ESG
AFRICA

# Sustainable finance in Africa faces critical moment

The continent is in need of transition financing but encounters challenges, including lack of credit support flexibility

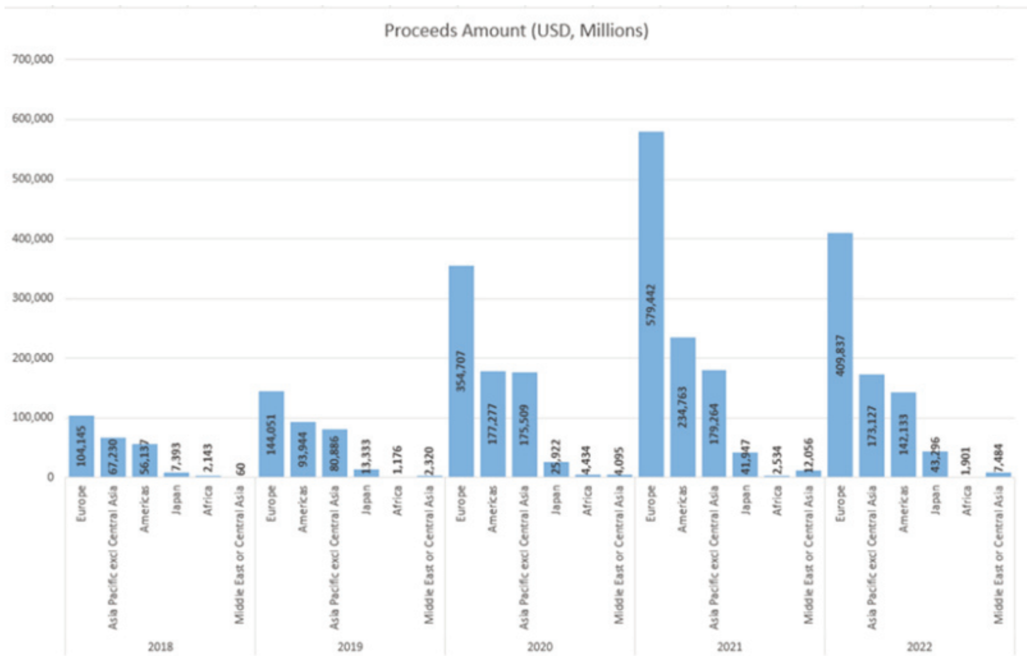
Despite global efforts to highlight the importance of sustainable finance in emerging markets, including at COP 27, Africa is in danger of being left behind in terms of the level of adoption and availability of sustainable finance, which is critical to enable the continent to realise its sustainable transition plans. This article considers:

- the sustainability challenges and funding shortages facing Africa and African borrowers / issuers; and
- the most significant barriers to the development of a vibrant Sustainable Finance market in Africa and how such barriers may be addressed.

## Background

Africa is particularly vulnerable to climate change and nature loss, despite its low contribution to global $CO_2$ emissions (2%–3%). Hundreds of millions of people located on the continent face increasingly extreme weather, which compounds existing high inequalities in health, income, employment, and gender. Further, many of the continent's commodity-dependent economies will be increasingly vulnerable as a result of the global low-carbon transition effort. At the same time, many of the world's most important carbon sinks and a large proportion of the raw materials required to facilitate the world-wide energy transition are located in Africa and are only accessible by Africans and with African support.

The Climate Policy Initiative estimates that Africa will need \$2.8 trillion between 2020-2030 to implement its Nationally




*Sustainable Finance deal value by region from 2018 to Q1 2023 - Refinitiv*

Determined Contributions (NDC) under the Paris Agreement, which translates to approximately $277 billion annually. However, annual climate finance flows in Africa stand at only $29.5 billion. The International Energy Agency estimates that Africa will need $133 billion annually in clean energy investment to meet its energy and climate goals. However, annual investment in renewable energy stands at a mere $9.4 billion.

## Market overview

The global sustainable finance market has grown rapidly in recent years; institutional investors and financial institutions with more than $130 trillion in assets under management have announced sustainable finance commitments. Unfortunately, although Africa saw a 14% increase in issuances of green, social, sustainability and sustainability-linked (GSSS+) bonds in 2022, Africa's sustainable finance market (and, therefore, sustainable capital flows into the region) remains limited.

## Key challenges

African borrowers and issuers face the following key challenges when seeking to access sustainable finance:

### Use of proceeds and green loans

The requirement that all green loan proceeds must be applied for environmentally beneficial and sustainable projects is often challenging for African borrowers. While African borrowers urgently need to finance their transition strategies, they may not have sufficient 'pure' green expenditure requirements. Sustainability-linked loans offer a helpful alternative on the basis that they do not create restrictions on the use of loan proceeds and provide critical flexibility for the borrower.

### Western transition expectations

The scale and pace of an African borrower's sustainable transition may not align with the requirements or expectations of the Western world, meaning that access to sustainable finance products and instruments may be limited. Further, the impact of COVID-19 and a chronic lack of international funding has adversely affected African national implementation measures, targets and objectives, including NDC pledges. Moreover, the ability of African governments to respond to climate change is limited, with government budgets already stretched and national debt at significantly high levels. A survey conducted during Africa Climate Week in 2019 found that more than half of the countries in the region have faced problems mobilizing climate finance in the international debt markets.

While sustainability-linked loans can offer critical flexibility for borrowers, they are 'target-based' instruments, and, therefore, such targets must be flexible and account for regional conditions and demands. In Africa, social key performance indicators (KPIs) are likely to be prioritised, and environmental sustainability performance targets (SPTs) may need to be less ambitious relative to the Western world. There are genuine concerns around greenwashing, but failing to provide African borrowers with sufficient flexibility to accommodate regional conditions and demands is unreasonable and inequitable, and adversely impacts genuine efforts to finance transition strategies and achieve a 'just transition' in Africa. For example, international institutions may need to acknowledge the difficulty an African borrower may face developing a Scope 3 GHG emissions KPI. Further, given Africa's relative development and limited contribution to global $CO_2$ emissions, social KPIs should be given greater emphasis, as they are likely to have a significant impact and long-lasting effect in the region.

### Availability of flexible credit support

Additional flexibility and innovation may be required to create appropriate credit support for sustainable finance in Africa. Examples may include:

a) sovereign-to-sovereign green guarantees from developed markets to emerging markets (this could follow the model of multilateral development bank guarantees on sovereign issuance);

b) a blended finance capital structure (e.g. junior / senior capital and policy risk hedging);
c) green export finance;
d) tax incentives (such as tax credits) from governments in emerging markets to increase green and sustainable investments;
e) increased availability for small and medium-sized enterprises to green finance subsidies; and
f) the potential for insurance / parametric insurance products to facilitate risk allocation in respect of climate change in Africa.

### Marginalisation of the African experience

The move towards sustainable finance has resulted in many NGOs, committees, task forces and commercial enterprises, often based in Europe or the US, reporting and advising on sustainable finance in Africa. It is not always clear to what extent input is considered from the African continent itself. About 80% of funding for research into climate issues affecting Africa goes to developed countries (e.g. US and Europe). As such, it is important for African governments, regulators, and public and private organisations to develop initiatives and action plans based on the concerns and priorities for sustainable development in Africa. Initiatives such as Africa Finance Corporation's whitepaper proposing a pragmatic path to Africa's achievement of net zero should be considered in determining whether a regional African green and/or social taxonomy that is specifically tailored to the conditions and demands of Africa is required.

### Under-developed internal capabilities

African government agencies, companies and institutions must continue to build their own internal ESG / sustainable finance capabilities. The costs and access to professional services required to develop green bond frameworks, market debt to prospective investors and advance the necessary governance and reporting systems are all significant barriers to entry for African borrowers and issuers. In addition, limited project development and management capacity means that African entities often struggle to develop projects and programmes that are 'bankable'. As such, it is important to prioritise training and education, embed ESG within internal corporate governance, develop a sustainability strategy or sustainable finance strategy, build internal capacity to monitor and report KPIs, and focus on data acquisition from relevant third parties.

## Conclusion

Sustainable finance is a relatively new concept in Africa and has huge application potential. Market participants globally must adopt a more nuanced, Africa-centric approach to sustainable finance for it to have relevance and success. The Western world must focus on this agenda at COP 28 and beyond to ensure that a '**just transition**' for Africa can be achieved.

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