



ESG Brief Note

First mentioned in the “Who Cares Wins” published by the United Nations Global Compact in 2004, the term “ESG” is a set of non-financial standards on corporates’ Environmental, Social and Governance performance to capture and evaluate its progress on sustainability¹. With ESG became a fiduciary duty of investors, ESG has increasingly been mainstreamed since then in the capital market. Corporates undergo ESG reporting to either comply with regulatory requirements by some stock exchanges or increase transparency voluntarily; ESG rating agencies review the information publicly available or submitted by corporates and assign an ESG rating for them; Taking the ratings into consideration, investors further identify the non-financial risks and forecast whether the said corporate has a solid financial and sustainable portfolio worthy of investing in the future.

Various drivers are contributing to the rising awareness of ESG. Firstly, large corporates must comply with heightened ESG regulations. Compliance and reporting are mandatory not only in Hong Kong, but in many other countries as well². Secondly, the public disclosure of a company’s ESG information, coupled with technological advancement³, has made relevant information more easily accessible. By benchmarking their ESG management practices and performance against the regulatory or voluntary ESG frameworks and industry peers, corporates can better track their progress on ESG integration and identify gaps and opportunities for improvements to advance their competitiveness. Thirdly, the emergence of global challenges such as Climate Change and COVID-19 have increased corporates’ vulnerability to ESG risks⁴. Without adopting ESG principles and managing risks adequately, corporates will be further exposed to rising complexities and increased threats, weakening their business

¹ The United Nations Global Compact. (2004). Who Cares Wins: Connecting Financial Markets to a Changing World. *New York*. Retrieved July 22, 2021, from

https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf

² Krueger, P., Sautner, Z., Tang, D. Y., & Zhong, R. (2021). The Effects of Mandatory ESG Disclosure around the World. *Available at SSRN 3832745*. Retrieved July 22, 2021, from

<https://ssrn.com/abstract=3832745>

³ In, S. Y., Rook, D., Monk, A., & Rajagopal, R. (2019). Alternative ESG data for investment decision making. *SSRN Electronic Journal*, 3380835. Retrieved July 22, 2021, from

https://www.researchgate.net/profile/Soh-Young-In/publication/333576030_Alternative_ESG_Data_for_Investment_Decision_Making/links/5d4b555aa6fdcc370a814b92/Alternative-ESG-Data-for-Investment-Decision-Making.pdf

⁴ Folqué, M., Escrig-Olmedo, E., & Corzo Santamaría, T. (2021). Sustainable development and financial system: Integrating ESG risks through sustainable investment strategies in a climate change context. *Sustainable Development*. Retrieved July 22, 2021, from

<https://onlinelibrary.wiley.com/doi/pdf/10.1002/sd.2181>



resilience. Additionally, as the new generation of investors takes ESG considerations into their algorithms and valuation process⁵, corporates with decent ESG performance will have greater potential to attract larger investments based on its long-lasting impact and return. The changing regulatory and investment landscape has significantly increased the need for corporates to respond to investor's expectations on ESG and deploy relevant measures into their core business strategies and operations.

In Hong Kong, the Hong Kong Exchanges and Clearing Limited (HKEX) requires the listed companies to publish yearly their ESG reports regarding the same period of their annual reports since 1 January 2016⁶. Within the first two years of mandatory disclosure, the number of ESG reports issued increased by nearly one-fourth, with the length of the reports growing steadily⁷ as well, suggesting that corporations in Hong Kong are dedicating more and more efforts to ESG reporting

ESG is closely related to the Sustainable Value Chains (SVC)⁸ concept by using ESG criteria as the guidelines for environmentally conscious and socially empowering value chain activities. Due to the latest update of disclosure requirements and calls for increased transparency, listed companies are obligated to report on the sustainability performance of not only their own operations but also their upstream and downstream business partners, such as how the climate, environmental and social risks have been identified in their supply chains, how they screen⁹ and engage the suppliers and partners who are most suitable for them, and how they promote environmentally preferable products and services. Therefore, advocating for ESG has the potential to influence and improve the resilience of their entire value chains.

⁵ Escrig-Olmedo, E., Rivera-Lirio, J. M., Muñoz-Torres, M. J., & Fernández-Izquierdo, M. Á. (2017). Integrating multiple ESG investors' preferences into sustainable investment: A fuzzy multicriteria methodological approach. *Journal of cleaner production*, 162, 1334-1345. Retrieved July 22, 2021, from <https://doi.org/10.1016/j.jclepro.2017.06.143>

⁶ Hong Kong Exchanges and Clearing Limited (2020), Appendix 27 Environmental, Social and Governance Reporting Guide. Retrieved on 22 July 2021, from <https://en-rules.hkex.com.hk/rulebook/environmental-social-and-governance-reporting-guide-0>

⁷ Hong Kong Monetary Authority. (2020, October 29). What can We Learn from Analysing Listed Firms' Esg Reports? – Observations From Hong Kong Based on Textual Analysis. Hong Kong. Retrieved on 22 July 2021, from <https://www.hkma.gov.hk/media/eng/publication-and-research/research/research-memorandums/2020/RM05-2020.pdf>

⁸ Centre for Civil Society and Governance. Sustainable Value Chains – About the Concept. Retrieved on 22 July 2021, from <https://ccsg.hku.hk/pslb/about/sustainable-value-chains/>

⁹ Castillo, V. E., Mollenkopf, D. A., Bell, J. E., & Bozdogan, H. (2018). Supply chain integrity: A key to sustainable supply chain management. *Journal of Business Logistics*, 39(1), 38-56. Retrieved on 22 July 2021, from <https://onlinelibrary.wiley.com/doi/pdf/10.1111/jbl.12176>