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Invest for Impact Nepal

Development Finance Institutions: Investment Priorities and Procedures in Nepal

What are development finance institutions?

Development finance institutions (DFIs) are specialised banks that invest with a focus on the development agendas of emerging and frontier markets through long-term financing. DFIs provide patient and concessional capital, and operate in the intermediary space between public aid and private investment, facilitating international capital flows in regions where commercial international investment is yet to flow at scale. The prime objective of DFIs is to promote the sustainable economic development of a country by providing growth capital to key sectors, together with technical assistance (TA) in areas such as environmental, social and governance (ESG) standards. DFIs are backed either by a single national government or by multiple governments.

Which DFIs are operating in Nepal?

Key DFIs present and investing in Nepal are International Finance Corporation (IFC), Asian Development Bank (ADB), OPEC Fund, European Investment Bank (EIB), Climate Investment Funds (CIF), Korean Development Bank (South Korea), Dutch entrepreneurial development bank-FMO and the Dutch Good Growth Fund, British International Investment (BII), Swiss Investment Fund for Emerging Markets (SIFEM), SwedFund (Sweden), Development Finance Corporation (United States), KfW/DEG (Germany), FinnFund (Finland), Proparco (France), OeEB (Austria) and Asian Infrastructure Investment Bank (AIIB). Some multilateral DFIs such as IFC have been active in Nepal for over two decades, while others, especially bilateral DFIs, have entered the Nepalese market fairly recently, with BII opening a country office in 2018.

How do the DFIs invest in Nepal?

Different DFIs have different priorities for impact and growth. Some DFIs are unable to invest in sectors that are, for example, on an exclusion list. Different DFIs use different vehicles for investments. In Nepal DFIs currently invest directly in large private companies, or channel investment to small and medium-size enterprises (SMES) through financial intermediaries such as commercial banks, private equity funds or venture capital funds. As DFIs bring in foreign direct investment (FDI), they are subject to Nepal's FDI laws and regulations, chiefly governing the minimum permitted threshold and the negative list of sectors in which investment is prohibited.

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Why do DFIs invest in the private sector in frontier and emerging markets?

DFIs have a mandate to invest in frontier markets such as Nepal, especially when the investment leads to significant growth for key sectors (such as energy, infrastructure or agriculture) and creates significant positive social and environmental change. This means they invest in the private sector to create employment, improve working conditions, enhance local prosperity, and generate tax revenues. To showcase the potential viability of investment, DFIs invest at scale in untested business models where the risks are perceived to be too high for private investors. Key sectors that are prioritised and have received DFI investment in Nepal include financial services, information and communication technology, and renewable energy. Through financial intermediaries such as commercial banks and private equity funds, DFIs have invested indirectly in SMEs engaged in agro-processing, tourism and e-commerce.

How do DFIs assess investment-readiness, and how do they support investment readiness?

DFIs usually make a minimum investment of US$10m (although in the past some have made direct investments in Nepal that are smaller than this). When DFIs invest in private equity funds, these funds usually have a minimum ticket size of US$500k to US$1.5m. Additionally, DFIs assess investment-readiness of an investment not only through the rate of financial return, but also by how that investment creates impact. Impact can include a range of areas, such as mitigating climate change and promoting inclusive employment, sustainable economic growth, accountability towards the environment, social inclusion, good governance, access to critical energy, education and so on. Many DFIs also operate tailored TA facilities that help investees become investment-ready (pre-investment TA), or more capable (post-investment TA). Such pre-investment TA could include support on corporate governance practices, environmental and social practices, risk management, energy efficiency gains, operations, and climate change adaptations. Pre-investment TA is delivered with the full support and commitment of the leadership of the potential investee.

What investment instruments do DFIs use?

Different DFIs use different investment instruments, depending on their mandate and investee requirements. Most DFIs use foreign-currency loans, for which hedging costs must be considered. In Nepal, some DFIs have used equity, and hold long-term stakes in a company, together with a seat on the board. Others use both secured and unsecured debt (in local and foreign currency) depending on the risk profile of the investee. DFIs have a long-term outlook, reflected in the tenors of their instruments. DFIs are also open to other innovative hybrid models increasingly seen in the Nepalese market, based on the needs of the potential investee.

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Why work with DFIs?

DFIs are able to invest in markets and ventures that are deemed highly risky by commercial banks. They can also invest at significant scale (US$100m+). They have the risk appetite for piloting new technologies, opening up new markets and scaling up proven solutions, and can inject finance that reduces risks for investors.

DFIs source their capital from national or international development funds, or benefit from government guarantees. This ensures their creditworthiness, which enables them to raise large amounts of money on international capital markets and provide financing on very competitive terms while ensuring minimal market distortion. DFI investments are often large and long-term. DFIs have the ability to mobilise significant financial resources for large-scale investments that are not met by commercial banks. They can also support a company's capital structure and credibility, which allows the investee to bring on board follow-on financing at favourable terms.

In addition to financing, they also bring with them a range of capacity-building technical support to help companies meet national and international regulatory and compliance requirements. Backed by international practices and experiences, they also support the private sector (including banks and the financial sector) with sound risk management tools to help mitigate environmental and social risks and improve corporate governance while also achieving viable financial returns. A DFI investment does not just bring access to capital, but also access to knowledge, which further adds value.

Are there preconditions for DFI engagement?

Compliance with all applicable national and local laws is the basic standard that DFIs require for any investment that is not on an exclusion list. Additionally, DFIs place a high priority on corporate governance and business integrity; they assess all holding and subsidiary companies in order to rule out any involvement in corruption, money laundering or economic sanctions, and evaluate other accountability practices (such as whistleblowing) before making investment decisions. In addition, DFIs screen financial institutions or companies on environmental, social and governance (ESG) criteria for investments. This does not mean that companies or financial institutions that do not meet the criteria do not receive investment. Often, DFIs will institute an action plan post-investment, sometimes together with disbursement triggers, to mandate ESG actions for the investee. Where possible, DFIs also seek to combine TA support with the investment, if a strong case can be made for it. Finally, DFIs seek strong commitments from the leadership and management team of the investee, due to the long-term nature of their potential engagement.

Responsible Business Practice: ESG

Environment	Social	Governance
Resource efficiency	Involuntary resettlement and land acquisition	Governance of stakeholder engagment
Pollution prevention	Cultural heritage	Transparent and accurate accounting methods
Sustainable management of natural resources	Protection of indigenous populations' rights	Treatment of minority shareholders
Biodiversity conservation	Labour and working conditions	Structure and functioning of the Board of Directors

Priorities for Investment

Value Proposition

- Product / Service
- Market Demand / Growth Potential
- Commercial Viability

Business & Financial Management

- Financial Management
- Business Planning

Management Team

- Organisation Structure and Growth Target
- Strong Management Team
- Track Record
- Technical Expertise

Responsible Business Practice

- Business Integrity
- Environmental & Social Impact
- Corporate Governance

How can I learn more and where can I contact DFIs active in Nepal?

Some DFIs (such as IFC, ADB and BII) have country offices in Nepal, while others cover Nepal from regional and international hubs. Invest for Impact Nepal can be contacted for further information.

Contact:

Invest for Impact Nepal

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