

SME-Focused Development Banks:

5

Key Missions
in a Time of Change

Abstract

In recent years, there has been a renewed appreciation for the critical role SME-focused development banks play in the economies of many countries. Besides supplying much-needed capital to businesses during times of crisis and recession, development banks are increasingly supporting essential change. This paper looks at five societal missions supported by SME-focused development banks: fostering social and economic inclusion; scaling up businesses to be more competitive; helping them adopt digital technologies; providing green financing in the transition to a low-carbon economy; and financing the creation and growth of innovative young companies.

This paper examines these roles with a focus on the members of The Montreal Group, a global forum of development banks focused on micro, small and medium-sized enterprises (MSMEs). It describes the evolving nature of development bank activities and concludes that, when properly governed and managed, they can be an irreplaceable force for social progress and prosperity around the world.

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For more information about The Montreal Group, please visit themontrealgroup.org.

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introduction

The financial crisis and recession of 2007–09 offered dramatic evidence of the countercyclical role state-owned development banks can play in national economies, stepping in to supply much-needed capital to businesses when private sector financial institutions withdraw.

Even in better times, the willingness of development banks to go where private sector institutions will not has long provided the central rationale for their existence. For development banks, focused on small and medium-sized businesses (SMEs), this means filling gaps in small business financing—providing longer term, patient capital at a reasonable cost to segments of the market that are too risky for private institutions.

Why SMEs? They represent over 95% of the total number of registered businesses worldwide and provide 50% to 70% of jobs, depending on countries' stage of development. They also create the majority of new jobs. In fact, across 132 countries, the number of total full-time employees in SMEs nearly doubled, from 79 million to 156 million, in the 2003–16 period (OECD, 2018). SMEs are an important source of growth, innovation and opportunity, including for people who suffer social and economic exclusion. They are key to generating higher levels of productivity, improving standards of living and helping countries adapt to rapidly changing technologies.

As the pace of economic change accelerates, the role of development banks is evolving and growing even more important. They are supporting new forms of financing and exploring ways to harness digital technologies to better serve SMEs. They are also recognizing that entrepreneurs need more than money to build thriving, growing businesses. That is why many now offer technical assistance, management training, advice and online content to build the skills of business owners.

This paper explores the roles development banks play in supporting micro, small and medium-sized businesses in developed and developing countries in an era of profound change. It identifies five key societal missions many are engaged in. Those missions are fostering greater social and economic inclusion; scaling up businesses to be more competitive; assisting them to adopt digital technologies; providing green financing to support the transition to a low-carbon economy; and financing innovative young companies. The paper also highlights the importance of good governance and program evaluation to the success of development banks in helping SMEs to generate sustainable growth and prosperity in countries around the world.

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A brief history of national development banks

The origins of national development banks can be traced back to the mid-1800s, when a handful of countries sought to finance industrialization through state-owned banks. In the modern era, a few banks were created before or during the Second World War, including Mexico's Nacional Financiera (NAFINSA), founded in 1934, Corporación de Fomento de la Producción de Chile (CORFO), founded in 1939, and the Business Development Bank of Canada (BDC), founded in 1944. However, it was not until after the war that a large number of banks were created to finance infrastructure development, agricultural production, exports and the conversion of wartime factories to peacetime purposes. One prominent example is Germany's Kreditanstalt für Wiederaufbau (KfW), created in 1948 for the purpose of channelling international aid, mainly from the U.S. Marshall Plan, and national funds to reconstruction of industry and infrastructure. In subsequent decades, many banks diversified their operations, including to provide financing to SMEs (Mazzucato and Penna, 2015).

In the decades leading up to the millennium, development banks came in for harsh criticism from some academics and multilateral institutions. They were attacked for having poor financial performance, crowding out private sector players, and being prone to political interference, cronyism and outright corruption. "In the framework of [the] efficient financial market school, the existence of public financial institutions, such as development banks, was—almost by definition—seen as negative. As a consequence, development banks were criticized—fairly and unfairly—and their role was reduced sharply in many countries. Some were liquidated." (Griffith-Jones, Ocampo, Rezende, Schclarek and Brei, 2018, p. 7)

However, the 2007–09 financial crisis led to a renewed appreciation for the countercyclical role development banks play in supplying business credit when the private sector withdraws in bad times. Development banks around the world reacted quickly and effectively to the crisis by significantly increasing their lending to SMEs, lessening the impact of the crisis in many countries and significantly supporting the economic recovery. In recent years, there has also been an increased emphasis on the role development banks can play in financing young, highly innovative firms and providing green financing as sustainability becomes a more prominent concern (Mazzucato and Penna, 2015).

Entrepreneurs in both developing and developed countries invariably identify access to financing as their most pressing challenge. In this context, there has been a growing recognition of the role well-run development banks can play in increasing access to financial services for SMEs generally, but also in supporting businesses that occupy especially important places in the economy, including innovative start-ups, medium-sized manufacturers and exporters. A more balanced view of the value of development banks has led to the creation of many institutions in recent years and the reinforcement of the mandate of others. Indeed, a World Bank survey of 64 national development banks found 25% had been created since 2000 (de Luna Martinez, 2018).

Different development bank models

Development banks come in many shapes and sizes in terms of the clients they target, how they are governed, managed and regulated, and the products and services they offer.

For most, their core activity is lending to businesses in support of national development goals. Some have a narrow focus on certain sectors or types of customers, while others have a broad mandate that typically calls upon them to promote social and economic development (de Luna Martinez, 2018).

The 64 banks in the World Bank survey were almost evenly divided between those with narrow and broad mandates. Of those with narrow mandates, the largest share—15%—were specifically focused on supporting SMEs (Figure 1).

However, a large majority of the banks (87%), including those mandated to focus narrowly on sectors, said their target clientele was micro, small and medium-sized enterprises (MSMEs) (Figure 2).

Development banks seek to increase financing for SMEs either by lending to them directly or indirectly. The indirect model involves development banks lending to private banks that then lend to SMEs. Many development banks also provide loan guarantees that encourage lending to entrepreneurs by reducing the exposure of banks in the case of default.

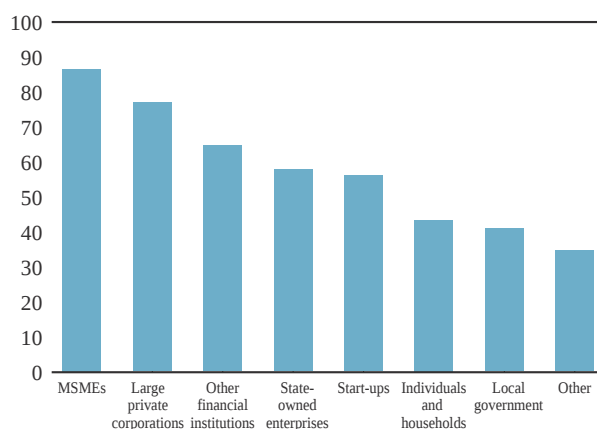
The World Bank survey found 10% of respondents only lend indirectly, 40% only lend directly, and 50% offer a combination of indirect and direct lending. Among the members of The Montreal Group, BDC is an example of a bank that lends directly to SMEs through its network of more than 120 branches.

Figure 1: Development banks, by type of mandate (percentage)

1. Narrow	49
Agriculture	10
Small and medium-sized enterprises	15
International trade	8
Housing	2
Infrastructure	13
Local governments	5
2. Broad	51
TOTAL	100

Source: de Luna Martinez, 2018.

Figure 2: Clients that development banks target (percentage)



Source: de Luna Martinez, 2018.

Brazil's Banco Nacional de Desenvolvimento Econômico e Social (BNDES) supports SMEs both directly and indirectly, while NAFINSA in Mexico operates largely on an indirect model.

There are pros and cons to the direct and indirect business models. A direct model is typically costlier because it requires a network of branches to deliver financial and non-financial services to clients. However, the costs of loans and other products are lower because private banks don't have to be compensated for their involvement.

Besides providing financing, many development banks also promote entrepreneurship and the growth of SMEs by offering advisory services and management training to business owners. The survey found that 55% of respondents offer consulting and training, and 41% offer other types of advisory and technical assistance activities, as well as networking and business matching.

An innovative example of a development bank offering non-financial services to entrepreneurs is the SME Bank of Malaysia and its Centre for Entrepreneur Development and Research (CEDAR). Founded in 2013, CEDAR provides entrepreneurs with training and coaching programs, and also conducts SME research.

"The needs of SMEs go beyond financial assistance," Dato' Razman Mohd Noor, Chief Operating Officer of the SME Bank of Malaysia, said in an interview. "We have to help them to scale up and build their capacity and nurture them."

France's Banque publique d'investissement (Bpifrance) is another development bank that puts a heavy emphasis on training and advisory services for entrepreneurs. Its initiatives include the following:

- Bpifrance Université—a portal, available online and in person, offering training to business owners on various business challenges
- Bpifrance Excellence—a network of 4,000 entrepreneurs who come together online and at events to exchange best practices, business opportunities and contacts

- Bpifrance Le Lab—a virtual "think tank" whose activities include publishing studies on key strategic issues facing French entrepreneurs, such as access to international markets, growth strategies and the realities of life as an entrepreneur

"Above and beyond financing, we want to give entrepreneurs the desire to grow, to encourage them to take their businesses further," Pascal Lagarde, Executive Director, International, Strategy, Studies and Development, at Bpifrance, said in an interview.

Another important role of many development banks, especially in developing countries, is to strengthen the private financing ecosystem for SMEs. They do so, most prominently, by providing loan guarantees to private lenders or by partnering with private investors in venture capital and private equity funds. Development banks also foster alternative financing markets for such products as factoring, leasing and securitization.

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— Pascal Lagarde, Bpifrance

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For example, NAFINSA operates an online reverse factoring system called Cadenas Productivas (Productive Chains). It allows SMEs to sell their accounts receivable from large companies to private sector banks and get their money immediately (albeit at a discount on the value of the invoices). This program, which allows SMEs to support their working capital needs, has been very successful. NAFINSA has entered into agreements with other development banks to implement similar schemes in several Latin American countries (de la Torre, Gozzi and Schmukler, 2017).

The countercyclical role

As previously mentioned, the global financial crisis sparked a renewed appreciation for the role development banks play in supplying business credit in difficult times. Development banks around the world stepped in during the crisis, providing credit to SMEs when private sector players withdrew from the market.

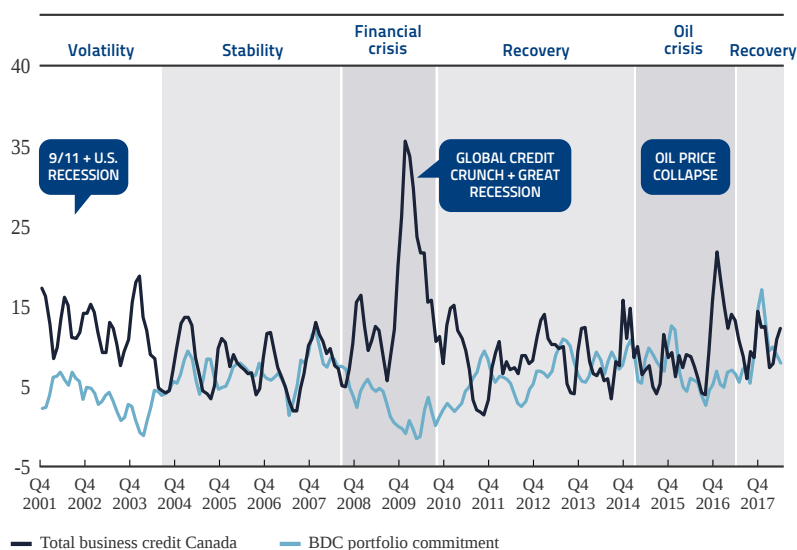
Respondents to a 2012 World Bank survey of development banks reported they had increased their loan portfolio by 36% on average between 2007 and 2009, well above the average 10% increase in private bank credit for those countries. In the same period, 9% of the surveyed development banks increased their loans by more than 100% (de Luna Martinez and Vincente, 2012).

One notable case was Brazil. The country was particularly hard hit by a sharp decline in international capital flows and repatriation of investments during the crisis. The Brazilian government responded through

BNDES, which rapidly increased its loan disbursements (Mazzucato and Penna, 2015). Indeed, BNDES, together with three other large development banks—the China Development Bank, Germany’s KfW and the Korean Development Bank—saw their loan portfolios expand by an average of 25% at the height of the crisis in 2008, compared to about 10% in the 2005–07 period (Além and Madeira, 2015).

More recently, development banks played a countercyclical role during the turmoil in resource-producing countries provoked by a sharp drop in oil and other commodity prices in 2015–16. In Canada, BDC provided the equivalent of US\$645 million (C\$850 million) in additional support for SMEs affected by the decline in oil prices. BDC’s countercyclical role during both the financial crisis and the collapse of oil prices can be seen in Figure 3.

Figure 3: BDC versus total Canadian business credit (three-month percentage change, annualized)



Source: BDC.

“Our experience demonstrates that a development bank can be a very effective policy instrument for responding quickly to economic shocks,” Michel Bergeron, BDC’s Senior Vice President, Marketing and Public Affairs, said in an interview.

A sometimes overlooked role played by development banks is helping SMEs recover from natural disasters. For example, following the devastating earthquake that hit Mexico in September 2017, NAFINSA provided guarantees to commercial banks for preferential loans to damaged businesses worth the equivalent of about US\$50 million (954 million pesos). Similarly, the Japanese Finance Corporation provides disaster recovery loans to help businesses resume operations after earthquakes and other natural disasters, including the March 2011 earthquake and nuclear catastrophe (See Figure 4.).

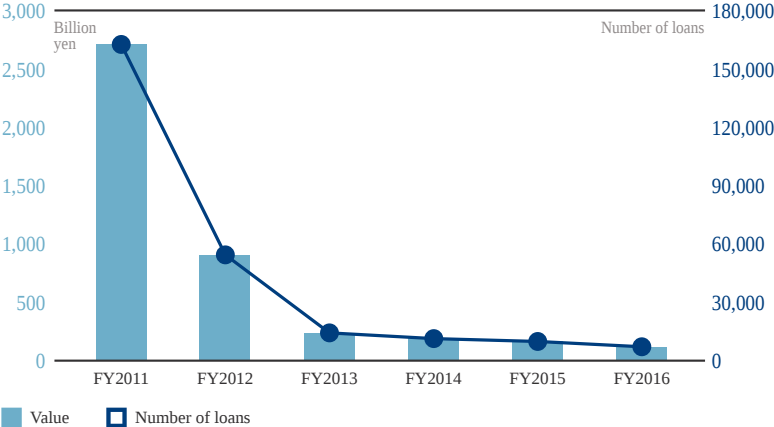
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— Michel Bergeron, BDC

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Figure 4: Japanese Finance Corporation disaster-related loans



Source: Japanese Finance Corporation.

Five key missions to promote development and structural transformation

From their beginning, development banks have financed the structural transformation of national economies, from the construction of infrastructure to industrialization to supporting SMEs.

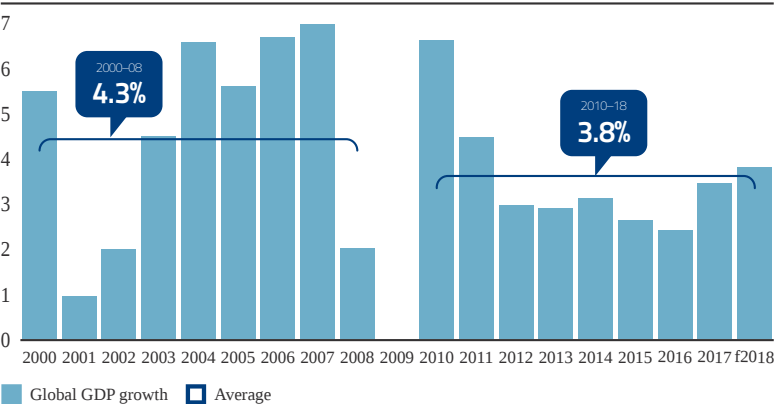
In recent times, development banks have been increasingly seen as important players in helping countries address such important societal challenges as eradicating poverty, combatting climate change and coping with rapid technological evolution.

The current uncertain economic climate will place even greater demands on development banks to encourage economic growth, job creation and innovation.

Growth throughout the world remains below pre-2008–09 levels amid a slowdown in productivity, subpar business investment and aging populations in many countries (See Figure 5.). At the same time, globalization has come under increasing attack in western industrialized countries, where depressed wage growth and rising inequality have fuelled protectionist sentiment.

In this context, SME-focused development banks are undertaking the five key missions described in this section.

Figure 5: Global growth appears to have peaked in the mid-2000s (GDP growth, percentage)



Note: GDP 2010 constant prices; f = forecast.
Source: International Monetary Fund, World Economic Outlook Update, July 2018.

#1

Promoting social and economic inclusion

While lending and credit conditions have improved in recent years, many SMEs, especially young and innovative firms, continue to have difficulty accessing both debt and equity financing. In the developing world, an estimated 200 million MSMEs have no access to credit at all (International Finance Corporation, 2017).

The Addis Abba Action Agenda, adopted at the 2015 United Nations Conference on Financing for Development, highlights the important role national development banks can play in fostering sustainable development and greater economic inclusion. The opportunity to create and grow a business contributes to the economic and social participation and upward mobility of disadvantaged or marginalized groups, including young people, women, seniors, migrants, ethnic minorities and the disabled (OECD, 2018, p. 7).

Many development banks have created programs to improve access to financing, training and advice for entrepreneurs from poor and marginalized groups. For example, the Small Industries Development Bank of India (SIDBI) Foundation for Micro Credit is working to create a national network of institutions

to provide micro-financing services to the economically disadvantaged, especially women.

In developed and developing countries alike, promoting entrepreneurship by women is a key focus of many of development banks, because of the benefits that flow to individuals, families and societies when women create and grow businesses. Women run one-third of SMEs in the formal sector globally, but financing can be especially challenging for them, because they are less likely to own assets and are more likely to suffer exclusion based on unequal property rights or discriminatory regulations, laws and customs. An estimated 70% of women-owned SMEs in the formal sector in developing countries are unserved or underserved by financial institutions. This amounts to a financing gap of \$285 billion, according to the World Bank (Alibhai, Bell and Conner, Conner 2017).

One example of an innovative program is the Women's Entrepreneurship Development Project in Ethiopia. The Development Bank of Ethiopia is a key partner in the US\$50-million lending program, targeting growth-oriented women entrepreneurs (Alibhai, Bell and Conner 2017). Besides providing business credit, the project trains several hundred women through its entrepreneurship training program each month. As of June 2016, the project had provided loans to more than 4,000 women entrepreneurs and entrepreneurship training to more than 7,500.

The project, which is financed by the World Bank, is also expanding the financing ecosystem in the country, with the Development Bank of Ethiopia acting as a wholesale lender to a group of private financial institutions that, in turn, make loans to women entrepreneurs.

In advanced economies, encouraging female entrepreneurship is also a priority for many development banks to foster equal opportunity, job creation and inclusive economic growth. In Canada, for example, BDC is aiming to bring the total value of its loans to women-owned businesses to the equivalent of about US\$1 billion (C\$1.4 billion) by the end of fiscal 2021, double its previous target. Its investment arm, BDC Capital, has also set up a US\$155-million (C\$200-million) Women in Technology Venture Fund to provide venture capital to women-led tech businesses.

#2

Helping businesses scale up

There is a growing recognition that size matters when it comes to the impact of SMEs on the economy. By expanding their businesses, entrepreneurs achieve economies of scale and productivity gains that help them generate greater profits, which, in turn, can be reinvested in the business—a virtuous cycle of improvement and increased competitiveness.

While medium-sized businesses represent only a tiny fraction of the total number of enterprises in any country, they have an outsized impact on economies. They are a key source of economic growth, job creation, innovation and international competitiveness. We can see this in Canada, where medium-sized business (defined as those with 100 to 499 employees) represent less than 1% of the total number of businesses but generate 12% of GDP, 12% of total export value, 17% of private sector research and development spending, and 16% of jobs (Ratté, 2016).

In response to the need to scale up businesses, many development banks have initiated programs that typically combine loans with strategic advice to assist entrepreneurs in their efforts to grow their businesses. Among its scaling-up programs, Bpifrance offers separate two-year accelerator programs for what it defines as SMEs (10 to 249 employees) and intermediate-size enterprises (250 to 4,999 employees), where entrepreneurs receive mentoring, strategic advice and networking opportunities aimed at giving them the tools to grow their businesses. “Scaling up is fundamental,” Bpifrance’s Pascal Lagarde observed in an interview. “As [Bpifrance CEO] Nicolas Dufourcq says, we don’t want to make a forest of bonsai trees. We want big tree companies that create jobs and value in our country and can compete internationally.”

Another example of a scale-up initiative is BDC’s growth driver program, which is aimed at

accelerating the growth of mid-sized businesses. The two-year program matches ambitious entrepreneurs with an executive advisor who leads a team to provide advice, coaching and professional resources.

In Finland, the Finnvera development bank is a key player in the Team Finland program, a network of public sector organizations that aims to be a one-stop shop supporting the efforts of entrepreneurs to go international by providing financing, advice, training, contacts and networking opportunities.

#3 Supporting the digital economy

Another emerging role for development banks is helping entrepreneurs invest in and use digital technologies to make their companies more productive, profitable and growth oriented. Indeed, such digital technologies as e-commerce, robotics, big data analytics, artificial intelligence and 3D printing are quickly becoming the difference-makers between businesses that can compete effectively and those that are being left behind. A study by French consultancy Roland Berger found that the most digitally mature companies grow six times faster than the least mature ones (Teisseyre et al., 2014).

Encouraging and supporting entrepreneurs’ efforts to adopt digital technologies is a development

bank mission that’s closely linked to scaling up, because larger businesses have more financial and technical resources to invest in technology. However, while new technologies are creating opportunities on many fronts, the rate of adoption is uneven. On one hand, high-growth “frontier” firms enjoy the virtuous cycle referred to earlier, with investments in new technology leading to higher profits and more growth. On the other hand, smaller, slower-growing companies struggle to make the investments that would allow them to keep pace. The same phenomenon is playing out on a global scale, with some countries outpacing others in technology adoption, contributing to income inequality among world regions.

Entrepreneurs not only have to find the money to invest but also figure out where best to invest it and how to integrate the new technology into their operations. What’s more, there can be a lag before investments begin paying off in higher productivity, sales and profits. That’s where development banks can play a critical role in providing both financing and technical assistance, advice and coaching.

BDC Chief Economist Pierre Cléroux said the scale and pace of current technological change are comparable to those in only a few other eras in history—such as during the spread of electricity—and are provoking huge disruption. “It’s not business as usual,” he said in an interview.

“The role of development banks is even more important at this time because businesses need more support to go through this transformation.”

One area that holds tremendous promise for improving SME access to financing are the technologies collectively known as financial technology, or fintech. Online fintech platforms bypass traditional intermediaries to match lenders directly to borrowers, using innovative credit scoring models based on big data analytics to assess credit worthiness and pricing of loan applications. Models include peer-to-peer lending, marketplace lending and crowdfunding. Many development banks are exploring how they can both support the growth of fintech platforms to boost SME financing and integrate fintech technology into their own banking operations.

However, with a little over half of the world’s population still without an Internet connection, a key challenge for banks in developing countries is to support the necessary investments to build basic Internet and telecommunications infrastructure. Mobile communications have emerged as an important channel for achieving this goal. By the end of 2016, an estimated two-thirds of the world’s population had personal access to a mobile phone, and a large and growing share of Internet use was occurring over mobile networks (Broadband Commission, 2017). Mobile now accounts for half of all web traffic, with many people accessing the Internet exclusively

via mobile devices. As a result, mobile banking is emerging as a transformative technology, especially in sub-Saharan Africa and Asia. It is enhancing financial inclusion by serving millions of people who are hard to reach with traditional bricks-and-mortar banking.

The World Bank Group and its partners have prioritized an initiative to achieve universal financial access by 2020. The goal is to enable people who are not part of the formal financial system to access a transactional account for storing money and sending and receiving payments. At the national level, more than 50 countries have made commitments to financial inclusion since 2010, while more than 30 have launched or are developing a national financial inclusion strategy (World Bank, 2018).

Mavis Chaile, Chief Investment Officer at the Development Bank of Zambia, said the spread of mobile phones has allowed for the growth of business activity in her country, through such things as online loans, money transfers and electronic payment. “Business is being done at the click of a button on a cellphone,” she told a 2017 conference of development bank chief economists (BDC, 2017).

At the same time, development banks have also launched many programs to help SMEs adopt digital technology to improve the competitiveness of their businesses and reach new markets. One example is the SME Bank of Malaysia’s Technology

Transformation Fund. It finances projects of medium-sized companies to upgrade and enhance their technology to increase their productivity, efficiency, cost management and export capabilities.

In Chile, the CORFO development bank has launched an advanced manufacturing technology program that provides grants of up to the equivalent of US\$3 million to fund advanced manufacturing projects developed by partnerships of SMEs, large companies, technology providers, research centres and universities.

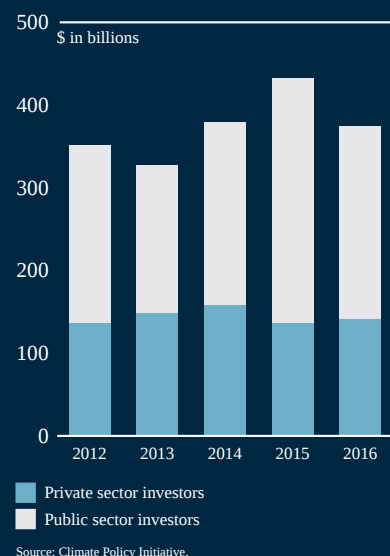
And Germany’s KfW launched a new innovation and digitization program in 2017 to provide better support for SMEs investing in this area. The program’s commitment volume of 1.5 billion euros in 2017 significantly exceeded expectations, according to KfW.

#4 Providing green financing

SME-focused development banks are playing an important role in financing the massive investments required as part of the global effort to transition to a low-carbon economy and limit climate change. Development banks finance businesses all along the green innovation chain, from those engaging in basic research and commercialization to mature renewable energy, green infrastructure and conservation businesses.

Global climate change investments totalled US\$383 billion in 2016. Of the public sector contribution to this figure, development banks were by far the largest contributors, representing 89% of public financing (Climate Policy Initiative, 2018).

Figure 6: Global climate finance flows



The Montreal Group has published a green financing white paper, outlining the role of development banks in financing climate-change mitigation and adaptation activities among MSMEs (The Montreal Group, 2016). The paper describes the unique strengths of development banks in mobilizing public and private funds toward effective green projects. These strengths include the ability to:

- positively influence government policy and programs
- channel public sector financing to businesses

- encourage private sector financing for green businesses while helping to coordinate the overall effectiveness of public and private sector investments

Members of The Montreal Group have successfully provided green financing and advice to SMEs through numerous programs, often supported by multilateral development institutions. Among the most striking examples are the following.

- The China Development Bank is one of the biggest green and renewable energy financiers in China, with US\$240 billion in green credit loans in its portfolio at the end of June 2015, or 21% of total green credit (Gilbert and Zhou, 2017).
- SIDBI has created an innovative product called End to End Energy Efficiency Solutions (4E Solutions) to provide MSMEs with both loans and technical support to implement energy efficiency measures in their businesses.
- NAFINSA has initiated a series of green programs for SMEs, including loan guarantees for financing the replacement of old equipment and appliances with energy-efficient models and loans for renewable energy projects. In 2015, NAFINSA became the first Mexican financial institution to issue a dollar-denominated green bond, followed by a peso-denominated bond in 2016. The proceeds will be used to fund a series of green

projects, including 11 wind farms, three photovoltaic plants and two mini hydro plants, while a new credit line also offers support for geothermal projects (Garcia, 2018).

- At BNDES, green financing initiatives include administering loans under the national Climate Fund to finance a wide range of programs aimed at mitigating climate change. BNDES is also the manager of the Amazon Fund, which provides grants for monitoring and combatting deforestation, and ensures the conservation and sustainable use of Amazon forests. BNDES was the first Brazilian bank to issue a green bond in the international market, with its US\$1 billion issue in May 2017.

No discussion of green financing by development banks can ignore the role played by KfW, both in Germany and abroad. In Germany, KfW's commitments to energy-efficiency programs for businesses totalled 5.7 billion euros in 2017. Commitments to the renewable energy program totalled 3.9 billion euros. Internationally, 55% of KfW's 8.2 billion euros of financing for developing countries was earmarked for climate change mitigation and environmental protection projects. As well, KfW played a crucial role in introducing solar energy to Germany, funding significant investments before 2009 and then reducing its role as private sources stepped in (Griffith-Jones, 2016).

#5

Creating more young, innovative companies

Young, fast-growing companies are key to economic growth, job creation and innovation. However, financing early-stage companies and their R&D projects is risky, and private sector institutions shy away from this market. In many countries, development banks have sought to fill this gap by providing grants, loans and venture capital to innovative young companies. Often, this support has the goal of both supporting the development of innovative firms and encouraging private sector investors to enter the market, leading to larger and healthier innovation ecosystems. As a result, development banks often partner with private investors in venture capital funds.

One interesting example is the Criatec venture capital funds in Brazil. The first Criatec fund was established in 2007 by BNDES and a regional public bank to provide capital to innovative start-ups. Based on the success of that fund,

a second Criatec fund was launched in 2013, drawing capital from other public banks, and a third Criatec fund launched in 2016 attracted the participation of private investors for the first time. A planned fourth fund is expected to be the largest in terms of commitments and to attract more private investors, according to Leonardo Botelho Ferreira, Head of the Institutional Funding Department at BNDES. The first three funds invested in more than 80 Brazilian companies, enabling the registration of about 70 patents and the creation of almost 1,000 products.

“Capital markets in Brazil are very concentrated in large companies and are in an early stage of development for start-ups,” Leonardo Botelho Ferreira said in an interview. “We are playing the role of not only market maker but also of creating an ecosystem of fund managers for venture and seed capital.” Currently, BNDES’s commitments in venture and seed capital funds are equivalent to nearly US\$240 million (1 billion reais).

Other SME-focused development banks are helping to fill the gap in financing for innovative young start-ups through large-scale venture capital activities.

BDC, Bpifrance, the China Development Bank and India’s SIDBI are all major venture capital investors, either directly or through funds.

There are many exciting programs in different countries, including one developed by Chile’s CORFO in cooperation with the Ministry of the Economy, called Start-Up Chile. It’s an accelerator that supports entrepreneurs from Chile and other countries around the world with grants, advice and connections to develop projects with high potential in Chile.

Start-Up Chile bills itself as the leading accelerator in Latin America and among the top 10 globally. From its creation in 2010 to June 2016, it admitted 1,400 start-ups, involving 4,000 entrepreneurs from 79 countries. Companies went on to raise US\$420 million (10 times CORFO’s investment), generate US\$276 million in sales and create 5,162 jobs, including 1,562 in Chile. Similar programs have been set up in at least 50 countries (Start-Up Chile, 2018).

Good governance and measuring the effectiveness of development banks

A number of researchers have studied the successes and failures of development banks and identified key characteristics of those that are successful.

These characteristics include a clear mandate in the context of a country's development strategy, a strong, independent board of directors, competent management, and freedom from corruption and improper government interference within a well-functioning regulatory framework.

Stephany Griffith-Jones, a leading development bank researcher, described the importance of these principles in the following way. "A major challenge is to ensure that existing and new development banks are 'good' development banks, in the sense they achieve both the aims of maximizing the sustainable and inclusive development impact of their transactions, as well as obtaining minimum commercial returns... 'Good' or 'well-run' public development banks especially need to have good governance, to ensure they are neither captured by private interests, nor by narrow political ones; however, they do need to reflect democratically defined national political priorities." (Griffith-Jones, 2016)

Even for the best-run banks, an important challenge is how to measure their impact on SMEs and the economy as a whole. That topic was examined at the 2017 Global Roundtable of Chief Economists, a major conference of development bank chief economists.

Measuring outcomes is important not only for reporting to stakeholders but also for improving the effectiveness of programs. However, several economists at the conference remarked on how challenging it is to conduct studies in this area (BDC, 2017). One key difficulty is identifying a control group of entrepreneurs in studies on the performance of programs. Questions that come up include the following.

- Is the entrepreneur receiving financing from other sources?
- Would the company have received financing without the involvement of the bank?
- Is the company's growth (or other performance metric) attributable to the bank's involvement?

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A major challenge is to ensure that existing and new development banks are 'good' development banks.

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Another major issue, especially for banks in developing countries, is accessing public and private data on businesses. As well, the lack of a common definition of what constitutes an SME is an impediment to international comparisons and benchmarking.

One economist at the conference said her bank has responded to these problems by increasingly using entrepreneur self-assessments. Ditte Rude Moncur, Head of Research and Analysis at Denmark's Vaekstfonden, said the assessments ask such questions as, "How much of the growth you are seeing is actually from the capital you got from us?"

BDC Chief Economist Pierre Cl  roux said another route is to compare the performance of firms before and after they receive financing from a development bank. Cl  roux, who co-hosted the chief economists' conference, said performance measurement is essential to the good functioning of a development bank, despite the challenges.

"It may not be perfect, but there's always a way you can measure the impact you have," he said in an interview. "It's important to demonstrate that support you give is having a positive impact on the companies and the economy."

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It's important to demonstrate that support you give is having a positive impact on the companies and the economy.

— Pierre Cl  roux, BDC

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conclusion

Following a period of retrenchment, when the relevance of national development banks was questioned, there has been a renewed appreciation in recent years for the important role they can play in building resilient, dynamic, inclusive and innovative economies. The support development banks provide to SMEs has become more multifaceted in response to the complexity and competitiveness of today's global economy.

This paper has looked at how well-run, SME-focused development banks are contributing to greater prosperity around the world. Their contributions include supporting entrepreneurship to empower those who are excluded from the economic mainstream. They are also proving to be an essential tool in taking on large-scale societal challenges, including the need to scale up businesses, harness technology, finance the transition to a low-carbon economy and support the growth of innovative young companies.

The mistakes of the past have shown that development banks must have a clear mission, and be well governed and managed, to successfully fulfill the many roles they are asked to play. However, when they are run according to best practices, history has shown they can be an irreplaceable force for a more prosperous, fair and sustainable world.

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