ASHESI UNIVERSITY

Impact Investing Ghana

# Catalytic Capital Investments In Ghanaian SMEs

## Strategies, Hurdles and Outcomes

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This report is made possible by the generous support of the Catalytic Capital Consortium. The contents are the responsibility of the authors and do not necessarily reflect the views of the Catalytic Capital Consortium.

Cover photo: Workers at Whesoyy, a small producer of healthy cereals that raised catalytic funding through Impact Investing Ghana's Deal Source Africa program.

# Contents

# Acknowledgements

This report was authored by Dr. Charles Atanga Adongo, Ms. Amma Lartey, Dr. Gordon Adomdza, and Dr. Sena Agbodjah Agyepong. Analytical support was provided by Mr. Sterling Tong, Mrs. Emelda Amoah, Ms. Mary Afenyie-Abekah and Mr. William Annoh.

The authors would like to acknowledge the guidance provided by a Steering Committee consisting of Prof. Angela Owusu-Ansah (Ashesi University), Ms. Hamdiya Ismaila (Venture Capital Trust Fund), and Mr. Nana Osei-Bonsu (Private Enterprise Federation).

This report would not have been possible without the funding support of the New Venture Fund of the Catalytic Capital Consortium.

We acknowledge the contributions and inputs of Mr. Zubeiru Salifu (AV Ventures), Mr. Emmanuel Egyam (Adenia Partners), Mr. Joseph Otoo (Buzisols Chartered Accountants) and Mr. Hammond Kwaku Wolanyo Mensah (Solidaridad).

Special thanks to the research stakeholder group that facilitated interviews and attended review and validation workshops:

1. Chamber of Corporate Trustees of Ghana
2. Ghana Securities Industry Association
3. Ghana Bankers Association
4. Ghana Venture Capital Association
5. Venture Capital Trust Fund
6. Social Enterprise Ghana
7. Private Enterprise Federation
8. Association of Ghana Industries
9. United States Agency for International Development Mobilizing Finance in Agriculture
10. Results for Development
11. Zebu Investments
12. Ghana Alliance for Clean Cooking
13. Palladium Group
14. Solidaridad
15. Mennonite Economic Development Associates

Editor: Mr. Franklyn Ayensu

# Foreword

If there has ever been a time to shine a spotlight on catalytic capital investments, that time is now. In the context of the weakening of the global economy, the slowdown in growth, widespread unemployment especially among the youth, the climate crises engulfing the planet, and the growing disparity between the well-heeled and the left behind, it is more urgent than ever that resources—not only those of governments but of the private sector—be invested in achieving the United Nations Sustainable Development Goals (SDGs).

Catalytic capital is particularly well-suited to playing a major role in meeting this challenge. Every day, millions of small and medium-size enterprises (SMEs) all over the world try to serve local communities, provide livelihoods, create jobs, fuel innovation, and achieve other developmental impact goals. But especially in the Global South, many of them lack access to capital offered on suitable terms through the conventional marketplace. SMEs in Ghana, as in other emerging markets, are hindered by both demand- and supply-side barriers to obtaining financing from traditional capital providers such as banks. On the supply side, high lending rates, short loan tenors, and substantial collateral requirements. On the demand side, limited financial literacy, low formalisation, and inadequate customer identification and verification documents.

Catalytic capital—investment capital that is patient, long-term, risk-tolerant, concessionary, and flexible—is a powerful and promising tool for supporting impact-led enterprises that are improving communities and expanding opportunities for ordinary people, including underserved populations, because the aim of catalytic capital is to unlock—literally catalyse—additional investment (often in the form of mainstream commercial capital) into small businesses that would not otherwise be possible if the catalytic capital had not first proceeded.

According to World Bank estimates, 600 million new jobs will need to be created by 2030 to absorb the growing global workforce. This should make supporting and growing SMEs a high priority for every government in the world, especially in an emerging market such as Ghana, where most jobs in the formal as well as informal sectors are generated by SMEs.

Yet as vital as SMEs are to the national economy as an engine of growth, the challenges they face in accessing finance are a persistent constraint on their own growth. The reality is that, even in impact investing, many capital providers today seek and expect market-rate returns. A 2020 investor survey by the Global Impact Investing Network (GIIN) articulates clearly that the impact investing sector, if it ever was, is no longer a philanthropic niche. Roughly a $715 billion sector in 2020, impact investing is projected to reach over $1 trillion in 2022, and with that growth has come the professionalization of its business models and strategic objectives as some of the world's largest private equity funds and other financial institutions—from Goldman Sachs and Bain Capital to KKR—enter the field.

This has inevitably brought inflexible expectations for high investment returns that are governed by internal organizational mandates. As a consequence, impact capital has become more market rate-oriented, so in spite of its promising size, it has not been able to fully address critical social needs around the globe—many of them encapsulated in the SDGs. According to the GIIN, successfully structuring appropriate investment capital across the risk and return spectrum has been the impact capital industry's greatest challenge over the last six years.

The result is that SMEs in Ghana, between the funds they need and what they can realistically access, face a financing gap of $4.8 billion, according to the International Monetary Fund—a funding gap that was estimated by other organizations to be as high as $15 billion back in 2019, and growing at 7 percent CAGR year-on-year.

Within this space, catalytic investment capital has the potential to carve a uniquely supportive bridging role—seeding and scaling innovative SMEs while simultaneously laying the foundation for mainstream investors to come in and participate in socioeconomically transformative investments.

With the world emerging from COVID and engaged in building back better, a rigorously researched, evidence-based study on the place of catalytic capital investments in the Ghanaian SME ecosystem could not be more timely. The authoring team have produced a piece of work that offers a wide range of stakeholders an empirically grounded frame of reference for discussing, planning, and weighing the options for genuine, broad-based, ground-up, impact-oriented development in Ghana. Anchored in rich granular data, this report presents insights, findings and recommendations that, if acted on and implemented, could lead to the mobilisation of significant new capital for small and medium-size enterprises in Ghana. Find the time to sit down, read it and digest it.

**Ms. Hamdiya Ismaila**
**General Manager,**
**Venture Capital Trust Fund**

**Mr. Nana Osei-Bonsu**
**CEO, Private Enterprise Federation**

**Prof. Angela Owusu-Ansah**
**Provost, Ashesi University**

# Executive Summary

## Purpose of this Report

The study that led to this report was launched to develop a better grasp of Ghana's catalytic capital investment ecosystem to provide insights that will allow key institutions to mobilise catalytic capital in ways that unlock additional appropriate commercial capital for small and medium-size enterprises (SMEs) and for impact. This report offers a broad overview of the landscape from 2004 to 2021 and provides insights and guidance that will enable both current and prospective impact-oriented institutions and practitioners to better understand

- How patient, long-term catalytic capital has been deployed in Ghana's SME financing sector, the roles it has played, and lessons to guide its future expansion

- The distinct forms catalytic capital takes, the uses to which SMEs have put it, and the outcomes it has generated, both positive and negative

- How catalytic capital has been deployed to address the social and economic needs of various underserved populations, and

- What kinds of concessions have been employed to unlock additional commercial capital for SMEs and to draw in conventional investors who normally target market-rate returns.

## Key Findings and Recommendations

A high-level finding in our research study is that in the context of an emerging market like Ghana, creativity and flexibility go a long way in unlocking financing for small and medium-size enterprises (SMEs). The most successful catalytic capital providers in our study took time to understand the needs of the SMEs they were working with, and the requirements of the commercial capital providers they wanted to draw in to innovate and create purposeful investment products.

### Findings

- We identified 72 SME financing schemes launched between 2004 and 2021, valued at $1.73 billion.[1] Of this, the capital actually invested in SMEs was $1.16 billion, of which almost all of it, $949 million, was catalytic capital. Over the 2004–2021 period, the financing volume steadily increased to about 5 times its initial amount. Third-party funding catalysed by those schemes for which data were disclosed (10 of them) totalled $552 million—about 5 times the value of capital investments of the 10 schemes combined. We found that catalytic capital schemes enable 3rd-party investments that are roughly **3 to 7** times the initial investment in the SME—an important and promising key to closing the SME financing gap in Ghana.

- Sources:[2] These catalytic investments were initiated by the private sector **(41%)**, development finance institutions (DFIs) **(34%)**, government **(21%)**, international development agencies, **(4%)**, and foundations **(1%)**.

- Forms: Of the concessions deployed, **63%** of the capital providers offered non-traditional terms tailored to the SME's needs (purpose); **42%** offered longer financing timelines (patience); **9%** used pledges, guarantees or risk insurance; and **8%** offered concessionary pricing.

- Roles: **92%** of the capital providers invested to help the SME to scale; **55%** to sustain operations, **27%** to help seed an impact enterprise because of the degree of risk involved; and **20%** to fund an innovative or unproven opportunity.

- Impact and outcomes were significant: Many SMEs reported increasing revenue or return on investment by **25%** or more, increasing

[1] All dollar amounts quoted in this report are in US dollars unless otherwise specified.
[2] For our study, comprehensively identifying actual sources of funding was not an easy task. In the end, we identified the institutions who designed and ran the initiatives.

employment by up to **60%,** unlocking very significant magnitudes of third-party investments, and enabling underserved populations to access financing, improve their livelihoods, and learn important new skills.

- What underlying choices drove these positive outcomes? In particular, offering longer investment tenors, using financial products such as convertibles, offering investment sizes that align well with the SME's needs, and funding at concessionary rates especially for early-stage businesses and enterprises located in, and led by members of, underserved populations.

- Investments that unlocked 3rd-party investments were deliberate in how they did this.
Examples: Venture Capital Trust Fund (VCTF) took subordinated, first-loss positions in all its investee funds. USAID's Financing Ghanaian Agriculture Project (FinGAP) used pay-for-performance and other innovative features. AV Ventures made investments in SMEs to de-risk them to make them more attractive to commercial investors, and co-invested in SMEs with commercial capital providers.

- As stated, creativity and flexibility go a long way in SME financing. The flexibility private equity/venture capital funds have to innovate around financing instruments may make them suitable to pilot innovative catalytic capital financing structures to work around some of the constraints SMEs face.

- Although emerging-fund managers often invest the smaller deal sizes SMEs look for, even managers with significant venture capital experience face challenges raising their first fund because prospective investors already want to see a track record of capital raised and a portfolio of investments that the manager has made from that fund. Structured support programmes for first-time managers could help.

## Five Ongoing Challenges

1. Some survey respondents felt (i) that catalytic capital can sometimes distort markets by giving some market participants special advantages in capital or information, and (ii) that the perception of easy money can induce lax due diligence or unneeded risk taking among some SMEs.
The strategies catalytic capital providers employ to avoid negative outcomes include
(i) targeting underserved markets such are sectors or geographies with very little funding to avoid distorting existing well-funded sectors or geographies, (ii) using blended finance to crowd in commercial investors to co-invest with them, (iii) de-risking investments instead of providing a concessionary rate, (iv) connecting the SME to commercial funding sources, (v) being accountable and transparent with their stakeholders, and—one of the most important— (vi) learning and adapting their vehicles and products to changing results and market conditions.

2. Catalytic capital providers identified currency risk as the highest risk, partly a result of the significant depreciation of the Ghanaian cedi against international hard currencies in recent years. There is a need for affordable currency hedging solutions and for government to put in more effort to stabilise the currency.

   Additionally, our respondents identified **three main gaps** in the financing landscape:

3. There is too little catalytic capital working with innovative financing models that can deliver appropriate, cost-effective financing to SMEs.

4. Only 4 out of 10 catalytic investors engage in gender lens investing, and many of those—besides dedicated gender-specific funds—are gender-considerate rather than actually deliberate.

5. Underserved geographical areas such as the north of Ghana receive disproportionately low levels of funding despite the potential for significant social impact. There is an urgent need to build a pipeline of investment-ready SMEs in such areas.

## Four Opportunities

Some interesting opportunities that came up during the research are worth highlighting.

1. As of the end of 2020, the potential pool of local capital providers that could be leveraged for catalytic financing, when pension funds are

included, is GHS22 billion ($5 billion). Another promising development is the launch of Development Bank Ghana (DBG) in 2021, which is expected to invest $600 million into SMEs through its beneficiary financial institutions and is a potential source of catalytic financing.

2. An estimated total of assets under management (AUM) of $50 billion is available from 60 private equity, private debt, and venture capital providers that have Ghana as one of the destinations they target, and which high-growth SMEs could leverage. This would require them to be investment-ready and be able to deliver returns and impact as competitively as successful SMEs in other African countries.

3. An innovative Fund of Funds is being sponsored by Impact Investing Ghana that could unlock significant pension funding for investment into venture funds.

4. The VCTF is creating a Fund Managers Development Programme, which could include warehousing and other support for emerging fund managers. Also, Impact Investing Ghana's dealsourceafrica.co platform has begun supporting fund managers to raise funding from limited partners.

### Six Actionable Recommendations

1. Catalytic capital can significantly increase financing for SMEs and the private sector, government, DFIs and IDAs should take action that increase the volume of catalytic capital and the number of financial intermediaries willing to work with it.
    - Private sector actors need to recognise the advantages of partnering with catalytic capital providers
    - Government programmes should disburse funding in ways that are transparent, and structure products to unlock third-party investments
    - Development finance institutions need to take on more risk and be catalytic by working with emerging fund managers, financing innovative funding vehicles etc.
    - International development funding should increase blended finance vehicle funds that actually deliver catalytic financing in addition to engaging in ecosystem building.

2. Ecosystem builders such as Impact Investing Ghana should partner with government and others to drive collaboration, increase capacity and develop a comprehensive strategy to significantly increase financing in key sectors and for underserved segments, and to draw catalytic investors into Ghana and track progress over time. These initiatives could include using a value-chain approach to work with underserved areas and groups such as northern Ghana, women, and young people. Another example could be mobilising catalytic capital to stabilise locally-managed, Tier 2 microfinance institutions, which focus on underserved populations. There is also a need for catalysing affordable foreign exchange hedging for local investors and supporting catalytic vehicles such as a fund of funds focused on unlocking local funding.

3. To increase the effectiveness of catalytic capital, providers of this kind of capital should design products that are likely to lead to positive outcomes and unlock third-party investments using lessons learned from this report to reduce the risk of negative outcomes.

4. Catalytic capital providers should commit to strong impact measurement and management of catalytic financing vehicles, with clear baselines to enable verification of, and learning from, the third-party investments actually unlocked. They should also urge beneficiary SMEs to embed sustainability in their strategy and core operations using tools such as the UNDP SDG Standards for Enterprises.

5. To increase the demand for catalytic capital and the effectiveness of SMEs, there needs to be commensurate investments in technical assistance and transaction advisory work, including increasing the number of capital raise service providers and strengthening the quality of enterprise support.

6. A strong economy enables growth. The government needs to work on stabilising the economy to reduce inflation, interest rates and currency depreciation. Current actions to improve the regulatory environment for private funds need to be completed.

# Abbreviations

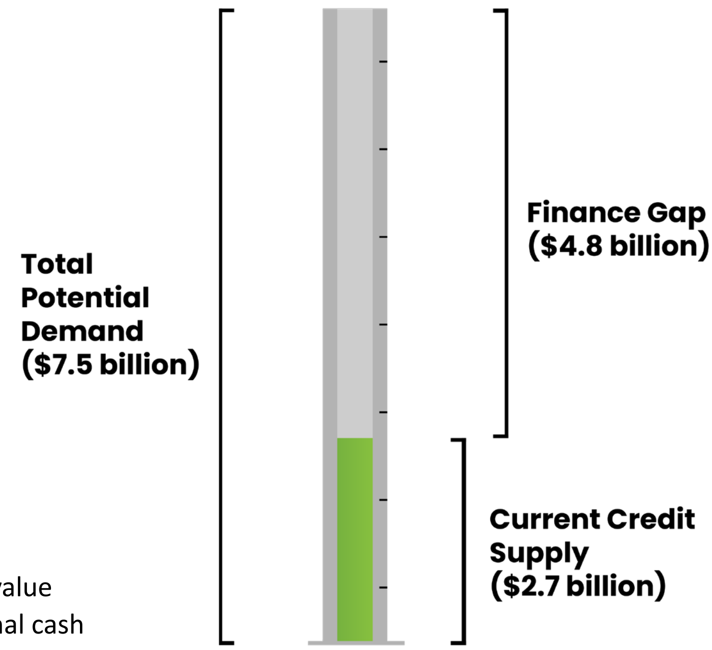
| | |
|---|---|
| ADVANCE II | Ghana Agricultural Development and Value Chain Enhancement II Project |
| AFAWA | Affirmative Finance Action for Women in Africa |
| AfDB | African Development Bank |
| AGF | African Guarantee Fund |
| AUM | Assets Under Management |
| BAS | Business Advisory Service |
| BoG | Bank of Ghana |
| CAPI | Computer-Assisted Personal Interview |
| CC | Catalytic Capital |
| CIDA | Canadian International Development Agency |
| DANIDA | Danish International Development Agency |
| DBG | Development Bank Ghana |
| DFI | Development Finance Institution |
| EBITDA | Earnings Before Interest, Tax, Depreciation and Amortisation |
| ELI | Eco-Lens Investing |
| ENGINE | Enhancing Growth in New Enterprises |
| ESG | Environmental, Social, and Governance |
| ESO | Enterprise Support Organisations |
| FI | Financial Institution |
| FinGAP | (USAID) Financing Ghanaian Agriculture Project |
| FMO | Dutch Entrepreneurial Development Bank |
| FSL | Financial Service Limited |
| GAC | Global Affairs Canada |
| GAIN | Ghana Angel Investing Network |
| GAIP | Ghana Agricultural Insurance Pool |
| GAX | Ghana Alternative Market |
| GDP | Gross Domestic Product |
| GEA | Ghana Enterprise Agency |
| GIIN | Global Impact Investing Network |
| GIRSAL | Ghana Incentive-Based Risk-Sharing System for Agricultural Lending |
| GIZ | Deutsche Gesellschaft für Internationale Zusammenarbeit |
| GLI | Gender Lens Investing |
| GMI | Global Medical Investments |
| GoG | Government of Ghana |
| GP | General Partner |
| GPP | Ghana Poultry Project |

| | |
|---|---|
| GROW | Greater Rural Opportunities for Women |
| GUA | Ghana Union Assurance |
| GVCA | Ghana Venture Capital and Private Equity Association |
| GVCF | Ghana Venture Capital Fund |
| HNWIs | High-Net-Worth individuals |
| IFI | International Financial Institution |
| IGVCF | Injaro Ghana Venture Capital Fund |
| IIGh | Impact Investing Ghana |
| IPO | Initial Public Offering |
| KfW | Kreditanstalt für Wiederaufbau (Credit Institute for Reconstruction) |
| LP | Limited Partner |
| MASLOC | Microfinance and Loans Centre |
| MDB | Multilateral Development Bank |
| MEDA | Mennonites Economic Development Associates |
| MFA | Mobilising Finance for Agriculture |
| MSMEs | Micro, Small and Medium-Size Enterprises |
| NEIP | National Enterprise and Innovation Centre |
| NGO | Non-Governmental Organisation |
| ODA | Official Development Assistance |
| PAGE | Partnership for Action on Green Economy |
| PE | Private Equity |
| PfR | Pay-for-Results |
| PPP | Private Public Partnership |
| PRISMA | Preferred Reporting Items for Systematic reviews and Meta-Analyses |
| RBF | Revenue-Based Financing |
| RDF | Rural Development Fund Ghana |
| ROR | Rate of Return |
| ROSCA | Rotating Savings and Credit Association |
| SDG | Sustainable Development Goal |
| SGMC | Sweden Ghana Medical Centre |
| SMEs | Small and Medium-Size Enterprises |
| SOVEC | Social Venture Capital Fund |
| SNV | Stichting Nederlandse Vrijwilligers |
| TA | Technical Assistance |
| TCX | The Currency Exchange Fund |
| USAID | United States Agency for International Development |
| USDA | United States Department of Agriculture |
| USDFC | United States International Development Finance Corporation |
| VC | Venture Capital |
| VCTF | Venture Capital Trust Fund |

# I. What is Catalytic Capital and Why is It Needed?

Small and medium-size enterprises (SMEs) in Ghana—the backbone of the nation's economy—face a very large financing gap. They are simply not getting the money they need—to grow, to scale up, or in many cases even to survive. For several reasons—later explained—traditional conventional ways of bridging this financing gap have not turned out effective. Patient, flexible catalytic investment capital is one innovative way to fill this financing gap.[3]

Ghana has one of the largest SME financing gaps in Africa—estimated at $4.8 billion. With the potential credit demand from SMEs of $7.5 billion far outstripping the estimated supply of $2.7 billion, 72 percent of the country's SMEs are financially constrained.[4]




Ghana's SME Financing Gap

The financing gap is high all around, but it is especially high in certain sectors, geographical areas, and population groups. The agriculture, forestry and fishing sectors, for instance, had received just 3.5 percent of the total credit from banks in the country within April 2022.[5]

There are bright spots within the SME sector. There is a small but growing venture capital industry, a number of innovative SMEs have brilliant products, teams and growth potential, and the government has committed significant amounts to support entrepreneurship especially among young people.[6] But on the whole, Ghana's SME sector is characterised by informality, weak governance, inadequate financial structures, weak value chains, limited management skills, and irregular or seasonal cash flows. On the supply side, financial institutions charge high interest rates—as high as 30 percent—require substantial collateral, in some cases up to 115 percent of the loan size, and tend to provide only short-term loans. All these supply-side features further limit SMEs' financing options. The result is a financing gap that leaves SMEs with little room to grow.

Besides this capital gap, shocks to the global economy—from the COVID-19 pandemic, to the Russia-Ukraine war, to severe climate events—aggravate the challenges Ghanaian SMEs already face. Further worsening the situation for them is that Ghana's economic growth, after averaging 7 percent between 2017 and 2019, declined to 5.4 percent by the end of 2021 following the outbreak of COVID-19.[7] Inflation at the end of 2021 was high, at 12.6 percent. Perhaps most egregiously, the local currency has

**Micro enterprises** are those that employ 1–5 workers or have fixed assets of $25,000 or less.

**Small enterprises** employ 6–30 workers or have $25,001–$100,000 in fixed assets.

**Medium enterprises** are those with 31–99 employees or with fixed assets between $100,001 and $3 million.

*(Source: Ghana Statistical Service)*

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[3] Impact Investing Ghana (IIGh), *Impact Investing in Ghana: Unlocking Private Sector Capital for Profit and Impact* (summary report) (2022), https://impactinvestinggh.org/publications/the-state-of-impact-investing-in-ghana-unlocking-private-sector-capital-for-profit-and-impact-22.

[4] World Bank, *MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small, and Medium Enterprises in Emerging Markets* (Washington, DC: World Bank Group, 2017), https://openknowledge.worldbank.org/handle/10986/28881.

[5] Bank of Ghana, *Monetary Policy Report May 2022* (2022), https://www.bog.gov.gh/wp-content/uploads/2022/06/Monetary-Policy-Report-May-2022.pdf.

[6] IIGh, Impact Investing in Ghana (summary report).

[7] Ministry of Finance, *Budget Statement and Economic Policy of the Government of Ghana for the 2022 Financial Year* (2022), https://mofep.gov.gh/sites/default/files/budget-statements/2022_Budget_Statement_v3.pdf.

been volatile and the country has experienced very high currency depreciation for most of 2022, making enterprises in Ghana less attractive to international financing.

Why is it imperative to finance Ghana's SMEs? SMEs make up more than 85 percent of businesses in Ghana. SMEs employ more than 80 percent of the country's workforce and generate about 70 percent of the national income.[8] A vital, dynamic SME sector is critical not only to addressing the country's social and environmental problems—from food and water to sanitation, hygiene and environmental pollution—but to driving economic growth and building resilience in the face of external shocks.

And that is where catalytic capital comes in. First off, what is it? Catalytic capital is a form of impact investment capital that accepts disproportionate risk and/or concessionary returns in order to generate positive impact and to unlock commercial third-party investments that otherwise would be unlikely.[9] Five concessions in particular make an investment catalytic:

| | |
|---|---|
| Price | Accepting a return on investment lower than the likely risk |
| **Patience** | Making investments that are likely to take longer than usual or whose timeline may even be uncertain |
| **Position** | Willingness to occupy a subordinated debt or equity position to enhance credit for the SME |
| **Pledge** | Using guarantees to provide credit enhancement |
| **Purpose** | Accommodating non-traditional terms in order to meet the needs of the SME, such as a smaller investment size or a collateral-free investment |

Four key definitions were used in this report and should be kept in mind to understand its findings:

**Catalytic capital** ▪ capital that accepts disproportionate risk and/or concessionary returns to generate positive impact and unlock additional commercial third-party investments that otherwise would not be possible or likely.[10]

**SME financing schemes** ▪ initiatives aimed at increasing financing for SMEs either directly through SME capital investments, or indirectly through programmes that build SMEs' capacity, facilitate transactions, build up the ecosystem, and so on.

**Capital investments in SMEs** ▪ capital invested in SMEs either directly or through financial intermediaries and funds.

**Catalytic capital investments in SMEs** ▪ a subset of capital investments in SMEs, these are investments that are specifically catalytic.

[8] Michaella Allen, Jeremy Gray and Lucia Schlemmer, ***Ghanaian MSME Resilience in the Face of COVID-19*** (Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), 2021), https://www.giz.de/expertise/downloads/The%20Resilience%20of%20MSMEs%20in%20Ghana%20in%20the%20Face%20of%20COVID-19.pdf.

[9] Tideline, ***Catalytic Capital: Unlocking more Investment and Impact*** (2019), https://tideline.com/wp-content/uploads/2020/11/Tideline_Catalytic-Capital_Unlocking-More-Investment-and-Impact_March-2019.pdf.

[10] Tideline, Catalytic Capital.

## The Study behind the Report

The study that led to this report was launched to develop a better grasp of Ghana's catalytic capital investment ecosystem to provide insights that will allow key institutions to mobilise catalytic capital in ways that unlock additional appropriate commercial capital for SMEs and for impact. Catalytic capital is often needed to make impact transactions attractive to a broader range of investors. This report offers a broad overview of the landscape from 2004 to 2021 and provides insights and guidance that will enable both current and prospective impact-oriented institutions and practitioners to better understand how patient, long-term catalytic capital has been deployed in Ghana's SME financing sector, the roles it has played, and the lessons that can guide its future expansion.

Five sets of questions guided our work:

1. Where within the SME space in Ghana has catalytic capital been deployed? Which investors have been active? What are their roles and motivations? And what market gaps still exist?

2. How has this catalytic capital been deployed? What were the terms of investment, the risk-return expectations, the investment vehicle type, and degree of subsidy provided? What approaches, if any, were used to mobilise additional conventional commercial capital, either simultaneously or over time?

3. In the deployment of catalytic capital, what attention has been paid to women, youth and other population groups that have historically been less able to access financing?

4. Compared to other forms of capital, in what ways have catalytic capital investments contributed to positive outcomes such as greater social and economic inclusion?

5. In what ways have catalytic capital investments contributed to negative or undesirable effects such as income inequality or market distortions?

These questions were answered through desk research and a literature review, together with 49 interviews and surveys of 164 suppliers and 200 recipients of catalytic capital. We also examined case studies, the results of which are presented in subsequent sections. (See Appendix 1 for more about the methodology we used.)

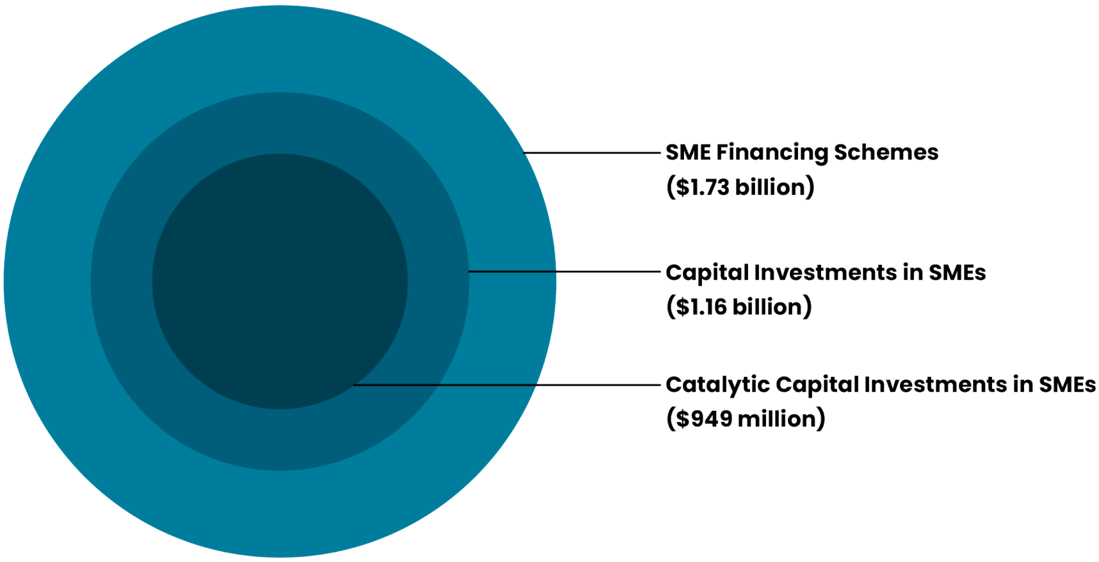
# II. Ghana's SME Financing and Catalytic Capital Landscape

## Identifying Catalytic Capital Investments in SMEs

To understand how much catalytic capital has been deployed in Ghana, we first identified all SME financing schemes launched between 2004 and 2021. These are initiatives aimed at increasing financing for SMEs—either directly through capital investments in the enterprise or in their financial intermediaries, but also indirectly through programmes that build the enterprise's capacity, facilitate transactions, develop the ecosystem, and so on. Next, we identified which of these schemes actually made capital investments into SMEs, and then which of those capital investments were intended as catalytic.[11]

All together, we identified 72 SME financing schemes valued at $1.73 billion. Of this, the capital invested in SMEs amounted to $1.16 billion, of which $949 million was in the form of catalytic capital. Total third-party funding enabled by those schemes for which data were disclosed (10 schemes) was $552 million. This amount is quite significant—about 5 times the value of the 10 schemes. For example, the Venture Capital Trust Fund (VCTF) invested $29 million of catalytic capital in SMEs through its intermediary venture funds, and in the process crowded in another $89.7 million in private capital from other limited partners in the funds, about three times the invested amount. When the value of the third-party investments unlocked by the schemes is added to the total value of capital investments in SMEs, the full value of capital investments in SMEs is $1.69 billion.[12]

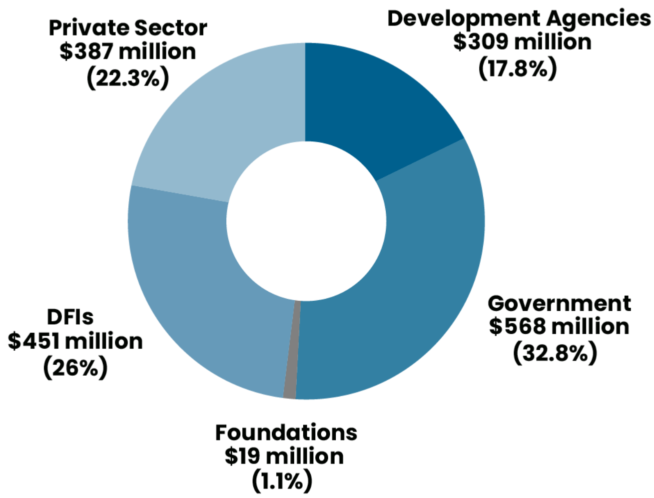
Most catalytic capital investors also provided SMEs with technical assistance to manage risk, increase the likelihood of success, and tackle systemic barriers that SMEs face in accessing finance. These include transaction facilitation, ecosystem building, and linkages along the value chain based on the risks identified or the levers needed to grow the SMEs or unlock the additional financing.



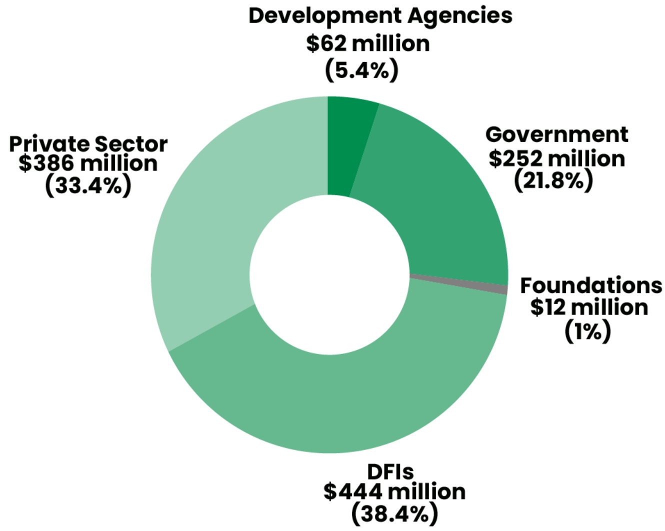

**Total Value of SME Financing Schemes and Investments, 2004–2021**

[11] Through research, interviews and surveys, we identified catalytic capital investments into SMEs, or into financial intermediaries for investment in SMEs. We included financial instruments such as guarantees, and innovative financing structures such as performance-based grants to financial institutions to de-risk and unlock financing for SMEs. But we excluded grants for activities like technical assistance, transaction facilitation, and ecosystem building. For entities that used both investment and technical assistance, we removed the technical assistance components from the capital investment and catalytic capital investment calculations.

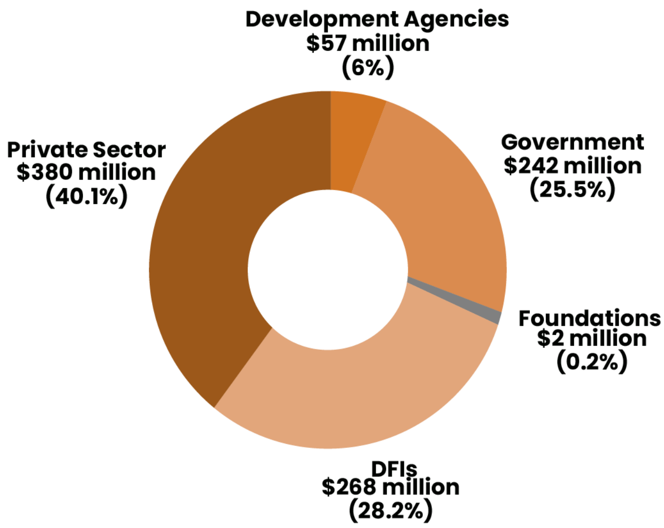
[12] Full value of capital investments refers to the combined value of capital investments in the SMEs in our study. This includes all publicly disclosed financing initiatives for SMEs and those identified through interviews and surveys. This is not the total supply of credit to SMEs in Ghana, which the IMF estimates at $2.7 billion. Further research is needed to expand the dataset to include more institutions to develop a more 3D understanding.




SME Financing Schemes by Investor Type[13]




Capital Investments in SMEs by Investor Type

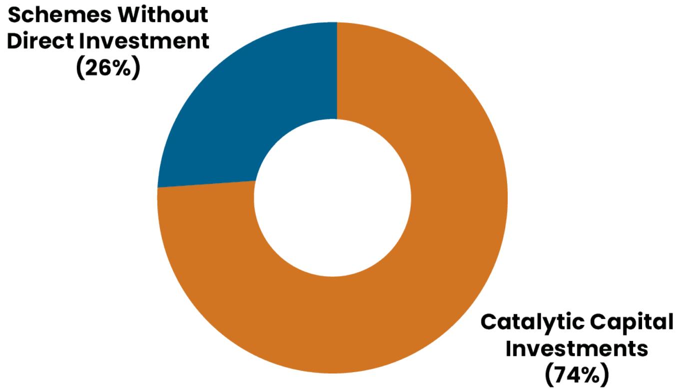



Catalytic Capital Investments in SMEs by Investor Type

[13] We classified financing schemes by the investor type, that is, the kind of entity that initiated the programme and was implementing it. In the few cases where an investment was made by one kind of entity but sourced from another, we classified the investment by the initiator and implementor. For example, where the Government of Ghana launched initiatives funded by loans from DFIs, we counted the investment as government funding.

## Unlocking Third-Party Investments

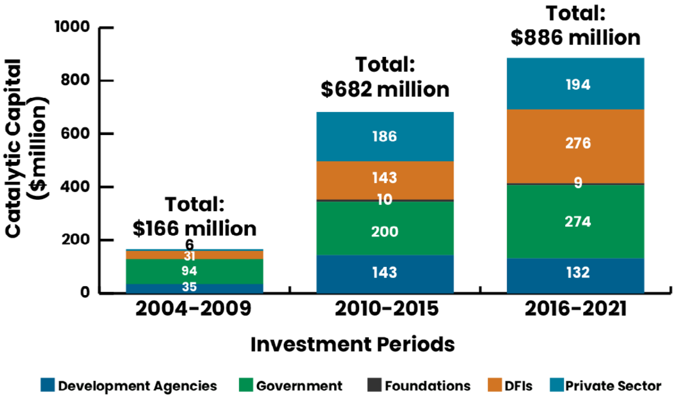
A majority of the institutions we identified were unable to provide verifiable data on third-party investments they had unlocked. Of the 10 schemes that provided this information, 74 percent of the third-party funding unlocked was done by institutions that undertook catalytic capital investments as part of their programmes; 26 percent was unlocked by institutions that did not make capital investments into the SMEs.



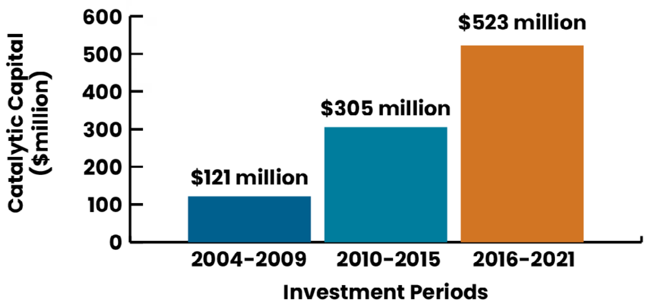

Who Unlocked Third-Party Investments?

## Trends in financing between 2004 and 2021

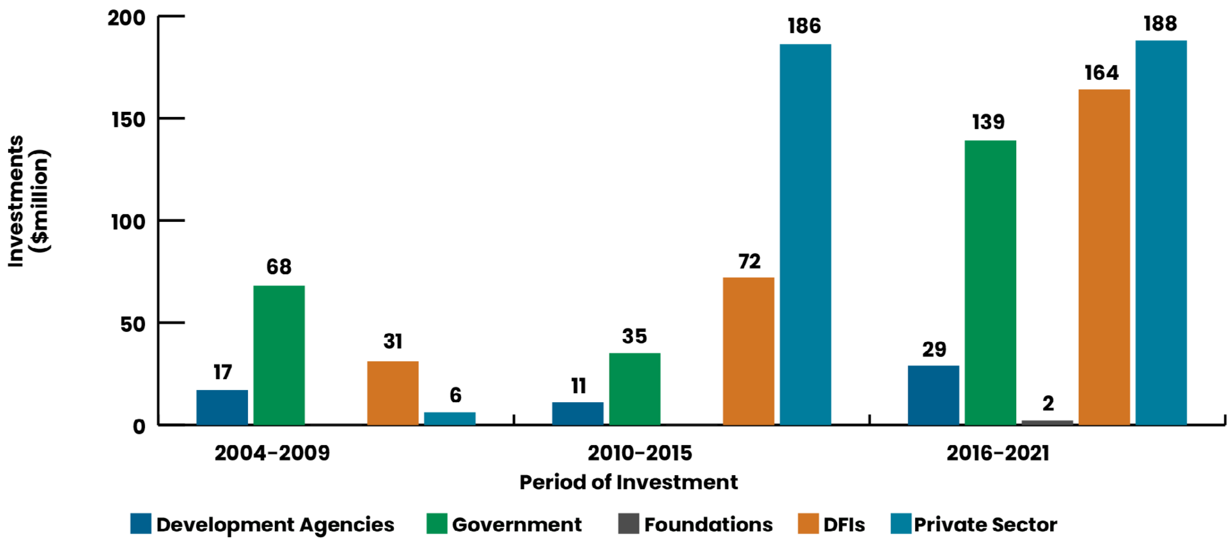
Between 2004 and 2021—the study period—SME financing schemes, capital investments in SMEs, and catalytic capital investments all increased about five times. Between 2004 and 2009, SME financing schemes spent $165 million. This grew to $886 million between 2016 and 2021. Over the same period, catalytic capital grew from $121 million to $523 million.




Trends in SME Financing Schemes, 2004–2021




Trends in Catalytic Capital Investments 2004–2021




Trends in Catalytic Capital Investments in SMEs by Investor Type, 2004–2021

## Average Investment Size

To understand the nature of the investments, we identified as many individual investments into SMEs as possible during the 2004–2021 period and were able to find 113 unique investment deals valued at $438 million. The average deal size was $2 million, with some variations across investor type. Direct investments by development finance institutions (DFIs) into SMEs were typically larger, averaging $8 million and ranging between $3 million and $20 million. The average investment size for fund managers was $1.5 million and ranged between $30,000 and $11 million. We were unable to isolate deals from other investor types.

## Suppliers of Capital

Currently, catalytic capital is supplied to SMEs in Ghana by more than 15 DFIs and multilateral development banks (MDBs), 7 development agencies, 17 foundations, and family offices, and several high net worth individuals (HNWIs). Of the foundations, the Mastercard Foundation (MCF) is the most visible development partner in Ghana, investing catalytic capital in SMEs through its Young Africa Works strategy. The MCF's notable SME financing initiatives include its partnership with the Ghana Enterprises Agency (GEA) on the Nkosuo programme, with a commitment of GHS90 million (about $15 million then).[14] MCF is also collaborating with the Kosmos Innovation Centre (KIC), investing $16 million over four years in KIC's programmes for SMEs, including financing them.[15] MCF has also partnered with CapPlus, the Bank of Ghana, and the Ghana Microfinance Institution Network (GHAMFIN) on the Financial Institution Resilience and Strengthening (FIRST+) programme to build the capacity of savings and loans, rural banks and microfinance institutions to increase lending to the agricultural value chain and other impact sectors. FIRST+ has attracted additional funding of $20 million from Oikocredit, a Dutch social investor.[16]

**Seeding** is providing finance to enable an early-stage enterprise to get its ideas off the ground and test its business models.

**Scaling** is expanding a business in a way that achieves operational efficiencies that enable it to grow at an accelerating rate, e.g., by innovating, automating, adding new products/services or expanding into new markets.

**De-risking** is reducing the investment risk associated with an investment to make it more attractive to private capital providers.

The government is also a significant supplier of catalytic funds to SMEs. It does this through the VCTF and other government agencies such as the GEA, the National Entrepreneurship and Innovation Programme (NEIP), the Microfinance and Small Loans Centre (MASLOC), and DBG.

Catalytic funding from government and development agencies such as the United States Agency for International Development (USAID) and Global Affairs Canada (GAC) was invested to **seed, scale** or **de-risk** SMEs or **offer incentives** to help catalyse investment from private investors that otherwise likely would not participate, especially in underserved sectors. Grant capital is also used to fund capacity building, technical assistance, transaction advisory services, and investment facilitation services to help create investment-ready SMEs. Consequently, these activities help to de-risk investments and build the capacity of SMEs to access and manage funds and close investment deals.

For example, through the Ghana Incentive-Based Risk Sharing System for Agricultural Lending (GIRSAL), which is a nonbank financial institution, the government has de-risked agricultural financing by guaranteeing loans worth $63.6 million (GHS700 million) as of September 2022. For detailed examples of catalytic financing schemes by government and development agencies, refer to the VCTF on page 48 and FinGAP on page 50.

[14] Mastercard Foundation, *NBSSI and Mastercard Foundation COVID-19 Recovery and Resilience Program to Support MSMEs in Ghana*, press release (September 16, 2020), https://mastercardfdn.org/nbssi-and-mastercard-foundation-covid-19-recovery-and-resilience-program-to-support-msmes-in-ghana.

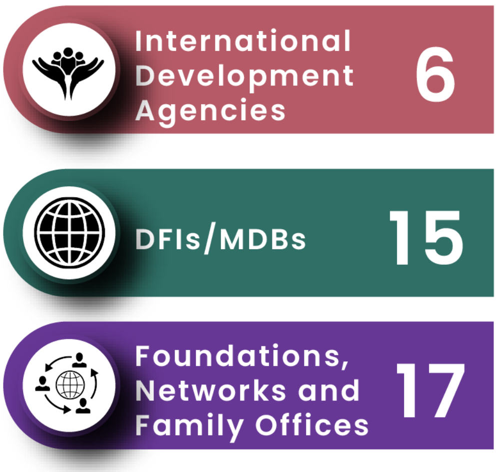
[15] Kosmos Innovation Centre, *The Mastercard Foundation and Kosmos Innovation Center join forces to train the next generation of young entrepreneurs in Ghana's agriculture sector*, press release (March 31, 2022), https://kicghana.org/the-mastercard-foundation-and-kosmos-innovation-center-join-forces-to-train-the-next-generation-of-young-entrepreneurs-in-ghanas-agriculture-sector

[16] Ghamfin, *First+ Program to Generate Work Opportunities for 60,000 Young Ghanaians*, press release (December 8, 2021), https://ghamfin.org/wp-content/uploads/2021/12/PRESS-RELEASE_CAPPLUS-AND-MASTERCARD-FOUNDATION-for-distribution1974.pdf.

## Financial Intermediaries

As regards intermediation of the deployment of catalytic capital, there are currently 23 commercial banks, 147 community and rural banks, 60 domestic and overseas fund managers and venture capital companies, and several other financial institutions that act as financial intermediaries, channelling catalytic capital from providers to beneficiary SMEs.

**Financial intermediaries** are institutions or vehicles used to channel catalytic capital from suppliers and investors to beneficiary SMEs.




Catalytic Capital Investors/Suppliers of Funds


Other Potential Investors and Intermediaries

Source: Impact Investing Ghana[17]

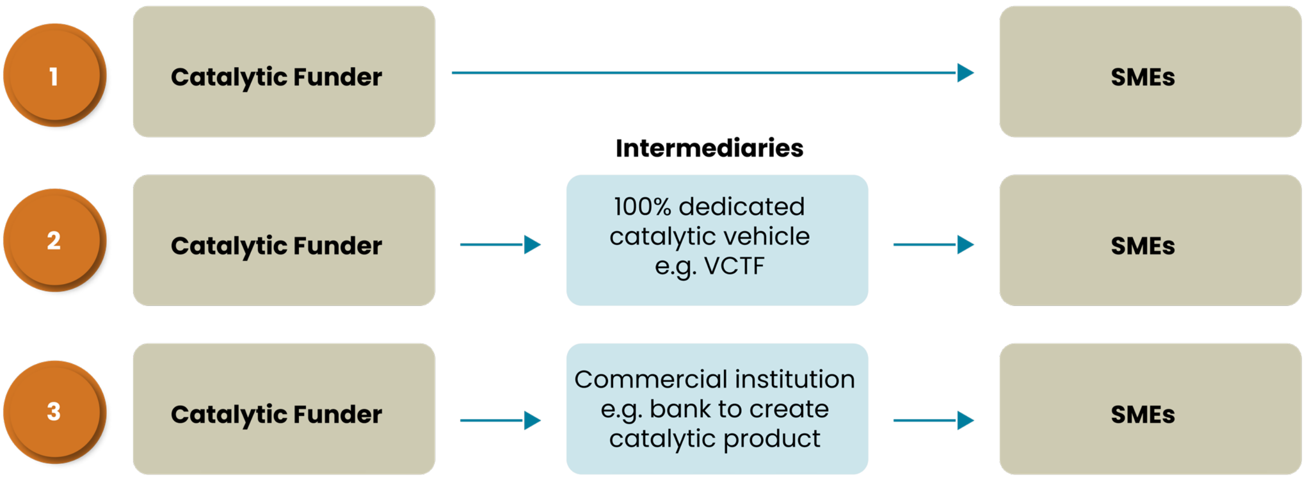
[17] IIGh, Impact Investing in Ghana (summary report).

# III. How Catalytic Capital is Deployed in SMEs in Ghana

To understand how catalytic capital has been deployed in SMEs in Ghana, we tracked individual catalytic capital investments made into SMEs or into their financial intermediaries over the 2004–2021 period. Through interviews, case studies and survey data, we looked for trends over the past 18 years, the concessions catalytic investors were willing to make, the lifecycle stage of the SMEs they were targeting, the sectors that receive the most catalytic investment, and the geographies in Ghana the investments targeted.

## How Catalytic Capital is Deployed into SMEs

Catalytic funds for SMEs in Ghana are deployed in three ways: (i) directly from funders to SMEs, (ii) indirectly through a catalytic vehicle such as the Venture Capital Trust Fund, or (iii) through a commercial financial intermediary, such as a bank, that then creates a catalytic product. Financial intermediaries are institutions or vehicles used to channel catalytic capital from suppliers and investors to SMEs. These transactions are sometimes supported by advisors, such as capital raise service providers, who assist the SMEs to prepare financial, marketing, and legal documents, conduct due diligence and so on.[18]

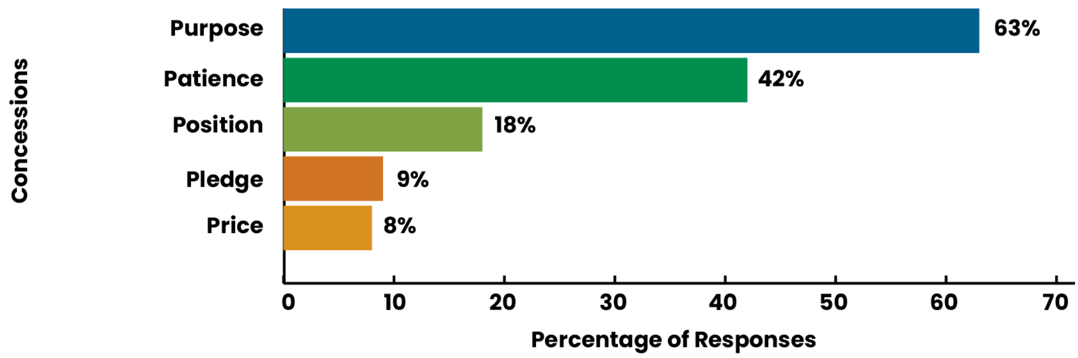



**Three Ways Catalytic Capital is Deployed in SMEs**

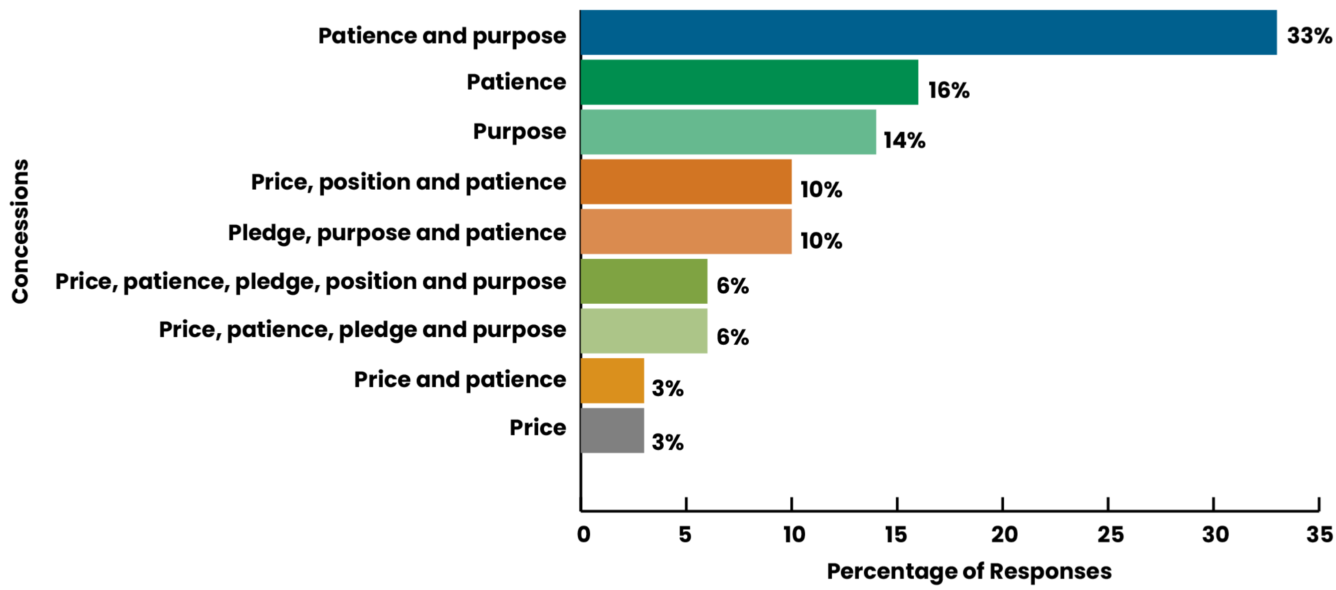
[18] US Agency for International Development, ***USAID INVEST Blended Finance Starter Kit: 10 Questions About Mobilizing Private Capital for Better Development Results*** (USAID, 2020), https://www.usaid.gov/sites/default/files/documents/1865/BlendedFinanceStarterKit1.pdf.

## Concessions offered by catalytic investors

The defining characteristic of catalytic capital is its willingness to make one or several of five concessions: (i) offer a lower **price (return on investment)**, (ii) exercise more **patience (longer timeline)**, (iii) take a subordinated **position**, (iv) provide a pledge or guarantee, or (v) structure unique terms to meet the purpose or needs of the SME. **An average of two concessions were used** to address various market gaps such as short investment tenors, lack of collateral and smaller investment sizes associated with conventional capital.




The most frequently used concessions




The most frequently used combinations of concessions

**Taking a closer look at each of the 5 concessions in turn:**

## I. Purpose: Accepting flexible or non-traditional terms to better accommodate the needs or current situation of an SME

The most frequently employed concession, we found, was purpose: **63 percent** of investors provided catalytic capital at non-traditional terms to better meet the needs of SMEs. This includes making a smaller investment, being flexible with investment requirements to meet the needs of SMEs, providing uncollateralized loans, and deploying convertible instruments (for example, convertible loans, royalty-based loans, and redeemable equity). For the investors who invested in convertible instruments, convertible debt was the most often deployed **(87 percent)**. The remaining **13 percent** of investors used convertible revenue-based financing (convertible RBF), where loans are repaid as a percentage of future revenues or cash flows, with an option to convert the debt to equity.

**Catalytic investors offered convertible instruments to SMEs for three main reasons:**

- To manage the concerns of the SME about a potential takeover, especially with equity investments.
- To help the SME manage volatility in its revenues. SMEs that benefitted from convertible debt found this instrument to be helpful, for example, during the COVID-19 pandemic, when most SMEs saw a marked reduction in their revenues. For the investors who held this instrument, it enabled them to convert debt to equity to minimise the accrued interest on the debt instruments.
- To allow SMEs access to risk capital without having to commit to a valuation or when the funder is uncertain about the value of the enterprise. In her book Adventure Finance, Aunnie Patton Power, founder of Intelligent Impact, notes:

> "It can be exceptionally challenging to value SMEs or start-ups in developing economies due to many issues. Investors lack reliable information about the operations of SMEs because of their poor record keeping and available data are patchy."[19]

Additionally, convertible debt instruments provide an advantage to investors, especially first-time catalytic investors. It gives them the opportunity to maximise their returns at exit, especially when the SME performs well in the long run. In instances where the SME has a high debt-to-equity ratio that does not make it attractive to either raise additional debt funding or ensure the catalytic investor's exit, such an investor can choose to convert its debt into equity to improve the SME's balance sheet and/or the debt-to-equity ratio to facilitate its ability to raise additional funding.

### An Impact Fund Using the Concession of Purpose

The Industrial Support Fund Ghana (ISF Ghana) is a closed-end venture capital fund that targets agro-processing and light (small-scale) manufacturing SMEs in Ghana to fulfil and leverage the vision of the Africa Continental Free Trade Agreement (AfCTA) and mitigate the economic effects of COVID-19 in Ghana. ISG Ghana is managed by Impact Capital Advisors, a Ghanaian fund management and advisory firm whose mission is to provide innovative financial solutions to the underserved portions of the SME sector and the bottom of the pyramid.

ISF Ghana invests all along the full business lifecycle of an enterprise—from start-up, to early-growth, to growth, to expansion. It typically invests amounts between GHS500,000 to GHS5 million in an SME using equity, quasi-equity, and structured debt instruments and profit-sharing arrangements customised to meet the needs of each individual company and position it for growth. Each SME that the fund invests in receives a customised package of concessions designed to support growth, drive efficiency, stimulate innovation, and crowd in other investors.

ISF Ghana prefers to focus on SMEs that are still being run by the founder or owner—indicating continuity and commitment—with great prospect for growth, financial returns and job creation. Sectors of interest include manufacturing and agro-processing, with a focus on export or import substitution.

[19] Aunnie Patton Power, *Adventure Finance: How to Create a Funding Journey That Blends Profit and Purpose* (Palgrave MacMillan, 2021).

Regarding purpose, Impact Investing Ghana (IIGh) recently identified a mismatch between the priorities of the suppliers and demanders of impact capital as one of the drivers of the SME financing gap. SMEs in Ghana, IIGh found, are typically looking for smaller investment amounts than what is being offered. Small-size enterprises typically require less than $50,000, and medium-size enterprises are usually looking for about $50,000–$1 million.

By contrast, most investors prefer investments in the $2 million–$5 million range.[20] In the current study, the investors who chose not to provide smaller investment amounts explained that investments under $500,000 are too small to justify the due diligence and other transaction costs, and that, at that rate, it would take years to fully deploy their funds. Stated one investment analyst at a development finance institution:

> "We are getting access to quite a lot of capital and therefore deploying in smaller pieces implies then it's going to take forever to actually deploy the capital, plus the cost of piecemeal due diligence. So we have sort of agreed to deploy them in bigger chunks to help us deploy it faster."

Some investors demand collateral because the guarantees available in Ghana provide only a partial cover—typically 50 percent of the loan principal. Such investors consider these guarantees insufficient to incentivize them to incur the risk associated with reaching underserved market segments.

## II. Patience: Accepting a longer or uncertain time period before exit

The next most frequently deployed concession by investors was Patience, representing **42 percent** of those surveyed. Catalytic investors offered long-term financing averaging 6 years for debt, with more moratoriums, accepted flexible repayment terms and open-ended equity agreements, and made room for extended periods before exit. Patient investors explained that SMEs in a developing economy such as Ghana need longer time horizons than usual to turn around their investment because in the short run they often experience slower growth. Indeed, data from Techno Serve's Enhancing Growth in New Enterprises Programme (ENGINE) show that early-stage SMEs in Ghana require a minimum of 3 years to break even.[21]

> "Catalytic funding should come with a relatively longer horizon, which is, it should be patient to support the growth of the beneficiary SMEs. It should also come with some concessions to give the beneficiary SME breathing space to utilise the capital, realise the desired expansion, and make an adequate return for stakeholders."
>
> — Fund analyst at an investment fund

It implies that more than half (58 percent) of investors engage in short- to medium-term investments, especially those offering debt. The World Bank (2021) has noted that about two-thirds **(67 percent)** of financial institutions in Ghana offer short-term loans (ranging 1–2 years). In our conversations with investors, they gave three main explanations for the shorter tenor of their debt investments:

- Restrictions on their capacity to offer longer tenors because of the revolving nature of their investment capital
- The need to mitigate the risk of a default associated with longer-term capital, particularly for seed-stage businesses that may tend to lack refined and proven business models
- The need to mitigate the foreign exchange risk that comes with longer-term investments. This is a problem when foreign currency loans are issued to local companies who earn local currency revenue but need to service the debt in the foreign currency.

[20] IIGh, Impact Investing in Ghana.

[21] UK Foreign, Commonwealth and Development Office (FCDO), *Enhancing Growth in New Enterprises (ENGINE). Development Tracker programme documents* (last updated 24 December, 2019), https://devtracker.fcdo.gov.uk/projects/GB-1-204112/documents.

"There are two main reasons we cannot undertake long term investments. One is that we are a revolving fund and hence have to make enough returns within relatively shorter times on our investment to quickly get the money back into the pool of funds. Obviously, we are not like the other funds which get money from donors frequently and can afford to do a 10+ years horizon. The second is the problem of forex risk associated with investing foreign-denominated funds in local companies over a long term."

—Investment director at a development finance institution

## III. Position: Providing credit enhancement via a subordinated debt or equity position

Our study found that **18 percent** of catalytic investors were willing to take a subordinated debt or equity position. These include the VCTF, which took a first-loss position in all the venture funds it invested in. If any of its investee funds make a loss, the VCTF's equity in that fund will be used to cover the loss ahead of the other investors. This arrangement has enabled VCTF's investee funds to raise funds from other investors. First-loss capital therefore has the potential to help unlock local funding. In light of that, IIGh is sponsoring the launch of a blended fund of funds to unlock local pension funds for SMEs by blending the funding from pensions with catalytic investors that have taken a first-loss position.

## IV. Pledge: Providing credit enhancement via guarantees and risk insurance

As with pricing concessions, only a few catalytic capital investments **(9 percent)** came in the form of guarantees. A guarantee is a formal assurance by a guarantor who promises to pay a borrower's debt if the borrower defaults on his or her loan obligation. Guarantors pledge their own assets as collateral against the loan (Power 2021). The few guarantee deals we came across were credit guarantees to financial institutions issued by the Ghana Incentive-Based Risk-Sharing System for Agricultural Lending Project (GIRSAL) and the African Guarantee Fund (AGF).


AGF, for instance, recently offered a portfolio loan guarantee worth about $4,343,780 (GHS35 million) to Société Générale to lend to SMEs within the hospitality and agribusiness sectors, with tenors of up to five years.[22] The others were guarantees issued by charity, aid or philanthropic agencies, as part of their sponsored projects and programmes, to make it possible for certain SMEs to borrow money. The Greater Rural Opportunities for Women (GROW) II Loan Guarantee Fund of the Mennonites Economic Development Associates (MEDA), funded by Global Affairs Canada, guarantees investments from financial institutions in the $500,000–$2.5 million range into women-led and women-owned agribusinesses in Northern Ghana.

Guarantees improve an SME's risk-return profile and thereby entice more risk-averse commercial investors to participate. As the Global Impact Investing (GIIN) puts it, catalytic first-loss capital—a credit enhancement tool through which a catalytic investor accepts to bear first losses in an investment—provides wary traditional investors with the opportunity to wade into hitherto uncharted waters by first dipping their toes in before plunging in, thereby encouraging their participation in deals they likely would not have entered.[23]

[22] African Guarantee Fund, *AGF partners with Societe Generale Ghana* (2022), https://africanguaranteefund.com/societe-generale-ghana-partners-with-african-guarantee-fund-to-provide-financing-solutions-to-ghanaian-smes.

[23] Global Impact Investing Network (GIIN), *Catalytic First-Loss Capital* (October 2013), https://thegiin.org/research/publication/catalytic-first-loss-capital.

| Provider | Fee | Maximum coverage percentage of losses | Sectoral focus | Amounts of investments enabled |
|---|---|---|---|---|
| GIRSAL | 1% of the guaranteed value for new applications, and 0.75% on the remaining guaranteed value of renewals | 70% | Agriculture-commodities and value chains | GHS699.7 million ($63 million) |
| African Guarantee Fund (AGF) | 0.50% on the approved amount | 50% except for the bank fundraising guarantee, which is 50–100% | Sector-neutral | |
| RDF Ghana | 0.50% on the approved amount | 50% | Agriculture and renewable energy | GHS18 million ($4 million) |

A consensus among the guarantee and risk mitigation service providers is that there is insufficient penetration and under-subscription of guarantee schemes for catalytic investments in Ghana. The following reasons were given to explain the low adoption rate:

- The domestic guarantee schemes, GIRSAL and Rural Development Fund Ghana (RDF) guarantee only local currency loans, and this keeps foreign currency loan providers from benefiting from those schemes.

- When the cost of securing guarantees is added to the cost of the loans, it makes it relatively expensive for the borrower, which undermines the ability of investors to introduce certain concessions. Current upfront guarantee fees range between 0–3 percent while annual commissions to commercial guarantors are between 0.5–2 percent of the guaranteed amount.

- Limited awareness of available risk mitigation initiatives and their products. More forums should be organised so that commercial guarantors can sell their products.

- Partial credit risk guarantees. Available guarantees do not meet risk cover expectations. Most guarantees cover 50–70 percent of the principal loan amount, excluding interest. Investors stated that this is only an assurance for loans they would in any case otherwise make, but not adequate to incentivize investment into riskier SMEs.

- Low confidence in the management and administration of some guarantee schemes. For instance, some respondents said that the pay-out of claims in the event of a default tends to be very low. Also, making claims and accessing payments when there is a loss is often time-consuming and mired in bureaucracy.

- Guarantees are overly focused on the agriculture sector, with less attention paid to other underserved but high-risk sectors such as health, hospitality and tourism.

## V. Price: Accepting a rate of return below the market return rate

The average interest rate that financial institutions in Ghana charge on their loans is 23 percent—out of reach for most SMEs. Yet only a few catalytic investors **(8 percent)** reported accepting a rate of return below market rate. The deals we tracked showed that these were mostly debt investments by development finance institutions, multilateral development banks, family offices and fund managers with one or more philanthropic limited. Even with the few who offered concessionary loans, the returns they targeted were close to commercial market rates and they typically required some guarantee cover.

> "So, we offer long-term patient capital and investing ticket sizes that other investors shy away from. However, it is at commercial rates as our investors are primarily commercial investors."
>
> —Manager of an investment fund

The majority of investors **(82 percent)** target a market rate of return on investment that matches expected risk and profit of funders. Generally, a fund manager's investment strategy needs to align with the priorities of their investors. For example, limited partners often expect venture capital funds to generate a market-rate return on the fund. Similarly, institutional funds such as pension funds must meet the return expectations of their beneficiaries, which typically means market risk-adjusted returns. Blended financial vehicles that combined catalytic and commercial capital resulted in a lowering of the interest rates for loan products while drawing in commercial capital.

Some government programmes, such as the GEA's, targeted below-market returns. The GEA offers SMEs loans and grants through programmes such as its Coronavirus Alleviation Programme Business Support Scheme (CAPBuss), which was funded by the Government of Ghana. CAPBuss gave loans at a concessionary rate of 3 percent, with a two-year tenor, to cushion micro, small and medium-size enterprises (MSMEs) from the widespread economic impacts of the pandemic. Businesses that had been adversely affected could apply for loans disbursed through partner banks. Sixty percent of the recipients were women, and the majority were informal businesses. A total of 302,001 MSMEs received long-term, concessionary loans amounting to GHS523.11 million ($80.4 million at the time).

## What Roles Does Catalytic Capital Play?

Our results showed that investors most often invest catalytic capital in SMEs mainly to help them **scale** (92 percent) and **sustain** (55 percent) their operations, with only a few investing in **seed impact** enterprises (27 percent) because of the degree of risk involved. Only 2 out of 10 investors reported using catalytic capital to fund new and unproven opportunities.

**Scaling** refers to expanding operations significantly and efficiently, for example, by innovating, automating, adding new products/services or expanding into new markets. The goal of **sustaining** is to invest in impact SMEs to enable them to continue to obtain access to essential services such as energy, water and education. No investors reported helping to rejuvenate declining or defunct impact SMEs. However, we were unable to secure data on the total number of declining or defunct SMEs in Ghana.

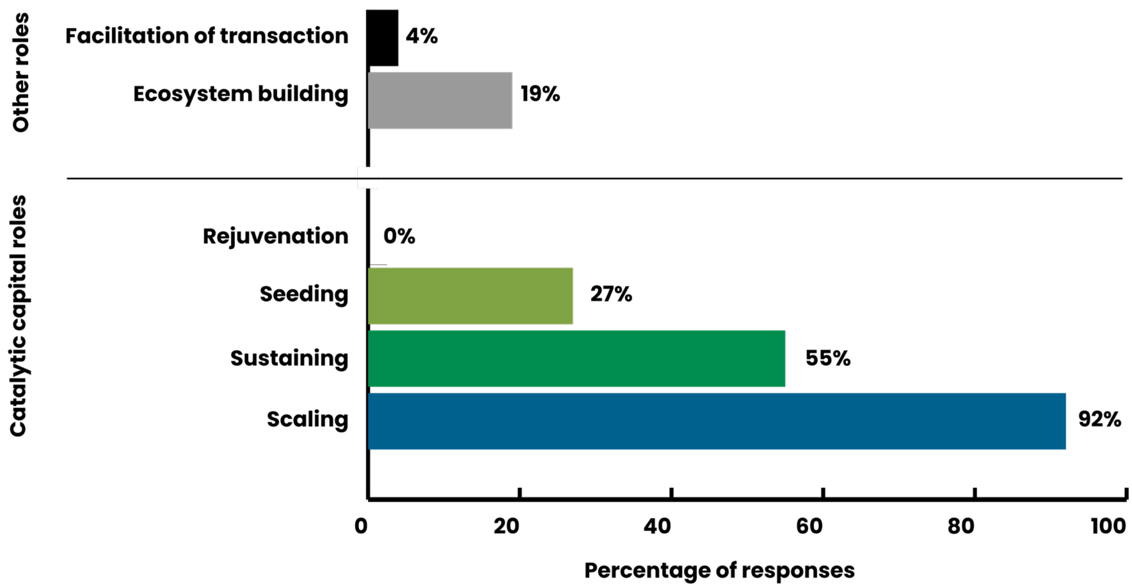
### Forms vs. roles vs. uses

When catalytic capital is offered to an SME, it takes one or more distinct concessionary **forms** (summarized as the 5Ps).

Second, catalytic capital can play different **roles** in supporting an SME—seeding early-stage enterprises, scaling innovative, impact-oriented business models, or sustaining cash-deficient, growth-stage SMEs.

Third, after catalytic capital is received, it can be **used** by the SME to achieve a range of different goals: facilitating innovation, establishing a track record, leveraging additional investment, signalling impact potential, or safeguarding the enterprise's mission.

Besides the traditional roles, ecosystem building **(19 percent)** and facilitation of transactions **(4 percent)** emerged as additional roles catalytic investors engage in. Ecosystem-building activities include establishing deal-sourcing platforms, funding and disseminating research insights, and funding policy dialogues. Transaction facilitation includes sharing due diligence data with other investors, referring prospective SMEs to other investors more suited to their transactions, and mentoring local funds.




Roles of Catalytic Capital

## How SMEs Use Catalytic Capital

How do SMEs use commercial catalytic capital? SMEs mostly used secured catalytic capital to aid scale-up (**81 percent** of surveyed beneficiary SMEs), build the SME's track record **(38 percent)**, and safeguard its mission **(34 percent)**. Catalytic capital is least used to facilitate innovation **(23 percent)**.

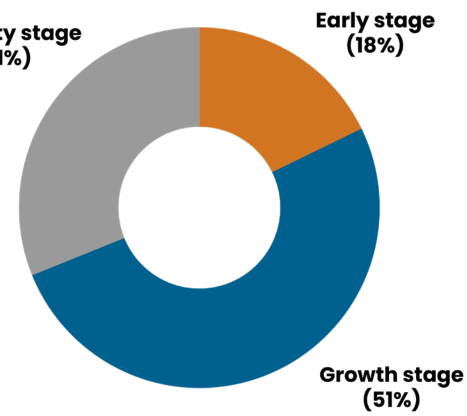

Uses of Catalytic Capital

## What Lifecycle Stage of an SME Do Catalytic Investors Target?

We found that catalytic investors tended to target either growth-stage **(51 percent)** or mature-stage **(31 percent)** SMEs rather than those in their seed and early stage **(18 percent)**. This indicates a conservative risk tolerance among the investors. Growth- and maturity-stage investments have lower risks and are more likely to generate expected returns such as jobs, which impact investors place importance on.

One justification catalytic investors often offered for this was that some growth- and maturity-stage SMEs needed the funds to sustain their activities and impacts until they were able to build the kind of track record that could attract commercial investments, and others needed the funds to maintain a focus on essential but less profitable activities. Another justification was that some mature-stage enterprises, although generating revenue and profits, were not generating enough cash to fund major expansions, acquisitions, or other investments.

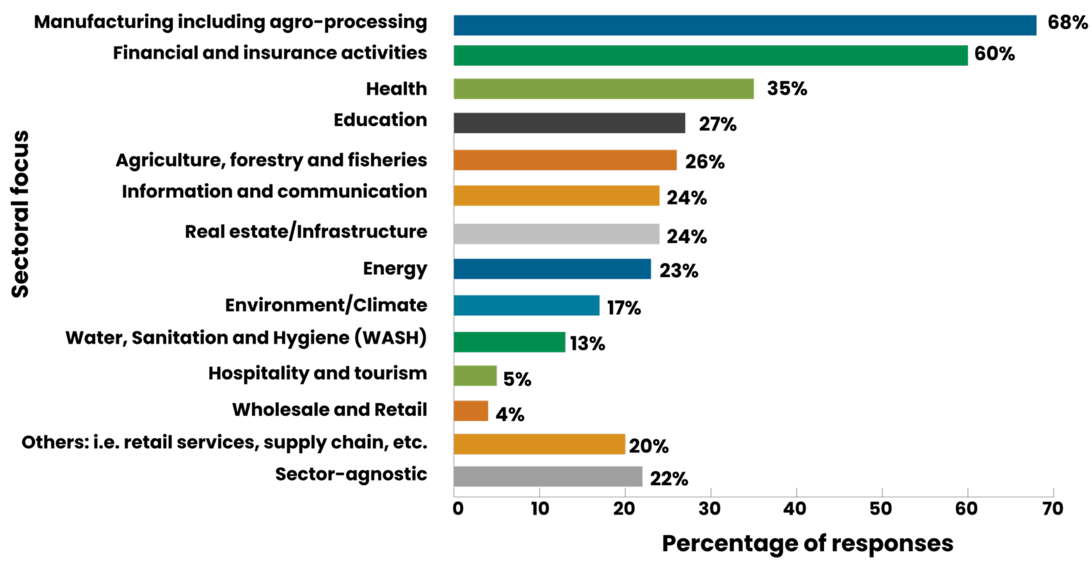
Although these justifications are valid, there is also a need to increase the financing of early-stage enterprises, especially those that have good products and services and have achieved proof-of-concept but need capital to establish strong stable operations. Catalytic capital initiatives could provide support to these early-stage enterprises to establish commercially viable businesses and operating models and become more attractive to commercial capital providers.
We argue that SMEs that face the steepest funding challenges are early-stage SMEs.




Lifecycle Stage of SMEs that Catalytic Investors Target

## What Sectors Do Catalytic Investors Focus On?

The top-five sectors targeted by catalytic investors are manufacturing, with an emphasis on agro-processing **(68 percent)**, financial and insurance services **(60 percent)**, health **(35 percent)**, education **(27 percent)**, and agriculture **(26 percent)**.




Sectoral Focus of Catalytic Investors (n = 150)

Investors noted that they target these sectors because

- they are the priority sectors of the Government of Ghana owing to their contribution to GDP, employment and living standards, and their potential to transform the national economy. For instance, in 2020, Ghana's GDP from agriculture including agro-processing was 19.25 percent and the sector employed nearly 50 percent of the labor force.[24]

- they are under-funded. The agriculture sector, for instance, currently receives just 3.6 percent of the funding available from banks because of its high risks, limited risk mitigation tools, and low risk-adjusted returns compared to other sectors. Data from the Statistical Bulletin report of the Bank of Ghana reveals that, as of March 2022, out of GHS58.9 billion distributed by banks as credit, only GHS2.1 billion went to the sector.[25] Investing in agriculture SMEs is perceived to be about twice as risky as other sectors and returned 4–5 percent lower than expected. The sector is considered high risk because of its exposure to unpredictable hazards such as drought, pests, and climate change, and because it is dominated by smallholder farmers who are more difficult to coordinate. Taken together, this limits capital flows to agriculture SMEs from local financial institutions.[26]

- large numbers of women and youth are part of the supply value chain, especially in the agro-processing and agriculture sectors, yet these population groups remain underserved and often have low access to vital services in the very sectors they are benefiting.

- they are critical to achieving the United Nations Sustainable Development Goals and the vision set out in the Africa Union's Agenda 2063 of a prosperous Africa driven by inclusive growth and sustainable development.[27]

> "Today our focus sectors include agribusiness, financial services, health care and education. In the past we didn't have any. We literally were investing in all sectors but over time as an organisation, we realised we needed to strategize, build specialty and contribute more meaningfully to the Ghana government's agenda, Planting for Food & Jobs."
>
> –Investment director at a development finance institution

Private-sector catalytic capital providers and DFIs, as opposed to other investors, prefer agro-processing SMEs to those that engage in primary production because of the relatively lower risk involved compared to primary agricultural production, which is production of crops and animals. Out of the 104 deals that had data on the sectoral focus of the investment (which were valued at $320 million), capital allocation to financial and insurance activities represented 27 percent ($85.5 million), manufacturing, including agro-processing, was 12.6 percent ( $42.4 million) and agriculture was 8 percent ($26 million). The least was energy (1 percent; $3.9 million).

Yet somewhat in opposition to this, it is our view that financing primary production using innovative models presents a win-win approach for investors. The development of strong primary agriculture production could provide the raw material base for the agro-processing sector to support the realisation of Ghana's import substitution and industrialization agenda. Agro-processing companies require a consistent (year-round) supply of raw materials from sources that are closer to production sites compared to importing from outside the country. Due to the inadequate availability of raw materials processing in the local market, some processing companies in Ghana need to import raw materials for production.

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[24] National Food Buffer Stock Company, ***Banks Still Lacks Expertise in Agric Financing- GIRSAL*** (2022), https://nafco.gov.gh/strategy/banks-still-lack-expertise-in-agric-financing-girsal.

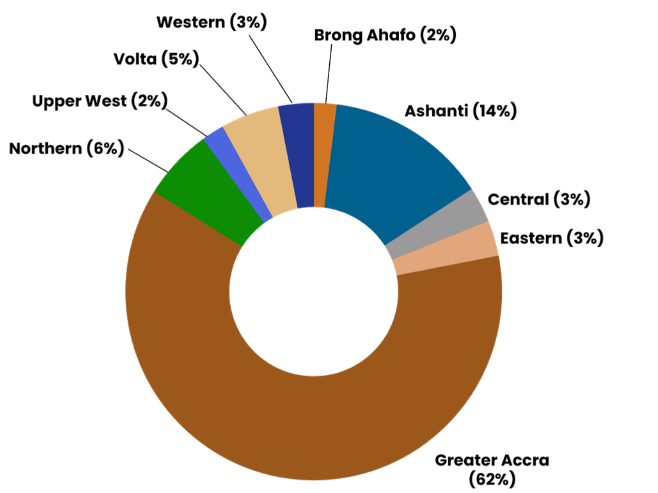
[25] Bank of Ghana, ***Monthly Statistical Bulletin*** (March 2022), https://www.bog.gov.gh/wp-content/uploads/2022/07/Statistical-Bulletin-MARCH-2022.pdf.

[26] Aceli Africa, ***Mobilizing Capital, Unlocking Impact*** (2022), https://aceliafrica.org.

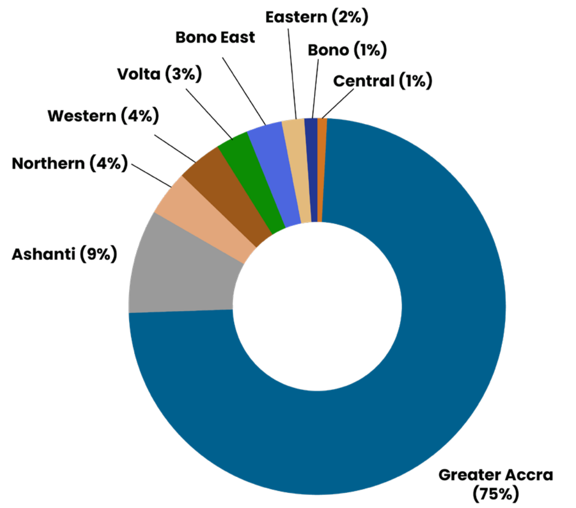
[27] African Union, ***Second Continental Progress Report on Agenda 2063***, (February, 2022) https://au.int/sites/default/files/documents/41480-doc-2nd_Continental_Progress_Report_on_Agenda_2063_English.pdf.

## Where are the beneficiary SMEs of catalytic capital located?

Our surveyed investors were asked where in Ghana their portfolio SMEs were. The majority **(62 percent)** said in Greater Accra. The next most common region was Ashanti **(14 percent)**. The Northern region came in third, at **6 percent**. None of the other regions exceeded **3 percent**, and in seven of the country's 16 regions, none of the investors reported investing there.




Regional distribution of portfolio SMEs of catalytic capital investors




Regional distribution of catalytic capital investments (n = 110) in SMEs, by dollar value

Of the investment deals that had data about the recipient SME's location—they totalled $334 million—the largest volume of funds **(75 percent)** was invested in SMEs in Greater Accra, followed by the Ashanti Region **(9 percent)**.

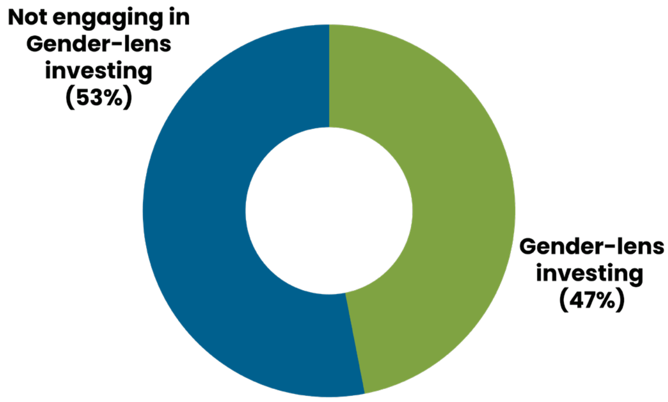
The distribution largely reflects the concentration of Ghana's SMEs in the Greater Accra and Ashanti regions. The four poorest regions of Ghana—Northern, Upper East, Upper West, and Brong Ahafo (now split into Bono East, Bono and Ahafo Regions)[28]—together accounted for just **8 percent** of the total funding value, with some, like the Upper East and Upper West, getting none of the investments.

The disparities in the distribution of catalytic funding suggest that the country's regional SME financing gap may continue to widen and continue to deepen deprivation in these underserved regions. This could reinforce adverse consequences such as inadequate access to healthcare services and education. Some of the SMEs based in one region have customers or serve customers in other regions, so in terms of actual services, the distribution is slightly less stark than it looks in the diagram. On the other hand, there are other indices of multidimensional poverty that make the distribution starker still.

[28] Ghana Statistical Service, *Integrated Business Establishment Survey*, September 2015 (Summary Report), https://www2.statsghana.gov.gh/docfiles/IBES_Questionnaires/IBES%201%20reports/SUMMARY%20REPORT_FINAL_FINAL_24-5-16.pdf.

## Gender Lens Investing

Research suggests that, around the world, women-led SMEs face a $320 billion shortfall in access to credit, and that COVID-19 worsened the picture.[29] Bridging the gender financing gap and improving gender outcomes are two long-standing issues (included in SDG 5). On this front, the news from Ghana is partly heartening. In 2019 Ghana placed second, after Uganda, in the world among countries with the highest percentage of women's business ownership. Ghanaian women own nearly 4 in every 10 businesses **(37.9 percent)**. However, this only reinforces the need to develop financing models that accommodate the circumstances and needs of women entrepreneurs and SME owners.[30]




Gender-lens investing status of catalytic investors

"Gender inclusiveness is an aspect of what we do. There is no single investment that we undertake without taking this into consideration. However, we do not force it. Our clients are profit-driven commercial investors who do not care which sex of the population receives their capital."

— Investment Lead, DFI

Fewer than half of the investors we surveyed **(47 percent)** engaged in gender lens investing (GLI). GLI is investing with a deliberate focus on addressing gender issues and promoting gender equity, including investing in women-owned and women-led enterprises.[31] Even those who did report engaging in GLI—apart from dedicated gender equality funds and investors—were mostly considerate rather than deliberate. Impact investing—and by extension catalytic financing—is a complex balance of sometimes seemingly competing priorities. Although development outcomes take precedence over profitability and risk reduction, impact and catalytic investing requires the simultaneous pursuit of profit, risk management, and development.[32] On the one hand, such investors are attempting to facilitate the economic development of the SMEs and, indeed, the countries, they are investing in. On the other hand, they have a fiduciary obligation to preserve capital or marginal returns within the best of their abilities.

Government and development partners (development agencies, foundations) that undertake direct or indirect capital investments in SMEs take a more gender-mainstreaming approach to the entire investment spectrum of their activities. For instance, AV Ventures, an investment management subsidiary of ACDI/VOCA that provides catalytic financing to agribusiness-related SMEs, adopts gender mainstreaming throughout the investment process—from sourcing and screening pipeline opportunities, to structuring transactions and portfolio management. AV Ventures prioritises gender lens investing dimensions such as taking into consideration the specific needs and challenges of women-owned businesses when screening and conducting due diligence of pipeline opportunities, promoting women into leadership, supporting women along various points of the supply chain, and safeguarding workplace equity in sourcing.

[29] 2x Challenge – Financing for Women, https://www.2xchallenge.org/home. See also KPMG, *Gender Lens Investing: Better Outcomes for Investors, Business and Society*, (2021), https://home.kpmg/xx/en/home/insights/2021/03/gender-lens-investing.html.

[30] Mastercard, *Index of Women Entrepreneurs* (2019), https://www.mastercard.com/news/media/yxfpewni/mastercard-index-of-women-entrepreneurs-2019.pdf.

[31] Global Impact Investing Network, *Gender Lens Investing Initiative* (2019), https://thegiin.org/gender-lens-investing-initiative.

[32] Deloitte, *Developmental Financial Institutions: Strategic Choices to Build a Sustainable Operating Model* (2021), https://www2.deloitte.com/content/dam/Deloitte/xe/Documents/risk/me_developmental-financial-institutions.pdf.

In addition, the deployment of innovative, flexible financing structures such as revenue-based debt and flexible collateral requirements are especially well-suited to women-owned companies because women often lack access to substantial physical collateral. A catalytic capital provider may also provide managerial support that enables portfolio companies to improve and implement internal policies such as gender-equitable labor policies.

Some investors also collaborate with financial institutions to understand the financing needs of women-led or women-owned enterprises and develop screening and selection criteria that are inclusive. In 2021 Ecobank launched its Ellevate programme to support businesses that are either owned by women, have a high percentage of female board members, have more than 30 percent female employees, or market their products mainly to women. Ellevate offers loans at discounted interest rates and with longer tenures as well as asset financing schemes. It also support women with training, mentoring, advisory and networking opportunities. Ecobank has committed to allocating 10 percent of its loan portfolio specifically to women.

We identified several gender-specific catalytic funds anchored by DFIs and MDBs. Examples of gender-equality financing schemes in Ghana include the Affirmative Finance Action for Women in Africa (AFAWA), a pan-African initiative of the African Development Bank that provided a $20 million line of credit to Ecobank Ghana for the Financing Climate-Resilient Agricultural Practices project, expected to benefit 400 women-led micro, small and medium-size enterprises. Access Bank's W initiative, launched in 2014 and seeded with a $25 million loan from Dutch Entrepreneurial Development Bank, FMO, is another.[33] A third example is the IDF Alitheia Fund, a $100 million gender-lens fund that invests in, and grows, SMEs led by gender-diverse teams in six African countries including Ghana.

It is also important to note the 2X Challenge, launched at the 2018 G7 Summit. It enjoined the G7, development finance institutions and private sector investors around the world to collectively mobilise $15 billion during the 2021–2022 period for investment in women-related enterprises directly or through their portfolio companies in order to provide women in developing countries with improved business opportunities.

## Eco-Lens Investing

Only 14 percent of the catalytic investors we surveyed were intentional about eco-lens investing (ELI) despite acknowledging incorporating such considerations in their investment mandates through their commitment to Environmental and Social Governance (ESG) requirements. However, these investors did not actually mandate the pursuit of green investments, and their appraisal of the process was typically undertaken in concert with other indicators.

Our observation of a low level of commitment to eco-lens investing not only reinforces earlier baseline findings by the Partnership for Action on Green Economy (PAGE) that there are few green investors,[34] but is also indicative of limited deliberate catalytic financing aimed at climate action.

Wangara Green Ventures is one of the examples of the few catalytic climate-lens investment providers to green SMEs that we identified. Its catalytic role is made possible with funding support from organisations such as the Dutch Good Growth Fund (DGGF) and the World Bank's Ghana Climate Venture Facility (GVCF) with funding from the government of Denmark and the Netherlands. The GVCF, for

[33] Dutch Entrepreneurial Development Bank, Project details (2018), https://www.fmo.nl/project-detail/53543.

[34] Partnership Financing for Action on Green Economy, ***Green finance Study in Ghana*** (Baseline Report), (2019) https://www.un-page.org/files/public/green_finance_study_ghana.pdf.

example, provided $1.5 million in catalytic first-loss capital as risk mitigation. Wangara Green Ventures is also managing a €1 million concessional loan program for Solidaridad and Achmea Foundation to support the adoption of climate-smart and good management practices in the oil palm industry.

Wangara makes patient, long-term, small-ticket investments primarily in the local currency. Wangara invests in equity, debt and quasi-equity with a preference for convertible notes. Initial investment amounts ranging between $50,000 and $500,000, and targets early-stage and growth-stage SMEs with high-growth and high-impact potential. The fund's priority sectors include renewable energy, energy efficiency, waste and water management, and climate-smart agriculture. Wangara also invests in SMEs that are going green by supporting them in their transition. Follow-on investment could be up $1 million through equity and quasi-equity instruments. Each portfolio enterprise benefits from customised pre-and-post investment technical assistance to de-risk recipient SMEs, enhance their growth, and promote climate-related action.

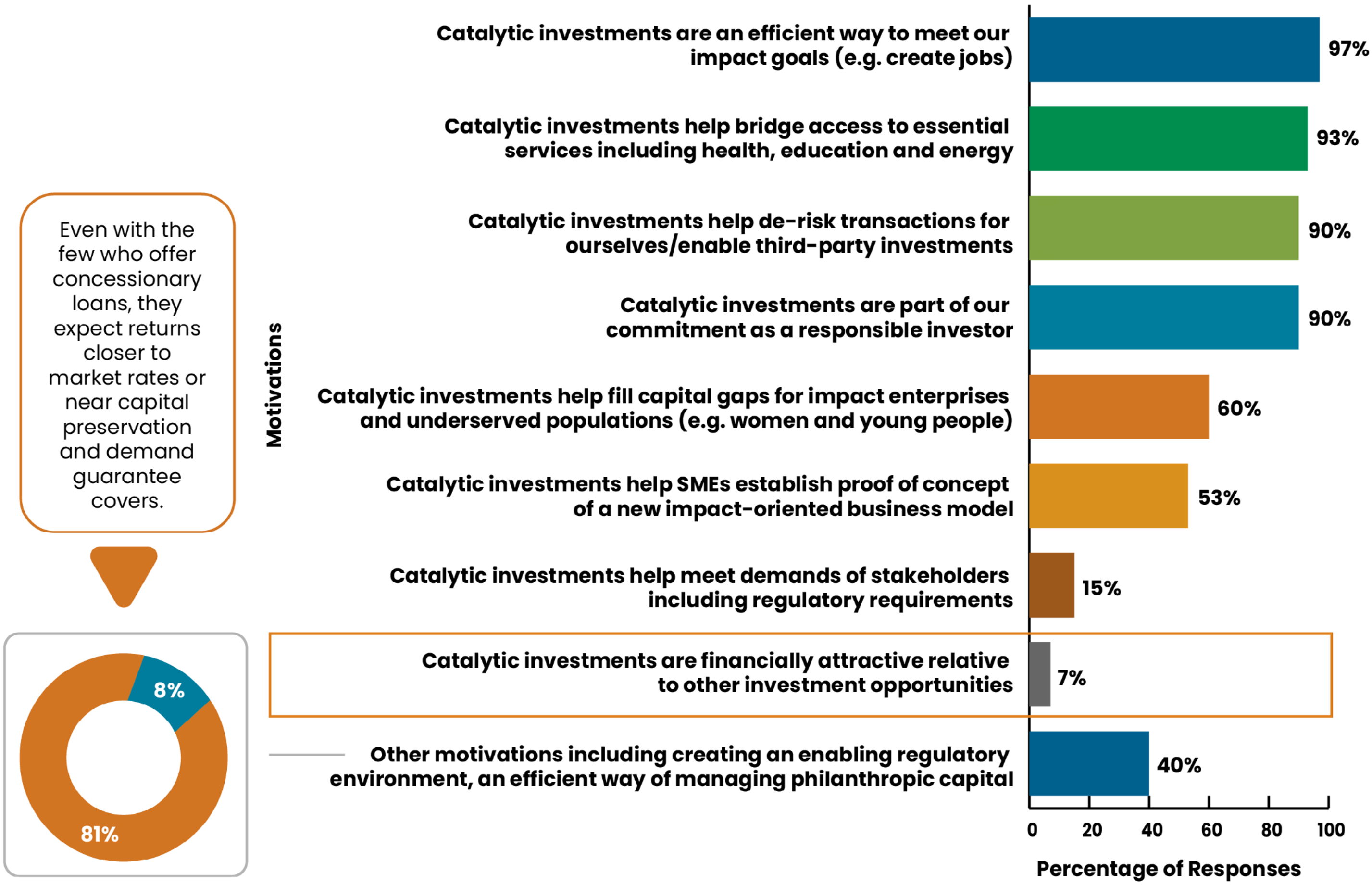
## Motivations of Catalytic Investors

Our survey results indicate that catalytic capital investors are driven by a mission to meet impact goals such as job creation and build new pipelines of investible enterprises. They are also motivated by the importance of bridging the capital gap to allow impact-oriented SMEs to build a track record or achieve adequate scale, rather than just responding reactively to external stakeholder demands to make a profit.

We identified various specific sources of motivation. The first three centre on achieving social and environmental impact. **First**, the majority (97 percent) of investors were driven by the conviction that catalytic capital is an efficient way to make an impact such as creating jobs to tackle Ghana's high unemployment rate. **Second**, they were motivated by the belief that catalytic investment in vital but underserved sectors is an effective way to create access to critical services (93 percent), especially for those owned or led by members of historically underserved populations (for example, women and youth). **Third**, since catalytic investments target underserved people and geographies, **90 percent** of investors regard it as integral to their commitment as responsible investors.

In addition, catalytic investors are motivated by a desire to de-risk investments and unlock additional funding from third-party investors. By contrast, achieving high financial returns on investment and responding to stakeholder demands, including regulatory requirements, are less important driving factors. Investors in Ghana are currently not mandated to allocate a certain proportion of their investment capital to specific sectors or under-served populations unlike the case of the Indian Priority Sector Lending Programme, which requires banks to disburse 18 percent of their loans to the agriculture sector.[35]

[35] Acleli Africa, *The Effect of Central Bank Policies on Lending to Agricultural SMEs in East Africa* (Learning Brief), (2022) https://aceliafrica.ams3.digitaloceanspaces.com/wp-content/uploads/2022/07/25233036/AceliAfrica_LearningBrief_vFINAL.pdf




**The Motivations of the Suppliers of Catalytic Capital**

"Our goal in investing catalytic capital is not to seek high returns, rather to seed enterprises that improve the ability of the poor to live with dignity."

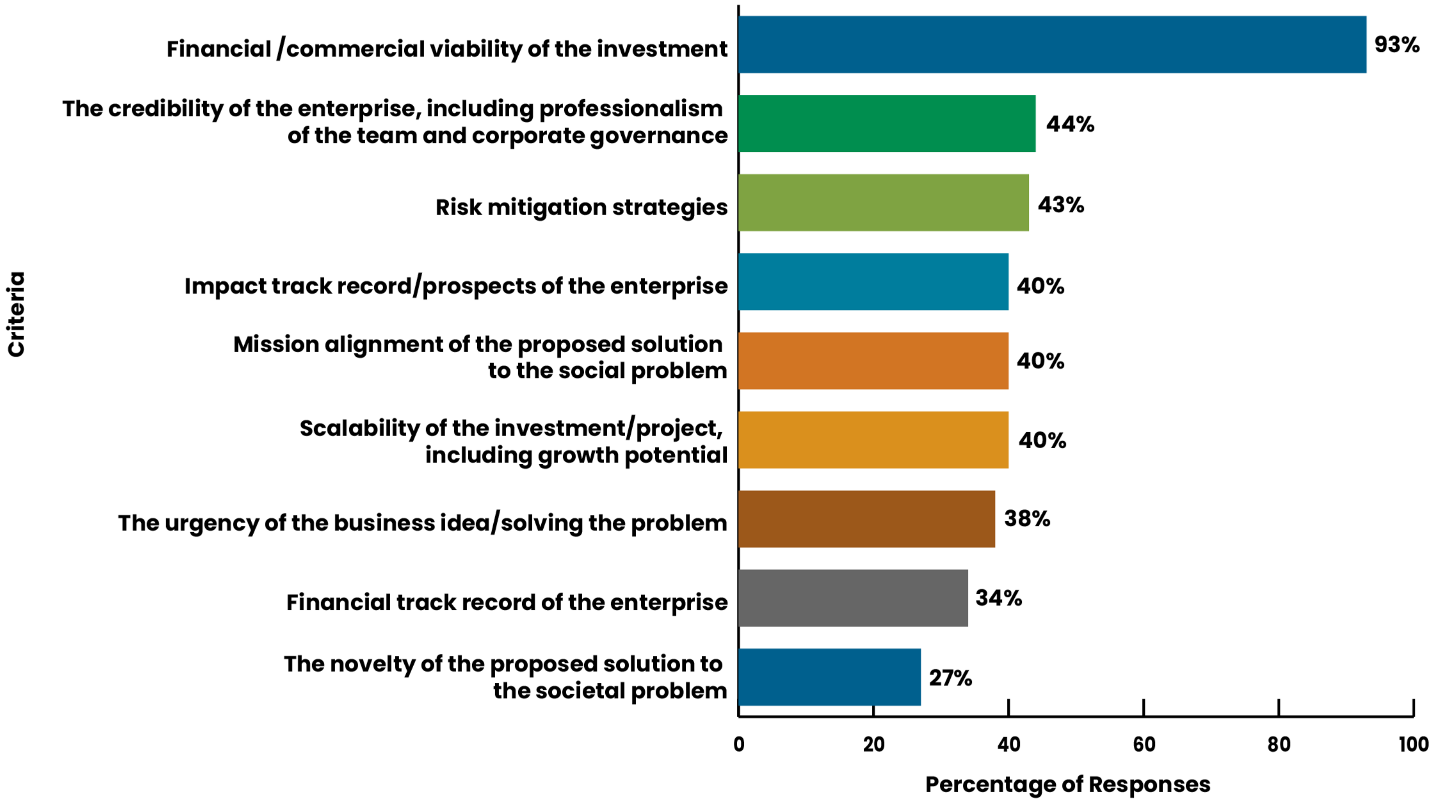
— Venture manager at an impact fund

## Selection Factors of Catalytic Investors

Catalytic investors prioritise SMEs that can show they already have proof of concept, the ability to meet financial and impact expectations, a level of credibility, growth potential or scalability, and alignment of the SME's investment with the investor's social impact mission. While some of their core considerations are similar to those of conventional investors, catalytic investors are more likely to be more flexible. Nevertheless, flexibility does not mean they do not take those considerations seriously. This section summarizes the screening criteria used by catalytic capital providers. SME owners and managers seeking catalytic funding will find this section helpful as they work on aligning the vision, mission and direction of their enterprise with these criteria.

The top-three selection factors that catalytic investors employ align with the considerations of conventional, profit-before-impact investors, suggesting that catalytic investors, although more flexible, are not entirely different from conventional investors. They are still business-minded. The remaining six selection factors are more properly impact-first considerations. The top-three considerations are (i) the financial/commercial viability of the investment **(93 percent)** including a rigorous plan and metrics for measuring its success; (ii) the credibility of the SME as measured by the team's professionalism and the enterprise's corporate governance **(44 percent)**; and (iii) risk mitigation strategies **(43 percent)**.

As part of the assessment of team professionalism and corporate governance, private equity holders look at the readiness of the SME to accept their involvement and to implement suggested improvements in their governance structures and systems. An example of this would be reconstituting the board and putting in place control structures.




**Factors Catalytic Investors Consider in Selecting SMEs**

However, from further discussions with catalytic investors, they mentioned while some of these considerations are similar to the requirements by non-catalytic investors catalytic investors are more likely to accept a relatively higher level of gaps across these considerations compared to conventional investors and sometimes are even able to utilise Technical Assistance (TA) resources to close some of these gaps during the investment period. For instance, a catalytic investor might be willing to invest in an SME with a bold but unproven innovation with high impact potential even though there is no historical operational data to prove the viability of the investment idea. This will less likely be acceptable to a commercial investor who will typically require historical operational data as a proof of viability.

Some of the remaining considerations are scalability of the investment, including its growth potential for impact **(40 percent)**, mission alignment of the proposed solution to a social problem **(40 percent)** and the SME's impact potential and impact track record **(40 percent)**.

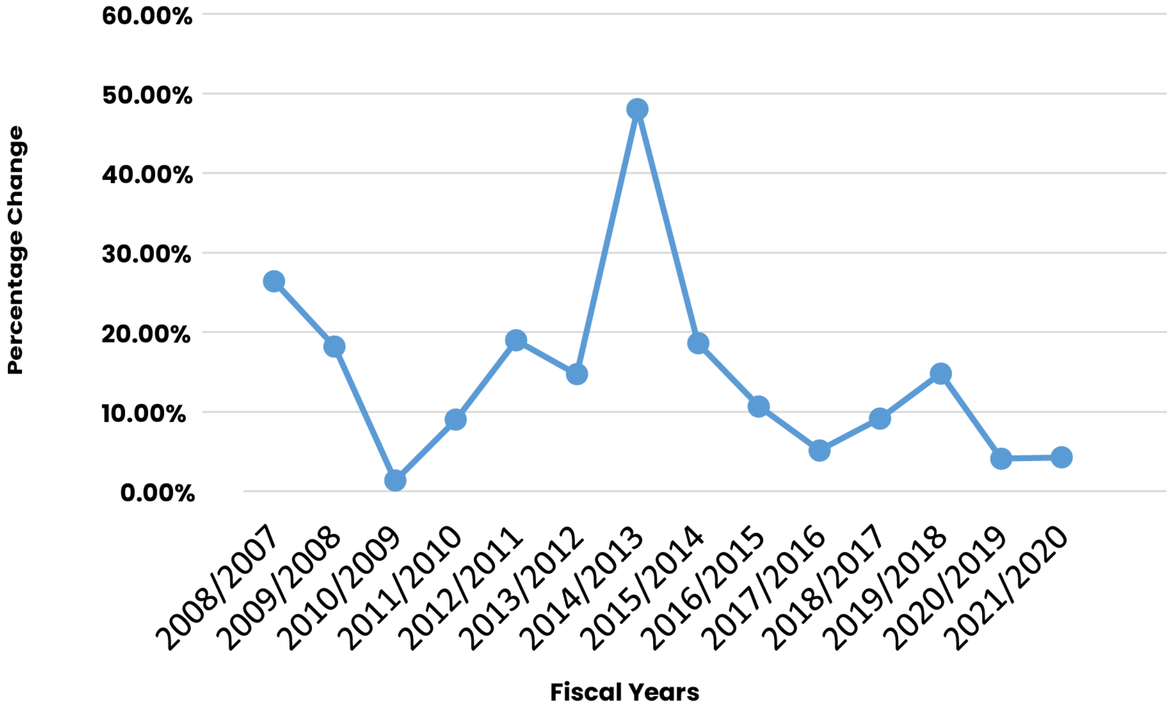
> "We look at the ability of the investment to impact society – change livelihoods, improve living standards of young people, women and disabled people, improve health and wellbeing of under-fives and conserve the environment."
>
> — Head of investment at a development finance institution

## The Risks Perceived by Catalytic Investors

In addition to potential returns, investors making and evaluating investments consider risks and uncertainties. The greater the perceived risk, the higher the expected return required: **92 percent** of catalytic investors perceived currency risk as their highest concern. Other risks were enterprises not achieving desired impacts **(67 percent)** and defaulting on payment **(58 percent)**.

### I. Currency risk

The Ghanaian cedi has frequently suffered sudden and significant depreciation against the US dollar and other international currencies. According to Bloomberg, the cedi lost 155 percent in value to the dollar between 2007 and 2022.[36] The cedi ended 2016 at 4.33 to the dollar but as of October 2022 stands at 14.00 to the dollar.[37] This can significantly erode the effectiveness of concessions; especially the pricing of loans for SMEs, and their associated catalytic gains and opens up financial intermediaries and SMEs to significant risk.




**Exchange-Rate Volatility (Year-on-Year) of the Cedi against the US Dollar[38]**

Source: Bank of Ghana

Most, if not all, long-term funds are mobilised from international investors and contributors in hard currency (mostly US dollars) and invested in enterprises that earn their revenue in a local currency by selling goods and services in their home markets. As a result, local fund managers and financial institutions are faced with managing the related forex risk while using borrowed money to fulfil catalytic roles.

[36] Our analysis of Bank of Ghana data does show that the year-on-year volatility of the cedi relative to the dollar for the past 15 years has averaged 14.53 percent.

[37] Myjoyonline, "*Cedi loses about ¢3.15 to dollar so far in 2022,*" 15 August 2022, https://www.myjoyonline.com/cedi-loses-about-¢3-15-to-dollar-so-far-in-2022.

[38] The Bank of Ghana interbank historical exchange rate was used for the analysis. Mid-rate was the preferred rate because it gives an average between the buying and selling rates.

If the value of a local currency declines significantly, borrowers with dollar-denominated loans often have no other option than to delay necessary investments or default. This risk is handled in two ways: generally, it is passed on to the beneficiary enterprise in the form of foreign currency-denominated facilities and repayments. Less often—and this is typically seen more with large regional funds run by development finance institutions than with domestic fund managers—it is hedged by the fund manager to allow the fund to offer the beneficiary enterprise local currency facilities. For example the Dutch Entrepreneurial Development Bank (FMO) hedged their local currency loans via the Currency Exchange Fund (TCX). The cost of hedging local currency loans is significant and defeats the pricing concession once this is added to the cost of the loan. When the risk is passed on to the beneficiary enterprise, local currency depreciation (especially when most of the enterprise's revenue is generated in local currency) also negates most of the pricing-related concessions: indeed, the enterprise may end up with an equivalent local currency cost similar to market rate.

This risk sometimes results in the offering of shorter-tenor facilities in order to manage the risk with forex uncertainties. To minimise the impact of forex risk, some investors prioritise SME business models that have the ability to earn revenue in foreign currencies through exports. This disadvantages impact-oriented SMEs that cannot earn foreign currency.

### II. Not achieving impact or defaulting on payments

Currency depreciation, because of the significant burden it places on borrowers, can trigger both the risk that an enterprise will not achieve its desired impact and that it will default on payments. Since catalytic investors are more likely to invest in businesses that operate in relatively riskier sectors or geographies, or at a riskier business stage, these risks are relatively higher than usual. In addition, catalytic investors, especially those that ask for lower collateral cover and are unable to secure credit guarantee instruments, are faced with a relatively higher loss in the event of a default.

> "There is a high default rate in repayments of catalytic funds given to SMEs when the beneficiaries are aware of the source of the fund, mainly when the suppliers, especially donor agencies, NGOs, and foundations, are heavily and directly involved in the disbursement of the fund. This implies that suppliers should mask their involvement and allow the intermediaries to lead in allocating the fund."
>
> — Manager at a rural bank

As a result, catalytic investors argue that even when they seek market-rate returns, they are accepting disproportionate risk for those returns. Some rural banks and MFIs were of the view that when a catalytic investment is sourced from philanthropic, government or international development funding, the mere involvement of these institutions in the disbursement of the funds can give some SMEs the impression that the money is essentially free—or at least that its terms are very soft—and this creates a mindset that can contribute to higher-than-average default rates. The absence of a robust credit-referencing system is therefore also a contributing factor.

### III. Failing to raise third-party capital for growth

Another risk factor that emerged is beneficiary SMEs failing to raise third-party capital for growth, although this was mentioned by fewer of the investors **(35 percent)**. These concerned catalytic investors stated that even after they have successfully seeded an impact

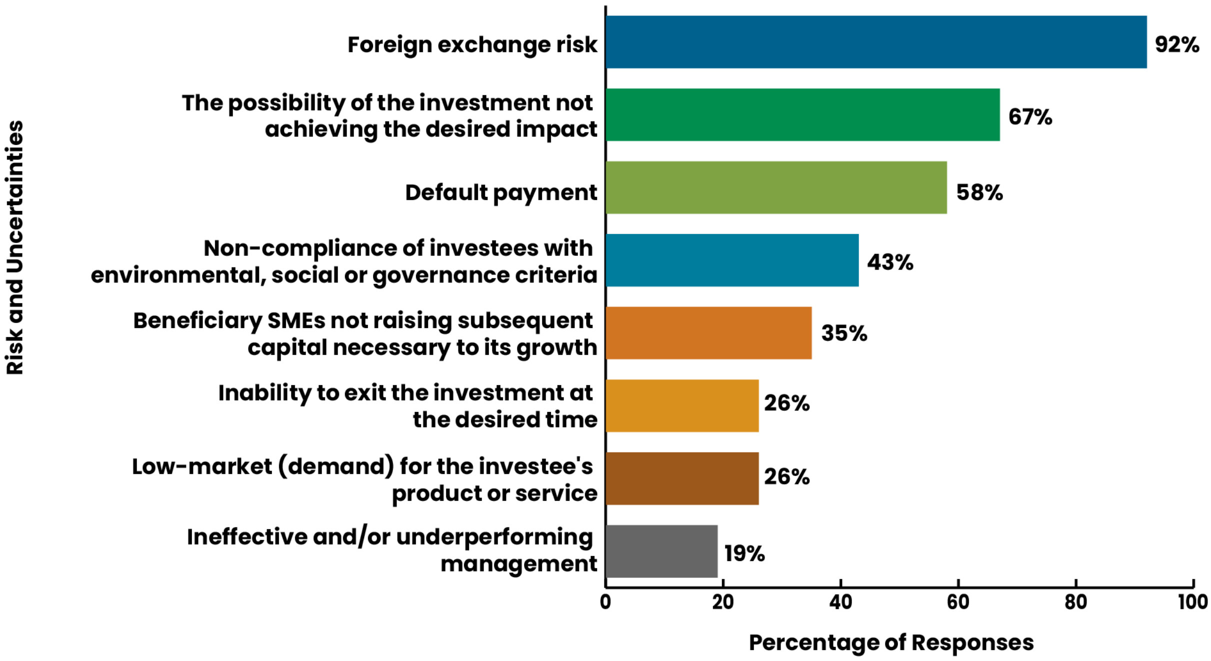
> "Just because you are a company that has primarily enjoyed catalytic capital and now seeking full cost capital with no concessions to invest, you are disadvantaged. It is worse if it was concessionary capital. Some investors are sceptical about your ability to manage commercial capital. Sometimes you try to convince them but no one wants to believe your story though in actual sense you can turn around commercial capital."
>
> — Beneficiary (Manager), Basic School

enterprise or a fund to demonstrate success, it could still struggle to attract mainstream capital, for one or more of the following reasons:

- Perceived track record not significant enough
- Not growing to a size that makes it attractive for the investor to exit
- The deal amount that the SME needs is small compared to what commercial investors are ready to invest

> "A seeded catalytic fund in essence is usually asked by your Limited Partner (LP) to take more risk by venturing into certain sectors or targeting certain populations, which presents a high likelihood that your fund won't do well. And now if you want to raise another fund from non-catalytic investors, they wouldn't pardon you because your impacts were great but with low returns. They care about their returns; unless you go back to the catalytic investors, but they are few."
>
> — Chief Executive Officer of an impact fund

- A perception that the enterprise has not attained a sufficiently low level of risk for a commercial investor to invest, a perception that may be reinforced if other catalytic investors also do not come forward to invest
- A perception by some commercial investors that SMEs and financial intermediaries seeded by catalytic investors may not provide competitive returns. The status of being a beneficiary of catalytic funding can act as a stigmatising tag that disadvantages a catalysed enterprise or intermediary from attracting commercial capital even though, ironically, it is precisely now that it can manage commercial capital.



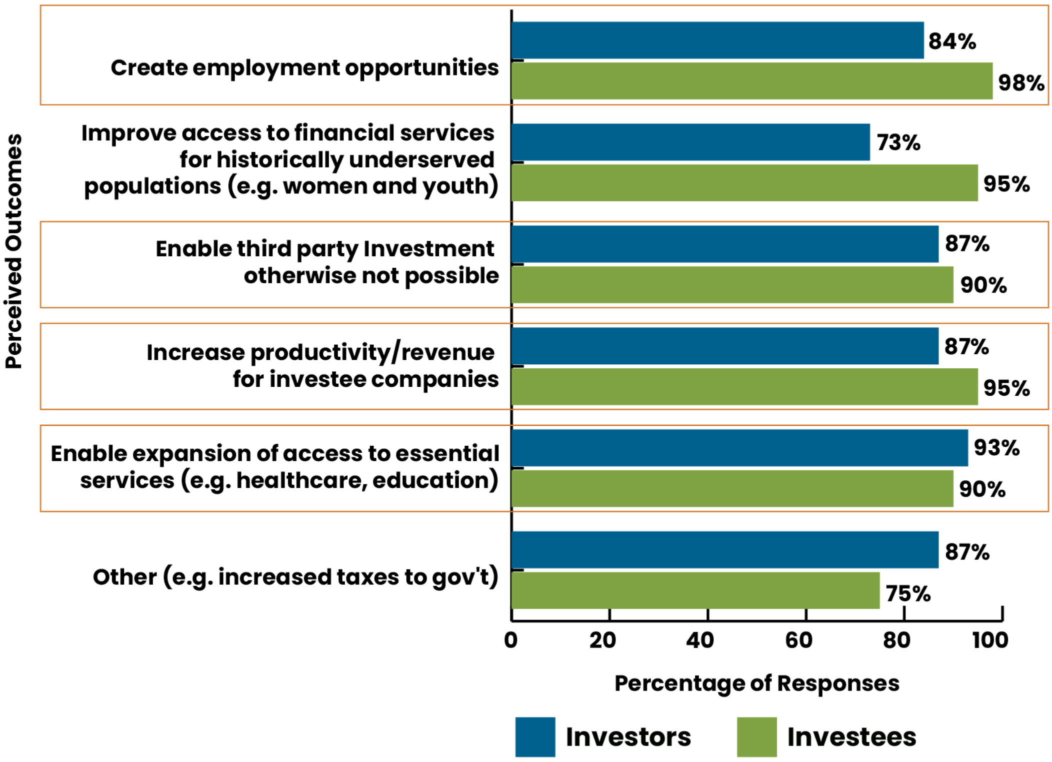

**Perceived Risks and Uncertainties of Catalytic Investors**

# IV. Outcomes and Constraints of Catalytic Capital Investments

## Outcomes of Catalytic Investments in SMEs

Overall, the majority of investors **(85 percent)** and SMEs **(90 percent)** that we surveyed believe that catalytic investments yield significant positive socioeconomic and environmental outcomes. We analysed the cases for which there were data to identify the outcomes. These include especially the following four:

**1. Employment:** Catalytic financing tends to stimulate employment creation, with huge implications for poverty reduction among beneficiary enterprises. From our analysis, we observed that beneficiary enterprises, for the cases analysed, increased employment by at least 60 percent when compared to before they received the catalytic investment. Catalytic funding enables SMEs in the start-up phase to get their ideas off the ground while enabling those at the growth or maturity stage to expand and scale their production capacities. In all instances, both direct and indirect employment opportunities are created, which helps to address unemployment in Ghana. The World Bank (2021) has estimated that 12 percent of Ghanaian youth are unemployed, and more than 50 percent of Ghanaians are underemployed. Both figures are higher than the average rates for Sub-Saharan Africa.




Perceived Outcomes of Catalytic Capital

"Enterprise has generated 20 new direct employment and approximately 100 indirect jobs across other segments of the value chain (logistics, transportation, and trading of grains) since the Fund's investment compared to 7 new jobs prior to the investment, representing an increase of 186 percent."

"The catalytic funding improved the enterprise's credibility, risk-return profile and visibility to other investors which has led to additional flow of private capital of up to $1 million to date from an international lender to support the company's working capital needs."

"The budding years (2011-2019), we saw slow and steady growth which predominantly was lower than 15 percent, but with the moderately priced patient convertible debt, rates of return saw massive improvements up to 26 percent in 2020, 32 percent in 2021, and expected 44.5 percent in 2022."

"SGCM has undoubtedly had a significant impact on Africans. Since 2012, the facility has treated over 8000 cancer patients with an annual average of 1500 patients"

**2. Enhanced Access to Finance:** Catalytic capital facilitates access to financial services for historically underserved populations (for example women and youth) whose enterprises or business models do not fit the risk- return profile of mainstream commercial investors. It is an alternative financing model many of the SMEs we spoke to believe would be one of the panaceas for closing the capital gaps among SMEs.

> "But for the guarantee, it would have been difficult or next to impossible to get a loan from the bank, talk less of the low-interest rate and collateral free [requirement] we enjoyed. We tried several times to get funding from financial institutions. However, we couldn't because our technology platform focuses on [targeting] a population mainly, smallholder farmers and aggregators in the agricultural sector, a sector considered too risky for investors."
>
> — Beneficiary, Technology Service Provider

Catalytic investors are willing to invest in SMEs with flexible considerations and less stringent requirements than traditional investors. They often accept alternative collateral such as floating assets and inventory, flexible loan repayments such as repaying a loan as a percentage of future revenue cash flows, acceptance of in-kind repayment, and revenue-sharing agreements. Some rural banks and microfinance institutions, for instance, accept repayment of agricultural loans in the form of produce. Additionally, catalytic investments sometimes come at lower interest rates—a solution to one of the significant constraints faced by Ghanaian SMEs seeking to access funds. These factors together make it easier for Ghanaian SMEs to secure funding.

**3. Increased Productivity:** Catalytic capital helps SMEs to increase their productivity and profit margins. Access to catalytic funding led to an increase in the annual return on investment/revenue of beneficiary enterprises averagely by at least 25 percent. With catalytic funding, SMEs are able to increase productivity and profit margins relatively better compared to conventional funding.

In addition to being relatively cheaper than conventional capital, the long-term nature and flexible payment terms of catalytic funding allow SMEs to turn over the capital more times to generate more profit. This would not have been possible or probably more difficult for the SME to attain if the payment terms were more rigid. Also, equity investments which typically relieve the SME from mandatory interest payments allow the SMEs to plough back cash flows (profits) into their businesses to further support their growth.

Pay-for-results incentives are arrangements that motivate performance by providing payments when targets are actually achieved, not just when a good effort is made. Example: A school is forgiven a loan upon meeting certain enrolment or academic performance targets for low-income students.

**4. Unlocking Third-Party Commercial Investments:** Respondents agreed that catalytic financing enables third-party investment that otherwise would have been possible due to the high risk often associated with investing in SMEs. We estimated that each dollar of catalytic investment in a beneficiary SME mobilised 3 to 7 times as much in third-party investments in the SME.

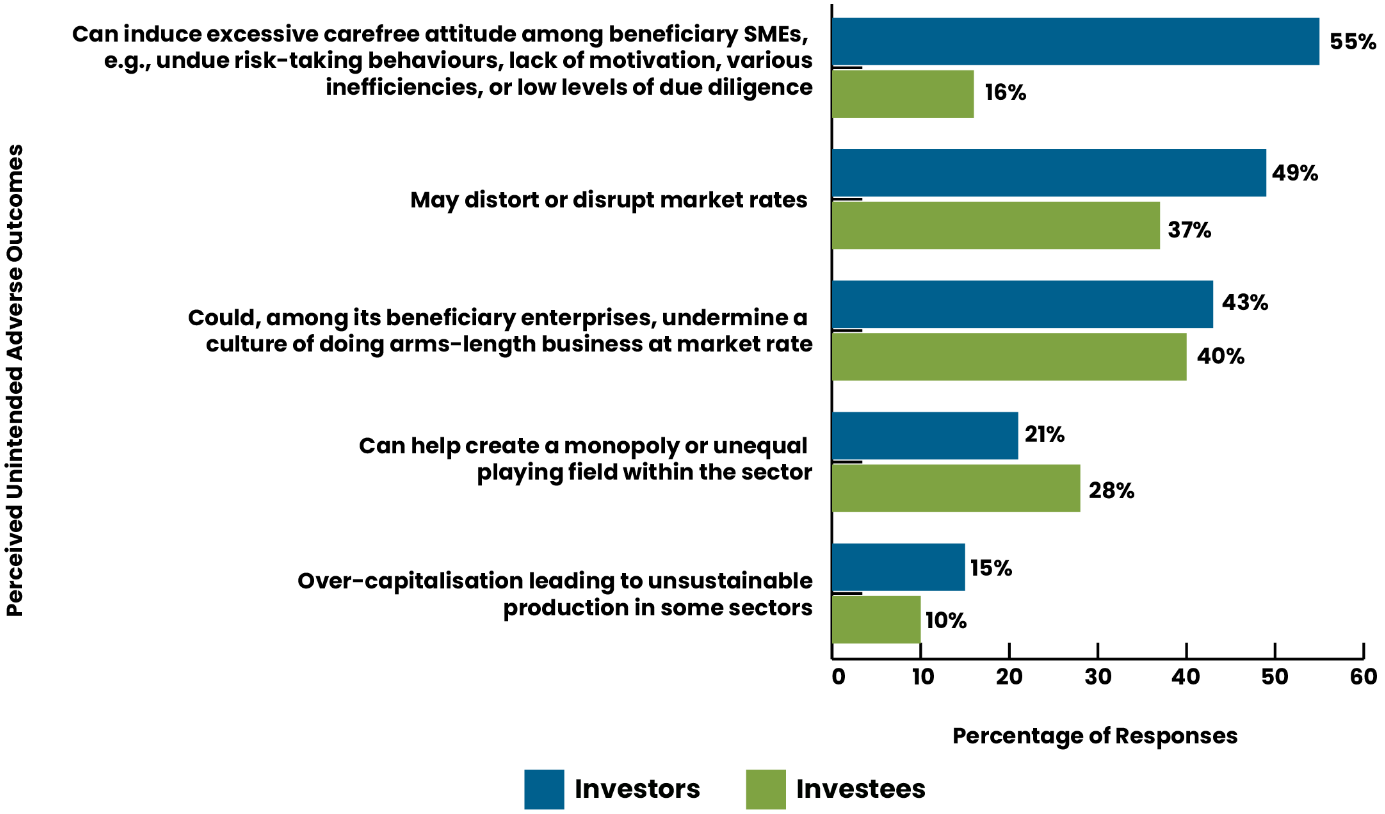
> "The loan we received from the NEIP helped us to set up the needed systems, which improved our asset value and helped us raise an additional loan from Fidelity Bank."
>
> —Co-founder, Beneficiary SME

The investments that were successful in unlocking financing were very deliberate in how they did this. Designing their investments in ways that would be attractive to third-party commercial investors. For example, the VCTF took a first-loss position in all its investee funds and supported them to raise additional funding from limited partners. This crowded in $89.7 million in private capital from other limited partners in the funds. FinGAP used **pay-for-performance** incentives to increase financing significantly for SMEs in the maize, soya bean and rice value chains. AV Ventures invested in SMEs to de-risk them for commercial investors and co-invested in them with those investors. There is a mini-case study on VCTF on page 48 and another on FinGAP on page 50.

Design choices that led to positive outcomes included concessions such as lower prices, deploying longer-term capital, making flexible collateral demands, and tailoring investment structures to meet the particular needs of the investee enterprise. Four case studies of financial intermediaries and six of investee SMEs are included to illustrate the outcomes and lessons of catalytic capital financing.

## Possible Negative Consequences of Catalytic Capital

Sometimes, the financial concessions and subsidies associated with the deployment of catalytic capital can have certain adverse unintended effects. It is important to recognise these effects if they occur and understand how they can be addressed.




**Perceived Unintended Adverse Outcomes of Catalytic Capital**

Overall, about **36 percent** of investors and **25 percent** of beneficiary SMEs said catalytic investments could yield certain unintended adverse outcomes, especially if the financing model is not designed with enough care. The ones most frequently mentioned were market rate distortions, the likelihood of poor investment decision-making, and a carefree mindset induced by over-reliance on concessional capital and a perception of it as relatively "easy money." Taking them in turn:

### I. Market distortions

Joan Larrea, CEO of Convergence, the global network for blended finance, describes market distortion as, in many respects, "the dark side of additionality."[39] "An institution runs the risk of causing distortion when it misjudges its capacity to add value to a facility or project, and in so doing mobilises millions of dollars in concessional finance only to dilute investors' returns, chase investors out and, waste public funds," notes Jack Aldane of *Development Finance*. Catalytic financing can potentially distort a market and raise barriers to market entry by (i) empowering some SMEs

[39] Jack Aldane, "Blended Finance: can the new rules avoid market distortion?" *Development Finance* (29 November, 2017), https://www.devfinance.net/blended-finance-distorting-reality.

at the expense of others through the concessions, technical support and access to information they receive, and by (ii) making concessional financing more attractive to beneficiary enterprises than commercial financing. For example, a bank on-lending a long-term concessional loan from a catalytic supplier will be more appealing to SMEs than commercial capital offered at full market-rate cost.

In our study, **49 percent** of respondents indicated that some catalytic financing concessions have the potential to exert distorting or disruptive effects on the market, creating a problem in the business landscape. One possible knock-on effect of such distortions is out-competing and crowding out investors (for example, commercial banks) who do business as usual. The challenge is how to keep the market stable while simultaneously deploying catalytic capital.

Then there is the spectre of monopoly. Market distortions can, in turn, inadvertently create a monopoly in which certain investors end up benefitting disproportionately. Catalytic funding can empower beneficiary SMEs at the expense of other firms, raising barriers to their market entry, and reinforcing information asymmetries. For example, despite its positive developmental impact, a concessionary loan or a technical assistance package can strengthen an SME's market power in an unfair way if other players in the space are not benefitting from similar concessions. Similarly, information asymmetries can be reinforced if some SMEs receive access to valuable market information that others do not.

In contrast, an almost equal proportion of respondents expressed the opposite view—that catalytic financing **does not** distort markets because its very aim is to address market failures by applying a much-needed and long-awaited correction. The question of a market distortion therefore should not even arise—or alternatively, should be kept in perspective because the disadvantages of such a distortion, if it does occur, will normally be significantly outweighed by the socioeconomic developmental benefits catalytic financing brings to traditionally marginalized and under-resourced population groups. Catalytic suppliers of funds, they said, target sectors such as agriculture and enterprises owned or run by underserved populations, such as women-owned start-ups, that mainstream investors are hesitant to venture into because of their perceived high risk.

> "If a catalytic fund is seeding a start-up in the agricultural sector with low to no collateral, a bank, for instance, is not worried about market distortion because they wouldn't have invested in such [a] business in the first place. Agriculture is a sector they are not passionate about; talk less about investing in a seed-stage [agri]-SME. So, what are you distorting? The bank may only be hoping that, in the future, the SME is weaned off catalytic funding when they can access commercial money."
>
> — Head of finance at a foundation

## II. Poor investment decision making

Some of our study respondents also said that, in some instances, catalytic financing—particularly those measures (such as lowered interest rates and uncollateralized investments) that buy down some or all of the perceived or actual risk of investments—can unwittingly encourage a carefree mindset and result in unnecessary risk taking. In the wrong hands, it can predispose beneficiary enterprises to low motivation, unguarded choices, and inefficiencies fueled by the perception of easy-come-easy-go capital. The argument is that the more beneficiary SMEs and financial intermediaries are insulated from the real-world risks of an investment or project, the less time, discipline, and energy they will tend to devote to undertaking proper due diligence and sound management, which ultimately raises the failure rate of such investments.

Some suppliers of funds addressed this problem of mindset by incorporating certain safeguard measures, such as offering technical assistance and introducing pay-for-results incentives. Such incentives motivate SME performance by providing payments only when certain targets are actually achieved, not just when a good effort has been made to achieve it. For example, a beneficiary SME is forgiven a loan upon meeting certain minimal environmental preservation targets.

> "When SMEs access funding that is priced relatively cheaper or has a longer duration, it undermines their investment efforts. They become carefree and take unnecessary risks. It is even worse when the funding is free and not monitored."
>
> — Head of finance at a microfinance institution

## Reducing the Unintended Adverse Outcomes of Catalytic Capital

Respondents offered the following strategies for minimising the potential adverse consequences of catalytic financing. We also illustrate some of these strategies through a profile of one impact fund:

- **Target underserved markets:** Be intentional about underserved markets and populations when targeting beneficiary SMEs. Avoid distorting the market by offering catalytic capital to businesses that are already quite attractive to existing commercial investors.

- **Crowd-in commercial investors:** Design catalytic programmes to crowd in as many meaningful commercial investors as possible. Bring in new commercial players by broadening, and raising awareness of, investment opportunities among eligible companies,[40] sharing market intelligence or due diligence findings with other investors, and working with financial intermediaries such as banks and impact funds.

- **De-risk investments:** Place less emphasis on providing funding at concessionary rates and instead offer incentives such as guarantees and other concessions to absorb some of the risk commercial capital providers face when they work with SMEs or underserved market segments. This could also include concessions such as taking a subordinated position and offering smaller investment amounts.

- **Use blended finance:** Instead of non-returnable grants or interest-free capital, minimise market distortion possibilities by blending it with capital that offers risk-adjusted returns and provides cost-effective yet competitive investment capital. The blended structure will tend to attract private sector investment that otherwise might not have occurred.

- **Encourage transition:** Facilitate the transition of beneficiary SMEs to commercial funding as soon as this is realistic, although in practice it may be challenging to determine exactly when this is appropriate. To determine the right stage, focus on fundamental indices such as bankability, financial track record including profitability, payment track record, and leverage ratios such as debt-to-EBITDA and debt service coverage ratio.

- **Learn and adapt:** During the design phase, anticipate the possible distorting effects of your chosen investment model on market structures. Continuously monitor progress and take mitigating measures as needed. Preferably get a third party to perform a progress evaluation. Involve third-party agencies and experts in building measures into interventions that help address potential distortions.

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[40] Donor Committee for Enterprise Development, ***Minimising the Risk of Negative Market Distortions in Private Sector Engagement: A practical framework*** (2018), https://www.enterprise-development.org/wp-content/uploads/DCED_Minimising-the-Risk-of-Market-Distortions-in-PSE_Practical-Framework.pdf.

- **Be accountable and transparent:** Publicise the financial intermediary or SME's funding and impact targets, activities and results, including market data and lessons learned, in an independent, transparent, widely accessible way that makes the information a source of continual learning.[41]

## Impact fund profile

How AV Ventures reduces potential unintended negative consequences of its investment.

| Potential Adverse Effect | Mitigating Action |
|---|---|
| Market distortions | AV ventures works with underserved, early-stage and growth-stage agri-SMEs, often unattractive to conventional capital providers. A royalty-based structure enables AV Ventures to share in the SME's revenue stream, allowing the fund to offer the SME an effective interest rate similar to what a bank would but structured to align closer to the business's cashflows |
| Crowding out of commercial investors | AV Ventures encourages beneficiary SMEs to transition by giving them less priority for follow-up loans and investments, supporting them to access follow-on funding from local banks if needed, and co-investing in the SME with the local bank |
| Inappropriate risk taking by an SME that develops a carefree mindset | The fund provides client SMEs with technical assistance or facilitates their access to it to help them recognise and minimise risk-taking behaviours |

# Challenges faced by catalytic investors

Seven interrelated factors constrain catalytic capital providers. They are also the reasons some investors choose not to invest in catalytic capital-seeking SMEs:

### 1. Few catalytic capital and intermediaries

Not enough catalytic capital providers to co-invest with commercial providers in SMEs. Besides the government, there are few large local potential sources of catalytic capital. A limited supply of grant capital for technical assistance, alongside the investment capital, and a low number of well-established local fund managers and financial intermediaries working with underserved SMEs, all hinder SMEs from accessing critical technical and other services to support growth. Note, however, that co-investments between catalytic and non-catalytic funders can generate decision-making friction because of competing interests and mandates, and misalignment in strategy and purpose.

### 2. Few investment-ready SMEs

Not enough investment-ready SMEs that match the preferred deal sizes of available catalytic capital providers, and few affordable transaction advisors and lawyers willing to service fundraising SMEs. Many SMEs also are reluctant to accept equity investments for fear of a takeover.

[41] Accountability Counsel, *Accountability Mechanisms: Benefits and Best Practices for Impact Investors* (2019), https://www.accountabilitycounsel.org/wp-content/uploads/2019/05/5-22-19-impact-investing-ams-benefits-w-best-practice-examples.pdf.

### 3. Limited literacy on catalytic investing among ecosystem players

Many local financial intermediaries are unfamiliar with blended finance, green finance, gender lens investing, and so on. Many investors do not know how to structure a deal in a way that makes it catalytic. They have difficulty in ascertaining the appropriate level of subsidy that will not result in adverse consequences such as market distortions and how to crowd in the private sector.

### 4. Fear of over-dependency

Some investors were concerned that SMEs may come to over-rely on concessional capital and develop certain poor business habits—low motivation, a carefree attitude, or weak due diligence.

### 5. High cost of transactions and limited risk-mitigation tools

Catalytic investing into SMEs, if it is not done right, can be risky and marginally profitable, with high transaction costs associated with such SMEs. Not all capital providers understand how to deploy de-risking mechanisms such as first-loss and credit guarantees, and available guarantees provide only partial coverage of losses.

### 6. Insufficient exits through capital markets

Venture catalytic capital investors have exited equity investments through sale to other investors, put options to sponsors and owners, and stock exchange listings. Although it is possible to exit through public capital markets such as the Ghana Alternative Market (GAX) that are designed specifically for SMEs, few companies are willing to go public and list on the GAX. There are not enough local investment banks ready to underwrite new share offerings ahead of listing on the capital markets. IPOs are few and far between, which partly accounts for the limited underwriting of new share offerings. Although the GAX partnered with the VCTF and the AfDB to set up the GAX-SME listing support fund to help SMEs cover part of the cost of raising capital and of advisory services for listing on the GAX, it continues to remain an untapped opportunity.

### 7. Policy, regulation and country risks are a barrier

- The cedi's high depreciation against international currencies erodes the benefits of concessions for SMEs.
- The high returns offered on government treasury securities disincentivises catalytic capital for SMEs. Government securities offer certain investors lower risk and better returns.
- The absence of a limited partnership legal structure creates additional administrative steps during exits for venture funds. (A proposal is under way to introduce one.)

Other reasons mentioned: Limitations imposed by an investor's mandate, and the fact that catalytic investments may not meet the target financial returns demanded by the investor's suppliers of capital.

## SME and financial intermediary concerns about catalytic capital investors

### SMEs' concerns

Our SME respondents expressed the following concerns about catalytic capital investors:

- The data requirements of investors during due diligence, and the requirements of ongoing reporting, can seem excessively burdensome. Some social and environmental impact metrics that investors require may not align well with the SME's business strategy and may require additional resources to deliver.

- Equity transactions sometimes take longer than necessary to close. Some SMEs fear that equity and mezzanine investments could position the incoming investor for a takeover.

- The investment selection criteria catalytic investors use are not always transparent or well known. This makes it difficult to know which investors to target and connect with during fundraising. Impact Investing Ghana and Impact Investors Foundation Nigeria's **dealsourceafrica.co** platform is addressing this problem of connecting SMEs to impact funds more effectively.

- When intermediaries blend catalytic capital with commercial capital for an SME, it sometimes makes the capital more expensive than originally intended by the catalytic capital provider.

- Financial institutions that supported an SME with catalytic funding because of incentives like guarantees or pay-for-performance from international development agencies etc. often suspend financing to the SME after the project closes. Raising subsequent funding—while carrying the status of a post-catalytic capital recipient—can then become quite challenging.

- Limited market opportunities for SMEs to sell their products and services often erode the initially expected gains of catalytic funding. Besides just catalytic funding, SMEs need other kinds of support, such as business training and access to market opportunities.

- Apart from acceleration programmes and philanthropic organisation grants, accessing catalytic capital to finance product and service innovations can be difficult.

- Despite the advantage of longer tenor of loans from impact funds, these are often denominated in foreign currencies, thereby exposing the SME to the forex risk of cedi depreciation and eroding the advantage of the longer tenor.

## Financial intermediaries' concerns

Financial intermediary respondents tabled these concerns about catalytic capital providers:

- Three major concerns expressed were investors' high financial return expectations, inadequate consideration of local context realities, and lack of flexibility to make room for adjustments when there are unforeseen circumstances. This leaves little room for learning and adaptation by intermediaries during deployment. Additionally, catalytic funds from government, donor agencies, and implementing partners can come with conditionalities or tailored implementation approaches that do not fit local market practices and conditions.

- New fund managers sometimes find the requirements of DFIs for team composition, strategy, and the track record of fund management companies unrealistic. Catalytic capital providers may also expect intermediaries to have a certain level of assets under management as a measure of their financial capability and track record, instead of looking at other equally valid parameters such as the team's investment experience, sectoral expertise, and portfolio quality. Additionally, the reluctance of many foreign suppliers to invest in local currency funds, and their preference for established multiple-country investment funds, make it challenging for first-time fund managers who often lack the capacity to manage such funds.

- There are only a few technical assistance grants and mentorship programmes to support the capacity development needs especially of first-time fund managers.

- The structuring, due diligence, and other core considerations of catalytic fund suppliers can be overly bureaucratic and burdensome.

- The preference of DFIs/MDBs for larger, SME-focused funds because of concerns about fund economics pressures many intermediaries into targeting deals above $1 million—which is often above the needs of "missing middle" SMEs that typically require $50,000 to $500,000.

## Profiling the Providers

Catalytic investors in Ghanaian SMEs are not a homogeneous group. They differ in their missions, motivations and strategies. We identified four broad subgroups: **(i) committed catalytic investors, (ii) occasional catalytic investors, (iii) inadvertent catalytic investors, and (iv) catalytic capital enablers,** profiled below:

**(i) Committed catalytic investors** ● Intentional about sharing, absorbing and/or re-distributing the risks associated with SME investments, committed catalytic investors are willing to take on disproportionate risk in order to catalyse funding for social and development impact. They either directly provide capital, or indirectly provide capital and/or guarantee covers to unlock commercial capital from conventional investors. They design, or invite others to design, specialized investment-oriented programmes to benefit SMEs, invest in catalytic funds managed by intermediaries or implementing partners, support initiatives to strengthen SMEs' access to finance, and devote resources to tracking and assessing impact. **Who are they?** Mostly international development agencies, foundations, governmental agencies, impact funds and private sector organisations that have catalytic capital investment embedded in their mission.

**(ii) Occasional catalytic investors** ● Share many of the characteristics of committed catalytic investors, but they provide catalytic capital more on an ad hoc basis. Only some of their investments are catalytic because they make both catalytic and conventional investments, depending on how it fits their mandate and investment strategy. Greater understanding of how to creatively structure catalytic capital deals may draw more of these into the committed category. **Who are they?** Mostly private sector firms including venture funds, commercial banks and non-bank financial institutions and other private capital providers.

**(iii) Inadvertent catalytic investors** ● These do not see themselves as, nor intentionally set out to be, catalytic capital investors but they stumble, as it were, into providing catalytic capital inadvertently through the SME-friendly concessions they sometimes provide—such as small investment sizes or accepting non-traditional collateral when structuring a deal in SMEs. While these concessions have similar beneficial effects on the recipient SMEs, such as catalysing additional financing, inadvertent investors do not go all the way to provide the full spectrum of support functions the SME may need because their goal was not catalytic capital investment. For them, it is just business as usual. Because they are not intentional they would not be considered impact investors however greater understanding may also draw more of these to be more intentional. **Who are they?** Mostly private sector firms including venture funds, commercial banks and non-bank financial institutions and other private capital providers.

**(iv) Catalytic capital enablers** ● These are enablers that do not directly invest capital in SMEs but rather fund indirect, system-strengthening activities such as ecosystem building, transaction advisory work, capacity building, market access, initiatives that provide investment-readiness support to SMEs, and policy and advocacy work to remove barriers to accessing investment capital. **Who are they?** Mostly industry associations, non-profits, government agencies, international development agencies and foundations.

# V. Catalytic Financing Initiatives: Four Case Studies

Section 6 reports on four catalytic capital initiatives intended to unlock financing for SMEs and the pathways through which they did.

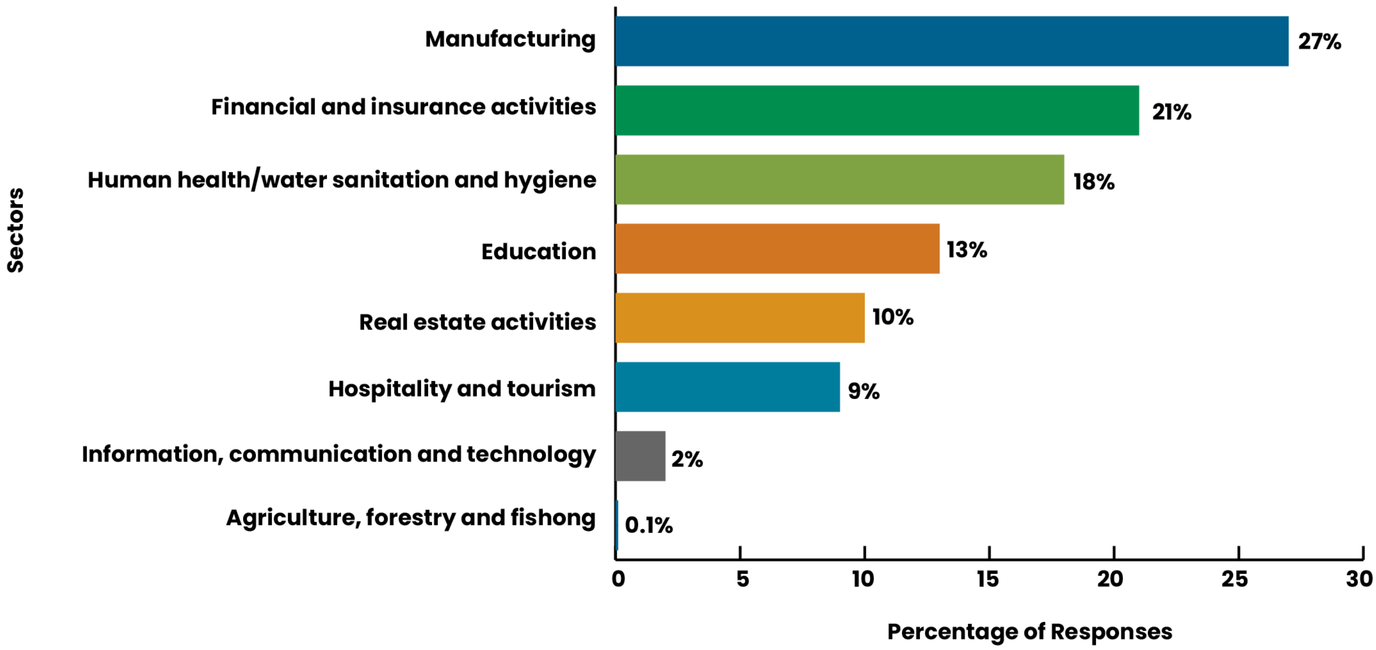
## Financing Initiative 1: Venture Capital Trust Fund • a Ghana government-led catalytic initiative

### Activity

As a government-backed venture capital fund-of-funds established in 2004, Ghana's Venture Capital Trust Fund (VCTF) provides SMEs with long-term, patient venture capital financing. The VCTF does this through joint ventures with partners that have an interest in the venture capital and private equity space. Thus far, the VCTF has invested some $29 million in 8 impact funds (Venture Capital Finance Companies), with a minimum investment tenure of 10 years and at below-market rates. The most recent is a GHS25 million ($2.4 million) commitment to Injaro Ghana Venture Capital Fund (IGVCF) to support viable SMEs.

The 8 funds, including Fidelity Equity Fund II Ltd, Ebankese Fund Limited, and the Industrial Support Fund have, in turn, invested in 63 portfolio companies. As shown in figure below, 27 percent of the value of the VCTF's funds is committed to portfolio SMEs in the manufacturing sector, including agro-processing enterprises, and 21 percent to enterprises in the finance and insurance sector. Less than one percent is invested in SMEs in primary agricultural production, forestry and fishing.

The VCTF also offers technical assistance to fund managers and other players on a needs basis to help manage weaknesses identified in the ecosystem, such as the limited knowledge of venture capital in Ghana. The VCTF as an




**VCTF Funding of Intermediary Fund Portfolio SMEs, by Sector**

impact-driven organisation strategically aligns with the government's agenda, regardless of the government in power. Additionally, the fund prioritises investments and fund managers that promote import substitution and honour tax obligations.

### Outcomes

The VCTF's catalytic investments have attracted an additional $89.7 million in investments from other investors into the SMEs that likely would not have occurred. The VCTF's investments through its intermediary funds have also created more than 3,400 direct jobs and 13,500 indirect jobs in different sectors, as a result of the expanded operations of the SMEs.

Other positive outcomes include the Fund's pioneering role in supporting the establishment of the Ghana Venture Capital & Private Equity Association (GVCA), Impact Investing Ghana (IIGH), and Ghana Angel Investing Network (GAIN), all of which are working to strengthen the development of Ghana's venture capital, private equity and impact investing sectors.

Additionally, in 2013, with support from the African Development Bank, the VCTF was instrumental in creating an alternative capital market space—the Ghana Alternative Market (GAX)—to facilitate the exit of equity investments (that is, the sale of shares in an enterprise to interested buyers) by investors. Unlike the Ghana Stock Exchange, GAX enables capital raising for SMEs, using flexible requirements, reduced fees, and other incentives. Between 2013 and 2021, six enterprises raised a total equity of GHS24.5 million ($3 million) on the GAX.

The VCTF has been recently recapitalised with $40 million by the government to enable it support more venture funds to fund viable SMEs.

### Challenges

Despite the VCTF's successes, it has faced certain constraints:

- A limited understanding of venture capital and catalytic capital among ecosystem players, including fund managers, limiting the number of intermediaries the VCTF can work with.

- A lack of reliable data for the effective valuation of investment deals.

- Some fund managers have had other competing interests, for example, managing other broader asset management platforms. This dilutes the attention they can focus on the VCTF's funds. For instance, SIC's Financial Services Ltd (FSL), the manager of Bedrock Fund, was not an independent fund manager. Its employees were affiliated with SIC rather than with the fund manager for Bedrock. The fund manager reported to the CEO of FSL, not to the LPs of the fund.[42]

- Forex risk from currency depreciation.

- The absence of a limited partnership corporate structure.

[42] World Bank, *Ghana Private Equity and Venture Capital Ecosystem Study* (2016), https://openknowledge.worldbank.org/bitstream/handle/10986/30165/Ghana-Private-Equity-and-Venture-Capital-Ecosystem-Study-FINAL-June-2016-SD-Edits.pdf

## Financing Initiative 2: USAID's FinGAP • a development agency-led catalytic initiative

### Activity

USAID's Financing Ghanaian Agriculture Project (FinGAP), now referred to as Mobilising Finance for Agriculture (MFA), was launched in July 2013 to help unlock finance at scale for enterprises in Ghana's principal food security agricultural value chains: maize, rice, and soy. Access to finance is a significant limiting factor to the development of commercial agriculture in the country.

The initiative was motivated by the belief that non-traditional "work-around" initiatives—such as incentives, capacity building and business advisory service and risk mitigation measures—could be just as effective as traditional financial initiatives in encouraging Ghanaian financial to increase lending to the agriculture sector. The other belief was that once systemic internal structures and the capacity to achieve these had been developed, incentives would no longer be needed to sustain the system. FinGAP went about it by using pay-for-results (PfR) methods, capacity building and business advisory services to encourage partner financial institutions to increase lending to the target value chain actors. Other strategies FinGAP employed were to unlock SMEs' access to alternative financing and help scale three tools available in Ghana for mitigating the risks associated with lending to the agriculture sector: USAID's Development Credit Authority, the Ghana Agriculture Insurance Pool, and credit guarantees provided by Eximguaranty.

> Alternative financing is financing from other parties, such as from venture capitalist and private equity, other than the traditional lenders.

The FinGAP project trained the BAS providers to provide enterprise support services to agribusiness SMEs to help them access affordable and alternative financing investment options.[43] The project also encouraged a broad range of financial institutions—commercial banks, micro-finance institutions, rural and community banks, savings and loans institutions, and impact and equity investors—to expand their supply of funds to the agricultural sector through "smart incentives," training and guidance on developing and modifying existing products to suit the needs of beneficiary SMEs and based on existing opportunities.

BAS providers signed performance-based contracts with the Fin GAP to identify SMEs seeking financing and help them through the fundraising and closure of deals with prospective private investors. The BAS providers were paid by FinGAP upon meeting agreed targets.

### Outcomes

At its closure in 2018, FinGAP had spent $22 million and unlocked about $168 million private capital—more than double the target of $75 million—in new financing to almost 3,000 agribusinesses in the selected value chains. Of the unlocked capital, 79 percent ($132 million) of it was for SMEs, of which 62 percent went to medium-size enterprises and the remaining 38 percent went to small enterprises. For example, in November 2017, Business Finance Consultant Limited facilitated a five-year concessionary loan of $2,936,850 from the Ghana EXIM Bank for a FinGAP beneficiary SME. The loan was repayable in Ghanaian cedis at an annual interest rate of 5 percent, compared to the 30–35% interest rates commercial banks were charging at the time.

Another $91.1 million in alternate financing had additionally been mobilised from the capital markets for two SMEs. This financing has had a positive effect on the profitability of the SMEs and the livelihoods of the farmers.

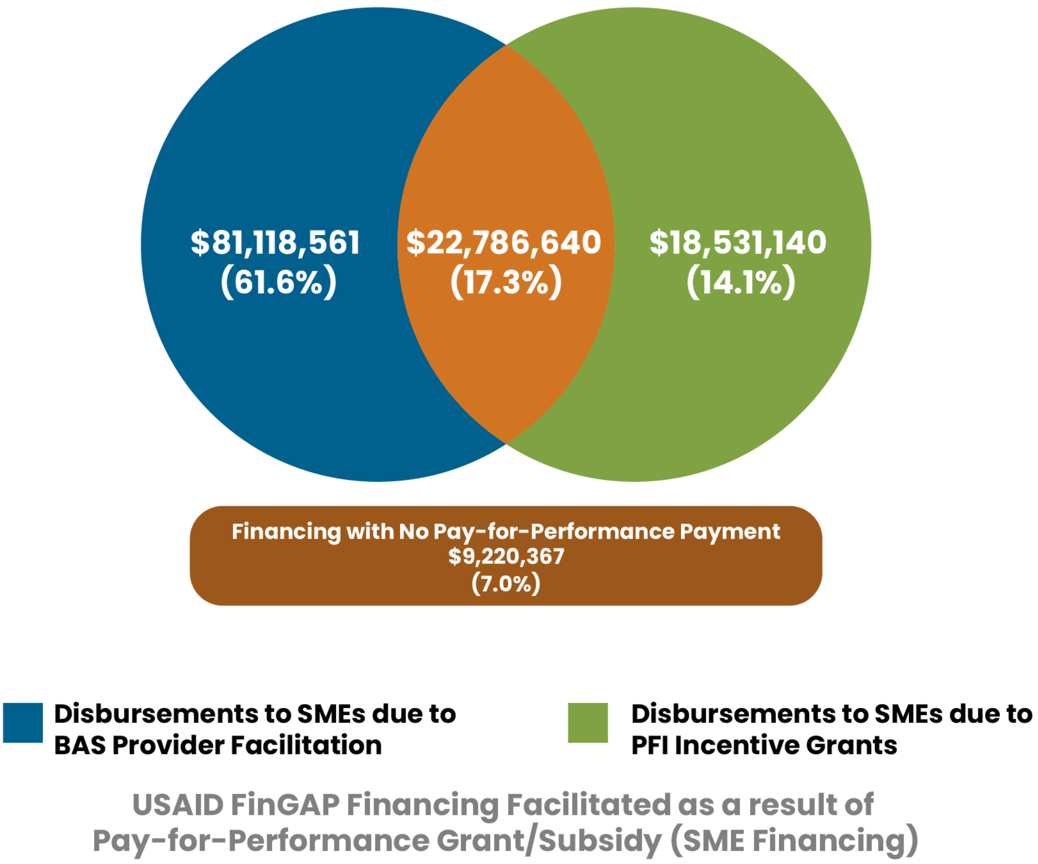
[43] FinGAP worked with large as well as small and medium enterprises, but since the theme of this report is SME financing, our analysis focuses just on the SMEs FINGAP worked with.

SMEs achieved significant incremental sales over the five-year period of the project and employed 85 percent more workers (from an average of 7.3 employees per firm to 13 employees per firm in 2018). Average smallholder revenues and profits doubled for all supported value chains within the five-year period of the project. FinGAP helped 1,231 women-led enterprises (40 percent of the SMEs that had been directly supported) to access financing directly.[44] However, being intentional about selecting both men and women as beneficiaries and addressing their respective needs, remained low at the project beneficiary level largely because implementing partners were not obliged to achieve that goal and therefore made little effort to.

At the closure of FinGAP in 2018, the value of agricultural loans to beneficiary SMEs by partner financial institutions as a percentage of their total loan portfolio increased from 6 percent to 14 relatives to the start of the project in 2013. Seventeen of the 39 institutions FinGAP partnered with modified and in some instances developed 31 new financial products to accommodate the needs of beneficiary SMEs. These included new insurance products for production, grain trading loans, input financing, warehouse receipt finance and inventory loans. These new products directly led to the disbursement of more than $62 million in loans to 1,597 agribusinesses from financial institutions that initially were reluctant to venture in because of worries about a possible lack of land tenure security, high rates of payment default, and the unpredictability of weather patterns.

### Factors underlying FinGAP's outcomes

FinGAP's successes over the 2013–2018 period can be ascribed to five things:




Source: USAID FinGAP (2018) illustration

[44] Palladium, *Financing Ghanaian Agriculture Project: USAID FinGAP* (Final Report) (July 2018), https://pdf.usaid.gov/pdf_docs/PA00TCM4.pdf.

- The two Pay-for-results (PfR) mechanisms deployed, which are pay-for-performance grants to participating financial institutions and pay-for-performance grants to participating BAS providers. These incentives singly and in combination stimulated their rapid venturing and expansion into agricultural financing. The pay-for-performance grants to the financial institutions, which accounted for 62 percent of the $132 million in investments leveraged, were the most effective at unlocking financing for SMEs. The financing mobilized by the BAS PfR incentives was less—about $19 million, or 77 percent less than the financing enabled by financial institutions—but the BAS providers were the most efficient way of unlocking financing for SMEs with smaller financing needs.

- Participating financial institutions noted that they reduced their interest rates charged on debt by an average of 2 percentage points from the prevailing rate of about 30 percent. Most beneficiaries, however, did not consider 28 percent significant enough to be catalytic.

- Training and technical assistance to financial institutions and BAS providers helped deepen their understanding of agricultural financing.

- Investment summits and networking events expanded business relationships and trust among actors in the agri-finance ecosystem.

- A reduction in the risk of agricultural lending through the use of insurance and credit guarantees from the Ghana Agricultural Insurance Pool (GAIP) and Eximguaranty Company (Ghana) Limited. The uptake of the credit guarantee from Eximguaranty however was low. Although it had the potential to reduce the financial institutions' risk by up to an average of 87 percent on principal repayment, hardly any of them were incentivized to offer loans to the agribusinesses using the guarantee. Among other factors, financial institutions said they did not have confidence that the provider would honour claims in the event of a default of payment of the guaranteed loans. Secondly, they said they could perceive that the cost of borrowing would likely be higher than initially expected, making their loans unattractive. Since the USAID-FinGAP subsidy was not 100 percent, guarantee charges levied by Eximguaranty would raise the cost of borrowing because the financial institutions would then have to pass the charges on to the SMEs.[45]

- To ensure that participating financial institutions and BAS providers shared in the risk associated with agriculture financing and encourage market sustainability, FinGAP carefully determined the appropriate level of PfR subsidies to incentivize behaviour and ensured that incentives were not over-priced nor subsidized past the tipping point. This was possible through frequent assessments of how well the incentives were working to motivate the behaviour the project intended via this PfR tool. Based on these regular assessments, the team recalibrated performance contracts and progressively lowered the level of subsidy provided.

## **Financing Initiative 3: AV Ventures** • a development agency-private sector catalytic initiative

### Activity

With the primary objective of providing better economic conditions for communities and generating social impact through greater inclusivity, AV Ventures, a subsidiary of ACDI/VOCA, is helping reduce poverty in Ghana by providing patient funding to agribusiness-related SMEs.[46] AV Ventures manages AV Ventures Ghana LLC, a $3.8 million blended fund launched through a $2 million grant facility from the US Department of Agriculture (USDA), which helped attract a further $1.8 million in commercial financing from the US International Development Finance Corporation (USDFC). The Fund deploys blended capital mainly to growth-stage SMEs in the form of mezzanine debt with a 3- to 5-year tenor.

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[45] United States Agency for International Development, *Financing Ghanaian Agriculture Project (FinGAP)—Final Report* (Washington, DC: USAID 2018), https://pdf.usaid.gov/pdf_docs/PA00TCM4.pdf.
[46] ACDI/VOCA, AV Ventures (2022), https://www.acdivoca.org/about/affiliates/av-ventures.

Deal sizes range between $250,000 and $700,000. However, agribusinesses that require less than the minimum size can benefit from partner financial institutions through the Fund's on-lending strategy. The Fund lends to partner financial institutions to on-lend to micro borrowers in the poultry and grain value chains who require less than $5,000. AV Ventures charges a competitive but below-market interest rate that is having a catalytic effect. Yet with a rate of return (ROR) typically of around 10 percent, it enables businesses to thrive.

### Outcomes

Footprints of the impact of AV Ventures and ACDI/VOCA are visible in the Ghanaian agriculture sector. ACDI/VOCA recently implemented two projects in the poultry and grain value chains: the Ghana Poultry Project (GPP) and Ghana Agricultural Development and Value Chain Enhancement II Project (ADVANCE II). GPP, a $16 million USDA-funded project, was instrumental in improving the competitiveness of the poultry value chain. AV Ventures has managed to sustain its portfolio companies by providing direct post-investment support to these companies to manage the shocks of the COVID-19 pandemic. AV Ventures continues to leverage ACDI/VOCA's significant experience in Ghana's agriculture sector to provide market linkage support and technical assistance to its portfolio companies in the grain and poultry value chains.

### Lessons

The case study underscores the fact that the unavailability of an appropriate risk guarantee is a challenge in financing agribusinesses in Ghana. Because of this, the Fund requires enough security or collateral cover to cushion it against significant credit risk. However, the primary challenge facing AV Ventures' portfolio enterprises is their exposure to forex risk, given that the funding provided to these companies is denominated in US dollars. The significant depreciation of the Ghanaian cedi against the dollar imposes a substantial burden on the cash flow of these businesses, who mostly generate their operating revenues and cash flow in cedis.

Because the cedi's volatility increases the forex risk exposure of agribusinesses with dollar-denominated loans, AV Ventures uses financial innovations such as revenue-based financing to try to share risk with borrowers. This was especially impactful during the pandemic because many businesses suffered reduced revenues and losses. The revenue-based loan structure, coupled with the patient nature of the capital deployed—a loan tenor of 3–5 years but subject to extension to meet agreed return expectations—provides borrowers with some loan repayment flexibility, which enabled them to better respond to the severe impact of COVID.

To minimise the impact of forex risk on the Fund, AV Ventures prioritises businesses whose operating business models enable them to earn foreign currency revenue through exports because this can position them to better absorb currency depreciation-related losses. This means that even though an agribusiness may have significant social impact potential, its inability to absorb forex risk could make it unattractive to the Fund.

Additionally, AV Ventures' ability to sell the idea of royalty-based loans to prospective borrowers has provided agribusinesses with an alternate financing structure they can weigh against the financing structure typically deployed by traditional banks. This is an example of a systemic change introduced in the financing of SMEs in Ghana.

Finally, the blended nature of the Fund has enabled AV Ventures to pursue a capital preservation strategy. But aside from the structure of the Fund itself, the expertise and quality of its investment team have emerged as major contributors to its success.

## Financing Initiative 4: Fidelity Young Entrepreneurs Fund • a catalytic capital bank product

### Activities

The GHS10 million ($1.7 million) Fidelity Young Entrepreneurs Fund (FYEF), launched by Fidelity Bank in 2021, supports impact-oriented SMEs owned or run by young people—with special attention on women-led and green businesses. The fund has a 50–70 percent guarantee cover from GIRSAL for agricultural loans, with women SMEs eligible for up to 75 percent cover. Beneficiary SMEs need to have been in operation for two years and can draw up to GHS200,000 ($50,000) at a 10 percent interest rate for a tenor of up to 3 years, with no collateral. So far, FYEF has disbursed GHS2.7 million to 32 SMEs (63 percent women-led) in agriculture, food services, health services, light manufacturing, education, fashion, transportation, water sanitation, and hygiene, and technology, including a jewellery manufacturer, an agro-processing company, a gas supplier, a leather goods and shoe manufacturer, and an animal feed producer.[47]

### Outcomes

Portfolio SMEs make about 40–50 percent return on investment. Two investees have leveraged FYEF's technical assistance to raise third-party funding. One of them, after securing funding of $50,000 from FYEF, has raised another $250,000.

### FYEF's success factors

- Technical assistance that builds the SME's managerial capacity through investment guidance, including cash flow management and registration guidance, minimizes poor decision-making and the possibility of developing a take-for-granted mindset that sometimes comes with accessing concessional capital.
- Low-cost loans with moderately long tenors give the SME room to work with the money without the stress of repaying high interest within a short span.
- Instead of direct money to the SME, FYEF makes disbursements to the vendors for the services the SME needs, minimizing diversion of capital.
- FYEF helps SMEs struggling to sell their products with market linkages, including sponsoring their participation in fairs.

### Challenges

Slow disbursement, forex risk. FYEF plans to start monitoring and evaluating investees' investment activities at the enterprise level, but currently does not because of the costs of M&E.

[47] Fidelity Bank, ***Fidelity Bank empowers young entrepreneurs***, press release (March 10 2021), https://www.fidelitybank.com.gh/news/371-fidelity-bank-empowers-young-entrepreneurs.

# VI. Beneficiaries of Catalytic Capital: Six Case Studies

Section 7 looks at six case studies on beneficiary SMEs and impact ventures that received catalytic funding. Each highlights the nature of the investment (instrument type, deal size and sectoral focus) and the outcomes of that investment. Some cases have been anonymised.

## Beneficiary Case Study 1: Golden Flakes Cereals

| | | | | | | |
|---|---|---|---|---|---|---|
| **Enterprise size pre-investment** | **small size** | | medium size | | large enterprise | |
| **Concessions** | **price** | **purpose** | **patience** | pledge | position | |
| **Lifecycle stage** | early stage | **growth stage** | maturity | rejuvenation | | |
| **Investment role** | seeding | | **scaling** | | sustaining | |
| **How SME used the investment** | **scale up** | facilitate innovation | safeguard its mission | **help build a track record** | signal impact potential | leverage more investment |
| **Outcomes** | **increased productivity** | **higher revenue** | **more jobs** | **adoption of climate-smart practices** | **better access to inputs** | **stronger SME-farmer business relationships** |
| **Outcome factors** | **concessions** | **accepting client in-kind payments** | **an integrative value chain** | **client trust due to business model transparency** | **technical assistance** | |

In 2020, Royal Holdings (fictionalised name), an agribusiness blended finance fund, provided a $500,000 long-term loan to Golden Flakes (fictionalised name), a medium-size producer and aggregator of cereals in Ghana. Golden Flakes integrates smallholder farmers into its supply chain by providing them with farming inputs, training, and mechanisation services which are key constraints inhibiting the farmers from expanding their production, in exchange for their produce at harvest. The investment supported Golden Flakes to scale its operations by expanding to Ghana after proving the commercial viability of its business model in another West African country. Although Golden Flakes had a strong potential to deliver high social impact, it needed a flexible investment structure to improve its overall financial viability and position to deliver high financial returns. Royal Holdings' investment is built in a self-liquidating royalty-based structure to align and share risks with Golden Flakes (please refer to Table 1 for further details).

**Table 1: Indicative terms of the loan**

| Term | Description |
|---|---|
| Amount | $500,000 |
| Year of investment | 2020 |
| Type of loan | Long-term royalty-based loan |
| Purpose | Scaling by supporting the company to expand into a new geographical area |
| Tenor | 5–7 years, subject to company meeting the agreed Total Obligated Amount |
| Moratorium period | 18 months |
| Repayment frequency | Quarterly |
| Interest rate | 5% p.a. |
| Security/collateral | Charge on floating assets (receivables, inventory, and cash) and not on physical assets or landed properties of the borrower |
| Royalty rate | 1.5% of the company's annual revenue |
| Targeted money multiple | 1.5x over the duration of the loan |
| Total Obligated Amount * | $750,000 over the duration of the loan but subject to extension by 2 years. Total financial return to the Fund is capped at Total Obligated Amount |
| Realised proceeds as of June 2022 | $160,000 representing 21% of the Total Obligated Amount |

*** Please note that the Total Obligated Amount includes the total amount of loan principal, interest, royalty and redemption premium expected to be received over the duration of the Loan.**

The concessional terms of the loan to Golden Flakes have enabled Golden Flakes to replicate its successful operating model and gain traction in Ghana. The funding by Royal Holdings improved Golden Flakes' credibility, risk-return profile, and visibility to other investors, which in turn led to an additional inflow of nearly $2 million from other initially hesitant investors. Royal Holdings' fund blends commercial and concessional capital from investors who have different risk-return expectations, thereby helping to mitigate both the real and perceived risks of other investors. This blending enabled it to price the loan to Golden Flakes at a concessionary interest rate.

| Indicator | Target* | Baseline** | Current situation*** |
|---|---|---|---|
| Income | $2 million | $200,000 | $500,000 |
| Production (metric tonnes) | 5000 MT | 650 MT | 1390 MT |
| Employment (direct jobs) | 150 | 7 | 50 |
| Access to inputs and markets | 3000 | 190 | 1358 |
| Number of communities reached | 50 | 5 | 36 |
| Number of farmers adopting climate-smart agricultural practices | 2000 | 20 | 800 |

* **Over the duration of the funds' investment**
** **Before the funds' investment**
*** **As of June 2022**

The additional capital raised by Golden Flakes has enabled it to expand to new geographical areas in Ghana to achieve greater social impact outcomes, especially the following:

- It has fostered stronger commercial relationships and partnerships between Golden Flakes and smallholder farmers in its network, resulting in improved incomes for the farmers. The farmers, predominantly women and youth, have collectively earned more than $500,000 through off-taker contracts over a period of one year after the Fund's investment, compared to $200,000 for the same period before the investment—an income increase of 150 percent from the baseline amount.

- Smallholder farmers in the cereal producer's network have increased their volume of grain production from 650 MT before the investment to 1,390 MT after, about 114 percent. The increase is driven by positive spillover effects such as improved agronomic practices, increased yields, and better land use as the farmers continue to gain more experience and leverage the knowledge and technologies they are learning from Golden Flakes.

- The number of farmers with improved access to training, inputs, mechanisation services and markets has risen—from 190 before investment to more than 1,358 since—an increase of 614 percent.

- Golden Flakes has generated 50 direct-employment jobs (and approximately 300 temporary jobs) since Royal Holdings' investment compared to just 7 direct jobs before the investment, an increase of 614 percent.

- The number of rural communities with out-grower farming schemes has risen from 5 before the injection of fresh capital to 36 since—an increase of 620 percent. This is the result of improved access to training, inputs, mechanisation services, and markets for the farmers in these rural communities. It has improved their livelihoods and enabled their transition from subsistence to commercial agriculture.

- Golden Flakes and its network of farmers are adopting climate-smart agricultural practices. More than 800 farmers in the network are using regenerative farming methods such as zero tillage and conservation agriculture since the Fund's investment compared to 20 farmers before—an increase of about 40 times the baseline case. This is leading to systemic change in land use and agricultural practices in parts of Northern Ghana.

Royal Holdings' investment provided additionality by strengthening the capacity of Golden Flakes to deliver social outcomes that would otherwise not have occurred any time soon. Furthermore, the Fund's investment has not resulted in any adverse outcomes such as distortions of prices and markets because the transaction was structured to provide commercial-level returns in spite of the concessional terms provided to Golden Flakes. Royal Holdings also introduced financial innovations such as royalty-based loans that are better suited to the needs of early- and growth-stage SMEs that have strong growth prospects but are less likely to appeal to commercial investors seeking market-rate returns.

## Beneficiary Case Study 2: Digi Online Trading Platform for Smallholder Farmers

| | | | | | | |
|---|---|---|---|---|---|---|
| **Enterprise size pre-investment** | **small size** | | medium size | | large enterprise | |
| **Concessions** | **price** | **purpose** | patience | **pledge** | position | |
| **Lifecycle stage** | early stage | growth stage | maturity | rejuvenation | | |
| **Investment role** | seeding | | **scaling** | | sustaining | |
| **How SME used the investment** | **scale up** | facilitate innovation | safeguard its mission | **help build a track record** | signal impact potential | leverage more investment |
| **Outcomes** | **increased digital trading of crops** | **deepen digital inclusion of women** | **more jobs** | **financial inclusion of farmers** | **better access to inputs** | **third-party investment** |
| **Outcome factors** | **concessions** | **an integrative value chain** | **platform's ease of use** | **client trust due to business model transparency** | **Ghanaian's increasing familiarity with digitization** | **technical assistance** |

In 2021, the Onyx Crown Fund (fictionalised name) provided a bridge loan of approximately $250,000 to Digi, a digital marketplace platform. Digi has developed an innovative online platform that facilitates access to markets and financial services for smallholder farmers. The bridge loan from Onyx Crown provided Digi with the working capital it needed to increase its volume of crop purchases, mainly from smallholder farmers, at transparent and fair market prices through its digital platforms. The loan was priced below market rate, with a flexible repayment schedule and no collateral requirements (please refer to table 1 for further details).

**Table 1: Indicative terms of the loan**

| Team | Description |
|---|---|
| Amount | $250,000 |
| Year of investment | 2021 |
| Purpose | Sustaining by supporting the working capital needs of the Company |
| Type of loan | Short-term bridge loan |
| Tenor | 24 months |
| Moratorium period | 12 months |
| Repayment frequency | Quarterly |
| Interest rate | 10% p.a. |
| Security/Collateral | No security |
| Redemption premium rate | 10–25% of outstanding principal subject the occurrence of a liquidity event |
| Targeted money multiple | 1.2x over the duration of the loan |
| Total Obligated Amount | $300,000 over the duration of the loan |
| Realised Proceeds as of June 2022 | $125,000 representing 41% of Total Obligated Amount |

The loan was structured as part of a Pre-Series A investment round with other participating international institutions including Shell Foundation, Rabo Foundation, and the United Kingdom's Foreign, Commonwealth and Development Office. These international philanthropic capital providers offered a partial first-loss guarantee to Onyx Crown and other investors in Digi. The catalytic capital in Digi's capital stack enabled Onyx Crown to provide the bridge loan to Digi despite its slightly higher risk because of its early-stage status and limited operating history. The catalytic funding improved the company's credibility, risk-return profile, and visibility to other investors, and has led to additional private capital flow of close to $1 million to date from an international lender to support Digi's working capital needs. Before the Onyx Crown investment, Digi had relied primarily on grants to support its operational expenses, which inhibited its growth and commercial viability.

The investment by Onyx Crown has resulted in the following outcomes:

- About 16,820 smallholder farmers who sell grain to Digi have reported an increase on average of 35 percent in their incomes from better prices for their crops since the investment, compared to an average increase of 5 percent before the investment.

- Over a period of one year after the investment, Digi has paid a total of more than $400,000 directly to smallholder farmers since the investment compared to $100,000 over the same period of one year before the investment—an increase of 300 percent.

- Through its digital platform, Digi facilitated the trading of 5,370 MT of grain last year, grown by smallholder farmers, at market prices, compared to an average yearly trading volume of 1611 MT before the Onyx investment—an increase of 233 percent. This has increased the farmers' return on investment by 10 percent annually.

- The company's online platform has facilitated access to input financing from private commercial financial institutions of more than $1 million for the farmers since the investment, compared to more than approximately $143,000 before—an increase of 623 percent. This has enabled the farmers to access high-quality inputs at competitive prices, resulting in a 40 percent increase in crop yields compared to an average annual increase of 5 percent before the investment.

- Gender and social inclusion has improved: since the Onyx Crown investment, nearly 50 percent of the active users of the online trading platform have been women, compared to 20 percent prior to the investment—an increase of 150 percent. The digital services Digi provides along the cereals value chain have reduced the number of unbanked smallholders' farmers in Ghana and improved access to financial services for female smallholder farmers, who are often disqualified from services such as microloans because of their limited access to collateral.

- Since the Fund's investment, Digi has generated 20 new direct-employment positions (along with approximately 100 indirect jobs) across other segments of the value chain—logistics, transportation, and grain trading—compared to 7 new jobs prior to the investment, an increase of 186 percent.

## Beneficiary Case Study 3: Talents International Academy

| | | | | | | |
|---|---|---|---|---|---|---|
| **Enterprise size pre-investment** | small size | | **medium size** | | large enterprise | |
| **Concessions** | price | **purpose** | **patience** | pledge | position | |
| **Lifecycle stage** | early stage | **growth stage** | maturity | rejuvenation | | |
| **Investment role** | seeding | | **scaling** | | sustaining | |
| **How SME used the investment** | **scale up** | facilitate innovation | safeguard its mission | help build a track record | signal impact potential | leverage more investment |
| **Outcomes** | **improve school infrastructure** | **higher revenue** | **more jobs** | **higher female student population** | **third-party investment** | |
| **Outcome factors** | **concessions** | **increase cash flow due to equity structure** | **increased demand** | | | |

In 2014, Sylvan Capital Group (fictionalised name), a private equity firm, invested $9,000,000 in Talents International Academy (fictionalised name), a private K–12 educational institution in peri-urban Ghana with more than 1,000 students. The purpose was to enable the school to expand by developing additional infrastructure to meet growing demand.

The investment's preference shares structure gave Talents International enough time to construct the infrastructure and start generating revenue from the expansion without worrying about having to repay the principal during this period. Although the preference shares also came with a dividend requirement of up to 10 percent per annum, which resulted in some financial strain on internally generated cash flow, the student population—particularly girls—grew by more than 60 percent over the investment period. Direct employment rose by 50 percent as the school required more teaching and non-teaching staff. Revenue also grew at a compounded annual rate of 25 percent over the investment period, even though margins remained fairly constant over the period.

Sylvan Capital's investment also crowded in more than $3 million in additional debt investments to support the expansion. This was made possible because the investment's equity structure left Talents International with enough free cash flow to support additional debt repayments.

## Beneficiary Case Study 4: Sweden Ghana Medical Centre

| | | | | | | |
|---|---|---|---|---|---|---|
| **Enterprise size pre-investment** | **small size** | | medium size | | large enterprise | |
| **Concessions** | **price** | **purpose** | **patience** | pledge | position | |
| **Lifecycle stage** | **early stage** | growth stage | maturity | rejuvenation | | |
| **Investment role** | **seeding** | | scaling | | sustaining | |
| **How SME used the investment** | scale up | **facilitate innovation** | safeguard its mission | **help build a track record** | signal impact potential | leverage more investment |
| **Outcomes** | **negative return on investment** | **more jobs** | **bridge access to cancer care** | **cancer treatment skills developed domestically** | | |
| **Outcome factors** | **low patronage** | **servicing of a high interest parallel loan from bank** | **forex risk** | **high costs of initial expat-heavy staff** | | |

With cancer a major global burden—Global Cancer Observatory's GLOBOCAN 2020 estimated that there were about 441,958 new cancer cases and 164,930 deaths in West Africa.[48] Sweden Ghana Medical Centre (SGMC) was set up in 2007 as a collaborative effort by the Swedish Government and a group of investors to help combat cancer in the Global South.[49] It is the first and only dedicated provider of cancer care in Ghana, serving as a substitute to patients otherwise obliged to seek treatment in other countries outside the country. Swedfund contributed $3.7 million, representing 98 percent of the deal, with the remaining 2 percent (a $760,000 convertible debt) coming from Fidelity Capital through the VCTF-seeded Fidelity Equity Fund II. Both investments were patient, spanning over a 10-year period, as well as flexible, involving both convertible debt and redeemable equity. Additionally, the interest rates—10 percent from Fidelity Capital, 12 percent from Swedfund—were below market rate.

### Outcomes and Lessons

Although profitability has been a challenge, the SGMC has seen encouraging growth in positive earnings before interest, tax and amortization (EBITA) since 2017. This was not the case in 2012–2016 because SGMC was servicing a loan facility acquired from a bank, coupled with low coverage that resulted in low patronage of the centre as a cancer treatment facility. Additional conditions contributing to the negative EBITA included staff expenses, particularly the expatriate team whose skill set the centre needed to run the facility in its initial operational stage.

The continual depreciation of the cedi was another challenge. When the loan facilities were procured, the cedi-to-dollar exchange rate was 1.2. At the time of exit the rate was 5.8, an enormous delta that negatively affected the interest to be paid on the loans.

SGCM has undoubtedly had a significant impact in the Global South. With a staff of 44, including 31 males and 13 females, the facility has treated more than 8,000 cancer patients at an annual average of 1,500 patients. SGCM continually organises free screenings for the public to determine their cancer risk levels. In addition, it has created employment opportunities and provided staff with skills training and professional development.

[48] International Agency for Research on Cancer, *Globocan 2018 Fact Sheet for Western Africa* (WHO, 2018), https://gco.iarc.fr/today/data/factsheets/populations/914-western-africa-fact-sheets.pdf.

[49] Sweden Ghana Medical Centre, *Management—European standards, African showcase for cancer care* (2022), https://www.sgmccancercentre.com/about-us/management.

## Beneficiary Case Study 5: Plato's Academy

| | | | | | | |
|---|---|---|---|---|---|---|
| **Enterprise size pre-investment** | small size | | **medium size** | | large enterprise | |
| **Concessions** | price | **purpose** | **patience** | pledge | position | |
| **Lifecycle stage** | early stage | **growth stage** | maturity | rejuvenation | | |
| **Investment role** | seeding | | **scaling** | | sustaining | |
| **How SME used the investment** | **scale up** | facilitate innovation | safeguard its mission | help build a track record | signal impact potential | leverage more investment |
| **Outcomes** | **improved educational infrastructure** | **increased return on investment** | **more jobs** | **increase access to education** | | |
| **Outcome factors** | **effective fee collection** | **sound financial management** | **strong leadership** | **congenial learning climate** | **investors' involvement in management & governance** | |

In 2011, Plato's Academy School (fictionalised name), received a combined initial investment of $900,000 in the form of convertible debt from Lahabare and Capital Leverages (fictionalised names), followed in 2013 by another $600,000, also as convertible debt. The investment started as quasi-equity but after COVID-19 emerged, it was converted into equity to cushion the business from the effects of the pandemic. The two investments were a pivotal turning point for the school. Now multiple branches, the schools provide pre-school to junior high education to 1,200+ students using an adapted form of the Montessori method. The school's intended impact is holistic, high-quality education to children of lower-middle-income parents in its neighbourhoods.

### Outcomes and lessons

The budding years (2011–2019) saw slow, steady growth, although generally lower than 15 percent. But starting in 2020, the rate of return exploded: 26 percent in 2020, 32 percent in 2021 and an expected 44.5 percent in 2022. Direct staffing has burgeoned from 30 in 2011 to 207 currently. With massive growth fuelled by the convertible debt investments, Plato's Academy has been able not only to create more employment but to increase its market visibility by setting up two new branches in Accra. However, with few outsourced services and a limited value chain network, it has had little impact on indirect employment.[50]

Factors contributing to Plato's Academy's success include the convertible debt and patient nature of the capital invested, which allowed the school to blossom over time. Additional factors are an effective fee collection system, blended with good financial management and the creation of a congenial learning climate under the leadership of an experienced finance and investment expert.

[50] Christopher Barnett, Edward Jackson, Peter O'Flynn, Hamdiya Ismaila, and Coleman Agyeyomah, *Understanding and optimising the social impact of venture capital: Three lessons from Ghana,"* African Evaluation Journal 6, no. 2 (2018), https://aejonline.org/index.php/aej/article/view/335/542#FN0014_335.

## Beneficiary Case Study 6: Mountain Crystal Water

| **Enterprise size pre-investment** | small size | | medium size | | large enterprise | |
|---|---|---|---|---|---|---|
| **Concessions** | price | **purpose** | **patience** | pledge | position | |
| **Lifecycle stage** | early stage | **growth stage** | maturity | rejuvenation | | |
| **Investment role** | seeding | | **scaling** | | sustaining | |
| **How SME used the investment** | **scale up** | facilitate innovation | safeguard its mission | help build a track record | signal impact potential | leverage more investment |
| **Outcomes** | **improved water production infrastructure** | **increased access to safe drinking water** | **more jobs** | **decreased administrative costs** | | |
| **Outcome factors** | **concessions** | **investors' involvement in management & governance** | **increased demand** | | | |

In 2018, Kalangu partners invested $7 million in Mountain Crystal Water, a producer of purified bottled and sachet drinking water, for infrastructural development: 50 percent equity and 50 percent in the form of a convertible quasi-debt at 12 percent interest. (Mountain Crystal had initially sought a 80:20 combination). The investment was intended to support Mountain Crystal's vision to provide Ghana and the West African sub-region with the highest-quality drinking water. It increased Mountain Crystal's asset valuation from $2.1 million to about $16.5 million and positioned it to project a revenue increase for 2022–2023 of between $20.6 million and $41.2 million from their Kumasi branch alone, a substantial leap over previous revenue.

The infrastructural upgrade has helped decrease administrative costs by 25 percent, increased employment by 25 percent, enabled Mountain Crystal to build new factories in two locations in the Greater Accra region, and expand its supply to other parts of Greater Accra where clean drinking water had been in short supply.

# VII. Key Findings and Recommendations

## Nine Core Findings

Before we get to the hard-fact findings, it would be helpful to step back and take a look at the big picture. In our study we found that, in the context of an emerging market such as Ghana, creativity and flexibility go a long way in unlocking SME financing. The most successful catalytic capital providers took time to understand the needs of the SMEs they were working with, and the commercial capital providers they wanted to draw in. In an economic and cultural context where the financing models that have traditionally worked elsewhere may not work nearly as well, the key is often to approach potential projects and opportunities with a good deal of pragmatism, flexibility and creativity.

The aim is to be open to your environment and adapt what you already know in order to create innovative, purpose-driven investment products that achieve an end result rather than fit a formula. SMEs who at first glance may appear to be unpromising candidates for delivering impact and financial returns can, given the chance, respond very positively to well-customised investment structure complemented with tailored support. Ultimately, significant commercial funding can be unlocked for SMEs to address the SME financing gap.

1. We identified 72 SME financing schemes between 2004 and 2021, valued at $1.73 billion. Of this, the capital actually invested in SMEs was $1.16 billion, of which almost all of it, $949 million, was catalytic capital. Over the 2004–2021 period, the financing volume steadily increased to about 5 times its initial rate. Third-party funding catalysed by the schemes for which data were disclosed (10 of them) totalled $552 million—about 5 times the value of the 10 schemes combined. We found that catalytic capital schemes enable 3rd-party investments roughly 3–7 times the initial investment in the SME—an important key to closing the SME financing gap.

2. **Sources:**[51] These catalytic investments were initiated by the private sector **(41%)**, DFIs **(34%)**, government **(21%)**, international development agencies, **(4%)**, and foundations **(1%)**.

3. **Forms:** Of the concessions the capital providers deployed, **63%** offered non-traditional terms tailored to the SME's needs (purpose); **42%** offered longer financing timelines (patience); **9%** used pledges, guarantees or risk insurance; **8%** offered concessionary pricing.

4. **Roles: 92%** invested to help the SME to scale; **55%** to sustain operations, **27%** to help seed an impact enterprise because of the degree of risk involved; **20%** to fund an innovative or unproven opportunity.

5. **Impact and outcomes were significant:** Many reported increasing revenue or return on investment by **25%** or more, increasing employment by up to **60%**, unlocking third-party investments **3–7** times the amount of the initial catalytic investment, and enabling underserved populations to access financing, improve their livelihoods, and learn important new skills.

6. What underlying choices drove these positive outcomes? In particular, longer investment tenors, using financial products such as convertibles, investment sizes that align well with the SME's needs, and funding at concessionary rates especially for early-stage businesses and enterprises located in, and led by members of, underserved populations.

7. Investments that unlocked 3rd-party investments were deliberate in using catalytic tools. Examples:

[51] For our study, comprehensively identifying actual sources of funding was not an easy task. In the end, we identified the institutions who designed and ran the initiatives.

VCTF took subordinated, first-loss positions in all its investee funds. FinGAP used pay-for-performance and other innovative features. AV Ventures made investments in SMEs to de-risk them to make them more attractive to commercial investors, and co-invested in SMEs with commercial capital providers.

8. As stated, creativity and flexibility go a long way in SME financing. The flexibility private equity/venture capital funds have to innovate around financing instruments may make them suitable to pilot innovative catalytic capital financing structures to work around some of the constraints SMEs face.

9. Although emerging-fund managers invest the smaller deal sizes SMEs look for, even managers with significant venture capital experience face challenges raising their first fund because prospective investors already want to see a track record of capital raised and portfolio of investments the manager has made from that fund. Structured support programmes could help.

## Five Ongoing Challenges

1. Some survey respondents felt (i) that catalytic capital can sometimes distort markets by giving some market participants special advantages in capital or information, and (ii) that the perception of easy money can induce lax due diligence or unneeded risk taking at some SMEs.

   The strategies catalytic capital providers employ to avoid negative outcomes include targeting underserved markets such are sectors or geographies with very little funding to avoid distorting existing well-funded sectors or geographies, using blended finance to crowd in commercial investors to co-invest with them, de-risking investments instead of providing a concessionary rate, connecting the SME to commercial funding sources, being accountable and transparent with their stakeholders, and—one of the most important—learning and adapting their vehicles and products to changing results and market conditions.

2. Catalytic Capital providers identified currency risk as the highest risk, partly a result of the significant depreciation of the Ghanaian cedi against international hard currencies in recent years. There is a need for affordable currency hedging solutions and for government to put in more effort to stabilise the currency.

   Additionally, our respondents identified three main gaps in the financing landscape:

3. There is too little catalytic capital working with innovative financing models that can deliver appropriate, cost-effective financing to SMEs.

4. Only 4 out of 10 catalytic investors engage in gender lens investing, and many of those—besides dedicated gender-specific funds—are gender-considerate rather than actually deliberate.

5. Underserved geographical areas such as the north of Ghana receive disproportionately low levels of funding despite the potential for significant social impact. There is an urgent need to build a pipeline of investment-ready SMEs in such areas.

## Four Opportunities

Some interesting opportunities that came up during the research are worth highlighting.

1. As of the end of 2020, the potential pool of local capital providers that could be leveraged for catalytic financing, when pension funds are included, is GHS22 billion ($5 billion). Another promising development is the launch of Development Bank Ghana (DBG) in 2021, which is expected to invest $600 million into SMEs through its beneficiary financial institutions and is a potential source of catalytic financing.

2. An estimated total of assets under management (AUM) of $50 billion is available from 60 private equity, private debt, and venture capital providers that have Ghana are one of the destinations they target, and which high-growth SMEs could leverage. This would require them to be investment-ready

and be able to deliver returns and impact as competitively as successful SMEs in other African countries.

3. An innovative Fund of Funds is being sponsored by Impact Investing Ghana that could unlock significant pension funding for investment into venture funds.

4. The VCTF is creating a Fund Managers Development Programme, which could include warehousing and other support for emerging fund managers. In addition, Impact Investing Ghana's dealsourceafrica.co platform has begun supporting fund managers to raise funding from limited partners.

## Six Actionable Recommendations

1. Catalytic capital can significantly increase financing for SMEs and the private sector, government, DFIs and IDAs should take action that increase the volume of catalytic capital and the number of financial intermediaries willing to work with it.
    - Private sector actors need to recognise the advantages of partnering with catalytic capital providers
    - Government programmes should disburse funding in ways that are transparent, and structure products to unlock third-party investments
    - Development finance institutions need to take on more risk and be catalytic by working with emerging fund managers, financing innovative funding vehicles etc.
    - International development funding should increase blended finance vehicle funds that actually deliver catalytic financing in addition to engaging in ecosystem building.

2. Ecosystem builders such as Impact Investing Ghana should partner with government and others to drive collaboration, increase capacity and develop a comprehensive strategy to significantly increase financing in key sectors and for underserved segments, and to draw catalytic investors into Ghana and track progress over time. These initiatives could include using a value-chain approach to work with underserved areas and groups such as northern Ghana, women, and young people. Another example could be mobilising catalytic capital to stabilise locally-managed, Tier 2 microfinance institutions, which focus on underserved populations. There is also a need for catalysing affordable foreign exchange hedging for local investors and supporting catalytic vehicles such as a fund of funds focused on unlocking local funding.

3. To increase the effectiveness of catalytic capital, providers of this kind of capital should design products that are likely to lead to positive outcomes and unlock third-party investments using lessons learned from this report to reduce the risk of negative outcomes.

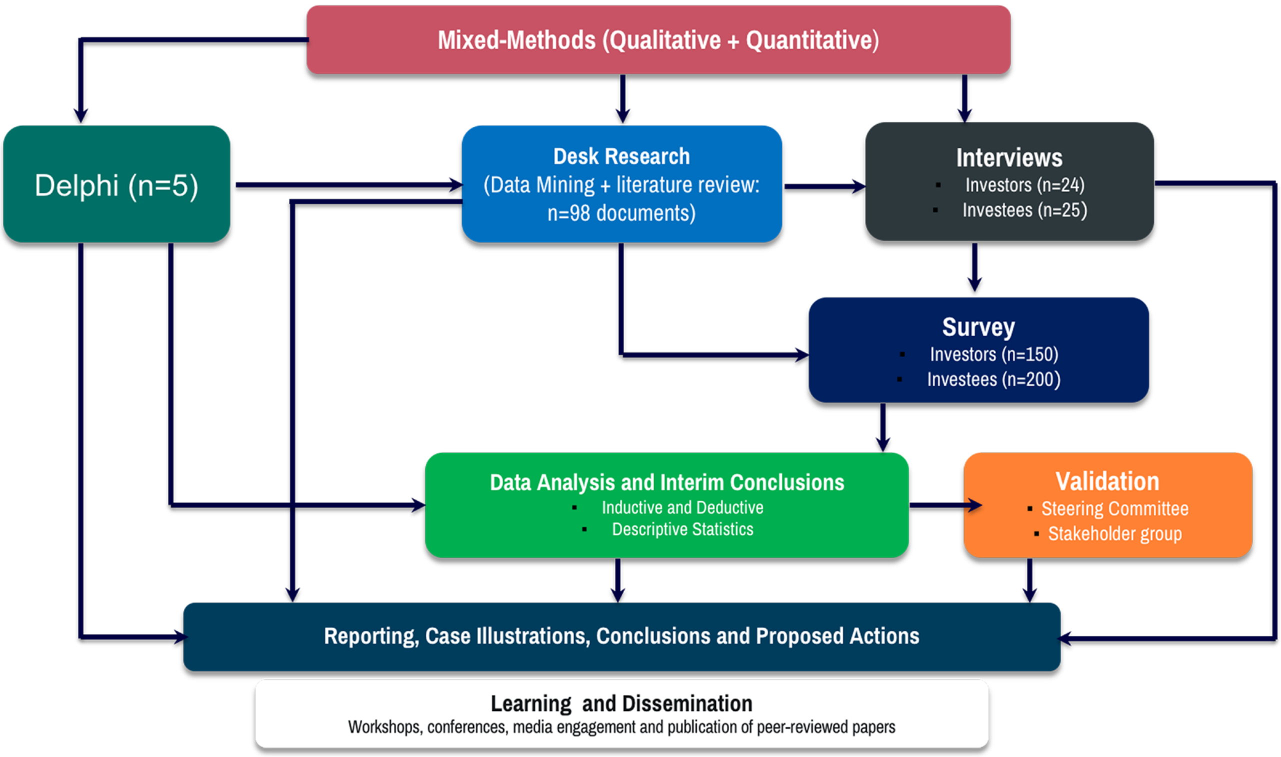
4. Catalytic capital providers should commit to strong impact measurement and management of catalytic financing vehicles, with clear baselines to enable verification of, and learning from, the third-party investments actually unlocked. They should also urge beneficiary SMEs to embed sustainability in their strategy and core operations using tools such as the UNDP SDG Standards for Enterprises.

5. To increase the demand for catalytic capital and the effectiveness of SMEs, there needs to be commensurate investments in technical assistance and transaction advisory work, including increasing the number of capital raise service providers and strengthening the quality of enterprise support.

6. A strong economy enables growth. The government needs to work on stabilising the economy to reduce inflation, interest rates and currency depreciation. Current action to improve the regulatory environment for private funds need to be completed.

# Appendix: Methodology

We approached this study using both qualitative and quantitative research tools for data curation, analysis, and reporting. We began with desk research and a review of peer-reviewed reports on SME financing, with a focus on catalytic capital investments dating back to 2004. That marks the date when the Venture Capital Trust Fund ACT, 2004 (ACT 680), a major policy initiative by the Government of Ghana to support the private sector, was enacted. The desk research was guided by the PRISMA (Preferred Reporting Items for Systematic reviews and Meta-Analyses) standard widely used in scientific reporting. The insights we gleaned enabled us to frame our study by identifying previous key learnings, which informed the design of our instruments for cross-sectional data collection.

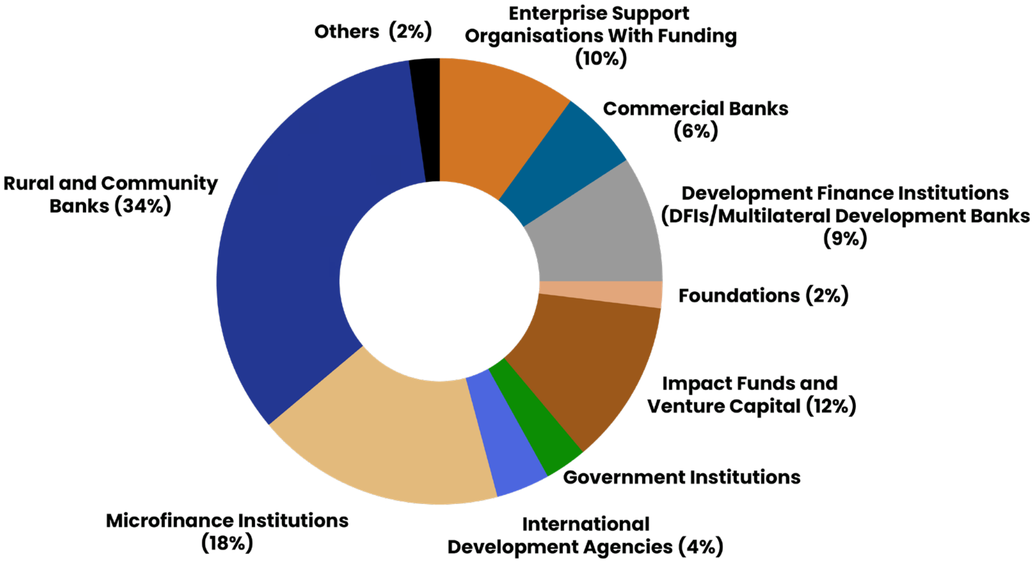



Subsequently, we conducted interviews with purposely selected catalytic investors—suppliers and intermediaries of funds ranging from development finance institutions and fund managers to microfinance companies and commercial, rural and community banks (figure 1). A second type of investor we interviewed were foundations, family offices, networks and development partners that provide capital for ecosystem-building, technical assistance, and blended finance. We additionally interviewed 25 beneficiary SMEs from various sectors and regions of the country, as well as experts with seminal knowledge and experience on SME financing in Ghana, including Sam Mensah of SEM Capital Advisors Limited, and Stephen Antwi-Asimeng of SAA Capital Limited.

We surveyed 164 randomly selected suppliers and intermediaries of funds (figure 1) and 200 beneficiary SMEs. We analysed 15 cases of catalytic financing initiatives, impact funds, and investments in SMEs and selected 10 of them for inclusion in this report. The outcomes of these investments and initiatives were assessed along three dimensions: additionality, impact, and returns on investment, comparing current measurement indices against baseline thresholds.

**Additionality** measures whether an intervention or funding brought in (additional) private sector participation that otherwise would not have occurred. **Impact** captures the intervention's contribution to sustainable socioeconomic, developmental or environmental benefits. **Returns** reflect the profitability of the investment.

Of the investors surveyed, rural and community banks **(34 percent)** and microfinance institutions **(18 percent)** dominated. Others included impact and venture capital funds **(12 percent)**, development finance institutions **(9 percent)** and commercial banks **(6 percent)**.




Profile of Survey Participants

## Methodology for Mapping Initiatives and Market Sizing

Accurately estimating the size of the catalytic capital market is vital; that is the primary metric that indicates the potential funds available to bridge the SME financing gap. Below we summarize the procedure we employed to estimate the size of the Ghanaian catalytic investing market and its funding activities. Briefly: for each supplier, we collected data on financing for SMEs and the portion of this that the supplier dedicated to catalytic financing (details below).

## Establishing the Universe of Catalytic Capital Investments in Ghanaian SMEs

We tracked SME financing initiatives from 2004 to 2021, noting those that could be classified as catalytic. Catalytic investments are an excellent indicator of funding efforts to narrow the financing gap for SMEs. The research steps were as follows:

- We used desk research through an online search and conducted interviews to identify 78 SME financing schemes, of which 63 were initiatives, programmes, and projects, and 15 were funds. We consulted various websites and databases of suppliers of funds and membership bodies—Ghanalinks, dev tracker, Aspen Network of Development Entrepreneurs (ANDE)— and the Ghana Agro-Processing Sector equity investment guide.[52]

- Of the 78 SME financing schemes, we subsequently identified 44 as catalytic capital investments: 29 initiatives, programmes or projects, and 15 funds. As a frame of reference for determining which SME financing schemes

[52] Investment Promotion in Agribusiness, *Ghana Agro-Processing Sector Equity investment and equity investors – a guide* (November 2021), https://impactinvestinggh.org/wp-content/uploads/2022/03/Ghana-Agrobusiness-Private-equity-guide-update-November-2021.pdf.

were or were not catalytic, we employed Tideline's definition of catalytic capital and the MacArthur Foundation's 5 concessions of catalytic capital: price, purpose, patience, pledges, and position.[53]

- For each initiative, we mapped a range of issues, including budget and sources of funds, by listing the names of funders and the sectoral focus. The financing sources helped to minimise possible duplication and double-counting.

- For initiatives for which we could not identify an investment amount, we did a further search for the amounts through online news content published about the transactions and, in other instances, interviewed representatives of the investors.

- For schemes that did not disclose their assets in US dollars, we used the dollar exchange rate on the date of the investment, or for investments for which we did not have a specific date of investment, 31st December of that year.

- We estimated the size of the Ghanaian catalytic capital universe by summing the total number of initiatives to determine the count of schemes, then totalled the amounts deployed for each initiative to determine the volume of funds.

- To aid further analyses, we categorised the schemes under five themes, and their possible combinations, based on which type of funder initiated the scheme: The categories were: Government of Ghana-led, development agencies-led, foundation-led, private sector-led and DFI-led.

## Exclusions, inclusions and conversional criteria

- To minimise the possibility of double-counting, we counted only final deals. This means that for the DFIs/MDBs and family offices, only direct deployments into SMEs or through financial institutions for SMEs were considered in the first stage, based on the available data we collected. At the second stage, we drilled down to capture their indirect investments through funds. Most fund managers publish the names of their portfolio SMEs, but most financial institutions do not.

- We included deals that involved grant capital in blended funds or for on-lending purposes.

- In determining what proportion of the volume of capital investments into SMEs is catalytic, we did not include components of catalytic funds dedicated to business development services and technical assistance or ecosystem building. We accounted for them separately.

## Quality Assurance Measures

We employed a series of quality assurance measures to check the quality and credibility of the data we used in our analysis, including:

- A steering committee that kept the research team accountable and guided the research process.

- Data collection tools reviewed by industry and academic experts for content.

- Saturation of views[54] and including varied ecosystem players guided sampling of respondents for both the survey and the interviews.

[53] Tideline, *Catalytic Capital: Unlocking more investment and impact* (2019), https://tideline.com/wp-content/uploads/2020/11/Tideline_Catalytic-Capital_Unlocking-More-Investment-and-Impact_March-2019.pdf.
[54] Benjamin Saunders, Julius Sim, Tom Kingstone, et al. "*Saturation in qualitative research: exploring its conceptualization and operationalization,*" Qual Quant 52, no. 4 (2018), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5993836/pdf/11135_2017_Article_574.pdf.

- Power calculation and random selection of respondents guided sample size estimation and selection for the surveys of investors and beneficiary enterprises.

- Use of a Computer-Assisted Personal Interviews (CAPI) mask for data collection. Digitally capturing the data reduced the probability of data-entry errors; several checks and logics were programmed to automatically reject wrong data entries.

- Use of co-enumerations, call-backs, and common method bias to verify data.

- Member checks: Verification of datasets and corresponding insights by the research team.

- Cohen's kappa statistic revealed an inter-coder/inter-rater reliability score of 0.637, suggesting optimal reliability across transcripts.

- Verification of interview transcripts and case studies by the organisations that participated in the study.

- Presentation of research results to a research stakeholder group, which provided feedback and insights.

## Limitations of the Methodology

Certain limitations should be borne in mind when utilising the evidence in this report to guide decisions or practice:

- Survey data were self-reported. This makes them potentially liable to false-positive bias, particularly the self-reported positive outcomes of catalytic investments.

- Assessments of some initiatives and case studies were based primarily on secondary reports.

- Case studies and illustrations were liable to our own team's selection bias.

- In our attempt to estimate the total universe of SME financing for the period under consideration, we could have missed some suppliers of funds, initiatives and deals.

- Although we went to strenuous efforts to control for double-counting, we cannot completely rule out the possibility.

Download the report and view online map at:

ghanainvestingmap.com