

# Demand-led Investment

*A new perspective on approaches  
to adapting capital and bridging the  
Missing Middle in Southeast Asia*

Supported by



Frontiers  
Lab Asia

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# Report introduction

## About this report

This report on demand-led investing for impact offers a new perspective on approaches to bridging the financing gap for small and growing businesses (SGBs) known as ‘the Missing Middle’.

Through this report, we look to provide the impact investment ecosystem with insight on how private capital can be deployed more effectively to scale the impact of SGBs in Southeast Asia. This is supported with principles, tools and examples for designing investment around the needs of SGBs.

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## The challenge at hand

Financial innovation alone has been insufficient to help investors to unlock the impact of SGBs in the Missing Middle; it must be paired with understanding the local context and adapting approaches to suit.

The report highlights examples of investments that have ‘fixed the capital’ rather than focus on ‘fixing’ SGBs through technical assistance until they meet predetermined investment readiness standards.

This report builds on practical insights from emerging markets developed through Scaling Frontier Innovation, Pacific RISE, the Collaboration for Frontier Finance, the Omidyar Network and others<sup>1</sup>. It provides a structured framework built on established tools from impact investing pioneers Village Capital and Tideline for better understanding the needs of SGBs and adapting capital to make demand-led investments that meet those needs.

## Who should read this report

The primary aim of this report is to generate actionable insights for impact investors and asset managers interested in financing the impact of the Missing Middle in emerging markets. The report is also intended to benefit and share the knowledge of other actors in the Southeast Asian entrepreneurial ecosystem. Further, we hope that this report is broadly useful to those in abutting areas, such as gender-lens investors and investors with a regional commitment to Southeast Asia.

While not intended as a research report, it brings together research across alternative finance, impact investment and gender-lens investment. In addition, the authors interviewed a range of investors, advisors, fund managers, and entrepreneur support organisations. These conversations served to better understand the current needs of the Missing Middle, how the market is failing to meet them, and how investment approaches can be adapted to address this.

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# Contents

## 01 CONTEXT 04

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Introduction

The Missing Middle needs more than alternative finance

Adapting capital to better meet the needs of impactful SGBs

Impactful SGBs face challenges connecting with investors throughout the investment journey

## 02 CHALLENGE 09

---

Foundations for demand-led investment

Understanding the needs of SGBs in Southeast Asia

Elements of the VIRAL Framework

## 03 ADAPTATIONS 16

---

Adapting capital to meet the needs of the Missing Middle

Local partners can help meet the impact opportunity

The Six Ps of adaptive capital

Adaptations in structure and beyond

Case studies

- Inclusive cricket farming, Cambodia*
- Pay-as-you-go induction cookstoves, Cambodia*
- Education for vulnerable youth, Philippines*
- Residential solar PV energy systems, Indonesia*
- Farm-sourced health beverages, Philippines*
- Farm to market produce distributor, Philippines*
- Impact-focused souvenir marketplace, Indonesia*

## 04 ACTIONS 35

---

Building better demand-led investments

Four steps for building better demand-led investments

An invitation to act and collaborate

## 05 APPENDICES 39

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Endnotes

Appendix 1: Research Summary

Appendix 2: Background Insights

Bibliography

01 CONTEXT

**Investable deals  
and appropriate  
capital: How supply  
and demand leave a  
Missing Middle**



# Introduction

## Too little risk capital reaches impact-oriented SGBs

The impact investment ecosystem in Southeast Asia is alive and thriving with significant investment activity from private impact investors and development finance institutions<sup>2,3</sup> building a track record of positive performance in terms of both impact and returns<sup>4,5</sup>. It is characterised by robust entrepreneurial activity<sup>6</sup> supported by in-country intermediaries and support organisations<sup>7</sup>. However, results are uneven: impact financing is skewed towards a few sectors that have capacity for larger ticket sizes<sup>8</sup>, while smaller businesses, and in particular those led by women<sup>9</sup>, face significant difficulty accessing capital<sup>10</sup>. The piece of the impact capital puzzle that has yet to be solved—the Asian elephant in the room—is how to increase access to seed stage impact capital<sup>11</sup> for SGBs. These businesses are too big for microfinance and informal local investors, but too small or too risky for traditional banks<sup>12</sup> and direct investors focused on financing later stage and larger companies. This challenge is further detailed in [Appendix 2](#).

## Why this matters

SGBs in emerging markets drive economic growth and play a critical significant role in improving social and environmental conditions. They create employment opportunities for women and the youth, and help provide essential goods, services and employment to those at the bottom of the income pyramid.

Yet outside of a few sectors, these critical engines of economic development and recovery struggle to access tailored financial products and services to help them grow, and are left to fund their own growth from internally generated cash flow.

Over 30% of SMEs in SE Asia do not have access to debt capital or lines of credit<sup>13</sup>, an effect that grows more stark when viewed with a gender lens: more than 70% of women-led SGBs in Vietnam, Philippines, Indonesia lack access to capital<sup>14</sup>.

## Key terms definitions

**Small and growing businesses (SGBs)** refers to commercially viable businesses with five to 250 employees that have significant potential, and ambition, for growth. Typically, SGBs seek growth capital from \$20,000 to \$2 million. *Aspen Network of Development Entrepreneurs (ANDE)*

**The Missing Middle** refers to SGBs that are too big for microfinance, too small for private equity, too risky and lack sufficient collateral for commercial banks, and lack the growth trajectory that venture capital seeks.

**Adaptive capital** refers broadly to inclusive approaches in which finance is tailored to meet SGB needs. Adaptations can be in mandates, non-financial supports, parties involved, timeframes, channels, processes, vehicles, instruments, and structures. This term is intended to be broadly inclusive of alternative finance, blended finance, gender-lens investment strategies, ecosystem-level investments.

# The Missing Middle needs more than alternative finance

## The Missing Middle finance gap

The Missing Middle is a pervasive gap in the capital landscape that has been observed in emerging markets around the globe<sup>15</sup>. It refers to the lack of medium to long-term risk financing in ticket sizes of US\$25,000-500,000.

The International Finance Corporation has valued the total financing gap for Small and Medium Enterprises (SMEs), of which SGBs are a subset at US\$5.2T globally<sup>16</sup>. Despite significant recognition of the problem, progress in bridging this gap has been slow.

Growing the pool of risk capital providers making private impact investments in Southeast Asia is one part of the solution. Private Impact Investors (PIIs) invest much less capital overall than Development Finance Institutions (DFIs), but they are more numerous and make smaller investments in greater volume. This challenge is further detailed in [Appendix 2](#).

## More than alternative finance

Alternative finance—financial channels, processes, and instruments that have emerged outside of the traditional finance system such as regulated banks and capital markets—is also part of the solution. In particular growing the supply of mezzanine finance, which incorporate elements of debt and equity in a single investment, offers another critical path<sup>17</sup>.

However, even with the advent and knowledge of alternative financing structures, the implicit biases embedded in how investors seek and assess investments act to keep impact investors and high impact SGBs apart, to the detriment of all.

## Unlock impact by understanding SGB needs in context

We need to understand the needs of SGBs to unlock the potential of these SGBs and strengthen impact, particularly for women and girls and vulnerable groups. We need to learn how and why the market is not currently meeting the needs of these businesses, and use this knowledge to adapt investment approaches to enable funders to meet these SGBs where they currently are<sup>18</sup>.

Adapting capital for SGBs calls for more private impact investors and a mix of alternative financing instruments that make the cost of investment and return potential commensurate with the nature of SGB operations. It also calls for engaged and inclusive pre- and post-investment processes tailored to the contexts of the SGBs.

# Adapting capital to better meet the needs of impactful SGBs

## Impact-oriented SGBs sit outside investor expectations

Many livelihood-sustaining and job-creating SGBs deliver significant impact, but fall outside funder expectations around investability for a variety of reasons:

- They tend to be smaller and slower-growing, so they deliver modest returns.
- They may be deemed risky because they lack a conventional track record and or cash flow.
- Their business systems and processes may be effective but undocumented, leaving them illegible to formal diligence processes.
- They may lack the audited financial statements expected by investors.
- They may be led by women or create products aimed at women, which investors consider niche.
- They need only modest amounts of capital, and may need other forms of support to succeed.
- The opportunities for investors to exit may be few and uncertain.

## What if investment-readiness is a catch-22?

It is common to approach this problem with a deficiency lens, and focus on “fixing” SGBs through technical assistance efforts to get them to a predetermined investment readiness standard. Meeting these standards often require investment to overcome, but which is often not forthcoming as SGBs are not at an investment-ready state; this recursive loop generates little to no investment, and SGBs stagnate.

There is an opportunity to bridge this divide through demand-led investment approaches that adapt capital to respond to the needs of SGBs as they currently exist in the market.

## Investor demand for impact goes unmet

It is not just SGBs’ need for appropriate finance that goes unmet when the two sides fail to meet. When impact-oriented SGBs are persistently excluded from finance, investor demand for impact goes unmet.

Funders seeking investment opportunities involving larger ticket sizes, more extensive track records, clearer exits, and rapidly scalable businesses often fail to find a path into the impact of the Missing Middle. This report invites investors and asset managers to tread in less-familiar territory and explore ways of adapting their approaches to satisfy their unmet impact mandate while delivering returns.

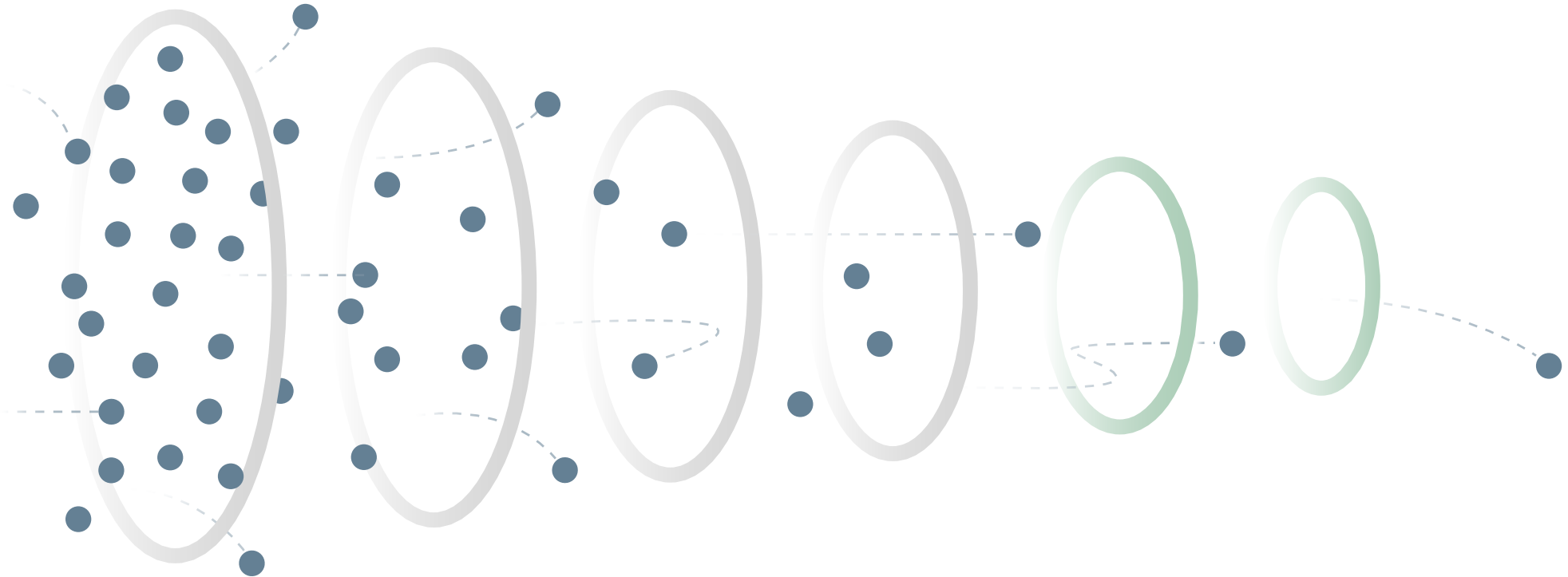
Emerging Southeast Asia is ripe with impact-oriented SGBs unable to access finance, particularly those owned or led by women, targeting women as customers, employing women, and growing equitable supply-chains.

## Demand-led investment to meet the Missing Middle

A demand-led investment approach offers investors the ability to adapt capital approaches to meet the needs of SGBs where they currently are, and thus engage with and finance high-impact opportunities with SGBs that might not otherwise be considered investable. By tailoring capital around the contexts and needs of promising SGBs investors can “fix” the capital on offer at the seed stage of financing, and find a middle place where the needs of SGBs and requirements of capital providers can meet.

Unlocking this stage enables an SGB to invest in improving and scaling their operations to a level that sets them up for scale and growth, including accessing more growth and scale-up financing.

# Impactful SGBs face challenges connecting with investors throughout the investment journey



## SOURCING

SGBs and non-local investors do not share networks, leading to high costs of sourcing.

## PRE-SCREENING

SGBs screened out for lacking conventional track record, collateral, or high growth trajectory.

## DILIGENCE

SGBs deemed not yet investment-ready in a due diligence process that is costly because investors lack local presence and expertise.

## PRE-INVESTMENT

Investors and SGBs do not understand each other's needs and build alignment.

## AT INVESTMENT

Investments are not structured to meet market conditions or include the non-financial support SGBs need to succeed.

## DURING INVESTMENT

Investors do not understand or are unprepared to meet on-going SGB support and capacity development needs.

## EXIT

Exits that fail to sustain impact or meet liquidity objectives discourage both SGBs and investors from future investment.

02 CHALLENGE

**How impact investors  
can better understand  
the SGB impact  
opportunity**

# Foundations for demand-led investment

We believe that a path to unlocking impact by adapting capital to needs of SGBs in Southeast Asia has to involve the following:

## INVESTOR COMMITMENT

Use the investment thesis to commit to creating impact and meeting the investor's expectations of returns, while leveraging the investor's knowledge and skills to identify how financing can be scaled in missing sectors.

## THE NEEDS OF SGBS

Inform approaches with an understanding of the needs and the contexts of the specific SGBs in question. This includes how gaps and deficiencies can be overcome in the face of other promising factors that warrant investment.

## EXISTING TOOLS AND DATA

Leverage what already exists to reduce the costs of sourcing, diligence and SGB support. Using existing frameworks and tools enables investors to articulate the situations of the SGBs they support<sup>19</sup>. It also enables better articulation of how investors are tailoring the structure, role or specific uses of capital to help unlock impact<sup>20</sup> on a consistent and comparable basis.

## ADAPTIVE CAPITAL APPROACHES

Adopt innovative financing instruments and wrap-around services to generate investor returns, reduce costs, and better meet the needs of SGBs investees.

## A GENDER AND POWER LENS

Use insight from the understanding of personal and systemic bias, coupled with a focus on gender and power at a company, value chain and sector level to better understand investments that will yield long-term value.

# Understanding the needs of SGBs in Southeast Asia

## Shared tools are better for all

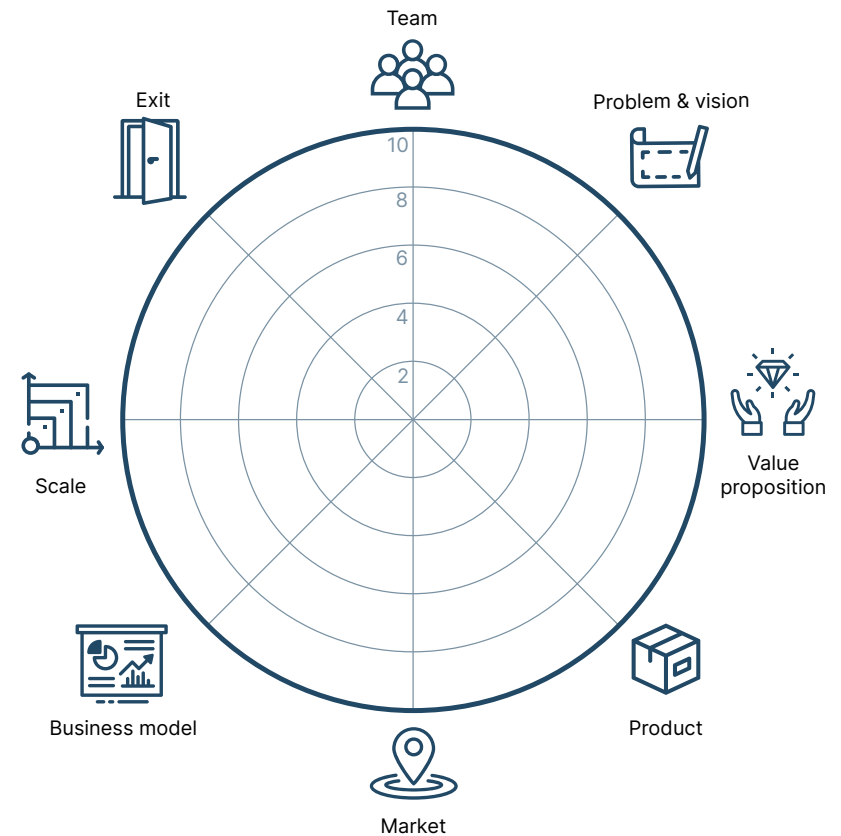
High quality shared conceptual and analytical frameworks enable impact investing's diverse actors to communicate in ways that are clear, concise, comparable, credible, and well-recognised<sup>21</sup>. This is particularly important to enabling new entrants to the field. In keeping with this principal, this report uses the eight components of Village Capital's VIRAL (Venture Investment-Readiness and Awareness Levels) Framework to consistently compare SGBs.

This approach communicates in consistent and comparable terms the ways in which SGBs in emerging economies are different, illuminating ways capital can be adapted to work with them.

By understanding investment readiness in terms of the maturity level of individual aspects of the SGB (rather than a yes-no hurdle), investors can see where gaps exist and how financing can be tailored to account for the specific gaps to be addressed.

## Village Capital's VIRAL Framework

The VIRAL Framework was designed to create a milestone-based pathway toward growth and scale for impact-oriented enterprises. It synthesises common concepts of investment-readiness for early-stage enterprises into a single tool and shared language that can be used by investors and entrepreneurs alike. The shared language and scales provided by the framework helps entrepreneurs better understand investor expectations, and equips them to articulate their investment-readiness, enabling investors to communicate the point at which they want to invest. The VIRAL Framework has undergone significant user testing and is being widely utilised by investors, and ecosystem support organisations in North America and around the globe<sup>22</sup>. Thus it makes a good communication tool for effectively and consistently representing how SGBs differ from one another, the specific ways they fall short of investor expectations, and how their capacities can be improved towards achieving growth and success.



*Village Capital's VIRAL Framework overlaid on a spider chart*

# Elements of the VIRAL Framework



## Team

The strengths, complementary skillsets and experience of a management team contribute to the overall success of a company. The team underpins its ability to execute its plans, to pivot successfully when conditions change, and persevere in the face of adversity.

Early team milestones<sup>23</sup> in this framework are:

1. 2+ co-founders with differentiated skillsets.
2. Senior members have lived experience of the problem and/or deep understanding of their target customer's problem.
3. Technical ability to build fully functional product and a clear understanding of the value chain and cost structures in their industry.
4. Clear understanding of how their target market operates and strong industry contacts in this market.
5. Clear strategy and understanding of sales.

### INSIGHT

Investors draw heavily on their perceptions of the entrepreneur and the founding team in their assessment of risk. Unconscious bias presented as “gut feel” disadvantages businesses that are led by women or historically disadvantaged minorities, who are often perceived as risk averse and insufficiently ambitious.

This leads investors to assess them as higher-risk teams, resulting in lower levels of confidence in the company.



## Problem & vision

Successful impact enterprises have a compelling and well-articulated vision of the problem they are addressing, the future state they are working to create, and how their strategy will deliver that in the long term.

Early problem & vision milestones in this framework are:

1. A specific, important, and large problem is clearly articulated.
2. Vision for how to solve the problem at scale and an ability to execute the solution.
3. Ability to articulate why business offers a superior value proposition to their competitors.
4. Ability to explain how a solution will create system-level change and transform the industry.
5. Evidence that by growing the business, the company solves the problem.

### INSIGHT

High-impact SGBs are often tailored around the local or regional specifics of how a complex problem manifests. A compelling vision of solving a problem at scale in one region may not be applicable beyond those boundaries.

Additionally, the benefits of an innovative and impactful solution might accrue primarily to the market or society more broadly rather than be captured by the SGB. The SGB may not be compensated for the expenses and risks undertaken in delivering that impact, creating a challenge for investors<sup>24</sup>.

This creates added nuance of how “solvable” the problem is as a true business case that generates financial returns, rather than a non-profit or hybrid model. For example, issues pertaining to government operations/accountability, citizen-government engagement or citizen-citizen engagement are often viewed as not “solvable” via a business model.



# Elements of the VIRAL Framework



## Value Proposition

A value proposition is the promise of value that will be delivered by the business and experienced by the customer. A strong value proposition clearly differentiates a business from its competitors, makes it easier to connect with target audiences, and establishes the foundation upon which a business' marketing and sales activities can be built.

Early value proposition milestones in this framework are:

1. Hypothesis of target customer whose problem they are solving.
2. Potential customers validate that the solution solves key pain point for them.
3. Evidence that customers will pay the target price.
4. Customer feedback demonstrating that the solution is dramatically better than competitors.
5. Initial target customers love the product and want to keep continue using it.

### INSIGHT

SGBs that serve the needs of women or historically disadvantaged minorities as customers may be unfamiliar and thus poorly understood by investors, especially in the absence of gender balanced investment teams, which are better at separating “good from great” businesses amongst these categories<sup>25</sup>.

SGBs may face a trade-off between impact and profit maximisation in terms of the markets they serve and suppliers they choose, leading equity investors to pass over financially viable enterprises that could deliver high impact, but not high returns.

Lack of financing options for impactful SGBs has ramifications for entire markets: it deprives consumers of the potential for better service and lower prices, and results in customers missing out on contextualized solutions that are focused on their particular problem.



## Product

A product or service is the key means by which a business solves the problem they've identified for their customer segment. Initial product is a critical vehicle for the businesses success in the early stages when driving toward a minimum viable product, but the initial product may decrease in importance to the business as market conditions evolve.

Early product milestones in this framework are:

1. Ability to develop low-fidelity prototype and a clear path not blocked by other patents.
2. A basic low-fidelity prototype that solves the problem.
3. A working prototype and product roadmap.
4. Clear understanding of product development costs and how to build the initial product cost-effectively.
5. A fully functional prototype with completion of product for wide commercial distribution in sight.

### INSIGHT

Experimentation is “critical for developing ever more efficient and effective solutions to social and environmental challenges”<sup>26</sup>, but can be particularly difficult for SGBs to fund without access to finance. Because of the sectors they operate in, these SGBs may struggle with uneven cash flows and a long runway to profitability, creating a catch-22 in which their inability to access capital because they have not yet achieved breakeven or have slim operating margins is exactly the thing that keeps them in that state<sup>27</sup>.

Additionally, products may need to be adapted significantly to be applicable in different markets because complex problems manifest differently in different locations.

# Elements of the VIRAL Framework



## Market

For a business to have traction to needed to succeed, market conditions must allow it to accrue value faster than they spend resources (cash/equity). This might mean growing market share by growing faster than an established market, or acquiring customers in a new market for less cost than the lifetime value of those customers.

Early market milestones in this framework are:

1. Understanding of total addressable market, the percentage they will capture, and initial target market.
2. Understanding of applicable regulations and strategy for compliance.
3. Initial sales provide evidence of ability to capture initial target market.
4. Evidence of \$100M to \$1B+ total addressable market.
5. Serious conversations with large strategic partners who can aid in capturing market faster/cheaper than the competition.

## INSIGHT

New markets are difficult to estimate in size. This impairs the ability of innovative SGBs to make the cashflow projections that allows them to take on debt. To private equity investors with approaches based on a combination of failures and very successful survivors, even businesses with a high chance of success but a modest total opportunity size are considered uninteresting and unviable investments.

This creates a “scale potential” mismatch for SGBs with smaller addressable markets to grow into, which may be considered ‘niche’ by investors<sup>28</sup>.



## Business Model

Business models are, at heart, stories that explain how enterprises work. They are a strategic tool for designing and describing, as a system, how the pieces of a business fit together to create, and deliver value and impact within a given set of market conditions. Business models are validated through unit economics and financial projections.

Early business model milestones in this framework are:

1. Outline of revenue model.
2. Existing pricing and business models of similar products support revenue assumptions.
3. Ability to articulate cost structure and unit economics.
4. Team has financial model with cost and revenue projections articulated and a strategy for hitting these projections.
5. Financial model with evidence of valid projections to reach positive unit economics.

## INSIGHT

The “frontier capital opportunity” for investors exists because SGB business models are often unproven, and hence undervalued in the market. SGBs that are “unproven business models that are asset-light and target a mixed-income base”<sup>29</sup> (a segment termed “frontier opportunities”) may attract conventional VC finance.

Capturing the tremendous impact potential of SGBs with “unproven business models that may be asset-intensive, serve only lower-income groups, and/or operate in countries with less-developed capital markets”<sup>30</sup> (termed “frontier plus opportunities”) requires more nurturing and creativity from investors.

# Elements of the VIRAL Framework



## Scale

Scaling is about making a business more efficient and improving its unit economics over time, for instance by increasing recurring revenue or decreasing of cost of sales. By comparison, growth is about acquiring and allocating resources such as recruiting sales people or expanding to other geographies. Companies can scale without growing in size (e.g. through automation), and grow in size without scaling. They can also scale their impact without scaling or growing their operations.

Scale milestones in this framework are:

1. Identification of multiple possible markets or customer segments and aspiration to scale.
2. Initial evidence that multiple markets experience the problem.
3. Clear strategy to scale to multiple markets.
4. Initial evidence that customers in multiple markets find value in the solution.
5. Initial evidence of positive unit economics in 2+ markets.

## INSIGHT

Many SGBs intend to see their companies grow organically over the long-run and do not prioritize rapid growth creating a mismatch of time-horizon and growth expectations with potential investors expecting rapid business growth<sup>31</sup>.

While this makes them intrinsically less attractive to some equity investors, this is realistic for their markets rather than a failing—many need to grow and scale more slowly to remain sustainable<sup>32</sup>, and some may simply not be suited for growth beyond their current size because of the nature of their business model<sup>33</sup>.

Pushing these companies to grow and scale up quickly is likely to cause failure rather than supporting rapid success. Additionally, for many impact-oriented SGBs the consequence of a potential failure extends far beyond the enterprise itself to significant negative implications for their clients and communities<sup>34</sup>.



## Exit

Exits are liquidity events through which an investor receives their capital and investment returns, whether through sale/conversion of shares, sale of property, or repayment of loan. Exits are critical for the growth and health of the entrepreneurial ecosystem, as they allow investors to meet liquidity objectives.

They also represent a key opportunity to ensure the long-term impact of their investments beyond exit<sup>35</sup>. Lack of suitable exit options is one of the most commonly cited challenges for the impact investment industry as a whole<sup>36</sup>.

Exit milestones in this framework are:

1. Understanding of need for exit and importance to investors.
2. Vision of how to ultimately deliver liquidity to investors.
3. Evidence that value proposition is of interest to acquirers.
4. Evidence that reputable companies have made serious investments in the industry.
5. Inbound interest from large potential acquirers.

## INSIGHT

Many SGBs operate in social sectors where there are few initial public offerings, mergers or acquisitions, apart from a few notable exceptions such as in health-tech sectors. Additionally, the long-term intent of these entrepreneurs may diverge from that of investors; they may have a strong preference to retain their business, its cash flow, and the ability to provide community jobs and local services in alignment with the SGBs original community roots.

As such they may require a “self-liquidating exit” in which equity is repurchased by the existing owners or a loan is repaid with money generated by the assets it is used to purchase.

03 ADAPTATIONS

# How impact investors are already meeting the Missing Middle

# Adapting capital to meet the needs of the Missing Middle

## The opportunity

Private impact investors have an incredible opportunity to deliver impact and financial returns by adapting their approaches to meet these businesses where they are, rather than waiting for them to be shaped into familiar-looking “investable deals”.

Adaptation also opens up paths to mitigating commonly cited investor challenges: the cost of deal sourcing and diligence, lack of capacity, and lack of exits. For instance, the smaller ticket sizes and non-dilution favoured by SGBs, allows for streamlined or shared diligence processes or investment in infrastructure or locally-administered working capital funds.

## Tideline's Pathways to Impact Framework

Tideline's Pathways to Impact Framework<sup>37</sup> provides investors with shared language for clarifying the rationale for their investments, the roles and uses of capital, and the ways that concessions can be incorporated into investments.

Village Capital's VIRAL Framework synthesises existing knowledge to foster more productive conversations between investors and entrepreneurs. In the same way, the Pathways to Impact Framework synthesised existing constructs into a single framework to foster more productive conversations within and between investors and investment managers who deploy catalytic capital in a variety of contexts.

## Laying out the levers for adapting capital

This report uses key constructs from the Pathways to Impact Framework to describe in consistent and comparable terms how capital can be adapted and complemented to better meet the needs of SGBs.

The Framework summarised the many forms of risk or return concession that can be included in the investment structures into “5 Ps”: price, pledge, position, patience and purpose.

This report adds a sixth element: Partners, such as entrepreneur support organisations (ESOs) or other funders. Alongside adapting the specific structure of finance, impact investors can choose to play specific impact-catalysing roles or target their investment at specific uses of capital.

Partners can play a variety of roles to support SGBs - these are outlined overleaf.

# Local partners can help meet the impact opportunity

## Local partners understand SGBs

Local knowledge, expertise and support can be the key to making investments that meet the needs of impact investors and SGBs. As has been observed in other markets<sup>38</sup>, fundraising is an instrumental need for SGBs in Southeast Asia, rather than a marker of success. The process is fraught for these businesses: taking on finance without careful consideration of the type, size, and timing of investment<sup>39</sup> can be damaging to SGBs, diluting their ownership or leaving them struggling under substantial amounts of debt. Moreover the need for funding can be superseded by concerns about access to markets, human resources, logistics, inputs, technology, regulations, and so forth<sup>40</sup>. They may fight to make themselves legible and appealing to investors, and still not get the targeted operational and technical support and development they need to maximise their chances of success and sustainable growth.

## Local partners de-risk investment

Local intermediaries and ecosystem support organisations play a key role in the functioning of impact investing markets, helping to de-risk deals and facilitate capital flow through services such as knowledge sharing, brokering, networking, enterprise incubation and acceleration, financial innovation, technical assistance, and impact enhancement and measurement<sup>41</sup>.

By virtue of their understanding of the needs of investors, the specific needs of and challenges faced by SGBs in the region, and the constraints of the local market, they are often able to propose financial solutions (design fit for purpose) to invest in or come up with terms and conditions that meet the need of enterprises and also mitigates the potential risks of the investors<sup>42</sup>.

## Local partners reduce barriers to investment

Incorporating local market actors as partners can address key barriers cited by investors: the cost of deal sourcing and diligence, and lack of capacity. Local partners bring critical on-the-ground expertise to the process. Incorporation of local partners also benefits the local entrepreneurial ecosystem, as the capacities that are developed in these partnerships accrue within the system, reducing barriers to investment over time<sup>43</sup>.

## Local partners open new paths to impact

Partnerships with local actors can open alternate paths for impact investments to unlock the impact of SGBs in a variety of ways. Where investors lack the ongoing local presence needed to build strong pipelines or the capital is not suited to direct investments in SGBs, investments can be invested via locally-managed funds or into working capital or trade finance facilities administered by or with local ESOs.

Co-investment partnerships can be formed through blended finance structures to leverage the capital of the relatively rare investors that can tolerate capital risk (i.e. that the SGB will not survive and the capital will be lost) to de-risk and maximise the impact of patient capital that tolerates extended timeframes and flexible capital which can tolerate variable risk.

# The Six Ps of adaptive capital

## PARTNERS\*

Bringing in additional parties to de-risk the arrangement and ensure that necessary capacities are developed and financial and impact goals are met.

## PRICE

Accepting an expected rate of return that is below-market relative to expected risk.

## PLEDGE

Providing credit enhancement via guarantees and risk insurance to provide assurance of principal repayment to other investors in the case of default.

## POSITION

Providing credit enhancement via a subordinated debt or equity position.

## PATIENCE

Accepting a longer or especially uncertain time period before exit.

## PURPOSE

Accepting non-traditional terms to meet the needs of an investee (e.g. unconventional or no collateral, self-liquidating structures, smaller investment sizes, higher transaction costs, etc.).

\* The Six Ps are Partners plus the '5 Ps' of Tidaline's *Pathways to Impact* framework<sup>44</sup>

# Adaptations in structure and beyond

**“Debt instruments (loans and bonds) can be adapted in a range of ways, such as below-market interest rates, flexible repayment timelines or generous grace periods, relaxed collateral requirements, and/or less rigid underwriting guidelines than those used by traditional lenders.”**

**Equity instruments can be adapted as willingness to invest in impact enterprises or investment intermediaries with limited track records, acceptance of significant uncertainty of return of capital relative to potential return on capital, a subordinated position designed to absorb losses before other investments, and/ or longer or undefined exit timing compared to traditional equity investments.”**

*Tideline 2019: p7*

## Levers for innovation

The Six Ps provide a set of levers for innovation that can be used to tailor approaches to fit the needs of both SGBs and impact investors. Outside of simple debt and equity, options are limited only by creativity. Alternative structures include convertible loans, royalty-based lending, redeemable equity, preferred shares, growth or revenue-based repayment mechanisms, finance facilities and more.

We invite investors to seek inspiration from the cases within this report, and from the resources of our colleagues listed within the bibliography<sup>45</sup>.

## Roles of capital

Roles in supporting SGBs can include:

- **seeding early-stage innovations**, example, through patient equity and convertible debt while businesses are overcoming early-stage challenges; and,
- **scaling impact business models**, e.g. supporting impact enterprises with concessionary debt, equity, and hybrid instruments while they realize economies of scale and reach new geographies and population segments.

## Uses of capital

Some key ways that investors can use their capital strategically to unlock SGB impact is by targeting specific uses of that capital by the investee, such as:

- **facilitating innovation** by giving investees the time and flexibility needed to develop and refine impact-oriented business models; and,
- **building track record** of impact-oriented business models, and SGB ability to deliver impact and repay investors within both the anticipated timeline and target financial return parameters.



# Inclusive Cricket Farming, Cambodia

**Investor: Red Hat Impact** - Unsecured 18-month syndicate loan arranged by Red Hat Impact involving 5 investors ranging from A\$2k to A\$28k.



## SGB needs and challenges

**Cricket House** is a woman-led enterprise that creates equitable livelihoods in sustainable cricket farming for people with disabilities and from marginalised communities. They are empowering farmers, modernising the Cambodian cricket farming industry through innovative agtech, and producing low-impact nutritional alternative insect proteins for local and global markets.

The team had the ability to make and deploy products to market, with a sophisticated solution on the farmer side. They needed capital to increase sales to further build out the proof of concept and traction with a view to entering a major funding round.

At the point of investment, there was enough traction to show an understanding of problem/market fit, but not in depth for the longer term vision. The team had initial evidence on both sides of their business—farmers and cricket product buyers—but not at scale.

Whilst the team was experienced, their confidence was challenged as they entered unfamiliar international markets where large volume orders could be found. They needed support to develop their understanding of the many different markets and channels in the international market for alternative proteins, and identify the markets with barriers to entry to target first.

## VIRAL Framework assessment



Image: Cricket House

## Investor considerations

Red Hat Impact takes a 'problem centric' approach to combine crowd-sourced impact debt capital with pre and post investment support for SGBs. Red Hat Impact's approach spreads risk across a syndicate (crowd) of 51 potential individual investors who opt in to individual deals at different levels depending on their impact and commercial risk appetite. They are based in Australia and New Zealand and have a track record in providing impact capital, advisory services and support across Asia Pacific.

Returns offered to Red Hat Impact's lenders are at or slightly above market rates for similar risk profiles. Lenders are offered a series of repayments of principal and interest across the life of the loan, rather than a single repayment at maturity.

Red Hat Impact saw Cricket House' capacity to create deep impact, and the opportunity to make an unsecured debt investment paired with tailored support that would help Cricket House access new markets and build the track record needed for future investment, while meeting investor goals.

Red Hat Impact paired capital with direct non-financial support. They delivered scheduled mentoring to strengthen Cricket House's fundraising skills to take them to the next level. Since the team were already comfortable with short term projections and were achieving early traction pre-COVID, this targeted the development of a deck specifically addressing long range projections and cost estimates.

Since the initial raise, Cricket House have increased the revenue of individual farmers and secured multiple major INGOs as clients.

## Capital adaptation needed to capture the opportunity

This investment was tailored to meet the needs of the SGB in several ways:

### PARTNERS

Red Hat Impact's syndicate (crowd) debt approach allows investors to set their own level of risk over a known term, allowing for smaller ticket sizes and lower diligence costs for each deal. Through this process, Red Hat Impact facilitates the development of a trust network between overseas private impact investors and SGBs that would not otherwise exist. Some investors form relationships with investee companies, becoming ongoing supporters in various ways.

### PRICE

8% simple interest was sufficient to attract investor interest across that term, given the stated impact objectives and Red Hat Impact's track record of success with similar investments in the region.

### POSITION

The loan was unsecured, with risk spread across participating investors. Red Hat Impact's syndication approach distributes risk across partner investors through each taking smaller or larger positions according to their own risk preferences.

### PATIENCE

The loan was repaid over an extended term of 18 months rather than 12 months, to provide a longer runway for Cricket House to get the necessary traction and market metrics in place to secure that next round of investment. The loan was structured with a lengthy initial period when no repayments were required.

# Pay-as-you-go induction cookstoves, Cambodia

**Investor: Red Hat Impact** - Working capital finance arranged by Red Hat Impact involving 11 investors ranging from A\$5k to A\$20k.



## SGB needs and challenges

### ATEC Biodigesters International (ATEC)

makes and sells products that reduce cooking smoke, produce energy from waste, and support the incomes of farmers in developing countries.

ATEC uses aspirational appliances to drive the uptake of clean cookstoves amongst low-income households who might not otherwise be in a position to prioritise the change. Their initial product was a biodigester sold with a twin biogas cookstove and rice cooker targeting off-grid households. These products were fully developed, selling well and supported by attractive offerings like price and pay-as-you-go purchase structuring.

ATEC's brand was reasonably well established in its target market, which embraced both product and pricing / payment structures.

Off the back of this ATEC focussed on building sales into this target market, and diversifying product offers. ATEC's platform for growth and scale was in place and all key parameters pointed towards attractive growth as their model was maturing - decreasing customer acquisition costs were backed by a growing customer base. Key partnerships were in place (e.g. partnership with PayGo). The timing was right to introduce a product for on-grid households.

ATEC saw the opportunity to extend their impact in the energy usage space by adding induction cook stoves that would significantly reduce electricity costs for on-grid families. The business had previously raised up to Series B capital. To do this, they required flexible capital to develop a new clean energy alternative without impacting current funding agreements attached to the biodigesters and gas cookstove model.

## VIRAL Framework assessment



## Investor considerations

Red Hat Impact is an intermediary that maintains and facilitates a crowd of impact investors that participate in syndicated commercial loans for businesses that have both a strong business model and a clear positive impact. Red Hat Impact's syndication approach distributes risk across partner investors through each taking smaller or larger positions according to their own impact and commercial risk appetite. They have a track record in providing impact capital, advisory services and support across Asia Pacific from their offices based in Melbourne, Australia and Nelson, New Zealand.

Returns offered to Red Hat Impact's lenders are at or slightly above market rates for similar risk profiles. Lenders are offered a series of repayments of principal and interest across the life of the loan, rather than a single repayment at maturity.

Red Hat Impact had previously supported ATEC at the point where products and sales were proven and increasing, and the management ability was there for tackling growth. ATEC's existing loan had been performing well, with all payments made on time. Thus making an affordable, appropriately structured debt investment that would unlock growth and scale ATEC's impact was a straightforward choice for Red Hat Impact and its investors.

Red Hat Impact structured a syndicate loan of A\$95,000 (approx. US\$70,000) to support how ATEC's working capital and cashflows work. In light of their pay-as-you-go sales model, the investment provides working capital loans against accounts receivables and loan structuring repayments over a workable timeframe. The loan was structured with a lengthy initial period when no repayments were required.

## Capital adaptation needed to capture the opportunity

This investment was tailored to meet the needs of the SGB in several ways:

### PARTNERS

Red Hat Impact's syndicate (crowd) debt approach allows investors to set their own level of risk over a known term, allowing for smaller ticket sizes and lower diligence costs for each deal. Through this process, Red Hat Impact facilitates the development of a trust network between overseas private impact investors and SGBs that would not otherwise exist. Some investors form relationships with investee companies, becoming ongoing supporters in various ways.

### PRICE

Because of the size of deal and the track record ATEC had with Red Hat Impact and its lender network, ATEC was assessed as lower-risk. Red Hat Impact was able to offer them lower fees and a lower interest rate.

### PATIENCE

Red Hat Impact's investors are flexible with respect to time, accepting the possibility of a longer investment period whilst still achieving an acceptable price.

### PURPOSE

Knowing that the purpose of this capital is to scale ATEC's impact, flexibility towards loan terms is an understood feature of the structuring. The terms of this deal mirrored ATEC's previous deal, so it wasn't a new set of terms or loan structure for the borrower, for Red Hat Impact, or its lender network.

# Education for vulnerable youth, Philippines

**Investor: xchange** - Convertible debt (x2 rounds) and equity (from growth funders) totalling US\$ 1.2M.



## SGB needs and challenges

This SGB (name withheld) initially offered a 2 month education and job preparation program to vulnerable/ unemployed youth paired with job placement upon graduation and a study-now-pay-later model. At least 80% of learners are able to access a job within 30-60 days of program completion.

The company had a clear understanding of the problem and the potential impact of the solution the enterprise was building to address this challenge. It had a scalable business model with the potential to reach 1,000 young people/learners in 3 years.

In its first year of operation, the SGB had been able to prototype its offerings and demonstrate its impact, it needed additional resources to scale its offerings to a level where it could attract growth funding. This was coupled with a need to improve and scale its operations, processes and approach, and even develop offerings that made it more accessible for learners to engage in the program.

While the founding team had a clear understanding of the problem-solution fit and ability to demonstrate how they would be able to effect systems-level change, they had to figure out a model that allowed for the organization to scale from a sales, operations building, and product scaling perspective.

## VIRAL Framework assessment





## Investor considerations

xchange is a philanthropic impact-first incubator focused on long-term engagement with organizations whose core mission is the creation of social value in the Philippines. xchange's incubation method includes investment via bespoke financial instruments tailored to match the needs of SGBs, paired with a commitment to work closely with them. They provide tailored mentorship, advisory and support services to help them reach scale, sustainability and investment-readiness in the shortest amount of time possible.

xchange have been actively working with this SGB for the last nine years. Based on their engagement with the SGB around its needs, xchange's first investment in the SGB's first raise was risk capital in the form of a two-year convertible debt instrument at 5% interest, with no-penalty rollovers. This was explicitly to allow the SGB the time and space to figure out how to scale and how to do so sustainably.

xchange's investment signaled trust in the enterprise's path to scale and their ability to deliver and further current impact. Their equitable and engaged approach fostered collaboration and innovation in pursuit of impact. The board (which included xchange) invited later investors to join on same terms as the first round. Based on their confidence in the SGB's potential, xchange and the SGB worked together to co-design a first loss guarantee fund focused on loans for the learners, to make it easier for the SGB to offer these loans.

As part of their continued investment and post-investment support, xchange assisted in the structuring of the SGB as a foreign-owned company with Philippine operations, and connected the SGB to foreign funders leading to a follow-on investment of US\$1M to date.

## Capital adaptation needed to capture the opportunity

Through the course of its relationship, xchange has used nearly every available tool to adapt its capital to meet the needs of the SGB:

### PARTNERS

xchange was very hands-on in post-investment support, meeting with the team weekly to support them in strategy, operations, and finance. They brought in multiple experts and external resources for targeted interventions to support and scale the startup's growth.

### PRICE

xchange offered convertible debt at below-market rate, and accepted full capital risk.

### PATIENCE

xchange engaged with the SGB over a period of nine years supported through three rounds and continuous support until they were in a position to access equity funding from external growth funders.

### PURPOSE

xchange supported the SGB through multiple investment rounds and supported them further through incubation services that are a core offering of all their investments; post-investment support is consistent feature of xchange's work. This also involved restructuring the entire instrument to meet the needs of the enterprise.

# Residential Solar PV Energy Systems, Indonesia

**Investor: New Energy Nexus (Indonesia 1) Pte. Ltd.** - Convertible debt repayable over 5 years with a 6-month grace period.



## SGB needs and challenges

**SolarKita** provides access to solar PV energy for urban residential home owners in Indonesia. It deploys integrated approaches from installation, easy maintenance and access to financing options.

At the time of investment, SolarKita had effective product offerings with demonstrated impact, having paid customers in both the B2B and B2C segments to show growing traction in their initial target market.

They needed capital to scale their sales and to develop complimentary offerings tied to their Solar PV systems to offer greater value to their customers.

SolarKita have been able to demonstrate a product-market fit in their initial B2B and B2C target markets, with evidence of a pricing model that delivers positive unit economics. This validated their wider customer acquisition strategy, and the capability of the founding team to build on it.

While SolarKita had a good founding team and product offerings with market adoption, they needed to grow their operations and capabilities to a level of scale to build on the initial promise. They required significant patient capital that would give them time and resources to invest into the organisation.

## VIRAL Framework assessment



## Investor considerations

New Energy Nexus (Indonesia 1) Pte. Ltd. (“the Indonesia 1 fund”) is a catalytic fund focusing on mobilizing early stage clean energy investments. It is supported by Ikea Foundation to enable investments from other funders to invest in follow-on rounds of promising clean energy ventures and offer scale funding in Indonesia. The Indonesia 1 fund provides quasi-equity, equity and loan facilities up to US\$250K as initial investor or co-invest with other investors.

It mobilizes investments in terms suitable to the context of the investee companies to enable the ventures to grow to a level where are considered as more investable to other later stage funders.

On the back of SolarKita’s demonstrated initial traction and the quality of the founding team to articulate and demonstrate a growth roadmap, the Indonesia 1 fund identified that the venture had a strong growth potential to scale rooftop solar PV adoption.

The fund identified that what SolarKita needed was time to invest and get to a level of scale to access further growth funding, and flexibility in how the loan could be repaid.

SolarKita has yet to articulate an exit plan for itself - an aspect that is often an investment-readiness expectation for most funders. By using convertible debt, the Indonesia 1 fund has created a path for multiple exit options:

1. Future round from other funders on the back of the expected growth of SolarKita’s operations; and
2. For the venture to repay the investment from growing revenues.

## Capital adaptation needed to capture the opportunity

This investment was tailored to meet the needs of the SGB in several ways:

### PRICE

To make this initial investment feasible for SolarKita, the Indonesia 1 fund accepted a concession on the potential returns of the loan terms. Should SolarKita choose to convert the debt, the Indonesia 1 fund will share in the upside offered by a liquidity event. This is likely, given the fund’s focus on scaling early-stage high-potential startups to a level where they are considered investment-ready by growth stage investors.

### PATIENCE

The seed investment was offered in the form of convertible debt repayable over five years with a six-month grace period. This was intended to provide a longer runway for SolarKita to grow its business.

### PURPOSE

The purpose of this capital is to provide supportive terms for SolarKita to scale its impact to build on its potential, the flexibility of the convertible option and long timeframe affords that.



# Farm-sourced healthy beverages, Philippines

**Investor: xchange** - Convertible debt and follow-on funding (external)



## SGB needs and challenges

This SGB (name withheld) is a beverage manufacturer that works with farmer communities to directly source organically-grown local crops to make healthy drinks for a Filipino market that is increasingly health-conscious and keen for locally-made products.

The SGB had validated its beverage product with consistent sales, while also working the supply operations where its main impact would be realised. Its operational impact is achieved through working together with farmers to adopt sustainable agriculture practices.

The SGB supports this by paying above-market prices for the directly sourced crops and offering support for farmers to shift to organic practices.

As an early venture, the small founding team could articulate its product roadmap with its impact potential. However, the roadmap needed expansion, reflective of the need to build out its internal operations to match the scale potential they desired.

The SGB recognised that to build a scalable business model for operations and impact, they needed additional investments and capabilities that were not available to the internal team.

In effect, the SGB needed to build an organization for two complimentary operations: beverage making and marketing, and farmer support and supplier development activities.

## VIRAL Framework assessment



Image: Josh Millgate

## Investor considerations

xchange is a philanthropic impact-first incubator focused on deep long-term engagement with organizations whose core mission is the creation of social value in the Philippines. xchange's incubation method includes investment via bespoke financial instruments tailored to match the needs of SGBs, paired with a commitment to working closely with SGBs by providing tailored mentorship, advisory and support services to help them reach scale, sustainability and investment-readiness in the shortest amount of time possible.

xchange recognised the SGB's impact potential across the value chain from source to end product—increased opportunities for organic farming that delivered healthy and locally-made beverages for Filipinos.

xchange's initial investment was zero-interest convertible debt instrument with one board seat, along with incubation focused post-investment support for building a scalable business model for the venture.

To get the venture to a suitable level, xchange realised the need to be closely involved in the building the organization, where their engagement included building the operations, accounting, hiring and HR, and value chain mapping capabilities to a level of self-sufficiency for the venture to execute.

By coming in at the early-stage, xchange enabled the venture to explore product-market fit sufficiently so that it became attractive to more growth-oriented and commercial strategic investors. xchange was able to exit from the venture after 40 months.

## Capital adaptation needed to capture the opportunity

This investment was tailored to meet the needs of the SGB in several ways:

### PARTNERS

As an impact-first investor, xchange offered zero-interest convertible debt, and accept the possibility of losing its full investment should the SGB fail.

### PRICE

As part of the post-investment support, xchange identified the need to bring in multiple experts and external resources for targeted interventions to support and scale the startup's growth.

### PURPOSE

Along with its core incubation support offering to build the SGBs enterprise management and finance capabilities, tailored instruments were essential in providing a flexible investment and return option to the venture.

# Farm to market produce distributor, Philippines

**Investor: Villgro Philippines** - a low-interest revenue-based loan of US\$40K with a 1-year moratorium on interest payments.



## SGB needs and challenges

The SGB (name withheld, see note) is a farm-to-market enterprise based in the Philippines. The SGB partners with organizations to offer training and capacity building for smallholder farmers. The company consolidates produce from smallholder farmers and manages distribution of produce to institutional buyers in Tagum City, in the south of the Philippines.

After a year in operation, the SGB could demonstrate recurring sales and delivery of quality products to established B2B customers including restaurants. This was clear demonstration of the problem/solution fit and value proposition.

Demand vastly outpaced what the venture could cater to, showing growth potential in their current market and opportunities to enter into new markets down the line.

The SGB needed capital to scale their business. Their main need at the point of investment was to scale the organization to capitalize on the potential opportunity in place. They also needed to strengthen operational practices, around financial models, growth-focused sales, and operations.

The SGB was able to demonstrate early promise at the time of investment. They built on this by articulating a strong vision, emergent model for growth, and the fundamentals of the venture's solo female founder and small team to deliver on it.

*Note: This investment is made by the Impact Pioneers Network, the first impact angel investment network in the Philippines. The name of the SGB has been withheld as at the time of writing, the term sheet has been agreed and signed and final documentation is being processed.*

## VIRAL Framework assessment



## Investor considerations

Villgro Philippines is an early stage impact incubator that supports meaningful social impact by working as a partner to promising social enterprises. Villgro Philippines brings an extensive hands-on experience in helping to build SGBs through its incubation activities with providing opportunities for financing and investment.

The SGB came through Villgro's WE Rise accelerator program; an investment-readiness and growth capital access program supporting 20 women entrepreneurs in the Philippines. After a period of pre-investment support, select SGBs from the program were put forward for investments to Impact Pioneers Network, an impact investment angel network, co-led by Villgro.

The SGB featured in this case, were selected for their proven early market traction, their strong vision. The company's fundamentals indicated their scale potential, despite weakness in terms of operational and financial maturity.

To provide the appropriate financing, a flexible financing instrument was proposed: a collateral-free, revenue-based loan with a one-year moratorium on payments that gives the SGB flexibility and freedom to experiment with growth approaches, and indicates trust in the enterprise's vision and their ability to deliver on it. In addition, the SGB was also supported by a local corporate foundation specialized in the agri sector with a grant and capacity building support.

Programs like WE Rise function as a supportive and low-cost form of due diligence, wherein SGBs demonstrate their potential over the course of the program through the pre-investment support and technical assistance offered. The support and incubation activities offered by Villgro also work to de-risk the creditworthiness to a level where the investment platform was able to provide a loan that was tailored to include very favourable terms.

## Capital adaptation needed to capture the opportunity

Villgro Philippines tailored this investment to meet the needs of the SGB in several ways:

### PARTNERS

Villgro Philippines is investing in the SGB along with other investors in the Impact Pioneers Network. In addition, they also partnered with a strategically aligned corporate foundation who also support Green Talks, to tailor the financial and capacity building to the enterprise.

### PRICE

The loan was offered at an interest rate that was lower than the traditional market rate, to match the return expectation within the context of the SGB's operations. However, there had been extended opportunity to directly assess both risk prior to the investment and confidence from the strategic market partnerships Green Talks has in place.

### PURPOSE

Villgro Philippines provided a revenue-based loan with no collateral and a one-year grace period to give Green Habits the freedom to use capital for experimentation towards its growth. By linking repayment to revenue rather than fixing interest payments, the SGB was protected from being overwhelmed by debt.

Despite the potential of the venture, Villgro Philippines identified that intense incubation, mentoring, and technical assistance was essential for the SGB to effectively utilise the capital provided for scaling its. Through the Impact Pioneers platform, Villgro will continue to provide post-investment strategic support to the enterprise.

*Image: Villgro Philippines*



# Impact-focused souvenir marketplace, Indonesia

**Investor:** BIDUK - Unsecured 12-month VPO of US\$25K with no minimum monthly payments.



## SGB needs and challenges

**Ecodoe** is a woman-owned business that create souvenir gift hampers for retail and corporate clients, composed of goods sourced from local suppliers including artists, craftsmen and small holder farmers. By creating a marketplace for their products, Ecodoe supports artisanal producers in remote locations to overcome barriers in accessing markets and gaining exposure to a larger client base.

In its first 5 years, Ecodoe demonstrated strong market traction, with 240% year-on-year revenue growth in March 2020. Ecodoe grew its network to over 350 suppliers and expanded its operations to new regions.

Ecodoe has a strong and credible founder, with a solid core team that has a track record for steady growth and timely pivots. Ecodoe has clear strategy for ambitious mid- to long-term, including developing digital marketing capabilities, expanding to international markets and creating an online business development platform for suppliers.

The Ecodoe needed short-term debt capital to diversify into new revenue streams, expand staffing and drive demand from new channels and clients. However, COVID-19 has caused substantial uncertainty for SGBs, resulting in unreliable projected cash flows and disrupted supply chains.

The Ecodoe team sought a loan that allowed them flexibility to make repayments based on their actual cash flows, without putting stress on the business. Being able to prioritize where cash is spent has helped Ecodoe weather COVID-19 and the surrounding supply chain and distribution channel issues.

Ecodoe has always paid the minimum, and pays against the remaining principal in months where their cash flows exceed their expenses.

## VIRAL Framework assessment



Image: Hifdzul Muhammad Siregar

Image: Hifdzul Muhammad Siregar

## Investor considerations

BIDUK is a lending platform that uses unsecured, flexible and commercially priced debt products to bridge the financing gap for impact SGBs in Indonesia. BIDUK's innovation is two-fold: 1) putting clients at the center of the lending process, by focusing on their specific needs to develop a financial product that works for their situation; and 2) a high-touch model to partner with SGBs to grow their business, beyond only financing.

The BIDUK lending process, due diligence screens and approval process have been designed to be free from gender bias, especially in support of women business owners.

BIDUK financial products (US\$10K to US\$150k loans) are suitable for early stage or smaller companies over the short term (4-12 months) and use specialised cash-flow analysis to determine the loan terms most likely to support clients' growth. BIDUK's review process and required documentation has also been tailored to be suitable for SGBs.

BIDUK's loan to Ecodoe is a variation on a Variable Payment Obligation (VPO). To develop a product that works specifically for Ecodoe, BIDUK developed a structured VPO, with a fixed monthly minimum, with the option to repay above the minimum. While loan terms stipulate full repayment must be made by the end of the 12-month agreement, Ecodoe has ultimate control over when it is fully repaid.

By building mutual trust and supporting clients to understand their business better, BIDUK endeavours to establish strong relationships with clients that go beyond a transaction. BIDUK's focus on client-centred relationships has been critical in ensuring Ecodoe's willingness to repay the unsecured loan.

BIDUK has seen success with the "partner" approach, with Ecodoe candidly flagging challenges and supply chain disruptions with BIDUK and being open to collaborative problem-solving.

## Capital adaptation needed to capture the opportunity

This investment was tailored to meet the needs of the SGB in several ways:

### PARTNERS

As part of the due diligence process, BIDUK was able to use their relationships with other credible players supporting early-stage businesses in Indonesia to verify and provide a more nuanced understanding of Ecodoe and the founding team. Conversely, Ecodoe was able to learn about BIDUK's reputation.

### PRICE

BIDUK uses risk-based pricing, meaning the ultimate interest rate charged to the client is based on the perceived risk of non-repayment. As an unsecured loan, BIDUK interest rates are competitive with credit cards in Indonesia, which aren't readily available to self-employed (entrepreneurs) in Indonesia.

### PATIENCE

Underwriting a loan for cash flow based lending can be more time consuming than prescriptive algorithms. However, it is crucial for maintaining high portfolio quality when lending to early-stage ventures. It also results in a "right sized" financial product structure for SGB—like a US\$25K VPO with a 12 month term—that effectively captures both the risk and reward between lender and borrower.

### PURPOSE

As an unsecured, cash flow-based lender, it was critical that BIDUK understand the cash flows, and could stress test major assumptions for the period under consideration. As a repeat client for BIDUK, mutual trust had developed which allowed for honest data sharing and analysis, conversations about a realistic scenario for repayment, and to co-develop terms and solutions that worked for both parties.

04 ACTION

# Actions for investors to meet the Missing Middle





# Building better demand-led investments

The investment cases included in this report are an invitation to imagine what is possible in adapting capital to meet the needs of high-impact SGBs in Southeast Asia. The goal of our analysis is not to provide investment recipes to be followed, but to inspire and empower private impact investors to step away from fixed expectations of investability that exclude these high-impact businesses and explore ways to meet them where they are in collaboration with local partners.

For those thinking about the design of investments, the next pages offers four steps that investors can take to start building better vehicles. These steps draw on the Criterion Institute's groundbreaking work on investment power dynamics<sup>46</sup>, and echo the recommendations of the recent Pacific Possibilities report.





# Four steps for building better demand-led investments

1

## Approach with a commitment to understanding and valuing local needs and possibilities

Set the intention to listen to and understand the needs and desires of local SGBs, and the specific market challenges and financing gaps they face<sup>47</sup>. Take the opportunity to invert the lens of your sourcing processes to see the opportunities that are being missed. Lead with your impact mandate to identify SGBs with high potential, and then consider how your skills, capital and other resources could be used to unlock that impact.

2

## Understand the different aspects of investment-readiness present, and consider what capacities can be developed or outsourced for success

SGBs in emerging markets are often uneven and non-linear in their development, depending on the specific conditions of their primary market. Let your commitment to understanding and valuing SGB needs in context drive a discovery process.

Rather than merely scanning for businesses that meet pre-specified investability criteria, follow the advice of system theorist Donella Meadows and “get the beat of the system” by understanding the local ecosystem and its interconnections before trying to change it<sup>48</sup>. Partner with local actors such as ecosystem support organisations to explore what likely SGB growth paths look like, and what they need to succeed<sup>49</sup>. Be flexible and creative in how those capacities can be developed, including through other partners and funders.

3

## Adapt capital using the Six Ps: partners, price, pledge, position, purpose, patience, purpose

Rather than starting from an expectation of fixing SGBs to meet a specific type of capital, approach investment as a design challenge informed by understanding local SGB needs. How could your capital be most effectively utilised—within the bounds of its current mandate, or under a revised mandate—to enable SGB impact and growth? Can the per-ticket costs of sourcing and diligence be reduced by incorporating partners? Can risk assessment processes be made more inclusive? Where can your power as an investor be leveraged to drive better outcomes? Explore by targeting particular needs that go underfunded, by bringing in local expertise, by structuring protections, flexibility or other concessions into the deal<sup>50</sup>.

4

## Set up robust feedback loops to evaluate investment and improve impact

Because you are designing new approaches rather than simply relying on existing ones, feedback loops are essential to understand whether adaptations are meeting investor intent. Set up inclusive processes that ensure that the views of local and regional experts, entrepreneurs, and affected communities are captured, and use those views to inform and guide future adaptation.

# An invitation to act and collaborate

## Speak up about adapting capital for impact

The emergence of adaptive capital approaches in Southeast Asia is a positive development in efforts to address the Missing Middle finance gap. These approaches improve the availability of aligned capital tailored to meet the needs of SGBs in the region, enabling them to scale their impact. This report is an argument for further adoption and continued experimentation with these approaches, with the view that they can be a driver of inclusive growth and sustainable development.

The authors have sought to highlight the tremendous impact opportunity offered by filling the financing gap that exists for SGBs in Southeast Asia's Missing Middle. This report has described how some pioneering private impact investors are stepping in to plug this gap by adapting capital to better meet the needs of these businesses. This builds on examples from the Latin American<sup>51</sup>, African<sup>52</sup> and Indian<sup>53</sup> markets.

## Use the framework to innovate and validate

In an effort to support adoption and experimentation, a framework has been developed that integrates existing tools to create a pathway and shared language for investors, entrepreneurs and intermediaries. This framework centres on the effective analysis and consistent representation of SGB needs for both capital and non-financial support, around which investment can be adapted.

This framework is intended to support all parties to align on what capacity building is required and how this can be achieved to support and then sustain SGB growth and scale impact. We invite you to validate this framework by using it in your own work, and sharing the results.

## Share learnings across the field

As a next step, we invite stakeholders across the field of impact investing to explore ways in which they can continue to advance demand-led investment in SGBs of the Missing Middle, and to share their learnings in a community of practice.

Less constrained asset owners, such as family offices, endowments, philanthropic investors and HNWI, can play a critical role in advancing experimentation and adoption.

We invite you to

- Submit comments and feedback to Shravan Shankar by contacting shravan@at.works
- Share this article on social media and tag key partners to join the dialogue and use the hashtag #AdaptiveCapital
- Are you active in demand-led investment? Email to join our Community of Practice
- Want to stay in touch and hear updates? Email to sign up to our newsletter

## Seek out other demand-led practitioners

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**05 APPENDICES**

**References and  
resources**



# Endnotes

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- 2 Global Impact Investing Network (GIIN) & Intellect. (2018).
- 3 Investing in Women, AusAID, & Value for Women. (2021).
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- 17 Benink, E., & Winters, R. (2016).
- 18 Armeni, A., & Ferreyra de Bone, M. (2017); Collaboration for Frontier Finance. (2019); Dutch Good Growth Fund. (2019d); Hilton, T., Saif, S. S., & Khan, J. (2021); and Pacific RISE (2021).
- 19 Commitment to using shared conventions, approaches, and standards for describing our impact goals, strategies, and performance is important enough to the field that it is considered a core characteristic of impact investing.
- 20 Similarly, using and supplementing--rather than replicating--the data and expertise already available in the field can help investors identify high-potential SGBs and inform their view of future value.
- 21 While these valuable conceptual and analytical frameworks are often perceived by users as universal, by definition these tools flatten variation through simplification. Assumptions that are well-tested at the centre of a field may not hold at the edges of the field where variation is highest. This disproportionately affects actors at the periphery of a field who often have the least power to shape the frameworks through which they are assessed. As Joy Anderson observed, in the groundbreaking report *Disrupting Fields: Addressing Power Dynamics in the Fields of Climate Finance and Gender Lens Investing*, "this projection of objectivity has obscured the biases within finance". These biases prevent impact investors and high impact SGBs apart, to the detriment of all.
- 22 Some investors in this research found the VIRAL framework disproportionately commercial in its focus, and did not use all of these components in their analysis of deals. In particular, considerations around exit were often excluded by investors in this research.
- 23 We are only including the first 5 of 9 levels, as these sit below the threshold for investment-readiness for most investors.
- 24 Tideline (2019).
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- 30 Ibid.
- 31 Hornberger, K.; Chau, V. (2018).
- 32 Dembek and York (2020); York and Dembek (2021); York and Dembek (forthcoming).
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- 37 Tideline (2019).
- 38 E.g. Pacific RISE (2021);Armeni, A., & Ferreyra de Bone, M. (2017).
- 39 Pacific RISE (2021): p1
- 40 Ibid.
- 41 Pacific RISE (2021) : pg 6
- 42 Pacific RISE (2021): pg 17
- 43 Village Capital (2017).
- 44 Adapted from Tideline (2019), with addition of "partners"
- 45 See, e.g. Armeni, A., & Ferreyra de Bone, M. (2017); Tideline (2019), Dutch Good Growth Fund (2018), Investing in Women, AusAID, & Value for Women (2021); Collaboration for Frontier Finance (2019)
- 46 Anderson (2021); Criterion Institute (2020).
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# Appendix 1

Research Summary

## Research Approach

In line with the authors' commitment to build what on existing knowledge and tools, the insights in this report draw from a synthesis of published literature and interviews with selected impact-oriented fund managers, field builders, ecosystem support organisations, and consultants undertaken as part of this research.

Desktop research covered SME finance in developing countries and emerging markets around the world, impact investment, gender-lens investment, entrepreneur support and capacity development, and sustainable business models. The full list of 70+ publications consulted is included at the end of the report.

## How to go deeper

The insights in the appendices that follow are part of the background information and analysis that went into driving the key hypothesis and approaches of this report. For those interested to read further into particular topics, links to relevant further reading are provided.

# Appendix 2

## Background Insights

### 1. Snapshot of the impact SGB landscape in Southeast Asia

**Activity** - Impact investing in South East Asia has been on a growth trajectory over the last few years. The amount of impact capital deployed in Southeast Asia in the last three years (US\$6.7B in 298 deals 2017-2019) is more than half of that deployed in the previous decade (US\$11.3B in 449 deals 2007-2016). The market is dominated by Development Finance Institutions (DFI) that invest in relatively fewer large ticket size deals (US\$6.23B from 9 DFIs in 141 deals 2017-2019). Private Impact Investors (PIIs) invest much less (US\$432M from 59 PIIs in 159 deals 2017-2019), but have invested in an increasing number of smaller size deals in recent years. 85% of PII deals were under US\$5M 2017-2019.

**Allocation Trends** - Impact capital from DFIs is primarily deployed into the financial services, energy and healthcare sectors, with only 30% of DFI investments flowing into other sectors. Over half of the PII capital was deployed in the financial services sector 2017-2019 (mainly fintech), followed by the energy sector.

The focus on financial services and energy can be attributed to the low risk profile and return potential on offer, as financing access and energy access are 2 of the most common needs for people living in the region.

Equally important impact sectors, primarily around livelihood improvement (e.g. education and workforce development) and addressing macro socio-environmental issues (e.g. environmental management and climate change) receive significantly less funding despite their importance. There was a sharp increase in impact capital deployed with a gender lens 2017-2019, with 39 registered GLI deals deploying US\$350M, primarily in financial services and agriculture.

**Distribution** - 5 countries absorb most impact investing in Southeast Asia - Cambodia, Indonesia, Philippines, Thailand, and Vietnam. Indonesia attracts the most amount of impact capital from both DFIs and PIIs; More than one-third of the PII investments 2017-2019 were in Indonesia, over 60% with ticket sizes above USD 10 million. Financial services are among the largest sectors funded by impact financing in each of these geographies, especially in Cambodia, although other sectors are prominent in certain geographies, e.g. agriculture in Indonesia, clean energy in Philippines and Thailand, and healthcare in Vietnam.

**Instruments** - Equity constitutes over 63% of PII deals and capital deployed, while 70% of DFI deals and 85% of capital deployed through debt. Equity-related deals have become more prominent in recent years as a result of greater awareness and knowledge from entrepreneurs and the rise in more quality investors offering a higher calibre of services, sector experience, ticket sizes, support, and access to market and networks. There is little data of the contribution of alternative financing in Southeast Asia against traditional venture equity or debt, but it can be safely assumed to be a small proportion given its nascence in the region, and the lack of many successful cases.

Over 60% of deals 2017-2019 were done by single impact investors investing alone, with only 3% of deals receiving co-investments from multiple impact investors. Around 35% of the deals received co-investment from non-impact focused regional as well as global investors.

**Local Presence** - Although most PII investors are not headquartered in their country of investment, many are headquartered in Singapore—the region's financial capital. Around 55% of the PIIs had no regional presence in SEA, which has had direct bearing on capital deployment by these investors in light of the COVID-19 pandemic and resultant travel and other restrictions globally.

Further reading:

[The Landscape for Impact Investing in Southeast Asia, GIIN and Intellectap, 2018](#)

[The Advance of Impact Investing in South East Asia – 2020 Update](#)

## 2. The women-led / women-forward SGB context

A key Missing Middle gap to bridge is improving financing access to women-led SGBs or women-forward SGBs - ventures that aim to improve the lifestyles and livelihoods of women in the region. SGBs run by women and targeting women are often excluded from funding. Programs have shown that despite women-led SGBs significantly outperforming peers, growing revenues 1.5 times faster and jobs twice as fast, they can still be excluded from financing.

Women-led SGBs face a disproportionate access to finance, including in the 3 most populous and vibrant Southeast Asian economies for impact: 82% in Indonesia, 80% in Vietnam, and 75% in the Philippines of women-led SGBs have not been able to access any form of financing.

The factors that lead to this are manifold; from, women founders in emerging economies lacking ownership or access to assets which can be demonstrated to mitigate financing risk, to an active or unconscious bias among fund managers to invest in women-led SGBs, to lack of female fund managers that reduces the ability for financiers to diversify investments.

Further Reading:  
[Gender Lens Investing In Southeast Asia: A Snapshot Of Progress In Indonesia, The Philippines, And Vietnam. Australian Aid, Investing In Women, Value For Women, 2021](#)

[Accelerating Entrepreneurs: Insights from USAID's Support for Small and Growing Businesses, USAID, 2018](#)

## 3. SGB segmentation and the multiple missing middles

There are multiple Missing Middles to tackle. There is no one silver bullet to closing the finance gap. The operating context and nature of ventures vary from the sectors they operate in, their geographical context, but we believe one of the most important ways for understanding the nature of the multiple Missing Middles is through the segmentation of the types of SGB and meeting their distinctive needs and requirements.

For this report, we recommend the segmentation types offered by the 2018 report by Omidyar Network and the Collaborative for Frontier Finance, [Segmenting Enterprises to Better Understand Their Financial Needs](#), that classified enterprises into 4 distinct types of ventures:

1. High growth ventures,
2. Niche ventures,
3. Dynamic enterprises,
4. Livelihood-sustaining enterprises.

Each has their own trajectories, operational nature, financing gaps, and most importantly, financing needs that determine suitability of investment, and the report offers quality insights on these multiple Missing Middles to be tackled.

Further reading:  
[Segmenting Enterprises to Better Understand Their Financial Needs, Omidyar Network and the Collaborative for Frontier Finance, 2018](#)

[Frontier Capital: Early Stage Investing for Financial Returns and Social Impact in Emerging Markets, Omidyar Network and the Collaborative for Frontier Finance, 2015](#)



#### 4. The supply-side barriers to investment

The cost of capital deployment and return potential, plays an outsized role in determining whether an investor opts to finance an SGB. The main body of the report looks less at this, as the majority of conversations to tackle the Missing Middle in Southeast Asia focus around aligning the cost of capital deployment and return potential in the form of differentiated financing instruments.

A snapshot of the financing constraints and the financing innovation to tackle it offer an overview on how barriers to be overcome; something that is demonstrated in the cases of this report, through the 6Ps of financing risk and concessions offered, and the commensurate financing structures that funders and financing entities employ to overcome these barriers.

Financing Constraints	Financing Innovation to tackle it
Higher Perceived Risk	Combine financing with a more high touch involvement in investees
Lower Returns	Tie investments with catalytic financing from funders, such as foundations, who are more purpose driven
Long Time Horizons	Deploy for patient capital structures with a 5 / 7 / 10 year return horizon
Fewer exit opportunities	Deploy more differentiated liquidity or return creating opportunities, e.g. milestone based payouts, convertibles, etc.
Higher transaction cost	Engage intermediaries to conduct more cost-effective screening and due diligence activities

To link to the previous insight on SGB segmentation, it is worth understanding that some constraints are prevalent in certain SGB types over others. For example, transaction costs are likely to be less of a barrier for high-growth ventures that look to raise larger ticket sizes with potential to access scale financing, but are barriers for dynamic and livelihood-sustaining enterprises.

Further reading:  
[Innovations In Financing Structures For Impact Enterprises: Spotlight On Latin America, Transform Finance, 2017](#)

[Closing the Gaps - Finance Pathways for Serving The Missing Middles, Collaboration for Frontier Finance 2020](#)

## 5. The importance of intermediaries and entrepreneur support

The form of adaptive capital for impact that we call to attention in this report is being practiced in other regions outside of Southeast Asia. We recommend readers looking to understand more to check out the links below that link to examples and cases of financing entities practiced adaptive capital in Latin America and Africa.

Further Reading:

[Accelerating Entrepreneurs: Insights from USAID's Support for Small and Growing Businesses, USAID 2017](#)

[A year of ViCap Communities: How ecosystem builders can best help entrepreneurs succeed, Village Capital 2017](#)

## 6. Global examples of adaptive capital

The form of adaptive capital for impact that we call to attention in this report is being practiced in other regions outside of Southeast Asia. We do recommend readers looking to understand more to check out the links below that link to examples and cases of financing entities practiced adaptive capital in Latin America and Africa. We also mention specific funds whom we felt had integrated the process of adaptive capital for bridging the Missing Middle as consistent approach of their activities.

Further Reading:

[Innovations In Financing Structures For Impact Enterprises: Spotlight On Latin America, Transform Finance, 2017](#)

A high quality repository that offers multiple examples against different scenarios for how funders have adapted capital to the context of SGbs in Latin America.

[Enabling entrepreneurship in frontier markets, Dutch Good Growth Fund 2019](#)

This report shares the success stories and lessons learned of five years of financing SMEs in frontier markets (2014-2019).

[lungo Capital, Kenya](#)

lungo Capital is an impact investment company that looks to bridge the Missing Middle in East Africa, by aligning financing, by supporting a local angel impact investor network, with financial and technical support.

[Adobe Capital, Mexico](#)

Adobe Capital provides tailored financing solutions and technical assistance to early-growth stage Mexican companies operating with competitive advantages in key development sectors where demand is high.

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