

# THE LANDSCAPE FOR IMPACT INVESTING IN SOUTHERN AFRICA



WITH SUPPORT FROM



**THE  
IMPACT  
PROGRAMME**

# ACKNOWLEDGMENTS

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The Bertha Center at the University of Cape Town contributed to this report by providing access to their database of active impact investors operating across sub-Saharan Africa.

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We would especially like to thank our interview participants. Without their key insights this report would not have been possible. We include a full list of interviewees in the Appendix.

For any questions or comments about this report, please email Rachel Bass at [rbass@thegiin.org](mailto:rbass@thegiin.org).

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## COMMON ACRONYMS

<b>AFD</b>	Agence Française de Développement (French Development Agency)	<b>IMF</b>	International Monetary Fund
<b>AfDB</b>	African Development Bank	<b>LP</b>	Limited Partner
<b>BIO</b>	Belgian Investment Company for Developing Countries	<b>MDG</b>	Millennium Development Goal
<b>BoP</b>	Base of the Pyramid	<b>MFI</b>	Microfinance Institution
<b>CEPGL</b>	Communauté Économique des Pays des Grand Lacs (Economic Community of the Great Lakes Countries)	<b>MSME</b>	Micro, Small, and Medium-Sized Enterprises
<b>COMESA</b>	The Common Market for Eastern and Southern Africa	<b>NGO</b>	Non-Governmental Organization
<b>CSR</b>	Corporate Social Responsibility	<b>OFID</b>	OPEC Fund for International Development
<b>DFI</b>	Development Finance Institution	<b>OPIC</b>	Overseas Private Investment Corporation (United States)
<b>DFID</b>	The Department for International Development (United Kingdom)	<b>PE</b>	Private Equity
<b>EIB</b>	European Investment Bank	<b>PPA</b>	Power Purchasing Agreement
<b>ESG</b>	Environmental, Social, and Governance	<b>PPP</b>	Purchasing Power Parity
<b>FDI</b>	Foreign Direct Investment	<b>PTA</b>	Preferential Trade Area Bank
<b>FMCG</b>	Fast-Moving Consumer Goods	<b>RFP</b>	Request for Proposal
<b>FMO</b>	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (Netherlands Development Finance Company)	<b>SACCO</b>	Savings and Credit Co-operative
<b>GDP</b>	Gross Domestic Product	<b>SGB</b>	Small and Growing Business
<b>GIIRS</b>	Global Impact Investing Ratings System	<b>SME</b>	Small and Medium-Sized Enterprises
<b>GIZ</b>	Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)	<b>SOE</b>	State-Owned Enterprises
<b>HDI</b>	Human Development Index	<b>TA</b>	Technical Assistance
<b>ICT</b>	Information and Communication Technology	<b>UN DESA</b>	United Nations, Department of Economic and Social Affairs
<b>IFAD</b>	International Fund for Agricultural Development	<b>UNCTAD</b>	United Nations' Conference on Trade and Development
<b>IFC</b>	International Finance Corporation	<b>USAID</b>	The United States Agency for International Development
		<b>VAT</b>	Value-Added Tax
		<b>VC</b>	Venture Capital
		<b>WASH</b>	Water, Sanitation, and Hygiene
		<b>WHO</b>	World Health Organization

## COMMON TERMS

<b>Early-stage business</b>	Business that has begun operations but has most likely not begun commercial manufacture and sales
<b>Focus countries</b>	Countries under study wherein non-DFI impact investors are most active, namely Madagascar, Malawi, Mozambique, South Africa, Zambia, and Zimbabwe
<b>Growth-stage business</b>	Company has a functioning business model, and its current focus is developing new products / services or expanding into new markets
<b>Mature business</b>	Profitable company with a developed and recognizable brand
<b>Non-focus countries</b>	Countries covered by the study but that have limited non-DFI impact investor activity, namely Angola, Botswana, Lesotho, Mauritius, Namibia, and Swaziland
<b>Venture-stage business</b>	Sales have begun but cannot sustain the company's operations. The business model is still being aligned with the realities on the ground

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# INTRODUCTION & METHODOLOGY



# FOCUS AND SCOPE

The impact investing industry has grown in prominence over the last decade, and impact investors globally have developed substantial and particular interest in sub-Saharan Africa. The 2015 impact investor survey from J.P. Morgan and the Global Impact Investing Network (GIIN) showed that more respondents have allocated a portion of their portfolio to sub-Saharan Africa than to any other emerging market, and more plan to increase their portfolio allocation to sub-Saharan Africa than plan to increase allocations to any other geography.<sup>1</sup>

Despite strong interest and a growing industry, relatively little research has examined impact investing markets at the country-by-country level. This type of granular information is essential to investors currently operating in a region or considering investments there in the future.

This series of reports, commissioned by the GIIN, seeks to address the lack of data available on impact investing in specific emerging economies. This is the fourth study of a region’s impact investing market and landscape to be published by the GIIN; others have focused on South Asia, East Africa, and West Africa.<sup>2</sup>

FIGURE 1. MAP OF SOUTHERN AFRICA



1 Yasemin Saltuk, Ali El Drissi, Amit Bouri, Abhilash Mudaliar, and Hannah Schiff, *Eyes on the Horizon: The Impact Investor Survey* (The Global Impact Investing Network and J.P. Morgan, 2015), <https://thegiin.org/knowledge/publication/eyes-on-the-horizon>.

2 These various reports can be downloaded from the GIIN website, <https://thegiin.org/knowledge-center/>.

For the purposes of this report, Southern Africa includes 12 countries: Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, and Zimbabwe. For each country, the report examines impact investing capital disbursed to date (by sector, size, and instrument). The report also analyzes key trends in the impact investing industry, as well as the challenges and opportunities available for both social enterprises and impact investors in each country. Further, the report offers analysis of political and economic factors that may inform and influence investment decisions on a country-by-country basis. These circumstances may have changed since initial data collection in mid-2015.

As defined by the GIIN, impact investments are “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.” A commitment to measuring social or environmental performance is also considered a hallmark of impact investing.<sup>3</sup> Investors who do not meet this definition have not been included in this report’s analysis.

Development finance institutions (DFIs) are important actors in the impact investing landscape, providing large amounts of capital both through direct impact investments and through indirect investments into other impact capital vehicles. Because of their large size and unique nature, this report analyzes DFI activity separately from the activity of other types of impact investors. As discussed in more detail in the Methodology section and in the DFI chapter, only international and regional DFIs have been considered in the report’s analysis, with special attention paid to DFIs local to South Africa, which play a notable role in the impact investing landscape. For the purposes of this report, bilateral and multilateral assistance provided directly to governments has been excluded from the definition of impact investing.

## DEFINITIONS



### DEVELOPMENT FINANCE INSTITUTION (DFI)

Government-backed financial institution that provides finance to the private sector for investments that promote development.



### NON-DFI IMPACT INVESTOR

Organizations or individuals actively making impact investments directly or through funds. This includes family offices, foundations, fund managers, pension funds, and banks, but excludes development finance institutions.



### IMPACT CAPITAL VEHICLE

A legal entity that holds capital intended for direct impact investments. These include impact funds, foundations, and formal entities used by high-net worth individuals to hold capital. DFIs are not included in this category for this report.

<sup>3</sup> The Global Impact Investing Network, <http://www.thegiin.org/>.

## A NOTE ON SCOPE

The definition of impact investing used in this study is based on investor intent to create positive impact. However, the authors recognize that intent can manifest itself in a range of different investment strategies. In particular, due to the unique nature and large size of DFIs, the authors of this report analyzed their activity separately from the activity of other types of impact investors (“non-DFI”), presenting this separate analysis where appropriate.

While there is value in attempting to segment investor portfolios into “impact investments” and “other” types of investments, doing so was not feasible for this study. Many impact investors, including several DFIs, continue to evolve in how they think about their portfolios. Some consider everything they do to be impact investing, while others have begun to segment their activities into buckets. However, most do not publicly indicate which of their investments they consider to be impact investments, and, given that there are many ways to achieve social and/or environmental impact, it would be inappropriate for the research team to segment portfolios for this study. Instead, we segment our analysis by investor type so readers are able to more easily interpret numbers in context.

# METHODOLOGY

## Data Collection and Analysis

This report presents the first comprehensive study of the Southern African impact investing landscape at a country level. To date, only limited research has mapped impact investing activity in this region to the degree of granularity achieved in this report.

As a result, the report relies heavily on primary research, including more than 60 interviews with local and international impact investors (including DFIs), social enterprises, ecosystem players, and government institutions (see the Appendix for a list of organizations interviewed). The research team also examined publicly available primary information, including analyzing investor documents and reviewing organizational websites and press releases to compile a comprehensive database of impact investing activity across all 12 countries in Southern Africa. This database includes all known impact investment deals as of the time of data collection in mid-2015. Where possible, the report draws on the existing body of research on impact investing in the region, as well as available data sets, newspaper articles, and summaries of impact investing activity.

Reflecting the variety of data used, the conclusions and findings in this report are drawn from a mix of sources, including qualitative interviews, experience working in the region, publicly available data and information, and existing research, among others. Where applicable and not prohibited by confidentiality requirements, specific sources have been identified and cited.

In analyses of the region overall, South Africa is considered separately from the rest of Southern Africa. South Africa is an exceptionally large market for impact investors relative to other markets in the region, accounting for 76 percent of all impact deals in Southern Africa; if grouped together, its relative size would conceal relevant trends across the rest of the region.

The full report includes data regarding the activities of 26 DFIs and 81 non-DFI impact investors across the Southern Africa region; these non-DFI investors manage 92 distinct impact capital vehicles.<sup>4</sup> Each organization was evaluated to determine whether it should be included as an “impact investor” based on its stated goals as gathered from organizational materials and interviews. This report includes only active impact investors—that is, those with existing investments in the countries studied or those actively seeking to place investments in Southern Africa.

## Non-DFI Impact Investors



The 92 impact capital vehicles are managed by 81 non-DFI impact investors, who have completed 503 direct investments across the 12 countries covered. This count excludes four indirect investments into impact funds, which are considered separately in order to avoid double counting. For each of these 503 deals, the research team collected the investment target, date, the amount invested, the instrument used, the currency disbursed, and other transaction notes as available. The data include known transaction sizes for 200 direct investments. For the remaining 303 direct investments, the research team used the average transaction value on a fund-specific basis in order to avoid systematically underestimating the amount of impact capital disbursed in the region. The majority of these estimated deals are larger than USD 10 million; therefore, all deals—including those with estimated sizes—are shown in all charts, including those which show the number of deals by deal size, since those charts split all transactions larger than USD 10 million into a single, separate category. To avoid skewing the remaining data, these deal counts exclude transactions made by Business Partners International, who report more than 70,300 transactions over the past 30 years in South Africa and who are considered separately in the South Africa chapter.<sup>5</sup>

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4 To identify these impact capital vehicles, the research team reviewed 665 vehicles operating across the investing ecosystem in Southern Africa. Of the organizations analyzed, 257 were excluded because they did not meet this report’s definition of impact investing. Organizations excluded for this reason were of multiple types, including, among others, commercial investors, government programs or bodies, donor or aid organizations, and ecosystem players. A further 118 organizations were found to be defunct, inactive, or not currently placing capital in Southern Africa. Finally, 84 were excluded because there was insufficient public information to determine their status or operations.

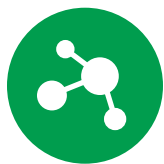
5 “Proving one could do ‘development’ and make profits,” Business Partners International (press release), June 11, 2015, <http://www.businesspartners.co.za/media-room/press-releases/posts/proving-one-could-do-development-and-make-profits-4115/>.

## DFIs



The 26 DFIs active in Southern Africa have completed 8,109 disclosed direct investments in the 12 countries covered. Indirect investments into impact funds are considered separately in order to avoid double counting and are excluded from the count of 8,109 direct investments. In total, DFIs have made 77 disclosed indirect investments into impact funds operating in Southern Africa today. This report excludes all bilateral and multilateral government assistance, which is not included in this report's definition of impact investing.

## Demand for Impact Capital and the Broader Ecosystem



Beyond the detail provided on impact investors, this report also includes information on the demand for impact capital, as well as outlining the broader ecosystem supporting both impact investors and organizations receiving or seeking impact capital.

On the ecosystem side, the research team examined 46 individual organizations operating across the 12 Southern African countries, including financial advisors, intermediaries, consultants, professional services firms, incubators, and accelerators.

On the demand side, the research team analyzed the types of organizations both seeking and receiving capital from impact investors in order to better understand both the challenges they face in raising capital and the opportunities they present for impact investors. These organizations ranged from startup and small-to-medium-sized enterprises to larger, more mature companies. They operate across a wide range of sectors, such as financial inclusion, agriculture, energy, and health.

Information on the demand for impact investment and the ecosystem to support it was drawn from interviews with entrepreneurs, impact investors, and ecosystem players, as well as from publicly available data, existing research, and the general experience of the OCA research team in working closely with social businesses in the region.

# REPORT STRUCTURE

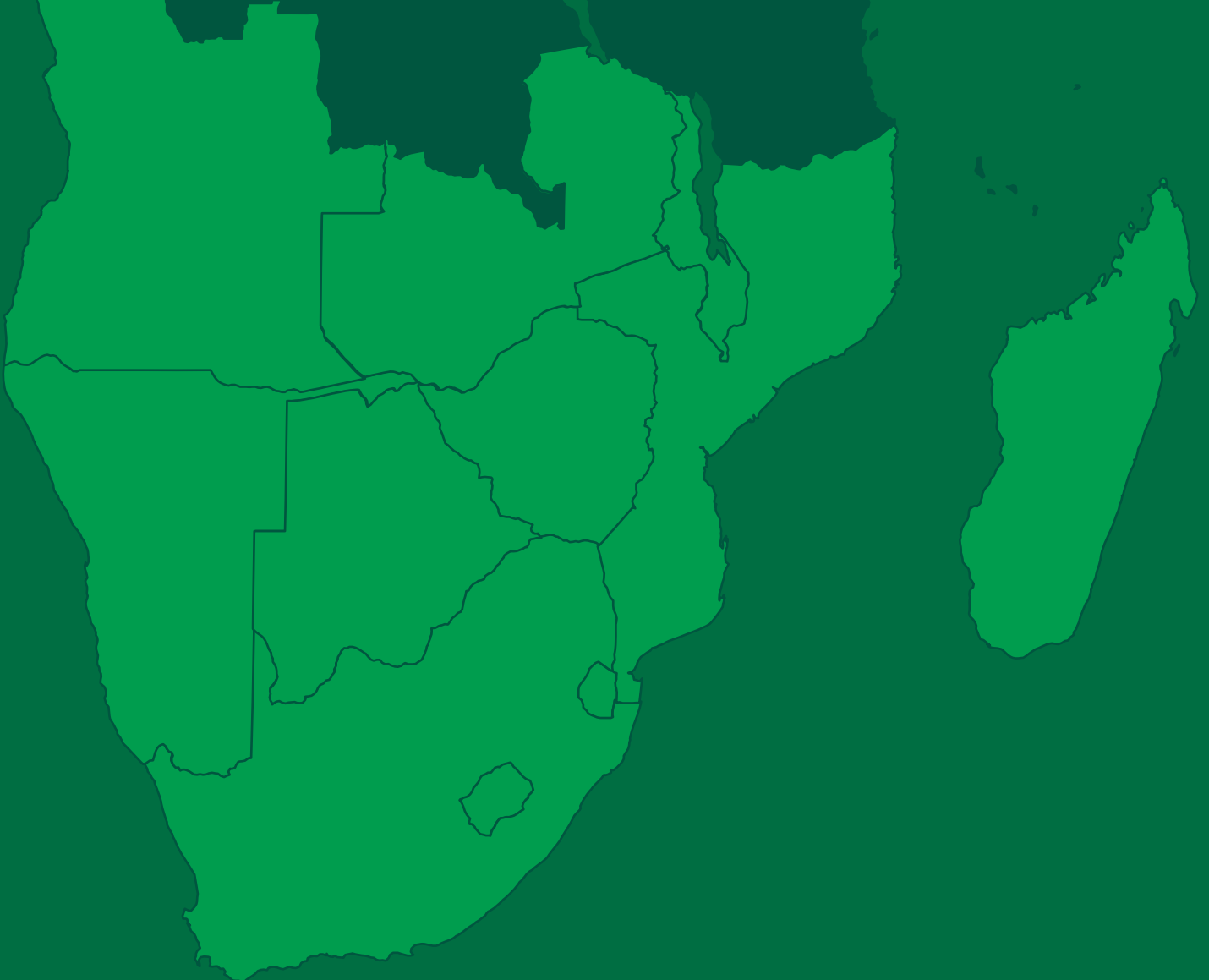
This report maps the impact investing landscape in 12 countries across Southern Africa. The Executive Summary provides an overview of key findings across the region, draws comparisons across countries, and summarizes selected aspects of the landscape for each country. As many impact investors operate regionally, this chapter highlights many of the trends, opportunities, and challenges shared by all countries in the region.

The report includes a chapter focused specifically on DFI activity. As noted earlier, DFIs remain central to the impact investing landscape, both through their direct investments and given the prominent role they play in capitalizing impact investing funds currently active in the region. This chapter profiles DFIs' history, structure, strategy, current operations, and existing investments.

Detailed country chapters follow, each exploring country-specific impact investing activity. These chapters examine each country's broader economic and investing landscape, as well as detailing the trends, opportunities, challenges, and demand for impact capital in each country.

# EXECUTIVE SUMMARY

ANCHORED BY SOUTH AFRICA,  
GROWING OPPORTUNITIES  
FOR IMPACT INVESTMENT  
THROUGHOUT THE REGION



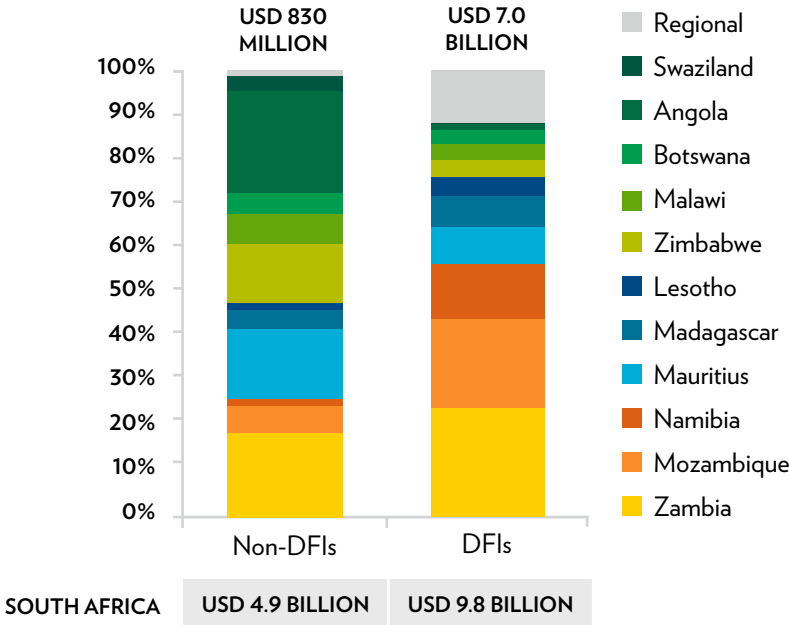
# INTRODUCTION

This report studies in detail impact investing activity across Southern Africa, examining the supply of global impact investment capital as well as the demand for investment resources from small and medium-sized enterprises (SMEs), social enterprises, and others who aim to drive development through the private sector. The report covers twelve countries: Angola, Botswana, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Zambia, and Zimbabwe.

Impact investors are defined as those who invest with the intention to generate positive social or environmental impact alongside financial returns. They include a wide range of investor types: development finance institutions (DFIs), foundations, banks, pension funds, and fund managers who raise capital from these various investor types and then channel it to enterprises.

Given DFIs’ long history and the size of their balance sheets, this report makes an effort to separate the activities of DFI impact investors (“DFIs”) from those of other impact investors (“non-DFI impact investors”). The included, separate chapter on DFIs provides more detail on the important role that this specific constituency plays in the region.

**FIGURE 1. PERCENT IMPACT CAPITAL DISBURSED BY COUNTRY**



Note: Figure excludes domestic South African DFI activity. Also excludes South Africa, which comprises > 90% of total non-DFI impact capital and > 30% of total DFI capital, to avoid skewing the chart.

Source: Open Capital Research

Within the region, South Africa is the largest market for impact investing, with a particularly active set of domestic South African DFIs that fund South African enterprises. These South African DFIs have disbursed more than USD 14.4 billion across 6,800 transactions to South African companies (comprising 85 percent of domestic South African DFIs' disbursements and 91 percent of domestic South African DFIs' transactions), some of which operate across the region. Broad-based Black Economic Empowerment (BBBEE) initiatives are closely linked to domestic DFI activity within South Africa, and these create interesting market dynamics and opportunities. For more information on domestic DFI activity and BBBEE in South Africa, see the DFI and South Africa chapters in this report.

The majority of impact capital in the region has come from international DFIs and a range of non-DFI impact investors. In total, non-DFI investors have closed more than 500 deals and disbursed USD 5.7 billion throughout the region.<sup>1</sup> It should be noted that the ten largest transactions in this group account for just over USD 3 billion of capital disbursed. International DFIs have closed more than 650 deals and disbursed USD 16.7 billion. Larger than either of these categories of actors alone, domestic South African DFIs have closed more than 7,500 deals and disbursed USD 17.1 billion throughout the region.

Even excluding this strong domestic activity, South Africa is the center of Southern African impact investing. Three-fifths of non-DFI impact deals in the region have been in South Africa, representing USD 4.9 billion of the total USD 5.6 billion non-DFI impact capital disbursed in the region. Notably, 47% of this USD 4.9 billion (USD 2.3 billion) was disbursed in just the three largest deals in South Africa. Over half of the USD 16.7 billion in DFI impact capital disbursed in Southern Africa has been in South Africa—more than triple the amount deployed in both Zambia and Mozambique, the two countries with the next highest amounts deployed (around 10 percent and eight percent, respectively; see Figure 1 for disbursements by country). Even excluding domestic DFI activity in South Africa, DFIs have provided the vast majority of impact capital to date, accounting for more than 75 percent of disbursements.<sup>2</sup>

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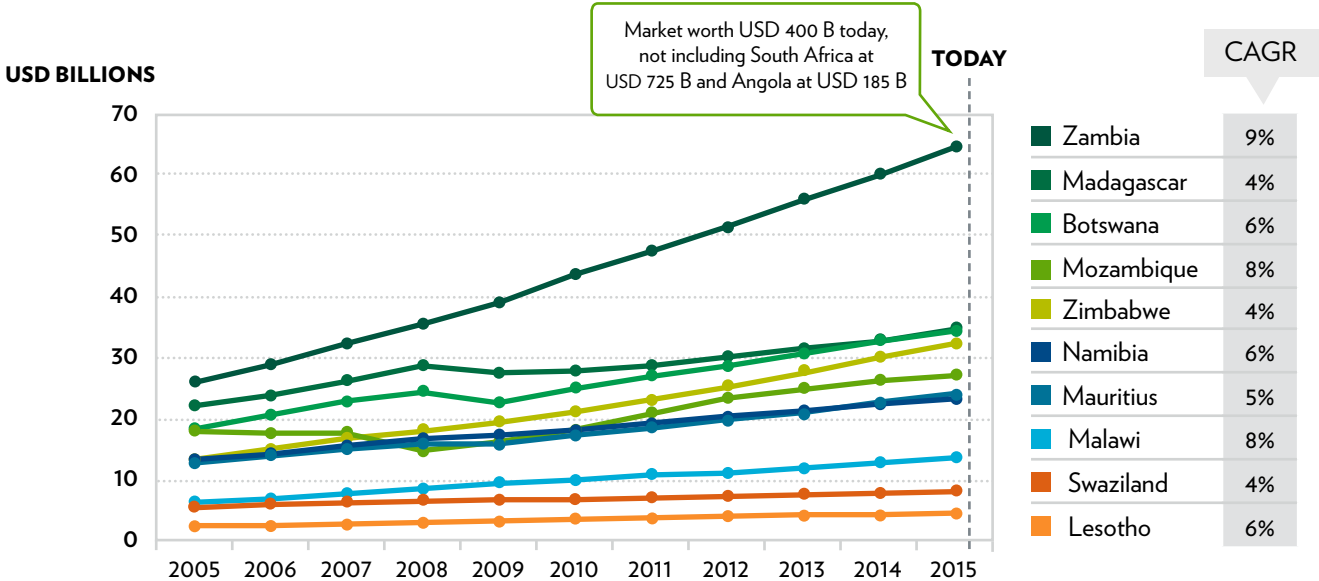
1 Please see the Methodology section for additional detail; non-DFI numbers exclude activity from Business Partners International, which has completed more than 70 thousand debt transactions over the last 30 years in South Africa.

2 Open Capital research.

# REGIONAL CONTEXT

South Africa anchors Southern Africa and uses its regional weight to push for continental integration, acting as the founding member of such continent-spanning organizations as the African Union (AU), as well as of organizations that focus regionally on Southern Africa, including the South African Development Community (SADC),<sup>3</sup> the Southern African Customs Union (SACU),<sup>4</sup> and the Common Monetary Area (CMA).<sup>5</sup>

FIGURE 2. GDP (PPP) GROWTH IN SOUTHERN AFRICA, 2005-2014



Note: Excludes South Africa (4% CAGR) and Angola (10% CAGR) to avoid skewing the chart.  
 Source: IMF World Economic Outlook, April 2015

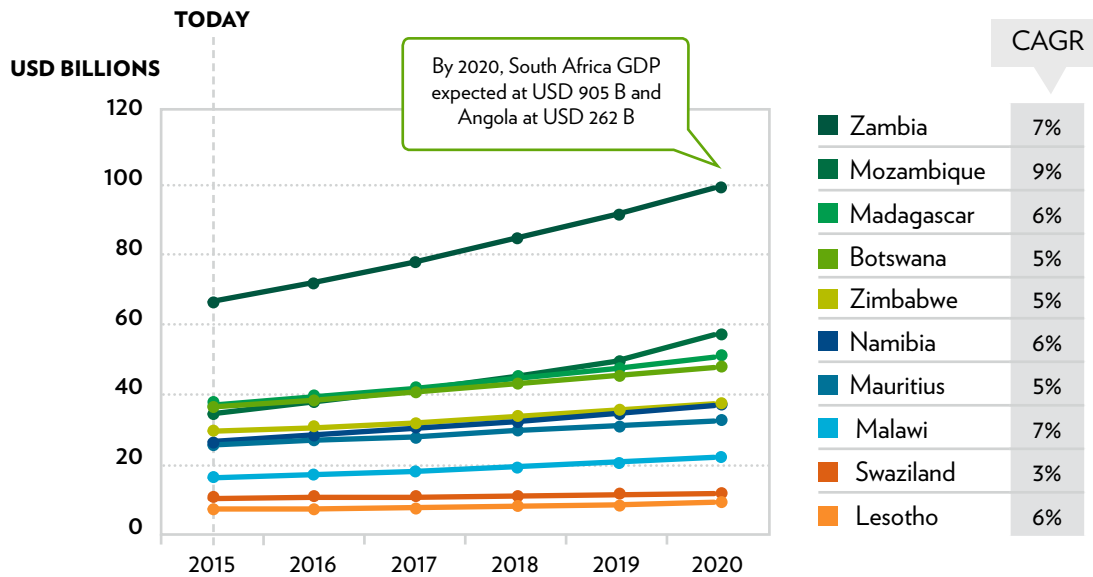
## Gross Domestic Product

Southern Africa has seen moderate growth in recent years, averaging a combined five percent annual growth in gross domestic product (GDP) at purchasing power parity (PPP) between 2005 and 2014 (see Figure 2). Across the region, total GDP (PPP) currently stands at approximately USD 1.2 trillion, with South Africa accounting for 60 percent and Angola a further 15 percent.<sup>6</sup> Over the past decade, Zambia and Mozambique were the two fastest-growing economies, at nine and eight percent compound annual growth rates (CAGR), respectively.

3 SADC member states are Angola, Botswana, the Democratic Republic of the Congo, Lesotho, Madagascar, Mauritius, Malawi, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.  
 4 SACU member states are South Africa, Lesotho, Swaziland, Namibia, and Botswana.  
 5 CMA member states are South Africa, Lesotho, and Swaziland.

6 World Economic Outlook Database (Washington, DC: International Monetary Fund), accessed April

FIGURE 3. PROJECTED GDP (PPP) GROWTH IN SOUTHERN AFRICA, 2015-2020



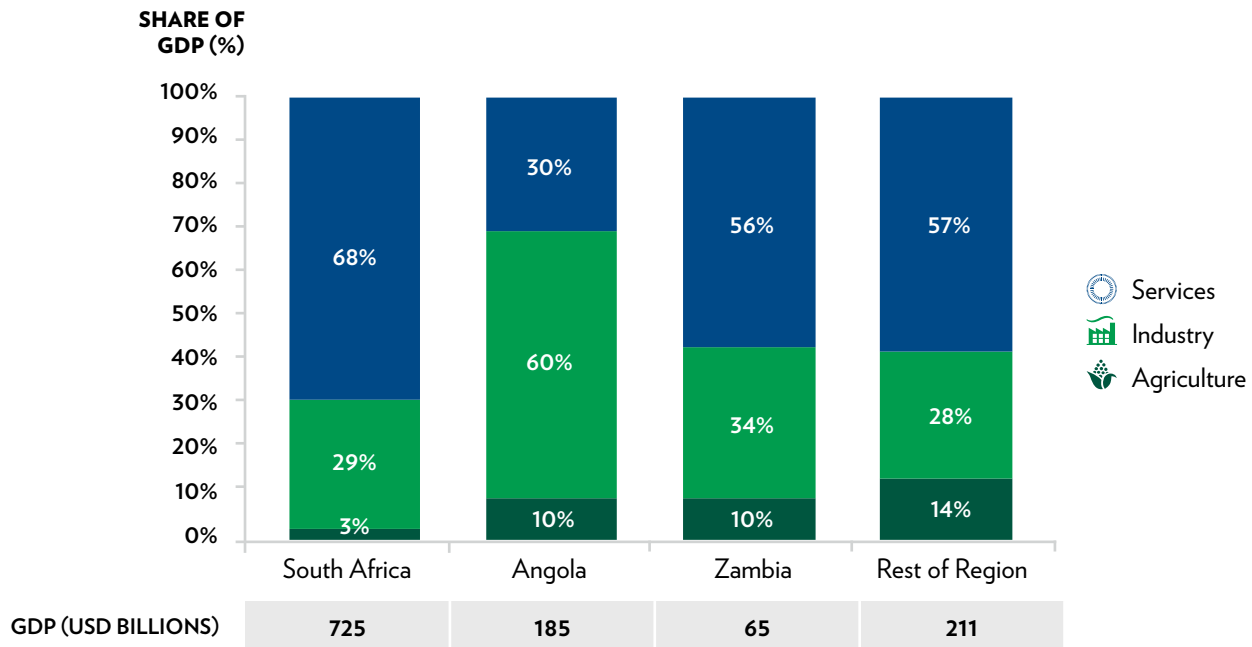
Note: Excludes South Africa (4% projected CAGR) and Angola (6% projected CAGR) to avoid skewing the chart.  
 Source: IMF World Economic Outlook, April 2015

The International Monetary Fund (IMF) projects that the region will continue to experience roughly five percent annual growth through 2020, with the region’s total GDP (PPP) growing to over USD 1.5 trillion. South Africa is projected to continue to comprise nearly 60 percent of the region’s GDP (PPP) and Angola to grow to nearly 18 percent. Though not the largest economy, Mozambique is expected to experience the strongest growth, with year-on-year rates of over nine percent.

Unlike in the rest of sub-Saharan Africa, agriculture is a small contributor to GDP in Southern Africa, driven largely by well-developed services markets in South Africa and a strong extractives industry in Angola (see Figure 4). Zambia’s proximity to South Africa has led to a strong services sector there, as well. The rest of the region is split, with some countries having very small agricultural sectors (e.g., Mauritius and Namibia), while others, such as Madagascar and Mozambique, more closely match trends elsewhere on the continent, with more than 20 percent of their GDP attributable to agriculture.<sup>7</sup>

7 The World Bank: Data, “Indicators,” <http://data.worldbank.org/indicator>.

FIGURE 4. GDP (PPP) BY SECTOR FOR SOUTHERN AFRICA, 2012 (LATEST AVAILABLE)



Source: World Bank Indicators, 2012 (latest available)

## Inflation and Exchange Rates

Countries across the region have struggled with inflation in recent years (see Table 1).

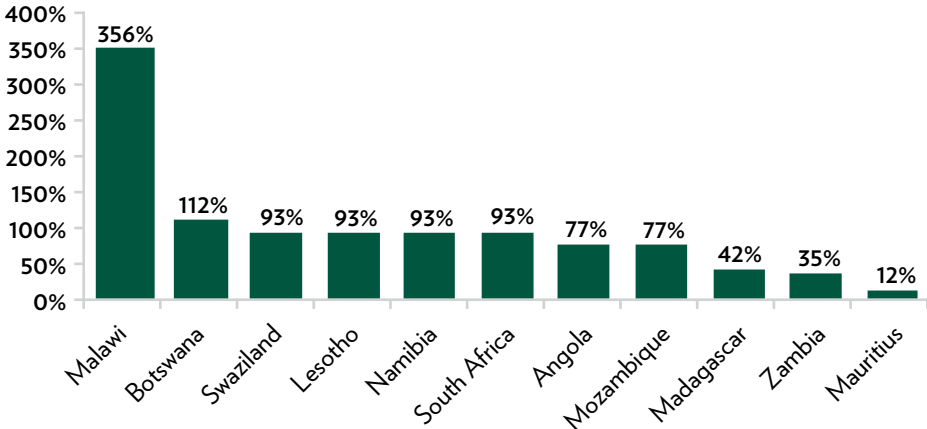
TABLE 1. AVERAGE INFLATION BY COUNTRY, 2005-2014

COUNTRY	Average Inflation	Standard Deviation
MALAWI	14.25%	7.2%
ANGOLA	12.90%	4.0%
ZAMBIA	10.01%	3.6%
MADAGASCAR	9.48%	3.4%
BOTSWANA	8.12%	2.3%
MOZAMBIQUE	8.02%	3.7%
SWAZILAND	7.05%	2.4%
LESOTHO	6.06%	2.1%
SOUTH AFRICA	6.01%	3.0%
NAMIBIA	5.99%	2.0%
MAURITIUS	5.50%	2.6%

In the late 2000s, Zimbabwe experienced one of the worst periods of hyperinflation ever recorded globally, peaking at a rate of inflation of over 231 million percent annually (for more information, see the Zimbabwe chapter).<sup>8</sup> Malawi has also experienced strong inflation since 2012, with average rates above 20 percent per year, which drives up its average in Table 1. Overall, every country in the region has experienced average inflation rates above five percent per year over the last decade, with significant fluctuations in all countries. In no year has any country had inflation below three percent.

Most countries also faced significant depreciation of their currencies against the US Dollar between 2005 and 2014 (see Figure 5). High inflation rates and significant monetary volatility pose substantial challenges to both impact investors and the enterprises they support, as input prices rise and relative incomes decrease. Concerns about foreign exchange rates complicate both impact investors’ ability to disburse local currency debt and enterprises’ ability to repay international currency obligations. Across the region, all countries have struggled to stabilize exchange rates. In showing cumulative depreciation, Figure 5 masks year-to-year and month-to-month variation, volatility that exposes investors to potentially sudden and significant foreign exchange losses while increasing the effective interest rate enterprises face for internationally denominated facilities and amplifying the likelihood of default for companies that collect revenues primarily in local currency.

**FIGURE 5. CURRENCY DEPRECIATION BY COUNTRY, 2005-2014**



Note: Data not available for Zimbabwe due to hyperinflation.  
 Source: Oanda Historical Currency Rates

8 Steve H. Hanke, “R.I.P Zimbabwe Dollar,” Cato Institute, February 5, 2009, <http://www.cato.org/zimbabwe>.

## Ease of Doing Business

According to the World Bank’s “Ease of Doing Business” rankings, the ease of operating a company in Southern Africa varies substantially by country (see Table 2). Mauritius ranks in the top 30 globally, alongside substantially more developed countries, as it has invested significant resources in order to become a global financial center. Similarly, South Africa ranks in the top 50, helping to drive a general understanding that business in South Africa operates much like it does in the United States and Europe. On the other hand, some countries in the region—such as Madagascar, Malawi, Zimbabwe, and Angola—are among the most difficult countries in the world in which to do business, as measured by this index.

TABLE 2. EASE OF DOING BUSINESS RANKINGS BY COUNTRY

COUNTRY	Ranking
MAURITIUS	28
SOUTH AFRICA	43
BOTSWANA	74
NAMIBIA	88
SWAZILAND	110
ZAMBIA	111
MOZAMBIQUE	127
LESOTHO	128
MADAGASCAR	163
MALAWI	164
ZIMBABWE	171
ANGOLA	181

Source: World Bank

# SUPPLY OF IMPACT CAPITAL

In total, 107 impact organizations are placing capital in Southern Africa. Of these, 23 are international DFIs, three are domestic South African DFIs, and 72 are non-DFI investors. The remaining nine include a mix of banks, pension funds, and foundations. Together, these impact organizations manage a combined 118 vehicles active in the region. More than 85 percent of non-DFI investors are impact fund managers, while the other 15 percent include a mix of foundations, pension funds, and banks (see Table 3).

TABLE 3. TYPICAL STRUCTURES, SECTORS, AND INVESTORS BY DEAL SIZE

Deal size range (USD)	Typical financial products	Typical sectors	Example providers in Southern Africa
Less than 500K	Debt, small equity stakes	ICT, Agriculture, Health, Energy	Small VC and debt-finance funds targeting early stage businesses, domestic DFIs
500K – 1M	Equity, debt, quasi-equity, convertibles	Agriculture, Financial Services, Health, Energy	Private equity funds, VC funds, and foundations targeting social businesses with some track record
1M – 5M	Equity, debt, quasi-equity, convertibles	Agriculture, Financial Services, Health, Energy	Larger impact funds and foundations
5M – 10M	Equity, debt, quasi-equity, guarantees	Financial Services, Energy	Smaller national DFIs and large impact funds
10M – 50M	Equity, debt, quasi-equity, guarantees	Financial Services, Infrastructure, Manufacturing	Regional and national DFIs
Over 50M	Debt, guarantees	Financial Services, Infrastructure, Energy	Large regional and national DFIs

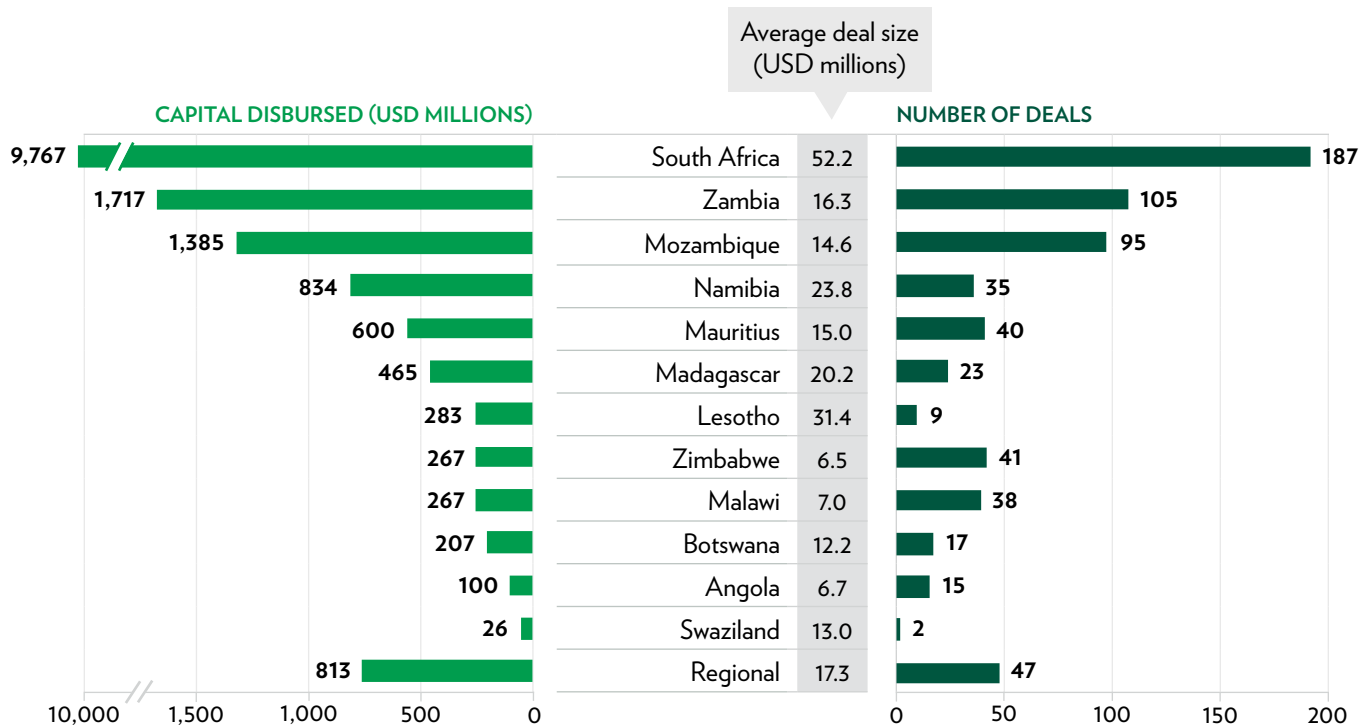
Source: Open Capital Research, interviews

## Impact Capital Disbursed

The vast majority of impact capital in the region has been disbursed in South Africa, primarily on account of an active set of domestic South African DFIs. Combined, these domestic DFIs have disbursed close to USD 25 billion across 7,500 deals to South African companies regionally. International DFIs, for their part, have closed

more than 650 deals and disbursed USD 16.7 billion (see Figure 6).<sup>9</sup> Last, but not least, non-DFI impact investors have closed more than 500 deals and disbursed USD 5.6 billion throughout the region (see Figure 7). As noted earlier, the 10 largest deals account for just over USD 3 billion of this amount.

FIGURE 6. TOTAL DFI DIRECT INVESTMENTS BY COUNTRY



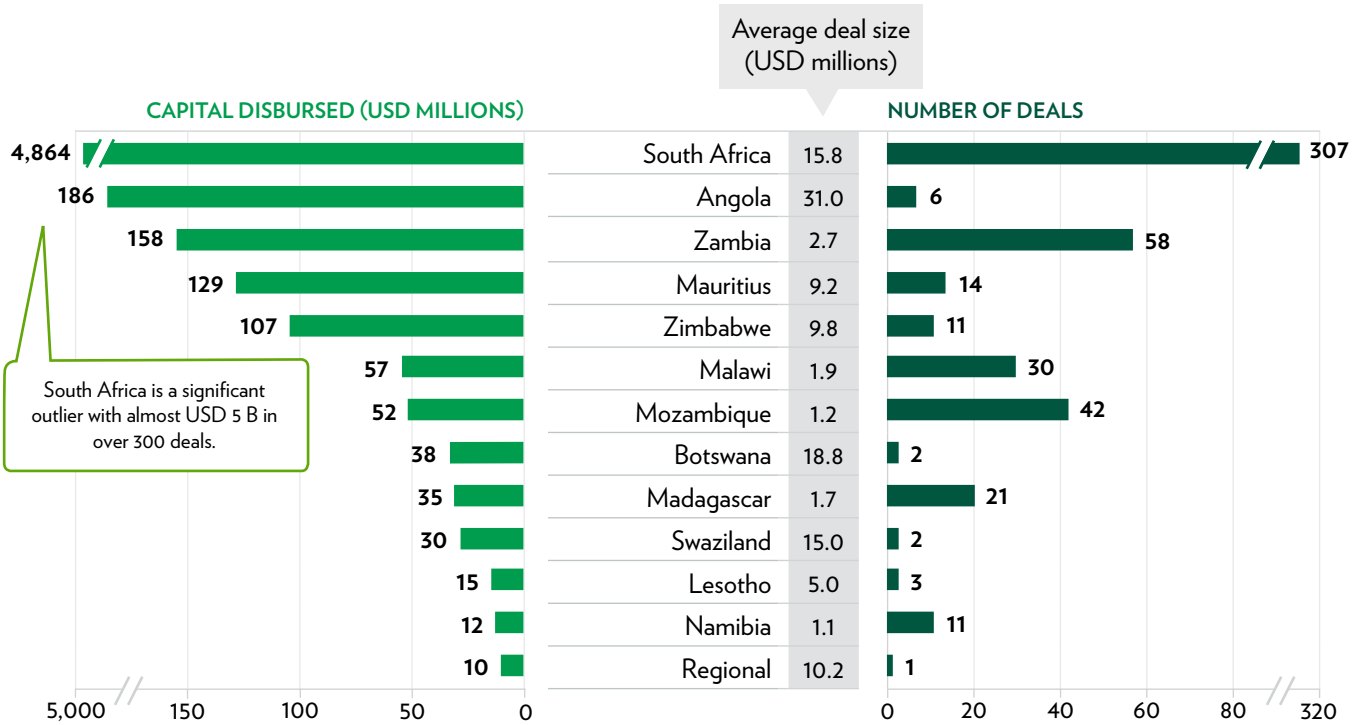
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes domestic DFI activity.

Source: Open Capital Research

Beyond its substantial domestic activity, South Africa was the destination for three-fifths of non-DFI deals and 30 percent of international DFI deals. Zambia and Mozambique come next, having each received approximately 15 percent of DFI investments and approximately 10 percent of non-DFI investments. However, with their significantly smaller average deal sizes, these countries have absorbed less than 10 percent of DFI capital and less than two percent of non-DFI capital. With its significantly larger average deal size, South Africa absorbs 85 percent of non-DFI capital disbursed, despite representing only 60 percent of deals transacted. Of the total USD 4.9 billion non-DFI capital disbursed in South Africa, 47 percent (USD 2.3 billion) was disbursed in just the three largest transactions.

<sup>9</sup> Please see the Methodology section for additional detail; non-DFI numbers exclude activity from Business Partners International, which has completed more than 70 thousand debt transactions over the last 30 years in South Africa.

FIGURE 7. TOTAL NON-DFI DIRECT INVESTMENTS BY COUNTRY



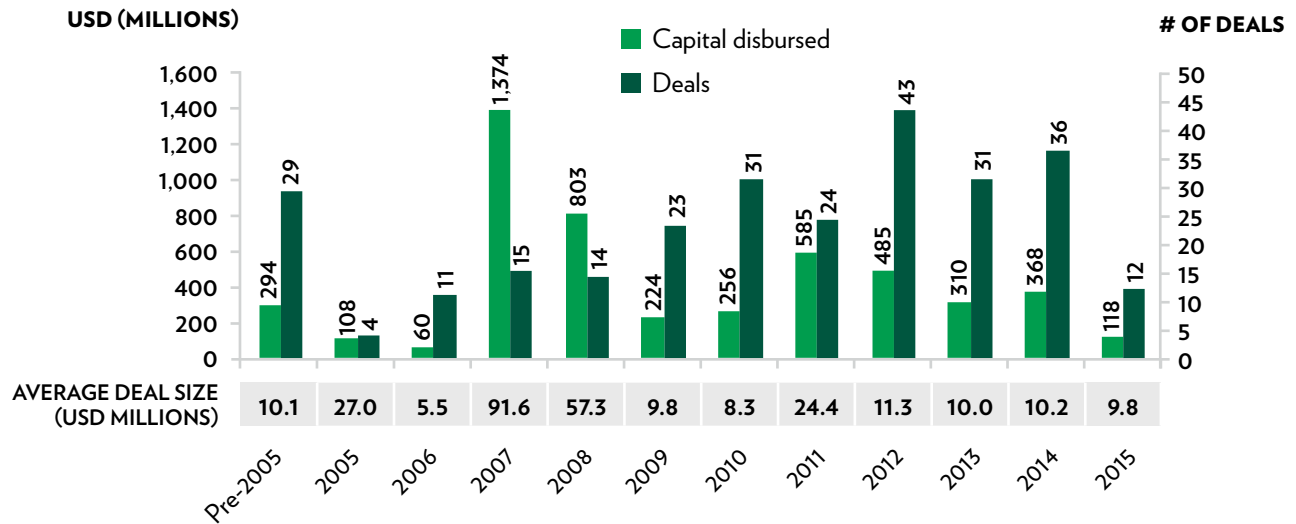
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Investments over Time

Throughout the region, there have been substantial investments over time. Non-DFI investment activity in the region has notably increased since 2006, with more transactions occurring each year on average (see Figure 8). The large disbursement volumes in 2007 and 2008 include large leveraged buyouts by impact investors in South Africa. Data for 2015 were collected mid-year and should not be interpreted as a reduction in activity; please see the Methodology chapter for more detail.

**FIGURE 8. TOTAL NON-DFI DIRECT INVESTMENTS BY YEAR**

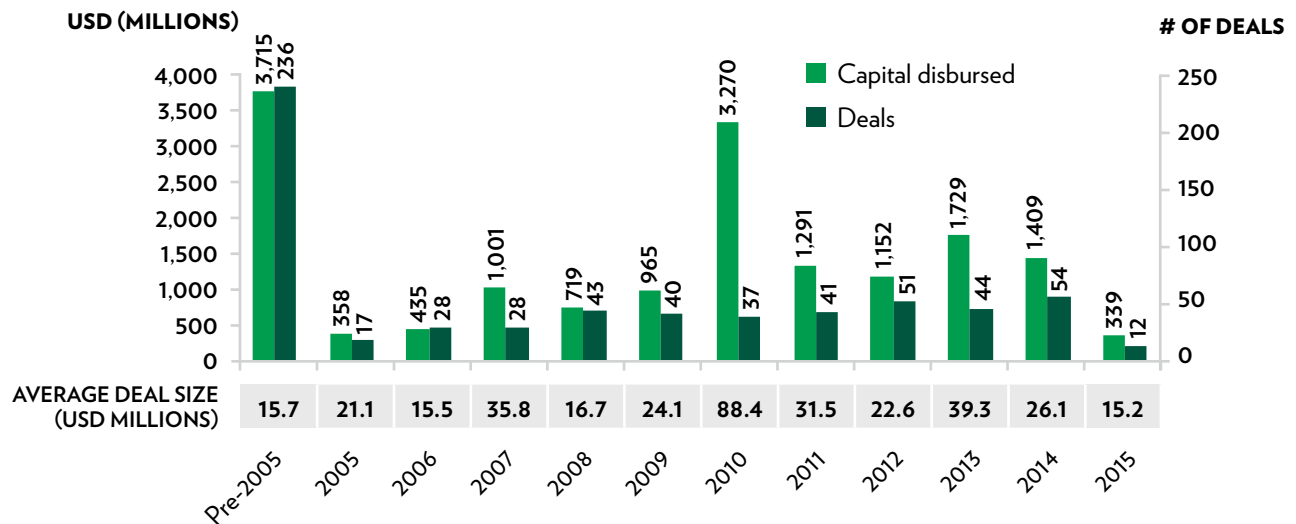


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 710 million in capital where year of investment is unknown.

Source: Open Capital Research

DFI investors have committed substantial resources to the region, with increasing average deal sizes since 2011 (see Figure 9). The notably large average deal size in 2010 is skewed by a single large deal in which the African Development Bank (AfDB) supported South Africa’s Medupi Power, a publicly known investment of nearly USD 2.5 billion in Limpopo province.<sup>10</sup>

**FIGURE 9. DFI IMPACT INVESTMENTS BY YEAR**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 384 million in capital where year of investment is unknown.

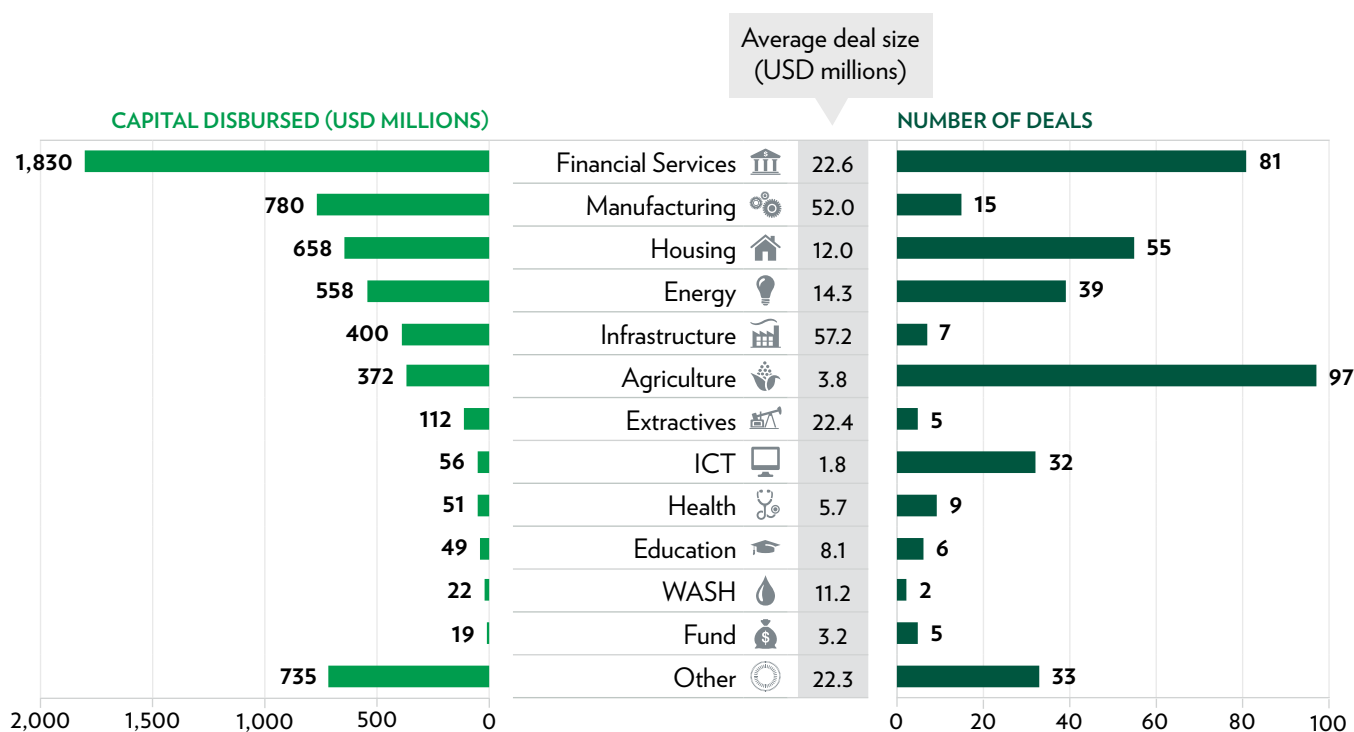
Source: Open Capital Research

10 “Medupi Power Project (Loan in Euro),” African Development Bank Group, <http://www.afdb.org/en/projects-and-operations/project-portfolio/project/p-za-faa-001/>.

## Sector

The distribution of investments by sector broadly reflects areas of investor interest (see Table 3). For non-DFI investors, agriculture and financial services have seen the largest number of deals (see Figure 10). A handful of large deals in financial services have driven the larger average deal size in that sector. Housing, energy, and information and communications technologies (ICT) are also popular sectors. For DFIs, financial services and manufacturing are the most popular sectors in terms of number of transactions (see Figure 11), though energy has seen the largest amount of capital disbursed, as transactions in this sector are very capital intensive. This figure includes the Medupi Power deal in South Africa described above.

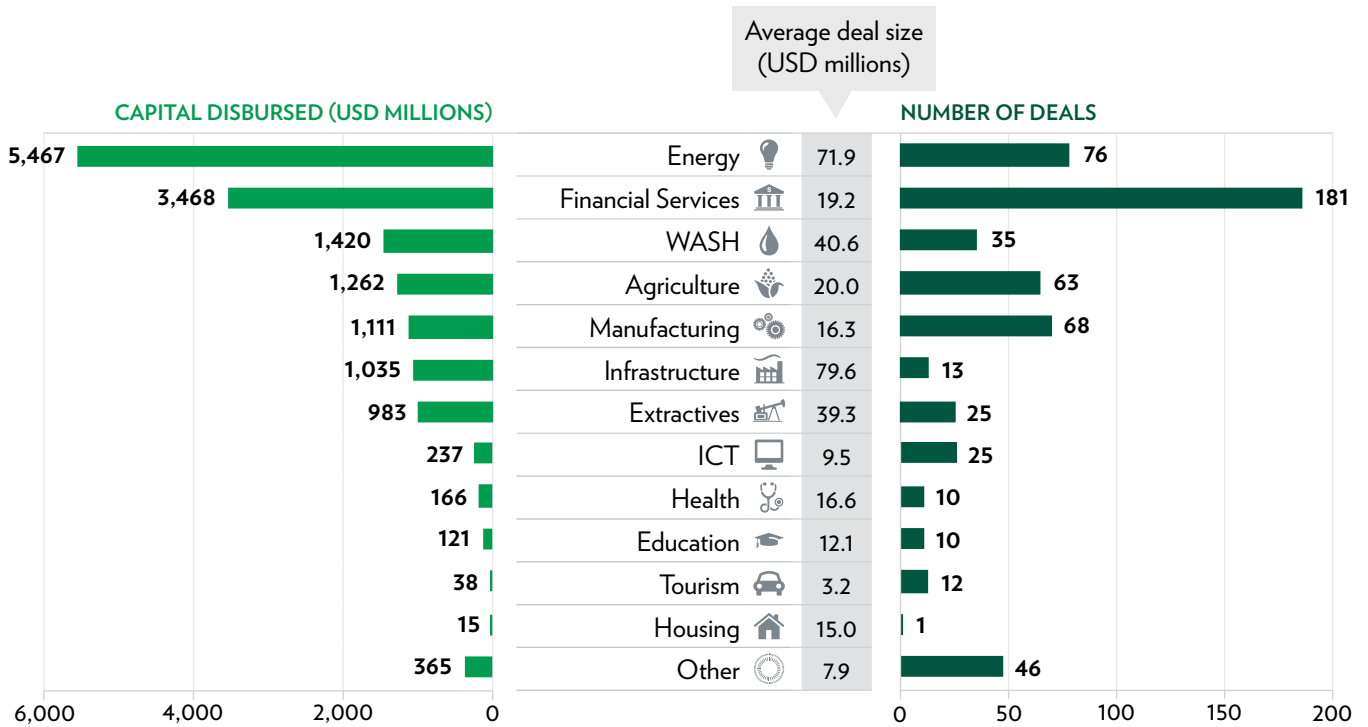
FIGURE 10. NON-DFI DIRECT INVESTMENTS BY SECTOR



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 54 million in capital where sector is unknown.

Source: Open Capital Research

FIGURE 11. DFI DIRECT INVESTMENTS BY SECTOR



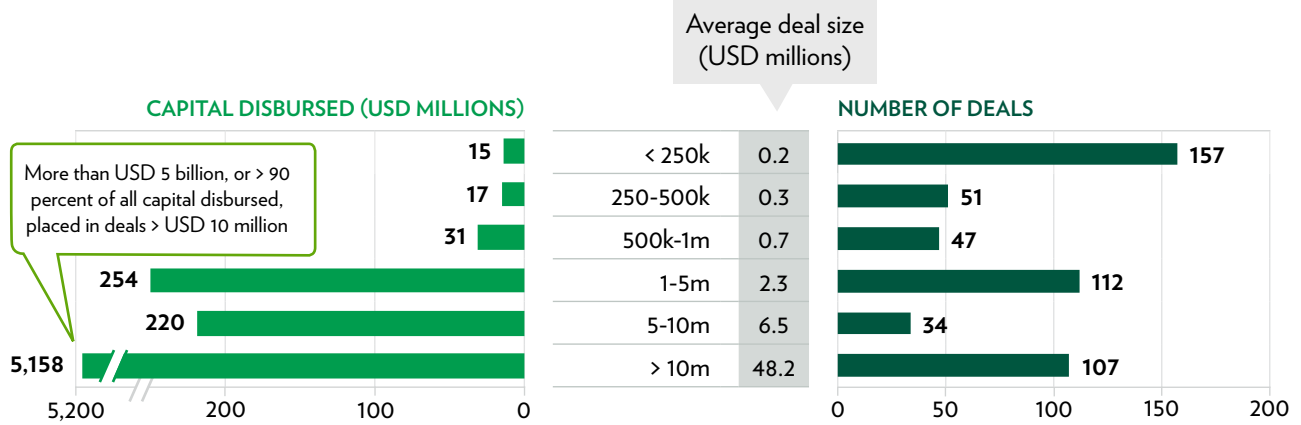
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 83 million in capital where sector is unknown. Excludes domestic South African DFIs due to limited data.

Source: Open Capital Research

## Deal Size

The majority of transactions completed by non-DFIs have been small, with nearly half being less than USD one million (see Figure 12). Roughly a quarter of deals have been in the range of USD one-to-five million. Perhaps surprisingly, a significant number of non-DFI deals (approximately 20 percent) have been above USD 10 million; these comprise more than 90 percent of non-DFI capital disbursed. These large deals are primarily in infrastructure, energy, and financial services.

**FIGURE 12. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE**

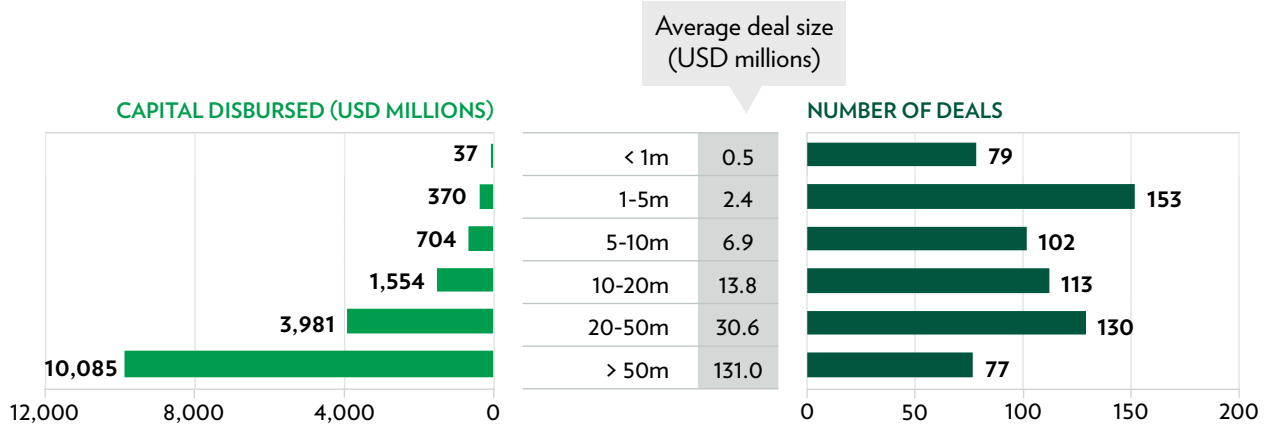


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

Meanwhile, only about 50 percent of DFI transactions have been smaller than USD 10 million (see Figure 13). Roughly 40 percent of DFI transactions were in the USD 10–50 million range, and a further 10 percent have been above USD 50 million.

**FIGURE 13. DFI IMPACT INVESTMENTS BY DEAL SIZE**



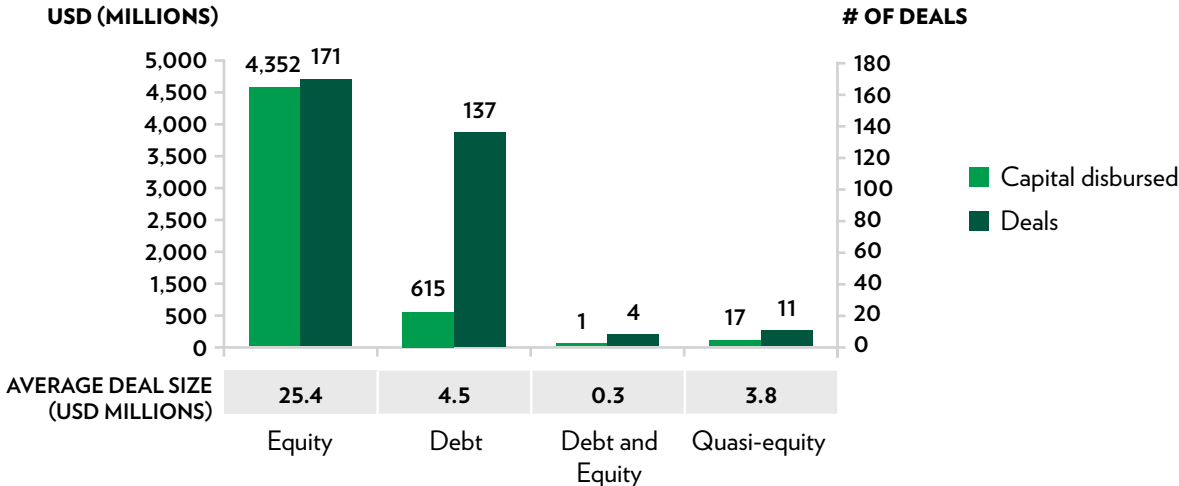
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes domestic South African DFI activity due to limited data.

Source: Open Capital Research

# Instrument

While non-DFI impact investors seem equally comfortable investing via both debt and equity, the average deal sizes for equity investments are far higher than for debt investments, primarily due to three large equity investments in South Africa worth a combined USD 2.3 billion (see Figure 14). Excluding these three large deals, the average equity transaction is USD 7.1 million.

FIGURE 14. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE

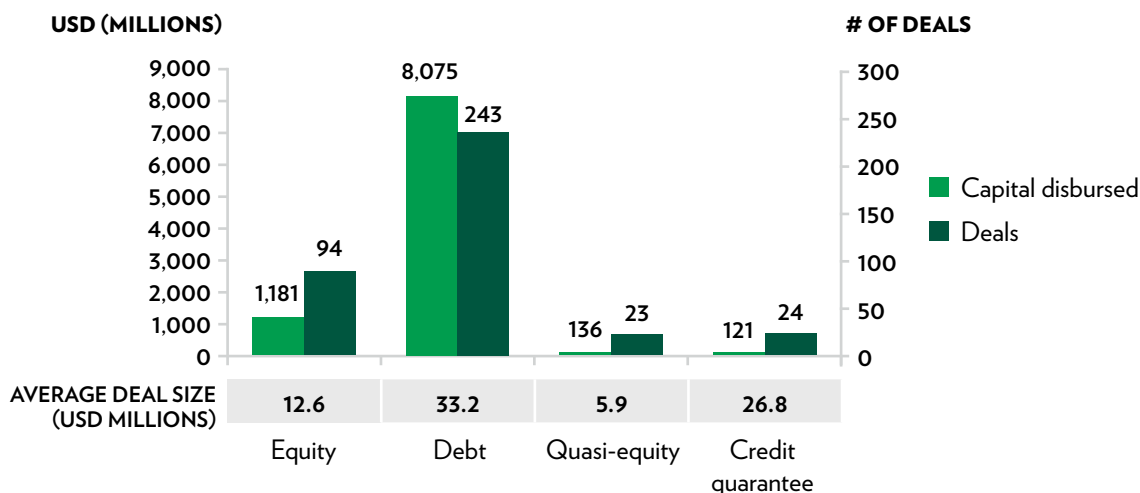


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 708 million in capital where instrument type is unknown.

Source: Open Capital Research

DFIs, however, strongly prefer debt deals to equity, having disbursed nearly seven times as much impact capital through traditional debt instruments as they have through equity (see Figure 15). Interestingly, DFI debt deals are also significantly larger than are DFI equity deals, opposite to the case of non-DFI impact investors. Occasionally, DFIs also use quasi-equity and credit guarantees.

FIGURE 15. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 7.2 billion in capital where instrument type is unknown.

Source: Open Capital Research

## Impact Tracking Standards

As is true globally, impact investors’ dual mandate to realize both financial and social or environmental returns requires them to maintain a strong focus on measuring impact as part of their core activities. In addition, many impact asset owners require impact reporting as a condition of their investments. This is particularly true for DFIs, who act as anchor investors in many impact investment funds.

Developing tools to track impact metrics in Southern Africa accurately and effectively has proven difficult, however. Beyond the methodological difficulty in designing measurement systems, tracking metrics can also be expensive and time-consuming overhead for early-stage businesses, potentially diverting resources from enterprise growth. Moreover, impact investors define impact in a wide variety of ways and emphasize different elements, complicating efforts to develop a universal standard or toolbox. However, this limited standardization can benefit portfolio companies, as impact investors are often willing and able to track customized metrics, which allows many more companies to demonstrate and measure their impact.

The majority of interviewed fund managers do not specify a particular language or tool but rather report impact using flexible structures adapted to each new investment. They generally design and track metrics after the investment in an individualized manner in order to minimize the burden placed on portfolio companies. This mirrors findings from studies of the landscape in other regions.

Among those that do specify the use of a known language or tool, IRIS has emerged as the most prominent.<sup>11</sup> Some fund managers select their own set of IRIS metrics; others use an existing tool, such as GIIRS,<sup>12</sup> which is built on the IRIS taxonomy.

## DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital across Southern Africa. Despite progress on key development indicators and strong markets in the region's anchor, South Africa, there remain significant gaps in the provision of key goods and services. This creates opportunities for entrepreneurs to build enterprises that meet the needs of disadvantaged populations while also realizing financial returns.

### Development Context

Within Southern Africa, countries vary substantially in their level of development, as illustrated by their scores on the United Nation's Human Development Index (HDI). Mauritius exceeds the global average HDI score, while Botswana and South Africa are near the global average of 0.69. At the same time, Malawi and Mozambique have HDI scores that are barely above half the global average, driven by poor performance on a variety of indicators related to poverty, health, and education.

TABLE 4. UN HDI SCORE AND RANK BY COUNTRY, 2014

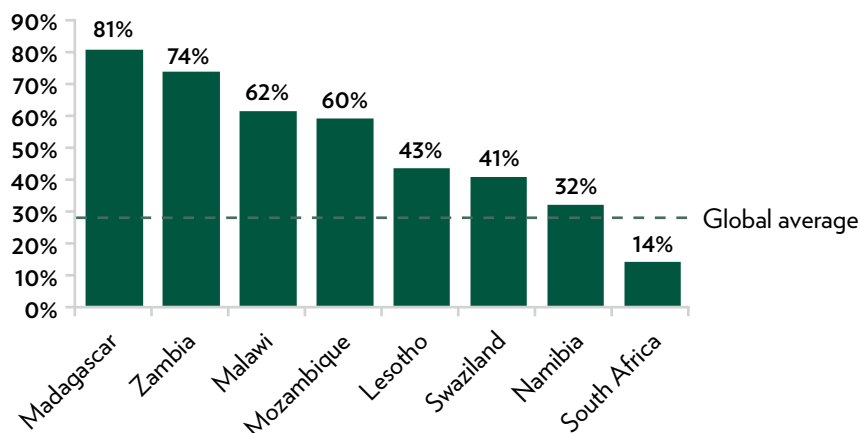
COUNTRY	HDI Score	HDI Rank
MAURITIUS	0.771	63
SOUTH AFRICA	0.683	109
BOTSWANA	0.658	118
NAMIBIA	0.624	127
SWAZILAND	0.561	141
ZAMBIA	0.530	148
MOZAMBIQUE	0.526	149
LESOTHO	0.498	155
MADAGASCAR	0.492	156
MALAWI	0.486	162
ANGOLA	0.414	174
ZIMBABWE	0.393	178

11 Information about IRIS, which is managed by the GIIN, is available at <https://iris.thegiin.org/>.

12 The Global Impact Investing Ratings System.

Regarding poverty statistics, there is great variation across the region (see Figure 16). With the exception of South Africa, in each country in the region, the proportion of the population living on less than USD 1.25 per day is higher than the global average.

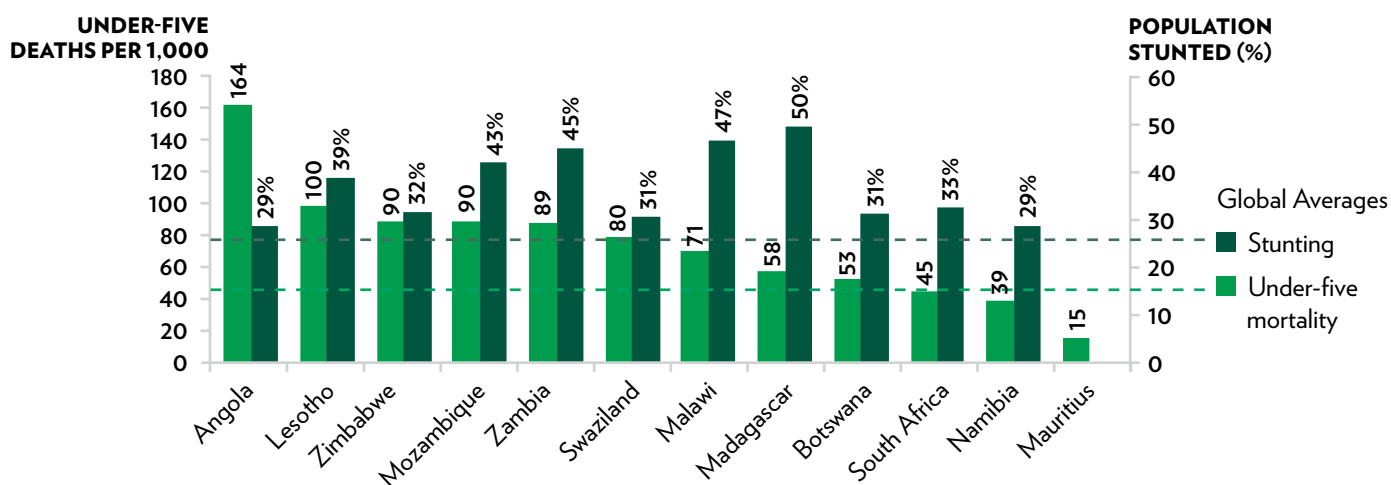
**FIGURE 16. POPULATION BELOW USD 1.25 PER DAY BY COUNTRY (LATEST AVAILABLE DATA POINTS)**



Source: UN Human Development Report 2014

Similar disparities can be seen in health metrics. For example, Angola has one of the highest under-five mortality rates in the world,<sup>13</sup> while Mauritius, South Africa, and Namibia perform better than global averages (see Figure 17). Children in Madagascar, Malawi, Mozambique, Zambia, and Lesotho suffer from malnourishment, as evidenced by their high stunting rates; stunting can prevent later cognitive development, as well as leading to a host of other challenges. Additional detail on development context by country is available in each country chapter in this report.

**FIGURE 17. UNDER-FIVE MORTALITY AND STUNTING BY COUNTRY (LATEST AVAILABLE DATA POINTS)**



Source: UN Human Development Report 2014

13 Khalid Malik et al., *Human Development Report* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Despite the historical volume of deals in Southern Africa, especially South Africa, impact investors face a variety of challenges ranging from insufficient investee capacity to complex government regulations. Challenges include:

- **Insufficient investment-ready opportunities:** Despite robust activity to date, many impact investors struggle to place the capital they have raised. Though many businesses have exciting potential, investors encounter few companies that are truly investment-ready. Early-stage businesses typically face certain, common challenges that keep them from being fully prepared for growth, including unproven operations, an unclear strategy to scale, informal financial and corporate records, and a lack of realistic forward-looking projections. These challenges affect businesses across sub-Saharan Africa just as much as in Southern Africa.
- **Insufficient human capital:** Limited access to highly skilled talent is the key constraint for many Southern African businesses. Companies struggle to find the talented, reliable management they need to plan for and reach scale. Though all skilled positions are difficult to fill, this talent shortage is particularly acute for financial professionals with five to 15 years of experience who can serve as a company's CFO. Even when a talented, experienced professional can be found, she or he often commands high wages that can be challenging for SMEs or social enterprises to support, especially in their early years.
- **Limited financing in local currency:** Many impact businesses engage with disadvantaged populations, often earning the majority of their revenues in local currencies. However, most impact investors track returns in international hard currencies and have little ability to invest in local currencies. This is especially challenging for investments using long-term debt instruments which require repayment in hard currencies, as these can appreciate five to 10 percent per year relative to local currency. Hedging options are often prohibitively expensive, though some impact investors with large funds report effectively using fund-level hedges to minimize currency risk.
- **Limited electrical capacity:** Power generation presents an opportunity across the region, as several countries in Southern Africa have historically traded electricity across international borders. Eskom South Africa's electric utility, generates almost half of the power consumed in all of Africa,<sup>14</sup> but still struggles to meet increasing demand, leading South Africa to import electricity from neighbors who have extremely low grid penetration. This in turn limits these neighboring countries' own investment potential in energy-intensive sectors, such as manufacturing and extractives.

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14 Alexandra Wexler, "Power Outages Mar South Africa's Economic Expansion," *www*, May 8, 2015, <http://www.wsj.com/articles/power-outages-mar-south-africas-economic-expansion-1431077401>.

Each country in Southern Africa has unique dynamics for impact investing. As a result, impact investors must learn about each country individually; strategies and solutions that are effective in one country will not necessarily work in another. Nevertheless, some high-level recommendations do apply to the region and can improve the overall impact investing landscape:

- **Leverage technical assistance (TA) facilities to build the pre-investment pipeline:** More pre-investment support for businesses is needed to develop a strong pipeline of investable opportunities. Increasingly, TA funders (e.g., USAID and DFID) recognize the importance of pre-investment support to get companies to the point where they can successfully raise capital. Several impact investors have successfully developed TA facilities for their portfolio companies. South Africa in particular is home to a large ecosystem of intermediaries and service providers. Targeted, tailored support requires an upfront commitment of resources but has proven effective in preparing potential targets for investment and in building high-quality deal flow. This process can also dramatically reduce diligence timelines if the investor is able, before investment, to increase familiarity with and visibility into a business.
- **Develop sector specialization:** Beyond bringing capital to portfolio companies, impact investors can drive growth, returns, and impact by focusing on the specific sectors in which their portfolio companies operate. For some investors, this sector focus has allowed them to leverage their existing knowledge to identify exciting, less well-known opportunities earlier and to reduce their diligence timelines. Sectors such as agriculture, energy, and financial services present large opportunities where different companies often face similar challenges; learnings can be shared across portfolio companies.
- **Expand investment instruments:** With the variety of early-stage businesses in Southern Africa, structured investments, such as milestone-based conversion and profit-sharing debt, can help to creatively fill a significant need for financing that straight equity and debt deals cannot. Such creative structures can help entrepreneurs meet their ongoing cash-flow requirements while delivering long-term returns in line with investor expectations.
- **Establish local presence:** Given the lack of readily available, investment-ready businesses, locally-based impact investors across the region report having a significant advantage in their ability to source investment opportunities.<sup>15</sup> Currently, only a handful of impact investors have staff in the region outside of South Africa, and limited impact capital is available there. Locally-based impact investors will be able to identify opportunities more easily and will incur fewer costs than investors operating with a fly-in, fly-out model that may require multiple trips in order to perform due diligence and manage the portfolio.

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15 Open Capital interviews.

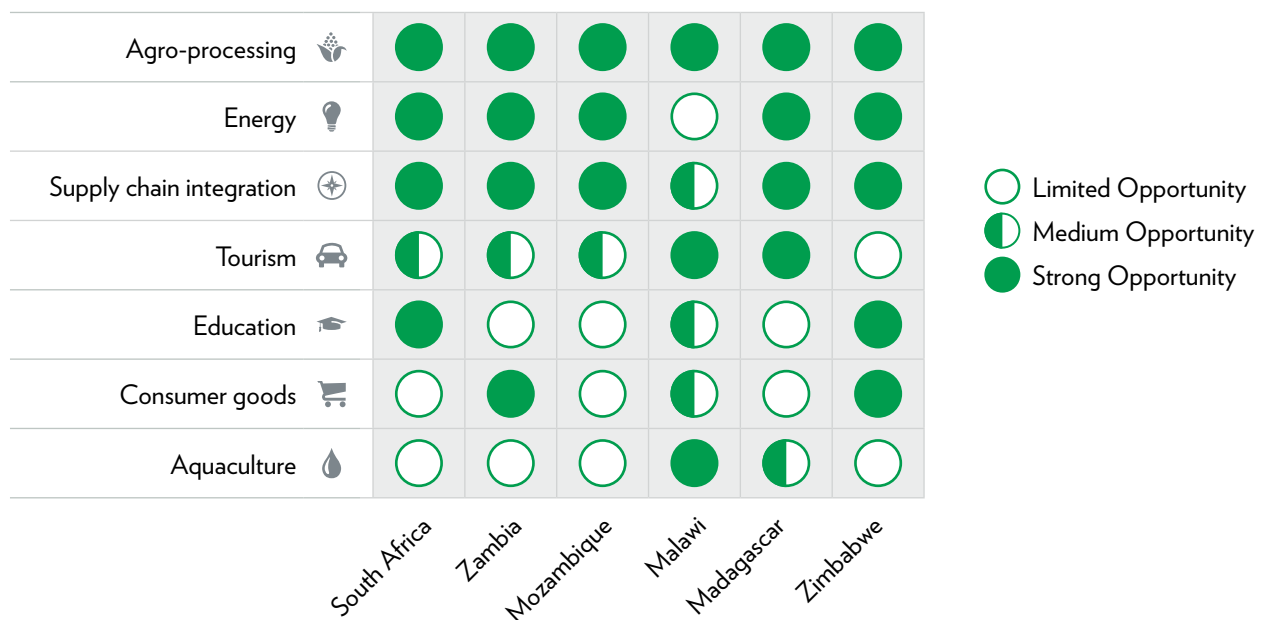
# SECTOR OPPORTUNITIES ACROSS SOUTHERN AFRICA

All Southern African countries share a demand for impact capital, with sizable populations well below global averages for human development despite recent economic growth. As such, investors will find many opportunities to support entrepreneurs who will generate both financial and social/environmental returns. The following sectors present particularly notable opportunities in Southern Africa.

- **Agro-processing:** Throughout Southern Africa, agriculture employs most of the population. Investment in this sector is important to increase incomes and improve food security. Given the predominance of smallholder farming, there are opportunities to aggregate production and create consistent, high-quality supply appropriate for processing. In addition, there are opportunities across a range of crops and agricultural sub-sectors, such as horticulture, livestock, and dairy, to connect directly with export markets.
- **Energy and electricity:** All countries in Southern Africa are looking to expand their power generation capacity in the coming decades, backed by strong government support. This opens the door to large-scale projects and creates the potential for improved power-purchase agreements and cross-border trade. At the same time, large segments of the population lack reliable access to grid power, especially outside of South Africa, which presents opportunities for micro-grid and off-grid solutions.
- **Supply chain integration:** Southern Africa has a number of large industrial value chains primarily destined for export, particularly in the extractives sector. The multinational companies operating these sites create demand for infrastructure, goods, and ancillary support services, which in turn creates new offtake opportunities for local, small businesses across sectors. In particular, interviewees highlighted opportunities in certain key areas: workforce education, housing, healthcare, and transportation.
- **Tourism:** Given the variety of attractions available in Southern Africa, from beautiful coasts to vibrant safari parks, there is great potential for tourism outside traditional destinations in South Africa. Governments across the region have started to encourage foreign investors and the returning diaspora to invest in the tourism sector, with some promising results. There are particularly opportunities in sustainable or eco-tourism, sectors which often directly support underserved populations and benefit the environment in Southern Africa.
- **Education:** Across the region, the demand for private provision of education has increased. A number of private schools have emerged to serve the region that offer high-quality but expensive educations, especially in South Africa. Interviewees expect that the market for these high-end educational opportunities will remain open, but they also pointed out that there are opportunities to establish mid-level and low-income private educational alternatives, as well.

- **Consumer goods:** The middle class is growing throughout the region, creating opportunities to produce consumer goods locally to target this growing market segment, which currently relies on imports from South Africa. Local production generates employment and broadens the range of products and services available to consumers, which may meet the impact theses of some impact investors.
- **Aquaculture:** Several coastal countries in the region have abundant access to reef and water resources, creating an opportunity to cultivate ornamental fish destined for export. Opportunities in this sector also include fishing for local and international consumption. In countries like Malawi, interviewees mentioned fishing as one of the most attractive targets for impact investment, though potential away from major bodies of water is limited.

FIGURE 18. SECTOR OPPORTUNITIES BY COUNTRY



Source: Open Capital Research, interviews

# RECOMMENDATIONS FOR FUTURE STUDY

This report presents the most comprehensive study to date of impact investments in Southern Africa, building from other work on the landscape completed in South Asia, East Africa, and West Africa. However, this series of reports raises several additional questions for future study, as follows.

**What types of support effectively prepare businesses for investment?** Several organizations in Southern Africa provide pre-investment and post-investment support. What types of support are most effective in developing investment-ready and scalable businesses? How does the effectiveness of these services vary by stage of company lifecycle? What role can mentorship, business acceleration, classroom lectures, tailored business support, market linkages, and other services play in helping businesses attract the capital they require to grow?

**How can social enterprises and impact investors attract, build, and retain top talent?** Talent is one of the most frequently cited challenges across Southern Africa. What can the social enterprise sector learn from top corporations about attracting, building, and retaining talent at all levels? What monetary and non-monetary compensation is expected by top talent who are considering a career path in Southern Africa? How can social enterprises and impact investors leverage non-monetary compensation to compete with top international firms and donor organizations for talent?

**What viable exit mechanisms can impact investors consider in Southern Africa?** How can impact investors identify exit strategies in the region, including methods to ensure that impact potential is not lost after an exit? How could a secondary market improve deal flow and incorporate learnings from prior attempts to create impact exchanges, establish dedicated secondary markets, and execute strategic acquisitions? How can social enterprises access the developed secondary markets in South Africa, in particular?



**DEVELOPMENT**

**FINANCE**

**INSTITUTIONS (DFIs)**

**CHANNELING CAPITAL AND  
SUPPORTING ECOSYSTEMS**

# BACKGROUND AND METHODOLOGY

Development finance institutions (DFIs) are government-funded investment corporations that combine the broad development objectives of traditional multilateral aid agencies with the commercial approach taken by private-sector banks and investors. DFIs are mostly funded by governments, though some also raise capital from private investors. As a result, the regions, sectors, businesses, and types of project they target often reflect the political environments in their home countries. In many cases, DFIs are expected to sustain their operations and growth from their investment returns. Expecting future injections of capital to be limited, DFI investment managers—like other impact investors—focus on investments that offer both attractive financial returns and social and/or environmental impact.

Given their long history, DFIs may be considered the first active impact investors, both globally and in Southern Africa (see Figure 1 for some example DFIs active in the region). In addition to direct investments, they provide capital to other impact investors (and especially to fund managers), catalyze the flow of private capital into new markets, and work with national governments to shape their investment policies.

FIGURE 1. SAMPLE DFIs ACTIVE IN SOUTHERN AFRICA

African Development Bank	DFID	
Finnfund	BIO	CDC
Swedfund	OPIC	Proparco
European Investment Bank	PTA Bank	FMO
Norfund	IFC	DEG

Due in part to the large assets that they manage, DFIs tend to have average deal sizes much larger than those of non-DFI impact investors, which makes it difficult for certain DFIs to invest directly in small- and medium-sized enterprises (SMEs). In response to this challenge, in the late 1990s and early 2000s DFIs increasingly began to invest in funds (both conventional and impact) focused on investing in smaller, earlier-stage businesses. This indirect approach allows DFIs to allocate capital specifically to SMEs and private-sector development while maintaining a large investment ticket size.

## A NOTE ON METHODOLOGY

Definitions of the term “DFI” vary substantially. The present analysis considers a DFI to be any predominantly publicly funded or owned investor that makes direct investments in private-sector companies and provides capital through any combination of equity, debt, or guarantees with an explicit goal to achieve social and/or environmental impact alongside a financial return. This definition excludes multilateral aid, direct loans to governments, pure development programs, and loans to individuals. In cases where a DFI both makes private-sector investments and funds governments directly, only their private-sector investments are considered here.

Private-sector investments include placements into parastatals and other corporations wholly or partially owned by governments.

Due to substantial and unique DFI activity in South Africa, this report distinguishes “domestic South African DFIs” from “international DFIs.” Major domestic South African DFIs include the Industrial Development Corporation (IDC), the Development Bank of Southern Africa (DBSA), and the National Empowerment Fund (NEF), as well as smaller domestic DFIs. These are government-funded development finance organizations based in South Africa and investing across the region. Though the Land and Agricultural Development Bank of Southern Africa (LADBSA or Land Bank) does strongly focus on development, its deposit-taking and retail-banking services mean it does not strictly fit the present definition of a DFI as a government-funded institution investing exclusively in businesses or projects. Its disbursements are therefore not included in the figures here.

International DFIs are national or regional DFIs that are funded primarily by the governments of nations that are not in the Southern Africa region. This analysis excludes national development corporations in Southern African countries besides South Africa due to limited publicly available data and less explicit narratives regarding impact.

## Incentives and Drivers

The public genesis of DFIs shapes their strategic incentives and investing behavior. Unlike private funds, which often close at a finite size and have specific objectives, DFIs are often open-ended, in terms of both annual funding and their investment philosophies. Motivated by development, DFIs seek investments in markets where others struggle to invest, but they also seek commercial returns. Several factors influence their ongoing behavior, as described below.

## Political Influences

Many DFIs are funded in large part—often entirely—by their respective governments. In many cases, they are directly subordinate to national ministries of finance or to development agencies. As a result, national development agendas strongly influence their investment strategies.<sup>1</sup> Political influence applies equally to multinational DFIs, like the International Finance Corporation (IFC) or the African Development Bank (AfDB), the governing boards of which comprise high-ranking representatives of member governments. At the same time, governments often look to multinational DFIs to define standards and guidance for their national DFIs. This serves to shape DFI strategy in the following ways:

- **Changing investment objectives:** As DFI investment strategies are shaped by government agendas, they can fluctuate over time. Many DFIs revise their overarching investment strategies over cycles, typically between three and 10 years. Unexpected strategic changes can occur when new political leadership is inaugurated, either at the country or group level (for example, World Bank leadership may dictate IFC’s direction).
- **More stringent risk standards:** Public scrutiny over government funds means that DFIs must consider reputational risk. Many DFIs have adopted stringent risk standards and vetting procedures to avoid directly or indirectly channeling funds to politically sensitive recipients or high-risk ventures.<sup>2</sup> This limits DFIs’ ability to work with early-stage businesses or in sectors such as agribusiness that often have high market concentration around a few incumbents with a long tail of smaller and less-established growth-stage businesses. However, as shown later in this chapter, some DFIs are developing new strategies to channel capital towards smaller organizations.

## Capital Allocation and Investment Targets

Though their investment philosophies do evolve with the political priorities of their home governments, DFIs often have very specific investment targets by sector, geography, and time frame. These investment quotas encourage DFI investment officers to look for a smaller number of large investment opportunities—particularly when one considers the complicated diligence and structuring costs associated with small deals. In Southern Africa, as in most emerging markets, this appetite for large deals naturally attracts DFIs to capital-intensive industries, such as energy, manufacturing, and infrastructure.

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1 For a review of various DFIs’ ownership and governance structures, along with other valuable information, see Christian Kingombe, Isabella Massa, and Dirk Willem te Velde, *Comparing Development Finance Institutions* (London: Overseas Development Institute, 2011), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/67635/comparing-DFIs.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/67635/comparing-DFIs.pdf).

2 See, for instance, IFC’s conditions on “Politically Exposed Persons.” In International Finance Corporation, *Correspondent Account KYC Toolkit, A Guide To Common Documentation Requirements* (2009), <http://www.ifc.org/wps/wcm/connect/dfb227004ec4ea109697bf45b400a808/CORRESPONDENT+ACCOUNT+KYC+TOOLKIT.pdf?MOD=AJPERES>.

The open-ended nature of DFI portfolios reinforces this focus. Because of political agendas and budget cycles, governments generally re-capitalize DFIs at neither predictable intervals of time nor amounts. Many DFIs therefore must rely on portfolio returns to cover overhead expenses, even while also investing in sectors that fit with their development mandates and that do not distort local markets. This emphasis on profitable impact lends itself to large investments in infrastructure, where strong government ties and regulatory controls portend relatively stable income streams, and in financial services, where investees are often already well-integrated into local markets.

## Additionality and Private-sector Inclusion

DFIs' parent governments and international organizations recognize the potential for DFI activity to distort private markets with their large amounts of public capital. Their response to this concern is to seek "additionality," the principle that DFIs should only be active in regions, sectors, or segments that are challenging for other, private-sector capital sources to address.<sup>3</sup> At the same time, through their actions, DFIs also seek to galvanize and crowd-in private-sector investors. Examples of such strategies include:

- **Catalyzing underserved markets:** DFIs are typically reluctant to provide capital where private-sector funding is already well-established. This has led many DFIs to intensify their focuses on frontier, fragile, and conflict markets (see, for instance, the IFC's Conflict Affected States in Africa Initiative, a multilateral DFI effort to support business growth in challenging African markets).<sup>4</sup> As a result, DFIs have disbursed a larger share of their capital to countries besides South Africa than have non-DFI investors, with the exception of the investment landscape in Zimbabwe, Angola, and Swaziland, where political concerns have made it difficult for DFIs to engage (see section below on DFI investment activity).
- **Syndicated loans:** Several DFIs offer syndicated loans that include third-party, private-sector financial institutions as co-lenders in their investments.<sup>5</sup> Under this structure, when a DFI makes a loan, it retains a portion of the loan for its own account (the "direct" loan) and sells the remainder (the syndicated loan) to participating financial institutions, such as banks. This provides syndication participants with lower default risk through the DFI's status as a strong creditor while enlarging the pool of capital available to borrowers. This structure's main challenge is how to incentivize local financial players to participate, particularly in markets where commercial rates are significantly higher than rates on the DFI loans, as is often the case in emerging economies.

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3 IFC has such a principle, for example. International Finance Corporation, *Additionality Primer* (2010), [http://www.ifc.org/wps/wcm/connect/696f81804b06f2adb09afa888d4159f8/Additionality\\_Primer.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/696f81804b06f2adb09afa888d4159f8/Additionality_Primer.pdf?MOD=AJPERES).

4 International Finance Corporation, *IFC's Conflict Affected States in Africa Initiative (2008–2013)*, <http://www.ifc.org/wps/wcm/connect/5f675b004540e75a95de9dc66d9c728b/IFC+CASA+I+Final+Report.pdf?MOD=AJPERES>.

5 "B Loan Structure and Benefits," International Finance Corporation, [http://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/ifc+syndications/overview\\_benefits\\_structure/syndications/b+loan+structure+and+benefits/bloanstructuredefaultcontent](http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+syndications/overview_benefits_structure/syndications/b+loan+structure+and+benefits/bloanstructuredefaultcontent).

- **Asset management products:** In an effort to mobilize more private-sector funding for development finance objectives, several DFIs have launched asset management services in recent years.<sup>6</sup> The IFC launched an asset management arm in 2009 and has since raised six funds, with over USD eight billion under management and funded by pension funds, insurance companies, and other private-sector actors in addition to public and quasi-public institutions. Through these funds, IFC has disbursed close to USD five billion across 68 investments globally, around USD 190 million of which has been in Southern Africa. More than 90 percent of the assets under management are available for investment in the Southern Africa region, although this capital does target emerging markets globally. Following IFC's pioneering role, the AfDB has planned a USD 10 billion fund to mobilize private capital for infrastructure.<sup>7</sup>
- **Public-private co-financing:** Some DFIs make investment conditional on third-party co-financing. The DFI will commit an anchor investment, typically for a minority stake, and then use its preferred-creditor status and strong reputation to encourage external, often private-sector investors to join deals that would not otherwise fit their risk profiles. Conversely, DFIs will also provide debt project financing once private entrepreneurs have committed sufficient equity.

## IMPACT APPROACH OF INTERNATIONAL DFIs AND INFLUENCE ON THE BROADER IMPACT SECTOR

DFIs have a direct mandate from governments and intergovernmental organizations to promote international development. Evaluating their success in this regard requires a formalized methodology to measure impact. All of the DFIs with direct investment activity in Southern Africa stipulate minimum impact requirements for their investment targets. Broadly, their methods for measuring impact can be grouped into two categories, though individual DFIs may use different terminology:<sup>8</sup>

1. **Environmental, Social, and Governance (ESG) monitoring:** This is the broadest method of measuring impact used by DFIs. Investees are required to meet threshold requirements limiting environmental damage, safeguarding human rights, and promoting fair and transparent governance structures. The specific

6 "IFC Asset Management Company," <http://www.ifcamc.org/>.

7 Daniel Runde, "Development Finance Institutions Come of Age," *Forbes*, October 17, 2014, <http://www.forbes.com/sites/danielrunde/2014/10/17/development-finance-institutions-come-of-age-dfi/>.

8 Cf. DEG, *Corporate-Policy Project Rating* (2013), <https://www.deginvest.de/DEG-Englische-Dokumente/About-DEG/Our-Mandate/Detailed-GPR-Description.pdf>; and OPIC, *Environmental and Social Policy Statement* (2010), [http://www.opic.gov/sites/default/files/consolidated\\_esps.pdf](http://www.opic.gov/sites/default/files/consolidated_esps.pdf).

metrics often vary according to the DFI and target company in question. Target companies that do not meet these requirements often receive technical assistance to help build the necessary structures for compliance.

As part of its Sustainability Framework, the IFC formulated a set of eight performance standards that investees are required to meet while they are receiving funding.<sup>9</sup> These standards form the basis by which most DFIs set their ESG standards. The eight standards across which the IFC requires investees to meet minimum requirements are:

- Assessment and management of environmental and social risks and impacts;
- Labor and working conditions;
- Resource efficiency and pollution prevention;
- Community health, safety, and security;
- Land acquisition and involuntary resettlement;
- Biodiversity conservation and sustainable management of living natural resources;
- Protection of indigenous peoples; and
- Safeguarding of cultural heritage.

In addition, many other common standards, such as the European Development Finance Institutions' (EDFI) Environmental and Social Standards, are derived from this IFC framework.

2. **Specific impact objectives:** The ESG- or IFC-type frameworks above are intended to ensure that financially attractive investments meet minimum social and environmental standards. However, some DFIs have recently begun to allocate funds proactively in order to achieve specific impact objectives using a broad variety of approaches.

For example, FMO, the Dutch government DFI, has a twin focus on both job creation and reducing greenhouse gas emissions. As another example, the Department for International Development (DFID) recently launched its Impact Fund, a CDC-managed fund-of-funds that aims to invest up to GBP 75 million in impact funds across sub-Saharan Africa and South Asia.<sup>10</sup> Another DFI, the US-based Overseas Private Investment Corporation (OPIC), recently conducted a thorough segmentation of its investment portfolio in order to better understand its impact. While OPIC concluded that all of its investments have “positive development impact,” it found that its investments in “high-impact sectors”—those that have been identified as particularly environmentally and socially beneficial—accounted for more than two-thirds of its investments in 2013.<sup>11</sup>

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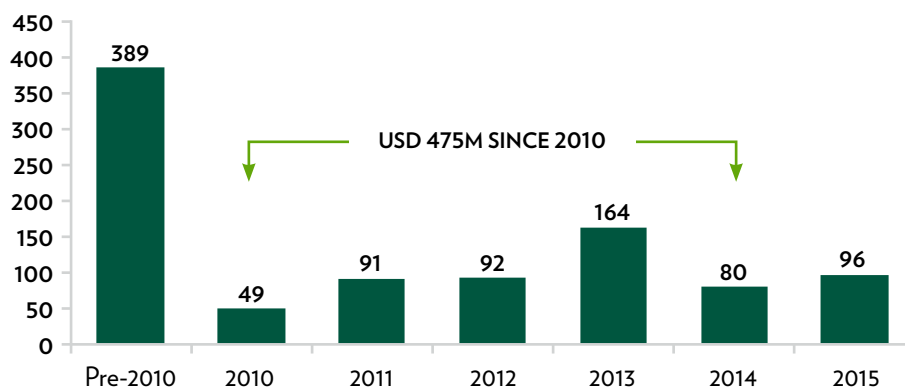
9 International Finance Corporation, *IFC Performance Standards on Environmental and Social Sustainability* (2012), [http://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afd998895a12/IFC\\_Performance\\_Standards.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afd998895a12/IFC_Performance_Standards.pdf?MOD=AJPERES).

10 “DFID Impact Fund,” CDC, <http://www.cdcgroup.com/dfid-impact-fund.aspx>.

11 “OPIC in Action: Impact Investing,” OPIC, <http://www.opic.gov/opic-action/impact-investing>.

A critical component of DFIs' philosophies of development and impact is to nurture the private sector by fostering SME growth. In South Africa, many SMEs are able to access funding through local banks and domestic DFIs, but there remains a wide SME financing gap across the rest of the region (described in more detail in individual country chapters) that international DFIs have attempted to fill. However, accompanying the financing of smaller businesses are relatively higher diligence costs, a lack of the security and assurances typical of public-sector projects, and a need for more flexibility than DFIs are typically able to accept. Addressing these constraints, DFIs have responded by funding impact fund managers (Figure 2), particularly those focused on SME investments.

FIGURE 2. DISCLOSED DFI FUNDING OF IMPACT FUNDS ACTIVE IN SOUTHERN AFRICA



Note: Incomplete reporting at the time of writing meant that the research team was unable to find capital disbursed data for DFI funding of impact funds in 2015.

Source: Open Capital research, organization websites.

The prevalence of DFI funding in Southern Africa's impact investing ecosystem has important implications (both positive and negative) for managers of impact funds:

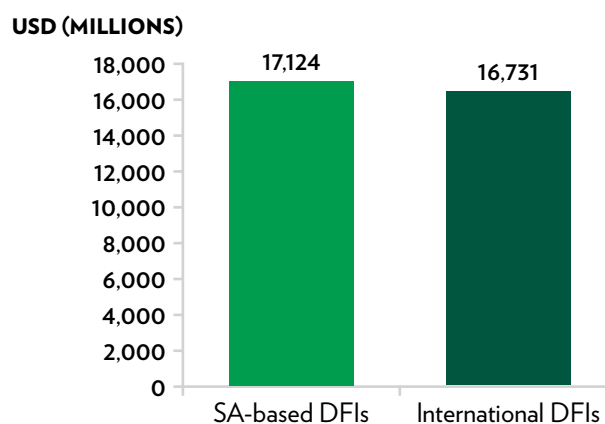
- **DFI importance:** DFIs are a major driver of impact capital committed to Southern Africa via impact funds (see Figure 2). Not only have they provided capital directly to impact funds, but they also often provide anchor investments that allow fund managers to raise the balance of their funds from other sources, such as commercial or philanthropic private investors. Correspondingly, this makes the landscape of impact funds somewhat vulnerable to changing DFI priorities. Few of the actors interviewed for this report believe that this reliance on DFIs will change until impact funds are able to demonstrate the kinds of commercial returns that would make the sector attractive to larger institutional investors, such as pension funds.
- **Fund manager homogeneity:** While many DFIs have funded impact funds in Southern Africa, the majority of capital has come from a small group of particularly active players. Two international DFIs account for over 75 percent of disclosed capital disbursed specifically to impact fund managers active in Southern Africa. This concentration of capital and the resulting influence exerted by this small group led several fund managers in the region, in interviews, to observe that

impact funds become homogenized as they—dependent on DFI anchor capital—look to align themselves with DFI expectations. The resulting similarities between funds exacerbate the perceived shortage of investment targets, as multiple investors pursue and indeed are constructed to pursue similar deals.

## DFI INVESTMENT ACTIVITY

Uniquely in the region, South Africa has several large, highly active domestic DFIs that, in some cases, have been investing in businesses since the beginning of the last century (see the sidebar for brief descriptions of these DFIs).<sup>12</sup> In fact, the three major return-seeking DFIs based in South Africa have together disbursed more capital in the region than all international DFIs combined. Of almost USD 34 billion disbursed in the region by DFIs, over USD 17 billion (or 51 percent) has come from DFIs owned or funded by the South African government (see Figure 3).

FIGURE 3. SOUTH AFRICA-BASED VS INTERNATIONAL DFI DISBURSEMENT

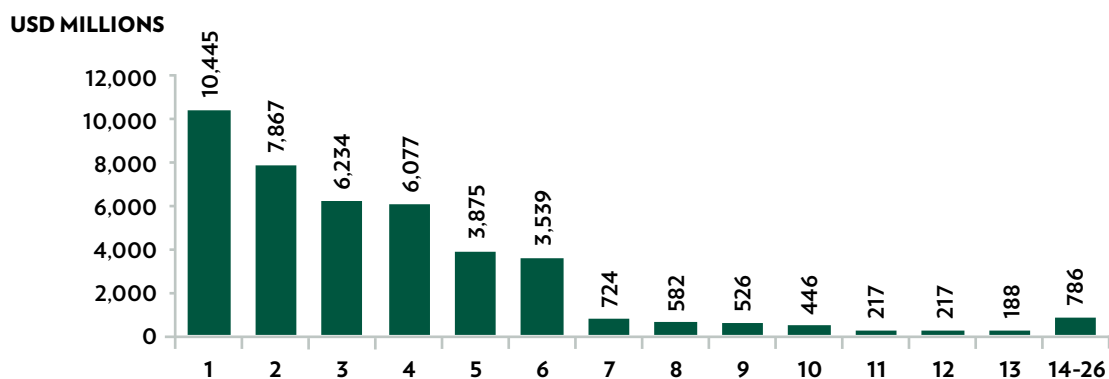


Source: Open Capital research

Including both domestic and international DFIs, 26 DFIs have publicized investments in Southern Africa, but the industry is remarkably concentrated. Two South African DFIs and three international DFIs combine to account for almost 90 percent of DFI capital disbursed in the region (see Figure 4).

12 "Development Bank of Southern Africa," International Development Finance Club, <https://www.idfc.org/Members/dbsa.aspx>; "Historical Milestones," Development Bank of Southern Africa, <http://www.dbsa.org/EN/About-Us/Pages/Historical-Milestones.aspx>; "Profile," Land Bank, <http://www.landbank.co.za/#!/profile/c1dcq>; and OCA interviews.

FIGURE 4: DFIs ARRANGED BY CAPITAL DISBURSED IN SOUTHERN AFRICA (ANONYMIZED)



Note: Incomplete reporting at the time of writing meant that the research team was unable to find capital disbursed data for DFI funding of impact funds in 2015.

Source: Open Capital Research

## Investments by Geography

Although many interviewees commented that the high availability of capital in South Africa from domestic DFIs, the banking sector, and Broad-Based Black Economic Empowerment (BBBEE) initiatives has crowded out international DFI funding, South Africa still accounts for a large majority of international DFI capital disbursed in the region. Specifically, of the USD 16.7 billion that international DFIs have disbursed in the region, almost USD 10 billion (roughly 60 percent) has been placed in South Africa. Reflecting the large disparities in market size and maturity between South Africa and the region, this amount of placed capital is almost six times higher than that placed in Zambia, the country with the next-most disbursed capital from international DFIs (see Figure 5). South Africa has also seen the largest number of international DFI deals (187 out of 654 total deals), even though, at 30 percent, its relative share of the total number of deals is lower than its share of capital disbursed. Furthermore, many international DFIs cover South Africa as an entirely separate mandate from the rest of the region, with separate investment teams, targets, and objectives, suggesting that there are still enough investment opportunities for international DFIs in the country to warrant such segmentation.

# DOMESTIC DFIs IN SOUTH AFRICA

## THERE ARE FOUR MAJOR DOMESTIC DFIS IN SOUTH AFRICA.

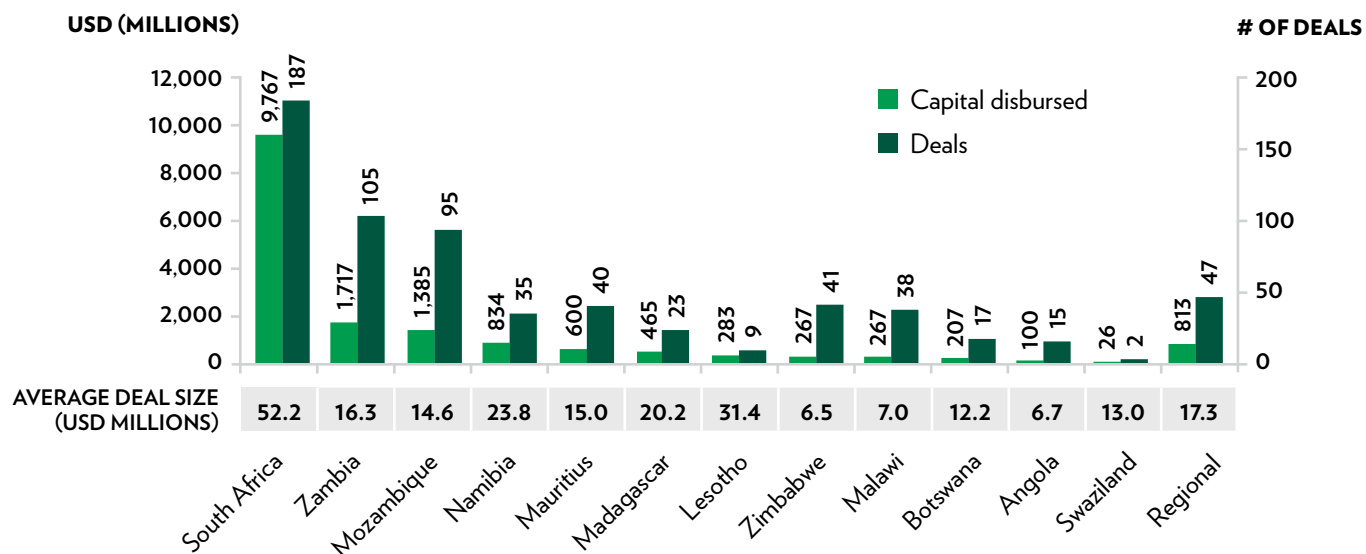
**Industrial Development Corporation (IDC):** The IDC provides financing for “high-impact and labor-intensive” projects across the whole of Africa, including mining, manufacturing, and infrastructure. Impact is measured on the basis of development scorecards that track metrics such as youth ownership, female ownership, black ownership, rural impact, and environmental impact. Since much of its portfolio is in extractives, the IDC has made it a priority to ensure ongoing private-sector development in mining communities beyond the useful life of their mines. It has also launched special initiatives to integrate SMEs into the supply chains of larger corporations.

**Development Bank of South Africa (DBSA):** The DBSA has a pan-SADC (Southern Africa Development Community) mandate to accelerate sustainable economic development, with a focus on social and economic infrastructure. As such, it has funded or co-funded a number of major projects in energy, healthcare, water, and education. The DBSA is increasingly broadening its reach across Southern Africa and has already supported several infrastructure initiatives in Namibia, Lesotho, Zambia, and Mozambique, among others.

**National Empowerment Fund (NEF):** The NEF is intended to catalyze Black Economic Empowerment by supporting and funding black entrepreneurs and black-owned businesses. The NEF funds a variety of businesses, from early-stage start-ups or franchises to USD multi-million projects. Unlike many traditional DFIs, the NEF maintains a “drop-in” store front where entrepreneurs can make in-person applications for financing. Since the NEF engages more with early-stage entrepreneurs than do most DFIs, it also runs various in-house incubation and technical assistance programs. Only black South Africans or South African businesses that are majority black-owned are eligible for NEF funding. Within this mandate, the NEF has put into place special initiatives to fund female entrepreneurs.

**Land and Agricultural Development Bank of South Africa (LADBSA or Land Bank):** The Land Bank provides access to financing for South African agri-businesses and farmers. Founded in 1912, it is one of the oldest financial institutions in Africa. The Land Bank supports agricultural and rural development in several forms, from large commercial-farming projects to projects facilitating access to agriculture for new entrants from disadvantaged backgrounds. Though the Land Bank strongly focuses on development, its deposit-taking and retail-banking services mean that it does not strictly fit the present definition of a DFI as a government-funded institution investing exclusively in businesses or projects. Its disbursements are therefore not included in the figures presented in this chapter. Nonetheless, it is one of the largest development financiers in the region, having disbursed close to USD 13 billion in loans over the last five years.

**FIGURE 5: INTERNATIONAL DFI INVESTMENTS BY COUNTRY**

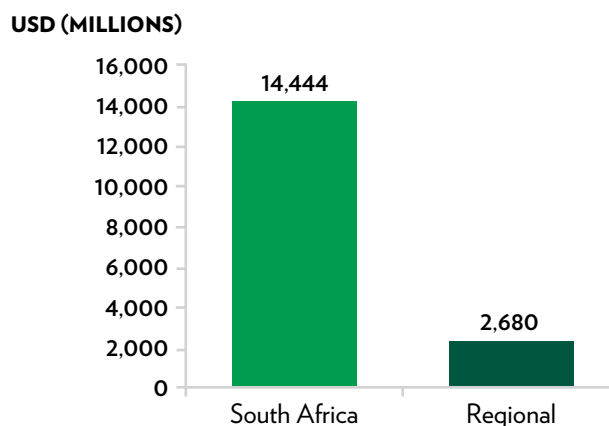


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes domestic South African based DFIs.

Source: Open Capital Research

Though some domestic South African DFIs have a broader regional mandate (e.g., the DBSA or the IDC), the vast majority of South African DFI capital has been disbursed in South Africa. Of the USD 17 billion disbursed by South African DFIs, only slightly more than USD 2.5 billion (16 percent) has been placed in other Southern African countries (see Figure 6). This reflects both investable opportunities in South Africa as well as some domestic DFIs’ deliberate focus on South Africa as part of their overall investment strategies.

**FIGURE 6. SOUTH AFRICA-BASED DFI DISBURSEMENT BY DESTINATION**

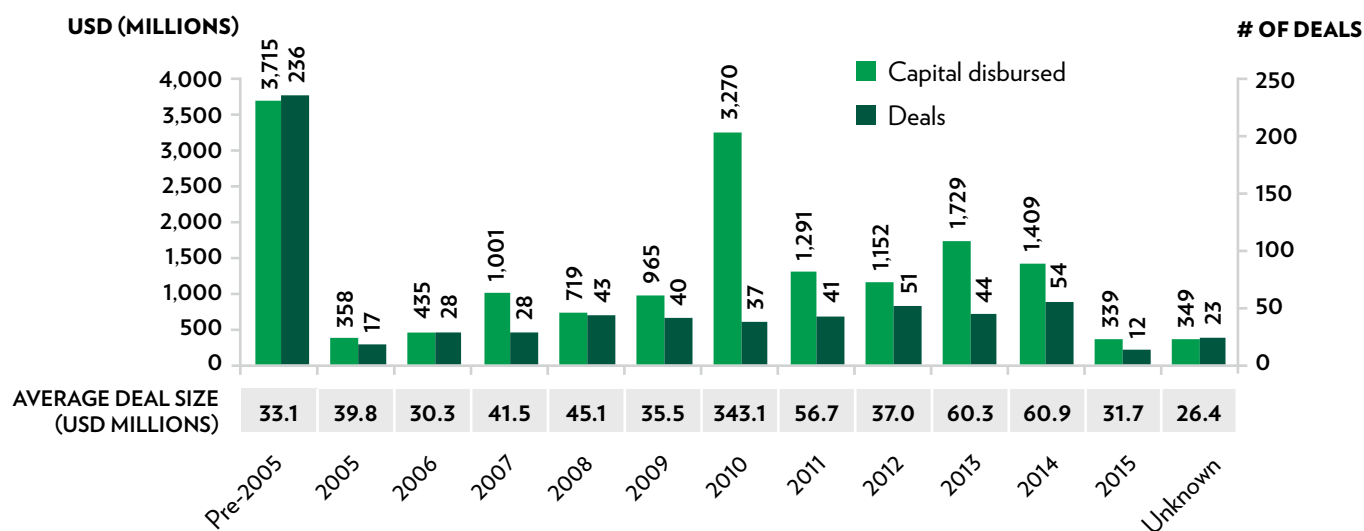


Source: Open Capital Research

## Investments Over Time

International DFI disbursements in Southern Africa have steadily increased over the past decade (see Figure 7). Capital disbursed rose from around USD 350 million in 2005 to around USD 1.5 billion in 2013 and 2014. Capital disbursed spiked notably in 2010 due primarily to one, USD multi-billion investment in South Africa’s power industry—the number of deals in 2010 is actually lower than in most other years—before returning closer to previous levels in the following years. Interestingly, average deal size has increased over time; that is, the number of deals has grown more slowly than capital disbursed, suggesting a growing number of opportunities for larger deals. The drop in deals and capital disbursed in 2015 is likely due to incomplete data reporting at the time of this writing, rather than due to any decline in investor interest.

FIGURE 7: INTERNATIONAL DFI INVESTMENTS OVER TIME

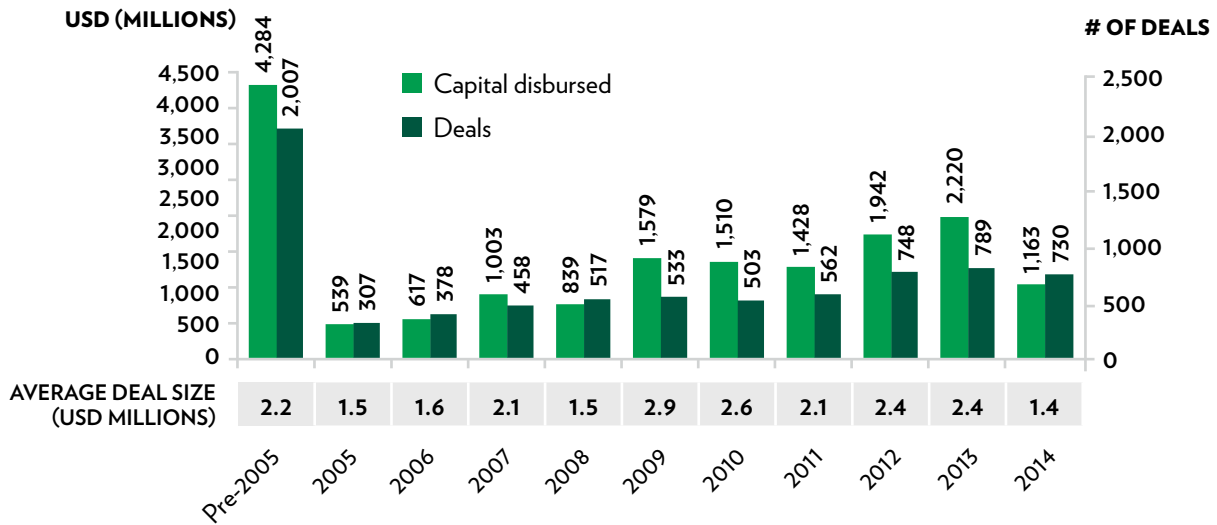


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes domestic South African based DFIs.

Source: Open Capital Research

By contrast to the more variable annual activity for international DFIs, South Africa-based DFI investments have demonstrated steady growth (see Figure 8). South African DFIs tend to invest, on average, much smaller amounts, directly supporting small and growing businesses through their investment activity. In 2014, for instance, South Africa-based DFIs completed over 70 times as many deals as did international DFIs.

FIGURE 8: SOUTH AFRICA-BASED DFI INVESTMENTS OVER TIME



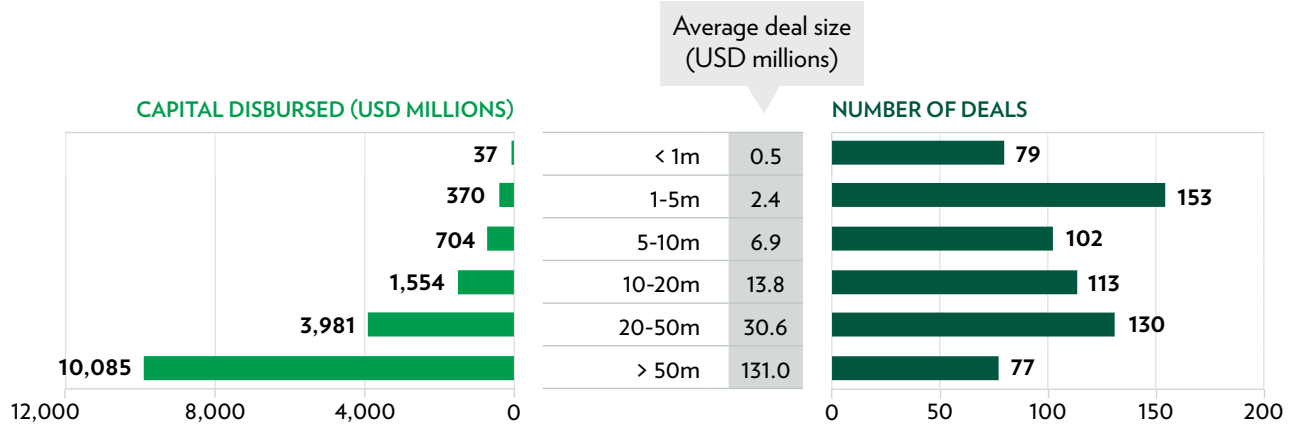
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Deal Size

Across the region, over 60 percent of capital disbursed by international DFIs has been in deals worth over USD 50 million (see Figure 9). Driving this trend is primarily investments into large energy projects that can easily exceed USD 100 million, many of which have gone to fund major hydroelectric power projects aimed at addressing the region’s acute energy shortage. Despite these large deals, most DFI investments are in the range of USD one to 10 million, often made to local banks that have an established presence and are generally perceived as lower risk investments than newer ventures. Due to limited data provided by domestic DFIs in South Africa, it is not possible to graph their deals by size, limiting the analysis presented here to the above discussion of average deal sizes by international DFIs.

FIGURE 9. INTERNATIONAL DFI INVESTMENTS BY DEAL SIZE



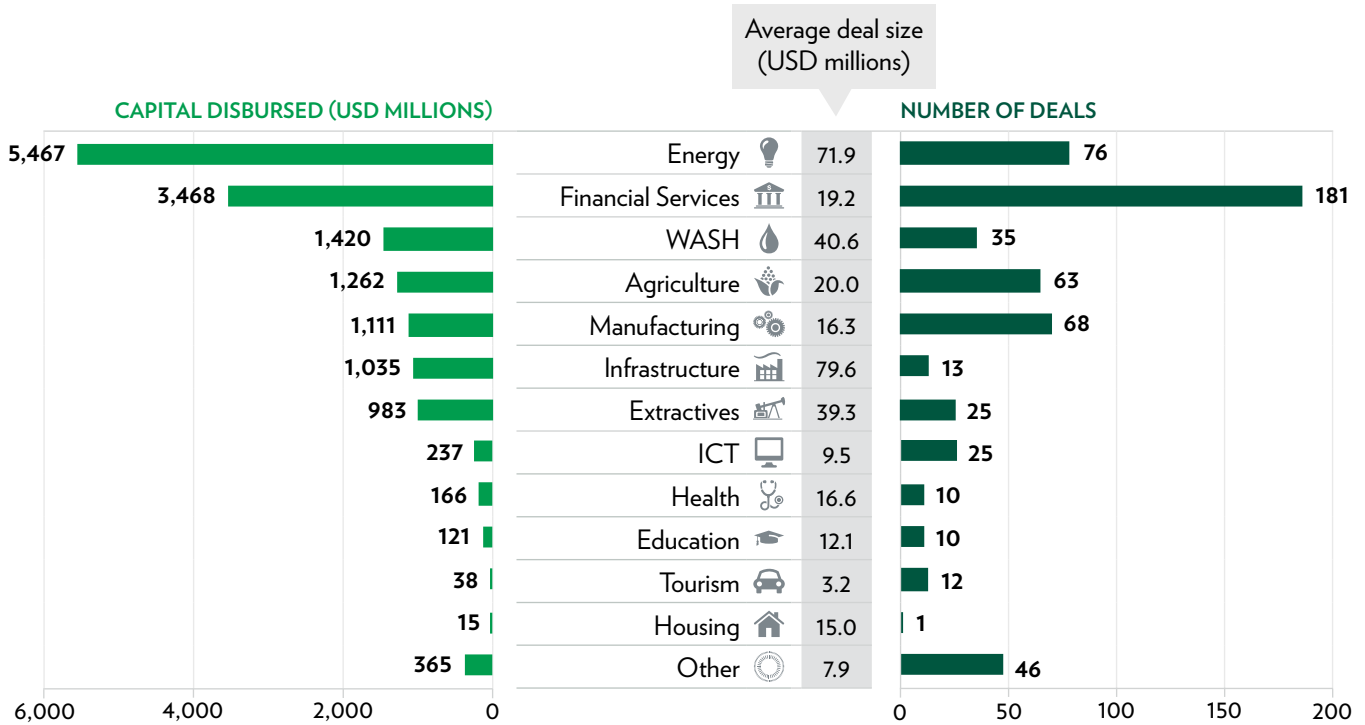
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes domestic South African based DFIs.

Source: Open Capital Research

## Sector

While energy has received the most international DFI capital of any sector, the financial services sector has attracted by far the largest number of deals, representing nearly 30 percent of all deals made (see Figure 10). Despite their potential for impact, education, healthcare, and housing together only account for around two percent of capital disbursed and less than three percent of deals. Interviewees noted that significant government presence often makes it difficult for investors to act effectively in these sectors. Due to limited data provided by South Africa-based DFIs, it is not possible to graph their deals by sector.

FIGURE 10. INTERNATIONAL DFI DIRECT INVESTMENTS BY SECTOR



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 83 million in capital where sector is unknown. Excludes domestic South African based DFIs.

Source: Open Capital Research

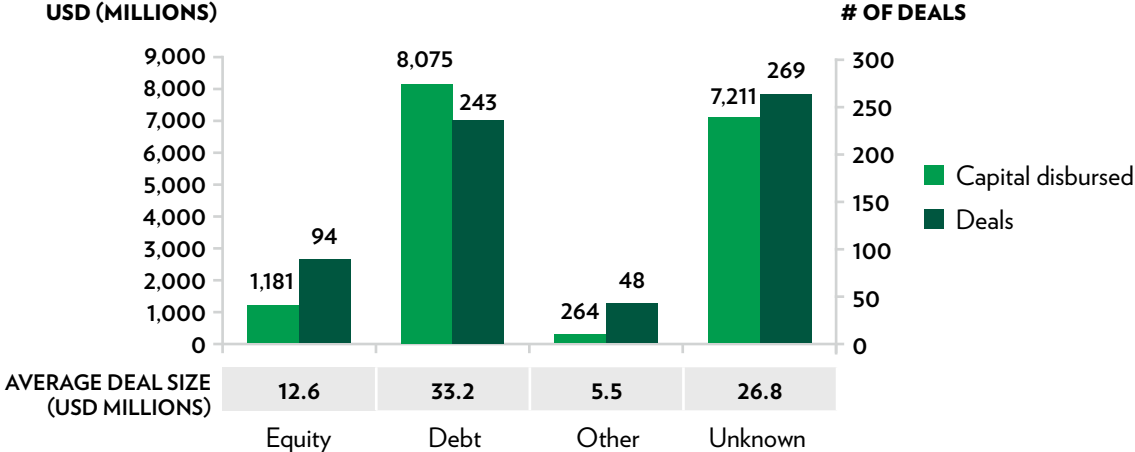
International DFIs have increasingly funded impact funds across global emerging markets (see *The Landscape for Impact Investing in East Africa* and *The Landscape for Impact Investing in South Asia* reports for a thorough discussion of DFI activity in East Africa and South Asia, respectively),<sup>13</sup> a pattern which also holds in Southern Africa. International DFIs have provided almost USD one billion in capital to private impact funds that include Southern Africa in their mandates. Importantly, however, many of these funds also target countries outside of Southern Africa, so it is unlikely that all of this capital will ultimately reach Southern African businesses. As discussed above, in many cases South Africa-based DFIs place similar types of capital with non-DFI impact investors outside of South Africa, guiding impact investment activity through their own direct investments.

13 The Global Impact Investing Network and Open Capital Advisors, *The Landscape for Impact Investing in East Africa* (2015), <http://www.thegiin.org/knowledge/publication/the-landscape-for-impact-investing-in-east-africa>; and The Global Impact Investing Network and Dalberg, *The Landscape for Impact Investing in South Asia* (2015), <http://www.thegiin.org/knowledge/publication/the-landscape-for-impact-investing-in-south-asia>.

# Instrument

The research team was unable to ascertain the instrument used for almost half of international DFI capital disbursed and for almost half of all deals. To the extent that the available data are representative, however, close to 85 percent of international DFI capital disbursed in Southern Africa has been invested as debt (see Figure 11), reflecting a general, global trend in DFI investing. In many cases, the use of debt matches the nature of the project: project finance for infrastructure, for instance, typically requires an upfront equity investment by an independent entrepreneur supplemented by DFI debt. In addition, many DFIs lack the organizational structure necessary to provide the heavy-touch oversight that successful equity investments into local businesses might require.

**FIGURE 11. INTERNATIONAL DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

Nonetheless, some DFIs have successfully carved out a niche for themselves by taking minority stakes in businesses—typically medium-sized—and by providing expertise, market knowledge, and technical assistance in addition to capital. DFIs have also allocated around USD 125 million in guarantees to Southern African banks, which are intended to catalyze activity from local financial institutions as part of DFIs’ “additionality” objective. Here, DFI investors have reported mixed results so far.<sup>14</sup> While guarantees have increased local bank engagement with SMEs, implementation is time-intensive and structuring often requires extensive use of intermediaries.<sup>15</sup> Limited data prevent further analysis of South Africa-based DFI activity by instrument.

14 Open Capital interviews.

15 Open Capital interviews.

# SOUTH AFRICA

THE REGION'S POWERHOUSE



# INTRODUCTION

FIGURE 1. MAP OF SOUTH AFRICA



Following the end of apartheid more than two decades ago, the South African economy has grown rapidly. The country's gross domestic product (GDP) has almost tripled to more than USD 700 billion in purchasing power parity (PPP) terms, making it the largest economy in Southern Africa and the second-largest economy on the continent (following Nigeria). With a population of over 50 million, South Africa's GDP per capita has reached around USD 13 thousand (PPP).<sup>1</sup> With this growth, South Africa forms the pillar of impact investing in Southern Africa. As the economic and financial capital of the region (see Figure 1), South Africa boasts the largest number of impact investors and the most impact capital disbursed of any country in the region. Indeed, South Africa tops virtually every metric in this report.

Despite the volume of impact investing activity in South Africa, impact capital represents a small part of the overall South African investment picture. South Africa has a large and comparatively advanced financial system with single-digit interest rates, unusual for the region. This affordable access to traditional capital, combined with well-functioning credit bureaus, dramatically increases transparency in lending, especially relative to the rest of the region.

Nevertheless, impact investing fills an important niche. Banks and traditional funds are risk-averse and unwilling to lend to some growing businesses. Despite a rising middle class, South Africa remains one of the most unequal countries in the world. Impact

1 "South Africa's Population," SouthAfrica.info, <http://www.southafrica.info/about/people/population.htm#.VhevPmqkqk>; and *World Economic Outlook Database*, s.v. "South Africa" (Washington, DC: International Monetary Fund, 2015), <http://www.imf.org/external/ns/cs.aspx?id=28>.

capital is needed to target underserved communities and drive development. High-potential sectors include education, energy, tourism, financial inclusion, and agriculture.

Impact investors should also be aware of the challenges that operations face in South Africa. Although generally open to foreign investment, the country has a complicated regulatory environment. Chief among these complicated rules are the Broad-Based Black Economic Empowerment (BBBEE) regulations, which provide affirmative action codes governing most elements of the business environment, including ownership, hiring policies, and supplier selection. Ongoing and severe nationwide energy shortages provide a second key barrier to operations for companies in South Africa. Since the beginning of 2015, South Africa has been plagued by rolling blackouts, which are forecast to cut GDP growth by an estimated 0.4 percent this year.<sup>2</sup>

## COUNTRY CONTEXT

Apartheid defined the course of South African history in the second half of the twentieth century.<sup>3</sup> The struggles of South Africa's black and colored populations, and the regime's subsequent violent crackdown on resistance, eventually drew the attention of the international community, prompting the United Nations to establish the Centre Against Apartheid in 1976.<sup>4</sup> An arms embargo intended to stop the sale and shipment of arms and ammunition to South Africa followed in 1977.<sup>5</sup> In 1985, South Africa's main trading partners—the European Community, the US, and Japan—imposed sanctions in a bid to end the apartheid system, sanctions which were labeled globally as the “disinvestment campaign”.<sup>6</sup>

When FW de Klerk became president of the republic in 1989, he immediately began to deconstruct the apartheid regime. Working closely with Nelson Mandela, de Klerk established a new anti-apartheid constitution, removed restrictions on political groups, and suspended executions of anti-apartheid activists.<sup>7</sup> The apartheid regime officially ended in 1994, and Mandela was elected as de Klerk's successor in a coalition government with a non-white majority.<sup>8</sup>

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2 “SA power crisis threatens country's economy,” *eNCA*, February 18, 2015, <http://www.enca.com/money/sa-power-crisis-threatens-countrys-economic-outlook>.

3 “South Africa profile—Timeline,” *BBC News*, June 25, 2015, <http://www.bbc.com/news/world-africa-14094918>.

4 United Nations Information Centre South Africa, *Special edition of the UNIC South Africa Library newsletter: The role of the United Nations in the abolition of apartheid* (Pretoria: UNIC South Africa, 2014), <http://unicpretoria.org.za/files/2013/06/Special-apartheid.pdf>.

5 “The United Nations: Partner in the Struggle against Apartheid,” United Nations, <http://www.un.org/en/events/mandeladay/apartheid.shtml>.

6 Ch. Hefti and E. Staehelin-Witt, *Economic Sanctions against South Africa and the Importance of Switzerland* (Bern, Schweizerischer Nationalfonds zur Förderung, 2015), [http://www.snf.ch/SiteCollectionDocuments/nfp/nfp42p/nfp42p\\_staehelin-e.pdf](http://www.snf.ch/SiteCollectionDocuments/nfp/nfp42p/nfp42p_staehelin-e.pdf).

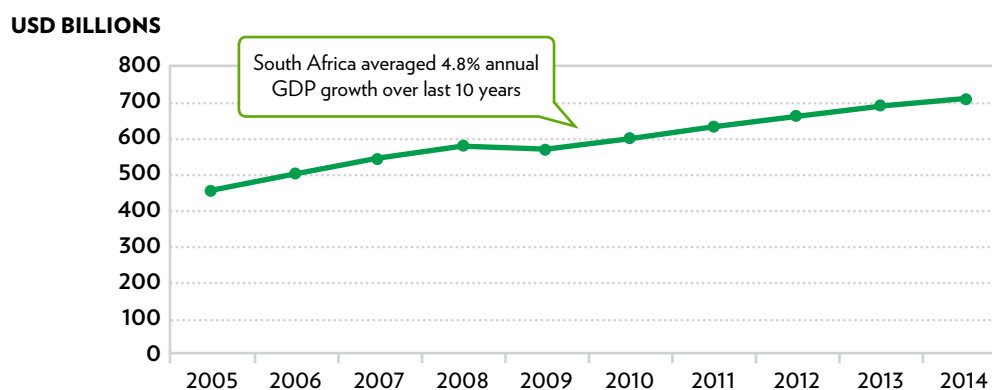
7 “FW. de Klerk Biography,” *Biography.com*, <http://www.biography.com/people/fw-de-klerk-9270025>; and “FW. de Klerk—Facts,” Nobel Media AB, *Nobelprize.org*, [http://www.nobelprize.org/nobel\\_prizes/peace/laureates/1993/klerk-facts.html](http://www.nobelprize.org/nobel_prizes/peace/laureates/1993/klerk-facts.html).

8 “Apartheid,” *History.com*, last modified 2010, <http://www.history.com/topics/apartheid>.

## Gross Domestic Product

In the more than two decades since the end of apartheid, South Africa has made great economic strides. The country's GDP (in PPP terms) has almost tripled—to over USD 700 billion since international sanctions were lifted in 1996, the economy growing nearly 4.8 percent annually in PPP terms between 2005 and 2014 (see Figure 2). However, recent real GDP growth tells a different story, with 2014 growth of only 1.5 percent, the lowest since 2008.<sup>9</sup> This slowdown has been driven by the weakening economies of trading partners (primarily China and Europe), electricity shortages, and extended strikes in the mining sector.<sup>10</sup> Real GDP growth is forecast to increase to two percent through the 2015–2016 fiscal year on the back of a global recovery as well as through growth in exports driven by a depreciating Rand.<sup>11</sup>

FIGURE 2. GDP (PPP), 2005–2014



Source: IMF World Bank Economic Outlook, April 2015

## Foreign Direct Investment

South Africa is the main destination for FDI in Africa,<sup>12</sup> though the country experienced a 31 percent drop in net FDI inflows (from USD 8.3 billion to USD 5.8 billion) from 2013 to 2014 (see Figure 3) due to a combination of slowing economic growth and outflows driven by increasing appetite for intra-African investment.<sup>13</sup>

9 “South Africa: Concluding Statement of an IMF Staff Visit,” International Monetary Fund, last modified June 23, 2015, <https://www.imf.org/external/np/ms/2015/062315.htm>.

10 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf).

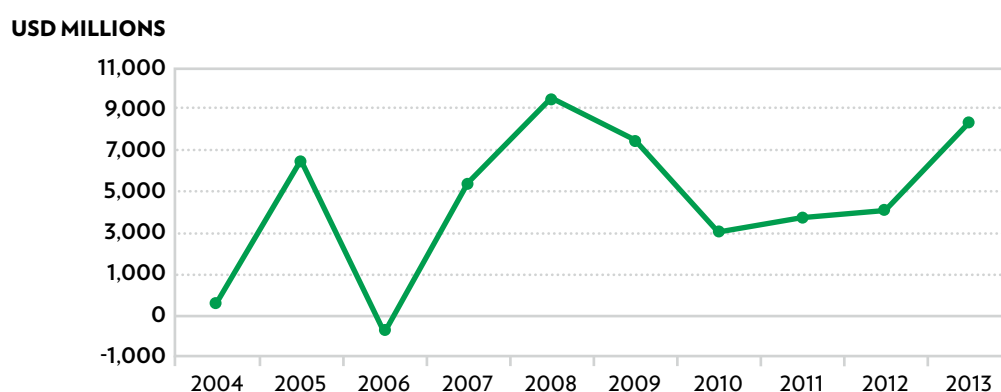
11 *Ibid.*

12 Ernst & Young, *EY's attractiveness survey: Africa 2014* (2014), [http://www.ey.com/Publication/vwLUAssets/EY-attractiveness-africa-2014/\\$FILE/EY-attractiveness-africa-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-attractiveness-africa-2014/$FILE/EY-attractiveness-africa-2014.pdf).

13 Lynley Donnelly, “SA takes foreign direct investment hit,” *Mail & Guardian*, June 26, 2015, <http://mg.co.za/article/2015-06-25-sa-takes-foreign-direct-investment-hit>; and United Nations Conference on Trade and Development, “Country Fact Sheet: South Africa,” in *World Investment Report 2015* (New York: United Nations Conference on Trade and Development, 2015), [http://unctad.org/sections/dite\\_dir/docs/wir2015/wir15\\_fs\\_za\\_en.pdf](http://unctad.org/sections/dite_dir/docs/wir2015/wir15_fs_za_en.pdf).

South African investments in other African countries increased significantly in 2014. With total FDI outflows of USD 6.9 billion in telecom, mining, and retail, South Africa was by a wide margin the largest outward-investing economy on the continent. Most of the investments were within the immediate geographic region, concentrated in Swaziland, Zimbabwe, and Botswana, taking advantage of strong regional links, regional markets, and existing value chains.<sup>14</sup>

FIGURE 3. NET FDI FLOWS, 2004–2013



Source: UNCTAD

## Inflation and Exchange Rates

South Africa's Central Bank targets inflation of three to six percent, but the country has struggled to maintain this range in recent years.<sup>15</sup> In 2008, inflation spiked to double digits, driven by global increases in food and oil prices as well as domestic issues, with a falling Rand and electricity constraints.<sup>16</sup> Inflation spiked again to 6.6 percent in mid-2014 before falling back into the target band in early 2015.<sup>17</sup>

With the exception of a sudden depreciation in 2009 largely driven by the global financial crisis, the Rand was generally stable until 2011 (see Figure 4) before steadily depreciating due to labor market unrest, increasing global unease with emerging-

14 United Nations Conference on Trade and Development, *World Investment Report 2015: Reforming International Investment Governance* (New York: United Nations Conference on Trade and Development, 2015), [http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf).

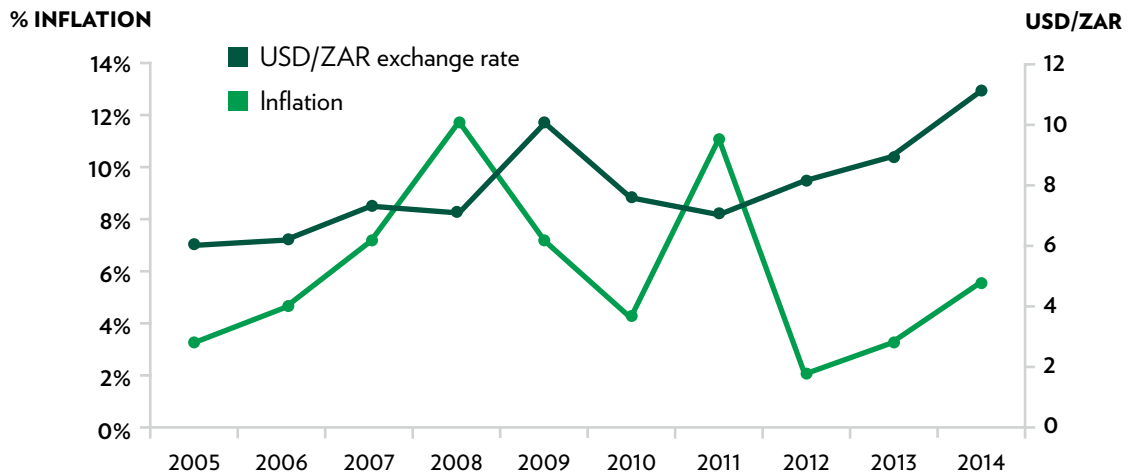
15 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf).

16 "High inflation in South Africa," *The Economist*, April 1, 2008, <http://www.economist.com/node/10947147>.

17 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf); and "CPI drops to levels last seen in 2011," Statistics South Africa (blog), February 18, 2015, <http://www.statssa.gov.za/?p=4155>.

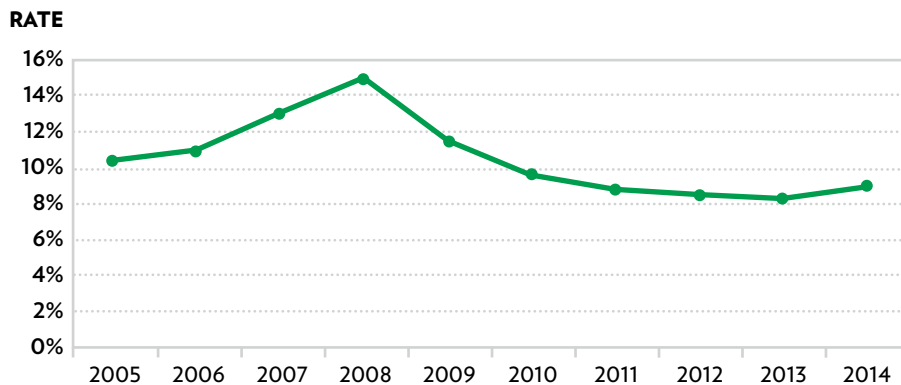
market currencies, and the country's rising current account deficit.<sup>18</sup> Continued depreciation prompted the South African Reserve Bank (SARB) to twice increase the base rate in 2014, the first such increase in six years.<sup>19</sup> Over the past decade, interest rates in South Africa have consistently been lower than in other countries in the region due to a comparatively strong South African economy and banking sector, which provides a friendly environment for bank loans in local currency (see Figure 5).

FIGURE 4. INFLATION AND USD/ZAR EXCHANGE RATE, 2005–2014



Source: World Bank Indicators

FIGURE 5. INTEREST RATES, 2005–2014



Source: World Bank Indicators

18 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf).

19 *Ibid.*

## Regional Influence

As the largest market in Southern Africa, South Africa has used its clout to drive both regional and continental integration. The country was a key player in establishing the African Union (AU),<sup>20</sup> and it is extremely influential in the South African Development Community (SADC) and the South African Customs Union (SACU).<sup>21</sup> South Africa accounted for approximately 41 percent of SADC trade in 2013, making it the leading economy within the community.<sup>22</sup> Under the SACU, all customs duty and excise revenue collected in the common customs area is shared between member nations. Some of the region's smaller economies, such as Lesotho and Swaziland, greatly depend on revenues generated largely by trade between South Africa and other SACU countries.<sup>23</sup>

South African corporations also have a strong regional presence. As discussed above, domestic corporations are increasingly seeking new markets, both within the region and on the continent more broadly. This is especially true for retail chains and banks. Publicly listed South African companies now earn almost two-thirds of their revenues outside of South Africa.<sup>24</sup>

## Broad-Based Black Economic Empowerment

The Broad-Based Black Economic Empowerment (BBBEE) Act is a government initiative aimed at increasing the economic participation of black South Africans.<sup>25</sup> The BBBEE Act applies to all state-owned enterprises (SOEs) and to private businesses with annual revenues over ZAR 10 million (around USD 710 thousand). Enterprises are rated based on a scorecard that allocates points for black empowerment across five metrics (see box).<sup>26</sup>

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20 Bertelsmann Stiftung, *BTI 2014: South Africa Country Report* (Gütersloh: Bertelsmann Stiftung, 2014), [http://www.bti-project.org/uploads/tx\\_itao\\_download/BTI\\_2014\\_South\\_Africa.pdf](http://www.bti-project.org/uploads/tx_itao_download/BTI_2014_South_Africa.pdf).

21 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf). SACU member countries include Botswana, Namibia, Lesotho, South Africa, and Swaziland.

22 *Ibid.* SADC member countries include Angola, Botswana, DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, the United Republic of Tanzania, Zambia, and Zimbabwe.

23 "Southern African Customs Union (SACU)," Republic of South Africa: Department of International Relations and Cooperation, last modified April 26, 2004, <http://www.dfa.gov.za/foreign/Multilateral/africa/sacu.htm>.

24 Steve Johnson, "South Africa's equity market power scrutinized," *Financial Times*, July 14, 2015, <http://www.ft.com/intl/cms/s/3/51ff94b0-2954-11e5-8613-e7aedbb7bdb7.html#axzz3mcv3UbSI>.

25 Standard Bank, *BBBEE Explained*, [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf). According to Standard Bank, the term "Black" includes "Africans, Coloureds, and Indians," including black women and youth, as well as disabled and rural people, who are citizens of South Africa by birth or who were naturalized before April 27, 1994.

26 Werksmans Attorneys, *Amendments to the BBBEE Act and the Codes Explained* (2014), <http://www.werksmans.com/wp-content/uploads/2014/11/041763-WERKSMANS-bbbee-booklet.pdf>.

## **BROAD-BASED BLACK ECONOMIC EMPOWERMENT (BBBEE) SCORING**

BBBEE scoring has five elements, and a company can reach a total of 100 points plus 13 bonus points. Details regarding the scoring system and how points are allocated can be found on the Department of Trade and Industry's website. Below is a high-level summary.

**Ownership (25 points):** The percentage of economic interest and exercisable voting rights held by Black South Africans.

**Management control (14 points + four bonus):** The representation of Black South Africans and persons with disabilities on the board, in management, and in other levels of employment.

**Enterprise & supplier development (40 points + four bonus):** Businesses are required to spend one percent of annual net profit, after tax, on contributions towards enterprise development and two percent on supplier development for majority (more than 51 percent) Black-owned businesses.

**Skills development (20 points + five bonus):** Expenditures on learning programs that contribute to skills development for Black South Africans.

**Socioeconomic development (Five points):** Businesses must allocate at least one percent of annual net, after-tax profit to socioeconomic contributions (including grants, guarantees, developmental capital, training and mentoring, and direct assistance provided to beneficiary communities).

Based on their scores, businesses are classified as being either non-compliant or falling in a compliance level between BBBEE Level 1 (the highest) to Level 8 (the lowest).<sup>27</sup> BBBEE scores have significant implications for an organization's ability to conduct business in South Africa. For example, state entities are required to use BBBEE scores when contracting suppliers, issuing licenses, or granting concessions.<sup>28</sup> Industries that require government licenses to operate (for example, financial services or liquor) typically require higher BBBEE scores. Financial services, construction, and extractives have the highest overall scores, while retail, manufacturing, and transport tend to have the lowest.<sup>29</sup> Critically, banks tend to offer preferential access to financing to enterprises with higher BBBEE scores.<sup>30</sup>

27 Standard Bank, *BBBEE Explained*, [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf).

28 Ashkar Rambully, "How BBBEE affects tender decisions," *Izikhuku Bee Ratings* (blog), July 9, 2015, <http://www.izikhulu.co.za/how-bbbee-affects-tender-decisions/>.

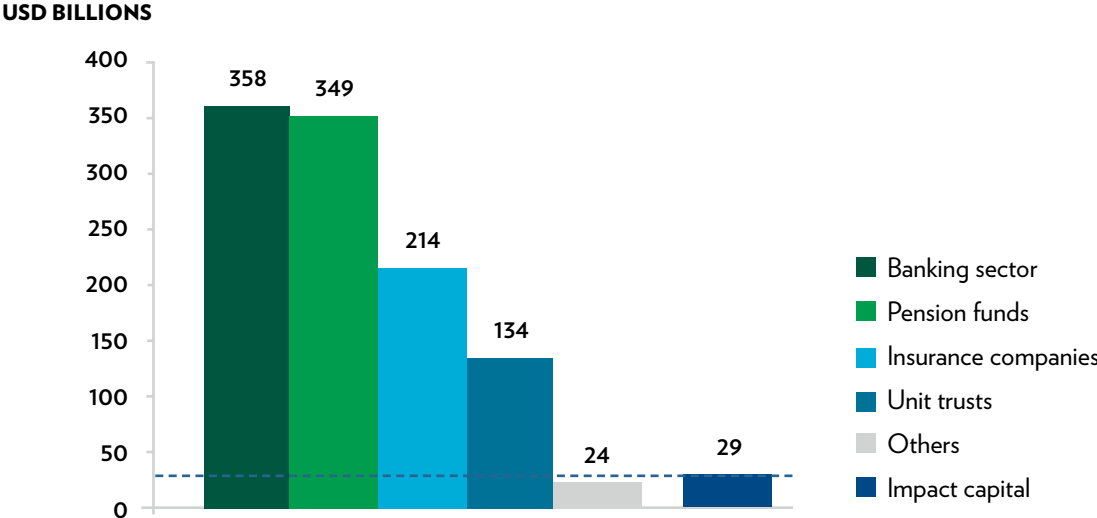
29 Economic Empowerment Rating Agency, "Impact of BEE Implementation on Profit Margin and Productivity," <http://www.empowerdex.com/Portals/5/docs/Impact%20of%20BEE%20Implementation%20on%20Profit%20Margin%20and%20Productivity.pdf>.

30 Standard Bank, *BBBEE Explained*, [http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank\\_BEE\\_Guide.pdf](http://www.standardbank.co.za/standing/Standard%20Bank/StandardBank/static%20files/Business/StdBank_BEE_Guide.pdf).

# THE BROADER INVESTMENT LANDSCAPE

Impact investing represents only a small part of the overall investment landscape in South Africa, which has a large and comparatively advanced financial system. The International Monetary Fund (IMF) estimates that total financial assets in South Africa are almost three times the size of the country’s GDP (see Figure 6).<sup>31</sup>

FIGURE 6. IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: International Monetary Fund

There are many players in the landscape of South African financial services. Banks and pension funds are the largest asset holders, but the market also includes insurers, fund managers, micro-lenders, and a vibrant stock exchange, among others. The country has four government-regulated credit bureaus that gather data from a variety of sources, including banks, credit card companies, and non-bank financial institutions.<sup>32</sup>

31 Cheng Hoon Lim et al., *South Africa: Financial System Stability Assessment* (Washington, DC: International Monetary Fund, 2014), <http://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf>. Impact capital shown is based on capital flows, which may overestimate capital available as some impact capital has been recycled through multiple deals.

32 *Ibid.*

## BANKS

The South African Reserve Bank (SARB) recorded 31 banks in South Africa at the end of 2014.<sup>33</sup> However, five major banks—Standard Bank, FirstRand Bank, Absa Bank, Nedbank, and Investec—control more than 90 percent of total banking assets, dominating the sector.<sup>34</sup> This concentration enables the major banks to control interest rates and to achieve high returns and profitability.<sup>35</sup>

With a prime lending rate of 9.5 percent in mid-2015,<sup>36</sup> access to affordable finance in South Africa is better than in the majority of other markets in the region. However, South African banks typically cater to the needs of large enterprises, as banks remain risk-averse and are usually unwilling to lend to SMEs, which they view as riskier and more costly to serve.<sup>37</sup> Furthermore, usury laws, the presence of which is intended to protect business owners, prevent banks from appropriately pricing the credit risk of lending to small businesses.<sup>38</sup>

## PENSION FUNDS

South Africa has a robust pension fund sector, with ZAR 3.8 trillion (around USD 270 billion) in assets under management as of 2013. The publicly owned Public Investment Corporation (PIC) is the largest pension fund of any type in Africa.<sup>39</sup> Changes in 2011 to Regulation 28 of the Pension Fund Act increased to ten percent the proportion of a pension fund's portfolio that could be invested in alternative asset classes—many of which, including unlisted equity, are favored by impact investors.<sup>40</sup> However, pension funds have limited investment in these asset classes to date given their typically conservative investment mandates.<sup>41</sup> For example, PIC's Isibaya fund, which invests in private equity, only constitutes 1.1 percent of total PIC assets under management.<sup>42</sup>

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33 South African Reserve Bank, *Bank Supervision Department: Annual Report (2014)*, <https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/6736/01%20BankSupAR2014.pdf>.

34 Cheng Hoon Lim et al., *South Africa: Financial System Stability Assessment* (Washington, DC: International Monetary Fund, 2014), <http://www.imf.org/external/pubs/ft/scr/2014/cr14340.pdf>.

35 *Ibid.*

36 “Current market rates,” South African Reserve Bank, <https://www.resbank.co.za/Research/Rates/Pages/CurrentMarketRates.aspx>.

37 Michael Fuchs et al., *Financing Small and Medium Enterprises in the Republic of South Africa* (Washington, DC: World Bank, 2011), <https://openknowledge.worldbank.org/handle/10986/12687>.

38 Hans Falkena et al., *SMEs' Access to Finance in South Africa: A Supply Side Regulatory Review* (Pretoria: Policy Board for Financial Services and Regulation, 2001), <http://www.treasury.gov.za/publications/other/Access%20to%20Finance%20in%20South%20Africa%20-%20A%20Supply-Side%20Regulatory%20Review.pdf>.

39 “Our clients,” Public Investment Corporation, <http://www.pic.gov.za/index.php/about-us/our-clients/>.

40 “Private Equity in Africa: Pension Fund Reforms,” *King & Wood Mallesons: Insights* (blog), February 1, 2013, <http://www.kwm.com/en/es/knowledge/insights/private-equity-in-africa-pension-fund-reforms-20130201>.

41 Anna B. Wroblewska, “Africa Private Equity Insider: In Pursuit Of Pensions,” *AFK Insider*, February 3, 2015, <http://afkinsider.com/87092/africa-private-equity-insider-pursuit-pensions/>.

42 Public Investment Corporation, *Integrated Annual Report (2014)*, <http://www.pic.gov.za/wp-content/PIC%20Annual%20Report%202014%20Web.pdf>.

## FUND MANAGERS

There are an estimated 200 fund managers (around 60 percent private equity [PE] firms and 40 percent other asset managers) in South Africa, managing ZAR 1,700 billion (around USD 120 billion) across more than 1,100 funds (around 15 percent PE funds and 85 percent asset manager funds).<sup>43</sup>

Fund managers in South Africa are engaged by a mix of domestic firms and international funds with local operations. Interestingly, many fund managers elect to set up their regional headquarters in South Africa, even if they invest predominantly in other countries (see sidebar).

## STOCK EXCHANGE

The Johannesburg Stock Exchange (JSE) is the largest in Africa, with almost 400 listed companies and a market capitalization of more than USD one trillion.<sup>44</sup> The exchange hosts the AltX listing for small and medium-sized companies; AltX has raised around ZAR 40 billion (USD three billion) since its launch in 2003.<sup>45</sup> At a ratio of almost three to one, the JSE has the second-highest market capitalization to GDP ratio globally (after Hong Kong), an indication of strong investor interest in public listings within the South African market.<sup>46</sup>

### FUND MANAGERS WITH A PRESENCE IN SOUTH AFRICA

Many funds base their regional head offices in South Africa, regardless of whether or not South Africa is one of their target markets. Interviewees reported many reasons for this, as follows.

**Airport hub:** Johannesburg Airport is a transport hub for most flights in the region, making it easy to travel between portfolio companies.

**Quality of life:** South Africa has a comparatively high standard of living at a reasonable cost, which makes it easier for funds to attract and retain talent.

**Infrastructure and support:** South Africa has better telecommunications and business services than most other countries in the region, making it easier to conduct business.

**Talent availability:** The country has a large pool of university-educated workers with expertise and experience in financial services.

**Political stability:** The country is often deemed as being relatively more stable, with a less rapidly changing policy environment, than its neighbors.

43 Philippe Franiatte and Yann-Ange Kouassi, *The African Investing for Impact Barometer 2014* (Cape Town: Bertha Centre for Social Innovation & Entrepreneurship, 2014), [http://www.gsb.uct.ac.za/files/African\\_IFI\\_Barometer\\_2014.pdf](http://www.gsb.uct.ac.za/files/African_IFI_Barometer_2014.pdf).

44 “JSE Overview,” Johannesburg Stock Exchange, <https://www.jse.co.za/about/history-company-overview>.

45 “AltX,” Johannesburg Stock Exchange, <https://www.jse.co.za/capital/altx>.

46 “South Africa’s equity market power scrutinized,” *Financial Times*, July 14, 2015, <http://www.ft.com/intl/cms/s/3/51ff94b0-2954-11e5-8613-e7aeddb7bdb7.html#axzz3o4hkzyVm>.

## MICROFINANCE INSTITUTIONS

The microfinance sector is large and growing in South Africa, with more than three thousand active organizations managing an estimated ZAR 50 billion (around USD 3.6 billion).<sup>47</sup> However, the vast majority (over 95 percent) of microcredit in South Africa is used for personal loans rather than for financing small businesses.<sup>48</sup>

## CORPORATE SOCIAL INVESTMENT AND BBBEE SPENDING

In South Africa, corporate social responsibility is typically referred to as corporate social investment (CSI). CSI is a significant source of funding for small and growing businesses in the country. In 2014, CSI was estimated at ZAR 8.2 billion (USD 620 million),<sup>49</sup> largely driven by the BBBEE-mandated expenditure of one percent after-tax net profit on socio-economic development.<sup>50</sup> In addition to CSI, corporations are required to spend two percent and one percent of after-tax net profit on supplier development and enterprise development, respectively.<sup>51</sup> Collectively, large corporations spent nearly an estimated ZAR 60 billion (USD 4.3 billion) in 2014 as part of BBBEE.<sup>52</sup> As a result, there is a significant amount of corporate funding to support black-owned SMEs in the country. Such funding takes many forms: there are a number of intermediaries providing technical assistance and training using BBBEE funds, in addition to direct corporate disbursements in the form of both grants and return-seeking capital.

## ANGEL INVESTORS AND HIGH-NET-WORTH INDIVIDUALS

South Africa has very high income inequality. The wealthy elite have begun to invest in start-up businesses, and interviewees cited domestic angel investors as a small but growing source of capital. Many of these individuals are looking for investment opportunities beyond the stock exchange and are seeking better returns in higher-risk ventures. The country has a number of networks of angel investors, including FNB Private Client, Shanduka Black Umbrella, and Angel Hub Ventures.

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47 Barbara Calvin and Gerhard Coetzee, "A Review of Microfinance in South Africa: Where to from Here?" (University of Pretoria, Centre for Microfinance, and the FinMark Trust), [http://www.finmark.org.za/wp-content/uploads/fpres\\_mfscan.pdf](http://www.finmark.org.za/wp-content/uploads/fpres_mfscan.pdf); and "Microfinance and poverty alleviation in South Africa," *KPMG Research*, November 5, 2013, <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/financial-services/pages/microfinance-and-poverty-alleviation-in-south-africa.aspx>.

48 "Microfinance and poverty alleviation in South Africa," *KPMG Research*, November 5, 2013, <http://www.kpmg.com/za/en/issuesandinsights/articlespublications/financial-services/pages/microfinance-and-poverty-alleviation-in-south-africa.aspx>.

49 "CSI expenditure is increasingly concentrated in education," *Dialogue*, March 17, 2015, <http://dialogue.co.za/csi-expenditure-is-increasingly-concentrated-in-education/>.

50 Department of Trade and Industry, "Broad-Based Black Economic Empowerment Act (53/2003): Issue of Codes of Good Practice," *Government Gazette Staatskoerant* (Republic of South Africa) 580, no. 36928 (October 11, 2013): 3–122, [https://www.thedti.gov.za/news2013/code\\_gud\\_practice10102013.pdf](https://www.thedti.gov.za/news2013/code_gud_practice10102013.pdf).

51 *Ibid.*

52 Stuart Theobald et al., *The Value of BEE Deals* (Sandton: Intellidex, 2015), <http://www.intellidex.co.za/wp-content/uploads/2015/06/Intellidex-report-The-Value-of-BEE-Deals.pdf>.

## Supply of Impact Capital

The term “impact investing” is less commonly used or understood in South Africa than elsewhere in the region or elsewhere in Africa. Many investors interviewed did not consider themselves to be impact investors, even when they had stated impact goals, explicitly tracked impact, and compensated their teams based on impact performance.

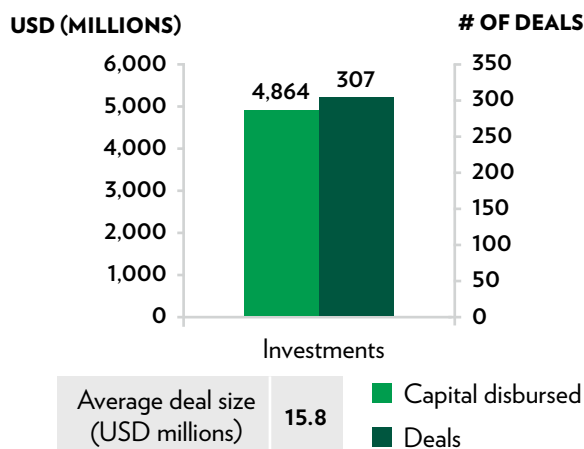
In some instances, investors cited a lack of familiarity with the term. One investor mentioned that only after attending a conference on impact investing the previous year had she become aware of the concept. Others associated impact investing more closely with East African countries and did not consider it a trend in South Africa. Many interviewees mentioned a general discomfort in South Africa with mixing “charity and business,” expressing that mandated CSI under BBBEE had exhausted corporations’ and high-net-worth individuals’ capacity to support impact initiatives.

Whether or not investors self-identify as impact investors, as defined by this report, South Africa is by far the largest market in Southern Africa for impact investing. The country has had more deals and capital disbursed by both development finance institutions (DFI) and non-DFI actors than all other markets in the region combined. Impact investors play an important role in delivering innovative solutions that target challenging sectors and markets that conventional investors often avoid, providing much-needed capital to businesses that would otherwise struggle to access finance.

## Impact Capital Disbursed

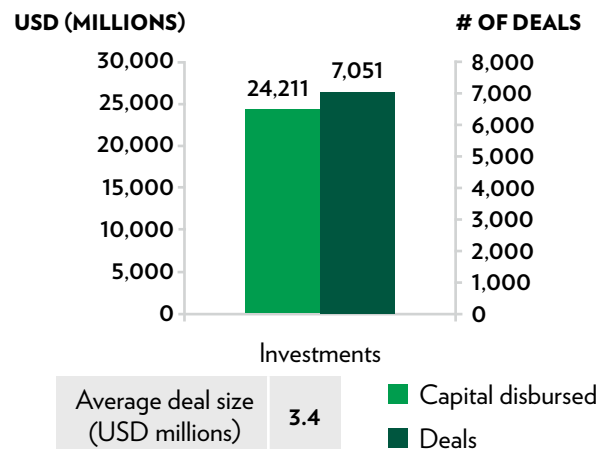
South Africa is the single largest market for impact capital in Southern Africa. Nearly three quarters (74 percent) of all impact capital disbursed in the region has been placed in South Africa, amounting to USD 4.9 billion of non-DFI capital and more than USD 24.2 billion of DFI capital. This is close to 15 times the amount deployed in Zambia, which ranks second in the region in terms of impact capital disbursed.

FIGURE 7. NON-DFI IMPACT INVESTMENTS



Source: Open Capital Research

FIGURE 8. DFI IMPACT INVESTMENTS













Note: Includes domestic South African DFI activity.

Source: Open Capital Research

## NON-DFI CAPITAL DISBURSED

A total of USD 4.9 billion in impact capital has been deployed by non-DFI investors across 307 deals by 46 unique investors (see Figure 7). Notably, 48 percent of this amount (USD 2.3 billion) was disbursed in the three largest deals, each significantly larger than the average non-DFI deal size of USD 15.8 million (see Figure 7). Overall, of these 46 investors, 25 are headquartered in South Africa, and an additional eight have local offices in the country. The vast majority of these organizations are fund managers, although a few are foundations or banks.

TABLE 1. TOP 10 NON-DFI TRANSACTIONS IN SOUTH AFRICA (TOTAL USD 3.1 BILLION)

Investor type	Amount (USD Millions)	Sector	Instrument	Year
Fund manager	1,200	Financial services 	Equity	2007
Fund manager	700	Manufacturing 	Equity	2008
Fund manager	434	Logistics 	Equity	2011
Fund manager	107	Infrastructure 	Unknown	Unknown
Fund manager	107	Infrastructure 	Unknown	Unknown
Fund manager	107	Infrastructure 	Unknown	Unknown
Fund manager	106	Energy 	Equity	2005
Fund manager	100	Financial services 	Equity	2014
Fund manager	97	Real estate 	Equity	2012
Fund manager	95	Financial services 	Equity	2013

## DFI CAPITAL DISBURSED

As with all other countries in Southern Africa, DFIs play a significant role in impact investing in South Africa. In order to compare to other countries in the region, this chapter separates activity of international DFIs from domestic DFIs, which are particularly active in South Africa (see sidebar). Together, international and domestic DFIs have disbursed more than USD 24.2 billion across more than seven thousand deals in South Africa, representing 83 percent of impact capital disbursed and 96 percent of impact deals in the region (see Figure 8).

### DOMESTIC DFIs IN SOUTH AFRICA

There are over a dozen national DFIs in South Africa, each with a unique mandate. The three major domestic DFIs are the following.

**Industrial Development Corporation (IDC):** The IDC provides finance for “high-impact and labor-intensive” projects across the whole of Africa, including mining, manufacturing, and infrastructure.

**Development Bank of South Africa (DBSA):** The DBSA has a pan-SADC mandate to accelerate sustainable economic development, with a focus on social and economic infrastructure.

**National Empowerment Fund (NEF):** The NEF is intended to catalyze Broad-Based Black Economic Empowerment (BBBEE) by supporting and funding black entrepreneurs and black-owned businesses.

International DFIs—such as the African Development Bank (AfDB) and the International Finance Corporation (IFC), among others—have disbursed almost USD 10 billion in South Africa, half of the total investment they have made in the region. Uniquely in the region, South Africa boasts more than a dozen large and active domestic DFIs, with the most activity from the IDC, DBSA, and NEF (see sidebar).<sup>53</sup> Funded by the South African government, these institutions invest in development initiatives both domestically and across the region. These domestic DFIs have invested over USD 14.4 billion in South Africa, while also investing a cumulative total of USD 2.5 billion across all other countries in Southern Africa combined.

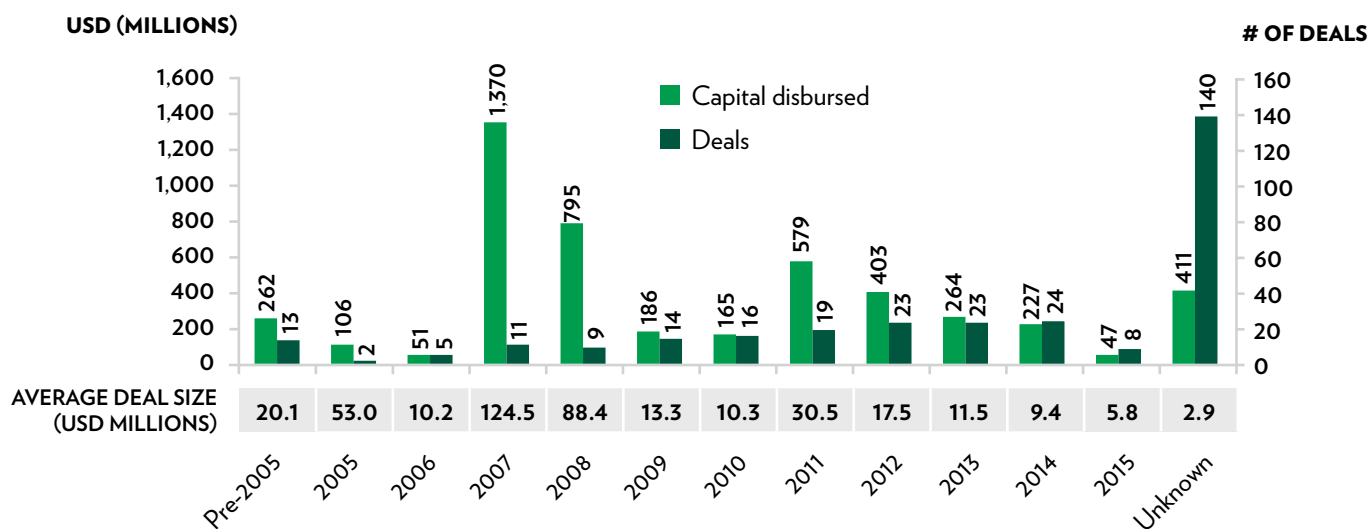
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53 “DFIs in South Africa,” *Public Sector Manager* (2011), <http://www.gcis.gov.za/sites/default/files/docs/resourcecentre/newsletters/issues.pdf>. For the purposes of this report, the Land and Development Bank of Southern Africa (LADBSA) has been excluded from the category of domestic South African DFIs, as LADBSA also operates as a retail, deposit-taking institution and provides loans directly to small farmers, much like an MFI would. Please see the DFI chapter of this report for more information.

## Investments Over Time

In analyzing non-DFI impact investments over time, one observes some interesting trends (see Figure 9). On the one hand, there has been steady growth in the number of deals per year, especially between 2008 and 2013. On the other hand, there has been a decline in the volumes of capital committed, from nearly USD 600 million in 2010 to USD 200 million in 2014. However, this latter trend is largely due to a small number of large deals in earlier years that were completed as leveraged buy-outs (see Table 1). The overall growth trend in transaction volume indicates a robust expansion in impact investor activity.

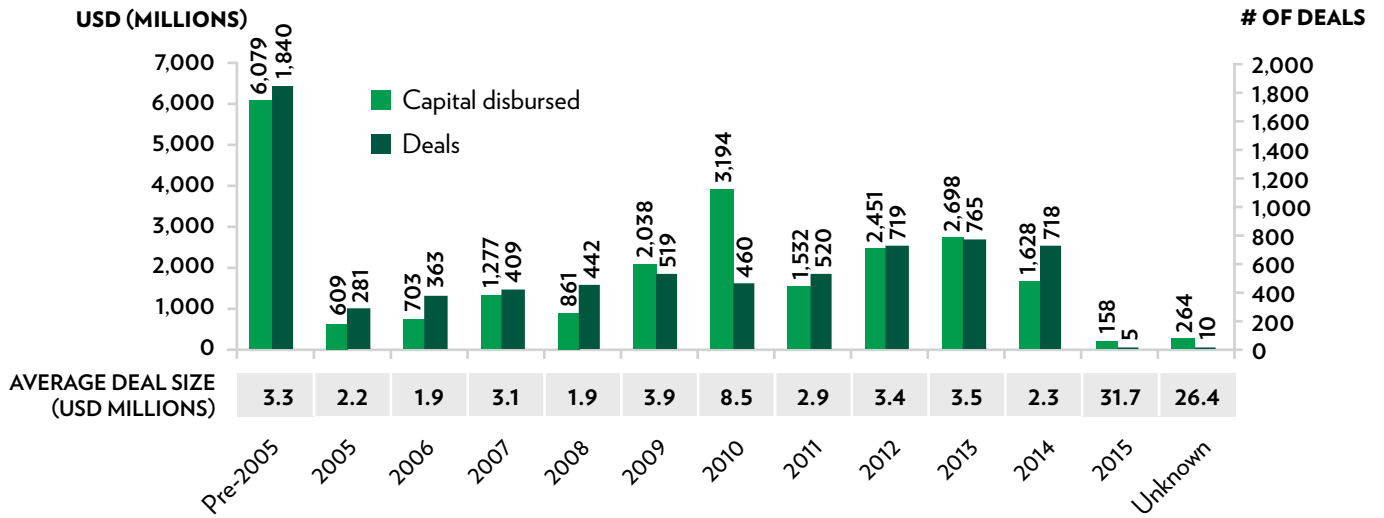
FIGURE 9. NON-DFI IMPACT INVESTMENTS BY YEAR



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

**FIGURE 10. DFI IMPACT INVESTMENTS BY YEAR**

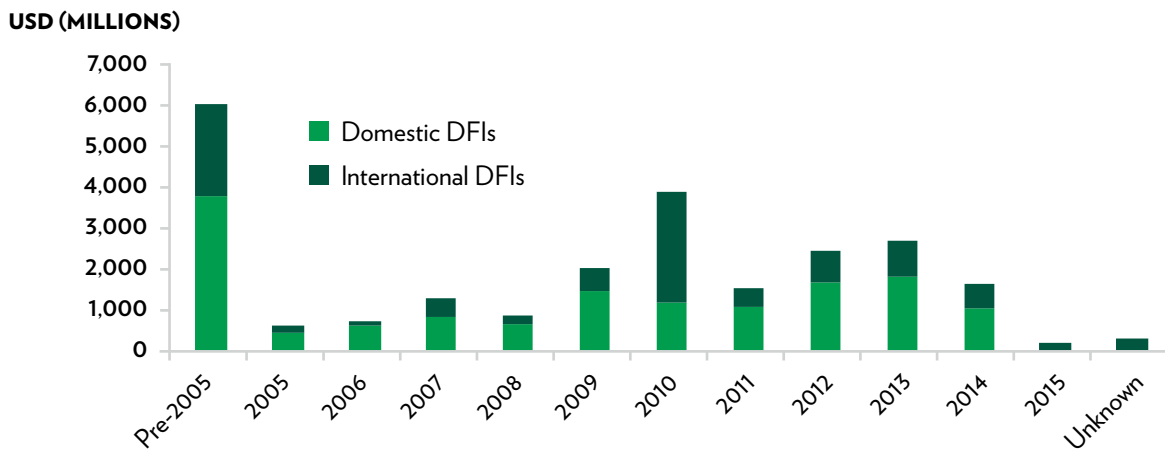


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Average deal sizes rounded to nearest 100,000. Includes domestic South African DFI activity.

Source: Open Capital Research

Many of the domestic DFIs have been active in South Africa for decades; for example, the IDC was established in 1940. Nevertheless, almost all of these organizations have significantly shifted and expanded their mandate in recent years, and, as a result, over 75 percent of recorded domestic DFI capital has been disbursed since 2005 (see Figure 11). Similarly, international DFIs have increased their investments in recent years: over 70 percent of international DFI capital has been disbursed since 2005. Across all figures, the reported decline in deals for 2015 likely resulted from incomplete reported data at the time of data collection in mid-2015.

**FIGURE 11. TOTAL INTERNATIONAL VS. DOMESTIC DFI INVESTMENTS, BY YEAR**

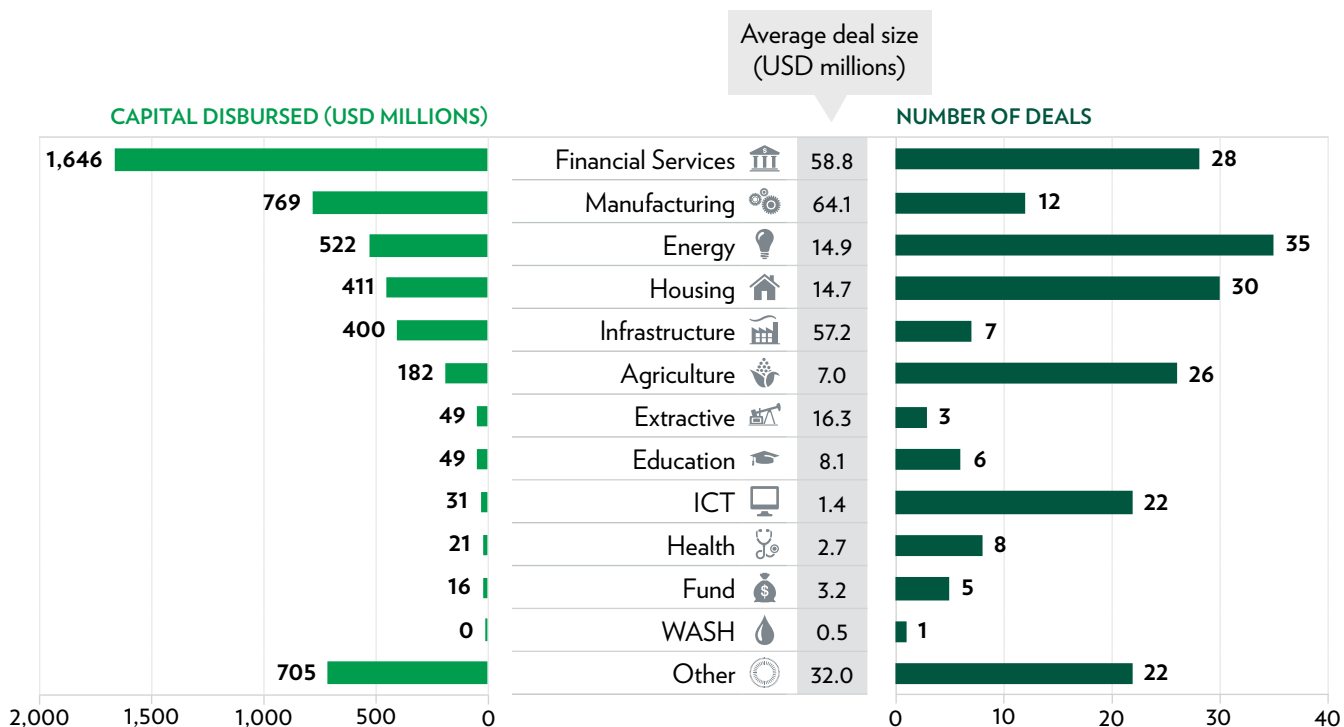


Source: Open Capital Research

## Sector

The distribution of investments by sector broadly reflects impact investors' sectoral preferences. In interviews, many non-DFI impact investors expressed particular interest in agriculture, financial inclusion, and affordable housing; indeed, more than 30 percent of non-DFI impact capital has been disbursed in financial services (see Figure 12). However, this allocation is driven by a few very large investments in the sector, predominantly into banks, with one deal accounting for USD 1.2 billion on its own (see Table 1). As evident from Figure 12, the number of deals in sectors such as energy, agriculture and housing match the numbers in financial services.

FIGURE 12. NON-DFI DIRECT INVESTMENTS BY SECTOR



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Excludes USD 33 million in capital where sector is unknown.

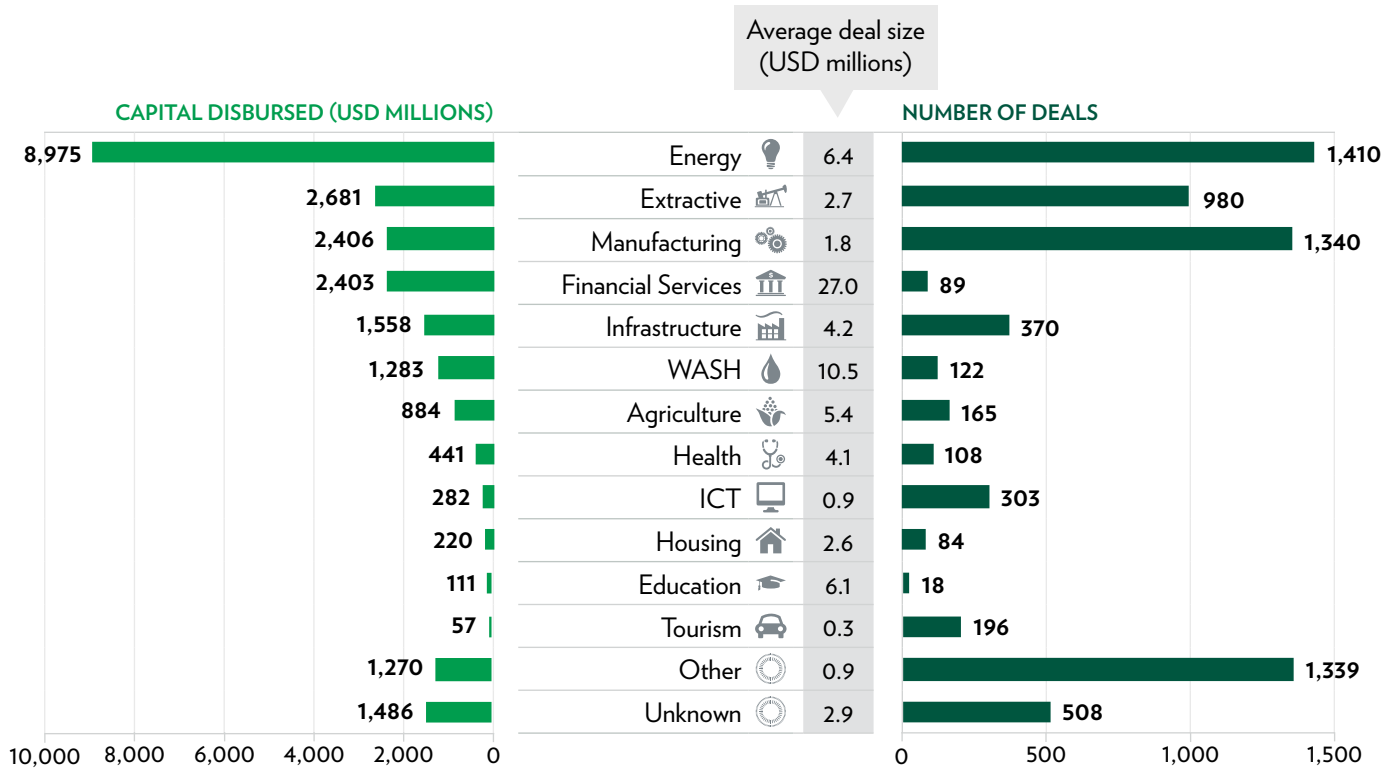
Source: Open Capital Research

Despite non-DFI impact investors' stated interests in education and health, these sectors have seen many fewer deals. Interviewees suggested that investors have seen fewer investable opportunities in these spaces, which are typically dominated by public provision.

International DFIs have disbursed a large majority of their capital in energy, financial services, and agriculture, which together have received 78 percent of total capital disbursed directly by international DFIs. The predominance of these sectors for DFI impact investment has been driven by South Africa's rising energy needs and by

agricultural investments targeting rural development. Domestic DFIs have invested in a substantial number of deals in the energy, extractives, and manufacturing sectors, indicative of the importance of industrial development in South Africa (see Figure 13 for combined international and domestic DFI activity by sector).

FIGURE 13. DFI DIRECT INVESTMENTS BY SECTOR



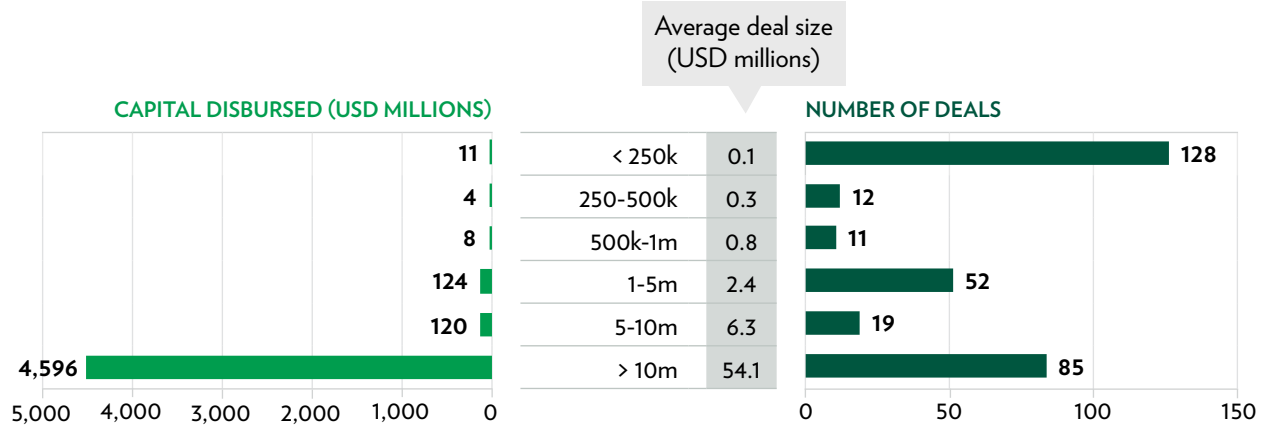
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Average deal sizes rounded to nearest 100,000. Includes domestic South African DFI activity.

Source: Open Capital Research

## Deal Size

Over half of non-DFI impact investments have been under USD five million (see Figure 14), with an average deal size around USD 700 thousand. Deals under USD 250 thousand have been the most common, followed by deals over USD 10 million; notably, such deals over USD 10 million in South Africa represent 90 percent of the capital disbursed regionally through non-DFI deals of this larger size (see Table 1).

**FIGURE 14. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE**

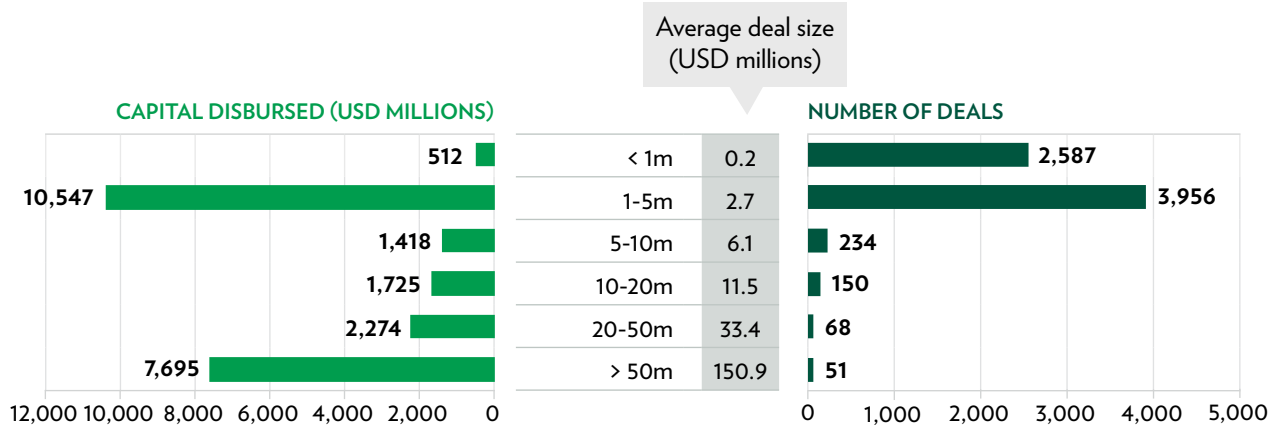


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

DFI direct investments are typically significantly larger (see Figure 15). The average deal size for DFIs in South Africa stands at nearly USD 50 million, a large average ticket size that primarily results from large DFI investments in agriculture, extractives, and financial services. Though deals under USD 10 million constitute roughly 37 percent of total direct DFI investments, just 11 percent of direct DFI deals were under USD one million, compared to more than 26 percent of deals made by non-DFI impact investors

**FIGURE 15. DFI IMPACT INVESTMENTS BY DEAL SIZE**



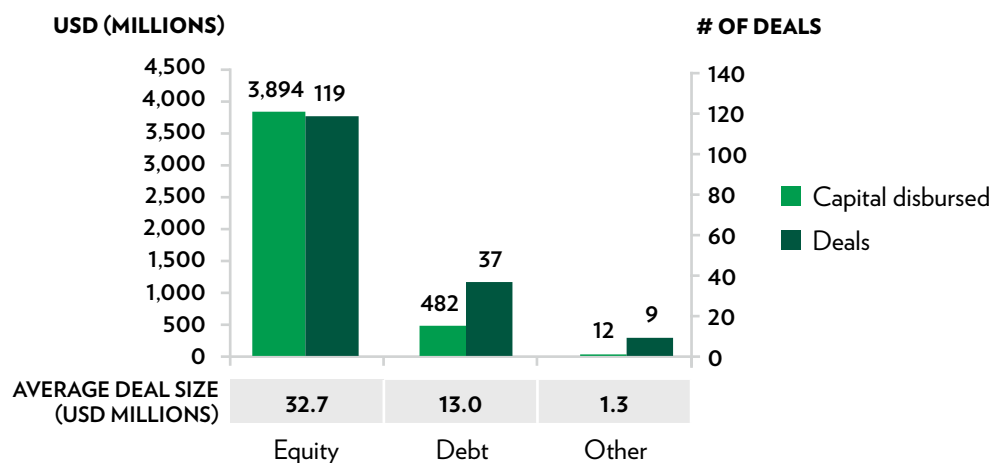
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Average deal sizes rounded to nearest 100,000. Includes domestic South African DFI activity.

Source: Open Capital Research

## Instrument

Unlike in the rest of region, non-DFI impact investors have shown an overwhelming preference for equity in impact deals in South Africa. Equity accounts for almost 90 percent of capital disbursed, though three large deals alone account for 60 percent of equity capital disbursed (see Table 2, Figure 16). It should be noted, however, that the research team was unable to determine the instrument used for around 45 percent of deals, accounting for around USD 477 million in capital disbursed.

FIGURE 16. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000. Average deal sizes rounded to nearest 100,000. Excludes USD 477 million in capital where instrument type is unknown.

Source: Open Capital Research

With a lack of available data at the time of writing, this report is unable to provide a definitive breakdown of investments by instrument for DFIs in South Africa, due largely to a lack of reporting from domestic DFIs, which have deployed the majority of DFI capital in South Africa.

## Local Presence

As discussed in the section above on the investment landscape, impact investors frequently have staff in South Africa both to serve the South African market and to use the country as a gateway to the region. Thirty-six impact investors have headquarters in South Africa (typically in Johannesburg, Pretoria, or Cape Town) and an additional 26 regional investors have local offices in the country.

## Impact Tracking Standards

Impact investors' dual mandate to realize both financial and social and environmental returns requires a strong focus on measuring impact as part of their core activities. As in the rest of Southern Africa, most impact investors in South Africa create tailored metrics for each portfolio company to accurately capture individual impact and reduce administrative burdens. For more detail on impact measurement in Southern Africa, refer to the Executive Summary.

# DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Despite a robust commercial funding landscape, there is considerable need for impact capital in South Africa. As discussed above, domestic DFIs and local corporations have made substantial inroads to providing this capital, but remaining economic disparities create the potential for additional impact.

## Development Context

South Africa is ranked 118<sup>th</sup> out of 187 countries in the United Nations Human Development Indicators (HDI) index.<sup>54</sup> While the country's HDI score is above the regional average, it remains below the global average (see Table 2, in the section 'Impact Capital Disbursed').

At 25 percent, unemployment rates in South Africa are high—twice the regional average and four times the global average.<sup>55</sup> One potential explanation for the high unemployment rate—despite the country's significant economic progress—is that a large proportion of jobs in South Africa are in the formal sector, especially when compared to other countries in the region. Whereas an unemployed worker elsewhere might leave the labor force to join the informal economy (and would therefore not be included in unemployment statistics), South Africa's unemployed workers continue to search for employment in the formal sector and are recorded as unemployed. Notably, 70 percent of the unemployed population is under the age of 34.<sup>56</sup>

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54 United Nations Development Programme, *Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>.

55 *World Economic Outlook Database*, s.v. "South Africa" (Washington, DC: International Monetary Fund, 2015), <http://www.imf.org/external/ns/cs.aspx?id=28>.

56 Christoff Hartmann, Jan Hofmeyr, and Siegmund Schmidt, *Sustainable Governance in the BRICS: Country Report South Africa* (Gütersloh: Bertelsmann Stiftung, 2013), <https://www.bertelsmann-stiftung.de/en/publications/publication/did/change-ahead-sustainable-governance-in-the-brics-2/>.

TABLE 2. SELECTED SOUTH AFRICA DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	South Africa	Regional Average	Global Average
HDI SCORE (RANKS 118 <sup>TH</sup> OF 187 COUNTRIES)	0.66	0.55	0.69
GDP PER CAPITA (USD, PPP)	12,867	6,874	17,975
UNEMPLOYMENT RATE (%)	25	13	6
POPULATION BELOW USD 1.25 / DAY (%)	14	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	45	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	74	41	59

The country has a Gini coefficient of 0.7, making it one of the most unequal economies in the world. This inequality is largely drawn along racial lines.<sup>57</sup> However, even within the black South African population alone, the coefficient has sharply increased with the emergence of black middle and upper classes.<sup>58</sup> This inequality has led to numerous labor strikes in the past, the most notable being the mining and metalworking strikes of 2014.<sup>59</sup> Labor strikes still occur regularly despite declining union membership and remain a considerable source of concern for investors.<sup>60</sup>

Economic inequality notwithstanding, South Africa's education rates are among the highest in the region, with 74 percent of the population having received some secondary education. However, the World Economic Forum's Global Competitiveness Report ranks South Africa's primary education system 140<sup>th</sup> out of 144 countries, ranking the primary school system last in Math and Science.<sup>61</sup> As a result, the independent education sector has grown 75 percent over the past decade amid quality concerns at state-run schools.<sup>62</sup>

57 Bertelsmann Stiftung, *BTI 2014: South Africa Country Report* (Gütersloh: Bertelsmann Stiftung, 2014), [http://www.bti-project.org/uploads/tx\\_itao\\_download/BTI\\_2014\\_South\\_Africa.pdf](http://www.bti-project.org/uploads/tx_itao_download/BTI_2014_South_Africa.pdf).

58 *Ibid.*

59 Wolassa Lawiso Kumo, Babatunde Omilola, and Arthur Minsat, *South Africa* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/South\\_Africa\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/South_Africa_GB_2015.pdf).

60 Lisa Steyn, "The Downward Spiral of SA unions," *Mail & Guardian*, November 14, 2014, <http://mg.co.za/article/2014-11-13-the-downward-spiral-of-sa-unions>.

61 World Economic Forum, "Rankings" in *Global Competitiveness Report* (Geneva: World Economic Forum, 2015), <http://reports.weforum.org/global-competitiveness-report-2014-2015/rankings/>.

62 "South Africa Education Crisis Fuels State School Exodus," *BBC News*, March 12, 2012, <http://www.bbc.com/news/world-africa-17315157>; and Ernst & Young, "Country Report: South Africa," in *w* (2013), [http://www.ey.com/Publication/vwLUAssets/The\\_power\\_of\\_three\\_-\\_SA/\\$FILE/EY%20G20%20Entrepreneurship%20Barometer%202013%20Country%20Report%20-%20South%20Africa\\_Low%20Res.pdf](http://www.ey.com/Publication/vwLUAssets/The_power_of_three_-_SA/$FILE/EY%20G20%20Entrepreneurship%20Barometer%202013%20Country%20Report%20-%20South%20Africa_Low%20Res.pdf).

South Africa has the fourth-highest rate of people living with HIV/AIDS in the world, at 19 percent,<sup>63</sup> and also has the highest absolute infected population—over six million.<sup>64</sup> The number of people under treatment currently stands at 2.5 million, with 500 thousand expected to join the program each year.<sup>65</sup> Treatment initiatives have raised life expectancies and have gone a long way towards changing public perceptions of the disease.

## Entrepreneurs

Only seven percent of South Africans are engaged in entrepreneurial activity, a quarter of the volume seen in other sub-Saharan African countries.<sup>66</sup> Many interviewees described a fiscally conservative, risk-averse mindset among South Africans, explaining that, if possible, the typical South African would rather find a salaried job with benefits than take the risk of starting a business. Given the comparatively large size of the corporate sector and corresponding opportunities for formal employment, this is a more viable option in South Africa than in other countries in the region.

Entrepreneurs in South Africa face many challenges. A complex regulatory environment makes it difficult to start a business, while strict labor laws make it expensive to employ and fire staff.<sup>67</sup> As in the rest of the region, many entrepreneurs also report lacking access to affordable finance.<sup>68</sup> BBBEE regulations further complicate the South African entrepreneurial landscape. Although the policy offers support and funding for early-stage, black-owned businesses, BBBEE scoring also incentivizes large corporations to hire black employees. As a result, well-educated, highly qualified black employees are greatly desirable and thus well-compensated, which reduces their incentives to start a business. On the other hand, many interviewees noted that white entrepreneurs are a growing group. Often former formal employees made redundant with BBBEE hiring, these workers have turned to entrepreneurship as an alternate form of employment. As a result, white entrepreneurs are over-represented relative to the general population.<sup>69</sup>

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63 *The World Factbook*, “Country Comparison: HIV/AIDS—Adult Prevalence Rates,” (Washington, DC: Central Intelligence Agency), <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2155rank.html>.

64 “Countries with the Most People Living with HIV/AIDS,” Aneki.com, [https://www.aneki.com/most\\_aids.html](https://www.aneki.com/most_aids.html).

65 “Budget 2014 spending at a glance,” *SouthAfrica.info*, February 26, 2014, [http://www.southafrica.info/business/economy/policies/budget2014b.htm#.Vf\\_8WN-qqko](http://www.southafrica.info/business/economy/policies/budget2014b.htm#.Vf_8WN-qqko).

66 Mike Herrington, Jacqui Kew, and Penny Kew, *GEM South Africa Report* (Global Entrepreneurship Monitor Consortium, Western Cape Government, Development Unit for New Enterprise, 2014), <http://www.gemconsortium.org/country-profile/108>.

67 *Ibid.*

68 *Ibid.*

69 Endeavor South Africa, “The State of Entrepreneurship in South Africa,” Endeavor White Paper, 2013, <http://endeavor.uberflip.com/i/344150-endeavor-white-paper-2013-the-state-of-entrepreneurship-in-south-africa>.

With youth unemployment at 49 percent,<sup>70</sup> there are certainly opportunities to support young entrepreneurs, and some government initiatives are aimed at accomplishing this (for instance, the National Youth Development Agency). However, young entrepreneurs typically have lower access to capital and less experience, struggles that make their businesses more likely to fail.

## ENABLING IMPACT INVESTING: THE ECOSYSTEM

South Africa has a generally friendly investment climate, particularly by comparison to other countries in the region. Among the easiest countries in the region in which to do business, it is home to more intermediaries, service providers, and other ecosystem players than any other Southern African country.

### Regulatory Environment

Overall, South Africa has a relatively welcoming regulatory climate, making few distinctions between foreign and local investors. According to the World Bank's "Ease of Doing Business" index, it is one of the easiest places to do business in Southern Africa, ranking 43<sup>rd</sup> of 189 countries globally and second in sub-Saharan Africa, after Mauritius.<sup>71</sup> Foreign investors generally find that rule of law is applied fairly and consistently across the country, and government policies are typically open to foreign investment. Special considerations include:

- **Land ownership:** South African law allows for both freehold and leasehold titles (for up to 99 years) on land,<sup>72</sup> with most land held under freehold title.<sup>73</sup> At present, foreigners are free to own land in South Africa without restriction.<sup>74</sup> However, if the proposed Land Holdings Bill is enacted, foreigners will be restricted from owning freehold agricultural land, though they will still be eligible for leases on agricultural land lasting between 30 and 50 years.<sup>75</sup> In addition, the Bill proposes to limit ownership of agricultural land to a maximum of 12 thousand

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70 The World Bank, "Economy Rankings," in *Doing Business 2015*, <http://www.doingbusiness.org/rankings>.

71 *Ibid.*

72 Francois Thevenau, "Thinking of Buying Property in Africa?" RMB Private Bank, [https://www.rmbprivatebank.com/downloads/RMBPrivateBank/evolve/about/newsletters/Thinking\\_of\\_buying\\_property\\_in\\_Africa.pdf](https://www.rmbprivatebank.com/downloads/RMBPrivateBank/evolve/about/newsletters/Thinking_of_buying_property_in_Africa.pdf).

73 "South Africa Guide: Land & Title," Just Landed, <https://www.justlanded.com/english/South-Africa/South-Africa-Guide/Property/Land-Title>.

74 Bowman Gilfillan Africa Group, "The Regulation of Foreign Land Ownership in South Africa," *Real Estate Business Owners of South Africa* (blog), March 19, 2015, <http://www.rebosa.co.za/the-regulation-of-foreign-land-ownership-in-south-africa/>.

75 Jenny, "Ownership of Land by Foreigners in South Africa," *Everingham's Inc.* (blog), April 16, 2015, <http://everingham.co.za/interesting-articles/2015/04/16/ownership-of-land-by-foreigners-in-south-africa>.

hectares per person for both locals and foreigners.<sup>76</sup> Notably, if passed, the law will only apply to future transactions.<sup>77</sup> To purchase land and any other immovable property, foreign individuals are required to register as South African taxpayers in order to track their capital gains liabilities. Foreign companies are required to register as foreign and to appoint as their public officer a natural person who is a resident in South Africa.<sup>78</sup>

- **Government enterprises:** State-Owned Enterprises (SOEs) in South Africa operate in a number of sectors, including transport, financial services, telecommunications, agriculture, manufacturing, mining, energy, and utilities.<sup>79</sup> SOEs in competition with private enterprises have in the past benefited from unfair competitive practices. For example, in the telecommunications sector, other providers have lodged complaints alleging that Telkom SA engages in excessive and discriminatory pricing for value-added network services.<sup>80</sup> Private airlines have challenged repeated government bailouts for South African Airways (SAA), arguing that they create an uneven playing field in air transport;<sup>81</sup> since 1999, SAA has received an estimated ZAR 30 billion (around USD two billion) of financial assistance from the government.<sup>82</sup>
- **Government incentives for foreign investors:** The government offers a variety of incentives to both domestic and foreign investors, across industries including manufacturing, agriculture, tourism, textiles, film and television, and development of infrastructure.<sup>83</sup> Some incentives include:
  - A cash grant equivalent to the lesser of 15 percent of the value of new manufacturing equipment and machinery or the actual cost of transferring existing manufacturing equipment and machinery to South Africa, up to a maximum of ZAR 10 million (about USD 700 thousand);<sup>84</sup>

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76 Bowman Gilfillan Africa Group, “The regulation of foreign land ownership in South Africa,” *Real Estate Business Owners of South Africa* (blog), March 19, 2015, <http://www.rebosa.co.za/the-regulation-of-foreign-land-ownership-in-south-africa/>.

77 *Ibid.*

78 Lara Colananni, *Foreigners Investing in S.A Property*, Guthrie & Rushton Attorneys, [http://www.gclaw.co.za/images/pdfs/foreigner\\_investing.pdf](http://www.gclaw.co.za/images/pdfs/foreigner_investing.pdf); and South Africa Institute of Chartered Accountants, “1740. Public Officer Awareness,” *Integritax: General* (June 2009), [https://www.saica.co.za/integritax/2009/1740\\_Public\\_officer\\_awareness.htm](https://www.saica.co.za/integritax/2009/1740_Public_officer_awareness.htm). A public officer is responsible for representing the company on all tax matters, such as the submission of annual tax returns.

79 “State-owned Enterprises,” Department of Government Communication and Information System, <http://www.gcis.gov.za/content/resourcecentre/contactdirectory/government-structures-and-parastatals>.

80 *Competition Commission v. Telkom 623/2008* (Republic of South African Supreme Court of Appeal [ZASCA] 2009), <http://www.comtrib.co.za/assets/Uploads/Case-Documents/Telkom%20SCA%20Judgement%20Nov09.pdf>.

81 Terry Markman, “Comair Goes to War Against State-owned Airline Bail-outs,” *Business Daily Live*, April 23, 2015, <http://www.bdlive.co.za/opinion/2015/04/23/comair-goes-to-war-against-state-owned-airline-bail-outs?service=print>.

82 Trust Matsilele, “Comair Challenges Government Bailout for SAA,” *CNBC Africa*, May 12, 2015, <http://www.cnbc.com/news/southern-africa/2015/05/12/comair-south-african-airways-eric-venter/>.

83 “Incentives for Specific Industries,” Government Investment Incentives, <http://www.investmentincentives.co.za/industry-specific-incentives>.

84 “Incentives for Capital Expenditure: Foreign Investment Grant,” Government Investment Incentives, <http://www.investmentincentives.co.za/expenditure-capital/foreign-investment-grant>.

- An “additional depreciation allowance” of up to a maximum 55 percent for greenfield manufacturing projects, provided the investment is worth at least ZAR 200 million (about USD 14 million),<sup>85</sup> and
- A cash grant of 10 to 50 percent of the cost of developing critical infrastructure for agro-processing projects or for projects that reduce dependence on national water and electricity grids, up to a maximum ZAR 50 million (around USD three million).<sup>86</sup>
- **Forex controls:** South Africa imposes no foreign exchange controls, allowing the Rand to float freely against international currencies.<sup>87</sup>
- **Interest rate controls:** Banks in South Africa are free to set interest rates; however, these depend on the repo rate determined by the Monetary Policy Committee of the South African Reserve Bank (SARB).<sup>88</sup> As of this writing (August 2015), the repo rate is six percent.<sup>89</sup> There is a fixed, 3.5 percent spread between the repo rate and the prime rate, which therefore is 9.5 percent.<sup>90</sup>
- **Exit opportunities/restrictions on exits:** Foreign investors may remit capital, profits, dividends, interest, and royalties subject to the approval of the SARB.<sup>91</sup> To obtain approval, an application must be submitted to the Financial Surveillance Department through the head office of an authorized foreign exchange dealer (typically a commercial bank), supported by all necessary documents.<sup>92</sup>
- **Conflict:** Although it is a factor unrelated to regulation, investors should also consider the possibility of political conflict. South Africa has witnessed cases of political violence in the recent past. For example, the period leading up to the May 2014 elections saw outbreaks of violence among opposing parties’ supporters in metropolitan areas.<sup>93</sup> Nor has political violence been confined to the electorate;

85 “Incentives for Capital Expenditure: Large Industry,” Government Investment Incentives, <http://www.investmentincentives.co.za/expenditure-capital/large-industry>.

86 “Trade, Export and Investment Financial Assistance (Incentives),” The Republic of South Africa Department of Trade and Industry, [https://www.thedti.gov.za/financial\\_assistance/financial\\_incentive.jsp?id=3&subthemeid=26](https://www.thedti.gov.za/financial_assistance/financial_incentive.jsp?id=3&subthemeid=26). Critical infrastructure is defined as that which either supports investment into a project or facilitates optimal operations for a project.

87 “Exchange Rate Policy,” South African Reserve Bank, <http://www2.resbank.co.za/internet/Glossary.nsf/0/6e77f482c063ea5742256b430031f732?OpenDocument>.

88 South African Reserve Bank, *Interest Rates and How They Work* (2007), <https://www.resbank.co.za/AboutUs/Documents/Interest%20rates%20and%20how%20they%20work.pdf>.

89 “Current Market Rates,” South African Reserve Bank, <https://www.resbank.co.za/Research/Rates/Pages/CurrentMarketRates.aspx>.

90 Rahul Anand et al., *South Africa: Selected Issues Paper* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2014/cr14339.pdf>; and “Current Market Rates,” South African Reserve Bank, <https://www.resbank.co.za/Research/Rates/Pages/CurrentMarketRates.aspx>.

91 US Department of State, “South Africa Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241954.pdf>.

92 Eversheds LLP, “South Africa: Exchange Control Regulations,” *Lexology*, February 15, 2012, <http://www.lexology.com/library/detail.aspx?g=06418fc8-635f-45c3-8da8-918775b68933>.

93 “What Does Increasing Political Violence Mean for the Future of South Africa’s Democracy?” *Institute for Security Studies Today* (blog), May 13, 2014, <https://www.issafrica.org/iss-today/what-does-increasing-political-violence-mean-for-the-future-of-south-africas-democracy>.

on estimated average, more than one political assassination has taken place per month in South Africa over the past decade.<sup>94</sup> Although the number of political assassinations has significantly declined over time, in 2014 there were at least seven.<sup>95</sup> In addition, there have been two major outbreaks of attacks against foreigners in the last ten years. In May 2008, countrywide attacks on foreigners resulted in 62 deaths (including those of South Africans).<sup>96</sup> In April 2015, another wave of xenophobic violence erupting in Durban and some parts of Johannesburg killed at least seven people.<sup>97</sup>

## Ecosystem Players

As the biggest market in Southern Africa, South Africa also has the largest supporting ecosystem in the region. More than 100 different organizations operate in support of impact investment and social entrepreneurship in South Africa,<sup>98</sup> covering a broad range that includes a variety of incubators and accelerators (e.g., Awethu Project or Invotech) and business consultants (e.g., Dalberg or Monitor Deloitte). South Africa's universities are also highly involved in providing research and support to emerging enterprises, with initiatives and programs such as the Bertha Centre for Social Innovation and Entrepreneurship at the University of Cape Town.

Large corporations, often as part of their mandated BBBEE spend, also provide enterprise support. An estimated 75 percent of corporations run in-house BBBEE programs, while the rest outsource this work to third parties.<sup>99</sup> Examples of corporate-run programs include Eskom's Enterprise Development program and Sappi's Project Grow. Additionally, government agencies support entrepreneurs, at both the national (the National Youth Development Agency, for instance) and regional (such as the Gauteng Enterprise Propeller) levels.

Nevertheless, impact investors still believe there are gaps in the available support, the majority of which is offered at the start-up or early stage; less support is offered for businesses in the acceleration or growth phase.<sup>100</sup>

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94 Gareth van Onselen, "Political Assassinations: How the ANC is Killing Its Own," *Business Day Live*, August 12, 2013, <http://www.bdlive.co.za/opinion/columnists/2013/08/12/political-assassinations-how-the-anc-is-killing-its-own>.

95 US Department of State, "South Africa Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241954.pdf>.

96 "Death Toll of 62 in SA Foreigner Attacks," *The Irish Times*, May 31, 2008, <http://www.irishtimes.com/news/death-toll-of-62-in-sa-foreigner-attacks-1.823653>.

97 "Xenophobic Violence: South Africa's Identity Crisis," *BBC News*, May 7, 2015, <http://www.bbc.com/news/world-africa-32580807>.

98 Aspen Network of Development Entrepreneurs, "South Africa's Entrepreneurial Ecosystem Map," <http://www.aspeninstitute.org/sites/default/files/content/upload/ANDE%20ENTREPRENEUR%20ECOSYSTEM%20MAP%202015.pdf>.

99 KPMG, *BEE Coming of Age: 2013 BEE Survey* (Johannesburg: KPMG, 2013), <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Advisory-Publications/Documents/KPMG%20BEE%20Survey%202013.pdf>.

100 Aspen Network of Development Entrepreneurs, "South Africa's Entrepreneurial Ecosystem Map," <http://www.aspeninstitute.org/sites/default/files/content/upload/ANDE%20ENTREPRENEUR%20ECOSYSTEM%20MAP%202015.pdf>.

## Other Service Providers

In addition to intermediaries and service providers who specifically target social enterprises and impact investors, South Africa boasts a mature landscape of general service providers, including accountants, lawyers, recruitment firms, and others. Largely because of its sophisticated corporate market, the market for service providers in South Africa is much more developed than in most other countries in the region. Often, international service providers have their regional headquarters in South Africa, using the country as an entry point to sub-Saharan Africa.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Though the macroeconomic environment in South Africa is particularly well-developed, impact investors face both challenges and opportunities placing capital locally. Some of the main challenges investors face include:

- **Large supply of competing capital:** A significant volume of conventional capital is available to enterprises in South Africa, which may decrease the relative attractiveness of impact capital. Due to mandated CSI expenditures, a large volume of capital and support is available to early-stage businesses. Total CSI spending in 2014 was estimated at ZAR 8.2 billion (approximately USD 620 million).<sup>101</sup> As a result, early-stage businesses, particularly those that qualify for BBBEE support, can often find free or affordable technical assistance and grant capital. For later-stage businesses, the relatively affordable cost of financing and the strength of the banking sector mean that traditional bank financing may be the most attractive option.
- **Pipeline building:** The abundance of capital sources means impact investors need to be particularly resourceful to source their investment pipeline. Urban centers tend to be particularly well-capitalized; impact investors should consider sourcing businesses in rural and underserved markets instead. These areas are typically more remote and have fewer entrepreneurs with business educations and experience, but they also tend to receive much less attention from competing sources of capital. Interviewees mentioned youth entrepreneurs as a second underserved market, though they, too, typically have less business experience.
- **Disincentives to reduce black ownership stakes:** Black ownership is an important component of a firm's BBBEE score, and higher scores lead to greater access to financial and business-support incentives. Although small businesses are exempt from scoring, it is prudent for entrepreneurs to consider the appropriate long-term

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<sup>101</sup> "CSI Growth Slows in 2014," *Trialogue*, March 17, 2015, <http://trialogue.co.za/csi-growth-slows-in-2014/>.

ownership in order to position for BBBEE scoring once they grow. As a result, entrepreneurs, wary of harming future scores, may be reluctant to accept equity investments from impact investors if this would mean diluting black ownership. As BBBEE laws are intended to support domestic affirmative action, investment by any foreign investor, regardless of race, does not qualify under BBBEE regulations. Investors must be careful when designing quasi-equity or hybrid structures that resemble equity, as there are serious repercussions if a government assessment determines that an investment structure is substantially equity.<sup>102</sup> In particular, in the most recent BBBEE amendment, the government criminalized the practice of fronting, which the Department of Trade and Industry defines as “a deliberate circumvention or attempted circumvention of the BBBEE Act and the Codes.”<sup>103</sup> The consequences for fronting include fines or jail time.<sup>104</sup>

- **Electricity shortages:** Eskom, South Africa’s power utility, generates almost all of the nation’s power and nearly half of the electricity in Africa.<sup>105</sup> However, it has been unable to keep up with demand, and South Africa is in an ongoing energy crisis, with load shedding commencing at the beginning of 2015. Medupi Power Station, the nation’s first new power station in decades, has suffered from construction delays, and its completion is not expected until 2018 or 2019. In the interim, shortages have impacted businesses, particularly in energy-intensive sectors, like extractives and manufacturing, and also in consumer-focused sectors, such as retail and hospitality.<sup>106</sup> The power crisis has reduced growth by an estimated 0.4 percent in 2015 and will likely continue to keep the economy below its potential in the coming years.<sup>107</sup>

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102 Republic of South Africa Department of Trade and Industry, *The Codes Of Good Practice On Broad-Based Black Economic Empowerment* (2004), [https://www.thedti.gov.za/economic\\_empowerment/docs/bee\\_archive\\_docs/CodeofGoodPractice.pdf](https://www.thedti.gov.za/economic_empowerment/docs/bee_archive_docs/CodeofGoodPractice.pdf).

103 “Economic Empowerment: Fronting,” Republic of South Africa Department of Trade and Industry, [https://www.thedti.gov.za/economic\\_empowerment/fronting.jsp](https://www.thedti.gov.za/economic_empowerment/fronting.jsp).

104 Nabelah Fredericks, “New BEE Codes Active,” *Small Business Connect*, May 2015, [http://www.dti.gov.za/sme\\_development/docs/SBC201505.pdf](http://www.dti.gov.za/sme_development/docs/SBC201505.pdf).

105 Alexandra Wexler, “Power Outages Mar South Africa’s Economic Expansion,” *The Wall Street Journal*, May 8, 2015, <http://www.wsj.com/articles/power-outages-mar-south-africas-economic-expansion-1431077401>.

106 Miriam Manak, “The Economic Impact of South Africa’s Energy Crisis,” *Public Finance International*, June 29, 2015, <http://www.publicfinanceinternational.org/feature/2015/06/economic-impact-south-africa%E2%80%99s-energy-crisis>.

107 “SA Power Crisis Threatens Country’s Economy,” *eNCA*, February 18, 2015, <http://www.enca.com/money/sa-power-crisis-threatens-countrys-economic-outlook>.

## Opportunities

Despite these challenges, impact investors have many opportunities to operate in South Africa and to leverage return-seeking investments in order to drive job creation, economic development, and opportunities for disadvantaged populations. Specific opportunities include:

- **Support corporate supply chains:** With South Africa's comparatively well-developed corporate sector, small businesses can tap into existing supply chains to ensure stable and guaranteed offtake. Examples of offtake markets include retail chains and mines. Many small businesses in South Africa can benefit from preferential Enterprise and Supplier Development (ESD) support, namely financial or other support to grow SMEs, to secure these contracts.
- **Leverage large domestic and regional markets:** With an expanding middle class, estimated at over eight million adults as of 2012,<sup>108</sup> South Africa presents a large and growing domestic market for goods and services. Additionally, South African businesses are the primary suppliers of consumer goods and machinery to neighboring countries. An increasing number of South African retailers are expanding across sub-Saharan Africa, offering the chance for their suppliers (including SMEs) to increase their own exports.
- **Greater exit opportunities:** The private-equity sector in South Africa is still relatively nascent, but many interviewees were optimistic about its growth in the coming years, particularly relative to other markets in the region. In the near term, interviewees cite corporate acquisition as the most probable and easiest exit opportunity, one which is much more feasible in South Africa than in any other country in the region.
- **Strong infrastructure:** South Africa's world-class ports handle the largest shipping volume of any country in sub-Saharan Africa—almost five times the volume of Nigeria, the next-biggest shipping market.<sup>109</sup> South Africa also has an extensive and generally high-quality national road network, making transport of goods both within and out of the country easy, fast, and affordable.
- **Partnering with BBBEE intermediaries:** Although BBBEE funding competes in many ways with impact capital, it also provides an opportunity for impact investors to ally or partner with intermediaries offering BBBEE-sponsored support. For example, incubators or accelerators can provide a pipeline of previously supported, investment-ready businesses.

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108 Benjamin Dürr, "A Toast to South Africa's Black Middle Class," *AfricaRenewal*, December 2013, <http://www.un.org/africarenewal/magazine/december-2013/toast-south-africas-black-middle-class>.

109 "Container Port Traffic (TEU: 20-foot Equivalent Units)," in The World Bank: Data, <http://data.worldbank.org/indicator/IS.SHP.GOOD.TU/countries>.

## High-potential Sectors

Impact investors and other actors in the industry report opportunities in the following sectors:

- **Education:** According to the World Economic Forum's national education rankings, South Africa ranks 144<sup>th</sup> out of 144 included countries in math and science and 140<sup>th</sup> in overall quality of education.<sup>110</sup> Quality of education in South Africa is as disparate as the distribution of wealth. The wealthier classes have access to better, typically private, educations, while the poor and rural populations contend with lower-quality public schools. There are immense opportunities for impact investors to invest in projects aimed at improving the quality of education for poorer segments of South African society.
- **Agriculture and agro-processing:** Rural populations in South Africa are comparatively poor, and interventions in agriculture could have catalytic effects in these communities. Under the post-apartheid land reallocation system, many communities that were not historically agrarian have been given large tracts of land, creating opportunities for impact investors to provide capital to develop these tracts, source offtake markets, and provide agricultural training to local populations. Investing in agro-processing could also provide offtake markets and add value for smallholder farmers.
- **Mining sector supply chains:** The extractives sector is a large component of South Africa's economy, but mining communities typically tend to have high inequality, with large portions of the community living in poverty. Simultaneously, mines have large procurement requirements for everything from technical mining equipment to uniforms and food. Impact investors could drive significant improvements in livelihoods by developing suppliers for the mining industry. These businesses could benefit from mining corporations' CSI and Enterprise and Supplier Development (ESD) spending, which would decrease the risk for impact investors. Further, this economic diversification could cushion the economic shock felt when a mine closes, as investing in supply chain development builds new industries and skills in mining towns. With an increasing number of South African communities suffering as their local mines close, the government (along with support from the mines) has set up a ZAR nine billion (around USD 670 million) fund to support and revitalize distressed mining communities.<sup>111</sup>
- **Financial inclusion:** Although South Africa has comparatively good access to credit versus the rest of the region, this access is concentrated among salaried workers, the white population, and urban dwellers. The unbanked South African population remains larger than 10 million, approximately 20 percent of the total population,<sup>112</sup> creating opportunities for impact investors in inclusive finance organizations, including MFIs and mobile money platforms.

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110 World Economic Forum, *The Global Competitiveness Report 2014–2015* (Geneva: World Economic Forum, 2014), <http://www.weforum.org/reports/global-competitiveness-report-2014-2015>.

111 "South Africa Sets Aside Billions to Revitalize Mining Towns," *SouthAfrica.info*, March 17, 2015, <http://www.southafrica.info/about/sustainable/mining-towns-170315.htm#.Vfj-oBGqqko>.

112 FinMark Trust, *FinScope South Africa 2014*, <http://www.banking.org.za/docs/default-source/financial-inclusion/finscope/finscope-sa-2014.pdf?sfvrsn=12>.

- **Sustainable tourism:** A vital component of the South African economy, in 2014 tourism contributed over ZAR 320 billion (USD 24 billion) to GDP and employed 1.4 million people.<sup>113</sup> The Department of Tourism has made responsible and sustainable tourism a top priority.<sup>114</sup> Impact investors have an opportunity to further develop eco-friendly tourist attractions. Investments in sustainable tourism could provide financial returns while also improving community livelihoods and supporting environmental protection.
- **Large energy projects:** An estimated 85 percent of the South African population has access to electricity, a figure second only to Mauritius in the region.<sup>115</sup> Unlike other countries in the region, there is less opportunity in South Africa for off-grid solutions. However, with the extreme energy shortages, a growing population, and ongoing importance of mining and other energy-intensive sectors to the country, investment in large, on-grid energy projects could unlock South Africa's economic growth and potential.

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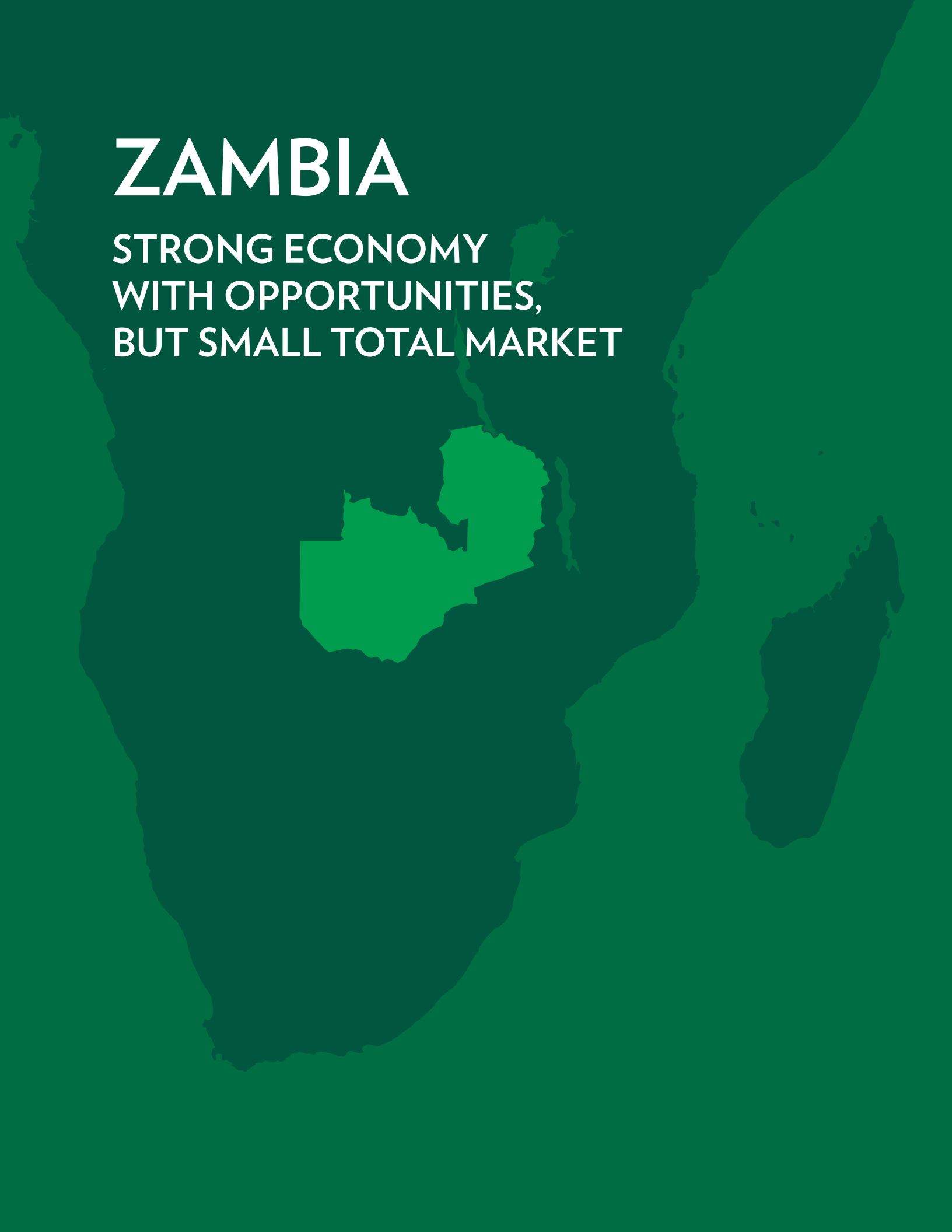
113 Republic of South Africa Department of Tourism, *Annual Report (2014/15)*, <http://www.tourism.gov.za/AboutNDT/Publications/NDT%20Annual%20Report%202014-15.pdf>.

114 "Responsible Tourism," Republic of South Africa Department of Tourism, <http://www.tourism.gov.za/CurrentProjects/ResponsibleTourism/Pages/Information.aspx>.

115 "Access to Electricity (% of Population)," in *The World Bank: Data*, <http://data.worldbank.org/indicator/EG.ELC.ACCS.ZS>.

# ZAMBIA

STRONG ECONOMY  
WITH OPPORTUNITIES,  
BUT SMALL TOTAL MARKET



# INTRODUCTION

Unlike many of its neighbors, Zambia has enjoyed peace and stability since gaining independence in 1964. Boasting relatively well-functioning institutions, the country has experienced rapid economic growth over the last decade and has attracted some of the highest flows of impact capital in the region.

Despite these positive trends, access to capital remains a key constraint for businesses in Zambia. Government borrowing is crowding out private lending by commercial banks, and, despite the large inflows of impact capital in aggregate, much of this capital has targeted housing and financial services or has been placed in large-scale projects by DFIs.

The macroeconomic environment creates further challenges, with regular nationwide power outages, inconsistent government policy, high fiscal deficits, and a depreciating currency. In addition, Zambia remains heavily dependent on copper mining: the recent global decline in copper prices has rippled throughout its economy. Despite a growing middle class, nearly 75 percent of the population continues to live on less than USD 1.25 per day.<sup>1</sup>

Despite these challenges, opportunities exist for impact investors with long-term investment horizons. Although management costs are high relative to available deal size and the investment-ready pipeline is limited, there is opportunity in Zambia for early investors who remain invested for long enough to capture long-term growth, particularly if these investors are able to fund multiple capital rounds at increasingly larger amounts.

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1 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

# COUNTRY CONTEXT

In the regional context, Zambia is generally considered to have a robust and stable economy. Copper mining is central to the national economy. Mining is primarily focused on a region known as the “Copperbelt,” which borders the Democratic Republic of the Congo (see Figure 1) and encompasses both the North Western and Copperbelt Provinces.

FIGURE 1. MAP OF ZAMBIA



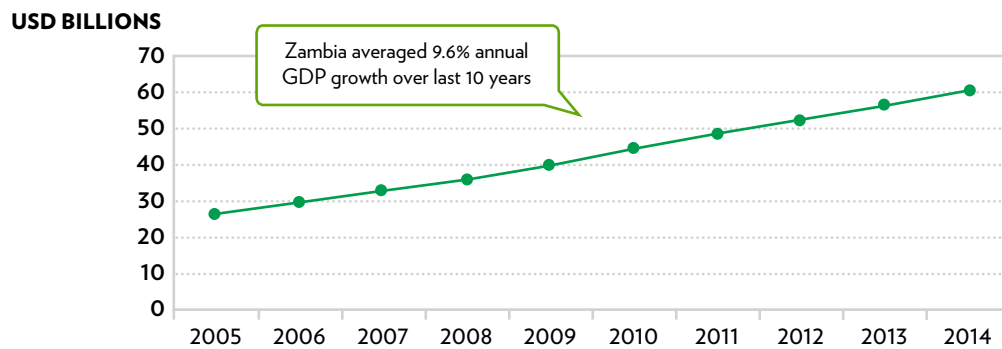
## Gross Domestic Product

Zambia has seen strong economic growth in recent years, averaging 9.6 percent growth in gross domestic product (GDP) at purchasing power parity (PPP) year-on-year since 2005 (see Figure 2).<sup>2</sup> GDP currently stands at USD 61 billion in PPP terms, making it a relatively strong regional economy.<sup>3</sup> Interviewees noted that growth has slowed in 2015, but, as of this writing, official statistics have yet to report on any slowdown.

2 *World Economic Outlook Database*, s.v. “Zambia” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

3 *Ibid.*

FIGURE 2. GDP (PPP), 2005–2014



Source: IMF World Bank Economic Indicators, April 2015

GDP per capita (PPP) has grown by approximately 75 percent since 2005, rising to USD 4,064 in 2014 and making Zambia a “middle-income” nation according to the IMF.<sup>4</sup> Growth has been primarily concentrated in manufacturing, mining, and construction, with copper accounting for 70 percent of the country’s export earnings and nine percent of formal employment.<sup>5</sup> The economy’s dependence on copper for export exposes it to exogenous influences. Any shifts in the price of copper ripple through the broader Zambian economy.<sup>6</sup>

The services sector accounts for nearly 55 percent of GDP, more than five times the contribution of the agricultural sector.<sup>7</sup> Nevertheless, the agricultural sector employs more than 70 percent of the population,<sup>8</sup> and the sector grew by six percent in 2014 due to a strong maize harvest.<sup>9</sup>

4 *World Economic Outlook Database*, s.v. “Zambia, GDP” (Washington, DC: International Monetary Fund, 2015), <http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/weorept.aspx?sy=2013&ey=2020&scsm=1&ssd=1&sort=country&ds=.&br=1&pr1.x=36&pr1.y=8&c=754&s=NGDPD%2CNGDPDPC%2CPPPDPDPC%2CPPPDPDPC&grp=0&a=>.

5 “Zambia transformation profile,” African Center for Economic Transformation, February 7, 2014, <http://africantransformation.org/2014/02/07/zambia/>.

6 Peter E. Rasmussen, *Zambia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zambia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zambia_GB_2015.pdf).

7 *Ibid.*

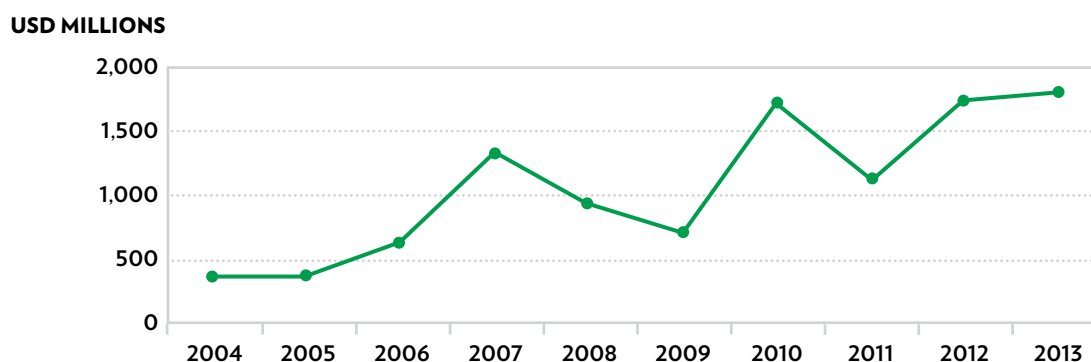
8 Central Statistics Office, Republic of Zambia, *Labour Force Survey: 2008* (2011), [http://www.zamstats.gov.zm/report/Demo/2008 Labourforce Survey Report.pdf](http://www.zamstats.gov.zm/report/Demo/2008%20Labourforce%20Survey%20Report.pdf).

9 Peter E. Rasmussen, *Zambia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zambia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zambia_GB_2015.pdf).

## Foreign Direct Investment

Zambia continues to attract foreign direct investment (FDI), with net FDI inflows growing by nearly 27 percent from 2011 to 2013 (see Figure 3).<sup>10</sup> In 2013, Zambia had the third-highest FDI inflows in Southern Africa at USD 1.8 billion,<sup>11</sup> which were also the highest FDI inflows among the 16 landlocked developing countries in Africa.<sup>12</sup>

FIGURE 3. FDI FLOWS, 2005–2013



Source: UNCTAD

Zambia's single largest source of FDI investments in 2013 was Australia, accounting for 16 percent of all FDI inflows (see Figure 4).<sup>13</sup> In terms of industry, FDI has predominantly focused on mining, construction, and services.<sup>14</sup>

10 James X. Zhan et al., *World Investment Report* (New York and Geneva: United Nations Conference on Trade and Development, 2014), [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf).

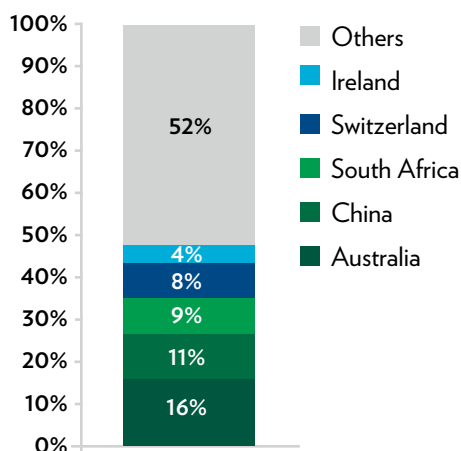
11 *UNCTADStat* (Geneva: United Nations Conference on Trade and Development), <http://unctadstat.unctad.org/EN/>.

12 James X. Zhan et al., *World Investment Report* (New York and Geneva: United Nations Conference on Trade and Development, 2014), [http://unctad.org/en/PublicationsLibrary/wir2014\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf).

13 International Monetary Fund, *Coordinated Direct Investment Survey* (Washington, DC: International Monetary Fund, 2014), available at <http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&slid=1390030109571>.

14 F. Kwesiga et al., *Republic of Zambia: 2011–2015 Country Strategy Paper* (Tunis: African Development Bank Group, 2010), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ZAMBIA-CSP-2011-2015.pdf>.

FIGURE 4. FDI INFLOWS, BY COUNTRY OF ORIGIN, 2013

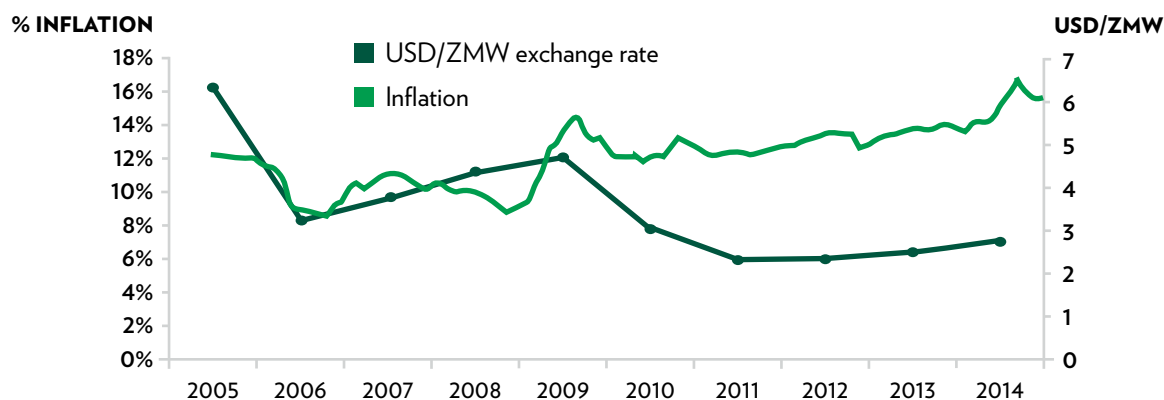


Source: International Monetary Fund

## Inflation and Exchange Rates

Between 2009 and 2013, the Zambian Kwacha (ZMW) maintained relative stability against the US Dollar (see Figure 5), but the currency has depreciated sharply since 2013. Driven in part by reductions in global copper prices, the Kwacha experienced a particularly steep drop in the second half of 2015, reflecting both a strengthening US Dollar and a weakening Zambian Kwacha.<sup>15</sup> This depreciation has complicated efforts to disburse debt in local currency, as shifts in foreign exchange can significantly alter the ultimate cost of the instrument, and cause fluctuations in the returns available to investors.

FIGURE 5. INFLATION AND USD/ZMW EXCHANGE RATE, 2005 - 2014



Source: World Bank Indicators

15 Matthew Hill, "Zambian Kwacha Breaches Seven per Dollar for First Time since June," *Bloomberg*, February 18, 2015, <http://www.bloomberg.com/news/articles/2015-02-18/zambian-kwacha-breaches-7-per-dollar-for-first-time-since-june>.

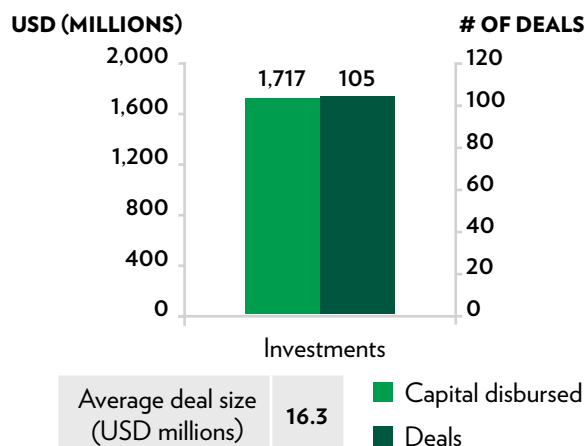
The central bank has set a target inflation rate of 6.5 percent. In 2014, inflation was slightly above this target, at just under eight percent.<sup>16</sup> Interviewees noted that this rate increased in 2015, though, as of this writing, this has yet to be reported by official statistics.

## SUPPLY OF IMPACT INVESTING CAPITAL

As with the rest of the region, the vast majority of Zambia’s impact capital is from development finance institutions (DFIs) making investments into large-scale projects in energy, financial services, and extractive industries. With over USD 1.7 billion in DFI capital disbursed through more than 100 deals, Zambia is the second-highest recipient of DFI capital in Southern Africa (Figure 6). Still, the gap between Zambia and the highest recipient is significant: international DFIs have deployed more than USD 9.7 billion into South Africa, or nearly six times the amount received by Zambia, which stands in addition to USD 14.5 billion invested by domestic South African DFIs. Zambian companies have not received any investment from domestic or regional DFIs.

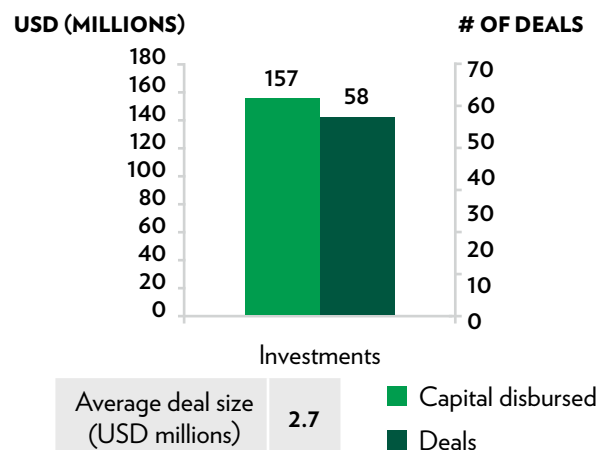
Zambia is also the third-highest recipient in the region of non-DFI impact investor capital, after South Africa and Angola, with more than USD 157 million disbursed through 58 deals (Figure 7). However, as with DFI disbursements, these figures lag far behind South Africa, which has received more than 30 times (roughly USD 4.8 billion) the amount of non-DFI capital as has Zambia.

FIGURE 6. DFI IMPACT INVESTMENTS



Source: Open Capital Research

FIGURE 7. NON-DFI IMPACT INVESTMENTS



Source: Open Capital Research

16 Peter E. Rasmussen, *Zambia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zambia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zambia_GB_2015.pdf).

Despite fairly robust aggregate numbers, particularly relative to the rest of the region excluding South Africa, social enterprises in most sectors in Zambia still struggle to source impact capital. Only a handful of impact investors have local offices, and fully USD 92 million of the USD 157 million disbursed by non-DFI impact investors has been placed into financial service providers and housing projects. Of the remaining approximately USD 65 million, more than USD 40 million was placed in just three investments. As a result, only some USD 25 million was disbursed to the social enterprise landscape more broadly.

## Broader Investing Landscape

Access to capital remains constrained in Zambia. The country's 19 commercial banks hold the vast majority—roughly 90 percent—of the financial sector's assets.<sup>17</sup> As of December 2013, commercial banks held approximately USD 5.7 billion in total assets, nearly two-thirds of which were held by the top five banks.<sup>18</sup>

These banks, however, are often unwilling to lend to businesses due to the high returns available on lower-risk government loans. Specifically, the Bank of Zambia caps commercial lending rates at roughly 24 percent annually,<sup>19</sup> while the yield on a 364-day Treasury bill from the Bank of Zambia was almost 22 percent as of August 12, 2015.<sup>20</sup> Given that the pricing is comparable, commercial banks often choose to invest in Treasury bills rather than issue loans to the private sector.

Still, bank lending to the private sector has not completely stopped. Some banks have continued to make private sector loans at rates below the cap as long-term investments in their customers' businesses.<sup>21</sup> In response to the cap, some banks have also increased fees, service charges, and other absolute costs in order to raise the effective interest rate on loans without violating the interest rate cap.<sup>22</sup> Even when willing to lend to the private sector, however, banks require substantial collateral and have minimum turnover thresholds, which prevent many businesses from being able to access financing.

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17 Bank of Zambia, *Financial System Supervision* (2013), <http://www.boz.zm/publishing/39/2013%20Financial%20System%20Report.pdf>.

18 *Ibid.*

19 Open Capital Interviews; Tsidi Tsikata et al., *Zambia: Selected Issues* (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/scr/2015/cr15153.pdf>; Hilda Lumba, "Volatility in Exchange Rate...As Banking Sector Bears Brunt," *Times of Zambia*, June 16, 2015, <http://www.times.co.zm/?p=61647>; Stuart Lisulo, "StanChart Calls for Statutory Reserve Ratio Review," *The Post*, April 6, 2015, <http://www.postzambia.com/news.php?id=7089>.

20 Bank of Zambia, <http://www.boz.zm/>. Research suggests that significant government spending in recent years has driven up yields on government debt.

21 Open Capital Interviews.

22 *Ibid.*

Microfinance institutions (MFIs) enjoy a higher cap on lending rates, which the Bank of Zambia set at 42 percent annually in January 2013.<sup>23</sup> For other non-bank financial institutions (NBFIs), effective annual interest rates are capped at 30 percent.<sup>24</sup> However, both MFIs and NBFIs have much less available capital than the commercial banks, and the high interest rates, along with stringent collateral requirements, limit the practical utility of this capital for many businesses.

Beyond these sources of capital, there are limited options for external financing, whether debt or equity. Interviewees were able to identify only a handful of local funds that actively placed capital in the country. There are high-net-worth individuals who invest in local businesses, but they have limited scale and can be difficult to attract as investors without a pre-existing relationship.

Interviewees identified the main alternative sources of capital for growing businesses (other than business cash flow) as strategic acquisitions or investments by large corporations either entering Zambia or already in-country. Interviewees noted several large companies aggressively acquiring in their sectors in order to create horizontally diversified companies.

## Impact Capital Disbursed

Zambia is one of the largest targets for impact investing activity in Southern Africa, largely due to robust DFI activity. DFIs have deployed more than USD 1.7 billion through 105 deals. Meanwhile, Zambia has received more than 10 percent of all non-DFI impact investing deals in the region (58 deals in total), through which investors have deployed more than USD 157 million. Despite these large aggregate disbursements, enterprises in most sectors in Zambia still struggle to source impact capital, as described above.

## Investments over Time

While limited data prevent detailed conclusions regarding non-DFI impact investing in Zambia, what public information is available about non-DFI deals demonstrates that there has been modest interest in Zambia from non-DFI impact investors over the past decade.

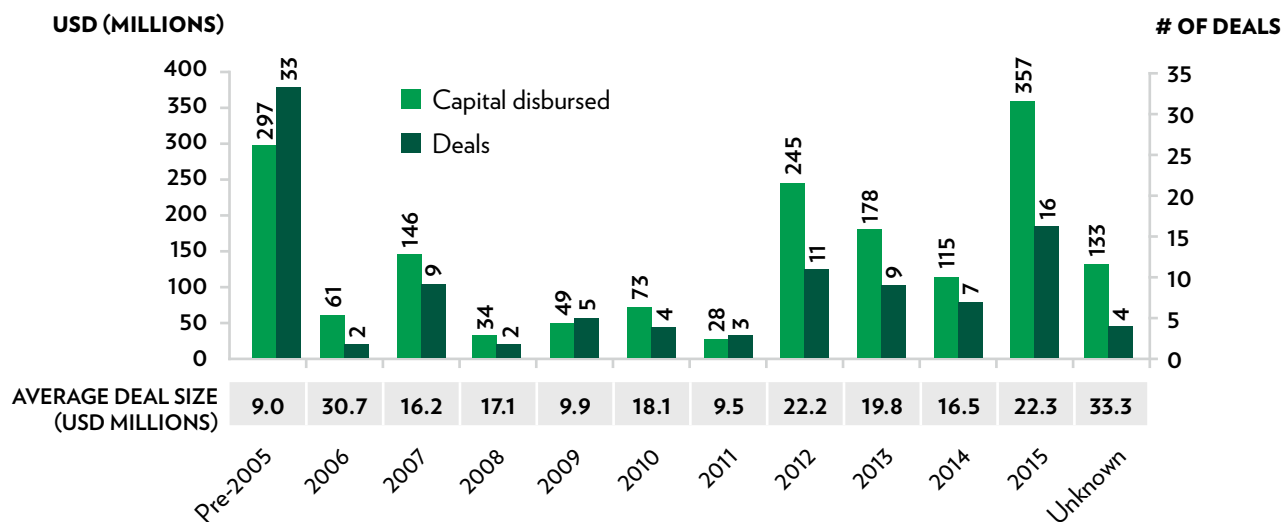
Historically, DFIs have demonstrated strong interest in Zambia, with more than 30 percent of deals taking place before 2005 (see Figure 8). Notwithstanding this long-term interest, DFI activity has notably increased since 2011. Lower numbers in 2015 can be attributed to the timing of data collection in mid-2015, which does not capture the full extent of 2015 activity for both DFIs and non-DFI impact investors.

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23 Matthew Hill, “Zambian Interest Rate Caps May Harm Micro Lenders, Industry Says,” *Bloomberg*, January 4, 2013, <http://www.bloomberg.com/news/articles/2013-01-04/zambian-interest-rate-caps-may-harm-micro-lenders-industry-says>.

24 Bank of Zambia, “Press Release on Interest Rates,” January 3, 2013, [http://www.boz.zm/\(S\(lxspk5md1equsj55nu0lkdmv\)\)/%5Cpublishing%5Cspeeches%5Cpress%20release%20on%20interest%20rates.pdf](http://www.boz.zm/(S(lxspk5md1equsj55nu0lkdmv))/%5Cpublishing%5Cspeeches%5Cpress%20release%20on%20interest%20rates.pdf).

FIGURE 8. DFI IMPACT INVESTMENTS BY YEAR



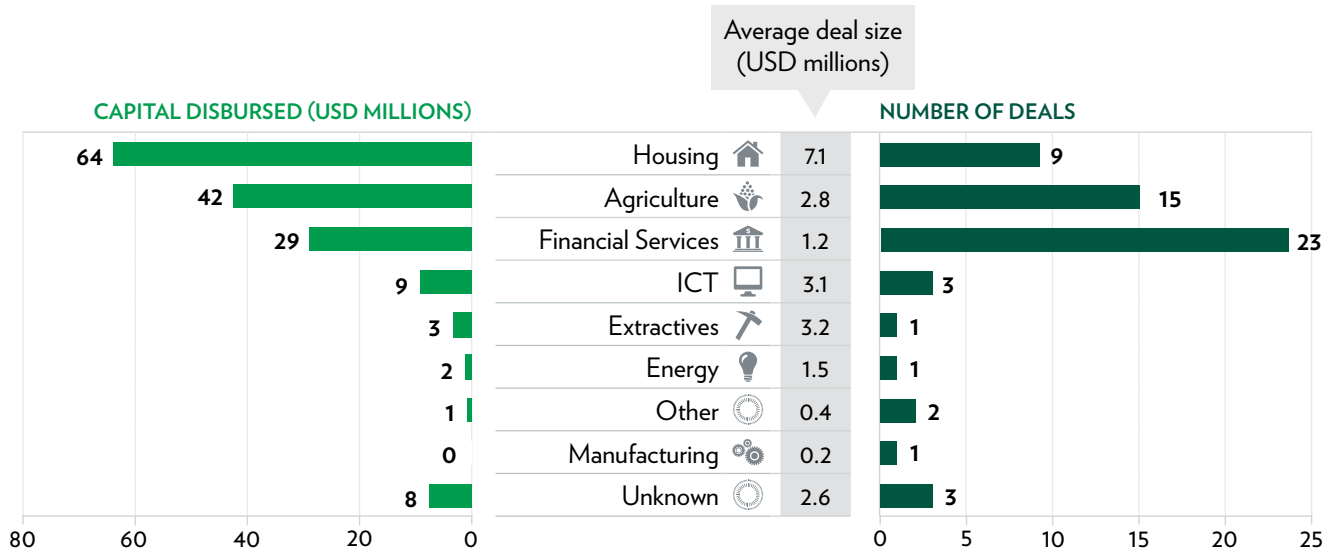
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.a

Source: Open Capital Research

## Sector

Non-DFI impact investing in Zambia is heavily focused in a few sectors (see Figure 9). Financial services constitute nearly 40 percent of deals by these investors. Of 22 deals in financial services, 18 were in just four companies (a commercial bank and three MFIs). Similarly, housing investments comprise just over another 40 percent of non-DFI impact investor capital disbursed, with a single investment accounting for nearly 70 percent of the total in this sector. Taken together, housing and financial services account for more than 55 percent of non-DFI impact investor deals and almost 60 percent of disbursements. Agriculture accounts for roughly 25 percent of both deals and total capital disbursed. Notably, though, two deals account for almost 80 percent of all the non-DFI impact investor capital disbursed in agriculture. All in all, non-DFI activity has been focused in a few sectors and a handful of companies.

FIGURE 9. NON-DFI IMPACT INVESTMENTS BY SECTOR

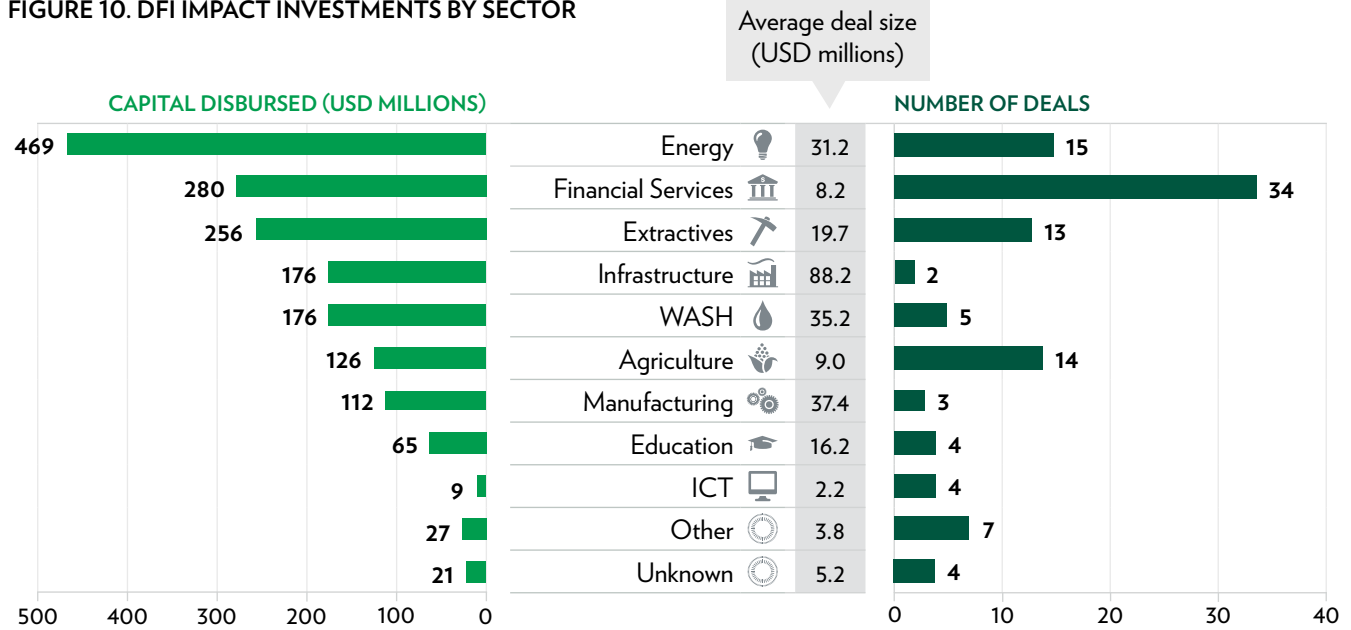


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

By contrast, DFIs have been active in a broader range of sectors, though they have paid most attention to energy, financial services, and extractives (see Figure 10). This activity is led by investments in hydroelectric power, commercial banks, and copper. In addition, most of the manufacturing investments were in plants that serve extractive industries, with an average deal size of more than USD 35 million (more than twice as large as the average DFI deal size across the region).

FIGURE 10. DFI IMPACT INVESTMENTS BY SECTOR



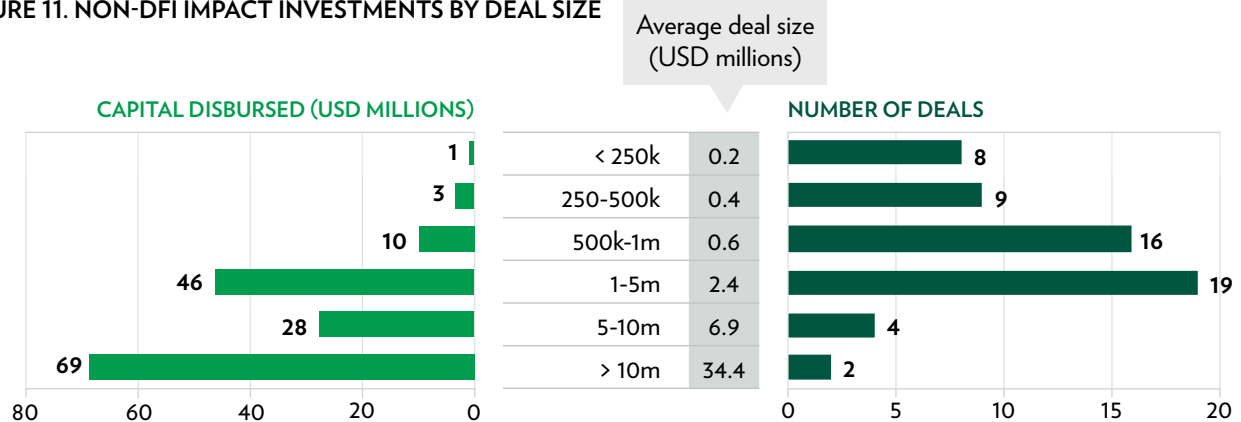
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Deal Size

The majority of non-DFI impact investments in Zambia are under USD one million. A further 30 percent of deals (less than 20 deals) are between USD one million and USD five million (see Figure 11). Interviewees report that it is difficult to find deals of this size and to develop a robust deal portfolio with tickets of this size. Reflecting their larger capital amounts, deals over USD five million account for more than 60 percent of all capital disbursed.

FIGURE 11. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE

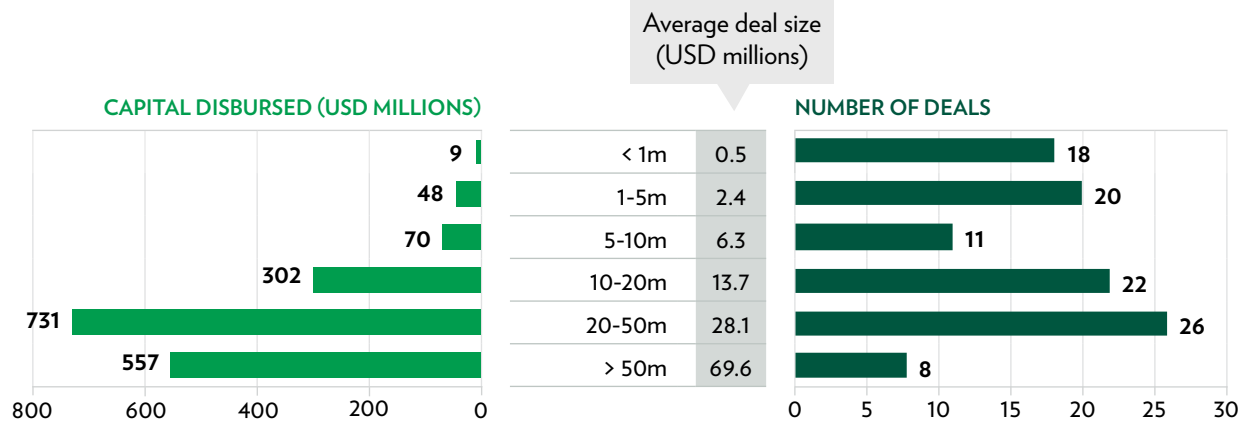


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

By contrast, DFI investments are much larger, averaging more than USD 16 million per deal. More than half of all DFI deals and more than 90 percent of DFI capital disbursed is through deals larger than USD 10 million.

**FIGURE 12. DFI IMPACT INVESTMENTS BY DEAL SIZE**



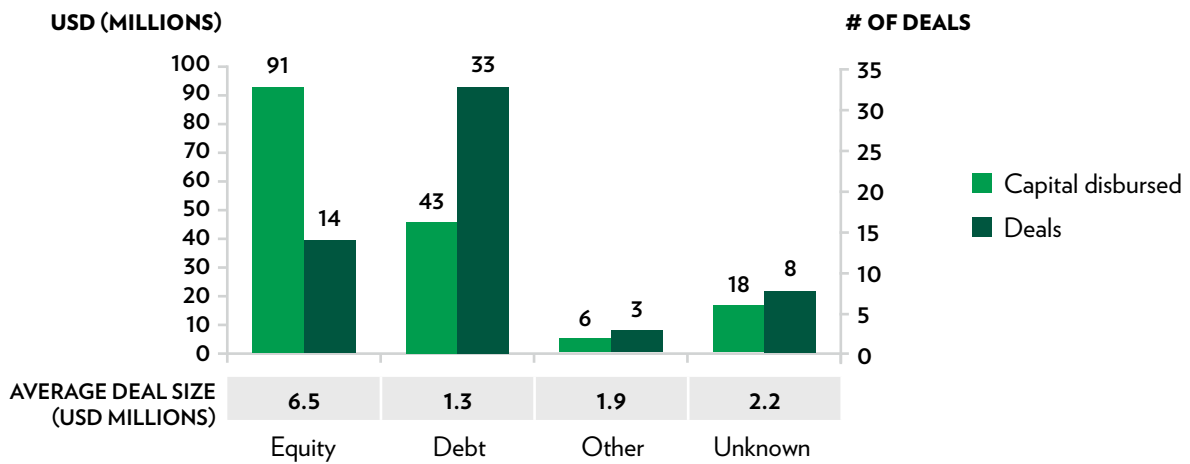
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Instrument

Non-DFI impact investors in Zambia generally use traditional debt and equity instruments when placing capital. Debt instruments account for more than 50 percent of all deals, which aligns with statements by interviewees who noted that many entrepreneurs in Zambia do not fully understand equity or are reluctant to give up even partial control of their company in exchange for capital. Nonetheless, when equity deals do take place, they are larger, so nearly 60 percent of capital disbursed by non-DFI impact investors is through equity placements.

**FIGURE 13. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE**

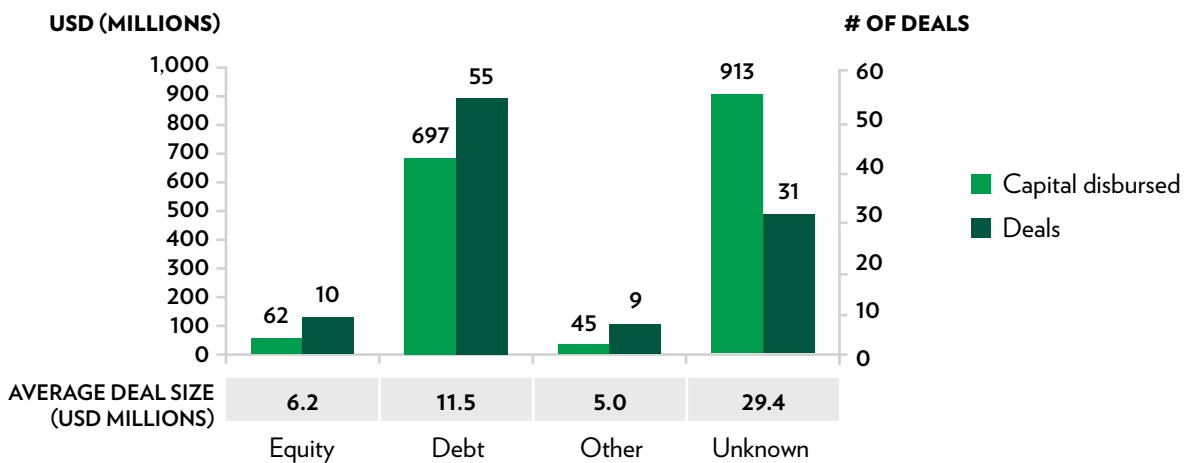


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

By contrast, known DFI investments overwhelmingly use debt instruments. Debt accounts for more than 80 percent of known deals and almost 90 percent of all known DFI capital disbursed.

**FIGURE 14. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Local Presence

There are only six non-DFI impact investors with a local presence in Zambia. Those with staff based in country report a significant advantage sourcing deals. Interviewees stressed the very high costs of due diligence on a fly-in, fly-out model given the limited pipeline of investment-ready businesses. For the same reason, interviewees also stressed the importance of local knowledge and context.

## Standards for Tracking Impact

As is true across Southern Africa, impact investors in Zambia do not use a specific standard for measuring impact. Instead, they report tailoring impact tracking structures to each investment, allowing them to reduce the administrative burden on their portfolio businesses and focus on the metrics that are most meaningful in context.

# DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital in Zambia. With limited access to capital from banks, MFIs, NBFIs, or private funds, businesses have difficulty accessing the credit they need to grow. Despite recent progress, moreover, Zambia faces significant development gaps that create opportunities for businesses to fill key needs while also realizing financial returns.

## Development Context

Zambia is ranked 143<sup>rd</sup> out of 187 on the United Nations Human Development Indicators (HDI) index.<sup>25</sup> With a score of 0.55, Zambia remains well below the global average of 0.69, despite recent improvements of its indicators. Its low score is attributable to the country's poor performance in key developmental indicators (see Table 1), especially income level metrics. Though Zambia's GDP per capita places it as a "middle income" country, nearly 75 percent of the population lives on less than USD 1.25 per day, compared to the global average of about 25 percent.<sup>26</sup>

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25 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

26 *Ibid.*

TABLE 1. SELECTED ZAMBIA DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Zambia	Regional Average	Global Average
HDI SCORE (RANKS 143 <sup>RD</sup> OF 187 COUNTRIES)	0.55	0.55	0.69
GDP PER CAPITA (USD)	3,925	6,874	17,975
UNEMPLOYMENT RATE (%)	13	13	6
POPULATION BELOW USD 1.25 / DAY (%)	74	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	89	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	35	41	59

Zambia also sits well below global averages in health outcomes, with child mortality rates almost double global averages.<sup>27</sup>

Only 35 percent of the population has some secondary education, compared to the global average of nearly 60 percent. School attendance rates have increased as a result of recent government focus on education, with education now comprising over 17 percent of total government expenditures.<sup>28</sup>

Education outcomes are critical for Zambia's future due to its disproportionately young population. Nearly 46 percent of the population is under the age of 15, and approximately 66 percent is less than 24 years old.<sup>29</sup>

## Entrepreneurs

Businesses from a range of impactful sectors, including agriculture, energy, healthcare, education, housing, and water, sanitation, and hygiene (WASH) are seeking capital across the spectrum of business stages, from seed to maturity. Currently, the majority of businesses are start-up and early-stage businesses, with fewer venture-stage or mature companies.<sup>30</sup>

27 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

28 Peter E. Rasmussen, *Zambia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zambia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zambia_GB_2015.pdf).

29 *The World Factbook*, s.v. "Zambia" (Washington, DC: Central Intelligence Agency), accessed August 11, 2015, <https://www.cia.gov/library/publications/the-world-factbook/geos/za.html>.

30 Open Capital interviews.

Access to capital is the primary challenge facing businesses in Zambia. As discussed above, commercial banks are often unwilling to lend to the private sector, and even when willing to lend, banks frequently have high collateral requirements.<sup>31</sup> This latter hurdle can be particularly restrictive, as much of the land in Zambia remains under a traditional land tenure system without formal documentation. Interviewees report that banks will typically not accept such land as collateral.

Beyond these issues related to collateral, high interest rates also pose a challenge. Most lenders charge rates close to the interest rate cap of 24 percent.<sup>32</sup> Microfinance institutions offer substantially higher interest rates, capped at 42 percent,<sup>33</sup> which makes MFI loans poorly suited for longer-term capital needs.

Last, but not least, businesses face high distribution costs in Zambia. Though there are concentrations of people in Lusaka and the Copperbelt, much of the country is very sparsely populated; the overall population density is just 18.7 people per square kilometer.<sup>34</sup> For businesses outside of Lusaka and the Copperbelt, this limits the potential market and increases costs of distribution, especially to rural populations.

Though roads between major cities are good, the network of infrastructure outside these main arteries remains poor. In addition to roads, the national electrical grid has limited reach, with 78 percent of Zambians lacking electricity.<sup>35</sup> The grid experiences load shedding for up to 10 hours a day,<sup>36</sup> which restricts processing and manufacturing operations in much of the country and raises costs for all businesses that must operate on generators using fuel transported over long distances.<sup>37</sup> Difficulties with infrastructure in much of Zambia are compounded by the lack of a large-scale mobile money or electronic banking system. Though these systems have begun to emerge, businesses still rely on cash for most transactions.<sup>38</sup> As businesses grow, reliance on cash increases the risk of theft and can become inefficient.

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31 Open Capital Interviews.

32 *Ibid*; Tsidi Tsikata et al., *Zambia: Selected Issues* (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/scr/2015/cr15153.pdf>; Stuart Lisulo, "StanChart Calls for Statutory Reserve Ratio Review," *The Post*, April 6, 2015, <http://www.postzambia.com/news.php?id=7089>; Hilda Lumba, "Volatility in Exchange Rate...As Banking Sector Bears Brunt," *Times of Zambia*, June 16, 2015, <http://www.times.co.zm/?p=61647>.

33 Matthew Hill, "Zambian Interest Rate Caps May Harm Micro Lenders, Industry Says," *Bloomberg*, January 4, 2013, <http://www.bloomberg.com/news/articles/2013-01-04/zambian-interest-rate-caps-may-harm-micro-lenders-industry-says>.

34 United Nations Statistics Division, s.v. "Zambia," accessed 2015, <http://data.un.org/CountryProfile.aspx?crName=zambia>.

35 97% of rural Zambians and 55% of urban Zambians lack electricity. Alliance for Rural Electrification, *Power Sector Market Brief: Zambia*, [http://www.ruralelec.org/fileadmin/DATA/Documents/06\\_Publications/Market\\_intelligence/AEEP\\_Zambia\\_Power\\_Sector\\_Market\\_Brief\\_EN.pdf](http://www.ruralelec.org/fileadmin/DATA/Documents/06_Publications/Market_intelligence/AEEP_Zambia_Power_Sector_Market_Brief_EN.pdf); International Renewable Energy Agency, *Zambia: Renewables Readiness Assessment 2013*, [http://www.irena.org/DocumentDownloads/Publications/RRA\\_Zambia.pdf](http://www.irena.org/DocumentDownloads/Publications/RRA_Zambia.pdf).

36 Terry Bell, "Up to Ten Hours of Load Shedding for Zambians," *Fin24*, August 6, 2015, <http://www.fin24.com/Economy/Up-to-10-hours-of-load-shedding-for-Zambians-20150806>.

37 F. Kwesiga et al., *Republic of Zambia: 2011–2015 Country Strategy Paper* (Tunis: African Development Bank Group, 2010), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ZAMBIA-CSP-2011-2015.pdf>.

38 United Nations Capital Development Fund, *Digital Financial Services in Zambia* (2014), <http://www.unctf.org/sites/default/files/Documents/zambia.pdf>.

Businesses also find it challenging to source human capital.<sup>39</sup> The entrepreneurial landscape is still young. Some interviewees expressed the opinion that there is less entrepreneurial drive in the Zambian population than in other parts of the region. For those that are starting businesses, identifying talent can be challenging.<sup>40</sup> That said, other interviewees strongly disputed the notion that there is a lack of human capital in Zambia, stating that the population is relatively well-educated, with many capable managers available.

Despite these difficulties, however, there are opportunities for entrepreneurs in Zambia. In particular, interviewees noted a growing entrepreneurial landscape in agriculture, with an increasing number of farmers and small agro-processors. In addition, entrepreneurs can take advantage of the growing middle class in Zambia that increasingly demands consumer goods, as well as a large export market to the Democratic Republic of the Congo that requires basic goods and services. More detail on opportunities by sector is provided in the “Challenges and Opportunities for Impact Investors” section, below.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

## Regulatory Considerations

Zambia has reasonably well-functioning institutions and a generally open regulatory environment, as described below. The World Bank currently ranks Zambia 111<sup>th</sup> of 189 countries in its “Ease of Doing Business” index.<sup>41</sup> However, recent policy changes, also described below, have contributed to investor concerns over policy inconsistency.

Several aspects of Zambia’s regulatory environment are particularly relevant to entrepreneurs and impact investors planning to place capital in the country:

- **Policy inconsistency:** The government of Zambia recently enacted several sharp and notable shifts in national policy. For example, in October 2014, the government announced that it was replacing all profit taxes on copper mining operations with increased mineral royalties (to 20 percent for open-cast mines, up from six percent).<sup>42</sup> This change went into effect in January 2015;<sup>43</sup> then, in July 2015, the policy was reversed, returning to a 30 percent corporate tax on profits while reducing the mineral royalty to nine percent, still higher than under the previous policy.<sup>44</sup>

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39 Open Capital Interviews.

40 *Ibid.*

41 The World Bank, “Zambia,” in *Doing Business 2015* (Washington, DC: The World Bank, 2014), <http://www.doingbusiness.org/data/exploreeconomies/zambia/>.

42 “Global Tax Alert: Zambia issues 2015 Budget proposals,” *Ernst & Young*, October 17, 2014, [http://www.ey.com/Publication/vwLUAssets/Zambia\\_issues\\_2015\\_Budget\\_proposals/\\$FILE/2014G\\_CM4805\\_Zambia issues 2015 Budget proposals.pdf](http://www.ey.com/Publication/vwLUAssets/Zambia_issues_2015_Budget_proposals/$FILE/2014G_CM4805_Zambia%20issues%202015%20Budget%20proposals.pdf).

43 *Ibid.*

44 Alexandra Wexler, “Zambia to Roll Back Copper Mining Taxes: Royalties Slashed and Mining Tax Reinstated After Industry Warns on Jobs,” *Wall Street Journal*, June 24, 2015, <http://www.wsj.com/articles/zambia-to-roll-back-copper-mining-taxes-1435147737>.

Similarly, the government recently revoked the export permit for maize and maize products.<sup>45</sup> The government also changed its policy on VAT returns for exports, increasing the requirements: the government now demands proof of sale, rather than just proof of export as solely required before.<sup>46</sup> They subsequently reversed this requirement in February 2013. In addition, the government introduced and then later reversed policies prohibiting the use of foreign currency as legal tender for domestic transactions and allowing the Bank of Zambia to monitor international transactions.<sup>47</sup>

These rapid changes reflect instability and unpredictability in the policy environment, and are expected to continue until the next general election in September 2016. Though the situation has stabilized in recent months, government policy could change both before and immediately after the election.<sup>48</sup>

- **Conflict:** Zambia has generally not experienced significant conflict or political unrest since independence. Those conflicts that have emerged have been resolved through non-violent avenues, such as the courts, whose decisions are normally upheld.<sup>49</sup> Outside of this norm, there have been two failed attempts to overthrow the Zambian government, in 1990 and 1997.<sup>50</sup> The government swiftly put down these coup attempts. Zambia is perceived to be a peaceful and stable country compared to the region.
- **Land ownership:** Zambia does not recognize freehold ownership. Instead, land may be held as customary land or as leasehold, with leases up to 99 years.<sup>51</sup> Customary land, in general, cannot be leased or held by international parties. To be leased, it must be converted into leasehold land.<sup>52</sup> The process of converting customary into leasehold land in Zambia is usually drawn-out and expensive, involving a physical survey of the land by the Commissioner of Lands and the consent of the local traditional leader and of any other person affected by the lease. This process

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45 “Government’s ‘Maize Policy’ Inconsistency Worries Millers,” *Daily Nation*, April 8, 2013, <http://zambiadailynation.com/2013/04/08/govts-maize-policy-inconsistency-worries-millers/>.

46 Hakainde Hichilema, “Economic inconsistencies—Bad for growth and investment,” *Lusaka Times*, May 12, 2015, <https://www.lusakatimes.com/2015/05/12/economic-inconsistencies-bad-for-growth-and-investment/>.

47 *Ibid.*

48 Hakainde Hichilema, “Economic inconsistencies—Bad for growth and investment,” *Lusaka Times*, May 12, 2015, <https://www.lusakatimes.com/2015/05/12/economic-inconsistencies-bad-for-growth-and-investment/>.

49 Judy Smith-Höhn, *A Strategic Conflict Assessment of Zambia* (Pretoria: Institute for Security Studies, 2009), <http://dSPACE.africaportal.org/jspui/bitstream/123456789/30965/1/M158FULL.pdf?1>.

50 Jane Perlez, “Failed Zambia Coup Weakens Leader,” *The New York Times*, July 1, 1990, <http://www.nytimes.com/1990/07/01/world/failed-zambia-coup-weakens-leader.html>; Donald G. McNeil, Jr., “Zambia Says a Coup is Over in Three Hours without Injury,” *The New York Times*, October 29, 1997, <http://www.nytimes.com/1997/10/29/world/zambia-says-a-coup-is-over-in-3-hours-without-injury.html>.

51 “Economic Trade and Investment,” High Commission of the Republic of Zambia in Canada, <http://www.zambiahighcommission.ca/investment.php>.

52 United States Agency for International Development (USAID), *Zambia—Land Tenure and Resource Governance Profile* (Washington, DC: USAID, 2010), [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Zambia\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Zambia_Profile.pdf).

can take as long as three years.<sup>53</sup> Foreign nationals can opt to apply for a 14-year lease for land that is not surveyed.<sup>54</sup> While holding a 14-year lease, applicants may choose to apply for a 99-year lease on the same land.<sup>55</sup>

In order for foreign nationals to hold leasehold land, they must meet at least one of the following conditions: (a) be a permanent resident of Zambia, (b) meet the Zambian Development Authority's (ZDA's) definition of an investor,<sup>56</sup> (c) be a company registered under the Companies Act with at least 75 percent local shareholding, (d) be seeking a lease of less than 14 years, or (e) be granted a concession or right under the National Parks and Wildlife Act.<sup>57</sup> Leasehold land may revert to government ownership if it is ruled to be underdeveloped after five years.<sup>58</sup>

- **Government and private sector:** No sectors are reserved for the government.<sup>59</sup> Currently, 27 wholly state-owned enterprises remain, spread across a range of sectors, including financial services, mining, energy, and communications. In 2014, the Zambian government created the Industrial Development Corporation as a holding company for the shares in each state-owned enterprise, structuring the Corporation as an investment company with a mandate to manage the enterprises efficiently and to promote jobs and industrialization within the country.<sup>60</sup> Now, the Industrial Development Corporation is actively taking steps to manage the portfolio of state-owned enterprises. Private enterprises and parastatals are generally allowed to operate on the same terms;<sup>61</sup> however, some private companies complain about the lack of a level playing field when competing with parastatals for concessions and licenses.<sup>62</sup>

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53 United States Agency for International Development (USAID), *Zambia—Land Tenure and Resource Governance Profile* (Washington, DC: USAID, 2010), [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Zambia\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Zambia_Profile.pdf).

54 *Ibid.* Requirements for a 14-year lease are a sketch plan of the land as well as the consent of the local traditional leader and any other person affected by the lease.

55 *Ibid.*

56 An investor is defined as “any person, natural or juristic, whether a citizen of Zambia or not, investing in Zambia in accordance with ZDA Act, and includes a micro or small business enterprise and rural business enterprise.” “Economic Trade and Investment,” High Commission of the Republic of Zambia in Canada, <http://www.zambiahighcommission.ca/investment.php>; Zambia Legal Information Institute, *The Zambia Development Agency Bill* (2006), <http://www.zambalii.org/files/zm/legislation/act/2006/11/zdaa2006236.pdf>.

57 “Economic Trade and Investment,” High Commission of the Republic of Zambia in Canada, <http://www.zambiahighcommission.ca/investment.php>.

58 KPMG, *Zambia Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile_2012-2013_01.pdf).

59 US Department of State, “Zambia Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229323.pdf>.

60 “About Us,” Industrial Development Corporation, accessed October 6, 2015, <http://www.idc.co.zm/about-idc>.

61 KPMG, *Zambia Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile_2012-2013_01.pdf).

62 US Department of State, “Zambia Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229323.pdf>.

- **Exit opportunities / restrictions on exits:** There are no restrictions on investment exits in Zambia.<sup>63</sup>
- **Forex controls:** All foreign exchange controls in Zambia were abolished in 1994.<sup>64</sup> The Bank of Zambia does monitor the movement of funds in and out of the country.<sup>65</sup> Foreign investors may repatriate 100 percent of net profits and dividends, capital investments, interest, management fees, royalties, and technical fees. Expatriates are also allowed to remit wages.<sup>66</sup>
- **Required local shareholding:** For most sectors, local ownership is not required,<sup>67</sup> nor are there foreign ownership restrictions on the Lusaka Stock Exchange.<sup>68</sup> However, some sectors do have restrictions on foreign ownership. Prior to entering the market, internationally licensed mobile phone operators are required to offer 10 percent of their shareholdings to Zambians on the Lusaka Stock Exchange.<sup>69</sup> In addition, the government only issues broadcasting licenses to companies with at least 75 percent local shareholding.<sup>70</sup> Foreigners with a small-scale mining license are required to have 75 percent local ownership.<sup>71</sup>
- **Government incentives for investors:** Zambia offers a range of incentives to encourage both foreign and local investment.<sup>72</sup> Companies investing USD 500 thousand or more in priority sectors and projects in the Multi-Facility Economic Zone will normally receive incentives including:<sup>73</sup>

63 United Nations Committee on Trade and Development (UNCTAD), *An Investment Guide to Zambia: Opportunities and Challenges* (New York and Geneva: UNCTAD, 2011), [http://unctad.org/en/Docs/diaepcb201008\\_en.pdf](http://unctad.org/en/Docs/diaepcb201008_en.pdf).

64 Zambia Development Agency, *Zambia: Africa's New Frontier for Investments and Profits* (2008), <http://www.zambia.or.jp/docs/Investor%20guide-%20Zambia.pdf>.

65 KPMG, *Zambia Fiscal Guide 2013/14* (Johannesburg: KPMG, 2014), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2014%20Fiscal%20Guides/Fiscal%20Guide%20Zambia.pdf>.

66 *Ibid*

67 US Department of State, "Zambia Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/242010.pdf>.

68 US & Foreign Commercial Service and US Department of State, *Doing Business in Zambia: A Country Commercial Guide for US Companies* (2005), <http://www.africa-resources.com/zambia.pdf>.

69 US Department of State, "Zambia Investment Climate Statement" (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229323.pdf>.

70 Zambia Development Agency, *Zambia: Application Manual for Investors* (2012), <http://www.zda.org.zm/?q=download/file/fid/69>.

71 *Ibid*.

72 US Department of State, "Zambia Investment Climate Statement" (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229323.pdf>.

73 Priority sectors include copper manufacturing, iron ore or steel products, horticulture, floriculture, education and skills training, water and energy development, processing of wheat flour and other foods, production and processing of textiles, among others. United Nations Committee on Trade and Development (UNCTAD), *An Investment Guide to Zambia: Opportunities and Challenges* (New York and Geneva: UNCTAD, 2011), [http://unctad.org/en/Docs/diaepcb201008\\_en.pdf](http://unctad.org/en/Docs/diaepcb201008_en.pdf); Zambia Legal Information Institute, *The Zambia Development Agency Bill* (2006), <http://www.zambia.ii.org/files/zm/legislation/act/2006/11/zdaa2006236.pdf>; Zambia Development Agency, *Zambia: Africa's New Frontier for Investments and Profits* (2008), <http://www.zambia.or.jp/docs/Investor%20guide-%20Zambia.pdf>.

- Tax exempt dividends for the five years following the first declaration;<sup>74</sup>
- Tax exempt profits for the first five years profits are made. For the sixth, seventh, and eighth years, 50 percent of profits are taxable, and 75 percent of profits are taxable in the ninth and tenth years;<sup>75</sup>
- Customs duty exemptions for capital goods, machinery, and raw materials for five years;<sup>76</sup>
- Deferred VAT on some machinery and equipment;<sup>77</sup> and
- Ability to claim a 100 percent improvement allowance for capital expenditures on improvements and infrastructure.<sup>78</sup> This accounting treatment makes these capital expenditures tax deductible, reducing taxable income over the term of the lease.<sup>79</sup>

Investors interested in these incentives are required to apply to the sixteen-member Zambia Development Agency (ZDA) board, which usually makes a decision in 30 days.<sup>80</sup>

## Ecosystem Players

There is a limited investment ecosystem in Zambia, though government efforts to support entrepreneurs and grants from technical assistance (TA) funders, such as USAID and DFID, have resulted in a growing pool of incubators.<sup>81</sup> Many of these new service providers are in agriculture or technology.<sup>82</sup>

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74 KPMG, *Zambia Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile_2012-2013_01.pdf).

75 *Ibid.*

76 *Ibid.*

77 “Zambia—Investment Incentives,” Southern African Development Community, <https://tis.sadc.int/french/regional-integration/tifi/tax/chapter-3/zambia/>.

78 Know Your Country, *Zambia: Risk and Compliance Report* (2014), [http://www.knowyourcountry.com/files/zambiaaamlaug14\\_2\\_.pdf](http://www.knowyourcountry.com/files/zambiaaamlaug14_2_.pdf).

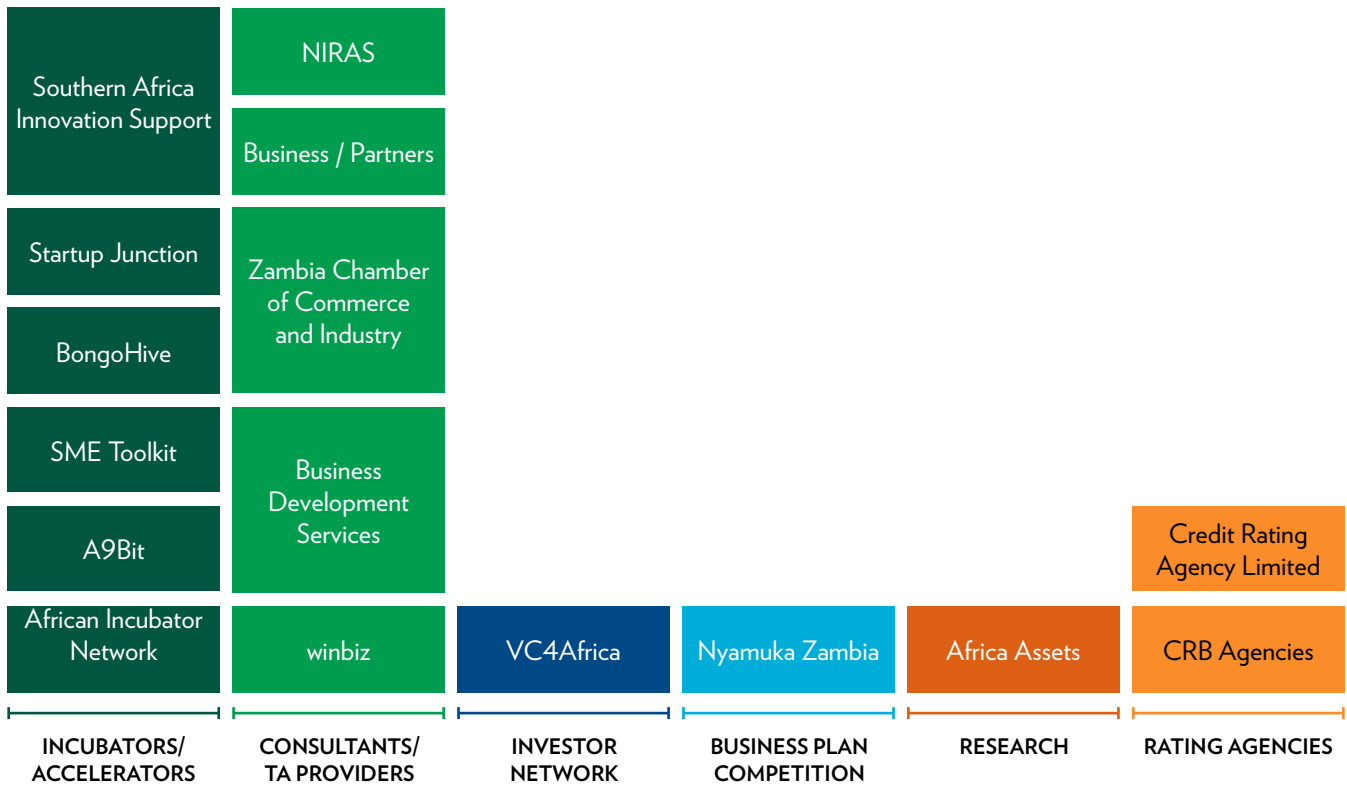
79 Desmond Connall, David Winstead, and Christopher Jones (Ballard Spahr LLP), “Seven Tax Aspects of Tenant Improvements” (2014), <http://www.ballardspahr.com/alertspublications/articles/-/media/files/articles/2014-05-28-7-tax-aspects-of-tenant-improvements.ashx>.

80 KPMG, *Zambia Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Zambia%20Country%20Profile_2012-2013_01.pdf).

81 Open Capital Interviews.

82 *Ibid.*

**FIGURE 15. SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS**



Note: Chart focuses on those with local presence; international players are also active.

Source: Open Capital research, organization websites.

However, there are few advisors who can provide tailored business support outside of incubators and accelerators. Interviewees noted that this was a significant impediment to deploying capital, as it limited the pipeline of investment-ready businesses. Instead, some impact investors interviewed noted that they must first invest in providing support and technical assistance to potential investee companies using in-house staff in order to prepare these businesses for capital.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Interviewees have split opinions on the Zambian market. Some interviewees stressed the opportunities available, noting the lack of presently available capital alongside Zambia's general peace and stability, growing middle class, well-functioning institutions, and strong GDP growth. By contrast, others drew attention to significant uncertainty generated by the recent policy instability, the regular power shortages, the large fiscal deficits, a depreciating currency, and a lack of entrepreneurial spirit among Zambians.

There are a variety of challenges related to placing capital effectively in Zambia. Several of these, such as the lack of sufficient investment-ready deal flow and the difficulty of managing currency risk, are shared across much of the region, as described in detail in the Executive Summary. Additional challenges specific to Zambia include:

- **Policy inconsistency:** Frequently cited as the single largest impediment to foreign investors, the government of Zambia recently enacted several sharp shifts in policy. These have led to a sense that national policy is unpredictable, as described in detail above. Though some interviewees noted that the situation has improved recently, most interviewees expect this instability in the policy environment to continue until the next general election in September 2016. Some also disputed that this instability was relevant outside of the mining sector, but most noted that abrupt policy changes relevant to the overall economy remain possible.
- **Few advisory or business-support service providers:** The intermediary and business advisory landscape in Zambia is limited. As a result, businesses facing challenges have few options to source expert advice and intensive support in order to professionalize. There are few venues (e.g., incubators) at which impact investors may meet well-prepared entrepreneurs and few intermediaries that can provide reliable, high-quality deal flow. Instead, impact investors must generate leads independently, which restricts the deal pipeline, increases costs, and privileges impact investors who have a strong local presence.
- **High management costs relative to deal size:** Zambia's vast geography and poor infrastructure raise the cost of making investments. Close oversight is required across the lifetime of an investment, from due diligence through exit. Though similar efforts are required across the region, Zambia's geography and poor infrastructure in particular result in higher costs for this in-person supervision. These challenges are particularly acute in Zambia because of the available deal sizes. Interviewees noted that most entrepreneurs required capital under USD one million. Profitably serving the sub-USD one million market is generally difficult, and the high management costs in Zambia make doing so particularly challenging, especially for investors with shorter time horizons. Investors with longer-term horizons may be able to capitalize on the growth of their portfolio companies over time to cover these management costs.

Despite these challenges, there are opportunities for impact investors with the correct structure and focus to operate effectively in Zambia and to leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Many of these opportunities, such as using technical assistance or other grant facilities to build a pre-investment pipeline and establishing a local presence, are common across the region and are described in additional detail in the Executive Summary.

Impact investors specifically interested in Zambia have opportunities related to an extended investment time horizon. Where possible, interviewees saw value in making time horizons longer to benefit from the economy's forecasted growth. The concentration of sub-USD one million investment opportunities can limit potential profit on shorter investment timelines, particularly in light of the high associated management costs. However, there is opportunity in Zambia for patient capital, and investors are beginning to recognize this opportunity.<sup>83</sup>

Interviewees mentioned strong investment opportunities in nearly every sector of the Zambian economy, including:

- **Agro-processing:** Despite strong fundamentals and a number of small-scale agro-processors, there remains ample opportunity for commercial-scale and domestic value addition in most agricultural value chains. A growing middle class and export markets increasingly demand processed agricultural products. Zambia's large geography also presents opportunities to establish small agro-processing facilities near primary production.
- **Primary agriculture:** Given Zambia's abundance of arable land and rainfall, primary agriculture offers significant potential for successful investments, including opportunities in staple crops, horticulture, and poultry. Furthermore, declining or unstable production in its neighboring countries creates opportunities for Zambia to export agricultural produce.
- **Renewable energy:** Given recent power shortages and a national electrical grid that reaches only three percent of the rural population,<sup>84</sup> there are many opportunities for micro-grid and off-grid solutions, as well as large-scale power production, in both hydroelectric and solar energy. Zambia currently generates virtually all of its power hydroelectrically, limiting the direct environmental impact of new, large-scale renewable projects. Nevertheless, such plants could improve the national grid, reducing the use of diesel generators.

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83 For example, a local venture firm is starting a new incubator fund, in conjunction with DFID, focused on Zambia's Solwezi area. The fund will provide around USD 150 thousand in first-stage financing for each business, along with strong hands-on management involvement. The local venture firm will consider successful businesses for larger, second-stage financing, providing the incubator fund with a profitable exit and realizing long-term value from growth for the investor.

84 "Zambia: Mini-grids," United Nations Industrial Development Organization, <http://www.unido.org/en/where-we-work/africa/selected-projects/zambia-mini-grids.html>.

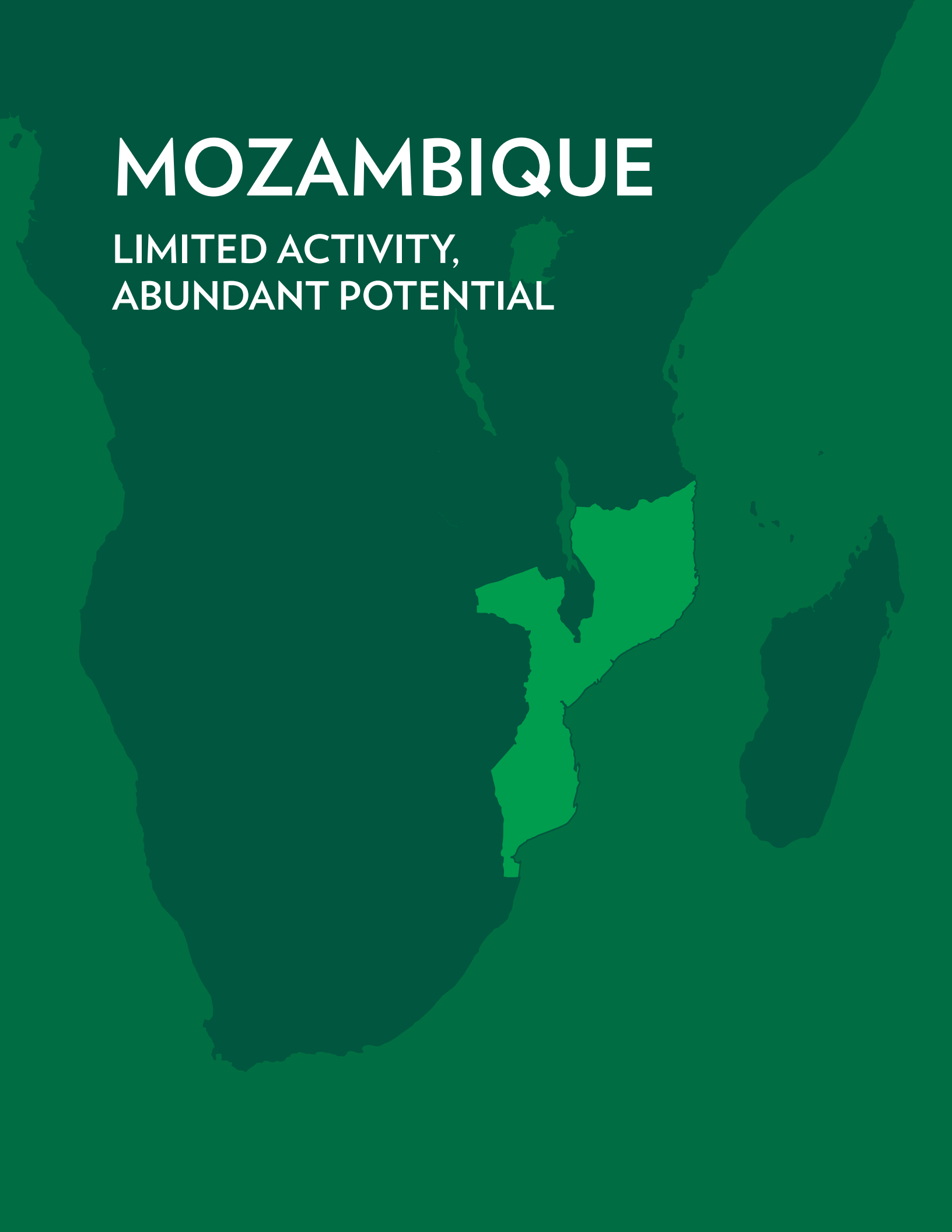
- **Consumer goods:** Zambia has a growing middle class fueled by strong GDP growth. As this segment grows, there are opportunities to produce consumer goods to target this market. Though near-term growth may slow, it may be expected to rebound in the mid- and long-term and fuel increasing demand for consumer goods.<sup>85</sup> Producing consumer goods generates local employment and provides new products and services to the local market.

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<sup>85</sup> International Monetary Fund, *Country Report: Zambia* (Washington DC: International Monetary Fund, 2015), <http://www.imf.org/external/pubs/ft/scr/2015/cr15152.pdf>.

# MOZAMBIQUE

LIMITED ACTIVITY,  
ABUNDANT POTENTIAL



# INTRODUCTION

Mozambique's path to stability has been long and difficult. After gaining independence from Portugal in 1975,<sup>1</sup> the Mozambique Liberation Front (FRELIMO) took over as the ruling party, banned all other political parties, and supported the struggle for independence in neighboring Rhodesia (now Zimbabwe; see Figure 1).<sup>2</sup> Attempting to destabilize the FRELIMO government, in 1976 the Rhodesian Central Intelligence Organization founded a rebel movement, the Mozambican National Resistance (RENAMO).<sup>3</sup> The struggle between FRELIMO and RENAMO became a brutal civil war that is estimated to have caused more than one million deaths before its 1992 end.<sup>4</sup>

The war and its aftermath left Mozambique as one of the poorest countries in the world, but the last two decades have seen a rapid recovery. Growth in gross domestic product (GDP) has hovered around nine percent annually over the last decade,<sup>5</sup> and the government has relaxed its once staunchly socialist policies. Along with the discovery of vast oil and natural gas reserves, this economic liberalization has caused a surge in foreign investment.

Impact investing in Mozambique has kept pace with rising commercial investment. Led by large DFI deals in infrastructure and energy, Mozambique has received the third-highest amount of impact capital of any country in the region. Realizing opportunities across sectors, however, will require addressing significant remaining challenges. Non-DFI impact investors have struggled to place capital, citing as some of the main obstacles the country's poor infrastructure, low levels of education, lingering political tensions, and high linguistic and cultural barriers for non-Portuguese speakers.

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1 "Mozambique Profile—Timeline," *BBC News*, January 15, 2015, <http://www.bbc.com/news/world-africa-13890720>.

2 Political Economy Research Institute, *Modern Conflicts: Conflict Profile Mozambique, 1975–1992* (Amherst, MA: University of Massachusetts), <http://www.peri.umass.edu/fileadmin/pdf/Mozambique.pdf>.

3 James Fearon and David Laitin, *Random Narratives: Mozambique* (Palo Alto, CA: Stanford University, 2005), available at <http://web.stanford.edu/group/ethnic/Random%20Narratives/MozambiqueRN1.1.pdf>.

4 Gerhard Seibert, "The Vagaries of Violence and Power in Postcolonial Mozambique," in *Rethinking Resistance: Revolt and Violence in African History*, ed. Jon Abbink, Mirjam de Bruijn, and Klaas van Walraven, 253–76. Leiden: Brill, 2003, [http://www.artsrn.ualberta.ca/amcdouga/Hist247/winter\\_2014/readings/mozambique\\_seibert.pdf](http://www.artsrn.ualberta.ca/amcdouga/Hist247/winter_2014/readings/mozambique_seibert.pdf).

5 *World Economic Outlook Database*, s.v. "Mozambique" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

# COUNTRY CONTEXT

After decades of colonial rule and a brutal civil war, Mozambique’s economy is now on the rise. Natural resource exploration—often funded by foreign direct investment (FDI)—and robust government spending have led to strong growth rates over the past decade. Moreover, the country benefits from proximity to major markets, neighboring South Africa (see Figure 1) as well as having excellent shipping access to Asia and the Middle East. Nonetheless, the recent economic boom has emerged from a low baseline. Mozambique remains one of the poorest countries in the world.

FIGURE 1. MAP OF MADAGASCAR



## Gross Domestic Product

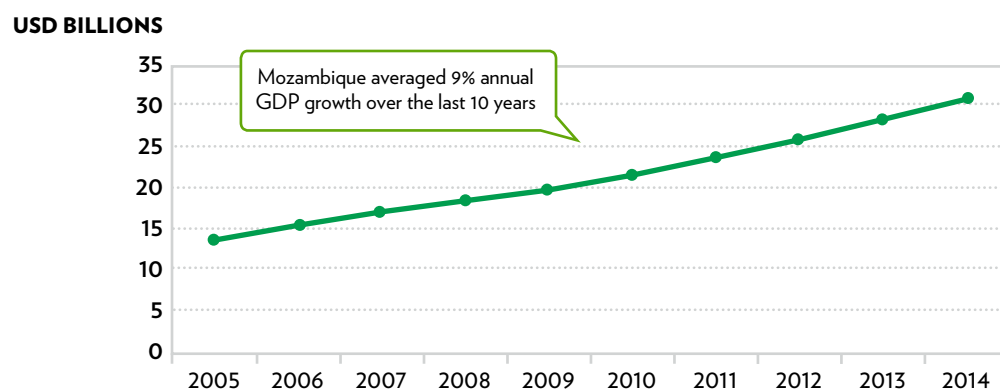
Mozambique’s GDP has grown steadily at approximately nine percent year-on-year in purchasing power parity (PPP) terms between 2005 and 2014, making it the fastest-growing economy in the region and the fastest-growing non-oil economy in sub-Saharan Africa (see Figure 2).<sup>6</sup> Much of this growth has come from FDI in Mozambique’s extractives sector, particularly coal and aluminum, along with exploration and early infrastructure for its vast and undeveloped natural gas reserves.<sup>7</sup>

6 *World Economic Outlook Database*, s.v. “Mozambique” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

7 Andrew England, “Mozambique Prepares to Harness Vast Gas Reserves,” *Financial Times*, October 26, 2014, <http://www.ft.com/intl/cms/s/0/678102c2-59e0-11e4-9787-00144feab7de.html#axzz3kUz3Mvtw>; and “Mozambique,” U.S. Energy Information Administration, <http://www.eia.gov/beta/international/analysis.cfm?iso=MOZ>.

Government spending in construction, services, transportation, and energy—financed largely by foreign debt—has also been a major driver of GDP growth.<sup>8</sup> Despite record levels of growth, however, GDP per capita remains at just USD 1,174 in PPP terms, the second-lowest in Southern Africa.<sup>9</sup> Although its population is roughly similar to that of Angola’s (at approximately 26 million), Mozambique’s economy is around a fifth the size of that of its fellow former Portuguese colony.<sup>10</sup>

FIGURE 2. GDP (PPP), 2005–2014



Source: IMF World Bank Economic Indicators, April 2015

## Foreign Direct Investment

FDI flows have been a major driver of economic growth in Mozambique. Particularly in recent years, international investments in extractives have dramatically increased levels of FDI. In 2013, net inward FDI flows totaled almost USD six billion, up from only USD one billion three years earlier (see Figure 3).<sup>11</sup> Mozambique’s primary trading partners and sources of FDI include South Africa, Portugal, and China.<sup>12</sup>

8 “Mozambique Economy: Expansionary Budget Carries Risks,” Economist Intelligence Unit, January 24, 2014, <http://performance.ey.com/wp-content/uploads/downloads/2014/01/EY-Performance-Mozambique-budget.pdf>.

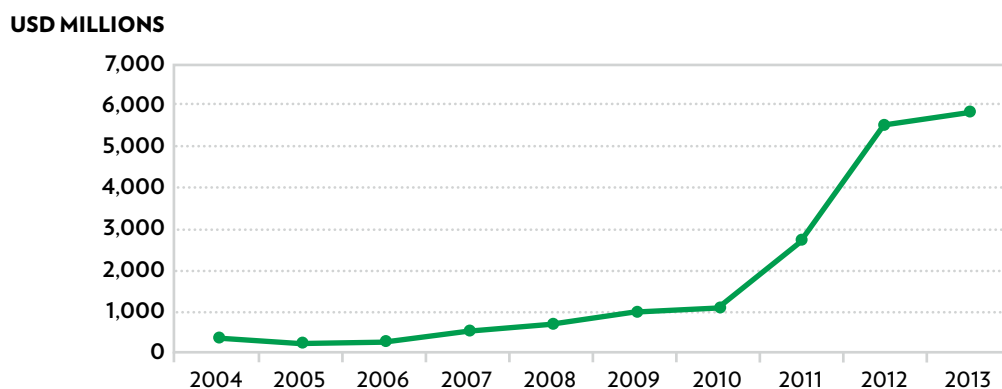
9 *World Economic Outlook Database*, s.v. “Mozambique” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

10 *Ibid.*

11 United Nations Conference on Trade and Development, *World Investment Report: Mozambique* (Geneva: United Nations Conference on Trade and Development 2015), [http://unctad.org/sections/dite\\_dir/docs/wir2015/wir15\\_fs\\_mz\\_en.pdf](http://unctad.org/sections/dite_dir/docs/wir2015/wir15_fs_mz_en.pdf).

12 “South Africa, China and Portugal Lead in New Investments in Mozambique in 2013,” *Macauhub*, March 3, 2014, <http://www.mcauhub.com.mo/en/2014/03/03/south-africa-china-and-portugal-lead-in-new-investments-in-mozambique-in-2013/>.

FIGURE 3. NET FDI FLOWS, 2004–2013

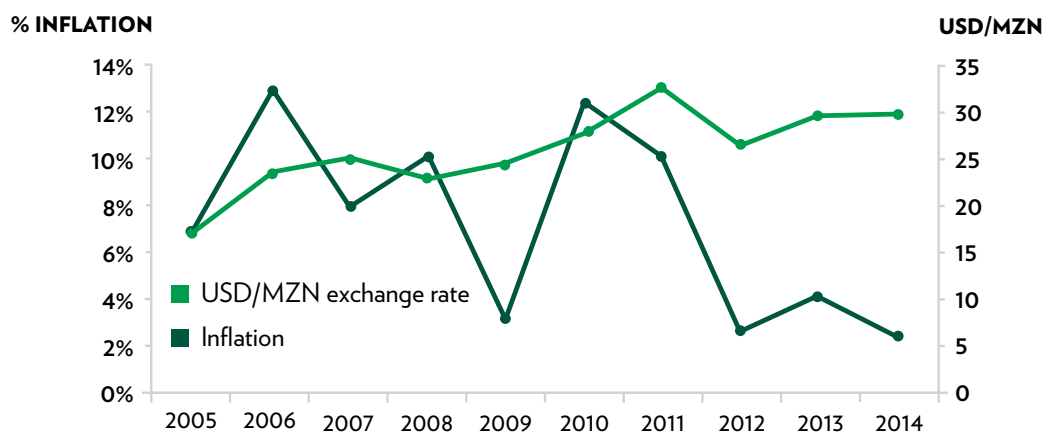


Source: UNCTAD

## Inflation and Exchange Rates

Financial-sector reform and an emphasis on discipline at the central bank have kept inflation in Mozambique at comparatively low levels.<sup>13</sup> Though inflation rates spiked to 12 percent briefly in 2006 and again in 2010, inflation was below three percent in 2012 and has since remained below five percent, giving Mozambique one of the lowest inflation rates in Southern Africa.<sup>14</sup> Price stability has been accompanied by currency stability. After a sharp depreciation and subsequent correction in 2010 and 2011, the value of the Mozambican Metical (MZN) has since depreciated slightly against the US Dollar (see Figure 4).<sup>15</sup>

FIGURE 4. INFLATION AND USD/MZN EXCHANGE RATE, 2005 - 2014



Source: World Bank Indicators

13 Dmitri G. Demekas et al., *Republic of Mozambique Financial System Stability Assessment Update* (Washington, DC: International Monetary Fund, 2009), <https://www.imf.org/external/pubs/ft/scr/2010/cr1012.pdf>.

14 *The World Bank: Data*, s.v. “Mozambique” in “World Development Indicators,” accessed 2015, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

15 “Historical Exchange Rates,” OANDA, <http://www.oanda.com/currency/historical-rates/>.

# SUPPLY OF IMPACT INVESTING CAPITAL

Considering both DFI and non-DFI activity combined, Mozambique has had the third-highest number of impact investing deals in Southern Africa, after South Africa and Zambia. Similarly, Mozambique has seen the third-highest amount of DFI impact capital. However, with only the seventh-highest amount of non-DFI capital disbursed among the 12 countries in Southern Africa, nearly all impact capital invested in Mozambique (>96 percent) has come from DFIs. These DFI-led projects have focused primarily on the manufacturing and energy sectors. In addition, there are fewer than 15 active non-DFI impact investors who have placed just USD 52 million in Mozambique to date, with the majority in agriculture. As a result, despite high overall inflows, social enterprises across sectors in Mozambique struggle to source impact capital.

## Broader Investing Landscape

Impact capital represents a small portion of the total capital available in Mozambique. The country's financial landscape is dominated by banks, which control approximately 95 percent of total assets in the financial sector (87 percent of which are concentrated at the country's five largest banks).<sup>16</sup>

Access to capital remains a challenge for businesses. While interest rates on commercial debt have declined since 2005 from nearly 20 percent, they still remain near 15 percent, making them impractical for many businesses.<sup>17</sup> In addition, banks often have high collateral and reporting requirements, which many smaller businesses are unable to meet.<sup>18</sup> Interviewees noted that few financial service providers cater to the needs of small, growing enterprises. In addition to the difficulty securing loans from established financial institutions, interviewees noted that Mozambique generally lacks an entrepreneurial culture or the involvement with entrepreneurs of high-net-worth individuals and angel investors.<sup>19</sup> Thus, many businesses fail to scale because they lack capital and mentorship.

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16 André A. Santos, Luca M. Roffarello, and Manuel Filipe, *Mozambique* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mozambique\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mozambique_GB_2015.pdf).

17 Open Capital interviews; *The World Bank: Data*, s.v. "Mozambique" in "Indicators," <http://data.worldbank.org/indicator/all>; and "Mozambique Lending Interest Rate," Quandl, accessed 2015, [https://www.quandl.com/data/WORLDBANK/MOZ\\_FR\\_INR\\_LEND-Mozambique-Lending-interest-rate](https://www.quandl.com/data/WORLDBANK/MOZ_FR_INR_LEND-Mozambique-Lending-interest-rate).

18 Open Capital Interviews.

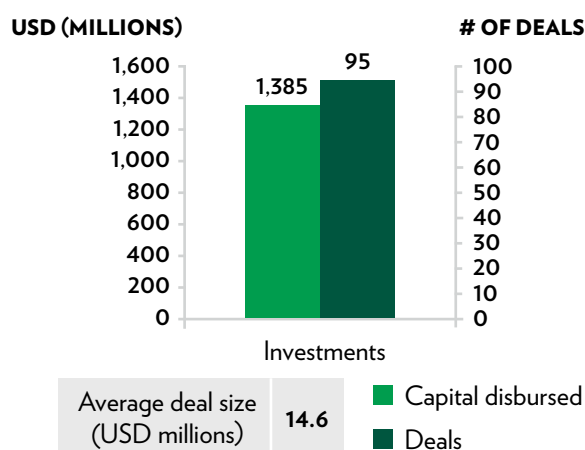
19 *Ibid.*

## Impact Capital Disbursed

Mozambique boasts the third-highest amount of DFI impact capital disbursed in the region, trailing only South Africa and Zambia. However, as mentioned above, the country ranks seventh in the region when considering non-DFI impact capital disbursed. In sum, there have been 137 identified investments in Mozambique (six percent of total regional deal volume), representing approximately five percent of total impact capital disbursed in Southern Africa (or approximately USD 1.4 billion).<sup>20</sup>

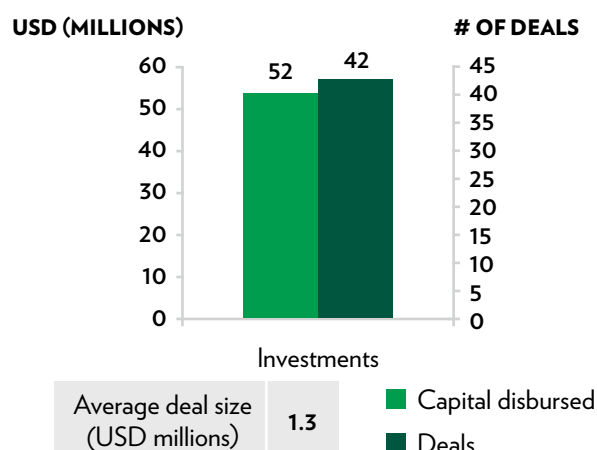
The vast majority—more than 96 percent—of this activity has been driven by DFIs (see Figure 5). Less than one percent of the non-DFI impact capital disbursed in the region has been placed in Mozambique, amounting to only USD 52 million across 42 deals (see Figure 6). Much of this activity is from a handful of local investors, as interviewees suggested that flows of non-DFI impact capital from nearby South Africa are limited due to perceived language barriers, country risk, and strong domestic opportunities in South Africa.<sup>21</sup>

FIGURE 5. DFI IMPACT INVESTMENTS



Source: Open Capital Research

FIGURE 6. NON-DFI IMPACT INVESTMENTS



Source: Open Capital Research

## Investments Over Time

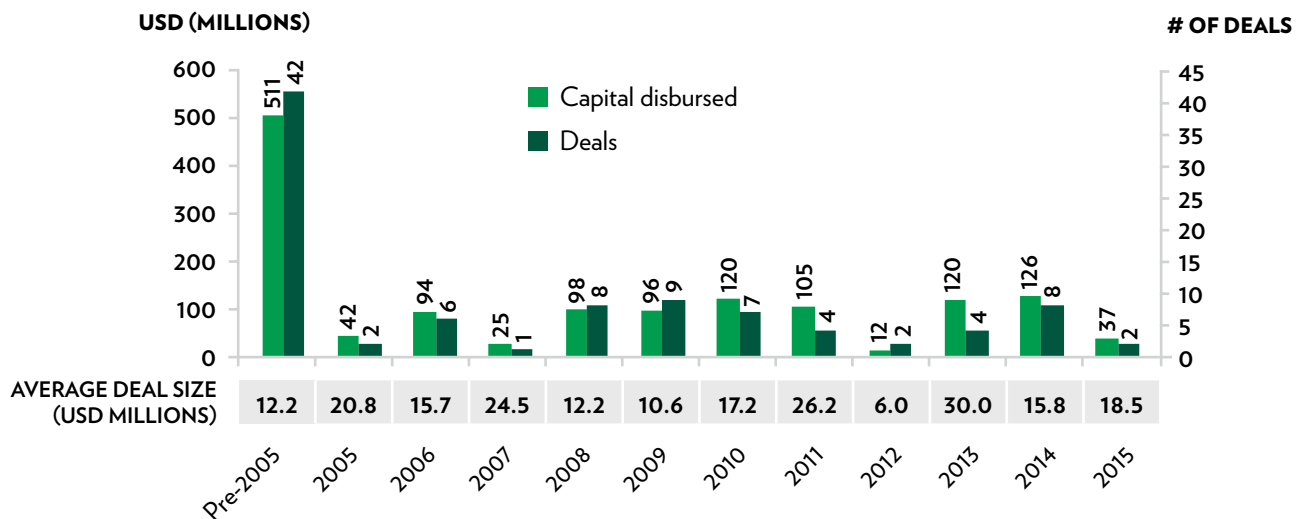
Though a lack of public information about deal timing prevents drawing concrete conclusions about the history of non-DFI impact investing in Mozambique, interviewees confirmed that its non-DFI impact investing landscape remains in its infancy.

<sup>20</sup> Open Capital Interviews.

<sup>21</sup> *Ibid.*

There is, however, a robust history of DFI investments in the country (see Figure 7). DFIs have historically shown strong interest in Mozambique, with more than 40 percent of recorded DFI investments placed before 2005. The reduction in deal flow shown in 2015 can be attributed to the timing of data collection in the middle of 2015, which therefore could not capture the full extent of impact investing activity in that year.

FIGURE 7. DFI IMPACT INVESTMENTS BY YEAR



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

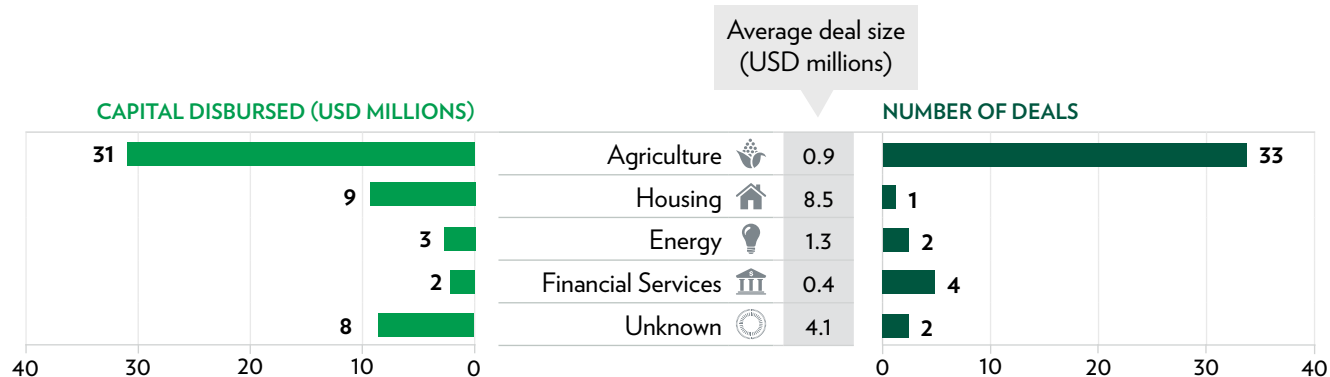
Source: Open Capital Research

## Sector

Of the sectors targeted by non-DFI impact investors, agriculture accounts for nearly 80 percent of deals and more than 60 percent of total capital disbursed (see Figure 8). Deals within the agricultural sector varied greatly by subsector, including investments in input production, fruit processors, sugar manufacturing, honey production, and various livestock businesses. Non-agricultural small- and medium-sized enterprises (SMEs) received just USD 20 million in non-DFI impact capital, which accords with statements from interviewees that these SMEs have trouble accessing impact capital.<sup>22</sup> In addition, a single investor completed approximately half of all non-DFI impact deals, indicating an even more constrained funding landscape for entrepreneurs who do not meet that specific impact investor's investment criteria.

22 Open Capital Interviews..

FIGURE 8. NON-DFI IMPACT INVESTMENTS BY SECTOR

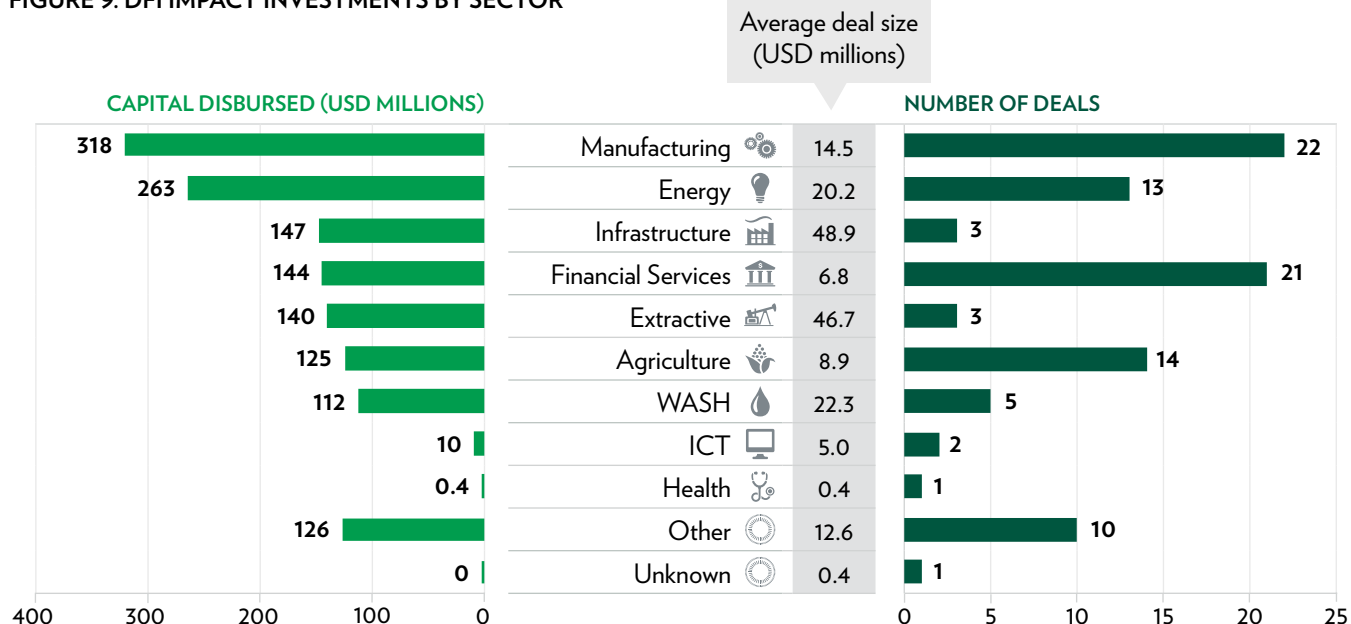


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

By contrast, DFIs have been active in a broader range of sectors, though they have focused most of their attention on energy, financial services, manufacturing, and agriculture (see Figure 9). Notably, investments in manufacturing, which represented the largest number of deals of any sector in Mozambique, included a number of investments in facilities that serve the extractive and agricultural industries.

FIGURE 9. DFI IMPACT INVESTMENTS BY SECTOR



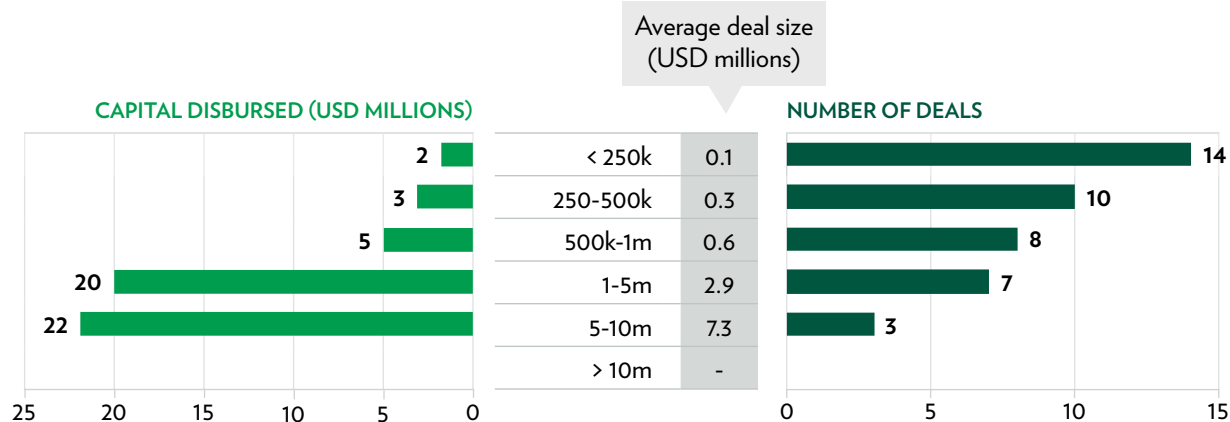
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Deal Size

Nearly 75 percent of non-DFI deals were below USD one million (see Figure 10). Of the 10 deals over USD one million, 65 percent were in agriculture, corroborating the statements of many interviewees who identified difficulties finding larger deals outside of agriculture.<sup>23</sup>

FIGURE 10. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE

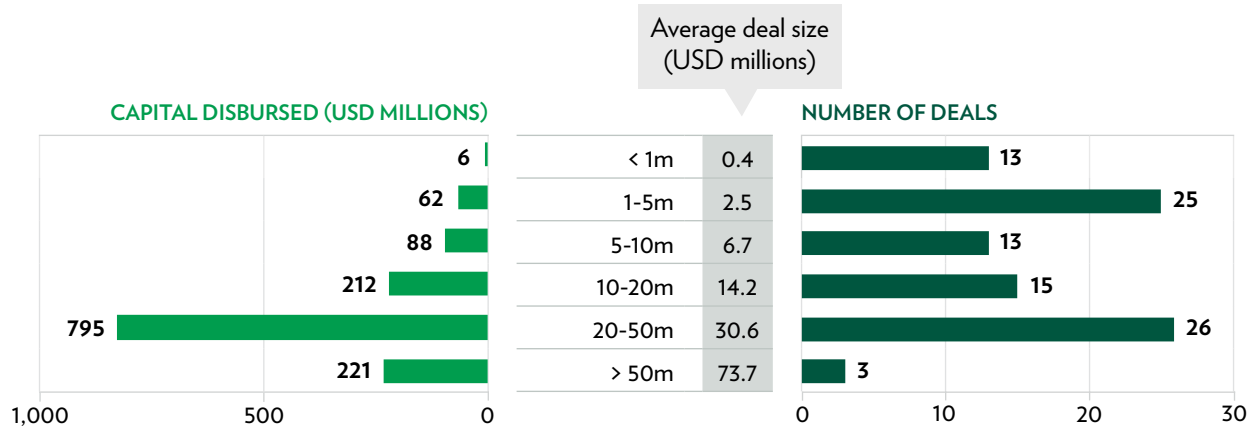


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

DFI direct investments in Mozambique, by contrast, were significantly larger, averaging nearly USD 15 million (see Figure 11). This difference is primarily due to the larger ticket sizes typically seen in investments in the DFIs' preferred sectors of energy, manufacturing, and financial services.

FIGURE 11. DFI IMPACT INVESTMENTS BY DEAL SIZE



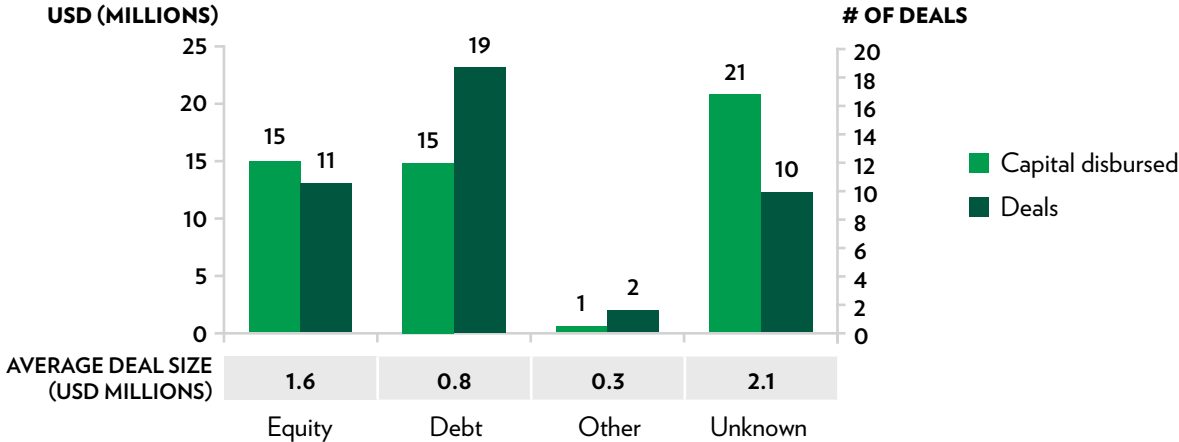
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

# Instrument

Non-DFI impact investors in Mozambique have used a fairly even split of traditional debt and equity (see Figure 12). Debt has accounted for nearly 60 percent of known transactions. Equity transactions were also used in a substantial fraction of deals, accounting for a third of known transactions. However, more capital has been deployed overall using equity than debt, given the larger deal sizes common with this instrument.

FIGURE 12. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE

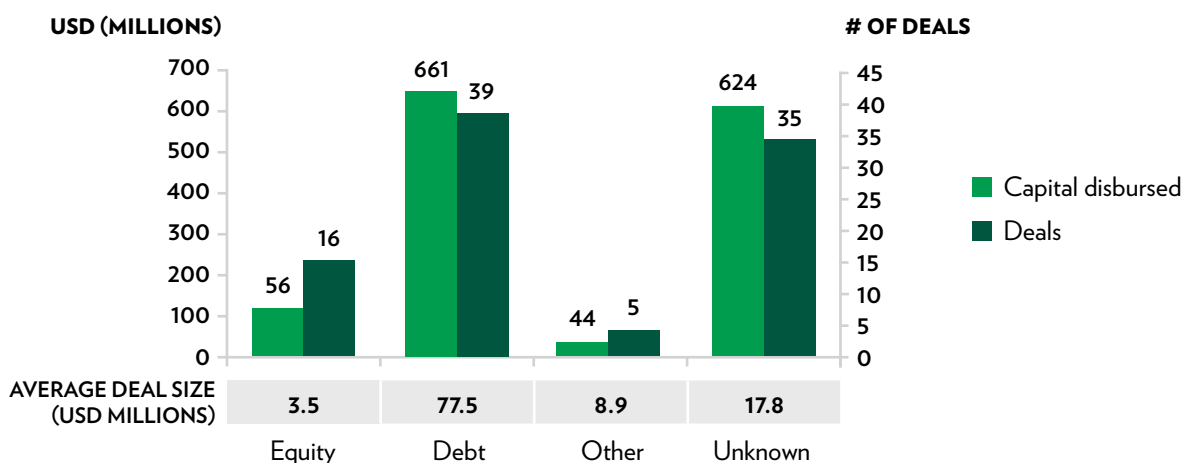


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

Based on available data, DFIs have an overwhelming preference for debt (see Figure 13). Debt instruments account for 65 percent of known deals and more than 85 percent of all known DFI capital disbursed.

FIGURE 13. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million. Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Local Presence

Very few impact investors have offices in Mozambique, and fewer than 15 non-DFI impact investors have placed capital in Mozambique. That said, interviewees noted there are significant advantages to operating with local presence, as investing in Mozambique often requires deep local knowledge, language proficiency, and connections to navigate a bureaucratic landscape.<sup>24</sup> Having a local presence provides significant advantages in terms of enabling investors to source proprietary deals.<sup>25</sup>

## Impact Tracking Standards

As in other countries in Southern Africa, impact investors typically do not use one specific impact tracking standard to measure social return. Interviewees noted that metrics are often customized on an investment-specific basis to fit the circumstances of the business and in order to minimize the administrative burden for portfolio companies and investors alike.<sup>26</sup>

<sup>24</sup> Open Capital Interviews.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

# DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Interviewees report that few entrepreneurs in Mozambique are looking for impact capital. Though foreign investment has boomed, FDI has focused on major projects in oil and gas; the country's SME landscape remains underdeveloped.<sup>27</sup> Nonetheless, a new generation of Mozambican entrepreneurs is emerging, actively supported by the government.<sup>28</sup> There remain significant gaps in the provision of key goods and services, particularly outside of Maputo, which creates opportunities for entrepreneurs to build enterprises that fill key needs while also realizing financial returns.

## Development Context

The country has seen recent improvement in terms of development indicators, but Mozambique's score on the United Nations' Human Development Index (HDI) of just 0.39 ranks 178<sup>th</sup> of 187 countries, the lowest in Southern Africa.<sup>29</sup> This ranking is reflected in poor performance across a number of indicators covering poverty, health, and education (see Table 1).

TABLE 1. SELECTED MOZAMBIQUE DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Mozambique	Regional Average	Global Average
HDI SCORE (RANKS 178 <sup>TH</sup> OF 187 COUNTRIES)	0.39	0.55	0.69
GDP PER CAPITA (USD, PPP)	1,174	6,874	17,975
UNEMPLOYMENT RATE (%)	22	13	6
POPULATION BELOW USD 1.25 / DAY (%)	60	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	90	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	43	37	27

<sup>27</sup> *Ibid.*

<sup>28</sup> "Mozambique Investing in a New Generation," United Nations Industrial Development Organization, <http://www.unido.org/en/where-we-work/africa/selected-projects/mozambique-entrepreneurs.html>.

<sup>29</sup> Khalid Malik et al., *Human Development Report* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>.

Mozambique's educational levels are among the lowest in the world. Less than four percent of the population has received some secondary education, by far the lowest in Southern Africa and the second-lowest globally for countries for which there are data.<sup>30</sup> At 26 percent, Mozambique's gross enrollment in secondary education is the lowest in Southern Africa, six percentage points behind Angola, the next-lowest country.<sup>31</sup> Similarly, almost 60 percent of Mozambique's population, or more than 15 million people, lives on less than USD 1.25 per day, well over double the global average and above average for Southern Africa.<sup>32</sup> Mozambique also significantly underperforms on health indicators. Mozambique's under-five mortality rates are close to double the global average and are the third-highest in the region behind Angola and Lesotho.<sup>33</sup> Levels of under-five stunting, an effective proxy for childhood and later general health, are close to the regional average, still considerably above the global average.<sup>34</sup>

Like much of sub-Saharan Africa, Mozambique has a disproportionately young population; 45 percent of the population is under the age of 15, and 65 percent is below 25.<sup>35</sup> This has led to high youth unemployment,<sup>36</sup> and Mozambique's low levels of education will make it challenging for the country to translate its youth boom into positive economic growth.

## Entrepreneurs

Mozambique has few early-stage or growth-stage privately owned businesses—especially given its robust economic growth over the past decade—and its culture of entrepreneurship remains weak.<sup>37</sup> Investors and intermediaries interviewed for this report identified Mozambique's comparatively recent escape from colonial rule and the lingering effects of socialist government as impediments to developing a culture of individual entrepreneurship.<sup>38</sup>

Those early-stage entrepreneurs who do exist in Mozambique face substantial challenges to getting their businesses investment-ready and struggle to find financing beyond friends and family. Bank financing is typically expensive, with interest rates on small-business loans rarely below 15 percent, which—though these rates are similar to those found in many other countries in sub-Saharan Africa—is particularly challenging in Mozambique given that inflation remains low. Such high rates prove especially

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30 Open Capital Interviews.

31 *Ibid.*

32 *Ibid.*

33 *Ibid.*

34 Open Capital Interviews.

35 *The World Factbook*, s.v. "Mozambique" (Washington, DC: Central Intelligence Agency), accessed August 26, 2015, <https://www.cia.gov/library/publications/the-world-factbook/geos/mz.html>.

36 Sam Cowie, "Few Jobs despite Booming Mozambique Economy," *Al Jazeera Media Network*, December 2, 2014, <http://www.aljazeera.com/indepth/features/2014/12/few-jobs-despite-booming-mozambique-economy-201412291727155364.html>.

37 Open Capital Interviews.

38 *Ibid.*

challenging for entrepreneurs in low-margin sectors like agriculture, which has seen the most non-DFI impact investment activity and still has substantial investment opportunities going forward.<sup>39</sup> Furthermore, because the government owns all agricultural land in Mozambique, entrepreneurs cannot use land as collateral.

Impact investors also note that many interesting early-stage businesses—and even some mature businesses—lack professional accounting and management systems.<sup>40</sup> Accounts are often informal, as many entrepreneurs lack sufficient accounting expertise to prepare accurate reports. In such cases, it is difficult for impact investors to build confidence in a business's operations or to trust the entrepreneur enough to place capital in the business.

Beyond access to capital, early-stage businesses also face significant challenges due to Mozambique's geographic size and poor infrastructure. The country stretches more than two thousand kilometers along Africa's eastern coastline, and internal road connections are underdeveloped and hazardous. The country has low population density and has been slow to urbanize, which requires growing businesses to rapidly expand their geographic reach in order to grow their revenues. One entrepreneur, for example, reported that the cost of transporting agricultural produce by lorry from an inland town to the nearest port 200 km away was the same as the cost of shipping that produce from the port to North America. Businesses seeking to scale to new geographic markets often operate multiple offices largely as separate endeavors. For example, inventory, sourcing, and distribution must often be re-created and run independently for each new location.

Sourcing adequate human capital to manage these dynamics is one of the most prominent challenges. As in much of the region, the pool of educated labor is small and consequently expensive, particularly at the levels of middle and senior management. Government restrictions on the number of expatriates businesses are allowed to hire exacerbate this problem. Depending on their total number of employees, Mozambican businesses are only permitted to employ foreign labor as five to ten percent of their total staff depending on the total staff size.<sup>41</sup> Educated Mozambicans are able to command high salaries that many early- or growth-stage SMEs cannot afford. The shortage of educated labor in Mozambique is particularly acute because the country does not have a large returning diaspora to supplement in-country talent.<sup>42</sup>

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39 Open Capital Interviews.

40 *Ibid.*

41 Ten percent foreign labor is permitted in small companies (maximum ten employees), eight percent in medium companies (11-100 employees), and five percent in large companies (over 100 employees). "Corporate Immigration Mozambique," Law Business Research, September 29, 2014, <https://gettingthedealthrough.com/area/47/jurisdiction/137/corporate-immigration-mozambique/>.

42 Open Capital Interviews.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

As with impact investment activity itself, the broader ecosystem supporting impact investors in Mozambique is still developing. Tellingly, one intermediary noted that when they first approached authorities with the idea to launch a business incubator, they were asked to explain why they wanted to enter the hatchery business.<sup>43</sup> Mozambique's rapid growth may be expected to present attractive opportunities for intermediaries and service providers in the future, but the country's nascent culture of entrepreneurship and challenges in the regulatory environment mean that its ecosystem development may be slow. Regulatory considerations include:

- **Land ownership:** The state owns all land in Mozambique,<sup>44</sup> and land-use laws can be daunting, privileging those who involve local counsel early in the process.

Broadly speaking, land use is regulated through government ordinances known as DUATs (*Direito de Uso e Aproveitamento dos Terras*).<sup>45</sup> The government issues DUATs to locals based on occupation or traditional norms, as well as to foreign investors and corporations after approval by the Investment and Promotion Center of Mozambique (CPI).<sup>46</sup> Foreign investors must first consult with local communities to determine if the land is occupied and to negotiate the conditions under which the community will agree to cede their rights.<sup>47</sup> If approved, applicants have two years to implement projects, after which a final DUAT, valid for a maximum term of 50 years, is granted. Should the applicant fail to implement their project within the allotted two years, the land, along with all improvements therein, reverts to the state without compensation.<sup>48</sup>

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43 Open Capital Interviews.

44 Zaida Kathrada, "Acquiring Land Rights in Mozambique," Norton Rose Fulbright, August 26, 2014, <http://www.financialinstitutionslegalsnapshot.com/2014/08/acquiring-land-rights-in-mozambique/>.

45 United States Agency for International Development, *Mozambique: Property Rights and Resource Governance Profile* (Washington, DC: United States Agency for International Development, 2011), [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Mozambique\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Mozambique_Profile.pdf).

46 German Technical Cooperation Agency (GTZ) and Sofala Commercial and Industrial Association (ACIS), *The Legal Framework for Recognising and Acquiring Rights to Rural Land in Mozambique* (GTZ and ACIS, 2007), [http://www.embamoc.co.za/\\_literature\\_124775/Legal\\_Framework\\_for\\_acquiring\\_land\\_rights\\_in\\_Mozambique\\_Edition\\_1](http://www.embamoc.co.za/_literature_124775/Legal_Framework_for_acquiring_land_rights_in_Mozambique_Edition_1); and United States Agency for International Development, *Mozambique: Property Rights and Resource Governance Profile* (Washington, DC: United States Agency for International Development, 2011), [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Mozambique\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Mozambique_Profile.pdf).

47 German Technical Cooperation Agency (GTZ) and Sofala Commercial and Industrial Association (ACIS), *The Legal Framework for Recognising and Acquiring Rights to Rural Land in Mozambique* (GTZ and ACIS, 2007), [http://www.embamoc.co.za/\\_literature\\_124775/Legal\\_Framework\\_for\\_acquiring\\_land\\_rights\\_in\\_Mozambique\\_Edition\\_1](http://www.embamoc.co.za/_literature_124775/Legal_Framework_for_acquiring_land_rights_in_Mozambique_Edition_1).

48 Adrian Frey, *Land Law Legislation* (Maputo: MozLegal Lda, 2004), <http://www.doingbusiness.org/-/media/FPDKM/Doing%20Business/Documents/Law-Library/Mozambique-Land-Law-Legislation.pdf>.

A DUAT itself cannot be bought, sold, or used as collateral to secure credit.<sup>49</sup> However, improvements and assets on DUATs in urban areas can be transferred,<sup>50</sup> though they must first be approved by the same authority that originally approved the DUAT.<sup>51</sup>

- **Government and private sector:** State Owned Enterprises (SOEs) dominate a variety of sectors, from telecommunications to transport and utility services, such as electricity. The state has recently privatized many publicly owned enterprises,<sup>52</sup> and the government has introduced reforms to promote free-market competition. For example, Mozambique adopted a new Competition Law in 2013 that applies to both private enterprises and SOEs. However, this new legislation has not created a level playing field, as reports of SOEs receiving favorable treatment, such as state subsidies and delayed tax payments, have continued.<sup>53</sup>
- **Government incentives for foreign investors:** A variety of investment incentives are available to both foreign and domestic investors in Mozambique. These include:
  - VAT exemption on certain capital goods during the first five years of a project's implementation.<sup>54</sup>
  - Credits on taxable income for projects located in certain rural provinces.<sup>55</sup>
  - Tax deductions based on modernizing equipment and training Mozambican workers.<sup>56</sup>

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49 United States Agency for International Development, *Mozambique: Property Rights and Resource Governance Profile* (Washington, DC: United States Agency for International Development, 2011), [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Mozambique\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Mozambique_Profile.pdf).

50 Regardless of where the land is located, an urban area is defined as any where income is primarily derived from private property, such as buildings, that has been developed on the land, whereas a rural area is any where the primary source of income is from the land itself. Zaida Kathrada, "Acquiring Land Rights in Mozambique," Norton Rose Fulbright, August 26, 2014, <http://www.financialinstitutionslegalsnapshot.com/2014/08/acquiring-land-rights-in-mozambique/>.

51 *Ibid.*

52 US Department of State, "Mozambique Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241884.pdf>.

53 The government has also at times unpredictably intervened in the economy. For example, the government partnered with a Chinese bank in 2012 to establish the Chokwe Agro-Processing Complex to process rice and preserve horticultural products. This decision was made without consulting the private sector, despite the fact that two rice-processing plants were already operating below capacity in the area due to difficulties accessing raw materials. "China Funds \$60 million Agro Industrial Complex in Mozambique," AidData, 2012, <http://china.aiddata.org/projects/31128?iframe=y>; Elin Cohen, Thomas Selemane, and Mariam Umarji, *The State's Engagement in Business in Mozambique* (Washington, DC: United States Agency for International Development, 2014), <http://www.speed-program.com/wp-content/uploads/2014/08/2014-SPEED-Report-011-The-states-engagement-in-Business-EN.pdf>; and US Department of State, "Mozambique Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241884.pdf>.

54 MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (Lex Mundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>.

55 "Investment Incentives," High Commission of the Republic of Mozambique in London, 2008 [http://www.mozambiquehighcommission.org.uk/?id\\_w=7&id\\_w1=31](http://www.mozambiquehighcommission.org.uk/?id_w=7&id_w1=31).

56 MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (Lex Mundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>.

- **Exit opportunities/restrictions on exits:** Companies are able to repatriate capital, profits, dividends, royalties, interest, and loan repayments, provided that: (1) the investment was larger than MZN 2.5 million (approximately USD 65,500 as of July 31, 2015),<sup>57</sup> (2) the investment was approved by the Investment and Promotion Center (CPI),<sup>58</sup> and (3) the approved investment was registered with the Banco de Moçambique (BoM), the central bank, within 90 days of approval.<sup>59</sup> Foreign investors who fail to meet all the requirements of the Investment Law are not allowed to remit funds.<sup>60</sup>
- **Forex controls:** BoM approval is required for all transactions by private individuals exceeding USD five thousand,<sup>61</sup> for non-residents who wish to open bank accounts in foreign currencies, for issuance of credit to residents in foreign currency, for all foreign capital transactions between residents and non-residents, and for the transfer of liquid instruments into and out of the country.<sup>62</sup> Obtaining approval for foreign exchange transactions can be a lengthy process, as it requires the Ministry of Economy and Finance to clear a foreign investor of any tax obligations. Investors are advised to ensure that clearance to carry out foreign exchange transactions is included in their documents regarding investment approval and registration.<sup>63</sup>
- **Required local shareholding:** There are restrictions on foreign participation in certain sectors of the economy. For example, foreign ownership of media companies is limited to a maximum of 20 percent of share capital,<sup>64</sup> and half of the share capital of foreign entities engaged in aviation,<sup>65</sup> explosives,<sup>66</sup> and mineral

57 Abreu Advogados, *Corporate Law in Mozambique* (2011), <http://www.esi-africa.com/wp-content/uploads/Dr-Rocha.pdf>.

58 “Star Up Procedures,” Centro de Promoção de Investimentos, <http://www.cpi.co.mz/index.php/en/start-up-procedures>; and MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (LexMundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>.

59 All foreign investment transactions that have not been registered are considered illegal, offenses which are punishable by fine and forfeit of all amounts and instruments involved to the State. MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (LexMundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>; and US Department of State, “Mozambique Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241884.pdf>.

60 MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (LexMundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>.

61 US Department of State, “Mozambique Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241884.pdf>.

62 MLGTS Legal Circle, *Guide to Doing Business: Mozambique* (LexMundi, 2012), <http://www.lexmundi.com/Document.asp?DocID=5680>.

63 US Department of State, “Mozambique Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241884.pdf>.

64 Abreu Advogados, *Corporate Law in Mozambique* (2011), <http://www.esi-africa.com/wp-content/uploads/Dr-Rocha.pdf>.

65 Samuel J. Levy, “Doing Business in Mozambique,” Thomson Reuters Practical Law, June 1, 2012, <http://us.practicallaw.com/9-520-6505#a250642>.

66 *Ibid.*

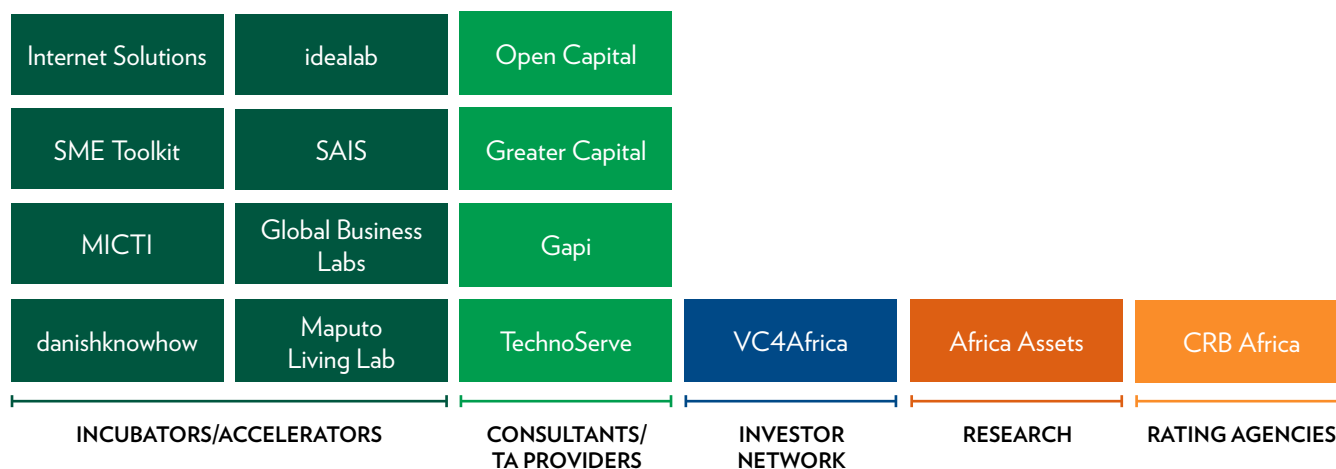
trading must be held by Mozambican nationals or companies.<sup>67</sup>

- **Quotas on foreign labor:** The government maintains strict quotas on the number of foreign employees Mozambican businesses can employ, limiting them as follows:<sup>68</sup>
  - 10 percent of all employees may be foreign for businesses with up to 10 employees;
  - Eight percent may be foreign for businesses with 11 to 100 employees; and
  - Five percent may be foreign for businesses with over 100 employees.

## Ecosystem Players

The research team identified 15 active ecosystem organizations (see Figure 14), and though not all of these had a local presence, the number who do is growing. In addition, there are a number of individual consultants. Several of the impact investors and entrepreneurs interviewed reported working with local ecosystem players on a project-by-project basis, though the small number of active investors has limited the growth of the ecosystem.<sup>69</sup> Investors noted that given low deal flows, they have been able to support their investees with one or two in-house staff on the ground.<sup>70</sup> Encouragingly, many of the smaller ecosystem players active in Mozambique have launched recently, suggesting that the sector as a whole may be growing.<sup>71</sup>

FIGURE 14. SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Note: Chart focuses on the legal framework for financing in Mozambique, as well as Caldeira Advogados da 2010; [http://www.scaldeira.com/index.php/pt/publicacoes/relatorios/doc\\_download/340-introducao-ao-quadro-legal-sobre-o-sector-mineiro-em-mocambique-segunda-edicao](http://www.scaldeira.com/index.php/pt/publicacoes/relatorios/doc_download/340-introducao-ao-quadro-legal-sobre-o-sector-mineiro-em-mocambique-segunda-edicao). Source: Open Capital research; organization websites.

68 “Corporate Immigration Mozambique,” Law Business Research, September 29, 2014, <https://gettingthedealthrough.com/area/47/jurisdiction/137/corporate-immigration-mozambique/>.

69 Open Capital Interviews.

70 *Ibid.*

71 *Ibid.*

As in much of the region, Mozambique's ecosystem predominantly comprises incubators and accelerators focusing on seed or very early, venture-stage businesses in specific sectors, such as information and communication technology (ICT). The relatively small number of growth-stage businesses has limited the opportunity for service providers to provide tailored support to SMEs. As Mozambique's economy continues to grow, service providers should see increased opportunities to provide support to businesses.

## Other Ecosystem Players

In addition to intermediaries, a number of accountants, lawyers, and other service providers are active in Mozambique, though, like all educated professionals in the country, they tend to be scarce and expensive. It can be challenging, particularly for small companies, to develop clear financial documentation and obtain high-quality legal representation. Several of the major global professional-services firms have local offices in Maputo, but their services are rarely affordable for early-stage businesses.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Given the lack of competition, pressing need for capital, and positive overall economic outlook, Mozambique offers opportunities for impact investors to generate both social and financial returns. The current investing landscape presents a clear gap that impact capital could fill. However, impact investors seeking to place capital will face the following challenges:

- **Poor infrastructure:** Though its civil war has been over for two decades, Mozambique's infrastructure remains underdeveloped outside Maputo. The existing transportation infrastructure is under increasing pressure as the extractives industry taps large coal and gas reserves. Fewer than 15 percent of Mozambicans are connected to the national grid; the majority of generated electricity is exported to South Africa.<sup>72</sup> Moreover, near-term demand for electricity is expected to grow approximately 15 to 20 percent annually, compared to just an 11 percent expected annual increase in supply.<sup>73</sup> Large-scale investment is required to keep pace with the growth of the extractives industry and its associated use of infrastructure. Overall, these infrastructure limitations, in combination with Mozambique's vast

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72 Electricidade de Moçambique, <http://www.edm.co.mz/>; and Embassy of the United States in Mozambique, "An Overview of Trade and Investment Opportunities in Mozambique" (Maputo: United States Department of State), <http://maputo.usembassy.gov/uploads/images/FYOezSg1q1quHkgFR8kMg/Invop.pdf>.

73 *Ibid.*

geography, can increase the costs of placing capital and monitoring portfolio companies.

- **Workforce:** Interviewees reported that one of the primary challenges they face in Mozambique is the population's low levels of education and the corresponding difficulty sourcing qualified staff to scale.<sup>74</sup> Qualified domestic labor is often entirely absorbed by the extractive industries, which creates additional demand for skilled foreign and vocationally educated labor. The lack of skilled labor has been partly offset by an influx of unemployed Portuguese moving to Mozambique in search of work.<sup>75</sup> The scarcity of local labor is particularly acute because Mozambique's labor laws, discussed above, restrict the number of foreign employees a Mozambican business can employ.
- **Crowding-out by donor funding:** Owing to historically high levels of poverty and poor scores on development indicators, Mozambique has been a major destination for foreign aid. Some impact investors interviewed noted that the abundance of donor funding in Mozambique has made return-seeking capital less attractive to businesses that believe that they can source cheaper capital from donors.<sup>76</sup> With a limited entrepreneurial landscape and few investable businesses, many attractive SMEs are able to meet their financing needs through grants or soft loans. If these businesses are able to continue to grow, however, impact investors should be well-positioned to provide additional rounds of growth capital.
- **Potentially high due-diligence and monitoring costs:** Given that most non-DFI impact investors lack a local presence and because of the time and difficulty associated with evaluating business opportunities outside of Maputo, due-diligence and ongoing portfolio-monitoring costs can be relatively high, especially considering the low average deal size for non-DFI impact investors.
- **Language and culture:** Investors must adapt in Mozambique to using Portuguese, which makes due diligence and investment more difficult. In addition, Mozambique's legal system is founded on civil law, not the English common-law system familiar to Anglophone impact investors. This different legal foundation can create misaligned expectations and increase the cost of legal due diligence.
- **Insufficient investment-ready deal flow:** Due to the historical underdevelopment of the private sector, interviewees suggested that there are only a limited number of businesses that are investment-ready and willing to accept external capital. For example, many enterprises operate informally, lacking the historical records and forward-looking strategies and projections needed to attract external capital. Family businesses often have a longer track record, but they tend to be less willing to accept external capital.

Despite the many challenges impact investors face, there are opportunities to deploy capital in return-seeking investments in Mozambique that can help drive economic

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74 Danish Trade Union Council for International Development Cooperation, *Mozambique Labour Market Profile* (2014), [http://www.ulandssekretariatet.dk/sites/default/files/uploads/public/PDF/LMP/Imp\\_mozambique\\_2014\\_final\\_version.pdf](http://www.ulandssekretariatet.dk/sites/default/files/uploads/public/PDF/LMP/Imp_mozambique_2014_final_version.pdf).

75 *Ibid.*

76 Open Capital Interviews.

development and job creation. Areas of opportunity for impact investors include:

- **Utilize TA facilities for the pre-investment pipeline:** As many of the businesses in Mozambique are not ready for investment, pre-investment support is often needed to help them reach a stage where they can raise capital and use disbursed funds effectively. There is an opportunity for impact investors to leverage technical assistance (TA) or grant funding to offset the upfront investment needed to develop investable deals.
- **Establish local presence:** Given the lack of competition, with an on-the-ground presence, local impact investors report having a significant advantage in their ability to source investment opportunities.<sup>77</sup> Only a handful of non-DFI impact investors have staff in Mozambique, despite the market's pressing lack of capital. Impact investors willing to invest resources in Mozambique today have the opportunity to source prime investments and establish a brand before the market becomes more competitive.

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<sup>77</sup> *Ibid.*

- **Work with local partners to navigate bureaucratic and legal landscape:** Interviewees consistently stressed the need to work with local partners and advisors in order to navigate the local context and bureaucracy. Without relationships and local knowledge, interviewees noted, placing capital can be significantly more difficult and costly.<sup>78</sup>
- **Take advantage of development corridors:** As a result of Mozambique's vast size, low population density, and poor infrastructure, many impact investors focus their attention on Maputo. However, many entrepreneurs operate outside Maputo and are overlooked. For impact investors who see these businesses as impactful, it will be necessary to build relationships beyond those in the major economic center. To successfully find and source such opportunities, impact investors should focus on development corridors throughout Mozambique. For example, there are potential opportunities in Biera, one of the most important transportation routes in the region, linking landlocked Zambia, Malawi, and Zimbabwe to the Indian Ocean. Of the ten million hectares of arable land in the area of the Biera corridor, only three percent is currently farmed for commercial purposes.<sup>79</sup>
- **Invest in greenfield projects:** As there are limited investable opportunities and a general lack of skilled management, impact investors with longer time horizons can look to greenfield projects to drive financial and social returns. Over time, investors who have the appetite, experience, and technical know-how to do so can create and grow these new endeavors into future market leaders.

In addition, impact investors in Mozambique see specific opportunities in the following sectors:

- **Agriculture:** There are significant opportunities in Mozambique to invest in primary agriculture. Only 12 percent of Mozambique's arable land has been cultivated,<sup>80</sup> and Mozambique is advantageously situated to reach key Asian export markets, expanding the potential market well beyond the size of Mozambique's own population.<sup>81</sup> In addition to primary production, interviewees highlighted agro-processing as a key opportunity, as many value chains currently have limited domestic value addition.<sup>82</sup>
- **Manufacturing:** Interviewees highlighted potential opportunities in food processing, light manufacturing, beverages, and textile manufacturing.<sup>83</sup> In addition, there are opportunities for investors to work with local companies to

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78 Open Capital Interviews.

79 The US Chamber of Commerce, *Investment Climate Update Mozambique* (2013), <https://www.uschamber.com/sites/default/files/legacy/international/africa/files/Mozambique%20ICU.pdf>.

80 Embassy of the United States in Mozambique, "An Overview of Trade and Investment Opportunities in Mozambique" (Maputo: United States Department of State), <http://maputo.usembassy.gov/uploads/images/FYOezSg1q1quHkgFR8kMg/Invop.pdf>.

81 André A. Santos, Luca M. Roffarello, and Manuel Filipe, *Mozambique* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mozambique\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mozambique_GB_2015.pdf).

82 Open Capital Interviews.

83 *Ibid.*

improve their production practices, help them access capital, transfer technical know-how, train staff, develop products, and expand their market reach. While domestic markets are limited, Mozambique's strategic location provides access to Asian economies, landlocked African nations, and neighboring South Africa. Moreover, Mozambique has a large supply of unskilled labor to support manufacturing.

- **Ancillary services and infrastructure for natural-resource projects:** Monetizing Mozambique's recent natural-resource discoveries will require the development of a range of ancillary support services to meet the coming demand. These industries will spur significant job creation, which may meet some impact investors' investment criteria. In particular, interviewees highlighted opportunities in workforce education, housing, healthcare, and transportation as key areas.<sup>84</sup>
- **Energy:** Only 14 percent of Mozambicans have access to the national electrical grid.<sup>85</sup> Correspondingly, there are opportunities for micro-grid and off-grid solutions, as well as for large-scale power production and distribution.

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84 Open Capital Interviews.

85 Embassy of the United States in Mozambique, "An Overview of Trade and Investment Opportunities in Mozambique" (Maputo: United States Department of State), <http://maputo.usembassy.gov/uploads/images/FYOezSg1q1quHkgFR8kMg/Invop.pdf>.

# ZIMBABWE

OPPORTUNITIES AMID ONGOING  
POLITICAL AND ECONOMIC RISK



# INTRODUCTION

Zimbabwe has experienced considerable economic challenges over the last fifteen years, and its political future remains uncertain. Land reform in 2000 was followed by years of economic decline, mass emigration of Zimbabweans, and one of the worst periods of hyperinflation in history. After a brief rebound following the introduction of a multi-currency regime in 2009, Zimbabwe's economy has once again decelerated sharply since 2012, and extremely low bank liquidity has driven the cost of capital to prohibitive levels. Businesses are often unable to source either needed working capital or capital to invest in new equipment and growth.

At the same time, Zimbabwe boasts one of the best-educated workforces in Southern Africa, along with vast tracts of prime farmland. Before its economic decline, the country was known as the region's breadbasket, as well as one of its economic powerhouses (see Figure 1 for its location in the region). Despite Zimbabwe's current difficulties, significant potential remains, and there are opportunities for investors to realize strong financial returns while driving positive social outcomes.

# COUNTRY CONTEXT

Significant macroeconomic upheaval continues to have strong effects on Zimbabwe’s economy today. In May 2000, the government embarked on “fast-track” land reform, amending the Land Acquisition Act to give the government effectively the power to expropriate land without compensation. The government then seized 110 thousand square kilometers of arable land from white Zimbabwean farmers, cancelled their title deeds, subdivided the pre-existing farms, and settled black Zimbabweans on the land.<sup>1</sup> Ownership of such land remains contested to this day between the government, the original holders of the title deeds, and newly settled persons.



The subdivision of commercial farms and settling of new farmers substantially reduced agricultural output. For example, production of tobacco, the country’s main cash crop, declined by 64 percent between 2000 and 2008.<sup>2</sup> Over the same period, commercial production of maize dropped 76 percent.<sup>3</sup> Between 1998 and 2001, exports contracted by more than 40 percent, from USD 2.1 billion to USD 1.3 billion.<sup>4</sup>

1 John Mutenyo and Brandon Routman, “Nationalization of the Zimbabwe Mining Sector: Another Blunder by the Mugabe Regime?” *The Brookings Institution* (blog), March 11, 2011, <http://www.brookings.edu/research/opinions/2011/03/21-zimbabwe-mining-mutenyo>.

2 Federal Reserve Bank of Dallas, “Hyperinflation in Zimbabwe,” in *Globalization and Monetary Policy Institute Annual Report* (2011), <https://www.dallasfed.org/assets/documents/institute/annual/2011/annual11b.pdf>.

3 *Ibid.*

4 John Mutenyo and Brandon Routman, “Nationalization of the Zimbabwe Mining Sector: Another Blunder by the Mugabe Regime?” *The Brookings Institution* (blog), March 11, 2011, <http://www.brookings.edu/research/opinions/2011/03/21-zimbabwe-mining-mutenyo>.

Large amounts of government spending accompanied this economic decline. Tax revenues did not keep pace with spending, and the poor economic conditions launched a wave of emigration to neighboring countries (roughly 10 percent of Zimbabwe's population had emigrated by 2010), further reducing the available tax base.<sup>5</sup> In response, the government of Zimbabwe printed increasing amounts of money to finance expenditures—notably its involvement in the Second Congolese War<sup>6</sup>—which led to rampant inflation (see below).<sup>7</sup>

In 2009, the government adopted a multi-currency regime, which permitted the US Dollar, the South African Rand, and the Botswanan Pula to be used as legal tender. For several years, the economy rebounded,<sup>8</sup> but growth has since slowed; investors remain wary of country risk in Zimbabwe.<sup>9</sup> Many investors fear that government policy could shift at any time and that executive succession to 91-year-old President Mugabe could spark further instability. In addition, some interviewees expressed continuing fears regarding the expropriation of private property or extortion by government officials.

## Gross Domestic Product

Zimbabwe's gross domestic product (GDP) has been volatile over the last ten years (see Figure 2). Contracting steadily between 2005 and 2007, it plunged roughly 15 percent in 2008 alongside hyperinflation. Since then, GDP has rebounded strongly, averaging 7.5 percent annual growth from 2009 to 2012 after the introduction of the multicurrency regime. Since 2012, the economy has slowed significantly, dropping from 12.6 percent GDP growth at purchasing power parity (PPP) in 2012 to six percent growth in 2013 and 4.7 percent growth in 2014.<sup>10</sup>

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5 Federal Reserve Bank of Dallas, "Hyperinflation in Zimbabwe," in *Globalization and Monetary Policy Institute Annual Report* (2011), <https://www.dallasfed.org/assets/documents/institute/annual/2011/annual11b.pdf>.

6 "Mugabe's Costly Congo Venture," BBC News, July 25, 2000, <http://news.bbc.co.uk/2/hi/africa/611898.stm>.

7 Federal Reserve Bank of Dallas, "Hyperinflation in Zimbabwe," in *Globalization and Monetary Policy Institute Annual Report* (2011), <https://www.dallasfed.org/assets/documents/institute/annual/2011/annual11b.pdf>.

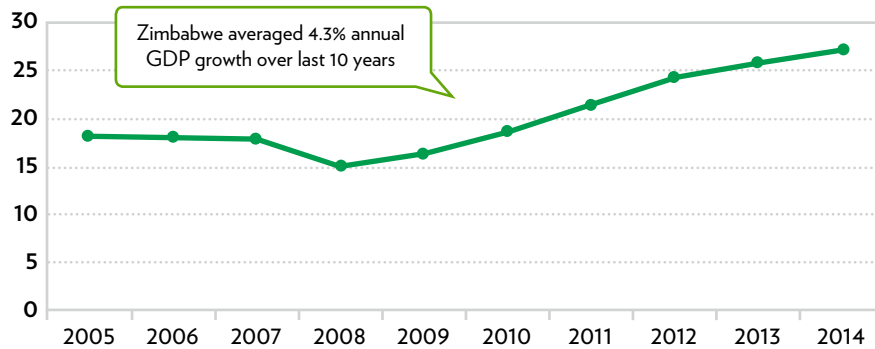
8 *Ibid.*

9 Open Capital Interviews.

10 *World Economic Outlook*, (Washington, DC: International Monetary Fund, 2015), <http://www.imf.org/external/pubs/ft/weo/2015/01/pdf/text.pdf>.

FIGURE 2. GDP (PPP), 2005–2014

USD BILLIONS



Source: IMF World Bank Economic Outlook, April 2015

Meanwhile, Zimbabwe is de-industrializing. Driven by aging machinery, a high cost of production, cheap imports, tight liquidity conditions, higher input costs, and inconsistent electric power, industrial capacity utilization stood at just 36.3 percent in 2014, declining more than three percent from its already low base of 39.6 percent in 2013.<sup>11</sup> This low utilization rate has led many manufacturing businesses to become unprofitable and close. By contrast, South Africa’s industrial utilization stood at 81.5 percent in the first quarter of 2015.<sup>12</sup>

Across sectors, the economy also continues to shed formal businesses in favor of the informal sector. Though challenging to collect statistics tracking the informal sector, Zimbabwe’s 2014 Labour Force Survey estimated that the informal economy now provides 94.5 percent of all jobs, up more than 10 percentage points over three years from 84.2 percent in 2011.<sup>13</sup> Though interviewees noted that government statistics are frequently unreliable, they widely acknowledged that the economy is rapidly becoming increasingly informal.<sup>14</sup>

11 Mary Manneko Monyau and Amarakoon Bandara, *Zimbabwe* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zimbabwe\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zimbabwe_GB_2015.pdf); and “Capacity Utilization Rate,” Investopedia, <http://www.investopedia.com/terms/c/capacityutilizationrate.asp>. Industrial capacity utilization is the “rate at which potential output levels are being met or used.”

12 “South Africa Capacity Utilization,” Trading Economics, <http://www.tradingeconomics.com/south-africa/capacity-utilization>.

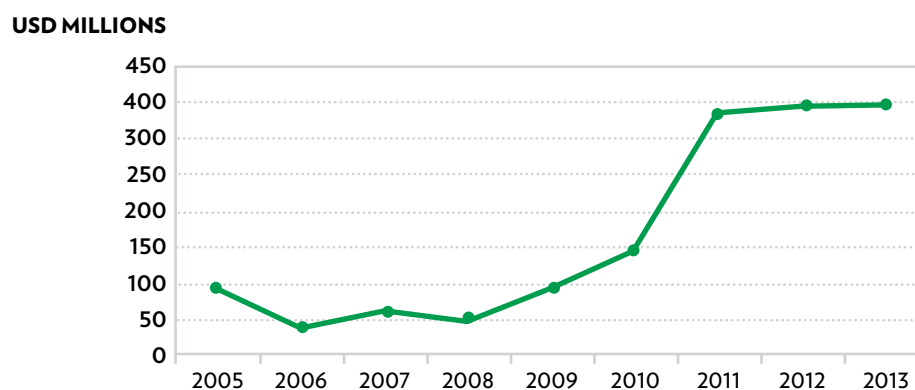
13 Zimbabwe National Statistics Agency, 2014 *Labour Force Survey* (2015), [http://www.zimstat.co.zw/dmdocuments/Labour/Labour\\_2014.pdf](http://www.zimstat.co.zw/dmdocuments/Labour/Labour_2014.pdf).

14 Open Capital Interviews.

## Foreign Direct Investment

Until the economic rebound in 2009, net flows of foreign direct investment (FDI) into Zimbabwe were meager, averaging just USD 35 million per year between 2000 and 2009 (see Figure 3).<sup>15</sup> However, net FDI flows increased following the introduction of the multi-currency regime, rapidly growing to roughly USD 400 million annually before plateauing in recent years.<sup>16</sup> The primary sources of FDI are China, Mauritius, and South Africa.<sup>17</sup>

FIGURE 3. FDI FLOWS, 2005–2013



Source: UNCTAD

## Hyperinflation and Exchange Rates

Between February 2007 and the 2009 introduction of the multi-currency regime, Zimbabwe experienced hyperinflation, defined as an inflation rate above 50 percent per month.<sup>18</sup> At its peak, inflation in Zimbabwe was among the worst ever recorded globally. In July 2008, inflation stood at a staggering 2,600 percent per month, or more than 231 million percent annually.<sup>19</sup> By September 2008, the International Monetary Fund (IMF) had estimated annual inflation at 489 billion percent.<sup>20</sup> Businesses that quoted prices in local currency updated these prices several times

15 John Mutenyo and Brandon Routman, “Nationalization of the Zimbabwe Mining Sector: Another Blunder by the Mugabe Regime?” e (blog), March 11, 2011, <http://www.brookings.edu/research/opinions/2011/03/21-zimbabwe-mining-mutenyo>. Note that as of this writing, UNCTAD data are not available for net FDI flows for 2014.

16 United Nations Conference on Trade and Development, <http://unctad.org/en/Pages/Home.aspx>.

17 “FDI in Zimbabwe,” Zimbabwe Investment Authority, [http://www.investzim.com/index.php?option=com\\_content&view=article&id=272&Itemid=685](http://www.investzim.com/index.php?option=com_content&view=article&id=272&Itemid=685).

18 Steve H. Hanke, “R.I.P Zimbabwe Dollar,” Cato Institute, February 5, 2009, <http://www.cato.org/zimbabwe>.

19 Federal Reserve Bank of Dallas, “Hyperinflation in Zimbabwe,” in Globalization and Monetary Policy Institute Annual Report (2011), <https://www.dallasfed.org/assets/documents/institute/annual/2011/annual11b.pdf>.

20 *Ibid.*

daily.<sup>21</sup> Zimbabwean Dollars lost nearly all value, and all accumulated local-currency debts, reserves, and savings were wiped out in a matter of months.

In response, most transactions shifted to US Dollars or other hard currencies. In February 2009, the government of Zimbabwe officially adopted a multi-currency regime, accepting the US Dollar, the South African Rand, and the Botswanan Pula as legal tender. The US Dollar today remains the dominant currency in Zimbabwe, even as the list of accepted currencies has grown to nine.<sup>22</sup>

Though historical inflation rates are skewed by hyperinflation and interviewees expressed skepticism at attempts to calculate precise rates, Zimbabwe is likely presently experiencing substantial deflationary pressure. Under the multi-currency regime, Zimbabwe has few tools to manage deflation and is experiencing a net outflow of US Dollars. For example, Zimbabwe has a substantial current-account deficit, with estimated exports of USD three billion compared to imports of USD six billion.<sup>23</sup> The majority of exports are derived from mining, which is capital-intensive and linked weakly to the rest of the economy, further reducing US Dollar availability.<sup>24</sup> Remittances, estimated in 2013 at USD 1.8 billion, only partially offset these outflows.<sup>25</sup> These reductions in the total money supply apply strong downward pressure on inflation, particularly in the context of an economy that continues to grow, albeit slowly. External factors have additionally contributed to deflation, including a weak South African Rand and low international oil prices.<sup>26</sup>

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21 Federal Reserve Bank of Dallas, "Hyperinflation in Zimbabwe," in *Globalization and Monetary Policy Institute Annual Report* (2011), <https://www.dallasfed.org/assets/documents/institute/annual/2011/annual11b.pdf>.

22 Reserve Bank of Zimbabwe, *Exchange Control Operational Guidelines and Compliance Framework to Authorized Dealers on Re-designation of Foreign Accounts and a Review of Exchange Control Measures* (2015), <http://www.cfuzim.org/images/rbzrq76.pdf>. The legally recognized currencies are the: US Dollar, Euro, British Pound, South African Rand, Chinese Renminbi, Australian Dollar, Japanese Yen, Indian Rupee, and Botswana Pula.

23 John Robertson (lecture, Central Africa Building Society [CABS] Head Offices, Harare, Zimbabwe, July 29, 2015).

24 Mary Manneko Monyau and Amarakoon Bandara, *Zimbabwe* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zimbabwe\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zimbabwe_GB_2015.pdf).

25 "MasterCard Launches Cross-Border Remittance Service in Zimbabwe," MasterCard Incorporated, March 3, 2015, <http://investor.mastercard.com/investor-relations/investor-news/press-release-details/2015/MasterCard-Launches-Cross-Border-Remittance-Service-in-Zimbabwe/default.aspx>.

26 Mary Manneko Monyau and Amarakoon Bandara, *Zimbabwe* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zimbabwe\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zimbabwe_GB_2015.pdf).

# SUPPLY OF IMPACT INVESTING CAPITAL

With 52 impact investments and almost USD 375 million in impact capital disbursed, Zimbabwe ranks in the middle of Southern African countries in terms of total impact capital inflows. Despite these sums, the practical availability of impact capital remains limited for most businesses. Of the roughly USD 107 million disbursed by non-DFI impact investors, almost USD 90 million went to the extractives industry or housing projects. Meanwhile, DFIs placed more than USD 225 million of approximately USD 267 million into projects of USD five million or greater. Notably, between 2001 and 2010, impact investors made just one deal in Zimbabwe.

## Broader Investing Landscape

Zimbabwe is experiencing a severe liquidity crunch, and access to financing remains sharply constrained. In 2012, as many as 43 percent of business owners were financially excluded, and only 18 percent of business owners used formal financial services.<sup>27</sup> Interviewees noted that the liquidity crunch has since intensified.

Nearly half of banks in Zimbabwe face liquidity challenges. Hyperinflation eliminated all debt assets, while the multi-currency regime eliminated all local currency reserves, devastating most banks' balance sheets. Foreign governments have not subsequently offered any large-scale injections of hard currency, meaning that commercial banks have had to rebuild slowly and unevenly. Though the banking sector showed signs of improvement in 2014, the financial sector remains divided between strong (frequently international) banks and weak banks.<sup>28</sup>

Until recently, bank lending rates averaged roughly 20 percent in US Dollar terms. Effective October 1, 2015, interest rates are capped at 18 percent per annum for both new and existing borrowers.<sup>29</sup> With such high rates in hard currency terms, bank financing is unaffordable for all but a tiny minority of businesses. Even if a business were able to afford the interest, banks frequently have high collateral requirements, a particularly restrictive hurdle since much of the agricultural land in Zimbabwe remains contested after the land reforms of the early 2000s. Interviewees report that banks will often not accept such land as collateral, making it very difficult for businesses, particularly agricultural businesses, to get loans.

Beyond commercial banks, there are few alternative sources of capital. The several large-scale microfinance institutions active in the country charge interest rates

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27 FinMark Trust, *FinScope MSME Survey Zimbabwe 2012*, [http://www.finmark.org.za/wp-content/uploads/pubs/FinScope\\_Zimbabwe\\_Broch13FNL.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/FinScope_Zimbabwe_Broch13FNL.pdf).

28 International Monetary Fund, *Zimbabwe* (2015), <http://www.imf.org/external/pubs/ft/scr/2015/cr15105.pdf>.

29 J. P. Mangudya, (Harare: Reserve Bank of Zimbabwe, 2015), <http://www.techzim.co.zw/wp-content/uploads/2015/08/RBZ-Mid-Term-Monetary-Policy-2015.pdf>.

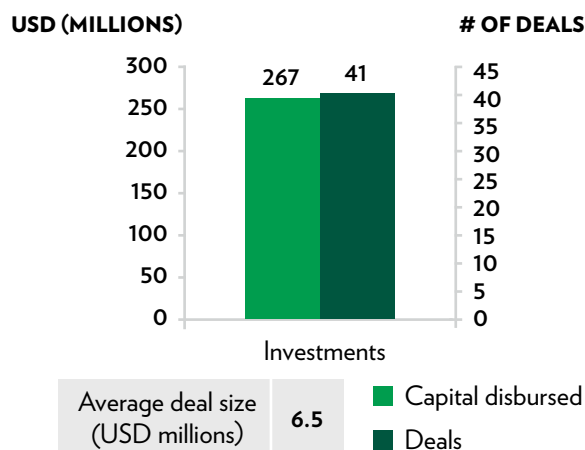
typically between four and five percent per month. As such, they are primarily able to serve traders looking to meet short-term needs for financing but are too expensive to act as longer-term funders.<sup>30</sup>

Interviewees were able to identify only a handful of local funds that actively place capital in Zimbabwe. There are also high-net-worth individuals who invest in local businesses, but they purposefully remain off-the-radar to avoid political risk; thus, they have limited scale and can be difficult to attract without a pre-existing relationship.<sup>31</sup>

## Impact Capital Disbursed

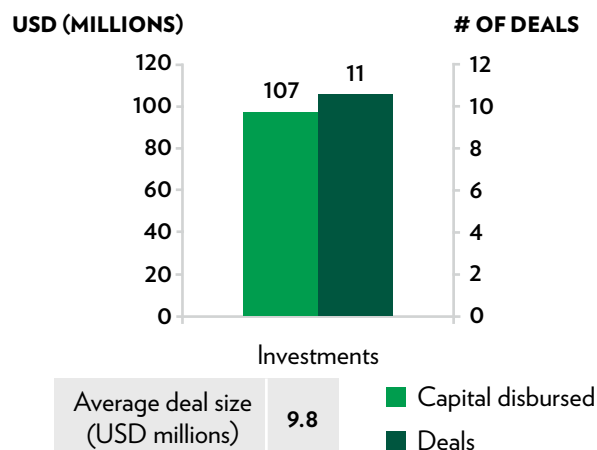
Zimbabwe has seen a modest amount of impact investment activity, ranking sixth in Southern Africa by number of deals and seventh in total impact capital disbursed. As in most of Southern Africa, DFI investments constitute the majority of impact investments; DFIs placed roughly USD 267 million across 41 investments (see Figure 4). Non-DFI impact investors disbursed just over USD 107 million across 11 deals (see Figure 5).

FIGURE 4. DFI IMPACT INVESTMENTS



Source: Open Capital Research

FIGURE 5. NON-DFI IMPACT INVESTMENTS



Source: Open Capital Research

## Investments over time

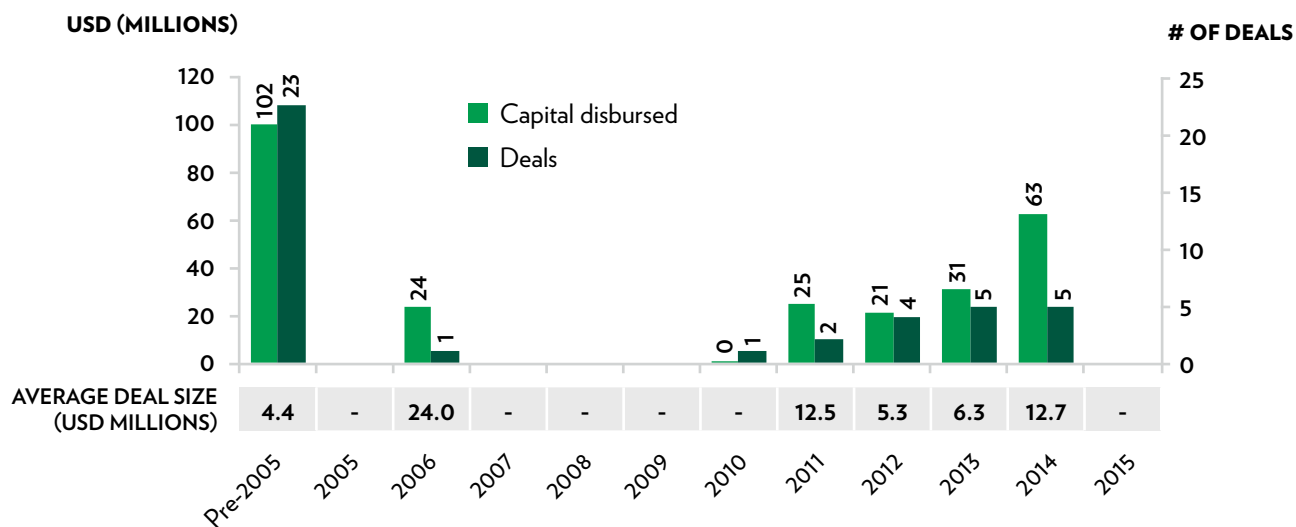
Impact investing activity has paralleled Zimbabwe's macroeconomic trajectory. Notably, though there have been only a handful of non-DFI impact investor deals, most without publically available information, nearly half of known deals occurred before 2000. No non-DFI impact investor placed capital in Zimbabwe between 2000 and 2009, with such investment only returning to the country after the introduction of

<sup>30</sup> Open Capital interviews.

<sup>31</sup> *Ibid.*

the multi-currency regime and the subsequent economic rebound. DFI investments follow the same general trend. More than half of all DFI deals occurred before 2000: between 2001 and 2009, there was only a single DFI investment (see Figure 6). Since the introduction of the multi-currency regime, DFI investments have steadily risen both in number and in total capital disbursed.

FIGURE 6. TOTAL DFI IMPACT INVESTMENTS BY YEAR



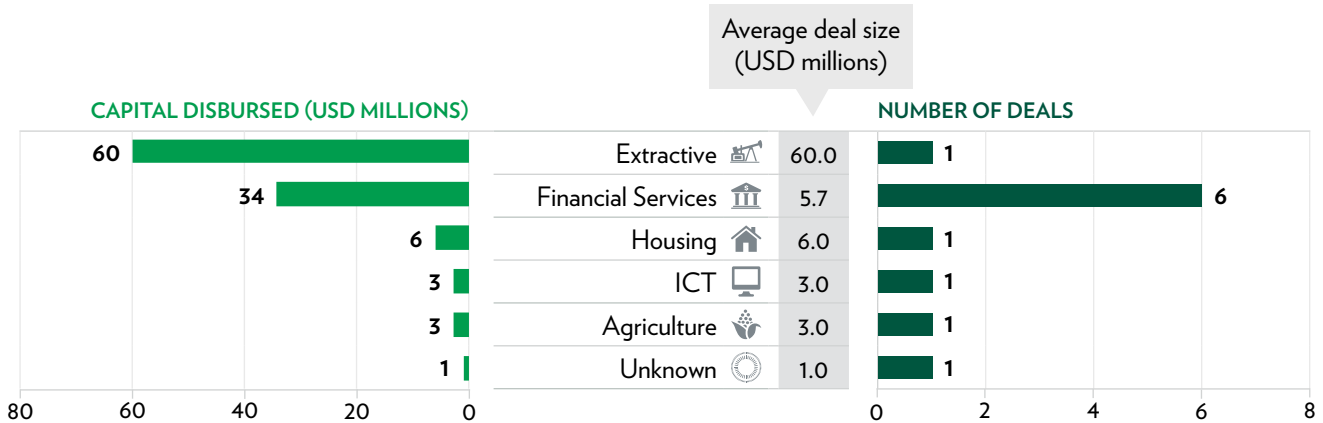
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Sector

Non-DFI impact investment activity has been heavily concentrated in financial services and extractives (see Figure 7). Of the approximately USD 107 million non-DFI impact investors have placed in Zimbabwe, fully USD 60 million was in a single deal acquiring a position in a large gold mine. An additional USD 29 million was placed into banks to finance housing projects in a number of deals by a single non-DFI impact investor. Non-DFI impact investors provided another USD 11 million to a housing project and a financial services provider. As a result, of the entire USD 107 million placed in Zimbabwe by non-DFI impact investors, just USD seven million went to the broader social-enterprise landscape.

**FIGURE 7. NON-DFI DIRECT INVESTMENTS BY SECTOR**

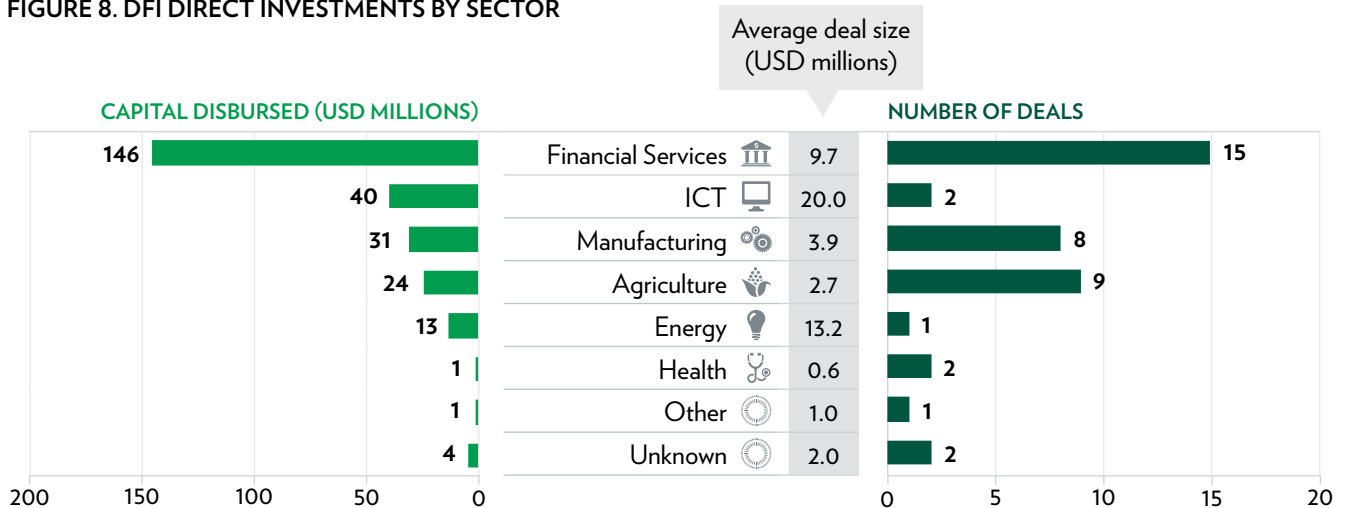


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

DFI impact investors disbursed capital across a wider range of sectors (see Figure 8). Financial services received more than 35 percent of all deals and almost 55 percent of all capital disbursed. Manufacturing constituted nearly another 20 percent of all DFI deals, but with a smaller average deal size, they contributed roughly 10 percent of total DFI disbursements. Similarly, agriculture comprised over 20 percent of total DFI deals but less than 10 percent of total disbursements.

**FIGURE 8. DFI DIRECT INVESTMENTS BY SECTOR**



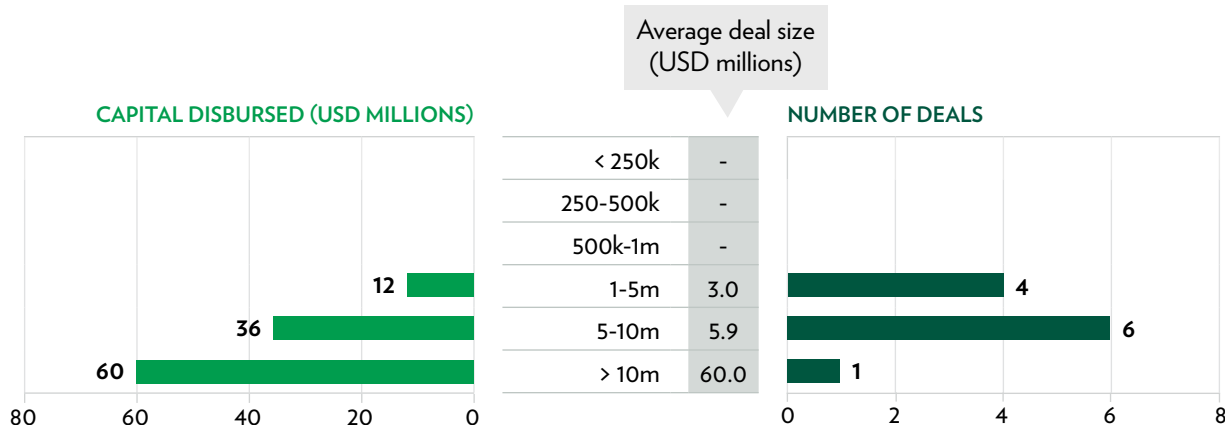
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Deal Size

Non-DFI impact investors did not make any investments in Zimbabwe under USD one million (see Figure 9). Among other countries in the region, only Lesotho, Botswana, and Swaziland likewise had no deals below USD one million, and all three boast fewer than half the number of non-DFI impact investor deals completed in Zimbabwe. Instead, the majority of non-DFI impact investor deals in Zimbabwe were for amounts of USD five million or above.

FIGURE 9. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE

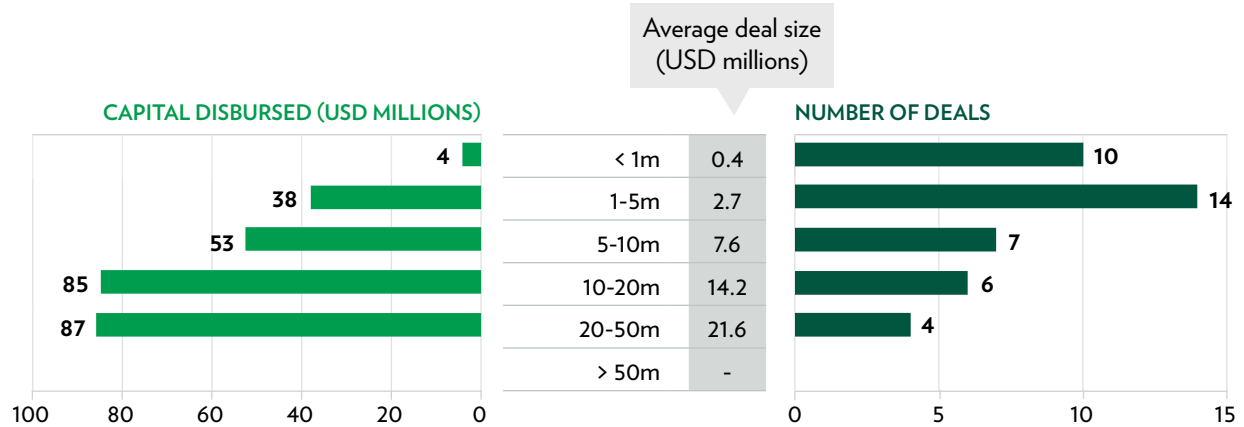


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

By contrast, nearly a quarter of DFI deals were for less than USD one million (see Figure 10). A further 35 percent of deals were for amounts between USD one million and USD five million. Altogether, nearly 60 percent of DFI deals were for less than USD five million. Indeed, at just over USD 6.5 million, Zimbabwe has the lowest average DFI deal size of any country in Southern Africa.

**FIGURE 10. DFI IMPACT INVESTMENTS BY DEAL SIZE**



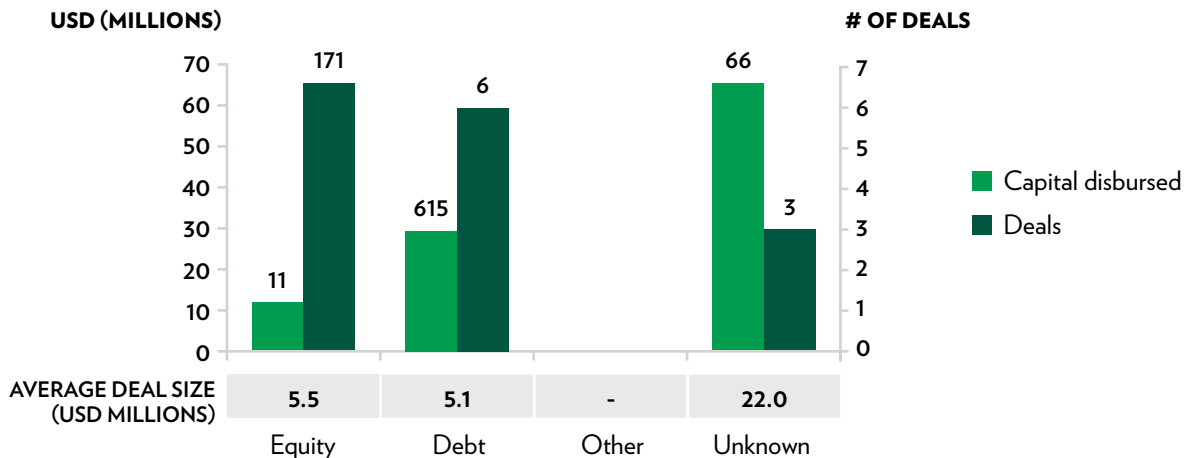
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Instrument

Though a small sample size—few deals have public information—prevents definitive conclusions, non-DFI impact investors appear to prefer self-liquidating debt instruments, potentially reflecting concerns about longer-term equity investments (see Figure 11). No deals were recorded that used any instrument other than debt or equity.

**FIGURE 11. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE**

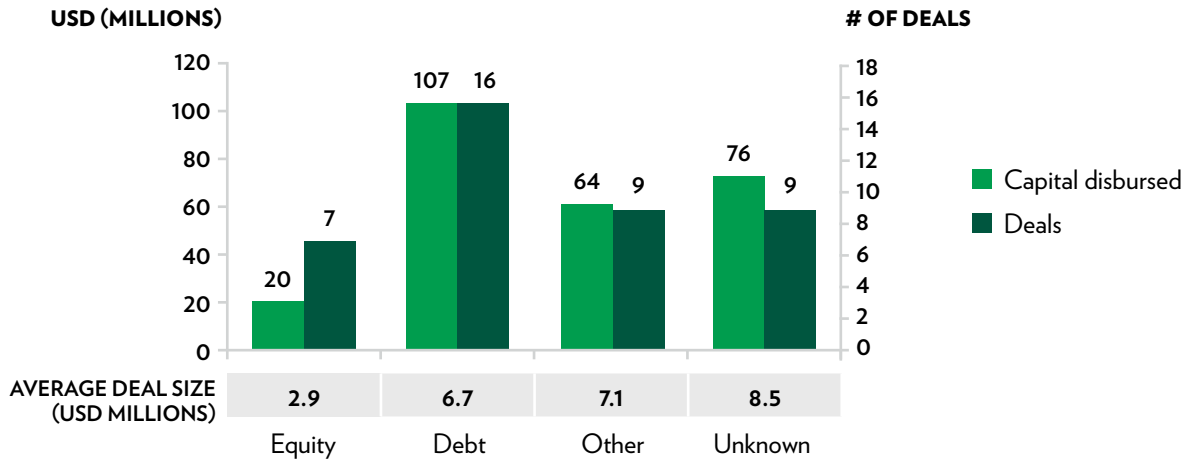


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

Similarly, DFIs also prefer debt instruments, using them in nearly 40 percent of all deals and capital disbursed (see Figure 12). Interestingly, DFIs also used quasi-equity instruments in nearly 20 percent of deals in Zimbabwe,<sup>32</sup> exceeding even their use of standard equity instruments. Zimbabwe ties South Africa for the highest number of quasi-equity DFI deals in Southern Africa, despite having but a fraction of the total number of DFI deals completed in the regional powerhouse. Reflecting the predominance of the US Dollar in the multi-currency regime, almost all transactions, regardless of instrument or source, were denominated in US Dollars.

FIGURE 12. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Local Presence

Only a handful of impact investors have a local presence in Zimbabwe, and interviewees identified few private institutional investors in Zimbabwe more generally. Local incorporation remains difficult for private-sector actors as a result of the indigenization policy, which requires that 51 percent of locally incorporated businesses be owned by indigenous Zimbabweans.

Nevertheless, interviewees uniformly stressed that local presence and local knowledge are critical to investing successfully in Zimbabwe. With the country experiencing such rapid changes in the recent past and with continuing uncertainty for the future, interviewees noted that local context was necessary to accurately identify trends. Moreover, with the informal sector increasingly monopolizing the economy, investing in and operating a business in Zimbabwe is heavily relationship-based, even more so than in other countries in the region. To build the necessary trust and rapport, local presence is vital.

<sup>32</sup> The totals for “Other” instruments referenced in Figure 12 predominantly include these quasi-equity instruments but also include a credit guarantee instrument.

## Impact Tracking Standards

As in the rest of Southern Africa, interviewees reported that impact investors placing capital in Zimbabwe do not use a specific standard for measuring impact but instead customize impact tracking metrics to each investment. Interviewees noted that this customization reduces the administrative burden on portfolio businesses and allows impact investors to focus on the most meaningful metrics.

# DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital in Zimbabwe. With the severe liquidity crunch, businesses have difficulty sourcing the capital they need to grow. Moreover, Zimbabwe continues to face significant development gaps that create opportunities for businesses that fill key needs while also realizing financial returns.

## Development Context

Zimbabwe is classified as a low human development country, ranking 156<sup>th</sup> out of 187 countries on the United Nations Human Development Indicators (HDI) index (see Table 1).<sup>33</sup> Zimbabwe has a score of 0.49, and though its indicators have improved in recent years, it remains well below the global average of 0.69.

TABLE 1. SELECTED ZIMBABWE DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Zimbabwe	Regional Average	Global Average
HDI SCORE (RANKS 156 <sup>TH</sup> OF 187 COUNTRIES)	0.49	0.55	0.69
GDP PER CAPITA (USD, PPP)	1,337	6,874	17,975
UNEMPLOYMENT RATE (%)	5	13	6
POPULATION BELOW USD 1.25 / DAY (%)	No available data	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	90	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	55	41	59

33 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

The most recent United Nations Human Development Report did not estimate a percentage of Zimbabweans living on less than USD 1.25 per day, but more than 70 percent of the population is below the national poverty line,<sup>34</sup> and rural poverty by that standard increased from 63 percent in 2003 to 76 percent in 2014.<sup>35</sup> At the same time, the World Bank estimates unemployment at a modest five percent,<sup>36</sup> but this estimate uses a model from the International Labor Organization that relies on old data.<sup>37</sup> Other estimates of unemployment vary remarkably widely, from 11 percent in the latest official labor survey,<sup>38</sup> which used a broad definition of unemployed that does not require those without work to be actively looking for work, to a staggering 95 percent by the country's National Association of Non-Governmental Organisations, which did not identify a specific methodology.<sup>39</sup> Besides widespread poverty and potentially extraordinary unemployment rates, Zimbabwe has under-five mortality rates nearly double the global average.<sup>40</sup> In addition, the country has experienced a rising prevalence of HIV, increasing from 14.3 percent in 2012 to 15.0 percent in 2013.<sup>41</sup>

Reflecting its history of strong investment in education, more than half of the population has some secondary education, which is nearly equal to global averages and significantly better than the regional average. However, gross secondary enrollment stands at just 26 percent, which is the lowest in Southern Africa and less than half the regional average. This agrees with statements from interviewees, who report that educational quality has fallen dramatically over the past decade and that government schools are now in very poor condition.

This deterioration threatens to erode a traditional national strength: Zimbabwe's well-educated workforce. This is particularly worrying given Zimbabwe's skewed age demographics (see Figure 13). Youth under the age of 25 make up more than 65 percent of the total population, and those under 35 are more than 80 percent of the total population. This sharply skewed age profile can be explained in part by the large-scale emigration during the country's macroeconomic upheavals. With such a high proportion of youth, declining educational quality could rapidly diminish the availability of skilled labor.

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34 United Nations Development Programme, "Zimbabwe Explanatory Note on 2013 Human Development Report Composite Indices," <http://hdr.undp.org/sites/default/files/Country-Profiles/ZWE.pdf>.

35 *Ibid.*

36 *The World Bank: Data*, s.v. "Zimbabwe" in "Unemployment," <http://data.worldbank.org/indicator/SL.UEM.TOTL.ZS>.

37 Sintha Chiumia, "Is Zimbabwe's Unemployment Rate 4%, 60% or 95%? Why the Data is Unreliable," Africa Check, October 1, 2014, <https://africacheck.org/reports/is-zimbabwes-unemployment-rate-4-60-or-95-why-the-data-is-unreliable/>.

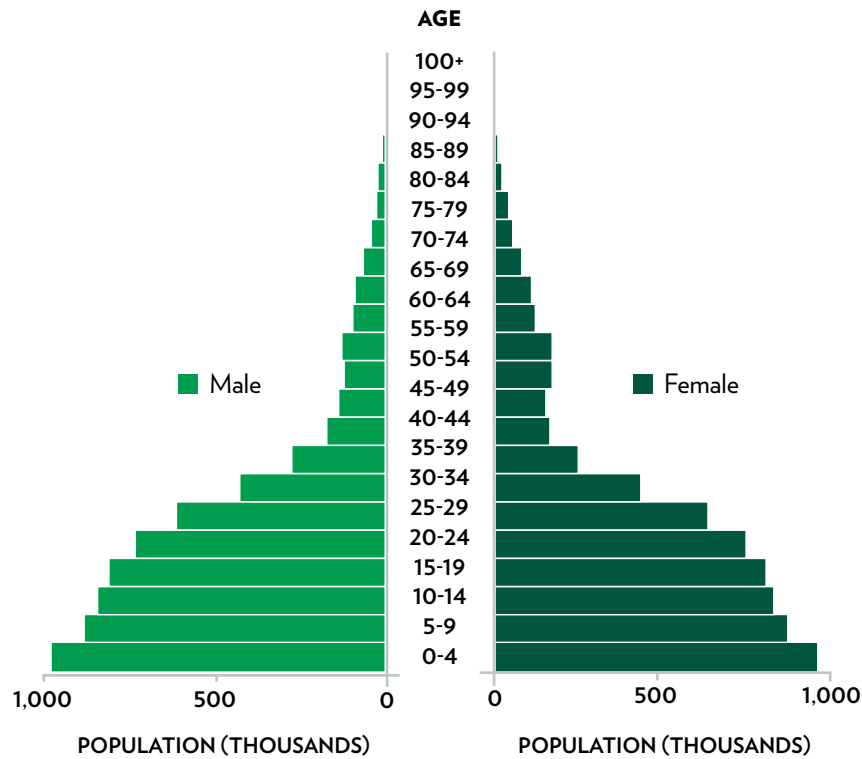
38 Zimbabwe National Statistics Agency, 2014 *Labour Force Survey* (2015), [http://www.zimstat.co.zw/dmdocuments/Labour/Labour\\_2014.pdf](http://www.zimstat.co.zw/dmdocuments/Labour/Labour_2014.pdf).

39 Sintha Chiumia, "Is Zimbabwe's Unemployment Rate 4%, 60% or 95%? Why the Data is Unreliable," Africa Check, October 1, 2014, <https://africacheck.org/reports/is-zimbabwes-unemployment-rate-4-60-or-95-why-the-data-is-unreliable/>.

40 United Nations Development Programme, 2014 *Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

41 United Nations Development Programme, "Zimbabwe Explanatory Note on 2013 Human Development Report Composite Indices," <http://hdr.undp.org/sites/default/files/Country-Profiles/ZWE.pdf>.

FIGURE 13. POPULATION BY AGE AND GENDER



Source: UN ESA, World Population Prospects

## Entrepreneurs

Access to capital is the primary constraint facing entrepreneurs in Zimbabwe. As discussed above, a severe liquidity crunch has made capital difficult to access. Even when available, bank interest rates are often above 20 percent in US Dollar terms, which makes bank loans impractical for all but a few, extremely high-margin businesses. In some instances, entrepreneurs may be able to receive funding from high-net-worth individuals, but these investments are often informal and constrained to existing relationships. As a result, most businesses must fund growth out of their own cash flows, which limits their potential.

Political risk also remains a concern for entrepreneurs, so many choose to operate informally rather than engage with government systems. Interviewees were split on their assessments of the risk of expropriation or extortion, but their divided opinion clearly indicates that uncertainty remains around the effect of operating “above the radar.” The potential or perceived danger associated with growing too large limits the possible scale a business can achieve.

For businesses seeking to formalize, full compliance with government regulations is time-consuming and expensive. For example, it takes an estimated 90 days to start

a business, and doing so costs nearly 115 percent of average per capita income.<sup>42</sup> After starting the business, any additional regulatory requirements—such as those for registering property, getting electricity, or obtaining construction permits—take additional time and expense. Zimbabwe ranks 171<sup>st</sup> out of 187 in the World Bank’s “Ease of Doing Business” rankings.

For entrepreneurs who do not meet the definition of “indigenous,”<sup>43</sup> the indigenization policy can be a substantial barrier. By requiring 51 percent “indigenous” ownership, the policy means that non-indigenous entrepreneurs must cede ownership and potentially control of their businesses to their partners. As trusted indigenous partners may not have the capital or time to contribute to the business, entrepreneurs may as a result part with a large part of the business for less than its true value. The required indigenous ownership can also strongly reduce the financial incentive for entrepreneurs to grow their businesses.

Many entrepreneurs also struggle to compete with cheaper imports. The macroeconomic fluctuations over the past 15 years have prevented many businesses from investing in upgrading aging equipment, which raises their cost of production relative to businesses in neighboring countries, such as South Africa. In addition, Zimbabwe faces a significant power deficit;<sup>44</sup> regular load shedding can last as long as sixteen hours a day,<sup>45</sup> though interviewees estimated that load shedding lasts on average between six and eight hours a day.<sup>46</sup> To compensate for load shedding, many businesses operate diesel generators, which increase costs.

Entrepreneurs in Zimbabwe, however, benefit from a robust market for talent. Reflecting a history of investment in education, in 2014 Zimbabwe had the highest literacy rate in Africa—91 percent—and its population is widely acknowledged to be very well-educated in general.<sup>47</sup> The resulting broad market for managers and middle management is currently further supplemented by broader economic deterioration as talented managers become available after their previous companies decline.

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42 Mary Manneko Monyau and Amarakoon Bandara, *Zimbabwe* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Zimbabwe\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Zimbabwe_GB_2015.pdf).

43 *Indigenisation and Economic Empowerment Act, 2007* (2008), [http://www.africayouthskills.org/images/pdf/Irg/National\\_Indigenization\\_and\\_Empowerment\\_Act.pdf](http://www.africayouthskills.org/images/pdf/Irg/National_Indigenization_and_Empowerment_Act.pdf). The definition of “indigenous Zimbabwean” is “any person who, before the 18th April, 1980, was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person, and includes any company, association, syndicate or partnership of which indigenous Zimbabweans form the majority of the members or hold the controlling interest.” In effect, this definition refers only to black Zimbabweans.

44 “ZESA Warns of 16-hour Cuts as Winter Demand Surges,” *New Zimbabwe*, May 28, 2015, <http://www.newzimbabwe.com/news-22818-Brace+for+16-hr+daily+power+cuts,+ZESA/news.aspx>.

45 *Ibid.*

46 Open Capital interviews; and “Why Do We Have Load Shedding?” ZESA Holdings Private Limited, <http://www.zesa.co.zw/index.php/component/k2/item/17-why-do-we-have-load-shedding?>. The Zimbabwe Electricity Supply Authority (ZESA), the state-owned company responsible for power generation, transmission, and distribution, estimates that load shedding will be “for not more than 5 hours.”

47 “Zimbabwe leads literacy rate in Africa,” *South African Broadcasting Corporation*, June 12, 2014, <http://www.sabc.co.za/news/a/5c11890044581c8fbd02fd744a7933f3/Zimbabwe-leads-literacy-rate-in-Africa-20140612>; and Open Capital interviews.

Contrasting sharply with most of the rest of Southern Africa, interviewees almost universally noted that it was easy to source capable, experienced staff in Zimbabwe.

Despite this abundance of talent, labor laws create challenges for entrepreneurs, requiring employers to provide long notice periods and generous retrenchment packages. Because these laws make it more expensive and time-consuming to let workers go, businesses face increased overhead costs and struggle to restructure to adapt to changing conditions. At the time of writing, the Supreme Court and the President are revisiting these laws.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

## Regulatory Environment

Government policy in Zimbabwe remains a significant source of concern for investors, who perceive policy as being inconsistently applied and subject to sharp and unpredictable change.<sup>48</sup> At the same time, interviewees noted that Zimbabwe's court system is effective and fair in adjudicating commercial disputes. Well-educated judges give thoughtful, impartial rulings on issues of business law,<sup>49</sup> though interviewees were careful to note that rulings on any politically sensitive matters could be unpredictable. Nevertheless, the general availability of legal recourse for most disputes eases operation.

Several aspects of Zimbabwe's regulatory environment are particularly relevant to entrepreneurs and impact investors planning to place capital in the country:

- **Land ownership:** Land ownership in Zimbabwe remains highly sensitive. As described above, the government embarked on a "fast-track" land reform program in May 2000, amending the Land Acquisition Act to allow the government to acquire land without compensation.<sup>50</sup> The government then effectively seized 110 thousand square kilometers of arable land from white Zimbabwean farmers, cancelled their title deeds, subdivided the pre-existing farms, and settled black Zimbabweans on the land.<sup>51</sup> Ownership of resettled land remains contested to this day among the government, the original holders of the title deeds, and the resettled persons. In March 2015, for instance, a sitting minister of government publicly tried to take over part of a chicken farm in Masvingo province.<sup>52</sup>

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48 Open Capital interviews.

49 *Ibid.*

50 *Land Acquisition Act* (2002), <http://archive.kubatana.net/docs/legisl/landacqact020919.pdf>; and Bronwen Manby et al., *Zimbabwe* (New York: Human Rights Watch, 2002), <http://www.hrw.org/reports/2002/zimbabwe/ZimLand0302-02.htm>.

51 Bill Corcoran, "White Farmers Forced to Flee," *The Irish Times*, September 24, 2005, <http://www.irishtimes.com/news/white-farmers-forced-to-flee-1.496629>.

52 "Mzembi Lose Battle for Lucrative Chicken Farm, to Get New Farm," *Harare24*, May 29, 2015, <http://www.harare24.com/index-id-news-zk-31551.html>.

- **Indigenization and Economic Empowerment Law:** On March 7, 2008, President Robert Mugabe signed into law the Indigenization and Economic Empowerment Act,<sup>53</sup> which stipulates that at least 51 percent of “every public company and any other business” as well as any “projected or proposed investment” should be owned by indigenous Zimbabweans.<sup>54</sup> The term “Indigenous Zimbabwean” is defined to effectively refer only to black Zimbabweans.<sup>55</sup> Though sweeping in its scope, this law has not always been applied consistently. For instance, the Indigenization Law includes exemptions for Chinese companies operating in certain sectors, such as agriculture.<sup>56</sup>
- **Government activity in the private sector:** There are 76 State-Owned Enterprises (SOEs) operating in a number of sectors, including agriculture, energy, telecommunications, public utilities, and transport.<sup>57</sup> SOEs in Zimbabwe have performed poorly in recent years due to a number of factors, including poor management, corruption, improper maintenance, lack of financing, and high executive salaries.<sup>58</sup> Where in competition with private enterprises, SOEs have often received favorable treatment. In 2014, for example, POTRAZ, the SOE responsible for the licensing and regulation of the telecommunications sector,<sup>59</sup> effectively extended for free the operating license for the state-owned mobile phone services operator NetOne by two years,<sup>60</sup> despite the fact that its private-sector competitors were required to pay substantial sums to obtain similar licenses.<sup>61</sup>

53 Wendy Zeldin, “Zimbabwe: Indigenization and Empowerment Act,” *Library of Congress: Global Legal Monitor*, April 2, 2008, <http://www.loc.gov/law/foreign-news/article/zimbabwe-indigenization-and-empowerment-act/>.

54 *Indigenisation and Economic Empowerment Act, 2007* (2008), [http://www.africayouthskills.org/images/pdf/lrg/National\\_Indigenization\\_and\\_Empowerment\\_Act.pdf](http://www.africayouthskills.org/images/pdf/lrg/National_Indigenization_and_Empowerment_Act.pdf); and *Indigenisation and Economic Empowerment (General) Regulations, 2010* (2011), [http://archive.kubatana.net/docs/legisl/indig\\_econ\\_empowrmnt\\_general\\_regs\\_si21\\_110325.pdf](http://archive.kubatana.net/docs/legisl/indig_econ_empowrmnt_general_regs_si21_110325.pdf). The Act was amended in 2010 by the Indigenization and Economic Empowerment (General) Regulations to include the specification that all foreign-owned businesses whose net asset value is USD 500 thousand or above are required to cede within five years a controlling interest of at least 51 percent of shares to indigenous Zimbabweans.

55 *Indigenisation and Economic Empowerment Act, 2007* (2008), [http://www.africayouthskills.org/images/pdf/lrg/National\\_Indigenization\\_and\\_Empowerment\\_Act.pdf](http://www.africayouthskills.org/images/pdf/lrg/National_Indigenization_and_Empowerment_Act.pdf). In the Act, the full definition of “indigenous Zimbabwean” is “any person who, before the 18th April, 1980, was disadvantaged by unfair discrimination on the grounds of his or her race, and any descendant of such person, and includes any company, association, syndicate or partnership of which indigenous Zimbabweans form the majority of the members or hold the controlling interest.”

56 “Chinese Firms Exempt from Indigenisation Law,” *New Zimbabwe*, March 2, 2011, <http://www.newzimbabwe.com/business-4588-Chinese+firms+exempt+from+indigenisation/business.aspx>.

57 US Department of State, “Zimbabwe Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/242012.pdf>.

58 US Department of State, “Zimbabwe Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/242012.pdf>; and Darlington Mutanda, “The Impact of the Zimbabwean Crisis on Parastatals,” *International Journal of Politics and Good Governance* 5, no. 2 (Second Quarter 2014), <http://www.onlineresearchjournals.com/ijopagg/art/152.pdf>.

59 “Licensing Overview,” Postal and Telecommunications Regulatory Authority of Zimbabwe, <http://www.potraz.gov.zw/index.php/licensing-overview/licensing-overview>.

60 Paul Nyakazeya, “Concern over NetOne Licence,” *The Financial Gazette*, January 16, 2014, <http://www.financialgazette.co.zw/concern-over-netone-licence/>.

61 *Ibid.*

- **Government incentives for foreign investors:** Investment incentives available to both foreign and domestic investors in Zimbabwe include:
  - VAT exemptions for agricultural machinery and equipment, as well as for certain farming inputs such as fertilizers, seeds, pesticides, and animals;<sup>62</sup> and
  - Tax reductions for income from manufacturing operations that export at least 30 percent of production.<sup>63</sup>

Additional incentives are available, such as special deductions for expenditures on boreholes and farm fencing,<sup>64</sup> but, as with other government policies, these are not clearly defined and there is considerable uncertainty regarding the consistency of their application.

- **Forex controls:** Zimbabwe operates under a multi-currency regime; transactions can be conducted in US Dollars, South African Rand, British Pounds, Euros, Australian Dollars, Chinese Yuan, Botswana Pula, Indian Rupees, and Japanese Yen.<sup>65</sup> Exchange rates between any two of these currencies fluctuate with daily prevailing market rates.<sup>66</sup>
- **Exit opportunities/restrictions on exits:** Foreign investors may repatriate 100 percent of capital, dividends, and after-tax profits without restrictions.<sup>67</sup> However, to repatriate proceeds from the sale of immovable property, foreign investors must first seek the approval of the Reserve Bank of Zimbabwe.<sup>68</sup>
- **Interest rate controls:** As of October 1, 2015, the Reserve Bank of Zimbabwe capped lending rates at 18 percent in US Dollar terms. The new interest-rate cap is applicable to both new and existing borrowers.<sup>69</sup>

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62 “Incentives,” Zimbabwe Investment Authority, [http://www.investzim.com/index.php?option=com\\_content&view=article&id=260&Itemid=676](http://www.investzim.com/index.php?option=com_content&view=article&id=260&Itemid=676).

63 “2015 Tax Rates,” Zimbabwe Revenue Authority, [http://www.zimra.co.zw/index.php?option=com\\_content&view=article&id=1611&Itemid=70](http://www.zimra.co.zw/index.php?option=com_content&view=article&id=1611&Itemid=70).

64 “Incentives,” Zimbabwe Investment Authority, [http://www.investzim.com/index.php?option=com\\_content&view=article&id=260&Itemid=676](http://www.investzim.com/index.php?option=com_content&view=article&id=260&Itemid=676).

65 Reserve Bank of Zimbabwe, *Exchange Control Operational Guidelines and Compliance Framework to Authorized Dealers on Re-designation of Foreign Accounts and a Review of Exchange Control Measures* (2015), <http://www.cfuzim.org/images/rbzrq76.pdf>.

66 Finbar Feehan-Fitzgerald, “Multiple Currencies and Gresham’s Law in Zimbabwe,” *Mises Institute Daily* (blog), January 8, 2015, <https://mises.org/library/multiple-currencies-and-gresham’s-law-zimbabwe>.

67 Embassy of the Kingdom of the Netherlands and The Office of the Agricultural Counsellor, *Agribusiness in Zimbabwe: Opportunities for Economic Cooperation* (2014), [http://southafrica.nlemembassy.org/binaries/content/assets/postenweb/z/zuid\\_afrika/netherlands-embassy-in-pretoria/import/the\\_embassy/economic-affairs/agribusiness-zimbabwe-2014.pdf](http://southafrica.nlemembassy.org/binaries/content/assets/postenweb/z/zuid_afrika/netherlands-embassy-in-pretoria/import/the_embassy/economic-affairs/agribusiness-zimbabwe-2014.pdf).

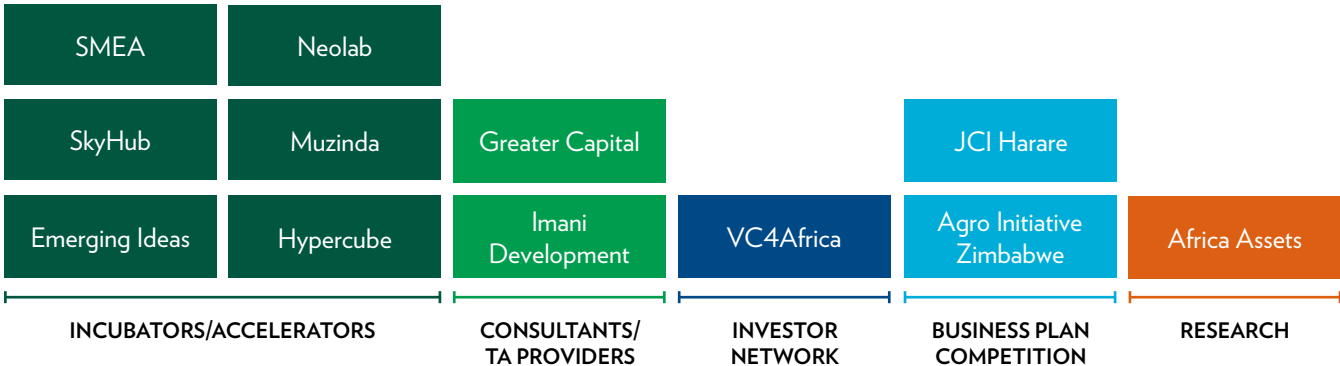
68 “RBZ Re-orient Exchange Controls,” *The Herald*, April 14, 2015, <http://www.herald.co.zw/rbz-re-orient-exchange-control/>.

69 J. P. Mangudya, *Beyond Stabilization: Mid-Term Monetary Policy Statement* (Harare: Reserve Bank of Zimbabwe, 2015), <http://www.techzim.co.zw/wp-content/uploads/2015/08/RBZ-Mid-Term-Monetary-Policy-2015.pdf>.

# ECOSYSTEM PLAYERS

Several incubators and accelerators are available in Zimbabwe to support early-stage businesses (see Figure 14). These organizations provide a range of services, including office space, training, networking, and investor linkage. In addition, there are several business plan competitions that offer technical assistance. Though formally available, interviewees noted that these efforts remain small scale and frequently are not visible or remain practically unavailable to entrepreneurs.

FIGURE 14. SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Note: Chart focuses on those with local presence; international players are also active.  
 Source: Open Capital research, organization websites.

A number of intermediaries primarily focus on corporate finance. Interviewees were able to identify more than 10 boutique firms present in Zimbabwe, though their services are typically too expensive for early-stage enterprises to access.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

While the overall macroeconomic environment in Zimbabwe remains challenging, some opportunities continue to prosper, in part by leveraging a talented workforce. Moreover, in an environment of extremely low liquidity, businesses with the financing to make capital investments and fund working capital requirements have a strong competitive advantage.

As described in the Executive Summary, impact investors across all markets in the region face several challenges, such as a lack of investment-ready enterprises. Additional challenges specific to Zimbabwe include:

- **Lack of credit:** As described above, Zimbabwe is currently experiencing a severe liquidity crunch, and businesses struggle to access financing. The cost of capital from commercial banks is prohibitively high for most businesses, and there are few other financing options available. This makes it challenging for investors' portfolio companies to access additional capital, particularly for short-term financing.
- **Political risk:** Government policy remains unstable and is often inconsistently applied, destabilizing the business environment. Moreover, policies such as the Indigenization Law hamper the ability of white Zimbabweans (less than 1% of the population), foreign investors, and foreign companies to operate freely in Zimbabwe. Interviewees had split opinions about the potential for direct government intervention. Some stated that such concerns, although valid in the past, no longer reflected reality. At the same time, many expressed concern about potential negative consequences if a business were to grow sufficiently to appear "above-the-radar" unless it had some political connections. There is also generally shared concern about potential political upheaval surrounding the succession to President Mugabe.<sup>70</sup> Now 91, the President's health is closely watched, and there is uncertainty about who will follow him to the Presidency.
- **Difficulty competing with cheap imports:** Businesses in Zimbabwe struggle to compete effectively with imported goods, mostly from South Africa. The high cost of capital limits businesses' ability to invest in upgrading aging equipment. Without up-to-date machinery, manufacturing companies incur higher costs relative to foreign producers of imports.
- **Limited local power generation:** The cost of production increases further due to persistent power shortages. For example, in July 2015, the country was estimated as having a 200MW power deficit.<sup>71</sup> The result is persistent load shedding, which interviewees estimated as lasting between six and eight hours per day. Companies must thus partly operate on backup diesel generators, further increasing cost.

Despite these challenges, there are opportunities for impact investors to operate in Zimbabwe and leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Opportunities for impact investors seeking to place capital in Zimbabwe include:

- **Partner with a strong local presence:** Though the importance of local presence is a shared theme across much of the region, the need is particularly acute in Zimbabwe. Zimbabwe's indigenization policy, confusing political landscape, and large informal economy make it particularly important for any foreign investor seeking to establish themselves in Zimbabwe to have trusted local partners. Trust and strong relationships are extremely important and require regular personal interaction.

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70 Open Capital Interviews.

71 John Robertson (lecture, Central Africa Building Society [CABS] Head Offices, Harare, Zimbabwe, July 29, 2015).

- **Extend investment time horizons:** Zimbabwe's near-term economic struggles will likely limit short-term growth and constrain potential exits to domestic investors. Instead, investors will have to realize returns from growth over time, which requires additional patience beyond that required to meet current challenges. At the same time, macroeconomic struggles create the potential for currently small businesses to grow to become market leaders, realizing significant long-term value for early investors.
- **Invest in restructuring existing businesses:** The economic upheavals of the past fifteen years and the ongoing liquidity crunch have led many businesses with sound operations and strong human capital to struggle with bad balance sheets. Often, such businesses have been unable to source the capital they need to invest in growth. Though interviewees noted that substantial overhauls may be needed to turn these businesses around, impact investors could realize significant financial and social returns by doing so.
- **Provide working capital:** Capital remains prohibitively expensive for most businesses, severely limiting their working capital as they manage cash flows. Those businesses with access to liquidity have a substantial competitive advantage at present and can rapidly scale their operations.

Interviewees noted specific investment opportunities in a broad range of sectors, including:

- **Agricultural processing:** Though interviewees were split on the opportunities available in primary agriculture (some noting the political risk and sensitivity around agricultural land while others noted that declining agricultural productivity generated opportunities), most interviewees agreed that there are opportunities in agricultural processing, such as day-old chicks and vegetable oils. Much of the existing agro-processing capacity uses old equipment or has seen declining utilization due to constraints on working capital. Opportunities exist to refurbish capacity and alleviate working capital restraints in order to improve utilization and reduce prices.
- **Construction inputs and other basic goods:** In the context of a faltering national economy, interviewees stressed the value of basic goods with a base level of demand. In addition, interviewees noted that real estate continues to receive significant investment from domestic sources, often funded by remittances. At the same time, many businesses producing basic goods, such as bricks, have struggled in recent years due to liquidity constraints and the legacy of hyperinflation. Developing businesses in these value chains could generate financial and social returns.
- **Healthcare:** Demand for the private provision of healthcare has increased as quality government service provision has eroded. An increasing number of private clinics have emerged, primarily serving high-income consumers. Though additional opportunities likely exist, there is a broad market opportunity for private healthcare provision to lower-income clients.

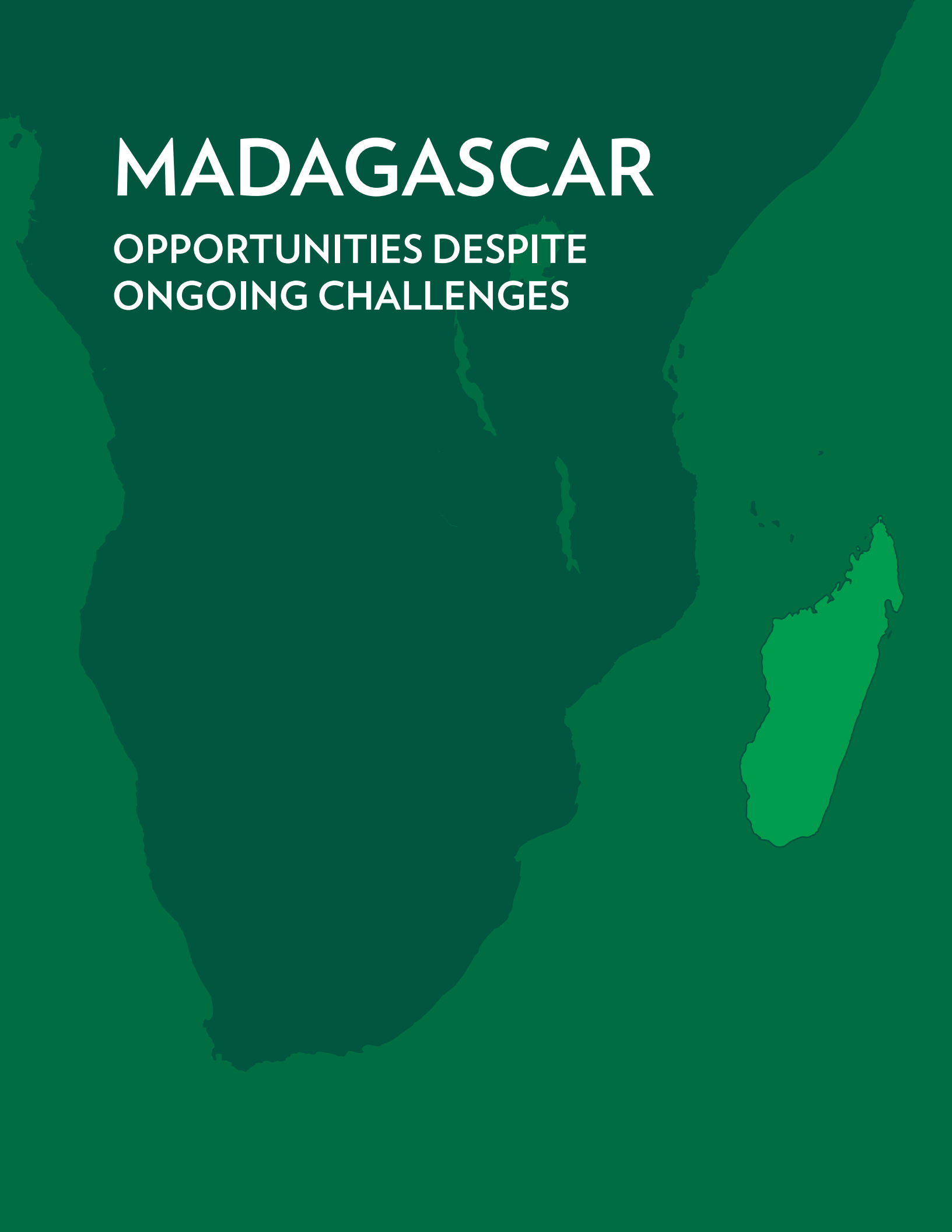
- **Education:** As the quality of government services declines, the demand for private provision of education has increased. A number of private schools have emerged, offering high-quality but expensive educations. Interviewees predicted that there is still additional space in the market for these high-end educational opportunities, but they also stressed that there are opportunities for mid- and low-income educational alternatives.
- **Renewable energy:** Zimbabwe has an ongoing power shortage, estimated at 200MW in July 2015.<sup>72</sup> Persistent load shedding can last up to 18 hours a day. There are many opportunities to provide backup power options at the retail and commercial levels, as well as to invest in large-scale power production.

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<sup>72</sup> John Robertson (lecture, Central Africa Building Society [CABS] Head Offices, Harare, Zimbabwe, July 29, 2015).

# MADAGASCAR

OPPORTUNITIES DESPITE  
ONGOING CHALLENGES



# INTRODUCTION

Madagascar (see Figure 1) has experienced extraordinary challenges over the past decade. Alongside a 2009 coup d'état that ushered in four years of instability, hardship, and economic contraction, the island has had to contend with devastating cyclones,<sup>1</sup> swarms of locusts,<sup>2</sup> and a recent outbreak of bubonic plague that claimed more than 70 lives in low-income areas of Antananarivo, the country's capital.<sup>3</sup>

FIGURE 1. MAP OF MADAGASCAR



Given these challenges, Madagascar has seen little international impact investment compared to the size of its market and its potential, though a small number of specialist local funds have been operating successfully for several years. As the country recovers from the aftermath of the coup and natural disasters, international impact investors should see increased opportunities to place capital, particularly in the country's recovering textiles industry and thriving agribusiness sector.

1 Lovasoa Rabary, *Madagascar Seeks International Aid after Tropical Storm Kills 68*, Thomson Reuters Foundation, January 28, 2015, <http://www.trust.org/item/20150128150550-mbmo2/?source=jtOtherNews1>.

2 Clár Ní Chonghaile, "Madagascar Could Lose Battle against Locusts if Funds Don't Come, UN Warns," *The Guardian*, January 27, 2015, <http://www.theguardian.com/global-development/2015/jan/27/madagascar-locusts-united-nations-food-agriculture-organisation>.

3 "Plague in Madagascar," World Health Organization, February 11, 2015, <http://www.who.int/csr/disease/plague/madagascar-outbreak/en/>.

# COUNTRY CONTEXT

Madagascar's 2009 political crisis and the ensuing instability curtailed a promising growth story. Under the coup regime (2009–2013), poverty rose, growth fell, and public well-being suffered. Elections in late 2013 welcomed President Hery Rajaonarimampianina, who vowed to combat corruption and stimulate investment.<sup>4</sup> Following a notable decline from 2008 to 2009 in gross domestic product (GDP) at purchasing power parity (PPP), annual growth rates have recovered to 4.5 percent—driven in large part by extractive industries—but have not returned to their pre-crisis levels, which averaged more than nine percent. Ongoing instability, weak institutions, and tenuous governance, compounded by the May 2015 impeachment of the President (since overturned by the courts), continue to limit Madagascar's economic prospects. More than 80 percent of the population lives below USD 1.25 (PPP) per day.<sup>5</sup>

Nonetheless, there is reason to believe that Madagascar's prospects may be improving. The IMF expects GDP growth to increase in 2015 from approximately 4.5 percent to 5.8 percent. In addition, the country—previously a textile hub—recently had trade preferences reinstated under the US African Growth and Opportunity Act (AGOA), which allows Madagascar to resume duty-free exports of textiles and a host of other goods to the United States.<sup>6</sup> Capitalizing on this and other opportunities will require a stronger investment climate, with a particular focus on infrastructure and commercial law, as well as investment in high-potential local entrepreneurs and enterprises.

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4 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

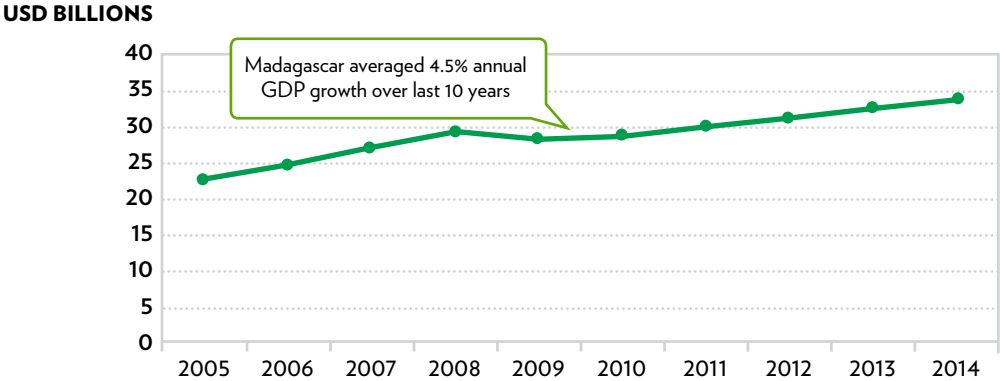
5 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>; and International Monetary Fund, *Republic of Madagascar: IMF Country Report No. 15/24* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf>.

6 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>; and Brock R. Williams, *African Growth and Opportunity Act (AGOA): Background and Reauthorization* (Washington, DC: Congressional Research Service, 2015), <https://www.fas.org/sgp/crs/row/R43173.pdf>.

# Gross Domestic Product

Prior to the 2009 political crisis, Madagascar experienced several years of nearly 10 percent annual growth in GDP (see Figure 2).<sup>7</sup> With the coup of 2009, GDP plummeted, contracting by four percent, and the economy grew by only one percent in 2010.<sup>8</sup> Growth began to recover in 2011, rising to 4.5 percent, but it still has not returned to its pre-crisis trajectory.<sup>9</sup> Investment in the extractives industry, particularly mining, has primarily driven recent growth, masking continued stagnation elsewhere in the economy. For example, agricultural production has increased by less than one percent since a severe locust infestation in 2013, and companies in the export processing zone grew by only two percent in 2014.<sup>10</sup> Relatively poor growth has compounded already low standards of living. GDP per capita is only USD 1,437 (PPP), compared to a regional average of USD 7,139 (PPP).<sup>11</sup>

FIGURE 2. GDP (PPP), 2005–2014



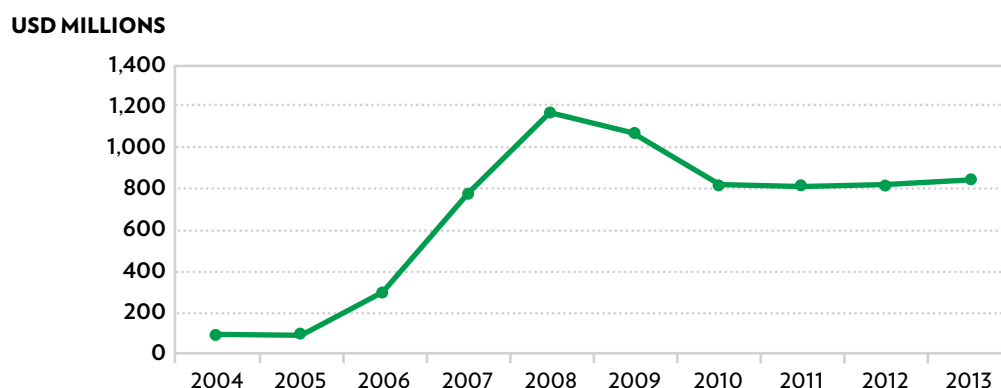
Source: IMF World Bank Economic Indicators, April 2015

7 International Monetary Fund, *World Economic Outlook Database* (2015), available at <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.  
 8 *Ibid.*  
 9 *Ibid.*  
 10 US Department of State, “Madagascar Investment Climate Statement” (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.  
 11 *World Economic Outlook Database*, s.v. “Madagascar” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

## Foreign Direct Investment

Foreign direct investment (FDI) in Madagascar peaked in 2008 at around USD 1.2 billion (see Figure 3).<sup>12</sup> As with economic growth, FDI dropped significantly after the 2009 crisis, to USD 800 million in 2010, and flows have since been flat.<sup>13</sup>

FIGURE 3. NET FDI FLOWS, 2004–2013



Source: UNCTAD

Canada was the single largest source of FDI during the period 2007–2011 (the last period with available data), accounting for just under 30 percent of inflows. The UK and Japan together comprised an additional 30 percent, followed by Mauritius, Korea, and France, each with around 10 percent of all FDI.<sup>14</sup> The majority of this investment, especially from Canada, was into extractive industries, particularly mining.<sup>15</sup>

## Inflation and Exchange Rates

Madagascar's currency, the Ariary, has weakened in recent years (see Figure 4). The official USD/MGA exchange rate was depreciating at 10 percent year-on-year in nominal terms as of the end of September 2014 and at 14 percent year-on-year by the end of November 2014.<sup>16</sup> According to the International Monetary Fund, the official rate is likely overvalued, as many large foreign-exchange transactions take place at a

12 United Nations Conference on Trade and Development, "Bilateral FDI Statistics," <http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx>.

13 *Ibid.*

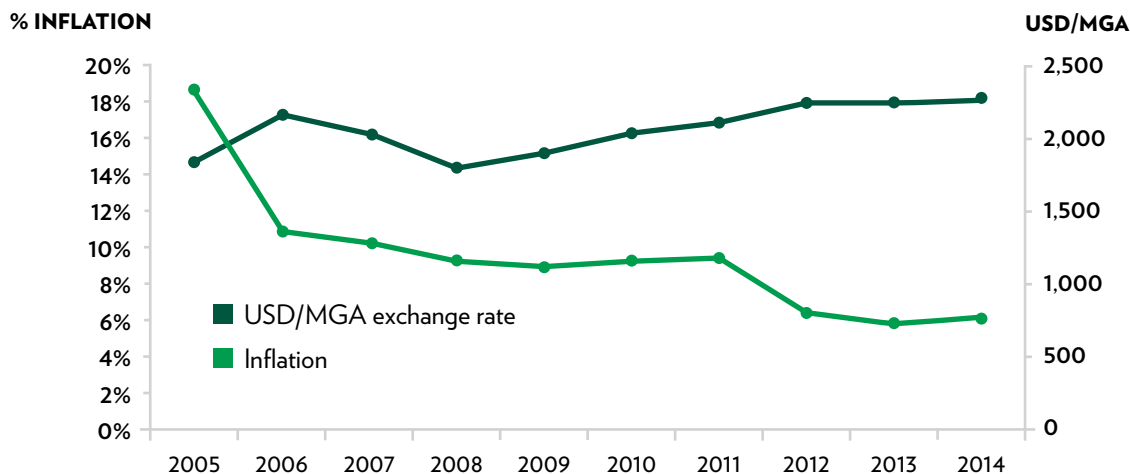
14 United Nations Conference on Trade and Development, "Bilateral FDI Statistics," <http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx>.

15 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>; and Open Capital interviews.

16 International Monetary Fund, *Republic of Madagascar: IMF Country Report No. 15/24* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf>.

more depreciated rate.<sup>17</sup> Inflation held relatively steady—around 10 percent—from 2006 to 2011 and has since declined to around six percent in 2014.<sup>18</sup> Rates may be higher in 2015 due to government cuts in fuel subsidies.<sup>19</sup>

FIGURE 4. INFLATION AND USD/MGA EXCHANGE RATE, 2005 - 2014



Source: World Bank Indicators

## SUPPLY OF IMPACT CAPITAL

Though many regional investors based elsewhere in Southern Africa include Madagascar in their broader investment mandate, few are actively placing capital, and only a handful have a local presence. As a result, Madagascar has seen few impact deals and little capital disbursed relative to its size. With just over USD 500 million placed, it has the sixth-most impact capital disbursed among the twelve countries in the region (less than 10 percent of which was placed by non-development finance institution [DFI] impact investors), and at 44 recorded investments, the eighth-most impact deals.

17 International Monetary Fund, *Republic of Madagascar: IMF Country Report No. 15/24* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf>.

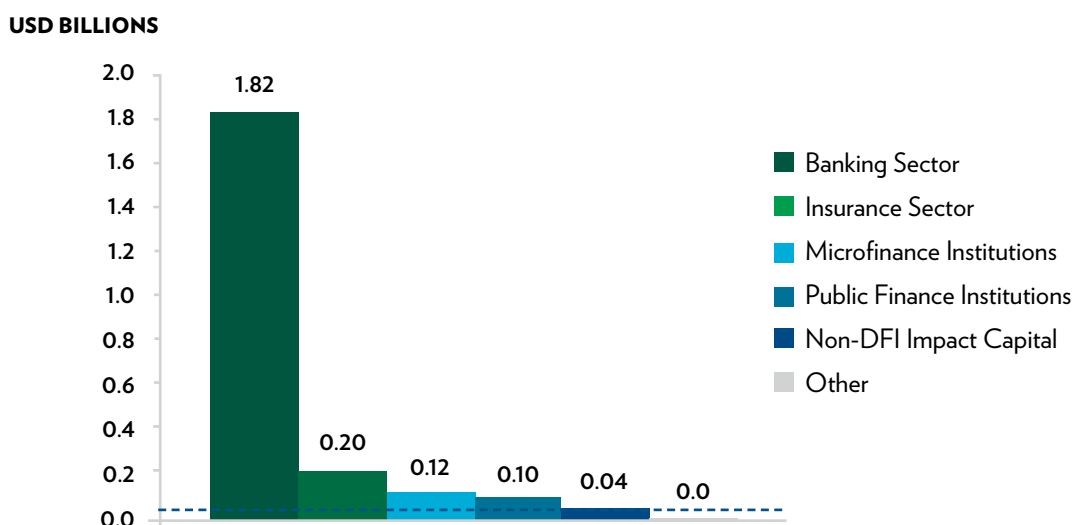
18 *The World Bank: Data*, s.v. “Madagascar” in “Indicators,” <http://data.worldbank.org/indicator>.

19 Lovasoa Rabary, “Madagascar Lifts Inflation, Revenue Forecasts for 2014,” *Reuters Africa*, July 30, 2014, <http://af.reuters.com/article/madagascarNews/idAFL6NoQ557E20140730>.

## Broader Investing Landscape

The modest volume of non-DFI impact capital means that impact investing remains relatively poorly understood among Malagasy entrepreneurs,<sup>20</sup> and traditional sources of finance dominate Madagascar’s investing landscape (see Figure 5). With an asset base around USD 1.8 billion, the country’s 11 retail banks constitute around 80 percent of the financial sector, and the four biggest banks account for over 85 percent of these assets and almost 90 percent of deposits.<sup>21</sup> Most of these banks are foreign-owned, based predominantly in Mauritius, France, and elsewhere in Africa.

FIGURE 5. IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: International Monetary Fund

Microfinance institutions (MFIs) have also built a strong presence in Madagascar, with an asset base of over USD 100 million across 31 MFIs.<sup>22</sup> These MFIs offer a limited range of financial products to low-income households, though interviewees reported that MFIs struggle in rural areas due to widespread suspicion among farmers regarding the use of land as loan collateral.

Accessing capital is generally extremely challenging for entrepreneurs in Madagascar. Annual commercial interest rates have been more than 45 percent for the last seven years, escalating in 2014 to an even more formidable 60 percent.<sup>23</sup> This has made it all

20 Open Capital interviews.

21 International Monetary Fund, *Republic of Madagascar: IMF Country report No. 15/25* (Washington, DC: International Monetary Fund, 2015), <http://www.imf.org/external/pubs/ft/scr/2015/cr1525.pdf>.

22 International Monetary Fund, *Republic of Madagascar: IMF Country Report No. 15/24* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf>. This asset base of USD 100 million is much larger than the capital known to have been deployed in financial services, as shown later in this chapter. One explanation for the discrepancy could be that these MFIs may have raised significant grant capital or capital from conventional investors.

23 *The World Bank: Data*, s.v. “Madagascar” in “Lending Interest Rate,” <http://data.worldbank.org/indicator/FR.INR.LEND/countries>.

but impossible for early- or growth-stage entrepreneurs to finance expansion through commercial loans, even when they are approved for financing.

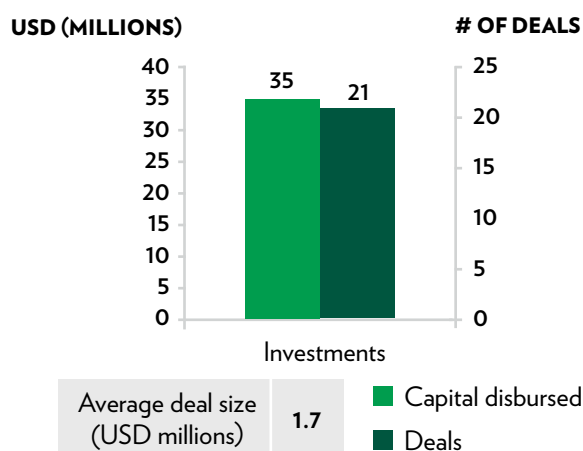
A small number of specialist investment firms have opened in Antananarivo to fill this gap. Alongside two impact investors, a small number of local private-equity investors offer early- and growth-stage finance.<sup>24</sup> Other initiatives have sought to address the high cost of financing more directly. In 2013, for instance, a partnership including the French Development Agency (AFD), the Madagascar guarantee institution SOLIDIS, and a local MFI set up a new guarantee fund to provide up to USD 1.8 million in credit guarantees to small and medium-sized enterprises (SMEs).<sup>25</sup> These efforts notwithstanding, accessing and affording finance remain critical constraints for Madagascar’s private sector.

## Impact Capital Disbursed

Madagascar has seen comparatively little impact capital disbursed given the size of its economy and population (see the “Challenges and Opportunities” section for a discussion of possible causes). At around USD 500 million across 44 deals, Madagascar accounts for 1.9 percent of both deals and capital placed in the region. Other countries in the region with smaller markets, such as Namibia or Mauritius, have attracted considerably more impact capital.

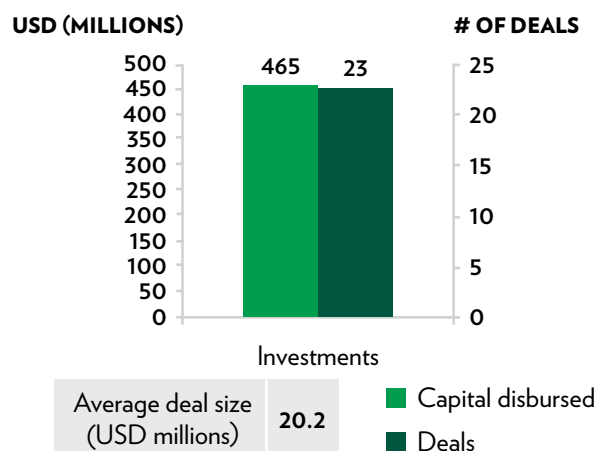
DFIs account for the vast majority of impact investment in Madagascar to date. Of the USD 500 million in capital disbursed, around USD 465 million—more than 90 percent—has come from DFIs (see Figures 6 and 7).

**FIGURE 6. NON-DFI IMPACT INVESTMENTS**



Source: Open Capital Research

**FIGURE 7. DFI IMPACT INVESTMENTS**



Source: Open Capital Research

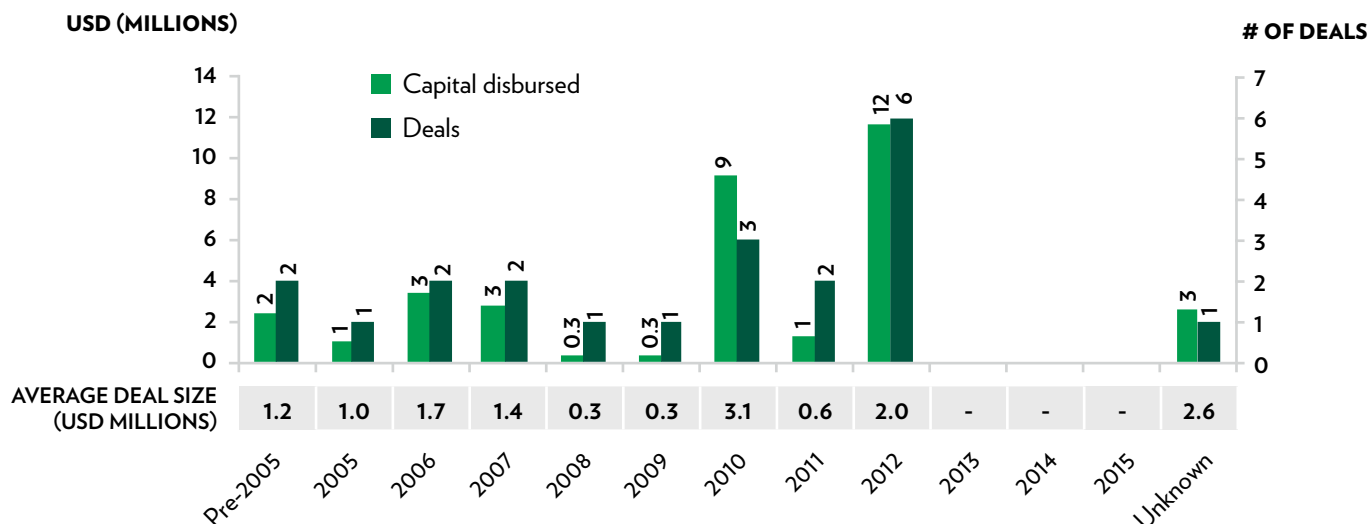
24 Open Capital interviews.

25 “Madagascar: Launch of a New Guarantee Fund for SMEs,” *Making Finance Work for Africa*, December 18, 2013, <http://www.mfw4a.org/news/news-details/article/2/madagascar-launch-of-a-new-guarantee-fund-for-smes.html>.

## Investments over Time

Non-DFI impact capital proved resilient after the 2009 political crisis, with both capital disbursed and number of impact deals reaching all-time highs in 2012 at nearly USD 12 million across six deals (see Figure 8). Research uncovered no impact deals from 2013 to 2015, though it is unclear if this reflects an actual lack of deals or rather indicates limited data availability.

FIGURE 8. NON-DFI IMPACT INVESTMENTS BY YEAR

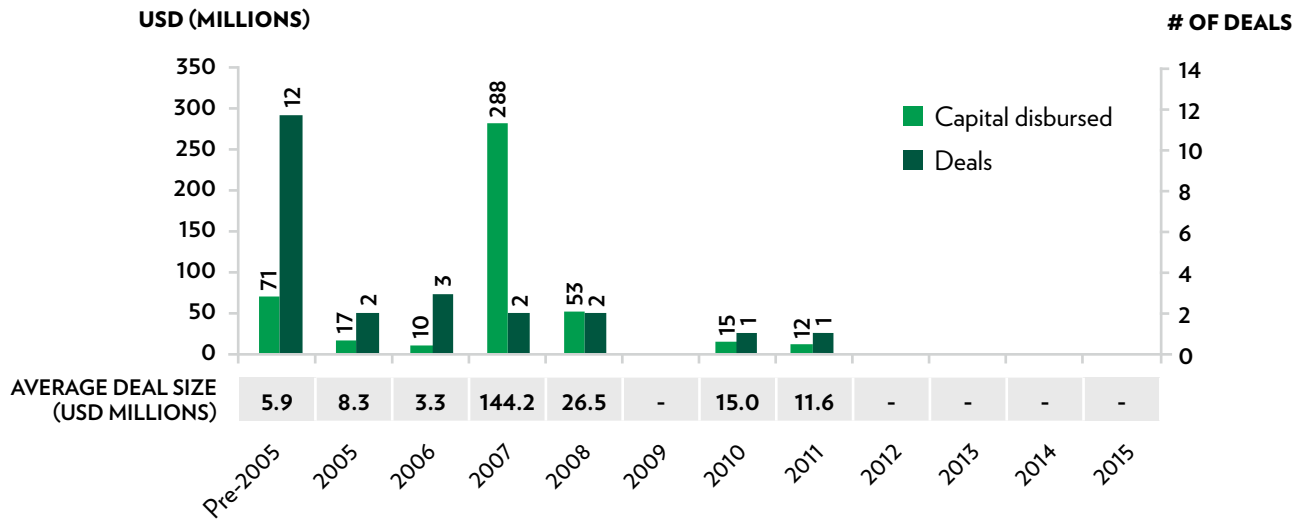


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

For DFIs, by contrast, the 2009 political crisis significantly dampened deal flows. While the research team recorded nearly USD 350 million disbursed by DFIs from 2007 to 2008, only around USD 25 million in DFI disbursements was recorded over the years following the military coup (see Figure 9). Considering the low number of deals even before the coup, however, it would be premature to conclude that investor interest in Madagascar is waning, nor did investor interviews support such a conclusion.

FIGURE 9. DFI IMPACT INVESTMENTS BY YEAR



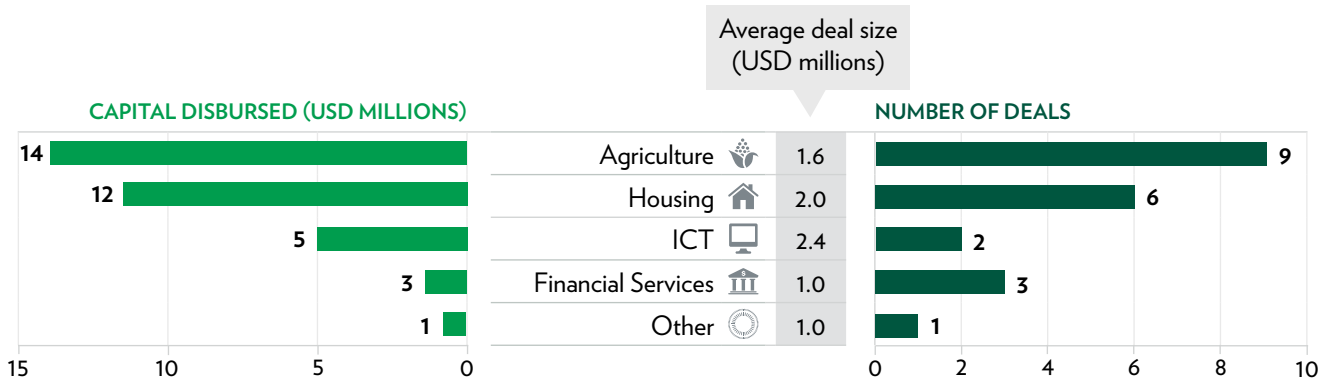
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Sector

Non-DFI impact investments in Madagascar have been heavily concentrated in a small number of sectors (see Figure 10), specifically, agriculture, housing, and information and communications technologies (ICT). Within agriculture, both aquaculture and tropical fruit production for export have generated particular investor interest.<sup>26</sup> The large amount of impact capital disbursed to the housing sector reflects the activity of one particular impact investor with a specific focus on affordable housing.

FIGURE 10. NON-DFI IMPACT INVESTMENTS BY SECTOR



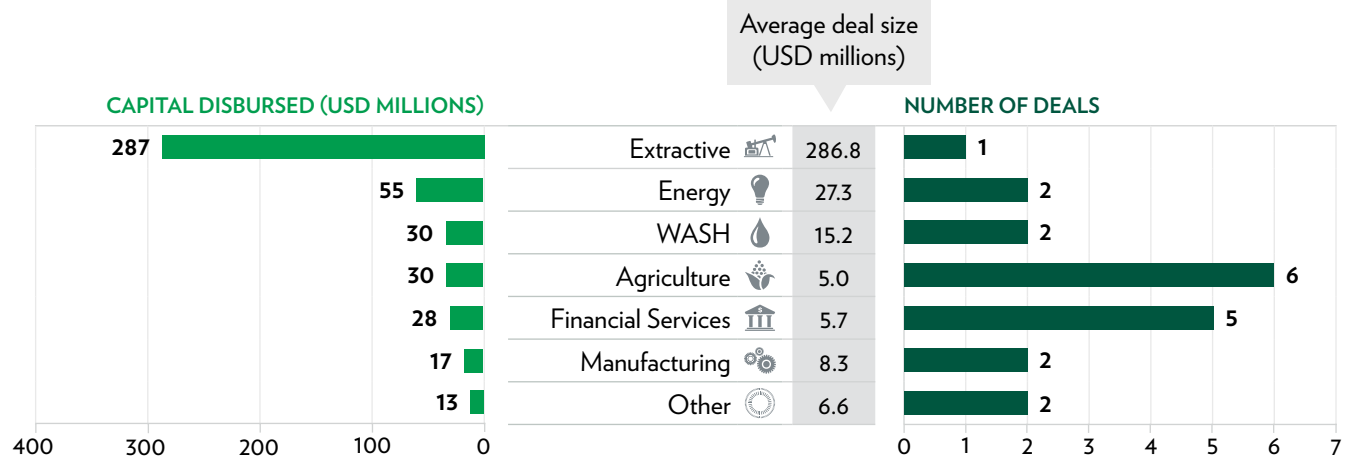
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

26 - Open Capital interviews and research.

DFI investments have been more broadly spread across sectors (see Figure 11). Roughly half of DFI deals have been in agriculture or financial services—mostly in aquaculture and large local banks—but energy, manufacturing, and water, sanitation, and hygiene (WASH) have all also seen multiple DFI investments. The extractive sector has received by far the largest share of disbursed impact capital, driven entirely by one very large investment into a nickel mining project.

**FIGURE 11. DIRECT DFI IMPACT INVESTMENTS BY SECTOR**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

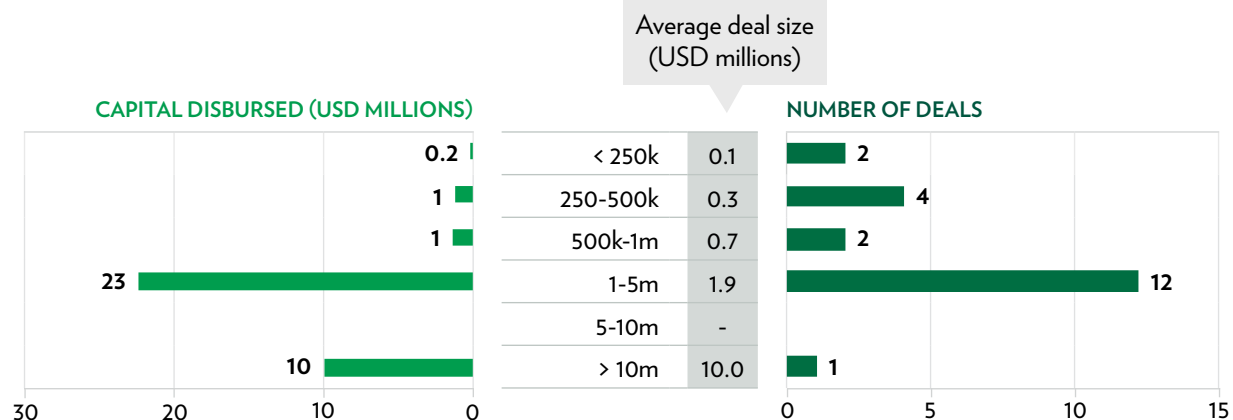
Source: Open Capital Research

Despite the sector’s general potential to generate impact, neither DFIs nor non-DFI impact investors appear to have found investment opportunities in healthcare. Interviewees noted that heavy involvement of government and non-governmental organizations (NGOs) has prevented the emergence of healthcare entrepreneurs and offered little room for private investors to engage. The textiles sector has also received relatively little impact capital, though the revival of duty-free exports to the U.S. under AGOA will likely attract investor interest.

## Deal Size

The majority of non-DFI impact deals in Madagascar have been in the range of USD one to five million, contrasting with the deal size profile for most other countries in the region, in which the bulk of non-DFI impact deals tend to be below the USD one million mark. There is only one recorded deal over USD five million.

FIGURE 12. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE

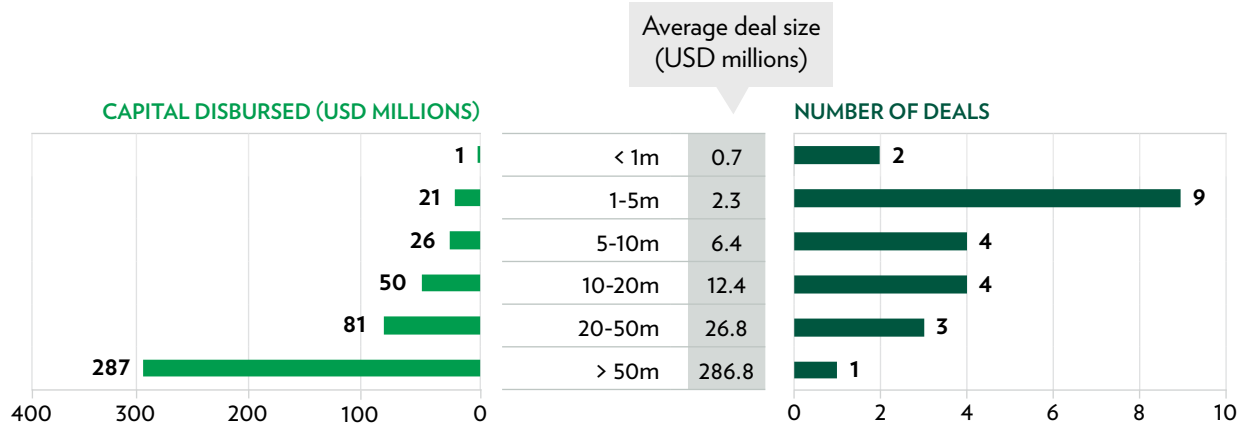


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

As with most of the region, DFI average deal sizes are considerably larger than non-DFI ones. Still, with the exception of the one large investment in nickel extraction, DFI deals have been comparatively small, with half falling below USD five million (see Figure 13). This may reflect the relatively low number of large projects in extractives, energy, and infrastructure that have characterized DFI investment elsewhere.

FIGURE 13. DFI IMPACT INVESTMENTS BY DEAL SIZE



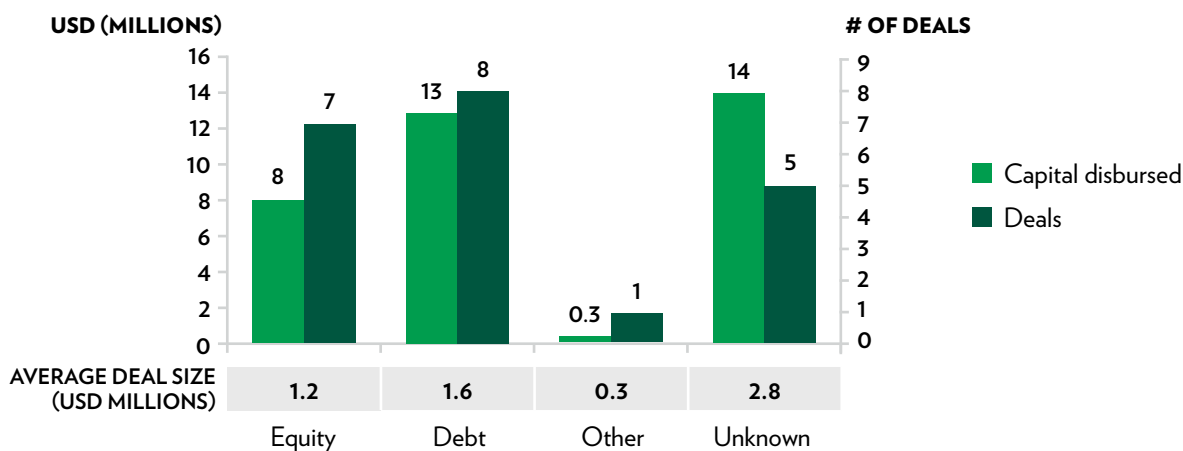
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Instrument

Non-DFI impact deals in Madagascar have been fairly evenly split between equity and debt (see Figure 14). Debt investments are slightly larger on average, possibly because investors tend to use debt for later-stage businesses. Of deals with known investment instruments, DFIs have shown a moderate preference for debt in Madagascar, with around 50 percent more DFI capital flowing through debt than through equity across three times as many deals (Figure 15). Very few recorded investments used hybrid or alternative instruments, such as quasi-equity. Notably, however, over half of DFI deals in Madagascar had no readily available data on instruments used, so readers should appropriately discount any conclusions drawn from the data presented here.

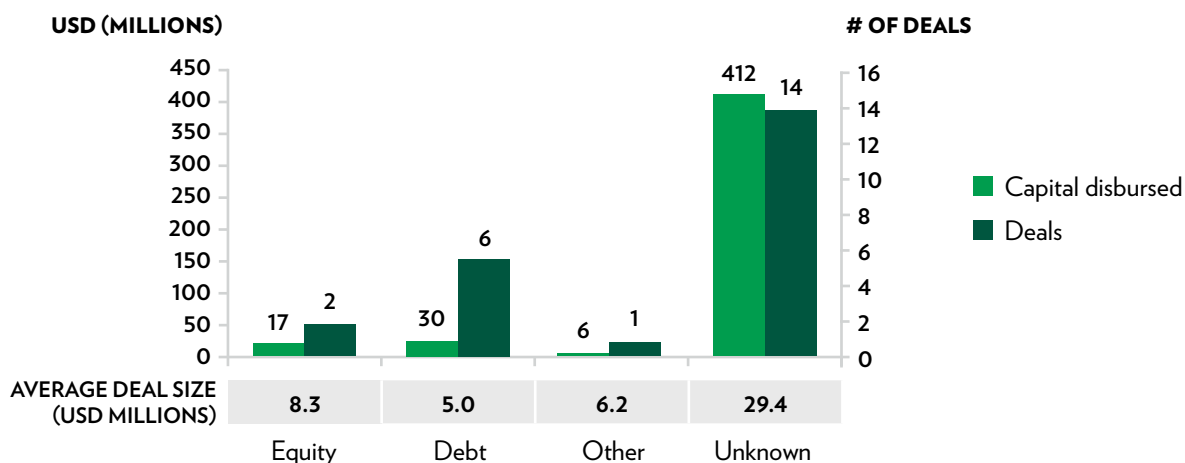
FIGURE 14. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

FIGURE 15. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Local Presence

Few non-DFI impact investors have a local presence in Madagascar; only two have offices in Antananarivo.<sup>27</sup> Investors with local offices typically staff their teams entirely with Malagasy staff who understand local culture and are able to navigate Madagascar’s highly relationship-driven business landscape.<sup>28</sup>

## Impact Tracking Standards

As is true across Southern Africa, impact investors in Madagascar do not use a specific standard for measuring impact. Instead, they report that they tailor impact-tracking structures to each investment, allowing them to reduce the administrative burden on their portfolio businesses and focus on the metrics that are most meaningful.

<sup>27</sup> Open Capital interviews.

<sup>28</sup> *Ibid.*

# DEMAND FOR IMPACT INVESTING CAPITAL

With reentry into AGOA and a political commitment to combat corruption and improve the business climate, Madagascar has the potential to achieve improved economic performance over the coming years. Enterprises and entrepreneurs throughout the country can take advantage of this environment, providing much-needed employment while also realizing financial returns. Given the various challenges they face, enterprises and entrepreneurs will need support beyond the limited bank financing that is currently available.

## Development Context

Madagascar is one of the poorest countries in the world (see Table 1). More than 80 percent of the population lives below the absolute poverty line (USD 1.25 per day in PPP terms), compared to a global average of 25 percent.<sup>29</sup> The country ranks 155<sup>th</sup> out of 187 countries according to the UN's Human Development Index (HDI), with a score of 0.50 compared to a global average of 0.69.<sup>30</sup>

TABLE 1. SELECTED MADAGASCAR DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Madagascar	Regional Average	Global Average
HDI SCORE (RANKS 155 <sup>TH</sup> OF 187 COUNTRIES)	0.50	0.55	0.69
GDP PER CAPITA (USD, PPP)	1,437	6,874	17,975
UNEMPLOYMENT RATE (%)	4	13	6
POPULATION BELOW USD 1.25 / DAY (%)	81	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	58	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	11	41	59

<sup>29</sup> United Nations Development Programme, 2014 *Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

<sup>30</sup> *Ibid.*

In terms of health outcomes, the under-five mortality rate, at 58 per thousand live births, exceeds the global average of 47, and the incidence of under-five stunting, a proxy for childhood health and long-term prosperity, is just above 50 percent, one of the highest rates in the world.<sup>31</sup> Meanwhile, children receive an average of 5.2 years of schooling, compared to a global average of 6.7.<sup>32</sup> Literacy rates are below 65 percent for both adults and youth, and secondary and tertiary enrollment ratios—the percentages of school-age children actually in school—stand at 38 percent and four percent, respectively.<sup>33</sup>

Though official unemployment is low at just under four percent,<sup>34</sup> this rate likely vastly understates Madagascar's labor market challenges. Rates of underemployment and vulnerable employment are likely significantly higher. Like other Southern African countries, Madagascar has a disproportionately young population, with more than 40 percent under the age of 15 and more than 60 percent below age 25.<sup>35</sup> Coupled with years of poor economic performance, this youth demographic bulge poses risks to the country's prospects for years to come. In addition to being very young, the population is also highly rural, with less than 35 percent living in urban areas.<sup>36</sup> Access to services is particularly poor in rural areas; for example, in 2012, only eight percent of the rural population had access to electricity. Unsurprisingly, internet usage across the country is also very low: less than four percent.<sup>37</sup>

Poor performance across social and economic indicators is compounded by Madagascar's vulnerability to natural disasters, including cyclones, flooding, and drought. The World Bank estimates that 25 percent of the population (around five million people) lives in zones that are at high risk for natural disasters.<sup>38</sup>

## Entrepreneurs

Though few businesses explicitly position themselves as “social enterprises,” the SME landscape in Madagascar has significant potential to generate positive social impact as well as financial returns. Impact investors in the country echo this sentiment,

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31 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

32 *Ibid.*

33 *Ibid.*

34 *The World Bank: Data*, s.v. “Madagascar” in “World Development Indicators,” <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

35 United Nations, *World Population Prospects* (New York: United Nations, 2015), [http://esa.un.org/unpd/wpp/Publications/Files/Key\\_Findings\\_WPP\\_2015.pdf](http://esa.un.org/unpd/wpp/Publications/Files/Key_Findings_WPP_2015.pdf).

36 *The World Bank: Data*, s.v. “Madagascar” in “World Development Indicators,” <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>; and United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

37 *The World Bank: Data*, s.v. “Madagascar” in “World Development Indicators,” <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

38 “Madagascar Overview,” The World Bank Group, last modified May 12, 2015, <http://www.worldbank.org/en/country/madagascar/overview>.

reporting a strong pipeline of high-potential businesses.<sup>39</sup> Many SMEs presently in the informal sector would benefit from formalization; others are already working in the formal economy but face a range of challenges that limit growth and could benefit significantly from impact funds.

Entrepreneurs and enterprises in Madagascar face many of the same challenges as those throughout the region. Primary among these is lack of access to finance. As the International Monetary Fund (IMF) points out, credit is expensive and limited. There is no debt market outside of government paper, and foreign-owned banks offering only basic savings and credit instruments to a limited customer base dominate the financial sector.<sup>40</sup> Prevailing interest rates, at over 45 percent per year, are unaffordable for most businesses.<sup>41</sup> Furthermore, entrepreneurs working in the agricultural/agribusiness sector are hesitant to use land as collateral, further limiting access to capital.<sup>42</sup> Notably, enterprises in Madagascar face challenges related to a lack of access to physical currency as well as to credit; see “Challenges and Opportunities,” below, for more detail.

Infrastructure also poses a significant challenge. In particular, access to electricity is limited and unreliable—one can expect daily blackouts, sometimes lasting for hours at a time—and transport infrastructure, including roads, ports, and airports, is inadequate. These transportation challenges compound the difficulties arising from Madagascar’s large geographic size (Madagascar covers more than twice the land area of the UK). Low population density implies that growing businesses must widely expand their geographic reach. Cities are located at significant distances from one another; as such, new markets are difficult to reach, and key business functions, including inventory, sourcing, and distribution capabilities, must often be re-created and run independently in each city.

Enterprises also face challenges related to the implementation of tax laws. Since the government’s tax revenue is extremely limited, entrepreneurs often fail to receive reimbursements to which they are entitled.<sup>43</sup>

Finally, businesses face challenges in securing support to establish systems and processes, particularly for financial management. As discussed below, there are a limited number of intermediaries providing such support in Madagascar. Where intermediaries are available, businesses struggle to afford their services. Furthermore, the local talent pool has a relatively small supply of potential CFO hires.<sup>44</sup> As a result, investors often have to help companies develop adequate financial statements during the diligence process and then must look outside the country for executive-level talent. Impact investing capital combined with technical assistance funds could be effective in addressing this constraint and unlocking the growth potential of local enterprises.

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39 Open Capital interviews.

40 International Monetary Fund, *Republic of Madagascar: IMF Country Report No. 15/24* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf>.

41 *The World Bank: Data*, s.v. “Madagascar” in “World Development Indicators,” <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

42 Open Capital interviews.

43 *Ibid.*

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

Though Madagascar's ecosystem poses few overt barriers to investors, the country ranks 163<sup>rd</sup> out of 189 countries in the World Bank's "Ease of Doing Business" rankings. That said, the World Bank ranks Madagascar 37<sup>th</sup> globally in terms of the ease of "starting a business," reflecting successful efforts by the government to de-bureaucratize business incorporation through its one-stop registration at the Economic Development Board of Madagascar (EDBM).<sup>45</sup>

In addition, though the legal system is generally welcoming to foreign investment, interviewees reported that policies were at times incompletely or unevenly implemented. Beyond formal legal processes, interviewees noted that cultural and informal political factors—such as a work culture that prioritizes maintaining harmonious relationships at the expense of the timely delivery of unpleasant but important feedback or reports of frequent interference by local politicians—can make Madagascar a challenging place to do business.

## Regulatory Environment

Madagascar's legal system and public administration are largely based on systems inherited from France during and after colonization. As such, investors or entrepreneurs unfamiliar with French civil law can find the legal regime challenging to navigate if they lack significant local knowledge.<sup>46</sup> Investors noted that even where the law is clear, it is at times inconsistently or inadequately enforced, creating additional legal risk.

Interviewees were unanimous that impact investors and entrepreneurs intending to be active in Madagascar should heavily involve local partners. Certain aspects of the regulatory environment require particular attention:

- **Land ownership:** Foreigners are allowed to lease land in Madagascar for terms up to 99 years,<sup>47</sup> though a foreigner may only be issued a lease if they intend to use the land for commercial purposes.<sup>48</sup> Buying land and reselling it, either in its original or developed state, does not count as a commercial use.<sup>49</sup>

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<sup>45</sup> The World Bank: Doing Business. <http://www.doingbusiness.org/rankings>.

<sup>46</sup> *Ibid.*

<sup>47</sup> US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

<sup>48</sup> Ministry of Economy, Planning, Private Sector and Trade and Ministry of Finance and Budget, *Madagascar Investment Law* (2007), <http://www.edbm.gov.mg/content/download/341/9470/version/2/file/MadagascarInvestment+law.pdf>.

<sup>49</sup> *Ibid.*

- **Government and the private sector:** Private-sector firms operate and compete on the same terms as state-owned enterprises (SOEs).<sup>50</sup> However, there have been reports of unfair treatment of private enterprises in competition with SOEs. For example, the government has on several occasions suspended the licenses of private media houses that have openly criticized its activities.<sup>51</sup> In addition, the government enforces some state monopolies, such as that of the national airline (Air Madagascar), as well as enforcing monopolies in water and electricity distribution.<sup>52</sup>
- **Exit opportunities/restrictions on exits:** Both local and foreign investors are free to relocate profits after paying required taxes, fees, and dividends.<sup>53</sup> However, investors must gain approval from the Ministry of Finance in order to repatriate capital raised from the liquidation of assets (or shares), capital from the transfer of stocks, or compensation for expropriation.<sup>54</sup>
- **Interest rate controls:** Madagascar removed interest rate ceilings in the 1990s.<sup>55</sup> However, the country's banking sector is relatively underdeveloped, and lending rates are high, especially for SMEs. In 2014, annual commercial lending rates averaged 60 percent over the year.<sup>56</sup>
- **Forex controls:** Madagascar follows the IMF's Article VIII statutory framework, meaning there are no restrictions on foreign exchange,<sup>57</sup> and the Malagasy government limits neither the use nor the availability of foreign exchange.<sup>58</sup> Nevertheless, at times, shortages of foreign currency have caused delays in the repatriation of funds.<sup>59</sup> In addition, businesses are required to transfer a portion of their export income back to the country, converted into local currency.<sup>60</sup>

50 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

51 Freedom House, *Madagascar* (Washington, DC: Freedom House, 2012), <https://freedomhouse.org/report/freedom-press/2012/madagascar-.VfK66pccpNU>.

52 US Department of State, "Investment Climate Statement Madagascar" (Washington, DC: US Department of State, 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191189.htm>.

53 Ministry of Economy, Planning, Private Sector and Trade and Ministry of Finance and Budget, *Madagascar Investment Law* (2007), <http://www.edbm.gov.mg/content/download/341/9470/version/2/file/MadagascarInvestment+law.pdf>.

54 Deloitte, *Guide to Fiscal Information: Key Economies in Africa 2014/2015* (2015), [http://www2.deloitte.com/content/dam/Deloitte/et/Documents/tax/ZA\\_Fiscal\\_Guide\\_2015\\_29012015.pdf](http://www2.deloitte.com/content/dam/Deloitte/et/Documents/tax/ZA_Fiscal_Guide_2015_29012015.pdf).

55 Koffie Nassar, "IMF Working Paper: Money Demand and Inflation in Madagascar" (International Monetary Fund, 2005), <https://www.imf.org/external/pubs/ft/wp/2005/wp05236.pdf>.

56 *The World Bank: Data*, s.v. "Madagascar" in "Lending Interest Rate," <http://data.worldbank.org/indicator/FR.INR.LEND/countries>.

57 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

58 *Ibid.*

59 World Trade Organization, "Madagascar: WT/TPR/S/318" (2015), [https://www.wto.org/english/tratop\\_e/tp\\_r\\_e/s318\\_sum\\_e.pdf](https://www.wto.org/english/tratop_e/tp_r_e/s318_sum_e.pdf).

60 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

- **Required local shareholding:** Foreigners can own up to 100 percent of ventures in which they invest, with no local participation required by law.<sup>61</sup> However, foreign ownership of companies operating in either the fixed-line or the mobile telecommunication sectors is limited to 66 percent.<sup>62</sup>
- **Government incentives for investors:** The Malagasy government provides a number of investment incentives for companies based in designated Export Processing Zones (EPZs) or operating in the mining sector, including:<sup>63</sup>
  - exemption from registration charges;<sup>64</sup>
  - VAT and duty exemption for raw materials;<sup>65</sup>
  - customs tax exemption for export;<sup>66</sup> and
  - taxes on expatriated income capped at 30 percent.<sup>67</sup>

## Ecosystem Players

The support ecosystem in Madagascar is sparse. There are a small number of incubators, dedicated mainly to the country's nascent ICT sector, but most other players in the ecosystem have a broader regional focus (see Figure 16). As such, they engage in Madagascar opportunistically and typically operate on a fly-in, fly-out basis, which can make travel expenses prohibitive for earlier-stage businesses seeking support. The research team identified nine ecosystem organizations active in Madagascar, of which only three have a full-time presence on the ground.

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61 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

62 "Investing Across Borders: Indicators of Foreign Direct Investment Regulation, Madagascar," World Bank Group, <http://iab.worldbank.org/Data/ExploreEconomies/madagascar>.

63 KPMG, *Madagascar Country Profile* (Johannesburg, KPMG: 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Madagascar%20Country%20Profile\\_2012-2013.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Madagascar%20Country%20Profile_2012-2013.pdf).

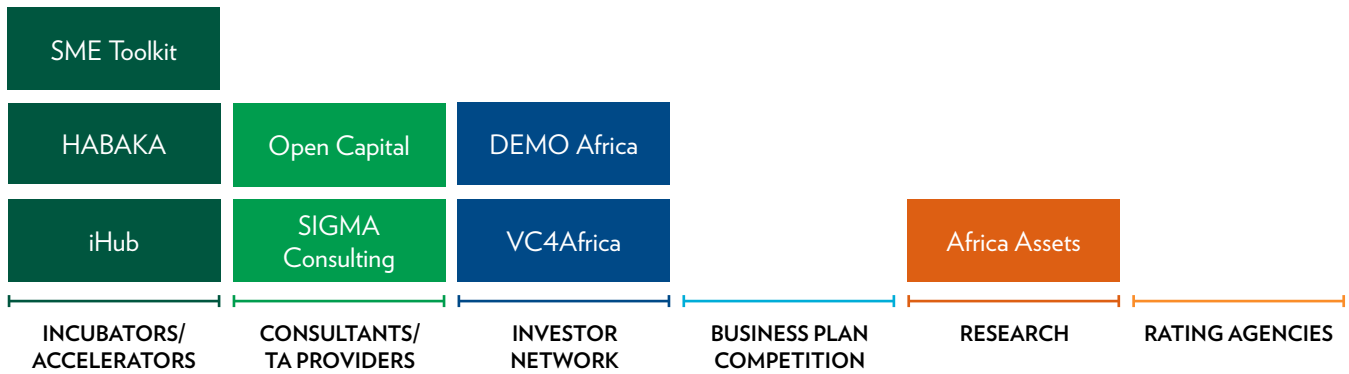
64 *Ibid.*

65 *Ibid.*

66 *Ibid.*

67 *Ibid.*

FIGURE 16. SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Note: Chart focuses on those with local presence; international players are also active.

Source: Open Capital research, organization websites.

Interviewees noted there is a cultural resistance to retaining third-party advisors, as entrepreneurs are often reluctant to share confidential business information and are unclear on the value proposition offered by consultants and support organizations. Most impact investors that have successfully built a portfolio in Madagascar have teams with deep local knowledge and are able to meet their due diligence and business support needs in-house.

## CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Madagascar’s ongoing political instability and variable implementation of its commercial and tax regulations have made it difficult for international investors to operate in the country. This difficulty is compounded by challenges in infrastructure, particularly in energy and transportation, as well as a lack of access to finance and difficulty investors have in adapting to local culture in order to identify high-potential opportunities. More specifically, challenges facing investors in Madagascar include:

- **Political risk and instability:** Recent political instability and the expectation that instability will continue in the coming years—people speak of five-year cycles of conflict—pose a significant challenge for investors in Madagascar. As a result, some investors are hesitant to engage in longer-term endeavors, preferring limited investments that offer the potential for short-term returns.

- **Regulatory environment:** Though the French-style legal code in Madagascar can be difficult for Anglophone investors to navigate, the primary challenges come not from the legal structure itself but from its implementation. In particular, businesses complain of significant tax harassment and often fail to receive reimbursements to which they are entitled. In large part, this stems from the government's low ratio of tax revenue to GDP and corresponding need to collect more revenue. Similarly, while foreigners are legally allowed to lease land for 99 years, in practice they often face land-right challenges, stemming from confusion over land titles.
- **Limited access to finance:** As in other countries in the region, businesses in Madagascar struggle to access credit, as they cannot afford prevailing interest rates. A further challenge is related to physical access to currency. Banks, particularly in rural areas, keep limited cash on hand, depending on Air Madagascar for replenishment. One entrepreneur in the agribusiness sector described renting a private plane to obtain currency to pay farmers when workers at Air Madagascar went on strike. Similarly, shortages of foreign currency are common; throughout 2014 and into 2015, investors complained of significant delays in obtaining dollars to pay suppliers.<sup>68</sup>
- **Poor infrastructure:** Lack of infrastructure—particularly electricity and transport—poses a significant challenge. The World Bank's *Doing Business* report ranks Madagascar last, globally, in terms of "Getting Electricity." Blackouts are common and will often last for hours each day. This is particularly problematic for businesses in energy-intensive sectors, such as textiles. Furthermore, road and rail infrastructure is limited—a challenge in such a large country—and air transport, critical to both the tourism industry and to operations in other sectors, depends on the monopoly held by Air Madagascar.
- **Lack of investment pipeline:** Self-described "social entrepreneurs"—or even entrepreneurs seeking risk capital—are few and far between, and there are few hubs of entrepreneurship.<sup>69</sup> As such, investors without a strong local presence and network find it challenging to locate promising entrepreneurs and to identify investment opportunities—though investors that have a local presence and network reported that they have little trouble.
- **Limited local talent in financial management:** Local businesses rarely have well-constructed or complete financial statements, requiring investors to construct financial documents during the diligence process.<sup>70</sup> Furthermore, investors often have to look outside of the country for CFO-level talent.<sup>71</sup>

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68 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

69 Open Capital interviews.

70 *Ibid.*

71 *Ibid.*

Despite these challenges, there are a number of promising opportunities for impact investors in Madagascar. These opportunities do not necessarily look like the businesses that impact investors typically seek; in Madagascar, there is limited awareness of “impact investing.” While few businesses explicitly position themselves as social enterprises, many investors are actively looking to create a positive impact through job creation and improving incomes. Opportunities include:

- **Integrate the informal sector:** Anecdotal evidence suggests that the post-2009 instability affected the informal sector less than the formal sector.<sup>72</sup> While the formal sector declined as major multinational companies pulled out and Madagascar lost its AGOA eligibility, some small- and medium-sized businesses in the informal sector experienced an increase in revenue. Today, there is opportunity to incorporate informal, mid-sized SMEs into export-oriented value chains. High-potential sectors include textiles—particularly with Madagascar’s return to AGOA and the agreement’s ten-year extension—as well as agribusiness and, potentially, mining.<sup>73</sup>
- **Establish a strong local presence:** Securing pipeline in Madagascar depends on a strong local network and relationships. To the extent that investors are not Malagasy, they should also develop local partnerships. In addition to assisting in securing deal flow, local presence and partnerships are critical to overcoming cultural challenges and to navigating bureaucracy. Local partners could include investors, village leaders (who are especially critical for agricultural investments), and, to the extent that they exist, intermediaries.
- **Capitalize on available human resources:** Madagascar has a population that is understood to be hard-working, reliable, and highly skilled in certain industries. There is significant potential for investments in companies and industries that build from this foundation of human capital, as described in the next section.

Investors pointed to particularly strong opportunities in the following sectors:

- **Textiles:** Madagascar benefited from preferential access to US markets under AGOA from 2001 to 2009, leading to a boom in textile exports, which averaged USD 231 million per year.<sup>74</sup> When Madagascar lost AGOA eligibility, apparel and clothing exports to the US dropped by 85 percent.<sup>75</sup> With Madagascar’s AGOA privileges reinstated in mid-2014 and extended for 10 years, investors anticipate significant opportunity. In addition to AGOA, this sector benefits from low-cost, highly-skilled labor that already has significant experience in apparel manufacturing.

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72 Open Capital interviews.

73 There is currently substantial informal mining activity. Anecdotally, the research team learned that minerals from Madagascar often appear on other countries’ import accounts, with no corresponding export registered on Madagascar’s books.

74 Soamiely Andriamananjara and Amadou Sy, “AGOA and Dutch Disease: The Case of Madagascar,” *The Brookings Institution* (blog), February 18, 2015, <http://www.brookings.edu/blogs/africa-in-focus/posts/2015/02/18-agoa-suspension-madagascar-andriamananjara-sy>.

75 *Ibid.*

- **Agribusiness:** Madagascar is the leading exporter of a number of high-value agricultural products and has the potential to become the leading exporter for many others. High-potential crops include vanilla, chocolate, various spices, lychees (Malagasy lychees currently supply 70 percent of the European market),<sup>76</sup> and various essential oils, including many used in cosmetics.<sup>77</sup> There are a large number of small businesses operating in the sector today, and there are opportunities to connect them to financing to expand. Currently, many businesses in the sector shy away from bank loans, as they are hesitant to use land as collateral.
- **Extractive industries:** Extractive industries, particularly mining, have driven economic growth in recent years, and the country has identified a number of new deposits, including iron ore, graphite, coal, and rare earths, for future development. Opportunities exist in extraction itself, as well as in supporting activities, such as supplying machines and power-generation equipment. Integrating informal, small-scale mining activities into formal, export-oriented value chains offers further opportunity, though doing so would require intensive on-the-ground capacity-building and cultural sensitization.<sup>78</sup> While outside the purview of many impact investors, these activities could generate substantial employment and may meet some impact investors' investment criteria.
- **Tourism:** As a World Bank study of the tourism sector notes, Madagascar is one of the world's only mega-biodiverse countries. This biodiversity includes not only 32 species of lemur—a primary tourist attraction—but also significant marine and coastal life, including marine mega-fauna. The country is the world's fourth-largest island and has nearly five thousand kilometers of coastline.<sup>79</sup> Despite these natural assets, Madagascar has a relatively underdeveloped tourism sector, likely due to recent political instability and challenges around infrastructure. Nonetheless, investors believe that there are opportunities in tourism, including opportunities focusing on sub-sectors (e.g., hotels), as well as in developing entire geographic areas for tourism, which requires more comprehensive investment.
- **BPO and call centers:** Investors, donors, and government entities all expressed enthusiasm for business-process outsourcing (BPO) and call centers. Anecdotal evidence suggests that the advent of the Arab Spring and ensuing instability in North Africa has prompted companies in need of French-language BPO to look for alternative locations. Madagascar, with its low labor costs and a population speaking neutral, clear-accented French, could be a high-potential substitute.

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76 European Commission, "Fruitful Trade in Madagascar" (2012), [http://trade.ec.europa.eu/doclib/docs/2012/may/tradoc\\_149443.pdf](http://trade.ec.europa.eu/doclib/docs/2012/may/tradoc_149443.pdf).

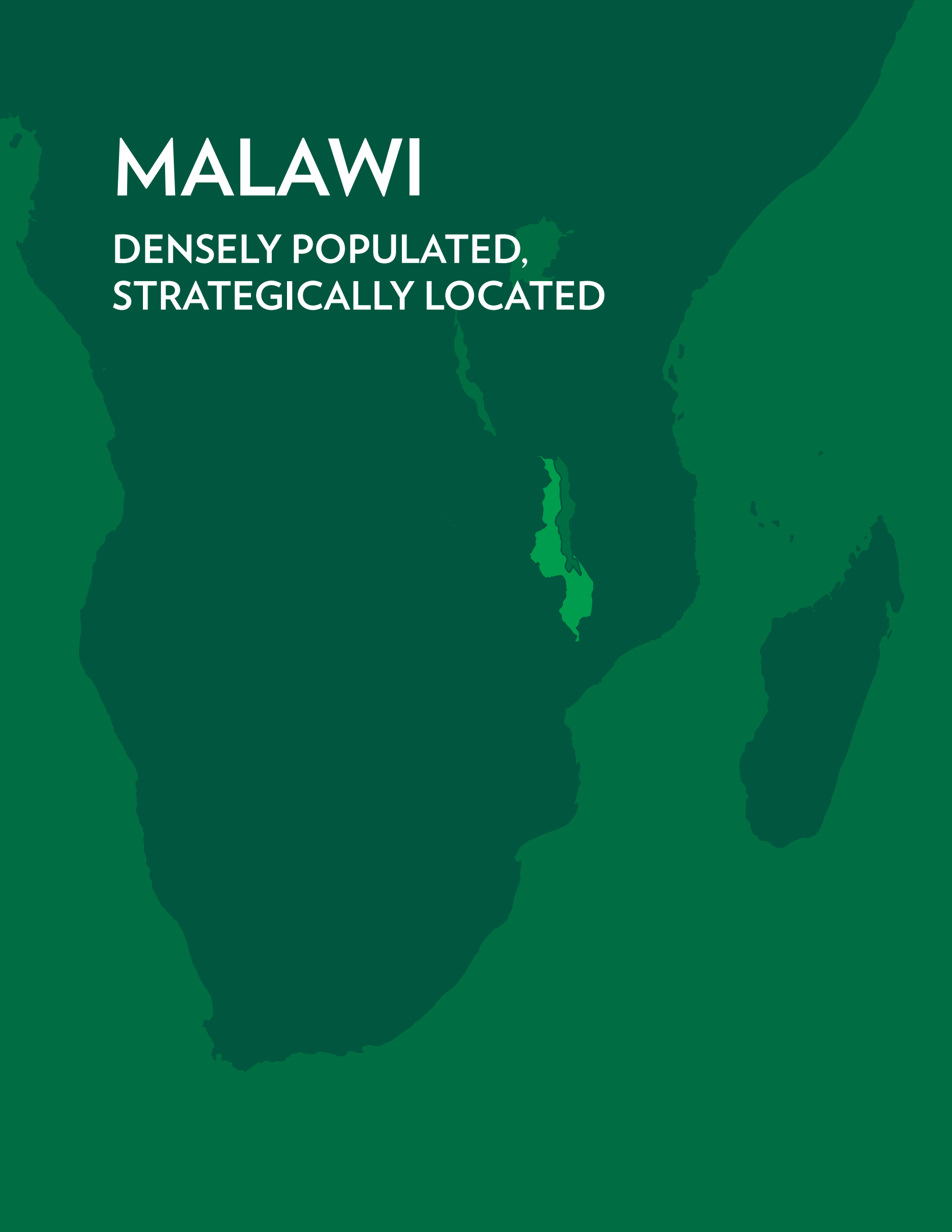
77 "Madagascar, Agri-food Hub for the Indian Ocean," Economic Development Board of Madagascar, <http://www.edbm.gov.mg/Economic-data/Sectors/Agribusiness-Madagascar-agri-food-hub-for-the-Indian-Ocean>.

78 US Department of State, "Madagascar Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241855.pdf>.

79 Iain T. Christie and D. Elizabeth Crompton, *Republic of Madagascar: Tourism Sector Study* (Washington, DC: The World Bank Group, 2003), <http://www.worldbank.org/afr/wps/wp63.pdf>.

# MALAWI

DENSELY POPULATED,  
STRATEGICALLY LOCATED



# INTRODUCTION

Malawi is a small, landlocked country of approximately 118 thousand square kilometers in Southern Africa, bordering Tanzania, Zambia, and Mozambique (see Figure 1). With a population of 16.36 million and at 142 people per square kilometer, Malawi is one of the most densely populated countries in the world.<sup>1</sup> Malawi is classified as a “least-developed country,” with a 2013 gross domestic product (GDP) per capita of only USD 226.<sup>2</sup>

FIGURE 1. MAP OF MALAWI



Malawi has attracted limited international impact investment. The country has an underdeveloped private sector and suffered in 2013 from a high-profile public corruption scandal, known as “Cashgate,” in which public officials embezzled more than USD 32 million.<sup>3</sup> Although Malawi’s economy is growing, it depends considerably on agriculture and suffers from a large trade deficit, as it lacks the industrial base necessary to produce many basic goods.

1 The World Bank, “Malawi,” in *Doing Business 2016* (Washington, DC: The World Bank, 2015), <http://www.doingbusiness.org/data/exploreeconomies/malawi/>; and KPMG, *Malawi Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Malawi%20Country%20Profile%202012-2013\\_01.pdf](http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Malawi%20Country%20Profile%202012-2013_01.pdf).

2 The World Bank: Data, s.v. “Malawi” in “Indicators: GDP Per Capita,” <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>.

3 J.O’S., “The \$32m heist,” *The Economist*, February 27, 2014, <http://www.economist.com/blogs/baobab/2014/02/malawi-s-cashgate-scandal?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

# COUNTRY CONTEXT

In 2014, Malawi celebrated 50 years of independence, throughout which it has enjoyed political stability. Since introducing a multi-party system in 1994, the country has held five relatively peaceful presidential and parliamentary elections. Malawi's most recent elections—in May 2014—featured 11 parties and resulted in the election of Professor Arthur Peter Mutharika of the Democratic Progressive Party (DPP) as President.<sup>4</sup> Mutharika, the brother of a former president, defeated the incumbent, Joyce Banda.<sup>5</sup> Ms. Banda's loss in the elections was likely influenced by the Cashgate scandal.<sup>6</sup>

Cashgate has had both economic and political implications, as many donor organizations withdrew monetary support for the Malawian government following the scandal: government grants fell from 14.5 percent of GDP in 2012-2013 to 4.4 percent in 2013-2014.<sup>7</sup> Without this support, the government's fiscal deficit in 2013-2014 exceeded 8.6 percent of GDP, a large increase from 1.3 percent in 2012-2013.<sup>8</sup> Although the government has made some attempts to reduce its discretionary spending, overall expenditures have increased due to interest payments on domestic debt and an increase in the public-sector wage bill.<sup>9</sup>

As a result of the scandal, donors report that many of the funds previously allocated directly to the government are now supporting specific projects instead.<sup>10</sup> It is unclear if or when donors will restore their previous levels of direct financial support for the Malawian government. This has created uncertainty for the government, private sector, and overall economy alike. Consequently, the government has reduced its expectations of donor funding in its 2014-2015 budget, planning to receive aid funds equivalent to only 6.1 percent of GDP.

Malawi is a member of the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA). As a result, Malawi has minimal tariffs to trade with other COMESA and SADC members under the terms of the COMESA Customs Union and SADC Free Trade Area, though some tariffs with South Africa remain in place.

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4 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

5 J.O'S., "An End to Uncertainty (but only that)," *The Economist*, June 2, 2014, <http://www.economist.com/blogs/baobab/2014/06/malawi-s-new-president#Lh0AykTB3CEqQpzh.99>.

6 J.O'S., "The \$32m heist," *The Economist*, February 27, 2014, <http://www.economist.com/blogs/baobab/2014/02/malawi-s-cashgate-scandal?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

7 Richard Record et al., *Malawi Economic Monitor Managing Fiscal Pressures* (Washington, DC: World Bank, 2015), [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484\\_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf).

8 *Ibid.*

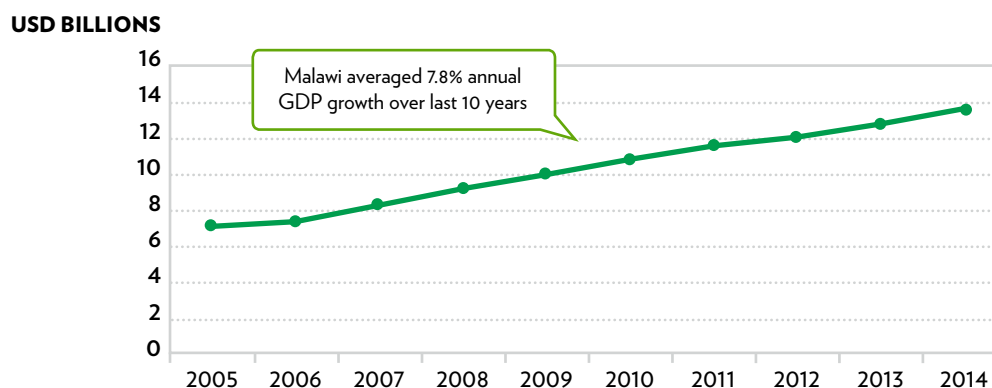
9 *Ibid.*

10 Open Capital Interviews.

## Gross Domestic Product

In 2014, Malawi's GDP at purchasing power parity (PPP) was USD 13.7 billion.<sup>11</sup> Malawi's GDP has grown approximately eight percent year-on-year in PPP terms over the last decade (see Figure 2).<sup>12</sup> This growth has been driven by expansion across sectors, primarily agriculture, and information and communication technologies (ICT), and wholesale and retail trade.

FIGURE 2. GDP (PPP), 2005–2014



Source: IMF World Bank Economic Indicators, April 2015

Agriculture, which grew 6.1 percent in 2014, remains the dominant sector in Malawi's economy.<sup>13</sup> Although it accounts for only 30 percent of GDP, agriculture is responsible for 90 percent of exports and employs over 80 percent of the population.<sup>14</sup> Tobacco, known as Malawi's "green gold," is the country's primary export crop, accounting for over half of its total exports;<sup>15</sup> tobacco was a major contributor to 2014 growth as production increased by 14 percent despite a reduction in price.<sup>16</sup>

Recent growth in the agricultural sector is partly due to public expenditure, as the government continues to heavily subsidize farming activities. The Farm Input Subsidy Program, which subsidizes up to 97 percent of the cost of inorganic fertilizer for

11 "General Profile: Malawi," United Nations Conference on Trade and Development, last updated 2014, <http://unctadstat.unctad.org/CountryProfile/454/en454GeneralProfile.html>.

12 *World Economic Outlook Database*, s.v. "Malawi" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

13 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

14 KPMG, *Malawi Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Malawi.pdf>.

15 C. Ojukwu et al., *Malawi Country Strategy Paper, 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Malawi%20-%20Country%20Strategy%20Paper.pdf>.

16 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

smallholder farmers, accounted for 70 percent of government spending on agriculture in 2014 and comprises 10 percent of the entire national budget.<sup>17</sup> Such heavy public spending limits the ability for producers to diversify both within agricultural value chains and to other sectors, both of which are sorely needed.

Efforts to diversify Malawi's economy have shown some success, with introductions of tea and cotton as new export crops and an increase in local manufacturing. The development of a uranium mine at Kayelekera accounted for 12 percent of 2013 exports and presented additional opportunities for diversification, though mining operations were suspended in February 2014 when fallen demand resulted in global uranium prices that were 50 percent lower. As a result, Malawi earned only USD 10 million from uranium exports in 2014, less than 10 percent of the value of uranium exports in 2013.<sup>18</sup>

## Foreign Direct Investment

Malawi's net foreign direct investment (FDI) has fluctuated significantly in recent years, from a high of USD 195 million in 2008 to a low of USD 49 million in 2009. The majority of FDI has been into the mining sector, with fluctuations largely driven by project finance requirements.<sup>19</sup> As part of its 2011–2016 Malawi Growth and Development Strategy (MGDS II), Malawi seeks to encourage FDI in agriculture, tourism, energy, and transportation infrastructure. Within agriculture, priority crops include sugar cane, legumes, and all large-scale commercial crops, as well as irrigation projects across value chains. To further facilitate FDI, the government established a One Stop Service Center in 2012 at the Malawi Investment and Trade Center (MITC) to serve investors. Though still nascent, this entity's goal is to streamline investor entry into Malawi and house all necessary information, functions, and registration procedures in one bureaucratic unit.<sup>20</sup>

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17 Richard Record et al., *Malawi Economic Monitor Managing Fiscal Pressures* (Washington, DC: World Bank, 2015), [http://www-wds.worldbank.org/external/default/WDSCContentServer/WDSP/IB/2015/04/14/000406484\\_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf](http://www-wds.worldbank.org/external/default/WDSCContentServer/WDSP/IB/2015/04/14/000406484_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf).

18 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

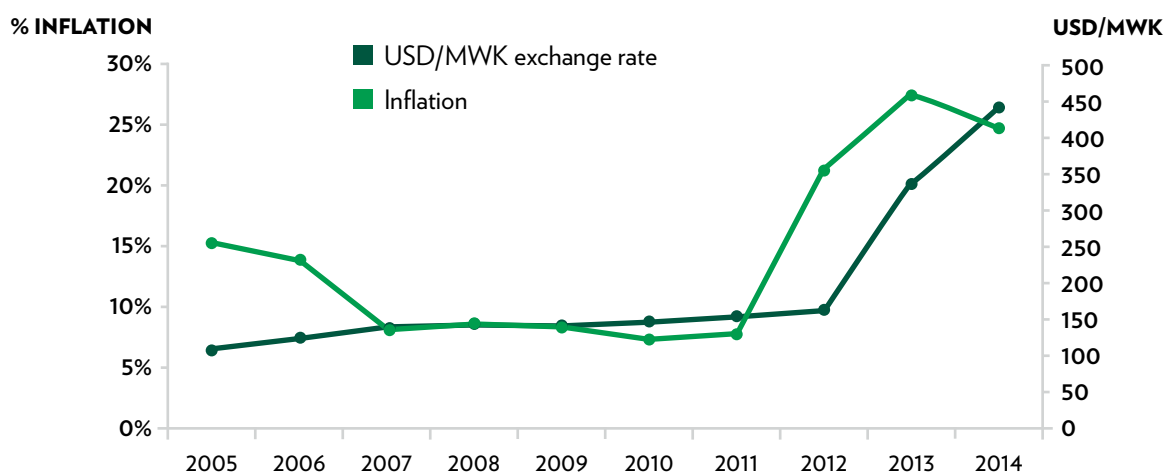
19 C. Ojukwu et al., *Malawi Country Strategy Paper, 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Malawi%20-%20Country%20Strategy%20Paper.pdf>.

20 US Department of State, "Malawi Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241857.pdf>.

## Inflation and Exchange Rates

Until 2012, the Malawian kwacha was pegged to the US Dollar at a fixed rate of 166 to one.<sup>21</sup> In May 2012, Banda's government devalued the kwacha by 33 percent to meet donor demands prior to increasing donor funding. Immediately following devaluation, Malawians saw sharp increases in the prices of basic goods and fuel. Since 2012, the kwacha has continued to depreciate against the dollar, including 15 percent depreciation in 2014 (see Figure 3).<sup>22</sup>

FIGURE 3. INFLATION AND USD/MWK EXCHANGE RATE, 2005 - 2014



Source: World Bank Indicators

Like the exchange rate, the inflation rate in Malawi has risen sharply over the past few years. Inflation tripled between 2011 and 2012 from seven to 21 percent. It reached a high of more than 27 percent in 2013 before falling to just over 24 percent in 2014.<sup>23</sup> The African Development Bank projects that inflation will fall to 15 and 10 percent in 2015 and 2016, respectively,<sup>24</sup> but as recently as February 2015, the World Bank estimated inflation at 19 percent.<sup>25</sup> High inflation continues to impair household cash flows, especially among the poor, while increasing the cost of borrowing and creating uncertainty for investors.

21 "Malawians Left Counting Rising Cost of Economic Reform," *The Guardian*, May 25, 2012, <http://www.theguardian.com/global-development/2012/may/25/malawians-counting-cost-economic-reform>.

22 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

23 *The World Bank: Data*, s.v. "Malawi" in "Indicators: Inflation and exchange-rates graphs," <http://data.worldbank.org/indicator>.

24 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

25 Richard Record et al., *Malawi Economic Monitor Managing Fiscal Pressures* (Washington, DC: World Bank, 2015), [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484\\_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf).

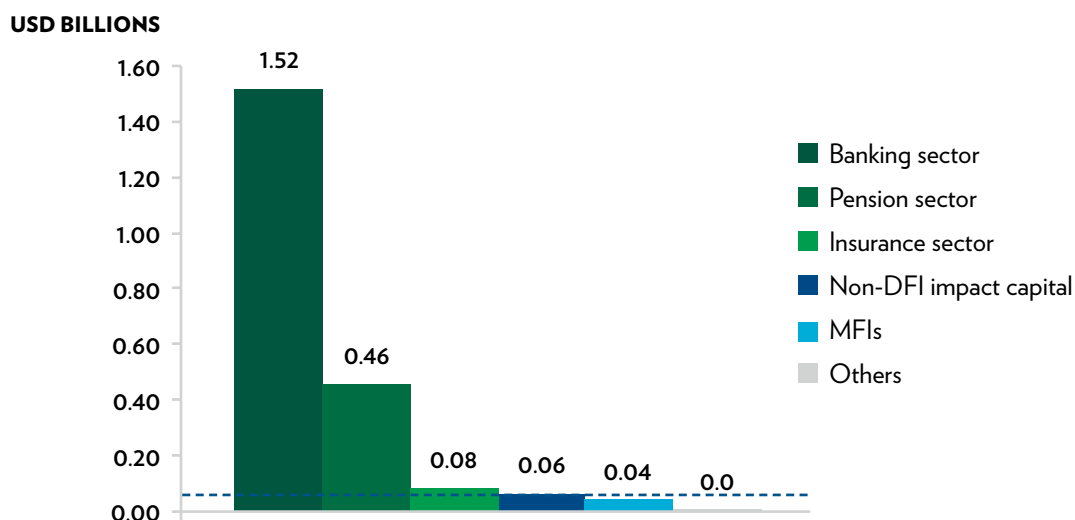
# SUPPLY OF IMPACT INVESTING CAPITAL

Impact capital is relatively limited in Malawi. Though many vehicles for impact capital based in South Africa and elsewhere include Malawi in their geographic mandate, few have operations in-country or staff on the ground, and only 68 known impact investments have been completed to date.

## Broader Investing Landscape

Impact capital therefore represents a small portion of the total capital available in Malawi (see Figure 4). Banks, which control approximately 70 percent of total financial-sector assets, dominate the country's financial landscape. Two privately owned banks hold more than half of total assets and deposits.<sup>26</sup> Overall, banks have access to sufficient, affordable capital and are performing well financially.<sup>27</sup>

FIGURE 4. IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: World Bank Indicators

26 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

27 Open Capital Interviews; and Richard Record et al., *Malawi Economic Monitor Managing Fiscal Pressures* (Washington, DC: World Bank, 2015), [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484\\_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/14/000406484_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf).

Nevertheless, access to finance is still a challenge for individuals and businesses, as only 54 percent of Malawi's population had access to formal financial services in 2014.<sup>28</sup> Interest rates are above 35 percent, making it challenging for companies with commercial debt to generate positive returns.<sup>29</sup> In addition, banks often have high collateral requirements that many businesses are unable to meet,<sup>30</sup> while local actors report that banks lack the understanding required to lend to small- and medium-sized enterprises (SMEs).<sup>31</sup> There are few financial-service providers to support the capital needs of start-ups and growing enterprises.<sup>32</sup>

Donor organizations are a key source of capital in Malawi, but, according to some interviewed development organizations, they often target larger companies with higher turnover, which are perceived as less risky. However, donors increasingly recognize the need growing businesses have for funding.<sup>33</sup> The United Nations Development Programme in Malawi launched the Malawi Innovation Challenge in 2014, a USD eight million facility providing up to 50 percent matching grants to innovative businesses in agriculture and manufacturing.<sup>34</sup>

## Impact Capital Disbursed

Malawi's small market size is reflected in the known impact investments to date. Only one percent of all non-development finance institution (non-DFI) impact capital disbursed in Southern Africa has been placed in Malawi, amounting to approximately USD 57 million in 30 deals (see Figure 5). Similarly, about one percent of all direct investment in the region by DFIs has been placed in Malawi, totaling just over USD 266 million disbursed through 38 direct investments (see Figure 6).

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28 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

29 Richard Record et al., *Malawi Economic Monitor Managing Fiscal Pressures* (Washington, DC: World Bank, 2015), [http://www-wds.worldbank.org/external/default/WDSCContentServer/WDSP/IB/2015/04/14/000406484\\_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf](http://www-wds.worldbank.org/external/default/WDSCContentServer/WDSP/IB/2015/04/14/000406484_20150414080015/Rendered/PDF/957130WP0P15380nal00Apr020201500203.pdf).

30 *Ibid.*

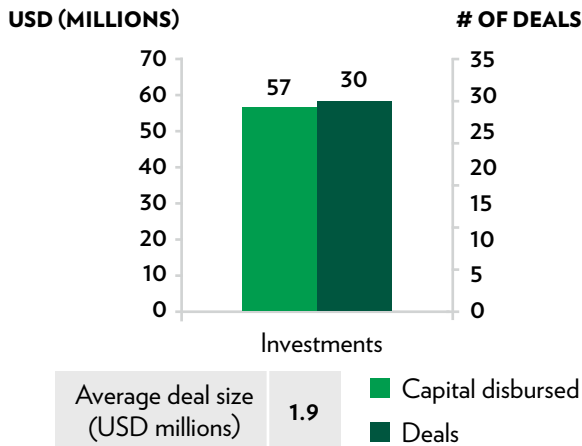
31 Open Capital Interviews.

32 *Ibid.*

33 *Ibid.*

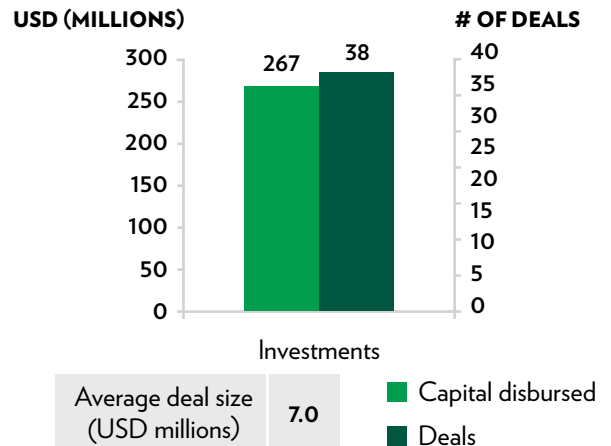
34 Malawi Innovation Challenge Fund, <http://www.micf.mw/>.

**FIGURE 6. NON-DFI IMPACT INVESTMENTS**



Source: Open Capital Research

**FIGURE 7. DFI IMPACT INVESTMENTS**

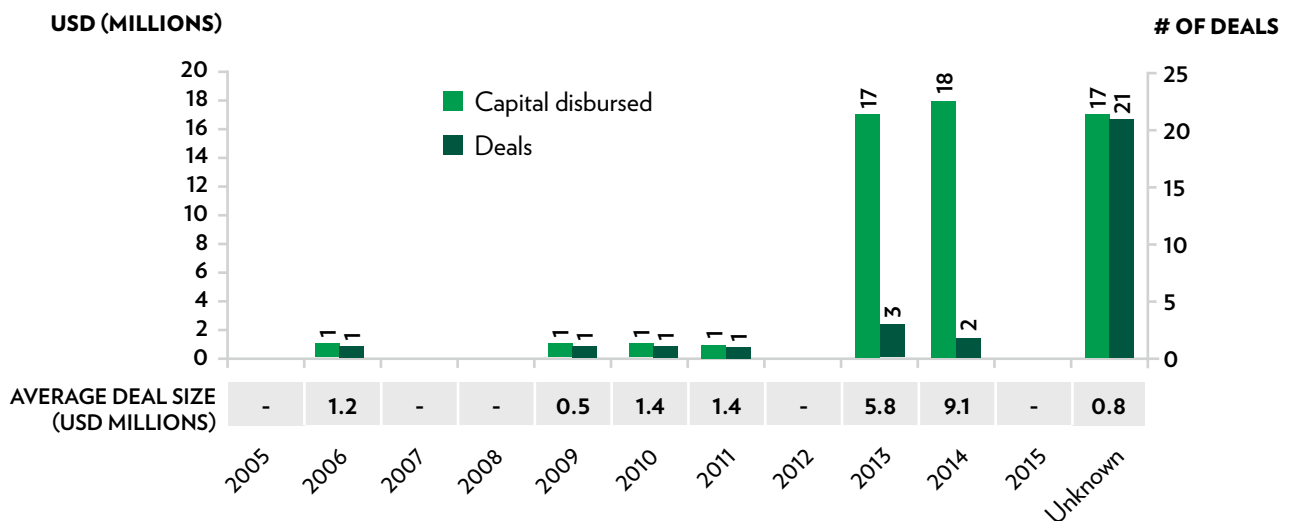


Source: Open Capital Research

## Investments Over Time

One of the reasons for Malawi’s low rates of impact investing is the relative infancy of the market, particularly for non-DFI investors (see Figure 7). The first non-DFI investments in Malawi were made in 2006, with investment growth picking up in 2011. (Worth noting is that the year of investment is unknown for a high proportion of deals.)

**FIGURE 7. NON-DFI IMPACT INVESTMENTS BY YEAR**

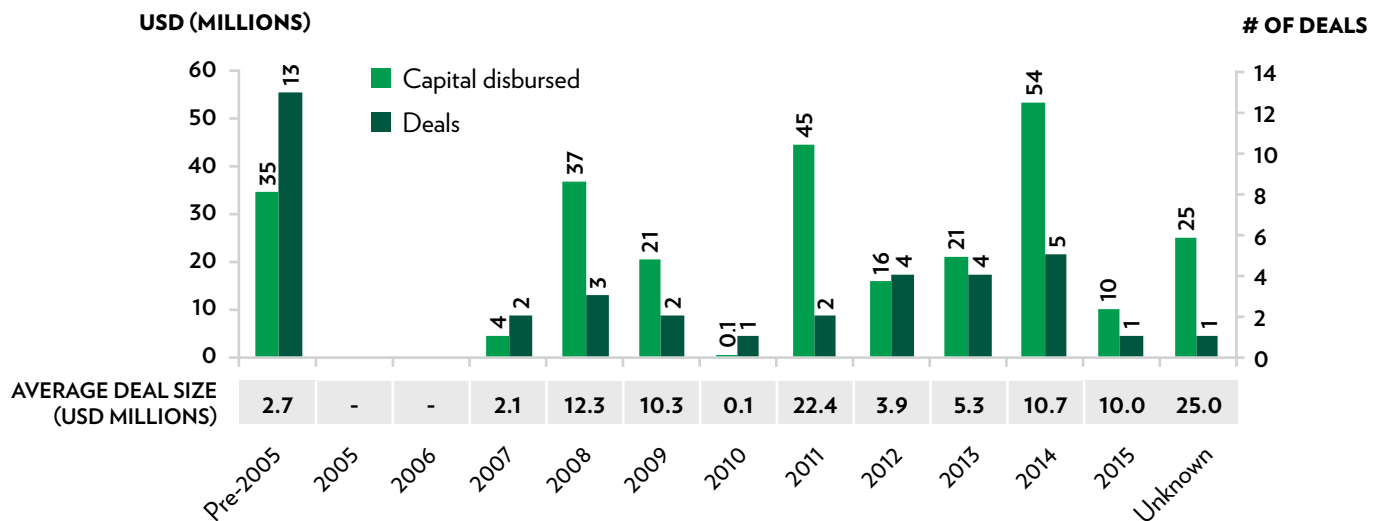


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

DFI investments have a longer history. Almost 40 percent of recorded investments were placed before 2005 (see Figure 8).

FIGURE 8. DFI IMPACT INVESTMENTS BY YEAR



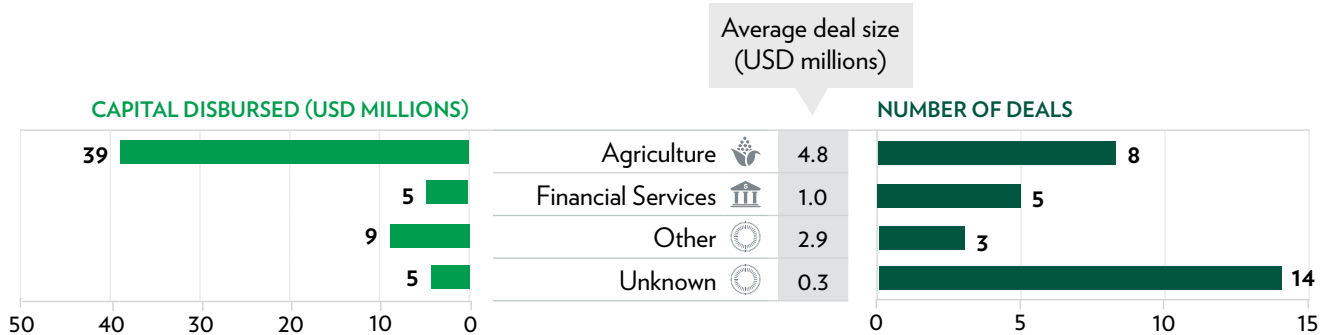
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Sector

Of the sectors targeted by non-DFI impact investors, agriculture has received the most attention (around 30 percent of all known deals in Malawi), with strong interest from multiple investors (see Figure 9). These deals included investments in primary production and inputs. As is common with non-DFI impact investments throughout the region, investment in financial services represents a large share of total investment due to the larger ticket sizes possible when placing capital into established institutions. Financial-services investments in Malawi have been focused in banks and microfinance institutions (MFIs).

**FIGURE 9. NON-DFI IMPACT INVESTMENTS BY SECTOR**

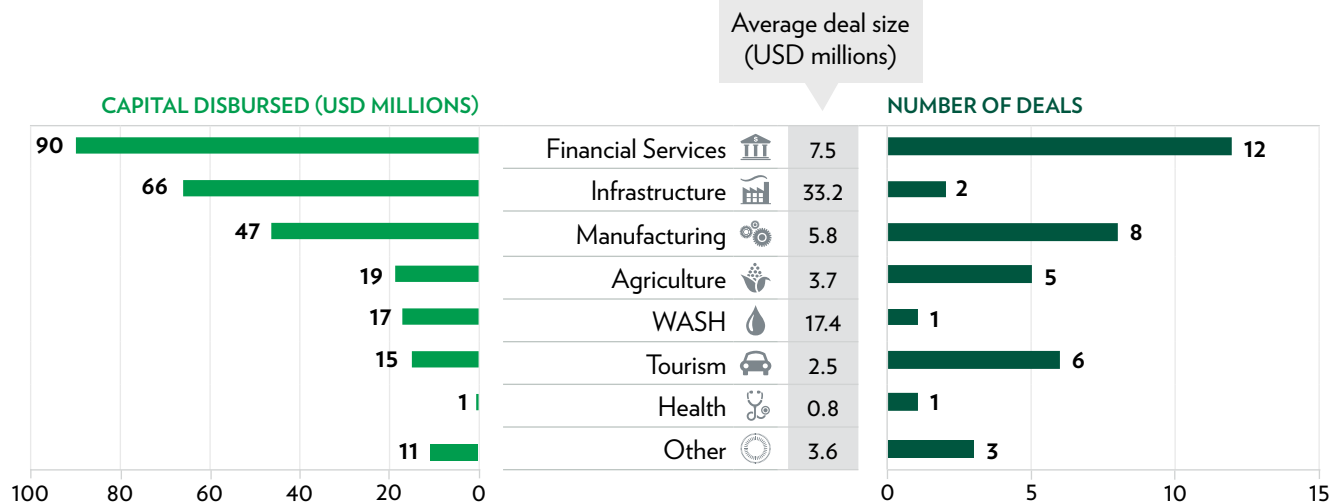


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

A large proportion of DFI direct investments have been in financial services (31 percent of all deals and 37 percent of total capital disbursed). These investments are predominantly in banks (see Figure 10). Meanwhile, tourism-related investments have mostly been made in hotels, and manufacturing investments have largely been focused in agro-processing.

**FIGURE 10. DFI IMPACT INVESTMENTS BY SECTOR**



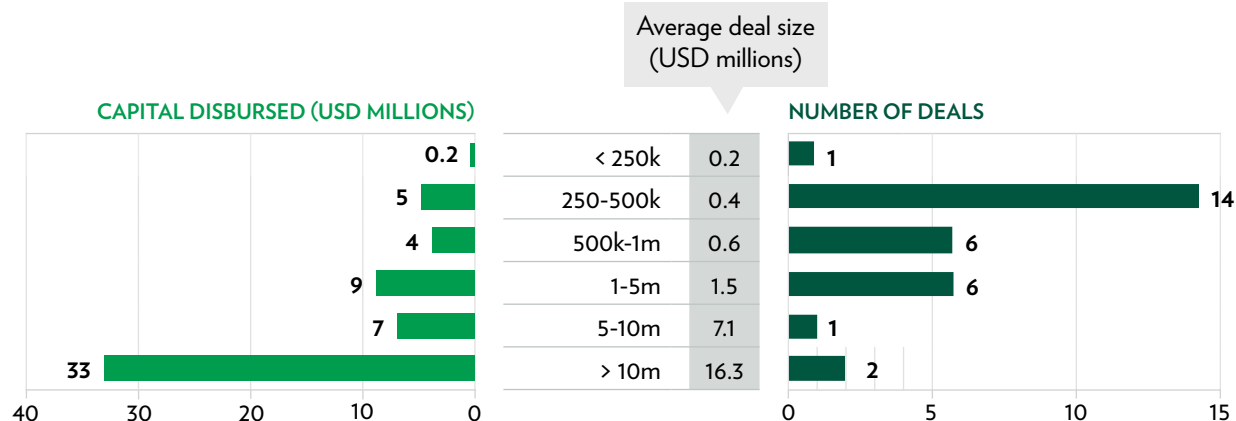
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Deal Size

Most non-DFI impact deals in Southern Africa are less than USD one million, and Malawi is no exception. In Malawi, almost 80 percent of deals have been below USD one million (see Figure 11).

FIGURE 11. NON-DFI IMPACT INVESTMENTS BY DEAL SIZE

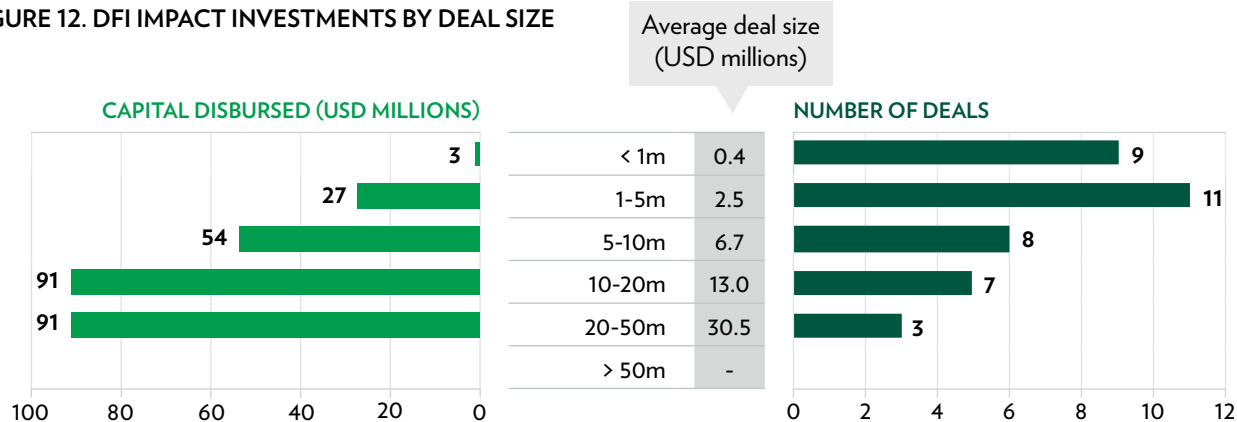


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

DFI direct investments in Malawi are often significantly larger, averaging over USD six million, more than five times the average size of non-DFI impact investor deals (see Figure 12). This difference is primarily due to DFIs' preference for investments in infrastructure and financial institutions. Malawi does, however, have a higher proportion of DFI deals under USD one million than does the region (25 percent of all deals compared to 12 percent regionally). This is likely due to the smaller opportunities in Malawi more broadly, with these small deals spread across a number of industries, including tourism, agriculture, manufacturing, and healthcare.

FIGURE 12. DFI IMPACT INVESTMENTS BY DEAL SIZE



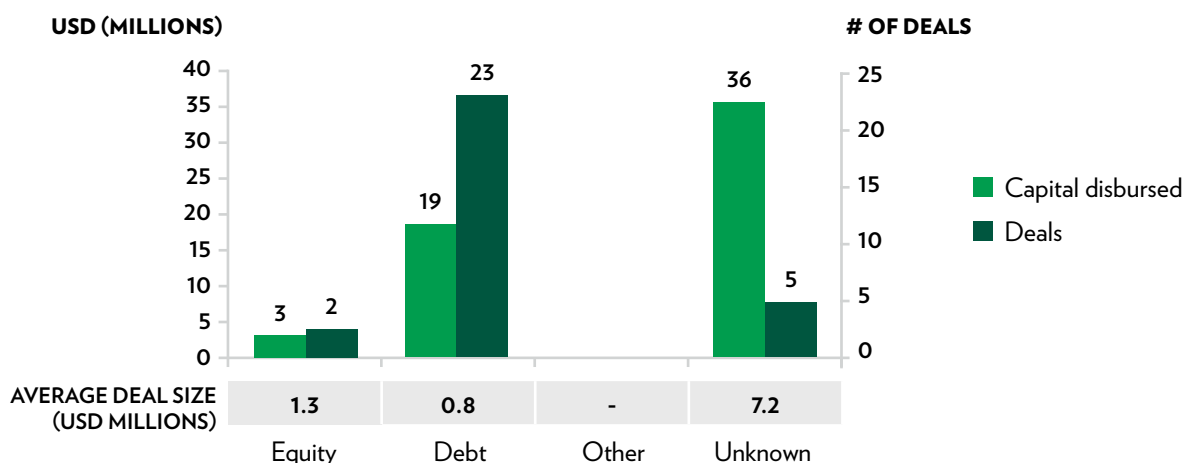
Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Instrument

Non-DFI impact investors in Malawi prefer debt instruments (see Figure 13). Anecdotally, many of those interviewed report that Malawian entrepreneurs do not understand equity instruments and, even when they do, are reluctant to relinquish company control to an external investor. Only two equity transactions have been reported, though these have been larger in size (averaging nearly USD 1.4 million) than debt transactions (averaging USD 0.8 million).

FIGURE 13. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE

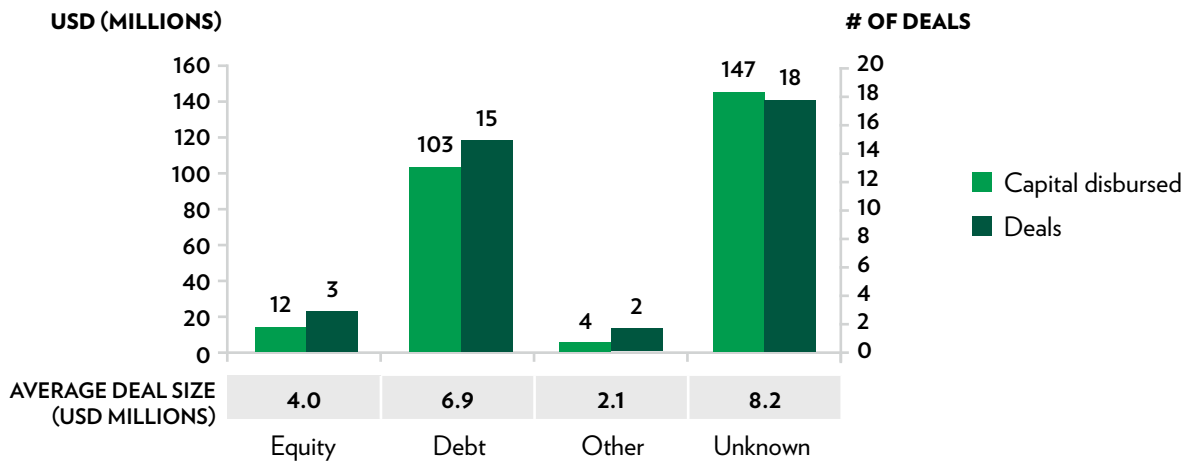


Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

The prominence of debt over other instruments is also seen in deals by DFIs, which have overwhelmingly used loans to make direct investments in Malawi (see Figure 14). These loans are, on average, substantially bigger in size (averaging nearly USD seven million) than the completed equity transactions (averaging USD four million).

FIGURE 14. DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

## Local Presence

Few impact investors have offices in Malawi. Only six impact investors have established a full-time presence in Blantyre or Lilongwe, none of which are headquartered in the country and four of which are DFIs. However, investing in Malawi often requires deep local knowledge and government connections in order to navigate the bureaucratic landscape and facilitate deals. Investors on the ground identified their local presence as a key factor in their success. Of those investors who are active in the country but do not have a local presence, interviewees identified finding local partners and hiring key management positions within their portfolio companies as alternative options to mitigate risk and facilitate success.<sup>35</sup>

## Impact Tracking Standards

Across the region, most impact investors do not use a specific standard for measuring the impact of their investments. This is also true in Malawi. Instead, investors typically use flexible reporting that is customized for each new investment, which allows investors to reduce the administrative burden for their portfolio companies and focus on the most meaningful metrics.

<sup>35</sup> Open Capital Interviews.

# DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Malawi has a strong need for impact capital across a wide range of industries. Even in agriculture, where the majority of the population is employed, there is little commercialization or value-addition. Further, many basic services are lacking or underdeveloped in Malawi, creating an opportunity for entrepreneurs and their investors to meet these needs.

Despite recent economic growth, Malawi has seen minimal improvement in human development indicators and continues to lag global and regional averages (see Table 1). In 2013, Malawi ranked 174<sup>th</sup> out of 187 countries in the United Nation's Human Development Index (HDI) with a score of 0.41, much lower than the regional average of 0.55.<sup>36</sup> Of countries in the region, only Mozambique has a lower HDI score than does Malawi. The country's low overall ranking indicates low performance across multiple measures, including measures of poverty, health, and education.

TABLE 1. SELECTED MALAWI DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Malawi	Regional Average	Global Average
HDI SCORE (RANKS 174 <sup>TH</sup> OF 187 COUNTRIES)	0.41	0.55	0.69
GDP PER CAPITA (USD)	750	6,874	17,975
UNEMPLOYMENT RATE (%)	8	13	6
POPULATION BELOW USD 1.25 / DAY (%)	62	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	71	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	9	41	59

More than 60 percent of Malawi's population lives on less than USD 1.25 per day, nearly three times the global average. Poverty disproportionately affects rural residents, as 95 percent of Malawi's poor live in rural areas.<sup>37</sup>

36 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

37 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

Malawi's gross enrollment in secondary education is half the Southern Africa average. Only nine percent of the Malawian population age 25 and above has attended some secondary school, a figure lower than every other Southern African country for which data is available, except Mozambique.<sup>38</sup> Improvement of Malawi's educational system is critical for its future development. Much like its neighbors, Malawi's population is disproportionately young, with 66 percent of the population under the age of 25. Without an adequate educational system, youth in Malawi struggle to find work, and entrepreneurs find it challenging to source talent with the skills needed to build their enterprises.

## Entrepreneurs

Malawi has an underdeveloped private sector that is largely defined by current and former parastatals and family businesses. As an import-based economy with a large trade deficit, Malawi depends on foreign goods to meet many basic needs.

Despite these gaps, it is challenging for entrepreneurs to start businesses. The private sector is plagued by a variety of issues including poor infrastructure, limited available talent, and burdensome regulation.<sup>39</sup> As mentioned above, access to capital remains another key constraint in Malawi, with banks lending at interest rates above 35 percent and few active impact capital vehicles. Entrepreneurs who lack adequate personal or family capital are often unaware of the process to follow to raise capital and struggle to find affordable financing.

Even if entrepreneurs are able to finance their businesses, government regulations make the process of starting a business challenging. Entrepreneurs interviewed report that the steps, costs, and requirements to register and launch a business are time-consuming and confusing. Interviewees report that the process is significantly more manageable for those who have professional or personal connections with government officials.

New enterprises also struggle to maintain profitability due to a lack of adequate infrastructure. Many report frequent power cuts and low-quality roads as factors that increase the costs of doing business. Those businesses producing physical goods for export cannot rely on the Malawi Bureau of Standards (MBS) to certify their products because it is not internationally recognized, so they must first send their goods to South Africa, which further increases their cost and time-to-market. Though donors have provided funding to increase MBS's capabilities, the government has yet to invest in the necessary infrastructure.<sup>40</sup>

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38 Note: Data unavailable for Angola and Madagascar. United Nations Development Programme, 2014 *Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

39 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

40 Open Capital Interviews.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

Malawi's ecosystem is challenging for entrepreneurs and investors to navigate, restricting business in the country. Opaque government regulations can stifle innovation, while high interest rates, volatile foreign exchange, and government intervention in the private sector limit profitability.

Businesses have limited options in the broader ecosystem when seeking support. While lawyers and accountants are available, few service providers or intermediaries are active in Malawi.

## Regulatory Environment

Though the Malawian government continues to express openness to investment in government communiqués, the country's current regulatory system makes it difficult to do business. The World Bank currently ranks Malawi 164<sup>th</sup> out of 189 countries on its "Ease of Doing Business" rankings, slipping Malawi one place since 2014.<sup>41</sup> Unpredictable government regulations create an uncertain economic environment, which makes day-to-day operations and long-term strategic planning challenging for both businesses and investors.

There have been some recent improvements. Donors have provided support to improve the regulatory environment, and the Malawian government has made efforts to foster investment, including the One Stop Service Center mentioned above.<sup>42</sup> Regulatory considerations include:

- **Land ownership:** Land ownership in Malawi is complex, with three types of land tenure—customary, leasehold, and public.<sup>43</sup> It is vital that investors understand the tenure and legal implications of any land they are looking to acquire. Customary land is held by groups and individuals in the community.<sup>44</sup> It cannot be sold outside that community.<sup>45</sup> The most common form of land tenure in Malawi, customary

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41 The World Bank, "Malawi," in *Doing Business 2016* (Washington, DC: The World Bank, 2015), <http://www.doingbusiness.org/data/exploreeconomies/malawi/>.

42 Open Capital Interviews.

43 Ephraim W. Chirwa, *Land Tenure Farm Investments and Food Production in Malawi* (Manchester, UK: Improving Institutions for Pro-Poor Growth, 2008), [http://www.eldis.org/vfile/upload/1/document/1106/Land%20tenure%20farm%20investments%20and%20food%20production%20in%20Malawi\[1\].pdf](http://www.eldis.org/vfile/upload/1/document/1106/Land%20tenure%20farm%20investments%20and%20food%20production%20in%20Malawi[1].pdf).

44 Government of Malawi, *Malawi National Land Policy* (2002), <http://www.cepa.org.mw/index.php/en/2015-02-13-13-10-21/legislation/policy-documents?task=download&id=98>.

45 US Agency for International Development, *Malawi: Property Rights and Resource Governance Profile*, [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Malawi\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Malawi_Profile.pdf).

land accounts for 70 percent of the total land.<sup>46</sup> The government has in the past leased out customary land to boost investment.<sup>47</sup> Leasehold land can be held for a fixed period of less than 99 years or a freehold for more than 99 years, depending on the intended use.<sup>48</sup> Leasehold land is available to foreigners, but first priority is given to Malawians.<sup>49</sup> Public land is owned by the government and publicly accessible, usually comprising national parks and historical and cultural areas.<sup>50</sup>

- **Government and private sector:** The Malawian government has given preferential treatment to certain State-Owned Enterprises (SOEs), which can make it difficult for private enterprises to compete. For example, some SOEs are allocated additional foreign exchange and receive subsidized financing from the central bank.<sup>51</sup> Other SOEs benefit from taxpayer bailouts. In 2005, it was reported that the government spent about USD 70 million annually assisting loss-making parastatals.<sup>52</sup> Nevertheless, the government has made some progress towards privatization. Over the past decade, 66 SOEs have been privatized, including the National Bank of Malawi, the National Insurance Company, Malawi Railways, and the Mining and Investment Development Corporation.<sup>53</sup>
- **Exit opportunities / restrictions on exits:** Malawi allows full repatriation of investment capital, dividends, profits, interest, and principal on internationally sourced funding. The Reserve Bank of Malawi (RBM) authorizes commercial banks to approve funds for remittance if sufficient foreign exchange is available and if the accounts are audited. However, foreign funding must be registered with the RBM, which approves the terms of any investment.<sup>54</sup>
- **Forex controls:** As discussed, the kwacha has experienced sharp swings since 2012. In a bid to ensure that the country has sufficient foreign exchange to cover imports, the RBM will sometimes withhold foreign exchange when scarce, typically from October to March, when the country does not receive foreign-exchange inflows from tobacco exports.<sup>55</sup>

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46 Oscar Matope, "Land Administration in Malawi," February 18, 2013, <https://www.citiesalliance.org/sites/citiesalliance.org/files/Urban%20Land%20Market%20Presentation%20OAA.pdf>.

47 US Agency for International Development, *Malawi: Property Rights and Resource Governance Profile*, [http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID\\_Land\\_Tenure\\_Malawi\\_Profile.pdf](http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_Malawi_Profile.pdf).

48 *Ibid.*

49 US Department of State, "Malawi Investment Climate Statement" (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/227359.pdf>.

50 Ephraim W. Chirwa, *Land Tenure Farm Investments and Food Production in Malawi* (Manchester, UK: Improving Institutions for Pro-Poor Growth, 2008), [http://www.eldis.org/vfile/upload/1/document/1106/Land%20tenure%20farm%20investments%20and%20food%20production%20in%20Malawi\[1\].pdf](http://www.eldis.org/vfile/upload/1/document/1106/Land%20tenure%20farm%20investments%20and%20food%20production%20in%20Malawi[1].pdf).

51 KPMG, *Malawi Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Malawi.pdf>.

52 "Malawi Parastatals Dissolved," *Fin24*, August 28, 2005, <http://www.fin24.com/Economy/Malawi-parastatals-dissolved-20050824>.

53 "Malawi Economic Justice Network, Civil Society Briefing, Issue 16," Brenton Woods Project, June 25, 2002, <http://www.brettonwoodsproject.org/2002/06/art-16285/>.

54 US Department of State, "Malawi Investment Climate Statement" (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/227359.pdf>.

55 *Ibid.*; KPMG, *Malawi Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Malawi.pdf>; and Open Capital Interviews.

- **Interest rate controls:** Currently, the RBM has no publicly stated interest rate controls; banks are free to set their own rates.<sup>56</sup> Despite this lack of explicit controls, regulated lenders are typically prohibited from charging rates that are too low, which the RBM considers anti-competitive.<sup>57</sup> In August 2015, Malawian commercial banks were charging interest rates above 35 percent per year. The high cost of borrowing is attributed to the RBM's high interbank lending rate, currently around 25 percent.<sup>58</sup>
- **Required local shareholding:** The Malawian government has very few regulations concerning foreign ownership in companies. The only restriction is that entities privatized under the SOE privatization program cannot be 100 percent foreign-owned.<sup>59</sup>
- **Incentives:** The Malawian government offers a wide range of investment incentives that apply equally to both foreign and local investors.<sup>60</sup> Some of these include:
  - Loss carry-forward of up to seven years.<sup>61</sup>
  - A 100 percent investment allowance for new buildings and equipment.<sup>62</sup>
  - A 40 percent investment allowance for used buildings and equipment.<sup>63</sup>
  - A 50 percent investment allowance on qualifying training costs.<sup>64</sup>
  - Operating expenses are 100 percent tax-deductible for manufacturing companies during the first 25 months of operation.<sup>65</sup>
  - No duty is charged on raw materials used by manufacturers.<sup>66</sup>

56 Christabel Dadzie, "Transparent Pricing Initiative in Malawi Off to a Great Start," MFTransparency, September 16, 2010, <http://www.mftransparency.org/transparent-pricing-initiative-in-malawi-off-to-a-great-start/>.

57 Open Capital Interviews.

58 Steven Nhlane, "On the Fast Lane of Malawi: High Interest Rates; Contradictions, Contradictions!," *Malawi Nyasa Times*, July 20, 2015, <http://www.nyasatimes.com/2015/07/20/on-the-fast-lane-of-malawi-high-interest-rates-contradictions-contradictions/>.

59 US Department of State, *Malawi Investment Climate Statement* (Washington, DC: US Department of State, 2015), <http://www.state.gov/e/eb/rls/othr/ics/2015/241645.htm>.

60 *Ibid.*

61 Malawi Investment and Trade Centre, "Incentives," <http://www.mitc.mw/index.php?Itemid=518>.

62 Nelson Nsiku, *Assessing Investment Incentives in Malawi* (Winnipeg: The International Institute for Sustainable Development, 2012), [http://www.iisd.org/pdf/2013/assessing\\_investment\\_incentives\\_malawi.pdf](http://www.iisd.org/pdf/2013/assessing_investment_incentives_malawi.pdf).

63 *Ibid.*

64 *Ibid.*

65 *Ibid.*

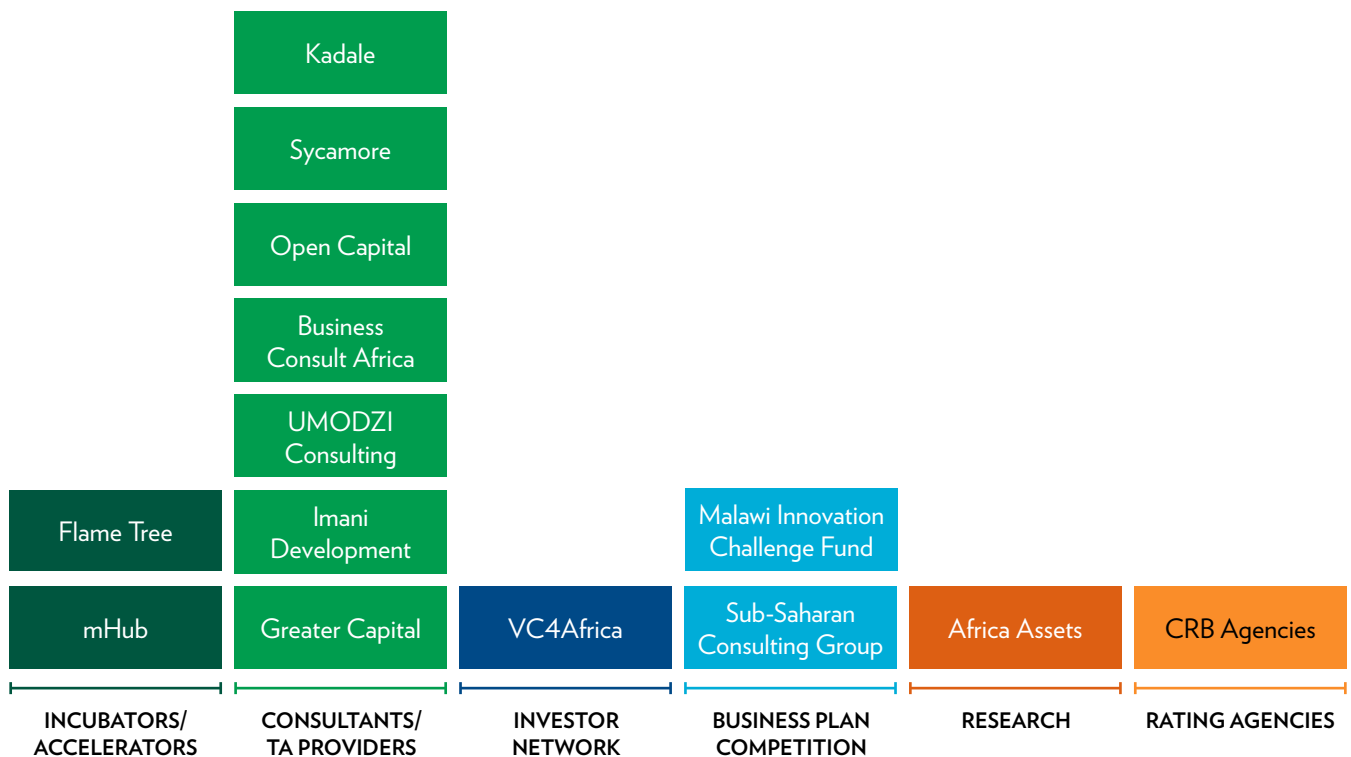
66 KPMG, *Malawi Country Profile 2012/2013* (Johannesburg: KPMG, 2014), [http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Malawi%20Country%20Profile%202012-2013\\_01.pdf](http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Malawi%20Country%20Profile%202012-2013_01.pdf); and US Department of State, *Malawi Investment Climate Statement* (Washington, DC: US Department of State, 2015), <http://www.state.gov/e/eb/rls/othr/ics/2015/241645.htm>.

## Ecosystem Players

Malawi has a limited network of support for entrepreneurs and businesses. The US Department of State notes that Malawi's inadequate educational system has created a skills shortage in certain service-oriented professions, such as law and accounting.<sup>67</sup>

Local entrepreneurs report that Malawi does not have a community to foster support and collaboration and lacks the stable institutions that could encourage such a community to develop. Other than mHub and Flame Tree Initiative, few incubators or accelerators exist to help entrepreneurs start new ventures. There are a few business-advisory firms present in Malawi, such as Imani Development and Business Consult Africa, while others, like Greater Capital, serve the country from regional hubs in Kenya and South Africa (see Figure 15).

FIGURE 15. SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Note: Chart focuses on those with local presence; international players are also active.

Source: Open Capital research, organization websites.

67 US Department of State, *Malawi Investment Climate Statement* (Washington, DC: US Department of State, 2015), <http://www.state.gov/e/eb/rls/othr/ics/2015/241645.htm>.

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

As Malawi continues to stabilize and grow, there are many areas where impact investors could generate both social and financial returns. Among other opportunities, these include the development and commercialization of agriculture, improved provision of basic goods and services, development of infrastructure, and diversification of Malawi's export base. The current financial landscape presents a clear gap that impact investors could fill, supporting innovative, high-potential businesses in various stages of growth.

However, as they seek to do so, investors are likely to face numerous challenges, including:

- **Insufficient investment-ready deal flow:** Due to the underdeveloped private sector in Malawi, few businesses are ready and willing to accept external capital. Many businesses still operate informally and lack both clear historical accounts and forward-looking strategies and projections. Businesses that are owned and operated as family enterprises often have a longer track record but are wary of equity investments.
- **Government relations:** As mentioned above, public and private interests are sometimes at odds in Malawi. The government's drive to increase revenues in light of its loss of donor funds due to the "Cashgate" scandal can come at the expense of the private sector. Onerous and unclear regulations make it challenging for entrepreneurs and investors to launch and sustain profitable enterprises in Malawi. Multiple interviewees expressed frustration at the lack of documentation regarding how to navigate government processes, mentioning this absence as a key inhibitor of their ability to start or grow a business. To succeed in this environment, investors must be patient and prepared to nurture relationships with government officials.
- **Corruption:** The status quo, in which businesses can struggle without government connections, lends itself to abuse and corruption by officials in power. As "Cashgate" demonstrates, the country continues to struggle with graft in the public sector, which can increase the cost of doing business and reduce operational efficiency. Malawi was ranked 110<sup>th</sup> out of 174 countries on Transparency International's 2014 "Corruption Perceptions Index," a substantial drop from its position at 91 the previous year.<sup>68</sup>
- **Competition with donor funding:** Donors have played an important role in Malawi's development, but they can alter the prospects for commercial funders looking to enter the market. With donors offering grant financing, entrepreneurs may be less likely to seek commercial funding. Donors also affect potential

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68 "Corruption Perceptions Index 2014," Transparency International, <http://www.transparency.org/cpi2014>.

markets for entrepreneurs: donor projects often provide goods and services the demand for which SMEs could otherwise fulfill, and businesses may struggle to convince customers to pay for products they previously received with subsidy. Finally, donors affect entrepreneurs' ability to recruit skilled talent in Malawi. Historically, donor organizations and the government have been viewed as the prime employment options for educated Malawians. Entrepreneurs report they must overcome this perception in order to recruit talent, only to find they must also compete with the wages paid by donor organizations, which may be significantly higher than their businesses can support.<sup>69</sup>

- **Forex and interest risk:** Recent foreign-exchange uncertainty makes it challenging for businesses to bear foreign-denominated debt. Few investors are able to bear forex risk and struggle to disburse in kwacha. Consequently, investors must charge high interest rates to mitigate this risk and must abide by the Reserve Bank's regulations, which may make it challenging to deploy capital.
- **Access to land:** Malawi is densely populated and has limited land. As mentioned above, approximately 70 percent of Malawi's land is classified as customary, controlled by traditional leaders and their communities.<sup>70</sup> Development requires the consent of these communities, who must be relocated and compensated. Through the Investment and Trade Centre, the government has launched initiatives to acquire and develop land for use by entrepreneurs and investors, but these are inconsistently available.
- **Inefficient borders and facilitation of trade:** Given its geographic location, Malawi is well-positioned to distribute goods to both East and Southern Africa, but regional trade accounts for only 30 percent of its current trade.<sup>71</sup> Despite regional trade agreements, Malawi still has non-tariff barriers inhibiting trade, including export bans on some crops, an ineffective Standards Bureau, and road blocks on major transportation routes.<sup>72</sup> Local actors also report inefficient operation of and corruption at border crossings.<sup>73</sup>

Despite these challenges, impact investors have numerous opportunities to deploy capital in Malawi effectively in order to generate financial and social returns while fostering economic growth and job creation. Given Malawi's current status, it is likely that investment in almost any sector—not just conventional impact areas—will generate social returns. For example, current impact investors have made investments in construction.<sup>74</sup> Though not a traditional impact sector, these investments were made with the intention to grow jobs and improve infrastructure. Areas of opportunity include:

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69 Open Capital Interviews.

70 Oscar Matope, "Land Administration in Malawi," February 18, 2013, <https://www.citiesalliance.org/sites/citiesalliance.org/files/Urban%20Land%20Market%20Presentation%20OAA.pdf>.

71 C. Ojukwu et al., *Malawi Country Strategy Paper, 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Malawi%20-%20Country%20Strategy%20Paper.pdf>.

72 Peter Mwanakatwe and Gebrehiwot A. Kebedew, *Malawi* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Malawi\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Malawi_GB_2015.pdf).

73 Open Capital Interviews.

- **Leverage TA facilities for building the pre-investment pipeline:** Many of Malawi's growing businesses are not ready for investment and lack the tools they need to adequately navigate the investment process. Pre-investment support is needed to help businesses improve their operations and reach a stage where they can successfully raise capital and use disbursed funds effectively.
- **Diversify Malawi's export base:** Malawi's exports currently rely on agriculture, with tobacco alone constituting more than half of total exports.<sup>75</sup> This makes the country vulnerable to external factors, such as fluctuations in the price of tobacco, and less robust to internal challenges, such as crop failures or unpredictable rains. The government recognizes the need to diversify the country's export base and is actively encouraging investment in other crops, including sugar, tea, and maize.<sup>76</sup>
- **Establish presence with limited competition:** Despite the need for financing, very few impact investors are currently active in the country. Impact investors willing to invest resources in Malawi today have the opportunity to source prime investments and establish a brand long before the market becomes more competitive.
- **Develop a local team and talent:** Investors and entrepreneurs interviewed stress that success in the Malawian market depends on a team that has experience and familiarity with the particular local context. Given the informal nature of business in Malawi and the challenging regulatory environment, it is vital that investors develop a local team with an active presence and the ability to navigate the market.

In addition, impact investors in Malawi see specific opportunities in the following sectors:

- **Agriculture:** Malawi's agricultural output is heavily dependent on smallholder farmers. Most farming still occurs without irrigation or mechanization. Investors have the opportunity to support commercial farming of numerous crops, which can increase production and food security while boosting agricultural exports, especially to regional partners.
- **Agro-processing:** Concurrently, much of Malawi's current agricultural output is exported to other markets for processing. Although reliable infrastructure is a challenge, investors and entrepreneurs have the opportunity to develop local agro-processing operations, which can reduce the country's dependence on imports while simultaneously boosting exports.
- **Tourism:** Malawi is well-known for Lake Malawi, yet it struggles to consistently attract significant numbers of international tourists due to the high costs of travel, poor infrastructure, and an underdeveloped tourism sector. Interviewees report that tourists can find better value visiting other countries, such as Kenya and South Africa, but that additional investment could spur the tourist industry in Malawi.

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75 C. Ojukwu et al., *Malawi Country Strategy Paper, 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Malawi%20-%20Country%20Strategy%20Paper.pdf>.

76 *Ibid.*

- **Manufacturing:** Malawi has an abundant supply of unskilled labor and a low cost base, both of which are conducive to the development of local manufacturing. Local markets exist, as well, since Malawi currently imports many basic goods. The country is also well-positioned geographically to reach markets across East and Southern Africa with locally produced goods.
- **Aquaculture:** Lake Malawi has an abundant supply of ornamental fish, yet few enterprises exist to export such fish. Opportunities in this sector also include fishing for local and international consumption.

# NAMIBIA

DIAMOND MINING  
IN THE DESERT



# COUNTRY OVERVIEW

Namibia (formerly South-West Africa) gained independence from South Africa in 1990, making it the last country in Africa to do so.<sup>1</sup> The country has a population of just 2.3 million and one of the lowest population densities globally, with only 2.7 people per square kilometer.<sup>2</sup> The Namib Desert runs along the west side of the country and is largely uninhabited; the majority of economic activity is accordingly concentrated in the central and eastern areas of the country (see map in Figure 1).

FIGURE 1. MAP OF NAMIBIA



Namibia’s gross domestic product (GDP) was estimated at USD 23.6 billion at purchasing power parity (PPP) in 2014,<sup>3</sup> having grown at an average of 6.4 percent annually over the past decade.<sup>4</sup> With GDP per capita of USD 10,800 (PPP), Namibia is categorized as an “upper-middle-income country”; however, the country faces extreme inequality, with the world’s highest ratio between the average income of the richest 10 percent and the poorest 10 percent and high unemployment at 17%.<sup>5</sup>

1 *The World Factbook*, s.v. “Namibia” (Washington, DC: Central Intelligence Agency), <https://www.cia.gov/library/publications/the-world-factbook/>.  
2 United Nations Statistics Division, s.v. “Namibia,” <https://data.un.org/CountryProfile.aspx?crName=Namibia>.  
3 *World Economic Outlook Database*, s.v. “Namibia” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.  
4 *Ibid.*  
5 Jeni Klugman et al., *Human Development Report* (New York: United Nations Development Programme, 2009), [http://hdr.undp.org/sites/default/files/reports/269/hdr\\_2009\\_en\\_complete.pdf](http://hdr.undp.org/sites/default/files/reports/269/hdr_2009_en_complete.pdf).

**TABLE 1. SELECTED NAMIBIA DEVELOPMENT INDICATORS**

DEVELOPMENT INDICATOR	Namibia	Regional Average	Global Average
HDI SCORE (RANKS 127 <sup>TH</sup> OF 187 COUNTRIES)	0.62	0.55	0.69
GDP PER CAPITA (USD)	10,800	6,874	17,975
UNEMPLOYMENT RATE (%)	17	13	6
POPULATION BELOW USD 1.25 / DAY (%)	32	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	39	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	34	41	59

Extraction and mineral processing comprise roughly 30 percent of GDP, with diamonds and uranium the two major subsectors.<sup>6</sup> Foreign direct investment (FDI), accounting for approximately five percent of GDP and dominated by South Africa and China, is highly concentrated in the mining sector.<sup>7</sup>

Namibia is a member of the Common Monetary Area (CMA) along with Lesotho, Swaziland, and South Africa.<sup>8</sup> Across this currency union, currencies are pegged one-to-one to the South African Rand, which also circulates within the country. As a CMA member, then, Namibia follows the monetary and exchange rate policies of South Africa.<sup>9</sup> Nevertheless, the government has a strong macroeconomic record, relying on fiscal policy to influence the economy; it spent heavily in 2008 and 2009 to stimulate the economy during the global economic crisis.<sup>10</sup>

6 *The World Factbook*, s.v. “Namibia” (Washington, DC: Central Intelligence Agency), <https://www.cia.gov/library/publications/the-world-factbook/>.

7 US Department of State, *Namibia Investment Climate Statement* (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241886.pdf>.

8 KPMG, *Namibia Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Namibia.pdf>.

9 Bank of Namibia, *Namibia’s Monetary Policy Framework* (Windhoek: Bank of Namibia, 2008), <https://www.bon.com.na/CMSTemplates/Bon/Files/bon.com.na/12/12253e03-31d8-4a91-882a-35833faec548.pdf>.

10 African Development Bank, *Namibia 2014–2018 Country Strategy Paper* (Abidjan: African Development Bank Group, 2014), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Namibia\\_Country\\_Strategy\\_Paper.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Namibia_Country_Strategy_Paper.pdf); Martha Phiri and Ojijo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

The private sector in Namibia benefits from a stable political environment. Namibia has a constitutional democracy, with the same party, SWAPO, in power since independence; nevertheless, Freedom House scores Namibia very well in the areas of freedom, civil liberties, and political rights.<sup>11</sup> SWAPO has led Namibia to a strong regional ranking on business-environment indicators, scoring 98<sup>th</sup> out of 189 countries (and eighth in Africa) on the World Bank's "Ease of Doing Business" index.<sup>12</sup> To achieve this, Namibia has focused on reducing corruption and driving policies for private-sector development.

Education is a top priority for the Namibian government. Almost a quarter of Namibia's national budget is directed toward education.<sup>13</sup> This investment has created a highly literate population, with literacy rates for 15-to-24-year-olds and adults estimated at 94 percent and 89 percent, respectively.<sup>14</sup>

## SUPPLY AND DEMAND OF IMPACT INVESTING CAPITAL

The formal financial sector in Namibia is small, with only four commercial banks and one microfinance institution.<sup>15</sup> Despite its size, its financial sector is one of the most sophisticated in Africa, and private sector access to credit is growing. In recent years, total credit provided to the private sector has risen by more than 13 percent annually,<sup>16</sup> with only 31 percent financially excluded in 2012 (as compared with 52 percent in 2007).<sup>17</sup> In this credit expansion, individuals and businesses are looking to take advantage of single-digit interest rates, which are significantly lower than the regional average and comparable to those in South Africa.<sup>18</sup>

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11 "Namibia," Freedom House, [https://freedomhouse.org/report/freedom-world/2015/namibia-.VeBvM\\_mqqko](https://freedomhouse.org/report/freedom-world/2015/namibia-.VeBvM_mqqko).

12 The World Bank, "Economy Rankings," in *Doing Business 2015* (Washington, DC: The World Bank, 2015), <http://doingbusiness.org/rankings>.

13 Martha Phiri and Ojjo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

14 *Ibid.*

15 KPMG, *Namibia Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Namibia.pdf>.

16 African Development Bank, *Namibia 2014–2018 Country Strategy Paper* (Abidjan: African Development Bank Group, 2014), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Namibia\\_Country\\_Strategy\\_Paper.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Namibia_Country_Strategy_Paper.pdf).

17 Martha Phiri and Ojjo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

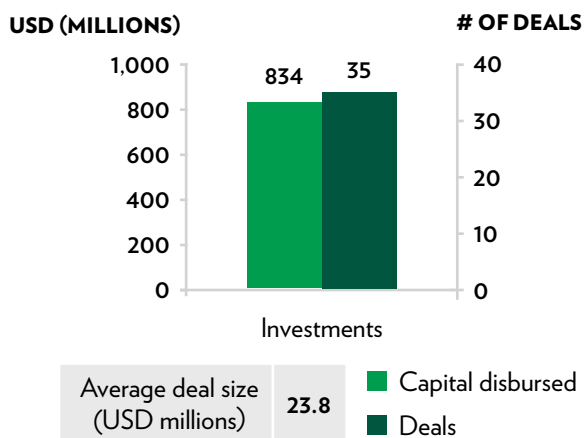
18 Bank of Namibia, <https://www.bon.com.na/>.

Still, challenges around access to credit persist. Only 64 percent of adults are covered by the existing private credit bureau.<sup>19</sup> Similarly, small- and medium-sized enterprises (SMEs) and start-ups report particular challenges accessing financial services due to low financial literacy, high fees and transaction costs, and an underdeveloped microfinance sector.<sup>20</sup> Impact investing can provide alternate financing for SMEs. Namibia has seen some impact capital disbursed in this regard, though the majority of capital dispersed has been from development finance institutions (DFIs) to support the financial services and infrastructure sectors.

To date, there have been 46 known impact investments into Namibia, totaling approximately USD 846 million. DFI investments account for around 75 percent of deals and almost 99 percent of total capital disbursed (see Figures 2 and 3).

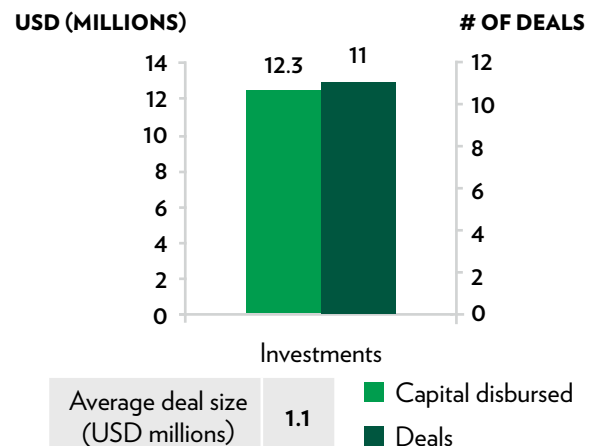
Deal flow in Namibia is generally limited, with almost half of DFI investments and nearly 40 percent of non-DFI investments made before 2005 (see Figures 4 and 5). Major sectors of focus for DFI investors have included energy, financial services, and information and communication technologies (ICT), while non-DFI investors have focused on housing and financial services.

**FIGURE 2. DFI IMPACT INVESTMENTS**



Source: Open Capital Research

**FIGURE 3. NON-DFI IMPACT INVESTMENTS**

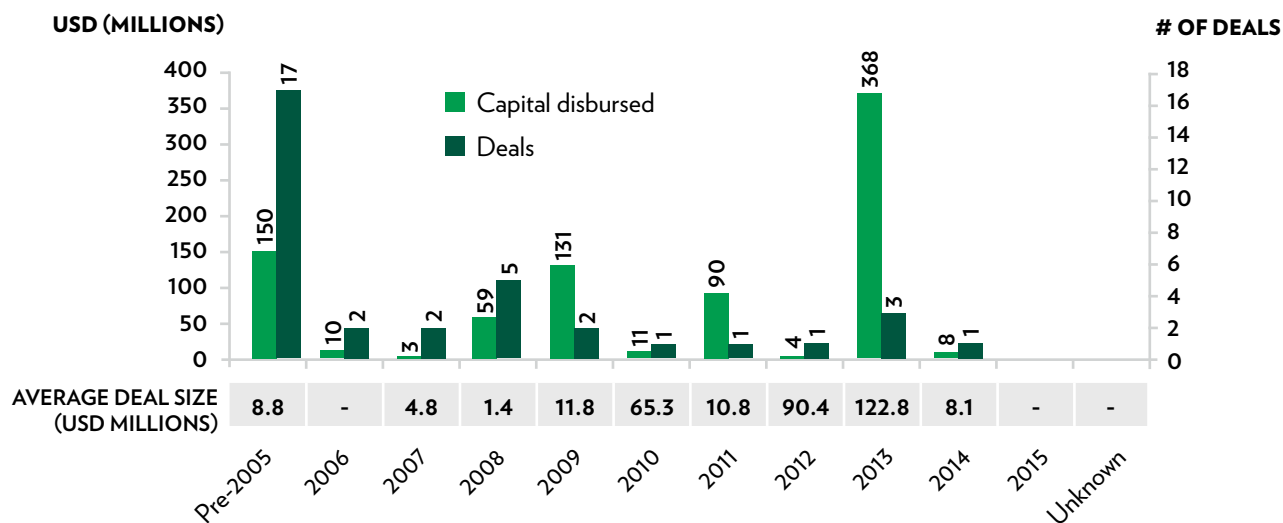


Source: Open Capital Research

19 Martha Phiri and Ojijo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

20 *Ibid.*; World Economic Forum, "Namibia," in *Global Competitiveness Report* (Geneva: World Economic Forum, 2013), <http://www3.weforum.org/docs/GCR2014-15/Namibia.pdf>.

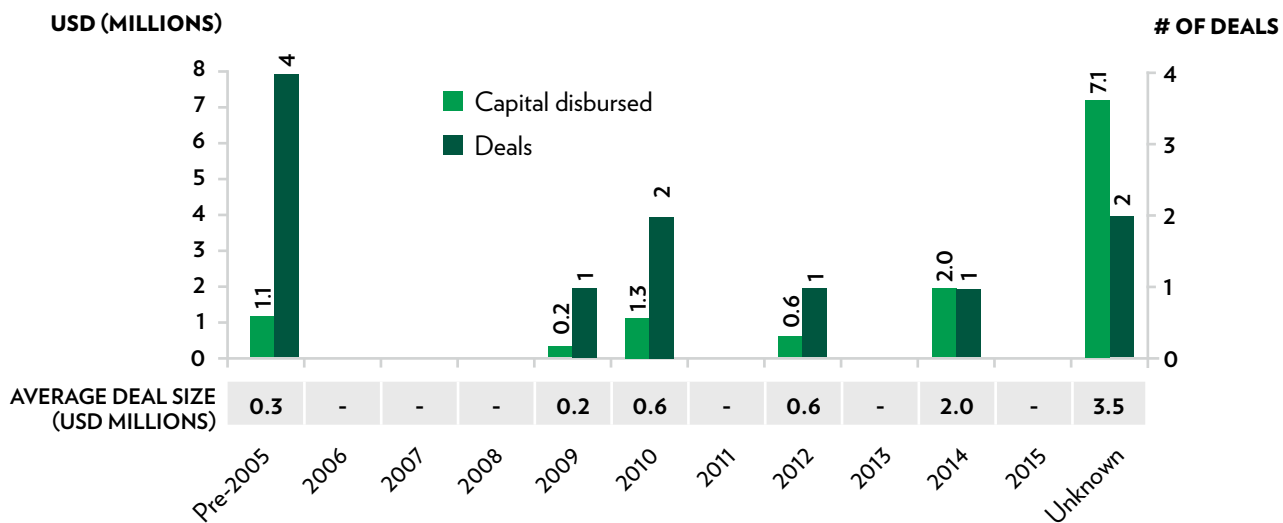
**FIGURE 4. DFI IMPACT INVESTMENTS BY YEAR**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

**FIGURE 5. NON-DFI IMPACT INVESTMENTS BY YEAR**



Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Namibia's combination of high unemployment, insufficient access to finance (especially for SMEs), and massive income inequality indicate a strong need for impact capital. However, impact investors will face challenges placing capital in Namibia, including:

- **Small and dispersed market:** With a small population and extremely high income inequality, the broader population exercises limited purchasing power. Consumer businesses face a challengingly small market size. This is further hindered by population dispersion: Namibia has the second-lowest population density of any sovereign nation in the world.<sup>21</sup>
- **Electricity supply:** Namibia suffers from an unstable power supply with frequent outages, which particularly interfere with agricultural processing and machinery-intensive manufacturing. The grid's frequent outages indicate a significant power deficit;<sup>22</sup> local energy production accounts for less than half of energy consumed, with the balance predominantly imported from neighboring South Africa and Zimbabwe.<sup>23</sup>
- **Skill shortages:** Despite the government's focus on education, the educational system has been plagued by mismanagement, and interviewees regard the school system as inadequate to help prepare a skilled workforce.<sup>24</sup> Employers cite a lack of skilled labor and insufficient productivity as key constraints on their businesses.<sup>25</sup>
- **Climate change:** As the driest country south of the Sahara, Namibia is highly susceptible to both droughts and floods, and climate change is a significant threat to the country; in the northern region of Kunene, rain has not fallen in three years, and the UN estimates that one-third of the population is either moderately or severely food insecure.<sup>26</sup> This is particularly true for the lowest-income population segments, the vast majority of whom are employed in agriculture.<sup>27</sup>

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21 United Nations, *World Population Prospects* (New York: United Nations, 2008), [http://www.un.org/esa/population/publications/wpp2008/wpp2008\\_text\\_tables.pdf](http://www.un.org/esa/population/publications/wpp2008/wpp2008_text_tables.pdf).

22 Martha Phiri and Ojjo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

23 CCS Africa, "Namibia Factsheet," [http://www.ccs-africa.org/fileadmin/ccs-africa/user/CCS\\_Africa\\_2/Namibia\\_factsheet.pdf](http://www.ccs-africa.org/fileadmin/ccs-africa/user/CCS_Africa_2/Namibia_factsheet.pdf).

24 Martha Phiri and Ojjo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

25 US Department of State, *Namibia Investment Climate Statement* (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241886.pdf>.

26 "Late Rains and Droughts in Namibia," *New Era*, January 20, 2015, <https://www.newera.com.na/2015/01/20/late-rains-droughts-namibia-2013-snapshot-future/>.

27 African Development Bank, *Namibia 2014–2018 Country Strategy Paper* (Abidjan: African Development Bank Group, 2014), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Namibia\\_Country\\_Strategy\\_Paper.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Namibia_Country_Strategy_Paper.pdf).

Despite these challenges, there are many opportunities for impact investors to operate in Namibia and leverage return-seeking investments to reduce inequality and bolster human capital. As the Namibian economy is heavily based on natural-resource extraction, industry diversification could reduce the economy's exposure to medium-term risk of a slowdown in mineral, especially diamond, demand.<sup>28</sup> Impact investors report seeing opportunities across the following sectors:

- **Clean energy:** With a growing population and grid assets that meet less than half of current need,<sup>29</sup> there is a large opportunity in clean energy. The potential for solar in Namibia is one of the strongest on the planet,<sup>30</sup> and a number of substantial solar projects are currently under way.<sup>31</sup> Similarly, wind and hydro power offer compelling investment opportunities for impact investors due to the abundance of these resources and favorable government feed-in tariffs.<sup>32</sup>
- **Food supply:** Given Namibia's massive income inequality, improving the food supply chain by reducing food costs through efficient procurement and distribution could result in major social gains. Increasing the availability of nutritious foods through efficient procurement and distribution offers both short- and long-term improvements in public health.
- **Tourism / ecotourism:** Strong government conservancy efforts place half of Namibia, including its full coastline, under legal protection.<sup>33</sup> Tourism supporting such programs and parks can generate both positive environmental impact and financial return.<sup>34</sup>
- **Aquaculture:** While fishing is a mainstay sector in Namibia, recent years have afforded poor wild fish catches, slowing growth in the industry.<sup>35</sup> Sustainable aquaculture and fish processing could yield short-term cash flow and long-term environmental and social returns.<sup>36</sup>

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28 Martha Phiri and Ojijo Odhiambo, *Namibia* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Namibia\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Namibia_GB_2015.pdf).

29 CCS Africa, "Namibia Factsheet," [http://www.ccs-africa.org/fileadmin/ccs-africa/user/CCS\\_Africa\\_2/Namibia\\_factsheet.pdf](http://www.ccs-africa.org/fileadmin/ccs-africa/user/CCS_Africa_2/Namibia_factsheet.pdf).

30 Detlof von Oertzen, *Namibia's Energy Future* (Windhoek: Konrad Adenauer Stiftung, 2012), [http://www.kas.de/wf/doc/kas\\_34264-1522-1-30.pdf?130503111302](http://www.kas.de/wf/doc/kas_34264-1522-1-30.pdf?130503111302).

31 Renewable Energy Industry Association of Namibia, <http://www.reiaon.com/>.

32 Martha Mwandingi, "Energy: Challenges and Opportunities" (presented at the UNDP Namibia Societal Acceleration Platform Prototyping Week), <https://www.pwc.com/na/en/assets/pdf/day2-energy-in-namibia-martha-mwandingi.pdf>.

33 "Namibia Overview," The World Bank, <http://www.worldbank.org/en/country/namibia/overview>.

34 British High Commission of Namibia, *Doing Business in Namibia* (Windhoek: British High Commission of Namibia, 2014), [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/301482/Doing\\_Business\\_in\\_Namibia\\_2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/301482/Doing_Business_in_Namibia_2014.pdf).

35 KPMG, *Namibia Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Namibia.pdf>.

36 Fishing companies which employ Namibians and use Namibian vessels pay lower government quota fees. KPMG, *Namibia Country Profile* (Johannesburg: KPMG, 2012), p. 10, <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Namibia.pdf>.

# ANGOLA

RECOVERING FROM WAR,  
DEPENDENT ON OIL



# COUNTRY OVERVIEW

After gaining independence from Portugal in 1975, Angola lurched into a civil war lasting more than 25 years and during which an estimated 800 thousand people were killed.<sup>1</sup> Since this civil war ended in 2002, the rebuilding country has been relatively stable (see Figure 1 for its location within the region). In the years immediately following the war, Angola's economy grew by more than 20 percent, while over the past decade Angola's gross domestic product (GDP) has averaged annual year-on-year growth of 12 percent, reaching USD 175.6 billion by 2014.<sup>2</sup> That said, in 2014, growth slowed to 4.5 percent.<sup>3</sup>

FIGURE 1. MAP OF ANGOLA



Natural resource extraction and petroleum dominate Angola's economy. Producing 1.7 million barrels a day, Angola is sub-Saharan Africa's second-largest petroleum producer, after Nigeria.<sup>4</sup> Petroleum accounts for nearly 50 percent of Angola's total

1 *The World Factbook*, s.v. "Angola" (Washington, DC: Central Intelligence Agency), accessed August 24, 2015 <https://www.cia.gov/library/publications/the-world-factbook/geos/ao.html>; and Political Economy Research Institute, *Modern Conflicts: Conflict Profile Angola* (Amherst, MA: University of Massachusetts), <http://www.peri.umass.edu/fileadmin/pdf/Angola.pdf>.  
2 *World Economic Outlook Database*, s.v. "Angola" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.  
3 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).  
4 *Ibid*; and US Department of State, "Angola Investment Climate Statement" (Washington, DC: US Department of State, 2015), <http://www.state.gov/documents/organization/241669.pdf>.

GDP, generates approximately 70 percent of government revenue, and accounts for 95 percent of exports.<sup>5</sup> Any shifts in the price of petrol ripple throughout the Angolan economy. The recent drop in international oil prices is largely responsible for the slowdown in Angola's GDP and has led to falling government revenues.<sup>6</sup>

Angola is attempting to diversify its economy beyond natural resources. For example, the country has significant agricultural resources that have remained untapped after the civil war. The sector contributes roughly 10 percent to the country's GDP yet employs 70 percent of all workers.<sup>7</sup> To foster growth, the government recently reduced the interest rate for loans through its Agricultural Credit Campaign from five percent to two percent and is working to build better extension services.<sup>8</sup> The government has also been developing special economic zones, industrial hubs, and economic corridors to encourage manufacturing in particular.<sup>9</sup>

Inflation has steadily declined, falling below eight percent in 2014.<sup>10</sup> Interest rates have dropped from extremely high rates a decade ago—standing in 2005 at more than 67 percent—to 15 to 20 percent since 2011.<sup>11</sup> Angola has seen a number of foreign direct investments (FDI) over the past decade, though the country has generally seen net-negative FDI flows due to divestment and repatriation of profits by multinational corporations, especially those in the extractive industries.<sup>12</sup>

Despite strong growth and high GDP per capita compared to the region, Angola's economic development has been unequally distributed.<sup>13</sup> The country's extractive-driven growth has not translated into broad-based growth for its population, more than a third of which lives in poverty.<sup>14</sup>

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5 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

6 *Ibid.*

7 *Ibid.*

8 *Ibid.*

9 *Ibid.*

10 "Angola Inflation Rates," Trading Economics, accessed 2015, <http://www.tradingeconomics.com/angola/inflation-cpi>.

11 *The World Bank: Data*, s.v. "Angola," in "World Development Indicators," <http://databank.worldbank.org/data/reports.aspx?source=2&country=AGO&series=&period=>.

12 United Nations Conference on Trade and Development, *Angola* (2015), available at <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx>; and "International Investment to Africa Down for Third Year Running, but Outlook Turns Optimistic, UNCTAD Report Says," United Nations Conference on Trade and Development, July 4, 2012, <http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=85>.

13 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

14 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

Angola's growth is also constrained by persistent and severe corruption; the country ranks 161<sup>st</sup> of 175 nations in Transparency International's "Corruption Perception Index."<sup>15</sup> At the same time, the country ranks 181<sup>st</sup> of 189 countries in the World Bank's "Ease of Doing Business" index, the lowest of any country in Southern Africa; starting a business in Angola takes 66 days and costs more than 120 percent of per capita income.<sup>16</sup> The country also suffers from poor infrastructure, including bad roads, limited access to the electric grid, which serves just 30 percent of its population, and a dilapidated rail network, all of which increase the cost of doing business.<sup>17</sup>

Though classified as an "upper-middle income economy" in 2012,<sup>18</sup> Angola continues to score poorly on key development indicators, especially those concerning health (see Table 1). For example, at 164 per thousand live births, Angola has by far the worst under-five mortality rate in Southern Africa: more than three times the global average, and more than 50 percent greater than the next-highest country in the region.<sup>19</sup> With a score of 0.53, Angola is ranked 149<sup>th</sup> out of 187 countries on the United Nations' Human Development Indicators (HDI) index.<sup>20</sup>

TABLE 1. SELECTED ANGOLA DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Angola	Regional Average	Global Average
HDI SCORE (RANKS 149 <sup>TH</sup> OF 187 COUNTRIES)	0.53	0.55	0.69
GDP PER CAPITA (USD)	7,200	6,874	17,975
UNEMPLOYMENT RATE (%)	7	13	6
POPULATION BELOW USD 1.25 / DAY (%)	Data not available	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	164	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	Data not available	41	59

15 Transparency International, "Angola," <http://www.transparency.org/country/#AGO>.

16 The World Bank, "Angola," in *Doing Business 2016* (Washington, DC: The World Bank, 2015), <http://www.doingbusiness.org/data/exploreeconomies/angola/-/media/giawb/doing%20business/documents/profiles./country/AGO.pdf>.

17 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

18 "Newest Country Classifications Released," World Bank, July 13, 2012, <http://data.worldbank.org/news/newest-country-classifications-released>.

19 United Nations Development Programme, *2014 Human Development Index* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/en/data>.

20 *Ibid.*

Though Angola's HDI score does not include poverty data, the African Development Bank has estimated that over 35 percent of the total population and 58 percent of the rural population lives on less than USD 2 per day.<sup>21</sup>

## SUPPLY OF IMPACT INVESTING CAPITAL

Access to capital remains constrained in Angola even though capital exists in the country's banks. Total banking solvency is near 20 percent, almost twice the required 10 percent, suggesting significant inefficiencies in capital allocation.<sup>22</sup> Nevertheless, just nine percent of small- and medium-sized enterprises (SMEs) have access to credit despite high access to banking services (86 percent of the population has access to financial products).<sup>23</sup> This divide is driven in part by the reluctance of commercial banks to lend, since the rate of non-performing loans spiked from 9.2 percent in January of 2014 to 17.4 percent in November 2014 as a result of the sharp drop in oil prices.<sup>24</sup>

Angola has received approximately USD 286 million of impact investment; the vast majority of this capital has been placed since the end of the civil war, with just one known deal occurring before 2002. Notably, and uniquely for Southern Africa, more non-DFI impact investor capital has entered Angola than has DFI capital. As a further contrast, in Angola, DFI deal sizes are much smaller on average (at USD six million) while non-DFI deal sizes are much larger (average USD 31 million) as compared to the rest of the region. This latter distinction is primarily due to one investor who has made large investments in sectors such as water infrastructure, housing, and energy.

Seven DFIs have disbursed USD 100 million across 15 transactions in Angola, with deal sizes ranging from less than USD one million to more than USD 10 million. DFI investments have prioritized two sectors: financial services (USD 20 million in seven deals) and manufacturing (USD six million in three deals). Five of these deals have been debt, along with three equity deals and three credit guarantees.

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21 Almeida A. Santos, *Angola Country Strategy Paper 2011–2015 and 2010 Country Portfolio Performance Review* (Tunis: African Development Bank Group, 2011), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations./ORSB%20Angola%20CSP%202011%20-%202015%20En%20Rev%20Version%2BMemox.pdf>.

22 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

23 *Ibid.*

24 *Ibid.*

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Despite a growing economy and recent government efforts to encourage businesses across a diverse range of sectors (described below), a number of challenges concerning successful investment in Angola remain. These include:

- **Limited infrastructure and power supply:** Even with improvements since the end of the civil war, Angola's infrastructure continues to constrain growth due to the limited availability of good roads, railways, water supply, and sanitation. In addition, the country's electrical infrastructure is unable to meet demand; blackouts are common due to insufficient power generation and large numbers of illegal grid connections.<sup>25</sup>
- **Bureaucracy and corruption:** Heavy economic regulations encumber efficient business in Angola. For example, importing certain goods requires specific authorization from particular ministries, which often leads to delays.<sup>26</sup> Similarly, foreign transactions carry the burden of large documentation requirements.<sup>27</sup> Widespread corruption compounds interactions with this bureaucracy. Petty corruption is commonplace (e.g., facilitation fees, checkpoint charges, and document award fees), and large-scale corrupt dealings are also present. For example, roughly USD 32 billion in oil revenues went missing between 2007 and 2010.<sup>28</sup>
- **Skills shortages:** Despite some government support for training programs, entrepreneurship, and technical assistance, the level of skill in the workforce is still a pressing challenge for businesses.<sup>29</sup> In particular, primary education in Angola struggles with funding, overcrowding, and hiring teachers, while secondary education is only available in large cities.<sup>30</sup> Adult literacy rates remain low.<sup>31</sup>

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25 KPMG, *Angola Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Angola.pdf>.

26 For example, saccharine, radios, plants, postal stamps, and samples of goods to be given away all require specific authorization. Office of the United States Trade Representative, "Angola" (Washington, DC: Office of the United States Trade Representative, 2013), <https://ustr.gov/sites/default/files/2013%20NTE%20Angola%20Final.pdf>.

27 "Angola," *Doing Business Guides*, <http://www.angola.doingbusinessguide.co.uk/the-guide/what-are-the-challenges/>.

28 "Angola: Explain Missing Government Funds," Human Rights Watch, December 20, 2011, <http://www.hrw.org/news/2011/12/20/angola-explain-missing-government-funds>; and Mecagni et al., *Angola* (Washington, DC: International Monetary Fund, 2011), <http://www.imf.org/external/pubs/ft/scr/2011/cr11346.pdf>.

29 World Economic Forum, "Angola," in *The Global Competitiveness Report 2014–2015* (Geneva: World Economic Forum, 2014), <http://www3.weforum.org/docs/GCR2014-15/Angola.pdf>.

30 KPMG, *Angola Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Angola.pdf>.

31 *Ibid.*

Businesses are also restricted in their ability to import skilled labor, as Angola limits the permissible number of foreign employees to 30 percent of a firm's workforce and requires that their compensation be comparable to the pay of the company's Angolan employees.<sup>32</sup>

If the challenges above can be addressed, abundant impact investment opportunities exist in Angola, including in the following specific sectors:

- **Agriculture:** Along with its other natural resources, Angola has significantly underutilized agricultural resources. A net exporter of agricultural produce before its civil war, Angola now imports roughly half of its food supply.<sup>33</sup> Yields remain low, even relative to other African nations. The government has undertaken several recent initiatives to realize Angola's agricultural potential by increasing smallholder farmers' access to credit, offering reduced borrowing rates, and assembling a USD 118 million fund through the Facilitating Credit Program and Agriculture Credit Campaign.<sup>34</sup>
- **Aquaculture:** Current fish farming on Angola's coastline is less than half of its sustainable potential,<sup>35</sup> and impact investment here could improve both livelihoods and food supply. As such, there is the opportunity to significantly expand production and the corresponding capacity to process fish while respecting environmental goals.
- **Local manufacturing:** Local manufacturing has grown steadily in recent years, including eight percent growth in 2014.<sup>36</sup> As recently as 2011, however, 80 percent of all consumed goods were imported, including infrastructure staples (such as cement) and basic consumer goods.<sup>37</sup> With government support, such as the Facilitating Credit Program—which aims to ease early-stage access to credit—local businesses and a quickly growing economy can enable investments in local manufacturing to be both impactful and profitable.<sup>38</sup>

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32 KPMG, *Angola Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Angola.pdf>.

33 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

34 *Ibid.*

35 Almeida A. Santos, *Angola Country Strategy Paper 2011–2015 and 2010 Country Portfolio Performance Review* (Tunis: African Development Bank Group, 2011), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ORSB%20Angola%20CSP%202011%20-%202015%20En%20Rev%20Version%2BMemox.pdf>.

36 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

37 Almeida A. Santos, *Angola Country Strategy Paper 2011–2015 and 2010 Country Portfolio Performance Review* (Tunis: African Development Bank Group, 2011), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ORSB%20Angola%20CSP%202011%20-%202015%20En%20Rev%20Version%2BMemox.pdf>.

38 Velloso et al., *Angola* (Washington, DC: International Monetary Fund, 2014), <https://www.imf.org/external/pubs/ft/scr/2014/cr14274.pdf>.

- **Training and education:** With over 60 percent of the population under 25 years of age, the traditional educational system is stretched beyond its capacity.<sup>39</sup> Government services are inadequate to meet educational needs, and demand is huge for both primary and secondary education, as is demand for training programs in virtually every discipline.<sup>40</sup>
- **Renewable energy:** Angola has inadequate infrastructure for power generation, and only 30 percent of the population can access electricity.<sup>41</sup> As such, there are many opportunities for both micro-grid and off-grid solutions, as well as for large-scale power production. With its abundant river resources, the possibility of hydroelectric generation has attracted some recent attention from impact investors.<sup>42</sup> By combining these water resources with arable land, biofuel power generation is also possible.<sup>43</sup> Solar potential in Angola is reasonably strong,<sup>44</sup> and feed-in tariffs are being discussed.<sup>45</sup> Installed solar capacity, however, is minimal to date.<sup>46</sup>

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39 *The World Factbook*, s.v. “Angola” (Washington, DC: Central Intelligence Agency), accessed August 24, 2015 <https://www.cia.gov/library/publications/the-world-factbook/geos/ao.html>.

40 Almeida A. Santos, *Angola Country Strategy Paper 2011–2015 and 2010 Country Portfolio Performance Review* (Tunis: African Development Bank Group, 2011), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/ORSB%20Angola%20CSP%202011%20-%202015%20En%20Rev%20Version%2BMemox.pdf>; and UK Trade and Investment, *Doing Business in Angola: Angola Trade and Export Guide* (Luanda: UK Trade and Investment, 2015), <https://www.gov.uk/government/publications/exporting-to-angola/doing-business-in-angola-angola-trade-and-export-guide>.

41 Joel D. Muzima and Fernanda R. Mendy, *Angola* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Angola\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Angola_GB_2015.pdf).

42 “Energy Profile Angola,” Reegle, [http://www.reegle.info/countries/angola-energy-profile/AO#renewable\\_energy](http://www.reegle.info/countries/angola-energy-profile/AO#renewable_energy).

43 KPMG, *Angola Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Angola.pdf>.

44 “Africa Global Horizontal Solar Radiation,” Climate Technology Centre and Network, 2005, <http://www.ctc-n.org/content/africa-global-horizontal-solar-radiation>.

45 Vitor Carvalho and Associados, *The New Angola’s Energy Strategy* (2011), [http://www.vca-angola.com/xms/files/Newsletters/THE\\_NEW\\_ANGOLA\\_S\\_ENERGY\\_STRATEGY.pdf](http://www.vca-angola.com/xms/files/Newsletters/THE_NEW_ANGOLA_S_ENERGY_STRATEGY.pdf).

46 “Africa Global Horizontal Solar Radiation,” Climate Technology Centre and Network, 2005, <http://www.ctc-n.org/content/africa-global-horizontal-solar-radiation>.



# MAURITIUS

SMALL IN SIZE,  
LARGE IN INFLUENCE

# COUNTRY OVERVIEW

The Republic of Mauritius is an island nation located in the Indian Ocean, approximately 1,000 kilometers east of Madagascar (see Figure 1).<sup>1</sup> Comprising several islands, Mauritius has a total population of 1.24 million and occupies only 2,040 square kilometers.<sup>2</sup> Despite its small size, the country has significant maritime control, with an Exclusive Economic Zone of 2.3 million square kilometers, one of the largest globally.<sup>3</sup>

FIGURE 1. MAP OF MAURITIUS



Mauritius gained independence from British rule in 1968 and has seen subsequent fair and smooth transfers of power across multiple election cycles.<sup>4</sup> According to the Democracy Index compiled by the Economist Intelligence Unit in 2014, Mauritius ranked 17<sup>th</sup> out of 167 countries worldwide in terms of the strength of its democratic institutions, the only African country categorized as a “full democracy.”<sup>5</sup>

1 “Madagascar to Mauritius Distance Location Road Map and Direction,” Distancebetween2, <http://distancebetween2.com/madagascar/mauritius>.  
2 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.  
3 Government of Mauritius, *Moving the Nation Forward: Government Programme 2012–2015* (Government of Mauritius, 2012), <http://mauritiusassembly.govmu.org/English/Documents/Add%20president/Govt%20Address%202012.pdf>.  
4 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.  
5 *Democracy Index 2014*, The Economist Intelligence Unit, <http://www.eiu.com/democracy2014>.

In addition to its strong governance, Mauritius has pursued sound economic policies to drive prosperity. In particular, its monetary policy has kept inflation in the single digits, and historical interest rates have encouraged domestic saving. In addition, Mauritian exchange rate policy has made its exporters competitive.<sup>6</sup> Its stable business environment, reflecting all of these factors, is arguably the best in sub-Saharan Africa. The World Bank ranks Mauritius first among African countries and 20<sup>th</sup> globally on its “Ease of Doing Business” index.<sup>7</sup> In addition, Mauritius actively seeks to attract investment, offering a number of financial incentives to both domestic and foreign investors, including more than 40 Double Taxation Avoidance Agreements.<sup>8</sup> Strong institutions enable the economy to withstand adverse external conditions, earning the country a stable sovereign credit rating of Baa1 (stable) in 2014.<sup>9</sup>

Mauritian gross domestic product (GDP) was USD 22.3 billion at purchasing power parity (PPP) in 2014 and grew at six percent annually over the last decade.<sup>10</sup> Mauritius, like most African countries, was historically dependent on agriculture, with sugarcane the primary crop produced and exported.<sup>11</sup> However, in recent years, the country has diversified its economy: today, the agricultural sector accounts for just three percent of GDP, while the service sector comprises 72 percent.<sup>12</sup> The country has built a highly regulated offshore financial sector that serves as a broad platform for investment into Africa. Information and communication technology (ICT) and tourism also drive growth in the service sector, which is complemented by strong exports in apparel, textiles, and jewelry.<sup>13</sup> As of 2014, the European Union was the main export market, accounting for 58 percent of all exports.<sup>14</sup>

Mauritius is classified as an “upper middle income” country, with a GDP per capita of USD 18,553, the highest in the Southern Africa region (see Table 1 for regional and global comparisons of this and other development indicators).<sup>15</sup> In comparison

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6 Ali Zafar, *Mauritius: An Economic Success Story* (Washington, DC: The World Bank, 2011), [http://siteresources.worldbank.org/AFRICAEXT/Resources/Mauritius\\_success.pdf](http://siteresources.worldbank.org/AFRICAEXT/Resources/Mauritius_success.pdf).

7 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.

8 *Ibid.*

9 Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

10 *World Economic Outlook Database*, s.v. “Mauritius” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>; *The World Bank: Data*, s.v. “Mauritius” in “Indicators,” <http://data.worldbank.org/indicator>. Advisors research has DFIs), Open Capital ate, titutiosn,-12, so how are these similar?g.- akin hem. If you simply want to

11 Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

12 *The World Bank: Data*, s.v. “Mauritius” in “Indicators,” <http://data.worldbank.org/indicator>. *The World Bank, Indicators* (2015), available at <http://data.worldbank.org/indicator>.

13 *Ibid.*

14 Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

15 *World Economic Outlook Database*, s.v. “Mauritius” (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

to the region, the country also has a relatively low—and falling—unemployment rate, around eight percent.<sup>16</sup> Low unemployment is largely attributed to the government’s economic reforms, which have aimed to open the country’s economy and drive foreign direct investment (FDI).<sup>17</sup>

TABLE 1. SELECTED MAURITIUS DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Mauritius	Regional Average	Global Average
HDI SCORE (RANKS 63 <sup>RD</sup> OF 187 COUNTRIES)	0.77	0.55	0.69
GDP PER CAPITA (USD)	18,553	6,874	17,975
UNEMPLOYMENT RATE (%)	8	13	6
POPULATION BELOW USD 1.25 / DAY (%)	<1	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	14	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	54	41	59

The island nation also performs well on the United Nations’ Human Development Index, falling into the “high” category with an HDI score of 0.77 in 2013. Mauritius’ HDI score has consistently been the highest among all Southern African countries, significantly exceeding the 2013 sub-Saharan African average of 0.50.<sup>18</sup> Under-five mortality, currently at 14 deaths per thousand live births, is also well below the 2015 Millennium Development Goals’ target of 60.<sup>19</sup>

16 Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

17 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.

18 Khalid Malik et al., *Human Development Report* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>; Jeni Klugman et al., *Human Development Report* (New York: United Nations Development Programme, 2010), [http://hdr.undp.org/sites/default/files/reports/270/hdr\\_2010\\_en\\_complete\\_reprint.pdf](http://hdr.undp.org/sites/default/files/reports/270/hdr_2010_en_complete_reprint.pdf).

19 Danzen You et al., *Levels and Trends in Child Mortality* (New York: United Nations International Children’s Emergency Fund, 2014), [http://www.data.unicef.org/fckimages/uploads/1410869227\\_Child\\_Mortality\\_Report\\_2014.pdf](http://www.data.unicef.org/fckimages/uploads/1410869227_Child_Mortality_Report_2014.pdf).

# SUPPLY OF IMPACT INVESTMENT CAPITAL

To date, there has been minimal impact investing activity within Mauritius. Excluding development finance institutions (DFIs), research has found only 14 transactions. The majority of deals are in the financial services and ICT sectors, with an average non-DFI deal size of around USD 10 million. In addition to banks and ICT platforms, capital has been deployed in real estate and manufacturing. Matching the profile of these industries and the average size of investment, many of the businesses receiving this capital were later-stage, more mature enterprises.

DFIs have been more active, closing 40 known deals in Mauritius and disbursing a total of approximately USD 600 million, of which USD 80 million was invested through funds of funds. With DFIs, too, financial services is the largest sector, comprising 25 percent of total deals to date.

## THE BROADER INVESTMENT LANDSCAPE

Despite minimal impact investing activity, overall FDI in Mauritius is robust, with real estate, construction, and financial and insurance activities driving the majority of capital inflows.<sup>20</sup> Over the past few decades, the government has transformed the country into one of the most open economies in the world; as a result, Mauritius is one of the highest recipients of FDI per capita.<sup>21</sup> In 2013, 23 percent of FDI in Mauritius originated from the United Kingdom, followed by India at 10 percent.<sup>22</sup>

Due to its geographic proximity to Africa, political and economic stability, and sophisticated infrastructure that encourages business, Mauritius is often considered a gateway for investment into the African continent. The country has a modern legislative regime for establishing funds, corporate companies, limited partnerships, trusts, and foundations.<sup>23</sup> Consequently, the jurisdiction is commonly used to structure investment into sub-Saharan Africa, especially across regional state borders. Mauritius

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20 Board of Investment Mauritius, *Foreign Direct Investment* (Port Louis: Board of Investment Mauritius, 2013), <http://www.investmauritius.com/media/32297/FDIQ12013.pdf>.

21 US Department of State, "Mauritius Investment Climate Statement" (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.

22 International Monetary Fund, *Coordinated Direct Investment Survey* (Washington, DC: International Monetary Fund, 2014), <http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&slid=1390030109571>.

23 "Mauritius' Financial Services Commission Grants JTC License to Conduct Operations," Global Finance Mauritius, [http://www.globalfinance.mu/index.php?option=com\\_content&view=article&id=436:mauritius-financial-services-commission-grants-jtc-licence-to-conduct-operations&catid=15&Itemid=885](http://www.globalfinance.mu/index.php?option=com_content&view=article&id=436:mauritius-financial-services-commission-grants-jtc-licence-to-conduct-operations&catid=15&Itemid=885).

currently has more than 600 investment funds operating from the country,<sup>24</sup> including both non-impact (e.g., Goldman Sachs and BlackRock) and impact-focused funds (e.g., GroFin and Phatisa).<sup>25</sup>

The Mauritian banking and financial system is well-capitalized and ranks 26<sup>th</sup> globally in “financial market development.”<sup>26</sup> Commercial banks are the most dominant players with total assets of USD 38.5 billion in 2014, of which the four largest banks hold 56 percent.<sup>27</sup> Bank lending rates were near 8.5 percent in 2013, a notable decline from rates exceeding 14 percent in 2005.<sup>28</sup> Mauritian households have the highest financial inclusion rate in the region, with only 10 percent of the population unbanked.<sup>29</sup> Access to credit is more challenging, with approximately half of Mauritians borrowing actively, though only 27 percent borrow from formal financial institutions.<sup>30</sup>

## MAURITIUS AS A CONDUIT OF CAPITAL

Many investment funds choose to use offshore jurisdictions, such as Mauritius, when operating in Africa. Mauritius has signed double taxation avoidance agreements with more than 40 countries, and the country has a strong overall business environment, legal and regulatory environment, and tax efficiency for distributions.

General Partners often choose to domicile their funds in Mauritius since this provides them the flexibility to easily structure and deploy capital into promising portfolio companies while providing their Limited Partners with liability protection and tax efficiency. For these reasons, among others, Mauritius is a preferred domicile for many investors focused on Africa and South Asia. In addition to the tax, legal, and financial incentives encouraging funds to locate in Mauritius, investors cite geography, political stability, and local professional service providers as key drivers of their decisions to domicile in the country.

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24 Trident Trusts, *Fund Administration Report* (2010), [http://www.tridenttrust.com/announcement/201006\\_fund\\_admin\\_report/TT-FAR-PE-Africa.pdf](http://www.tridenttrust.com/announcement/201006_fund_admin_report/TT-FAR-PE-Africa.pdf).

25 Phatisa, <http://www.phatisa.com/contact/>; Trident Trusts, *Fund Administration Report* (2010), [http://www.tridenttrust.com/announcement/201006\\_fund\\_admin\\_report/TT-FAR-PE-Africa.pdf](http://www.tridenttrust.com/announcement/201006_fund_admin_report/TT-FAR-PE-Africa.pdf).

26 World Economic Forum, “Mauritius,” in *The Global Competitiveness Report 2014–2015* (Geneva: World Economic Forum, 2014), <http://www3.weforum.org/docs/GCR2014-15/Mauritius.pdf>.

27 Bank of Mauritius, *Financial Stability Report* (2015), [https://www.bom.mu/pdf/fsu/fsr\\_feb15/FSR%20FEB%202015%20Full.pdf](https://www.bom.mu/pdf/fsu/fsr_feb15/FSR%20FEB%202015%20Full.pdf); “Financial Services,” Board of Investment Mauritius, accessed 2015, <http://www.investmauritius.com/investment-opportunities/financial-services.aspx>.

28 *The World Bank: Data*, s.v. “Mauritius” in “Lending Interest Rate,” <http://data.worldbank.org/indicator/FR.INR.LEND>.

29 FinMark Trust, *FinScope Consumer Survey Mauritius* (2014), [http://www.finmark.org.za/wp-content/uploads/pubs/Pres\\_FS\\_-\\_Mauritius-2014.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/Pres_FS_-_Mauritius-2014.pdf).

30 *Ibid.*

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Mauritius continues to present a business-friendly environment with a vibrant private sector. There are no restrictions on remittances of profits, dividends, or capital gains earned by foreign investors.<sup>31</sup> As mentioned above, the country has double taxation avoidance agreements with more than 40 countries. While the investment environment is clearly favorable, its combination of low poverty and low unemployment figures, along with high HDI scores, limit the potential to create impact through investments, particularly relative to other opportunities in the region.

Impact investors will face the following challenges placing capital in Mauritius:

- **Small market:** As one of the smallest countries in Southern Africa by both geography and population, there is limited potential to scale businesses in the domestic market. For instance, the limited land area and high population density leaves little opportunity for expansion of the agricultural sector. As an island nation, local businesses must carefully assess strategies for regional expansion and export opportunities.
- **Skilled labor:** While Mauritians have high literacy levels compared to other countries in the region, there is a lack of talent available with the skills necessary to succeed in the evolving economy. As the economic focus shifts from primary production to services, the World Economic Forum lists an “inadequately educated workforce” among the top challenges to doing business in the country.<sup>32</sup>

Despite these challenges, the government of Mauritius is implementing a strategy intended to propel the state to high-income status by 2025. This plan prioritizes high-potential sectors that present opportunities for potential investors. Impact investors could find attractive opportunities in these sectors to drive job creation:

- **ICT and Business Process Outsourcing (BPO):** The ICT sector posted overall growth of 6.8 percent in 2014,<sup>33</sup> while the number of mobile phone subscribers has been growing annually at 12 percent since 2004, providing opportunities for software and mobile application development.<sup>34</sup> Opportunities in the BPO sector have increased due to Mauritius’s growing service-based economy and English-speaking population. Segments of interest include telemarketing, customer support, technical helpdesks, and data centers, among others.

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31 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.

32 World Economic Forum, “Mauritius,” in *The Global Competitiveness Report 2014–2015* (Geneva: World Economic Forum, 2014), <http://www3.weforum.org/docs/GCR2014-15/Mauritius.pdf>.

33 Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

34 “Statistics,” International Telecommunication Union, accessed 2015, <http://www.itu.int/en/ITU-D/Statistics/Pages/stat/default.aspx>.

- **Ocean economy:** With its control of an Exclusive Economic Zone of more than two million square kilometers, Mauritius has untapped investment opportunities in ocean-related industries such as fishing, seaweed harvesting, pearl culturing, wind and tidal renewable energy, and tourism.
- **Healthcare and pharmaceuticals:** The government is encouraging growth in the healthcare sector, with a particular focus on pharmaceutical manufacturing and marine biotechnology.<sup>35</sup>
- **Agribusiness:** Although agriculture comprises a small portion of total GDP, opportunities remain in this sector. Currently, sugar plantations dominate more than 90 percent of arable land, and the government has identified diversification into other cash crops, such as rice and maize, as a key priority.<sup>36</sup> The country relies heavily on food imports, so investments in agriculture will bolster national food security.

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35 US Department of State, “Mauritius Investment Climate Statement” (Washington, DC: US Department of State, 2014), <http://www.state.gov/documents/organization/229138.pdf>.

36 Statistics Mauritius Ministry of Finance and Economic Development, *National Accounts of Mauritius 2012* (2013), <http://statsmauritius.govmu.org/English/Publications/Documents/Regular%20Reports/national%20accounts/nareport2012.pdf>; Ndoli Kalumiya, and Asha P. Kannan, *Mauritius* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Mauritius\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Mauritius_GB_2015.pdf).

# BOTSWANA

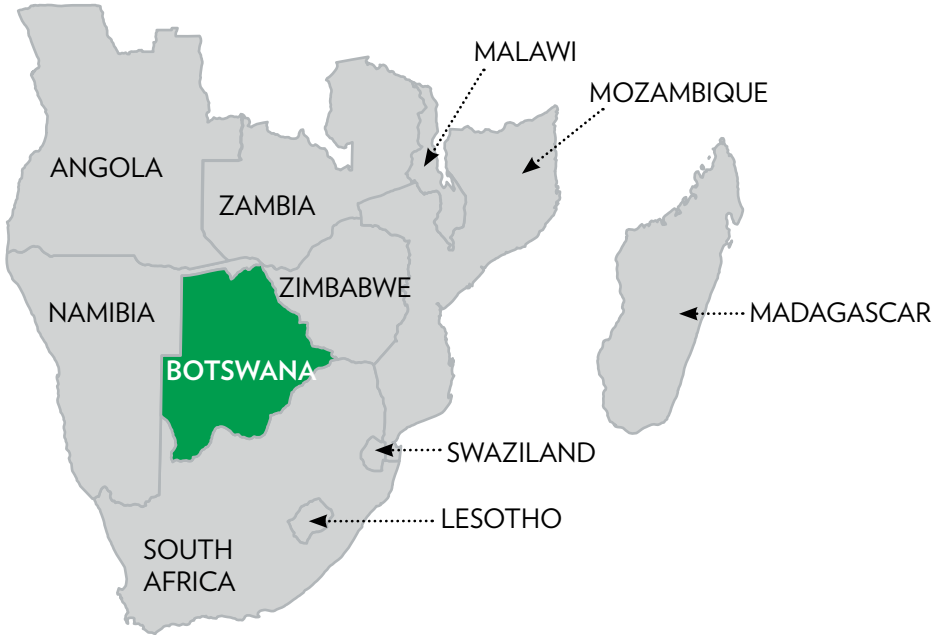
STABLE AND WELL-REGULATED,  
BUT SPARSE



# COUNTRY OVERVIEW

Botswana gained independence from the British Commonwealth in 1966,<sup>1</sup> and the country has since remained a stable democracy. With a population of only two million spread over approximately 580 thousand square kilometers, the country has an extremely low population density (3.4 people per square kilometer).<sup>2</sup> Landlocked, surrounded by South Africa, Namibia, Zambia, and Zimbabwe (see Figure 1), Botswana boasts the expansive Okavanga River Delta in the north, though the semi-arid Kalahari Desert in the south covers 70 percent of the country.<sup>3</sup>

FIGURE 1. MAP OF BOTSWANA



1 *The World Factbook*, s.v. “Botswana” (Washington, DC: Central Intelligence Agency), accessed August 11, 2015, <https://www.cia.gov/library/publications/the-world-factbook/geos/bc.html>.  
2 United Nations Statistics Division, s.v. “Botswana,” <http://data.un.org/CountryProfile.aspx?crName=botswana>.  
3 “Botswana,” Southern Africa Development Community, <http://www.sadc.int/member-states/botswana/>.

Botswana is a member of the African Union, the Southern African Customs Union (SACU), and the Southern African Development Community (SADC).<sup>4</sup> The country has strong north-south rail and road infrastructure connecting it to neighboring South Africa and Zimbabwe.<sup>5</sup>

Botswana's 2014 gross domestic product (GDP) was USD 33.7 billion at purchasing power parity (PPP).<sup>6</sup> Over the past decade, GDP grew at an average annual rate of 6.7 percent,<sup>7</sup> and it is important to note that GDP per capita, at close to USD 16 thousand, is substantially higher than that of the region as a whole.<sup>8</sup> Diamond extraction is the country's dominant economic driver, contributing one-third of GDP, 70 percent of export revenues, and half of government revenues.<sup>9</sup> Government regulations, including a new Mining Code, are aimed at attracting investment, increasing skilled jobs, and capturing more of the downstream supply chain within the diamond trade.<sup>10</sup> A second key and growing sector is international tourism, supported by diverse natural wildlife and strong conservation practices, especially in the Okavango River Delta.<sup>11</sup>

Foreign direct investment (FDI) across sectors totaled only USD 188 million in 2013, with over 40 percent of FDI coming from Luxembourg; other key investors included China, South Africa, and Australia.<sup>12</sup> The majority of FDI inflows were in mining and financial services.<sup>13</sup>

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4 "Botswana," The Commonwealth, <http://thecommonwealth.org/our-member-countries/botswana>.

5 "Investment Climate Ease of Doing Business," Botswana Investment and Trade Centre, <http://www.bitc.co.bw/investment-climate-ease-doing-business>.

6 *World Economic Outlook Database*, s.v. "Botswana" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

7 *Ibid.*

8 *The World Factbook*, "Country Comparison: GDP per capita" (Washington, DC: Central Intelligence Agency), <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2004rank.html>.

9 KPMG, *Botswana Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Botswana.pdf>.

10 Peninah Kariuki, Fitsum Abraha, and Senny Obuseng, *Botswana* (OECD Development Centre: African Economic Outlook, 2014), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN\\_Long\\_EN/Botswana\\_EN.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Botswana_EN.pdf).

11 KPMG, *Botswana Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Botswana.pdf>.

12 International Monetary Fund, *Coordinated Direct Investment Survey* (Washington, DC: International Monetary Fund, 2014), <http://data.imf.org/?sk=D732FC6E-D8C3-44D1-BFEB-F70BA9E13211>.

13 KPMG, *Botswana Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Botswana.pdf>.

**TABLE 1. SELECTED BOTSWANA DEVELOPMENT INDICATORS**

DEVELOPMENT INDICATOR	Botswana	Regional Average	Global Average
HDI SCORE (RANKS 109 <sup>TH</sup> OF 187 COUNTRIES)	0.68	0.55	0.69
GDP PER CAPITA (USD)	16,000	6,874	17,975
UNEMPLOYMENT RATE (%)	18	13	6
POPULATION BELOW USD 1.25 / DAY (%)	--	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	53	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	75	41	59

The South African Rand was the official currency in Botswana until 1976, when the Pula was introduced.<sup>14</sup> In recent years the Pula has depreciated against the US Dollar but risen against the South African Rand, the country's major trading partner.<sup>15</sup>

Over the past three decades, Botswana has had one of the fastest rates of improvement in the United Nations Human Development Index (HDI), with a 2013 HDI value of 0.68,<sup>16</sup> second-highest in the sub-Saharan region and 109<sup>th</sup> overall in the world (see Table 1 for regional and global comparisons of select development indicators).<sup>17</sup> In one of the most dramatic improvements, the share of population living in extreme poverty fell from roughly a quarter in 2002 to 6.5 percent in 2010.<sup>18</sup> Nonetheless, high unemployment has sustained high economic inequality across the population. Though data are sparse, Botswana is believed to have a Gini coefficient of 0.63, one of the highest in the world.<sup>19</sup>

Botswana has the third-highest adult prevalence rate of HIV/AIDS in the world,

14 Bank of Botswana, "History of the Pula," <http://www.bankofbotswana.bw/index.php/content/2009110912000-history-of-the-pula>.

15 Peninah Kariuki, Fitsum Abraha, and Sennye Obuseng, *Botswana* (OECD Development Centre: African Economic Outlook, 2014), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN\\_Long\\_EN/Botswana\\_EN.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Botswana_EN.pdf).

16 Khalid Malik et al., *Human Development Report* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>.

17 Jeni Klugman et al., *Human Development Report* (New York: United Nations Development Programme, 2009), [http://hdr.undp.org/sites/default/files/reports/269/hdr\\_2009\\_en\\_complete.pdf](http://hdr.undp.org/sites/default/files/reports/269/hdr_2009_en_complete.pdf).

18 The World Health Organization, "Prevalence of HIV among adults aged 15–49: Estimates by country", <http://apps.who.int/gho/data/node.main.562?lang=en>.

19 *The World Factbook*, "Distribution of Family Income Gini Index" (Washington, DC: Central Intelligence Agency), <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2172rank.html#bc>.

with over 21 percent of the adult population suffering from the disease.<sup>20</sup> The government has enacted a strong pharmaceutical program enabling 96 percent of eligible HIV-positive patients to receive anti-retroviral therapy.<sup>21</sup> Effective government spending has also increased access to general healthcare, with 95 percent of the total population (and 89 percent of the rural population) living within 15 km of a health center.<sup>22</sup>

## SUPPLY OF AND DEMAND FOR IMPACT INVESTING CAPITAL

The formal financial sector in Botswana is small but robust. There are only four large commercial banks, which hold more than 80 percent of commercial banking assets.<sup>23</sup> At around 2.5 percent, the ratio of non-performing loans is relatively stable due to the country's stringent supervisory standards.<sup>24</sup> Beyond banking, a number of ongoing government initiatives are aimed at strengthening Botswana's financial sector, with the specific goal of increasing access to capital and improving financial inclusion.<sup>25</sup> Further, China is a big investor in large-scale capital projects. To date, results have been mixed. An airport project was begun but not completed. A coal-fired power station was completed, but interviewees believe the station was built to poor quality standards.

The impact investing sector in Botswana is still nascent. The country has received the second-smallest share of impact investing capital disbursed in the region. In total, 19 transactions worth approximately USD 250 million have taken place since 2000. Of these, development finance institutions (DFIs) made the vast majority (85 percent by capital and 90 percent by number of investments). These DFI investments were predominantly in the financial-services sector but also included investments in agriculture, extractives, and water, sanitation, and hygiene (WASH). Of the two known deals, less than USD 40 million has been disbursed by non-DFI investors, into financial services and information and communication technologies (ICT).

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20 United Nations Development Programme, "Botswana: HIV/AIDS Overview," [http://www.bw.undp.org/content/botswana/en/home/ourwork/hiv\\_aids/overview.html](http://www.bw.undp.org/content/botswana/en/home/ourwork/hiv_aids/overview.html).

21 Peninah Kariuki, Fitsum Abraha, and Senny Obuseng, *Botswana* (OECD Development Centre: African Economic Outlook, 2014), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN\\_Long\\_EN/Botswana\\_EN.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Botswana_EN.pdf).

22 *Ibid.*

23 Bank of Botswana, *Banking Supervision Annual Report* (Gaborone: Bank of Botswana, 2013), [www.bankofbotswana.bw/assets/uploaded/bob-bsar-2013-web-933.pdf](http://www.bankofbotswana.bw/assets/uploaded/bob-bsar-2013-web-933.pdf).

24 Peninah Kariuki, Fitsum Abraha, and Senny Obuseng, *Botswana* (OECD Development Centre: African Economic Outlook, 2014), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN\\_Long\\_EN/Botswana\\_EN.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Botswana_EN.pdf).

25 *Ibid.*

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

The combination of a democratic and stable political climate, low levels of corruption, strong rule of law, and low tax rates creates an attractive landscape for investors in Botswana.<sup>26</sup> Indeed, Transparency International ranks Botswana 31<sup>st</sup> (out of 175 countries globally) in its Corruption Perceptions Index, making Botswana the highest-ranking country in Africa.<sup>27</sup> However, these positives are offset by specific, noteworthy challenges, some of which include:

- **Small market:** With a population of only two million and a low population density, the addressable market for consumer-facing businesses can be small and difficult to reach.
- **Bureaucracy:** Botswana’s “Ease of Doing Business” metrics (as determined by the World Bank) have fallen in recent years, although new government initiatives in 2011 and 2012—including the introduction of the National Doing Business Committee and numerous bills—aim to simplify business formation and operations processes and to attract investors.<sup>28</sup> The overall regulatory environment in Botswana encourages foreign investment more than do those of many neighboring developing countries.<sup>29</sup>
- **Power shortages:** Despite generous coal deposits within Botswana and one of the strongest solar exposures on the planet, the country has an insufficient supply of power to cover domestic demand. It has historically relied on the Southern Africa Power Pool (predominantly generated in South Africa) to supply 80 percent of its electricity.<sup>30</sup> In 2015, supply challenges limited the transmission of power from regional partners, causing beyond-normal load shedding within the country.<sup>31</sup>
- **Climate change:** With scarce distribution of water resources, Botswana is highly susceptible to both droughts and floods. Climate change is a significant threat to both the agriculture and tourism sectors.

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26 “Investment Climate Ease of Doing Business,” Botswana Investment and Trade Centre, <http://www.bitc.co.bw/investment-climate-ease-doing-business>.

27 Transparency International, “Botswana,” accessed 2015, <http://www.transparency.org/country/#BWA>.

28 The World Bank, “Ease of Doing Business Index,” <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>; George J. Honde and Fitsum G. Abraha, *Botswana* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Botswana\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Botswana_GB_2015.pdf).

29 KPMG, *Botswana Country Profile* (Johannesburg: KPMG, 2012), <http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Botswana.pdf>; The World Bank, “Botswana,” in *Doing Business 2015* (Washington, DC: The World Bank, 2014), <http://www.doingbusiness.org/data/exploreeconomies/botswana/-/media/giawb/doing%20business/documents/profiles/country/BWA.pdf?ver=2>.

30 AECOM International Development, *National Energy Policy for Botswana* (Gaborone: AECOM International Development, 2009), [http://pdf.usaid.gov/pdf\\_docs/Pnadu385.pdf](http://pdf.usaid.gov/pdf_docs/Pnadu385.pdf).

31 “Load Shedding,” Botswana Power Corporation, [http://www.bpc.bw/Pages/load\\_shedding.aspx](http://www.bpc.bw/Pages/load_shedding.aspx).

- **Skill shortages:** Although the government has placed concerted focus on the issue, the education system is seen as being generally of low quality, inadequate to prepare workers for skilled roles.<sup>32</sup> Despite high literacy and relatively high educational attainment, the country suffers from persistently high unemployment. Youth are disproportionately impacted, with a 34 percent unemployment rate among those aged 20-24.<sup>33</sup>

Nevertheless, Botswana presents opportunities for impact investors to enter the market and place return-seeking capital. Nationally, decreasing dependence on diamond extraction and trade will diversify and strengthen Botswana's economy. Impact investment opportunities may be found in the following sectors:

- **Ecotourism:** With a desire to diversify away from extractive industries and a strong history of government support for conservancy, Botswana has an outsized opportunity to further develop ecologically-friendly tourist attractions. Impact investment in tourism has the opportunity to build on an already-robust tourism infrastructure to improve livelihoods, support environmental safekeeping, and provide financial returns.
- **Energy:** Given that local power assets supply less than 20 percent of Botswana's power needs, energy investments could catalyze other revenue-generating businesses and improve quality of life. More importantly, Botswana boasts one of the highest rates of solar radiation on the planet, a massive resource ripe for solar power generation and project development.<sup>34</sup> The government recently began renewable energy feed-in tariffs to promote investment in the sector.<sup>35</sup>
- **Agriculture:** The agricultural sector has steadily declined since independence (falling from 43 percent of GDP in 1966 to less than two percent today).<sup>36,37</sup> Nevertheless, more than 70 percent of rural households survive by subsistence farming.<sup>38</sup> The livestock industry, a major contributor to rural livelihoods, is already subsidized.<sup>39</sup> Investments in irrigation, rural roads and infrastructure, and agro-processing could increase the incomes of rural populations.

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32 Open Capital Interviews.

33 George J. Honde and Fitsum G. Abraha, *Botswana* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Botswana\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Botswana_GB_2015.pdf).

34 AECOM International Development, *National Energy Policy for Botswana* (Gaborone: AECOM International Development, 2009), [http://pdf.usaid.gov/pdf\\_docs/Pnadu385.pdf](http://pdf.usaid.gov/pdf_docs/Pnadu385.pdf).

35 "Botswana 2014," Renewable Energy and Energy Efficiency Partnership, last modified October 11, 2013, <http://www.reeep.org/botswana-2014>.

36 Andrew Mwaba et al., *Botswana 2009–2013 Country Strategy Paper* (Tunis: African Development Bank Group, 2009), available at [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/BOTSWANA\\_2009%20E2%80%93%202013%20COUNTRY%20STRATEGY%20PAPER.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/BOTSWANA_2009%20E2%80%93%202013%20COUNTRY%20STRATEGY%20PAPER.pdf).

37 This decline over 50 years is largely due to Botswana's entry into diamond mining, which today contributes one third of GDP and half of government revenues. For more information, see [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/BOTSWANA\\_2009%20E2%80%93%202013%20COUNTRY%20STRATEGY%20PAPER.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/BOTSWANA_2009%20E2%80%93%202013%20COUNTRY%20STRATEGY%20PAPER.pdf).

38 United Nations Development Programme, "Agriculture and Food Security Policy Brief: Botswana," [https://sustainabledevelopment.un.org/content/documents/1008National\\_Report\\_\(Agriculture\)\\_-Botswana.pdf](https://sustainabledevelopment.un.org/content/documents/1008National_Report_(Agriculture)_-Botswana.pdf).

39 "Livestock Management and Infrastructure Development," Government of Botswana, <http://www.gov.bw/en/Ministries--Authorities/Ministries/MinistryofAgriculture-MOA/Animal-Husbandry/Livestock/Livestock-Management-and-Infrastructure-Development-LIMID/>.



# KINGDOM OF LESOTHO

SOUTHERN AFRICA'S  
SMALLEST ECONOMY

# COUNTRY OVERVIEW

The Kingdom of Lesotho (Lesotho) sits atop a small, mountainous plateau, wholly surrounded by South Africa (see Figure 1). It has a population of approximately two million and covers an area of just 30 thousand square kilometers—comparable to Maryland, US, or Belgium.<sup>1</sup> A constitutional monarchy, Lesotho is among the last three monarchies in Africa.<sup>2</sup> Political instability has dominated the country in recent years. After electing the continent’s first coalition government in 2012, the country suffered from conflicts between coalition parties, and parliament was suspended in mid-2014.<sup>3</sup> After an attempted coup, the Maseru Facilitation Declaration, brokered by the Southern African Development Community (SADC), was signed in late 2014, re-opening parliament and calling for elections in February 2015.<sup>4</sup> The result of these elections was the formation of a new coalition government, led by the previous opposition.<sup>5</sup>

FIGURE 1. MAP OF LESOTHO



- 1 *The World Factbook*, s.v. “Lesotho” (Washington, DC: Central Intelligence Agency), accessed August 26, 2015, <https://www.cia.gov/library/publications/the-world-factbook/geos/lt.html>.
- 2 “About Lesotho,” Lesotho National Development Corporation, <http://www.lndc.org.ls/Lesotho/default.php>.
- 3 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).
- 4 Amogelang Mbatha and Mathabiso Ralengau, “Lesotho’s Leaders Agree to Early Vote to End Political Stalemate,” *Bloomberg*, October 2, 2014, <http://www.bloomberg.com/news/articles/2014-10-02/lesotho-s-leaders-agree-to-early-vote-to-end-political-stalemate>.
- 5 Marafaele Mohloboli, “Update 2—Lesotho’s Opposition Forms Coalition after Tight Election,” *Thomson Reuters*, March 4, 2015, <http://af.reuters.com/article/lesothoNews/idAFL5NoW6ORX20150304?sp=true>.

Lesotho is closely linked to South Africa, its sole neighbor. It is a member of the SADC, the Southern African Customs Union (SACU),<sup>6</sup> and the Common Monetary Area (CMA), in the latter along with South Africa, Swaziland, and Namibia. The government pegs Lesotho's currency, the Loti, to the South African Rand. As a result, the country does not have an independent monetary or exchange rate policy.<sup>7</sup>

Lesotho's membership in the SACU is economically vital. Within this union, all customs duties and excise revenues are shared between member nations.<sup>8</sup> This revenue is allocated based on both share of trade and need, with the intent to foster development in poorer member states.<sup>9</sup> As a result, SACU customs duties are the government of Lesotho's single largest revenue source.<sup>10</sup> Other major sources of government funding include remittances and export revenue.<sup>11</sup>

Lesotho's gross domestic product (GDP) was USD 5.1 billion at purchasing power parity (PPP) in 2013, making it the smallest economy in Southern Africa.<sup>12</sup> GDP in Lesotho has seen modest growth in recent years, averaging 4.3 percent growth in 2014.<sup>13</sup> GDP is expected to rise by around 5 percent in 2015, driven by developments in mining (particularly diamonds), agriculture, financial services, and construction.<sup>14</sup> Lesotho's economy is highly susceptible to exogenous shocks due to its dependence on South Africa for imports and on the United States for exports (particularly textiles).<sup>15</sup>

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6 Kingdom of Lesotho, *National Investment Policy of Lesotho* (Maseru: One-Stop Business Facilitation Centre, 2013), [http://www.obfc.org.ls/legislation/National\\_Investment\\_Policy\\_Lesotho\\_final\\_draft.pdf](http://www.obfc.org.ls/legislation/National_Investment_Policy_Lesotho_final_draft.pdf).

7 US Department of State, "Lesotho Investment Climate Statement" (Washington, DC: US Department of State, 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191183.htm>.

8 "Southern African Customs Union (SACU)," Republic of South Africa: Department of International Relations and Cooperation, <http://www.dfa.gov.za/foreign/Multilateral/africa/sacu.htm>.

9 *Ibid.*

10 Keith Jefferis and Lemmy Manje, *Making Access Possible Lesotho: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho\\_Diagnostic-report\\_final\\_2014.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho_Diagnostic-report_final_2014.pdf).

11 KPMG, *Lesotho Country Profile* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile_2012-2013_01.pdf).

12 *World Economic Outlook Database*, s.v. "Lesotho" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

13 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

14 *Ibid.*

15 African Development Bank, *Kingdom of Lesotho Country Strategy Paper 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Lesotho%20-%20Country%20Strategy%20Paper.pdf>.

Lesotho is classified as a “lower-middle-income” country with gross national income per capita of USD 1,444.<sup>16</sup> However, it suffers from extreme income inequality, with 43 percent of the population surviving on less than USD 1.25 per day.<sup>17</sup> The unemployment rate is estimated at 25 percent among the overall population, with significantly higher unemployment among rural and youth populations—populations who are also disproportionately affected by poverty.<sup>18</sup>

Education is a stated government priority, with spending on schooling comprising around 12 percent of GDP.<sup>19</sup> Thanks to this investment, Lesotho has an 85 percent literacy rate, among the highest in Africa.<sup>20</sup> Despite this success, however, dropout and grade repetition rates are high among Lesotho’s students.<sup>21</sup>

At 22.9 percent, Lesotho’s HIV/AIDS adult infection rate is second-highest in the world, trailing only Swaziland.<sup>22</sup> The epidemic disproportionately impacts certain subgroups of the population—for instance, half of women in urban areas are estimated to be infected.<sup>23</sup> Recent interventions through investments by international donors and the government have helped stem the spread of the disease, leading to a drop in mother-to-child transmission,<sup>24</sup> but its impact remains severe. Life expectancy at birth is less than 50 years, and Lesotho has rising rates of child mortality, particularly in rural regions.<sup>25</sup> Table 1 reviews development indicators for Lesotho.

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16 United Nations Statistics Division, s.v. “Lesotho,” <http://data.un.org/CountryProfile.aspx?crName=lesotho>.

17 Khalid Malik et al., *Human Development Report* (New York: United Nations Development Programme, 2014), <http://hdr.undp.org/sites/default/files/hdr14-report-en-1.pdf>; Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

18 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

19 KPMG, *Lesotho Country Profile* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile_2012-2013_01.pdf).

20 *Ibid.*

21 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

22 The World Health Organization, “Prevalence of HIV among adults aged 15–49: Estimates by country,” <http://apps.who.int/gho/data/node.main.562?lang=en>.

23 KPMG, *Lesotho Country Profile* (Johannesburg: KPMG, 2014), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile\\_2012-2013\\_01.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Lesotho%20Country%20Profile_2012-2013_01.pdf).

24 “Country Profile: Kingdom of Lesotho,” Action for Southern Africa, last modified September 2011, <http://www.actsa.org/Pictures/Uplimages/pdfs/Lestoho%20Country%20Profile%20September%202011.pdf>.

25 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

TABLE 1. SELECTED LESOTHO DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Lesotho	Regional Average	Global Average
HDI SCORE (RANKS 128 <sup>TH</sup> OF 187 COUNTRIES)	0.49	0.55	0.69
GDP PER CAPITA (USD)	2,764	6,874	17,975
UNEMPLOYMENT RATE (%)	25	13	6
POPULATION BELOW USD 1.25 / DAY (%)	43	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	100	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	21	41	59

## SUPPLY AND DEMAND OF IMPACT INVESTING CAPITAL

Investing in Lesotho is challenging due to its small size and lack of investment-ready deal flow. To date, there have been a total of 12 known impact investments in the country, nine of which were completed by development finance institutions (DFIs). Through these nine deals, DFIs have invested USD 280 million in Lesotho, predominantly in water, sanitation, and hygiene (WASH) and in energy infrastructure projects. The three investments made by non-DFI investors have totaled approximately USD 15 million, with investments in agro-processing, information and communication technologies (ICT), and housing.

Access to credit remains a key constraint for entrepreneurs in Lesotho. The three foreign-owned banks in the country—Ned Bank, Standard Bank, and First National Bank—control a combined 90 percent of the country’s banking assets.<sup>26</sup> The commercial banks—including these three plus one locally-owned bank controlling 10 percent of the country’s banking assets—are well-capitalized and highly profitable but mostly lend to the public sector.<sup>27</sup> In 2004, the government of Lesotho established PostBank, the one locally-owned bank, to provide financial services to citizens

26 US Department of State, “Lesotho Investment Climate Statement” (Washington, DC: US Department of State, 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191183.htm>.

27 *Ibid.*

who otherwise did not have access to such services.<sup>28</sup> PostBank, however, lacks the economies of scale of the foreign-owned banks and has not yet achieved financial sustainability.<sup>29</sup> Today, less than four percent of Lesotho's adults, most of whom are located in the capital, Maseru, have access to bank credit.<sup>30</sup>

Non-bank financial institutions (NBFIs) are more dominant than banks in Lesotho, controlling an asset base larger than 50 percent of GDP.<sup>31</sup> In contrast to the small number of commercial banks, there are more than 230 NBFIs, including microfinance institutions (MFIs), insurers, and money lenders.<sup>32</sup> Only 10 percent of small business owners have credit with regulated financial institutions (either bank or NBFI), while a further 37 percent access credit through unregulated lenders or through family and friends.<sup>33</sup> Despite these low levels of access to credit, the total amount of credit available to the private sector has grown in recent years, rising by 12 percent in 2014, and the amount of credit is expected to continue growing.<sup>34</sup> Government deposits caused by a rising budget surplus and government initiatives to increase access to credit—such as opening a Credit Reference Bureau in 2014 and setting up guarantee schemes—have been largely responsible for this growth.<sup>35</sup>

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28 US Department of State, "Lesotho Investment Climate Statement" (Washington, DC: US Department of State, 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191183.htm>.

29 Keith Jefferis and Lemmy Manje, *Making Access Possible Lesotho: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho\\_Diagnostic-report\\_final\\_2014.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho_Diagnostic-report_final_2014.pdf).

30 *Ibid.*

31 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

32 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf); Keith Jefferis and Lemmy Manje, *Making Access Possible Lesotho: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho\\_Diagnostic-report\\_final\\_2014.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho_Diagnostic-report_final_2014.pdf).

33 Keith Jefferis and Lemmy Manje, *Making Access Possible Lesotho: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho\\_Diagnostic-report\\_final\\_2014.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/MAP-Lesotho_Diagnostic-report_final_2014.pdf).

34 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

35 *Ibid.*

# CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Impact investors looking to deploy capital in Lesotho will likely face these challenges, among others:

- **Small market:** As the smallest nation in the region by GDP, there is limited potential for scale in-country. Businesses seeking attractive returns will need to expand regionally and prioritize exports. Lesotho's memberships in the SACU and SADC, along with other preferential trade agreements addressing European and US markets, support the potential of its export market.
- **High costs of export:** Despite trade agreements, poor infrastructure and lack of sea access often make exports costly and difficult.<sup>36</sup> The government has identified infrastructure as a key constraint limiting private-sector development and has committed, along with DFIs like the African Development Bank (AfDB), to invest in new infrastructure.<sup>37</sup>
- **Human capital:** Lesotho suffers from a shortage of skilled labor. With the increasing importance of manufacturing and mining, its economy has a rising need for skilled and semi-skilled labor.<sup>38</sup> High HIV/AIDS rates have further decreased labor productivity and supply.

Despite these challenges, there are certainly opportunities for investment in Lesotho. The government launched the National Strategic Development Plan (NSDP) in 2012 in an attempt to attract more foreign direct investment (FDI).<sup>39</sup> The government has also been streamlining customs procedures and its land tenure system in an effort to promote investment.<sup>40</sup> As a result, the country rose 25 spots in the World Bank's "Ease of Doing Business" index between 2012 and 2015, from 153<sup>rd</sup> to 128<sup>th</sup> out of 189 countries.<sup>41</sup>

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36 "Lesotho Foreign Investment," Santander Trade, last updated August 2015, <https://en.santandertrade.com/establish-overseas/lesotho/investing-3>.

37 African Development Bank, *Kingdom of Lesotho Country Strategy Paper 2013–2017* (Tunis: African Development Bank Group, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Lesotho%20-%20Country%20Strategy%20Paper.pdf>.

38 *Ibid.*

39 Kingdom of Lesotho, *National Investment Policy of Lesotho* (Maseru: One-Stop Business Facilitation Centre, 2013), [http://www.obfc.org.ls/legislation/National\\_Investment\\_Policy\\_Lesotho\\_final\\_draft.pdf](http://www.obfc.org.ls/legislation/National_Investment_Policy_Lesotho_final_draft.pdf).

40 US Department of State, "Lesotho Investment Climate Statement" (Washington, DC: US Department of State, 2012), <http://www.state.gov/e/eb/rls/othr/ics/2012/191183.htm>.

41 The World Bank, "Lesotho," in *Doing Business 2015* (Washington, DC: The World Bank, 2014), <http://www.doingbusiness.org/data/exploreeconomies/lesotho/-/media/giawb/doing%20business/documents/profiles/country/LSO.pdf>.

Though there is limited impact investment activity in Lesotho today, the combination of high poverty rates (particularly in rural areas) and rising inequality indicate a strong need for impact capital. Opportunities include:

- **Agribusiness:** While agriculture only accounts for nine percent of GDP, it is the primary source of income for the majority of the rural population in Lesotho.<sup>42</sup> Investments in primary agriculture could directly target inequality and poverty within agrarian populations. There are particular opportunities to develop the livestock value chain—the dominant agricultural subsector in the country—including mohair, wool, and hides for the vibrant textiles market.<sup>43</sup>
- **Water:** Though Lesotho has abundant water, it has little infrastructure to supply it to businesses and households. Additionally, with South Africa currently unable to meet its high and growing demand for water, there are therefore clear opportunities to invest in the Lesotho water sector.<sup>44</sup> The Lesotho Highlands Water Project, a multi-billion dollar, multi-phase project, is currently underway to divert water from Lesotho to Johannesburg.<sup>45</sup> There are further opportunities around the supply of water to rural populations in the highland areas.<sup>46</sup>

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42 Edirisa Nseera, Adeleke Salami, and Alka Bhatia, *Lesotho* (OECD Development Centre: African Economic Outlook, 2015), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN\\_data/CN\\_Long\\_EN/Lesotho\\_GB\\_2015.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2015/CN_data/CN_Long_EN/Lesotho_GB_2015.pdf).

43 African Development Bank, *Kingdom of Lesotho Country Strategy Paper 2013–2017* (African Development Bank, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Lesotho%20-%20Country%20Strategy%20Paper.pdf>.

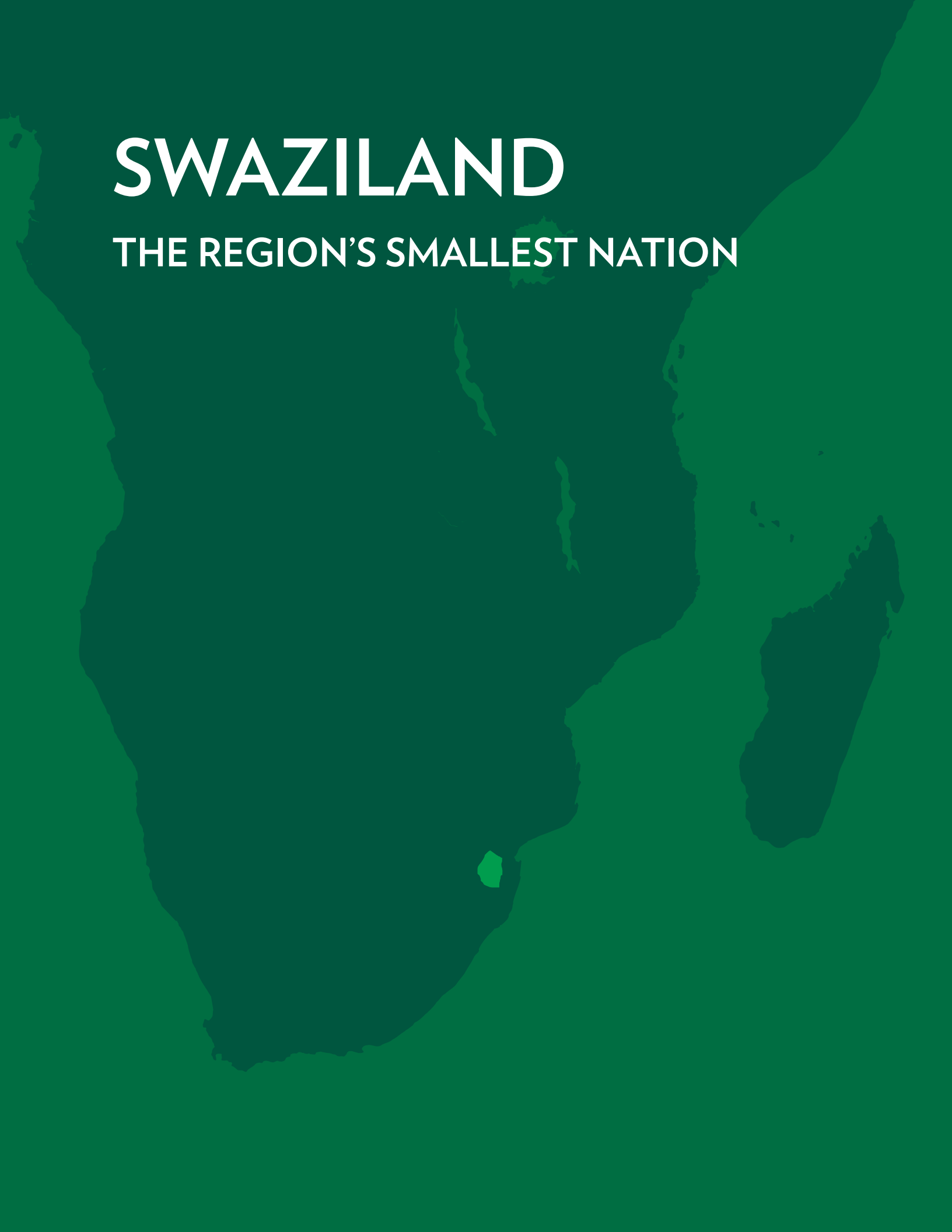
44 *Ibid.*

45 “Lesotho Highlands Water Project Phase II Project Description,” Lesotho Highlands Development Authority, <http://www.lhda.org.ls/phase2/>.

46 African Development Bank, *Kingdom of Lesotho Country Strategy Paper 2013–2017* (African Development Bank, 2013), <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2017%20-%20Lesotho%20-%20Country%20Strategy%20Paper.pdf>.

# SWAZILAND

THE REGION'S SMALLEST NATION



# COUNTRY OVERVIEW

Swaziland is a small, landlocked country with a population of 1.4 million living in 17 thousand square kilometers (see Figure 1), making it one of the smallest states in Africa.<sup>1</sup> Granted independence from British rule in 1968, it is today the only remaining absolute monarchy on the continent.<sup>2</sup>

FIGURE 1. MAP OF SWAZILAND



Except for a short border with Mozambique to its east, Swaziland is encircled by South Africa, which exerts strong political and economic influence. South Africa provides 80 percent of Swaziland's imports and is the destination for 60 percent of its exports. As part of the Common Monetary Area (CMA) along with South Africa, Lesotho, and Namibia, the government pegs Swaziland's currency, the Lilangeni, to the South African Rand.<sup>3</sup> As a result, the country has neither an independent monetary nor an independent exchange rate policy.

Swaziland's membership in the Southern Africa Customs Union (SACU) is a vital component of its economy.<sup>4</sup> Under the union, all customs duties and excise revenue

1 *The World Factbook*, s.v. "Swaziland" (Washington, DC: Central Intelligence Agency), accessed 2015, <https://www.cia.gov/library/publications/the-world-factbook/geos/wz.html>.

2 "Country Profile: Swaziland," Action for Southern Africa, last modified September 2011, <http://www.actsa.org/Pictures/UpImages/pdfs/Swaziland%20Country%20Profile%20September%202011.pdf>.

3 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_-\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper_-_Draft_Version_.pdf).

4 The SACU has five member states: Botswana, Lesotho, Namibia, South Africa, and Swaziland.

collected in the common customs area is shared between member nations.<sup>5</sup> This revenue is allocated by each nation's share of trade and by need, with the intent to foster development in poorer member states. According to the allocation by need, 15 percent of funds are distributed in inverse proportion to gross domestic product (GDP) per capita.<sup>6</sup> As a result, about 60 percent of the Swazi government's revenue derives from the SACU alone.<sup>7</sup>

Swaziland's GDP was USD seven billion at purchasing power parity (PPP) in 2014.<sup>8</sup> GDP growth in Swaziland has been slow over the past decade, averaging 3.9 percent annually, far below the regional average, and it was nearly flat over the decade before that.<sup>9</sup> With its small size and dependence on its neighbors, the country is highly susceptible to exogenous shocks. For instance, GDP growth slowed significantly from 2009 through 2011 as South Africa suffered from the global recession as a result of declining commodity prices. The resulting decline in SACU revenues further damaged Swaziland's economy, as Swaziland suffered its worst economic crisis since independence.<sup>10</sup>

TABLE 1. SELECTED SWAZILAND DEVELOPMENT INDICATORS

DEVELOPMENT INDICATOR	Swaziland	Regional Average	Global Average
HDI SCORE (RANKS 127 <sup>TH</sup> OF 187 COUNTRIES)	0.53	0.55	0.69
GDP PER CAPITA (USD)	7,800	6,874	17,975
UNEMPLOYMENT RATE (%)	29	13	6
POPULATION BELOW USD 1.25 / DAY (%)	40	51	25
UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)	80	75	47
POPULATION WITH SOME SECONDARY EDUCATION (%)	48	41	59

5 "Southern African Customs Union (SACU)," Republic of South Africa: Department of International Relations and Cooperation, <http://www.dfa.gov.za/foreign/Multilateral/africa/sacu.htm>.

6 *Ibid.*

7 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper__Draft_Version_.pdf).

8 *World Economic Outlook Database*, s.v. "Swaziland" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>.

9 *World Economic Outlook Database*, s.v. "Swaziland" (Washington, DC: International Monetary Fund, 2015), <https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx>; "Country Profile: Swaziland," Action for Southern Africa, last modified September 2011, <http://www.actsa.org/Pictures/Uplmages/pdfs/Swaziland%20Country%20Profile%20September%202011.pdf>.

10 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper__Draft_Version_.pdf).

Swaziland is classified as a “low-middle-income” country, with its per capita income of USD 7,800 more than twice the average in sub-Saharan Africa.<sup>11</sup> However, the country suffers from extreme income inequality, with more than 40 percent of the population surviving on less than USD 1.25 per day (see Table 1 for a summary of selected development indicators for Swaziland).<sup>12</sup> The unemployment rate is estimated to be about 30 percent among the overall population, and unemployment is almost twice as high among youth under the age of 24.<sup>13</sup>

With 26 percent of its population infected with HIV/AIDS, Swaziland has the highest infection rate in the world.<sup>14</sup> Though government and donor intervention provide both prevention and treatment, which has recently stabilized the infection rate,<sup>15</sup> the impact of the disease is immense. Life expectancy at birth has fallen below 50 years—the fourth-lowest rate globally.<sup>16</sup>

## SUPPLY AND DEMAND OF IMPACT INVESTING CAPITAL

There has been minimal impact investing activity in Swaziland to date, with a total of just four known impact investments in the country—two from development finance institutions (DFIs) and two from non-DFI investors—in the agriculture and water, sanitation, and hygiene (WASH) sectors. Total capital disbursed is less than USD 60 million, approximately equally split between DFI and non-DFI actors.

Investing and working in Swaziland continue to be difficult due to government monopolies, a bureaucratic business environment, and a limited talent pool (as detailed in the “Challenges” section below).

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11 Central Intelligence Agency, *The World Factbook: Swaziland* (2015), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/wz.html>; “Country Profile: Swaziland,” Action for Southern Africa, last modified September 2011, <http://www.actsa.org/Pictures/UplImages/pdfs/Swaziland%20Country%20Profile%20September%202011.pdf>.

12 United Nations Development Programme, *Human Development Report: Swaziland* (New York: United Nations Development Programme, 2013), <http://hdr.undp.org/sites/default/files/Country-Profiles/SWZ.pdf>.

13 “Country Overview: Swaziland,” The World Bank, <http://www.worldbank.org/en/country/swaziland/overview>; Zuzana Brixiová, Thierry Kangoye, and Robert Fakudze, *Youth employment challenge and entrepreneurship in Swaziland* (African Economic Conference, 2012), <http://www.africaneconomicconference.org/2012/Documents/Papers/AEC2012-132.pdf>.

14 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper__Draft_Version_.pdf).

15 *Ibid.*

16 KPMG, *Swaziland Country Profile* (Johannesburg: KPMG, 2012), [https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Swaziland%20Country%20Profile\\_2012-2013.pdf](https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Swaziland%20Country%20Profile_2012-2013.pdf).

Accessing finance is difficult in Swaziland. The World Economic Forum's Global Competitiveness Report lists "access to finance" as the single biggest constraint to doing business in the country.<sup>17</sup> Although interest rates are pegged to South African rates and are therefore comparatively low for the region (8.6 percent in 2014),<sup>18</sup> banks are reluctant to lend to entrepreneurs, and fewer than four percent of Swazi small- and medium-sized enterprises (SMEs) borrow from formal financial institutions.<sup>19</sup> Even for the 17 percent of entrepreneurs who are able to access informal credit, such as savings groups, the high interest rates often curtail the potential for their businesses to grow.<sup>20</sup>

## CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Swaziland's private sector is very small and underdeveloped, especially in comparison to its public sector.<sup>21</sup> Businesses that do exist are small; over 80 percent of SMEs are classified as "micro" enterprises.<sup>22</sup> Though there is limited impact investment activity in Swaziland today, the country's combination of high poverty rates, rising inequality, and insufficient access to finance indicate a strong need for impact capital.

However, impact investors will face several challenges in placing capital in Swaziland, including:

- **Small market:** As the smallest country in Southern Africa, both by population and geography, there is limited potential in-country for scale. New businesses seeking attractive returns will need to expand regionally and to prioritize exports.
- **Export procedures:** Despite Swaziland's participation in the SACU and other trade agreements, the country is constrained by difficult border procedures, which can slow exports.

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17 World Economic Forum, "Swaziland," in *Global Competitiveness Report* (Geneva: World Economic Forum, 2014–2015), <http://www3.weforum.org/docs/GCR2014-15/Swaziland.pdf>.

18 *The World Bank: Data*, s.v. "Swaziland" in "Lending Interest Rate (%)," <http://data.worldbank.org/indicator/FR.INR.LEND>.

19 Mia Thom et al., *Making Access Possible Swaziland: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/Rep\\_MAPSwaziland\\_Diagnostic\\_FNL2.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/Rep_MAPSwaziland_Diagnostic_FNL2.pdf).

20 *Ibid.*

21 Ebrima Faal et al., Kingdom of Swaziland: Country strategy paper, 2014–2018 (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper__Draft_Version_.pdf).

22 Mia Thom et al., *Making Access Possible Swaziland: Diagnostic Report* (United Nations Capital Development Fund, FinMark Trust, and Centre for Financial Regulation and Inclusion, 2014), [http://www.finmark.org.za/wp-content/uploads/pubs/Rep\\_MAPSwaziland\\_Diagnostic\\_FNL2.pdf](http://www.finmark.org.za/wp-content/uploads/pubs/Rep_MAPSwaziland_Diagnostic_FNL2.pdf). Finmark Trust defines micro-enterprises as those having three or fewer employees, less than €50 thousand (-USD 56 thousand) in assets, and less than €60 thousand (-USD 67 thousand) in annual turnover.

- **Bureaucracy:** Although the government has been investing in simplifying business processes, bureaucratic and inefficient government systems are frequently cited as one of the top challenges for business, especially in regards to land ownership.<sup>23</sup>
- **Electricity:** Electrification is a further challenge. Swaziland imports 80 percent of its power from South Africa and 10 percent from Mozambique,<sup>24</sup> creating an expensive and unstable supply of electricity.
- **Skilled labor:** There is a shortage of skilled labor in the country. With the increasing importance of the service sector, particularly in financial services and telecommunications, the economy has a rising need for skilled and semi-skilled labor. This creates a significant mismatch between required skills and the existing labor force.<sup>25</sup> High HIV/AIDS rates further decrease both labor productivity and supply.
- **Competition from SOEs:** State-owned enterprises (SOEs), alongside Tibiko Taka Ngwane, the Royal Family's private trust, have invested in nearly every sector; the majority of large investments in the country involve either the government or the King as a shareholder.<sup>26</sup>

Despite these challenges, there are opportunities for impact investors to operate in Swaziland and leverage return-seeking investments to reduce inequality, drive job creation, and create opportunities for disadvantaged populations.

- **Manufacturing:** The manufacturing sector comprises around 40 percent of GDP.<sup>27</sup> Manufacturing presents an opportunity to diversify away from sugar and textiles, especially with expiring preferential trade agreements in these industries.<sup>28</sup> In particular, there are opportunities to expand the food and beverage manufacturing sector for both domestic and export consumption, as well as opportunities in a growing timber-processing sub-sector.<sup>29</sup>

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23 "Country Overview: Swaziland," The World Bank, <http://www.worldbank.org/en/country/swaziland/overview>.

24 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_-\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper_-_Draft_Version_.pdf).

25 *Ibid.*

26 "Swaziland: Swazi King Attacks Lavish Lifestyles," *All Africa*, February 23, 2015, <http://allafrica.com/stories/201502240269.html>; Freedom House, "The Deformed Economy and its Consequences for Swazi People," in *Swaziland: A Failed Feudal State* (Washington, DC: Freedom House, 2013), <https://freedomhouse.org/report/swaziland-failed-feudal-state/deformed-economy-and-its-consequences-swazi-people#.VYKG-fmqkko>.

27 "Manufacturing and Processing," Swaziland Investment Promotion Authority, <http://www.sipa.org.sz/en/investment-opportunities/manufacturing-and-processing>.

28 Albert Mafusire and Fatou Leigh, *Swaziland* (OECD Development Centre: African Economic Outlook, 2014), [http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN\\_Long\\_EN/Swaziland\\_EN.pdf](http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Swaziland_EN.pdf).

29 "Manufacturing and Processing," Swaziland Investment Promotion Authority, <http://www.sipa.org.sz/en/investment-opportunities/manufacturing-and-processing>.

- **Agribusiness:** Food security is a major concern in Swaziland. The country struggles with poor farming practices, low rainfall, and limited land availability; historically, about 20 percent of its required food has been imported.<sup>30</sup> With almost 70 percent of Swazis employed in agriculture,<sup>31</sup> there is some opportunity to improve livelihoods through investments in irrigation and extension services. Potential investors should note that the nature of land tenure and soil erosion can present significant challenges.
- **Energy:** With Swaziland's high dependence on its neighbors for electricity, there is immense need for investment in domestic energy production. Given the prevalence of sugar processing in Swaziland, co-generation from sugar biomass is particularly promising.
- **Child support:** With its young population, high HIV/AIDS infection rates, and correspondingly high percentage of children orphaned, there is significant opportunity to invest in support for children, particularly in the education and childcare sectors. These interventions will support the development of the next generation and enable caregivers to seek employment outside of the home.

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30 Ebrima Faal et al., *Kingdom of Swaziland: Country strategy paper, 2014–2018* (Tunis: African Development Bank Group, 2013), [http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018\\_-\\_Swaziland\\_Country\\_Strategy\\_Paper\\_\\_Draft\\_Version\\_.pdf](http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2014-2018_-_Swaziland_Country_Strategy_Paper__Draft_Version_.pdf).

31 *Ibid.*

# APPENDIX: ORGANIZATIONS INTERVIEWED FOR THIS REPORT

We extend our sincerest thanks to the following organizations, who contributed their time and expertise for this report:

Adenia Capital	Edge Growth	National Empowerment Fund
Aga Khan Development Network	Engineers Without Borders	Northern Farms
Africa Assets	European Investment Bank	One Thousand and One Voices
Africa Development Bank	Fintrac	Pangaea Securities
AgDevCo	Global Environment Fund	Private Enterprise Programme— Zambia
Agribusiness Incubation Trust	Grain Traders Association of Zimbabwe	Remoggo
ANDE (The Aspen Network of Development Entrepreneurs)	Greater Good South Africa	Scaling Up Nutrition Business Network
Anonymous (5)	GroFin	Securico
Ashoka	Idea Lab	Simanye
Atlantic Asset Management	Impacto Capital	SME Association of Zimbabwe
Aurik Investment Holdings	International Development Corporation (IDC)	Strong Eagle
Awethu Project	International Finance Corporation (IFC)	Surrey Group
Banco Nacional de Investimento (BNI Mozambique)	International Monetary Fund (IMF)	Takura Capital
Barclays Bank Zambia	Imani Development	TechnoServe
Battery World Group	Investisseurs & Partenaires (I&P)	Techzim
Bertha Centre for Social Innovation and Entrepreneurship	Investment Promotion Centre (CPI Mozambique)	Tukula Farms
Bongo Hive	Java Foods	United Nations Development Programme (UNDP)
Bushproof	Katunda	USAID Southern Africa
Business Consult Africa	Kukula Capital	World Bank
Business Partners International	Lafaza	Yombwe Investments
Cactus Advisors	Leapfrog Investments	Zambia Association of Manufacturers
Cadiz	Lynton Edwards Stockbrokers	Zambia Chamber of Small and Medium Business Associations
Clifftop Colony	Malawi Investment and Trade Centre	Zambia Development Agency
Delegation of the European Union in Malawi	Malawi Mangoes	Zimbabwe Investment Authority
Delegation of the European Union to the Republic of Zambia and COMESA	mHub Malawi	Zimbabwe National Chamber of Commerce
Economic Development Board of Madagascar	Msasa Capital	
	Musika	



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The Global Impact Investing Network (GIIN®) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see [www.thegiin.org](http://www.thegiin.org).

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