THE LANDSCAPE FOR IMPACT INVESTING IN SOUTHERN AFRICA
ACKNOWLEDGMENTS

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We would especially like to thank our interview participants. Without their key insights this report would not have been possible. We include a full list of interviewees in the Appendix.

For any questions or comments about this report, please email Rachel Bass at rbass@thegiin.org.

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COMMON ACRONYMS

AFD  Agence Française de Développement (French Development Agency)
AfDB  African Development Bank
BIO  Belgian Investment Company for Developing Countries
BoP  Base of the Pyramid
CEPGL  Communauté Économique des Pays des Grand Lacs (Economic Community of the Great Lakes Countries)
COMESA  The Common Market for Eastern and Southern Africa
CSR  Corporate Social Responsibility
DFI  Development Finance Institution
DFID  The Department for International Development (United Kingdom)
EIB  European Investment Bank
ESG  Environmental, Social, and Governance
FDI  Foreign Direct Investment
FMCG  Fast-Moving Consumer Goods
FMO  Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (Netherlands Development Finance Company)
GDP  Gross Domestic Product
GIIRS  Global Impact Investing Ratings System
GIZ  Gesellschaft für Internationale Zusammenarbeit (German Agency for International Cooperation)
HDI  Human Development Index
ICT  Information and Communication Technology
IFAD  International Fund for Agricultural Development
IFC  International Finance Corporation
IMF  International Monetary Fund
LP  Limited Partner
MDG  Millennium Development Goal
MFI  Microfinance Institution
MSME  Micro, Small, and Medium-Sized Enterprises
NGO  Non-Governmental Organization
OFID  OPEC Fund for International Development
OPIC  Overseas Private Investment Corporation (United States)
PE  Private Equity
PPA  Power Purchasing Agreement
PPP  Purchasing Power Parity
PTA  Preferential Trade Area Bank
RFP  Request for Proposal
SACCO  Savings and Credit Co-operative
SGB  Small and Growing Business
SME  Small and Medium-Sized Enterprises
SOE  State-Owned Enterprises
TA  Technical Assistance
UN DESA  United Nations, Department of Economic and Social Affairs
UNCTAD  United Nations’ Conference on Trade and Development
USAID  The United States Agency for International Development
VAT  Value-Added Tax
VC  Venture Capital
WASH  Water, Sanitation, and Hygiene
WHO  World Health Organization

COMMON TERMS

Early-stage business  Business that has begun operations but has most likely not begun commercial manufacture and sales
Focus countries  Countries under study wherein non-DFI impact investors are most active, namely Madagascar, Malawi, Mozambique, South Africa, Zambia, and Zimbabwe
Growth-stage business  Company has a functioning business model, and its current focus is developing new products / services or expanding into new markets
Mature business  Profitable company with a developed and recognizable brand
Non-focus countries  Countries covered by the study but that have limited non-DFI impact investor activity, namely Angola, Botswana, Lesotho, Mauritius, Namibia, and Swaziland
Venture-stage business  Sales have begun but cannot sustain the company’s operations. The business model is still being aligned with the realities on the ground
MADAGASCAR

OPPORTUNITIES DESPITE ONGOING CHALLENGES
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ABOUT THIS REPORT

MOTIVATION

The impact investing industry has grown in prominence over the last decade, and impact investors globally have developed substantial and particular interest in sub-Saharan Africa, given the region’s strong potential for investments to drive positive social and environmental impact. Despite strong interest, relatively little research has examined impact investing markets at the country level within the continent. This type of granular information is essential to investors currently operating in the region or considering investments there in the future.

This study provides detailed information on impact investing activity across 12 countries in Southern Africa. For each country, the report examines impact investing capital disbursed at the time of data collection in mid-2015 (by sector, size, and instrument), analyzes key trends in the industry, and describes the challenges and opportunities available for social enterprises and impact investors. Political and/or economic circumstances may have changed since initial data collection.

SCOPE

As defined by the GIIN, impact investments are “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return.” A commitment to measuring social or environmental performance is considered a hallmark of impact investing. Investors who do not meet this definition have not been included in this report’s analysis.

Development finance institutions (DFIs) are important actors in the impact investing landscape, providing large amounts of capital both through direct impact investments and through indirect investments through other impact capital vehicles. Because of their large size and unique nature, this report analyzes DFI activity separately from the activity of other types of impact investors.

METHODOLOGY

This report relies heavily on primary research, including more than 60 interviews with local and international impact investors, social enterprises, ecosystem players, and government institutions. The research team also examined publicly available primary information, including analyzing investor documents and reviewing organizational websites and press releases to compile a comprehensive database of impact investing activity across all 12 countries in Southern Africa. Overall, this report includes data regarding the activities of 25 DFIs and 81 non-DFI impact investors, totaling over 8,600 transactions including substantial activity from DFIs based in South Africa.

More detailed information on methodology and scope is provided in the ‘Introduction & Methodology’ chapter. All chapters of this report can be found at www.thegiin.org.
INTRODUCTION

Madagascar (see Figure 1) has experienced extraordinary challenges over the past decade. Alongside a 2009 coup d'état that ushered in four years of instability, hardship, and economic contraction, the island has had to contend with devastating cyclones,\(^1\) swarms of locusts,\(^2\) and a recent outbreak of bubonic plague that claimed more than 70 lives in low-income areas of Antananarivo, the country’s capital.\(^3\)

![Figure 1. Map of Madagascar](image)

Given these challenges, Madagascar has seen little international impact investment compared to the size of its market and its potential, though a small number of specialist local funds have been operating successfully for several years. As the country recovers from the aftermath of the coup and natural disasters, international impact investors should see increased opportunities to place capital, particularly in the country’s recovering textiles industry and thriving agribusiness sector.

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COUNTRY CONTEXT

Madagascar’s 2009 political crisis and the ensuing instability curtailed a promising growth story. Under the coup regime (2009–2013), poverty rose, growth fell, and public well-being suffered. Elections in late 2013 welcomed President Hery Rajaonarimampianina, who vowed to combat corruption and stimulate investment. Following a notable decline from 2008 to 2009 in gross domestic product (GDP) at purchasing power parity (PPP), annual growth rates have recovered to 4.5 percent—driven in large part by extractive industries—but have not returned to their pre-crisis levels, which averaged more than nine percent. Ongoing instability, weak institutions, and tenuous governance, compounded by the May 2015 impeachment of the President (since overturned by the courts), continue to limit Madagascar’s economic prospects. More than 80 percent of the population lives below USD 1.25 (PPP) per day.

Nonetheless, there is reason to believe that Madagascar’s prospects may be improving. The IMF expects GDP growth to increase in 2015 from approximately 4.5 percent to 5.8 percent. In addition, the country—previously a textile hub—recently had trade preferences reinstated under the US African Growth and Opportunity Act (AGOA), which allows Madagascar to resume duty-free exports of textiles and a host of other goods to the United States. Capitalizing on this and other opportunities will require a stronger investment climate, with a particular focus on infrastructure and commercial law, as well as investment in high-potential local entrepreneurs and enterprises.

Gross Domestic Product

Prior to the 2009 political crisis, Madagascar experienced several years of nearly 10 percent annual growth in GDP (see Figure 2). With the coup of 2009, GDP plummeted, contracting by four percent, and the economy grew by only one percent in 2010. Growth began to recover in 2011, rising to 4.5 percent, but it still has not returned to its pre-crisis trajectory. Investment in the extractives industry, particularly mining, has primarily driven recent growth, masking continued stagnation elsewhere in the economy. For example, agricultural production has increased by less than one percent since a severe locust infestation in 2013, and companies in the export processing zone grew by only two percent in 2014. Relatively poor growth has compounded already low standards of living. GDP per capita is only USD 1,437 (PPP), compared to a regional average of USD 7,139 (PPP).

FIGURE 2. GDP (PPP), 2005–2014

USD BILLIONS

Madagascar averaged 4.5% annual GDP growth over last 10 years

Source: IMF World Bank Economic Indicators, April 2015

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8 Ibid.
9 Ibid.
Foreign Direct Investment

Foreign direct investment (FDI) in Madagascar peaked in 2008 at around USD 1.2 billion (see Figure 3). As with economic growth, FDI dropped significantly after the 2009 crisis, to USD 800 million in 2010, and flows have since been flat.

Canada was the single largest source of FDI during the period 2007–2011 (the last period with available data), accounting for just under 30 percent of inflows. The UK and Japan together comprised an additional 30 percent, followed by Mauritius, Korea, and France, each with around 10 percent of all FDI. The majority of this investment, especially from Canada, was into extractive industries, particularly mining.

Inflation and Exchange Rates

Madagascar’s currency, the Ariary, has weakened in recent years (see Figure 4). The official USD/MGA exchange rate was depreciating at 10 percent year-on-year in nominal terms as of the end of September 2014 and at 14 percent year-on-year by the end of November 2014. According to the International Monetary Fund, the official rate is likely overvalued, as many large foreign-exchange transactions take place at

13 Ibid.
a more depreciated rate. Inflation held relatively steady—around 10 percent—from 2006 to 2011 and has since declined to around six percent in 2014. Rates may be higher in 2015 due to government cuts in fuel subsidies.

**FIGURE 4. INFLATION AND USD/MGA EXCHANGE RATE, 2005 - 2014**

<table>
<thead>
<tr>
<th>% INFLATION</th>
<th>USD/MGA</th>
</tr>
</thead>
<tbody>
<tr>
<td>20%</td>
<td>2,500</td>
</tr>
<tr>
<td>18%</td>
<td>2,000</td>
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<tr>
<td>16%</td>
<td>1,500</td>
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<tr>
<td>14%</td>
<td>1,000</td>
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<tr>
<td>12%</td>
<td>500</td>
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<td>10%</td>
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<td>8%</td>
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<td>6%</td>
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<td>500</td>
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<td>2%</td>
<td>0</td>
</tr>
<tr>
<td>0%</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: World Bank Indicators

**SUPPLY OF IMPACT CAPITAL**

Though many regional investors based elsewhere in Southern Africa include Madagascar in their broader investment mandate, few are actively placing capital, and only a handful have a local presence. As a result, Madagascar has seen few impact deals and little capital disbursed relative to its size. With just over USD 500 million placed, it has the sixth-most impact capital disbursed among the twelve countries in the region (less than 10 percent of which was placed by non-development finance institution [DFI] impact investors), and at 44 recorded investments, the eighth-most impact deals.


Broader Investing Landscape

The modest volume of non-DFI impact capital means that impact investing remains relatively poorly understood among Malagasy entrepreneurs, and traditional sources of finance dominate Madagascar’s investing landscape (see Figure 5). With an asset base around USD 1.8 billion, the country’s 11 retail banks constitute around 80 percent of the financial sector, and the four biggest banks account for over 85 percent of these assets and almost 90 percent of deposits. Most of these banks are foreign-owned, based predominantly in Mauritius, France, and elsewhere in Africa.

Microfinance institutions (MFIs) have also built a strong presence in Madagascar, with an asset base of over USD 100 million across 31 MFIs. These MFIs offer a limited range of financial products to low-income households, though interviewees reported that MFIs struggle in rural areas due to widespread suspicion among farmers regarding the use of land as loan collateral.

Accessing capital is generally extremely challenging for entrepreneurs in Madagascar. Annual commercial interest rates have been more than 45 percent for the last seven years, escalating in 2014 to an even more formidable 60 percent. This has made it all

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20 Open Capital interviews.
22 International Monetary Fund, Republic of Madagascar: IMF Country Report No. 15/24 (Washington, DC: International Monetary Fund, 2014). https://www.imf.org/external/pubs/ft/scr/2015/cr1524.pdf. This asset base of USD 100 million is much larger than the capital known to have been deployed in financial services, as shown later in this chapter. One explanation for the discrepancy could be that these MFIs may have raised significant grant capital or capital from conventional investors.
but impossible for early- or growth-stage entrepreneurs to finance expansion through commercial loans, even when they are approved for financing.

A small number of specialist investment firms have opened in Antananarivo to fill this gap. Alongside two impact investors, a small number of local private-equity investors offer early- and growth-stage finance.24 Other initiatives have sought to address the high cost of financing more directly. In 2013, for instance, a partnership including the French Development Agency (AFD), the Madagascan guarantee institution SOLIDIS, and a local MFI set up a new guarantee fund to provide up to USD 1.8 million in credit guarantees to small and medium-sized enterprises (SMEs).25 These efforts notwithstanding, accessing and affording finance remain critical constraints for Madagascar’s private sector.

Impact Capital Disbursed

Madagascar has seen comparatively little impact capital disbursed given the size of its economy and population (see the “Challenges and Opportunities” section for a discussion of possible causes). At around USD 500 million across 44 deals, Madagascar accounts for 1.9 percent of both deals and capital placed in the region. Other countries in the region with smaller markets, such as Namibia or Mauritius, have attracted considerably more impact capital.

DFIs account for the vast majority of impact investment in Madagascar to date. Of the USD 500 million in capital disbursed, around USD 465 million—more than 90 percent—has come from DFIs (see Figures 6 and 7).

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24 Open Capital interviews.

Investments over Time

Non-DFI impact capital proved resilient after the 2009 political crisis, with both capital disbursed and number of impact deals reaching all-time highs in 2012 at nearly USD 12 million across six deals (see Figure 8). Research uncovered no impact deals from 2013 to 2015, though it is unclear if this reflects an actual lack of deals or rather indicates limited data availability.

For DFIs, by contrast, the 2009 political crisis significantly dampened deal flows. While the research team recorded nearly USD 350 million disbursed by DFIs from 2007 to 2008, only around USD 25 million in DFI disbursements was recorded over the years following the military coup (see Figure 9). Considering the low number of deals even before the coup, however, it would be premature to conclude that investor interest in Madagascar is waning, nor did investor interviews support such a conclusion.
FIGURE 9. DFI IMPACT INVESTMENTS BY YEAR

Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.
Source: Open Capital Research

Sector

Non-DFI impact investments in Madagascar have been heavily concentrated in a small number of sectors (see Figure 10), specifically, agriculture, housing, and information and communications technologies (ICT). Within agriculture, both aquaculture and tropical fruit production for export have generated particular investor interest.26 The large amount of impact capital disbursed to the housing sector reflects the activity of one particular impact investor with a specific focus on affordable housing.

FIGURE 10. NON-DFI IMPACT INVESTMENTS BY SECTOR

Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.
Source: Open Capital Research

26 Open Capital interviews and research.
DFI investments have been more broadly spread across sectors (see Figure 11). Roughly half of DFI deals have been in agriculture or financial services—mostly in aquaculture and large local banks—but energy, manufacturing, and water, sanitation, and hygiene (WASH) have all also seen multiple DFI investments. The extractive sector has received by far the largest share of disbursed impact capital, driven entirely by one very large investment into a nickel mining project.

Despite the sector’s general potential to generate impact, neither DFIs nor non-DFI impact investors appear to have found investment opportunities in healthcare. Interviewees noted that heavy involvement of government and non-governmental organizations (NGOs) has prevented the emergence of healthcare entrepreneurs and offered little room for private investors to engage. The textiles sector has also received relatively little impact capital, though the revival of duty-free exports to the U.S. under AGOA will likely attract investor interest.
Deal Size

The majority of non-DFI impact deals in Madagascar have been in the range of USD one to five million, contrasting with the deal size profile for most other countries in the region, in which the bulk of non-DFI impact deals tend to be below the USD one million mark. There is only one recorded deal over USD five million.

As with most of the region, DFI average deal sizes are considerably larger than non-DFI ones. Still, with the exception of the one large investment in nickel extraction, DFI deals have been comparatively small, with half falling below USD five million (see Figure 13). This may reflect the relatively low number of large projects in extractives, energy, and infrastructure that have characterized DFI investment elsewhere.
Non-DFI impact deals in Madagascar have been fairly evenly split between equity and debt (see Figure 14). Debt investments are slightly larger on average, possibly because investors tend to use debt for later-stage businesses. Of deals with known investment instruments, DFI s have shown a moderate preference for debt in Madagascar, with around 50 percent more DFI capital flowing through debt than through equity across three times as many deals (Figure 15). Very few recorded investments used hybrid or alternative instruments, such as quasi-equity. Notably, however, over half of DFI deals in Madagascar had no readily available data on instruments used, so readers should appropriately discount any conclusions drawn from the data presented here.

**FIGURE 14. NON-DFI IMPACT INVESTMENTS BY INSTRUMENT TYPE**

Notes: Average deal sizes may not equal displayed capital disbursed divided by deal sizes. Capital disbursed rounded to nearest million, except where less than 1 million (rounded to nearest 100,000). Average deal sizes rounded to nearest 100,000.

Source: Open Capital Research
Local Presence

Few non-DFI impact investors have a local presence in Madagascar; only two have offices in Antananarivo.\(^9\) Investors with local offices typically staff their teams entirely with Malagasy staff who understand local culture and are able to navigate Madagascar’s highly relationship-driven business landscape.\(^8\)

Impact Tracking Standards

As is true across Southern Africa, impact investors in Madagascar do not use a specific standard for measuring impact. Instead, they report that they tailor impact-tracking structures to each investment, allowing them to reduce the administrative burden on their portfolio businesses and focus on the metrics that are most meaningful.

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27 Open Capital interviews.
28 Ibid.
DEMAND FOR IMPACT INVESTING CAPITAL

With reentry into AGOA and a political commitment to combat corruption and improve the business climate, Madagascar has the potential to achieve improved economic performance over the coming years. Enterprises and entrepreneurs throughout the country can take advantage of this environment, providing much-needed employment while also realizing financial returns. Given the various challenges they face, enterprises and entrepreneurs will need support beyond the limited bank financing that is currently available.

Development Context

Madagascar is one of the poorest countries in the world (see Table 1). More than 80 percent of the population lives below the absolute poverty line (USD 1.25 per day in PPP terms), compared to a global average of 25 percent. The country ranks 155th out of 187 countries according to the UN’s Human Development Index (HDI), with a score of 0.50 compared to a global average of 0.69.

<table>
<thead>
<tr>
<th>DEVELOPMENT INDICATOR</th>
<th>Madagascar</th>
<th>Regional Average</th>
<th>Global Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>HDI SCORE (RANKS 155th OF 187 COUNTRIES)</td>
<td>0.50</td>
<td>0.55</td>
<td>0.69</td>
</tr>
<tr>
<td>GDP PER CAPITA (USD, PPP)</td>
<td>1,437</td>
<td>6,874</td>
<td>17,975</td>
</tr>
<tr>
<td>UNEMPLOYMENT RATE (%)</td>
<td>4</td>
<td>13</td>
<td>6</td>
</tr>
<tr>
<td>POPULATION BELOW USD 1.25 / DAY (%)</td>
<td>81</td>
<td>51</td>
<td>25</td>
</tr>
<tr>
<td>UNDER-FIVE MORTALITY (PER THOUSAND BIRTHS)</td>
<td>58</td>
<td>75</td>
<td>47</td>
</tr>
<tr>
<td>POPULATION WITH SOME SECONDARY EDUCATION (%)</td>
<td>11</td>
<td>41</td>
<td>59</td>
</tr>
</tbody>
</table>

30 Ibid.
In terms of health outcomes, the under-five mortality rate, at 58 per thousand live births, exceeds the global average of 47, and the incidence of under-five stunting, a proxy for childhood health and long-term prosperity, is just above 50 percent, one of the highest rates in the world.\(^{31}\) Meanwhile, children receive an average of 5.2 years of schooling, compared to a global average of 6.7.\(^{32}\) Literacy rates are below 65 percent for both adults and youth, and secondary and tertiary enrollment ratios—the percentages of school-age children actually in school—stand at 38 percent and four percent, respectively.\(^{33}\)

Though official unemployment is low at just under four percent,\(^{34}\) this rate likely vastly understates Madagascar’s labor market challenges. Rates of underemployment and vulnerable employment are likely significantly higher. Like other Southern African countries, Madagascar has a disproportionately young population, with more than 40 percent under the age of 15 and more than 60 percent below age 25.\(^{35}\) Coupled with years of poor economic performance, this youth demographic bulge poses risks to the country’s prospects for years to come. In addition to being very young, the population is also highly rural, with less than 35 percent living in urban areas.\(^{36}\) Access to services is particularly poor in rural areas; for example, in 2012, only eight percent of the rural population had access to electricity. Unsurprisingly, internet usage across the country is also very low: less than four percent.\(^{37}\)

Poor performance across social and economic indicators is compounded by Madagascar’s vulnerability to natural disasters, including cyclones, flooding, and drought. The World Bank estimates that 25 percent of the population (around five million people) lives in zones that are at high risk for natural disasters.\(^{38}\)

**Entrepreneurs**

Though few businesses explicitly position themselves as “social enterprises,” the SME landscape in Madagascar has significant potential to generate positive social impact as well as financial returns. Impact investors in the country echo this sentiment, reporting a strong pipeline of high-potential businesses.\(^{39}\) Many SMEs presently in the

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32 Ibid.

33 Ibid.


39 Open Capital interviews.
informal sector would benefit from formalization; others are already working in the formal economy but face a range of challenges that limit growth and could benefit significantly from impact funds.

Entrepreneurs and enterprises in Madagascar face many of the same challenges as those throughout the region. Primary among these is lack of access to finance. As the International Monetary Fund (IMF) points out, credit is expensive and limited. There is no debt market outside of government paper, and foreign-owned banks offering only basic savings and credit instruments to a limited customer base dominate the financial sector.\(^{40}\) Prevailing interest rates, at over 45 percent per year, are unaffordable for most businesses.\(^{41}\) Furthermore, entrepreneurs working in the agricultural/agribusiness sector are hesitant to use land as collateral, further limiting access to capital.\(^{42}\) Notably, enterprises in Madagascar face challenges related to a lack of access to physical currency as well as to credit; see “Challenges and Opportunities,” below, for more detail.

Infrastructure also poses a significant challenge. In particular, access to electricity is limited and unreliable—one can expect daily blackouts, sometimes lasting for hours at a time—and transport infrastructure, including roads, ports, and airports, is inadequate. These transportation challenges compound the difficulties arising from Madagascar’s large geographic size (Madagascar covers more than twice the land area of the UK). Low population density implies that growing businesses must widely expand their geographic reach. Cities are located at significant distances from one another; as such, new markets are difficult to reach, and key business functions, including inventory, sourcing, and distribution capabilities, must often be re-created and run independently in each city.

Enterprises also face challenges related to the implementation of tax laws. Since the government’s tax revenue is extremely limited, entrepreneurs often fail to receive reimbursements to which they are entitled.\(^{43}\)

Finally, businesses face challenges in securing support to establish systems and processes, particularly for financial management. As discussed below, there are a limited number of intermediaries providing such support in Madagascar. Where intermediaries are available, businesses struggle to afford their services. Furthermore, the local talent pool has a relatively small supply of potential CFO hires.\(^{44}\) As a result, investors often have to help companies develop adequate financial statements during the diligence process and then must look outside the country for executive-level talent. Impact investing capital combined with technical assistance funds could be effective in addressing this constraint and unlocking the growth potential of local enterprises.

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42 Open Capital interviews.
43 Ibid.
44 Ibid.
ENABLING IMPACT INVESTING: THE ECOSYSTEM

Though Madagascar’s ecosystem poses few overt barriers to investors, the country ranks 163rd out of 189 countries in the World Bank’s “Ease of Doing Business” rankings. That said, the World Bank ranks Madagascar 37th globally in terms of the ease of “starting a business,” reflecting successful efforts by the government to de-bureaucratize business incorporation through its one-stop registration at the Economic Development Board of Madagascar (EDBM).45

In addition, though the legal system is generally welcoming to foreign investment, interviewees reported that policies were at times incompletely or unevenly implemented. Beyond formal legal processes, interviewees noted that cultural and informal political factors—such as a work culture that prioritizes maintaining harmonious relationships at the expense of the timely delivery of unpleasant but important feedback or reports of frequent interference by local politicians—can make Madagascar a challenging place to do business.

Regulatory Environment

Madagascar’s legal system and public administration are largely based on systems inherited from France during and after colonization. As such, investors or entrepreneurs unfamiliar with French civil law can find the legal regime challenging to navigate if they lack significant local knowledge.46 Investors noted that even where the law is clear, it is at times inconsistently or inadequately enforced, creating additional legal risk.

Interviewees were unanimous that impact investors and entrepreneurs intending to be active in Madagascar should heavily involve local partners. Certain aspects of the regulatory environment require particular attention:

• **Land ownership:** Foreigners are allowed to lease land in Madagascar for terms up to 99 years,47 though a foreigner may only be issued a lease if they intend to use the land for commercial purposes.48 Buying land and reselling it, either in its original or developed state, does not count as a commercial use.49

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46 Ibid.
49 Ibid.
• **Government and the private sector**: Private-sector firms operate and compete on the same terms as state-owned enterprises (SOEs). However, there have been reports of unfair treatment of private enterprises in competition with SOEs. For example, the government has on several occasions suspended the licenses of private media houses that have openly criticized its activities. In addition, the government enforces some state monopolies, such as that of the national airline (Air Madagascar), as well as enforcing monopolies in water and electricity distribution.

• **Exit opportunities/restrictions on exits**: Both local and foreign investors are free to relocate profits after paying required taxes, fees, and dividends. However, investors must gain approval from the Ministry of Finance in order to repatriate capital raised from the liquidation of assets (or shares), capital from the transfer of stocks, or compensation for expropriation.

• **Interest rate controls**: Madagascar removed interest rate ceilings in the 1990s. However, the country’s banking sector is relatively underdeveloped, and lending rates are high, especially for SMEs. In 2014, annual commercial lending rates averaged 60 percent over the year.

• **Forex controls**: Madagascar follows the IMF’s Article VIII statutory framework, meaning there are no restrictions on foreign exchange, and the Malagasy government limits neither the use nor the availability of foreign exchange. Nevertheless, at times, shortages of foreign currency have caused delays in the repatriation of funds. In addition, businesses are required to transfer a portion of their export income back to the country, converted into local currency.

58 Ibid.
• **Required local shareholding:** Foreigners can own up to 100 percent of ventures in which they invest, with no local participation required by law.61 However, foreign ownership of companies operating in either the fixed-line or the mobile telecommunication sectors is limited to 66 percent.62

• **Government incentives for investors:** The Malagasy government provides a number of investment incentives for companies based in designated Export Processing Zones (EPZs) or operating in the mining sector, including:63
  - exemption from registration charges;64
  - VAT and duty exemption for raw materials;65
  - customs tax exemption for export;66 and
  - taxes on expatriated income capped at 30 percent.67

**Ecosystem Players**

The support ecosystem in Madagascar is sparse. There are a small number of incubators, dedicated mainly to the country’s nascent ICT sector, but most other players in the ecosystem have a broader regional focus (see Figure 16). As such, they engage in Madagascar opportunistically and typically operate on a fly-in, fly-out basis, which can make travel expenses prohibitive for earlier-stage businesses seeking support. The research team identified nine ecosystem organizations active in Madagascar, of which only three have a full-time presence on the ground.

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64 Ibid.

65 Ibid.

66 Ibid.

67 Ibid.
Interviewees noted there is a cultural resistance to retaining third-party advisors, as entrepreneurs are often reluctant to share confidential business information and are unclear on the value proposition offered by consultants and support organizations. Most impact investors that have successfully built a portfolio in Madagascar have teams with deep local knowledge and are able to meet their due diligence and business support needs in-house.

**CHALLENGES AND OPPORTUNITIES FOR IMPACT INVESTORS**

Madagascar’s ongoing political instability and variable implementation of its commercial and tax regulations have made it difficult for international investors to operate in the country. This difficulty is compounded by challenges in infrastructure, particularly in energy and transportation, as well as a lack of access to finance and difficulty investors have in adapting to local culture in order to identify high-potential opportunities. More specifically, challenges facing investors in Madagascar include:

- **Political risk and instability**: Recent political instability and the expectation that instability will continue in the coming years—people speak of five-year cycles of conflict—pose a significant challenge for investors in Madagascar. As a result, some investors are hesitant to engage in longer-term endeavors, preferring limited investments that offer the potential for short-term returns.
• **Regulatory environment:** Though the French-style legal code in Madagascar can be difficult for Anglophone investors to navigate, the primary challenges come not from the legal structure itself but from its implementation. In particular, businesses complain of significant tax harassment and often fail to receive reimbursements to which they are entitled. In large part, this stems from the government’s low ratio of tax revenue to GDP and corresponding need to collect more revenue. Similarly, while foreigners are legally allowed to lease land for 99 years, in practice they often face land-right challenges, stemming from confusion over land titles.

• **Limited access to finance:** As in other countries in the region, businesses in Madagascar struggle to access credit, as they cannot afford prevailing interest rates. A further challenge is related to physical access to currency. Banks, particularly in rural areas, keep limited cash on hand, depending on Air Madagascar for replenishment. One entrepreneur in the agribusiness sector described renting a private plane to obtain currency to pay farmers when workers at Air Madagascar went on strike. Similarly, shortages of foreign currency are common; throughout 2014 and into 2015, investors complained of significant delays in obtaining dollars to pay suppliers.68

• **Poor infrastructure:** Lack of infrastructure—particularly electricity and transport—poses a significant challenge. The World Bank’s *Doing Business* report ranks Madagascar last, globally, in terms of “Getting Electricity.” Blackouts are common and will often last for hours each day. This is particularly problematic for businesses in energy-intensive sectors, such as textiles. Furthermore, road and rail infrastructure is limited—a challenge in such a large country—and air transport, critical to both the tourism industry and to operations in other sectors, depends on the monopoly held by Air Madagascar.

• **Lack of investment pipeline:** Self-described “social entrepreneurs”—or even entrepreneurs seeking risk capital—are few and far between, and there are few hubs of entrepreneurship.69 As such, investors without a strong local presence and network find it challenging to locate promising entrepreneurs and to identify investment opportunities—though investors that have a local presence and network reported that they have little trouble.

• **Limited local talent in financial management:** Local businesses rarely have well-constructed or complete financial statements, requiring investors to construct financial documents during the diligence process.70 Furthermore, investors often have to look outside of the country for CFO-level talent.71

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69 Open Capital interviews.

70 Ibid.

71 Ibid.
Despite these challenges, there are a number of promising opportunities for impact investors in Madagascar. These opportunities do not necessarily look like the businesses that impact investors typically seek; in Madagascar, there is limited awareness of “impact investing.” While few businesses explicitly position themselves as social enterprises, many investors are actively looking to create a positive impact through job creation and improving incomes. Opportunities include:

- **Integrate the informal sector**: Anecdotal evidence suggests that the post-2009 instability affected the informal sector less than the formal sector.\(^{72}\) While the formal sector declined as major multinational companies pulled out and Madagascar lost its AGOA eligibility, some small- and medium-sized businesses in the informal sector experienced an increase in revenue. Today, there is opportunity to incorporate informal, mid-sized SMEs into export-oriented value chains. High-potential sectors include textiles—particularly with Madagascar’s return to AGOA and the agreement’s ten-year extension—as well as agribusiness and, potentially, mining.\(^{73}\)

- **Establish a strong local presence**: Securing pipeline in Madagascar depends on a strong local network and relationships. To the extent that investors are not Malagasy, they should also develop local partnerships. In addition to assisting in securing deal flow, local presence and partnerships are critical to overcoming cultural challenges and to navigating bureaucracy. Local partners could include investors, village leaders (who are especially critical for agricultural investments), and, to the extent that they exist, intermediaries.

- **Capitalize on available human resources**: Madagascar has a population that is understood to be hard-working, reliable, and highly skilled in certain industries. There is significant potential for investments in companies and industries that build from this foundation of human capital, as described in the next section.

Investors pointed to particularly strong opportunities in the following sectors:

- **Textiles**: Madagascar benefited from preferential access to US markets under AGOA from 2001 to 2009, leading to a boom in textile exports, which averaged USD 231 million per year.\(^{74}\) When Madagascar lost AGOA eligibility, apparel and clothing exports to the US dropped by 85 percent.\(^{75}\) With Madagascar’s AGOA privileges reinstated in mid-2014 and extended for 10 years, investors anticipate significant opportunity. In addition to AGOA, this sector benefits from low-cost, highly-skilled labor that already has significant experience in apparel manufacturing.

\(^{72}\) Open Capital interviews.

\(^{73}\) There is currently substantial informal mining activity. Anecdotally, the research team learned that minerals from Madagascar often appear on other countries’ import accounts, with no corresponding export registered on Madagascar’s books.


\(^{75}\) Ibid.
• **Agribusiness:** Madagascar is the leading exporter of a number of high-value agricultural products and has the potential to become the leading exporter for many others. High-potential crops include vanilla, chocolate, various spices, lychees (Malagasy lychees currently supply 70 percent of the European market), and various essential oils, including many used in cosmetics. There are a large number of small businesses operating in the sector today, and there are opportunities to connect them to financing to expand. Currently, many businesses in the sector shy away from bank loans, as they are hesitant to use land as collateral.

• **Extractive industries:** Extractive industries, particularly mining, have driven economic growth in recent years, and the country has identified a number of new deposits, including iron ore, graphite, coal, and rare earths, for future development. Opportunities exist in extraction itself, as well as in supporting activities, such as supplying machines and power-generation equipment. Integrating informal, small-scale mining activities into formal, export-oriented value chains offers further opportunity, though doing so would require intensive on-the-ground capacity-building and cultural sensitization. While outside the purview of many impact investors, these activities could generate substantial employment and may meet some impact investors’ investment criteria.

• **Tourism:** As a World Bank study of the tourism sector notes, Madagascar is one of the world’s only mega-biodiverse countries. This biodiversity includes not only 32 species of lemur—a primary tourist attraction—but also significant marine and coastal life, including marine mega-fauna. The country is the world’s fourth-largest island and has nearly five thousand kilometers of coastline. Despite these natural assets, Madagascar has a relatively underdeveloped tourism sector, likely due to recent political instability and challenges around infrastructure. Nonetheless, investors believe that there are opportunities in tourism, including opportunities focusing on sub-sectors (e.g., hotels), as well as in developing entire geographic areas for tourism, which requires more comprehensive investment.

• **BPO and call centers:** Investors, donors, and government entities all expressed enthusiasm for business-process outsourcing (BPO) and call centers. Anecdotal evidence suggests that the advent of the Arab Spring and ensuing instability in North Africa has prompted companies in need of French-language BPO to look for alternative locations. Madagascar, with its low labor costs and a population speaking neutral, clear-accented French, could be a high-potential substitute.

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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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