IFC Advisory Services in Sustainable Business

Sustainable Investment in Sub-Saharan Africa

ISSUE BRIEF

In partnership with the government of South Africa

International Finance Corporation
World Bank Group

INTRODUCTION

IFC, a member of the World Bank Group, creates opportunities for people to escape poverty and improve their lives. Sustainable investment – the integration of environmental, social, and corporate governance (ESG) factors into investment decisions and processes - supports this goal. IFC's advisory services encourage investors and market participants to integrate ESG factors into capital allocation and portfolio management, using IFC's own investment practices as a model. IFC promotes sustainable investment by developing enhanced stock market indices, designing financial instruments, conducting market research, and helping private equity funds establish ESG analytical processes.

IFC commissioned a series of reports covering sustainable investment in economically significant emerging economies and regions. Information on markets and opportunities is less available in emerging markets. Through May 2011, these reports have covered Brazil, China, India, the Middle East/ North Africa, and Turkey. This summary of the Sustainable Investment in Sub-Saharan Africa report, downloadable from IFC's website, provides a snapshot of sustainable investment in Sub-Saharan Africa, and is unique in the series by focusing on the private equity (PE) asset class.

Sustainable Investment in Sub-Saharan Africa focuses on three key economies - Kenya, Nigeria, and South Africa – in this 48-country region, which is predicted to have a population of nearly 1.5 billion by 2050. The report is based on primary and secondary research conducted 2010 - 2011, including interviews with over 160 investment practitioners active in Sub-Saharan Africa.

SUSTAINABLE INVESTING IN AFRICA

Africa's investment case is compelling. The Sub-Saharan Africa region gross domestic product (GDP) grew for the 15th consecutive year to 2009, reaching $1.02 trillion in 2010, driven by a rapidly growing middle class. Africa's growth prospects are underpinned by generally improved macroeconomic policies, lower public debt, and a greater degree of political stability. However, significant barriers remain including poor infrastructure and weak regional infrastructure links, limited access to market information, the absence or failure of regulatory mechanisms, and the small size of many domestic markets.

Sub-Saharan Africa is developing an organic approach to SI. There is growing awareness that such investment can play an essential part in tackling the social and economic challenges in the region – and that the resulting economic growth will benefit investors over the long term. Sustainability concerns in South Africa, Nigeria, and Kenya include issues that are common internationally, such as governance, corruption, climate change, water use, diversity, human rights, job creation and health and safety of workers.

The importance of integrating ESG factors into investment is particularly important for developing countries, which have limited resources to mitigate or adapt to rapid urbanization, agricultural production swings, food price volatility, or the anticipated effects of climate change. In the African context, these broader systemic concerns may include the need for employee health care to cover a proactive HIV/AIDS policy that supplements public health services, or private sector water treatment systems that deliver treated water both as a factory input, and as a public good.

African investor and business perspectives on ESG priorities are heterogeneous. Similar to other emerging markets, the private sector is expected to play a positive role in society. But screening out exposure to a country based on norms of an international convention may be more of a compelling concern to investors in New York, Tokyo, or Geneva than to investors in Lagos, Nairobi, or Cape Town. Local investors may well rate the opportunity to grow new businesses where there are none today – and which provide basic services to local communities – as the most compelling SI rationale.

SUSTAINABLE INVESMENT MARKET SNAPSHOT

Sustainable investment is an established niche in Sub-Saharan Africa, predominantly in the largest institutional investment market, South Africa. In Sub-Saharan Africa, funds profiled and/or marketed as ESG-branded at 31 December 2010 total about $5.5 billion in assets under management (AuM) (<1% AuM). But using a broader definition that covers self-reported integration of ESG factors into fund investment policy and/or process, sustainable investment in South Africa, Kenya, and Nigeria is estimated at $125 billion AuM (20% AuM). The relative size of the overall Sub-Saharan African sustainable investment market ranks ahead of markets such as the United States and Brazil.

ESTIMATES OF THE PROFESSIONAL SUSTAINABLE INVESTMENT AUM IN SUB-SAHARAN AFRICA, END-2010 ($ BILLION)					
General asset management					
	Total AuM	**ESG-integrated**	**%ESG-integrated / total region AuM**	**ESG-branded**	**%ESG-branded / total region AuM**
South Africa	556.2	111.2	*20.0%*	4.2	*0.8%*
Kenya, Nigeria, and/or Sub-Saharan Africa ex-SA (**)	18.3	3.5	*18.9%*	0.0	*0.0%*
TOTAL (sum of South Africa and ex-South Africa – except %)	574.5	114.7	*20.0%*	4.2	*0.7%*
Private equity					
	Total AuM	**ESG-integrated**	**%ESG-integrated / Total Region AuM**	**ESG-branded**	**% ESG-branded/ Total Region AuM**
South Africa	14.2	6.3	*44.0%*	1.1	*8%*
Kenya, Nigeria and/or Sub-Saharan Africa ex-SA	9.8	4.3	*44.2%*	0.2	*2%*
TOTAL (sum of South Africa and ex-South Africa – except %)	24.0	10.6	*44.1%*	1.3	*5%*

Compiled by SinCo from composite data from SinCo, RisCura and multiple sources; see report for detail

The estimate of the ESG-integrated market is based on a qualitative analysis of available quantitative information, along a spectrum of proxies:

- Percentage of interview/survey respondents self-reporting managing assets for DFIs (by definition requiring ESG integration in investment mandates).
- Percentage of interview/survey respondents (private equity and general asset management) self-reporting their firm uses a "fully integrated ESG strategy applied to the majority of their investments".
- Self-reported gross AuM from members/signatories of SI-type initiatives such as the Carbon Disclosure Project or Principles for Responsible Investment.

The relatively high proportion of ESG-integrated investment is the result of the largest asset owner in the largest African investment market, South Africa's Government Employee Pension Fund (GEPF) and the asset manager of 92% of its assets, Public Investment Commission (PIC), both adopting ESG-integrated sustainable, responsible and/or developmental investment policies. Regulatory changes, for example Regulation 28 of the Pension Funds Act in South Africa, that in 2011 introduced enabling regulation for the concept of integrating ESG factors, is expected to further the growth of the institutional market. Kenya's and Nigeria's regulatory frameworks are more focused on governance issues. But government-led regulations or associations-led initiatives such as the Extractive Industries Transparency Initiative are having a positive impact.

Demand for pure-play SI mandates in general asset management is low. Investment managers complain of static demand from asset owners who request education and advocacy, but seldom fund mandates.

A FOCUS ON PRIVATE EQUITY

Private equity (PE) is a small but growing investment discipline in Sub-Saharan Africa, expanding in response to improving economic fundamentals. PE fundraising activity in Sub-Saharan Africa almost tripled from $800 million in 2005 to over $2.2 billion in 2008. PE funds manage an estimated $24 billion, with South Africa-specific funds accounting for around $14 billion. More capital is coming: 92 percent of PE investors interviewed expect an increase in PE commitments into Sub-Saharan Africa over the next five years.

Of the two common PE management models —traditional financial investor with focus on financial engineering and selective changes in the governance model of portfolio companies; versus seeking value creation through active ownership,—the latter is most prevalent in Africa. The fundamental active ownership PE model has both PE investors and their investee companies aligned on a longer time horizon (5-10 years) and vested interest in growing firms with lower risks, higher returns, and better corporate governance in order to sell to prospective investors, often strategic buyers.

DFIs have been a major positive contributor to funding PE mandates integrating ESG in Africa. The DFI-PE relationship affirms the fit between the PE asset class in Africa and the sustainable investment theme. In addition, large South African institutional investors invest up to 5% in alternative investments, mostly in domestic PE funds.

BARRIERS TO SUSTAINABLE INVESTMENT

Barriers to SI in Sub-Saharan Africa are similar to those in other regions. They include knowledge gaps, dominant investment practices that are hard to change ("investment-as-usual"), poorly applied regulations at both company and/or investor levels, and the incorrect perception of SI as only "ethical" investment and/or negative screening in investment process. The chart (below)[1] captures the most ranking of perceived barriers to SI in the region over the next three to five years.

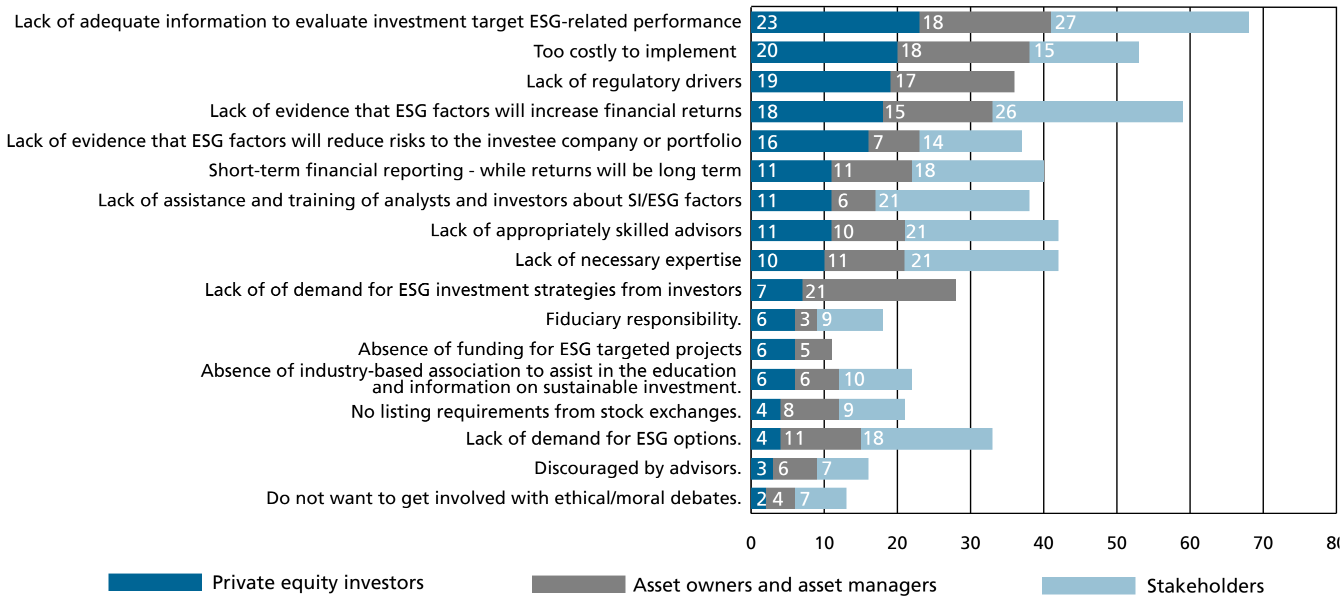
RECOMMENDATIONS

A systematic approach will encourage integration of ESG factors in investment decisions in Sub-Saharan Africa. The report makes the following recommendations:

- **Key influencers to drive messaging:** The SI message should be presented in the language of investors; andthe message must be driven by the end clients – the asset owners.
- **Streamline reporting:** Reduce information gathering and execution costs by streamlining the ESG reporting approaches of and increasing comparability of ESG impacts through guidelines for PE.
- **Leverage local knowledge:** Leverage local and regional insights in sustainable investment to develop new global best practices.
- **Make the investment case:** presenting the sustainable investment case to make the proposition that SI has the potential to generate increased returns and/or reduced risks across all asset classes.
- **Keep score:** Investors and investment stakeholders need to keep abreast of investment performance and ESG impact. Regular surveys of investment products, portfolios, and performance are required, along with benchmarking through a regional sustainability index.

What do you see as important barriers to ESG in investment in Sub-Saharan Africa in the next 3-5 years?

[Ranking of 17 answer options; n=45 PE investors + 43 asset owners/asset managers + 49 stakeholders; January 2010-April 2011]



1. SinCo analysis of SinCo+RisCura data; January 2010 - April 2011 interviews.

The challenges and solutions identified, as well as recommended strategies, are discussed in full detail in the report.
Sustainable Investment in Sub-Saharan Africa 2011, full report: http://www.ifc.org/sustainableinvesting

Written by: Graham Sinclair and Roselyne Yao, SinCo [sinclairconsult.com] based on research by SinCo + RisCura [riscura.com].
Edited by: Cecilia Bjerborn
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International Finance Corporation • 2121 Pennsylvania Avenue NW • Washington, DC 20433 USA
Tel. 1-202-473-3800 • Email: asksustainability@ifc.org • www.ifc.org/sustainableinvesting