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Sustainable Investment in Asian Emerging Markets

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INTRODUCTION

To support the growth of sustainable capital flows, IFC's advisory services seek to influence, support and enable capital market stakeholders to better integrate environmental, social and governance factors (ESG) into capital allocation and portfolio management processes, using IFC's own investment practices as a model. IFC is playing its part to support the growth of the market by funding the development of enhanced stock market indices, financial instruments, and through targeted market research.

Compiling data on the state of development of the sustainable investment (SI) industry is important for global investors and investment managers to understand the opportunities in the market for sustainable investment products. While a number of organizations provide this information in developed economies such data is scarcely available in emerging markets.

This issue brief provides a comparative overview of the state of sustainable investment markets in key emerging markets across the Asian region, based on findings from seven Sustainable Investment Roundtables conducted by the Association for Sustainable & Responsible Investment in Asia (ASrIA), with the support of IFC, during the second half of 2010. This issue brief covers the roundtables in Bangkok, Beijing, Ho Chi Minh City, Jakarta, Kuala Lumpur, Manila and Shanghai.

OVERVIEW

Many roundtable participants were looking to China for a lead on sustainability issues rather than towards Europe, North America or Australia /New Zealand. The growing dominance and leadership by the Chinese economy and the 'green' emphasis of the Chinese stimulus packages at the time of the recession are some reasons behind this. There was also strong interest by participants in cross-regional insights.

A clear finding of the roundtables was that though awareness of ESG issues and the concept of sustainable investment is quite broad across the financial services industry, it is still early days in terms of practice in Asian emerging markets. There is, however, a foundation for rapid future growth in adoption of sustainable investment across the region.

An increasing number of regional financial institutions are alert to sustainable investment issues and even integrating aspects into their wider investment policies. With awareness of sustainability issues generally very high across the region, this trend is likely to continue gathering pace.

Some distinctions are evident between global players which are starting to allocate more resources into building specialist sustainable investment teams in the region or subscribing to third party research and rating services. Regional financial institutions tend to rely more on the knowledge of their fund managers to apply screens on environmental and social risks, for example.

Regulatory authorities have been requiring enhanced ESG disclosure by companies, while increasing numbers of regional financial institutions have been signing up to initiatives such as the Principles for Responsible Investment (PRI), and joining industry associations such as ASrIA. A number of regional stock exchanges, notably the Bursa Malaysia and the Shanghai Stock Exchange have played a key role in raising awareness and recently introduced a mix of best practice ESG guidelines, sustainability indexes, awards and specialist market services. Additionally, more specialist service providers, such as ESG research and ratings providers, are establishing themselves in the regional market.

More tools, information and momentum around sustainable investment, therefore, indicate that a platform is being developed which could support strong growth in adoption of sustainable investment, and support the shift to more sustainable economies in the region over the coming decade.

ESG INTEGRATION

The roundtables showcased an increasing number of financial institutions paying attention to sustainable investment in terms of integration of ESG issues into active investment policy. The picture, however, is variable. Some global financial institutions, in particular private equity investors, are conducting ESG due diligence, or contracting third parties to conduct ESG due diligence, as part of their investment assessments. Thus, there is distinct growth in consultancies getting business to conduct ESG due diligence in the region on behalf of financial clients.

Discussions further indicated that some regional sustainable investment funds have adopted standard global ESG screens and others have attempted to devise screens they felt were more relevant to the Asian context.

There has been variable progress in developing engagement strategies. Fund managers were typically not sending out ESG related questionnaires to companies or actively engaging with companies on ESG related issues, but applied the screens based on

their own knowledge of companies. Though several participants in the roundtables claimed that they practiced engagement and many noted this on questionnaires passed around prior to the events, few provided details on how they conducted engagement.

There has been a significant increase in the number of ESG research, information and ratings providers actively focusing on Asian emerging markets, culminating in the set up of new firms or the establishment of regional satellite offices. Leading financial media have also started to provide ESG information services to their subscribers.

Both global and regional investment institutions, therefore, have access to third party assistance and advanced ESG investment tools. Reference to ASrIA's portal of sustainable investment funds, which details funds known to adopt ESG practices, shows that many globally based funds investing into the region rely on third party services for ESG due diligence and ratings. As many global funds rely on third party research and ratings, Asian companies are rarely contacted directly by global investors on ESG issues and, therefore, some have received a misleading impression that investors are not taking account of such issues.

An increasing number of global financial institutions are basing ESG experts in the region or looking to hire regional talent. Regional financial institutions or regional offices of global institutions are actively participating in conferences and even conducting in-house training for their staff and analyst teams on ESG related issues.

However, several regional representatives of global financial institutions who attended the roundtables noted that they were fully aware of the ESG policies of their head-offices, but that ESG integration and corporate engagement was still relatively new to them.

In summary, key findings on the state of ESG integration in Asia include:

- wide variance in the adoption of ESG across the region exists;
- human resources and capital devoted to ESG are becoming more readily available in the region;
- global financial institutions are drawing on these resources;
- regional actors are beginning to consider ESG issues and corporate engagement; and
- regional actors tend to lack capacity and possibly have constrained financial resources to draw on ESG tools commercially available in the region.

VALUE AND VALUES

The issue of values was rarely far from the discussions at the roundtables. Two key issues were the relationship between value and values, and on whether or not there should be a distinctive Asian approach to ESG.

In Shanghai and Beijing, there were discussions on the distinction between Western and Asian values and on the potential for a distinct Asian approach to sustainable investment. Simply adopting or implementing a Western approach that does not incorporate the Asian cultural or value system in the process may not be effective.

At the events in Jakarta and Kuala Lumpur, there were quite vigorous discussions on what policies to adopt with respect to investment in controversial sectors and the distinctions between perceived global and local perspectives on these issues. There were differing approaches on how to engage with controversial sectors between local and global offices of investment institutions, and it was recommended that global offices should have active dialogue with their regional counterparts in order to gain consensus on such issues. In these markets, there is potential for further growth in Shariah-compliant funds.

At the event in Ho Chi Minh City, there was a particularly strong emphasis on, and even sensitivity to, the importance of governance within financial institutions and the organizations they are investing in or engaging with.

Global sustainable investment funds tend to clearly establish their own value perspectives. However, an observation from the roundtables was that sustainable investment funds should take time to learn and understand the values of the countries they are investing into, and take both sets of values into account. During the discussions it was suggested that funds take a multi-stakeholder approach and stress-test their value screens against regional perspectives.

A number of leading Asian organizations have clearly defined and strongly expressed values. In some cases, these values came from founder families considered by some participants as a potential area of corporate strength in the Asian context. The value placed on building and nurturing relationships (between companies, and between companies and suppliers) was seen as a core Asian strength that may, however, be considered a weakness by some investors. For example, Asian companies had been slower than many Western companies to lay off workers during the recession and held a strong feeling of obligation to provide secure working environments for their employees.

In summary, key findings of the dialogue on values and value approach to investing in the region include:

- the majority of participants at the roundtable events were new to the concept of sustainable investment;
- participants were interested, but have not yet had an opportunity to develop sophisticated models which could reflect Asian perspectives for integration in the investment practice;
- distinct Asian approaches to sustainable investment are emerging, but no clear consensus on what those would be in practice; and
- greater clarity on distinctive aspects to Asian investment practices will emerge as more products which take account of ESG criteria are launched in Asia, including indexes, funds and green bonds.

GOVERNANCE AND BRANDING

Governance issues were widely discussed at the roundtables, attracting particular focus at the Ho Chi Minh City, Jakarta, Manila, Beijing and Shanghai roundtables. There was some discussion as to whether strict interpretation of global governance standards was fully practical and whether there should be some progressive introduction of standards into emerging markets. Local regulatory authorities had to play a guiding role in introducing appropriate standards, relying not only on enforcement, but also focusing on education (e.g. integration of governance into MBA programs) and incentive schemes (e.g. public awards).

IFC cooperation with regulators across regional financial markets to introduce good practice guidelines was noted as a very positive initiative. Whether governance should be interpreted more widely to include management of environmental and social issues, covering such issues as climate change preparedness and disclosure, disaster preparedness and labor management was also debated.

In summary, key findings of the dialogue on governance and branding in the region include:

- progressively more Asian companies are investing heavily into their brand proposition and reputation. Such investment could be at risk if company branding is superficial and not based on good governance and responsible management at the board level;
- financial institutions need to express stronger value sets to attract more investors and develop sustainable long term relationships with their clients and suppliers; and
- companies developing brands outside their home markets require awareness of differing regional and global values in the markets into which they are investing and doing business.

FUTURE OUTLOOK

Learning how other markets around the region are progressing in terms of adopting sustainable investment practice and managing the shift to more sustainable economies made for valuable discussions. Many of the regional participants showed particular interest in China's future development and a lead on sustainability issues.

Chinese capital market stakeholders are currently taking a lead role in the region on a number of fronts, including the implementation of progressive regulations on a broad range of ESG issues. In addition, the massive infrastructure investments outlined in current and preceding Chinese Five-Year Plans have been integrated with country-wide sustainability objectives. The Shanghai and Shenzhen stock exchanges have also been progressive in terms of adopting best practice guidelines, setting up governance and sustainability indexes, and investigating the development of regionally relevant ESG criteria.

With this impetus from China, institutional investors from around the region are increasingly focused on sustainable investment resulting in greater interest and awareness of ESG by investment managers and service providers. This trend towards greater uptake of more sustainable investment is destined to grow among the fast-moving Asian economies. Asian stock exchanges are playing a leading role and regulators are setting policy direction in this regard.

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