Knowledge Exchange Series

The Impact Investing Institute's Knowledge Exchange Series is a series of roundtables providing a platform for mutual learning and practical knowledge sharing between mpact investing National Advisory Boards in different countries, to help strengthen impact investing markets globally.

Beyond allies: How DFIs and NABs can partner to move more capital for impact in local markets

This session of the Knowledge Exchange Series explored **how impact investing National Advisory Boards (NABs) and other market-building organisations can effectively partner with development finance institutions (DFIs)** to leverage sources of finance, expertise and solutions to support economic development and quality of life in their respective markets.

The session was moderated by **Laurie Spengler,** Lead Expert for International Development at the Impact Investing Institute. The session featured **Tenbite Ermias**, Managing Director and Head of Africa at CDC, the UK DFI; **Maria Glover**, Projects Lead at the Impact Investors Foundation (the Nigerian NAB); and **Jeroen Harteveld**, manager of the Dutch DFI's (FMO) MASSIF Fund and Member of the Netherlands NAB, alongside participants from global NABs and market-building organisations.

Key Insights

- **There is great scope for NABs and DFIs to co-create opportunities together and work innovatively**, in order to strengthen the pathways to crowd-in more private sector investment.
- **There are multiple ways in which NABs can add value for DFIs** to extend their understanding of and capacity in the market. These include market mapping, policy shaping and providing advisory support to businesses seeking to work with DFIs.
- A pressing challenge of the impact ecosystem that NABs and DFIs are well placed to jointly tackle is that of the **"missing middle"**. These are firms that are too large for microfinance and too small or risky for banks or private equity firms. Without focused segmentation and direct engagement, this missing middle will remain underserved – and partnerships between DFIs and NABs to support such firms can be highly impactful.
- As the investment mandate of DFIs is anchored in meeting the development needs of local markets, **NABs can help contextualize and specify these needs**, thereby increasing the alignment between DFI capital and local market needs.

Q&A

How can NABs and DFIs kickstart a market?

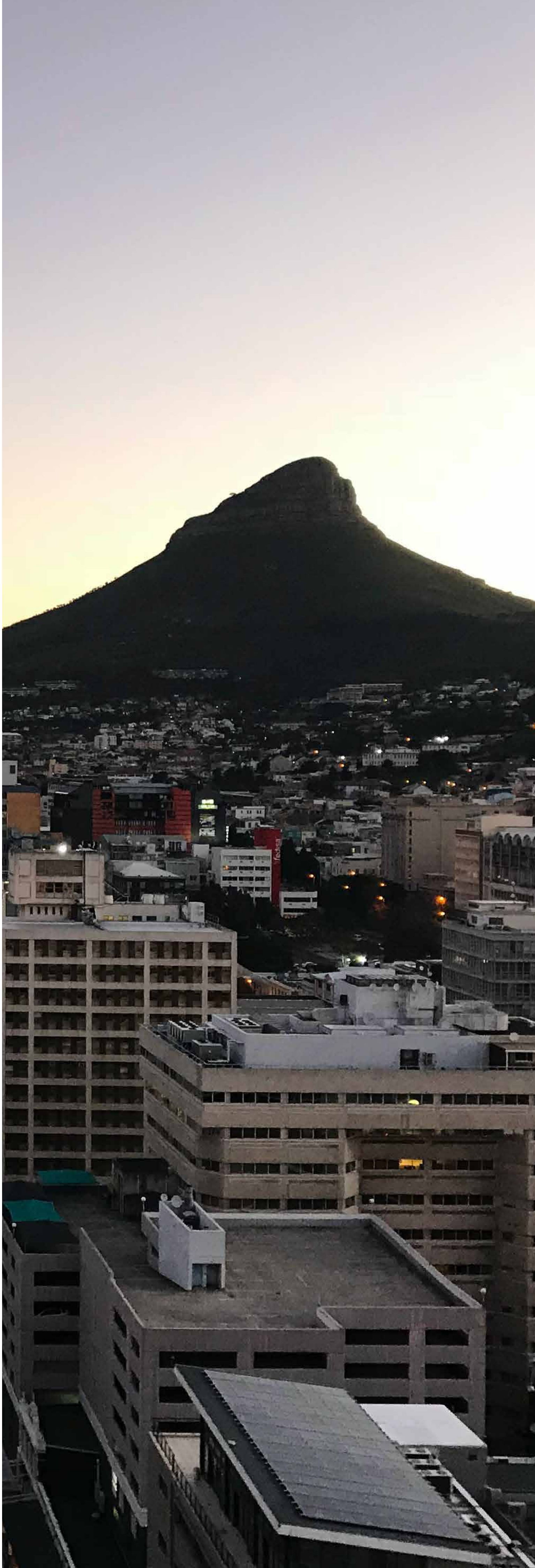
- **NABs can encourage the entrepreneurial ecosystem** to generate ideas and make propositions investable. By doing so, NABs can work as "accelerators" that transform growth-stage businesses into investment-ready propositions
- **DFIs can provide more impact-first capital** (currently a relatively small part of the impact investing landscape) – this will allow enterprises to crowd-in more total capital while offering the opportunity to deliver greater social impact.
- In order to fulfil the potential referenced above, **NABs require resources and DFIs need to move beyond their current risk appetites**. This is work-in-progress for NABs and DFIs that should be part of ongoing discussion, debate and effort.

How do we ensure that DFIs are not competing with each other?

- In addition to innovation around products and ticket sizes, DFIs can ensure that they do not compete for the same deals by **expanding the geographic diversity** of their investment activities, both domestically and internationally.
- It is true that ecosystem actors tend to coalesce in specific countries and major urban centres and that some DFIs face geographic constraints introduced by their shareholder. However, even with these constraints investment activity from DFIs tends to focus on certain locations within target countries (e.g. urban areas), certain sectors (e.g. financial services and infrastructure) and larger ticket sizes.
- **This cluster effect needs to be addressed** by demonstrating that there is opportunity beyond the 'clusters' and by continuing to build the investable market.

How can NABs work with DFIs to deepen impact?

- **NABs are well placed to break down silos** within the impact investing ecosystem in their country. NABs can also promote **greater visibility and engagement between actors**. In particular, NABs can frame discussion between and among actors to identify the people and places to whom insufficient capital is flowing.
- Through more explicit and focused engagement, the expectation should be to stimulate more creative and constructive collaboration between and among actors, including innovative transaction structuring, technical assistance resources being mobilised alongside investment capital and more efficient and scalable blended capital deals.
- NABs and DFIs should strengthen their market-level discussions by **sharing information** not only about the quantum of capital coming into a market but about the distribution of that capital along the full spectrum of opportunity and need in a given market.



Global Spotlights

CDC (UK)

CDC is the UK DFI with over 70 years of experience in emerging markets. CDC is one of the biggest private equity investors in Africa and South Asia, being a limited partner in nearly 90 private equity funds in Africa.

- **There are four ways for NABs to add value for DFIs** to help extend their capacity in the market and drive the demonstration effect for commercial investors to invest.

1. **Demand generation** - NABs can help DFIs identify businesses that they can invest in as NABs are familiar with their specific markets. This can be done in several ways including:
    - **Market maps** - The development and sharing of market maps helps DFIs identify businesses to invest in.
    - **Making introductions to businesses** – Where specific businesses are known to NABs, making introductions is a helpful tool for DFIs, bearing in mind DFIs' commercial and impact criteria.
    - **Helping businesses articulate their development story** – NABs can help businesses articulate their development story to DFIs that considers both their commercial and impact criteria.
2. **Advisory support to businesses** – The issue facing many small businesses in the Global South is often not a shortage of capital but being ready to access it. NABs can advise businesses to prepare their commercial case for investment and can explain to them the value-add that DFI financing and technical assistance can bring.
3. **Policy shaping** – NABs are well placed to aggregate information across a range of DFIs; they can make observations across the ecosystem and understand where bottlenecks exist for investment in a way that DFIs, which often operate at a higher level, cannot.
4. **Supply collaboration** – NABs can help DFIs mobilise pools of capital locally. NABs can connect DFIs to local pension funds or other pools of capital, helping them to deepen their understanding of local pools of money.

- In their effort to provide more **catalytic capital** to the Global South, CDC has developed a specific team to focus on investments with a lower commercial hurdle. The team identified a set of fund managers in the Global South who wanted to start private equity funds and advised them on their creation, working in collaboration with other DFIs. In addition, the team invested into smaller enterprises at an earlier stage of business development, the purpose being to crowd-in more private sector investment.

Impact Investors Foundation (Nigeria)

The Impact Investors Foundation (IIF) engages and collaborates with key stakeholders active in the impact investing space to unlock capital for social investments in Nigeria. Their overarching goal is to promote the growth and excellence of impact investing in Nigeria.

- **The impact investing market in Nigeria is dominated by DFIs**. Between 2015 and 2019, DFIs deployed 85% of the impact capital in the country, totalling over US$4 billion.
- **International DFIs are the largest supply-side actor**. They provide 53% of the funding, although the deployment of capital from local DFIs is increasing.
- **For international DFIs, there is a strong desire to seek out large transactions, which enable them to keep transaction costs manageable**. Even when DFIs are conducting indirect investment, they are often also requesting banks to lend with relatively large loan sizes.
- **This is not necessarily aligned with market needs**. The average ticket size that DFIs deploy is over $60 million, which does not meet the needs of many micro, small and medium enterprises (MSMEs). DFIs also have a strong preference for financing through debt.
- **The smaller transaction sizes of domestic DFIs and the private sector contrast strongly with the wider DFI sector**. The tickets sizes of local DFIs also have the advantage of being in naira, which reduces the currency exchange risks. The Bank of Industry and the Development Bank of Nigeria aim to serve MSMEs through the provision of smaller investment amounts. They deploy capital at levels lower than $1 million per deal (with an average deal size of $30,000). Having the right kind of financing for the estimated 41.5 million MSMEs in Nigeria will enable them to scale and develop the economy.
- **Private sector investment is not enough and stands at only $700 billion**. Given the large presence of international DFIs, there are extensive opportunities for investors to work more closely with them to unlock investments and crowd-in more commercially oriented capital. There is an opportunity to employ tailored incentives to direct different types of capital towards the places in the market where they will be most impactful.
- **There must be more dialogue between DFIs**. Too often, multiple DFIs are pursuing the same deals, at the expense of other opportunities that go missed. Similarly, local DFIs and domestic DFIs could work to share best practice in the effort to address the “missing middle”.

FMO (the Netherlands)

FMO is the Dutch Development Bank and is structured as a bilateral, private-sector, international finance institution. The Dutch Government is the largest stakeholder with 51% ownership and private banks owning the remainder. FMO has a focused strategy, supporting banks and private equity funds in over 80 countries around the world.

- **A clear part of FMO's mission statement is to collaborate with partners, other DFIs, impact investors and NABs**. FMO participated in the financial inclusion platform in the Netherlands (predecessor to the Netherlands NAB) to share knowledge and grow the impact investing market both domestically and abroad.
- **FMO was a co-founder for the Netherlands Advisory Board on Impact Investing, recognising the need to catalyse impact-driven stakeholders to achieve the SDGs**. The two key priorities that FMO identified are reducing inequalities and fighting climate change.
- **FMO's MASSIF fund is a fund that normally invests in fragile or post-conflict states**. The fund provides resources to MSMEs by supporting the local financial intermediaries that contribute to their development.
- **Three important action areas are necessary to support the missing middle**. These are firms that are too large for microfinance and too small or risky for banks or private equity firms.
    - **Knowledge** – It is critical for DFIs to work with academics and local actors on the ground. NABs and DFIs are allies and can support each other in the impact investing space.
    - **Network** – There is a great opportunity for NABs and DFIs to co-create opportunities together and work with Governments to drive change.
    - **Capital** - DFIs must think innovatively to help support MSMEs and develop the market capacity of the region. To support this effort, the MASSIF fund has specialised in smaller ticket sizes, guarantee schemes and collaborated with the European Commission.

Resources

CDC

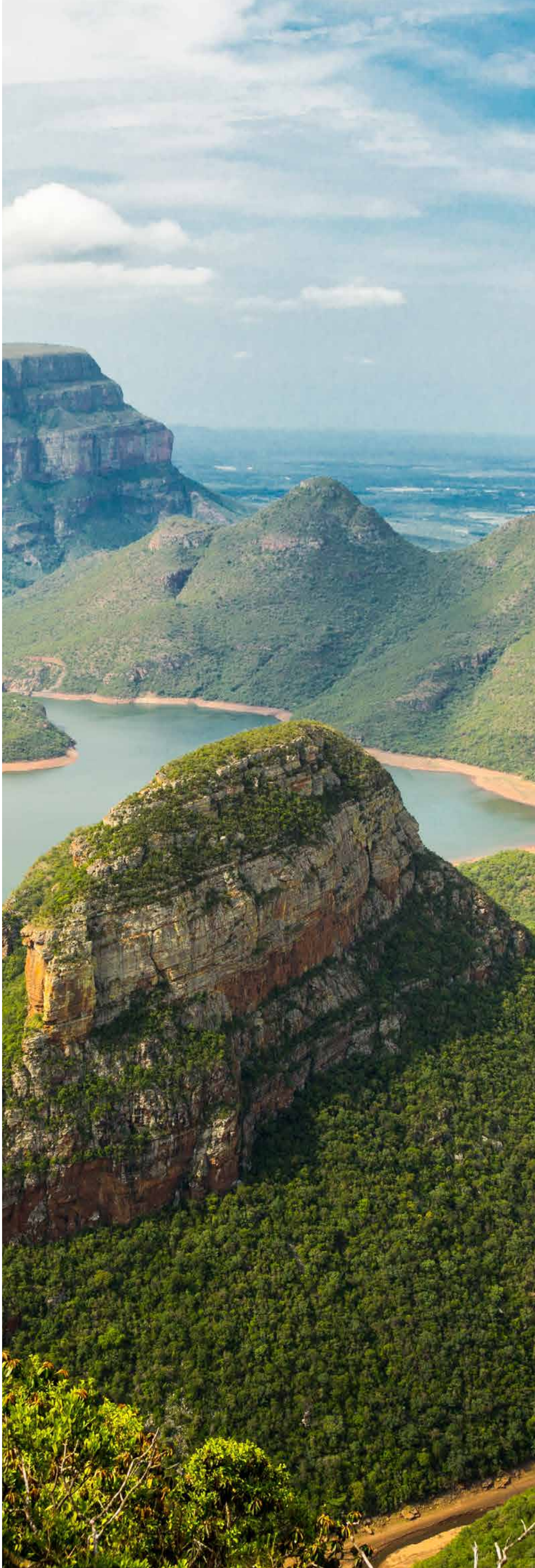
- CDC’s Homepage
- CDC’s Approach to Investing
- CDC’s Investment Solutions
- Types of Capital that CDC has Available

Impact Investors Foundations

- Nigeria and Ghana Impact Investing and Policy Landscape Analysis

FMO

- FMO’s Homepage



The Impact Investing Institute is an independent, non-profit organisation which aims to accelerate the growth and improve the effectiveness of the impact investing market. Our vision is for lives to improve, as more people choose to use their savings and investments to help solve social and environmental challenges, as well as seeking a financial return.

We drive change through education and awareness raising, providing useful tools and resources, and advocating for supportive policies.

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