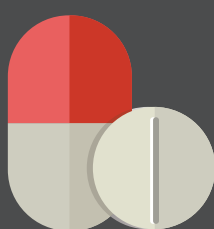


AUGUST

2015

SURVEY OF THE IMPACT INVESTMENT MARKETS 2014

**CHALLENGES AND OPPORTUNITIES IN
SUB-SAHARAN AFRICA AND SOUTH ASIA**



**THE
IMPACT
PROGRAMME**

LIST OF ACRONYMS

AO	– Asset Manager
BDS	– Business Development Services
BoP	– Base of the Pyramid
DFI	– Development Finance Institution
DFID	– Department for International Development (UK)
EIB	– European Investment Bank
FM	– Fund Manager
FMO	– Financierings Maatschappij voor Ontwikkelingslanden (<i>Netherlands Development Finance Company</i>)
GP	– General Partners
IFC	– International Finance Corporation
IRR	– Internal Rate of Return
SME	– Small and medium-sized enterprise
TA	– Technical assistance

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ACKNOWLEDGEMENTS

In this report, we capture the thinking and experience of 103^{*} organisations who self-selected as active in the impact investing markets in Sub-Saharan Africa and South Asia at the end of 2014. First and foremost, this report would not have been possible without the collaboration and input of these organisations and individuals. As we highlight, the voices in the market were vocal and confident in their opinions and offered insights and views generously, for which we are grateful.

Individuals from across the DFID Impact Programme (CDC, the GIIN and PwC – see back cover) and its Steering Group have all been instrumental in bringing together the thinking for the survey and for the report. Particular thanks go to: Joe Shamash and Caroline Ashley for their tireless analysis of data, interpretation of findings and much of the drafting contained within; Sara Taylor, who provided detailed feedback on the survey structure and the interpretation of results; and to Jo Kelly, who was instrumental in designing and conducting the survey itself. Thanks also to Emma Schofield and Jack Newnham for their valuable inputs. Finally, of course, thank you to the funders of this report, UK aid from the UK government.

^{*}Annex A contains a list of organisations who were willing to be acknowledged publically.

FOREWORD

THE MARKET FOR IMPACT INVESTMENT PROVIDES BOTH OPPORTUNITIES AND CHALLENGES FOR A WIDE RANGE OF INVESTORS SEEKING A SOCIAL OR ENVIRONMENTAL IMPACT AS WELL AS A FINANCIAL RETURN. THIS IS WELL DOCUMENTED IN AN INCREASING NUMBER OF REPORTS AND RESEARCH PUBLICATIONS ACROSS THE SECTOR, BUT A SHROUD OF COMPLEXITY AND LACK OF SUFFICIENT DATA TO EVIDENCE BOTH FINANCIAL AND IMPACT RETURNS PERSISTS – ESPECIALLY FOR IMPACT INVESTMENTS WHICH SEEK TO IMPACT ON POVERTY IN DEVELOPING COUNTRIES.

The Impact Programme, established by the UK Department for International Development (DFID) in 2013, aims to foster the impact investment market in South Asia and Sub-Saharan Africa by testing and demonstrating the development impact and financial viability of this type of investment and by building the ecosystem to support this. The Impact Programme Market Survey 2014 engaged stakeholders active in impact investment in these regions and gathered information on where the market is at and where it is going. This is the first of a series of biennial surveys through which we seek to play our part in increasing transparency, reducing information asymmetries and ensuring we identify and tackle appropriate constraints.

The survey is unique in its focus on Sub-Saharan Africa and South Asia, home to nearly 2 billion poor people living below the \$2.50 poverty line (PPP 2005, per person per day), and in its investigation of investor strategies for social impact.

There are several surveys out there and we are truly grateful to the 103 organisations that made time to complete our survey, and to our vocal and insightful respondents that were interviewed by telephone. Respondents not only shared data on commitments and trends, but provided a wealth of considered perspectives on their strategies, plus suggestions for market growth and effectiveness.

In 2013, the Impact Programme Market Baseline Study summarised key data from a literature review and highlighted the piecemeal and anecdotal nature of our information on the Sub-Saharan African and South Asian markets. As this new Market Survey is repeated every two years, we hope it will help to build a clear picture of changes in the market. Results will inform the UK Government's activities to support investors in businesses that serve poor and low-income people.

We hope this report also provides rich insights for other investors, policymakers, donors and facilitators interested in understanding the level of commitments, expectations of financial return, approaches to social impact, constraints, perceptions and suggestions for market growth and effectiveness for impact investing in these regions.



EXECUTIVE SUMMARY

THE IMPACT PROGRAMME CONDUCTED A SURVEY IN OCTOBER AND NOVEMBER 2014 TO EXPLORE THE IMPACT INVESTMENT MARKET IN SUB-SAHARAN AFRICA AND SOUTH ASIA. THE REMIT FOR THE SURVEY WAS BROAD AND SOUGHT TO EXAMINE THE MARKET SHAPE AND SIZE AS WELL AS RETURN EXPECTATIONS, CHALLENGES AND RECOMMENDATIONS FOR MARKET DEVELOPMENT IN THESE REGIONS.

Respondents described a diverse and growing market with strong clear voices indicating increasing confidence and an evolving ecosystem. There are a wide and increasing range of investors pursuing different strategies with different impact objectives, different impact measures and different social and financial returns. Innovation is ongoing.

A range of risks and challenges were also voiced, as were a host of recommendations on what is needed for a stronger impact investment market in these regions.

This report aims to share key insights from this research with investors, policymakers, donors and other stakeholders in these markets.

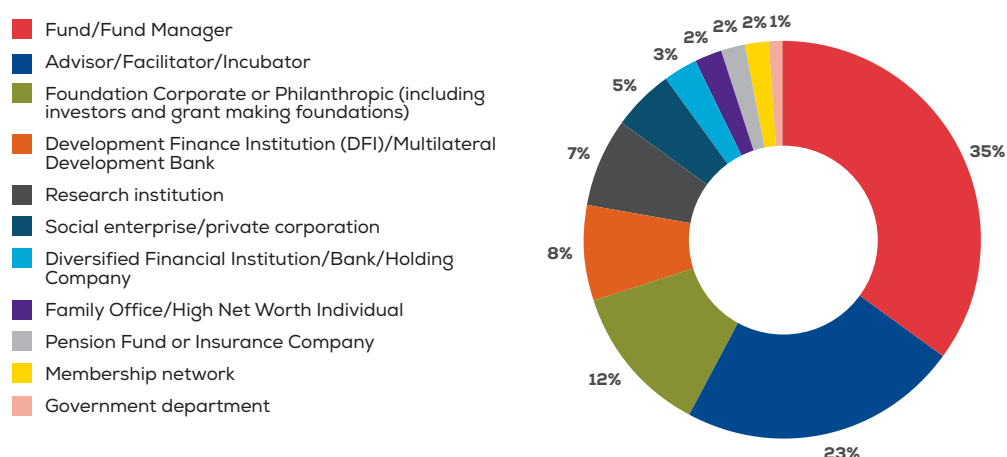
Profile of respondents operating in Sub-Saharan Africa and South Asia

The survey targeted organisations active in the impact investment market in Sub-Saharan Africa and South Asia. This included investors (Fund Managers and Asset Owners) and wider ecosystem actors.

One hundred and three organisations participated, 82 of which completed a full online survey only, 17 of which completed a full online survey and also an interview, and four of which completed an interview only. Of the 99 (total) organisations completing the online survey, 52 were investors¹ and 28% of these were headquartered in South Asia or Sub-Saharan Africa. Of the organisations based in the regions, over half were Fund Managers and none were Asset Owners². Of the 21 organisations completing interviews, 18 were investors and three were other actors.

This sample represents only a fraction of the total impact investment market active in these regions. Data and findings from this research is representative of the respondent group only and cannot be claimed to be representative of the market as a whole. The findings do, however, provide clear indications of trends, patterns, priorities and perceptions which can be further investigated in future research.

Figure 1: Breakdown of organisations completing the online survey (n=99)



¹ Investors' included Asset Managers (Funds and Fund Managers) and Asset Owners (financial institutions, DFIs, Family Offices and a sub-set of Foundations that also provided financial data)

² The 52 survey respondents categorised as 'investors' include both Asset Owners (those that allocate their own capital either via intermediaries or direct businesses) and Fund Managers (those that manage the capital of others and act as intermediaries). Fund Managers in our sample may manage money allocated by Asset Owners in our sample thus we do not sum Asset Owner and Fund Manager capital to limit the degree of double-counting when presenting or analysing capital flows. The perspectives of Fund Managers may be influenced by the demands and expectations of Asset Owners, particularly in terms of financial and social return expectations, thus we separate out investor types where possible to provide transparency on this..

The interviews revealed vocal and far-sighted respondents, providing views on challenges and recommendations. Most emphasised where they differ from others in a diverse market and were able to take a long-term view of market needs.

Growing commitments and planned investments of respondents

Asset Owner respondents reported global commitments totalling \$47.8 billion, of which over 22% (over \$10 billion) is committed in Sub-Saharan Africa and 13% (over \$6 billion) is committed in South Asia.

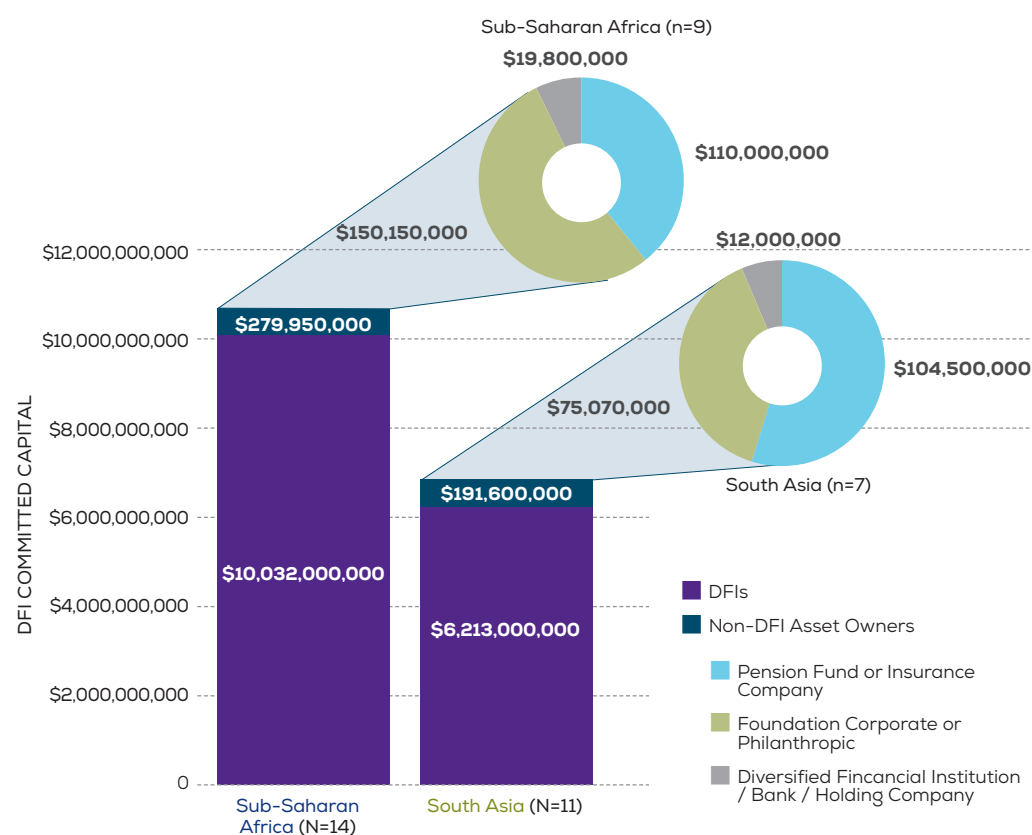
Fund Managers collectively deployed close to \$1.1 billion in each region.

Less than half of all Asset Owner respondents were Development Finance Institutions (DFIs) but these accounted for 97% of total Asset Owner commitments to the two regions³. See Figure 2 below.

Table 1: Key elements of respondent commitments

Asset Owner respondents	Fund Manager respondents
\$47.8 billion committed globally	\$1.1 billion deployed to each region
Steady increase in commitments expected over next 5 years	Steady increase in commitments expected over next 5 years
22% committed capital in Sub-Saharan Africa 13% committed capital in South Asia	Greater and faster growth anticipated South Asia in than Sub-Saharan Africa
97% of capital from DFIs (DFIs less than half all Asset Owner respondents)	Significant fundraising successes in last year (nearly \$1.7bn raised reported by 19 Fund Managers)

Figure 2: Total value of current capital commitments by Asset Owners⁴



³This figure includes all private sector investments for some DFIs

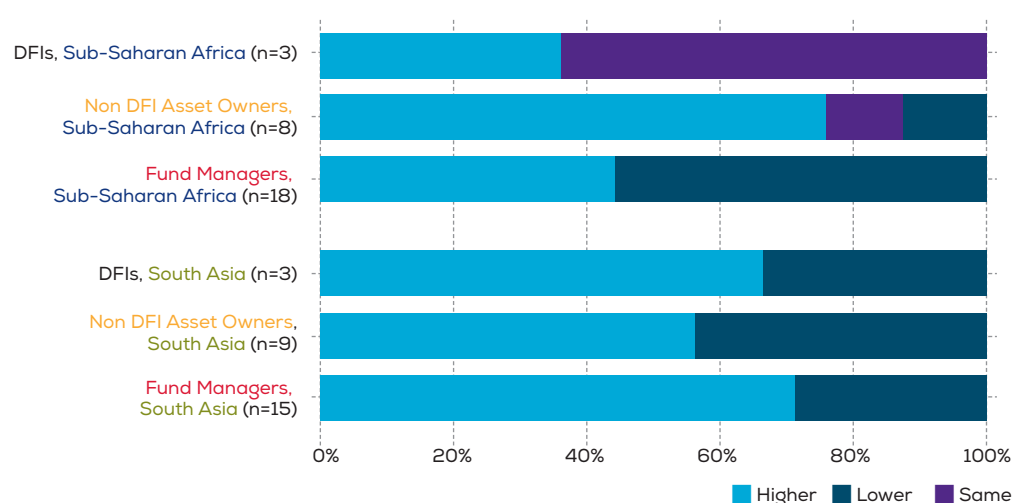
⁴Asset Owners were asked (Q7_1 / Q9_1): 'What is the total value of your commitments globally at time of completing this questionnaire?' and 'Approximately what percentage of your current total global commitments is in South Asia/ Sub-Saharan Africa?'

Non-DFI Asset Owners commitments in the last 12 months account for nearly half of their total current commitments to date in both regions, suggesting a rapid increase in non-DFI investment. Despite this, investments by non-DFIs are likely to remain a tiny fraction of total impact investment markets in Sub-Saharan Africa and South Asia for many years and currently only represent 3% of reported capital commitments.

Fund Managers in these regions also report deploying nearly half of their total deployed capital in the last 12 months, again suggesting rapid increase over the last few years and indicating an early stage market.

Fund Managers anticipate continued steady growth over the next five years with new commitments indicated of close to \$350 million for the next 12 months and around \$1.4-1.5 billion for the next five years in each of the two regions. See Figure 3 to understand how investment trends in the next 12 months will compare to the last 12 months.

Figure 3: Investment forecast for next 12 months compared to the last 12 months, by region (n=36)⁵



Most investors targeted Growth and Mature stage companies in both regions (54% of investors in Sub-Saharan Africa, 60% in South Asia), although investors in Sub-Saharan Africa more frequently target Venture stage companies than investors in South Asia (27% against 10%). No Fund Managers reported a focus on Mature companies.

Table 2: Characteristics of respondent investments

Asset Owner respondents	Fund Manager respondents	Sub-Saharan Africa investor respondents	South Asia investor respondents
<ul style="list-style-type: none"> • Broader range of instruments, longer investment period and typically lower expected returns reported • No DFIs reported investing in Seed or Start-up companies 	<ul style="list-style-type: none"> • Narrower range of instruments but a greater range of investment durations reported • No Fund Managers reported investing in Mature companies 	<ul style="list-style-type: none"> • Later stage company emphasis in both regions • More investors in venture stage companies • Range of sectors per investor in both regions • Food and Agric sectors more frequent 	<ul style="list-style-type: none"> • Later stage company emphasis in both regions • Fewer investors in venture stage companies • Range of sectors per investor in both regions • MFI and Finance sectors more frequent

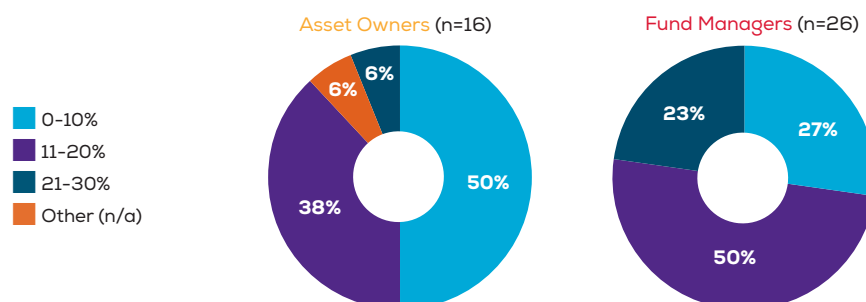
⁵ Asset Owners were asked (Q10_2): 'Approximately how much capital do you intend to commit to South Asia / Sub-Saharan Africa over... The next 12 months; The next 5 years?' Fund Managers were asked (Q19_2): 'Approximately how much capital do you intend to invest in South Asia / Sub-Saharan Africa over... The next 12 months / The next 5 years?'

Most investors target multiple sectors with a mean of three to four per investor. Food and agriculture followed by energy access were the two most common sectors for investors in Sub-Saharan Africa with 70% and 53% of investors indicating activity in these sectors. Microfinance and financial services were both targeted by over half of all investors in South Asia, although none exclusively so. 61% of investors use Technical Assistance (TA) often.

Diverse approaches to financial return and social impact

There was a spread of target rates of return reported with the most commonly targeted range being 11-20% (see Figure 4).

Figure 4: Targeted return by investor type⁶



Those investors targeting single digit returns more frequently invested in Sub-Saharan Africa, more frequently targeted early stage companies and more frequently used debt-type finance. Those investors targeting double digit returns were more frequently invested in South Asia, more frequently invested in later stage company and more frequently used equity-type finance (see Table 3).

Table 3: Characteristics of investors targeting single and double digit returns

Single digit return (0-10%)	Double digit return (11+%)
50% of Asset Owners 25% of Fund Managers	44% Asset Owners 75% Fund Managers
58% focus early stage companies (not necessarily exclusively)	70+ % focus on later stage companies (not necessarily exclusively)
Debt-type finance more frequently used	Equity-type finance more frequently used
More frequent in Sub-Saharan Africa than South Asia (Although 11 – 20% is most frequently targeted in both regions overall)	More frequently in South Asia than Sub-Saharan Africa (Although 11 – 20% is most frequently targeted in both regions overall)

Some of these findings are counter-intuitive to the expectation of correlating higher risk with high target return, as would be found in mainstream markets. For example, risks in Sub-Saharan Africa were ranked higher than risks in South Asia but the targeted return seems to be lower. Similarly early stage companies typically carry higher risk than later stage companies but, again, seem to be more frequently invested in by those targeting a lower return. This suggests that targeted Internal Rate of Return (IRR) is not based on risk alone in these markets and that other factors are at play, such as different types of investor, different liquidity in different markets, different instruments and different investment strategies.

A number of investors explained in interview why their impact strategy did or did not enable them to target or tolerate different brackets of financial return. Some investors explained that their social impact strategy was to provide financing for a section of the market that would not otherwise be viable, typically focusing on early stage or unproven businesses and/or undeveloped sectors where targeting low-income beneficiaries requires them to take on higher risk investments and expose them to greater losses but at a lower return.

Social impact was prioritised highly by all respondents but strategies to deliver impact varied widely, as did definitions of 'the BoP' and measurement/reporting practices. This was explored mainly in qualitative interviews and included, for example, impact strategies that focus on certain demographics, sectors or geographies as well as broader impact strategies that focus on stimulating general economic growth.

Figure 5: Summary of different social impact strategies of impact investors



⁶ Respondents were asked what average net IRR they targeted in each region. The differences in targeted return between Asset Owners and Fund Managers are not surprising and a number of reasons may underlie them: Asset Owners net IRR has to allow for Fund Managers fees, so would be expected to be lower; Fund Manager respondents as a whole make greater use of equity instruments, and respondents that use equity on average target higher net IRR, while the respondent Asset Owners use a wider range of instruments. And finally, the IRR reported is only 'target IRR'. There may be stronger incentives for Fund Managers, who have to fund raise, to be optimistic in reporting target IRR.

Risks, constraints and gaps in an early stage market

There was considerable consensus on current risks and challenges across investor types and regions although risks were scored higher (i.e. worse) overall in Sub-Saharan Africa compared to South Asia. The risks and constraints highlighted indicate a young and evolving sector across the ecosystem with need to build significant capacity and evidence base at many levels.

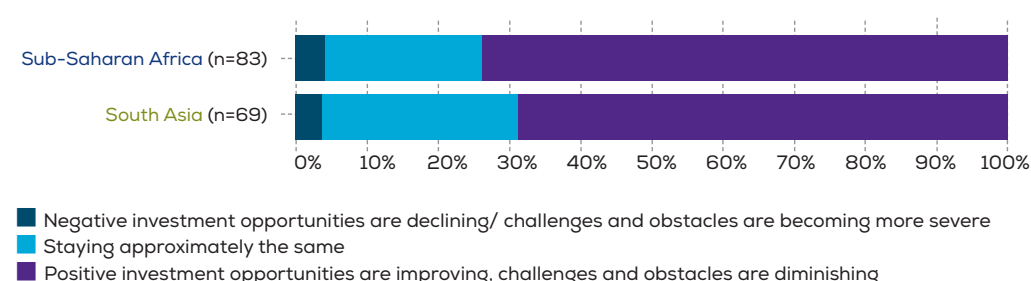
Table 4: Risks, constraints and gaps

Top Risks to current investment – ranked higher in Sub-Saharan Africa	Constraints to increased investment – Asset Owners	Constraints to increased investment – Fund Managers	Gaps in the wider market
<ul style="list-style-type: none"> • Business model & Management risk • Liquidity & exit risk • Country & currency risk 	<ul style="list-style-type: none"> • Lack of FMs with relevant skills & experience • Lack of sufficient data to qualify opportunities • Lack of opportunities with which to achieve impact 	<ul style="list-style-type: none"> • Lack of businesses with relevant skills and experience • Lack of investable propositions w/ track record • For Fund Managers: lack of banking facilities 	<ul style="list-style-type: none"> • Limited evidence of exits and impact • Tension between social impact and financial return • Limited volume and range of financing available • Limited coordination and availability of market data

Perceptions of the market and suggestions for growth and effectiveness

70% of respondents active in South Asia and 75% of respondents active in Sub-Saharan Africa indicated a positive perception of market trends (See Figure 6).

Figure 6: Perceptions of the market in Sub-Saharan Africa and South Asia



Respondents and interviewees were forthcoming about the further development of the wider impact investment market identifying both challenges and recommendations. Interviewees also discussed – with different views – the interaction between social impact and financial return. They pointed to the limited volume and range of financing available and limited coordination and availability of market data.

“There’s a huge market opportunity which is only going to grow –in both South Asia, and Sub-Saharan Africa, infrastructure is improving, economies are growing, and demographics are changing, all in favour of opening up a thriving impact investment market.”

A FUND MANAGER

One topic with particularly prominent and diverse views is the role of different investments, seeking different levels of financial return, in the wider growing 'impact investment' market. Two areas of debate emerged:

1. Whether investments that tolerate lower returns are essential for businesses that are innovative, early stage and/or reaching the lowest-income groups OR do these same investments risk diluting and muddling the market by being insufficiently commercial in approach
2. Whether investments that seek higher returns are exactly what the market needs in order to achieve scale and attract mainstream capital OR whether these deals inevitably create pressure for larger deal sizes, less risky investments and businesses that serve the middle-income groups and, thus, conflict with needs of BoP impact businesses.

Whilst diversity within the market was one of the most common themes, there was a considerable degree of overlap in views of what the market now needs:

1. **Disaggregate and better categorise the market:** recognise and accommodate the diversity
2. **Develop structures that leverage different market segments:** particularly hybrid financing deals that use public or subsidised capital to leverage investment by a greater number of more commercial investors
3. **Increase the diversity of and access to capital and range of instruments:** particularly debt instruments and capital for early stage ventures
4. **Address relatively high transactions costs:** investors cannot expect the classic 'two-and-twenty'⁷ investment fee terms on impact investment funds
5. **Improve access to business development services:** both through subsidised TA and through development of the market ecosystem
6. **Build stronger capacity in the global South:** working with leadership networks
7. **Increase the evidence base and information sharing:** where possible, disaggregated for different market segments (as per (1)).

"We need hybrid models, blending patient capital with more commercial capital, which enables commercial capital to come in when otherwise (in the absence of concessional capital) it cannot."

AN ASSET OWNER

⁷ 'Two and twenty' is a classic investment management fee structure in which a Fund Manager charges a flat 2% of assets invested and also 20% of any profits earned.

THE AIM OF THIS REPORT IS TO SHARE AND PRESENT INSIGHTS INTO THE STATE OF THE MARKET FOR INVESTING WITH IMPACT IN SOUTH ASIA AND SUB-SAHARAN AFRICA BASED ON DATA GATHERED BY THE FIRST IMPACT PROGRAMME MARKET SURVEY 2014.

1.1 Purpose of the Market Survey

Impact investment is recognised by DFID as having high potential to rapidly grow and contribute to development in the world's two poorest regions: Sub-Saharan Africa and South Asia⁸. At present there is a substantial lack of information on impact investment in these markets. This report aims to shed light on three broad issues:

- current patterns of investment
- investor confidence and perceptions of market conditions
- recommendations of market actors for future development of the market

The findings of this report will inform the UK Government's activities to support investors in businesses that serve low-income people, including the Impact Programme. The survey report also provides publically available information to investors, policymakers, donors and other stakeholders. In so doing, this report aims to increase transparency in these markets.

The survey will be repeated every two years over the next decade to track progress and provide a more complete and valuable picture of market trends evolving over time.

⁸ South Asia: Afghanistan, Bangladesh, Bhutan, India, Maldives, Myanmar, Nepal, Pakistan and Sri Lanka

Sub-Saharan Africa: Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Central African Republic, Chad, Comoros & Mayotte, Democratic Republic of Congo, Republic of Congo, Cote d'Ivoire, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gabon, The Gambia, Ghana, Guinea, Guinea Bissau, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Sao Tome & Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, Sudan, South Sudan, Swaziland, Tanzania, Togo, Uganda, Zambia and Zimbabwe

⁹ See Annex A for a list of respondent organisations. The online survey was distributed to respondents to RFPs for the Impact Programme, DFIs, Fund Managers in activity in the regions and information in the public domain, the GIIN newsletter and on social media

¹⁰ October – November 2014

¹¹ Investing or planning to invest and either Asset Owners or Fund Managers

1.2 Methodology and sample size

This report is based on data and inputs provided by 103 organisations⁹. Ninety-nine organisations completed the online survey¹⁰, of which 82 did the online survey only and 17 completed the online survey and an interview. In addition, four other organisations completed an interview only. Respondents identified themselves as matching the survey criteria, i.e. seeking social and/or environmental impact alongside a financial return. The survey analysis team has made no judgements on this issue although differences in social impact strategy are discussed.

Of the 99 online respondents, 52 are active impact investors¹¹; 47 are advisors, facilitators, associations and other stakeholders. Of the active investors, 34 are Fund Managers and 18 are Asset Owners. Ten of the Asset Owners are non-DFI investors; eight DFIs are included.

We have categorised respondents into three groups for clarity of presenting data: Asset Owners, Fund Managers and Other stakeholders (see *box overleaf*). In some instances we subdivide Asset Owners into DFIs and non-DFIs to enable a greater level of detail to be understood.

Figure 7: Breakdown of respondents to the online survey



DEFINITION OF SURVEY RESPONDENT CATEGORIES

Asset Owners: Defined as those organisations that allocate their own capital. These included foundations, Pension Funds and DFIs. Asset Owner capital is allocated either via intermediary structures (which might include their own funds) or direct to businesses but it is their own capital.

Fund Managers: Defined as those organisations that manage the capital of others and act as intermediaries between Asset Owners and investee businesses. Fund Managers invest predominantly as General Partners (GP) in a traditional fund structure.

Other stakeholders: Including advisers, facilitators, research institutions and associations.

A sample set of survey questions is available online at www.theimpactprogramme.org.uk¹². The annexes contain more detailed information about the survey respondents, the methodology of the survey and the terminology used in this report. Quotes from interviews are not attributed due to the confidential nature of our conversations.

1.3 Data caveats and interpretation

This survey and interview sample is likely to represent only a fraction of the total market and capital flows for impact in these regions and the proportion of different types of respondents is unlikely to be representative of those in the wider market. As with any survey, we will have had sample bias in terms of different institutions having different appetites for sharing information in surveys and also in terms of the reach of our email and social media targeting.

Similarly, we left it to respondents to determine which parts of their portfolio(s) they chose to report in this survey, based on their interpretation of social impact, and whether they answered on behalf of their entire organisation or just one part of it. In particular, many DFIs have a specific poverty-focused, inclusive business or social impact 'envelope' within their wider structure. Of the six DFIs which reported capital commitments, four of these reported for the entirety of their private sector investment. Information on specific 'envelopes' targeting certain types of social impact, geography, sector or types of business, is also discussed. The context of DFI private sector investments and specific 'envelopes' is covered in greater detail in Section 4.2.

Given these factors, we reference data and findings from this research as representative of the respondent group rather than representative of the market as a whole. Trends reported and evidenced here, however, provide some clear hypotheses for trends in the wider impact market in these two regions.

In terms of interpretation, it should be noted that the perspectives of Fund Managers may be influenced by the demands and expectations of Asset Owners, particularly in terms of financial and social return expectations. As noted in Section 1.2, we separate out investor types where possible to provide transparency on this.

For the section looking at return expectations (Section 4), it is important to note that respondents were asked what average net IRR they target for investments in each region but that we did not collect specific information about the composition of the portfolio or the degree of risk taken alongside these expected returns. In short, the average net IRR could be the same across very different types of investor portfolios. As we don't have data for risk-adjusted return across the investments, only broad correlations can be made regarding return with use of instruments and some findings on return and risk. These caveats are expanded upon in Section 4.1, where return data is looked at.

Several questions in the online survey presented lists in which respondents were asked to score each item on a scale of importance from 1 (very unimportant) to 5 (very important). The average scorings are presented here to indicate the level of importance assigned.



We will build on these findings to further explore trends across the broader market in future surveys. If you would like to be added to the list of recipients for the 2016 questionnaire, or have suggestions for how the questions can be improved, please contact us at theimpactprogramme@uk.pwc.com.

¹² The live online survey automatically tailored questions depending on previous responses, for example, some questions were phrased differently for Asset Owners and Fund Managers and depending on which regions had been selected. The online versions are examples only and show one for an Asset Owner and one for a Fund Manager.

1.4 Characteristics of the impact investment market

In the pages that follow, we aim to share the results of the survey clearly and to do so without judgement or interpretation, which risks bias. We aim to provide a platform for the strong and confident voices of our respondents to speak for themselves. However, in examining the totality of the results, we noted several characteristics emergent from the data which, in our opinion, describe the collective nature of the market and its investors. We offer these as our interpretation of the context for results (see *Table 5*) and flag throughout the report where we see these traits evidenced in the data by using the icons. Where we have applied interpretation or judgement elsewhere, it is clearly signposted.

Table 5: Characteristics of the impact investment market and impact investors in Sub-Saharan Africa and South Asia 2014

 Characteristics of the impact investment market	 Characteristics of impact investors
Diverse	Divergent
Evolving	Far-sighted
Growing	Confident
Early stage	Vocal

PROFILE OF SURVEY RESPONDENTS

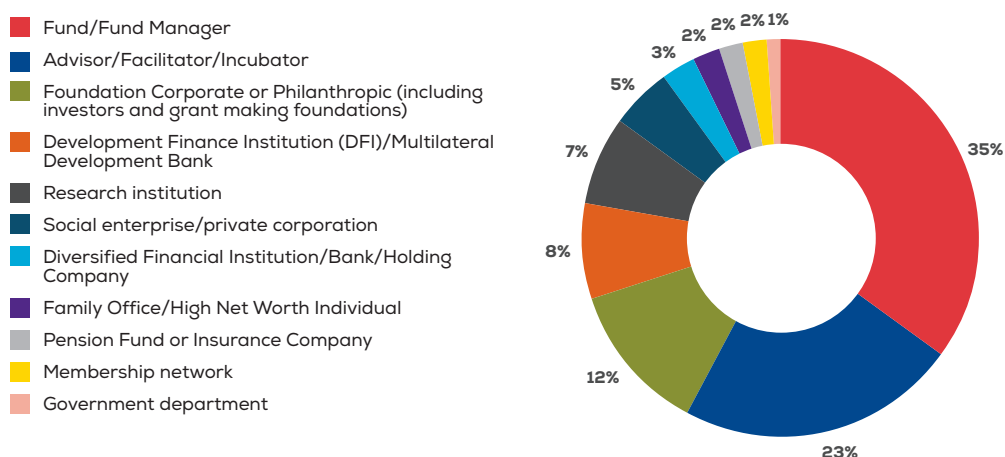
IN THIS SECTION WE PROVIDE AN OVERVIEW OF THE CHARACTERISTICS OF THE 99 ORGANISATIONS WHO RESPONDED TO OUR ONLINE SURVEY. THIS INCLUDES AN OVERVIEW OF ORGANISATION TYPE, INVESTOR TYPE, WHERE OUR SAMPLE ORGANISATIONS ARE HEADQUARTERED AND WHERE THEY ARE ACTIVE.

2.1 Organisation type

The single largest category of respondent is Fund Managers, which accounts for 34% of all respondents.

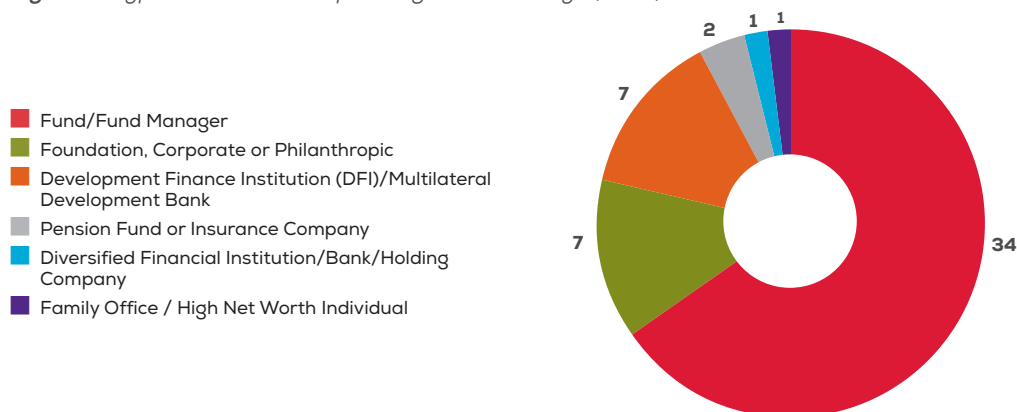
A full breakdown of respondent types can be seen in Figure 8 below¹³.

Figure 8: Type of organisation responding to our survey¹⁴ (n=99)



Funds, Fund Managers, financial institutions, DFIs, Family Offices and seven of the 12 foundations provided quantitative data in survey questions and are collectively termed 'investors' in this report, accounting together for 53% of the sample (see Figure 9).

Figure 9: Type of investors responding to our survey¹⁵ (n=52)



¹³ The proportions of organisation types shown here is subject to sample bias and unlikely to be representative of the proportions of different types of organisations in the wider market.

¹⁴ Respondents were asked (Q4): 'Which of the following best describes the type of organisation you work for?'

¹⁵ Categorised based on responses to organisation type and data on capital flows.

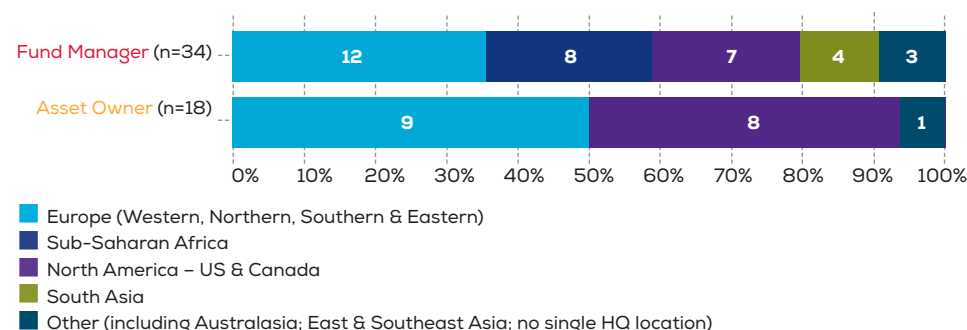
¹⁶ It is possible that Fund Manager respondents manage money allocated by Asset Owners who are also respondents. For this reason, we do not sum Asset Owner and Fund Manager capital to limit the degree of double-counting when presenting or analysing capital flows.

Of the investors in the sample, we categorise 65% as Fund Managers and 35% as Asset Owners. The data is disaggregated by these two types of investors to provide clearer figures for total capital commitments and minimise the risk of double counting¹⁶. We also disaggregate by DFIs and other Asset Owners in some instances.

2.2 Location and target geographies

Almost two-thirds of all those who completed the online survey have their headquarters in the global North¹⁷. 20% are based in Sub-Saharan Africa, while 8% are based in South Asia. Of the 28 organisations based in Sub-Saharan Africa or South Asia, almost half (46%) are Funds or Fund Managers, while none are Asset Owners (see Figure 10).

Figure 10: Organisation headquarters of Asset Owners and Fund Managers



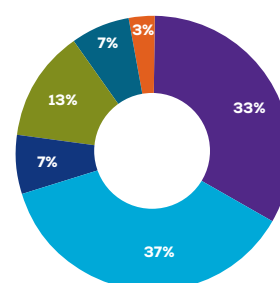
The majority of investors in both regions had some presence on the ground. In Sub-Saharan Africa, 27 of 40 investors operated through a regional office or were headquartered locally. In South Asia, the ratio was slightly lower, with just over half (16 out of 30) having either a regional office or headquarters in the region. No Asset Owners were headquartered in either of the regions.

All investors are active in either one or both target regions. Asset Owners are more consistently active in multiple regions than Fund Managers. Only two Asset Owners were active only in Sub-Saharan Africa and one was focused exclusively in both regions without also investing elsewhere. Amongst Fund Managers, only half were active across more than one region¹⁸ with 10 being active only in Sub-Saharan Africa and four being active only in South Asia.

Figure 11: Region of investment of Asset Owners (n=18)



Figure 12: Region of investment of Fund Managers (n=28)



¹⁷ Respondents were asked to indicate the location of their headquarters by region.

¹⁸ Note that 'South Asia' is defined as one region, and East and South-East Asia is a different region.

GROWING COMMITMENTS AND PLANNED INVESTMENTS

IN THIS SECTION WE EXAMINE THE SIZE AND SHAPE OF THE MARKET AND LOOK AT COMMITMENTS REPORTED BY ASSET OWNERS AND FUND MANAGERS, BY REGION. THIS SECTION ALSO CONSIDERS THE FOCUS OF INVESTMENT BY SECTOR AND ENTERPRISE STAGE, AS WELL AS INSTRUMENTS USED AND INVESTMENT DURATION.

3.1 Capital flows to Sub-Saharan Africa and South Asia

Key findings of respondent commitments

Asset Owner respondents	Fund Manager respondents
<ul style="list-style-type: none"> • \$47.8 billion committed globally • Steady increase in commitments expected over next 5 years • 22% committed capital in Sub-Saharan Africa • 13% committed capital in South Asia • 97% of capital from DFIs 	<ul style="list-style-type: none"> • \$1.1 billion deployed to each region • Steady increase in commitments expected over next 5 years • Greater and faster growth anticipated South Asia in than Sub-Saharan Africa • Significant fundraising successes in last year (nearly \$1.7bn raised reported by 19 FMs)

Current commitments

Asset Owners reported total commitments worth \$47.8 billion globally¹⁹ of which over \$16 billion is committed in the target regions of Sub-Saharan Africa and South Asia. 22% of their global capital commitments are committed to Sub-Saharan Africa (over \$10 billion) and 13% to South Asia (over \$6 billion). Despite DFIs accounting for only eight of the 18 Asset Owners reporting, 97% of total capital committed is invested by DFIs (see box below for detail). The remaining 3% is largely provided by pension funds, particularly in South Asia, and foundations, particularly in Sub-Saharan Africa.

THE SIGNIFICANCE OF DEVELOPMENT FINANCE INSTITUTIONS

DFIs accounting for only eight of the 18 Asset Owners respondents to our Market Survey and 97% of total capital committed. There are some methodological reasons that explain their high significance in the results. Firstly, DFIs typically provided data for the entirety of their private sector investments rather than just for specific funds or envelopes²⁰ targeting certain types of social impact, sector or geography, which accounts to some extent for size of the DFI capital figure. Secondly, we recognise that the survey probably covered a much higher percentage of the total DFI market in the regions, due to targeted outreach, than it did of the non-DFI investors. However, while the amount may be less than 97% of total commitments, the significant contribution of DFIs to total investment commitments is not in doubt. *The Landscape for Impact Investing in South Asia* report by GIIN and Dalberg (2015)²¹ finds a similar trend, noting DFIs account for between 65-95% of impact capital reported.

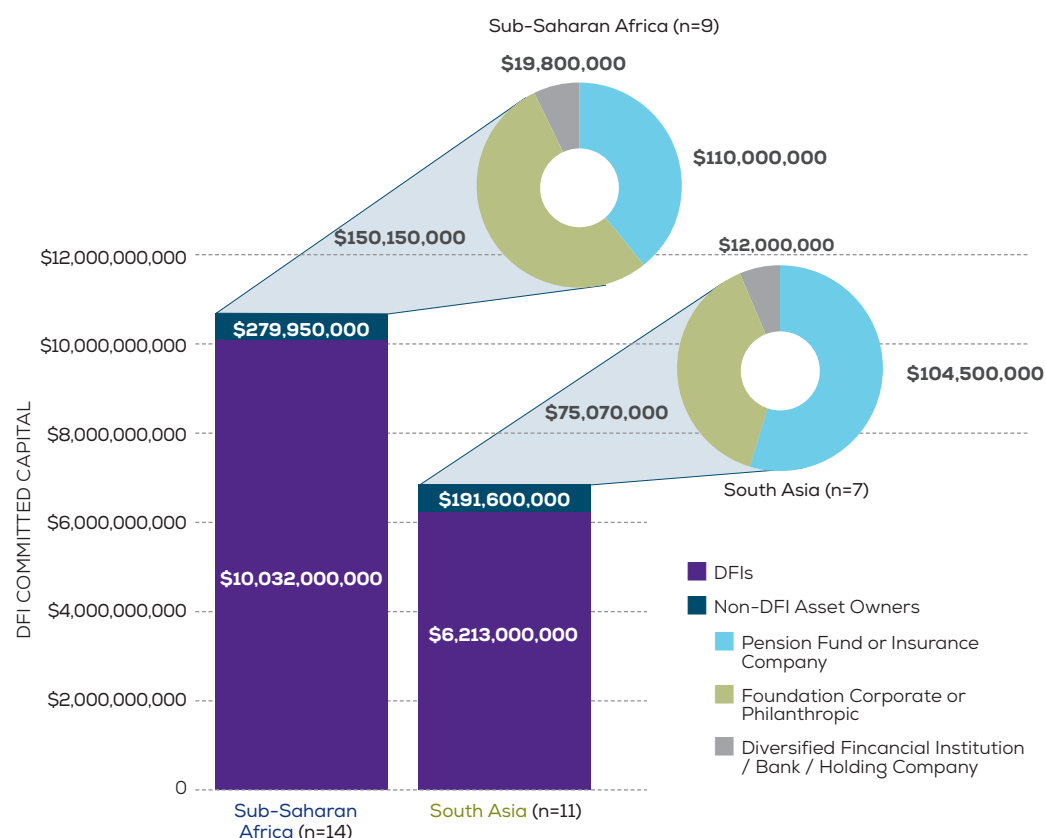
¹⁹ Respondents were asked: "What is the total value of your commitments globally at time of completing this questionnaire?"

²⁰ The survey left it to respondents to determine which of their investments should be counted as having impact – see Section 1.3

²¹ <http://www.thegiin.org/cgi-bin/iowa/resources/research/642.html>.

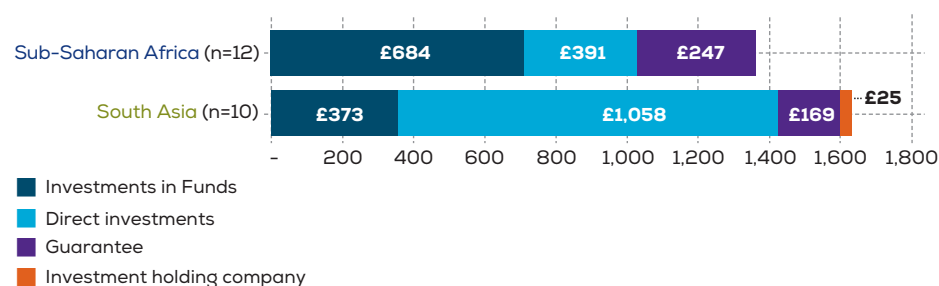
Figure 13 illustrates current levels of Asset Owner commitments in the two regions. This includes 15 Asset Owners in total, including 10 active in both regions, four active in Sub-Saharan Africa but not South Asia and one active in South Asia but not Sub-Saharan Africa.

Figure 13: Total value of current capital commitments by Asset Owner Respondents²²



Thirteen Asset Owners shared details of how they allocate capital to Funds and/or to direct investments. In Sub-Saharan Africa, a higher proportion of capital was invested in Funds, whilst in South Asia a higher proportion was allocated to direct investments (see Figure 14).

Figure 14: Asset Owner committed capital (USD millions), by type of investment²³



²² Respondents were asked (Q11_1): 'Thinking about your current commitments in South Asia &/or Sub-Saharan Africa, what is your approximate allocation to each of the following strategies? Funds / Direct investments / Other (specify)'.

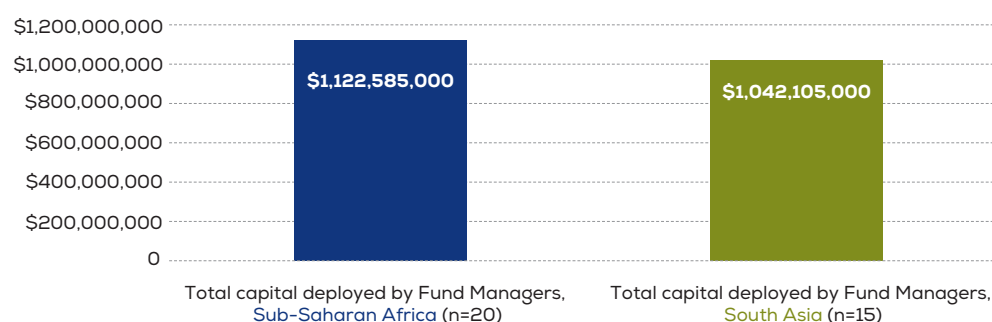
Also, total commitments shown in Figure 14 sum to a smaller amount than those in Figure 13 as only 13 respondents provided a breakdown by type of investment, while 14 provided figures for total capital commitments in the region. Furthermore, some respondents did not provide full breakdowns of allocation of capital to different types of investment, for example one large DFI provided only estimates for investments in Funds, which represented a fairly small proportion of total capital commitments.

²³ The two Fund Managers were not the same across both regions.

Fund Managers reported a total of close to \$2.2 billion deployed in the target regions combined, with around \$1.1 billion in each region. Nearly half of the total deployed capital in each region can be attributed to just two large Fund Managers²³.

Fund Managers in Sub-Saharan Africa reported lower levels of investment on average, with a mean average of \$58 million compared to \$70 million in South Asia.

Figure 15: Total current value of deployed capital, Fund Managers²⁴



In summary, the data provides a picture of the \$16 bn of current commitments of Asset Owners to the two regions, and the \$2bn commitments of Fund Managers to the two regions. The picture is broadly similar between Sub-Saharan Africa and South Asia, with DFI commitments reaching a different order of magnitude: averaging around \$1.6-\$2 bn per DFI while other Asset Owner commitments average around \$200+ million, and Fund Manager commitments averaging around \$60-70 million, though the averages hide some considerable variation within relatively small samples.

Table 6: Key findings on investment commitments in Sub-Saharan Africa and South Asia

	Sub-Saharan Africa	South Asia
No. of respondents with committed capital in the region	33	26
- of which Asset Owners (DFIs)	14 (5)	11 (4)
- of which Fund Managers	19	15

Asset Owner Respondents	Sub-Saharan Africa	South Asia
Total capital committed to the region ²⁵	\$10,312 million	\$6,405 million
- of which DFI capital	\$10,032 million	\$6,213 million
- of which non-DFI capital	\$280 million	\$192 million
Average capital committed per DFI	\$2,006 million	\$1,601 million
Average capital committed per non-DFI	\$31 million	\$27 million
Largest component of non-DFI capital	Foundations	Pension Funds and Insurance Companies
Majority focus of Asset Owner investments	Funds	Direct investment to business

Fund Manager Respondents	Sub-Saharan Africa	South Asia
Total deployed capital to the region ²⁶	\$1,105million	\$ 1,042 million
Average capital deployed per Fund Manager	\$58 million	\$70 million

²⁴ Fund Managers were asked (Q15_1 / Q18): 'What is the total value of your deployed capital (globally) at time of completing this questionnaire?' and 'Approximately what percentage of your current total global deployed capital is in the region?' for both South Asia and Sub-Saharan Africa

²⁵ Asset Owners were asked (Q7_1 / Q9_1): 'What is the total value of your commitments globally at time of completing this questionnaire?' and 'Approximately what percentage of your current total global commitments is in South Asia / Sub-Saharan Africa?'

²⁶ Fund Managers were asked (Q15_1 / Q18): 'What is the total value of your deployed capital globally at time of completing this questionnaire?' and 'Approximately what percentage of your current total global deployed capital is in the region?'

²⁷ J.P. Morgan and GIIN 2014 Impact Investor Survey: Spotlight on the Market <http://www.thegiin.org/binary-data/2014MarketSpotlight.PDF>

²⁸ In the J.P. Morgan and GIIN 2014 Impact Investor Survey, DFIs accounted for 6% of respondents but 42% of assets.

COMPARISON WITH OTHER SURVEY RESULTS

We know these figures do not capture the full market and are heavily weighted by DFI commitments to the private sector in the regions, which were captured in full as impact investments. Nevertheless, these figures give a sense of scale similar to the investment volumes reported in the *J.P. Morgan and GIIN 2014 Impact Investor Survey*²⁷. That survey examines Assets Under Management (AUM) and reports a global total of \$46 billion, including \$6.9 billion (15%) AUM in Sub-Saharan Africa and \$4.6 billion (10%) in South Asia (sample of 124²⁸). The *Landscape for Impact Investing in South Asia* report by GIIN and Dalberg (2015) recorded a total \$8.9 billion deployed in the region (the majority of which was deployed between 2009 and 2014).

Commitments during the past 12 months

New commitments in the last 12 months represent a large proportion of total commitments for investors in both regions. Respondents were asked specifically for their commitments during the last 12 months. This provides a snapshot of current levels of activity by type of investor. Comparing this data to total current commitments in the two regions also provides an indicator of how young their current portfolio is.

Asset Owner total reported commitments over the last 12 months amount to just over \$700 million in Sub-Saharan Africa and \$1.1 billion in South Asia. Not surprisingly, these figures for total volume are driven mainly by DFIs which account for \$1.6 billion of the total \$1.8 billion reported new commitments across both regions.



The most striking aspect of the figures for the last 12 months emerges from the data from non-DFI Asset Owners. These constitute 36-43% of their total committed capital in the regions (see Table 7). This suggests significant recent growth in capital for these investors and illustrates the early stage of their investments. The pattern is quite different for DFIs, for whom investments in the last year represent a smaller proportion of total current commitments. Table 7 summarises commitments in the last 12 months by region and Asset Owner type.

Table 7: Summary of Asset Owner committed capital in the last 12 months

Asset Owners	Sub-Saharan Africa		South Asia	
	DFIs	Non-DFIs	DFIs	Non-DFIs
Number reporting	4	8	3	5
Total new investments in the last 12 months ²⁹	\$638 million	\$96 million	\$1,065 million	\$77 million
Total value of all commitments	\$6,494 million	\$265 million	\$4,060 million	\$177 million
Last 12 months as % of total current portfolio	10%	36%	23%	43%
Average in last 12 months	\$160 million	\$12 million	\$355 million	\$15 million

Fund Managers deployed more than \$900 million total to both regions in the last 12 months. Average Fund Manager commitments were \$34 million in South Asia and \$43 million in Sub-Saharan Africa. Again, this represents a considerable percentage of total commitments in the region, particularly in Sub-Saharan Africa where more than half of current commitments were deployed in the past year.

Comparing Fund Manager commitments in the past year to Asset Owner commitments reveals one other consideration. Fund Manager respondents deployed around \$900 million during the past year, while non-DFI Asset Owner respondents deployed well under \$200 million. Either non-DFI Asset Owners are disproportionately under-represented in our survey, or, if this were a long-term trend, the difference indicates the on-going importance of DFIs to sustain Fund Manager activity.

Table 8: Summary of Fund Manager deployed capital over the last 12 months

Fund Managers	Sub-Saharan Africa	South Asia
Number reporting	12	12
Total new investments in the last 12 months ³⁰	\$521 million	\$405 million
Total value of all commitments	\$966 million	\$1,030 million
Last 12 months as % of total current portfolio	54%	39%
Average in last 12 months	\$43 million	\$34 million

²⁹ Asset owners were asked (Q10_1): 'What has been the approximate total value of new commitments you have made to South Asia / Sub-Saharan Africa in the last 12 months?'

³⁰ Fund Managers were asked (Q16_1): 'How much capital did you deploy in new transactions over the last 12 months?' And (Q19_1): 'What percentage (approximately) of new transactions in the last 12 months has been with entities operating in South Asia / Sub-Saharan Africa?'



Expected future commitments

Investors expect mixed levels of growth. Respondents were asked their forecast commitments for the next 12 months and five years. Responses (from relatively small sample sizes) indicate mixed levels of growth by investor type and by region.

Asset Owner forecasts indicate similar commitments over the next 12 months compared to the last 12 months. In total, \$1.5 billion of DFI commitments are expected and around \$200 million of commitments from non-DFI respondents as Table 9 shows. By volume, DFIs look likely to remain the leading source of new capital commitments across both regions in the next 12 months and the next five years. However, if we compare estimates for the next five years (bearing in mind these are no more than indicative) to current commitments, it is the non-DFI Asset Owners that expect to commit volumes that are greater than their total current commitments. The difference is most marked in Sub-Saharan Africa, where non-DFI Asset Owners estimated \$513 million of new commitments over five years, which is roughly double their current commitments in the region, while the DFI estimates represent only around one third of current commitments. In South Asia, the ratio of five year estimates to current commitments is also higher for non-DFI Asset Owners, though the difference is less marked.

COMPARISON WITH OTHER GROWTH FORECASTS

The J.P. Morgan and GIIN 2014 Impact Investor Survey (2015) covers global, not regional investment trends, though the majority of Assets Under Management reported within the survey are in emerging markets. However, the trend is not dissimilar. It reveals an increasing number of players globally and an increase of 10% between capital committed for global impact investment in 2012 and that reported in 2013. Looking forward, respondents indicated a forecast growth of 19% between 2013 and 2014, with more deals and a greater mean deal size in 2014 compared to 2013.

*The 2015 Venture Finance in Africa*³¹ report by Venture Capital for Africa reports that total invested capital more than doubled in the Africa region compared to the previous year. *The EMPEA Data Insights*³² paper (Q3 2014) points out that while there are more funds available in South Asia, the number of investments made is increasing at a greater rate in Sub-Saharan Africa.

Table 9: Asset Owner forecast capital commitments over the next 12 months and five years

Asset Owners	Sub-Saharan Africa		South Asia	
	DFIs	Non-DFIs	DFIs	Non-DFIs
Total capital to be committed in next 12 months	\$455 million	\$121 million	\$1020 million	\$87 million
Number reporting	3	8	3	7
Average in next 12 months (similar to last 12 months average commitments)	\$152 million	\$15 million	\$340 million	\$12 million
Total capital to be invested in next 5 years (comparison with current commitments)	\$2,005 million <i>A third of total current commitments</i>	\$513 million <i>Double current commitments</i>	\$4,235 million <i>Similar to current commitments</i>	\$260 million <i>1.5 times current commitments</i>
Number reporting	3	8	3	6
Average over 5 years	\$668 million	\$64 million	\$1,412million	\$43 million
Average for 1 year (assuming equal each year)	\$195 million	\$12,8 million	\$420 million	\$8,6 million

³¹ The J.P. Morgan and GIIN 2014 Impact Investor Survey (2015) <https://vc4africa.biz/2015-report/>

³² The 2015 Venture Finance in Africa <http://empea.org/research/data-and-statistics/empea-data-insights-q3-2014>

Fund managers anticipate substantial new commitments in both regions. The big picture indicates considerably growth: estimated Fund Manager commitments in the next five years are approaching \$1.5 billion per region, compared to current commitments of around \$1 billion in each region. Looking in more detail at the estimates provided in Table 10, the average forecasts are slightly lower than the levels reported for the last 12 months. This may reflect the typical stage of Fund maturity in the sample, which includes several Funds that have significantly expanded commitments in the last year and may be nearing full capacity. It also hides considerable variation between respondents, detailed further below.

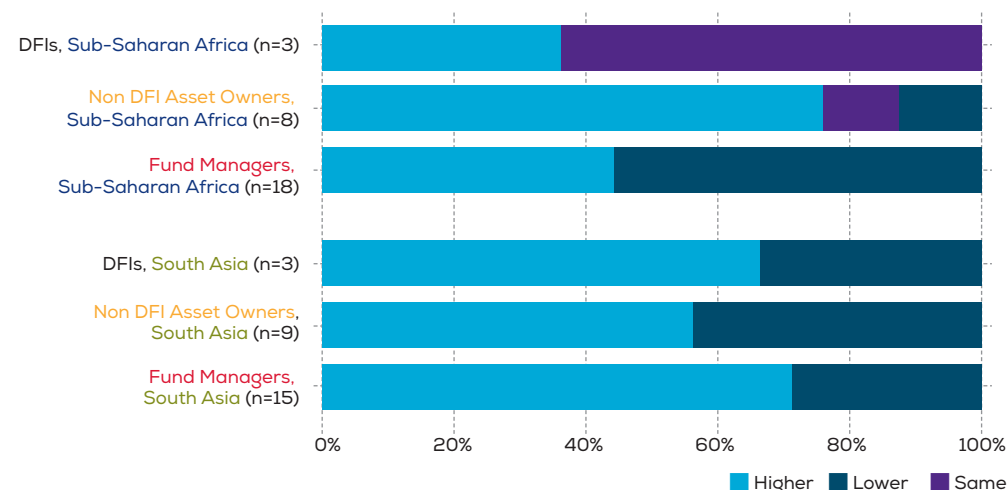
Table 10: Fund Manager forecast capital deployment over the next 12 months and five years

Fund Managers	Sub-Saharan Africa	South Asia
Total capital to be committed in next 12 months	\$334 million	\$345 million
Number reporting	18	14
Average in next 12 months	\$19 million <i>Half of last 12 months average</i>	\$25 million <i>Below last 12 months average</i>
Total capital to be invested in next 5 years	\$1,424 million <i>1.5 times current commitments</i>	\$1,496 million <i>1.5 times current commitments</i>
Number reporting	19	14
Average over 5 years	\$75 million	\$107 million
Average for 1 year (assuming equal each year)	\$15 million	\$21,6 million



Looking at data across all investors, we can see some variation behind the averages. Analysing how many investors plan to invest more in the next 12 months compared to the last 12 months (based on the actual figures reported) shows that 17 out of 25 expect increased commitments in South Asia and 16 out of 29 in Sub-Saharan Africa (see Figure 16). Looking at Fund Managers only, those in South Asia are more likely to increase their investment than those in Sub-Saharan Africa.

Figure 16: Investment forecast for next 12 months compared to the last 12 months, by region³³



³³ Asset Owners were asked (Q10_2): 'Approximately how much capital do you intend to commit to South Asia / Sub-Saharan Africa over... The next 12 months; The next 5 years?' Fund Managers were asked (Q19_2): 'Approximately how much capital do you intend to invest in South Asia / Sub-Saharan Africa over... The next 12 months / The next 5 years?' The graph shows the result of comparing these two answers.

Fundraising

Eighteen Fund Managers reported raising close to **US\$1.7 billion** in total over the last 12 months. The 10 funds operating only in Sub-Saharan Africa reported higher levels of fundraising in the last 12 months than those operating only in South Asia – although South Asia-only funds reported a higher level of funds to be raised over the next 12 months and five years.

Table 11: Capital raised in the last 12 months and forecast for the next 12 months and five years³⁴

	Total capital raised in last 12 months	Total fundraising target next 12 months	Total fundraising target next 5 years
Total fundraising	\$1,676 million	\$2,050 million	\$6,503 million
Number of Funds reporting	18	21	20
Average fundraising per fund	\$93 million	\$98 million	\$325 million

3.2 Investment focus: enterprise stage, instrument and sector

Key findings of respondents' investments

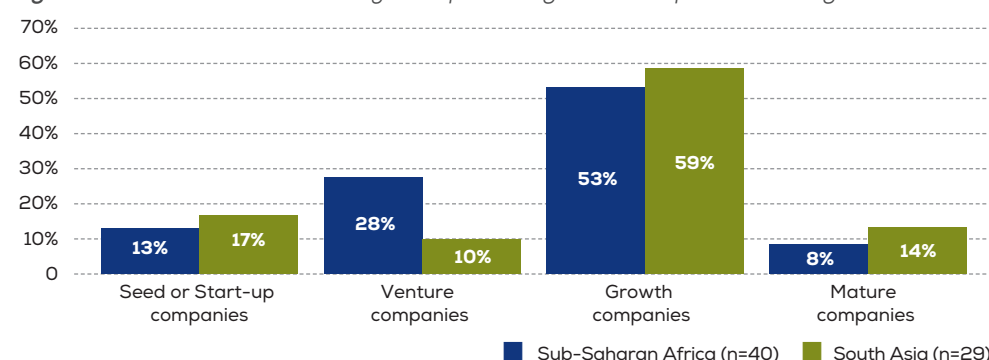
Asset Owner respondents	Fund Manager respondents	Sub-Saharan Africa investor respondents	South Asia investor respondents
<ul style="list-style-type: none"> • Broader range of instruments, longer investment period and typically lower expected returns reported • No DFIs reported investing in Seed or Start-up companies 	<ul style="list-style-type: none"> • Narrower range of instruments but a greater range of investment durations reported • No Fund Managers reported investing in Mature companies 	<ul style="list-style-type: none"> • Later stage company emphasis in both regions • More investors in venture stage companies • Range of sectors per investor in both regions • Food and Agric sectors more frequent 	<ul style="list-style-type: none"> • Later stage company emphasis in both regions • Fewer investors in venture stage companies • Range of sectors per investor in both regions • MFI and Finance sectors more frequent



Most investment activity is targeted at Growth stage³⁵ companies in both Sub-Saharan Africa (53% of investors) and in South Asia (59% of investors). At the global level, the *J.P. Morgan and GIIN 2014 Impact Investor Survey* also found that the vast majority (89%) of impact investors focus on Growth or Mature stage companies.

Some differences between respondent types could be observed. Respondents investing in Sub-Saharan Africa more frequently focus on Venture stage companies (28% of investors) than those in South Asia (10% of investors)³⁶. Asset Owner respondents focus more frequently on later stage opportunities and Fund Manager respondents more frequently on earlier stage opportunities. No Fund Managers reported a focus on Mature companies. Sample sizes for those investors most interested in Mature companies and Start Up companies are too small to identify any patterns.

Figure 17: Focus of investments by enterprise stage of development and region³⁷



³⁴ Fund Managers were asked (Q15_2): 'How much capital has your fund raised in the last 12 months?' And (Q15_3): 'How much capital do you target raising in... The next 12 months / The next 5 years?'

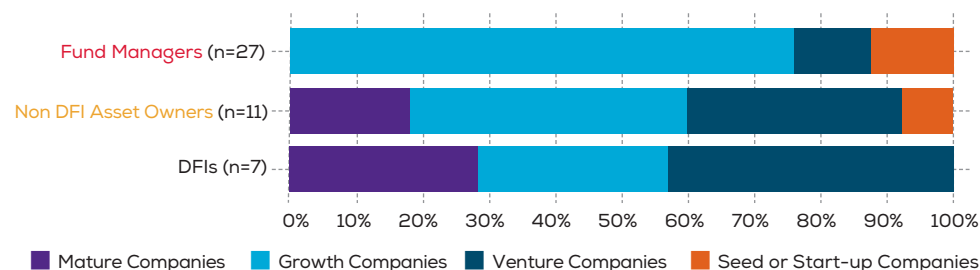
³⁵ Four stages of enterprise development were defined in the survey as: Start Up companies; Venture stage companies; Growth stage companies; and Mature companies. See Section 1.3.1 for definitions.

³⁶ The EMPEA Data Insights (Q3 2014) paper shows an increasing trend for more private equity investments into Venture stage companies. The report does not separate impact investments from other private equity investments.

³⁷ Respondents were asked 'Where do you focus the majority of your investment activity in terms of company focus?' Four stages of enterprise development were defined in the survey as Start Up companies, Venture stage companies, Growth stage companies and Mature companies. See Section 1.3.1 for definitions.

Looking specifically at DFIs across both regions, investments are fairly evenly distributed across different enterprise stages: three focus on Venture stage companies; two focus on Growth companies; and two on Mature companies. DFIs investing in Mature companies typically report substantially higher levels of investment so, while only a few investors target this stage, a higher proportion of the total capital will flow to more mature investee companies.

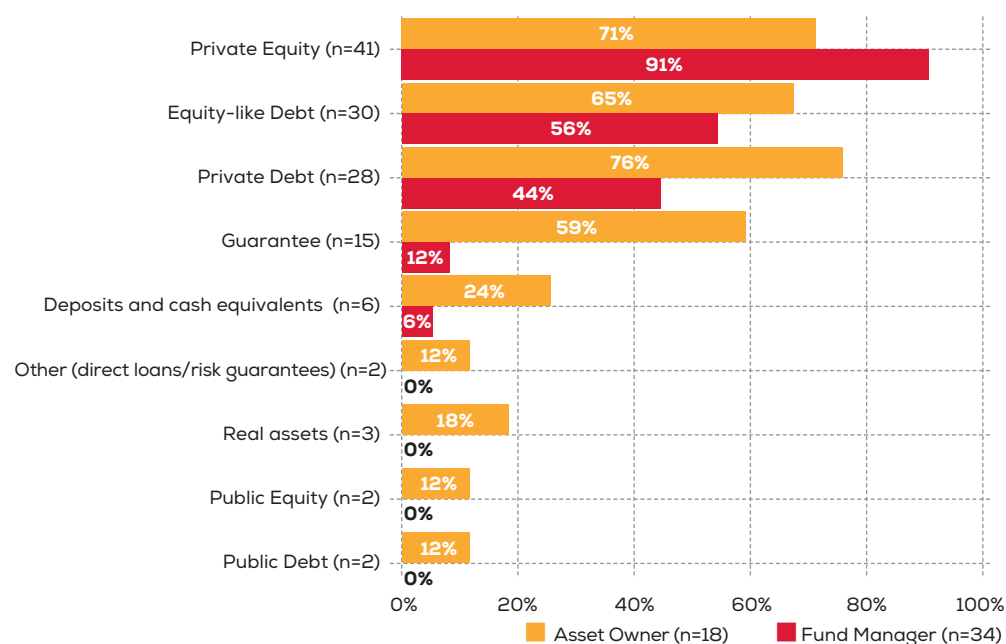
Figure 18: Focus of investments by type of company and type of investor³⁸



The range of instruments used varies by type of investor but with little variation between the two regions. Asset Owners typically use a broader range of instruments with a focus on debt and guarantees in particular.

Asset Owner investment is typically longer in duration than Fund Manager investment. The majority of Asset Owners typically focus on investment life spans between six to 10 years. Fund Managers are split roughly equally between four to five and six to 10 years. See Figure 31 in Annex D for a more detailed look at typical durations of investment by investor type and region.

Figure 19: Financial instruments used by Asset Owners and Fund Managers³⁹



³⁸ Respondents were asked 'Where do you focus the majority of your investment activity in terms of market focus?' Frontier Markets, Emerging Markets and Developed Markets were defined in the survey. See Section 1.3.1.

³⁹ Respondents were asked (Q5): 'What instrument(s) does your organisation use to make investments? Please tick all that apply.'

⁴⁰ Microfinance and clean technology are excluded from the sector focus of the DFID Impact Programme. No investor reported focusing only on either of these sectors.

The majority of respondents invest in multiple sectors⁴⁰, with an average of three to four sectors per investor. There is little observable difference between Fund Managers and Asset Owners in their number of focus sectors.

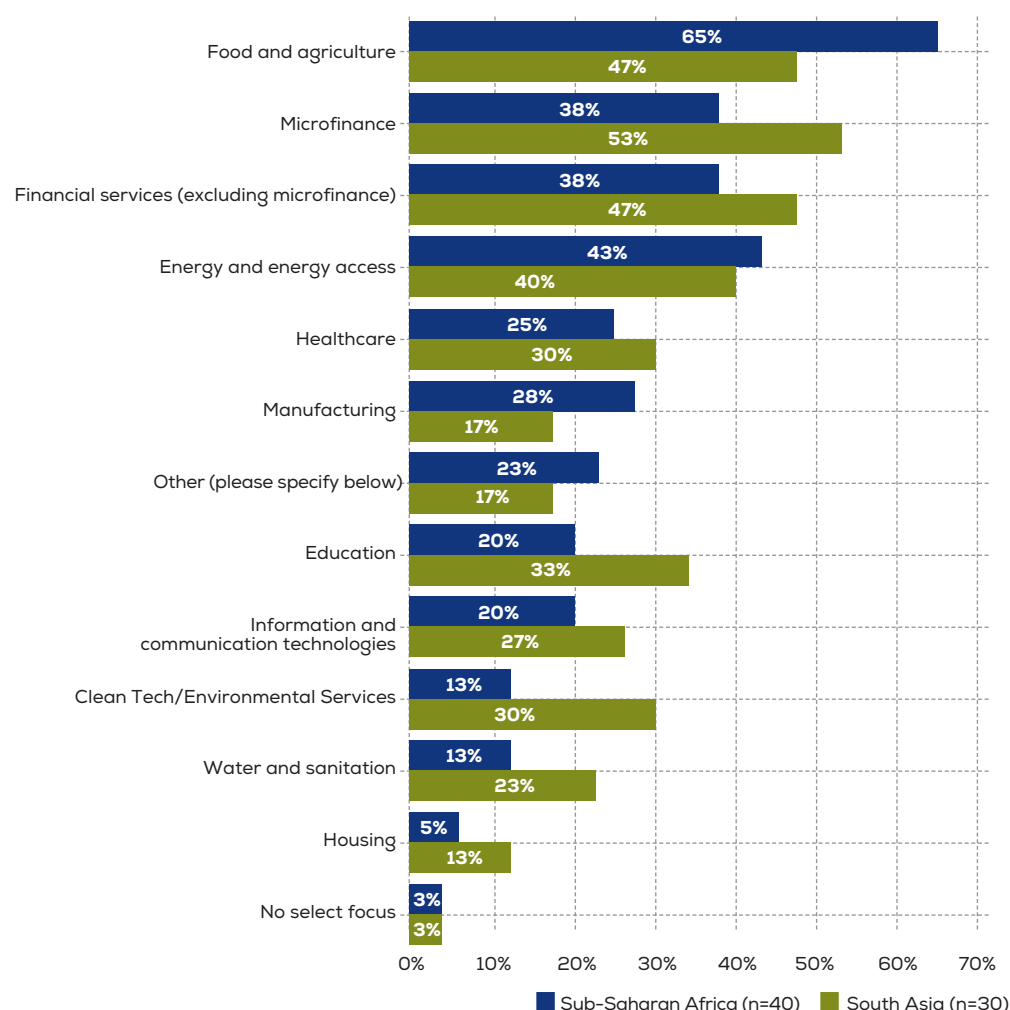
Investors in South Asia reported a more diverse range of sectors over the last 12 months than those in Sub-Saharan Africa. Across both regions, only five out of 42 investors who provided sectoral information focused on only one sector.

The most popular sectors for investment in the last 12 months in both Sub-Saharan Africa and South Asia were:

1. Food and agriculture
2. Microfinance
3. Financial services excluding microfinance
4. Energy and energy access

Roughly half of all investors in South Asia include microfinance and financial services in their portfolio, although none exclusively so. Two-thirds of investors in Sub-Saharan Africa focus on the food and agriculture sector, with energy access as the second most common sector for investment in the region.

Figure 20: Sectors targeted for investment in the last 12 months in South Asia and Sub-Saharan Africa (n=42)⁴¹



3.3 Use of Technical Assistance

The majority of respondents use Technical Assistance (TA) alongside financial investments. Twenty-eight of 44 (64%) said that they use TA often or nearly always. Others use it occasionally or are considering it while almost 20% said they do not use it because it is not part of their investment strategy.

In the qualitative interviews some comments were also made as to what counts as TA, with some interviewees saying they provide business development support, but not a separately packaged input described as 'TA'⁴². Others said they were shifting towards separating out TA, partly in order to account for it and fund it separately.

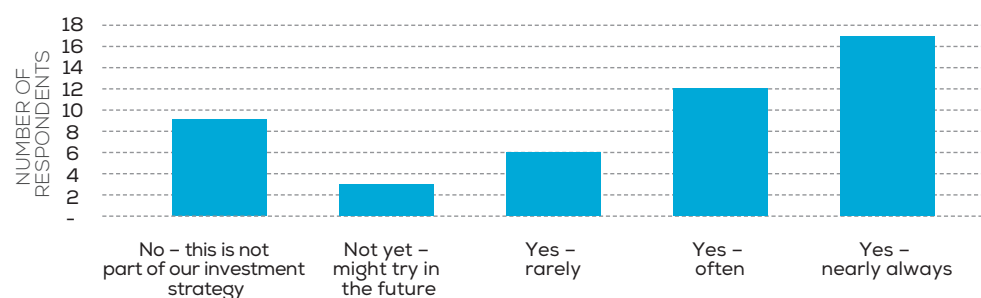


⁴¹ Respondents were asked: 'What - if any - have been your sector focus(es) for your commitments / deployed capital' to South Asia / Sub-Saharan Africa in the last 12 months? Select all that apply.' (For Asset Owners / Fund Managers respectively)

⁴² Respondents were asked: 'Do you provide Technical Assistance alongside your investments?'

⁴³ Respondents were asked: 'Do you provide Technical Assistance alongside your investments?'

Figure 21: Use of Technical Assistance (n=44)⁴³



04

DIVERSE APPROACHES TO FINANCIAL RETURN AND SOCIAL IMPACT



IN THIS SECTION WE EXPLORE OVERALL PATTERNS IN HOW THE STATED TARGET RETURN WAS REPORTED BY INVESTOR TYPE, REGION FOR INVESTMENT AND TYPE OF INVESTMENT FOCUS. INTERVIEWEES' VIEWS ON HOW THEIR SOCIAL IMPACT STRATEGY DRIVES THEIR APPETITE FOR RISK AND TARGET IRR ARE EXPLORED.

INTERPRETING RETURN DATA

Respondents were asked what average net IRR they targeted for investments in each region which offer a positive social and/or environmental return, and were given five options to choose from: 0 – 10%, 11 – 20%, 21 – 30%, 31 – 40% and Above 41%. Several caveats need to be borne in mind when interpreting this data.

Firstly, target return is not necessarily the same as actual return achieved in the market. Secondly, we do not have sight of the composition of the portfolio or the degree of risk taken alongside these expected returns, thus each category of target return could encompass a range of different approaches. Some investors may consistently make low-risk low-return investments (maybe via debt instruments) which are likely to result in very limited volatility across the portfolio. Others may invest in a range of high-risk high-return investments where there is likely to be few highly successful investments and several failures. The average net IRR could be the same across both types of investor portfolio.

We do not have data for risk-adjusted return across the investments but the sections below explore, to the extent possible, the broad correlations that emerge with use of instrument, and some findings on return and risk.

Although data here is not risk adjusted, the 0 – 10% and 11 – 20% ranges are likely to indicate strategies that target / tolerate a below-market rate of return⁴⁴ involving subsidised capital at some point in the chain. Although clear lines cannot be drawn, qualitative and quantitative data indicate significant differences between respondents in the 0 – 10% and 11 – 20% ranges, particularly in terms of their social impact thesis and views on the wider market. We explore this further in Section 4.3.

In short, although target return cannot be disaggregated in any detail for different instruments, sectors or markets, this section reports some interesting trends which start to help us understand how the diversity of impact investors begin to cluster and act in the market.



4.1 Investor trends by target return in Sub-Saharan Africa and South Asia

Across all respondents, 11-20% was the most commonly reported target IRR. 0-10% was the second most common option overall, particularly common amongst Asset Owners and those investing in Africa.

Table 12: Characteristics of investors targeting single and double digit returns

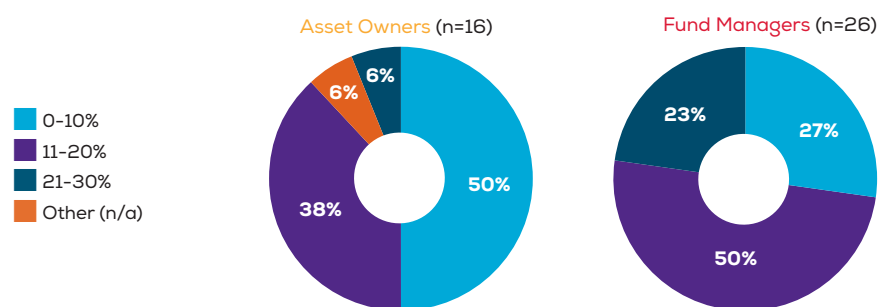
Single digit return (0-10%)	Double digit return (11+%)
50% of Asset Owners 25% of Fund Managers	44% Asset Owners 75% Fund Managers
58% focus early stage companies (not necessarily exclusively)	70+ % focus on later stage companies (not necessarily exclusively)
Debt-type finance more frequently used	Equity-type finance more frequently used
More frequent in Sub-Saharan Africa than South Asia (Although 11 – 20% is most frequently targeted in both regions overall)	More frequently in South Asia than Sub-Saharan Africa (Although 11 – 20% is most frequently targeted in both regions overall)

⁴⁴ Some surveys classify respondents according to whether they expect a 'market or near-market' rate of return, a 'below-market' return, or just capital preservation. We don't give a value to 'market rate' in this survey, recognising this would differ across markets and contexts, but we assume 'market rate' represents the return expected for a given level of risk in the mainstream market, where social impact and / or subsidy are not at play.

Variation by investor type and instrument

In both regions, Fund Managers typically aim for higher financial returns than Asset Owners.

Figure 22: Targeted return by investor type⁴⁵



The differences are not surprising and a number of reasons may underlie them: Asset Owners net IRR has to allow for Fund Managers fees, so would be expected to be lower; Fund Manager respondents as a whole make greater use of equity instruments, and respondents that use equity on average target higher net IRR, while Asset Owners use a wider range of instruments. And finally, the IRR reported is only 'target IRR.' There may be stronger incentives for Fund Managers, who have to fund raise, to be optimistic in reporting target IRR.

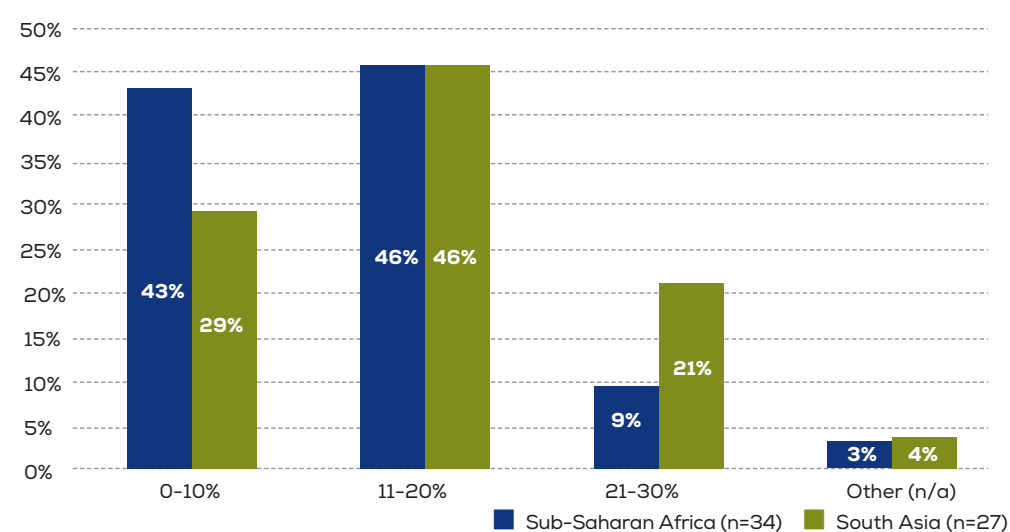
Return data was not collected by instrument type but can be mapped against the range of 'main instruments used' reported by respondents. The vast majority of respondents use both debt and equity. However, those that use only debt-type finance typically expect lower net IRR, while those that use only equity-type finance typically expect higher net IRR.

Target return by region

Financial return expectations are higher in South Asia than in Sub-Saharan Africa.

As Figure 23 shows, more than a fifth of investors target returns of 21%-30% net IRR in South Asia (9% of investors targeted this return in Sub-Saharan Africa). By comparison, a greater number of investors target returns of 0 - 10% net IRR in Sub-Saharan Africa than in South Asia (43% compared to 29% respectively). The 11-20% net IRR range is the most common target bracket in both regions.

Figure 23: Targeted return by region⁴⁶



⁴⁵ Respondents were asked what average net IRR they target for investments in South Asia and Sub-Saharan Africa that offer a positive social and/or environmental impact. Five answer ranges were offered.

⁴⁶ Twenty respondents provided answers for both regions. In most cases the answers were the same across South Asia and Sub-Saharan Africa but two Fund Managers reported different target return brackets for each region. Both of them target 11-20% net IRR in Sub-Saharan Africa and 21-30% in South Asia.

For a breakdown of the targeted return by investor type and region, (see Figure 33 in Annex D).



COUNTER INTUITIVE INVESTMENTS TARGETING LOWER RETURNS IN HIGHER RISK CONTEXTS

Some data presented here appears to be counter-intuitive to the expectation of correlating higher risk with higher target return, as would be found in mainstream markets. For example, although respondents target higher returns in South Asia compared to Sub-Saharan Africa, they also perceive lower risks here.

Another pattern that appears counter-intuitive based on mainstream market expectation is that respondents investing in later stage companies target higher IRR than those investing in earlier stage companies.

This suggests that the pattern of net target IRR is not based on perceived risk alone but could, for example, be because (1) the type of investor is different (requiring a higher return in South Asia for any given level of risk) or (2) higher returns are possible because of the relative maturity of the markets, with South Asia (particularly India) having more options for liquidity and exit. Insight to the reasons for this emerge from the qualitative interviews⁴⁷.

A number of investors explained that their social impact strategy to focus on early stage unproven businesses and/or undeveloped sectors and targeting low-income beneficiaries requires them to take on higher risk investments and expose them to greater losses but at a lower return. Whereas an investor in the mainstream market conditions would expect higher return for this level of risk, these investors accept a lower return in order to provide financing for this area of the market that would not otherwise be available. The range of target returns noted therefore reflect the range of different investor strategies in this area, as well as underlying differences in the investment itself, markets in which they operate and the instruments used.

Target return by enterprise and market maturity

There is a correlation between the respondents' targeted return and the typical stage of enterprise maturity they invest in. Of those targeting 0-10% IRR only 40% focus on later stage (Growth stage and Mature) companies. By contrast, 71% of respondents that target a return of 21-30% net IRR, and 68% of those that target 11-20%, invest in later stage companies (not necessarily exclusively).

Looking at the data another way, investors targeting early stage companies more frequently expect 0-10% net IRR than those targeting other stages of enterprise development. Those targeting later stage companies more frequently expect returns in the 11-20% net IRR bracket. As with the regional breakdown, this may appear to run counter to pricing in mainstream capital markets, whereby risky early stage ventures would be expected to require a higher IRR. But specific kinds of investor operate in this space, seeking social impact through early stage investment, and tolerating lower IRR for the level of risk, as responses outlined in the section below on social impact explain.

Respondents with a focus on frontier markets reported higher targeted returns compared to those in emerging markets, although 11-20% was the most common reported target IRR in both types of markets.



4.2 Return and social impact

Social returns are a high priority for almost all investors, but strategies for generating positive social impact vary considerably. Survey answers from virtually all respondents indicated the importance of social impact, with minimal differentiation. However, the interviews revealed considerable differences in social impact strategy. The priority focus ranges from innovation to specific sectors and from economic growth to beneficiaries with particular demographic features. Wide variance in how beneficiaries are defined also emerges, with a substantial minority using a tight definition and a focus on low-income people, while several others use broad terms for 'underserved' beneficiaries without specific definition.

A range of impact measurement approaches were described by interviewees, along with challenges of measurement, and some debate over the extent to which measurement data can be interpreted or should be prioritised.

⁴⁷ In the design of the Market Survey, one of the main reasons for including a set of qualitative interviews was to explore complex issues around social impact and returns, as this cannot be easily captured in online formats.

The importance of impact

The majority of respondents indicated that social impact was 'very important' to their investment decisions in the last 12 months and that improving the lives of poor and low-income people is a 'major component of social impact'. There is little variation on this topic across respondents or regions.

Figure 24: Importance of positive social impact when making investment decisions in the last 12 months (n=52)⁴⁸

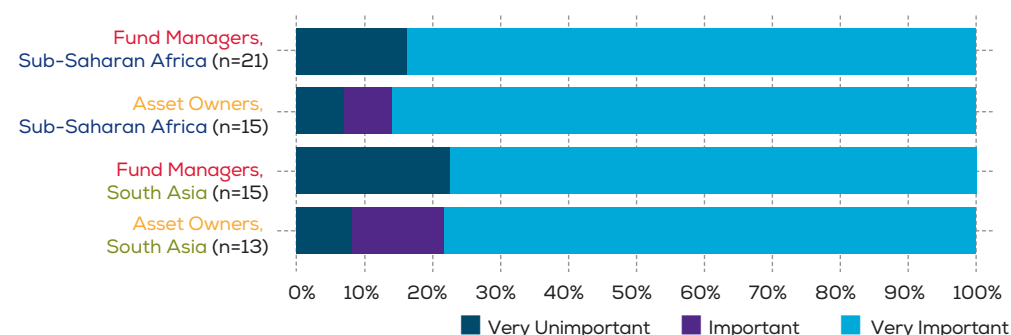
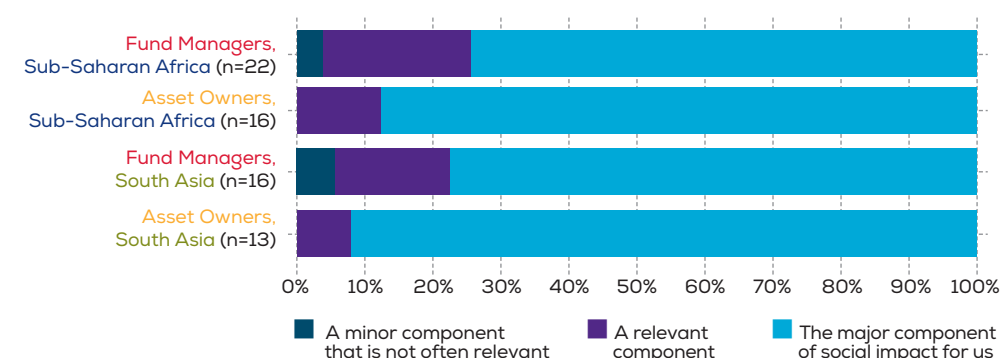


Figure 25: Importance of focusing on improving lives of poor and low-income people during social impact assessment⁴⁹ (n=46)

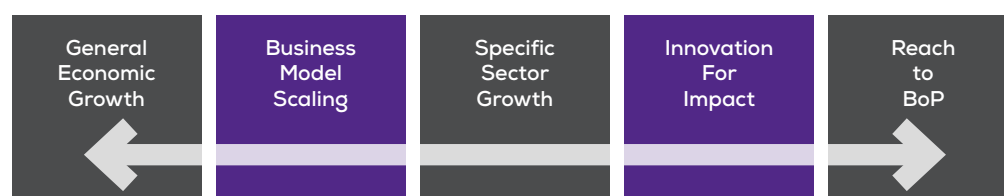


Diversity in strategies for achieving impact

There was a range of approaches across the investor group in defining social impact and strategies to achieve this. A recurrent theme in interviews was acknowledging this diversity and the segmentation of approaches within the label of impact investment.

Most interviewees stated that they have a strategy to maximise social impact but routes to achieving this varied. The five strategies below outline the range of impact logic reported:

Figure 26: Diversity of social impact strategies



⁴⁸ Respondents were asked 'Please score the importance of achieving positive social &/ or environmental impact over the last 12 months when making commitment decisions?' and offered a choice of five levels of importance.

⁴⁹ Respondents were asked: 'In your assessment of social impact, to what extent is a focus on improving the lives of poor and low income people an important factor?' and were presented with four options to choose from.



Organisations' social impact strategies typically emphasised one of the following as the primary driver for social change:

- **Demographic beneficiary focus** – focus on the poor or underserved and invest in businesses that have the potential to create benefit for this group, with varying degrees of specification.
- **Innovation focus** – focus on developing new or innovative business models that tackle social problems and invest to develop new or under-developed markets with social reach.
- **Sector focus** – focus on specific sectors which have most potential for social impact and invest to speed growth of the sector (e.g. agriculture, technology).
- **Business growth focus** – focus on driving increased impact through scaling of successful businesses with social impact.
- **General economic growth focus** – focus on driving wider economic growth and job creation, whether through investing in small and medium-sized enterprises (SMEs), infrastructure, or growing the private sector.

Those that target impact through broader economic development explain their impact strategy as creating a dynamic economy that will create wealth across levels of income, often with a focus on areas or countries that are low-income or less economically successful: *"A lot is about vibrant economies, not numbers of individuals."* said one Fund Manager, while a DFI commented *"We feel that if you invest in the poorest 50 or so countries, FDI contributes to the wellbeing of the country – in particular for investments in SMEs, which the engine of economic growth, and providing access to finance for the unbanked populations. Significant development impacts can be achieved like this."*



Different types of investors noted that they also aim to catalyse *additional* investment in the future as part of their strategy to derive social impact. These investors aim to develop a pipeline of investable propositions for later stage investors. This is true for investors in pre-Growth stage companies and under-developed sectors where investments build a pipeline for those who are willing to invest at a later stage. It is also true for investments in Growth stage companies which aim to catalyse investment from the mainstream capital markets for the sector as a whole.

Diversity of social impact strategy within DFIs

Most DFIs emphasise economic growth, private sector development and creating jobs as priorities in their social impact strategy. However, many of the DFIs also have a specific element of their total private sector lending that has a more direct focus on businesses that directly engage and benefit people at the BoP. As noted above, responses from seven DFIs (both via the survey and via interview) include those both those answering for the organisations' entire private sector operation and those answering in relation to their specific envelope, fund, or unit focused on this kind of high-impact business. The social impact strategy, investment focus, and relatedly the definition of social impact is different for the two types.

The mechanism used for BoP-targeted investment varies. It can be a separate fund, a facility, a financing envelope, or a type of investment within the portfolio – there is no common structure. For example, CDC manages a specific and separate Fund (the DFID Impact Fund), the European Investment Bank (EIB) has a financing envelope, ADB has a growing share of its core private sector deals categorised and assessed as inclusive business and the International Finance Corporation (IFC) has analysed its entire portfolio to identify those that count as inclusive business. Table 13 summarises the current status of these within seven DFIs that operate in Sub-Saharan Africa and South Asia.

Table 13: DFI global commitments and specific envelopes with different social foci

DFI	Global commitments to private sector investment ⁵⁰	Specific fund, envelope, or unit with different social focus	Status or size
ADB	\$1,6 billion committed in 2013	Six out of 22 deals in 2013 are defined as inclusive businesses: commercially viable, innovative, meets needs of low-income people (the majority below \$3 pp per day at 2005 PPP) and provide systemic solutions to problems faced by low-income people.	Work on inclusive business started in 2010. In 2013, \$225 million committed to 6 inclusive business deals.
CDC	\$5 billion	DFID Impact Fund managed by CDC invests through vehicles that have a clear strategy to invest in businesses that achieve positive impact on the BoP population in target regions.	Investments have been made in 3 funds and up to £75 million is available for commitment.
EIB	\$494 million ⁵¹ in 2013	EIB ACP-IF Impact Financing Envelope (IFE), designed to invest in potentially riskier projects than the normal EIB mandate, in order to deliver a higher development impact.	Euro 125 million available to invest. Just commenced. Euro 500 million IFE envelope. Commenced Q4, 2014.
FMO	\$9,3 billion	FMO has a number of pots of money for specific high(er) risk investments which are off balance sheet. The Dutch Government is also setting up the Good Growth Fund.	Various. Some pots are used up. The Good Growth Fund is under development.
IFC	\$17,2 billion	400 companies are defined as inclusive business investments: commercially viable and replicable business models that include low-income consumers, retailers, suppliers, or distributors in core operations.	Commenced in 2010. \$11 billion committed to inclusive business investments to date.
OPIC	\$18 billion	A subset of investments are in "impact sectors," that face the most difficult challenges raising capital, such as agriculture, education, access to finance, SMEs, water and sanitation. Certain investments are distinguished by the fact that they had "impact intent," meaning that the explicit aim of the project was to address a social or environmental challenge, while also generating stable financial returns.	\$222 million with impact intent in 2013. \$2.7billion in 2013 in 'impact sectors'
Proparco	\$4,16 billion	FISEA – Investment & Support Fund for Business in Africa (FISEA) launched in 2009.	Target of Euro 250 million commitments in 5 years

⁵⁰ Figures sourced from survey responses and from Institution Annual Reports (2013). EIB and Proparco figures are converted from Euro to USD using exchange rates as at year end 2013, (EUR1:USD1.17799) <http://www.oanda.com/currency/converter/>
Figures are total commitments outstanding, except where noted.

⁵¹ This figure is for private sector investment in ACP countries (Africa, Caribbean and Pacific) not global lending, which would be many times higher given that around 90% of lending is within the EU.



These newer elements have a social strategy that tends to be focused on benefits to people who are low-income. The point was made however, that this should not be taken to imply that the wider DFI does not have social impact; the impacts are, however, more diverse and more indirect and there was some discussion of the extent to which all DFI investment in the private sector should count under the impact investment label. Social impact was generally ranked high by DFI respondents. One DFI interviewee commented, “the word ‘Impact’ in relation to investment gets on my nerves, as if other types of investment do not have an impact”.

Diversity in financial return and social impact expectations

Interviewees gave contrasting descriptions of how they balance financial return and social impact. A common theme was the diversity of approaches within a segmented market.

Views of respondents targeting 0-10%

Several of those whose survey replies stated a target average net IRR in the 0-10% category explained that their social impact strategy leads them to tolerate a low financial return⁵² relative to the risk taken. Three inter-related types of social impact strategy were mentioned by these respondents who prioritise:

- Investment in new business models that are early stage and/or unproven
- Investment in agriculture as a sector
- Investment in business models that reach low-income segments within the BoP.

These priorities all mean investing in markets that are under developed, where many businesses find it challenging to sustain commercial rates of return. In addition, they often result in small transaction sizes with relatively high transaction costs and/or a large share of failures, resulting in a low aggregate IRR (as losses are not compensated by a few big winners).

“The opportunity for commercial return with impact is overplayed. We get frustrated at the presumption that you can get commercial returns and get impact. It’s not always the case... Our organisation goes into the sector and works with the stage [of business] that delivers impact. Commercial investment cannot operate here unless first loss / blending of capital is used due to the early stage of the market, small ticket size, transaction cost and risk.”

“We always seek a positive return from an investment. But we expect to lose some. We hope to achieve 0% or more overall, but accept risk... We may recover 110% overall, but we may recover 80% overall.”

“The need is for small deals, under \$5 million, but that is hard to structure to generate a good return.”

Views of respondents targeting 11-20%

Respondents targeting 11-20% did not suggest any diminution of their social impact strategy. Rather they emphasised that they prioritise:

- Companies with strong growth potential (particularly SMEs), or larger Fund Managers with more experience, and a focus on scale of impact
- Investment management to build robust investees
- Demonstrating viability at near-commercial returns to build a ladder to mainstream capital.

“We look for the ‘best in class’ and only where we have footprint on the ground.”

“In many cases more people can be reached by investments in 2nd time Fund Managers. I.e. larger funds, bigger deals, more track record, more employment creation.”

“We focus on the most un-serviced and high-risk segments, markets in which typically 70-90% of SMEs fail to reach the fifth year. Our businesses have an 80% success rate.... We have learnt that you can only get a certain return. If you have no subsidy or support, the IRR will never be high enough for finance first commercial investors.”

⁵² These examples focus on those for whom 0-10% is clearly well below a market return. Other respondents in the 0-10% target IRR category explained this was largely due to their use of debt instruments.



Views of respondents targeting 21-30%

A number of interviewees indicated that they are now developing new funds or investments that seek a higher return than their previous investments. This was mentioned by interviewees in the 0-10% IRR category.

Another interviewee targeting returns of 21-30% described such a shift as part of an evolving strategy, increasingly focused on companies with growth potential, larger scale and a different type of exit.

"We focus on Growth stage businesses – larger companies, larger ticket sizes... those hungry for real scale. In our first years we were too accepting of failure and too small. We have shifted focus to be more hard-nosed. Today's investment focus is still on early stage companies and as a first investor, but focusing on those with huge potential for scale and huge capital needs – more of a classic VC model. We aim for an exit to an IPO which means a very different kind of company – we look to take them from \$10 million to \$100 million."

Interviewees did not only define their own position, in terms of target social and financial return, but in doing so often provided perspectives on tensions in the wider market.

Divergent views were expressed on impact investment that seeks a financial return that is substantially below a market return:

A number of interviewees argued that investments that tolerate lower returns are essential for businesses that are innovative, early stage and/or reach the lowest income groups. Some saw a need for greater recognition of the value of this segment, or realism about its constraints.

At the same time, questions were raised as to whether these same investments risk diluting the market by being insufficiently commercial in their approach. Comments were made on the need to ensure robust commercial processes and to be clear where subsidised capital is used. One investor commented, *"Some smaller funds are only surviving because they effectively receive grants, not investments. We need to differentiate between 'real' impact investment and 'venture philanthropy' and similar."*



Divergent views were also expressed on investment approaches that seek higher, close-to-market returns:

- Some indicated that this is exactly what the impact investment market needs to achieve scale and attract mainstream capital by demonstrating commercial feasibility.
- Others raised concerns whether these approaches inevitably create pressure for larger deal sizes, less risky investments and businesses that serve the groups.

The challenge of combining and balancing financial and social return is discussed further in Section 5, where views on market challenges are presented.



Describing the 'Base of the Pyramid' and low-income households

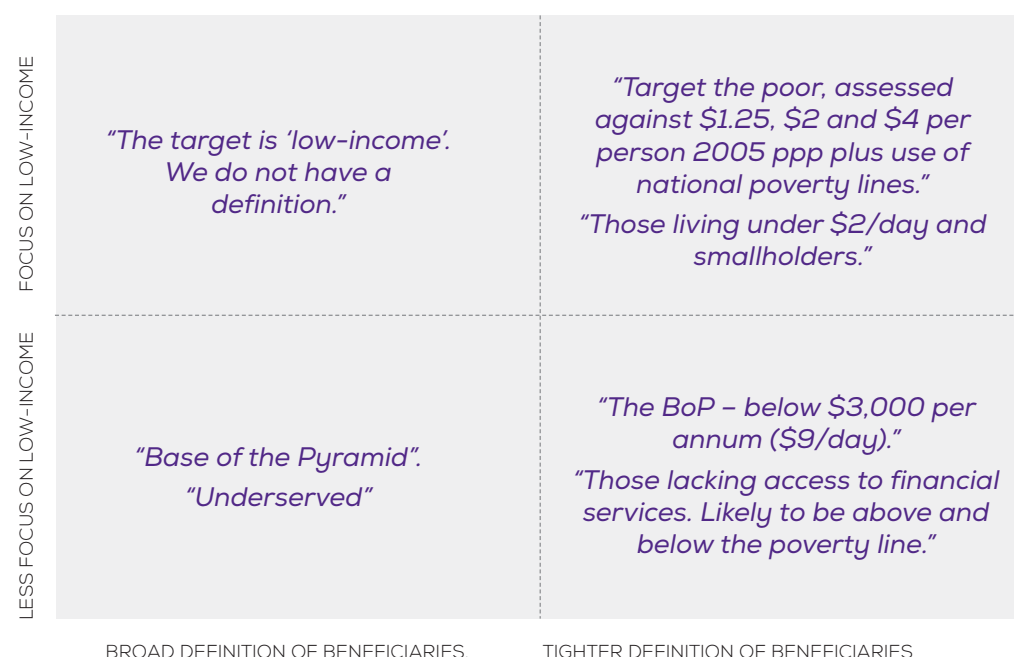
Interviewees were asked about how they define their target beneficiaries. For some, benefit to specific beneficiary groups is the key element of social impact, while for others social impact is much wider (about economic opportunity for example) than direct benefits accruing to specific individuals.

Many use the terms 'underserved' or 'base of pyramid' to describe their target beneficiaries. Some do not define this further, while others provided quite specific definitions⁵³. Some focus on specific low-income groups while others do not have income thresholds or targets.

⁵³ Diversity in definitions of BoP reflects the current state of the market and is discussed further in an Impact Programme Discussion Paper, Tracking Reach to the Base of the Pyramid, <http://bit.ly/ImpactBoP>.

We use a two-by-two matrix to demonstrate the range of beneficiary definitions (see Figure 27 below) we heard. Broadly speaking, two main clusters emerged amongst the 17 interviewees that discussed this with us. These are represented in the dark blue quadrants, bottom left and top right:

Figure 27: Interviewees approaches to defining target beneficiaries



From this:

- Seven out of 17 have fairly specific definitions of their target beneficiaries, including a focus on low-income people, as defined by income level (e.g. under \$1.10, \$2, \$3, or \$4 per person per day), location (live in low-income areas of the country), function (smallholders) or other proxy indicators.
- Seven out of 17 use a broad definition such as 'Base of the Pyramid' or 'underserved', people in low or middle-income countries, and do not target a specific income groups.
- A few have a more specific definition, while encompassing a broader range of income levels. And one has a focus on 'low-income' within the BoP, but no specific definition.



Measurement of social impact

Interviewees described varying approaches to measuring social impact. The lack of standard practice was noted and seen as a challenge for the market.

Most interviewees confirmed that they focus heavily on social impact during the pre-investment selection and due diligence phase and require less measurement post investment.

For post-investment monitoring, most rely on metrics reported quarterly or annually, though the mix of specific indicators varies (see Table 14). Other measurement tracking tools mentioned by 17 interviewees who discussed measurement practice, in order of frequency, were:

- Deep dive verification by an external or independent organisation on a sample of investees (in operation/development for four, planned by two)
- Own performance framework using a combination of specific indicators or categories, which is used across all investments for comparing results (mentioned by five)
- In-field verification by investment officers, or by visiting businesses/suppliers (two mentions).

Table 14: Examples of core indicator reporting from five different interviewees

Respondent organisation type	Core indicators reported across the portfolio
DFI	Consistent metrics are number of beneficiaries, number of low-income beneficiaries, number of females, rural/urban breakdown and net employment creation. Plus sectoral metrics as appropriate.
DFI	Sixteen indicators covering issues like taxes, employment, and also whether [our organisation] has had a catalytic impact as an investor (if it's a first close, if we are an anchor investor etc.)
Foundation	Job creation measurement and tax paid, top line revenue, access to products in supply chain are the key social impact indicators
Fund Manager, Africa focus	Primarily job creation in low-income economies; moving towards measuring job sustainability, female empowerment (both employment and female entrepreneurs); company turnover growth, company 'value add' (purchases from local suppliers, tax contributions), business sustainability and formalisation
Fund Manager, global	Quantitative indicators are reported regularly – some monthly, some quarterly, some annually. Qualitative indicators around child labour, GMOs (genetically modified organisms) are included.

Several comments were made about impact measurement practice, indicating frustration with current practice as well as caution on using certain approaches. There were also comments on how much measurement should be expected without undermining the effectiveness of the investment:



"Lack of impact measurement is a challenge – we want to but don't know how. We need clear agreement on what is impact – for DFIs, banks, Impact Investors... We would like a harmonisation tool."

"We look to microfinance as a cautionary tale... Getting measurement and management of impact in place is vital."

"No best practice in impact measurement at the moment, a few pioneers and a lot doing the basics."

Some interviewees challenged the appropriateness of using the definition "lives touched" as a basis for defining ultimate beneficiaries.

"We used to, and still can, track numbers of people but are also trying to be more conscious of quality of outcomes. For example, if 600 million users visit a website – is that the same kind of impact as those who are pupils in a school every day, or users of a life-saving drug, or those who have obtained a loan to start a business? We realise that we also need to look beyond reach to actual sector-level outcome."

A number of interviewees also noted the risks of requiring too much impact reporting from investees and how this resource burden could alter effectiveness of the investment.

"For measurement it is important to understand upfront if the organisation is really in the position to gather all relevant data as well as to determine the minimum number of core KPIs that are a must (often driven by what is the investor's information needs). If investors are asking for too much then they are significantly raising transaction costs of doing business with them."

In overview, frustration with impact measurement practice was mentioned by several, although several efforts by organisations to improve their social impact measurement were also apparent.

RISKS, CONSTRAINTS AND GAPS IN AN EARLY STAGE MARKET



IN THIS SECTION WE CONSIDER BOTH THE RISKS FACING CURRENT INVESTMENTS IN OUR TWO REGIONS OF INTEREST – SUB-SAHARAN AFRICA AND SOUTH ASIA – AND THE CONSTRAINTS TO INCREASING FUTURE INVESTMENT WE THEN GO ON TO CONSIDER THE GAPS AND CHALLENGES TO THE BROADER DEVELOPMENT OF THE IMPACT INVESTING MARKET IN THE TWO TARGET REGIONS.

5.1 Overview

Relatively consistent patterns emerge in relation to risks facing current investments across both regions and type of respondent (see *Table 15*). The top two constraints to future investment – limited experience and relevant skills in executive teams/ Fund Managers, and lack of investable business/ funds – are also commonly reported, although some other differences in perspective emerge.

Limited track record and limited evidence of successful exits shine through as significant challenges to the market as a whole. Various concerns around disproportionate transactions costs, how and where to best use subsidy (including TA) are also reported as key themes emerging from interviews.

Table 15: Risks, constraints and gaps

Top Risks to current investment – ranked higher in Sub-Saharan Africa	Constraints to increased investment – Asset Owners	Constraints to increased investment – Fund Manager	Gaps in the wider market
<ul style="list-style-type: none"> • Business model & Management risk • Liquidity & exit risk • Country & currency risk 	<ul style="list-style-type: none"> • Lack of FMs with relevant skills & experience • Lack of sufficient data to qualify opportunities • Lack of opportunities with which to achieve impact 	<ul style="list-style-type: none"> • Lack of businesses with relevant skills and experience • Lack of investable propositions w/ track record • For Fund Managers: lack of banking facilities 	<ul style="list-style-type: none"> • Limited evidence of exits and impact • Tension between social impact and financial return • Limited volume and range of financing available • Limited coordination and availability of market data

5.2 Risks to current investments

The three factors that were identified as the most important contributors to risk related to current investments across both regions were:

1. Business model execution and management risk
2. Liquidity and exit risk
3. Country and currency risk

The prioritisation of all 'contributors to risk' factors for current investments was very similar in both regions. However, the absolute scores given for risks in Sub-Saharan Africa were consistently higher than those in South Asia (See *Figure 34* in Annex D).

COMPARISON WITH OTHER RISK ANALYSIS

The risks identified in this survey are not new. The top two risks identified in our Market Survey for Sub-Saharan Africa and South Asia were the same as the two top risks in the J.P. Morgan and GIIN 2014 Impact Investor Survey with a global focus. The G8 social impact investment taskforce supplementary report, Allocating for Impact, lists capital risk, lack of track record, liquid and exit risk, and impact risks ("impact evidence not sufficiently robust to justify diversion of funds from other impact-creating opportunities") as the key risk factors.⁵⁴

These quantitative results are generally consistent with the responses to qualitative interviews. One Asset Owner said: *"Africa has a lot of opportunity [but] the market is less mature [than South Asia] so there is less liquidity – and possibly more political risk."*

It was also highlighted in interviews that lower perceptions of risk in South Asia may be due to the concentration of investment in India, which represents a more mature and less risky market for impact investing than some regional neighbours.

There is one area where there was less consistency between quantitative and qualitative results. *"Not achieving/not being able to adequately evidence positive social and/or environmental impact"* was the lowest ranking contributor to risk in both regions on the online survey yet interviewees frequently highlighted this as an important operational challenge.

For each of the three highest ranked risks we set out more detail on the interview responses in the sections below.

Business model execution and management risk

Nearly all interviewees spoke to a lack of skills and capacity as a major risk to investments. Both Asset Owners and Fund Managers focused on the business model execution and management risks associated with the underlying companies that receive investment. Asset Owners were also concerned about the risks associated with Fund Managers and their ability to deliver on their investment theses.

Several areas of skill and capacity deficiencies were specifically cited in interviews, including:

- lack of leadership
- poor understanding of proof of concept and business models
- low levels of human resource
- distribution and supply chain management
- Management Information Systems know-how.



VOCAL

One Asset Owner, operating in Sub-Saharan Africa, specifically identified middle-management as being particularly weak: *"There is lots of talent at CEO level but nothing in the business 'engine room' – middle management is lacking and this is a binding constraint."*

Mitigation measures to limit these business model execution and management risks mentioned included:

- Placing a major emphasis on fund and business management teams during investment selection and approval processes
- Working closely with leadership teams pre and post investment providing even fairly basic support regarding business plans and core functions
- Close monitoring of company reports and proactive response to these with TA
- Providing a high degree of core business support
- Exiting at a strict time limit.

⁵⁴ <http://www.socialimpactinvestment.org/reports/Asset%20Allocation%20WG%20paper%20FINAL.pdf>



Liquidity and exit risk

Views expressed in interviews on why liquidity and exit risk is so high fell into two camps:

1. Those who attributed the risk largely to the immaturity of the sector, but were generally positive about perceptions of liquidity and exit reducing as the sector matured
2. Those who are generally less positive, and attributed the liquidity and exit risk to fundamental challenges in many deals which seek an impact return as well as a financial return

Typical comments from the first camp included: *"We are not particularly worried about achieving exits [per se], it's just a question of the right timing"; "The industry is too young to reduce this risk", and "We've not had any major exits yet."*

Typical comments of the latter camp included: *"Exits are always an issue" and "I think there are a lot of impact investors sitting on tens of millions of investments for which exits are not realisable – no trade sales and not enough income generated for a management buy-back."*

Unsurprisingly, liquidity and exit risk are perceived to be higher when working with new Fund Managers. Investors seeking impact need to work with first-time Fund Managers more regularly than mainstream investors due to the immaturity of the sector. Fund Managers seem to be aware of this and have largely identified the need to build a track record of exits as a strategic priority.

Several Fund Managers cited the use of debt and blended financing structures as risk mitigation measures for liquidity and exit risk: *"To date, we have only exited from debt investments"; "Debt allows us to stay in deals for longer – balancing the portfolio is key to enabling private equity (PE) stakes to be held for a long time whilst keeping some liquidity via debt repayments."*

One Fund Manager also commented on considering exits from the outset: *"We spend a lot of time at the beginning assessing exit prospects... A big part of due diligence should be microeconomic analysis."*

Country and currency risk

Country and currency risks are a slightly different type of risk, as they apply to mainstream investments as well. As such, the primary mitigation measures reported are unsurprising: hedging to balance risk of currency volatility and investing in multi-country funds to spread country and currency risk.

5.3 Constraints to increasing investment in the regions

The two constraints that were most frequently highly scored by both types of investor⁵⁵, and discussed further below, were:

1. Lack of Fund Managers / businesses with an executive team that have relevant skills, knowledge and experience.
2. Lack of investable propositions/funds with a successful track record.⁵⁶

In addition, Fund Managers also highlighted a lack of suitable banking facilities as a significant constraint.

A lack of opportunities with which to achieve positive impact was the third most important constraint for Asset Owners, while for Fund Managers it was the least important constraint.

Several other market constraints were noted beyond those listed in the online survey including operating model and transaction costs which are also discussed further below. For the full list of constraints identified by Asset Owners and Fund Managers, see *Figures 35 and 36* in Annex D.

These constraints echo the most frequently ranked constraint of the J.P. Morgan and GIIN 2014 Impact Investor Survey: shortage of high quality investment opportunities with track record.

⁵⁵ Fund Managers were asked to rate seven potential constraints; Asset Owners were asked to rate a total of six potential constraints.

⁵⁶ This is a key constraint identified in other reports as well. The 2012 Monitor Report From Blueprint to Scale cites "lack of sufficient absorptive capacity for capital" as a major constraint. The G8 taskforce supplementary report on International Development suggests that "smaller enterprises cite lack of appropriate funding, and investors cite lack of quality scalable enterprises."



Lack of skills, knowledge and experience

Lack of skills, knowledge and expertise of businesses or Fund Managers was the highest ranking risk for both Fund Managers and Asset Owners, and commentary related to this constraint underlines its significance to both types of investor. Comments included: *"The main constraint is lack of good business plans"* and *"The lack of a capable management team at investee level is one of our key constraints."* We also heard that: *"It is difficult to find entrepreneurs sophisticated enough for Fund Managers to invest in and, relatedly, intermediaries don't typically exist to identify and support these entrepreneurs."*

One established Fund Manager that invests in businesses in Africa, Asia and Latin America commented on the complexity of this area, noting that it is not only hard skills that are needed: *"The biggest challenge is to create change in enterprises in terms of mind-set, management capacity and corporate thinking."*

Lack of investable propositions and pipeline

The message we heard in response to interviews as to whether or not a lack of investable propositions is a major constraint in the market is *"it depends"*, yet this constraint stood out in the quantitative analysis as the second highest ranked. It depends what kind of investor you are, what you are looking for as a financial rate of return, what you are looking for as a social return, how much risk you are willing to take and what you count as 'track record'. That said, there was consensus that the more exits that take place, evidencing a stronger track record, the greater the likely confidence in the market at every level.

Illustrating different view-points, two DFI-managed funds expressed the view that, if pressure on financial return is reduced, a wider selection of potential businesses – including early stage firms – should be available for investment and, therefore, relieve pressure on *"lack of investable propositions"*. As part of their mission to play a catalytic role in these markets, these two DFI funds sometimes invest in funds without a proven track record but where individuals within the team have experience. However, a different opinion was also expressed in which it was asserted that, even with a theoretical lower return expectation, it is still harder to find a business to invest in for an impact return as well as a financial return. This is because more is being demanded of the business than it would be if the investment was for a financial return only. It was observed that, in practice, there are so few businesses operating in Frontier Markets with a significant turnover that defining 'market rate return' becomes nearly meaningless in this context.



Other constraints: operating model and transaction costs

Other constraints noted in the interviews included the higher operational risks and costs in developing markets and the relatively high transaction costs given the deal sizes. A DFI respondent commented: *"It's ridiculous to think that impact investors, investing in the kind of geographies that we invest in, would have a similar model, cost-base, or structure as other funds."*

One Asset Owner operating in Sub-Saharan Africa commented: *"The two-and-20 model for investment is ridiculous in this space. The true cost is almost double, given the high degree of support and high risk involved. It's not an argument many want to listen to but it is clear."*

Given the size of typical deals and the higher cost of due diligence compared to mainstream investments in more developed markets, transaction costs are proportionately higher which makes investment more costly – the challenge of small ticket sizes, which are needed by businesses but raise administrative costs, was raised many times. For example, one Fund Manager commented that: *"The main challenge is high transaction costs for deals of less than a few million, which make it hard to get positive return."*

5.4 Challenges and gaps for broader market development

In addition to the risks and constraints to current investments, we also asked respondents about the challenges and gaps in the development of the broader market. These were open-ended questions, on which respondents contributed their own ideas, often strongly expressed.



EARLY
STAGE

In Section 5.5 we set out the high levels of optimism that respondents have as to the future opportunities in the market, and very few respondents indicated a negative overall trend in the market. Nevertheless, they also described challenges to effectiveness and growth of the market, in the following categories:

1. Limited evidence of exits and investment impact
2. Tension between social impact and financial return
3. Limited volume and range of financing available
4. Limited coordination and availability of market data



EARLY
STAGE



EVOLVING

Limited evidence of exits and investment impact

We heard statements about the market being young, few exits being made and few experienced teams making deals. Comments were optimistic but highlighted the very real question mark over the lack of exits made so far and impact funds being 'unproven'. *"The next three to five years will be the proof – if we don't perform, the momentum and interest will disappear"* and *"Once you get past top five Fund Managers, there isn't a huge amount of confidence – and probably not enough trust to see big blocks of capital coming through."*

A number of interviewees reported seeing a significant lack of risk appetite by investors to invest in early stage companies and / or very BoP-targeted companies, which are seen as those with greatest potential to reach the BoP.



DIVERGENT

Diversity of approaches to social impact and financial return

Virtually all interviewees recognised the diverse approaches to financial and social return within the sector, positioned themselves relative to others, and called for greater clarity and segmentation within the sector.

We heard a diversity of views on the extent to which investments can deliver both commercial return and social impact. There were clear voices which challenged the narrative that investments can generate commercial returns and reach those at the BoP, as was demonstrated by the interview quotes listed in Section 4.2.

There were similar comments around investors moving towards easier access and simpler deals in emerging markets, rather than frontier markets, and targeting 'Middle of the Pyramid' rather than BoP beneficiaries. A Fund Manager that finances businesses in Africa and the Middle East said: *"In this market, most players end up going 'up the ladder' towards private equity – either that or their deals fall over and die. Working in frontier markets is high-risk and challenging. Since we started, we have seen other Fund Managers stop functioning or leave this space."*

Questions were raised about whether businesses that serve mainly middle-income groups count as social impact. *"The opportunity to reach the BoP very much depends on the business model. It is very clear, for example, with producer models focusing on farmers but much less evident for cross-subsidisation models with, for example, companies providing rural healthcare in Africa. Many of them operate in semi-urban areas not primarily targeting the poor but the middle-income. They may, for example, open one day a week for low-income patients. Is that a company worth supporting with impact investment?"*

Other interviewees saw a lack of commercial discipline amongst those accepting lower return as a risk to the market. *"If the public sector and not-for-profit organisations start playing in this space, they MUST do so with the rigour of for-profit success, as otherwise they will not be driving the results they seek."* Some of those seeking higher returns were keen to emphasise the difference between their organisations and philanthropic venturing, and emphasised that their more commercial approach was what was needed to bring in mainstream investors.

Survey respondents identified a number of other tensions between social and financial return, and perspectives on the use of grant finance to help stimulate the development of the market. As one Asset Owner said: *"The lack of grants to get businesses to the point of investability is a key issue."*

Limited volume and range of financing available

One area of common consensus was the need for more debt financing for impact companies. An array of different types of investors in both target regions commented on the over-reliance on equity, lack of working capital, lack of local bank finance, and the need for expansion of debt instruments within the impact investing market. While interviewees perceived an increase in the number of equity funds being established in the two target regions, they see less evidence of a broader range of capital, specifically debt. The more general challenge is for companies to access the appropriate type of capital at the appropriate stage in the growth of a company⁵⁷.



Comments were strongly voiced by different investor types, with the comments below coming from a DFI and an Asset Owners.

"As companies grow there is not enough debt available. They have to rely on equity finance for capital intensive growth. Companies can't expand. If they do expand it affects pricing and which demographic they can serve, or they need equity which will accept a lower return. If impact investment can only be equity, it's a joke. But for banks, impact businesses don't screen so well from a conventional perspective as businesses serving the top quintile. If they are based in a peri-urban slum, they can't get debt, even if their cash flow is as strong as any other business."

"Small scale debt for SMEs is the most underserved part of the market. Equity doesn't work at this level."

Different views emerged on the question of how best to grow the volume and range of investment available. For some respondents, attracting investors that require market returns is a core goal and is part of why they want to demonstrate strong financial returns from their investments. One Asset Owner said: *"The impact investment market separates itself from mainstream market to its detriment."*

A Fund Manager operating in India commented: *"Over time, mainstream will shift into Impact and the boundary will blur, the term will eventually go."*

However, those that see more of a trade-off between commercial return and impact perceived a risk of mission drift as impact investment attracts investors that require strong financial returns and larger deal sizes. Such respondents were more likely to emphasise the need for capital willing to invest in smaller deals, which are perceived by many as a major area of market need.

In terms of appetite for investments with social impact, one interviewee said: *"The market doesn't care yet"*. Another said: *"Mainstream investors support Growth stage companies but don't understand impact companies – and when they stray into the space, they flop."*

There is also a need for investors who can take the risk of funding such enterprises in the intermediate phase i.e. the phase after starting up but before the high growth period.



Limited coordination and availability of market data

Fragmentation and lack of coordination were identified as limitations to the growth of the market. We heard that: *"The sector is too fragmented – there is a lot of money out there but it is uncoordinated and often too restrictive and / or diverse in terms of perspective and mandate"*. Views were expressed that: *"So far there is little evidence of 'match-making' [in the market]"* and that the right deals were not always finding the right businesses.

We also heard that coordination amongst DFIs and other investors is a constraining factor: there needs to be greater co-ordination between investors as it currently takes too long (24 months plus) to bring products to market, and a lot of this is spent on herding investors.

⁵⁷The problem may be lack of access to debt not lack of debt financing per se. With inadequate equity capitalisation, many companies cannot access the debt that is in theory available. So this should not be seen as an 'either-or' debate.

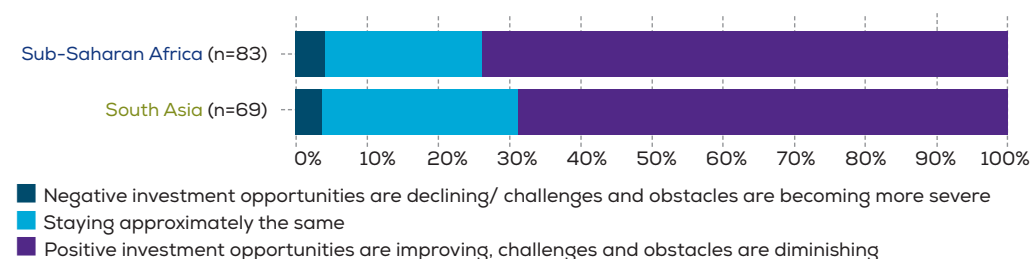


5.5 Perceptions of market trends and market confidence

A clear majority of respondents consider the trajectory in the market for investing with impact in both South Asia and Sub-Saharan Africa as 'positive' going forward – meaning opportunities increasing and challenges and obstacles diminishing.

There is not a significant difference between responses for South Asia and Sub-Saharan Africa – they are both overwhelmingly optimistic – but there is an even higher percentage that are optimistic in Sub-Saharan African than South Asia, suggesting that Sub-Saharan Africa is 'catching up' with South Asia in terms of respondents' perspectives. The higher risk identified in Sub-Saharan Africa, as presented in Section 5, does not seem to diminish their confidence going forward.

Figure 28: Market perceptions, South Asia and Sub-Saharan Africa



Disaggregating the above into the perceptions of investors (split by Fund Managers and Asset Owners) and other respondents shows that Fund Managers are, on the whole, slightly less positive than Asset Owners in Sub-Saharan Africa, while in South Asia the reverse applies.



Our interviews suggest that this overriding optimism may be largely driven by the steadily increasing number of Asset Owners, including in particular non- DFI's, and Fund Managers investing in this space, as well as a variety of developments of the wider market ecosystem. Typical comments included: *"We see more funds and more funders than there were previously"; "There is lots happening in the ecosystem – in the last three years there are an increasing number of ecosystem players like intermediaries, accelerators, incubators."*



There was also recognition that the pipeline of companies available for investing with impact is likely to grow. The online survey captured comments around the emerging middle class in Sub-Saharan Africa and the fertile ground this provides for entrepreneurs. One respondent commented: *"There is a growing set of enterprises focused on meeting real needs in society"*. There is also a growing number of investors and Asset Owners who *"care more about the world than just their bank account."* The challenge now is how to combine / link the two.



The regulatory landscape was also noted to be improving, providing a better enabling environment for investors.

Overall, the reported reasons for optimism in these markets is summarised in the words of one survey respondent: *"There's a huge market opportunity which is only going to grow – in both South Asia and Sub-Saharan Africa, infrastructure is improving, economies are growing, and demographics are changing, all in favour of opening up a thriving impact investment market."*

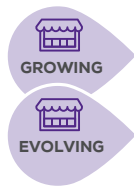
Voices of optimism about a diversifying growing market

"There's a huge market opportunity which is only going to grow – in both South Asia and Sub-Saharan Africa, infrastructure is improving, economies are growing, and demographics are changing, all in favour of opening up a thriving impact investment market." Fund Manager

"In the past one to three years, we have seen an increased focus and engagement of institutional investors." Facilitator

"There is lots happening in the ecosystem – in the last three years there are an increasing number of ecosystem players like intermediaries, accelerators, incubators." Fund Manager

From our online survey: *"Capital remains cautious but seems to be becoming more comfortable with the region."*



An index of market confidence

As noted above, respondents perceive risks as somewhat higher in Sub-Saharan Africa compared to Asia, but also report greater optimism about trends going forward in that region. As a basis for tracking changes in market confidence over time, we have piloted a 'confidence index' which combines respondents' perceptions of both the current and future market. This ranks confidence levels from a lowest possible score of 2, to a highest possible score of 10. It is not a sophisticated tool, but will provide over the years a proxy for changes in market confidence in the two regions.

The Market Confidence index is based on

1. Respondent perceptions on trends in the regions – whether investment conditions are improving, staying the same, or getting worse (50% of the score).
2. Respondent scores of overall levels of risks faced within current investments in the regions (25%)
3. Respondent scores of constraints to additional investment in the two regions (25%).

This survey report also covers investor forecasts for growth in new commitments and investments over the next 12 months and next five years, which is useful comparison, but is not part of the calculation of the index because the respondent base is too small, and the results are affected by the stage of a portfolio. Lower forecasts for subsequent years than last year may be more of a reflection on the maturity stage of Fund Managers, rather than a proxy for confidence. See Annex B for further information on index methodology.

The Confidence Index results can be presented in two ways: the average score for the region, and the breakdown of respondents per region reporting high, medium or low confidence;

- The average confidence score for South Asia was 6.89 and for Sub-Saharan Africa it was 7.23.
- This trend is reversed if only the views of active investors (not other market players) are used. In South Asia the average confidence score rises to 7.03, compared to 6.53 for investors in Sub-Saharan Africa, as Table 16 shows. Confidence scores amongst active investors are higher in South Asia because risks and constraints were consistently ranked slightly lower than in Sub-Saharan Africa.

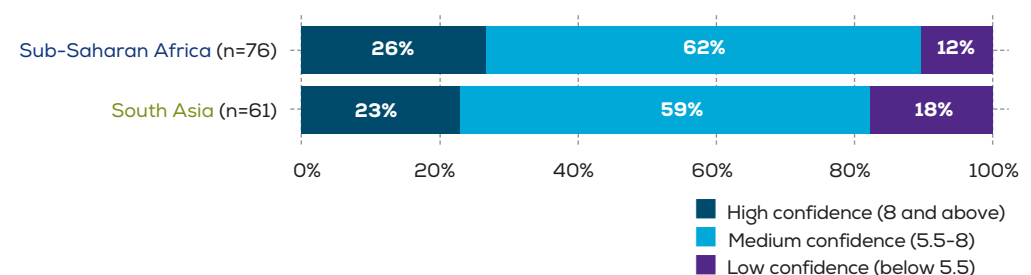


Table 16: Market Confidence Index scores in Sub Saharan Africa and South Asia

	Sub-Saharan Africa (n=76)	South Asia (n=61)
Average confidence index rating, all respondents	7.23	6.93
Average confidence index rating, active investors only	6.53 (n=35)	7.03 (n=26)
High confidence rating (8-10)	26%	23%
Medium confidence rating (5.5-8)	62%	59%
Low confidence rating (below 5.5)	12%	18%

Average scores hide variation amongst respondents. As *Figure 29* shows, there are more 'high' scoring and 'medium' scoring respondents for Sub-Saharan Africa than for South Asia, but the overall pattern is very similar in both regions.

Figure 29: High, medium and low market confidence levels in South Asia and Sub-Saharan Africa



06

SUGGESTIONS FOR MARKET GROWTH AND EFFECTIVENESS

IN THIS SECTION WE SET OUT A RANGE OF SUGGESTIONS THAT WERE MADE TO INCREASE INVESTMENT AND SUPPORT FUTURE MARKET GROWTH – MAINLY FROM INTERVIEWS, BUT SUPPLEMENTED BY OPEN QUESTIONS IN THE SURVEY.



GROWING



EVOLVING



FAR-SIGHTED

There was overwhelming consensus that greater clarity is needed within this thin and diverse market, which should improve understanding and reduce confusion, as well as enable different stakeholders to come together to leverage a broader range of capital. Some fundamental challenges of working with investments in poor parts of the world were identified, along with the need for more effective business support. There were also calls for more support for entrepreneurs and intermediaries and a general need for more and better disaggregated information and evidence. We have grouped these suggestions into seven broad recommendations:

1. Disaggregate and better categorise the market
2. Develop structures that leverage different market segments
3. Increase the diversity of capital and range of instruments
4. Address relatively high transactions costs
5. Improve access to business development services
6. Build stronger capacity in the global South
7. Increase evidence base and information sharing



VOCAL

Recommendation 1: Disaggregate and better categorise the market

A consistent theme emerged that there is a lot of confusion in the impact investment market, and that the clear and consistent use of terminology, and better disaggregation of the wide range of stakeholders will be helpful to all. Impact investment can mean different things to different people. *"We need a taxonomy of expectations in different markets. It's not established yet."*

One Fund Manager urged more classification of the different opportunities and strategies for achieving impact in different sectors, stages of business, market segments and geographies. *"There is a need to provide clear information to funds, investors and businesses – particularly by sector and stage of business."*

There was also common agreement for more evidence and transparency in a better disaggregated market. Amidst several fairly typical calls, many added the need to focus more on segmentation within the market, and to provide data and evidence for each different segment.

One Asset Owner aiming for medium returns stressed the need for greater clarity around the application of subsidy and investment, for example distinguishing more between grant funding (venture philanthropy) and impact investment. Others highlighted the need to understand when grant subsidy is used to finance technical assistance to investees.

Many linked the need for greater clarity and disaggregation with opportunities to increase volume and scale. A DFI respondent commented: *"If we really want to achieve scale and play a real role in being catalytic, the sector needs to share learnings and insights, with agreed parameters on what kind of fees could and should be charged, what kind of returns could or should be made, what kind of impact could or should be expected"*. The theme was echoed by another respondent who called for *"the rules for the sector"*.

Recommendation 2: Develop structures that leverage different capital sources

Many respondents touched on the need to combine different sources of finance as a way to increase the range and volume of investments in the market. This often involved an intermediary combining different sources of finance, and using more patient capital to leverage more commercial capital. In addition to blending sources of finance in a fund, there were also calls for companies to be able to draw more effectively on different capital sources for different needs.

Developing structures that leverage different capital sources was described in different terms, sometimes in relation to what DFID, DFIs or the public sector should do; sometimes as a route to attracting larger volumes of less patient capital:

- Many respondents called for greater provision of first loss guarantees
- A Fund Manager investing in Africa commented: *"We need risk sharing mechanisms (guarantees, first loss, etc.) to enable existing on the ground intermediaries to take larger risks and support more companies."*
- A respondent from a pension fund described how donors and other investors can create incentives to enter: *"If you construct a portfolio where the public sector takes the downside risk and you've got a lot of upside risk, it makes it interesting and attractive to mainstream investors."*

Others also described these deals as essential for tapping into more mainstream finance. *"We need hybrid models, blending patient capital with more commercial capital, which enables commercial capital to come in when otherwise (in the absence of concessional capital) it cannot. There are complex structures that can be designed. But essentially the suggestion is to have available concessional grant money that can absorb the first losses, which is needed to leverage up returns for investors. This will give more commercial investors confidence to enter the market. This approach can increase investment 10-100 times over, and does not mean asking institutions to change their operating model."*

A market facilitator urged: *"Look at grants and first-loss structures, perhaps with private investor benefit caps. Add in partnerships with corporate social responsibility programmes (typically well-run)"*. And an Asset Owner called for vertically integrated capital stacks in a single intermediary offering accelerator grants, TA and risk capital that meet the dynamic requirements of SMEs at various stages in their development.⁵⁸

Several commented that it is DFIs and donors that can play an acceleration role, fill the gap of first loss high-risk capital and make blended structures happen. And several respondents commented that more funds like the DFID Impact Fund that are able to take greater risk and accept lower returns are needed, but not in isolation from private sector investors.

Recommendations were made that DFID should provide funding (with a spectrum of investment returns) alongside others into either funds or social enterprises and which reflect tiered capital structures that leverage investment with lower risk/return tolerance.

Similar recommendations have been made in other fora. Respondents to the J.P. Morgan and GIIN 2014 Impact Investor Survey were asked about the perceived helpfulness of different government policies. The most helpful was seen to be the improving risk-return profiles of investments through credit enhancement (guarantees, first loss etc.) or tax credits or subsidies for investors.

Two themes underpin the array of respondents' recommendations: the first is for public and more concessional money to buy down risk in deals to leverage in private capital; the second is to apply creativity when creating investment structures. One survey respondent noted the need for: *"...thinking outside the box in terms of managers, structures and flexibilities for investment and funding sources."*

⁵⁸ This respondent appears to be calling for layering of finance not in one deal, but in a facility, but the core idea is the same.



Recommendation 3: Increase the diversity of capital and range of instruments

The volume of capital available for investment is low, but in addition there are also some clear gaps where there is very little capital available, and constraints due to the limitations in the range of instruments available.

Some of these gaps can be addressed through the sorts of structures discussed above that bring together different forms of capital and investors with different return requirements, but there are also some clear gaps and limitations in scale driven by other factors.

The two key recommendation areas were:

- The need for capital beyond equity – this was often mentioned, in particular, provision of debt and mezzanine for working capital
- More early stage/high-risk capital.

These specific recommendations were linked to a broader recognition of the need to develop appropriate funding structures at different stages of business growth. The point was clearly put by two different DFIs.

“We need to look at a whole progression map for these types of businesses – how do they arrive at being investable? How early stage do ‘Impact Investors’ invest? And who will invest after exit? How will IPO’s be conducted and who are secondary buyers of these businesses?”

“All investee companies need a lot of working capital, at the moment there is a real focus on Private Equity amongst investors but it’s not just PE, its debt, its mezzanine, it’s the full spectrum of instruments that are needed.”

The role of grant support was also recognised, particularly for early stage business. Donor facilities such as the Africa Enterprise Challenge Fund were considered useful by some Fund Managers, for example, to create a pipeline for their own investments. We revisit the use of TA in the next section, but there was certainly calls from some to include more early stage grant-based TA to help address the relatively high transaction costs associated with limited pipeline.

Recommendation 4: Address relatively high transactions costs of impact investments

To tackle the problems of small deal size, high due diligence costs, and high management costs of impact investments, recommendations were made for more flexibility on legal and administrative structures, and, where necessary, moving away from the typical ‘two and twenty’⁵⁹ model frequently found in the mainstream market. We heard suggestions for:

- A Fund Manager that identified high due diligence costs of small investment sizes as the main challenge suggested: *“Club lending, so that organisations could share these. That’s the main reason coordination is needed.”*
- Co-financing with a range of investors – foundations were given as an example
- Higher fees – one comment made about CDC’s investments at the BoP was: *“CDC needs to treat these funds differently than their traditional commercially oriented funds – fees will need to be higher to cover full cost of active management.”*
- Identifying organisations with strong existing governance procedures for smaller transactions, reducing oversight requirements.

Various ideas were put forward to help address the combination of relatively high transaction costs compared to the risk weighted returns available. One Asset Owner urged DFID to purchase defined social outputs (e.g. through futures contract type arrangements) that create an income stream for social enterprises and that enhance their overall financial returns so that they can leverage wider sources of capital, while ensuring managers have an aligned incentive to maximise both financial and social returns.

The contribution of grant-funded business development services or TA was acknowledged by several respondents, both Fund Managers and Asset Owners alike, as discussed in the following point.

⁵⁹ ‘Two and twenty’ refers to a management fee structure for Fund Managers in which they charge a flat 2% of total asset value and an additional 20% of any profits earned.

Recommendation 5: Improve access to business development services

While there was a high degree of consensus on the value of business development support, for specific businesses and also for growth of the overall market, there were some different views on the way forward.

Some called strongly for more TA. One commented that: *“Technical Assistance facilities tend to be rarer and rarer but they are crucial to the development of the sector on one hand and to build sustainable and responsible businesses on the other hand”*. In particular, the need for TA at investee company level for SMEs and earlier stage investments is emphasised by various respondents when commenting on market-building needs.

However, others made forceful points against separately funded and managed TA, arguing that investors need to provide strong business support to their investees, without compartmentalising it as TA. *“Our strong view is that the moment you separate TA from investment operations, you are doomed to failure”*.

Providing all business support within core investment management has implications for the management fee, as identified in Section 3.3 above. Others commented that the label ‘TA’ does not work well, and would rather offer business development services.

Others found that more analysis and evidence is needed of how TA is best deployed by whom and when. So far, there is little transparency and/or evidence about the successful application of TA and more systemic application of TA is needed.

Discussion went beyond grant-funded technical support, to cover business development services delivered through the market. The need for *“bankability development services”* was identified, along with other ecosystem support. Support for businesses in the transaction preparation phase (prior to getting them investment ready) was highlighted. This means working with businesses to understand their business model/balance sheet to understand what type of financing structure/investment package businesses need. Stakeholders other than investors and Fund Managers were encouraged to focus on greater support to bolster entrepreneurship ecosystems which are essential to creating investible opportunities.

Recommendation 6: Build stronger capacity in the global South

Several areas for capacity building activities were highlighted, in particular for activities that focus on the global South, and in particular African (and Asian) leadership, i.e. current and future business leaders and other local stakeholders.



Respondents noted that it is important to create/stimulate true systemic change from within the markets rather than from the outside. This means identifying existing relevant players and working with them. This recommendation was made forcefully by various respondents and is also flagged as an area specifically for the Impact Programme and for the GIIN. One respondent urged: *“Get out of the North and engage in the South... approach the African Leadership Network to see if they would like to engage, and talk to others that have been effective at plugging into local networks.”*

Recommendation 7: Improve evidence base and information sharing

Strong recommendations were made to invest in improved measurement and reporting of impact. One Asset Owner described this as more important than adding capital arguing it is critical for DFID and DFIs to bring capital to impact investing, but the bigger gap is support for impact measurement and practice. This needs genuinely large-scale support to become a major public good, not just for impact investment but for social impact activities of all kinds. There is a need to build a knowledge base around evidence, moving beyond sharing of measurement frameworks and approaches to outcome and examples. The same respondent urged DFID to support the public good of impact measurement and management practice, and consider how it helps organisations that focus on this.

Others also called for investment in improved measurement and sharing of good practice and results:

- Greater education to investors and investees on what results can be practically expected, specifically relating to financial returns; social impact and reach to beneficiaries at the BoP, as well as the economic impact that private capital has on developing economies

- A DFI called for greater agreement on reporting standards which will help to better benchmark and compare funds against each other. Another DFI commented that metrics harmonisation amongst DFIs has not sufficiently addressed social metrics. More rigorous measurement standards and reporting is also emphasised by Fund Managers.

There is a long lead time before successful track record can be demonstrated, particularly for funds, but greater transparency particularly from those that seek commercial returns could help shorten this lead time.

Calls were also made for a step change in the amount of information that is available: a database of funds that goes beyond a simple list but provides transparency of position, valuations of underlying companies based on independent checks, qualitative info, benchmarking, and history of performance of each Fund Manager. That *“will be a big game changer”*.

Several other recommendations were made for information sharing, often with specific topics or groups:

- Information sharing for specific needs and interests of certain stakeholder groups, e.g. capacity building for investee companies, focused discussions for investors on specific topics (e.g. exits)
- More information sharing: *“TED talks on successes and failures.”*

A desire for greater clarity, disaggregated detail and ‘rules of the game’ for different investors.

“Outside of impact investing, you know where you are and what your expectations should be in terms of these factors. Inside impact investing, it’s not so clear. If we really want to achieve scale and play a real role in being catalytic, the sector needs to share learnings and insights, with agreed parameters on what kind of fees could and should be charged, what kind of returns could or should be made, what kind of impact could or should be expected.” Asset Owner

A need to differentiate types of investor and creatively blend capital.

“We need hybrid models, blending patient capital with more commercial capital, which enables commercial capital to come in when otherwise (in the absence of concessional capital) it cannot. There are complex structures that can be designed. But essentially the suggestion is to have available concessional grant money that can absorb the first losses, which is needed to leverage up returns for investors. This will give more commercial investors confidence to enter the market. This approach can increase investment 10-100 times over, and does not mean asking institutions to change their operating model.” Asset Owner



THE VARIETY, URGENCY AND CLARITY OF VIEWS ON THE WIDER IMPACT INVESTMENT MARKET WERE STRIKING – WITH A COMBINATION OF OPTIMISM AND CHALLENGE.

On key indicators, respondents were on balance optimistic: commitments are growing, they self-report more optimism than pessimism, and several comments outlined the growth of the range of market actors. But within that context, several risks, challenges and constraints were clearly identified. Consensus on some issues, such as the need to disaggregate the market, and to increase the range of instruments, emerged clearly. On other topics, such as the feasibility of market returns, views were more divergent.

Analysing, aggregating and presenting respondents' views has, of necessity, involved some interpretation and no doubt subjective judgement plays its part. So, in conclusion, we wish to go no further in interpreting the many clear views expressed, but condense our interpretation of them into the following table, outlining reasons for optimism, risks, challenges, market constraints, and recommendations.

Summary of respondents' views

Main reasons for optimism	<ul style="list-style-type: none"> • Growing range of business • Growth of the ecosystem and supporting infrastructure
Top risks to current investments	<ul style="list-style-type: none"> • Business model and management risk • Liquidity and exit risk • Country and currency risk
Top constraints to future investments	<ul style="list-style-type: none"> • Limited skills and experience • Lack of investable propositions • For Fund Managers: lack of banking facilities
Challenges in the wider market	<ul style="list-style-type: none"> • Lack of successful exits • Lack of track record • Transaction costs
Recommendations for market growth and effectiveness	<ol style="list-style-type: none"> 1. Disaggregate and better categorise the market 2. Develop structures that leverage different market segments 3. Increase the diversity of capital and range of instruments 4. Address relatively high transactions costs 5. Improve access to business development services 6. Build stronger capacity in the global South 7. Increase evidence base and information sharing
Main differences between Sub-Saharan Africa and South Asia	<p>Risks scored as stronger in Sub-Saharan Africa than South Asia, but confidence high in both.</p> <p>Respondents emphasise their diversity and how they differ from others, but the need to leverage complementary segments is echoed across the spectrum.</p>

ANNEX A: LIST OF RESPONDENT ORGANISATIONS

THE AUTHORS ARE GRATEFUL TO THE MANY ORGANISATIONS THAT TOOK THE TIME TO PARTICIPATE IN THIS SURVEY, MANY OF WHOM AGREED TO BE ACKNOWLEDGED HERE:

- 3ie
- Aavishkaar Venture Management Services Private Limited
- Adinugraha Internasional (International Award for Young People Indonesia)
- African Economic Research Consortium
- AgDevCo
- Agence Française de Développement
- Alterfin
- Asian Development Bank
- Aspen Network of Development Entrepreneurs (ANDE)
- AXA Investment Managers
- Barefoot Power
- BASSELA Consultoria e Servicos
- Batha Agro and General Supplies Ltd
- Blue Skies Holdings Ltd
- BlueOrchard Finance SA
- Calvert Foundation
- CDC Group
- Children's Investment Fund Foundation
- CIIE
- Clifftop Colony Capital Partners
- ClimateCare
- Clinton Giustra Enterprise Partnership
- Creation Investments Capital Management, LLC
- Creation Investments Capital Management, LLC
- Dolma Advisor Pvt Ltd- Advisor to Dolma Impact Fund I
- FMO N.V.
- GAWA Capital
- Gearbox
- GRM Futures Group
- GroFin
- ICCO Investments
- IFMR LEAD
- Impact Investment Exchange (Asia) Pte Ltd
- Impact Trust
- Imprint Capital Advisors
- Injaro Investments Ltd.
- InReturn Capital
- Insitor Management
- International Finance Corporation (IFC)
- Investisseurs & Partenaires (I&P)
- ISTAC cic - Invest Somalia Transformation Action Group
- JPMorgan Chase & Co.
- Koltai & Company LLC
- LGT Venture Philanthropy Foundation
- London Bridge Capital Ltd
- Low Carbon Enterprise Fund
- Lundin Foundation and Adolf H Lundin Charitable Foundation
- Madagascar Development Partners LLC
- Manocap
- media development investment fund
- Michael & Susan Dell Foundation
- Moringa Partnership
- Namalere forest conservation
- NIPFP, Ministry of finance
- Open Capital Advisors
- Open Society Foundations
- OPIC
- Pacific Capital Partners (PNG) Limited
- Partnership for Economic Policy
- PPS SARL Togo
- Proparco
- PwC
- REEEP
- responsAbility Investments AG
- Results for Development Institute
- Sahel Capital
- Sarona Asset Management
- SDG
- Shell Foundation
- SinCo
- Social Finance
- SOLARWAY
- Southern African Regional Programme on Access to Medicines
- Steinbeis Foundation
- Strathmore Energy Research Centre
- SunFunder
- Terra Global Capital, LLC
- The Global Fund To Fight AIDS, TB and Malaria
- TIAA-CREF
- UBERIS Capital
- UC Berkeley
- Unitus Seed Fund
- VC4Africa
- Venture Investment Partners Bangladesh Limited
- Voxtra
- Voxtra East Africa Agribusiness Fund

ANNEX B: ADDITIONAL INFORMATION ON METHODOLOGY AND TERMINOLOGY

Survey respondents and methodology

The online survey primarily targeted stakeholders with investments, planned or current, in South Asia and Sub-Saharan Africa, and who identify themselves as seeking a social and/or environmental impact alongside financial return.

Fifty-five of the 102 online respondents were investors for impact, of which 48 are active in the two target regions. Forty-seven identified themselves as other organisations that participate in the market, including facilitators, advisors, associations, philanthropic grant-givers and similar.

The online survey was directly distributed to over 345 targets identified by the Impact Programme. The survey was also available publically on the Impact Programme website and social media. No minimum or maximum investment value criteria were set for respondents and we actively sought perspectives of those about to invest and/or which play other roles in these investing for impact ecosystems.

The online survey asked respondents to provide information on five key areas:

1. Profile information, to understand who was sharing data with us
2. Portfolio information, to understand the shape and scale of the current market and likely changes
3. Perspectives on risks, constraints and opportunities for investing with impact in these regions
4. Perspectives on the Impact Programme and the DFID Impact Fund
5. Perspectives on the wider impact investment market, current and future

The interviews sought to explore some of the survey issues in greater depth, particularly the reasons underpinning some answers collected online and views on the direction of change in these markets.

The 21 in-depth interviews included:

- Eight Fund Managers
- Six Development Finance Institutions (DFIs) including funds or units within DFIs
- Four non-DFI Asset Owners
- Three organisations that are active facilitators or advisors in this market.

Terminology used in the report

All financial figures are reported in **US dollars**.

‘Survey respondent’ or sometimes just ‘respondent’ is used to indicate those who shared data with us through the online survey. **‘Interviewee’** refers to those who participated in the semi-structured interviews.

We report investment focus on ‘early stage’ and ‘later stage’ companies based on grouping stages of enterprise development as defined in the survey:

- **Start Up companies**
Defined as those where a business idea exists but little has been established operationally and revenues are typically not yet generated.
- **Venture Stage companies**
Defined as those established but which may or may not be generating revenues and which typically are not yet profitable and do not yet have a positive EBITDA.
- **Growth Stage companies**
Defined as those that are already profitable with a positive EBITDA and which are positioned to begin scaling output.
- **Mature companies**
Defined as those that have stabilised, are at scale and are operating profitably.

We cluster Start Up and Venture Stage companies as **‘early stage’** and Growth and Mature companies as **‘Later Stage’**.

The survey also outlined three stages of market development as:

- **Frontier Markets**
Those which cover most lower income countries with nascent and higher risk markets. This includes, for example, Bangladesh, Ethiopia, Malawi, Myanmar and Uganda.
- **Emerging Markets**
Those which cover most middle-income and lower/middle-income economies, and have currently maturing investment markets. This includes, for example, Bahrain, Botswana, Cote D’Ivoire, Ghana, India, Malaysia, Namibia, South Africa, Swaziland, Taiwan, Tonga, Vietnam.
- **Developed Markets**
Also called ‘mature markets’, those with higher income economies. This includes, for example, Australia, Europe, Japan, New Zealand, North America and Singapore.

Technical Assistance

The survey asked whether respondents provide Technical Assistance (TA) alongside financial investment. Some respondents preferred to talk about ‘Business Development Services’ (BDS) as part of their investment management to strengthen investees, rather than ‘Technical Assistance’, which some perceive as a separately bounded, separately funded, activity. Where interviewees used either TA or BDS, we represent these as stated.

Market Segmentation

Many respondents referred to differences within the market under the broad label of ‘impact investment’. A wide variety of terms were used to emphasise the presence of different investor types. Differences in social impact strategy and target financial return were emphasised. We use the term ‘market segmentation’ to refer to this presence of different investor types. An even wider range of terms were used to describe the way in which different investor

types within the segmented market could co-invest together. We give this the broad description of 'hybrid finance' and describe the wider range of terms used to describe these ideas in Section 6.

Non-DFI Asset Owners

For some data points a further sub-division of Asset Owners has been conducted to enable analyses of Non-DFI Asset Owner commitments as distinct from DFI commitments. We do this to enable non-DFI data to be more clearly represented (DFI's account for only 44% of Asset Owners respondents but 97% of capital committed).

Market Confidence index method

The confidence index is calculated in the following way:

Index Component 1: Perceptions of market trends

Weighting: 50% of total confidence index score.

Survey question: *What is your perception of the current trend in market conditions for investing in South Asia &/or Sub-Saharan Africa to achieve both a positive &/or environmental return as well as a financial return?*

Scoring Responses:

"**Positive**, investment opportunities are improving, challenges and obstacles are diminishing" = assigned maximum score of 5

"Staying approximately the same" = neutral score of 3

"**Negative**, investment opportunities are declining/ challenges and obstacles are becoming more severe" = minimum score of 1

Index component 2: Risk and constraint levels

Weighting: 25% of total confidence index score accounted for by the average constraint rating, plus 25% accounted for by the average risk rating.

Constraint rating survey question: *To what extent do the following factors constrain you from allocating more capital to commitments that offer a positive social &/or environmental return as well as a financial one?*

Listed 7 constraints rated by respondents on a scale from very unimportant to very important. For respondents, very unimportant scored 1 and very important scored 5. For the confidence index, we have flipped these so that a better situation scores higher, in line with the question on market trends.

Risk rating survey question: *What are the current biggest contributors to risk in making new transactions in your investment portfolio in South Asia and Sub-Saharan Africa?*

Listed 8 risk factors to be rated on a scale from very unimportant to very important) Scoring was as for constraints.

Step 1: Average constraint rating and average risk scores are calculated for each respondent. The average is taken for the bucket of risks, and the bucket of constraints.

Step 2: The respondent's average risk rating and constraint scores are then added together and divided by two to get an average overall risk and constraint score.

Minimum score is 1 (risks and constraints are all very important) and maximum score is 10 (risks and constraints are all very unimportant). *So if average risk rating is 3 and average constraint rating is 4, total average rating = 3.5.*

Combining Index components

Adding the combined risk/ constraint score to the perception of the market score gives a total from minimum 2 (lowest possible confidence rating) to 10 (highest possible confidence rating).

Assigning high/medium/low values to scores

Confidence levels are broken down in to high, medium and low categories.

High = a score of 8 or above

A score of 8 or above requires either:

- Positive overall outlook on the market (5) plus risks and constraints rated as neutral or unimportant (3-5)
- Neutral outlook on the market (3) plus constraints and risks rated as very unimportant (5)

Medium = a score above 5.5 and below 8

A medium score requires either:

- Positive outlook on the market (5) plus constraints and risks rated as important or very important (below 3)
- Neutral outlook on the market (3) plus constraints and risks rated as moderately important or unimportant (above 2.5, but below 5)
- Negative overall outlook (1) plus constraints and risks rated as very unimportant (above 4.5).

Low – a score from 2 (the absolute minimum score) to 5.5.

A low confidence index score requires either:

- Neutral (3) outlook on market trends plus constraints rated as important (below 2.5)
- Negative outlook on market trends (1), plus constraints and risks rated as between very important and unimportant (1-4.5)

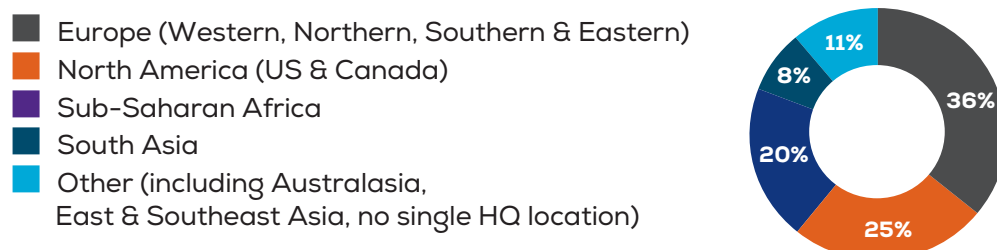
Acknowledging investment forecasts

While forecast levels of new commitments are useful indicators of confidence, these have not been factored in to the market confidence index, and are reported separately, for the following reasons:

- Limited data on forecasts: a low proportion of respondents provided forecasts for planned commitments or investments in the regions. By comparison, almost two thirds of respondents provided information on risks, constraints and overall perceptions in South Asian markets, and more than three quarters of respondents provided information on Sub-Saharan African markets.
- Complex factors underlying forecasts: Respondents included investors answering on behalf of specific Funds, many of whom had made substantial commitments in the last year. In such circumstances, lower forecasts for subsequent years may be more of a reflection on the maturity of the Fund, as Funds focus on managing near complete portfolios and/ or achieving exits, rather than a proxy for confidence.

ANNEX C: ADDITIONAL DATA ON SAMPLE PROFILE

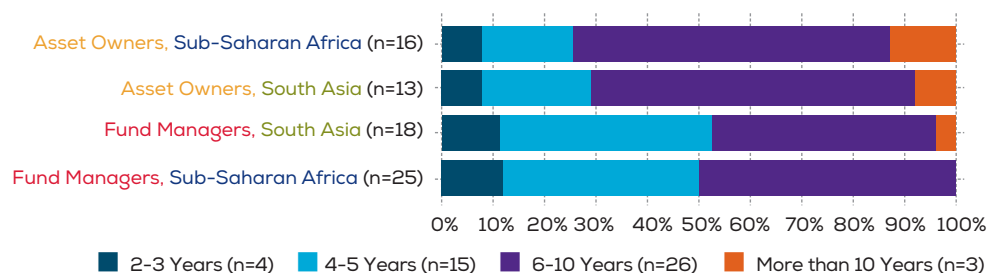
Figure 30: Organisation headquarters of respondents⁶⁰ (n=99)



ANNEX D: ADDITIONAL INSIGHTS INTO THE STATE OF THE IMPACT INVESTMENTS MARKETS IN SOUTH ASIA AND SUB-SAHARAN AFRICA

Duration of investments

Figure 31: Typical duration of investments by Fund Managers and Asset Owners active in South Asia and Sub-Saharan Africa⁶¹ (n=45)

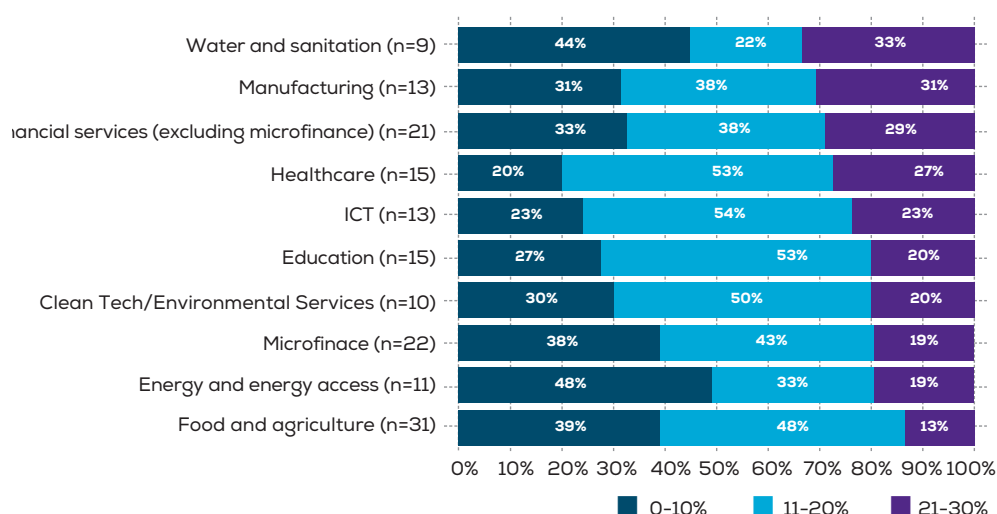


Targeted returns

Return by Sector

Most respondents invest across a range of sectors and that applies to each IRR category. A high proportion of those seeking a 0-10% IRR include food and agriculture, and energy in their sectors covered. A high proportion of those seeking 20% plus include financial services in their sector coverage.

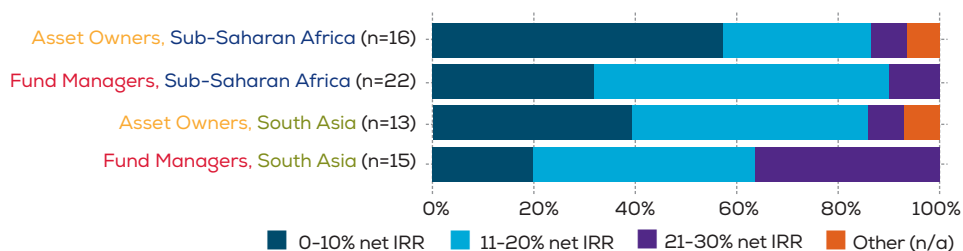
Figure 32: Targeted net IRR by sector of investment (n=42)



⁶⁰ Respondents were asked (Q6.1): 'Where is your organisation headquartered?'

⁶¹ Respondents were asked (Q13(B)): 'What is the typical duration of an investment for you?' And were asked to tick one of five categories presented.'

Figure 33: Targeted return by investor type and region (n=42)



Risks and Constraints

Figure 34: Most important 'contributors to risk' for investments, by region⁶² (n=96)

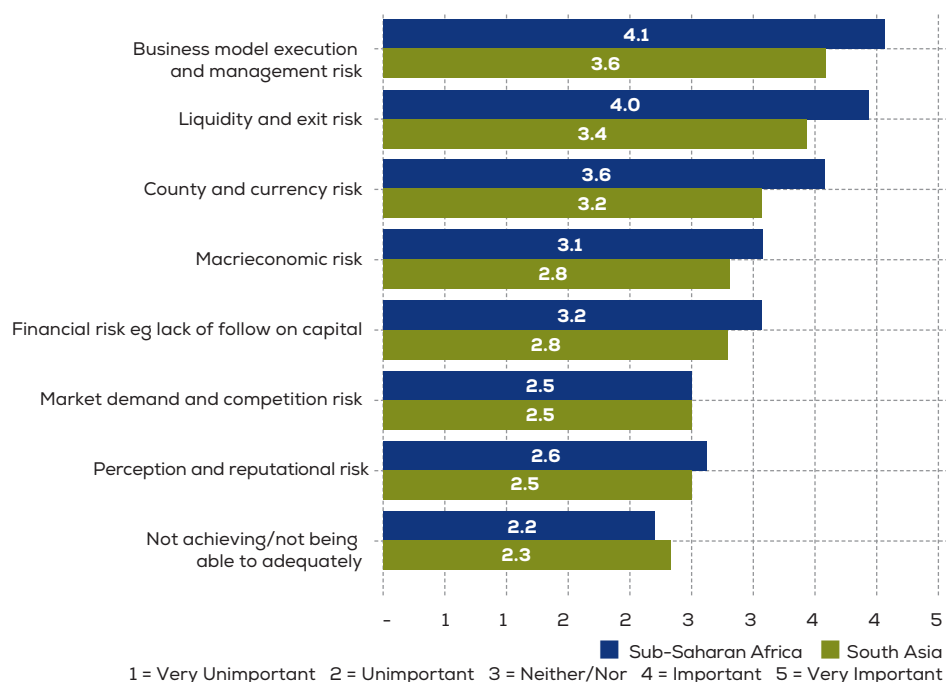
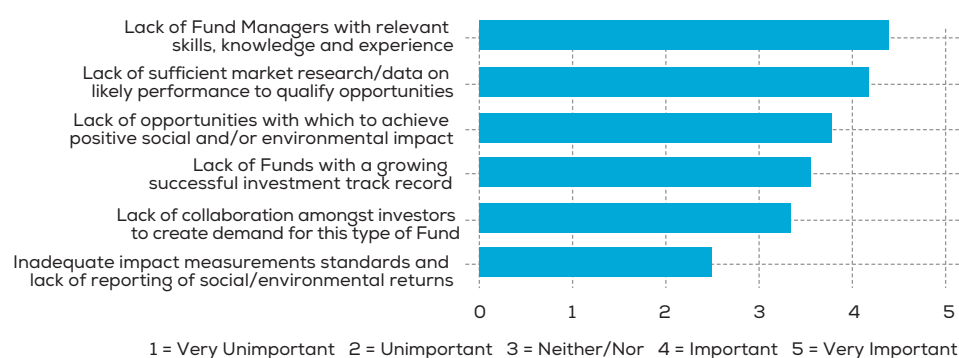


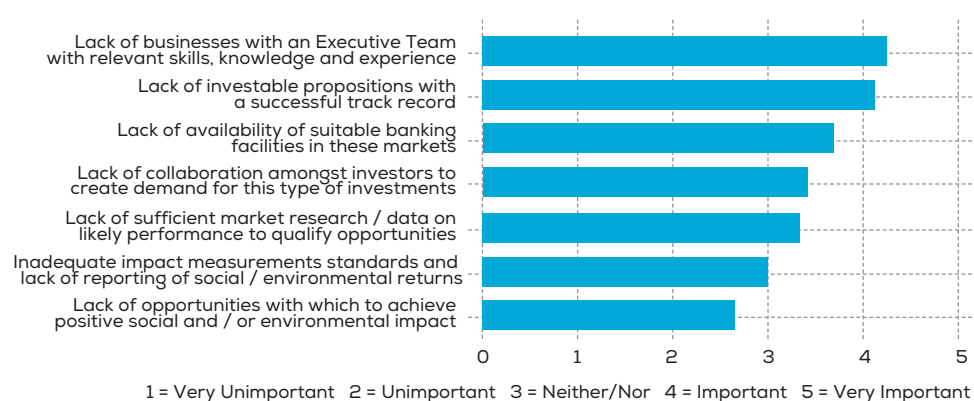
Figure 35: Key constraints to Asset Owner investment in Sub-Saharan Africa and South Asia⁶³ (n=15)



⁶² Respondents were asked 'What, in your opinion, are the current biggest contributors to risk for investing with impact in South Asia and Sub-Saharan Africa?' and asked to score each risk presented on a scale of 1 – 5.

⁶³ Respondents were asked: 'To what extent do the following factors constrain you from allocating more capital to commitments that offer a positive social and/or environmental return as well as a financial one in South Asia and Sub-Saharan Africa?' and asked to score each constraint presented on a scale from 1 – 5.

Figure 36: Key constraints to Fund Manager investment in Sub-Saharan Africa and South Asia⁶⁴ (n=30)



⁶⁴ Respondents were asked: 'To what extent do the following factors constrain you from allocating more capital to commitments that offer a positive social and/or environmental return as well as a financial one in South Asia and Sub-Saharan Africa?' and asked to score each constraint presented on a scale from 1 – 5.

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The Department for International Development (DFID) leads the UK's work to end extreme poverty. We're ending the need for aid by creating jobs, unlocking the potential of girls and women and helping to save lives when humanitarian emergencies hit.

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- Improving the lives of girls and women through better education and a greater choice on family planning.
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The Global Impact Investing Network (GIIN) is a non-profit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN addresses systemic barriers to effective impact investing by building critical infrastructure and developing activities, education, and research that attract more investment capital to poverty alleviation and environmental solutions.

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