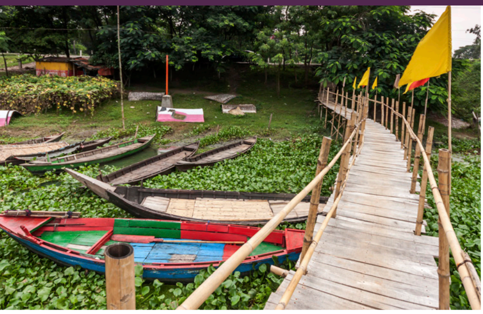
BANGLADESH

# 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**






Dalberg

GIIN
GLOBAL IMPACT INVESTING NETWORK

# LIST OF COMMON ACRONYMS

**ADB** | Asian Development Bank

**AIF** | Alternative Investment Funds

**BoP** | Base of the Pyramid

**BRICS** | Brazil, Russia, India, China, South Africa

**CA** | Chartered Accountancy

**CIIE** | Centre for Innovation, Incubation and Entrepreneurship

**CGTMSE** | Credit Guarantee Fund Trust for Micro & Small Enterprises (India)

**CSR** | Corporate Social Responsibility

**DFI** | Development Finance Institution

**DFID** | Department for International Development

**FIL** | Foreign Investment Law

**FDI** | Foreign Direct Investment

**GAAR** | General Anti-Avoidance Rules (India)

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

**HDI** | Human Development Index

**HNWI** | High Net-Worth Individual

**HR** | Human Resources

**ICT** | Information and Communication Technology

**IFC** | International Finance Corporation

**IFI** | International Financial Institution

**IE** | Impact Enterprise

**IIC** | Impact Investors' Council (India)

**IMF** | International Monetary Fund

**LP** | Limited Partner

**LTTE** | Liberation Tigers of Tamil Eelam

**MDG** | Millennium Development Goal

**MEB** | Myanmar Economic Bank

**MFI** | Microfinance Institution

**MFTB** | Myanmar Foreign Trade Bank

**MNC** | Multinational Corporation

**MICB** | Myanmar Investment and Commercial Bank

**NABARD** | National Bank for Agriculture and Rural Development

**NASE** | National Association of Social Enterprises (India)

**NEDA** | National Enterprise Development Authority (Sri Lanka)

**OPIC** | Overseas Private Investment Corporation

**PE** | Private Equity

**PM** | Prime Minister

**PPP** | Purchasing Power Parity

**RBI** | Reserve Bank of India

**SEBI** | Securities and Exchange Board of India

**SIB** | Social Impact Bond

**SIDBI** | Small Industries Development Bank of India

**SME** | Small or Medium Enterprise

**SMED** | Small and Medium Enterprise Development (Sri Lanka)

**SVF** | Social Venture Fund

**VC** | Venture Capital

**WHO** | World Health Organization

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Maps within the report are based on UN maps. Source: UN Cartographic Section

# ABOUT THIS REPORT

The objective of this study is to develop an understanding of the status of the impact investing markets in six countries in South Asia—Bangladesh, India, Myanmar, Nepal, Pakistan, and Sri Lanka. The full report includes an introduction and a chapter for each country. This research is intended to serve as a critical input to future investments and engagement to build and grow these markets. The key themes explored include the current status and trends in terms of the types of active investors, capital deployment, opportunities for and challenges to investing, the demand for impact capital, challenges to accessing capital and opportunities for enterprise growth, and the vibrancy and scale of the supportive ecosystem for the industry.

## Introduction

In recent years, impact investing has become prominent on the global stage as an approach to deploying capital with social/environmental goals as well as financial return objectives. Deployed in both developing and developed markets, impact investments are made across a range of sectors and asset classes.

South Asia is home to more than 1.6 billion people and has experienced dramatic economic growth over the last decade. However, this rapid growth, while changing some economies dramatically, has been uneven between and within countries; about a quarter of the region's population continues to live on less than USD 1.25 per day[1] and large population segments lack access to quality social services, finance, energy, and infrastructure as well as to affordable consumer products. The opportunity for impact through the deployment of capital into organizations and enterprises that increase incomes, create jobs, and provide access to essential services is significant, and the status of the impact investing industries in these countries is worthy of attention.

## Who is an impact investor?

Impact investments are "investments made in companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return."[2]

The three key characteristics of an impact investor are as follows:

- Expectation of a financial return that can range from the return of capital to risk-adjusted market-rate returns and that can be derived from investments in a range of asset classes.

1 *Weighted average calculated with the latest country data (2010–2012) from World Bank Development Indicators; Myanmar figures are not included in the weighted average.*

2 *For more details, refer to the GIIN website, www.thegiin.org.*

- Intent to generate a positive social and/or environmental impact through investments. For example, investors may seek to use investments to increase access to basic services or invest in solutions aimed at mitigating the negative effects of climate change.

- Commitment of the investor to measure the social/environmental performance of underlying investments.

This report focuses significantly on the impact investing landscape in each of the six countries covered. Various terms may be used to refer to the impact investing landscape, including "impact capital" and "impact funds," depending on the context. For the sake of fluency, the modifier "impact" will be dropped when the context is clear.

While the central goal of this study is to map the current landscape of impact investing activity, there is also significant investment activity on the periphery of impact investing that is interesting to explore. In particular, we consider the following two types of investment activity:

a. Investments in businesses serving BoP populations by investors who have may not have explicit impact intention

b. Investments where there is some intention to have social and/or environmental impact, but this impact is assumed to occur as a by-product and is not measured in any meaningful way

Such investment activity is also important for an analysis conducted to gain a better understanding of the broader opportunity landscape for impact investing going forward. When a section in the report focuses particularly on the investment activity in this peripheral region, we will explicitly refer to these as "impact-related" investments, thereby clearly differentiating them from "impact investing." (Please note that we are using these labels purely for the ease of reference and do not intend the names to imply any subjective judgment on the nature of an investor's investment activity or approach.)

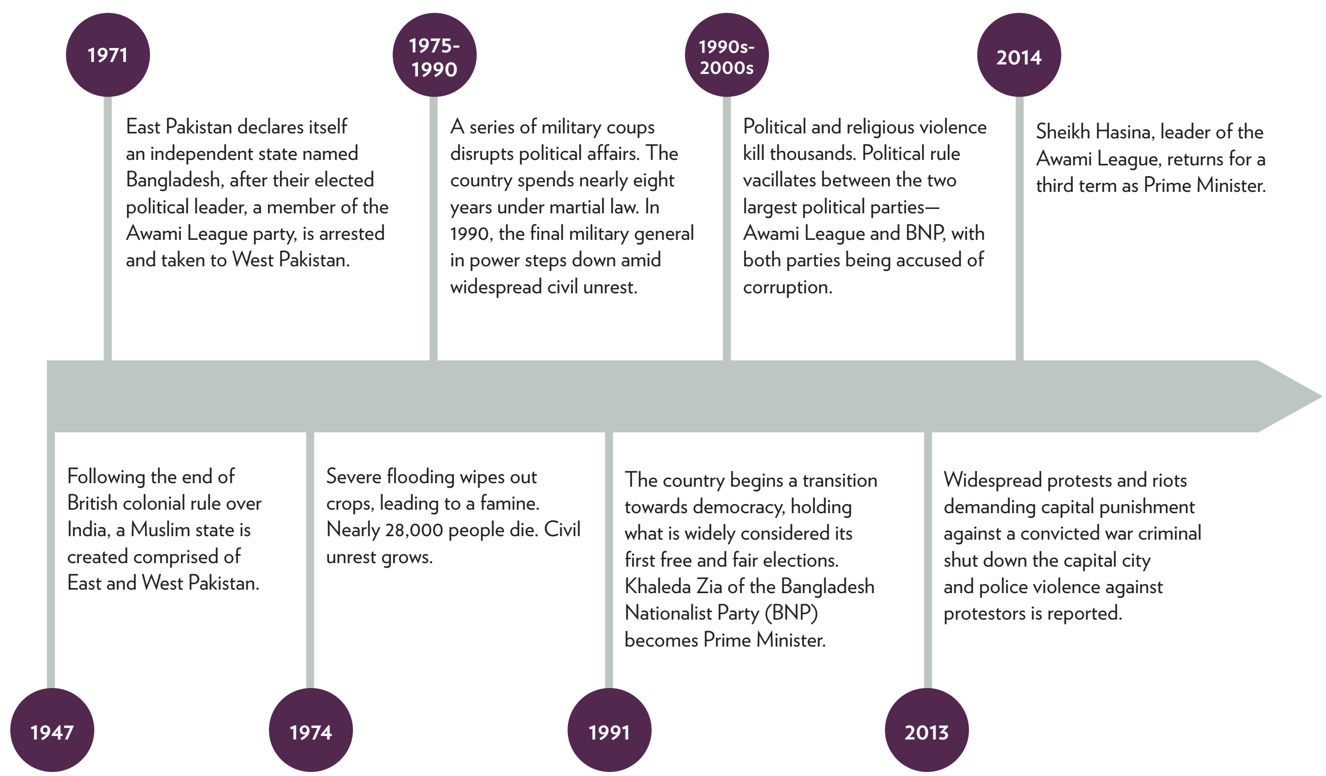
# COUNTRY CONTEXT

## Overview

**Bangladesh has the third most active impact investing market in South Asia after India and Pakistan. A sizeable amount of capital is currently deployed—an estimated USD 955 million or 11.2% of the total impact capital in the countries under study.** A number of impact investors are entering South Asia's third-largest economy, encouraged by high economic growth, a large potential market, and an addressable social need. Given that the impact investing industry is still in its early stages, impact investors are pursuing impact through investments in businesses with an impact intent as well as in companies that operate in sectors that investors believe make valuable contributions to the economy and generate jobs. While these trends in capital flow and investor activity are exciting and signal a positive trend, significant challenges remain to grow the industry to its full potential.

**Despite many years of instability, violence, and civil unrest ever since Bangladesh's independence in 1971, investors express a belief that the political environment is relatively stable at present.** After achieving independence from Pakistan (then called West Pakistan) in 1971, Bangladesh underwent a number of military coups until the final military general in power stepped down in 1990 amid civil unrest. The country has since made a transition toward democracy. While the political system continues to run predictably, there has been widespread political and religious violence since the early 1990s. Most recently, massive protests in response to perceived leniency toward a political figure convicted for war crimes set off riots in Dhaka that soon spread to other cities, and in 2013, labor strikes effectively shut down businesses in the capital. However, there is a widespread belief among local and foreign investors that the country is stable and political transitions will continue to occur peacefully and on schedule due in large part to the generally positive long-term trends in economic growth, foreign direct investment (FDI) inflows, and the stock market growth, despite the decades of political turmoil and civil unrest. In short, the expectation is that business will continue as usual.

**FIGURE 1: TIMELINE OF KEY EVENTS IN BANGLADESH'S HISTORY**

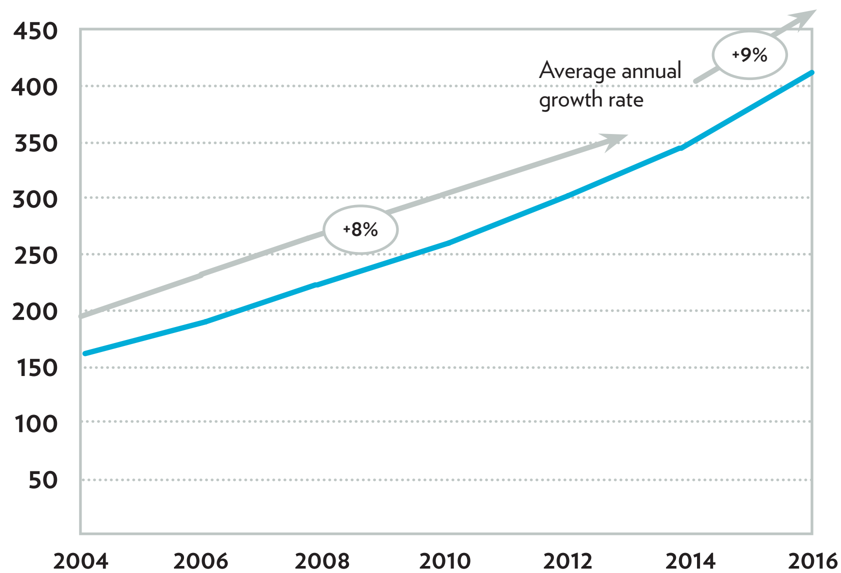



Source: BBC News (2014). Bangladesh profile—Timeline

# GDP growth and drivers of FDI

**Investors express strong optimism about prospects in Bangladesh, given the country's strong, growing, and diversifying economy and appealing demographic.** In 2013, GDP topped USD 325 billion (PPP, current international dollars), making it the third-largest economy in South Asia.[3] Growth has averaged 8% annually in the last decade (through 2013) and is forecasted to continue increasing at 9% annually through 2016.[4]

**FIGURE 2: HISTORICAL AND FORECASTED GDP GROWTH (PPP, CURRENT INTERNATIONAL DOLLAR BILLIONS)**




Source: IMF World Economic Outlook Data 2014; Notes: 1990-2012 actual, 2013 estimated, 2014-2016 forecasted as of June 30, 2014

**This growth has been primarily spurred by a diversification of the economy within the industry and the service sectors.** While agriculture, industry,[5] and services have all grown in absolute terms, agriculture has shrunk in terms of the percentage of value added to the GDP, from 26% of GDP in 1995 to 18% in 2012.[6]

A strong services sector and growing industry sector have outpaced growth in the agriculture sector, with the expansion and diversification of the sub-sectors within each sector. Most notably, manufacturing, which is captured in the industry sector, is a booming segment, due to a large and expanding textile and garment industry. Manufacturing alone contributed 18% to the GDP in 2012, up from 15% in 1995.[7]

3 *IMF World Economic Outlook Data 2014.*

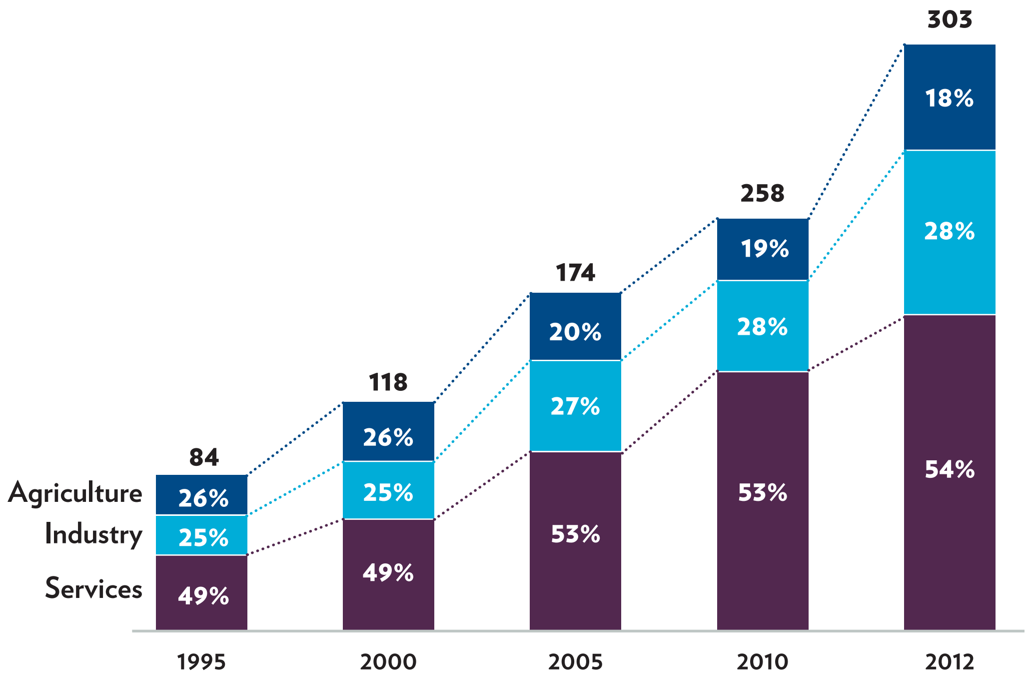
4 *IMF World Economic Outlook Data 2014.*

5 *Industry defined by the United Nations' International Standard Industrial Classification of All Economic Activities, Rev.3 (ISIC Rev 3) as mining, manufacturing, construction, electricity, water, and gas.*

6 *World Development Indicators, The World Bank.*

7 *World Development Indicators, The World Bank.*

FIGURE 3: SECTOR GROWTH AS PERCENTAGE OF GDP (PPP CURRENT INTERNATIONAL DOLLAR BILLIONS)




Source: World Development Indicators, The World Bank

**Additionally, Bangladesh's large population and shifting demographics make the country appealing to investors as both a sizeable labor market and a large potential consumer market.** Bangladesh is the eighth most populous country in the world with a total population of 157 million.[8] The population is relatively young—89% of the people are under the age of 54 years, and 45% are under the age of 24 years.[9] For investors, Bangladesh's large young population translates into a large potential labor market. There were more than 76 million economically active people as of 2012,[10] and nearly 50 million more will be added in the next decade. Yet, despite significant economic growth in labor-intensive sectors (like manufacturing and agriculture), unemployment remains high, particularly among the youth. As of 2012, 9.3% of the females and 8.6% of the males between 15 and 24 years of age were unemployed; these figures have remained more or less constant since the turn of the century.[11]

8 *World Development Indicators, The World Bank.*

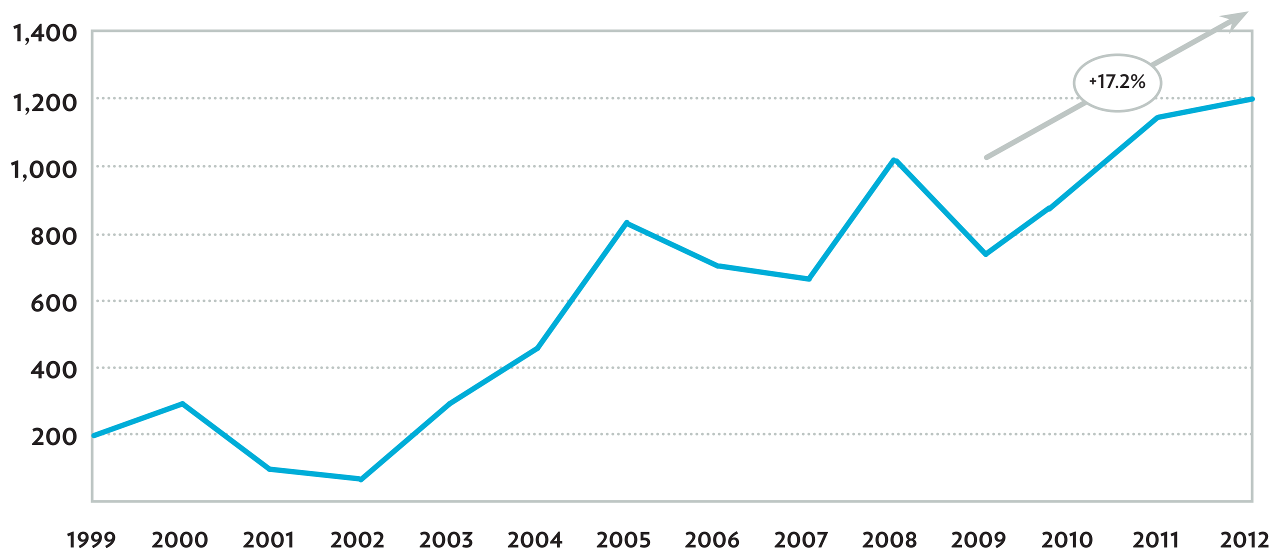
9 *CIA World Fact Book.*

10 *ILO Key Indicators of the Labor Market Database.*

11 *ILO Key Indicators of the Labor Market Database.*

**Recent investor optimism has led to sharp increases in FDI inflows since 2009, following a decade of instability, but concerns around infrastructure and policy implementation remain.**[12] FDI inflows have increased by 17% since 2009 (Figure 4). While foreign investors are responding positively to low labor costs and an increasingly investment-friendly climate shaped by recent policy changes, they have also been discouraged by continuing regulatory uncertainty, which reduces the country's appeal as an investment destination. Investors also cite poor physical infrastructure as a critical limitation and express disillusionment with the actual implementation of investment-friendly policies and the capacity of bodies responsible for enforcing these policies.[13]

**FIGURE 4: FDI NET INFLOWS IN CURRENT USD MILLIONS**




Source: World Development Indicators, The World Bank

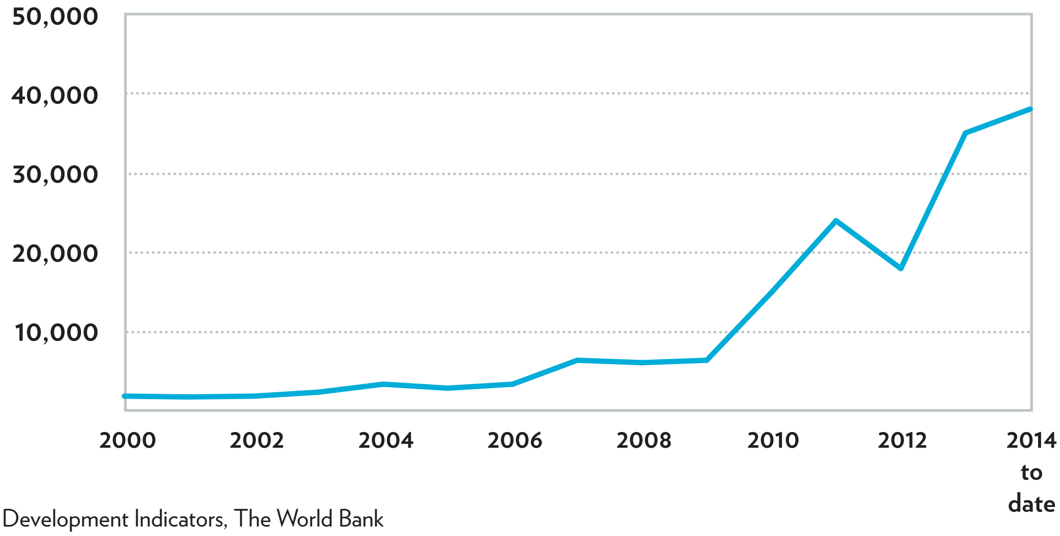
**Bangladesh's capital markets are also growing, driven primarily by a developing domestic investment culture.** Market capitalization has grown fifteen-fold since 2000.[14] Further, there are currently 533 listed companies in the Dhaka Stock Exchange (Figure 5). Following a decade of growth in the stock market averaging about 31% per year from 2000 to 2010, there was a sharp decline in 2011 when capital flowed back toward the developed markets recovering from the 2008 financial crisis. Further drops followed in October and November of the same year, allegedly due to malpractice in the markets, causing public protests and sit-ins by small investors. The market has since recovered, but domestic investors report considerably increased wariness.

12 *World Development Indicators, The World Bank.*

13 *Research Center on Development and International Relations (2010). A Study of Major Determinants and Hindrances of FDI inflow in Bangladesh.*

14 *World Development Indicators, The World Bank.*

**FIGURE 5: MARKET CAPITALIZATION OF LISTED COMPANIES IN USD MILLIONS**




Source: World Development Indicators, The World Bank

**Despite this growth, investment, and optimism, 43% of Bangladesh's population lives below the poverty line of USD 1.25 per day,[15] although the poverty headcount ratio is on a strong downward trend**. Even with a strong and growing GDP, the country has the second-lowest GDP per capita in the region (USD 752, in current USD). For impact investors, the implications are two-fold: i) the poverty headcount translates into a sizeable need and an opportunity to address this need through a range of impact strategies (for example, providing capital to the numerous organizations that deliver goods and services to BoP populations), but for some investors, ii) the high poverty headcount also calls into question the potential in the consumer market and necessitates an approach that reaches those with some disposable income in order to ensure returns.

# INVESTING IN BANGLADESH: THE SUPPLY SIDE

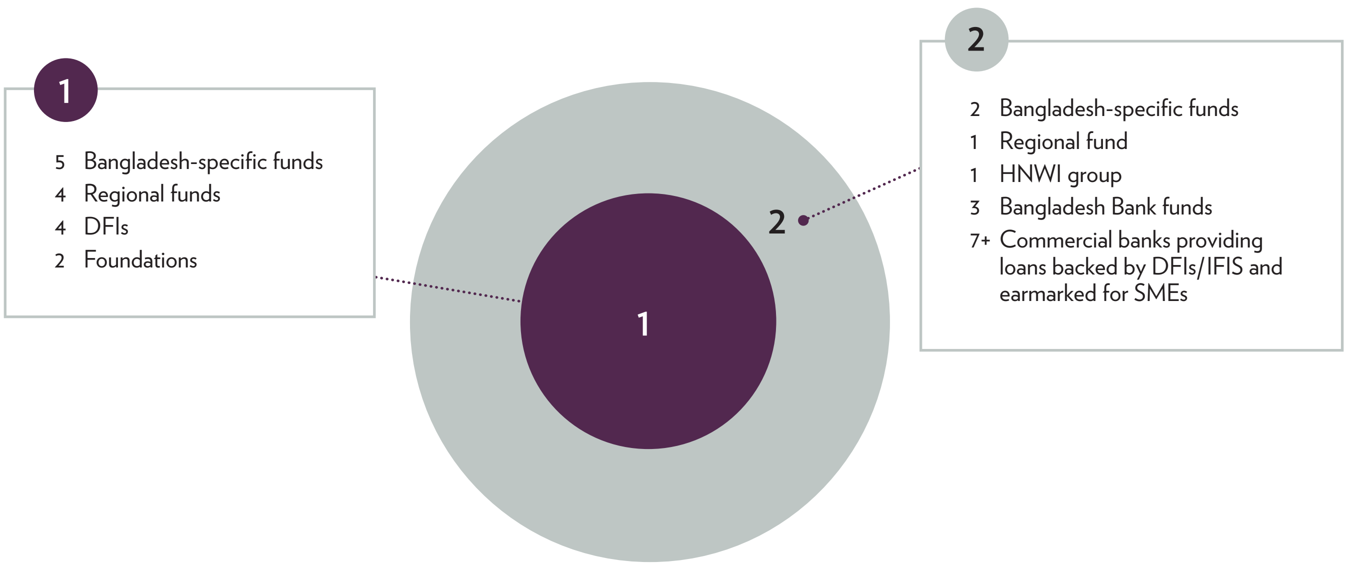
The impact investing market in Bangladesh is nascent, but, of the countries under study, it is the third-most active after India and Pakistan and is likely to continue to see strong growth over the next few years. Nearly USD 955 million is currently deployed by impact investors, and an additional USD 744 million by a peripheral group of impact-related investors. The Bangladesh market accounts for 11.2% of the total capital deployed among the countries under study, has the fourth-largest number of active players, and has a number of investors scoping the market for possible entry.

15 *The figure of USD 1.25 a day is based on the World Bank's revised poverty line at 2005 purchasing power parity.*

# The broad impact capital market in Bangladesh

**There are at least 15 impact investors currently active in Bangladesh with a total of USD 955 million in deployed capital.**[16] Among these investors, there are nine funds (five investing only in Bangladesh and four regionally), four DFIs, and two foundations (Figure 6). These investors currently have more than 50 active investments.[17] While most of these investments have been made by a few small private equity funds, the bulk of capital represents investments by DFIs in enterprises and banks and by microfinance institutions (MFIs). The section "Key trends of impact investing in Bangladesh" discusses in detail the emerging trends among these investors.

FIGURE 6: NUMBER OF DIRECT IMPACT AND IMPACT-RELATED INVESTORS ACTIVE IN BANGLADESH




Sources: Stakeholder interviews; Investor websites; Dalberg analysis

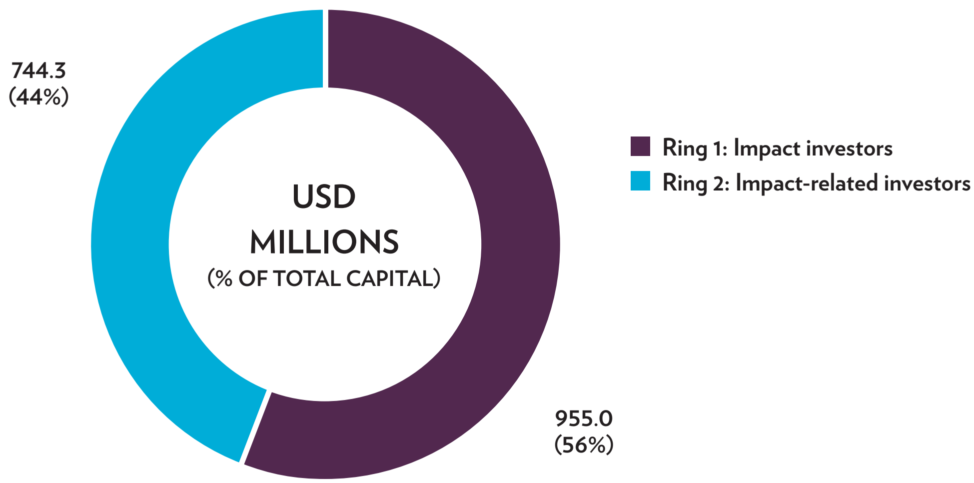
**Beyond these impact investors, at least 14 impact-related investors have current investments in Bangladesh of about USD 744 million (Figure 7).** Most of this capital has been provided as loans to SMEs through commercial banks. The remaining investors are funds and a small group of high net-worth individuals (HNWIs). While commercial banks have a clear primary focus on financial returns and, for now, see their impact as a by-product of their lending activity, some of these other impact-related investors may develop a more explicitly intentional strategy, as they seek to formalize their impact measurement and articulate clearer non-financial

16 *Figures in this report represent a best effort to size the total impact investing market in Bangladesh, including both impact and impact-related investors. While there may be additional investments on the margins that remain uncaptured, these figures provide a directionally accurate estimate of the market.*

17 *This excludes one outlier, which has more than 2,200 investments; many of these investments are small, microfinance-like investments, while a few are equity investments into SMEs.*

objectives. As many of these investors have focused on gaining a foothold in the market and achieving financial sustainability, impact intention has not been a core focus to date, but this is likely to become clearer over time.

**FIGURE 7: TOTAL CAPITAL DEPLOYED BY RING, BANGLADESH**




Sources: Stakeholder interviews; Investor websites; Dalberg analysis

**Investors of the same type (DFIs, foundations, etc.) are largely concentrated within the same ring, with the exception of fund managers that appear in both rings**. All DFIs and both foundations are impact investors, whereas commercial banks, three Bangladesh Bank funds, and one group of HNWIs are impact-related. There is more diversity among fund managers, which are found in both rings.[18]

## Active impact and impact-related investors in Bangladesh

**We see a diverse range of investors operating in Bangladesh**. A range of players are active in Bangladesh as either impact or impact-related investors, including funds, DFIs, foundations, HNWIs and family offices, diversified financial institutions and banks, and the Bangladesh Bank, which, while being primarily the country's central bank, also manages three funds.

**Funds are the most common type of investor currently**. There are 12 active funds in Bangladesh—seven of these funds are only making investments in Bangladesh, while the remaining five are regional with capital deployed in other countries. Ten of the 12 are private equity (PE) funds and two are venture capital (VC) funds. PE funds are backed by a range of limited partners (LPs), mostly DFIs but also foundations,

18 *The Bangladesh Bank operates three programs that provide subsidized debt to banks for SME lending: The Equity and Entrepreneurship Fund (EEF), JICA-SME Loans, and ADB Refinance Scheme.*

HNWIs, and family offices. The three VC funds are investing off their own books with capital invested by the general partners. Of these funds, nine are impact investment funds while three are impact-related but invest in relevant markets.

**DFIs are responsible for the largest portion of impact capital through investments directly in enterprises**. Currently, four DFIs have nearly USD 834 million of investments in enterprises, primarily in information and communication technology (ICT),[19] energy, manufacturing, financial services, and agro-processing. DFI investments account for 87% of the capital deployed from impact investors. Details on DFI investment preferences are discussed further in the section "Key trends of impact investing in Bangladesh."

**DFIs (and one multilateral donor) have also provided USD 739 million in debt and guarantees to banks for SME[20] loans**. An industry-wide liquidity crisis in 2011[21] prompted four DFIs to provide capital to seven banks, earmarked for SME loans. One DFI and one bilateral donor have also provided funding to the Bangladesh Bank for SME lending through commercial banks, and an estimated USD 153 million has been loaned through these funds.

**About 94% of the capital originates with DFIs through their direct investments into enterprises, guarantees, and indirect investments (anchoring funds and backing commercial SME loans), and given this sizeable role in the impact investing market, DFIs are driving trends across the space**. The significance of DFIs is twofold: i) as a vital and significant source of capital for enterprises and funds and ii) as a catalyzing force signaling the potential of the market and the credibility of local enterprises and fund managers. In an effort to draw in other investors, DFIs often back funds as anchor investors. In some cases, DFIs have succeeded in catalyzing as much investment from other investors as they themselves have put in. In others, investors have chosen to wait to observe some fund investment activity before making a commitment. While it is difficult to demonstrate the catalytic effect of DFIs at this stage since the industry is so new, we do see fund managers actively seek DFI anchor participation for both these reasons. However, the fact that some funds with DFI commitments have been unable to raise matching capital, suggests that DFI participation alone is not sufficient. More broadly, prospective investors are also waiting to observe a stronger track record of exits before entering the market.

**DFIs are also driving trends beyond capital, often setting benchmarks for defining and measuring impact and advocating pro-investment policies**. Many trends in the placement of capital discussed in depth throughout the Bangladesh report are driven by the substantial DFI spending, but investors are also looking to DFIs for impact definitions and measurement standards. In Bangladesh, DFIs have

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*19 ICT includes information technology companies (e.g., internet service providers and software developers) and communication technology companies (e.g., mobile network providers).*

*20 SMEs are defined by the Bank of Bangladesh as follows: (i) not publicly listed and (ii) 10–100 employees and fixed assets of USD 6,400–1.9 million for trading and services or 25–250 employees and fixed assets of USD 64,000–3.9 million for manufacturing.*

*21 In late 2010, the Central Bank moved to address inflation and reign in financial markets by raising the cash reserve ratio of banks and asking financial institutions to adjust their stock investment exposure. The move heavily reduced liquidity in the banking sector, and in part, contributed to the stock market crash in 2011.*

identified job creation and economic growth as core impact goals, and this has led them to focus their activities on high-growth sectors. DFIs are also using their legitimacy to advocate for pro-investment policy changes within the government. For example, one DFI is working with policymakers to address the lack of understanding about venture capital and private equity in order to develop stronger regulatory frameworks that make Bangladesh more appealing to both PE and VC investors. DFIs have also been advocating for the loosening of a three-year lock-in period for investors following an initial public offering (IPO).[22]

**Only two foundations are currently active as investors, but foundations are also providing business development services**. While only one domestic foundation is providing debt financing to SMEs and one international foundation has made an equity investment, foundations have been active in offering technical assistance to business managers, discussed further in the section "*Enabling impact investing: The ecosystem*."

**HNWIs are likely a large source of start-up capital, most of which is provided informally; foreign HNWIs have backed a few funds, and at least two family offices are scoping the market**. Family and friends are the primary source of seed capital for young entrepreneurs. A number of successful Bangladeshi entrepreneurs have also provided start-up capital. In most cases, these investments are made without any formal documentation or set timelines, and due to their informality, it is difficult to scope the exact size of this market. However, most players in the market estimate this capital to be substantial. Beyond this, only a few formal domestic HNWIs offer capital as angel investors. Foreign HNWIs have backed impact funds, but typically in small amounts. At least two foreign family offices have been in talks to back a local fund.

**Institutional investors largely operate on a commercial basis as lenders, but seven banks have portfolios targeting lending to SMEs and women-owned enterprises**. Seven banks have received capital from DFIs that has been earmarked for SME lending. Banks are also lending to SMEs in priority sectors driven by government mandate rather than by impact intention.

*22 The Securities and Exchange Commission mandates that "the securities (equity share) subscribed by the Sponsors/Promoters/Directors as described in the Prospectus, shall be subject to a lock-in period as under: 'Three years in case of Companies intended/intending to go for Initial Public Offering (IPO) from the date of its approval thereof by the Commission or from the start of its commercial operation, whichever is later.' There will be no lock-in on foreign sponsors."*

**FIGURE 8: TYPES OF IMPACT AND IMPACT-RELATED INVESTORS ACTIVE IN BANGLADESH**

| TYPE OF INVESTOR | ESTIMATED NUMBER | DETAILS OF INVESTORS IN BANGLADESH |
|---|---|---|
| Funds and fund managers | 12 | Ten private equity funds and two venture capital funds testing the market with equity and quasi-equity investments |
| DFIs | 4 DFIs and one donor | Drivers of market trends through both large, direct investments into enterprises (mostly debt to mature stage companies), as well as indirect investments (acting as LPs of funds or providing debt capital to banks for SME lending) |
| Foundations | 2 | Limited number of players in the impact investment market— one providing small amounts of debt financing to SMEs and one that has made an equity investment—but more active as business development providers |
| HNWIs/Family offices | 5-10 formal and many more informal | Friends and family are likely one of the largest sources of seed funding, but most of these investments are made informally—with no documentation or timelines. Only a small number of HNWIs offering capital beyond this—as LPs or making direct investments—and at least two family offices looking to back a fund. |
| Diversified financial institutions/banks | 7+ | Seven banks lending to SMEs with debt provided by DFIs |
| Bangladesh Bank (central bank of Bangladesh) | 3 funds | Managing three funds providing subsidized debt to banks making SME loans to targeted sectors or disadvantaged groups |

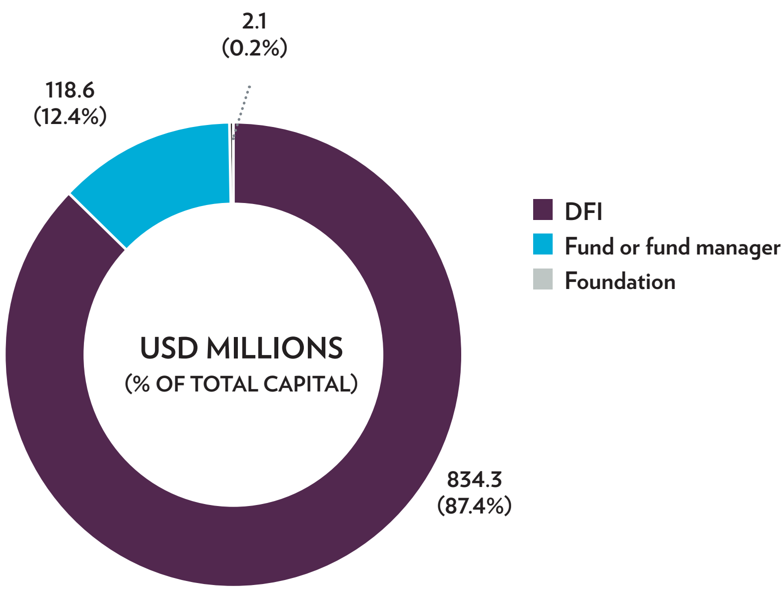
## Key trends of impact investing in Bangladesh

The following section examines trends among impact investors, the "core" ring of investors under study. The figures quoted in this section refer only to this set of investors, who collectively have about USD 955 million currently deployed. The activities of impact-related investors will be discussed in the section "Beyond the impact investing market." Given the sizable amount of capital deployed in Bangladesh, we see interesting trends emerging around impact investor preferences in terms of instrument, growth stage and deal size, and sector.

## INVESTOR MIX

Among all the known impact investors, DFIs have deployed the largest amount of impact capital into enterprises. About 87% of the capital is deployed by DFIs. The remaining 13% has been deployed by fund managers and foundations.

**FIGURE 9: IMPACT CAPITAL DEPLOYED DIRECTLY BY TYPE OF INVESTOR (USD MILLIONS)**

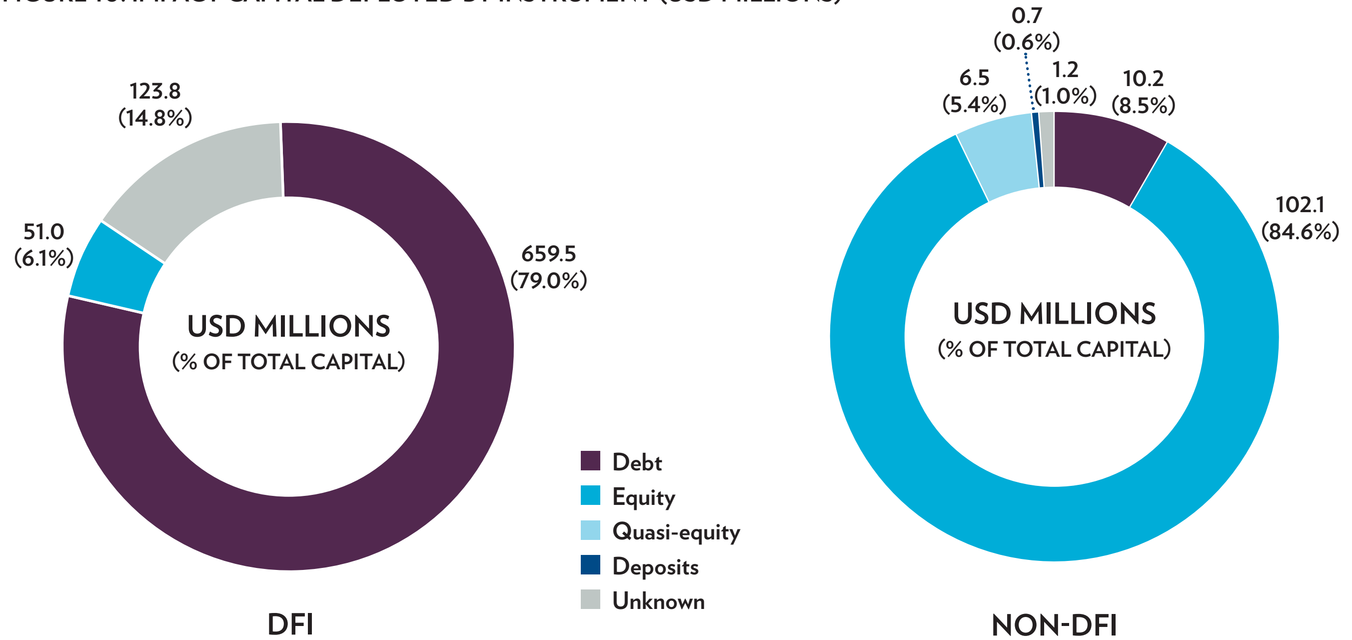



Sources: Stakeholder interviews; Investor websites; Dalberg analysis

## INSTRUMENT

**Seventy percent of the total impact capital currently deployed has been through debt**. The overall trend can largely be explained by the sizeable amount of capital flowing from DFIs. As we see in Figure 10, 79% of the USD 834 million invested by DFIs is through debt. This preference for debt is driven by risk aversion, regulatory barriers for using other instruments, and a greater familiarity with debt (particularly among business managers). In contrast, only about 9%, or USD 10 million, of capital from non-DFIs is structured as debt.

**FIGURE 10: IMPACT CAPITAL DEPLOYED BY INSTRUMENT (USD MILLIONS)**




Sources: Stakeholder interviews; Investor websites; Dalberg analysis

**Equity and other instruments are being tested in small amounts by all types of investors, but are the most common type of instruments for non-DFI investors.** Instruments other than debt make up about 17% of the known capital among impact investors. As seen in Figure 10, equity is the most common instrument used, outside of debt. While DFIs have made equity investments worth USD 51 million (or about 6% of their investments by value), it is the non-DFI investors that are primarily exploring instruments beyond debt. About 91% of the non-DFI capital has been deployed through equity, quasi-equity, or deposits. This is largely driven by a single large domestic fund that has made nearly USD 100 million in equity investments.

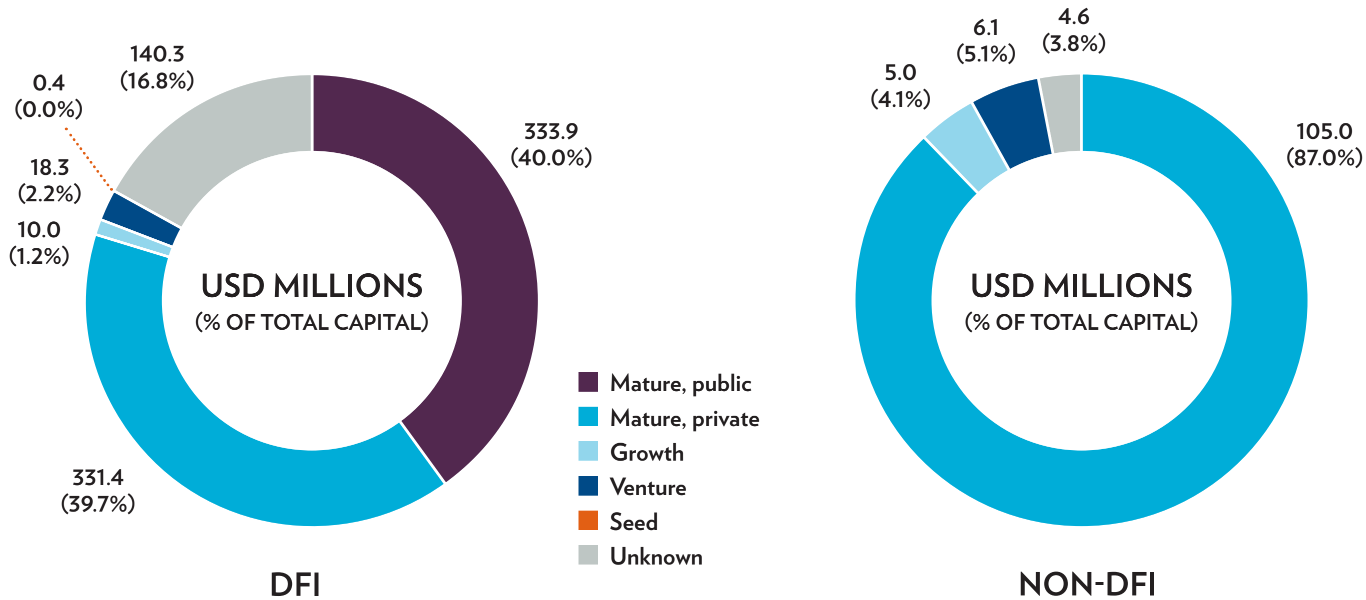
**In general, both investors and entrepreneurs express that debt is preferable given their needs and expectations.** Investors, unsurprisingly, are looking to minimize their risks in the nascent impact investing market of Bangladesh, and debt allows them to assume less risk than other instruments. While one may expect early and growth stage entrepreneurs to seek equity investments, as these are often appropriate for their stage of growth, entrepreneurs tend to be more familiar and comfortable with debt structures and are reluctant to give up stake in their company. Many business owners do not recognize the value of instruments beyond debt and are unaware of the risk mitigation that equity structures can allow.

**Regulatory structures surrounding equity investments, particularly those around exits and legal protection of the investor and investee, also fuel the preference for debt.** The regulatory process for exits through IPO is unclear, and investors face a three-year lock-in of their investment following a public listing. Investors and investees are also uncertain of the legal framework for addressing disputes that might arise.

## GROWTH STAGE AND DEAL SIZE

**Mature companies have received most of the known capital, as these companies can absorb larger amounts and meet the operating requirements of the investors**. Mature companies are attracting most of the capital from both DFIs and non-DFI investors for two reasons. First, only mature companies are of a size capable of absorbing the amount of capital that many impact investors look to invest in deals, i.e., typically more than USD 1 million. Second, mature companies have an established operating history, are legally registered, and keep (at least partially) accurate financial records—all important requirements for investors. However, there is some concern that the pipeline of attractive opportunities in mature companies is limited. Investors scoping the market have suggested that the few large funds operating in Bangladesh have already taken the "low hanging fruit" of desirable investments, and hence, impact investors, finding it more difficult to secure investments in mature companies, are expected to begin exploring investments in earlier growth stages. Further, as VC funds continue to explore the market, it is likely that capital will be more diversified across different business stages.

**FIGURE 11: IMPACT CAPITAL DEPLOYED BY GROWTH STAGE (USD MILLIONS)**

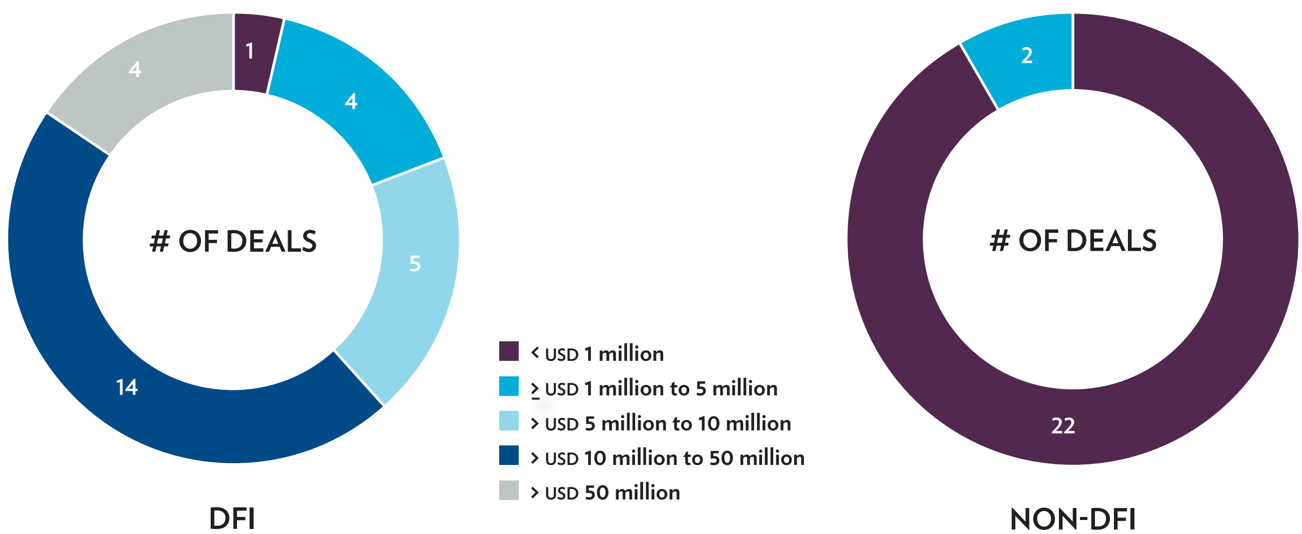



Sources: Stakeholder interviews; Investor websites; Dalberg analysis

**While seed funding is nearly negligible as a share of the total capital deployed through formal channels, entrepreneurs with strong networks can raise seed capital from friends and family; those without strong networks struggle to raise seed capital, which is a major gap in the market**. Entrepreneurs, finding it difficult to access bank loans (due to high collateral requirements) or to reach other investors, often turn to friends and family for start-up capital. Seed capital needs are often minimal, and for amounts less than USD 10,000, well-connected entrepreneurs can access capital through such informal channels. Given that many young entrepreneurs are launching start-ups that require minimal capital expenditure, particularly in the ICT sector, informal funding is likely to constitute a significant amount of capital. However, this source of funding is not available to all entrepreneurs; thus, a gap still exists for some entrepreneurs looking for seed funding.

**Venture and growth stage funding represent the largest gaps.** For growth and venture stage companies looking for capital in the range of USD 50,000 to USD 1 million, accessing capital is a significant challenge. These challenges will be discussed later in the section titled "Challenges facing investors deploying impact capital in Bangladesh."

**FIGURE 12: IMPACT CAPITAL BY DEAL SIZE (USD MILLIONS)**




Sources: Stakeholder interviews; Investor websites; Dalberg analysis . Notes: This excludes one outlier, which has more than 2,200 investments; many of these investments are small, microfinance-like investments, while a few are equity investments into SMEs.

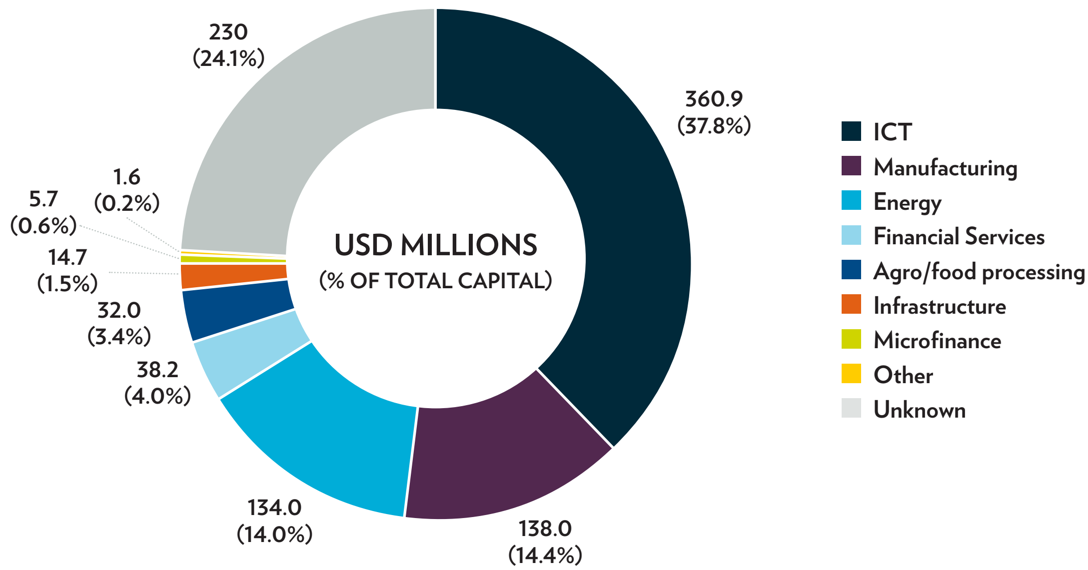
**There have been about 50 investments to date, of which about half have been less than USD 1 million in size, reflecting the small portfolio sizes of the non-DFI investors and the capital needs of the target investees.** As seen in Figure 12, DFI deals have been typically at the larger end; only one DFI deal has been less than USD 1 million, while 18 have been greater than USD 10 million. Meanwhile, 22 out of 24 non-DFI deals have been less than USD 1 million. Although not presented in the above chart, it is worth highlighting that one local impact fund has made 2,245 investments in small enterprises that can only absorb small amounts in the range of USD 30,000.

**Deal size is largely dependent on sector—most ICT companies look for relatively small investments, whereas manufacturing tends to require more capital.** With the exception of one large phone company, most enterprises in the ICT sector are small and looking for a corresponding amount of capital. Thus, relatively small funds are investing in these companies.

## SECTOR

**The sectors receiving most of the impact investing capital are high-growth sectors such as ICT, manufacturing, and energy**. Investor confidence in these sectors is high due to strong historical performance and future growth prospects. Both ICT and energy have been identified as government thrust sectors, further driving interest in these areas. The high-growth sectors are appealing because of their potential to both provide financial returns and help meet the investors' impact goals, as these sectors are likely to generate jobs and stimulate economic growth (which, as will be described later, have been identified by DFIs as the core impact objectives).

**FIGURE 13: IMPACT CAPITAL DEPLOYED BY SECTOR (USD MILLIONS)**




Sources: Stakeholder interviews; Investor websites; Dalberg analysis. Note: Approximately USD 104 of USD 120 million of non-DFI investments are unknown with respect to sector, and therefore the above graph largely represents trends of DFI investors.

**Financial services and microfinance are also receiving a small portion of capital from both DFIs and funds. Bangladesh is the birthplace of the microfinance movement**[23] and has seen a large number of organizations grow to a large scale over the past three decades. Foreign investors have expressed that the MFI market is rather saturated, so we see few direct investments in these sectors. However, DFIs are providing guarantees and debt to lending institutions—including banks and some of the country's largest MFIs—in an effort to increase SME access to finance that is often constrained. In other words, in Bangladesh, DFIs are using MFIs and other banks as vehicles for SME lending; this activity is being captured as "Ring 2" investments, as loans from banks and MFIs to SMEs. This is further discussed in the "Beyond the impact investing market" section.

23 *While microcredit existed informally prior to the 1970s, Professor Muhammad Yunus is widely credited as bringing microfinance to the global stage. Yunus began making informal loans in the 1970s and started Grameen Bank in 1983. Grameen Bank, along with a Bangladesh-based non-profit BRAC, are now two of the largest microfinance institutions in the world by number of borrowers.*

## Exit possibilities

**Investors express a preference for IPO exit, and optimism is growing regarding the viability of this exit strategy as one impact investor is approaching an IPO with a current investment**. IPOs are favored as they are perceived to yield the highest returns. To date, no impact investor has exited an investment through an IPO, so investors are watching with tempered optimism as the first impact investment is moving through a public listing. The process for IPO is long (typically a year) as the exact process is unclear and can change from investment to investment. Therefore, investors—particularly domestic investors—expressed interest in the outcome of the first impact investment being exited through public listing.

**While IPO is the preferred exit, secondary sales, trade sales, and owner buyback are all viewed as feasible exit options**. Because of the difficulties associated with IPO exits—including long lock-in periods and an uncertain process—investors have instead exited investments through secondary sales, trade sales, and owner buybacks, and they believe that these avenues remain feasible options for exiting investments going forward as well.

## Impact measurement

**Of the 15 impact investors active in Bangladesh, at least four DFIs and six funds have reasonably well-developed impact metrics that are measured and reported**. DFIs typically define impact in the context of Bangladesh as "job creation," with additional metrics in place to ensure ESG compliance. Fund managers typically follow DFI standards for measuring and reporting impact, given that DFIs act as LPs for some funds (and thus, require specific reporting of metrics) and because DFIs are the most active players in this field. The preference for ESG compliance is also driven by widespread availability of ESG metrics and recognition that ESG compliance satisfies basic "impact" criteria and mitigates the risk of non-compliance for investor and investee. Nevertheless, in some cases, investors are further customizing metrics to look beyond ESG compliance, measure more relevant indicators, and reduce the reporting burden for the investees. For example, these metrics include "the number of products sold to poor households," "the number of poor households reached per USD 100,000 of investment," and "the estimated trade generated (in USD)." The metrics selected are case specific (dependent on the type of enterprise and intended impact).

**Outside of these 10 organizations, and outside of ESG metrics, most investors provide anecdotal reporting of the impact**. Impact measurement is considered secondary to managing the investment, which, in the context of Bangladesh, requires a large investment of time and resources on the part of the investor. As a result, many investors have limited capacity to define metrics and measure non-financial performance, and therefore either focus on more limited metrics, are still working to develop appropriate metrics, or report only anecdotally. These investors believe impact measurement is important and intend to develop more formal processes and metrics based on standardized approaches once they have sufficient capacity to do so.

## Beyond the impact investing market

**The most active investors on the periphery of impact investing are commercial banks lending to SMEs**. About USD 731 million, or 98% of the capital deployed by this ring, is commercial bank lending to SMEs with capital from DFIs and one bilateral donor. While information on the individual portfolios of these banks is not publicly available, the following trends can be summarized:

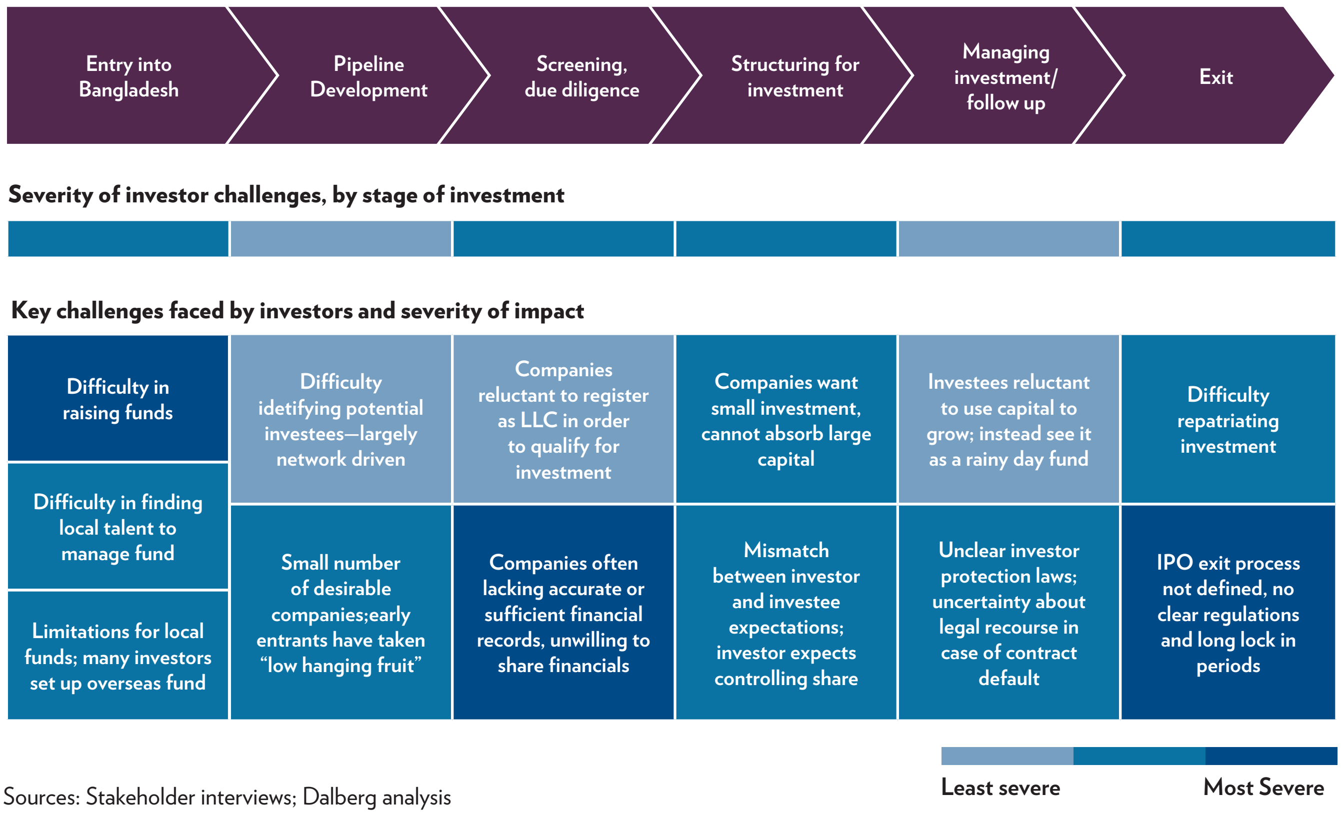
- All of this capital has been deployed as debt to SMEs.
- Growth stage preference depends on the lender, but as the banks require at least a few years of operating history to qualify an entity for a loan, there is mostly no seed funding and minimal venture stage funding.
- Sector preferences depend on the lender, but most lending is sector agnostic. However, preference may be given to government thrust sectors and women-owned enterprises.
- As these funds target SMEs, deal sizes are likely to be less than USD 1 million.

**Beyond SME lending, three impact-related funds and one group of HNWIs are providing small amounts of equity and deposits**. In total, these investors have USD 14 million in active investments—41% as equity and 59% as deposits—with deals ranging from USD 36,000 to USD 5 million. While the growth stage is unknown for most of this capital (61%), we see about USD 500,000 invested in venture stage organizations and USD 5 million in mature private enterprises. Investments have flowed into a number of sectors. Health has received the largest segment of capital from these investors (USD 5 million); however, this is the result of a single, relatively large investment. Beyond health, these investors, like impact investors, prefer high-growth sectors. Agro/food processing, manufacturing, ICT, and agriculture have absorbed 52% of the capital from these investors, and the remaining capital has been spread across a diverse range of sectors in small amounts.

## Challenges facing investors deploying impact capital in Bangladesh

While impact investors are fairly optimistic about Bangladesh due to political stability, GDP growth, and demographic trends, there are still significant challenges that dissuade investors from entering the market.

FIGURE 14: CHALLENGES FACED BY INVESTORS AND ASSET MANAGERS ACROSS THE INVESTMENT CYCLE




Sources: Stakeholder interviews; Dalberg analysis

**For asset managers, the key challenges at the entry stage have been the difficulty in raising funds and the regulatory limitations surrounding domiciliation.** Nearly all Bangladesh-specific funds have had difficulty in raising capital, with only one fund successfully closing after meeting its target. Most fund managers would like DFIs to act as LPs, with seven of the eight funds (six active and two scoping) currently or previously approaching DFIs for funding. While DFIs have backed two funds and committed capital to others scoping the market, securing additional co-investors has been a challenge for fund managers. A part of this challenge has been scale; DFIs typically require their investment to be both fairly large (e.g., USD 20 million) and only a portion of the total fund (usually 25%–30%). Therefore, large amounts of additional capital need to be raised, but this has proved challenging. Only one fund has successfully raised its target capital, with many others closing well below their targets and some unable to raise sufficient capital to launch the fund. A suggested reason for the difficulty in raising funds is that LPs are waiting for one large fund to exit a few deals before committing, in order to better gauge the market.

In addition to difficulties in raising funds, fund managers face regulatory issues around both overseas and domestic domiciliation of equity funds. Because regulations limit access to foreign capital for companies that are not appropriately registered to accept foreign capital, investing out of foreign-domiciled funds can be challenging as it limits the potential of the investment pipeline. This leads fund managers to see the need to domicile in Bangladesh. However, domiciling in Bangladesh can be a long process, particularly for funds with foreign LPs, and given that there is no explicit option to structure and register a fund locally, domestic funds often have to go through the process of registering as a private company.

**While pipeline development is a challenge, issues can be overcome if investors (whether asset owners or fund managers) can develop networks and establish a local presence**. Early funds have taken the "low-hanging fruit" in the market, as only a few companies are currently structured and registered appropriately for investment. As a result, fund managers must invest quite a bit of time scoping for investment opportunities. This is particularly true for those with small portfolios, as they can only make small deals and finding investable companies of this size requires a heavy investment of time. While this creates an additional barrier for investing, it is not insurmountable. Many fund managers have started developing a local presence, and partnerships are developing across funds to leverage strong networks.

**Screening companies and structuring these companies for investment represent the largest challenges facing investors, particularly equity investors**. Many companies in Bangladesh lack strong governance and financials that are accessible and sufficiently accurate to structure a deal. Companies are often run as traditional family businesses, operating with multiple financial accounting records—one for tax purposes and another that is more accurate. For investors, a large amount of time and resources must be devoted to working with business managers to set up governance structures and create financial records prior to making any investment. Even more difficult, investors have to convince business managers of the value of equity, as most are unfamiliar with the instrument, are unwilling to dilute their ownership, or do not want to legally register as a corporation in order to accept equity. Therefore, business managers prefer debt.

Screening and due diligence are less challenging for debt investors because there are more safety mechanisms in place, including credit rating agencies to evaluate risks.

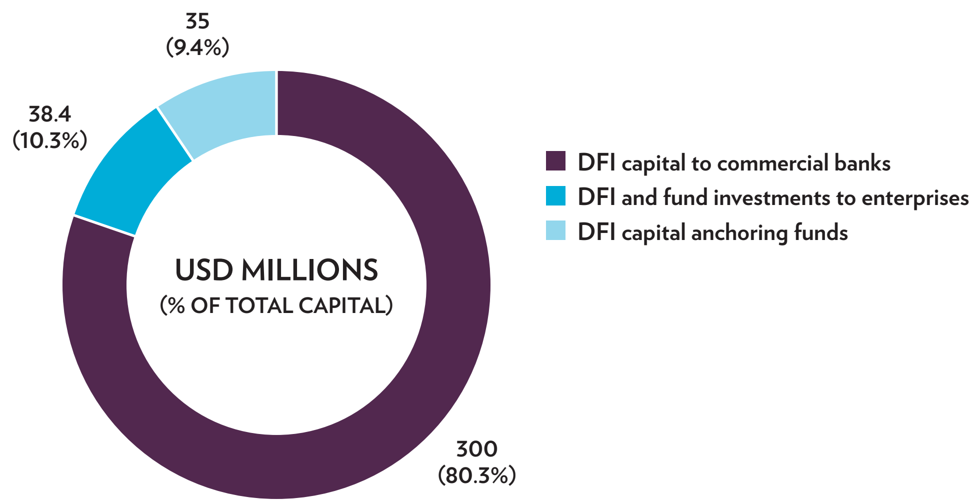
**Although uncertainty around exits makes it difficult for some asset managers to raise funds, active investors have not been deterred by exit uncertainty**. All equity investors expressed a preference for exit through IPO. They expect the greatest returns from public listing and are most familiar with this mechanism. Investors express hope that IPOs will be a viable option at the end of their investment periods, but believe that other options may be more feasible, such as owner buy-back and trade sales. Secondary sales are rare due to a limited number of senior funds.

To date, no equity investments have gone through an IPO process, so while IPOs are the preferred exit among equity investors, it is uncharted territory. IPOs are not common due to unclear and somewhat unfavorable regulations regarding the IPO process. For example, long lock-in periods imply that equity investors cannot sell their shares immediately after listing, increasing their time horizon and potentially lowering their returns. Additionally, despite open repatriation policies on paper, in practice, investors have found the process to be quite challenging. That said, there has been active engagement of the investors and donors with the government and the regulators to identify such challenges, and there is a strong perception that there is commitment to reform and develop a more conducive framework for capital investors.

## Looking forward

**The landscape for impact investing is evolving**. Active investors have already committed additional capital (beyond what has been deployed), funds are raising capital, and impact definitions are becoming more sophisticated.

FIGURE 15: FUNDS COMMITTED BUT NOT DEPLOYED




Sources: Stakeholder interviews; Investor websites; Dalberg analysis

**Investor optimism is evident, with an additional USD 373 million committed but not yet deployed by impact investors and others on the periphery of impact investing**. About USD 300 million of the USD 373 million has been committed to commercial banks for SME lending. About USD 38 million has been committed by direct investors—five investments in companies by an existing fund and direct investments in a hospital and a power plant.

**Fund managers are looking to raise capital and are confident that they will be successful**. At least four fund managers are looking to raise a combined total of USD 750 million. A few funds have even hired local fund managers before the fund closes, expressing confidence that capital will be raised and an eagerness to begin sourcing deals.

**Additionally, there are expectations that local government bodies will be allocating more capital for SMEs**. The government has identified SMEs as a focus area for financial and technical support. As such, it is expected that the government will be launching new financing schemes for SMEs, but few details are known.

**The types of investors present are expected to diversify as the market evolves**. Although still nascent, more players active in the impact investing market recognize that Bangladesh is at an inflection point. While investors to date have primarily been DFIs, commercial banks/non-bank financial institutions (NBFIs), and small funds, there are expectations that the space is on the brink of diversification. In fact, new venture capital firms and angel investors are already emerging, all of them local with small portfolio sizes.

**Investors scoping but not yet active in the market are waiting for the two largest funds to fully deploy and for a few successful exits before entering the market**. A number of foreign investors interested in the country expressed that while they are enthusiastic about the potential of the market, they are waiting for the currently active impact investors to test and prove this potential. As discussed previously, one fund is currently in the process of an IPO exit, and the outcome will be a critical moment for impact investors.

**At the early stage of the market's development, the threshold for "impact" is still unclear, but it is expected that measurement and intention will become more sophisticated as impact investors become more targeted in their portfolios**. To date, investors have been primarily looking to DFIs to take the lead on defining impact, as DFIs are both LPs for funds (and thus, have specific measurement and reporting requirements) and early movers with an articulated impact thesis. As a result, in Bangladesh, "impact" is largely defined in terms of job creation. This is a relatively easy metric to measure and requires little customization. However, as impact investors become more established, many want to identify metrics that use a broader set of indicators specific to the sector and the expected impact of the investment. For instance, one fund manager expressed that their focus to date had been on financial returns with the investor himself dedicating all his time and resources to mentoring entrepreneurs, leaving no time for thinking through impact definition or measurement. However, this investor is now looking for strong examples of impact measurement and reporting to incorporate into his investing activities.

# NEEDS AND OPPORTUNITIES: THE DEMAND SIDE

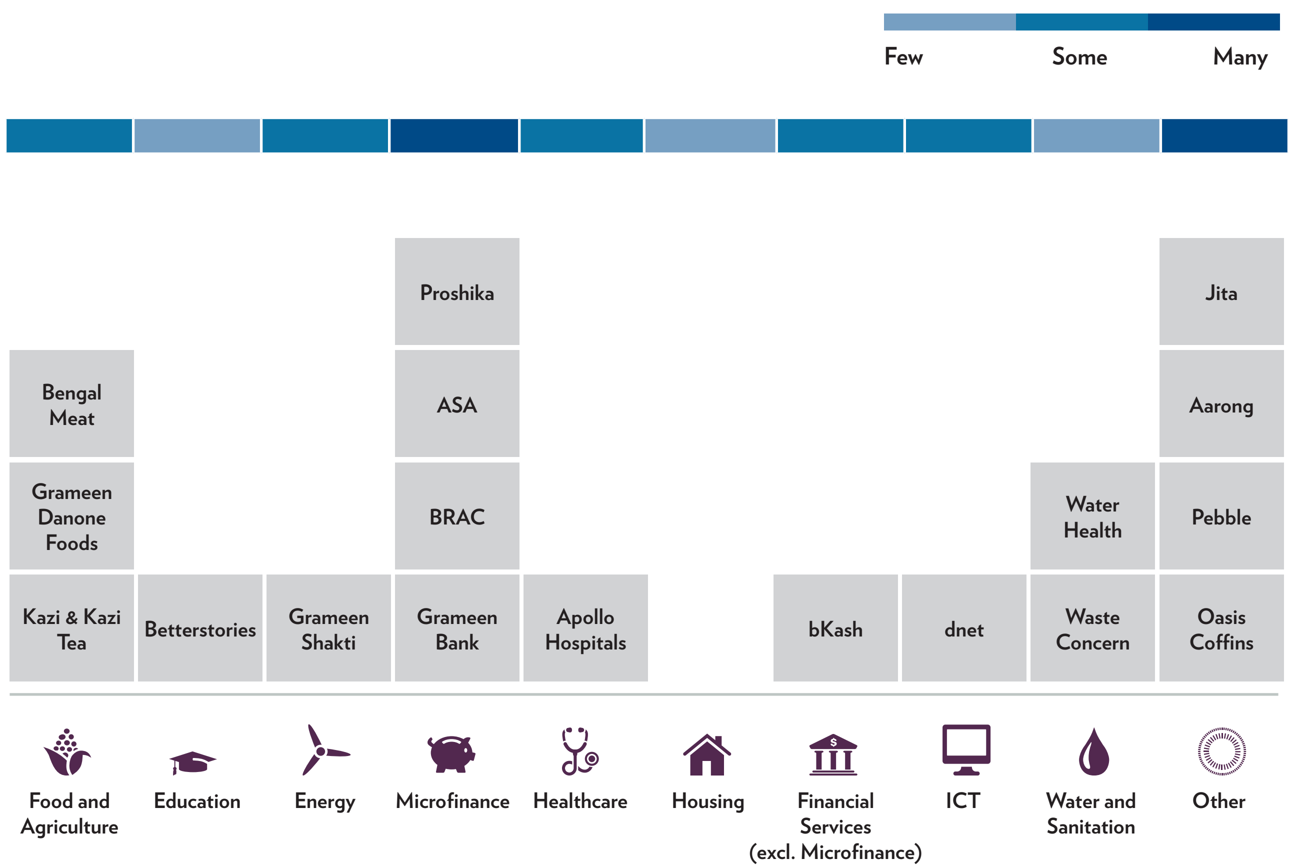
**We see impact capital in Bangladesh deployed into a wide range of enterprises, including impact enterprises,[24] SMEs, and other companies operating in sectors that make valuable contributions to the economy and generate jobs**. Only about USD 6.5 million is currently invested in impact enterprises. The remaining capital has flowed into SMEs and organizations in sectors with a high potential for job creation.

24 *Impact enterprises for the purposes of this report are defined as those that have articulated a core objective to generate a positive social or environmental impact (i.e., as a part of their operating model rather than an ancillary activity as with CSR programs); and seek to increase their financial viability and sustainability.*

## Overview of social enterprise ecosystem in Bangladesh

**The impact enterprise landscape is vibrant but still developing.** The concept of "impact enterprise" is a relatively new one in Bangladesh; however, the landscape is built on a foundation laid by Professor Muhammad Yunus, who introduced the idea of "social business"—a venture that serves a social need by selling a product or service.[25]

FIGURE 16: RELATIVE NUMBER OF IMPACT ENTERPRISES BY SECTOR, WITH EXAMPLES




Sources: Yunus, Moingeon, Ortega (2010); Stakeholder interviews; Organization websites; Dalberg analysis

25 *In Bangladesh, Muhammed Yunus first coined the term "social business" to refer to businesses that are designed to address a social problem. "Social businesses" are explicitly non-loss and non-dividend in structure; i.e., profits realized by the company must be reinvested. While this is a term that strongly resonates with Bangladeshi entrepreneurs, investors, and regulators, we have retained the above definition of "impact enterprises" throughout this report in order to maintain consistency across the region but do note the importance of this business approach in creating space for impact enterprises.*

**The Grameen family and the Bangladesh Rural Advancement Committee (BRAC) pioneered the social business model and have each spun out several entities with a dual social and financial mandate**. Both the Grameen Group and BRAC have in-house incubators/accelerators that focus on growing these impact enterprises by providing technical assistance and financing. The sector focus has largely been on renewable energy, healthcare, and manufacturing/retail. In addition, Grameen and BRAC enterprises often provide seed capital for new impact-oriented enterprises, creating an informal impact investing sector that on its own has created a network of 30–40 companies defined as social businesses under the Yunus philosophy. Not all of these may be attractive candidates for impact investors, given that some of them retain their non-dividend philosophy, but some of them have spun out as independent entities. A few examples are provided in Figure 16.

**The impact enterprise space is also driven by foreign social entrepreneurs that see an opportunity and have an understanding of social business models**. Foreigners have launched a number of impact enterprises that align closely with various social business models known globally, such as reinvesting profits or focusing on fair trade. For the most part, foreigner-owned impact enterprises are producing their products locally using ethically-sourced, environment-friendly inputs and exporting goods to more developed markets. These entrepreneurs typically launch the enterprise with their own seed funding, but a few have taken investments at venture or growth stages.

**Many local entrepreneurs are launching businesses that address a social need, target BoP customers, or incorporate local communities into business operations as suppliers, distributors, or employees, but these entrepreneurs do not explicitly define themselves as impact enterprises**. While the impact enterprise model is used in practice, most local entrepreneurs do not self-identify as such. These enterprises, recognizing an opportunity created by gaps in the provision of basic services, are addressing a need through for-profit business models rather than operating with an explicit impact intention, as we see among the Grameen and BRAC entities and foreign entrepreneurs that have launched social businesses in Bangladesh.

**Microfinance is the sector with the largest number of impact enterprises, with more than 600 registered MFIs and four very large MFIs**. This is unsurprising, given that Bangladesh is often seen as the birthplace of the microfinance model now used around the world, as noted earlier. Among impact enterprises, MFIs are the most active. There are four large MFIs currently active in the country, including the first movers Grameen Bank and BRAC.

**Outside of microfinance, renewable energy and ICT (including mobile financial services) are emerging sectors for impact enterprises**. Renewable energy enterprises have emerged in response to the limited power infrastructure in Bangladesh. Increasingly, impact enterprises are addressing access to energy issues with mini-grids and solar lighting for homes. With nearly 70% of the population using mobile phones, ICT and mobile financial services are also growing in appeal. In fact, recently, two large players servicing the BoP with ICT services have emerged, and both have received investments greater than USD 10 million.

**While growing as impact enterprise sectors, education and healthcare have service gaps that have traditionally been addressed by a large NGO sector offering free services**. Given the historical precedent set by an active NGO sector, both consumers and entrepreneurs tend to expect education and healthcare services to be provided free-of-charge.

**One gap identified by investors as an impact sector that is largely neglected is housing**. There is a sizeable need for low-income housing options, and as NGOs are not addressing all of the need, there is a strong potential for enterprise-based solutions and thus, an opportunity for investors to support such enterprises.

**There are four common impact models, or theories of change, that we see among impact enterprises, and these models differ across sectors**. First, many impact enterprises aim to create jobs and generate economic growth. These enterprises tend to be in high-growth sectors such as manufacturing. Second, some impact enterprises manufacture products using ethically-sourced, environment-friendly inputs. Often, these products are exported or sold through socially-oriented retail stores. Third, some impact enterprises incorporate low-income or marginalized populations into their supply chains. These are usually agriculture or handicraft production companies. Finally, impact enterprises may provide some much-needed services (such as healthcare services) to the BoP, often through MFI lending. Some enterprises have adopted multiple theories of change. For example, one manufacturer is developing a rural supply chain to source environment-friendly inputs and is setting up production sites in low-income communities.

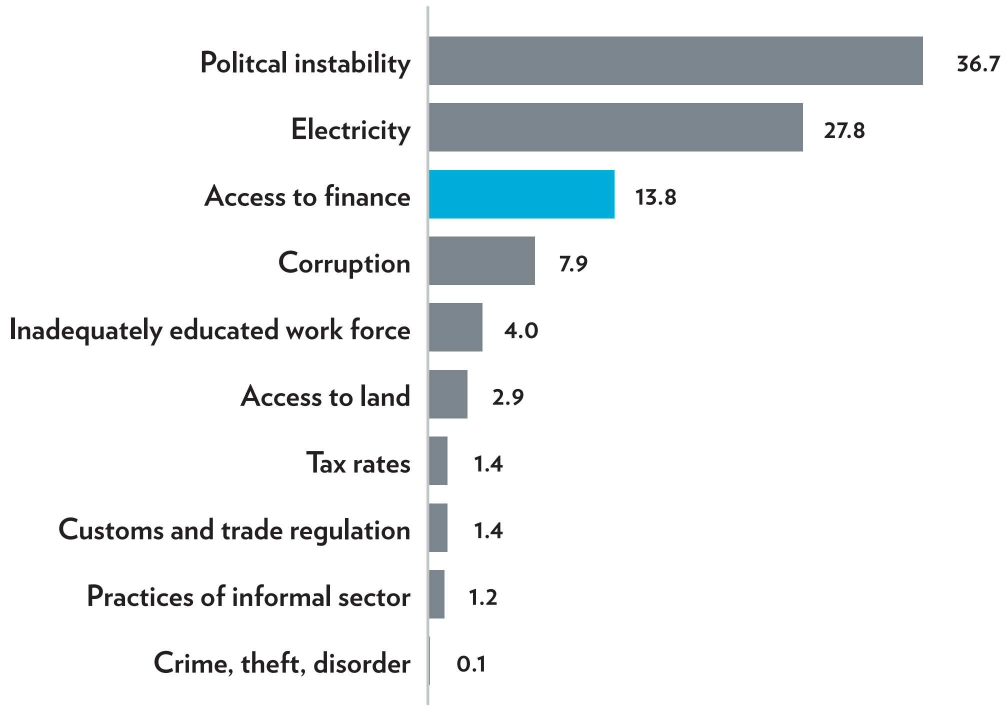
**Given the high rate of unemployment and low GDP per capita, both investors and impact enterprises acknowledge job growth as the primary impact focus at present**. Irrespective of the sector or business model, most business managers describe their enterprise's impact as job creation, particularly among the BoP or marginalized populations. As described earlier, most impact investors also articulate impact in similar terms.

## Access to finance

**As in other countries, most impact enterprises were seeded out of an entrepreneur's own savings or from friends/families due to a lack of seed capital available or a reluctance to take on debt/equity**. Most early-stage impact enterprises have not accessed formal channels for capital, preferring instead to provide initial financing from their own pockets or from personal networks. The reasons vary, particularly across instruments. For debt, collateral requirements and interest rates are too high to warrant taking a bank loan, particularly for seed capital. With respect to equity, entrepreneurs have several concerns: they are not familiar with the instrument, are reluctant to cede control to an investor, are concerned that the investor's values may not align with the core values of the enterprise (or that the investor will prioritize financial returns over social impact), or feel that they may have difficulty in identifying the appropriate impact investors.

**A survey of 1,442 enterprises in Bangladesh[26] reveals that access to finance is the third largest constraint for companies (Figure 17).** Like investors, enterprises recognize political instability and limited infrastructure as the most significant challenges, but access to finance is also identified as an important issue.

**FIGURE 17: CHALLENGES FACING ENTERPRISES IN BANGLADESH (% OF RESPONDENTS)**

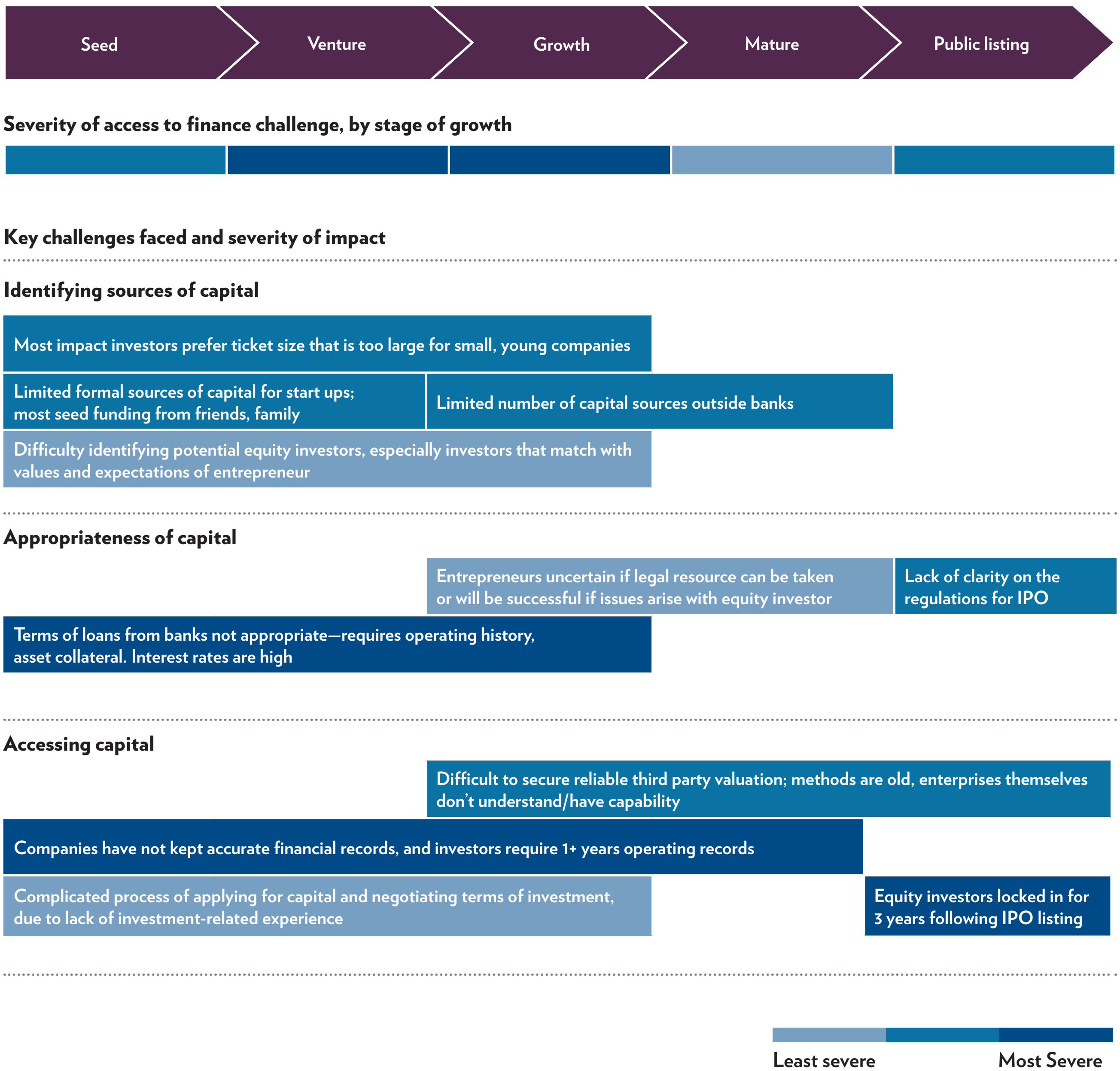



Source: World Bank Enterprise Survey of 1,442 enterprises in Bangladesh, 2013

*26 World Bank Survey of 1,442 enterprises in Bangladesh, 2013. http://www.enterprisesurveys.org/data/exploreeconomies/2013/bangladesh*

**Closely looking at the challenges related to access to finance reveals that growth and venture stage companies face the greatest constraints.** As seen in Figure 18, enterprises at these stages have difficulty in both identifying appropriate sources of capital and accessing capital. Formal sources of capital are difficult to secure or are not available for these companies.

FIGURE 18: ACCESS TO FINANCE CHALLENGES ACROSS GROWTH STAGES




Sources: Stakeholder interviews; Dalberg analysis

**Identifying sources of capital is the most difficult for early-stage companies**. Even though most deals are under USD 1 million, the ticket size is still often too large for young companies. Outside of banks, there are few sources of capital available.

**Furthermore, the capital available is often not appropriate for enterprises, particularly in the early stages. Legal and regulatory constraints limit the types of capital available to business managers**. Additionally, perceptions of equity and a lack of knowledge about non-debt instruments limit the interest among business managers. The terms for investments are often not appropriate, as debt requires high collateral and investors require an operating history and financial records that many companies do not have. Debt in early stages can also be crippling, due to interest repayment.

**Accessing capital is the most challenging area for enterprises across growth stages**. Regulations require that equity investors are locked in for three years following an IPO. Also, companies do not keep accurate financial records or are not willing to share records, which investors require during the due diligence process. Lastly, companies often view investments as "rainy-day" funds rather than an injection for growth.

**Regulatory challenges are barriers across identifying and accessing capital**. Regulations are restrictive, due to both a lack of clarity and, when there is clarity, the perception that the existing regulations and processes are too constraining to facilitate investment.

# ENABLING IMPACT INVESTING: THE ECOSYSTEM

**Bangladesh has made strong efforts to improve the investment climate through regulatory changes, leading to the country's gain in the overall ease of doing business, although its rank still remains quite low overall**. Bangladesh climbed two spots in 2014 to 130 out of 189 countries in the World Bank's Ease of Doing Business Ranking, following a downward trend in the rankings in previous years. Strong reforms on paper over the last year to improve the ease and process of starting a business contributed to the abovementioned rise in rank, but the country still scores relatively low overall. Interestingly, Bangladesh scores very high on investor protection, ranking 22 in 2014,[27] but it is important to note that this largely reflects the experience of foreign direct investors who have benefited from the country's steady economic growth and regulation reforms that have promised to open the market for foreign investors, and is less reflective of the capital-only investors (e.g., private equity investors or venture capitalists), who still feel relatively unprotected due to the lack of clarity in the regulations with respect to equity investments and the potential recourse for a contract default.

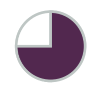
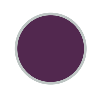
27 *World Bank "Ease of Doing Business" Rankings.*

**Investors and business managers are enthusiastic about the future trajectory of the country, given its GDP growth, but infrastructure gaps in power and roads, as well as labor issues, remain troubling**. While most players in the impact investing market recognize that the investment climate in Bangladesh is improving, there is still skepticism about key gaps. Limited power and poor road infrastructure have prevented the country from realizing its full economic potential (Figure 19). Poor labor laws also remain a barrier to growth, particularly in the manufacturing sector (textile production), which has suffered a few very public tragedies that have spurred debate around labor standards. For instance, the labor strikes in 2013 were paralyzing for businesses in Dhaka, the nation's capital.

**Despite regulatory changes that have resulted in a recent increase in the ease of doing business, regulatory constraints remain the largest ecosystem challenge**. While policies are considered liberal on paper, execution is erratic, conservative, and slow. Often, business managers and investors have little certainty about how regulations will play out in practice, despite clear policies in many aspects. For example, investors express that the process for filing for an IPO is uncertain, as the expected timeline varies substantially, regulatory bodies may not follow the process as it is defined, and consequently, the outcome of the IPO is not predictable. While the dominant perception among industry players is that regulatory bodies recognize these constraints and are open to addressing barriers, the consensus is that this process will take time (probably a year or more). Some specific regulations include the following:

- There is a three-year lock-in period for equity investors following a public listing.
- Foreign investors are restricted from investing in companies that are not appropriately registered for receiving FDI.
- Board of Investment must approve deals, rather than just receiving a notification.
- There are some regulatory barriers to repatriating dividends.
- If domiciled in Bangladesh, a fund must be registered with the Government of Bangladesh in order to make investments.
- Foreign investors cannot provide debt to Bangladeshi companies.

**FIGURE 19: SEVERITY OF INVESTMENT CLIMATE CONSTRAINTS IN BANGLADESH**

| | Key components | Key ecosystem constraints in Bangladesh | Severity of constraint |
|---|---|---|---|
| Investment climate | Political stability | • Waves of political unrest over the last decade<br>• Domestic perception that political climate is improving, but foreign investors are wary<br>• Labor strikes in late 2013 were paralyzing for businesses— especially severe in ready made garment sector, but whole economy affected and concerns about recurrence |  |
| | Macroeconomic governance | • Interest rates on the high end for the region (up to 18% depending on credit rating). Some caps exist for particular sectors and investor types, but real rates often high<br>• Strong government regulations limit foreign borrowing; this is being relaxed on a case-by-case basis<br>• Tax rates perceived as reasonable, but processes/administration are cumbersome and slow |  |
| | Infrastructure | • Power supply is erratic and unreliable. Even small enterprises require power back-up systems which are expensive to run. Inconsistent fuel supply compounds issue<br>• Road infrastructure is poor. Traffic conditions in major corridors slow business and raise costs. E.g. Dhaka Chittagong highway, the main artery, is extremely congested<br>• Ports are highly inefficient which increases business costs for enterprises, especially those importing and exporting |  |
| | Regulatory environment | • Liberal policies on paper, but execution is erratic, conservative, and processes slow<br>• Perceptions of significant corruption to get processes moving or completed<br>• Bangladeshi companies not allowed to access foreign debt, but regulations relaxing<br>• Key concerns include:<br>» Land purchase, transfer approvals<br>» Visas, work permits<br>» High fee for company registration (for small domestic entrepreneur)—BDT 50,000 (~USD 645), so people incorporate as proprietorship to save money<br>» Unclear regulation for PE/VC as there is no explicit guidance around governance, minimum capital requirements, or reporting. This is expected to be addressed within 2014<br>» Unfavorable IPO regulations e.g. lock-in period of 3 years (under review by SEC after discussions with investors and donors)<br>• Investors agree that regulators are open to reform but the process will take time |  |

Least severe
Most severe

Sources: Stakeholder interviews; Dalberg analysis

**There are three bodies responsible for the regulation and investment climate in Bangladesh; perceptions of their efficacy and degree of private-sector friendliness vary.** Among these bodies, the Bangladesh Securities and Exchange Commission (SEC) is perceived by investors as the most supportive of the pro-investment policies (Figure 20).

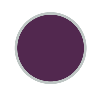
**FIGURE 20: ROLES, MANDATE, AND PERCEPTIONS OF THE THREE KEY REGULATORS IN BANGLADESH**

| | Role / mandate | Investor perceptions / challenges |
|---|---|---|
| Board of Investment Bangladesh | • Established in 1989 by the Investment Board Act<br>• Mission to encourage private sector investment, to identify constraints to investment, and provide necessary facilities and assistance<br>• Services include "investment promotion and facilitation covering support, suggestion and aftercare support to the investors." | • Perception that low effectiveness among bureaucrats reduces utility in practice |
| Bangladesh Bank | • Chief monetary and financial system regulator established under Bangladesh Bank Order 1972<br>• Key functions include formulation and implementation of monetary/ credit policies; supervision and regulation of banks and NBFIs; issuance of currency; maintaining deposit insurance scheme; money laundering prevention; acting as banker to the government | • Aware of gaps in policy and overly restrictive regulations<br>• Perception that the Bank is willing to address gaps and loosen policy, but that process will take some time (one year at least) |
| Securities and Exchange Commission | • Capital market regulator; mandated under Securities and Exchange Commission Act 1993<br>• Key functions include: registration/regulation of capital market investors and intermediaries; prevention of fraudulent/unfair trade practices; promoting investor and intermediary training; undertaking investigations/inquiries as needed; conducting research and publishing information | • Perception that SEC supports private sector development and is in favour of regulatory changes to improve the investment climate |

Sources: Stakeholder interviews; Dalberg analysis

**There is a growing support system for investors and business managers, but the budding ecosystem has not been sufficient to fully address needs (Figure 21).** While gaps exist for investors, the largest constraints are for enterprises looking for service providers to assist in building key business skills.

FIGURE 21: CONSTRAINTS TO INVESTOR AND ENTERPRISE SUPPORT IN BANGLADESH

| | Key components | Key ecosystem constraints in Bangladesh | Severity of constraint |
|---|---|---|---|
| Investor and Enterprise support | Investor support | • The regulatory process to set up and register a fund is complicated and difficult to navigate with little support available<br>• Few organizations exist that support international investors with their pipeline development—e.g. deal-sourcing or matchmaking is not a commonly available service (this is less of a constraint for domestic investors as their networks tend to be more effective for pipeline development)<br>• Similarly, the dearth of providers of valuation services based on modern methods (e.g. projected cash flows rather than book value or net present value) means both the initial structuring and exiting of equity investments is difficult<br>• On the fund management side, most are first time fund managers, though many have worked in banking/financial services (and several with Grameen/BRAC networks) and some have international experience, but in general, fund management experience is low, and exposure to international learnings and best practices are limited so there is some need for training and networking to build this capacity for fund managers in the impact investing space<br>• Limited complexity in impact measurement, as many funds are new and many managers are new to impact investing |  |
| | Enterprise support | • In addition to access to finance challenges, entrepreneurs face a range of other constraints to growth including their own business mindset, skills and knowledge, as well as access to information and networks.<br>• Few organizations currently exist to support/address these needs in a comprehensive, easy-to-access way, and those that exist are relatively new and have minimal reach<br>• Key areas of need include:<br>» Aggregation/networking/knowledge sharing amongst entrepreneurs<br>» Training in key business management functions—both strategic and operational<br>» Linkage to investors or platforms for accessing investor information |  |

Least severe
Most severe

Sources: Stakeholder interviews; Bangladesh Enterprise Institute studies; Dalberg analysis

**Investors often find themselves providing technical assistance (TA) to enterprises in order to fill ecosystem gaps**. Many enterprises are not receiving the development support that they require. As a result, at least six investors are also providing TA in the form of direct management support to business managers in order to help the enterprise progress to an investable level (in the case of pre-investment support) and to increase profitability (for post-investment support). Often, the TA focuses on basic skills around structuring a company for an investment and setting up governance structures. Some investors are also providing financial support to SMEs for securing TA.

**In addition, formal ecosystem players have emerged, but most are new to the space**. A small number of incubators and accelerators have launched within the last year, but most are still piloting their services, which primarily include improving investment readiness of enterprises (maintaining financial records, developing a business plan, pitching to investors, etc.) and strategy design. Ecosystem players are also hosting networking events and workshop trainings, but these are relatively new. Access to these services is limited, not just because these service providers are few in number, but also because these services are restricted to Dhaka and awareness of these programs is limited.

**Credit rating agencies are the most active in this field, but most impact investors are not utilizing their services, even for conducting valuations.** Regulators have licensed a large number of credit rating agencies, which some speculate is due to political considerations as Bangladesh has more credit rating agencies than any of its neighbors, including India or China. However, only banks are using their services for assessing the credit worthiness of borrowers. Other investors do not use credit rating services, even for conducting valuations, despite the lack of formal valuation knowledge among many investors (particularly local investors) and business managers.

**FIGURE 22: ACTIVE ECOSYSTEM PLAYERS IN BANGLADESH**

**Incubators/Accelerators**

| | | | | |
|---|---|---|---|---|
| The Wave | Open Accelerator | Biz Cube | Startup Dhaka | Team Engine |

**Advisory Services**

| | | |
|---|---|---|
| Light Castle Partners | Asian Tiger Capital Partners | Bangladesh Enterprise Institute |

**Credit Rating Services**

| | | | |
|---|---|---|---|
| The Bangladesh Rating Agency Ltd. | WASO Credit Rating Company (BD) Ltd. | Emerging Credting Rating Ltd. | Credit Rating Information and Services Ltd. |
| ARGUS Credit Rating Services, Ltd. | AlphaRating | National Credit Ratings Ltd. | Credit Rating Agency of Bangladesh United |

**TA Providers**

| | | |
|---|---|---|
| IFC, World Bank Group | Bangladesh Bank | SME Foundation |

Sources: Stakeholder interviews; Bangladesh Enterprise Institute studies; Dalberg analysis

# AREAS FOR FURTHER RESEARCH

In order to further understand the opportunities in the impact investing market in Bangladesh, we propose several areas for further research.

First, given that impact investing in Bangladesh is beyond the idea phase, as in some other South Asian markets, investors are seeking more sophisticated ways of measuring their impact but lack good examples or tools to do so. As part of the maturing process of the impact investing landscape, given that investors have a history in the market, the desire to be more rigorous about impact measurement and to tailor impact metrics to different sectors and types of enterprises requires further study on tools for the Bangladeshi context. Investors and enterprises alike are looking to move beyond output measurement to outcome and impact measurement, and will benefit from a resource that examines these within the local setting.

Second, there are opportunities for exploring the potential role of the Bangladeshi diaspora's contribution to the growth of the investment landscape in several ways. Either through a mobilization of networks abroad, or through direct investments in their home country, a significant amount of potential capital can be unleashed provided there are appropriate awareness and channels to do so. Furthermore, Bangladeshis who have acquired experience in the financial services industry abroad are also now returning and managing funds. Research on capitalizing on the movement of the diaspora, and providing a clear overview of the opportunities to optimize this engagement, can contribute to the growing impact investment market in Bangladesh.

Lastly, as the market in Bangladesh evolves, an increasing number of investors are interested in public listings as an option for exiting their investment. In reality, however, only the first impact investment is going through an IPO at this moment, and the process is largely undefined. Additional research and information to support strategic exit options, including the definition and analysis of the conditions under which certain exit options are better than others and a preparation during earlier stages of the investment, will be considerably beneficial for both investors and investees.

# ANNEXES

## Annex 1—Interview participants

### FUND MANAGERS

- Subrata Mitra and Dipok Kumar Roy, *Venture Investment Partners Bangladesh Ltd*
- Marten van Middelkoop, *Incluvest*
- Md. Minhaz Zia, Asian *Tiger Capital Partners*
- Shawkat Hossain and Muhammad Raisul Amin, *BD Ventures Limited*
- Maksudul Islam, *Brummer & Partners*
- Jerry Nicholson, *Tindercapital*
- Mohammad Altaf and Uz Zaman, *SEAF Bangladesh Ventures*
- James Perry, *Panahpur*

### DFIS

- Arsalan Alfred M. Ni and Sayef Tanzeem Qayyum, *International Finance Corporation*

### INSTITUTIONAL INVESTORS

- Ershad Hossain, *The City Bank Ltd.*
- Mominul Islam, *IPDC*
- Habib Yousuf, *Habib Bank*

### ECOSYSTEM PLAYERS

- Farooq Sobhan, *Bangladesh Enterprise Institute*
- Samira Zuberi Himika, *Team Engine*
- Saifur Rahman, *LightCastle Partners*
- Jerry Nicholson, *Open Accelerator*
- Maroof Mohsin, *Yunus Centre*
- Mustafizur Rahman Khan, Samad Miraly, and M Fayaz Taher, *The Wave*
- Mahmudul Hasan Sohag, *Onnorokom Group*
- Muzaffar Ahmed, *CRISL*
- Serajul Islam, *EEF*
- Arif Khan, *SEC*

- Md. Masum Patwary, *Bangladesh Bank*
- AK Chowdhury, *Hoda Vasi Chowdhury & Co*

**IMPACT ENTERPRISES**

- David How, *Oasis Coffins*
- Samantha Morshed, *Pebble Child*
- Minhaz Anwar, *Better Stories*

## Annex 2—Survey respondents

**FUND MANAGERS**

- Subrata Mitra, *Venture Investment Partners Bangladesh Ltd.*
- Marten van Middelkoop, *Incluvest*

**INSTITUTIONAL INVESTORS**

- Ershad Hossain, *The City Bank Ltd.*
- Mominul Islam, *IPDC*

**ENTERPRISES**

- Amer Khan, *Magnito Digital*
- Asif Saleh, *BRAC Bank Ltd.*