EIF Enhanced Integrated Framework
Trade for LDC development

Impact Investment

BACKGROUND AND PURPOSE:

There is a growing consensus that public finances won't be enough to help least developed countries (LDCs) recover from COVID-19. The pandemic is straining Official Development Assistance (ODA) and raising the transaction costs of international trade for LDCs due to supply chain disruptions and troubles in accessing trade finance.[1] Small and medium enterprises in LDCs that have had to rely on small amounts of funding from their savings, credit or loans from friends and family for their day-to-day operations are among the hardest hit by these global challenges.

The Enhanced Integrated Framework's Trade Funding Insights series is highlighting innovative financing opportunities for trade in LDCs, in order to help LDCs to take advantage of these opportunities. In this Insight, we explore how impact investment can support trade and help LDCs recover from COVID-19.

WHAT IS IMPACT INVESTMENT?

Impact investments are investments that are made with the intention to generate positive social and environmental impact, as well as a financial return.[2]

Impact investors can be commercial banks, individual investors, entrepreneurs, non-profits, foundations, governments, corporations, development finance institutions and institutional clients like pension funds and insurance companies. Impact investment firms may manage funds from a number of these types of investors.

Impact investments can be made in the form of cash, equity, loans and fixed income. Impact investors also usually commit to measuring and reporting on the social and environmental performance and progress of their investments.

HOW CAN IMPACT INVESTMENT SUPPORT TRADE?

Impact investment plays an important role in providing financing to cooperatives and businesses that are considered to be too large for microfinance but too small for commercial bank support.

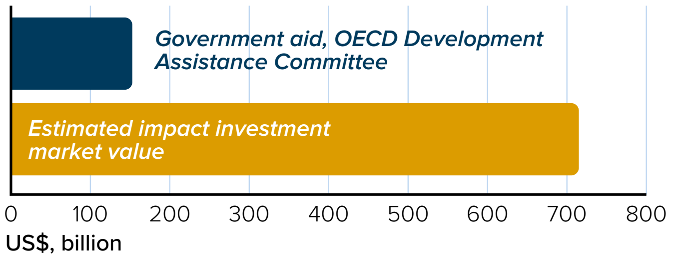
Some ways that impact investments can support trade include:

- Enabling small and medium enterprises and smallholder farmer cooperatives to secure access to national, regional and global markets;
- Overcoming bottlenecks in value chains;
- Enhancing certification, traceability, local transformation;
- Promoting the diversification of production;
- Transitioning producers from creating only low-value raw products to higher value processed products for export; and
- Providing supply chain finance and the offer of other financial services to support operations and growth in value chains.

Impact investors also often provide advisory support to investees to build their capacity to conduct business.

HOW MUCH IMPACT INVESTMENT DO LDCS CURRENTLY RECEIVE?

A 2020 survey of the world's leading impact investors estimates the impact investment market at US$715 billion.[3] This means impact investment is nearly five times larger than government aid from the OECD Development Assistance Committee (US$152.8 billion in 2019)[4].



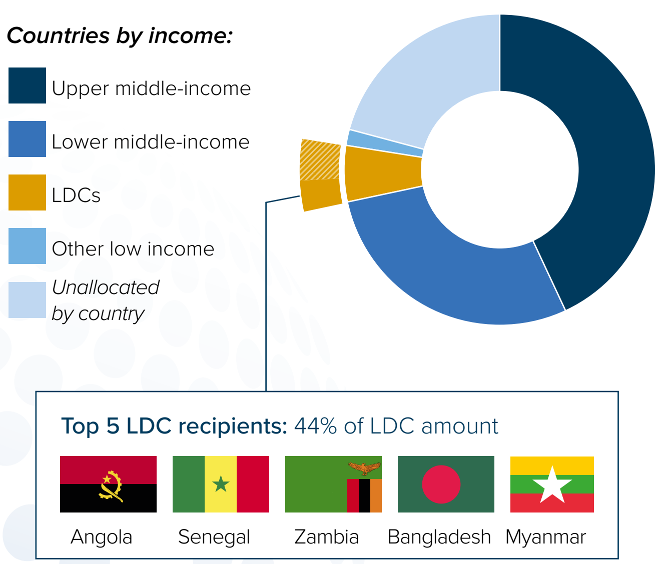
The survey also found that most capital (59%) is allocated to 'emerging markets', with sub-Saharan Africa attracting nearly a quarter (21%) of capital. The sectors receiving the most impact investment are energy, banking and financial sectors. However, there does not seem to be further breakdowns of the amount of impact investment received by LDCs.

Looking at private sector finance more broadly, between 2012 and 2018, investments made by governments through official development assistance (ODA) encouraged the private sector to invest US$13.4 billion in LDCs.[5] This is also known as blended finance - when a government or philanthropic institution makes an initial investment to get a project off the ground, even if that means accepting larger risks or lower returns. It can make the project more attractive to private investors who seek higher financial returns but require lower risk.

However, only 6% of this blended finance (US$9.3 billion) benefitted LDCs. And of the LDCs that did benefit, 44% of the financing went to just five LDCs.[5]

The average size of a blended finance deal in LDCs is US$6.1 million, which is significantly less than average deals in lower middle-income countries ($27 million) and upper middle-income countries ($60 million).[5]

Private finance mobilised for development[5]



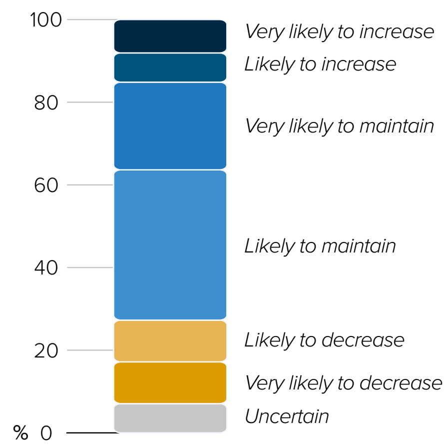
HOW MIGHT COVID-19 AFFECT IMPACT INVESTMENT?

A survey of the world's leading impact investors in early 2020 showed that most respondents (57%) indicated that they are 'unlikely' to change the volume of capital they had planned to commit to impact investments in 2020.[3]

In fact, 15% of respondents said they would 'likely' commit more capital in 2020 than they had originally planned. Investors seem to be mitigating financial risks from COVID-19 by renegotiating loan terms with their investees, investing more to support their investments, and being patient to see if their investees would meet their performance expectations over the longer term.

63% of respondents also said that COVID-19 is 'unlikely' to change their impact investment objectives over the next five years.

Expected changes to 2020 planned investment activity as a result of COVID-19[3]



WHAT CHALLENGES DO IMPACT INVESTORS FACE WHEN INVESTING IN LDCS?

Often, impact investment is too small, too silo-ed, or perceived as too risky to attract large sums of money.

Other challenges investors face are:

- High transactional costs (relative to deal size);
- Perceptions of high risk;
- Low financial returns;
- Costly and time-consuming project preparation;
- Untested business models;
- Information, data, infrastructure and capacity gaps; and
- Challenges 'doing business' e.g. contract enforcement, property registration, opening a business, etc.

HOW CAN LDCS ATTRACT MORE IMPACT INVESTMENT IN TRADE?

There are many ways in which governments and businesses can encourage more impact investment in trade.

For LDC authorities in charge of/supporting trade efforts:

- Build the banking sector's capability to provide loans to formal SMEs;
- Establish regulations that encourage investment and innovation as well as protect consumers, especially those who are vulnerable;
- Promote and protect fair and strong competition;
- Ensure political stability and access to robust infrastructure; and
- Build relationships with impact investors by engaging with national investment promotion agencies.

For LDC businesses:

- Contact impact investors. Search impact investment databases such as impactspace.com to find impact investors that may be interested in investing in your business.

For government investors through ODA, federal ministries or development finance institutions:

- Support LDC governments to pursue blended finance opportunities. Investors need more blended finance vehicles that are specifically designed to support small and medium enterprises in key sectors in LDCs. Setting up well-designed blended finance vehicles to enable large investment opportunities for private investors but small investments in SMEs is key. This also involves supporting LDC governments to pursue the opportunities brought by these vehicles;
- Maintain or increase development finance to LDCs. It is important to ensure that a growing use of blended finance does not lead to a decline of development finance to those LDCs where blending is difficult; and
- Ensure financing alignment. With LDC national priorities and with broader SDG financing strategies.[5]

READ MORE

1. World Economic Forum (2020). COVID-19 is exacerbating the global trade finance gap https://bit.ly/36sWyq5
2. Global Impact Investment Network: What is impact investing? https://thegiin.org/impact-investing/
3. Global Impact Investment Network (2020). Annual impact investor survey https://bit.ly/3kfyStT
4. OECD (2019). Official Development Assistance (ODA) https://bit.ly/32xywsG
5. OECD & UNCDF (2019). Blended Finance in the Least Developed Countries https://bit.ly/2GNbDK2

WHICH IMPACT INVESTORS CURRENTLY INVEST IN TRADE IN LDCS?

There are many different types of impact investors pursuing a variety of objectives and targets across many sectors and countries. Here are some that invest in trade in LDCs.

BAMBOO CAPITAL PARTNERS

Bamboo Capital Partners invests in emerging markets mainly in four sectors – financial inclusion, access to clean energy, access to healthcare and agribusiness. They are also spearheading a blended finance initiative called SDG500 that will provide US$500 million in impact investment to finance small and medium enterprises in developing countries, including LDCs, taking them from "too small and too risky" to commercial viability and bankability. It will also support agribusiness value chains and companies that generate positive impact for women as employees, customers or suppliers.

responsAbility

responsAbility invests in unlisted companies in emerging and developing economies in three main sectors – sustainable food, climate finance and financial inclusion - like microfinance institutions which provide credit and other banking services to micro, small and medium-sized enterprises who have previously had limited access to formal financial services. It manages US$3.5 billion in assets and as invested US$10 billion since inception.

BlueOrchard
Impact Investment Managers

BlueOrchard was founded in 2001, by initiative of the UN, as the first commercial manager of microfinance debt investments worldwide. TO date it has invested over US$7 billion across more than 80 countries and helped 211 million people with low income in emerging and frontier markets receive access to financial and related services.

Find more impact investors by searching the ImpactSpace database: impactspace.com

We can help

The Enhanced Integrated Framework can help connect LDCs with impact investment opportunities in trade.

Contact *EIFpartnerships@wto.org*

EIF's briefs offer an overview of key trade-related issues and up-to-date analysis based on the programme's work with the world's least developed countries, and offer expertise on essential matters related to local, national, regional and global trade.

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The Enhanced Integrated Framework brings together partners and resources to support the Least Developed Countries in using trade for poverty reduction, inclusive growth and sustainable development.

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EIF Partner Agencies

International Monetary Fund (IMF)

International Trade Centre (ITC)

United Nations Conference on Trade and Development (UNCTAD)

United Nations Development Programme (UNDP)

World Bank Group (WB)

World Trade Organization (WTO)

United Nations Industrial Development Organization (UNIDO)

World Tourism Organization (UNWTO)

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