DCED
The Donor Committee for Enterprise Development

Market Creation for SME Finance Community of Practice[1]

Terms of Reference

1. Background

The DCED is grounded in the reality that the private sector at large, and SMEs in particular, can thrive and create positive change when embedded in appropriate support systems. This includes access to finance and business services. Secondly, the DCED's guiding principle has always been to avoid duplicating the efforts of other institutions and platforms, and as such, to add value where it is uniquely positioned to do so. For example, when CGAP spun off from DCED in 1995, DCED no longer actively pursued a microfinance agenda; and because growing interest in impact investing soon resulted in the establishment of the Global Impact Investment Network (GIIN) in 2009, DCED primarily focused on measurement aspects of impact investing.

The interest in Business Development Services (BDS) in the second half of the 1990s sparked a 'revolution' in the form of the shift toward 'indirect' implementation, 'facilitation', and what would become systems thinking. The lack of traction of early BDS programming, combined with the success of Markets for the Poor (M4P) initiatives with an emphasis on embedded services, resulted in an approach currently known as Market Systems Development (MSD). MSD has a strong focus on systems and facilitation, as well as embedded services and some transacted services (e.g., vocational training) - particularly in agricultural value chains and some (service) industries; it is however less knowledgeable on SME finance and associated services. While embedded technical services (e.g., advice on how to use equipment) are highly relevant to increasing SME productivity, their ability to facilitate fast SME expansion is more limited. Therefore, the question how to create SME access to finance and the appropriate services to facilitate investment continued to linger in the background.

This PSD practice gap is mirrored in a SME finance gap, also dubbed the 'missing middle'. It is difficult for SMEs to obtain access to finance, starting from USD 50K-100K to USD 1M-2M. This is because the market for SME finance—including actors, instruments, practices, regulations and market data—remains underdeveloped. In other words, the 'missing middle' refers to financial instruments *and* the institutions that could deliver these.

At the DCED's 2023 Annual Meeting, the Argidius Foundation organised the Thematic Day on 'SMEs: The Transforming Middle', bringing a renewed focus on the topic. In the 2024 DCED Member Survey, fourteen members referred to finance, in various forms, as a priority. The most frequently mentioned topics included SME financing, BDS/Enterprise Support Organisations (ESOs), and nurturing entrepreneurship ecosystems.

[1] Note that the DCED ExCo and Secretariat are proposing to change the name of 'Working Groups' to 'Community of Practice', as part of a wider forthcoming proposal to members on strategic shifts in the DCED's operations in light of discussions at the DCED 2025 Annual Meeting Business Session.

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In May 2024, DCED organised a member consultation on SME finance to better understand member priorities and where they felt DCED could add most value. This helped to further flesh out member priorities and questions in three key themes (for details refer to Section 3 below):

1. **Systemic financial market creation for SMEs (comparable to the microfinance industry build up)**
2. **Bridging the gap between donors (and donor-funded PSD/MSD) and (developmental) finance**
3. **Good practices for measuring and reporting SME impact of, and for, financial market creation**

The 2025 DCED Member Survey suggested that finance remains a donor priority, also informed by pressures to 'do more with less' and a desire to mobilise the private sector and commercial finance for trade, climate adaptation and jobs where possible, including in less dynamic and more resource-intensive environments.

Following this, at the 2025 Annual Meeting, members approved the creation of a **Community of Practice (CoP) on Market Creation for SME Finance**.

2. Objective

The purpose of the CoP is to contribute to the development of good practices to create markets for SME finance, thereby addressing the missing middle. Members can share lessons learned, support the development of guidelines and case studies, facilitate research, and foster collaboration and coordination with financial stakeholders, as well as PSD and finance practitioners.

The CoP will maintain a systems perspective. This means that it will focus on business models, practices and linkages that can support sustainable finance 'supply chains' developing between asset/capital owners, capital providers, capital allocators and SMEs in the 'missing middle'. In addition to this, it will consider access to information and services and a conducive business environment, to reduce (capital and operational) costs and risks, and risk perceptions. As appropriate, the CoP will build on existing work and/or exchange or collaborate with other CoPs within the DCED, notably the MSDWG, BEWG and PSE WG.

Creating markets for SME finance defined in this manner will bring together, and fill the void between, Financial Sector Engagement and Market Systems Development (MSD). Financial sector engagement is geared toward mobilising private finance for emerging and frontier markets, using financial instruments such as 'blended finance' and 'first loss guarantees' to achieve development outcomes at acceptable returns. MSD market facilitation is geared toward supporting market actors (in finance, in BDS, or as part of value chains or the public sector) to develop more sustainable models, practices and linkages with other actors to form more inclusive and adaptive systems.

Where appropriate instruments 'meet', i.e., can flow through appropriate financial actors enveloped in supportive systems to reach SMEs at diverse stages in their expansion, the missing middle should narrow down. Conversely, where MSD can strengthen systems and thereby help SMEs become more productive and profitable, a pipeline of investment opportunities for upstream financial actors can emerge.

A system map is to be inserted.

3. Priority Themes

Based on member consultation, the CoP will focus on the three priority themes listed above (SME finance market creation, donor-DFI coordination, and good measurement and reporting practices). The table below break down these themes into the various elements mentioned by members in the consultative process.

1. Systemic financial market creation for SMEs. This includes:

- ✓ Support to banks to innovate, segment SME markets, develop last-mile products and processes (including regulatory reform required for this).
- ✓ Support to Local Capital Allocators (to help diversify the ecosystem in terms of types of financial products such as equity, mezzanine) in terms of establishment and improving fund economics (by reducing the time to attract funds, standardising legal requirements, and thereby reducing costs, standardising social standards and reporting requirements and thereby reducing costs).
- ✓ Improving capital flow through local (currency) capital market development and reform (this includes strengthening local system actors such as credit rating agencies) and best practice use of (blended) financial instruments to reduce costs and risks.
- ✓ Support the establishment of finance (aggregation and wholesaling) platforms to match supply and demand for diverse investment sizes and risk appetites.
- ✓ Support the digitalisation of the value chain, including transactions and employment, to create transaction records that facilitate access to finance.
- ✓ Support for the financial inclusion of underserved market segments (women, youth, etc).
- ✓ Creating cost-effective access to business services (embedded, transacted, subsidised) and (entrepreneurship/start-up) ecosystems, or market systems, to help enterprises improve productivity, increase their margins and capital, improve business and impact records to attract investment, and create awareness of different financing options and providers.

2. Bridging the gap between donors, PSD/MSD initiatives and (developmental) finance. This includes:

- ✓ How PSD/MSD can originate deals, support pipeline development for DFIs and, vice versa, how DFIs can support PSD/MSD.
- ✓ How systemic private sector development and systemic financial sector development (as described above) can intersect and benefit each other.
- ✓ Coordination and exchange between the 'PSD/MSD world' and finance sector bodies and experts.
- ✓ How donors can more effectively leverage private capital by pooling resources, agreeing on instruments and conditions.

3. Good practices for measuring and reporting SME impact of, and for, financial market creation. This includes:

- ✓ Tracing the impact of financial instruments through several layers of actors on SMEs or households (this includes the notion that for some layers, information may be self-reported or 'lean').
- ✓ Good measuring and reporting practices to enable SMEs to report credible impact to attract finance in a manner that is conducive to managing their business.
- ✓ Understanding secondary mobilization, i.e., not just how much capital was mobilized at the time of a deal, but how much additional capital (and other effects) came about down the line with an intelligently defensible contribution from the work.
- ✓ Assessing the positive and negative effects of financial inclusion of those previously underserved.
- ✓ Measuring the effect of policy reform on financial market development.
- ✓ Measuring system change in the financial sector in support of SME financing.
- ✓ Understanding SME demand for finance (different SME segments, different gaps, different options).
- ✓ Sharing lessons learned: what worked, what did not, and why.

4. Chair, Meetings and Task Teams

The COP is chaired by one or more DCED members. In their absence, the DCED Secretariat will chair the COP. The COP will seek to meet at least three times per year, with one meeting being an in-person meeting.

In line with its ambition to collaborate with financial stakeholders and finance and PSD practitioners, these can be invited to take part in meetings or be part of task teams.