middle east investor relations association

# Navigating ESG in MENA: factors driving demand and programme implementation

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Sustainable investing has experienced rapid growth in recent years. Investors around the world are increasingly investing in companies that monitor their Environmental, Social and Governance (ESG) performance, providing an opportunity to better measure risk and unlock growth opportunities. The MENA region has been gaining pace in its progress towards improved ESG disclosure, with companies and stock exchanges beginning to adopt ESG metrics as standard for both operations and reporting. This white paper sheds light on how ESG is developing in the Middle East, views from investors, stock exchanges and corporates, and outlines an approach for companies looking to incorporate ESG into their strategies.

## The call to action on ESG

Responsible investors incorporate environmental, social and governance aspects into their investment and screening process. While sustainable investment was once considered a niche, this is no longer the case as companies that have managed ESG risks have consistently shown more resilient performance.

Morningstar research shows that funds that invest according to ESG principles attracted net flows of $71.1bn globally between April and June 2020, pushing assets under management in such products to a new high of just over $1tn. During the same period, Morningstar reported that 51 out of 57 of their sustainable indices outperformed their broad market counterparts, while MSCI reported 15 of 17 of their sustainable indices outperformed their broad market counterparts. Analysis by Blackrock showed that 94% of sustainable investment products outperformed their parent benchmarks in Q1 2020.

With the Covid-19 pandemic causing heightened market volatility, there was an inflection point in demand for sustainable investment products. The uptick in interest from asset managers is partly driven by regulation, but more so by asset owners demanding increased ESG engagement and reporting as part of their investment mandates.

The Climate Action 100 group of investors – with $47 trillion under management between them – has challenged the 161 largest corporate carbon polluters to dramatically reduce their carbon emissions and demanded companies work with suppliers who also meet high ESG standards. And across the world, environmental and social issues are becoming a prevalent topic of discussion for decision makers. Today, the MENA region is no exception.

## ESG frameworks

A wide range of constituents — including investors, corporates, policy makers, regulators, NGOs, and civil society — use corporate sustainability reporting to inform decisions. A dynamic, and rather complex, ecosystem of organizations has evolved to meet these information needs. Disclosure standards and frameworks, such as SASB and GRI, are at the heart of this ecosystem. They guide the disclosure of comparable, consistent, and reliable ESG information making comparative ESG analysis and benchmarking more feasible. Initiatives such as the UN SDGs and organisations such as TCFD help develop a common language.

Last year, five frameworks and standard setting institutions of international significance (CDP, CDSB, GRI, IIRC and SASB) have come together to help resolve this confusion and to show a commitment to working towards a comprehensive corporate reporting system. This should, in future, help to simplify the process of complying with global standards.

The UN SDGs provide a roadmap to address the world's most urgent sustainability challenges by setting 169 targets to be achieved by 2030. Corporates can prioritize SDGs to act and report on, based on the management's vision and strategy.

The Stakeholder Capitalism Metrics released by WEF and its International Business Council (IBC) measure long-term enterprise value creation for all stakeholders by offering 21 comparable disclosures focused on people, planet, prosperity and principles of governance that are considered critical for business, society and the planet.

The UN Global Compact is the world's largest corporate sustainability initiative. The initiative calls on companies to align their strategies and operations to 10 universal principles in the areas of human rights, labour, environment and anti-corruption, and to take action to meet the UN SDGs.

The Task Force on Climate-related Financial Disclosures seeks to strengthen and protect global financial markets from systemic risks such as climate change. The TCFD recommendations are structured around four thematic areas that represent core elements of how organizations operate: governance, strategy, risk management, and metrics and targets.

GRI Sustainability Reporting Standards are the most commonly accepted global standards for sustainability reporting by companies. GRI standards are available for reporting across a wide range of ESG-related topics, ranging from anti-corruption practices to biodiversity and emissions.

The Sustainability Accounting Standards Board (SASB) is an independent non-profit organization that sets standards to guide the disclosure of financially material sustainability information by companies to their investors. SASB Standards identify the subset of ESG issues most relevant to financial performance in 77 industries.

The Carbon Disclosure Project aims to study the implications of climate change for the world's principal publicly traded companies.

"At Franklin Templeton, we take an economic based approach to the integration of ESG within our investment management processes. That means we analyse material ESG factors alongside traditional financial and economic measures to promote a more comprehensive view of the value, risk and return potential of an investment. We leverage established industry frameworks and initiatives to help establish and promote ESG best practices e.g., our ESG Sector Framework Guides were partly informed by SASB and identify a minimum set of ESG issues most likely to materially impact the operating performance or financial condition of a typical company in its industry group.

As we consider the above frameworks in the MENA context, key issues would range from workplace diversity, labour conditions – particularly of overseas employees, to environmental issues of water scarcity and climate considerations. Preparedness of management around these key issues are highly relevant and likely to impact on the outlook of the issuers we invest in.

From an opportunity set, sustainable infrastructure and the 'green' energy transition are areas the region can benefit from. The IMF Director for Middle East and Central Asia, Jihad Azour, has noted its importance for high-quality investment in green infrastructure. Lower carbon forms of hydrocarbon energy such as gas along with emission-free energy such as wind, solar, tidal and hydroelectric power are high priorities of Middle Eastern issuers," explained Preyesh Patel, ESG Analyst at Franklin Templeton.

## Case study: introducing an ESG programme

Majid Al Futtaim launched its sustainability strategy in 2018 aligning the Company's strategy to 10 of the UN SDGs. The Company's strategy addresses social and environmental priorities of governments and stakeholders in their operating markets and focuses on three pillars: Transforming Lives, Rethinking Resources and Empowering People.

In 2019 the company achieved 81% of its sustainability targets, raised $1.2 billion through two Green Sukuk, reduced CO2 emissions by 2.4%, and launched a number of initiatives to roll out renewable energy across assets, support communities and train employees.

## MENA stock exchanges and the regional ESG landscape

Stock exchanges across the region have almost unilaterally recognised and communicated the need for companies to incorporate ESG into their business strategies and reporting practices. A number of exchanges in the Middle East have developed guidelines for issuers to report on their ESG performance, and other exchanges have set in motion plans to launch an ESG index – for example, Tadawul in Saudi Arabia, in partnership with MSCI. In 2020, the Arab Federation of Exchanges in partnership with Refinitiv launched a Low Carbon Select Index, providing investors the opportunity to commit capital to MENA companies that actively promote and invest in low carbon activities across their business operations.

In 2020 the Bahrain Bourse issued voluntary ESG reporting guidelines for listed companies. The guidelines aim to increase awareness and understanding of the importance and benefits of ESG reporting, while assisting listed companies in actually addressing their most material ESG issues.

Sheikh Khalifa Bin Ebrahim Al-Khalifa, Chief Executive Officer of Bahrain Bourse said:

*"As a Partner Exchange Member of the Sustainable Stock Exchanges (SSE) initiative and a member of the World Federation of Exchanges, Bahrain Bourse has made a formal commitment to drive sustainability in the capital market of the Kingdom of Bahrain. Building upon this initiative, we have issued the ESG reporting guidance to encourage and assist listed companies in disclosing ESG information that investors can utilize to make informed and responsible investment decisions.*

*The guideline includes the latest third-party reporting methodologies widely adopted by the industry and aims to assist listed companies in navigating the evolving standards on ESG reporting and disclosure. We are looking forward to enhance transparency and disclosure in Bahrain's capital market by supporting listed companies' alignment with Bahrain Economic Vision 2030 and the UN Sustainable Development Goals (SDGs)."*

## How can issuers launch their ESG journey?

### 1. Benchmarking

Companies can start their journey by assessing their performance against a group of industry peers. A benchmarking study will offer companies insight into their positioning relative to peers and the most effective areas for improvement. It will also provide tangible guidance on how to do things "right", and how not to do things "wrong", based on the experiences and achievements of regional and international peers. Findings should be qualitative and quantitative, to inform management and board-level decision making on appropriate next steps.

### 2. Materiality assessment

A materiality assessment is key for companies to identify and prioritise ESG issues that are most critical to their organization and to begin to engage with internal and external stakeholder to identify their needs and expectations. The materiality assessment allows companies to evaluate ESG issues based on the impact to their organization and based on the importance to each stakeholder group. Only once a thorough materiality assessment has been executed does it become feasible to build and deploy an impactful and relevant ESG strategy.

### 3. Developing a strategy

Once companies have identified key ESG issues to address, they can develop a roadmap to integrate ESG into their business strategy. This includes identifying

### 4. Reporting

Best practice ESG reporting incorporates a holistic approach to material ESG matters the company has identified. Reporting should be an output of a strategic ESG disclosure requirements, engaging stakeholders on ESG matters, integrating ESG into core business processes and strategies, and extending ESG considerations in the value chain. As part of this phase, companies will also improve their capability to monitor ESG performance and targets, to communicate commitments and performance to stakeholders, and select the most relevant and appropriate international frameworks with which to comply.

framework and used as a tool to communicate the company's progress against a broader ESG strategic programme. ESG reporting should be consistent in nature, and build-up in sophistication and depth over time. Even the most discerning investors don't expect to see "zero to one hundred" in the first attempt, but they do expect to see a recognition of shortcomings and a commitment to closing gaps in the years ahead. It *is* a journey.

Oliver Parry, Partner, ESG Advisory, Instinctif Partners comments:

*"ESG issues are now a priority for boards and management, with Covid-19 accelerating the need for companies to embrace higher standards of ESG. The benefits of addressing ESG issues are significant, and a fully integrated and robust ESG programme can not only open-up access to more capital, but can also help develop a stronger brand and, crucially, promote sustainable long-term growth on behalf of the company and its shareholders. ESG is no longer just a PR tactic. It is your bottom line.*

*For those companies in MENA embarking on an ESG programme, they should generally look to undertake three key projects, including an evaluation of the existing approach to ESG, a peer review analysis and a perception analysis to understand what stakeholders, in particular investors, think about the approach to ESG. These findings will enable the company to develop a long-term ESG programme.*

*Ultimately, an ESG strategy should be fully integrated with the overall business plan, with success measured against internal metrics, which of course differ from company to company, investor expectations, local, regional and international best practice as well as regulatory requirements and listing rules."*

Companies across all industries in the MENA region will increasingly be asked about a number of key topics by current and prospective shareholders who are incorporating ESG metrics into their investment process. Across the region, exchanges have set in motion ESG reporting guidelines and other initiatives, to encourage companies to kick-start their ESG journey. Incorporating ESG metrics into decision making will eventually become critical for corporate management and boards to unlock new pools of capital, demonstrate competitive value, build a strong brand proposition and drive sustainable growth.

George Allen
Partner

**E:** George.Allen@instinctif.com
**M:** +971 4369 9353
instinctif.com/mena

middle east
investor relations
association

Office 10, Floor 2
The Offices 2, One Central
PO Box 9576
Dubai, United Arab Emirates

T: +971 (0)4 516 3043
E: info@meira.me