

Gaining Ground—Sustainable Investment Rising in Emerging Markets

International Financial Corporation

March 2009

Objective:

The objective of this survey was to gauge the growth of sustainable investments made by emerging market equity managers and the levels of seriousness regarding integrating ESG factors into investments.

Methods Used:

Mercer conducted a global survey among 514 equity managers through Mercer’s Global Investment Manager Database (GIMD). Of these, 177 represented Emerging Market Equity (EME) managers. In addition to this survey, Mercer also conducted 40 research meetings with investment managers on-site in China, India, South Korea and Brazil, to evaluate the managers’ capabilities with respect to ESG integration and active ownership.

Key Findings:

- Over USD 300 billion in assets under management represent either a Sustainable Investment (SI) labeled fund or a mainstream fund that has some commitment to integrate ESG into the core investment process.
- Almost half (46%) of the 177 managers invested in EME surveyed have a policy regarding the integration of ESG issues into their investment policies.
- 34% of all equity managers surveyed indicate that managers have been more proactive in developing ESG policies.
- A very small proportion (7%) of EME products are branded as Socially Responsible Investments (SRI). But almost half of the products take ESG issues into account with their investment process.
- On being asked whether managers raise ESG issues with the management of the investee company, 21% claimed that they raised corporate governance issues, while 18% claimed that they raised all ESG issues.
- Sustainable Investment practices in China:
 - Managers acknowledged that ESG is a significant trend in the asset management industry, although the level of ESG integration in this industry is variable.
 - Engagement and active ownership is at an early stage of development in China where the dominance of state ownership is a challenge for implementing engagement activities.
 - Policies require that companies seeking listing on the Chinese stock exchanges should undergo an environmental assessment first.
- Sustainable Investment practices in India:
 - Within the investment management community in India, ESG is at its infancy.

- At a company level, Indian companies are not well represented in global sustainability funds, and overall, India lags behind other emerging markets in attracting sustainable investment.
- Most managers did not receive high ESG ratings and all of them had more or less similar ratings.
- A minority of managers displayed limited awareness of local social issues as a backdrop for evaluating investment opportunities and risks, although they admit that this is not a strong area of their skills.
- Sustainable Investment practices in South Korea:
 - There is reasonable recognition within the investment community of the importance of ESG issues.
 - Investment managers noted that they are keen to see a stronger compliance regime sanctioned by the government to effectively further the pursuit of SI.
 - The number of SI labeled funds increased from 2 in December 2005 to 45 in May 2008.
 - An eco-index is being developed that will track companies that engage in the production of eco-friendly goods and alternative energy development projects.
 - The number of companies reporting on sustainability issues increased from 0 in 2001 to more than 50 in 2008.
- Sustainable Investment practices in Brazil:
 - Brazilian companies tend to have weak corporate governance levels as compared to their global counterparts.
 - Although there appears to be firm-wide commitment to ESG issues and a general awareness of sustainability/ESG amongst most investment managers, this does not translate to integration into the investment process in Brazil.
 - Corporate governance is the strongest factor impacting on investment decisions rather than environmental or social issues.
- Investment in SI-labeled EME funds has risen more than five times since 2003 to over USD 50 billion in 2008.
- There are 110 global SI-labeled equity funds that invest some of their assets into emerging market equities. The average exposure of these funds to emerging markets is 6%, although the actual investment varies between 0% and 40%.

Conclusion:

Although the tremendous economic growth witnessed in emerging economies has increased the speed of depletion of natural resources, sustainable investment is gradually evolving in such markets.

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