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República
Thursday, February 9, 2012

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Foreign Direct Investment (FDI) can bring great advantage to the host country. It fuels economic growth, helps reduce poverty, creates employment opportunities and assists building of physical infrastructures. With the same intention, the government has decided to observe 2012-2013 as Nepal Investment Year and setup Nepal Investment Board (NIB) to spur and facilitate foreign investments in the country.

To attract foreign investment, NIB is launching promotional events like road shows in countries like India, UK and the US. NIB is targeting foreign firms that have the resources to invest in mega projects in sectors like energy, tourism, infrastructure development and commercial agriculture. Dr. Baburam Bhattarai-led cabinet has also passed Investment Board Act, which facilitates investments above Rs. 25 billion through single window policy. A population of 28 million, rising per capita income (mainly due to remittance), demographic dividend, underexplored natural resource, and Non Residential Nepalis' global network provides enormous market size and opportunities for investors in Nepal.

Having said that, the government and other enthusiasts needs to recognize that simply declaring 2012-2013 as Investment year won't be enough to attract foreign investment. Capital inflow in a particular country depends on domestic and international macroeconomic situation and investment climate. For a traditional foreign investor the risk in Nepal is very high. According to the World Bank established international sovereign rating standard, Nepal is rated CCC+. With this rating, Nepal is boxed under "High Default risk" category.

Additionally, due to perpetual "in-house" hurdles like militant labor, extortion, local opposition, arbitrary government policies, red tape, corruption, and bandas, Nepal's foreign private capital attracting capability is also undeveloped and fragile. In 2010, Nepal attracted the least amount of private commercial capital in the South Asian region. According to the World Investment Report 2011, Nepal was ranked 134 out of 141 countries in the Inward FDI Performance Index. Despite the potential market opportunity in Nepal, traditional large scale investors will continue to be reluctant to invest until issues like high investment risk and cost of capital are addressed.

While the government should continue scouting for large scale investors through Nepal Investment Board, it should also create appropriate environment to lure in a small but a growing breed of financers called Impact Investors. These investors are willing to take investment risk in developing countries like Nepal and understand the market dynamics of low income countries to reduce the cost of capital through innovative financial products. The capital they deploy intends to create (beyond financial returns) positive social and environmental impact.

These investors believe in building entrepreneurial culture and invest in small businesses that use market-based approaches to provide scalable solutions to socio-economic problems. Investments are generally made in sectors that serve the people at the base of the economic pyramid (those earning less than US

$3,000 per annum). Impact investors target sectors like affordable education, healthcare, renewable energy, access to finance and sustainable agriculture. While government or charity solutions will sometimes provide these products or services, impact investment can complement government and philanthropic capital to reach more people.

In recent year a board range of organizations has shown interest in adopting impact investing model in developing countries. The list includes but is not limited to investment banks, sovereign wealth funds, and endowments, philanthropic foundations and international development organizations. Traditionally, inflow of foreign capital (not including remittance) in developing countries like Nepal has taken place in the form of investment designed to maximize financial returns, with no consideration of its social impacts. Likewise, foreign aid is structured to maximize social returns, with no expectation of monetary returns. Impact investing provides a platform to blend capital from both foreign aid and foreign investments to support entrepreneurship culture in developing world. The impact investor operates in the missing middle and fills the capital gap above micro-financing and below institutional financing. They structure their investment vehicles (like venture capital/private equity fund and investments in businesses) in the form of equity, quasi-equity and debt. Some of the investors are also willing to accept below-market financial returns in order to maximize social and environmental returns.

To the best of my knowledge, there is no impact investing funds currently operating exclusively in Nepal. However, there are few initiatives in the pipeline. One of them is Ventures Nepal, one of the funds in the International Financial Corporation's (IFC) SME Ventures program, which will provide risk capital financing and complementary advisory services to small businesses in Nepal. With the fund size of US $10 million, Venture Nepal aims to make risk capital investments of up to US $500,000 in small and medium enterprises (SMEs).

Another is Dolma Development Fund (DDF), structured as a non-profit domiciled in United Kingdom, which is currently raising US $10 million for investment in SMEs in Nepal. DDF plans to deploy the money over a period of 3-5 years with a focus on target sectors like rural connectivity (internet/mobile), healthcare, affordable private education, clean drinking water, eco-tourism and off-grid renewable.

Small businesses are the backbone of any developing economy. Not only do small businesses/startups help job creation and poverty reduction they also bring wealth of replicable innovations to market. Attracting more impact investors in the Nepal means more startups will have access to capital. The scope of impact investing extends beyond meeting capital shortage though; it also includes establishing infrastructure and overlaying networks of intermediaries, institutions and investors.

Thus, one of the top priorities of NIB should be to put in place regulatory incentives and safeguards to attract impact investors. This will help build entrepreneurial culture and provide capital for sustainable growth and job creation. In the short run, it is the small-size foreign investments that will build appropriate FDI friendly environment in Nepal before the country can attract large scale commercial capital.

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