HSBC

Press Release

18 September 2018

Are ASEAN Supply Chains Vunerable to Lag in Adoption of ESG By Asian Corporates?

**24% of Asian respondents have an ESG strategy compared to 48% of corporates globally*
*** Supply chains are the second most important ESG decision-making driver for large Asian companies*

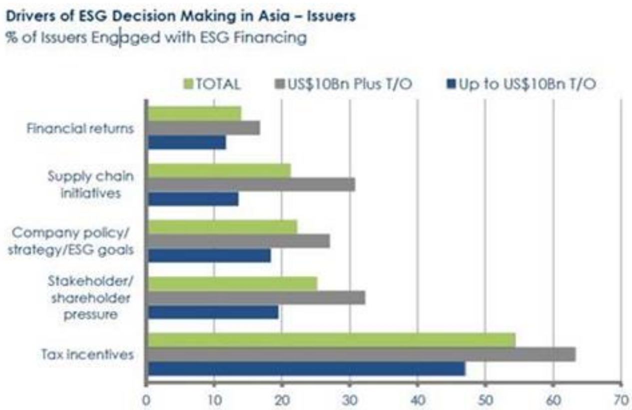
Asian companies, particularly those in Southeast Asia, are at risk of falling off multi-national corporations' supply chains if their Environmental, Social and Governance (ESG), strategies are not addressed.

The view comes following the release of a HSBC-commissioned report[1], in partnership with East & Partners, which looks at 1,731 companies and institutional investors' attitudes and actions around ESG. The research included responses from more than 300 companies and investors in Asia – specifically China, Hong Kong, and Singapore.

Asian companies trailing global peers in adopting ESG strategies
According to the HSBC report, 24% of Asian respondents have an ESG strategy compared to 48% of corporates globally and 87% of European and UK companies

Supply chain initiatives and stakeholder pressure key ESG drivers for Asian corporates
The report finds that, globally, tax incentives and financial returns are the two biggest drivers for corporates undertaking ESG-related activity.

However, Asian corporates' motivations depart from their global peers. Whilst tax incentives are the biggest driver, Asian corporates feel that stakeholder pressure and supply chain initiatives also contribute in driving ESG decision making. In fact, supply chains are the second most important driver for larger Asian companies.



Will Asian corporates' slow ESG strategy adoption impact ASEAN supply chains?
The disconnect between European and Asian companies' adoption of ESG strategies, and the sensitivity of Asian corporates to stakeholder pressure and supply chain initiatives, raises the question of what this means for Southeast Asia's supply chains.

European and British companies have deep and historic supply chain connections in ASEAN. For example, many European corporates are invested in electronics, textile and auto industries in the region. And the connectivity is growing:

- Europe accounted for 22% of all FDI flows into ASEAN between 2000-2016[2].
- Recent research shows that 51% of European firms view ASEAN as the region with the best economic opportunities, followed by China (26%)[3].
- 86% of European firms expect their level of trade and investment in ASEAN to increase over the next five years[4].

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[1] Sustainable Financing and ESG Reporting, East and Partners, September 2008
[2] EU-Asean Business Sentiment Survey 2018
[3] EU-Asean Business Sentiment Survey 2018
[4] EU-Asean Business Sentiment Survey 2018

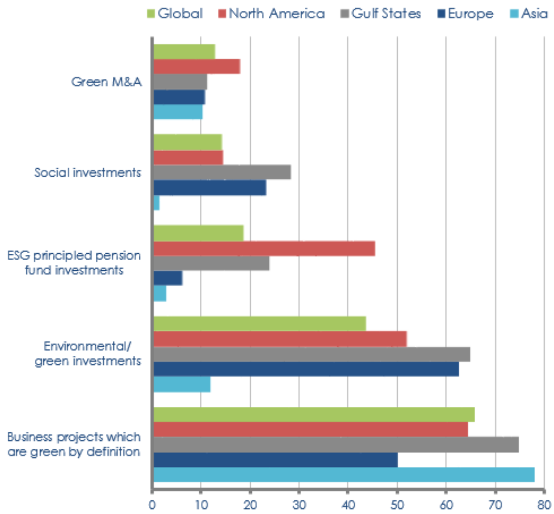
- Electronics is one of ASEAN's most important sectors directly employing more than 2.5 million workers[5] Singapore, Malaysia, Thailand, Vietnam, Philippines, and Indonesia account for over 90% of ASEAN industry exports[6]
- In textiles, Malaysia, Thailand, Indonesia, Philippines and Vietnam's exports of apparel and textile products nearly tripled from US$24.4 billion in 2001 to US$71.8 billion in 2014. In 2016, Vietnam alone exported US$42 billion. The next ASEAN country, Indonesia exported US$16 billion worth of goods.
- The automotive sector in Thailand is one of the key sectors in the Thai economy, continuing to grow at around 8.1% of GDP[7].

The pressure for Asian corporates involved in supply chains within Southeast Asia is further compounded by separate research by the Carbon Disclosure Project which indicates 80-90% or more of a business's environmental impact is located in its supply chain[8].

HSBC's Global Head of Sustainable Finance, Daniel Klier said: "With Europe's clear leadership in ESG adoption, it stands to reason that large corporations will want to see a similar shift in their suppliers' ESG stance. ASEAN is increasingly becoming the supply chain 'factory' for several sector strongholds for Germany, France, UK and China including electronics, textiles and automotive. These companies are making very clear and public proclamations on their ESG strategies as well as their expectations on their suppliers. ASEAN suppliers of European clients who are not alive to this change risk being left behind."

Asian corporates' green finance foray is project-specific

HSBC's research finds that when Asian corporates tap green finance, it's overwhelmingly for specific projects rather than general purpose. According to the HSBC report, 78% of Asian corporates who have accessed green finance use it for business projects that are green by definition – more than any other region. This is good news because Asian corporates will more likely be eligible for financing under the Asia Pacific Loan Market Association Green Loan and Green Bond Principles[9]. Green funding requires companies to state what the use of proceeds are for and, that said proceeds are tracked and monitored.



HSBC's Green Finance lead in Asia, Jonathan Drew, said: "The research suggests that less Asian companies have an ESG strategy compared to their global peers; however, when they do seek ESG-related finance, it seems to be for specific projects. This creates an opportunity for both Asian corporates to reinforce their position by utilizing green labelled financing to communicate their focus on sustainability issuers, and for others to gain advantage over their peers whilst 'sustainability leadership' remains relatively scarce. This is particulalrly relevant as we're increasingly seeing regulators, investors and customers in supply chains want more understanding and transparency of both if and how corporates are addressing ESG issues generally and specifically how their 'green' capital is actually being applied and whether it aligns with promises originally made."

"Thus ESG has become a competitive area, with urgency required given the significant rewards and incentives for Asian corpprates to move now to address the issues and communicate this to stakeholders. Green finance is a great tool to achieve this with better disclosure of approach and through reporting measures to distinguish between investments that are financially sustainable and those that are less so. This brings a whole new level of attention to not only the type of business

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[5] According to the International Labour Office (ILO)

[6] ASEAN in Transformation. Electrical and Electronics: On and Off the Grid', International Labour organisation, 2016.

[7] "Thai the knot," GoAuto News Market Insight Report, August 5, 2009, No. 494, pg. 18

[8] Carbon Disclosure Project

[9] See Editor's notes for details

you're engaged in but how you go about that business. If you're a corporate issuing a green bond or green loan, your stakeholders and investors know they are supporting a business that is addressing environmental challenges. That's a great label to wear and it impacts on the cost of capital."
In Indonesia, there has been some initiatives to reach the goal of aligning to Sustainable Development Goals (SDG), one of which is by opening up to private investment opportunities in green financing and green bonds. This is shown through real action, as the first country to issue green sukuk that is based on sustainable finance and shariah, worth USD3bn 5/10Y.

"For that, HSBC will thrive to reach an understanding and have more concern towards sustainable principles in business practice. We hope that this sustainable principles can be implemented in a broad manner throughout different sectors." Stated by Nuni Sutyoko, Head od Coporate Sustainability HSBC Indonesia.

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Note to editors:

About the report

The reporting is based on direct interviews with 1,731 global entities, including 863 issuers and 868 investors, conducted by East & Partners over a five-week period ending 29 June 2018 Group Treasurers, CFOs, CIOs and heads of investments strategy included in the sample frame were located across Europe, North America, Asia and the Middle East. Demographic breakdowns are provided in the methodology section of the analysis report, broken down by interviewee, assets under management (AUM), annual revenue and industry distribution for the two respective segments.

About Green Loans and Green Bonds

On 21 March 2018 the Loan Market Association and the Asia Pacific Loan Market Association jointly issued the Green Loan Principles to formalise what constitutes a green loan. These set out 4 key criteria that a Green Loan should adopt being:

1. **Use of Proceeds:** that the loan is exclusively used for green projects and that the environmental benefits, which will be assessed and reported, are articulated in the finance documents
2. **Project Selection and Evaluation**: The development of a company framework stating the borrower's environmental sustainability objectives; the process to determine how projects fit within the eligible categories set; and how they will identify and manage environmental risks associated with proposed projects that they wish to seek green funding. Borrowers are also encouraged to disclose any green standards or certifications
3. **Management of Proceeds:** The proceeds of a green loan should be credited to a dedicated account otherwise tracked by the borrower in an appropriate manner; and establish internal governance process for the tracking of funds towards designated green projects
4. **Reporting:** Borrowers will articulate how they maintain in real-time information on the use of proceeds for all green projects under finance including the amounts allocated and their expected impact.

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