December 2024

Event Summary:

Private Investments in Emerging Markets:

Solutions to scale and impact

SDG Impact Finance Initiative (SIFI) hosted an event at the 2024 edition of Building Bridges, a yearly sustainable finance and impact investing conference in Geneva, Switzerland. The event, "*Private Investments in Emerging Markets: Solutions to scale and impact*", addressed the two key barriers to impact investing on which SIFI focuses currently: misperception of risk and illiquidity. The event started with a panel discussion featuring Ana M. Camelo Vega (Senior Economics and Finance Researcher, Columbia Center on Sustainable Investment (CCSI)) – CCSI is partnering with SIFI on a study on the potential of blended finance to mainstream impact investing, Lapo Guadagnuolo (Global Head of the Centre of Excellence for Methodologies, S&P Global), Sylvain Goupille (Founder and Managing Director, Octobre) - Octobre is a SIFI Innovation Window winner, and Deniz Harut (CEO, Agri3 Fund) – Agri3 Fund is a SIFI Product Window winner. This panel discussion was followed by interactive conversations bringing together professionals from asset managers, banks, impact investors, insurers, foundations and governments. These discussions provided the insights contained below.

Key Insights

Perception of risks in emerging markets

The panel discussion highlighted the **complex nature of risk assessments** and the **need for more data** and standardization to better evaluate the specific risks associated with private impact investments in emerging markets and developing economies (EMDEs). Credit ratings should be seen as **relative rankings of creditworthiness** rather than absolute indicators of survival. It was noted that market participants often lack discernment in distinguishing between **countries and contexts across EMDEs, as well as in differentiating between "unbankable" and "marginally bankable"** projects. The panel concluded by stressing that, while blended finance is an effective tool for de-risking private impact investments in EMDEs, it cannot serve as a standalone solution.

Participants in the interactive discussions echoed these observations. They identified the data gap as a clear constraint on the growth of private impact markets in EMDEs and emphasized that **while blended finance has demonstrated its effectiveness at de-risking specific investments, it has not yet led to the emergence of self-sufficient markets**. They noted that **blended finance sends dual signals to market actors** – a positive one, as it reassures private investors, and a negative one, as it can attest to the need of an investment to be artificially supported by concessional capital. Currently, there is only **anecdotal evidence of reduced concessionality** in the second iteration of blended finance instruments. For **blended finance to effectively change risk perceptions, more must be done to support the ecosystem**. Participants identified a range of approaches to correcting perceptions of risk:

- **Minimal Concessionality:** Blended finance transactions should be designed with the minimal level of concessionality, ensuring transparency to avoid fostering dependency and to promote the development of self-sustaining markets.
- **Role of MDBs and increased public-private coordination:** Reshape MDB mandates to prioritize risk-sharing and scalable solutions for below investment-grade projects, ensuring they crowd in private sector capital effectively.
- **Role of Insurance companies:** Insurance-backed guarantees can foster a stable investment environment by encouraging long-term participation. Partnerships between insurers, MDBs, and private investors should be explored to leverage insurance tools for risk mitigation.
- **Market mechanisms:** Tools like auctions and benchmarks can drive transparent and competitive capital allocation for investment-grade and below-investment-grade projects, helping investors make informed decisions. Transparency and clear processes for pricing, risk allocation, and project selection criteria remain central to market efficiency and stakeholder alignment.
- **Better Data, Definitions and Understanding:** Private impact markets in EMDEs should be studied closely to generate data, standardize definitions and improve the understanding of EMDEs' markets, all of which will increase the confidence of investors.

Addressing Illiquidity:

The panel discussion on illiquidity underscored that while illiquidity is not unique to private impact investments in EMDEs, it remains a significant concern for many investors **exploring these opportunities. The discussion emphasized the need for innovative financial instruments and structures to offer greater liquidity to investors**. The speakers concluded by reframing the issue, suggesting a shift in focus toward **the additionality provided by patient capital, rather than solely centering the narrative on liquidity risk**.

Participants in the interactive discussions echoed the **importance of liquidity as a key driver of growth for private impact markets** in EMDEs. Investing in EMDEs was compared to Hotel California: "you can enter anytime, but never leave." Innovative liquidity solutions were highlighted as promising avenues to provide clear exit pathways for investors. More broadly, participants emphasized that **strengthening local financial markets and stock exchanges in EMDEs** could foster the development of deep private markets.

They also underscored the **role of regulation in incentivizing greater participation from institutional investors**, suggesting measures such as modifying the terms of fiduciary duty or imposing a minimal threshold for impact investments in portfolios. Finally, participants noted that, as **relative illiquidity is a feature of private markets overall, expectations must be aligned** in the private sector to reflect this reality. They identified several ways to transform private impact markets in EMDEs:

- **Liquidity Solutions:** Liquidity should be increased through innovative means of structuring funds (e.g. open-ended) and products (e.g. pooling and securitization), as well as the provision of new tools (e.g. Octobre's Liquidity Guarantee Facility).
- **Secondary markets and strengthening of local capacity :** Growth of secondary markets is essential to enable investor turnover, improve liquidity, and foster more dynamic private impact investment ecosystems in EMDEs. Local EMDEs' stock exchanges and financial markets should be strengthened through adequate regulation and policies to foster the emergence of deep local private markets.
- **Participation Incentives:** Participation in private impact markets should be incentivized through adequate regulation, in particular pertaining to institutional investors and their fiduciary duty, which would increase the liquidity of these markets and attract smaller investors as well.
- **Expectations Management:** The expectations of investors should be managed to ensure that the inherently lower liquidity of private impact investments in EMDEs is recognized as a necessity.

At the heart of the SDG Impact Finance Initiative (SIFI) is our commitment to advocate for essential action points highlighted during our recent panel discussion on scaling up impact investing in developing markets. SIFI is dedicated to not only pioneering the innovation of new financial vehicles and scaling up impact funds but also to assembling a solution driven coalition of institutions and market participants.

Our goal is to establish the necessary framework conditions that foster a thriving ecosystem around impact investing. By aligning our efforts, we aim to propel investments towards the Sustainable Development Goals (SDGs) in developing markets at the required scale, ensuring meaningful and sustainable impact. To learn more about our activities and how we are driving change in impact investing, follow us on [LinkedIn].