



## State of responsible business (Asia)

September 2011

**T**his report explores the current state of responsible business practice across the world, with a specific focus on how well companies in Asia are managing the environmental, social and governance (ESG) risks they face. Our research finds that over 90% of the 2,090 global companies analysed have left at least one ESG risk unmanaged.

Responsible investment is still in its infancy in Asia. Our research finds that Japanese companies are demonstrating the best overall ESG performance in Asia, closely followed by those based in South Korea. Companies from Hong Kong and Singapore have made only limited progress to date. The world's second largest economy, China, has made limited progress on environmental issues but still lags behind its peers in most areas. Whilst the picture is uneven, we conclude that companies in Asia are making progress on ESG issues and are catching up with those based in Europe in North America. However, across the world there remains significant scope for improvement.

### Introduction

Asia is achieving some of the strongest rates of economic growth in the world. In contrast to many Western economies, economies in Asia are not as constrained by over indebtedness or by the need to rebuild their financial sectors.

Countries such as China have huge growth potential in the years ahead as a result of their high savings rates, young populations and cheap labour bases. As economic growth continues, domestic demand for goods and service will continue to add further momentum to growth in Asia.

Asia is also home to some of the world's largest and most profitable businesses. However, unlike Europe and North America, responsible investment is still in its infancy in Asia.

This report assesses how companies in Asia (most notably those from Japan, China, Hong Kong, Singapore and South Korea) are addressing key ESG challenges and compares their performance to their European and North American peers, where responsible investment has become more established. Where possible, we have included retrospective analysis to see if companies have progressed on ESG issues since EIRIS' last major state of responsible business report was published in 2008.

Our research focuses on a number of key ESG challenges including bribery, climate change, environment, health & safety, human rights, supply chain labour standards, and corporate governance.

Companies researched include all constituents of the FTSE All World Developed Index, along with a selection of 50 Chinese companies selected because they have shown at least some management of ESG issues.

### Key points

- **EIRIS analysis shows that over 90% of the world's 2,090 largest companies have left at least one ESG risk unmanaged.**
- **Japanese companies demonstrate the strongest ESG performance in Asia, closely followed by those in South Korea. Companies in China still lag behind others in Asia.**
- **Asian companies perform well on climate change, but still need to address other 'material' environmental risks arising from water management and biodiversity.**
- **Social stakeholder issues remain a key challenge. Almost all (90%) of Asian companies with operations in countries relevant for human rights concerns have no human rights policies in place.**
- **The biggest drivers of ESG improvement in Asia are likely to come from increased regulatory pressures, greater reporting requirements and the development of sustainability indices.**



## 1 Economic outlook

Recent economic growth has been far stronger in Asia than in Europe and North America, signalling the potential influence this region can have on Responsible Investment. According to figures from the IMF the Emerging Asia region, which includes the countries Hong Kong, Korea, Singapore, Taiwan, China & India, saw a 9.6% growth in GDP in 2010, compared with growth of 1.8% in the European Union area and 2.8% in the United States. Strong economic performance is expected to continue in Asia: GDP growth is predicted to be 8.1% in 2011 and 8% in 2012. Over the same period, GDP growth in the European Union is expected to be 1.8% and 2.1%; in the USA it is expected to be 2.8% and 2.9%.<sup>1</sup>

### Responsible Investment - global context

According to Eurosif the total value of money managed according to responsible investment (RI) criteria amounted to approximately EUR 7.6 trillion at the end of September 2010,<sup>2</sup> with Europe holding the largest share with EUR 4.9 trillion. Assets under management accounted for approximately EUR 2.5 trillion in North America, EUR 58 billion in Australia/NZ and approximately EUR 5 billion in Japan. RI assets represent approximately 10% of the entire asset management industry in Europe. The Forum for Sustainable and Responsible Investment (US SIF) estimates that this figure is slightly higher in the US where approximately one in every eight dollars (12.5%) is invested in some form of social fund.<sup>3</sup>

The relative size of SRI funds is much smaller in Asia. For instance, the Japanese Social Investment Forum (SIF-Japan) estimated that RI funds accounted for around 0.8% of its total investment market in 2009.<sup>4</sup> The first publicly available responsible fund was not launched in Japan until 1999, many years after such funds first appeared in Europe and North America. According to the Association of Sustainable and Responsible Investment in Asia (ASRIA), major Asian state pension funds lag behind Europe, North America and Australia in terms of responsible investment.<sup>5</sup>

It is widely recognised that sustainable investing - and responsible business practice more generally - has a strong bias towards environmental issues in the Asia region. By contrast social and governance issues, such as human rights and corruption, are reported less widely. Reasons for this rest largely with the key drivers for RI and the later adoption of RI in this region compared to Europe and North America. Global environmental issues have become far more prominent over the past decade, with the world becoming much more aware of climate change, resource use and the potential risks involved. In Japan, this was reflected with the launch

of the 'Nikkei Eco Fund', its first sustainable investment product.<sup>6</sup> The continuing global concern about the state of the environment and climate change has prompted more changes in legislation in the region. In China, environmental and social stresses caused by rapid resource exploitation has led to increased environmental awareness and the push for further regulation in these areas. A report conducted by CSR Asia highlights the role social media is playing in publicising the importance of environmental awareness in the region. Such developments have helped stimulate an increasing interest in this type of investment.<sup>7</sup>

<sup>1</sup> <http://www.imf.org/external/pubs/ft/reo/reorepts.aspx>

<sup>2</sup> <http://www.eurosif.org>

<sup>3</sup> <http://ussif.org/>

<sup>4</sup> [http://www.sifjapan.org/document/nenpo09\\_english.pdf](http://www.sifjapan.org/document/nenpo09_english.pdf)

<sup>5</sup> <http://list.asria.org/sri/report/lcia.html>

<sup>6</sup> [http://www.sifjapan.org/document/nenpo09\\_english.pdf](http://www.sifjapan.org/document/nenpo09_english.pdf)

<sup>7</sup> [http://www.lrq.com.hk/Images/LR-CSR\\_2010\\_tcm98-197937.pdf](http://www.lrq.com.hk/Images/LR-CSR_2010_tcm98-197937.pdf)



## 2 Drivers for responsible investment in Asia

Legislation is a significant driver for responsible investment (RI) in Asia. In Korea the government's 'Low Carbon, Green Growth' initiative is seen as the most significant driver for RI. This commits South Korea to lowering carbon emissions to 50% of 2008 emissions by 2050. Similarly, in Japan, a government initiative sought to reduce carbon emissions to 25% below 1990 levels by 2020.<sup>8</sup> In China the government is said to be promoting ESG disclosure as a means of 'promoting the brand, reputation and competitiveness of Chinese companies'.<sup>9</sup> A voluntary initiative in China aimed to reduce 2005 carbon emissions by 40-45% by 2010. China has also launched a Green stimulus package in 2009 aimed at promoting alternative energies as part of the economic recovery. Although largely introduced at government level, such initiatives either expect companies to contribute to the national commitment or are given incentives and generally encouraged to develop or adopt sustainable technologies, design or practices. Investors then have the opportunity to assess how companies are responding to these goals.

Governments across Asia are also introducing new reporting guidelines and rules requiring companies to disclose ESG information. In China the Shenzhen and Shanghai Stock Exchanges have issued guidance notices on sustainability reporting. In Shanghai this was supported with a set of environmental disclosure guidelines. Indonesian legislation requires companies in the resource sector to disclose on ESG activities, whilst in the Philippines, the government requires companies that have applied for investment assistance to implement corporate social responsibility (CSR) programmes. In Thailand, the government is beginning to encourage sustainability reporting from its listed companies.<sup>10</sup>

The emergence of responsible stock exchanges is further promoting RI in Asia and is also providing companies with a business case for addressing their ESG performance. The Korean Exchange Socially Responsible Investment (SRI) Index was launched in late 2009, and was followed in 2010 with a further two indices including the KRX Green index focussing on green industry related businesses which have acquired green technology licenses given by the Korean government. The Shanghai Stock Exchange, the world's fifth largest

exchange by market capitalisation, launched a responsible index in August 2011.<sup>11</sup> This will focus on environmental and educational issues. In June 2011 the Singapore Exchange (SGX) introduced a sustainability reporting guide for its listed companies.<sup>12</sup> In Indonesia the SRI-Kehati Index was launched in 2009 by the Indonesian Biodiversity Foundation, KEHATI. This Index is supported by the Indonesian Stock Exchange (IDX). The index assesses companies based on their performance across a number of ESG areas including environment, community, corporate governance, human rights, business behaviour and labour practices. Although the index was set up by an organisation concerned with conservation efforts and biodiversity issues, it also has a strong social and governance focus. In Malaysia listing rules require all companies to provide a description of their ESG activities.

Other significant drivers include the rise of stakeholder-style organisations in the region, such as CSR Asia, Syntao, ASrIA and various other CSR fora. These help to promote CSR and responsible investing across the region and encourage better ESG disclosure from companies. Asset owners and managers signing up to voluntary agreements such as the United Nations Principles for Responsible Investment (UN PRI) and the Emerging Market Disclosure Project (EMDP) are also likely to enhance ESG reporting. For the five Asian countries featured in this report, there are 50 PRI signatories with others in countries such as Indonesia. However, the degree to which voluntary initiatives can actually bring about change in the Asian region still remains uncertain.

There is no doubt that through globalisation, Asian companies, and particularly those based in emerging economies will be influenced in some way by European and North American led ESG initiatives. Larger Asian corporations that wish to operate in Western economies may feel they will need to comply with rules and norms beyond their home country. At the same time, exposure to a broader investment base may further drive Asian companies to improve their ESG performance. However it should be noted that the move to responsible investment in Asia will not be driven entirely by Western ideals. According to the International Finance Corporation (IFC) many Asian companies are now looking to China for a lead on sustainability issues and feel that Asian companies should develop their own responsible business models.<sup>13</sup>

<sup>8</sup>[www.factiva.com](http://www.factiva.com)

<sup>9</sup>[www.csr-asia.com](http://www.csr-asia.com)

<sup>10</sup>[http://www.csr-asia.com/report/report\\_ASEAN\\_sustainability\\_disclosure.pdf](http://www.csr-asia.com/report/report_ASEAN_sustainability_disclosure.pdf)

<sup>11</sup>[http://www.responsible-investor.com/home/article/shanghai\\_stock\\_exchange\\_launches\\_sustainability\\_development\\_index/](http://www.responsible-investor.com/home/article/shanghai_stock_exchange_launches_sustainability_development_index/)

<sup>12</sup>[www.sgx.com](http://www.sgx.com)

<sup>13</sup>[http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/p\\_SIAAsianEmergingMarkets/\\$FILE/IFC\\_Brief\\_Asia.pdf](http://www.ifc.org/ifcext/sustainability.nsf/AttachmentsByTitle/p_SIAAsianEmergingMarkets/$FILE/IFC_Brief_Asia.pdf)



## 3 Research findings

This section discusses the current state of ESG performance across the globe, looking in detail at how each region performed on each of the environmental, social and governance areas. All figures are based on data extracted from the EIRIS database in July 2011. Where possible we have also included data from a previous study in 2008 which also assessed ESG performance. The research initially focused on how the Asian region performed compared with Europe, North America and Australia/New Zealand on ESG issues. The report also specifically compares the performance of Asian companies from the various countries studied.

For each ESG issue, a company's performance is categorised using the following terms:

**Unmanaged risk** – the company has disclosed little or no information in relation to a specific issue

**Some progress** – the company shows some positive actions but still needs to take further steps to address the risk

**Good** – the company has demonstrated sufficiently developed approaches to have managed the risk, but still has scope to improve.

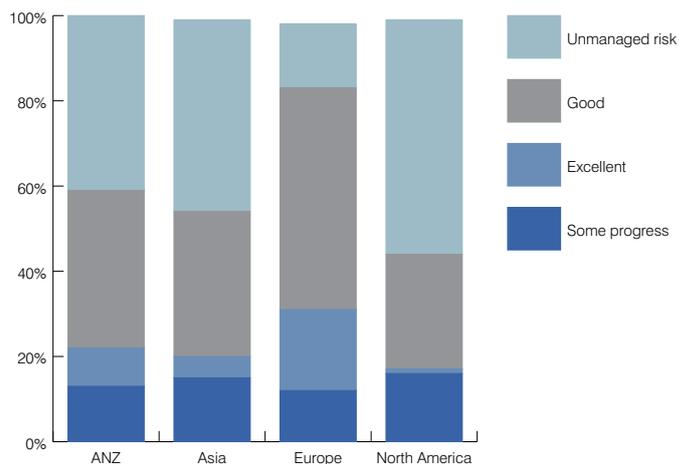
**Excellent** – the company has managed the risk and is likely to be using its ESG strategies to seek competitive advantage.<sup>14</sup>

The report will also assess companies using EIRIS' Convention Watch service. Convention Watch looks specifically at companies that are alleged to have breached the spirit of global conventions such as the Universal Declaration of Human Rights, International Labour Organisation (ILO)'s Declaration on Fundamental Principles and Rights at Work, and the UN Convention Against Corruption and the Convention on Biological Diversity. If an alleged breach of convention is identified, EIRIS will begin to engage with the company and assess its response with a view to determining whether the company has addressed the allegation. This will typically require the company to respond in detail to the allegation, making clear that they have compensated the community/person/area affected as relevant to each specific convention area. We also check to see if the company has improved its systems to ensure that the likely reoccurrence of the breach is reduced.

<sup>14</sup> EIRIS does not use the 'excellent' category for biodiversity or health & safety issues. In these issues 'good' is the highest assessment possible.

### Environment

Figure 1: Environmental policy assessment by region



Approximately two thirds of all the companies analysed have been assessed as having made at least some environmental commitment, while just under half of the companies (42%) were assessed as having environmental policies considered to be good or excellent. These companies have demonstrated that they have policies in place covering the key environmental issues for their sector (e.g. energy & waste), have assigned board-level responsibility for monitoring environmental compliance and have set clear performance targets.

Figure 2: Environmental management systems assessment by region

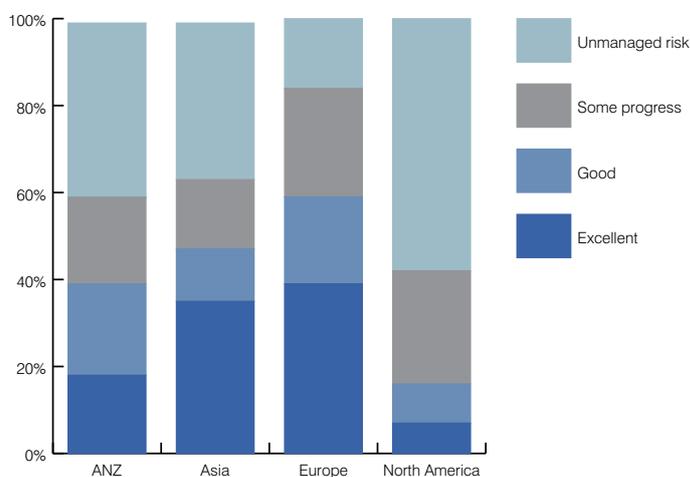
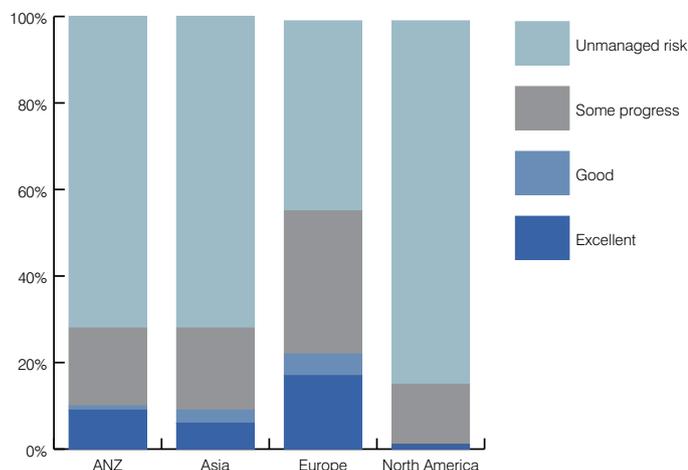




Figure 3: Environmental reporting assessment by region



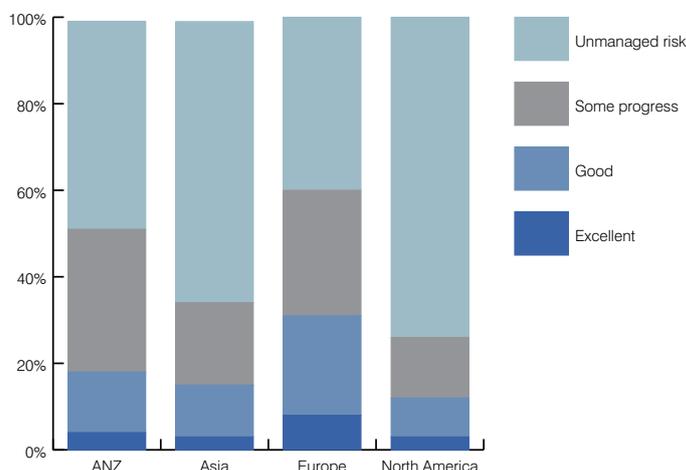
Whilst European companies have made the most progress on environmental policy (over two thirds of European companies were assessed as good or excellent on environmental policy), Asian companies also performed comparatively well, with over 40% of companies assessed as good or excellent. By contrast, only a quarter of North American companies demonstrated good or excellent environmental policies. Regulation and the rise of environmentally-focused stock exchanges are the reasons why so many Asian companies performing well on environmental issues.

The majority of companies that have good environmental policies in place have also demonstrated evidence of good environmental management systems. In total, 13% of the companies studied were assessed as having good environmental management systems, while a further 26% of companies were assessed as excellent. This is likely to reflect the growing number of companies having environmental management systems certified to ISO 14001.

Asian companies performed comparatively well on environmental management systems and significantly closed the gap on their European peers. Australasian companies also demonstrated good environmental management systems. By contrast, North American companies fell short of their global peers.

Since EIRIS last conducted a study into global environmental performance in 2008 there has been a slight improvement in companies' management response to environmental issues. More companies are providing good or excellent management responses to environmental issues today than were doing so in 2008. Asian companies made the most progress.

Figure 4: Environmental performance assessment by region



The data shows that actual reporting of environmental issues is far less complete than the policy and systems. Only 10% of all companies studied demonstrated good or excellent reporting of environmental issues.

Less than 10% of the Asian companies assessed demonstrated good or excellent reporting on environmental issues. Whilst the Asian companies did perform comparably to Australasian companies and out-performed their North American peers, they lagged significantly behind Europe where almost a quarter of companies demonstrated adequate reporting.

One reason for so many companies failing to provide adequate environmental reporting is because companies are failing to recognise all key environmental issues relative to their sector. Whilst companies are becoming better at reporting greenhouse gas (GHG) emissions, and to a lesser extent waste and water use, there is a reluctance to report data for other key areas such as emissions to air and emissions to water. Where companies recognised the key issues they often failed to provide quantitative data or report on targets.

The data also shows that the vast majority of companies have failed to achieve overall improvements in environmental performance. As with companies' environmental reporting, failure to provide data across all key areas is likely to be the main reason for the significant levels of unmanaged risk. Of the global regions studied, Asian companies performed comparatively well to their Australasian and North American peers. European companies were the best performers.

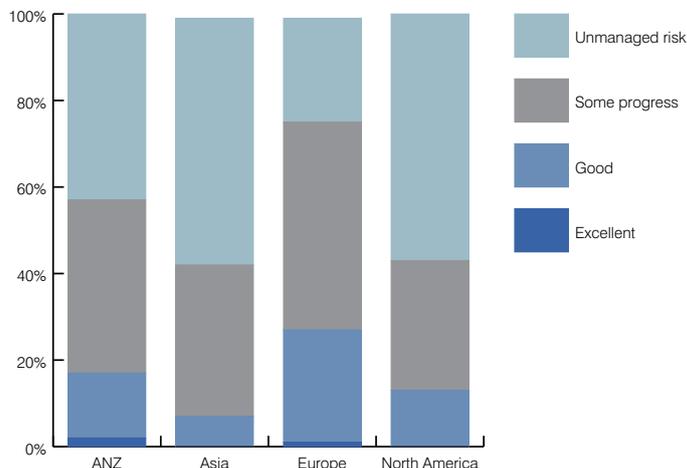


## Climate change

Looking specifically at companies' management response to climate change, 80% of the companies studied were identified as making at least some climate change commitment. However, only 14% of the companies demonstrated a climate change response assessed as good or excellent. In Asia less than 10% of companies were assessed as good.

This is surprising given the range of climate change legislation and initiatives in place across Asia. European companies were again the top performers with approximately a quarter of companies managing climate change risk. Compared with data reported in 2008, more companies provided a good or excellent climate change response in 2011. In 2008 10% of companies provided a good or excellent response, compared with 15% in 2011. This was particularly the case for Asia, where a higher proportion of companies now seem more willing to fully address climate change challenges.

Figure 5: Climate change assessment by region

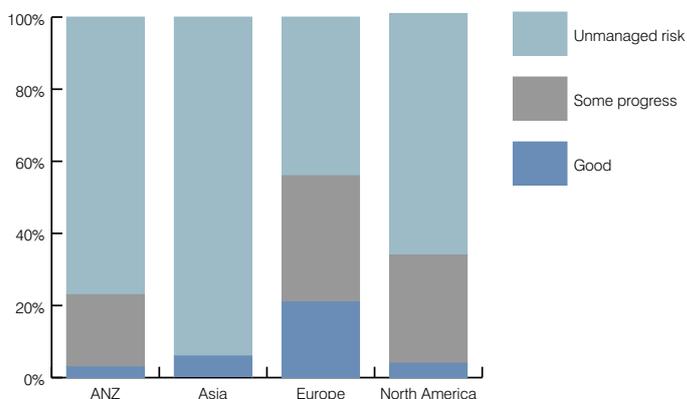


## Biodiversity

Only half of all companies identified as impacting on biodiversity have made some form of commitment in this area. Asian companies were the worst performers with only one of the companies assessed as managing biodiversity risk. The figure was much higher in Europe where approximately 20% of the companies studied were assessed as good.

This difference is thought to be due to the lack of focus on biodiversity issues in Asia, especially in the less developed economies. With the exception of Indonesia (Kehati Index), where rainforest deforestation is a key issue, and to a lesser extent Japan, where the Sumitomo Trust launched a biodiversity fund in 2010, the impacts of biodiversity have received less attention than other environmental issues such as climate change.

Figure 6: Biodiversity assessment by region



## Water management

EIRIS recently began assessing companies' management of water issues. Our research focussed on those companies considered to be at high risk from water usage and who operate in countries where water scarcity is an issue. The research shows that the vast majority of companies which are identified as facing significant exposure to water management issues, are taking little or no action to manage the issue.

Asian companies performed particularly poorly. None demonstrated good management and very few companies were making some progress. Australasian, European and North American companies all performed slightly better as demonstrated in Figure 7 right.

Figure 7: Water management assessment by region for higher impact companies

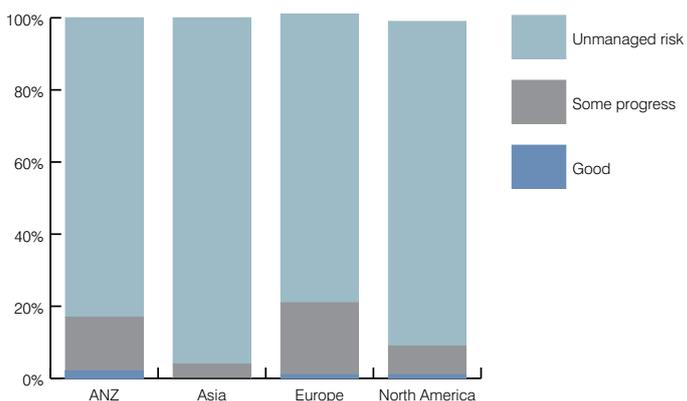




Figure 8: Asia environmental policy assessment by country for higher impact companies

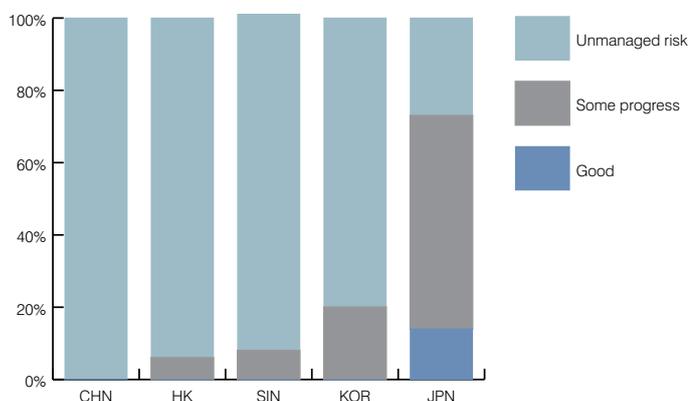


Figure 9: Asia climate change assessment by country

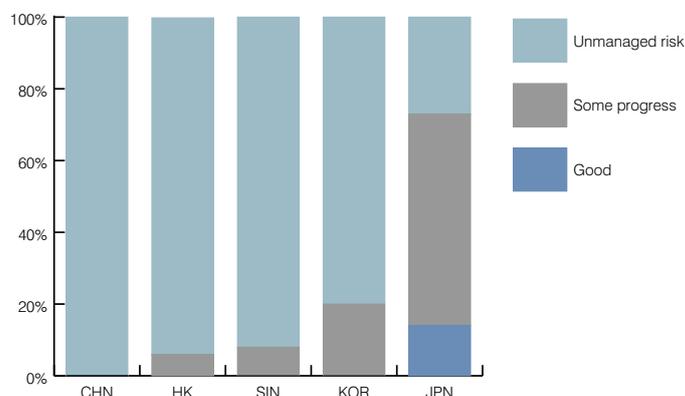


Figure 10: Asia environmental management systems assessment by country

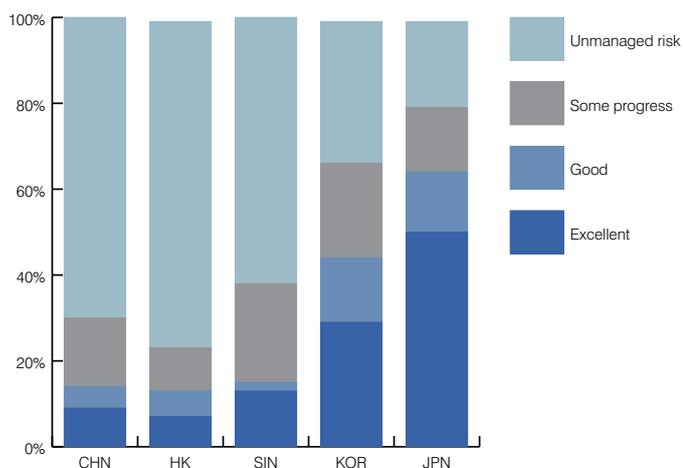
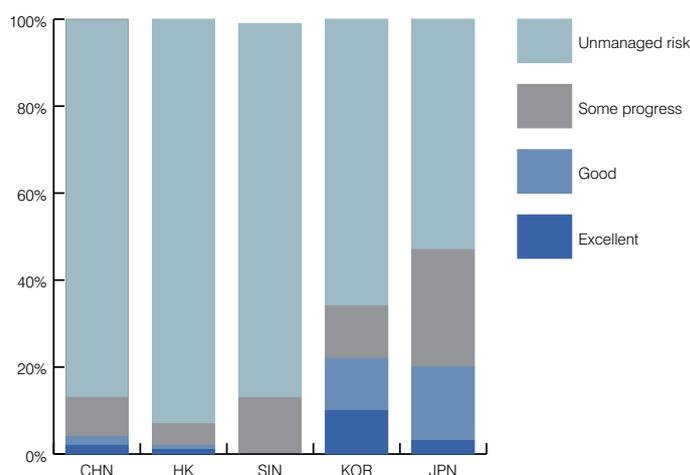


Figure 11: Asia environmental performance assessment by country



## Environment policy in Asia

Figures 8 to 11 show that Japanese companies are the clear leaders in terms of overall environmental performance. Over half the Japanese companies studied had good or excellent environmental policies and over two thirds demonstrated that they had good or excellent environmental management systems in place. Japanese companies also outperformed their Asian peers on climate change, being the only Asian country studied to have companies assessed as managing climate change risk. This was perhaps not surprising given that Japan is the most developed economy in the region, and has the most established responsible investment market.

South Korean companies ranked second overall on environmental issues. However, and perhaps surprisingly, none of the South Korean companies were assessed as managing their climate change risk. Whilst just under a quarter of the companies demonstrated some progress, the vast majority of South Korean companies have unmanaged risk in this area. This seems even more surprising given the South Korean government's Low Carbon Green Growth Strategy. South Korean companies will need to start reducing carbon emissions if the country is to stay on track to meet its target.

South Korean companies performed better on general environmental issues, and only slightly lagged behind their Japanese peers on environmental policy and environmental



management systems. In terms of environmental performance, South Korean companies outperformed their Japanese peers, and were in fact the best performing Asian country on this indicator. Of the South Korean companies studied 10% demonstrated good environmental performance and a further 13% were deemed excellent, which makes it all the more surprising that they are showing poor management of climate change risk.

Companies from Singapore and Hong Kong follow in third and fourth places respectively on environmental issues. Singapore had a higher proportion of companies with adequate environmental policy and management systems; however no companies from Singapore were assessed as having managed their risk in terms of environmental performance.

Chinese companies were outperformed by their Asian peers on almost all of the environmental indicators except environmental management systems. Only 5% of the 54 Chinese companies studied were assessed as having good environmental policies, and only a further 2% showed some progress. Chinese companies performed better in terms of environmental management systems, performing comparatively well with their Hong Kong and Singaporean peers.

Whilst Chinese companies are showing some progress, more work is needed if they are to meet the government's aim of enhancing their corporate reputations through enhanced ESG reporting.

## Breaches of international conventions on environmental issues

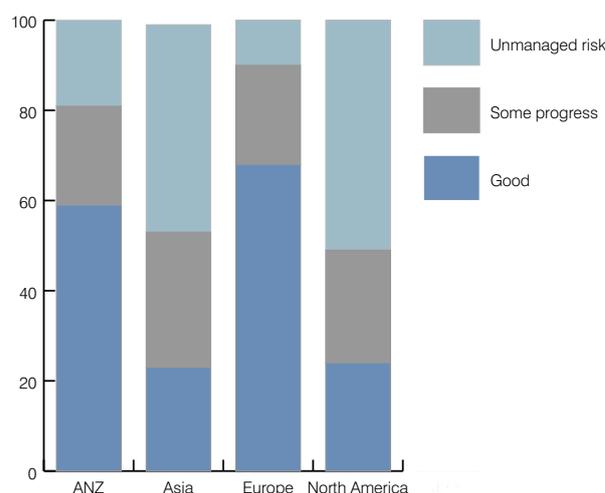
Nineteen of the companies studied in our global survey currently face serious allegations of breaches of international norms on environmental pollution.<sup>15</sup> 40% of these cases were in North America and a further 40% of cases were in Europe. Whilst on the one hand this suggests that Asian companies are mitigating large-scale environmental risks better than their global peers, disclosure of these issues can be significantly lower in emerging economies, which potentially explains the lower number of reported Asian breaches.

To date, the healthcare company Merck (USA) is the only company that has been assessed as addressing the allegations.

The other 18 companies have demonstrated at least some response or disclosure of a relevant environmental policy, but none have demonstrated that they have implemented what are considered to be necessary corrective actions:

- (i) to stop the pollution
- (ii) to ensure no recurrences
- (iii) compensation and rehabilitation of the communities/areas affected. Whether companies' management of environmental pollution incidents improves in response to the financial and reputation lessons learned from high profile cases (such as the recent Gulf of Mexico incident involving BP) remains to be seen.

Figure 12: Health and safety assessment by region



Forty two of the companies studied currently face allegations of breaches of international conventions on biodiversity. These allegations were spread almost evenly amongst the European, Asian and North American companies, with a few Australian companies also facing allegations. None of the Asian companies studied have fully addressed the allegations against them. The only Asian company that demonstrated partial management of the allegation was Sumitomo Corporation from Japan. The remaining 12 companies either failed to respond at all, or provided only a limited reply. By contrast, European companies addressed 3 of the 14 allegations against them; while a further 5 companies demonstrated at least partial management of the issue.

<sup>15</sup>By serious allegations EIRIS means those allegations which provide sufficient supporting details relating to considerable and/or persistent adverse effects on the environment

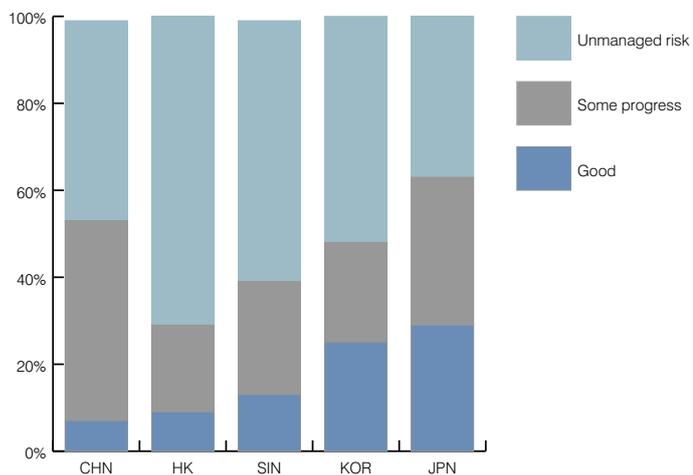


## Social

### Health and safety

Over half of all companies studied achieved some progress or good progress in EIRIS' assessment of their health and safety systems. When looking specifically at the Asian companies, this figure was much lower with only a quarter of companies demonstrating they had good health and safety systems in place. This perhaps reflects the fact that of all the ESG drivers in the Asian region there is less of a focus social issues than environmental issues.

Figure 13: Asia health and safety assessment by country



European companies were the best performers with over two thirds of companies demonstrating good health and safety systems. Australasian companies followed closely behind as seen in figure 12. North American companies ranked bottom alongside the Asian region.

Almost one third of Japanese companies were assessed as having good health and safety systems and a further third were assessed as making some progress. By comparison, a quarter of South Korean companies were assessed as good whilst a further quarter showed at least some progress. Companies from Singapore and Hong Kong were ranked third and fourth respectively. China have the lowest percentage of companies managing health and safety risk. Despite this, it was surprising to note that China had the highest percentage of companies making some progress, meaning they were second only to Japan in terms of having the least number of companies with no management systems in this area.

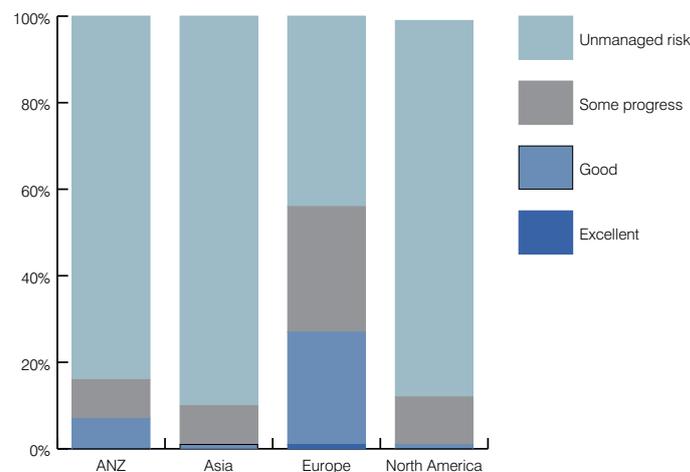
Forty of the companies studied currently face allegations of breaches of health and safety standards in the workplace in which an incident involving the death or serious injury of

five or more employees is alleged to have taken place. Of these, 17 cases (45%) have been addressed by the company involved. This means that the company has responded to the allegation by demonstrating that they have compensated those affected by the accident, and have improved their health and safety systems to prevent a reoccurrence of the breach.

Out of the 40 companies facing allegations, 11 were from Asia, representing just over 1% of the Asian companies studied. Of these, only two companies (18%) addressed the allegations against them. Australasian companies were best at addressing their allegations, having addressed three out of four allegations (75%). European companies addressed 11 out of the 18 allegations (61%). North American companies have addressed a quarter of the allegations.

### Human rights

Figure 14: Human rights policy assessment by region



Since the last study in 2008, there has been limited improvement on companies' management responses to human rights issues. As in 2008 approximately half of the companies currently considered to be at risk from human rights concerns have demonstrated some commitment in this area, while only 8% of the companies had policies considered good or excellent.

Worryingly, almost all (90%) of the Asian companies studied that operate in countries human rights are at high risk had no human rights policies in place. Those companies that did have policies failed to address all the International Labour Organisation (ILO) core areas of freedom of association, the right to collective bargaining and the prohibition of forced and child labour. The vast majority of Australasian and North American companies also had unaddressed risk in this area.



European companies performed considerably better. Here over a quarter of companies provided good or excellent human rights policies.

Companies assessed as having a large strategic presence in high-risk countries (e.g. significant oil or mining interests) performed slightly better than those with a low strategic presence. This was particularly the case for Asian companies.

When looking at management systems and reporting on human rights, less than half of the companies in our global analysis were assessed as making some progress and only 2% of the companies studied had good or excellent systems in place. These companies were all in Europe, North America and Australasia with no companies in Asia having addressed their risks. In terms of reporting on human rights performance, only 16 (less than 1%) of the companies studied demonstrated good or excellent reporting. 10 of these were in Europe, four in North America and two in Australasia. No companies from Asia demonstrated good reporting and only three companies were assessed as showing some progress.

Since 2008 when EIRIS last produced a report on the state of responsible business, there has been little improvement on the number of companies providing an adequate management response to human rights issues, both in companies' owned operations and in the supply chain.

Companies appear to be better at managing human rights in their supply chain than in their own operations; however there was still significant unmanaged risk in this area. Of the companies studied, 354 were identified as being either high or medium risk for supply chain labour issues. This means that they source high risk products from countries identified to be at high risk from human rights issues. In total, 60% of the companies were seen to be making at least some progress towards addressing supply chain labour issues, evidenced through many companies' adoption of at least some of the core ILO principles. However only 20% of the companies had good or excellent policies, showing that whilst companies are recognising the ILO core areas, they may not be recognising all key areas, or may have failed to communicate the policy adequately to their suppliers. Systems and reporting were even less complete. Overall, there was very little progress reported on supply chain labour standards since the 2008 study.

Asian companies performed better on supply chain issues than on human rights issues, but they still lagged behind their European peers in this area. European companies again showed most commitment to supply chain issues with 39% of companies having good policies in place, and a further 6% excellent. Asian companies were also outperformed by their peers in Australasia and North America. Notably, Asian

Figure 15: Supply chain policy assessment by region for higher risk companies

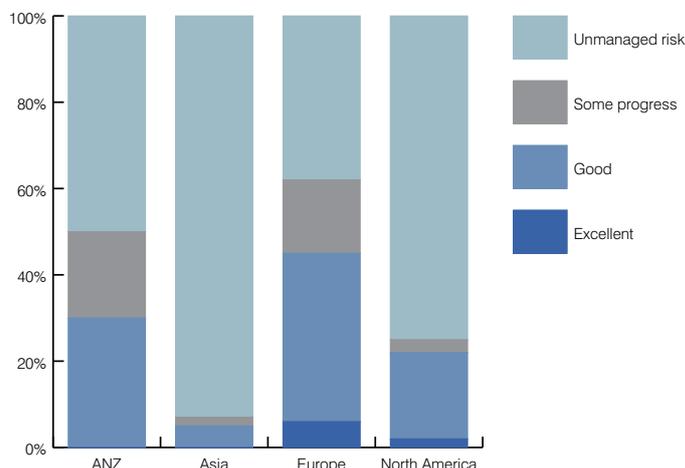
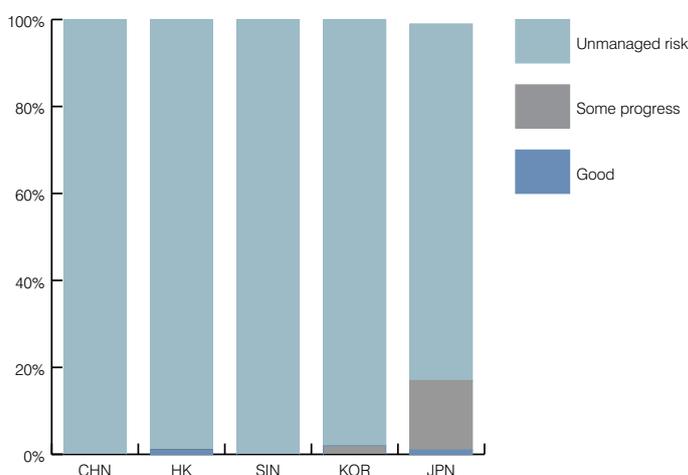


Figure 16: Asia human rights policy assessment by country



companies trailed behind their European peers with only 5% of companies having good policies in place.

When compared with environmental and other social issues, all Asian companies performed poorly on human rights, both in their own operations and also in their supply chains. In fact only four companies from Japan and one from Hong Kong demonstrated good human rights policies. These companies were Hang Seng Bank from Hong Kong, and Marubeni, Mitsubishi, Olympus and Taisei from Japan. The low proportion of Asian companies achieving such levels may be explained by differences in the cultural perceptions of what constitutes human rights, as well as relatively lower levels of NGO and responsible investor activity in Asian countries.



Companies from Hong Kong slightly outperformed their Asian peers on supply chain issues. Here 7% of companies were assessed as having good policies in place, compared with 6% on South Korea and 4% in Japan. No companies from Singapore or China managed risk in this area.

Reasons for the comparatively poor performance by Asian companies on human rights and supply chain issues include the large societal differences between Asia and Europe, and the way corporate entities have developed. In Japan and South Korea the corporate culture has traditionally had a strong paternalistic nature. In Hong Kong, companies emphasise good corporate citizenship by supporting education and employee benefits, while issues such as human rights are more readily overlooked.

## Breaches of international conventions on human rights and labour standards

Fifteen of the companies studied currently face human rights allegations. 6 of these companies were based in Asia, 4 in Europe, 4 in North America and 1 in Australasia. Asian companies were particularly poor at addressing human rights allegations. Only 2 Asian companies provided a basic response while the remainder failed to respond at all to the allegations. Of the North American and European companies researched, only Newmont Mining from the USA was assessed as having partially managed the allegation made against them; the remaining companies managed only a limited response.

Half of the companies at high risk of supply chain labour standard issues (i.e. companies operating in sectors that source from less economically developed countries) currently face allegations of breaches of international conventions on supply chain labour issues. In total, 18% of these companies have addressed the allegations. European companies were most effective at addressing the allegations. In Asia, only one company was assessed as having addressed the allegations, namely Showa Shell Sekiyu, an Oil and Gas producer from Japan.

## Governance

### Board practice

Almost all companies studied had at least some of the core board practice elements in place, however the response to this issue varied greatly depending on geographic region and local governance code. Only 14% of the Asian companies studied demonstrated they had adopted of the following:

- (i) having a separate chair and chief executive;
- (ii) having a majority of independent non-executive directors on the board;
- (iii) having a majority of independent non-executive directors on the audit committee;
- (iv) disclosure of directors' remuneration.

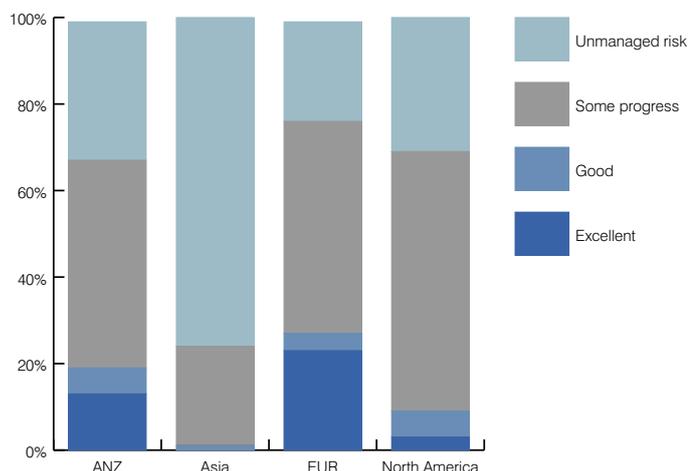
By contrast almost all companies in Australasia had adopted all four elements. European companies performed well as 56% of companies adopted all four elements. In North America, only one third of companies were assessed as having managed their risk, largely reflecting the failure of US companies to separate the roles of chairman and chief executive.

All companies from Asia have adopted at least some of the board practice elements. Companies in Singapore performed best in this area with 60% of all companies adopting all four board practice elements. Perhaps most interesting was that Chinese companies ranked second with just over a quarter of all companies' studied demonstrating that they have some board practice elements in place. Japanese companies lagged significantly behind the rest of Asia. This was largely due to Japanese companies failing to have a majority of independent non-executive directors on their boards.



## Bribery

Figure 17: Bribery policy assessment by region



Whilst only 10% of the companies studied in our global analysis had bribery policies considered good or excellent, a much higher percentage of companies were seen to be making some progress. This demonstrates that whilst a number of companies have introduced anti-bribery policies, many have failed to address bribery issues beyond the giving and receiving of bribes. Many companies failed to address other key areas such as the prohibition or restriction of facilitation payments.

The majority of companies from all regions studied (excluding Asia) were seen to have made some progress in this area. When EIRIS last conducted a study into the global state of responsible business in 2008, 10% of the companies identified as being high risk for bribery demonstrated a good or advanced management response to this issue. Today this figure is higher with almost 17% of high risk companies demonstrating a good or excellent management response.

Reasons for the marked improvement in bribery response and the regional differences are likely to be due to legislation concerning bribery, particularly in Europe and North America. In Europe a number of countries have their own laws such as the Legislative Decree 231 in Italy and the Bribery Act in the UK. Similarly the USA has the Sarbanes-Oxley Act and the Foreign Corrupt Practices Act. Companies in regions where bribery legislation is less prominent demonstrated poorer anti-bribery management systems and policies.

Disclosure of management systems and reporting performance on bribery was far less complete than bribery policy. Only 3% of companies in our global analysis had good or excellent bribery systems in place and the majority of these

companies were again from either Europe or Australasia. Europe also had the most companies assessed as having made some progress in terms of bribery reporting. Only three companies from each of Asia, North America and Australia were considered to have made some progress.

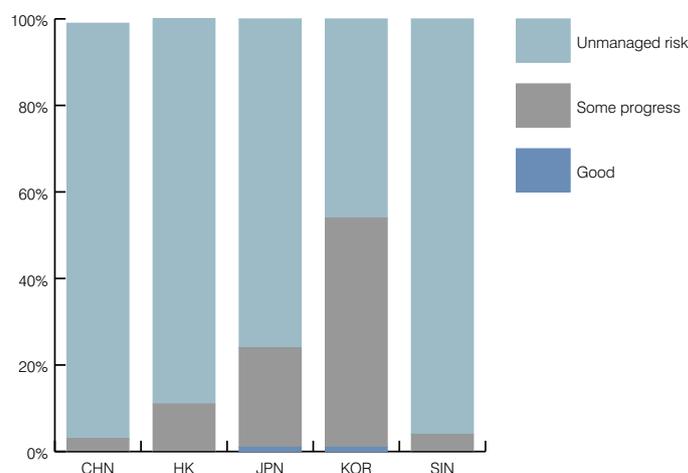
Looking within Asia, only four companies from Japan and one from South Korea were considered to have bribery policies sufficient to manage risk. Despite this, Asian companies have improved since the last study in 2008. Over half of all South Korean companies and a quarter of all Japanese companies are now assessed as making some progress on bribery.

## Breaches of international conventions on bribery and corruption

Forty-two of the companies studied in our global analysis currently face allegations of corruption. The majority of these allegations relate to Asian and European companies. In Asia, 16 of the companies studied face allegations while 19 European companies face allegations. By contrast, only 5 of the North American companies face allegations and only 2 in Australia.

None of the 16 companies from Asia addressed these allegations and only 20% of the companies have provided an intermediate response. By contrast, North American companies addressed 80% of the allegations facing them, while European and Australasian companies addressed approximately half each

Figure 18: Asia bribery policy assessment by country





## 4 Conclusions and recommendations

The results show that the vast majority of companies studied, both in Asia and the rest of the world, face significant unmanaged risk in at least one key area, and that companies are failing to recognise the true benefit of fuller ESG management, perhaps perceiving it more as a cost or burden on the business.

Out of the three ESG pillars, companies demonstrated far better management of environmental issues compared to social and governance issues. This was particularly the case for the Asian companies studied, and is not surprising given the strong environmental focus in this part of the world. Legislative requirements and increasing environmental and social awareness among a growing middle class appear to be the key drivers for companies' stronger performances on environmental issues. However, whilst companies' management of environmental issues was promising, actual reporting of environmental performance was less complete, leaving investors in the dark when it comes to truly understanding whether companies have fully managed their environmental risk, and whether they are making a sufficient contribution to any national targets and commitments. We also found that companies have a tendency to concentrate on climate change issues to the exclusion of other environmental risks such as water use, waste and biodiversity.

Management of social issues was far less complete than management of environmental issues, and varied greatly depending on geographic region, with Asian companies performing particularly poorly. According to Duncan Paterson, Director of the Hong Kong-based Association for Sustainable and Responsible Investment in Asia (ASrIA) this is not surprising: "The retail investment market in Asian economies other than Japan is relatively nascent, and so companies are not asked these questions as often as they are in other markets"<sup>16</sup> Asian companies in particular need to do more to ensure that they are effectively managing their social issues. One penalty for failure in this area is likely to be reputation damage.

As with social issues, companies' management of bribery and corruption varied by geographic region, and is influenced, at least in part, by whether or not anti-corruption measures being enshrined in law or other regulations. It should also

be recognised that providing bribes and gifts are still seen as the way of 'doing business' in certain parts of the world. The results also show that whilst some companies have committed to addressing these issues - perhaps demonstrated through public policies and systems - the actual reporting of bribery and corruption issues is often incomplete.

Overall, European companies generally outperformed their Asian peers. With the exception of environmental issues, and to a lesser extent health and safety, Asia lags considerably behind the rest of the world. Much more is needed - especially in the areas of human rights and bribery - if Asian companies are to match their global peers. Responsible investment is still in its infancy in many parts of Asia, and accounts for only a small portion of the investment market. This alone presents a huge opportunity for investment houses to develop new RI products while at the same time encouraging better ESG practices, so becoming a force for change.

In terms of performance within Asia, Japanese companies continue to set the benchmark across all ESG areas, although South Korean companies are showing signs that they are catching up. Whilst South Korean companies have demonstrated good environmental reporting, they need to improve their performance to help their country to stay on track towards meeting its 50% greenhouse gas reduction by 2050 (based on 2008 levels). Chinese companies fell short of the bar set by both Japanese and South Korean companies, although it should be noted that they did perform well on health and safety issues, coming second only to Japan in this area (although the pre-selection of Chinese companies may distort the trend to some extent). Nevertheless, Chinese companies will still need to do more if they are to support their government's drive to foster better corporate reputations. If companies from Singapore and Hong Kong are to keep pace with their Japanese and South Korean peers, they will need to improve their overall ESG reporting and performance.

The overall Asian picture shows that despite improvements in some countries and advances in some areas, there is still scope for considerable improvements. A major effort is still required before it can be claimed that best practices are being implemented across Asia. The continuance of existing drivers and the strengthening of others such as listing requirements will help support this.

<sup>16</sup>Duncan Paterson, CEO of EIRIS' Australian partner CAER ([www.caer.org.au](http://www.caer.org.au)) and Director of the Hong Kong-based Association for Sustainable and Responsible Investment in Asia (ASrIA)



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## 5 What should companies and investors be doing?

1. In line with the United Nations Principles for Responsible Investment (PRI), investors should incorporate ESG risk into their investment strategies. Doing so will in turn encourage companies to be proactive and stay ahead of legislative changes and norms, and therefore enhance corporate value and reputation. Failure to address ESG risk could lead to a damaged corporate reputation and reduce the value of the company. In line with Principle 2 of the UN PRI, investors should be looking to adopt engagement strategies to improve company ESG performance. Investors should become active owners in the entities in which they invest by incorporating ESG issues into their ownership policies.
2. Companies need to further address overall ESG reporting to demonstrate to investors that they are managing ESG risk. The data shows that whilst companies often have policies and systems in place, there was a failure to report actual performance. This makes it difficult for investors to know whether a company's policies and systems are working. This is particularly crucial for environmental management and climate change disclosure where companies can play a major role in helping meet national targets and commitments such as those aimed at reducing carbon emissions, etc.
3. In Asia there is a huge opportunity for companies and investors to exploit the first mover advantage presented by enhanced social and governance disclosure. Increased coverage of social and governance issues will expose Asian companies to a broader investment base, particularly outside Asia, where responsible investment is more established. Asian companies may feel they need to improve their overall ESG performance if they are to find markets or develop competitive operations overseas, where social and governance issues are of more concern to those societies.

**Report author:** Oliver Jackson with thanks to Stephen Hine, Michael Marshall, Mark Robertson and David Tozer



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## About EIRIS

EIRIS is a leading global provider of independent research into the environmental, social, and governance, (ESG) and ethical performance of companies. With over 28 years' experience of conducting research and promoting responsible investment strategies, EIRIS now provides services to more than 100 asset owners and asset managers globally. We work with clients to create their own ESG ratings and rankings, to engage with companies and to create specific funds for their clients. EIRIS has a multinational team of over 50 staff in London, together with offices in Boston and Paris. Additionally, we have a global network of research partners which includes research organisations in Australia, France, Israel, Germany, Mexico, South Africa, Spain and South Korea.

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## State of responsible business (Asia)

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