Private markets ESG - from grey to growth

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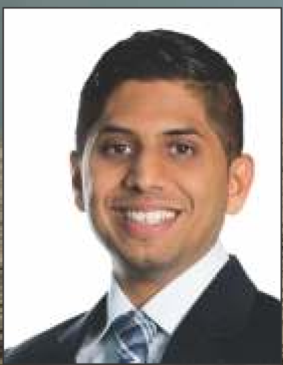

As market participants tune into the ESG frenzy of late, it's expected that adaptation will occur in companies who wish to benefit from capital allocations. Therein lies the rub. The fact that the greening behaviour of "cleaning up" the corporate balance sheet can often be led by investor wooing, rather than a deliberate strategic or economic advantage being actioned, is problematic.

By way of example, we have evidenced listed companies across the globe disposing of high carbon producing assets into separate special purpose vehicles, listed companies or selling them off into the private arena. On the surface, it raises the ESG ratings profile of that company. However, considering a country level or overall capital market perspective, its shifting deck chairs and no real net economic benefit accrues. This is referred to as "greenwashing".

The role of asset management

Asset managers making use exclusively of listed assets lay claim that keeping assets in the listed arena allows for more opportunities for investment with greater investor scrutiny. Some may even suggest that private markets are a grey area where ESG practices are flouted, a case which can be strongly refuted.

According to David Moore, Head of Alternatives at Alexander Forbes Investments, some of the most compelling reasons to consider investing in private markets is for their explicit ESG dividend. Private markets are characterised by the following:

- Longer dated investments are aligned with ESG integration and pension fund time horizons – these longer dated time horizons are needed when transitioning companies to a low carbon economy but also to capitalise on the opportunities presented by new technologies.
- They enable a more influential investor base where real action can be taken to achieve better outcomes.
- Lower return volatility and impact from short term performance mean fewer distractions and greater focus on strategic imperatives such as ESG enhancement.

Can ESG really add value in private markets?

Without question, but it depends on what your objectives are. If you are focused on short term outperformance or liquidity, perhaps you are missing the thrust of the opportunity being tabled by private market investments for retirement funds to consider.

"If investments are strongly linked to a domestic economy and its social or environmental challenges, it could boost economic growth and close the savings-investment gap.

Private market investment taps the so-called unbankable SMMEs by providing funding, skills transfer and market penetration to mention a few benefits. It can be a potential lifeline for economies that are fiscally strapped," says Premal Ranchod, Head of ESG Research at Alexander Forbes Investments.

If the investments are related to foreign direct investments, then domestic economies can benefit from trade and narrowing of the current account deficits. Since 2018 the South African Investment Conference has sought to act upon the ambitious 5 year target of attracting R1.2 trillion. To date R770 bn has been committed and R290bn (38%) has already flowed into the economy.

Capital meets social and environmental challenges

It's not to say that all the capital above will flow to unlisted assets, but given the challenges we face it is likely that private markets will play a significant part. The domestic economy is hamstrung by its energy pressures; unsustainable reliance on state-owned coal-fired energy, Paris climate commitments and levels of unemployment. When the above coincides with a world looking toward clean energy and a thirst for yield it makes sense to align objectives.

THE SOUTH AFRICAN GOVERNMENT LAUNCHED THE REIPPP PROGRAMME IN 2012 WITH THE FIRST BIDDING ROUND OF A PLANNED 7 000 MW PROGRAMME. NOW IN ITS FOURTH BIDDING ROUND, REIPPP HAS PROCURED 6 422 MW FROM 112 INDEPENDENT POWER PRODUCERS, BRINGING INVESTMENT OF R201 BILLION. THE RECENT SIGNING OF 27 NEW PROJECTS BRINGS R56 BN INVESTMENT ALONE[1].

Looking beyond into the African frontier, the same if not a more compelling case for private capital can be made. Listed markets north of the South African border are concentrated, illiquid, and volatile. Countries have poor infrastructure as well as low tax bases with collection mechanisms that are weak. The opportunity exists in that the demographic is young with strong demand for basic enablers such as energy, water and funding.

Accessing private markets opportunities

We think that the pressing needs tabled above and a confluence of regulatory pressures globally and locally with shrinking listed capital markets will force diversification into unlisted markets over the next decade. It will be critically important to strike public-private partnerships that learn from the past errors and that have clear plans, timelines, transparency and accountability.

Ranchod concludes, "Given that private markets are not homogenous, it's necessary to assess your pension provider's competency and track record of investment in asset classes, such as private equity, private debt, infrastructure, unlisted property across the continent and globally.

[1] AIIM Case Study: Renewable Energy Investment in South Africa