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Tackling climate change in emerging markets

As the human effects of climate change continue to intensify around the world, asset owners and managers are rightly grappling with their responsibilities to help avoid catastrophe.

The prevailing perception is that investing in emerging markets means investing in fossil fuels and heavy industry. In fact, many home-grown emerging markets companies are tackling climate change problems with innovative and promising solutions.

Investing in those companies that form part of the solution, rather than part of the problem, goes hand-in-hand with superior long-term returns. The companies benefiting from a shift to a more sustainable development path will experience greater growth tailwinds, and face fewer risks, than those threatened by such a shift.

The climate state of play in emerging markets

The importance of environmental decisions made in emerging markets cannot be underestimated. The heart of most environmental issues tends to centre in emerging markets, from air quality to topsoil erosion. Total global emissions depend more than anything else on the energy mix in China and India. Deforestation is a Brazilian and Indonesian issue, driven by demand for agricultural goods from emerging Asia.

Further, the societies that are most dependent on a changing planet and have the least resources and institutional ability to adapt and mitigate are all developing countries. Whether it is floods in Pakistan or more intense typhoons in the Philippines, the communities in these countries are most directly and dramatically affected.

In our opinion, the notion that the developing world should get rich first, and then go green, is nonsensical. Unabated climate change severely threatens the rainfall patterns, water tables, and ecological services that these societies depend upon. An economy simply cannot deliver high living standards to people in a scenario of chronic water scarcity or routine crop failures.

Paving a different development path for EM economies

The idea of a trade-off between the environment on one hand and human development on the other is therefore only true in an extremely narrow sense. Providing the farmers of India and Africa with electricity tomorrow using coal-fired power generation would result in immediate gains in living standards. However, within a decade, all those gains would be erased as climate change makes their farms untenable and destroys the livelihoods on which those social gains depend.

We believe that emerging markets will have to follow a different development path compared with today's wealthy countries. It is the only one open to them in order to deliver high standards of living to their people in the long term.

In practice, this means employing technology to leapfrog stages now in the development process. Western Europe is only now shifting aggressively toward renewables in the form of wind and solar; India and Africa will make the same shift at a far earlier point in their development.

The EM opportunity

For stock pickers in emerging markets, this context represents both a challenge and opportunity. We must be conscious of the risks that come with investing in polluting industries that will not have many decades to operate inherently unsustainable business models. Many of the largest companies in the developed world operated for decades on unsustainable linear models of production and consumption, and are now having to reinvent their businesses to become more sustainable.

Emerging markets companies, operating in societies at an earlier stage of development, have the chance to build business models that in their nature are kinder to the planet and people.

We must be alert to the exciting prospects of investing in emerging markets companies that have embedded sustainability into their mission from the outset.

For example, Brazilian company WEG*, has built expertise in key components for hydroelectric, solar and wind power generation. WEG has been able to develop into a globally leading expert in renewable electricity generation infrastructure and now derives more than half its sales from overseas. Its equipment will help the rest of the world's energy mix catch up with Brazil in the pursuit of net zero.

Equally, Indian IT company KPIT Technologies* has developed into an expert in the embedded software used in electric vehicles (EVs). Their solutions help integrate batteries and motors, and provide tools like control systems and diagnostics to help EVs run smoothly and safely. In this niche, KPIT is globally competitive, counting 12 of the largest 15 auto companies globally amongst their clients. Their services will help vehicle fleets around the globe to make the transition to electric power.

Investing in emerging markets can mean allocating capital to companies like WEG and KPIT Technologies that are contributing solutions to environmental issues, and thus are benefiting from growth derived from the shift to a more sustainable development path. Such companies are likely to continue to provide attractive long-term returns over time.

The opportunity for active emerging markets investors is to continue to find and invest in businesses that should thrive as they contribute to and benefit from sustainable development.

Jack Nelson
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