INTRODUCTION

THE LANDSCAPE FOR IMPACT INVESTING IN EAST AFRICA

WITH SUPPORT FROM

GIIN
GLOBAL IMPACT INVESTING NETWORK

OPEN CAPITAL

UKaid
from the British people

THE IMPACT PROGRAMME

ACKNOWLEDGMENTS

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

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

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LIST OF COMMON TERMS AND ACRONYMS

AFD | Agence Française de Développement (French Development Agency)

AfDB | African Development Bank

BIF | Burundian Franc

BIO | Belgian Investment Company for Developing Countries

BoP | Base of the Pyramid

CEPGL | Communauté Économique des Pays des Grand Lacs (Economic Community of the Great Lakes Countries)

COMESA | The Common Market for Eastern and Southern Africa

CSR | Corporate Social Responsibility

DFI | Development Finance Institution

DFID | The Department for International Development (United Kingdom)

DRC | Democratic Republic of the Congo

EAC | East African Community

Early-stage business | Business that has begun operations but has most likely not began commercial manufacture and sales

EIB | European Investment Bank

ESG | Environmental, Social, and Governance

ETB | Ethiopian Birr

FDI | Foreign Direct Investment

FMCG | Fast-Moving Consumer Goods

FMO | Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (Netherlands Development Finance Company)

Focus countries | Countries under the study where non-DFI impact investors are most active in. Namely Ethiopia, Kenya, Rwanda, Tanzania, and Uganda

GDP | Gross Domestic Product

GEMS | Growth Enterprise Market Segment

GIIRS | Global Impact Investing Ratings System

GIZ | Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)

Growth-stage business | Company has a functioning business model and its current focus is developing new products / services or expanding into new markets

HDI | Human Development Index

ICC | International Criminal Court

ICT | Information and Communication Technology

IFAD | International Fund for Agricultural Development

IFC | International Finance Corporation

IMF | International Monetary Fund

IRIS | Impact Investing and Reporting Standards

KES | Kenyan Shilling

LP | Limited Partner

Mature business | Profitable company with a developed and recognizable brand

MDG | Millennium Development Goal

MFI | Microfinance Institution

MSME | Micro, Small and Medium Enterprise

NGO | Non-Governmental Organization

Non-focus countries | Countries covered in the study but have limited non-DFI impact investor activity. Namely Burundi, Djibouti, Eritrea, Somalia, South Sudan, and Sudan

OFID | OPEC Fund for International Development

OPIC | Overseas Private Investment Corporation

PE | Private Equity

PPA | Power Purchasing Agreement

PPP | Purchasing Power Parity

PPP | Public-Private Partnership

PTA | Preferential Trade Area Bank

RDB | Rwanda Development Board

RFP | Request for Proposal

RWF | Rwandan Franc

SACCO | Savings and Credit Co-operative

SAGCOT | Southern Agricultural Corridor of Tanzania

SDG | Sudanese Pound

SGB | Small and Growing Business

SME | Small and Medium-Sized Enterprises

SOE | State-Owned Enterprises

SOS | Somali Shilling

SSP | South Sudanese Pound

TA | Technical Assistance

TIC | Tanzania Investment Centre

TZS | Tanzanian Shilling

UGX | Ugandan Shilling

UN DESA | United Nations - Department of Economic and Social Affairs

UNCTAD | United Nation's Conference on Trade and Development

USAID | The United States Agency for International Development

VAT | Value-Added Tax

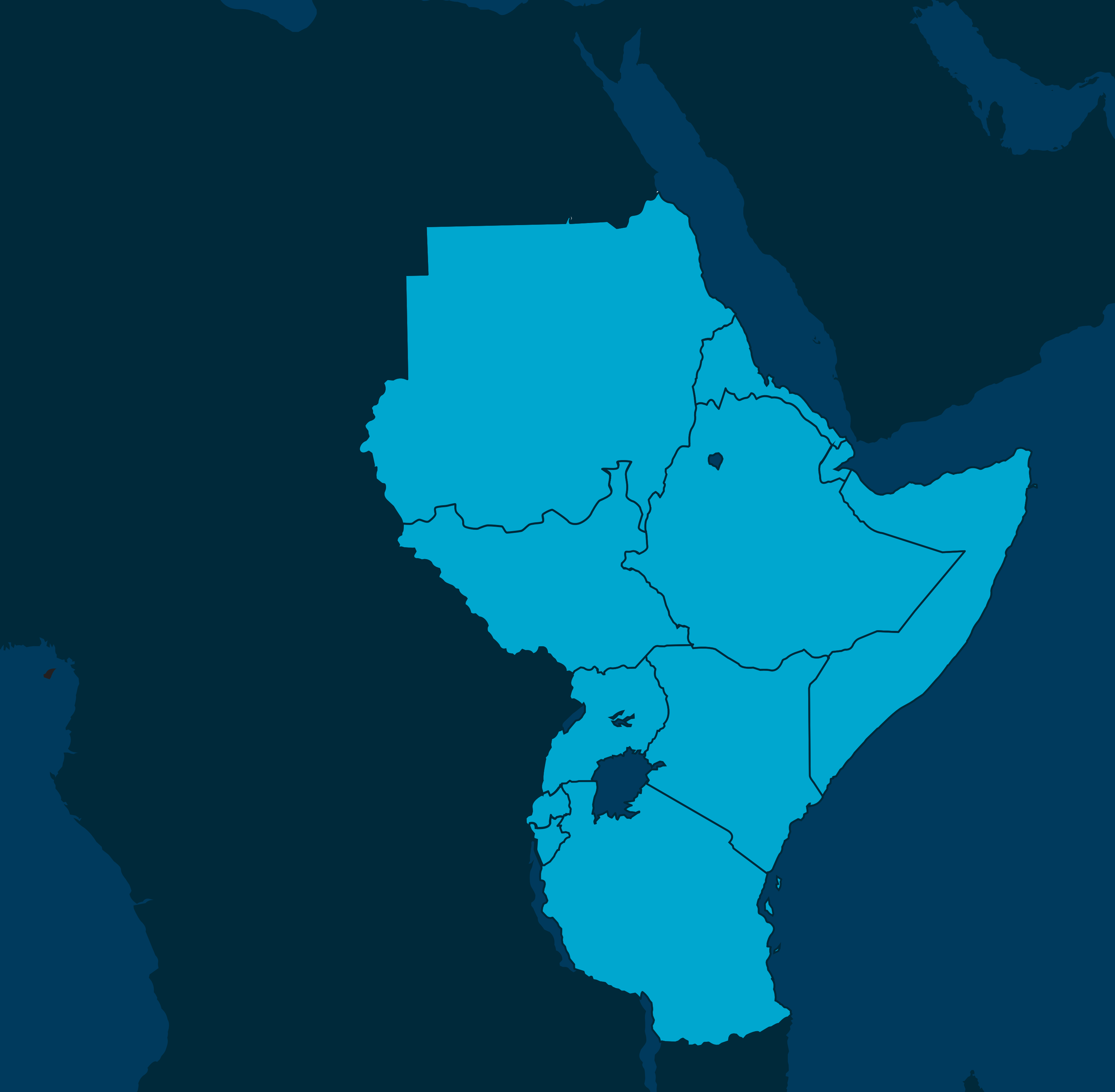
VC | Venture Capital

Venture-stage business | Sales have begun but cannot sustain the company's operations. The business model is still being aligned with the realities on the ground

WASH | Water, Sanitation, and Hygiene

WHO | World Health Organization

INTRODUCTION & METHODOLOGY



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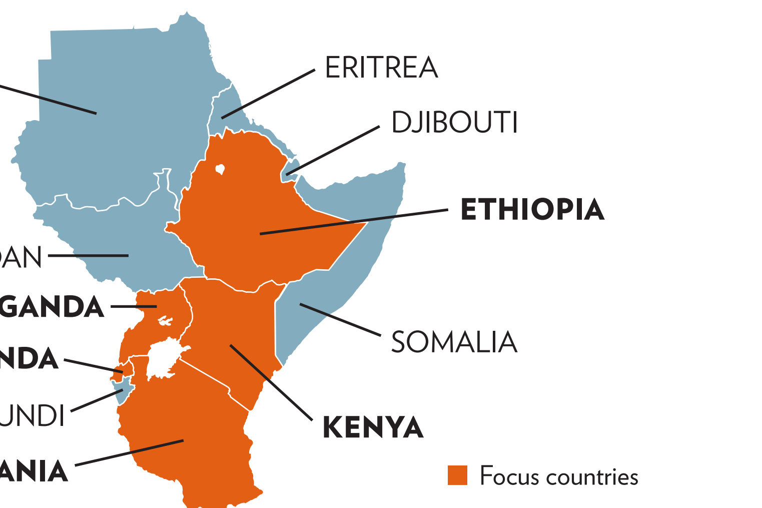
FOCUS AND SCOPE

The impact investing industry has grown in prominence over the last decade, and impact investors globally have developed significant interest in sub-Saharan Africa in particular. The most recent global impact investor survey conducted by J.P. Morgan and the Global Impact Investing Network (GIIN) shows that more respondents have allocated a portion of their portfolio to sub-Saharan Africa than to any other geography, and more plan to increase allocations to that region than to any other region.[1] Despite strong interest from a growing set of impact investors, there has been relatively little research that examines impact investing markets at the country-by-country level. This type of granular information is essential to investors currently operating in the region or considering investments there in the future.

This is the second regional market landscaping study published by the GIIN in a series that seeks to address the lack of data available on impact investing in specific emerging economies. The first such report examined impact investing in South Asia, with a particular focus on Bangladesh, India, Myanmar, Nepal, Pakistan, and Sri Lanka.[2] The present report explores impact investing in East Africa and will be followed by reports on West and Southern Africa, respectively.

FIGURE 1: MAP OF EAST AFRICA



As defined for this report, East Africa includes 11 countries: Kenya, Uganda, Tanzania, Rwanda, Ethiopia, Burundi, Somalia, Djibouti, Eritrea, Sudan, and South Sudan. Due to their relatively active impact investing markets, this report places particular attention on Kenya, Uganda, Tanzania, Rwanda, and Ethiopia (referred to as

1 The Global Impact Investing Network & J.P. Morgan, *Spotlight on the Market: The Impact Investor Survey* (2014), *available at* http://www.thegiin.org/binary-data/2014MarketSpotlight.PDF.

2 The Global Impact Investing Network & Dalberg Global Development Advisors, *The Landscape for Impact Investing in South Asia* (2015), *available at* http://www.thegiin.org/cgi-bin/iowa/resources/research/642.html

"focus countries"). For each country, the report examines sources of impact capital, investment instruments, sector focus, investment amounts, and disbursements over time. The report also analyzes key trends in the impact investing industry as well as the challenges and opportunities available for both social enterprises and impact investors in each country.

As defined by the GIIN, impact investments are "investments made into companies, organizations and funds with the intention to generate social and environmental impact alongside a financial return." A commitment to measure social/environmental performance is also considered a hallmark of impact investing.[3] Investors who do not meet this definition have not been included in this report's analysis.

Development finance institutions (DFIs) are important actors in the impact investing landscape, providing large amounts of capital both through direct impact investments and through impact investing funds. Because of their large size and unique nature, this report presents analyses of DFI activity separately from the activity of other types of impact investors. As discussed in more detail in the Methodology section and the DFI chapter, only international and regional DFIs have been considered in the report's analysis. Bi-lateral and multi-lateral assistance directly to governments has been excluded from the definition of impact investing for the purposes of this report.

FIGURE 2: DEFINITIONS

DEVELOPMENT FINANCE INSTITUTION (DFI)

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

NON-DFI IMPACT INVESTOR

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

IMPACT CAPITAL VEHICLE

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

3 The Global Impact Investing Network website, www.thegiin.org

11 COUNTRIES

This report analyzes impact investing activity in eleven countries in East Africa.

KENYA · UGANDA · TANZANIA · RWANDA · ETHIOPIA · BURUNDI · SOUTH SUDAN · SUDAN · ERITREA · DJIBOUTI · SOMALIA

20 DFIs

There are 20 development finance institutions (DFIs) making investments in the region.

135 NON-DFI IMPACT INVESTORS

There are 135 non-DFI impact investors allocating capital in the region.

186 IMPACT CAPITAL VEHICLES

The non-DFI investors are making investments through 186 known impact capital vehicles.

The research team identified **1,131 TRANSACTIONS** for analysis in this report, which are split as follows.

DFI INVESTMENTS

429 DIRECT

107 INDIRECT

NON-DFI INVESTMENTS

546 DIRECT

19 INDIRECT

49 ECOSYSTEM ORGANIZATIONS

The research team identified 49 organizations offering support services for the impact investing industry in East Africa.

METHODOLOGY

Data Collection and Analysis Methods

This report presents the first comprehensive landscaping study of the East African impact investing landscape at a country level. To date, there has been limited research that maps impact investing activity in this region at the degree of granularity achieved in this report.

As a result, the report relies heavily on primary research, which includes more than 60 interviews with local and international investors, social enterprises, ecosystem players, DFIs, and government institutions (see the Appendix for a list of organizations interviewed). The research team examined publicly-available primary information—including investor documents, and organization websites, and press releases—to compile a comprehensive database across all 11 countries in East Africa. Where possible, the report draws on the existing body of impact investing research in the region, as well as available data sets, newspaper articles, and summaries of impact investing activity.

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

This report includes data from 20 DFIs and 186 other impact capital vehicles managed by 135 distinct organizations.[4] Each organization was evaluated based on its stated goals gathered from organizational materials, as well as interviews to determine if it should be included in the sample. Only active impact investors, i.e. those with existing investments in the countries studied, are included in this report.

Non-DFI Impact Investors

The 186 impact capital vehicles are managed by 135 non-DFI impact investors who have completed 546 direct impact investments across the 11 countries covered. This count excludes 19 indirect investments into impact funds, which are considered separately to avoid double

4 The initial long-list of investment vehicles identified by the research team comprised 665 vehicles operating across the investing ecosystem in East Africa. Of the organizations analyzed, 257 were excluded because they did not meet the definition of impact investing, including commercial investors, government programs or bodies, donor or aid organizations, and ecosystem players, among others. A further 118 were either found to be defunct, inactive, or not currently placing capital in East Africa. Finally, 84 were excluded because there was insufficient public information to determine their status or operations.

counting.[5] Information collected on each of these deals includes the target, date, amount invested, the instrument used, the currency disbursed, and other transaction notes. The data includes known transaction sizes for 314 direct investments. For the remaining 232 direct investments, the research team used the average transaction value on a fund-specific basis to avoid systematically underestimating the amount of impact capital disbursed within the region.

Many of the organizations studied, especially impact investors active in East Africa, operate across sub-Saharan Africa or beyond, with many organizations considering investments globally in both developed and emerging markets. For the purposes of this report, capital committed to East Africa is allocated according to each impact capital vehicle's internal allocation. Where internal allocations were unavailable, the total capital committed was allocated based on the ratio of the vehicle's historical deal flow to the region or according to general foreign direct investment flows.

Development Finance Institutions

The 20 DFIs active in East Africa have completed 429 disclosed direct investments within the 11 countries covered. Indirect investments into impact funds are considered separately, and excluded from the 429 direct investments. In total, DFIs have made 107 disclosed investments into impact funds operating in East Africa today. This report excludes all bi-lateral and multi-lateral government assistance, which is not included in the definition of impact investing for the purposes of this report.

Demand for Impact Capital and the Broader Ecosystem

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

On the ecosystem side, the research team examined 49 individual organizations operating across the 11 countries under study, including financial advisors, intermediaries, consultants, professional services firms, incubators, and accelerators.

On the demand side, the team analyzed the types of organizations both seeking and receiving capital from impact investors to better understand both the challenges they face in raising capital and opportunities they present for investors. These include organizations ranging from start-up and small-to-medium enterprises to larger, more

5 To identify the 546 direct investments and 19 indirect investments, the research team considered nearly one thousand total transactions made by investors active in East Africa. The excluded transactions were removed from the sample either because the investor did not meet our definition for impact investing or because the transaction did not occur in East Africa.

mature companies. They operate across a range of sectors, such as financial inclusion, agriculture, energy, and health.

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

REPORT STRUCTURE

This report maps the impact investing landscape in 11 countries across East Africa. The Executive Summary provides an overview of key findings across the region and includes comparisons across countries as well as country summaries. The Regional Overview chapter provides additional detail and data on the impact investing landscape in East Africa overall. As many impact investors operate regionally, the Regional Overview chapter draws out many of the trends, opportunities, and challenges shared by all countries in the region.

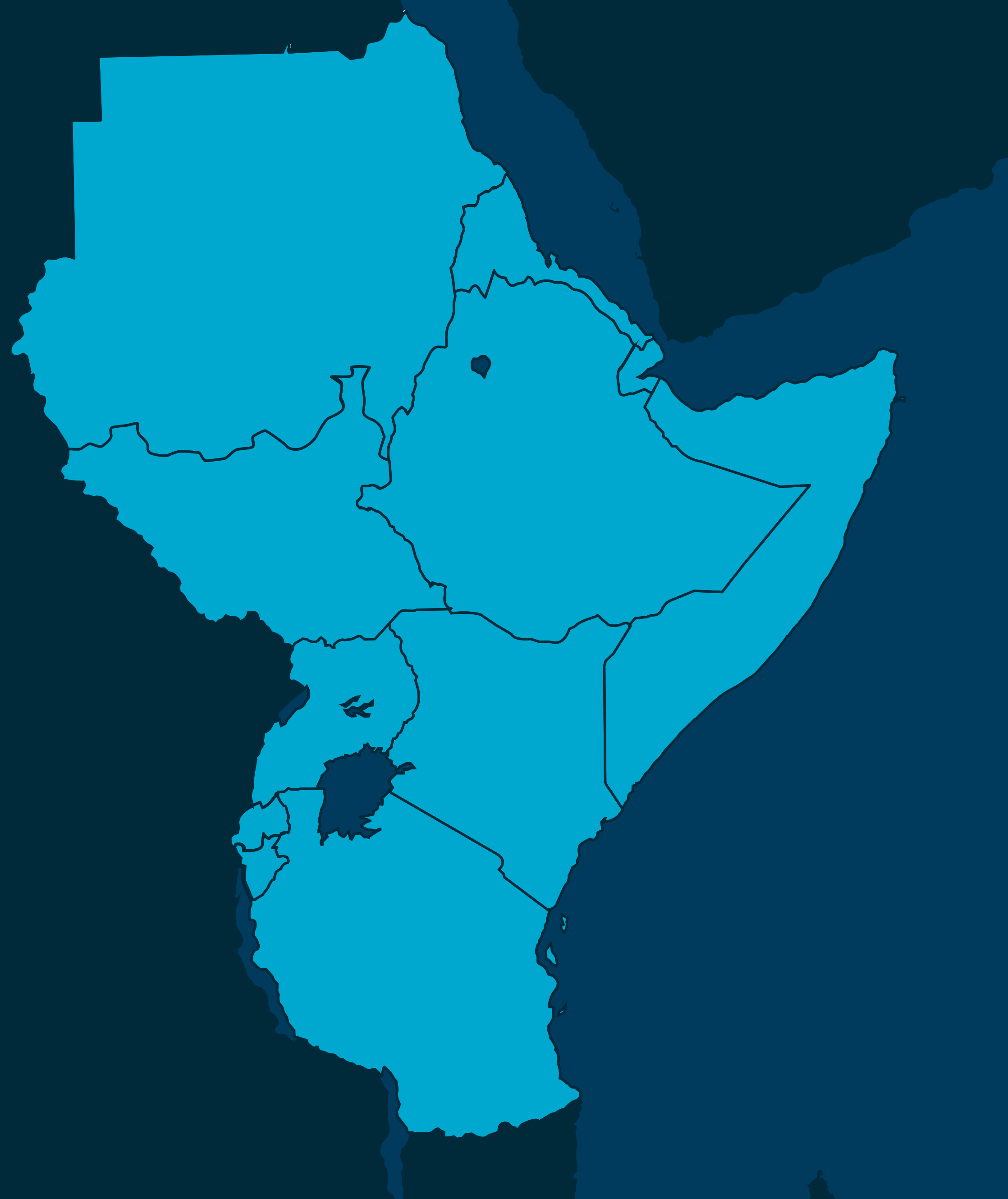
The report includes a chapter focused specifically on DFI activity. As noted earlier, DFIs remain central to the impact investing landscape both through direct investments as well as the prominent role they play in capitalizing impact investing funds currently active in the region. The DFI chapter focuses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

Detailed country chapters for each of the focus countries follow. The focus countries—Kenya, Uganda, Tanzania, Rwanda, and Ethiopia—have seen the vast majority of impact investments in the region and each chapter explores country-specific activity in detail. These chapters examine the broader economy and investing landscape as well as the trends, opportunities, challenges, and demand for impact capital in each country.

The report closes with country chapters for each of the non-focus countries—Burundi, Somalia, Djibouti, Eritrea, Sudan, and South Sudan—where there has been limited impact investing activity to date. These chapters describe the activity that has occurred and analyze the factors that have constrained impact investment, as well as what conditions must change in order to improve the outlook for impact investing.

EAST AFRICA

VAST OPPORTUNITIES AND EXPECTATIONS FOR IMPACT DEALS IN COMING YEARS



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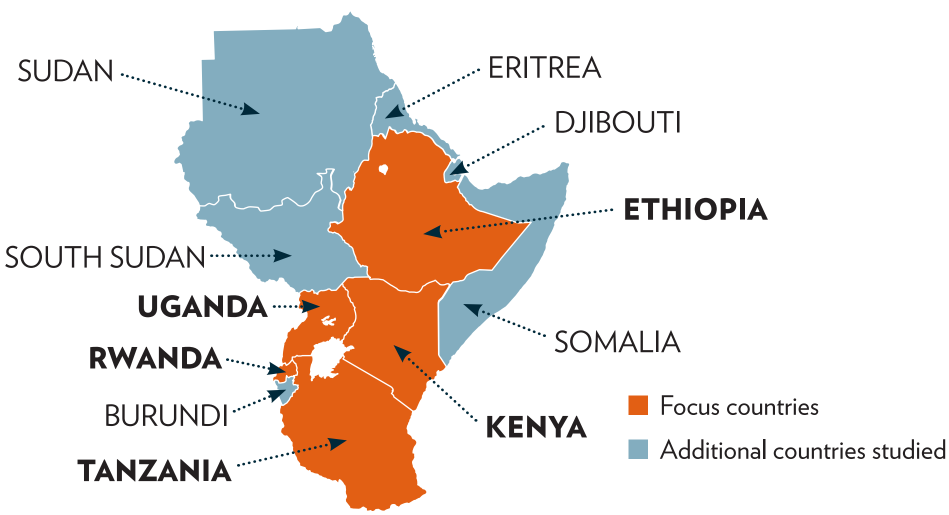
INTRODUCTION

Over the last five years, impact investing has gained strong momentum throughout East Africa. As outlined in the coming chapters, 155 impact investors have made investments in the region, including 20 development finance institutions (DFIs) and 135 other impact investors.[1] Due to the unique nature and large size of 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. The 135 non-DFI impact investors, overseeing 186 distinct vehicles, have disbursed USD 1.4 billion through more than 550 investments in East Africa.[2] In addition, the 20 DFIs have placed USD 7.9 billion directly into East African enterprises and a further USD 700 million into impact funds.[3]

Non-DFI impact investors appear to have substantial capital, with an estimated USD 3 billion committed to the region. Many of these investors also operate outside of East Africa, including many that place capital globally. In practice, these impact investors usually do not divide their capital into country-specific pools but rather invest opportunistically across the markets they cover. This means available capital could be deployed elsewhere if sufficient investment opportunities are not found in East Africa, or could grow rapidly if impact investors see more promising opportunities in the region.

FIGURE 1: COUNTRIES IN THIS STUDY



1 For this report, impact investments are those made by investors who meet the GIIN's definition of impact investing—i.e. an intention to generate a beneficial social or environmental impact alongside a financial return, who measure the impact generated by their investments. See Introduction and Methodology section of this report for more information.

2 The figures used throughout this report represent publicly available information regarding total disbursements from impact investors active in East Africa today. Where impact investors operate across a region larger than East Africa, capital has been allocated according to available internal allocation targets or net foreign direct investment flows to the countries where the fund operates. See the Methodology section for more detail.

3 For a definition of DFI for the purpose of this report, please see the DFI section.

REGIONAL CONTEXT

Many stakeholders see great opportunities for regional trading blocs, though progress to implement recommended policies has been slow. The East African Community (EAC) includes Burundi, Kenya, Rwanda, Tanzania, and Uganda, and intends to create a single trading bloc with integrated immigration policies, a single currency, and free internal trade.[4] Though the EAC has made progress—for example, launching an integrated East Africa tourist visa in 2014[5]—these changes are not well-known, and progress towards a unified currency and free trade proceeds slowly.[6]

Beyond the EAC, several countries studied for this report participate in the Common Market for Eastern and Southern Africa (COMESA), including Burundi, Djibouti, Eritrea, Ethiopia, Kenya, Rwanda, South Sudan, Sudan, and Uganda. COMESA also aims to create free trade between members and progress towards a unified visa, among other customs and trade treaties.[7] Tanzania is also a member of the Southern African Development Community.[8]

Despite regional trade treaties, countries in East Africa operate and govern largely independently. Each country has a different political context, functions with an independent regulatory system, is culturally unique, and presents different opportunities for investment. Successful operations in one country do not necessarily transfer to another and each new context must be considered separately. At the same time, these 11 unique governments represent a combined 300 million citizens, presenting a large opportunity for social enterprises[9] that are able to successfully expand and reach large swaths of the global population.[10]

4 Korwa G. Adar, Centre for Studies on Federalism, *East Africa Community* (2011), *available at* http://www.internationaldemocracywatch.org/attachments/458_EAC-adar.pdf.

5 Ismail Musa Ladu & Risdel Kasasira, "EAC Single Tourist Visa Launched," *Daily Monitor* (Feb. 21, 2014), *available at* http://www.monitor.co.ug/News/National/EAC-single-tourist-visa-launched/-/688334/2215296/-/usri45z/-/index.html.

6 Masafumi Yabara, The International Monetary Fund, *Capital Market Integration: Progress Ahead of the East African Community Monetary Union* (2012), *available at* http://www.imf.org/external/pubs/ft/wp/2012/wp1218.pdf.

7 "COMESA Strategy," *COMESA*, *available at* http://about.comesa.int/index.php?option=com_content&view=article&id=78&Itemid=118.

8 "Member States," *Southern African Development Community*, *available at* http://www.sadc.int/member-states/.

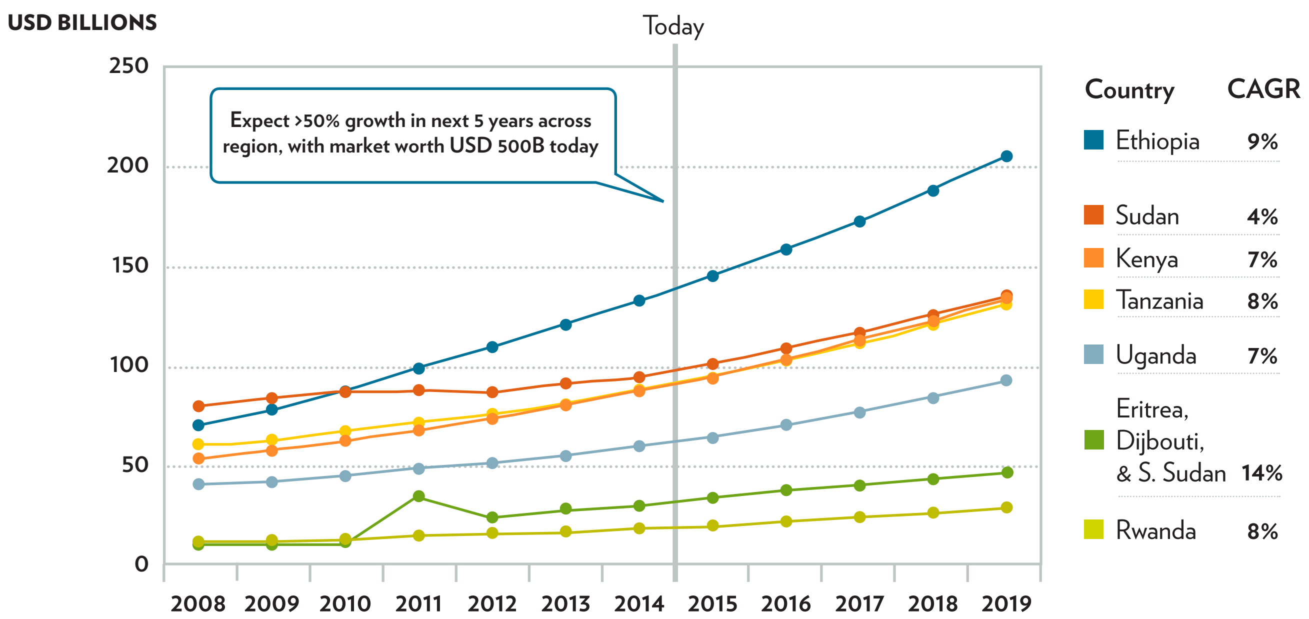
9 For this report, social enterprises are defined to be businesses that seek to measure impact as well as generate a financial return.

10 Population: Total, *The World Bank Group*, *available at* http://data.worldbank.org/indicator/SP.POP.TOTL; Note that population estimates are not available for South Sudan or Somalia.

Gross Domestic Product

East Africa has seen strong growth in recent years, averaging a combined 7% GDP (PPP) growth annually for the last seven years (see Figure 2), and the International Monetary Fund (IMF) expects increases to continue. Across the region, total GDP currently stands at approximately USD 500 billion in PPP terms. Ethiopia represents the largest market in both GDP and population, with a GDP of USD 121 billion (PPP) and 90 million citizens (more than 30% of East Africa's total population). While Eritrea, Djibouti, and South Sudan represent the region's fastest growth, this is from a small base of GDP.

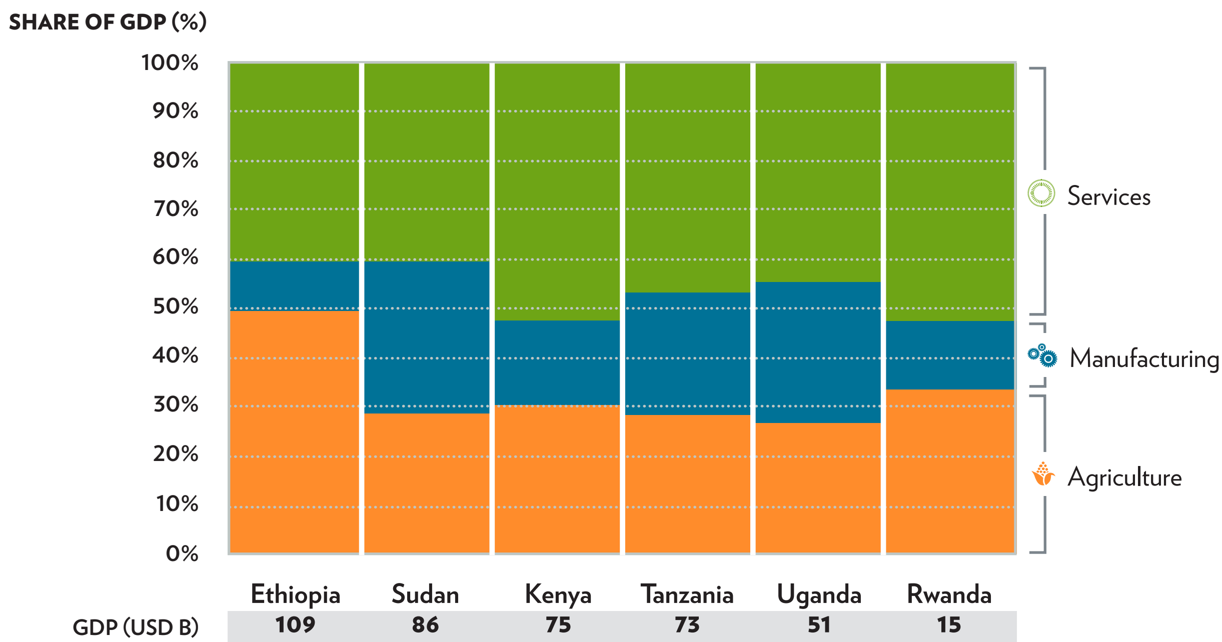
FIGURE 2: GDP (PPP) IN EAST AFRICA, 2008–2019 (2014–2019 PROJECTED)



Source: IMF World Economic Outlook, April 2014

Across the region, agriculture remains the single largest sector, accounting for more than 30% of GDP and employing the majority of the labor force (Figure 3). Individual sector opportunities differ by market; for example Kenya has a particularly strong services sector.[11] Strong telecommunications penetration throughout the region has helped develop the services sector, and most countries in the region have multiple telecom providers with the exception of a few countries such as Ethiopia, Djibouti, and Eritrea, where telecom is still a restricted industry run by the government.[12]

FIGURE 3: GDP BY SECTOR FOR SELECT COUNTRIES IN EAST AFRICA, 2012



Source: World Bank Indicators as of 2012

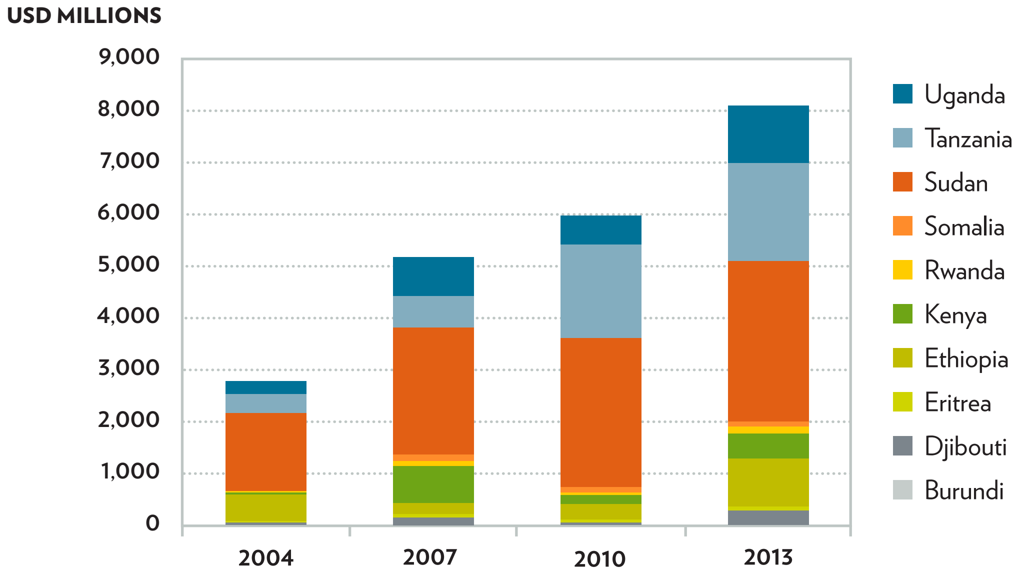
11 World Development Indicators, *The World Bank Group*, *available at* http://data.worldbank.org/indicator/BG.GSR.NFSV.GD.ZS.

12 Janelle Plummer, The World Bank, *Diagnosing Corruption in Ethiopia_Perceptions, Realities and the Way Forward for Key Sectors* (2012), *available at* http://www.ethiomedia.com/addis/diagnosing_corruption.pdf.

Foreign Direct Investment

Strong GDP growth has been accompanied by increasing foreign direct investment (FDI). In 2013, the region received more than USD 8 billion in total FDI inflows (Figure 4).[13] Sudan and Tanzania lead net FDI flows, driven by strong interest in the countries' oil and gas sectors. Recent discoveries of large oil and gas reserves in Uganda and Kenya have also fueled increases in FDI, which are expected to continue in coming years.[14]

FIGURE 4: FDI INFLOWS IN EAST AFRICA IN SELECT YEARS, 2004-2013



Source: UNCTAD

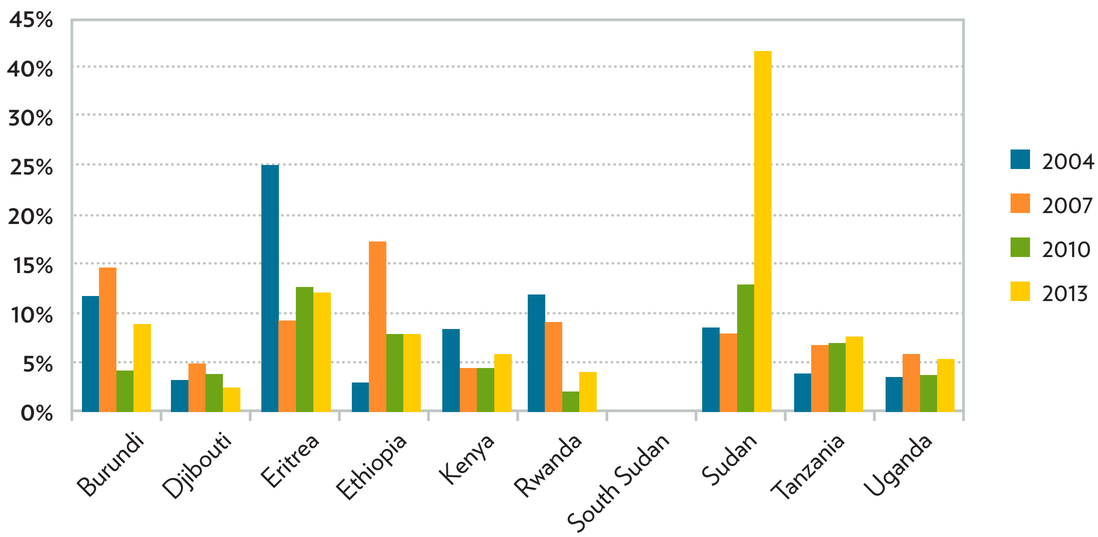
13 UNCTAD STAT Data Center, *United Nations Conference on Trade and Development*, *available at* http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en.

14 KPMG, *Oil and Gas in Africa_Africa's Reserves, Potential and Prospects* (2013), *available at* https://www.kpmg.com/Africa/en/IssuesAndInsights/Articles-Publications/Documents/Oil%20and%20Gas%20in%20Africa.pdf; Rolake Akinkugbe, "Top Trends to Watch in sub-Saharan Africa's Extractives Sector (Part I)," *African Arguments* (Aug. 8, 2013), *available at* http://africanarguments.org/2013/08/08/top-trends-to-watch-in-sub-saharan-africa%E2%80%99s-extractives-sector-part-i-%E2%80%93-by-rolake-akinkugbe/.

Inflation and Exchange Rates

Inflation rates have varied substantially across the region, ranging from a low of 2% in Djibouti in 2009 to a high of nearly 45% in Ethiopia in 2008 (see Figure 5). The entire region experienced higher rates of inflation in 2008, though all countries have experienced volatility since 2004. High inflation rates and significant volatility pose substantial challenges to both impact investors and the enterprises they support, as input prices rise and relative incomes decrease.

FIGURE 5: INFLATION RATES BY COUNTRY, 2004-2013

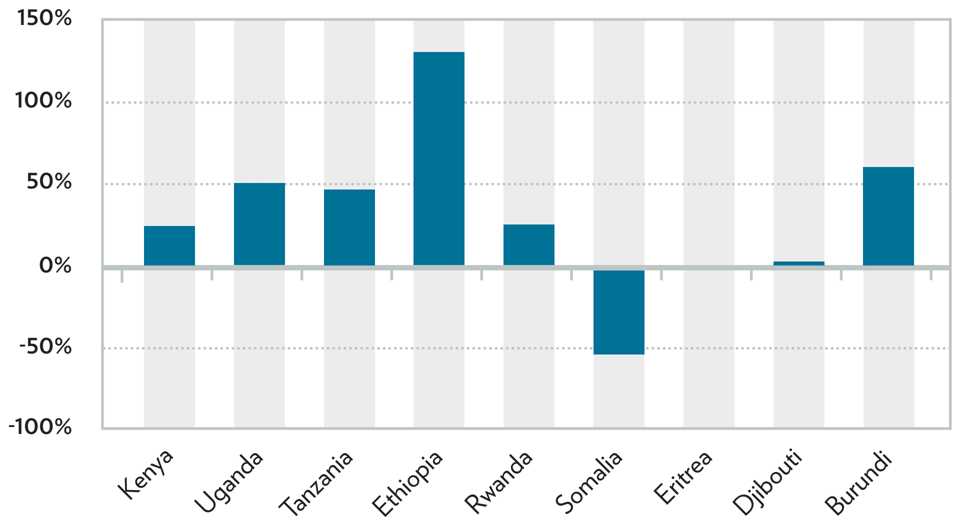


Source: World Development Indicators

Concerns about foreign exchange rates complicate impact investors' ability to disburse local currency debt. Across the region, all countries have struggled to stabilize exchange rates. Figure 6 shows cumulative currency depreciation from 2006 to 2014; however, this cumulative depreciation masks significant fluctuations and corrections within individual years. For example, the Kenyan Shilling was one of the most volatile currencies in the world in 2011, when it lost more than 25% against the dollar in nine months before returning to prior levels.[15] This volatility exposes non-DFI impact investors to potentially sudden and significant foreign exchange losses, which in turn limits their ability and interest to lend in local currency. This volatility can also make it difficult for companies to purchase foreign currencies to repay hard currency loans, increasing both the effective interest rate they face for short- and long-term facilities and the likelihood of default for companies that collect revenues primarily in local currencies. Additionally, exchange rate fluctuation poses challenges for businesses operating in the region, especially when they need to import supplies from foreign countries in hard currencies.

15 Luke Mulunda, "Economists Trim Kenya's Growth Forecast to 4 Percent Over General Election Jitters," *Business Daily* (Jan. 25, 2012), *available at* http://www.businesstoday.co.ke/news/2012/01/25/economists-trim-kenyas-growth-forecast-4-percent-over-general-election-jitters.

FIGURE 6: CURRENCY DEPRECIATION BY COUNTRY, 2006-2014



Source: Oanda Historical Currency Rates

SUPPLY OF IMPACT CAPITAL

East Africa has attracted significant attention from impact investors. In total, 186 impact capital vehicles are active across East Africa, managed by 107 fund managers and 28 other impact asset managers including foundations, family offices, banks, and angel networks. In addition, 20 DFIs are active in the region. Most impact investors work in multiple countries in the region. Kenya is a clear leader in terms of investor interest, followed by Uganda, Tanzania, Ethiopia, and Rwanda. It should be noted that many impact investors work across large swaths of the developing world, looking beyond East Africa to Sub-Saharan Africa and globally, as well. Since inception, DFI investors active in the region today have publicly recorded more than USD 7.8 billion across over 410 direct investments, while non-DFI impact investors have disbursed nearly USD 1.4 billion through more than 550 deals.[16]

Broader Investing Landscape

The volume of impact investing activity in East Africa represents only a small part of the overall investment landscape. Several countries, including Kenya, Rwanda, and Tanzania, have publicly traded companies that have raised substantial funding. Banks in the region lend significant capital to local companies. In Kenya alone, chamas[17] and

16 Open Capital Research; see Methodology section for more information.

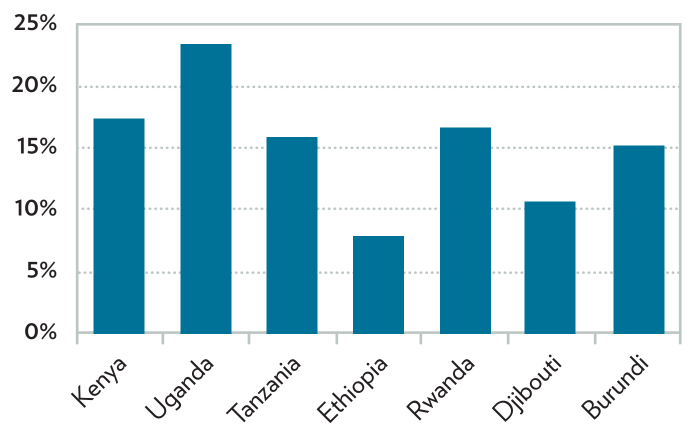
17 Chamas are informal cooperative savings groups that invest the pooled funds for a return. Chamas are particularly widespread in Kenya and are not regulated.

SACCOs[18] have more capital under management than all non-DFI impact investors in East Africa.

However, there remains a substantial gap in the market that impact investing looks to fill. Public markets have rigid listing requirements and limited liquidity while commercial banks in the region remain risk averse and are often unwilling to lend to early-stage ventures (which represent a large share of businesses in the region, particularly those of interest to impact investors). When willing to lend, commercial banks in East Africa have high collateral requirements, often exceeding 100%, which many early-stage enterprises are unable to meet.

Moreover, even if available, bank financing is expensive. The countries within East Africa vary significantly in average bank lending rates, though all are typically well above developed country rates. Prevailing rates in Kenya, Uganda, Tanzania, Rwanda, and Burundi are all above 15% (Figure 7).[19] By comparison, small businesses in the United States find prevailing base interest rates of only 3.25%, and rates are as low as 0.5% in the United Kingdom.[20] Banks often charge a premium for lending to small and medium enterprises (SMEs), but the difference between corporate and SME lending is not large in developed markets.[21] In East Africa, some SMEs face a risk premium that drives interest rates beyond what is offered to large corporations for both local and hard currency loans from national banks.[22] These high interest rates make debt expensive, especially long-term debt. As a result, there remains a gap in the market for earlier-stage investments that may be higher risk.

FIGURE 7: PREVAILING BANK LENDING RATE BY COUNTRY (LATEST AVAILABLE DATA POINT)



Source: World Development Indicators. Note: Rates shown for most recent year available, 2008–2013

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

19 Lending Interest Rates (%), World Development Indicators, *The World Bank Group*, *available at* http://data.worldbank.org/indicator/FR.INR.LEND/countries.

20 *Ibid.*

21 Deutsche Bank, *EU Monitor: Global financial markets* (2014), *available at* https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000344173.pdf.

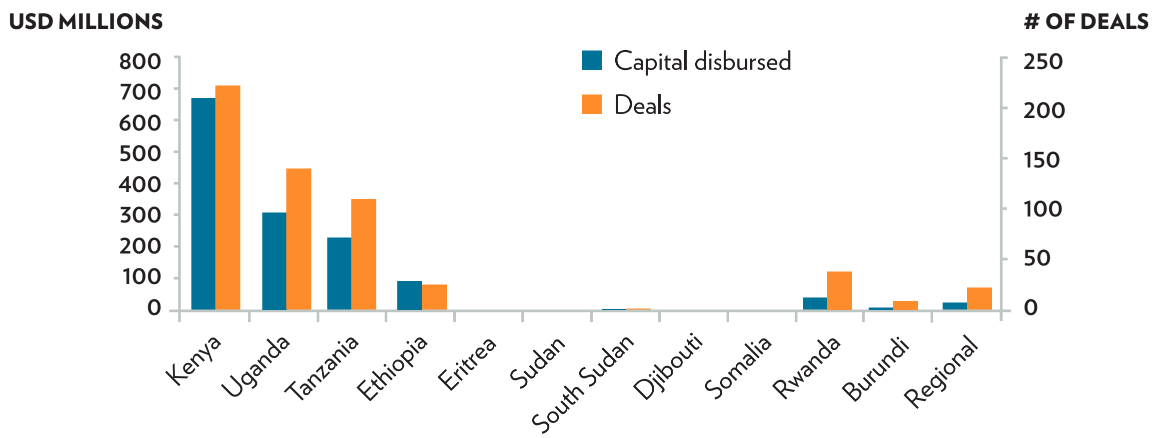
22 Open Capital interviews.

Local banks, chamas, SACCOs, and other conventional sources also do not have any specific impact focus, but rather concentrate only on financial returns, often investing in real estate, deposits, and treasury bonds. Impact investors are the only institutionalized funders who intentionally seek to push development and therefore proactively seek innovative solutions in difficult sectors or circumstances that conventional investors would otherwise overlook or dismiss.

Impact Capital Disbursed

Within the impact investment landscape in East Africa, Kenya plays a prominent role. Most tellingly, almost half of all known non-DFI impact capital disbursed in East Africa has been placed in Kenya. This represents more than USD 650 million of a total USD 1.4 billion disbursed (Figure 8). Kenya has more than double the amount of impact capital deployed compared to Uganda, which has the next highest amount of impact capital deployed. The number of impact deals completed is not quite as skewed, suggesting that Kenya has a slightly larger average deal size than other countries in the region. Notably, the research team was unable to find any evidence of non-DFI impact investments in Eritrea, Sudan, Djibouti, or Somalia, and only minimal activity in Burundi and South Sudan.

FIGURE 8: TOTAL NON-DFI IMPACT INVESTMENTS BY COUNTRY



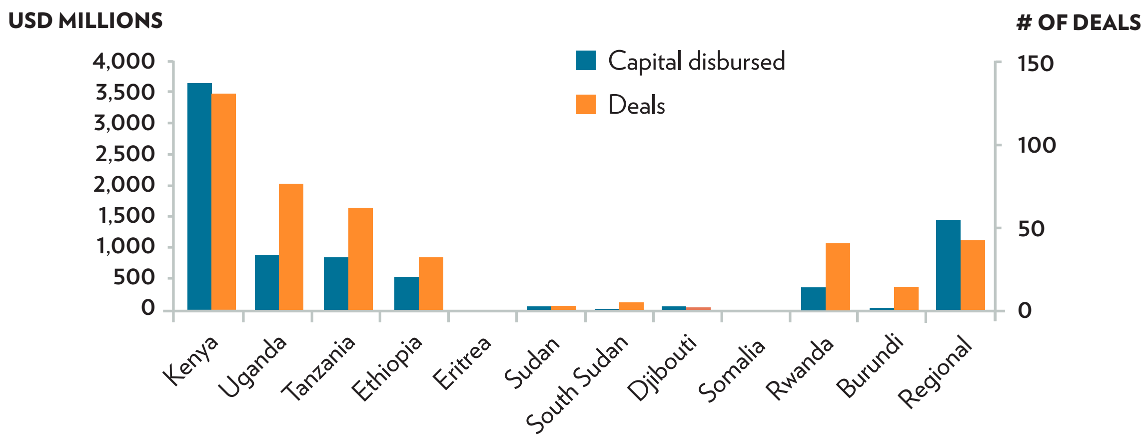
Source: Open Capital Research

DFI direct investments tell a similar story (Figure 9). DFIs have made (and disclosed) nearly USD 7.9 billion in direct investments in East Africa. This excludes 107 indirect investments into funds worth approximately USD 680 million.[23] Similar to non-DFI impact investor activity, Kenya represents nearly half of direct disbursements and more than four times the capital deployed in either Uganda or Tanzania, each of which has approximately USD 850 million in known DFI direct disbursements.

23 See DFI chapter for more detail.

Notably, the research team could not find any evidence of DFI direct investment activity in either Eritrea or Somalia, and found only minimal publicly disclosed activity in Sudan, South Sudan, and Djibouti. That is not to say that DFIs are not active, but rather that the majority of support in these countries is through bi-lateral or multi-lateral government loans, which are not included in the definition of impact investing for this report (see Introduction and Methodology section for more details).

FIGURE 9: TOTAL DFI IMPACT INVESTMENTS BY COUNTRY

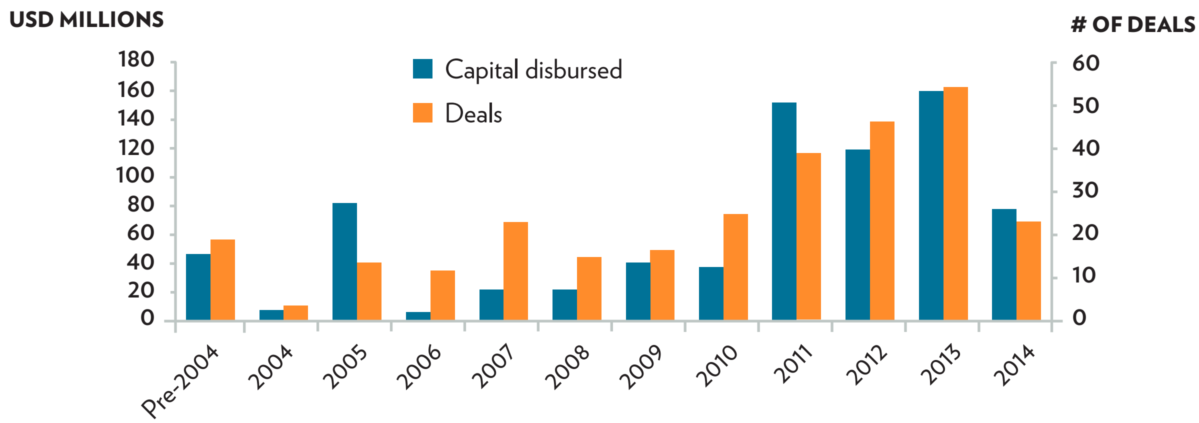


Source: Open Capital Research

Investments Over Time

Non-DFI impact investors have been actively investing in East Africa for more than a decade, but investments only began to pick up after 2010 (Figure 10), though the large number of deals with undisclosed details prevents additional conclusions about non-DFI impact investor activity. Despite the limited data, this trend aligns with impressions from non-DFI impact investors, who report interest in impact investing in East Africa gaining momentum in 2010 and beyond.[24]

FIGURE 10: NON-DFI IMPACT INVESTMENTS BY YEAR



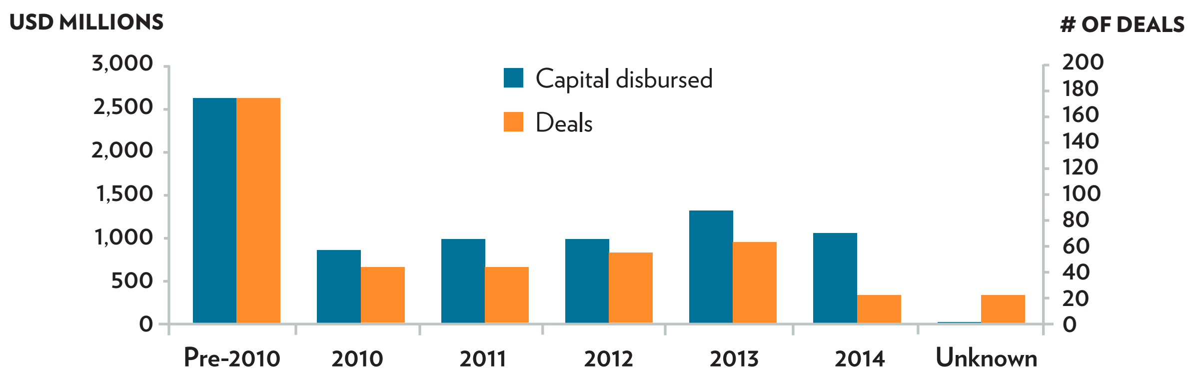
Source: Open Capital Research. Note: 2014 represents partial data as of October. Also, 274 deals, totaling approx. USD 586 million, with unknown year have been omitted

With the data available (274 deals with unknown year have been omitted), it appears that average deal sizes increased from 2011 onwards, as the amount of capital disbursed increased faster than the number of deals. The decline for 2014 is likely the product of incomplete data reporting at the time of data collection in late 2014, as many try to close final investments before the end of the calendar year.

24 Interviews with non-DFI impact investors conducted for this study.

The nascent state of the industry is also reflected in DFI direct investment activity (Figure 11). Capital disbursed and deals completed since 2010 have both exceeded activity pre-2010. As with non-DFI impact investments, the decline in deals in 2014 is likely due to incomplete data reporting at the time of data collection.

FIGURE 11: DFI DIRECT INVESTMENTS BY YEAR

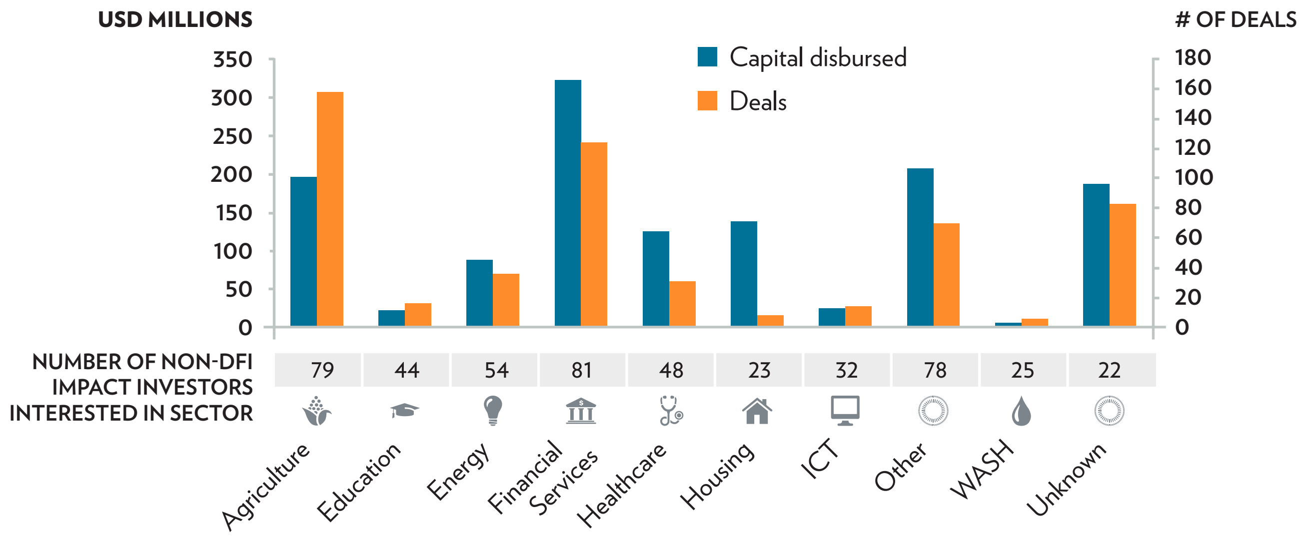


Source: Open Capital Research. Note: 2014 represents partial data as of October

Sector

The distribution of investments by sector broadly reflects investor interest areas. Agriculture and financial services have received the most deals (approximately 50% of all known deals in East Africa) and have strong interest from multiple non-DFI impact investors (Figure 12). Despite the larger number of deals in agriculture, the large investment sizes possible when placing capital into established banks or MFIs drive a larger total amount of capital to financial services. Similarly, housing projects tend to have larger average deal sizes than other sectors because they often must internally finance mortgages for low-income customers in addition to their own, typically high, construction costs.

FIGURE 12: NON-DFI IMPACT INVESTMENTS AND INTEREST BY SECTOR

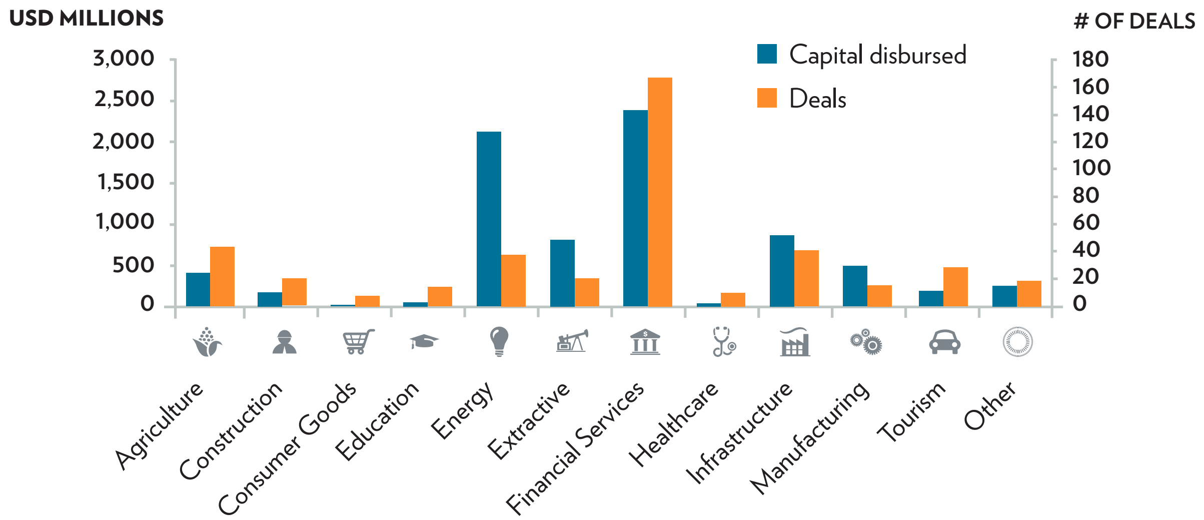


Source: Open Capital Research

Despite their prominence as sectors of interest (Figure 12), education and energy have seen relatively few deals. The disconnect between interest in these sectors and the number of deals implies that investors see limited viable, investible opportunities and have difficulty placing capital in these sectors.

DFI direct investments also favor investments in financial services (nearly 40% of all direct deals). After this, however, DFIs diverge from non-DFI investors. The energy sector has received 25% of capital deployed to date (driven by large energy projects such as dams and wind farms), while infrastructure and mining have also been prominent (Figure 13).

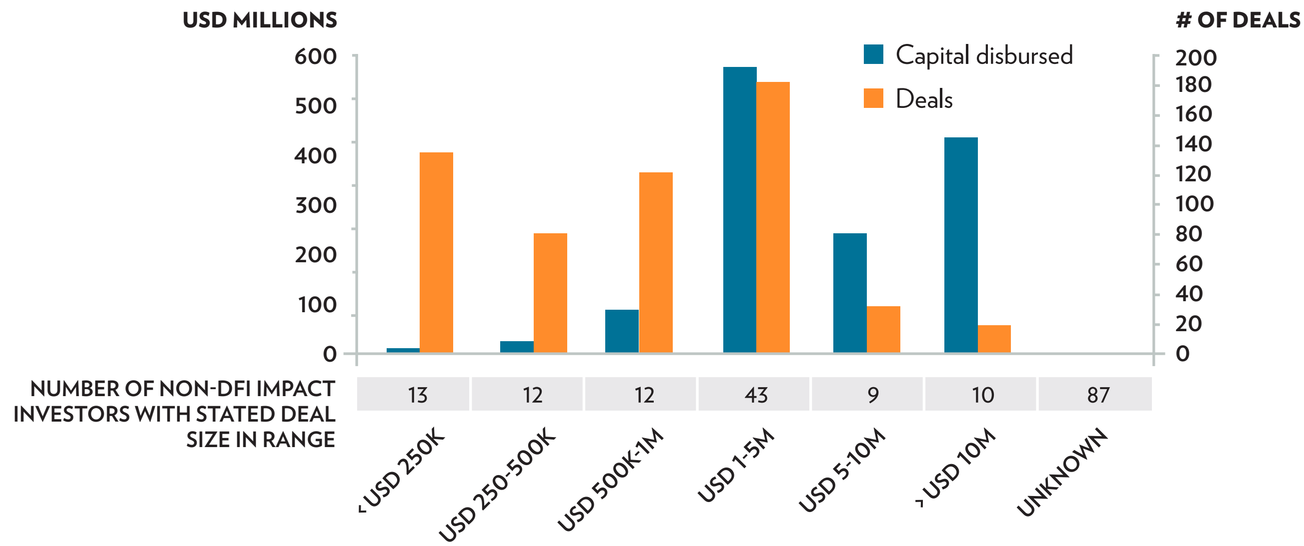
FIGURE 13: DFI DIRECT INVESTMENTS BY SECTOR



Deal Size

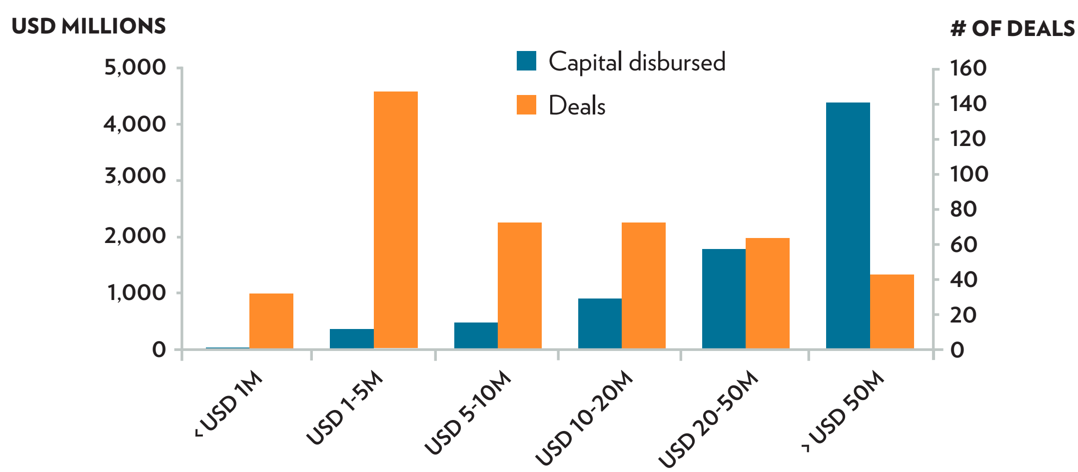
The majority (almost 60%) of deals by non-DFI impact investors in East Africa have been less than USD 1 million, though this represents only 10% of capital disbursed (Figure 14). More than 90% of deals and 50% of capital disbursed are through deals under USD 5 million. Across the region, just under 25% of deals are for amounts under USD 250,000. Very few non-DFI impact investors place capital over USD 5 million per deal, though a number of DFI direct deals are in this range (Figure 15). Despite the number of funds without stated investment sizes, interviewed non-DFI impact investors interviewed report that most capital is focused on varying degrees of early-stage businesses, often with the intention to tranche larger rounds of capital to multiple disbursements.

FIGURE 14: NON-DFI IMPACT INVESTMENTS AND INTEREST BY DEAL SIZE



Source: Open Capital Research

FIGURE 15: DFI DIRECT INVESTMENTS BY DEAL SIZE

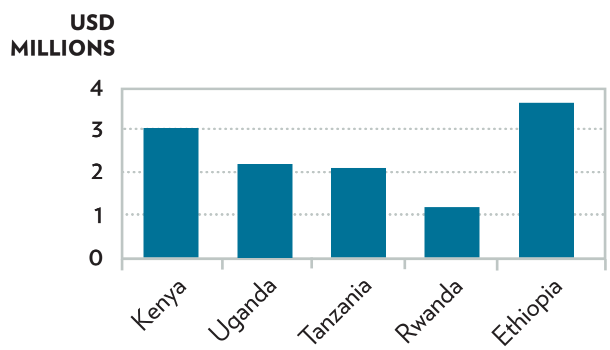


Source: Open Capital Research

Despite the interest in early-stage businesses, there is a critical gap for seed-stage investments under USD 100,000, indicating that although impact capital is more risk tolerant than other types of capital, impact investors still need evidence of some success before disbursing capital. This also suggests that there remains a gap in funding for capital-intensive seed-stage businesses, such as those in agriculture or manufacturing, that have funding needs beyond what can be sourced through friends and family. Countries also vary substantially in their average deal sizes; Ethiopia's average is more than USD 3.5 million while Rwanda's is just above USD 1 million (Figure 16). Data for the non-focus countries studied is too limited to compare.

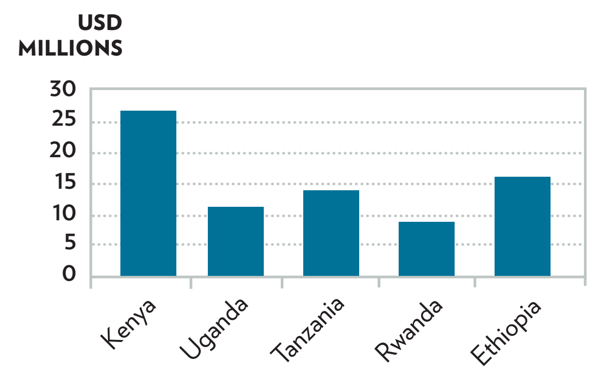
By contrast, average deal size for DFI direct investments is more than USD 18 million, nearly eight times the average size of non-DFI impact investors. This is driven primarily by large energy projects and large investments in commercial banks. Though deals under USD 10 million constitute close to 60% of total direct DFI investments, most of these are well over USD 1 million. Among the focus countries, Kenya leads in DFI deal size, followed by Ethiopia (Figure 17). Rwanda is the only focus country with an average DFI direct investment under USD 10 million.

FIGURE 16: AVERAGE DEAL SIZE BY NON-DFI IMPACT INVESTORS



Source: Open Capital Research

FIGURE 17: AVERAGE DFI DIRECT INVESTMENT SIZE BY COUNTRY

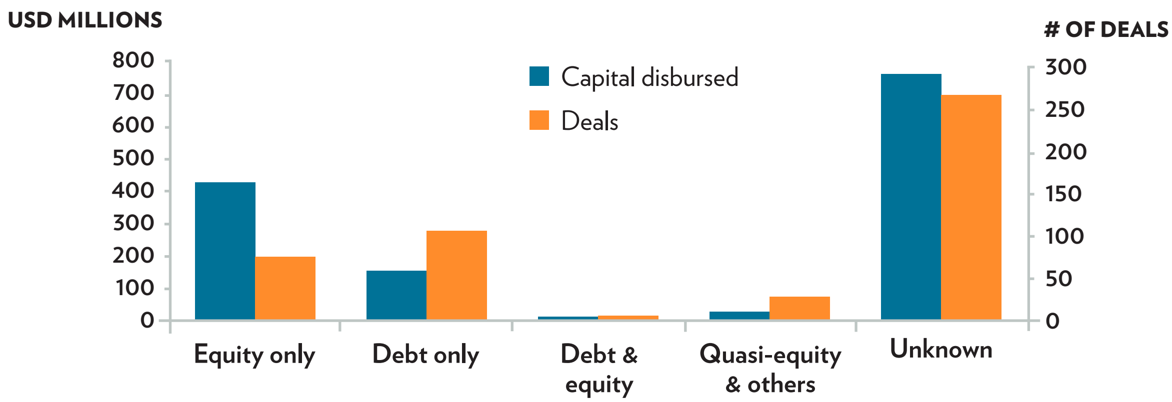


Source: Open Capital Research

Instrument

For a large proportion of non-DFI deals, the instrument used is unknown, preventing a definitive understanding of the breakdown these investments by instrument. Deals with disclosed instruments favor traditional debt and equity, as shown in Figure 18. However, investors and other ecosystem players report that in recent years, non-DFI impact investors have begun to adopt more creative investment instruments. They increasingly consider quasi-equity structures such as convertible debt or revenue-participating debt. Reflecting non-DFI impact investors' focus on smaller deals and earlier stage investments, these structures help balance risk with limited cash flows common for early-stage companies.

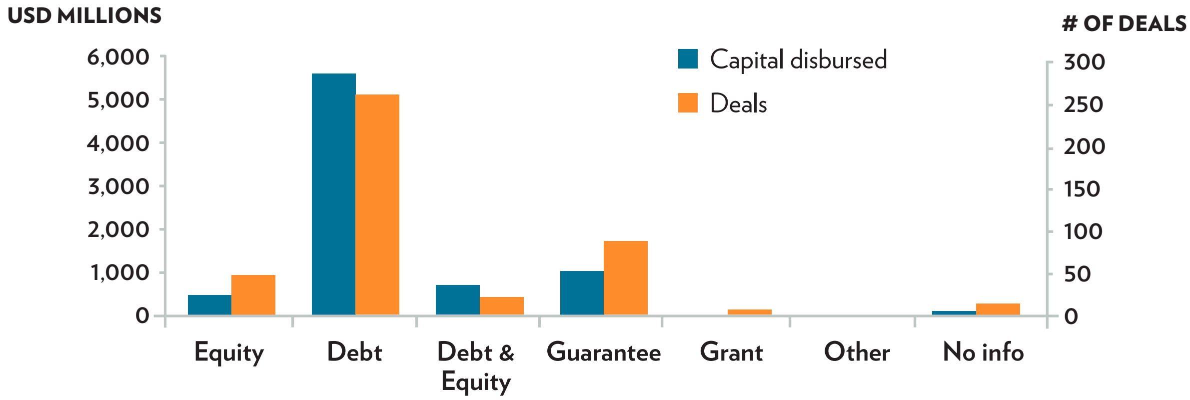
FIGURE 18: NON-DFI IMPACT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research.

Though creative structures are becoming increasingly common among non-DFI investors, DFI direct investments have been overwhelmingly in the form of debt, with a handful of equity deals (Figure 19). Debt investments constitute more than 70% of known capital disbursed as DFI direct investments and nearly 60% of direct DFI transactions. Together, debt and equity investments account for approximately 75% of all direct DFI deals and more than 85% of all direct capital disbursed through DFI direct investments. DFIs also offered a number of loan guarantees, primarily driven by USAID, which account for more than 80% of all guarantees. OPIC and IFC contributed nearly all of the remaining guarantees.

FIGURE 19: DFI DIRECT INVESTMENTS BY INSTRUMENT

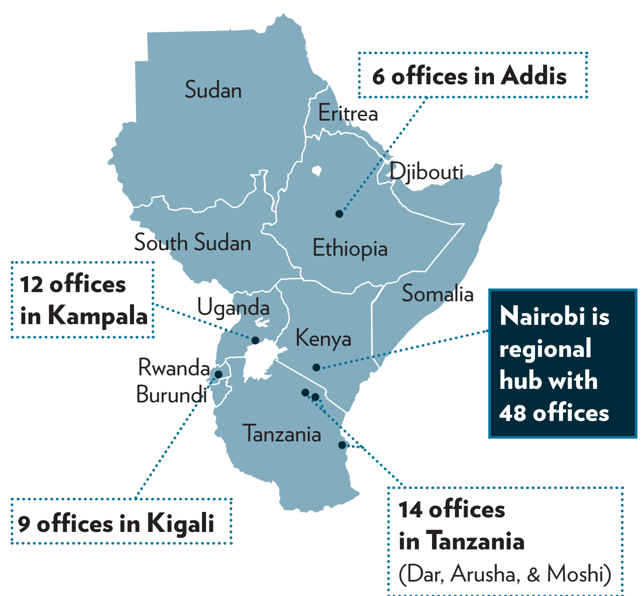


Source: Open Capital Research

Local Presence

Investors making impact investments in East Africa are generally based in Europe or the United States, but are increasingly developing a local presence to source and support portfolio companies (Figure 20). Nairobi is the clear hub for local offices, with 48 investors based in Kenya's capital city. Non-DFI impact investors in particular increasingly see Nairobi as a gateway to reach the entire region; there are now five non-DFI impact investors that have chosen to headquarter their operations there. Meanwhile, even investors specifically looking to invest outside of Nairobi will often start operations there.[25] Kenya's position as the heart of the impact investing landscape in East Africa is so pronounced that recently some investors have deliberately based their operations outside of Kenya to avoid what they perceive as a saturated market.[26]

FIGURE 20: IMPACT INVESTORS WITH LOCAL OFFICES



Source: Open Capital Research

Though still placing staff in Nairobi, many investors share the concern that the Kenyan impact investing landscape, and Nairobi in particular, is saturated. Others argue that this perception results from insufficient engagement or knowledge of the market, believing that creative investors are able to find ample pipeline. Regardless, more and more impact investors are actively looking for deals in rapidly growing second-tier cities and other countries in the region, particularly Uganda and Tanzania. However, to date, few currently have full-time staff outside Nairobi or the capital cities within the region.

25 See, e.g., Eleos Foundation and Ascent Capital.

26 See, e.g., Mango Fund and HRSV.

Though still placing staff in Nairobi, many investors share the concern that the Kenyan impact investing landscape, and Nairobi in particular, is saturated. Others argue that this perception results from insufficient engagement or knowledge of the market, believing that creative investors are able to find ample pipeline. Regardless, more and more impact investors are actively looking for deals in rapidly growing second-tier cities and other countries in the region, particularly Uganda and Tanzania. However, to date, few currently have full-time staff outside Nairobi or the capital cities within the region.

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, many impact asset owners require it. This is particularly true for DFIs, which act as anchor investors in many impact investment funds.

However, developing tools to accurately track impact metrics has proven difficult. Beyond general inexperience designing methodologies for measuring impact accurately over time, tracking metrics is perceived by some as expensive and time-consuming for an early-stage business, potentially diverting resources from enterprise growth. Moreover, impact investors define impact in a wide variety of ways and emphasize different elements, complicating efforts to develop a universal standard or toolbox. In many ways, this is beneficial for SMEs, who do not all fit the same definition.

The majority of fund managers interviewed do not specify a particular language or tool but rather report using flexible structures adapted to each new investment. Though many investors have rigorous and rigid impact guidelines to make an investment, they generally design and track metrics after the investment in an individualized manner to minimize the burden placed on portfolio companies.

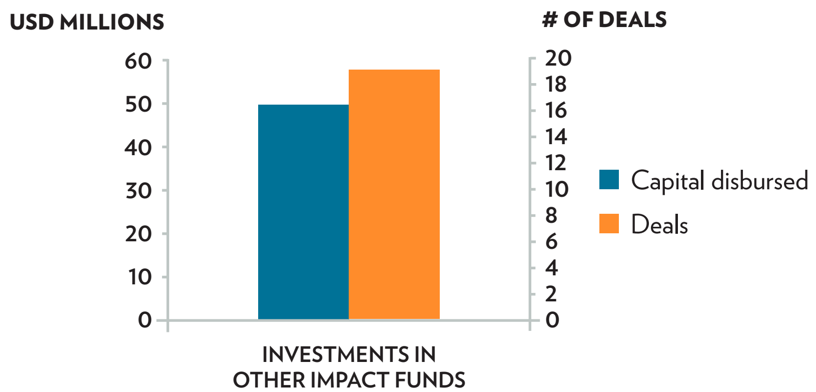
Among the few that do specify using a known language or tool, IRIS[27] has emerged as the most prominent. Some fund managers select their own set of IRIS metrics; others use an existing tool, such as the Global Impact Investment Rating System (GIIRS), which is built on the IRIS taxonomy.

27 IRIS (formerly known as Impact Reporting and Investment Standards) is a set of standardized metrics for impact measurement managed by the Global Impact Investment Network (www.iris.thegiin.org).

Indirect Investment into Impact Funds

Beyond placing direct investments, some impact investors have invested in other impact capital vehicles. In total, non-DFI impact investors disbursed USD 50 million into other funds (approximately 3% of known deals and 4% of capital disbursed by such investors) through 19 disclosed deals (Figure 21). By contrast, DFIs have placed nearly USD 700 million via indirect investments into impact funds.

FIGURE 21: NON-DFI IMPACT INVESTORS' INDIRECT INVESTMENTS



Source: Open Capital Research

Non-DFI impact investors interviewed for this report suggest that existing impact fund managers may find it more difficult to raise future funding until they have proven their track record from existing capital due to increasing frustration from asset owners with low disbursement rates. Instead, these investors expect to place more capital directly. DFIs, however, are expected to continue indirect investments through impact fund managers.

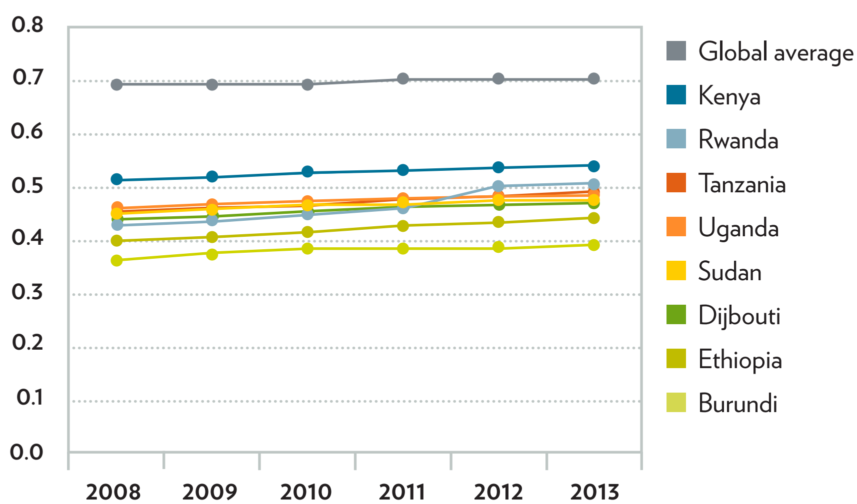
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

There is strong demand for impact capital among entrepreneurs operating in East Africa. Despite the region's progress on key development indicators, there remain significant gaps in the provision of key goods and services, which create opportunities for entrepreneurs to build enterprises that fill needs while also realizing financial returns. As noted earlier, most of these businesses are in early stages of development and growth.

Development Context

All countries in East Africa are well below global averages for human development indicators (HDI) as defined by the United Nations. Kenya ranks highest within the region, at 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 (Figure 22).[28] The other countries studied for this report score even lower.

FIGURE 22: UN HDI SCORE BY COUNTRY, 2008–2013

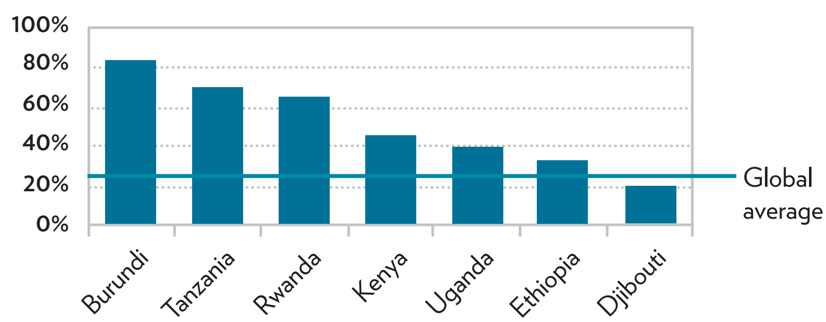


Source: UN Human Development Index. Note: 2014 report does not include 2009 HDI scores. 2009 scores show are calculated as an average of 2008 and 2010 scores.

28 The UN HDI aggregates a number of metrics including 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; 2010 Human Development Index, The United Nations Development Programme (Apr. 2010), available https://www.imf.org/external/pubs/ft/weo/2010/01/weodata/download.aspx.

These low rankings are driven by poor scores in key developmental indicators. For example, across the region, nearly 50% of the population lives on less than USD 1.25 per day, well above the global average of roughly 25%. This burden is not consistent in all countries—more than 80% of Burundians live on less than USD 1.25 while Djibouti performs better than the global average (Figure 23).[29]

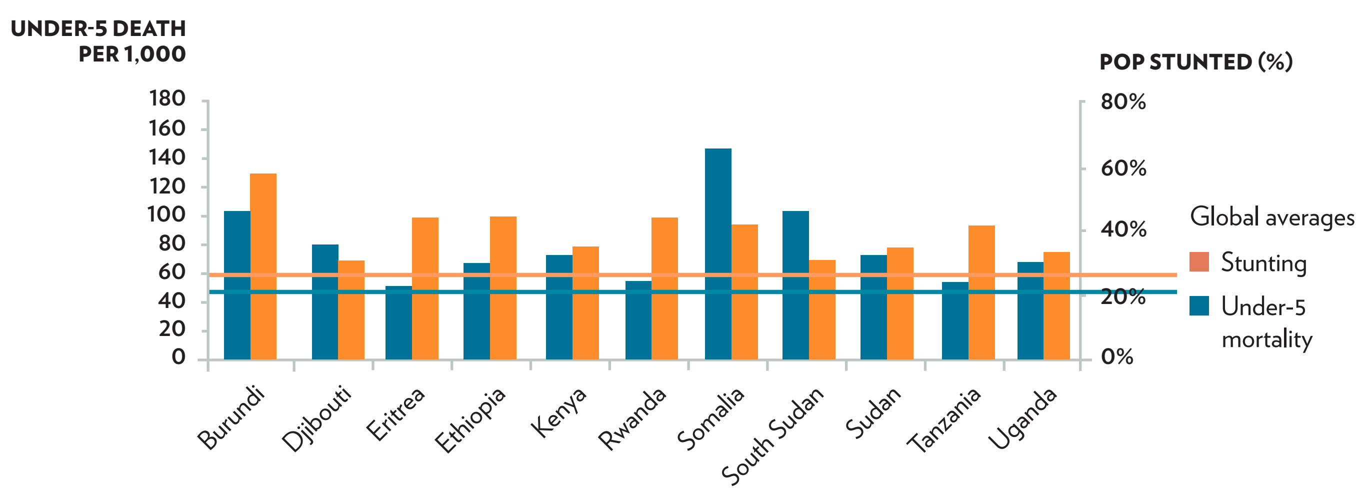
FIGURE 23: POPULATION BELOW USD 1.25 / DAY BY COUNTRY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014

Similarly, all countries studied considerably underperform global averages on key health metrics. Burundi and Somalia in particular face high child mortality and stunting rates. Ethiopia, Eritrea, Rwanda, and Tanzania also face high stunting rates, particularly acute in rural areas for disadvantaged populations (Figure 24).[30]

FIGURE 24: UNDER-5 MORTALITY AND STUNTING BY COUNTRY (LATEST AVAILABLE DATA POINT)



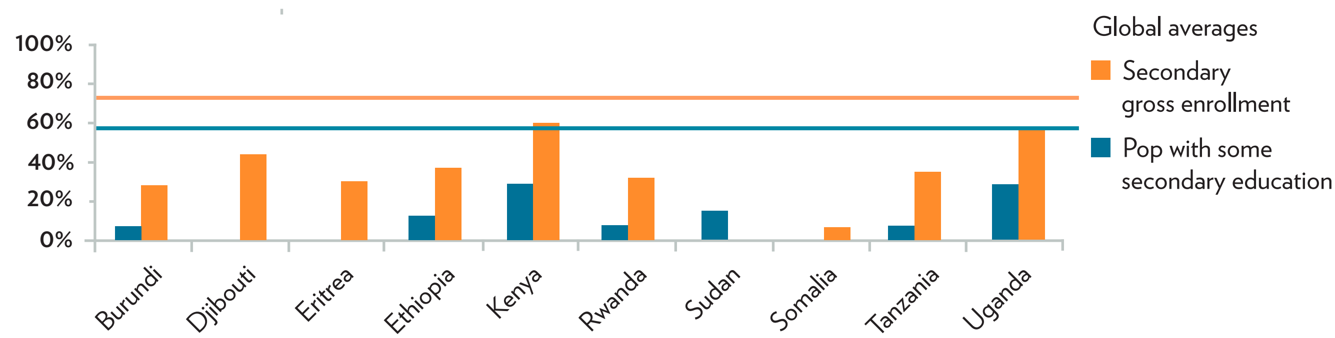
Source: UN Human Development Report 2014

29 *Ibid.*

30 *Ibid.*

As with health and poverty metrics, East African countries show varied performance on educational metrics, though all countries are well below global averages (Figure 25). For example, Kenya has approximately 60% gross secondary school enrollment (the highest rate in East Africa) and more than 25% of the population over age 25 has at least some secondary education. By contrast, Burundi has a gross secondary school enrollment rate of less than 30% and just 7.1% of the population over age 25 has some secondary school education. Ethiopia, Rwanda, Tanzania, Sudan, and Somalia all also have particularly low percentages of the population with secondary education.[31]

FIGURE 25: KEY EDUCATION INDICATORS BY COUNTRY (LATEST AVAILABLE DATA POINT)



Source: UN Human Development Report 2014. Note: No data available for population with some secondary education in Somalia or secondary gross enrollment in Sudan.

31 *Ibid.*

Educational metrics are an especially important indicator for future development given East Africa's demographics. The region has a disproportionately young population, where nearly 45% is under the age of 15 and almost 65% is below age 25 (Figure 26).[32] Each country in East Africa has a population pyramid that skews heavily towards youth. This has led to high youth unemployment,[33] but higher levels of education make it more likely that the youth boom will translate to strong positive economic growth as these youth enter new employment opportunities and begin to create entrepreneurial activity.

FIGURE 26: POPULATION BY AGE AND GENDER, EAST AFRICA (LATEST AVAILABLE DATA POINT)

Source: UN ESA, World Population Prospects

32 "The World Factbook," *Central Intelligence Agency*, *available at* https://www.cia.gov/library/publications/the-world-factbook/wfbExt/region_afr.html.

33 For example, youth unemployment in Rwanda is estimated at 40%. 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.

Entrepreneurs

With increasing interest from impact investors, many entrepreneurs in East Africa see an opportunity to start new social enterprises.[34] Many of these opportunities include disadvantaged populations and the mass market as suppliers, consumers, or both. Entrepreneurs have launched businesses across sectors of interest to impact investors—education, housing, healthcare, water and sanitation, energy, etc.—and seek capital across the spectrum of funding from start-up needs to SME-size deals to capital for scaling up, though they are primarily concentrated in the start-up and early phases. This focus on earlier-stage businesses aligns with the local landscape, in which there are few mature social enterprises.

Despite growing demand for capital, entrepreneurs across the region face substantial challenges regardless of their stage of development. Though early-stage entrepreneurs are sometimes able to source capital to begin operations from friends, family, and various community financing organizations such as SACCOs or MFIs, they struggle to find the next round of capital to test and pilot their ideas in the market. Many businesses at this stage operate informally—they are unlikely to have clear financial records, access to formal markets, or access to government services. This makes it difficult for investors to disburse capital, even those looking for early-stage deals.

In their early stages of development, formal and informal businesses often face common challenges preventing them from being fully investment ready, including a lack of realistic forward-looking projections, unclear capital use plans, and limited management capacity to scale operations. In addition, entrepreneurs often run several projects simultaneously and have limited attention to devote to a single enterprise.

While these challenges are not as common for more developed businesses, high potential, rapidly scaling companies are more likely to have existing access to credit through strong relationships with local commercial banks. When businesses do seek impact capital, they are typically well-known to investors, leading to competition among impact investors and/or a large number of co-investors.

By and large, impact investors report that the most interesting, sophisticated businesses typically do not market themselves as "social enterprises." Instead, they present strong commercial cases for investment and have social impact embedded in the success of their business model. Notably, these high-potential businesses typically view impact investors first and foremost as sources of capital, regardless of the investors' impact intent.

In countries that have less mature impact investing and social enterprise ecosystems, entrepreneurs have few examples of success and limited access to networks to find funding. Burundi, Djibouti, Eritrea, Somalia, South Sudan, and Sudan have very few social entrepreneurs, making it difficult for entrepreneurs to know where to get the support needed to grow and scale. In countries where social enterprises have already succeeded in attracting global attention like Kenya, Uganda, Tanzania, Ethiopia, and Rwanda, there are some existing contacts to help guide new entrepreneurs through

34 Open Capital Research.

the complicated funding process. However, even in these more active countries, there are only a few successful examples of young, rapidly growing companies. This dearth of successful start-ups can contribute to entrepreneurs viewing their businesses as a way to earn a modest living rather than as a highly-scalable enterprise. Investors across East African countries will need to invest in local networks to understand the landscape and help entrepreneurs translate their ideas into investible plans.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

East Africa is home to many intermediaries and other service providers in the impact investing ecosystem. These players are largely concentrated in Kenya, though there are an increasing number emerging in Uganda, Tanzania, Ethiopia, and Rwanda. While there is considerable country-specific variation, the broader business environment is becoming more supportive and sophisticated in East Africa, providing more options to partner with suppliers, distributors, and other commercial entities.

Regulatory Environment

Overall, East Africa has a reasonably welcoming formal regulatory climate for international investors, though this varies by country (Figure 27). In general, each country has a number of lawyers who can provide local legal advice, but the quality varies by country and price as well as local lawyers' familiarity with foreign regulations that may apply to foreign-registered investors. Despite being in general fairly open, most regulatory environments in East Africa remain challenging due to inefficient and large bureaucracies, although this also varies by country. For additional detail on the regulatory landscape, please see each individual country chapter.

With the notable exception of Rwanda, all countries in East Africa rank poorly in the *World Bank's Ease of Doing Business* rankings. South Sudan and Eritrea are at the very bottom of the global rankings, reflecting a young regulatory system and a closed economy, respectively. In these challenging environments, the private sector may require more upfront grant support before conventional investors are able to actively engage. These initial private sector efforts can have substantial impact by demonstrating to governments what is required to grow businesses locally, potentially leading to more open policies.

FIGURE 27: WORLD BANK *EASE OF DOING BUSINESS* RANKINGS

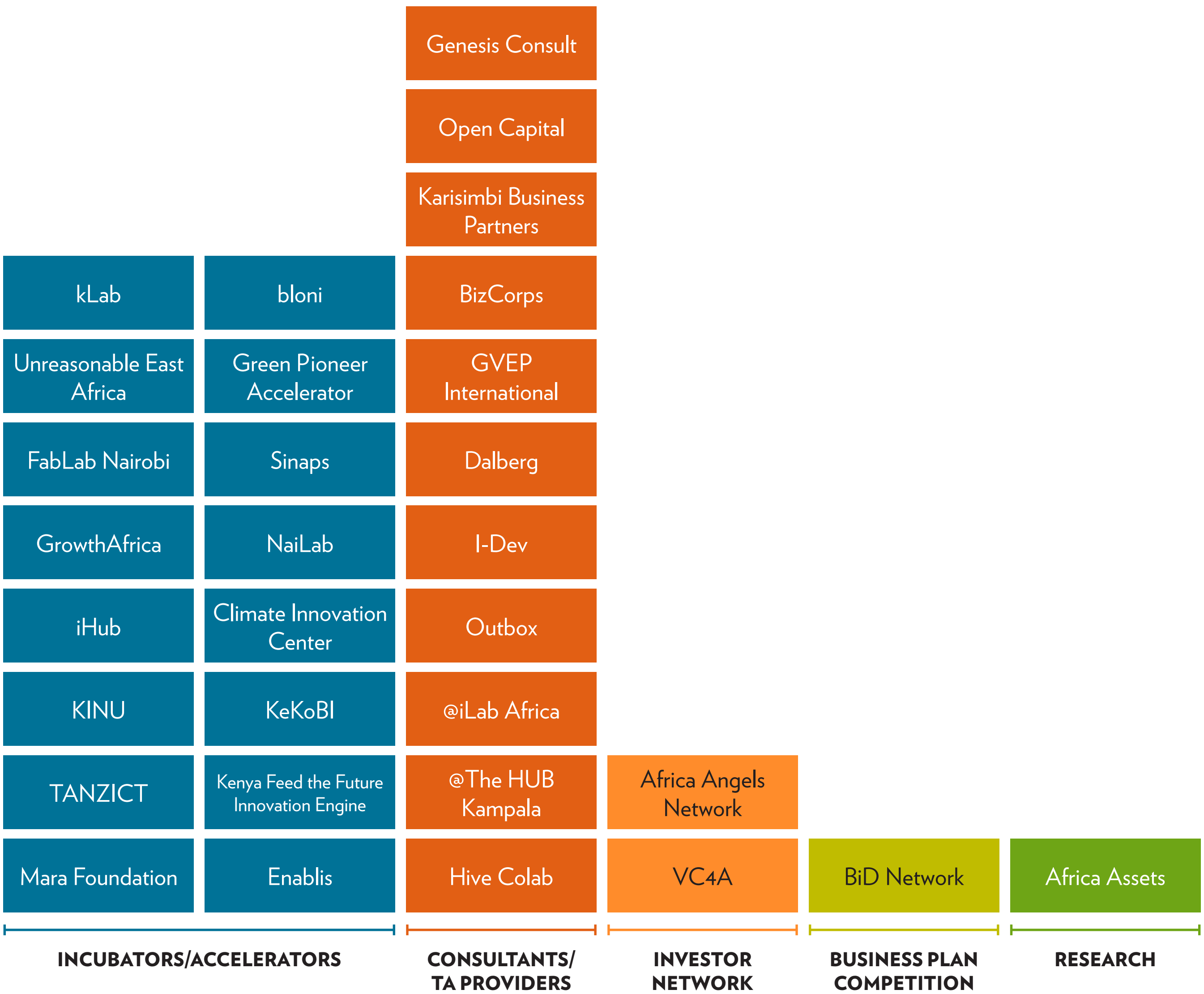
RWANDA	46
TANZANIA	131
ETHIOPIA	132
KENYA	136
UGANDA	150
BURUNDI	152
DJIBOUTI	155
SUDAN	160
SOUTH SUDAN	186
ERITREA	189

Source: World Bank

Ecosystem Players

Most of the region's intermediaries and service providers are based in Kenya and provide support throughout the region. More than 40 different organizations operate to support impact investment and social entrepreneurship within the region (Figure 28). Despite a large number of organizations, impact investors still report gaps in the support available, in particular for organizations that can produce a large number of investment-ready opportunities.

FIGURE 28: SELECTION OF INTERMEDIARIES AND SERVICE PROVIDERS CURRENTLY ACTIVE IN EAST AFRICA



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

The support ecosystem primarily includes incubators and accelerators. These organizations predominantly provide mentorship, training, and access to financing directly or through a network cultivated by the incubator. Many provide shared office space, which can help young businesses attract talent and business opportunities. There are also consultants, investor networks, and business plan competitions, though many are too new to have demonstrated effectiveness or results.

Incubators tend to focus on seed or very early-stage businesses. The ecosystem's skew toward incubators implies that there are a significant number of enterprises in these earlier stages. As most impact investors are focused on businesses with key operational structures and track record in place, and correspondingly larger capital requirements compared to seed-stage businesses, a gap may exist for intermediaries and service providers operating with businesses that are slightly more mature. Many incubators have a strong sectoral focus, often in information and communications technologies (ICT) and/or energy. However, many impact investors express an interest in agriculture, health care, and other sectors, which may be more capital intensive and less of a fit for these incubator programs.

Beyond incubators, there are a number of consultants and technical assistance (TA) providers focused on the impact investing ecosystem, including Biz Corps, Dalberg, I-DEV, and Open Capital Advisors. These organizations support SMEs as they grow with intensive, tailored support. They frequently approach impact investors to raise capital for their clients and tend to be sector agnostic, supporting individual businesses on a case-by-case basis. There are also a number of individual business consultants who perform similar services. As individuals, these consultants are typically limited to a smaller number of engagements.

There is a broad gap in the market for detailed market research and data to support both impact investors and social enterprises, despite the strong efforts of organizations such as Africa Assets and the Bertha Center. For example, there is limited data on comparable impact deals or exit multiples for impact investors to benchmark their valuations or financial performance. From an operational standpoint, detailed market data on consumption and purchasing habits often do not exist. This can present a challenge to both impact investors and social enterprises when evaluating growth assumptions and opportunities.

Other Service Providers

In addition, East Africa boasts a wide range of service providers including accountants, lawyers, recruiting firms, and others. Most countries in East Africa require annual audited accounts, and a large industry has developed to serve this requirement. However, the quality of audits 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 of varying quality is widely available. International firms have begun to consider the region, but few have full-time staff on the ground.

In addition to professional firms, there are a wide variety of marketers, talent recruiting firms, and other business service providers, yet there is substantial variation in availability across countries. Even when available, they are of substantially varying quality, and few firms operate with local presence in multiple countries.

SECTOR OPPORTUNITIES ACROSS EAST AFRICA

All East African countries share a demand for impact capital with populations well below global averages for human development, despite robust recent economic growth, averaging a combined 7% annual GDP (PPP) growth for the last eight years. As such, there are ample opportunities for investors to support entrepreneurs who will generate both financial and social returns. The following sectors present particularly notable opportunities in East Africa:

- **Agriculture**: Throughout East Africa, agriculture contributes more than 30% of GDP, employs most of the population, and is an important sector to increase incomes and improve food security. Given the predominance of smallholder farming, there are opportunities to aggregate production and create consistent, high-quality supply. In addition, there are opportunities to connect directly with export markets. There is also significant potential in agricultural processing across a range of crops and in agricultural sub-sectors such as horticulture, livestock, and dairy.

- **Renewable energy**: All countries in East Africa are looking to expand power generation capacity in the coming decades, with strong government support. This opens the door for large-scale projects and creates the potential for improved power purchase agreements and cross-border trade. 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.

- **Aquaculture**: Fisheries and fish processing also show high potential, with the export of fish and fishmeal becoming an increasingly significant part of the East African economy. Sustainable fisheries can provide a critical source of protein and have the potential to reduce increasing pressure on important coastal areas.

- **Tourism**: Given the variety of attractions available in East Africa, from beautiful coasts to vibrant safari parks, there is high potential for tourism, although countries will need to be conscious of addressing security concerns to attract tourists. Governments across the region have started encouraging foreign investors and the returning diaspora to invest in the sector with some encouraging results. Tourism presents a particular opportunity for the non-focus countries in this report as a near-term potential employment source.

- **Consumer goods for the mass market**: With East Africa's rapidly growing middle class, impact investors report seeing increasingly attractive opportunities to supply goods and services to consumers with rising disposable incomes. These businesses often create substantial employment opportunities, which may align with impact criteria for some impact investors.

- **Urban development**: Non-DFI impact investors also note rapid urbanization and growing demand for businesses to serve expanding cities as an area of opportunity. Service sectors cited by impact investors include affordable housing, water, and sanitation.
- **Basic services distribution**: Throughout the region, increasing incomes and populations put growing pressure on the provision of basic services, including healthcare, education, water and sanitation, energy access, and financial services. Across these sectors, social enterprises struggle to distribute products and services across urban, peri-urban, and rural areas. Providing distribution as a basic service could have an exponential effect in driving growth for social enterprises and their investors.

CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Common Challenges

- **Insufficient investment-ready opportunities**: Despite robust market activity to date, many non-DFI impact investors still struggle to place the capital they have raised. Though investors acknowledge that there are many businesses with exciting potential, investors encounter few companies that they believe are truly investment ready. Early-stage businesses, which are the primary target for impact investors, face certain common challenges that constrain them from being fully prepared for investment, including unproven operations, an unclear strategy to scale, informal financial and corporate records, and a lack of realistic forward-looking projections.
- **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 shortage is particularly acute for finance professionals with 5-15 years of experience who can serve as a company CFO. Even when talented, experienced professionals can be found, they often command high wages that can be challenging for SMEs or social enterprises to support, especially in their early years.
- **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 East Africa.[35] These remote investment committees often interpret risk differently than their investment teams operating on the ground, which can cause due diligence and deal closing timelines to stretch to 12 to

35 Open Capital interviews with entrepreneurs, intermediaries, and investors.

18 months for both debt and equity investments.[36] This can frustrate entrepreneurs, and put additional pressure on businesses as they must survive without needed capital.

- **Difficulty accessing bank financing**: Though entrepreneurs are sometimes able to source capital to begin operations from friends, family, and various community financing organizations, they struggle to find the next round of capital to test and pilot their ideas in the market. In particular, conventional bank financing is difficult to access for early-stage businesses, as conventional banks in the region are very risk averse. Even if willing to lend, they require high collateral ratios (often in excess of 100% of the loan amount), which few entrepreneurs are able to meet.

- **Limited local currency financing**: Many impact businesses earn 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.

- **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 is not yet clear how this will develop in coming years. Without a successful track record of exits, it can be difficult for impact investors to raise additional funding or a second investment fund. Some fund managers interviewed for this report believe it may be easier for a new impact investor to raise funds than for an experienced one, as the latter are expected to demonstrate a track record before raising a second fund.

Common Opportunities

Each country in East Africa is unique. As a result, impact investors must learn about each country individually; strategies and solutions that are effective in one East African country will not necessarily work in another. Nevertheless, there are some high-level recommendations for investors that apply to the region as a whole:

- **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. Such support can also significantly reduce diligence timelines if the investor is able to increase familiarity and visibility into the business pre-investment.

36 *Ibid.*

- **Develop sector expertise**: Beyond bringing capital to portfolio companies, impact investors can drive performance 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 consistent challenges across portfolio companies.

- **Source opportunities outside capital cities**: 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, instead of the capital cities or regional hubs where investment staff are based. For investors who see these entrepreneurs' businesses as attractive impact investment opportunities, it will be increasingly necessary to build relationships beyond those made in major cities.

- **Expand investment instruments**: With the variety of early-stage businesses in East Africa, creative investment structures—such as milestone-based conversion and profit-sharing debt – can help to fill a significant gap that straight equity and debt deals do not. Such structures can help entrepreneurs meet ongoing cash flow requirements while delivering long-term returns in line with investor expectations. There is also an opportunity to expand sharia-compliant investments to support Muslim entrepreneurs, using Murabaha[37] and Ijara[38] methods to help align impact investor goals with sharia law in areas with large Muslim populations in the region.

- **Increase local decision-making**: Impact investors have cited significant improvements in their portfolio from increased local decision-making and local support. 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.

37 Murabaha is an Islamic financing system in which an intermediary purchases an asset desired by the customer. The intermediary owns the asset completely and then agrees to sell that asset to the customer for a fixed sale price, paid in installments.

38 Ijara is an Islamic financing system in which an intermediary purchases an asset (e.g. a house) and then rents it to a customer for a fixed payment. In this system, the intermediary retains ownership of the asset, though some variants of Ijara also allow the customer to purchase the asset.

DEVELOPMENT FINANCE INSTITUTIONS

ENGINES FOR IMPACT INVESTMENT IN EAST AFRICA

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BACKGROUND AND METHODOLOGY

Development finance institutions (DFIs) are government-funded investment corporations that combine the broad development objectives of traditional multilateral aid agencies with the commercial approach taken by private-sector banks and investors. DFIs are funded in most part by governments (though some also raise capital from conventional investors). As a result, targeted regions, sectors, businesses, and project types can change with the political environment. In many cases, DFIs are expected to sustain their operations and growth from their investment returns, with limited future capital injections.

DFI managers must balance a development focus with fiscal independence, leading many DFIs to prioritize investments that present both attractive financial returns and social/environmental impact. DFIs can therefore be considered the first active impact investors, both globally and in East Africa in particular. In addition, they play other important roles related to impact investing, such as providing capital to other impact investors, catalyzing the flow of private capital into new markets, and working with national governments to reform investment policy.

DFI activity in East Africa began several decades ago. CDC Group, the United Kingdom's DFI, has been investing in the region since 1948. The International Finance Corporation (IFC) has been active in the region since the 1960s, beginning with investments into the Kenyan tourism sector.[1] At the same time, African nations established their own regional DFIs, notably the African Development Bank (founded in 1964),[2] the East African Development Bank (1967)[3] and, somewhat later, Preferential Trade Area (PTA) Bank established by the Common Market for Eastern and Southern Africa (COMESA) in 1985.[4] Deals were initially sparse and sporadic amid political instability and transition from colonial powers over the following decades. Beginning in the late 1980s and 1990s, two sectors came to define DFI activity in East Africa—telecommunications and energy. The IFC has been at the forefront of the telecommunications revolution in many emerging markets over the last thirty years, often supplying loans to establish technological infrastructure. These early telecom investments proved extremely prescient, with substantial financial returns in many cases. Along with telecommunications, the other main sector of DFI activity in East Africa in the 1980s and 1990s was infrastructure, specifically electrification and energy access. As East African economies began to emerge from conflict and political turmoil, power infrastructure became an urgent priority to drive

1 "World Bank Historical Chronology: 1960-1969," *The World Bank*, *available at* http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTARCHIVES/0,,contentMDK:20035660~menuPK:56316~pagePK:36726~piPK:437378~theSitePK:29506,00.html.

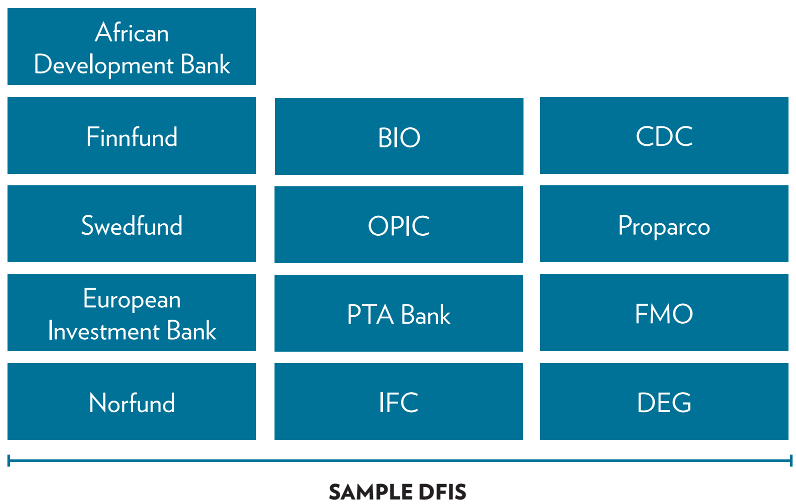
2 "About Us," *African Development Bank*, *available at* http://www.afdb.org/en/about-us/.

3 "EADB About Us," *East African Development Bank*, *available at* http://eadb.org/about-us/.

4 "PTA Bank Our History," *PTA Bank, Eastern and Southern African Trade and Development Bank*, *available at*, http://www.ptabank.org/index.php/bank-profile/our-background#.VHgpozGUdqU.

stability and economic independence. DFIs—again, principally the IFC—funded much of Africa's early electrification. The World Bank further enabled this investment by helping to shape policy around Power Purchase Agreements (PPAs) for many emerging economies.

FIGURE 1: SAMPLE DFIS ACTIVE IN EAST AFRICA



As one of the earliest movers in the region, and the largest impact investor in East Africa, the IFC has set many of the standards and investment patterns for other DFIs. The IFC's pioneering involvement in telecommunications and energy paved the way for more DFIs to enter the region. These DFIs benefitted from the infrastructure already in place but also from increased familiarity with the financing process and more knowledgeable local counterparts in business and government. From the late 1990s onward, single-government-affiliated DFIs began to enter the region, often carving out niches around the IFC's activities by targeting smaller deals and underserved sectors such as agriculture. Nonetheless, DFIs generally continue to favor large deals in sectors such as infrastructure, energy, and financial services, which are able to absorb large amounts of capital while still offering a clear and compelling development story. Of the approximately USD 7.9 billion in disclosed capital DFIs have disbursed to the East Africa region since the year 2000,[5] approximately USD 5.4 billion has been deployed to these three sectors.

DFI efforts to engage directly with SMEs have seen mixed success, largely due to the high fixed costs DFIs incur through an intensive diligence process and often-substantial investment targets for individual deals. In response to this challenge, DFIs began to increasingly fund both conventional funds and impact funds in the late 1990s and early 2000s. This indirect investing approach allowed DFIs to allocate capital specifically for SMEs and private sector development while maintaining a low-risk, large-deal investment profile. As a result, DFIs have been a major driver in more

5 Data on deals before the year 2000 is extremely limited.

than 50% of impact capital committed to East Africa by impact fund managers, with an average of approximately USD 50 million in disclosed DFI funding entering the sector via impact funds in each of the last five years.

A NOTE ON METHODOLOGY

Definitions of the term "DFI" vary substantially. For the present analysis, a DFI is considered to be any predominantly publicly-funded investor that makes direct investments in private-sector companies or funds through any combination of equity, debt, or guarantees with an explicit goal to achieve social and/or environmental impact alongside a financial return. This definition excludes multilateral aid, direct loans to governments, and development programs. In cases where DFIs make private sector investments and fund governments directly, only their private sector activity is considered. Private sector activity includes parastatals and other corporations wholly or partially owned by governments. This analysis excludes national development banks from East African countries due to limited publicly available data and less explicit impact narratives.

INCENTIVES AND DRIVERS

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

Political influences

Many DFIs are funded in large part—and often entirely—by their respective governments, and are in many cases directly subordinate to national ministries of finance or development agencies. As a result, their investment strategies are strongly influenced by national development agendas.[6] This applies equally to multinational DFIs like the IFC or the African Development Bank, whose governing boards are made up of high-ranking member government representatives. At the same time, governments often look to multinational DFIs such as the IFC for standards and guidance for their national DFIs. This serves to shape DFI strategy in the following ways:

- **Changing investment objectives**: DFI investment strategies are shaped by government agendas and can fluctuate over time. Many DFIs revise their over-arching investment strategies over cycles, typically between 3-10 years. Unexpected strategy changes can also occur when new political leadership is inaugurated, either at a country or group level (e.g. World Bank leadership dictating IFC direction).

- **More stringent risk standards**: Public scrutiny over government funds means that reputational risk is an important consideration for DFIs. Many DFIs have adopted stringent risk standards and vetting procedures to avoid directly or indirectly channeling funds to politically sensitive recipients.[7] This limits DFIs' ability to work with early-stage businesses, or in sectors such as agribusiness, which often face high market concentration around a few incumbents, and a long tail of smaller, less-established, growth-stage businesses. However, as shall be seen later in this chapter, some DFIs are developing new strategies to channel capital towards smaller organizations.

6 For a review of various DFIs' ownership and governance structures along with much other valuable information see Christian Kingombe, Isabella Massa and Dirk Willem te Velde, *Comparing Development Finance Institutions* (2011), *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/67635/comparing-DFIs.pdf.

7 See for instance the conditions on "Politically Exposed Persons" in IFC, Correspondent Account KYC Toolkit, *A Guide To Common Documentation Requirements* (2009), *available at* http://www.ifc.org/wps/wcm/connect/dfb227004ec4ea109697bf45b400a808/CORRESPONDENT+ACCOUNT+KYC+TOOLKIT.pdf?MOD=AJPERES.

Capital allocation and investment targets

DFIs often have very specific investment targets by sector, geography, and time frame. These investment quotas encourage DFI investment officers to look for a smaller number of large investment opportunities—particularly when considering the complicated diligence and structuring costs associated with small deals. In East Africa, this appetite for large deals naturally attracts DFIs to capital-intensive industries such as energy, manufacturing, and infrastructure.

This focus is reinforced by the open-ended nature of DFI portfolios. Political agendas and budget cycles mean governments do not generally re-capitalize DFIs at predictable time intervals or amounts. Many DFIs need to rely on portfolio returns to cover overhead expenses while also investing in sectors that fit with development mandates and that do not distort local markets. This emphasis on profitable impact lends itself to investments in infrastructure, where strong government ties and regulatory controls portend relatively stable income streams, and financial services, where investees are often already well-integrated into local markets.

Additionality and private sector inclusion

DFI parent governments and international organizations recognize the potential for their activity to distort private markets with large amounts of public capital. The DFI response to this concern is to seek "additionality"[8]—DFIs should only be active in regions, sectors, or segments that are challenging for other private sector capital sources. This has led many DFIs to intensify their focus on frontier, fragile, and conflict markets, and to galvanize the private sector. Examples of this activity include:

- **Syndicated loans (example IFC "B-loans")**:[9] Several DFIs offer syndicated loans that focus on including third-party private sector financial institutions as co-lenders in their investments. Under this structure, when DFIs make loans, they retain a portion of the loan for their own account (the "direct" loan) and sell the remainder (the syndicated loan) to participating financial institutions such as banks. This provides participants with lower default risk through the DFI's strong creditor status while enlarging the pool of capital available to borrowers. This structure's main challenge is to incentivize local financial players, particularly in markets where commercial rates are significantly higher than rates on the DFI loans, as is often the case in emerging economies.

- **Asset management products (example: IFC Asset Management Company)**:[10] In an effort to mobilize more private sector funding for development finance objectives, the IFC launched an asset management arm in 2009 and has raised

8 See for instance IFC Additionality Primer, *available at* http://www.ifc.org/wps/wcm/connect/696f81804b06f2adb09afa888d4159f8/Additionality_Primer.pdf?MOD=AJPERES.

9 "B Loan Structure and Benefits", *available at* http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+syndications/overview_benefits_structure/syndications/b+loan+structure+and+benefits/bloanstructuredefaultcontent.

10 "IFC Asset Management Company", *available at*: http://www.ifcamc.org/.

six funds with over USD 6 billion under management. The model is funded by pension funds, insurance companies, and other private sector actors, in addition to public and quasi-public institutions. Close to USD 4 billion has been disbursed across 57 investments globally, and more than 90% of the assets under management are available for investment in East Africa, although this capital broadly targets emerging markets globally.

- **Public-private co-financing:** Some DFIs make third party co-financing a condition for investment. The DFI will commit an anchor investment, typically for a minority stake, then use their preferred creditor status and their strong reputations to encourage external, often private-sector investors to join in deals that would not otherwise fit their risk profiles. Conversely, DFIs also will provide debt project financing when private entrepreneurs have committed sufficient equity.

DFI IMPACT APPROACH AND INFLUENCE ON IMPACT SECTOR

DFIs have a direct mandate from governments and intergovernmental organizations to promote international development. Evaluating success requires a formalized impact measurement methodology and all of the DFIs with direct investment activity in East Africa stipulate a minimum impact requirement for their investment targets. Broadly, these methods can be grouped into two categories, but individual DFIs may use varying terminology:[11]

1. **Environmental, Social & Governance (ESG) monitoring**: This is the broadest impact framework commonly used by DFIs, and it is also utilized by many of the impact investors interviewed for this report. Investees are required to meet threshold requirements limiting environmental damage, safeguarding human rights, and promoting fair and transparent governance structures. The metrics often vary according to the DFI and target company in question. Companies that do not meet these requirements often receive technical assistance to help build the necessary structures for compliance.

   As part of its Sustainability Framework, the IFC formulated a set of eight performance standards that investees are required to meet while they are receiving funding.[12] These standards form the basis by which most DFIs set their ESG

11 See for instance DEG's *Corporate-Policy Project Rating* (2013), *available at* https://www.deginvest.de/DEG-Englische-Dokumente/About-DEG/Our-Mandate/Detailed-GPR-Description.pdf, or OPIC's *Environmental and Social Policy Statement* (2010), *available at*: http://www.opic.gov/sites/default/files/consolidated_esps.pdf.

12 IFC, *IFC Performance Standards on Environmental and Social Sustainability* (2012), *available at* http://www.ifc.org/wps/wcm/connect/c8f524004a73daeca09afdf998895a12/IFC_Performance_Standards.pdf?MOD=AJPERES.

standards. In addition, many other common standards such as the European Development Finance Institutions' (EDFI) Environmental and Social Standards are derived from the IFC framework. Specifically, the IFC requires investees to meet minimum requirements across each of these standards:

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

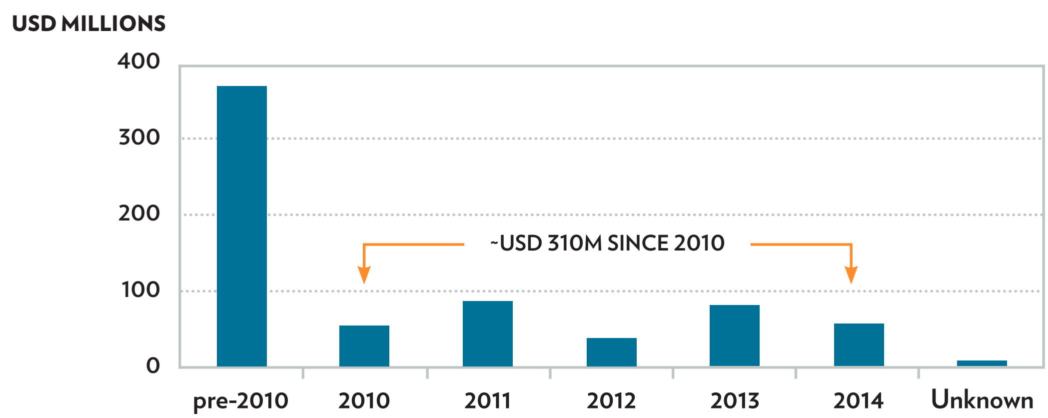
2. **Specific impact objectives**: The purpose of the ESG- or IFC-type frameworks mentioned above is to ensure that financially attractive investments meet minimum social and environmental standards. However, some DFIs have recently begun to allocate funds to proactively achieve specific impact objectives, and the variety of approaches used is broad. One example is FMO, the Dutch government DFI, which has a twin focus on both job creation and reducing greenhouse gas emissions. Another example is the recently launched DFID Impact Fund, a CDC-managed fund-of-funds that aims to invest up to GBP 75 million[13] in impact funds across sub-Saharan Africa and South Asia. Another DFI, the US-based Overseas Private Investment Corporation (OPIC), recently conducted a thorough segmentation of its investment portfolio to better understand its impact. While all of its investments have "positive development impact", investments in "high impact sectors" that have been identified as particularly environmentally and socially beneficial accounted for over two-thirds of investments in 2013. Investments with "impact intent" with the explicit goal to address social and environmental challenges alongside financial return accounted for approximately 5% of OPIC's investments in 2013.[14]

13 "DFID Impact Fund," *CDC*, *available at* http://www.cdcgroup.com/dfid-impact-fund.aspx

14 "OPIC in Action: Impact Investing," *OPIC*, *available at* http://www.opic.gov/opic-action/impact-investing

A critical component of DFIs' development and impact philosophies is to nurture the private sector by fostering SME growth. However, smaller businesses come with higher relative diligence costs, lack the security and assurances of public sector projects, and may require more flexibility than DFIs are typically able to accept. In response, DFIs have addressed these constraints by funding impact fund managers (Figure 2), particularly those focused on SME investments. Indeed, no single factor has done more to shape the impact investing sector in East Africa than the flow of DFI capital into impact funds. Based on disclosed deals and information provided by fund managers, DFIs account for at least 50% of estimated impact capital currently committed to East Africa via impact funds. This figure presents a conservative estimate of the influence of DFI capital in East Africa's impact funds, as some of the smaller DFIs do not disclose individual deal sizes, although they are known to invest in impact funds. Nevertheless, these figures roughly align with evidence gathered from interviews with impact fund managers, several of whom report an approximately 50/50 split between DFI funding and private sector investments.

FIGURE 2: DISCLOSED DFI FUNDING OF IMPACT FUNDS IN EAST AFRICA



Source: Open Capital Research. Note: 2014 values as of October 2014.

DFI capital disbursed to impact funds during the last five years accounts for close to 50% of total disclosed funding of impact funds by DFIs. Since 2010, disclosed DFI disbursements to impact funds have remained relatively constant at approximately USD 50 million per year, despite a drop in 2012 amid political uncertainty surrounding the Kenyan presidential elections and fears of this spilling into the region.

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

- **DFI importance:** DFIs are a major driver in at least 50% of impact capital committed to East Africa via impact funds. This figure underestimates the true significance of DFI capital as DFIs often provide anchor investments, which allow fund managers to raise the balance from other sources such as commercial or philanthropic funding. This makes the impact fund landscape vulnerable to changing DFI priorities. While there is no reason at present to assume they will discontinue support for East African impact vehicles, DFIs have only recently started placing capital in this manner. The model has yielded mixed results so far, in contrast to the strong returns often achieved by DFIs through their direct investments.[15] Few of the actors interviewed see the reliance on DFIs changing until impact funds are able to demonstrate the kinds of commercial returns that would make the sector attractive to larger institutional investors like pension funds. While DFIs also seek financial returns, their development mandate has facilitated more capital to flow into the sector than a strictly commercial approach might warrant.

- **Fund manager homogeneity**: While a large number of DFIs have funded impact funds in East Africa, the majority of capital has come from a small group of particularly active players. The five most active DFIs account for over 80% of disclosed capital disbursed to impact fund managers. This concentration of capital and resulting influence exerted by this small group has led several fund managers in the region to observe a homogenization of impact funds, which—dependent on DFI anchor capital—look to align themselves with DFI expectations. The resulting similarity between funds exacerbates the perceived shortage of investment targets as many investors are constructed to pursue similar deals.

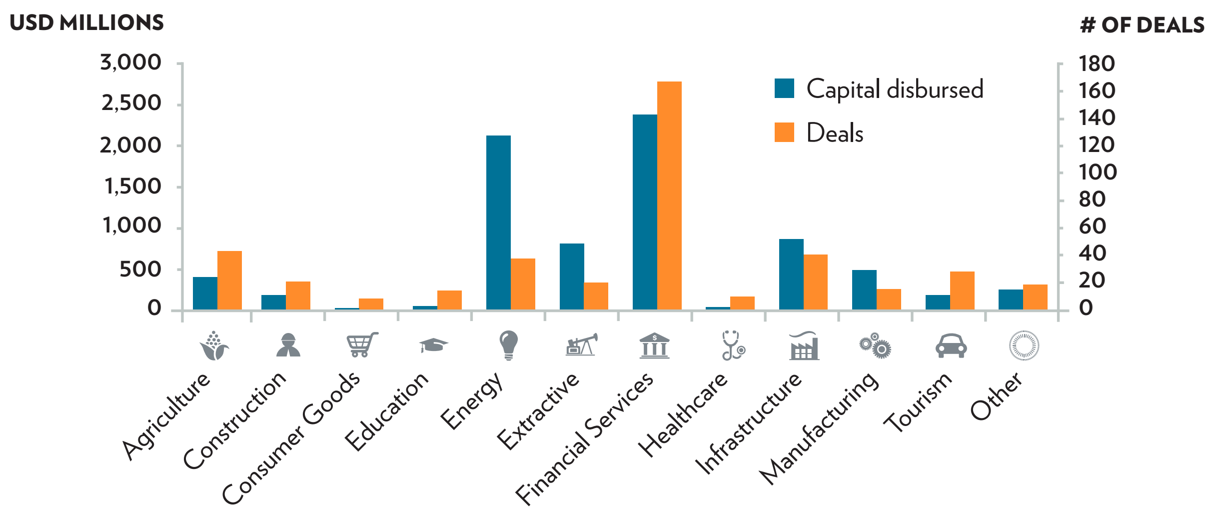
- **Investment manager proliferation**: The relative inexperience of the East African impact investing sector and the mixed results thus far on exits and returns have made reinvesting into existing funds difficult for some DFIs. Investor interviews suggest that first-time fund managers generally find it easier to raise capital from DFIs than do existing funds with more ambivalent records. Indeed, only around 15% of disclosed investments by DFIs into impact funds have been repeat investments into the same fund or fund manager. (At the same time, larger private equity fund managers have successfully attracted multiple rounds of DFI funding for successive funds built from a longer track record.) Of course, the flip side to this is that, with DFI support, a greater number of impact fund managers are able to become active, which strengthens the base of intermediation in the market.

15 For instance, it is generally well known that DFI investments in the telecoms space in the 1980s and 1990s performed very strong financially.

DFI DIRECT INVESTMENT ACTIVITY

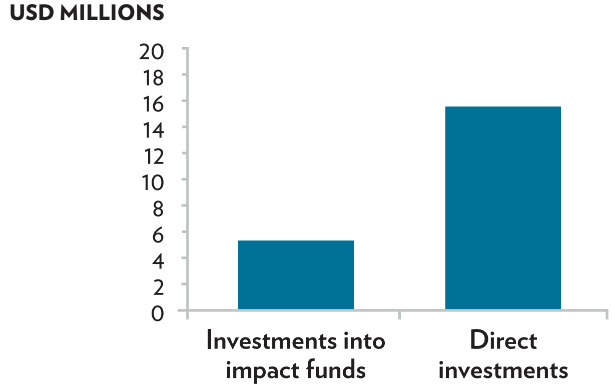
Although DFI funding has come to define East Africa's impact fund landscape, the bulk of DFI capital in the region has taken the form of direct debt or equity investments into enterprises and public-private partnerships. Total disclosed DFI activity in the region amounts to approximately USD 8.5 billion across 536 recorded deals, of which approximately USD 700 million has flowed to impact funds. The remaining USD 7.8 billion has been predominantly invested into energy, financial services, infrastructure companies, and projects, which make up close to 65% of disbursed capital combined (Figure 3). The combination of scale, low risk, ticket size, and large-scale approach to impact, along with government access, has made these sectors particularly attractive to DFIs. This is reflected in average DFI deal sizes, which are almost three times higher for direct investments than for impact fund capitalization (Figure 4, next page).

FIGURE 3: DFI DIRECT INVESTMENTS BY SECTOR



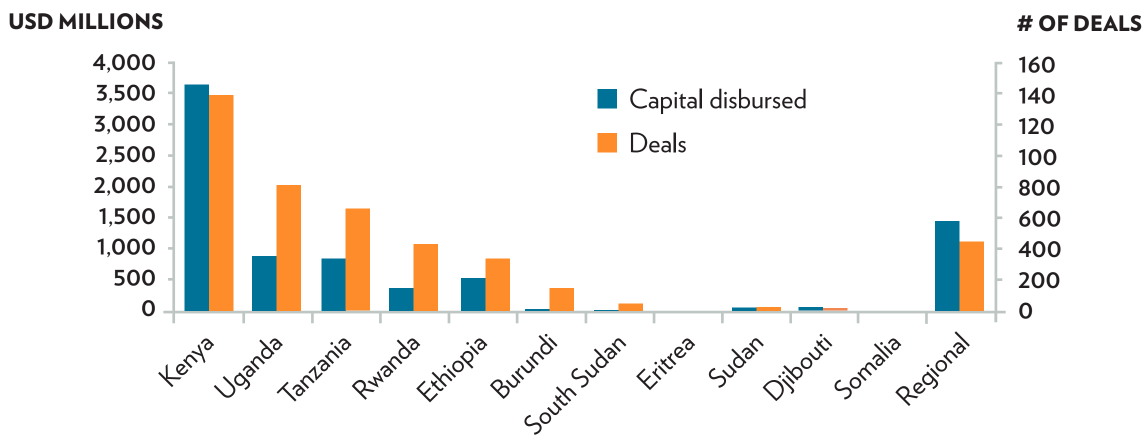
Source: Open Capital Research

FIGURE 4: AVERAGE DFI INVESTMENT SIZE



The regional distribution of direct DFI investments mirrors that of non-DFI impact investors. Investments in Kenya make up nearly 50% of capital disbursed, while Kenya, Rwanda, Tanzania, Uganda and Ethiopia together account for almost 80% (Figure 5). This number rises to nearly 98% once investments spanning multiple countries within the region at once ("regional") are taken into account. Despite their pioneering role in entering new markets, activity outside these five countries has been extremely limited even for DFIs, with only a handful of investments in Burundi, Djibouti, Sudan, and South Sudan, and none observed in Eritrea and Somalia. Note that "regional" direct investments have not been allocated specifically to East Africa, though the number of DFI investees operating across both East Africa and other African regions is still relatively limited today. Investments in regions outside East Africa are excluded.

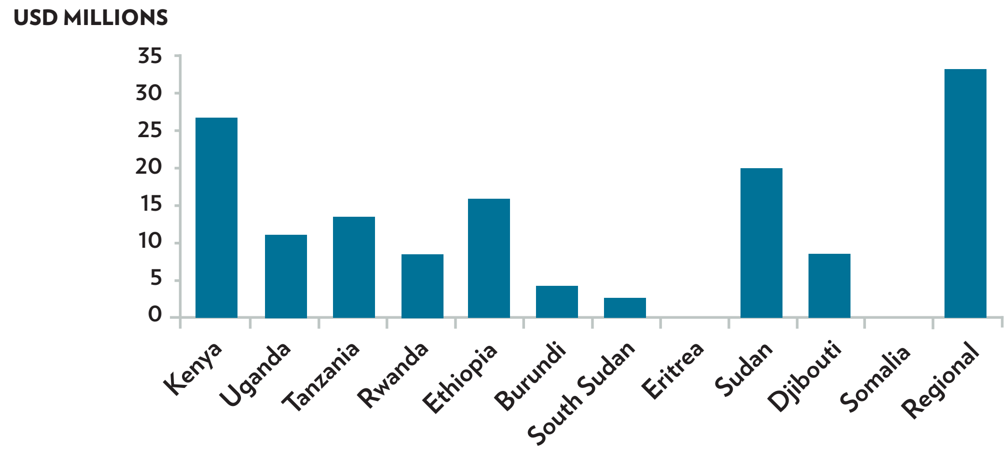
FIGURE 5: DFI DIRECT INVESTMENTS BY COUNTRY



Source: Open Capital Research

Unsurprisingly, average deal size by country closely mirrors capital disbursed, as countries with more investment opportunities and more welcoming investor climates are able to build larger businesses, which need larger capital injections (Figure 6). Ethiopia is a notable exception, having seen relatively little capital disbursed by DFIs except in a few large deals in oil and gas, and Ethiopian Airlines' fleet expansion. Similarly, the limited DFI funding that has been disbursed to Sudan has typically occurred in the form of large investments, mostly into the country's sugar industry.

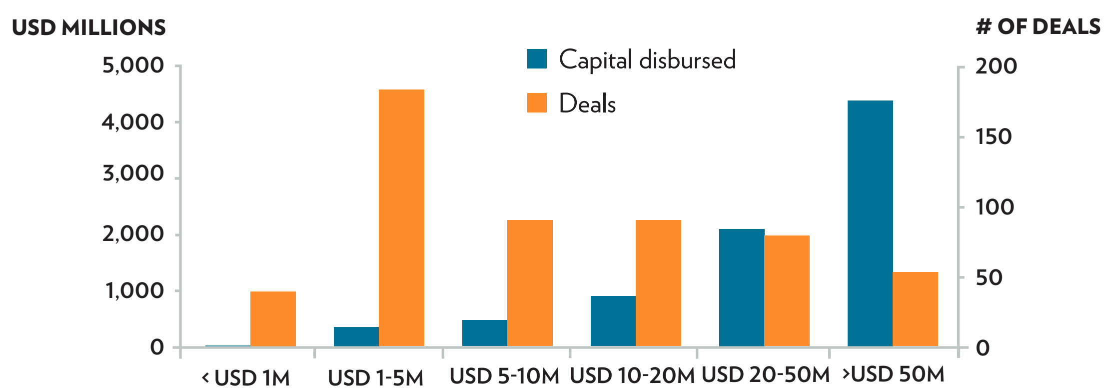
FIGURE 6: AVERAGE DFI DIRECT DEAL SIZE BY COUNTRY



Source: Open Capital Research. Note: 2014 values as of October 2014.

Across the region, the majority of capital—well over 50%—has been disbursed in deals worth over USD 50 million (Figure 7). This trend is driven primarily by investments into large infrastructure and energy projects that can easily exceed USD 100 million, many of which have gone to fund geothermal, wind, and other renewables projects in Kenya's booming power sector. Despite these large volume deals, most DFI investments are still in the USD 1-10 million range, though many outlays are in the form of credit guarantees to local banks.

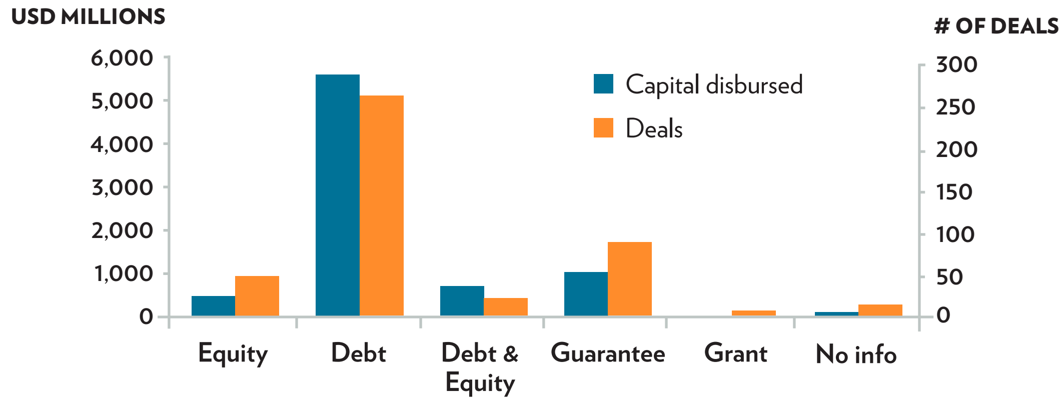
FIGURE 7: DFI DIRECT INVESTMENTS BY DEAL SIZE



Source: Open Capital Research

DFIs have shown an overwhelming preference for debt financing for direct investments. More than 70% of DFI capital deployed in East Africa as direct investments has been invested as debt (Figure 8). In many cases this reflects the nature of the project; project finance for infrastructure, for instance, typically requires an upfront equity investment by an independent entrepreneur supplemented by DFI debt. In addition, many DFIs lack the organizational structure to provide the heavy-touch oversight that successful equity investments in local businesses might require. Nonetheless, some DFIs have successfully carved out a niche for themselves by taking minority stakes—typically in medium-sized businesses—providing expertise, market knowledge, and technical assistance in addition to capital. In some instances DFIs have placed both debt and equity into the same investee. A very small amount of direct DFI investment has occurred in the form of grants, though these have only been included in this report if they accompany other forms of financing. These grants are typically made for technical assistance alongside investment capital.

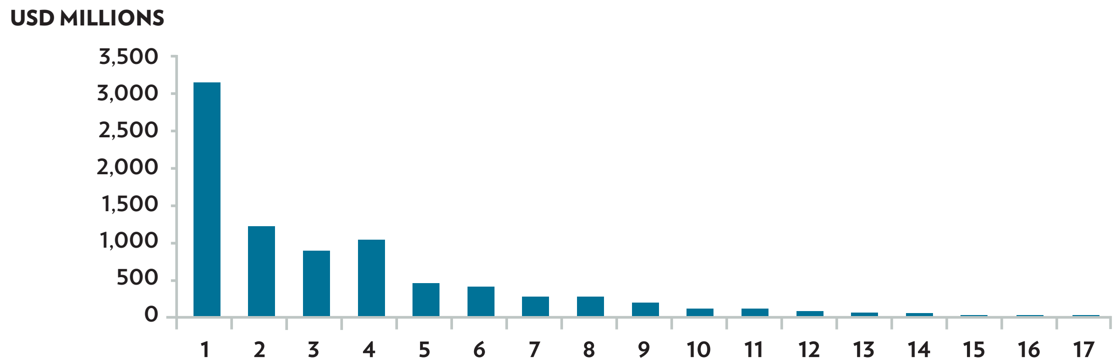
FIGURE 8: DFI DIRECT INVESTMENTS BY INSTRUMENT



Source: Open Capital Research

Even though 17 DFIs have publicized direct investments in East Africa, the industry is remarkably concentrated. Two DFIs account for over 50% of capital disbursed as direct investments since 2000. The top five DFIs have between them placed over 80% of all DFI disbursements (see Figure 9). This concentration reflects the breadth of institutions active in the space, with smaller national investment corporations operating alongside major international organizations.

FIGURE 9: DFIS ARRANGED BY CAPITAL DISBURSED IN EAST AFRICA (ANONYMIZED)



Source: Open Capital Research

FUTURE TRENDS

DFIs are likely to remain central actors in East Africa's impact investing landscape. DFI impact funding to the region—both in the form of direct investments and capital placed into impact funds—shows few signs of ebbing and DFIs have publicly expressed their intentions to redouble their impact investing activities in Africa's emerging markets. In its 2014-2016 Road Map, for instance, the IFC lists its main strategic priorities as strengthening its focus on frontier markets, addressing climate change and social sustainability, addressing private sector infrastructure constraints, and developing local financial markets, focusing particularly on access to finance for SMEs.[16] Impact fund managers and ecosystem players anticipate little shift in DFI sectoral or geographic focus, though, as economies like Ethiopia continue to develop their budding private sectors, it seems likely that increased DFI funding will follow. Rather, the key trend is DFIs' increased efforts to deploy capital more effectively by preparing businesses and impact funds for investment.

Some DFIs such as Belgium's Belgische Investeringsmaatschappij voor Ontwikkelingslanden (BIO) have begun to provide grants for technical assistance along with their debt and equity investments. These grants typically fund external consultants to provide pre-investment or post-investment support directly to portfolio companies. DFIs are increasingly exploring the possibility of adding specifically earmarked technical assistance capital to their fund investing activity. This additional capital, most often in the form of grants, would be used to fund intermediaries and build investment-readiness for their potential direct investments. A specific example of this trend is DFID's recently launched GBP 75 million Impact Fund, managed by CDC. The fund will not invest directly but will deploy capital through impact funds, non-profit organizations, and holding companies, and is supported by a separate GBP 7.5 million technical assistance facility. There is great potential value for these facilities in markets characterized by successful but often highly informal businesses. At the same time, DFI representatives caution that appropriate incentives need to be in place for technical assistance funds to be managed effectively. Having investees contribute to the costs of technical assistance, for instance, signals commitment and ensures buy-in on the part of businesses. Additionally, fund managers will need to devote sufficient resources to selecting consultants—ideally together with businesses—and appropriately scoping and monitoring technical assistance projects.

16 IFC, IFC ROAD MAP FY14-16 Leveraging the Private Sector to Eradicate Extreme Poverty and Pursue Shared Prosperity(2013), *available at* http://www.ifc.org/wps/wcm/connect/1d30b9004028f151b28fff23ff966f85/Road+Map+FY14-16+redacted.pdf?MOD=AJPERES