INTRODUCTION

This brief advocates for the use of Environmental, Social, and Governance (ESG) performance measurement and disclosure in supporting sustainable development in Africa. The following discussion emphasizes the increasing importance of ESG information as a driver of investment and development policy decision making. It points out that the pursuit of sustainable development—and recovery from COVID-19—will task the ability of African governments and business entities to attract and deploy finance in a sustainability principled manner. It argues that while global sustainable finance is budding, the continent’s opportunities can be enhanced by environmental and social performance measurement and disclosure initiatives that guide investors by identifying good and bad performers. Finally, the paper recommends a framework for such ESG disclosure and rating initiatives in the continent (United Nations Environment Programme, 2016). Speeding up Africa’s economic growth presents significant challenges to reduce the region’s ecological footprint and protect the life-support system provided by healthy land, water, biodiversity, and air.

For African economies, recovery from the COVID-19 pandemic presents an opportunity to raise awareness and action on long-term environmental and social sustainability considerations. There are striking similarities and linkages between the impacts of the pandemic and environmental and social outcomes and risks. For example, debates on the origins of the COVID-19 outbreak have highlighted linkages between environmental and social issues like biodiversity and community health management risks. On the other hand, the impacts of the pandemic are comparable to catastrophic events that can happen due to continued negligence of environmental and social sustainability. Likewise, environmental, and social impact management concepts such as sustainable supply chains, social safety nets, hu.

KEY MESSAGES

1. Policymakers, investors, and international development partners are increasingly aware of the importance of Environmental, Social, and Governance (ESG) information for investment decisions and international cooperation to drive sustainable development, especially given lessons learned during the COVID-19 pandemic.
2. Strategic initiatives are needed to improve ESG disclosure and rating of sovereign and non-sovereign African entities and businesses.
3. Such initiatives will bolster finance mobilization, facilitate the channeling of finance toward ESG-friendly practices, and encourage participants to build ESG management capacity.

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man capacity management, and responsive governance structures will largely determine the outcome of the pandemic for many corporate entities and sovereign economies.

Availability of finance is a critical determinant of Africa's sustainable development. Estimates suggest Africa will need more than $574 billion a year until 2030 to finance the Sustainable Development Goals (SDGs) (Coulibaly, 2020). The continent will have to be able to mobilize these resources from domestic, international, private, and public sources and deploy them effectively in alignment with the principles of sustainable development. This requires effective cooperation between domestic and global capital markets and financial systems, government agencies, international private capital flows, and official development assistance to the continent, all of which are increasingly characterized by ESG considerations.

2 | ESG INFORMATION AS A MARKET DRIVER

The COVID-19 pandemic has caused significant slumps in markets, disrupted business and trade, and burdened social systems, economic development, and financial systems in unprecedented ways. These failures reinforce growing awareness of the need to deepen long-term, sustainability-informed approaches to investment and development. The importance of environmental and social considerations to financial performance and risk for different asset classes, including equities, investment-grade corporate, and sovereign debt markets, have been documented (Allianz Global Investors, 2015–17).

There is some evidence of some investments that took such considerations into account proving more resilient and performing better than traditional investment strategies during the COVID-19 pandemic (Darbyshire, 2020). Figure 1 presents a comparison carried out by Morgan Stanley Capital International (MSCI), showing four standard global MSCI ESG equity indexes that integrate the MSCI ESG Ratings compared to their the MSCI All Country World Index (ACWI) parent index in the first quarter of 2020. MSCI’s global sustainable equity indexes outperformed the MSCI All Country World Index (ACWI) by 1–3 percentage points during the first quarter of 2020. While these observations were seen in the few months of Q1 2020, they were consistent with long-term performance and across different regions (MSCI, 2020). These observations point to the importance of environmental and social risk considerations as a cornerstone of sustainable development.

Environmental and social considerations were being integrated rapidly into development policy and investment decision making before the pandemic, via strategies that either proactively fostered positive environmental and social impacts or at least avoided negative effects. Established capital markets are already pricing environmental and social performance across different asset classes. Since 2016, more than 150 institutional investors (representing US$30tn of Assets Under Management) and 19 credit rating agencies have become signatories to the United Nations Principles for Responsible Investment (UNPRI) statement on ESG in credit ratings and analyses.

Some forecasts (Uzsoki, 2020) indicated that global environmentally and socially informed investments (using the broader sense of environmental and social integration) were expected to continue growing and to pass the USD 100 trillion mark by 2030 (Figure 2).

According to a global survey by FTSE Russell (2020), up to 72% of asset managers were implementing or evaluating

FIGURE 1 RELATIVE PERFORMANCE OF SELECT MSCI ESG INDEXES TO MSCI ACWI INDEX
environmental and social considerations in their investment strategies. It also found that interest in such considerations was increasing around the world and was more pronounced among larger asset owners (those with more than USD 10 billion in assets under management).

In the corporate debt and equity market, the relevance of environmental and social factors to credit risk varies by industry sector, individual corporate strategy, and time horizon. As public attention on environmental and social impact grows—along with the frequency and severity of such events—the relevance of and corporate exposure towards these risks are expected to continue to gain prominence.

In the sovereign debt market, financial and macroeconomic factors are usually quantifiable. Hence, investors and traditional credit rating agencies prefer using these indicators to calculate sovereigns’ credit risk and to price their securities. Such indicators can signal sovereign creditworthiness in the short term but do not account for economic development drivers linked to environmental and social risks. On the other hand, elevated exposure to environmental degradation and social imbalance coupled with weak management capacity can damage countries’ creditworthiness. For instance, weak environmental regulation enforcement can feed into systemic risks like desertification, water scarcity, and extreme weather events, which can disrupt existing supply chains and infrastructure. Such shocks can threaten sovereign financial performance. Similarly, long-lasting social dissatisfaction and unrest can translate into risks for investments and development initiatives both locally and globally, as seen with the COVID-19 pandemic.

Notably, while the global volume of assets under management (AUMs) that incorporate elements of sustainable investing is large and growing rapidly, the volume and growth of sustainable finance in emerging markets and developing economies significantly lags that in developed markets (Boitreaud et al., 2020).

3 | UNDERSTANDING ESG INFORMATION DISCLOSURE AND RATING: CONCEPTS

Several ESG information metrics/frameworks (most of which are proprietary, with varying levels of acceptance and usage) have emerged to help guide investment strategies (Guenster et al., 2011; Schultze and Trommer, 2012). They broadly fall into two groups.

The first group of metrics tends to focus on positive actions the entities being evaluated have taken to improve environmental and social impacts, including investing in sustainability innovations, renewable energies, recycling, pollution prevention, and environmental and socially responsible policies and programs. These metrics reflect an “opportunity” focused approach and tend to provide insight into an entity’s future performance and potential competitive advantage thanks to innovations and commitments.

The second group of metrics uses a “risk” approach to reflect the adverse impacts of an entity’s behavior on environmental and social systems, including environmental degra-
The risk-focused metrics tend to capture information about the broader categories (business sector, development status) that the assessed subject belongs to. They tend to reflect the entity’s historical performance in terms of negative impacts created by their business processes and activities but can also indicate future liabilities and long-term costs of negative externalities.

There is also potential to combine these two types of approaches.

4 | ESG INFORMATION DISCLOSURE AND RATING IN AFRICA: CHALLENGES

For Africa to continue its drive toward sustainable development after the pandemic, it must promote the complementarity of the various players integrating sustainability considerations into their investment and development policy decisions.

Two critical aspects of such an approach are (i) the ability of sovereign and non-sovereign actors in the continent to leverage the use of ESG information to attract sustainable development financing and (ii) the capacity to identify and support high-performance players that have demonstrated the commitment and ability to pursue economic development while safeguarding the natural and social capital of the continent. However, ESG information disclosure and rating in Africa faces major challenges in this respect, including:

- insufficient awareness of the importance of ESG information disclosure;
- lack of appropriate infrastructure for the collection and processing of relevant data;
- weak institutional capacity and enabling frameworks for both voluntary and mandatory actions to integrate and disclose environmental and social commitments and actions;
- inconsistent policy engagement in the form of harmonized standards and enforcement as well as other fiduciary incentives for ESG disclosure; and
- lack of transparency and information on environmental and social actions and performance.

These gaps present major challenges. A better understanding of sustainability as well as guidance on the relevance of indicators on performance and impact are needed to boost environmentally and socially sustainable investment, especially in developing countries in Africa.

5 | RECOMMENDATIONS

To benefit from the growing global interest in sustainable finance and, consequently, sustainable development in Africa, strategic initiatives are needed to provide information and transparency on the environmental and social performance of sovereign and non-sovereign entities in Africa. This will encourage these entities towards stronger environmental and social governance capacity and, eventually, sustainable development in the continent.

Such initiatives should focus on the performance of these entities in terms of policy, procedures, implementation capacity, and management of environmental and social risk. This perspective ties in well with the overall strategic goal of strengthening the capacity of these entities in environmental and social safeguards management. It also promotes a more proactive, preventive focus through capacity building, while helping position these entities to benefit from their efforts to attract sustainable finance investment. These efforts should aim at the following:

a. Reducing information asymmetry

As measurements and disclosures make environmental and social performance more transparent, they can help development and business entities apply sustainability criteria to their choices. This is also true for international trade entities, who may want to apply similar considerations in international trade strategies.

b. Strengthening Africa’s environmental and social risk management capacity

The proposed initiatives should provide both peer pressure and a benchmarking incentive to encourage sovereign and non-sovereign actors to move toward sustainable development policies and practices. As these high-profile, publicly disseminated performance disclosures take on greater importance, these entities will respond more decisively to pressures from stakeholders over environmental and social sustainability issues. Accordingly, the disclosures will provide benchmarks to help these partners to identify gaps, allocate resources, and implement capacity-strengthening measures to improve their performance.

Emphasis on ESG performance measurement and disclosure initiatives are sparingly present in Africa. The situation presents an opportunity for credible stakeholders such as the African Development Bank to spearhead initiatives to fill this gap and provide a unique public good. Such a continental initiative would enhance local knowledge and transparency in Africa’s ESG information disclosure and rating arena. It would also draw the attention of players on the continent to the issues of ESG and further the objectives of both domestic and global partners to pave a clear path for Africa to sustainable development.
REFERENCES


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