

WATER STEWARDSHIP AND SUSTAINABLE INVESTING



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Water is a critical resource that plays a fundamental role in both environmental sustainability and social equity. Changing climate patterns, pollution, and aging water infrastructure systems threaten the availability and quality of water. As such, effective water management is yet another challenge that the investment industry, including stakeholders across the value chain, grapples with and which puts at risk the sustainability of current and future investment returns.

Water risks in ESG

Water-related risks can manifest in various forms, including scarcity, pollution and regulatory challenges. These risks can have significant financial implications for companies, particularly those operating in water-intensive industries such as agriculture, manufacturing and energy, where supply chain disruptions can be devastating. For asset managers, understanding and mitigating these risks is crucial to preserving and enhancing long-term investment returns.

Our global managers often focus on water risks within the broader context of climate change. Rising global temperatures and shifting precipitation patterns are exacerbating water scarcity in many regions, increasing the vulnerability of businesses dependent on consistent water supplies. Additionally, the regulatory landscape is becoming more stringent as governments and international bodies push for better water management practices. Of course, understanding companies' sensitivity to water as well as their current and potential future impact on water can only be fully appreciated with adequate company disclosure.

Locally, we face unique water challenges. South Africa has experienced severe droughts in recent years, highlighting the critical importance of effective water management for economic stability and social equity. For our South African managers, water stewardship is not just an environmental concern but also a social imperative, given the direct impact of water scarcity on communities and livelihoods.

Innovative approaches to water stewardship

Both local and global asset managers are employing innovative strategies to address water-related risks within their ESG frameworks. There are three broad areas of activity.

1. Water efficiency and conservation initiatives

In South Africa, asset managers are engaging with companies and industry stakeholders, including local and provincial governments, to promote water efficiency and conservation practices that enable reliable water supply for company operations. For example, companies in the agricultural sector are being encouraged to adopt precision irrigation systems that optimise water use and minimise waste. There are examples of large local industrial companies that had to resort to using municipal potable water in their operations due to safety and quality concerns around other water sources. Of course, this practice risks negatively impacting surrounding communities. To address these risks, initiatives include investing in technologies that reduce water usage, and encouraging recycling and reuse.

Global managers are focusing on investing in companies that lead in water innovation. These include firms developing

advanced water filtration and desalination technologies, which are crucial in regions facing chronic water shortages. They are also taking a tougher stance on poor water management. For example, a water utility company's consistently poor environmental management resulted in a high volume of leaks, pollution incidents and sewer flooding, adding to their operating costs and highlighting a structural lack of capex to fix these issues. After numerous unsuccessful engagements with the organisation, the corporate credit team of one of our global bond managers, decided to take an underweight to zero exposure to the company.

2. Stakeholder engagement and collaboration

Given the social implications of water scarcity, local managers are emphasising the importance of stakeholder engagement. They are working closely with companies to ensure that water management strategies are aligned with the needs of local communities and that there is senior level commitment and accountability. This includes advocating for corporate responsibility in ensuring access to clean water and supporting community-based water initiatives. In driving accountability and alignment at a strategic level, one of our managers stated the following:

"We place significant emphasis on advocating for transparent disclosure and encouraging companies to disclose in a manner that is relevant to their own strategies and sustainability requirements. Alongside disclosure, engaging for the inclusion of appropriate water metrics within executive remuneration policies has been high on our agenda."

Global managers are increasingly collaborating with international organisations and NGOs to drive global water stewardship. By participating in initiatives like the UN's CEO Water Mandate, these managers are encouraging companies to commit to sustainable water management practices and transparency in reporting their water usage and impact.

3. Regulatory compliance and advocacy

Regulatory compliance is a key focus for local managers as the granting of water licences in South Africa is becoming increasingly strict. Managers are actively engaging with companies to ensure adherence to local water regulations, while advocating for stronger water governance frameworks. This approach not only mitigates regulatory risks but also promotes sustainable water use practices. As an example, a JSE-listed paper company was cited to have had potential river flow issues at their Maine, US, facility in 2021. Regulators threatened to remove a dam essential for the year-round water supply to their mill due to the threat this dam had on the breeding grounds of endangered Atlantic Salmon and other fish.

Internationally, asset managers are pushing for harmonised water regulations across regions. By advocating for global standards, they aim to reduce water-related risks and encourage consistent water management practices among multinational companies.

Water stewardship in action

A prominent example of water stewardship within an ESG framework comes from a local manager's engagement with a major agricultural company in South Africa. The company faced significant challenges due to recurrent droughts, which threatened its crop yields and, by extension, its financial stability. In response, the local manager worked closely with the company to implement a comprehensive water management strategy. This included the adoption of precision irrigation technologies, which reduced water usage by 30%, and the development of water recycling systems that allowed the company to reuse up to 50% of its wastewater. Additionally, the company invested in community water projects, providing access to clean water for nearby villages, thereby enhancing its social license to operate.

Moving water stewardship up the agenda

The environmental pillar of ESG encompasses complex, multi-faceted issues, all of which require attention. At a global scale, climate change, including carbon emissions, continues to dominate environmental engagements and global portfolios appear to have limited exposure to water sustainability issues at a macro level. Where there is such a focus, the issues are typically addressed on a case-by-case basis as part of asset managers' bottom-up research. It is however encouraging that at a local level, water sustainability is increasingly getting the attention it deserves, given the risk it poses to investment returns as well as community and ecosystem wellbeing.

