

Exploring the Barriers to Impact Investing in the Sustainable Energy Area in West Africa

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Abstract

Impact investing can be an important investment vehicle as part of the development of sustainable energy projects in West Africa, especially in rural areas. However, impact investing is still facing major challenges in West Africa. Through an analysis of relevant documents on this subject, this research strives to identify and address barriers to impact investing as part of sustainable energy projects development in West Africa. It leads to actions that might be undertaken to make impact investing an effective instrument that can help boost sustainable energy in West Africa. Finally, this study identifies avenues for future research.

Keywords: Sustainable Energy; Impact Investing.

Introduction

According to the International Energy Agency, 1.3 billion people are without access to electricity and 2.6 billion people are without clean cooking facilities¹. More than 95% of these people are either in sub-Saharan Africa or developing countries in Asia and 84% are in rural areas. The level of access to energy for ECOWAS countries, especially in the rural areas, is the lowest in the world (ECREEE, ITC & Casa Africa, 2013). This is a surprising paradox insofar as energy resources are particularly abundant in West Africa. This not only deprives tens of millions of individuals of access to modern energy, but, in addition, it hinders health and environment of the local communities and hence their socio-economic development.

In recent years, efforts have been made in terms of improvement and extension of electricity systems and development of cleaner energy, such as renewable energy. As an example, between 2004 and 2009, investment in renewable energy in Africa grew from US\$300 million to US\$700 million and leapt to \$3.6 billion in 2010 (Griffith-Jones et al., 2012). Important efforts have been also made to boost sustainable energy projects and policies in West Africa. The ECOWAS Centre for Renewable Energy and Energy Efficiency (ECREEE), based in Praia, Cabo Verde, was established in 2010 to create favorable framework conditions for renewable energy and energy efficiency markets in the 15 member states of the

Economic Community of West African States (ECOWAS).

Despite these significant advances, the majority of African countries, especially those in West Africa, still face major challenges. Beyond the political, social, environmental and institutional challenges, access to financial services is often considered as one of the major barriers to access to energy in West Africa.

In the context of renewable energy projects in Africa, the ability of end users to bear the costs related to energy services is certainly one of the major barriers to the development of sustainable energy (ECREEE, ITC & Casa Africa, 2013). To this end, inclusive finance, particularly microfinance, is often used as an alternative financing to access to modern energy. However, beyond microfinance, it is urgent to design and test alternative and complementary financial systems better suited to the emergence of decentralized energy systems in rural areas. Impact investing may be an investment vehicle to boost sustainable energy development in West Africa.

Impact investing is “an investment designed with intent to generate positive social and/or environmental impact” (J.P Morgan and Rockefeller Foundation, 2010) beyond financial returns. This type of investment is gaining popularity as individuals and institutional investors (pension funds, banks, insurance companies etc.) seek ways to obtain financial returns while making positive impact on the society and the environment (Daragh & Nurkholisoh, 2012, p.2). As impact investments typically target poor and disadvantaged population and the natural environment, they can contribute to stimulate economic growth, generate infrastructure projects and other initiatives (IISD, 2013) such as sustainable energy projects.

This research has several contributions. Firstly, it goes beyond inclusive finance by harnessing the power of impact investing for the sustainable energy sector, especially as part of decentralized and off-grid sustainable energy systems. Secondly, by investigating impact investment as an investment vehicle for sustainable energy in West Africa, this research is a shift from traditional approaches in Africa based on philanthropy,

¹ <http://www.iea.org/topics/energy-poverty/>

development assistance or aid to a new track that consists of investing with impact in the renewable energy development. Thirdly, funders, micro-finance institutions, NGOs, governments and investors, especially impact investors, can refer to this study to better understand the challenges to impact investing in West Africa and better consider solutions to deal with them.

The rest of this paper is laid out in the following manner: first of all, we will clarify our research question and objectives. This will be followed by the presentation of the methodological issues. Then, we will describe our findings. Finally, we will discuss the results and highlight both the scope and the limits of this study.

Research Objectives

Impact investing can contribute to solve major social and environmental problems in the developing countries, particularly in Africa (Dalberg, 2011) where governments lack sufficient resources to cope with social and economic challenges. Impact investing can be an important vehicle for the governments who are committed to fighting against poverty, energy crisis, youth unemployment, agricultural crisis and food security etc. However, the actions taken by the government to boost the impact investing are few and even scattered. To this, are added barriers to the growth of impact investing.

The following fundamental question structures this research: **What are the challenges associated with impact investing in the sustainable energy area in West Africa?** The main objective of this research is to examine the barriers that might prevent from investing with impact in the sustainable energy sector in West Africa.

Impact investment funds vary with respect to the source of the capital, the location, expectations (Daragh & Nurkholisoh, 2012). Freireich & Fulton (2009), in a report published by the Monitor Institute, identify two kinds of impact investors: impact first investors and financial first investors. Impact investors seek to optimize social or environmental impact with a floor for financial returns. They primarily aim to generate social or environmental good, and are often willing to give up some financial return if they have to. (p.31). Financial first investors seek to optimize financial returns with a floor for social or environmental impact. They are typically commercial investors who seek out subsectors that offer market-rate returns while achieving some social or environmental good.(p.31). Grabenwarter & Liechtenstein (2011) highlights five (05) key characteristics to impact investing: 1) Profit Orientation; 2) Correlation Between Impact and Financial Return; 3) Intentional Impact; 4) Measurable Impact; 5) Positive Effect on Society. (p.10). These authors state that there is no trade-off between profit and social impact because the two elements are positively correlated. Simon & Barmeir (2010) emphasize the fact that impact investing targets regions and sectors

that traditional direct foreign investment does not. As part of this paper, we argue that, whatever the expectations, impact investing may be an important investment vehicle for the sustainable energy. In this respect, it is important to understand the barriers to such investment.

This research strives to not only examine the barriers to impact investing. Thus, it is intended to foresee solutions to barriers identified as part of this study and open up avenues of research in the field of impact investing applied to renewable energy in rural areas.

Methods

This research is mainly based on a review of existing papers, reports and other documents analyzing impact investing in the African (especially West African) context. Particular attention is given to the relationship between impact investing and renewable energies. Consulting secondary sources may be particularly useful in the early stages of research for generating sensible hypotheses or for other aspects of the research development (Cowton, 1998, p.429). In order to ground this research in a real context (Yin, 2003), West Africa is chosen as a case study.

According to the data from the World Bank², West Africa key facts are:

- 15 countries
- A population of 245 million.
- About 65 percent of them live in rural areas.
- Two sub-regional organizations: Economic Community of West African States (ECOWAS): Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Senegal, Sierra Leone and Togo. ECOWAS works to promote co-operation in the region on a range of economic and political issues including conflict resolution. Eight countries in the region (Benin, Burkina Faso, Cote d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo) are members of the West Africa Economy and Monetary Union (WAEMU) and share a common currency, a common central bank, a development bank, a regional stock exchange and a common banking regulator.
- Over 55 percent of West Africans live with less than \$1 a day. According to the Human Development Index of the UNDP, Ghana and Cape Verde were the only countries ranked in the medium human development category. The rest of the ECOWAS countries were classified at the low human development level.

West Africa is also a hub for several organizations:

- Multinational companies: extractive industries, telecom, banks etc.
- NGOs that contribute to eradicating poverty promoting education, preserving the environment.
- Foundations
- UN organizations
- Etc.

Despite political instability noted in some countries, West Africa continued to grow faster than other sub-regions of the continent (ACET, 2013). However, it should be noted that West Africa is not a homogeneous sub-region. Some countries are considered as rich-resource countries, while others are less fortunate. The same applies to the adoption of policy and financing sustainable energy projects financing. As such, Ghana could be considered as a model for other countries in West Africa. Thus, barriers or challenges identified in this research are those most of West African countries face in terms of impact investing.

Results

The complexity of regulations, corruption, political instability and weak communication networks are, among others, the main challenges to consider when investing (even with impact) in emerging markets (Arosio, 2011). This observation also applies to African markets. As for impact investing strictly speaking, the IISD (2013) has identified 8 factors as the most critical challenges to the growth of the impact investing industry in low-income and developing countries. These challenges are 1) lack of appropriate capital across the risk/return spectrum, 2) shortage of high-quality investment opportunities with track record 3) difficulty exiting investments (exit options) 4) lack of common way to talk about impact investing, 5) lack of innovative deal/fund structures to accommodate portfolio companies' needs, 6) inadequate impact measurement practice, 7) lack of research and data on products and performance, 8) lack of investment professionals with relevant skills.

According to a report by Dalberg & APIX (2012), beyond the lack of awareness, the barriers to impact investing come from the demand challenges (lack of adequate financing sources, limited capacity building, no recognition of particular needs of impact enterprises etc.), supply challenges (lack of investment vehicles, limited deal flow, limited exit options) and directing capital challenges (lack of clarity under the fiscal framework). Even though West African Governments are making efforts to establish an institutional framework conducive to the development of business and investment flows, there are still major challenges, particularly in the field of impact investing. One of these challenges is how to get institutional investors (commercial banks, pension funds, insurance companies etc.) on board with impact investing. Despite the important role they play in the West African economy, investors are still very conservative "and stick to investing in treasury bills and real estate" (Dalberg, 2011, p.39). This conservatism is even greater when it comes to investing in the sustainable energy sector,

especially the rural areas. This sector is still considered as unprofitable and high risk and investors, particularly financial-first-investors, are often wary even suspicious.

As previously mentioned by the IISD (2013), lack of reliable data is one the most critical challenge to the development of impact investing. Investors with a long-term time horizon, such as impact investors, are, indeed, more and more interested in environmental, social and governance issues and ask, beyond the financial reports, more detailed information (CICA, 2010). Lack of information on financial and non-financial performance as well as the absence of credible reports on the impact of their activities are some of the great challenges most of impact investors are facing in West Africa (Dalberg, 2011). This can have a negative impact on investment and capital flows in Africa, especially in the context of sustainable energy development projects. In West Africa, the non-availability of reliable and updated energy information creates a major constraint for investors and project developers in the sustainable energy sector in the ECOWAS region³.

Another barrier to impact investing in West Africa is related the electrification system. According to ECREEE, ITC & Casa Africa (2013), rural electrification is highly dependent on the national electricity plan. This leaves too little room to autonomous, decentralized and cheaper rural mini-grid systems fueled by renewable energy. This also inhibits entrepreneurship and projects development in sustainable energy sector in West Africa. Therefore, investments, including impact investing, in renewable energy in the rural areas are still low.

Discussion

The following question structured this research: what are the challenges associated with impact investing in the sustainable energy area in West Africa? The main objective was to examine the barriers that might prevent from investing with impact in the sustainable energy sector in West Africa. To do that, we relied on both academic and professional literature to identify some of the major constraints to impact investing in West Africa. We found that barriers to impact investing in West Africa come from regulatory, financial, fiscal, political etc. challenges and the lack of reliable data. Moreover, the national electricity systems in place tend to limit the establishment of autonomous and cheaper rural power systems and, thus, to inhibit entrepreneurship and projects development in this sector.

The scope of this research lies in its exploratory nature. By identifying and analyzing barriers to investing impact, this study recognizes the potential of such an investment to help fight energy poverty in West African rural areas. However, such challenges can only be met if concrete measures are taken by policy makers. Because it does offer benefits, impact investing has valid arguments for garnering the support of governments (IPCV & IRI,

³ <http://www.ecreee.org/page/knowledge-management-and-awareness>

2011). We believe that the current context of fuel poverty requires open and bold actions. For this purpose, it is important to undertake three major actions.

Firstly, the countries of West Africa should promote autonomous and decentralized energy systems using renewable energy. Because they can better adapt to different socio-economic contexts and be rooted in local cultures, such systems may contribute to an integrated community development. Secondly, we think it is also important that institutional investors embark on impact investing by exploring and investing in areas such as renewable energy. To date, as mentioned by ECREEE, ITC & Casa Africa (2013), few benefits are granted to private capital to invest in renewable energy in West Africa. In addition, investments in this area are often funded by official development assistance (ODA). As private investments are largely dependent on the policies in place (IPCV & IRI, 2011), institutional investors must, however, benefit from a favorable environment to help boost energy development in rural areas. Future studies might explore the ways governments can tailor investment incentive programs to target the different types of impact investors and involve them in the promotion of sustainable energy in West Africa. While our recommendations suggest that solutions should come from policy makers, an ecosystem approach could also be considered in the search for solutions to the challenges of access to energy. This approach would better highlight the complexity surrounding the sustainable energy issues.

Despite its scope, however, this research has limitations. One of the key limitations is that it is based solely on documentary research. Interviews conducted in situ with major stakeholders could give a more practical character. Future research might also rely on renewable energy projects in rural areas as case studies. Future research might also use a critical approach by exploring, for example, to what extent does impact investing crowd local investments.

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