



A recent roundtable explored the challenges of institutional investing in emerging markets for a just and inclusive climate transition, while targeting risk-adjusted returns in Africa

# Investing for climate equity in emerging markets

By David Brown



This blog reflects on the practical experiences shared at a recent roundtable on the challenges to unlocking institutional capital to invest in emerging markets for climate action, with a particular focus on Africa. The event was organised by *Pensions for Purpose* in conjunction with the UK charity *Shell Foundation* and the US Government's *Prosper Africa* initiative, and hosted by international law firm, *Pinsent Masons*, at their London office.

Is there a case for investing for impact and risk-adjusted returns in the African continent? From the moral perspective of the sustainable development goals (SDGs) and universal ownership there is a compelling case for arguing yes. In practice, the current position is vastly different with negligible allocations in Africa for most UK pension funds that in aggregate manage over £2 trillion in assets. Why should this be? And how/could this position change? These questions were the focus of this roundtable discussion with leading UK asset owners and the emerging markets impact focused development finance community, including the UK, US and Nordic government agencies and funders.

## Symbiotic investing

Sustainable investing in emerging markets can deliver real world impact. It also facilitates private sector investment's contribution towards the \$4.5bn annual shortfall needed to meet the SDGs by 2030. As one of the attendees suggested, 'symbiotic investing' is a more accurate description of emerging market impact investing, given the need to form mutually beneficial relationships between disparate groups – including engaging with communities in planning for

new investment projects – and also given the overly used term 'impact investing' is now largely perceived as either charitable or sub market-return strategies by mainstream commercial and institutional investors.

## Perceived risk and return

Feedback from asset owners indicated the extra risk associated with investing for impact in emerging markets, including Africa. We drilled down into whether this risk was 'perceived' or 'real'. Perceived risks included the need to sacrifice some return, and higher political and currency related uncertainties. Ordinarily, a low return, high risk proposition in emerging markets would make investment difficult for a pension fund from a fiduciary duty perspective. Is this challenge insurmountable?

The roundtable considered solutions that are available to address the challenges of higher risk and potentially lower returns. Examples included the use of blended funds with different tiers of capital ranging from grants, catalytic capital, to acceptance of concessionary returns from some investors such as public and private philanthropic investors, development finance institutions, multilateral development banks etc. This blended finance approach sometimes guarantees underwriting any losses and removes many of the perceived risks. In turn, it is therefore practical to structure financing to offer market-attractive returns for pension funds, thus fulfilling their fiduciary duties. While, to date, the majority of such blended finance funds have been too small to be relevant for institutional investors such as pension funds (due to concentration limit constraints among other factors) – of late this is changing with several larger-sized impact focused blended finance funds coming to the market.





## Asset owner event blog

The above approach is also consistent with *Pensions for Purpose's* recent Impact Lens research which found financial returns from funds with a dual positive impact objective are in line, and sometimes ahead, of traditional funds. *(Note the results of this project mostly focused on developed markets – further research is needed on impact investing performance in emerging markets).*

Financial innovation connecting investors willing to provide concessionary and flexible capital and the needs of pension funds requiring market attractive returns and investment-grade strategies means there is an important role for investment consultants to step up. They can help provide the connection between different investors to drive new pools of capital to the emerging market impact opportunities.

### Size of opportunity

While other risks such as currency, political and lack of credit ratings remain, these do need to be taken in the context of an African continent, consisting of 54 countries, where population and economic growth is anticipated to be exponential. For example, Africa presents a roughly \$277 billion annual green investment opportunity until 2030 to meet Paris-aligned climate targets<sup>1</sup>. Further, Africa is expected to have the largest workforce in the world within 15 years. This huge market is going to need significant investment in sectors such as infrastructure, technology (eg bringing the internet to all) and climate solutions / mitigation. Investing in Africa still offers first mover advantages in a large market and the potential for high returns.

Importantly, we heard examples of US pension funds undertaking site visits to African countries to support their impact investing decision making, which resulted in many of the perceived risks falling away.

Despite this mitigation, barriers remain to investing for impact in Africa. Governance budgets and resourcing available to UK pension funds remains tight. Also, as one pension fund highlighted, they can invest in renewable energy in the UK at relatively minimal risk with competitive returns and while supporting the home market of their members. Whilst this view is perfectly valid, we do need clean energy solutions across

the globe, not just in our home markets, especially when more than 675 million people globally (mostly in Africa) – roughly equivalent to 90% of Europe's entire population – still do not have any access to basic home electricity as of 2021<sup>2</sup>. After all, a tonne of CO2 released into the atmosphere is the same, wherever it has been generated, so we need to take that real world view. In addition, public or private market investing in Africa will have a relatively low correlation with developed markets, thus acting as a helpful diversifier.

### Solutions

The skills and tools for impact investing are available. Master trust defined contribution schemes are growing exponentially and have long-term investment time horizons. Additionally, the introduction of the Long-term asset fund (LTAF) makes it easier to invest in private market, relatively illiquid opportunities including in positive impact opportunities in developed and emerging markets. In the local government pension scheme (LGPS) market, the growing size of the investment pools should also allow scale and governance resource, particularly when collaborating, to understand, explore and allocate to impact investment opportunities in emerging markets, including the African continent.

Ultimately, stakeholders, such as asset managers, investment consultants and public/private philanthropies, working alongside pension funds, can help grow investment allocations to impact opportunities in emerging markets with the right mindset. At *Pensions for Purpose*, we will continue to work with all stakeholders to help pension funds develop their investment theses and theories of change to make this a reality.

### More information

If you are interested in a conversation on this topic, please e-mail [David Brown](#).



[Read the synopsis of the event](#)

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### Help for asset owners

*Pensions for Purpose* offers asset owners bespoke pension committee training and facilitated workshops to help funds clarify their priorities, goals and how to achieve them. Our [Knowledge Centre](#) contains a huge collection of Thought Leadership

articles from our members, with over 300 on Paris Alignment alone, as well as our own content.



### REFERENCES

- 1 Herles, B, KPMG, 2023, *KPMG report highlights significant untapped green investment opportunities in Africa*, viewed April 2024 <<https://kpmg.com/xx/en/home/media/press-releases/2023/12/kpmg-report-highlight-significant-untapped-green-investment-opportunities-in-africa.html>>.
- 2 Birol, F, et al, 3 International Bank for Reconstruction and Development / The World Bank, Washington, 2023, *Tracking SDG 7 – the energy progress report*, viewed April 2024 <[https://trackingsdg7.esmap.org/data/files/download-documents/sdg7-report2023-full\\_report.pdf](https://trackingsdg7.esmap.org/data/files/download-documents/sdg7-report2023-full_report.pdf)>.