The State of Sustainable Investment in Key Emerging Markets

SYNTHESIS REPORT

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IFC International Finance Corporation
World Bank Group

ABOUT IFC

IFC, a member of the World Bank Group, is the largest global development institution focused on the private sector in developing countries. IFC creates opportunity for people to escape poverty and improve their lives by providing financing to help businesses employ more people and supply essential services, by mobilizing capital from others, and by delivering advisory services to ensure sustainable development. In a time of global economic uncertainty, IFC's new investments climbed to a record $18 billion in fiscal year 2010. For more information, visit www.ifc.org .

ABOUT ILLAC

A signatory to the UN Principles of Responsible Investment (UN PRI), ILLAC is a research and advisory services firm with a social mission, incorporated in London in 2001. ILLAC is specialized in corporate governance and sustainability with a focus on emerging markets and Turkey specifically. ILLAC undertakes voluntary not-for-profit projects, as well as commercial assignments, with the objective of helping the advancement of governance frameworks and practices in emerging markets. Please direct questions and comments to info@illac.com.

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INTRODUCTION

To support the growth of sustainable capital flows, IFC's Advisory Services team seeks to influence, support, and enable capital allocation and portfolio management processes, using IFC's own investment practices as a model. IFC is playing its part in supporting the growth of the market by funding the development of enhanced stock market indices and financial instruments and through targeted market research.

Compiling data on the state of development of the sustainable investment (SI) industry is important for global investors and investment managers seeking to understand the scale and location of opportunities in the market for sustainable investment products. Although a number of organizations provide this information in developed economies, such data are scarcely available in emerging markets (EM).

IFC thus launched a series of sustainable investment country reports covering major emerging capital markets attracting global portfolio investors: Brazil, India, China, Sub-Saharan Africa, the Middle East and North Africa (MENA), and Turkey.

"The State of Sustainable Investment in Key Emerging Markets" provides a snapshot of the findings of these country reports and seeks to identify common themes and trends across and highlight crucial differences among these markets.

The report is intended as a summary and the actual country reports themselves would provide a fuller picture of the state of sustainable investing in each market. While this report seeks to capture the findings from the individual reports it does not reflect specific input from the authors themselves. Equally the synthesis and analysis reflects the thoughts of the author of this report not of the individual country reports.

Although the country reports have a similar content, there are differences among them that reflect the authors' style, their analytical approach, and the unique attributes of the markets covered. In general, the authors have defined sustainable investments as investments that incorporate environmental (E), social(S) and governance (G) factors into the investment processes. The six reports primarily investigate sustainable investments through the supply of financial capital to publicly listed firms in the form of equity investments through the stock markets, using strategies that incorporate environmental, social, and governance (ESG) risks into the investment process, with a long-term perspective. These investments can be purposefully ESG-inclusive and marketed as such (theme-based or labelled), or they can include ESG factors somehow in the processes without explicitly referring to sustainability-related factors.

The reports also consider the supply of financial capital in various classes and forms to listed and privately held firms with a consideration of the investment's impact on economic and social development or on investors' values.

The data are based on end of 2008 figures for Brazil and India and end of 2009 figures for South Africa, Turkey, and the Middle East and North Africa (MENA). The key markets covered—India, China (excluding Hong Kong), Turkey, and South Africa—constituted 51 percent of the MSCI Emerging Markets Index at the end of 2009.

TABLE 1: MARKETS COVERED BY IFC'S COUNTRY REPORTS ON SUSTAINABLE INVESTMENTS

EMERGING MARKETS	FRONTIER MARKETS
Brazil	*Kenya(SA)*
India	*Nigeria(SA)*
China	*Bahrain(MENA)*
Turkey	*Kuwait(MENA)*
South Africa	*Lebanon(MENA)*
Egypt(MENA)	*Oman(MENA)*
Morocco(MENA)	*Qatar(MENA)*
	Tunisia(MENA)
	United Arab Emirates(MENA)

OVERVIEW

SI trends in emerging markets have to be understood in the wider context of the countries' overall economic and sustainable development. We present a summary of key macroeconomic indicators for the countries covered in table 2 and stock market indicators in table 3 below.

TABLE 2: MACROECONOMIC INDICATORS FOR KEY EMERGING MARKETS

Country	GDP	GDP Rank	GDP per Capita	Growth Rate of Real GDP (%)	Projected Growth Rate	Unem-ployment	Popula-tion	Popula-tion	Gross	Current Account Balance (%)	FDI	FDI
						(%)	2009	2015	Do-mestic		Inflows	(%)
									Savings (%)			
Brazil	1,574.04	9	8,220.36	4.7	4.69	8.1	191.48	231.89	16.15	-1.54	25.948	1.65
China	4,984.73	2	3,734.61	10.8	9.66	4.3	1,334.74	1,453.12	54.17	5.96	78.193	1.57
India	1,236.94	4	1,031.59	8.41	7.15	10.7	1,199.06	1,396.05	29.84	-2.88	34.577	2.64
South Africa	276.77	25	5,684.68			24.301	49.32	52.979	18.58	-3.97	5.354	1.88
Turkey	614.466	16	8,711.16	6	4.47	14.03	70.54	83.57	13.68	-2.27	7.955	1.29

Notes: GDP is in current prices ($ billion), GDP per capita is in current prices (USD), the growth rate of real GDP is the average of the growth rates between 2004-2008, the projected growth rate is based on the average of the projections from 2010 to 2015, Unemployment is expressed as % of total labor force, Population is in million. Gross domestic savings are expressed as % of GDP. Imports and Exports are in from the IMF (Figures for India reflect 2008 data), Balance of Payments Statistics Yearbook and they are expressed in current $ million. FDI inflows are in $ million and FDI in % is expressed as a fraction of GDP.
Source: All data are from the World Development Indicators (September 2010) and International Monetary Fund, World Economic Outlook Database (October 2010).

TABLE 3: STOCK MARKET INDICATORS FOR KEY EMERGING MARKETS

	Stock Market	Since	Number of Listed Companies	Stock Market Capitalization ($ Millions)	Number of Listed Companies-Jan. 2011	Stock Market Capitalization ($ Millions)-Jan. 2011
Brazil	BM & FBOVESPA (2009)	1890	386	1,337,248	373	1,476,951
China	Shanghai SE (2009)	1891	870	2,704,778	899	2,724,037
China	Shenzhen SE (2009)	1990	830	868,374	1,195	1,233,101
India	Bombay SE (2009)	1875	4,955	1,306,520	5,047	1,436,567
India	National Stock Exchange India (2009)	1992	1,453	1,224,806	1,558	1,403,069
South Africa	Johannesburg Securities Exchange (2010)	1887	885	746,000	395	841,143
Turkey	Istanbul SE (2009)	1986	325	233,997	340	282,852
Egypt	Cairo Stock Exchange Market (2010)	1883	220	75,212	228	69,661
Morocco	Casablanca Stock Exchange (2010)	1929	73	60,468	74	69,885

Source: Compiled from IFC's Sustainable Investment country reports (2009-2010)

The markets covered also exhibit differences with respect to regulatory interventions in promoting SI, acceptance of global frameworks and norms, level of law enforcement, and voluntary disclosure (see table 4 below).

The markets further differ with respect to their sustainability challenges. Using the authors' observations of and insight into individual markets, three risk areas stand out as cross-cutting themes across all of the countries; water sanitation, climate change adaption, and labor rights. These are followed by water scarcity, air quality, human rights, poverty, corruption, disclosure, and corporate ethics as key sustainability issues.

Table 5 summarizes eight indicators associated with sustainability, drawn from a set of globally recognized research and surveys.[1]

TABLE 4: VOLUNTARY DISCLOSURE

	UN PRI Signatories	Investor CDP 2010	GRI 2010
Brazil	46	47	134
China	1	17	61
India	3	42	24
South Africa	31	65	53
Turkey	6	12	10
Egypt	0	0	1
Morocco	0	0	0

Source: Websites of UN-PRI(www.unpri.org) , CDP(www.cdp.org) and GRI(www.gri.org) accessed in February 2011.

TABLE 5: GLOBAL PROXIES OF ESG PERFORMANCE

Category	Variable	Brazil	China	India	South Africa	Turkey	Egypt	Morocco
Environmental	Environmental Performance Index 2010	63.4	49	48.3	50.8	60.4	62	65.6
Social	The Global Competitiveness Index – Rank 2010-2011	58	27	51	54	61	81	75
Social	The Global Competitiveness Index – Score 2010-2011	4.28	4.84	4.33	4.32	4.25	4.00	4.08
Social	Human Development Index- Rank 2010	73	89	119	110	83	101	114
Social	Human Development Index- Score 2010	0.699	0.663	0.519	0.598	0.679	0.62	0.567
Governance	Anti-director Rights Index 1998	5	1	5	5	3	3	2
Governance	Anti-self-dealing Index 2008	0.27	0.76	0.58	0.81	0.43	0.2	0.56
Governance	Ease of Doing Business - Rank	127	79	134	34	65	94	114
Governance	Corruption Perceptions Index-Score	3.7	3.3	3.5	4.5	4.4	3.1	3.4
Governance	Corruption Perceptions Index – Rank 2010	69	87	78	54	56	98	85

Sources: Environmental Performance Index (2010): http://epi.yale.edu , The Global Competitiveness Index (2010): http://gcr.weforum.org/gcr2010/ , Human Development Index (2010): http://hdrstats.undp.org , Ease of Doing Business Index (2010): Doing Business, 2011, the World Bank Group, Corruption Perception Index (2010): http://www.transparency.org , Anti-director rights Index: La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997,1998),Anti-self-dealing index: Djankov, La Porta, Lopez-de-Silanes and Scleifer(2008)

1. Readers should consider these rankings as broad guidelines and as sources of additional knowledge, rather than absolute insights; rankings based on proxies and perceptions are context- and culture-dependent.

THE STATE OF SUSTAINABLE INVESTMENTS IN KEY EMERGING MARKETS

The total stock of SI in key emerging markets covered by IFC country reports is summarized in table 6.

A common feature of all the markets is the lack of data on SI. Figures are best estimates based on extrapolations of available data and interviews with market players. The figures are more reliable for domestic SI, and firm-specific holdings of international institutional investors are not available because they rarely reach the threshold level that requires disclosure. There is a consensus, however, that in markets where foreign institutional investors dominate; 1 to 2 percent of the investments take sustainability factors into consideration.

TABLE 6: SI MARKET ESTIMATIONS BY COUNTRY AND REGION

	Estimated Stock of Investment ($ Billion)	ESG-Integrated ($ Billion)	%ESG-integrated / Total AUM	Sustainable Investments in PE ($ Billion)
Brazil (end of 2008)	585	86	15.0%	Not estimated
China-branded (1. Q 2009)	411.6	4.12	1.0%	Not estimated
India (1.Q 2009)	170	1.13	0.7%	Not estimated
South Africa (end of 2010)	556	111.2	20.0%	14.2
Turkey (end of 2010)	234	1.5	0.6%	1
Middle East and North Africa (2010)		17.1	0.7%	
Canada (2008)		609.2	19.9%	
USA (2010)		3,070	12.2%	
European Union (2010)		3,500	45.7%	

Sources: IFC country reports for emerging markets, Eurosif and Social Investment Forum reports for advanced markets.

We provide the following summary of highlights from each key market.

BRAZIL

Brazil is the world's 10th largest economy. Its main stock exchange, BM&F BOVESPA, is the world's 13th largest exchange. In 2008, the net asset value of 8,300 investment funds reached around $700 billion, out of which about $500 billion was controlled by the top 40 asset managers. Brazil has a well-developed fund management and pension fund industry built on domestic savings, which has increased significantly in recent years. The country's 278 pension funds have combined assets of about $185 billion, representing 22 percent of total assets under management. This amount corresponds to 18 percent of GDP. Thirty-two percent of pension fund assets are invested in equities or equity funds. The majority of the leading pension funds manage their equity portfolios in house. Eighteen pension funds representing 60 percent of the country's total pension fund corpus, amounting to $110 billion, are signatories to the UN PRI. Retail customers constitute around 22 percent of the assets. Nine percent of those investments belong to 143,000 high net worth individuals.

Against these domestic portfolios, the total stock of foreign portfolio investments stood at about $232 billion in 2008, while American Depositary Receipts (ADR) issued by Brazilian companies and traded on the New York Stock Exchange had a total market cap of a further $110 billion. The São Paolo stock exchange is dominated by the financial sector, oil and gas, mining and steel. Thirty-four percent of the benchmark IBOVESPA Index is concentrated in two stocks: Petrobras and Vale do Rio Doce.

Uniquely among the emerging economies, ESG issues have had a prominent place in the Brazilian financial and investment community for a decade. BM&F BOVESPA introduced its corporate governance-themed Novo Mercado listing segment in 2001, and in the same year Banco Real launched Brazil's first socially responsible investment (SRI) mutual fund. This was followed by BM&F BOVESPA's corporate sustainability index, the ISE, launched in December 2005. In 2009, 10 asset managers offered retail SRI funds with combined assets under management of $315 million.

The enabling environment for SI in Brazil is relatively strong, particularly in terms of voluntary disclosure. About 60 percent of companies in the IBOVESPA publish sustainability reports. Five Brazilian companies are included in the Dow Jones Sustainability Index (DJSI).

Foreign institutional investors play a less important role in Brazil's SI market, although they have become increasingly important to the economy.

INDIA

India is the world's 12th largest economy. India has two main stock exchanges: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE is the 14th largest market in the world by market capitalization, while the NSE is the 16th largest. At the end of 2008, the total market cap of the two exchanges was $600 billion. The estimated stock of investments in listed Indian equities was around $151 billion (excluding the ADRs). Sixty percent of this amount is held by international institutional investors. Pension funds are largely absent in India's stock markets, representing only about 0.4 percent of investments in listed equities. The key local players in the market are the 22 life insurance firms. The state-owned Life Insurance Corporation of India (LIC) has a 74 percent market share in the sector. LIC had $36 billion invested in listed equities in 2008. India's first and only sustainability themed mutual fund, launched in 2007 as the Sustainable Development Fund, raised around $12 million but fell to around $2.6 million toward the end of 2008. The fund's ESG analysis is provided by S&P's local representative, based on the methodology of the S&P ESG India Index. This index was launched in January 2008 but has not yet had a discernable impact on the market.

There is little information about ESG integration in foreign institutional investors' investment processes in India. India attracts private equity (PE) investments from all over the world, thanks to its vibrant economy and exit opportunities. The existing examples of PE investments are encouraging from a sustainability perspective.

India's enabling environment for SI in listed equities is currently weak. Nonfinancial reporting and voluntary disclosure is low, although there are signs of improvement.

CHINA

China became the world's third largest economy in 2009, up from ranking 10th in 1978. In 2009, the Shanghai and Shenzhen Exchanges listed more than 1,500 firms with a combined market capitalization of $2.74 trillion. This figure compares to a $2.12 trillion market capitalization for the Hong Kong Stock Exchange. At the end of 2008, there were 61 fund management companies of which 33 were joint ventures. The estimated stock of investments in Chinese equities was around $1 trillion at the end of 2008. Three hundred sixty-four retail funds represented 26 percent of the total market capitalization in the country, whereas individual investors accounted for 51.3 percent of the total market. This figure compares to 24.4 percent for Brazil, 13.1 percent for India, and 10 percent for Turkey. Domestic pension funds represented 10 percent of the equity investments, insurance firms 6 percent, and international institutional investors (Qualified Foreign Institutional Investors-QFII) 3 percent—up to the limit allowed by the applicable quotas. In 2008, the combined quota of 85 QFIIs was $10.8 billion. Twenty-six of these QFIIs are UN PRI members; however, data are not available on the extent to which they incorporate sustainability factors into their investment strategies in China.

The pension system in China is underdeveloped. The National Social Security Fund (NaCSSef) was established in 2000 with initial funding from the government. The fund is the largest in China with total assets of $82 billion. It can invest in equities, up to a 40 percent limit, and has a responsibility to take a long-term investment perspective to facilitate sustainable development of the Chinese economy. Despite this mandate, NaCSSef has not yet developed a formal approach to SI.

In 2006, the Shenzen Stock Exchange issued social responsibility guidelines for listed companies. At the same time, the government mandated that state-owned enterprises issue sustainability reports on an annual basis. As of 2008, 150 leading state-owned enterprises were issuing sustainability reports. In the same year, the Shanghai Stock Exchange mandated that financial-sector companies and companies issuing stocks abroad publish sustainability reports. Two hundred eighty-two listed firms released sustainability reports in 2009. The China Banking Association followed suit and published guidelines for Chinese banks for the fulfilment of their "social responsibilities" and requested its members to issue sustainability reports in 2009. The guidelines call for integration of sustainability concerns into the banks' business structures, governance, and assessment mechanisms. Sectorwide reporting programs in the manufacturing sector and in the textile and apparel industries support the sustainability reporting trend.

The Shanghai Stock Exchange (SSE) launched the SEE Corporate Governance Index (SEE CGI) in January 2008. In May 2009, the index included 230 companies. The companies can voluntarily apply to be included in the index, provided they meet the criteria. Building on the success of CGI, SEE launched the first sustainability index in China, SEE Social Responsibility Index (SSE SRI), in 2009. The index selects 100 leading companies out of the members of SSE CGI. SSE has adopted a unique methodology that measures the social contribution per share of each listed firm.

The first SI product, the China-Industrial Social Responsibility Fund, was established in 2008 by AEGON Industrial Management. The fund's criteria are specific to China and differ from developed-market models. In 2009, the fund was one of the top five funds in terms of growth. Although the history is too short to be conclusive, the fund has outperformed its benchmarks. The second SI fund was launched in 2009 by CCB Principal Asset Management (CCB) as a passive fund, following the SSE CSR Index. At the time the China report was written, CCB was planning to launch the first SI Index Exchange-Traded Fund in China, while Sumitomo Trust and Banking was planning to launch an SRI Retail Fund.

TURKEY

Turkey is the 16th largest economy in the world, and it is expected to grow at an average of 5 percent until 2015. It is the largest economy in the process of integration with the European Union (EU). Although Turkey has a vibrant functioning market economy, the equity market is much smaller than in the BRIC countries. The total market capitalization of listed companies in the Istanbul Stock Exchange (ISE) was $234 billion at the end of 2009. This represents 37 percent of Turkey's GDP with a little over 300 listed firms. The free float of total equity is around 35 percent. The market is highly concentrated with 16 companies representing 64 percent of the market capitalization and 55 percent of total trading volume. Despite the shallowness of the market, individual investors' intensive trading activities keep the market highly liquid. Turkey's domestic saving rates are historically low and directed toward short-term deposits and fixed-income instruments, predominantly government bonds.

Turkey relies on foreign capital inflows to finance its current account deficit. Foreign institutional investors dominate the stock market, but their average holding period is under a year. Total investments in Turkish equities stood around $85 billion at the end of 2009. Foreign institutional investors represented 67 percent of this figure, whereas individual investors represented 20 percent. Local institutional investors' total equity exposure is estimated to be around 3.2 billion. Four leading fund management firms represent more than 70 percent of the market. The overlap between asset management and asset ownership creates moral hazard problems.
The state pension system is not integrated with the economy and remains a budget item with increasing liabilities; however, the private pension industry, although very small, is well-regulated and growing fast. Private pension firms' equity investment, despite their minuscule levels, is the main source of domestic institutional investments in the country.

Banks affiliated with business groups dominate the financial sector and control the top four asset management companies. By the end of 2009, there were 23 asset management firms in Turkey with total assets under management of around $25 billion.

Currently, there are no sustainability themed funds in Turkey. There is also no indication of incorporation of sustainability factors into investment process in a systematic way by the mutual fund industry although there are examples of heuristic approaches for screening badly governed companies by the leading asset management firms. One asset management firm became a signatory to the UN PRI in 2009. The only investment category that incorporates ESG factors is PE, although the size is small.

The Istanbul Stock Exchange launched the first sustainability-related index, the Corporate Governance Index (CG), in 2005. It is a voluntary scheme, and 30 companies were included in the index by the end of 2010. The CG index in Turkey underperforms the benchmark indexes and it is not used for developing investment products. The Istanbul Stock Exchange became a member of UN PRI in 2009 and is planning to launch its sustainability index-ISE SI toward the end of 2011.

There is a growing interest in sustainability issues within the corporate sector in Turkey. A notable increase in voluntary disclosure reflects this trend. EU integration appears to be the strongest driver and enabler for SI to emerge and grow in Turkey.

SOUTH AND SUB SAHARAN AFRICA

South Africa is the largest economy on the African continent with estimated $354.4 billion in GDP in 2010. As invitee in 2011 to the BRIC bloc of emerging markets and a member of the G-20, South Africa is a middle-income, emerging market with a formal economy covering mining, manufacturing, agriculture, financial services, and retail. The country also has well-developed financial, legal, communications, energy, and transport sectors.

The total market capitalization of the Johannesburg Securities Exchange (JSE) at the end of 2010 was $893 billion, making the JSE the 19th largest exchange in the world. The JSE has comprehensive regulations and stringent listing requirements: following the incorporation of The King Report on Governance for South Africa 2009 (King III) into the Johannesburg Stock Exchange (JSE) Listings Requirements, listed companies are required to issue an integrated report for financial years starting on or after 1 March 2010, or to explain why they are not doing so. South Africa has a well-developed pension fund system. In 2009, the net worth of South African households was estimated at $690 billion ($600 billion in financial assets, $250 billion in tangible assets, and $160 billion in debt). Of this, roughly a third was invested in pension funds. In South Africa, pension fund assets more than doubled between 2002 and 2009, from about $100 billion to $250 billion.

South Africa is the biggest investor in Sub-Saharan Africa. Exchange control reforms are expected to increase South African institutional investment into Sub-Saharan Africa beyond 2010. Regional and international exposure by South African-listed firms demonstrates the value of globalization: the top 10 companies by market capitalization earn about 43 percent of their revenues from outside Africa. The institutional investment segment outstrips the retail market, driven by pension fund investments amounting to $250 billion (2009). In February 2011, a RisCura analysis of South Africa's top 25 asset managers estimated institutional fund assets to be $511 billion, or $381 billion excluding the Public Investment Corporation (PIC), which invests funds on behalf of South Africa's public-sector entities.

Business and investment guidelines have merged in The King Report on Corporate Governance South Africa launched in 2009 (King III) and the draft Code for Responsible Investing by Institutional Investors in South Africa (CRISA) is due to launch in 2011. The King

Code focuses on the corporate governance of companies and is widely supported by South African business, while the Code for Responsible Investment in South Africa (CRISA) is an institutional investor initiative. Furthermore, a Framework for Integrated Reporting, 2011, outlines a principles-based approach to integrated reporting. Regulatory changes, for example Regulation 28 of the Pension Funds Act in South Africa, that in 2011 introduced enabling regulation for the concept of integrating ESG factors, have the potential to be a strong driver for SI in South Africa and in the region.

In Sub-Saharan Africa, funds profiled and/or marketed as ESG-branded at 31 December 2010 total about $5.5 billion in assets under management (AUM) (<1% AUM). But using a broader definition that covers self-reported integration of ESG factors into fund investment policy and/or process, sustainable investment in South Africa, Kenya, and Nigeria is estimated at $125 billion AUM (20% AUM). The relatively high proportion of ESG-integrated investment is the result of the largest asset owner in the largest African investment market, South Africa's Government Employee Pension Fund (GEPF) ($131 billion AUM) and the asset manager of 92 percent of its assets, Public Investment Commission (PIC), both adopting ESG-integrated sustainable, responsible and/or developmental investment policies. Demand for pure-play SI mandates in general asset management is low. Investment managers complain of static demand from asset owners who request education and advocacy, but seldom fund mandates.

Private equity (PE) is a small but growing investment discipline in Sub-Saharan Africa, expanding in response to improving economic fundamentals. In South Africa in 2010, sustainability-branded PE funds made up $1.1 billion of ESG-integrated PE funds amounting to $6.3 billion of around $14 billion PE in SA. Development Finance Institutions (DFIs) have been a major positive contributor to funding PE mandates integrating ESG in Africa, while large South African institutional investors invest up to 5% in alternative investments, mostly in domestic PE funds. More capital is coming: 92 percent of PE investors interviewed in the survey supporting the 'Sustainable Investment in Su-Saharan Africa' report expect an increase in PE commitments into Sub-Saharan Africa over the next five years. A counter-intuitive finding from the IFC/SinCo 2011 study is that, while a much smaller asset class, PE funds relative to general asset management, has greater exposure and experience in integrating ESG factors in the region.

THE MIDDLE EAST AND NORTH AFRICA

The MENA region[9] includes diverse economies with different fundamentals and varying degrees of development. The region produces $1.5 trillion in GDP and represents 3 percent of global GDP. Asset clustering is problematic due to significant differences and political risk correlations in the region. There is no key emerging market in MENA. Egypt and Morocco are two countries that are included in the MCSI EM Index. The majority of the remaining markets are included in MSCI's Frontier Markets Index. MENA's growth has been lower than the average for emerging markets during the past decade.

Fourteen sovereign wealth funds (SWF) comprise an estimated 60 percent of all assets under management in the region, with $1.54 trillion in net assets. MENA's SWF assets account for 44 percent of all the SWF assets in the world with the Abu Dhabi Investment Authority as the largest SWF in the world. A growing emphasis on sustainability in national development agendas suggests SWFs will play a large role in SI in MENA, but these SWF investments are generally not transparent. Four funds in MENA have signed the Santiago Principles of the International Working Group of Sovereign Wealth Funds (IWG), the voluntary guidelines that assign best practices for the operations and transparency of SWFs.[10] This affiliation with IWG represents a major shift and an opportunity for SI in the region.

During recent years, most of the MENA countries have undertaken reforms to improve the functioning of their stock markets and increase diversification of their oil-based economies. Most of these reforms focus on fundamental corporate governance issues. Large corporations and business organizations have, more recently taken a leadership role in creating awareness of sustainability issues. The level of broad-based SI in the MENA region is estimated to be around 0.7 percent of total investment in equities, on par with peer countries. This figure is much lower than Shari'ah-complaint investments, which are twice the size of SI in the region. The countries that receive the highest level of SI in MENA are the United Arab Emirates with an estimated $14 billion and Egypt with an estimated $1.5 billion.

A regional ESG index-S&P/Hawkamah Pan Arab ESG Index was launched in February 2011. The index included 50 companies from 11 MENA countries. S&P also launched the S&P/EGX ESG Index together with the Egyptian Stock Exchange earlier in March 2010 and included 30 stocks.

PE plays a significant role, as in other emerging markets, as a catalyst for creating awareness of ESG issues.

9. For countries covered please see Table 1
10. The principles were proposed in 2008 through a joint effort between the International Monetary Fund (IMF) and the "International Working Group of Sovereign Wealth Funds" (IWG-SWF).

ANALYSIS

There are significant differences across these markets with respect to the savings rate, size, and depth of stock markets, the size of the pension funds, and the development of the asset management industry. Domestic institutional investors dominate the Brazilian and South African markets, whereas individual investors dominate the Chinese market. In India and Turkey, where domestic savings are low, foreign institutional investors are the dominant owners of traded stocks. Pension funds are the leading players in shaping investment trends in South Africa and Brazil, whereas the government, regulators, and industry associations are more effective in China. In Turkey, corporations and business organizations set the trends.

Emerging markets further differ from each other with respect to their economic fundamentals and institutional frameworks. The interplay between firm-level sustainability factors and these institutional factors is also different in each market. These differences manifest themselves in a diverse set of sustainability issues, priorities, and key players.

Government quality, state ownership, domestic savings, and financial-sector development shape the investment landscape, which can be less or more enabling for SI. There are prerequisites for sustainable investments to emerge and take root in an emerging economy: the size and depth of the stock market, the size and competitiveness of the local investment industry, and a country's sovereign credit rating. These highly correlated conditions separate emerging economies such as Brazil, China, and South Africa from others. These markets serve as a hub, as a financial center from which investments are managed, and norms are developed and transmitted to the neighboring markets. Cluster effects are not apparent in all regions.

Academic research suggests that political institutions (e.g., the absence of corruption) and the prominence of an egalitarian ideology are the most important determinants of firms' social and environmental performance in a given market. Therefore, we see a greater role for regulatory interventions (both public and private) accross emerging markets in promoting SI and addressing conflicts of interests associated with the concentration of economic power.

ESG information about emerging market assets is, in general, substandard, incomparable, limited in scope and coverage, and frequently missing out on what matters. The underlying reasons are the difficulty of codifying sustainability information in emerging markets due to the complexity of issues, unreliability of disclosures, and high costs associated with collecting and verifying data. These aspects pose challenges for analysts unfamiliar with this context. Further sustainability information based on corporate disclosure without independent verification may create noise, cause adverse selection and inflate the demand for larger companies which already have preferential access to finance in emerging markets.

The authors of these reports agree that there is space in the financial market for emerging-markets specialization in ESG/sustainability research—with an emphasis on governance. None of these markets have yet managed to support the establishment of an indigenous sustainability research and rating industry; while international research houses have not managed to scale up their coverage to include emerging-market firms. Their current coverage is limited to a handful of firms from each country, and assessments are arguably lacking depth, reliability, and relevance. The availability of comparable, reliable, and relevant data with sufficient coverage on ESG can provide a basis for the development of collective investment instruments.

Although sustainability is a more important concern for emerging economies for investors and also for issuers and their stakeholders, the percentage of investments that factor in firm-level sustainability factors is much lower in emerging markets than in developed ones, with the exception of South Africa. At the micro level, capital market institutions and collective investment frameworks are significant drivers for social and environmental performance. In countries with high domestic savings and a competitive domestic asset management industry, SI can be driven by retail investors. On the other hand, in other emerging markets that rely on foreign capital inflows to finance the growth of their economies, foreign institutional investors can play a role in promoting sustainable investments and sustainable business practices.

There does appear to be a difference in emphasis between domestic and international investors. Domestic investors in emerging markets tend to focus on opportunities related to climate change and on the investment's positive social impacts. These considerations sometimes overshadow the potential negative impacts of investment projects. Global investors, on the other hand, focus on risk management and as such appear concerned about mitigating an investment projects' negative impact. Differences in values and ethical norms between domestic investors and global investors suggest that engagement strategies may be useful to develop a mutual understanding between global investors and issuers. The studies however, report an absence of engagement efforts in emerging markets. This reluctance may be related to concentrated ownership that marginalizes minority shareholders' voices.

PE investments in all of the key emerging markets are on the rise. In most markets, they represent the very first attempts to integrate sustainability concerns into the investment processes whereby the ESG risks are monitored by direct control and private contracts. We also note that PE investments, backed by international financial institutions with social and environmental conditionality, act as a catalyst in the emergence of this segment in all the countries surveyed. However, PE investments appear to have had little systematic impact on the development of the institutional investment industry and public stock markets. Similarly, project finance and intermediated loans provided to local banks by IFIs with ESG conditionality help mitigate the negative impact of large-scale projects and create awareness of sustainability issues.

CONCLUSION

All the reports note that Sustainable Investment has found a foothold in all markets but has done so in a number of different ways. With the exception of one or two markets SI is still very much a niche play. While the reports suggest that there are significant opportunities for the growth of these markets the drivers will be specific to each country and region. There is yet no sign of proven approaches that are universally applicable to promoting SI in emerging markets. In general, asset managers prefer to use their own methodology and/or heuristics in integrating sustainability factors into investment decisions. There is a consensus among the authors of country reports that the global asset management industry is in apparent need of innovation to overcome the barriers to sustainable investments in emerging markets. Without collective action, investments will continue to gravitate around a handful of companies with an increasing exposure to ESG risks and miss opportunities for sustainable, and probably higher, returns. Opportunities for making a positive impact on equitable development will also be missed out. Unless the growing interest in sustainability in emerging markets can be effectively matched with investor capacity and action, sustainable investments in emerging markets may ultimately stay on the margins or even fade away.

The Reports
The series of market reports can be found in full at www.ifc.org/sustainableinvesting. The individual reports were prepared by:
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