a critical opportunity to reshape access to the critical small business sector in emerging economies. In doing so, development stakeholders and local governments will be able to better drive inclusive and sustainable development. Key reflections include:

- **Foster local solutions**: Prioritizing LCPs and NBFIs enables the financing system to reach underserved businesses, particularly women led and rural MSMEs. Facilitate the participation of domestic institutional capital from pension funds and other large domestic capital holders. is essential for creating inclusive financing mechanisms that can adapt to local realities.
- **Catalyze local capital providers** offering innovative approaches. Provide the patient and concessionary capital to take to scale local small business funds. In doing so support innovative approaches, alternative credit mechanism, digital tools that can provide the continuum of capital that small businesses require as they grow.
- **Support intermediary vehicles** to bridge from large capital holders to small business funds. Provide the requisite concessionary and commercial capital via fund-of-funds (FoFs) to pool resources, enabling the deployment of capital to critical sectors while diversifying across a large portfolio of local capital managers. Support the implementation of platforms to lower costs and improve efficiencies regarding governance, legal, tax, regulatory compliance to accelerate the launching and scaling of new local small business funds.
- **Strengthening partnerships**: Collaboration between DFIs, governments, and private investors is key to scaling successful initiatives and ensuring that resources are allocated efficiently.
- **Establish shared learning platforms** at the national level across emerging markets.
- **Address systemic barriers that preclude emerging market banks from lending to SGBs**: this includes reforms to regulatory regimes that would ease current barriers facing small businesses and enhancing engagement with Small Business Funds.

- **Build resilience**: Financing should prioritize Small Business Fund Managers who, with local expertise, can implement investment strategies that foster sustainability and climate resilience in affected industries.

The Fourth International Conference on Financing for Development must deliver targeted, actionable reforms that close the financing gaps faced by MSMEs, particularly in emerging markets. By scaling Local Capital Providers, leveraging institutional capital, and implementing regulatory flexibility, FfD4 can lay the groundwork for a more inclusive and resilient global economy. CFF's Launch+ Capital, with its innovative approach to addressing market failures and supporting LCPs, serves as a powerful example of how DFIs and private investors can catalyze sustainable development outcomes. These reforms are critical to ensuring that the commitments made at FfD4 are realized and that sustainable development goals are achieved.

Annex I. About The Collaborative for Frontier Finance

The Collaborative for Frontier Finance is a multi-stakeholder initiative that aims to increase access to capital for small and growing businesses in emerging markets.

We work with diverse stakeholders – including fund managers, funders, and field builders – to accelerate financing solutions that target SGBs. We aim to set a common action agenda for SGB finance; to test and scale promising financing models; and to facilitate the flow of capital to the SGB market. With a bias to action, CFF works with stakeholders to identify, co-design and launch initiatives – or specific solutions that table SGB financing challenges - that are too complex for any one stakeholder to launch on their own. We do this in three ways:

NETWORK

We connect stakeholders facing similar pain-points to a peer network of actors operating with shared principles, values, and ambitions to learn from and support one another.

ACTIONABLE RESEARCH

We facilitate research on hot topics to improve transparency within the sector, provide a practical guide for those less familiar with the sector, and dispel common misconceptions.

INITIATIVES

We identify concrete initiatives which CFF can take ownership of to provide tangible support to the broader early-stage investing sector. Through leveraging the resources of the CFF network, we're working to amplify the voices of local capital providers.

For more information, please visit: https://www.frontierfinance.org/about-cff