

ESG priorities in China

How companies in China
are approaching ESG

Written by

**ECONOMIST
IMPACT**

Contents

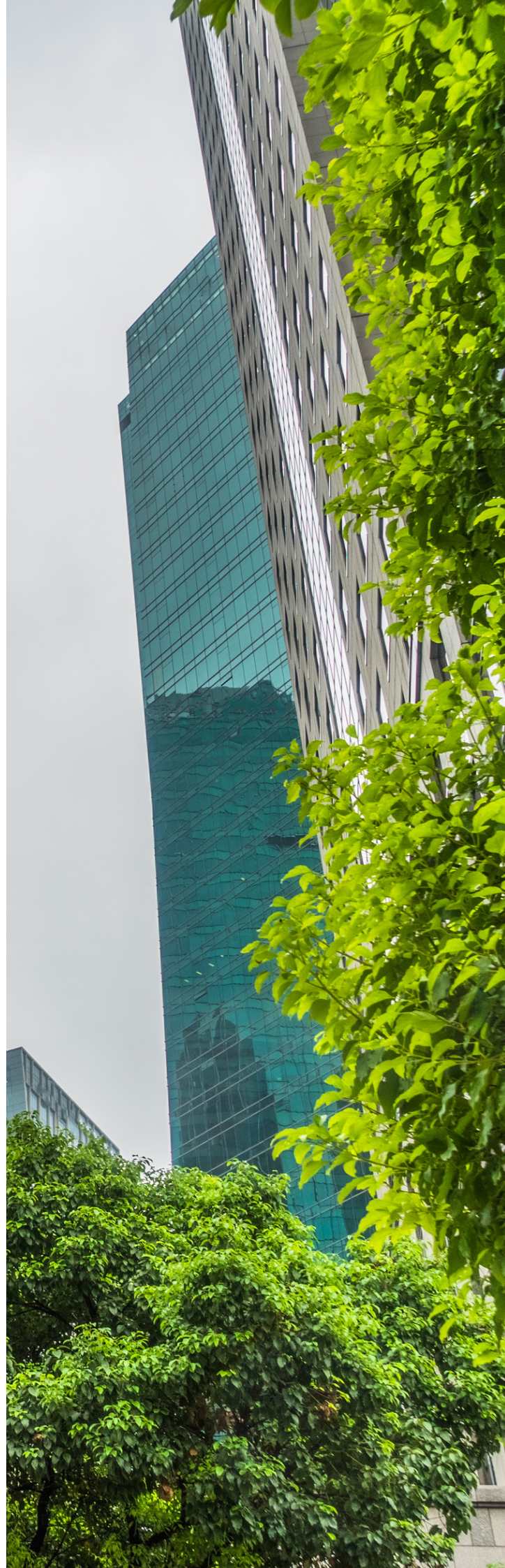
Contents	1
About this report	2
Foreword	3
Executive summary	4
Introduction	5
The regulatory landscape	6
The global imperative for ESG change in China	6
China's ESG regulation matures	7
Are Chinese firms adopting ESG?	8
Drivers of change	8
ESG strategies and reporting	11
ESG strategy development inputs	12
Strategic challenges	13
Overcoming the ESG skills gap	14
Governance: enhancing board structure and diversity	16
Board composition	16
ESG oversight	18
External assurance	20
Governance guardrails	21
Current focus areas: E, S or G?	23
Sustained change	25
Appendix	29
Appendix A: survey demographics and methodology	29

About this report

China's ESG priorities: How companies in China are approaching ESG is a report commissioned by Fidelity International and written by Economist Impact. The report reflects the findings of a survey of 262 C-suite and director-level corporate executives based in China. It encompasses those who work at listed organisations of different sizes and ownership structures across a range of industries. The research and editing team comprised **Alexander van Kemenade, Anjali Shukla, Jin Yanning, Georgia McCafferty, Helena Lim** and **Amanda Simms**.

Economist Impact would like to thank all participants in the survey who generously offered their time and insights.

The findings and views expressed in this report are those of Economist Impact and do not necessarily reflect the views of Fidelity International.



Foreword

ESG has gained increasing traction among Chinese investors, corporates and policymakers as China shifts towards an economic development model that focuses more on quality and sustainability. As a long-term investor in China and a firm advocate for sustainable investing, we are delighted to see ESG being embraced by more and more Chinese companies, and we are keen to be part of this significant evolution. Our approach to sustainable investing is to integrate ESG considerations into every step of our investment decision-making—from defining the investment universe and security selection to portfolio construction and post-investment stewardship (voting and engagement) activities.

We apply the same approach to our investments in China, which allows us to have in-depth conversations with our investee companies on sustainability issues that are material to their long-term development. Not only do these conversations send a clear signal that, as an investor, we expect these companies to be responsible for their environmental impact and to take care of their key stakeholders in addition to delivering financial returns, but it also helps them to progress on their sustainability journey as best practices are shared and discussed. Moreover, the ESG insights we obtain on companies through these conversations and our proprietary research will feed into our investment decision-making, especially for our sustainable funds that seek to promote sustainable business practices.

As an important component of sustainable investing, stewardship plays a key role for asset managers who seek to deliver sustainability outcomes alongside

investment returns for their clients. To better understand the development of stewardship in China, in 2020 and 2022 we conducted a proprietary study of shareholder voting and engagement trends covering more than 650 companies, 6,000 shareholder meetings and over 40,000 resolutions in partnership with ZD Proxy Shareholder Services. Our study found that local investors are becoming more active in voting and engagement activities, putting the market on the right track to continuing ESG advancement.

Following our study on investors' stewardship activities in China, this year with the support of Economist Impact we set out to understand how companies develop and implement their ESG strategies by surveying 262 senior executives based in China who work at listed companies. The findings included in this report offer a window into the thinking behind the latest ESG efforts taking place in Chinese companies and can also serve as a reference for investors to engage with Chinese companies more effectively.

We remain committed to sustainable investing through ESG integration and investment stewardship. Looking ahead, we will draw on our global experience and continue to work with companies, industry partners and regulators in China to contribute towards the long-term sustainable development of the Chinese economy.



Flora Wang
Head of Stewardship,
Asia, Fidelity International

Executive summary

This report sheds light on how companies in China are currently developing and implementing ESG. It is based on a survey of 262 executives from publicly listed companies in China that seeks to understand how they view their ESG priorities and the actions taken to incorporate these into their organisations.

The survey finds that Chinese companies are in a state of transition from largely domestically driven priorities emanating from China's unique period of breakneck industrialisation to a set of goals more aligned with international ESG practice. Whereas companies were more likely to follow government regulation in the past, the current drivers of this change are primarily demands from investors and customers.

The main findings of the survey as follows:

- Levels of ESG adoption and awareness are robust among listed Chinese companies, although still lagging their Western counterparts. Fifty-three percent of surveyed firms claim to have announced an ESG, sustainability or corporate social responsibility (CSR) strategy and 71% employ staff dedicated to implementing ESG goals.
- Signalling that market concerns are increasingly taking a front seat in shaping corporate behaviour, 47% and 44% of firms cited demands from customers and investors, respectively, as leading drivers of ESG adoption. The third most cited factor was government initiatives, with 37% of firms naming these as a key driver.
- A controlled analysis reveals several firm characteristics associated with ESG adoption. Chinese firms listed on overseas stock exchanges are more likely to adopt ESG (measured by whether the firm has published an ESG strategy) than those solely listed on domestic ones. Larger firms are also more likely to adopt.
- Areas of ESG focus for Chinese firms are different from those of their Western counterparts. Climate change and diversity, for example, take a secondary position to issues such as product and workplace safety. This likely reflects the differing priorities created by the regulatory, social and economic context that Chinese firms operate in.
- There will likely be convergence in ESG goals between Chinese firms and their global counterparts in the future. While not the top priority areas for current action, climate change and gender diversity on company boards were listed by respondents as leading priorities for future action.
- While Chinese listed companies tend to follow a compliance-driven approach to board independence, progress is being made on the establishment of board committees such as remuneration and nomination committees. Survey results indicate these committees are now nearly universal, exceeding what current regulations require.

Introduction

For listed companies globally, ESG has risen up the agenda of corporate boards and management. Once an afterthought, pressure from regulators, shareholders and customers to improve corporate ESG performance and mitigate risks has seen ESG move from a communications function to a C-suite and board-level consideration.¹

More than 90% of S&P 500 companies in the US now publish ESG reports,² and China is catching up, with 86% of companies in the CSI300 publishing ESG and sustainability reports as of mid-2020. Yet despite its growing importance to global financial markets, reliable information about the ESG performance of listed companies in the world's second-largest economy³—China—remains patchy.

The quality of ESG reports differs vastly, and a lack of historical, standardised ESG disclosure indicators has meant that robust, verified data on the ESG performance of listed companies in China is lacking.⁴ The China Enterprise Reform and Development Society published voluntary disclosure guidance in 2022 to address these data concerns,⁵ but the country's ranking on global ESG indices remains low. Listed companies in China have significantly lower median ESG ratings than companies from other major economies based on MSCI assessment⁶, while China ranked 120th out of 150 countries in The Economist Intelligence Unit's 2023 ESG index.⁷

The globalised and interconnected nature of business and financial markets means that China's ESG trajectory has increasingly important implications domestically, as well as for international organisations that invest in them. Listed companies globally are under growing regulatory pressure to measure and disclose not just their direct emissions but also their Scope 3 emissions⁸—all indirect emissions that occur in the upstream and downstream activities of an organisation's supply chain. There are also other similar requirements on supply chain due diligence on other ESG indicators such as labour rights and standards, pollution, and biodiversity impact.

As the world's largest manufacturing economy and exporter of goods, Chinese listed companies feature prominently in such supply chains. They will need to rapidly improve their ESG reporting and data transparency if they hope to maintain their export markets into the future. Failure to do so is also likely to impede the long-term growth prospects of these companies and increase their perceived ESG risk.⁹

This report aims to shed light on the current and future planned areas of ESG-related activity of Chinese companies. Through a survey of 262 C-suite executives from listed companies across China, it gathers feedback directly from the people who are crafting and implementing China's corporate ESG strategies on the ground. It provides a snapshot of the evolution of ESG strategies in China, perceived areas of progress, plans and programmes that Chinese listed companies are implementing today, as well as their intentions for future transformation.

The regulatory landscape

In understanding ESG progress in China's listed companies, the evolution of ESG regulation—both global and domestic—is instructive. Domestically, Chinese government policy will continue to be the key factor that influences ESG policies and reporting. However, global policies that target external and supply chain emissions are growing in importance due to their impact on trade and international supply chains.¹⁰ This, in turn, is affecting domestic regulation and increasing pressure on Chinese companies to hasten their ESG reforms to comply with international ESG reporting standards.

The global imperative for ESG change in China

As the need to transition into a sustainable economy grows more urgent, global investors have ratcheted up efforts to direct capital into areas that contribute to this transition while companies also seek out financing to fund their transition plans.¹¹ By mid-2022 global sustainable assets were worth an estimated US\$2.5trn,¹² while Bloomberg Intelligence estimates that the global market for ESG assets will exceed US\$50trn by 2025.¹³

ESG investing needs accurate and timely information to guide strategy and asset allocations, and the finance and accounting sectors soon started demanding ESG data¹⁴ derived from corporate metrics¹⁵ for companies looking to issue sustainable debt instruments and access ESG investment in general. In response, regulators in developed countries introduced new reporting regulations and stronger corporate ESG policies that increasingly hold companies accountable for their impact to level and clarify the corporate reporting field.

In response to the growing need for ESG information, the Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) in 2017 to develop recommendations on the types of information that companies should disclose to provide the finance sector with the information they need to accurately price ESG risks.¹⁶ The EU, Singapore, Canada, South Africa and Japan are among those that have voluntarily adopted

the TCFD recommendations, while the UK and New Zealand^{17 18} will be mandating TCFD-aligned disclosures.

The TCFD helped fill a large information void, but as frustration with the growing number of regulations across different jurisdictions grew, the International Financial Reporting Standards Foundation formed the International Sustainability Standards Board (ISSB) in 2021 to harmonise the global ESG disclosure framework.

This marked a turning point in global regulation, as the ISSB consulted with regulators and stakeholders globally to deliver a set of ESG disclosure frameworks that provide a baseline for ESG reporting. The resulting ISSB framework builds on the TCFD and other market-led, investor-focused reporting initiatives to provide a global baseline of sustainability disclosures.¹⁹ Due to be issued in the second quarter of 2023, it will underpin global sustainability reporting rules and the comparison of sustainability outcomes across sectors and markets.

While the global landscape for ESG reporting is evolving, regional development in this space also continues to accelerate, such as the EU's ESG reporting requirements which are now one of the most stringent in the world.²⁰ The EU's Corporate Sustainability Reporting Directive (CSRD),²¹ which was enforced in January 2023, requires almost 50,000 large companies and listed SMEs to report on and audit a broad range of ESG indicators.

The CSRD is indicative of how changes to the ESG landscape in one global jurisdiction can have ripple effects for ESG policies and regulation in Chinese listed companies. In seeking to meet Scope 3 greenhouse gas emissions targets, the CSRD will soon apply to companies that were not previously subject to ESG disclosure requirements, including non-EU companies that operate in the bloc.^{22 23} Many Chinese companies that export to EU markets will also need to begin reporting their emissions for the EU's Carbon Border Adjustment Mechanism,²⁴ which imposes a tariff on carbon intensive products imported by EU companies.

China's ESG regulation matures

Aware that the ESG performance of its listed companies is under growing scrutiny from overseas investors and in line with the continued reform of industry,^{25 26} the Chinese government has introduced its own ESG regulations for Chinese companies, although these are often fragmented and some are voluntary at present. The Chinese government is also more explicitly incorporating ESG into its national policies, although elements of ESG have formed part of China's economic planning for decades.

China's 14th Five-Year Plan (FYP), covering 2021-25, builds on the carbon intensity reductions outlined in its 13th FYP²⁷ to reconcile its long-term climate goals with short- and medium-term social and economic objectives.²⁸ China has a framework to help the country transition from coal by focusing on renewable energy, with a target to reach a carbon peak by 2030 before achieving carbon neutrality by 2060.

As the world's largest emitter of greenhouse gases (on an aggregate basis), meeting these pledges will require significant domestic and overseas capital investment to spur business transformation and innovation in key areas from energy and construction to transport and technology.^{29 30} As a result, China's rapidly expanding ESG fund market³¹ has developed together with its green finance sector, which is foundational to the country's present ESG architecture.

To manage its green finance growth and its financial opening-up, China has adopted a mix of voluntary and mandatory ESG financial reporting practices that emphasise the country's "dual carbon" and "common prosperity" goals from its FYP.³² However, the fragmented nature of ESG regulations in China, which can differ across industries, stock exchanges and government agencies, has created confusion.

China's SOEs, for example, need to meet ESG regulations set by the State Owned Assets Supervision and Administration Commission of the State Council

(SASAC),³³ while companies listed on the Shenzhen³⁴ and Shanghai stock exchanges,³⁵ which are part of the UN's Sustainable Stock Exchanges Initiative, provide written guidance on ESG reporting requirements. These have had a significant impact on creating ESG momentum among listed companies in China.

To provide greater clarity, China's State Council-backed think-tank, China Enterprise Reform and Development Society, published voluntary guidelines in June 2022 that aim to standardise ESG reporting.³⁶ The framework comprises around 100 standards that broadly align with the ISSB's draft rules while making provisions for domestic Chinese ESG priorities, like corporate charity or common prosperity. Although these are currently voluntary, they offer a glimpse into what a mandatory framework that accounts for China's FYP goals—referred to in China as "ESG with Chinese characteristics"³⁷—may eventually look like.³⁸

Many Chinese companies are adopting some of these guidelines, and as of mid-2020 86% of the CSI300 had published ESG and sustainability reports, nearly matching the 90% rate among S&P 500 companies.³⁹ But management of ESG risk and opportunities, data quality and veracity remains a pressing issue when compared with overseas entities, and the ESG performance and risk ratings for Chinese companies provided by groups like MSCI⁴⁰ and Morningstar Sustainalytics⁴¹ remain comparatively low as a result.⁴²

China has also been working with the EU since 2020 to establish a Common Ground Taxonomy that clarifies areas of commonality and difference between the two financial markets' taxonomies to provide a basis for a mutual approach to green finance and to support green finance development globally.⁴³ Frictions are still apparent between the two approaches,⁴⁴ but the ongoing partnership is a further important step to ESG harmonisation that aims to align China's ESG approach with that of its overseas partners while maintaining its unique ESG goals.

Are Chinese firms adopting ESG?

As this global and domestic momentum behind ESG gathers pace, Chinese firms are rapidly evolving their ESG strategies. Economist Impact’s comprehensive survey of 262 China-based leaders of listed companies across a range of industries shows the significant impact that this shift is having on ESG progress and the remaining work needed to increase such standards in Chinese companies.

From reporting and hiring to strategy development and implementation, Chinese companies are growing their ESG capabilities and developing the frameworks they need to incorporate ESG into their operations. Yet while there is emerging recognition of the importance of ESG as a framework, Chinese companies often have a different focus. China’s FYP looms large in its influence, and considerable reporting and measurement gaps still need to be overcome.

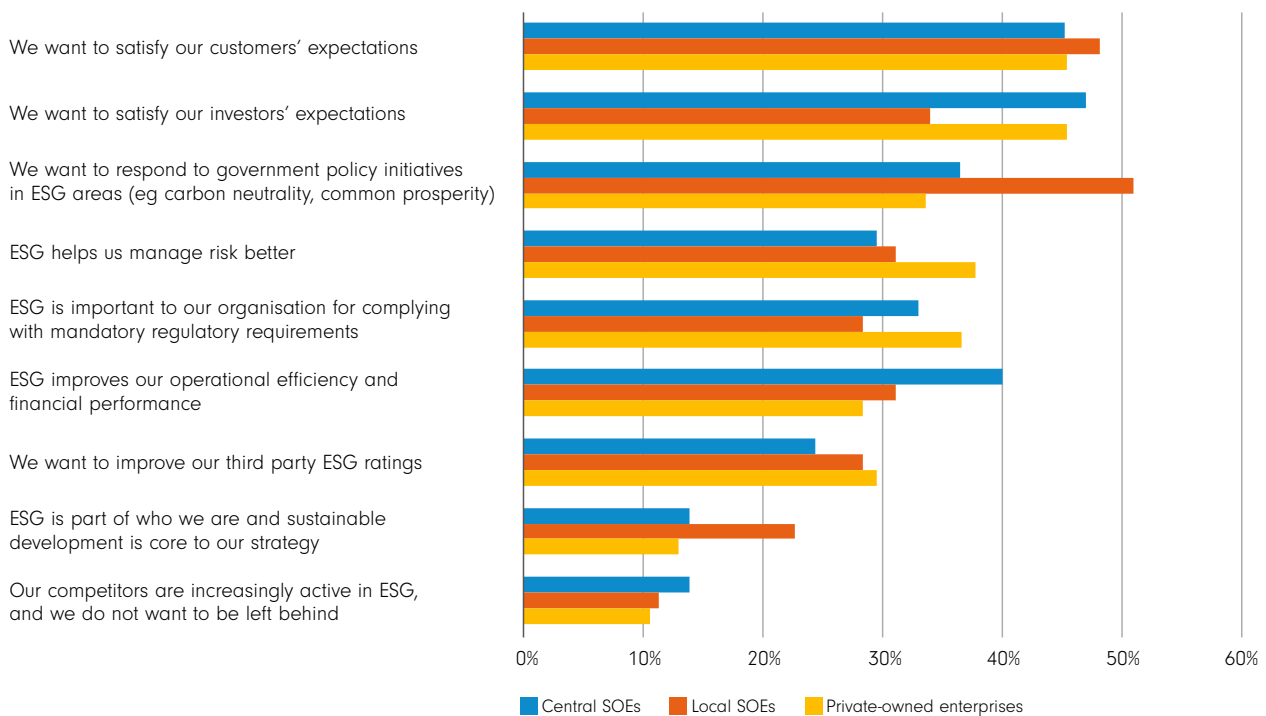
Drivers of change

Although the development of strategy in Chinese listed companies needs strengthening to reach global standards, customers and investors are increasingly demanding change, and this pressure is likely to continue to have a direct impact on progress. Almost half of surveyed companies (47%) said that they developed an ESG strategy to meet customer expectations while 44% aim to meet investor expectations.

The importance of ESG strategies in meeting customer expectations coincides with growing consumer activism in China. ESG concerns among the country’s growing middle class are likely to significantly shape business practices going forward, with over 80% of consumers from mainland Chinese cities across the Greater Bay Area (GBA) saying they expect brands to be more environmentally and socially responsible⁴⁵ in a recent survey.

Figure 1: Customer and investor expectations are the most common drivers of ESG strategy development in Chinese listed companies

What are the key drivers in your company’s decision to develop and implement an ESG strategy? Please select up to top three drivers.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

Fidelity Perspective

Investment stewardship on the rise in China

As China's capital market matures, an increasing number of investors have started to take an active stewardship approach to clearly communicate expectations with investee companies through voting and engagement, echoing the survey results that investor expectations have become a key driver for corporate ESG strategy development.

In 2020 and 2022 we conducted a [proprietary study](#) of shareholder voting and engagement trends covering more than 650 companies, 6,000 shareholder meetings and over 40,000 resolutions. We found that investors are becoming more active and willing to express their opinions through voting and engagement, putting the market on the right track to continuing ESG advancement.

According to the latest report, the average voter turnout among minority shareholders climbed to 27.5% in 2021, from 26.2% in 2019, despite the difficult backdrop of the covid-19 outbreak and related travel restrictions. Moreover, the number of resolutions where more than 10% of all shareholders cast against or abstained votes surged to 1,831 (or 3.7%) from 2020 to mid-2022, compared with 1,070 in 2017-19 (or 2.5%).

If companies listed in China follow the ESG trajectory of their counterparts listed on international stock exchanges, the drivers for ESG change are likely to evolve as regulation in China strengthens—and this is reflected in the survey results.

Government policies (37%) and regulations (35%) and improved risk management (35%) are already important ESG drivers among Chinese listed companies, according to survey respondents.

Even when companies have controlling shareholders, which is quite common among Chinese firms, minority investors can still have an impact on a firm's ESG strategy, especially on the governance front. For example, when a tech company that provides automotive diagnostics products proposed an employee stock ownership plan for one of its subsidiaries in 2022, minority shareholders raised serious concerns regarding the suitability of the remuneration structure. Specifically, investors questioned the plan's outsized scale, low pricing and a potential conflict of interest arising from the participation of the controlling shareholder. The company eventually responded by downsizing the scheme and excluding its controlling shareholder from participating before seeking shareholder approval.

Apart from investors becoming proactive, the companies themselves have also stepped up their efforts to increase shareholder communication. Notably, the proportion of listed companies in the A-share market discussing earnings results with investors rose from 55% in 2020 to 94% in the third quarter of 2022, and the number of firms within the study publishing ESG reports (excluding CSR reports) has also increased dramatically, rising to 262 as of the first three quarters of 2022, threefold the same period a year earlier.

State-owned enterprises (SOEs) in China are responsible for half of the country's carbon emissions. In November 2021, SASAC released policy guidance that requires SOEs to reduce their carbon emissions by 18% by 2025 compared with 2020 levels, and by 65% by 2030 compared with 2005 levels.⁴⁶ This prompted an immediate response, and 20 of the country's 97 central SOEs have established roadmaps to reach their carbon neutrality goals,

while many state-owned generators are growing their investments in low-carbon technologies.

Interestingly, motivations differ depending on whether companies are SOEs or privately owned. For central SOEs, the role of ESG strategy in improving operational efficiency and financial performance (40%) is more important than risk management, reflecting research that shows that improving ESG elements across a business can reduce operational costs, improve human capital management and increase productivity.⁴⁷ These are critical enhancements for SOEs, which are traditionally considered less productive or nimble than private companies.

The important role that provincial governments in China play in policy implementation⁴⁸ is also apparent. Over half of local SOEs (51%) cite the need to respond to government policy as a key driver of their organisation's decision to implement an ESG strategy, with most other drivers aside from customer expectations well below this level. Private-owned organisations, by contrast, are more focused on risk management (38%), with operational efficiency and financial performance (29%) less important than managing customer and investor expectations (46%).



ESG strategies and reporting

As domestic momentum for ESG management and integration gathers pace, and the risk of losing foreign investment and export markets from increasingly stringent global regulation grows, levels of ESG engagement in Chinese companies are becoming more robust. More than half (53%) of the surveyed companies have publicly announced an ESG, CSR or sustainability strategy either in a report or on their website. Those that have not yet made a public announcement are working hard to address this—18% of organisations have plans to publicly announce their ESG strategy in the future while the remaining 29% are addressing ESG as an internal strategic focus.

Almost two-thirds (64%) also publish annual ESG reports, while 29% have plans to publish an annual ESG report within the next three years.

Regression analysis of the relationship between company characteristics and the likelihood of publishing an ESG strategy reveals two key characteristics positively associated with ESG strategy sharing. The first is dual listings in the US or London. Over 80% of companies listed on exchanges in mainland China and either the US or London have publicly shared their ESG strategies, reflecting the US Securities and Exchange Commission’s ‘comply-or-explain’ regime⁴⁹ and mandatory disclosure rules for larger companies in the UK.⁵⁰

By contrast, the rates of public ESG disclosure among companies that are listed solely on the Shanghai (59%) or Shenzhen (53%) stock exchanges—where companies have been encouraged to voluntarily disclose ESG information since 2020—lag significantly, despite a steady increase among those releasing ESG reports for shareholder review and approval.⁵¹

Figure 2a: Large Chinese listed companies are more likely to publicly share their ESG strategies

Share of Chinese listed companies that publicly announce their ESG strategies by company size

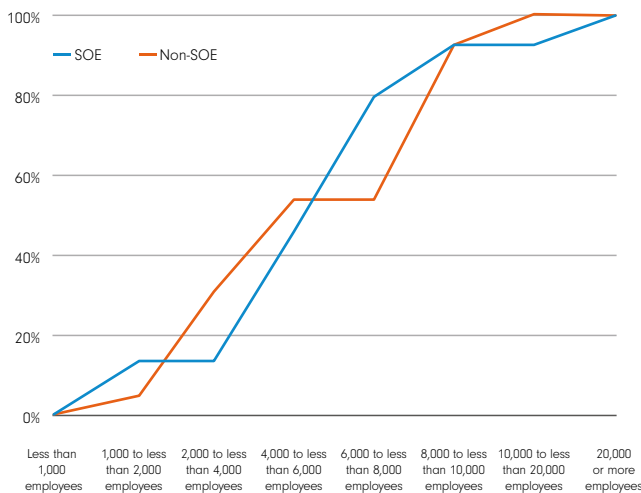
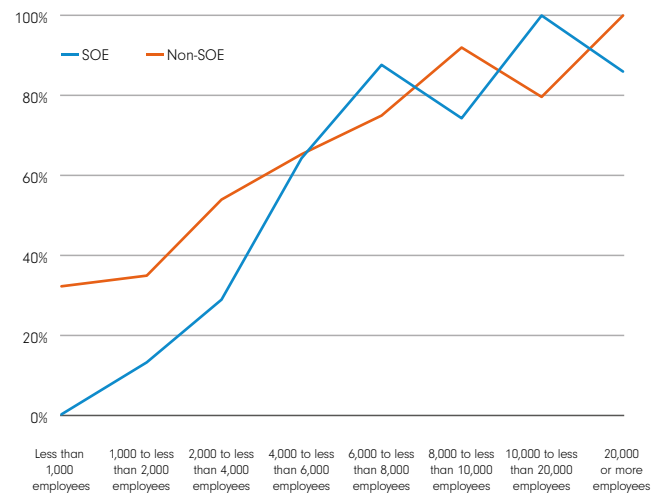


Figure 2b: Smaller SOEs have lower rates of ESG publication than private-owned enterprises of the same size

Share of Chinese listed companies that publish ESG reports by company size



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

The second factor strongly associated with ESG strategy sharing is company size, both in revenue and headcount. Almost all (94%) of the large, listed companies surveyed (those with more than 8,000 employees) have shared their ESG strategies publicly, compared with 48% for medium organisations (2,000-8,000 employees) and 7% for small enterprises (1,000-2,000 employees) (see figure 2(A)).

Hence, 60% of local and central SOEs have publicly announced their ESG strategy, compared with only 49% of private-owned organisations, which are, on average, smaller than SOEs. After controlling for company size, there is no difference in ESG strategy sharing between state-owned and private companies. In fact, when it comes to publishing ESG reports, smaller SOEs have lower rates of ESG publication than private companies of the same size (see figure 2(B)).

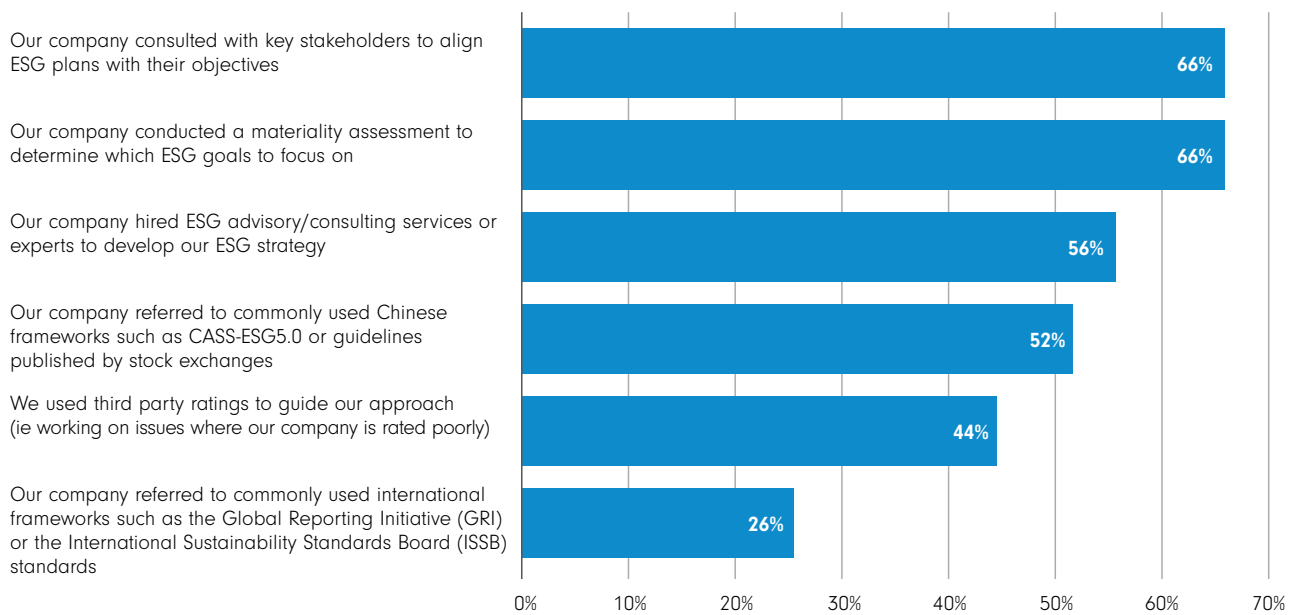
ESG strategy development inputs

As well as developing and publishing ESG strategies, Chinese companies are employing increasingly sophisticated tools when developing their ESG plans, according to the survey. Two-thirds (66%) of organisations consulted with key stakeholders to align their ESG plans with their own objectives. Materiality assessments are considered a best practice prerequisite before disclosing ESG information,⁵² and two-thirds of the surveyed listed companies in China have been conducting these to determine which ESG goals to focus on.

Over half (56%) of the surveyed companies also hired ESG experts to build in-house capacity and develop their strategy. This push for more robust ESG standards is reflected in rapid growth in demand for ESG services. China now has around 20 domestic ESG rating

Figure 3: Chinese listed companies are using more sophisticated tools to develop ESG plans, but progress is needed to reach global standards

How did your company approach the development of its ESG strategy? Please select all that apply.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

agencies and numerous global rating agencies also operate in the country.⁵³ Many are growing rapidly, and Sustainalytics, a sustainable ratings and consultancy agency, for example, reported a 36% year-on-year increase in its revenue in China in 2022.⁵⁴

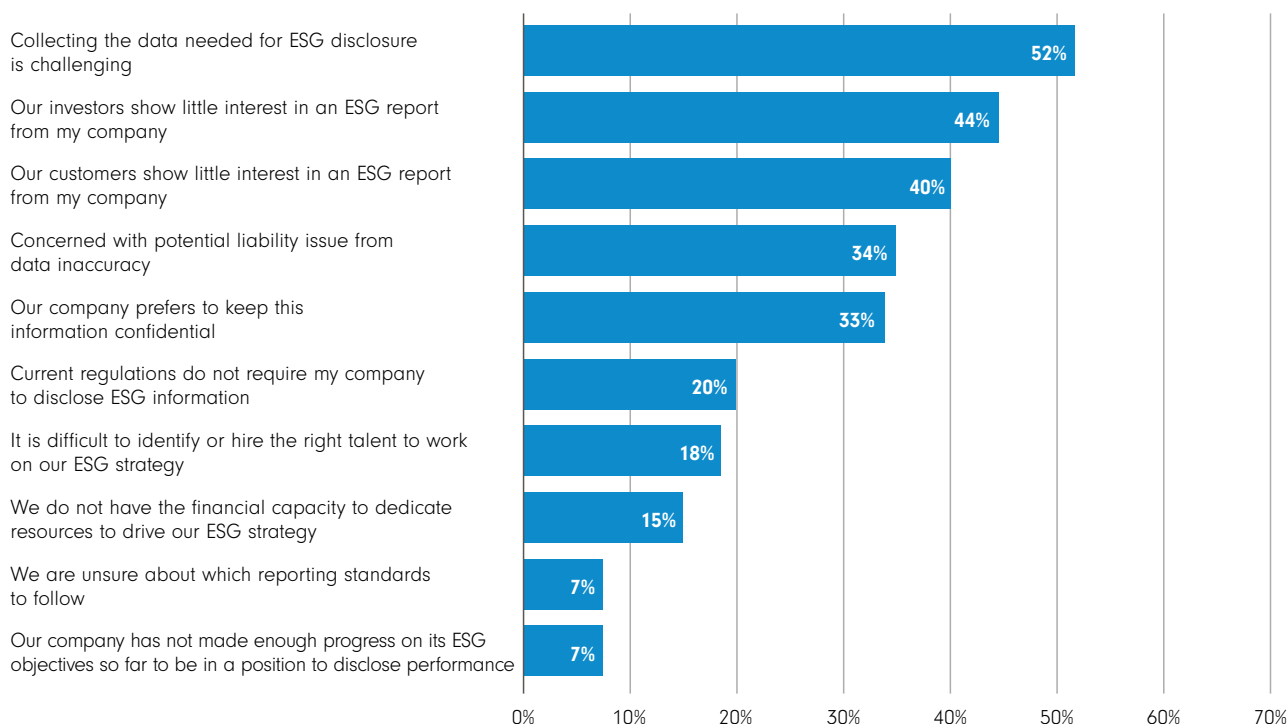
Although this demonstrates a growing commitment among Chinese companies to seek external input, the survey also shows that further progress is needed to reach global standards.⁵⁵ International ESG frameworks are also only used by a minority of Chinese listed companies that were surveyed. While over half of Chinese companies (52%) referred to Chinese frameworks or guidelines such as CASS-ESG 5.0 when developing their strategies, just a quarter (26%) referred to international guidelines such as the Global Reporting Initiative or the ISSB standards. These results hold true even for companies with dual stock exchange listings involving international exchanges.

Strategic challenges

While many companies have made ESG progress, and the number of listed Chinese companies publishing annual ESG reports is growing, this progress is still low by global standards.⁵⁶ Moreover, foreign investors continue to struggle with the lack of transparent information on Chinese businesses.⁵⁷

For the 36% of Chinese listed companies that have not yet published an annual ESG report, this is because of numerous roadblocks preventing them from publicly sharing these results. Chief among these is data. More than half of the survey respondents (52%) whose organisations do not publish ESG reports said they face challenges collecting the data required for ESG disclosure.

Figure 4: More than half of Chinese listed companies not publishing ESG reports find data collection to be a challenge
Which of the following reasons are behind your company’s decision to not publish ESG/CSR/Sustainability reports?
Please select up to three reasons.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

ESG data are a common problem for companies and investors globally.⁵⁸ Often it is not the data that are the problem, but a lack of standardised data, reporting formats and verification.⁵⁹ The Chinese government’s new regulations may help address this for companies domestically, and global frameworks like ISSB will slowly improve the global reporting landscape, but ESG data are likely to remain a challenge for companies and investors in the short to medium term.

Among the surveyed companies that have not yet published ESG reports, the second most cited reason is a lack of interest from investors. Conversely, among those already publishing ESG reports, 43% also cited investor expectations as an important driver of ESG strategy, shedding light on the role investors play in promoting progress.

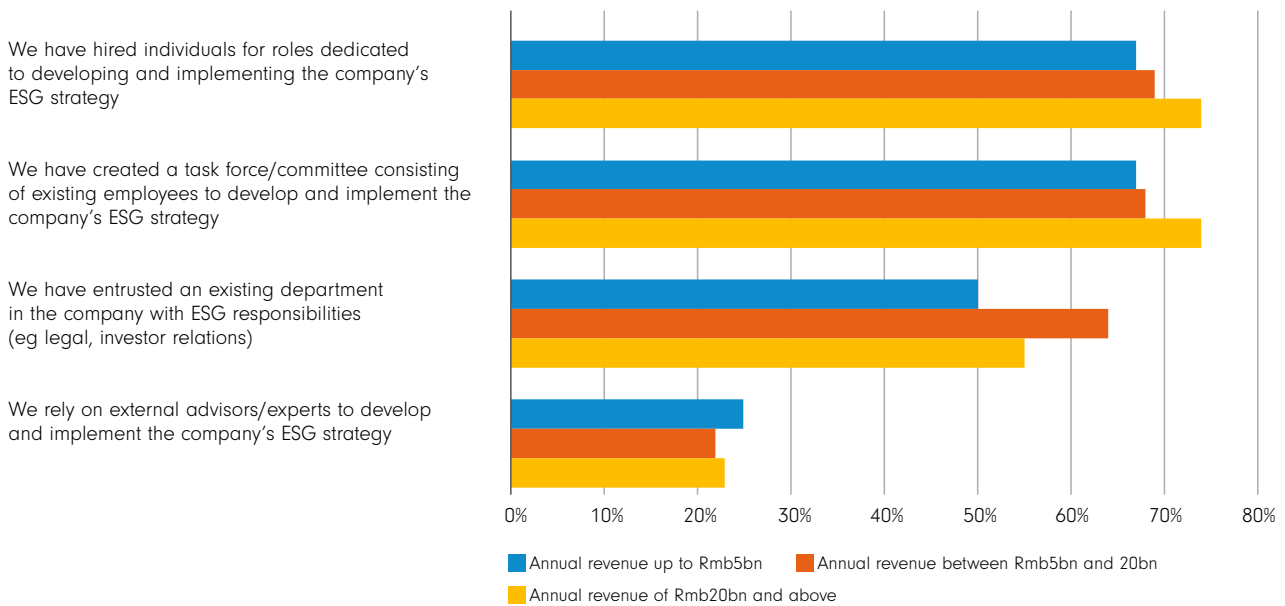
Overcoming the ESG skills gap

As the results above show, there is still room for improvement among Chinese listed companies across ESG strategy development and reporting. Finding the right ESG talent to help advance strategy and address roadblocks in implementation and reporting is critical to ESG success.⁶⁰ The ESG talent gap is a global challenge, but China is among the countries at the higher end of the shortage.^{61 62} Many companies are employing creative human resource (HR) strategies to equip their organisation with the right processes and teams to advance ESG development and implementation.

The most popular approach among surveyed companies is to hire individuals for roles dedicated to developing and implementing the organisation’s ESG strategy (71%). This is especially true for organisations with a large headcount (more than 8,000 employees) and high annual revenue (Rmb20bn and above).

Figure 5: Chinese listed companies prefer in-house expertise when developing and implementing ESG strategies

How did your company approach the development of its ESG strategy? Please select all that apply.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

A significant share of companies (70%) is also creating dedicated ESG task forces or committees that engage existing employees. This is a clever approach, as employees are a key ESG stakeholder constituency and consulting them can highlight areas for action, build a knowledge base and embed ESG strategic goals across a company.⁶³

A third common HR strategy to manage ESG implementation for 60% of surveyed companies is to entrust ESG responsibilities to an existing department such as legal or investor relations. This matches the approach from companies in other countries and reflects ESG's complex risk management and compliance impacts.⁶⁴

What is clear is that building and utilising in-house expertise is preferred, with only 23% of surveyed companies relying on external advisors or experts to develop and implement their organisation's ESG strategy. This suggests that companies see ESG strategy roles as a long-term commitment.

ESG HR challenges are due in part to the relatively nascent nature of the industry. According to a recent survey, 94% of hiring decision-makers globally said that they currently lack the necessary talent to implement their ESG goals,⁶⁵ while 76% are hiring for one or more E, S or G roles, making competition fierce. This is reflected in China, where a shortage of high-end ESG talent is pushing ESG salaries higher.⁶⁶ The surge in demand for ESG experts is only predicted to increase as ESG reporting becomes mandatory and investors' awareness and expectations of ESG become more sophisticated.⁶⁷ As such, the ESG talent gap is likely to remain a challenge in China in the immediate term.



Governance: enhancing board structure and diversity

Robust ESG governance is integral to the effective utilisation of ESG talent and successful implementation of ESG strategy. This section discusses Chinese listed companies’ progress on fundamental governance metrics. Board composition is a key measure of corporate governance health, and while improvements are apparent, Chinese listed companies still have some significant structural hurdles to overcome.

Board composition

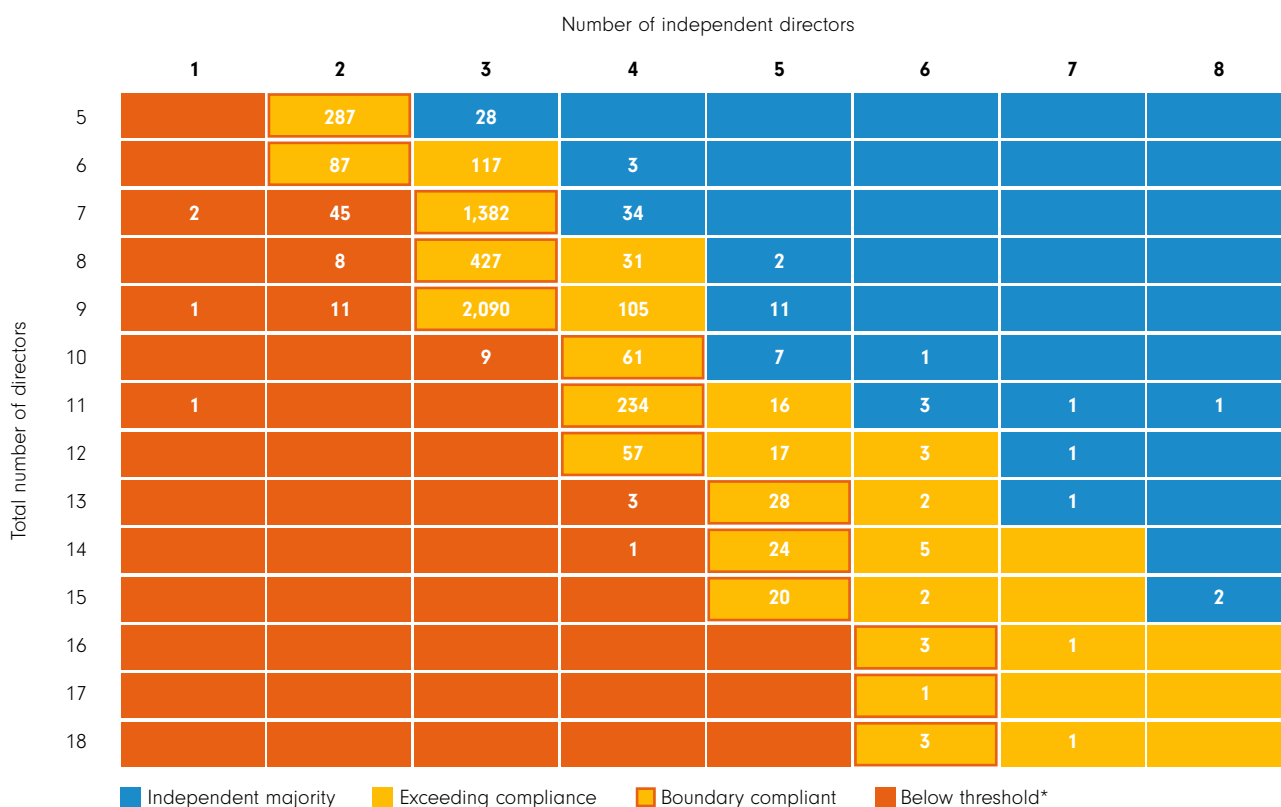
A diverse board with a high share of independent board members who can challenge management and protect shareholder value is considered best practice and important to a firm’s success.⁶⁹ In China, regulations require that at least one third of the directors on boards of listed companies are independent.⁷⁰

Chinese companies currently tend to follow a compliance-driven approach to board composition and structure their governing bodies according to minimum regulatory requirements. Figure 6 shows the distribution of directors of 5,180 companies listed on the Shanghai and Shenzhen stock exchanges.

91% of the companies shown are boundary compliant, meaning that if any one independent director were to be replaced by a non-independent one, the board would fall into non-compliance (below 33% independence). Conversely, only 1.6% of companies are governed by a board with an independent majority (more than 50% independence), which is recommended practice by the CFA Institute and also required in a number of jurisdictions, either through legislation or by the listing rules of individual exchanges.

Figure 6: 91% of A share companies in China are “boundary compliant”

Number of companies listed on the Shanghai and Shenzhen stock exchanges by number of directors on the board



*Below threshold does not necessarily imply non-compliance

Source: Wind Financial Terminal

The average share of independent directors among CSI 300 companies is 39% as of May 2023, significantly lower than in most developed economies. S&P500 (US) companies’ board independence rate was 86% while that for FTSE 100 and Top 50 FTSE 250 (UK) firms was 72%. China is positioned closer to other Asian economies. For Nikkei 225 (Japan) and the Hang Seng Composite Large Cap Index (Hong Kong), the board independence rates are 42% and 43%, respectively.⁷¹

There are signs that Chinese companies intend to catch up with their global counterparts. 44% of companies in Economist Impact’s survey claim that they have “set tangible goals to exceed regulatory requirements in the future”. Increasing board independence is the third-highest future priority behind climate change and gender diversity.

Another area slated for improvement in governance structures is board committees. Current regulations in China only require listed firms to establish an audit committee, but, encouragingly, an increasing number of companies have also established nomination and remuneration committees in recent years. The establishment of these committees is now nearly

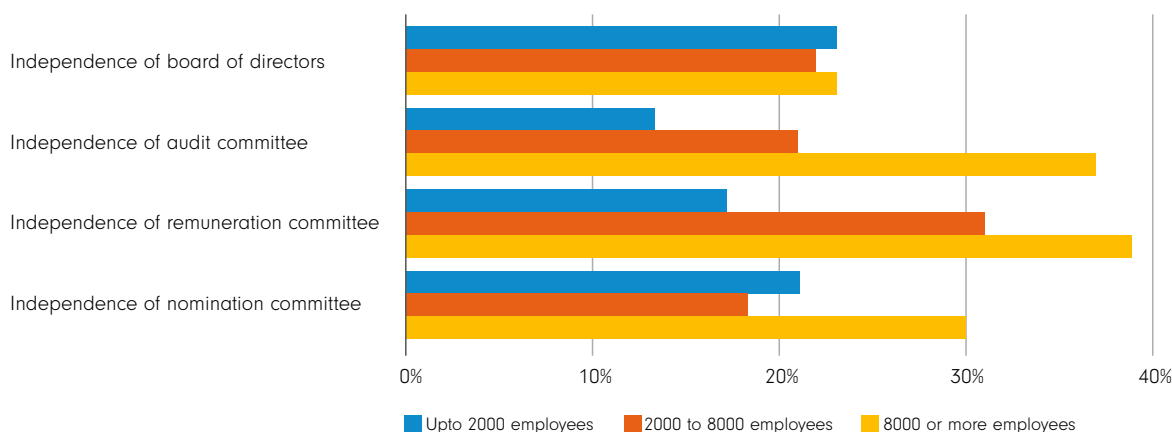
universal according to survey data, indicating a move towards greater transparency and accountability.

Board committees in China face an independence requirement of greater than 50%, in line with global jurisdictions such as Australia, Singapore and Italy. In Canada and the US, 100% independence is either mandated or recommended.⁷²

Many firms in China already exceed regulatory requirements in committee independence, notably larger ones with over 8,000 employees (see figure 7). As larger firms generally lead smaller ones in implementation of ESG-related reforms, an important trend to watch will be whether smaller firms in China catch up on board committee independence in the future.

A third critical area of ESG progress on board composition is gender diversity. At 61% China has a moderately high female workforce participation rate by global standards. Yet the picture changes at more senior echelons of business. For Chinese companies in the MSCI World Index, women represented 15% of board directors, compared with the global level of 31%.

Figure 7: Larger firms are more likely to outperform regulations on committee independence, but not overall board independence
Share of companies “already outperforming regulatory requirements” in board and committee independence



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

Fidelity Perspective

Board gender diversity in China

Having an effective board is essential for a company to successfully implement its ESG strategy. We believe having a diverse leadership team, including gender diversity, can prevent “groupthink” and strengthen board effectiveness and better steer a company on a sustainable path. However, as this study reveals, the ratio of female representation on boards varies significantly among Chinese companies.

According to the [Fidelity 2022 China Gender Diversity Report](#), where we conducted a proprietary analysis of the FTSE China A50 constituents, China’s largest public companies are displaying a lack of urgency towards promoting gender diversity despite lagging behind global peers on female directorship. Only one of the A50 firms had disclosed a formal gender diversity policy, while 19 others have issued general statements acknowledging the importance of female representation, with no measures to boost diversity.

Nevertheless, there are signs of a slow but steady rise in gender inclusivity at listed Chinese firms. On average, women accounted for 12.6% of board directors among listed Chinese firms in 2020, up from 8.6% in 2011, according to a study by Tianjin-based Nankai University. Collaborations between Chinese companies and

investors on gender diversity are also taking shape, such as the Xiangmihu Female Board Members initiative, which was founded in 2020.

We actively engage with investee companies to encourage gender-balanced boards and implement a voting policy to oppose company boards that fall short of a minimum ratio of female directors. For example, we voted against director re-election at a Chinese integrated optical components and products manufacturer in 2021 and 2022, citing the lack of progress on female representation on an all-male board. In 2022 we enhanced the dialogue with the company as a member of the 30% Club Hong Kong, a business campaign working to bring more women on to corporate boards.

The aforementioned company responded to investor concerns positively, and we are encouraged to see that it followed through on its promise with a new female independent non-executive director joining its board in January 2023, which not only improved diversity but also the board independence level. The company had also committed to looking for more suitable female director candidates beyond 2023, which we will continue to monitor and track progress on.

ESG oversight

Board oversight of ESG issues is important to the development and success of an ESG strategy, as well as to fulfil the fiduciary duty of its directors to address material risks.⁷³ The boards’ oversight structure of ESG depends on company-specific characteristics

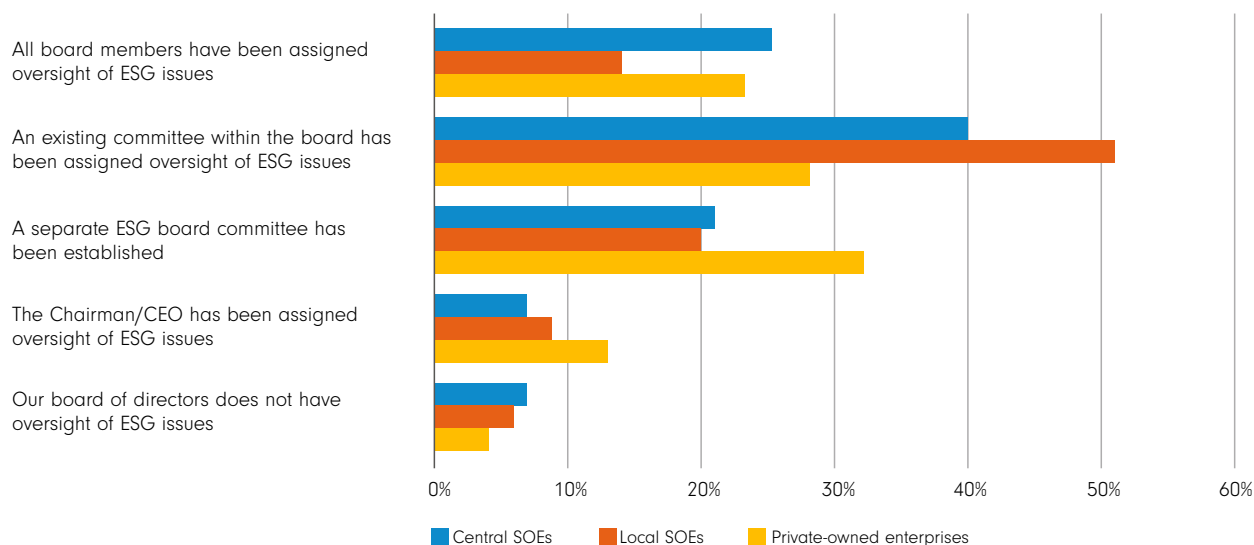
such as the industry it belongs to, board composition and the company’s strategic priorities—in particular, how it links its sustainability objectives with its overall strategy. Some approaches followed include assigning oversight to all board members, to existing committees, setting up a separate ESG committee or even using a combination of these approaches.

The survey results show that 23% of Chinese listed companies have full board oversight of ESG issues, with central SOEs (25%) and private-owned organisations (23%) more likely to have all board members overseeing ESG issues, compared with just 14% of local SOEs. Assigning ESG oversight to existing board committees is the most common practice among Chinese listed companies: almost 34% reported following this structure, with local and central SOEs leading this trend (51% and 40%, respectively). This is in line with global practice, including in the US where a 2020 study of S&P 500 proxy statements⁷⁴ found the largest share of companies (41%) assigning ESG oversight to their nomination and governance committees.⁷⁵

A further 28% of surveyed Chinese companies have established a separate ESG board committee altogether. Companies facing a high degree of complexity in terms of ESG risks are likely to adopt this governance practice owing to the need for deeper expertise. Out of the mining and oil and gas companies among the FTSE 100 companies, 100% were found to have set up a dedicated ESG committee.⁷⁶ The survey results show that private-owned organisations (32%) followed this approach the most, along with companies dealing in energy, capital goods and consumer durables. Although a small share, 5% of companies reported that their boards do not have oversight of ESG altogether: central and local SOEs lead this trend (7% and 6%, respectively).

Figure 8: Assigning ESG oversight to existing board committees is the most common approach among Chinese listed companies, in line with global practice

Currently, how is board members’ oversight of ESG issues structured in your organisation? Please select one response only.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

External assurance

China has a mix of mandatory and voluntary ESG reporting requirements, but listed companies, as in other countries, face more scrutiny and stringent measures than their private counterparts. This is starting to show in improvements in the processes that the boards and committees with ESG oversight in Chinese listed companies are employing to enhance the veracity of their ESG information.

Independent assurance, for example, is an important mechanism to enhance credibility in reporting processes and gives stakeholders a reason to trust the ESG data they are presented with. Although it can add an extra level of complexity, all the listed companies surveyed that do publish ESG reports obtain either reasonable (68%) or limited (31%) third-party assurance for their information, which is a positive trend.

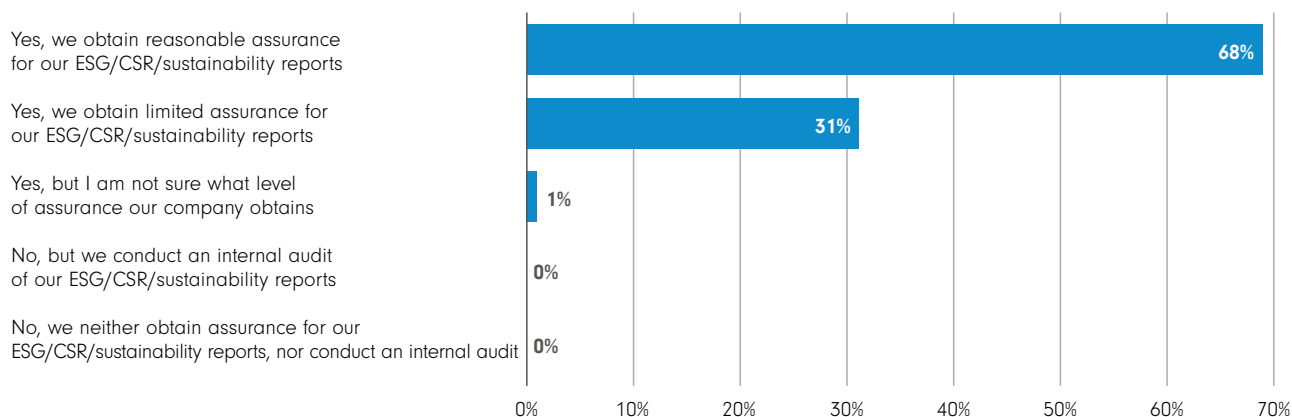
An inverse association was found between revenue size and the practice of obtaining reasonable assurance; the higher the revenue, the relatively

lower the assurance rates. On the other hand, a positive association was found between revenue size and the practice of obtaining limited assurance.

These findings appear to be at odds with claims from assurance firms that report dispensing mostly limited assurance and only few reasonable assurance⁷⁷ due to the lack of clarity and consistency around data. Globally, obtaining limited assurance is a more common practice as opposed to reasonable assurance: for instance, a 2021 report found that 83% of 1,269 companies worldwide obtained limited assurance, with Hong Kong being the only jurisdiction where reasonable assurance exceeded limited assurance.⁷⁸ The trend of assuring ESG reports is likely to pick up as reporting becomes more common practice and independent third-party service providers are called upon to ensure that the data are accurate and that ESG management systems are aligned with best practice.⁷⁹

Figure 9: All surveyed Chinese listed companies that publish annual ESG reports have obtained at least limited external assurance

Does your company obtain independent external assurance for your ESG/CSR/sustainability reports? Please select one response only.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

Governance guardrails

According to the survey results, several corporate governance guardrails are being established and strengthened, but progress is varied across listed Chinese organisations and many companies still lack some of the basic corporate protections for its board. However, it also highlights the impact of corporate governance scandals in changing corporate behaviour.

For example, 79% of organisations have a provision for liability insurance purchase for directors or indemnity against losses, with another 16% planning to put provisions in place in the future.

This is a strong result, with liability insurance rates the highest for private-owned organisations (82%), although it may reflect the Kangmei Pharmaceuticals scandal, where company executives and its external accountants were found guilty of fabricating the firm’s financial statements between 2016 and 2018.

The company’s independent directors were required to compensate investors for Rmb2.5bn (US\$391m) in losses

due to the fraud, raising awareness of the importance of liability insurance and triggering the mass resignation of independent directors in at least 20 other companies listed on the Shanghai and Shenzhen stock exchanges.⁸⁰

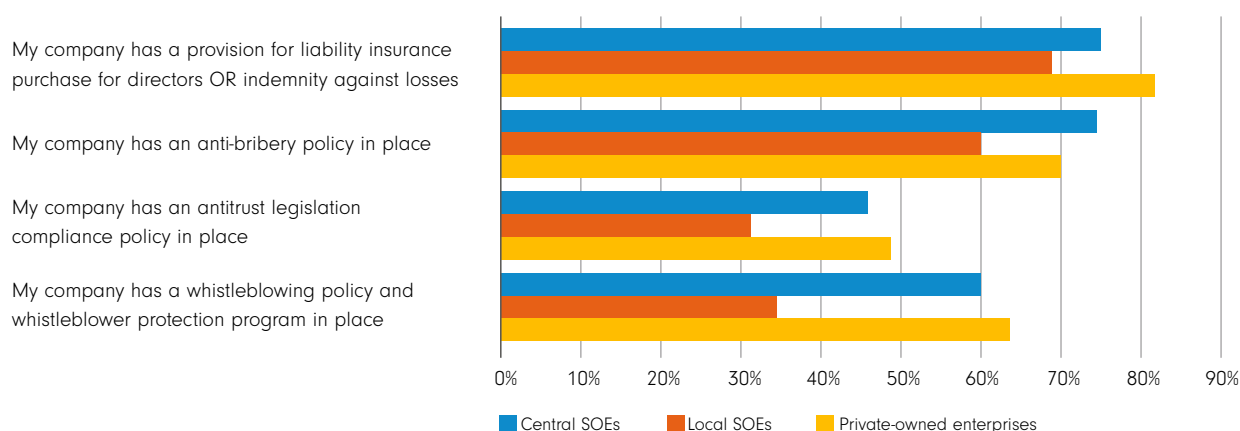
Over two-thirds of organisations (69%) also have an anti-bribery policy in place, with relatively high prevalence rates among central SOEs (74%).

About 19% of private-owned organisations and 17% of local SOEs have plans to put this policy in place, but almost 23% of local SOEs have no such plans, compared with 12% of private-owned organisations.

Progress on antitrust legislation compliance policies is relatively slow in comparison. Less than half (46%) of surveyed companies have these in place. This low result is surprising given the recent wave of antitrust activity from Chinese regulators targeting large domestic technology firms to set a standard of behaviour.⁸¹ Yet while 17% of listed surveyed companies have no plans to develop antitrust compliance policies, the recent measures may have spurred action, with 36% of organisations planning to implement an antitrust policy in the future.

Figure 10: Progress on governance guardrails is varied, and many Chinese listed companies still lack basic corporate protections for their boards

Share of companies that self-report having governance guardrail policies in place



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

Over half of surveyed companies (58%) have a whistleblower policy and/or protection programme in place, but local SOEs lag in this area and have the lowest rates (34%) compared with central SOEs (60%) and private-owned organisations (63%). Progress in this area lags behind other global markets, such as Australia, where almost 90% of the country's large corporations publish their whistleblower policy documents on their corporate websites, as it is a legally binding requirement.⁸² As corporate regulations continue to tighten in China, provisions that encourage the reporting of misconduct and major violations are expected, especially if they pose a serious threat to public interest,⁸³ so whistleblower policy rates are likely to increase in the future.

Of key concern to foreign investors, close to 65% of surveyed companies also have a dividend policy with clear parameters and guidance for shareholders in place. These measures typically cater to investor demands, and paying dividends is more likely at companies where directors have experience working overseas.⁸⁴ Any changes to China's corporate dividend policies will be followed closely, especially given Chinese companies' recent lag in dividend growth.⁸⁵



Current focus areas: E, S or G?

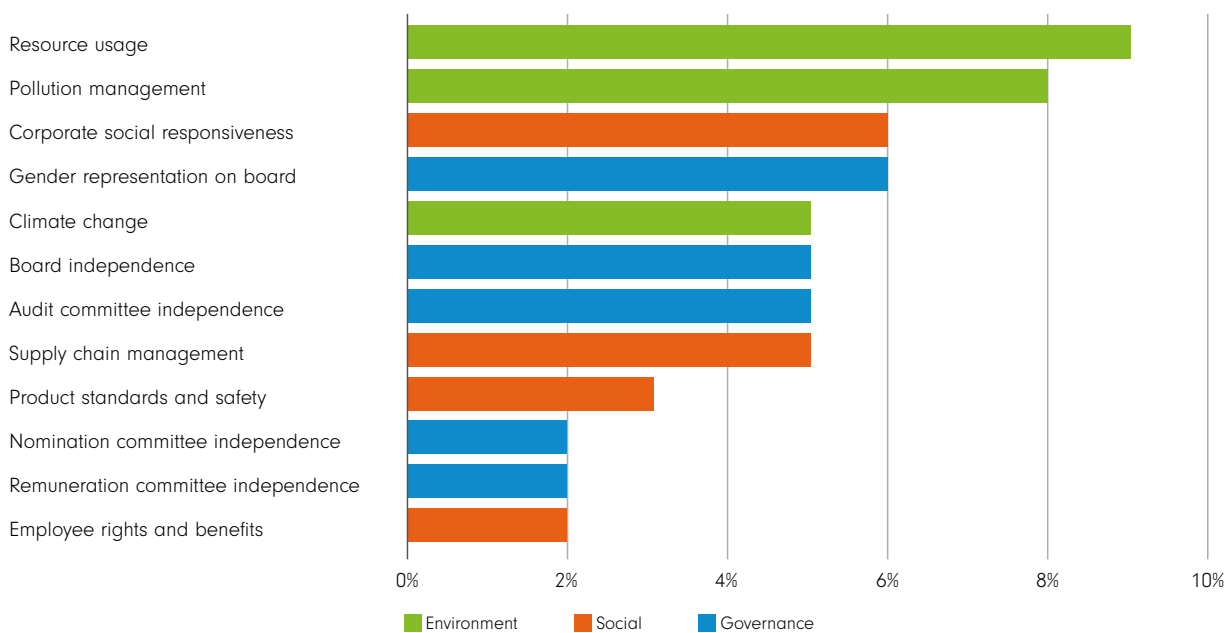
When asked to assess their own company’s performance on a range of ESG areas, executives’ responses showed a pattern of ESG priorities that differed significantly from those currently occupying management and board meetings in the US and Europe. This likely reflects differences in the economic, social and regulatory development China has experienced in recent decades.

The most notable such difference is the lack of relative priority given to environmental issues. Climate change mitigation and associated efforts to conserve resources and reduce waste are likely to top the agenda of ESG-related discussions in Western boardrooms, but these issues were rated as the least important among a range of focus areas respondents were asked about in the survey (see figure 12). Similarly, hotly debated issues relating to diversity and inclusion in the West, such as female board representation, also appeared to feature as a relatively low priority for the surveyed firms.

It is important to note that the data in figure 12 only reflect the relative priorities of Chinese firms. Even though 9% of respondents report not having taken any action on resource usage, the issue with the highest such proportion, the implication is that 91% of companies have taken action. Thus environmental issues remain a high priority for Chinese firms. They are simply not as high a priority as they are for Western firms.

The highest priority ESG issues for Chinese firms are a mix of governance and social items. Employee welfare and product safety/quality standards feature highly on the list, likely reflecting eminent issues in contemporary Chinese society. In a country emerging from a period of intense industrial development, where gruelling overtime work and workplace health and safety incidents are a recurring theme, better worker protections are seen as an important ESG issue.

Figure 11: The “S” and “G” in ESG lead over “E”
Share of companies that selected “we have not taken action in this area yet”



*The options included “we have not taken action in this area yet”, “we have taken action to make sure that we meet regulatory requirements in this area”, “we have set tangible goals to be met in the future that exceed regulatory requirements in this area”, “we are already outperforming regulatory requirements in this area”, and “this area is not applicable to my organisation”.
Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

The same can be said for product safety. Over the past two decades, high-profile and deadly food safety incidents involving contaminated products ranging from fake alcohol to infant milk formula have been a constant concern for consumers. In 2016, the China Food and Drug Administration reported over 500,000 food safety violations in the first three quarters of the year alone. The incidence of violations has reduced in recent years: the pass rate for food sampling inspection by regulatory authorities had remained above 96% for five years in a row from 2016 to 2020.⁸⁶

Given this context, it is unsurprising that product safety is seen as such a priority area for ESG. Chinese consumers are highly alert on this front, and companies often go to great lengths in product marketing to highlight the safety credentials of their goods. In such marketing content, safety often overlaps with environmental concerns. For example, the Chinese term “environmentally friendly” (环保) is often used to denote that the product is free of content harmful to humans. That contrasts with the Western application of “environmentally friendly”, which typically refers to product features such as the use of recycled or biodegradable materials or animal-friendly production methods.

In addition to labour and product standards, surveyed executives also identified a number of governance areas where progress had been made, notable in appointing independent members of audit, remuneration and nomination committees. Progress here is likely to be driven by regulation. Since the independent director system was introduced in 2001, Chinese regulators have continually strengthened expectations for their responsibilities and involvement in the supervision and governance of listed companies. In 2022, China’s securities regulator formalised the guidance that had been in place since 2001 which requires a third of listed companies’ boards to consist of independent directors and for independent members to comprise at least over half of the audit, remuneration and nomination committees.⁸⁷ Following the update in 2022, CSRS has recently released (April 2023) another new version of its regulations on the roles of independent directors for consultation, setting out clearer expectations for listed companies.⁸⁸ Despite a generally high rate of compliance with the rules, however, the survey findings reveal that board independence in China lags behind levels found in other major economies as discussed, as discussed in the previous section of the report.



Sustained change

China’s appetite to bring ESG into the corporate agenda is on the rise and here to stay, but priorities will continue to evolve. Sixty-seven percent of surveyed companies plan to review focal areas for ESG in the coming 12 months. Indications are that Chinese companies will move closer in line with global ESG trends as time passes.

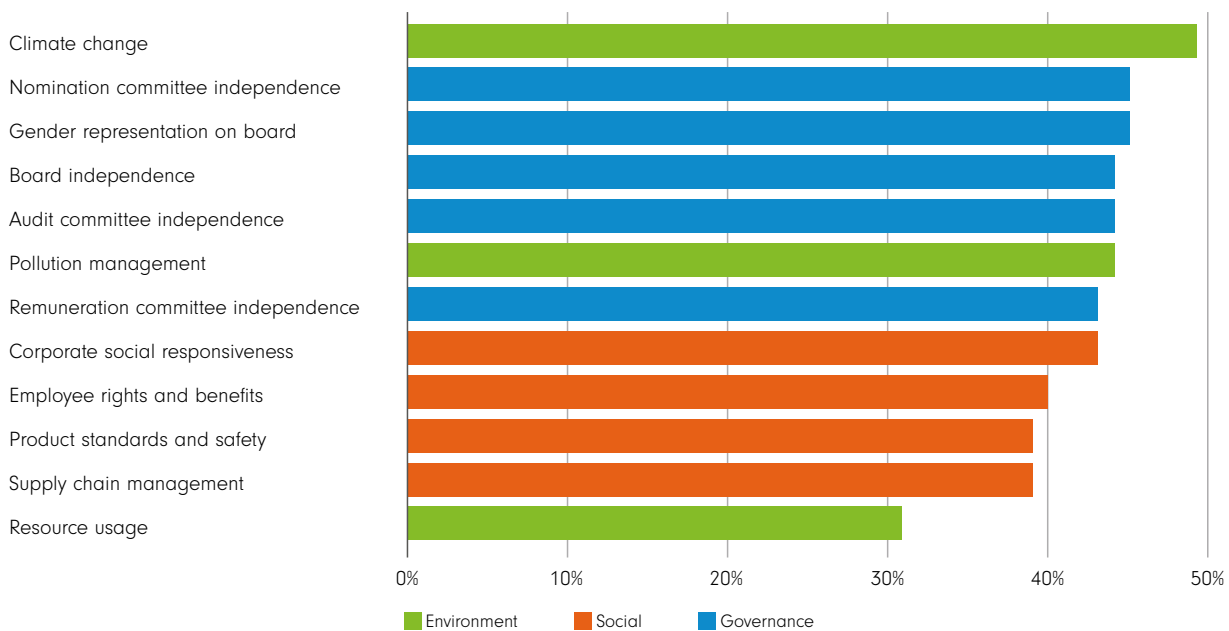
Climate change, for example, was the focal area that received the most responses for future ESG goals (see figure 13). Gender diversity on boards is another. As noted in the preceding sections, the relative lack of current focus on issues such as climate change and

diversity marked a key difference in the way that firms in China currently approach ESG compared with their Western counterparts, but that gap appears to be likely to narrow.

Board independence, notably for members of nomination committees, is another area surveyed firms noted as a future priority. As observed in the previous section, board independence is an area where listed Chinese companies clearly lag their global counterparts. The designation of independence as an area for future progress is thus a promising sign that corporate transparency and accountability will continue to improve.

Figure 12: Chinese listed companies are prioritising climate change and board independence when setting ESG goals for the future

Share of companies that selected “we have set tangible goals to be met in the future that exceed regulatory requirements in this area”



*Survey options included “we have not taken action in this area yet”, “we have taken action to make sure that we meet regulatory requirements in this area”, “we have set tangible goals to be met in the future that exceed regulatory requirements in this area”, “we are already outperforming regulatory requirements in this area”, and “this area is not applicable to my organisation”.

Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

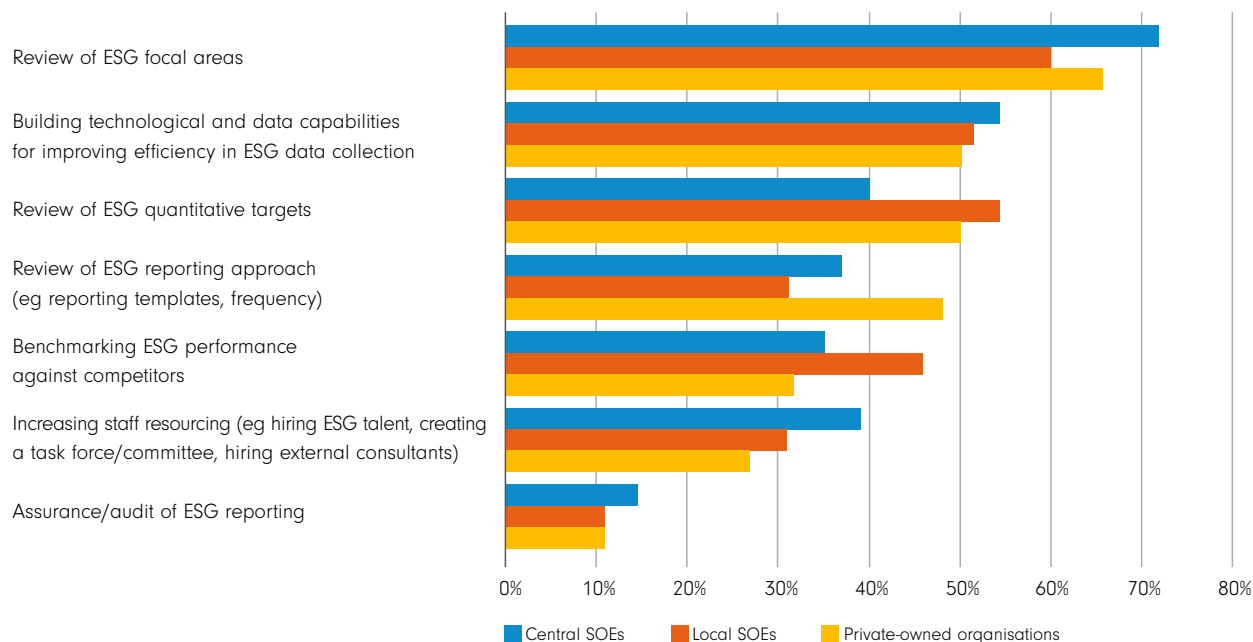
Investments will be required to support the shift in ESG goals. Over half of surveyed companies plan further investment in building technological and data capabilities to improve the efficiency in ESG data collection (51%). This is a particularly important area for larger organisations (those with over 2,000 employees) and a consistent priority across organisation type. Among the organisations that currently do not publish an ESG report due to the challenges of data collection, 53% also intend to build their technological and data capabilities to improve ESG data collection.

This is an important priority, as technology-enabled ESG tools can automate, expedite and simplify procedures while reducing the risk of error, increasing the pace of ESG change. According to insurance and

financial services company PingAn, introducing artificial intelligence into its ESG platform shortened the firm’s annual reporting period in 2020 by 40 days compared with 2018⁸⁹—and its ESG rating was upgraded to an ‘A’ by MSCI just two years later.⁹⁰

A third priority, being pursued by 47% of listed surveyed companies, is reviewing quantitative ESG targets. Having clear, measurable goals can ensure that companies stay on track, progress is measured and adequate oversight is in place.⁹¹ Also on the agenda is the review of companies’ approach to ESG reporting, including the choice of templates and the frequency of reporting (43%)—this is particularly pronounced for private-owned organisations (48%), compared with central SOEs (37%) and local SOEs (31%).

Figure 13: In the next 12 months, reviewing ESG focal areas is a priority for the majority of surveyed Chinese listed companies
Which strategic areas of ESG does your company plan to focus on within the next 12 months? Please select up to three options.



Source: Economist Impact ESG survey of publicly listed companies in China (December 2022–January 2023)

Fidelity Perspective

Sustained ESG improvement through engagement

One of the most important tools that investors can deploy to help corporates sustain momentum and achieve ESG goals is effective engagement. Compared with exclusion, engagement allows us to deliver meaningful changes for companies, track their progress and, ultimately, create value for clients.

In a study conducted by the Tokyo Institute of Technology (TIT) and published in [Japan's Government Pension Investment Fund 2020 ESG Report](#), an empirical analysis was conducted to gauge the effectiveness of investor engagement activities. As one of the participants of the study, Fidelity provided engagement data on 248 dialogues that we conducted with 117 Japanese companies with the goal of enhancing corporate value from 2017 to 2019. The study concluded that engagement improved a company's governance, evidenced by decreases in the ratio of cross-shareholdings to total assets and the removal of takeover defense measures. As for impacts on the share price, companies where we engaged with the CEO to escalate our issues of concern were found to have a higher Tobin's Q (a financial ratio that measures the market value of a company relative to its book value or total asset replacement cost). Last year, the study by TIT was expanded to cover environmental and social impact. After analysing the engagement data from four asset managers including Fidelity, the research found that environmental and social engagement by institutional investors improves environmental and social indicators of the companies they engage with.

As Chinese companies step up efforts to align with global peers, investors can inform companies on industry best practices to accelerate this process; in return, we can gain more insight into companies' plans and actions. For example, Fidelity carried out a thematic engagement series with several Chinese banks in 2021 and 2022, mapping out progress and best practice across the industry on green finance.

In an engagement with one of China's largest state-owned commercial banks in 2021, we provided recommendations for the bank's green finance strategy that included publicising green finance targets, making time-bound commitments for exiting high-emitting sectors, enhancing disclosure with reference to the Task Force on Climate-related Financial Disclosures' guidelines, and broadening out stress test to include more industries. In a follow-up engagement in 2022, we discussed its latest progress and shared best practices in the region, such as measurement and disclosure of Scope 3 financed emission.

On both occasions, the bank responded positively by adopting the recommendations promptly, and we are encouraged to see it is launching a trial calculation of carbon footprints for asset portfolios in carbon-intensive industries in its latest disclosure. The bank's continuous improvement was also recognised by external ESG rating providers, one of which raised the bank's rating twice in the past three years.

Engagements, as a tool, can have real-world impacts. Effective engagement is an ongoing process where case-by-case analysis on companies within the local context is crucial for deriving the relevant conclusions and feedback.

An investors' ability to communicate in local languages and understand cultural connotations enhances communication quality too. That is an important reason why Fidelity has committed on the ground sustainable investing teams in every large market including Japan and China, which work hand in hand with investee companies to deliver positive changes over the long term.

Leveraging ESG analytics data could, in theory, provide companies with insights into competitors' exposure to material risks and help with gaining a competitive advantage.⁹² However, this level of analysis requires quality data to first be collected and standardised. Only then can companies' ESG performance be adequately compared.

The assurance and audit of ESG reporting is the lowest priority item for companies in the coming 12 months, which is understandable given the present stage of ESG development at most Chinese listed companies. Although it is important to build credibility and trust, this can only realistically occur once all reporting templates, teams, data and targets are in place.

Appendix

Appendix A: survey demographics and methodology

Economist Impact conducted a survey of 262 business executives of listed companies in China to obtain insights into their ESG plans and progress.

Respondent profile: the executives represented a mix of C-suite executives, vice presidents, managing directors and directors, with 49% of surveyed respondents being C-suite executives. In terms of their business functions, they ranged from ESG/CSR/sustainability to operations, investor relations, compliance, finance, HR, marketing/communications and legal. The executives represented companies across the following main industry groups: energy, materials, industrials, consumer discretionary, consumer staples, healthcare, financials, information technology, telecommunications, utilities and real estate.

Sampling approach: the survey was sampled using an online approach, where respondents were drawn from individuals who had voluntarily opted into joining a panel for research purposes. Only respondents who passed the screening criteria based on the targeted respondent profiles were allowed to participate. The survey questionnaire was translated as needed.

The screening question asked to respondents to assess familiarity with ESG issues is as follows:

How involved are you in managing your organisation's ESG initiatives?

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