Why We Must Redefine 'Responsible Investing' in Africa
By Stéphane Bacquaert

In Africa, the challenge isn't getting more investors to embrace the concept of 'responsible investing.' To a large extent, this has already happened. Among GPs engaged in African private equity, 95% already have a responsible investment or ESG policy in place, according to a 2021 industry survey by the African Private Equity and Venture Capital Association (AVCA).[1] Among LPs, more than 97% already believe it is important to consider environmental, social, and governance factors when making investment decisions.[2]

This isn't surprising. Development finance institutions have played a pivotal role in attracting private capital to the continent for decades, and DFIs began discussing the need for environmental standards as far back as the 1990s. What's more, in a continent where 600 million people still don't have access to electricity, 320 million are without safe drinking water, and 250 million suffer from hunger, there are more opportunities for investors to make a positive economic, environmental, or social impact here than in any other region in the world.

Going forward, the new challenge is to get investors deploying capital in Africa to embrace a more-expansive definition of responsible investing. That definition must reflect:

- The specific needs of private businesses on the continent, which is witnessing rapid population growth, urbanization, and an emerging consumer class.
- An appreciation of the complexities surrounding the environmental debate in Africa. On the one hand, Africa is among most-affected continents when it comes to climate change, evidenced by droughts, floods, severe weather events, and reduced agricultural yields that are likely to result in billions of dollars in adaptation costs over the next several decades, according to the Africa Adaption Initiative. Moreover, CO_2 emissions are growing faster in dozens of emerging economies, including Nigeria, Congo, Uganda, and Ethiopia, than the world national average, according to a recent World Bank report.[3]
- On the other hand, distinctions must still be made when it comes to environmental considerations in Africa compared with the developed world

[1] *2021 African Private Equity Industry Survey*, African Private Equity and Venture Capital Association. April 2021, page 30
[2] *2021 African Private Equity Industry Survey*, African Private Equity and Venture Capital Association. April 2021, page 14
[3] Emerging Emitters and Global Carbon Mitigation Efforts, World Bank working paper. Can Cui, Dabo Guan, et al.

owing to sheer scale. In Kenya, for example, the per capita carbon footprint is less than 3% of that of the United States'. In Nigeria, it's less than 5%, according to the World Bank. [4] In other words, with the average Nigerian emitting the same amount of CO_2 a year as the typical American does in 17 days, growth and carbon emissions are not as intrinsically linked in Africa as they are in developed markets.

- A fundamental understanding that economic growth equals social impact. More so than in any other region of the world, meaningful economic growth, coupled with real rising incomes, can have a powerful trickle-down effect in Africa on issues ranging from educational opportunities to health outcomes. The key is making sure that these opportunities and outcomes are distributed broadly and equitably.

What Makes Africa Different

Africa's demographics and development offer a compelling backdrop for private capital. The continent's 2.7% average annual population growth, for example, is twice as fast as South Asia's (1.2%) and Latin America's (0.9%) growth rates, and those are the next-fastest growing regions in the world. At this pace, Africa's population is expected to double to 2.5bn people by 2050.

Africa's population is also rapidly urbanizing. Today, out of 1.36 billion current inhabitants, 587 million, or 43%, live in urban centers.[5] The promise of brighter economic prospects within city centers continues to draw rural dwellers into cities and towns, meaning the number of urban residents is set to rise to over 1.1 billion, or 50%, by 2040. Meanwhile, macroeconomic and political governance in Africa has improved markedly since the 1980s. With better economic management, further privatization of state enterprises, a greater embrace of foreign trade and investment, strengthened legal, tax, and regulatory systems, and growing infrastructure investment, the environment for the private sector has never been more promising. Businesses, as a result, have seen significant gains in turnover and in productivity.

At a macro level, these "mega-trends" may be easy to see, but investors may not be able to detect how these trends are unfolding — and how quickly — unless they are actually on the ground and living in these communities. With urbanization comes increasing construction, traffic, energy demand, waste management and changing consumer behavior among other resulting impacts. With economic growth comes greater demand for power and water. At Adenia, all of our investment professionals live

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[4] World Bank Open Data, based on 2018 figures (most recent available)

[5] *UN World Urbanization Prospects: The 2018 Revision*, United Nations Department of Economic and Social Affairs. 2019, page 25

and work on the ground and can witness these trends firsthand. For example, we see the speed of urbanization in our daily commutes into the office. We see the growing and sustained demand for energy in our utility bills.

Having our investment team on the ground gives Adenia a competitive advantage in understanding the key markets in which we work. Being a part of the community allows us to identify opportunities, thoroughly vet potential investments via our broad and active networks, understand local risks, and meet entrepreneurs with whom we can do business down the road.

The Challenges of Scaling Growth in Africa

While investment opportunities are burgeoning on the continent, Africa is in many ways a market in transition. Countries that are evolving from low-income to middle-income status are also experiencing a transformation when it comes to corporate culture. In these transition markets, emerging companies are increasingly aware of the need to graduate from an entrepreneurial focus to professional management process, relying less on a founder's dynamism and relationships and more on the competencies of a management team with appropriate decision-making systems in place. At Adenia Partners, utilizing our control investment strategy, we support emerging companies to make this transformation by developing their people and systems.

For Adenia, the key factor for any successful investment is the team. We rely on close partnership with our management teams to achieve a shared vision and tackle the challenges that inevitability arise during our holding period. Majority ownership also allows Adenia to install experienced managers, directors, and advisors to bring operational and strategic expertise to our investees. Beyond top management, we ensure that the conditions to create a high-functioning workforce are in place; health and social benefits, professional development and training, and promoting gender equality and diversity. By developing a company's competencies through specific recruitments and dedicated training, we help investees sharpen their competitive edge in their respective markets. Developing human capital is so key for Adenia, we measure it across our portfolio via a Job Quality & Diversity score as part of our Impact Measurement framework.

Similarly, at Adenia, through our control strategy, we are focused on improving the sustainability of operations of all our portfolio companies. By supporting them to engage in ambitious capex programs, we help our investees raise the barriers to entry for potential competitors. Our control strategy also enables us to drive management teams to install and integrate professional ESG standards into their processes and strive for relevant international best practices as it pertains to their industry. We take our responsibility to put in place the necessary structures to scale a business sustainably seriously and measure it too.

The Challenges of Sustaining Growth in Africa

In addition to growing EBITDA, all of the aforementioned measures taken by Adenia also improve the quality and robustness of our investees' EBITDA. By reinforcing sustainable business pillars around human capital and sustainable operations, Adenia is able to exit at better EBITDA multiples than at acquisition, which we can attest to across our 16 exits and two fully liquidated funds.

At Adenia, the key is not to let the momentum built during the holding period stall as exits take place. Recently, the global pandemic offered some guidance on how to sustain growth over multiple cycles and owners. The pandemic demonstrated that certain business models were shielded from short-term shocks, whether triggered by the economic shutdowns caused by Covid or routine cyclical downturns. Companies focused on recurring revenues, regional market penetration and diversification, and technology — traits that we actively cultivate through our control investment process — are best positioned to thrive post-exit.

Also critical is a commitment to sustainable growth post-exit. At Adenia, we believe sustained growth first requires laying a solid foundation. Part of this foundation is built on culture. Potential buyers, for instance, understand Adenia's principles and appreciate the procedural and ESG integration with which we imbue our portfolio companies. Then as those companies achieve a long-term record of success, the managerial systems and infrastructure we install take shape and harden, increasing the chances of being able to build upon that success post-exit.

Redefining Responsible Investing

In Africa, being a responsible investor is meaningless unless you take responsibility for showing promising companies how to bring about positive change. In Adenia's case, that means guiding companies to grow by helping them gain access to the services and capital they'll need to transition to the next level; supporting them how to grow the right way by helping them transition to professional management and processes; and showing them how to scale that growth so they can transform their communities environmentally, socially, and financially.

With two decades of experience, Adenia has seen that our hands-on approach, which drives financial performance and successful exits, has been critical in creating significant and sustainable impact. At the end of the day, we believe that GPs with purpose, and who refuse to compromise on their values and value creation will be the ones who ultimately help Africa reach its potential.

An abbreviated version of this article can be found on the ESG Clarity website – https://esgclarity.com/why-is-esg-different-in-africa/