Mobilizing the private sector is one important channel to foster economic growth and help financing the sustainable development goals in developing countries. However, the lack of funding resources in these countries means entrepreneurs who try to start or grow their firms face severe credit constraints.

Given commercial banks in developing countries tend to focus on clients with sufficient available collateral, microcredit was once seen as a panacea to alleviate these ills. However, a growing body of studies show that even if microcredit finances small income generating activities, it does not deliver the expected impulse for transformative changes on living conditions.

In this paper, we focus on a new funding initiative aimed at firms that are too big for traditional microcredit institutions while remaining too small to fulfil commercial bank’s criteria. These firms are stuck in what we call a “financial missing-middle” but possess a large potential for economic growth both in terms of generated income and employment.

Using two novel datasets we collected on entrepreneurs and their firms in Panama and Uganda, we examine how this funding initiative affects different measures of entrepreneurial activity (sales, investment, wages, number and type of employees). We use a difference-in-difference approach to show that the funding initiative entices entrepreneurs to increase their capacity through long-term investments. However, the short-term effects of these loans on sales and employment are negligible, even negative, because financing institution’s repayment conditions are too stringent. We also compare the effect of the institutional setting on the funding initiative.

In order to mobilize more of the private sector and increase the sources of financing for the sustainable development goals, the repayment terms of funding schemes in developing countries need to be adjusted so entrepreneurs may reap some of the short-term benefits from the loan and increase employment. Our study fits in a literature identifying microcredit’s impact on economic welfare and provide practitioners with a new initiative to alleviate the financial missing-middle in developing countries.