There are many ways in which a firm can construct the illusion of shareholder value creation (as they often do), while actually hurting it over the long term. Take, for example, a manufacturing business that might cut costs, boosting short-term profits by releasing untreated sewage into a river. Doing so will seemingly lift its short-term cash flows but will also substantially increase the variability of its long-term cash flows because the potential threat of regulatory actions, that may thwart business, is never far off. Similarly, a firm can cut back on research and development expenses to boost short-term profits. But that can often damage its long-term prospects.

Therefore, a focus on solely short-term profit generation may allow observers to draw misleading conclusions about a firm’s long-term prospects. In accurately assessing a firm’s long-term prospects, it pays to understand the environmental and social impacts of its business practices on all stakeholders involved, which could lead to better outcomes for shareholders in the long run. By stakeholders, we mean employees, a firm’s neighboring community, supply chain, customers and regulators in addition to shareholders. This is what the incorporation of Environmental, Social and Governance (ESG) factors in investment analysis purports to achieve. Businesses that meet ESG standards are generally businesses that make human or business activity less destructive to the environment, as well as promote positive social and economic developments. Therefore ESG focus is part of a focus on long-term shareholder value creation as companies that fit this bill may be better able to spot and execute on long-term growth opportunities. Equally importantly, such companies may be also better able to identify and manage risks effectively, potentially resulting in improved risk-adjusted outcomes for company shareholders.

Asia: Act Locally, Impact Globally

For investors looking to make investment decisions based upon ESG factors, Asia represents one of the best opportunities to gain exposure to companies that can make a long-term difference to the region and the world. There are a range of global ESG issues that cannot be addressed effectively and solved globally unless they are addressed and solved in Asia first. For instance, with respect to climate change, Asia today is the largest regional emitter of carbon. It emits approximately 2.5x the carbon that North America emits, and four times that of Europe.
On the back of impressive growth over the last several decades, the Asia Pacific region accounts for 28% of global GDP and 31% of stock market capitalization. Asia’s growth has lifted hundreds of millions of people out of poverty and created a large and vibrant middle class. But an economic model that prioritized growth without regard to externalities has led to rapid deterioration of the environment.

The China Factor

China is the world’s second-largest economy and the largest Co2 emitter since 2006. But it is still a relatively poor country by developed world standards. In 2010, China was only as rich as the U.S. was in 1941 but with an economy eight times as large. The U.S. quadrupled its real GDP per capita since 1941 and if China—with its much larger economy, were to do the same over the coming decades under the business-as-usual scenario—it is likely to push the world over 450 parts per million (ppm)—
considered a critical threshold at which scientists say global warming may be irreversible. For China and Asia, climate change isn’t just an abstract concern. There are real costs as much of the Co2 emitted results from coal usage, which also emits harmful particulate matter. It is not a surprise then that the vast majority of the 7 million global deaths due to air pollution occur in Asia. While these issues present an enormous challenge, they also present vast investment opportunities as governments, regulators, consumers and, of course, companies gear up to tackle these critical issues by investing in such things as urban transit systems, energy efficiency and pollution alleviation technologies.

In addition to the climate change and air pollution challenges, half of Asian households don’t have access to safe, piped water supply. Currently, 75% of the countries and over 90% of the population live in “less-than-capable water situations,” according to the Asian Development Bank. If the situation is dire now, imagine what the future might hold. There is a large investment opportunity in the shift from an economic model that once didn’t care about externalities to one that now does.

Quality of Life Issues

For Asia’s vast, newly minted middle classes, quality of life issues are increasingly becoming front and center. Governments and regulators are also becoming increasingly more serious about enforcement. Such a focus creates enormous opportunities for forward-thinking companies that are able to provide goods and services that improve quality of life while addressing social, economic and environmental challenges.

Asian ESG investing also offers the biggest opportunity to make an impact globally in terms of number of lives affected. Take health care for instance. South Asia has over 1.5 billion people who spend less than US$100 per year on health care on average. Given their lack of spending power, providing access to affordable health care products and solutions is a critical social issue. There are millions of Hepatitis C patients in South Asia, for instance, but very few, if any, are able to afford Gilead Sciences’ recent, highly effective drug Sovaldi for the simple reason that it was priced at US$1,000 per pill in the U.S., and the treatment lasts 12 weeks costing US$84,000. To make this wonder drug available to people across the developing world, Gilead licensed it to several generic drug manufacturers that make the 12-week treatment available for under US$1,000. With its high quality, globally competitive pharmaceutical and biotech businesses that have very low cost structures, the Asia region has been able to address this problem of affordable access profitably.

Asia also presents an enormous challenge and opportunity in terms of access to finance. For instance, there are hundreds of millions of people without bank accounts and access to credit in Asia. In parts of South and Southeast Asia access to credit is abysmally low. Very often access to small credit is often the difference between a family becoming mired in poverty with no prospects versus having a sustainable livelihood—by operating small businesses such as a bike repair shop in Jakarta or a fresh vegetable cart at a wet market in Manila—in order to be able to educate its children. This is a great investment opportunity in Asia as it is home to some of the best micro finance and group-based lending models.
Gender Equality: Miles to Go

Gender issues in Asia are also important from a global impact standpoint. Some Asian countries have quite skewed gender ratios as male children are traditionally preferred over female children, leading to female feticide. These inequalities persist through school, university and job markets. As a result there is also an enormous gender divergence at the senior management and board levels at listed firms. While countries like Thailand are nearly on par with the U.S., countries like South Korea and Japan lag in terms of female representation on boards. In Japan, given the government’s concerted efforts, things are moving in the right direction there but much more needs to be done.

Therefore, to make a meaningful dent in important global problems such as climate change, air and water pollution, access to health care, financial inclusion and gender inequality one has to effectively tackle these issues in Asia.
Where Does Asian ESG Fit?

Asia presents an exciting and meaningful opportunity to make an impact by virtue of being the world's most populous region with a mix of some of the most dynamic developed, emerging, and frontier countries with diverse growth drivers. It is home to some of the world's most challenging ESG issues but also to companies that are providing effective solutions to tackle the problems. Not being exposed to this region would result in a loss of a tremendous global impact opportunity for investors. From a regional investor's standpoint, an ESG focus has the potential to help generate solid risk-adjusted returns resulting from its inherently long-term horizon as well as its focus on companies with strong risk identification and mitigation.

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As of October 13, 2015, accounts managed by Matthews Asia did not hold positions in Gilead Sciences, Inc.

ESG factors can vary over different periods and can evolve over time. They may also be difficult to apply consistently across regions, countries or sectors. There can be no guarantee that a company deemed to meet ESG standards will actually conduct its affairs in a manner that is less destructive to the environment, or promote positive social and economic developments.

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