Status, Challenges and Strategic Direction of the ESG Development in China

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Abstract. ESG stands for abbreviation of environmental, social and corporate governance investment. ESG concept has been more and more widely used in the world. Compared with European and American countries where ESG development is more mature, China's ESG development is still in its infancy, and there are still problems and challenges in many prospects. From the perspective of ESG investment, ESG evaluation system and ESG report of listed companies, this paper explores status、challenges of ESG development, puts forward some suggestions on the development of ESG in China. It is foreseeable that ESG will be widely adopted in China with the country's rapid economic development.

Keywords: ESG · Status · Challenges · Strategic direction

1 Introduction

Under the impact of the pandemic, the scale of sustainable investment funds was not affected during recent years. The Chinese government has introduced a series of measures on carbon emissions, anti-monopoly and corporate governance to actively transition to a low-carbon economy. Considering that the proportion of responsible investment is small, but the growth rate is very fast in China, this paper provides a thematic review of ESG development to explore further implementation of the ESG in China. The innovation and development of ESG in China are expected to be promoted on the basis of absorbing international experience.

2 Status

Under the background of global trade friction, regional conflictsand partial anti-globalization, sustainable development is becoming a rareconsensus in the differentiation of globalization. ESG is an important investment concept and enterprise action guide rising in the financial market in recent years, which is also a concrete projection of the concept of sustainable development at the financial market and micro enterprise.

With the rise and development of religion, the concept of ESG investment originated from ethical investment. According to the report published by Global Sustainable Investment Alliance (GSIA) from 2016 to 2020, the proportion of global assets invested

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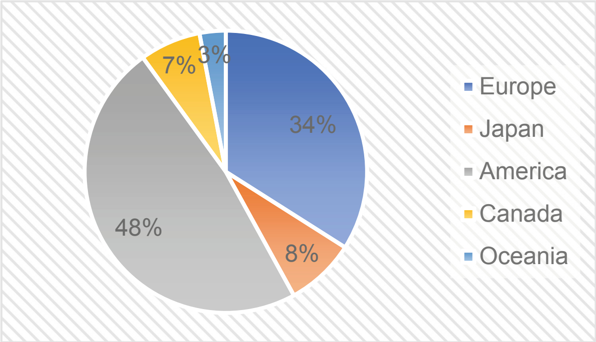

Fig. 1. The proportion of ESG investment scale in major global markets in 2020. Table Credit: Original

according to the broad standard of sustainable investment in total assets under management increased from 28% to 36%, indicating an obvious growth trend of sustainable investment [1].

After the outbreak of the COVID-19, ESG has become increasingly important, and its scale of ESG asset management has increased. Bloomberg forecasts that global ESG assets management scale is expected to exceed $53 trillion by 2025, accounting for more than one-third of the projected total assets management ($140.5 trillion).

2.1 The Global State of the ESG Development

It is worth noting that ESG investment continues to grow in most countries. China ESG Development White Paper (2021) found that, in 2020, the scale of ESG investment in the United States reached US$17.08 trillion, accounting for 48%, which surpassed Europe to become the region with the largest scale of ESG investment in major global markets. The European market took second place, with ESG investment achievingUS$12.02 trillion in 2020, which accounted for 34%. The scale of ESG investment in Japan has grown rapidly, surpassed Oceania and Canada in 2018 and, reach US$2.87 trillion in 2020, accounting for 8%. The sustainable investment scale of the United States and Europe accounts for more than 80% of the world and dominates [2] (Fig. 1).

2.2 Overview of ESG Development in China

The ESG concept and responsible investment started late in China, which is mainly mentioned in the development concept of ESG of listed enterprise. The earliest ESG investment in China began in 2002. At that time, Qingyun Venture Capital established the first ESG related fund in China, namely the China Environmental Protection Fund. Then it gradually entered the public view in China after 2016. Compared with European and American countries, China's ESG started late but developed rapidly.

Since 2017, China Securities Investment Fund Industry Association initiated the special research on ESG, actively promoted and advocated the concept of ESG. Since June 2018, A shares have been officially included in MSCI Emerging Market Index and

MSCI global index. In this process, MSCI will give ESG ratings to all listed companies in China, and those that do not meet the standards will be eliminated, which makes major institutions and listed companies in China strengthen their research and exploration of ESG. At the same time, a series of relevant policies and regulations have been issued and implemented.

On April 15, 2022, the China Securities Regulatory Commission (CSRC) issued the guidelines for the management of investor relations of listed companies, which will come into force on May 15, 2022. [4] This document for the first time includes "corporate environmental, social and governance information" in the communication content of investor relations management, thus accelerating the development process of ESG information disclosure and ESG investment in China.

Currently, investment institutions, enterprises and third-party service institutions mainly implement ESG by joining internationally recognized organizations and principles.According to the statistics of China Securities Investment Fund Industry Association, the number of public and private funds in the direction of green, sustainable and ESG had been close to 1000by the end of the third quarter of 2021, with a total scale of more than 790 billionyuan, an increase of 36% over the scale at the end of 2020.

3 Challenges

In fact, ESG could consider developing from an "ESG practice" and "ESG investment" perspective. The practice of ESG at the enterprise level (especially at the level of listed companies) combines environmental, social and governance factors with the management and operation process of enterprises, which is consistent with the corporate social responsibility (CSR) advocated by all sectors of society; ESG is also an investment philosophy that focuses on corporate environmental, social and governance performance rather than just financial performance, and advocates incorporating ESG factors into investment research, decision-making and management processes.

The overall ESG work of listed companies is still in its infancy, and only a few listed companies have established relevant committees. Therefore, the importance of ESG work has not been fully recognized by domestic listed companies, and ESG work has just started in the group of listed companies.

3.1 ESG Disclosure

As the social responsibility report of listed companies is not a compulsory disclosure, only a few listed companies in Shanghai and Shenzhen stock exchanges actively disclose social responsibility reports in present, and the overall level of ESG information disclosure is not high.

As for ESG evaluation, there is no effective method to pry out the internal information of enterprises, and only public data can be relied on, which affects the early warning function of ESG to some extent. On the basis of the survey of Shenzhen Stock Exchange, regular reports are still the main carrier of ESG information disclosure, and less than 30% of listed companies specifically disclose ESG reports, social responsibility reports or sustainable reports.

Table 1. ESG report disclosure for listed companies in recent years

Year	Number of companies disclosed	Number of companies	Rate of disclosure
2016	799	3052	26.2%
2017	867	3485	24.9%
2018	939	3584	26.2%
2019	1000	3777	26.5%
2020	1121	4154	27.0%

Source: WIND is a leading provider of financial and economic data for China. Details of the data provider can be found at: https://www.wind.com.cn/ Table Credit: Original

Moreover, the current ESG disclosure lacks unified standards. Before mandatory disclosure, it is necessary to develop a system of enforceable standards. For example, carbon emission is an important quantitative information in ESG, but the disclosure of total carbon emission and intensity should be based on unified accounting standards, accounting methods and statistical caliber. If the preliminary basic work is not perfect, the company will face high cost burden, and the authenticity and comparability of disclosed information cannot be guaranteed, and the information quality is low (Table 1).

3.2 The Rating Results Vary

The expansion of ESG asset management overseas has driven the rapid development of rating agencies. According to incomplete statistics, there are more than 600 ESG rating agencies. As summarized by Wang Kai and Zou Yang (2021). A prominent problem of global ESG evaluation is the low consistency of evaluation results among different institutions, and even some enterprises may give opposite evaluation [5].

For example, there are differences in index selection and weight allocation among the more mainstream foreign indexes such as KLD, MSCI, Thomson Reuters and FTSE Russell, and their conclusions have no reference relevance and low consistency. Major domestic rating agencies include Wind, Harvest Fund, China Securities, Runling and so on. There are also huge differences in the ratings of these agencies.

In addition, domestic and foreign ratings are not consistent. ESG evaluation is currently in the initial stage of development, and its data and methodology are not mature enough. The credit rating industry, comparable to ESG assessments, has taken a century to achieve a degree of consistency. The rating gap is likely to continue to narrow as the industry matures. However, it is also possible that different institutions will have different interpretations and judgments based on the same data, so inconsistencies will persist.

3.3 The Realization of the ESG

Wang Dadi and Huang Jie (2021) found that, ESG investing is based on theory and value and requires a lot of background knowledge to understand, which also creates a cognitive barrier that makes it difficult to be widely accepted by entities and investors [6].

3.3.1 From the Perspective of Companies

ESG is the occupation of enterprise resources in the short term, and it is difficult to achieve immediate results. But in the long run, it will be of great benefit to the sustainable development of enterprises.

It is obvious that all sectors of society should make it clear that enterprises cannot sacrifice large amounts of economic benefits in return for social development and ecological protection. The two are “sharing weal and woe”.

Chen Daofu (2020) found that the companies have not paid much attention to the importance of ESG management [7]. At the current stage of economic development, Chinese enterprises focus on the size and speed of economic growth. ESG is also a process of gradual development in the international market. Developed countries attach more importance to ESG’s investment concept than some developing and less developed countries. It takes time for the importance of ESG come into Chinese enterprises.

3.3.2 From the Perspective of Investment Institution

While ESG investing is clearly ethical, it is still a profit-driven investment. The correlation between ESG and ROI has yet to be tested. First, the positive correlation between ESG performance and ROI has not been widely accepted by mainstream investment groups at the empirical level. Some studies show that good ESG performance will also produce good operation and financial performance. However, Richard Paul Gregory (2021) find no difference in market efficiency between ESG and Standard indexes.[8] Some market data in the same period show that the performance of different ESG asset classes and even different products under the same category of ESG fund are very different, so it is difficult to directly correlate the investment return with ESG performance. Second, the information in the market is still highly asymmetric. The issue of transparency in ESG investments is an important part of the issue of information transparency in the whole sustainable financial system. The problem of information transparency mainly includes issuer disclosure, third-party institution disclosure and investor disclosure. The lack of transparency in the market will reduce the external pressure and violation cost of all participants in the sustainable financial market as a whole, weakening the impact of public participation and social supervision. Third, the quantification and application of ESG is the biggest challenge faced by ESG investors. The quantitative problems of ESG make it impossible for ordinary investors to establish a positive correlation between ESG performance and financial return, thus lacking the motivation to invest in ESG. Integrating ESG analysis with fundamental analysis and valuation model in the actual decision-making process, which hinders the actual promotion of ESG investment.

4 Strategic Directions

In recent years, domestic financial market participants have continued to pay more attention to ESG. As ESG is highly consistent with the high-quality development of

China's economy and has great development potential, it is expected to get greater development in the future.

4.1 Improve the Level of ESG Information Disclosure

ESG information disclosure is not only a compulsory course for listed companies, but also an important way to show the intrinsic value of the company to investors in multiple dimensions.

4.1.1 From the Perspective of Companies

Government departments should actively promote listed companies to implement environmental governance. The promotion scope of ESG can be gradually implemented according to the nature and scale of enterprises. ESG disclosures and practices focus on long-term effects, so individuals need to bear some costs in the short term to implement ESG and may cause waste of resources. Enterprises that can bear the initial cost and can better realize ESG benefits in management and operation can be selected, preferably some representative and socially influential enterprises. As the development of ESG continues to deepen, policy makers can set short, medium and long-term planning goals and gradually expand the scope of ESG implementation entities.

Listed companies should improve the information disclosure and publicity of ESG reports to promote the market and the public to have a more comprehensive understanding of the company's ESG situation.

The number and proportion of listed companies that actively disclose ESG information have increased, and the quality of information disclosure has improved. In order to improve the transparency, effectiveness and pertinence of information disclosure, some listed companies should actively explore and try the disclosure mode under the framework of the internationally recognized climate related financial information disclosure working group (TCFD). There is a long way to go to build a high-level and in-depth participation, horizontal coordination and vertical linkage ESG management organization system.

4.1.2 From the Regulatory Institutions

ESG information disclosure should be gradually strengthened in China. Regulators need to establish and improve rules and standards for financial institutions' ESG information disclosure, construct an evaluation system for financial institutions' ESG information disclosure, strengthen supervision over financial institutions' information disclosure, and promote the overall improvement of information disclosure quality of financial institutions.

At present, the International Financial Reporting Standards (IFRS) is considering introducing a set of standards on ESG, which has been solicited internationally and is expected to be released by the end of 2022. At that time, various countries will be able to learn from this international standard and issue matching guidelines based on their own circumstances. However, it can be expected that the standard will be widely adopted similar to IFRS, and it will have an impact on the operation of every company in the world. The key to the solution is to formulate ESG disclosure standards that are both in line with international standards and reflect Chinese characteristics.

Achieving the "3060" dual carbon target requires the integration of ESG disclosure frameworks and standards and a more efficient allocation of resources. Drawing on the leading experience of the European Union and Hong Kong, the ESG disclosure standards of listed companies need to be advanced rationally by multiple departments. And promote ESG integration information disclosure through top-down mandatory legislation.

4.2 Strengthen the Construction of Rating System

ESG rating, as a landmark achievement of related work of listed companies, is an important indicator worthy of investors' attention. The rating information of international mainstream institutions is one of the important information channels. Moreover, a localized ESG evaluation system needs to be established.

As the domestic market has not yet established a universally applicable ESG rating standard, Chinese Association of Listed Companies and other relevant institutions will continue to promote the establishment of an ESG evaluation system that conforms to international standards and national conditions. China's regulators also should gradually strengthen the requirements for ESG related information disclosure, so that there are more channels to obtain such information.

At present, the international mainstream ESG rating system has been relatively mature. Listed companies should actively strengthen communication with international mainstream ESG rating agencies and promote the improvement of ESG's management level and rating results by understanding the rating methods and requirements of benchmarking indicators. At the same time, in order to reduce the impact of differences in cultural concepts and business practices, listed companies can actively feedback opinions and suggestions to overseas ESG rating agencies to enhance mutual understanding and reflect their own core values more fairly.

Chinese Association of listed companies and other relevant institutions will continue to promote the construction of an ESG evaluation system in line with international standards and national conditions.

4.3 The Implement of ESG

The concept and practice of ESG in various institutions in China still need to be improved. The overall attention of China's capital market to ESG is increasing rapidly. There is still a long way to go from concept to specific practice, especially the construction of investment framework and the complete system of green investment implementation are missing.

4.3.1 ESG Practice at the Enterprise Level

ESG should not only be reflected in the company's strategy, but also be implemented in the daily operation, which has become the consensus of many experts. Listed companies should explore to establish a perfect ESG internal system. The government should formulate ESG targets according to the characteristics of the industry, reasonably decompose specific work, and fully consider and disclose the increasing proportion of A-share institutional investors and foreign institutions in M&A transactions.

Companies that bear the initial costs are better able to realize ESG benefits over the long term in management and operations. As the development of ESG continues to deepen, these enterprises should develop short, medium and long-term planning goals and gradually expand the scope of ESG implementation entities. ESG has constructed a new evaluation system to measure the company's value from the long-term dimension.

ESG not only considers the multi-dimensional interests of stakeholders, but also conforms to the long-term interests of shareholders. It is not only an effective means to comprehensively evaluate the corporate governance system, but also helps to reduce their investment risk.

4.3.2 ESG at the Investment Level

It is of vital importance for investors incorporating ESG evaluation into investment decisions. David C. Broadstock et al. (2021) show that high-ESG portfolios generally outperform low-ESG portfolios ESG performance in China. [9] Doron Avramov et al. (2021) found that, in equilibrium, the market premium increases and demand for stocks declines under ESG uncertainty. [10] Many studies have found that companies with above-average ESG scores actually outperform their competitors on both standard measures of operating performance and stock market returns.

According to the principles of internationalization, specialization and differentiation, combined with the experience of advanced domestic investment institutions, the implementation of ESG concept is practiced from the following three aspects. First of all, the concept of ESG involves the company's resource investment, process system construction, assessment and incentive, and promotes ESG's landing in equity, fixed income, product, risk control and other business lines. Second, a complete internal ESG evaluation system needs to be built, so as to become a data sharing platform between researchers and fund managers, prompting fund managers to fully consider ESG-related information in their investment decisions. Third, build a multi-level ESG product system, actively participate in media activities and association activities, disseminate and share ESG investment ideas, and advocate the whole industry to jointly promote the implementation of ESG ideas.

More investment institutions will strengthen ESG investment strategy, and the advantages of ESG friendly projects will gradually emerge in the future. Therefore, sustainable and long-term ESG investment in China is an irresistible trend of The Times.

5 Conclusions

China's ESG market has just entered the initial stage, and there is a huge space for development in the future. This paper suggests that on the basis of continuing to build and improve China's ESG market from a vertical and horizontal perspective, but is limited in nature and cannot provide a whole picture of all participants who need to integrate into the historical torrent of ESG from the consideration of their own perspective. Do corporate translate ESG into greater use of capital and higher revenue, or how to compare and evaluate different entities according to different ESG rating agencies? How to seek common ground while putting aside differences when comparing inter As more progress and practice are made, we expect further studies to tackle these questions.

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