



# Unlocking investment potential in emerging markets: a 'finance first' approach

Investing in emerging markets and developing economies through a 'finance first' approach can yield risk-adjusted market returns while aligning with sustainable development goals

By David Brown & Ashish Kumar



This blog reflects on a *Pensions for Purpose* roundtable event with the *CrossBoundary Group* and *US Government's Prosper Africa* held during London Climate Action Week. It included representation from UK and US institutional capital allocators, such as pension funds and family offices, to consider the case for impactful investments in emerging markets (EM), with a focus on Africa and climate finance for the just and inclusive energy transition.

The discussion focused on the lens of capital allocators with a 'finance first' investment approach aiming for risk-adjusted market returns alongside positive sustainable development goal-aligned impact objectives in emerging markets and developing economies (EMDEs). This blog highlights some of the main takeaways from constructive discussions.

## Improving macro-economic indicators

After a period of relative underperformance in the EMDEs the case was made this may be changing in many regions due to many positive indicators. These include improving literacy rates, lower infant mortality, leading to reduced fertility, smaller family sizes and better education for children – particularly

girls. Smaller family sizes are generally associated with higher savings, which can lead to lower interest rates supporting investment. However, it is crucial to ensure this is the right investment and emphasise the importance of symbiotic investing where all stakeholders benefit. Additionally universal electricity and power access are made more feasible by lower interest rates reducing the cost of projects and contributing to economic growth.

These improving metrics are emerging from the backdrop of several systemic challenges – such as climate change and biodiversity loss – which can be even more acute in the EMDEs. Other challenges include political, regulatory, cost of capital and

currency risk. The extremely high cost of capital and weak and volatile local currencies have been inhibiting private/institutional investment in sectors such as power and universal electrification, (directly related to SDG 7 – affordable and clean energy).

## Emerging market innovations

We heard how the above risks and challenges can be mitigated for capital allocators through several financial and market innovations already demonstrated, ranging from insurance (including political risk cover), blended finance instruments such as 'first loss' to guarantees cover etc. One of these innovations was presented during the roundtable from the UK Government's

*FCDO MOBILIST* programme that, alongside technical assistance and other services, also provide equity capital to grow listed stock and bond products that catalyse sustainable finance flows to drive climate and SDG goals in the EMDEs.

Specifically, MOBILIST referenced their part in a recent transaction with *Bayfront* – providing catalytic equity as a part of a debt securitisation transaction through a special purchase vehicle structure. The securitisation business model included loan assets for green infrastructure projects to be purchased. These would then be made warehouse ready to distribute to institutional investors that would otherwise be unsuitable for finance first impact investors. In short, through







## Institutional allocator event blog

the provision of equity MOBILIST could offer familiar instruments such as bonds with competitive terms for all investors.

### Local versus global impact priorities

So, if there are tailwinds supporting investment in many emerging markets and support from actors such as multilateral development banks providing guarantees and insurance to de-risk projects, what is holding back asset owners? One challenge was that it is easier to invest with impact in domestic markets than in emerging ones – for example, a solar park generating clean energy in your home region. In fact, the UK government consultation (issued before the UK 2024 election) proposes local government pension scheme (LPGS) funds invest up to 5% of assets locally to support levelling up. Also noted were the perceived limitations of some investment consultants in advising on appropriate impact opportunities in emerging markets, and whether better regulation and oversight was needed. From a US perspective, an additional challenge arises depending on whether the State where the fund resides is red (Republican) or blue (Democrat). Republican states tend to be more resistant to environmental, social and governance (ESG) and impact investing.

### Gathering impact-performance evidence to tackle perceived risks

In the past the perceived risk of investing in EMDEs across the asset classes could be two or three times the actual risk. Strong evidence building and investor advocacy can help tackle this. During the roundtable, research on investment returns achieved by impact fund managers, conducted by the *Global Impact Investing Network (GIIN)* and *Pensions for Purpose* were cited. *Pensions for Purpose's* Impact Lens research '[Impact investment performance – a UK asset owner & investment consultant perspective](#)' reviewed five asset classes: listed equities, listed debt, private equity, real estate and infrastructure, and revealed returns were often in line or above benchmarks used for non-impact funds. One of the limitations of the research was the small proportion of impact investments into EMDEs. This needs to change if we are to address global systemic risks arising from climate change and biodiversity loss. This is also the focus of *Pensions for Purpose's* next Impact Lens, which will be published later in 2024.

### Help for asset owners

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