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# ESG Integration in Emerging Markets: Knitting it All Together

Marketing communication

**CANDRIAM** 

A NEW YORK LIFE INVESTMENTS COMPANY

# About the authors

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ESG Analyst



Joining Candriam in 2021 as an ESG Analyst for Emerging Markets, Hien Nguyen has developed her ESG experience from both the asset owner side as well as the asset manager side. Her previous experience includes roles as an SRI analyst at both AXA Group and AXA IM, including equity and debt issuer analysis, green bond assessment, engagement, regulatory trends, and reporting issues. As a consultant with Ernst & Young, she helped insurance companies, asset managers, and other financial institutions to develop and evaluate ESG and Impact strategies.

Hien holds a Master's degree in International Economic Policy from Sciences Po Paris, with a specialization in emerging economies, and a Bachelors of Economics Degree from Sciences Po with a specialization in International Studies.

## Galina Besedina

Portfolio Manager  
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Galina Besedina is a co-lead Portfolio Manager of Candriam Sustainable Equity Emerging Markets. Galina Besedina joined Candriam in September 2020 as a senior EM equity Portfolio Manager/Senior Analyst for which she offers extensive expertise. Following a short stay at AXA IM in Paris as an analyst for EM Europe, in 2008 she started and built an impressive career as an Emerging Markets specialist at Comgest SA, acting as an analyst, PM, and partner, contributing to the strong growth of the company.

Born and raised in Russia, Galina earned her master's degree at the Russian State University of Trade Economics, in Moscow, before moving to France in 2006 where she added a MIB at the Grenoble Graduate School of Business and an Executive MBA at the HEC Paris.

## Paulo Salazar

Head of Emerging Markets Equity



Named Co-Head of Emerging Markets Equities in 2021, Paulo Salazar has been with Candriam's EM Equities Team since 2015, as both a Portfolio Manager and a Senior Equity Research Analyst.

Prior to joining Candriam, Paulo worked as a private equity associate at The Riverside Company and as an equity research analyst at firms including Equitas and Banco Itaú. He has been involved in the financial markets since 2006, covering several industries in Latin America, the US, and elsewhere.

Paulo earned his BBA in Corporate Finance and Financial Markets from FGV-EAESP in Sao Paulo and holds an International Diploma in Finance from University of California, Berkeley Extension. Brazilian by birth, he is a Portuguese citizen, and a resident of Belgium.

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# Xinyi Solar is a leading manufacturer of products which generate green energy – but is this enough to make it *Responsible*?

Green energy is a mega-trend, a driver of growth. Xinyi augments its contribution to cleaner energy generation through its internal efforts to de-carbonize the energy employed in its manufacturing processes.

The **E** in ESG is not just Energy. What about the rest of the Environment? Balanced against this climate-friendly top line is the resource-intensive nature of Xinyi's products, and an imperfect record on pollution control.

And what about the **S**ocial? Many manufacturers in the solar industry have been accused of using forced labor. Xinyi, by contrast, has Health and Safety targets and performance indicators in place. And **G**overnance? Good industry experience on the Board, but we would like a little more transparency.

So will Xinyi Solar qualify for our ESG-eligible universe? Will Xinyi fit *megatrends*, or '*pockets-of-growth*' preferences for Emerging Markets equities investments? But more importantly, how do we knit ESG factors and investment analysis together, to truly integrate ESG into investing? Candriam's ESG analysts develop an ESG score which feeds into our fundamental analysis and valuation. With 25 years of Emerging Markets Equities investing, 25 years of ESG investing, and 15 years of managing Sustainable Emerging Markets Equities portfolios, we like to think Candriam can offer a practical approach.

**“Green energy is a mega-trend, a driver of growth.”**

# ESG in Emerging Markets: Doubling the Drivers of Performance?

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**To state the obvious, Emerging Markets represent the majority of global Greenhouse Gas emissions, the majority of global GDP, the majority of the global population, and the majority of the world's growth. Since the industrial revolution, *economic growth has gone hand in hand with growth in emissions.***

As the world's manufacturing base, the Emerging economies also represent the majority of our opportunities for tackling climate change. Firstly, by the opportunity to generate green energy for their own growth, breaking the historical link between GDP growth and emissions. Secondly, through the products the Emerging Markets provide to the entire world. Generating green energy around the world? Solar panels, for example, are largely manufactured in Emerging nations. Reducing energy use in every nation? Semiconductors are necessary 'greenablers' for devices to reduce energy consumption. And batteries for electric vehicles are an obvious key for reducing GHG emissions.

Responsible Investing is a brief phrase attempting to group a number of interconnected goals. Let us not forget the goal of Investing – that is, to generate risk-adjusted returns. In Emerging Markets, Candriam analyzes megatrends and pockets of growth in our search for return. Responsible – that is, responsible to all stakeholders, from employees and suppliers to customers and investors, as well as society and the environment.

Can investors combine these two potential sources of growth? Or can investors integrate these two potential sources of performance so that they become not only additive, but potentially synergistic?

At Candriam, it is our strongly-held belief that companies which embrace sustainability-related opportunities and challenges in combination with financial opportunities and challenges are the most likely to generate shareholder value.

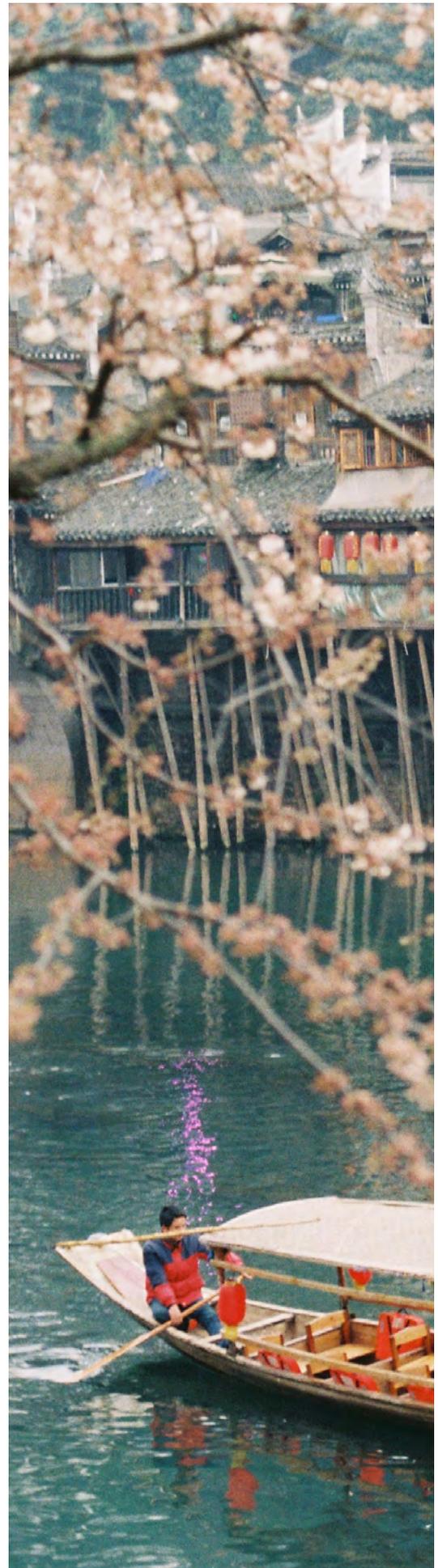
**“If you want your investments to help mitigate climate change, you have to be invested in Emerging Markets.”**

*Emerging market companies: Eyeing a sustainable future?,  
Candriam Investor Seminar, June 2022*

# ESG Integration Supported by Country and Sector Frameworks

**Candriam has developed a rigorous and specific Emerging Market ESG analysis process<sup>1</sup> which recognizes the complexity of EM issuers. This draws on our Country, Sector, and Corporate ESG frameworks.**

The EM equity asset class is much more varied than those of the larger equity markets. EM equity markets range across continents and cultures, increasing the complexity of analysis. In general, company transparency<sup>1</sup> is less standardized, information is less readily available, market structures are less developed, and investor access may be lower. For us, this is partially mitigated by the predominance of large-cap holdings in our portfolios. As many of these companies are global leaders in their industries, their investor bases are typically more sophisticated and demanding.



# The ESG Frameworks: Analyzing Country, Sector and Corporate ESG Risks and Opportunities ...

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Given the wide disparities among the nations in which these firms operate, we find assessing the ESG risk of the [Countries](#) in which firms are based and operate can provide substantial investment insight.

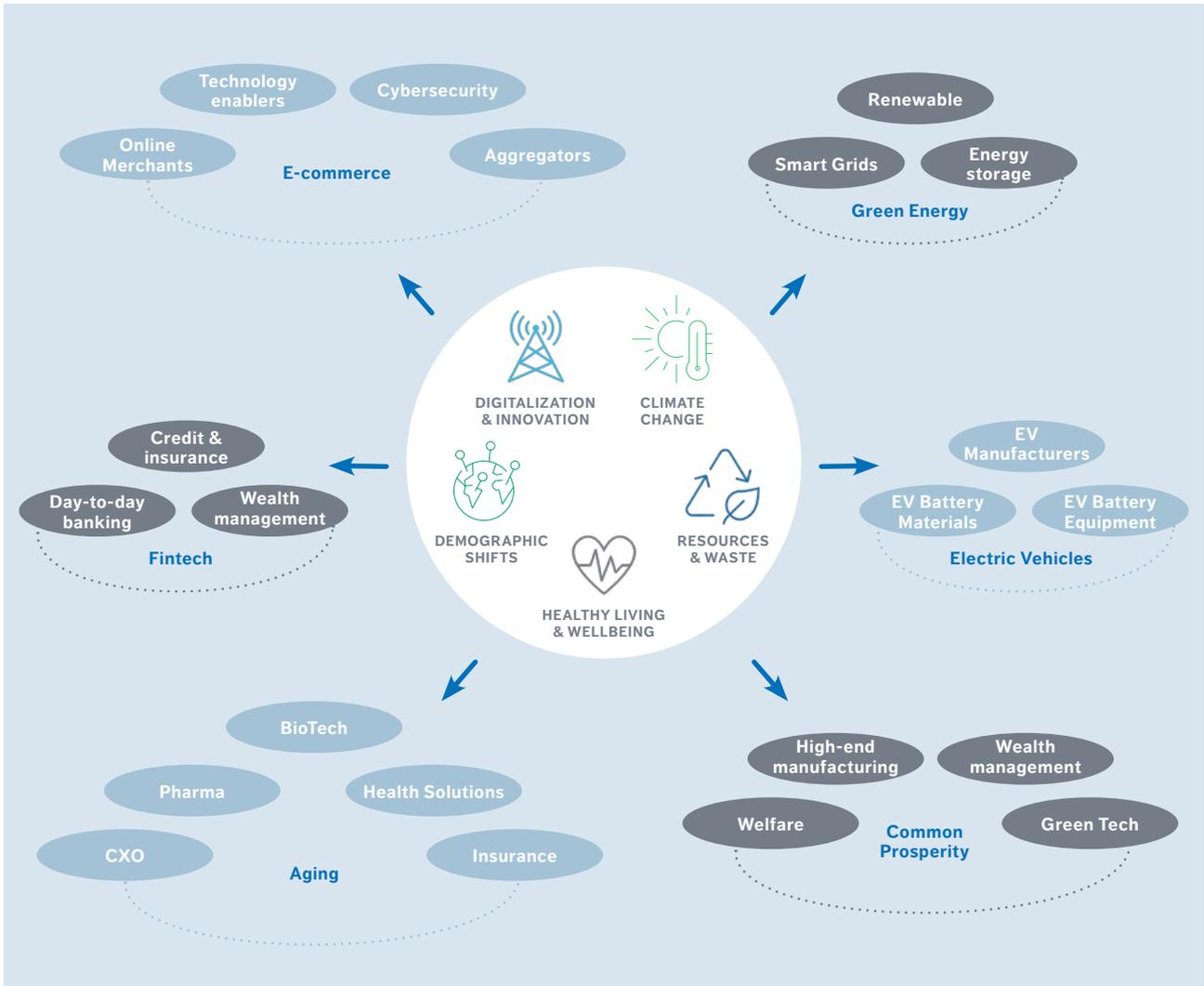
Our core [Company](#)<sup>2</sup> analysis framework analyses companies across two broad ranges of factors, **Business Activities**<sup>3</sup> and **Stakeholder Analysis** (figures 3 and 4). We also avoid certain precisely-defined [Controversial Activities](#)<sup>4</sup>; for example, manufacturers of cluster munitions, thermal coal, and tobacco.

## Opportunities ...

Given our long history of specific ESG frameworks, the **Integration** of ESG trends in our investment process has become a natural part of our way of thinking. This integration is most visible within our Business Activities analysis, in which we analyse the long-term sustainability trends in which companies operate and which present their future challenges and opportunities.

Our EM Equities investment philosophy seeks strong business models and fundamentals, emphasizing companies whose strategies benefit from supportive global mega-trends and/or pockets of growth, such as Demographics, Infrastructure, Disruptive Technologies, or macro, market, or (geo)political trends. Figure 1 attempts to show how these parts of the process are intimately intertwined – truly integrated.

**Figure 1: ESG Business Analysis Sits Neatly Inside the Global Megatrends**



Source: Candriam, July 2022. Indicative data which may change over time.

Analyzing the ESG challenges and opportunities of, for example, Healthy Living and Wellbeing, is inseparable from our search for companies which benefit from Demographic mega-trends. When these Demographic trends lead us to consider human capital and employees as corporate stakeholders, one can see how ESG and profit are truly integrated given how the treatment of employees fed into business continuity and

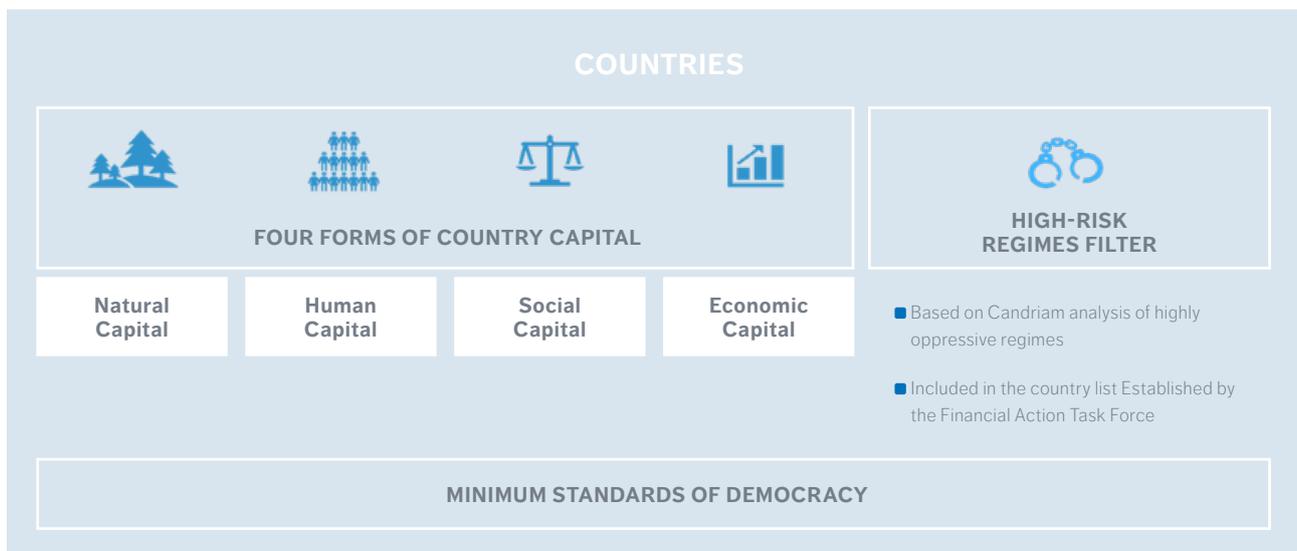
profits for so many firms during the pandemic. The examination of Resources and Waste lead easily to obvious areas such as battery materials and battery recycling, as well as to less-obvious but related businesses. Climate change is both an ESG factor, and a growth path, for a range of companies including less-obvious data suppliers, and suppliers of intermediary products and services.

### Sovereign Analysis:

Candriam's Sovereign model helps us understand the wide range of national markets in which we invest. ESG is more than climate; Social and Governance factors have long been central to investing in the most rapidly-expanding nations and financial markets. An understanding of these national risk factors has been central to Emerging Market investing long before the term 'ESG' was coined.<sup>6</sup>

In an explicit manner, our country scores aid us in evaluating the risks of state-owned companies. We believe it is necessary to take a long-term approach in our thinking about countries that do not respect democratic norms. Totalitarian regimes of any kind are by their nature unsustainable, because of the level of physical and psychological violence needed to enforce restrictions. More holistically, the inputs and factor subscores into our country model provide insight and cross-checks. We note that our investment processes are bottom-up, but we do look at country allocations as a check, rather than a return driver.

**Figure 2: Candriam Sovereign Model and the Four Capital Pillars**



Source: Candriam, July 2022. Indicative data which may change over time.

These four capital domains incorporate a wide range of material ESG factors which we evaluate using our internally-defined Key Performance Indicators (KPIs). This generates a dynamic capital-based analytical tree, which covers the sustainable development challenges and opportunities faced by each country.

In addition, we pay close attention to companies with operations in high-risk countries. For example, since 2021, we have entered into dialogues with a list of companies that are present in Myanmar, in order to assess any potential links to the military government as well as each company's measures to respect human rights. Through these dialogues, we evaluate whether companies have implemented adequate human rights policies in Myanmar, and those that we should continue monitoring.

### Controversial Activities and Norms-based Analysis:

ESG considerations are central to Candriam's investment philosophy. For many years, and with the gradual rise of ESG investing, certain investors have been excluding the defense sector from their investments due to the adverse nature of weapons which have often served to infringe human rights and led to devastating effects on human lives and the overall well-being of society. Candriam's company-wide controversial activities policy integrates ESG factors including exclusions of controversial weapons, thermal coal, and tobacco. Additional and more stringent exclusions (including, among others, oil & gas, fossil fuel-based electricity generation, alcohol, gambling) are applied to SRI strategies.

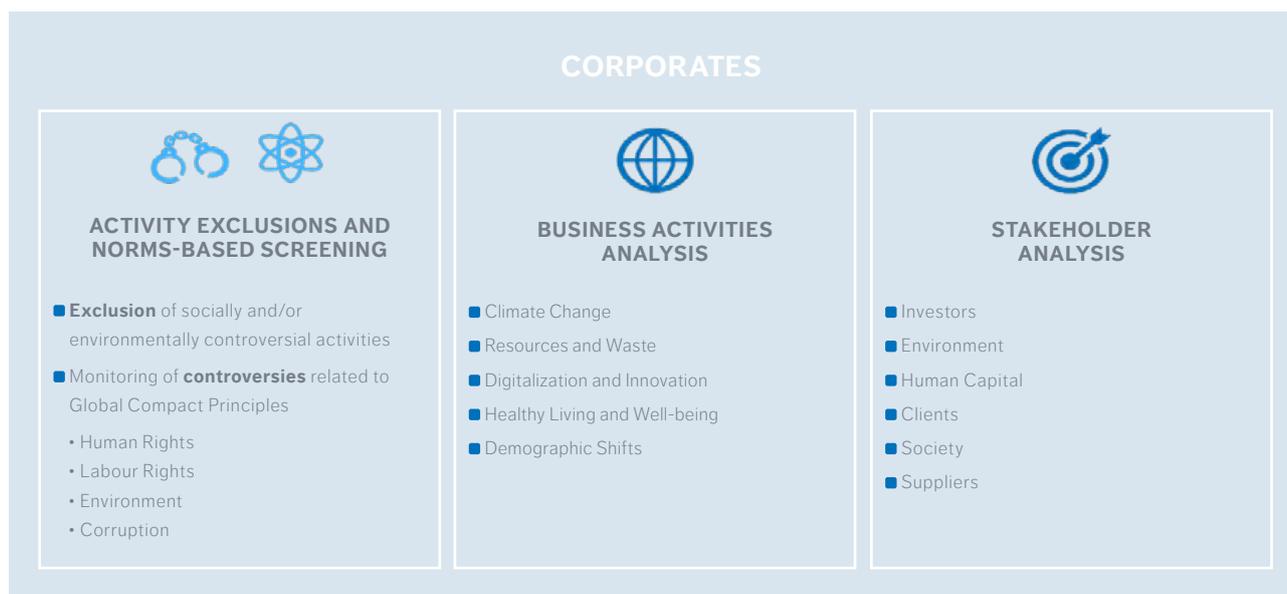
We also conduct a *Norms-based Analysis* of each company, and its trend and direction, under the principles of the UN Global Compact. Those which repeatedly violate, or which fail to demonstrate a plan for improvement, are excluded.

### Company Analysis:

After screening out roughly 50% of the 1,700 companies in the broadly-defined EM universe with our Controversial Activities review and Norms-based analysis, we construct an investible universe of approximately 700 companies which our ESG team's analysis shows are the best able to address the opportunities and risks of sustainability challenges.

To determine the best-positioned companies we apply two pillars of sustainable fundamental analysis -- *Business Activities, and Stakeholder Analysis*.

**Figure 3: EM ESG Corporate Approach**

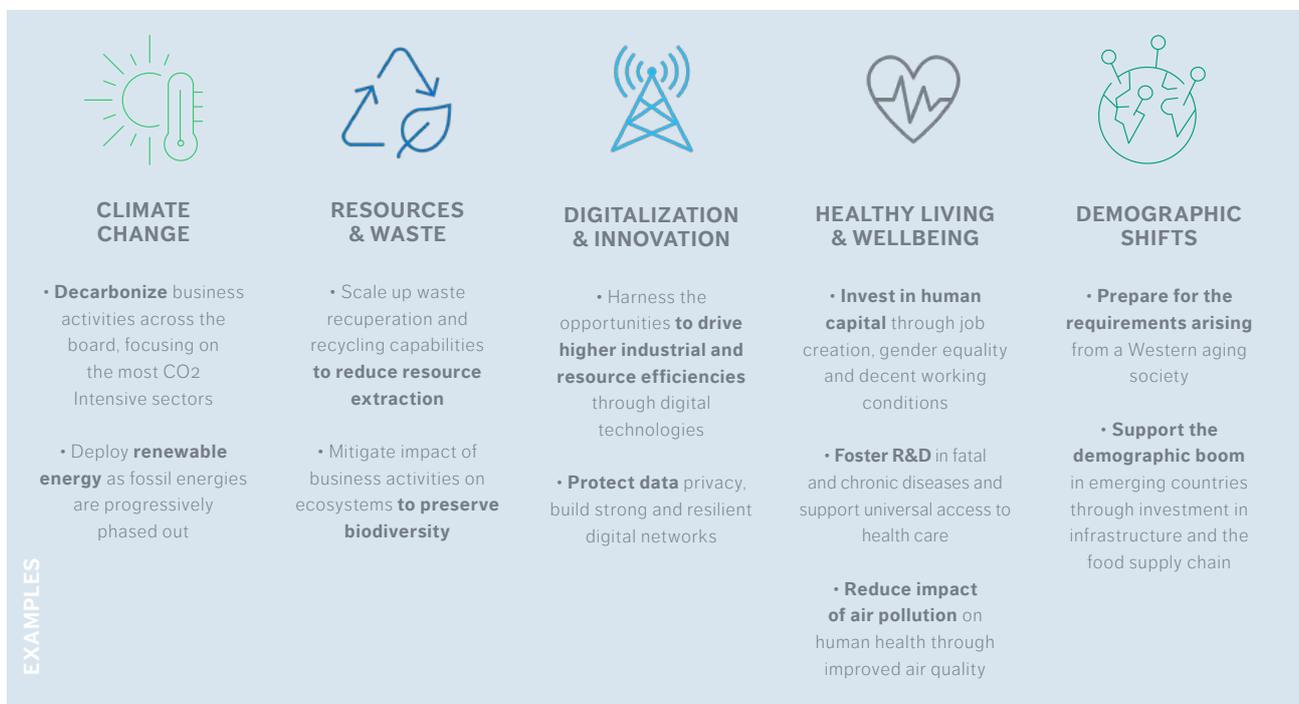


Source: Candriam, July 2022. Indicative data which may change over time.

### Analysis of Company Business Activities:

Our ESG analysts assess the sustainability of the business model of each company using our internally-constructed, proprietary in-house ESG database. We group companies based on the industry or sector in which they operate, their geographic location, and business model. We then determine the degree to which each industry group is exposed to five major development challenges (Climate Change, Resources & Waste, Healthy Living & Well-being, Demographic Shifts and Digitalization & Innovation), and score them from 0 to +100.

**Figure 4: Candriam Business Activities ESG Framework**



Source: Candriam, July 2022. Indicative data which may change over time.

### Analysis of Company Stakeholders:

How companies conduct their relationships with, and governance towards, its stakeholders can give rise to opportunities as well as risks, and are therefore determinants of long-term value. We evaluate the extent to which each company incorporates the interests of stakeholders in its long-term strategy, along six categories of stakeholders:

**Figure 5: Candriam Stakeholder Management ESG Framework**



Source: Candriam, July 2022. Indicative data which may change over time.

The materiality of each stakeholder category may vary by sector, although Investors are a common stakeholder category across all sectors. The quality of corporate governance can also determine in part how well the company would manage its relations with the other stakeholders. Our Stakeholder analysis combines a range of qualitative and quantitative indicators, including Board independence and effectiveness, alignment with shareholders' interest, GHG emission reduction trend and targets, employee policy, turnover rate, occurrence and severity of controversial events such as accidents, investigations or regulatory fines. For example, during the pandemic, our long-term work on Human Capital, or employees as stakeholders, paid off in an ability to forecast and anticipate the rapidly-changing pool of labor for investee companies.



## Case Study:

# Consider Magnitude and Direction

Yunnan Energy New Material is a China-based supplier of packaging, printing, and separator film products. In particular, its products include lithium separator films, a key component in lithium-ion batteries. We are supportive of the company's contribution to battery manufacturing and to low-carbon transportation.

Historically, the company had been excluded from Candriam's SRI strategies because it also manufactures tobacco packaging. Recognizing the negative health and societal impacts of tobacco use, Candriam excludes companies that derive more than 5% of their revenues from the manufacturing or retailing of tobacco products.

In recent years, Yunnan Energy New Material is increasingly expanding its lithium separator films business, which now represents more than two-thirds of its total operating revenues. The company supplies to major battery manufacturers such as Samsung SDI, LG Energy Solutions, CATL, and BYD. Its involvement in tobacco packaging has consistently declined over the years and, as of end 2021, accounts for just over 1% of total operating revenues. Based on both the level and importantly, the *trend*, Yunnan Energy New Material is now acceptable under Candriam's tobacco exclusion threshold.

In addition to the sustainable impacts of companies' business activities, we also pay close attention to the way they conduct and operate business. With Yunnan Energy New Material's changing business activities, we increasingly scrutinize the quality and safety measures it applies to its products (because separator films play an important function in the chemical stability and overall safety of batteries), as well as its environmental practices (because measures and targets related to reducing operational CO<sub>2</sub> emissions and improving energy efficiency and water efficiency are more important as the business mix changes).

### **Stewardship:**

Beyond bottom-up ESG analysis, stewardship is a key part of our long-term investment process, given its potential impacts on corporate behavior and investor returns. Stewardship can take the form of voting at annual shareholder meeting, direct and individual dialogues with the company, or collaborative engagement campaigns in coordination with other investors.

*It is our policy to vote all proxies for holdings in the Sustainable Equities Emerging Markets portfolio. Candriam's voting policy favors resolutions that support sustainable development principles in accordance with our Sustainable and Responsible approach. As a pioneer in ESG, we also encourage sustainable development in the financial markets by sharing our expertise with customers, the media, and the broader financial community through educational initiatives, working groups, and conferences.*

Candriam engages with the management of its investment candidates for two-way exchange of information and views. In 2021, we directly engaged with 17 companies in emerging markets, and participated in 22 collaborative initiatives engaging with a further score of companies, on topics ranging from environmental (de-carbonization, mine safety, sustainable palm oil) to social and human rights (forced labor, responsible supply chain, living wages, digital rights). A significant proportion of our engagements focused on environment issues, as emerging markets account for 50% of all CO<sub>2</sub> emissions, making them key in the global energy transition. Candriam is lead investor on several EM companies in the Climate Change campaign coordinated by the Carbon Disclosure Project. One example being Dino Polska, a company that we have also engaged with on corporate governance and human capital aspects. We also conduct a dedicated engagement with LONGi Green, a global leader in solar PV component manufacturing, to encourage environmental and human right best practices in the solar supply chain.”

*Engagement also informs our bottom-up ESG analysis, especially in markets where corporate sustainability disclosure is less robust. As an example, we reached out to Alibaba to better understand its human capital management, in part because until recently the company had not published any disclosure in this area. The results of these dialogues have been incorporated into our ESG and fundamental analysis of Alibaba.*

# Closing the Circle

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While we have laid out our process as a line for your understanding, every day it is a dynamic and interactive process. Every part of our ecosystem is based on our Conviction that companies which embrace sustainability-related opportunities and challenges in combination with financial opportunities and challenges *are the most likely to generate shareholder value*.

With 25 years of Emerging Markets Equities investing, 25 years of ESG investing, and 15 years of ESG Emerging Markets portfolios, this is not a set of Lego blocks snapping together. It is a truly integrated way of looking at things. It is no accident that the megatrends and pockets of growth we seek mesh so well with the ESG advantages we identify.



# Statement of Investment Risks

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Risk factors include Risk of capital loss, Equity risk, Foreign exchange risk, Emerging countries risk, ESG investment risk, Sustainability risk, Liquidity risk, Risk associated with derivative financial instruments, Risk associated with Chinese "A" shares, Counterparty risk, Risk of changes to the benchmark index by the index provider, Risk related to external factors, Hedging risk of the share classes.

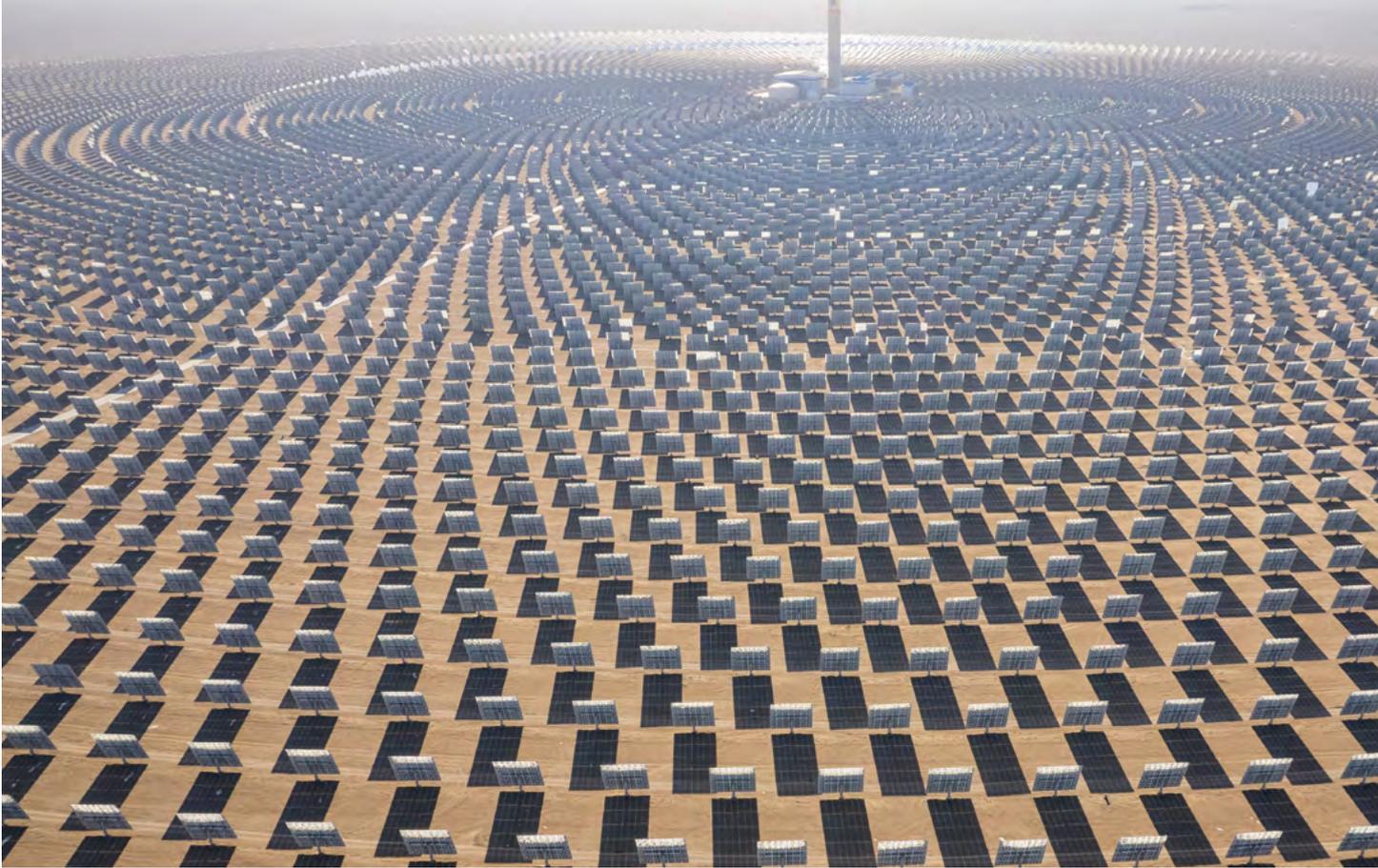
## Notes & References

<sup>1</sup> Transparency is greater in some companies and countries, and less so in others – but overall, standardization is an issue in EM corporates.

<sup>2, 3, 4</sup> [CANDRIAM'S Article 9 Emerging Markets SRI Strategies Transparency Code, March 2022](#)

<sup>5</sup> [CANDRIAM'S Candriam Exclusion Policy, March 2022](#)

<sup>6</sup> The phrase ESG was apparently coined in 2005.



**€150 B**

AUM as of  
31 December 2021



**570**

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committed professionals



**25 years**

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sustainable investing

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