# How Asia Stacks Up On ESG

By Drew Bernstein

***Embrace of ESG principles by Asian companies will be decisive in solving global environmental issues.***

Today there are trillions of dollars in the U.S. and Europe in funds dedicated to Environmental, Social, and Governance (ESG) investments. Many of the largest money managers and institutional investors have made ESG considerations a core criterion when evaluating companies.

81% of U.S. institutional investors and 83% of European institutions said they plan to increase their allocations to ESG investing in the next two years, according to a survey by PwC. The SEC has proposed new rules requiring U.S. public companies to disclose climate-related risks to their operations and measure their direct and indirect greenhouse gas emissions, including "upstream and downstream activities in its value chain."

While there has recently been some political backlash against so-called "woke investing," most Western management teams appear to welcome greater clarity and consistency about what defines ESG excellence. Showing progress against ESG objectives is important because it matters to many of their customers and shareholders.

In Asia, ESG adoption is still at an earlier stage. But progress on these issues in Asia-Pacific has enormous consequences for efforts to slow the pace of global warming and other environmental harms. For one, Asia accounts for the majority of global carbon emissions, with 17.7 billion tons of carbon dioxide generated by energy coming from Asia, versus 5.6 billion from North America in 2021. In addition, Asia accounts for 81% of all plastics that flow into the world's oceans, according to a recent study, with just one country, the Philippines, contributing nearly one-third of the global total.

The campaign to decarbonize the economy will be primarily decided by what occurs in Asia's factories, roadways, and power plants. And many of Asia's megacities, including Jakarta, Shanghai, Bangkok, Mumbai, and Ho Chi Minh City, are at severe risk of permanently flooding if the ocean levels rise. Recognizing this peril, eight out of ten countries in Southeast Asia have committed to achieving "net-zero" emissions by 2050. Despite these aspirations, emissions by the region's fastest-growing economies, including Indonesia, Vietnam, and the Philippines, are expected to grow by 25 to 35% through 2030.

Western investors and corporates first embraced ESG, while Asian companies have been slower to recognize the importance of these issues due to cultural and regulatory factors.

The 2023 Corporate Governance and ESG Survey by AON found that while 58% of companies in Asia-Pacific say that ESG is critical to their long-term success, only 29% have developed

KPIs for ESG performance. Creating a clear framework for what ESG objectives are most important and how a company can impact change is essential to make sustainability more than a slogan. Most importantly, companies and their leaders must have clear economic incentives to attain these goals.

Some players in Asia have demonstrated progress in meeting these challenges. The Singapore Exchange (SGX) implemented its own Sustainability Reporting requirements for listed companies. Insurance broker and risk adviser Marsh recently announced that companies in Asia may now be considered for preferred directors and officers (D&O) liability insurance policy terms and conditions based on the strength of their ESG risk frameworks. A recent report by Bloomberg found that ESG funds in Asia doubled their market share in 2022, even as political and regulatory upheavals slowed inflows for ESG investing in the U.S. and Europe.

Several of Asia’s leading companies have launched sophisticated ESG campaigns targeted to global investors. Alibaba has begun disclosing more information about its ESG practices, including steps to reduce carbon emissions by optimizing its logistics through digitalization and investment in renewable energy while launching various programs and initiatives to assist small and medium-sized enterprises in adopting sustainable business practices. TSMC, the leading Taiwanese semiconductor manufacturer, has been recognized for reducing the company’s environmental impact and promoting sustainable business practices. China's BYD Company, one of the world's largest manufacturers of electric vehicles, has made significant investments in renewable energy and sustainable transportation.

While commitment to ESG principles may open up new sources of financial support, failure to comply may have dire consequences. For example, European countries have begun to impose requirements to audit global supply chains for the environmental and human rights practices of all suppliers. Poor environmental practices could lead to losing vital contracts, while a strong ESG profile may enable a company to take market share or charge premium prices to MNCs.

To engage with investors and customers, Asian management must navigate a complex maze of terminology, standards, and rating systems. The European Union enacted new rules for ESG investments in 2022, the Sustainable Finance Disclosures Regulation, while the SEC in the U.S., the FCA in the U.K. , and regulators in Hong Kong and Singapore have all proposed their own different standards. The impetus for these regulations is to achieve substantive definitions and metrics for ESG and to impact investing products to minimize the practice of “greenwashing,” in which environmentally dubious industries are repackaged as ESG-friendly.

Public companies are expected to engage with multiple rating systems, including the Carbon Disclosure Project, ISS-ESG, Sustainalytics, and S&P Global ESG, all of which employ their own criteria to evaluate ESG risk and rank companies. A host of consulting firms has emerged to help manage these new reporting requirements, with specialties including biodiversity assessments, carbon offsets, lifecycle assessments, portfolio carbon footprinting, and water accounting.

China poses perhaps the most dramatic test to ESG investing's promise that investors can positively influence global events through better investing choices. China is both the single largest source of carbon emissions, and the global leader in renewables. It generates twice as much energy from solar and wind power as the U.S. market while also permitting two new coal-fired power plants every week in 2022.

China's ambition to inject green investing practices into its financial market has made significant progress. China's Green Bond Principles, published in July 2022, closely align with international green bond standards and help unify the formerly fragmented domestic market. A key amendment requires 100% of the proceeds to fund green projects instead of the 50-70% previously.

China has seen an explosion of ESG funds targeting retail investors, promising to make investments that contribute to achieving the government's pledges to achieve net zero in 2060 and alleviate rural poverty. But of 170 ESG funds, 15% are invested in coal companies, which are by far the most significant contributors to greenhouse gases, and 62% own steel stocks, which are large consumers of coal, according to a Bloomberg analysis.

With ESG disclosures being a new requirement, it will be interesting to see how definitions of ESG evolve. For now, there is an opportunity to find a balance that has a meaningful impact on people and demonstrates good economics. This is especially relevant when looking at a Chinese company as compared to one from the United States, because the ESG priorities will be more relevant to each region. In China, investors are willing to wager that stocks of companies aligned with China's policy goals will have a better chance of paying off. This may include contributing to reducing rural poverty or energy self-sufficiency. In the Western World, the focus may differ.

Expecting a system for selecting stocks and bonds to solve all of the world's challenges may be too great of a burden. ESG investing will ultimately be as successful as the diplomatic engagement and government policies that collectively define what we are trying to achieve.

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