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IMPACT INVESTING IN NIGERIA: KEY CONSIDERATIONS TO IMPROVE SUSTAINABLE IMPACT INVESTMENTS

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The need to attain the sustainable development goal in Nigeria, as well as other emerging markets, creates a financing and investment gap of about Ten Billion United States (US) Dollars ($10,000,000,000.00) per annum, according to the United Nations. [Punch Newspaper 1st June 2023, accessed January 2024.] This presents investors with an opportunity to address these needs while also generating financial returns. In 2015, according to a report by the Nigerian Economic Summit Group (NESG) and Nigerian National Advisory Board for Impact Investing (NABII) [NESG 2023, accessed 22 January 2024.], the Nigerian investment market witnessed a massive shift in investment patterns as investors began to prioritize social and environmental gains as opposed to a singular focus on financial returns.

Also, the Global Impact Investing Network (GIIN) in its 2023 report [GIIN 2023, accessed January 2024.] stated that investors plan to step up their capital allocation to emerging markets, with sub-Saharan Africa attracting more than half of these investments. This is due to Africa being a green investible ground with multiple opportunities. This strategy of investing for both financial and measurable positive societal outcomes is described as Impact Investment. Synonymous with sustainable investing, this shift is reshaping the investment landscape in Nigeria and around the world.

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Further, according to a report by the Business Research Company, the global impact investing market grew from $420.91 billion in 2022 to $495.82 billion in 2023 representing a compound annual growth rate (CAGR) of 17.8%. [The

Business Research Company, 4 January 2024), accessed January 2024.] Bloomberg also reported that banks made Three billion USD ($3,000,000,000.00) on green debt in 2023. According to this report, financial institutions made more money underwriting bonds and providing loans for green projects than they earned from financing oil, gas, and coal activities. [Tim Quinson, 'World's Biggest Banks Made $3 Billion on Green Debt in 2023' (Bloomberg, 3 January 2024) accessed 20 January 2024.]

UNDERSTANDING THE CONCEPT OF IMPACT INVESTING The GIIN defines impact investing as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return." ['Impact Investing' (The GIIN) accessed 20 January 2024] At its core, this investment involves deploying capital into scalable businesses, funds, or structures that generate both financial returns and viable social or environmental impact.

Impact investing contrasts with philanthropy, which focuses on charitable giving. Investments could be made in startups, growth, or mature businesses. The business models solve environmental and social problems like affordable housing, renewable/clean energy, greater access to education, unemployment, food security, financial inclusion, etc. Additionally, this investment encompasses a variety of asset classes such as private debt, publicly traded debts, private equity, public equity, equity-like debt, etc.

In structuring impact investment, certain key considerations need to be incorporated into the structure and agreements, such as the application of funds, board governance of funds, deployment, and proposed exit structure. These considerations are geared towards ensuring an impactful and sustainable investment.

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Impact investing attracts a diverse array of investors, spanning high net worth individuals, family offices, foundations, endowments, public and private pension plans, Development Finance Institutions (DFIs), governmental or quasi-governmental organisations like the International Finance Corporation (IFC) of the World Bank, funds-of-funds, insurance companies, and other institutional investors. These stakeholders share a common goal of balancing financial returns with positive impact. To them, one of the key priorities is ensuring that investments are made to cater to teething problems affecting global development.

Therefore, creating innovative deal structures and investment vehicles tailored to their specific requirements and objectives to meet these problems become a tool for investing in impactful business ventures.

These structures whether direct or indirect need to ensure seamless impact investment. Thus, impact investments must address challenges facing traditional investments such as fewer exit options, concerns about emission preservation, long-term commitment to enterprise, higher chances of failure, etc., and effectively navigating regulatory frameworks while optimizing risk-return profiles and ensuring alignment with impact targets.

Notably, the transactions may provide for a revenue-based Investment agreement. Impact investments intend to generate positive, measurable social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets and target a range of returns from below market to market rate, depending on investors' strategic goals. Thus, in the application of funds, key consideration is given to investment that helps suppress global challenges.

The growing impact investment market provides capital to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education. Therefore, consideration is given to the board composition such that investors with impact-focused ideas are onboarded as investors'. The investee companies are careful to onboard as board members only technically tested and trusted investors considering what the impact of their decision will affect sustainability and investment decisions in the investee companies, thus a rigorous process is undertaken to hire the best hands for the company.

However, investors can receive equity in impact investing through private equity as one of the primary instrument types that receive the largest capital allocation among impact investors, along with private debt. According to the Global Impact Investing Network, Annual Impact Investing Survey, 16% of the impact investing market is through private equity investments. This is evidence of private equity as a good alternate investment platform for impact investment.

The investment could also be structured as self-liquidating equity. The investment is designed to generate returns through ongoing cash distributions or periodic divestments of assets held by the company. This approach aligns with the concept of sustainability and financial prudence, as it aims to provide investors with a steady stream of income or capital repayment while allowing the company to maintain operational continuity and pursue its growth objectives.

Further, the investment may be structured as redeemable equity. This would require that the company purchase the investor's shares at a price determined at the time of exit. The repurchase could be made contingent on the company having a redemption pool and the terms should stipulate contingency plans to address potential issues. These investors are also required to maintain continuous relationships with relevant stakeholders such as regulators, investment bankers, legal practitioners who anticipate policy changes or opportunities that would affect the businesses.

REGULATORY FRAMEWORK FOR IMPACT INVESTING IN NIGERIA

Though Nigeria has witnessed a low pace in impact investments, such as the Babban Gona Agriculture franchise, Andela investment, etc. this to a large extent is due to reasons such as; the lack of adequate enlightenment on the benefits of impact investment, the inability to generate social or environmental change, and the risk of low returns compared to returns obtained in traditional investment, absence of an adequate regulatory framework governing the application of impact investment in Nigeria, as the intentions of the investment, investee, and stakeholders will be defeated if not regulatory adequately catered for.

Further, at the core of these concerns is compliance with the existing regulatory framework. The general legal framework for the regulation of business and investment in Nigeria is the Companies and Allied Matters Act 2020, the Investment and Securities Act 2007, the Securities and Exchange Commission (SEC) Rules, 2013, the Nigerian Exchange Rules, the Nigeria Investment and Promotion Commission Act.

The Companies and Allied Matters Act regulate the formation, incorporation, and operation of companies, incorporation of Limited Liability Partnerships, Limited Partnerships. This would facilitate the setting up of startups, investment companies, or holding companies for the portfolio companies.

Additional legislations include the Nigerian Investment Promotion Act, the Consolidated Rules and Regulations of the Securities and Exchange Commission, the Foreign Exchange (Monitoring and Miscellaneous Provisions) Act, the Industrial Inspectorate Act, the National Office for Technology Acquisition and Promotion Act, the Finance Act, the immigration Act, the Rulebook of the Nigerian Exchange, specifically the rule on green bonds which covers debt instruments that would be exclusively applied to financing new/existing projects that have a positive environmental impact, and the recently enacted Nigerian Startup Act 2022, among various others.

It is important to note that while investing is significant, the current laws except the SEC rules on green bonds are not adequately tailored to address the specific nuances of impact investing, for example, in the green bonds rules only cover sustainable finance without and there are no laws providing for incentives for private capital investment in private companies and startups. There are however some incentives that accrue to Venture Capitalists funds that make an investment that is not less than 25 per cent of the total capital required for the venture project as stated in the Venture Capital (Investment) Act of 1993 such as capital allowance deductions, capital gains tax exemptions, and withholding tax reductions. [the Venture Capital (Investment) Act of 1993 CAP V2 LFN 2004.]

A significant concern for investors is the need for investment readiness support for business, this is achieved by gaining a deep understanding of the prospective investee company, the investment tools/instruments such as equity and debt, and investment opportunities in the region where these businesses are located. To do this, some suggested means [Impact Investors Foundation, accessed January 2024.] include setting up funds housed in the regions they choose to invest in and building partnerships with investment banks and professional advisory firms like Stren & Blan Partners that are based in target regions.

CONCLUSION

As the country strives to achieve its Sustainable Development Goals, the regulatory gap presents a compelling space for investors to make meaningful contributions. Impact investing aligns with the growing awareness of corporate social responsibility, ESG, and sustainability which are all catalysts for positive change that empower entrepreneurs and promote economic inclusion without a reoccurring negative impact on the society at large.

To ensure that both goals are achieved the key considerations such as investable instruments, board composition, and key legal clauses need to be aligned. Moreover, a robust legislative framework provides the necessary foundation for investment activities, ensuring compliance and fostering a conducive environment for impact-driven initiatives. By integrating impact considerations into investment transactions and leveraging tailored structures, stakeholders can maximize both financial and societal outcomes, driving sustainable change and economic prosperity in Nigeria and beyond.

Noble Obasi is the Team Lead of the Private Equity, Capital Market, and Merger & Acquisition Practice Group at Stren & Blan Partners while Chidinma Anuforo is an Associate in the firm's Private Equity, Capital Market, and Merger & Acquisition Practice Group. Stren & Blan Partners is a full-service commercial Law Firm that provides legal services to diverse local and international Clientele. The Business Counsel is a weekly column by Stren & Blan Partners dedicated to providing thought leadership insight on business and legal matters.

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Stren & Blan Partners is a full-service commercial Law Firm that provides legal services to diverse local and multinational corporations. We have developed a clear vision for anticipating our clients' business needs and surpassing their expectations, and we do this with an uncompromising commitment to Client service and legal excellence.

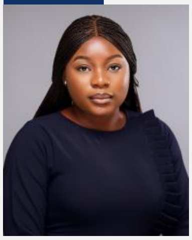
THE AUTHORS

Noble Obasi
Team Lead

nobleobasi@strenandblan.com

Chidinma Anuforo
Associate

chidinmaanuforo@strenandblan.com



Ibitola Akanbi
Associate

ibitolaakanbi@strenandblan.com

Oghenemega Igbru
Associate

oghenemegaigbru@strenandblan.com

Stren & Blan Partners

+234 (0)702 558 0053
3 Theophilus Orji Street, Off Fola Osibo Road, Lekki Phase 1, Lagos, Nigeria

www.strenandblan.com
contact@strenandblan.com
@strenandblan