

The Development and Prospects of ESG Implementation in Chinese Enterprises

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Abstract. The fundamentals of Environment, Society, and Governance (ESG) are becoming more essential for organisations across all industries [1]. The United Nations Global Compact established governance in 2004 as a collection of principles and criteria used by firms to examine and show their commitment to environmentally friendly growth, social accountability, and ethical business practises [2]. To attain their goals, Chinese businesses must embrace low-carbon business strategies. Increasing carbon emissions to zero by 2030 and achieving carbon neutral by 2060 [3]. China's Ministry of Ecology and Environment (MOE) has lately been able to execute the Measures for Enterprise Environmental Information Disclosure in line with the Law. This programme attempts to increase environmental transparency and responsibility across industry. This programme intends to increase environmental transparency and responsibility across industries [4]. These include key polluting enterprises, enterprises subject to mandatory liquidation review, publicly traded companies and their subsidiaries at all levels, businesses issuing bond issues and non-financial corporate debt financing instruments, and other organisations required by law and regulation to report environmental information. In recent years, China has experienced an increase in the quantity of unfavourable news articles as corporations prioritise turnover over all other aspects. For example, the "Wei Zexi Incident"[5], which occurred between April and May 2016, involved fraudulent medical advertisements as well as the "maliciousness" of the search platform bidding system, resulting in online search service companies' inability to meet their corporate social responsibility (CSR). Furthermore, many online community operators highlight hotspots and controversies in their algorithms, and related industries are under strict regulatory scrutiny; the public is very dissatisfied with the business behaviour of companies that are solely concerned with their own profitability, and the introduction of negative news frequently leads to regulatory action [6]. The public is seeking for a more useful valuation criteria than a single guide to company profitability, and ESG represents that value proposition. In this study, analyses the development prospects and feasibility of ESG concepts in Chinese companies are analysed, and introduces mainstream international ESG assessment systems and examples of ESG implementation in Japanese companies. The study also summarises the strengths and weaknesses of ESG implementation in Chinese companies are also summarized and puts forward.

Keywords: ESG, China, Sustainable development, ESG Rating System.

1. Introduction to international mainstream ESG rating systems

Dow Jones Sustainability Indexes (DJSI) identify firms that are setting the standard for sustainability by evaluating their social, governance, and environmental performance [7]. The DJSI ESG Scorecard assesses over 600 firms' environmental, social, and economic performance across many dimensions. The DJSI comprises both general and industry-specific indicators and weights the scores for each indicator to arrive at an industry-specific final score [8].

Public information, firm documentation, questionnaires (public information must be submitted while completing the questionnaire), and direct contact with companies via four channels [7] are the primary sources of data for evaluating DJSI enterprises. Following the collection of corporate information, the firms are appraised, and the top 10% sustainability performers in each sector are chosen as components of the DJSI index series.

CDP, a UK-based non-governmental organization founded in 2000, annually requests that the world's major corporations submit information on their carbon emissions, climate change plans, and actions [9]. CDP will analyse whether or not companies are genuinely invited to respond to the

questionnaire. The questionnaire is published immediately on the CDP website, and based on their replies, CDP ranks firms on a scale of A to F (A being the highest and F being the lowest) [10]. The questionnaire is published directly on the CDP website, and firms that do not reply are graded on a four-point scale ranging from A to D, symbolizing the four steps of the journey to environmental leadership.

The Sustainalytics system incorporates an ESG risk viewpoint to analyse risk by taking a company's ESG performance into account. Sustainalytics' rating measures are divided into three core rating modules: Corporate Governance, ESG Substantive Issues, and Company-Specific Issues [13,14]. The ESG module (Substantive Issues) is the ratings' primary and core module, covering different indications across the ESG dimensions [11].

MSCI publishes a set of seven indexes. These indicators are updated on a regular basis, with the ESG Index being one of seven categories and one of MSCI's five research directions, with the goal of assisting investors in allocating capital to more scientific and risk-averse portfolios through ongoing, in-depth research on ESG investing [12].

MSCI's ESG ratings are divided into three categories: environmental, social, and governance. These dimensions encompass ten topics and 37 important performance indicators [13]. MSCI uses the Global Industry Categorization Standard (GICS) to classify rating firms into 11 clusters, 24 sectoral groupings, 69 trades, and 158 sub-sectors after examining the basic indicators. Furthermore, each fundamental topic is weighted from 5% to 30% based on the thematic risk of the various industries [13]. Finally, the organisations' performance levels were compared to their counterparts and rated in descending order of magnitude, as shown in table 1.

Table 1. MSCI ESG Indicator Ranking

CCC	B	BB	BBB	A	AA	AAA
Industry lagging		Industry average			Industry leader	

MSCI scores are calculated using three main sources: macro data from universities, governments, and non-governmental organisations (NGOs); published company information, such as sustainability/environmental, social, and corporate responsibility (ESR) reports or official company websites; and individual company data from government databases, over 1,600 media outlets, NGOs, and other stakeholder sources [13].

Over the past few years, many Japanese companies have changed their business models in a more sustainable direction [14]. To illustrate, a growing number of companies are willingly opting to highlight their commitment to sustainability through press releases and public meetings. They are also including sections on ESG practices and sustainability in their regular reports and financial statements. Although the amount of ESG data published by Japanese companies is still less than in Western countries such as the United States and Europe, the amount of such data has been increasing every year [15].

In terms of environmental systems, 38 per cent of Japanese companies rank in the first and second quartiles. This means that Japan is still below European levels (48 per cent of companies in the first and second quartiles), but better than the United States (30 per cent) and emerging economies (32 per cent) as shown in fig.1. This suggests that although Japan is the fifth largest emitter of greenhouse gases, Japanese companies are working with the government to develop strategic policies to address environmental issues [16].

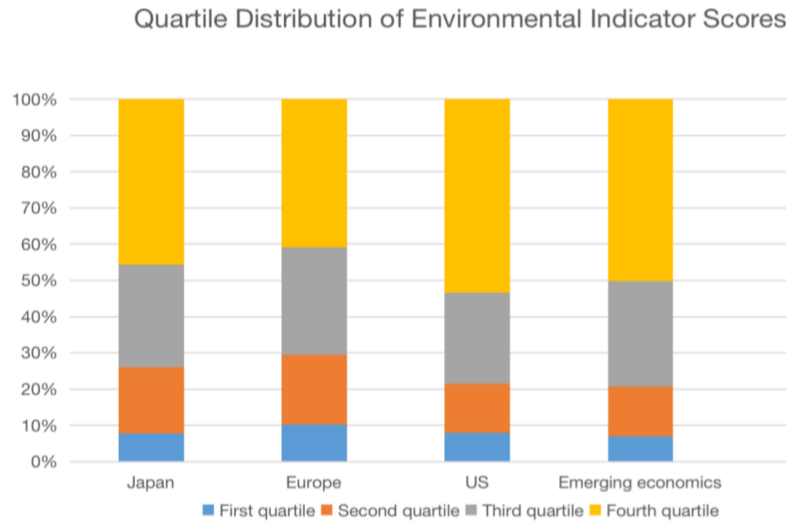


Figure 1. Quartile Distribution of Environmental Indicator Scores

As shown in fig. 2, in terms of social systems, Japanese companies lead the world, with 56 per cent of Japanese companies in the 1st and 2nd quartile of social ratings, higher than in Europe (52 per cent), the US (33 per cent) and emerging markets (40%) [14,19] (Figure 2).

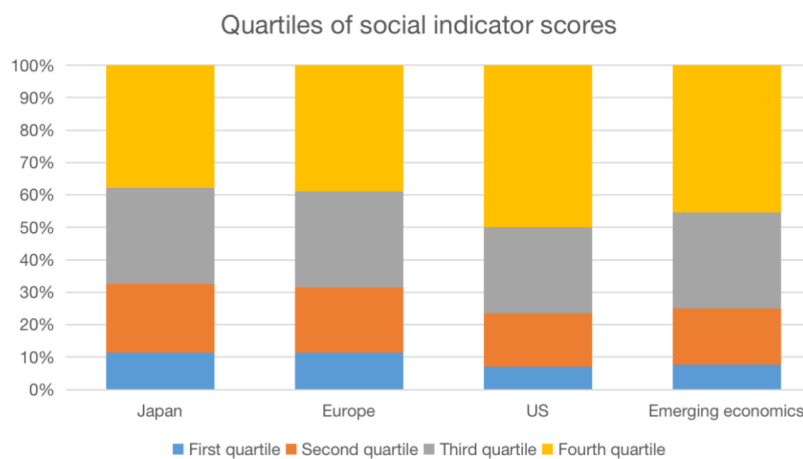


Figure 2. Quartile Distribution of Social Indicator Scores

On governance indicators, both Japan and emerging markets rank poorly, with 27 per cent of Japanese firms in the 1st and 2nd quartiles, compared to 82 per cent in Europe and 67 per cent in the US [14] as shown in fig.3.

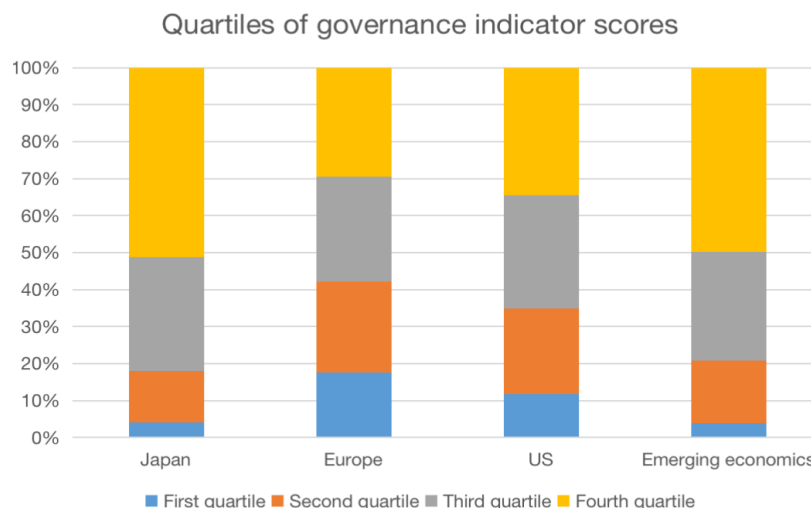


Figure 3. Quartile Distribution of Governance Indicator Scores

Japan's business model consists of multiple corporate consortia, which explains the success of the Japanese Corporate Governance Code announced by the Financial Supervisory Authority (FSA) in 2013 and implemented in June 2015, both of which have had a substantial influence on enhancing Japanese enterprises' corporate governance and delivering a fair return to shareholders [19].

Overall, Japan's ESG implementation trajectory as a developed Asian country serves as a lesson for the future development of ESG in China.

2. ESG Promotion in Chinese Enterprises: Is That a possibility

2.1. Consistent with the dual-carbon concept

The State Council's State Affairs Surveillance and Accounting Commission (SASAC) made the opening comments at the 2021 China ESG Forum Summer Summit on July 18, emphasising how ESG concepts have been integrated into SASAC's core functions. This integration seeks to increase corporate social responsibility [18]. These activities are projected to generate significant potential for moving ESG investments forward across the country [2].

Climate change mitigation ESG investment will provide critical assistance for achieving low-carbon economic transformation, and ESG investment will confront significant development potential. As a result of the national dual-carbon strategy, ESG value and ESG investment will usher in new chances for development.

2.2. ESG concepts are in line with traditional Chinese collectivism

The conventional and prevalent legal idea is shareholder-centered: the primary method of corporate existence and development is to produce value for shareholders, who, as the primary stakeholders, have a wide range of rights and interests. In accordance with the legislation and the articles of incorporation [19]. However, there have been continual criticisms of the single-minded pursuit of "shareholder value" throughout the course of economic growth in industrialised countries. People born in the 1980s and 1990s fall into three separate sub-groups: Social Investors, Chill Worker Bees, and Successful Individuals. Work-life balance is important to social investors. Cold Work Bees like a pleasant working atmosphere, but Successful People prioritise professional growth.

In China, SynTao Green Finance has developed the SynTao Green ESG Information Assessment System, which contains a three-level indicator system [20]. Level 1 indicators cover the three dimensions of ESG, Level 2 indicators include 13 categorised topics, while Level 3 indicators contain 127 specific indicators [20]. The evaluation system consists of two types of indicators: generic and industry-specific. The generic indicators are designed to be applicable to all listed companies, whereas the industry-specific indicators are tailored for each specific industry and only relevant to companies within their respective industry classification. The absence of standardized mandatory guidelines has posed challenges and uncertainties for companies and investment institutions in implementing ESG practices and making ESG investments. There is a need to further promote and develop unified standards and guidelines so that companies and investment institutions can better carry out ESG-related work and investments [17].

At present, the perception of ESG practices in most cases remains in environmental protection and social responsibility, which is highly related to the fact that mainland China has not yet introduced comprehensive mandatory ESG legal requirements [21]. In fact, regulators are already aware of this and are expected to incorporate more ESG norms in the rules to be issued in the future.

Meanwhile, as China's economy enters a new phase and regulators tighten capital constraints, more and more companies and investors are prioritising the long-term interests of their companies.

3. Scaling solutions to ESG challenges in China

3.1. Get familiar with mainstream rating requirements

It is important for enterprises to understand and familiarise themselves with the requirements of each mainstream rating. Enterprises should take the initiative to understand the content, process and response methods of mainstream ESG ratings and compare them with their own ESG management and disclosure status to make necessary improvements in advance [21].

3.2. Internal and external ESG communication

Effective internal and external ESG communication is essential. Companies should recognise the value of communication and continue to improve their communication skills. On the one hand, companies should engage in dialogue with investors, shareholders and other key stakeholders to discuss ESG matters and strive to gain their understanding, acceptance and support. On the other hand, companies need to maintain communication with rating agencies to keep abreast of ESG trends in the capital market so that they can better respond to rating requirements and obtain more financing opportunities [20].

4. Conclusion

ESG rating systems are crucial in promoting ESG principles globally. These systems provide a framework that assists investors in assessing and comparing companies' ESG performance. Moreover, case studies of companies in developing Asian countries, particularly Japan, demonstrate successful implementation of ESG principles, indicating a growing recognition among Asian companies about the importance of ESG for long-term sustainability. However, promoting ESG in China faces several challenges, including the lack of mandatory harmonized ESG standards and shortcomings in integrating ESG regulatory documents. Additionally, Chinese companies tend to be more focused on short-term benefits, limiting the promotion of ESG. To overcome these challenges, it is recommended that Chinese companies familiarize themselves with mainstream rating requirements, strengthen internal and external ESG communication, and enhance ESG management. Furthermore, adopting targeted ESG disclosure measures can improve transparency and overall ESG performance. Despite the challenges, by strengthening ESG management, improving disclosure, and raising ESG awareness, Chinese companies are expected to make significant progress in sustainability.

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