

THE LANDSCAPE FOR IMPACT INVESTING IN SOUTH ASIA

Understanding the current status,
trends, opportunities, and challenges
in **BANGLADESH, INDIA, MYANMAR,
NEPAL, PAKISTAN, and SRI LANKA**



ACKNOWLEDGMENTS

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LIST OF COMMON ACRONYMS

ADB Asian Development Bank	MDG Millennium Development Goal
AIF Alternative Investment Funds	MEB Myanmar Economic Bank
BoP Base of the Pyramid	MFI Microfinance Institution
BRICS Brazil, Russia, India, China, South Africa	MFTB Myanmar Foreign Trade Bank
CA Chartered Accountancy	MNC Multinational Corporation
CIIE Centre for Innovation, Incubation and Entrepreneurship	MICB Myanmar Investment and Commercial Bank
CGTMSE Credit Guarantee Fund Trust for Micro & Small Enterprises (India)	NABARD National Bank for Agriculture and Rural Development
CSR Corporate Social Responsibility	NASE National Association of Social Enterprises (India)
DFI Development Finance Institution	NEDA National Enterprise Development Authority (Sri Lanka)
DFID Department for International Development	OPIC Overseas Private Investment Corporation
FIL Foreign Investment Law	PE Private Equity
FDI Foreign Direct Investment	PM Prime Minister
GAAR General Anti-Avoidance Rules (India)	PPP Purchasing Power Parity
GIZ Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)	RBI Reserve Bank of India
HDI Human Development Index	SEBI Securities and Exchange Board of India
HNWI High Net-Worth Individual	SIB Social Impact Bond
HR Human Resources	SIDBI Small Industries Development Bank of India
ICT Information and Communication Technology	SME Small or Medium Enterprise
IFC International Finance Corporation	SMED Small and Medium Enterprise Development (Sri Lanka)
IFI International Financial Institution	SVF Social Venture Fund
IE Impact Enterprise	VC Venture Capital
IIC Impact Investors' Council (India)	WHO World Health Organization
IMF International Monetary Fund	
LP Limited Partner	
LTTE Liberation Tigers of Tamil Eelam	

FOREWORD

DEAR READERS,

The Global Impact Investing Network (GIIN) is pleased to publish The Landscape for Impact Investing in South Asia, in partnership with Dalberg Global Development Advisors and with support from UK aid from the UK Government through the Department for International Development's Impact Programme. The first regional market landscape report developed by the GIIN, this report provides a comprehensive overview of the impact investing industry in South Asia, focusing on the countries of Bangladesh, India, Myanmar, Nepal, Pakistan, and Sri Lanka. Through this research, and additional upcoming regional landscaping studies, the GIIN aims to deepen our understanding of investor opportunities at a country-specific level.

The impact investing industry is relatively young, and so the degree of market development varies from one country to the next. This variation is present in South Asia, one of the least developed yet most populous regions in the world—a region with significant potential for impact investing. If we are to accelerate impact investing in South Asia, an understanding of the current state of the market is critical in identifying opportunities for and challenges to deploying impact capital and growing the industry.

Through our partnership with Dalberg, a firm with a strong track record in global development and investment research, we were able to conduct a detailed analysis of capital flows and the current state of impact investing in South Asia. In addition to examining the activities of various impact investors and impact enterprises, the full report highlights the role of key industry actors such as government bodies, investment advisors, incubators, and accelerators.

Looking forward, we are encouraged by clear areas of opportunity, such as the enormous potential market for affordable products and services to meet the needs of “base of the pyramid” populations. There is an undeniable need for improved access to quality housing, healthcare, education, financial services, and energy in South Asia, warranting continued exploration and increased activity in the impact investment market.

We hope this report will accelerate interest, innovation, and investment in the region. Ultimately, this research is intended to inform investors currently deploying capital in the region, and spark further interest from those considering investing in the region.

We look forward to continued work with our network in future landscaping reports, and thank readers of this report for their interest and support.

Sincerely,



Amit Bouri

CEO, The Global Impact Investing Network

OVERVIEW AND CURRENT STATE OF THE MARKET

This extensive report aims to provide a “state of the market” landscape analysis of the impact investing industry in six countries across South Asia—Bangladesh, India, Myanmar, Nepal, Pakistan, and Sri Lanka.¹ Impact investments, as defined by the Global Impact Investing Network (GIIN), are investments that intentionally seek to generate social and/or environmental impact alongside a financial return. In addition, the report captures other activity that may be relevant for impact investors, such as investments at the base of the economic pyramid that may lack an explicit intention for positive impact.

Overall, although the market activity and dynamics of impact investing differ among the countries under study, the countries do share some common trends and areas of opportunity, as well as common challenges to be mitigated.

India is the largest and most active impact investing market in the region (see Figure 1), benefiting from a broad range of investor and entrepreneur experience with impact investing. To date development finance institutions (DFIs) have deployed USD 5 billion while other impact investors have deployed USD 437 million. However, there is still room for growth in several areas, such as the development and use of a wider range of instruments, gap filling in early-stage investing, and the development of strategic and consistent impact measurement practices.

FIGURE 1A: KNOWN CAPITAL DEPLOYED BY DFIS, USD MILLIONS

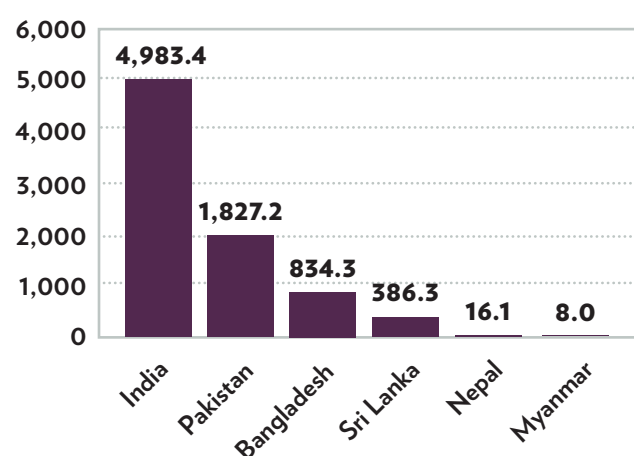
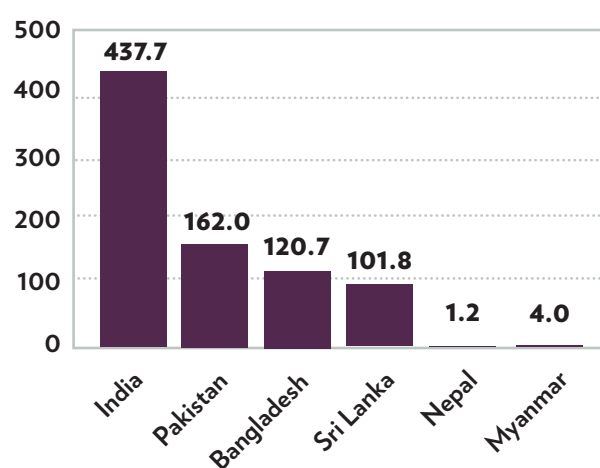


FIGURE 1B: KNOWN CAPITAL DEPLOYED BY NON-DFI IMPACT INVESTORS, USD MILLIONS



Source: Dalberg analysis. Notes: Figures represent aggregate capital deployed from 2004-2014. The majority of the capital represented here was deployed between 2009 and 2014. This is due in part to the limited availability of data for 2004-2009.

¹ Chapters on Bangladesh, Nepal, and Pakistan as well as an introductory section (“Setting the Scene”) were published in December 2014 along with this Executive Summary.

After India, Pakistan and Bangladesh are the most active countries for impact investing in the region. Non-DFI impact investors have deployed USD 162 million and USD 121 million in Pakistan and Bangladesh, respectively. DFIs, for their part, have deployed USD 1.8 billion and USD 834 million. In Pakistan, while political instability and terrorism are major concerns for many foreign investors, the domestic business community remains largely undeterred by these factors. Rather, domestic investors and fund managers in Pakistan have demonstrated optimism about the industry, given the large domestic market, relatively favorable regulatory environment, strong history of entrepreneurial activity, and interest from some foreign providers of impact capital. In Bangladesh, market potential (based on GDP and large population), and a long-standing presence of development finance institutions (DFIs) are key facilitators of impact investment.

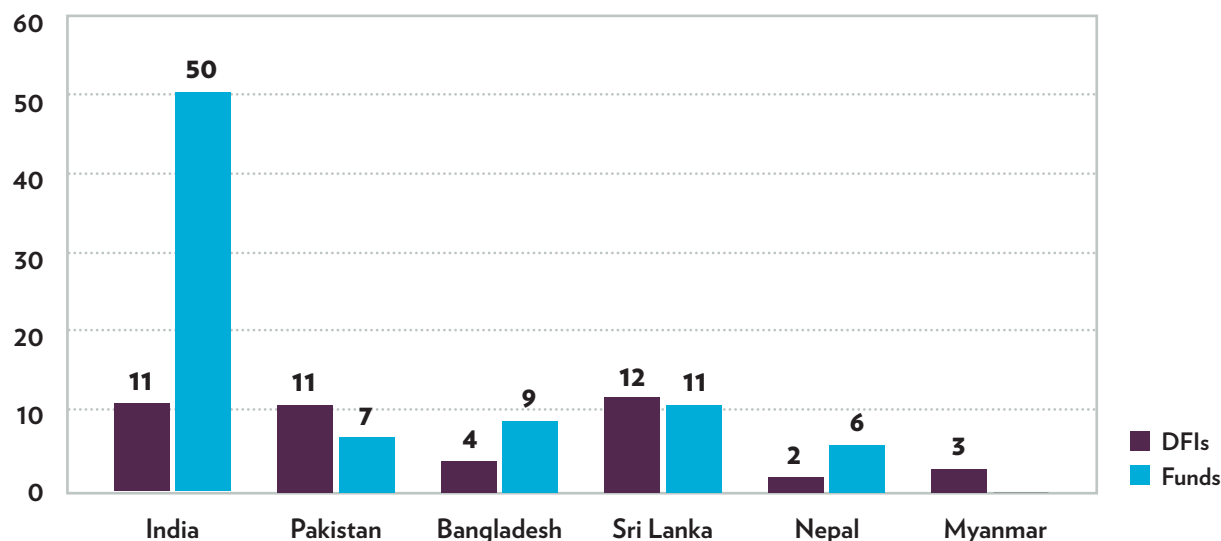
Myanmar and Sri Lanka are two of the fastest growing economies in the region, and impact investors considered in this study have shown a strong interest in these two countries. In Myanmar, while only USD 12 million has been deployed to date, a further USD 109 million has been committed by various investors for deployment in the next two to four years. Sri Lanka offers a relatively favorable regulatory environment for investors. However, in both these countries, small overall market sizes and gaps in enterprise capacity pose challenges for investors. Still, over USD 100 million has been deployed to date by non-DFI impact investors in Sri Lanka and a further USD 386 million has been deployed by DFIs, demonstrating the potential for capital flows across the region if the market climates are investment-friendly.

In Nepal, despite strong macroeconomic growth trends and recent improvements in the investment climate, there has been relatively little impact investing activity (as well as little overall investing activity). Nevertheless, there has been some growth and impact investor interest in certain economic sectors such as hydropower and tourism. In addition, approximately USD 54 million has been raised or committed by DFIs and funds; however, this money has not yet been deployed.

Roughly a dozen DFIs have deployed capital in each of India, Pakistan, and Sri Lanka, while a smaller number have been active in Bangladesh, Nepal, and Myanmar. Across the region, most (65-95%) of the impact capital currently originates from DFIs and is then deployed either directly into enterprises and projects or through funds of varying sizes. DFIs' role as a dominant capital provider puts them in a position to drive trends in investment practice and impact measurement. In some countries, they also play a role in influencing the policies and the regulatory environment for investment.

There are also many impact investment funds active across countries in the region. Most impact funds have a multi-geographic focus, including not just multiple countries in the region but a variety of countries worldwide. Bangladesh and India are the only countries with a handful (three or more) of country-specific impact funds with deployed capital. Five country-specific impact funds have been established in Nepal; however, only one of these has currently deployed capital (as of 2014). Overall, there are roughly 50 impact investment funds active in India, 11 in Sri Lanka, nine in Bangladesh and seven in Pakistan. These funds raise capital from a variety of sources, including DFIs, institutional investors (pension funds and insurance companies), family offices, high-net-worth individuals (HNWIs), commercial banks, and foundations. Some family offices, HNWIs, and foundations are also active in

FIGURE 2: NUMBER OF IMPACT FUNDS AND DFIS ACTIVE IN SOUTH ASIA



Source: Dalberg analysis. Notes: Nepal has five country-specific impact funds; however, only one of these has currently deployed capital.

making direct impact investments.

There are also several funds, banks, and family offices/HNWIs active in South Asia that are making investments on the periphery of impact investing—for instance, those who invest in enterprises providing goods, services, or employment to populations at the base of the economic pyramid (BoP), but without explicit impact intent.² These include local wealthy families and individuals who often provide start-up financing, particularly to entrepreneurs within their family or social networks. Many local commercial banks, meanwhile, provide debt financing to SMEs (often mandated by policy) at the behest of DFIs.

Impact investors in the region target their investments in a number of ways, including one or both of the following:

1. by the intention of the enterprise to create impact (“impact enterprises”—see side bar for definition);
2. by the potential of the enterprise to create impact (regardless of whether it explicitly intends to do so), e.g., investing in SMEs that can provide local employment; investing in enterprises in sectors the investor considers inherently impactful, such as health and education; or investing in high-growth sectors with job creation potential, such as manufacturing.

For this study, we define **impact enterprises** as those that

- have articulated a core objective to generate positive social or environmental impact (as a part of their operating model rather than an ancillary activity); and
- seek to grow to financial viability and sustainability

² In this report, we use “base of the pyramid (BoP)” as a general term to refer to poor or low-income populations, with no specific threshold in terms of income level.

Thus far, across the region, only a relatively small proportion of the total capital deployed by impact investors has been directed at impact enterprises, perhaps due to the small investment sizes required (along with relatively high transaction costs), the limited pipeline of the investment-ready impact enterprises, and the fact that self-defining as an “impact enterprise” is itself an emerging practice.

OPPORTUNITIES

SECTORS

The markets in South Asia offer a diverse array of investment opportunities in different sectors. Across the region as a whole, the largest amounts of capital have been deployed in the sectors of energy, financial services (including microfinance), and manufacturing, and these remain active sectors for investment. There is notable variation between the sectors targeted by DFIs and those targeted by other impact investors, with the former preferring sectors that are able to absorb large investments, while the latter are more readily able to target impact enterprises. For instance, DFI energy investments have focused on large scale infrastructure projects, whereas energy investments by other impact investors have supported smaller, off-grid technologies. Similarly, DFI investments in financial services have targeted bigger banks, while financial services investments by other impact investors have focused more on microfinance institutions.

There is also growing interest among impact investors in other sectors such as agro-business, health, and information and communication technology (ICT), and in businesses providing basic goods and services to the base-of-the-pyramid (BoP) consumers.

FIGURE 3A: KNOWN CAPITAL DEPLOYED BY DFIS, USD MILLIONS

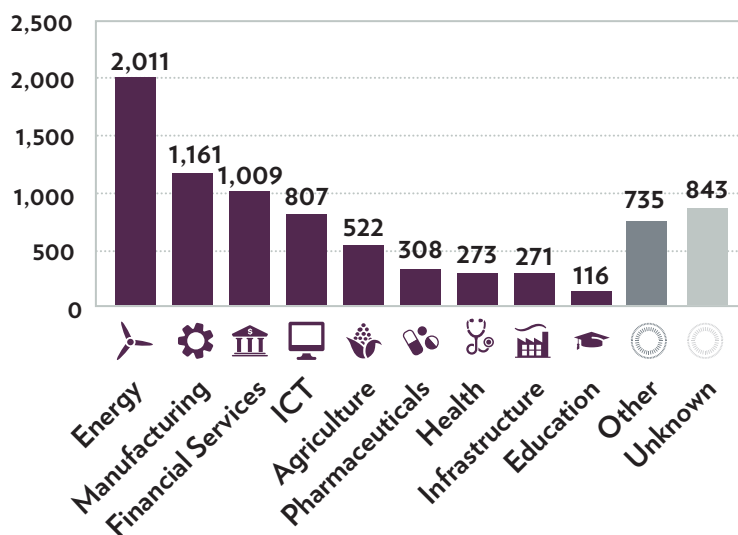
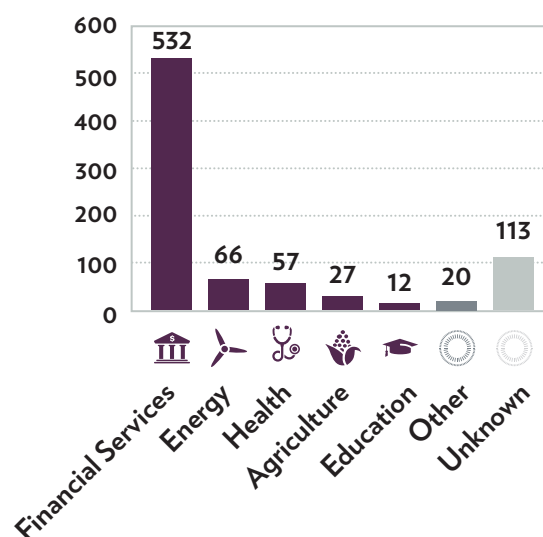


FIGURE 3B: KNOWN CAPITAL DEPLOYED BY NON-DFI IMPACT INVESTORS, USD MILLIONS



Source: Dalberg analysis. Note: Figures includes the overall totals across all six countries considered in this study.

TABLE 1: OVERVIEW OF KEY IMPACT INVESTING SECTORS IN SOUTH ASIA

India		Most impact capital has been deployed in the manufacturing, financial services, and energy (both renewable and non-renewable) sectors, and a sizeable number of deals have been in other sectors such as education and healthcare. Funds are shifting toward a less opportunistic and more hypothesis-driven approach to selection; in this new approach, these funds start with the identification of a problem in a given sector, then identify a potential solution (hypothesis), and subsequently seek organizations that contribute to this solution.
Pakistan		Energy, financial services (microfinance institutions (MFIs) and others), and manufacturing have been the most attractive sectors to date. Impact investors see high potential in businesses serving the large domestic consumer base. Angel investors on the periphery of impact investing are particularly drawn to ICT-related investment targets.
Bangladesh		Most impact capital has been deployed in growing sectors such as ICT, energy, and manufacturing, particularly as many investors target job creation as their main impact objective and see these sectors as having the best potential to meet this core goal.
Sri Lanka		Microfinance and other financial services have drawn the bulk of impact capital. Tourism and hospitality have been attractive to investors as well. There is a growing interest in investment in BoP-focused enterprises in the ICT, energy, health, and technology sectors.
Nepal		Transportation and tourism have drawn the largest proportion of impact capital to date—these sectors are attractive because they can absorb large ticket-size investments. For the future, impact investors are excited about opportunities in hydropower and tourism, which have been growing and are expected to continue to do so.
Myanmar		To date, most impact capital has been deployed in real estate due to a dearth of investible opportunities in other sectors. There is a strong interest among impact investors in financial inclusion for future investments.

PRODUCT AND INSTRUMENT DEVELOPMENT

Across the region, the majority of impact capital deployed by DFIs has been through debt instruments. On the other hand, the majority of capital deployed by other impact investors has been through equity. DFIs prefer debt for several reasons, including a lower risk appetite (given that they are investing taxpayer money), a lower level of due diligence required as compared to making equity investments, and less active management of the investment when compared with equity investments. In some countries, regulations can be unclear and restrictive regarding equity, further driving the preference for debt. Although interest exists in some countries around exploring new instruments such as quasi-equity, thus far, there has been little experience with these alternatives.

FIGURE 4A: KNOWN CAPITAL DEPLOYED BY DFIS , USD MILLIONS

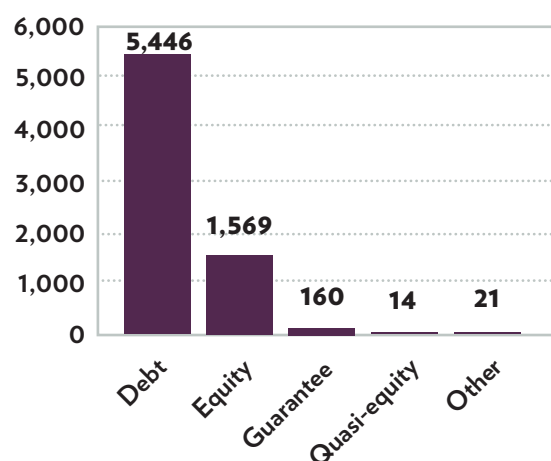
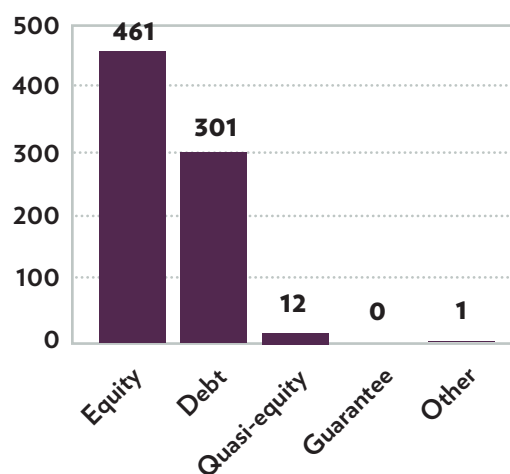


FIGURE 4B: KNOWN CAPITAL DEPLOYED BY NON-DFI IMPACT INVESTORS, USD MILLIONS



Sources: Stakeholder interviews; Investor websites; Dalberg analysis. Note: Capital deployed where instrument is unknown not included in charts.

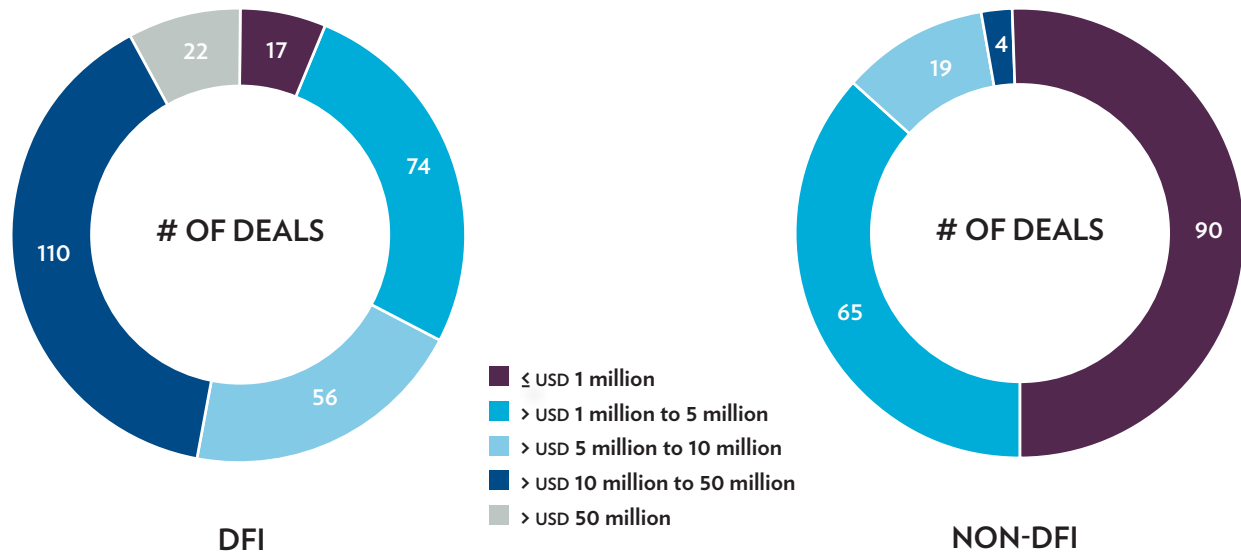
Opportunities for product and instrument development vary across the region, as detailed in the table below.

TABLE 2: OVERVIEW OF MIX OF INSTRUMENT USE IN IMPACT INVESTING IN SOUTH ASIA

India		Debt is the most common instrument in terms of the amount of capital, particularly because the primary source of overall capital is DFIs, who prefer debt instruments. However, DFIs indicate a growing preference for equity instruments in order to establish more integrated partnerships with their investees. Foreign funds are prohibited from investing in debt and, as a result, most of the capital from impact funds is deployed through equity instruments. Consequently, small domestic funds are emerging to fulfill the need for early-stage debt.
Pakistan		Most impact capital has been deployed through debt driven by DFI investors. Interest in quasi-equity has been articulated by impact investors, but thus far, there haven't been any deals. The interest derives from the perceived difficulty of exiting pure equity investments (there have been no impact equity exits in Pakistan to date).
Bangladesh		Most impact capital has been deployed through debt, with which both investors and entrepreneurs tend to have greater familiarity and comfort. Regulatory restrictions on equity investments (e.g., a three-year lock-in after public listing and lack of certain protections for investors and investees) also fuel the preference for debt.
Sri Lanka		Debt accounts for a majority of impact capital deployed, with early-stage investments tending toward equity. Impact investors have also provided some small to mid-sized guarantees to support access to finance for SMEs and non-bank microfinance institutions.
Nepal		Debt is preferred, due in large part to the lack of a developed regulatory framework for equity. However, equity is being tested in small amounts by investors that are not legally registered as lending institutions and therefore, are not allowed to provide debt.
Myanmar		Debt is preferred among both current and future impact investors, again driven by the fact that most of the capital is deployed by DFIs. Foreign investors are prohibited from debt transactions, so they will have to invest through equity or other instruments as they enter the market.

Direct investments by DFIs tend to target mature companies, as DFIs prefer relatively large deal sizes that only mature companies are able to absorb. Investments in more mature companies are relatively easy because risk is mitigated by operating and financial histories and transaction costs are more easily accommodated by large deals. On the other hand, smaller investments in early-stage companies (start-ups as well as companies in early growth phases) are challenging and have been more limited to date. Thus, most DFI investments have been in the USD 10-50 million range, with a handful even above USD 50 million. In contrast, most investments by non-DFI investors have been below USD 1 million, and thus typically into growth and venture stage organizations.

FIGURE 5: IMPACT INVESTMENTS BY SIZE OF DEAL IN SOUTH ASIA



Sources: Dalberg analysis.

CHALLENGES







In taking advantage of these opportunities, investors will need to bear in mind several challenges. While these challenges do not pose insurmountable obstacles to impact investing in the region, they need to be understood by investors and other stakeholders so that they can be mitigated, circumvented, or resolved. Key barriers include regulatory issues, difficulties in deal sourcing, and issues of scale in terms of portfolios and deal sizes.


REGULATORY ENVIRONMENTS

Challenges in navigating regulatory environments—affecting both impact and conventional investors—are a common theme across countries, although there is some variation by country. These challenges tend to be related to complexity, variability, inefficiency, and restrictiveness. For example, in India, relevant laws and policies have repeatedly changed over the past few years. Currently, there are also restrictions on the use of various instruments: foreign investors cannot make pure debt investments, and certain structured products are not sanctioned by the Reserve Bank of India (e.g., non-convertible preferred shares). Entrepreneurs also face barriers in establishing and scaling businesses, as bureaucratic processes add to the transaction costs and time required to establish a business and to maintain compliance with regulations during growth phases.

In Bangladesh, foreign equity investors face the dual challenge of regulations related to a) local companies accepting foreign capital (which requires separate registration) and b) establishing a locally domiciled fund (through a lengthy and complex process). In addition, there are unclear or unfavorable regulations around public offerings (e.g., a three-year lock-in period). Nepal's environment is characterized by general uncertainty as the country does not currently have a constitution, and regulations for equity (a new instrument in the country) have not yet been defined. In Myanmar, the key regulatory constraints include complex and opaque screening and investment approval mechanisms, regulations that prohibit most foreign investors from debt lending, and complicated separate laws governing foreign and domestic investment. Although not completely devoid of challenges, Sri Lanka's and Pakistan's regulatory environments are relatively favorable for investment and enterprise.

TABLE 3: SUMMARY OF CONSTRAINTS BY INVESTMENT STAGE

		Entry into Country	Pipeline Development	Screening and Due Diligence	Structuring for Investment	Managing Investment/Follow-up	Exit
Bangladesh							
India							
Myanmar							
Nepal							
Pakistan							
Sri Lanka							



Least severe

Most Severe

DEAL SOURCING

Sourcing deals that meet various investor requirements of impact potential, risk, return, and size of investment is challenging. Impact capital across the region tends to be concentrated in certain sectors (particularly energy and microfinance) and stages of business (growth stage for funds and mature companies for DFIs). There is also a need to bring less-exposed enterprises into the fold in a number of countries. Even in India, where formal networks of entrepreneurs exist, it is difficult to find enterprises that are not a part of these networks. Additionally, in many countries studied, there is a gap between investor and investee expectations. This is due in part to the entrepreneurs' limited comfort and familiarity with investment concepts such as ownership, equity, and valuation.

SCALE

Many investors face scale issues related to small market sizes (particularly in Sri Lanka and Nepal) and to small enterprise sizes across the region. Therefore, there is a need for vehicles to deploy smaller sums of capital, particularly in early-stage deals. However, funds seeking DFI investment often need to establish larger funds that deploy in larger ticket sizes (e.g., more than USD 1 million). This is because DFIs often have minimum investment sizes (e.g., USD 20 million) plus a requirement that their stake be no more than a certain percentage of total capital in the fund (e.g., 25-30%). This also presents a challenge for fund managers to raise enough matching capital to secure the DFI anchor investment.

Constraints vary by country and by stage of investment process, reflecting the differing investment environments and enterprise landscapes of the countries in the region. For example, while entry (e.g., establishing a fund or presence in the country) is a challenge in Myanmar and Nepal due to regulatory and fundraising issues, in India, Pakistan, and Sri Lanka, the more severe challenges come at the later stages of the process such as due diligence, deal structuring, and exit. Table 3 illustrates this variation, and details on these constraints can be found in the country chapters.

REPORT STRUCTURE

In the chapters that follow, readers will find greater depth and detail on the current state of and future opportunities for impact investing in each of the six countries in this study. Each chapter includes sections on the general country context, the supply of impact investing capital, the demand for capital from potential investees, and the ecosystem that supports the actors involved in impact investing. We hope that this information proves useful for both investors already active in the region and potential investors currently scoping new opportunities. As the country chapters show, the region is diverse and full of potential for making sound investments that can both generate a financial return and address a host of social and environmental issues.

