

APAC is Better at ESG and EVs Aren't Enough

Featuring:

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Mike Disabato:

What's up everyone and welcome to the weekly edition of ESG Now, where we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host, Mike Disabato and this week we have two stories for you. First, we discuss why some of the highest risk markets in the Asia Pacific region have seen some of the biggest improvements in ESG scores in the past three years. And then we discuss what would happen to emissions everyone in the world drove an electric vehicle. Thanks as always for joining us, stay tuned.

The Asia Pacific region often referred to by its acronym, APAC, is one of the richest in terms of environmental, social and governance opportunities. One example on the environmental side is the use of renewable energies is growing more in APAC than any other region and governments, especially in China are pushing the adoption of electric vehicles more and more.

But APAC has also historically one of the most challenging in terms of ESG risks, because it is such a global hub of manufacturing and processing and historically has been kind of lax on regulatory oversight. There are issues with pollution, supply chain, complications, and labor rights. But across the region, tighter regulation, rising awareness of ESG and more pressures from investors have led to a step up and overall ESG performance over the past three years. This is all according to my colleague and guest Miranda Carr, who just finished researching the topic and has a report out called ESG and APAC could laggards become leaders. So, when I called Miranda up, I asked her first, if she could set the context for me, what was the perception of APAC usually with regards to ESG and how has it changed?

Miranda Carr:

Well in the APAC region as a whole, you've got a huge variety in terms of ESG adoption and the whole understanding and performance on ESG, because you've got some markets like Japan, Australia, New Zealand, where the adoption's been quite long-term. The companies understand that the investors understand this, and there's been a big push for quite a number of years in those markets and the scores are very high in terms of how the companies perform on ESG. But in other markets where there hasn't been such a widespread adoption

over such a long period of time, particularly in the big markets of China, India, and South Korea, you've had loose scores. And so, people have this perception of the sort of APAC being low scoring on the ESG funds, the lots of ESG risks in the region.

And so, therefore there were sort of worried about the company's performance on sort of key ESG metrics. And also you get the companies themselves complaining that they are not being given the recognition that they deserve in terms of how they approach ESG as well. So, there's been this perception that the whole region is low scoring and low performing on ESG, but that is changing dramatically. And that's what we've seen over the past three to five years in some of the key markets.

Mike Disabato:

Miranda is going to use the word score often in this podcast. And I want to kind of explain the real world context of an ESG score. I know we've done this before because we're an ESG company and this is an ESG podcast, but I think it's always good to do a quick real world check on the jargon. So, an ESG score is obtained as an output from a model and all models out there use data inputs like company issued data, regulatory, datasets, hazard layers, things like that. And those inputs are used to create a score that puts into context, how company or sovereign or an investment is affecting the world's environment, that society, as well as how its governing structures play into those environmental and societal factors.

And these data points are constantly being updated. For example, we update company's estimated carbon emissions regularly using company reported data or estimated data when that data's not available. And the real world context of those inputs is that for example, if carbon emissions are going down, then that means theoretically climate change is slowing down and people aren't dying as much from air pollution and waters are turning less acidic. And so, I don't think I'm too biased in saying when ESG scores improve society might get a bit better.

Miranda Carr:

Well, one of the most interesting sectors in APAC broadly is the financial sector where you've seen, that's been one of those best performers in terms of improving its ESG performance over the last two or three years. And that's to do with a combination of factors. So, the green financing and the sort of push for climate bonds and environmental financing has been pushed by both the stock markets and the individual governments, particularly in areas like China and Singapore and in markets like Taiwan. So, you've seen a lot of adoption by the sort of big banks and the securities companies. And so, but in tandem with the regulators and the government pushing those factors, then you're also seeing the companies reporting more on those metrics itself throughout the region. So, that if you like, that's been a combination of the regulators and the companies themselves, but there's really interesting thing.

And some of the key markets and particularly the high risk ESG sectors. So, things like the, these are the ESG sectors that investors love to hate. So, things like consumer staples, the utility sector, materials and energy where there's huge risks in terms of environmental issues in terms of pollution climate, and also on even things like the sort of human capital element in terms of treatment of their workforce. But this is where you're actually seeing some of the biggest improvements. And this was one of the really surprising things about the

study. And so, we looked into quite in detail why that was happening. And some of that is regulation. So, the government, I mean, China's another good example where they've really put in much, much tougher environmental protection regulations in over 2015 and also again in 2018.

And that is now being reflected in how the company practices literally cleaning up their act and that's then being reflected in their ESG performance and their ESG scores. But you're also seeing that in other markets in India, they've had regulation on the sort of pollution and waste side also in South Korea. And that means that the companies are now adopting much better practices and that's then being reflected in their overall performance.

Mike Disabato:

And as Miranda told me, this increase adoption is also being spurred by investors, such as millennials in the APAC region that want more ESG reporting from companies as well as actually women investors who are pushing companies in the APAC region to report more on their corporate practices. That is happening in conjunction with these government regulations on environmental protection and data and privacy, as well as stock markets in the region saying, if you want to be listed on our exchange, you need to disclose more data on ESG factors. We've seen this in China, Hong Kong and South Korea. And this has meant we have a very different corporate world in the APAC region than we saw even two or three years ago.

Miranda Carr:

Well, if we take the China market as an example, one of the key things has been that you're actually seeing the, it's not just the Chinese companies who are saying that they are following better practices. It's actually their competitors who are also saying that they are not seeing such bad practices in the market as well. So, some of the smaller competitors have closed down. Some of the sort of high polluting companies have closed down. So, therefore a lot of the, what you would have as that low level, potentially low cost competition in the market, which had basically potentially the highest ESG risks in terms of their performance on both energy things like energy efficiency, but also students like the pollution and waste regulation. Now, if you're seeing the competitive environment improve because everyone's now following better practices, I think that's a really tangible effect that you can actually see, not just for the Chinese companies themselves, but also for the international companies who are operating in those markets.

Mike Disabato:

We've been talking about APAC generally because the acronym is easy and often APAC is grouped together in industrial lexicon, but within APAC, there are markets like in Japan, Australia, New Zealand and Singapore, for example, that already had robust data disclosure practices in place. And what is interesting is unlike the markets that are just getting started, the markets that Miranda has basically been discussing, the ESG score momentum in these established regions is trending a bit negative. So, I asked Miranda why that might be if it was due to the companies in that region already having high scores. So, it's harder to have a noticeable, positive momentum, or if there was another contributing factor.

Miranda Carr:

Well, yes. I mean, they do have pretty high scores already. So, obviously you're not going to see such a big improvement, but there are risks potentially emerging where you're actually seeing some of the companies and some of the sectors fall back on areas where they've been doing very well historically. So, things like on the pollution and waste site, both in Japan and in the Taiwanese market, you basically had companies who are potentially previously very good, actually beginning to score low because you're getting more regulation. They have to meet higher standards. And if they're not coming up to those higher standards, then of course, obviously the performance that we look at is going to fall back.

Mike Disabato:

That fallback can mean that the regulations are working. There are serious environmental problems that our economies help to perpetuate through their current normal functioning. So, regulation that is trying to correct the negative externalities created by the normal functioning of system should in theory, make the current system less effective. But a slip in ESG scores can also be a signal for those investors that own these companies in those sectors to engage. Engagement is a big part of the ESG industry. Shareholder resolutions are often highlighted as the way companies move on issues. And we've talked about them as such on this podcast, but actually engagement. What happens behind closed doors between investors and companies often move the sustainability needle more than say, a public dispute that is settled during the proxy season. And if certain sectors are falling in established markets and not improving as quickly as other sectors and up and coming markets, then that might be an engagement bat signal of sorts.

Miranda Carr:

Yeah. That things like the consumer staples sector. So, that covers sort of the agricultural food and beverages and where you've got a lot of issues around the biodiversity problems, the environmental problems that sort of the climate problem, but also on the human capital side and treatments of both migrant workers and the workforce in general. And that's where some of the really big issues in the region. And we didn't see a big improvement there either in the sort of high scoring markets or in the low scoring markets. So, that's an area where investors need to really look very carefully. And if they're looking for places sort of to contact companies and sort of target some of their investment campaigns.

Mike Disabato:

We're going to see this investor push as a large part of the increased adoption of ESG in APAC. But this is not all due to altruism or general interest in ESG. In 2021, there has been an upsurge of regulations that are focused more on how investors are incorporating ESG into their investment process and trying to hold investors more accountable that are saying they're doing this. This has put pressure on investors and in turn, those investors have begun pushing the companies they're giving capital to, to provide more ESG information where required. That in a general understanding by APAC companies had more people, both abroad and at home want to invest in solutions to these global problems and are willing to provide a lot of money

to companies that proffer those solutions are all part of the reason why we're seeing an increased adoption and positive momentum about ESG in the APAC region.

Car companies are making huge promises about their electric vehicles in the coming decade. Ford, GM, Volvo, Jaguar, Land Rover have all promised an all electric future and I'm probably missing some companies in there. And other companies are announcing the release of an all electric fleet that they hope will power their sales in years to come. So, let's say we went back in time and everyone, instead of buying and driving a internal combustion engine vehicle, a traditional vehicle in 2019, what if everyone drove an electric vehicle? What would happen to global missions? They would fall sure, but by how much? Well, my colleague Yu Ishihara answered that very question in some of his recent research. So, I had to call him up and ask about what he found.

Yu Ishihara:

In 2019, according to MSCI climate risk center statistics, the automobile industry was responsible for just under five gigatons of CO2 equivalent in emissions. Now that's 13% of total global emissions. So, it's not insignificant. And I'd say about 80% of this came from vehicle tailpipe. So, this is the target. This is what electric vehicles is about. And so, the idea behind it is to really sort of think about, okay, well, what happens when we get to this electric vehicle future and everything is electric? Do we hit a zero emission vehicles? And unfortunately, the answer is, at least from your analysis is no. On average, I think industry players so you had reduction about 30% reduction in emissions, which is not insignificant by itself, but it's certainly not zero. And, the main reason boils down to the charging.

EVs obviously required batteries. These need to be charged to operate the vehicle. And there'll be a certain non insignificant increase in the demand for electricity around the world. And so, then you have this ultimate scenario where EVs are sold around the world and the key factor that defines the emissions becomes the regional grid intensities of where these cars are driven. So, obviously, countries where there are a higher percentage of electricity is generated by burning fossil fuels. The transition to EV by itself would have probably less of an environmental impact than say, selling all EVs in Norway where the majority of electricity generated is from renewables.

Mike Disabato:

Damn. That's a bit sobering, isn't it? That the emissions would only go down by 30%, that there's still 70% of the emissions out there that electric vehicles will be responsible for?

Yu Ishihara:

Certainly that is one way to think about it. But another way to sort of think about it is, yes. It's a bit disappointing that EVs aren't necessarily zero emissions, but the automobile industry is definitely doing their part in this. I mentioned earlier around a 30% reduction, that's not small. And ultimately it boils down to these grid intensities. And this is outside of the control of these companies, but just as OEMs would be doing their part in terms of launching these cars, you can imagine that as the shift, obviously it's not going to happen overnight in my analysis, but the transition to renewable energy will accompany this. And so, as this happens and

electric vehicles are launched, the world will slowly, gradually get closer to getting to that elusive zero emission vehicle. But again, as it stands right now, it's not just about the cars.

Mike Disabato:

And that's it for the week. I want to thank Miranda and Yu for joining me to discuss this week's news with an ESG twist. I want to thank you so much for listening. I really appreciate it. Don't forget to rate and review wherever you get your podcasts if that's even possible. It's useful. It's nice. I like to see feedback and subscribe of course. I hope your week is going a little bit better than last week or the weeks before, or it's staying the same if it's already good and I'll talk to you next week.

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