ISSN: 2472-3703 DOI: 10.6911/WSRJ.202304_9(4).0003

ESG Investment in China: Current Situation and Future Prospects

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Abstract

In recent years, ESG investment concept has been vigorously developed in China, and has become a top concern in academic and practical circles. The development of ESG investment can help transform the economic development mode, change the current economic structure and promote the realization of the "double carbon" goal. This paper reviews the ESG research literature and summarizes the connotation of ESG concept, investment behavior research, and the influencing factors of ESG investment in China. The paper concludes with corresponding policy recommendations and future development trends around the real-life challenges faced by ESG investment in China.

Keywords

ESG; ESG investment; ESG disclosure; ESG regulation.

1. INTRODUCTION

In the past decade, with the continuous growth of global population and economic scale, energy consumption, environmental pollution and ecological degradation have emerged, among which global warming has brought the most serious challenges to human survival and development. The sustainable development of human society is facing serious threats, and the path of sustainable development has gradually become a broad consensus among all sectors of the international community.

At present, China is the world's largest carbon emitter, accounting for about 28% of the global carbon emissions in 2022. In recent years, the Chinese government has actively advocated the new development concept of "innovation, coordination, green, openness and sharing", and actively responded to the trend of global green and low-carbon transformation and improving sustainable development capacity. In September 2020, China made a solemn commitment to the world to achieve the ambitious goal of "achieving the peak of carbon dioxide emissions by 2030 and achieving carbon neutrality by 2060".

The Central Economic Work Conference, the "Government Work Report" of the "Two Sessions" and the "14th Five-Year Plan" all clearly point out that we should do a good job in achieving carbon peaks and carbon neutrality, and strive to fulfill our commitments to the international community as scheduled. Under the guidance of the "double carbon" target, the development speed of ESG investment in China will be further enhanced.

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2. ESG INVESTMENT

2.1. ESG investment concept

The concept of ESG (environmental, social and governance) was first proposed by the United Nations Global Compact in June 2004, advocating the consideration of non-financial indicators in the dimensions of environmental protection, social responsibility and corporate governance. While pursuing financial returns, the sustainable development of society and the social responsibility and long-term value of enterprises are considered comprehensively. ESG, as an investment concept for the evaluation of corporate non-financial information content disclosure [1], represents that enterprises have an inescapable and important role in environmental development, social responsibility commitment and corporate governance in sustainable development. Grewal et al. (2020) proposed that the sustainability of enterprises can be measured by climate change, resource efficiency, employee welfare, inclusiveness and diversity, product safety and quality, and anti-corruption, among others. Although fewer listed companies have made environmental and socially relevant disclosures since 2010 (Grewal et al., 2021), high ESG ratings are increasingly being used to reduce information asymmetry among investors and reduce fraud and "greenwashing" as the results of high ESG ratings can convey the fundamental situation of the company [2] (Huang, S. 2022), more and more investors are preferring companies with high ESG ratings, and more companies are incorporating ESG ratings into their corporate development strategies (Gillan & Wei, 2020).

2.2. ESG investment behavior study

Fangzhao Zhou et al. find that firms with better ESG responsibility performance have higher excess returns and are more resilient to risk [3]. Jieying Gao et al. found that good ESG performance improves firms' investment efficiency, and ESG performance mitigates underinvestment by reducing agency costs and lowering financing constraints, and reduces overinvestment by alleviating agency problems [4]. The effect of good ESG performance on firms' investment efficiency is more significant for firms that are mature, have more efficient information transmission, and are located in a more market-oriented environment with better rule of law. Shanaev and Ghimire found that an increase in ESG rating leads to lower and insignificant returns, and a downgrade in ESG rating has a negative impact on stock returns [5]. Serafeim and Yoon found that ESG rating results from different rating agencies have different predictive power and that the ratings of the providers with the strongest predictive power predict future stock returns in the presence of widely divergent rating results [6]. Christensen D.M., Serafeim G , Sikochi A found that rating agencies' ESG ratings based on corporate ESG ESG ratings based on outcome metrics are more divergent than ESG ratings based on ESG input metrics; ESG rating divergence significantly affects firms' stock prices, resulting in firms being less likely to obtain external financing and more dependent on internal funding [7].

2.3. Influencing factors of ESG investment

Schanzenbach and Sitkoff find that ESG investments permitted in U.S. fiduciary law need to meet two conditions: the ESG investment will directly benefit the trustee by increasing the risk-adjusted rate of return; and the trustee's sole motivation for making the ESG investment is to obtain this direct benefit [8]. The authors believe that there are three core factors that constrain ESG investments, which are conceptual perception, degree of disclosure and cultural differences.

3. THE DEVELOPMENT STATUS OF ESG IN CHINA

With the increasing economic status of China in the world and the gradual maturity of the national system, China put forward the first guiding document on green finance - "Guidance on Building a Green Financial System" in 2016 [9] , at present, the leading sector of ESG in China is

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still the Chinese government, exchanges and relevant regulators, as of By 2021, there are more than ten ESG-related policies and guidelines in China, but the system is still not perfect compared to the number of international markets [10] .

According to public information statistics, the volume of ESG reports issued by A-shares in 2022 has increased significantly, and as of November 5, 2022, 1,460 companies have disclosed their 2021 social responsibility reports, accounting for 31.03% of all A-share companies. 2021 China's major responsible investments have seen a steady increase in the balance of green credit compared to 2020, and the scale has steadily ranked first in the world. With the increasing weight of ESG information in investment management decisions and the cumulative transmission of earnings and improvement mechanisms, the positive correlation between ESG performance and corporate share prices is becoming increasingly evident.

4. REALISTIC CHALLENGES OF ESG DEVELOPMENT

4.1. The requirements and quality of ESG information disclosure in China still need to be improved

Since China has proposed the goal of carbon neutrality and carbon peaking, the Chinese government and various enterprises have been paying more and more attention to carbon emission issues, so it is necessary to further promote the improvement and enhancement of the quality of corporate ESG information disclosure. The domestic capital market can refer to the sustainability disclosure standard IFRS SDS issued by ISSB (International Sustainability Standards Board), actively build a domestic enterprise ESG information disclosure system that is in line with international standards, expand the scope of ESG information disclosure, and improve the quality of ESG information disclosure of domestic enterprises, expand the scope of ESG information disclosure, and improve the quality of ESG information disclosure of domestic enterprises [11]. At the same time, listed companies are encouraged to disclose the content of indicators not explicitly proposed by policies or requirements, so as to help accelerate the development of ESG ecology in China.

4.2. The strengthening of ESG regulation in China is urgent and imperative

The strengthening of ESG regulation is not only to improve the development of ESG ecology in China, but also to improve ESG risk management. More and more stakeholders in the financial market not only start to pay attention to ESG investment but also start to focus on ESG risk, and ask how to measure ESG risk and manage it, so the strengthening of ESG regulation in China is urgent and imperative. A sound regulatory policy can help establish uniform and fair evaluation guidelines and ESG ecological participation methods, and can also positively guide and motivate market participants who follow ESG concepts, further promoting the development of ESG.

4.3. The quality of ESG information varies, and investors have a single access to information

At present, China adopts the voluntary disclosure of ESG information, and only 30% of companies in the A-share market disclose ESG information. Therefore, regulators should gradually improve the ESG information disclosure system. Due to different assessment standards and data sources, the assessment results of the same company by different assessment agencies often differ significantly, lacking comparability and verifiability, which easily hinders investors' decision making. Therefore participating institutions should improve the transparency of assessment indicators and indicator weights. ESG information of enterprises is widely distributed, and it is difficult to form a comprehensive evaluation by self-disclosure alone. In the future, the accuracy and timeliness of ESG information acquisition can be improved by means of technology.

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4.4. General lack of investor awareness of ESG

Individual investors have low awareness and relevant experience of ESG investment and do not have systematic ESG investment ability. Individual investors are easily influenced by the exaggerated propaganda of institutions to blindly pursue maximum financial returns. Although institutional investors have strong capital strength, they are under heavy pressure of short-term performance assessment, and fund managers have difficulty in executing long-term investment strategies and verifying the effectiveness of investment strategies. Therefore, it is particularly important to strengthen the publicity and education for investors, which needs to be promoted by financial institutions, regulators, research institutes, news media, and practitioners, in order to improve the current general lack of awareness of ESG investment among investment subjects.

5. FUTURE PROSPECTS OF ESG INVESTMENT DEVELOPMENT

5.1. Future research direction of ESG

Since the launch of the United Nations Principles for Responsible Investment in 2006, the ESG evaluation system in the world is now more and more perfect, and more and more stakeholders focus on risk control of ESG investment, how to measure and reduce ESG risk is still an unknown, and risk control in financial investment has now become the mainstream trend of investment, so ESG risk management performance will become the next research Therefore, ESG risk management performance will be a hot issue for future research.

5.2. ESG investment scale will continue to expand

In recent years, ESG investment concept has been widely mentioned, and the launch of relevant policies and the deepening of capital market reform have provided many investment opportunities for the market. Under the wave of carbon neutrality, ESG concepts in wind power, photovoltaic, energy storage, new energy vehicles and related industry chains, as well as biodegradable plastics will be highly respected in the market. Expanding the scale of ESG investment is also a must for China's capital market to open up to the outside world and align with international standards.

5.3. ESG information disclosure system will be gradually standardized

In recent years, the requirements for ESG information disclosure of listed companies in China have transitioned from "advocating voluntary disclosure" to "mandatory disclosure by some enterprises", and the willingness and level of ESG information disclosure of A-share listed companies have improved significantly. In the past five years, the government, regulators and exchanges have been improving ESG information disclosure standards for listed companies and promoting a mandatory environmental information disclosure system. In the future, we can also draw on the widely used global reporting framework GRI, develop sustainability accounting standards and include carbon emissions in the corporate ESG information disclosure framework.

5.4. A wider range of ESG products and funding sources

Pension funds, insurance funds and other large institutional investors are the mainstay of global ESG investment. At present, the market scale of "green investment by pension funds, insurance funds and other long-term funds" in China is still relatively limited, and the investment strategy is single, with few investment targets to choose from.[12] . Therefore, in the future, we can build a model for long-term funds such as social security funds and pension funds to participate in the market operation, and develop suitable ESG investment products in a targeted manner. More varieties of low-carbon transition bonds and low-carbon transition-

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linked bonds will be introduced to meet the financing needs of a wider range of transition subjects and facilitate enterprises to achieve their transition goals.

ACKNOWLEDGMENTS

This work is supported by 2022 Anhui University of Finance and Economics Undergraduate Scientific Research Innovation Fund Project (Grant No.: XSKY22176).

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