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2008 Review of the corporate responsibility performance of large emerging market enterprises

Note by the UNCTAD secretariat and Ethical Investment Research Services

Executive summary

The objective of the present note is to provide insight to regulators and enterprises on the methodology used by investment analysts in assessing the environmental, social, and governance (ESG) performance of enterprises. The findings, along with the insights into ESG assessment practices, are expected to provide policymakers and enterprise managers a greater understanding of how they might achieve ESG goals and attract increased investment.

The present note analyses the state of corporate responsibility among leading companies from emerging markets, using a subset of Ethical Investment Research Services' (EIRIS') assessment methodology. Publicly available documents of 40 leading companies in 10 emerging markets were examined and each company was assessed against key ESG indicators. This analysis illustrates how some of the largest emerging markets companies are addressing ESG issues.

The study's relatively small sample size and focus on the disclosure of large companies means that caution should be used when extrapolating the findings. Nevertheless, a number of useful observations emerge:

(a) Companies scored much better in environmental areas than in social or governance areas, with some reaching grades in environmental performance and systems on a par with developed country environmental leaders;

(b) Companies in higher impact sectors, including those in the resources sectors where risks are typically greater, performed relatively well on issues such as health and safety and environment;

* ISAR documents were previously issued under the symbol TD/B/COM.2/ISAR/…

(c) Public disclosure of key governance issues was high, including director remuneration (33 out of 40 companies) and the separation of the roles of chair and chief executive officer (28 out of 40 companies);

(d) The selected South African and Brazilian companies stood out overall as consistently having the highest assessments among the companies sampled. These countries also developed some of the first responsible investment indices in emerging markets, indicating the interest of investors in these countries in ESG performance.

Current trends suggest the need for increasing cooperation among policymakers, stock exchanges and investors in improving domestic ESG practices. Such cooperation may involve setting up joint initiatives to further increase understanding among enterprise directors and management of good practices in ESG disclosure and management. Awareness raising and technical training may be required for management to measure, compile and interpret ESG information. A possible long-term outcome of improving enterprise performance on ESG factors is a strengthening of investor confidence and a reduction in market volatility. In this way, countries that put in place policies to reinforce ESG performance can do so as part of a broader strategy to attract investment and reduce investor perception of country risk.

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Introduction

1. Corporate environmental, social and governance (ESG) disclosure has been a focus of work for the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) for a number of years. At its twenty-fourth session, in 2007, ISAR reiterated the importance of corporate responsibility reporting for meeting the increasing information demands of various stakeholders. It acknowledged that concise, comparable and performance-oriented reports in that area added value for shareholders and other stakeholders, and promoted sustainable economic development. The group of experts also noted the increasing integration of social and environmental issues into the broader corporate governance framework. ISAR further agreed at its twenty-fourth session that UNCTAD should continue to coordinate its work on this subject with a range of organizations active in the area of corporate responsibility reporting, together with private and public sector stakeholders. It suggested that case studies on corporate responsibility reporting be conducted to provide practical feedback on the status of corporate responsibility reporting around the world.

2. This report presents a review of corporate responsibility practices among a sample of large emerging market enterprises, based on the corporate reports and other publicly available information of those companies. It was conducted in cooperation with Ethical Investment Research Services (EIRIS), a London-based not-for-profit provider of independent research into the social, environmental, governance and ethical performance of companies.[1] EIRIS is a provider of ESG research for such equity indices as the FTSE4Good, which tracks companies trading on the London stock exchange that demonstrate good corporate responsibility practices, and the Johannesburg Stock Exchange's Social Responsibility Index, which tracks leading South African companies based on their ESG performance.

3. Corporate responsibility, often seen as the preserve of major companies in developed economies, is gaining ground in emerging markets. Initiatives such as the United Nations Global Compact, the United Nations Principles for Responsible Investment (PRI) and the Carbon Disclosure Project (CDP) are increasingly focusing on emerging markets as investors turn towards these markets. This paper provides the results of a study of 40 companies to analyse the state of corporate responsibility in emerging markets, using a subset of EIRIS' assessment methodology. Publicly available documents of 40 leading companies in 10 emerging markets were examined and each company was assessed against key environmental, social, and governance indicators, including board practice, bribery, human rights, labour practices in the supply chain, health and safety, environment, climate change, and biodiversity. This analysis illustrates how some of the largest companies from emerging markets are addressing ESG issues.

4. The sample selected for this study is comprised of the top four companies by market capitalization from each of the ten largest United Nations member States within Morgan Stanley Capital International's Emerging Markets Index (MSCI EM Index). This analysis is based on the research methods used by EIRIS, and serves to illustrate how ESG analysts view corporate ESG performance, and provides an ESG assessment of some of the largest companies based in emerging markets. Chapter I provides additional background on the growth of ESG analysis in emerging markets. Chapter II provides a general methodology of the study, and is followed by three chapters (III–V) which provide key findings of the study grouped by general subject area (environment, social and governance). Potential users of this data include regulators and investors who will be able to better understand

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[1] This document was prepared and edited by the UNCTAD secretariat based on EIRIS research compiled by Sonia Wildash and Shohko Iwami, with thanks to Stephen Hine and Stephanie Maier.

the current state of corporate responsibility among large companies in emerging markets, and better understand current practices in analysing ESG performance.

I. Background on the growth of ESG analysis in emerging markets

5. Forces associated with globalization are driving the growing need to address corporate responsibility issues in companies around the world. As noted in UNCTAD's 2006 *World Investment Report*, the regional and global challenges to meet good practices in ESG management are increasingly affecting transnational corporations (TNCs) based in emerging markets.[2] TNCs from developing countries and economies in transition are increasingly seeking to address issues of corporate responsibility. Looking at the United Nations Global Compact, for example, a voluntary initiative that companies can sign up to, approximately 55 per cent of signatories come from emerging markets.

6. Investors are among the key drivers of this trend. Even though emerging market investments typically account for a smaller portion of institutional investment portfolios, investor exposure to emerging markets is much larger than is implied by notional allocations, given the increasing operational exposure of developed world TNCs to emerging markets. Combining these opportunities with responsible investment provides a unique set of risks and opportunities for investors as evaluated in EIRIS' 2006 paper, *Broadening horizons for responsible investment – an analysis of 50 major emerging market companies*.[3] Developments in corporate responsibility in emerging markets may also create market opportunities from which knowledgeable investors can benefit, although emerging market volatility may need to diminish before ESG issues noticeably add to or subtract from shareholder value. Indeed, one of the first pension fund mandates to seek global emerging market equity strategies containing elements of ESG within its remit was announced in October 2007, when PGGM, the €88 billion Dutch healthcare pension fund, began a search for high-performing emerging markets equities managers that had ESG at the core of their strategy.[4]

7. Investors based in developing countries also express a strong interest in ESG issues. In 2004, the Brazilian Pension Fund Association (ABRAPP) launched a set of guidelines on responsible investment covering issues such as improving environmental care, labour practices and corporate transparency on ESG issues. ABRAPP encourages pension funds to take these guidelines into account when considering investments. The São Paulo Stock Exchange (Bovespa) also has a local sustainability index which tracks the corporate ESG performance of companies as well as their economic and financial performance.

8. Additionally, high-profile funds from both South Africa and Brazil, such as the South African Government Employees Pension Fund, and PREVI (the employee pension fund of the federal Banco do Brasil) have signed onto the United Nations Principles for Responsible Investment (PRI), joining over 50 other signatories from emerging markets totalling $250 billion in assets under management. Countries such as Indonesia and Malaysia are also developing initiatives to improve corporate responsibility reporting, with the Indonesian Institute of Management Accountants holding national sustainability awards

[2] UNCTAD (2006). *World Investment Report*. Chapter VI, section D, "Corporate Social Responsibility and TNCs from Developing and Transition Economies".
[3] "Broadening horizons for responsible investment - an analysis of 50 major emerging market companies". http://www.eiris.org/files/research%20publications/emergingmarketseep06.pdf.
[4] Press release 22 October 2007: http://www.mercer.com/pressrelease/details.htm?idContent=1285435.

and the Malaysian Government legislating mandatory corporate responsibility reports for listed companies.[5, 6]

9. Such investor interest is expected to increase over time. A 2008 joint report by the International Finance Corporation (IFC) and the Economist Intelligence Unit survey shows that about 80 per cent of asset owners who currently do not integrate ESG policies in their emerging market investments expect to do so over the next three years.[7] The complete report, to be published towards the end of 2008, will detail investment in emerging markets that is based on ESG factors. Investors are already demanding increased information from emerging markets companies on their ESG practices. Linking into this is the ongoing Emerging Markets Disclosure Initiative. This is an initiative launched in 2008 by the United States Sustainable Investment Research Analyst Network and the asset management firm Calvert to improve sustainability disclosure in emerging markets. So far, the project has conducted a study of the state of sustainability reporting among companies in several emerging markets, and has a sign-on statement for investors encouraging emerging market companies to improve sustainability reporting.[8] As of May 2008, the sign-on statement has been endorsed by 28 global institutional investor signatories (representing $960 billion in assets under management) and 15 affiliated supporters (non-governmental organizations (NGOs) and research organizations). The final stage of the project focuses on targeted outreach and engagement in order to promote disclosure by companies operating in Brazil, China, India, the Republic of Korea, the Russian Federation, South Africa, and Taiwan Province of China. A number of other reports on sustainability trends in emerging markets are due to be published this year from the World Resources Institute, IFC and Mercers.

10. Global corporate responsibility initiatives, such as the Global Compact, and the increasing interest from investors, emphasize the increasing importance of ESG issues for emerging markets companies and for this reason, shares of companies which embrace sustainability may be more sought after, leading to higher valuations if investors use corporate responsibility measures as a proxy for management quality. Already, companies with good governance are more likely to be of interest to international investors. Many asset managers already consider corporate governance issues in their investment decisions, albeit not always systematically. These issues are seen as particularly important in the case of State-owned enterprises and family-owned enterprises, both of which are common ownership structures in many emerging markets.

11. Environmental issues such as climate change are also becoming increasingly material to investors, especially if Governments increase regulation in this area. As government policies increasingly move toward constraining greenhouse gas emissions and introducing a price for carbon dioxide emissions, investors are increasingly looking to take emissions into account in their investment strategies while seeking to maintain the financial performance of their portfolios. It is possible that over the longer term, decreased country risk stemming from good corporate reporting and performance on environmental, social and governance factors could lead to lower market volatility as uncertainty is reduced and investors have more clarity on the longer-term outlook. In this way, strengthening corporate ESG practices, particularly in the area of corporate reporting, could be used as a point of differentiation and could lead to a competitive investment advantage.

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[5] CSR awards launched to reward transparency for stakeholders. www.thejakartapost.com/news/2008/06/27/csr-awards-launched-encourage-transparency-stakeholders.html.
[6] http://www.csrwire.com/News/7423.html.
[7] Press release 28 April 2008: http://www.mercer.com/pressrelease/details.htm?idContent=1305005.
[8] Emerging Markets Disclosure Initiative July 2008 update: www.eurosif.org/content/download/1093/6024/version/1/file/Emerging+Markets+Disclosure+Initiative_July+2008.pdf.

II. Methodology

12. This study has assessed companies primarily by looking at information published by the company, including annual reports, sustainability or corporate social responsibility (CSR) reports, company documents and company websites. The data examined relates to 40 companies in total, comprised of the largest four enterprises from the top 10 largest United Nations member States by index weighting found within the MSCI EM Index (see appendices II and III for the list of countries, industries, sectors, and companies). The study assesses this sample of 40 companies on a range of ESG issues. The research was largely conducted by EIRIS, with companies from Brazil, Israel, the Republic of Korea and Mexico researched by EIRIS research partners. Ecodes[9] was responsible for researching Brazilian and Mexican companies, Greeneye[10] for Israeli companies and KOCSR[11] for Republic of Korea companies. All figures are based on information extracted from the EIRIS databases as of August 2008.

13. It is important to note that only publicly available policies and systems were assessed. Some of the companies may indeed have undisclosed internal policies and procedures relating to the issues covered. The present report focuses on the corporate responsibility and governance issues identified by United Nations bodies, including ISAR and the Global Compact, utilizing a subset of EIRIS criteria described in table 1 below.

Table 1. EIRIS criteria

Environment	Environmental issues Climate change Biodiversity
Social	Human rights Supply chain Health and safety
Governance	Board practice Bribery

14. Observations are reported by industry sector. Companies have been grouped into industries based on their Industry Classification Benchmark (ICB) classifications.[12] The ICB system allocates companies to subsectors based on a definition which most closely describes the nature of its business. The nature of a company's business is determined by its source of revenue. Subsectors are then amalgamated into sector groups which are then fed into broad industry classifications. See annex II for a sector summary.

15. It is important to take company impact or level of risk that a company may face into account when analysing a company's corporate responsibility activities. This study uses a range of sources to determine levels of risk corresponding to each area researched. High-risk exposure in a particular area signifies greater materiality than low-risk exposure. For this paper, risk exposure has been determined by examining the nature and location of companies' operations for the following subject areas: environmental issues, climate change, biodiversity, human rights, supply chain, and bribery. In these

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[9] A long-standing Spanish NGO in the field of environment and development, EcoDes, began ethical investment research in 1997. The research function was originally established to supply data to an environmental fund set up by EcoDes, but has now expanded to provide data on Spanish, Portuguese and Latin American companies to EIRIS. www.ecodes.org.

[10] Greeneye is the environmental advisor to the Maala CSR Tel Aviv Stock Exchange Index, and is EIRIS' research partner in Israel. www.greeneye.co.il.

[11] KOCSR is a provider of corporate responsibility research on Republic of Korea companies and is partially owned by CCSR. www.kocsr.com.

[12] http://www.icbenchmark.com/docs/English_Structure_Defs.pdf.

areas, companies are assigned a risk or impact indicator based on their exposure to the issues. Further details are available for each issue in the relevant sections. Since not all companies in the study are subject to the same types of risks, sample sizes can vary from on subject area to another (see table 2).

Table 2. Sample of companies examined

	Number of enterprises (Max = 40)		
Risk exposure	**Very high/ high/ large**	**Medium/ small**	**Low**
Environmental issues	18	14	8
Climate change	17	1	22[a]
Biodiversity	11	4	25[a]
Human rights	18	10	12[a]
Supply chain	4	2	34[a]
Bribery	21	16	3

[a] Policy, systems, and reporting are not assessed for these companies. For the corresponding graphs where not all companies are assessed, n = the number of companies assessed.

16. For each of the areas, this study has used a standardized grading system which indicates the level of company response. The grades are summarized in table 3 below.

Table 3. Grading system

	Grade	**Explanation**
Lowest	No evidence	No evidence of the selected indicators
↓	Limited	There is some evidence that the company is aware of this issue and has taken steps to address it
	Intermediate	The company is some way towards managing the issue
	Good	The company is managing the issue well
Highest	Advanced	This category is intended to identify leading companies that may be gaining a competitive advantage (with stakeholders or society in general) by addressing the issues

III. Environment

A. Environmental issues

17. Issues such as climate change, water shortages and local pollution are driving the environmental agenda in many emerging markets. This study classifies companies as “high”, “medium”, or “low impact”, based on the direct impacts of their business activities on the following key issues: energy use, air pollution, water pollution, waste and water consumption. The sample of emerging market companies was then evaluated on their responses to environmental issues under the following categories according to the EIRIS methodology: policy, management systems and reporting. Based on their performance in each of these categories, the companies were assigned one of five assessment grades: “no evidence”, “limited”, “intermediate”, “good” and “advanced”. Examples of indicators which are used in this study to assess companies’ environmental policies and practices include setting objectives and targets in key areas, quantitative data on all key impacts, and ISO 14001 environmental management system coverage. In order to be assessed as having a “good” environmental policy, a company would have to have a combination of the following: a demonstration of a commitment to all key environmental issues impacted by their business, board level responsibility for environmental issues, environmental objectives and targets, operating standards beyond

compliance, a commitment to environmental reporting, a commitment to environmental auditing and/or monitoring, stakeholder involvement, and product stewardship where applicable. In order to be assessed as having a “good” environmental management system, a company would need to demonstrate that objectives and targets have been set in all key areas and that the company has a means to achieve them, evidence of an audit plan and of internal reporting for management review purposes. The depth of its environmental management systems and the extent or percentage of the company which is covered is also considered which includes looking at both externally-certified and internally-developed systems. A “good” environmental reporting grade would include such elements having a good quality publicly available environmental report. The report must contain meaningful performance data and show the company’s performance against targets in the key areas. The report also has to be independently verified.

Key findings

18. More than two thirds of the companies in the study were in “high” or “medium” impact sectors (figure 1). The companies assessed scored much better for environmental areas than for social or governance areas. As noted in figure 2, many companies achieved good or advanced scores, grades more typically seen amongst developed country environmental leaders. As expected, companies in high impact sectors, such as those in the resource sector, tended to have better environmental policies, systems and reports. However, some low or medium impact financial companies also scored well.

19. The assessments for environmental areas were highest for the four South African companies studied. One reason for this is that the Johannesburg Stock Exchange requests listed companies to report annually on the nature and extent of their environmental management policies and practices, among other corporate responsibility indicators. The four Brazilian companies studied also stand out in terms of their excellent assessments. The two Republic of Korea companies that received advanced grades for environmental systems have significant international operations and over 95 per cent of their operations are ISO 14001 certified. Many Republic of Korea companies have recognized that ISO 14001 certification is an important strategy for industrial competition and for improving company and product recognition.

Figure 1. Environmental impact

(number of companies)

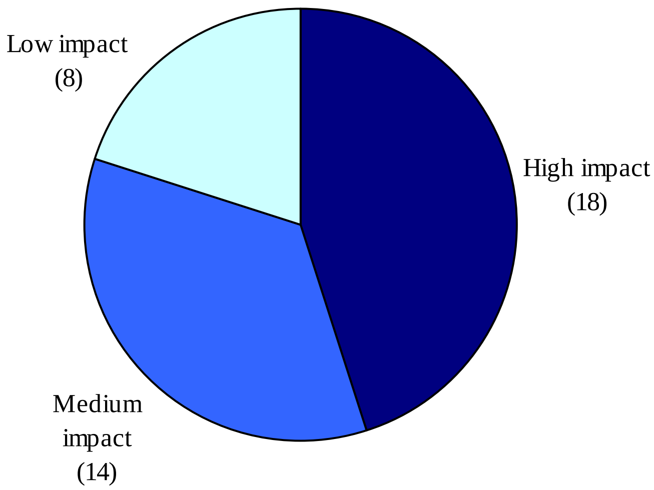
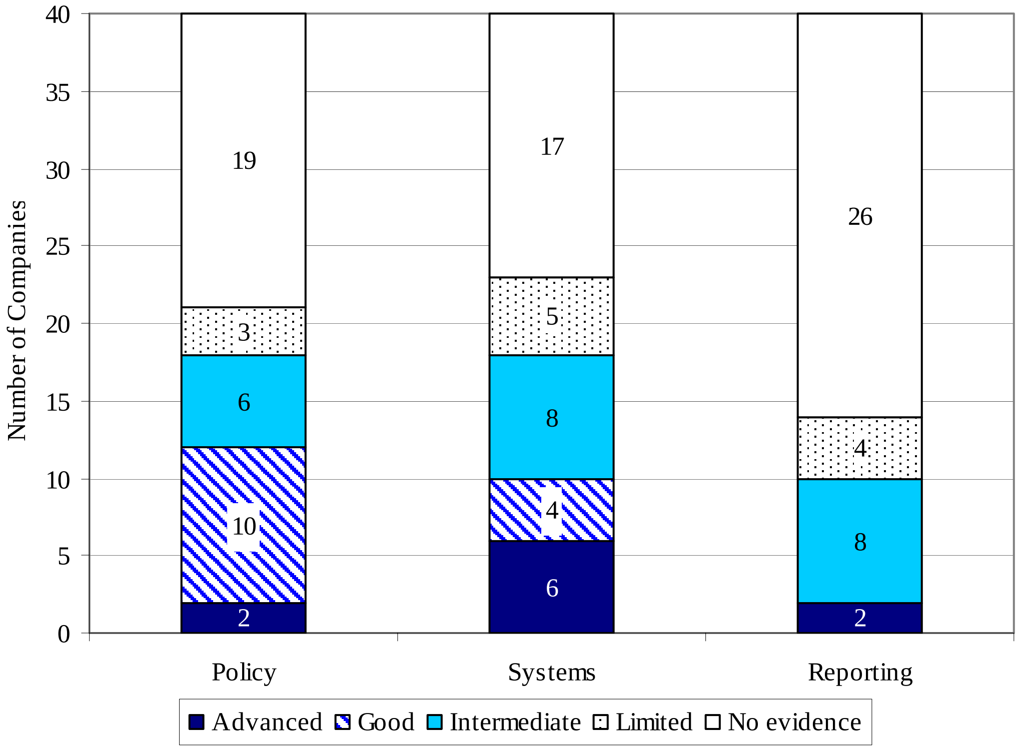


Figure 2. Environmental management
(companies assessed for environmental management = 40)



B. Climate change

20. Climate change has the potential to impact shareholder value, especially as increasingly strict regulation is introduced and emissions trading schemes are developed. There is more focus on the issue in emerging market companies now that the Climate Disclosure Project has 5 of its 14 partners located in

emerging markets, including Brazil, China, India, the Republic of Korea and South Africa. Four of the five emerging market partners have been added since 2007. This study examined companies' risk exposure and management response to the issue including disclosure of data, policy and governance, strategy and performance. In terms of climate change impact based on their operations, companies are categorized as "very high", "high", "medium", or "low risk". This is based on the direct, indirect and product emissions over which companies have control. Classifications also take into account the projected growth of emissions in the sector, the overall impact of the sector (e.g. benefits of public transport), the allocated share of upstream and downstream emissions, and the strategic importance in contributing to solutions to climate change.

21. Companies are then assessed on their management response and disclosure of company performance. Indicators include evidence of target setting and disclosure of emissions, including disclosure of performance against targets. Based on their performance in each of these categories, the companies were assigned one of five assessment grades: "no evidence", "limited", "intermediate", "good" and "advanced". In order to be assessed as having a "good" management response to climate change, the company would need to show evidence of the following indicators: senior responsibility for climate change related issues, climate change commitment, product-related climate change commitment (where relevant), long-term strategic climate change goals or short-term management targets linked to greenhouse gas emissions reductions. In order to reach a "good" grade for disclosure, companies are required to provide data on its absolute and normalized emissions, the scope of those emissions, trend emissions data, as well as product or service related emissions (where relevant). They also would need to demonstrate minimum operations emissions reductions of 2.5 per cent or other efficiency gains as well as product emissions reductions if relevant. Companies whose impacts were categorized as "low risk", such as those in the financials and technology industries, were not assessed.

Key findings

22. A total of 18 companies in the study were seen as having a medium to very high risk for climate change impacts (figure 3). The management response to climate change was strongest amongst the resource companies, as might have been expected given the energy intensive nature of the sector. However, it is interesting to note that 6 out of 12 resource companies had no evidence of climate change disclosure while five of the remaining six companies attained an intermediate grade (figure 4). Given the high impact that many of these companies have on climate change, this is an area in which both regulators and investors will likely be interested.

Figure 3. Climate change risk
(number of companies)

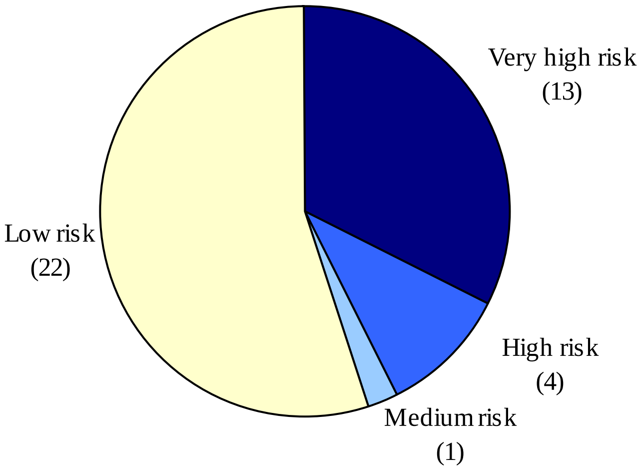
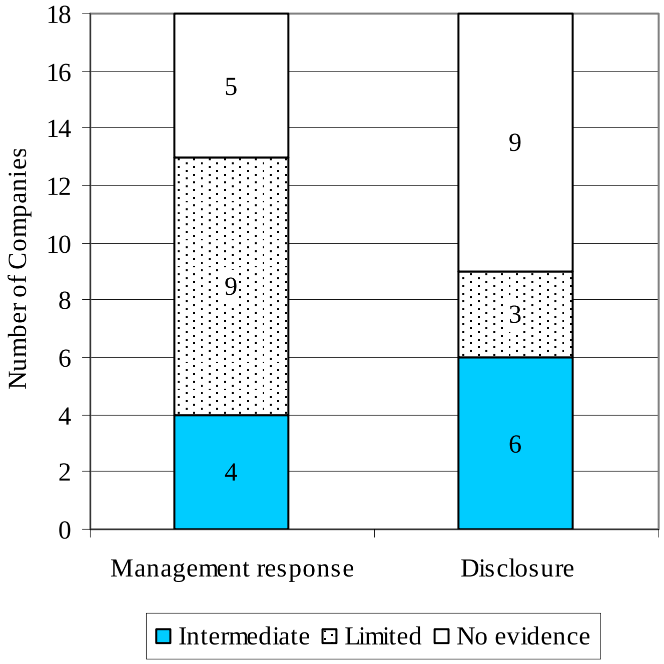


Figure 4. Climate Change
(Companies assessed for climate change = 18)



C. Biodiversity

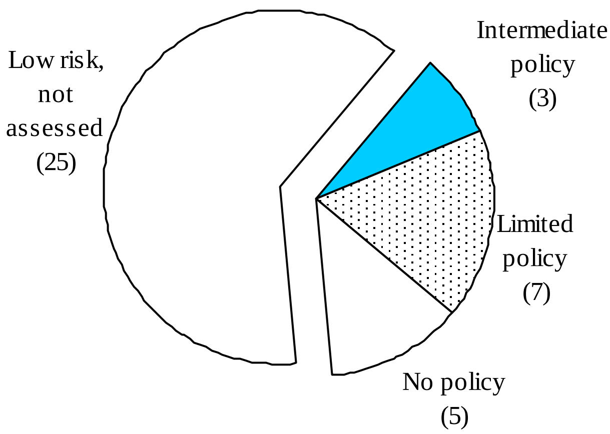
23. The biggest threat to biodiversity is from changes in land use leading to habitat destruction, fragmentation or simplification. Biodiversity has practical implications for enterprise. Many industries – for example, forestry, fishing and agriculture – depend directly on biological resources, and destruction of biodiversity is therefore a risk to their resource base. Others may depend on the quality of the local environment or require ecosystem "services" – for example, the purification of sewage discharges by river systems. For the purposes of this paper, biodiversity policies were assessed for the 15 companies that were categorized as "medium" or "high risk" for this issue. Those companies' biodiversity policies were graded as "no evidence",

"limited", "intermediate" or "good". Examples of indicators which are used by ESG analysts to assess companies' biodiversity policies and practices include evidence of a biodiversity action plan, assessment of potential for enhancement and disclosure of biodiversity improvements.

Key findings

24. Out of the 40 companies evaluated, 25 were in sectors for which biodiversity was not a significant issue, and therefore not assessed (see figure 5). Five of the remaining 15 companies did not have a biodiversity policy; 7 had a basic or "limited" policy while three were assessed as having a moderate or "intermediate" policy. No companies had a "good" biodiversity policy, the highest grade available. In order to achieve a "good" grading under the EIRIS methodology, a company must demonstrate the majority of the following criteria: a group-wide policy or biodiversity action plan, involvement of conservation organizations in developing specific biological action plans at a strategic level, an assessment of the potential for enhancement, and – where relevant – a policy to source natural resources from suppliers operating an appropriate certification scheme. Resource and industrial companies had more comprehensive biodiversity policies than those in the consumer or health industries. Companies in the financial or technology industries do not have biodiversity as a significant issue and so were not assessed.

Figure 5. Biodiversity policy
(number of companies)



IV. Social

A. Human rights

25. Due to increased concerns about the role of business and human rights, and new and novel forms of foreign direct liability for corporate complicity in human rights abuses, investors increasingly see human rights issues as both a moral responsibility as well as a material concern affecting their investments. The issues and standards used in this study to provide benchmarks for human rights research are based on internationally endorsed conventions, notably the United Nations Universal Declaration of Human Rights and the core Conventions of the International Labour Organization (ILO), which cover child labour, forced labour, freedom of association and collective bargaining, and non-discrimination.

26. Whilst noting that human rights violations can occur in all countries, ESG investment analysts typically focus their research on particular countries where human rights are perceived as being most at risk (based on a risk

assessment using information from a range of sources, including the Freedom House Annual Survey, World Bank Political Stability and Absence of Violence Governance Indicator, Amnesty International and Human Rights Watch). The size of a company's operations identified in a country of concern was also taken into consideration and categorized as "large", "small-medium" or "low". EIRIS, for example, categorizes a company as having a "large" presence in a country if it has been identified as having more than £100 million of annual turnover or assets or over 1,000 employees in its operations in the country. A company is categorized as having a "small" presence if its operations in a country fall under the above mentioned thresholds.

27. The sample companies' overall performance on human rights was assessed according to EIRIS methodology by looking at the quality of their human rights policy, management systems, and reporting mechanisms. Based on their performance in each of these categories, the companies studied were assigned one of five assessment grades: "no evidence", "limited", "intermediate", "good" and "advanced". Indicators which were used in this study to assess companies' human rights policies and practices include evidence of board level responsibility, details of policy communication, and staff training. In order to achieve a "good" human rights policy under the EIRIS approach, a company would need a public policy which included all five core ILO labour areas, an explicit statement of support for the Universal Declaration of Human Rights, board level responsibility, evidence of policy communication to all employees, and where relevant, an armed guards policy, based on United Nations guidelines as well as a policy on indigenous rights. A "good" human rights system under the EIRIS approach would include such areas as an identification of major human rights challenges, training of all employees, consulting independent local stakeholders, monitoring and procedures to remedy non-compliance, and an integration of its systems into risk assessment procedures. For human rights reporting, a "good" grade would include the public communication of details of many of the aspects of human rights systems such as details of risk and impact assessments and details of engagement with local governments or NGOs. It would also need to include at least one detailed example of human rights performance in the developing world, a statement on compliance with human rights policies and whether there were any breaches, in addition to other criteria.

Key findings

28. As indicated in figure 6, there were 12 companies with low exposure to human rights risk; these 12 were not assessed, leaving 28 companies in the "small-medium" and "large" exposure categories for assessment. In figure 7, it is seen that slightly more than half of these 28 companies had policies on human rights. A much smaller proportion of the companies studied, however, report on the details of their systems and performance. The data shows that there may be a greater tendency for resource companies to recognize human rights as an issue than companies involved in the financial sector which may reflect the type of work being done in each field. Ten out of 11 resource companies have some sort of human rights policy in place, compared with none of the 7 financial companies. The results for human rights systems and reporting show the same tendencies: companies where the risk is greatest appear to be reporting on the issue more fully. However, only 2 out of the 30 companies assessed had better than a limited policy and no companies achieved above a limited grade for systems or reporting, showing that further emphasis is needed in this area.

Figure 6. Exposure to human rights risk
(number of companies)

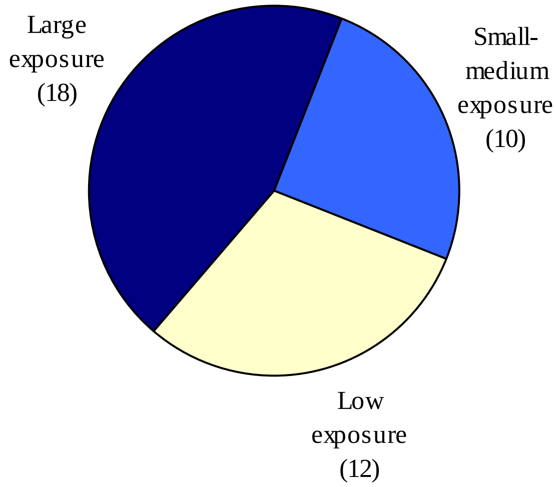
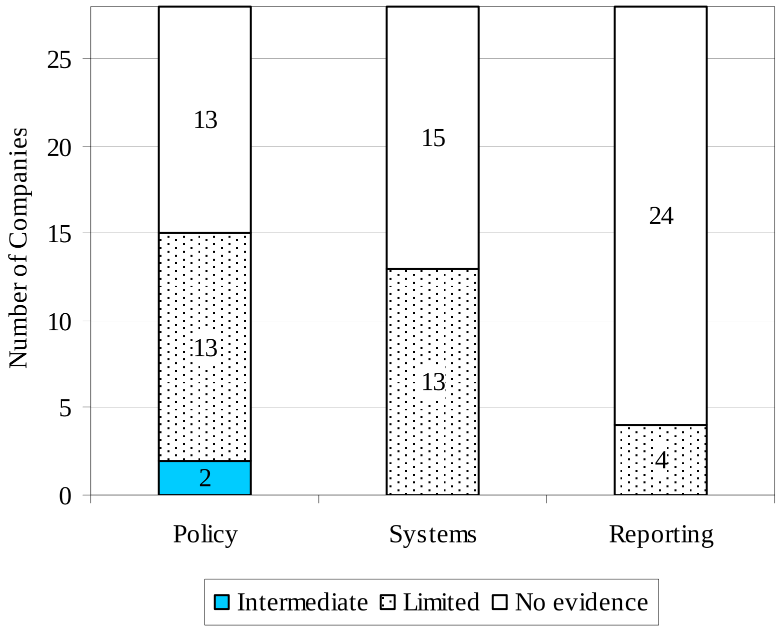


Figure 7. Human rights
(Companies assessed for human rights = 28)



B. Labour practices in the supply chain

29. Due to the increasingly international nature of production and trade, an ever-growing number of products are being assembled or processed in many different countries all over the world and greater attention is beginning to be paid to the working conditions in the countries of origin. EIRIS categorizes the companies according to their exposure to supply chain labour risk based on their sector, the countries from where their products are sourced, and the size of their operations. Companies determined as having high or medium exposure to supply chain labour risk were then assessed on their supply chain policy, management systems, and public reporting. Based on their performance in each of these categories, the companies were assigned one of five assessment grades: “no evidence”, “limited”, “intermediate”, “good” and “advanced”. Indicators which were used to assess companies’ supply chain labour standards policies and practices include integration of policies into

procurement procedures, monitoring and auditing, and procedures for addressing non-compliance.

Key findings

30. As noted in figure 8 below, only six companies from the sample analysed were considered to face a “high” or “medium” supply chain risk exposure; therefore, caution should be used in drawing firm conclusions from this small sample size. Only two companies had a supply chain policy for labour standards and they only met the weakest grade of EIRIS assessment, “limited” (see table 4). One company had a limited system for assessing compliance with its policy and none of the companies reported on supply chain labour practices. A “good” grade in these areas, according to the EIRIS approach, would include a public commitment to the four core ILO convention areas as well as at least two of the other key ILO convention areas selected by EIRIS. The company would also need to show evidence of policy communication to its suppliers, a demonstration of procedures to remedy non-compliance on sourcing standards and have senior level responsibility to champion the company’s policy on this issue. It would also need to report substantively on labour conditions in its supply chain, including providing details of remedies for non-compliance and would either have its reports independently verified or provide some notable details.

31. In general, there appears to be a lack of attention being paid by the companies in this study to this issue at the moment. This is in stark contrast to many developed market multinational companies which often have exacting standards of labour practices in their supply chain which tend to be based in emerging markets.

Figure 8. Exposure to supply chain risk
(number of companies)

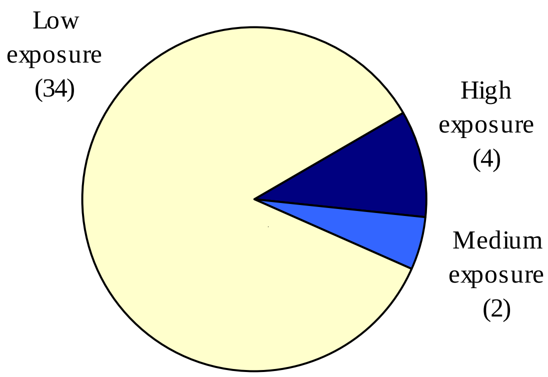


Table 4. Labour practices in supply chain
(number of companies)

Assessment	Policy	Systems	Reporting
No evidence	4	5	6
Limited	2	1	0
Intermediate	0	0	0
Total	6	6	6

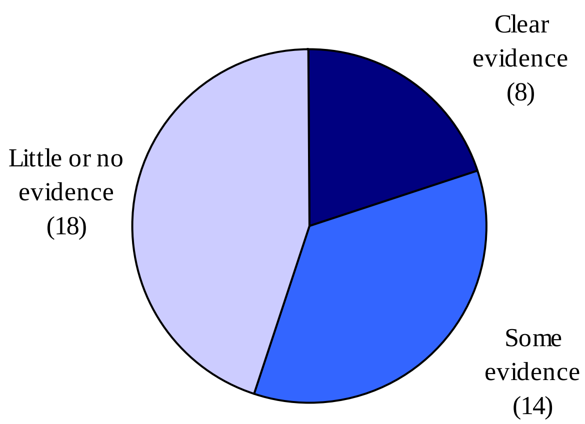
C. Health and safety

32. Investors see health and safety issues as symptomatic of material issues related to quality of management, liability, productivity and risk of work disruptions. ESG analysts typically assess all companies on health and safety systems. EIRIS for example, grades companies as “little or no evidence”, “some evidence” or “clear evidence”. Indicators used to assess companies’ health and safety practices include evidence of senior responsibility, quantitative data on its health and safety record, and details of staff training. “Clear” evidence of health and safety systems could include details of senior responsibility, details of training, significant awards won, and detailed quantitative data illustrating changes to performance and/or sectoral comparisons.

Key findings

33. Almost half of the companies in the sample studied showed “little or no evidence” of managing health and safety in their operations (figure 9). However, industrial companies and all but two companies in the resource industry had either “some” or “clear” evidence of health and safety systems, compared with only 4 out of 15 financial companies. This shows that for industries where health and safety represent significant operating risks, the companies in the study are addressing this issue.

Figure 9. Health and safety systems
(number of companies)



V. Governance

A. Board practice

34. The way in which boards are structured should facilitate good corporate performance by ensuring that a company is managed in the best interests of its owners. Although improved governance practices and procedures cannot provide a foolproof safeguard against deliberate fraud or financial collapse, many investors see their existence as evidence of sound management practice within a company.

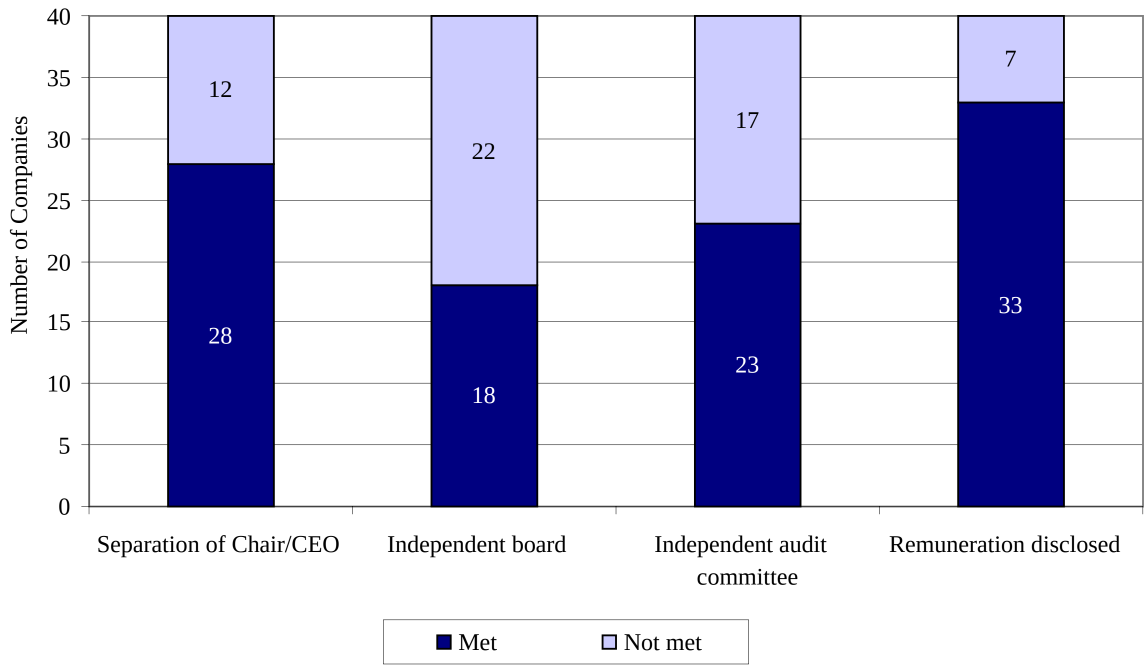
35. This study focuses on four key indicators to determine the strength of board practices: the separation of the roles of chair and chief executive, proportion of independent directors, independence of the audit committee, and disclosure of director remuneration. According to the EIRIS methodology, a non-executive is not considered independent if they have served the same company for a long period (over 10 years), have close family relationships with executive directors of the company, represent a major shareholder/supplier/customer of the company, have a close consultancy or

advisory relationship or contract with the company, or were otherwise employed by the company or one of its subsidiaries within the previous three years.

Key findings

36. All but one of the companies in our sample had at least one core element of corporate governance and 36 out of 40 had at least two of the core elements of good board practice. As indicated in figure 10 below, public disclosure of director remuneration (33 out of 40 companies) and the separation of the roles of chair and CEO (28 out of 40 companies) seemed to be much more prevalent among companies than having a board made up of at least 33 per cent independent directors (18 out of 40 companies). Out of the 40 companies researched, 23 companies had audit committees made up of at least 33 per cent independent directors. The country divisions below seem to reflect the influence of national codes in place in some countries. Enforcement of governance, especially if those codes have only recently been adopted, may also differ by country. For example, in the Russian Federation, the level of voluntary compliance to the domestic corporate governance code differs significantly from one company to another although some larger companies who plan to enter foreign financial markets have taken steps to comply with corporate governance best practices such as actively appointing independent directors. The South African Corporate Governance recommendations, outlined in the King II code, not only address core corporate governance issues, such as director independence and splitting CEO from Chair positions, but also provide guidelines for disclosing social and environmental performance.

Figure 10. Board practice
(Companies assessed for board practice = 40**)**



B. Bribery

37. Corporate bribery and corruption can have serious consequences for investors and enterprises alike. Corruption can have financial, legal and reputational repercussions that can damage the growth and development of an enterprise. Companies involved risk lawsuits and material financial penalties. It can also undermine the effectiveness of government policies and market mechanisms. In many countries, regulators and prosecutors are becoming ever

more vigilant and convictions and fines for business corruption are rapidly increasing.

38. The EIRIS approach to ESG analysis identifies companies' risk exposure to bribery and corruption ("low", "medium", or "high risk") and provides a comprehensive analysis of a company's anti-bribery policy, its systems and reporting in the public domain. Based on performance in each of these categories, the companies were assigned one of five assessment grades: "no evidence", "limited", "intermediate", "good" and "advanced". Indicators which are used by this study to assess companies' anti-corruption policies and practices include evidence of board commitment, whistle-blowing procedures and staff training. In order to receive a "good" assessment from EIRIS for an anti-corruption policy, a company would need to publicly demonstrate that it prohibits bribes, obeys laws, restricts so-called "facilitation payments" and improper gifts,[13] has board level commitment on the issue, transparency of political donations and that the policy is applicable to contractors, suppliers, and agents. "Good" systems would include the following: communication of the policy to employees and business partners as well as training, evidence of compliance mechanism, whistle-blowing procedures, a sanctions process, an assessment of risks, and appropriate systems for the appointment and remuneration of agents. "Good" reporting would include details of policy communication, training, monitoring, auditing, compliance mechanisms, systems for the appointment and remuneration of agents, as well as other elements such as details of performance, non-compliance, or independent verification, among others.

Key findings

39. For all but three companies in the sample, bribery was assessed as being a "medium" or "high" risk issue based on their sector, countries of operation and involvement in traditionally high risk activities such as government contracts and licensing (see figure 11). Most companies have a public bribery policy of some description but no companies attained a "good" or "advanced" grading (see figure 12). Key factors which were examined included whether active and passive as well as direct and indirect aspects of bribery were considered in the policy and how far the company communicated its policy – both externally to its suppliers, contractors and agents, and internally to employees and its subsidiaries.

40. Fewer companies had clear systems in place to implement their policies and companies either showed no evidence of reporting on their initiatives to counter bribery or only disclosed limited details of their management systems and performance. All four Brazilian companies studied appear to be the most transparent in terms of their overall initiatives to counter bribery as all had an "intermediate" policy, all had either "limited" or "intermediate" systems and all had at least some level of disclosure in reporting. The four Republic of Korea companies studied also stood out as having good overall practices to counter bribery. This may be the result of a range government policies in the Republic of Korea that have specifically sought to improve good governance at all levels.

[13] Terms such as "facilitation payments" and issues such as the propriety of gifts are defined and clarified in the Organization for Economic Cooperation and Development Convention on Combating Bribery of Foreign Public Officials.

Figure 11. Exposure to bribery risks
(number of companies)

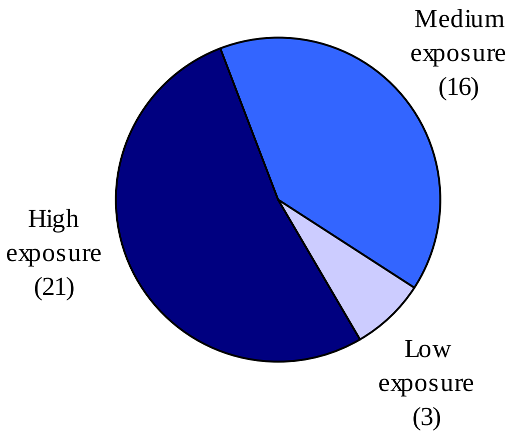
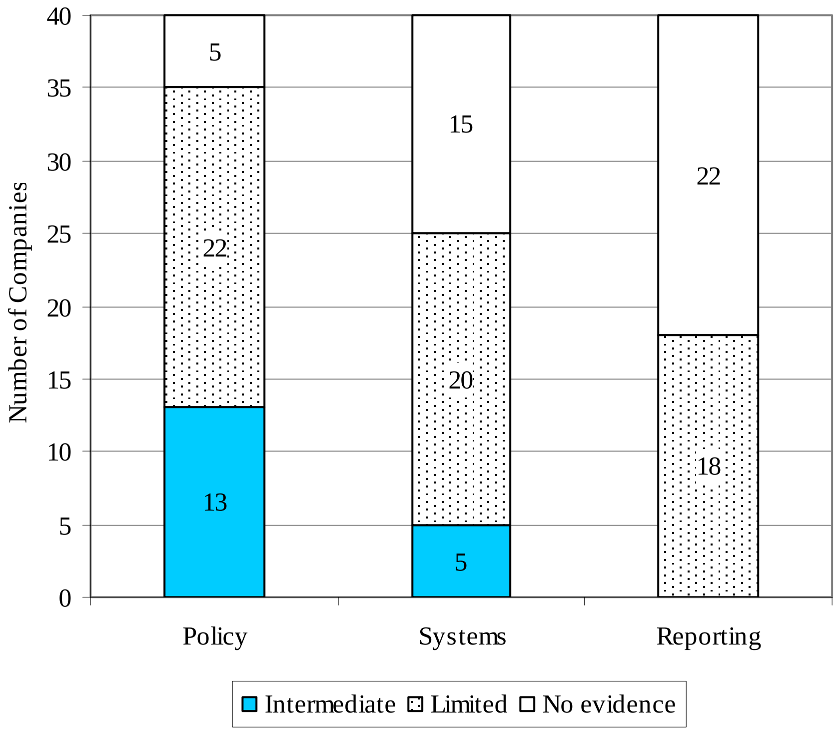


Figure 12. Countering bribery
(Companies assessed for anti-bribery practices = 40**)**



VI. Conclusions

41. This study's findings indicate that the majority of the 40 companies in the study have shown evidence of addressing at least some ESG issues in their public disclosures. The study's relatively small sample size and focus on the disclosure of large capitalization companies means that caution should be used when extrapolating the findings. Nevertheless, the study has facilitated a number of useful observations:

(a) The South African and Brazilian companies studied stood out overall as consistently having the highest assessments among the companies sampled. These countries also developed some of the first responsible investment indices in emerging markets, indicating the positive role that investors can play;

(b) Companies scored much better in environmental areas than in social or governance areas, with some reaching grades in environmental performance and systems on a par with developed country environmental leaders;

(c) Higher impact companies, including those in the resources sectors, performed better on issues such as health and safety and environment, where the risk is greater;

(d) Public disclosure of director remuneration (33 out of 40 companies) and the separation of the roles of chair and CEO (28 out of 40 companies) were high.

42. The majority of companies in the study have shown evidence of addressing at least some ESG issues in their public disclosures. However, the analysis presented in this study indicates that the eight large South African and Brazilian companies sampled performed better on ESG issues than their peers in the other emerging market countries studied. This may be a function of national policy initiatives to improve corporate responsibility, responsible investing, and ESG disclosure. It is noted that all four of the South African firms in this study are also constituents of the Johannesburg Stock Exchange's responsible investment index, and three of the four Brazilian firms are members of Bovespa's sustainability index.

43. South African firms appear to be ahead of most other emerging market enterprises in disclosing corporate responsibility activities. This may reflect a number of policy choices and initiatives in that country, including the development of the King Reports[14] and the Johannesburg Stock Exchange's responsible investment index.[15] The most recent King Report recommends the annual use of the Global Reporting Initiative guidelines for disclosing social and environmental performance for companies listed on the Johannesburg Stock Exchange as well as addressing core corporate governance issues. There is also evidence of domestic investor demand for responsible investment products. In 2007, South Africa had approximately $33 billion of assets managed with some sort of responsible investment strategy.[16] The four Brazilian companies in this study also scored highly against the criteria employed and, similarly, there seems to be a strong background of domestic interest among investors in ESG issues, and strong support from institutions such as Bovespa.

44. Although the findings of this study suggest that corporate responsibility activities are well established in South Africa and Brazil, it is possible that in other countries actual corporate responsibility-orientated activities may be greater than their public disclosure. It is difficult to assess whether the lack of ESG disclosure reflects formal corporate policies toward disclosure or simply a lack of awareness among managers that these issues are of interest to investors. Some companies may be reluctant to disclose details of their corporate responsibility initiatives until a cohesive program is in place.

45. Another significant observation of this study is that the companies scored much better in environmental areas than in social or governance areas, with some reaching grades in environmental performance and systems typically seen amongst developed country environmental leaders. As companies' environmental policies and systems were superior to their reporting disclosure across the board, this may indicate an ongoing evolution of company responses to the issues. Although it is encouraging that

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[14] Institute of Directors – South Africa. King Report on Corporate Governance for South Africa – 2002 (King II Report) http://www.iodsa.co.za/king.asp.

[15] The JSE SRI index is compiled based on data provided by EIRIS.

[16] The State of Responsible Investment in South Africa. http://www.unisa.ac.za/contents/colleges/col_econ_man_science/ccc/docs/State%20of%20responsible%20Investment%20in%20South%20Africa.pdf.

environmental issues are catching the attention of company management, it is important that the many material issues in the social and governance domains are also considered. Effective anti-corruption programmes not only mitigate legal risk but can also enhance commercial opportunity by strengthening reputation and credibility. Links have been made between corporate governance practices and share performance which indicate that good corporate governance is positively viewed by investors. Investors and policymakers should continue their efforts to strengthen the capabilities of enterprises to strengthen ESG structures, including disclosure.

46. There are 13 companies in our sample for which a climate change policy response or disclosure is a significant result, as most of them do not have the benefit of institutions such as carbon trading markets which would create transparent price incentives for action. Instead, action appears to be driven by other pressures, such as customers, competitors, investors or outside regulators. In Asia, for example, the influence of developed country TNCs on companies in their supply chain is often very pronounced and, as a result, many of these companies are rapidly improving their environmental and labour practices.[17]

47. Domestic regulation is likely to increase as a driver for improved performance in the future. China, for example, has introduced new laws on water pollution which are directed at company executives[18] and new labour laws which give additional protections to workers.[19] China's State Environmental Protection Association (SEPA) is also tightening the rules on the listing of companies involved in high-polluting industries on the Shanghai share index. The new rules will see SEPA working with the China Securities Regulatory Commission to decide if a company with a poor environmental record should be allowed to list on the exchange.[20]

48. Failure to apply corporate responsibility practices poses tangible risks and missed opportunities for emerging markets in terms of attracting investment. This study shows that some of the top companies in emerging markets risk failing to meet the ESG tests of international investors. On the other hand, those emerging market companies that devote resources to ESG activities may well gain potential financial benefits from being seen as leaders among their peers. Applying ESG analysis to emerging market investments provides analysts with a new set of challenges regarding debate over complex ESG issues in rapidly evolving developing countries and economies in transition. But it can also provide investors with greater opportunities for engagement and improvement of ESG performance within companies. For emerging market enterprises, improvements in ESG performance can enhance the ability to attract investment.

49. One way to improve ESG practices in emerging markets involves investors engaging with companies in a constructive way. This entails transparent, regular contact with companies and regular follow-up on their ESG actions. Such an engagement approach should lead companies towards more sustainable practices, and will also favour the development of additional financial and ESG research. Investors may want to consider being more vocal in requiring minimum ESG disclosure standards from emerging market legislators and exchanges. Actions such as the United Nations Global Compact's, which removed 394 of its over 4,000 corporate participates from its online database in January 2008 show that serious initiatives are underway to convince companies of the merits of corporate responsibility. Most of the

[17] The development of CSR in Asia, 1 September 2008. http://www.asria.org/news/press/1220240367.
[18] Tougher law to curb water pollution. 1 March 2008. http://www.syntao.com/E_Page_Show.asp?Page_ID=6858.
[19] Fair Labor Association. 15 January 2008. http://flaglobalaction.blogspot.com/2008/01/assessing-impact-of-new-china-labor.html.
[20] China to smoke out worst polluters. 23 August 2007.
http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/08/23/cnchina123.xml.

de-listed companies were based in emerging markets, and were removed for failing to report on corporate responsibility issues.[21]

50. As corporate responsibility seems to work best when instigated domestically, as in the cases of South Africa and Brazil, emerging market regulators, policymakers and stock exchanges can also work to reduce some of the ESG risks that serve as barriers to certain investors in their countries. Emerging market Governments can put their own stamp on the issue, and affect the levels of corporate take-up when they have specific issues they want to promote (such as black economic empowerment in South Africa) or when they see corporate responsibility as a source of comparative competitive advantage. This can be accomplished by setting up initiatives to further increase understanding among domestic companies about corporate responsibility and responsible investment and encourage sustainability reporting, using guidelines such as those developed by ISAR or the Global Reporting Initiative.

[21] Press Release 28 January 2008. http://www.unglobalcompact.org/newsandevents/news_archives/2008_01_28.html.

Annex I. List of companies in the study

Company	Industry	Country
PETROBRAS	Resources	Brazil
VALE DO RIO DOCE	Resources	Brazil
BANCO BRADESCO	Financials	Brazil
BANCO ITAU HLDG FIN.	Financials	Brazil
CHINA MOBILE	Technology	China
ICBC	Financials	China
CHINA LIFE INSURANCE	Financials	China
PETROCHINA CO	Resources	China
RELIANCE INDUSTRIES	Resources	India
ICICI BANK	Financials	India
INFOSYS TECHNOLOGIES	Technology	India
HOUSING DEV FINANCE CORP	Financials	India
BUMI RESOURCES	Resources	Indonesia
TELEKOMUNIKASI INDONESIA	Technology	Indonesia
ASTRA INTERNATIONAL	Consumer	Indonesia
BANK CENTRAL ASIA	Financials	Indonesia
TEVA PHARMACEUTICAL	Healthcare	Israel
ISRAEL CHEMICALS	Resources	Israel
BANK HAPOALIM	Financials	Israel
BANK LEUMI	Financials	Israel
SAMSUNG ELECTRONICS	Technology	Republic of Korea
POSCO	Resources	Republic of Korea
KOOKMIN BANK	Financials	Republic of Korea
SHINHAN FINANCIAL GROUP	Financials	Republic of Korea
BUMIPUTRA COMMERCE HOLDINGS	Financials	Malaysia
IOI CORP	Consumer	Malaysia
SIME DARBY	Industrial	Malaysia
MALAYAN BANKING	Financial	Malaysia
AMERICA MOVIL	Technology	Mexico
CEMEX	Industrial	Mexico
TELEFONOS DE MEXICO	Technology	Mexico
WALMART DE MEXICO	Consumer	Mexico
GAZPROM	Resources	Russian Federation
LUKOIL HOLDING	Resources	Russian Federation
SBERBANK	Financials	Russian Federation
NORILSK NICKEL	Resources	Russian Federation
SASOL	Resources	South Africa
MTN GROUP	Technology	South Africa
IMPALA PLATINUM	Resources	South Africa
STANDARD BANK GROUP	Financials	South Africa

Annex II. Sector summary

The following table summarizes the sectors which made up the industrial groupings. These are based on the ICB classifications but only those sectors which had analysed companies were included in the industry groupings.

Industry	**Sectors**
Consumer	Automobiles and parts, food producers, food and drug retailers
Financials	Banks, life insurance, general financial
Health	Pharmaceuticals and biotechnology
Industrial	General industrials, construction and materials
Resources	Oil and gas producers, industrial metals, chemicals
Technology	Mobile telecommunications, software and computer services, fixed-line telecommunications