

New Partnership for Sustainable Impact Investing in Frontier Markets (INFRONT)

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Organisation: Global Affairs Canada

Country: Canada

Level of government: Central government

Sector: Economic affairs

Type: Partnerships

Launched in: 2013

Link to the innovation's website

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Description

INFRONT is a pilot blended finance initiative funded by Canadian ODA. Blended finance generally understood as a framework that initiates the blending of public and private capital to finance development goals, increase the effects of international development investments and achieve both sustainable results and financial returns. INFRONT works to expand the ability of SMEs to access investment capital, adopt enlightened business practices, and accurately measure social impact. The initiative has two components: \$15M serves as a first-loss guarantee to crowd in private capital in the Sarona Frontier Markets Fund II; \$4.75M for technical assistance implemented by MEDA to support SMEs and local fund managers to improve the sustainability of their operations, with a focus on environmental, social and governance policies and practices. As part of this second component, MEDA established the Evaluation Learning Advisory Group to contribute to the knowledge and practice of impact investing.

Why the innovation was developed

- Small and medium-enterprises (SMEs) are an important engine for economic growth and poverty reduction in emerging markets, where formal SMEs contribute up to 45 percent of total employment and up to 33 percent of national income.
 - The poverty reduction potential of SMEs is constrained by their limited access to finance in the form of an estimated financing gap of USD 1.2 trillion for formal SMEs worldwide.
 - Private investment capital to SMEs in frontier and emerging markets is constrained in part by a limited understanding of investment climate and the perceived risk.
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Objectives

Improve access, Support economic growth

- Helping to reduce poverty; piloting a blended-finance model; improved environmental, social and governance policies and practices of SMEs.
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Main beneficiaries

Businesses

Results

Other improvements

- It is still early to assess the development impact. Initial progress includes:
- SFMF 2 LP closed at USD 150 million in December 2014.
- As of March 2016, USD 58 mm was invested 63 SMEs in emerging markets in Latin America, Africa, Asia and Eastern Europe.
- As of May 2016, 4,608 full time high quality jobs have been created, of which 1,158 jobs were created for women.
- As of May 2016, a total of CAD 250 mm was paid in taxes by 58 companies in SFMF 2 LP.
- Additionally, there is emerging evidence that INFRONT's focused on environment, social and governance issues has encouraged funds and portfolio companies to increase their commitment to these areas.

Development

Design

SFMF1 launched in 2010 as a proof-of-concept. After the first fund's experience, SFMF2 launched in 2013 to refine and scale the fund of funds approach. In early 2012, Sarona began developing SFMF2 with a target capitalization of USD 250M. Given its staff capacity and experience, Sarona undertook all fund design and fundraising internally. To augment initial funding from private investors, Sarona responded to a call for proposals for impact investment funds from the U.S. OPIC., which selected Sarona. While in discussions with OPIC, SFMF2 continued to raise capital from private investors. However, fundraising was difficult and slow as many private investors demanded a higher risk-adjusted return than SFMF2 could offer. Because of this obstacle, as well as existing relationships, Sarona approached the Canadian government's aid agency (now GAC), to support SFMF2. GAC provided CAD 19.75M contribution as first-loss capital and CAD 4.75M was allocated to technical assistance managed by MEDA. Design time: 1 year(s) 5 month(s)

Testing

- INFRONT is a pilot initiative, as such GAC will be commissioning an independent mid-term evaluation that will serve to generate lessons learned that can be applied to future GAC programming of a similar nature. As part of the project, Mennonite Economic Development Associates established an Evaluation and Learning Advisory Group to develop a robust monitoring and evaluation plan, building on existing Impact Reporting and Investment Standards (IRIS) to evaluate the contribution of impact investment on poverty reduction. This will be instrumental in gathering lessons learned and best practices.

Testing time: 1 year(s) 5 month(s)

Implementation

Tools used:

- GAC barrier in completing the investment was its lack of authority to accept reflows. To overcome this obstacle, MEDA established a special purpose account for reflows in which a decision on reflows will only be made at the end of the fund's life, with the expectation that GAC will have specific policies on reflows by that time.
- Capital from GAC and OPIC invigorated SFMF2's fundraising process from private investors. Specifically, the GAC first-loss capital mitigated risks for private investors by absorbing losses of principal invested in underlying funds and also improved returns; GAC does not receive proportional returns, which improves overall risk-adjusted return for LPs.

Resources used:

- n/a
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Partnerships

Multiple partners

Civil Society, Private sector

Mennonite Economic Development Associates (MEDA); Sarona Asset Management (Sarona); MaRS Centre for Impact Investing (MaRS).

MEDA manages the technical assistance component of the project. Sarona Asset Management, a private fund manager, manages the investment fund with the primary objective of supporting entrepreneurs in under-served markets develop their companies and their communities profitably and sustainably. This innovative partnership between the public sector, private sector and civil society is essential to the success of INFRONT.

Lessons Learned

Lessons Learned

- Value of GAC first loss guarantee: Sarona recently conducted a survey of its investors indicating that GAC's first-loss guarantee positively influenced their decision to contribute to the Fund. There is still little evidence, however, regarding blended finance structures and the appropriate amount of concessional capital required to catalyze private capital.
 - Blended finance approach (balance between return on investment and social impact): Practitioners in blended finance grapple with balancing social impact and profitability.
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Conditions for success

- Selection of Partner (i.e. Sarona): Blended finance involves many stakeholders with divergent values and objectives, trust among partners is critical to the overall success of the initiative.
 - Value of TA when coupled with first-loss guarantee: Coupling technical assistance with the investments added value. The TA allows us to work on the investment climate by building the capacity of businesses to improve the sustainability of their operations in high impact industries including agriculture, financial services, consumer goods, health and construction, with a focus on environmental, social and governance (ESG) policies and practices.
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Other information

In general, development organisations continue to have capacity constraints in terms of reviewing/ structuring these types of financial investments. One way to overcome this challenge is to participate in investments in which other DFIs are already involved. This could provide development organisations with the opportunity to leverage due diligence performed by DFIs prior to subscribing to potential investments.

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