THE LANDSCAPE FOR IMPACT INVESTING IN EAST AFRICA
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<th>Acronym</th>
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<tr>
<td>AFD</td>
<td>Agence Française de Développement (French Development Agency)</td>
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<td>BoP</td>
<td>Base of the Pyramid</td>
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<td>Mature business</td>
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<td>Venture-stage business</td>
<td>Sales have begun but cannot sustain the company’s operations. The business model is still being aligned with the realities on the ground</td>
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DJIBOUTI
CAPITALIZING ON A STRATEGIC LOCATION
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INTRODUCTION

With a population of less than a million people and an approximate area of 23,000 km², Djibouti is the smallest country in East Africa by both population and size. The country has few natural resources or available land but is in a prime strategic location on the maritime crossroads of Africa, Europe, Asia, and the Middle East (Figure 1). As a result, the economy is primarily service-based and focused on income from port services and foreign military bases.

FIGURE 1: MAP OF DJIBOUTI

Given its limited natural resources, the Djiboutian government understands the importance of foreign investment in driving economic development. In recent years, the government has worked to improve Djibouti’s business and regulatory environment in an effort to attract investment. The government has also started major projects in a USD 6 billion investment to expand infrastructure and enhance electricity and water access, further enabling private sector development.

Djibouti suffers from high unemployment and poverty rates, and a more robust private sector could offer opportunities for wealth and job creation. However, businesses are constrained by a conservative financial sector that does not provide sufficient capital, a gap impact investors could help fill. Despite the demand for capital and the improving business environment, only USD 18 million in impact capital has been disbursed in Djibouti to date and this has been entirely by DFIs.¹ Impact investors face a number of challenges in investing in Djibouti, including a cumbersome bureaucracy, corruption, a weak legal system, unfavorable labor laws, and high costs for basic inputs such as water and power.

¹ Due to the unique nature and large size of development finance institutions (DFIs), the authors of this report analyzed their activity separately from those of other types of impact investors (“non-DFI”), and present this separate analysis when appropriate. See the Introduction and Methodology section of this report for more details.
Country Context

Djibouti, originally referred to as French Somaliland, gained independence from France in 1977. It has a population of approximately 860,000, with nearly 80% residing in urban areas. Djibouti is inhabited by two major ethnic groups: the Issaa (60% of the population) and the Afars (35%). Though Djibouti experienced some internal conflict in its initial post-independence years, it has maintained relative stability over the past decade despite conflict in neighboring countries.

Hassan Gouled Aptidon was Djibouti’s first president in 1977. He led an Issa-dominated government under a one-party system. Discontent with this system led to civil war between Aptidon’s regime and Afar rebels in 1992. Two peace treaties were eventually signed in 1994 and 2000, leading to the country’s first multiparty elections. Ismael Omar Guelleh won the elections and has served as president of Djibouti since. After amending the constitution to allow presidents to serve three terms, Guelleh was re-elected for a third term in 2011.

Djibouti is primarily a service-based economy dependent on foreign military bases and port services. The country has capitalized on its strategic position as the deepest port in one of the world’s busiest trade routes. Djibouti is also the main import-export route serving landlocked Ethiopia, which is its largest trade partner and accounts for 70% of port activity.

Because of its strategic position on the Gulf of Aden, Djibouti is also a key location for many foreign militaries. It hosts US, French, and Japanese military bases and the European anti-piracy force, Operation Atalanta.

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Gross Domestic Product

Djibouti’s GDP has grown steadily over the past decade, increasing at an average annual rate of 6% to approximately USD 2.5 billion (PPP) in 2013 (Figure 2). This growth has been driven by foreign direct investment (FDI) and port activity. FDI reached a record USD 286 million in 2013, accounting for 11.4% of GDP. Some examples of FDI in Djibouti include China Merchants Holdings International’s acquisition of a 23.5% stake in the recently privatized Port of Djibouti (PAID) and continuing infrastructure investment.

![FIGURE 2: GDP (PPP), 2004–2013](image)

Source: IMF World Bank Economic Indicators, April 2014

With the implementation of new investment programs and infrastructure projects, such as a new Djibouti-Addis railway expected to be completed in mid-2015, the government’s recurrent expenditure is set to increase. Infrastructure projects such as the railway require heavy borrowing by the Djiboutian government, leading to an increase in the budget deficit, which has been relatively stable at 2% of GDP. However, the expense has been justified with the projected increase in tax revenues and boost to the service sector that the railway project is expected to bring.

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9 Ibid.
10 Ibid.
Foreign Direct Investment

The marked increase in FDI into Djibouti since 2010 (Figure 3) is largely attributable to China. Other than China, major sources of FDI in Djibouti include Yemen, Ethiopia, the U.S., and France. Much of Djibouti’s FDI has been used to develop port and shipping infrastructure. This includes USD 80 million received since 2012 from the Saudi Fund for Development and the Arab Fund for Social and Economic Development for the expansion of the port of Doraleh and construction of a facility in Tadjaurah designed to ship potash from Ethiopia. Similarly, Djibouti secured USD 64 million from the China Export Import Bank in 2012 to construct a port that will facilitate salt and gypsum exports. There are also plans to build an oil refinery and pipeline from South Sudan that have attracted interest from Brazilian and Russian investors.

FIGURE 3: FDI FLOWS, 2004–2013

Increasing foreign investment is a key priority of the Government of Djibouti. To improve the investment landscape, the government instituted a new commercial code in 2012 and established free trade zones, which stimulate economic growth by offering office space, light industry units, and tax incentives to investors. There are currently 160 businesses from 39 different countries operating in the free trade zone. Djibouti also opened the DAM commercial zone in the southern region in 2013 and plans to open two more free trade zones, the Khor Ambado Free Zone and Jabanas Free Zone, in the coming years.

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Inflation and Exchange Rates

Inflation in Djibouti depends primarily on its two main imports: food and oil.\textsuperscript{14} The country has, however, maintained a low inflation rate generally ranging from 3-5%, aside from a spike to 12% in 2008 due to a surge in food and fuel prices that drove up inflation across East Africa (Figure 4). Given that Djibouti imports almost 97% of its food, the rising food prices between 2005 and 2008 are estimated to have contributed to an increase in extreme poverty from 40% to 54%.\textsuperscript{15} Djibouti is still vulnerable to such fluctuations, as the country has made very little investment in agriculture to secure its food supply.

\textbf{FIGURE 4: INFLATION IN DJIBOUTI, 2004 - 2013}

\begin{center}
\includegraphics{inflation_djibouti.png}
\end{center}

Source: World Bank

Djibouti’s currency, the Djibouti Franc, has been pegged to the US dollar since 1973, and no change in policy is expected in the short- to medium-term.\textsuperscript{16} The government maintains parity by holding 105% coverage of foreign exchange against currency in circulation.\textsuperscript{17}

\begin{itemize}
\item \textsuperscript{17} Ibid.
\end{itemize}
SUPPLY OF IMPACT CAPITAL

This study was unable to find evidence of any non-DFI impact investment in Djibouti in recent years. Although there has been a recent increase of foreign investment in logistics and infrastructure projects, this has not translated to corresponding growth in impact investment.

Broader Investing Landscape

The Djiboutian government is well aware that foreign investment is a key driver of economic development in the country and continues to make conscious efforts to improve Djibouti’s business environment, thereby increasing foreign investment. Djibouti’s efforts to attract investors include revisions of its regulations, creation of Free Trade Zones, adoption of a new commercial code, and increased investment in infrastructure. Djibouti also offers significant incentives to private sector individuals and corporate investors. For example, investments greater than USD 280,000 that create permanent jobs are exempted from registration and license fees, property taxes, and taxes on profits.18

These efforts have made it easier to conduct business in Djibouti, leading to a substantial improvement in the World Bank’s Ease of Doing Business ranking, from 171st out of 189 countries in 2013 to 154th in 2014.19

The government has primarily concentrated on expanding Djibouti’s services sector to further capitalize on the country’s access to Africa, Europe, Asia, and the Middle East by positioning Djibouti as a transit hub for neighboring, landlocked countries.20 Government investments have sought to increase the country’s trade profile and serve as a regional hub for trade, handling, and financial services.

The government created a new USD 6 billion investment program with a particular focus on infrastructure. The program is predominantly funded by Chinese investors and the international aid community, with the goal of expanding infrastructure and enhancing access to electricity and water. Projects in the program include the previously mentioned ports as well as the Djibouti-Addis Ababa railway line, an aqueduct to transport water from Ethiopia, a desalination plant, an electricity line from Ethiopia, and a geo-thermal power station.22 It is expected that the investment program will catalyze growth in private sector investment in the near future.

22 Ibid.
Although the majority of investment has been in large, commercial enterprises, the government has begun to support small and medium enterprise (SME) development through Djibouti’s Economic Development Fund. This USD 3 million fund was started specifically to provide financial support to SMEs with the overall goal of fighting unemployment, reducing poverty, and boosting economic growth. The fund offers affordable loans, primarily targeting agriculture, services, tourism, transportation, and logistics.

In recent years, interest rates in Djibouti have fluctuated between 9% and 12%. The entry of eight new banks between 2006 and 2012 increased competition and reduced interest rates, which are low compared to those in other East African countries, though still quite high relative to rates found in more developed economies. As of 2013, unsecured loans were offered at a 12% interest rate, while overdrafts and housing loans received rates of 15% and 10% respectively.

Impact Capital Disbursed

Excluding DFIs, no known impact capital has been disbursed in Djibouti. Despite the lack of deals in the country, at least 45 impact capital vehicles operating regionally include Djibouti in their investment mandates, though none of these are exclusively dedicated to Djibouti. As a result, there is approximately USD 522 million in available capital committed that could be invested in Djiboutian businesses, but it remains unlikely that Djibouti will capture a significant portion of that capital.

DFI activity has also been minimal in the country, with disbursement of about USD 18 million across two projects in Djibouti. With an improving business environment, and increased focus by the government on SME development, both the pipeline of viable investment opportunities and the interest of impact investors are expected to increase in the coming years.

24 No data is available on interest rates for these loans.
DEMAND AND NEED FOR IMPACT INVESTING CAPITAL

Although there is currently very limited impact investment activity in Djibouti, high poverty rates, the underdevelopment of key sectors like agriculture, health, and education, and insufficient access to finance indicate that there is need for impact capital and nascent opportunities for investment.

Development Context

Despite economic growth and foreign investment over the past decade, economic gains have been highly concentrated in the hands of a few while overall poverty levels have risen. More than 40% of the population lives in extreme poverty. This problem is even greater in rural areas, where nearly 97% of the population lives in poverty.

Though Djibouti has made recent investments in basic services, like health and education, it still performs poorly on human development indicators, ranking 164th out of 187 countries on the UN’s Human Development Index in 2013.

The Djiboutian government’s recent investments in health include programs to support maternal and child health, including drug availability and medical service provider trainings, as well as improvements in general delivery of health services. Indeed, Djibouti has a stunting ratio only slightly below the global average and nearly 25% better than the East Africa average. Despite these efforts, Djibouti’s under-5 mortality rate of 81 deaths per 1,000 live births and infant mortality rates remain among the highest in the region (Figure 5, following page) while its general health indicators remain amongst the worst in the world.

Djibouti has made some progress in improving its education system, and thus expanding its available workforce. The country has raised primary enrollment levels from 53% in 2002 to 83% in 2012. It has also managed to achieve approximate gender parity in primary school enrollment with female enrollment rising to 81% against male enrollment of 85% in 2012.

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Nevertheless, the quality of education in Djibouti is still relatively poor, with overcrowded classrooms and high teacher absenteeism. Most youth in Djibouti are not receiving a full education; only 44% of eligible students are enrolled in secondary school—well below the global average of 74% (Figure 6), although marginally above the 43% average across sub-Saharan Africa.

**Figure 5: Under-5 Mortality and Stunting (Latest Available Data Point)**

- **Under-5 Deaths per 1,000 Births**
  - DJIBOUTI: 90
  - Global Averages: 20%

- **Population Stunted**
  - Global Averages: 40%
  - DJIBOUTI: 0%

Source: UN Human Development Report 2014

**Figure 6: Secondary School Gross Enrollment**

- **Global Average**
- **DJIBOUTI**: 80%

Source: UN Human Development Report 2014
A vibrant education system is particularly important in a country with Djibouti’s demographics. Djibouti has a very youthful population; only an estimated 3% of the population is older than 65 while 55% of the population is younger than 25 (Figure 7).31

![Figure 7: Population by Age and Gender, 2010](image)

Source: UN ESA, World Population Prospects

Djibouti is unable to provide employment opportunities for its large youth population. Unemployment rates for those younger than 30 are estimated to be as high as 70%, 32 which is nearly 50% higher than the 2012 estimate of 48% unemployment for the general population.33

Unemployment stems from several factors, such as inadequate levels of economic activity, an under-qualified human capital pool, high immigration, and ineffective stabilization policies.34 Further, the unemployment trend is forecasted to continue as the population increases. With a growing young population, the pace of job

33 Ibid.
creation will need to double in order to begin to decrease unemployment levels in the country.\textsuperscript{35}

The Port of Djibouti, the US Naval Base, and the public sector are the primary employers for most households.\textsuperscript{36} The government is the largest single employer, employing more than 44\% of those working in the formal sector.\textsuperscript{37} As a result, wages comprise approximately a third of the government’s annual budget.\textsuperscript{38} Nevertheless, as many as a third of households subsist on informal trade and casual labor.\textsuperscript{39}

**Entrepreneurs**

The concept of impact investing is relatively unknown to Djiboutian entrepreneurs. However, access to capital in the country remains low and private sector businesses, particularly SMEs, are increasingly looking to alternate sources of capital to fund growth. However, private sector development is currently hindered by a number of factors, including limited access to finance, high infrastructure costs, high labor costs, and a lack of skilled human capital.

Accessing financing is difficult in Djibouti—in the World Bank’s Ease of Doing Business rankings, the nation ranks 180\textsuperscript{th} of 186 countries for “Obtaining Credit.”\textsuperscript{40} As recently as 2012, a mere 12\% of the population had access to banking services.\textsuperscript{41} Similarly, Djibouti’s SMEs have limited access to bank financing, and those that do have access struggle to meet bank requirements. Djiboutian banks are highly risk averse, and typically lend only to well-established businesses who can meet high collateral requirements.\textsuperscript{42} As a result, the country has a low rate of non-performing loans (~6\%), but banks are unwilling to finance start-ups or early-stage ventures; SMEs receive only about 5\% of capital allocated to enterprises.\textsuperscript{43}


\textsuperscript{39} USAID, *Djibouti Livelihood Profiles October 2004*.

\textsuperscript{40} World Bank Group, *Ease of Doing Business in Djibouti*, available at http://www.doingbusiness.org/data/exploreworld/
data/exploreworld/djibouti/.


\textsuperscript{44} Ibid.
Djibouti’s microfinance sector has grown in recent years, increasing access to credit for the population typically excluded from the mainstream banking system. However, MFIs’ reach is limited where only 4% of the population currently benefits from microcredit.

Infrastructure access and cost is another major constraint for Djiboutian businesses. The cost of electricity in Djibouti is among the highest in the world, despite poor quality and availability—costing an average of USD 0.20 per kWh, compared to a regional average of USD 0.07 per kWh. In an effort to reduce the cost of electricity, Djibouti connected to Ethiopia’s electricity grid in 2011. This reduced electricity tariffs by 30% for more than 50% of consumers and reduced fuel imports by the state-owned power company. Ongoing investments in renewable energy are expected to further reduce the cost of electricity for consumers and entrepreneurs.

Djibouti is also plagued by chronic water shortages and high water prices as it produces only half of the estimated 30 million cubic meters required for annual consumption. The average price for water is USD 1.10 per cubic meter, compared to USD 0.28 per cubic meter across the region. Similar to electricity access, ongoing projects in aqueducts and desalination plants are expected to lower costs and increase water access in the future.

Labor costs in Djibouti are also very high relative to the region. For example, a laborer earns an average monthly wage of USD 300 in Djibouti, compared to USD 70 in Ethiopia or USD 100 in Egypt. Despite the high cost, labor productivity remains low due to a lack of skills and frequent mismatches in skill sets offered by labor compared to those needed by enterprises.

ENABLING IMPACT INVESTING: THE ECOSYSTEM

The Djiboutian ecosystem is not especially conducive to impact investing. The government has been working to improve the regulatory and legal environment, but investors must still navigate complex and lengthy bureaucratic systems. Despite the increase in investment in recent years, many foreign investors are still discouraged by Djibouti’s bureaucratic systems, reputation for corruption, and high labor and living costs.54

Regulatory Environment

To attract investment, the government has been working to improve Djibouti’s regulatory and legal systems. In 2001, the government established the National Investment Promotion Agency (NIPA) to promote private sector investment, facilitate investment operations, and modernize the country’s regulatory framework.55 Despite improvements, the business environment in Djibouti still requires significant reforms, including simplification of the tax code and streamlining investment procedures.

- **Repatriation of profits and dividends:** Djibouti does not have foreign exchange restrictions, so foreign businesses are free to repatriate profits.56

- **Foreign exchange controls:** Djibouti has free movement of capital, without limitations on transferring money or in- and out-flows of cash. There are also no restrictions on conversion of the Djibouti franc into any currency.57 The Djibouti franc is pegged to the US dollar, and thus remains a relatively stable currency.

- **Local ownership requirements:** Foreign companies are not required to have a local partner, with the exception of the insurance industry.58,59

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58 Insurance companies that are registered as local companies, as opposed to a branch of an existing foreign company, must have a local business partner.

• **Government enterprises**: State-owned enterprises comprise a large portion of the Djiboutian economy. The government controls telecommunication, water, and electrical distribution in Djibouti. Other services, such as media, garbage collection, and real estate are not legal monopolies, but government-backed enterprises have advantages relative to private sector competitors through programs such as government-backed loan guarantees. Legally, private businesses are afforded the same access to markets, land, and credit as state-owned enterprises, but such government programs impact fair competition. This constrains both existing businesses and the potential for aspiring entrepreneurs to develop new businesses in these sectors.

**Ecosystem Players**

Along with a lack of impact investment activity in Djibouti, the ecosystem of intermediaries supporting investors and businesses is also underdeveloped. There are very few examples of accelerators, incubators, or other business development service providers in the country.

One exception is the Global Innovation through Science & Technology (GIST) initiative, which works across 86 emerging markets, including Djibouti. GIST supports promising entrepreneurs working in technology through global networking, entrepreneurship skill building, in-depth mentorship, and strategic seed funding.

In early 2014, The World Bank and partners committed USD 2 million to provide business development services (BDS) to SMEs in Djibouti through a matching grant program. Although no specific BDS providers are cited in the program plan, by increasing access to funding for technical assistance this program is expected to foster development of intermediaries available to Djiboutian SMEs.

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CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS

Challenges

Despite government efforts, there are still many challenges that discourage foreign investment, including impact investment:

• **Small market:** Djibouti is the smallest country in East Africa both by population and geography. With less than a million people, there is limited potential for scale in-country and new businesses seeking to grow and generate attractive returns will quickly need to expand regionally. This expansion to new markets creates challenges for new businesses, which must learn a new operating environment as well as have sufficient human capital to manage operations in multiple markets.

• **Bureaucracy:** Improvements to the regulatory framework have somewhat eased the process of investing in Djibouti, but investors still frequently struggle to practically navigate the bureaucracy, which can lead to challenges such as a slow release of funds by relevant government agencies.

• **High cost of operations:** In addition to the high cost of water, electricity, and labor, Djibouti City is also one of the most expensive cities in the world. The high cost of living is largely a result of rapidly increasing housing expenses.

• **Weak legal system:** The World Bank scores Djibouti poorly on the rule of law governance indicator, which is particularly poor when applied to foreign businesses. Foreign investors have reported delayed court deliberations and legal decisions biased against foreign companies.

• **Unfavorable labor laws:** Djibouti’s labor laws are another barrier to foreign investment as they tend to favor employees, particularly in cases of disputes and termination. Further, because skilled labor is in short supply relative to unskilled labor, the government has instituted measures to replace foreign workers with locals and have correspondingly increased the cost of obtaining a work permit.

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66 Ibid.
Opportunities

Despite the many challenges investors face, Djibouti’s investment climate is relatively friendly compared to those in neighboring countries such as Eritrea and Ethiopia. With its high poverty and unemployment rates there is great need for impact investment and private sector development. The country’s improving business environment is paving the way for impact investors to enter the market. Some opportunities include the following:

- **Developing talent pool:** Given the high unemployment rate, lack of available skilled talent in Djibouti, and the high cost of living for expatriates, impact investors could invest in talent development initiatives, such as training programs or business development services, to increase the pool of high-potential entrepreneurs and businesses for investment.

- **Investing in SMEs:** To date, the majority of foreign investment into Djibouti has been into large infrastructure and transportation projects, with little focus on start-ups or other SMEs. There is an opportunity for impact investors to focus their attention on this latent investment market to source businesses with high potential for impact that have yet to be discovered.

There are a number of high-potential sectors for entrepreneurs to launch or grow businesses with the support of impact capital:

- **Tourism:** Most visitors to Djibouti are business travelers affiliated with the country’s military bases. However, due to its coastal location, there are untapped opportunities in ecotourism and dive tourism. The World Bank projects that tourism is one of the most promising sectors for job creation—expecting that Djibouti could grow tourism from 50,000 visitors annually today to 500,000 tourists by 2030, generating up to 30,000 direct jobs.

- **Transport and logistics:** This sector is the backbone of the economy, employing approximately 10% of the actively employed population. As the government continues to invest in new ports, railways, and airports, there will be a corresponding need for businesses that offer support services in the sector.

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68 Ibid.

• **Fishing:** Although Djibouti is a coastal nation, its fisheries sector remains underdeveloped. The country’s annual catch is estimated at only 1,800 metric tons, compared to 157,000 in Kenya or 30,000 in Somalia; however, with additional investment in equipment, training, and exploration, the sector could increase significantly in the next decade.

• **Energy:** In 2012, President Guelleh pledged to make a full transition to renewable energy by 2020. With this strong government support, there are opportunities for impact investors to develop Djibouti’s renewable energy resources (e.g. geothermal, wind, and solar).

• **Agriculture:** Djibouti currently produces approximately 3% of its food and imports the rest, leaving the country highly exposed to external market risks such as sudden surges in food prices. Agriculture in Djibouti is particularly difficult because of the arid climate, which opens opportunities to invest in businesses that are able to transition to drought-resistant crop technologies, and to invest in needed water mobilization and irrigation to increase yields.

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ABOUT THE GLOBAL IMPACT INVESTING NETWORK

The Global Impact Investing Network (GIIN®) is a nonprofit organization dedicated to increasing the scale and effectiveness of impact investing. The GIIN builds critical infrastructure and supports activities, education, and research that help accelerate the development of a coherent impact investing industry. For more information, see www.thegiin.org.

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