

ASrIA Annual Conference 2002

The Agenda for Long-term Investment

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IFC

- The International Finance Corporation (IFC) is the Private-sector arm of the World Bank Group
 - Mandate is to reduce poverty by promoting development of the private sector
 - Take commercial risk; never take a gov't guarantee
 - We take minority equity stakes in companies, and we provide long-term financing, as well as technical assistance to our clients.
- I am responsible for IFC's investments in the financial sector in East Asia, which includes China, Indonesia, Thailand, Vietnam and the Philippines.
 - We do not invest in some of the wealthier countries, such as Hong Kong and Singapore, nor do we invest in Taiwan.
- IFC has a portfolio of about \$5 billion in East Asia
- This year, close to \$800 million in the region; over \$300 million in China.
- Thus, I approach SRI as an investor, rather than a policymaker or an analyst.
 - Need to answer the tough question, Why is SRI important to my investment strategy? ...the same question that Pension Funds must ask.
 - I want to explain how I see the business case, but first I want to say something about the intuitive case for sustainable, responsible investment

The Intuitive Case for Sustainable, Responsible Investment

- All aware that there is tremendous pressure on natural resources around the world, but especially in Asia.
 - Extractive Industries—Oil, gas and mining
 - Air, water and land
- Some people refer to these resources as natural capital and consider them as important as human or financial capital.
- One of the goals of SRI is to utilize our natural capital efficiently, just as we pay close attention to how we use our financial capital.
- In Asia, natural capital is coming under increasing pressure from environmental degradation and urbanization.
 - 5 of the world's 7 most polluted cities are in Asia (Calcutta, Beijing, Jakarta, new Delhi, Sheyang)
 - Beijing's air is 35 times more contaminated than London's; 16 times worse than Tokyo's
 - In the past decade, the level of air pollution has tripled in Seoul and Bangkok, and doubled in Taipei, Jakarta and Kuala Lumpur

- World Bank estimates that economic growth in Asia utilizes seven times the amount of natural resources as the same level of growth in OECD countries.
- The statistics go on and on...
- What seems intuitive and clear to me, is that this is a trend that is NOT sustainable, AND
- Any long-term investment strategy that relies on it will not succeed.

SRI as an Investment Philosophy

- SRI is important.
- As Peter Montagnon said yesterday, our goal should be to take SRI out of the realm of public relations and help it to become a core investment criteria
- It is not something that will succeed only by legislation, although legislation may help at the beginning
- It is not something that will work if we rely solely on excluding various companies through different types of screens—this is too black and white.
- And we cannot and should not judge success by the size of SRI Funds under management, as all companies—to some extent—succeed or fail in addressing sustainability and responsibility.
- SRI will only work if investors consider it to be a sound investment strategy. You must convince Warren Buffet that it makes sense!

IFC's Sustainability Framework

- For decades, IFC has invested using this SRI as an investment strategy.
- Although we have not used this exact term until the past couple years.
- Our investment framework includes the three pillars of SRI:
 - Corporate Governance
 - Accountability and transparency
 - Protection of minority shareholder rights
 - Environmental Responsibility
 - Compliance with world-class standards
 - Pro-active environmental approaches, such as investments that reduce energy consumption
 - Social Responsibility
 - Labor-force health and safety
 - Local community support
- Within this framework, IFC's investments represent a continuum of SRI performance
 - Compliance with world standards
 - Outperforms in some areas, but not all
 - Outperforms in most areas
 - World-class leader

Developing Value Matrix

- Drawing on our experience in emerging markets, IFC released a study this summer that makes the business case for SRI.
- It is entitled Developing Value, and is based on 240 case studies, 30 of which are in the East Asia region. Copies are available outside.
- Developing Value uses these cases to draw the link between the three pillars of SRI and business success.
- We broadly define these three pillars as:
 - Sound governance
 - Environmental responsibility
 - Social Responsibility
- To be precise, six different factors of business success were measured:
 - Revenue growth and market access
 - Cost savings and productivity
 - Access to capital
 - Risk management
 - Development of human capital
 - Brand value and reputation
- What the study found was that there were clear links between certain business success factors and certain sustainability factors, but that the results varied by company and by region.
- For example:
 - A company making improvements in working conditions is likely to achieve greater labor productivity.
 - A company with sound environmental practices is more likely to build strong brand value and a sound reputation
 - A company that is sensitive to local economic growth has a better chance of increasing their market access and revenue growth
- On the other hand:
 - A company that produces environmentally sound products may not save costs or be more productive.

Lead by Example

- A case study: the link between good corporate governance and access to capital and increased market capitalization.
- Bank of Shanghai
 - Established in 1995 through a merger of 99 urban and credit cooperatives
 - Needed capital and T/A to survive competition from foreign banks as WTO is implemented.
 - Today has 50 branches, 4,500 employees, and a total balance sheet of nearly \$14 billion.
- IFC first invested in 1997, took a 5% stake
 - Recommended operating guidelines

- Active role at Board level – appointed an experienced Mandarin-speaking banker
 - IAS
 - Audit Committee
 - Compensation Committee
- Bank of Shanghai today:
 - Improved corporate governance
 - More seasoned management
 - Better credit and risk controls
 - Improved prospect for listing
 - More attractive to foreign investors
 - December 2001, HSBC took an 8% stake.
 - First time foreign commercial banks invested in a Chinese bank since 1949.

Why Should Pension Fund Managers Care About SRI?

- All of this is a long way to explain why pension fund managers should care about SRI.
- First, there is an intuitive case for using our natural capital just as effectively as we use our financial capital.
- Second, there is a sound business case for considering SRI as a key investment criteria.
 - Companies that are socially responsible tend to have better long-term prospects than those who ignore this part of their business environment.
- Third, pension fund managers are in the best position to adopt SRI practices—two reasons:
 - Exposed to the entire economic spectrum.
 - Must take a long-term view; cannot afford to be short-term oriented.
- Calpers is perhaps the world’s largest pension fund, with US\$160 billion in assets.
 - So big that it is invested in nearly major company in the economy.
 - The Chairman of Calpers recently commented that he is not so interested how one company might outperform another during the past quarter.
 - What he is interested in is whether the economy as a whole will be healthy in 20 or 30 years when pension payments come due.
- ABP, Europe’s largest pension fund is in a similar situation.
- From the perspective of pension fund managers, exposure to the entire economy over a long period sounds very much like the intuitive case for managing capital
- Means SRI makes sense.

What is Different About the Case in Asia?

- Think about this in an abstract or philosophical way.
- The relationships amongst corporations, their owners and the public in Asia are very different than in the West.
- **Relationship of owners to the corporation**
 - Lower level of ownership concentration through institutional investors

- US pension funds own 33% of the market capitalization of US companies
- European pension funds own 42% of the market cap of European companies
- In contrast, many of Asia's companies are owned by families
- Overall, this trend makes it more difficult to achieve good corporate governance, which is one of the key levers to achieve SRI
- **Relationship of the corporation to the public**
 - Responsible toward their own employees
 - Often only responsible to the public if it affects their market – supply chain management
 - Perhaps Asian CEOs do not see their Confucian family extending beyond their immediate employees.
- **Relationship of the public to the corporation**
 - In the West, the religious community was the source of change
 - In Asia, it is the opposite.
 - Confucian believers are taught not to challenge authority, otherwise it will lead to a loss of face.
 - Buddhist communities abhor confrontation and are unlikely to criticize openly

SRI in Asia Will Require an Asian Solution

- Given these cultural differences, the highly ineffective use of natural capital in Asia, and the resilience and strength of the Asian people, I am very hopeful that an Asian approach to SRI will emerge.
- Whatever the approach may be, I believe that Japan should take a leadership role in developing the Asian solution. Japan is in the best position to do this because:
 - Highest concentration of world-class companies that already practice some form of SRI
 - Most sophisticated capital markets in the region.
- Finally, I would like to propose that one measure of ASrIA's future success will be the predominance of Asian speakers at its Annual Meetings.
- To be successful, I think that more and more Asians must take a view on this important issue.
- This is your challenge going forward.

Thank you very much.