HEIFER INTERNATIONAL
NEPAL

IMPACT INVESTMENT LANDSCAPE IN NEPAL

Challenges and Opportunities

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This study is a collaborative effort between Heifer International Nepal and SAFAL Partners.

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FOREWORD

We are excited to present this report on the challenges and opportunities of attracting impact investment in Nepal's agriculture sector. This initiative underscores Heifer International's commitment to empowering smallholder farmers and women-led agri-enterprises through sustainable solutions. Our study aims to strengthen the investment ecosystem, fostering growth and technical support in this sector.

As a non-profit organization dedicated to ending hunger and poverty while caring for the earth, Heifer International Nepal, supports over 400,000 households across 50 districts through 300 women-led cooperatives. These cooperatives serve as business hubs, advancing women's empowerment, agricultural transformation, and sustainable practices.

Our new program model prioritizes private sector engagement and investment, enhancing productivity, optimizing supply chains, and scaling businesses in collaboration with communities, governments, civil society, and the private sector. Our efforts span diverse value chains, including goats, milk, vegetables, spices, and seeds, offering technical services and facilitating investments based on blended finance and impact investment principles.
We have facilitated USD 18.6 million in investment for 11,000 farm businesses as part of a broader USD 76 million commitment from 21 BFIs and impact investors. These investments have empowered farmers, increased production, and boosted local economies.

Despite these achievements, agribusinesses and cooperatives still face barriers to affordable investments, including insufficient collateral, high transaction costs, and limited expertise among local fund managers and impact investors. Strengthening business operations, impact assessment, and reporting systems is crucial to building investor confidence. Building technical capacity, improving policy advocacy, and unlocking further opportunities are essential steps forward.

The future of impact investment in Nepal relies on collaboration among governments, Development Finance Institutions, private investors, BFIs, development agencies, and agribusinesses. By addressing systemic challenges, Nepal can unlock capital for sustainable development and become a model for emerging economies balancing economic growth with environmental and social sustainability.

We extend our heartfelt gratitude to Mr. Ashutosh Tiwari, Managing Director of SAFAL Partners, for his unwavering support in organizing and facilitating a series of consultations and meetings. His dedication has been instrumental in advancing impact investment in agribusiness for Nepal, aligning with Heifer's commitment to developing a sustainable food system.

Dr. Tirtha Raj Regmi
Country Director - Heifer International Nepal

A. EXECUTIVE SUMMARY

Heifer International Nepal engaged SAFAL Partners to study the challenges and opportunities in attracting impact investment in Nepal's agriculture sector. This initiative reflects Heifer International's ongoing dedication to developing impactful solutions for Nepal's smallholder farmers and women-led agri-enterprises. The study's primary objective was to assess and strengthen the impact of the investment landscape in Nepal, fostering increased financial support and growth opportunities for these vital sectors.

The study encompassed two main components: extensive desk research and direct consultations. The desk research involved a comprehensive review of existing literature, data, and case studies on the impact of investment in Nepal.

Concurrently, SAFAL Partners consulted with diverse stakeholders, including the leaders of cooperative federations, impact investors, private equity firms, and blended finance experts. These interactions provided a multifaceted perspective on the investment ecosystem and identified key opportunities and barriers.

The report highlights several critical insights into the current status of impact investment in Nepal.

First, it underscores the challenges that need to be addressed to attract potential and interested impact investors to the region. These challenges include regulatory hurdles, a lack of investor confidence, and limited access to reliable market data.

Second, the study identifies strategies to unlock more capital for impact-oriented initiatives. These strategies encompass enhancing financial and investment literacy, improving transparency and governance within agribusinesses and cooperatives, and fostering partnerships between the public and private sectors to create a more conducive investment environment.

Furthermore, consulted financial institutions shared several critical challenges hindering Nepal's agriculture sector investment. The commodity value chains lack clear and distinct opportunities for targeted interventions. There is a significant shortage of bankable projects, as most farmers and agribusinesses—aside from a few large companies—struggle to develop compelling, investment-ready proposals. Existing policies need urgent reform to foster greater private sector participation and unlock the sector's full potential.
In conclusion, the findings from this brief study provide a strategic roadmap for policymakers, investors, and development organizations to foster a more robust and inclusive impact investment climate in Nepal. Addressing the identified challenges and implementing the recommended strategies can significantly boost financial inflows and support the sustainable growth of agri enterprises in Nepal. The report highlights suggestions for a way ahead. These include creating a working group of impact investment practitioners, making agri-enterprises ready to attract and absorb impact investment, networking with potential impact investors and firming up agreed-upon impact indicators.

B. BACKGROUND

At the current economic juncture, the world must decide whether to adopt a sustainable growth model or continue prioritizing the extraction of profits from people and the environment, which would result in inequality and environmental destruction. The latter is the logical choice, as it is more practical and beneficial in the long run. However, this transition faces significant challenges, primarily in terms of investment.

Investments now require a new mindset beyond financial returns and consideration of social and environmental impacts. Philanthropists have long used their resources and influence to mitigate the negative social consequences of business activities. More recently, individual investors practicing socially responsible investing have avoided investing in companies that harm society and the environment.

The COVID-19 pandemic, global recession, wars, and inflation have strained government budgets and increased debt, making it harder for them to continue funding these initiatives alone.

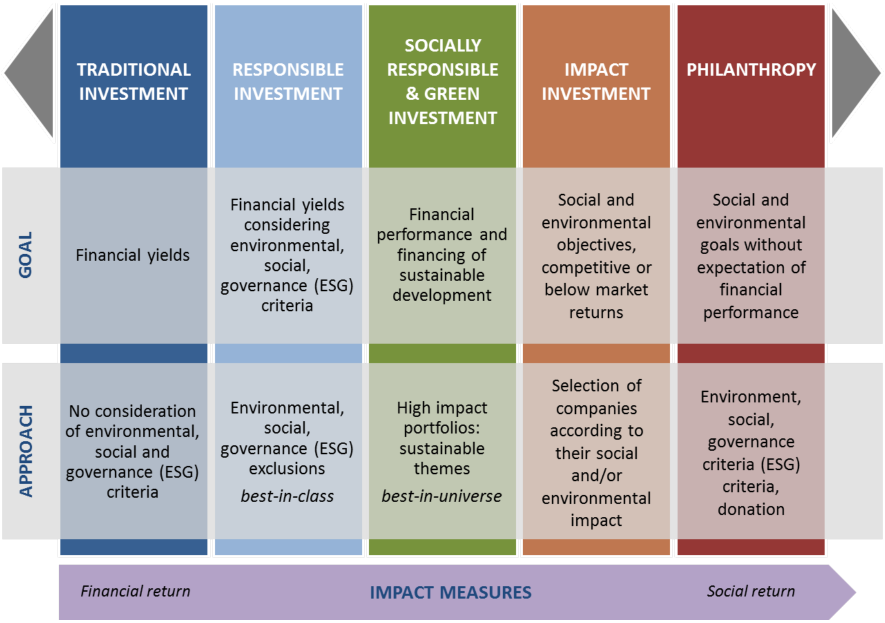
Meanwhile, the private sector has shown growing interest in sustainable projects that deliver visible environmental and social benefits. The emergence of the triple bottom line approach, which measures the company's financial, social, and environmental results, has further advanced the cause of impact investing. This surge in alternative investing reflects a growing social awareness of the need to address our global challenges. As more people recognize these issues, they seek solutions that offer both financial returns and positive impacts. With the right tools and platforms, private investors can significantly contribute to financing the transition to a sustainable economy.

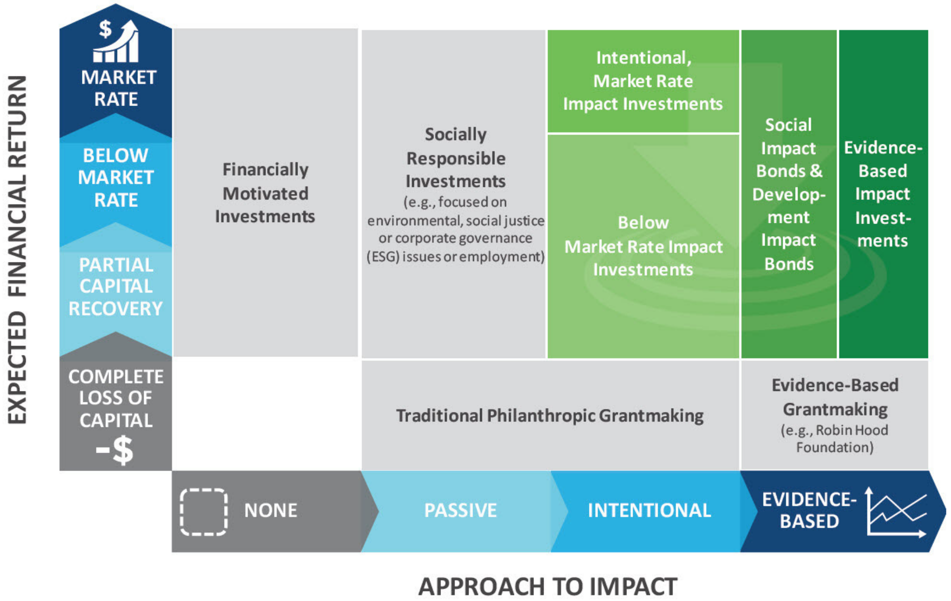
Challenges like sustainability, global warming, and climate change are not confined to any country. There is growing evidence of market demand for sustainable, impactful investments, and private capital is increasingly viewed as a vital source of funding for social and environmental initiatives.

B.1. Impact Investing

Mark Zapletal of Wartenberg Trust first coined “impact investing” in 2005 when he presented “Impact Investing, a Door to Sustainable Philanthropy” at the Global Family Office Summit in New York.

As defined by Global Impact Investing Network (GIIN), an international think tank on impact investing dedicated to increasing its scale and effectiveness around the world, impact investment is defined as “Investments made to generate positive, measurable social and environmental impact alongside a financial return”. Impact investments are made in emerging and developed markets and target a range of returns from below market to market rate, depending on investors’ strategic goals.





A study by GIIN (Global Impact Investing Network) estimated that the private impact investment market grew to approximately $1.2 trillion at the end of 2021— up 63% since 2019. This growing market provides important capital to address the world’s most pressing SDG challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, gender and affordable basic services, including housing, healthcare, education, etc. (Dean Hand, 2022)

Impact investing was pictured as a continuum from financial returns to impact outcomes. It was considered an emerging asset class seeking positive environmental and social outcomes. This limited impact investing to a tradeoff between financial and impact returns rather than an integrated approach across asset allocations. Recently, impact investing has been widely understood as an investment strategy that can be used across all asset classes.

B.2. Impact Investment in Nepal

The impact investing market in Nepal is relatively nascent and small. To date, impact investors have deployed approximately USD 17.3 million, with Development Finance Institutions (DFIs) contributing USD 16 million. Nepal's low GDP growth and political uncertainty deter many investors from seeking financial returns. However, those focusing on social impact see opportunities to address the country's significant social needs.

Nepal does not have a long history of foreign capital investments, and predictably, the concept of impact investment is quite new to the country. Financial capital investment started in Nepal with the entry of Development Financial Investments (DFI) and a few Private Equity firms (PE) roughly in the last decade (2014 onwards). Despite decent macroeconomic growth trends and recent improvements in the investment climate, especially before COVID, Nepal has seen relatively little impact on investing activity compared to neighboring countries.

With the second-smallest population in the region and a USD 1,400 GDP per capita in 2023, Nepal's consumer expenditures and market potential are not very attractive to investors. While the growth trends and investor interest observed in a few economic sub-sectors like tourism, hospitality, and hydropower have been hopeful, they have failed to raise overall investor confidence. This is reflected in low capital market investments, FDI inflows, and the impact-investment growth rate, which has not been up to expectations for various reasons.

Additionally, domestic investors in Nepal are not heavily engaged in the impact investment space. This is mainly due to low access to financial services, poor understanding, and a relative lack of trust in these services. Although the banked population grew considerably to approximately 62% in 2022 from 33.8% in 2014 due to increased savings/deposits, lending and investment generally have remained low, further attesting to the lack of familiarity with and trust in other asset classes.

However, the scenario has slightly changed over the past couple of years, and the risk capital market is primarily driven by impact investors (unlike in other markets where there is an existing set of commercial private equity (PE) and venture capital (VC) investors). With the active impact investments from DFIs coupled with the rise of the PEVCs, the investment from the private capital looks promising.

B.3. Impact Investors in Nepal

A range of investors is active in Nepal's impact investing space, like the Development and Financial Institutions (DFIs), domestic diversified financial institutions/banks, family offices/high net-worth individuals (HNWIs), Private Equity (PE), Venture Capitalist (VC), Specialized Investment Fund (SIF). There are eight active impact investors in Nepal, including five local funds, two DFIs, and one regional fund. However, Nepal's investment landscape is fragile, with many funds either not deploying raised capital or being put on hold due to market difficulties and management issues. DFIs dominate the impact investing space, accounting for 93% of the deployed capital, mainly through debt instruments.

Small local funds and other investors are still in the early stages of testing the market with minimal investments. There have been recent efforts by local fund managers to raise new funds, but these are largely not yet active or deploying capital. There are three main institutions related to investments: Nepal Investment Board, NRB, and SEBON.

B.3.1. Development Financial Institution (DFI)

Development Finance Institutions (DFIs) are the most active investors by capital deployed in the case of Nepal. However, they only recently entered the market and are still in a trial phase. The total DFI Investments in Nepal from 2008-2023 has amounted to $1.1 billion. Remarkably, between 2021 and 2023, the financial sector attracted $629.9 million in investments from DFIs.

DFI's commitment to Nepal in 2023 was $300.75 million. The number of DFI investment commitments spiked after 2018 as the government opened the external commercial borrowing window that allowed foreign lenders (like British International Investment) to come and engage with Nepali banks. About 59% of the DFI commitments have been invested into financial services, 28% in energy, 10% in the funds and the rest in other sectors. 84% has been invested in debt form in hydropower projects or banks, 15% in equity and with few DFIs deploying guarantee instruments. (Dean Hand, 2022)

The top five investors in Nepal by commitments in the last 15 years are the IFC (International Finance Corporation), DFC (The United States International Development Finance Corporation), BII (British International Investment), the Dutch Development Bank FMO and ADB (Asian Development Bank).

Deep structural issues, legal and regulatory ambiguities and political uncertainty in Nepal are the biggest challenges for DFIs. Removing these hurdles requires a policy change. However, with the surge in DFI investments over the last couple of years, the confidence in DFI investment looks to be increasing. Unlike in other countries where DFIs take on a more catalytic role to stimulate the market, in Nepal, they remain cautious. Although the DFIs are relatively less active in Nepal than their regional counterparts, both in terms of deal numbers and deal sizes, DFIs still represent a significant portion of the impact investing market.

Understanding their potential as market catalysts, DFIs employ guarantees as an investment tool in Nepal and direct lending to commercial banks. Similar to practices in other frontier markets, DFIs support SME portfolios for commercial banks to enhance lending to these enterprises in Nepal. They have provided guarantees to five banks to promote SME lending. These investments illustrate DFIs' interest in testing the market without taking on excessive risk and their commitment to improving SME access to finance in Nepal.

Nepal faces a significant funding gap in achieving the Sustainable Development Goals (SDGs) by 2030. The country is also poised to graduate from a Least Developed Country (LDC) to a Middle-Income Country (MIC) in 2026. While these changes offer substantial opportunities for investors, there is currently a shortage of viable business opportunities. (Prasain, 2024)

To address this, impact investors, especially Development Finance Institutions (DFIs), focus on market creation as part of their long-term strategy for Nepal. This approach aims to generate interest and create market opportunities, enabling development banks and other impact investors to engage in private sector development in areas they currently cannot reach. By leveraging their skills, expertise, and partnerships, DFIs aim to overcome Nepal's investment challenges.

Their primary goal is to improve the success rate of early-stage enterprises while considering Environmental, Social, and Governance (ESG) factors. To support these objectives, BII, FMO, and SDC have established Invest for Impact Nepal, an NGO dedicated to creating a robust market system and facilitating the financial ecosystem for investments.

DFIs want to expand the range of financial institutions, including Class B banks, microfinance institutions, and the digital financial services industry. They also aim to collaborate with other investment ecosystem stakeholders to advance sustainable finance, ESG, client protection, gender equity, and climate financing for more impactful results.

It is important to note that the number of DFIs and impacts investors in Nepal's financial service industry has increased from 2 to 8, with the number of commercial banks receiving investments rising from 2 to 6.

Furthermore, DFIs collaborating with the donor agencies actively advocate for pro-investment policy changes to benefit the investment community. In this regard, the DFIs are also actively engaging in conversations with fund managers and regulators to address regulatory gaps and constraints for attracting more foreign-impact funds. Regulators view these DFIs and donor agencies as knowledgeable and credible and have responded to several of their concerns. The DFIs have gained recognition in Nepal's Foreign Investment and Loan Management Bylaws. In February 2024, the Nepal Rastra Bank (NRB) addressed key issues related to debt investment by amending these bylaws. In this regard, the DFIs have been able to exert their growing influence and reduce the lock-in period for all DFI investments from 3 years to 1 year.

B.3.2. Diversified Financial Institutions and Banks

Diversified financial institutions and banks have been relatively inactive as impact investors. Commercial banks' lending to small and medium-sized enterprises (SMEs) is limited, as they typically prefer to finance less risky, well-collateralized, and diversified business entities. Despite efforts to encourage financial institutions to increase SME lending through government mandates and DFI guarantees, reaching SME owners with formal financial services remains challenging due to Nepal's large unbanked population.

Consequently, only a small amount of capital—primarily debt provided or guaranteed by DFIs and on-lent through commercial banks—is directed through institutional investors. In Nepal, investors perceive this type of investment as safe and low risk.

B.3.3. High Net Worth Individuals (HNWIs)

Diversified financial institutions and banks have been relatively inactive as impact investors. Commercial banks' lending to small and medium-sized enterprises (SMEs) is limited, as they typically prefer to finance less risky, well-collateralized, and diversified business entities. Despite efforts to encourage financial institutions to increase SME lending through government mandates and DFI guarantees, reaching SME owners with formal financial services remains challenging due to Nepal's large unbanked population.

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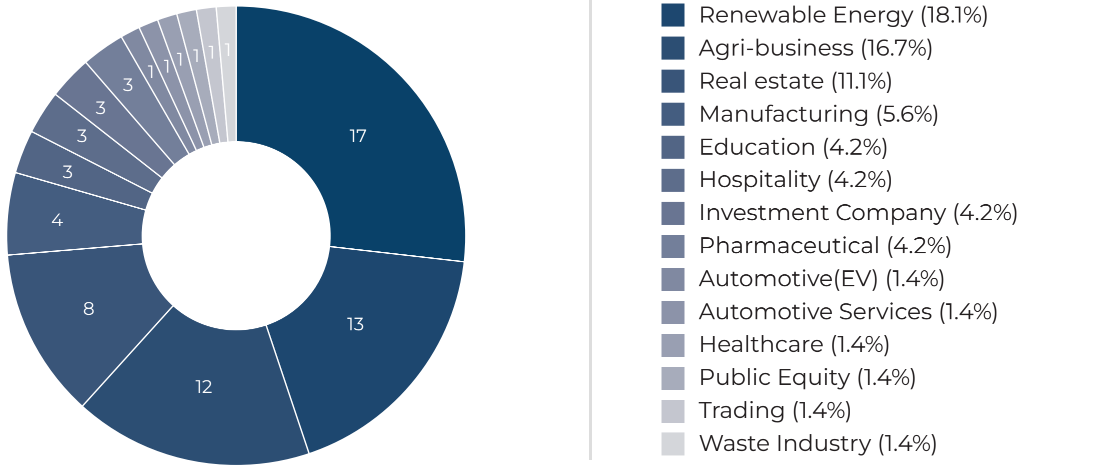
B.3.4. Private Equity and Venture Capitals (PEVCs)

There are a couple of PEVCs in Nepal, though the concept is new to the market. Some pioneers in Nepal's PEVC sector are One to Watch, founded in 2010; Dolma Impact Fund, founded in 2014; Business Oxygen, founded in 2015; True North Associates, founded in 2016; and Team Ventures, founded in 2016. Despite a delayed initiation compared to other developing economies, the Nepali government has recently recognized the promising potential of PEVC as an alternative investment avenue.

Industry-wise number of Investments

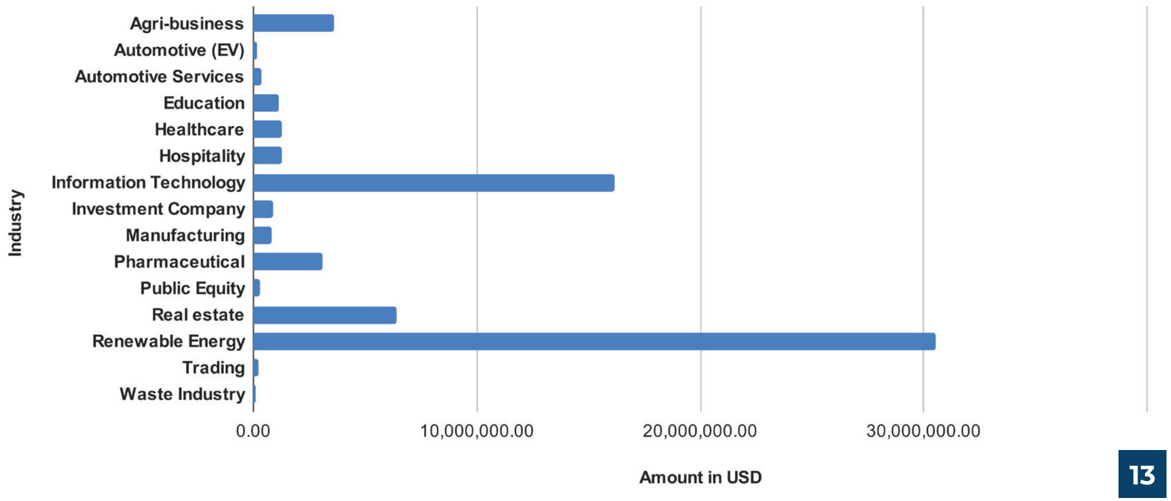


Industry	No. of Investments
Agri-business	12
Automotive(EV)	1
Automotive Services	1
Education	3
Healthcare	1
Hospitality	3
Information and Technology	17
Investment Company	3
Manufacturing	4
Pharmaceutical	3
Public Equity	1
Real estate	8
Renewable Energy	13
Trading	1
Waste Industry	1
Grand Total	**72**

Industry-Specific Total Investment Amount

Renewable Energy	(46.0%)
Information and Technology	(24.4%)
Real estate	(9.7%)
Agri-business	(5.4%)
Pharmaceutical	(4.7%)
Hospitality	(2.0%)
Healthcare	(2.0%)
Education	(1.7%)
Investment Company	(1.3%)
Manufacturing	(1.2%)
Automotive Services	(0.5%)
Public Equity	(0.4%)
Trading	(0.3%)
Waste Industry	(0.1%)
Automotive(EV)	(0.1%)

TOTAL INVESTMENTS MADE IN VARIOUS SECTORS BY PEVC FIRMS



B.3.5. Specialized Investment Funds (SIFs)

In 2017, the Securities Board of Nepal (SEBON) introduced licenses for the Specialized Investment Fund (SIF), a license vehicle which provides a regulatory framework for PEVC and hedge funds in Nepal. This initiative has been perceived as a proactive step by the government to cultivate a favorable environment for PEVC and create confidence in investors. SEBON has granted SIF licenses to approximately 12 fund managers so far. In addition, numerous merchant banks in Nepal have taken the initiative to establish distinct entities dedicated to managing SIFs. This list includes esteemed institutions such as Nabil Investment Banking, Laxmi Capital Market, NIC Asia Capital, NMB Capital, and Prabhu Capital.

Nepal's regulatory framework and procedures for equity investments are not yet fully established. Equity deals require approval from the central bank, but the process is lengthy and ambiguous, creating uncertainty for investors. Moreover, domestic investors risk being blacklisted from financial markets or services if they invest in equity and the company fails, although this regulation has recently been lifted for foreign investors. That is why debt is considered the most feasible and least risky option, even among investors who have not yet actively invested. However, equity is being tested in small amounts, especially by investors not legally permitted to provide debt.

While equity regulations are restrictive for investors, debt provision can only be made by investors registered as banks in their home country. This requirement is impractical for small funds, so they test the market through equity investments instead.

B.4. Sectors Invested by the Impact Investors

Most of Nepal's currently deployed impact capital has been invested in mature companies, largely due to significant investments from Development Finance Institutions (DFIs). Non-DFI investors have primarily focused on growth-stage companies, as these businesses have capital needs that align with the smaller ticket sizes of the active funds. Faced with a shortage of investment-ready enterprises, the DFIs and the impact investors are hesitant to confine their portfolios to specific sectors. These investors have taken an opportunistic approach to sector selection, focusing on identifying investable companies regardless of sector. Consequently, most impact investors remain sector-agnostic, resulting in increased capital flowing into sectors with investable companies.

These attractive sectors primarily include IT, hydro, solar energy, tourism, and hospitality, which are expected to generate significant economic growth. Nepal's impact investors mostly include a mix of DFIs and bilateral donors exploring using investment instruments to complement their traditional grant-based financing. Although the scale is smaller than in other markets, the aforementioned impact investors represent a significant volume relative to the current level of investment. Additionally, some small angel funds are in the market as impact investors, which would address the critical need for seed funding accompanied by technical assistance and mentorship.

B.4.1. Agriculture

Nepal is an agricultural-based economy, with more than 60% of its population directly or indirectly engaged in agriculture. Farmers and agri-based entrepreneurs only focused on achieving a set production level and finding a market for the produce. With the rise in visibility of sustainable agriculture, which incorporates the economic, environmental, and social aspects of agribusiness models, these enterprises' possible “impacts” are emerging as one of the core considerations in developing their businesses and business models. The agriculture sector grows to be potentially interesting for impact capital.

However, the investors perceive two main challenges: i) most enterprises are small scale as agriculture is mostly for subsistence and commercialization is still limited, and ii) While many enterprises are in the sector, most are unfamiliar with external capital and unable to deploy external capital.

B.4.2. Tourism and Hospitality

Tourism and hospitality are key employment generators, attracting many local, international, and commercial banks. They have also invested substantial capital in the market, creating many hotels and resorts that cater to foreign and domestic investors.

B.4.3. Energy

Energy is one area that is increasingly seen as a growth opportunity for impact enterprises and, therefore, for investors as well. The energy sector in Nepal offers substantial growth opportunities for impact investors, especially in the renewable energy sectors (hydro, solar and wind energy). This is aligned with the Government of Nepal's big vision to export (renewable) energy to Asian countries like India, China, Bangladesh and even Sri Lanka. To realize this vision, the GoN has already invested billions of dollars and is continuing.

Therefore, the impact investors are open and interested in investing in the enterprises working in the solar energy sector and the like to tap into the vast potential of Nepal's renewable energy. The focus is more on relatively large-scale hydro plant development. With the increase in ease of IPO exits, more capital inflow for hydropower projects, even during its construction phase, has been on the rise. In addition, the small-scale enterprises in the hydro and solar energy sectors have also been attracting impact investments in blended finance models. The trend is expected to continue, if not grow significantly.

B.4.4. Information, Communication and Technology

The Information, Communication and Technology (ICT) industry is considered the transformative industry for Nepal, with an estimated worth of more than half a billion dollars that accounted for 1.4% of Nepal's GDP and 5.5% of foreign exchange reserves in 2022. (IIDS reference). The informally run ICT sector is equally blooming and contributes to Nepal's revenues and employment opportunities. The ICT sector is one of the fastest-growing sectors in Nepal. With the government's recent announcement that the next decade will be the Information and Technology decade, there is general anticipation of tremendous growth and investment in the ICT sector in the coming years. ICT enterprises can appeal to impact investors and more outstanding impact capital by creating jobs and upskilling opportunities for women and marginalized communities.

B.5. Challenges and Opportunities for Impact Investors in Nepal

The primary challenges for impact investors in Nepal include political instability, regulatory uncertainties, and infrastructural deficits. The process for approving equity investments is particularly cumbersome and undefined, creating an additional layer of risk for investors. Moreover, local investors face severe penalties if their equity investments fail, discouraging equity financing. Despite these challenges, there are significant opportunities for impact investors to make a positive social impact. Investments in basic services, infrastructure, and economic opportunities can address the substantial needs of Nepal's population.

Additionally, an expected influx of USD 54 million in undeployed capital could signal growing interest and potential future growth in the market. Nepal's impact investing landscape characterizes significant challenges and offers substantial opportunities for addressing social needs. While the market is still developing, the presence of committed impact investors, particularly DFIs, and the evolving support ecosystem suggest growth potential. With further research and improved frameworks, Nepal could become a more attractive destination for impact investments to drive social change.

Despite these positive markers and trends, overall investor confidence has been low, reflected in low capital market investments and FDI inflows. In 2012, FDI net inflows reached about USD 1 billion, or about 4.9% of the GDP. In the same year, market capitalization totaled USD 4.1 billion. Investors considering regional opportunities prefer investing in larger, more dynamic markets such as India and Bangladesh.

Two broad dimensions capture the overall challenges for the impact investors in Nepal.

1) macro investment climate (such as ease of doing business, political stability, macroeconomic status, governance, infrastructure strength and reliability, regulatory framework, etc.)

2) the support available for investors and enterprises for navigating the investment landscape (such as deal sourcing and matchmaking, market creation, enterprise development, etc.).

The research done by GIIN together with Dalberg Global Development Advisors on the hurdles faced by the investors in the early stages of entering the market in Nepal stated the following as the major challenges:

1) Constraints navigating regulatory processes (particularly those related to registration and approvals)

2) Identifying talented fund managers (since there is little history of PEVC in Nepal, there are few experienced managers).

3) Foreign investors face a cumbersome FDI process, which requires a minimum investment of USD 150,000 and pre-investment approval by certain authorities (rather than post-investment notification as in other markets).

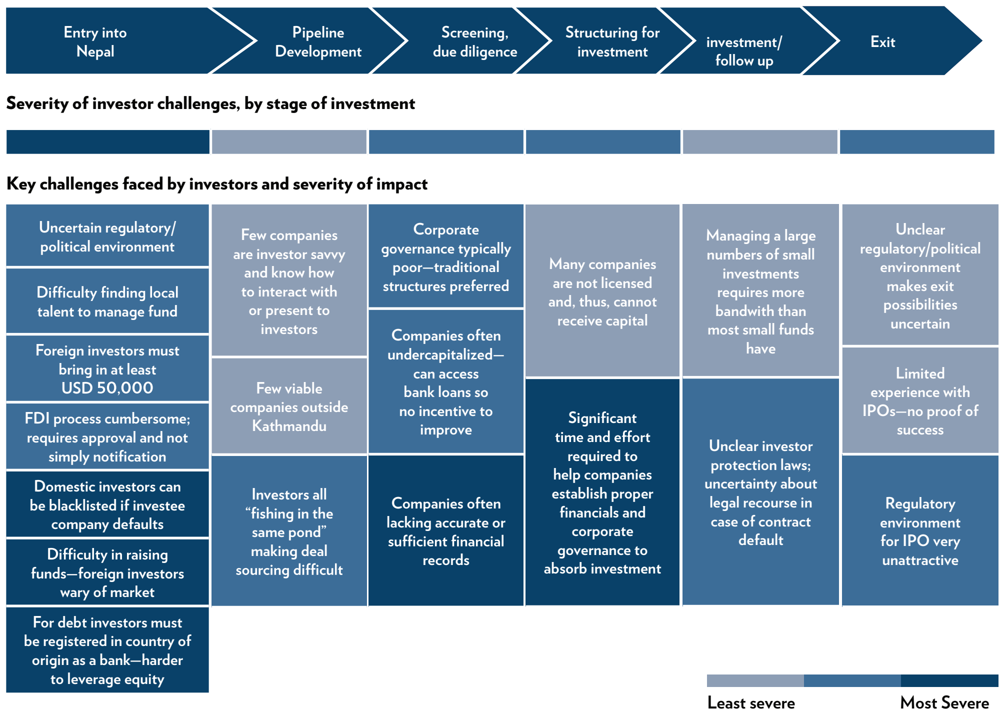
4) Domestic investors, while not facing the same challenges, are subject to a "blacklisting" regulation that states that equity investors in a company that defaults or fails altogether are blacklisted in the financial markets, a threat that significantly lowers the investors' risk appetite. Foreign investors were recently exempted from this regulation.

5) Fund managers find it challenging to raise funds from foreign and domestic investors who are uncertain about Nepal's potential.

6) Foreign investors must obtain approval from the Department of Industries for all equity investments. The process requires additional registration and approvals for new equity investors.

7) A foreign investor providing debt must be registered with the appropriate officials as a bank in their country of origin, and the Department must also approve the industry loan.

8) Upon public listing, no premium valuation of shares is allowed.



In addition to restrictive regulatory elements, the unpredictability of regulation application is another problem. For example, investors view regulatory restrictions related to IPO exits as a barrier to investments due to the uncertainty of their enforcement. With a limited history of IPOs in the market, investors have no evidence of the viability of this exit option.

So much so that a few foreign impact investors have found a lot of regulatory hassles in bringing foreign capital. Hence, they have changed their business model to work with commercial banks under subsidized loans to fund their projects, which regulatory processes have hassled to bring in foreign capital.

Therefore, while clearly defined on paper, there is no certainty that the regulatory process will be followed in practice as this is new to the market.

On the optimistic side, the regulations have improved. For instance, the binding three-year lock-in period for investors following a company's public listing has recently been shortened to one year, which indicates the government's understanding of the significance of impact investments.

One of the practical challenges for the impact investors is to get the identified enterprises to the actual execution of the deal. Standard due diligence, business plans, governance issues, records, etc., are all part of the deal structuring, and it takes a long time and a heavy investment in resources from the investor's standpoint. Even when there is an understanding between the investor and investee, these parties face challenges from the Nepal Rastra Bank and the Department of Industry (DOI) for these parties. Most of the time, government agencies do not approve the deals. Though the government of Nepal presents itself as pro-business-friendly, the general perception is that of a slow and lethargic bureaucracy.

Risk	Description
Sovereign Credit	Countries/soverign off-takers may not have sovereign credit rating. or it may be beow investment grade.
Political	General political risk may be perceived as high.
Currency	Local currencies can have high volatility against the US dollar, some are pegged to the Indian Rupee (e.g. Nepal, Bhutan).
Execution	Project executioncan carry risks including engineering, geological, remote locations, and government licensing delays.
Other	After deploying all the above, investors may still percive high risk relative to returns

B.6. Blended Finance in Nepal

Blended finance is seen more in the light of development financing, particularly towards meeting the SDG goals. Development sectors have deployed blended finance to fund the renewable energy sectors, especially the hydropower sector, and to unlock private financing to meet a significant financing gap to attain the country's development goals, including the SDGs. The blended finance mechanism has pooled funds from various stakeholders, including government-led initiatives, banking and finance institutions, private sector leaders, philanthropic funds, private equity funds, and international development partners.

Nepal's government is forward-looking in terms of deploying blended finance to attract and deploy more capital in power generation, transportation, and infrastructure and improve existing mechanisms for SME financing. In Nepal, Private Equity Venture Capital (PEVCs), which have been operating in an institutional and structured manner since the 2010s, have blended finance components and successfully attracted climate funding for their portfolio companies.

Business Oxygen (BO2) is a good example of blended finance, with subordinated debt investments from IFC (World Bank Group), Climate Investment Funds, and FCDO as co-investors. On a larger scale, the 216MW Upper Trishuli -1 is an example of blended finance with IFC, a Korean consortium, and local investments.

As of now, development finance Institutions have been taking the lead in Nepal in amplifying the practice of blended finance. This also reflects their greater risk appetite than commercial investors, and they are eager to help develop the financial markets.

To that end, blended finance is one prominent way of de-risking investments in Nepal, as in other frontier markets. However, despite its potential, blended finance remains underutilized. Some key challenges include difficulty structuring blended finance due to its complex nature, issues aligning expectations among various stakeholders, and a lack of available risk capital.

C. METHODOLOGY

To do the research, SAFAL first undertook desk research, which threw up questions and concerns. These questions and concerns were discussed with experts and practitioners in one-on-one meetings. The meetings were conversational in that the experts shared their practical experiences working with entrepreneurs, investors, and regulators and the procedural difficulty of bringing impact capital to Nepal.

Mapping Potential Impact Investors and Preparing a Questionnaire

SAFAL started by conducting thorough research to identify potential impact investors aligned with the goals of promoting sustainable agriculture and gender equality, which is crucial. For this, SAFAL utilized both online and offline resources to compile a comprehensive list of impact investors, domestic and international, operating in Nepal. SAFAL then made a strategic list of the key impact investors for this study assignment.
This was followed by preparing a draft questionnaire during expert meetings with these identified impact investors.

Organizing Expert Meeting

Separate expert meetings were organized with domestic and global impact investors, PEs, cooperatives, development agencies, and private sector representatives to engage potential investors and stakeholders. The meeting minutes included key discussion points, action items, and next steps.

Meeting Between SAFAL and Heifer Nepal Team in Kathmandu

The SAFAL team met with the Heifer Nepal Team at their country office in Kathmandu. The overarching objective of this meeting was to comprehensively understand Heifer's work in Nepal, focusing on agriculture-centric cooperative businesses and investment mobilization. Discussions revolved around the methodologies and outlook for the final project report.

Preparation and Submission of Final Report

The final step involved preparing and submitting the comprehensive project report, which encapsulated the process's findings, recommendations, and outcomes. By following this structured methodology, the project aimed to engage with stakeholders effectively, identify potential investors, and produce a comprehensive report that is aligned with Heifer's goals of promoting sustainable agriculture and gender equality in Nepal.

D. UNDERSTANDING THE SUPPLY SIDE OF IMPACT INVESTMENT

SN	Segments of investors	Name of the prominent players in the segment
1	Development Financial Institutions (DFI)	• FMO • British International Investment (BII) • Swedish Development Finance Institution • International Finance Corporation (IFC) • DFC • JICA • Finnfund
2	16 Funds and Fund Managers (PEVC) in Nepal	• BO2 • Dolma Impact Fund • Tele Ventures • One to Watch • True North Associates • Aadhyanta Fund • Team Ventures
3	12 Specialized Investment Fund managers (SIF)	• Global Equity Fund • Avasar Equity Diversified Fund • National Fund Management • NIBL Ace Capital • Alpha Plus Ventures • Prabhu Capital • Reliable Venture Capital • Laxmi Capital • Nabil Investment Banking • Laxmi Capital Market • NIC Asia Capital • NMB Vapital
4	HNWIs/ Family offices	Information is not available in the public.
5	Diversified Financial Institutions/ Banks	• Global IME Bank • Siddhartha Bank • NMB Bank

E. ANALYTICAL SUMMARY

E.1. Nepal as a Destination for Impact Investment

Impact Investment is quite new in Nepal, and its history spans less than two decades. Traditionally, capital inflows have been predominantly in grants and donations, fueling the growth of Micro, Small, and Medium Enterprises (MSMEs). Only recently, in two decades, have entrepreneurs and investors taken steps to transition towards commercial investment.

There has been a gradual shift towards commercial investment, following a linear progression from grants to philanthropy, venture capital, and private equity, with emerging possibilities for blended finance.

Nepal's capital flow ecosystem remains in its infancy, characterised by gaps in policies, systems, and resources necessary for diverse forms of capital investments and exits in SMEs. Consequently, global impact investors regard Nepal as a frontier market with higher risks and lower returns than global standards.

As Nepal transitions from aid dependence to economic independence, graduating from Least Developed Country to Developing Country status, the focus is shifting towards sustainable capital flow solutions.

The rising global trend of impact investment, along with Nepal’s transition in economic status, is preparing the country to attract and manage more impact investment.

Nepal is a fertile land for those wanting to generate tangible socio-economic impacts at the ground level. That is why investment firms like Dolma Impact fund, despite being the finance-first fund, still focus on their impacts, which are as follows:

i. Access to finance unlocked many opportunities for creation (in terms of manufacturing, be it shoes or garments) and eventually substituted imports.

ii. Enabling compliance to government regulations (tax contribution made by Dolma investees), labour law, and accounting compliances to maintain transparency, good governance and minority shareholder protections

Elaborating on this, Nepal can cater to impact funds focused on impacts in terms of employment creation, carbon emission reduction, health and nutrition, sustainable agriculture, skills development, access to finance, compliance to government regulations, carbon emission reduction, women-focused employment, etc. Sectors such as solar energy and digital agriculture present viable investment opportunities.

The meetings with experts indicated that Nepal is still not a big enough or profitable market for a selective impact investment. That's why almost all the impact investors operating in Nepal are sector agnostic. Yet, sectors include hydropower, solar energy, EV charging service, information technology, tourism and hospitality, education, e-commerce, manufacturing and agro-processing industries.

E.2. Challenges

Nepal lacks credit scoring systems, which makes it difficult for impact investors to assess risk and define a return rate. Investing in rural communities like smallholder farmers or women-led enterprises is even more challenging.

The challenge is further aggravated by the stark absence of a local network to guide the impact investors in identifying and developing a strong pipeline of investable impact-driven SMEs. There is a painful scarcity of Nepali SMEs that (can) deliver good enough financial returns, and this is a trend that has been observed across various industries in Nepal.

While cooperatives are appealing entities to collaborate with and invest in, given their local member engagement and sustainability component, impact investors face several challenges when working with them.

First of all, the cooperatives are too used to the aid and grants format of capital, which implies that these cooperatives do not have the competence regarding day-to-day management, financial literacy, understanding of crucial concepts (like interest rates, returns, risk, and bankable projects), financial reporting, investor-communications in terms of value-for-money framework, etc.

The cooperatives and Nepali SMEs also need training on incorporating locally relevant global ESG (Environment, Social, and Governance) compliances and explaining their impact through ESG lenses.

In this regard, transitioning from traditional donation and grant-based philanthropy to impact investment has proven challenging for entrepreneurs and investors alike.

In the same context, impact investing in smallholder farmers and women-led enterprises in Nepal is particularly challenging. That is because of their lack of willingness and ability to formalize their operations and financial reports, which severely cripples their scaling ability and appeal to raise more funds from formal channels and mechanisms.

Moreover, foreign impact investors encounter challenges related to hurdle rates. A 6% hurdle rate for dollar returns translates to a significantly higher rate when factoring in local currency fluctuations.

This currency risk is further compounded by the snail-paced and complicated bureaucratic hassles and processes that extend the period by which foreign investors receive the cash in their accounts. This greatly diminishes the return rate value and the motivation to invest in Nepali SMEs.

Hard-nosed impact-focused investments may fail in the Nepali market due to the lack of scale and infrastructure that global investors look for. Nepali economy cannot provide the scale and supporting infrastructure (like systems for reporting, fund transfers, etc.) in terms of impact numbers (for example, the number of women employees to be hired with that investment or creating a “green” supply chain) that global investors are used to with.

That is why, although there are many impact-first and impact-focused funds, many fail to continue in the Nepali market due to the rigidly defined impact targets that are difficult to achieve.

Therefore, impact investors need to be more flexible when investing in Nepal in the present scenario. In general, it is the right time for impact investors to invest in Nepali SMEs if the impact-first funds take a more flexible approach to defining impact targets, financial return, and success metrics while rejecting the hard-nosed model of defining impact metrics that they are more used to.

E.3. Monitoring and Evaluation

The local impact investors deploy M&E tools based on the criteria set by the funders. Regarding international impact funds, the M&E guidelines align with their country's law and Nepal's legal policies such that the local impact fund manager does not have to develop M&E tools.

The local Impact funds have started incorporating ESG compliances in their M&E reporting to evaluate and explain impacts.

As local impact fund managers, the bigger contribution and responsibility is to provide on-ground vigilance, timely and accurate progress reports and updates, and support to the investee so that they can meet their KPIs and deliver the impact.

E.4. Partnerships and Collaborations

One clear fact that experts say is that Nepal is high on the list of risky destinations for impact investments--so much so that few investors experienced Nepali turf jokingly express that it would take an investor in life with Nepal to consider investing in Nepal.

Given this context and building on the opportunities, challenges and ecosystem explained above, the following are the potential high-value driven areas where local players and institutions like Heifer International Nepal can deliver solid value.

The first area of value-driven partnership is creating success stories and preparing a pipeline to showcase to the impact investors. Such a pipeline can be developed by building the capacity of interested and potential enterprises and developing a robust mechanism to scout enterprises with growth potential. It should be noted that scouting is resource-intensive regarding operational cost, processes, human resources and networks to tap into.

Additionally, impact investors face challenges as a lack of a local network(s) that is credible and ready to collaborate with potential impact investors, both domestic and international, who can help these investors navigate the local communities and work closely to scope potential investees.

Another area for partnership is building systems that mitigate the risks present in Nepal’s government body's working methods and discourage investors from making investments.

For this, entities like Heifer can work on building the capacities of local SMEs by providing them with investment-readiness training, especially in bookkeeping, financial management, etc. In addition, Heifer-like entities can leverage their local community-based network to set up community-based risk mitigation systems, such as community-led hedge funds, and mechanisms to deal with uncertainties like livestock diseases.

Thus, the ultimate goal of the partnerships is to create success stories of impact investments, especially in Nepal's smallholder farmers and women-led enterprises segment. This will help unlock even more significant impact investments for Nepali SMEs.

In conclusion, while the journey of impact investing in Nepal is rife with challenges, strategic partnerships, innovative approaches, and a nuanced understanding of the local context are key to unlocking its transformative potential.

F. CONCLUSION AND THE ROAD AHEAD FOR IMPACT INVESTMENT IN NEPAL

Access to finance remains a significant barrier to the growth of Nepal's micro, small, and medium enterprises (MSMEs). Although commercial banks offer few schemes that provide subsidized loans for agri-focused MSMEs and women entrepreneurs, these businesses often struggle to secure capital that aligns with their specific needs and characteristics.

In this context, impact-driven investments can help address the MSMEs' demand for patient, nurturing, and sustainability-focused capital. However, existing policy and regulatory gaps, along with the lack of necessary systems and infrastructure for diverse capital investments and exits, combined with Nepal's challenging macroeconomic environment, make Nepal a high-risk, low-return investment destination—more so for international impact investors.

However, domestic impact investors and organizations like Heifer International Nepal also deal with their share of challenges as they face bureaucratic hurdles, a lack of risk-mitigation mechanisms, and insufficient financial instruments. Additionally, MSMEs and agri-focused cooperatives are often not investment-ready (at operations, policy, or mindset level), limiting the potential for impact-investment inflows.

To unlock the potential of impact investment for Nepali MSMEs, organizations like Heifer International Nepal should prioritize empowering these ground-level MSMEs and fostering collaborative ecosystems. The recommended key activities to unlock impact fund-led development, particularly for smallholder farmers and women-led enterprises, are as follows:

F.1. Capacity Building Programs: Develop a Pipeline of Investment-Ready MSMEs/Cooperatives and Foster an Enabling Ecosystem

An enabling ecosystem for impact funds requires investment-ready MSMEs and ecosystem players, including cooperatives, impact fund managers, and local government units that facilitate capital flow.

That is why effective capacity-building programs should target three levels:

a. **Demand Side: MSMEs/Cooperatives**
b. **Supply Side: Impact Fund Managers**
c. **Local Government Units**

Demand Side: MSMEs/Cooperatives

Capacity-building for MSMEs involves providing orientation, skills, and knowledge to enable them to shift from a grant-dependent mindset to understanding the potential and opportunities of raising impact funds. Training should focus on what impact investors seek (e.g., a reporting process that ensures transparency), the value of engaging with them, and the necessary operational systems and processes to attract investment (e.g., cash flow reports, HR practices, etc.).

Supply Side: Impact Fund Managers

Alternative capital providers, such as Private Equity and Venture Capital, have only recently emerged in Nepal. These providers must develop a deep understanding of defining and measuring impact within Nepal's context that helps (M)SMEs achieve impact targets while maximizing impact-based returns for these investors.

To that end, the collaboration of these PEVCs with Heifer International Nepal can help develop performance benchmarks, impact measurement practices, and workshops and training to equip fund managers with the financial modelling, deal structuring, and valuation skills necessary to enable impact funds to invest or collaborate with local funds. In addition, the fund managers should be upskilled in evaluating and reporting investments based on Environmental, Social, and Governance (ESG) criteria.

Local Government Units

Engagement with local government units is crucial to developing blended finance models. Nepal ranks as a high-risk destination for impact investments, and blended finance catalyzes impact capital inflow for agriculture-focused and women-led SMEs. Initiatives to educate local government bodies on global impact investing trends and help them align impact funds with local government plans will enable leveraging resources for larger, sustainable impacts.

F.2. Develop Local Networks: Establish Pipelines for Investment-Ready SMEs and Community-Led Risk Mitigation Mechanisms

Organizations like Heifer International Nepal, which has extensive networks of agri-focused SMEs, cooperatives, and women-led enterprises, should create local networks to identify and prepare potential investment candidates. These networks can support the ecosystem by providing knowledge and training and fostering exchanges between service providers, entrepreneurs, and investors. They should also mobilize local resources to establish community-led risk mitigation mechanisms, such as hedge funds that assist SMEs in livestock farming with cash flow needs while awaiting insurance claims.

F.3. Create Success Strategies and Business Cases: Develop Business Cases and Narratives to Attract Impact Capital

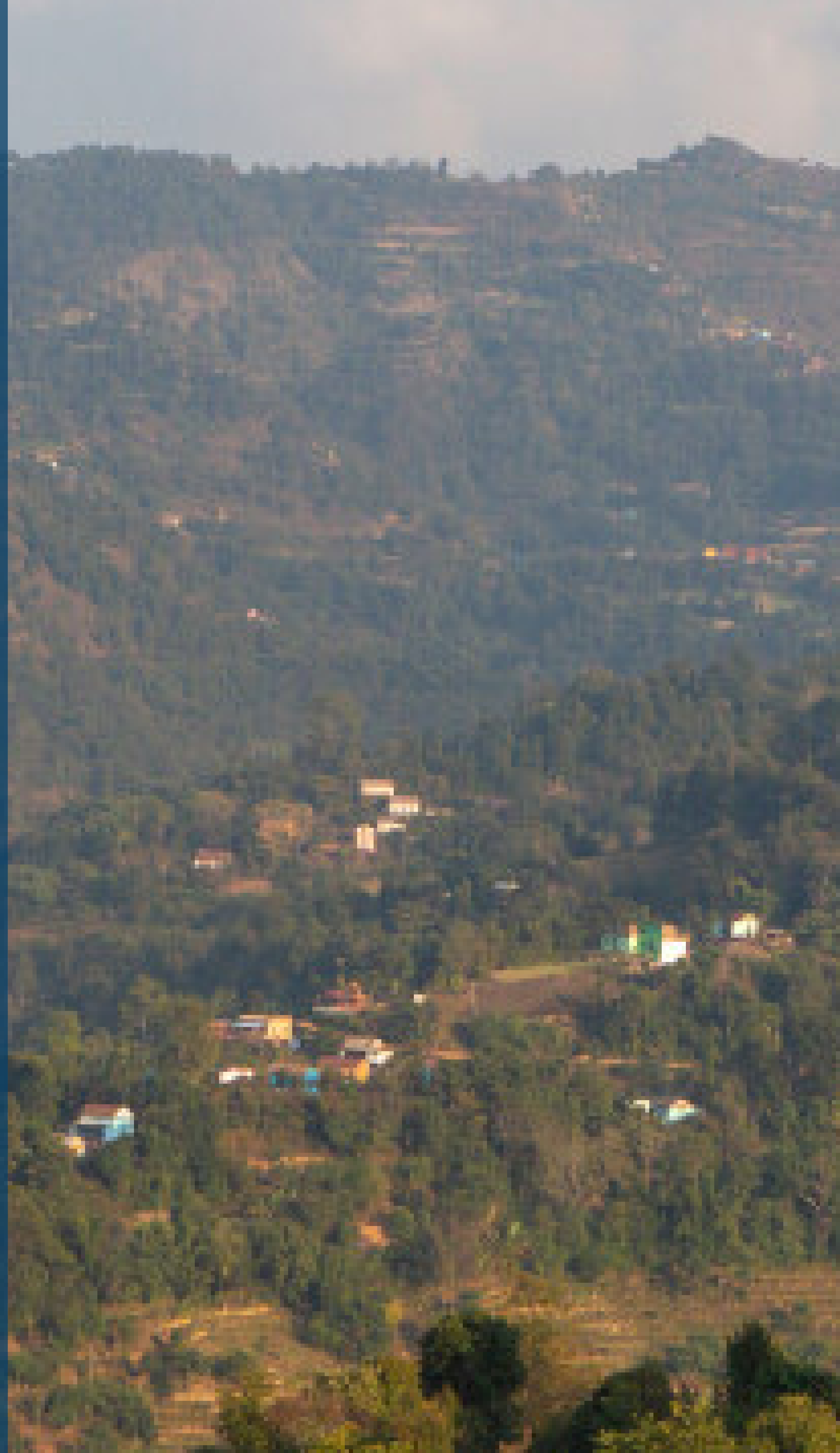
Nepal is often viewed as a high-risk destination for impact investment. However, this perception can be mitigated through effective communication and compelling narrative-building. Organizations like Heifer should collaborate with local ecosystem players to create and publicize stories of progress and initiatives that reduce risk and highlight opportunities for impact investing in Nepal over the next decade.

These success stories can be leveraged to develop compelling business cases, attract more impact capital, and advocate for regulatory changes and system enhancements to facilitate impact fund flow.

By focusing on these strategies, Heifer International Nepal can play a pivotal role in transforming the landscape of impact investment in Nepal, fostering growth and sustainability for MSMEs, and contributing to broader economic development.

LIST OF ACRONYMS

ADB	Asian Development Bank
BFI	Banking and Financial Institutions
BII	British International Investment
DFC	The United States International Development Finance Corporation
DFIs	Development Financial Institutions
ESG	Environmental, Social and Governance
FMO	The Dutch Entrepreneurial Development Bank
GDP	Gross Domestic Product
GIIN	Global Impact Investing Network
GoN	Government of Nepal
HNWI	High Net-Worth Individuals
ICT	Information and Communication Technology
IFC	International Finance Corporation
IIN	Invest for Impact Nepal
IPO	Initial Public Offering
IRR	Internal Rate of Return
JICA	Japan International Cooperation Agency
MW	Mega Watt
NCP	National Cooperative Federation
NIB	Nepal Investment Board
NPV	Net Present Value
NRB	Nepal Rastra Bank
NREP	Nepal Renewable Energy Program
PE	Private Equity
SDC	Swiss Agency for Development and Cooperation
SDG	Sustainable Development Goal
SIF	Specialized Investment Fund
SME	Small and Micro Enterprises
VC	Venture Capital



Heifer International Nepal
GPO Box: 6043
Hattiban, Lalitpur - 15
T: +977-1-5913120 / 5911873
E: heifer.nepal@heifer.org
W: heifernepal.org