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ESG Strategies and Practices of Chinese Listed Companies

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Abstract

In the wake of the global outbreak of the new coronavirus, many organizations have been subjected to stress tests, including companies and some contractual organizations. This, coupled with challenges ranging from economic inequality to racial inequality to climate change and those already closely tied to business, has combined to create an extraordinary test for business. Capital market investors are also re-examining traditional growth models and placing greater emphasis on sustainability, with a new surge in global ESG investment and practice. China's economy has benefited from a combination of sustainable development strategies and high-quality development strategies, making it the world's first major economy to recover from the epidemic. The government has introduced a series of initiatives on carbon emissions, anti-monopoly, and corporate governance to positively transform to a low-carbon economy. When asked about how to handle the deep-rooted problems facing society, companies often say that they cannot afford to invest in environmental protection, high employee compensation, or other social issues because they must return sufficient profits to shareholders. To address this issue, this paper will use the ROSI model developed by the Stern Center for Sustainable Business (CSB) to embed ESG strategies into corporate development strategies to better integrate, track report on the financial performance of companies owing the implementation of ESG strategies, which will improve management decisions related to ESG and sustainable practices and provide investors with more actionable information.

Keywords: ESG strategy, ROSI, Chinese listed companies

1. Introduction

In recent years, the global community has been facing the impact of climate change, new epidemics, geopolitical conflicts and other events, and the uncertainty of the macro-environment for business operation is continuously. In China, with the national Carbon peak and carbon neutrality goal and the strategy of common prosperity, the economic development patterns are transformed into a new paradigm that combines environmental and social well-being. As shown in Figure 1, the ESG topic has been increasing rapidly in China and global in recent years.

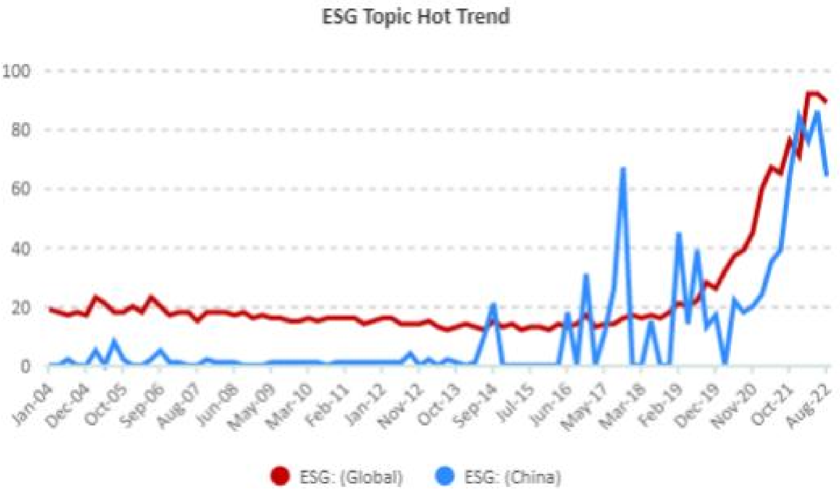


Figure 1.

Data source: Google Trends

ESG is a corporate evaluation system that incorporates economic efficiency, environmental and social impact, and corporate governance, with sustainable development values at its core. The change from a financial performance system to an ESG system is a major change in business civilization, from a shareholder perspective to a stakeholder perspective. When size and profit are no longer the only criteria for judging a company, how to meet the concerns of all parties and how to integrate business strategy with ESG strategy become the proposition of the times that companies must seriously answer.

The Stern Center for Sustainable Business at New York University, in partnership with Rockefeller Asset Management, has examined the relationship between ESG and financial performance in one of more than 1,000 research papers from 2015 to 2020. Over the past five years, we have seen an exponential growth in ESG and impact investing, partly in response to growing evidence that business strategies focused on significant ESG issues are synonymous with high-quality management teams and improved returns.

At present, most of the leading enterprises in China have recognized the strategic significance and long-term value of ESG and have made many useful attempts. However, there are still various issues such as incomplete ESG coverage, positioning ESG implementation as a cost rather than a strategic benefit, fragmentation between ESG and business, and lack of systematic promotion mechanism, which prevent enterprises from utilizing ESG transformation to maximize value creation.

In this paper, we combine previous academic research with the current ESG situation of Chinese companies and suggest how to balance ESG and business growth. It is recommended that to maximize ESG value, companies should clarify the relationship between ESG and business, define ESG positioning, prioritize appropriate ESG issues, set goals and detailed initiatives, make necessary adjustments to business models, and provide an effective organizational support.

2. Literature Review

Domestic scholars' research on ESG in the Chinese context mainly focuses on three aspects: evaluation system, information disclosure, and economic consequences.

2.1 ESG Evaluation System

China's ESG evaluation system suffers from unclear concepts and large differences in evaluation indicators, and companies' self-assessment reports are diverse, and companies use different ESG indicators for self-assessment, and there is little research on the overall ESG evaluation system. ESG evaluation analysis focuses on the non-financial performance and sustainable development of companies, and its main data are derived from the publicly disclosed social responsibility reports or ESG reports of companies, which are usually not audited to determine the accuracy of the data, thus making it difficult to verify or compare the performance of companies. ESG ratings conducted by external organizations also lack standardization, and third-party ESG data providers and rating agencies use different data and rating systems. Compared with traditional credit rating systems, differences in evaluation frameworks and data sources make the evaluation results of different ESG rating agencies vary widely.

2.2 ESG Information Disclosure.

According to Wind ESG data, as of April 30, 2022, 1,410 A-share listed companies have disclosed independent ESG reports this year, accounting for 29% of all A-share companies, an increase of 22.5% compared to last year (Figure 2). At this stage, Chinese companies' ESG reports belong to the voluntary disclosure category, and there is no obvious guidance on investment needs at the institutional level and a lack of authoritative guidelines, and companies are not sufficiently aware of ESG information disclosure and lack the corresponding information disclosure ability, in addition, the ESG report has the phenomenon of greenwashing and overstates the environmental achievements of enterprise. It is practical to unify ESG information disclosure standards, clarify the responsibility of information disclosure, and consider implementing a mandatory or semi-mandatory ESG information disclosure system by referring to international experience.

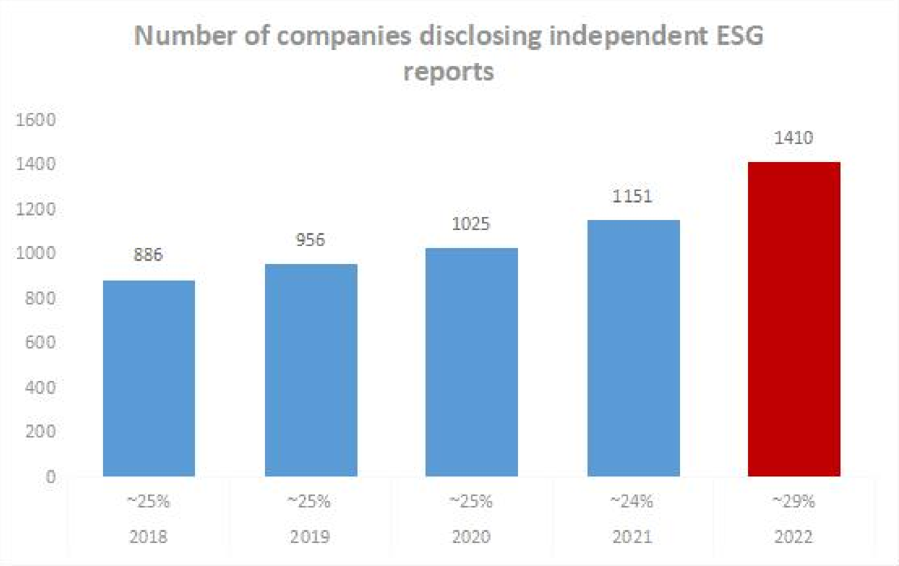


Figure 2.

Data source: Wind ESG database

In addition, ESG reporting metrics are not the same as effective use of ESG strategies. The ESG data that companies use may not be a real reflection of ESG practices. Also, companies need to understand good ESG strategy and execution results, not arbitrary results. Non-financial ESG metrics reporting is completely disconnected from financial metrics. Few companies track the financial returns of their ESG investments or efforts in their accounting systems. As a result, there is virtually no link between accounting data and sustainability investments. However, some studies indicated the existence of ESG risk premiums in capital markets and ESG bias among insurance funds and institutional investors.

2.3 The Economic Consequences of ESG.

It has been shown that ESG performance can inhibit corporate financialisation, reduce the risk of stock price volatility, enhance corporate value through mechanisms of action such as easing financing constraints, improving operational efficiency, and reducing financial risk, promote corporate financial performance by enhancing corporate innovation, and that media attention has a moderating role in the impact of ESG performance on corporate financial performance. However, there are differences in the economic consequences of corporate ESG performance in different industries, such as the differential effects of ESG performance on corporate financing costs, the more significant value-enhancing effects of ESG performance on firms in non-polluting industries, and the differences in the positive effects of ESG performance on earnings per share of firms in different industries.

By reviewing the academic research on ESG evaluation system, information disclosure and economic consequences, and considering the current situation of ESG practice in Chinese enterprises, the above research found that there are a lot of shortcomings. Therefore, I suggest that enterprises should explore the decision-making process and practice ESG actively, encourage enterprises practice actively ESG concept, and embed ESG strategy into the company's business strategy.

3. Methodology

This paper draws on the ROSI model of the Center for Sustainable Business (CSB) at New York University's Stern School of Business to embed ESG (environmental, social and governance) issues into corporate strategy. This is not only beneficial for increasing company profits but is also critical for fostering customer loyalty and guarding against major issues that pose threats to social stability, vitality, and inclusiveness, the very factors that make healthy business possible.

Return of Sustainability Investment (ROSI) is a framework proposed by the NYU Stern School of Business (NYU Stern) in 2016 that aims to help business managers and investors better understand ESG data to drive sustainable integration into corporate growth strategies and help companies improve decision-making.

The approach works by reviewing academic research on corporate operations to understand what factors positively impact financial performance when significant sustainability factors are embedded in a company. When a company incorporates sustainability ESG into its strategy and practices, this drives financial and stakeholder benefits (Whelan and Fink 2016). Once these benefits are operationalized for a specific company, they can be monetized in a variety of accounting ways. In other words, for sustainability/ESG practices that have been implemented, as well as those under consideration, current or future economic benefits can be predicted for the future.

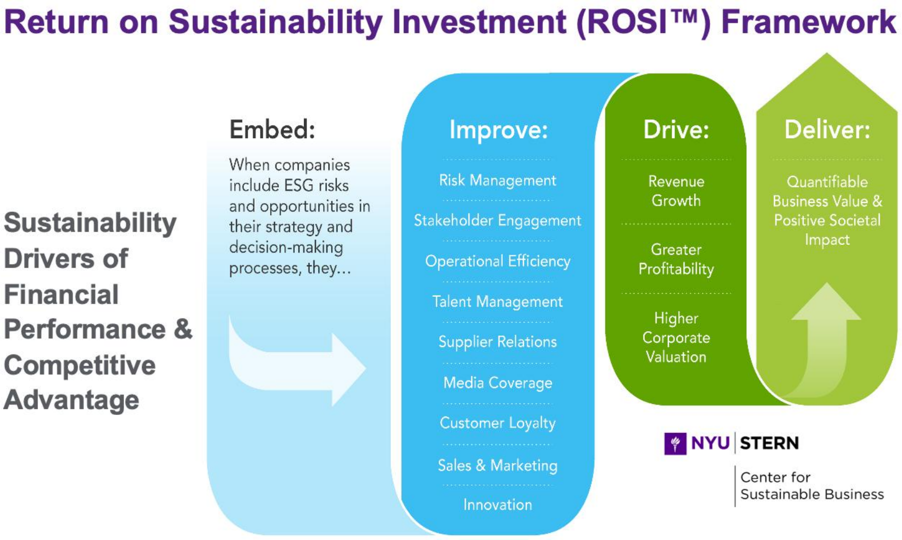

Return on Sustainability Investment (ROSI™) Framework
Sustainability Drivers of Financial Performance & Competitive Advantage
Embed:
When companies include ESG risks and opportunities in their strategy and decision-making processes, they...
Improve:
Risk Management
Stakeholder Engagement
Operational Efficiency
Talent Management
Supplier Relations
Media Coverage
Customer Loyalty
Sales & Marketing
Innovation
Drive:
Revenue Growth
Greater Profitability
Higher Corporate Valuation
Deliver:
Quantifiable Business Value & Positive Societal Impact
NYU STERN
Center for Sustainable Business

Figure 3.

Source: stern.nyu.edu/csbrosi

When a company embeds sustainability, this will affect a range of mediating factors to deliver quantifiable and monetized economic benefits to the business and society. Companies with embedded sustainability can be characterized by:

1) systematic and ongoing assessment of interest in company-specific key ESG factors and stakeholders, 2) organization-wide sustainability/ESG goals or key performance indicators (KPIs), 3) public reporting of KPIs/SDGs and third-party audits of progress on KPIs/targets, 4) development goals, 5) employee accountability and incentives that support sustainability goals, 6) sustainability commitment to informing capital allocation decisions, 7) robust, ongoing engagement of key stakeholder groups on long-term ESG strategies and, 8) active participation of investors around long-term, sustainable management strategies.

4. ESG Strategy Formulation

Referring to the ROSI framework, corporate ESG strategy development can be done in 5 steps.

Step 1 Assess opportunities and risks.

Use SASB or GRI as a guide to determine the ESG development strategy for your industry and company. No less than a dozen major ESG reporting frameworks exist globally, each with its own metrics, methodologies, and scoring systems. One reason for the growing number of ESG reporting frameworks is the wide variety of companies that now engage in reporting. Different industries have different ESG factors and implications and therefore need to report on different metrics.

Some of the most popular ESG frameworks today include the Global Reporting Initiative (GRI Standard), the International Organization for Standardization (ISO 26000), the Task Force on Climate-related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB), and others. Some of these frameworks encompass multiple topics, while others focus on specific topics within the ESG. In addition, companies also consider the primary audience for reporting when selecting an ESG framework. The differences between the dominant international ESG frameworks are shown in the table.

Table 1. ESG reporting framework standards and differences

Framework Title	Single Topic/Multi-Topic	Industry Distinct/Industry General	Primary Audience
GRI	Covering a wide range of economic, environmental, and social criteria	General	Multiple Stakeholders
IIRC	Covering all financial and non-financial issues	General	Investors and Other Stakeholders
SASB	Economic, Environmental, Social	Specific industries	Regulators
ISO	Subject-specific criteria, such as temperature and air, energy management or social procurement	General	Multiple Stakeholders
TCFD	Climate Change	Specific industries	Investors, lenders and insurers
CDP	Climate change, supply chains, water and forests	Specific industries	Investors and Clients

In a recent survey, 59.6% of Chinese listed companies refer to GRI for ESG disclosure, and large companies such as State Grid and China Resources Power, which we are familiar with, also use GRI as the first reference standard. Compared with foreign countries, the ESG system was established rather late and lagging in China, and a systematic ESG-related system has not yet been formed. We should actively learn from relevant experiences and build up a system under the framework of stakeholder collaboration.

At present, the ESG-related system is still led by government departments, financial regulators, and stock exchanges, with the core of guiding companies to practice ESG concepts and promoting companies to ESG information disclosure. Till September 2021, the representative ESG regulatory files issued by regulatory authorities and self-regulatory bodies, such as SFC, CBRC, CFPA, SSE, SZSE and HKEx are shown in Table 2.

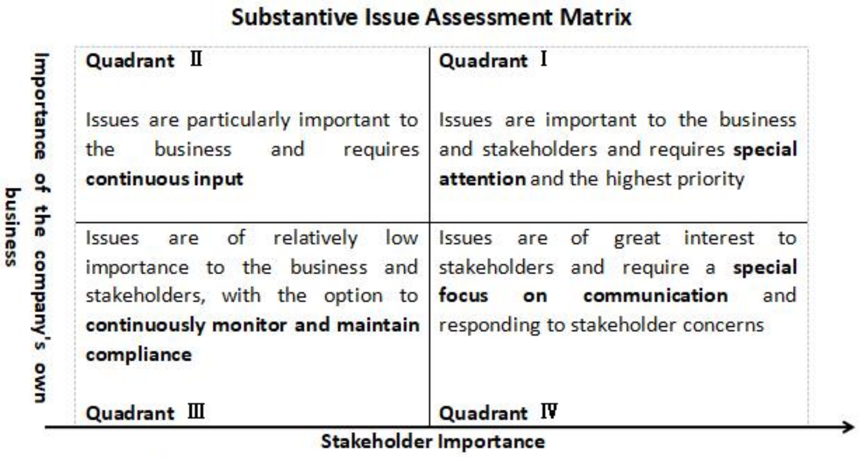
Table 2. Representative ESG regulatory documents in China

Year	Institution	File name
2006	Shenzhen Stock Exchange (SZSE)	*Guidelines on Social Responsibility of Listed Companies*
2008	Shanghai Stock Exchange (SSE)	*Guidelines for Disclosure of Environmental Information by Listed Companies on the Shanghai Stock Exchange*
2012 (2015 2019 Modification)	Hong Kong Stock Exchange	*Environmental, Social and Governance Reporting Guidelines*
2012	Banking and Insurance Commission (BCI)	*Green Credit Guidelines*
2016	PBOC and other 7 departments issued jointly	*Guidance on building a green financial system*
2018	China Fund Industry	*Green Investment Guidelines (Trial)*

	Committee	
	China Securities Regulatory Commission (CSRC)	*Code of Governance for Listed Companies*
2020	Shenzhen Stock Exchange (SZSE)	*Information disclosure work assessment methods for listed companies*
	Shanghai Stock Exchange (SSE)	*Guideline No. 2 on the Application of Self-Regulatory Rules for Listed Companies on the Shanghai Stock Exchange—Voluntary Disclosure*
	Shanghai Stock Exchange (SSE)	*Shanghai Stock Exchange Corporate Bond Issuance and Listing Rules Application Guideline No. 2—Corporate Bonds of Specific Species*
	Banking and Insurance Commission (BCI)	*Guidance on promoting the high-quality development of the banking and insurance industry*
2021	China Securities Regulatory Commission (CSRC)	*Guidelines on Investor Relations Management for Listed Companies (Draft for Comments)*

Step 2 Identify relevant strategies.

It is common practice for leading companies to evaluate ESG issues using an issue materiality assessment matrix, taking into account both the relationship to the business and the expectations of stakeholders. Companies need to prioritize ESG issues in terms of their importance to the business (impact on revenue/profit, brand image value, core business capabilities) and to stakeholders (employees, government and regulators, suppliers, partners, users, public, etc.) (Figure 4). The issues in Quadrant I are important to both the business and stakeholders, and therefore require special attention. Issues in quadrant II require ongoing investment because they are significant to the business. Issues in Quadrant IV require a special focus on communication with stakeholders and responding to stakeholder concerns. Quadrant III issues are primarily targeted at monitoring and compliance.



Substantive Issue Assessment Matrix

Quadrant Ⅱ

Issues are particularly important to the business and requires **continuous input**

Quadrant Ⅰ

Issues are important to the business and stakeholders and requires **special attention** and the highest priority

Issues are of relatively low importance to the business and stakeholders, with the option to **continuously monitor and maintain compliance**

Quadrant Ⅲ

Issues are of great interest to stakeholders and require a **special focus on communication** and responding to stakeholder concerns

Quadrant Ⅳ

Figure 4. Substantive Issue Assessment Matrix

Deep management involvement and broad stakeholder engagement are important in the substantive assessment of issues. Managers are in the best position to assess the effectiveness of ESG issues in their business because they are in the best position to understand the company's future business strategy. Companies also need to identify stakeholders and gather stakeholder feedback in a variety of formats. Telephone discussions, questionnaires, on-site interviews and meetings are all forms that are useful to determine the level of stakeholder interest in each ESG issue.

Step 3. Determine the expected benefits.

Determine the potential and realized financial and social benefits of these practice approaches through intermediate factors of financial performance (innovation, operational efficiency, supplier loyalty, etc.).

Assessing expected business returns is typically done in three steps.

(1) Making basic judgments about the status and trends of corporate earnings and identifying the main influencing factors.

(2) Expected earnings, examining the various major factors at play in the development of changes.

(3) Medium and long-term trend forecasting, mainly considering the various factors that affect stable earnings in the medium and long-term.

The main determining factors such as the demand factor of the product, if the product demand is high, can the electricity, equipment, transportation, and capital required for production be satisfied? The development of ability of new products, the quality of the workforce, the operation and sales ability of the product, the status of various policies of the government, industry and society to ensure, etc.

In addition, the expected revenue based on the evaluation of technology assets is neither the current status of revenue nor the actual revenue after transfer, but the expected revenue that can be generated in the normal operation in the future as determined by the current status of technology assets. It contains three levels of meaning: the expectation of revenue must be based on the realistic situation as the starting point. New occurring factors affecting the revenue of technology assets must not be included in the expected revenue. And the revenue is expected according to the realistic possible way of the best utilization of technology assets.

Step 4. Quantify the benefits results.

Quantify the benefits that result from sustainable practices. Each benefit is company specific and must be quantified. For example, determine the percentage of manufacturing waste that is recycled and reused. For example, for deforestation-free palm oil, it may lead to x more tons of palm oil produced per year because instead the soil is improved to plant palm trees in another location after the soil is depleted, x tons of greenhouse gases saved per year by reducing slash-and-burn agriculture, producers may see x% increase in productivity, x% increase in employee satisfaction following a deforestation-free commitment, x A positive news report about the company's deforestation-free commitment Positive news stories are likely to be published.

Step 5. Monetize the benefits.

When a company monetizes benefits, it is usually to increase sales or improve operational efficiency because there are tangible improvements to measure. For example, a reduction in energy use equates to a savings per kilowatt. For less tangible applications, we will need to establish a monetization process. The method of accounting for monetizing benefits may include a set of methods and may change depending on the type of benefit and the data available. To acquire this information, we will interview different functional teams within the company (e.g., finance, operations, sustainability, human resources) to gather data. In the absence of data to monetize or assume benefits, estimates can be made from the literature. An example of tangible data is the reduction of costs through better management and more efficient use of inputs. We calculate the change in actual input expenditures before and after the adoption of improved practices. More abstract concepts, such as talent retention, can be calculated by assessing the costs associated with turnover, weighted by probabilities. Uncertain benefits can be probability weighted to reflect the expected net present value and can be calculated over a range. Examples include valuing the tons of greenhouse gases in the global carbon market, valuing the monetary value of increased employee retention because of more job satisfaction, and valuing the monetary value of positive new reports, etc.

5. Conclusion

Much of a company's value is its intangible assets—its intellectual property, its brand, its reputation, and so on. Accounting as a profession, however, is better suited to valuing capital assets than intangible assets. Some sustainability benefits, such as cost savings or increased sales, fall under current accounting principles, and can be easily tracked. Other benefits related to risk, innovation, customer, supplier and employee loyalty, and better media coverage are intangible and require more of a management monetization approach. So, management and investors need to engage in thoughtful decision-making based on a full understanding of the financial benefits of sustainability.

Scholars and corporate managers need a clearer understanding of the business implications of ESG, without which companies will not expand their practices in sustainability in the face of climate change, New Coronary Pneumonia (COVID-19), inequality, and many other perceived and real challenges to the corporate bottom line. Capital market investors also need more and better information to be confident that a company focused on ESG practices can also meet its fiduciary responsibilities.

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Return on Sustainable Investment (ROSI™) methodology, developed by New York University's Stern Center for Sustainable Business (CSB) website: stern.nyu.edu/csbrosi or stern.nyu.edu/sustainability.

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