THE FORUM OF
YOUNG GLOBAL LEADERS
SHAPING THE FUTURE

WORLD ECONOMIC FORUM

COMMITTED TO IMPROVING THE STATE OF THE WORLD

The Missing Middle Initiative:
Highlighting the Problem, Accelerating the Solution

Contributions of the YGL Community:
Ideas – Proposals – Taskforces – Caselets

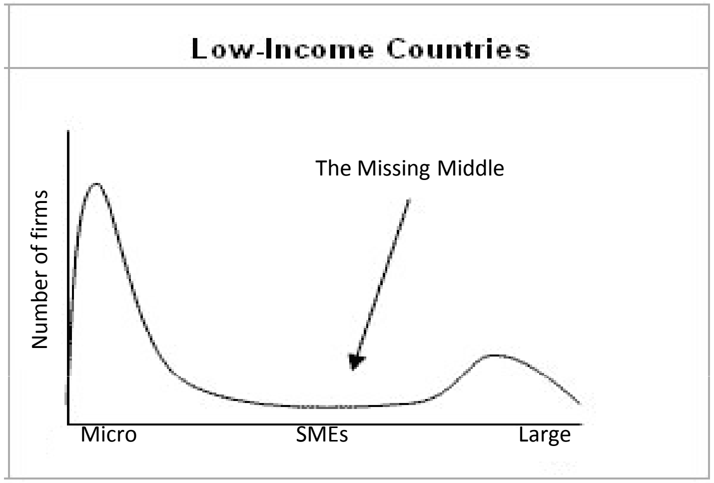
Missing Middle Initiative

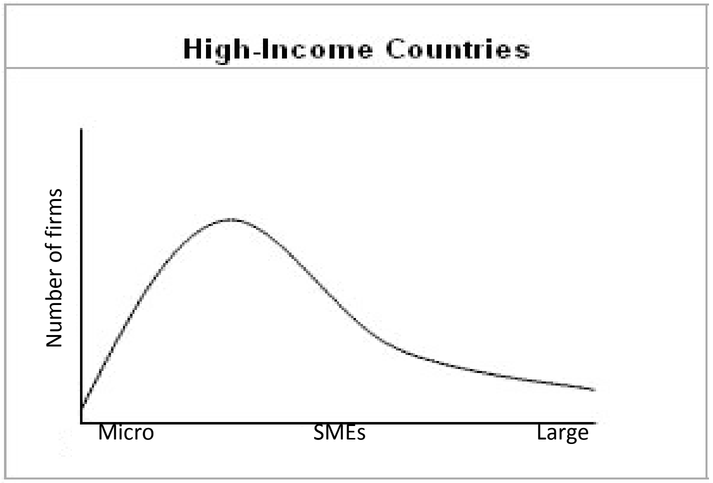
Mission:
The purpose of the Missing Middle Initiative is to put a spotlight on the gap in capital in emerging markets and to accelerate the momentum of SME venture funds that are beginning to fill this gap.

Within emerging markets there exists a gap in capital, the Missing Middle, which is above micro-finance and below traditional institutional financing.

Vision:
The Missing Middle provides a unique opportunity for investors to achieve both competitive financial returns and significant social impact in emerging markets.

This opportunity has begun to attract the attention of innovative SME venture funds that are investing small-medium sized capital (SMC) into emerging market SME's that are ready for capital, supporting a trade vs. aid strategy.





Source: Center for International Development at Harvard University.

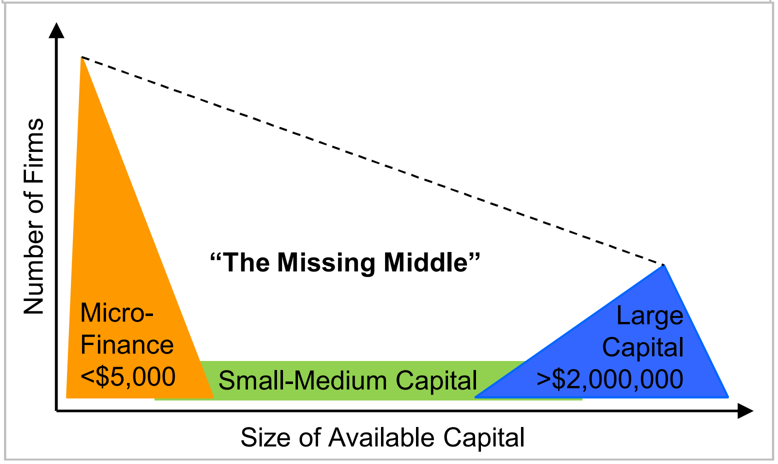
What is Missing?

Micro Capital Finance:
A segment that provides small loans and enables individuals and families to generate an income. Typically these efforts do not scale beyond local markets and are not aimed at job creation beyond an immediate group.

Small-Medium Capital Finance:
Small-medium sized enterprises (SMEs) are a critical underserved segment in emerging markets. Small-medium sized capital (SMC) covers what has traditionally been known as early-mid stage growth capital.

Large Capital Finance:
Banks and large financial firms serve mature companies that traditionally have had access to capital based on collateral. In addition to bank-based credit, large businesses in some markets have had access to private equity and public markets.

Size of Capital



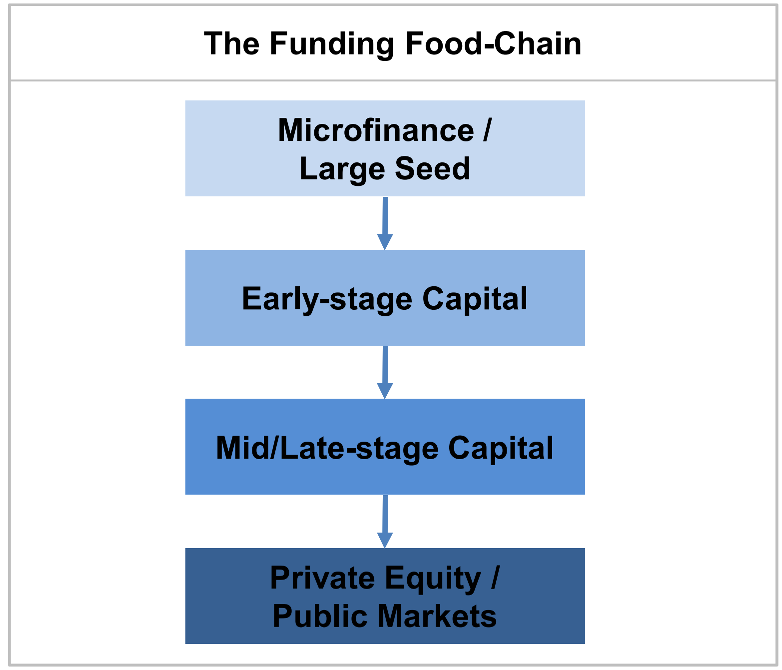
There is a gap in available capital and SME Venture Funds serving SMEs.

What is Missing?

Completing the Financial Eco-System:
The Missing Middle is the next wave of capital development after Microfinance for emerging markets. SME Venture Funds are bridging the gap within the finance food chain.

As SME Venture Funds become a mature asset class, they have begun to segment themselves into various investment sectors such as:
- Investment Size (Seed/Early/Mid/Late stage),
- Strategy (Debt/Equity/Blend),
- Industry (Agriculture, Energy, Telecom, Finance, etc),
- Purpose (Financial/Social/Balance).

In developed countries, SME's represent more than half of the GDP and account for nearly 2/3 of employment. In developing countries, SMEs are largely missing from the formal economy.



A healthy funding food-chain = A thriving SME base.

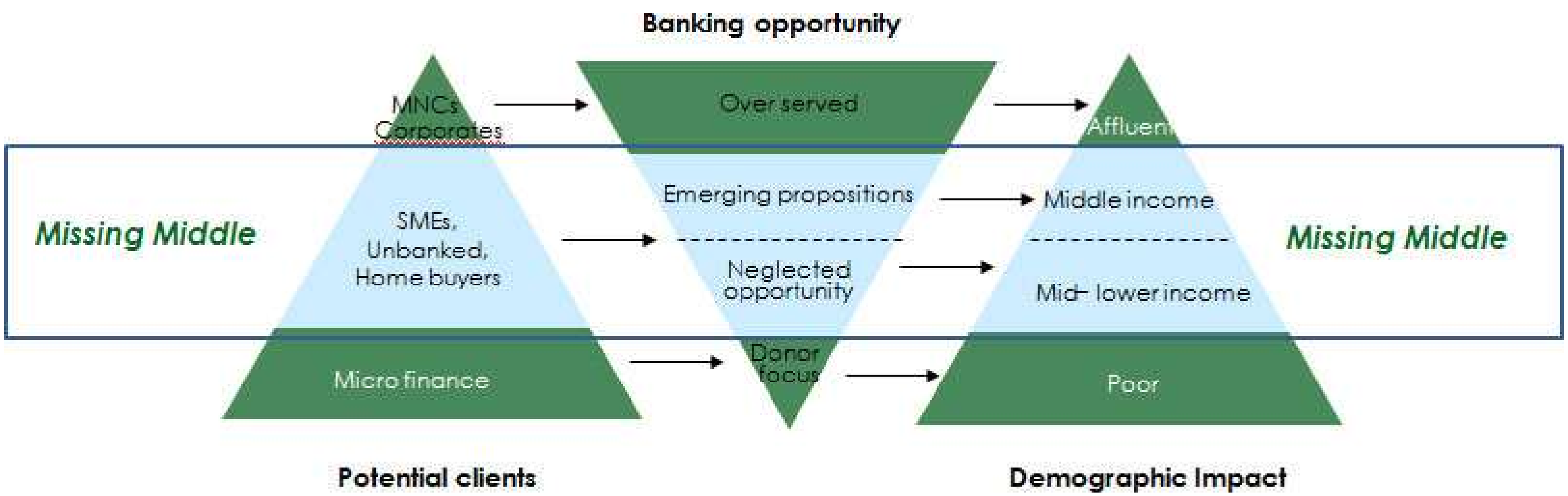
Why It Matters?

The "Missing Middle" addresses some of the most significant income and wealth gaps faced by developing countries and communities around the world.

In order to fill the large wealth gaps, capital needs to flow to SMEs in developing regions to create sustainable economic and social growth.

In the new world economic order, India and China have emerged as economic super powers and South Africa and Brazil as regional powers. This new structure requires a re-thinking for how we can better serve all nations and holders of economic influence.

- Promotes job creation through sustainable growth
- Develops an entrepreneurial spirit and optimism
- Builds a middle class = poverty elevation
- Produces robust GDP growth
- Creates stability: politically, economically, and socially
- Primes for larger investments in SME's
- Promotes innovation



Source: Summit Development Group.

"...developing the financial sector and improving access to finance are likely not only to accelerate economic growth but also to reduce inequality and poverty," World Bank report.

Challenges to Bridging the Gap

Micro

SME Venture Funds

- Lack of available capital for SME investing
- Lack of exit options given limited public markets
- Lack of skilled human capital on investing teams
- High transaction costs
- Lack of transparency/trust of SMEs
- Some SMEs operate outside of clear legal system

Small-Medium Enterprises (SMEs)

- Lack of business and investment education
- Cultural barrier in sharing equity ownership
- Limited number of SME venture funds
- Lack of a healthy funding food chain
- Higher perceived risk
- Lack of collateral

Macro

Intermediaries

- Lack of a large number s of capable intermediaries to address the needs of SMEs
- Lack of a variety of intermediaries
- Lack of leadership and understanding of the space
- Lack of on-the-ground team presence
- Lack of robust networks for SMEs and investors

Institutions

- Ambiguity of language for Missing Middle sector
- Lack of defined SME Venture Capital segments
- Lack of reliable resources for SMEs and investors
- Lack of well defined legal system
- Need central institution for SMEs and SMC investors
- Need policies to make SME investments easier

Solutions to Filling the Gap

Micro

SME Venture Funds

- Create investment choices for all investor types
- Reduce investment risk by using strategies such as debt and equity like components
- Key exits are pre-defined with debt, strategic acquisitions, or public markets where available
- Attract capital with competitive financial returns and significant social impact
- Create new investment funds, fund of funds, and invest in current SME Venture Funds

Small-Medium Enterprises (SMEs)

- Generate competitive market rate returns for investors
- Achieve significant social impact using key metrics
- Identify and use leap-frog technologies
- Become educated on best business practices and build awareness of financing options and structures

Macro

Intermediaries

- Spread the stories of successful SME Venture Funds and SMEs
- Build on the ground teams and use local networks
- Create networks to link the SME community
- Educate SMEs about business development
- Help establish universal term sheets SMEs/investors

Institutions

- Market SME Venture funds as a mature asset class to legitimize the industry
- Identify countries that are ready for capital
- Produce useful reports on various SME industries
- Create a resource center for SME community
- Put spotlight on gap in capital for SMEs

Champions in the Space

(A working list)

SME Venture Investors

Africa:

4DI Capital
African Agriculture Capital
Business Partners SA
HBD Venture Capital
Heart Global
Identity Development Fund
Industrial Development Corporation
Innovation Fund
InReturn Capital
InVenFin
Khula Enterprise Finance
National Empowerment Fund

Asia:

Aavishkaar
Google.org
Kula Fund
SME Development Fund (SDF)

Latin America:

Aconcagua Ventures
ACR Capital Partners
Angel Ventures Mexico
Austral Capital
Blue Water Argentina
Cap Venture Capital
Chrysalis Argentina
Club de Business Angels Del IAE
Club de Inversores Ángeles de Inversor Global
Colombia Opportunity Fund
DLJ South American Partners
Escala Capital
Fondo de Innovacion Tecnologica
IGNIA
Innovatekne
Insignia Capital
Latin Idea Ventures
Nexxus Capital
North Bay Equity Partners
Pampa Capital
Patagonia Ventures
Pegasus Capital Group
Progresa Capital
Prorsus Corp
Proventus Partners
Southern Cross Group
Transandino Colombia
Tribeca Capital Partners
Water Capital

Middle East :

Abraaj Capital
iLab Ventures (Access Turkey Capital Group)
İşGirişim
IV Holdings
Teknoloji Yatırım
The SME Commercial Finance Fund

Global:

Acumen Fund
Aureos Capital
E+Co
Endeavor Network
FMO
Grassroots Business Fund
Gray Ghost Ventures
Hasso Plattner Ventures
i3 Global Impact Fund
The ILEX Group
Norfund
Omidyar Network
Root Capital
SEAF
Soros Economic Development Fund
Swedfund

Champions in the Space

(A working list)

Intermediaries

Agora Partnerships
Artemisia
Ashoka
Business Council for Peace
Development Capital Strategies
Echoing Green
Endeavor
eTohum
Gauteng Enterprise Propeller
Innovant Capital
Global Impact Investing Network (GIIN)
MyC4
Seven Fund
Shared Interest
South African Chamber of Commerce in America (SACCA)
TechnoServe
Total Impact Advisers

Institutions

Brookings Institute
Clinton Global Initiative
CORFO
DFID
Harvard University, Center for Int'l Development
IFC
Kauffman Foundation
Milkin Institute
Monitor Institute
New Ventures – World Resources Institute
OPIC
Rockefeller Foundation
Shell Foundation
Skoll Foundation
Small Enterprise Development Agency (SEDA)
The Aspen Institute
The European Commission
USAID
White House Office of Social Innovation
World Economic Forum

Microfinance

Accion
FINCA International
Grameen Bank
Gray Ghost Microfinance Fund
Kiva.org
MicroPlace
SKS Microfinance
Grassroots Capital

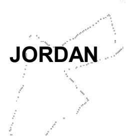
High-Impact Entrepreneurs

Bento Koike holds a degree in aeronautical engineering, and was invited by the Brazilian government to develop the country's Space program. In 1995, Bento combined his academic and industry expertise by starting a small wind blade company in the countryside of Sao Paulo.

Today, Tecsis has become the world's second largest producer of wind blades for wind power turbines, with 66% market share in the US wind energy market.

Vinny's vision was to empower anyone in the world, especially small business owners, to create their own website for free. He founded SynthaSite, renamed Yola in March 2009, to do just that—allowing users without programming skills to build a web presence through a simple drag-and-drop system.

The South Africa-based company now counts over two million users, continues to grow rapidly, and is receiving accolades from such publications as BusinessWeek.



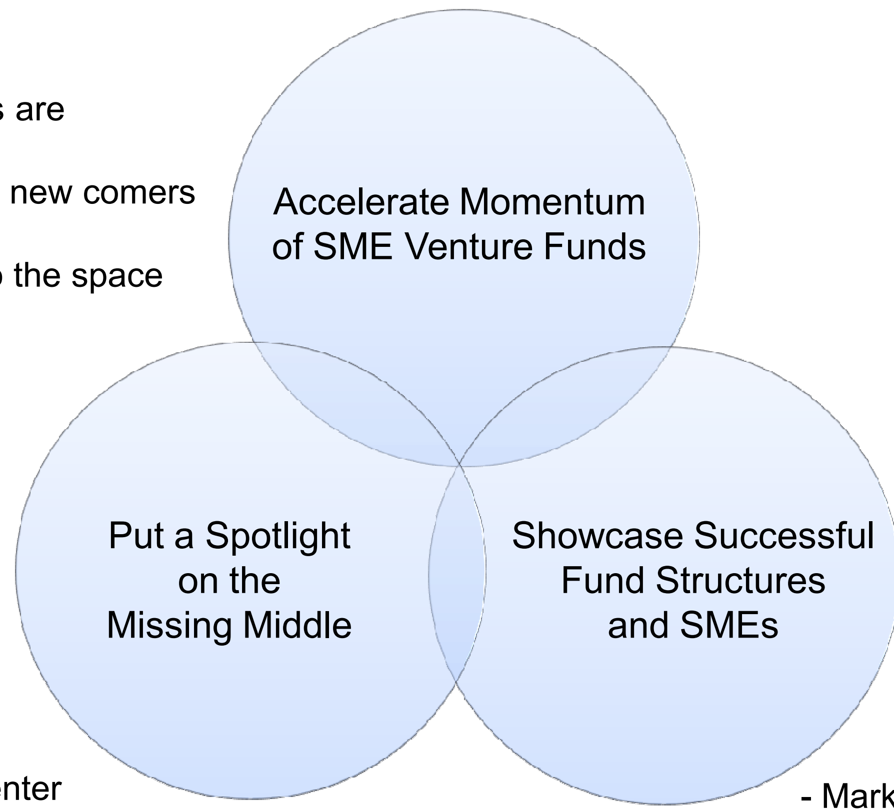
Dr. Amjad Aryan's vision was to make his company, Pharmacy 1, the "CVS of the Middle East." He returned to Jordan in 2001—after working his way up the ladder at CVS from intern to manager of the Boston area—with a mission to modernize and standardize the industry.

Now, Pharmacy 1 is the number one retail pharmacy chain in Jordan, with 45 branches employing 350 people.

Source: Endeavor Entrepreneurs.

Missing Middle Initiative: Intersecting Goals

- Indentify who the players are
- Connect champions with new comers
- Drive capital and firms to the space



- Create an information center
- Highlight obstacles & solutions
- Define financial/social returns

- Market and legitimize industry
- Present a methodology
- Show successful execution

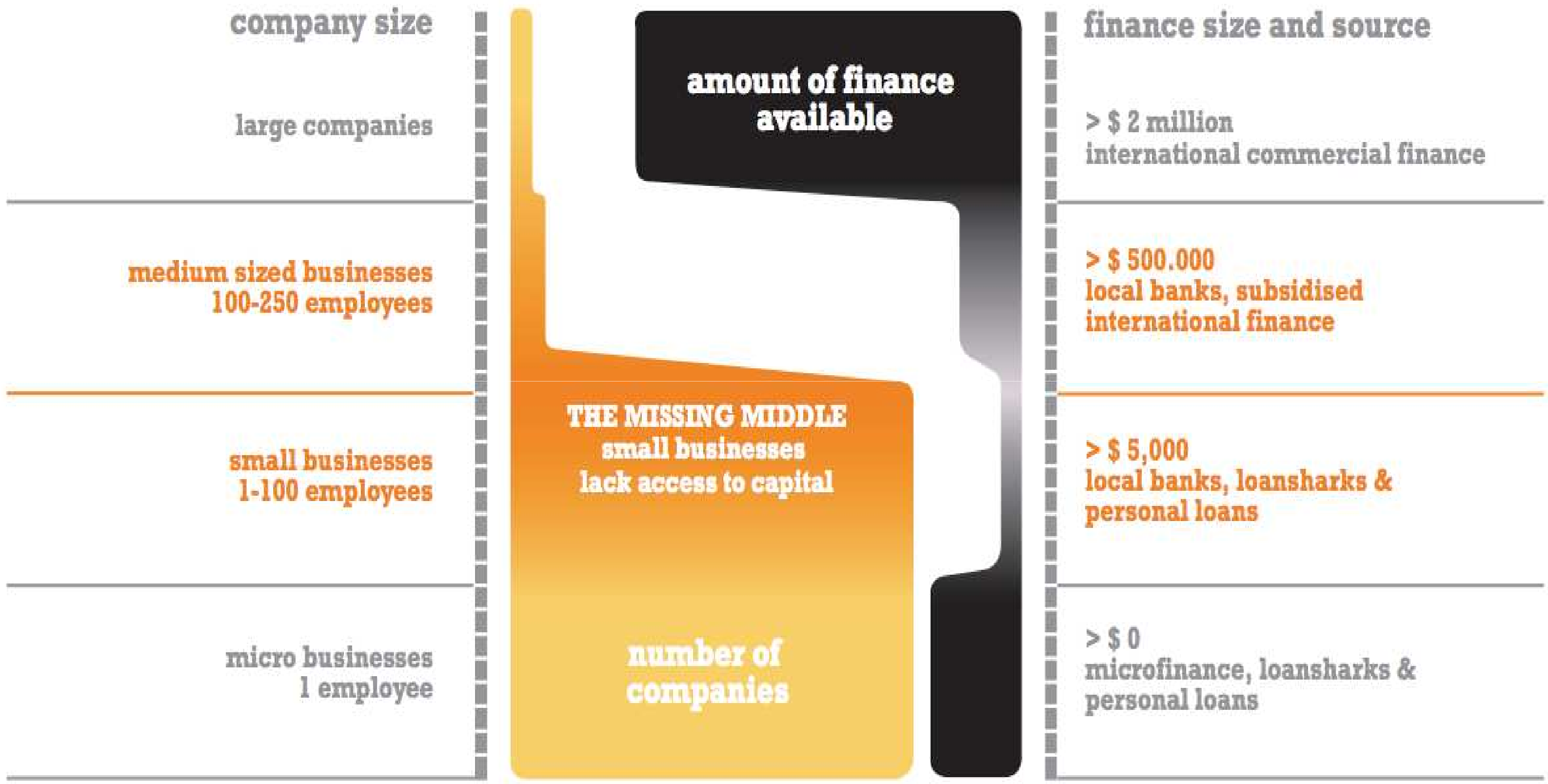
Next Steps: Closing the Gap

- Expand an list of the players in the space – funds, intermediaries, and institutions
- Establish a "Missing Middle" central resource document – aggregate information and share with community
- Continue to reach out to more champions in the space and network the industry
- Market the industry as an evolving asset class – provide legitimacy to the sector
- Accelerate flow of capital to current SME venture funds, new SME Venture Funds and SME fund of funds

Davos presents a unique opportunity to foster entrepreneurial and financial eco-systems.
This is where the most relevant players – policy makers, strategic consultants, capital providers, academics, and entrepreneurs – come together.

A Call to Action – Move from Talking About the Issue to Doing Something About It

Appendix



"THE MISSING MIDDLE"

Finance is available for large and micro businesses, but is limited for the small in the developing countries

Source: MYC4.

Debt & Equity Investment Structures

A mix of debt and equity products (often referred to as quasi-equity) enables SMEs to access lower overall cost of capital in some cases.

Examples of Quasi-equity Instruments:

Convertible Subordinated Debt:
A loan that carries standard interest payments as well as the option to convert the loan into a share at a pre-determined price.

Royalty Financing:
A loan against future sales. Typically the lender collects a part of the revenue at a determined interval up until a pre-determined amount.

Long Term Debt with Warrants:
A long-term loan that carries a standard interest payments as well as the right to buy a share at a pre-determined price after the loan is paid off.

Equity investments in SMEs in emerging markets have not proven to be commercially viable on a large scale without donor money of some form.

Many existing SME equity funds in developing economies are fully or partially funded by:

- A government organization (e.g. Swedfund)
- An international organization (e.g. SEAF)
- A state bank (e.g. SIDBI Venture Capital Limited)
- Or a combination of the above entities

Source: Milken Institute.

Additional Information

- The bulk of SMEs have between 5-200 employees.
- The biggest gap in capital for SMEs in emerging markets is between $5,000 and $2,000,000.
- Capital access and cost of capital are ranked as one of the most constraining features for SMEs.
- Finance is available for larger and micro-businesses, but is limited for the small-medium sized businesses in developing countries.
- Smaller firms financing obstacles have almost twice the effect on their growth as larger firms capital constraints.
- There is a strong need for credit bureaus and other independent credit analysis firms to facilitate SME lending.
- Microfinance's success – couples with new technologies – has contributed to building credit scoring databanks, which cover the previously unbanked population.
- Many of the most efficient MFIs are able and willing to make bigger loans, in the $10,000-$50,000 range, entering de facto into the SME space.
- The bulk of financing for SMEs in the 19th century was in the form of loans, not equity.
- Historically, financing came mainly from grass-roots local intermediaries with great information on local markets than large banks.
- Credit information sharing and join liability loans were effective tools in increasing the flow of capital to SME.
- There is a large need for intermediaries to offer technical assistance in developing their business plan, understand and evaluate growth opportunities, overcome legal and regulatory issues, and present a financial plan to potential investors, among others.

Source: Milken Institute.

Resources (working group to grow list of resources and stakeholders):

The Aspen Institute: Aspen Network of Development Entrepreneurs
http://www.aspeninstitute.org/policy-work/aspen-network-development-entrepreneurs/about-ande

The Brookings Institution:
http://www.brookings.edu/papers/2007/03development_de_ferranti.aspx

The Center for International Development at Harvard University:
http://www.cid.harvard.edu/efl/finance.html
http://www.cid.harvard.edu/cidresources/files/cid08_empowerment_lab.pdf

Certified General Accountants of Canada: Global SME Survey:
http://finance.yahoo.com/news/Global-SME-survey-shows-cnw-764752647.html?x=0&.v=1

Clinton Global Initiative:
http://www.nextbillion.net/blog/filling-the-finance-gap-the-clinton-global-initiatives-poverty-a
http://video.clintonglobalinitiative.org/health_cast/player_cgi2007_nointro.cfm?id=3508

European Commission: The New SME Definition
http://ec.europa.eu/enterprise/enterprise_policy/sme_definition/sme_user_guide.pdf

Endeavor:
http://endeavor.org/

Google.org:
http://www.google.org/SME_Brief.pdf
http://blog.google.org/2008/02/investing-in-missing-middle.html

Milken Institute:
http://kmifellows.org/course/PDF/0402missingmiddle.pdf

The New Yorker - What Microloans Miss:
http://www.newyorker.com/talk/financial/2008/03/17/080317ta_talk_surowiecki

OECD:
http://www.oecd.org/dataoecd/57/59/34908457.pdf

Palli Karma-Sahayak Foundation (PKSF): Scaling-Up Micro Finance to SME Finance:
http://www.pksf-bd.org/speeches%20&%20Papers/Scaling%20up%20Microfinance/Scaling%20up%20Micro%20Finance%20to%20SME%20Finance.doc

Riches for Good Blog: 6 International SME Financing Organizations:
http://richesforgood.blogspot.com/2009/02/6-international-sme-financing.html

Shell Foundation:
http://www.shellfoundation.org/pages/core_lines.php?p=corelines_inside_content&page=aspire&newsID=309

Summit Development Group:
http://www.summitdevgp.com/vision.html

Think Change India: Op-Ed, Microfinance revisited and its role in reaching the missing middle:
http://www.thinkchangeindia.org/2008/03/26/op-ed-microfinance-revisited-and-its-role-in-reaching-the-missing-middle/

World Bank:
http://siteresources.worldbank.org/INTFINFORALL/Resources/4099583-1194373512632/FFA_book.pdf

World Resources Institutes:
http://earthtrends.wri.org/features/view_feature.php?fid=69&theme=5

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