

Ex-Ante Evaluation
Private Sector Investment Finance Division,
Private Sector Partnership and Finance Department, JICA

1. Name of the Project

Country: Nepal

Project: Impact Investment Promotion Project

Signing Date: December 19, 2022

2. Background and Necessity of the Project

(1) Current State and Issues of Industrial Development and the Energy Sector in Nepal

Despite the fact that Nepal experienced a temporary economic downturn due to the occurrence of an earthquake in 2015, it has since recovered from the earthquake, and thanks to benefitting from the economic development of its neighboring country, India, it has continued to achieve steady economic growth, and is expected to graduate from the Least Developed Countries (LDC) category by 2026. However, Nepal is a landlocked country with a lot of steep mountainous regions and, due to being burdened with these geographical restraints from the perspective of imports, exports, and domestic logistics, it is difficult to cultivate industries that have a high labor-force absorption capacity and are internationally competitive, so currently the main industries are service industries, such as the tourist industry, the farming, fishing, and forestry industries. Due to this situation, many workers end up going abroad to work, which has the effect of hollowing out the economy and creating a vicious cycle that ends up with even more workers going abroad for work, so there is an urgent need to develop domestic industries with high labor-force absorption capacity. Taking these issues into account, the Nepalese government formulated an Industrial Policy (2011) that designated 10 industries, including healthcare, IT, and energy, as priority industries, and promoted investment.

With regard to healthcare, the government stated in its 15th Five-Year Plan (2019/20-23/24) that it aimed to provide all citizens with high-quality medical care, ranging from basic health services to advanced medical services, and formulated the Health Sector Strategy (2015-2022) to help achieve this objective. However, there is an insufficient number of public healthcare facilities in Nepal, and currently pharmaceutical companies in Nepal can only satisfy around half of the domestic demand for pharmaceutical products, so it's important to promote investment in not only public medical facilities, but also private medical facilities and pharmaceutical companies, in order to improve medical services in Nepal.

The Nepalese government is also focusing on the IT and digital fields, and in 2019 the MoCIT (Ministry of Communication and Information Technology) formulated the Digital Nepal Framework that included specific guidelines aimed at promoting development in Nepal through the promotion of digitalization, and in 2022 they announced that they had invested 22 billion rupees into the Digital Nepal Framework. Nepal has the advantage of an abundant young workforce at low wages that can speak English, and due to this the growth of IT services companies, such as business process

outsourcing companies, has been remarkable in recent years, and the number of employees of these types of companies is also rapidly increasing. According to the Nepal Computer Association, the number of employees of IT services companies has been increasing at an annual rate of 15-20% in recent years (Nepal Journal of Multidisciplinary Research, 2021).

Micro, small and medium enterprises (hereafter referred to as MSMEs), including start-up enterprises, account for a large portion of the new industries mentioned above, but the funding gap for Nepal's MSMEs is estimated to be 3.6 billion dollars, and only 16% of the total number of start-up enterprises that have access to financing, so improving the financial access for MSMEs and start-up enterprises is also a big issue (UN ESCAP, 2020).

With regard to the energy sector, the Nepalese government has formulated plans like "10-year Action Plan for Hydroelectric Power Development" (2016) and "The Current Situation and Roadmap for the Energy, Water Resources and Irrigation Sectors" (2018), as part of its efforts to speed up energy development as it's seen as an important issue for national development. However, although the country has plenty of potential for hydroelectric power generation development and an economically feasible hydroelectric power generation potential capacity of 42,000 MW, the installed capacity of hydroelectric power generation in 2021 was stuck at 1,413 MW, and when combined with thermal and solar power the installed capacity was 1,468 MW (with an output of 6,045 GWh), which is slightly below the maximum power demand of that year of 1,482 MW. The consequence of this shortage of installed capacity was that in 2021 Nepal imported 2,806 GWh (32% of the demand for electric power) from India to make up for this gap in supply and demand, so further domestic development of electrical power resources is desirable from the perspective of improving its international balance of payments. According to the World Bank, the funding gap for climate change investment centered on renewable energy from 2018 to 2030 is estimated to be 46 billion dollars, and the electric power sector needs an annual average investment of around 1.3 to 2.1 billion dollars from 2019 to 2040. Under these circumstances, it's extremely important that private companies develop electrical power resources in the renewable energy field, such as hydroelectric power generation, and there is a requirement to obtain new sources of funds from foreign capital markets and investors.

The Impact Investment Promotion Project (hereafter referred to as "the Project") will mainly support industries in Nepal in the healthcare, IT and digital fields, as well as renewable energy projects, with the aim of solving the issues related to industrial development, job creation and promoting renewable energy use, and thus, the Project is consistent with the government policies for each sector.

(2) Japan and JICA's Policy and Operations in the Private Sector

Japan's Country Assistance Policy for Nepal (September 2021) identifies "economic growth and poverty reduction" as one of the priority areas. In addition to support for the improvement of social and economic infrastructure, enhancement of energy supplies, and the improvement of healthcare, including infection control measures and improved access to healthcare, in an attempt to boost the strengthening of the Nepalese economy through efforts to revitalize the private sector. Furthermore, JICA Country Analysis Paper for Nepal (August 2020) also notes the importance of promoting FDI

with the aim of promoting and developing domestic industry, and it also has a policy of supporting hydroelectric power development. Therefore, the Project is also consistent with those policies and analyses. In addition, JICA is currently involved in several projects in Nepal to promote investment and support the renewable energy sector, such as the Policy Loan for Economic Growth and Resilience (ODA loan, 2022), the Project on Integrated Power System Development Plan (technical cooperation, 2021 onwards), Foreign Investment Advisor (individual experts, (scheduled for) 2023 onwards), and the Project on Career Development and Entrepreneurship Support Program for International Migrants (technical cooperation, (scheduled for) 2023 onwards), and this project is expected to be mutually complementary with these existing projects.

3. Project Description

(1) Project Objective

The objective of the Project is to promote industrial development, job creation, and renewable energy use, by providing funding to industries such as healthcare, IT and digital, as well as renewable energy projects, thereby contributing to the development of key industries and mitigation of the effects of climate change in a developing area centered on Nepal.

(2) Project Site / Target Area

Nepal¹

(3) Project Components

We will invest in (1) healthcare companies, (2) IT and digital companies and, (3) renewable energy projects, mainly in Nepal, through an investment in Dolma Impact Fund II (hereafter referred to as DIF2) as a LP (Limited Partnership) investor. DIF2 will provide technical cooperation focused on social and environmental considerations to companies that we have invested in through DIF2.

(4) Total Project Cost: 71.96 million dollars

(5) Project Implementation Structure

- ① Investee: Dolma Impact Fund II (DIF2)
- ② Project Executing and Operating Agency: Dolma Fund Management (hereafter referred to as DFM)

(6) Environmental and Social Consideration / Cross-Sectoral Issues / Gender Category

1) Environmental and Social Consideration

- ① Category: FI
- ② Reasons for Categorization: The Project is in accordance with the Japan International Cooperation Agency's Environmental and Social Consideration Guidelines (announced in January 2022, and hereafter referred to as "the JICA Guidelines"), as the subprojects in this project could not be specified before JICA's financing agreement, but it is assumed

¹ In addition to Nepal, up to 13% of the total commitment, investing in multinational companies operating businesses in other developing countries is also considered.

that those types of subprojects will have an impact on the environment.

- ③ Other: In the Project, DIF2 plans to take environmental and social considerations into account for each project, based on its own system for environmental and social considerations and the JICA Guidelines. Also, a mutual understanding has been reached on the principle of not including subprojects in Category A.

2) Cross-sectional Matters: Renewable energy projects have been designated as one of the main sectors for investment in the Project, and renewable energy installed capacity and the reduction of CO2 emissions have been included in the project effects, so, as it will contribute to preventing global warming, the Project will be a part of climate change countermeasures (mitigation measures).

3) Gender Category: GI (S): Gender Activities Integration Project

<Reasons for classification> As job creation for women is set as a quantitative indicator. In addition, as the Project meets a direct criteria for the 2X Challenge (Financing for Women) (33.3% of senior management are women) and an indirect criteria (30% of the expenditure ratio is to companies that fulfill the 2X criteria), it is planned to apply for 2X Challenge recognition.

(7) Other Important Issues: None in particular

4. Targeted Outcomes

(1) Quantitative Effects:

Indicator	Baseline (2022)	Target (2031*)
Renewable energy installed capacity (MW)	N/A	44
Reduction of CO ₂ emissions (10,000 tons of CO ₂ /year)	N/A	16.01
Number of jobs created (people)	N/A	8,600
Number of jobs created for women (people)	N/A	1,900
Percentage of investment to female business operators (%)	N/A	30
Number of patients provided with medical services (people)	N/A	46,000

(*) The year that the Fund's term ends

(2) Qualitative Effects: Enhancement of industrial competitiveness, and raising awareness of environmental and social considerations.

5. External Factors and Risk Control

None in particular

6. Lessons Learned from Past Projects

(1) Evaluation Findings of Similar Past Projects

We learned from an overseas investment and financing project in India for “regional enterprise

development fund,” the importance of (1) establishing replacement criteria for the Fund managers, (2) requiring the production of a report that can accurately evaluate development effects, (3) drawing up a long list of investment recipients, and (4) confirming taxation related aspects with JICA.

(2) Lessons for the Present Project

Taking these lessons into account, the following points were confirmed in the review. (1) Three people, CEO Tim Gocher, MD Bidhya Sigdel, and Investment Director Shabda Gyawali, were identified as being key persons among the fund managers, and it was agreed that if by some chance that any of them ceased to be involved in the management of this fund, new investment activities would be suspended until their successors were approved by a majority of the investors. (2) It was agreed a report would be submitted to JICA every year with operational and effectiveness indicators as mentioned above. (3) A long list including investment candidates was obtained, and the probability of each company’s profitability and exit was verified. (4) It has been confirmed that this fund has been set up in Mauritius, and avoids the major taxation risks of Nepal.

7. Evaluation Results

As described above, the Project is consistent with Nepal’s developmental issues and policies, as well as Japan’s cooperation policies, its necessity has been acknowledged, the project plan is appropriate and there is a sufficient expectation of success. Therefore, it is highly meaningful to support the implementation of the Project.

8. Plan for Future Evaluation

(1) Indicators to Be Used: As shown in Section 4.

(2) Future Evaluation Schedule (estimate): Ex-post evaluation in the year that the Fund’s term ends.

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