THE HONG KONG POLYTECHNIC UNIVERSITY
香港理工大學

PASS Conference Opening Remarks (PM)

Research Findings on ESG Reports of Hong Kong Listed Firms

Dr. Louis Cheng,
Professor of Finance and Director,
Center for Economic Sustainability and Entrepreneurial Finance (CESEF), The Hong Kong Polytechnic University

IDEAS
Innovation-driven Education and Scholarship
Discover · Design · Deliver

Faculty of Business
工商管理學院

School of ACCOUNTING & FINANCE
會計及金融學院

Opening Minds • Shaping the Future
啟迪思維・成就未來

Economic Sustainability & Entrepreneurial Finance
The Hong Kong Polytechnic University
香港理工大學
可持續經濟與創業金融中心

Prof. Louis Cheng
Professor of Finance
Director of CESEF Center

Areas of Concerns and Misunderstanding in ESG Reporting: The Case of Hong Kong Listed Firms

Research Report:

Louis Cheng and Hauman Yeung

November, 2019

Pictures: http://pngimg.com/imgs/nature/earth/ and http://pngimg.com/imgs/people/hands/

Research Findings on Misinformation related to ESG Reports for Hong Kong Listed Firms

Using the HKEx Guidelines as the comparison framework, we examined the ESG reports of 181 firms (163 reports for 2018 and 18 reports for 2016/17). Based on the types of the misinformation, we classify the misinformation into five categories of concerns:

- Concerns about Misunderstanding of Stakeholder Engagement
- Concerns about Environmental Data Collection
- Concerns about Environmental Data Calculations
- Concerns about Misunderstandings in Social Aspect
- Concerns about Misalignment between HKEx Guidelines and Content

Limitation of research: Since we do not get the source data, our analysis can be a guessing game, specially for our second concern. We also acknowledge that our findings are subject to human errors in the evaluation process.

Concerns about Misunderstanding of Stakeholder Engagement

- Stakeholder engagement is a key part of ESG in the world recognized standard GRI. Companies engage their stakeholders through different channels to find out what environmental and social matters they concern most. Companies also need to engage stakeholders that regard what aspect will have major impact to the future development of the company.

- Under the HKEx guideline, the rationale of stakeholder engagement is to engage different stakeholder groups in order to identify the materiality issues for the ESG reports. Through engagement process, the company should able to set up future policy to mitigate risk and address the concern of stakeholders.

However, many ESG reports approach the wrong stakeholders and/or ask the wrong questions to the stakeholders.

Concerns about Environmental Data Collection

Environmental KPIs is the most important aspect of ESG report which has direct and huge impact on climate change. A lot of organizations including United Nations have tried hard to identity climate-related financial risk and report such risks in form of financial disclosures. Correct understanding of environmental KPIs and data integrity are a pre-requisite for a good ESG report.

However, we found that:

a. Wrong units used for presenting Environmental KPIs.

b. Fail to report GHG Emissions in an appropriate manner (e.g. skipping the process of separating the GHG Emissions into 3 scopes (Scope 1, Scope 2 and Scope 3) and calculate the intensity accordingly.

c. Fail to report the intensity of Environmental KPIs.

Concerns about Environmental Data Calculations

Some figures reported were obviously problematic. They may report a large number far beyond the industrial average or even higher than the maximum limitation of the government regulation. Some of the data are overly small when compare to other companies in similar business and scale. This may due to the problems appeared in data collection and calculation process. Some companies gave obvious wrong statement on their environmental performance.

a. Calculation problems about NOx and SOx Emissions

b. Calculation problems in Water Resource Usage

c. Calculation problems of Particulate Matter Emissions

d. Calculation problems of Chemical Oxygen Demand

Concerns about Misunderstandings in Social Aspects

- There are eight social aspects listed in the HKEx guidelines that cover many social issues in the ESG report. These social aspects have their sustainability rationale behind their narratives. Numerous reports misinterpret the meaning behind these aspects (e.g., mainland companies have a different cultural background and therefore a different definition of diversity, anti-discrimination, etc.). Some reports mix up the meaning of product quality and supply chain.

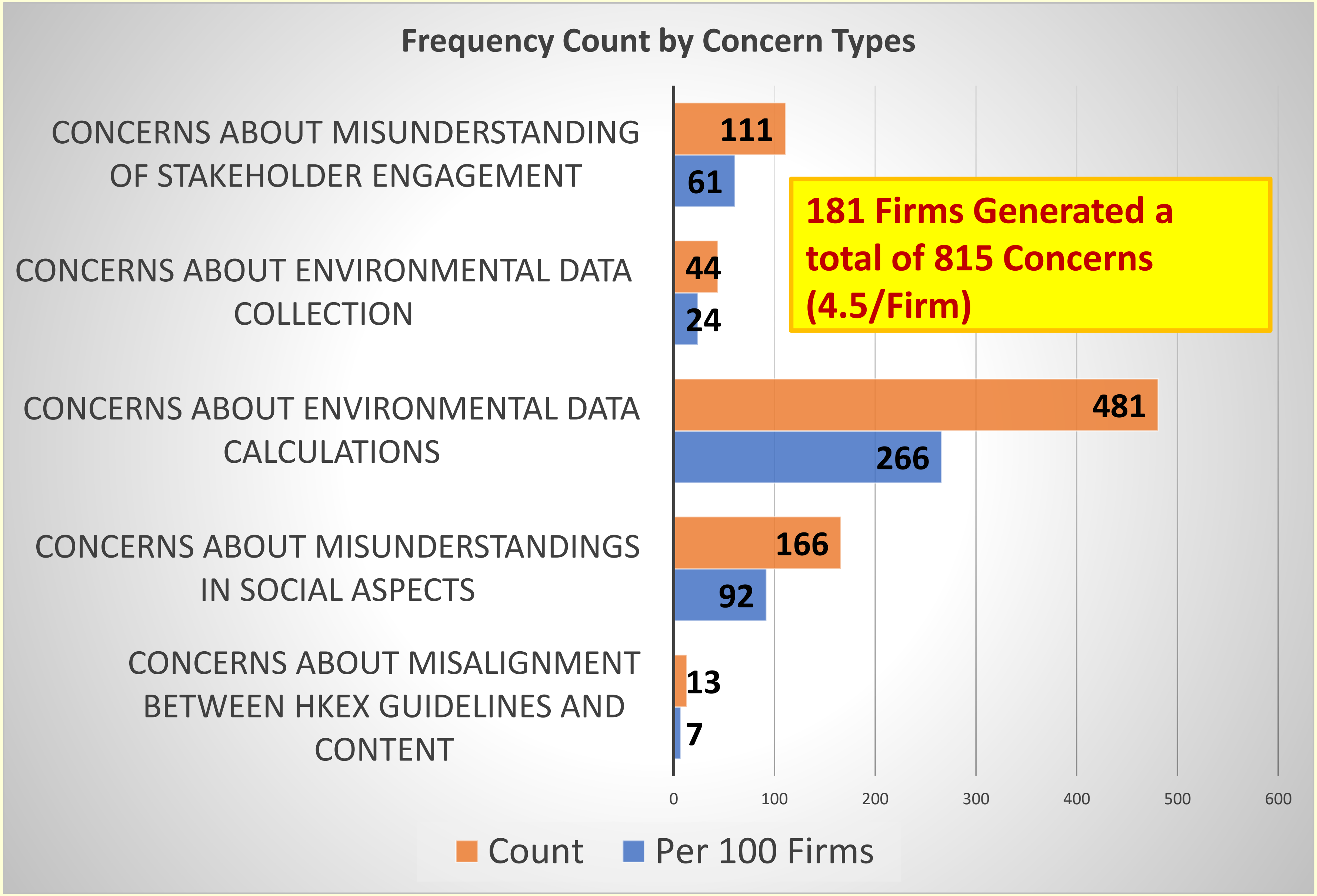
- **Supply chains** fall outside of a company's core operations. However, it is very important in ESG analysis as they expose the company to uncontrollable risks include human rights, labor welfare, discriminations and diversity, corruption, environmental depletion, pollution and abuses of indigenous people. Fail to manage supply chain's ESG risk properly can harm the company's reputation, operations and financial performance. To manage the supply chain risk, company should evaluate their potential risks by monitoring the environmental and social performance of their material, product, and service suppliers.

Concerns about Misalignment between HKEx Guidelines and Content

- The HKEx ESG Reporting Guide was launched in 2012 and became mandatory requirement in 2016. The GRI standard has been considered as reference reporting framework used by different Exchange and Regulators. These standards navigate the listed companies to report with logical sequence for easy understanding by the ESG report readers.

- At present, the aspects and KPIs under general disclosure are mandatory elements of ESG report. Listed companies should follow the HKEx guideline to prepare the ESG report.

However, misalignment occurs due to inconsistence of format, missing aspects or KPIs, and no quantitative data reported.


Frequency Count by Concern Types
CONCERNS ABOUT MISUNDERSTANDING OF STAKEHOLDER ENGAGEMENT
111
61
CONCERNS ABOUT ENVIRONMENTAL DATA COLLECTION
44
24
CONCERNS ABOUT ENVIRONMENTAL DATA CALCULATIONS
481
266
CONCERNS ABOUT MISUNDERSTANDINGS IN SOCIAL ASPECTS
166
92
CONCERNS ABOUT MISALIGNMENT BETWEEN HKEX GUIDELINES AND CONTENT
13
7
0
100
200
300
400
500
600
Count
Per 100 Firms
181 Firms Generated a total of 815 Concerns (4.5/Firm)

Conclusion and What is Next?

- **Misinformation varies among industries**

  Industry variation in misinformation intensity does exist. It is not clear whether the variation is due to firm size or nature of business. Additional quantitative analysis using a multiple regression format to control for firm level characteristics is needed to identify sources of misinformation.

- **Setting up a feedback system to report misinformation**

  Is it possible to establish feedback system to reflect the misinformation to respective firm for improvement? If so, how should such a system be established in a sustainable and efficient manner?

- **Each firm focuses on materiality issues unique to its circumstances**

  Given that firms are expected to continue to improve the quality of their ESG data disclosure, what can top management and board do so that firms can better focus on materiality issues unique to their firms to make an impact?

The Way Forward

We believe that ESG integration is an important channel to achieve sustainability for the society as a whole. Through ESG investments, corporations will take sustainability issues more seriously and investors and stakeholders can vote with their feet. ***The power of finance*** should play a vital role in enhancing sustainability through ESG integration.

~ End ~