MAPPING THE IMPACT INVESTING SECTOR IN ZAMBIA

Summary of findings

September 2019

Report compiled by Kukula Capital Ltd on behalf of the National Advisory Board for Impact investing (NABII) with support from the UK aid funded Private Enterprise Programme Zambia (PEPZ)

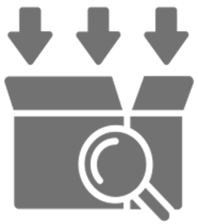
pep ZAMBIA Private Enterprise Programme - Zambia

UKaid from the British people

Introduction

In 2015, as a means to address global challenges and provide a global framework, the United Nations (UN) invited the global community to connect around ***17 Sustainable Development Goals*** (SDGs).These ambitious goals represent a major call for transformative changes if they are to become a reality. According to the SDG Centre for Africa (SDGC/A)[1], Africa needs to raise over ***USD 500 billion*** in additional funding every year to achieve the SDGs by 2030. The complex objectives underlying the SDGs, require sophisticated funding that will generate more than a simple financial return. The possible answer: Impact Investing. Impact investments is defined by the Global Impact Investing Network (GIIN) as "*investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside a financial return*"

Overview of the study



The study explored the state of the five pillars of the impact investing ecosystem in Zambia by examining:

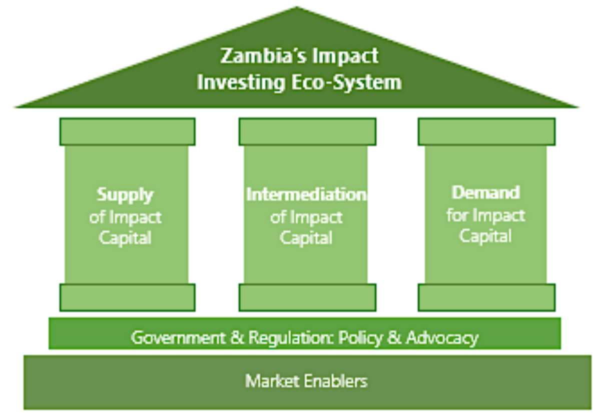
1) the **Supply** of impact capital. Represents actors that provide funding, directly or indirectly, to impact businesses. These include institutional investors, high net worth individuals and retail investors
2) the **Demand** for impact capital. Represents actors that provide impact solutions and have financing needs to carry out those solutions
3) the **Intermediation** of capital facilitate the exchange of impact capital between the supply and demand side. These include funds (often venture capital, growth funds or fund of funds), as well as wholesalers and stock exchanges
4) the **Enablers** and market builders of the ecosystem. Includes actors that facilitate the impact ecosystem, without necessarily providing capital. These range from financial advisors to research centres or NABs
5) the **Regulatory** environment. Catalyses the ecosystem through its policy making tools.

In addition, study assessed the main barriers and challenges of each pillar in order to highlight how to support the entire impact investing ecosystem.

Study scope

This study was informed by Quantitative and qualitative data collected from 30 stakeholders. The ***screening process*** used a 'top down' method of reviewing databases and previous research findings while a 'bottom up' approach captured data that could have been missed in the former. This study analyses the Zambia's impact investing landscape starting from 2015 where *GIIN (2015): The Landscape For Impact investing in Southern Africa* report acts as the base. For the purpose of limiting the scope of the screening process the study employed a selection criteria.

Pillars of Zambia's Impact Investment Eco-system[5]

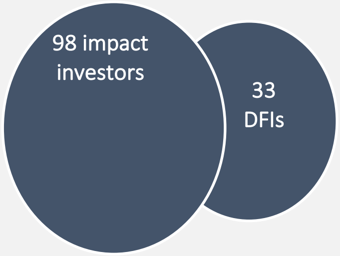


Selection criteria for Impact investments

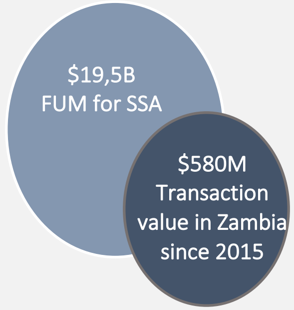
- Investment of at least USD 100,000
- Have an expected financial return
- Negative screening of Environment, Social & Governance (ESG) at investment stage
- Positive environmental and societal benefits
- Direct investments into for profit businesses in Zambia
- Focus on Europe, Africa and NA investors

Supply Pillar- Key takeaways

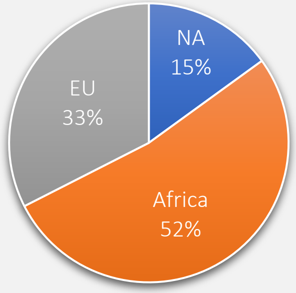
No. of Impact Investors covering Zambia



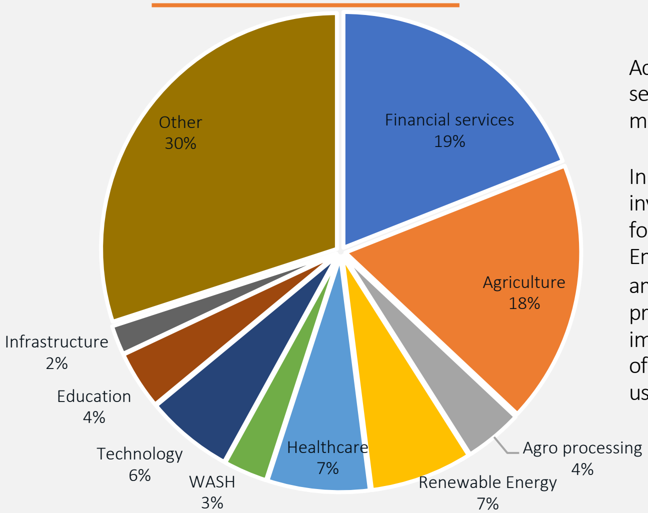
Deal flow & SSA & FUM



Origin of investor & Funds* (ex DFI funding)



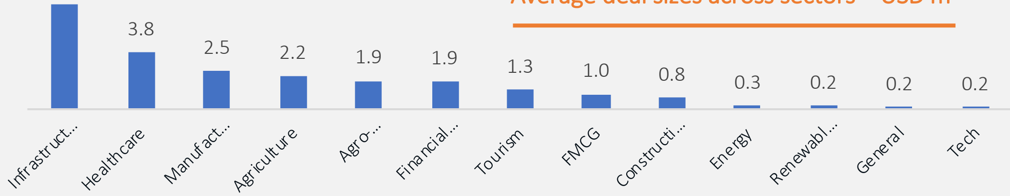
Sector breakdown of Investment



According to research findings Zambia has seen Impact investments worth USD 580 million since 2015.

In Zambia its mainly sector agnostic investors who invest and the dominant part focus on Financial Services, Agriculture and Energy which makes up 44% of the total amount of investors. Furthermore, the preferred financial instruments for these impact investors and DFIs are a combination of equity and debt, with only a minority using mezzanine.

Average deal sizes across sectors – USD m



***Study only covers investors from Europe, North America and Africa.**

Supply barriers

Lack of investment opportunities

Many foreign investors prefer investments with a large ticket size, but Zambian businesses are demanding smaller investments.

Lack of scalable businesses

Zambian impact businesses are in the early stages with a lack of knowledge and experience with balancing financial and social returns in a scalable way

Lack of Transparency

A lack of transparency between businesses and investors as well as an underdeveloped market increases the risk perception of the Zambian Impact Market

Macroeconomic environment

Impact investors highlighted exchange rate volatility, governance structures, corruption, and the macro economic outlook as concerns

Opportunities

Initiatives for increasing impact flow..

- *Help incorporate* standardized ESG reporting guidelines for businesses to promote transparency towards investors.
- *Promote Zambian crowdfunding* platforms.
- *Promote Zambia-specific* business-angel networks for HNWI.
- *Create improved platforms* for businesses to communicate value propositions to investors.
- *Use the capital of local pension funds* to anchor or seed local investment funds and attract additional foreign capital as co- investments.
- *Use local platforms* and communities to faciliate partnership with regional investor networks to attract capital

…to high impact sectors*

- *Create incubator funds* within impact sectors that are partly funded by national pension funds or government.
- *Improve the regulatory framework* for impact capital, promoting private equity activity within impact sectors.
- *Offer incentives to support projects / businesses* within high impact sectors and develop stronger connection with international impact communities.
- *Promote DFI activity* in impact sectors by using government or corporate bodies to co-invest and share risk.

Demand Pillar- Key takeaways

Estimation of capital demand

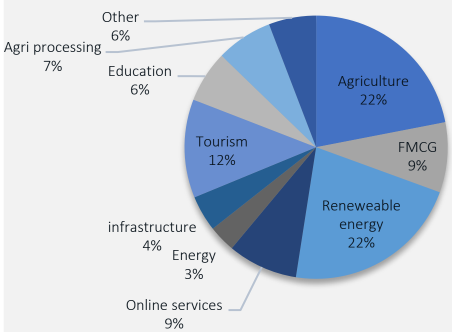
Non-bank demand		Bank demand		Utility scale Energy demand		Total demand
USD 0.3bn	+	USD 0.7bn	+	USD 1.9bn	=	USD 2.9bn (USD 957m Impact capital demand)

5 renewable energy businesses seeking to raise $780m

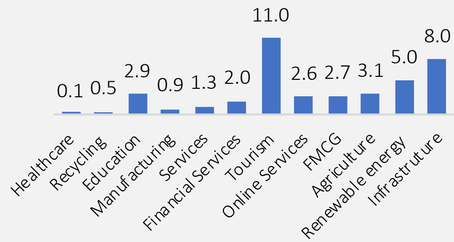
&

503 businesses screened, **77 ex Energy** Impact businesses currently fundraising **USD 177m** across **12 sectors**

Split of impact capital investment demand sector, total = USD 177m



Average investment size per sector of demand for impact capital



Survey findings

1. Major **SDG contributions** are No Poverty, Decent work & Economic Contribution, Responsible consumption & production
2. Even though **80% of respondents** preferred debt, only **29% received** debt while 57% had a combination of debt and equity
3. **50% of respondents** were actually at start up level when they first received impact capital

Demand barriers

Lack of Information

There is lack of information available on which impact investors are active in Zambia

Impact investor preference

There is lack of Knowledge within businesses on what impact investors are looking for in a preferred investment

Lack capacity for impact reporting

There is limited capacity to meet impact specific reporting requirements during due diligence as well as ongoing reporting through out the lifespan of the investment

Macroeconomic environment

A challenging macroeconomic environment makes it harder for businesses to perform and sell a positive outlook to international investors

Opportunities

Active promotions

Active promotion of impact business in high impact sectors with a great potential for scale. These would be in areas such as Health, Education and agri-processing

Alternative channels

Alternative financing solutions such as crowdfunding which could present a great opportunity as the collateral required for this sort of funding is other more flexible

Coaching

Coaching of businesses so as to ensure that the company fundraising has a strong management team, solves a real social or environmental need, is in a high impact sector and is scalable

Business Type

Improve the awareness on the types of impact capital and which best fits various types of companies

Business Association

Leverage existing business associations on the importance of education of impact investment, or how certain businesses can transition to an impact-focused entities through development of an impact strategy and enhanced reporting structures

Intermediary pillar- key takeaways

Intermediation models for Impact Investments in Zambia is quite underdeveloped due to the small ticket-size of investment in the sector. This directly hints to the fundamental challenges from the ***demand vs. supply*** of impact capital. Despite this, there is a sizeable number of service providers including financial/corporate advisors and private equity firms. However, to avoid ambiguity in determining the size of potential funds available for Zambia, PE and venture capital (VC) firms have been included in the supply sections of this study.

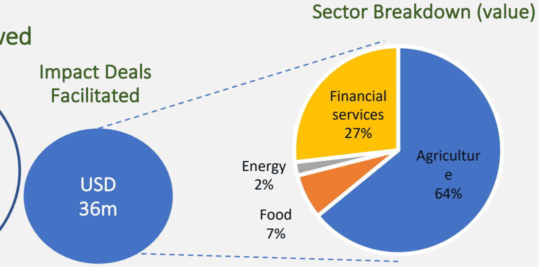
We undertook a gap analysis to determine the intermediation models present in Zambia by making comparisons with a more mature market such as the UK. The analysis, revealed that Zambia has a sizeable number of intermediaries, though most fall within similar categories and few has any specialisation within Impact investments

Feedback from players of this sector shows that challenges are similar to those listed in the supply and demand sections.

Sample Players Interviewed

Corpus, Open Capital Advisors, Ventus, 30Thirty Capital, Investpire, Deloitte.

Impact Deals Facilitated



There is very little that has been done to ensure that intermediaries are well positioned and offer varied services that could promote the impact investment landscape as it grows. A few activities include: Local Programs Spearheaded by Donor Agencies which are building competencies amongst businesses by offering technical assistance for optimizing their operations and the Pension and Insurance Authority (PIA) introduction of a percentage threshold* of 5% of total assets of pension funds and long-term insurers can invest in unlisted securities such as private equity, which increases the capital available for suppliers, the deal flow in Zambia and subsequently the activity for intermediaries. Similar and more ambitious targets has been made for NAPSA for alternative asset classes such as Private equity and specifically for Social investments.

Gap analysis of the Intermediation Models

Intermediation model type	United Kingdom*	Zambia*
Impact-Focused Arrangers and Advisors	Investing for Good, Worthstone	Market Gap
Impact-Focused PE/ Venture Capital Firms	RISE, Northstar Ventures, Cheyne Capital	Partial market gap — Inside Capital Partners, Kukula Seed, Two Nine Group
SME-Focused Arrangers and Advisors	Numbers for Good, Good Finance	Zenga, Kukula Capital, Open Capital Advisors
General Corporate Finance Advisors	JPMorgan Chase & Co., EY, BainCapital	Imara Investing in Africa, Pangaea Securities, pwc
Social Stock Exchanges, Social Banks, Crowdfunding	social stock exchange, Triodos Bank	Market Gap

*Note: The provided are merely samples and are not an exhaustive list of players per category

Key Challenges of intermediaries and mitigation strategies

Challenge	Mitigation Strategy
There is a skills gap among intermediaries within best practice deal structuring in general as well as impact investment specific advisory.	Intermediaries could be supported with medium term secondment of specialist advisors to bridge the knowledge gap in general corporate finance advisory as well as impact specific advisory.
Low willingness and ability amongst businesses to pay for financial advisory services.	Intermediaries have adopted a pragmatic approach to this where they focus on larger transactions. Programs such as PEPZ bridges the gap for small enterprises by subsidizing the upfront fees.
'Green washing' – i.e. labelling all deals as impact so as to increase the pool of interest among investors.	Need for intermediaries to apply clear definitions within impact investments to avoid the term being diluted.

Regulatory Pillar - Key takeaways

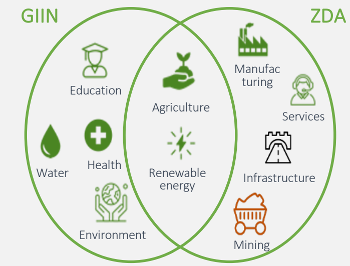
Major players under regulation

Main regulatory bodies for investments in Zambia include: Bank Of Zambia (BOZ), Securities Exchange Commission (SEC), Competition and Consumer Protection Commission (CCPC), and Zambia Development Agency (ZDA). However there **is no specific regulation for Impact investments**

Government investment entities

Even though the government investment companies are making efforts to promote impact investment, there seems to be no clear coordination and joint strategy among the investment entities.

Global Impact Investment Network (GIIN) impact sectors vs ZDA priority sectors



The Zambian Government through ZDA has outlined six priority sectors for investment: Agriculture, Energy, Infrastructure, Manufacturing, Mining and Tourism. The below matrix illustrates which sectors can contribute to each SDG. This speaks to the fact that even though there is no impact specific regulation, Government is indirectly promoting some of the high impact sectors through the ZDA act and the vision 2030

Priority Sectors	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
Agriculture	X	X	X					X			X		X				
Energy	X						X	X	X	X	X						
Infrastructure	X							X	X								
Manufacturing	X							X	X								
Mining	X							X			X						
Tourism	X							X									

The above matrix highlights the following:

- All six of the ZDA priority sectors can contribute towards the SDC goal of **NO POVERTY**.
- All six of the ZDA priority sectors can contribute towards **DECENT WORK AND ECONOMIC GROWTH**.
- ***Agriculture*** and ***Energy*** can contribute towards the largest number of SDGs.

Key Challenges

- Only partial alignment between government defined impact sectors and internationally recognized Impact investment sectors
- Regulatory framework under SEC are not fully up to date with new Impact investment products such as Social Impact bonds and Crowdfunding platforms.
- Current incentives for priority sectors are not easily obtained and realized.
- Despite recent reforms there is still low supply of capital towards impact sectors being facilitated through government institutions or pension funds.
- Limited experience and lack of dedicated funding towards impact investments among government investment arms such as IDC and ZCCM.

Opportunities

- Tax relief on social impact investments to incentivize investment in social enterprises.
- Enforce investments by local pension funds into Alternative asset classes such as Private equity in General as well as impact investments.
- Establish a regulatory framework for crowdfunding and social banks.
- Align ZDA priority sectors with GIIN impact sectors.

Enabler Pillar - key takeaways

Enablers of the impact investing in the Zambian concept can be segmented into two overall categories:

a. Enablers focused on creating and improving an ecosystem that enables impact investment (macro enablers) for all businesses
b. Enablers focused on enabling individual businesses' potential for obtaining impact investment (micro enablers

Macro Enablers

Educational Institutions: Supporting quality of management by educating and training student. Networks amongst students and between the students and businesses.

Advisory Boards and Councils: Advice for the implementation of policies and programs to better enable businesses to attract impact investments

Associations: Facilitation of events and conferences, workshops and network building

Embassies: Sponsor networking and knowledge-sharing events and influence policy-making. Social entrepreneurship boot camps.

Overview of key Macro Enablers

Educational institutions	Advisory boards and councils	Associations	Embassies & Donor Funded Programmes
University of Lusaka	Zambia Development Agency; GSG Driving real impact; ZBIDF	Impact Capital Africa; PSDA; Economics Association of Zambia; Capital Markets Association Of Zambia	UKaid; PEP Zambia; USAID; JICA; Sida; giz

Key challenges	Mitigation mechanism
Lack of data on Sectors, Industries and Markets. A low degree of available information on impact sectors increases the risk perception of investors by lowering the level of analysis on trends and characteristics within each sector which creates a barrier to investments	Improving the information flow from impact sectors will increase transparency and ease the due-diligence process of all investors and for international investors, in particular who controls the largest amounts of Funds under management
Lack of university programs within corporate finance, venture capital, Private equity and impact investments	Promote programmes on finance and investments in local universities
Lack of skills among intermediaries	The enablers should focus on developing intermediaries and not only businesses
Lack of co-operation across pillars	The NABII can act as an overall coordinator between the pillars

Opportunities

1) **Lobby ZDA** to publish annual research reports on high impact sectors
2) **Collaborate** with Universities to foster innovation and entrepreneurship
3) **Lobby for increased liberalisation of the energy market** to promote private Renewable Energy investments

All the above are opportunities that could be leveraged by enablers to grow the impact investing ecosystem in Zambia

Gap Analysis- Supply and demand of impact capital

The gap analysis compares the desired amount and type of impact capital requested by for-profit impact enterprises in the private sector with the supply by analyzing the impact deals from 2015-2018.

Minimum excess Demand for impact capital

USD 40m

77 businesses is actively fundraising USD 177 m in Zambia across 19 sectors and the current total value of impact transactions for the first 9 months of 2019 being USD 120m. Applying a CAGR of 13% equal to the projected growth, the next 12 months will include impact deals of USD 135 m. This creates a **USD 40m** gap of excess demand. In reality, this gap is likely to be much bigger as mismatch in sectors, deal sizes as well as investor and demand preferences opposes a perfect match.

Average deals comparison

	Average deal size (supply)	Desired deal size (demand)
Renewable Energy*	4	3,5
Agriculture	2,4	2,4
Manufacturing	3,8	0,9
Overall	5	3,2

Impact fundraising has a desired average deal size of **USD 3,2m**. The historical deal size average for impact investors is USD 5m, indicating that even with outliers, the average deal size of impact transaction is way above the demand of businesses. When zooming in on three top impact sectors, the average supply deal exceeds the future demand and **shows that a gap exists across sectors** (besides Agriculture) with manufacturing having the biggest gap. This can create challenges for SMEs within Agro-processing and attenuate the growth.

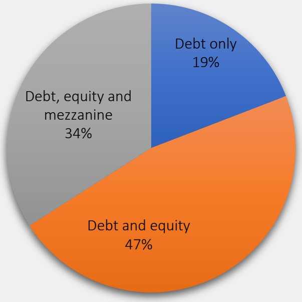
Comparison of sectors

Most deals have been made in the financial services sector, but only **2% of Impact businesses are looking to fundraise are within this sector**. Agri – and Aquaculture, Tourism and Tech are sectors where there is a bigger share of businesses' demanding impact capital than the percentage of historical deals.

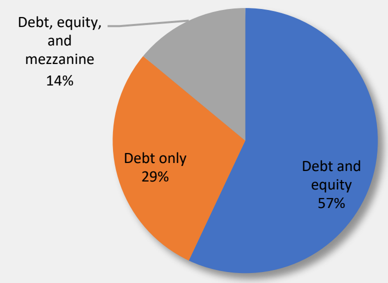
*This excludes utility scale renewable energy projects

Comparison of Financing instruments

Supply



This is similar for impact investors, who prefer to use a mix of debt and equity but are less willing to offer debt only. Most impact investors prefer to provide growth capital over seed or startup capital, but half of all businesses interviewed have had seed investments. More business demand debt compared to what investors offer.



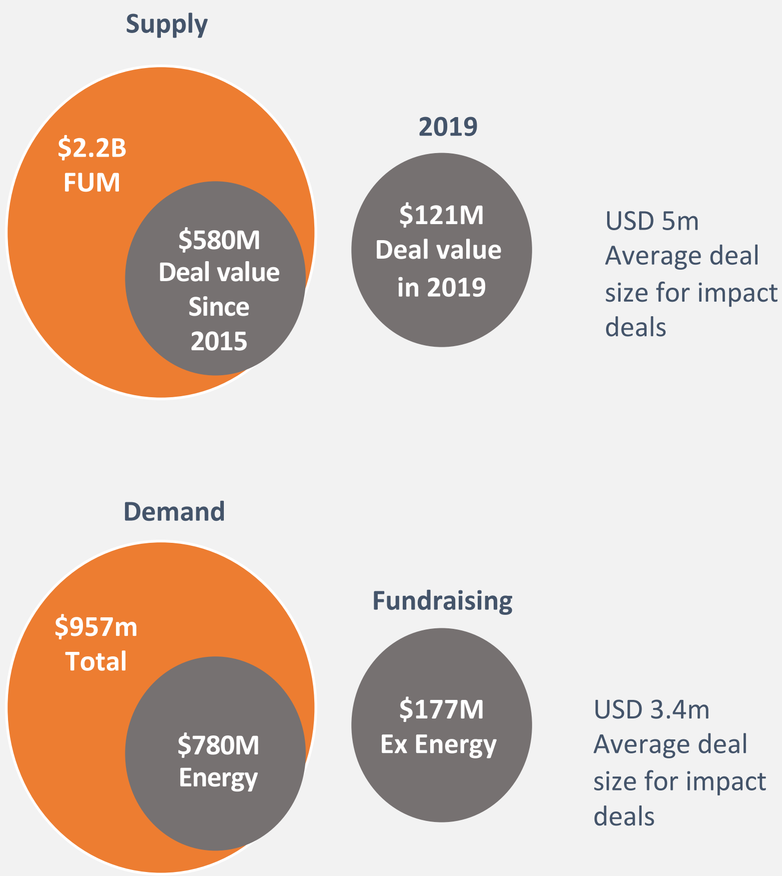
Demand

SDG comparison

29%, contribute to SDG 1; No poverty, SDG 8; Decent work and Economic growth and SDG 9; Industry innovation and infrastructure. The same percentage of investors focus on these SDGs with the majority targeting SDG 8. As shown, some industries have a significant gap in the SDG focus between investors and businesses. Increasing the amount of businesses within Manufacturing, Agriculture, Agro-processing and Renewable Energy could then help attract more impact capital.

Conclusions

Supply & demand sizing



Overall takeaway from study

- A **supply - demand gap** exists between the investment size and impact sectors
- A paradox exist whereby local impact investors have a strong pipeline but **limited capital available** for investments
- There is currently **no specific regulation** for impact capital but a few pro-impact policies supporting the ecosystem
- A small handful of **enablers** are actively promoting impact investments
- Zambia needs to increase the level of investments to impact sectors **five fold to USD 5 bn per year** in order to achieve the SDGs by 2030
- The supply-demand gap could be bridged **by lobbying for Zambian pension funds** to make impact investments directly and indirectly through local impact funds
- **Alignment of the ZDA priority sectors with globally defined impact sectors** would facilitate a better match between supply and demand
- **A business angle network** could be established to promote local HNWIs carryout impact investments
- New intermediaries such as **social banks or crowdfunding platforms** could be introduced to the Zambian ecosystem through new regulation
- **An opportunity exist** for donor agencies and other enablers to supplement the existing work done on impact sectors and to support implementation of the recommendations of this study.