| FUND LAUNCHED | FUNDS UNDER MANAGEMENT | NET ASSET VALUE PER SHARE |
|---|---|---|
| **2005** | **£521.0** MILLION | **365.3%** SINCE INCEPTION* |

UTILICO
Emerging Markets Trust plc

# Governance in Emerging Markets

March 2023

**Strong Corporate Governance: the foundation for growth in emerging markets**

Emerging markets are a very attractive area in which to invest, due in part to the potentially higher economic growth prospect, coupled with an improvement in physical and legal infrastructures. They are responsible for a greater proportion of global growth, with this sector accounting for 66% of global GDP growth(1) in the past 10 years (2012-2022).

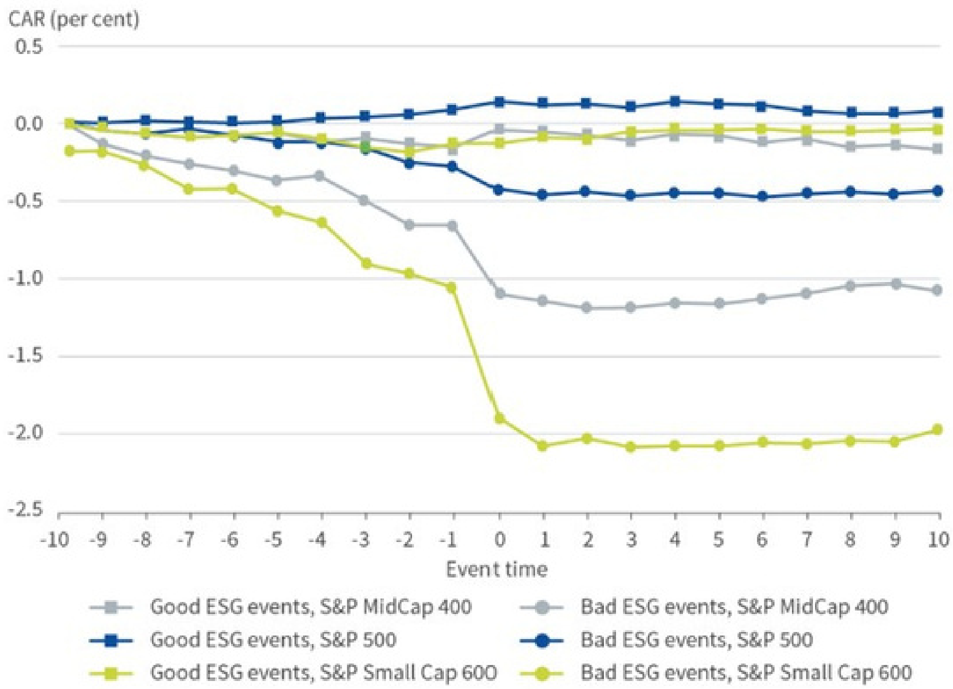
However, investing in companies that operate within emerging markets comes at a risk. Potential political and macroeconomic volatility means that the extent of company share price performances in these regions can often be at the mercy of political leaders and their monetary and fiscal policies. Corporate structures in emerging markets can be characterised by concentrated ownership that can have a profound effect on the governance risk, through management entrenchment, or the risk of expropriation of minority shareholders. These risks mean that investing in emerging markets can be volatile, highlighting the need for a strong and stable corporate governance structure to guide companies through challenging political and macro environments.

What does corporate governance consist of? It takes many forms, however it is the structure of rules, practices, and processes used to direct and manage a company. The guiding principles include a credible and diverse board, a transparent and accountable management team, external committees, and sound accounting and compliance practices are comparable across all markets. These fundamentals form the basis of how we evaluate a company's corporate governance practice.

An increased awareness of, and improvements in corporate governance standards has enabled this growth in emerging markets. Evidence suggests that a greater level of governance has led to an improved foreign direct investment (FDI) inflow(2). The development of basic disclosure requirements with the timely release of financial statements, meeting agendas, and reporting on the board's composition and oversight activities have been key. These, coupled with an increase in public scrutiny and the competition for FDI, have enabled a material improvement in responsible business conduct.

The importance of assessing and quantifying governance structures is undeniable, especially where market risk is heightened. Failing to take into account these considerations can have a prolonged and adverse impact on investments. Two-thirds of companies hit by a major ESG controversy saw their stock price underperform the MSCI World by an average of 12% in each of the following two years[3]. Furthermore, market reactions are much more prominent for bad news than good news as investors anticipate the negative impact[4].

**Cumulative average abnormal returns of ESG events (2000-2018)**




Source: Monash University

Encouraging strong and proper corporate governance practices is rightfully an inherent part of asset managers fiduciary duty. Having a proactive engagement strategy, instead of reactive, enables investors to build a relationship with investees and alleviate the potential 'forest for the trees' concern which arise from intricate corporate structures. The evolution of Investor Relations (IR) channels has made it easier for investors to communicate their opinion with investees.

Past corporate scandals lay a stark reminder of the seismic effect that aggressive executive conduct and poorly implemented internal controls can have. This makes rewarding and acknowledging good corporate governance practices even more important. Voting in favour of directors' stock options, reappointment of directors and remuneration packages can act as a motivator and signal content with corporate governance practices. Rewarding directors solely based off corporate governance practices will be difficult; however, coupled with performance can be impactful.

**Utilico Emerging Markets Trust - our ESG approach**

Utilico Emerging Markets Trust Plc ("UEM") has a thorough ESG due diligence and reporting process that comprises of 21 ESG factors, 62 questions and 35 metrics. Of these, UEM has 6 factors, 25 questions and 13 metrics dedicated to corporate governance, with a weighting of 40% allocated to this section. Each category is scored and any ESG concerns are flagged, which enables UEM to diligently engage with a company. To reduce the likelihood of ESG issues, UEM monitors and votes against resolutions if it is believed the company is not addressing issues that have been raised.

Where possible, UEM believes it is important to go direct to investee companies when collecting data, meaning UEM does not rely on potentially inaccurate and discrepancy ridden sustainability data which some third-party providers offer. Until company disclosures improve, and a global reporting standard is developed, providers will struggle to produce meaningful comparable data. This will take time, and therefore sourcing sustainability data will continue to be a time-consuming task for the foreseeable future. ESG has evolved from an overhead to a value-added task, and thus is a fundamental part of UEM's investment process, which enables UEM to unlock value and maximise returns to investors.

**Jack Cuddigan**
13 March, 2023

Source Data: ICM Limited.
([1] World Economics (2002), https://worldeconomics.com/Regions/Emerging-Markets/
[2] Globerman, S. & Shapiro, D. (November 2002) 'Global foreign direct investment flows: the role of governance infrastructure'. World Development, 30(11), 1899-1919. (https://doi.org/10.1016/S0305-750X(02)00110-9)
[3] CNBC, (7th February 2020) 'ESG high controversy events can cost stocks' (https://www.cnbc.com/2020/02/07/esg-high-controversy-events-can-cost-stocks.html) - Research by Societe Generale
[4] Bei Cui and Paul Docherty, (17th March 2020) 'Stock price overreaction to ESG', (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3559915) - research conducted by Monash University (Figure 1)

*Total return is calculated based on undiluted Net Asset Value, plus dividends reinvested and adjusted for the exercise of warrants and subscription shares

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