Will Approach To ESG Separate Asia From The Rest Of Emerging Markets?

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"Earth provides enough to satisfy every man's need, but not every man's greed."

Mahatma Ghandi

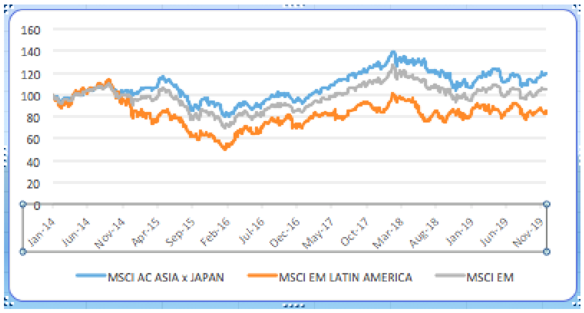
Asia historically had a positive attitude towards thinking of the future rather than living the day. In most Asian countries, either for historical or cultural reasons, there has been a high tendency to save both at good or at bad times. This applies to governments, corporations as well as individuals. Just as an example, the traditional Chinese Knot which is a symbol for lucky charm is known to be associated with notions such as happiness, harmony as well as the concept of saving money for a prosperous future. This is how embedded saving has traditionally been within the Asian culture.

Although there is variation across countries and over time, Asia as a whole is a high-saving, high- investment, and high-growth region. High growth accompanied by low risk profile is a function of Asian markets generally basing their long-term growth on productivity as opposed to trying to stimulate growth through consumption– just like it is being done in some other emerging markets.

When the Asian crisis hit in 1997 - a crisis that resembled a currency crisis when the root cause was worsening debt levels in Asia - there was a successive slowdown in investment rates. Some countries (Thailand, Indonesia, Korea) were more affected from the crisis than others. Most have resumed investments over time but only at variable rates. The blessing was that Asia quickly went back to its strong suit and core strength: high saving rates. Some Asian countries that were struck by the crisis saw their savings rates remain stable accompanied by lower investment rates, leading to a current account surplus. Countries that recovered faster (China) saw their savings rates increase substantially with their investment rates also picking up, however more slowly than the savings. This again led to a current account surplus. Those surpluses across Asia have been sticky to this date. They are healthy because they provide a cushion to local currencies when under pressure from the rising dollar.

According to 2018 World Bank data, domestic savings rates (excluding high income) in East Asia and Pacific region indeed average about 43,1% of GDP, while the saving rates in LatAm (Latin America) are only around 18,4% and in MENA (Middle East and Africa) around 24,8% of GDP.[1]

This means that the ability of thinking with a long term perspective through higher savings ratio has served Asian markets well in terms of risk management. If we could take the stock market as an indication, MSCI Index for Asia x-Japan has indeed grown much faster compared to MSCI Index for Latin America or for Emerging Markets in recent years.



Nowadays, ESG is becoming more and more a mainstream topic as stakeholders are abandoning their focus on financials only and integrating long-term sustainability practices in their decision process in quantifiable ways in order to be more resilient against risks.

Given the natural propensity of Asian market participants for long term thinking, a fair question would be whether the region could use their higher savings rate mentality and apply it to the new environment defined by ESG trends for risk management and resilience.

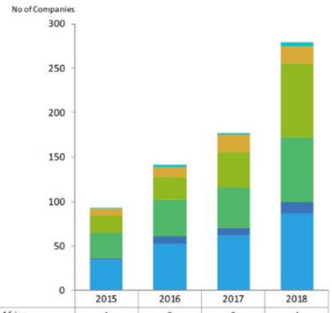
There is some analysis that may lead us to think that Asia has already started to put more focus to ESG relative to other regions, since the region ranked high at many metrics just after the developed regions. According to a 2018 survey from KPMG, the share of Asian companies reporting on ESG jumped from 49% in 2011 to 78% in 2017, thus posting the highest increase globally.[2] According to GPIF study on ESG disclosure, the number of reports complying with GRI Standards increased significantly in Asia-ex Japan between 1999 and 2015, which had 27% share in total at the time, stood just after Europe's 34% share and grew at a higher rate than LatAm with 17% share. Additionally, Asian companies that reference SASB in their information disclosure have grown faster than other emerging regions such as LatAm and MENA between the years 2015 and 2018, and stood at second position just after the U.S.[3]

[1] https://data.worldbank.org/indicator/ny.gds.totl.zs

[2] https://assets.kpmg/content/dam/kpmg/be/pdf/2017/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf

[3] https://www.gpif.go.jp/en/investment/research_2019_full_EN.pdf

Fig14: Companies That Make Some Reference to SASB in Their Information Disclosure



	2015	2016	2017	2018
Middle East & Africa	1	2	2	4
Latin America & the Caribbean	8	11	19	20
Asia Pacific	19	26	40	83
Europe	29	41	46	73
Canada	1	8	8	12
United States	35	53	62	87

Source: Prepared by Nissay Asset Management Co., Ltd. on the basis of the data and materials provided by SASB.

Another positive signal is that regulatory agencies and stock exchanges within the region are currently having a strong influence on how corporations report on ESG items. The detected trend in these markets is that regulatory agencies indeed start with voluntary disclosure recommendations at first, only to turn those voluntary policies and guidelines over time to mandatory disclosure. This means that what seems to be voluntary guidance as an introduction is soon followed by enforcement to be adapted widely in those markets. Starting with voluntary, but later turning it into compulsory is important because according to CFA Institute research, "ESG Disclosures in Asia Pacific" in markets where disclosures are voluntary, the progress has been slower compared to markets where disclosure has been compulsory. [4]

Asian exchanges and regulators moreover compete with each other for investor attention because when one adopts a new policy, others tend to follow it very quickly. Hence a good ESG practice in one market tends to spread to other ones. Market data notes the following facts:[5]

- Thailand published its Guidelines for Sustainability Reporting in 2010. Later by 2014, Thailand's Securities and Exchange Commission (SEC) was already requiring social responsibility reporting.
- India published voluntary guidelines on corporate responsibility in 2011. In 2012, the Securities and Exchange Board of India (SEBI) issued a circular that made it mandatory for the largest 100 listed companies to publish an annual business responsibility report. The requirement was then expanded to the 500 largest companies in SEBI's Disclosure Requirements Regulations in 2015.
- In Hong Kong, ESG reporting guidelines issued in 2012 by the Stock Exchange of Hong Kong (HKEX) were initially voluntary, but five years later, in 2017 some of guidelines became required on a comply-or-explain

[4] https://www.cfainstitute.org/-/media/documents/article/position-paper/esg-disclosures-apac.ashx

[5] https://sseinitiative.org/stock-exchange/idx/

basis. The Securities and Futures Commission (SFC), which regulates HKEX, has additionally indicated that it is considering making ESG disclosures mandatory, to harmonize with China's policy direction by 2020.

- China is preparing to move from a voluntary disclosure regime to a mandatory one, with the introduction of mandatory ESG reporting within 2020.
- In Malaysia, Bursa Malaysia issued amendments to their listed requirements in October 2015, and now - under the so-called Sustainability Amendments - listed issuers are required to disclose a narrative statement of material economic, environmental and social risks and opportunities ("Sustainability Statement") in their annual reports.
- In Singapore, SGX published the Sustainability Reporting Guide in 2016, which mandates annual sustainability reporting by all listed companies on a comply-or-explain basis.
- In Philippines, the stock exchange first offered guidance on corporate governance: Code of Corporate Governance launched in November 2016. By 2019, the Securities and Exchange Commission announced the requirement of sustainability reporting on comply or explain basis for all listed companies.
- In Indonesia, companies are required to publish Sustainability Reporting started off in 2019 for financial service companies and expected to apply to all listed companies from 2020 on.

Some Asian markets have been faster than others in adapting to ESG. Thailand is a great example in initiating sustainability efforts early on and setting an example for other markets. According to research conducted by SSE (Sustainable Stock Exchanges) initiative, in 2001, the Stock Exchange of Thailand was the only exchange reporting and publishing its own data on sustainability.6 Thailand is also the only Asian Emerging Markets country, whose stock market, has made it into the "Top Ten" list for best ESG disclosure in 2018, according to a study conducted by SSE. As explained above, Thailand led by example other Asian exchanges by publishing certain guidelines for sustainability reporting early on in 2010 and by requiring social responsibility reporting by 2014. Hence, a good example started by Thai stock exchange spread over the companies in the index first voluntarily and later compulsory.

India is another good example in terms of adapting to ESG policies, which was highlighted by a special India report of "Sustainability Governance Scorecard" research conducted by Argüden Governance Academy. According to the research, which analyzes companies through a governance lens, Indian corporations listed on the Bombay Stock Exchange scored well on a number of ESG issues (i.e., product life-cycle sustainability, stakeholder engagement, and supply chain policy). This was a result of the integration of the Business Responsibility Report into their reporting first on recommendation basis and later mandated by SEBI for the 500 largest companies.[7]

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[6] https://sseinitiative.org/wp-content/uploads/2018/10/SSE_On_Progress_Report_FINAL.pdf

[7] https://sgscorecard.argudenacademy.org/reports/india-special-report-updated.pdf

In examining ESG compliance, some market participants will give explanations or excuses about why a certain market may have a harder or easier time vs. others in adopting ESG. For example, they will mention their economic history or they will mention how some markets have a more flexible mindset, while others being resistant to change because of entrenched habits and history. Furthermore, there will be heavy critics about the quality of data. In fact, according to the research by CLSA, "the volume of ESG data in the region is skyrocketing, the worth of that data is hotly contested."[8] Even though those excuses may be true to some extent, one should keep in mind that assigning priority to ESG is a conscious choice. Either you assign priority to ESG or you don't.

With respect to Asia, and its "arguably" more practically minded stock exchanges and regulatory agencies that are trying to make sure their markets are not being left behind, there is a good chance of better future results. More importantly, as responsible investment is gaining attraction, any market participants that have a tendency to prioritize something else are likely to face negative business consequences that will increase their financing cost in the future.

In conclusion, Asian markets should continue their focus on ESG and apply the same sensible attitude, which they had in the past (e.g., promoting savings rate and long-term investment over consumption in the short term) to set a good example in the new investment environment. Just as this has served them well as a great risk management tool, ESG and thinking sustainability could also serve them well again for more sustainable long-term returns.

[8] https://www.clsa.com/wp-content/uploads/2018/12/CG-Watch-2018-Short-version-181205-L.pdf