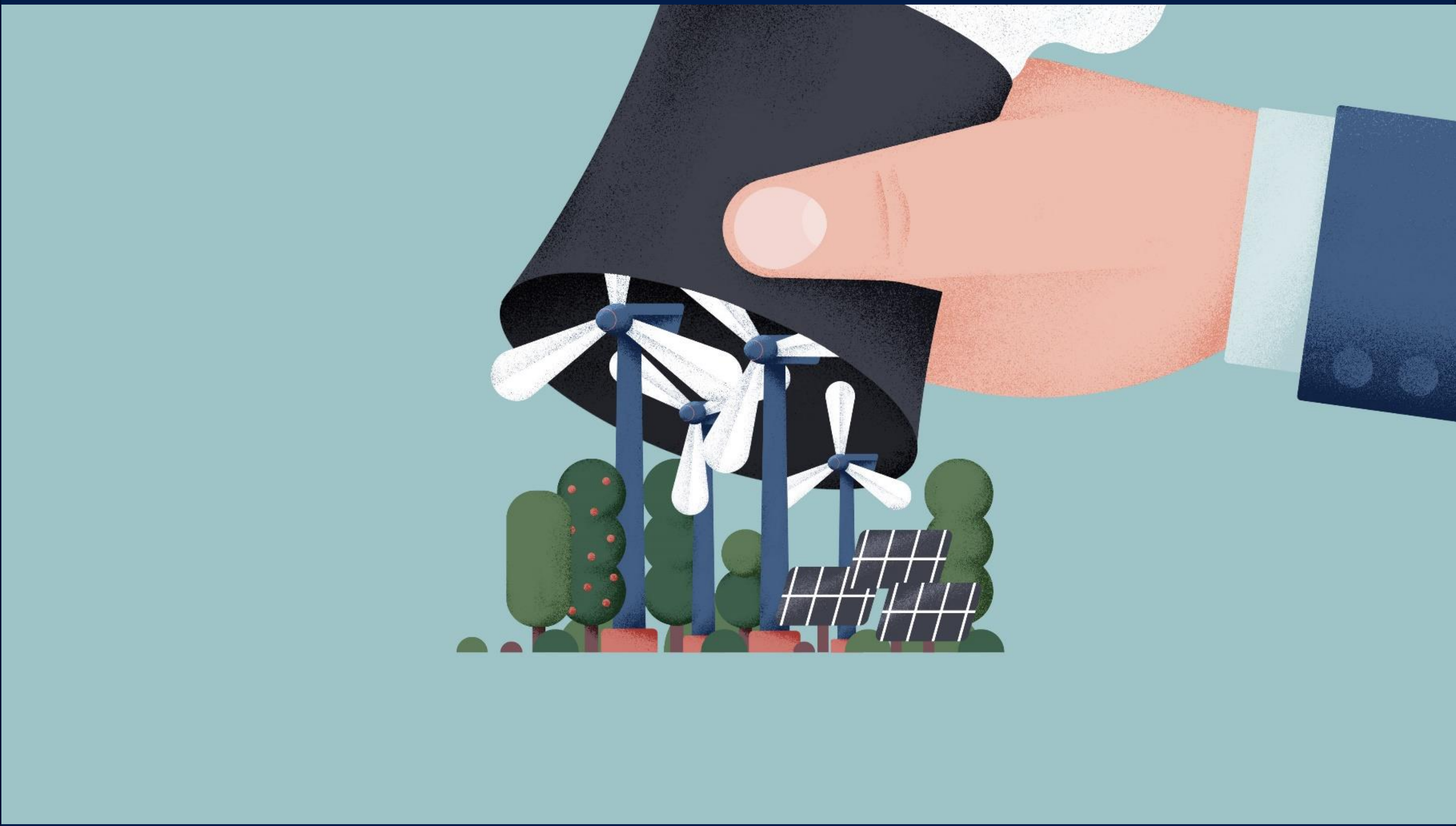
ThinkSpace



Supporting the Sustainability Transition in the Emerging Markets

23 AUG 2021

Boon Chin Hau
Managing Director
Head of Infrastructure (Asia, Latin America & Credit), GIC

GIC Managing Director and Head of Infrastructure (Asia, Latin America and Credit) Boon Chin Hau recently participated in an investor-focused roundtable on the topic of "Supporting the Sustainability Transition in the Emerging Markets" at the Asia Infrastructure Forum 2021.

This article is adapted from his opening remarks at the roundtable, and discusses the long-term fundamentals of the emerging markets and GIC's approach to sustainable infrastructure investing.

Sustainability has gained significant attention and traction in recent years, with the ongoing pandemic bringing to fore its impact on global markets. At the same time, global growth continues to shift towards the emerging markets, where there is rapid population growth, urbanisation and industrialisation, all of which point towards a greater demand for infrastructure investment. Given infrastructure's long-term and essential nature, it displays tremendous potential for supporting the sustainability agenda. As a global long-term investor, GIC is in a unique position to support this sustainability transition in the emerging markets.

Long-term fundamentals of emerging markets

The emerging markets have been a focus for GIC, given their positive long-term fundamentals[1]. One key avenue to access this structural theme is through infrastructure investment, which is projected to continue growing strongly over the next 10 to 20 years. According to the Swiss Re Institute[2], up to USD 66 trillion in infrastructure spending is expected between 2021 and 2040, of which some USD 43 trillion will come from the emerging markets. Of the USD 43 trillion, around 80%, or USD 35 trillion, is expected to be driven by emerging Asia, including China.

Sustainable developments, particularly in energy, is expected to be a major driver of this growth in infrastructure investment, especially as governments have become increasingly cognisant of the impact of climate change, and have undertaken commitments to meet ambitious carbon reduction targets. Already between 2015 and 2019, investment in renewable energy has risen sharply in the emerging markets and outpaced that of developed markets[3]. While more still needs to be done, the pandemic has since led to governments prioritising spending for other economic and social needs. Private long-term investors can help meet this infrastructure

[1] Please refer to the feature article on Asia's Growing Importance in the Global Economy and Financial Markets in GIC's FY2018/19 Annual Report.
[2] Swiss Re SIGMA Report 2020 - Power up: investing in infrastructure to drive sustainable growth in emerging markets
[3] https://reglobal.co/global-trends-in-renewable-energy-investment-2020/

investment need, whilst driving the sustainability agenda, given their positive impacts in the emerging markets.

Even as we actively support the energy transition in the emerging markets, we are conscious of the different starting points and needs compared to the developed markets. In the emerging markets, the key challenge is building new sustainable infrastructure, as opposed to replacing older, “less-sustainable” infrastructure of past generations. Beyond those differences, there is a wide range of risk and return related issues that come into play in these markets: affordability, political stability, regulatory policies, and the appropriate type of capital funding. For GIC, our long track record and experience in the emerging markets have allowed us to better assess these considerations and tailor our investment and partnership approach.

GIC’s long-term and holistic approach to sustainable investing, including infrastructure in the Emerging Markets

As Singapore's sovereign wealth fund, GIC’s mandate is to preserve and enhance the global purchasing power of the funds placed under our care over the long term. Naturally, sustainability is core to our mandate and investment approach, as we believe that companies with strong sustainability practices will offer prospects of better risk-adjusted returns over the long term. In particular, climate change is a key concern for us, given the impact of physical, transition and market risks on the value of physical assets and companies over the long run. Beyond the environmental aspects, we actively bear in mind governance and social objectives, which in some emerging markets are more pronounced.

As such, we need to ensure that our portfolio can weather a range of market and economic conditions by taking sustainability risks into account at every stage of the investment process. We must also tap on the many new investment opportunities that will emerge in the sustainability space, as regulators and consumers act on sustainability issues, businesses rethink operating models and new technologies emerge. For example, GIC launched the Sustainable Investment Fund (SIF) in July 2020 as a dedicated investment portfolio to identify and invest in attractive sustainability-related opportunities across both the public and private markets.

Another key feature of our long-term investment approach is to add meaningful value to our investee companies, such as by providing patient capital, helping to shape their strategy, elevate their governance standards, and connect them to our global networks. **In many ways, it is this "long game" that makes a global long-term investor like GIC well-suited to investing in sustainability, including in the emerging markets and infrastructure**.

Within GIC, decarbonisation has been a significant theme for the Infrastructure group. Energy makes up nearly 75% of global emissions[4], and within the energy sector, the largest emitting sector is electricity and heat generation, followed by transportation and manufacturing. Hence from energy consumption to transportation networks, sustainable infrastructure has a key role in reducing global emissions.

Ultimately, the speed at which the world can achieve decarbonisation depends on the efforts of many stakeholders, from governments to individual companies to investors like ourselves, as well as other developments and considerations, such as the pace of technological progress, time needed for transition plans to come to fruition, and reduction of carbon emissions from key industrial production processes. How GIC can meaningfully support this journey is by being invested in the transition effort, including in the emerging markets where there are arguably stronger impacts given their significant share of global emissions[5] and higher vulnerabilities[6] to climate risks (eg. rising sea levels, drought and slumps in agricultural output).

"
… In many ways, it is this "long game" that makes a global long-term investor like GIC well-suited to investing in sustainability, including in the emerging markets and infrastructure.

One example is our investment in Greenko in India, which we remain invested in since 2015. Today, it is one of India's largest pure-play renewable energy companies, with a net

[4] Source: Climate Watch Data (Historical GHG Emissions)
[5] EM Asia alone accounts for about 40% of total global carbon emissions. Source: Climate Watch Data
[6] Sources: Climate Change and Emerging Markets after COVID-19 by Pictet Asset Management and the University of Oxford Smith School of Enterprise and the Environment; The Economics of Climate Change: Impacts for Asia by Swiss RE (May 2021)

installed capacity of 7.2 GWdc across 15 states. Through a mix of hydro-, solar- and wind-power, it provides a sustainable source of power to meet India's growing demand, and helping to reduce carbon emissions.

We also approach sustainability in a holistic and long-term manner. After all, we work with different stakeholders across different countries, sectors, industries, companies – each with different starting point and with its own idiosyncratic situations and considerations. **Hence, we believe it is much more constructive to engage companies, understand their business practices, and support them in their transition towards a low-carbon world, rather than to mechanically divest from specific industry sectors.** We do this in a way that recognises the dynamics of "brown to green" transitions across the industries and markets that we operate in, and not in a "one-size-fits-all" way.

An illustration of this would be the palm oil and other agriculture-related industries that could create pollution, whilst some companies have improved on their production methods and supply certified "sustainable palm oil". As a long-term investor, we believe that we should encourage such transitions towards more sustainable practices, as doing so would contribute to the collective global effort of transitioning to a lower-carbon world.

For example, we recently invested in AC Energy in the Philippines, where our investment will help them transition from fossil-based to clean, sustainable energy. AC Energy is owned by the Ayala Group, the largest and oldest conglomerate in the Philippines, and seeks to build one of Southeast Asia's leading renewables platform.

We collaborate with fellow asset owners in organizations and initiatives such as the Asian Investor Group on Climate Change (AIGCC), CDP, Climate Action 100+, and TCFD on the topic and pace of energy transition. For example, GIC, together with 12 members of the AIGCC, are participating in the Asian Utilities Engagement Program, a new investor-led initiative to engage with utility companies in Asia. This is an important effort as Asian utilities are responsible for 23% of the world's total carbon emissions.

In our pursuit of sustainability or ESG (Environmental, Societal, and Governance) goals, we should also try to avoid unintended consequences. For instance, while fossil fuel companies may face “stranded asset” risks, there are other factors to consider, including market demand, their use of technology and plans to transition towards cleaner outcomes, as well as the community’s need to access affordable energy sources in the short term. This is especially evident in the emerging markets where energy from fossil fuels remains necessary for economic growth and the livelihoods and life prospects for affected communities. Hence, while it is important that we look at the “Environmental” aspect, we should also consider the “Social” aspect of ESG in addition to the longer-term sustainability direction of the company.

Lastly, as GIC seeks to steer our investees globally towards a transition pathway, this would require us to have a strong understanding of each company and their sustainability risks, before taking the appropriate investment action. This in turn involves engaging in dialogue with company management to convey our views, and to ensure the company is acting to mitigate those risks and has strong governance, or voting on sustainability related issues as a shareholder or Board member. Even for cases where they may be some conflict between sustainability objectives in the short term, our interests must converge over the long term. In the most serious cases where blatant negligence towards sustainability risks has led to negative implications for the company or its stakeholders, we have passed on the investment or divested our positions.

Conclusion

Infrastructure demand in the emerging markets will continue to grow rapidly given their positive underlying fundamentals, and so will the need to incorporate sustainability in these assets in order to meet critical global carbon emission targets. Private long-term capital can play a key role in plugging this infrastructure investment gap, while governments can do their part by improving governance standards and providing quality infrastructure projects that are sustainable and commercially attractive to institutional investors.

GIC has a well-established track record and on the ground experience in many emerging markets[7], across both the public and private markets. This has allowed us to better understand the macro and micro market conditions, and hence tailor our investment and partnership approach accordingly. Supporting the transition towards a lower carbon world, through our infrastructure investments and working alongside our investee companies and partners to achieve their sustainability goals, will remain a key feature of our broader approach to sustainability investing. Ultimately, we believe this will not only drive resilient returns for GIC's portfolio over the long run, but also positive social, economic and environmental outcomes in the communities that we invest in.

[7] GIC has 10 offices around the world, including Beijing, Shanghai, Mumbai and Sao Paolo.

GIC

@gicsg

@gic

www.gic.com.sg

ThinkSpace

We explore topics of long-term importance that shape our perspectives.

Get our latest insights in your inbox monthly. To subscribe, visit www.gic.com.sg/thinkspace