Investing in stability around Europe

Responsible investing is not just a question of what, but – to have the most effect – a question of where

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In recent years there has been a growing concern about the 'ring of instability around Europe'. Conflicts, terrorism, and the migration crisis pose threats to the delicate stability in some countries and increase the instability in others. All of these are indicators which scare most traditional investors. Yet those who dare to look beyond the surface and the daily headlines will see that there are plenty of opportunities to get a foothold in rapidly developing markets with many investment opportunities, now and in the years to come. This article aims to provide 1) context and 2) suggestions for investors, illustrated with a few examples, why we believe that responsible or impact investing will have substantially more effect if done in emerging and frontier markets.

The current situation does not seem to bare a bright future

As can be seen on the news every day, the European neighborhood is facing various conflicts. For example, in the East there is an ongoing conflict in Georgia. In the South, there still is war in Syria and Iraq, anarchy in Libya and civil war in Yemen. Parts of Algeria and Egypt are also facing acute issues, just like Afghanistan. Eritrea sees human rights violations, and Somalia is still caught up in an armed conflict and restrictions on humanitarian access. This instability can proliferate to fragile states and vulnerable regions such as West-Africa, the Sahel, and the Horn of Africa.

Meanwhile the lack of stability has left them vulnerable to the rise of various terrorist groupings like Al-Qaida allies are present in Yemen, Syria, and Iraq. Some groups like ISIS in Iraq and Syria and Boko Haram in Nigeria are better known by

the larger public, but also Mali, Tunisia, Libya, Egypt, Nigeria, and Lebanon are vulnerable. The presence of these terrorists in turn further destabilizes these countries. The motives of young people to join violent extremist groupings are diverse. However, especially a lack of economic perspective for the youth has proven to be a major factor that makes them vulnerable to recruitment by extremist groups or to migrate (UNDP, 2017). The presence of ongoing violence has led to an unprecedented crisis with more than 60 million people fleeing. Many of these people try to get away from the violence and initially go to neighboring countries.

Simultaneously another trend has been evolving further to the South. Due to a growing population, bad governance and scarcities, many young West-Africans see no future in their countries and undertake dangerous journeys to reach Europe in search for a better life. Investing in Europe's neighboring countries will most likely initially increase the number of migrants undertaking dangerous journeys. This should however be looked at as a symptom of the underlying development issue: high (youth) unemployment levels and a lack of decent salaries in the West-African countries.

What are the key drivers behind these issues?

The main reason for Africans to migrate is a lack of economic perspective which is one of the so-called 'root causes' of migration. The root causes can be divided into three categories: political, economic and environmental. Poverty, inequality, bad governance, food and water insecurity, and corruption are factors influencing a growing group of young Africans to take the journey. Especially in West-Africa, more and more Africans younger than 18 tend to leave their homes. Reason being is they are expected to contribute to the household and become self-reliant while the available jobs offer no decent income. Responsible investors should look beyond mere unemployment figures though. For example, the Maghreb region (the northwestern part of Africa) faces very high overall unemployment rates and even higher youth and women unemployment rates (e.g. youth unemployment in Tunisia was 35,4% in 2017 (UN, 2017)). West-Africa shows significantly lower unemployment rates. Sub-Saharan Africa is plagued by vulnerable employment and so-called 'working poverty'. It is estimated that around 70% of the people in SSA are in vulnerable jobs and around 60% is facing working poverty (i.e. earning less than $3.10 per day (UN, 2017)). This working poverty is the main reason that people from West-Africa seek economic perspectives outside of their country of origin.

Climate change serves as an important catalyzer for the issues at hand. A decline in available fresh water sources, food insecurity, and natural disasters will fuel existing conflicts and thereby increase instability. This will have a severe impact on fragile states and will pose a threat to the economic growth. This can result in an exponential growth of environmental refugees moving to more habitable places such as Europe.

Africa has the fastest growing population of the world. Towards 2050, 50% of the world's population growth will be in Africa. Estimates show a total population in Africa of around 2 billion in 2050 and 4 billion in 2100. The fact that the youth population already constitutes 60% of the total population combined with the expectation of an absence of a parallel growth of the economy, will create an enormous population of unemployed youth in Africa (UN, 2017). Since research shows that an unemployed youth can be a trigger for "social upheaval and armed rebellion" and for (economic) migration, this population growth acts as an important catalyzer for conflicts, terrorism, and migration (UNDP, 2017) (GIZ, 2015). At the same time the relatively young population offers an enormous potential for labor force and a vast market place potential.

Climate change can result in an exponential growth of environmental refugees moving to more habitable places such as Europe

What can investors do?

The answer is to invest responsibly in both Africa and in the 'Ring around Europe'. Invest in those businesses and projects which are drivers of the real economy. We suggest investors to choose themes to guide their strategies and not necessarily an asset class even though we would argue that investments in the real economy are much more effective then adding (indices of) listed assets to your portfolio. We would also argue to remove or at least broaden the geographical and liquidity limitations often set out in mandates. Diversification is a commonly used method to spread risk Yet the often applied limitations, even though they provide a sense of security, are limiting the possibilities to invest.

Theme 1. 'Build economic stability around Europe'

The impact of all three drivers (climate chance, lack of economic perspective and a growing population), comes together in the 'European Neighborhood'; Morocco, Algeria, Tunisia, Libya, Egypt, Jordan, Lebanon, Syria, Turkey, Georgia, Armenia, Azerbaijan, Moldova, Ukraine and Belarus. This region faces some of the highest youth unemployment rates globally. Since an unemployed youth can act as a fuel for destabilization, special attention should be paid to support the creation of jobs for the youth. By increasing investments in the local economy, investors can help to foster political stability.

Investors may choose theme 1 as it is potentially more understandable for their clients as the news regularly reports on these markets, creating awareness and a sense of urgency. It may also feel comfortable as these markets are literally closer to home and may have even been a holiday destination of the past.

Theme 2. 'Support self-reliance of refugees and host communities'

Investors can help by contributing to build jobs in host countries. Best practice has shown that these initiatives should not only target refugees, but should rather focus on both the host community and the refugee community (Betts & Collier, 2017). ING works together with local micro-finance institutions and FMO to support Syrian entrepreneurs in Turkey. The large majority of these business are profitable and even expanding, while contributing to jobs for refugees and the local Turkish economy.

The youth population offers an enormous potential for labor force and a vast market place potential

This is a theme that may potentially cover not just investments in the countries around Europe, but may provide a mix which could include investments in Europe. For example by investing in Italy, Spain and Greece where unemployment is also a concern or even in businesses in the North of Europe in those communities where refugees are stationed. Of the latter a growing number of new businesses are emerging. Like the Dutch New Bees and Buitengewoon, both still small companies who work with refugees and others who want to work, but are unable to navigate their way to the Dutch workplace. The number and sizes of funds investing in social businesses is also rising. We suspect that some of these funds will be fundraising, now and in the next 1-2 years.

Looking back, investors have often chosen not to invest in these Southern European and Middle-Eastern countries because of (perceived) volatility and (perceived) increased risk. But by doing so have indirectly unintentionally contributed to growing tensions across Europe. Selecting this investment theme now will help to positively contribute to the circumstances in these countries and will provide relief for many communities.

Theme 3. 'Address the root causes of migration'

The majority of irregular migration flows originate from Africa. Several root causes, but also here the predominant lack of decent work for the youth encourages adolescents to seek economic opportunities elsewhere and undertake perilous journeys. Investors' efforts should therefore focus on addressing the root causes of irregular migration. Investors could focus on investing in the growth of small and medium enterprises which are catalytic for employment growth and self-employment for youth. For most investors based in the western world this type of direct investing will pose an impossible investment and monitoring task. However, investing in financial intermediaries such as banks or locally based funds might provide the scale many investors seek. At the same time more and more (development) institutions offer investment solutions for institutional investors by offering bonds, acting as lead arrangers, fund advisors or taking on dedicated mandates. The market is rapidly growing and with every new and substantial investment, new opportunities arise. These can be profitable as many institutional investors have already seen and contribute substantially towards creating new jobs by financing local SMEs which are the engines for any economy.

Kick starting the engine of an economy- how investing in certain sectors makes a bigger difference

Some sectors are greater enablers of economic growth than others. Having access to finance is essential for economic growth and for that reason part of UN Sustainable Development Goal (SDG) 8 'Decent jobs and Economic growth'. Investing in financial institutions with the aim of on-lending to Micro, Small, Medium sized Entrepreneurs ((M) SMEs), young and/or female entrepreneurs has a very positive effect on local economies. A strong (M)SME segment is the engine of blossoming economy. Besides a local financial institution (or fund manager) has knowledge of both the entrepreneurs and the business opportunities in its region. It is not a lack of entrepreneurialism that limits development, but a lack of available finance. There are several ways to do so. Think of banks, but also of other financial intermediaries such as leasing and insurance companies or of PE or VC funds. Investing in the form of debt, (green) bonds of private equity. There are risk return opportunities suitable and available for every type of investor.

Another element entrepreneurs require is reliable and affordable energy. Countries around the Mediterranean, North and West-Africa also have great potential for producing renewable energy (SDG 7). Be it in the form of wind, solar or even hydro power, all will also lead to the need for investments in (local) grids and storage. Invest-

Some examples of recent and sizable investments

In December last year the Dutch development bank FMO arranged a USD 200 million loan facility with a tenor of 5-7 years for Ecobank. At least 75 per cent of the loan facility will be directed to SME-lending across various sectors. Ecobank is a leading independent pan-African banking group. It currently has a presence in 36 African countries. The group employs over 17,000 people in 40 different countries in over 1,200 branches and offices.

In February of this year FMO arranged a USD 100 million loan facility for Access Bank in Nigeria. The proceeds of the loan will be used by Access Bank to support private business in Nigeria involved in agricultural production, processing, distribution and consumption. This will help to further boost the country's agricultural sector. Agriculture remains the base of Nigeria's economy, providing the main source of livelihood for most Nigerians and employing over half of the entire workforce.

In March of this year Amundi and IFC closed a USD 1.42 bln investment fund focused on building the market of green bonds issued by financial institutions in emerging and frontier markets. Having IFC on board means investors can rely on high ESG standards. This will likely make the investment qualify as responsible or impact investing.

In Jordan, the 200 MW Baynouna Solar Energy project is being constructed. This USD 260 million project commenced construction in 2017 and is excepted to be complete early next year. It will replace energy which currently requires 1.4 bln liters of imported crude oil and will reduce 360.000t. of GHG per annum. The energy produced (563.3 GWh) is expected to be enough for 110.000 Jordan homes. The financing came from both commercial parties and development banks.

ing indirectly via funds or directly in companies that provide these services may not be such a bad idea.

Last but not least, the growing population needs to be fed well and sustainably. There are numerous agribusiness related companies, including Dutch, who are active worldwide and who are making a difference on the ground by providing access to better growth materials, while raising the bar of labor circumstances and improving productivity. The Dutch e.g. are very skilled in producing high quality food. Backed by investors, these businesses can grow in these markets and investors may claim that they contribute to SDG 2 'Zero Hunger'.

In conclusion: investors have a choice

Choices are there to be made. Investors can provide finance to sustainable businesses and projects which foster economic stability, which in turn fosters political stability and new investment opportunities. This stability will also create better economic perspectives for the youth, which decreases the motivation to engage in violence reducing risk and thus improving the quality (risk levels) of the finance. It will also reduce the desire to migrate for economic reasons reducing tensions elsewhere. It can be a virtuous upwards spiral.

The question to investors is simple: will you invest responsibly or not

The question to investors is simple: will you invest responsibly or not? Not investing effectively means missing out on a realistic investment opportunity which touches upon the lives of many young people, who – directly or indirectly – will touch upon our lives going forward. The additional plus of investing in these countries is that it helps to align your investments with the UN Sustainable Development Goals. Last but not least, there has been quite extensive research (G. Friede et all, 2015) that responsible investing may result in at least similar returns as traditional investing. There is simply no reason not to invest responsibly anymore. ■

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Notes

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