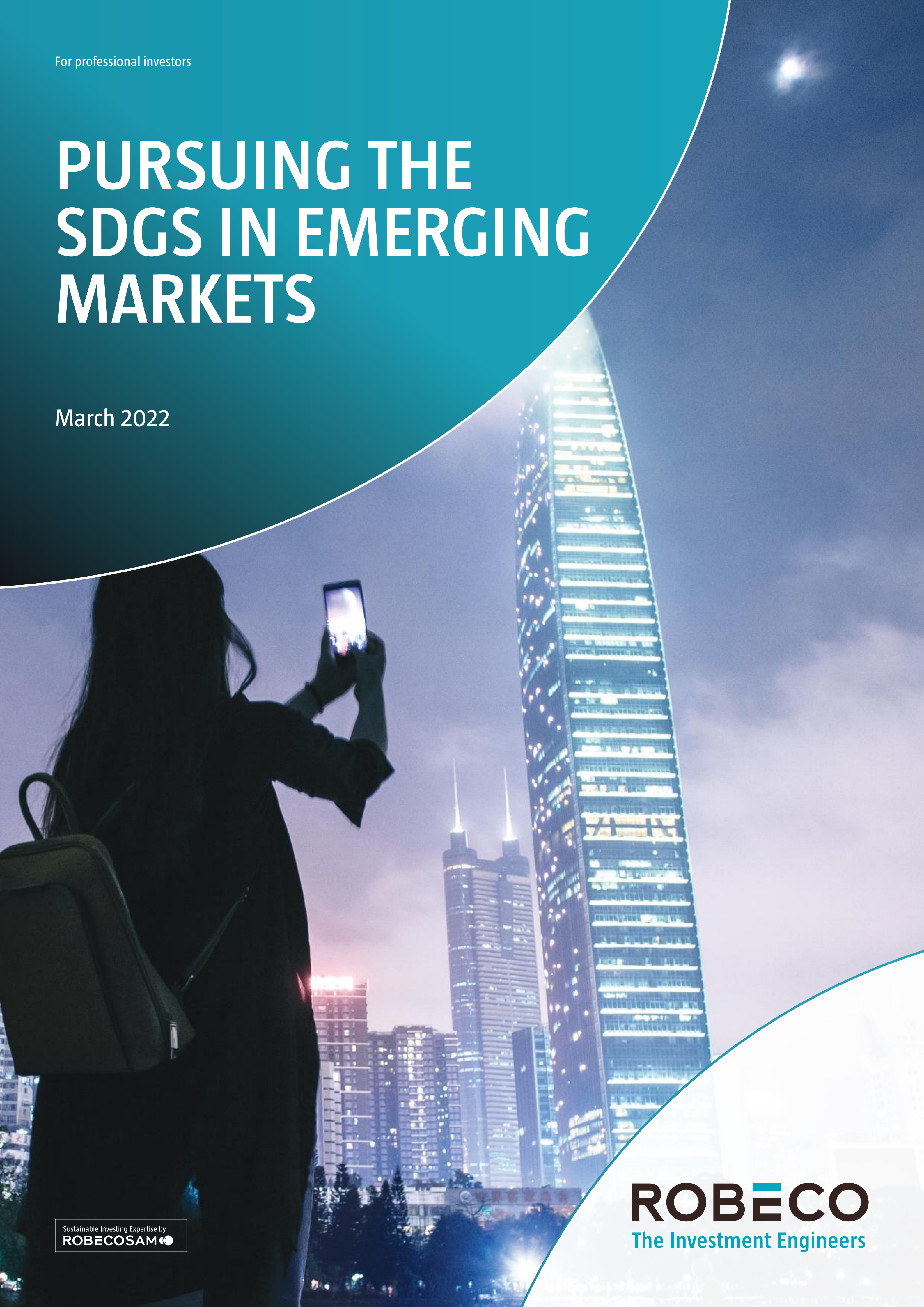
For professional investors

PURSUING THE SDGS IN EMERGING MARKETS

March 2022



Sustainable Investing Expertise by ROBECOSAM

ROBECO
The Investment Engineers

The deadline for the UN Sustainable Development Goals (SDGs) to be met – 2030 – is fast approaching, but the progress towards reaching them that's been made so far has been much too slow. Overall, progress has been particularly slow in emerging markets.

There's still time to achieve the goals, though, and we believe that investors have a big role to play by channelling finance to companies providing products, services and technologies in support of the SDGs. Robeco provides a number of impact-aligned investing strategies that invest in companies that are contributing to the goals' achievement.

In this article, we set out the need to step up SDG financing in emerging markets. Such markets have a particularly long road to travel if they are to attain the goals, while also facing a significant hurdle in accessing the finance needed to accelerate progress. We explain how Robeco assesses which companies are making a positive impact towards the goals and should therefore be prioritized in sustainable investing strategies, and we discuss some of the opportunities available to such firms in selected sectors.

Speed read

- Emerging markets are, overall, further away from meeting the SDGs than developed markets
- Companies helping emerging markets make progress towards the SDGs could represent attractive investment opportunities
- Robeco's SDG Framework helps us identify which companies are contributing to the SDGs and which are working against them

Emerging markets have a long way to go if they're to meet the SDGs

In 2015, all the member states of the United Nations adopted the 17 Sustainable Development Goals – a collection of interlinked global goals designed to represent a "blueprint to achieve a better and more sustainable future for all". They seek to promote sustainable economic growth, advance social inclusion and safeguard the natural environment.

The goals apply to every country in the world, regardless of their income level. This is an important point: while development was traditionally viewed as a challenge only for poor countries, the SDGs acknowledge that even the world's richest countries face issues such as environmental degradation, inequality and pollution. Sustainable development requires all countries, no matter how rich they are, to work together to safeguard the health of our planet and everyone who lives on it.

Since the adoption of the SDGs there has been some progress towards meeting some of them. For instance, women are now slightly better represented in parliaments (SDG 5), the proportion of renewables in the energy mix is slowly increasing (SDG 7) and marine areas are starting to be better protected around the world (SDG 14).[1]

But overall progress has been far too slow, and we are still facing immense challenges: average global temperatures continue to rise, biodiversity is eroding at an alarming rate and the pandemic has cost millions of lives and disrupted societies and economies. It has also exacerbated inequalities and halted or even reversed some of the progress that had been made towards many of the SDGs.[2]

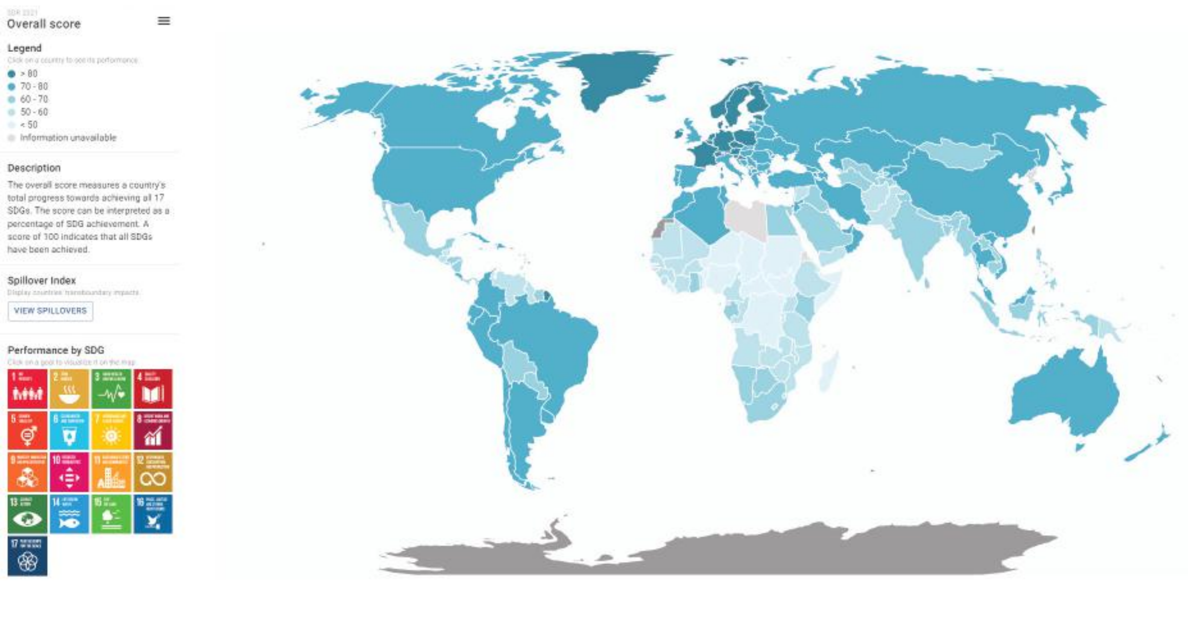
[1] United Nations (2021). The Sustainable Development Goals Report 2021. Retrieved from: https://unstats.un.org/sdgs/report/2021/
[2] Idem

Emerging markets are bearing the brunt of these challenges. Every year, the Sustainable Development Solutions Network, a body that promotes approaches to implement the SDGs and the Paris Climate Agreement; and the Bertelsmann Stiftung, a foundation working to promote a future-oriented society, collect data on countries' progress towards the SDGs to create their SDG Index.

Their assessment[3] shows that emerging markets are making progress on some of these goals. For instance, many sub-Saharan African and South Asian countries are on track to attain SDG 13 (Climate Action) due to their low greenhouse gas emissions. Yet they face major challenges on socio-economic goals, such as ending hunger (SDG 2) and ensuring people have access to safe water and sanitation (SDG 6). More advanced economies, on the other hand, tend to fare better on goals that aim to improve people's wellbeing, but they are being faced with major challenges themselves, particularly those related to safeguarding the natural environment and promoting sustainable agriculture (SDGs 2, 13, 14 and 15).

As well as assessing countries' progress towards individual SDGs, the SDG Index aggregates individual scores into a total score for each country, ranging from 0% (no SDG achieved) to 100% (all SDGs achieved). We show a snapshot of their 2021 assessment in the figure below, in which the countries colored dark blue are closest to achieving the SDGs and those in light blue are furthest away. As shown in the figure, Western European countries are closest to reaching the goals. Nations in sub-Saharan Africa, followed by many in South and South-East Asia, have the most work to do. Overall, it's clear that emerging markets are furthest away from meeting the SDGs.

Progress towards the SDGs around the world



Source: SDSN and Bertelsmann Stiftung (2021).[4]

If the SDGs are to be reached by 2030 – their due date – progress needs to speed up everywhere, but especially in emerging markets. Promoting the SDGs around the world is in everyone's interests – a great example of which is the ongoing pandemic. While vaccination rates are generally high in rich countries, developing nations still face significant problems in obtaining enough vaccines to protect their populations. If people remain unvaccinated the risk of new variants emerging increases, affecting everyone around the world.

[3] https://dashboards.sdgindex.org/map/goals/sdg13
[4] SDSN & Bertelsmann Stiftung (2021). Sustainable Development Report 2021. Retrieved online from: https://www.sdgindex.org/

Inclusion in financial markets is key to achieving the SDGs

Emerging markets face a range of hurdles on the road towards attaining the SDGs. One of the most significant is gaining sufficient access to financing.

Getting the financial sector involved is critical if the SDGs are to be a success. And it's becoming more important than ever: a number of assessments, including by the IMF, reveal that the world is not investing enough in the SDGs. According to the IMF's estimates, additional spending of USD 2.6 trillion a year is required up to 2030, an amount that is equivalent to 2.5% of the world's estimated GDP in 2030.[5]

Spending requirements for the SDGs differ by country, with the IMF differentiating between emerging market economies and lower-income developing nations. In the former group, countries such as Guatemala and Indonesia need to spend 4% of their GDP in 2030 per year more than they are at present if they are to attain these goals. The latter group, which includes countries such as Vietnam, Rwanda and Benin, faces much higher additional spending needs, estimated to be 15.4% of their 2030 GDP per year more than is currently being spent on average.

These figures stand in stark contrast to the additional spending requirements of more advanced nations. According to the IMF, high-income countries need to invest more in some areas linked to the SDGs, like electricity, roads and water & sanitation, but the additional investments needed are estimated to be below 1% of 2030 GDP per year. Meanwhile, the IMF believes these countries do not need to make extra investments in education and healthcare, but rather ensure that educational and health outcomes are improved. Overall, emerging markets need much more additional investment than developed countries if they are to meet the SDGs.[4'6]

Not only is more financing required for activities that help countries meet the SDGs, there's also a pressing need to cut financing of activities that are in conflict with the SDGs' aims. An example is financing of energy generated by fossil fuels. Although financing fossil fuels may enhance countries' ability to provide their people with access to energy and support industrialization, it conflicts with the need to take climate action (SDG 13) and limit global warming to 2ºC above pre-industrial levels, a goal that several emerging markets are currently doing well on.

The challenge is to find ways of providing more financing to countries that are a long way off reaching the SDGs, while directing this towards activities that are in support of the goals and do not conflict with them. This requires a deep understanding of the impacts of companies' activities on progress towards the SDGs.

Identifying companies' impacts on progress towards the SDGs

Allocating to companies that contribute to the SDGs and operate in emerging markets is one way for investors to help these countries achieve the goals. But how can investors identify such firms? And, which of the SDGs are ideally suited for companies to support?

To answer these questions, at Robeco we developed our SDG Framework in 2017. It is based on a three-step process to define to what extent a company makes a positive or negative contribution towards the goals. The three steps are as follows.

1. **Products**: in the first step, we identify to what extent a company's products or services make positive or negative contributions to particular SDGs. In doing so we follow a rules-based approach, including around 200 key performance indicators (KPIs) that assess the impacts of products and services linked to particular sub-sectors to identify which SDGs (and which sub-targets of these overall goals) a company has an impact on. Thresholds related to each KPI specify to what extent that impact is positive or negative.

[5] Gaspar, V., Amaglobeli, M. D., Garcia-Escribano, M. M., Prady, D., & Soto, M. (2019). Fiscal policy and development: Human, social, and physical investments for the SDGs. Washington D.C.: International Monetary Fund.

[6] OECD (2020). Global Outlook on Financing for Sustainable Development. Retrieved online from: https://www.oecd.org/newsroom/covid-19-crisis-threatens-sustainable-development-goals-financing.htm#:~:text=The%20projected%20USD%201.7%20trillion,the%2017%20SDGs%20by%202030.&text=Just%20 20%25%20of%20financial%20assets,people%20on%20the%20planet%20live.

2. Procedure: in the second step we assess whether the company's business conduct contributes positively or negatively towards the SDGs. Relevant factors that we assess include the company's gender equality performance, its environmental track record and its corporate governance. In this step our analysts have the opportunity to incorporate their individual perspectives about companies' impacts in our overall assessment.

3. Controversies: in the final step we investigate whether the company has been involved in any controversies, such as cases of corruption or fraud or environmental accidents. If there have been such controversies, we assess whether the company has taken action to remedy the adverse impact that has occurred and prevent similar occurrences in the future.

Following this three-step assessment, we score companies on their impacts on each of the SDGs. These scores are on a seven-point scale ranging from -3 (signifying that they have a large negative impact on a goal) to +3 for the firms making the biggest positive contributions. A score of 0 signifies a firm has a neutral effect. Once we have scored a company's impacts on the 17 SDGs, we go on to calculate its overall SDG score. We do this according to what we call our 'min-max' rule: a company without any negative scores for any individual SDG is assigned the highest (max) score as its overall SDG score. But if a company has a negative score for any of the SDGs, it will receive the lowest (min) score as its overall SDG score.

For example, a bank may be assigned a +2 score for SDGs 8 and 9 for providing loans to small-to-medium-sized enterprises if it has neutral scores for the other goals. In this case, it would receive an overall SDG score of +2. But should the bank become involved in a case of corruption, for which it could, for instance, receive a score of -1 for SDG 16, then its overall SDG score would become -1. In this way, we are recognizing that the SDGs are integrated and should be promoted simultaneously, and that a negative impact on one SDG cannot be mitigated by positive impact on another goal.

In our SDG Framework we also pay attention to the national context in which impacts are being created. Some of the KPIs are specific to emerging markets. For instance, a relevant KPI for banks is their percentage of loans outstanding in emerging markets. This KPI helps identify positive impacts related to SDG 1 (No Poverty), since SDG target 1.4 aims to ensure that everyone has access to finance. In our framework, if over 33% of a bank's loans go to emerging markets its SDG score for this goal would be +2, and if more than 66% are to emerging markets it would be +3. This way, we want to prioritize positive impact in those countries that need it the most.

Our SDG Framework helps us to integrate a consideration of the SDGs into our investment strategies. Once we have calculated an overall SDG score for the issuers in the investment universe, we can include the best companies in our investment universe while avoiding investing in firms making a negative impact.

Figure 1 | Robeco's SDG Framework – a three-step process

Step 1 **Products**	**Step 2** **Procedure**	**Step 3** **Controversies**
What do companies produce?	How do companies produce?	Are controversies known?
Positive contribution examples: Medicine, water, healthcare Negative contribution examples: Shale gas, fast food, gambling	Governance factors Pattern of questionable conduct? Differentiate between firms with highest SDG impact	Examples of controversies: Spills, Bribery and fraud, Mis-selling

Source: Robeco

Advancing the SDGs through asset allocation and active ownership

When we know how the companies in our universe contribute to the SDGs, we have two approaches at our disposal for promoting the SDGs through our investment strategies.

The first is deciding which firms to invest in. We can use our SDG scores to screen the universe and allocate more to companies making a positive contribution to the SDGs and avoid financing those having an adverse effect on progress towards the goals. In this way, we are signaling that we support the firms making a positive impact by providing them with capital. In emerging markets, which are less liquid overall than developed markets, providing sustainable companies with strong support in the secondary market may help them gain improved access to financing.

The second approach is active ownership. By voting at annual meetings, we can encourage companies to pursue sustainability objectives as part of their strategies. And by engaging with these firms, we can use our influence and provide them with support to increase their positive impacts. Engaging with firms in emerging markets is particularly powerful from a sustainability perspective, as EM companies often welcome collaborations with investors on the topic and react with changes or enhancements in strategy many times faster than global companies in developed markets. Our aim is to form a win-win partnership in which we as investors share our knowledge of best practices and new insights with a company's management team, thereby boosting the firm's sustainability (and financial) performance.

SDG-aligned investing in emerging markets

Which of the 17 SDGs do companies in emerging markets contribute to most frequently and thus provide the most investment opportunities? To answer this question, we analyzed the impact on progress towards the SDGs of the companies in the MSCI Emerging Markets Index using Robeco's SDG Framework. We found that 26% of firms have a negative impact on the SDGs, 22% do not make a significant contribution either way, and around 52% of companies contribute positively to the goals. When taking into account company size, we find that 26% of the index by weight has a negative impact, 13% has a neutral impact and 61% has a positive impact.

The chart below shows the proportions of companies in the MSCI Emerging Markets Index making positive (blue) and negative (purple) contributions to individual SDGs. For example, 35% of the companies in the benchmark contribute positively to SDG 9 – Industry, Innovation and Infrastructure. Conversely, 12% of companies have a significant negative impact on SDG 13 – Climate Action, while 2% make positive contributions towards this goal. Some SDGs are not very investable: no companies support (or significantly harm) SDG 10 on Reduced Inequalities, which aims to reduce socioeconomic inequalities at a macroeconomic level that companies have little direct influence over. Likewise, few companies help advance (or detract from) SDGs related to education (SDG 4) or gender equality (SDG 5). And while we do see some firms with a significant negative (-3) score for Life on Land (SDG 15), for instance due to their influence on deforestation, relatively few companies provide solutions that help preserve nature (SDGs 14, 15).

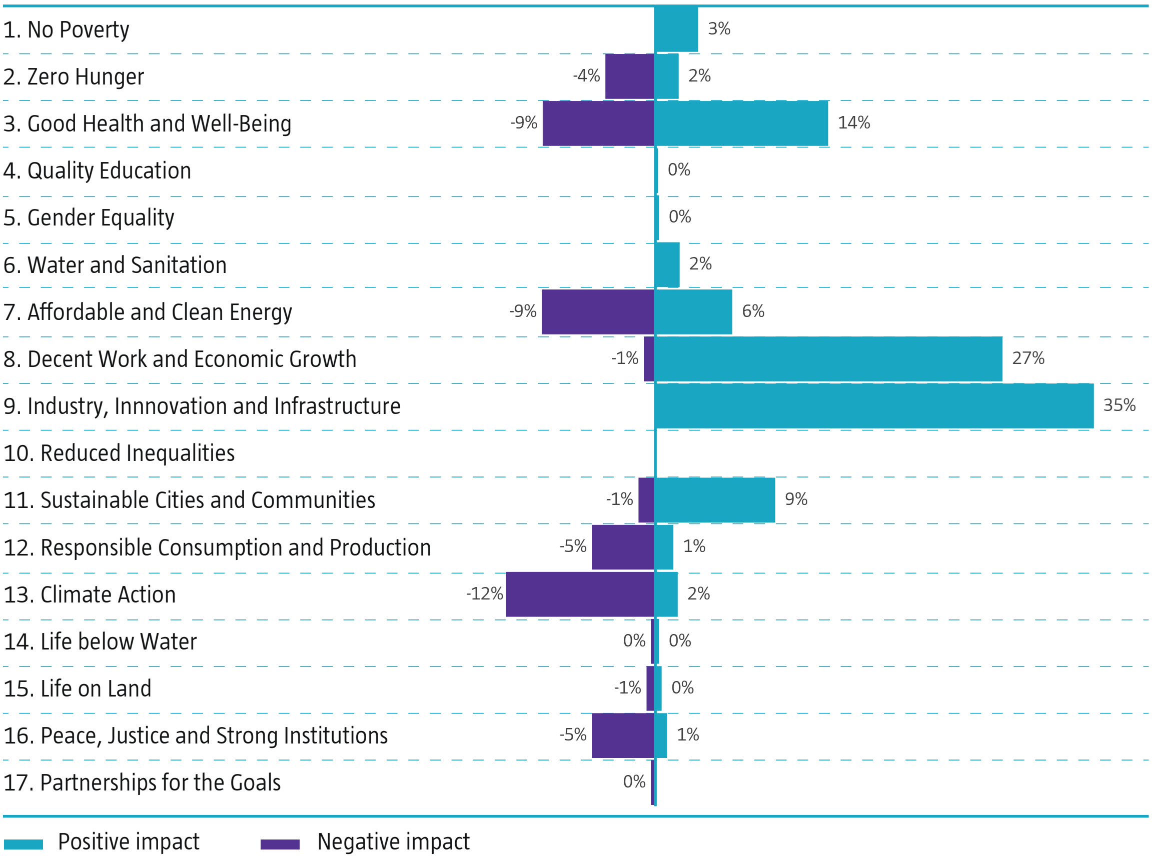
As we can see, the most positive impacts are being made in SDGs linked to economic objectives (SDGs 8 and 9), health (SDG 3) and other basic needs (SDGs 2, 6, 7, 11), and the eradication of poverty (SDG 1). The most negative impacts are to be found in SDGs linked to clean energy and climate (SDGs 7, 13), pollution, waste, and overconsumption (SDG 12), people's health (SDGs 2, 3), justice (SDG 16) and tax evasion (SDG 17).

Comparing SDG scores to ESG ratings in emerging markets

These SDG scores for companies in emerging markets are relatively similar to those we have calculated for companies in developed countries. This is in marked contrast to traditional ESG ratings, which often show that emerging market companies perform worse with respect to sustainability issues than firms from richer countries.

The explanation for emerging market companies' worse ESG scores is that ESG focuses on sustainability risk rather than sustainability performance. In short, ESG assesses whether a company's financial performance may be adversely affected by environmental, social and governance challenges. ESG issues that are priced into valuations may not lead to low scores, while

MSCI Emerging Markets Index – Exposure to individual SDGs (n=1,418)



poor performance in some areas may be offset by good performance in others. For instance, alcohol and tobacco companies are often seen to have excellent ESG ratings.[7] In contrast, their SDG score will be negative, recognizing the adverse impacts of their core business to people's wellbeing. Rather than focusing on sustainability risks, the RobecoSAM SDG score assesses companies' sustainability performance. If a company contributes to the SDGs it will get a positive score, while a firm that causes adverse impacts will get a negative score, regardless of any risks to its financial performance

Emerging markets tend to have relatively weak institutions and less developed regulation, which can translate into higher environmental, social, or governance risks. These risks may affect companies' future performance potential. A poor ESG rating can be an outcome of these factors for companies operating in emerging markets. But there is no clear rationale why companies from less developed countries would have more frequent and more severe negative impacts than companies from richer countries, as ESG ratings tend to suggest. For example, some of the world's largest fossil fuel, alcohol and tobacco companies are from the most advanced countries. Indeed, our assessment shows that companies in emerging markets overall do not have significantly worse SDG scores than firms from developed economies. We therefore believe that the SDG score provides a useful tool for sustainable investing, in emerging as well as developed markets.

Investment opportunities: two case studies

There are several sectors in which companies from emerging markets can make a meaningful positive impact on progress towards the SDGs and that also have a promising growth outlook. In some cases, they are underrepresented in the MSCI Emerging Markets Index.

[7] See e.g., https://www.robeco.com/en/insights/2022/02/do-esg-ratings-align-with-the-values-of-large-institutional-asset-owners.html?cmp=so_3_3975&cmp=so_3_6288

Let's take a look at the education and sanitation sectors as examples, in which there are good investment opportunities to be found that have in many cases been overlooked by the market. But it's important to remember that there are companies in emerging markets contributing to all of the SDGs – not least:

- Access to finance for everyone
- Improved access to healthcare solutions
- Nutrition and better agricultural productivity, especially in low-emission food sources
- Renewable energy
- Sustainable land use

In this section we consider companies with a market capitalization of at least USD 850 million, just to establish a minimum size and liquidity assumption compatible with investments from a global equity fund.

Education

Even though access to education is improving around the world, around 258 million children and youths do not attend school.8 This is equivalent to around 14% of the global school-age population.

Most of these children live in low-income countries with relatively poor access to education because of political instability or population growth. In sub-Saharan Africa, for example, the primary-school-aged population more than doubled between 1990 and 2017. As a result, even though the rate of children not in school fell by over 50% over this period, the number of children not attending school was barely changed as investment in education was not enough to keep up with population growth.

Given that low-income countries often have poor infrastructure for online learning, the pandemic has further exacerbated the disparity between developed and emerging countries. Students in São Paulo in Brazil, for example, learnt only 28% of what they would have in face-to-face classes, and the risk of dropout increased more than threefold.[9]

As countries struggle to achieve universal primary and secondary education by 2030, global expenditure on education will need to almost triple to reach the USD 3 trillion of annual investments by 2030 deemed necessary to achieve SDG 4, which targets universal access to education. The lion's share of this required investment needs to be in low-income developing nations and emerging economies, where education spending needs are estimated to be 2.3% and 3.2% of GDP respectively.[10] Despite the need to increase public spending on education, there is still a sizable funding gap, which financial markets will need to fill. This represents a compelling opportunity for sustainable impact strategies.

Key figures

- Students could lose USD 17 trillion in lifetime earnings in present value as a result of school closures during the pandemic – the equivalent of 14% of today's global GDP.[11]
- Before the pandemic, the proportion of children in learning poverty was over 50%.This is now expected to rise to 70%.
- Adult literacy rates have been rising in emerging markets, hitting 93% of people aged 15 and above in 2015, according to Euromonitor. [12] The increased availability of digital content and internet access has played an important role in this trend.
- Despite significant progress in Asia-Pacific, most countries in the region are still not on track to achieve SDG 4 targets on education, according to a report released in 2021 by UNESCO,[13] revealing great disparities in access to quality education across the region.

Investable universe

There are over 30 companies listed in emerging markets that form part of Robeco's eligible universe and are involved in schooling, learning systems and education-related publishing and REITs linked to education services.

- These companies have a total of USD 57 billion in market capitalization
- Expected sales growth of 20% for the education sector in 2022 and 2023
- At least 85 million students being reached
- These companies only account for 0.10% of the MSCI EM Index
- These companies have a median RobecoSAM SDG score of +2, signaling they have a medium positive impact on the SDGs

8 UNESCO (2019). Institute for Statistics.
9 https://www.unicef.org/media/111621/file/%20The%20State%20of%20the%20Global%20Education%20Crisis.pdf%20.pdf
10 Gaspar, V., Amaglobeli, M. D., Garcia-Escribano, M. M., Prady, D., & Soto, M. (2019). Fiscal policy and development: Human, social, and physical investments for the SDGs. Washington D.C.: International Monetary Fund.
11 https://www.worldbank.org/en/topic/education/brief/learning-poverty#:~:text=To%20spotlight%20this%20crisis%2C%20we,simple%20text%20by%20age%2010.
12 https://www.euromonitor.com/article/rising-education-standards-in-emerging-market-economies-will-support-income-and-economic-growth
13 https://bangkok.unesco.org/content/persistent-education-disparities-underscore-new-urgency-achieve-sdg-4-asia-pacific

Sanitation

In 2010, the UN General Assembly recognized access to safe and clean drinking water and sanitation as a basic human right. However, only 45% of the global population has access to a safely managed sanitation service, according to the latest WHO report in 2021.[14]

Some 827,000 people in low- and middle-income countries die each year as a result of inadequate access to water or sanitation or poor hygiene, representing 60% of the total number of people dying from diarrhea-related disease. Diarrhea remains a major killer, but is largely preventable: better water quality, improved sanitation and good hygiene could prevent the deaths of 297,000 children under five every year.

Good hygiene is critical in preventing the spread of infectious disease and it makes children less likely to miss school, resulting in better learning outcomes. Good hygiene also reduces the need for spending on health care. A WHO study in 2012[15] calculated that every USD 1 invested in sanitation returned USD 5.50 due to reduced health costs, greater productivity and fewer premature deaths.

Many people in low-income countries live in conditions that make it difficult to maintain good hygiene and where water for washing hands is often widely unavailable. This means that manufacturers of household and personal care products, such as water filters, and local water and environmental services providers can play a critical role in helping people maintain good hygiene even if basic infrastructure is unavailable.

Massive investment is needed in emerging markets to provide clean water and waste collection to improve people's access to water and sanitation and their hygiene conditions. This requires public and private capital. Due to a lack of public funds and the high amount of investment needed, there are plenty of opportunities for private companies to get involved in these activities. Likewise, some of the products made by household and personal care companies can help alleviate sanitation problems.

Key figures

- Over 180 million people in crisis-torn countries have limited access to drinking water, according to UNICEF.[16]
- More than 80% of wastewater resulting from human activities is discharged into rivers or seas without being treated.[17]
- It is estimated that 36 million hectares (equivalent to the size of Germany) of cropland in peri-urban areas is irrigated by untreated urban wastewater.[18]
- Estimates suggest that 2.3 billion people do not have access to both water and soap at home to wash their hands.[19]

Investable universe

Water utilities, companies involved in environmental services and personal care and home appliance firms can have a major impact on improving sanitation. There are 96 listed companies in these areas in emerging markets that could represent attractive investment opportunities.

14 https://www.who.int/teams/environment-climate-change-and-health/water-sanitation-and-health/monitoring-and-evidence/water-supply-sanitation-and-hygiene-monitoring
15 https://www.who.int/water_sanitation_health/publications/2012/globalcosts.pdf
16 https://www.unicef.org/sites/default/files/press-releases/glo-media-Progress_on_Drinking_Water_Sanitation_and_Hygiene_2017.pdf
17 https://www.unep.org/explore-topics/water/what-we-do/monitoring-water-quality
18 https://www.who.int/publications/i/item/9789241514705
19 https://www.unicef.org/press-releases/fact-sheet-global-handwashing-day-unicef-warns-3-10-people-do-not-have-basic#:~:text=According%20to%20the%20latest%20estimates,without%20any%20facility%20at%20all.

- These 96 companies have a combined market capitalization of USD 342 billion
- Average expected sales growth of 15% for companies providing services and products related to hygiene and sanitation over 2022 and 2023
- Providing 409 million people with water and sewage services
- The companies only account for 1.03% of the MSCI Emerging Markets Index
- The median RobecoSAM SDG score of these companies is +2, signaling they have a medium positive impact on the SDGs

Summary

Impact investing[20] is a relatively new phenomenon in emerging markets but it has caught up rapidly in recent years. The Global Impact Investing Network (GIIN) estimates the size of the global impact investing market to be around USD 715 billion at the end of 2019 and 59% of its capital is allocated to emerging markets.[21]

There is still considerable scope for investors to make a positive impact in emerging markets, which, overall, are further away from attaining the SDGs than developed countries. But it's vital that investors are able to work out which firms are contributing towards the SDGs and which are working against them. Robeco's SDG Framework enables us to do just that. Armed with this information, we can then seek to invest in companies with attractive return potential as well as making a positive impact on the world around us.

20 Impact investing refers to investment strategies that actively allocate capital towards companies with positive impacts on the SDGs while avoiding financing firms with negative impacts. This can be understood as an 'impact-aligned' way of investing, in contrast to strategies that actively create real-world change themselves, for instance through active ownership ('impact-generating')

21 https://thegiin.org/assets/GIIN%20Annual%20Impact%20Investor%20Survey%202020.pdf