



This 2012 emerging markets report is a follow-up to the previous report carried out in 2009¹ by the Emerging Markets Disclosure Project (EMDP). The aim of this 2012 report is to survey global investors to assess what changes, if any, there have been in the level of investment in emerging markets and in those ESG issues that interest responsible investors the most. The report combines investors' sentiment on emerging markets with EIRIS' assessment of how the world's most commonly-invested emerging market companies are responding to ESG issues. Our analysis focuses on 800 companies spread across 30 emerging economies.

Survey responses were collected and analysed by EIRIS, who also produced this report. EIRIS is a leading provider of global environmental, social and governance (ESG) research for responsible investors. EIRIS is also a member of the EMDP.

Responses to this 2012 emerging markets investor survey were collated from the beginning of August to the beginning of September.

The survey asked 20 questions on a range of investment issues related to both emerging markets and ESG factors. There was a mixture of both quantitative and qualitative questions.

Acknowledgements are due to the Principles for Responsible Investment (PRI), US Social Investment Forum (SIF), Boston Common Asset Management and Responsible Investor for their invaluable support in producing this piece of research.

Introduction

This 2012 investor survey shows there is a continuing expansion of investment into emerging markets, with a significant growth since 2009 in the level of assets under management assigned to these markets. The survey responses also provide evidence that more investors are moving into emerging markets.

Alongside the overall growth in emerging market investment there is a call for improved ESG disclosure and performance by the investors surveyed. This is unsurprising with PRI membership amongst the respondents at around two thirds.

The actions of stock exchanges and listing regimes were identified as being fundamental to driving forward ESG disclosure in emerging markets through the development and promotion of innovative products such as sustainability indices and listing rules that encourage reporting on ESG criteria.

Key points:

- Investment allocations to emerging markets are up by almost 30% since 2009
- Around a quarter of surveyed investors have increased their exposure to emerging markets in the aftermath of the financial crisis
- Stock exchanges in Brazil and South Africa have leap-frogged their developed-world peers by creating advanced ESG listing requirements, sustainability indices and other products to drive disclosure
- Governments in Brazil and South Africa also lead on initiatives to encourage corporate ESG performance with China, India, Turkey, Mexico and Hong Kong making good progress
- Poor corporate ESG disclosure remains the number one challenge to investing in emerging markets, with more than 78% of surveyed investors mentioning it
- Environmental issues, compliance with international norms and corporate governance remain core responsible investment concerns in emerging markets, just as they are in developed markets

¹ EIRIS, *Emerging Markets Investor Survey Report: An analysis of responsible investment in Emerging Markets* USSIF June 2009

Responsible investment in emerging markets

The most compelling economic story of the 21st century so far has been the increase in size, influence and integration into the global economy of what are often referred to as emerging markets.

This rapid expansion can be demonstrated by a few statistics:

- in 2012 emerging markets will overtake developed markets in terms of gross domestic product (GDP) measured at purchasing power parity, making up 50.8% of global GDP. By 2020 it is forecast that this figure will have risen to nearly 60%
- between 2000 and 2012 real GDP in emerging markets will have grown by over 100% whilst in developed economies the figure is just 20%
- by 2020 emerging economies will account for over 85% of the world's population²

Over the last decade the leading emerging markets, especially (but not only) the BRIC countries (Brazil, Russia, India, China), have become much more integrated into the global economy. This integration has included increased levels of investment in companies from these countries.

There are now both 'pull' and 'push' factors driving increased demand for ESG information from emerging market companies, as investors seek to put money into these rapidly expanding economies.

The 'pull' factors are dominated by a growing realisation among investors that the incorporation of ESG issues into the investment process to reduce risk, drive performance and identify investment opportunities can have a positive influence on the financial performance of companies – particularly over the long-term.

The 'push' factors reflect pressures from a wide range of stakeholders including NGOs, campaign groups, trade unions, community representatives and, crucially, by some emerging market governments, to ensure that the negative social and environmental impacts of corporate activity are mitigated in some way.

It is true that emerging market investments still represent a relatively small proportion of global direct investment. However as shown by the increase in assets under management (AUM) in emerging markets in the survey, the direction of travel is clearly towards larger allocations, particularly to the advanced emerging economies, such as the BRICs.

² Euromonitor International from national statistics/Eurostat/OECD/UN/International Monetary Fund (IMF), World Economic Outlook (WEO)

Materiality of ESG issues in emerging markets

“The ‘company’ remains a key component of modern society. In fact, in many respects, companies have become a more immediate presence to many citizens and modern democracies than either governments or other organs of civil society” King II Report - 2002

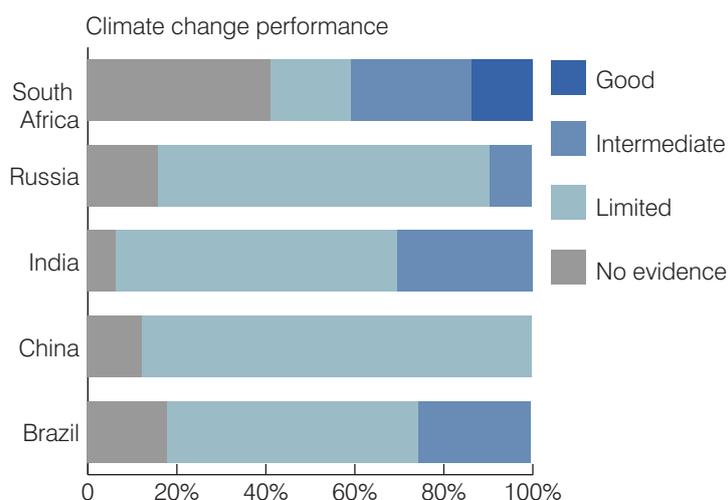
There is no doubt that there is a heightened materiality of ESG issues in emerging markets. Whether it is deforestation of the Amazon in Brazil, the conflict between Vedanta³ and indigenous peoples in India⁴ or environmental pollution or labour issues in China it is clear that company ESG issues have a major impact on peoples’ lives in emerging markets. For this reason there will be strong pressure from those affected, or likely to be affected, to mitigate the negative impacts of company operations. This is likely to feed into demands for better ESG disclosure and performance.

Climate change has been recognised as a systemic risk for investors. The Stern Review has clarified the threats posed to the economy as well as the financial costs of not addressing it.⁵ If anything, these threats are more material in emerging markets where vulnerability to extreme weather events and rising sea levels is greater as there are less resources for protections such as flood defences. Climate change is not just an issue that will affect future generations; it is possible that we are already experiencing changes in weather patterns as a result of it.

EIRIS’ analysis shows that of those emerging market companies identified as having a significant climate change impact, some are already working to mitigate the associated risks they face from climate change but there is a long way to go.

How are emerging market companies addressing the issue of climate change?

In this chart it’s clear that most companies from Brazil, China, India, Russia and South Africa with a significant climate change impact are not doing enough to mitigate these impacts. Although there are some positives, with around 40% of South African and 30% of Indian companies scoring Intermediate level or better at addressing the issue of climate change, the main picture is one of companies only managing a limited response to the issue.



As the impacts of climate change become more severe it is highly likely that this will lead to stronger calls from civil society for companies to improve their management of the issue. This may result in a tighter regulatory framework and a perception by companies that their license to operate is at least partially dependent upon how they manage the risk of climate change.

Given the materiality of climate change and its associated issues, government policy in emerging markets is likely to be a significant driver for improved ESG disclosure and performance. An example of this is the increasing focus upon sustainability by the Chinese government as evidenced by the latest five year plan.

International initiatives such as the Global Reporting Initiative (GRI) and integrated reporting are placing additional focus on value chains. Many companies from emerging markets have a preeminent role as suppliers in the global economy. This may result in additional pressure on those companies to standardise their systems and increase their levels of disclosure.

³ <http://www.eiris.org/files/research%20publications/EIRISVedantaResourcesUpdate2012.pdf>

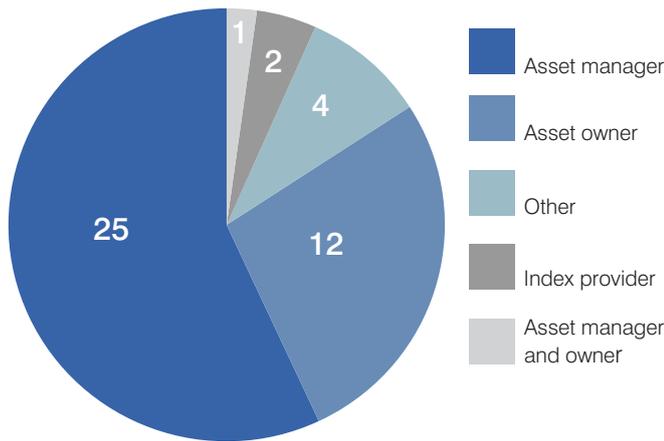
⁴ <http://www.guardian.co.uk/world/2012/apr/08/indian-tribe-avatar-supreme-court>

⁵ Stern, N (2006) Stern Review: The Economics of Climate Change

Global investor survey

In total there were forty four responses to this 2012 survey, compared to sixty seven responses to the 2009 survey. Whilst the 2012 response rate is lower, the total assets under management (AUM) assigned to emerging markets by the 2012 respondents are significantly larger than the 2009 survey group.

Breakdown of respondents

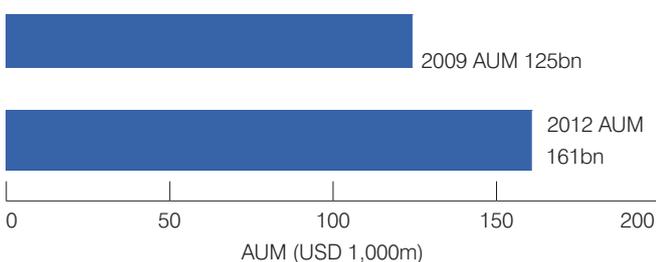


Over half of the forty four respondents identified themselves as asset managers and over a quarter as asset owners. The percentage of asset managers has not changed since the 2009 survey but the proportion of those identifying themselves as asset owners has risen approximately 10%. Two of the 2012 respondents identified themselves as index providers, there were no respondents who identified themselves as such in the 2009 survey.

Allocations to Emerging Markets up almost 30% since 2009

The total AUM of the 2012 survey respondents came in at a figure of nearly USD 2.4tn. Of the USD 2.4tn around USD 161bn, approximately 7%, was allocated to emerging markets. The respondents to the 2009 survey reported that they had around USD 125bn allocated to emerging markets. This means that emerging market AUM in 2012 is almost 30% higher than the 2009 figure, despite the respondent group being smaller.

AUM 2009 vs 2012



More investors are moving into Emerging Markets

Over half of the respondents said they have been investing in emerging markets for more than six years, the longest option for this question. Around 60% of 2009 respondents also had a similar length of involvement in emerging markets. Five of the respondents (just over 10%) indicated that they had been investing in emerging markets for less than a year. This shows that there are still significant numbers of investors moving into these markets.

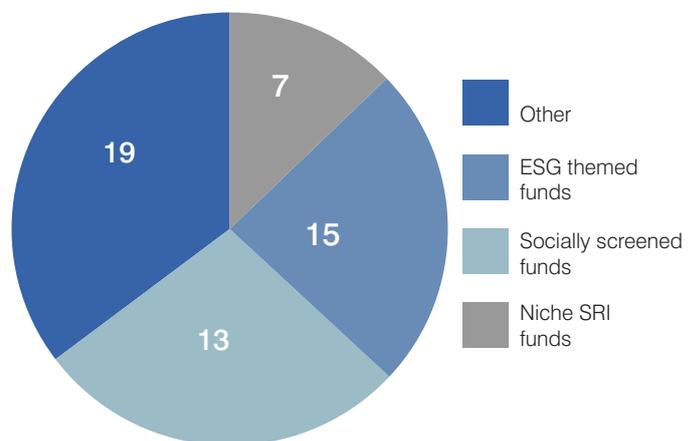
Caution needs to be applied when comparing the 2009 figures to the 2012 ones as there were only two respondents to the 2012 survey who also completed the 2009 survey. However, it is clear that there are significant sums of money being invested in emerging markets by responsible investors and that the levels of fund allocation are on the increase.

ESG-themed funds the most popular Emerging Markets responsible investment strategy

EIRIS research also shows how companies based in different parts of the world differ in their approaches to sustainability and pinpoints the areas which investors should focus on to drive sustainability performance and to reduce ESG risk. Just under half (42.5 %) of respondents run a stand-alone emerging markets strategy while just over half (52.5%) invest in emerging markets companies within an existing strategy.

Investors named strategies ESG-themed funds as the most popular emerging markets investment strategy, followed closely by general socially responsible investment (SRI) funds and then niche SRI funds. For this category we mean thematic or sector focused funds – though it is possible that there is some overlap with the ‘other’ category.

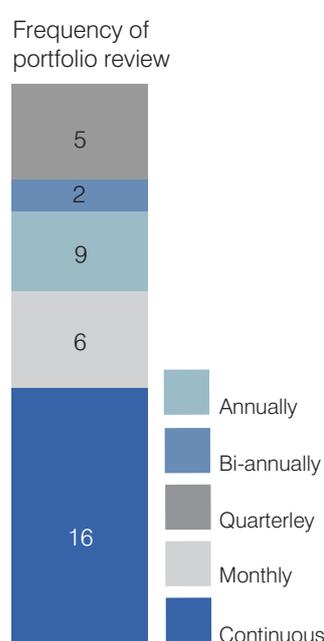
Investment approaches



Other approaches identified included the integration of ESG factors into the standard investment process, investment in general emerging market funds and emerging market exchange traded funds (ETFs) and screening out investments based upon business activity in countries of concern, such as Sudan and Iran. Niche investments such as providing micro credits and investing in vineyards were also mentioned.

Frequency of portfolio review

When asked how frequently investors reviewed/rebuilt their portfolios there was a fairly even split between those investors who carry out continuous updates and those that only update on a monthly or less frequent basis. There is a breakdown in the chart below.



Asset managers are more likely to update on a continuous basis, with asset owners tending to review/rebuild on a monthly or longer timescale.

Investor collaborations: PRI continues to be a significant force

Some advocates of responsible investment have found that one of the most effective ways to promote the integration of ESG factors into investment decisions is through combining their voices within umbrella organisations. This collaboration has resulted in a large number of multi-stakeholder initiatives emerging in the last decade targeted at investors.

These include organisations aimed at promoting responsible investment overall, such as the Principles for Responsible Investment (PRI) and others with a more focused mission, such as the Emerging Markets Disclosure Project, which

has a goal to assess and improve corporate ESG reporting in emerging markets. The Carbon Disclosure Project (CDP) which provides a global system for companies to measure, disclose, manage and share climate change and water consumption information, is another example.

Other initiatives include the Sustainable Stock Exchanges Initiative launched by Aviva Investors with support from the PRI. Its aim is to promote a global listing environment that requires companies to consider how responsible and sustainable their business model is and to encourage them to put a forward-looking sustainability strategy to the vote at their annual general meeting (AGM).

Responsible Investment organisation membership

Respondents were asked to indicate from a list which responsible investment/corporate social responsibility (CSR) organisations that they are members of. The responses are broken down in the chart opposite.

The PRI is clearly the organisation with the largest number of members, with around two thirds of those taking the survey saying that they are a member. There is then a relatively even spread of membership across the other organisations.

Launched in 2006, the PRI provides a framework for incorporating ESG issues into the investment practices of asset owners, consistent with their fiduciary responsibility. Those who sign up to the PRI commit to integrating ESG issues into conventional investment analysis; to being active, responsible owners by promoting good corporate practice in these areas; and to reporting transparently on what actions have been taken in this area. According to the PRI's 2012 annual report there are now nearly 1,100 signatories, including asset owners, investment managers and service providers, with total assets under management in excess of USD 32tn.⁶

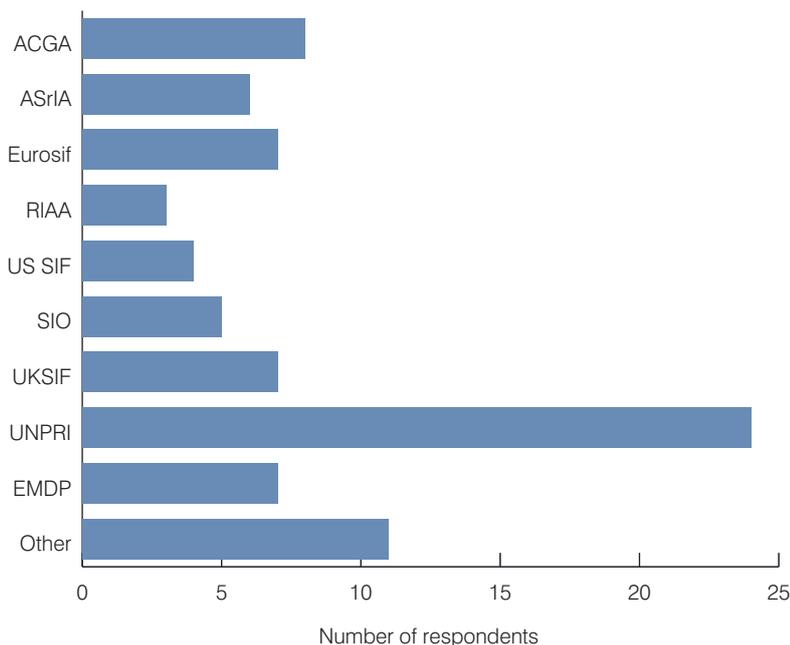
The PRI has established country and regional networks in a number of emerging markets including Brazil, South Africa and South Korea. Domestic investors in these three countries have been active and very successful in raising awareness and developing and benchmarking practices around the incorporation of ESG information into investment practice and will play an important role promoting future improvements to ESG reporting in these countries.

In addition to the groups listed in the chart opposite, respondents also said they were members of a number of other groups, including faith-based responsible investment organisations such as the Interfaith Center on Corporate Responsibility (ICCR) and the Church Investors Group and climate change focused groups such as the Asia Investor Group on Climate Change (AIGCC) and the Carbon Disclosure Project (CDP).

For those who identified their organisations as EMDP investor signatories there was a question asking if they had participated in any of the country teams as a formal member, or as a signatory to the letters.

Of the twenty four respondents that identified themselves as an EMDP investor signatory, eight indicated that they participated either as a member of one of the country teams or as a signatory to the EMDP's letters. Of the remaining sixteen, thirteen said they had not participated and three were unsure if their organisation had participated or not.

Responsible investment organisation membership



⁶ UNPRI 2012 annual report

Emerging market investments

We asked survey participants to identify which emerging markets they currently have holdings in, to identify their ten largest holdings in emerging market companies as at June 30th 2012, and to mention any emerging market indices they used.

Top five countries invested in:

Rank*	Country	Investees
1 (2)	China	26
2 (1)	Brazil	25
3 (5)	Taiwan	23
4 (N/A)	Thailand	21
=5 (2)	India	21
=5 (N/A)	Indonesia	21
=5 (4)	South Africa	21

*2009 ranking in brackets

Top ten emerging market company holdings:

Rank*	Company name	Country
1 (2)	Samsung Electronics	South Korea
2 (4)	Taiwan Semiconductor Manufacturing	Taiwan
3 (3)	China Mobile	China
4 (N/A)	Industrial & Commercial Bank of China	China
5 (7)	America Movil	Mexico
6 (1)	Petrobras	Brazil
7 (8)	Gazprom	Russia
8 (N/A)	CNOOC	China
9 (N/A)	China Construction Bank	China
10 (6)	Vale	Brazil

*2009 ranking in brackets

The most frequently cited index was the MSCI Emerging Market index.

It is unsurprising to see that China has moved up a place to be the number one country for emerging market investment, given its development into the second largest global economy after the US.

India has dropped down to fifth position from joint second with China in the 2009 investor survey. Given the size of India's population and the economic potential of the world's 10th largest economy⁷ it is surprising it has slipped down the list. One possible explanation for this is because of the strict investment regulations applied in that country in the last few years. The current government is moving towards relaxing some of those rules in an attempt to liberalise the market.

Thailand and Indonesia are both new entrants in 2012 with Russia, Mexico and South Korea all dropping out of the top five from 2009.

Interest in Emerging Market 'behemoths' holds steady

Looking at the top ten emerging market company holdings there is a lack of any major movement compared to the 2009 list. Four out of the top six companies in 2012 also appeared in the top six in 2009. Overall, seven top ten companies from 2012 were also in the top ten in 2009. Given that there is often a perception that emerging markets are fast moving and more volatile than developed markets this lack of change in the top ten company holdings is notable.

The dominance of companies from the banking, electronics and energy sectors is noticeable. This demonstrates the increasing vertical integration of emerging markets into the global economy with representatives from the primary (extractive), secondary (manufacturing) and tertiary (services) sectors of the economy making up the top ten.

The main change in 2012 is three new entrants from China: Industrial & Commercial Bank of China, CNOOC and China Construction Bank. This is further evidence of the growing importance of China and Chinese companies to investors.

⁷ <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>

Case study: China

“China will be more integrated into the world economy not only in terms of production and international trade but also accounting rules and disclosure”
Survey response

Although most Chinese companies still lag behind when reporting on sustainability, the reporting trend on CSR reporting overall is promising, as an ever-increasing number of Chinese companies start to produce CSR reports. In China, the total number of CSR reports reached over 700 in 2010⁸. In terms of regulatory framework, the Chinese government seems supportive of advancing company sustainability. This is in line with the government’s next ‘Five Year Plan’⁹, which commits China to adopt a more resource efficient and environmentally friendly model of economic development.

In March 2011 the Chinese government gave a strong indication that it is keen to promote ESG disclosure with the State Council’s Assets Supervision and Administration Commission (SASAC) issuing a notice stating that all state-owned companies should have released a corporate social responsibility (CSR) report by the end of 2012. State owned enterprises (SOEs) are a significant part of the Chinese economy, representing around 30% of its asset value in 2010.¹⁰ Their sheer size means that SOEs play a leading role in the Chinese economy, so this commitment to producing CSR reports is a significant development in promoting sustainability reporting amongst Chinese companies.

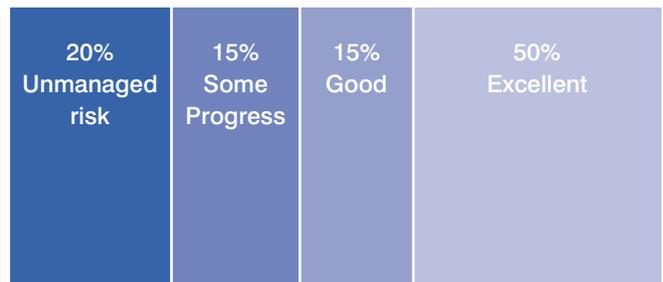
Sustainability is now a central part of the Chinese government’s policy agenda and an integral part of the Chinese government’s 12th Five Year Plan, running from 2011 to 2016.¹¹ The government has set targets of reducing energy use per unit of GDP by 16%, reducing carbon emissions per unit of GDP by 17%, raising the share of non-fossil fuel primary energy consumption to 11.4% and reducing sulphur dioxide emissions by 8%. Chinese companies have a key role to play in achieving these targets which should help drive improved environmental performance and disclosure by those companies.

“The Chinese central government is highly concerned about issues such as climate change and high carbon emissions, resulting in policies that are expected to have a great impact on further development and acceptance of corporate sustainability practices. Such political context would likely usher in better reporting on corporate social responsibility in terms of both quality and quantity.”
Yu You – EIRIS analyst

It is possible to draw some potential parallels between the current Chinese experience and what has taken place in Japan. Just like China over the last 30 years, Japan experienced rapid industrialisation in the post war period. This led to a number of significant public health issues in the 1960’s including cases of mercury poisoning in Minimata city and severe respiratory problems caused by air pollution in the city of Yokkaichi¹². These became high profiles cases in Japan and led to demands for environmental regulations to be tightened.

One of the outcomes of these pollution incidents was the creation of the Japanese Environmental Agency in 1971, a body that has been credited with doing much to advance good practice in environmental management systems by Japanese companies. As shown in the chart below, it is now the case that many Japanese companies score very well when assessed by EIRIS on their environmental management.

Japanese company environmental management assessments



“It is certainly the case that environmental damage and the implications for public health are high up the agenda in China due to its rapid industrialisation. There have been cases of riots in response to potentially polluting factories opening. It remains to be seen if this will lead to the level of environmental sustainability now exhibited by many Japanese companies but it is a strong possibility, given the Chinese government’s often stated aim to avoid social unrest”.

Jowoon Park, Head of EIRIS Korean research partner KOCSR

⁸ http://www.syntao.com/Uploads/%7B6775AF0E-5CEA-4B98-B877-D596DD982D15%7D_A%20Journey%20to%20Discover%20Values%202010.pdf

⁹ http://www.chinadaily.com.cn/bizchina/2010-10/13/content_11405466.htm

¹⁰ <http://blogs.worldbank.org/eastasiapacific/state-owned-enterprises-in-china-how-big-are-they>

¹¹ <http://www.joneslanglasalle.com/GSP/en-gb/Pages/Global-Property-Sustainability-Perspective-urbanization-china-sustainable-trends.aspx>

¹² http://human-security.jp/blog/2007/11/the_four_big_pollution_disease.html

Impact of the 2008 financial crisis

The financial crisis that flared up in 2008 has revealed the risks that investors are exposed to across all asset classes. The crisis highlighted the need for greater accountability, transparency, the consideration of 'extra-financial' research in investment processes, responsible ownership and long-term investing.

We believe the crisis provides empirical evidence that a focus on short-term incentives is damaging to the overall performance of markets. Arguably one of the positive effects of the crisis has been to convince an increasing number of mainstream investors of the value of taking factors such as climate change, environmental and social disclosure and corporate governance into account when making their investment decisions and exercising their ownership obligations.

Nearly one quarter of respondents have increased their exposure to emerging markets in the aftermath of the crisis

Investors were asked if they had increased their exposure to emerging markets as a result of the 2008 financial crisis. The results show a clear trend that this is the case. Nearly a quarter of respondents say they have increased their exposure as a result of the financial crisis with only 5% having reduced their exposure. Just over 50% said there had been no change.

As a result of the financial crisis in developed markets investors have experienced reduced returns and an increase in risk brought about by market instability. This has led to a recalibration of risk/return ratios that make emerging markets more attractive to investors. In some ways emerging markets have become a safe haven for investment returns, this helps to explain the shift towards increasing investment allocations to these markets.

What we are seeing is a confluence of factors that should advance ESG disclosure in emerging markets, with investors moving away from traditional developed markets towards emerging markets, a drive towards longer term investment decisions and a desire for better integration of ESG criteria into investment decisions. These processes are fundamental to emerging market companies being able to grow in a sustainable way.

ESG in emerging markets

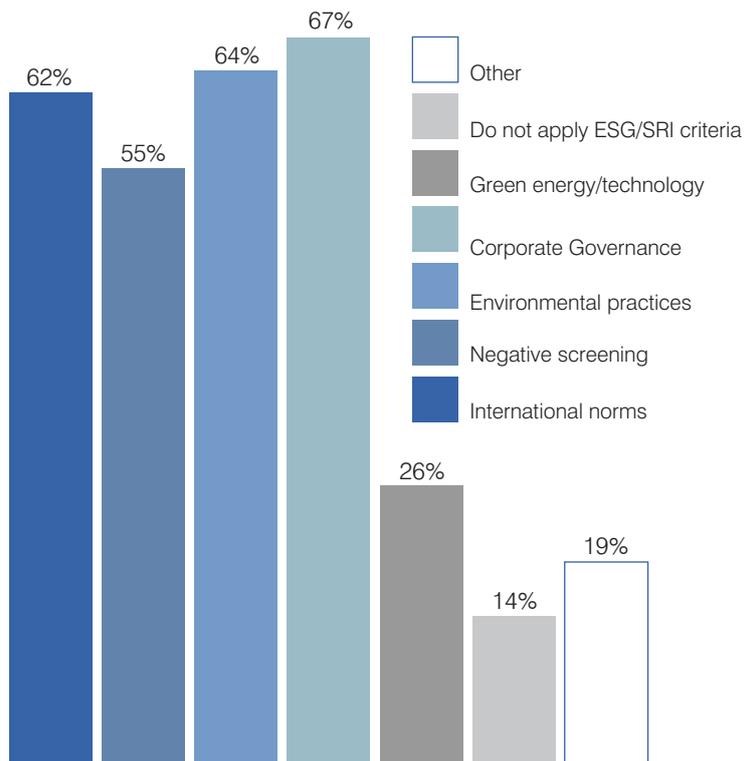
The survey also asked respondents to outline how they apply ESG criteria and what they believe the future holds for ESG in emerging markets. We asked:

- what the most important ESG issues to investors are when they analyse companies?
- what are the key challenges of investing in emerging markets?
- what are the big emerging market ESG issues in the future?
- which countries do they think are making positive progress towards improved ESG disclosure?

“ESG issues will come more to the fore. Those companies that recognize this shift and are successfully able to capitalize on them within their markets will demonstrate above average growth rates.”
Survey response

Which ESG criteria do investors take into account?

There is a relatively uniform application of the core ESG criteria to their emerging market portfolios by the respondents. Over half the respondents use negative screening in their investment decisions.



Investment approaches

In terms of comparing this survey's results with the 2009 survey, the percentages are very similar for the top four. The only significant change is that there are about 10% less respondents to the 2012 survey that apply green energy and technology criteria to their emerging market portfolios. This could be linked to the global trend for the reduction of governmental subsidies and stimulus in these areas and the reduced attraction of these investments due to their volatility.

Other criteria used by investors taking the survey include assessing companies against the Global Compact and identifying positive themes and opportunities related to ESG factors.

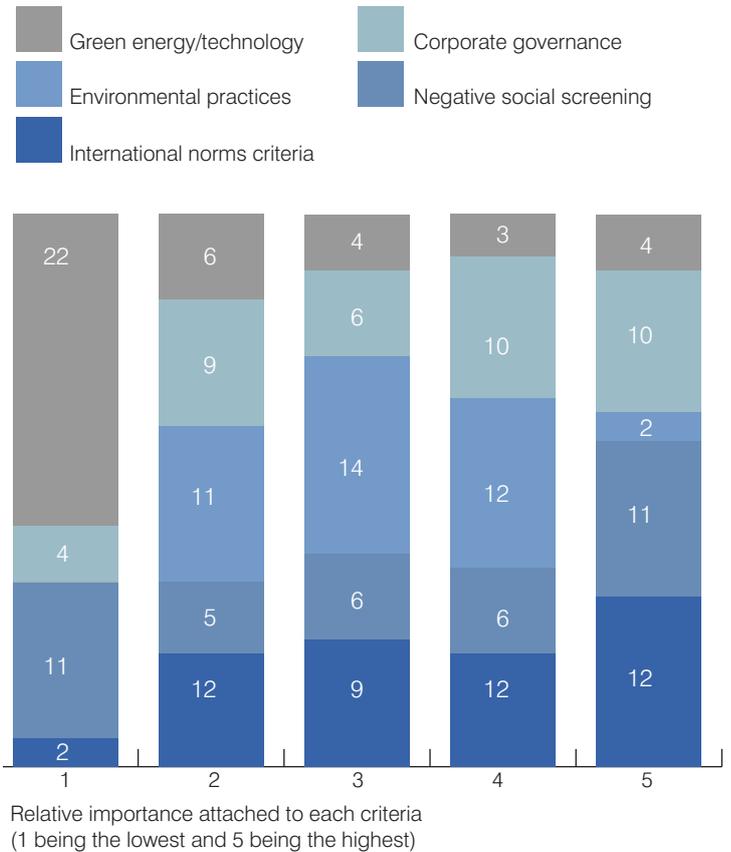
The survey respondents were asked to rank each investment approach in order of importance from one to five, with one being the least important and five being the most important

The approach voted the most important through being awarded a score of five is shared roughly equally between international norms (for example human rights, labour standards), negative screening (eg tobacco, Sudan) and corporate governance, with each of them getting around 30% of the highest score.

For those criteria marked as the least important, with a score of one, there is a clear consensus that green energy/technology is the least important, getting over 50% of the vote. Negative screening is second with nearly 30% of the vote.

Somewhat surprisingly, only 5% of respondents said that environmental practice is the most important criteria used to analyse emerging market companies. However, this is offset by the fact that none of the respondents marked it as the least important criteria, with the large majority of the votes assigning it mid-range importance. Negative screening on the other hand is voted as the most important by around 30% of respondents and least important by 30% showing that attitudes towards it as an approach to ESG analysis are polarised.

Investment approaches



Key challenges

When asked to identify the key challenges to investing in emerging markets, a lack of company ESG disclosure was the top finding with 78% of respondents mentioning it. This is in keeping with the results from the 2009 survey where just under 70% saw it as a key challenge.

Lack of clarity around ESG issues is not solely down to a lack of disclosure by emerging market companies. One of the key challenges EIRIS experiences when researching emerging market companies is around language. Where possible our analysts research company reports in their original language. The reason for this is that our analysts have highlighted a number of cases in the past where, due to errors in translation, what is written in the English language report is different from what appears in the original language version.

Another barrier to full ESG disclosure is that there can be an imbalance in how emerging market companies report on their activities in their home country and their operations in other countries.

“Russian companies’ relatively poor scores for human rights systems and reporting is a concern given the number of large Russian extractive companies which have subsidiaries not only in Russia but also in other countries of concern for human rights such as Iraq, China or Libya. Whilst those companies often report on their Russian operations, they don’t report to the same standard on their subsidiaries in other countries.”
EIRIS analyst Liliya Akhmadullina

Both corporate culture and access to local markets were identified by over 50% of the respondents as key challenges, with a lack of ESG research highlighted as a significant issue by around 40% of those taking the survey.

The main finding to take away from this is that investors identify the environment, compliance with international norms, such as human rights, and corporate governance as their core sustainability concerns in emerging markets, just as they are in developed markets.

This perspective was reinforced by the responses to the question asking what the participants saw as the future ESG issues deemed to be most salient in emerging markets, with the current core ESG areas and disclosure mentioned most. The stance of most respondents can be summed up in one comment:

“We believe that many of today’s issues that we take into consideration when investing in emerging markets will continue into the future.”
Survey response

The next most identified issue was resource scarcity, with five respondents identifying it as a key future issue. Several investors identified resource scarcity as a particularly important issue in Africa. Within the question of resource scarcity, water was mentioned several times, as were issues around land rights.

The future regulatory environment and issues around shareholder rights were also mentioned as likely to be major ESG concerns in the coming years.

Top performers on emerging markets disclosures

The survey finished by asking investors which emerging market countries they consider to be making positive steps towards ESG disclosure and what those steps are.

Below is a table with the top five countries in terms of progressing ESG disclosure and the reasons why they have been identified as leaders.

Rank	Country	Main driver of progress
1	Brazil	the activities of the BM&FBOVESPA stock exchange and its initiatives to promote ESG and corporate governance disclosure
2	South Africa	the King code on corporate governance, listing rules and SRI indices
3	Turkey	changes to listing rules that encouraged better ESG disclosure
4	Malaysia	changes to listing rules that encouraged better ESG disclosure
5	China	changes to listing rules that encouraged better ESG disclosure

Looking back to the 2009 survey, the top two performers remain unchanged whilst China, which had been ranked third, has been leap-frogged by Turkey and Malaysia. South Korea and India have been displaced from their top five ranking in 2009.

The identification of Brazil and South Africa as leaders in terms of ESG is borne out by EIRIS research, with a majority of companies from these two countries consistently scoring better than their emerging market peers. In fact, the top ranked companies from Brazil and South Africa often do as well, or better than, the best performers from any markets, developed or emerging.

“Brazil and South Africa are bespoke leaders in fostering transparency from local companies. They were among the first to establish listing rules including extra-financial dimensions and to develop sustainability stock indices.”
Survey response

Stock exchanges and listing standards drive ESG innovation

When discussing which countries demonstrate the best progress on ESG disclosure, respondents cited the existence of sustainability indices and listing rules as key drivers.

On the product side a number of emerging market stock exchanges have leap-frogged their developed world peers in developing sustainability/green or socially responsible indices and financial products in the last five years. The motivations for this leadership include:

- a desire among emerging market stock exchanges to differentiate themselves
- significant environmental and social challenges in their counties/regions
- a willingness to demonstrate improving ESG standards to attract global capital

Over a decade ago, there were only a handful of sustainability indices available to investors. As ESG investment analysis has expanded, so have related indices. A small but growing number of companies, for example, are linking their remuneration to becoming, and remaining, part of an ESG index (though this is not yet common in emerging markets). Indices can also provide investors with a powerful platform for engagement.

Progress on sustainability reporting has continued to be made by stock exchanges in emerging markets. The Brazilian exchange, the BOVESPA, has now adopted a comply or explain regime for sustainability reporting.

The Mexican stock exchange went live with its own sustainability index in December 2011. Selection of the twenty three constituents that make up the index was based upon research carried out by EIRIS' Mexican partner Ecovalores.

Both the Singapore and Hong Kong exchanges have introduced guidelines on voluntary sustainability reporting and both have indicated that such reporting could well become mandatory in the future under a comply or explain regime. For the Hong Kong Exchange this could be as early as 2013. In November 2011 the Securities and Exchanges Bureau of India (SEBI) implemented compulsory ESG disclosure for the 100 largest companies listed on their exchange.

In the course of our work with the Johannesburg Stock Exchange (JSE) to develop and provide data for their SRI index, EIRIS has noticed that the response rates by South African companies that are sent surveys to assess whether they make it into the JSE SRI index are better than the usual response rates from companies. EIRIS has also seen a similar spike in response rates for those companies contacted in relation to potential entry to the FTSE4Good responsible investment index. This is evidence of sustainability becoming embedded in the company environment as a result of sustainability indices.

Case study: South Africa and integrated reporting

It is a requirement of the King III corporate governance code in South Africa that companies who want to list on the JSE will need to move to integrated reporting. An integrated report is a single report that includes both financial and non-financial information and which discloses the environmental, social and governance context in which a company operates. EIRIS' work with the JSE sustainability index has given us an insight into how companies are putting this requirement into action.

Around a quarter of the companies being assessed for entry into the 2012 JSE sustainability index are now using integrated reports, with a significant number of the remaining companies saying they are moving towards integrated reporting in the future in order to comply with the King III code. At this stage it is mostly the larger companies that have adopted integrated reporting as they are the ones with the resources and capacity to make the change.

The move to integrated reporting puts South Africa at the forefront of the drive to improve ESG disclosure, not just amongst emerging markets but globally. It is an example of innovation and, like the sustainability indices being developed in other emerging markets, evidence that responsible investment may be evolving as it spreads through emerging markets.

“Responsible Investment is still in its infancy in the Mexican financial market. However social responsibility is an important topic, so much so that around 700 companies apply every year to receive a “Socially Responsible Company” distinction. The companies are aware that such distinctions or certifications schemes represent a competitive edge; consequently the topic has gained importance.”

Luisa Montes – Director of Ecovalores

It is probably fair to say that the development of sustainability indices and the promotion of ESG reporting by emerging market stock exchanges are initiatives aimed partially at countering the charge that these markets lag international standards in terms of ESG. They are a useful tool to enhance the image of their markets on the global stage. At the same time there is evidence that these initiatives are driving improvement in ESG disclosure in emerging markets and helping governments to address the environmental and social challenges these nations face.

Where an exchange is part of the government regulatory framework, such as in China or India, where sustainability criteria are promoted this gives a clear signal to companies that this is an area that the government is keen to promote so it makes sense for them to develop their ESG capacity as it is likely to be an area they will be regulated on in the future.

It is worth bearing in mind the central role played by the state in many emerging market economies and the influence this brings over company behaviour in these countries. If emerging market states are keen to promote sustainability, and the evidence seems to point towards this, then they are well placed to get companies to go along with these initiatives’.

Conclusions

It is clear that there are a number of strong currents within emerging markets that are carrying forward ESG disclosure and performance by companies.

These currents include; the continuing process of the integration of emerging markets into the global economy with increasing inflows of investment into emerging market companies; the growing determination of investors to include ESG factors in their investment decisions as evidenced by the expansion of responsible investment organisations such as the PRI; and the significant materiality of ESG issues in emerging markets.

It also seems to be the case that many of the leading emerging market governments are keen to promote sustainability through regulatory frameworks, such as the King III governance code in South Africa, the development of sustainability indices and listing rules such as in Brazil or the requirement for state owned enterprises in China to produce CSR reports. This is evidence that responsible investment is evolving as it spreads into emerging markets.

What investors need to do

- Engage with emerging market companies to reduce ESG risks and drive improvements in performance
- Reward companies that behave transparently and commit to sustainability
- Take action where companies act in an unsustainable way
- Participate in multi-stakeholder organisations such as the PRI, the CDP or integrated reporting initiatives
- Support innovation in emerging markets such as sustainability indices
- EIRIS provides a range of products to enable investors to tailor their investment decisions about emerging market companies to meet their sustainability objectives

How we can help – EIRIS Emerging Markets Service

EIRIS Emerging Markets Service provides global ESG research to enable investors to apply ESG strategies to their global emerging market portfolios. The service enables responsible investors to rate, rank and screen emerging market companies to reduce risk or identify better performers.

The service provides screens covering 800 emerging market companies across 30 emerging market economies, with the option to drill-down further into the ESG risk profile of 300 largest companies from this sample.

For further information on EIRIS’ products and services for responsible investors please email: contact@eiris.org or call:

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- > Europe +33(0) 1 48 03 92 24
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Appendix

Survey questions

- Do you represent an asset owner or asset manager?
- Which organizations are you a member of?
- If you are an EMDP investor signatory, did you participate in any of the country teams as a formal member? Or as a signatory to the letters?
- Did you participate in the 2009 EMDP Investor Survey? If so what was your AUM at that time?
- What is your AUM now, as of June 30th, 2012?
- In your international portfolio, what dollar amount was in emerging markets as of June 30th, 2012?
- What types of investment vehicles do you run in emerging markets?
- How long have you been investing in emerging markets?
- Do you have a stand-alone emerging market portfolio strategy?
- In which emerging market countries do you currently have holdings?
- What were your top ten largest company holdings in emerging markets as of June 30th, 2012?
- How often do you review/rebuild your portfolio?
- Do you use an emerging market index and if so which index do you use?
- Have you changed your exposure to emerging markets in response to the 2008 global financial crisis?
- When investing in Emerging Markets, what ESG/SRI criteria do you take into account?
- Please rank the criteria below in terms of importance for how you analyse ESG issues with emerging market companies, with 5 being the highest.
- What do you think are the key challenges to investing in emerging markets?
- What future ESG issues do you see as becoming salient to investing in emerging markets? Please indicate if these are applicable to a specific region.
- Which emerging market countries do you consider are making positive steps towards ESG disclosure? Please describe how the countries you've listed are making positive steps.
- Any additional comments?

About EIRIS

EIRIS is a leading global provider of independent, global research into the environmental, social, and governance, (ESG) and ethical performance of companies. With almost 30 years' experience of conducting research and promoting responsible investment strategies, EIRIS now provides services to more than 150 asset owners and asset managers globally. We work with clients to create their own ESG ratings and rankings, to engage with companies and to create specific funds for their clients. EIRIS has a multinational team of over 60 staff in London, together with offices in Boston and Paris. Additionally, we have a global platform of research partners which includes research organisations in Australia, Germany, Israel, Mexico, South Africa, Spain and South Korea.

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