

# Big Futures for the Smallest Firms

Finance That Works for Nano, Micro  
and Small Enterprises

June 2025 • Alexander Sotiriou, Swati Sawhney,  
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# Executive Summary

**F**ROM BUSTLING OPEN-AIR MARKETS across Africa to family-run businesses in Asia and Latin America, micro and small enterprises (MSEs) help sustain livelihoods and foster inclusive growth. They are the backbone of economies worldwide, particularly in emerging markets and developing economies (EMDEs), accounting for nearly all businesses and most employment opportunities. Despite their economic importance, they remain consistently underserved by financial institutions due to systemic credit barriers, limited digital access, and policies that often prioritize larger businesses.

As a result, MSEs face a persistent financing gap estimated at nearly \$5 trillion (Dalberg 2019). Many remain excluded from formal financial systems, particularly nano enterprises and women-led businesses, which struggle with barriers such as limited credit histories, collateral requirements, and digital exclusion.

As the financial sector undergoes rapid technological transformation, digital innovations—such as fintech lending models and alternative credit scoring—hold immense potential to bridge the finance gap. Yet, technology alone is not a panacea. Many of the most excluded MSEs, particularly women-led nano enterprises, continue to rely on informal financial sources and lack the digital footprints required for purely algorithmic lending decisions or purely digital customer interfaces. This underscores the importance

of hybrid approaches that blend digital capabilities with human-centric financial services.

This report examines the challenges and opportunities of expanding MSE finance, focusing on nano and micro enterprises, women-led businesses, and the evolving role of technology in fostering their inclusion. Drawing on CGAP's research, it sheds light on both the promise and the limitations of digital innovation.

The paper concludes with recommendations for stakeholders across the MSE finance ecosystem, but especially for donors and investors, who can help usher in the next generation of inclusive MSE finance ecosystems by focusing on the following four strategic priorities:

1. **Develop a deeper understanding of MSE heterogeneity to enable tailored solutions.** Invest in research and data-driven segmentation that reflects MSE diversity by size, sector, gender, and informality. This targeted approach allows financial service providers (FSPs) and other stakeholders to design solutions and remove barriers that address specific needs and structural constraints.
2. **Support the adoption of hybrid business models.** Encourage digital finance solutions combined with human touchpoints to build trust and support uptake among underserved MSEs—particularly women-led and nano enterprises. This approach ensures inclusive, scalable services that cater to the most excluded businesses.

3. **Incorporate informal, semi-formal, and community-based FSPs into the digitization journey.** Facilitate these providers' transition to digital platforms through investment, training, and partnerships with formal institutions. This will enable them to maintain strong community relationships, scale effectively, and better serve excluded MSE segments.
4. **Expand risk-tolerant capital to support early-stage fintechs and responsible market development.** Provide targeted debt and equity to help inclusive fintechs innovate and reach underserved MSEs. Strengthen consumer protection, promote enabling regulations, and invest in digital infrastructure to ensure responsible growth of the inclusive finance ecosystem.

## PART 1

# The Smallest Enterprises Have Colossal Impact: MSEs Provide Jobs and Livelihoods to Billions

**E**FFORTS TO SUPPORT THE GROWTH AND resilience of micro and small enterprises (MSEs) have long been at the forefront of international development, and for good reason. In emerging markets and developing economies (EMDEs), there are almost 500 million MSEs (Sawhney et al. 2022), accounting for nearly all businesses and almost all jobs available to low-income workers. They fuel local economies by providing essential goods, services, and strengthening livelihoods, making them a cornerstone of economic stability and resilience.

In Kenya, for example, a study by the Kenya National Bureau of Statistics showed that micro enterprises account for nearly all firms (+97 percent), employ most of Kenya's labor force (~57 percent), and create the vast majority of new jobs (84 percent) (KNBS 2016). These dynamics are not unique to Kenya or the African continent. In India, micro enterprises account for 99 percent of businesses (Government of India 2017), and in Peru, the figure is 97 percent (OGEIE 2018). And across nearly all EMDEs, MSEs are the primary channel consumers turn to for their everyday staples, such as soap, rice, and cooking oil (Ivers et al. 2022).

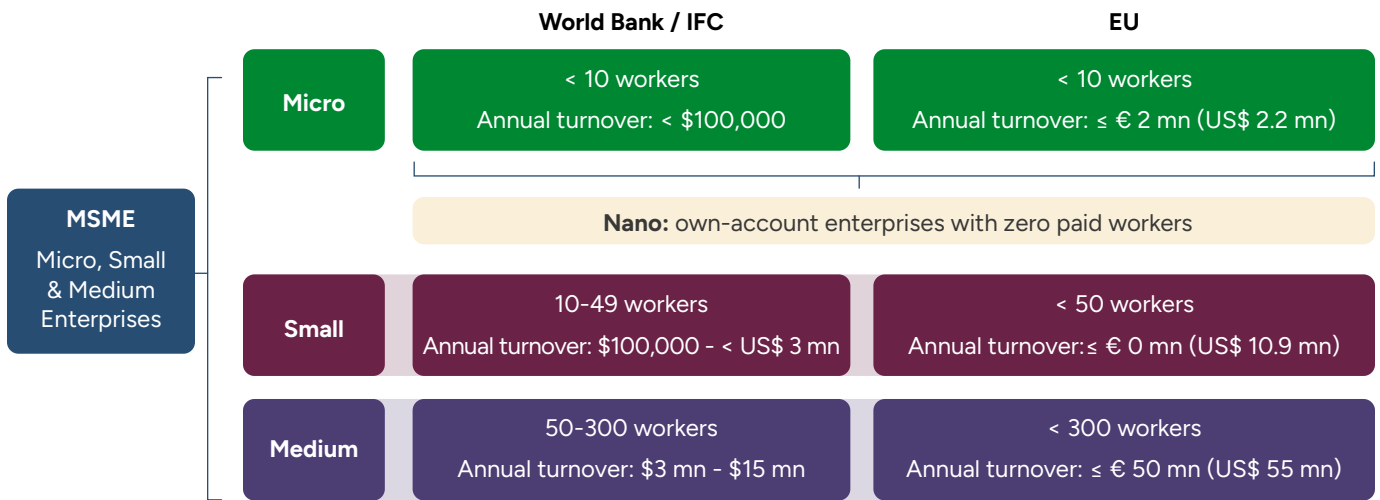
But what exactly is an MSE? The definitions of what makes an enterprise micro, small, or medium (MSME) vary considerably by country and institution. Most definitions are based on the number of paid workers, and gravitate around the thresholds summarized in Figure 1 below.

**The term MSE emerged because of the unique challenges these smaller businesses face compared to their medium-sized counterparts. But even the term MSE is overly broad and obscures the immense diversity of realities and needs.**

CGAP has adopted the term “nano enterprise,” which has emerged more recently to describe the smallest enterprises—those operated solely by the owner—which are sometimes called own-account entrepreneurs, sole proprietorships, or the self-employed. These firms are the smallest and most vulnerable enterprises and are often the most excluded from the formal financial sector.

An ILO study (ILO 2019) (see Figure 2 below) demonstrates that nano enterprises alone provide more than 50 percent of employment in low and lower-

FIGURE 1. Most common definitions of MSMEs worldwide

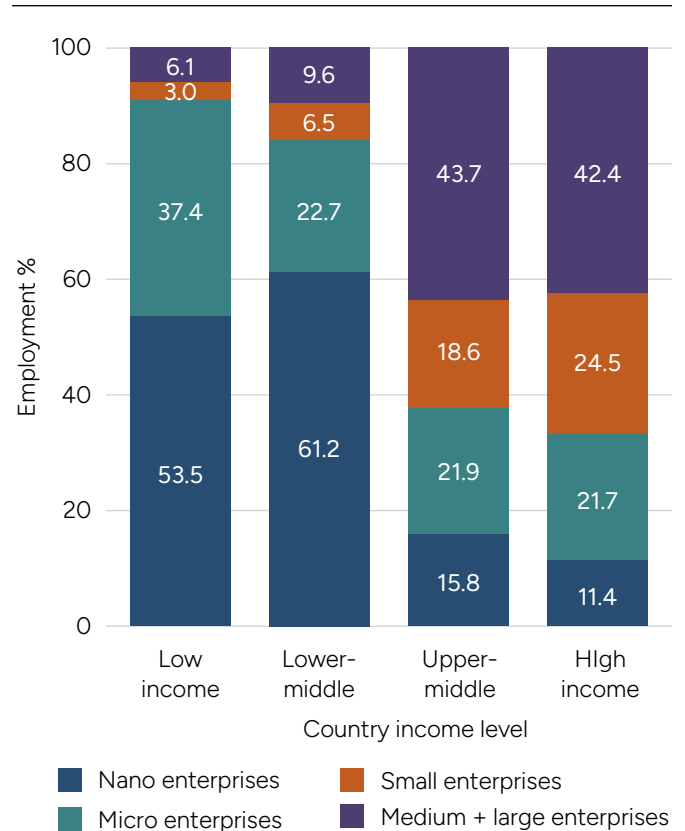


Source: Authors.

middle-income countries, and when micro enterprises with up to nine employees are included, that figure rises to over 80 percent.

Globally, these nano and micro enterprises (NMEs) provide jobs and livelihoods to hundreds of millions of people, and it is imperative that the international development community continues to refine its understanding. Failing to grasp the varied realities leads policy makers and funders to leave large segments of enterprises—particularly the smallest and most vulnerable—falling through the cracks.

FIGURE 2. Employment share of MSMEs by country income group



Source: ILO (2019).

## PART 2

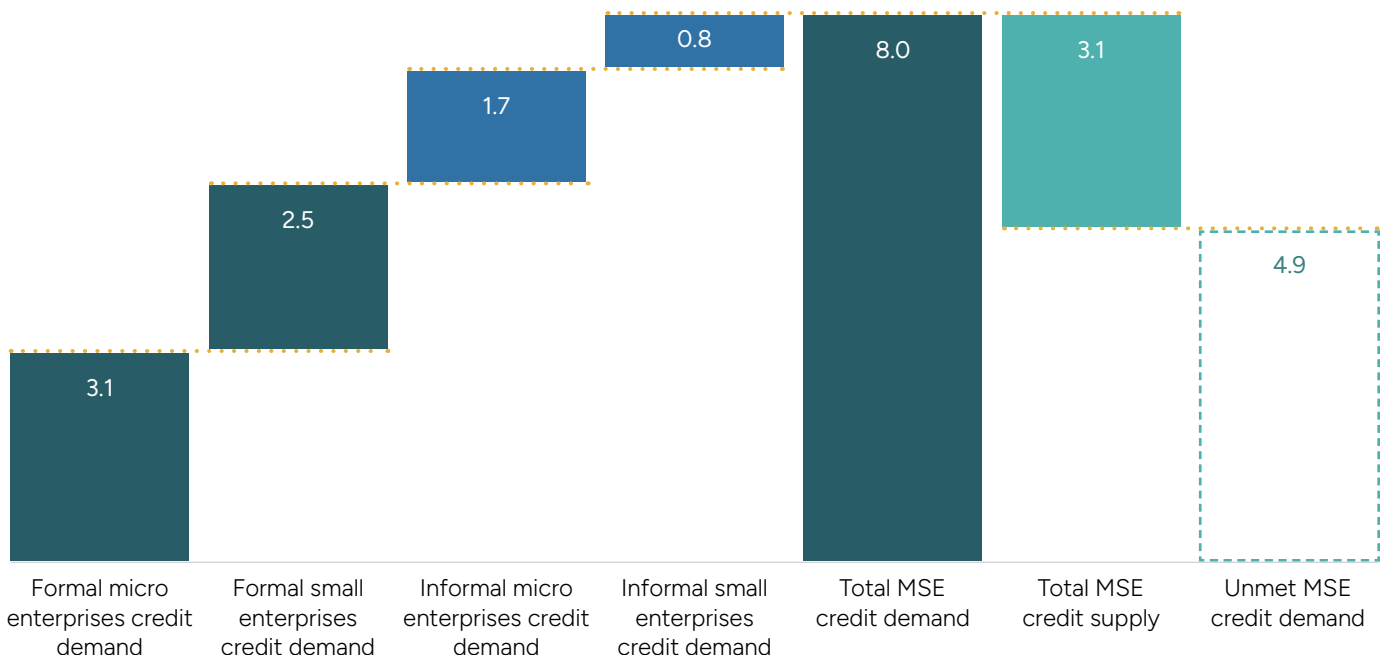
# Recognizing MSE Diversity is Crucial Because One-Size-Fits-All Finance Leaves the Most Vulnerable Behind

**A**CCCESS TO RESPONSIBLE FINANCIAL services is crucial to MSEs' growth, sustainability, and resilience. Without adequate financing, many struggle to manage cash flow fluctuations, expand inventory, or invest in productivity-enhancing tools. Responsible credit enables them to navigate economic uncertainties, seize growth opportunities, and build long-term stability. For nano

entrepreneurs, access to fair and flexible credit can be the difference between survival and closure, allowing them to sustain daily operations, adapt to changing market conditions, and provide for their families.

However, despite decades of efforts by the development community, many MSEs can still not access the credit they need. According to CGAP and

FIGURE 3. Estimated global MSE credit gap



Source: Dalberg (2019).

Dalberg, the financing gap is estimated to be nearly \$5 trillion dollars (Dalberg 2019). Bridging this gap is urgent for empowering MSEs to stabilize, expand, and provide more secure jobs and livelihoods to the hundreds of millions of households that depend on them.

**To close the finance gap, funders, policy makers, and financial service providers (FSPs) need to be more targeted in the types of enterprises they intend to support.**

A 2022 CGAP paper (Sawhney et al. 2022) underscores the importance of integrating an understanding of MSE heterogeneity into designing solutions to address the specific needs of each segment. In summary, it is important to understand the specific characteristics of both the entrepreneur themselves, as well as the business they operate. Figure 4 below illustrates potential segmentation dimensions.

We have already discussed the diversity of MSEs based on one of the above dimensions: a firm’s size. Another critical dimension is the gender of the entrepreneur.

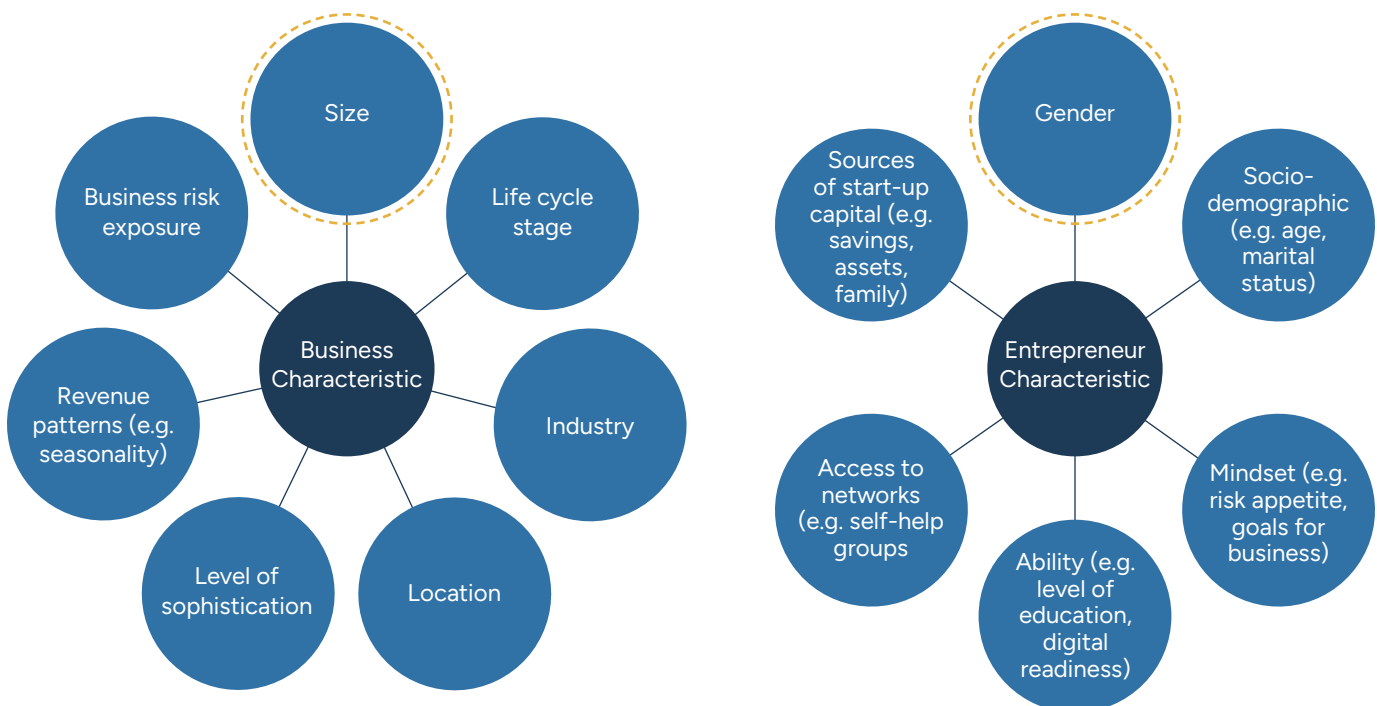
**Women are concentrated in nano and micro enterprises, which makes these smallest firms a critical entry point for promoting women’s economic empowerment.**

Women-led NMEs face systematic barriers to credit. Studies show that women entrepreneurs receive smaller loans, pay higher interest rates, and are often required to provide spousal guarantees (Sawhney, Kimani, and Sotiriou 2025). This is exacerbated for women-led nano enterprises, where socioeconomic norms, asset ownership disparities, and a lack of formal financial histories can become insurmountable obstacles.

*“Men have easy access to loans to expand their businesses because they have collateral. Women, on the other hand, often lack such assets, which limits their ability to secure loans necessary for growth.”*

—Woman, Nano, Trade, Rural Uganda

FIGURE 4. Summary of MSE segmentation dimensions



Source: Authors.

The challenges WNMEs face are rooted in social norms and manifest at the earliest stage of a company’s life cycle, the start-up phase. CGAP research [add hyperlink to forthcoming WNME paper] shows that, even among nano and micro enterprises, women have less to invest in their businesses, as illustrated in Figure 5 below.

*“You know, the businesses here in the rural areas are mostly done according to one’s ability [capital]. Like for myself, the shop that I have, I started with very little money—8000 shillings. I would have wanted to start something big, but because I did not have the ability [capital], I decided to start small.”*

—Woman, Nano, Manufacturing, Kenya

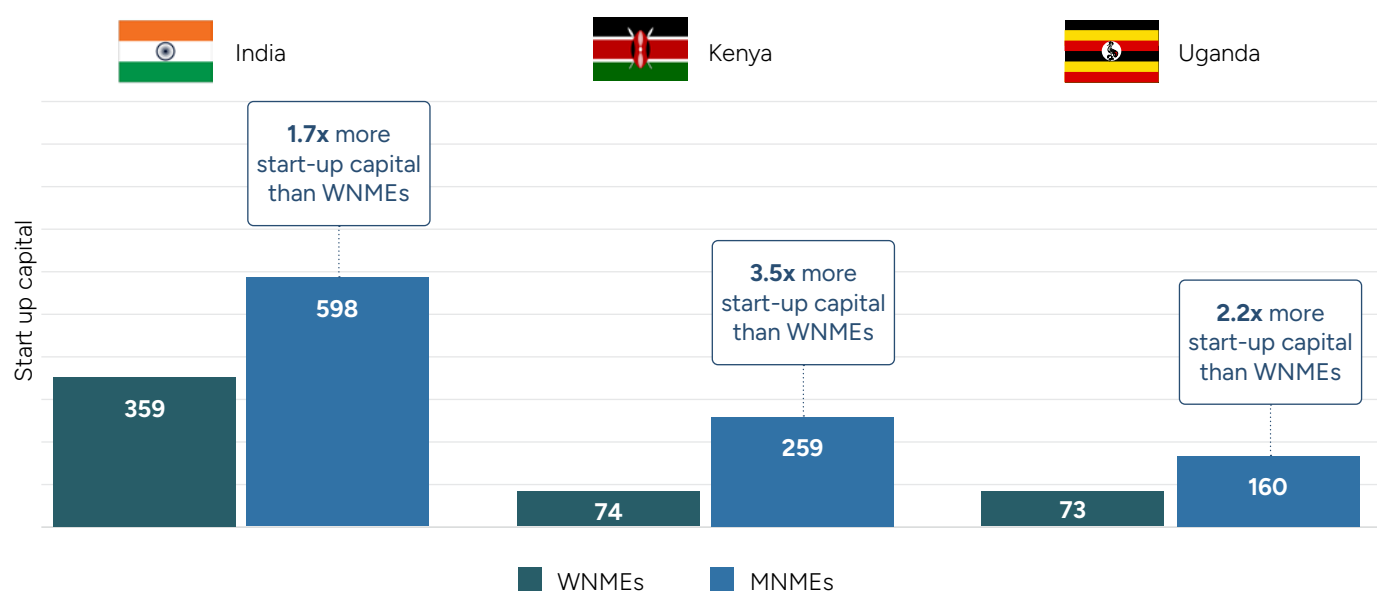
Adding to the challenges WNMEs face is that they tend to enter sectors with low barriers to entry and are hence less profitable, and they continue to be subject to gender norms that, among other things, divert profits from the business to the household.

This leads to women-led businesses being trapped in a vicious cycle that results in lower growth and resilience for their businesses, as illustrated in Figure 6.

Breaking the vicious cycle for WNMEs demands targeted, carefully tailored approaches. WNMEs are a diverse group, with variations across the other segmentation dimensions summarized in Figure 4 earlier on. They operate in rural and urban locations across sectors and vary by marital status, level of education, and the mindset they bring to their businesses. If we do not take these differences into account, we will fail to close the gender gap among MSMEs.

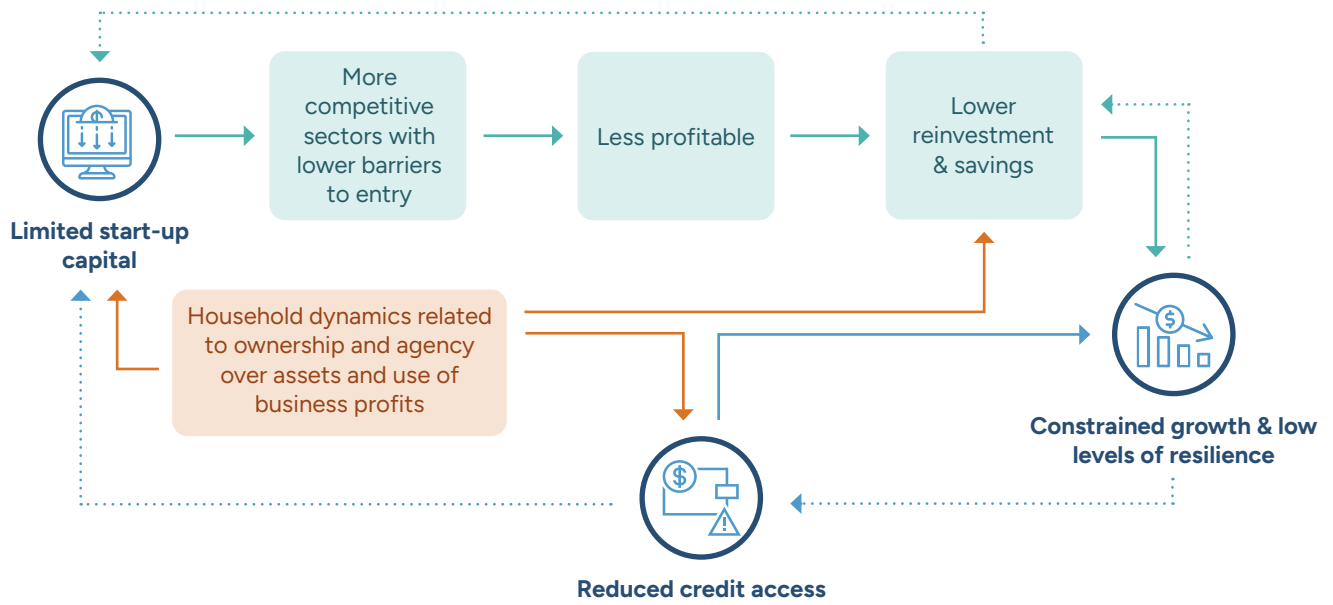
Similar complexities apply to other underserved segments, underscoring the limits of broad “MSME finance” strategies. Without nuanced segmenting, the firms that need financing the most risk being further marginalized.

FIGURE 5. Start-up capital gap between WNMEs and MNMEs (in USD)



Source: Sawhney et al. (2025).

FIGURE 6. The vicious cycle that hinders WNME development



Source: Sawhney et al. (2025).

## PART 3

# Technology is Driving Innovations that Can Address the Finance Gap, Even for Hard-to-Reach MSEs

**A** S THE WAVE OF DIGITAL transformation sweeps over the financial sector, a new generation of business models has the potential to dramatically advance the frontier of MSE finance, including among some of the most underserved and excluded MSE segments. CGAP research reveals that the firms that are most successful in reaching underserved segments do so by taking a hybrid approach that leverages digital technology, but also includes physical touchpoints (Anand et al. 2024). This section provides an overview of these business models and their impact on MSEs.

**Three innovations power the next generation of MSE finance, helping FSPs overcome traditional barriers and leading to improved customer outcomes.**

The supply-side barriers to delivering inclusive credit to MSEs are well known. MSEs rarely have reliable financial statements or credit histories, which makes it difficult for lenders to assess their risk profile. Often, a bigger challenge is overcoming the high relative cost and the low relative revenue of providing small loans. For example, consider the unit economics of providing a \$100 loan versus a \$1,000 loan, both of which carry an interest rate of 10 percent. It is likely that a lender incurs similar costs to provide and service both loans, but the second yields 10 times as much revenue. These

dynamics create powerful incentives for lenders to go up-market, where they can provide larger loans, creating a lower bound beneath which it is impossible to create a sustainable business.

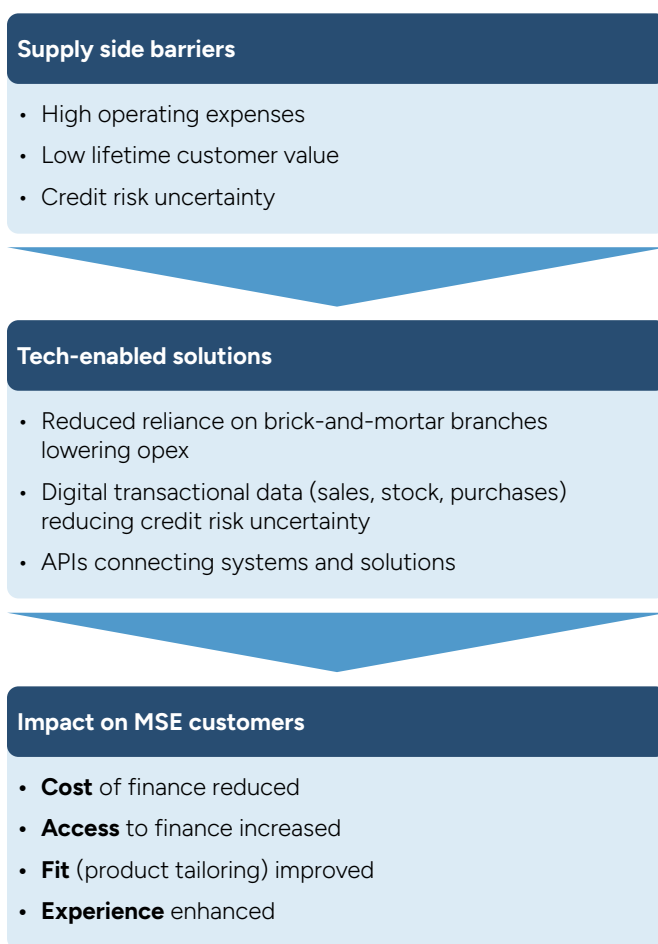
Broadly speaking, three sets of technological innovations have emerged that are helping the next generation of innovative MSE finance providers overcome these supply-side barriers:

- **Reduced reliance on brick-and-mortar branches** and increased reliance on digital payments infrastructure, like mobile money, lowers the expense of providing small-ticket financial services.
- **Digital data trails**, especially those that are close proxies to cash flows, like inventory or payment data, enable more efficient and accurate risk assessments. CGAP research demonstrates that transactional data can have similar predictive power in credit scoring as credit history (Caire and Fernandez Vidal, 2024).
- **Application programming interfaces (APIs)** allow FSPs to scale swiftly by interconnecting and embedding financial and non-financial services across multiple parties.

Collectively, these innovations translate into better offerings for MSEs—lower-cost loans, faster service,

products that match cash flows more precisely, and a more user-friendly experience, as summarized in Figure 7 below.

FIGURE 7. **How technology results in better outcomes, addresses barriers to MSE finance, and has a positive impact on MSEs**



Source: Hommes et al. (2022)

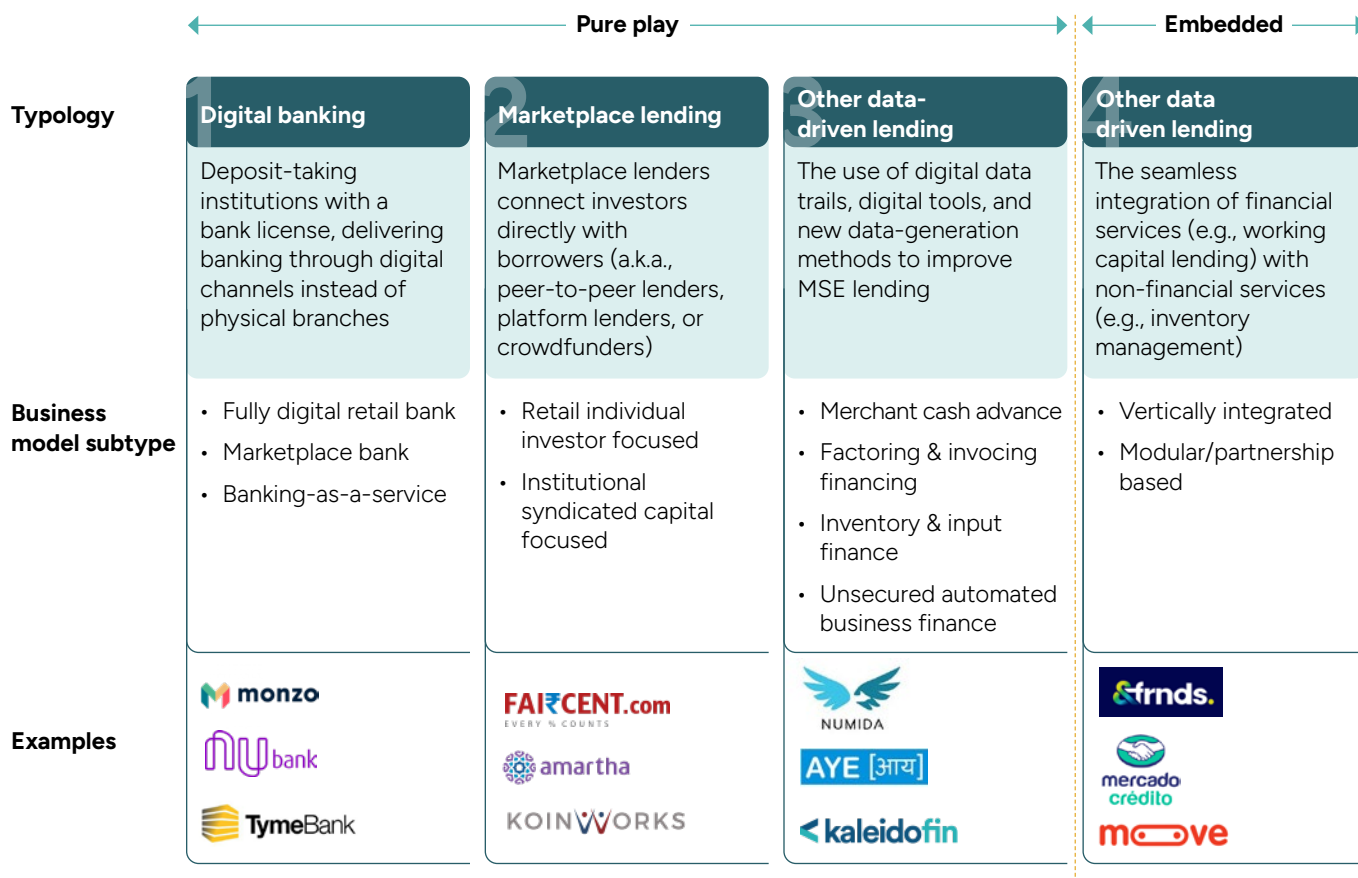
### 3.1 Fintech companies stand at the vanguard of innovation, pioneering new technologies, approaches, and business models that provide a glimpse into the future of MSE finance.

CGAP has spent the last five years working with and studying fintech companies that have employed the above tech-enabled solutions to provide inclusive credit to MSEs. Our efforts have focused on cutting through the fintech noise to identify some signals indicating real potential to address the needs of excluded MSE segments. In the publication “The Promise of Fintech for Micro and Small Enterprises” (Hommes et al. 2022), CGAP highlights four categories of inclusive fintech business models that show great promise in addressing the MSE finance gap, as illustrated in Figure 8 below.

The first three categories are “pure play” financial services providers, meaning that their core business is providing financial services. They include variations of digital banking, marketplace lending, and other data-driven lending (e.g., merchant cash advance). The fourth category is embedded finance, which CGAP defines as “the seamless integration of financial services with a non-financial service” (Hommes et al. 2022). Embedded finance providers are not necessarily focused on providing financial services and are often ecommerce companies that embed financial services into their ecommerce offerings.

As examples of firms that have leveraged technology to support vulnerable MSEs and the people whose livelihoods depend on them, consider the cases of three CGAP fintech partners: Kaleidofin, &frnds, and Boost.

FIGURE 8. Typology of promising inclusive fintech business models



Source: Hommes et al. (2022)

## LEVERAGING TECHNOLOGY TO SUPPORT WOMEN-LED ENTERPRISES: KALEIDOFIN



Kaleidofin uses data and technology to provide

financial access to underserved businesses, particularly those owned by women in India’s informal sector, with a strong focus on inclusivity. Their proprietary “ki score” credit-scoring algorithm analyzes diverse data sources—including credit bureau records, demographic insights, savings behavior, and repayment patterns—to create a more inclusive credit assessment that does not automatically exclude borrowers with past late payments. By distinguishing between short-term cash flow delays and true credit risk, Kaleidofin enables financially excluded women to access affordable individual loans, transitioning them away from informal, often exploitative credit sources. Additionally, the company enhances accessibility

through tools like the “ki credit” platform, the “ki cash” app, and a local-language chatbot, ensuring that financial products are tailored to the needs of its users.

A CGAP/60 Decibels survey of Kaleidofin’s customers found that 9 out of 10 reported an increase in revenue due to Kaleidofin’s financing, demonstrating the impact well-targeted solutions can have on women-led MSEs.

## EMPOWERING CORNER STORES THROUGH EMBEDDED FINANCE: &FRNDS AND BOOST

Mom-and-pop store, duka, warung, and bodega are some of the many names that countries have for their neighborhood shops. These microretail stores, ubiquitous in emerging markets and developing economies, sell fast-moving consumer goods (FMCGs), including commodities such as rice, flour, spices, or cooking oil, alongside consumer brands, such as soft

drinks, packaged foods, and toiletries. Microretailers provide incomes to millions of families, as well as essential goods and services in neighborhoods across the globe. These millions of small stores constitute a \$900+ billion global industry, accounting for most grocery sales in EMDEs (The Business Research Company 2021).

A growing number of ecommerce platforms now cater to these shops, offering next-day delivery of wholesale inventory. CGAP has studied the growing number of ecommerce platforms that now cater to these shops (Kruijff, Sawhney, and Wright 2024). They typically provide a smartphone app that allows the shopkeeper the opportunity to buy the inventory they need to keep their shop running without needing to leave their shop to restock, often with next-day delivery. Think of Amazon, but instead of providing consumers with retail products, they are providing businesses with wholesale products.



Operating in the Philippines, &frnds exemplifies this approach. The company employs an asset-light model, using a digital ordering platform alongside a field sales force to connect microretailers with community wholesalers. Their “consignment services” resemble a buy-now-pay-later (BNPL) option for business inventory, with credit terms that would be considered impossibly generous by traditional MSE finance providers. The MSEs pay zero interest, can return unsold stock, and can test new products with minimal risk.

For more detailed information about &frnds, please see the video, [here](#).



**Boost** Similarly, in Nigeria, Boost partners with Unilever distributors to supply micro enterprises. One thing that makes Boost Nigeria unique is that it partners with a non-profit that uses grant funding to offset the higher cost of reaching women-led nano enterprises in remote areas. Once shopkeepers have established a purchase history, they become eligible for “Stock Boost,” a BNPL credit product that allows them to buy more than their available cash.

A CGAP/60 Decibels survey of Boost Nigeria’s customers demonstrates the impact this kind of financing can have:

- 69 percent of customers improved their ability to manage their finances
- 69 percent increased their savings
- 71 percent improved their access to emergency funds
- 75 percent reported a better quality of life
- 85 percent reported an increase in income

**Even if a single fintech does not scale or survive, fintech innovation spurs industry-wide transformation.**

Cutting-edge technology companies serving micro and small enterprises play an essential role in the inclusive finance ecosystem. They push the boundaries of innovation, demonstrate what is possible, and spur competitors to adopt new technologies and approaches. Several of the fintech companies CGAP has studied and partnered with over the years have reached enormous scale, even unicorn status, but others have not. Some have been acquired or pivoted to different business models, and some have failed. However, even those companies that do not scale play their part in making the ecosystem more dynamic. Others take up their technologies and ideas, pushing the ecosystem as a whole to evolve.

## 3.2 Traditional microfinance institutions have been rapidly adopting some of the same innovations pioneered by fintech companies.

Now considered traditional, microfinance institutions (MFIs) are the original innovators in the MSE finance ecosystem. The business models they pioneered in the 1980s and 1990s—including the group loan method pioneered by Grameen Bank and the individual loan method pioneered by South American MFIs—were revolutionary in their time. Before these innovations, providing loans to MSEs at scale seemed unfathomable. Today, MFIs represent one of the most significant pillars of the MSE finance ecosystem. Data from MIX Market in 2018 recorded nearly 140 million microfinance borrowers globally and a total lending portfolio of almost \$125 billion (Convergences 2018)—which is likely a vast underestimate because of MIX Market’s limited sample.

That last generation of MFIs are no longer the disrupters; they are the incumbents, with large balance sheets and significant customer bases (relative to the MSE sector). To remain competitive and deliver better services, many are adopting the digital tools and data-driven approaches pioneered by fintechs.

Through interviews, pilots, and by convening a community of practice, CGAP has identified and tested the factors that have led to both the [failure](#) and the [success](#) of MFIs’ digitization. In summary, CGAP has identified six principles MFIs should focus on to have a successful digitization journey:

### 1. **An Incremental Pathway to Digitization**

In contrast to the widespread idea of leapfrogging through digitization, where technology overhauls an

institution, [CGAP finds that digitization](#) is a process of building value-generating use cases and, as such, is often incremental (Flaming et al. 2023).

### 2. **The Core Business**

MFIs gain the greatest benefit from digitizing their core lending processes. Automated credit decisioning significantly speeds up approvals and reduces operating expenses.

### 3. **An Agile, Minimal Viable Product (MVP)–Driven Approach**

Early successes in digital initiatives often stem from straightforward technology and a focus on minimal functionality. This keeps teams from being overwhelmed and enables quicker wins that foster momentum.

### 4. **Develop Tailored Return on Investment (ROI) Targets**

Every technology investment requires a disciplined return-on-investment (ROI) assessment, but different investments require different approaches. An investment in an agent network may yield specific and short-term returns, while the returns from an investment in a data warehouse may be more diffuse and take longer to materialize.

### 5. **Tracking Customer Behavior**

MFIs need to go beyond basic productivity indicators and assess how customers change their usage patterns. By analyzing transaction data, loan renewal frequency, and repayment behavior, they gain insights that inform product refinement and service enhancements.

### 6. **Leadership and Change Management**

Committed leadership is essential for digital transformation. Successful MFIs often replace or augment C-suite roles to ensure they have the digital expertise required. They also invest heavily in staff training and establishing internal buy-in.

As an example of an MFI taking CGAP's recommended approach, consider the case of FINCA:

## **FINCA IMPACT FINANCE: CREATING VALUE THROUGH IMPROVED RISK RATING**



FINCA Impact Finance (FIF) launched "FINCA Score" in 2017 to automate credit

decision-making for its international network of 20 banks and MFIs. The system uses up to eight data points, including three related to repayment history, to generate a risk rating from one to five. This rating helps subsidiaries preapprove loans, apply risk-based pricing, and significantly reduce both processing time and judgment errors. By 2020, between 35 to 50 percent of all follow-up loans were underwritten using FINCA Score, enabling a streamlined process without compromising portfolio performance.

Customers benefit from faster credit approvals, preapproved offers before loan maturity, and lower interest rates for lower-risk borrowers. In subsidiaries with already low portfolio-at-risk (PAR) rates, FINCA Score helps maintain these performance levels while scaling-up automated lending. The scoring model has proven robust—low-risk loans perform 80 percent better than the average portfolio, while high-risk loans are five times riskier. Although the initial system involved some manual uploads and communications, FIF planned to automate FINCA Score with decision engine software.

This example from FINCA, and many others like it that CGAP has studied, demonstrates that embarking on a digitization journey based on these principles does not require a bold investment in technology but a bold vision, focus, consistency, and agility. It also requires an investment in a strong business intelligence capability to track business and customer outcomes.

## PART 4

# For Tech-Enabled Solutions to Reach their Potential, Two Challenges Must Be Addressed: Developing Hybrid Business Models, and Funding Inclusive Fintech

### 4.1 A purely digital approach to MSE lending is unlikely to close the gap among the most excluded MSEs, especially women-led nano enterprises.

As fintech companies begin to scale and incumbent financial institutions, including MFIs, transform into more digitally enabled businesses, we are witnessing the emergence of the next generation of microfinance providers. The next generation of providers has the potential to advance the MSE finance frontier, but technology alone will not solve the problem.

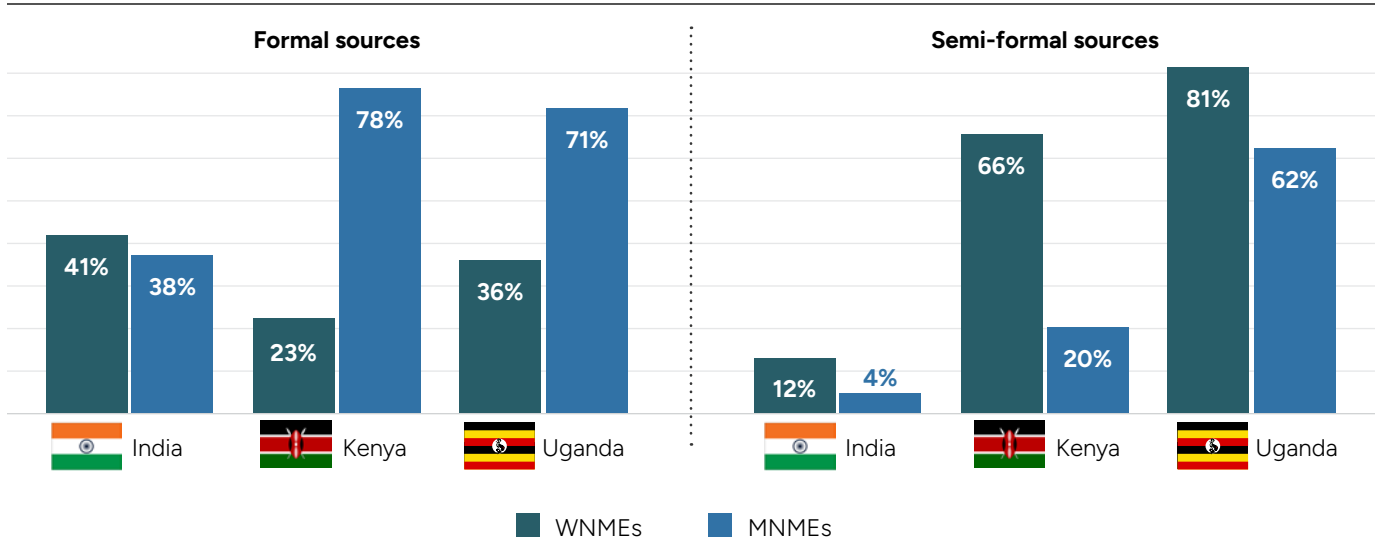
CGAP's research suggests that while some MSEs increasingly use digital technologies to improve their businesses, too many continue to face barriers preventing them from realizing the benefits these technologies offer. Many MSEs, especially those in the most excluded and vulnerable segments, were unable or unwilling to adopt technologies because of a lack of skills (e.g., basic literacy, digital literacy), infrastructure and cost issues (e.g., affordable internet data, smartphones), social norms, or trust.

A digital divide in broader usage—smartphone usage, social media, online marketplaces—often translates into a digital divide in finance. An MSE with a larger digital footprint—particularly in areas like digital payments, accounting, and order management—is far better positioned to access the next generation of digitized financial solutions. Conversely, those that remain offline face an increasing risk of exclusion. This challenge is especially severe for the most vulnerable MSEs—those that are rural, nano, informal, or women-led—which are at the highest risk of being left behind.

CGAP research demonstrates that women-led nano and micro enterprises are far more reliant on informal (e.g., friends and family) and semi-formal (e.g., Village Savings and Loans Associations) sources of credit than their male-led peers, as illustrated in Figure 9 below.

All of these factors indicate that women-led MSEs have been historically better served by less formal providers that are more analog. Without more focused interventions that take the specific needs and profiles of women-led MSEs into account, the digital revolution in MSE finance risks exacerbating rather than

FIGURE 9. Comparing formal and semi-formal sources of credit, in percent (%)



Source: Sawhney et al. (2025).

ameliorating the digital divide between male-led and women-led MSEs.

Reaching excluded MSEs in EMDEs with inclusive credit will require a human touch for the foreseeable future. However, FSPs can still reap enormous benefits from hybrid business models that combine high-tech solutions driving credit decisions with high-touch human interactions at the point of contact.

TymeBank and Moniepoint—both valued at over \$1 billion—are prominent African fintechs taking this hybrid approach. As a 2024 TechCrunch article (Kene-Okafor 2024) highlights, “...both fintechs are taking a hybrid approach to banking, blending the convenience of digital banking with real-world, physical touchpoints.” In the case of TymeBank, they have developed a network of over 15,000 kiosks and agents through partnerships with some of South Africa’s leading retailers. In Nigeria, Moniepoint has built a network of over 200,000 small businesses nationwide that act as agents for their services.

## 4.2 Even with the best intentions, most inclusive credit fintechs fail, often due to lack of funding. But a new class of innovative asset managers is creating bridges to scale and impact.

Companies like &frnds, and many others CGAP has studied, demonstrate that with the right focus and intention, fintech companies can address the needs of underserved MSEs. However, despite some success stories, inclusive credit fintechs face considerable funding challenges. Over half of inclusive fintechs struggle to secure capital beyond their initial round, limiting their ability to meet the significant credit gap for MSEs. CGAP research shows that 54 percent of inclusive credit fintechs do not make it past the first round of funding, and only 15 percent will complete three or more funding rounds (Kruijff and Sotiriou 2025). The high failure rate is due in part to an inadequate funding runway. Additionally, the pressure of surviving to the next round of funding has pushed fintechs to become less inclusive by chasing the lower-hanging fruit of wealthier and more included customers.

FIGURE 10. The three-step approach for innovative lending to inclusive fintech start-ups



Source: Kruijff and Sotiriou (2025).

One particular funding challenge early-stage inclusive fintech companies face is securing debt financing to grow their portfolio of loans. The lack of debt funding forces the fintechs to use equity capital to grow their loan book, which is inefficient and expensive and dramatically accelerates a company's cash burn rate. There are many good reasons why traditional debt investors might steer clear of early-stage fintechs—including limited track records and credit risk management practices that haven't fully matured.

A new category of data-enabled asset managers, such as Untapped Global, ALMA Sustainable Finance, Cauris Finance, and Lendable, is emerging with strategies designed to mitigate these risks. These firms use advanced data analytics to assess risk with greater precision, enabling them to fund high-potential fintechs that traditional investors might otherwise overlook. By

integrating directly with fintechs' loan management systems, they gain real-time insights into portfolio performance, refine credit risk models, and design tailored financial structures. This approach reduces investor risk and supports fintechs in scaling sustainably and responsibly. Figure 10 illustrates this three-step process, from establishing data connections to offering more flexible, higher-level financing structures.

By reducing the information asymmetries between the lender and the fintech and enabling real-time credit risk management, these innovative asset managers are creating more reliable pathways for inclusive fintech companies to scale and ultimately meet the needs of more MSEs.

## PART 5

# Funders Must Work Together to Build the Next Generation of Inclusive MSE Finance Ecosystems

**T**ECHNOLOGY HOLDS IMMENSE potential to enhance MSE finance, but meaningful progress requires a nuanced understanding of the sector through a segmentation lens. And technology alone cannot bridge the financing gap, nor is access to capital the only barrier MSEs face. Limited market access, intense competition, regulatory burdens, infrastructure deficiencies, digital exclusion, and supply chain constraints all shape their resilience and growth.

For technology to reach its potential, funders, policy makers, and FSPs must coordinate their efforts to build an ecosystem that enables inclusive and scalable financial solutions for all MSE segments. Doing so will require all stakeholders in the MSE finance ecosystem, especially funders, to take on CGAP's four key recommendations below:

## 1. Develop a deeper understanding of MSE heterogeneity to enable tailored solutions

Funders should invest in research and partnerships to better understand MSE segment diversity, gender disparities, and structural market constraints so that FSPs and other market actors can design more

effective, inclusive solutions and other market actors can remove key barriers to closing the financing gap.

### WHY IT MATTERS:

While the financial inclusion community has long recognized the importance of supporting MSEs, a persistent challenge is the tendency to treat the MSE sector (or worse, the MSME sector) as a monolithic category. This oversimplification leads to one-size-fits-all financial solutions that fail to address the diverse needs, constraints, and opportunities of different MSE segments. In reality, MSEs vary widely in size, sector, formality, growth potential, digital readiness, and the specific barriers they face in accessing finance.

Making further progress in reducing the MSE finance gap will require an intentional and more targeted focus on segments that continue to be excluded.

More specifically, funders can:

- Support data-driven segmentation that incorporates a more nuanced perspective on firm size as well as gender, informality, sectoral differences, and social norms that shape access to finance.
- Fund research and pilots that help FSPs understand root causes of disparities (e.g., why women-led nano enterprises struggle to obtain start-up capital).

- Engage and support policy makers and regulators to address structural barriers (e.g., legal restrictions on women’s asset ownership and financial reporting requirements that exclude informal enterprises).

## 2. Support the adoption of hybrid business models

Funders can promote the adoption of hybrid (tech + touch) financial service models to ensure that the most excluded MSEs—especially nano enterprises and women-led businesses—can access and effectively use financial services.

### WHY IT MATTERS:

For MSE finance to be inclusive, scalable, and effective, FSPs must adopt a hybrid approach that leverages technology for efficiency but retains human interaction where necessary to build trust, support adoption, and address the needs of the most excluded businesses. While digital-first solutions can streamline operations, human touchpoints remain critical in ensuring that MSEs, particularly those in the informal sector, can effectively access and utilize financial services.

By blending the power of technology with human engagement, financial service providers can significantly enhance the reach, quality, and affordability of financial services for MSEs.

More specifically, funders can:

- Encourage FSPs to integrate human touchpoints into their digital finance strategies to support trust-building and customer engagement.
- Support pilot projects and research on hybrid models to develop evidence on their effectiveness for different MSE segments.
- Invest in partnerships between fintechs and MFIs to create blended service models that combine digital accessibility with relationship-based finance.

## 3. Incorporate informal, semi-formal, and community-based FSPs into the digitization journey

Funders can support the digitization of informal, semi-formal, and community-based financial providers—so they can reach scale and continue to serve excluded MSEs.

### WHY IT MATTERS:

Informal, semi-formal, and community-based financial providers will continue to play a crucial role in serving the most excluded MSEs, particularly women-led businesses and nano enterprises. However, their limited use of technology prevents them from scaling effectively and offering more sophisticated financial products. By digitizing their operations, linking them with formal financial institutions, expanding mobile and agent banking, and enhancing digital literacy, we can unlock greater financial inclusion for the most underserved MSEs.

Integrating informal, semi-formal and community-based providers into the digital finance ecosystem can create more reliable growth and resilience pathways for MSEs.

More specifically, funders can:

- Support the investments of community-based institutions in digital tools, training, and partnerships with formal institutions.
- Encourage linkages between fintechs and community-based providers—leveraging technology without replacing trusted, human-centered models.
- Ensure that as informal, semi-formal, and community-based FSPs digitize, regulatory frameworks support their inclusion in the digital financial ecosystem.

## 4. Expand risk-tolerant capital to support early-stage fintechs while promoting responsible market development

Funders can expand the availability of targeted debt and equity capital to help early-stage inclusive fintechs scale, drive market-wide innovation, and ensure that inclusive financial solutions reach underserved MSEs while promoting responsible market development.

### WHY IT MATTERS:

Early-stage inclusive fintechs struggle to secure funding, which limits their ability to test and develop financial solutions for MSEs; traditional investors hesitate to fund fintechs targeting excluded MSEs because of higher perceived risks. Yet even fintechs that do not scale contribute to market evolution. Enabling early-stage inclusive fintechs with adequate financing enables market development and needs to be done responsibly.

More specifically, funders can:

- Support innovative asset managers and financing mechanisms that specialize in funding inclusive fintechs at different stages of their growth, including through the use of blended finance.
- Promote regulatory and policy frameworks, including open finance and alternative credit data usage, that create a more enabling environment for fintechs serving excluded MSEs.

- Fund research and engage with regulators to ensure responsible market development for strengthening consumer protection and fair lending practices.
- Support investments in digital public infrastructure that enable financial providers to serve MSEs more efficiently and inclusively.

The evolution of MSE finance markets is happening at different speeds in different countries, amid rapidly evolving ecosystems that include a wide range of MSE finance providers, investors, and donors functioning in an environment of vastly diverse policies, regulations, and macroeconomic contexts. These are complex market dynamics, but by following these four strategic priorities, stakeholders across the development ecosystem can help ensure that both innovation and capital flow where they are most needed. When guided by a nuanced understanding of different MSE segments and a commitment to blended digital and human services, technological advancements can make finance more inclusive, strengthening enterprises and the broader economies that depend on them. Ultimately, narrowing the MSE finance gap is an investment in the resilience and prosperity of the millions of entrepreneurs who form the foundation of global economic growth.

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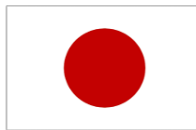
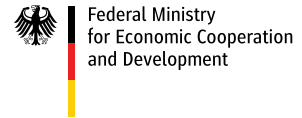
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# CGAP Members (continued)



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