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Boston Common Regional View: ESG in Asia

Thought Piece
May, 2012

Boston Common is one of the few U.S.-based ESG integrated asset managers offering international and global investment strategies.

As such, companies located in the Asia region comprise over 20 percent of our international portfolios. In keeping with our broad efforts to hold the companies we own to high ESG standards, we have made engaging companies in Asia an advocacy priority.

In contrast to Asia, Europe has developed a robust regulatory environment supported by the European Union and national governments to address corporate behavior. In the United States, companies have responded to a consumer base that has broad expectations of transparency, environmental impact mitigation, and risk management. Asian corporate culture, conversely, has developed without domestic mandates on transparency, whether federally imposed or as a function of public demand. We are finding that this trend is changing as global investors are beginning to demand improved standards of accountability from companies in all world regions.

A pervasive lack of reporting has been a primary obstacle for investors in Asia. However, disclosure is simply a first layer in addressing material ESG issues. In Asia, these have historically included labor management, human rights, and corruption. Meanwhile, governance, equal work opportunity, and issues such as access to medicines and climate change, have taken on increased importance in the regional ESG discourse.

In Brief

- Asian corporate culture has developed largely without an emphasis on transparency. This trend is changing now that investors are beginning to demand improved accountability from companies in all world regions.
- Over the past seven years, we have made engaging companies in the Asia region an advocacy priority. In the last six months we have met with nearly 20 company managements in Korea, Japan, and Singapore to discuss material ESG issues.
- Over our years of advocacy in the region we have observed a number of distinct ESG traits, including better company performance on managing environmental risk than social impact, and a limited understanding of what tools are available for addressing sustainability issues.
- We have created a set of operating principles for successful engagement in the region, including collaboration with local partners, concise communications and focused conversations, and using “Commend, Push, Inquire” and peer-based “Compare and Contrast” methods.

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Our advocacy work in Asia has enabled us to identify a number of defining ESG themes in the region.

Over the past seven years, we have engaged Asian companies on significant human rights issues. These have included responsible global supply chain practices, such as worker health and safety, conflict minerals, human trafficking, and cotton sourcing. We have also engaged them on environmental practices related to climate change, water sustainability, and toxic chemicals. We have made regular visits with management at companies' headquarters in order to gauge their responses to ESG imperatives, and to observe implementation first-hand. We have also led multi-stakeholder initiatives designed to increase sustainability reporting and ESG performance across the region.

Broadly speaking, we have observed that companies in Asia have made the greatest strides in addressing environmental risk management. Many of the largest companies in the region, particularly in Japan and South Korea, have established ISO 14001 certified environmental management systems and have actively improved disclosure of GHG emissions through reporting to the Carbon Disclosure Project (CDP). We believe there is room for companies to improve their disclosure of material environmental risks and impacts, and to set measurable targets for further improvement.

Asian companies generally lag their American and European counterparts in addressing social issues such as human rights, workplace diversity, and stakeholder engagement. In Japan and Korea, many of the companies we have engaged limit their approach to social issues to philanthropy and local community initiatives. Globally-oriented corporations, such as Honda, Sony, Toyota, and Samsung, have taken more robust approaches by establishing comprehensive supply chain oversight systems. Nonetheless, despite being susceptible to, and possibly complicit with, in a range of regionally distinct human rights abuses, many of the companies we have interacted with do not adequately address all four International Labour Organization (ILO) Core Conventions.

While many have adopted policies intended to eliminate forced and child labor, and discrimination, most have not adequately addressed the rights to freedom of association and collective bargaining. Issues like workplace diversity and equal opportunity also fall toward the bottom of companies' ESG agendas. Female employees have been historically underrepresented, and continue to represent only a small fraction of the total workforce of many industries, even in countries like Japan. The same lack of diversity is manifest on corporate boards and executive management teams.

On the subject of governance, we have noted a growing understanding of the need to address issues such as bribery and corruption. While some companies have adopted policies to address these concerns, many currently lack the management systems to enforce them.

In short, we have observed a willingness among company managements to take proactive measures to tackle ESG issues; however, there persists a limited understanding of the mechanisms available to do so. This, therefore, is where we have chosen to focus our engagement efforts in the region.

Based on our years of advocacy with Asian companies, we have created a set of operating principles for successful corporate engagements.

When initiating conversations with company managements, we have recorded our highest response rates to communications which are brief and succinct. Recognizing that English is not the language of business in most Asian countries, by reducing our communications to concise requests, we help ensure that our message is not lost in translation.

Similarly, in meeting with managements, many of whom are just beginning to incorporate ESG sensibilities into their thinking, we focus our discussions on the key points of the engagement. Our most fruitful discussions have been those that are focused on core, material ESG issues. We have traditionally used a "Commend, Push, and Inquire" model of discussion: first commending the company on areas in which they have excelled, pushing them on areas where we believe they can improve, and inquiring about new areas that have not been identified or addressed. This approach has been especially productive in raising emerging issues, such as water sustainability, human rights, and stakeholder engagement.

In the past six months, we have met with nearly 20 company managements in Korea, Japan, and Singapore to discuss ways to systematically address ESG issues including, and beyond, disclosure.

We believe that collaboration with local partners is an indispensible tool when working in Asia. In South Korea, for instance, we have partnered with Korea CSR Research Service (KOCSR) for the past four years. We have regularly relied on the on-the-ground investigative capabilities of Singapore-based Responsible Research. Pursuing local partnerships allows us to be sensitive to local norms of corporate culture, to gain insights that may be otherwise inaccessible to us as foreigners, and to engage in the local language for meaningful discussions of critical and nuanced issues.

A further point of leverage that we have found to be productive is to highlight the performance of regional peers. While we generally hold all players to global ESG expectations, a historical eagerness among Asian companies to outperform their foreign counterparts - for instance, Hyundai in Korea versus Toyota in Japan - makes the "compare and contrast" method an effective advocacy tool. Companies have proven to be responsive to the proposition that they should establish ESG practices that rival those of their regional competitors.

Building transparency into the Asian corporate climate is an issue that we have taken head-on.

International investors are increasingly pouring into global markets, at the same time that Asian companies are expanding beyond regional marketplaces. As a result, corporations in Asia are finding themselves no longer immune to expectations on sustainability disclosure. We have served as co-chair of the Emerging Markets Disclosure Project (EMDP) since 2009. As a co-leader of the EMDP South Korea team with KOCSR, we published the findings of our first investigation into the state of corporate disclosure in Korea in an April 2010 study entitled Unlocking Investment Potential: ESG Disclosure in Korean Companies. Our work on EMDP was highlighted in an article in the ESG Asia 2012 Conference Report.

In the absence of disclosure, many investors are turning to sustainable indices as a proxy for ESG management in emerging markets. Asian companies are responding to the positive brand implications associated with indices such as FTSE4Good and the Dow Jones Sustainability Index. We have participated in this trend by collaborating with stock exchanges in emerging markets as they develop sustainability criteria for their listed companies. Through an initiative organized by BSR we have provided feedback to the Shanghai Stock Exchange on its ESG disclosure listing requirements. Meeting the sustainability listing requirements provides an easily accessible set of goals for company management teams, and we have frequently used these as tool in our discussions with Asian corporations.

A primary method of engagement has been to encourage the companies we own to join international industry initiatives, giving them an avenue to publicly express their commitment to best industry practices. We successfully urged Samsung to join the Electronic Industry Citizenship Coalition (EICC). In so doing, it adopted a code of conduct that addresses labor, health, safety, and environmental issues. In meetings in Korea in March 2012, we further encouraged Samsung and LG Electronics to join the Public-Private Alliance for Responsible Minerals Trade (PPA), and Samsung to adopt the UN Global Compact. We also encouraged semi-conductor manufacturer Hynix, recently acquired by SK Telecom, to join EICC, in order to support the group's efforts against conflict minerals.

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We have sought to join conferences, roundtables and other multi-stakeholder events to observe the emergence of new ESG trends, and to participate in investor and company led movements to address them.

In meetings in Japan in November 2011, we asked Toray to join the CEO Water Mandate and to disclose its water use and impacts to the Water Disclosure Project. We also urged Mitsui Fidosan to adopt sustainable timber sourcing by procuring only Forest Stewardship Council (FSC) certified timber.

In May 2010, we helped to convene the first Corporate-Investor SRI Roundtable in Tokyo. Boston Common, along with ASrIA and Bloomberg, brought together Japanese and international investors, service providers, NGOs, and corporations to share perspectives on ESG engagement in Japan.

Prior to the ESG Asia 2012 conference, we organized a private investor strategy discussion on Access to Healthcare and Access to Medicines in Asia. As global drug companies are coming to view developing countries less as manufacturing bases and more as potential end markets, the pharmaceutical industry is facing a host of new issues in the region.

One of the critical findings from this discussion was the importance of pairing engagement efforts with local investors, who may have greater access to local generic drug companies and other home-based healthcare actors. We are currently exploring formal avenues of collaboration with these investors.

As we stand at the helm of ESG integrated international investing in the U.S., we will continue to view our advocacy with Asian companies as a primary engagement imperative.

In the coming months, we intend to urge the companies in our portfolios to comply with the California Transparency in Supply Chain Act, to take systematic measures to address human trafficking and modern day slavery in their supply chains, to adopt responsible sourcing of materials such as minerals, cotton, timber, and palm oil, to improve their work practices in relation to diversity, and to start assessing their water footprint. In addition, we will continue to engage on emerging issues such as user-rights to privacy and freedom of expression with technology and telecom companies. We are continuing our participation in the Emerging Markets Disclosure Project, and will encourage Korean and Japanese companies to implement our ESG disclosure recommendations.

Boston Common Asset Management

is an investment manager and a leader in global sustainability initiatives. We specialize in long-only equity and balanced strategies and pursue long-term capital appreciation by seeking to invest in diversified portfolios of high quality, socially responsible stocks. Through rigorous analysis of financial, environmental, social, and governance (ESG) factors we identify what we believe are attractively valued companies for investment. As shareholders, we urge portfolio companies to improve transparency, accountability, and attention to ESG issues. Our focus is global; we manage U.S. and international portfolios to meet the needs of institutional and individual investors. We are independent, employee-owned, and field a seasoned, close-knit team of professionals.