

Better Returns in a Better World:

“Emerging Markets: ESG Risks & Opportunities”

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Key message

For the emerging markets investment opportunity to materialise, and for investment to be a force for development and poverty reduction, investors need to:

- look beyond stock-specific risks and take a more holistic view of risk management where they consider and manage wider structural and reputational risks – e.g. poverty and inequality - as an integral part of their investment process.

Opportunities and Risks for investors

- Emerging markets (EMEs) are sources of future growth and returns for investors – both through direct investments in EMEs companies and other assets and for investments in companies that expand in those countries.
- Structural drivers of growth e.g. growing populations, infrastructure needs, growing ‘middle classes’, consumption changes, etc.
- But equally major sources of risk. E.g. natural resources competition, farmland, poverty...

Opportunities and risks for EMEs

- This interest in EMEs represents an opportunity for capital-starved countries, but the impact on those countries' development will be determined by the extent to which investments take into account social and environmental impacts, and the wider societal and structural challenges – e.g. poverty.
- Investors hold major responsibility as capital allocators and proxy owners of companies.

Growing social and regulatory pressure on investors

- Collective not only individual risks.
- Increasing scrutiny of investors for their ESG impacts.
- Growing expectations of better alignment between financial and social returns.

These pressures affect the investment universe, the ability to access or exit investments & might carry transaction or other costs.

Managing growing pressures

The risks that need to be managed are not just those related to the specific risk/return characteristics of the investment itself but also that risk management strategies need to take account of market condition and of the more general pressures on investors to take a more responsible approach to their investments.

Risk management strategies

1. Solid processes for identifying and assessing ESG issues associated with investments.
2. Engagement with investee companies to ensure proper ESG management.
3. Engagement with relevant to create the right conditions for the kind of patient long-term investment that emerging markets need.

Better Investment Analysis and Decision-making

Better due diligence, better decisions.

But integrating poverty and development issues pose real practical challenges:

- general absence of investment-relevant research and financial tools to assess the financial significance of these issues.
- many investment managers are simply not aware of the nature, scale and risks associated with development issues.

Plus a set of practical hurdles

- Weaknesses in corporate disclosures on social issues
- Lack of clear correlations btw measures of corporate social performance (e.g. the existence of human rights policies, supply chain auditing) and measures of financial or investment performance.
- Difficulties in assigning a financial value to particular social impacts (e.g. living wage in global supply chains).
- Difficulties in predicting the social consequences of environmental issues (e.g. water- risks).

Influencing corporate practice through engagement and voting

- Positive impact of investment engagement – individually and collectively - on company performance, systems and processes, quality of information, e.g. access to medicines, labour standards and climate change.
- Few shareholder resolutions relating to companies environmental and social performance or reporting have been filed, but expected to increase.

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Influencing public policy

➤ Weaknesses in public policy frameworks are at the core of poverty-related challenges.

➤ While investor engagement can do much to encourage companies to take a more proactive approach to these issues, the reality is that effective action is in many cases constrained by limitations in public policy.

➤ Examples of investors' support of the Extractive Industries Transparency Initiative (EITI) and the public policy work of the Institutional Investors Group on Climate Change (IIGCC).

Conclusion

Investors need to go beyond the narrow context and risks associated with specific investments and consider the wider structural arguments if they are to benefit from EMEs' growth:

- Significant risks faced by companies are not those associated with the business itself but the broader business context within which it operates.
- These cannot be addressed through better due diligence or investment analysis but require that attention is paid to the wider context within which the business is operating.

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Recommendations for investors

1. Integrate consideration of poverty and development issues into their own investment processes and decisions.
2. Encourage better investment research, in particular on social issues.
3. Encourage companies to improve their disclosures on these issues.
4. Constructively engage with other stakeholders and contribute to public policy debates on environmental and social issues.

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All reports and information about
Better Returns in a Better World
is posted at: www.oxfam.org.uk/business

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Thank you !

