

# FSD Africa submission to the IDC inquiry on the UK's strategy towards development finance institutions

## January 2023

### Introduction

1. FSD Africa is a UK aid-funded regional programme operating in more than 30 countries in Africa to make finance work for the continent's future. We work on policy and regulatory reform, capacity strengthening and improving financial infrastructure in order to address systemic challenges in Africa's financial markets with a particular focus on enabling capital to flow to underinvested parts of the green economy. We also provide investment capital, grants or returnable grants to innovative but higher risk projects with potential for system-wide impact.
2. Through our market-building initiatives, we have directly and indirectly crowded in around £1.9 billion in long-term capital, availing finance for SMEs, affordable housing and sustainable energy projects. Our work has also enabled development of innovative products, increasing access to financial services for close to 12 million people in Africa<sup>1</sup>.
3. FSD Africa sees British International Investment (BII) as a valued partner in the development of Africa's financial markets which are crucial to delivering the sustainable economic growth which is at the heart of "*The UK government's strategy for international development*," presented to Parliament in May 2022.
4. The two organisations have begun to forge a close working relationship. BII sits on FSD Africa's Investment Committee, bringing its technical expertise to decisions on new investments.
5. We have also collaborated with BII on several projects and investments where our different roles and strengths have proved complementary. More broadly, FSD Africa's work on developing policy, regulations, building market infrastructure and developing products such as green bonds and gender bonds, is helping to build an investible marketplace and pipeline for BII to invest in.

### How does the BII's strategy align with the FCDO's development agenda?

6. FCDO's May 2022 International Development Strategy identifies British International Investment as one of the main tools to provide honest and reliable finance to low and middle-income countries, supporting them to grow their economies without burdening them with unsustainable debt. For Africa, the role of development finance institutions such as BII is particularly important at a time when the economic fallout from the COVID-19 pandemic and Russia's invasion of Ukraine has undermined the ability of many African nations to service their sovereign debt.
7. As of 30 November 2022, according to the IMF, 22 low-income countries in Africa were either in debt distress or at high risk of debt distress<sup>2</sup>. The situation is expected to worsen in 2023 limiting the capacity of many African countries to raise the necessary finance to address the social and economic problems facing them. In the African Development Bank's recent report *Africa's Macroeconomic Performance and Outlook - January 2023*<sup>3</sup>, it expressed cautious optimism about

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<sup>1</sup> FSD Africa, *Impact Report 2022* [https://fsdafrica.org/wp-content/uploads/2022/12/2022.12.08-Impact-Report\\_Final.pdf](https://fsdafrica.org/wp-content/uploads/2022/12/2022.12.08-Impact-Report_Final.pdf)

<sup>2</sup> International Monetary Fund, *List of LIC DSAs for PRGT-Eligible countries* (30 November 2022) <https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf>

<sup>3</sup> African Development Bank, *Africa's Macroeconomic Performance and Outlook - January 2023*

the resilience of African economies but emphasised that “it is imperative to enact policies that can mobilize and leverage private financing for development in Africa.”

8. Crowding in private finance will be crucial to filling Africa’s funding gap and capital markets have a key role to play by connecting pools of capital to viable projects. Yet the ability of Africa’s financial markets to play their role is challenged by a number of factors including a weak regulatory and policy environment, limited capacity for innovation, a shortage of bankable projects and asset classes and the negative perception among international investors that investing in Africa is high risk.
9. Our collaboration with BII aims to help address these challenges both through pooling our capital and by jointly supporting the policy, regulatory, infrastructure and product developments needed to build a more investible market. Our partnership recognises that we work in very different but complementary ways.
10. Through its investment arm, FSD Africa Investments (FSDAi), FSD Africa is able to provide relatively small scale, risk-bearing capital to early-stage, innovative or untested business models in Africa’s financial sector. FSDAi is mandated by FCDO to accept a relatively low rate of return in exchange for wider social and economic benefits for instance for investments designed to demonstrate the potential of a new asset class or financing mechanism.
11. BII has access to a much larger pool of capital but has much stricter requirements for both the size of the investment and the return. By co-investing in funds which address some of the most urgent or intractable problems facing Africa, with FSD Africa bearing greater risk and accepting a lower return and BII as the anchor investor providing volume and reassurance to the market, we are able to unlock capital from other investors.
12. For example, in 2020, there was an urgent need to provide finance to micro finance institutions (MFIs) in order to support micro, small and medium enterprises (MSMEs) impacted by the Covid-19 crisis. Following an approach by BII (then known as CDC Group), FSDAi was able to rapidly obtain approval for an investment of £7.42 million in the Blue Orchard Covid-19 Emerging & Frontier Markets MSME Support Fund. FSDAi’s investment was in the form of higher risk junior or first loss shares, while BII invested approximately £25m in the form of less risky senior shares<sup>4</sup>. This enabled Tier II and III banks to access immediate liquidity to manage their deteriorating portfolios, and long-term finance to prevent them becoming insolvent. In turn, these institutions were able to continue providing finance for MSMEs, poor households and informal businesses – preserving revenues, incomes and jobs.
13. An increasing area of focus for both FSD Africa and BII is green finance. Unlocking finance to tackle the challenges of climate change, including adapting to a changed climate, whilst also contributing towards achievement of the UN Sustainable Development Goals, is one of the key pillars of the UK’s development strategy and nowhere is the need greater than in Africa.
14. According to research by Climate Policy Initiative<sup>5</sup>, conceived by FSD Africa and co-funded with the Children’s Investment Fund Foundation, total annual climate finance flows in Africa for 2020, domestic and international, were \$30 billion, just 11% of the \$277 billion needed annually to fund Africa’s climate commitments or NDCs. This leaves a funding gap of almost \$250 billion a year

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<https://www.afdb.org/en/documents/africas-macroeconomic-performance-and-outlook-january-2023-highlights>

<sup>4</sup> BII, *Responding to a crisis: Keeping small businesses alive* (November 2021)

<https://www.bii.co.uk/en/story/responding-to-a-crisis-keeping-small-businesses-alive/>

<sup>5</sup> Climate Policy Initiative, *Landscape of Climate Finance in Africa* (September 2022)

<https://fsdafira.org/publication/landscape-of-climate-finance-in-africa/>

which must come either from international public sources or from the domestic and international private sectors.

15. An important mechanism for raising green finance is the green bond, which allows the issuer to raise money specifically for an environmentally friendly project, such as renewable energy or clean transport.
16. FSD Africa launched its first green bonds initiative, the Kenya Green Bond Programme, in 2017 and has since supported green bonds in 20 countries in Africa for example by developing listing guidelines and a pipeline of potential issuers or creating a pool of local licensed verifiers as well as supporting broader debt capital markets reforms.
17. We are now working with BII to support green bond issuances by several significant commercial banks in Africa. FSD Africa will provide upfront advisory support, using its grant funding from FCDO to engage with regulatory authorities where necessary and hand-hold issuers through the bond development process, while BII acts as an anchor investor, providing assurance to issuers that the bond, once issued, will be fully subscribed.
18. Another area of co-operation between FSD Africa and BII, and a key priority for UK aid, is the empowerment of women and girls. At FSD Africa, our programmes have helped to increase access to savings products among women, to boost female digital financial inclusion, and to extend crucial financial services to female business owners. In 2022 FSDAi invested £8m in Nyala Venture<sup>6</sup>, a special purpose vehicle targeting a new class of capital providers serving small and growing businesses, particularly those which are led by women or are applying a gender lens investment strategy.
19. In doing so we were able to build on the insights and leadership of BII in this area. For example, FSDAi is one of the appointed Advisors for the 2X Ignite programme<sup>7</sup> aimed at providing capacity and financing support for African female fund managers. In addition, FSDAi was on the selection committee for its 2X Sprint, a 6-month accelerator for 7 female-led or gender-balanced fund managers with gender-smart investing strategies across Africa. The 2X Ignite is backed by a group of development finance institutions of the G7 group of nations led by BII, now part of 2X Global.
20. Gender bonds are a growing area of interest for both organisations. In 2022 FSD Africa partnered with NMB Bank on its maiden gender bond<sup>8</sup>, the first gender bond to list on an exchange in Africa. FSD Africa provided technical input to develop the Social Bond Framework and the technical assistance towards the framework's second-party opinion.
21. We are now working with BII on producing a gender bond tool kit and building a pipeline for future gender bonds. We expect to be able to announce further areas of co-operation in the near future.
22. In conclusion, we believe that both organisations can benefit from working together and ultimately the impact of UK aid is greatly increased. It is important to appreciate the multifaceted nature of the financial system and, in Africa, the sheer breadth of challenges that prevent the sector from playing its full potential - and that different players have different, but complementary roles to play in addressing these challenges.

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<sup>6</sup> FSD Africa news release (June 2022) <https://fsdafrica.org/press-release/fsd-africa-investments-commits-8m-to-finance-a-new-class-of-asset-allocators-in-africa/>

<sup>7</sup> 2X Ignite website <https://www.2xignite.org>

<sup>8</sup> NMB Bank news release (February 2022) <https://www.nmbbank.co.tz/about-us/main-media/press-release/711-nmb-bank-plc-opens-another-bond-investment-opportunity-for-social-economic-empowerment-named-as-nmb-jasiri-bond>