

Working together to design better funds

October 2020

Recommendations arising from the Working Group on Small and Medium Enterprise Fund Design

Abstract: Pacific RISE became aware of a number of organisations developing funds to support Pacific small and medium enterprises (SMEs) to respond to the COVID-19 crisis or have existing funds that they are pivoting to respond. Pacific RISE saw an opportunity to bring them together to share processes and findings in navigating this novel crisis. Pacific RISE convened a working group to share ideas and analysis on how best to provide financing to Pacific enterprises as they respond to, and recover from, COVID-19 disruption. The group identified opportunities to 'build back better' by providing appropriate and timely investment for enterprises; developing competitive, inclusive and resilient market systems; and strengthening agricultural value chains. Pacific RISE has distilled key recommendations for fund design in the brief below. An ongoing community of practice is expected to emerge from the working group.

The world's response to COVID-19 has profoundly affected national, regional and international markets by restricting the movement of goods and people. The crisis has severely disrupted Pacific economies, given the region's reliance on both exports and tourism. While the Pacific has proved resilient in the face of regular shocks, the global and extended nature of the current crisis poses unique challenges. Donors have been quick to mobilise resources, designing different types of funds and facilities to provide support.

From May to August 2020, Pacific RISE convened the Working Group on SME Fund Design for COVID-19 Response and Recovery in the Pacific, bringing together development organisations, investment intermediaries and business groups. Representatives of Pacific programs and enterprises ensured on-the-ground perspectives on the impacts of COVID 19.¹

The working group provided fertile ground for open and transparent discussion on the challenges and opportunities presented by the COVID-19 crisis, and the need for appropriate and timely financing that is focused on the needs of Pacific markets and SMEs.

The regular working group included 10 funds that are being designed to support SMEs in the Pacific. Participants shared information about how best to shift fund designs in light of COVID-19, explored ways to collaborate, and identified gaps in fund designs by analysing the financial vehicles through the lenses of gender and power dynamics.

An opportunity to 'build back better'

Through information sharing and analysis, the group determined that disruption caused by COVID-19 in the Pacific has highlighted:

- » an over-reliance of some Pacific countries on the tourism sector

- » the fragility of the Pacific's export markets, mainly due to the high price of airfreight without tourism to subsidise airline costs.

The COVID-19 response and recovery phase provides an opportunity for Pacific countries to 'build back better' by strengthening the region's agricultural sector and bolstering domestic markets through increased intercountry connectivity and import substitution.

The working group identified investment opportunities to build back better at three levels:

1. Supporting enterprises
2. Developing market systems
3. Strengthening agricultural value chains.

At each level, Pacific RISE has distilled recommendations arising from the working group discussions.

1. Supporting enterprises through appropriate capital investment

The COVID-19 crisis has caused massive disruption to Pacific enterprises. Rapid surveys indicate that roughly two-thirds of businesses in the Pacific have experienced a decline in revenue, with a large number forced to close or pause operations. Some enterprises are continuing to operate with significantly reduced or skeletal staff. Enterprises associated with the tourism sector have been immediately and severely affected. As a result, many enterprises and employees have moved from tourism to the informal sector, which has seen extraordinary growth.

In considering the design of funds, and assessing the most appropriate capital to support enterprises, the timing of investments emerged as a critical factor. The working group considered the most useful forms of capital during three consecutive phases of the crisis:

- » an immediate **response** phase requiring relief grants for enterprises
- » a subsequent **recovery** phase, which would stimulate employment growth and open up markets
- » a '**new normal**' phase, characterised by more business certainty and stable growth.

A majority of traditional investment capital will only finance the 'new normal', but donors have an opportunity to target the needs of different enterprises in the response and recovery phases through the design of funds (Table 1).

¹ See end of document for list of participants

Table 1: Needs of enterprises in crisis response, recovery and 'new normal' phases

N enterprise and/or household need **C** appropriate forms of capital **S** support services

	Response	Recovery		'New normal'
Position of enterprise	Provide immediate relief	Stimulate re employment	Open up markets	Invest in stability/growth
<i>Enterprises that are growing</i>	<ul style="list-style-type: none"> N Stable growth C Working capital S Planning for recovery phase 	<ul style="list-style-type: none"> N Stable growth C Investment capital, working capital S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Investment capital, working capital S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Investment capital S Choice of stability or growth
<i>Enterprises that are stable or experiencing small decline</i>	<ul style="list-style-type: none"> N Stability C Working capital S Planning for recovery phase 	<ul style="list-style-type: none"> N Stable growth C Working capital S Cash flow planning 	<ul style="list-style-type: none"> N Diversification C Trade finance S Explore new opportunities 	<ul style="list-style-type: none"> N Stable growth C Working capital S Establish business model
<i>Enterprises that are downsizing</i>	<ul style="list-style-type: none"> N Liquidity, employee support C Grant S Planning for recovery phase 	<ul style="list-style-type: none"> N Review business model C Working capital S Assessment of opportunities 	<ul style="list-style-type: none"> N Diversification C Trade finance, concessional debt S Planning for 'new normal' phase 	Not Applicable
<i>Enterprises that are on pause</i>	<ul style="list-style-type: none"> N Household and employee support C Grant S Warehousing and storage 	<ul style="list-style-type: none"> N Restart operations C Working capital, grant S Assessment of opportunities 	<ul style="list-style-type: none"> N Diversification C Trade finance, concessional debt S Planning for 'new normal' phase 	Not Applicable
<i>Enterprises that need to pivot</i>	<ul style="list-style-type: none"> N Household and employee support C Grant S Planning for pivot 	<ul style="list-style-type: none"> N Plan for restart C Seed capital S Assessment of opportunities 	<ul style="list-style-type: none"> N Restart operations C Revenue rights, concessional debt S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Working capital S Planning for recovery phase
<i>Enterprises that will close</i>	<ul style="list-style-type: none"> N Household and employee support C Grant S Support for closure 	<ul style="list-style-type: none"> N Plan for restart C Seed capital S Assessment of opportunities 	<ul style="list-style-type: none"> N Restart operations C Revenue rights, concessional debt S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Working capital S Planning for recovery phase
<i>Informal sector (unregistered)</i>	<ul style="list-style-type: none"> N Household support C Grant S Planning for recovery phase 	<ul style="list-style-type: none"> N Supply chain liquidity C Working capital (microloan), grant S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Working capital S Planning for 'new normal' phase 	<ul style="list-style-type: none"> N Stable growth C Working capital S Support for stability

Enterprises have not remained static during the response phase. Many are moving between different positions – for example, from downsizing to pause to pivot or closure. In such circumstances, finance needs to support restructuring. For example, Business Link Pacific is designing an SME financing facility for the New Zealand Ministry of Foreign Affairs that will provide grants and concessional working capital to support enterprises to pivot or diversify their business model. This facility will also offer local business advisory support alongside capital. BLP is also launching

a “Finance Finder” application, an online finance market place that will provide information on the availability of SME specific loans and finance throughout the Pacific.

However, the working group also noted it’s still uncertain what the 'new normal' will look like, and when this phase will begin. This lack of market intelligence makes it difficult to plan for the future. In research conducted by ygap for the Scaling Frontier Innovation program, enterprises noted their hesitation to take on debt, given the uncertainty and inability to make reliable forecasts.²

² ygap (2020), 'Impact of COVID-19 on the Scaling Frontier Innovation program network in the Pacific'.

Eventually, markets will reopen, and entrepreneurs who had to close their business or pivot to new models will need seed capital for the recovery phase. They will also need support to assess the potential for enterprises to restart or pivot. The working group identified a gap in finance that was specifically tailored to the needs of Pacific women entrepreneurs who need to reposition their businesses.

Research conducted by Brightlight Impact Advisory during the design phase of its Invest Pacific fund found that Pacific communities and governments see the most appealing investment opportunities as those that:

- » increase women's participation in the economy
- » support agricultural value-adding
- » generate employment for disadvantaged communities.

To kick-start the recovery of Pacific enterprises, donors will need to work with Pacific partners to identify opportunities for guarantees, invoice financing, trade financing and other risk-sharing instruments. The focus should be on businesses that support stability and resilience, rather than a focus on growth models favoured by traditional finance vehicles.

Recommendations

- » Finance risk-sharing instruments and mechanisms for enterprises through non-traditional channels that do not rely on debt.³
- » Establish a fund (ideally a gender fund) to support recovering Pacific enterprises with:
 - seed funding for experienced entrepreneurs who had to close or pivot their business – particularly women entrepreneurs
 - working capital to kick-start operations for businesses that had to pause operations
 - concessionary capital for stable and resilient businesses.
- » Provide non-financial support for both enterprises and fund managers to better engage with capital during a crisis.

2. Developing competitive, inclusive and resilient market systems

Market systems consist of value chains that interact with households and other systems, such as ecosystems and education systems (Figure 1). Enterprises respond to crises in the broader context of market systems – for example, by moving across value chains or between the formal and informal sector. The COVID-19 situation has highlighted the importance of developing market systems.

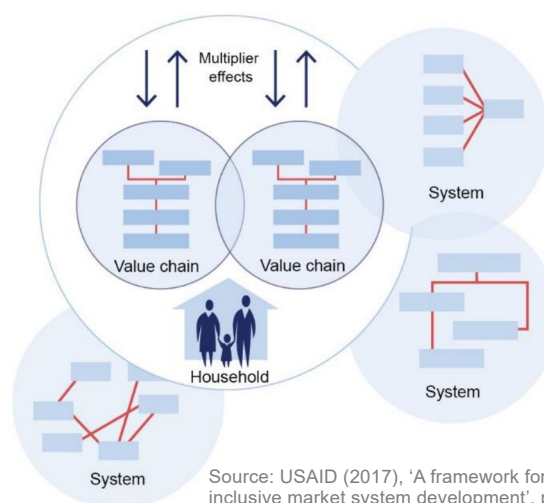
USAID defines three objectives of market system development:

- » **Competitive** – A competitive market system allows actors to effectively innovate, upgrade, and add value to their products and services to match market demand

- » **Inclusive** – An inclusive market system delivers sustainable benefits to a range of actors, including the poor and otherwise marginalised, and society as a whole; and
- » **Resilient** – A resilient market system enables actors to address, absorb, and overcome shocks in the market, policy environment, resource base, or other aspects of the system.⁴

All three objectives are linked, as inclusive market systems are also more resilient and more competitive in the long term. Within market systems in the Pacific, households – particularly women – have played a critical role in resilience to the COVID-19 crisis.

Figure 1: Market system interaction with households and other systems



Source: USAID (2017), 'A framework for inclusive market system development', p. 2.

The working group acknowledged the importance of building up market systems in the Pacific, as enterprises are often significantly impacted by market system failure. Finance can play a role in supporting recovery by addressing market failure or challenges. In particular, providing finance for the agricultural sector is critical at a time when agricultural value chains are supporting many enterprises and households through the crisis, following severe restrictions in the tourism value chain.

Recommendations

- » Engage investors through a vision of the Pacific's future to help address uncertainty.⁵
- » Finance infrastructure investments to strengthen local trade, including through e commerce, domestic marketplaces and informal economies.
- » Finance reskilling and training to strengthen households as they move dynamically across value chains.
- » Finance research and market intelligence to guide enterprises and investors in predicting the 'new normal'.

³ Pacific RISE is exploring such instruments and mechanisms through the menstrual health trade finance vehicle and investigating how this could be adapted to other sectors. Due to their small size and geographic spread, Pacific menstrual health producers face particular market challenges, such as the inability to access competitively priced materials.

⁴ United States Agency for International Development (USAID) (2017), 'A framework for inclusive market system development', Leveraging Economic Opportunities Brief, p. 1.

⁵ Pacific RISE is talking with Pacific networks, gender-focused organisations and investors about the Pacific RISE investment thesis (designed in 2018) and the opportunity to 'build back better'.

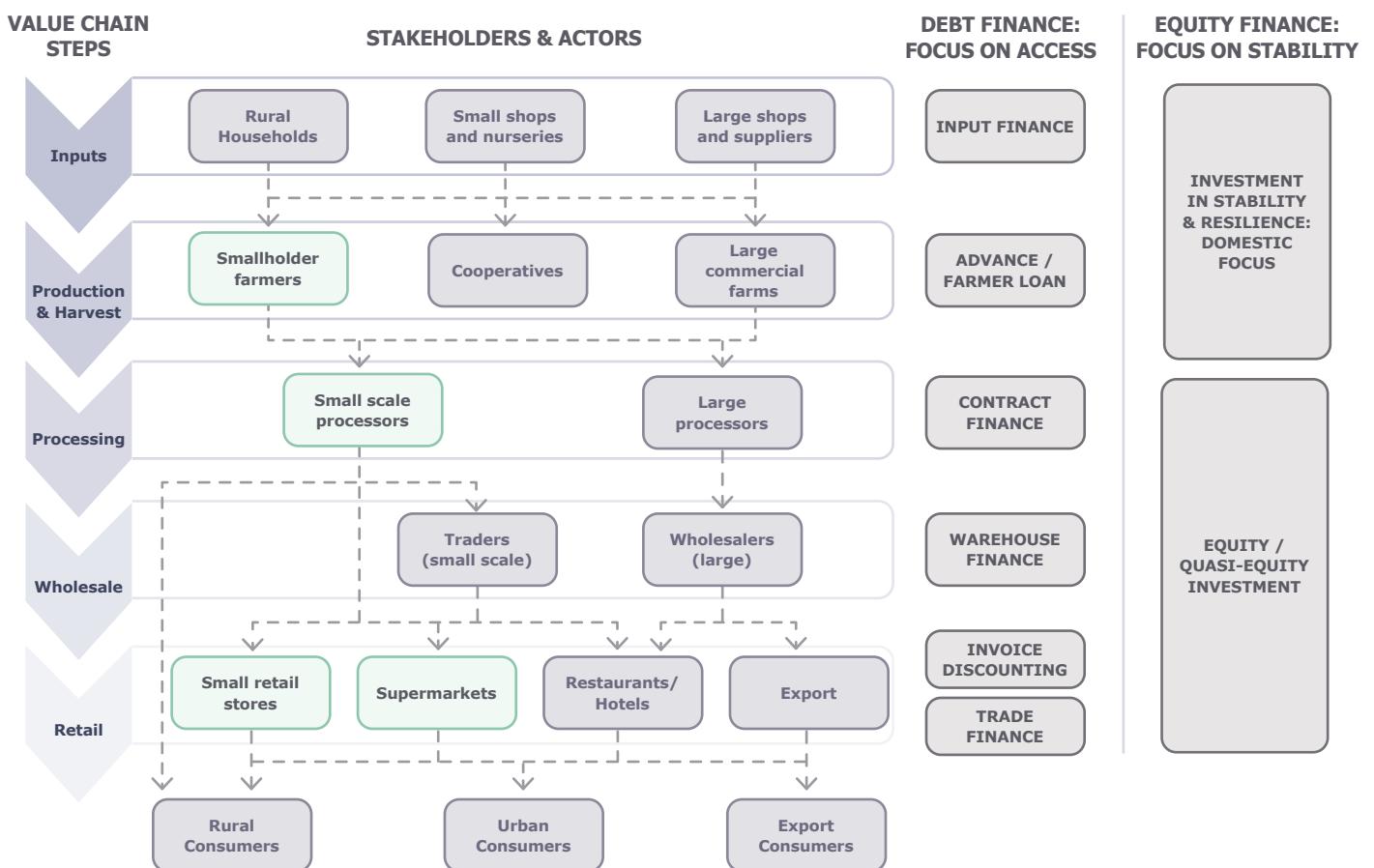
3. Strengthening agricultural value chains

As noted above, the working group identified agricultural value chains as a critical investment opportunity. The COVID-19 crisis has led to reverse migration in the Pacific, with a number of workers who were previously engaged in tourism moving back to their villages and working in agricultural cultivation and production, thus boosting the rural economy. Domestic markets have thrived as a result, with informal markets playing a critical role. Some Pacific countries have seen a notable return to barter in the absence of cash flow.

In these growing informal markets, women in particular are selling seedlings and planting food and fibre crops. The increased production is leading to oversupply and a reduction in prices – good for households, but not for enterprises in the sector.

In a typical agricultural value chain, smallholder farmers, small-scale producers and processors, small retail stores and informal market sellers will find it difficult to access financial products. The working group identified an opportunity to increase financial access at every stage of the value chain, through products such as input finance, advances for harvest, invoice discounting and warehouse finance (as illustrated in Figure 2).

Figure 2: Financing opportunities in the agricultural value chain



*green boxes indicate value chains with a higher proportion of women

Source: Adapted from CARE/MEDA (2017), Market Analysis and Value Chain Project Design e-course.

Risk sharing is a critical consideration when designing COVID-19 recovery funds for Pacific SMEs, as most of the recovery capital in the broader economy will be administered through formal channels and financial structures that inherently favour large-scale enterprises in the formal sector. Given the current uncertainty, smallholder farmers and small-scale producers are hesitant to take on additional debt, so financial products need to be structured as risk-sharing instruments linked to revenue for repayment.

In Fiji, for example, Good Return is looking at where it can support agricultural value chain financing by engaging the informal sector in Fiji's formal economy. Good Return is contextualising its impact investment model and developing partnerships with Financial Service Providers (FSPs), agricultural organisations, and others to adapt to suit the local climate whilst supporting job creation especially for women. Good Return will undertake gender analysis across its work and support FSPs to undertake institutional gender analysis to demonstrate improved gender practices in its institutions, including their products and services.

Some of the larger hotel chains in Fiji have shown interest in supporting employees with retraining and to start small agricultural businesses. This will benefit the hotels by strengthening their supply chains for agricultural products once the tourism sector bounces back. Pacific RISE is looking at opportunities to coordinate with tourism businesses and to support the work of the Fiji Business Disaster Resilience Council.

Recommendations

- » Provide specific agricultural finance for:
 - inputs to enhance agricultural production at the earliest stage
 - working capital in agricultural value chains, using invoice finance and trade finance
 - storage solutions through both capital expenditure and working capital
 - improving value-added processing, including investment in processes to prolong the shelf life of agricultural produce.

Developing a community of practice

Pacific RISE is reflecting on how the working group discussions can support the design of the finance vehicles it is funding, such as Good Return's Impact Investment Model and Social Impact Fund, the Pacific Business, Sport and Entrepreneurs (PBSE) diaspora fund, and the menstrual health trade finance vehicle.

At the same time, Pacific RISE is continuing to collaborate with other organisations to address some of the gaps identified in the design of other finance vehicles, and is exploring ways to share information with donors, national governments, chambers of commerce, and business associations.

As the COVID-19 crisis continues to evolve, the working group is also expected to evolve into a community of practice that will continue to collectively examine fund design through the lenses of power dynamics and gender.

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