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THE FUTURE OF ESG IN SINGAPORE

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I. INTRODUCTION

Globally, policymakers are having to rethink how best to tackle sustainability issues in their own economies, issues created in large part by corporate short-termism.[1] Short-termism refers to an "excessive focus on short term goals at the expense of longer-term objectives".[2] For companies, the excessive focus on short term growth and earnings without due regard of long terms costs have accelerated the pace of environmental degradation and social inequality.[3] It is within this context that I discuss the importance of companies (specifically Singapore listed companies) integrating Environmental, Social and Governance [ESG] factors into their business practices.

ESG factors refer to the deployment of business and finance in a manner that protects the stability and resilience of the environment, facilitates social justice and promotes long-term economic prosperity, thereby securing the "social foundation" of humanity without further degradation of the "planetary boundaries".[4]

* LLB (Candidate) (NUS). All errors and views expressed in this article remain my own. Weblinks cited in the article are functioning as of the date of publication.

[1] Ernest & Young Poland, "Short-termism in business: causes, mechanism and consequences" (2014) online: <https://www.ey.com/Publication/vwLUAssets/EY_Poland_Report/$FILE/Short-termism_raport_EY.pdf> at 6.
[2] *Ibid* at 7.
[3] See generally Henry M Paulson Jr, "Short-termism and the threat from climate change" (1 April 2015), *McKinsey & Company*, online: <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change>.
[4] Beate Sjåfjell and Christopher M Bruner, "Corporations and Sustainability" in Beate Sjåfjell and Christopher M Bruner (eds), *Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (UK: CUP 2019) 3, 7-10.

II. THE IMPORTANCE OF ESG FACTORS

There is a growing consensus around the world that ESG factors are a key determinant factor in the corporate performance of companies, and would become even more important in the near future,[5] exacerbated in the wake of Covid-19 with increased scrutiny on how companies treat their employees and customers,[6] coupled with the rise of carbon taxes.

According to a report by the Chartered Financial Analyst [CFA] Institute that studies ESG Integration among companies in Asia [CFA Report],[7] among the 3 ESG factors, corporate governance was the main driver of share prices in listed companies in 2017. More importantly however, the report also indicated that social and environmental issues will have an even greater impact on share prices moving forward.[8]

It is striking that Singapore listed companies, while ranking amongst the highest in Asia for ESG, surprisingly rank amongst the lowest when rankings are adjusted to only reflect Environmental and Social factors [E/S] as compared to companies in other highly developed economies in Asia such as Hong Kong, Korea, Taiwan and Japan.[9] While this is a testament to the long standing reputation of Singapore's good corporate governance, it also highlights how comparatively, environmental and social factors are lacking.

With the rise of institutional shareholding in listed companies all around the world, institutional investors' portfolio selection of companies can have a very large impact on a company's share price performance due to the enormous amount of funds they have at their disposal for

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[5] See generally S&P Global Ratings, "The ESG Advantage: Exploring Links to Corporate Financial Performance" (March 2020), online: <https://www.spglobal.com/_assets/documents/ratings/the-esg-advantage-exploring-links-to-corporate-financial-performance-april-8-2019.pdf>.

[6] Pippa Stevens, "Sustainable investing is set to surge in the wake of the coronavirus pandemic" (7 June 2020), *CNBC*, online: <https://www.cnbc.com/2020/06/07/sustainable-investing-is-set-to-surge-in-the-wake-of-the-coronavirus-pandemic.html> [Stevens (2020)].

[7] CFA Institute, "ESG Integration in Asia Pacific: Markets, Practices, and Data" online: <https://www.cfainstitute.org/-/media/documents/survey/esg-integration-apac.ashx> at 18. The report noted that in relation to the impact of ESG issues on share prices: (i) governance issues had a 71% impact in 2017 and are predicted to have a 78% impact in 2022, (ii) environmental issues had a 22% impact in 2017 and are predicted to have a 56% impact in 2022, (iii) while social issues had a 22% impact in 2017 and are predicted to have a 47% impact in 2022.

[8] *Ibid* at 143.

[9] See Jamie Allen et al, "CG Watch 2018: Hard Decisions Asia faces tough choices in CG reform", (5 December 2018), *CLSA & ACGA*, online: <https://www.acga-asia.org/cgwatch-detail.php?id=362> [*CG Watch 2018*] at 8.

investment.[10] Importantly, institutional funds are increasingly screening for E/S factors when making their investment decisions.[11] Taken together, a company that winds up on the negative list of a large international institutional fund such as Blackrock or Vanguard could see its share price drop precipitously.[12]

However, one might argue that the impact of a low E/S score in the Singapore context is less pronounced. Afterall, Singapore's shareholder landscape is dominated by government linked and family owned companies, where institutional investors do not have a substantial shareholding.[13] Consequently, the impact of an institutional fund's perception of companies listed in Singapore might not be as pronounced as in the West.

Be that as it may, the implications of having a low E/S score would go beyond altering the perception of institutional investors, to also affecting a company's reputation amongst their consumers and employees as well. This is especially so in the wake of the Covid-19 pandemic.[14] Also, with the introduction of carbon taxes in Singapore,[15] the cost of noncompliance by companies would be higher, since companies would have to pay more taxes if they are less fuel efficient and this would in turn negatively affect the financial performance of such companies.

In addition to the financial implications for companies, the stakes are even higher for Singapore, which markets itself an International Financial Centre [IFC].[16] Scoring significantly lower than the

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[10] See generally Lucian A Bebchuk, Alma Cohen & Scott Hirst, "The Agency Problems of Institutional Investors" (2017) 31(3) J Econ Perspect 89 [Lucian et al (2017)].

[11] See Sara Bernow et al, "From 'why' to 'why not': Sustainable investing as the new normal" (25 October 2017), *McKinsey & Company*, online: <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal>.

[12] See Robert G Eccles & Svetlana Klimenko, "The Investor Revolution", (May-June 2019), *Harvard Business Review*, online: <https://hbr.org/2019/05/the-investor-revolution> accessed 29 June 2020.

[13] Dan W Puchniak & Samantha Tang, "Singapore's Puzzling Embrace of Shareholder Stewardship: A Successful Secret" (October 23, 2019) NUS Law Working Paper No. 2019/022, Vand J Transnat'l Law (Forthcoming), online: <https://ssrn.com/abstract=3474151> [Punchniak & Tang (2019)] at 5.

[14] See generally, Stevens (2020), *supra* note 6.

[15] Masagos Zulkifli, "Welcome Address by Mr Masagos Zulkifi, Minister for the Environment and Water Resources, at the Launch of Singapore Exchange's (SGX) Inaugural Review of Sustainability Reports Produced by Singapore-listed Companies, on 4 December 2019" (4 December 2019), *Ministry of the Environment and Water Resource, Singapore*, online: <https://www.mewr.gov.sg/news/welcome-address-by-mr-masagos-zulkifli--minister-for-the-environment-and-water-resources--at-the-launch-of-singapore-exchange-s-sgx-inaugural-review-of-sustainability-reports-produced-by-singapore-listed-companies--on-4-december-2019#:~:text=Welcome%20Address%20by%20Mr%20Masagos,Companies%2C%20on%204%20December%202019&text=Good%20morning%20to%20all.> [Masagos (2019)] at [24].

[16] Woo Jun Jie, "Positioning Singapore in a new financial world order" (2 October 2019), *Today*, online: <https://www.todayonline.com/commentary/positioning-singapore-new-financial-world-order>.

other developed economies in the Asia-Pacific region on environmental and social factors is not beneficial to Singapore's reputation.

According to the CFA report, the main reasons for companies in Singapore being reluctant in adopting E/S practices are, *inter alia*: (i) the "[l]ack of comparable and historical data" (47%), (ii) a "[l]imited understanding of ESG issues" (44%), (iii) "[n]o evidence of investment benefits" (36%), and (iv) a "[l]ack of company culture" (27%).[17] Firstly, ESG remains a highly ambiguous term to many people, and they do not completely understand what ESG entails.[18] Secondly, the correlation between embracing ESG and better corporate performance, specifically E/S factors is still not clear. Currently, studies on corporate outperformance focus predominantly on Europe and the United States. Even when there are case studies that showcase the benefits of ESG, they do not highlight the opportunity costs. The lack of comparable and historical data is also a recurring problem in Singapore.[19] Thirdly, Singapore lacks a culture for ESG integration. While Singapore may be slightly more advanced on ESG integration than other parts of Asia and have a more advanced understanding of ESG, much of this knowledge remain scarce in local companies.[20]

In this article, I will attempt to diagnose the causes of this underperformance, and surmise that a combination of reasons such as a (i) lack of a clear working definition of E/S, (ii) a dearth of data on the relationship between E/S and corporate performance within Singapore, (iii) a weak corporate culture promoting E/S and (iv) a weak regulatory framework to ensure companies comply with E/S principles are all contributing reasons to this phenomenon.

In turn, I propose that an independent regulatory agency be established to assess the quality of the sustainability reports submitted by listed companies in Singapore based on a set list of criteria. These sustainability reports should plug the informational gap that explains how embracing E/S policies is tied to a company's long-term financial performance. The regulatory agency should also issue recommendations on areas where companies can improve. Additionally, the agency should ensure that companies follow through with E/S policies which they had pledged to adopt in their sustainability reports. Finally, stewardship would play an important role in helping companies

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[17] *Supra* note 7 at 146. The report notes that: "Percentages represent those who thought each item was a main barrier. Survey respondents could choose more than one answer."

[18] *Ibid.*

[19] *Ibid.*

[20] *Ibid.*

embrace E/S factors in the coming years. Both the Singapore Stewardship Code[21] and Family Stewardship Code[22] should be improved by having clearer guidelines on what ESG means and how it should be implemented within companies.

III. CURRENT REGULATORY REGIME

Free trade jurisdictions with open financial markets like Singapore are perceived to prefer incentive based regulation, for fear than an overly-prescriptive approach might drive investment and businesses away.[23] So far, the Singapore Government's approach to regulation is consistent with such a perception, as shown in the government's generous funding in supporting companies in their pursuit of sustainability,[24] while simultaneously maintaining a generally flexible regulatory regime.

As of 2016, the Singapore Exchange [SGX] has introduced a regime requiring listed companies to publish annual reports on a "comply or explain" basis.[25] However, these sustainability reports issued by companies have been criticised for box-ticking.[26] Critically, companies are seen to be publishing these reports "without a clear sense of what it means for their future", and whether environmental issues such as climate change would force them to alter their business model in the long term.[27]

Furthermore, there is no body that serves the function of an independent auditor/regulator monitoring the accuracy and the extent to which these companies actually follow through with the

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21 Stewardship Asia, "Singapore Stewardship Principles for Responsible Investors", (November 2016), online: <https://www.stewardshipasia.com.sg/sites/default/files/Section%202%20-%20SSP%20(Full%20Document).pdf>.

22 Stewardship Asia Publications, "Stewardship Principles for Family Businesses: Fostering Success, Significance and Sustainability", (October 2018), online: <https://www.stewardshipasia.com.sg/sites/default/files/SSP-brochure-0913_approved%20for%20printing.pdf>.

23 Jackie Horne, "Singapore ESG Financing: Dirty hands make green work?" (15 January 2019), *Finance Asia*, online: <https://www.financeasia.com/article/singapore-esg-financing-dirty-hands-make-green-work/449097> [Horne (2019)].

24 Masagos (2019), *supra* note 15 at [24]-[27].

25 See SGX, "Sustainability Reporting", online: <https://www.sgx.com/regulation/sustainability-reporting>, for an explanation of the "comply or explain" regime put in place for sustainability reporting by companies as of June 2016.

26 See Claudia Tan, "Investors to see more useful data in mandatory sustainability reports", 5 December 2019, *Business Times* online: <https://www.businesstimes.com.sg/companies-markets/investors-to-see-more-useful-data-in-mandatory-sustainability-reports> [Tan (2019)].

27 *CG Watch 2018*, *supra* note 9 at 323.

E/S plans they publish in their sustainability reports. In contrast, in Japan, the top ranked economy for E/S factors in the CG Watch Report 2018,[28] most of the corporate disclosures with regard to environmental and social issues have to be sent "to the national regulators for monitoring and compliance purposes".[29]

Additionally, under the current regime, there is no prescribed method of issuing a sustainable reporting and companies have carte blanche over the topics they want to report on.[30] Consequently, there is a lack of comparable data that other companies can rely on to better implement their own E/S strategies. Also, this flexible regulatory framework opens up the possibility for companies to engage in green washing, where companies can promise to engage in lofty sustainability and corporate social responsibility programmes in their sustainability reports without having to actually follow through on these promises.[31]

There are suggestions as to whether the government should follow the European Union, "which is debating whether to deploy a stick and become a lot more prescriptive in its approach".[32] In the European Union and the UK where awareness of sustainability issues is high, hard law provisions regulating these issues make sense because compliance is likely to be high. However, in Asia, where many companies are still trying to grapple with E/S concepts, either due to a strong profit maximisation mindset or simply a lack of information,[33] a softer regulatory regime that focuses on education rather than penalties could be more appropriate. Arguably Singapore is in the latter scenario, and in a phase where companies are still trying to grapple with E/S concepts. However, once E/S factors have gained a stronger traction in Singapore, more can be done to ensure companies continuously look for ways integrate E/S concepts into their business practices such as through instituting harsher penalties for failing to comply with E/S laws and guidelines.

On the other hand, the results have shown that the current approach might not be sufficient on its own to achieve the desired results. At the very least, SGX could improve the current regulatory regime by issuing clearer guidelines on what companies should report on, so that

[28] *CG Watch 2018*, *supra* note 9.
[29] WBCSD, "Corporate and sustainability reporting trends in Japan" (10 February 2019), online: <https://www.wbcsd.org/Programs/Redefining-Value/External-Disclosure/The-Reporting-Exchange/Resources/Corporate-and-sustainability-reporting-trends-in-Japan> at 5.
[30] See Tan (2019), *supra* note 26.
[31] *Ibid.*
[32] See, Horne (2019), *supra* note 23.
[33] Eric Ng, "Why is Asia lukewarm to sustainable investing?" (14 October 2017), *South China Morning Post*, online: <https://www.scmp.com/business/companies/article/2115233/why-asia-lukewarm-sustainable-investing>.

companies will publish useful data that others can reference to make their own E/S related decisions. For this, inspiration can be taken from the Global Reporting Initiative, an international independent standards organization that helps businesses, governments and other organizations understand and communicate their impact on issues such as climate change, human rights and corruption.[34] In their 2013 conference, it was suggested that sustainability reports be assessed based on basic reporting principles such as materiality, stakeholder inclusiveness, completeness, comparability, balance, accuracy and reliability.[35]

Additionally, the government could consider setting up an independent regulator, or rely on existing regulators such as SGX or the Monetary Authority of Singapore to make sure that companies actually follow through on what they propose to do in their sustainability reports. Alternatively, the government could mandate that companies have to send their sustainability reports to independent auditors for monitoring purposes. External checks on sustainability reports "reduce the risk of greenwashing and reports being used as" marketing exercises by companies.[36]

IV. THE SINGAPORE AND THE FAMILY STEWARDSHIP CODES TO PLAY A ROLE BEYOND HALO SIGNALLING

Stewardship is another area of focus which the government could look into to help companies better integrate E/S factors into their businesses. The Singapore Stewardship Code and Family Stewardship Code were Singapore's unique response to the UK's Stewardship Code[37], which itself was enacted in response to the rise of institutional investors as the largest investor group in listed

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[34] See link for a brief description of goals of the Global Reporting Initiative, see GRI, "About GRI", online: <https://www.globalreporting.org/information/about-gri/Pages/default.aspx>.

[35] See generally Global Reporting Initiative, "2013 Global Conference on Sustainability and Reporting" (May 2013), online: <https://www.globalreporting.org/resourcelibrary/2013-GRI-Global-Conference-in-Review.pdf>.

[36] European Court of Auditors, "Reporting on sustainability: A stocktake of EU Institutions and Agencies" (June 2019), online <https://www.eca.europa.eu/Lists/ECADocuments/RCR_Reporting_on_sustainability/RCR_Reporting_on_sustainability_EN.pdf> at 35.

[37] Financial Reporting Council, "The UK Stewardship Code" at 5, (September 2012), online: <https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf>.

companies in the United Kingdom [UK] and to compel them to play a supervisory role to alleviate the shareholder-management agency problem.[38]

Unlike the UK, institutional ownership of listed Companies in Singapore continue to be small, and Singapore's shareholder landscape is dominated by family owned and government-linked companies [GLCs].[39] Consequently, as pointed out by Prof Dan W Puchniak & Samantha S Tang in their article "Singapore's Embrace of Shareholder Stewardship: A Puzzling Success", Singapore's stewardship codes were designed to be "toothless",[40]and instead were enacted to signal good corporate governance in the country by keeping up with developments in "Anglo-American-cum global standards of good corporate governance", despite not having any real need for it.[41]

There are a couple of reasons why the Singapore Stewardship Code and Family Stewardship Codes lack any "tooth" in compelling Institutional investors and Family Controllers to comply with them.[42] Firstly, the Singapore Stewardship and Family Stewardship code do "not articulate a singular model of stewardship with which investors should comply".[43] Secondly, the codes do not employ a "comply or explain" approach, and it operates purely on a voluntary basis.[44] Thirdly, there is no mechanism/metric to determine if institutional investors have complied with the codes.[45] Finally, there is no regulatory agency in Singapore that is responsible for the administration of the codes.

Stewardship Asia, the organisation tasked with drafting the stewardship codes, is only responsible for promoting the code, and does not perform any regulatory function.[46] Given Temasek, Singapore's state owned investment trust's close relationship with Stewardship Asia, Puchniak & Tang argue that Temasek is located within an institutional architecture that serves as a functional substitute for shareholder activism and monitoring of management.[47] There are also significant legal obstacles that limits excessive "state influence from being exerted on Temasek's board or its subsidiary companies", which "ensures that decisions made by Temasek's

[38] See generally Lucian et al (2017), *supra* note 10. See also, Puchniak & Tang (2019), *supra* note 13, "Abstract".
[39] Puchniak & Tang (2019)*, supra* note 13 at 5.
[40] *Ibid* at 6.
[41] *Ibid* at 9.
[42] *Ibid* at 20.
[43] *Ibid* at 20.
[44] *Ibid* at 21.
[45] *Ibid* at 21-22.
[46] *Ibid* at 22.
[47] *Ibid* at 25.

management are made for commercial and not political reasons".[48] Temasek has also committed itself to refrain from any direct involvement in the management of its investee companies.[49] This arrangement has served Singapore well in the area of corporate governance, and subsidiary companies of Temasek can operate without a great amount of interference from Temasek.[50] It thus would be accurate to conclude that Singapore's successes in the area of corporate governance are 'in spite of' rather than 'because of' the Stewardship code, and by maintaining the status quo.

However, the viability of such an arrangement is put into question when tackling issues arising from E/S factors. As established earlier,[51] because of the multitude of reasons such as the corporate culture in Singapore, coupled together with a lack of solid data, the management of listed companies remain predominantly focused on maintaining high returns on investments, without adequate regard for E/S factors.

Admirably, Temasek has in recent years been more vocal about promoting sustainability efforts.[52] However, the very institutional architecture that has prevented it from interfering directly with the management of GLCs could now also impede its ability to compel the management of GLCs to seriously consider integrating E/S factors. Without greater interference from Temasek, it is unlikely that GLCs would have the necessary incentives to integrate E/S factors into their business practices.

The same criticisms of the Singapore Stewardship Code could also be levelled at the Family Stewardship Code, which was tailored for family owned companies, with the aim of enabling owners to become better stewards of their company. Based on a textual analysis of the Family Stewardship Code, it does not seem to have a huge focus on ESG.[53] ESG factors seem to be implied rather than expressly mentioned in the code, and there are no guidelines on what E/S actually means. For example, Principle 6 of the family stewardship code appears to reflect environmental, social and governance concerns. It states, "Do well, do good, do right; contributing to community".[54] As Puchniak & Tang note:

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48 *Ibid* at 26.
49 *Ibid.*
50 *Ibid* at 15.
51 *CG Watch 2018*, *supra* note 9 at 323.
52 See Temasek, "Temasek Review 2019", online: <https://www.temasekreview.com.sg/overview/from-our-chairman.html>.
53 *Supra* note 22 at 6-9.
54 Puchniak & Tang (2019), *supra* note 13 at 29, see also *supra* note 22 at 6.

> This principle promotes the importance of "non-economic wealth", such as "social capital, communal ties, family reputation and core values".[55]

Puchniak & Tang also mention that similar to GLCs, there are functional substitutes in the area of corporate governance with regard to family owned companies, where the controlling shareholder (often the family or family members) would naturally act in the best interests of the company and monitor management.[56] However, I question the extent to which family controllers are able to gauge the long term interests of the company, especially since there is a lack of important data showing tangible financial returns from engaging in these E/S practices and a lack of knowledge of how to plan for the long term in light of these E/S factors. As such, due to the lack of knowledge, family controllers might not know the best way to integrate E/S factors into their business practices.

Additionally, in many of these family-controlled companies, there is a long-established business culture and a set way of doing things which had ensured the success of these companies in the past.[57] Owing to these prior successes, it would be difficult to convince the controllers of these companies that urgent change is required, and especially since there are not enough case studies or information available that link the integration of E/S factors with the long-term success of the company.

In view of these problems unique to the Singapore landscape, I am of the view that the objective of stewardship codes should go beyond signalling good corporate governance to also aid in the integration of E/S factors into company's business practices. For example, stewardship codes can help to spread best practice and have an educative effect on companies, preparing companies for the "potential strengthening of hard law provisions" on sustainability in Singapore.[58] Unlike the area of corporate governance, which is predicated on shareholders having a specific amount of corporate control,[59] institutional investors could play an integral role in educating companies on ESG best practices, regardless of the size of their stake in the company. These institutional

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[55] *Ibid.* Although it is apposite to note they the principle does not go into detail on how best to effect its goals.

[56] Puchniak & Tang (2019), *supra* note 13 at 31.

[57] Philip Kunz, "Family businesses need to move on sustainability or be left behind" (19 February 2020), *The Business Times*, online: <https://www.businesstimes.com.sg/hub-projects/whos-who-in-private-banking-feb-2020/family-businesses-need-to-move-on-sustainability>.

[58] Dionysia Katelouzou & Alice Klettner, "Sustainable Finance and Stewardship: Unlocking Stewardship's Sustainability Potential" (April 17, 2020) European Corporate Governance Institute – Law Working Paper No. 521/2020, online: <https://ssrn.com/abstract=3578447> at 24.

[59] Puchniak & Tang (2019), *supra* note 13 at 5.

investors have better knowledge and experience on how best to integrate E/S practices to boost corporate performance. Also, the presence of clear and fixed metrics in stewardship codes when determining whether stewards have done enough to assist companies on E/S factors would provide the necessary incentives for institutional investors to engage in adequate stewardship since falling short would be detrimental to their reputation, on which they rely on predominantly to attract investors.[60]

More importantly, there should be a regulator monitoring stewardship activity in Singapore. Previously, I have discussed the possibility of SGX being the one to monitor companies' sustainability reports. Similarly, they could also be the regulator ensuring the intended stewards of these companies exercise proper stewardship since there is likely to be synergy between the two roles.

V. CONCLUSION

I have discussed the reasons for Singapore's underperformance with regards to E/S factors and possible policies that can be implemented to improve performance. While every policy has to be tailored to suit Singapore's needs, there is much to be learnt from observing other economies, especially economies which have done better in the E/S sphere. For now, the priority should be to ensure that Singapore's companies are keeping up with global developments in the E/S sphere. While the current arrangement of maintaining the status quo has worked well in the area of corporate governance as evinced by Singapore's high score in this area, this approach has to be tweaked to facilitate greater integration of E/S factors by listed companies in Singapore.

[60] Franklin Templeton, "ESG Study: How Institutional Investors Embrace Responsible Investing" (16 January 2020), *Beyond Bulls & Bears*, online: <https://global.beyondbullsandbears.com/2020/01/16/esg-study-how-institutional-investors-embrace-responsible-investing/>.