Baker McKenzie.

From Strategy to Action — Advancing ESG in Asia Pacific

Asia Pacific Business Renewal Series

Foreword

ESG issues have been moving up the corporate agenda for over a decade but the pandemic has cemented the ESG movement as an urgent imperative for all businesses. Our research shows that ESG and environmental issues now rank 7th out of the 14 top concerns facing Asia Pacific businesses, ahead of challenges as such as failure to innovate. Almost half of business leaders in Asia Pacific (46%) say they are approaching sustainability issues more seriously than before the pandemic.

At a global level, the pandemic has emphasized hyper-connected nature of the world today and brought ESG issues ranging from climate change to inequality into sharper focus. The G-7 group (Canada, France, Germany, Italy, Japan, United Kingdom and the US) announced their intention to mandate the disclosure method recommended by the Taskforce on Climate-related Financial Disclosures (TCFD). This announcement comes ahead of the COP26 international climate negotiations (the 26th annual meeting of the Conference of the Parties) in Glasgow in November 2021.

Among others within the region, Mainland China is placing increased emphasis on sustainability — stating its ambition to have CO_2 emissions peak before 2030 and to achieve carbon neutrality before 2060 as well as publishing **green investment principles (GIP)** that will inform its Belt & Road Initiative. Financial institutions from Japan, Hong Kong and Singapore are part of the 27 institutions that have signed up to the GIP. Additionally, the Australian Securities and Investments Commission (ASIC) has increased monitoring efforts on climate-related financial disclosures and Australia's banking regulator, Australian Prudential Regulation Authority (APRA) is in the process of finalizing guidance around investments vis-à-vis climate risk.

Despite the rise of government and regulatory action, not every business is at a tipping point for ESG — 41% say the crisis has had no impact on their approach to sustainability. In part, this may be because the tipping point for many corporates had already been reached or the preoccupation with other internal issues such as protecting revenues to prevent layoffs or operational losses. Others argue that the current imperative is to focus on traditional models of growth and recovery.

The pandemic will likely bring continued pressure on the ESG front. This includes a battle for funding for sustainability initiatives, the uneven rate of economic recovery in the region and the need for flexibility in the market; all of which limit businesses from prioritizing ESG. Respondents among the 13% for whom the pandemic has reduced the focus on sustainability state they are currently in survival mode, devoting all their resources to remaining viable.

In the midst of balancing recovery and navigating the path to longer-term renewal, business leaders in the region remain acutely aware of the need to drive ESG initiatives and to embed them into business operations, culture and relationships. A key feature of the ESG landscape in Asia Pacific remains the varied levels of commitment and action due to economic uncertainty — leading to questions about the level of cohesion and clarity for ESG regulation, governance and measurement.

Ilona Millar
Global Head of Climate Change Practice
Sydney

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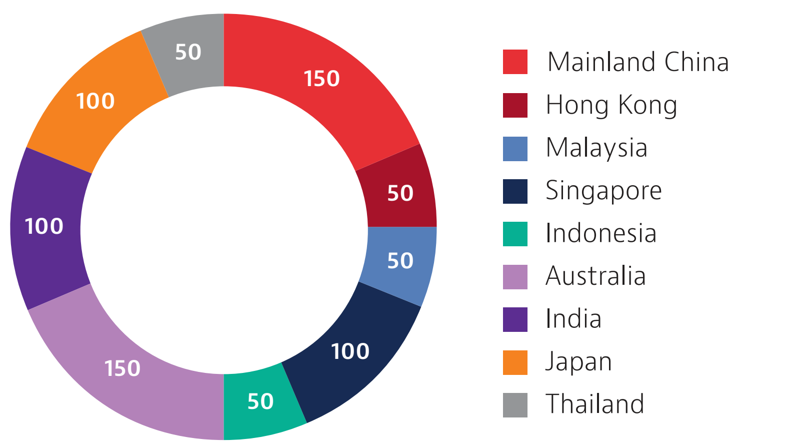
1 About the Asia Pacific Business Renewal Series

Unpacking the hypercomplex nature of business in 2021, the Asia Pacific Business Renewal Series sheds light on the momentum and mindset of business leaders and decision-makers in the region as they navigate challenges relating to four main areas of business: Supply Chains, New M&A Landscape, Digital Transformation and Sustainability.

Each report features key considerations and action points to helping businesses to understand the horizon ahead as they make strategic decisions, pursue growth and secure lasting success.

By Jurisdiction

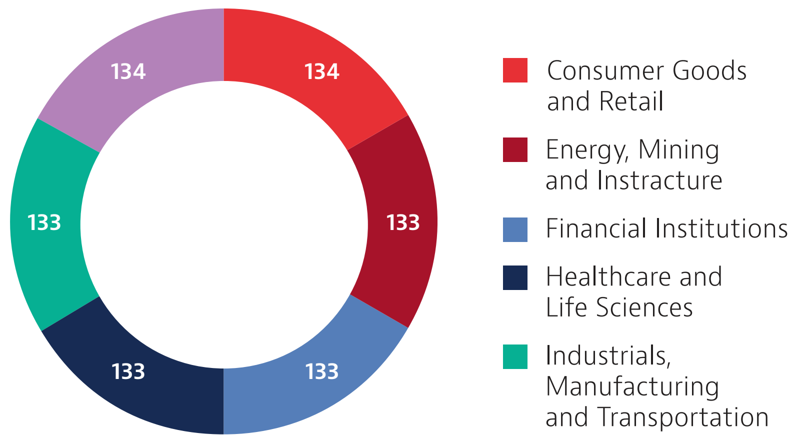


About the Research

Findings from this report and others within the series were conducted in Q1 2021 in partnership with Acuris.

800 respondents were surveyed across nine jurisdictions and six sectors, including Technology Media and Telecomms (TMT) , Healthcare and Life Sciences (HLS), Consumer Goods and Retail (CG&R), Industrial, Manufacturing and Transport (IMT), Financial Institutions (FI) and Energy, Mining and Infrastructure (EMI). This Asia Pacific business and legal issues research has been run every two years since 2016 by Baker McKenzie in Asia Pacific.

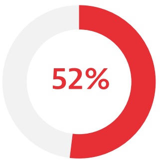
By Sector



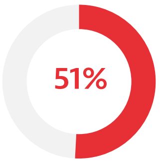
2 An Uneven Regional Landscape

Uneven attitudes toward ESG in Asia Pacific exist across jurisdictions and sectors, building a complex landscape for ESG regulation, governance and measurement in the region.

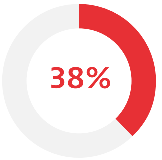
Rising Importance



of TMT respondents say they are approaching sustainability more seriously and with more urgency.

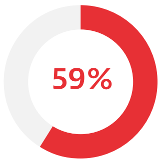


of HLS companies say the same is true.

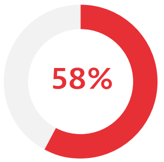


Just **38%** of EMI say this is true.

Transformative Change



of Australian respondents say their organizations have increased focus on sustainability.



58% of Singaporean respondents say the same.

However, just **36%** of Mainland Chinese and Malaysian, and **22%** of Thai respondents say this is true.

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> “The pandemic has made us realize that we need to take sustainability more seriously and unless we do so, there will be many negative consequences.”
>
> **Chief Operating Officer, Japanese electronics company**

Sentiment across Asia Pacific varies significantly. In Australia and Singapore, more than half of respondents say their organizations have increased focus on sustainability. However, these figures drop to between the 20% to 40% range in Mainland China, Malaysia and Thailand.

Such variance can be attributed to government action and the make-up of primary industries in each economy. In Australia, the focus on ESG issues existed even before the crisis was significant, not least because of strong regulatory requirements on financial reporting. The country’s highly conservative approach to the pandemic has further concentrated corporate efforts, with a ban on international travel banned and strict lockdowns in many parts of the country.

In Mainland China, the relatively low rate of ESG focus during the pandemic could reflect the lack of requirements for mandatory ESG disclosures. However, this is set to change. Corporations could step up their ESG efforts in the months and years to come, with the Mainland Chinese government now emphasising sustainability and publishing green investment principles that will inform its Belt & Road Initiative. “We were already taking responsibility on important issues such as safety management, emissions control and response to climate change to name a few,” reflects the General Counsel of a Mainland Chinese mining business.

The view across industries shows that organizations from the TMT and HLS sectors are particularly likely to be more focused on sustainability in the wake of COVID-19; the opposite is true for EMI businesses.

One possible explanation for this is that businesses in sectors that have found it easier to cope with COVID-19 disruption have had more bandwidth to focus on sustainability. TMT businesses, for example, have typically found it more straightforward to move to remote working than their counterparts in the EMI sector, indicating greater agility than other sectors in the current economic climate.

Another possibility for the low EMI figure is that businesses in this sector are heavily regulated from an ESG perspective. A greater focus on sustainability was therefore likely to pre-date the pandemic. “We were already monitoring the environmental impact of our production and distribution very closely,” points out the Managing Director of a Mainland Chinese energy company.

Nadia Soraya, Partner in Jakarta, mentions that “energy transition has become an important part of the conversation on growth, renewal and sustainability for companies in the EMI sectors, and in general, the “E” (environment) and “S” (social) factors are both in the spotlight. Demand for certain metals is rising because they are needed in the production of batteries, along with the increasing trend of electric vehicles. This is coupled with increasing consciousness of the industries of their carbon footprints, necessitating the rise of green infrastructure development in metals and mining, which is sometimes tied to green incentive packages from governments. That said, ESG regulation for the EMI sectors is becoming a lot more stringent and this can potentially slow down the pace of projects or delay entry into new markets.”

3 Mapping Challenges

3.1 Top ESG Risks and Concerns

Regulation, regulatory enforcement and investigations emerge as high risk areas, prompting businesses to seek support.

Top 3 ESG Risks

57% cite regulatory enforcement and investigations as a top ESG risk.

44% cite new regulation as a top ESG risk.

33% cite changing buyer behaviour as a top ESG risk.

Where Business are Seeking Support

67% are seeking support with regulatory enforcement and investigations.

53% are seeking support with managing new regulation.

34% are seeking support with litigation and class actions.

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3.2 Managing ESG Regulation and Enforcement

As countries across Asia Pacific continue to implement new ESG regulation, businesses face an intimidating compliance workload. Regulatory reforms are ongoing, from new disclosure standards in Mainland China to an increased focus on stewardship across much of Southeast Asia.

Against this backdrop, more than half of respondents (57%) cite regulatory enforcement and investigations as a top ESG risk. In addition, 44% pick out new regulation as the top ESG risk. These are also the two areas where respondents state they are most likely to seek external advice from lawyers and other professionals, further emphasizing the importance on corporate agendas.

Part of the problem, particularly for multi-national organizations, is the fragmented nature of ESG regulation across Asia Pacific. Currently, regional ESG disclosure frameworks are not as well-established as those in the European Union and emerging in North America. Clear and consistent taxonomy is absent, and global ESG standards, frameworks and initiatives are not universally adopted. Increased harmonization and greater regional collaboration between the regulatory authorities will, in time, help resolve some of these challenges. In the meantime, however, many organizations expect to continue depending on specialist advisers able to provide a cross-border view.

Elsewhere, respondents point to risks such as reputational damage and regulatory sanction. "New regulations come with new expectations," says the Head of Marketing at an Indian pharmaceuticals company. "We are especially concerned about the costs involved and the cost of penalties in cases of non-compliance."

Given these concerns, it might be surprising that 64% of respondents describe themselves as highly or somewhat prepared for a possible increase in climate-related regulation. However, close to half concede there is more work to do, while a further 37% say they are either taking a wait-and-see-approach to new regulation or that they are currently unprepared. These findings suggest that there is great potential in the region to accelerate ESG strategy and action, pending more clarity on ESG regulation and enforcement.

The case for taking third-party advice looks strong in this context, in order for organizations to mitigate regulatory risk — both known and unknown. "We do not know what the penalty for non-compliance would be," warns the Chief Executive Officer of a Malaysian consumer goods company. "We have to take these issues seriously if we are to avoid reputational damage."

> "Looking forward, once Australia's major trading partners move to mandatory disclosures aligned with the TCFD, Australian companies will likely to be asked to provide those disclosures to any investors (including banks) from places where they are required. Companies looking to access overseas financing will therefore need to provide climate risk information in the same format, and of the same quality, as what the laws in those places demand. This is an added catalyst for the existing calls in Australia to introduce laws requiring climate disclosures."
>
> **Ilona Millar**
> **Global Head of Climate Change Practice**
> **Sydney**

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Spotlight on Compliance Investigations and Shareholder Activism

by Mini vandePol, Asia Pacific Head of Compliance and Investigations, Hong Kong, and Robert Wright, Partner, Hong Kong

"Greenwashing" claims are on the rise with activists and investors holding companies to account when actions do not meet the standards set out in the ESG policies. A credible ESG strategy requires more than just paper promises. In our experience, the "S" (Social) aspects of ESG are often not well understood or managed.

The scope of issues in this area are multifaceted, comprising compliance risks such as ethical supply chain systems as well as health, safety and product liability. As we engage with companies and investors, it is increasingly clear that getting the "S" wrong can result in significant business risk with potentially long term damage to reputation.

4 Change Abounds — Propelling ESG

4.1 UN SDGs as a Force for Good

For many organizations, the question of how to drive an enterprise-wide culture of sustainability is a crucial one. Our research suggests the United Nations' Sustainable Development Goals (SDGs) — and the 169 targets they include — are an increasingly important part of this process. Indeed, 68% of respondents say they embed the SDGs into their strategic planning in some way.

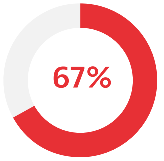
For many businesses, the SDGs provide a tangible means through which to move their ESG activities. "The strategic use of these goals has facilitated positive changes," says the Senior Vice President of an Australian energy business. "Departments meet their targets and we can determine their performance levels clearly; the use of digital tools for mapping SDGs has also been highly useful."

Moreover, as the Managing Director of a Mainland Chinese energy business explains, the SDGs provide important credibility with external audiences. "The perspective of our stakeholders will change if we embed the SDGs successfully," the executive says. In an era where stakeholder capitalism has become increasingly prevalent and consumers are becoming ESG-conscious, reputation and credibility can be a strong motivating factor for businesses to turn their attention to ESG.

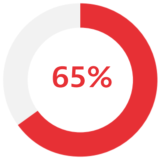
Research shows that the SDGs are now more relevant in catalyzing businesses into action than ever. In 2019, just a quarter of respondents described the UN's goals as central to their planning. Today, that figure has risen by more than half to 39%. Simultaneously, the number of respondents who say they are not embedding the UN SDGs into their strategic planning has also fallen, from 26% in 2019 to 21% in 2021.

4.2 Supply Chain Reactions

Nature of Sectors Affect Agility



of HLS respondents say they have a high degree of visibility and controls over ESG risks and metrics within their supply chain.



of FI respondents say the same.

This figure is at **43%** for EMI respondents and **51%** for CG&R respondents.

Many businesses in the region recognize the importance of embedding ESG within their supply chains — close to a quarter of respondents (23%) say they have a high degree of visibility of ESG risk in their supply chains and have controls in place. Another 35% say they have a high degree of visibility and are moving towards greater control.

These responses vary across sectors. In both FI and HLS sectors, approximately two-thirds of respondents are performing strongly on supply chain ESG visibility and controls. In EMI and CG&R, the figures fall to between 40 to 50%. This reflects the different nature of these industries. For service sector businesses that use relatively little in the way of raw materials, supply chains are easier to track — and may often be shorter.

Elisabeth White, Asia Pacific Head of Healthcare and Life Sciences shares more. "In our experience in the Healthcare and Life Sciences (HLS) subs-sectors, transparency, due diligence and control in relation to supply chain compliance and third-party ESG are critical. Many HLS companies outsource, collaborate or use third party contractors or agents for a range of functions including R&D activities, manufacturing, distribution, sales and marketing, and data management. The operational complexity of HLS supply chains, and the significant safety and reputational issues associated with HLS compliance, mandate a careful and considered approach to downstream ESG due diligence and supply chain governance."

However, all organizations are going to come under increasing pressure to account for their supply chains in ESG work. Consumer goods businesses and retailers, in particular, can expect customers to demand more information on where the products they buy come from, including the ESG impacts of the entire supply chain.

4

Sector Spotlight — CG&R and EMI

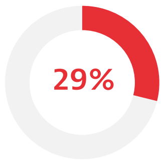
While ESG-linked risks loom large across the region, at a sector level, nuances are clear. While the threat of regulatory enforcement is top of mind in several industries — and a key risk in all of them — respondents in the CG&R and EMI sectors are more likely to cite changing buyer behaviours as a key risk. In both sectors, supply chain and third-party issues are also regarded as pressing.

Certainly, for consumer-facing businesses, the fact that so many consumers worldwide are becoming more conscious of ESG issues — often adapting their purchasing decisions accordingly — is a crucial imperative to address. "Consumers increasingly want to purchase products from organizations that are good at achieving their ESG goals," says the Head of Marketing at a Thai consumer goods company.

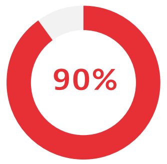
In the EMI sector, consumer facing businesses in areas such as energy delivery have similar concerns. Those that are one step removed from consumer markets must accept that supply chain scrutiny means their behaviours will still be analyzed. There is also the danger of being caught up in campaigns — "environmental activists have become more active in markets and they also have the choice of posting their opinions online," says the Head of Finance at a Singaporean energy company.

4.3 Corporate Transactions Momentum

ESG Deal Matters



of respondents say that ESG questions are a central consideration in the decision-making process during M&A activity.



Over **90%** say ESG is at least a part of the discussion.

Explore the key drivers of strategic transactional activity in **Charting Growth — The New M&A Landscape in Asia Pacific**, our second report of the **Asia Pacific Business Renewal Series.**

Some highlights include:

- How the "E" aspect of ESG is driving increasing investment into companies which develop technologies that minimize our harm to the environment.
- Why investments are being made into, and higher valuations are being placed on, companies with strong ESG track records.
- How ESG trends are putting new demands on manufacturers to innovate via investor and customer pressure to improve operations.

> "ESG goals are also becoming more engrained in financing packages and new financial products are being developed to help support businesses adjust to low-carbon economies. Green and sustainability linked financial products are gaining in popularity and governments around the region are encouraging financial institutions to help facilitate corporates transition to more sustainable business models."

Gavin Raftery
Partner, Tokyo

ESG pressures will also increase in other areas of corporate activity, including private equity, sovereigns, corporate funding and M&A. Almost a third of respondents say that ESG questions are a central consideration in the decision-making process during M&A — and an overwhelming majority of 90% say ESG is at least a part of the discussion.

Given the extent to which ESG now represents an additional risk factor in any transaction, this sentiment speaks to deal prudence from both the buy-side and sell-side. The dangers for organizations making investments without taking ESG into account during the due diligence process are considerable. "We request complete disclosures of ESG performance [from acquisition targets] because it is essential to consider the materiality of these factors," shares the Managing Director of an asset management firm in Hong Kong.

Rising emphasis on ESG due diligence no doubt increases deal complexity, suggests Kiyoshi Endo, Partner, Tokyo. Endo shares that, "once seen as voluntary, these mandatory disclosures bring legal consequences for making false, misleading or deceptive comments to the market. Moreover the rules also differ by jurisdiction, which means that both buy-side and sell-side stakeholders should seek legal advice in the pre-deal and post-deal stages."

Investor confidence is key and this applies to businesses' own shareholders as well. As the Managing Director of an Indian bank shares, "Our investors have told us that ESG considerations should be highly important during any acquisitions or investments." One of the three key goals of COP26 includes a mandate to amplify the role of finance in securing global net zero; particularly realizing the commitment to mobilize at least USD 100 billion in climate finance per year from 2020. Given that one way to incentivize businesses and investors is to make key information available, major governments and regulators have been passing laws that force companies to make these ESG-related disclosures to potential investors.

ESG due diligence forms a key component in the process of investment decision-making and portfolio management for institutional investors. It has no doubt added another layer of deal complexity, suggests Robert Wright, Partner, Hong Kong. Wright shares that, "increased investor demands and the roll out of mandatory disclosure requirements are driving improved ESG review and reporting practices across the region. However, while it is encouraging to see many global asset managers well advanced on ESG due diligence protocols and governance regimes, there are concerns that others outside the large institutions may require greater support in areas such as ESG training, access to data and analytical tools to evaluate ESG risks. We expect to see an exciting new wave of ESG support systems for fund managers, investors and other [market participants] in response to increased regulation and reporting requirements."

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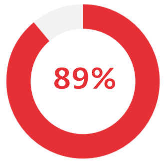
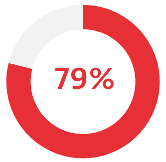
4.4. Raising the Bar for ESG Competency

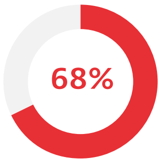
Current Standards



see their current ESG reporting and disclosure practices as fit for purpose.

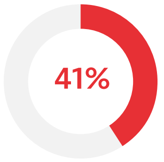


say the same of ESG policies and practices.

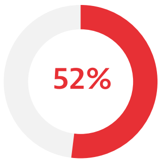


say the same of ESG crisis management plans.

Gaps to be Filled



say they have good quality ESG management training.



are content with the extent to which they have signed up to ESG standards.

4

Identifying ESG strengths and weaknesses will be the key way to accelerate the adoption of ESG practices across the region. Inconsistency is part of the reality as most organizations have mixed rates of progress in advancing their ESG capabilities and competencies.

In particular, almost 90% of respondents have put ESG reporting and disclosure practices in place with which they are happy; almost 80% say the same of ESG policies and practices. However, fewer than half of respondents say they have good quality ESG management training and just half are content with the extent to which they have signed up to ESG standards.

Organizations that have moved furthest on implementing ESG systems urge others to follow their lead, stressing the benefits of such work, particularly in areas such as risk mapping. At a technology company in Singapore, for example, the Director of Marketing says: "Risk mapping has proved invaluable to understanding our risk exposures: we know what the imminent ESG risks are that threaten the continuity of our business."

"Businesses should consider all aspects of ESG, and put in place processes that enable their organization to identify risks and confront them early on. To do this effectively, it is necessary to have visibility over the organization's exposures, but also a detailed understanding of the external environment they operate in. In particular, organizations should be asking forward-looking questions such as: what are the regulatory imperatives that must be complied with; what compliance guidelines and pre-emptive measures can be put in place to minimize the risk of regulatory failure; how can we create a culture that encourages compliance above and beyond foundational regulatory imperatives, to achieve best practice governance and sustainable development?"

Alyssa Auberger
Chief Sustainability Officer
Paris

5 Conclusion: ESG Remains Entrenched in Business Renewal Strategy

The pandemic represents a watershed moment for ESG in the Asia Pacific region, requiring corporations to respond rapidly. While some organizations have already moved ESG up the corporate agenda and taken action, few companies have yet built ESG frameworks and processes that are sufficiently advanced and rigorous for the realities of today's marketplace.

However, a roadmap is now emerging for businesses in both camps. This research highlights three crucial steps that corporations in Asia Pacific must now take to manage ESG risk as they focus on recovery and growth.

Align ESG with Renewal

A renewed focus on ESG goes hand in hand with managing business disruption. Weaknesses in operational resilience and broader supply chains can be mitigated through sustainability.

Strategic consideration of sustainability and broader ESG issues will ensure tomorrow's organizations are more robust — and more growth-ready.

Identify and Fill Competency Gaps

There is a need for organizations to ensure visibility of ESG risk mapping across corporate activity; whether it relates to supply chains, management training or to decision-making for strategic investments or transactions.

The ability to simultaneously identify risks and shore up expertise will position businesses for growth and renewal.

Leverage Support for ESG Regulation

It is now crucial to prioritize the ability to deal with top ESG risks such as regulation, enforcement and changing policies.

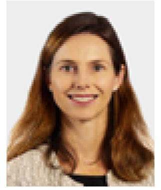
Leveraging specialist third-party advice can save businesses time, money and resources in avoiding reputational cost and financial penalty due to breach of ESG compliance.

Respondents have indicated that businesses in every industry recognize the imperatives of accelerating ESG plans. However, varied take-up and adoption rates across jurisdictions and sectors remain the longer-term barrier. Such fragmentation, particularly vis-à-vis regulation, will further burden the compliance workload — making it challenging to manage without third-party assistance.

In the near-term, the reality is that businesses which are less likely to be making the SDGs central to their planning, have good visibility and controls over their supply chains or less likely to take ESG considerations into account when looking at M&A risk reputational damage and brand value erosion.

Given the growing importance of external factors, including consumer demand for improved ESG standards, Asia Pacific businesses now need to move particularly quickly to resolve shortfalls and gaps. This will also help with region-wide progress on ESG regulation harmonization and collaboration, which can in turn, have positive impacts on the economic recovery and renewal in the region.

6 Key Contacts



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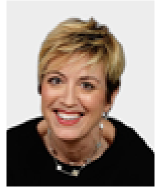

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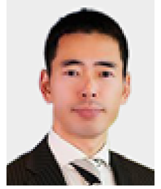

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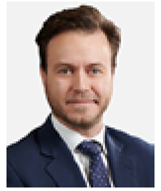

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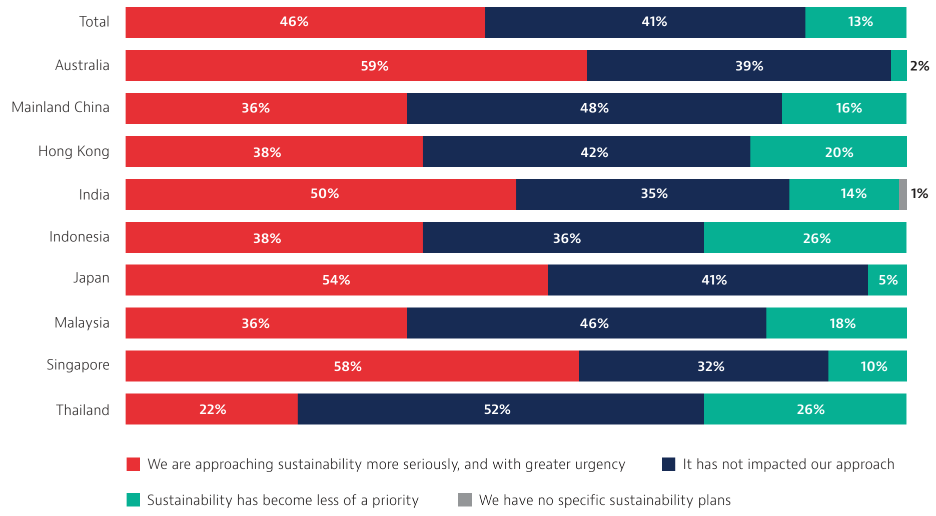
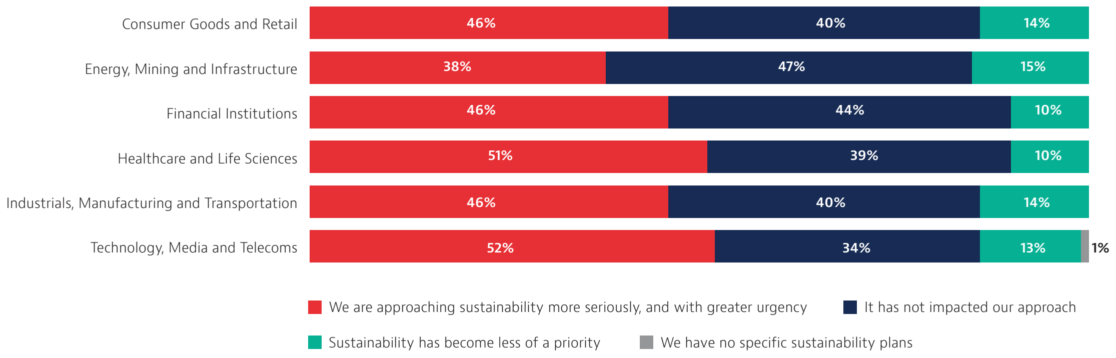
7 Appendix of Figures

FIGURE 1. IMPACT OF THE PANDEMIC ON EFFORT TO CREATE A MORE SUSTAINABLE OPERATION (JURISDICTION VIEW)



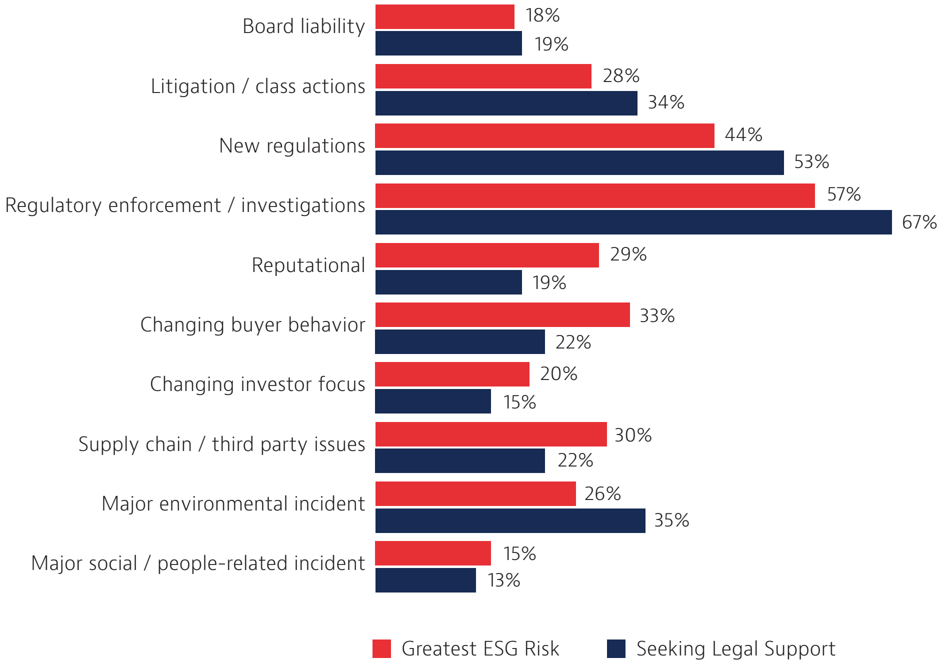
Source: Acuris

FIGURE 2. IMPACT OF THE PANDEMIC ON EFFORT TO CREATE A MORE SUSTAINABLE OPERATION (SECTOR VIEW)



Source: Acuris

FIGURE 3. TOP ESG-RELATED RISKS AND AREAS FOR LEGAL/EXTERNAL ADVICE



Source: Acuris

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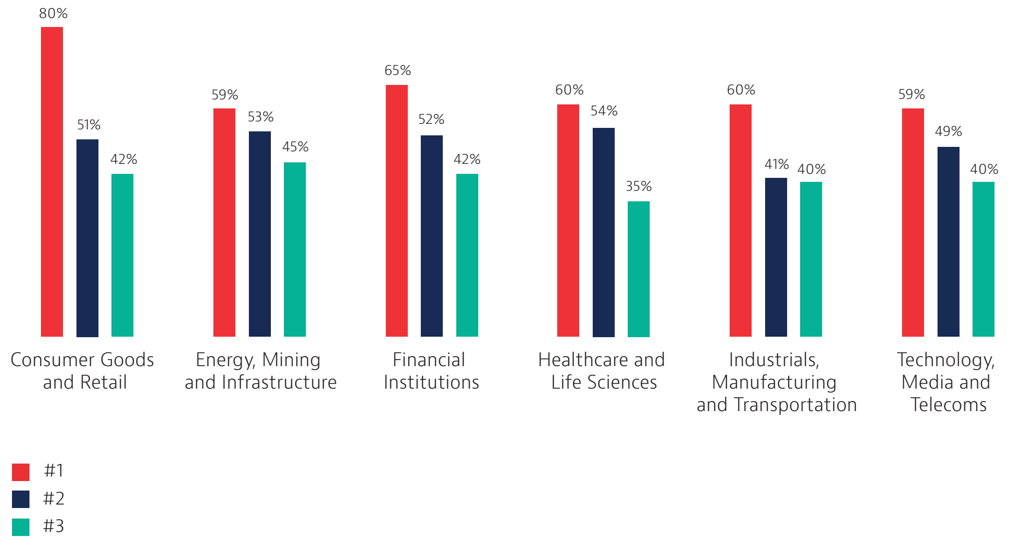
FIGURE 4. PREPAREDNESS FOR POSSIBLE INCREASE IN CLIMATE-RELATED REGULATION AND ENFORCEMENT

Source: Acuris

FIGURE 5. TOP ESG-RELATED RISKS AND AREAS FOR LEGAL/EXTERNAL ADVICE (SECTOR VIEW)



Source: Acuris

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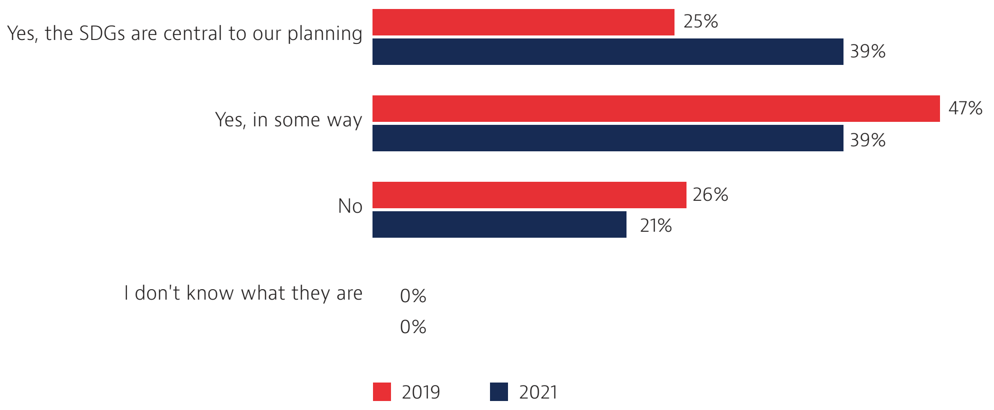
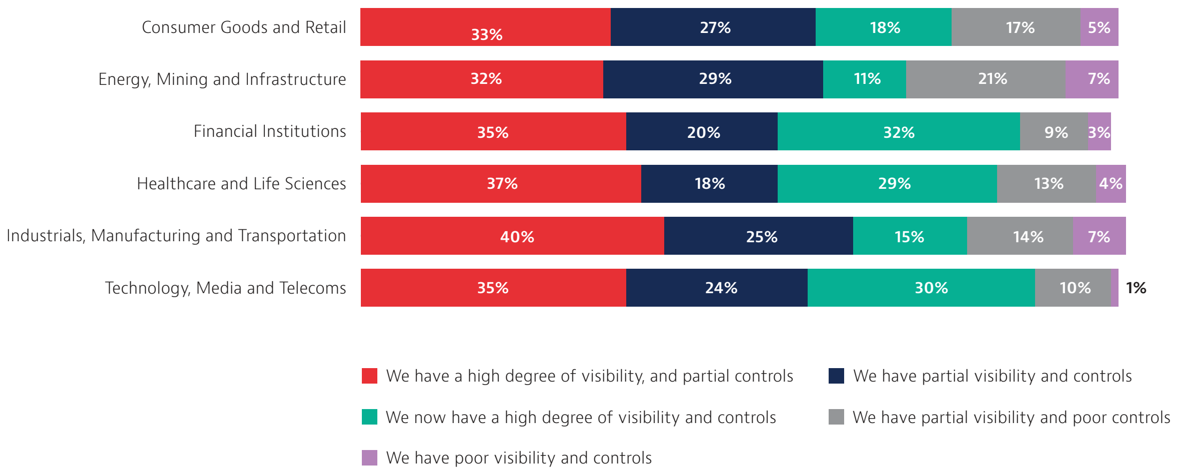
FIGURE 6. EMBEDDING THE UN SUSTAINABLE DEVELOPMENT GOALS INTO STRATEGIC PLANNING (2019 VS 2021)



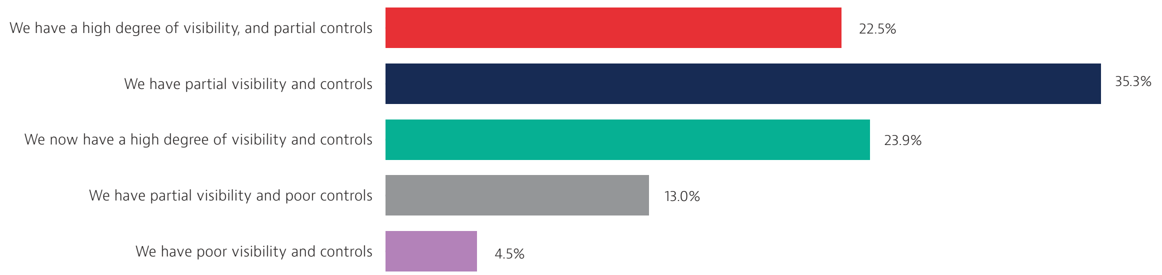
Source: Acuris

FIGURE 7. VISIBILITY AND CONTROLS REGARDING ESG RISKS AND METRICS WITHIN SUPPLY CHAIN



Source: Acuris

FIGURE 8. VISIBILITY AND CONTROLS REGARDING ESG RISKS AND METRICS WITHIN SUPPLY CHAIN (SECTOR VIEW)



Source: Acuris

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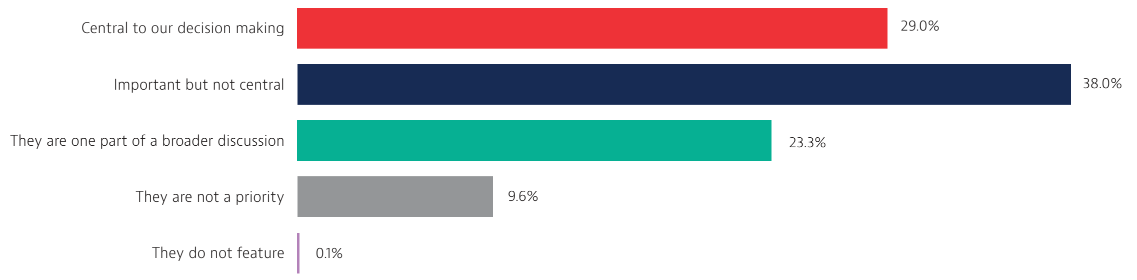
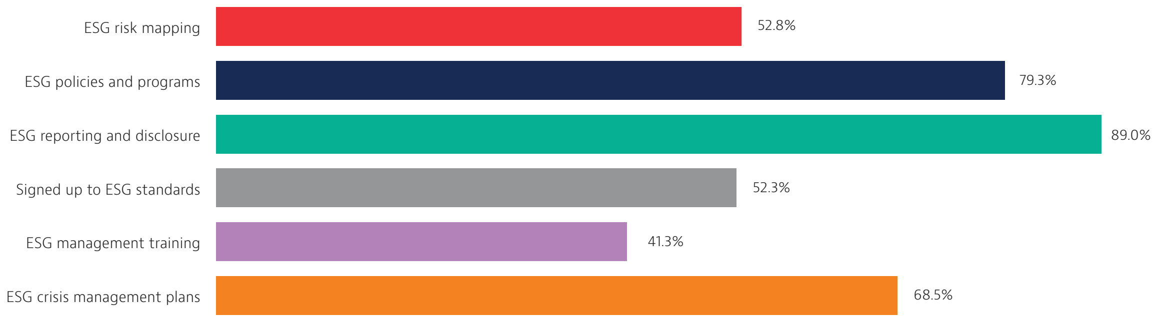
FIGURE 9. IMPORTANCE OF ESG CONSIDERATIONS RELATING TO ACQUISITIONS AND OTHER INVESTMENTS



Source: Acuris

FIGURE 10. CURRENT APPROACHES TO ESG DESCRIBED AS FIT FOR PURPOSE



Source: Acuris

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