Sustainability as a driver for institutional investment in Africa

How sustainability can act as a catalyst to business growth and job creation

Throughout 2024, ETK will be focusing on how the sustainability agenda has the potential to transform growth trajectories for businesses in the global south. In a series of articles, we will look beyond a focus on the necessary aspects of achieving the UN's Sustainable Development Goals to consider how businesses and governments in the Global South can harness the sustainability agenda to drive growth. The push towards net zero, greater transparency in business governance and social impact, and more effective risk management around environmental risks create new obligations for businesses, new ways of working, and new challenges to be managed. But with these challenges come new opportunities for growth, better risk management, improved efficiency, and service and product differentiation.
In this first article in the series, we discuss how the sustainability agenda is impacting the way institutional investors engage with businesses in Africa. Other articles in the series will cover a range of topics, and go into detail around subjects including:

- How the sustainability agenda is driving trade with Africa
- Job growth and innovations in sustainable agriculture, with a focus on South / South dialogue
- Job creation and opportunities in the circular economy
- Entrepreneurship and innovation in sustainability: The role of small and growing businesses

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SUSTAINABILITY AS A DRIVER FOR INSTITUTIONAL INVESTMENT IN AFRICA

As part of our commitment to developing robust, viable, growth-enabled businesses in markets across Africa, we at ETK wanted to explore how the sustainability agenda is affecting institutional investment in Africa. In this article, we will look at how the focus on sustainability is creating entirely new business models and new opportunities for existing businesses while considering the challenges these businesses face in accessing financing from institutional investors. We also will look at how institutional investors and the sustainability agenda are creating a new set of obligations for all businesses – regardless of sector or geography – in terms of transparency and reporting around non-financial ESG measures.

Institutional Investors in Africa

Before we look at how sustainability has affected the investment strategies of large institutional investors, it's worth considering who we mean when we refer to institutional investors, and how they have typically evaluated investment opportunities. Some examples of institutional investors include organisations such as pension funds, insurance companies, mutual funds, hedge funds, endowments, sovereign wealth funds, private equity firms, multilateral institutions, development finance institutions, and investment banks.
Institutional investors often have significant financial resources to deploy and invest large sums of money on behalf of others across a range of different asset classes, including stocks, bonds, real estate, private equity, and alternative investments. Institutional investors are increasingly affecting the way that businesses operate by mandating reporting on business performance with respect of ESG measures (environmental, social, governance).
When making investment decisions, institutional investors consider a range of different criteria, including investment risk; opportunities and challenges for a particular market, sector, or business; the likely impact of any given investment on achieving positive outcomes; and the institutional investor's overall investment strategy.

The sustainable financing gap

Institutional investors have a key role to play in helping to close the sustainable financing gap, which is defined as the shortfall between the expected investment required to meet the UN's Sustainable Development Goals, and existing investment currently allocated towards achieving those goals. In Africa, the sustainable financing gap is estimated to be approximately 7% of the continent's gross domestic product (GDP). In dollar terms, the shortfall each year for the years 2015 - 2021 averaged US$ 194 billion. Harnessing the power of institutional investment to achieve these goals can go a long way towards helping the continent to develop and grow while also ensuring that we achieve our collective aims, like limiting global temperature rises to 1.5 degrees Celsius above pre-industrial levels.

New business models and new opportunities

Institutional investment in Africa has historically focused on high growth areas with long-term potential and high returns in sectors like real estate, energy infrastructure, transportation infrastructure, and telecommunications. However, with the increased focus on sustainable use of natural resources, entirely new business models and new opportunities for existing businesses have sprung up, attracting the attention of institutional investors. Some examples of these include:

- Renewable energy services, from large scale solar and wind farms, to micro scale solar for individual household use;
- Businesses in the circular economy that focus on recycling and reuse of a range of goods and materials;
- Innovations in sustainable agriculture and new forms of farming like vertical farming and urban farming which are made possible by technologies such as hydroponics.
- New financial instruments and markets built around the sale of carbon credits and carbon offsets.

As the sustainability agenda continues to gain prominence, further innovations aimed at addressing environmental and social challenges are certain to emerge, attracting investor attention and driving further growth.

Challenges

While the drive towards responsible lower-emission businesses has created significant opportunities, there remains a disconnect between the funding needs of businesses, and the expectations and requirements of investors. Some of the challenges that businesses face in accessing funds from institutional investors include:

- Smaller investor base: Relatively smaller number of investors operating in the region means that there are fewer potential sources of capital compared to other regions.
- Perceived Risk: Institutional investors may perceive investing in Africa as being riskier compared to more developed markets, leading to concerns about political instability, security risk, regulatory uncertainty, currency risk, and infrastructure challenges.
- Lack of Transparency and Information: Limited transparency and information about African markets and investment opportunities can make it difficult for institutional investors to conduct thorough due diligence and assess the risks and potential returns on investments.
- Regulatory Hurdles: Complex and inconsistent regulatory environments across African countries can create barriers to investment, requiring businesses to navigate multiple legal and regulatory frameworks.
- Currency and Exchange Rate Risks: Fluctuations in currency values and exchange rates can increase the risk exposure of institutional investors operating in Africa, particularly for businesses with revenues denominated in local currencies.
- Infrastructure Constraints: Inadequate infrastructure, including transportation, energy, and telecommunications, can impede business operations and increase costs, reducing the attractiveness of investment opportunities for institutional investors.

Some examples of businesses that have struggled to access institutional investment

With the creation of new sustainability-driven business models, the need for capital to fuel growth has outpaced the willingness of institutional investors to provide the necessary capital. Here are some examples of some sustainability focused businesses that have struggled to gain access to investment from institutional investors.

M-KOPA Solar:
M-KOPA Solar, a Kenyan company, provides affordable solar energy solutions to off-grid households. Despite its positive impact on rural electrification and reducing carbon emissions, securing adequate financing has been challenging. The company faces hurdles related to creditworthiness, regulatory barriers, and investor risk perceptions.

GreenBio Energy:
GreenBio Energy, based in Nigeria, focuses on converting organic waste into clean energy. Their biogas and biofuel projects contribute to waste management and reduce greenhouse gas emissions. However, accessing climate finance remains difficult due to limited awareness, complex application processes, and insufficient support from financial institutions.

EcoPlanet Bamboo:
EcoPlanet Bamboo operates sustainable bamboo plantations across Africa. Their goal is to provide an alternative to traditional timber while promoting reforestation and carbon sequestration. Despite their environmental benefits, securing long-term financing for large-scale bamboo projects has been a struggle.

AgriProtein:
AgriProtein, a South African company, pioneers insect-based protein production from organic waste. Their innovative approach addresses food security, waste reduction, and sustainable agriculture. However, attracting investors and accessing climate funds has proven challenging, partly due to the novelty of their business model.

BBOXX:
BBOXX, headquartered in Rwanda, offers solar-powered home systems to off-grid communities. Their inclusive business model aligns with sustainable development goals. Yet, obtaining climate finance for scaling up operations and expanding market reach remains an uphill battle.

- Limited Track Record and Corporate Governance: Some African businesses may lack a proven track record of performance and transparency in corporate governance practices, making them less attractive to institutional investors seeking reliable and well-managed investment opportunities.
- Access to Capital Markets: Limited access to capital markets and financial services in certain African countries can constrain businesses' ability to raise capital from institutional investors through public offerings or debt issuance.

Addressing these challenges requires collaboration between businesses, policymakers, and investors to improve transparency, strengthen regulatory frameworks, enhance infrastructure, and mitigate risks, ultimately fostering a more conducive environment for attracting institutional investor capital to Africa.

How institutional investors are changing the way businesses operate

As institutional investors ramp up their efforts to address key sustainability challenges, they are increasingly changing the way that they engage with businesses. This additional scrutiny is manifested in heightened levels of due diligence, and increased focus on company performance with respect of ESG measures. In addition to conducting comprehensive assessments of ESG performance, investors frequently mandate that businesses hire external advisors to help them monitor key areas of risk. Some examples of ESG risks include the following:

Environment Risks:

- Inefficient energy consumption leading to unnecessarily high costs.
- Threats from operations to other scarce natural resources, like water.
- Unacceptably high emissions that run afoul of air quality standards and regulations.

Social Risks:

- Negative impact of operations on communities within which a business operates.
- Violations of labour laws or treaty obligations.
- Insufficient quality control of products resulting in harm to customers.

Governance Risks:

- Insufficient controls over suppliers, risking violations of applicable labour laws.
- Lack of independent Board of Directors, leading to shareholder lawsuits.
- Lack of governance over data compliance, leading to violations of regulations and laws.

Investors are increasingly seeking assurances that these risks are carefully addressed and managed, and are making compliance with ESG reporting a condition for the receipt of funds. While this creates an additional burden on the firm, the added transparency increases the likelihood that businesses will be able to secure the long-term investment needed to grow and thrive.

About ETK
Since our founding as an African owned and led consultancy in 2010 to provide cutting-edge market entry, business expansion, consulting and project management services, ETK has delivered projects in 34 African markets, participating in deals worth more than $1 billion. Our services are constantly evolving, supported by people, process and technology.

As specialists in helping businesses to grow and scale, we provide a full range of services targeted to helping African businesses reach their expansion targets, including:

- Organisational Transformation & Capacity Development
- ESG Strategy, Reporting & Auditing
- Market Entry & Expansion Services
- Access to Capital Markets & Financing
- The ETK African Business Console Managed Business Service

Our business is built on sustainable development and the empowerment of the African private sector. Our strength is the innovation of our people, the leadership of our team, and the desire for change from our clients.
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Conclusion

Institutional investors have long been critical to the growth and development of economies in Africa. As they have turned their focus to addressing the risks and challenges of climate change, businesses are having to learn to respond, and to change practices accordingly. And while this added scrutiny has created additional overheads, it has also created significant opportunities, with the creation of new business lines, greater focus on efficiency, and greater awareness of the way a business impacts the communities within which it operates.

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ChatGPT was used as a research assistant in writing this article.

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