Supporting Startup Ecosystems through Innovative Financing Instruments

Minsoo Kim
CCDT (Digital Technology for Development)
September 2024

Capital is Crucial

- **Availability of well-allocated capital in early stages can:**
    - Increase the amount of interest in startups in the market from various players
    - Embolden more people to become entrepreneurs and launch companies
    - Stimulate pro-startup and innovation-related activity (e.g., regulatory tailwinds, resource allocation by incumbents, reduction of brain drain, foreign investment)
    - Speed up technology adoption in the market

- **Financing is the key even in markets where all other pieces of the equation are ready.**
    - Even if the previously mentioned challenges are addressed, without risk capital, an ecosystem cannot grow and reach critical mass.

How Can ADB-led Financing for Venture Capital Funds Help?

Catalytic financing, such as a fund-of-funds, focused on mobilizing risk capital for venture capital investment firms allocating to ADB's DMCs (including emerging managers) could help with:

- **Accelerating support**
  ADB can provide or facilitate access to: funding (for investors willing to match at least 1x allocation into designated DMCs/region), facilities, advice, mentorship, training, etc.
- **Support for patient capital targeting deep tech R&D**
  Just as ADB Ventures Fund 1 was set up with a fund lifetime of 17 years (with the industry standard being 7 to 10 years), ADB could promote investment into funds that are committed to providing patient capital to startups.
- **Development of a culture of excellence for startups, founders, and investors**
  ADB could, alongside funding, provide additional support such as events with public sector and industry counterparts to foster learning and discussions promoting innovation and startups.

ADB

DIGITAL TECHNOLOGY FOR DEVELOPMENT

ADB’s Role

As a development finance institution, ADB is well-poised to be a catalytic force for startup ecosystems in DMCs by leveraging experience across upstream (reforms and institutional strengthening to improve policy and enabling environment), midstream (advisory and project preparation to create opportunities for private investment and operation), and downstream (non-sovereign financing and sovereign investment financing that crowds in private sector) projects. While digital technology is a core platform that is a key starting point for any startup ecosystem, strong support for startups inevitably leads to innovations in deeptech and climate technology.

Facilitating increased access to financing, which will mobilize private sector capital for investment into startups in DMCs, requires this experience for midstream preparation work and potentially also for eventual downstream operations.

Yet, as startup ecosystems are still nascent in most DMCs, it is unclear what form such a program should take, which channel(s) funding and support should go through, and which external and internal partners should be engaged.

ADB

DIGITAL TECHNOLOGY FOR DEVELOPMENT

However…

Even a comprehensive support program would be limited in its ability to effectively address:

- **Small markets, remoteness, regulatory barriers, etc.**
  If a market is too small for founders and startups to find product-market fit or customers, catalytic funding may not be super helpful.
- **Underdeveloped startup / entrepreneurship culture**
  A market where the startup industry is too small and early could result in talent not considering it as a viable option – it is not clear whether funding to investors would help alleviate the issue.
- **Talent demand-supply mismatch**
  Certain markets are seeing the brain/founder drain reverse naturally due to progressing maturation of the local startup scene, making them a good target for catalytic capital.

As such, it is important to identify a region or market that is at a stage where risks related to these factors are somewhat mitigated for the impact from a financing program to be maximized.

ADB

DIGITAL TECHNOLOGY FOR DEVELOPMENT

Candidate Regions

Central West Asia	Southeast Asia
The Central West Asia ecosystem is at a very nascent stage with a limited number of active local investors, which consist of a significant number of family offices who are not very open. It will be possible to shape the ecosystem given how early it is, but it will be a slow and high-effort/supervision project.	The SEA region has a mix of larger markets with early but growing ecosystems as well as immature markets with governments keen to support. The region has a good mix of private and public sector players to collaborate with and seems ripe for acceleration. There is a good amount of competition, yet this provides more options to choose from as ADB and as a fund of funds – catalytic capital can really help accelerate the development of the startup and tech ecosystems in the region.
The region has a population of 90 million people, which is not very large. Impact in terms of number of people reached could be lower than SEA, and there could be a limited selection of managers to back and startups for them to invest in. The scope will be limited.	Economic downturn and uncertainty in pathways to exit have resulted in lower levels of fundraising – the region would benefit from additional support at this time.
Competition is not a fierce as SEA and the scene is still very local, so it may be possible to back a fund manager that eventually becomes the premier local venture capitalist in the region.	Smaller markets like Lao PDR or Cambodia may lack sophisticated digital deep technology, so it may be necessary to balance between digital-enabled SMEs and true digital startups across markets.
Despite drawbacks, there still would be high impact resulting from a project focused on the region – it has struggled to support its startup ecosystem take off, and any help it can get would be beneficial	Certain markets are becoming the center of global supply chain – Vietnam in manufacturing and Indonesia in batteries. As a result, ADB's participation can result in high impact – also in the climate area.

ADB

DIGITAL TECHNOLOGY FOR DEVELOPMENT

Regional Fund of Funds (FoF)

A **Regional Fund of Funds** would be structured to invest as a limited partner in venture capital funds across a particular region, potentially with significant institutional investors, such as the ADB, acting as key partners. This fund could pool capital from governments, institutional investors, and/or private donors to strengthen regional venture ecosystems. It could back both emerging and established fund managers, driving private capital into the region while supporting the growth of startups with global potential.

The fund could improve the quality of local venture capital fund management capability and foster regional startup ecosystem development by providing ecosystem-building activities in addition to financing This may include initiatives such as accelerators, training programs, and market access support.

Such a model could leverage regional resources and talent, centralize and lower costs, and mobilize private capital. It builds trust in the local venture capital landscape, creating a well-resourced fund that drives both ecosystem development and financial support, ensuring sustainable growth. The fund would also promote investment in high-potential emerging ecosystems, allowing smaller regions with talented founders to benefit from international capital.

The challenge is balancing development impact and financial returns. Smaller, less-developed ecosystems may struggle to attract investment without support, and first-time fund managers could face barriers. There is a risk that nascent ecosystems may be overlooked in favor of mature ones. However, proportional investment distribution could mitigate this, and private capital may still flow into emerging ecosystems with high potential and talented founders.

Business Model Scoping: Investment Vehicles

Based on dialogues with DMC representatives, the financing gap for startup ventures is a persistent challenge. Angel investor networks and venture capital firms tend to be less prominent. The public sector tends to be restricted in its ability to provide funding, apart from grant modalities. Hence, CCDT will undertake research to:

Explore possible business models and counterparts, depending on the target market/

- Reimbursable Grants, PPPs, Loans, PBLs, Regional Smart FoF
- **Stakeholders (internal & external):** ADB Operations, Local and National Governments, Private Sector

Identify potential target markets that may benefit from ADB-led funding schemes

- Central Asia (regionally or by individual market): Kazakhstan, Uzbekistan, Georgia, Mongolia, Pakistan
- South Asia (regionally or by individual market): Bangladesh, Pakistan, Sri Lanka, India
- Southeast Asia (regionally or by individual market): Vietnam, Philippines, Indonesia, Thailand

Potential Business Models (Requires More Discussions) - 1

Reimbursable Grants: A TA to provide reimbursable grants to fund managers, backed by ADB and other donors, could be formed.

Examples: Providing reimbursable grants to a small number of funds to start, from a pilot TA. These grants would be provided to funds with the reimbursement mechanism to track ROI/KPI for the program and allow ADB to also benefit from any gains. Or a separate TA could be set up for one specific country (perhaps starting with 2-3), with the purpose of partnering with prominent local venture investors, and coinvesting in startups alongside them. ADB could share economics and provide support in measuring impact.

Circumstances: A small number of donor countries are interested and keen to participate quickly – not a large quantum of capital is needed to catalyze impact

Pro: Able to organize, structure, and launch quickly; Flexibility in administering funding and capital; Replicable across a wide range of markets and countries; Private sector expertise can be tapped into

Con: Limited investment size; Overall program may need to be kept small to be effective/efficient

Potential Business Models (Requires More Discussions) - 2

Public-Private Partnership: ADB could assist government donors in evaluating and selecting private sector partners/bidders (i.e., fund of funds managers) to form a fund to invest in new or up-and-coming local venture capital firms and support the development of and mobilization of capital for the next generation of fund managers in their respective countries.

> **Example**: An ADB-advised PPP setting up a venture capital-focused fund of funds financed by a group of government donors, aimed at investments into venture capital firms in the donors' respective markets, with potential ADB involvement in implementation.
>
> **Circumstance**: A group of donor countries that include larger markets with enough fund managers to back are open to participating.
>
> **Pro**: Governments could be advised to work with a private sector bidder that would maximize development impact; Countries and markets that are not in the same region, but of similar "typology" may pool together resources to develop their respective ecosystems; Private sector participation is maximized
>
> **Con**: ADB would not be involved in the administration of the resulting fund of funds after set-up; Countries with existing "fund of funds" programs may not be a fit

ADB

DIGITAL TECHNOLOGY FOR DEVELOPMENT

Potential Business Models (Requires More Discussions) - 3

Trust Fund: A trust fund could be set up to invest as a limited partner into venture capital funds, with ADB as the investor of record.

> **Example**: A trust fund, formed with pooled capital from donors from either the public or private sector or both, focused on one specific subregion (e.g., Southeast Asia) or all of Asia and the Pacific and backing emerging fund managers via equity investments as a limited partner in funds with the aim of pooling in additional risk capital from the private sector.
>
> **Circumstance**: ADB aims to launch a new business that speeds up technology/startup ecosystem development in countries/markets with significant existing momentum and/or partners with donors that have certain commercial return expectations
>
> **Pro**: Commercial returns and ROI may be maximized; Amount of private capital mobilized could be maximized; Size of the fund/program would be large
>
> **Con**: May not be able to make investments that maximize development impact to balance with commercial considerations; Small countries with very nascent ecosystems may be left out; Emerging or first-time fund managers likely would not be the beneficiaries