Analysis on Materiality Discloser of ESG Report by Hong Kong Consumer Staple Listed Companies under HKEx

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Abstract. The materiality approach has been recommended as the instrument in capital market for scoping and defining the content for sustainability reporting or reports that ESG factors that are relevant to both businesses and stakeholders. The study aims to analyze whether firms' ESG disclosure comply with the expectation of the Hong Kong Stock Market. This research selects 51 samples among year 2020 ESG reports from 107 number of Hong Kong listed companies in consumer staples industries to conduct statistical comparison analysis. Hong Kong listed companies in consumer staples industries' concerns about environmental and social topics in ESG report are unevenly distributed. These companies that provides materiality assessment mark social aspects as priority whereas the environment aspects as least relevant to both the company and the stakeholders. This research reveal that Hong Kong food companies have different weight on disclose from HKEx. The suspected reason for low materiality level of environment aspect by those corporations is that high fine for environment disturbance may disclose by the ESG report of such companies. The speculated causes for companies mark high materiality might be in response to the current government policy of talent employment retention. The proposed suggestion to the Hong Kong Stock market as they have the imitative to regulate listed companies. To improve the quality of listed company through their ESG report, the Hong Kong exchange market could implement punishment and premium to promote these company to meet the disclose standard.

Keywords: ESG report, Materiality, Sustainability accounting.

1. Introduction

In recent years, environmental and social issues have become increasingly important as many consumers demand to buy more environmentally friendly products [1]. In responding to customer's need, more investors are looking to invest in companies that are not financially profitable, but also sustainable in the long term for society, which agreed by corporate finance leader of EY, Ben Warren.[2] ESG factors (ESG stands for environmental, social and governance) have now become essential criteria for the investment choices of many capital providers to see if a company whether is sustainable [3]. However, information gap exists which is driven not only by companies' varying degrees of compliance with ESG disclosure requirements, but also by issuers' discretionary interpretations of material information.

This research selects 51 samples among year 2020 ESG reports from 107 number of Hong Kong listed companies in consumer staples industries. The reason for choosing Hong Kong listed companies is because Hong Kong Stock market employ the same reference standard of ESG reports for Hong Kong listed companies. The aim of this study is to reduce information gap by comparing the real-life situation of Hong Kong listed food companies to the HKEx ESG guideline and provide suggestions by analyzing the comparison of their materiality level.

The finding is that these 51 companies set light of emission, use of resources, and climate change. While HKEx utilize HSI to mark emission, and use of resources as highly material, which means the emission and use of recourse should be fully disclose with high emphases. but over half of the company marked emission and use of resources as medium material. which poses a warning sigh for companies in food industry as they should take more social responsibilities since they use more package material such as paper box, plastic bag, or glass bottle then other industries. Moreover, climate change suggested by HKEx should disclose as medium material, but over half of the company marked climate change as low material. HKEx viewed Health and safety of the workplace and labor standard as medium material, however, over half of the companies attach importance to the social aspect as highly material.

2. Literature review

2.1. Materiality in ESG report

The concept of materiality is derived from financial reporting that is commonly viewed as a threshold for influencing the economic decisions of those using an organization's financial statements, investors [4]. The concept of materiality in ESG report defined by the Hong Kong Stock Exchange market relates to identifying and prioritizing the most relevant sustainability topics, considering the effect each topic has on an organization and its stakeholders. A material topic is a topic that will substantively influence and impact the assessments, decisions, actions and performance of an organization and its stakeholders in the short, medium, or long term.

International standards or guidance, such as the GRI Standards and the TCFD Recommendations and the other guides address many environmental and social issues, but not all these issues are relevant to all companies. Depending on the industry, geographical locations of its operations and other factors, an issuer may consider certain aspects to be material to its business, whilst others are not. Under this reason, HKEx 2020 adopted a "comply or explain" approach to ESG reporting. It is important for an issuer to ascertain which aspects are material to its business and priorities relevant content in its ESG report accordingly by reporting on provision or provide considered reasons why information in respect of provision has not been reported on.

As suggested by *Farooq, Z. S. &K*, stock exchanges should consider introducing together corporate governance requirement for improving materiality assessment disclosures [5]. Improved materiality assessment disclosures have societal implications as it allows corporate stakeholders to understand and evaluate the process used by sustainability reporters in identifying material issues for reporting. The HKEx (Hong Kong Stock Exchange) (2020) introduce materiality disclosures requirement for all Hong Kong listed company and defines materiality in ESG report as follows: "the threshold at which ESG issues are determined by the board to be sufficiently important to investors and other stakeholders that they should be disclosed."

The Environmental, Social and Governance Reporting Guidelines (ESG Reporting Guidelines) in Appendix 27 of the HKEx Listing Rules used in this report are the most widely referenced preparation guidelines [6]. The ESG factors measured by each listed company in this report are organized into two ESG subject areas: Subject Area A -Environmental, namely A1 emission to A4 climate change, and Subject Area B-Social namely B1 employment-B8 community investment as referred to ESG Reporting guide.

2.2. Materiality assessment process

Materiality is a fundamental concept of corporate reporting of all kinds, which is often presented as a binary concept: an issue is either material (reported on) or immaterial (not reported on) [7] However, for the purpose of this study, the term "materiality assessment" is used, and undertaking a materiality assessment is highly complex and inherently subjective. The principle of materiality assessment in *HKEX 2020* categorized into internal and external materiality assessment [8], which requires reporters to consider a range of internal and external sources of information and by engaging with a wide range of senior managers and stakeholders, to identify and evaluate material issues for reporting.

2.3. Heng Sang Index and materiality level

Heng Sang Index (HSI) [8] have engendered a greater awareness towards companies' ESG performances by providing a new standard, referring to Table 1, which generate stronger incentives for listed companies to work towards more sustainable corporate practices in boosting their weightings, given that the newly launched indexes encompass a higher sensitivity to ESG performances. Industry observers commented that companies that join the ESG indexes will attract more passive fund managers.

HSI adopted in this research provides benchmark, its ESG information disclosure represents and leads the trend of ESG reporting of Hong Kong listed companies, both in terms of report release ratio and overall quality, for materiality level. A materiality level in ESG research is a level of importance from high, medium to low that an organization attributes to specific environmental or social factors.

Table 1. HSI Materiality table by HKEx – by Consumer Staples industry and ESG subject area from A1 to B8

Subject Area	Materiality Level (HSI)
A1: emission	High
A2: Use of Resource	High
A3: Natural Resource	Medium
A4: Climate Change	Medium
B1: Employment	Medium
B2: Health and safety	Medium
B3: Development and training	N/A
B4: Labor Standard	Medium
B5: Supply Chain	High
B6: Product Responsibility	High
B7: Anti-corruption	Medium
B8: Community Investment	N/A

3. Research Method

3.1. Sample Selection and Data Source

Given that the Hong Kong Stock Exchange released the requirement of mandatory ESG report for Hong Kong enterprises in 2019, this research use ESG reports from 2020 instead of 2019 because several companies could not publish ESG reports in 2019 because of the sudden mandatory requirement or the COVID-19.

This paper selects 51 out 107 companies listed by Hang Seng ESG for Hong Kong stocks with materiality assessment in 2020 as the research sample as these companies provide high, medium, and low material level result. The ESG performance (Hang Seng Index) and the rest of the financial information in the above sample were obtained from the HKEx database.

The step of approaches as follows:

(1) Conducts ESG reports from the HKEx: 51 ESG report with materiality assessment of 107 Hong Kong listed company in food industries in year 2020 are examined to see if their materiality level of ESG factors matches the expectation of Hong Kong stock market.

(2) Categories each ESG factor into Subject Area A1-B8.

(3) Record corresponding materiality level: whether this company view A1 is high, medium, or low material.

(4) Calculate the number of total ESG factors in one subject Area with material level.

(5) Calculate the weight percentage to decide the materiality level of the subject Area.

(6) comparing with HIS materiality table to find if the result of those food company’s materiality assessment same as the HIS materiality table.

(7) Analysis the comparison result.

3.2. Result

3.2.1. ESG factors 2020 summary

Table 2 is summary of all the ESG factors recorded by 51 sample companies, categories by each row of subject area from A1 to B8, and by each column of materiality level. Calculate the weight by dividing the number of ESG factors with the sum of same row which includes the number of ESG factors of low materiality, the number of ESG factors of medium materiality, and the number of ESG factors of high materiality. Then the result shows that the materiality level of most companies under 12 ESG subject are which is from A1 emission to B8 community.

Table 2. Weighted percentage of 2020 ESG factors

Materiality level Subject Area	Low Number of factors	Weight (%)	Medium Number of factors	Weight	High Number of factors	Weight
A1: emission	21	19.63%	63	58.88%	23	21.50%
A2: Use of Resource	25	18.52%	87	64.44%	23	17.04%
A3: Natural Resource	14	25.45%	29	52.73%	12	21.82%
A4: Climate Change	11	45.83%	9	37.50%	4	16.67%
B1: Employment	9	8.33%	74	68.52%	25	23.15%
B2: Health and safety	6	9.68%	27	43.55%	29	46.77%
B3: Development and training	11	21.57%	29	56.86%	11	21.57%
B4: Labor Standard	8	19.05%	21	50.00%	13	30.95%
B5: Supply Chain	10	12.82%	43	55.13%	25	32.05%
B6: Product Responsibility	21	8.61%	92	37.70%	131	53.69%
B7: Anti-corruption	10	12.82%	38	48.72%	30	38.46%
B8: Community Investment	47	45.19%	38	36.54%	19	18.27%

Since sample companies are prepared follow the instruction of the HKEx, as shown in Table 2, this paper assumed they use same materiality standard to conduct comparison analysis.

Table 3. Materiality level Comparison between 2020 Hong Kong listed food company and HIS suggested

Subject Area	Materiality Level (Calculated)	Materiality Level (HKEx)	Consistency (N/Y/N/A)
A1: emission	Medium	High	N
A2: Use of Resource	Medium	High	N
A3: Natural Resource	Medium	Medium	Y
A4: Climate Change	Low	Medium	N
B1: Employment	Medium	Medium	Y
B2: Health and safety	High	Medium	N
B3: Development and training	High	N/A	N/A
B4: Labor Standard	High	Medium	N
B5: Supply Chain	High	High	Y
B6: Product Responsibility	High	High	Y
B7: Anti-corruption	Medium	Medium	Y
B8: Community Investment	Low	N/A	N/A

The above table marks that the inconsistency between 51 Hong Kong listed food company and HSI suggested-on materiality level of A1 emission, A2 use of resources, A4 Climate Change, B2 Health and Safety, and B5 community investment.

3.3. Discussion

The 51 Hong Kong listed companies viewed A1-Emission and A2-use of resource as moderately important to disclose, and A4-Climate change as relatively low important to disclose for the company and its stakeholders. Through the Hang Seng Index, this article argues that food companies should be disclose up a level about their emissions, climate change and use of resources.

It is import for food company to know emission is highly material and climate change is moderately material to their companies because food production is responsible for 1 quarter of world's green gas emissions [10]. Reducing emissions from food production will be one of our greatest challenges in the coming decades. Unlike many aspects of energy production where viable opportunities for upscaling low-carbon energy are available, namely renewable or nuclear energy, such as use electricity car to replace gasoline, the ways in which the company and customers can decarbonize agriculture are less clear. The companies need inputs such as fertilizers to meet growing food demands, and most Diary company can't stop cattle from producing methane. The further research could focus on the need of solutions: changes to diets; food waste reduction; improvements in agricultural efficiency; and technologies that make low-carbon food alternatives scalable and affordable.

The use of resources includes the use of water, electricity and most obvious the package materials. Food packaging lies at the very heart of the modern food industry and very few foods are sold unpackaged [11]. Robertson argues the key role that packaging plays since good packaging prevents waste and ensures that the food retains its desired quality throughout its shelf life. However, Gupta and Dudeja have different opinion that food package can at times be a cause of concern for food safety.[12] Some packaging materials such as certain types of plastic, polythenes, and styrofoam can release toxins both to the consumers and environment.

4. Conclusion

ESG disclosure are mandatory disclosre for Hong Kong listed company for the sake of stakeholders as it poses significant effects on investors looking to assess a company's ESG performance to make investment decisions. This research points out that publicly available ESG information do not meet the expected standard of HKEx by comparing the actual situation of materiality level of ESG factors measured by each Hong Kong listed Company to HSI suggested materiality level.

Hong Kong listed companies in consumer staples industries that provides materiality assessment tends to be emphasized on social aspects like B1 to B8 more than the environment aspects such as A1 to A4. Connecting to the Hong Kong current policies of Quality Migrant Admission Scheme [13], this research founds out that the Hong Kong government weighted more on talent attraction, which might be a signal for Hong Kong listed company to focus on providing safe and health workplace for the citizens then the sustainability of the environment. However, Freeman's stakeholder theory reshapes the role and purpose of the firm. Freeman argues that the main goal of a firm is not profit maximization, but a consequence of its existence. Most importantly, companies must satisfy all stakeholders (employees, customers, suppliers, etc.) by minimizing externalities and maximizing social welfare [14]. The Hong Kong listed companies could maximize social welfare by allowing public supervision and disclosing more about their emission and use of resources.

This research suggests on the dynamic planning and development for company on ESG aspects, advising it work properly and reasonably. The sample of 51 customer staples companies are examines to get a whole picture by comparing the average mean of the industry to the HIS reference materiality level. In the further research, the consequence of low compliance to the ESG requirement from capital market to certain companies from the sample will be critically evaluated. The foreseen consequence may include the undervalue of such companies' firm value, negative ESG signals resulted in unwillingness of shareholders to buy such companies' stock, and concerns regard of reputations.

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