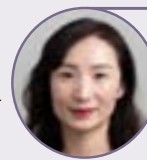




**Rohit Khuller**  
MBA, CFA  
Vice President,  
Investment Management,  
Lead Portfolio Manager



**Mila Krassiouk**  
MBA, CFA  
Co-Associate,  
Senior Portfolio Manager



**Yongai Xu**  
CFA  
Co-Associate,  
Portfolio Manager

# Importance of ESG Considerations in Emerging Markets

*In recent years, Environmental, Social, and Governance (ESG) factors have gained significant traction within the investment community.*

This trend is particularly notable in emerging markets, where ESG considerations can greatly influence investment performance and risk management. Unlike developed markets, emerging markets present unique challenges and opportunities, making ESG integration essential for long-term sustainable growth. This discussion explores why ESG considerations are crucial in emerging markets and how their impact differs compared to developed markets.

## Why ESG Matters in Emerging Markets



**Higher Risk Exposure:** Emerging markets often face greater environmental, social, and governance risks compared to developed counterparts, including political instability, regulatory uncertainty, and weaker law enforcement. Integrating ESG factors helps investors identify and mitigate these risks, ensuring more resilient and stable portfolios. For instance, companies with poor environmental practices may encounter substantial regulatory penalties, significantly affecting their financial performance.



**Long-term Value Creation:** ESG integration promotes long-term value creation through sustainable business practices. Companies that prioritize ESG are better equipped to adapt to regulatory changes, environmental challenges, and social expectations. This adaptability is critical in emerging markets, where rapid economic growth can lead to significant environmental and social pressures. Investing in companies with strong ESG practices supports sustainable development and yields superior long-term returns.

**“...Companies that prioritize ESG are better equipped to adapt to regulatory changes, environmental challenges, and social expectations....”**



**Attracting Foreign Investment:** As global investors increasingly prioritize ESG, companies in emerging markets with robust ESG frameworks are more likely to attract foreign investment. This capital influx can drive growth and development, enhancing market stability and performance. It also encourages local companies to adopt better ESG practices in order to remain competitive globally.

## Letko Brosseau's Approach to ESG in Emerging Markets

Letko Brosseau, a Canada-based investment management firm, exemplifies ESG integration in the LBA Emerging Markets strategy. We believe ESG integration allows our clients to achieve sustainable returns while making a positive societal impact. Our ESG framework is based on the Sustainability Accounting Standards Board's (SASB) Materiality Map<sup>1</sup>, identifying material ESG issues relevant to different industries.

We engage actively with company management and boards of directors, challenging them when their actions are not in shareholders' best interests. This engagement includes advocating for better environmental practices, fair labor policies, and robust governance structures. Commitment to ESG is reflected in our investment choices, avoiding sectors with significant negative social impacts, and focusing on companies with sustainable business models.

**"...We engage actively with company management and boards of directors, challenging them when their actions are not in shareholders' best interests...."**



### Environmental Considerations

Environmental risks such as pollution, resource depletion, and climate change are more pronounced in emerging markets. Companies in these regions face stricter scrutiny from local and international stakeholders regarding their environmental impact. Investors must assess how companies manage these risks and their strategies for mitigating environmental damage. Companies innovating in sustainable technologies and reducing their carbon footprint are more likely to succeed in the long-term.

By engaging with company management, we encourage businesses to adhere to environmental regulations and act responsibly. This proactive approach helps identify companies that are compliant and forward-thinking in their environmental strategies.



### Social Considerations

Social issues, including labor practices, community relations, and human rights, are critical in emerging markets. Companies that fail to address these concerns can face operational disruptions, reputational damage, and financial losses. Investors should evaluate how companies engage with their workforce and communities, ensuring they contribute positively to social development and growth.

Letko Brosseau avoids investing in sectors like tobacco and gaming due to their negative social impacts. Instead, focus is placed on companies that create sustainable value for all stakeholders, ensuring equitable sharing of benefits. This commitment to social responsibility builds a positive brand image and fosters long-term growth.

<sup>1</sup> Licenses and application of the SASB Materiality Map® Disclosure Topics and Accounting Metrics in its work.



## Governance Considerations

Governance issues such as corruption, lack of transparency, and poor corporate governance are prevalent in many emerging markets. Strong governance practices are essential to protect shareholder interests and ensure ethical business conduct. Investors need to assess the governance structures of companies, including board composition, executive compensation, and shareholder rights.

Letko Brosseau integrates governance considerations into the investment process, ensuring every material ESG factor is incorporated into the analysis and selection of investments. The firm engages with companies to promote better governance practices, reducing the risk of fraud and enhancing overall corporate accountability.

**“...ESG analysis can uncover hidden risks and opportunities not immediately apparent through traditional financial analysis....”**

## Differences Between Emerging and Developed Markets

The impact of ESG considerations in emerging markets is often more significant than in developed markets due to several factors:

- **Regulatory Environment:** Emerging markets typically have less stringent regulatory frameworks and weaker enforcement mechanisms. This makes ESG integration crucial for identifying companies that voluntarily adhere to higher standards and are less likely to face regulatory penalties.
- **Market Inefficiencies:** Emerging markets are less efficient, leading to more frequent mispricing and opportunities for value investors. ESG analysis can uncover hidden risks and opportunities not immediately apparent through traditional financial analysis. This additional scrutiny helps investors make more informed decisions and capitalize on undervalued stocks with strong ESG credentials.
- **Socioeconomic Challenges:** Emerging markets often face more severe socioeconomic issues, such as poverty, inequality, and inadequate infrastructure. Companies addressing these challenges through their business practices can achieve significant social impact while benefiting from improved operational efficiencies and market access. For example, firms investing in community development or workforce training can enhance their reputation and secure a loyal customer base.
- **Environmental Vulnerability:** Environmental risks in emerging markets, such as pollution and climate change, can have more immediate and severe impacts on businesses. Companies proactively managing their environmental footprint are better positioned to withstand these challenges and benefit from regulatory incentives or subsidies promoting sustainability.

**Conclusion:**

ESG considerations are essential in emerging markets, where the risks and opportunities differ significantly from those in developed economies. Integrating ESG factors into investment decisions helps identify sustainable opportunities, mitigate risks, and achieve long-term value creation. As global investors place greater emphasis on sustainability, companies in emerging markets with strong ESG practices are better positioned to attract investment and drive sustainable development.

**“...Integrating ESG factors into investment decisions helps identify sustainable opportunities, mitigate risks, and achieve long-term value creation....”**

Letko Brosseau’s approach to ESG integration in emerging markets serves as a model for investment managers navigating these complex environments. By prioritizing environmental stewardship, social responsibility, and robust governance, we believe investors may benefit from sustainable returns over the long-term, while effecting a positive societal impact. As the significance of sustainable practices continues to rise, these considerations will play an increasingly pivotal role in shaping the future of investment in emerging markets.

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**END NOTES:**

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