

KENYA

TRADITIONAL LEADER,
REGIONAL POWERHOUSE



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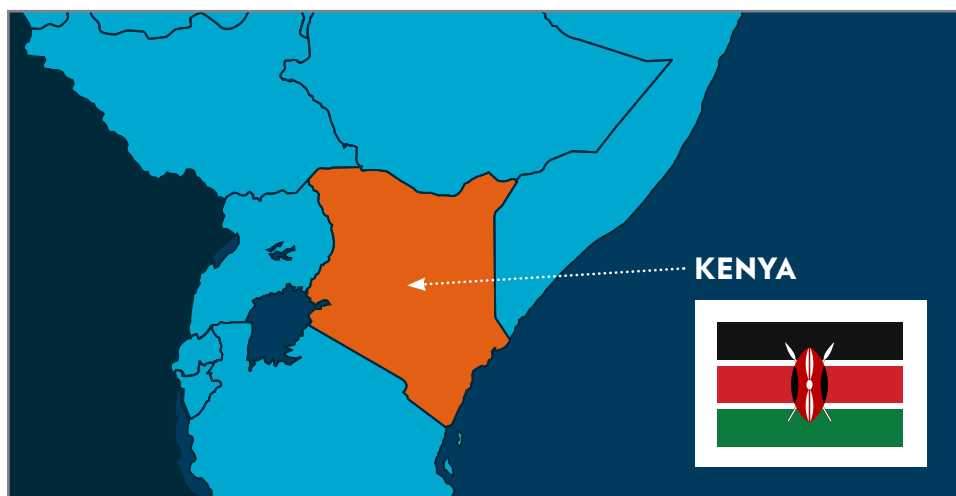
INTRODUCTION

Kenya and its capital city Nairobi are the center of East African impact investing. As the economic and financial capital of East Africa, Kenya boasts the largest concentration of impact investors and the most impact capital disbursed. Nairobi is often the first port of call for both impact and conventional investors operating in the region, even if they look for opportunities beyond Kenya. Indeed, when comparing the countries in the region, Kenya comes out on top for virtually every metric measured for impact investing in this study.

Beyond activities in impact investing, the Nairobi Stock Exchange launched the Growth Enterprise Market Segment (GEMS), specifically designed to provide a way to publicly list smaller companies. Though GEMS has seen limited uptake to date, the platform represents a broader market commitment to small and medium enterprise (SME) support.¹ The Kenyan banking sector has also been expanding their SME lending. This includes expanded product ranges with new structures like trade financing as well as extensive marketing and outreach efforts. While hurdles like high collateral requirements remain, small and medium enterprises (SMEs) increasingly gain access to financing through both impact and conventional sources.

The greatest threat to Kenya's central role in East African impact investing relates to ongoing concerns around the country's security and political stability. Kenya has suffered numerous terrorist attacks from the Somali terrorist group Al-Shabaab, the most visible of which was an attack the Westgate shopping mall attack in September 2013. In addition to these attacks, Kenya's overall political stability has been fragile since the dramatic post-election violence in 2007-2008. Nevertheless, concerns over the security and political situations appear to have subsided as of this writing in early 2015.²

FIGURE 1: MAP OF KENYA



- 1 Most of the non-DFI impact investors active in Kenya focus on early-stage businesses that have some track record and operational structures in place. For more detail on this early-stage focus, please see the East Africa regional chapter of this report.
- 2 Information for this report was gathered prior to the April 2015 attack at Garissa University College. The insights presented here do not reflect possible changes in the perception of stability following that event.

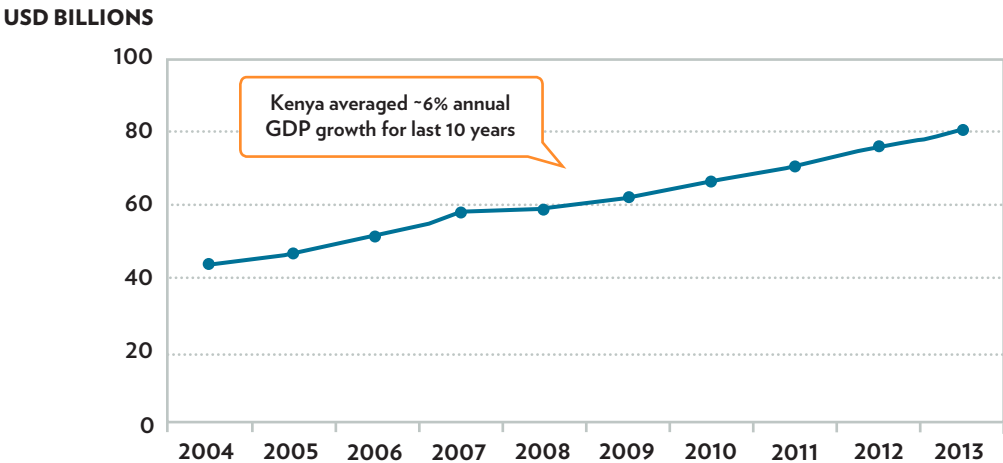
COUNTRY CONTEXT

With the exception of post-election violence in 2007-2008, Kenya is generally considered to be one of the strongest and most stable countries in the region. This is reflected across economic indicators, though the country still requires support to improve human development indicators and increase linkages between disadvantaged populations and the rapidly growing national economy.

Gross Domestic Product

Kenya has seen strong growth in recent years, averaging 6% GDP purchasing power parity (PPP) growth year-on-year for the last ten years (see Figure 2). GDP currently stands at approximately USD 87 billion in PPP terms, and USD 52 billion in current price terms, making it a strong regional player and the largest economy in the East African Community trading block, which includes Kenya, Uganda, Rwanda, Tanzania, and Burundi.³

FIGURE 2: GDP (PPP), 2004-2013



Source: IMF World Bank Economic Outlook, April 2014

Estimated GDP jumped 25% in September 2014, when Kenya re-based its GDP currency calculation by changing the base year from 2001 to 2009.⁴ The higher figure improved Kenya’s debt-to-GDP ratio, which may help the government borrow money at more favorable rates in international markets. However, re-basing increased Kenya’s GDP per capita to just over USD 1,200 and moved it from “low-income” country

3 Farai Gundan, “Kenya Joins Africa’s Top 10 Economies After Rebased of Its Gross Domestic Product (GDP),” *Forbes* (Oct. 1, 2014), available at <http://www.forbes.com/sites/faraigundan/2014/10/01/kenya-joins-africas-top-10-economies-after-rebased-of-its-gross-domestic-product>.

4 *Ibid.*

status to “middle income,” which could reduce access to low-interest foreign debt available through the World Bank and International Monetary Fund.⁵

Re-basing improved the 2013 GDP growth rate from an estimated 4.7% to 5.7%.⁶ Regardless of re-basing, Kenya has enjoyed strong GDP growth over the last decade, interrupted only in 2008/2009 in response to both the post-election violence and the global financial crisis.⁷ This follows inconsistent growth in the 1990s, with GDP growth ranging from negative figures to 4%.⁸

In addition, the industrial sector is expected to grow in the next few years in response to Kenya’s strong push to expand power generation, which is ongoing. The government has committed USD 1.8 billion to add 5,000 MW in power supply capacity by 2017, building on its 1,664 MW of current capacity in an attempt to reduce inconsistent supply and planned blackouts, which currently pose challenges for the manufacturing and processing industries.⁹

5 Farai Gundan, “Kenya Joins Africa’s Top 10 Economies After Rebasing of Its Gross Domestic Product (GDP),” *Forbes* (Oct. 1, 2014), available at <http://www.forbes.com/sites/faraigundan/2014/10/01/kenya-joins-africas-top-10-economies-after-rebasing-of-its-gross-domestic-product>; David Malingha, “Kenya Overtakes Ghana, Tunisia as Data Revision Boosts GDP,” *Bloomberg Business* (Sep. 30, 2014), available at <http://www.bloomberg.com/news/articles/2014-09-30/kenya-overtakes-ghana-tunisia-as-size-of-economy-climbs-by-25->.

6 *Ibid.*

7 World Economic Outlook: Gross Domestic Product, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>.

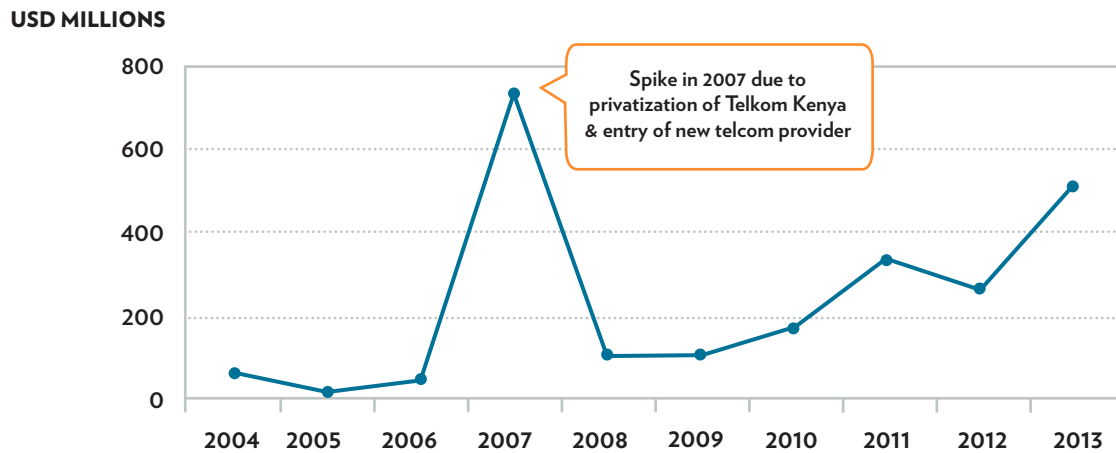
8 “Economy,” *Denmark in Kenya: Ministry of Foreign Affairs of Denmark*, available at <http://kenya.um.dk/en/about-kenya-new/economy-new/>.

9 George Obulutsa, “Kenya Power to Invest \$1.8 B in % 5 years to Expand Network,” *Reuters* (Oct. 11, 2013), available at <http://www.reuters.com/article/2013/10/11/kenya-power-idUSL6N011RQ20131011>.

Foreign Direct Investment (FDI)

Strong GDP growth has been accompanied by increasing FDI. In 2013, there were more than USD 500 million in FDI inflows (see Figure 3).¹⁰ Despite these robust absolute FDI inflows, a strong local economy means that Kenya has the second lowest FDI as a percentage of GDP of any country in the region.

FIGURE 3: FDI FLOWS, 2004-2013

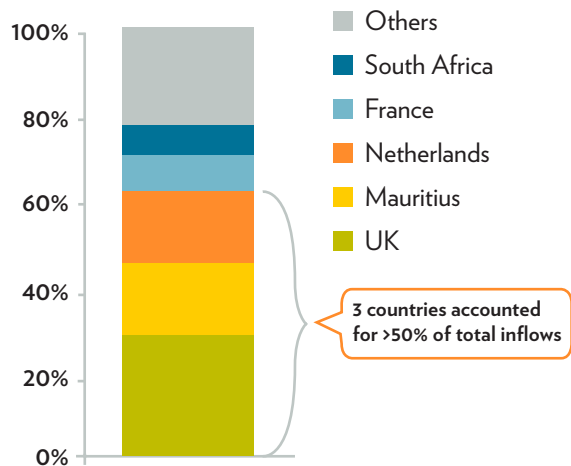


Source: UNCTAD

¹⁰ Inward and Outward Foreign Direct Investment Flows: Annual 1970-2013, *United Nations Conference on Trade and Development*, available at <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=88>.

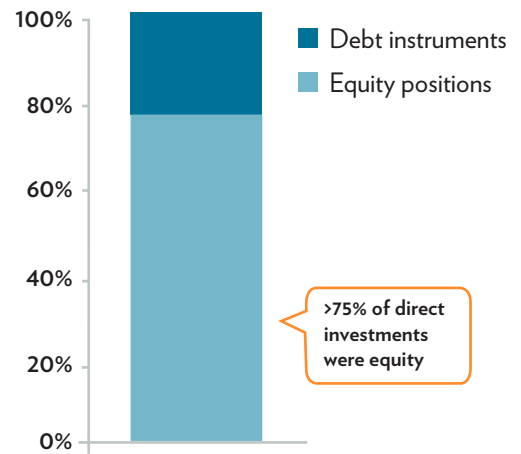
The single largest source of FDI remains the United Kingdom, of which Kenya was formerly a colony. Together with Mauritius and the Netherlands, these three countries originate more than 50% of all Kenyan FDI inflows, predominately through equity vehicles (see Figures 4 and 5).¹¹ Strong FDI inflows are also expected in the future, given recent oil discoveries near Lake Turkana and continuing plans to develop the Lamu corridor pipeline and port.

FIGURE 4: FDI INFLOWS, BY COUNTRY OF ORIGIN, 2012



Source: US Department of State

FIGURE 5: FDI INFLOWS, BY INSTRUMENT, 2012



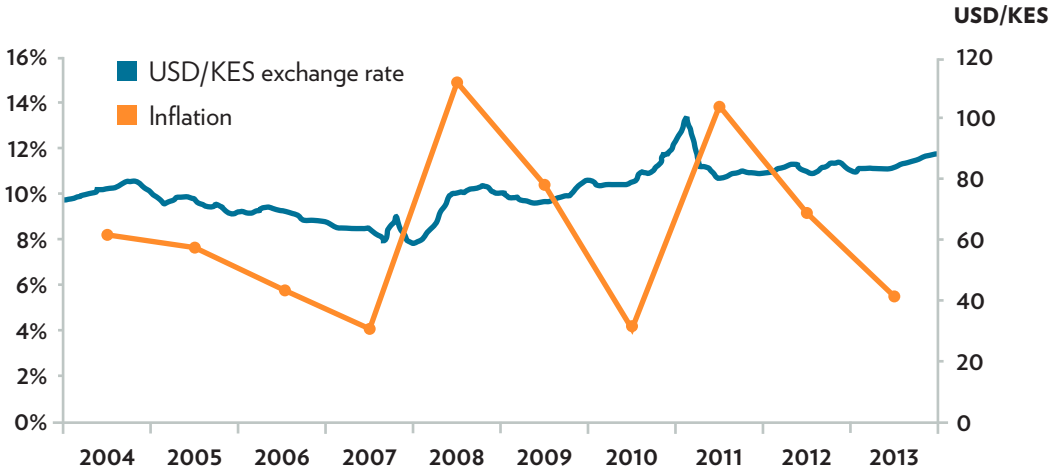
Source: US Department of State

11 After the UK, Mauritius and the Netherlands constitute the next two largest sources of FDI into Kenya. Despite these two countries' relatively small size, they represent a large source of FDI because many private equity and venture capital funds base themselves in these jurisdictions to benefit from favorable tax regimes.

Inflation and Exchange Rates

Kenyan inflation has been extremely volatile, fluctuating from around 4% to more than 15% (Figure 6). In addition, concerns about foreign exchange rates complicate impact investors’ ability to disburse local currency debt. The Kenyan Shilling has steadily depreciated against the US dollar since 2008, reaching approximately 90-to-1 in late 2014, reducing the hard currency value of any local currency debt that international investors disburse in Kenya.

FIGURE 6: INFLATION AND USD/KES EXCHANGE RATE, 2004 - 2013



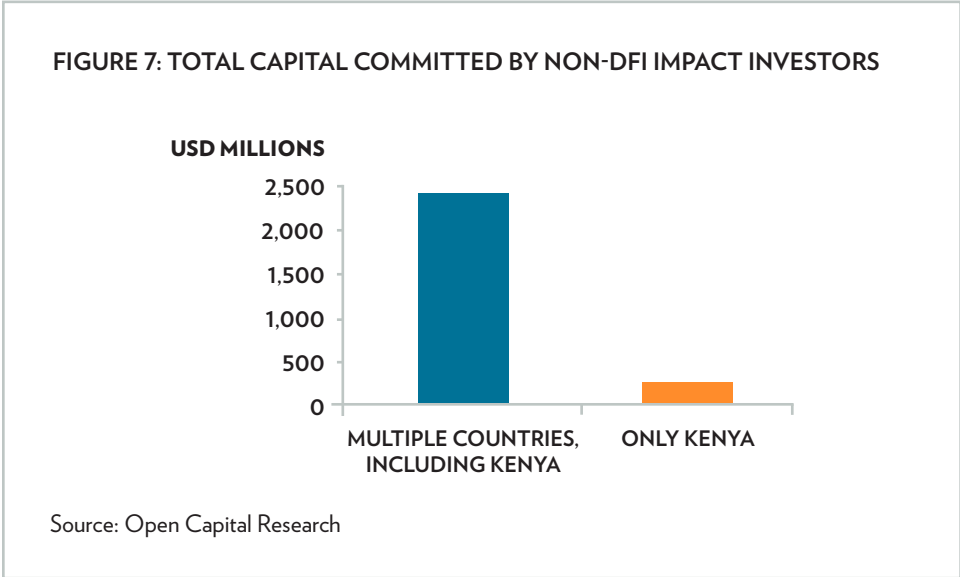
Source: World Bank Indicators

However, impact investors are most concerned by the sudden spike in foreign exchange rates in 2011, when the Kenyan Shilling depreciated sharply against the dollar and then rapidly returned to prior levels. In that year, the Kenyan Shilling was one of the most volatile currencies in the world. Multiple potential reasons for this volatility have been given, including policy changes made by the Central Bank of Kenya in 2010 and the increasing macro-economic imbalance of Kenya’s economy.¹² Regardless of the cause, such rapid swings expose investors to potentially sudden and significant foreign exchange losses, which in turn limit their ability and interest to lend in local currency. Please see the East Africa regional chapter for additional discussion of local currency dynamics.

12 Wolfgang Fengler, “Why has the Kenyan Shilling declined so sharply?” *The World Bank Group* (Oct. 17, 2011), available at <http://blogs.worldbank.org/africacan/why-has-the-kenyan-shilling-declined-so-sharply>; AfDB, OECD, UNDP, UNECA, Kenya (2012), available at <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/PDF/Kenya%20Full%20PDF%20Country%20Note.pdf>.

SUPPLY OF IMPACT INVESTING CAPITAL

Excluding DFIs,¹³ at least 136 impact capital vehicles are active in Kenya, managed by some 95 impact investors. Most non-DFI impact investors in Kenya work in multiple countries, but at least USD 240 million has been committed specifically to investments in Kenya (Figure 7). Beyond these dedicated funds, there is nearly USD 2.5 billion in capital committed regionally that could be deployed in Kenya and, following historical deal flow, is more likely to be deployed in Kenya than in any other country.

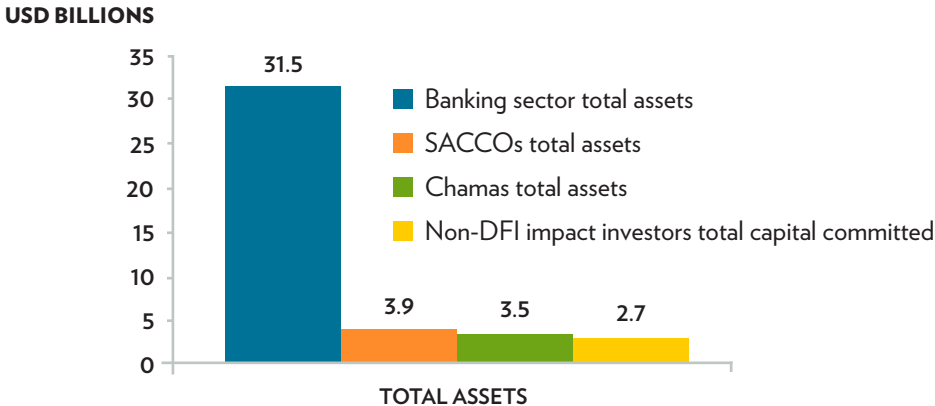


¹³ Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

Broader Investing Landscape

Despite the volume of impact investing activity in Kenya, it represents a small part of the overall investment picture. For example, banks, SACCOs,¹⁴ and chamas¹⁵ together have almost USD 39 billion in total assets under management and there are other sources of capital, such as commercial private equity funds, hedge funds, and others, that even further increase assets under management (Figure 8). Banks had more than USD 17 billion in loans outstanding in 2013 alone, which is almost 27 times the disbursements made by non-DFI impact investors and more than 4 times more than disbursements made by all impact investors over the same period.¹⁶

FIGURE 8: IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: Central Bank of Kenya, SACCO Societies Regulatory Authority, Kenya Association of Investment Groups, Open Capital Research

Impact investing fills an important gap in the market for early-stage financing, even though it only represents a small portion of total investment activity to date. Though more willing to lend than banks in much of the region, Kenyan banks remain risk averse and are usually unwilling to invest in start-up or early-stage enterprises. When willing to lend, banks typically require extremely high collateral ratios, occasionally higher than 100% of the loan amount. Many early stage businesses are unable to satisfy these requirements. Kenyan banks are improving access, offering creative structures like trade financing or crop cycle-based repayments, but there still remains a large gap in the market for early-stage investments that may be higher risk. Even if a business can post required collateral, Kenyan bank interest rates are high and have steadily increased over the past decade, rising from 12.5% in 2004 to 17.3% in 2013.

14 SACCOs are cooperative savings groups that typically take deposits and offer loans. SACCOs are formally recognized institutions and are subject to government regulation.

15 Chamas are informal lending associations set up voluntarily. Though similar in function to SACCOs, they are not legally recognized. Nevertheless, chamas are extremely common and most Kenyans belong to at least one chama.

16 Central Bank of Kenya, *Bank Supervision Annual Report (2013)*, available at <https://www.centralbank.go.ke/images/docs/Bank%20Supervision%20Reports/Annual%20Reports/2013BSD.pdf>; Open Capital interviews.

Indeed, in 2012 interest rates spiked to nearly 20%, more than four times higher than the average bank interest rate in the United States over the last ten years, which stood at over 4%.¹⁷

These high interest rates limit the practical availability of bank financing. For example, despite strong demand for new housing, there are less than 14,000 mortgages in Kenya,¹⁸ due in part to the high cost of debt. This limited availability for conventional financing structures provides a market opportunity for private investors who are able to provide equity capital, cheaper debt options, or who require less collateral for lending to both consumers and companies.

Impact investors fill an important role to identify innovative solutions that address difficult sectors and circumstances that conventional investors may overlook or dismiss, providing needed capital to businesses that would otherwise struggle to access finance. By contrast, most local banks, chamas, SACCOs, and conventional sources do not have an impact focus and therefore do not look to invest in social enterprises. Chamas, for example, are an excellent source of local capital, but tend to focus on financial returns, investing in real estate, deposits, and treasury bonds, rather than the innovative new businesses that impact investors often seek.

Impact Capital Disbursed

Kenya’s pre-eminent position in East African impact investing is illustrated in the numbers. Most tellingly, almost half of all impact capital disbursed in East Africa has been placed in Kenya—this represents more than USD 650 million of non-DFI capital and more than USD 3.6 billion of DFI capital (Figure 9). This is more than double the amount deployed in the next most active country in East Africa (Uganda) for non-DFI investments.

FIGURE 9: IMPACT INVESTMENTS IN KENYA

	Capital disbursed	Deals made
DFI	USD 3.6 Billion	136
NON-DFI	USD 650 Million	221

Source: Open Capital Research

17 World Development Indicators: Lending Interest Rates (%), *The World Bank Group* (2014), available at <http://data.worldbank.org/indicator/FR.INR.LEND?page=2>.

18 Simon Walley, The World Bank, *Developing Kenya’s Mortgage Market* (2011), available at http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/Kenya_Expanding_Mortgage_Finance_May_2011.pdf.

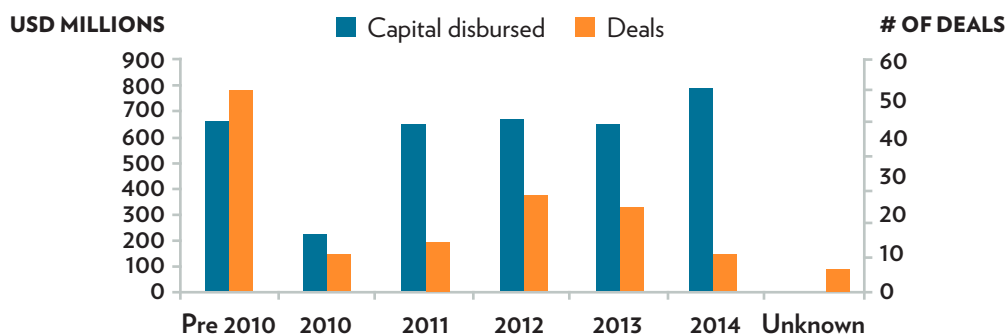
In addition, Kenya boasts the largest number of non-DFI impact capital vehicles (136) and the most non-DFI impact capital committed, with over USD 240 million committed specifically to Kenya and a further USD 2.5 billion committed to multiple countries, including Kenya. These figures are similar to most East African countries, as most impact capital vehicles have a wide geographic focus spanning multiple countries in East Africa and often Sub-Saharan Africa. However, despite the fact that about 90% of the capital committed to Kenya could be deployed elsewhere, Kenya is more likely to receive regionally committed capital if the pattern of historical deal flow continues.

Investments over Time

Impact investing remains a relatively young sector. Non-DFI impact investors have been present and investing in Kenya for more than a decade, but the limited data available with specific dates for non-DFI impact investments prevents more definitive conclusions. Nevertheless, non-DFI impact investors almost universally report that impact investing activity began to pick up after 2008. Given this timeline, many non-DFI impact portfolios in Kenya are beginning to seek exits from their earlier investments. There are still few examples of successful exits and it will be interesting to see what exit examples emerge over the next 5-10 years.

The industry's youth is also reflected through DFI direct investments, which have grown over the last four years, especially since 2010 (Figure 10). In addition to an increasing number of deals, the average deal size has also increased, driven in part by large energy projects such as the Lake Turkana Wind project and larger disbursements into commercial banks. The slight decline in deals for 2014 in Figure 11 is likely the product of incomplete data reporting at the time of data collection in late 2014, as many investors attempt to close final deals before the end of the year.

FIGURE 10: DFI DIRECT INVESTMENTS BY YEAR

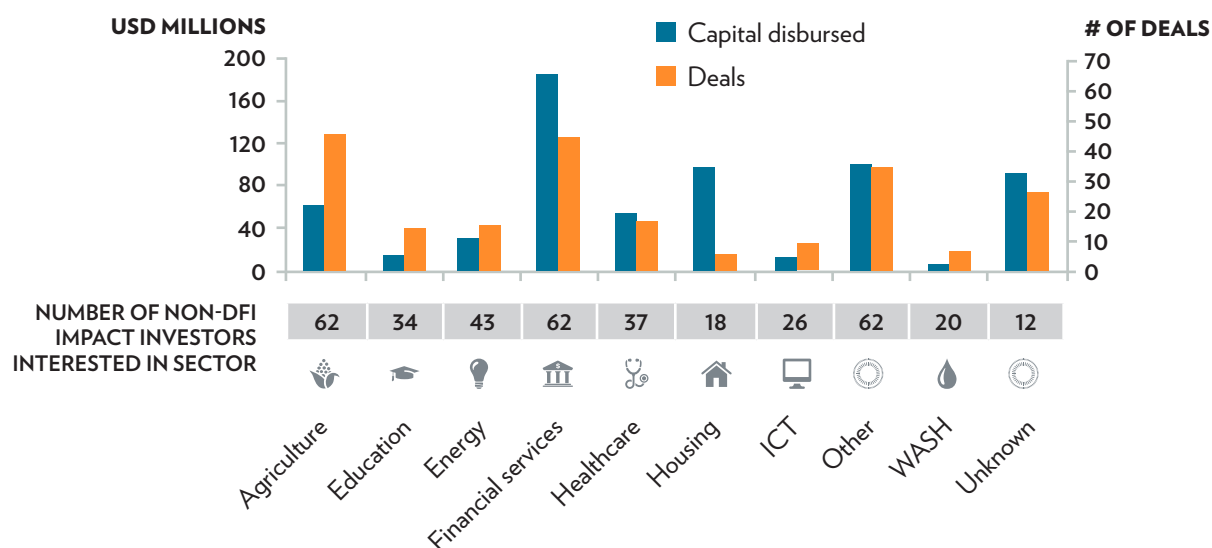


Source: Open Capital Research

Sector

The distribution of investments by sector broadly reflects impact investor interest areas (Figure 11). Most non-DFI impact investors have expressed interest in agriculture and financial services as target sectors, while these two sectors have also received the most deals (more than 40% of all deals in Kenya). Despite a slightly larger number of deals in agriculture, the large investment sizes possible when placing capital into established banks and MFIs drives a larger total amount of capital to financial services. Similarly, housing projects tend to have larger average deal sizes than other sectors as these projects must often internally finance mortgages for low-income customers in addition to funding typically large construction costs.

FIGURE 11: NON-DFI IMPACT INVESTMENTS BY SECTOR

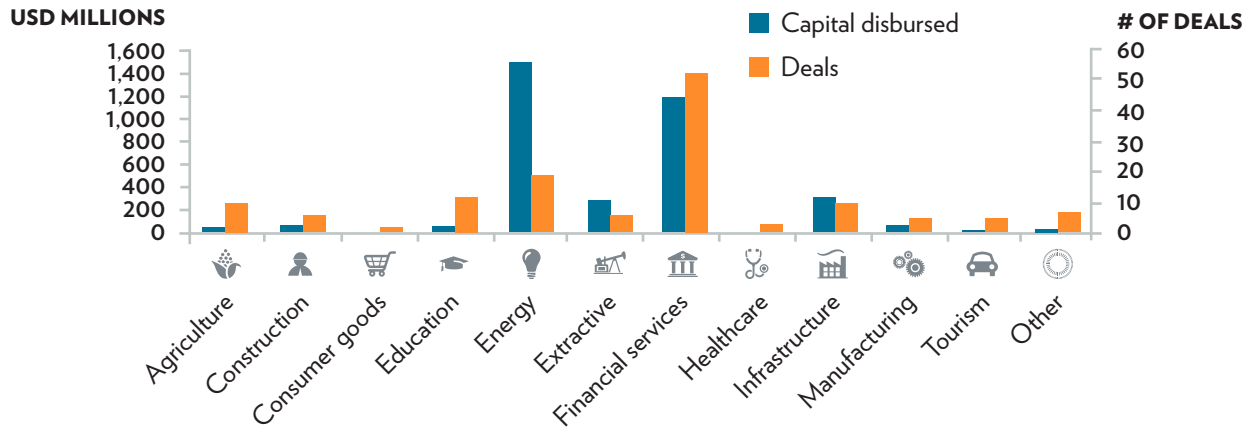


Source: Open Capital Research

Despite their prominence as interest sectors for non-DFI impact investors, education and energy have seen significantly fewer deals. The disconnect between interest in these sectors and the number of deals implies that impact investors see fewer viable, investible opportunities and have difficulty placing capital.

By contrast, DFIs overwhelmingly favor direct investments in financial services (more than 38% of all investments) and energy (roughly 14% of all investments). These two sectors have received more than 70% of the total capital disbursed directly by DFIs, driven by large energy projects such as a dams and wind farms as well as significant investments in local commercial banks (Figure 12).

FIGURE 12: DFI DIRECT INVESTMENTS BY SECTOR

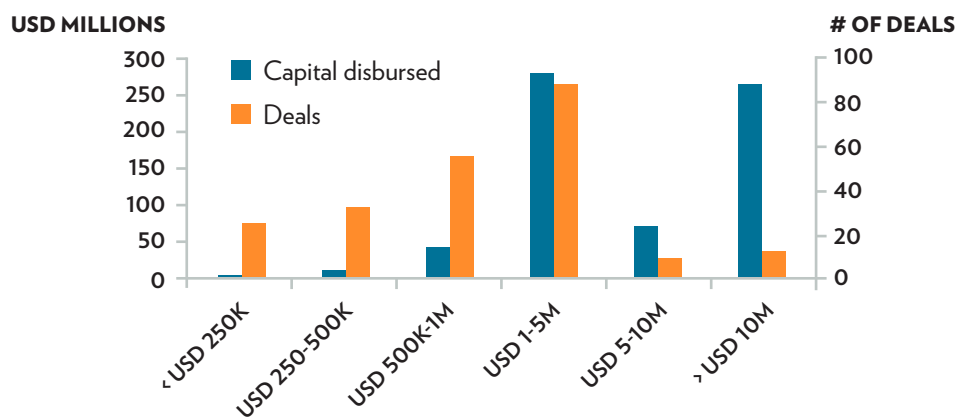


Source: Open Capital Research

Deal Size

Examining the size of deals disbursed reveals that almost two-thirds of non-DFI impact investments in Kenya are between USD 500,000 and USD 5 million, with the average deal size at just over USD 3 million (Figure 13). Around 11% of deals are below USD 250,000, though interviews suggest that many of these transactions anticipate placing larger amounts of capital through later tranches. In particular, non-DFI impact investors tend to look for businesses that are young but have at least some key operational structures and track record in place.

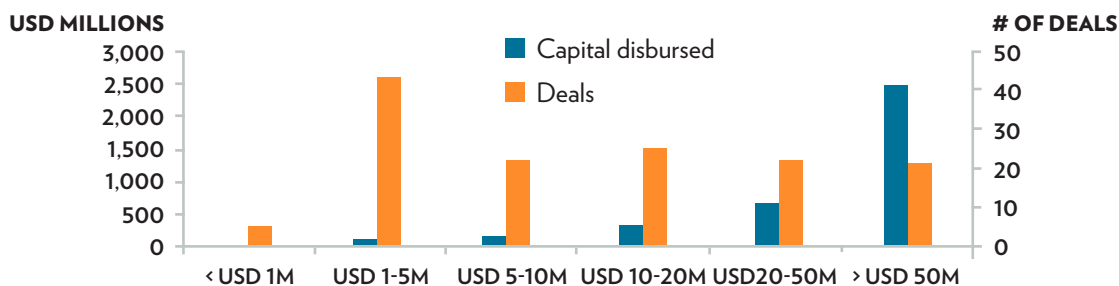
FIGURE 13: NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

By contrast, DFI direct investments are typically significantly larger. The overall average deal size for DFI direct investments stands at more than USD 26 million, nearly nine times the average size of non-DFI impact investor deals (Figure 14). This large ticket size is driven primarily by large investments in energy projects as well several large placements in commercial banks. Moreover, though deals under USD 10 million constitute roughly 50% of the total direct DFI investments, just 3% of direct DFI deals were under USD 1 million, compared to more than 50% of deals made by non-DFI impact investors.

FIGURE 14: DFI DIRECT INVESTMENTS BY DEAL SIZE



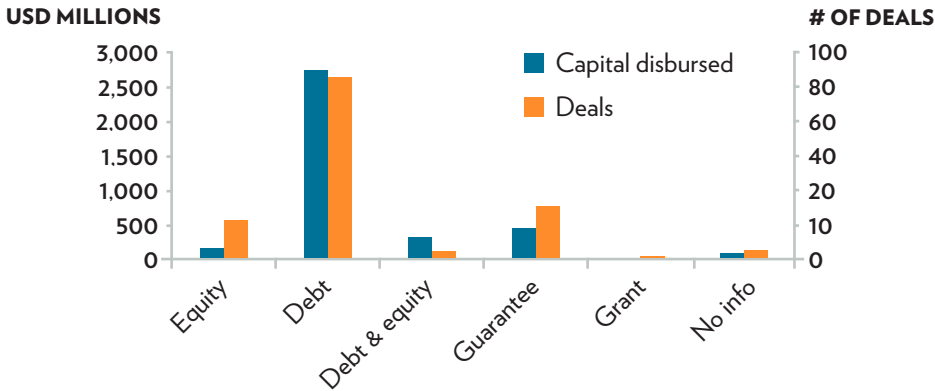
Source: Open Capital Research

Instrument

Due to lack of available data at the time of writing, this report is unable to provide a definitive break-down of non-DFI direct investments by instrument in Kenya. However, investors interviewed report that in recent years they have begun to adopt more creative investment instruments beyond the traditional debt and equity used in most of the known deals. In Kenya, more than anywhere else in East Africa, non-DFI impact investors report increasingly using quasi-equity structures such as convertible debt or revenue-participating debt. Reflecting their focus on earlier stage investments, these structures help balance investor risk and return expectations with the typically limited cash flows common to early-stage companies.

Though creative structures have become increasingly common among non-DFI impact investors, DFI direct investments have been overwhelmingly in the form of debt, with some additional equity deals (Figure 15). Debt investments constitute nearly 75% of all capital disbursed by DFI direct investments and more than 60% of all direct DFI deals. Together, debt and equity investments account for more than 75% of all direct DFI deals and more than 85% of capital disbursed through DFI direct investments.

FIGURE 15: DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

Local Presence

In addition to the intensity of investing activity in Kenya itself, impact investors increasingly place local staff in Kenya as a gateway to reach the entire region; there are now five impact investors that have chosen to headquarter their operations in Nairobi and 43 more have local offices (see Figure 16). In addition to the staff on the ground, Nairobi is the most common destination when impact investors based abroad visit the region.

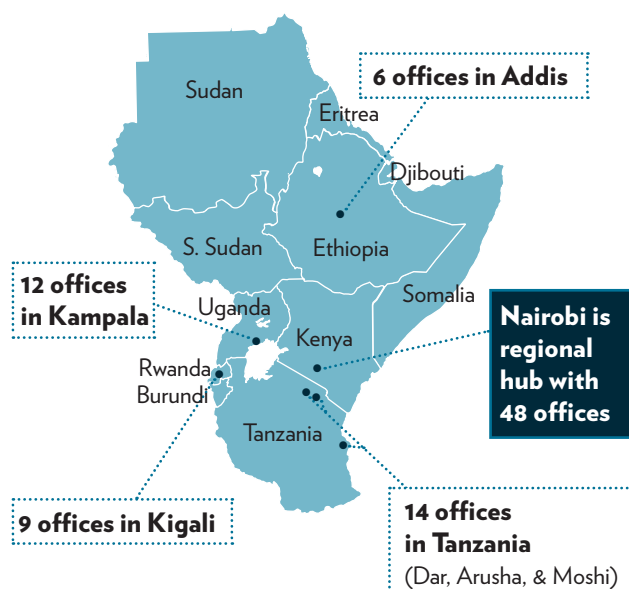
This concentration of impact investor presence does not extend beyond the capital. However, an increasing number of impact investors are actively looking for deals in Kenya's rapidly growing second-tier cities, as well as in the other countries in the region (particularly Uganda and Tanzania). Nairobi is so central to the impact investing industry in East Africa that some impact investors have begun to voice concerns that the Nairobi market may be saturated. In fact, some impact investors have deliberately based their staff outside of Kenya to avoid the perceived saturated market.¹⁹ This proposition is contested, however, as some impact investors argue that creative, locally-connected investors are able to source high-quality deals without competition.

Beyond pipeline development, impact investors see significant value in strong local networks as they evaluate opportunities. Investing in this market, with limited legal recourse, requires implicit trust between the impact investor and the entrepreneur. Particularly if an enterprise has been operating informally, it can be difficult to evaluate its history. As such, being embedded in local social networks that can evaluate the trustworthiness of the entrepreneur is extremely important. Deep social and professional networks that extend beyond the impact investing sector will be difficult to develop without long-term local presence.

Impact Tracking Standards

Impact investors' dual mandate to realize both financial and social/environmental returns requires a strong focus on measuring impact as part of their core activities. As in the rest of East Africa, most impact investors in Kenya create tailored metrics for each portfolio company to accurately capture individual impact and reduce administrative burdens. For more detail on impact measurement in East Africa, see the East Africa regional chapter of this report.

FIGURE 16: IMPACT INVESTORS WITH LOCAL OFFICES



Source: Open Capital Research

¹⁹ See, e.g., Mango Fund and HRSV.

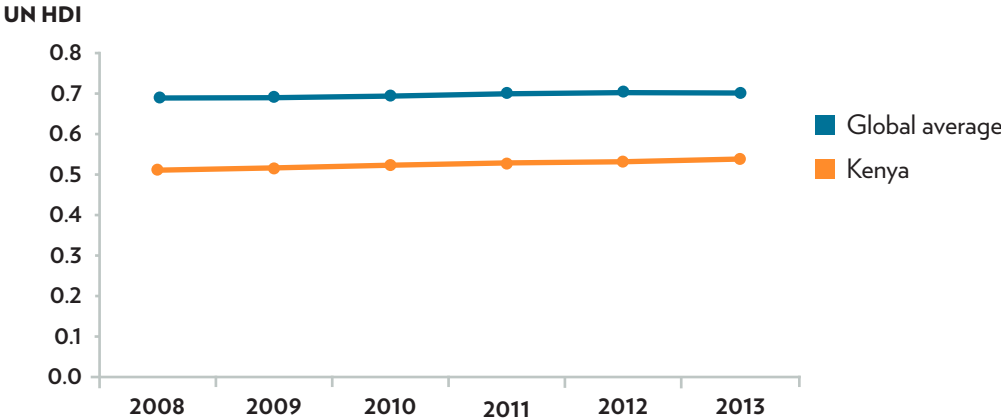
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital from entrepreneurs operating in Kenya. Despite Kenya’s progress and relative development compared to other countries in the region, significant gaps remain in the provision of key goods and services, creating opportunities for entrepreneurs to build enterprises that fill these needs while also realizing financial returns.

Development Context

Despite robust economic growth and official recognition as a middle-income country in 2014, Kenya remains well below global averages for human development indicators (HDI) as defined by the United Nations (see Figure 17). Overall, Kenya ranks 147th out of 187 countries according to the UN HDI Index, which is a composite statistic of a number of metrics, including health, education, and income indices.²⁰

FIGURE 17: UN HDI SCORES, 2008-2013



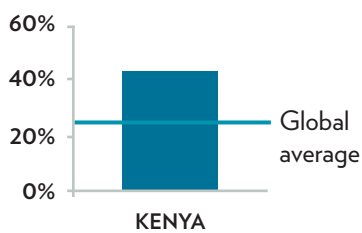
Source: United Nations Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

20 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

This low ranking is driven by Kenya's performance in key developmental indicators. For example, more than 43% of Kenyans live on less than USD 1.25 per day, well above the global average of roughly 25% (Figure 18). Similarly, more than 45% of Kenyans live below the Kenyan national poverty line, compared with roughly 35% on average globally. Notably, however, less than 16% of Kenyans live in extreme poverty as compared with 18% globally.²¹

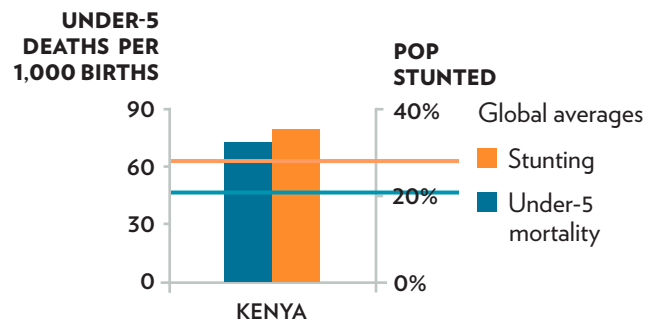
Kenya also considerably underperforms global averages on key health metrics. Kenya's indicator for under-five mortality is more than 50% higher than the global average, reflecting unequal access to healthcare between wealthy and low-income populations. Under-five stunting, an effective proxy for childhood health and long-term prosperity, is roughly 30% higher than global averages (Figure 19).²²

FIGURE 18: POPULATION BELOW USD 1.25 / DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

FIGURE 19: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



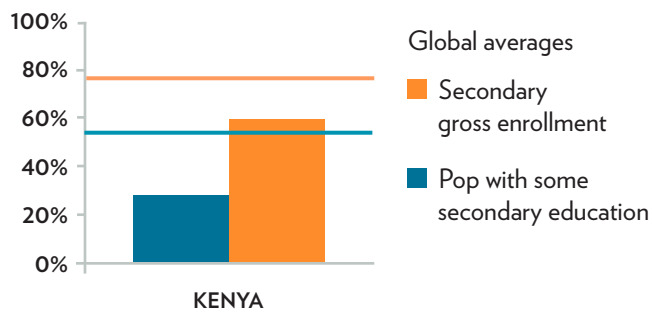
Source: UN Human Development Report 2014

21 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

22 *Ibid.*

On both health and poverty metrics, Kenya broadly resembles the rest of East Africa, though tends to be higher than regional averages. However, on some educational metrics, Kenya significantly outperforms the region, though it still remains well below global norms. For example, nearly 30% of Kenyans age 25 and above have at least some secondary education, which is nearly twice the East African average but only half the global average. Approximately 60% of appropriately aged Kenyans are currently enrolled in secondary education, which is also nearly twice the East African average but less than the global average of 74% (Figure 20). However, Kenya remains close to East African averages along other educational metrics, such as literacy rates and gross enrollment in tertiary education.²³

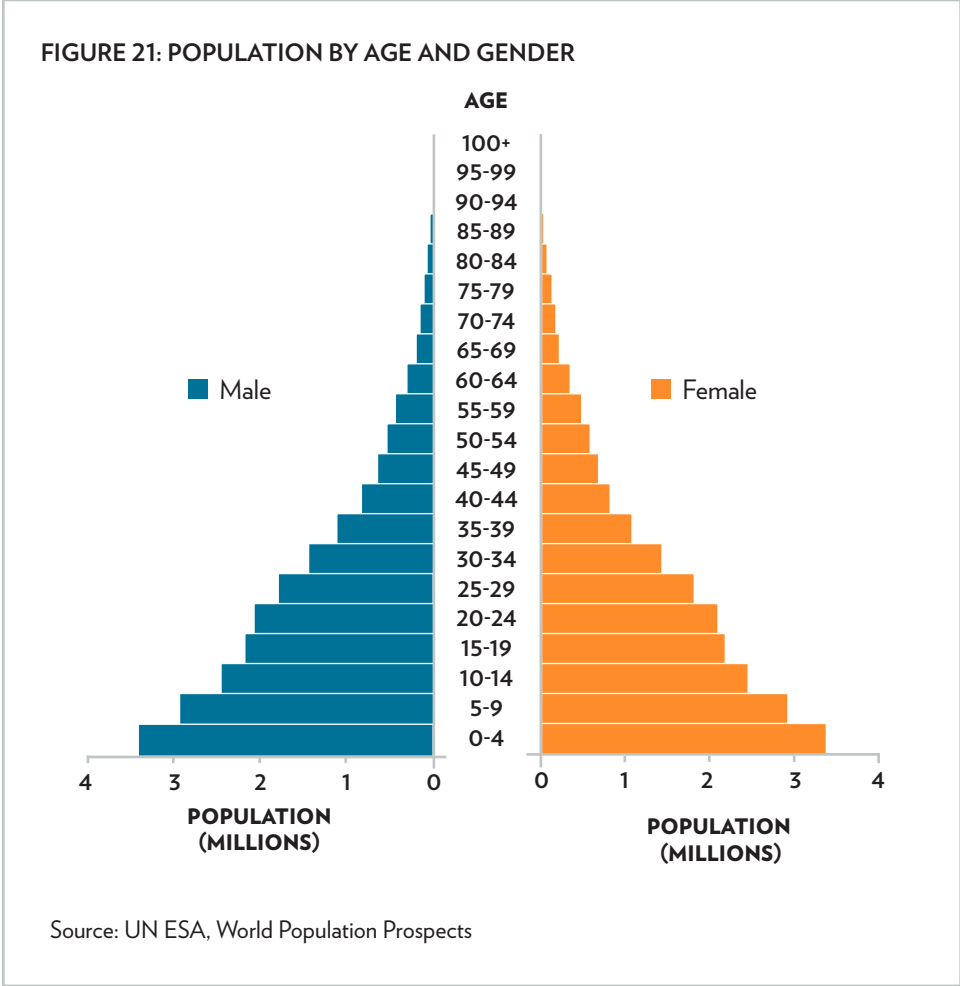
FIGURE 20: KEY EDUCATION INDICATORS (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

²³ 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

Educational metrics are a particularly important barometer for future progress because of Kenya’s demographics. Like other East African countries, Kenya has a disproportionately young population, where almost 45% is under the age of 15 and more than 60% is under age 25 (Figure 21).²⁴ This has led to high youth unemployment, but higher levels of education make it more likely that the youth boom will translate to positive economic growth as these youth enter new employment opportunities and begin to create entrepreneurial activity.



²⁴ “The World Factbook: Kenya,” *Central Intelligence Agency* (Jun. 20, 2014), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/ke.html>.

Entrepreneurs

Kenyans are generally strongly entrepreneurial, and both entrepreneurs and impact investors see opportunities for new businesses across sectors including education, housing, healthcare, water and sanitation, energy, etc. Correspondingly, social enterprises seek capital across the spectrum of funding from start-up and SME-size deals to capital for scaling up, though they are primarily start-up and early-stage businesses. This matches the focus for many non-DFI impact investors, who primarily target earlier-stage businesses, and also aligns with the local landscape. As with the rest of East Africa, there are few mature social enterprises.

However, despite Kenya's relatively developed business environment compared to the rest of East Africa, entrepreneurs still face substantial challenges, including difficulty accessing capital to test their ideas in the market, limited management capacity, informal operations, a lack of realistic forward-looking projections, and limited detail describing ways they would use capital raised. For more detail about the challenges facing early-stage entrepreneurs, see the East Africa regional chapter of this report.

Though these challenges are less common in growth-stage companies, high-potential, rapidly scaling companies are rare even in Kenya. Those who have reached this stage are generally well known. When these businesses seek capital from impact investors, they are generally highly desirable investments and generate competition among impact investors and/or a large number of co-investors.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

Kenya is home to almost 50% more intermediaries, service providers, and other ecosystem players than any other East African country. The broader business environment is becoming more supportive and sophisticated, providing more options to partner with suppliers, distributors, and other commercial entities. It is expected that Kenya's strong growth will continue as it garners more attention and support.

Regulatory Environment

Overall, Kenya has a welcoming regulatory climate with few distinctions between foreign and local investors. According to the World Bank's Ease of Doing Business rankings, it is one of the easier places to do business in East Africa, ranking 4th of the 11 countries in the region, and 12th in Sub-Saharan Africa overall.²⁵

The primary regulatory risk in the near future is Kenya's ongoing devolution process, designed to provide increasing autonomy to local county governments. The new 2010 Kenyan Constitution devolved significant powers from the central government to 47 newly created county governments. The exact division of responsibilities between the national government and the counties is still unclear and is only outlined in broad strokes in the constitution, leading to uncertainty about which level of government to approach for regulation. Devolution has also expanded the number of organizations with regulatory power, opening the door to inconsistent regulations and enforcement in different counties and correspondingly complex compliance requirements.

Despite this, the overall regulatory climate in Kenya supports foreign investment across a number of dimensions:

- **Repatriation of profits and dividends:** Kenyan law actively protects foreign investor exits, guaranteeing capital repatriation and remittance of both dividends and interest. Foreign investors can convert and repatriate profits without difficulty, including un-capitalized retained earnings. The only salient difference between local and foreign investors in this regard is that the withholding tax on dividends distributed to residents and East African Community citizens is 5% compared to 10% for foreign nationals.
- **Foreign exchange controls:** Kenya has open foreign exchange rules. Foreign exchange is freely available from commercial banks and can be acquired at similar rates by locals and foreign nationals. Exchange across East Africa still poses a significant risk, as hedging tertiary global currencies can be prohibitively expensive, especially for smaller transactions. Since 2011, when the Kenyan Shilling lost and recovered more than 25% in the course of a year, Kenya has successfully managed

²⁵ "Economy Rankings," *The World Bank Group* (Jun. 2014), available at <http://www.doingbusiness.org/rankings>.

foreign exchange risk, with the Kenyan Shilling depreciating less than 4% on an annual basis using a free-floating exchange.²⁶

- **Leasehold structure for foreign land ownership:** The most prominent regulatory restriction in Kenya is on foreign ownership of land, particularly agricultural land. Land is a charged issue in Kenya and the basis for considerable ongoing political dispute. Land use, management, and ownership were among the key issues that led to the new constitution in 2010. The new constitution mandated that non-citizens can only hold land in 99-year leases directly from the government and automatically converted all previous foreign ownership interests to leases. These leases have no rent, but the leasehold structure permits the government to reclaim the land later if desired.
- **Agricultural land:** Agricultural land is defined as land that is outside the municipality jurisdiction and which has not been approved for another purpose.²⁷ All transactions involving agricultural land must be approved by the Land Control Board, which will not approve transactions to non-citizens. To circumvent this sweeping restriction, some non-citizens have formed companies owned entirely by Kenyan citizens while retaining control by appointing non-citizen directors and requiring the shareholders to sign agreements giving the non-citizens control of the shares, if not legal ownership. This allows the formal requirements of the law to be met while enabling non-citizens the use and control of agricultural lands.²⁸
- **Local ownership requirements:** By and large, Kenya does not restrict foreign investors from owning shares in a company except in a few specific industries. These industries include insurance (wherein foreign ownership is capped at 66.7%), telecommunications (80%), mining (65%), shipping (49%), fisheries (49%), and publicly listed companies (75%).²⁹ In addition, foreign brokerage companies and fund management firms are only allowed to participate in the local capital market through locally registered companies, which must have Kenyan ownership of 30% and 51% respectively.³⁰ This regulation pertains specifically to public markets, and does not apply to private placements common for impact investors. Similarly, there are no prohibitions on the acquisition of Kenyan firms by foreign-owned firms or on joint venture arrangements between Kenyans and foreigners.

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

27 “Foreign Ownership of Shares and Land Protection of Foreign Investors,” *International Law Office* (Mar. 12, 2007), available at <http://www.internationallawoffice.com/newsletters/detail.aspx?g=7bb56275-1bcb-db11-adf6-001143e35d55>.

28 James Makau, “Foreigners Form Dummy Firms to Keep Kenyan Land,” *Business Daily* (Aug. 4, 2010), available at <http://www.businessdailyafrica.com/Corporate-News/Foreigners-form-dummy-firms-to-keep-Kenyan-land/-/539550/970374/-/11inr7x/-/index.html>; Hogan Lovells, Kenyan Land Act: Questions (2012), available at http://www.hoganlovells.com/files/Publication/218e0b4a-79f1-4a92-8c34-b6cad0af48b3/Presentation/PublicationAttachment/c079f758-aca3-438c-8260-e5813cab485d/Africa_September_2012_newsletter_-_Kenya_Land_Act_questions_article.pdf.

29 “Foreign Ownership of Shares and Land Protection of Foreign Investors,” *International Law Office* (Mar. 12, 2007), available at <http://www.internationallawoffice.com/newsletters/detail.aspx?g=7bb56275-1bcb-db11-adf6-001143e35d55>; U.S. Department of State, Department of State: 2014 Investment Climate Statement (2014), available at <http://www.state.gov/documents/organization/229096.pdf>.

30 The Africa Asia Business Forum, *Kenya Investment Guide*, available at http://www.aabf.org/kenya_inv_guide.htm.

- **Government enterprises:** Once occupying a prominent place in the economy, the Kenyan government has largely exited the private sector except in certain key industries, like energy. To the extent that parastatals are still active, they largely compete on a level playing field with the private sector.³¹

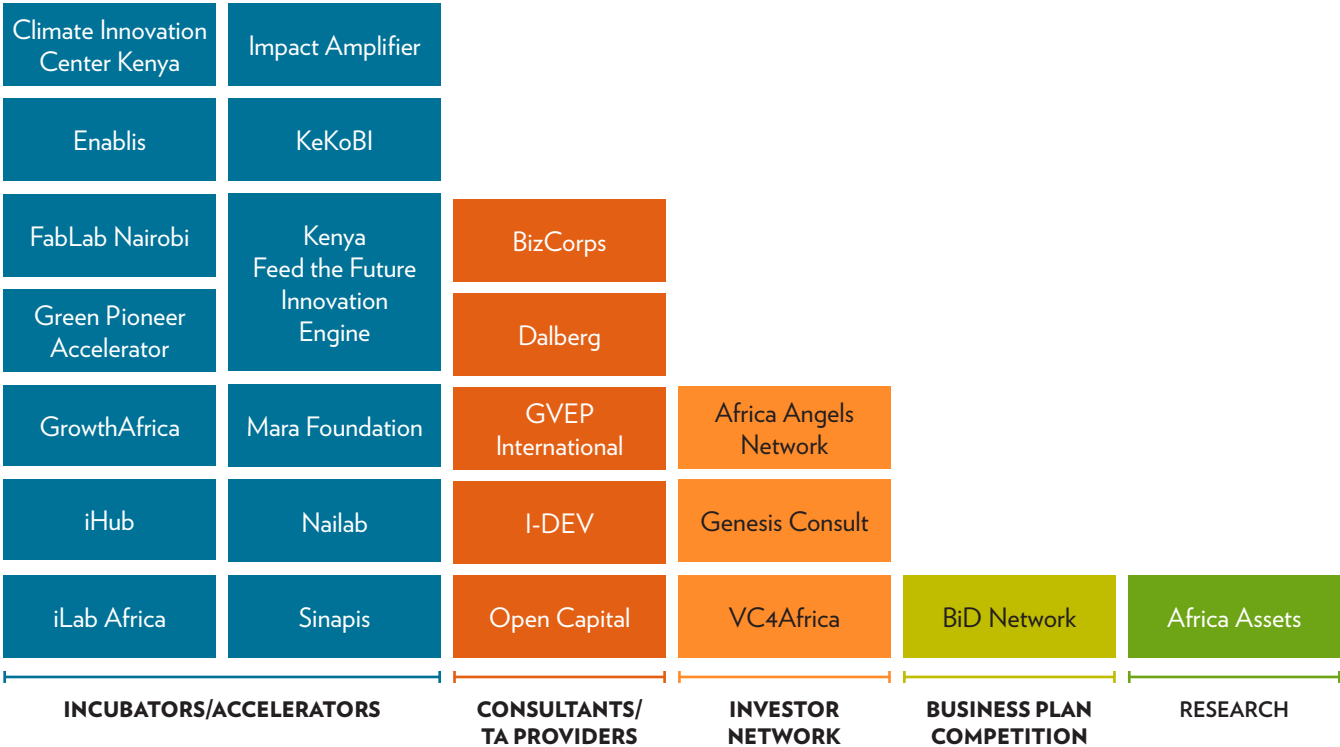
Kenya's Companies Act makes it clear that enterprises intending to profit from their activities must incorporate using traditional company structures. In addition, it can take significant time and compliance to register a local nonprofit. Many social enterprises have responded by incorporating local for-profit companies that partner closely with international nonprofit affiliates that provide broad support for the activities undertaken by the local company.

³¹ U.S. Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/documents/organization/229096.pdf>.

Ecosystem Players

As the center of impact investing in East Africa, Kenya boasts the largest supporting ecosystem in the region. More than 30 different organizations operate to support impact investment and social entrepreneurship in Kenya (Figure 22). Besides having more active organizations in-country, these same organizations tend to focus more on Kenya despite the fact that many operate regionally. Nevertheless, impact investors still believe there are gaps in the support available, in particular for organizations that can produce a large number of investment-ready opportunities.

FIGURE 22: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Source: Open Capital research, organization websites. Note: chart focuses on those with local presence; many international players active

As elsewhere in East Africa, the support ecosystem is primarily comprised of incubators and accelerators. There are also a number of business consultants, such as Open Capital Advisors, I-DEV International, Dalberg, and Biz Corps, as well as several investor networks and business plan competitions available locally in Nairobi. As many of these players work throughout the region, the same services are generally offered across countries. As in the rest of East Africa, there is a broad gap in the market organizations that can produce detailed market research and data for both impact investors and social enterprises. For more detail on active ecosystem players, their operations, and gaps in the market, please see the East Africa regional chapter.

Other Service Providers

In addition to intermediaries and service providers specifically targeting social enterprises and impact investors, Kenya boasts a wide range of general service providers including accountants, lawyers, recruitment firms, and others. Every company in Kenya must produce annual audited accounts and many providers have developed to serve this requirement. However, quality varies widely and so does the reliability of any accounts produced. Particularly for small companies or family-owned businesses, developing clear financial documentation can be challenging. Similarly, legal representation is widely available, though also of varying quality. There are a few widely known and respected firms that are well-suited for high-quality legal due diligence on larger deals, but they are often too expensive for smaller investments.

Beyond these professional firms, there are a wide variety of marketers, talent recruiting firms, and other business service providers that are available to companies operating in Kenya. Alongside the expanding number of reliable suppliers, distributors, and other commercial partners, these service providers increasingly contribute to a supportive business environment.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite dramatically increasing interest in raising capital to deploy in Kenya and the increasing number of deals completed each year, impact investors face a variety of challenges. These challenges present opportunities for current impact investors, new impact investors, and other eco-system players to support rapidly growing, high-potential SMEs that drive impact across sectors in Kenya and beyond. The following challenges are commonly faced in Kenya:

- **Insufficient investment-ready opportunities:** Despite robust activity to date, many non-DFI impact investors struggle to place the capital they have raised. This is particularly frustrating in Kenya, where there are a host of entrepreneurs seeking capital with a social purpose, but few who are genuinely investment-ready when they attempt to raise capital. However, many investors believe that active local presence can address this gap (see the opportunities section below).
- **International decision makers:** Many non-DFI impact investors have investment committees based abroad and whose members may not have on-the-ground experience with investments in Kenya and East Africa.³² These remote investment committees often interpret risk differently than their investment teams operating on the ground, which can result in misalignment between the investment officers forming relationships with entrepreneurs and the investment committees making the ultimate investment decisions.
- **Long diligence process:** Correlated to the lack of investment-ready deal flow and the international decision making common to many impact investors, the diligence process can often stretch 12-18 months for both debt and equity investments.³³ This can frustrate entrepreneurs and put additional pressure on the business, reducing long-term returns as companies must survive without needed capital.
- **Few exit examples:** For new funds looking to raise capital, the relative youth of the impact investment industry means there are few examples of successful exits. As more impact portfolios in East Africa near the end of their tenors, there will be significant pressure on funds to exit investments, though it not yet clear how this will develop in coming years. Without a successful track record of exits, it can be difficult for fund managers to raise a second fund. Some fund managers

³² Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

³³ Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

interviewed for this report believe it may be easier for a new impact investor to raise new funds than for an experienced one, as the latter are expected to demonstrate a track record before raising a second fund.

- **Insufficient human capital:** Talent is the key constraint for many East African businesses. Companies struggle to find the talented, reliable management needed to plan for and reach scale. Though true for all skilled positions, this challenge is particularly acute for finance professionals with 5-15 years of experience who can serve as a company CFO. Even when a talented, experienced professional can be found, s/he often commands high wages that can be challenging for SMEs or social enterprises to support, especially in their early years.
- **Limited local currency financing:** Many impact businesses engage with disadvantaged populations, often earning the majority of their revenues in local currencies. However, most impact investors track returns in international hard currencies and have little ability to invest in local currencies. This is especially challenging for long-term debt instruments which require repayment in hard currencies that can appreciate 5-10% per year. Hedging options are typically prohibitively expensive, though some impact investors with large funds report effectively using fund level hedges to minimize risk.

Opportunities

Despite challenges, there are many opportunities for impact investors to operate in Kenya and leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Opportunities for impact investors include the following:

- **Leverage technical assistance (TA) facilities for pre-investment pipeline building:** More pre-investment support for businesses is needed to develop a strong pipeline of investible opportunities. Increasingly, TA funders (e.g. USAID, DFID) recognize the importance of pre-investment support to get companies to the point where they can successfully raise capital. Several impact investors have successfully developed TA facilities for portfolio companies. Kenya, in particular, offers a robust intermediary ecosystem, and many of these players operate across the region. Targeted, tailored support requires an upfront commitment of resources, but has proven effective in preparing potential targets for investment and building high-quality deal flow. This process can also dramatically reduce diligence timelines if the investor is able to increase familiarity and visibility into the business pre-investment.
- **Develop sector expertise:** Beyond bringing capital to portfolio companies, impact investors can drive growth, returns, and impact by understanding the specific sectors where their portfolio companies operate. For some investors, this sector focus has allowed them to identify exciting, less well-known opportunities earlier and reduce their diligence timelines by leveraging existing knowledge. Sectors such as agriculture, energy, and financial services present large opportunities where companies often face similar challenges—these learnings can be shared across portfolio companies.

- **Increase local decision-making:** Impact investors have cited significant improvements in their portfolio from increasing local decision-making and local support where possible. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to respond to changing realities on the ground. Placing staff and investment committees locally can also reduce diligence timelines, as these individuals are more familiar with local trends and norms. In an environment of increasing competition between impact investors for high-potential deals, designing effective diligence procedures aligned to the region could be a key differentiator for successful impact investors.
- **Source opportunities outside capital cities:** While non-DFI impact investors with staff on the ground in major cities like Nairobi report having an easier time finding investments than do those based abroad, many entrepreneurs operating in rural areas do not spend much time in Nairobi. For non-DFI impact investors who see these types of businesses as highly impactful, it will be increasingly necessary to build relationships beyond those made in the capital city.

In addition, impact investors report seeing opportunities across the following sectors:

- **Agriculture:** In Kenya, average smallholder plot sizes are often smaller than one acre, creating an opportunity to consolidate production and significantly increase yields. Given the smallholder landscape, there are also opportunities to aggregate production and create consistent, high-quality supply. This type of aggregation may allow farmers to connect directly with export markets, especially attractive regionally. There is also significant potential in agricultural processing across a range of crops.
- **Renewable energy:** Non-DFI impact investors noted a number of opportunities for renewable energy as Kenya looks to expand power generation capacity. Strong government support for new businesses and approaches opens the door for large-scale projects and improved power purchase agreements. At the same time, there are large segments of the population that lack reliable access to grid power, creating opportunities for micro-grid and off-grid solutions.
- **Consumer goods for the mass market:** With Kenya's growing middle class, impact investors believe there are increasingly attractive opportunities to supply goods and services to consumers with rapidly increasing disposable incomes. These businesses often create substantial employment opportunities, which may fit impact criteria for some impact investors.



UGANDA

SECOND TO KENYA; CATCHING UP

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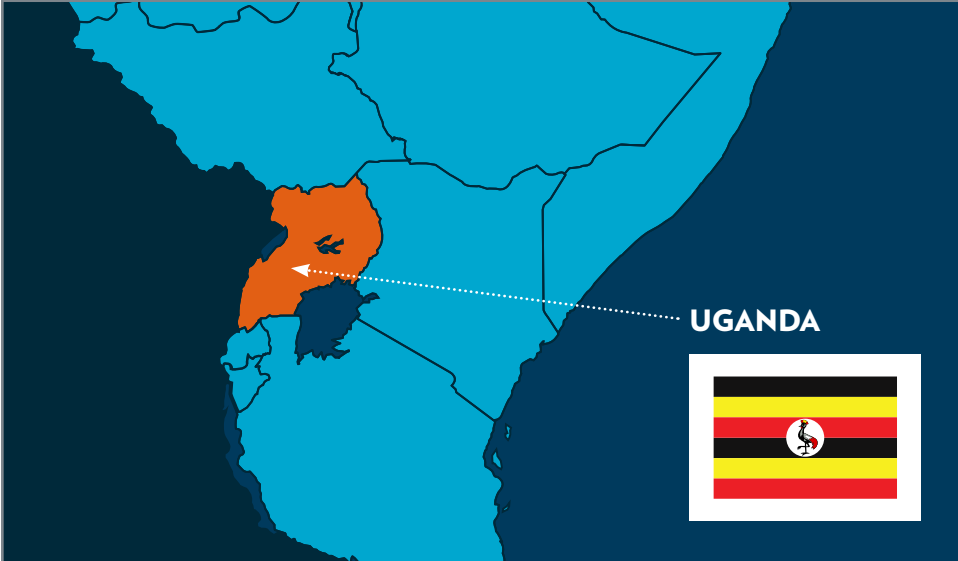
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INTRODUCTION

Uganda is the second largest impact investing market in East Africa, after Kenya. Within East Africa, Uganda boasts the second highest number of deals and second largest amount of capital disbursed in support of social and environmental impact—and the market is expected to continue to grow. Most impact investors interviewed noted there were no significant country-specific impediments to impact investing in Uganda but rather that the primary challenge was a less favorable business environment than they perceive in Kenya. Impact investors see considerable potential, and as the country continues to grow, they expect the general business environment to improve, presenting more opportunities to drive social change through sustainable social enterprises.

Despite these positive trends, many adverse conditions persist. Acquiring talent, particularly middle management employees, remains extremely difficult. Many businesses operate informally with multiple sets of accounts, which can compromise impact investors’ ability to place capital. Nevertheless, Uganda has a growing economy and is a primary target for impact investors. Most impact investors active in the region work in Uganda, and as impact investors diversify beyond Kenya, Uganda will be a primary destination.

FIGURE 1: MAP OF UGANDA



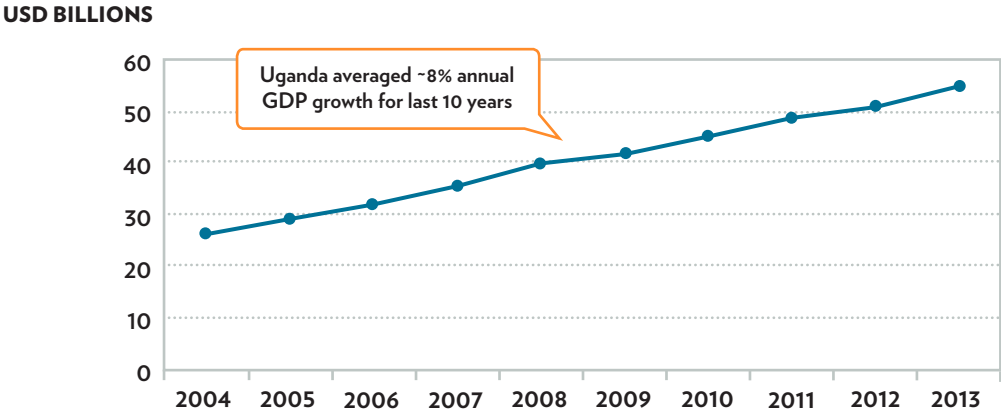
COUNTRY CONTEXT

Uganda has a rapidly growing economy and has been comparatively stable for decades.¹ This is reflected across economic indicators, although the country requires support to improve human development indicators and increase linkages between disadvantaged populations and the rapidly growing national economy.

Gross Domestic Product

Uganda, like most countries in the region, has seen strong GDP growth over the last decade (Figure 2). The economy has expanded at nearly 8% at purchasing power parity (PPP) per year, reaching approximately USD 54 billion GDP in PPP terms in 2013. This growth is expected to continue; the World Bank predicts that by 2019, Uganda's GDP (PPP) will have grown to more than USD 91 billion or roughly 170% its 2013 size.

FIGURE 2: GDP (PPP), 2004–2013



Source: IMF World Bank Economic Indicators, April 2014

Despite growth, enterprises continue to face challenges with high infrastructure costs, lack of financing, and limited access to skilled workers. With most imports coming through Kenya by truck, input costs can be high. This difficulty importing and transporting goods, however, opens new opportunities for local manufacturing.

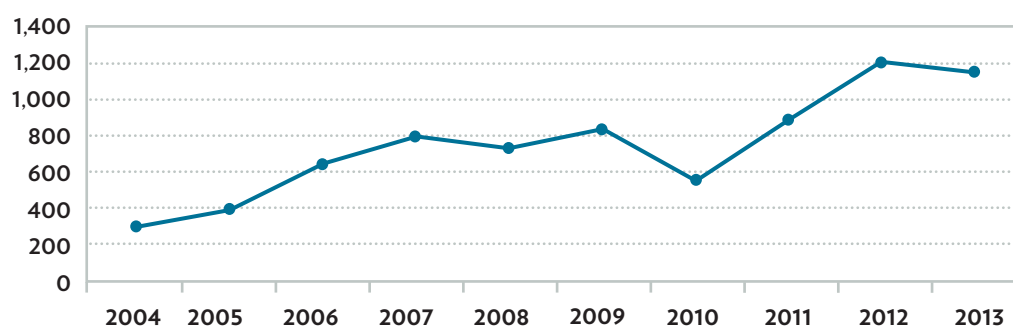
1 US Department of State—<http://www.state.gov/r/pa/ei/bgn/2963.htm>.

Foreign Direct Investment (FDI)

The growing economy has been matched by rapidly expanding foreign direct investment. FDI flows have grown by a compounded annual growth rate of nearly 15% in the past decade and are the third highest in the region (Figure 3).²

FIGURE 3: FDI FLOWS, 2004-2013

USD MILLIONS



Source: UNCTAD

These large FDI flows are driven primarily by oil and gas exploration, where the mining and quarrying sector attracted 42% of all FDI inflows in 2012. Real estate comprised another 18% and manufacturing a further 15%.^{3,4} Foreign oil and gas investment is expected to increase as the government of Uganda awards additional exploration licenses in 2015.⁵ At present, only three companies have active operations in Ugandan oil—China National Offshore Oil Corporation, Tullow Oil, and Total.⁶

2 Inward and Outward Foreign Direct Investment Flows: Annual 1970-2013, *United Nations Conference on Trade and Development*, available at <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=88>.

3 Bank of Uganda, *Private Sector Investment Survey 2013 Report*, available at <https://www.bou.or.ug/bou/bou-downloads/publications/PrivateSectorCapital/PSIS/2013/All/PSIS-2013---REPORT.pdf>.

4 Nicholas Bariyo, "Uganda Set to Award New Exploration Licenses in 2015," *The Wall Street Journal* (Jun. 3, 2014), available at <http://online.wsj.com/articles/uganda-set-to-award-new-oil-exploration-licenses-in-2015-1401793334>.

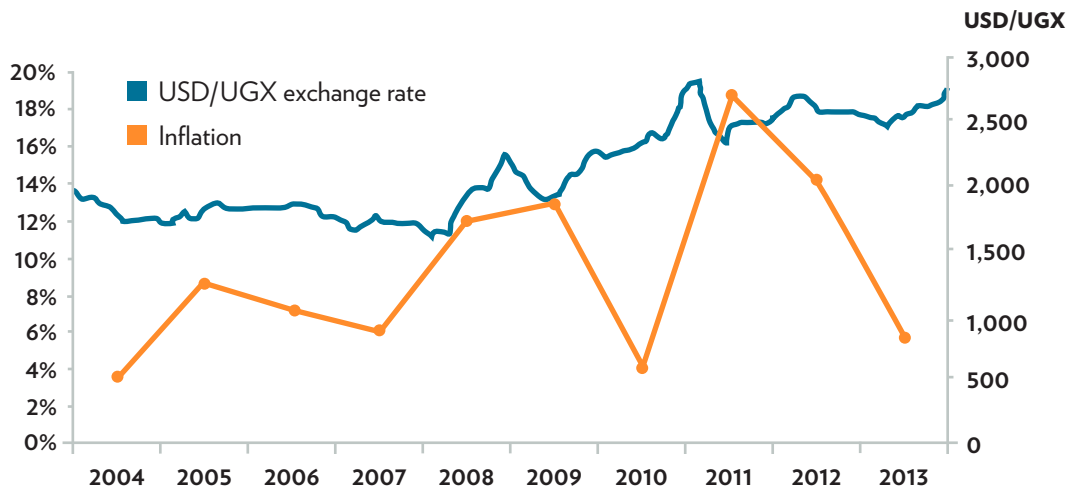
5 *Ibid.*

6 *Ibid.*

Inflation and Exchange Rates

High and volatile local inflation rates, reaching greater than 18% in 2011⁷ (Figure 4), and concerns about depreciating foreign exchange rates complicate some international impact investors' ability to disburse local currency debt. The Ugandan Shilling has depreciated by an average of 8% annually against the US dollar since 2008, reducing the hard currency value of any local currency debt.

FIGURE 4: INFLATION AND USD/UGX EXCHANGE RATE, 2004-2013



Source: IMF World Bank Indicators, Oanda Historical Currency Rates

7 World Bank Indicators.

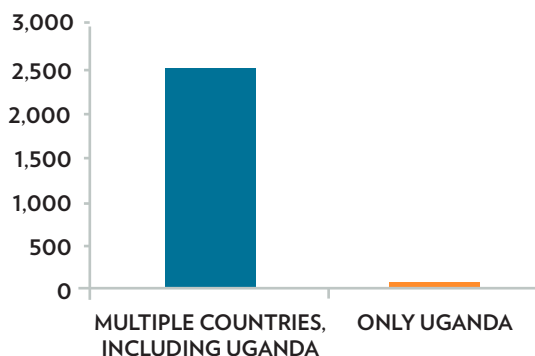
SUPPLY OF IMPACT INVESTING CAPITAL

Non-DFI⁸ impact investors view Uganda as the country with the second highest potential in the region after Kenya, and expect it to grow in size and importance, following the same trajectory Kenya did several years ago.

There are at least 119 impact capital vehicles active in Uganda, managed by some 82 non-DFI impact investors—nearly as many as in Kenya. Most of these impact capital vehicles are active across the region, but at least USD 54 million has been committed specifically to investments in Uganda (Figure 5). There is an additional USD 2.5 billion in capital committed regionally that could be deployed in Uganda and, if historical deal flows persist, it is the country most likely to receive regional capital after Kenya. Most of these non-DFI impact investors focus on early-stage businesses that have some track record and operational structures in place. Excluding DFI activity, there have been at least 139 impact deals in Uganda, resulting in more than USD 300 million disbursed, more than 20% of all investment activity in East Africa overall.

FIGURE 5: TOTAL CAPITAL COMMITTED BY NON-DFI IMPACT INVESTORS

USD MILLIONS



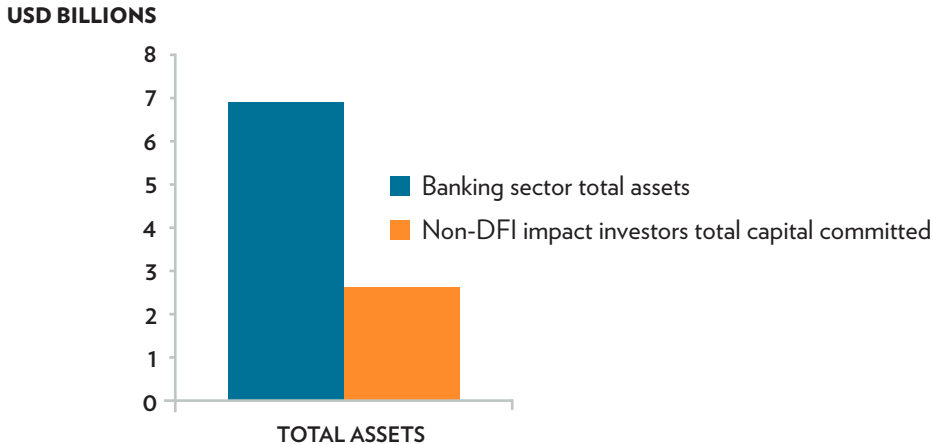
Source: Open Capital Research

8 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate.

Broader Investing Landscape

Despite the volume of impact investing activity in Uganda, it represents a small portion of the overall Ugandan investment landscape. For example, local banks have nearly USD 6.9 billion in total assets under management, which is significantly more than the USD 2.5 billion in total non-DFI impact assets allocated to the region that could be deployed in Uganda (Figure 6). Indeed, banks lent approximately USD 3.3 billion in 2013, almost three times the disbursements made by both DFIs and non-DFI impact investors in Uganda to date.

FIGURE 6: IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: Bank of Uganda, Open Capital Research

In addition, there is a large informal financing sector in Uganda that is not regulated. The dearth of reporting makes it impossible to estimate the total assets available through informal financing, but anecdotal evidence indicates the amount is substantial in the Ugandan financing landscape. Loan sharks run large operations that can provide significant amounts of financing quickly and with limited due diligence. However, they charge extremely high interest rates, which limits their attractiveness, particularly for longer-term financing.

Although impact investing represents a small portion of total investment activity in Uganda, it fills an important gap in the market for earlier-stage enterprises. Access to financing from commercial banks remains limited, with only approximately 20% of Ugandan adults having a formal bank account.⁹ This is due in part to an absence of physical bank branches—commercial banks have offices in most urban centers but limited penetration in rural areas. Even for those with physical access to formal financing, commercial banks remain risk averse and are unwilling to invest in early stage enterprises (which represent a large share of businesses in the region, particularly those of interest to non-DFI impact investors). When willing to lend, they

9 Economic Policy Research Centre, *Uganda 2013: FinScope III Survey Key Findings: Unlocking Barriers to Financial Inclusion* (2013), available at http://www.score.or.ug/uploads/FINSCOPE_%20III_%20Survey_%202013_%20findings.pdf.

require extremely high collateral ratios which often exceed 100% of the loan amount. Many early-stage businesses are unable to satisfy these requirements.¹⁰

Even if they are able to meet these stringent requirements, businesses must still face the highest lending rates in East Africa, which reached a record high of more than 26% in 2012 and still stood at more than 23% in 2013. These extremely high rates—roughly six times higher than average bank rates in the United States, which have been under 5% on average over the last 10 years—prompted a protest by most shop-owners in the capital city of Kampala, who closed shop for three days in January 2012.¹¹

The collateral requirements and high interest rates from both banks and informal financiers make debt investments extremely expensive and limit the practical availability of financing for enterprises. This limited availability in conventional settings provides a market opportunity for private investors who are able to provide equity and/or cheaper or less collateralized debt, particularly for early stage, longer-term investments that may be higher risk.

This gap is filled at times by non-commercial grant financing, which is available from donors active in Uganda such as charitable foundations, international aid agencies, and private individuals. Non-DFI impact investors report that they occasionally compete with donor funding for high potential deals, as those entrepreneurs who seek capital from impact investors are typically also aware of donors. Donor presence can complicate negotiations for impact investors because entrepreneurs may view donor funding as an opportunity to raise free capital and to avoid investors' comparatively high return expectations. Many donor agencies, however, are unwilling to lend to commercial enterprises and often have stringent reporting or operational requirements that are less attractive for businesses. This opens up an opportunity for impact investors.

10 Emmanuel Akika Othieno, Makerere University, *Bank Lending, Information Asymmetry, Credit Accessibility and Performance of Farmers: The Case of Tororo District* (2010), available at <http://www.mubs.ac.ug/docs/masters/mba/Bank%20lending,%20information%20asymmetry,%20credit%20accessibility%20and%20performance%20of%20farmers.pdf>; Open Capital Advisors research.

11 World Development Indicators: Lending Interest Rates (%), *The World Bank Group* (2014), available at <http://data.worldbank.org/indicator/FR.INR.LEND?page=2>; "Kampala Shops Shut Over Uganda Interest Rates," BBC News (Jan. 11, 2012), available at <http://www.bbc.co.uk/news/world-africa-16508825>.

Impact Capital Disbursed

Uganda boasts the second largest deal flow in the region, around half the activity in Kenya. In total, non-DFI impact investors have disbursed more than USD 300 million to date (Figure 7), or over 20% of disbursements in East Africa. The country has received a smaller proportion of DFI direct investments (approximately 11%), or just over USD 875 million (Figure 7).

FIGURE 7: IMPACT INVESTMENTS IN UGANDA

	Capital disbursed	Deals
DFI	usd 879 millions	79
NON-DFI	usd 306 millions	139

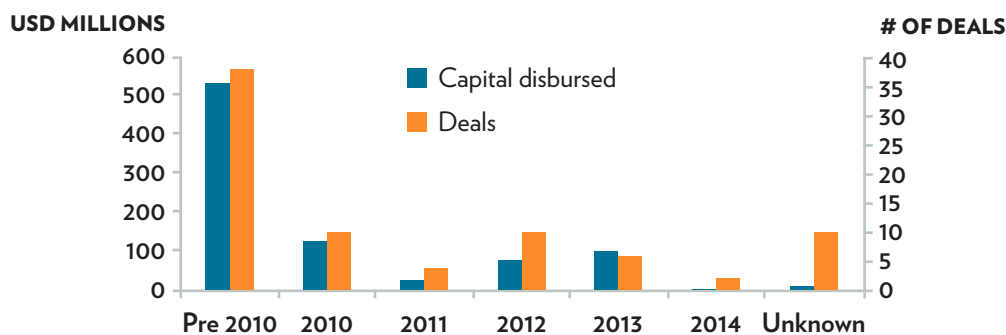
Source: Open Capital Research

Investments Over Time

Impact investing remains a young sector. As in Kenya, non-DFI impact investors have been present and investing in Uganda for more than a decade, but the large number of deals with undisclosed details prevents additional conclusions about non-DFI impact investor activity over time. Nevertheless, anecdotal reports from investors suggest that impact investing activity began to consistently pick up in 2010 and beyond.

Unlike the rest of East Africa, DFI activity in Uganda has not shown any clear growth trend (Figure 8). Though the level of DFI direct disbursements is high relative to the rest of East Africa—Uganda has the second highest amount of DFI direct capital disbursed in the region—the country has not seen the increasing attention characteristic of the other focus countries.

FIGURE 8: DFI DIRECT INVESTMENTS BY YEAR

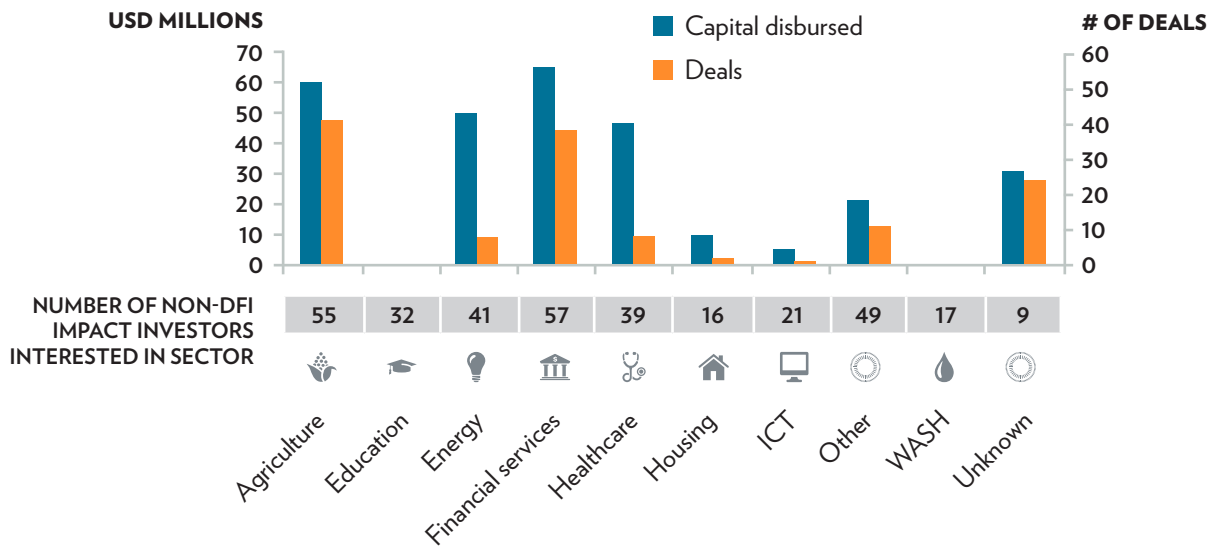


Source: Open Capital Research

Sector

The distribution of investments by sector broadly reflects non-DFI impact investor interest areas (Figure 9). Agriculture and financial services have received the most attention from non-DFI investors (roughly 40% of their deals in Uganda) and have the greatest expressed interest from investors.

FIGURE 9: NON-DFI IMPACT INVESTMENTS BY SECTOR

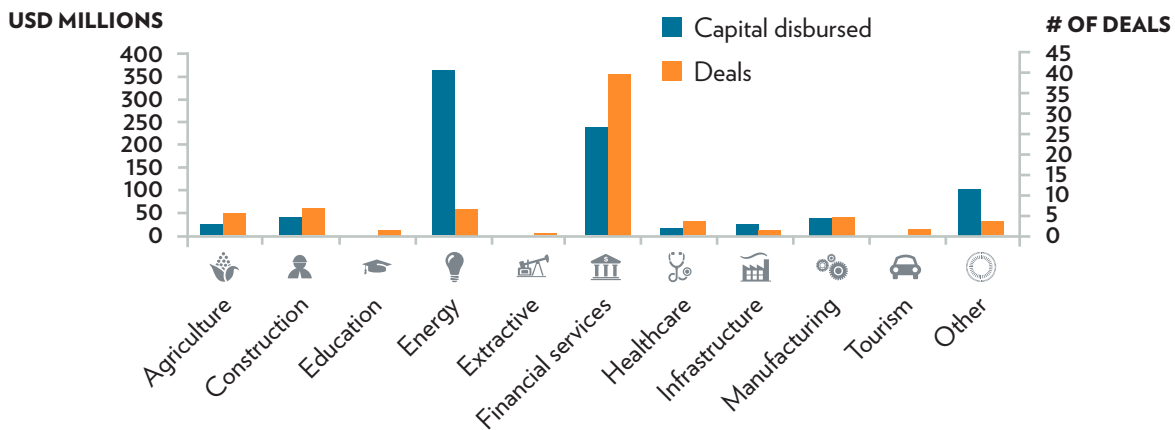


Source: Open Capital Research. Note: Chart shows total number of non-DFI impact investors interested in sector; may be multiple sectors

Unlike the rest of East Africa, Uganda saw significant capital disbursed into energy deals. This exceptional activity was driven by a single large transaction accounting for nearly 60% of the total capital disbursed in the sector. Uganda, unlike much of East Africa, has significant amounts of capital disbursed in the health sector. As with the energy sector, this is driven by a single large investment amounting to nearly 70% of the capital disbursed in the health sector. Correspondingly, both the energy and health sectors have high average ticket sizes, though the median deal size is significantly lower.

DFI direct investments favor investments in financial services, which make up 50% of direct deals and more than 25% of capital disbursed directly (Figure 10). The energy sector has the highest total capital disbursed (more than 40% of DFI direct capital disbursed), reflecting the large ticket size for many DFI-funded energy projects, but relatively few deals—less than 10%.

FIGURE 10: DFI DIRECT INVESTMENTS BY SECTOR

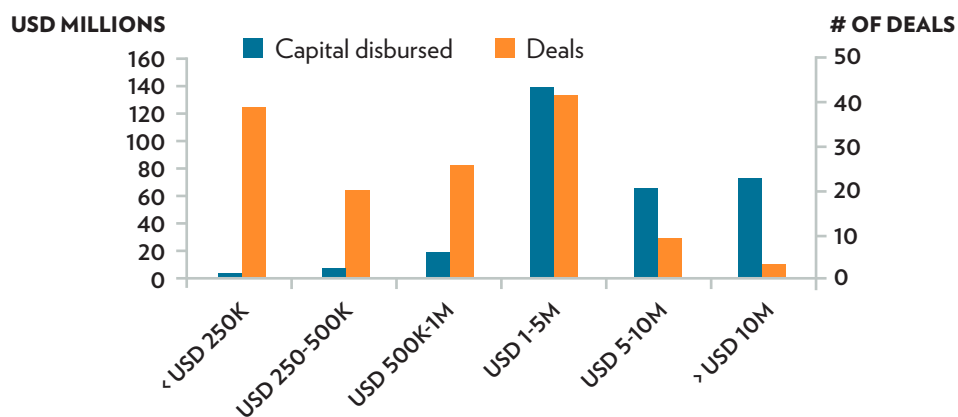


Source: Open Capital Research

Deal Size

As shown in Figure 11, nearly 50% of capital disbursed by non-DFI impact investors in Uganda has been through deals larger than USD 1 million in size; however, more than 60% of the individual deals are under USD 1 million. Deals under USD 250,000 represent nearly 30% of all known non-DFI impact deals in Uganda. This proliferation of small deals contrasts with Kenya, where only 11% of non-DFI impact deals are below USD 250,000, and suggests that impact investors in Uganda find interesting businesses to be comparatively small.

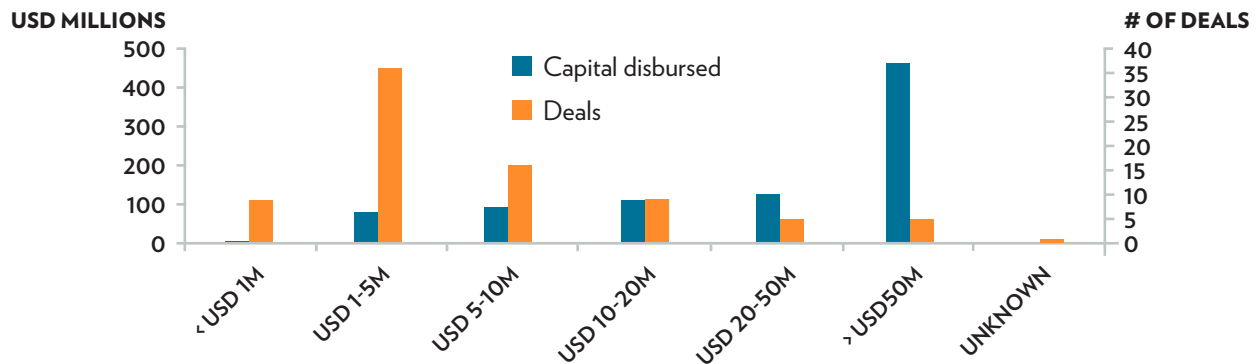
FIGURE 11: NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

By contrast, the average deal size for known DFI direct investments in Uganda is more than USD 11 million, greater than five times the average for non-DFI impact investors (Figure 12). This high average deal size is driven by three large investments in energy projects, which accounted for nearly 40% of DFI capital disbursed. Moreover, though deals under USD 10 million make up more than 75% of DFI direct investments, only approximately 10% of direct DFI deals were under USD 1 million compared to about 60% of non-DFI impact investor deals.

FIGURE 12: DFI DIRECT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

Instrument

Traditional debt and equity investments remain most common in Uganda, though this report is unable to provide a definitive break-down of non-DFI investment instruments due to insufficient available data at the time of writing. However, the preponderance of debt investments in the available data (debt investments were almost twice as common as equity investments among non-DFI impact investors), aligns with investor perceptions that it is sometimes challenging to explain equity investments to entrepreneurs in Uganda.

Though traditional debt and equity instruments are most common, non-DFI impact investors report that, as in much of the rest of East Africa, they increasingly consider quasi-equity structures such as convertible debt or revenue-participating debt. Especially given non-DFI impact investors' focus on smaller deals and earlier-stage investments, these structures balance the limited cash flows common for earlier-stage companies with the return expectations and risk mitigation required by investors.

As elsewhere in the region, DFIs' direct investments are overwhelmingly debt (Figure 13). Debt investments constitute more than 80% of all capital disbursed by DFIs directly and nearly two-thirds of known direct DFI deals. However, in contrast to the rest of East Africa (except Ethiopia), Uganda also attracted a number of debt guarantees, driven almost exclusively by a single DFI's activity.

FIGURE 13: DFI DIRECT INVESTMENTS BY INSTRUMENT



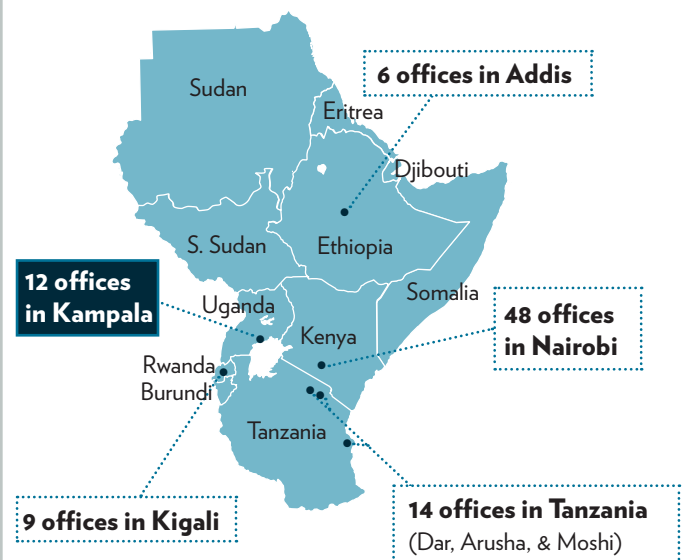
Source: Open Capital Research

Local Presence

A number of impact investors have chosen to place staff on the ground in Uganda, primarily in the capital city, Kampala (Figure 14). Uganda is home to the third largest number of impact investors in the region and two impact investors have their headquarters there.

Nevertheless, the impact investing community in Uganda remains small compared to that in Kenya and there are only a few local impact investor offices. Those based in Uganda noted that they knew all of the other players active in the ecosystem and consider this familiarity a strength, as it creates a friendly environment to share information about entrepreneurs and potential investments. This collegiality is an important source of pipeline and a valuable asset during due diligence. Several interviewed believe it would be unlikely for any investment to occur without their knowledge and that almost all high-potential entrepreneurs are quickly known to the entire space.

FIGURE 14: IMPACT INVESTORS WITH LOCAL OFFICES



Source: Open Capital Research

Impact Tracking Standards

Impact investors' dual mandate to realize both financial and social or environmental returns requires a strong focus on measuring impact as part of their core activities. Beyond tracking metrics as best practice, impact asset owners require it. This is particularly true for DFIs, which act as anchor investors to many non-DFI impact investors.

As is true across the region, most impact investors in Uganda do not apply a specific pre-defined framework or system for measuring the impact of their investments. Instead, they typically choose metrics that suit each investment. Investors believe this customization reduces the administrative burden for their portfolio businesses and enables a focus on the metrics that are most meaningful. For more detail on impact measurement in East Africa, see the East Africa regional overview chapter of this report.

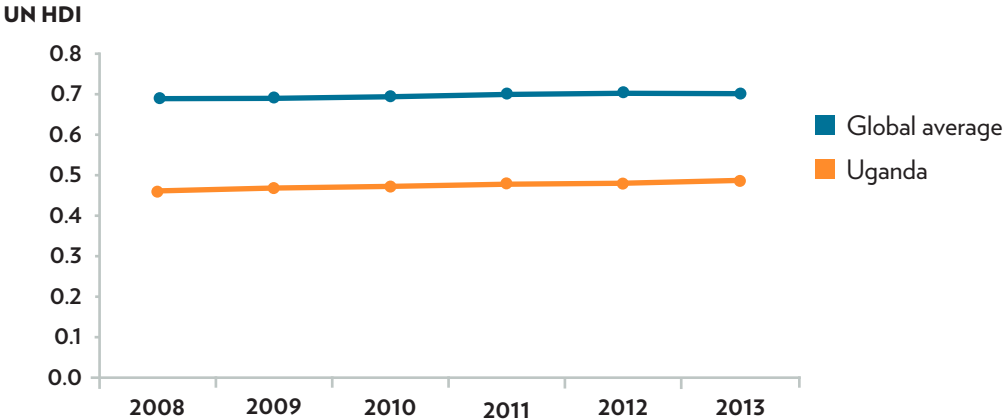
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital from entrepreneurs operating in Uganda. There are significant gaps in the provision of key goods and services, which create opportunities for entrepreneurs to build enterprises that fill key needs while also realizing financial returns.

Development Context

Uganda has seen slight recent improvement in human development indicators, but still remains well below global averages. Overall, Uganda ranked 164th out of 187 countries in the United Nation’s Human Development Index, scoring below the Sub-Saharan Africa average (Figure 15).¹² This low ranking is reflected in poor performance across a variety of individual development indicators, including poverty, health, and education.¹³

FIGURE 15: UN HDI SCORES, 2008-2013



Source: United Nations Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

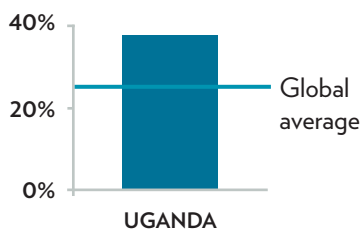
12 The UN HDI score aggregates income, education, and health indicators to produce a holistic development score from 0 to 1. 2014 Human Development Index, *The United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

13 2014 Human Development Index, *The United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

More than a third of Ugandans live on less than USD 1.25 per day, which is more than 50% higher than the global average (Figure 16). Nevertheless, the country has achieved its Millennium Development Goal to reduce poverty, raising a large proportion of the population above the national poverty line. More than 55% were living below the national poverty line in 1992/93, compared to less than 25% in 2009/10.¹⁴

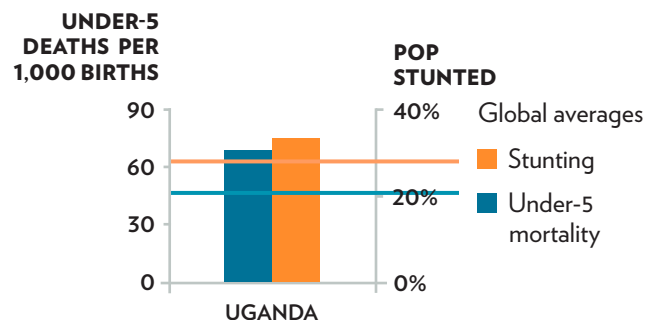
Uganda's health metrics are also well below global averages (Figure 17). For example, under-five mortality stands at 69 for every 1,000 live births, compared to 47 globally.¹⁵ Similarly, approximately 33% of Ugandans under five suffer from moderate or severe stunting, compared to a global average of just over 25%.¹⁶ Uganda has made only modest progress on other health metrics. For example, maternal mortality decreased only slightly from 506 for every 1,000 live births in 1990 to 438 in 2011.¹⁷ Also, HIV/AIDS prevalence rates among the population aged 15-24 increased from 2.9% in 2004/05 to 3.7% in 2011.¹⁸

FIGURE 16: POPULATION BELOW USD 1.25/DAY



Source: UN Human Development Report 2014

FIGURE 17: UNDER-5 MORTALITY AND STUNTING



Source: UN Human Development Report 2014

14 The World Bank, *Poverty Trends in Uganda: Who gained and who was left behind?*, available at <http://siteresources.worldbank.org/INTUGANDA/Resources/uganda-poverty-and-inequality-trends-full-policy-note.pdf>.

15 The United Nations Development Programme, *Human Development Report 2014*, available at http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/UGA.pdf. http://hdr.undp.org/sites/all/themes/hdr_theme/country-notes/UGA.pdf.

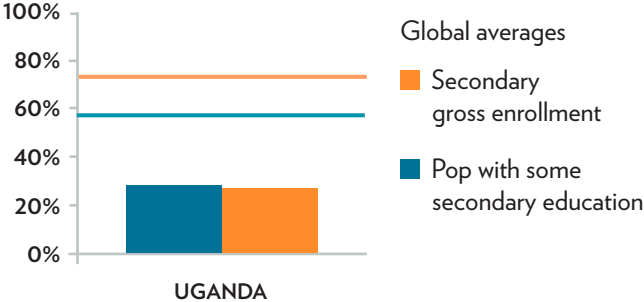
16 *Ibid.*

17 Ministry of Finance, Planning and Economic Development, *Millennium Development Goals Report for Uganda* (2013), available at <http://planipolis.iiep.unesco.org/upload/Uganda/Uganda%20MDG%20Report-Oct%202013.pdf>.

18 *Ibid.*

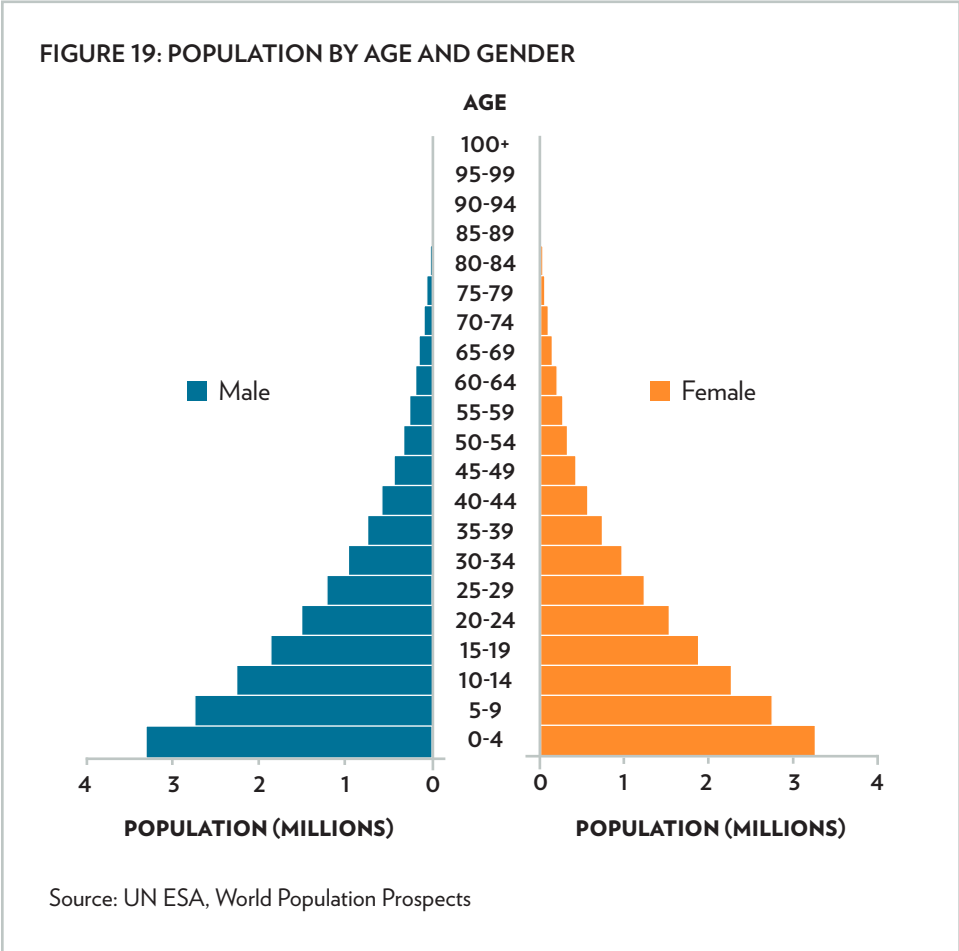
Like the rest of the region, Uganda’s performance on educational metrics is poor relative to global averages (Figure 18). Uganda’s gross secondary enrollment of 28% is less than half the global average and among the worst in East Africa, above only Somalia and approximately equal to Burundi. Its population aged 25 and above with at least some secondary education is less than half the global average, although it leads East Africa.

**FIGURE 18: KEY EDUCATION INDICATORS
(LATEST AVAILABLE DATA POINT)**



Source: UN Human Development Report 2014

Educational metrics are an especially important indicator for future development given Uganda’s demographics. Like other East African countries, Uganda has a disproportionately young population, where over 48% is under the age of 15 and nearly 70% is below age 25 (Figure 19). This youth boom has led to high unemployment among young people which, when compounded with low levels of education, poses a challenge to economic growth.



Entrepreneurs

There is optimism from both entrepreneurs and impact investors predicting ample opportunity for growth in Uganda.¹⁹ Many of these opportunities are social businesses in sectors of interest to impact investors—education, housing, healthcare, water and sanitation, energy, etc. These entrepreneurs seek capital across the spectrum of funding, from start-up and SME-size deals to capital for scaling up, although they are primarily start-up and early-stage businesses. This concentration in earlier stages aligns with the local landscape, in which there are few mature social enterprises, as with the rest of East Africa.

¹⁹ Open Capital Research.

However, despite growing demand for capital from enterprises in these sectors, entrepreneurs face substantial challenges. Encouragingly, interviewees did not identify any significant country-specific impediments to growth in Uganda. Rather, the primary challenge is seen to be a general lack of development of the broader business environment, as is common throughout the region. For more detail on the challenges facing both early- and growth-stage companies in East Africa—which include limited human capital, informal operations, sourcing capital beyond family and friends, and a strong need for local relationships—see the East Africa regional chapter of this report.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

The impact investing ecosystem in Uganda remains challenging and is a key constraint on the growth of the sector. The lack of a well-developed business environment affects potential investees as well as impact investors.

Regulatory Environment

Today, Uganda is relatively politically stable and has a generally welcoming regulatory landscape for investors. For example, investors are able to access foreign currency easily, repatriate profits, and own local companies. The country has been relatively free of armed conflict since the Lord's Resistance Army was expelled in 2006, though there has been some instability on the borders as a result of continuing conflict in South Sudan and the Democratic Republic of Congo.

Despite the welcoming formal environment, Uganda remains one of the more difficult countries to do business in, ranking 150th of 189 countries in the World Bank's Ease of Doing Business rankings and 5th out of the 11 countries in East Africa.²⁰ While the underlying regulations and investment environment are open to foreign investment, interacting with the Ugandan state to pay taxes or apply for licenses, for example, can be complicated due to inefficient bureaucracies.

- **Government incentives:** Uganda provides a number of incentives for foreign and local investors to place capital. For example, Uganda offers a 10-year tax holiday to investments in export-oriented production and concessionary import duties on some capital goods that meet certain criteria, which for foreign investors is reserved for capital goods in excess of USD 500,000.²¹ Beyond tax incentives, Uganda offers free access to industrial parks to investors in priority sectors including information and communications technology (ICT), tourism, value-added agriculture, and value-added investments in mineral extraction.²²
- **Repatriation of profits and dividends:** In general, Uganda does not restrict capital transfers, though it does require a tax clearance certificate for repatriations

20 "Economy Rankings," *The World Bank Group* (Jun. 2014), available at <http://www.doingbusiness.org/rankings>.

21 The Government of Uganda, *The Investment Code*, available at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CCY-QFjAA&url=http%3A%2F%2Fwww.ilo.org%2Fdyn%2Flegosh%2Fen%2F%3Fp%3DLEGPOL%3A503%3A3192607443802%3A%3A503%3AP503_REFERENCE_ID%3A140160&ei=7_1iVMqAO-lm3PNmugSA&usq=AFQjCNH3fPh3SF_bv3M26VNU0J-zOUI6Aw&bvm=bv.79189006,d.d2s.

22 "2012 Investment Climate: Uganda," *U.S. Department of State* (Jun. 2012), available at <http://www.state.gov/e/eb/rls/othr/ics/2012/191256.htm>.

in excess of UGX 50 million (about USD 20,000).²³ In addition, Uganda must authorize repatriation for foreign investors who take advantage of investment incentives under the Ugandan Investment Code Act, which governs investing activity in Uganda.²⁴

- **Foreign exchange controls:** Uganda has open foreign exchange rules. Foreign exchange is freely available from commercial banks and can be acquired and held equally by locals and foreign nationals.²⁵
- **Land ownership:** The formal land system is complex, with four different land tenure systems. Foreigners may only lease land in Uganda and must seek approval from the Ugandan Investment Authority before leasing more than 50 acres for agriculture or livestock.²⁶ Though each plot is governed by a single system, neighboring plots may be held under a different system. Freehold land may be owned permanently by Ugandan citizens and leased by foreigners. Leasehold land may be leased by nationals and foreigners alike. Customary land and Mailo land pose more challenges—customary land is governed by the traditions of the area, and typically does not have a title deed. Mailo land use must be approved by lawful residents, which includes many squatters. Freehold land makes up 22% of all land in Uganda, with customary land making up the majority of the rest.²⁷ Despite complicated regulations, local impact investors report that most land of interest to them is governed by the more favorable land tenure systems.
- **Local ownership requirements:** Foreign investors may own up to 100% of any local company except in the petroleum industry, in which foreign investors may supply goods and services not available in Uganda only via a joint venture with a Ugandan company. In such a joint venture, the Ugandan company must own at least 48% of the shares.²⁸
- **Government enterprises:** Since 1993, the state has been privatizing Uganda's state-owned enterprises. Major divestitures include the Uganda Commercial Bank to Stanbic Bank, the Sheraton Kampala to MIDROC, and the Uganda Electricity Distribution Company concession to Umeme Uganda.²⁹ The government still has interests in the mining, housing, electricity, and transport sectors, though it is open to private competition.³⁰

23 Deloitte Touche Tohmatsu Limited, *International Tax: Uganda Highlights 2014*, available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-ugandahighlights-2014.pdf>.

24 United States Department of State, *2014 Uganda Investment Climate Statement*, available at http://photos.state.gov/libraries/adana/766947/public/2014_uganda_investment_climate_statement.pdf.

25 KPMG, *Uganda country profile (2012)*, available at <https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Uganda.pdf>.

26 United States Department of State, *2014 Uganda Investment Climate Statement*, available at http://photos.state.gov/libraries/adana/766947/public/2014_uganda_investment_climate_statement.pdf.

27 Land Deal Politics Initiative, *Governance of Large-Scale Land Acquisitions in Uganda (2012)*, available at <http://www.cornell-landproject.org/download/landgrab2012papers/stickler.pdf>.

28 United States Department of State, *2014 Investment Climate Statement: Uganda*, available at <http://www.state.gov/documents/organization/229298.pdf>.

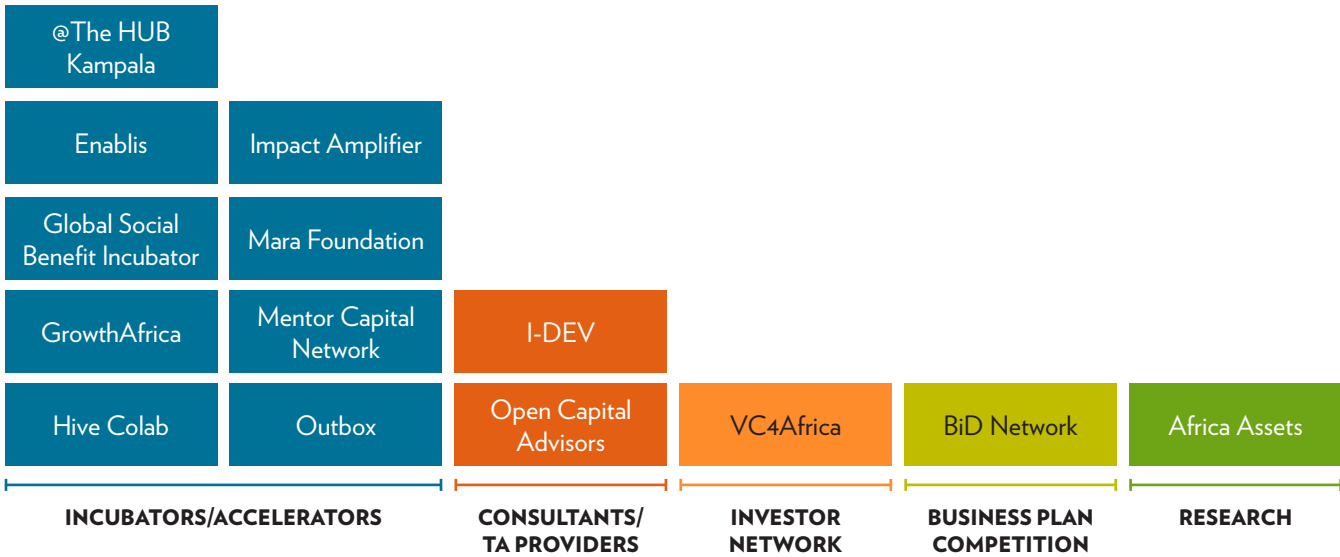
29 Muriisa Roberts, *The Privatisation Experience in Uganda (2005)*, available at <http://www.codesria.org/IMG/pdf/9-Roberts.pdf>; <http://www.uedcl.co.ug/>.

30 KPMG, *Uganda country profile (2012)*, available at <https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Uganda.pdf>.

Ecosystem Players

There are few ecosystem players active in Uganda (Figure 20). With around twenty identified organizations supporting impact investing, Uganda has roughly two-thirds the number of Kenya. Many of these organizations operate regionally. As in most of the rest of East Africa, the support ecosystem primarily comprises incubators and accelerators, which tend to focus on seed or very early venture stage businesses in specific sectors, leaving a gap for service providers to support businesses more appropriate for non-DFI impact investors across a range of sectors. For more detail on intermediaries and service providers in East Africa, see the East Africa regional chapter of this report.

FIGURE 20: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Source: Open Capital research, organization websites. Note: chart focuses on those with local presence; many international players active

Beyond incubators, there are a number of consultants and technical assistance providers focused on the impact investing ecosystem, including Open Capital Advisors, I-DEV International, and Global Village Energy Partnership (GVEP). Despite consultants and technical assistance providers operating in Uganda, there remains a lack of detailed market research and data to support both non-DFI impact investors and social enterprises. This market gap is consistent with the rest of the region, and is discussed in more detail in the East Africa regional overview chapter.

Few of the impact investors and entrepreneurs interviewed report using intermediaries or service providers. Impact investors noted that even when interested, entrepreneurs struggled to identify high-quality service providers and that ecosystem players often struggle to adequately explain their services to entrepreneurs. Nonetheless, the challenges facing entrepreneurs clearly indicate there is a need for greater investment preparedness, human resources, and financial sophistication, which present

opportunities that intermediaries and service providers could address. One impact investor interviewed proposed that, if given significantly more capital, they would use it to establish an intensive pre-investment support program to supplement the management team for interesting businesses in order to build the business in-house. As investors and entrepreneurs become increasingly active in Uganda, the ecosystem appears ready to grow accordingly.

In line with the general impact investing ecosystem in Uganda, there are gaps in the availability of more general business service providers. Every company in Uganda must produce annual audited accounts, and a large industry has developed to serve this requirement. However, quality varies and so does the reliability of any accounts produced. Developing clear financial documentation can be challenging, particularly for small companies or family-owned businesses, even if they are operating formally. Similarly, legal representation is available, but of varying quality. Impact investors report that reliable legal advice is difficult to find, even from expensive providers.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Impact investors based in Uganda stress that there are many opportunities and that, while the business environment remains challenging, it is improving. That said, they also note that the pipeline of businesses with strong performance and sophistication is thin. As a result, most opportunities remain risky and require significant support before being investment ready. The difficult business environment presents a range of challenges for impact investors seeking to place capital in Uganda. These challenges include:

- **Insufficient investment-ready opportunities:** Despite robust activity to date, many impact investors struggle to place the capital they have raised. Although there are many businesses with exciting potential, investors encounter few companies that are truly investment ready. Early stage businesses, which are the primary target for non-DFI impact investors, typically face certain common challenges that keep them from being fully prepared, including inefficient or unproven operations, an unclear or ineffective strategy to scale, poor financial management, a lack of realistic forward looking projections, and unsupported capital asks.
- **Insufficient human capital:** Talent is the key constraint for many Ugandan businesses. Companies struggle to find the talented, reliable management needed to plan for and reach scale. This challenge is particularly acute for finance professionals with 5-15 years of experience who can serve as a company CFO. Even when a talented, experienced professional can be found, they often command high wages that can be challenging for impact businesses or impact investors to support, especially in their early years.
- **Lack of local presence:** Even though interest in Uganda is growing, only a handful of impact investors have staff on the ground, and then only in Kampala. Investing in this market, with limited legal recourse, requires implicit trust between investor and entrepreneur. Entrepreneurs remain wary of investors, particularly those seeking equity, and if an entrepreneur has been operating informally, it can be difficult to evaluate their history and trustworthiness without a strong personal relationship, which is hard to build from abroad. Local social networks can provide insight on a potential target that is extremely important to an investment decision.
- **International decision makers:** Many impact investors have investment committees that are based abroad and include international decision-makers who may not have experience with on-the-ground investments in Uganda or East Africa.³¹ These remote investment committees interpret risk differently than do their investment teams operating locally, creating friction between investment

³¹ Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

officers forming relationships with entrepreneurs and investment committees making the ultimate investment decisions.

- **Competition with donor funding:** Grant financing is widely available from donors active in Uganda. At times, non-DFI impact investors compete with this grant capital as entrepreneurs looking for funding from impact investors are typically also aware of donors. The presence of donor funding can complicate negotiations for commercial capital as entrepreneurs may believe that donors can provide them cheaper capital and that investor return expectations are comparatively too high.
- **Long diligence processes:** Correlated with the lack of investment-ready deal flow and international decision-making, the diligence process for impact investors can often stretch from 12 to 18 months for both debt and equity investments.³² This lengthy process can damage relationships with entrepreneurs, who often view it as indicating a lack of trust. It puts additional pressure on the business and can lower long-term returns as companies must survive without needed capital, creating a significant opportunity cost as management teams spend time courting investors.
- **Few exit examples:** For new funds looking to raise capital, the relative youth of the impact investment industry means there are few examples of successful exits. Without a successful track record, it can be difficult for fund managers to raise a second fund—some interviewed for this report believe it may be easier for a new fund manager to raise funds than it can be for an experienced one to do so.
- **Difficulty accessing local currency instruments:** Many social businesses engage with disadvantaged populations, often earning the majority of their revenues in local currencies. However, most impact investors track returns in international hard currencies and have little ability to invest in local currencies. This is especially challenging for long-term debt instruments that require repayment in hard currencies that can appreciate 5-10% per year.

At present, investees typically bear the resulting currency risk, which can place a substantial burden on the business if the local currency depreciates, and may endanger the ability of the company to achieve the desired growth and repay the loan.

Opportunities

Despite these challenges, there are many opportunities for impact investors to leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Opportunities for impact investors in Uganda include:

- **Leverage technical assistance facilities for pre-investment pipeline building:** Many impact investors have successfully raised technical assistance facilities for portfolio companies. Increasingly, TA funders such as USAID or DFID recognize

³² Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

the importance of pre-investment support to get companies to the point where they can pass rigorous investment committee requirements. One impact investor interviewed proposed that, if given sufficient capital, they would establish an intensive pre-investment support program to strengthen management teams and build the business in-house.

Targeted, tailored support, whether from the impact investor or a third party, requires an upfront commitment of resources but impact investors report that it has proven effective in preparing potential targets for investment and building high quality deal flow. This can dramatically reduce diligence timelines if the investor is able to increase familiarity and visibility during pre-investment support.

- **Increase local decision-making:** Where possible, impact investors have cited significant improvements in their portfolio through local decision-making and local support. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to respond to the realities on the ground as things often change in emerging markets. Placing staff and investment committees locally can also reduce diligence timelines, as these individuals are more familiar with local trends and realities. In an environment of increasing competition between impact investors for high potential deals, designing effective diligence procedures aligned to the region could be a key differentiator for successful impact investors.
- **Source opportunities outside major cities like Kampala:** Many impact investors with staff on the ground in East Africa report finding investments more easily than those based abroad. However, many entrepreneurs operate in rural areas or smaller cities, rather than in Kampala. For impact investors who see these types of businesses as highly impactful, it will be increasingly necessary to build relationships beyond those made in economic centers.

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

- **Agriculture:** Overwhelmingly, impact investors identify agriculture as a key opportunity sector. Uganda has ample arable land, favorable weather conditions, and fertile soil. While plot sizes are already considerably larger than in Kenya, impact investors see opportunity to aggregate smallholder plots into even larger plots and significantly increase yields. In addition, there is a rapidly expanding extractives industry in Uganda whose large, concentrated labor force will require significant amounts of high-quality agricultural produce. Impact investors also noted opportunities for entrepreneurs in agricultural sub-sectors, such as dairy.
- **Renewable energy:** Impact investors identify strong government support for new businesses and approaches in energy, as Uganda looks to expand its power generation capacity. This opens the door for large scale projects as the government has been willing to allocate tracts of land for energy projects in particular. At the same time, there are large segments of the population that lack reliable access to grid power, opening opportunities for micro-grid and off-grid solutions.
- **Urbanization:** Impact investors also noted that Uganda is rapidly urbanizing and demand for services to support these expanding cities is expected to grow strongly. This includes affordable housing, infrastructure development, water, healthcare, and sanitation.



TANZANIA

INCREASINGLY POPULAR
DESTINATION FOR IMPACT CAPITAL

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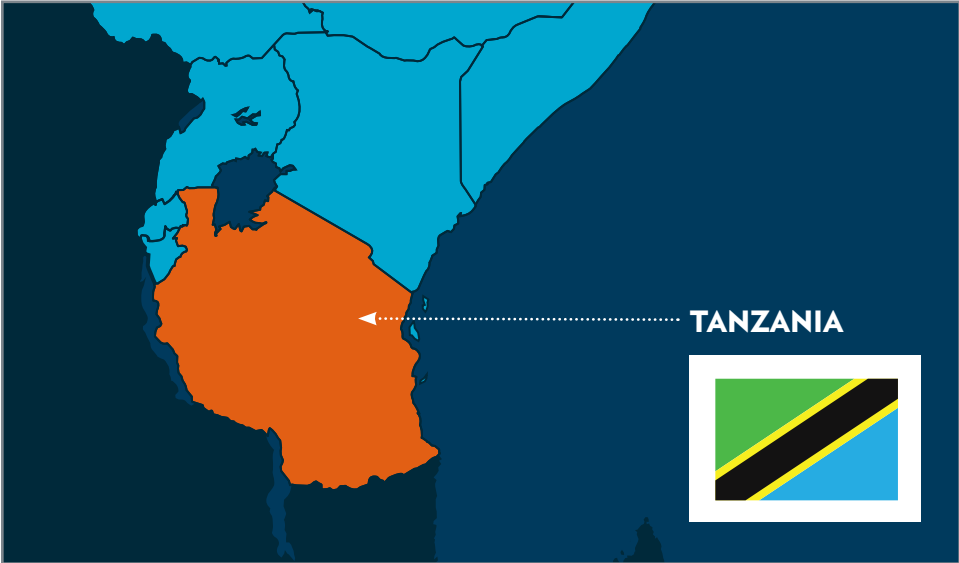
INTRODUCTION

Tanzania is a core part of the East African impact investing landscape, and most impact investors active in East Africa operate in Tanzania. Although Kenya remains the primary target for impact capital, Tanzania is an increasingly popular destination.

Despite positive trends, many adverse conditions persist in Tanzania. Sourcing talent, particularly for middle management, remains extremely difficult. Many businesses operate informally with multiple sets of accounts, which can compromise impact investors' ability to place capital. There are few investment-ready businesses, due in part to the lack of high-quality pre-investment support for promising enterprises. In addition, the nature and timing of government involvement in the private sector is unpredictable and can have severe economic consequences.

Nevertheless, Tanzania has a growing economy and is an area of focus for impact investors. Most impact investors active in the region work in Tanzania, and it has the third largest number of impact investments in East Africa. Moreover, as impact investors diversify beyond Kenya, Tanzania will be a primary beneficiary, and the amount of capital deployed is expected to increase accordingly.

FIGURE 1: MAP OF TANZANIA



COUNTRY CONTEXT

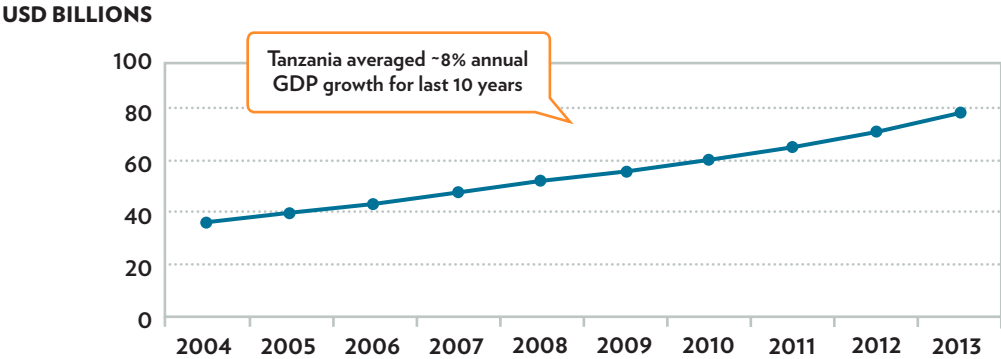
Tanzania is one of the most politically stable countries in East Africa and has seen strong growth in recent years. This is reflected across economic indicators, though the country requires support to improve human development indicators and increase linkages between disadvantaged populations and the rapidly growing national economy.

Notably, Tanzania is a member of both the East African Community (EAC) and the Southern African Development Community (SADC). This dual membership expands Tanzania’s trade options and has resulted in many South African companies being active in Tanzania, despite them being much less active in other East African countries.

Gross Domestic Product

Tanzania’s GDP has grown approximately 8% year-on-year in PPP terms between 2004 and 2013 (Figure 2). GDP stands at USD 86 billion in PPP terms, though only USD 36 billion in current price terms. With a population slightly larger than Kenya’s (roughly 49 million), Tanzania has a similar GDP in PPP terms, but a much lower GDP in current price terms. This demonstrates the significantly lower price levels for common goods and services in Tanzania compared to Kenya.

FIGURE 2: GDP (PPP), 2004–2013



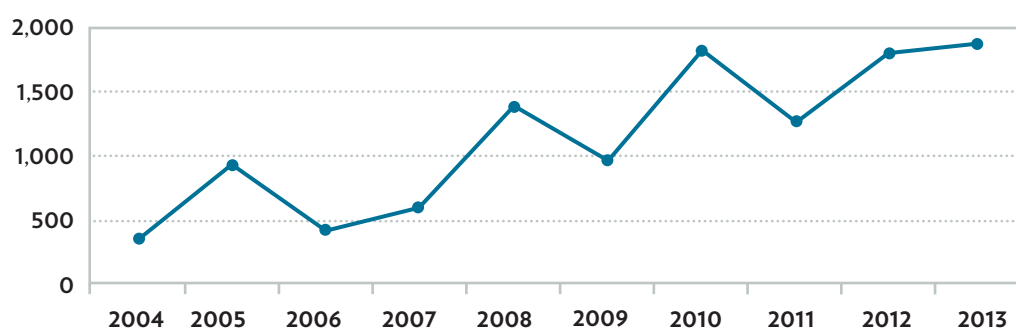
Source: IMF World Bank Economic Indicators, April 2014

Foreign Direct Investment

Strong GDP growth has been accompanied by even stronger foreign direct investment (FDI) inflows, increasing at nearly 19% year-on-year over the last decade.¹ Tanzania realized more than USD 1.8 billion in FDI inflows in 2013, the second highest FDI inflow in East Africa.² This large and growing FDI is primarily driven by oil and gas exploration, with the mining and quarrying sector accounting for more than 43% of all FDI inflows between 2008 and 2011.³ The primary sources of this FDI have been the United Kingdom, South Africa, and Canada, which together account for more than 70% of all FDI to Tanzania from 2008 to 2011.⁴

FIGURE 3: FDI FLOWS, 2004–2013

USD MILLIONS



Source: UNCTAD

1 Inward and Outward Foreign Direct Investment Flows, annual, 1970–2013, *United Nations Conference on Trade and Development*, available at <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=88>.

2 *Ibid.*

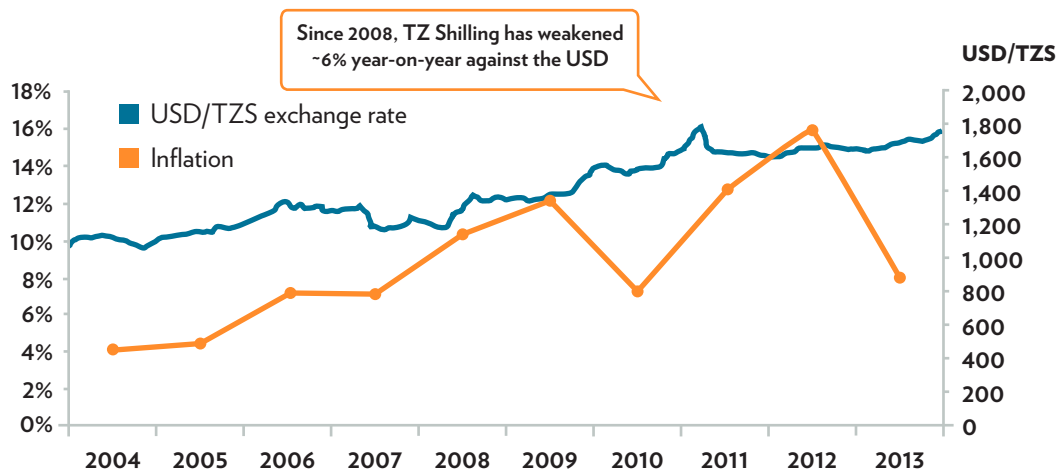
3 G. Mwakibolwa, et al., Tanzania Investment Centre, et al., *Tanzania Investment Report 2012: Foreign Private Investment and Investor Perception* (2013), available at <http://www.tic.co.tz/media/TIR2012%20Main%20Report%20for%20Web.pdf>.

4 *Ibid.*

Inflation and Exchange Rates

Over the past decade, Tanzania has experienced high and volatile local inflation rates reaching as high as 16%. In addition, the Tanzanian Shilling has depreciated by approximately 6% per year against the US dollar since the beginning of 2008, reducing the hard currency value of local currency debt that international investors disburse in Tanzania. For additional information on the impact of exchange rates on debt instruments, see the East Africa regional chapter.

FIGURE 4: INFLATION AND USD/TZS EXCHANGE RATE, 2004-2013



Source: IMF World Bank Economic Indicators, Oanda Historical Currency Rates

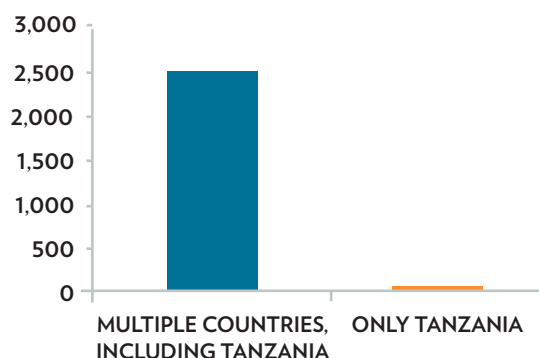
SUPPLY OF IMPACT INVESTING CAPITAL

Tanzania is typically considered the third country of focus for impact investing in the region, after Kenya and Uganda, and will likely see increased activity as impact investors expand their focus beyond Kenya. That said, the gap in impact investing activity between Tanzania and Kenya and Uganda is large. There have been at least 109 non-DFI⁵ impact deals in Tanzania, disbursing approximately USD 227 million in capital—roughly half the number of deals and a third of the capital disbursed in Kenya.

There are 129 impact capital vehicles managed by 92 non-DFI impact investors that actively consider Tanzania—nearly as many as consider Kenya. Most of these impact capital vehicles are active across the region, where more than USD 2.5 billion in capital committed regionally could be deployed in Tanzania (Figure 5). Tanzania, however, is likely to capture only a small share of this capital if historical deal flows persist. There is less than USD 35 million that has been committed exclusively to Tanzania. Most of the non-DFI impact investors active in Tanzania focus on early-stage businesses that have some track record and operational structures in place.

FIGURE 5: TOTAL CAPITAL COMMITTED BY NON-DFI IMPACT INVESTORS

USD MILLIONS



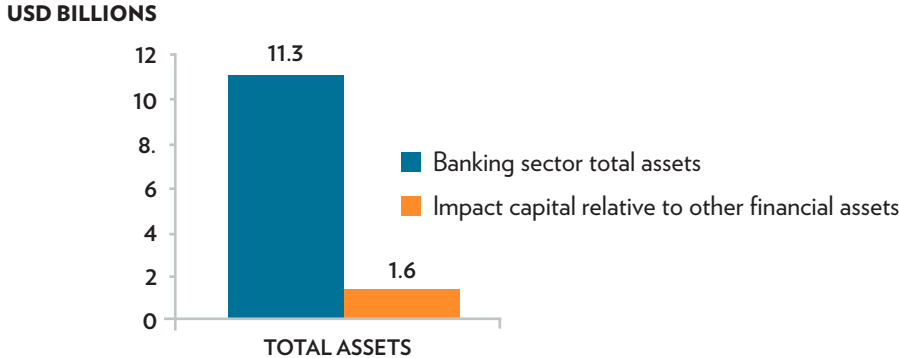
Source: Open Capital Research

5 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

Broader Investing Landscape

Impact investment assets represent a small part of the overall investment picture in the country. For example, local banks had more than USD 11 billion in assets under management in 2011 (Figure 6) while additional sources of capital—such as commercial private equity funds, hedge funds, savings and credit cooperatives (SACCOs), and microfinance institutions (MFIs)—further increase this number.⁶ Indeed, banks had more than USD 4.5 billion of outstanding loans in 2011, or nearly 20 times the known disbursements made by non-DFI impact investors in Tanzania to date and more than four times more than known disbursements made by all impact investors in Tanzania.⁷

FIGURE 6: IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: Bank of Tanzania, Tanzania Chamber of Commerce, Open Capital Research

Although impact investing represents a small portion of total investment activity, it fills an important gap in the market for the early-stage businesses of interest to most non-DFI impact investors. Tanzanian banks remain risk averse, even more so than in other East African countries, and are often unwilling to invest in start-up or early-stage enterprises. When willing to lend, they require extremely high collateral ratios, frequently more than 100% of the loan amount.

Entrepreneurs face high interest rates, even if they are able to meet collateral requirements. Over the last ten years, Tanzanian bank rates have fluctuated between 14% and 16%.⁸ This compares favorably with Kenya, which has experienced larger volatility and where, as of 2013, rates stood 1.5% higher. Nevertheless, Tanzania's interest rates remain high by international standards, often more than three times

6 Serengeti Advisors, *Tanzania Banking Survey 2012* (2012), available at <http://www.tccia.com/tccia/wp-content/uploads/2011/07/Tanzania-Banking-Survey-2012-FINAL-July-2012.pdf>.

7 *Ibid.*

8 World Development Indicators: Lending Interest Rates (%), *The World Bank Group* (2014), available at <http://data.worldbank.org/indicator/FR.INR.LEND?page=2>.

higher than the average bank interest rate in the United States, which stood below 5% between 2004 and 2013.⁹

Stringent collateral requirements and high interest rates limit the practical availability of bank financing for enterprises. The limited availability provides a market opportunity for private investors who are able to provide equity and/or debt that is cheaper or has lower collateral requirements.

This gap is at times filled by grants, which are widely available from donors active in Tanzania. Non-DFI impact investors report that they frequently compete with donor funding for high potential deals, as social entrepreneurs speaking with impact investors are often aware of donor opportunities. Even if an entrepreneur is not directly sourcing capital from donors, their presence in the market can complicate negotiations for impact capital as entrepreneurs may view donor funding as an opportunity to raise free capital and to avoid investors' comparatively high return expectations. Many grant-making institutions, however, are unwilling to lend to commercial enterprises and often have stringent reporting or operational requirements that are less attractive for businesses.

Impact Capital Disbursed

Tanzania boasts one of the most robust deal flows in the region, although it remains well below the level of activity in Kenya. In total, non-DFI impact investors have disbursed at least USD 227 million to date, or about 17% of known non-DFI impact capital disbursed in East Africa (Figure 7). The country has received a similar proportion of known DFI direct investments (about 11%), with nearly USD 850 million disbursed (Figure 7).

FIGURE 7: IMPACT INVESTMENTS IN TANZANIA

	Capital disbursed	Deals
DFI	USD 846 Millions	65
NON-DFI	USD 227 Millions	109

Source: Open Capital Research

⁹ *Ibid.*

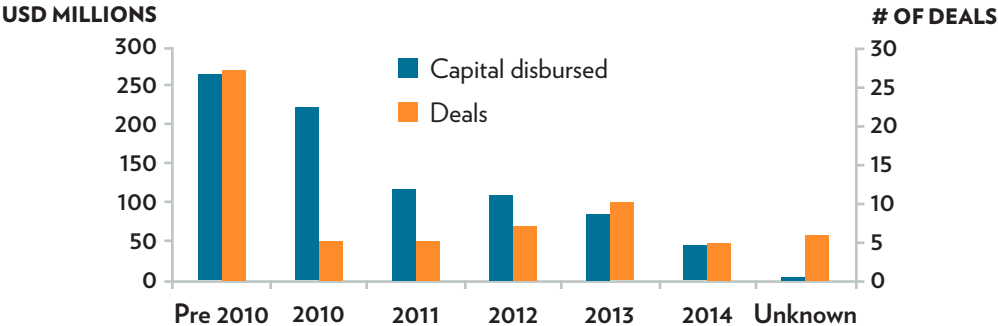
Tanzania boasts significantly more impact investing activity than the next most active country, Ethiopia—about 2.5 times the known amount of non-DFI impact capital disbursed and more than four times the number of known non-DFI impact deals.¹⁰ This aligns with the view of most non-DFI impact investors that Kenya, Uganda, and Tanzania are the core impact investing markets in East Africa.

Investments Over Time

With a large number of deals with undisclosed details, few definitive conclusions can be drawn about the timing of non-DFI impact investing in Tanzania. It is likely that most of these deals occurred after 2010, if consistent with the general trend in impact investing in East Africa.

DFI direct investments in Tanzania have grown over the last four years (Figure 8). The decline for 2014 is likely due to incomplete data at the time of data collection in late 2014, as many attempt to close final investments before the end of the calendar year.

FIGURE 8: DFI DIRECT INVESTMENTS BY YEAR



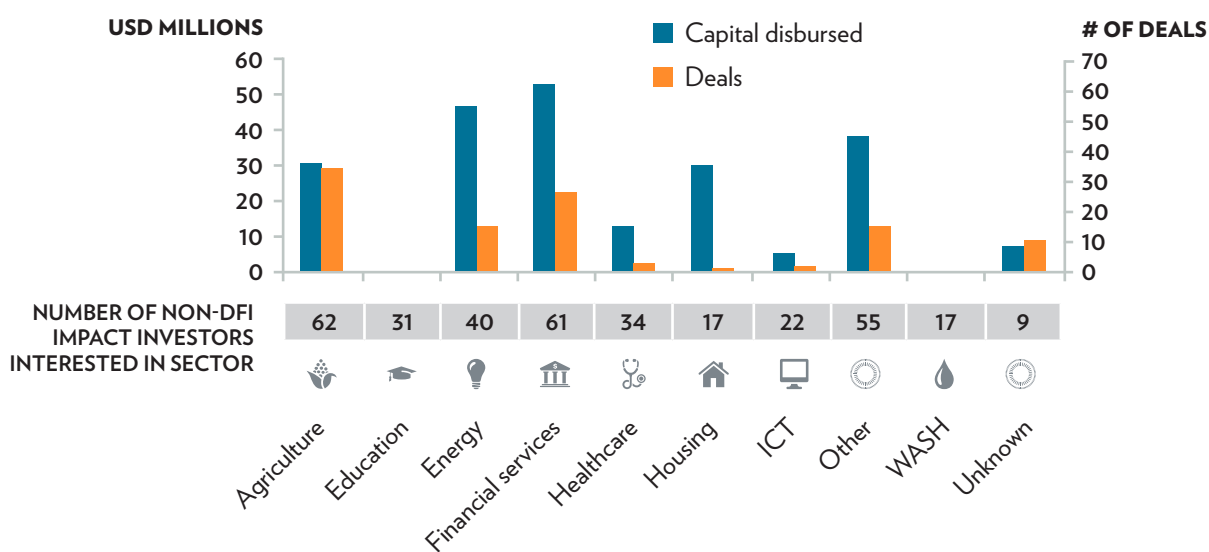
Source: Open Capital Research

¹⁰ Rwanda has more known deals than Ethiopia—38 compared to 25. Tanzania has nearly three times the number of deals as Rwanda.

Sector

The distribution of investments by sector broadly reflects impact investor interest. Agriculture and financial services have received the most deals from non-DFI impact investors (over 55%) and have strong interest from several investors (Figure 9). Despite the larger number of deals in agriculture, the large investment sizes possible when placing capital into established banks or MFIs drives a greater total amount of capital to financial services. Similarly, the housing sector has seen significant capital disbursed despite relatively few deals. These projects tend to have larger average deal sizes than other sectors due to substantial construction costs and the frequent need to internally finance mortgages for low-income borrowers. The energy sector in Tanzania has also received significant capital disbursed, driven primarily by three large deals by a single non-DFI impact investor.

FIGURE 9: NON-DFI IMPACT INVESTMENTS BY SECTOR

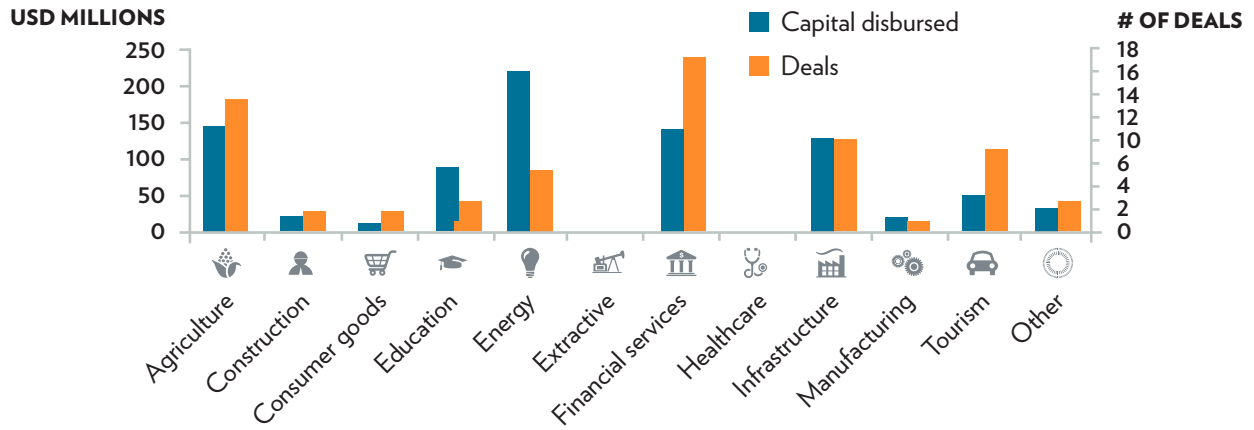


Source: Open Capital Research. Note: Chart shows total number of non-DFI impact investors interested in sector; may be multiple sectors

Despite their prominence as interest sectors for non-DFI impact investors, education and health have seen relatively few deals. The disconnect between interest in these sectors and the number of deals implies that impact investors see limited viable, investible opportunities and have particular difficulty placing capital.

As can be seen in Figure 10, known DFI direct investments also favor investments in agriculture (20% of deals and approximately 17% of capital disbursed) and financial services (more than 25% of all deals and approximately 16% of all capital disbursed). The energy sector received the most capital (more than 25% of total DFI capital disbursed in Tanzania), although more than half was due to a single large investment.

FIGURE 10: DFI DIRECT INVESTMENTS BY SECTOR

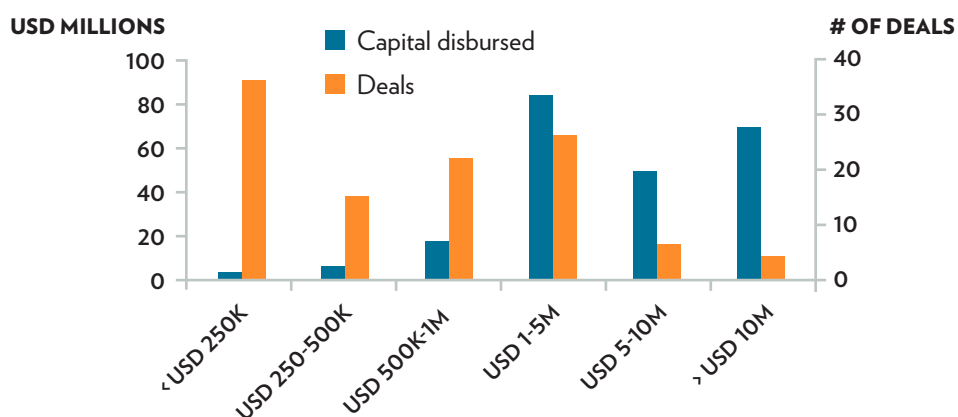


Source: Open Capital Research

Deal Size

As shown in Figure 11, the vast majority of capital disbursed by non-DFI impact investors has been in amounts above USD 1 million, although two-thirds of known impact deals in Tanzania are less than USD 1 million in size. Deals under USD 250,000 represent a full third of all impact deals in Tanzania. These small deals contrast with Kenya, where only about 11% of deals are below USD 250,000, suggesting that non-DFI impact investors are finding that most interesting businesses in Tanzania are still relatively small.

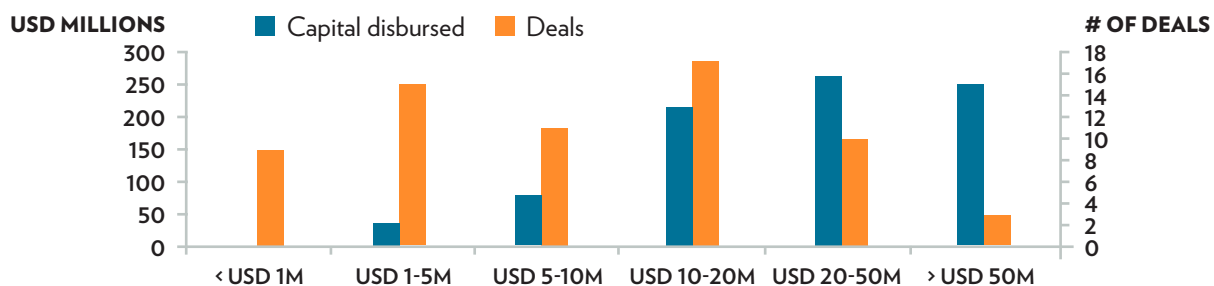
FIGURE 11: NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

By contrast, the average deal size for known DFI direct investments in Tanzania is above USD 13 million (Figure 12), more than six times the average deal size of non-DFI impact investors. This is driven by investments in sizeable energy projects as well as large placements in sectors like energy, extractives, and infrastructure. Even though deals under USD 10 million constitute more than half of the total direct DFI investments, approximately 13% of direct DFI deals were under USD 1 million compared to 67% of non-DFI impact investor deals.

FIGURE 12: DFI DIRECT INVESTMENTS BY DEAL SIZE

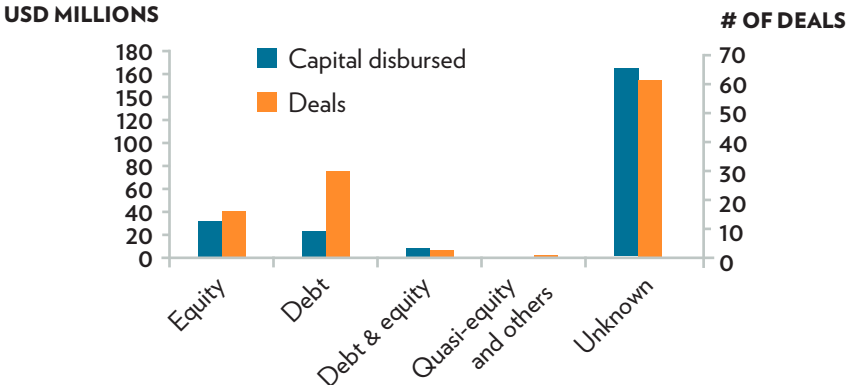


Source: Open Capital Research

Instrument

The large number of deals with undisclosed details prevents a definitive breakdown of non-DFI investment instruments; however, known deals indicate that traditional debt and equity are the most common instruments (Figure 13). Of these known deals, non-DFI impact investors have made nearly twice as many debt investments as equity, aligning with interview findings from investors that it can be challenging to explain equity investments to entrepreneurs. Unlike their counterparts in Kenya or Uganda, non-DFI impact investors in Tanzania reported that they have not begun to use non-traditional structures such as convertible debt or revenue-participating debt.

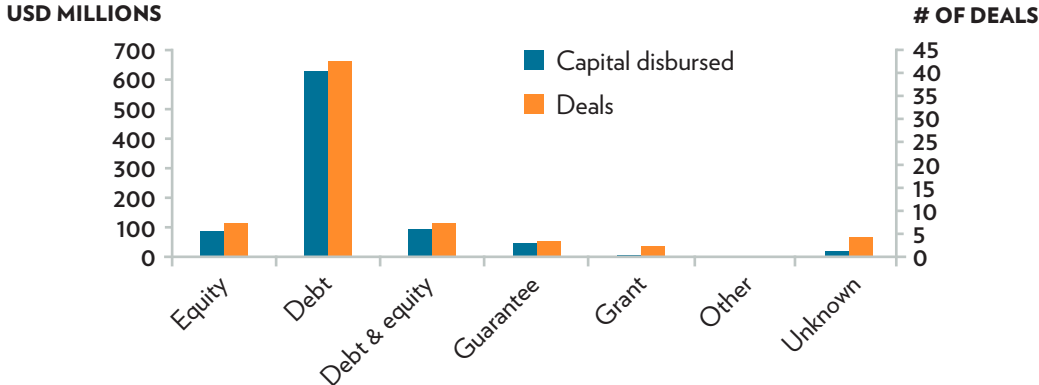
FIGURE 13: NON-DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

As elsewhere in the region, DFI direct investments are overwhelmingly debt, with a handful of equity deals (Figure 14). Debt investments constitute more than 70% of all capital disbursed and nearly two-thirds of deals made by DFIs directly. Together, debt and equity investments are nearly 90% of direct DFI deals and capital disbursed.

FIGURE 14: DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

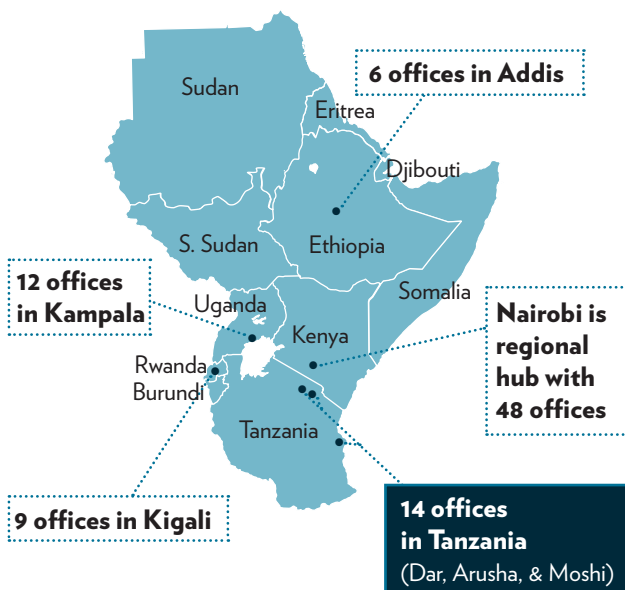
Local Presence

A number of impact investors have chosen to place staff on the ground in Tanzania, predominantly in Dar es Salaam, but also in Arusha and Moshi (Figure 15). Indeed, Tanzania is home to more impact capital vehicles than any other country except Kenya, and two impact investors have their headquarters there.

The impact investing community in Tanzania remains small, but because it is dispersed across multiple cities, more businesses have access to a local impact investor. Impact investors interviewed noted that they know each other well and have close, collegial relationships. These connections allow free sharing of information about entrepreneurs and potential investments, which assists investors to develop pipeline and more effectively conduct due diligence on potential investments.

Fluency in Kiswahili is critical to leverage local presence in Tanzania. To a much greater extent than Kenya, Tanzanians do not use English, which can complicate efforts to form relationships. Without Kiswahili, impact investors limit the number of strong relationships they can form and their ability to source new deals.

FIGURE 15: IMPACT INVESTORS WITH LOCAL OFFICES



Source: Open Capital Research

Impact Tracking Standards

Impact investors' dual mandate to realize both financial and social returns requires a strong focus on measuring impact as a part of their core activities. Beyond tracking metrics as best practice, many of their supporters require it, including DFIs, which act as anchor investors to most impact funds.

Most impact investors in Tanzania do not specify a standardized approach for measuring the impact of their investments across their portfolio. Instead, they typically use flexible structures adapted to each new investment. Many impact investors have rigorous and rigid impact guidelines to make an investment, but they design and track metrics after the investment in an individualized manner to minimize the burden placed on their portfolio companies. Further information on challenges in impact measurement is provided in the East Africa regional chapter of this report.

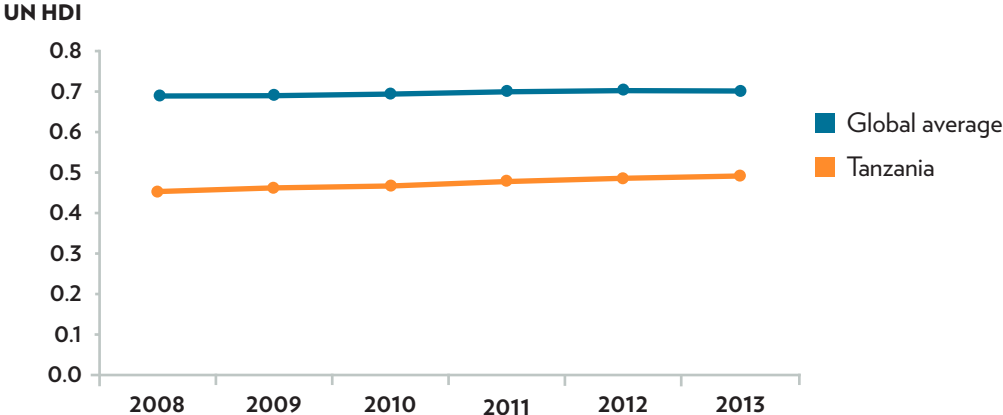
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital from entrepreneurs operating in Tanzania. Despite recent progress, there remain significant gaps in the provision of key goods and services, which create opportunities for entrepreneurs to build enterprises that fill key needs while also realizing financial returns.

Development Context

Tanzania has seen recent improvement in human development indicators, but still remains well below global averages (Figure 16). Overall, Tanzania is ranked 159th of 187 countries evaluated in the United Nation’s Human Development Index.¹¹ This low ranking is reflected in poor performance across a number of individual development indicators covering poverty, health, and education.

FIGURE 16: UN HDI SCORES, 2008-2013



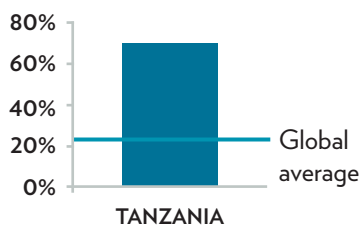
Source: United Nations Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

11 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

More than two-thirds of Tanzania's population, or more than 30 million people, live on less than USD 1.25 per day (Figure 17), nearly three times the global average. This is the second worst poverty level in East Africa, after Burundi.

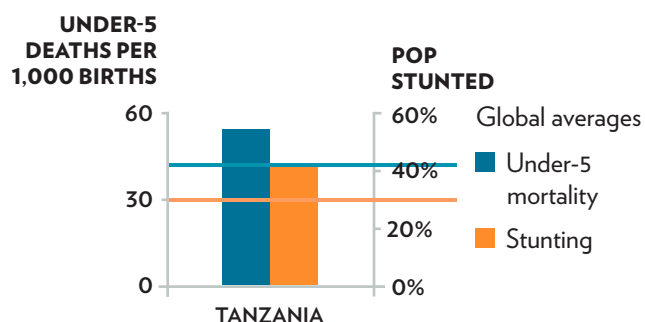
Tanzania also has poor health indicators, significantly underperforming global averages. Tanzania's under-five and infant mortality rates are both somewhat above global averages.¹² Despite being well above global averages, Tanzania's under-five mortality rate is the second lowest in East Africa, behind only Eritrea's. By contrast, its rate of under-five stunting, an effective proxy for childhood and later health in general, is slightly worse than the East African average and is more than 50% greater than the global average (Figure 18).¹³

FIGURE 17: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

FIGURE 18: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



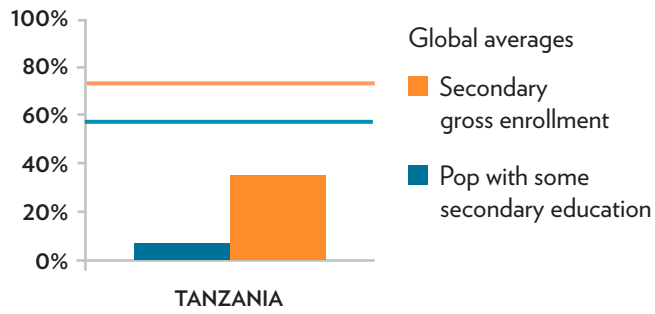
Source: UN Human Development Report 2014

12 Tanzania's infant mortality rate was 38 per 1,000 live births in 2012, compared to a global average of 34 in 2013. UNICEF Statistics: http://www.unicef.org/infobycountry/tanzania_statistics.html.

13 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

On the other hand, Tanzania's gross secondary education enrollment is slightly above East African average. Nevertheless, it remains below half of the global average—less than 8% of the Tanzanian population age 25 and above has attended some secondary school, which is less than 15% of the global average (Figure 19).¹⁴

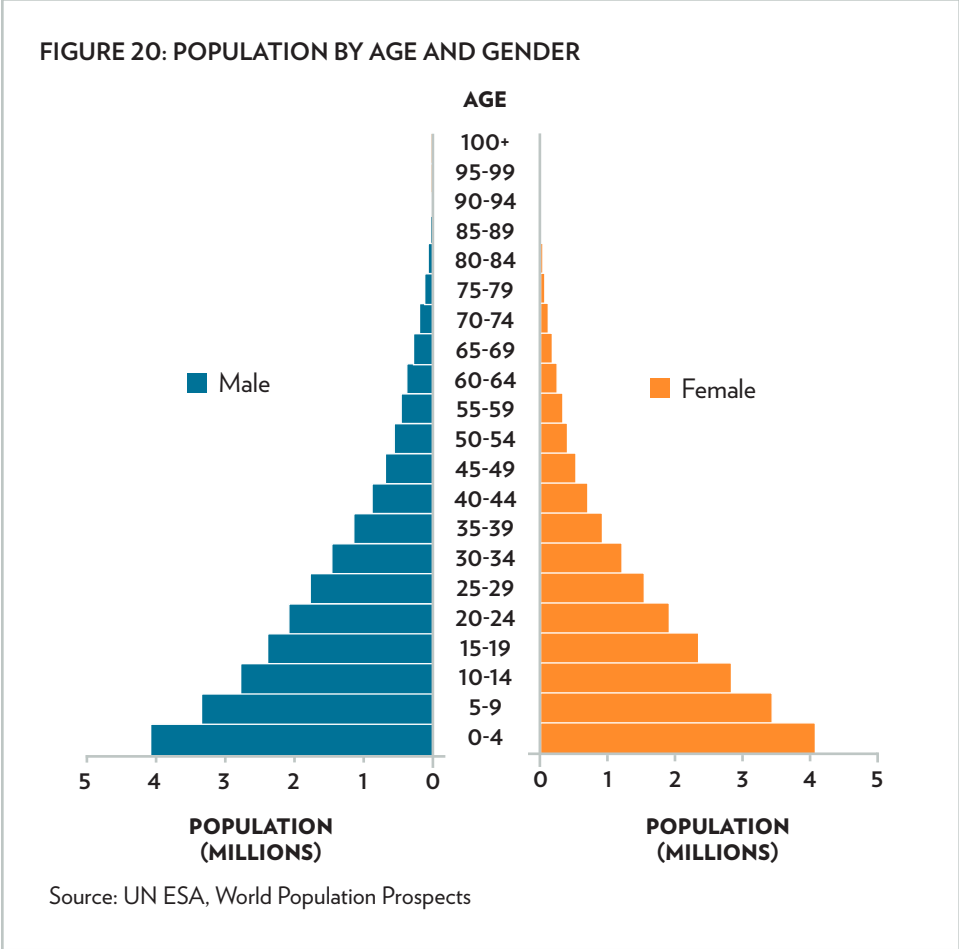
**FIGURE 19: KEY EDUCATION INDICATORS
(LATEST AVAILABLE DATA POINT)**



Source: UN Human Development Report 2014

¹⁴ *Ibid.*

Educational metrics are an especially important indicator for future development given Tanzania’s demographics. Like other East African countries, Tanzania has a disproportionately young population, where nearly 45% is under the age of 15 and more than 60% is below age 25 (Figure 20). This youth boom has led to high unemployment among young people which, when compounded with low levels of education, poses a challenge to economic growth.



Entrepreneurs

As is the case across the region, Tanzania has many early-stage businesses that operate across a range of impactful sectors, including education, housing, healthcare, water and sanitation, energy, etc. These businesses seek capital across the spectrum of funding from start-up and SME-size deals to capital for scaling up, although they are primarily start-up and early-stage businesses. Similarly, non-DFI impact investors focus on early-stage opportunities that have some track record and operational structures in place.

Despite growing interest in placing capital in Tanzania, entrepreneurs face substantial challenges to become investment-ready and struggle to find financing beyond friends and family. Bank financing can be particularly difficult and expensive. As in much of the region, collateral requirements are high. However, this hurdle can be even more restrictive in Tanzania, as impact investors report that banks in Tanzania often do not accept land as collateral because of difficulties arising from community

land ownership. Without land as security, many entrepreneurs, particularly those in agriculture, find it impossible to access bank financing. Non-DFI impact investors note that banks also rarely have products or processes suited to agricultural investments and that they prefer to place capital in government bonds. There have been new entrants to the banking sector from Kenya, but these new banks have yet to significantly expand access to financing.

Impact investors note that many potentially interesting early-stage businesses and even some large businesses operate informally. They often have different sets of accounts for different audiences (e.g., one for the revenue authority, one for their family, and one that is accurate). In such cases, it is difficult for impact investors to build confidence in a business's operations or trust in the entrepreneur. This makes it hard for investors to disburse capital. Beyond the lack of transparency, informal businesses often do not comply with relevant laws, which is a threshold condition for some impact investors. More generally, informal businesses are significantly less likely to have clear financial records, access to formal markets, or access to government services, making them less likely to be an attractive target for impact capital.

Early-stage businesses face significant challenges arising from Tanzania's geographic size and poor infrastructure. Low population density implies that growing businesses must expand their geographic reach rapidly, which is challenging. New markets are far from headquarters and must be operated largely as a separate endeavor. For example, inventory, sourcing, and distribution must often be re-created and run independently.

Sourcing adequate human capital to manage these dynamics is one of the most prominent challenges businesses face. As with much of East Africa, there is a limited pool of talented middle and senior management talent and, when available at all, capable managers are costly. This problem is particularly acute in Tanzania because the country does not have a large returning diaspora to supplement in-country talent. Impact investors note that many exciting small businesses have some foreign management, despite many impact investors' desire to find local entrepreneurs. In some cases, these are managers from the region. Alternatively, some strategic investors have supplied management talent as part of their investment offering. This model overcomes initial management challenges while the fixed timeline requires training of and transition to local management after a short time.

In addition to these challenges, early-stage businesses often suffer from similar challenges as early-stage businesses across the region, such as insufficient human capital and lack of access to bank financing (see the Regional Overview chapter of this report for more detail). Though such challenges are not as common with growth-stage businesses, high potential, rapidly scaling growth companies are significantly rarer. For more detail on the challenges facing both early- and growth-stage companies in East Africa, see the East Africa regional chapter of this report.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

The impact investing ecosystem in Tanzania remains challenging and is a key constraint for investors. Government intervention can be extensive and unpredictable. Impact investors interviewed consider sectors with a history of government involvement broadly unsuitable and report being wary of the government imposing new regulatory burdens on any rapidly growing sectors.

The broader business environment is not yet as developed as it is in other East African countries. There are few active intermediaries or service providers to provide needed pre-investment support and facilitate deal flow. Even though there are a number of accountants and law firms, there is substantial variation in quality. While good advisors are available, they are generally expensive; impact investors estimate legal costs to be twice as high in Tanzania as in Kenya.

Regulatory Environment

Tanzania is one of the most politically stable countries in East Africa and has a generally welcoming regulatory landscape for investors. It is one of the easier countries to conduct business in in East Africa, ranking second in the region in the World Bank's Ease of Doing Business rankings.¹⁵ Other than land ownership, there are few differences in regulation for foreign and domestic investors. Investors are able to access foreign currency easily, repatriate profits, and own local companies.

Nonetheless, impact investors report uncertainty around government policies as a major impediment to placing capital. In addition, interacting with the Tanzanian state to pay taxes or apply for licenses can be complicated due to inefficient bureaucracies. Some key features of Tanzania's regulatory landscape are described below:

- **Repatriation of profits and dividends:** Tanzania does not restrict foreign investors from repatriating returns; profits, dividends, and capital can be easily repatriated after tax.¹⁶ These repatriations may generally occur in any currency.¹⁷
- **Foreign exchange controls:** Tanzania has open foreign exchange rules. Foreign exchange is freely available from commercial banks and can be acquired and held equally by locals and foreign nationals. Any person may open a foreign currency account with an authorized bank. Recently, the Tanzanian government required all

15 "Economy Rankings," *The World Bank* (Jun. 2014), available at <http://www.doingbusiness.org/rankings>.

16 U.S. Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204744.htm>; Deloitte, *International tax: Tanzania Highlights 2014 (2014)*, available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tanzaniahighlights-2014.pdf>.

17 Deloitte, *International tax: Tanzania Highlights 2014 (2014)*, available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tanzaniahighlights-2014.pdf>.

foreign source loans to be registered with the Bank of Tanzania.¹⁸ The reporting obligation lies with the local bank, though individual businesses and impact investors seeking to place capital may be required to share additional information in response to this reporting requirement.¹⁹

- **Land ownership:** All land in Tanzania is public—the country does not recognize absolute private ownership of land. At most, it may be leased from the government for 99 years. Foreigners are only permitted to lease land through the Tanzania Investment Center (TIC).²⁰ The TIC has allocated specific plots for foreign investors, although the process to allocate new land can be lengthy.²¹ Less than 10% of land has been surveyed and title deed registration is completed manually at the local level, further complicating matters.²² The TIC maintains a bank of land for investment purposes, but restrictions on foreign land ownership can significantly delay investment.

Foreign investors may form joint ventures with Tanzanians to own land. In these joint ventures, the Tanzanian retains the leasehold and provides use to the foreign investor.²³ In order to be considered a Tanzanian company, a company must be majority owned by Tanzanian citizens.²⁴

- **Local ownership requirements:** Foreign investors may purchase up to 100% of any local company except in telecommunications (65% foreign shareholding maximum), shipping (50%), or mining (variable) sectors. Local shareholders are defined as Tanzanian citizens or companies where at least 51% of the shares are held by Tanzanian citizens.²⁵
- **Government intervention:** The Tanzanian government remains heavily involved in the economy and can impose difficult regulatory burdens unpredictably. For example, Tanzania has a history of ad hoc decisions to ban exports of certain

18 KPMG International Executive Series, *Thinking Beyond Borders: Tanzania* (2012), available at <http://www.kpmg.com/global/en/issuesandinsights/articlespublications/thinking-beyond-borders/documents/tanzania.pdf>; Deloitte, *International tax: Tanzania Highlights 2014* (2014), available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-tanzaniahighlights-2014.pdf>.

19 Clyde & Co, *Registration of Private Sector Foreign Loans with the Bank of Tanzania* (2014), available at <http://www.inhousecommunity.com/upload/pdf/40c8a62e649214db564b636b23bb961e.pdf>.

20 US Department of State, *2013 Investment Climate Statement: Tanzania* (2013), available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204744.htm>.

21 *Ibid.*

22 *Ibid.*

23 *Ibid.*

24 Hogan Lovells, *Foreigners' Land Rights in Tanzania - are they there?* (2014), available at http://www.hoganlovells.com/files/Publication/cf5c8bf2-cc64-46b7-9182-395020bcb732/Presentation/PublicationAttachment/c02e06e1-de0e-4dd5-991b-3cbe3f8f9922/Foreigners_Land_Rights_in_Tanzania_are_they_there_May_2014.pdf.

25 Jeffrey Delmon & Victoria Rigby, Kluwer Law International, *International Project Finance & Public Private Partnerships* (2010), available at http://books.google.co.ke/books?id=V4RuM_1kPhAC&pg=RA10-PA19&pg=RA10-PA19&dq=Tanzania++%2B+Required+local+shareholding+participation&source=bl&ots=C7I7G_tiAG&sig=4IDHaahtOgeFJmgT1LeUw1Newv4&hl=en&sa=X&ei=JHpYVIXpEcOUar-MgUA&redir_esc=y#v=onepage&q=Tanzania%20%20%2B%20Required%20local%20shareholding%20participation&f=false.

foods and at one point banned grain exports.²⁶ The government also sets prices in some sectors, such as coffee and cashew. In some cases, government prices have been set above the international market, meaning local producers are unable to sell through formal channels.²⁷ Beyond price setting, impact investors believe the government may look to growing sectors for opportunities to raise tax revenue. For example, impact investors expressed concern over a proposal to remove the VAT exception for solar products, but this proposal was later shelved.²⁸ The government continues to operate state-owned enterprises in large-scale energy, telecommunications, banking, rail, and mining that receive government subsidies and other preferential treatment.²⁹

26 Bernard Kagira, USAID, *The Case Study: Tanzania Drops Export Ban on Grains* (2011), available at http://www.competeafrica.org/Files/Case_Study_-_Tanzania_Export_Bans_02122011.pdf.

27 Shenoy Karun, "Tanzania Floor Price Zaps Cashew Imports," *The Times of India* (Mar. 6, 2012), available at <http://timesofindia.indiatimes.com/city/kochi/Tanzania-floor-price-zaps-cashew-imports/articleshow/12155687.cms>.

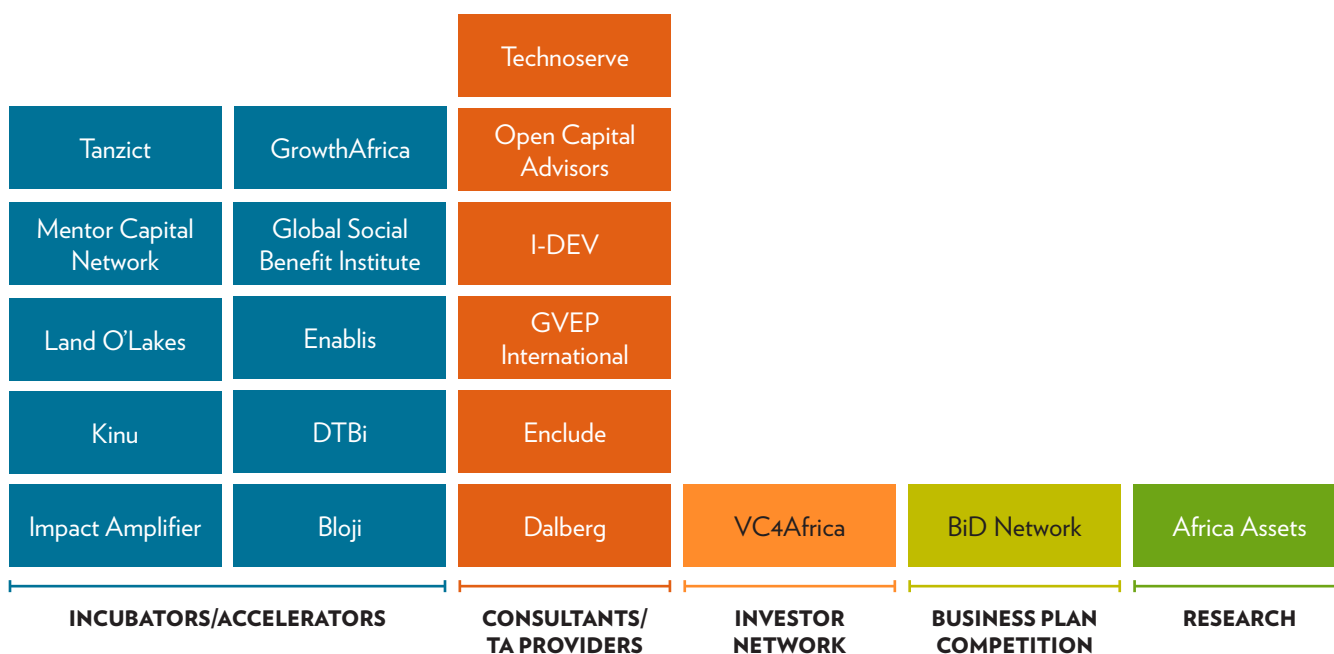
28 Finnigan wa Simbeye, "Treasury: No Plans for VAT on Solar Panels," *Daily News* (Nov. 14, 2014), available at <http://www.dailynews.co.tz/index.php/biz/38256-treasury-no-plans-for-vat-on-solar-panels>.

29 US Department of State, *2013 Investment Climate Statement: Tanzania* (2013), available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204744.htm>.

Ecosystem Players

There are a growing number of ecosystem players active in Tanzania. The research team identified 22 active organizations, primarily comprised of consultants and incubators/accelerators. Despite the number of ecosystem players formally active in the market, few impact investors and entrepreneurs interviewed report working with local ecosystem players.

FIGURE 21: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Source: Open Capital research, organization websites. Note: chart focuses on those with local presence; many international players active

Although there are a number of regional incubators and accelerators, most are based elsewhere in the region. Encouragingly, several new technology hubs have opened in Dar es Salaam. Impact investors think these new hubs are indicative of increasing interest in incubating technology ventures in Tanzania, although they are not able to meet demand today.

These ecosystem players offer similar services as their counterparts across East Africa. As in the rest of the region, the skew towards incubators and accelerators, which tend to focus on seed or very early venture-stage businesses in specific sectors, leaves a gap for service providers to support growth-stage businesses across a range of sectors. For more detail on active players' service offerings and gaps in the ecosystem, please see the East Africa regional chapter.

Other Ecosystem Players

In line with the general impact investing ecosystem in Tanzania, social enterprises often struggle to access needed services. Every company must produce annual audited accounts and, while there are several high-quality auditors that are well-known in the market, they tend to be prohibitively expensive for small businesses. Outside of these few providers, quality varies widely, as does the reliability of accounts produced. Particularly for small companies, developing clear financial documentation can be challenging, even if they are operating formally.

Legal representation is also available but of varying quality. There are a handful of respected firms that are well suited for high-quality legal due diligence, but they are often too expensive for smaller investments. In general, the lack of broad, high-quality legal representation increases transaction costs for new transactions; impact investors estimate that legal diligence costs in Tanzania are twice as high as in Kenya.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Impact investors based in Tanzania stress that there are many opportunities, but that to be successful, investors need to be flexible in their investment criteria. Rigid criteria around sector, impact, or stage of business can be counterproductive and prevent completing investments. This emphasis on flexibility implies an underlying sentiment that there are still few high-potential entrepreneurs in Tanzania. Without the depth of talent and potential investments present in other countries such as Kenya, there is less room for impact investors to focus only on a sub-set of opportunities.

Challenges

There are, however, a variety of challenges for current impact investors, new impact investors, and other eco-system players in Tanzania. Challenges commonly faced in Tanzania include:

- **Insufficient investment-ready deal flow:** As elsewhere in the region, many impact investors struggle to disburse capital in Tanzania. Efforts are complicated by a substantial informal sector where many businesses, even large ones, have multiple sets of accounts. Even if a clear financial history can be determined, informal businesses are seldom fully compliant with applicable regulations. Like companies in the rest of the region, businesses in Tanzania also suffer from inefficient operations, a lack of realistic strategies and projections, and a limited plan to use capital invested.
- **Government intervention:** The government of Tanzania remains actively involved in the economy, and its involvement in specific sectors can be unpredictable. Sudden changes with strong effects on the business environment for a sector are possible and uncertainty about government policies can be a major impediment to placing capital.
- **Competition with donor funding:** Grant financing is widely available from donors active in Tanzania. At times, impact investors compete with grant capital as entrepreneurs who seek capital are typically also aware of donors. Donor presence in the market can complicate negotiations for commercial capital as entrepreneurs may believe they can raise free capital or may believe investor return expectations are too high.

- **International decision makers:** Many impact investors have investment committees based abroad that include international decision-makers who may not have experience with investments in East Africa. These remote investment committees interpret risk differently than do their investment teams operating on the ground, creating friction between investment officers forming relationships with entrepreneurs and investment committees making the ultimate investment decisions.³⁰
- **Long diligence process:** Correlated with the lack of investment-ready deal flow and international decision making, the diligence process for impact investors can often stretch 12-18 months for both debt and equity investments.³¹ This lengthy process can damage relationships with entrepreneurs, who often view it as reflecting a lack of trust. It can put additional pressure on businesses and lower long-term returns as companies must survive without needed capital, creating a significant opportunity cost as management teams spend time courting investors.
- **Few exit examples:** For new funds looking to raise capital, the youth of the industry means there are few successful exit examples. Without a successful track record, it can be difficult for impact fund managers to raise a second fund—some interviewed for this report believe it may be easier for a new fund manager to raise funds than for an experienced one to do so.
- **Limited experienced local talent:** Impact investors struggle to find experienced local staff to support both their own investment teams and management teams within growing portfolio companies. This challenge is particularly acute for finance professionals with 5-15 years of experience who can serve as a company CFO, investment officer, or portfolio manager for an impact investor, despite the large number of students graduating each year with degrees in accounting and finance. Even when a talented, experienced professional can be found, they often command high wages that can be challenging for SMEs or social enterprises to support, especially in their early years. Similarly, lean impact investors, particularly those operating small funds, find it difficult to pay high wages. This shortage is particularly acute in Tanzania, as the diaspora has not yet begun to return to the country.
- **Difficulty accessing local currency instruments:** Many social businesses engage with disadvantaged populations, often earning the majority of their revenues in local currencies. However, most impact investors track returns in international hard currencies and have little ability to invest in local currencies. This is especially challenging for long-term debt instruments, which require repayment in hard currencies that can appreciate 5-10% per year. Hedging options are expensive at both the individual investment level and at the fund level, although some impact investors report effectively using fund level hedges to minimize risk. Please see the East Africa regional chapter for additional detail on the dynamics of local currency investments.

30 Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

31 Based on primary and/or secondary research conducted during this study; see “Introduction and Methodology” chapter of this report for details.

Opportunities

Despite these challenges, there are many opportunities for non-DFI impact investors to operate in Tanzania effectively and leverage return-seeking investments to drive job creation, economic development, and opportunities for disadvantaged populations. Opportunities for impact investors in Tanzania include the following:

- **Leverage TA facilities for pre-investment pipeline building:** Many impact investors have successfully raised technical assistance facilities for portfolio companies. Increasingly, TA funders such as USAID and DFID recognize the importance of pre-investment support to get companies to the point where they can pass rigorous investment committee requirements. Targeted, tailored support requires an upfront commitment of resources but impact investors report that it has proven effective in preparing targets for investment and building high quality deal flow. This support can dramatically reduce diligence timelines if the investor is able to increase familiarity and visibility into the business pre-investment in order to assess the company's operations and ability to execute.
- **Ease rigid investment criteria:** Impact investors in Tanzania repeatedly stressed the need for more flexible non-financial investment criteria. Rigid criteria around sector, impact, and stage of business are generally seen as impediments to investing in the few investment-ready opportunities that arise. Without the volume of high-potential entrepreneurs and opportunities in Tanzania as in, for example, Kenya, impact investors benefit from being able to place capital where opportunities arise, rather than focusing on a sub-set of opportunities.
- **Increase local decision-making:** Where possible, impact investors cited significant improvements in their portfolios through local decision-making and in-country support. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to quickly respond to realities on the ground.
- **Source opportunities outside major cities, like Dar-es-Salaam:** Though impact investors with staff on the ground in major cities already report an easier time finding investments than those based abroad, many entrepreneurs operating in rural areas do not spend much time in Dar-es-Salaam. For impact investors who see these types of businesses as highly impactful, it will be increasingly necessary to build relationships beyond those made in economic centers.
- **Innovate with new models of investment vehicles:** The Tanzanian impact investing community is innovating and experimenting with interesting new models. For example, DFID recently established an impact capital vehicle focused specifically on agricultural companies in the Southern Agricultural Corridor of Tanzania (SAGCOT) that is currently raising capital. This narrow geographic and sector focus will create detailed market awareness and push concentrated capital into this challenging region with a high potential for impact.

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

- **Agriculture:** Overwhelmingly, impact investors identify agriculture as a key opportunity. Tanzania is the third largest country by area in the region and there is ample arable land. Impact investors note that working directly with smallholders can be difficult given their willingness to change crops or side-sell, and they see significant opportunity in agricultural processing and post-harvest marketing and infrastructure, including warehousing, cold storage, and transport.
- **Renewable energy:** Large segments of the Tanzanian population lack reliable access to grid power, opening opportunities for micro-grid and off-grid solutions. However, entrepreneurs must be wary of potential government regulation. For example, the government at one point considered lifting VAT exemptions on solar products, but it has since confirmed the exemption.³²

³² Finnigan wa Simbeye, "Treasury: No plans for VAT on solar panels," *Daily News* (Nov. 14, 2014), available at <http://www.dailynews.co.tz/index.php/biz/38256-treasury-no-plans-for-vat-on-solar-panels>.



RWANDA

SMALL MARKET, PROMISING
REGIONAL EXPORTS

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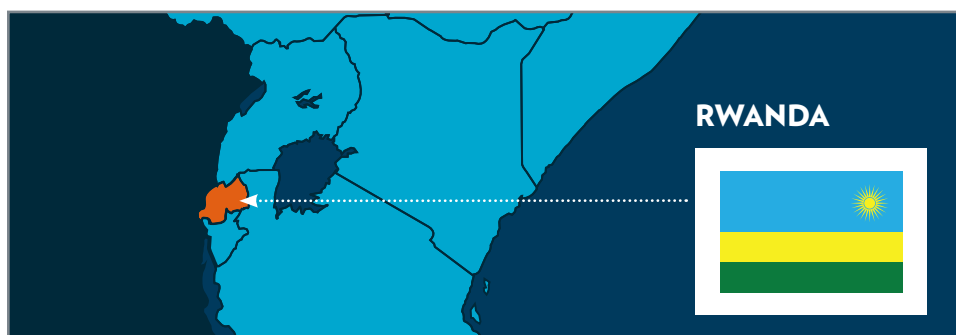
INTRODUCTION

Rwanda has experienced an impressive era of rapid economic growth. Its Asian Tiger-like model of state-led development helped the nation recover quickly from one of the most horrific chapters in recent African history, and set Rwanda on course for two decades of unprecedented growth and modernization. Starting in the early 2000s, international donors began to view bilateral aid to the Rwandan government—untied to any specific program or purpose—as one of the best deals in development. However, relations with foreign governments and investors weakened after a 2012 United Nations (UN) report accused key Rwandan government figures of supporting rebel forces in the Democratic Republic of the Congo (DRC),¹ further destabilizing one of Africa’s most volatile regions. International aid flows—which made up around 40% of the Rwandan government’s budget—diminished in response to the UN report; in the future, these flows will depend on Rwanda’s ability to convince donors that it has not played a role in regional political and ethnic issues. Nonetheless, many consider Rwanda to have the most efficient and least corrupt government in East Africa, with the strongest rule of law.

Impact investors have responded to Rwanda’s relatively favorable business environment. Although Rwanda’s small population and young markets have restrained deal flow to date, most investors active in East Africa list Rwanda as one of their target countries. The Rwandan government has made a point of creating a business environment friendly to foreign and local entrepreneurs that increasingly look to establish headquarters in its capital city, Kigali.

Allegations over Rwanda’s relations with paramilitary groups in the eastern DRC remain a concern for the country, as well as a threat to its future as a market for impact investing.² Ethnic hostilities involving Rwanda are ongoing in the eastern DRC, and it is unclear when this situation will be fully resolved.³

FIGURE 1: MAP OF RWANDA



1 Hege, Alusala, de Koning, Serralta and Spittaels, UN Security Council briefing S/2012/843 available at http://www.securitycouncilreport.org/atf/cf/%7B65BF9B-6D27-4E9C-8CD3-CF6E4FF96FF9%7D/s_2012_843.pdf.

2 “Eastern Congo: The hills are alive again.” *The Economist* (May 29, 2013), available at: <http://www.economist.com/blogs/baobab/2013/05/eastern-congo?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

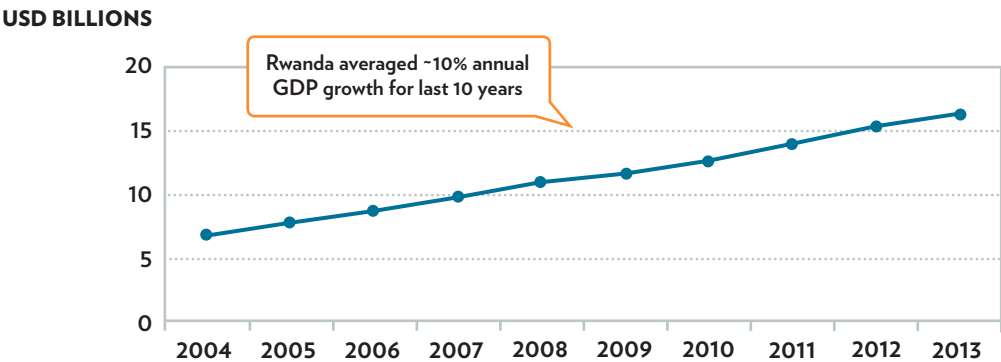
3 Louis Charbonneau. “Congo tells UN its offensive against Rwanda rebels going well,” *Reuters Africa* (May 16, 2015), available at: <http://af.reuters.com/article/topNews/idAFKBN0O106Y20150516?pageNumber=1&virtualBrandChannel=0>.

COUNTRY CONTEXT

Despite its turbulent past and recent UN allegations, Rwanda is today considered one of the most stable and promising economies in the region. This is reflected across economic indicators, though there is still substantial need to improve human development indicators and increase linkages between disadvantaged populations and the rapidly growing national economy.

Gross domestic product (GDP) in Rwanda has seen strong growth in recent years, averaging approximately 10% GDP (PPP) growth for the last eight years (see Figure 2). GDP currently stands at over USD 16 billion in PPP terms, and USD 7.4 billion in current prices, making it the smallest economy of this report’s focus countries⁴ and the second smallest economy—ahead of Burundi—in the East African Community (EAC) trade bloc.⁵

FIGURE 2: GDP (PPP), 2004-2013



Source: IMF World Bank Economic Indicators, April 2014

Although GDP growth slowed from around 15% ten years ago to closer to 7% in 2013, Rwanda has seen some of the strongest growth in East Africa over the past decade, trailing only Ethiopia. This is partly due to increasing population—it is the most densely populated country in sub-Saharan Africa—but much of this growth is attributable to productivity gains. GDP per capita more than doubled over the last 10 years, overtaking Uganda for the first time in 2012.

The makeup of Rwanda’s economy has remained relatively stable over the last decade. Services account for the bulk of GDP, though booming telecommunications

4 Focus countries for this report are Ethiopia, Kenya, Rwanda, Tanzania, and Uganda. Detailed chapters are provided for these countries, while brief overviews are provided for Burundi, Djibouti, Eritrea, Somalia, South Sudan, and Sudan.

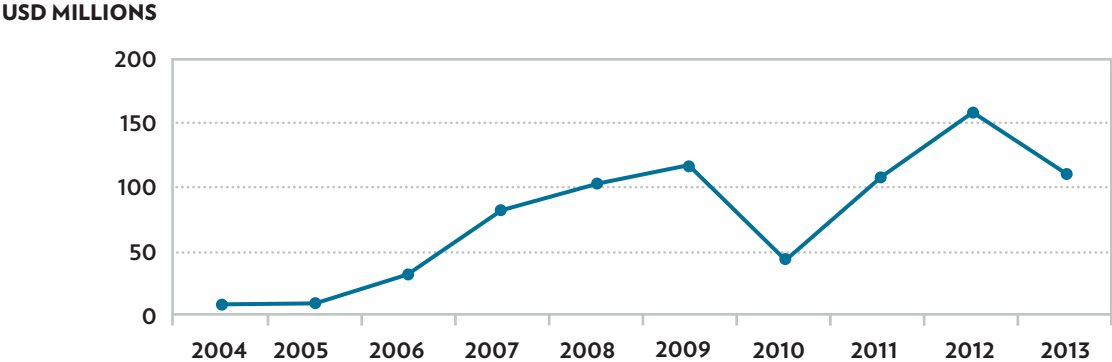
5 World Economic Outlook: Gross Domestic Product, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>.

and tourism sectors have increased this share from 48% to 53%, the highest in the region. Agriculture remains the single strongest sector, making up more than 30% of GDP. Substantial public and private investment in major construction and real estate projects have maintained the share of industry at just below 15%. Overall, Rwanda has one of the smallest manufacturing sectors relative to GDP in the region, ahead of only Ethiopia. Industrial sectors are likely to benefit from Rwanda’s strong push to expand power generation, in which the government plans to spend close to USD 5 billion to increase electrification from 20% today to 70% in 2017, adding 1,000 MW of generating capacity from hydro, methane gas, geothermal, and peat energy sources.⁶

Foreign Direct Investment

Strong GDP growth has been accompanied by increasing foreign direct investment (FDI) in Rwanda. In 2013, there was approximately USD 110 million in FDI inflows to Rwanda, up from only USD 8 million ten years ago (see Figure 3).⁷ Nevertheless, in absolute terms, Rwanda remains among the lowest recipients of foreign investment in East Africa, with FDI making up less than 1% of GDP in 2013.

FIGURE 3: FDI FLOWS, 2004–2013



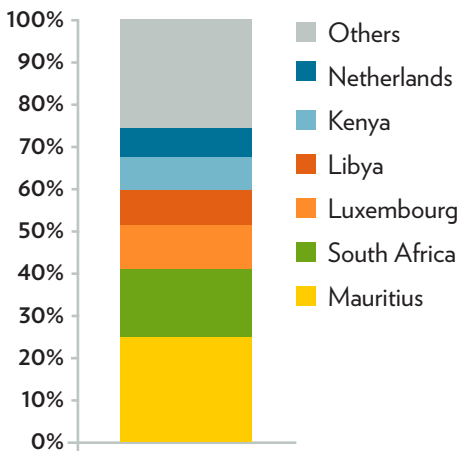
Source: UNCTAD

6 “70% of Rwandans to Have Access to Electricity By 2017,” *Republic of Rwanda* (Jan. 10, 2013), available at http://www.gov.rw/newsdetails2/?tx_ttnews%5Btt_news%5D=896&cHash=316d0869ab5ddfe36ce5424a011fca18.

7 Inward and Outward Foreign Direct Investment Flows: Annual 1970-2013, *United Nations Conference on Trade and Development*, available at <http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=88>.

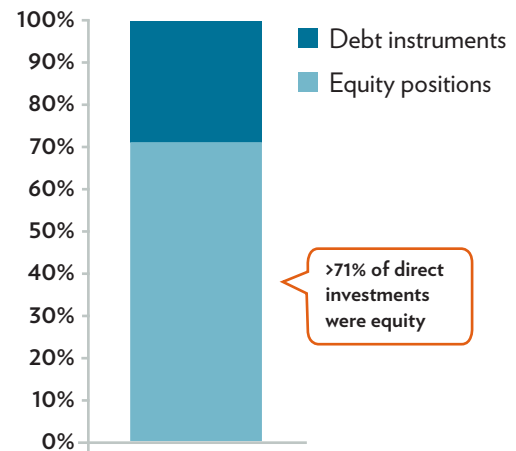
Mauritius, South Africa, and Luxembourg together originated more than 50% of all FDI into Rwanda in 2013 (Figure 4), predominately through equity vehicles (Figure 5).⁸ Kenya and Libya also provided a large share of FDI at a little below 10% each. Strong FDI inflows are expected in the future, particularly as Chinese loans begin to increasingly complement Western aid as a source of government funding.⁹

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



Source: US Department of State

FIGURE 5: FDI INFLOWS, BY INSTRUMENT, 2013



Source: US Department of State

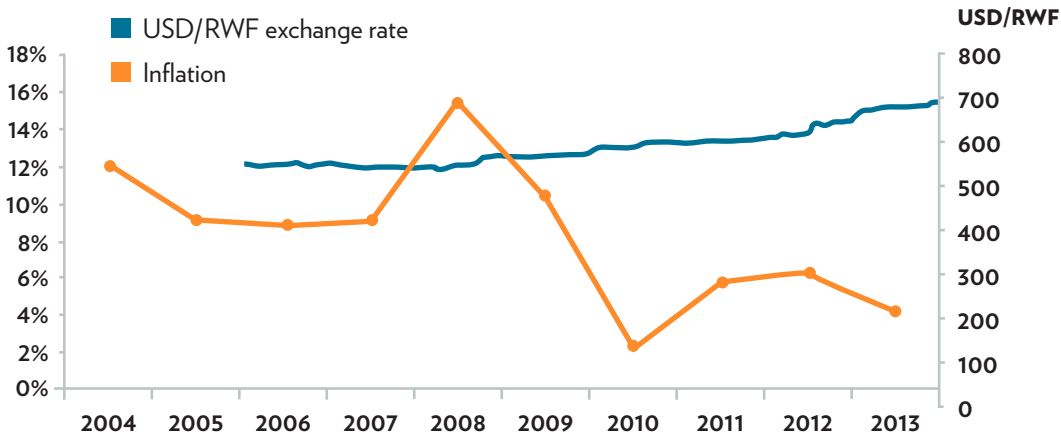
8 Mauritius and Luxembourg constitute the largest and third largest sources of FDI into Rwanda. Despite these two countries' relatively small size, they represent a large source of FDI because many private equity and venture capital funds base themselves in these jurisdictions to benefit from favorable tax regimes.

9 "The President Tightens His Grip," *The Economist* (Sep. 19, 2013), available at <http://www.economist.com/news/middle-east-and-africa/21586597-president-tightens-his-grip-safe-and-sorry?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

Inflation and Exchange Rates

Rwandan inflation has been volatile, dropping from 15% in 2008 to just 2% two years later, although inflation rates have stabilized since (Figure 6). Stable prices have resulted in a stable currency. Although the Rwandan Franc has steadily depreciated against the US dollar since 2006, depreciation has been uncommonly smooth and much less pronounced than that experienced by other EAC currencies. The Franc's stability greatly benefits Rwanda's investment climate, as it reduces foreign exchange risk.

FIGURE 6: INFLATION AND USD/RWF EXCHANGE RATE, 2004 - 2013

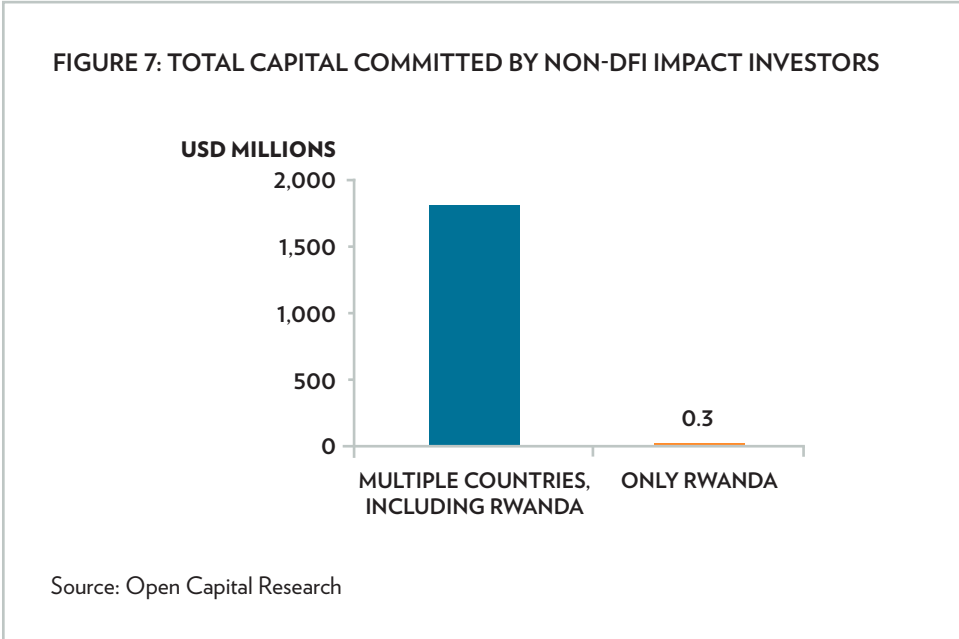


Source: IMF World Bank Economic Indicators, Oanda Historical Currency Rates

While the Franc has remained more stable than other currencies, long-term political uncertainty has prompted some investors to seek hedging protection or implement exchange rate bounds for repayments in loan agreements. Please see the East Africa regional chapter of this report for additional detail on common investor approaches to mitigating currency risk.

SUPPLY OF IMPACT INVESTING CAPITAL

To date, non-DFI impact investors¹⁰ have made at least 38 investments in Rwanda, disbursing more than USD 44 million in capital, though this represents only 3% of all non-DFI impact investment activity in East Africa overall. Many investors would like to deploy capital in Rwanda: there are 94 active non-DFI impact investing vehicles managed by 69 investors that would consider investing in Rwanda, 17 of whom have already deployed capital. Currently there is less than USD 1 million in capital committed (but not yet deployed) by non-DFI impact investors to investments specifically in Rwanda. However, most of these investors take a regional approach; there is a further USD 1.8 billion in capital committed regionally that is available to be invested in Rwanda amongst other countries (Figure 7). While much of this is likely to be deployed in Kenya, Tanzania, or Uganda, some will also make its way to Rwanda.



10 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

Broader Investing Landscape

Despite strong growth in recent years, Rwanda's banking sector remains small compared to those in some of the more financially developed economies in the region. In total, its banks hold close to USD 2.5 billion in assets,¹¹ much less than banks in Kenya, which has a population four times greater but a banking sector over ten times larger. Similarly, Rwandan banks lent just under USD 1.4 billion in 2013, compared to USD 15 billion by banks in Kenya. As is true for the entire region, non-DFI impact investing represents a very small share of overall financial activity in Rwanda; bank loans in 2013 amounted to nearly 30 times the disbursements made by non-DFI impact investors over the same period.

Rwandan bank lending rates available to the private sector have been among the highest in the region over the past decade, consistently above 16% between 2004 and 2010. This is around four times higher than the average bank lending rate in the United States over the same period, which stood at just over 4%.¹² IMF data is not available beyond 2010, but research and interviews conducted for this report suggest that rates have remained comparable since. These continuing high rates limit the practical availability of bank financing. This provides a market opportunity for private investors who are able to provide equity capital, cheaper debt options, or require less collateral for lending to both consumers and companies.

While impact investing represents a small portion of total investment activity, it fills an important gap in the market. As with commercial banks throughout the region, Rwandan banks remain extremely risk-averse and often require extremely high collateral ratios (please see East Africa chapter for more detail on access to commercial debt).

11 Development Bank of Rwanda, *Annual Report 2013*, available at https://www.brd.rw/IMG/pdf/BRD_ANNUAL_REPORT_2013.pdf.

12 World Development Indicators: Lending Interest Rates (%), *The World Bank Group* (2014), available at <http://data.worldbank.org/indicator/FR.INR.LEND?page=2>.

Impact Capital Disbursed

Rwanda's small market size is reflected in the amount of impact investment activity to date. Only around 3% of all non-DFI impact capital disbursed in East Africa has been placed in Rwanda, amounting to approximately USD 44 million (Figure 8), the lowest of this report's five focus countries. A similar percentage of all direct investment by DFIs in the region has been placed in Rwanda, totaling a little over USD 370 million disbursed through 43 direct investments (Figure 8).

FIGURE 8: IMPACT INVESTMENTS IN RWANDA

	Capital disbursed	Deals
DFI	USD 371 Million	43
NON-DFI	USD 44 Million	38

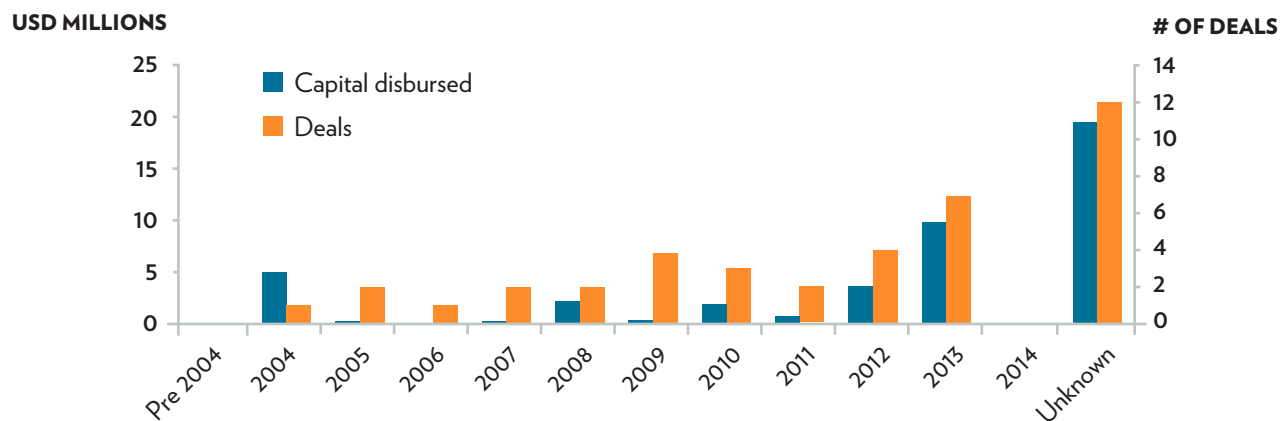
Source: Open Capital Research

However, compared to other countries in the region, Rwanda's openness to investors has led a large number of non-DFI impact investors to target Rwanda. Of 186 non-DFI impact investment vehicles active in East Africa, 94 are interested in investing in Rwanda, almost double the number targeting neighboring Burundi, which has a similar population. Ethiopia, with an economy more than ten times larger than Rwanda's, is only targeted by 80 non-DFI impact investing vehicles. Nonetheless, the difference between the amount of capital available to Rwanda and the amount of capital actually disbursed is larger than in any other East African country.

Investments Over Time

One of the reasons for Rwanda's low conversion rate on impact investments is the youth of its impact investing market. Impact investing is a recent phenomenon in the country, with the first investments by non-DFI impact investors starting in 2004 and significant growth in investments picking up in 2012, though it should be noted that the year of investment is unknown for a high proportion of deals (Figure 9).

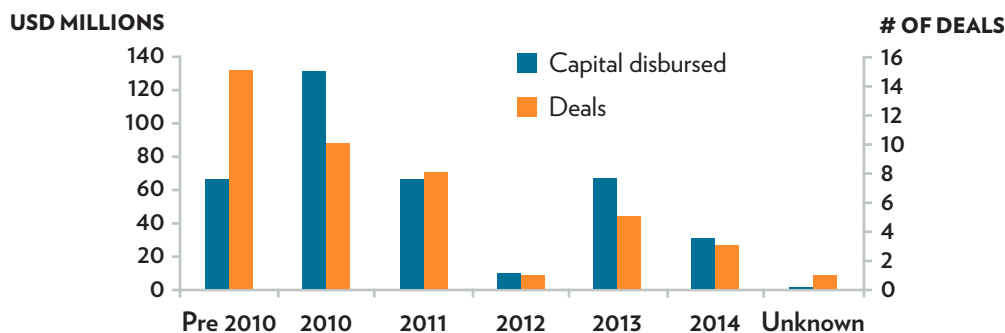
FIGURE 9: NON-DFI IMPACT INVESTMENTS BY YEAR



Source: Open Capital Research

While non-DFI impact investments have increased in recent years, DFI direct investments have declined since 2010 (Figure 10). DFI activity dropped dramatically in 2012 as foreign governments began to distance themselves from Rwanda after UN allegations of political interference in the DRC. Notably, this did not appear to have deterred private investors. DFI direct investments rebounded in 2013 as diplomatic relations improved. The decline in 2014 is likely a result of incomplete data collected through Q3 2014. See the Introduction and Methodology chapter of this report for additional detail.

FIGURE 10: DFI DIRECT INVESTMENTS BY YEAR

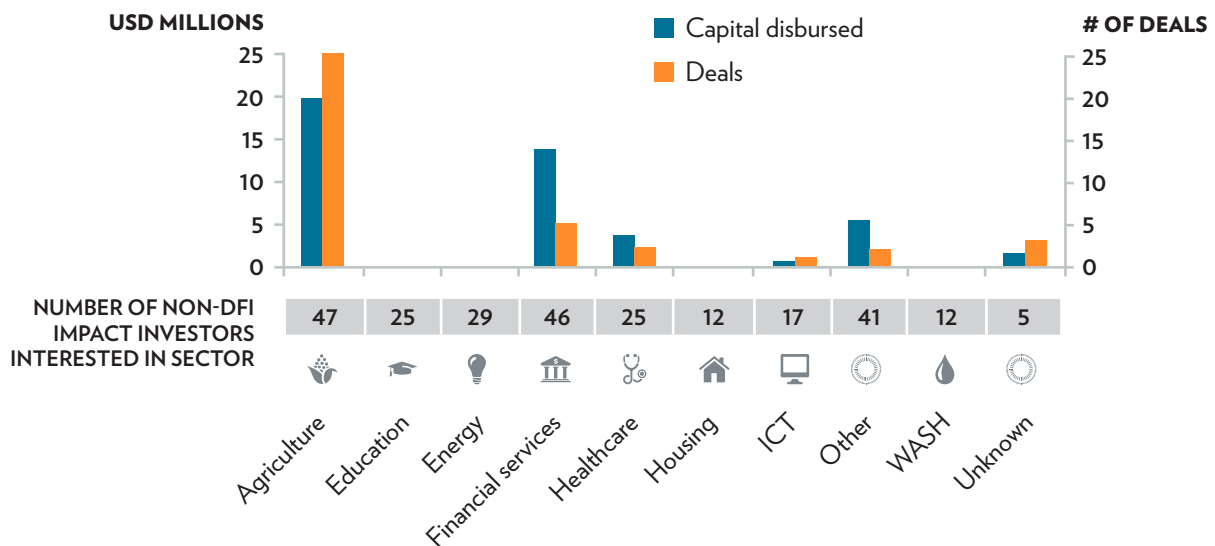


Source: Open Capital Research

Sector

Of the sectors targeted by non-DFI impact investors, agriculture has received by far the most deals (65% of all deals in Rwanda) (Figure 11). Multiple investors are interested in investing across the agricultural value chain. As is common with non-DFI impact investments across the region, financial services has represented a large share of absolute investment, due to the larger ticket sizes possible when placing capital into established banks or microfinance institutions (MFIs). A small number of investments into real estate make up most of the capital disbursed in the “Other” category. As is the case across the region, investors see few viable opportunities in education and renewable energy, with very few deals in Rwanda in these sectors, despite their common perception as having a high potential for impact. In general, however, the small number of deals recorded in Rwanda compared to the country’s great potential means data by sector may not represent future trends.

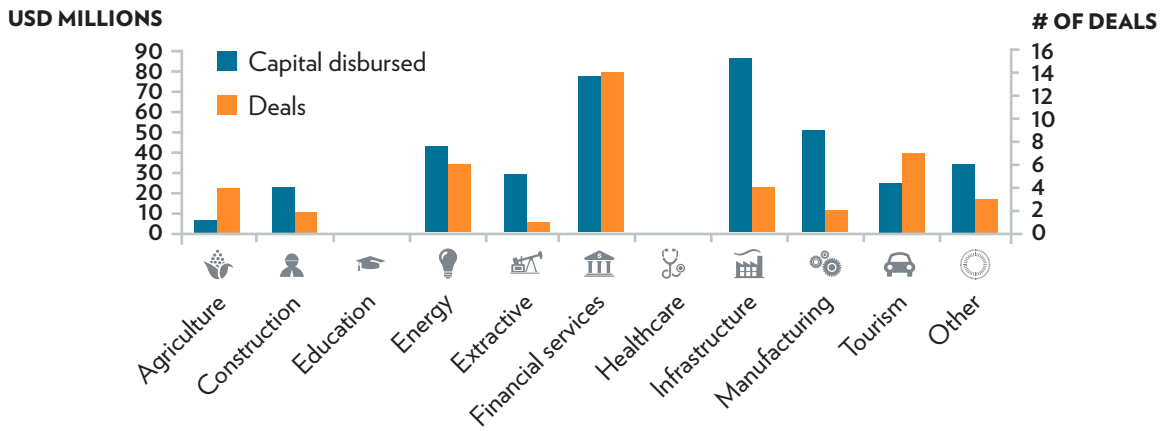
FIGURE 11: NON-DFI IMPACT INVESTMENTS BY SECTOR



Source: Open Capital Research. Note: Chart shows total number of non-DFI impact investors interested in sector; may be multiple sectors

A large proportion of DFI direct investments are in financial services (nearly 30% of all investments) and energy (13% of all investments). Infrastructure, financial services, and manufacturing absorb more than 50% of total capital disbursed directly by DFIs, driven by investments into air transport, commercial banks, and production of building materials (Figure 12).

FIGURE 12: DFI DIRECT INVESTMENTS BY SECTOR

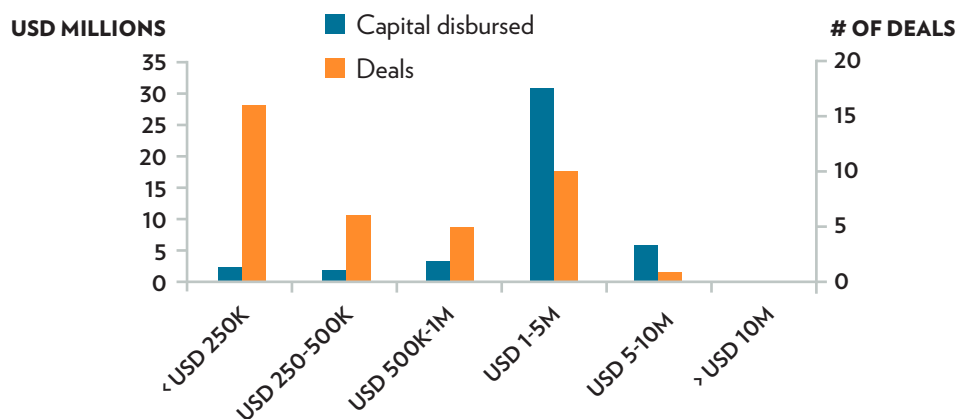


Source: Open Capital Research

Deal Size

As mentioned in the East Africa chapter, most non-DFI impact deals in East Africa are less than USD 1 million (Figure 13). In Rwanda, more than 70% of deals completed are below USD 1 million. Non-DFI impact investors report that most high-growth businesses—in Rwanda and elsewhere in the region—require smaller amounts of capital to achieve early growth, but these businesses often lack the track record and sophistication required by investors. Please see the East Africa Regional Overview chapter of this report for more detail on investor expectations.

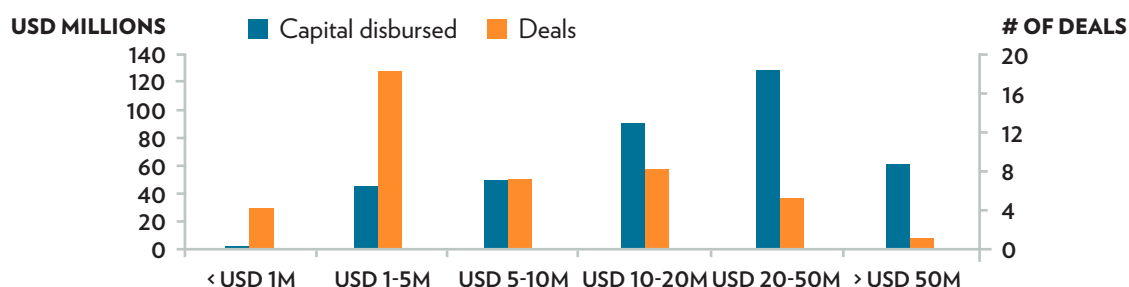
FIGURE 13: NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research. Note: Assigns non-DFI impact investor based on average deal size where possible

DFI direct investments in Rwanda are often significantly larger, averaging almost USD 9 million, nearly ten times the average size of non-DFI impact investor deals (Figure 14). This difference is primarily due to investments in energy and infrastructure projects, as well as several large placements in commercial banks. As in other countries in the region, DFI deals under USD 1 million are not common, accounting for only 9% of deals.

FIGURE 14: DFI DIRECT INVESTMENTS BY DEAL SIZE

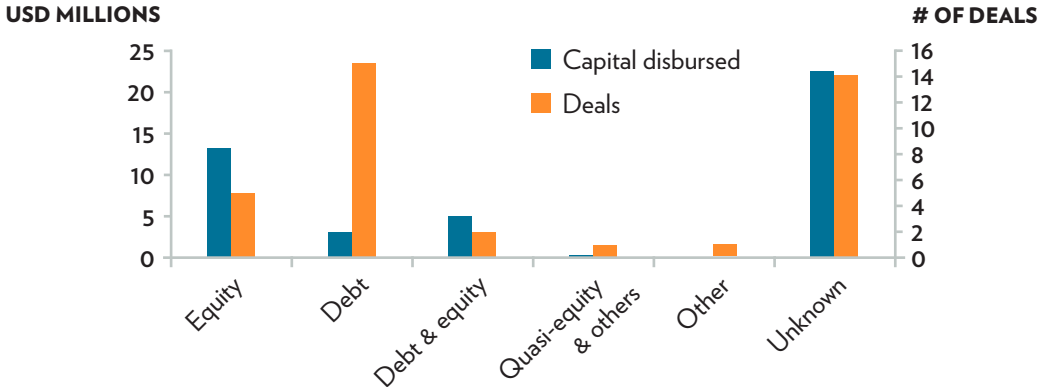


Source: Open Capital Research

Instrument

Non-DFI impact investors in Rwanda follow the regional trend to adopt more creative instruments, though traditional debt and equity instruments are by far the most common (Figure 15). Despite the large number of private deals made with unknown instruments, the small average deal size for known debt investments stands out. Rather than being indicative of any trend, however, this mostly reflects high activity of one particular fund that specializes in small debt investments in Rwanda.

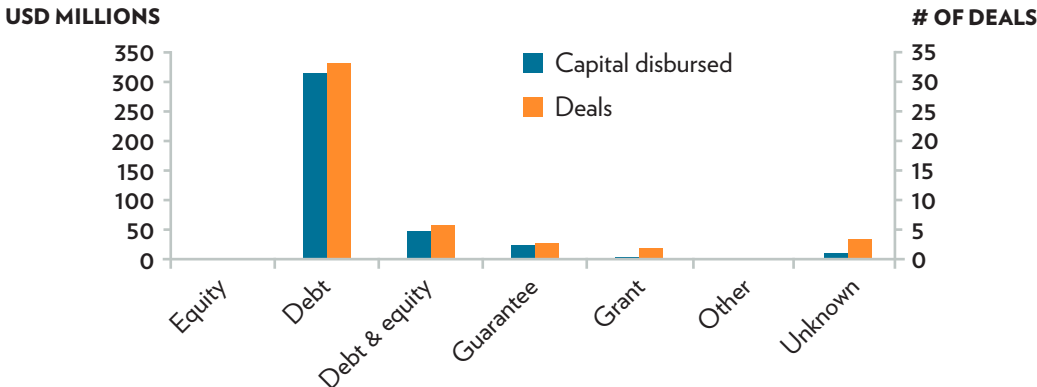
FIGURE 15: NON-DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

The prominence of debt over other instruments is also seen among DFIs, which have overwhelmingly used loans as their preferred instrument for direct investments in Rwanda, in some cases offering a combination of debt and equity. Pure debt investments constitute close to 90% of all capital disbursed by DFI direct investments and close to 70% of direct DFI deals (Figure 16). No disclosed equity investments by DFIs are recorded for Rwanda.

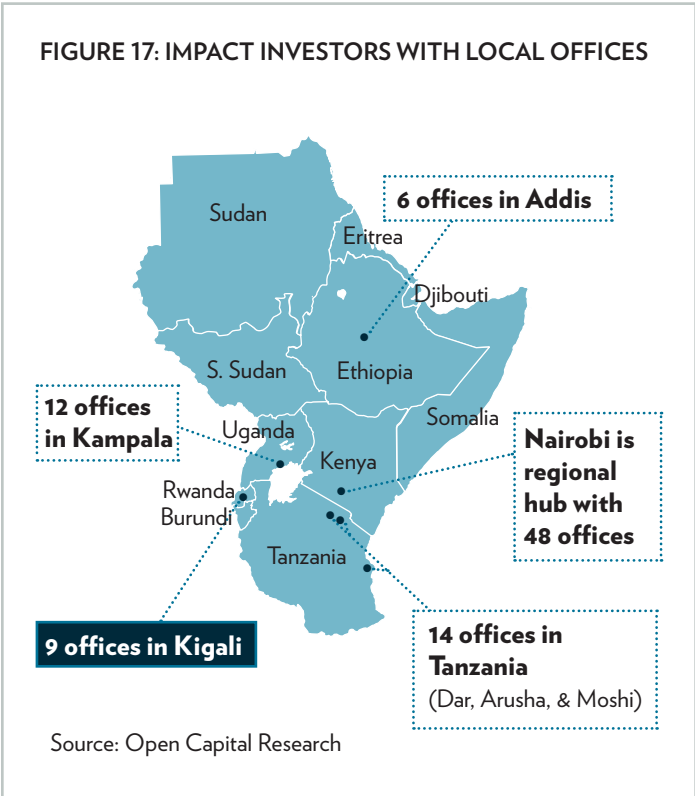
FIGURE 16: DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

Local Presence

The ease of setting up an investment company in Rwanda is reflected in the number of investors with local presence. Kigali boasts more impact investor offices (9) than Addis (6), and is not far behind Kampala (12), despite Uganda’s population and economy being over three times larger than Rwanda’s (Figure 17). An additional 39 impact investors interested in Rwanda have offices in the region—primarily in Nairobi—while the remaining 48 are based outside the region, mainly in Europe and North America. To date, no impact investors have headquartered in Rwanda.



Impact Tracking Standards

Across the region, most impact investors do not specify a specific standard for measuring the impact of their investments. This is also true in Rwanda. Instead, investors typically report using flexible structures that are customized for each new investment. This customization allows investors to reduce the administrative burden for their portfolio businesses and focus on the metrics that are most meaningful. For more detail on impact measurement in East Africa, please see the East Africa regional chapter of this report.

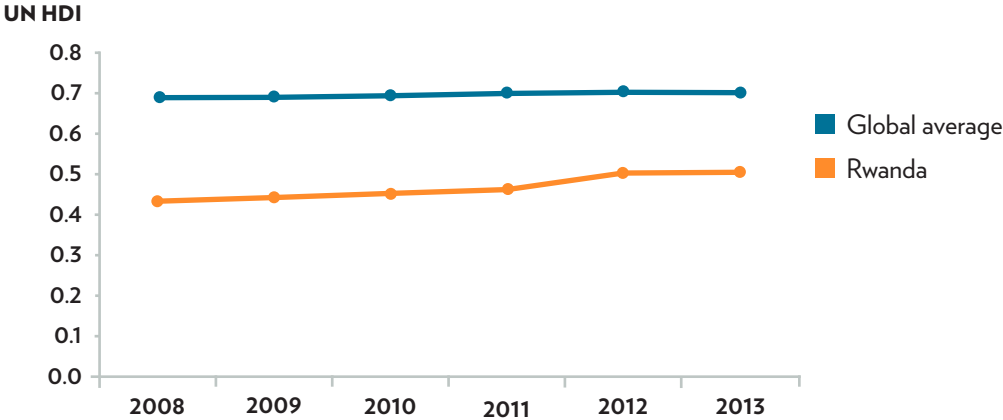
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Rwanda’s small economy naturally limits the number of active social entrepreneurs, but the existing demand for impact capital appears to be strong. Despite Rwanda’s progress and development compared to other countries in the region, there remain significant gaps in the provision of key goods and services which create opportunities for entrepreneurs to fill these needs while also realizing financial returns.

Development Context

Despite robust economic growth and rapid modernization, Rwanda remains well below global averages for human development indicators as defined by the United Nations (Figure 18). Overall, Rwanda ranks 151st out of 187 countries on the UN Human Development Index, a composite statistic of life expectancy, education, and income indices.¹³

FIGURE 18: UN HDI SCORES, 2008-2013



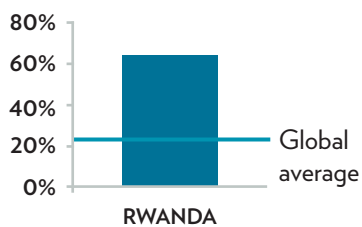
Source: United Nations Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

13 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data> ; 2010 Human Development Index, *United Nations Development Programme* (Apr. 2010), available <https://www.imf.org/external/pubs/ft/weo/2010/01/weodata/download.aspx>.

Rwanda performs below global averages on almost all key development indicators. For example, more than 60% of Rwandans live on less than USD 1.25 per day, well above the global average of around 25% (Figure 19). Similarly, almost 45% of Rwandans live below the Rwandan national poverty line, compared with 30% globally.

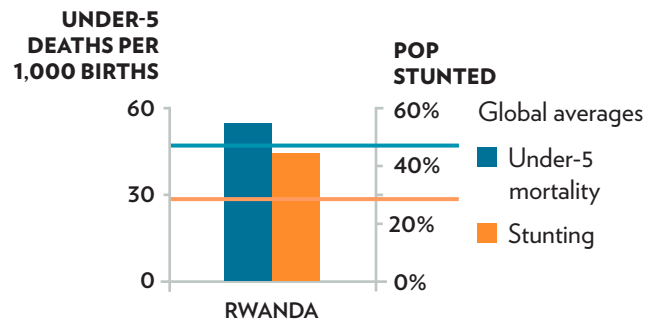
Rwanda also performs considerably below global averages on key health metrics. Its ratios for under-five mortality and infant mortality are significantly higher than global averages. These low rankings reflect the unequal access to healthcare for wealthy and low-income populations that is endemic to the region. Under-five stunting, for instance, is nearly 50% higher than global averages (Figure 20).¹⁴

FIGURE 19: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

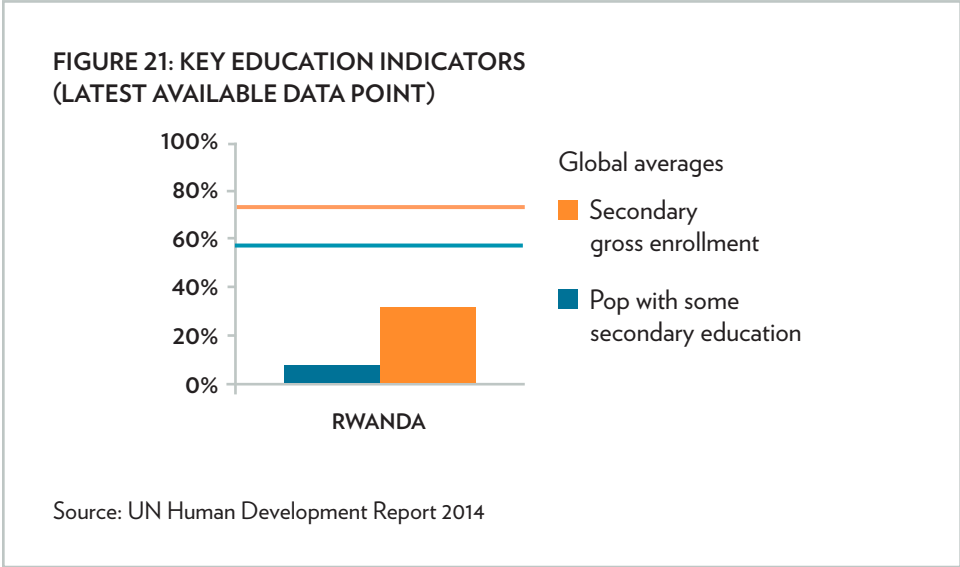
FIGURE 20: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

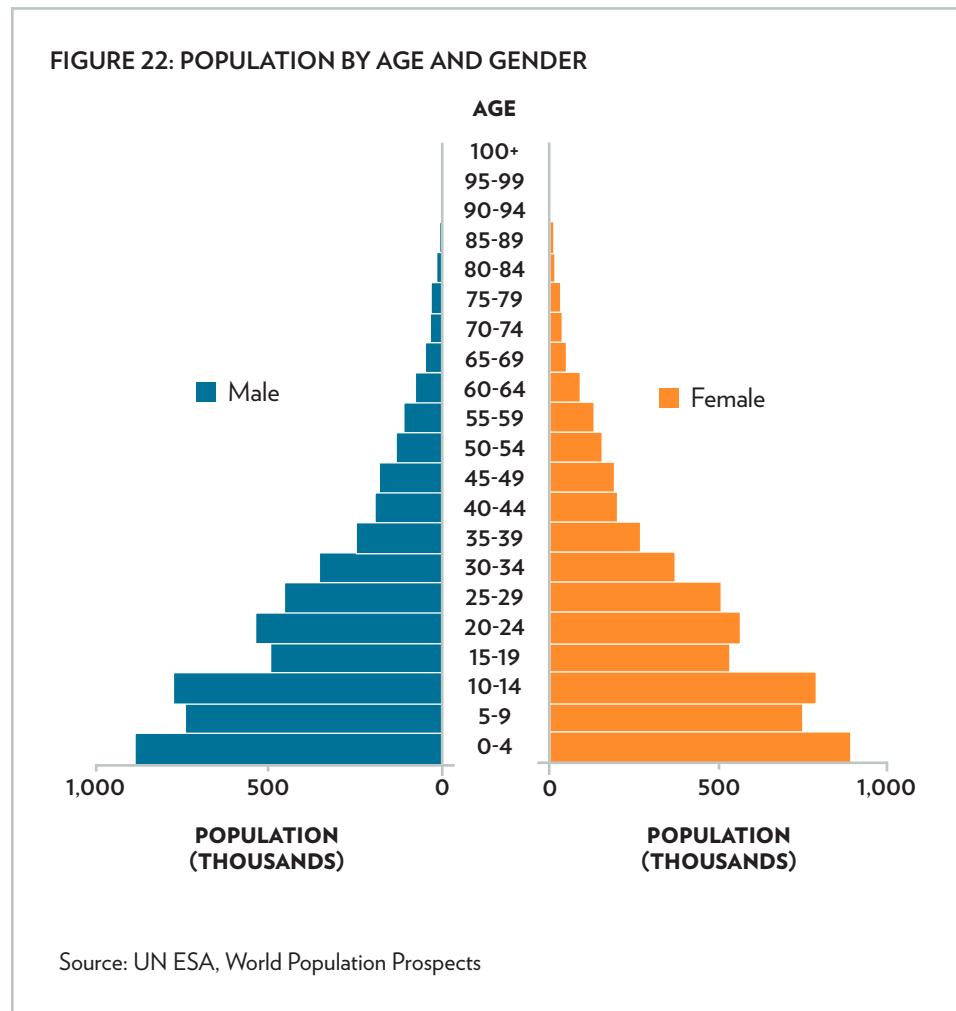
14 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

Rwanda significantly underperforms compared to the regional average on some education metrics (Figure 21). For example, only 7% of Rwandans have at least some secondary education, less than half the East African average. Approximately 32% of appropriately aged Rwandans are currently enrolled in secondary education, close to the East African average of 33%, but only around half of Kenyan enrollment rates.¹⁵



15 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

Like other East African countries, Rwanda has a disproportionately young population, where 45% is under the age of 15 and more than 60% is below age 25 (Figure 22).¹⁶ This has led to high youth unemployment and underemployment—over 40% according to the African Development Bank¹⁷—that could in future undermine Rwanda’s strong economic performance to date.



Entrepreneurs

As in the rest of East Africa, entrepreneurs in Rwanda are responding to increasing interest from investors—many of whom perceive Rwanda to have the friendliest business climate in the region—by starting new social enterprises. At the same time, social entrepreneurs in Rwanda who are seeking impact capital face many of the same challenges as their counterparts across the region. Please see the Entrepreneur section of the East Africa regional chapter of this report for details.

¹⁶ “The World Factbook: Rwanda,” *Central Intelligence Agency* (Jun. 20, 2014), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/rw.html>.

¹⁷ African Development Bank, et al., *African Economic Outlook 2012: Rwanda*, available at http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/Rwanda%20Full%20PDF%20Country%20Note_01.pdf.

Enabling Impact Investing: The Ecosystem

Rwanda is home to relatively few intermediaries and service providers, which is perhaps unsurprising given its small market and low volume of impact investing activity to date. At the same time, several regional service providers based elsewhere in East Africa, especially consultants, regularly provide support to local businesses and investors. Setting up a business in Rwanda is easy, and its business environment provides fertile ground for new intermediaries and service providers as the economy continues to grow and more impact investors search for deals. Large multilateral aid institutions have begun to directly enter Rwanda's impact ecosystem, as well. For example, GIZ—the German governmental development agency—launched its EcoEmploi program in 2013, providing incubator-type services such as training and counseling for SMEs.¹⁸

Regulatory Environment

Rwanda has successfully built a reputation as the most welcoming business environment in the region. The World Bank's Ease of Doing Business rankings reflect these efforts: At 46th globally, Rwanda ranks first in East Africa and third in sub-Saharan Africa, behind only Mauritius and South Africa.¹⁹

Investors and entrepreneurs generally echo the World Bank's conclusions. The Rwanda Development Board (RDB) has set up a one-stop center that processes incorporation, immigration and certification requirements in a matter of days. Moreover, several of those interviewed for this report praise the government's efficiency and transparency, as well as its receptiveness to listen to and act on complaints, particularly if lodged by businesses or investors bringing larger amounts of capital. Government is seen to successfully promote exports, for instance by introducing quality seals and certification standards to mark agricultural produce as import-grade for the European Union.

Although registering a business in Rwanda is remarkably easy, several interviewees also note that the regulatory landscape grows more complicated after registration. Various offices and ministries do not always coordinate, so instructions or advice given to a business by one government agency may directly contradict advice from another. For instance, some entrepreneurs experienced difficulties in obtaining approved work permits due to imperfect communication between the Rwandan Development Board and the immigration authorities.

18 "Promotion of Economy and Employment", *GIZ*, (Oct, 2013), available at <http://www.giz.de/de/downloads/giz2013-en-factsheet-ecoemploi.pdf>.

19 "Economy Rankings," *The World Bank Group* (Jun. 2014), available at <http://www.doingbusiness.org/rankings>.

Despite this, the overall regulatory climate in Rwanda supports foreign investment across a number of dimensions:

- **Repatriation of profits and dividends:** The Rwandan constitution protects tax-free repatriation of principal and dividends.²⁰ However, certain restrictions apply: export earnings must be repatriated within three months of goods crossing the border and sold on domestic foreign exchange markets or kept in foreign currency accounts at licensed commercial banks.²¹ In general though, investors report very few complications with repatriating capital.
- **Foreign exchange controls:** Rwanda has open foreign exchange rules. Foreign exchange is freely available from commercial banks and can be acquired at similar rates by locals and foreign nationals. Exchange across East Africa still poses a significant risk, as hedging tertiary global currencies can be prohibitively expensive.
- **Leasehold structure for foreign land ownership:** Rwandans and foreigners are freely able to acquire land both from the government and private persons. Land leases are limited to 49 years for foreign investors, though these leases are freely renewable, and freeholds are granted to businesses if ownership is over 51% Rwandan or if they are located in Special Economic Zones. Government land leases are “emphyteutic”, meaning that acquiring land can be conditional on putting it to certain uses (cultivating specific crops, for instance).²² Indeed, some investors expressed frustration that the government would mandate planting specific crops on leased land. Similarly, the government is known to repossess land from investors that fail to implement planned projects. In 2011, the government reclaimed 100 hectares from an American investor after a manufacturing project stalled.²³
- **Local ownership requirements:** By and large, Rwanda does not restrict foreign investors from owning shares in a company, though the government strongly encourages local participation. Similarly, there are no prohibitions on foreign firms acquiring Rwandan firms or on joint venture arrangements between Rwandans and foreigners.
- **Government enterprises:** Though the government has increasingly made an effort to privatize, state interests still pervade the private sector. The state holds minority interests in many major businesses in telecommunications, tourism, and financial services.²⁴ For instance, Crystal Ventures, a Rwandan investment company that owns some of the largest businesses in the country, is owned by the Rwandan

20 “Investment Incentives & Tax Codes,” *Rwanda High Commission United Kingdom*, available at <http://www.rwandahc.org/trade-and-investment/investment-incentives-and-tax-codes/>.

21 Imani Development International Ltd, *2007 Survey of Non-Tariff Barriers to Trade: Rwanda* (2007), available at <http://www.tradebarriers.org/documents/survey-reports>.

22 “Land Acquisition for Investment,” *Rwanda Natural Resources Authority*, available at <http://rnra.rw/index.php?id=67>.

23 Rodrigue Rwirahira, “Rwanda Seeks Land Reforms,” *The EastAfrican* (Jan. 18, 2013), available at <http://www.theeastafrican.co.ke/Rwanda/News/Rwanda-seeks-land-reforms/-/1433218/1669604/-/p13f76/-/index.html>.

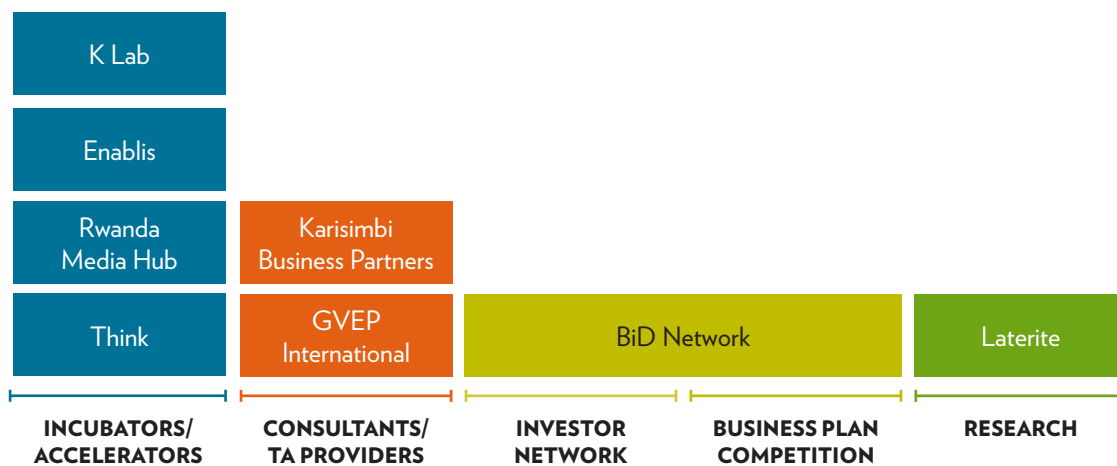
24 KPMG Services Proprietary Services Limited in South Africa, *Rwanda: Country Profile* (2012), available at <https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/RWanda.pdf>.

Patriotic Front, Rwanda’s ruling party.²⁵ Although overt corruption is extremely low in Rwanda, there is still the perception among investors and entrepreneurs that state-run companies receive preferential treatment, which in turn undermines free-market competition.

Ecosystem Players

As one of the smaller markets in the region, Rwanda’s impact ecosystem remains relatively undeveloped. While there are more than 30 different organizations supporting impact investment and social entrepreneurship in Kenya, far fewer are based in Rwanda (Figure 23). There are clear gaps in the support available, in particular for organizations that can produce a larger number of investment-ready opportunities.

FIGURE 23: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Source: Open Capital research, organization websites. Note: chart focuses on those with local presence; many international players active

25 William Wallis, “Rwandan Patriotic Front: Party Builds A Formidable Business Group,” *Financial Times* (Sep. 24, 2012), available at <http://www.ft.com/intl/cms/s/0/7fcab78c-ff1b-11e1-a4be-00144feabdc0.html#axzz3LiDQdDST>.

The support ecosystem includes many players common to the region. As in other countries in East Africa, support is skewed toward seed-stage ventures, leaving a gap for intermediaries and service providers operating with business more appropriate for non-DFI impact investors—please see the ecosystem players section of the East Africa Regional Overview chapter of this report for more detail. A small number of consultants have local offices in Kigali and specialize in serving the Rwandan market. A greater number operate in Rwanda but are based abroad, predominantly in Nairobi. To date, few investor networks and business plan competitions have been available in Kigali, reflecting Rwanda’s emerging entrepreneurship scene. Some investors based in Kigali address the lack of support for early-stage businesses by providing their own incubators, which then serve as the primary source of pipeline for subsequent investments.

Other Service Providers

In addition to intermediaries, a number of accountants, lawyers, and other service providers are active in Rwanda, though several investors interviewed are skeptical of the quality of professional services. Particularly for small companies or family-owned businesses, developing clear financial documentation and obtaining high-quality legal representation can be challenging. Several of the major global professional services firms have local offices in Kigali, but these are rarely affordable for the stage of business typically targeted by impact investors.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite Rwanda's reputation for business friendliness and government efficiency, impact investors face a variety of challenges:

- **Small markets:** With only a little over 10 million inhabitants, Rwanda's population is a third of Uganda's, a quarter of Tanzania's and Kenya's, and an eighth of Ethiopia's. Even the most promising businesses will have relatively few customers. This problem is particularly acute for businesses that do not directly serve base of the pyramid consumers, given the infancy of Rwanda's middle class. In response, several entrepreneurs and investors are considering Rwanda as a launching point for concurrent operations in Burundi and the eastern DRC (see below).
- **Import and transportation costs:** As a landlocked country with nascent extraction, power, and manufacturing industries, Rwanda faces high production and logistics costs. In theory this creates opportunities to fill these needs, but at present costs can be prohibitive for investors and entrepreneurs. Goods imported by sea must travel through Kenya and Uganda before reaching Kigali. As a result, transport often comprises up to 40% of the total value of both imports and exports, compared to an average of 17% in developed countries.²⁶ Rwanda's hilly terrain and heavy rainfall complicate road construction and maintenance. Distribution infrastructure remains poor, particularly from neighboring countries into Rwanda, though the government hopes the USD 13.5 billion Mombasa-Kampala-Kigali railway, expected in 2018, will alleviate some of these issues.²⁷
- **Weak entrepreneurial culture:** Several investors noted that Rwanda's base of talented entrepreneurs is considerably weaker than in some other East African countries, even on a per-capita basis. Some attributed this to the legacy of donor aid money over the last decades. There is a perception among local investors that Rwandan entrepreneurs lag regional counterparts in embracing and applying basic business concepts such as bulk discounts.²⁸ Government-run entrepreneurship training has sought to tackle this gap, though some investors wondered whether these efforts are sufficiently focused on individuals with signs of entrepreneurial talent.

26 "Rwanda," *IFRTD*, available at http://www.ifrtd.org/en/regions/country_pages/Rwanda.php.

27 Mark Tran, "Rwanda Rail Project on Track to Bridge Africa's Economic Divide," *The Guardian* (Sep. 30, 2014), available at <http://www.theguardian.com/global-development/2013/sep/30/rwanda-rail-project-bridge-economic-divide>.

28 "Business in Rwanda: Africa's Singapore?" *The Economist* (Feb. 23, 2012), available at <http://www.economist.com/node/21548263?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

- **Limited pool of experienced, local staff:** Based on interviews conducted for this report, impact investors struggle to find experienced local staff to support both their own investment teams and their portfolio companies' management teams. On the one hand, entrepreneurs note that Rwanda's tertiary education system does not adequately prepare graduates for professional jobs; on the other hand, the government's replacing French with English as the official language of education led to what some view as a lost linguistic generation—a generation who lack the French skills to engage with Rwanda's mostly francophone rural areas, but also lack the English skills to connect to international markets. As a result, many middle and senior managers are drawn from Uganda, Kenya, or even India. Even when a talented, experienced professional can be found, they often command high wages that can be challenging for SMEs or impact businesses to support, especially in their early years.
- **Government involvement:** Investors and entrepreneurs almost unanimously praise Rwanda's government for its transparency and lack of corruption. At the same time they are quick to point out that no deal happens without government involvement, regardless of sector. Typically this involves relatively benign intervention to ensure that individual projects tie in with official growth policies. Nevertheless, local investors caution that, despite the Rwandan government's reputation for being business friendly, investors still need to pay careful attention to meeting various government requirements.
- **Immature investment markets:** Most Rwandan SMEs operate informally and lack the financial records and account-keeping standards that impact investors often require. Entrepreneurs frequently keep multiple sets of financial records and merge business and personal banking. Local entrepreneurs have limited experience with private equity-type investment deals and often wildly overvalue their companies. As a result, the number of deals to date, and the number of investible companies, are highly limited, as are the number of successful exits. This lack of exits has made it difficult for impact investors to prove their track records.
- **Long diligence processes:** Due to limited market research and a lack of strong local service providers, investor diligence can often stretch 12 months or more. This lengthy process can damage relationships with entrepreneurs, who often view it as indicative of a lack of trust. It also puts additional pressure on the business and can lower long-term returns as companies must survive without needed growth capital, creating a significant opportunity cost as management teams spend time courting investors.

Opportunities

While these challenges are significant, they present many opportunities for impact investors to respond and strengthen their operations in Rwanda. Specific opportunities for impact investors are as follows:

- **Expand to neighboring markets:** Burundi and the DRC provide strong expansion opportunities for businesses and investors based in Rwanda. Affluent Burundians and Congolese already make routine trips to Kigali for medical treatment and banking. Both Burundi and the DRC are less than four hours' drive from Kigali along safe, well-paved roads, and both hold large, underserved markets. Together, the two countries add another 30 million potential consumers. These markets are challenging; Burundi has some of the weakest institutions in the region and the Eastern DRC has limited rule of law. At the same time, the Rwandan government is actively encouraging cross-border trade, for instance through new bonded warehouses in Rusizi and Rubavu, near the Congolese border.²⁹
- **Develop sector expertise:** Beyond bringing capital to portfolio companies, impact investors can drive growth, returns, and impact by understanding the specific sectors where their portfolio companies operate. For some investors, this sector focus has allowed them to identify exciting, less well-known opportunities earlier and reduce their diligence timelines by leveraging existing knowledge. Sectors such as agriculture, energy, and financial services present large opportunities where companies often face similar pre-competitive challenges—these learnings can be shared across portfolio companies.
- **Increase local decision-making:** Where possible, impact fund managers have cited significant improvements in their portfolio through local decision-making and local support. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to quickly respond to changing realities on the ground.
- **Take active oversight roles:** Impact investors in Rwanda have increasingly sought to mitigate the challenges above through more direct participation than might be necessary in more mature East African markets. Some investors have shifted to a majority-stake model after experiencing difficulties in getting entrepreneurs to execute agreed strategies. This type of structure could also allow for a management buy-back of majority ownership as an exit strategy.

Impact investors also highlight opportunities across the following sectors:

- **Agriculture:** Rwanda is extremely fertile and widely recognized as a prime grower of tea and coffee, among other crops, presenting significant opportunities for export to developed markets. However, these industries lack modernization, particularly in terms of inputs and storage, and yields are still well below international benchmarks. Exports are also more costly due to Rwanda's land-locked geography. The agriculture sector not only lacks technological

²⁹ Republic of Rwanda: Ministry of Trade and Ministry, *Rwanda Integrated Trade Logistics Facilities Project: Bonded Warehouse at Rusizi and Rubavu* (2014), available at http://www.rdb.rw/fileadmin/user_upload/Documents/tender/2014/RFQ_Bonded_Warehouse_Rusizi_and_Rubavu.pdf.

sophistication, but is inadequately financed by local banks. Many interviewees identify opportunities for agriculture-tailored financing products that take into account the cyclical and uncertainty of commodities markets.

- **Renewable energy:** Rwanda's power generating capacity is still well below what is needed to power its growing economy. Much of Rwanda's energy is imported, making electricity costs among the highest in the region at an estimated USD 0.22 per KWh, more than double the regional average.³⁰ The government is devoting significant resources to increasing local generation and rural electrification, but there is still room for private sector energy products in a country where 80% of the population does not have access to the grid.
- **Manufacturing inputs:** Along with the high cost of power, one of the key constraints for Rwanda's manufacturing sector is the lack of raw materials and inputs. Most of these are imported at high cost from Kenya and Uganda, as well as India and China in some cases. For instance, an agricultural processing business interviewed noted that there are no Rwandan producers of flour storage sacks. Though the manufacturing sector will likely benefit from the government's investment in local extractive industries, key inputs will remain undersupplied without private sector initiative.

³⁰ Ambassade de la République du Rwanda à Bruxelles, *A Transformative Power* (Mar. 12, 2012), available at <http://www.ambarwanda.be/pdf/Rwanda%20Flash%20News%2092-EN%20.pdf>.

ETHIOPIA

EAST AFRICA'S RISING GIANT



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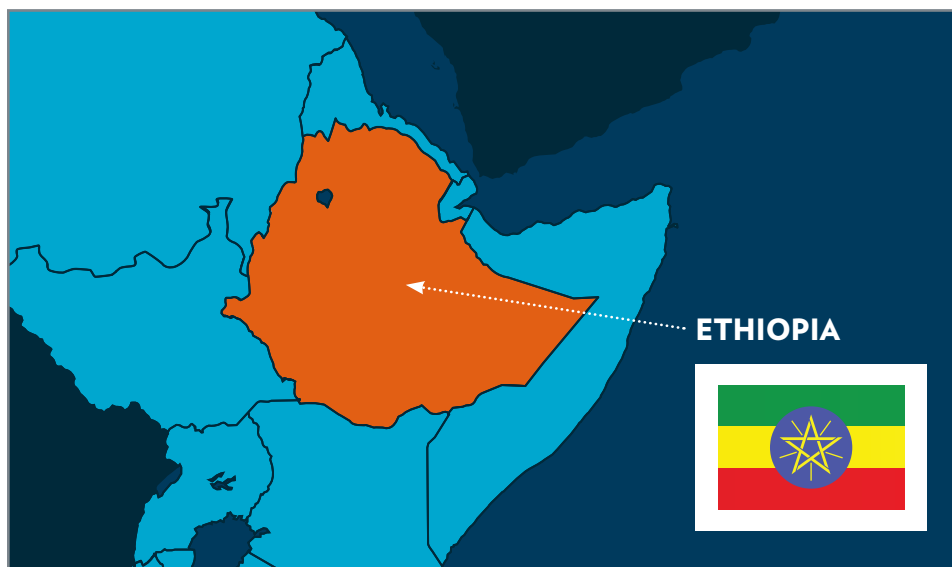
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INTRODUCTION

With a population of more than 90 million, Ethiopia represents the largest single market by population in all of East Africa (Figure 1). Unlike the other countries profiled in this report, Ethiopia retained sovereignty throughout the 18th and 19th centuries, and maintains a strong spirit of independence. This translates to a vibrant entrepreneurial landscape, with a number of enterprises looking to serve a rapidly growing market.

Ethiopia's financial services sector—and particularly the financing options available to small and medium enterprises (SMEs)—lags that of other major East African economies. Despite heavy governmental influence in the banking and lending industry, a number of new banks have expanded their offerings beyond those available from the Commercial Bank of Ethiopia (CBE). CBE held a monopoly position as recently as the 1990s, but due to loosening of government restrictions, CBE held less than 50% of banking sector assets by 2008.¹ Though hurdles like high collateral requirements and high interest rates remain, SMEs are increasingly able to access financing through both impact and conventional sources. In 2008, Ethiopia introduced one of the most successful commodities exchanges in Africa, managing more than USD 1.1 billion in trades. Price data is transmitted real-time to 32 outdoor ticker boards in rural areas, and is available through an automated phone system, which receives more than 1 one million calls per month, 70% from rural areas.² Together, these positive trends signal an increasingly friendly environment for impact and conventional investments.

FIGURE 1: MAP OF ETHIOPIA



1 Eleni Gabre-Madhin, *A Market for Abdu: Creating a Commodity Exchange in Ethiopia*, International Food Policy Research Institute, 2012 available at <http://www.ifpri.org/sites/default/files/publications/oc70.pdf>.

2 Eshete, Tesome and Abebe, *Competition in Ethiopian Banking Industry*, African Journal of Economics Vol. 1 (5), December 2013 available at <http://internationalscholarsjournals.org/download.php?id=974147144939569119.pdf&type=application/pdf&op=1>.

COUNTRY CONTEXT

After decades of authoritarianism, Ethiopia’s economy is on the rise. Exceptional growth rates, spurred by a wave of privatization and robust foreign direct investment (FDI) flows, have fueled rapid modernization, especially in the past decade. Nonetheless, Ethiopia’s living standards lag behind those of its peer countries; the economy is still overwhelmingly agriculture-based, and linkages between urban affluence and rural populations are weak.

Gross Domestic Product

Ethiopia has seen exceptional growth in recent years, averaging around 13% GDP (PPP) annual growth for the last ten years (Figure 2), making it the fastest growing non-oil driven economy in Africa.³ Fueled by substantial government investment into Ethiopia’s manufacturing sector, GDP currently stands at close to USD 121 billion in PPP terms, making it the largest economy in the region, approximately 30% larger than the second largest, Sudan. Although growth has slowed from record levels of 16% in 2004, the IMF expects growth to remain high at just under 10% over the next five years.⁴

FIGURE 2: GDP (PPP), 2004–2013



Source: IMF World Economic Outlook, April 2014

3 “A New Fund Attests to the Country’s Allure—and to the Value of Connections,” *The Economist* (May 12, 2014), available at <http://www.economist.com/node/21554547?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

4 World Economic Outlook: Gross Domestic Product, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>.

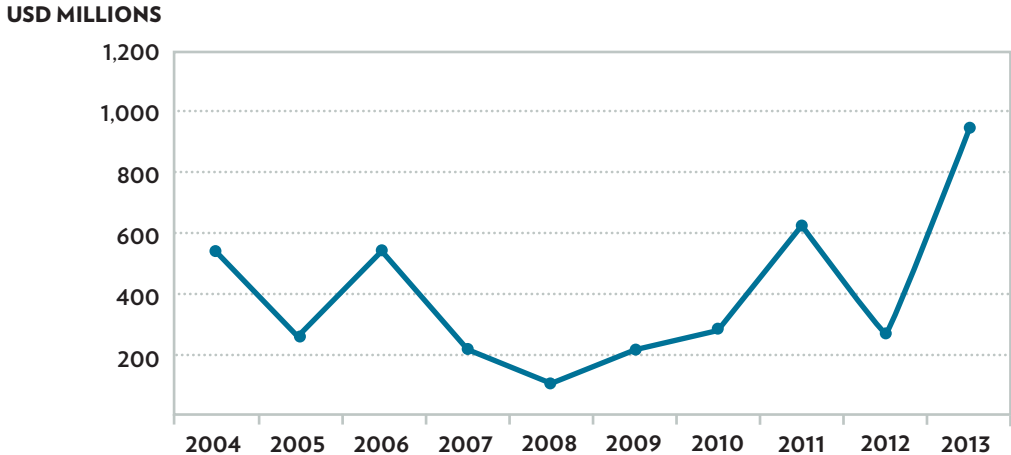
Standards of living, however, remain low. With a population of around 90 million—the second largest in Africa behind Nigeria—Ethiopia’s GDP (PPP) per capita is only USD 1,400 which ranks ahead of only Burundi, Eritrea, and South Sudan regionally (no data for Somalia). The share of GDP from agriculture is close to 50%, by far the highest in the region, and agriculture employs 80% of Ethiopians, compared to only 50% in neighboring Kenya.⁵ While the government’s efforts to promote industry have done much to boost growth, industry is still a small share of GDP compared to agriculture. Most non-agricultural economic activity takes place in Addis Ababa, resulting in a concentration of wealth in the country’s capital. Nonetheless, pressure on farmers is likely to rise as increasing population growth pushes down land availability and reduces average plot size.

Elsewhere, large-scale industrial projects are likely to absorb substantial government spending. The Grand Millennium Dam—already 30% complete—will add 6 GW of electrical capacity to Ethiopia’s grid with a construction cost of nearly USD 5 billion.⁶

Foreign Direct Investment

While GDP growth has been strong, foreign direct investment (FDI) flows have fluctuated significantly over the past decade (Figure 3). There was a particularly marked jump in FDI in 2013, with approximately USD 1 billion in inflows. However, Ethiopia’s large economy has meant that FDI inflows have been relatively low as a percentage of GDP, at less than 1%.

FIGURE 3: FDI INFLOWS, 2004-2013



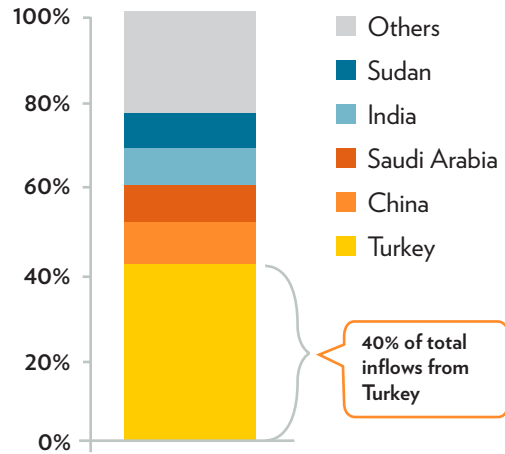
Source: UNCTAD

5 “An Ideological Competition Between Two Diametrically Opposed Economic Models,” *The Economist* (Mar. 2, 2013), available at <http://www.economist.com/news/special-report/21572379-ideological-competition-between-two-diametrically-opposed-economic-models-doing-it-my?zid=304&ah=e5690753dc78ce91909083042ad12e30>.

6 Emmanuel Igunza, “Will Ethiopia’s Grand Renaissance Dam Dry the Nile in Egypt?” *BBC News Africa* (Mar. 22, 2014), available at <http://www.bbc.com/news/world-africa-26679225>.

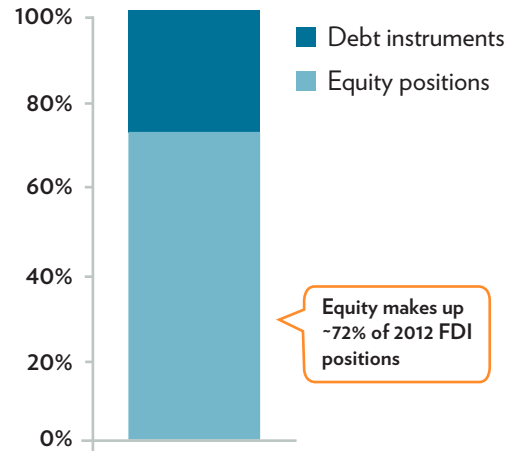
The single largest source of FDI in the last fiscal year with available data was Turkey, which accounted for over 40% of inflows (Figure 4). China, Saudi Arabia, India, and Sudan each account for a further 7%-10%. Most FDI flows into manufacturing, construction, mining, and other labor-intensive industries. Further, most investment has taken place through equity vehicles (Figure 5), typically over an eight to ten year investment horizon.

FIGURE 4: FDI FLOWS BY COUNTRY OF ORIGIN



Source: US State Department Data

FIGURE 5: 2012 FDI INFLOWS BY INSTRUMENT

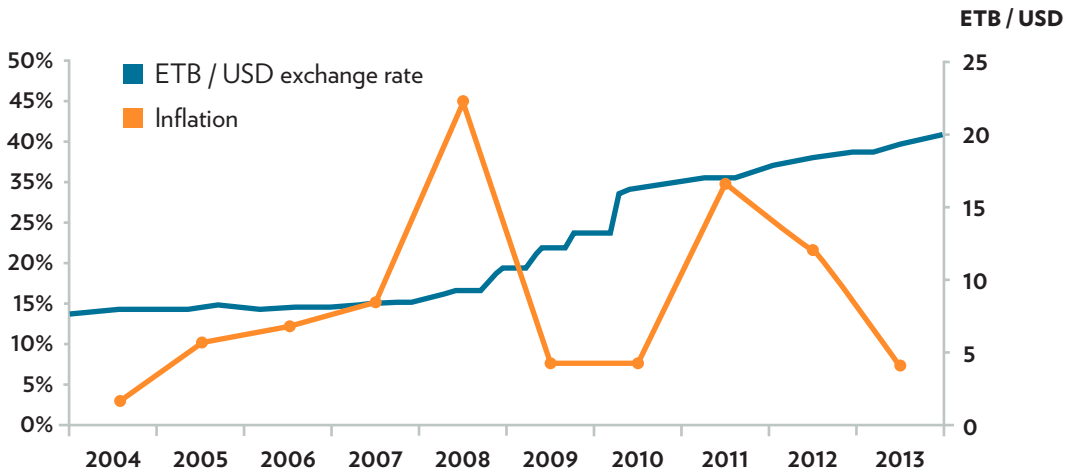


Source: IMF Data

Inflation and Exchange Rates

Ethiopia's state-funded development has led to record growth rates over the past decade, but has occasionally led to high inflation, peaking at over 40% in 2008 and reaching 30% again in 2011 (Figure 6). While inflation has slowed since, continued government spending and vulnerability to commodity supply shocks mean Ethiopian price levels remain volatile. The Ethiopian National Bank has worked to depreciate the Ethiopian Birr gradually, but sometimes stepwise as occurred in 2010. Many stakeholders believe the Birr is still overvalued and expect further depreciation. Exchange rate and price uncertainty have made investors hesitant to issue loans, especially in local currency.

FIGURE 6: INFLATION AND USD EXCHANGE RATE, 2004-2013

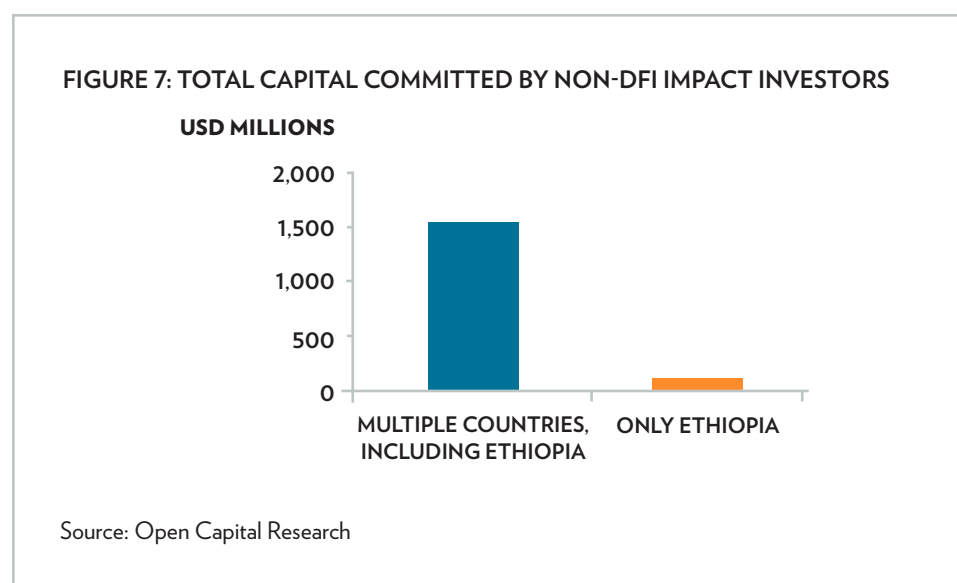


Source: World Bank Indicators

SUPPLY OF IMPACT CAPITAL

Despite having the largest population and the leading economy (in PPP terms) in the region, Ethiopia has been at the periphery of impact investing in East Africa until recently. Economic activity has been dominated by the government for decades, and while privatization began as early as 1995, a truly independent private sector has only slowly begun to emerge in recent years. Impact investors increasingly see enormous opportunities and untapped markets, but the legacy of socialism and government control continue to prove challenging.

Despite these challenges, research indicates that close to USD 100 million of non-DFI impact capital has been disbursed to Ethiopia alone and a further USD 1.6 billion of regional non-DFI impact capital would consider investments in Ethiopia should they identify attractive opportunities there (Figure 7).⁷



Broader Investing Landscape

There is a significant need for impact capital in Ethiopia, as local financial institutions remain markedly underdeveloped compared to other countries in the region. With approximately USD 1 billion under management⁸, Ethiopia's banking sector is orders of magnitude smaller than those in other large East African countries such as Kenya, which boasts more than USD 30 billion in assets held by banks.⁹ Savings clubs and

7 Based on primary and/or secondary research conducted during this study; see "Introduction and Methodology" chapter of this report for details. Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors ("non-DFI"), and present this separate analysis when appropriate.

8 The National Bank of Ethiopia, *Annual Report 2012/13*, available at <http://www.nbe.gov.et/pdf/annualbulletin/Annual%20Report%202012-2013/Annual%20Report%202012-2013.pdf>.

9 Kenyan Banking Sector Registers Improved Performance," *Central Bank of Kenya* (Mar. 31, 2013), available at <https://www.centralbank.go.ke/index.php/news/296-kenyan-banking-sector-registers-improved-performance>.

other sources of communal lending are also much less common in Ethiopia than in other countries in the region. Unlike other countries, impact investors are a large source of potential capital as a proportion of the overall national capital market.

Bank lending rates have been remarkably constant over the last decade due to heavy banking regulation—much more constant than in other countries in the region. Bank lending rates stand at around 12%, approximately triple the average interest rate in the United States over the last 10 years¹⁰, but lower than rates in other major East African economies. While low rates facilitate government borrowing for infrastructure projects, they discourage saving, limiting the overall size of the banking sector. Ethiopia's banking sector remains weak, and access to debt can be difficult.

Similar to banks in other East African countries, Ethiopian banks remain extremely risk averse and are largely unwilling to invest in start-up or early-stage enterprises. When they are willing to lend, banks often require large amounts of collateral that can be greater than 100% of the loan amount. Many early-stage businesses are unable to satisfy these requirements. Even large real estate projects often need to be 50% complete before commercial banks will consider project financing. Local banks lack the sophistication to offer creative structures like trade financing or crop cycle-based repayments. As a result, there remains a large gap in the market for early-stage investments that offer risk capital to high-potential businesses. In this capital-scarce environment, Ethiopia's 31 microfinance institutions (MFIs) play an important role; in 2012, MFIs reached nearly 3 million Ethiopians and held USD 500 million in loans and USD 300 million in savings.¹¹

Beyond access to capital, Ethiopian firms face restrictions in accessing the foreign currency they need to import goods and services often used as inputs. Ethiopia maintains several foreign exchange restrictions that diverge from international standards. The government limits foreign currency trade as well as the amounts that individuals and corporations can hold.¹² This can create significant shortages of foreign currency reserves.

Impact Capital Disbursed

Impact investors seem to have a growing interest in Ethiopia, despite limited activity to date. Overall, 80 non-DFI impact vehicles are able to place capital in Ethiopia, managed by 58 non-DFI impact investors, although barely any have made investments or set up local offices, and only 7% of all non-DFI impact capital disbursed in East Africa has been placed in Ethiopia. This represents over USD 90

10 World Development Indicators: Lending Interest rates (%), *The World Bank Group*, available at <http://data.worldbank.org/indicator/FR.INR.LEND?page=2>.

11 Admit Wondifraw Zerihun, Haile Kibret & James Wakiaga, African Development Bank, The Organization for Economic Co-operation and Development & The United Nations Development Programme, *African Economic Outlook: Ethiopia 2014* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Ethiopia_EN.pdf.

12 Tom Keatinge, *Growing an Economy: Impact of Foreign Exchange and Remittances on Ethiopian Development*, Global Center on Cooperative Security, September 2014, available at http://www.globalcenter.org/wp-content/uploads/2014/09/14Sept26_Growing-an-Economy_PB.pdf.

million in 25 disclosed non-DFI impact deals (Figure 8), far behind Kenya, Tanzania, and Uganda, despite a significantly larger economy. A similar percentage of DFI direct investments have been placed in Ethiopia, totaling over USD 400 million across 17 deals (Figure 8).

FIGURE 8: IMPACT INVESTMENTS IN ETHIOPIA

	Capital disbursed	Deals
DFI	USD 423 Million	17
NON-DFI	USD 91 Million	25

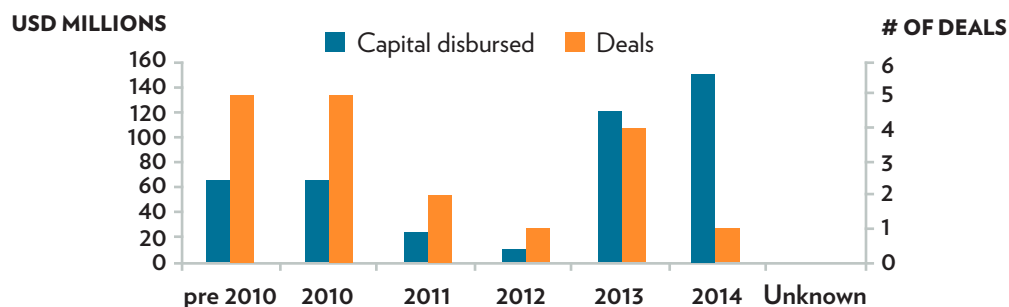
Source: Open Capital Research. Note: DFI direct investments exclude 16 USAID credit guarantees to local banks worth ~USD 90M

Investments Over Time

Impact investing is a young sector in East Africa, and particularly in Ethiopia. While the large number of deals with undisclosed details prevents additional conclusions about non-DFI impact investor activity, interviews with investors suggest that deals were extremely scarce until 2012 or 2013.

This nascent stage of the industry is also reflected in DFI direct investments (Figure 9), which have begun to pick up again following a decline that reached a low in 2012. The high capital disbursed figure for 2014 is primarily driven by one large DFI investment in an Ethiopian petroleum business. Overall, 2014 values are likely underestimated due to incomplete data at the time of this report in early 2015.

FIGURE 9: DFI DIRECT INVESTMENTS BY YEAR

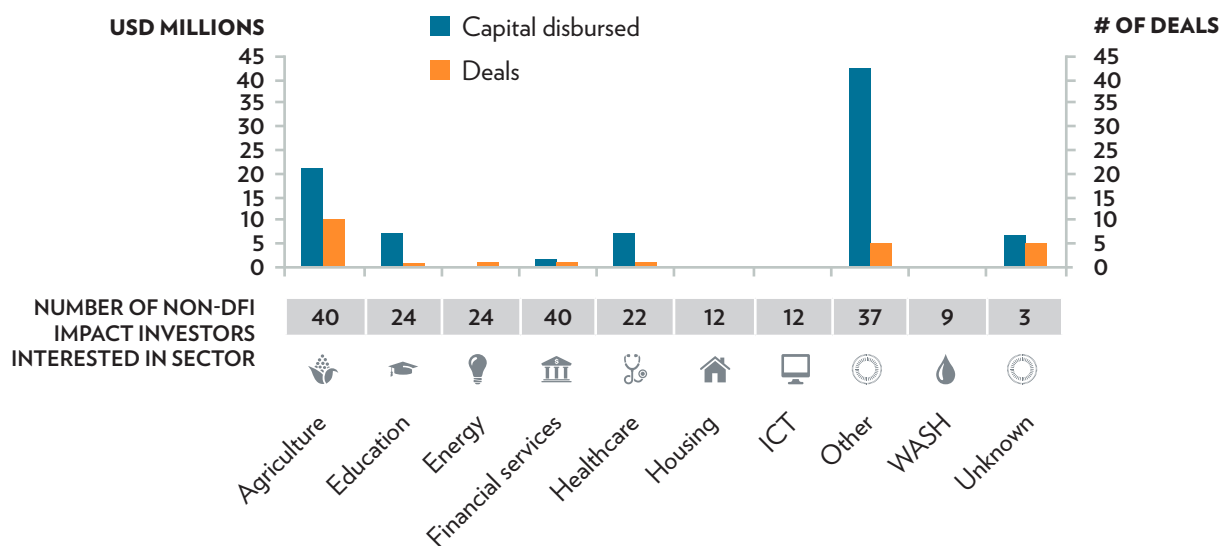


Source: Open Capital Research. Note: excludes 16 USAID credit guarantees to local banks worth ~USD 90M

Sector

Ethiopia’s distribution of investments by sector is unique within the region and reflects the government’s restrictions on investors (Figure 10). Foreign investors are restricted from investing in financial services, although several investors active in Ethiopia target financial services in other countries. Agriculture has received the most deals and capital (approximately 40% of all deals in Ethiopia) and has strong interest from many non-DFI impact investors. Despite the smaller number of deals, the large investment sizes possible in manufacturing and food processing—which make up most of the “Other” column in Figure 10—drive a larger total amount of non-DFI impact capital into these sectors.

FIGURE 10: NON-DFI IMPACT INVESTMENTS BY SECTOR

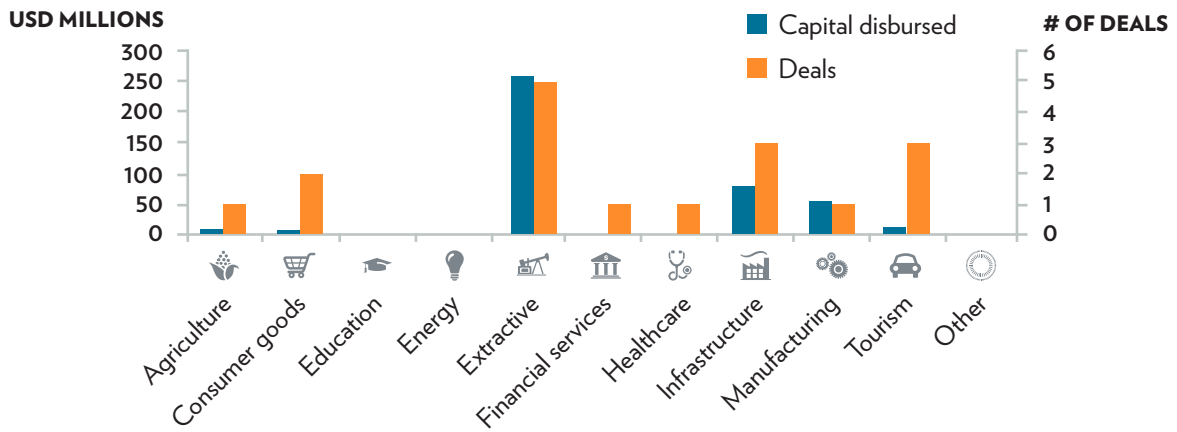


Source: Open Capital Research. Note: Chart shows total # of non-DFI impact investors interested in sector; may be multiple sectors

Energy, housing, information and communications technologies (ICT), and water, sanitation, and hygiene (WASH) have seen relatively few deals, despite their prominence as sectors of interest for non-DFI impact investors. The disconnect between interest in these sectors and the number of deals implies that impact fund managers see limited viable, investible opportunities and have particular difficulty placing capital.

By contrast, DFI direct investments overwhelmingly favor extractive industries, infrastructure, and manufacturing (Figure 11). These three sectors absorb over 90% of the capital disbursed directly by DFIs in Ethiopia. DFIs face the same restrictions on investments in the financial services sector, with only one recorded deal (of undisclosed size).

FIGURE 11: DFI DIRECT INVESTMENTS BY SECTOR

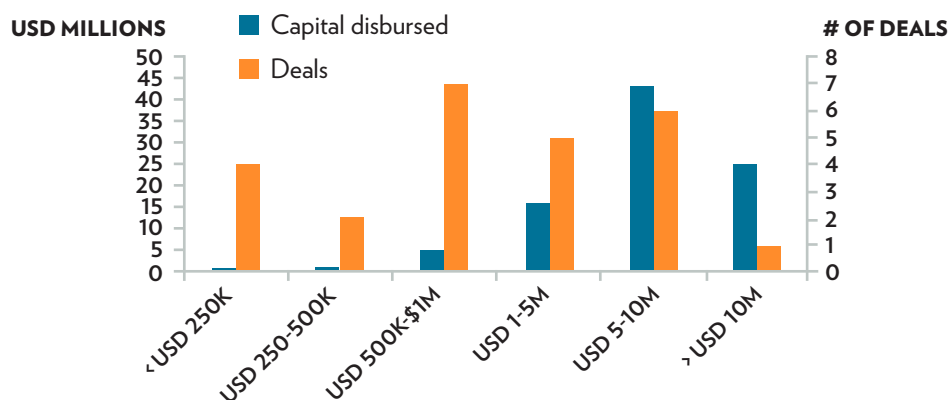


Source: Open Capital Research. Note: excludes 16 USAID credit guarantees to local banks worth ~USD 90M

Deal Size

Across East Africa, the majority of non-DFI impact deals are less than USD 1 million in size. The picture is similar in Ethiopia (Figure 12); however, several larger investments in manufacturing and processing skew deal sizes upwards. Among non-DFI impact investors, close to 50% invest between USD 1 million and USD 5 million per deal, although most impact deals are less than USD 1 million. To date, the majority of capital has been disbursed in the USD 1 million to USD 5 million range, reflecting opportunities in Ethiopia's rapidly growing manufacturing sector.

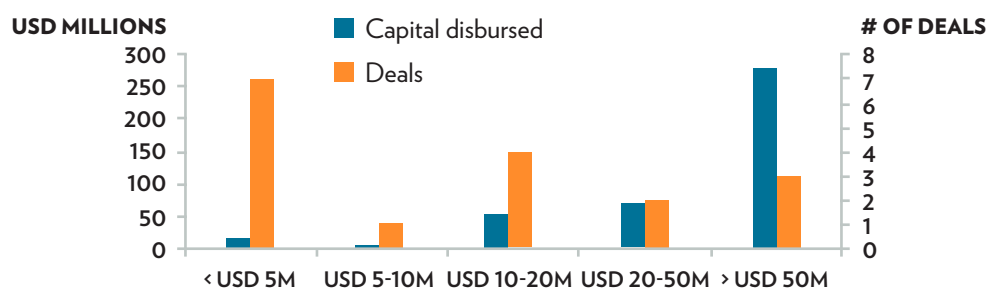
FIGURE 12: NON-DFI IMPACT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

By contrast, DFI direct investments are often significantly larger (Figure 13). The average deal size for DFI direct investments in Ethiopia is approximately USD 25 million, more than six times the average size of non-DFI deals. This is driven by large infrastructure and oil and gas projects. While deals under USD 10 million constitute close to 50% of the direct DFI investments, none were under USD 1 million, compared to 50% of non-DFI impact investor deals.

FIGURE 13: DFI DIRECT INVESTMENTS BY DEAL SIZE



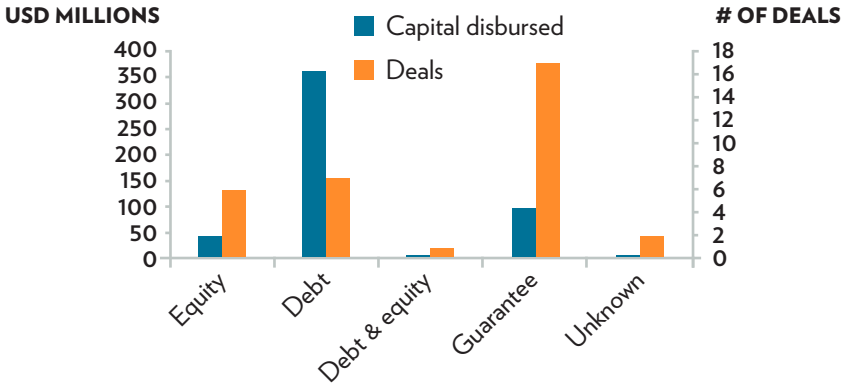
Source: Open Capital Research. Note: excludes 16 USAID credit guarantees to local banks worth ~USD 90M

Instrument

Due to lack of available data, this report is unable to provide a definitive breakdown of non-DFI direct investments by instrument. Available evidence suggests that though impact investors are increasingly using more creative investment structures in East Africa, they have not yet done the same in Ethiopia. While investors in Kenya, for instance, increasingly consider quasi-equity structures such as convertible debt or revenue-participating debt to help balance risk with limited cash flows, the vast majority of disclosed deals by non-DFI investors in Ethiopia used traditional equity instruments. Ethiopia’s private investment market is young, and investors interviewed believe entrepreneurs have insufficient knowledge of more complicated structures to permit their use.

DFIs have invested both debt and equity, though debt investments constituted more than 70% of all capital disbursed (Figure 14). Credit guarantees to Ethiopian banks make up the bulk of DFI transactions, though much of this capital has not actually been disbursed.

FIGURE 14: DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research. Note: For guarantees, “disbursed” column denotes maximum disbursements should guarantee payments come into effect

Local Presence

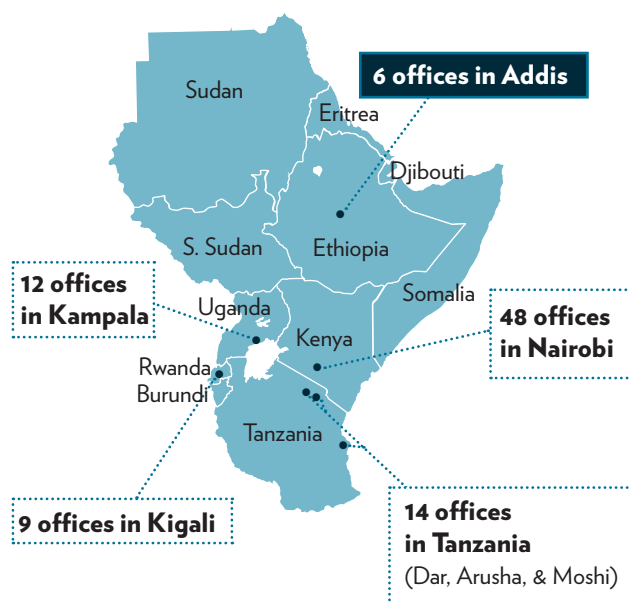
Few impact investors have opened offices in Ethiopia. Only six impact investors have established a presence in Addis (Figure 15), one of which is headquartered there and three of which are DFIs. Ethiopia requires specialized market knowledge and experience that does not easily transfer from other countries in the region, making it more difficult to expand to Ethiopia than to other East African countries from an existing hub (like Nairobi). The five-year Growth and Transformation Plan (GTP) released in 2010 (described in more detail later in the “Regulatory Environment” section in this chapter), provides added incentives for investors to establish a local presence, as close ties with the Ethiopian Investment Authority are essential to take advantage of the GTP, and easier to establish in person.

Impact Tracking Standards

Impact investors’ dual mandate to realize both financial and social returns requires a strong focus on measuring impact as a part of their core activities. Beyond tracking metrics as best practice, many impact asset owners require it. This is particularly true for DFIs, which act as anchor investors to most impact funds.

Across East Africa, most impact investors do not specify a specific standard for measuring the impact of their investments. This is also true in Ethiopia. Instead, investors typically report using flexible structures that are customized for each new investment. This customization allows investors to reduce administrative burden for their portfolio businesses and focus on the metrics that are most meaningful. For more detail on the challenges in impact measurement in East Africa, see the regional chapter of this report.

FIGURE 15: IMPACT INVESTORS WITH LOCAL OFFICES



Source: Open Capital Research

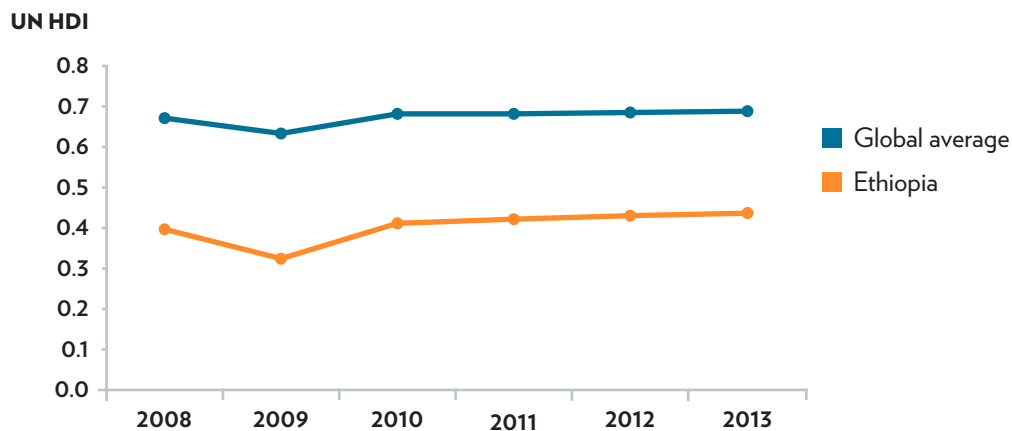
DEMAND FOR IMPACT INVESTING CAPITAL

Despite record growth over the past decade, Ethiopia lags other countries in the region in the provision of key goods and services. This creates opportunities for entrepreneurs to build enterprises that fill these needs while also realizing financial returns. As the private sector continues to grow and entrepreneurs take advantage of these opportunities, they will increasingly look beyond banks and family savings to finance business growth. This is likely to translate into demand for impact capital and private equity more generally (despite currently variable and often low levels of familiarity with these concepts).

Development Context

Ethiopia remains well below global and regional averages for human development indicators (Figure 16). Ethiopia ranks 173 out of 187 countries according to the UN Human Development Index, the lowest in the region except for Eritrea, which is in 182 place.¹³

FIGURE 16: UN HDI SCORES, 2008-2013

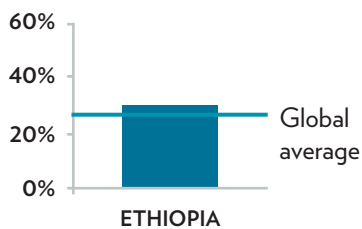


Source: United Nations Human Development Report 2014

13 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>; 2010 Human Development Index, *United Nations Development Programme* (Apr. 2010), available at <https://www.imf.org/external/pubs/ft/weo/2010/01/weodata/download.aspx>.

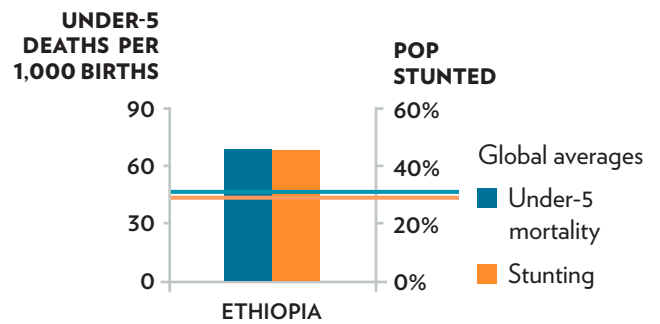
This low ranking is driven by Ethiopia's performance across a range of key developmental indicators. For example, more than 30% of Ethiopians live on less than USD 1.25 per day, above the global average of 25% (Figure 17). Similarly, Ethiopia underperforms global averages on key health metrics. Ethiopia faces under-five mortality and infant mortality well above global averages (Figure 18), reflecting unequal access to healthcare for wealthy and low-income populations. Under-five stunting, an effective proxy for childhood health and long-term prosperity, is around 50% higher than the global average.¹⁴

FIGURE 17: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

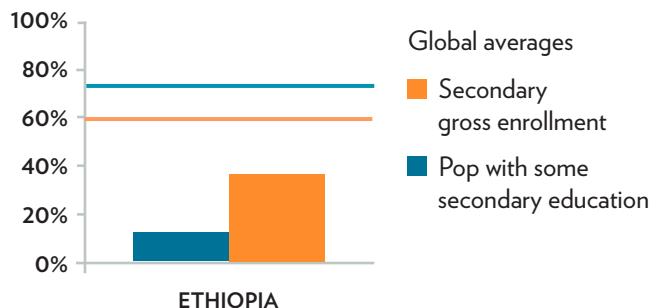
FIGURE 18: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

The picture is similarly bleak for education (Figure 19). Only 15% of Ethiopians have at least some secondary education, just a quarter of the global average, while only 40% of appropriately aged Ethiopians are currently enrolled in secondary education, half the global average.

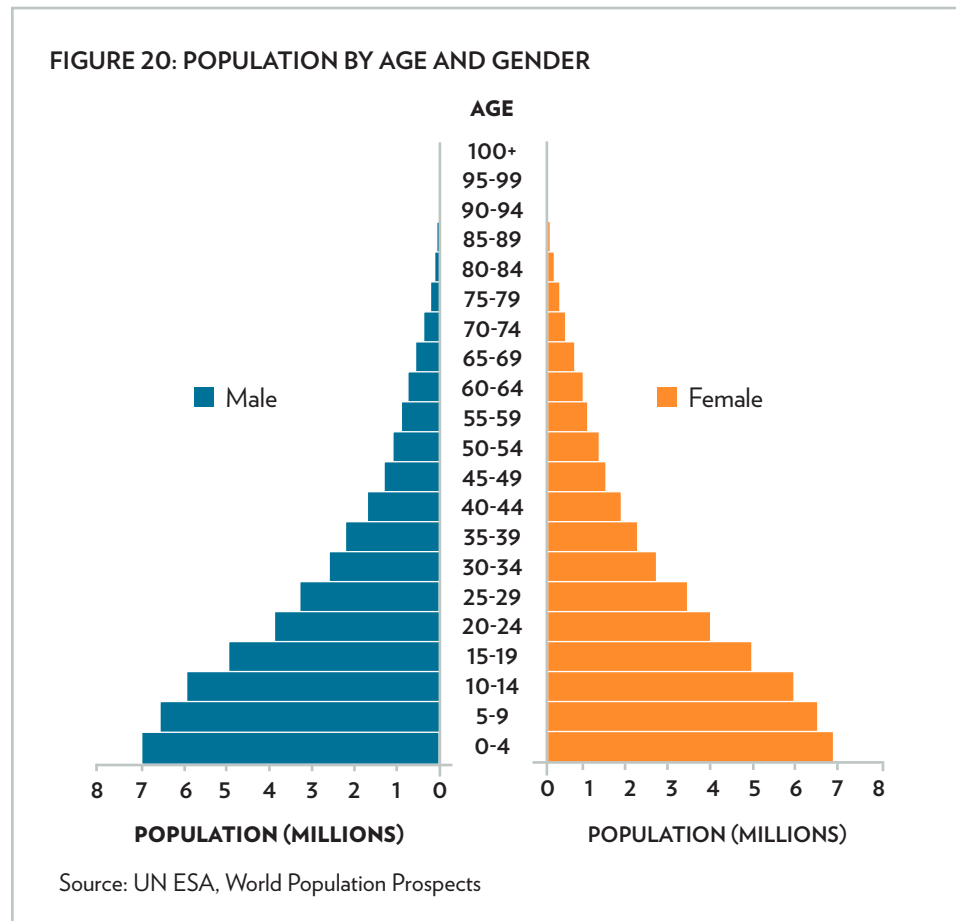
FIGURE 19: KEY EDUCATION INDICATORS (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

14 2014 Human Development Index, *United Nations Development Programme* (2014), available at <http://hdr.undp.org/en/data>.

Like other East African countries, Ethiopia has a disproportionately young population, where more than 40% is under the age of 15 and more than 60% is below age 25 (Figure 20).¹⁵ This has resulted in high youth unemployment, which coupled with low levels of education could undermine Ethiopia’s strong economic performance over the coming decades.



Entrepreneurs

As is the case in much of East Africa, increasing investor interest in Ethiopia is encouraging entrepreneurs to start new social enterprises. In Ethiopia, these opportunities are numerous, given the large disadvantaged populations and the limited supply of locally produced goods and services. Entrepreneurs have begun launching businesses particularly in healthcare and manufacturing for import substitution. Given the youth of Ethiopia’s private sector, these are mainly concentrated in the start-up and early phases.

Entrepreneurs in Ethiopia face many of the same challenges as their counterparts across the rest of East Africa (see the Entrepreneurs section of the East Africa regional chapter of this report for more detail), along with other challenges that appear more pronounced in Ethiopia. Specifically, Ethiopian entrepreneurs expressed

¹⁵ “The World Factbook: Ethiopia,” *Central Intelligence Agency* (Jun. 22, 2014), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/et.html>.

frustration over impact investors' hesitancy to provide local currency loans. With the exception of the Ethiopian Development Bank, DFIs typically denominate loans in Euro or USD, as do private-sector impact investors. At the same time, Ethiopia's stringent foreign currency controls mean that entrepreneurs primarily have to run operations in Ethiopian Birr, leaving them exposed to currency risk. Entrepreneurs stress the positive impact that could be achieved if larger international institutions offered foreign exchange risk-sharing mechanisms for SMEs.

Investors, for their part, also face a range of challenges. As in the rest of East Africa, entrepreneurs in Ethiopia commonly struggle to create realistic forward-looking strategies and projections, a plan to use capital, and efficient operations. Entrepreneurs often run several projects simultaneously and have limited attention to devote to a single enterprise. Growth-stage companies are far fewer in Ethiopia than early-stage companies or startups. Furthermore, many of the most interesting businesses do not explicitly present themselves as social businesses, even when their potential for impact is high (see the Entrepreneurs section of the East Africa regional chapter for more detail).

Beyond pipeline development, impact investors see significant value in strong local networks to evaluate opportunities. Investing in this market, with limited legal recourse, requires trust between the impact investor and the entrepreneur. Particularly if an enterprise has been operating informally, it can be difficult to evaluate its history and trustworthiness without local social networks to provide insight on the entrepreneur. This is particularly true in Ethiopia where high linguistic and cultural barriers often present challenges to international impact investors. Deep social and professional networks that extend beyond the impact investing sector will be difficult to develop without long-term local presence.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

Like impact investor activity, the broader ecosystem for impact investing in Ethiopia is still developing. Ethiopia's rapid growth presents an attractive picture for intermediaries and service providers as well as investors, but a challenging regulatory environment means ecosystem development progress may be slow.

Regulatory Environment

Today, Ethiopia is relatively stable politically. Though the current Prime Minister has shown guarded enthusiasm for liberalization and free-market reform,¹⁶ most government institutions are hesitant to fully engage in the private sector. Investors and entrepreneurs interviewed generally regard Ethiopia's government as one of the more functional and benevolent in the region. Both foreign and local interviewees highlight the low levels of corruption, echoed by the World Bank's *Ease of Doing Business* rankings, placing Ethiopia third in the region, just ahead of Kenya.¹⁷

Further, even though Ethiopia has a reputation for opaque government regulations and a challenging business environment, the government is reportedly growing more welcoming to private equity investments. In 2010, the Ethiopian government released its five-year Growth and Transformation Plan (GTP), which specifically emphasizes foreign investment as a key component of Ethiopia's growth strategy. Investors active in sectors prioritized by the GTP—large-scale agriculture and manufacturing for export in particular—will receive particularly favorable incentives.

Despite these positive developments, the government retains tight control over the country's economy and certain restrictions present challenges for investors:

- **Restrictions on foreign investment:** Ethiopia's Investment Code lays out foreign investment regulations reserving the following occupations for Ethiopian nationals: banking, broadcasting, attorney and legal consultancies, indigenous medicine preparation, advertisement, domestic air transport, and packaging.¹⁸ Several sectors are further reserved for domestic investors, including several agricultural sectors, manufacturing, some consumer goods, construction, pre-secondary education, diagnostic services, capital goods leasing, and printing. The government reserves exclusive rights to postal services, grid energy transmission, passenger air transport, weapons, and telecommunications. In general, investors find it essential to build close relationships with various government bodies before placing capital, to

16 "Hailemariam Desalegn," *The Economist* (Nov. 12, 2012), available at <http://www.economist.com/news/21566482-hailemariam-desalegn>.

17 "Economy Rankings," *The World Bank Group* (Jun. 2014), available at <http://www.doingbusiness.org/rankings>.

18 Ethiopian Investment Agency, *Ethiopian Investment Guide 2013*, available at http://ethiopianembassy.be/wp-content/uploads/2014/05/Investment_Guide_2013.pdf.

ensure regulations are understood and interpreted correctly. The minimum capital requirement for foreign investors is USD 100,000 unless accompanied by a domestic partner, in which case the minimum capital requirement is USD 60,000.

- **Repatriation of profits and dividends:** Although the government of Ethiopia officially allows repatriation of profits and dividends, in practice this requires careful structuring and complicated official registration of all investments with the Ethiopian Investment Authority. This remains one of the greatest hurdles cited by impact investors.
- **Foreign exchange controls:** The National Bank of Ethiopia (NBE) actively manages foreign currency reserves and exchange rates. The Ethiopian Birr is not freely convertible and all foreign currency transactions must be approved by the NBE.¹⁹ As a result, foreign exchange shortages are common, particularly among smaller businesses whose currency needs are typically subordinate to those of larger corporations.²⁰
- **Land ownership:** All land in Ethiopia is owned directly by the state, which provides leaseholds for up to 99 years. The precise lease terms vary according to location, type of investment, and class of land.²¹ Investors and businesses negotiate leases with local governments, which can increase the administrative burden on cross-regional projects. The government has attempted to limit land speculation and fluctuations in leasehold prices and, with an urban land lease proclamation in 2011, it has the right to revalue any land involved in transfers of leasehold rights.²²

Ecosystem Players

Intermediaries and service providers are underrepresented in Ethiopia relative to its size and economic potential. With around a dozen identified organizations (Figure 21), Ethiopia has the fewest active intermediaries and service providers of any of the five focus countries, and a small fraction of the number in Kenya. The relatively early stage of Ethiopia's private sector has limited the overall market for service providers. Unlike in the rest of East Africa, the impact ecosystem in Ethiopia primarily comprises consultants and technical assistance (TA) providers. There are only a few incubators active in Ethiopia, despite the need for more. Some of the larger professional services firms, such as Deloitte, Ernst & Young and Grant Thornton offer regional expertise on accounting, strategy consulting, tax, and other intermediary services from their offices in Addis. However, these firms' services are almost always more expensive than SMEs can afford. In addition to locally based consultants, there are a number of regional consulting firms that routinely support investors and entrepreneurs.

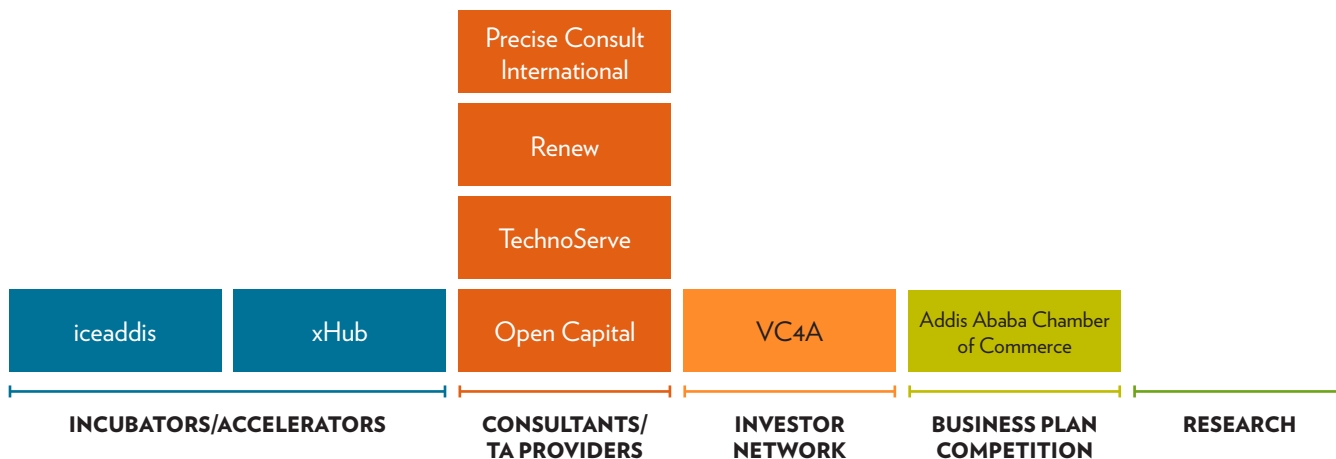
19 U.S. Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/documents/organization/228594.pdf>.

20 Office of the United States Trade Representative, *Foreign Trade Barriers-Ethiopia*, available at http://www.ustr.gov/sites/default/files/Ethiopia_0.pdf.

21 "About Ethiopia," *Federal Democratic Republic of Ethiopia: Ministry of Foreign Affairs*, available at <http://www.mfa.gov.et/aboutethiopia.php?pg=3&page=3>.

22 U.S. Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/documents/organization/228594.pdf>.

FIGURE 21: SELECTION OF CURRENTLY ACTIVE INTERMEDIARIES AND SERVICE PROVIDERS



Source: Open Capital research, organization websites. Note: chart focuses on those with local presence; many international players active

Currently, the intermediary landscape is relatively small, but research indicates that it is growing rapidly. Most intermediaries and service providers entered the market recently, including two interviewees who set up businesses in late 2014. At present the market still remains untested. Few of the impact investors and entrepreneurs interviewed report using intermediaries or service providers, and there is uncertainty around the value provided beyond facilitating introductions to government officials. Nonetheless, the challenges both investors and entrepreneurs face in Ethiopia clearly indicate a large gap in investment preparedness, human capital, and financial sophistication. Additionally, as with other countries in the region, there is limited data available on comparable impact deals or exit multiples for impact funds to use to benchmark their valuations or financial performance. As investors and entrepreneurs become increasingly active in Ethiopia, the need for service providers will only intensify.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Ethiopia's complex business environment has made it difficult for East African impact investors to effectively navigate its markets and find investable deals. The early stage of the private sector and the subsequent lack of mature businesses have further limited investor pipeline. These challenges are described in further detail below:

- **Insufficient investment-ready deal flow:** Many impact investors struggle to disburse capital raised, similar to elsewhere in the region. In Ethiopia, efforts to disburse capital are complicated by a large informal sector. Businesses in Ethiopia suffer from the same weaknesses seen across the region, where companies struggle to develop efficient operations, build strong strategic plans, create realistic forward-looking projections, and present a plan to use desired capital.
- **Lack of understanding of private investment:** Ethiopia has attracted large inflows of donor funding from multilateral aid agencies and foundations. Investors report that decades of grant funding have considerably diluted Ethiopian entrepreneurship and understanding of investment. Seeking grants remains the default for many companies, which often specifically position themselves to be attractive to grant money. Impact investors need to ensure that businesses are sufficiently educated on the private investment process and the value it can provide.
- **Informal record keeping:** Investors unanimously lament the informality of financial record keeping, especially in smaller businesses. Corporate bank accounts and personal bank accounts are often mingled, even for larger businesses. Most businesses are family-owned and struggle with transfer pricing between sister companies. Many observers note that investors—particularly foreign investors—are unrealistic in their expectations of financial sophistication.
- **Limited experienced local talent:** Impact investors struggle to find experienced local staff to support both their own investment teams and management teams within growing portfolio companies. This challenge is particularly acute when seeking finance professionals with 5-15 years of experience to serve as a company CFO or portfolio manager, despite the large number of Ethiopian university students graduating each year with degrees in accounting and finance. Even when a talented, experienced professional can be found, they often command high wages that can be challenging for impact businesses to support, especially in their early years.
- **Restrictions on foreign investment:** As described above, several sectors are restricted for foreign investment. This includes access to foreign currency, which can be difficult unless investments are properly registered, requiring close

collaboration with the Ethiopian Investment Authority. Although working with the government has made some investors hesitant, the general perception seems to be that working closely with the government results in successful investments and clear expectations for foreign currency availability, repatriation of profits and dividends, and ability to enter specific sectors that are government priorities.

Opportunities

Nonetheless, Ethiopia's enormous but largely undeveloped market presents significant opportunities to impact investors, particularly those that are willing to take on earlier-stage risk. Opportunities that could generate measurable social and environmental impact for investors in Ethiopia are described below:

- **Leverage technical assistance facilities for pre-investment pipeline building:** Many impact investors have successfully raised technical assistance facilities for portfolio companies. Increasingly, TA funders recognize the importance of pre-investment support to get companies to the point where they can pass rigorous investment committee requirements. Targeted, tailored support, whether from the impact investor or a third party, requires an upfront commitment of resources, but in Ethiopia it has reportedly proven effective in preparing potential targets for investment and building high quality deal flow. This can reduce diligence timelines if the investor is able to increase familiarity and visibility pre-investment in order to assess the company's operations and ability to execute.
- **Increase local decision-making:** Where possible, impact investors have cited significant improvements in their portfolio through local decision-making and local support. This allows investment officers to form meaningful relationships with portfolio companies, where they are empowered to respond more quickly and efficiently to changing realities on the ground.
- **Source opportunities outside major cities such as Addis Ababa:** Impact investors with staff on the ground in major cities report that it is easier for them to find investments than those investors based abroad, but many entrepreneurs operating in rural areas do not even spend much time in Addis Ababa, so even being based in major cities may not be sufficient. For impact investors who see these types of businesses as highly impactful, it will be increasingly necessary to build relationships beyond those made in economic centers.

Non-DFI impact investors see particularly strong opportunities in Ethiopia in the following sectors:

- **Agriculture:** Ethiopian smallholders have larger plot sizes than do farmers in other countries in the region, but there are still opportunities to consolidate production and significantly increase yields. Given the smallholder landscape, there are also opportunities to aggregate harvests and create consistent, high-quality supply. Aggregation could allow farmers to connect directly with export markets, which are especially attractive regionally. There is also significant potential in agricultural processing across a range of crops and considerable opportunity to advance basic farming practices which are poor, even compared to East African standards.

- **Renewable energy:** Only 23% of Ethiopia's population has access to electricity²³. As a result, impact investors identify strong government support for new businesses and approaches, as Ethiopia looks to dramatically expand power generation capacity. This opens the door for large-scale projects and seems promising to improve power purchase agreements. At the same time, there are large segments of the population that lack reliable access to grid power, opening opportunities for micro-grid and off-grid solutions.
- **Consumer goods for the mass market:** At 20% of the population, Ethiopia's middle-class is robust compared to many other countries in the region²⁴. With rapid growth, impact investors believe there are increasingly attractive opportunities to supply goods and services to these consumers. These businesses often create substantial employment opportunities, which may fit impact criteria for some impact investors and often require investments in manufacturing, which align with the government's priority sectors within the Growth and Transformation Plan.

23 World Development Indicators: Access to electricity (% of population), *The World Bank Group*, available at <http://data.worldbank.org/indicator/EG.ELC.ACCS.ZS>.

24 The Middle of the Pyramid, *African Development Bank*, available at: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/The%20Middle%20of%20the%20Pyramid_The%20Middle%20of%20the%20Pyramid.pdf.



BURUNDI

SMALL MARKET,
GROWING OPPORTUNITY

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INTRODUCTION

Burundi is a small, landlocked country with a population of just over 10 million people. Bordering Rwanda, the Democratic Republic of Congo, and Tanzania, Burundi is strategically situated between the East Africa Community and the Economic Community of Central African States (Figure 1).

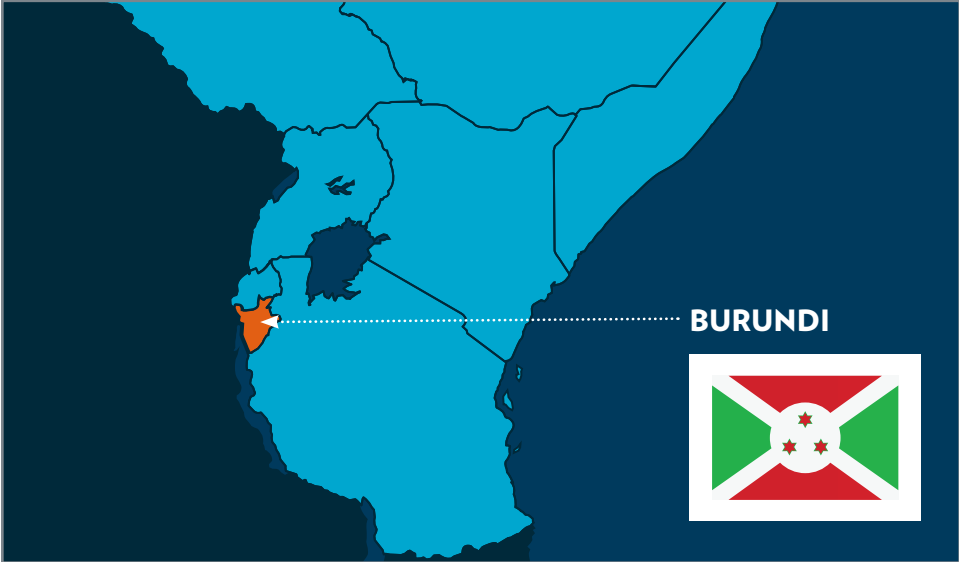
Burundi has a nascent private sector with approximately 3,000 registered companies, most of which are small and medium enterprises, providing employment to a total of approximately 37,000 people. While the government of Burundi (GoB) has introduced reforms to foster private sector development and investment, the sector remains constrained by numerous factors including inadequate road networks, unreliable energy, political instability, corruption, limited qualified human capital, underdeveloped regulatory frameworks, and insufficient access to finance.

To date, Burundi has seen limited impact investing activity. Few non-DFI¹ impact investors operate in Burundi; however, DFIs have been more active, deploying more than 30 times the amount of capital that other types of impact investors have deployed in known deals.

PLEASE NOTE

As with the rest of the Landscape for Impact Investing in East Africa report, research and writing for this chapter were largely conducted in the fourth quarter of 2014, several months before the attempted military coup on May 13, 2015. Ongoing unrest and uncertainty is expected through Burundi's scheduled elections in June 2015, which may also be contested. Those interested in Burundi are cautioned to review the latest news reports on the rapidly developing political situation.

FIGURE 1: MAP OF BURUNDI



1 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

COUNTRY CONTEXT

Burundi has experienced periods of sustained internal conflict since independence in 1962, often due to ethnic tensions. During the 1980s, more than 100,000 Hutus were killed by Tutsis, forcing thousands to flee the country. In 1993, a full-scale civil war was triggered by the assassination of then President Melchior Ndadaye. Despite peace talks in the intervening years—including talks facilitated by then South African President Nelson Mandela—Burundi’s conflict continued for more than a decade.

In 2003, Pierre Nkurunziza, leader of the Hutu rebel group Forces for Defense of Democracy (FDD), signed a peace agreement with President Domitien Ndayizeye, ending fighting by one of the major rebel groups. In 2005, the FDD triumphed in parliamentary elections, leading to the election of Nkurunziza as president by parliament. Despite his election, clashes continued until a peace agreement was signed in 2008.²

Since his election and re-election in an uncontested poll in 2010, Nkurunziza has implemented various economic measures intended to stabilize the country. Notable efforts include integration into the East Africa Community and revitalization of the Economic Community of the Great Lakes Countries (CEPGL) with Rwanda and the Democratic Republic of Congo (DRC).³

At the time of writing, internal tensions continued in the run-up to presidential elections in May 2015. Meanwhile, there is continuing concern that ongoing conflicts in eastern DRC and northwestern Uganda could spill over into Burundi.⁴

2 “Burundi Profile,” *BBC News Africa* (Nov. 26, 2014), available at <http://www.bbc.com/news/world-africa-13085064>.

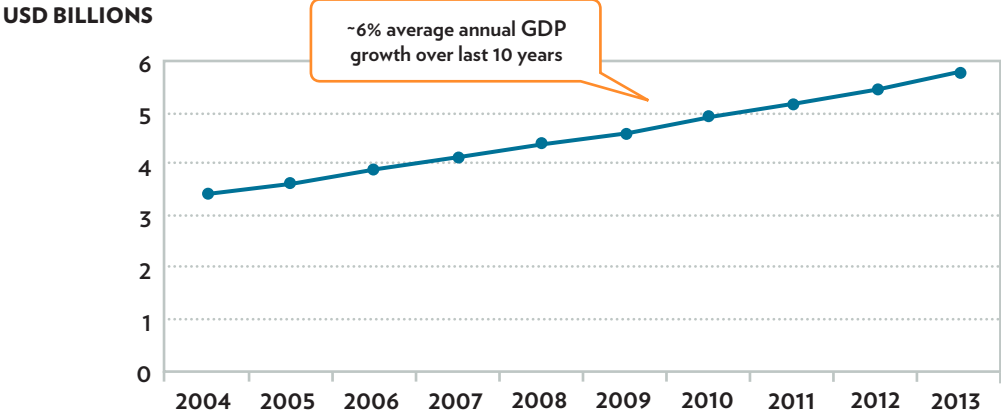
3 *Ibid.*

4 Sherman Hollar, “Pierre Nkurunziza,” *Encyclopaedia Britannica*, (Jun. 3, 2013), available at <http://www.britannica.com/EBchecked/topic/1090732/Pierre-Nkurunziza>.

Gross Domestic Product

Burundi has experienced steady economic growth over the past decade, averaging approximately 6% annual GDP growth between 2004 and 2013 (Figure 2). In 2013, Burundi's GDP stood at USD 5.76 billion (PPP), making Burundi one of the smallest economies in the region, outranking only Eritrea and Djibouti in size. GDP growth slowed somewhat in 2009 as Burundi felt the impact of the global financial crisis; however, growth has since increased in recent years.⁵

FIGURE 2: GDP (PPP), 2004–2013



Source: IMF World Bank Economic Indicators, April 2014

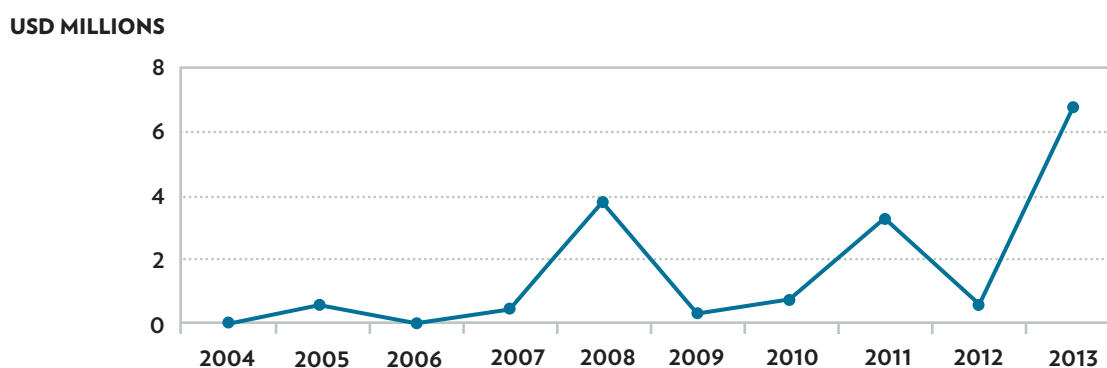
As is the case in much of East Africa, agriculture employs a significant majority of Burundi's population. Coffee is the most important agricultural product, grown on approximately 60,000 hectares of land.⁶ Together with tea, it also accounts for around 90% of foreign exchange earnings.⁷ However, both coffee and tea are susceptible to volatile global prices and past production challenges in Burundi have limited their contribution to Burundi's growth. Other major crops grown in Burundi include cotton, corn, sorghum, and bananas.

5 Sherman Hollar, "Pierre Nkurunziza," *Encyclopaedia Britannica*, (Jun. 3, 2013), available at <http://www.britannica.com/EBchecked/topic/1090732/Pierre-Nkurunziza>.
6 COMESA, *Burundi Investment Guide* (2012), available at <http://www.investburundi.com/attachments/article/267/BURUNDI%20Investment%20Guide%202012.pdf>.
7 "Burundi-Financial sector profile," *Making Finance Work for Africa*, available at <http://www.mfw4a.org/burundi/financial-sector-profile.html#c10566>.

Foreign Direct Investment

On average, FDI inflows to Burundi grew 65% annually between 2004 and 2013, although there has been significant variation year to year (Figure 3). Burundi's 2013 FDI of USD 6.8 million is almost twice as high as any other point in the last decade. Nevertheless, this remains the lowest FDI inflow in East Africa. By comparison, Eritrea received close to USD 44 million, the second-lowest in East Africa.⁸

FIGURE 3: FDI FLOWS, 2004–2013



Source: UNCTAD

A comprehensive breakdown of Burundi's FDI inflows is not readily available. The Burundian Investment and Promotion Authority (known by its French acronym API) does not distinguish between FDI and domestic investment in its statistics. However, according to their data, 193 investment projects worth BIF 824 billion (approximately USD 588 million) have been approved since 2011, primarily in tourism, energy, agribusiness, transportation, and manufacturing.⁹

Foreign direct investment in Burundi has come from a variety of international sources including Kenya, Switzerland, India, Uganda, and the United States.¹⁰ Burundi's recovery from civil war has helped to increase both bilateral and multilateral foreign aid. Aid sources currently account for 42% of Burundi's national income, the second-highest rate in Sub-Saharan Africa.¹¹ Burundi will likely continue to rely on foreign aid in coming years as it continues to reduce high poverty rates and improve education, as well as build its underdeveloped infrastructure, weak legal system, and administrative capacity.¹²

8 World Economic Outlook: Gross Domestic Product, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>.

9 COMESA, *Burundi Investment Guide* (2012), available at <http://www.investburundi.com/attachments/article/267/BURUNDI%20Investment%20Guide%202012.pdf>.

10 *Ibid.*

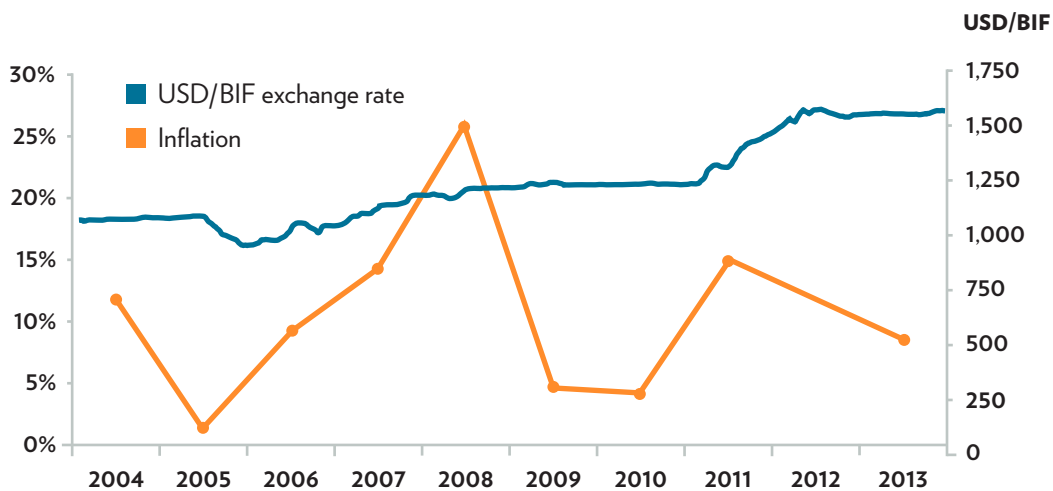
11 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

12 "FDI in Burundi," *Burundi Investment Promotion Authority*, available at <http://www.investburundi.com/en/fdi-in-burundi>.

Inflation and Exchange Rates

Over the last decade, inflation in Burundi has been erratic—swinging from as low as 1% in 2005 to a peak of 26% in 2008 (Figure 4). It has declined since 2011 and was estimated at 9% in 2013. Meanwhile, the Burundian Franc has gradually depreciated against the dollar since 2006. In early 2013, the government attempted to stabilize the Burundian Franc through a managed float,¹³ which has served to keep it relatively stable against the US Dollar, with an average exchange rate of BIF 1,550 to the dollar.¹⁴ If the float is revoked, Burundi runs the risk of a further depreciation of the Burundian Franc.

FIGURE 4: INFLATION AND USD/BIF EXCHANGE RATE, 2004-2013



Source: World Bank Indicators, IMF World Bank Economic Outlook, April 2014

13 Jiska Gietema & Katelijne Blom, Ministry of Foreign Affairs of the Netherlands, *Private Sector Development in Burundi: Overview of Dutch efforts 2005-2011* (2012), available at <http://psosamenwerken.files.wordpress.com/2012/03/country-report-psd-burundi-final-march-2012.pdf>.

14 "Burundi Economic Profile 2014," *Index Mundi* (Aug. 23, 2014), available at http://www.indexmundi.com/burundi/economy_profile.html.

SUPPLY OF IMPACT INVESTING CAPITAL

With the end of the civil war, Burundi is experiencing increased stability that may be suitably attractive to investors. However, with a small total market size and limited economy, investors are less attracted to Burundi than to other countries in the region, as evidenced by limited FDI inflows. As such, only 23 known impact investment transactions have occurred in Burundi, 15 by DFIs and eight by non-DFI impact investors.

Broader Investing Landscape

Burundi has a relatively small financial sector with only seven commercial banks as of 2012.¹⁵ Burundi's banks represent nearly 75% of the country's available financial assets, demonstrating a lack of diversity in the financial sector.¹⁶ Burundi's three largest commercial banks—Interbank Burundi, Burundi Credit Bank, and Burundi Commercial Bank—have total assets of USD 481.7 million combined.¹⁷

The financial sector does not yet reach the vast majority of the population. Only 2% of the total population has a formal bank account and less than 0.5% can access credit.¹⁸ Similarly, microfinance institutions, though growing, still have limited reach. There are fewer than 30 licensed MFIs in Burundi, which have a penetration rate of just 7% for credit and 26% for savings.¹⁹ Those who can access formal credit have seen interest rates in Burundi decline over the past decade as the country has recovered from civil war. Interest rates have fluctuated from a high of 18% in 2004, to a low of 12% in 2010, but have since risen to 15%.²⁰

15 World Development Indicators: Lending interest rate, *World Bank* (2014), available at <http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=world-development-indicators>.

16 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

17 *Ibid.*

18 "Burundi-Financial sector profile," *Making Finance Work for Africa*, available at <http://www.mfw4a.org/burundi/financial-sector-profile.html#c10566>.

19 C. Baumont-Keita, et al., AfDB-ADF, *Burundi Country Strategic Paper 2012-2016* (2011), available at <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Burundi%20-%20CSP%202012-16.pdf>.

20 "Burundi Economic Profile 2014," *Index Mundi* (Aug. 23, 2014), available at http://www.indexmundi.com/burundi/economy_profile.html.

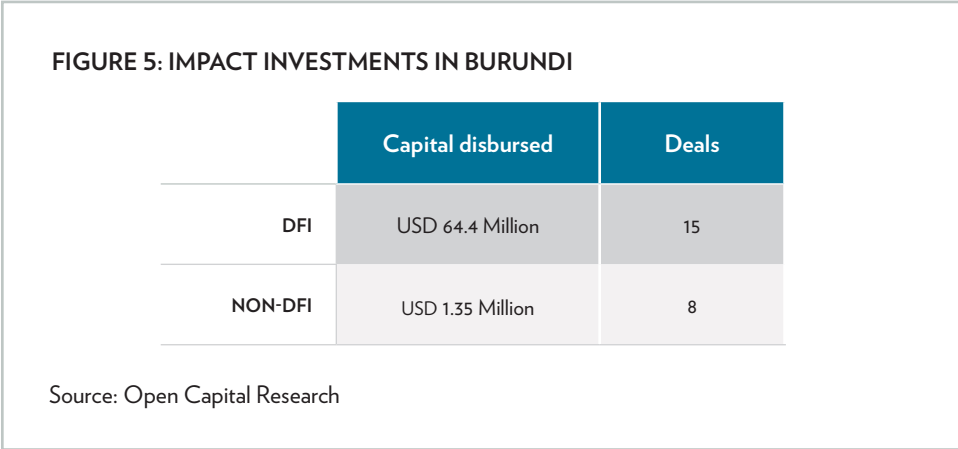
Impact Capital Disbursed

Burundi has seen very little impact investing activity. Excluding DFIs, only a known USD 1.4 million has been invested through eight deals (Figure 5). The majority of this capital was placed in a single agriculture deal, with the others largely in financial services. Overall, this represents less than 0.1% of all impact investing activity in East Africa.

There are 57 known impact funds that list Burundi as part of their target geography. However, the majority of those funds have large geographic reaches—often global or including all of sub-Saharan African—and Burundi is likely to be a low-priority target.

There is no known additional impact capital committed (and not yet deployed) specifically to investments in Burundi. Although at least USD 679 million in regional impact capital could be deployed in Burundi, it remains unlikely that any notable fraction will actually be invested in the country. However, the potential availability implies that substantial pools of capital could be shifted to investments in Burundi as the climate improves.

Meanwhile, DFIs have deployed significantly more capital in Burundi, with 15 known deals totaling nearly USD 65 million—the highest concentration of DFI capital in the non-focus countries considered for this report (Figure 5). These deals cover a variety of sectors including agriculture, financial services, and infrastructure.



Instrument

The limited number of impact investments in Burundi provides little concrete information on the instruments most commonly used by impact investors. Of the eight non-DFI deals, 50% were equity while the rest did not disclose details on the instrument used. In contrast, 80% of deals by DFIs were debt in addition to two guarantees and one equity investment.

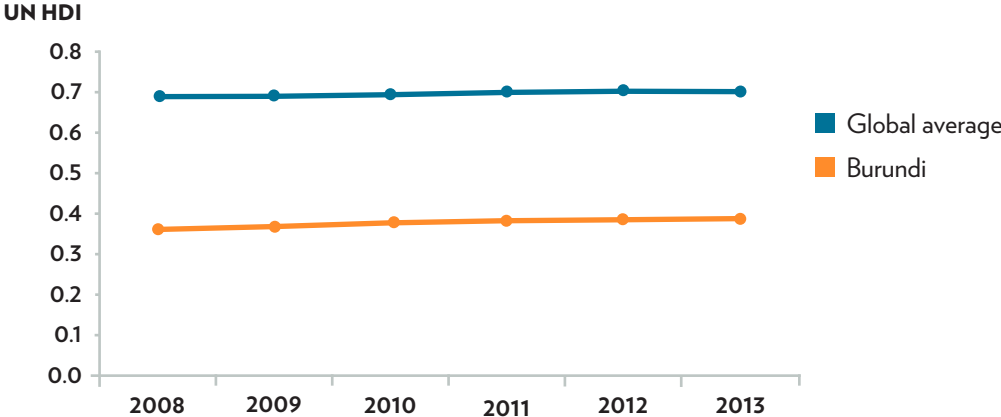
DEMAND FOR IMPACT INVESTING CAPITAL

With continuing growth and significant developmental needs, Burundi offers an increasingly interesting proposition to impact investors.

Development Context

Despite recent economic growth, Burundi’s Human Development Indicators (HDI) have remained relatively constant and lag well behind global standards. With a 2013 HDI score of 0.39, Burundi is one of the lowest performers in the world, ranking 180th out of 187 countries on the United Nation’s Human Development Index.²¹ Over the past six years, Burundi’s average score of 0.36 lags the regional average of 0.43 and is far behind the global average of 0.67 (Figure 6).²²

FIGURE 6: UN HDI SCORES, 2008-2013



Source: UN Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

21 Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

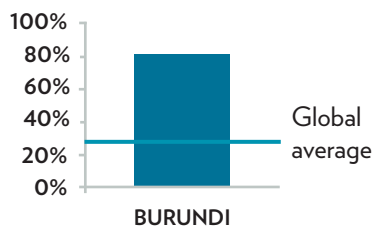
22 *Ibid.*

Burundi's lack of socioeconomic progress has been punctuated by high poverty rates and driven by factors such as limited arable land, few natural resources, and overpopulation²³—in 2013, Burundi's population density of 396 people per square kilometer was the third-highest in Africa.²⁴ Approximately 80% of Burundi's population lives on less than USD 1.25 per day, more than three times the global average of 25% and nearly 70% higher than the East African average (Figure 7).²⁵

Most of Burundi's population lives on small plots of land and struggles to produce enough food for subsistence. As a result, many people are undernourished and stunting rates are nearly 60%, more than twice the global average (Figure 8).²⁶

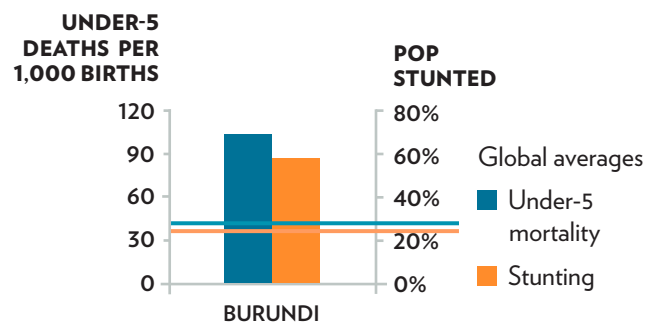
Access to health services is improving but still insufficient. Burundi averages one doctor per 19,231 inhabitants, almost that recommended by the World Health Organization (WHO) of one doctor per 10,000 inhabitants.²⁷ Under-5 mortality stands at 104 per 1,000 births, much higher than the regional average of 80 and 120% higher than the global average of 47 (Figure 8).²⁸

FIGURE 7: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

FIGURE 8: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

23 Bertelsmann Stiftung, *BTI 2014 | Burundi Country Report (2014)*, available at <http://www.bti-project.org/reports/country-reports/esa/bdi/index.nc>.

24 Population density (people per sq. km of land area), *The World Bank*, available at http://data.worldbank.org/indicator/EN.POP.DNST?order=wbapi_data_value_2013+wbapi_data_value+wbapi_data_value-last&sort=desc.

25 Human Development Statistics Tables, *United Nations Development Programme (2014)*, available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

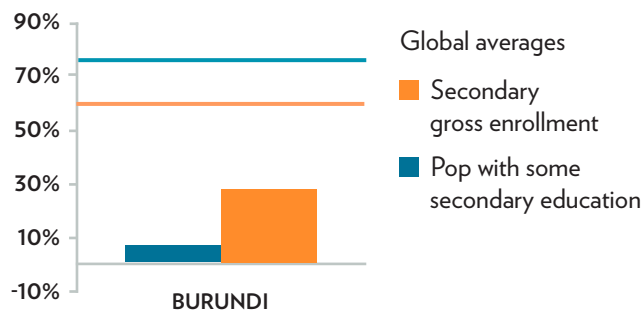
26 *Ibid.*

27 Bertelsmann Stiftung, *BTI 2014 | Burundi Country Report (2014)*, available at <http://www.bti-project.org/reports/country-reports/esa/bdi/index.nc>.

28 Human Development Statistics Tables, *United Nations Development Programme (2014)*, available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

Burundi's education system has been severely affected by its civil war. Not only were many rural schools closed, but the conflict created a large population of vulnerable persons who did not have adequate access to education, such as widows, orphans, and the internally displaced. As a result, Burundi has low literacy rates and limited school enrollment. For example, only 7% of Burundians aged 25 and above have received some form of secondary education, well below the regional average of 15% and more than eight times below the global average of 59% (Figure 9).²⁹ A dearth of qualified teachers, appropriate materials, adequate infrastructure, and needed investment in education continues to contribute to poor educational outcomes among Burundi's population.

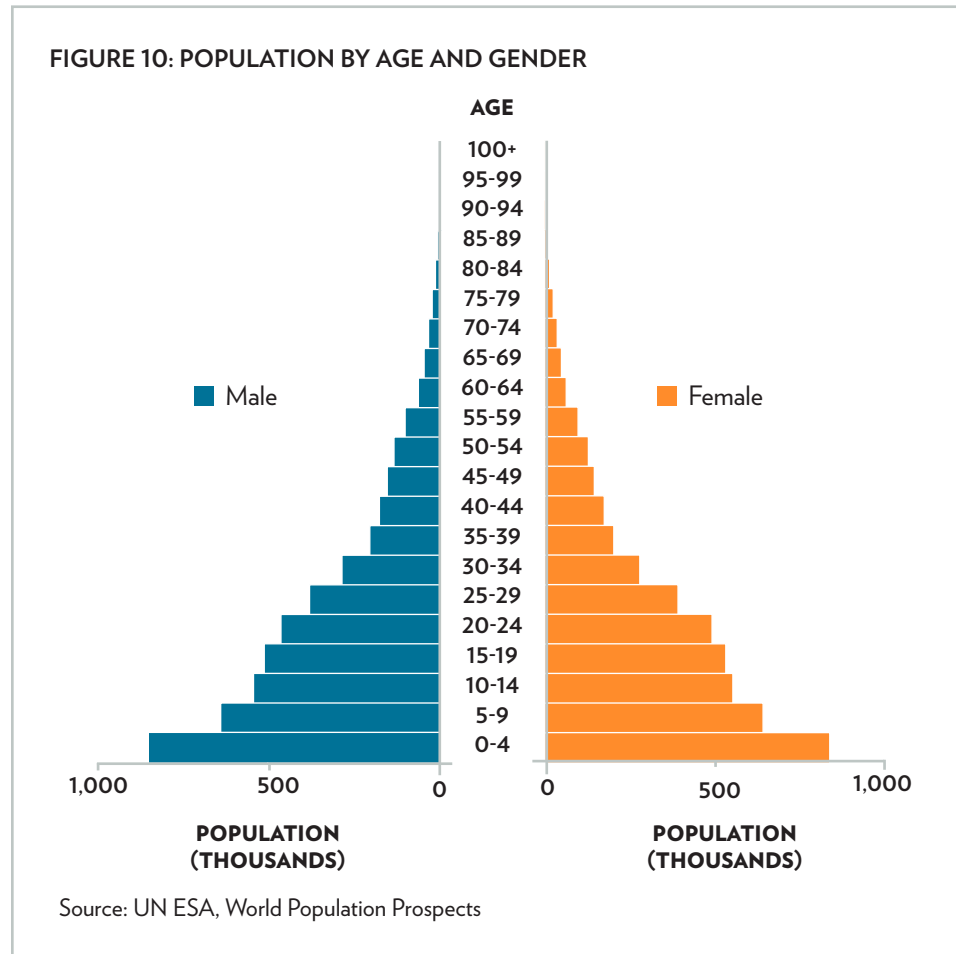
**FIGURE 9: KEY EDUCATION INDICATORS
(LATEST AVAILABLE DATA POINT)**



Source: UN Human Development Report 2014

²⁹ Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

Burundi has a population of 10 million and is growing at an estimated 3.3% annually.³⁰ Similar to that of its East African neighbors, Burundi's population is heavily skewed toward the young, with 55% of the population below age 20 (Figure 10).³¹ Approximately 52% of the country is of working age, classified as 15-60 years, providing a relatively large labor force.³² However, low levels of education and limited private sector development provide inadequate employment opportunities. As Burundi continues to grow, investment in education, health, and social services—especially for its large segment of youth—will be vital for economic prosperity.



30 "Population Growth Rate," *Central Intelligence Agency* available at <https://www.cia.gov/library/publications/the-world-factbook/fields/2002.html>.

31 2012 World Population Prospects, *United Nations Department of Economic and Social Affairs* (2012), available at http://esa.un.org/wpp/Excel-Data/EXCEL_FILES/1_Population/WPP2012_POP_F07_1_POPULATION_BY_AGE_BOTH_SEXES.XLS.

32 *Ibid.*

Entrepreneurs

Burundi's business environment still poses many challenges for those seeking to start a company. One of the primary challenges is access to finance, as Burundi's financial sector has limited reach in the country, especially in non-urban areas. Even entrepreneurs who can access capital from financial institutions often fail to meet commercial banks' high collateral requirements. In particular, Burundian banks prefer to secure loans with land, but much of the land in the country is unregistered and lacks title deed to use as security. As a result, entrepreneurs are left without the means to secure a loan.³³

ENABLING IMPACT INVESTING: THE ECOSYSTEM

Burundi's government actively seeks to support business development. Among other measures, this includes the creation of the Investment Promotion Agency (API using the French abbreviation) in 2009. API's mandate is to develop and promote investment in Burundi by enforcing laws pertaining to investors, providing resources for potential investors, and encouraging reforms that help develop the business environment, including making it easier to start new enterprises and clarifying regulations for businesses.

Regulatory Environment

By and large, Burundi provides foreign investors with the same status as domestic investors, except in matters related to the military, weapons, or munitions, where Burundi's government limits private investment.³⁴ API's work has helped improve Burundi's general regulatory framework for entrepreneurs and investors, reflected in Burundi's improvement in the World Bank's 2014 Ease of Doing Business report. The country was ranked 152nd out of 189 nations in 2013, an improvement of 19 positions from the previous year—one of the largest one-year advancements across Sub-Saharan Africa.³⁵ Burundi supports foreign investment in many areas:

- **Investment incentives:** Burundi's government actively works to attract foreign investment, offering a variety of tax incentives with the intention to spur investment. These tax incentives vary, and to qualify investors must meet specific criteria related to size of the investment, jobs created, and location. For example,

33 USAID, *USAID Country Profile Property Rights and Resource Governance - Burundi*, available at http://usaidlandtenure.net/sites/default/files/countryprofiles/fullreports/USAID_Land_Tenure_Burundi_Profile.pdf.

34 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

35 *Ibid.*

in 2008, the government passed the Investment Code, which provides tax exemptions for investors creating and distributing goods and services. These include tax exemptions on assets purchased for new investments, reduced tax on profits for any investor who employs 50 or more Burundians, and a tax exemption of up to 5% if a company employs more than 200 Burundians.³⁶

While Burundi uses factors such as location and employment of nationals to evaluate tax incentives awarded to a business, the government does not restrict investments based on these factors.³⁷ In addition, Burundi's government has established a Free Economic Zone (FEZ), which provides a variety of tax incentives for businesses. As a condition of operating in the FEZ, export companies must purchase inputs and other goods from Burundi whenever possible.

- **Opening a business in Burundi:** Starting a business in Burundi takes just over one month and requires 11 procedures, which compares favorably to other East African nations. In general, Burundi does not require entrepreneurs to have a minimum amount of capital to register a company except³⁸ in banking, financial institutions, petroleum import and export, and insurance.³⁹
- **Local ownership requirements:** Burundian law allows foreigners to hold 100% equity stakes in any venture. The government does not require that Burundian ownership in a foreign investment increase over time nor does it require that businesses owned by foreigners transfer any proprietary technology to Burundian firms. Burundian regulations, however, do mandate that investors who are issued permits in oil and mining stipulate Burundi as their elected domicile and function as a local company.⁴⁰

36 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

37 "Incentives," *Burundi Investment Promotion Authority*, available at <http://www.investburundi.com/en/incentives>.

38 As of 2009, minimum requirements vary by industry ranging from USD 647 thousand in petroleum import/export to USD 3 million in banking.

39 "Establishing a Business in Burundi," *Burundi Investment Promotion Authority*, available at <http://www.investburundi.com/en/establishing-a-business-in-burundi>.

40 International Business Publications USA, *Burundi Mineral, Mining Sector Investment and Business Guide Volume 1*, available at http://books.google.co.ke/books?id=q6MYk4NbPGIC&pg=PA159&lpg=PA159&dq=Burundi+domicile+requirements&source=bl&ots=590vnlsVxy&sig=Pt8O4gNhZ08c37A2QEeEbphbLTM&hl=en&sa=X&ei=SadgVOMYPMPGP7AalkoCQAQ&redir_esc=y#v=onepage&q=Burundi%20domicile%20requirements&f=false.

- **Foreign exchange controls/repatriation of profits:** Burundi's Investment Code places no restrictions on access to foreign exchange for the purpose of repatriating profits. However, as a practical matter, access is limited due to the Central Bank's constraints. Burundi's Central Bank holds, on average, a foreign currency reserve equal to four months of imports while importers of key staple goods such as medicines and agricultural inputs often have priority access to these reserves. Due to limited amounts of foreign currency and limited experience with such transactions, it is not uncommon for foreign investors to experience delays in obtaining foreign currency.⁴¹
- **Expropriation and compensation:** The government is legally allowed to expropriate private property in exceptional circumstances, but it must provide adequate compensation to the property owner in such cases. This general rule varies somewhat for the mining sector, where the government is permitted to require mining operators to cease operations without compensation or indemnity if they are found to be in violation of the mining code. The code is unclear regarding how significant violations must be to merit forced withdrawal.⁴²
- **Government enterprises:** The government maintains state-run enterprises in the telecommunications and utility industries, including ONATEL, a state-owned telecommunications carrier offering landline, mobile, and internet services and REGIDESO, Burundi's only producer and distributor of electricity and potable water.⁴³ Though previously state controlled, Burundi's coffee industry was privatized in 2009.⁴⁴

Ecosystem Players

Burundi lacks a comprehensive ecosystem to support private enterprise development. A few international intermediaries and service providers are active in Burundi, but most do not have local presence, limiting their practical availability. Intermediaries and service providers with prior experience in Burundi include BiD Network and the Global Social Benefit Incubator, which offer training, mentorship, advisory, linkages to investors, and networking between entrepreneurs. The Africa Enterprise Challenge Fund and Global Social Venture Competition provide entrepreneurs with funding and exposure through annual competitions. Other types of intermediaries and service providers include networks linking start-ups and angel investors such as VC4 Africa.

41 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

42 *Ibid.*

43 *Ibid.*

44 *Ibid.*

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite local and international efforts to build the economy in Burundi, there are several constraints that hamper the development of impact investing. These include:

- **Inadequate infrastructure:** Years of conflict in Burundi have destroyed important infrastructure throughout the country. Lack of an adequate road network and unreliable access to power make it challenging to do business in Burundi and increase costs for entrepreneurs.
- **Corruption:** Corruption is a major hindrance to investment and business in general in Burundi. Corruption is widespread, and evident in issues such as upholding contracts.⁴⁵ Cabinet members, parliamentarians, and anyone appointed by presidential decree have immunity from prosecution for corruption, further perpetuating a lack of accountability. In 2013, Burundi ranked 157th out of 177 countries on the Transparency International corruption index.⁴⁶
- **Lack of stable political institutions:** Burundi's underdeveloped political framework struggles to provide the support and stability required for private sector growth. Independent assessments show that the legal system lacks transparency and the capacity to efficiently resolve cases, leading to a large backlog.⁴⁷ In addition, international partners assert that corruption and Burundi's neopatrimonial political system hinder the government's ability to manage public resources efficiently.^{48,49}

45 US Department of State, *2014 Investment Climate Statement-Burundi*, available at <http://www.state.gov/e/eb/rls/othr/ics/2014/228482.htm>.

46 *Ibid.*

47 *Ibid.*

48 Embassy of the Kingdom of the Netherlands, *Multi-Annual Strategic Plan (2014)*, available at [file:///C:/Users/Business%20Analyst/Downloads/burundi-multi-annual-strategic-plan-2014-2017%20\(1\).pdf](file:///C:/Users/Business%20Analyst/Downloads/burundi-multi-annual-strategic-plan-2014-2017%20(1).pdf).

49 Ministry of Foreign Affairs of the Netherlands, *Private Sector Development in Burundi (2012)*, available at <https://psosamenwerken.files.wordpress.com/2012/03/country-report-psd-burundi-final-march-2012.pdf>.

Opportunities

Although Burundi presents numerous challenges, opportunities exist for impact investors to support businesses that drive social change while creating jobs, stimulating economic growth, and providing financial returns:

- **Develop local presence:** As Burundi's economy continues to grow and entrepreneurs develop businesses to meet local needs, an increasing number of impact investment opportunities will arise in Burundi. Investors with staff on the ground to identify and build relationships with promising entrepreneurs will have a distinct advantage in developing a robust pipeline in the country.⁵⁰
- **Increase renewable energy production:** With a 10% rate of electrification, much of Burundi's population does not have reliable access to electricity. The government aims to increase the electrification rate to 20% by 2020. While approximately 85% of Burundi's current capacity of 36MW is provided by hydropower, there remain significant hydropower and renewable energy resources that could be developed. Burundi has identified 156 potential hydropower sites beyond the 29 existing ones, with more than 80% yet to be explored. Opportunities also exist in solar, geothermal, and biomass.⁵¹

Despite the challenges described above, entrepreneurs increasingly recognize opportunities to provide goods and services to fill gaps in the market. Many of these enterprises have the potential for social impact by incorporating disadvantaged populations as suppliers, consumers, or both. Specific sector opportunities include the following:

- **Agriculture:** Agriculture drives Burundi's economy and provides an important source of income and subsistence for the majority of the population. However, there is a shortage of agricultural land as the population grows in this geographically small country. Decreasing average plot sizes could create an opportunity to consolidate production and significantly increase yields by shifting to modern farming methods. Investing in agri-businesses to support smallholder and commercial farms through improved inputs, best practices, mechanization, credit, and other services could reduce the country's dependency on food imports and improve long-term nutritional outcomes.
- **Water and sanitation:** Access to water and sanitation continues to be a problem throughout Burundi, especially in rural areas. In the nation's capital of Bujumbura, 85% of the population has access to potable water, while only 55% of the rural population does. Private enterprises, potentially in collaboration with the government, could fill this gap and help improve Burundi's water and sanitation infrastructure.

50 Jiska Gietema and Katelijne Blom, Ministry of Foreign Affairs of the Netherlands, *Private Sector Development in Burundi: Overview of Dutch efforts 2005-2011* (2012), available at <http://psosamenwerken.files.wordpress.com/2012/03/country-report-psd-burundi-final-march-2012.pdf>.

51 Minister for Energy and Mines, *Investment Opportunities in Renewable Energy Burundi* (2012), available at <http://www.bi.undp.org/content/dam/burundi/docs/publications/Investment%20opportunities%20in%20renewable%20energy%20Burundi.pdf>.

- **Social services:** Burundi's social services, such as education and health care, were decimated by the country's long civil war. Effects on the education system were especially pronounced as many schools closed and educators fled or were exiled.⁵² The system is slowly recovering, but numerous challenges persist, including poor teacher training, insufficient resources, and unequal access to education in secondary and tertiary institutions. Burundi receives foreign aid designated for education and health, and many NGOs and development partners currently work in the space. Businesses add to this ongoing work and help provide sustainable solutions to many of these needs.

52 Bertelsmann Stiftung, *BTI 2014 | Burundi Country Report (2014)*, available at <http://www.bti-project.org/reports/country-reports/esa/bdi/index.nc>.

SOUTH SUDAN

THE CONTINENT'S NEWEST
COUNTRY



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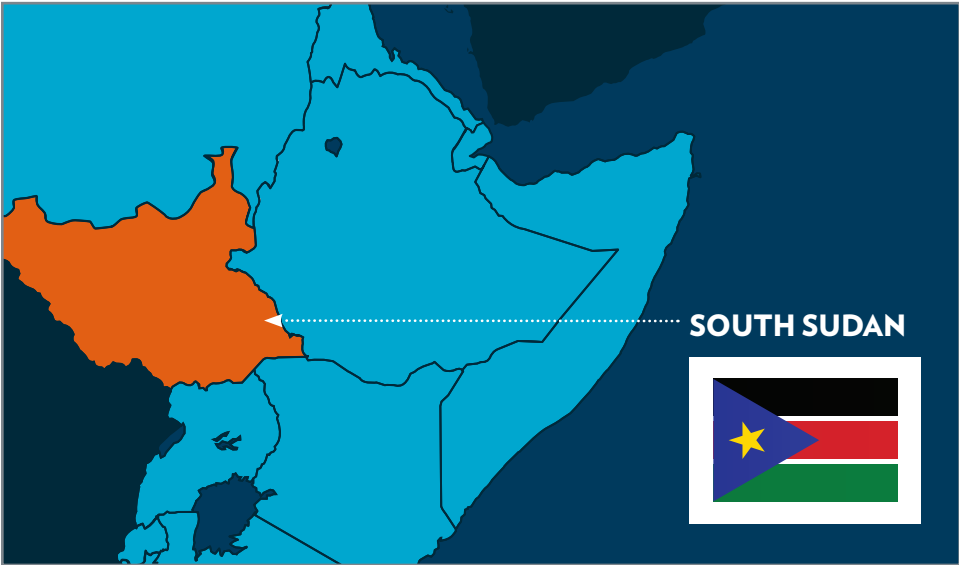
INTRODUCTION

Following decades of conflict with Sudan, South Sudan declared independence in a referendum in 2011. At the end of 2013, civil war broke out in the country following a political struggle between the president and former vice-president.

The South Sudanese economy is heavily reliant on oil, which comprises the vast majority of GDP, exports, and government revenue. Foreign investment has been highly concentrated in the oil sector. However, the government has acknowledged the importance of private sector development and diversification for the future of the country, and has begun streamlining the regulatory environment and investment process to facilitate this growth.

To date, South Sudan has seen very little impact investment, but it could play an important role as the country begins to develop independently. Impact investors face a number of challenges in South Sudan that have hindered them from entering the market and deploying capital. These challenges include ongoing conflict, a difficult regulatory environment, and a limited talent pool available to South Sudanese businesses.

FIGURE 1: MAP OF SOUTH SUDAN



COUNTRY CONTEXT

South Sudan is the world's newest state at the publication of this report and remains a fragile, underdeveloped country wracked by conflict. The nation was founded on July 9, 2011 when South Sudan gained independence from Sudan following decades of conflict between the Southern rebels and Sudan's Khartoum-based government.

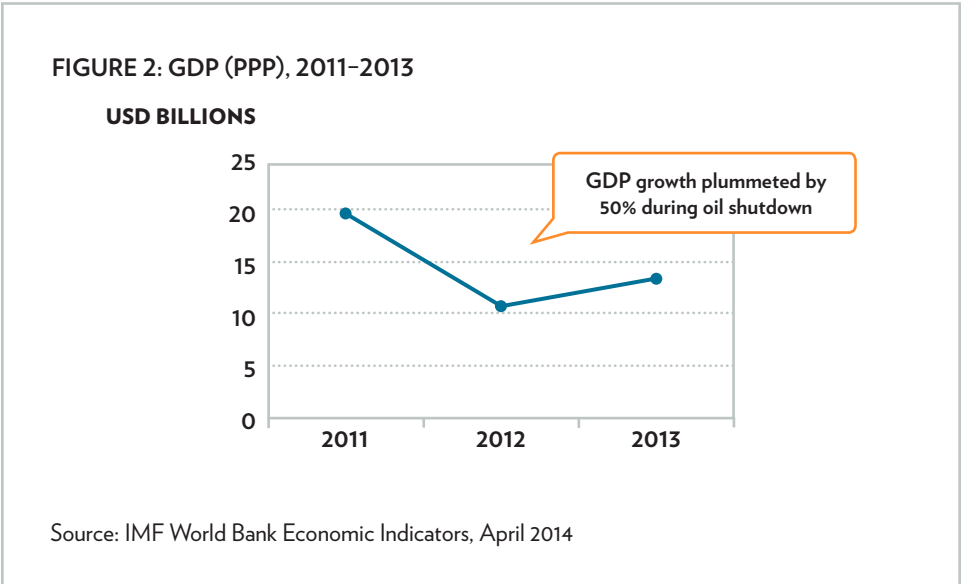
South Sudan was initially established as a semi-autonomous region in 1972 as part of the peace agreement that ended the country's first civil war. The removal of this autonomy in 1983 led the Sudanese People's Liberation Movement (SPLM) to take up arms against the central government, prompting a second civil war. This conflict lasted until 2005 with the formation of a power-sharing government and restoration of South Sudanese autonomy.

Following independence in 2011, South Sudan and Sudan remain at odds on a variety of issues including status and rights of nationals in each country, oil fees, and Abyei, a disputed region with significant oil resources. Punctuated by ongoing skirmishes and clashes between their armed forces, the ongoing conflict has killed thousands of people and displaced more than one million.¹

¹ "South Sudan Profile", *BBC* (6 August, 2014), available at <http://www.bbc.com/news/world-africa-14019202>.

Gross Domestic Product

South Sudan's economy has struggled recently due to civil unrest and ongoing disagreements with the government of Sudan over oil rights, as well as other disruptions to economic activity. In 2012, a dispute over oil fees led Sudan to shut down South Sudan's oil export pipelines, only resuming shipments in 2013.² As a result, South Sudan's GDP declined approximately 50%—from nearly USD 22 billion in 2011 to just under USD 12 billion in 2012 (Figure 2). While GDP grew about 25% to almost USD 15 billion between 2012 and 2013, South Sudan's recovery has been hampered by the civil war. Despite the country's abundant oil resources, South Sudan's GDP per capita was only USD 1,350 in 2013,³ approximately 50% of the sub-Saharan average of USD 2,673 per capita.⁴



Oil is the driving factor of the economy and is estimated to account for up to 80% of GDP and almost all exports, making South Sudan the most heavily oil-dependent nation in the world.⁵ The government of the Republic of South Sudan (GoSS) is also deeply dependent on these exports as nearly 98% of its revenues in recent years have been generated by the oil industry.⁶

South Sudan's 2012 oil shutdown demonstrated the importance of oil to the economy. In January 2012, the government was forced to halt production and export of oil due to ongoing disagreements with Sudan, primarily around fees to use Sudan's infrastructure. These disagreements stem from uneven distribution of oil reserves

2 "South Sudan Profile", *BBC* (6 August, 2014), available at <http://www.bbc.com/news/world-africa-14019202>.

3 World Economic Outlook: South Sudan gross domestic product based on purchasing-power-parity (PPP) per capita GDP, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>.

4 *Ibid.*

5 The World Bank, *South Sudan Overview*, available at <http://www.worldbank.org/en/country/southsudan/overview>.

6 *Ibid.*

and infrastructure dating back to pre-independence; as of 2014, Sudan possesses 1.5 billion barrels in oil reserves while South Sudan has more than twice that number—3.5 billion barrels.⁷ While almost 70% of unified Sudan's oil reserves were in the south, the majority of export infrastructure was developed in the north. Therefore, independent South Sudan lacks the necessary infrastructure to export its oil, forcing it to rely on Sudan and making it vulnerable to conditions imposed by the Sudanese government.

Without revenues generated by oil production and export, the GoSS was forced to implement significant austerity measures, reducing its 2012 spending by approximately 45% from 2011 levels followed by additional spending cuts in its 2012/2013 budget. These cuts included reductions in operating costs, capital expenditure, and transfers to South Sudanese states, leading to GDP decline and economic challenges. With the resumption of oil flows, the economy rebounded in the second half of 2013, despite production levels nearly 40% lower than 2011.⁸

While oil is the key driver of South Sudan's economy, agriculture is the primary economic activity for most South Sudanese citizens. Agriculture is still primarily subsistence farming as almost 80% of South Sudanese households rely on crop farming or animal husbandry as their primary source of income.⁹ The reliance on subsistence agriculture makes the country susceptible to natural disasters such as floods, droughts, and crop diseases. Such disasters disproportionately impact South Sudan's most vulnerable; among Sudan's bottom quintile by income, more than 80% rely on agriculture for their primary source of income.¹⁰

7 U.S. Energy Information Administration, "Sudan and South Sudan," *U.S. Energy Information Administration* (September 3, 2014), available at <http://www.eia.gov/countries/cab.cfm?fips=SU>.

8 CIA, *The World Factbook – South Sudan*, available at <https://www.cia.gov/library/publications/the-world-factbook/geos/od.html>.

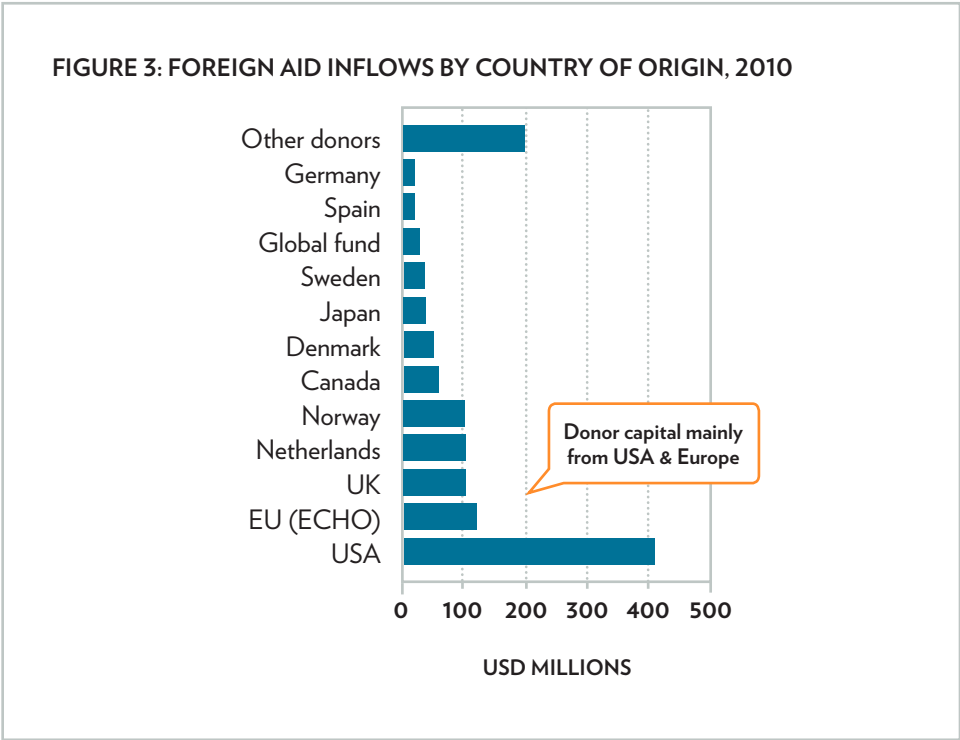
9 HumanIPO, "Top network operators see South Sudan as next big mobile-money zone," *HumanIPO* (Jul. 20, 2012), available at <http://www.humanipo.com/news/965/top-network-operators-see-south-sudan-as-next-big-mobile-money-zone/>.

10 Bertelsmann Stiftung, *BTI 2014 – South Sudan Country Report*, available at http://www.bti-project.de/uploads/tx_itao_download/BTI_2014_South_Sudan.pdf.

Foreign Direct Investment

With South Sudan’s weak private sector and history of conflict, there have been limited international investments in the country. Although FDI statistics for South Sudan as a nation are unavailable, the oil sector receives the majority of foreign investments given its role in the economy. These are primarily from large foreign oil companies including China’s National Petroleum Company, Malaysia’s Petroliam Nasional Berhad (PETRONAS), and India’s Oil and Natural Gas Corporation (ONGC). Other countries with business interests in South Sudan’s oil industry include the U.S., Russia, France, and Kuwait. Other than oil investments, international companies that operate in South Sudan include South African brewer SABMiller, telecommunications operators MTN, Vivacell, and Zain, airlines such as Air Uganda and East Africa Airlines, as well as insurance and banking institutions from Kenya, South Africa, and Ethiopia.¹¹

South Sudan continues to receive a substantial amount of foreign aid, primarily from the United States and Europe (Figure 3). Since 2005, aid agencies have sent more than USD 4 billion in foreign aid to South Sudan¹² primarily for health, infrastructure, and social and humanitarian affairs.



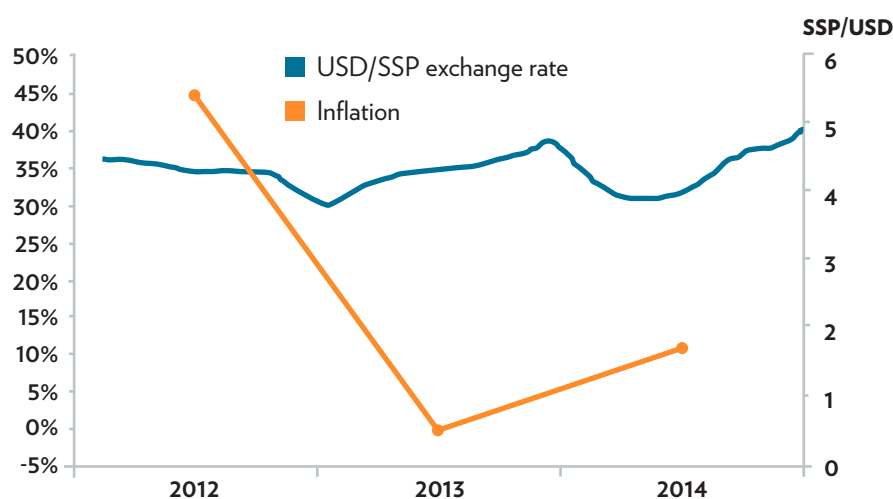
11 US Department of State, 2013 Investment Climate Statement-South Sudan, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

12 Economy watch, “South Sudan Economic Statistics and Indicators,” Economy watch, available at <http://www.economywatch.com/economic-statistics/country/South-Sudan/>.

Inflation and Exchange Rates

South Sudan's Central Bank was established shortly after independence in 2011, and there is limited reliable data available on the bank's operations and lending rates to date. Inflation in South Sudan has been erratic due to the economic uncertainty that has plagued the country since independence (Figure 4). Starting at 45% in 2012, the inflation rate peaked at almost 80% in mid-2012 due to rising fuel prices and exchange rate pressure.¹³ The inflation rate then plunged to just slightly negative in 2013 before rising to an estimated 11% in 2014. The International Monetary Fund (IMF) expects inflation in South Sudan to gradually decline and stabilize at approximately 5% over the next few years, but continued unrest may drive inflation higher than expected.¹⁴

FIGURE 4: INFLATION AND USD/SSP EXCHANGE RATE, 2012-2014



Meanwhile South Sudan's currency, the South Sudanese Pound (SSP), has remained fairly stable, averaging an official exchange of 4 SSP to the dollar between 2012 and 2014, although investors interviewed for this report suggest that black market exchange rates fluctuate significantly. It is heavily supported by the country's foreign exchange reserves from oil. As a result, the 2012 oil shutdown led to a slight devaluation of the SSP as the government was forced to spend foreign exchange reserves.¹⁵

13 CIA, *The World Factbook – South Sudan*, available at <https://www.cia.gov/library/publications/the-world-factbook/geos/od.html>.

14 World Economic Outlook: South Sudan inflation, average consumer prices, *International Monetary Fund* (Apr. 2014), available at <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/download.aspx>; African Economic Outlook, South Sudan (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/SoudanDuSUD_ENG.pdf.

15 South Sudan National Bureau of Statistics, *The South Sudan Millennium Development Goals Status Report* (2012), available at <http://www.undp.org/content/dam/southsudan/library/Reports/MDG%20Report%202012.pdf>.

SUPPLY OF IMPACT INVESTING CAPITAL

There has been minimal impact investing activity in South Sudan to date. Investing and working in South Sudan continues to be challenging due to a variety of factors, including ongoing conflict, a poor regulatory environment, and a limited talent pool available to South Sudanese businesses. This is reflected in South Sudan's place in the World Bank's Ease of Doing Business rankings where the country is recognized as one of the poorest environments for business, ranking 186th out of 189 countries.¹⁶

Broader Investing Landscape

Impact capital represents only a small part of the overall investing landscape, with limited evidence of activity to date. Access to conventional capital continues to be a challenge for both local and foreign businesses due to the country's newly independent financial sector. South Sudan has fewer than 20 banks and just 70 foreign exchange bureaus country-wide. Foreign exchange is strictly controlled, with the four largest bureaus controlling almost 70% of the sector's total assets.¹⁷ In addition, South Sudan's banks are risk averse and unwilling to lend to early stage ventures as the nascent regulatory environment does not offer sufficient protection to lenders. Most banks are centered in urban areas such as Juba and Wau and have limited presence in rural areas; even MFIs have limited reach due to the country's poor infrastructure.¹⁸

Investments in the oil sector remain the largest area of investment in the country, with little investment in other sectors. However, the government acknowledges the importance of private sector development and diversification for the future of the country, and has begun streamlining the investment process to facilitate this growth. They established the One Stop Shop Investment Centre (OSSIC) to act as a central contact point for investors to apply for all required approvals and permits.¹⁹

After years of conflict, the country is in desperate need of infrastructure investments. Plans for infrastructure development had begun to be laid out, but ongoing civil unrest has largely halted these projects.²⁰

16 Economy Rankings, *World Bank Group*, available at <http://www.doingbusiness.org/rankings>.

17 US Department of State, *2013 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

18 *Ibid.*

19 African Economic Outlook, *South Sudan (2014)*, available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/SoudanDuSUD_ENG.pdf.

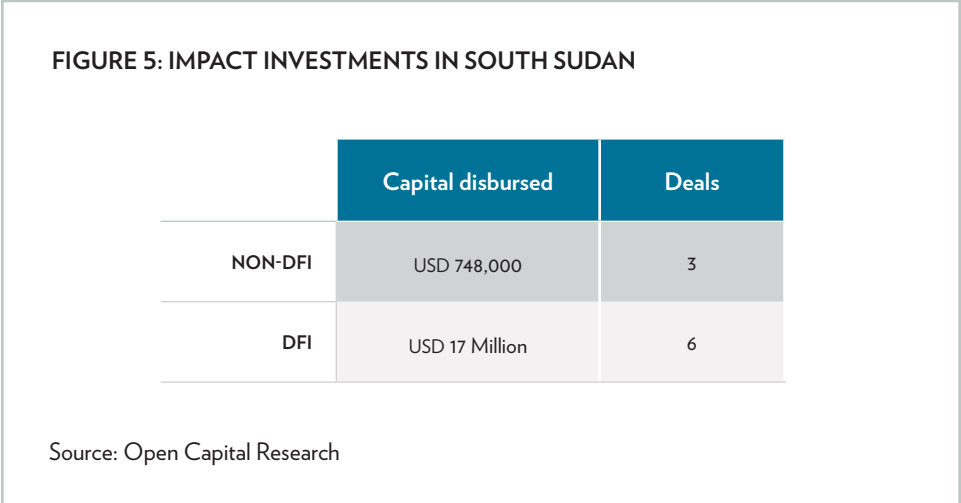
20 *Ibid.*

Impact Capital Disbursed

There are 50 known impact funds (excluding DFIs)²¹ that list South Sudan as part of their target geography. These non-DFI impact investors have deployed USD 748,000 in impact investments in the country to date (Figure 5). These vehicles have very large geographic reaches—often global or sub-Saharan African wide—and most do not prioritize investments in South Sudan, resulting in the small amount deployed so far. It is unclear whether many of these non-DFI impact investors would be willing to seriously consider an investment in South Sudan despite its formal inclusion as a target country. Indeed, only one non-DFI impact investor has placed staff locally in Juba.

Reflecting this lack of focus on South Sudan, only USD 4.5 million is committed specifically to impact investments in the country from non-DFI investors. Beyond this, there is at least a further USD 611 million in capital committed regionally that could be deployed in South Sudan. However, it remains highly unlikely that any notable fraction of this capital will be deployed in the country. Still, this availability does imply that if the investment environment improves, there are substantial pools of capital that could rapidly shift to investments in South Sudan.

By contrast, DFIs have been much more active deploying capital in South Sudan with approximately USD 17 million disbursed across six known investments in 2012 and 2013 (Figure 5). These investments were concentrated in financial services—four USAID-funded investments provided guarantees totaling approximately USD 7 million to financial institutions such as KCB Sudan and Equity Bank South Sudan. The remaining capital was provided by IFC and Norfund to companies in construction and real estate.



21 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

South Sudan struggles with a weak private sector and minimal entrepreneurship by the local population. Northern Sudanese dominate most businesses and trade in the country, while Kenyans and Ugandans provide most imports. Of the few businesses started by South Sudanese nationals, South Sudanese repatriates are responsible for a larger portion than “indigenous” South Sudanese. Local entrepreneurs tend to focus on the informal sector in areas such as retail, livestock, vehicle repair, transportation, and equipment maintenance.²²

Without significant entrepreneurial activity, most of South Sudan’s industries have little competition to drive growth and innovation. While this can make it challenging to find proficient and dependable local business partners and suppliers, it also represents an opportunity for investors and entrepreneurs to start new businesses in a variety of sectors.²³

Development Context

After years of conflict, South Sudan is understood to have strong development needs, but due to its relative infancy, there are few reliable measures to objectively understand South Sudan’s socioeconomic conditions or to compare the country to regional and global indicators; for example, the United Nations has yet to rank South Sudan on its Human Development Index.

The country has little socioeconomic development in non-urban areas and is plagued by high poverty rates. As of 2009, more than 50% of South Sudan’s population lived on less than USD 1.00 a day (Figure 6).²⁴

South Sudan also suffers from a shortage of basic health services, and those that do exist are of poor quality. The maternal mortality rate is 730 deaths per 100,000 live births, making it the seventh worst country in the world for maternal health.²⁵ Meanwhile, only 17% of South Sudanese children are fully immunized,²⁶ and nearly 40% of children in South Sudan die before their fifth birthday, as the under-five mortality rate is 381 deaths per 1,000 births, far worse than in nearby countries. This

22 Peace Security and Development Network, *Public Private Cooperation in Fragile States Country report: Southern Sudan* (2009), available at http://www.clingendael.nl/sites/default/files/20090900_report_cru_southern_sudan.pdf.

23 *Ibid.*

24 Bertelsmann Stiftung, *BTI 2014 – South Sudan Country Report*, available at http://www.bti-project.de/uploads/tx_itao_download/BTI_2014_South_Sudan.pdf.

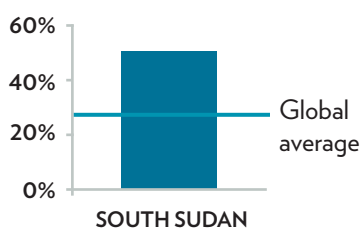
25 “Maternal mortality has declined steadily since 1990, but not quickly enough to meet the MDG target,” *UNICEF* (Jul 2014), available at <http://data.unicef.org/maternal-health/maternal-mortality>.

26 “South Sudan Overview,” *The World Bank* (Nov. 13 2014), available at <http://www.worldbank.org/en/country/southsudan/overview#1>.

rate is more than 2.5 times greater than in Somalia and nearly six times greater than in neighboring Ethiopia.²⁷

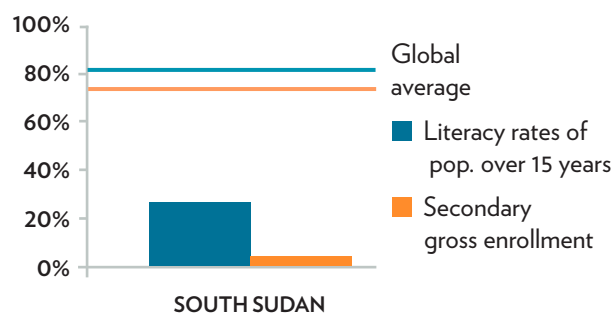
South Sudan has similar challenges along educational metrics. Approximately 75% of South Sudanese heads of household have not completed any formal education²⁸ and the literacy rate among those aged 15 years and older is only 27% (Figure 7) with a significant disparity in male literacy (40%) and female literacy (16%), a reflection of boys receiving better educational opportunities.²⁹ Moreover, just 4% of students of secondary school age are enrolled in secondary school, less than one-eighth the East African average of approximately 33%, and nearly 20 times lower than the global average of 74%.³⁰ South Sudan continues to rely on NGOs, churches, and other charitable organizations to provide public goods such as healthcare and education.³¹

FIGURE 6: POPULATION BELOW USD 1/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014; Bertelsmann Stiftung, BTI 2014 - South Sudan Country Report. Note: Chart shows population below USD 1/day, but global average refers to population below USD 1.25/day from the UN Human Development Index

FIGURE 7: SECONDARY SCHOOL GROSS ENROLLMENT



Source: UN Human Development Report 2014; Bertelsmann Stiftung, BTI 2014—South Sudan Country Report

27 Bertelsmann Stiftung, *BTI 2014 – South Sudan Country Report*, available at http://www.bti-project.de/uploads/tx_itao_download/BTI_2014_South_Sudan.pdf.

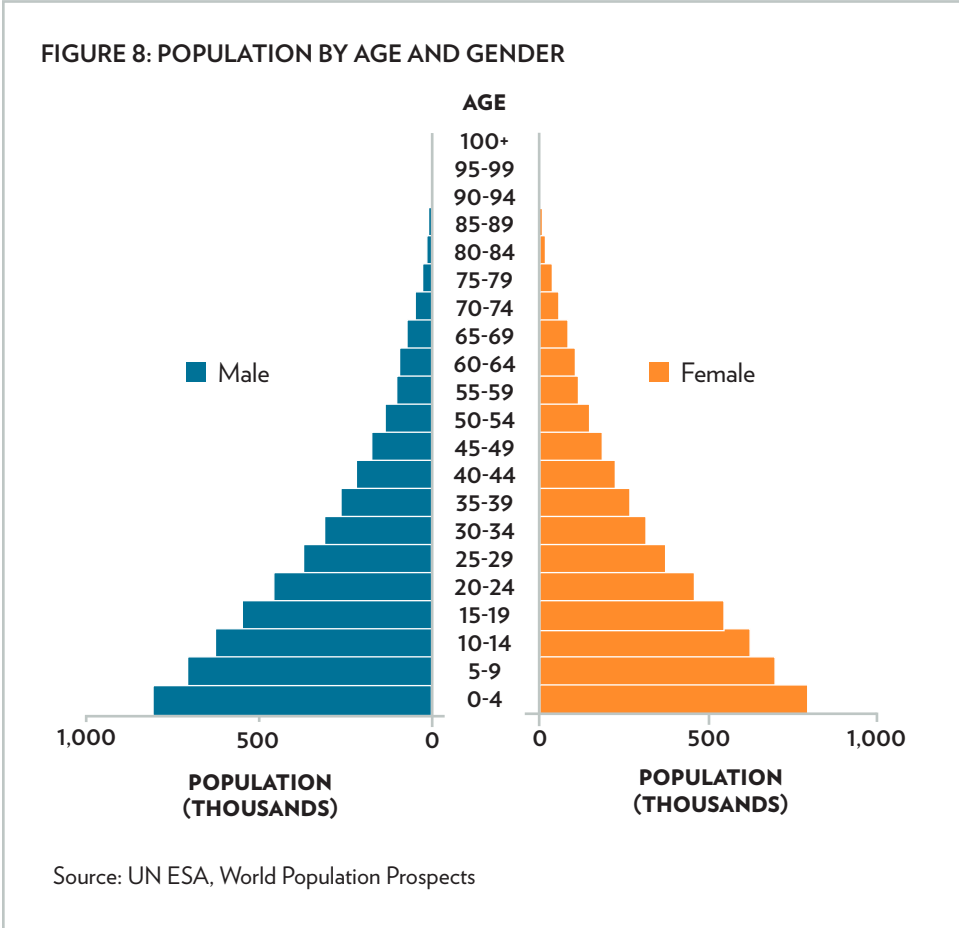
28 *Ibid.*

29 “South Sudan Overview,” *The World Bank* (Nov. 13 2014), available at <http://www.worldbank.org/en/country/southsudan/overview#1>.

30 Bertelsmann Stiftung, *BTI 2014 – South Sudan Country Report*, available at http://www.bti-project.de/uploads/tx_itao_download/BTI_2014_South_Sudan.pdf.

31 *Ibid.*

Educational metrics are an especially important indicator for future development given South Sudan’s demographics. Like other East African countries, South Sudan has a disproportionately young population, where 63% of the population is below the age of 25 and more than 40% below the age of 15 (Figure 8). This has led to high youth unemployment. Low levels of education make it more challenging to translate the youth boom into positive economic growth as these youth begin to seek employment opportunities.



Entrepreneurs

It is challenging to start a new business or transition a business from the informal to the formal sector due to numerous regulatory requirements. As recently as 2011, the high cost of setting up a business in South Sudan made Juba the second most expensive commercial capital in the world. An entrepreneur registering a business in South Sudan must go through 11 procedures and pay USD 3,077, almost three times the annual income per capita.³²

As mentioned earlier, non-South Sudanese such as Ugandans, Kenyans, and northern Sudanese dominate most business ventures. Development of home-grown businesses in South Sudan will require investing in an enabling environment and in local entrepreneurs.

³² Ease of Doing Business, *South Sudan*, available at <http://www.doingbusiness.org/data/exploreeconomies/south-sudan>.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

As a new country, South Sudan is still building an ecosystem capable of encouraging private sector growth. This is evident across the regulatory and service provider market as well as the general business environment.

Regulatory Environment

After independence, the government of South Sudan was forced to develop the new country's regulatory framework while maintaining continuity with previous systems. The country still uses some laws enacted during its period of semi-autonomy from 2005 to 2009, and it has also passed several new acts, including the 2012 Imports and Exports Act and the 2012 Companies Act. Nevertheless, its regulatory framework remains underdeveloped.

- **Repatriation of profits and dividends:** South Sudan's Investment Promotion Act guarantees the right to transfer profits into and out of the country; however, as a practical matter, many companies have trouble repatriating profits. The supply of foreign currency is in short supply, and the Central Bank regulates which businesses are given US dollars, which can complicate efforts by foreign investors to repatriate profits.³³
- **Foreign exchange controls:** The Central Bank uses foreign exchange rationing as a monetary instrument—banks are required to report significant foreign exchange transactions to the Central Bank, which caps the supply of foreign currency to businesses and private citizens.³⁴
- **Land ownership:** Under South Sudan's 2009 Land Act, foreigners may not own land but are permitted to lease land for up to 99 years. Leases for mining or quarrying are limited to the life of the mine or quarry.³⁵ Though inadequate land regulation has made access to land a challenge, various foreign entities have successfully acquired leases to substantial land holdings, including 2.28 million hectares in Boma National Park leased by an Emirati company and 600,000 hectares leased by US-based Nile Trading and Development. It is estimated that as of the 2011 independence vote, non-South Sudanese entities in various sectors such as ecotourism and agriculture had acquired approximately 5 million hectares in the country.³⁶

33 US Department of State, *2014 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

34 African Economic Outlook, *South Sudan* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/SoudanDuSUd_ENG.pdf.

35 US Department of State, *2013 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

36 USAID, USAID Country Profile-Property Rights and Resource Governance – South Sudan, available at http://usaidlandtenure.net/sites/default/files/country-profiles/full-reports/USAID_Land_Tenure_South_Sudan_Profile.pdf.

- **Local ownership requirements:** Foreigners are allowed to own or control businesses in any sector, but the Board of Directors of South Sudan’s Investment Authority Board has the authority to enact or change regulations that limit the sectors in which foreigners may invest.³⁷ Medium and large companies must have at least 31% South Sudanese shareholding, though there is a common misperception that this rule applies to all businesses.³⁸ Small businesses—specifically companies that employ fewer than seven people and meet certain other financial requirements—may only be operated by South Sudanese citizens.³⁹
- **Government enterprises:** Given the importance of oil to the economy, it is apt that an oil company is the GoSS’ only enterprise. Nilepet, operated by the Ministry of Mining and Petroleum, manages South Sudan’s oil reserves. In instances of public-private partnership, the GoSS will enter into joint ownership of a company with a foreign investor often with a controlling stake of 51% equity. The GoSS requires that investors in such enterprises be registered in South Sudan and typically enters into public-private partnerships in oil exploration, timber development, water, and mining.⁴⁰
- **Taxation:** South Sudan’s corporate tax rates vary by company size. The government levies 10%, 15%, or 20% taxes on small, medium, and large companies respectively. Companies must pay an additional 10% withholding tax on dividends, royalties, interest, and rent.⁴¹ Regulations state that both foreign- and locally-owned businesses should receive tax exemptions on machinery and equipment, agricultural imports, and capital investments, although as of the publication of this report they fail to specify the size or length of exemptions.⁴²

Ecosystem Players

Along with a poorly developed private sector, South Sudan has a limited ecosystem to support private development. International organizations such as Technoserve and VC4Africa cover South Sudan but do not have a local presence. The Africa Enterprise Challenge Fund has awarded several grants to companies operating in South Sudan. Beyond these few activities, there are few intermediaries and service providers active in country.

37 US Department of State, *2013 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

38 *Ibid.*

39 *Ibid.*

40 World Bank Group, *The Republic of South Sudan- Regulatory Reform Status*, available at <https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/business-regulation/upload/Country-Presentations-South-Sudan.pdf>.

41 Deloitte, *International tax – South Sudan Highlights 2014*, available at <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-southsudanhighlights-2014.pdf>.

42 US Department of State, *2013 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Current and potential impact investors in South Sudan face many challenges entering the market and sourcing high potential opportunities:

- **Political risk and insecurity:** Given ongoing civil conflict and recurring disagreements with Sudan, South Sudan continues to have high insecurity and instability, limiting the ability of investors to deploy capital.⁴³ Beyond the direct threat of violence and difficulty operating in an insecure environment, the significant internal displacement—more than one million people have been displaced⁴⁴—makes it difficult for businesses to establish reliable consumer bases and scale operations in order to be attractive for investors, whether conventional or impact.
- **Underdeveloped financial and regulatory structures:** South Sudan's poorly developed institutions and regulations make it challenging for impact investors to operate in the country. Constraints include limited government data, poorly enforced regulations, lack of a credit reference bureau, and minimal documentation to prove land ownership. South Sudan's government has not yet instituted regulations to provide sufficient protection for lenders, making financiers reluctant to extend loans. Not only does South Sudan have an insufficient regulatory framework to support the private sector, it is also often challenging for entrepreneurs and investors to develop a full understanding of current legislation.⁴⁵
- **Limited talent pool:** The lack of human capital is a consistent challenge throughout East Africa, and it is particularly acute in South Sudan. After decades of conflict and instability, South Sudan's education system has noticeably suffered. The country has one of the lowest literacy rates in the world, making it difficult to source qualified staff to scale. In addition, businesses' access to foreign talent is limited due to an unofficial expectation that 70-90% of positions in all companies be held by South Sudanese citizens.⁴⁶

43 Peace security and Development Network, *Public Private Cooperation in Fragile States Country report: Southern Sudan* (2009), available at http://www.clingendael.nl/sites/default/files/20090900_report_cru_southern_sudan.pdf.

44 "South Sudan Profile," *BBC* (6 August, 2014), available at <http://www.bbc.com/news/world-africa-14019202>.

45 US Department of State, *2013 Investment Climate Statement-South Sudan*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204855.htm>.

46 *Ibid.*

Opportunities

While hurdles exist for impact investors interested in Sudan, there are also opportunities for investors to deploy capital to provide financial returns while driving economic growth and long-term development:

- **Leverage technical assistance (TA) facilities for pre-investment pipeline building:** Given South Sudan's economic challenges, impact investors will continue to struggle to find businesses suitable for investment. Several impact investors have successfully developed TA facilities for portfolio companies within the region, and this will be especially important to address the lack of talent in South Sudan.
- **Infrastructure development:** As recently as 2011, South Sudan had approximately 60 miles of paved roads, severely limiting the ability to move goods and human capital through the country.⁴⁷ Investors could partner with DFIs and other stakeholders to support infrastructure development efforts in roads, electricity, and other sectors, which will lead to long-term economic growth and the introduction of new businesses.

In addition, several sectors are ripe for the development of new businesses and could present viable opportunities for investment:

- **Agriculture:** Agriculture remains an underdeveloped sector in South Sudan with considerable potential. Roughly half of the country's land is arable (approximately 41 million hectares), but the effects of war and minimal investment have left crop yields vulnerable to climate conditions and natural disasters. Most agriculture is subsistence farming with little commercial activity; these crops could benefit significantly from modern technologies and crop management practices. Investments in commercial agriculture, mechanization, input supply, technical assistance, and outgrower schemes would help develop the industry and provide greater food security.⁴⁸
- **Telecommunications:** As South Sudan develops, a strong telecommunications sector is increasingly important for industry and government. Between 2010 and 2013, the number of mobile subscribers grew approximately 24% annually, nearly doubling from 1.5 million to 2.5 million over the period. Despite this strong growth, South Sudan currently lacks the infrastructure to reach the 80% of the population that lives outside major urban areas. Zain, a Kuwaiti company and one of South Sudan's leading mobile providers, estimates that the percentage of South Sudanese with mobile phones will grow from 13% to 36% over the next four years. With limited access to the formal financing sector, increasing use of mobile phones may facilitate access to mobile money, with important consequences for

47 "South Sudan Faces Hurdles as World's Newest Country," *International Monetary Fund* (July 18, 2011), available at <http://www.imf.org/external/pubs/ft/survey/so/2011/car071811a.htm>.

48 Peace security and Development Network, *Public Private Cooperation in Fragile States Country report: Southern Sudan* (2009), available at http://www.clingendael.nl/sites/default/files/20090900_report_cru_southern_sudan.pdf.

commerce.⁴⁹ Multiple phone companies currently operate in South Sudan, but none currently offer mobile money services.

- **Renewable energy:** With the lowest per capita electricity consumption in Africa, South Sudan's energy industry is sorely in need of development and investment. South Sudan's electricity grid reaches only 1% of the population. Firewood and charcoal serve as the primary means to heat and cook for 96% of the population, presenting an opportunity for solar energy and other low-cost renewables. South Sudan has plans to dramatically increase power generation capacity (20 MW at time of writing), including a 38 MW hydropower plant to be completed in 2016, and the 540 MW Bedden Dam hydropower plant expected to cost USD 1.4 billion. South Sudan also received a USD 26 million grant from the African Development Bank (AfDB) in 2013 to expand the country's electricity distribution infrastructure.⁵⁰
- **Industrial diversification:** Despite its importance to the economy, South Sudan has a limited reserve of oil. The World Bank estimates that the country's oil reserves will steadily decline until exhausted in 2035.⁵¹ Other promising sectors include forestry, infrastructure, transportation, tourism and hospitality, health, manufacturing services, and mining.⁵²

49 HumanIPO, "Top network operators see South Sudan as next big mobile-money zone," *HumanIPO* (Jul. 20, 2012), available at <http://www.humanipo.com/news/965/top-network-operators-see-south-sudan-as-next-big-mobile-money-zone/>.

50 U.S. Energy Information Administration, "Sudan and South Sudan," *U.S. Energy Information Administration* (September 3, 2014), available at <http://www.eia.gov/countries/cab.cfm?fips=SU>.

51 The World Bank, "South Sudan Overview," *The World Bank* (Oct. 10, 2014), available at <http://www.worldbank.org/en/country/southsudan/overview#1>.

52 Peace security and Development Network, *Public Private Cooperation in Fragile States Country report: Southern Sudan* (2009), available at http://www.clingendael.nl/sites/default/files/20090900_report_cru_southern_sudan.pdf.

SUDAN

DIVERSIFYING BEYOND OIL,
BUT STILL CHALLENGING
FOR INVESTORS



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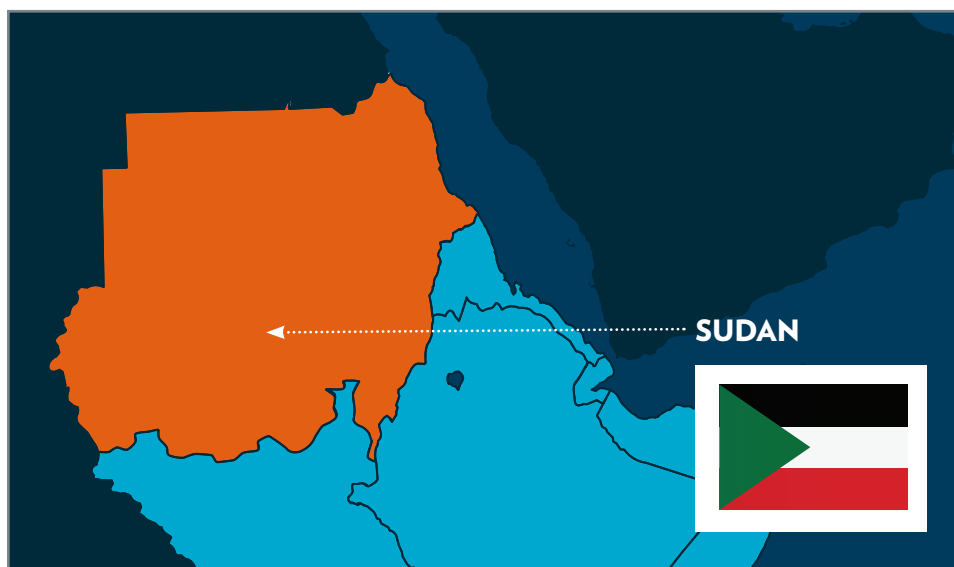
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INTRODUCTION

Sudan is East Africa's second biggest economy, rich in natural resources, such as gold, that have fueled growth. However, its history is marked by internal conflict, culminating in the secession of South Sudan in 2011. Sudan lost the majority of its oil reserves in the split, and is still recovering from economic shock, which precipitated an increased fiscal deficit, high inflation, and depreciation of the Sudanese Pound.

Like many frontier economies in the region, there has been little recorded impact investment by private investors in Sudan to date. Most impact capital has been placed by development finance institutions (DFIs),¹ which have funded a number of projects in oil, infrastructure, and agricultural processing. Sudan's financial sector is poorly developed by regional standards. Banks are the primary source of financing, yet most are small, risk-averse, undercapitalized, and concentrated in major cities.

FIGURE 1: MAP OF SUDAN



1 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

COUNTRY CONTEXT

Sudan gained independence in January 1956. The country has been at war internally for the better part of its existence, rooted in the cultural and religious divide between the Islamic North and Christian South.² Between 1983 and 2005, Sudan was embroiled in a civil war that left two million people dead and four million displaced. The conflict was primarily between the Khartoum-based government in the north and the Sudanese People's Liberation Army (SPLA), which sought control of oil-rich southern Sudan. The war culminated in South Sudan's secession in July 2011—the final stage of a six-year peace agreement that ended decades of civil war.³

Despite popular support for secession,⁴ relations between the two countries have remained tense due to disputes over border demarcation, security arrangements, and oil resources. Secession severely affected Sudan's economy, as 75% of the country's oil resources were lost to South Sudan. Sudan also lost 36% of its budget revenue, more than 65% of foreign exchange earnings, and 80% of total exports.⁵

Despite the government's best efforts, the threat of terrorism throughout Sudan remains high—particularly in the Darfur region. Clashes between militia groups and Sudanese military forces occur sporadically along the border with Chad. There are also hostilities between Sudanese forces and armed opposition groups in Blue Nile and Southern Kordofan states, as well as in Abyei, a disputed oil rich region to which South Sudan also lays claim.⁶

2 "The History of Sudan," *Fact Rover*, available at http://www.factrover.com/history/Sudan_history.html.

3 "Sudan: Conflict Profile," *Insight on Conflict* (March, 2014) available at <http://www.insightonconflict.org/conflicts/sudan/conflict-profile/>.

4 "South Sudan Profile," *BBC News* (Aug. 6, 2014), available at, <http://www.bbc.com/news/world-africa-14069082>.

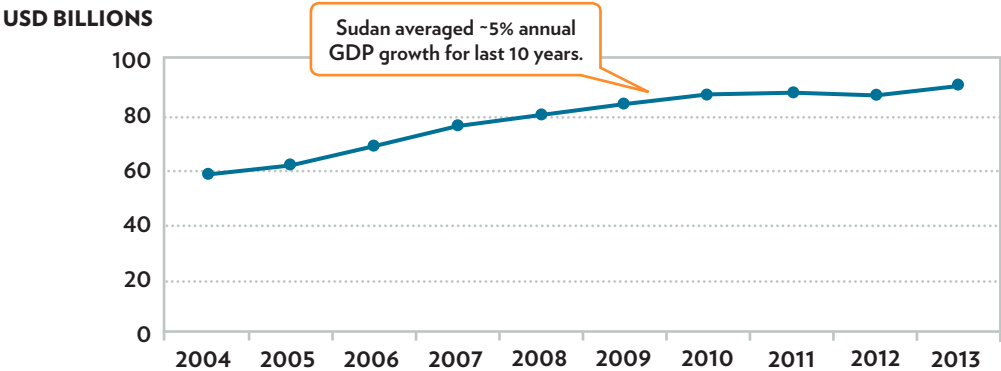
5 "Struggling Sudanese economy," *CMR Michelsen Institute* (Jan. 29, 2014), available at <http://www.cmi.no/news/?1137=struggling-sudanese-economy>.

6 "2013 Investment Climate Statement: Sudan," *U.S. Department of State* (April, 2013), available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204736.htm>.

Gross Domestic Product

In spite of ongoing conflict and other challenges, Sudan’s economy has grown consistently, averaging approximately 5% annual GDP growth over the past decade (Figure 2). In 2013, the Sudanese economy recorded GDP of USD 90.5 billion at purchasing power parity (PPP), making Sudan’s economy second in size only to Ethiopia’s in East Africa in PPP terms, and first in current price terms. Sudan’s GDP per capita of USD 2,631 is about 60% higher than the Sub-Saharan average of USD 1,615 per capita,⁷ and has earned it the World Bank’s “lower-middle-income” classification.⁸

FIGURE 2: GDP (PPP), 2004–2013



Source: IMF World Bank Economic Indicators, April 2014

Agriculture is the primary source of income and employment for most Sudanese people, with 80% of the population engaged in agriculture.⁹ Sudan’s primary agricultural outputs include sugarcane, sorghum, onions, groundnuts, and milk (both cow and goat). With 6.8 million metric tons of sugarcane produced in 2013, Sudan is the third largest sugar cane producer in Africa behind South Africa and Egypt.¹⁰ Many large investments by development finance institutions (DFIs) in Sudan have aimed to support its growing sugar industry. The nation also produced 4.5 million metric tons of sorghum in 2013, second only to Nigeria in Africa. Sudan’s major agricultural exports include sesame seed, cotton lint, mutton, vegetable produce, and sorghum.¹¹ Major export markets for Sudanese goods include the United Arab Emirates, China, Japan, India, and Canada.¹²

7 “Sub-Saharan Africa-developing only,” *The World Bank Group* (2014), available at <http://data.worldbank.org/region/SSA>.

8 World Economic Outlook Database, *International Monetary Fund* (Oct. 2014) available at <http://www.imf.org/external/pubs/ft/weo/2014/02/weodata/WEOOct2014all.xls>.

9 “Economy,” *Sudan Hub Group*, available at <http://www.sudanhub.co.uk/sudan-overview/economy/>.

10 FAOSTAT, *Food and Agriculture Organization of the United Nations* (2011), available at <http://faostat3.fao.org/download/Q/QC/E>.

11 FAOSTAT, *Food and Agriculture Organization of the United Nations* (2011), available at <http://faostat.fao.org/site/339/default.aspx>.

12 “Sudan Profile of Exports, Imports and Trade partners,” *Observatory of Economic Complexity*, available at <http://atlas.media.mit.edu/profile/country/sdn/>.

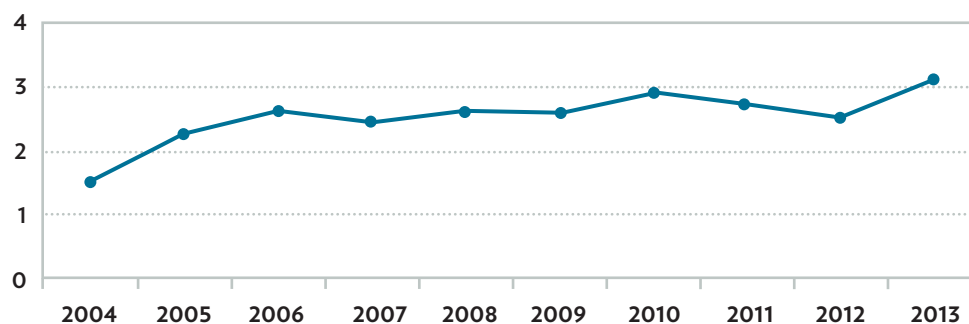
Foreign Direct Investment (FDI)

Sudan has been subject to comprehensive United States-led economic, trade, and financial sanctions since 1997, limiting aid and investment from the West.¹³ These sanctions were imposed as a result of the government's links to international terrorist organizations. Subsequent sanctions were imposed in May 2007 in response to ethnic violence in the Darfur region.¹⁴

Despite international sanctions, FDI in Sudan has steadily grown over the last ten years, doubling from USD 1.5 billion in 2004 to USD 3.1 billion in 2013 (Figure 3), the most FDI received by any country in the region.¹⁵ These large inflows equal 3.4% of GDP, the second highest FDI to GDP ratio in the region after Djibouti's (11.4%).¹⁶

FIGURE 3: FDI FLOWS, 2004-2013

USD BILLIONS



Source: UNCTAD

Foreign investors have mainly been drawn to Sudan's extractive industries, with oil and mining attracting 74% of FDI between 2000 and 2010. Asian countries, namely China, Malaysia, and India, are the biggest investors in Sudan's oil sector, and account for more than 95% of FDI oil inflows.¹⁷

13 "Sudan, US-Sudan relations", *Embassy of the United States - Khartoum*, available at http://sudan.usembassy.gov/ussudan_relations.html.

14 UC Regent, *Understanding Sudan: The Sanctions Regime* (2009), available at <http://understandingsudan.org/Oil/OilResources/L2FS4-SanctionsRegime.pdf>.

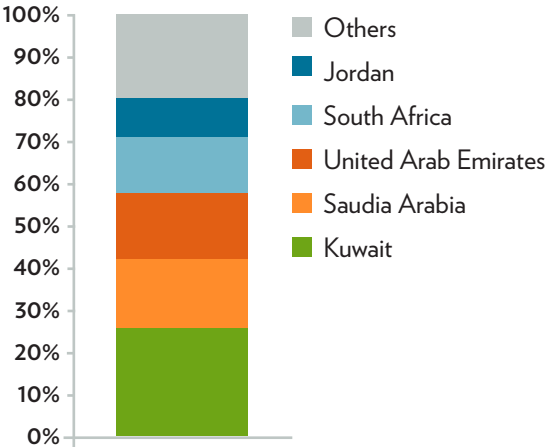
15 Inward and Outward Foreign Direct Investment Flows: Annual 1970-2013, *United Nations Conference on Trade and Development*, available at <http://unctadstat.unctad.org/wds/TableView/tableView.aspx?ReportId=88>.

16 Open Capital Advisors analysis.

17 Hassan Ali Gadkarim, *CMR Michelsen Institute*, *Will the Sudanese Paradox Continue?* (2012), available at <http://www.cmi.no/publications/file/4595-will-the-sudanese-paradox-continue.pdf>.

With most Western countries barred from investing in Sudan, foreign investment in Sudan’s non-oil sectors has primarily come from the Arab Gulf. Sudan’s biggest sources of non-oil FDI are Kuwait, Saudi Arabia, and the United Arab Emirates (Figure 4).¹⁸ Of Sudan’s non-oil sectors, services (17% of FDI inflows) have been most attractive to foreign capital, followed by industry (8%) and agriculture (1%). In the services sector, banking and telecommunications have received the most FDI, followed by construction and contracting, tourism, and transport.¹⁹

FIGURE 4: FDI INFLOWS TO NON-OIL SECTORS BY COUNTRY OF ORIGIN



Source: Ministry of Investment, Sudan

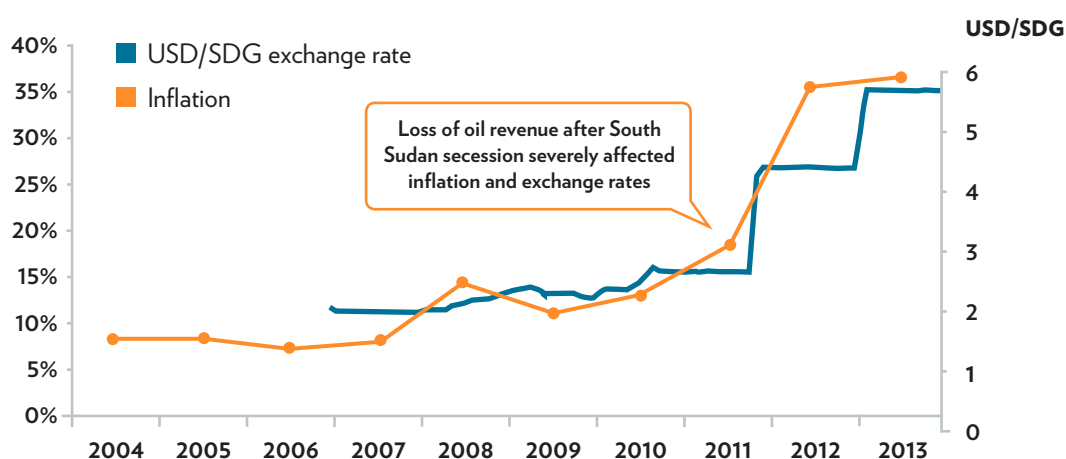
18 Hassan Ali Gadkarim, *CMR Michelsen Institute*, Will the Sudanese Paradox Continue? (2012), available at <http://www.cmi.no/publications/file/4595-will-the-sudanese-paradox-continue.pdf>.

19 *Ibid.*

Inflation and Exchange Rates

The loss of oil revenues dealt a significant blow to Sudan's economy and state revenues. The government implemented a variety of austerity measures to curb the increasing fiscal deficit—which rose from 2.7% of GDP in 2010 to 5.0% in 2011²⁰—including the removal of fuel subsidies and a devaluation of the Sudanese Pound, which cut the fiscal deficit to 1.7% of GDP in 2013.²¹ In spite of this reduction, inflation continues to remain high (Figure 5). In 2010, inflation averaged 13%, yet by 2013 the annual average rate was as high as 37%.²² The high rate in 2013 was driven by high debt, high fuel prices, and the devaluation of the Sudanese Pound. Ongoing disinflation efforts are expected to lower the inflation rate, with the 2015 forecast set at 23.2%.²³

FIGURE 5: INFLATION AND USD/SDG EXCHANGE RATE, 2004-2013



Source: IMF World Bank Economic Indicators, April 2014

A USD shortage in 2012 led the government to devalue the Sudanese Pound in an effort to stabilize the exchange rate and curb black market trading of the dollar. This further increased inflation and import prices.²⁴ Government intervention in Sudan's foreign exchange markets generally creates uncertainty for investors who seek to import inputs or repatriate profits.

20 AfDB, OECD, UNDP and UNECA, *African Economic Outlook 2012: Sudan* (2012), available at http://www.youthpolicy.org/national/Sudan_2012_Youth_Unemployment_Briefing.pdf.

21 Yousif M.A. Bashir Eltahir, Suwareh Darbo & Kabbashi M. Suliman, *African Development Bank, African Economic Outlook: Sudan* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Soudan_EN.pdf.

22 International Monetary Fund, *IMF Country Report: Sudan* (Oct. 2013), available at <https://www.imf.org/external/pubs/ft/scr/2013/cr13317.pdf>.

23 Yousif M.A. Bashir Eltahir, Suwareh Darbo & Kabbashi M. Suliman, *African Development Bank, African Economic Outlook: Sudan* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Soudan_EN.pdf.

24 Mohamed Nureldin Abdallah, "Sudan Pound Again Under Pressure After Devaluation," *Reuters* (May. 30, 2012), available at <http://www.reuters.com/article/2012/05/30/ozabs-sudan-currency-idAFJ0E84T08Z20120530>.

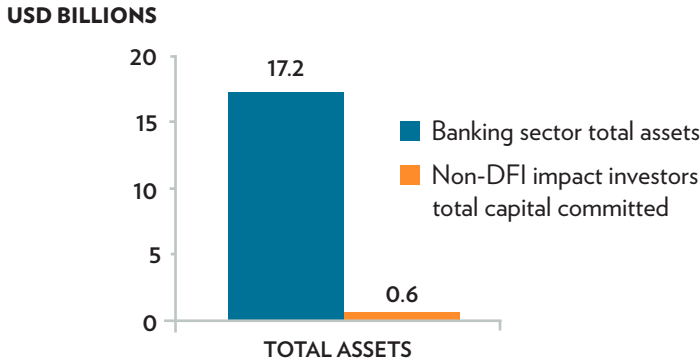
SUPPLY OF IMPACT INVESTING CAPITAL

There have been no recorded private impact investments in Sudan to date. However, funds that include Sudan in their geographical mandate have approximately USD 565 million of capital committed to the region, which could potentially be disbursed to Sudanese businesses. However, given historical impact capital flows, it is unlikely that much of this will reach Sudan in the near future. Sanctions imposed by the United States and the United Nations, along with Sudan’s history of conflict, have generally prevented Western investors from engaging in the country.

Broader Investing Landscape

Banks dominate Sudan’s financial sector and have more than USD 17 billion in outstanding loans and advances (Figure 6).²⁵ Sudan’s banking system follows Islamic sharia law, which prohibits interest on debt. Instead, the banking sector relies on partnership and risk sharing. Frequently used financial products include Mudarabah (passive partnership), Musharakah (active partnership), Murabaha (sale contract at a profit markup), and Salam (forward sale contract).²⁶

FIGURE 6: IMPACT CAPITAL RELATIVE TO OTHER FINANCIAL ASSETS



Source: Central Bank of Sudan, Open Capital Research

25 Bank Audi, *Sudan Economic Report* (2010), available at <https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=4&cad=rja&uact=8&ved=0CDUQFjAD&url=http%3A%2F%2Fwww.banqueaudi.com%2FGroupWebsite%2FopenAudiFile.aspx%3Fid%3D1980&ei=QLmGVNWWBYq8UffXg5gK&usg=AFQjCNE7lQviz-EoMJO26pB-qCjss1zxBg&bvm=bv.81449611,d.d24>.

26 Al Siddig Talha Mohamed Rahma, The National Ribat University: Sudan, *The Sudanese Islamic Banking Experience* (2011), available at <http://www.slideshare.net/alhudacibe/the-sudanese-islamic-banking-by-al-siddig-talha-mohamed>.

In 2013, 23 MFIs active in Sudan reached more than 700,000 people. While this was a 43% increase from 2012, it represents less than 2% of Sudan's population.²⁷ Access to microfinance has grown steadily, though Sudan still lags behind other countries in the region. The government sees microfinance as a poverty alleviation tool and currently requires commercial banks to allocate 12% of their capital for microfinance loans. Overall, there is a strong demand for microfinance services, as most Sudanese lack access to formal and informal credit; this could potentially be a large untapped market for impact investors.²⁸

Following the loss of large oil reserves and oil revenues in 2011, the government has sought to increase investments in other sectors, such as mining and agriculture, to expand its revenue sources.²⁹ In agriculture, the government has identified several commodities—including sugar, leather, and edible oils—to promote through tax breaks and foreign exchange allocations. As a result, the country's agricultural sector has attracted USD 230 million in greenfield investments³⁰ from Saudi and Qatari investors since 2013.³¹

27 Suna, "SDG 2 billion Allocated to Microfinance," *Sudan Vision Daily* (Mar. 17, 2014), available at <http://news.sudanvisiondaily.com/details.html?rsnpid=233421>.

28 "Doing Business for Sudan's Poorest," *The World Bank Group* (Apr. 4, 2013), available at <http://www.worldbank.org/en/news/feature/2013/04/04/building-businesses-for-sudan-s-poorest>.

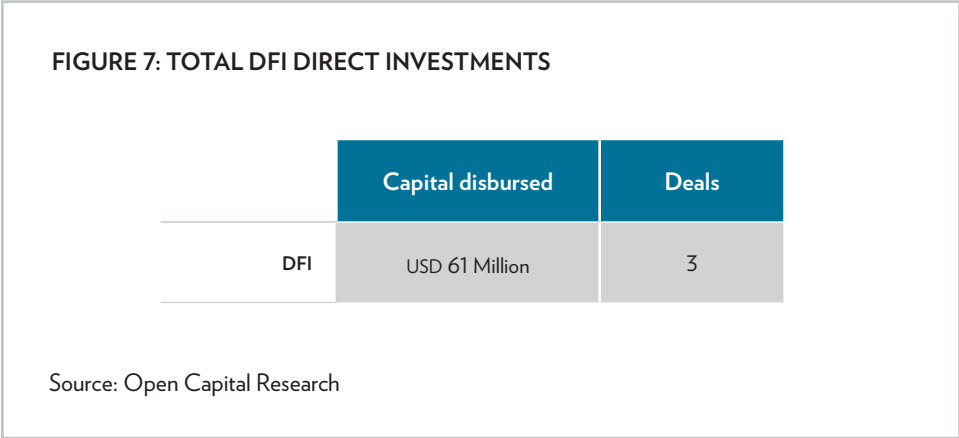
29 KPMG Africa, *Country Profile: Sudan* (2014), available at http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Sudan%20Country%20Profile_2012-2013.pdf.

30 A greenfield investment is one in which the investor starts a new venture in a foreign country by constructing new facilities from the ground up, rather than investing in an existing company.

31 Yousif M.A. Bashir Eltahir, Suwareh Darbo & Kabbashi M. Suliman, *The African Development Bank, African Economic Outlook: Sudan* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Soudan_EN.pdf.

Impact Capital Disbursed

At least 48 impact funds operating in the region list Sudan as one of their geographical focus countries. While there is no record of impact funds disbursing capital in Sudan, development finance institutions (DFIs) have disbursed at least USD 61 million to projects in Sudan despite the difficult investment climate.³² With their strong relationships to governments and global brands, DFIs seem to be more able to engage in difficult environments such as Sudan. However, there have been limited investments to date; the USD 61 million disbursed to date has been by one DFI across three investments in the sugar processing industry.



Instrument

The three aforementioned DFI investments were all via debt, but with so few data points it is difficult to reach any conclusions about preferred investment instruments. It is worth noting that Sudan has stringent laws in place which make foreign equity ownership difficult and may lead investors to opt for debt instruments, as long as these are compatible with Islamic financing laws.³³

32 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

33 “Starting a Foreign Business in Sudan,” *Afrbiz* (Sep. 1, 2010), available at <http://www.afrbiz.info/content/2010/starting-a-foreign-business-in-sudan>.

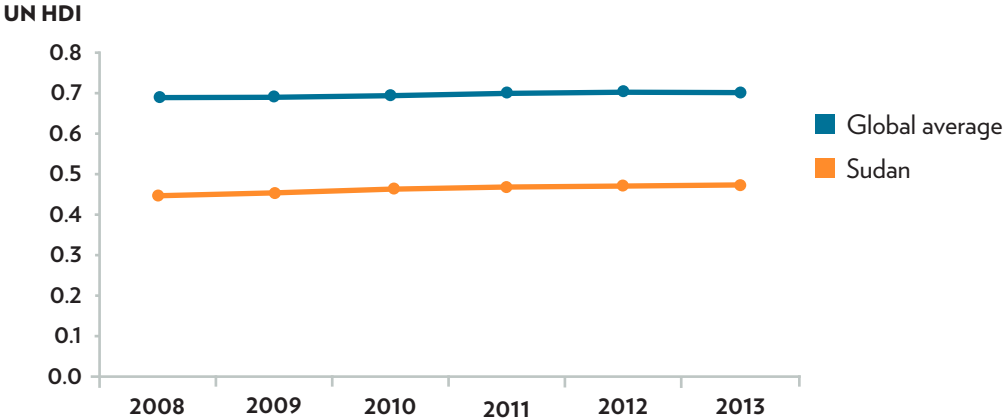
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Sudan’s oil wealth has not reached the vast majority of its population. Many Sudanese lack access to basic goods and services and functioning infrastructure. Provided the government can stabilize the country, minimize conflict, and foster a stable business environment, these gaps represent opportunities for the development of a variety of businesses.

Development Context

Although Sudan has experienced constant economic growth in the last decade, social conditions, as represented by the country’s human development indicators, have stagnated. Sudan’s UN Human Development Index (HDI) score of 0.47 in 2013 is on par with the regional average of 0.46, but well below the global average of 0.69 (Figure 8).³⁴ With this score, Sudan ranks 166th out of 187 countries and falls in the low human development category despite Sudan’s high GDP per capita, nearly 60% higher than the average in sub-Saharan Africa.³⁵

FIGURE 8: UN HDI SCORES, 2008-2013



Source: UN Human Development Report 2014. Note: 2014 report does not include 2009 HDI scores. 2009 scores shown are calculated as an average of 2008 and 2010 scores

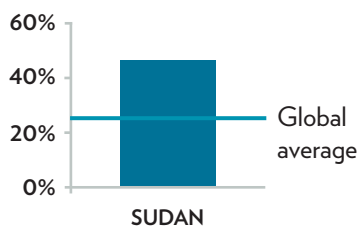
34 Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

35 Sub-Saharan Africa (Developing Only), *The World Bank Group*, available at <http://data.worldbank.org/region/SSA>.

This low ranking is reflected in key development indicators such as poverty, health, and education. Approximately 47% of the population lives on less than USD 1.25 per day, on par with the East African average of 49% yet more than twice the global average (Figure 9).³⁶ Poverty rates are substantially higher in Sudan's rural areas, with 58% of households living below the poverty line compared to 27% in urban areas.³⁷

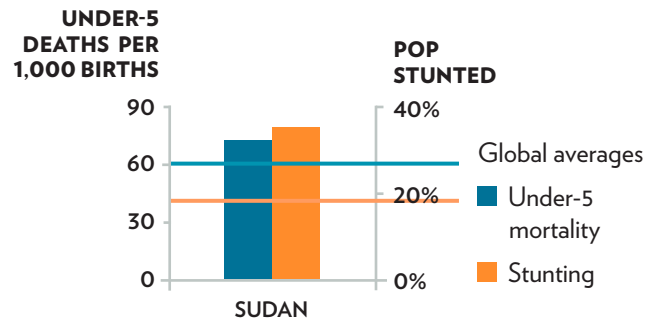
Sudan's health indicators are also far behind global standards. Sudan's under-5 mortality rate is 73 per 1,000 births, more than twice the global average of 30 but slightly better than the regional average of 80 (Figure 10).³⁸ Sudan's rate of stunting is more favorable at 35%, which is lower than the East Africa average of 40%.³⁹

FIGURE 9: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

FIGURE 10: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

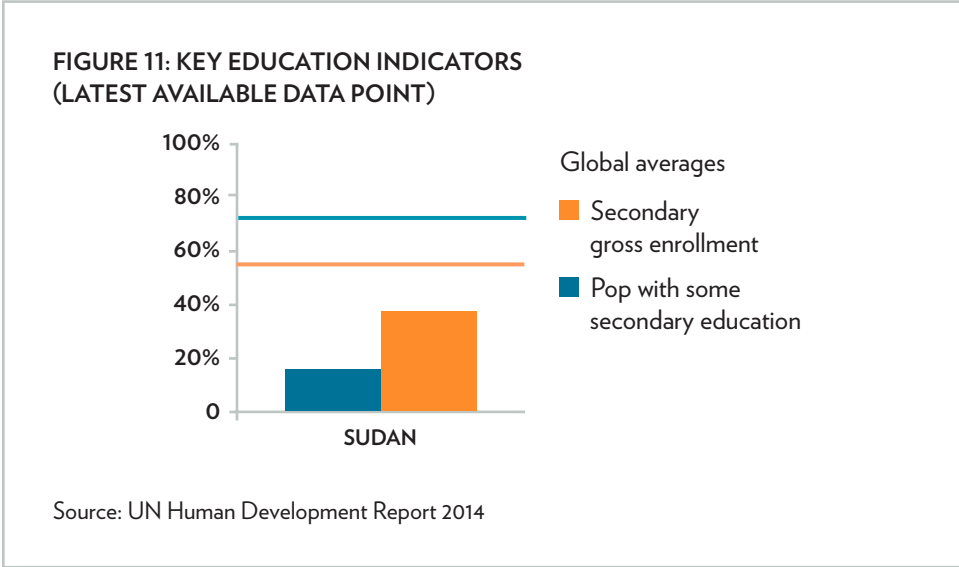
36 Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

37 *International Monetary Fund, Sudan: Interim Poverty Reduction Strategy Paper* (2013), available at <http://www.imf.org/external/pubs/ft/scr/2013/cr13318.pdf>.

38 Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

39 *Ibid.*

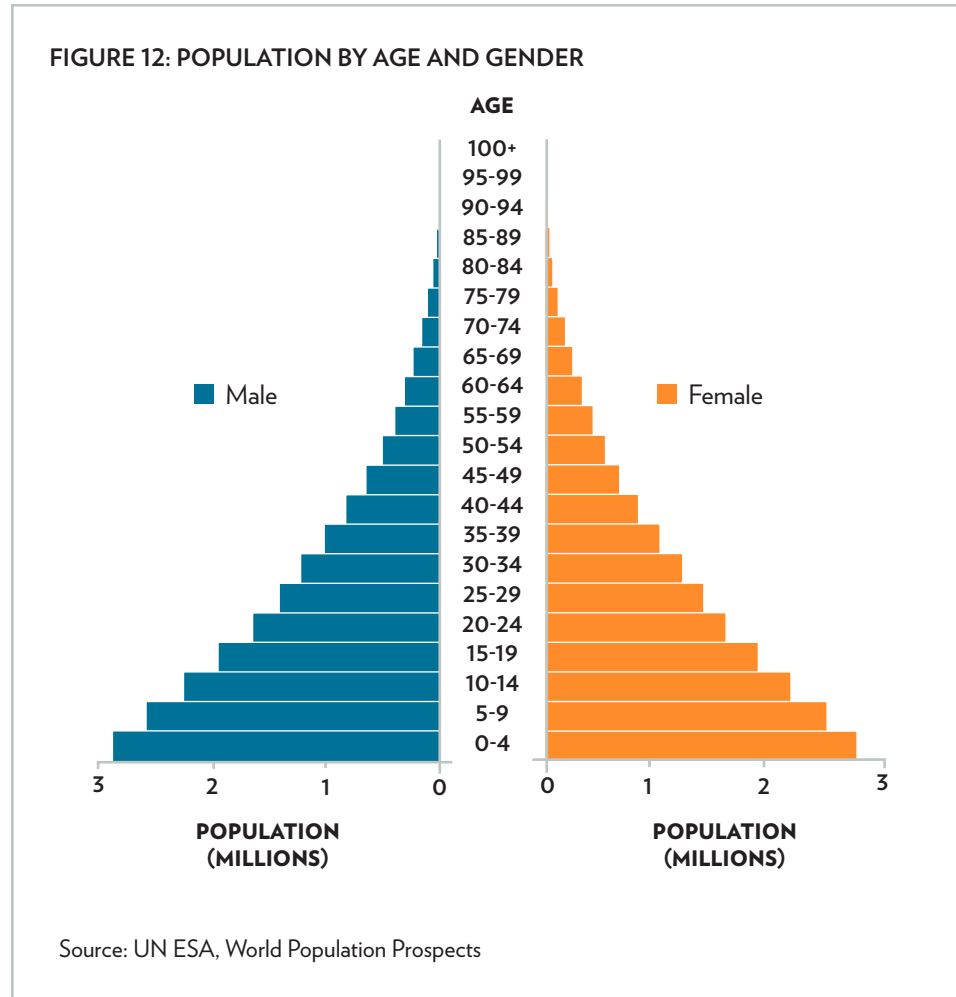
Education indicators are similarly discouraging. Only 16% of the population has received some form of secondary education, three times less than the global average, though on par with the regional average of 15% (Figure 11).⁴⁰ Of those who are of secondary school age, only 37% are currently enrolled in secondary school, which is slightly above the East African average of 33% but much less than half the global average of 80%.⁴¹



40 Human Development Statistics Tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

41 *Ibid.*

Like most countries in the region, Sudan's population is very young: around 62% of the population is aged 24 years and below (Figure 12).⁴² With low levels of education and ongoing conflict, Sudan's youth have struggled to find employment, resulting in a youth unemployment rate of approximately 24% since 2010.⁴³ However, with adequate investment in education, health, and social services, this group could drive future economic growth in Sudan.



42 2012 World Population Prospects, *United Nations Department of Economic and Social Affairs* (2012), available at http://esa.un.org/wpp/Excel-Data/EXCEL_FILES/1_Population/WPP2012_POP_F07_1_POPULATION_BY_AGE_BOTH_SEXES.XLS.

43 "Unemployment, Youth Total (% of Total Labor Force Ages 15-24)", *The World Bank Group*, available at <http://data.worldbank.org/indicator/SL.UEM.1524.ZS>.

A challenging demographic trend is Sudan's ongoing migration. More than 94,000 workers left Sudan in 2012, up from 10,000 workers in 2008. The majority are seeking employment abroad in medical and technical fields.⁴⁴ Common destinations for migrants include Saudi Arabia, Kuwait, United Arab Emirates, and Qatar. Many of these migrant workers send remittances back to Sudan, totaling USD 1.1 billion in 2012, which helped offset the country's widening trade deficit.⁴⁵ Nevertheless, prolonged migration of skilled workers could present a serious problem for investors and entrepreneurs in Sudan as it limits the availability of skilled and educated talent.⁴⁶

Entrepreneurs

Sudan is a challenging environment for entrepreneurs. It ranks 160th out of 189 countries in the 2015 World Bank's Ease of Doing Business rankings, a decline from 153rd in 2014. Access to credit in Sudan can be especially challenging for entrepreneurs and others as Sudan's bankruptcy and collateral laws do not generally favor borrowers. Sudan has, however, made some improvements that may enhance access to credit, including the establishment of a private credit bureau.⁴⁷

Increasing costs for inputs, labor, and distribution present additional challenges for Sudanese enterprises. Imported inputs are particularly expensive due to rising exchange rates and high import duties of up to 40%.⁴⁸ In 2012, the government raised the minimum wage by almost a factor of three, which has increased labor costs for businesses.^{49,50} Poor infrastructure throughout the country further increases the cost of doing business, especially outside Sudan's main urban areas.

44 "Thousands Flee Crisis-Hit Sudan In 'Brain Drain'," *Gulf News* (Mar. 7, 2013), available at <http://gulfnews.com/news/region/sudan/thousands-flee-crisis-hit-sudan-in-brain-drain-1.1155315>.

45 "Remittance Flows Worldwide in 2012," *Pew Research Center's Social & Demographic Trends Project* (Feb. 20, 2014), available at <http://www.pewsocialtrends.org/2014/02/20/remittance-map/>.

46 Ulf Laessing, "Tired of Economic Crisis, Sudanese Try Luck Abroad," *Reuters* (May. 15, 2013), available at <http://in.reuters.com/article/2013/05/15/us-sudan-emigration-idINBRE94E0OY20130515>.

47 The World Bank, *Doing Business 2015: Going Beyond Efficiency: Economy profile 2015* (2014), available at <http://www.doingbusiness.org/data/exploreeconomies/sudan/-/media/giawb/doing%20business/documents/profiles/country/SDN.pdf?ver=2>.

48 Yousif M.A. Bashir Eltahir, Suwareh Darbo & Kabbashi M. Suliman, *The African Development Bank, African Economic Outlook: Sudan* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Soudan_EN.pdf.

49 "Cash-starved Sudan to double minimum wage," (Dec. 30, 2012), available at <http://www.dailystar.com.lb/News/International/2012/Dec-30/200394-cash-starved-sudan-to-double-minimum-wage.ashx#axzz3KFVwiq4y>.

50 "Sudanese president officially signs off on increasing minimum wage," *Sudan Tribune* (Oct. 3, 2013), available at <http://www.sudantribune.com/spip.php?article48307>.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

Even though Sudan has a challenging regulatory environment, the rapidly growing economy may begin to support an active ecosystem over time.

Regulatory Environment

The Sudanese government has attempted to develop a regulatory framework to support the development of trade and enterprise. However, numerous regulations still limit foreign investment, including restrictions on foreign exchange and foreign entry into certain sectors:

- **Sanctions:** Sudan remains subject to economic, trade, and financial sanctions imposed by the United States and the UN. While not all countries have complied with the sanctions—for instance, Sudan has increased trade with Asia and borrowing from Gulf States⁵¹—they nevertheless limit opportunities for investors and entrepreneurs.
- **Repatriation of profits and dividends:** Sudan's 2013 Investment Act permits foreign and domestic entities to repatriate capital and profits from business operations in Sudan. However, the law requires that investors open investment accounts at the Central Bank of Sudan (CBOS) before they enter into business. The CBOS must subsequently approve transfer of foreign currency from Sudan. In some instances, the government has restricted repatriation of profits as a means to manage foreign exchange deficits, thus posing a risk for international investors.⁵² Some foreign investors working on large projects have attempted to mitigate this by establishing preemptive contracts with the government clearly defining capital repatriation terms.⁵³
- **Foreign exchange controls:** Given the importance of oil to Sudan's economy and government revenues, reductions in the price of crude oil coupled with the effects of the global financial crisis of 2008 have led to shortages of public foreign exchange reserves. As a result, the government has significantly tightened conversion and transfer policies.⁵⁴ Even though foreigners are permitted to hold foreign currency accounts in commercial banks, access to foreign currency can often be delayed or limited. It is not unusual for the government to abruptly

51 Katrina Manson, "US Sanctions take toll on Khartoum," *Financial Times* (Jul. 23, 2014), available at <http://www.ft.com/intl/cms/s/0/96af3278-d1a5-11e1-bbbc-00144feabdc0.html#axzz3K49aEbbL>.

52 "Zain Sudan repatriated part of its profit abroad in 2012," *Sudan Tribune* (Mar. 21, 2013), available at <http://www.sudantribune.com/spip.php?article45919>.

53 "Lebanese firm to invest \$800M in Sudan agriculture project," *Al Arabiya* (May 23, 2013), available at <http://english.alarabiya.net/en/business/economy/2013/05/23/Lebanese-firm-invests-800m-in-Sudan.html>.

54 KPMG, *Country Profile: Sudan* (2014), available at http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Sudan%20Country%20Profile_2012-2013.pdf.

change policies on currency access and conversion, creating uncertainty and risk for investors.⁵⁵

- **Land ownership:** While Sudan permits the purchase of privately or publicly held land, sales have been rare to date. Sudan's policies governing land lease place no restrictions on the amount or duration; however, any transfers of a lease must receive government approval.⁵⁶ Sudan's government has tried to attract foreign investors by providing access to land while retaining ownership. These allocations include 25,000 hectares to Jordan and 690,000 hectares to South Korea for wheat farming in 2008.
- **Local ownership requirements:** Foreign investors do not need a local partner or sponsor,⁵⁷ and companies operating in Sudan may be 100% foreign owned.
- **Restrictions by sector and instrument:** Although Sudan's government has attempted to open the economy to foreigners and has no local ownership requirements, it maintains restrictions on foreign equity ownership in certain sectors. Foreigners are not permitted to invest in railway freight transportation, airport operation, television broadcasting, and newspaper publishing. Other sectors such as telecommunications, electricity, and financial services also have restrictions on foreign ownership.⁵⁸
- **Government enterprises:** Sudan's government operates enterprises across several sectors, which can distort markets and impede market entry of new businesses. The government announced a privatization campaign in 2011 but has yet to enact this in practice.⁵⁹ Examples of state-owned businesses can be found in financial services,⁶⁰ air travel,⁶¹ rail travel,⁶² television,⁶³ and print media.⁶⁴
- **Government control of the internet:** While internet use and penetration have increased in Sudan, the Sudanese government has instituted controls on internet

55 US Department of State, *2013 Investment Climate Statement-Sudan* (2013), available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204736.htm>.

56 KPMG, *Country Profile: Sudan* (2014), available at http://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/2012-2013%20Country%20Profiles/Sudan%20Country%20Profile_2012-2013.pdf.

57 "African Empowerment Policies Compared," *Lex Africa* (Aug. 2010), available at <http://www.lexafrica.com/news-african-empowerment-policies-compared>.

58 "Starting a Foreign Business in Sudan," *Afrbiz* (Sep. 1, 2010), available at <http://www.afrbiz.info/content/2010/starting-a-foreign-business-in-sudan>.

59 US Department of State, *2013 Investment Climate Statement: Sudan* (2013), available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204736.htm>.

60 "Sudan Names New Central Bank Governor," *Islamic Finance* (Dec. 16, 2013), available at <http://www.islamicfinance.de/?q=node/5872>.

61 Ulf Laessin, "Sudan Dreams Big With New Airports Despite Crashes," *The Globe and Mail* (Oct. 31, 2012), available at <http://www.theglobeandmail.com/report-on-business/international-business/african-and-mideast-business/sudan-dreams-big-with-new-airports-despite-crashes/article4801520/>.

62 "Sudan Railways Corporation," *Institute of Developing Economies*, available at http://www.ide.go.jp/English/Data/Africa_file/Company/sudan05.html.

63 IREX, *Media Sustainability Index* (2008), available at http://www.irex.org/system/files/2-Africa_08_sudan.pdf.

64 Stanhope Centre for Communication Policy and Research, *Sudan Media Brief*, available at <http://www.stanhopecentre.org/training/EA/Sudan.doc>.

access and content. These include an Internet Service Control division within the National Telecommunication Corporation whose function is to censor internet content. For instance, it responded to protests in September 2013 by disabling the internet for a day across the country.⁶⁵

Ecosystem Players

There are very few intermediaries and service providers with offices in Sudan. Most have regional offices and include Sudan as one of the countries they cover. Competitions such as Africa Enterprise Challenge Fund and Global Social Venture Competition will often consider enterprises that are based in Sudan. There are also a mix of accelerators and incubators outside Sudan that consider Sudanese businesses. There are a number of international NGOs with programs in Sudan, including AMREF, World Vision International, Save the Children UK, and Oxfam. All run a wide variety of impact programs in health, education, water, nutrition, and gender issues,⁶⁶ but do not make investments in Sudanese businesses.

65 Freedom House, *Freedom on the Net - Sudan* (2013), available at <https://freedomhouse.org/report/freedom-net/2013/sudan>.

66 "Profiles of NGOs Operating in Sudan," *Partners and Food in Emergency and Development Aid*, available at http://pfeda.univ-lille1.fr/Ethiop/ngopro_su.htm.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Sudan is a challenging market for private investors and has seen very little impact investing activity as a result. Impact investors considering placing capital in Sudan should be particularly aware of the following constraints:

- **Sanctions:** As long as Sudan is still subject to economic, trade, and financial sanctions, investors will have limited ability to deploy capital. Growth prospects and return expectations must be tempered for those who do invest in Sudan as sanctions will continue to limit the country's long-term economic development.
- **Limited talent:** As the country has been wracked by decades of civil war, much of the population has received inadequate access to education. Without these opportunities, there are a limited number of people with the skills and background required to develop dynamic businesses with the potential to scale and have impact. Many of those with these skills have left Sudan to escape conflict and seek opportunities elsewhere.
- **Poor regulatory system:** Sudan's unfavorable regulatory environment makes it challenging to start and grow businesses in the country. Numerous factors, including government restrictions on private entry into certain sectors, insufficient protection for lenders, and endemic corruption need to be resolved to make Sudan a more suitable environment for entrepreneurs and investors.

Opportunities

Even though Sudan's business environment is challenging, the country's steady economic growth demonstrates there are opportunities for investors to seek social and financial returns, including:

- **Economic diversification:** While South Sudan's secession had a negative impact on the Sudanese economy with the loss of 75% of oil resources and 36% of government revenue, it also presents an opportunity for economic diversification. With reduced oil resources, the government has begun to stimulate other sectors of the economy, which could develop new businesses and investment opportunities for impact investors.
- **Investing in technical assistance to build pre-investment pipeline:** Sudan has very few intermediaries and service providers providing advisory and business development services to local enterprises. Impact investors could replicate models

in other countries in the region where pre-investment technical assistance has helped businesses grow to investment readiness.

While economic diversification and development of technical assistance in South Sudan are promising for the broader economy as a whole, several sectors present possible opportunities for social enterprise:

- **Basic health and education:** Sudan's poor ranking in health, education, and poverty indicators demonstrate that the government has struggled to provide adequate public services, a gap that could be filled by private enterprise. With the right policies in place, these are sectors that could yield double-bottom line returns by improving healthcare outcomes and increasing educational attainment.⁶⁷
- **Agribusiness:** Agriculture in Sudan, especially at small scale, remains highly undeveloped. Most agricultural technology deployed in Sudan is focused on industrial crops, neglecting the needs of small-scale farmers. The absence of modern technologies and mechanization is a limiting factor even for commercial agriculture. Businesses providing improved agricultural technology, inputs, and access to credit could help boost productivity and improve economic and nutritional outcomes.⁶⁸
- **Mobile and e-commerce:** Mobile and internet penetration in Sudan have grown rapidly over the last decade. The number of mobile phone subscribers grew by approximately 44% annually from 1 million in 2004 to nearly 28 million by 2013. Similarly, more than 22% of Sudan's population now has internet access, up from less than 1% in 2004. Sudan's internet penetration rate is now second only to Kenya's in the region. Entrepreneurs with the right skill sets could capitalize on this growth in connectivity while achieving substantial social impact, for instance with mobile money, mobile insurance, or mobile education products.

67 Human development statistics tables, *United Nations Development Programme* (2014), available at http://hdr.undp.org/sites/default/files/hdr14_statisticaltables.xls.

68 Abdelrazig Elbashir, et al., *Food and Agriculture Organization, Sudan-Poverty Reduction & Programs in Agriculture* (2004), available at http://coin.fao.org/coin-static/cms/media/5/12825482911700/sudan_poverty_strategy_paper_agricultural_sector.doc.



ERITREA

A CLOSED ECONOMY,
SLOWLY OPENING

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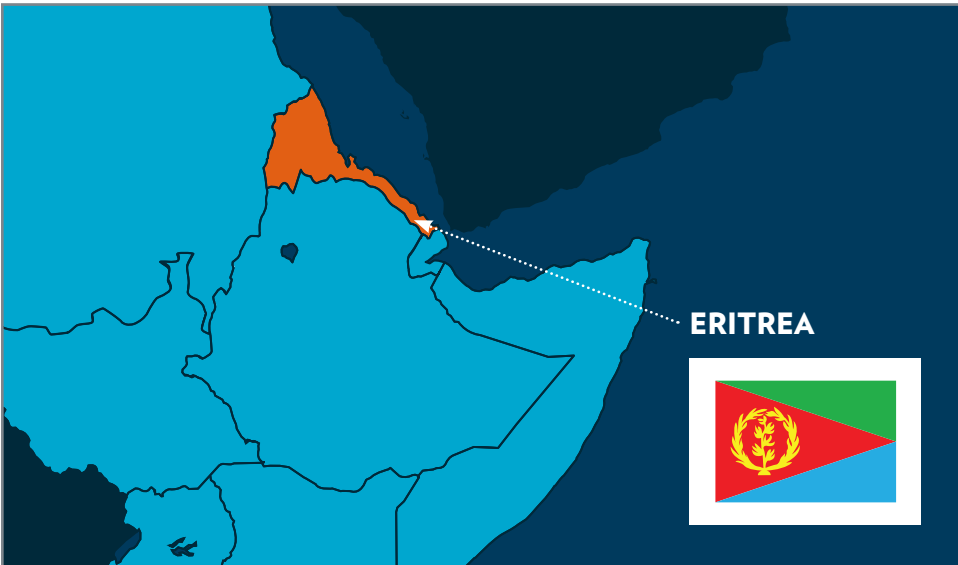
INTRODUCTION

Eritrea is one of the world’s most closed economies. It has no constitution, functioning legislature, independent judiciary, elections, independent press, or non-governmental organizations. Eritrea gained independence from Ethiopia in 1993, and has since been ruled by the People’s Front for Democracy and Justice (PFDJ). All power is concentrated in the hands of the government. The PFDJ established a policy of “self-reliance” that restricts foreign investment and aid from foreign organizations on the grounds that these have too many conditions and infringe on national sovereignty.

Due to Eritrea’s closed economy, difficult regulatory environment, and small private sector, there has been no known impact investing in the country to date. Although there are some indicators that the economy is liberalizing and the regulatory environment is improving, Eritrea is still a challenging market for investors.

Eritrean businesses need support to grow and create wealth. The most promising investment areas for future impact investors are agriculture, aquaculture, and tourism. Given the lack of development and sophistication of the private sector, however, investors will likely need to invest in significant technical assistance for their portfolio.

FIGURE 1: MAP OF ERITREA



COUNTRY CONTEXT

Since gaining independence from Ethiopia in 1993, Eritrea has faced intense economic challenges stemming from a volatile political situation and restrictive economic policies. A former Italian and British colony, Eritrea was established by the United Nations (UN) as an autonomous entity federated within Ethiopia in 1952. A decade later the government of Ethiopia dissolved the Eritrean parliament and annexed the country, triggering a 32-year struggle for independence.

Eritrea declared independence from Ethiopia in 1993 through a UN-sponsored referendum, in which more than 99% of the population voted for independence.¹ All power is concentrated in the hands of President Afwerki,² who has been in power since independence. His party, the PFDJ, is the sole legal political party.³

Relations between Eritrea and Ethiopia were tense in the years following independence, culminating in a border war between the two countries in 1998.⁴ After several years of mediated efforts to provide an agreeable ruling on the border dispute, a peace agreement was eventually brokered at the end of 2009. However, the two countries disagree on the implementation of the peace plan, and recently both countries remilitarized their borders.⁵ In 2008, there were clashes along the Eritrea-Djibouti border, and Eritrea was condemned by the international community for initiating hostilities.⁶ Eritrea has also been accused of supporting armed militant groups in Somalia.

The international community has condemned these conflicts. Shortly after independence in 1992, the UN imposed an arms embargo on Eritrea, and in 2009 the UN Security Council imposed new sanctions against the ruling party's elites, including an arms embargo, a travel ban, and an asset freeze.⁷ The sanctions were a result of Eritrea's support for armed insurgents in Somalia and its refusal to release Djiboutian prisoners of war captured during a 2008 invasion of Djiboutian territory.⁸

1 Crisis Group Africa, *Eritrea: The Siege State* (2010), available at <http://www.crisisgroup.org/-/media/Files/africa/horn-of-africa/ethiopia-eritrea/163%20Eritrea%20The%20Siege%20State.pdf>.

2 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

3 Crisis Group Africa, *Eritrea: The Siege State* (2010), available at <http://www.crisisgroup.org/-/media/Files/africa/horn-of-africa/ethiopia-eritrea/163%20Eritrea%20The%20Siege%20State.pdf>.

4 US Department of State, "A Brief History of Eritrea-Part 1," *about education*, available at <http://africanhistory.about.com/od/eritrea/p/EritreaHist1.htm>.

5 Habtemicael Weldegiorgis, International Federation of Surveyors, *The Cadastral System in Eritrea: Practice, Constraints and Prospects* (2009), available at https://www.fig.net/pub/monthly_articles/september_2009/september_2009_weldegiorgis.pdf.

6 UNSC, "Security Council Committee pursuant to resolutions 751 (1992) and 1907 (2009) concerning Somalia and Eritrea," UN Site, available at <http://www.un.org/sc/committees/751/>.

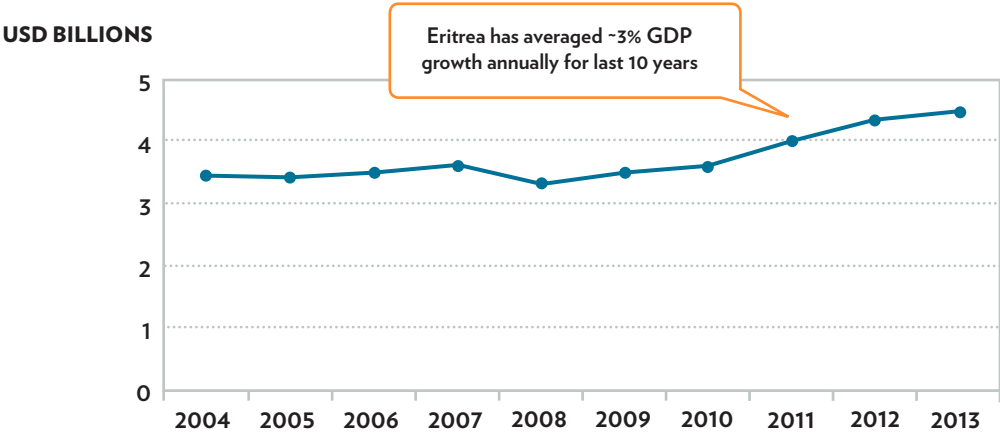
7 *Ibid.*

8 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

Gross Domestic Product

GDP growth in Eritrea has been irregular over the past decade, averaging 3% annually (Figure 2). In 2011, Eritrea recorded an 11% GDP growth rate, making it one of the fastest growing economies in the world.⁹ This sharp increase in GDP resulted from the commencement of gold production in the country. However, Eritrea's economic growth rate fell sharply to 1.1% in 2013 following a decline in economic activity in most sectors except mining, as well as a decline in remittances into the country.¹⁰ GDP was expected to grow at 1.9% in 2014 from 2013 levels of USD 4.5 billion (PPP).¹¹

FIGURE 2: GDP (PPP), 2004-2013



Source: IMF World Bank Economic Indicators, April 2014

9 "Eritrea Overview (2012)," *The World Bank*, available at <http://www.worldbank.org/en/country/eritrea/overview#1>.

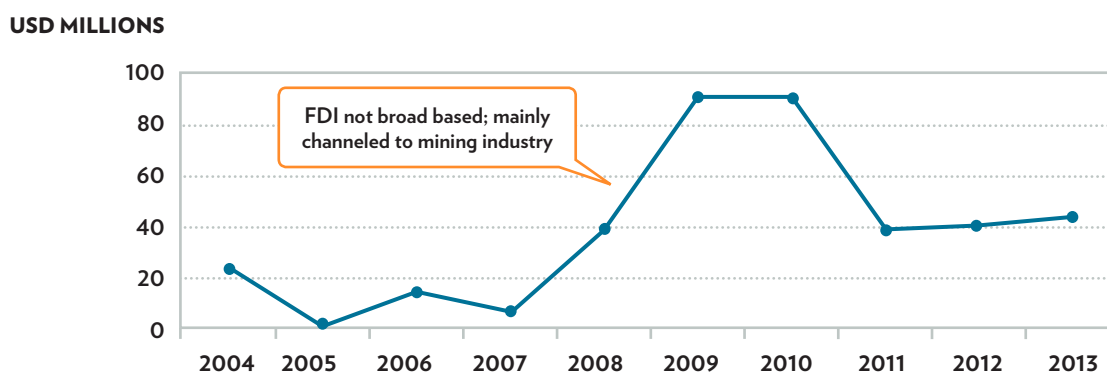
10 Magidu Nyende & Luka Okumu, UNDP, *African Economic Outlook (2014)*, available at <http://www.er.undp.org/content/dam/eritrea/docs/MDGs/AfricanEconomicOutlookEritrea2014.pdf>.

11 "Eritrea Economic Outlook," *African Development Bank Group (2014)*, available at <http://www.afdb.org/en/countries/east-africa/eritrea/eritrea-economic-outlook/>.

Foreign Direct Investment

Mineral production has also boosted foreign direct investment (FDI) inflows into the economy. Between 2011 and 2013, FDI in Eritrea grew by 13% (Figure 3), and FDI inflow is projected to increase again in 2014, with growing interest in the country's mining sector expected to be the main driver.¹² Nevertheless, Eritrea has the second lowest FDI inflows in East Africa, largely due to the country's isolation from the global community and unstable economy.

FIGURE 3: FDI FLOWS, 2004–2013



Source: UNCTAD

Historically, diaspora remittances have been an important source of capital. The government has a 2% “recovery and development tax” (or “diaspora tax”) that all Eritreans living abroad are required to pay. In the mid-2000s, these remittances were estimated to account for 20% of GDP.¹³ However, recent UN sanctions restrict the transfer of this tax due to concerns that the diaspora tax is being used in efforts to destabilize the region (e.g., to purchase arms for opposition groups).¹⁴ As a result, remittances declined to 10% of GDP in 2012 and are expected to continue to decline. Effects of the sanctions include a sharp decline in flow of hard currency to the country and a weakening of the country's overall financial position.¹⁵

12 COMESA, *Foreign Direct Investment and small and medium enterprise linkages in COMESA* (2013), available at <http://investmentpolicyhub.unctad.org/Upload/Documents/2013%20COMESA%20Investment%20Report.pdf>.

13 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

14 United Nations, *Security Council, by Vote of 13 in Favour, Adopts Resolution Reinforcing Sanctions Regime against Eritrea 'Calibrated' to Halt All Activities Destabilizing Region*, (2011) available at <http://www.un.org/press/en/2011/sc10471.doc.htm>.

15 Magindu Nyende & Luka Okumu, *AFDB, African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9_EN.pdf.

Inflation and Exchange Rates

Inflation is an ongoing problem in Eritrea as the country has averaged double-digit inflation over the past decade. Estimated inflation for 2013 was over 12% and is expected to remain at similar rates in upcoming years.¹⁶ The main drivers of inflation have been scarcity-induced rising food prices and ongoing defense expenditures.¹⁷

The Central Bank of Eritrea (CBE) was formed in 1994 and is the sole institution in the country providing retail and commercial banking services.¹⁸ The bank also controls the state's foreign exchange policy. For the past decade, Eritrea's currency, the Nafka, has been pegged at 15 Nafka to the USD, but given inflation, the Nafka is generally believed to be substantially overvalued.¹⁹

16 "World Economic Outlook Database," *International Monetary Fund* (2013), available at <http://www.imf.org/external/pubs/ft/weo/2013/02/weodata/index.aspx>.

17 "Eritrea Economic Outlook," *African Development Bank Group* (2014), available at <http://www.afdb.org/en/countries/east-africa/eritrea/eritrea-economic-outlook/>.

18 Bekezela Ncube, Wharton, *Eritrea*, available at <http://fic.wharton.upenn.edu/fic/africa/Eritrea%20Final.pdf>.

19 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012*(2012), available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

SUPPLY OF IMPACT CAPITAL

To date, there has been no known impact investing in Eritrea. This is predominantly due to the same factors that limit general foreign investment in the country: a closed and centrally planned economy, restrictive government policies, and few desirable investment opportunities.

Broader Investing Landscape

Eritrea is an incredibly challenging environment for investors, in large part due to its self-reliance policy (see text box). Eritrea stopped requesting financial aid from the United States in 2005 and in 2006 blocked aid from third-party NGOs funded by western nations.²⁰ The government, however, appears to be softening its stance on this in recent years.²¹ In 2013, the government of Eritrea and the UN agreed on a four-year USD 188 million cooperation framework for capacity building, food security, environmental improvements, and social services. Under the framework, the UN will provide USD 50 million in grant funding and attempt to raise the remaining money from donor countries.²² Other recent evidence of efforts to drive development include:

- The Global Health Fund provided a government grant to improve basic services.
- The International Fund for Agricultural Development (IFAD) supported the national agriculture project through a USD 17.8 million grant to the national government.
- The Abu Dhabi Fund for Development (ADFD) extended an AED 183.6 million concessionary loan to the government to help meet its budgetary deficit.
- The African Development Bank (AfDB) Group loaned USD 19.2 million to the government to improve equitable access to vocational education and training.

Recent trends in the general investment sector show signs of the economy beginning to liberalize, which may enable impact investors to move into the country. These trends include increasing privatization of state-owned enterprises, gradual opening to foreign investors, and a softening of the government's self-reliance policy, as well as an increase in private investment, particularly in the mining sector.

ERITREA'S SELF-RELIANCE POLICY

Beginning with independence, the government of Eritrea established a policy of strict self-reliance, turning away foreign aid and expelling the UN from the country. The government has said that it is best qualified to look after the interests of its citizens. The government has also accused the UN and the West of failing to resolve the border dispute with Ethiopia.

20 Mawuna Remarque Koutonin, "We Don't Want Aid. Please Keep it for Your Local Poor!," *Eritrea-Ministry of Information*, (April 18, 2014), available at <http://www.shabait.com/categoryblog/16773-we-dont-want-aid-please-keep-it-for-your-local-poor>.

21 Edmund Sanders, "Eritrea Aspires To Be Self-Reliant, Rejecting Foreign Aid," *Los Angeles Times* (Oct. 2, 2007), available at <http://www.latimes.com/world/la-fg-eritrea2oct02-story.html#page=1>.

22 "World Report: Eritrea (2014)," *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

Since 2013, the government has begun privatizing state-owned firms in a plan to encourage private sector participation in the country. In total, 13 large- and medium-sized enterprises were identified for privatization including the Eritrean Telecommunication Company, Asmara Breweries, and the National Insurance Corporation of Eritrea.²³ South Africa Breweries is currently in negotiations to acquire Asmara Breweries,²⁴ while the government has already sold part of its stake in the telecommunications business to domestic investors.²⁵

To attract foreign investors, the Eritrean government has developed free trade zones in the port cities of Massawa and Assab. Investors operating in these zones are exempt from paying taxes on profits or dividends. Eritrea also provides relief from duties and taxes on imports that receive value-added processing prior to export.²⁶ The zones allow 100% foreign ownership and repatriation of profits. However, very few foreign companies operate in the zones, which are marred by corruption and alleged smuggling of consumer goods across the border to Sudan.²⁷ Most companies that have expressed interest have been Chinese firms.²⁸

Eritrea is also investing in infrastructure and expanding its road network, particularly to mines and free trade zones.²⁹ The government is strongly encouraging companies and individuals to invest in infrastructure projects, particularly in building residential housing, roads, airports, ports, and hospitals.³⁰

Despite the liberalizing of the economy, accessing capital remains difficult. The central bank controls all retail and commercial activities in the country. The bank holds 90% of the country's deposits and 80% of private sector claims.³¹ Collateral requirements can reach 100% of the loan value, which severely limits borrowers. The CBE prefers lending to large state-owned and private manufacturing firms, which are considered low risk, and controls interest rates to meet the country's development objectives.³²

23 "Eritrea to Re-start Aggressive Privatization Program," *Tefsanews* (Dec. 27, 2013), available at <http://www.tefsanews.net/eritrea-to-re-start-aggressive-privatization-program/>.

24 "More Foreign Companies are Seeking Business with Eritrea," *Madote* (Nov. 23, 2013), available at <http://www.madote.com/2013/11/more-foreign-companies-are-seeking.html>.

25 "Eritrea Offers Stake in EriTel to Domestic Buyers Only," *Telecompaper* (Jan 7, 2013), available at <http://www.telecompaper.com/news/eritrea-offers-stake-in-eritel-to-domestic-buyers-only--917220>.

26 Eritrea Investment Center, *Investment Policies and Opportunities of the State of Eritrea* (2003), available at http://www.eritreaembassy-japan.org/data/Investment_Policy_and_Opportunities_of_the_state_of_Eritrea.pdf.

27 "2012 Investment Climate Statement: Eritrea," *US Department of State*, available at <http://www.state.gov/e/eb/rls/othr/ics/2012/191144.htm>.

28 "2014 Investment Climate Statement: Eritrea", *US Department of State*, available at <http://www.state.gov/documents/organization/227167.pdf>.

29 Magindu Nyende & Luka Okumu, UNDP, *African Economic Outlook: Eritrea* (2014), available at <http://www.er.undp.org/content/dam/eritrea/docs/MDGs/AfricanEconomicOutlookEritrea2014.pdf>.

30 *Ibid.*

31 Bekezela Ncube, Wharton, *Eritrea*, available at <http://fic.wharton.upenn.edu/fic/africa/Eritrea%20Final.pdf>.

32 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012*(2012), available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

Impact Capital Disbursed

Despite the government relaxing its self-reliance policy and an increase in general investment activity, to date there are no documented examples of impact funds investing in Eritrea. There is approximately USD 840 million in committed impact capital from regional investors who consider the entire region, but based on historical deal flow it seems unlikely that much of this capital will flow to Eritrea.

To date, all DFI³³ capital disbursed has been to government agencies and programs (as outlined in the 'Broader investing landscape' section above) rather than to private sector players. Please see the Introduction and Methodology chapter for more detail on the definition of impact investing used throughout this report.

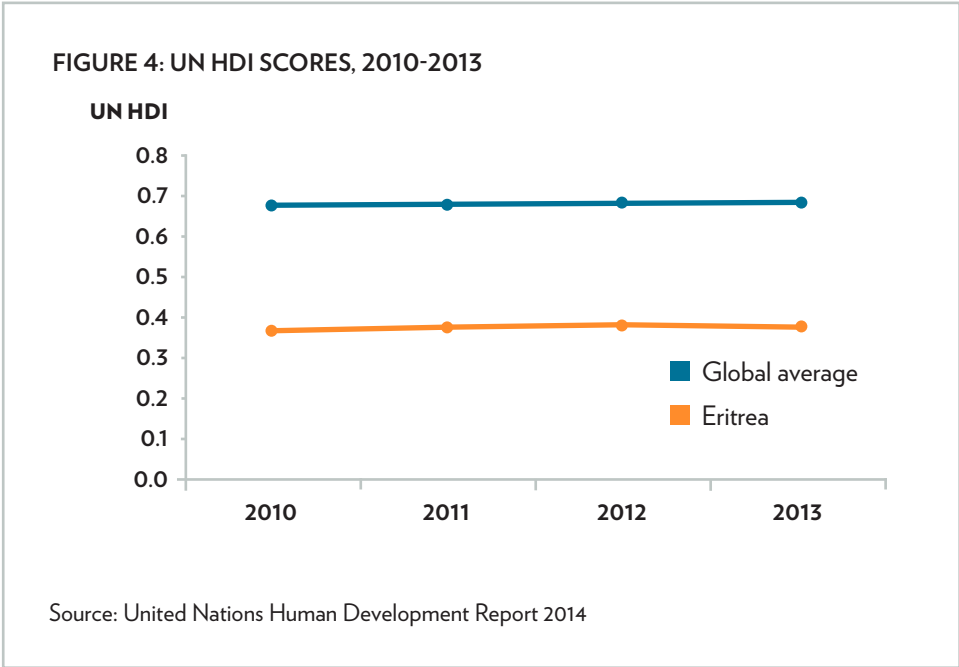
³³ Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors ("non-DFI"), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Given the poverty levels in the country, many Eritrean businesses implicitly have a social impact by targeting base of pyramid (BoP) consumers, addressing a social need and/or having an impact within the communities in which they operate. Such businesses may be of interest to impact investors.

Development Context

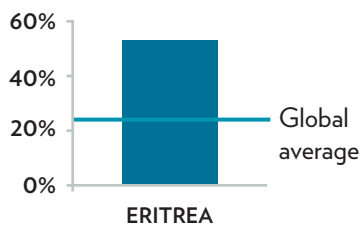
Eritrea is one of the least developed countries in the world, ranked 181st out of 187 countries on the UN’s Human Development Index. It struggles to provide important social services for its population, which is reflected in the country’s HDI score. Although data is only available since 2010, Eritrea’s aggregate HDI score in that time has been no higher than 0.38 (Figure 4), lower than the regional average of 0.43 and far behind the global average of 0.68. It is estimated that more than 53% of Eritreans live under the poverty line, earning less than USD 1.25 per day (Figure 5), while 37% of the rural population lives in extreme poverty.³⁴



34 WHO, *Health Action in Crises: Eritrea* (2008), available at http://www.who.int/hac/crises/eri/eritrea_oct08.pdf.

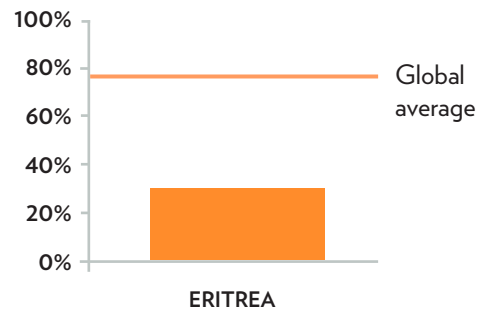
Eritrea has invested in education since independence and, as a result, literacy rates compare favorably with other East African countries. Gross enrollment in secondary school was 32% in 2010 (Figure 6) compared to 36% in Ethiopia and 28% in Uganda.³⁵

FIGURE 5: POPULATION BELOW USD 1.25/DAY (LATEST AVAILABLE DATA POINT)



Source: World Health Organization

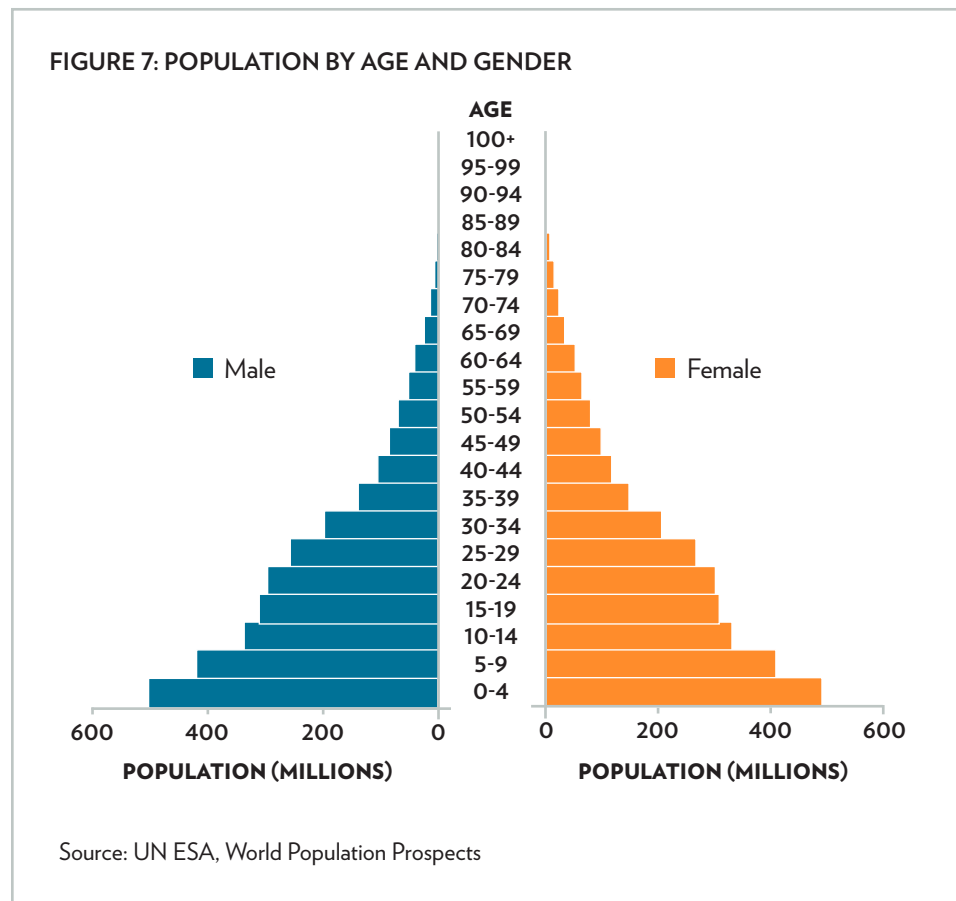
FIGURE 6: SECONDARY SCHOOL GROSS ENROLLMENT



Source: UN Human Development Report 2014

³⁵ UNESCO, *Education For All Global Monitoring Report, Regional Fact Sheet, Education in Eastern Africa* (2013), available at <http://unesdoc.unesco.org/images/0021/002193/219351e.pdf>.

Like the rest of East Africa, Eritrea has a disproportionately young population (Figure 7). Half of its youth are unemployed³⁶ and skills are not being developed to match the demands of the labor market. In addition, the absence of data on youth and labor limits the government’s ability to make informed policy decisions.



Eritrea’s mandatory military conscription policy has exacerbated the shortage of young talent. Due to the long-standing conflict with Ethiopia, as well as recent border skirmishes with Djibouti, all Eritrean men and unmarried women under the age of 50 must complete compulsory military service, and are enlisted for indefinite periods. Hundreds of thousands of Eritrea’s most productive workers are employed by the army, with an estimated one in 20 Eritreans living in army barracks.³⁷ As a result, a significant share of the most productive section of Eritrea’s population is committed to compulsory military service, greatly limiting the labor force and weakening the private sector.³⁸

There has been a mass exodus of Eritreans fleeing forced conscription and other human rights violations in the country, further decreasing available labor. Human Rights Watch characterizes human rights conditions in Eritrea as “dismal,” citing

36 AfDB, OECD, UNDP, UNECA, *African Economic Outlook: Eritrea 2012*, available at http://www.youthpolicy.org/national/Eritrea_2012_Youth_Employment_Briefing.pdf.

37 “National Service in Eritrea, Miserable and Useless,” *The Economist*, (Mar. 10, 2014), available at <http://www.economist.com/blogs/baobab/2014/03/national-service-eritrea>.

38 Sally Healy, Chatham House et. al, *Eritrea’s Economic Survival* (2007), available at <https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/200407eritrea.pdf>.

indefinite military service, extreme restrictions on freedoms of expression and religion, torture, and arbitrary detention as some of the worst offences.³⁹ Since independence, an estimated 6% of the Eritrean population has fled the country and thousands more flee every month—a continuous “brain drain.”⁴⁰ Among those citizens not in the army or not fleeing the country, there is a dearth of readily apparent entrepreneurs. More than 75% of the population lives in rural villages and there are few support programs or policies that enable citizens to successfully launch a business.⁴¹

Entrepreneurs

Ranked last out of 189 countries in the World Bank’s *Ease of Doing Business* report, Eritrea is not an easy country in which to start or run an enterprise.⁴² Private sector development has been severely limited by lack of capital, restrictive government policies, and a shortage of talent. As a result, the private sector, including the capital market, is underdeveloped and small.

Access to capital is a major constraint plaguing Eritrea’s private sector. The Eritrean financial services industry is significantly underdeveloped and uncompetitive. The state has a majority stake in the country’s five financial institutions—Central Bank of Eritrea, the Commercial Bank of Eritrea, the Housing and Commerce Bank of Eritrea, the Eritrean Development and Investment Bank, and the National Insurance Corporation of Eritrea—which limits private sector participation.⁴³ The lack of competition means that businesses struggle with low access to credit. Credit supply to the private sector has grown slowly, between 1% and 4% annually over 2009 to 2011.⁴⁴ Eritrea’s banking sector has stringent collateral requirements and high interest rates, which are administered by the government and typically prohibitively high—often exceeding 30% per annum.⁴⁵

Currently the Central Bank of Eritrea (CBE) deploys only 29% of the funds collected from its depositors.⁴⁶ The CBE lends mainly to large state-owned and private-owned manufacturing businesses, which results in a lack of finance for small firms and restricts growth of these companies. Collateral requirements are a significant hindrance as the CBE requires that businesses provide up to 100% of the loan value

39 World Report: Eritrea (2014), *Human Rights Watch*, available at <http://www.hrw.org/world-report/2014/country-chapters/eritrea>.

40 *Ibid.*

41 Ravinder Rena, “Eritrea: Rural Enterprises to Catalyze Economy (Opinion),” *Norwegian Counsel for Africa* (June 15, 2007), available at <http://www.afrika.no/Detailed/14379.html>.

42 Economy Rankings,” *Ease of Doing Business Index* (2014), available at <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>.

43 Magindu Nyende & Luka Okumu, AFDB, *African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9_EN.pdf.

44 *Ibid.*

45 *Ibid.*

46 Henk von Eije, Michael Fishazion and Clemens Lutz, *Journal of Eritrean Studies, Accessing Bank Credit in Eritrea: Bottlenecks for Small Firms and for the Commercial Bank of Eritrea*, available at http://arts.eldoc.ub.rug.nl/FILES/publications/general/other/2002/eije.h.von_costs/accessing.pdf.

in collateral, which is impossible for many small firms. The bank also often asks to see financial statements and feasibility studies.

Without capital to support small businesses, the Eritrean economy relies heavily on remittances from the diaspora for its survival. Studies show migrants send home an average of USD 300-400 per year. Remittances form nearly a third of the value of GDP (USD 1.2 billion)⁴⁷ and are proportionately the highest in the world.⁴⁸

Businesses in Eritrea also face many infrastructure challenges, such as high fuel prices and inconsistent provision of electricity and water.⁴⁹ Eritrea's electricity generation capacity per capita is 61 kWh, which is far below the country's energy needs. In comparison, per capita electricity generation capacity is 4,301 kWh in South Africa, 694 kWh in Zimbabwe and 129 kWh in Kenya.⁵⁰ Recent developments in the mining sector and free-trade zones have further increased pressure on the grid.

47 Berhane Tewelde, *Journal of Middle Eastern Geopolitics, Remittances As a Tool For Economic Development and Reconstruction in Eritrea*, available at <http://ojs.uniroma1.it/index.php/JMEG/article/viewFile/3123/3107>.

48 Sally Healy, Chatham House et. al, *Eritrea's Economic Survival* (2007), available at <https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/200407eritrea.pdf>.

49 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

50 Eritrean Embassy-Japan, *Investment Opportunities in the Energy Sector of Eritrea*, available at <http://www.eritreanembassy-japan.org/data/Investment%20Opportunities%20in%20the%20Energy%20Sector%20of%20Eritrea.pdf>.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

In response to the regulatory, legal, and infrastructure challenges facing both businesses and investors, the government of Eritrea has begun to work on reform to improve the business environment. With the softening of its self-reliance policy, more NGOs and DFIs are being allowed back into the country and have started to improve the investment ecosystem in Eritrea.

Regulatory Environment

Eritrea lacks an organized regulatory system. The country does not have a sitting parliament and laws governing the country are issued by proclamation from the executive arm of government.⁵¹ The country's regulatory framework is opaque and inconsistently enforced, but the following are particularly relevant to potential investors:

- **Repatriation of profits and dividends:** The Foreign Financed Special Investment (FFSI) policy makes allowances for the remittance of net profit, dividends accrued from investments, debt service payments, savings from expatriate salaries, and proceeds from the sale or transfer of shares. However, the government's strict control of foreign currency makes repatriation of profits difficult and discourages investors.⁵²
- **Foreign exchange controls:** The government controls all foreign exchange in the country. Only state-owned entities are authorized to manage foreign exchange activities.⁵³ The black market is pervasive, where the Eritrean Nafka trades for less than a third of its nominal value.⁵⁴
- **Leasehold structure for foreign land ownership:** All land in Eritrea is owned by the state but the government issues lifetime usufruct rights. Nevertheless, the government also has a history of withdrawing usufruct rights on land without notice or compensation, including housing and commercial property, which is a considerable risk for both investors and entrepreneurs interested in developing businesses in the country.⁵⁵ Despite state ownership, traditional land tenure systems persist in rural areas, where communities allocate land.

51 US Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/documents/organization/227167.pdf>.

52 *Ibid.*

53 *Ibid.*

54 *Ibid.*

55 *Ibid.*

- **Local ownership requirements:** The FFSI proclamation restricts foreign investment in certain sectors of the Eritrean economy, including financial services, domestic wholesale trade, domestic retail trade, and commission agencies. However, foreign investment in other sectors is permitted.⁵⁶
- **Government enterprises:** Almost all medium and large enterprises in Eritrea are controlled by the government.

Ecosystem Players

With a small formal private sector and no impact investing activity, there are very few ecosystem players operating in Eritrea at this time.

⁵⁶ US Department of State, *Department of State: 2014 Investment Climate Statement (2014)*, available at <http://www.state.gov/documents/organization/227167.pdf>.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

As evidenced by the lack of impact investing in Eritrea, investors face a number of challenges in investing in the country:

- **Weak legal system:** Eritrea's inconsistent legal system makes it difficult for investors to enact and enforce legal contracts.
- **Challenging regulatory system and corruption:** Regulation and government policy-making are highly opaque. The government often does not announce new or amended regulations prior to implementing them, and they may be subject to abrupt change.⁵⁷ Sudden changes in regulation and uneven implementation of laws have led to uncertainty and rising corruption in the country. In Transparency International's 2013 Corruption Index, Eritrea ranked 160th out of 177 countries.⁵⁸
- **Expropriation risk:** In theory, the law guarantees against confiscation of investment without just cause or compensation but the risk of expropriation is high regardless. The government has nationalized private businesses in the past without notice or compensation. For example, in 2008 the government terminated the Intercontinental Hotel's management contract for a government-owned hotel in Asmara and later reopened the hotel as a government-operated establishment.⁵⁹
- **Profit repatriation risk:** There is generally a hard currency shortage in Eritrea. Some airlines, for instance, report deposits of hundreds of millions of unconvertible Nakfa held in local banks. These conditions prompted Lufthansa to cease operations to Eritrea in 2013, while its competitors are now charging fares directly in hard currency.⁶⁰
- **Lack of investment options:** As a result of Eritrea's restrictive regulations and policies, there is minimal private sector participation in the country and consequently there are very few desirable businesses for impact investors to consider for investment.

57 US Department of State, *Department of State: 2014 Investment Climate Statement* (2014), available at <http://www.state.gov/documents/organization/227167.pdf>.

58 "Corruption Perceptions Index," *Transparency International* (2013), available at <http://www.transparency.org/cpi2013/results>.

59 "2013 Investment Climate Statement: Eritrea," *US Department of State*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204637.htm>.

60 Ravinder Rena, "Eritrea: Rural Enterprises to Catalyze Economy (Opinion)," *Norwegian Counsel for Africa* (June 15, 2007), available at <http://www.afrika.no/Detailed/14379.html>.

Opportunities

Despite challenges, there are opportunities in Eritrea. The most promising sectors of the Eritrean economy include agriculture, aquaculture, tourism, and mining. As impact investors do not typically operate in extractive industries, the following sectors present the greatest opportunities for impact capital:

- **Agriculture:** Eritrea possesses abundant arable land, and 80% of the population is engaged in agricultural activities. However, frequent drought, famine, and poor climatic conditions and unsophisticated production practices have hampered agricultural growth in the past. Nevertheless, with investments in training, irrigation, and equipment, the country has considerable potential to generate growth in agricultural production, agro-processing, and livestock production.⁶¹ Eritrea's ecological environment is ideal for growing a wide range of crops, and the economy could benefit from developing high-value horticultural ventures.
- **Aquaculture:** Fisheries and fish processing also show high potential, with the export of fish and fishmeal becoming an increasingly significant part of the Eritrean economy. Eritrea's coast is abutted by over 52,000 square kilometers of prime fishing waters, rich in a wide variety of fish species.⁶²
- **Tourism:** Given Eritrea's coastal location, there is high potential for tourism which has not been realized to date. The government has started encouraging both foreign investors and the returning diaspora to invest in the sector with some encouraging results, as a Qatari firm has begun construction on a multimillion-dollar resort complex on Dahlak Kabir Island in Eritrea.

61 Magindu Nyende & Luka Okumu, AFDB, *African Economic Outlook: Eritrea* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Erithr%C3%A9a_EN.pdf.

62 Eritrea Investment Center, *Investment Policies and Opportunities of the State of Eritrea* (2003), available at http://www.eritreambassy-japan.org/data/Investment_Policy_and_Opportunities_of_the_state_of_Eritrea.pdf.



DJIBOUTI

CAPITALIZING ON A
STRATEGIC LOCATION

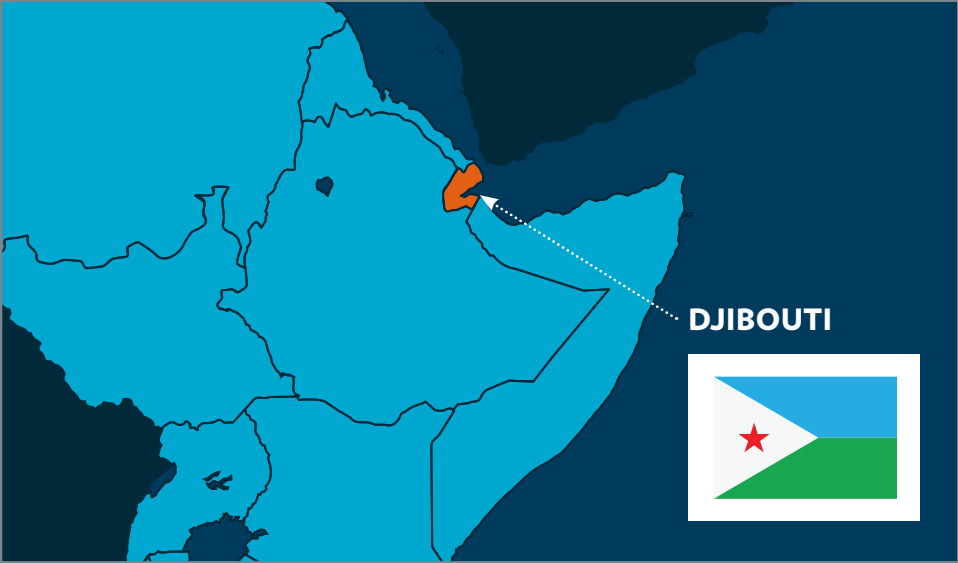
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INTRODUCTION

With a population of less than a million people and an approximate area of 23,000 km², Djibouti is the smallest country in East Africa by both population and size. The country has few natural resources or available land but is in a prime strategic location on the maritime crossroads of Africa, Europe, Asia, and the Middle East (Figure 1). As a result, the economy is primarily service-based and focused on income from port services and foreign military bases.

FIGURE 1: MAP OF DJIBOUTI



Given its limited natural resources, the Djiboutian government understands the importance of foreign investment in driving economic development. In recent years, the government has worked to improve Djibouti’s business and regulatory environment in an effort to attract investment. The government has also started major projects in a USD 6 billion investment to expand infrastructure and enhance electricity and water access, further enabling private sector development.

Djibouti suffers from high unemployment and poverty rates, and a more robust private sector could offer opportunities for wealth and job creation. However, businesses are constrained by a conservative financial sector that does not provide sufficient capital, a gap impact investors could help fill. Despite the demand for capital and the improving business environment, only USD 18 million in impact capital has been disbursed in Djibouti to date and this has been entirely by DFIs.¹ Impact investors face a number of challenges in investing in Djibouti, including a cumbersome bureaucracy, corruption, a weak legal system, unfavorable labor laws, and high costs for basic inputs such as water and power.

1 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

Country Context

Djibouti, originally referred to as French Somaliland, gained independence from France in 1977. It has a population of approximately 860,000, with nearly 80% residing in urban areas.² Djibouti is inhabited by two major ethnic groups: the Issaa (60% of the population) and the Afars (35%).³ Though Djibouti experienced some internal conflict in its initial post-independence years, it has maintained relative stability over the past decade despite conflict in neighboring countries.

Hassan Gouled Aptidon was Djibouti's first president in 1977. He led an Issa-dominated government under a one-party system. Discontent with this system led to civil war between Aptidon's regime and Afar rebels in 1992. Two peace treaties were eventually signed in 1994 and 2000, leading to the country's first multiparty elections. Ismael Omar Guelleh won the elections and has served as president of Djibouti since.⁴ After amending the constitution to allow presidents to serve three terms, Guelleh was re-elected for a third term in 2011.

Djibouti is primarily a service-based economy dependent on foreign military bases and port services. The country has capitalized on its strategic position as the deepest port in one of the world's busiest trade routes.⁵ Djibouti is also the main import-export route serving landlocked Ethiopia, which is its largest trade partner and accounts for 70% of port activity.⁶

Because of its strategic position on the Gulf of Aden, Djibouti is also a key location for many foreign militaries. It hosts US, French, and Japanese military bases and the European anti-piracy force, Operation Atalanta.⁷

2 World Bank, "Djibouti at a glance," available at http://devdata.worldbank.org/AAG/dji_aag.pdf.

3 Central Intelligence Agency, "Djibouti," *CIA World Factbook*, available at <https://www.cia.gov/library/publications/the-world-factbook/geos/dj.html>.

4 Culture Grams, "Republic of Djibouti (2009)," available at <http://www.aasd.k12.wi.us/Staff/hendrickjohn/Africa/Djibouti.pdf>.

5 US Department of State, *Investment climate statement- Djibouti (2014)* available at <http://www.state.gov/documents/organization/227156.pdf>.

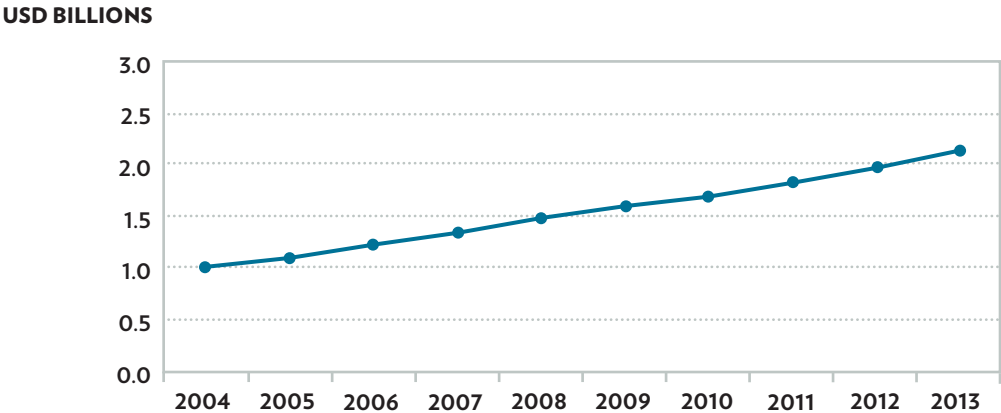
6 EPRI, "Djibouti," available at <http://epri.org.za/wp-content/uploads/2011/03/14-Djibouti.pdf>.

7 African Economic Outlook, *Djibouti 2014*, available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Djiouti_EN.pdf.

Gross Domestic Product

Djibouti's GDP has grown steadily over the past decade, increasing at an average annual rate of 6% to approximately USD 2.5 billion (PPP) in 2013 (Figure 2). This growth has been driven by foreign direct investment (FDI) and port activity. FDI reached a record USD 286 million in 2013, accounting for 11.4% of GDP.⁸ Some examples of FDI in Djibouti include China Merchants Holdings International's acquisition of a 23.5% stake in the recently privatized Port of Djibouti (PAID) and continuing infrastructure investment.⁹

FIGURE 2: GDP (PPP), 2004-2013



Source: IMF World Bank Economic Indicators, April 2014

With the implementation of new investment programs and infrastructure projects, such as a new Djibouti-Addis railway expected to be completed in mid-2015, the government's recurrent expenditure is set to increase. Infrastructure projects such as the railway require heavy borrowing by the Djiboutian government, leading to an increase in the budget deficit, which has been relatively stable at 2% of GDP.¹⁰ However, the expense has been justified with the projected increase in tax revenues and boost to the service sector that the railway project is expected to bring.

8 African Economic Outlook, Djibouti 2014, available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Djiouti_EN.pdf.

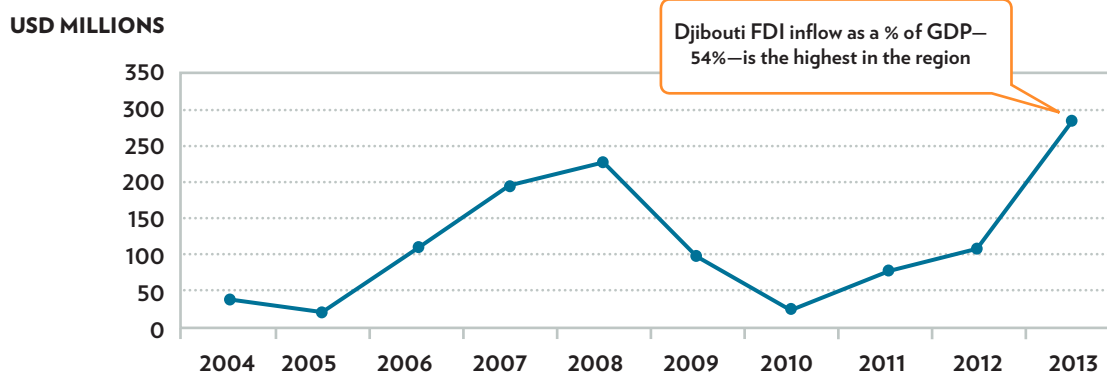
9 *Ibid.*

10 *Ibid.*

Foreign Direct Investment

The marked increase in FDI into Djibouti since 2010 (Figure 3) is largely attributable to China. Other than China, major sources of FDI in Djibouti include Yemen, Ethiopia, the U.S., and France.¹¹ Much of Djibouti's FDI has been used to develop port and shipping infrastructure. This includes USD 80 million received since 2012 from the Saudi Fund for Development and the Arab Fund for Social and Economic Development for the expansion of the port of Doraleh and construction of a facility in Tadjaurah designed to ship potash from Ethiopia. Similarly, Djibouti secured USD 64 million from the China Export Import Bank in 2012 to construct a port that will facilitate salt and gypsum exports. There are also plans to build an oil refinery and pipeline from South Sudan that have attracted interest from Brazilian and Russian investors.¹²

FIGURE 3: FDI FLOWS, 2004–2013



Source: UNCTAD

Increasing foreign investment is a key priority of the Government of Djibouti. To improve the investment landscape, the government instituted a new commercial code in 2012 and established free trade zones, which stimulate economic growth by offering office space, light industry units, and tax incentives to investors. There are currently 160 businesses from 39 different countries operating in the free trade zone. Djibouti also opened the DAM commercial zone in the southern region in 2013 and plans to open two more free trade zones, the Khor Ambado Free Zone and Jabanas Free Zone, in the coming years.¹³

11 Santander Trade, "Djibouti: Foreign Investment," available at <https://en.santandertrade.com/establish-overseas/djibouti/investing-3>.

12 Maria Levitov, Bloomberg, Djibouti to raise \$5.9B from investors for infrastructure (May 8, 2013), available at <http://www.bloomberg.com/news/2013-05-08/djibouti-to-raise-5-9-billion-from-investors-for-infrastructure.html>.

13 U.S. Department of State, Investment climate statement- Djibouti (2014) available at <http://www.state.gov/documents/organization/227156.pdf>.

Inflation and Exchange Rates

Inflation in Djibouti depends primarily on its two main imports: food and oil.¹⁴ The country has, however, maintained a low inflation rate generally ranging from 3-5%, aside from a spike to 12% in 2008 due to a surge in food and fuel prices that drove up inflation across East Africa (Figure 4). Given that Djibouti imports almost 97% of its food, the rising food prices between 2005 and 2008 are estimated to have contributed to an increase in extreme poverty from 40% to 54%.¹⁵ Djibouti is still vulnerable to such fluctuations, as the country has made very little investment in agriculture to secure its food supply.

FIGURE 4: INFLATION IN DJIBOUTI, 2004 - 2013



Source: World Bank

Djibouti's currency, the Djibouti Franc, has been pegged to the US dollar since 1973, and no change in policy is expected in the short- to medium- term.¹⁶ The government maintains parity by holding 105% coverage of foreign exchange against currency in circulation.¹⁷

14 African Economic Outlook "Djibouti," available at <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Djibouti%20-%20African%20Economic%20Outlook.pdf>.

15 FAO, "High Food Prices: Causes and Possible Actions," available at <http://www.ima.kth.se/utb/MJ1501/pdf/Engfeldt.pdf>.

16 African Economic Outlook "Djibouti," available at <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Djibouti%20-%20African%20Economic%20Outlook.pdf>.

17 *Ibid.*

SUPPLY OF IMPACT CAPITAL

This study was unable to find evidence of any non-DFI impact investment in Djibouti in recent years. Although there has been a recent increase of foreign investment in logistics and infrastructure projects, this has not translated to corresponding growth in impact investment.

Broader Investing Landscape

The Djiboutian government is well aware that foreign investment is a key driver of economic development in the country and continues to make conscious efforts to improve Djibouti's business environment, thereby increasing foreign investment. Djibouti's efforts to attract investors include revisions of its regulations, creation of Free Trade Zones, adoption of a new commercial code, and increased investment in infrastructure. Djibouti also offers significant incentives to private sector individuals and corporate investors. For example, investments greater than USD 280,000 that create permanent jobs are exempted from registration and license fees, property taxes, and taxes on profits.¹⁸

These efforts have made it easier to conduct business in Djibouti, leading to a substantial improvement in the World Bank's Ease of Doing Business ranking, from 171st out of 189 countries in 2013 to 154th in 2014.¹⁹

The government has primarily concentrated on expanding Djibouti's services sector to further capitalize on the country's access to Africa, Europe, Asia, and the Middle East by positioning Djibouti as a transit hub for neighboring, landlocked countries.²⁰ Government investments have sought to increase the country's trade profile and serve as a regional hub for trade, handling, and financial services.

The government created a new USD 6 billion investment program with a particular focus on infrastructure. The program is predominantly funded by Chinese investors and the international aid community,²¹ with the goal of expanding infrastructure and enhancing access to electricity and water. Projects in the program include the previously mentioned ports as well as the Djibouti-Addis Ababa railway line, an aqueduct to transport water from Ethiopia, a desalination plant, an electricity line from Ethiopia, and a geo-thermal power station.²² It is expected that the investment program will catalyze growth in private sector investment in the near future.

18 Profit, "Country Profile: Djibouti," available at http://www.bk-conseil.com/espaceinformation/documentation/tourism/Djibouti_Country_Profile.pdf.

19 World Bank Group, *Ease of Doing Business in Djibouti*, available at <http://www.doingbusiness.org/data/exploreeconomies/djibouti/>.

20 Adaptation Fund, "Developing Agro-Pastoral Shade Gardens As An Adaptation Strategy For Poor Rural Communities," available at <http://www.undp.org/content/dam/undp/documents/projects/DJI/GB.pdf>.

21 African Economic Outlook, "Djibouti," available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Djiouti_EN.pdf.

22 *Ibid.*

Although the majority of investment has been in large, commercial enterprises, the government has begun to support small and medium enterprise (SME) development through Djibouti's Economic Development Fund. This USD 3 million fund was started specifically to provide financial support to SMEs with the overall goal of fighting unemployment, reducing poverty, and boosting economic growth.²³ The fund offers affordable loans,²⁴ primarily targeting agriculture, services, tourism, transportation, and logistics.

In recent years, interest rates in Djibouti have fluctuated between 9% and 12%.²⁵ The entry of eight new banks between 2006 and 2012 increased competition and reduced interest rates, which are low compared to those in other East African countries, though still quite high relative to rates found in more developed economies. As of 2013, unsecured loans were offered at a 12% interest rate, while overdrafts and housing loans received rates of 15% and 10% respectively.²⁶

Impact Capital Disbursed

Excluding DFIs, no known impact capital has been disbursed in Djibouti. Despite the lack of deals in the country, at least 45 impact capital vehicles operating regionally include Djibouti in their investment mandates, though none of these are exclusively dedicated to Djibouti. As a result, there is approximately USD 522 million in available capital committed that could be invested in Djiboutian businesses, but it remains unlikely that Djibouti will capture a significant portion of that capital.

DFI activity has also been minimal in the country, with disbursement of about USD 18 million across two projects in Djibouti. With an improving business environment, and increased focus by the government on SME development, both the pipeline of viable investment opportunities and the interest of impact investors are expected to increase in the coming years.

23 OFID, "Investing in Djibouti's small entrepreneurs," available at http://www.ofid.org/Portals/0/Documents/ImpactStories/AR_2012_Djibouti.pdf.

24 No data is available on interest rates for these loans.

25 AUHF, *Djibouti launches a housing bank*, available at <http://www.auhf.co.za/wordpress/assets/AUHF-Newsletter-February.pdf>.

26 African Economic Outlook "Djibouti," available at <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Djibouti%20-%20African%20Economic%20Outlook.pdf>.

DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Although there is currently very limited impact investment activity in Djibouti, high poverty rates, the underdevelopment of key sectors like agriculture, health, and education, and insufficient access to finance indicate that there is need for impact capital and nascent opportunities for investment.

Development Context

Despite economic growth and foreign investment over the past decade, economic gains have been highly concentrated in the hands of a few while overall poverty levels have risen. More than 40% of the population lives in extreme poverty.²⁷ This problem is even greater in rural areas, where nearly 97% of the population lives in poverty.²⁸

Though Djibouti has made recent investments in basic services, like health and education, it still performs poorly on human development indicators, ranking 164th out of 187 countries on the UN's Human Development Index in 2013.

The Djiboutian government's recent investments in health include programs to support maternal and child health, including drug availability and medical service provider trainings, as well as improvements in general delivery of health services. Indeed, Djibouti has a stunting ratio only slightly below the global average and nearly 25% better than the East Africa average. Despite these efforts, Djibouti's under-5 mortality rate of 81 deaths per 1,000 live births and infant mortality rates remain among the highest in the region (Figure 5, following page) while its general health indicators remain amongst the worst in the world.²⁹

Djibouti has made some progress in improving its education system, and thus expanding its available workforce. The country has raised primary enrollment levels from 53% in 2002 to 83% in 2012. It has also managed to achieve approximate gender parity in primary school enrollment with female enrollment rising to 81% against male enrollment of 85% in 2012.³⁰

27 World Bank, *Djibouti*, available at <http://www.worldbank.org/en/country/djibouti>.

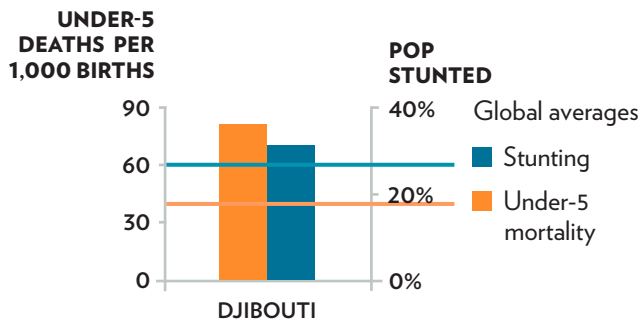
28 IMF, *Djibouti: Poverty Reduction Strategy Paper*, available at <http://planipolis.iiep.unesco.org/upload/Djibouti/PRSP/Djibouti%20PRSP.pdf>.

29 The World Bank, *Country Partnership Strategy for The Republic of Djibouti*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDS/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

30 African Economic Outlook, *Djibouti (2014)*, available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Djiouti_EN.pdf.

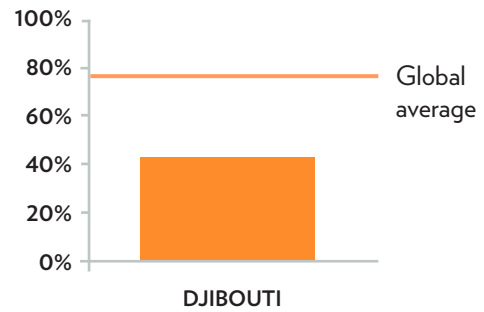
Nevertheless, the quality of education in Djibouti is still relatively poor, with overcrowded classrooms and high teacher absenteeism. Most youth in Djibouti are not receiving a full education; only 44% of eligible students are enrolled in secondary school—well below the global average of 74% (Figure 6), although marginally above the 43% average across sub-Saharan Africa.

FIGURE 5: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



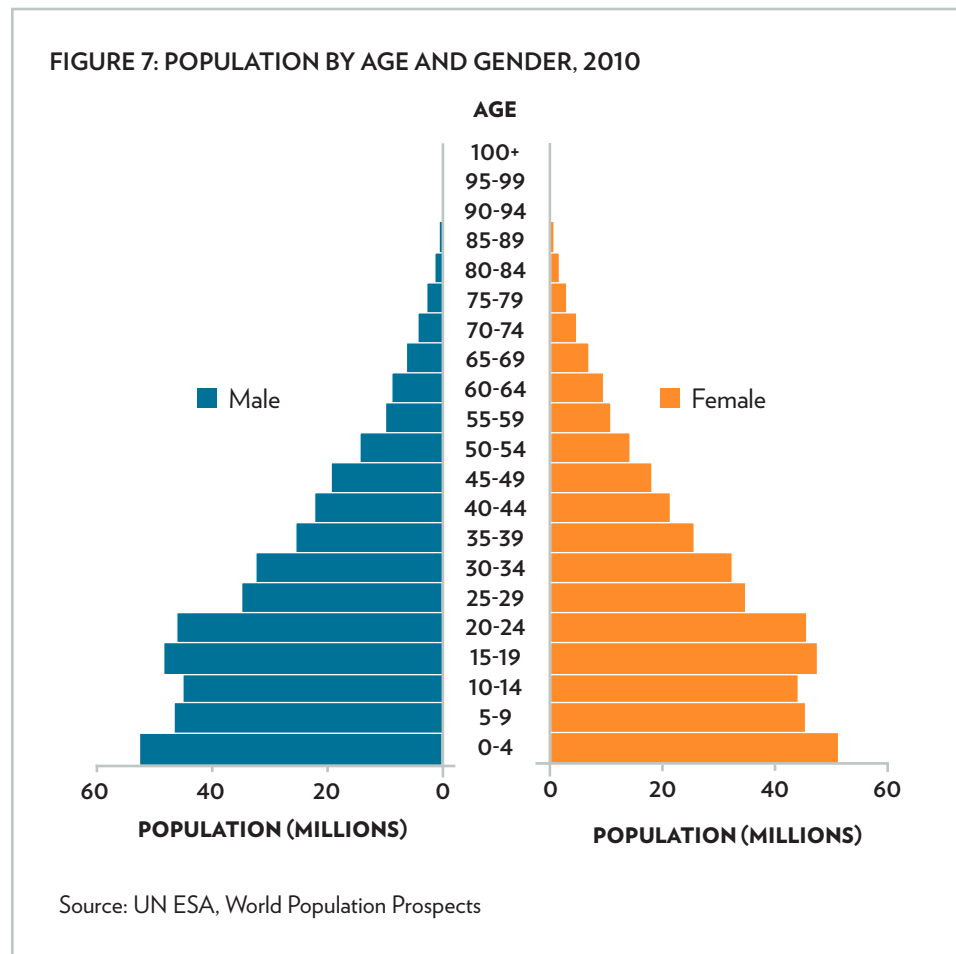
Source: UN Human Development Report 2014

FIGURE 6: SECONDARY SCHOOL GROSS ENROLLMENT



Source: UN Human Development Report 2014

A vibrant education system is particularly important in a country with Djibouti's demographics. Djibouti has a very youthful population; only an estimated 3% of the population is older than 65 while 55% of the population is younger than 25 (Figure 7).³¹



Djibouti is unable to provide employment opportunities for its large youth population. Unemployment rates for those younger than 30 are estimated to be as high as 70%,³² which is nearly 50% higher than the 2012 estimate of 48% unemployment for the general population.³³

Unemployment stems from several factors, such as inadequate levels of economic activity, an under-qualified human capital pool, high immigration, and ineffective stabilization policies.³⁴ Further, the unemployment trend is forecasted to continue as the population increases. With a growing young population, the pace of job

31 CIA, World fact book(2014), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/dj.html>.

32 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDS/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

33 *Ibid.*

34 IMF, *Djibouti: Poverty Reduction Strategy Paper*, available at <http://planipolis.iiep.unesco.org/upload/Djibouti/PRSP/Djibouti%20PRSP.pdf>.

creation will need to double in order to begin to decrease unemployment levels in the country.³⁵

The Port of Djibouti, the US Naval Base, and the public sector are the primary employers for most households.³⁶ The government is the largest single employer, employing more than 44% of those working in the formal sector.³⁷ As a result, wages comprise approximately a third of the government's annual budget.³⁸ Nevertheless, as many as a third of households subsist on informal trade and casual labor.³⁹

Entrepreneurs

The concept of impact investing is relatively unknown to Djiboutian entrepreneurs. However, access to capital in the country remains low and private sector businesses, particularly SMEs, are increasingly looking to alternate sources of capital to fund growth. However, private sector development is currently hindered by a number of factors, including limited access to finance, high infrastructure costs, high labor costs, and a lack of skilled human capital.

Accessing financing is difficult in Djibouti—in the World Bank's Ease of Doing Business rankings, the nation ranks 180th of 186 countries for "Obtaining Credit."⁴⁰ As recently as 2012, a mere 12% of the population had access to banking services.⁴¹ Similarly, Djibouti's SMEs have limited access to bank financing, and those that do have access struggle to meet bank requirements. Djiboutian banks are highly risk averse, and typically lend only to well-established businesses who can meet high collateral requirements.⁴² As a result, the country has a low rate of non-performing loans (~6%), but banks are unwilling to finance start-ups or early-stage ventures;⁴³ SMEs receive only about 5% of capital allocated to enterprises.⁴⁴

35 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

36 US Department of State, 2014 Investment Climate Statement-Djibouti (2014), available at <http://www.state.gov/e/eb/rls/othr/ics/2014/226946.htm>.

37 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

38 Wharton, "Djibouti," available at <http://fic.wharton.upenn.edu/fic/africa/Djibouti%20Final.pdf>.

39 USAID, *Djibouti Livelihood Profiles October 2004*.

40 World Bank Group, *Ease of Doing Business in Djibouti*, available at <http://www.doingbusiness.org/data/exploreconomies/djibouti/>.

41 US Department of State, "2014 Investment Climate Statement – Djibouti," available at <http://www.state.gov/e/eb/rls/othr/ics/2014/226946.htm>.

42 World Bank, *High-Level Development Exchange Launch of Vision Djibouti 2035*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/10/24/000469252_20141024103322/Rendered/PDF/916950WP0DJIBO0x385342B00300PUBLIC0.pdf.

43 AFDB, *Djibouti - Country Strategy Paper 2011-2015*, available at <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Djibouti%20-%20CSP%202011-15.pdf>.

44 *Ibid.*

Djibouti's microfinance sector has grown in recent years, increasing access to credit for the population typically excluded from the mainstream banking system.⁴⁵ However, MFIs' reach is limited where only 4% of the population currently benefits from microcredit.⁴⁶

Infrastructure access and cost is another major constraint for Djiboutian businesses. The cost of electricity in Djibouti is among the highest in the world, despite poor quality and availability—costing an average of USD 0.20 per kWh, compared to a regional average of USD 0.07 per kWh.⁴⁷ In an effort to reduce the cost of electricity, Djibouti connected to Ethiopia's electricity grid in 2011.⁴⁸ This reduced electricity tariffs by 30% for more than 50% of consumers and reduced fuel imports by the state-owned power company.⁴⁹ Ongoing investments in renewable energy are expected to further reduce the cost of electricity for consumers and entrepreneurs.

Djibouti is also plagued by chronic water shortages and high water prices as it produces only half of the estimated 30 million cubic meters required for annual consumption.⁵⁰ The average price for water is USD 1.10 per cubic meter, compared to USD 0.28 per cubic meter across the region.⁵¹ Similar to electricity access, ongoing projects in aqueducts and desalination plants are expected to lower costs and increase water access in the future.

Labor costs in Djibouti are also very high relative to the region. For example, a laborer earns an average monthly wage of USD 300 in Djibouti, compared to USD 70 in Ethiopia or USD 100 in Egypt.⁵² Despite the high cost, labor productivity remains low due to a lack of skills and frequent mismatches in skill sets offered by labor compared to those needed by enterprises.⁵³

45 African Economic Outlook, "Djibouti 2014," available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Djibouti_EN.pdf.

46 Governor, Central Bank of Djibouti Ahmed Osman Ali, "Djibouti's Financial Sector," available at https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=5&cad=rja&uact=8&ved=0CDUQFjAE&url=http%3A%2F%2Fwww.firstmagazine.com%2FDownloadSpecialReportDetail.3519.ashx&ei=CuZuVObdLseBywO2lIGQDw&usq=AFQjCNE-tHjIjE4jjXt5YhLwdND_4f1-6g&bvm=bv.80185997,d.d2s.

47 US Department of State, "Djibouti," available at <http://www.state.gov/r/pa/ei/bgn/5482.htm>.

48 Chatham, "Djibouti: Changing Influence in the Horn's Strategic Hub," available at http://www.chathamhouse.org/sites/files/chathamhouse/public/Research/Africa/0413bp_djibouti.pdf.

49 IMF, "Djibouti: Sixth Review Under the Extended Credit Facility Arrangement and Request for Waivers of Nonobservance of Performance Criteria," available at <http://www.imf.org/external/pubs/ft/scr/2013/cr1378.pdf>.

50 AFDB, *Djibouti - Country Strategy Paper 2011-2015*, available at <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Djibouti%20-%20CSP%202011-15.pdf>.

51 US Department of State, "Djibouti," available at <http://www.state.gov/r/pa/ei/bgn/5482.htm>.

52 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

53 African Development Bank Group, *Djibouti, Country Strategy Paper 2011-2015*, available at <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Djibouti%20-%20CSP%202011-15.pdf>.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

The Djiboutian ecosystem is not especially conducive to impact investing. The government has been working to improve the regulatory and legal environment, but investors must still navigate complex and lengthy bureaucratic systems. Despite the increase in investment in recent years, many foreign investors are still discouraged by Djibouti's bureaucratic systems, reputation for corruption, and high labor and living costs.⁵⁴

Regulatory Environment

To attract investment, the government has been working to improve Djibouti's regulatory and legal systems. In 2001, the government established the National Investment Promotion Agency (NIPA) to promote private sector investment, facilitate investment operations, and modernize the country's regulatory framework.⁵⁵ Despite improvements, the business environment in Djibouti still requires significant reforms, including simplification of the tax code and streamlining investment procedures.

- **Repatriation of profits and dividends:** Djibouti does not have foreign exchange restrictions, so foreign businesses are free to repatriate profits.⁵⁶
- **Foreign exchange controls:** Djibouti has free movement of capital, without limitations on transferring money or in- and out-flows of cash. There are also no restrictions on conversion of the Djibouti franc into any currency.⁵⁷ The Djibouti franc is pegged to the US dollar, and thus remains a relatively stable currency.
- **Local ownership requirements:** Foreign companies are not required to have a local partner, with the exception of the insurance industry.^{58,59}

54 Santander Trade, "Djibouti: Foreign Investment," available at <https://en.santandertrade.com/establish-overseas/djibouti/investing-3>.

55 SantaFe Associates International, "Legal Market Overview," available at <http://www.santafe-associates.com/archivos/pdf/legal-market-overview-investment-climate-SFAI.pdf>.

56 US Department of State, *2014 Investment Climate Statement-Djibouti* (2014), available at <http://www.state.gov/e/eb/rls/othr/ics/2014/226946.htm>.

57 African Economic Outlook *Djibouti*, available at <http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2013/PDF/Djibouti%20-%20African%20Economic%20Outlook.pdf>.

58 Insurance companies that are registered as local companies, as opposed to a branch of an existing foreign company, must have a local business partner.

59 US Department of State, *2014 Investment Climate Statement-Djibouti* (2014), available at <http://www.state.gov/e/eb/rls/othr/ics/2014/226946.htm>.

- **Government enterprises:** State-owned enterprises comprise a large portion of the Djiboutian economy. The government controls telecommunication, water, and electrical distribution in Djibouti. Other services, such as media, garbage collection, and real estate are not legal monopolies, but government-backed enterprises have advantages relative to private sector competitors through programs such as government-backed loan guarantees. Legally, private businesses are afforded the same access to markets, land, and credit as state-owned enterprises, but such government programs impact fair competition.⁶⁰ This constrains both existing businesses and the potential for aspiring entrepreneurs to develop new businesses in these sectors.

Ecosystem Players

Along with a lack of impact investment activity in Djibouti, the ecosystem of intermediaries supporting investors and businesses is also underdeveloped. There are very few examples of accelerators, incubators, or other business development service providers in the country.

One exception is the Global Innovation through Science & Technology (GIST) initiative, which works across 86 emerging markets, including Djibouti. GIST supports promising entrepreneurs working in technology through global networking, entrepreneurship skill building, in-depth mentorship, and strategic seed funding.⁶¹

In early 2014, The World Bank and partners committed USD 2 million to provide business development services (BDS) to SMEs in Djibouti through a matching grant program.⁶² Although no specific BDS providers are cited in the program plan, by increasing access to funding for technical assistance this program is expected to foster development of intermediaries available to Djiboutian SMEs.

60 US Department of State, 2014 Investment Climate Statement-Djibouti (2014), available at <http://www.state.gov/e/eb/rls/othr/ics/2014/226946.htm>.

61 GIST, *About*, available at <http://gist.crdfglobal.org/about-gist>.

62 The World Bank, *Concept stage: P146250*, available at http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2014/01/30/000333037_20140130122423/Rendered/PDF/8436001SDSoP140Box382138B00PUBLIC0.pdf.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite government efforts, there are still many challenges that discourage foreign investment, including impact investment:

- **Small market:** Djibouti is the smallest country in East Africa both by population and geography. With less than a million people, there is limited potential for scale in-country and new businesses seeking to grow and generate attractive returns will quickly need to expand regionally. This expansion to new markets creates challenges for new businesses, which must learn a new operating environment as well as have sufficient human capital to manage operations in multiple markets.
- **Bureaucracy:** Improvements to the regulatory framework have somewhat eased the process of investing in Djibouti, but investors still frequently struggle to practically navigate the bureaucracy, which can lead to challenges such as a slow release of funds by relevant government agencies.⁶³
- **High cost of operations:** In addition to the high cost of water, electricity, and labor, Djibouti City is also one of the most expensive cities in the world. The high cost of living is largely a result of rapidly increasing housing expenses.⁶⁴
- **Weak legal system:** The World Bank scores Djibouti poorly on the rule of law governance indicator, which is particularly poor when applied to foreign businesses. Foreign investors have reported delayed court deliberations and legal decisions biased against foreign companies.⁶⁵
- **Unfavorable labor laws:** Djibouti's labor laws are another barrier to foreign investment as they tend to favor employees, particularly in cases of disputes and termination. Further, because skilled labor is in short supply relative to unskilled labor, the government has instituted measures to replace foreign workers with locals and have correspondingly increased the cost of obtaining a work permit.⁶⁶

63 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

64 Hiiran Online, "Djibouti, Arab World's Most Expensive City," (July 25, 2011) available at http://hiiraan.com/news2/2011/July/djibouti_arab_world_s_most_expensive_city.aspx.

65 US Department of State, *2013 Investment climate statement- Djibouti*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204631.htm>.

66 *Ibid.*

Opportunities

Despite the many challenges investors face, Djibouti's investment climate is relatively friendly compared to those in neighboring countries such as Eritrea and Ethiopia. With its high poverty and unemployment rates there is great need for impact investment and private sector development. The country's improving business environment is paving the way for impact investors to enter the market. Some opportunities include the following:

- **Developing talent pool:** Given the high unemployment rate, lack of available skilled talent in Djibouti, and the high cost of living for expatriates, impact investors could invest in talent development initiatives, such as training programs or business development services, to increase the pool of high-potential entrepreneurs and businesses for investment.
- **Investing in SMEs:** To date, the majority of foreign investment into Djibouti has been into large infrastructure and transportation projects, with little focus on start-ups or other SMEs. There is an opportunity for impact investors to focus their attention on this latent investment market to source businesses with high potential for impact that have yet to be discovered.

There are a number of high-potential sectors for entrepreneurs to launch or grow businesses with the support of impact capital:

- **Tourism:** Most visitors to Djibouti are business travelers affiliated with the country's military bases. However, due to its coastal location, there are untapped opportunities in ecotourism and dive tourism.⁶⁷ The World Bank projects that tourism is one of the most promising sectors for job creation—expecting that Djibouti could grow tourism from 50,000 visitors annually today to 500,000 tourists by 2030, generating up to 30,000 direct jobs.⁶⁸
- **Transport and logistics:** This sector is the backbone of the economy, employing approximately 10% of the actively employed population.⁶⁹ As the government continues to invest in new ports, railways, and airports, there will be a corresponding need for businesses that offer support services in the sector.

67 US Department of State, *2013 Investment Climate Statement – Djibouti*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204631.htm>.

68 *Ibid.*

69 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDS/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

- **Fishing:** Although Djibouti is a coastal nation, its fisheries sector remains underdeveloped. The country's annual catch is estimated at only 1,800 metric tons, compared to 157,000 in Kenya or 30,000 in Somalia;⁷⁰ however, with additional investment in equipment, training, and exploration, the sector could increase significantly in the next decade.⁷¹
- **Energy:** In 2012, President Guelleh pledged to make a full transition to renewable energy by 2020.⁷² With this strong government support, there are opportunities for impact investors to develop Djibouti's renewable energy resources (e.g. geothermal, wind, and solar).
- **Agriculture:** Djibouti currently produces approximately 3% of its food and imports the rest, leaving the country highly exposed to external market risks such as sudden surges in food prices.⁷³ Agriculture in Djibouti is particularly difficult because of the arid climate, which opens opportunities to invest in businesses that are able to transition to drought-resistant crop technologies, and to invest in needed water mobilization and irrigation to increase yields.⁷⁴

70 FAO, *Statistical Query Report: Capture*, available at <http://www.fao.org/figis/servlet/SQServlet?ds=Capture&k1=COUNTRY&k1v=1&k1s=&outtype=html>.

71 World Bank Group, *Country Partnership Strategy For The Republic Of Djibouti Fy2014-2017*, available at http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2014/03/12/000333037_20140312152815/Rendered/PDF/838740REVISED0010Box382156B00OUO090.pdf.

72 US Department of State, *2013 Investment Climate Statement – Djibouti*, available at <http://www.state.gov/e/eb/rls/othr/ics/2013/204631.htm>.

73 Economy Watch, “Djibouti Economy,” available at http://www.economywatch.com/world_economy/djibouti.

74 Adaptation Fund, “Developing Agro-Pastoral Shade Gardens As An Adaptation Strategy For Poor Rural Communities,” available at <http://www.undp.org/content/dam/undp/documents/projects/DJI/GB.pdf>.



SOMALIA

A VIBRANT PRIVATE SECTOR
SUSTAINED BY DIASPORA

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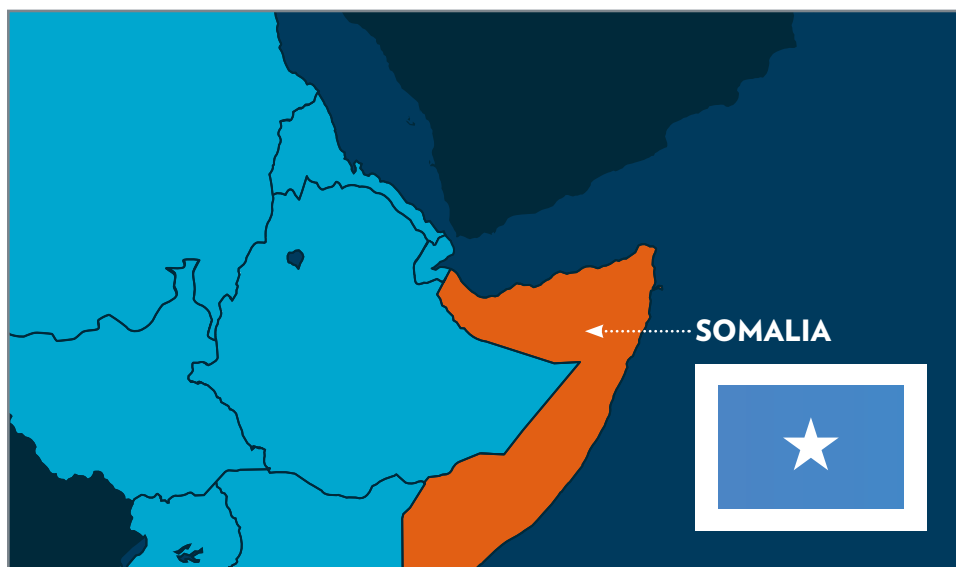
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INTRODUCTION

Over the past few decades, Somalia has experienced conflict and insecurity, and has witnessed the disintegration of its central government. Despite these uncertainties, the country has maintained a growing private sector. In many cases, the private sector has filled roles typically held by public institutions such as financial services, security, and education. With a new, internationally backed government now in power and the militant Islamist group Al-Shabaab expelled from all urban centers, there is hope for a new era of stability. Sufficient peace could allow the government to establish regulatory and legal systems to encourage foreign investment and the formalization of the private sector.

Despite these improvements, no impact capital has been disbursed in Somalia to date, including by development finance institutions (DFIs).¹ Impact investors face serious challenges to investing in Somalia, including high political uncertainty, no formal banking or foreign exchange mechanisms, a weak legal system, and insufficient regulatory protection. However, many impact investors include the entire East Africa region in their geographic mandates, representing approximately USD 500 million in impact capital. Given the lack of investing activity to date, however, it seems unlikely that much or any of this will be placed in Somalia in the near future.

FIGURE 1: MAP OF SOMALIA



1 Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.

COUNTRY CONTEXT

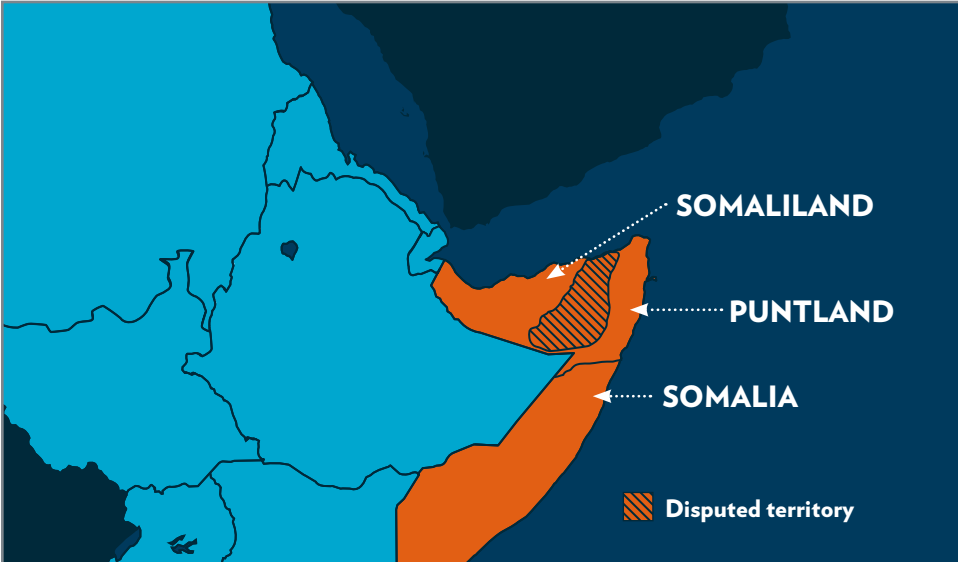
Somalia has experienced prolonged periods of conflict and instability, accompanied by intense fighting, population displacement, food insecurity, and a lack of centralized governance structures.

After the collapse of President Siad Barre’s regime in 1991, the country went more than two decades without a formal parliament. It was not until 2012 that a new, internationally backed government came into power. In the intervening years under transitional governments, the country suffered from clan warfare and the rise of Islamist militant groups, most notably Al-Shabaab.

By the middle of 2012, a coordinated operation between the Somali Army and international forces re-captured most of the territory held by Al-Shabaab, including Mogadishu, the capital, and other major urban centers. Al-Shabaab still controls many rural areas of the country.

During many years of conflict, Somalia fragmented into three de-facto autonomous regions: South Central Somalia, which contains Mogadishu; Puntland in the north-east; and Somaliland in the north (Figure 2).² After President Barre’s fall in 1991, Somaliland declared itself a sovereign state and has since been seeking the international community’s recognition as such.³ Puntland declared its autonomy in 1998, although it seeks only recognition as an autonomous region within Somalia, not as an independent state.⁴

FIGURE 2: REGIONS OF SOMALIA



2 African Development Bank Group, *Somalia: Country Brief 2013-2013* (2013) available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

3 *Ibid.*

4 “Puntland Profile,” *BBC News* (Jan. 8, 2014), available at <http://www.bbc.com/news/world-africa-14114727>.

Although the term “Somalia” is often used to refer to only South Central Somalia, for the purpose of this study the three political entities are referred to as South Central Somalia, Puntland, and Somaliland, while Somalia refers to all three entities collectively.

Gross Domestic Product

After years of conflict without a central government or state institutions, Somalia lacks reliable economic and social statistics, making it difficult to accurately monitor economic and social development.

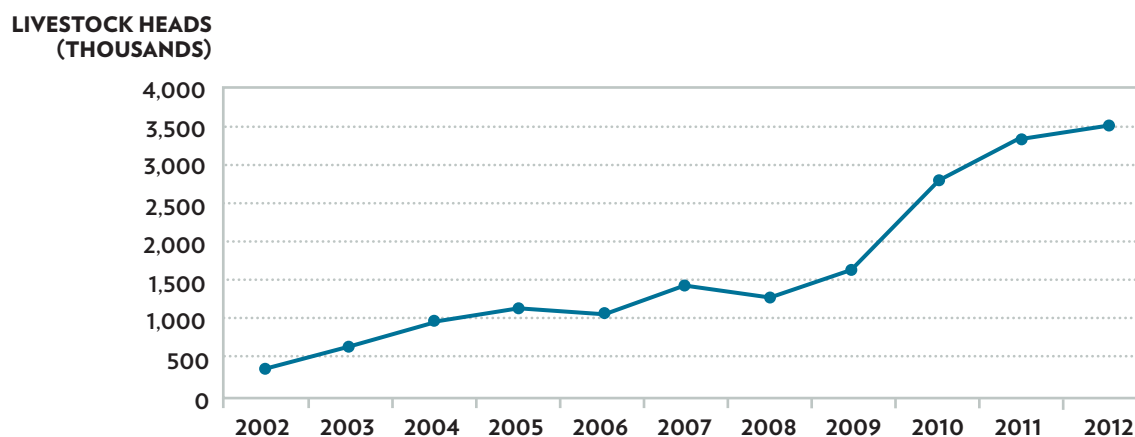
Nonetheless, Somalia’s GDP was estimated at USD 5.8 billion in 2010, the last year in which official data was available, while GDP per capita was estimated at USD 600.⁵ At these figures, Somalia is the fourth smallest market in the region. The economy is predominantly informal and dominated by agriculture, which accounts for approximately 65% of GDP and employment.⁶

5 Ahmed Dualeh, African Development Bank Group, *African Economic Outlook Somalia 2014* (2014), available at http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Somalia_EN.pdf.

6 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

Within agriculture, livestock production is the biggest sub-industry. Somalia has a large pastoral population that is dependent on livestock for its livelihood and, in aggregate, livestock accounts for 40% of GDP and more than 50% of export earnings.⁷ This is even higher in Somaliland, where livestock is estimated to make up 65% of GDP.⁸ The export of cattle is also an important and growing sector in the Somaliland economy—in 2012 an estimated 4 million cattle were exported from the region (see Figure 3).

FIGURE 3: CATTLE EXPORTS, SOMALILAND, 2002-2012



Source: Somali Ministry of Trade and Investment

Driven largely by the diaspora, remittances are a large source of revenue in Somalia and the largest source of foreign currency.⁹ It is estimated that remittances add up to USD 1-2 billion annually, more than 25% of GDP.¹⁰ Almost 40% of households rely on diaspora funds to cover basic needs like food, clothing, education, and medical care. North America and Europe are the largest sources of remittances.

7 “The World Factbook Somalia,” *Central Intelligence Agency* (Jun. 23, 2014), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/so.html>.

8 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

9 Manuel Orozco & Julia Yansura, Oxfam America, Africa Development Solutions & Inter-American Dialogue, *Keeping the lifeline open: Remittances and markets in Somalia* (2013), available at <http://www.oxfamamerica.org/static/media/files/somalia-remittance-report-web.pdf>.

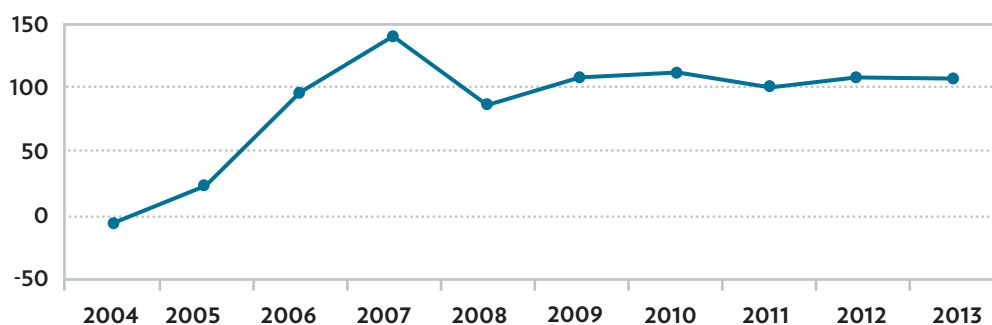
10 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

Foreign Direct Investment (FDI)

With increased stability, foreign direct investment in Somalia is expected to grow in the coming years, yet current levels remain low, with USD 107 million in estimated inflows in 2013 (Figure 4). The Somali government views foreign investment as a key component of rebuilding the economy, and actively encourages new investors. They have released multiple statements to this effect and hosted conferences to promote Somalia as an attractive investment opportunity. For example, the government co-hosted the Somalia Trade and Investment Event with the UK Department for International Development (DfID) in May 2013 and another conference in Dubai in May 2014 with the Dubai Chamber of Commerce.

FIGURE 4: FDI FLOWS, 2004-2013

USD MILLIONS



Source: UNCTAD

In South Central Somalia, food processing has historically attracted the most FDI, although the telecommunications sector has recently superseded it. The primary sources of FDI reaching South Central Somalia are United Arab Emirates, Yemen, and Oman.¹¹ Somaliland FDI is estimated to have significantly increased in recent years with key investments from Kuwait, China, and France in the transport and service sectors.¹² At present, remittances still far outweigh FDI as a source of foreign capital.

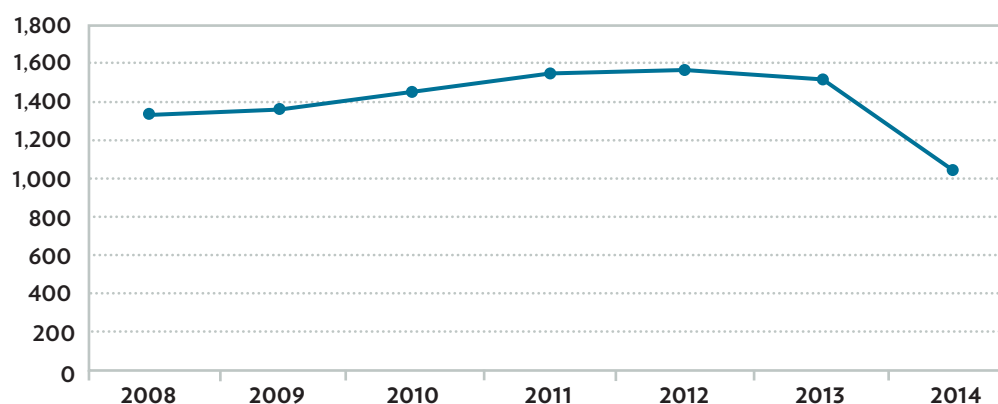
11 Somalia: "Foreign Investment" *Santander trade* (Oct. 2014), available at <https://en.santandertrade.com/establish-overseas/somalia/investing-3>.

12 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

Inflation and Exchange Rates

The US Dollar and the Somali Shilling are both widely accepted currencies in Somalia; however, Somaliland also has its own currency, the Somaliland Shilling. The exchange rate is informally set by black-market traders rather than financial markets or the Central Bank. Over the past year, the Somali Shilling has been the world's strongest performing currency, rising more than 60% relative to the USD (Figure 5).¹³ This has been attributed to a shortage of shillings due to high volumes of remittances, inflows of donor aid, and growing FDI.¹⁴ The rising value of the Shilling has had a destabilizing effect on the economy—the majority of Somali families rely on remittances, and the falling value of foreign currencies relative to the Shilling has caused their purchasing power to fall.

FIGURE 5: USD/SOS EXCHANGE RATE, 2008-2014



Source: Oanda

Inflation is also a serious challenge. Although reliable figures are unavailable, current estimates put inflation near 300% per year,¹⁵ caused largely by uncontrolled foreign currency inflows. Inflation is expected to abate somewhat as the Central Bank begins to take greater control of monetary policy.

13 *Financial Times*, “The curious tale of the world-beating Somali shilling”, <http://blogs.ft.com/beyond-brics/2014/03/20/the-curious-tale-of-the-world-beating-somali-shilling/>.

14 *Ibid.*

15 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

SUPPLY OF IMPACT INVESTING CAPITAL

There have been no known impact investments to date in Somalia. Persistent conflict has discouraged investors—including impact investors—from placing capital in the country.

Broader Investing Landscape

With increasing stability, the government has declared Somalia “open for business.”¹⁶ In conjunction with its marketing message, the government is investing resources to improve Somalia’s legal and regulatory systems to further encourage investment. Parts of Somalia have experienced a wave of new businesses and capital inflows. At present these largely originate with the Somali diaspora, who have played a significant role in fostering economic regeneration, but there are also opportunities for non-Somali investors. International companies are opening or re-opening offices in Somalia. After ending operations in 2006, Coca-Cola, often one of the first foreign businesses in frontier markets, is re-opening its factory in Mogadishu, while a conglomerate of Djiboutian investors have invested USD 15 million to open a second Coca-Cola factory in Somaliland.¹⁷ The Coca-Cola factory is the largest single foreign direct investment in Somaliland since its formation. Other international companies in Somalia include Turkish Airlines, Africa Oil, and Range Resources.¹⁸ There has also been a recent emergence of diaspora groups geared toward promoting micro, small, and medium enterprise growth and private sector development such as Shuraako and the Somaliland Business Fund in Somaliland.

Despite this investment activity, most of the money channeled into Somalia is from international donor agencies. These funds are directed towards the infrastructure, agriculture, and livestock sectors aimed at rebuilding Somalia’s economy.

The Somali financial sector is weak and underdeveloped. In 2009, the transitional government re-opened the Central Bank of Somalia, but the bank is still setting up formal systems and currently has no foreign currency reserves or a coherent monetary policy.¹⁹ In Somaliland, the Bank of Somaliland (a regional arm of the Central Bank) is involved in elementary treasury activities, government payment functions, and basic commercial banking activities, mainly offering national remittance services through its network of 14 branches. The bank offers savings and current accounts to a limited

16 See for instance <http://www.telegraph.co.uk/news/worldnews/africaandindianoccean/somalia/10040710/Somalia-is-open-for-business-says-president.html>.

17 The Guardian, “*Somaliland bottles its hopes on Coca-Cola*”, available at <http://www.theguardian.com/global-development/2012/jul/20/somaliland-bottles-hopes-coca-cola-plant>.

18 The East African (9/02/2013) <http://www.theeastafrican.co.ke/news/With-improved-security-investors-eyeing-Somalia-/2558/1689618/-/f9iwpuz/-/index.html>.

19 Financial Times, “*The curious tale of the world-beating Somali shilling*”, <http://blogs.ft.com/beyond-brics/2014/03/20/the-curious-tale-of-the-world-beating-somali-shilling/>.

number of clients, typically government bodies. To date, the Somaliland Government has not instituted a legal framework for commercial or Islamic banks.²⁰ In Puntland, Puntland State Bank and Dayax Islamic Bank are the only banking institutions present, and Puntland State Bank also serves as the government treasury.²¹

Apart from banks, whose reach remains limited, the main actors in Somalia's financial sector are Somali remittance companies, which have extensive networks of agents that serve all towns and villages in the country, as well as major international cities with significant Somali diaspora presence.²²

Impact Capital Disbursed

Impact investors face many challenges in the region and, as a result, no known impact capital has been disbursed in Somalia to date—by either DFIs or other impact investors. However, many impact investors have regional investment mandates that include Somalia, amounting to about USD 500 million in capital committed to the region, including Somalia. A growing pipeline of viable businesses, especially in Puntland and Somaliland, could increase the attractiveness of Somalia to impact investors and stimulate impact capital flows into the country; however, based on historical investment flows, it is unlikely this would account for a significant portion of the capital committed.

20 Istanbul Conference “Banking, remittances, and the role of the central bank in promoting financial and private sector development in Somalia (2010),” available at <http://www.somalitalk.com/2010/may/istambul/banking.pdf>.

21 UNHABITAT, “Municipal Finance and Public Service Delivery in the Puntland State Of Somalia,” available at <http://www.isgi.cnr.it/wp-content/uploads/2012/07/Operational-study-entire.pdf>.

22 Istanbul Conference “Banking, remittances, and the role of the central bank in promoting financial and private sector development in Somalia (2010),” available at <http://www.somalitalk.com/2010/may/istambul/banking.pdf>.

DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Somalia lacks consistent government rule and lags global development indicators across the board. The combination of the development needs and a surprisingly vibrant private sector could present interesting opportunities for businesses to generate social impact.

Development Context

Somalia ranked 165th in the United Nation's 2010 Global Human Development Report, with an HDI score of 0.285. Of the three key dimensions used to measure a country's development, Somalia ranks lowest in education, followed by income and health.²³

Approximately 73% of Somalis live on less than USD 2 per day.²⁴ The divide between urban and rural populations is significant—whereas 61% of urban residents are below the poverty line, the poverty rate rises to 94% in rural areas. Poverty rates reach 89% in South Central Somalia, 75% in Puntland, and 72% in Somaliland.

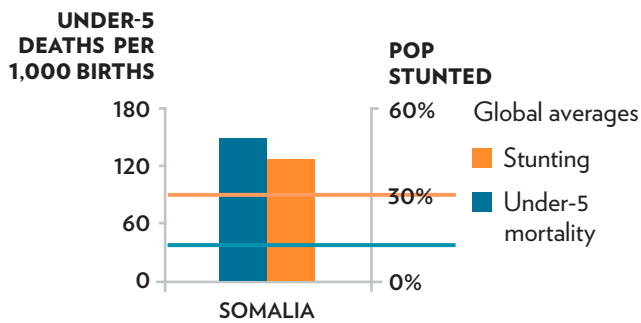
23 UNDP "Somalia Human Development Report 2012 Empowering Youth for Peace and Development," (2012) *available at*, <http://www.undp.org/content/dam/undp/library/corporate/HDR/Arab%20States/HDR-Somalia-Factsheet-2012-E.pdf>.

24 UN HDI Data.

Somalia's health indicators are among the worst in Africa. Years of conflict resulted in the near total destruction of most health facilities and infrastructure. The public health sector is slowly recovering but still remains highly reliant on the UN and donor agencies. Somalis have an estimated life expectancy of 49.7 years. Infant and child mortality rates stand at 108.4 and 178 per 1,000 live births, respectively (Figure 6). Maternal mortality rates are similarly high at 1,400 per 100,000 live births, compared with 683 on average for Africa. Nationally, only 29% of the population has access to improved water sources, and 23% to improved sanitation facilities, while these values fall to 9% and 6% respectively in rural areas.²⁵

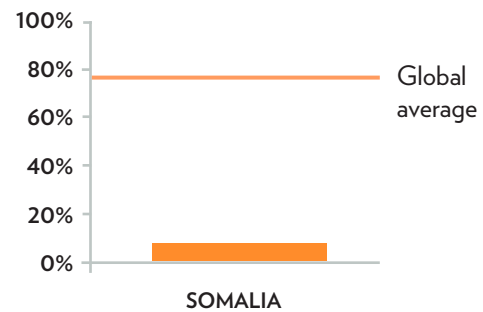
Somalia also underperforms on education metrics relative to the region. Only 22% of children aged 6-17 are in formal schooling, with boys' enrollment at 24% higher than girls' at 19%.²⁶ Seven percent of the secondary school-age population is enrolled in school (Figure 7).

FIGURE 6: UNDER-5 MORTALITY AND STUNTING (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

FIGURE 7: SECONDARY SCHOOL GROSS ENROLLMENT

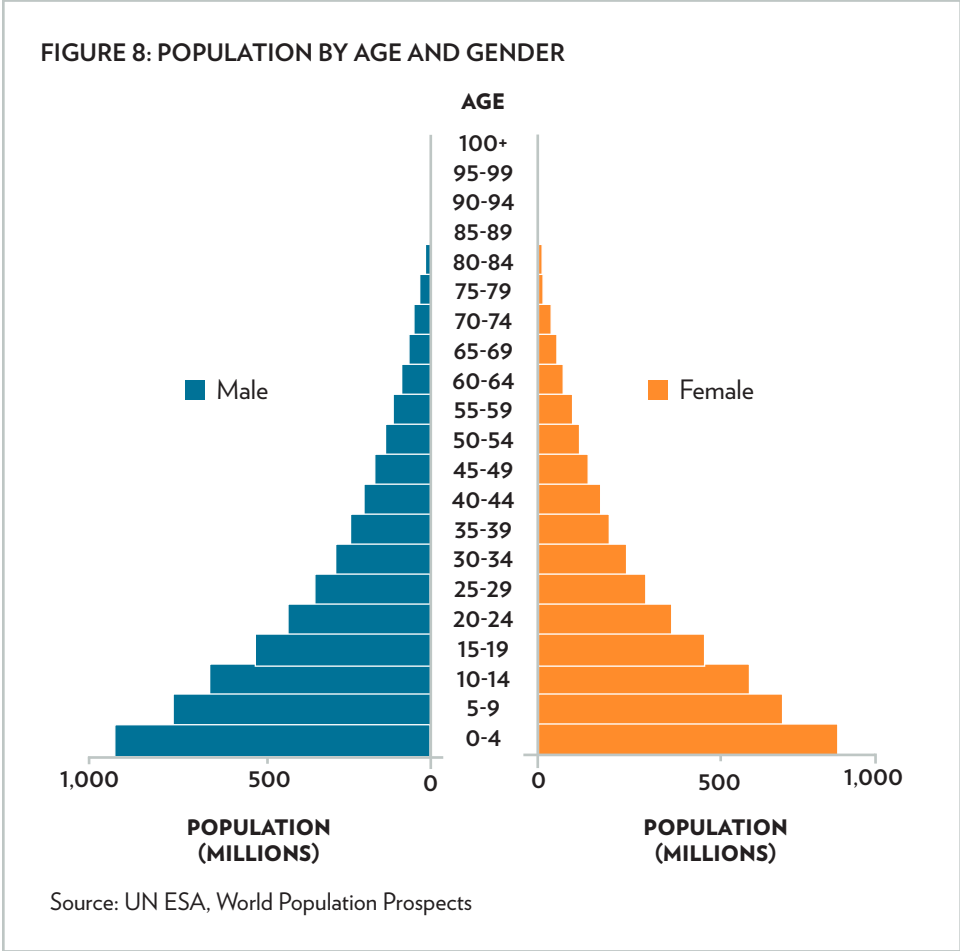


Source: UN Human Development Report 2014

25 African Development Bank Group, *Somalia: Country Brief 2013-2015* (2013), available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

26 UNESCO, *Education Sector Strategic Plan*, available at <http://planipolis.iiep.unesco.org/upload/Somalia/Somalia-Puntland-Education-Sector-Plan-2012-2016.pdf>.

Somalia's youth (14-29 years) comprise 42% of the population (Figure 8).²⁷ Somalia has one of the highest youth unemployment rates in the world at 67%. Unemployment, conflict, and poverty have left many youth frustrated, fueling both piracy and terrorism. More women than men are unemployed, with female unemployment rates as high as 74% compared to men at 61%.²⁸



27 The survey conducted for the Somalia Human Development Report used 14-29 years as a parameter for youth following consultations with various Somali stakeholders, including young Somali men and women, <http://www.undp.org/content/dam/undp/library/corporate/HDR/Arab%20States/HDR-Somalia-Factsheet-2012-E.pdf>.

28 UNDP "Somalia Human Development Report 2012 Empowering Youth for Peace and Development," (2012) available at, <http://www.undp.org/content/dam/undp/library/corporate/HDR/Arab%20States/HDR-Somalia-Factsheet-2012-E.pdf>.

Entrepreneurs

Despite the relative success of the private sector in the face of instability and the many opportunities for businesses to contribute, entrepreneurs still face many challenges that limit the growth of the sector, including access to finance. The Somali financial sector remains underdeveloped, informal, and unsupervised, with limited access to credit and savings. Somalia's few existing banks provide only limited services, and local entrepreneurs are forced to largely rely on savings or remittances to finance their businesses.²⁹ Further private sector growth will require additional sources of finance.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

The Somali ecosystem is not especially conducive to investing. The current administration is working to improve the regulatory and legal environment, but it still offers little protection for investors. There are also few intermediaries or other third parties to support emerging social enterprises or impact investors.

Regulatory Environment

After the fall of Barre in 1991, Somalia underwent a prolonged period without a central administration. In its absence, the country established what academics term “governance without government.”³⁰ Communities cobbled together alternate governance structures, borrowing from customary systems and foreign regulatory systems that were overseen by a combination of local authorities, civic groups, and private businesses.

Under the new regime, the new Federal Government of Somalia (FGS) has committed to establishing stability and building regulatory institutions. Under the Somalia New Deal Compact, the government has laid out its five peace- and state-building goals. It has also committed to adopting a constitution by the end of 2015 and holding elections in 2016.³¹ Despite these promising improvements, the regulatory and legal environment is still weak and limits Somalia's appeal to investors:

29 Istanbul Conference “Banking, remittances, and the role of the central bank in promoting financial and private sector development in Somalia (2010),” available at <http://www.somalitalk.com/2010/may/istambul/banking.pdf>.

30 Humanitarian Futures Program, “Prospects for an alternative approach? The private sector in Somalia's new statebuilding agenda”, available at <http://www.humanitarianfutures.org/wp-content/uploads/2014/01/SOMALIA-REPORT-FINAL.pdf>.

31 AFDB *Somalia Country Brief 2013-2013* available at, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

- **Foreign exchange controls:** Somalia does not have a central foreign exchange market. The system is controlled by private sector Hawala money transfer institutions dealing primarily in expatriate remittances.^{32,33} Exchange rates pose a significant risk to investors, given the instability of the Somali Shilling.
- **Land ownership:** The current land tenure system in Somalia is a mixture of secular, sharia, and Xeer law (customary Somali law).³⁴ The new federal constitution in South Central Somalia states that “every person has the right to own, use, enjoy, sell, and transfer property” and that property will not be expropriated unreasonably.³⁵ With the exception of this clause, there is little formal legislation regarding land at the federal level. The Constitution of Somaliland stipulates that, “land is a public property commonly owned by the nation, and the state is responsible for it.” Both foreigners and Somalilanders are freely able to purchase and sell property.³⁶ Investors should, however, be aware that land record systems are still being developed, so title searches can be challenging. In Puntland, all land belongs to the state, and the government is the only body able to allocate land.
- **Government enterprises:** Without a central administration, Somalia’s public entities disintegrated during years of war. The private sector noticed the void created by failed public institutions and moved to capitalize on this. Today, the private sector offers essential services such as health and education and is involved in court services such as dispute resolution, contract enforcement, property rights protection, and law and order.

Ecosystem Players

There are very few intermediaries operating to support social enterprises or impact investors. One example of an emerging organization is the Iftiin Foundation, a social enterprise established in 2012 to bring members of the diaspora and locals together by teaching leadership skills to young people in Mogadishu and connecting entrepreneurs to funders.³⁷ Similarly, the Shuraako Initiative is a non-profit that helps micro, small, and medium enterprises connect with capital by providing pro-bono support in writing business plans and conducting initial due diligence on potential investments. The initiative’s goal is to encourage investment in Somalia by sourcing

32 Wharton “Somalia,” available at <http://fic.wharton.upenn.edu/fic/africa/Somalia%20Final.pdf>.

33 Hawala is an informal money transfer system of a large number of money brokers operating outside of the formal financial sector.

34 Shuraako, “Land Tenure in Somalia,” available at <http://shuraako.org/sites/shuraako.org/files/documents/Land%20Tenure%20in%20Somalia%20A%20Potential%20Foundation%20for%20Security%20and%20Prosperity.pdf>.

35 The Federal Republic of Somalia. Provisional Constitution. August 1, 2012. Article 26, available at <http://unpos.unmissions.org/LinkClick.aspx?fileticket=RkJTOSpoMME>.

36 Ministry of Trade and Investment “An Investment Guide to Somaliland Opportunities & Conditions,” available at http://somalilandinvest.net/somaliland_investment_guide.pdf.

37 The National, “Back to the future: the challenges facing Somalia’s returning diaspora”, available at <http://www.thenational.ae/arts-lifestyle/the-review/back-to-the-future-the-challenges-facing-somalias-returning-diaspora#ixzz3KHM6xw9i>.

investment opportunities.³⁸ Finally, the Somaliland Business Fund offers matching grants to eligible small businesses to enable them to purchase physical assets and/or acquire business development services.³⁹ As the investment landscape matures, it is expected that an increasing number of intermediaries will enter the Somali ecosystem to support promising social enterprises.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Potential impact investors face several significant challenges:

- **Political uncertainty:** Arguably the largest barrier to investing in Somalia is political uncertainty. The country has often been referred to as the world's "most failed state,"⁴⁰ and decades of conflict and repeated failed interventions have left investors wary. In addition, Somalia's weak regulatory and legal systems leave both investors and entrepreneurs vulnerable.
- **Foreign exchange:** In the absence of banks or a formal foreign exchange market, it is difficult for investors to obtain local currency or adequately hedge against currency risk. Foreign investors use three main systems to get money into Somalia: Hawala, investment-in-kind, and cross-border currency systems. Hawala is heavily used by the diaspora to remit money back to family in Somalia. Investment-in-kind is popular with international NGOs. This form of support entails the delivery of materials, goods, or labor from other countries because the equivalent does not exist in sufficient quantity in Somalia.⁴¹ Cross-border currency is normally used by investors mainly in the more unstable regions of Somalia like Mogadishu. Some investors may also move money through small airports like the Wilson and Garissa airports in Kenya. Both methods are, however, extremely risky.

38 Shuraako, "For Investors", available at <http://shuraako.org/investors>.

39 Somaliland Business Fund, "Frequently Asked Questions", available at <http://www.somalilandbusinessfund.com/index.php/faq>.

40 The Fund for Peace, "The failed states index, 2013", available at <http://ffp.statesindex.org/rankings-2013-sortable>.

41 Shuraako, "Somalia Banking: Transfers, Challenges And Opportunities," available at <http://shuraako.org/sites/shuraako.org/files/documents/Somalia%20Banking%20Transfers,%20Challenges%20And%20Opportunities.pdf>.

Opportunities

Despite these challenges, members of Somalia's large, global diaspora are beginning to invest and/or return to the country with active encouragement from the government.⁴² Generally, they are motivated by a combination of a desire to help their homeland and an understanding of the potential prospects. A number of opportunities are beginning to emerge for impact investors:

- **Invest in technical assistance to build pre-investment pipeline:** Somalia has very few intermediaries providing any advisory and business development services to local enterprises. Impact investors could replicate models in other countries in the region (e.g., Kenya) where pre-investment technical assistance has helped businesses grow to investment readiness.
- **Develop a regional focus:** Levels of conflict and instability vary across Somalia. Somaliland and Puntland have been essentially operating as relatively stable independent states in recent years, and most likely offer the most amenable environments for impact investment at present.
- **Partner with returning diaspora members:** Over one million Somalis live outside the country, often having acquired valuable skills and experience abroad. The government has recognized the diaspora's potential to help rebuild the economy and is actively encouraging their return by promoting the opportunities to rebuild the country and make money. Returning diaspora benefit from both an understanding of local markets as well as foreign expertise, and could provide a rich source of entrepreneurs, intermediaries, or investment partners.

Somalia's poverty levels and low human development indicators demonstrate that there is great need for investment to provide basic services, create employment, and drive economic growth. There are opportunities for entrepreneurs to launch businesses across a variety of sectors:

- **Agribusiness:** Somalia is heavily dependent on imported food. Years of conflict have displaced farmers from their land and destroyed productive assets such as irrigation systems. Along with frequent droughts, this has led to a decline in agricultural production.⁴³ Investing in agribusinesses and supporting farmers with inputs, credit, and productivity-enhancing measures could reduce the country's dependency on food aid and imports while also improving nutrition.
- **Fishing:** The Somali coast is among the richest fishing grounds in Africa, and holds great potential for development.⁴⁴ The sector has struggled to develop due to lack of skills and equipment and insufficient regulatory frameworks. Investments in the fisheries sector could dramatically improve the welfare of coastal communities.

42 The National, "Back to the future: the challenges facing Somalia's returning diaspora", available at <http://www.thenational.ae/arts-lifestyle/the-review/back-to-the-future-the-challenges-facing-somalias-returning-diaspora#ixzz3KHM6xw9i>.

43 AFDB *w available at*, <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2013-2015%20-%20Somalia%20-%20Country%20Brief.pdf>.

44 Relief Web, "EU boosts the Somali fishing industry", available at <http://reliefweb.int/report/somalia/eu-boosts-somali-fishing-industry>.

- **Water and sanitation:** Somalia suffers from poor access to water and sanitation services. Although Somaliland and Puntland have invested some resources in these sectors, South Central Somalia has very little in the way of centralized sanitation systems, and there has been little government investment. Improvements will require private sector investment and public-private partnerships.
- **Basic health and education:** Social services like health and education have suffered greatly in Somalia in the absence of a central administration. Although NGOs and development partners are investing in the sector, there may be additional opportunities for private players to enter the market.