ACCELERATING ENTREPRENEURS

Insights from USAID's Support for Small and Growing Businesses

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EXECUTIVE SUMMARY

Entrepreneurs drive economic growth, job creation and innovation worldwide. However, many critical barriers limit them from reaching their full potential, including access to financing networks, market information, business development services and market infrastructure. These entrepreneurs find themselves in the "pioneer gap"—too big for seed funding, but too risky for traditional investment.

The U.S. Agency for International Development (USAID) aims to unlock the potential of entrepreneurs by taking a systems-change approach to closing these gaps. USAID works with intermediaries, investors and other donors to improve entrepreneurial ecosystems, while also supporting individual entrepreneurs and ecosystem-focused learning initiatives.

USAID's Partnering to Accelerate Entrepreneurship (PACE) Initiative aims to catalyze private sector investment into early-stage enterprises and help entrepreneurs bridge the pioneer gap—thus unlocking the potential of thousands of promising enterprises around the world. Working in partnership with more than 40 incubators, accelerators and seed-stage impact investors, USAID creates public-private partnerships dedicated to testing ways to help entrepreneurs overcome barriers to growth. These partnerships are expected to leverage $145 million[1] in combined public and private investments over their lifetime.

FIGURE 1: PACE-supported SGBs by region.

1 All dollar figures in this report refer to US Dollars.

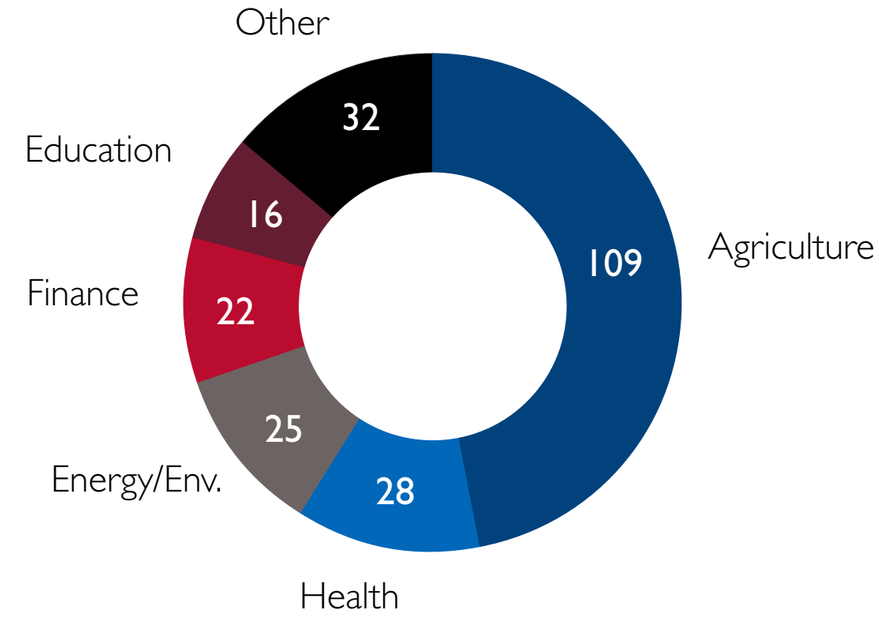
OBJECTIVES & METHODOLOGY

To better understand how working with intermediaries supports entrepreneurs around the world, USAID conducted a mid-term strategic review of the PACE Initiative.[2] The review drew on qualitative and quantitative information from 17 intermediaries that received funding from USAID between 2014-2017. These intermediaries provide coordinated technical assistance and/or financing to more than 800 small and growing businesses (SGBs) across at least 13 sectors and 27 countries.[3] PACE-supported intermediaries ("PACE intermediaries") are still in the process of implementing their activities.[4]

The report provides three kinds of insights:

- How different types of intermediaries contribute to the growth of the firms
- How to assess the efficiency of investments into intermediaries
- The extent to which intermediaries can realize financially sustainable business models

FIGURE 2: PACE-supported SGBs by sector.



2 The PACE Initiative began in 2013 and funding for current grants ends in 2020.

3 This report uses the Aspen Network of Development Entrepreneurs (ANDE) definition for SGBs: commercially viable businesses with five to 250 employees that have significant potential and ambition for growth.

4 The 17 intermediaries included in the Strategic Review are Catalyst for Growth, Edge Growth/ASISA Fund, Enclude, Intellecap, Investisseurs & Partenaires, Jibu, MCE Social Capital, Open Capital Advisors, Root Capital, Shell Foundation with Factor (E) and Sangam Ventures, the IIX Foundation, Unitus Seed Fund, Village Capital, Villgro, and Yunus Social Business Uganda.

This strategic review aims to inform the decisions of public funders, private investors and policymakers who are interested in working with intermediaries in entrepreneurial ecosystems.

HOW DO INTERMEDIARIES AFFECT SGB PERFORMANCE?

There is compelling evidence that PACE intermediaries successfully identify and serve growth-oriented firms. While more time and data are required to fully assess the degree to which SGBs' growth can be attributed to intermediaries, SGBs supported by PACE intermediaries increased revenues by 68 percent and jobs by 77 percent in a one-year period.[5] This growth exceeds OECD and Bureau of Labor Statistics benchmarks for high-growth firms.

Beyond direct support to SGBs, PACE intermediaries strengthen the ecosystems in which SGBs operate. Intermediaries contribute in different ways to at least six of the eight defining features of an entrepreneurial ecosystem—business support, markets, finance, policy, human capital and research and development.[6]

SGB performance differs considerably across PACE intermediaries. Several patterns shed new light on how intermediaries might affect SGB performance.

- **Women-led SGBs working with PACE intermediaries significantly outperform their peers, growing revenues 1.5 times faster and jobs twice as fast.** Yet, despite owning faster-growing businesses, women do not raise significantly higher amounts of capital.
- **SGBs working with intermediaries that primarily provide equity investment see 1.5 times faster revenue growth than SGBs** that work with debt-providing intermediaries or intermediaries that broker capital from other sources.
- **SGBs that receive shorter, less individualized technical assistance—such as cohort based, time-bound incubators and accelerators—demonstrate an average revenue growth over two times and job growth over one-and-a-half times that of other SGBs.** These other SGBs work predominantly with intermediaries providing more in-depth and customized training.
- **Entrepreneurs operating in more robust entrepreneurial ecosystems fare better than those in less developed ecosystems.** American and South Asian SGBs supported by PACE intermediaries achieve about double the revenue growth (2.6 and 1.7 times higher, respectively) compared to the portfolio average of 68% per year.

5 Job and revenue change figures are calculated by estimating the weighted annual average growth rate in SGB jobs and revenues for each intermediary individually, weighting each intermediary's rate by the number of SGBs for which data were available, and then combining these rates into a single number. This analysis includes data from 11 of 17 intermediaries in the Strategic Review.

6 ANDE, "Entrepreneurial Ecosystem Diagnostic Toolkit," (2013).

DO INTERMEDIARIES EFFICIENTLY SUPPORT SGBS?

Preliminary estimates suggest that donor investment in intermediaries is an efficient use of funds.[7]

- On average, an increase of one job at an SGB required $11,918 of donor support per job, depending on the intermediary.
- For every dollar of donor support, SGB revenue increased by an average of $3.07.
- For every dollar of donor support to intermediaries, SGBs received nearly $10 in private investment.[8]

These ratios are comparable to available job creation benchmarks, as well as USAID's goals for leverage from private investment, providing early indications that supporting intermediaries is a cost-effective use of donor funds.[9] However, these outcomes cannot yet be conclusively attributed to the funding provided by donors.

FIGURE 3: Performance of SGBs supported by PACE intermediaries.

*Job and revenue change figures are for a single year and calculated by estimating the weighted annual average growth rate in SGB jobs and revenues for each intermediary individually, weighting each intermediary's rate by the number of SGBs for which data were available, and then combining these rates into a single number. This analysis includes data from 11 of 17 intermediaries in the Strategic Review.

**Capital raised is for 2016.

***Ratios of revenue to total donor investment and capital raised to total investment are reported for the five intermediaries with the most robust data between 2014-16.

7 For the purposes of this report, the term "donor" refers to all providers of grant funding to intermediaries, including USAID and various foundations.

8 Depending on the intermediary, an increase of one job at an SGB required between $3,867 and $31,121 of donor support per job, and for every dollar of donor support, SGB revenue increased between $0.17 and $10.22.

9 Many job creation investments in developing countries show costs per job created between $11,000 and $88,000. Most of these benchmarks emerge from studies that, like this review, did not find statistical significance. (McKenzie, "Identifying and Spurring High-Growth Entrepreneurship: Experimental Evidence from a Business Plan Competition," (2015))

CAN INTERMEDIARIES BE FINANCIALLY SUSTAINABLE?

Despite supporting broader economic growth for SGBs, few intermediaries have established sustainable business models for themselves.

- On average, grant revenue accounts for over 70 percent of intermediaries' total revenue. Intermediaries earn non-grant revenue through a mix of fees to SGBs, fees to investors and returns on their investments in SGBs. Each of these revenue streams faces challenges: many SGBs are reluctant to pay fees, often because they can get free technical assistance from other programs; most intermediaries are young and need to demonstrate profitability prior to charging investor fees; and most intermediaries' investments in SGBs have not had time to mature and show returns.

- Intermediaries supported by USAID for two years show roughly the same need for grant support in Year 2 as they did in Year 1. It is likely that many PACE intermediaries will not attain financial sustainability (i.e., fully cover costs through earned revenues) during the period of USAID's support, which is generally three years.

Intermediaries that provide capital and longer, more tailored technical assistance to SGBs incur greater costs per SGB served.

- Intermediaries that primarily provide SGBs with capital incur costs of about $70,000 per business. The need to rapidly deploy capital drives significant due diligence and SGB acquisition costs—on average, 1.5 times those incurred by intermediaries that primarily provide technical assistance, and more than two times those of intermediaries that balance support with investment.

- Intermediaries that provide longer, more tailored technical assistance to SGBs see 1.5 times higher costs (about $60,000) per SGB served than intermediaries that provide shorter, less tailored support (about $40,000). Given the challenges in constructing robust, comparable data on costs across intermediaries, further validation will be needed to confirm these results.

PRACTICAL INSIGHTS FOR FUNDERS, INVESTORS AND POLICYMAKERS

How do intermediaries contribute to different types of strategic development objectives?

Intermediaries are effective vehicles for realizing a range of strategic development objectives, including rural development, women's economic empowerment and job growth. The key, however, is to know how to choose the kinds of intermediaries that are best positioned to deliver on specific objectives. Successful intermediaries tailor their services to very specific contexts, such as geography, sector, or type of SGB.

- While primarily equity investments perform well across the PACE portfolio, intermediaries combining debt and technical assistance offerings appear to be better options for funders aiming to support agricultural enterprises. In PACE's experience, these types of intermediaries show the highest growth in agricultural revenues and jobs.

- Intermediaries equipping SGBs with equity financing are well suited to support high-growth enterprises, particularly young SGBs that do not have the collateral, cash flow or performance history to attract debt capital.

- Intermediaries with highly tailored, hands-on approaches to support services seem to be more appropriate for markets with high risk and/or lower average levels of entrepreneurial capacity.

This study challenges the widespread belief that highly-intensive and highly-tailored support drives higher job and revenue growth than less-intensive, less-tailored approaches. The PACE experience seems to indicate that shorter, less-tailored technical assistance approaches, including time-bound, cohort-based incubators and accelerators, can deliver similar or better results for certain types of firms (e.g., those that retain trained managers or have access to strong mentors) in certain environments (e.g., markets with robust entrepreneurial ecosystems). These intermediaries may offer better value to social impact funders, based on both cost per SGB and cost per unit of revenue and job growth.

Funders and entrepreneurs alike have had difficulty in defining the types of intermediaries most likely to be effective in spurring growth. One way that funders are working to get greater clarity is to fund activities that measure the effectiveness of intermediaries and bring greater evidence to this overall field, such as the Global Accelerator Learning Initiative.[10]

FIGURE 4: What PACE is learning.

Women-led SGBs outperform their peers, growing revenues 1.5 times faster and jobs 2 times faster.*

SGBs that operate in more robust entrepreneurial ecosystems see stronger revenue growth than those in less developed ecosystems.

SGBs that work with intermediaries that primarily provide equity investments see 1.5 times faster revenue growth than other SGBs.

SGBs that receive shorter, less tailored approaches to technical assistance show over 2 times revenue growth than seen by other SGBs.

SGBs supported by gender-sensitive and/or Investment-led PACE intermediaries raise 3 times the capital of their peers.

*All revenue and job growth figures are for 2015-16.

10 The Global Accelerator Learning Initiative is a partnership between USAID, Omidyar Network, The Lemelson Foundation, the Argidius Foundation, the Aspen Network of Development Entrepreneurs, and Emory University to investigate the effectiveness of accelerator programs around the world. Learn more at www.galidata.org.

What should funders expect for financial sustainability, and how can funders help intermediaries to achieve this?

Funders should not expect financial sustainability in the near-to-medium term. Most intermediaries are far from financial sustainability and are making slow, if any, progress. Those that take equity stakes have promise, but most have yet to realize any substantial returns. However, additional pathways to financial sustainability are currently being tested and are worth exploring further: (1) payment sharing for intermediary services with corporates interested in supply chain management, (2) bundling loan payments with technical assistance payments, (3) delayed payments and (4) embedded services.

How can funders promote gender equality in entrepreneurship through intermediaries?

Women-led SGBs receive disproportionately less follow-on financing. Despite outperforming their peers in revenues and job growth, women-owned businesses struggle to receive investment. As of this review, only one third of PACE-supported SGBs are women-led. Promoting high-performing, women-led SGBs would seem to require that intermediaries take even more intensive measures, including:

1. Mitigating unconscious bias in the SGB screening process, e.g., through automated tools

2. Providing financial products that meet women's needs and unique constraints, e.g., loans that do not require significant upfront collateral

3. Proactively identifying women-led SGBs to support, e.g., by connecting with networks of women entrepreneurs

4. Sharing more lessons learned, e.g., via partnerships with organizations such as the Aspen Network of Development Entrepreneurs or Value for Women

How can funders measure the impact of the intermediaries that they fund?

In order to set conclusive benchmarks for performance among intermediaries, funders need more and better data. Since intermediaries are the source of this information, funders must provide them with better incentives to collect and share data.

Acknowledgements: Individuals from several organizations provided valuable input to this report, including Agora Partnerships, Argidius Foundation, Catalyst for Growth, Edge Growth, Enclude, ePesos, FACTOR[e], Global Accelerator Learning Initiative, Intellecap, Investisseurs & Partenaires, Jibu, Microclinic Technologies, MCE Social Capital, Montpelier Foundation, Open Capital Advisors, Root Capital, Rosquillas Alondra, Sorenson Foundation, Sangam Ventures, the Shell Foundation, IIX Foundation, Unitus Seed Fund, Village Capital, Villgro and Yunus Social Business.