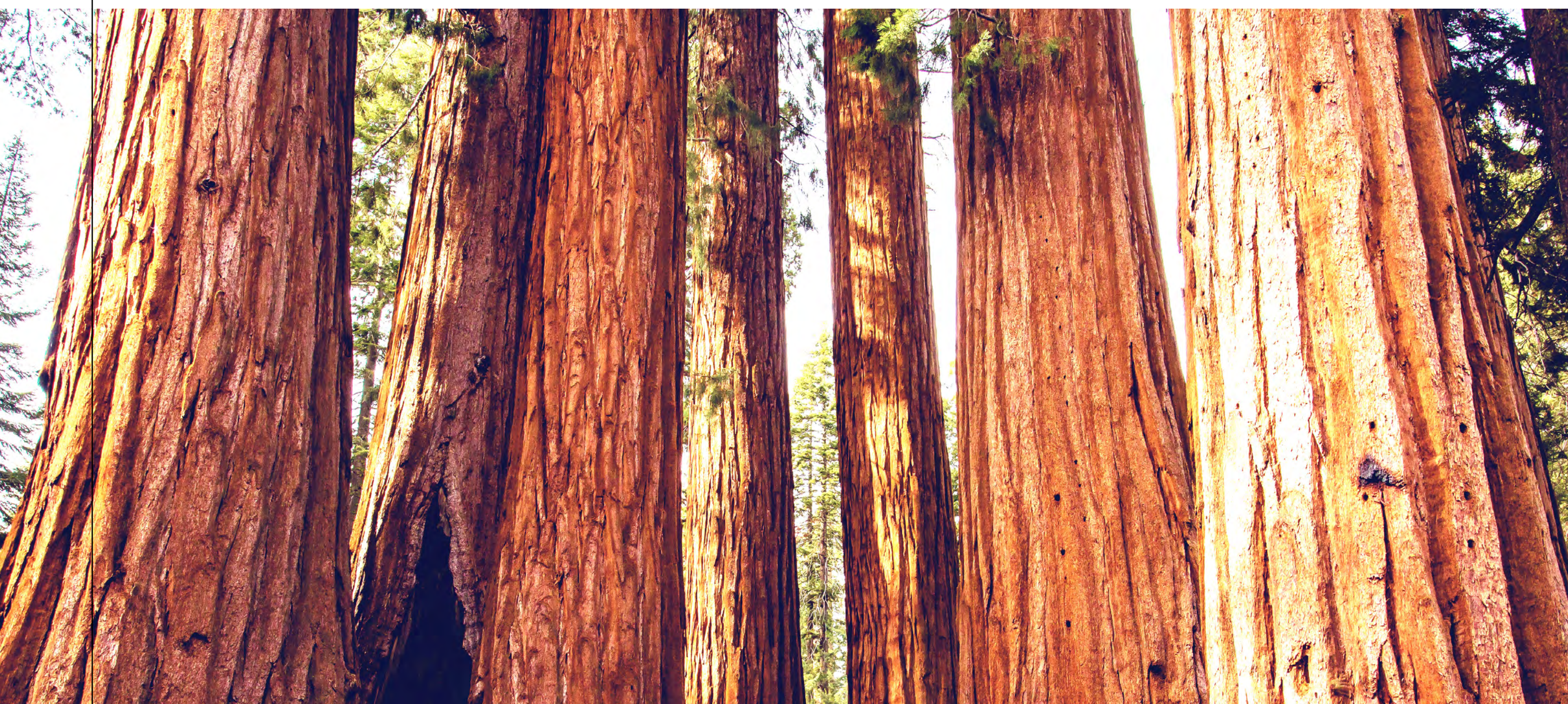
GLOBAL EQUITY

Investment Management
active.williamblair.com

Strengthening ESG Standards in Emerging Markets: A Catalyst for Investments and Growth



Enhancing environmental, social, and governance (ESG) standards is not just a responsible endeavor but a strategic imperative for attracting capital, increasing business domestically and internationally, and attracting talent. Emerging markets (EMs) have historically lagged in this endeavor due to a lack of awareness, resource constraints, and weaker regulatory frameworks, driving consistently lower ESG ratings by major rating agencies. But the encouraging trend of positive initiatives, such as improved corporate governance codes, heightened environmental disclosures, and efforts to promote gender diversity, underscores the growing significance of ESG in EMs.

October 2023

Portfolio Specialist
Romina Graiver, Partner

Strengthening ESG Standards in Emerging Markets

ESG practices and disclosures have evolved to become critical considerations for companies in EMs.

Demonstrated strong ESG credentials can help companies attract institutional investors, which increasingly recognize that a company's ESG performance is an indication of its long-term sustainability and risk-management capabilities.

ESG credentials also have an increasing impact on companies' ability to access international markets because major developed market (DM) trading partners are imposing stricter requirements for imports.

Further benefits relate to companies' ability to access lower-cost capital, attract talent, and increase customer acceptance. Indeed, the portion of EM consumers who care about sustainability is 15 to 25 percentage points higher than that of DM consumers, according to a recent report by BCG's Center for Customer Insight.

The Current Landscape of ESG Disclosure

EM companies typically have weaker ESG disclosures and lower ESG scores than their DM counterparts, and this is commonly cited as a key impediment to stronger capital allocation as asset owners increasingly integrate ESG considerations into their investment strategies.

A study by Mobilizing Institutional Capital Through Listed Products (MOBILIST), a U.K. government program, that interviewed market practitioners about the impact of ESG on capital allocation to EMs confirmed that issues around ESG data gap and scoring biases may exacerbate inefficiencies in capital allocation and reduce flows to EMs.

Disclosure weakness also stems from limited awareness, resource constraints, and divergent corporate governance practices. EM companies typically have less experience reporting ESG data than companies in Europe, where disclosure regulations have been in place for many years.

Given the increasing importance of ESG considerations in attracting capital and growth opportunities, regulators and stock exchanges have ramped up efforts to provide guidelines for better corporate disclosure. These efforts are starting to pay off. We have seen significant improvement in data availability in Malaysia, Thailand, Philippines, South Africa, United Arab Emirates, India, and China, for example.

Improving Trends Could Drive Better Outcomes

Several notable regulations and initiatives aim to strengthen ESG practices and disclosure.

- In January, Brazil's Securities and Exchange Commission Resolution 59 came into effect, requiring enhanced disclosure about ESG activities and risk-management practices. Drawing on the mandated reporting of board members' demographics by gender and race, B3, the Brazilian Stock Exchange, introduced the Idiversa B3 index in August, designed to recognize listed companies that excel in diversity, combining gender and racial criteria. On the climate front, the upcoming vote on a bill establishing a Brazilian Greenhouse Gas Emissions Trading System (SBCE) is a significant development signaling Brazil's efforts to meet its climate commitments.

"We have seen significant improvement in data availability in Malaysia, Thailand, Philippines, South Africa, United Arab Emirates, India, and China, for example."

Romina Graiver, Partner

A Catalyst for Investments and Growth

- The Securities and Exchange Board of India's 2023 introduction of the Business Responsibility and Sustainability Reporting (BRSR) framework replaces the Business Responsibility Reporting (BRR) and requires India's 1,000 largest companies to file mandatory quantitative metrics on sustainability-related factors. The regulator also introduced assurance requirements for corporate sustainability reporting and created more stringent mutual fund naming and disclosure regulations.
- UAE, alongside other Middle Eastern countries, is behind more advanced EMs with regard to ESG practices and disclosures but is ramping up efforts. The Securities and Commodities Authority has set ESG metrics and indicators for corporate reporting. It has also supported the creation of an ESG stock index on the Dubai exchange, which is designed to include UAE companies that show sustainability best practices. Moreover, the regulator will require a minimum of one woman board member by 2025. In just two years, the number of women on company boards has more than doubled.

As ESG awareness and efforts by companies and regulators accelerate in EMs, the recent International Sustainability Standards Board (ISSB) sustainability reporting framework has the potential to serve as a catalyst for significant improvements in reporting. ISSB provides a globally recognized and standardized framework for sustainability reporting that promotes consistency, transparency, and comparability. EMs that are relatively early in their ESG reporting journeys may leapfrog reporting standards and adopt international best practices, helping attract new capital and growth.

Conclusion

Enhancing ESG standards is not just a responsible endeavor but a strategic imperative for attracting capital, increasing business domestically and internationally, and attracting talent.

EMs have historically lagged in this endeavor due to a lack of awareness, resource constraints, and weaker regulatory frameworks, driving consistently lower ESG ratings by major rating agencies.

The encouraging trend of positive initiatives, such as improved corporate governance codes, heightened environmental disclosures, and efforts to promote gender diversity, underscores the growing significance of ESG in EMs. Moreover, the ISSB framework offers EMs a unique opportunity to elevate their ESG standards to international levels, potentially unlocking new increased investments and growth.

The journey toward robust ESG standards and the potential that this represents for EMs may not be fully appreciated by the market. We believe it is important for investors and stakeholders to monitor the evolving ESG trends and engage with EM companies and regulators to obtain the potential benefits of positive developments and their potential for acceleration.

About William Blair
William Blair is committed to building enduring relationships with our clients. We work closely with private and public pension funds, insurance companies, endowments, foundations, and sovereign wealth funds, as well as financial advisors. We are 100% active-employee-owned with broad-based ownership. Our investment teams are solely focused on active management and employ disciplined, analytical research processes across a wide range of strategies, including U.S. equity, non-U.S. equity, and emerging markets debt. William Blair is based in Chicago with global resources providing expertise and solutions to meet our clients' evolving needs.

17479115 (10/23)