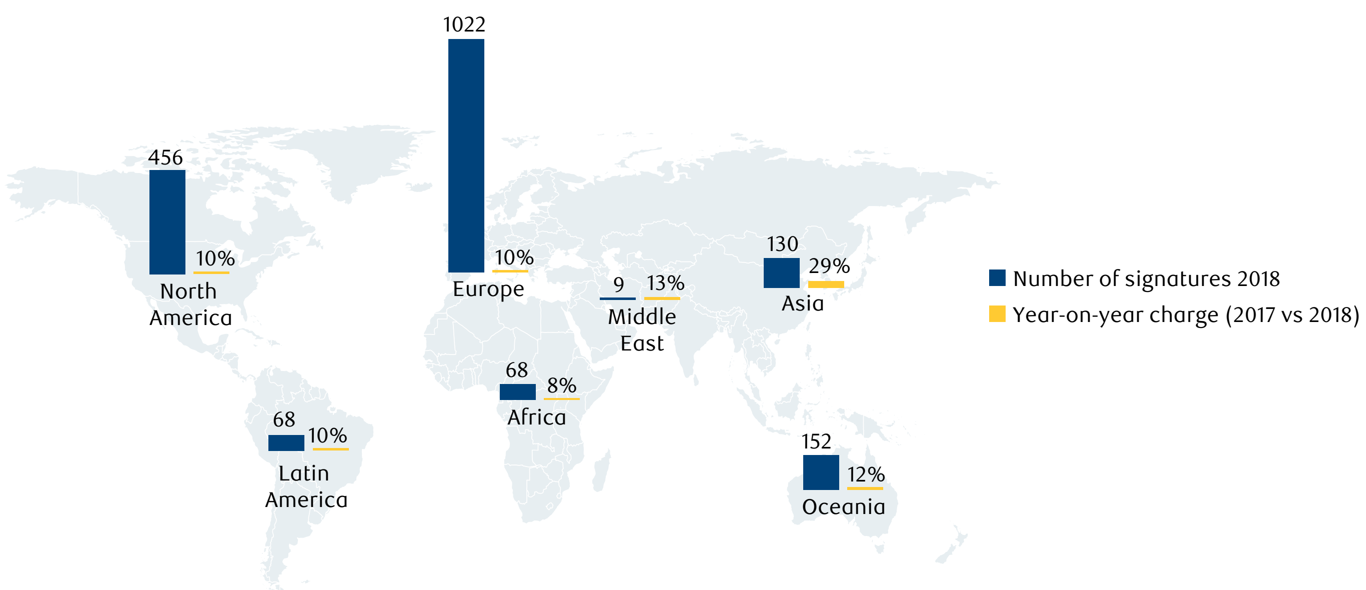
RBC Global Asset Management

Changing attitudes towards responsible investment in Asia

The UN Principles for Responsible Investment (PRI) is an international network of investors working together to put six principles of responsible investment into place. PRI signatories in Asia increased by 29% in 2018, growing at more than double the rate of the other regions. This reflects the region's increasing interest and commitment towards responsible investment and growing consideration of environmental, social, and corporate governance (ESG) factors. While Asia lags behind developed markets in terms of ESG practices, improvements in ESG are gaining momentum. Below, we highlight progress being made in Japan, Korea, and China.

Growth in PRI signatories by region



Source: The PRI in numbers annual report, 2018.

Japan

The Government is leading corporate governance reform. Institutionally, Japan has made a significant shift to integrate ESG factors into its investment strategies. The Japanese Government Pension Investment Fund (GPIF) – the world's largest pension fund with approximately US$1.3 trillion in AUM – became a signatory to the UN PRI in 2015.[1]

That same year, Prime Minister Shinzo Abe launched the new Corporate Governance Code, which focused on unwinding cross shareholdings (when a publicly traded company owns stock in another publicly traded company) and encouraged broader adoption of compensation and nomination committees, and greater gender diversity on boards. Japanese companies have reached significant milestones since the reform, with meaningful progress made in terms of unwinding of cross-shareholdings, increasing share buybacks and dividends, more companies issuing integrated reports, and more companies with multiple independent directors. These reforms are an important step towards moving Japanese companies closer to global governance best practices.

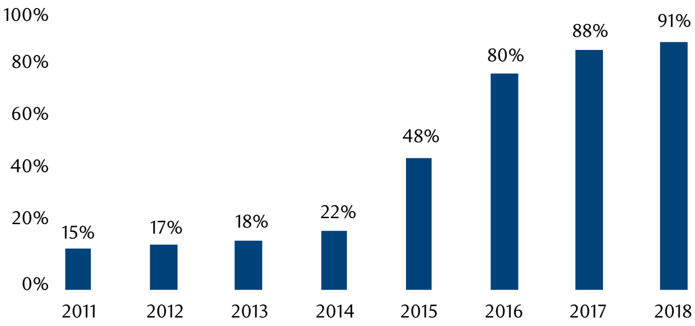
[1] Japanese Government Pension Investment Fund, September 2019.

Government is leading the ESG reform – Key milestones

Date	Milestone
Jun 2013	Japan Revitalization Plan approved Corporate Governance as part of the agenda
Jan 2014	Nikkei JPX 400 introduced emphasis on corporate governance, greater transparency, higher ROE
Feb 2014	Stewardship Code - asset managers responsible for constructive dialogue with companies
Jun 2015	Corporate Governance Code - companies responsible for constructive dialogue with shareholders
Sept 2015	Government pension (GPIF) became signatory of UN PRI

Source: RBC Global Asset Management, September 2019

Percentage of companies with two or more independent directors (TSE)



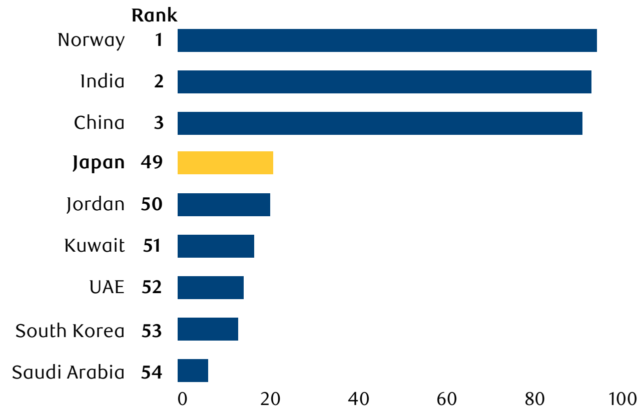
Source: Tokyo Stock Exchange, Inc. July 2018.

Gender diversity remains an issue

Despite progress in certain areas, Japanese companies continue to lag global peers when it comes to gender diversity. Only 20.2% of publicly traded companies in Japan have at least one female board member, which is to say that nearly 80% have none. This places Japan 49th out of 54 in a recent survey of countries that have at least 100 publicly listed companies. Many Japanese companies have recently started taking corrective action – industrial conglomerate Hitachi, for instance, aims to have 10% of its senior executive positions held by women by 2020, four times the current number.[2]

Japan is not the worst offender in East Asia when it comes to gender diversity in the corporate boardroom. That dubious honor goes to South Korea, which is ranked above only Saudi Arabia globally. In contrast, India and China ranked 2nd and 3rd respectively, with 88.4% and 86.2% of companies having at least one female board member. Asian nations such as Thailand, the Philippines, and Bangladesh also ranked in the top 10 of the same global survey, higher than the United States, which came in 11th with 69.4% [3]

Women on the boards of major companies



Source: Nikkei Asian Review, "Japan Inc. scrambles to find female directors," March, 2018.

China

Tackling widespread environmental issues

Decades of unparalleled economic growth in China have been accompanied by significant problems with pollution. China's government has of late become determined to address the myriad air and groundwater pollution problems that are prevalent across the country, with President Xi Jinping championing the 2015 Paris climate change agreement and looking to work more closely with European countries in this regard.

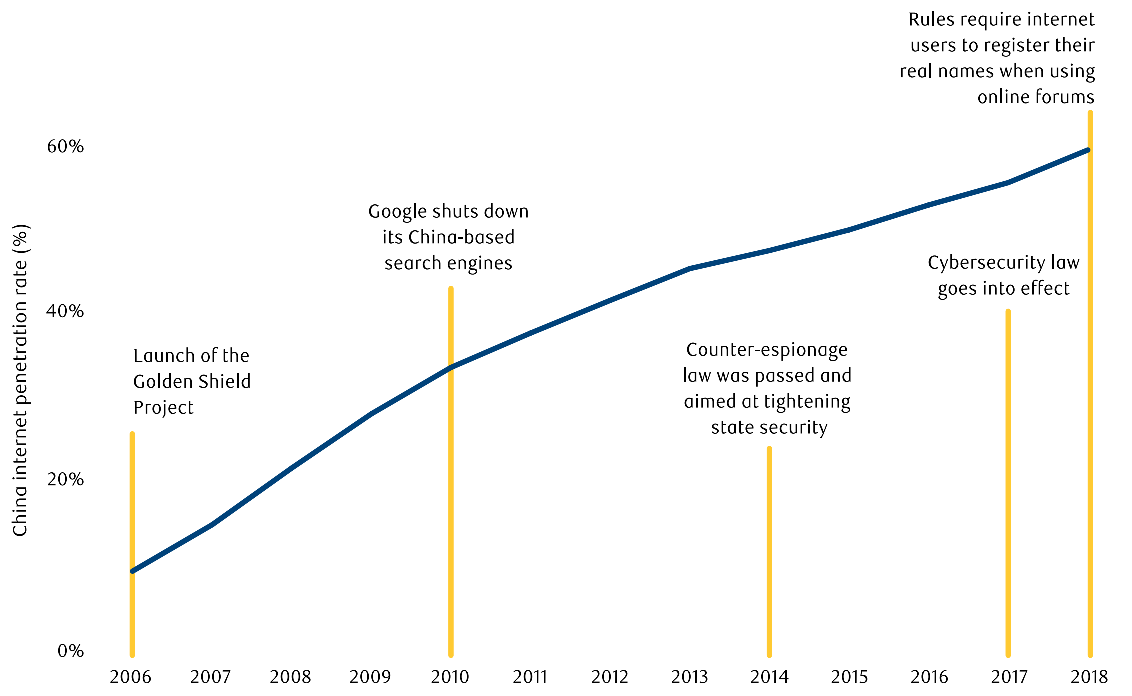
In 2018, the China Securities and Regulatory Commission (CSRC) issued new guidelines requiring listed companies that are heavy polluters to provide specific information on emissions and encouraging all listed firms to voluntarily disclose information on social responsibility initiatives and shareholder engagement. The CSRC aims to make it mandatory for all listed firms to disclose environmental impact information by the end of 2020.

[2] Nikkei Asian Review, "Japan Inc. scrambles to find female directors" March 22, 2018.
[3] Tokyo Stock Exchange, Inc. July 2018.

Such initiatives are consistent with China's environmental efforts, which have also yielded a marked improvement in the enforcement of environmental regulations. There has also been a phasing out of more energy-intensive and pollutive factories and industries. Renewable energy production and electric vehicles have been promoted via government mandates and state subsidies.

Increasing security initiatives concerning China's environmental efforts have shown encouraging progress, and we also believe general governance has improved at a corporate level since China's crackdown on corruption that reached a peak in 2012. However, we are concerned about China's motives and the impact of its increased initiatives on "security." This is symptomatic of a larger, more pervasive issue regarding personal freedoms in China, but is also now being conducted at a company level with strong links to the state. We believe that this is an emerging risk that will require significant investor scrutiny going forward.

Towards an all-seeing state



Source: Internet penetration: China Internet Network Information Centre, 2019. Events: CNBC, "China has launched another crackdown on the internet — but it's different this time", Oct 26, 2017. BBC, "Timeline: China's net censorship", June 29, 2010. CNNIC, 2019. Reuters "Timeline: Under Xi, five years of tighter controls across Chinese society" October 17, 2017. The Telegraph, "China hijacks internet traffic: timeline of Chinese web censorship and cyber attacks" Nov 18th , 2010).

South Korea

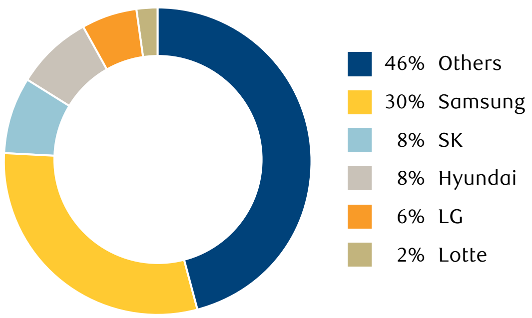
"Chaebol" reform

The family-controlled conglomerates that dominate South Korea's economy are referred to as chaebol. The shares of chaebol-linked companies tend to trade at lower earnings multiples relative to family-owned enterprises in other developed markets. This is due to concerns regarding cronyism and cross-shareholding issues, a phenomenon often referred to as "the Korea discount".

Following a bribery scandal at Samsung in 2017, there was a huge public outcry – both political and economic – regarding the power wielded by the chaebols. Regulators and investors have since been pushing to improve the governance structures of chaebol companies. President Moon Jae-in pledged to reform the country's powerful family-owned conglomerates through new regulations aimed largely at unwinding cross-shareholdings as well as changing the rules on inheritance taxes. The country's Fair Trade Commission also proposed legal amendments that impose limits on ownership and voting rights and place greater controls on related-party transactions.

More recently there has also been greater notice paid to the (voluntary) Stewardship Code, and the National Pension Service (NPS) – the largest domestic investor in Korea, which owns over 5% in as many as 90% of KOSPI companies – became a signatory in 2018.[4] As a result, the NPS will likely be increasingly active in voting rights and engagement in terms of corporate decision-making.

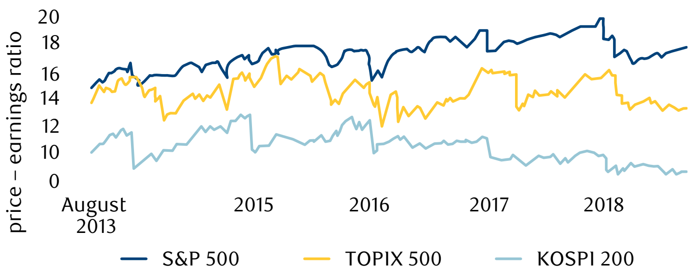
The five biggest chaebols make up half of the Korean Stock Index



Source: Bloomberg, "South Korea's Chaebol" Aug 29, 2019.

The Korea discount

The KOSPI 200 stock index trades at a 30 to 40 percent discount to its global peer, in part because of the chaebol overhang



Source: Bloomberg, "Chaebol Reform Needs Investor Skin in the Game" Aug 27, 2018.

Conclusion

As illustrated by these examples, attitudes towards ESG are changing in Asia. While the region lags in terms of developed market practices, progress continues to be made to narrow this gap.

[4] Chaebol Reform Needs Investor Skin in the Game" Aug 27, 2018.

ABOUT THE AUTHOR

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Prior to joining RBC in 2015, Chris was a sell-side equity analyst with Bank of America Merrill Lynch based in Hong Kong, specializing in the financial sector across the Asia ex-Japan region. He spent his early career at HSBC in the International Management program in a number of sales and risk management roles.

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