FCA Investments (FCAI) is an impact-driven company specializing in SME development. FCAI believes in the role of responsible and scalable SMEs as a driver for building sustainable and inclusive economic growth in developing countries. Therefore, FCAI aims to leverage the power of "**finance**", **"Technology"** and "**business development support**" (BDS) to turn the missing middle[1] challenge into an investable and impactful opportunity.

FCAI is a 100% subsidiary of Finn Church Aid (**FCA)**, which is the largest Finnish non-governmental organization and second largest in humanitarian aid. FCA has been in operation for more than 70 years in some of the world's most challenging and fragile contexts. As a subsidiary, FCAI seeks to build on the core competencies of FCA to ensure that all the investments-made are not only sustainable but that they have a positive social or/and environmental impact in the target countries.

To achieve this, FCAI has made a conscious decision to earmark its direct investments to those countries where there is a presence of FCA in order to utilize the institutional knowledge and build on FCA's interventions in these countries to maximize synergies.

Based on anecdotal evidence and the lessons-learned, key barriers to access to affordable finance for sustainable SMEs in the target countries are believed to be:

1- High collateral requirements and lack of long-term financing
2- High default rate (insufficient assets and low capitalization), and vulnerability to market fluctuations/shocks
3- Limited "know-how", low technical capacity and productivity, and data asymmetry
4- High transaction and management costs (mainly due to smaller tickets and costly financing processes)

To address this multidimensional challenge, FCAI aims to establish a service provider that can offer essential services and technological solutions to target SMEs to help them: 1) become more productive, 2) adopt proper management practices (especially those related to bookkeeping and financial management), and 3) become more transparent and investment ready. That service providing company is called "Missing Middle Opportunity Facility". By supporting the target SMEs, FCAI will be in a better position to invest in them, and the terms will be significantly less stringent due to the mitigated risks (as a result of the provided services).

However, we understand the financial constraints that SMEs are facing, so the services cannot be sold at market rates at least pre-investment. Once the investment is made, the cost of the needed services can be considered in the investment proposal, but before that, the services need to be affordable and "fit for purpose".

To help implement the model, FCAI plans to get donors support and grants to bring the cost down in the short to medium term. In addition, the role of technology and digital solutions will also help make the designed interventions more cost-effective. After achieving certain milestones and becoming more investment-ready, the service recipients (SMEs) will be eligible to receive an affordable loan for growth and development purposes from the MMOF Alternative Investment Fund (AIF).

[1] The term 'Missing Middle' refers to the absence of the SME-sector in many low-income countries mainly due to the lack of access to finance which is more available for large and micro businesses.

FCAI's Investment Scope: The size of our investment in an individual SME ranges from 100,000 euros to one million euros. As per its mandate, FCAI's focus lies in value creation, employment, and improving the productive capacity of the target SMEs and associated value-chains. Hence, the productive sectors mentioned below attract special attention (as these sectors are believed to be the largest overall employers also for women and youth). FCAI is also open to investments in other impactful sectors with a strong connection to the productive sectors mentioned (e.g., **Hi-Tech start-ups and Fintech**).

Investment Criteria:

- The business creates a measurable social and/or environmental impact.
- Commitment to the principles of good governance and transparency.
- Socially and environmentally responsible.
- Business is profitable or expected to be profitable (with at least a two-year track record)
- Having sufficient operational capacity.
- Condition for the investment is to commit to the service package, if need be, which can be financed partially by the investee.
- Female and young entrepreneurs attract special attention.
- Financing between 100,000 - 1,000,000 euros.

Farming
Agribusiness
Fisheries
Livestock
Poultry
Manufacturing
Renewable Energy

Missing Middle Opportunity Facility MMOF:

Introduction:

Mobilizing additional (public and private) funding and investing in responsible SMEs for a positive impact may sound imperative to achieve the SDGs especially in vulnerable and challenging contexts. Yet, the execution part is far more complicated and involves numerous challenges.

To address some of the main challenges, we structure our interventions based on three interconnected pillars that are considered prerequisites for sustainable and more effective investments in SMEs in target countries.

1- Business Development Services (BDS) facility
2- Local presence and building relationships
3- Risk sharing & mitigation products

Business Development Services (BDS) and SME's Capacity Building

FCA Investments aims to invest (mainly but not exclusively) in SMEs involved in the productive sectors of the economy with emphasis on Farming, Food-Processing, Fisheries, Livestock, Poultry, Manufacturing, and Clean Energy. Whereas these sectors are among the largest employers, they also have the potential to employ a large number of Women and Youth. Therefore, we consider the development of the productive sectors as a means to improving the environment and livelihoods of vulnerable communities (mainly via job-creation, and impactful and responsible business practices).

Nonetheless, due to the limited SME's productive capacities, organizational and technological capabilities in the target countries, FCAI considers pairing "capital" with "BDS" key to conduct successful and impactful investments.

Some studies have shown that a "capital plus" model (which factors in technical assistance alongside capital) is essential in many developing countries. That model is also applicable across the spectrum of both early-stage and more mature SMEs[2] to address capacity deficiencies and also reduce the investment default rate. However, we acknowledge the difficulties associated with trying to cover different SME's technical needs (as there is no one-size-fits-all model). Therefore, FCAI is focusing on key crosscutting areas prior to investing to design a tailored action plan and allocate resources to implement it before and during the investment tenor. (See the MMOF process and structure)

Local Presence and building relationships:

FCAI believes in active engagement/investment and places a strong emphasis on the local presence in the target countries to be able to identify, originate, support and invest-in responsible, impactful, and economically viable SMEs.

It is widely acknowledged that scalable SMEs in developing countries need long term and affordable finance (patient capital). However, FIs also need to build strong relationships with these SMEs to facilitate lending by tackling the low bankability and productivity levels and becoming more experienced in the SME-financing area.

The lack of investment-ready deals in challenging contexts is a significant impediment to the development of the SME-sector as it limits capital accessibility at scale. To tackle this issue, investors need to adopt a "relationship-lending/investing" approach to engage with investment prospects, build trust, and find ways not only to invest but to help improve efficiency and investability (via pre and post investment interventions).

When properly managed, the active engagement with potential investees helps:

- Address the opaque nature of SMEs.
- Build partnerships with different actors active the SME-Ecosystem that can lead to more successful investments;
- And also improve the capacity of the investor to deal with and address the actual needs of the target SMEs.

Accordingly, FCAI relies on the FCA country offices, in house capacity, and other partners with similar mandates to achieve the objectives mentioned above. Moreover, FCAI seeks strong local presence and registration as per the related national laws.

Risk Mitigation/sharing Instruments

It is highly recommended that investors (who want to target the "last mile" and/or the "missing middle" in LDCs) need to integrate risk mitigation/sharing instruments in their investment strategy and implementation and adopt a portfolio approach for scalable and viable solutions. Supporting the "missing middle" and the associated customers, suppliers, and employees requires high risk-tolerant investment vehicles. As expected, FCAI is encountering high levels of risks associated with SME's funding such as (but not limited to):

[2] World Bank Document

- Weak regulatory frameworks (government and industry led regulations)
- Data asymmetry
- High transaction cost relative to the ticket size
- Lack of adequate management capabilities and technical capacity at the investee-level
- Country risk and market instability
- High level of uncertainty associated with nature of the market and the relatively longer-term investments: 5-7 years. (e.g. market trends, foreign exchange, fluctuated costs of commodity etc.)

Apart from these risk factors, FCAI acknowledges the underlying opportunities that, if harnessed, could stimulate a sustainable and inclusive economic growth. In addition, the impact will not be limited to SMEs only but also across the value chains (due to the pull factor and spillover effect that the SME-sector can generate). However, we also understand that many of these risk factors are hard to avoid and/or mitigate through conventional due diligence activities.

SMEs are less resilient when it comes to market shocks and disruption mainly due to liquidity constraints, limited management capabilities, and low productive capacity. Now as the COVID-19 crisis has exacerbated the challenges many SMEs are encountering, investors active in the SME-funding sphere need to be more innovative and acquire adequate risk mitigation instruments to be able to step in and support those SMEs.

Risk Insurance Products

- **MIGA: Political risk insurance**

To increase the risk-tolerance and as mentioned earlier, FCAI has approached MIGA (Multilateral Investment Guarantee Agency) and applied for its political risk insurance to cover the "intended" direct investments in Somalia. FCAI shared with MIGA documents relating to its investment processes, ESG management, conducted due diligence, etc.

MIGA has already provided valuable support and guidance on how to apply and showed a high level of flexibility to adapt to our investment approach in Somalia and the relatively smaller ticket sizes.

The plan is to have a master agreement that covers investments in local SMEs in the country up to $10 million for 15 years while each single investment will be handled and approved separately under the SIP (small investment program) guarantee facility. Accordingly, MIGA has started the underwriting process and the political risk insurance for the first three investments is expected to be granted later this year.

Depending on the outcomes of that collaboration with MIGA, FCAI may be able to fast-track its operations in Somalia and also consider this facility in other fragile settings in the future.

- **Loan Portfolio Guarantee**

At present, FCAI is trying to develop a structure that allows for a practical fund mobilization process and enables us to attract like-minded investors. Having a separate vehicle (an SPV) under FCAI is key for fundraising and scalable and sustainable interventions. However, apart from the associated practicalities, acquiring investment guarantees or loss protection products will provide more confidence for the target investors and that will significantly facilitate the fundraising process.

Guarantee products are not only important for risk mitigation and fundraising, but they also help reduce the transaction cost and increase the management efficiency due to the larger size of the total AUM (as a result of the additional funding that otherwise wouldn't be there).

For that reason, FCAI plans to approach a couple of guarantee-product providers with the aim to apply for a suitable and cost-effective guarantee products moving forward to advance our plans.

MMOF Model:

FCAI envisages a model that offers "fit-for-purpose" essential business management services and financial interventions to the target SMEs.

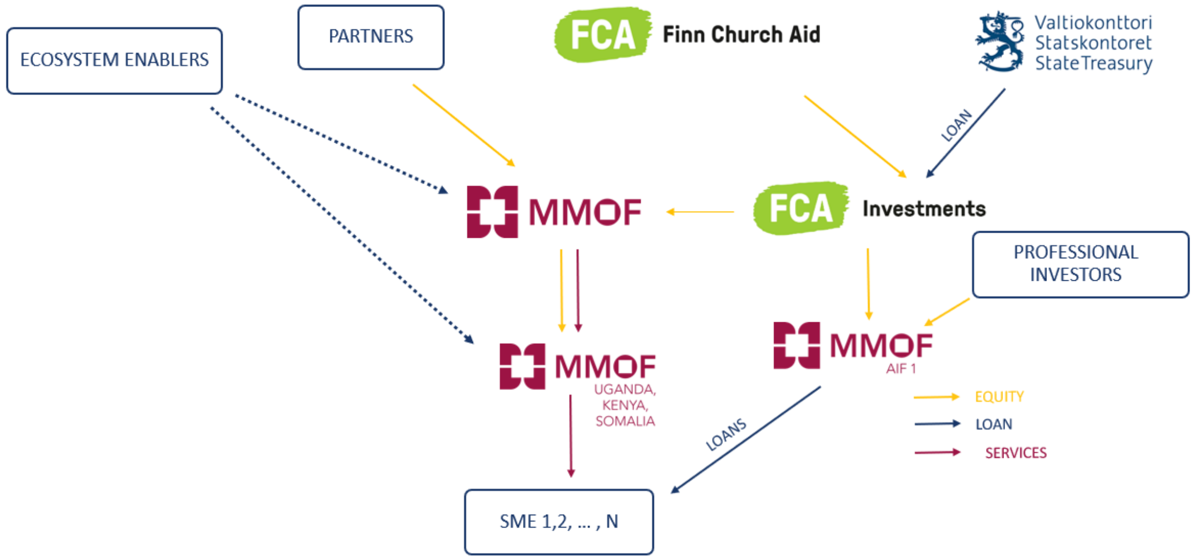


Figure 1 MMOF model

The idea is to establish two entities (MMOF and MMOF AIF) to engage effectively with the target SMEs. That engagement aims to create a pathway (consists of multiple development stages) for those SMEs not only to become investment-ready but also to get financed as well. This approach can address the misalignment issue that may occur when addressing access to finance and capacity building separately.

With the capital requested from the Finnish MFA (a €10 million loan yet to be approved) and potentially additional funding from other development partners, the model would help create investment opportunities that are considerably safer and consistent with the related regulations for professional and institutional with a high impact appetite.

Competitive Advantage

The competitive advantages of the MMOF BDS lies in:

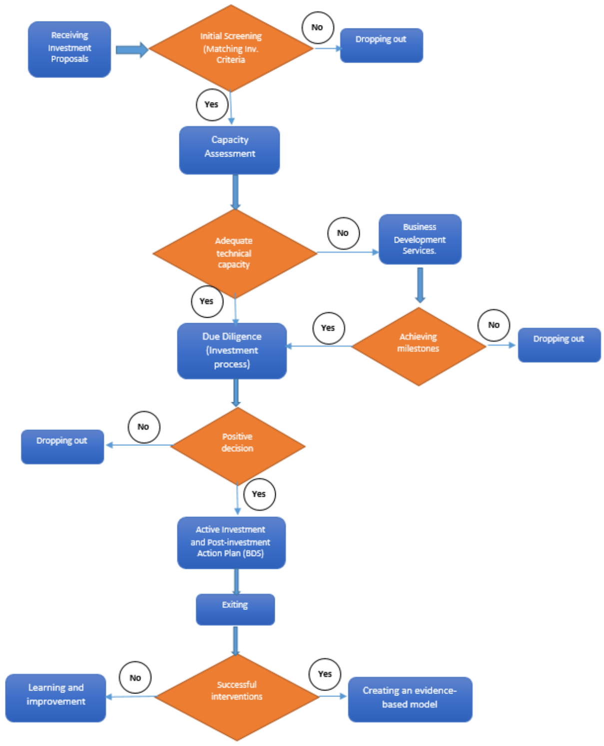
- The commitment to provide an affordable loan upon the achievement of certain BDS goals
- The ability to optimize some of the SME's operations which can result in cost-saving (given the scalability of this shared service model)

- The available capacity in the country (professional teams and networks on the ground)
- The shared objectives (which would drive both MMOF and its clients to be transparent and act as partners)

By targeting SMEs that match our basic investment requirements, MMOF would initiate a tendering process and/or utilize the existing partnerships (in focus countries) to allow SMEs to apply for the offered package. According to the initial screening, those companies who qualify for investment (more investment-ready) would be offered: **Lending** via MMOF AIF and a set of **post-investment BDS** as needed. However, those who are not ready but show high potential to be so, would be offered a 1-2 year BDS package with clear milestones that once reached, the financing element (loan) would be unlocked through the MMOF AIF (see the MMOF process flowchart).

Business Development Services (BDS) Element:

It's clear that different SMEs have different business development needs. Therefore, MMOF would be focusing on key cross-cutting areas that are assessed prior to financing to design an action plan and allocate resources to implement it before and during the investment tenors (if the investment materializes). We believe that not all SMEs have to handle all management-related aspects in house, some outsourced services can be more robust and cost-effective. The plan is to design a BDS facility that allows MMOF to not only offer capacity building interventions to develop the in-house capacity of the target SMEs but also to manage some of the business areas (mentioned below) when feasible on behalf of the target SMEs for a certain period of time based a scalable shared-service approach. We call this BDS element "essentials as a service".



The services FCAI plans to provide consists of three key modalities:

- CFO as a service (Financial Controlling and accounting):
- Sales and Marketing strategy
- Responsibility and sustainability/ESG

Given the cost associated with providing BDS for SMEs. There is a strong presumption that many SMEs will find it difficult to pay for that extremely needed facility, and that might add a financial constraint to their development. MMOF is planning to offer a 25%-50% concessional rate on the provided BDS to target SMEs (though the discount rate could start higher and end lower than that rate).

To make that scenario feasible, FCAI considers and seeks grants and other "low-to-pro bono" services from some of the out-sourced service providers to partially finance and deliver the BDS facility. In that regard, FCAI is actively engaging with partners (donors, NGOs, and like-minded service providers) to channel the needed services as and when needed.

As alluded, these services will help develop key management practices for the client-SMEs and at the same time de-risk the future investment in them and reduce the financing cost. We aim to integrate the BDS facility in the financing model as opposed to treating it as a complementary or side product. The process would start with the same current screening activities to ensure alignment with FCAI criteria and to assess the eligibility of an SME to receive MMOF's support. A digital tool may be used to help with this process and also allow SMEs to share a set of documents and requirements to make the screening process as efficient as possible. The next step is to identify the gaps in accordance with the modalities above that (if properly addressed) can unlock the potential of these prospective SMEs, improve efficiencies, and/or increase transparency and bankability.

FCAI would then start deeper engagements and interactions with these SMEs to design and price a service package (given the toolbox and the available resources) and certain milestones/targets that once reached, the requested loan will be offered. The interest will however depend on different criteria, but it will be lower than the normal rate (without BDS services).

The target outputs and timeframe of these three modalities are as follows:

- CFO as a service – Output 1: Establish transparent, well-documented and proper bookkeeping/accounting practices and a functional financial management/control system (in line with at least the related national laws and preferably international standards). A digital solution might be deployed along with direct support from MMOF to achieve this output. The direct support comprises system design, bookkeeping management, troubleshooting, and capacity building for proper implementation.
  Timeframe: 6-12 months pre-investment and up to 4 years post investments
- Sales and Marketing strategy Output 2: Establish an effective sales and marketing process including but not limited to: access (or go to) to market strategy, clear value proposition, online presence, and effective segmentation and distribution processes. Note: collaboration with external marketing partners/service providers may be needed.
  Timeframe: 6-12 months pre-investment and up to 3 years post investments.
- Responsibility and sustainability/ESG: Ensure responsible business conduct (RBC) by putting in place proper governance structure, policies for socially and environmentally sound business practices in line with FCAI investment principles and guidelines. The process of this intervention includes:
    - Identification of material breaches, key RBC gaps, impacts and opportunities
    - ESG categorization
    - Assessment of ESG risk factors
    - Meetings, discussions, site visit, and capacity needs assessment
    - Development of an Action Plan with clear targets and timeframe.
    - Receive company's commitment to implement the action plan
    - Ongoing support and tracking progress for effective and proper implementation

  Note: External consultants could be hired to conduct a sector specific environmental or social assessment and design a proper action plan (if need be).
- Timeframe: 6-12 months pre-investment and up to 4 years post investments.

Aside from these specific BDS services, we acknowledge the importance of digitization and the digital skills of the client-SMEs as crosscutting aspects. Therefore, identifying digital tools or solutions and building digital capacities to help design, deliver, and implement certain services (across the spectrum of our interventions) are considered. Some digital tools and digital capacity building services will be sought from reliable partners. For example, FCAI is holding now discussions with actors like Microsoft and Accenture to forge partnerships or MOU aimed at providing or channelling digital solutions to our target SMEs (part of the MMOF's service package).

SME Lending (MMOF AIF)

Based on anecdotal evidence and lessons-learned, it has been acknowledged that typical small investments (less than $1M) in SMEs in Africa struggle to completely recover the invested capital (not to mention the expected returns).

In a hypothetical scenario, financiers would offer (for example) SMEs a 5-year loan with a 10% interest rate (no additional BDS services). Considering the high risk and the associated costly diligence and management fees, financiers would need to allocate (approximately) 5% for loss-provision and 5% for management fees. Therefore in this scenario, the financiers would end up with almost zero net interest as the annual interest rate could merely cover the loss provision and the management cost while SMEs are bearing a 25% total interest over the loan tenor (given the annual interest rate: (10% x 5y)/2).

Applying the MMOF concept, SMEs would receive a good (if not the best) value for money BDS services delivered with a shared objective. A successful BDS intervention will, on one hand, enable the SME to improve their management practices, access BDS grants (if available) and eventually receive the capital needed with a relatively lower interest rate through the MMOF AIF, and on the other hand, it will significantly reduce the due diligence cost and risk profile, which would make the lending relatively cheaper and safer.

In that context, the MMOF AIF will offer a (5-6) year loan as follows:

- 5%-9% (7% on average) annual interest rate EUR terms or 9% on USD terms (depending on the risk level, impact, country, and ticket size). Accordingly, the allocated management fee would be 0% (as the service entity will help manage the investment part of the service agreement) and loss-provision would range from 1% to 4% as per predefined criteria.
- The AIF may also offer a mezzanine finance with a lower interest rate and a profit-sharing mechanism.
- In Somalia: AIF will use Murabaha to comply with the Islamic Finance requirements

Market Fit and proof of concept:

The proof of concept is not ready for the shared service model yet. However, FCAI is conducting now a feasibility study (in Kenya and Uganda) to assess the demand, service packages, costs, partnerships, etc. FCAI is also collaborating with Accenture Finland to further advance and ensure the commercial viability of the model. In addition, we have an ongoing pilot project where FCAI is co-managing an investee-SME in Uganda and charging fees for the provided services and also providing operational support and financial management services to two more companies. So far, the indications are positive and support the assumption of the viability of the model.

Moreover, a study conducted last year by (FCA/FCAI) on the SME-Ecosystem in Somalia and Uganda shows the importance of offering well-coordinated, interconnected, and result-based interventions aiming at strengthening the technical capacity of the SMEs and unlocking financial resources to develop the SME-ecosystem in these countries.

The comparative advantages of the MMOF BDS lies in:
- The commitment to provide an affordable loan upon the achievement of certain BDS goals
- The ability to optimize some of the SME's operations which can result in cost-saving
- The available capacity in the country (professional teams and networks on the ground)
- The shared objectives (which would drive both MMOF and its clients to be transparent and act as partners)

Sustainability & Development Objectives:

MMOF AIF has clear social and environmental objectives and seeks to promote business practices aligned with international ESG standards and IFC's Environmental and Social Performance Standards. It targets responsible and growth-oriented SMEs that can create decent jobs and improve the livelihoods where they operate and across the related value-chains. These objectives include:

- [OB1] Promoting inclusive economic growth, by supporting responsible SMEs in target countries
- [OB2] Providing decent jobs esp. for youth and women
- [OB3] Protecting worker's rights and promoting safe and just working environments, esp. for female workers.
- [OB4] Boosting innovations, productivity, resource efficiency and more environmentally and socially responsible production and consumption.
- [OB5] Ensure that vulnerable segments of society (especially women, youth, and minorities) have equal rights to economic resources and gains, and access to basic services.