

# The ESG Information Disclosure in Financial Market of China

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**Abstract.** In recent years, ESG (Environmental, Social and Corporate Governance) has become an indispensable factor in investment decisions. ESG information disclosure of listed companies has played an important role in finance. Since companies with good ESG performance focus on long-term development and sustainable value creation. And they have better internal governance mechanisms which help to manage risks better. These companies would have stronger sustainable competitive advantages in the market. While in China's ESG disclosure development, there still could be some issues that need to be addressed. This paper will from three perspectives to discuss the existing problems. Firstly, an official ESG disclosure framework and a regulatory force are needed to help standardize and legitimize the disclosed information. Secondly, there could be other ESG information besides the environmental problems that may also cause financial risks that need to be noticed during the disclosure. Lastly, to catch up the aggregated development of worldwide ESG disclosure, the supporting ESG infrastructure need to be improved. To solve these problems, this paper also gives relatively possible solutions: to construct a ESG management system and disclosure norms suitable for the Chinese market; to construct ESG-based bank credit facilities; to promote the development of digitalization and informatization of the disclosure.

**Keywords:** ESG, information disclosure, ESG investment, green finance, financial risk.

## 1. Introduction

The term ESG is the shortcut from three main factors: environment (E), social (S) and governance (G) [1]. ESG information is non-financial information which mainly includes climate change, pollutions emission, employees' rights, food security, anti-corruption etc. Nowadays, sustainable investment has drawn increasing attention of many investors, these investors tend to care about the ESG information disclosure on the capital market [2]. Following the spread of social media, increasing bad news like pollution, social equity and corporation responsibility have been exposed in China, where many of listed companies are included. The efficient market theory states that stock prices can reflect all available related information. Bassen and Kovács thought all new information, including financial and non-financial information such as ESG problems, could have potential impact to the valuation of equity [3]. Therefore, the exposure of this kind of problem could lead to negative affect to the stock prices and credit issues, which not only those companies lose out but also investors and credit institutions. One of the possible reasons could be the ESG information asymmetry. In China, the government just has started to discover and develop the ESG financial system. Since 2016, the central bank of the state has been publishing a series of programs and principles of green finance to provide rough guidelines of some emerging green financial products like green loan, green debts, green insurance, and some green projects like clean energy solutions. Furthermore, the state intervenes in the market to incentivize investment in environmental industries and requires disclosure of environmental information by heavy pollution industries, such as by granting subsidies. With the gradual awakening of ESG awareness and the introduction of more policies, China's ESG investment has achieved the following results: By the third quarter of 2023, the market size of China's sustainable portfolio investment had reached 3.66 trillion yuan, and sustainable equity investment had reached 0.82 trillion yuan. The number of organizations in China that have signed the United Nations Principles for Responsible Investment (PRI) is also growing at a relatively fast pace, reaching 138 by the first half of 2023, and the asset size of ESG funds has reached RMB 592 billion, accounting for 3.73% of the size of China's non-monetary funds. Nevertheless, there are some problems, this paper

is going to discuss the present problems and some possible solution of ESG information disclosure in China finance market.

## **2. Problems**

### **2.1. ESG Information Disclosure Framework**

Currently, the financial ESG information disclosure framework in China is not complete. This problem could mainly reflect on the following aspects. Firstly, there are no comprehensive and standardized requirements for financial ESG information disclosure. Most of current ESG reports by some financial professionals refer to different standards like the Global Reporting Initiative (GRI) or the International Organization for Standardization (ISO) [4]. This would cause the differences in the caliber of ESG information and the classification of items in the statistics, which would further lead to the lack of comparability of information for investors. Secondly, there are not dedicated regulatory authorities to supervise and manage the disclosure of ESG information. In present, China has not enacted any mandatory requirements to disclose ESG information for corporations [5]. So many enterprises in China have insufficient willingness to participant in ESG information disclosure, and the disclosed information is lack of accuracy and reliability. According to 21st Century Capital Research Institute, as of August 2023, the disclosure rate of ESG reports of China's A-share listed companies was only 33.8%. This ratio is still very low in relation to the total number of enterprises in China. Moreover, the quality of ESG disclosure cannot be guaranteed, and the disclosure contents are not comprehensive. Therefore, it is not conducive to investors' identification and screening of disclosed information, and this would increase the time cost and extra risks in the decision-making process for investors [6]. Besides, the risk of green finance on the bank side shows a significant upward trend, which is reflected on that the bad loan ratio of green loan of some banks has risen since 2022.

### **2.2. Awareness of Social and Governance**

Most of China's policies and activities around ESG and disclosure of information are environmentally related, with very little in the way of social responsibility and about corporate governance. (China's green investment structure is unique in that it favors environmental factors and is relatively weak in social and governance factors.) In recent years, China's green financial system has green credit as its main core, with green bonds as a supplementary component, and the structure differs greatly from that of developed countries. In the US, the investment in the three ESG factors is relatively balanced, with 33.56% in society, 33.23% in governance and 33.21% in environment. Meanwhile, the U.S. has gradually begun to focus on Racial Justice Investing (RJI) and Gender Lens Investing (GLI), which are designed to help communities with issues such as gender inequality and discrimination against women. In contrast, China's green investment structure is unique, and the green fund industry, which mainly invests in stocks and equities, is relatively weak. In addition, in terms of ESG investment themes, about 60% of China's green investment is focused on energy saving and environmental protection, and compared to developed regions, the overall willingness to invest in social and governance topics is relatively low. Not only about the environmental information, but social indicators could also affect the estimation of the future performance of the corresponding security. The estimation should be more precise, the more comprehensive and trustworthy the information that could be accessible. Furthermore, in the 17 UN Sustainable Development Goals, there are 8 goals about societal [7]. In terms of the corporate governance, the value of reputation, quality, brand equity, safety, workplace, culture, strategy, and a host of other assets are important in a knowledge-based global economy that cannot be adequately conveyed to management and investors through company financial statements [3]. The questionnaire published by China SIF in the Responsible Investment Report 2020 showed the result that the most concerned issues of investors include besides environmental pollution, the financial fraud, product quality issues, safety accidents, and corruption and bribery of executives are also concerned. There are studies states that corporate

governance would promote the ESG performance significantly, this could prevent agency problem [8].

### **2.3. ESG Financial Supporting Infrastructure**

In China, the digitalization and informatization of ESG finance needs to be further developed urgently. By providing funding to socially conscious businesses and pressuring them to give social concerns more attention, ESG finance, as a financial practice centered on environmental preservation and social responsibility, encourages the successful implementation of corporate social responsibility [9]. Therefore, it would be urgent to promote the construction of infrastructure for ESG finance. Since China's ESG finance is at the starting stage, the relative supporting infrastructure, like a information sharing system, has not yet been mature [6]. So, for credit institutions the cost of identifying reliable green projects is relatively high, which would affect the efficiency of green-fund supply. And the digitalization and informatization of the financial market based on the ESG framework that has not been well established would affect the transparency and openness of ESG information. As there are only few parts of listed corporations that choose to disclose ESG data presently, so for individual investors, the accessibility and convenience of ESG information is lacking. Besides, the reliability of ESG evaluation by third parties is insufficient. Because the evaluation of environmental and social benefits is highly specialized and technical, and third-party evaluation organizations may not have sufficient authority and reliability, while the verification of damage to environmental and social benefits usually takes a long time and costs a lot, which would directly affect the quality of green finance and the effectiveness of policies.

## **3. Possible Suggestions**

### **3.1. Construction of ESG Disclosure Standardised Framework**

First, promote the construction of ESG management system. It will improve the legal and institutional foundations under the ESG framework, intensify efforts to cultivate ESG-oriented green financial talents, and promote the construction of an ESG management system. Second, promote the construction of ESG information disclosure standards. The European ESG disclosure could be an example to be referred that establishing more comprehensive, open, timely and accurate disclosure mechanisms. Since for the purpose of assessing risk, setting prices, and making investment decisions, different financial market participants require consistent, dependable, and comparable information on climate investments [10]. In line with the United Nations Sustainable Development Goals (SDGs) and with reference to the standards of the International Sustainability Standards Board (ISSB) and the United Nations Principles for Responsible Investment (PRI), the company has constructed an ESG disclosure framework that includes objectives, strategies, governance and risk management, and discloses environmental, social and governance indicators of sustainable development, as well as information on risks and opportunities.

### **3.2. Construction of ESG-based Bank Credit Facilities**

Establishment of ESG-based bank credit facilities would reduce ineffective and inefficient financial supply, increase effective and efficient financial supply, and thus enhance financial financing. The adoption of ESG principles can reduce ineffective and inefficient financial supply, increase effective and efficient financial supply, enhance the efficiency of financial resources allocation and smooth the virtuous cycle between finance and the real economy, realize sustainable economic development, prevent financial systemic risks, and contribute to the structural transformation of the financial supply side [11]. Along with preventing financial systemic risks and offering a fresh direction for structural transformation of the financial supply side, it can also achieve sustainable economic development. Additionally, there should be increased emphasis placed on risk detection and management in the banking industry. Environmental and social difficulties have been the primary cause of numerous business credit failures in recent years. Micro and small businesses

have paid comparatively little attention to these risks. The limitations of analysing a single financial indicator can be adequately compensated for by using ESG to represent corporate credit quality. Banking institutions can enhance their risk detection and early warning capabilities by integrating Environmental, Social, and Governance (ESG) into the entire credit-granting process and performing ESG assessments of businesses.

### 3.3. Construction of ESG Financial Supporting Infrastructure

Firstly, promote the digitization and informatization of the green financial market. Some studies believe that digital technology helps solve the problem of information asymmetry [12]. It will establish a green project database, build a public information sharing mechanism covering the environment, public security, taxation, electric power, transportation, and other departments, enhance ESG-oriented green finance-related data collection, governance, and monitoring, and rely on financial technology to empower the measurement and business verification of green finance activities, broaden application scenarios, and improve the efficiency of green finance resource allocation. Secondly, promote the construction of ESG evaluation standards. Formulate uniform and standardized green financial standards in line with China's national conditions, embed ESG evaluation standards into the evaluation of green financial projects, gradually converge with international mainstream ESG standards, optimize the ESG orientation while improving the enforceability and comparability of China's green finance, and make good use of the ESG evaluation results in a problem-oriented and result-oriented manner, so as to reduce the risk of mismatch of green financial resources and continuously improve the efficiency and effectiveness of green financial supply. The results of ESG evaluation should be used in a problem-oriented and result-oriented way to reduce the risk of mismatch of green financial resources and continuously improve the efficiency and effect of green financial supply.

## 4. Conclusion

Environmental, social, and corporate governance, or ESG, has grown to be a crucial consideration when making investments in recent years. The financial industry has benefited greatly from listed businesses' ESG information sharing [2]. As a result, businesses that exhibit strong ESG performance prioritize long-term growth and sustainable value creation. Additionally, they have improved internal governance systems that aid in better risk management. These businesses would benefit from more robust, long-term competitive advantages in the marketplace. Even with China's advancements in ESG disclosure, several difficulties may still need to be resolved. This paper will address the current issues from three different angles. A regulatory body and an established framework for ESG disclosure are firstly required to help standardize and validate the information that is provided. Second, it's important to note during disclosure that there might be additional ESG data in addition to environmental issues that could pose financial risks. Finally, the infrastructure enabling ESG disclosure needs to be enhanced to keep up with the overall global development of ESG disclosure. This article offers some feasible solutions to these issues as well: creating an ESG management system and disclosure guidelines appropriate for the Chinese market; creating bank credit products based on ESG principles; and encouraging the advancement of digitalization and informatization of disclosure.

While in this paper, there are also research limitations. First, this paper only discussed the issues and possible solutions from theoretical perspective. In the future research, it could be better to add some case studies even statistical supporting. Second, this paper deliberated some of the current problems in China from only three aspects, but there are many other aspects that can be added in future research.

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