FROM FINANCIERS TO CATALYSTS: HOW DFIs CAN SHAPE THE NEXT WAVE OF IMPACT INVESTING

INTRODUCTION

Access to finance remains a significant hurdle in African frontier and emerging markets. Capital availability in these regions remains limited, and when financial resources are accessible, they are often provided through short-term credit facilities carrying relatively high interest rates. These conditions constrain private sector investment and are further affected by currency volatility, political uncertainty, and underdeveloped regulatory frameworks. Collectively, these factors reduce the attractiveness of such markets to potential investors.

Development Finance Institutions (DFIs) play an important role in addressing these risks and supporting private sector participation. Owing to their development-oriented mandate, DFIs are able to assume higher levels of risk and offer more favourable terms than traditional commercial lenders. Their capacity to utilise public funding for risk mitigation, coordinate activities among development finance stakeholders, and draw on established expertise and networks enables them to promote collaboration in both early-stage project development and co-investment.

Historically, DFIs have faced criticism for adopting risk-averse investment behaviours and focusing primarily on transactional aspects of deals. This has led to an emphasis on financial performance over developmental impact and a tendency to prioritise established markets and lower-risk sectors, with a preference for debt instruments rather than equity. As a result, DFI activity has been concentrated in lower- and upper-middle-income economies, including South Africa, Nigeria, and Kenya, which together have accounted for 47 per cent of country-specific DFI investments since 2010. Fewer than 10 per cent of these investments have been denominated in local currencies.

While the measurement of private sector mobilisation remains difficult due to limited transparency and varying methodologies, recent studies indicate that DFIs have achieved relatively low mobilisation ratios, typically between 0.1 and 1.0. This is significantly lower than the ratios achieved by impact investing funds that utilise public and philanthropic catalytic capital, which report mobilisation ratios of up to 3.0.

This paper is the first in a series examining the challenges associated with mobilising private sector capital in African markets, as well as the strategies, instruments, and tools that DFIs can employ to enhance the appeal for private investors. Serving as an introduction, this paper provides context for the series, while subsequent publications will delve deeper into potential solutions to the challenges identified.

KEY CHALLENGES AND BOTTLENECKS

Several factors contribute to the limited ability of DFIs to mobilise private capital effectively. One key issue relates to the nature of DFI product offerings. Many institutions take a product-driven approach, designing financial instruments they wish to deploy, rather than tailoring solutions to the specific needs of the markets they serve. As a result, products often misalign with local conditions. The dominance of USD-denominated investments over local-currency financing, the reliance on senior debt, and the preference for large ticket sizes are among the product-related issues that constrain DFI investment in Africa.

Institutional structures, incentives, and organisational culture within DFIs also limit the ability to invest and mobilise private capital effectively. Many institutions exhibit a deeply embedded aversion to risk, reinforced by hiring practices that often favour professionals from traditional finance backgrounds rather than those with impact-oriented expertise. Internal incentive systems tend to reward transaction completion, which encourages staff to focus on less complex, higher-income markets instead of fragile or underserved environments where additionality is greatest. Furthermore, the desire to maintain high self-imposed credit ratings, such as AAA or AA, limits DFIs' willingness to assume greater risk. At the same time, stringent integrity requirements and robust environmental and social safeguards, while essential for responsible investment, can pose significant compliance burdens for companies that often lack the capacity to meet these standards, thereby narrowing the pool of eligible investees.

Another challenge arises from the potential misalignment between DFI mandates and local development priorities. Government-owned DFIs, in particular, may face competing pressures between their developmental objectives and the foreign policy interests of their shareholders. Although these institutions are designed to operate based on development impact, their strategic direction can be influenced by political or economic considerations to remain consistent with national aid policies.

External market conditions further compound these challenges. Exchange rate volatility, political and security risks, and weaknesses in regulatory and governance frameworks can undermine investor confidence and increase the cost of doing business in certain countries.

Finally, limited investment pipeline development outside major markets continues to restrict the reach of DFI activity. Nearly half of DFI investment in Africa since 2010 has been directed towards the continent's three largest economies. In many other countries, a lack of local presence and limited market knowledge have made it difficult for DFIs to invest in early-stage project preparation or to identify bankable opportunities capable of attracting private co-investment.

FROM FINANCIERS TO CATALYSTS: THE STRATEGIC SHIFT IN DFI MANDATES

Addressing the barriers that limit investment in African frontier and emerging markets will require a strategic shift in how DFIs operate. This shift spans three interrelated areas: product design, organisational practices, and internal incentive structures. Each area presents opportunities for DFIs to enhance their ability to mobilise private capital and align more effectively with development priorities. In the next series of publications, we will examine these solutions in greater detail and present practical examples of their application.

From a **product standpoint**, DFIs can deploy a wider set of instruments designed to reduce perceived risk and improve the commercial viability of investments. Blended finance structures, including the use of concessional capital and donor-funded guarantees, can create conditions that enable private investors to enter markets they might otherwise avoid. Anchor investments can help establish confidence in new funds or platforms, while greater use of local currency financing can mitigate exchange rate risk for investees. In addition to capital deployment, technical assistance and broader ecosystem support can address non-financial constraints such as capacity gaps, regulatory complexity, and market inefficiencies that cannot be resolved through capital alone. Subsequent papers will examine how the Africa Agriculture and Trade Investment Fund (AATIF), NASIRA (FMO), IFC's Local Currency Facility, EIB's Boost Africa, and ResponsAbility, among others, have deployed instruments tailored to African market conditions to crowd in additional investment.

Improvements in **organisational practices** within DFIs are equally important. Adopting a portfolio-based approach to investment can allow DFIs to balance higher-risk opportunities with more established assets, enabling them to engage more proactively in underserved markets. Product development processes that begin with market needs and local development priorities, rather than predefined product offerings, can result in more relevant and effective solutions. Enhanced approaches to opportunity identification and sourcing, such as IFC's establishment of upstream teams to shape markets and build pipelines, and BII's emphasis on developing deep local knowledge through its regional presence, demonstrate how stronger market proximity can expand the supply of bankable projects. These examples will be part of the case studies explored in following publications.

Finally, **internal incentive systems** will need to evolve to ensure that impact considerations are embedded within decision-making processes. Incentives that focus predominantly on deal execution or financial performance may limit the institution's ability to invest in complex or early-stage opportunities that offer high developmental value. Future papers will analyse how the integration of development-impact metrics into staff performance assessments, reward systems, and organisational targets can shift institutional behaviour towards a more impact-oriented approach, drawing on examples from FMO and BII.

Collectively, these changes can position DFIs to play a more catalytic role in mobilising private capital, strengthening local markets, and supporting sustainable development outcomes.

CONCLUSIONS

In conclusion, DFIs play a crucial role in shaping Africa's evolving investment landscape, however, to unlock greater flows of private sector finance and advance inclusive economic development, they must move beyond conventional models, adopting innovative strategies that reflect local realities, flexible product design, and incentive structures rooted in developmental impact.

Looking forward, the next series of papers will examine in detail the specific actions DFIs can undertake to mobilise private capital both effectively and efficiently. These forthcoming publications will provide practical guidance and real-world case studies to support the strategic transformation required for DFIs to serve as true catalysts for sustainable investment and growth.