

# Why responsible investing has greater potential in emerging markets

**Dara White**  
Global Head of Emerging Markets Equities

**Kyle Bergacker**  
Senior Responsible Investment Analyst

The emerging markets universe has 26 countries and arguably, environmental, social and governance (ESG) issues matter far more in these regions than in developed markets. There is more room for companies to improve and for investors to influence change, for the good of society and investors themselves. That means greater potential for alpha generation and having a positive impact. Emerging markets rely more on natural resources and have more labour-intensive manufacturing businesses, so there is naturally more opportunity for improvement.

ESG standards are beginning to matter more. Consider the growing populations, rising middle class, urbanisation and expanding energy consumption. Clearly you need to improve regulation and governance for these economies to grow in a responsible way. Countries such as China and India are jumping ahead in terms of renewable energy adoption. India has a target of generating 57% of its energy from renewable sources like wind and solar by 2027.<sup>1</sup>

ESG investing in emerging markets adds value. Research from the University of Waterloo in Canada shows that the MSCI Socially Responsible Investing (SRI) Index not only ranked higher in terms of mean return than most emerging market portfolios, but also was less vulnerable to negative shocks.<sup>2</sup>

## Finding “quality”

There is a huge spectrum of “quality” – defined in terms of both ESG and investment generally – but I would argue this is greater in emerging markets (EM) than in developed markets. Quality businesses look after the interests of investors, employees and society; they manage capital responsibility and have good corporate governance. Well-run businesses can take market share away from competitors such as state-owned enterprises that aim primarily to provide employment and aren’t as competitive.

Additionally, there are family-run businesses which studies show tend to generally outperform. While they

do not always have great corporate governance, often the family's interests are aligned with investors' interests in terms of long-term growth and avoiding risk.

Clearly, there is also a long list of bad players. While the situation is improving, loose regulations and unstable policy environments do allow bad practice to continue.

## Data analysis

Our data models act as a first screen, allowing fund managers to focus their research with greater intensity. A fund manager may, for example, look at a company that the models indicate as being of lower quality but decide it is improving and that is not being picked up by the models quite yet. There is a great opportunity to generate alpha by engaging with these companies to uncover hidden value. That's where our most fruitful dialogue happens.

Columbia Threadneedle Investments' bespoke responsible investment model has more than 250 million data points. We are also working on a platform to go alongside that with more than three billion data points. The data covers about 90% of the MSCI Emerging Markets Index and tells us if a company is making an impact or not. Even if a company doesn't publish a data point, you can infer that through machine learning by capturing related data.

For instance, gallons of water used, or hazardous waste emitted. While there is still less data in emerging markets, corporate disclosures are growing quickly in response to pressure from governments and large investors like sovereign wealth funds and pension funds.

## Emerging market themes

Among the themes we are interested in is fintech, which is an exciting area because it increases financial inclusion across our markets. There are huge benefits in moving from cash to digital transactions; this transition is happening quickly in some emerging markets and digital payments are the first step towards digital banking. While recognisable names include Alipay and Tenpay – China's payments duopoly – the likes of StoneCo and PagSeguro<sup>3</sup> in Brazil also enable digital payments.

Turning to renewable energy, countries such as China and India are adopting these technologies on a massive scale. Companies in solar and wind have large numbers of potential consumers. Furthermore, China has poured billions of dollars into support for electric vehicles and leads the industry worldwide.

There are also opportunities in education companies as there is a big appetite for online education services that give children in rural areas more opportunity.

## The power of engagement

Engagement is important for sourcing data from companies and helping them to improve ESG practices. We make our views known and help companies to improve performance. Say, for example, you are Coca-Cola and water is a key input. Obviously, reducing water wastage improves your income statement and increases free cash flow. Collaborating with companies helps them to achieve a double win – in terms of both ESG and financial performance.

A lot of policy makers are taking action, setting renewable energy targets as well as introducing stewardship codes. We feel that with the right team and tools there is an opportunity to influence and be at the forefront of change. We believe it is a great time to dive in and invest in emerging markets using an ESG strategy.

### Sources:

- 1 [The Guardian, India plans nearly 60% of electricity capacity from non-fossil fuels by 2027, 22 December 2016.](#)
- 2 [Weber, Olaf, and Ang, Wei Rong. "The Performance, Volatility, Persistence and Downside Risk Characteristics of Sustainable Investments in Emerging Markets."](#)
- 3 [Mention of specific companies should not be taken as a recommendation to buy.](#)

To find out more visit  
**COLUMBIATHREADNEEDLE.COM**



**Important Information: For use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients).** This document is intended for informational purposes only and should not be considered representative of any particular investment. This should not be considered an offer or solicitation to buy or sell any securities or other financial instruments, or to provide investment advice or services. **Investing involves risk including the risk of loss of principal. Your capital is at risk.** Market risk may affect a single issuer, sector of the economy, industry or the market as a whole. The value of investments is not guaranteed, and therefore an investor may not get back the amount invested. **International investing** involves certain risks and volatility due to potential political, economic or currency fluctuations and different financial and accounting standards. **The securities included herein are for illustrative purposes only, subject to change and should not be construed as a recommendation to buy or sell. Securities discussed may or may not prove profitable.** The views expressed are as of the date given, may change as market or other conditions change and may differ from views expressed by other Columbia Threadneedle Investments (Columbia Threadneedle) associates or affiliates. Actual investments or investment decisions made by Columbia Threadneedle and its affiliates, whether for its own account or on behalf of clients, may not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not take into consideration individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon and risk tolerance. Asset classes described may not be suitable for all investors. **Past performance does not guarantee future results, and no forecast should be considered a guarantee either.** Information and opinions provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. This document and its contents have not been reviewed by any regulatory authority.

**In Australia:** Issued by Threadneedle Investments Singapore (Pte.) Limited ["TIS"], ARBN 600 027 414. TIS is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and relies on Class Order 03/1102 in marketing and providing financial services to Australian wholesale clients as defined in Section 761G of the Corporations Act 2001. TIS is regulated in Singapore (Registration number: 201101559W) by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289), which differ from Australian laws.

**In Singapore:** Issued by Threadneedle Investments Singapore (Pte.) Limited, 3 Killiney Road, #07-07, Winsland House 1, Singapore 239519, which is regulated in Singapore by the Monetary Authority of Singapore under the Securities and Futures Act (Chapter 289). Registration number: 201101559W. This advertisement has not been reviewed by the Monetary Authority of Singapore.

**In Hong Kong:** Issued by Threadneedle Portfolio Services Hong Kong Limited 天利投資管理香港有限公司. Unit 3004, Two Exchange Square, 8 Connaught Place, Hong Kong, which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 regulated activities (CE:AQA779). Registered in Hong Kong under the the Companies Ordinance (Chapter 622), No. 1173058.

**In EEA:** Threadneedle Management Luxembourg S.A. Registered with the Registre de Commerce et des Societes (Luxembourg), Registered No. B 110242 44, rue de la Vallée, L-2661 Luxembourg, Grand Duchy of Luxembourg.

**In UK:** Issued by Threadneedle Asset Management Limited. Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority.

**In Switzerland:** Issued by Threadneedle Portfolio Services AG, Registered address: Claridenstrasse 41, 8002 Zurich, Switzerland.

This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors' with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparties and no other Person should act upon it. **Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.**  
**columbiathreadneedle.com** Issued 05.21 | Valid to 12.21 | J31497 | APAC\_EMEA 3560122