Net Gains: Chinese Tech Companies Rapidly Gaining Ground in ESG

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ESG is becoming an increasingly important feature of the Chinese tech space.

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As ESG moves further into mainstream, global business strategy, and following a general trend across its listed businesses, China's tech sector is quietly making progress in a number of important ESG domains.
The governance challenges in this all-important sector of the Chinese economy are well documented, as are the responses from government. This is particularly true in regards to the terms of increased regulation – e.g., the requirement by the China Securities Regulatory Commission (CSRC) for listed entities to disclose ESG risks associated with their operations in 2020 and the 2021 guidelines requiring them to make ESG disclosures in annual and semiannual reports. However, there has been less focus on the efforts of major Chinese mainland tech companies in other ESG domains. Environmental and social considerations are becoming increasingly important parts of their overall approach to competitive advantage and differentiation as these tech companies mature.

Chinese tech companies are not alone in having adopted ESG best practices and learned lessons from businesses based in developed markets. However, particularly around the design of their ESG strategies, Chinese tech companies have also moved to forge their own identities, which focus on material sustainability-related issues. As highlighted above, this is set against a background of increasing regulatory and policy requirements and a desire to expand globally to compete with their peers in the Global North.

Our analysis of the sustainability reports published by such companies reveals a clear and decisive move towards developing and embedding ESG strategies into the core of the business, while highlighting the importance of industry partnerships, advocacy, community engagement, social impact and, most importantly, environmental protection. In general, their ESG reports did not attempt to overlook the challenges faced by such companies in terms of governance and transparency or the steps needed to improve their ratings in these domains.

Critics may suggest that Chinese tech companies are late to the ESG party and that the improvement is only due to increased and more rigorous state regulation. Indeed, Asia in general is often widely dismissed by commentators as 'lagging' behind the North when it comes to ESG in corporates. It's believed that governance remains a critical weakness in many sectors. However, those involved in the detailed tracking and analysis of corporate governance over time[1] have observed that Asia has made significant and, in some cases, rapid progress. Whilst notable differences remain, both within countries and sectors and particularly when compared to the West, there have been notable upticks in sector level performance as noted by ACGA (2021). This is particularly true in Materials and Capital Goods, driven by diversified boards, better capital structures and a focus on efficiency and emissions, followed closely by technology, which made considerable gains. In China, the state's overall carbon neutrality target set out in the 14th Five Year Plan can be seen as an important driver, as it not only has implications for the transport and utilities sector, but also for the tech sector.

Companies recalibrate towards purpose and seek competitive advantage as they look to integrate ESG into their core business

Teneo's analysis of Chinese mainland tech sector ESG reports since 2017 (acknowledging that some have only been reporting more recently) finds a general trend of significant evolution, greater transparency and improved performance as their ESG journeys evolve. They also prioritise, and have a greater understanding of, ESG materiality in their business and wider sectors, including the need to work in partnership with external stakeholders.

Table 1: ESG report publishing history among leading Chinese tech companies

	First year publishing ESG report	Frequency of publishing
Alibaba	2018	2018; 2022
JD.com	2020	Yearly
Tencent	2018	Yearly
Baidu	2019	Yearly, with quarterly updates
Netease	2019	Yearly
Ant Group	2017 (sustainability report)	Yearly
Meituan	-	-

**Based on information disclosure on companies' investor relations websites*

1. See Asia Corporate Governance Association's Corporate Governance Watch reports from 2016 onwards. E.g., https://www.acga-asia.org/cgwatch-detail.php?id=362

The impacts of COVID-19 cannot be underestimated as a catalyst in raising their understanding of, and responsibility to address, overall sustainability goals. During the outbreak, Chinese e-commerce/consumer-tech players, such as digital payment and food delivery platforms, played an important role in supporting the economy and overall productivity. Online learning platforms supported continuing education, whilst cloud companies offered free audio and video chat tools to support overall business operations. They also helped Chinese consumers manage their money when making payments, borrowing, saving and investing.

We see a clear trajectory towards the maturing of sustainability reporting within the Chinese tech space. For example, JD.com, a leading e-commerce platform in the Chinese mainland, first started reporting on its sustainability performance in 2020. Its early report highlighted its Corporate Social Responsibility (CSR) efforts, but by 2021, it was positioning itself as a key actor in the 'new real economy' by anchoring its ESG efforts within a strategic business and enterprise context. The report also highlighted a strategic pivot towards responsible consumption and consumer behaviour, echoing China's prioritised policy agenda and aligning with wider national development goals.

Furthermore, our analysis reveals that, rather than reacting to increased market scrutiny, Chinese tech businesses are pursuing ESG initiatives as a means of driving internal efficiency, reducing risk and supporting talent acquisition and retention. The pioneering fintech company Ant Group started publishing its ESG report in 2017, despite being a private company. Table 1 shows that it was the earliest company on our research list to adopt ESG criteria while others were still focused on corporate social responsibility. The company's ESG evolution is well documented in its reporting since then. Its ESG goals have become increasingly ambitious, and it has developed a better understanding of its own performance in a more global context (e.g., in aligning its ESG strategy and reporting against the UN Sustainable Development Goals) in an increasingly sophisticated regulatory landscape.

Ant Group's latest 2021 sustainability report places significant emphasis on financial inclusion as part of a wider social responsibility pivot. The business has provided a clearer articulation of why ESG matters in the report and identifies a series of strategic pillars to guide its ESG trajectory and objectives to 2030. This includes digital inclusion (key to the overall business in a post-pandemic world), green and low-carbon development, technological innovation and an open ecosystem. The group also inked its first green loan in 2022. This more ambitious strategy and these clear goals have been noted by a number of external rating agencies. MSCI, for example, has rated Ant Group on a par with its Western peers (Visa and Mastercard) on their access to finance metric.

Decarbonization remains a priority; increased calls for industry collaboration and community advocacy

Unsurprisingly, our analysis finds significant focus across the Chinese tech universe on the importance of addressing climate change, specifically focusing on climate change targets and reporting progress against Scope 1 (direct) and Scope 2 (indirect) Greenhouse Gas (GHG) Emissions. Four out of seven companies on our research list have disclosed their carbon neutrality roadmap in the last year or two (Table 2). These disclosures included clear goals and a pathway for achieving carbon neutrality for Scopes 1, 2 and 3 GHG emissions. Of note, Ant Group announced that it has already achieved carbon neutrality in its operations (Scope 1 & 2 GHG emissions) in 2021; a commitment that will remain in place until it achieves net-zero emissions (Scope 1, 2 & 3) by 2030.

Table 2: Progress of carbon neutrality among leading Chinese tech firms

	Carbon neutrality roadmap	Specification of Scope 1,2 and 3 emissions	Third-party certification
Alibaba	2021	• Inventory and methodology • Details of categories and emission source under each scope • Extended to definition of Scope 3+	CEC Bureau Veritas
JD.com	-	• Definition and related business activities (emission source) under each scope	SGS
Tencent	2022	• Inventory and methodology • Definition and major emissions activities (emission source) under each scope	PWC
Baidu	2022	• Methodology • Emissions source and emission factor under each scope	Bureau Veritas
Netease	-	• Scope of statistics • Emission factor	CEC
Ant Group	2021	• Details of categories and emission source under each scope	CEC
Meituan	-	-	-

Chinese tech companies are heavily focused on the concept of 'green computing' as a means to reduce the CO2 emissions in their facilities. This includes investing in high performance computing infrastructure, improving use of computing resources, reducing resource consumption and responsibly disposing of electronic waste. Data centres, often criticised for their significant energy intensity and emissions due to the cooling necessary for them to function efficiently, have been increasingly subject to better controls thanks to new technology. This new technology includes submerging large-scale data centres in liquid coolant to lower operating temperatures, thus reducing energy consumption by 70 percent. On the software side, breakthroughs in more efficient algorithms and workload distributions have also made more energy-efficient data centres possible. In 2021, internet service giant Baidu disclosed in its annual ESG report that it reduced the carbon intensity of its operations by 577 tonnes CO2e over 2020 by upgrading its own data centres.[2] Within Ant Group, aggressive deployment of green computing technologies at scale within its operations has saved the carbon equivalent of driving a gasoline-powered vehicle driving some 146 million kilometres.[3]

Our analysis also found that leading tech firms are increasingly adhering to more rigorous ESG-related standards and placing stringent demands on their suppliers worldwide. For example, Apple has called on its global supply chain to address their GHGs and actively evaluates its key manufacturing partners on their climate impacts and reduction targets in support of Apple's overall decarbonisation goals.

Some tech players have also chosen to take a leading role within the industry and broader Chinese business community in order to achieve a shared goal of addressing climate change. In 2022, the e-commerce group Alibaba vowed to eliminate 1.5 gigatonnes of CO2 emissions across its entire business ecosystem by 2035, announcing Scope 3 GHG (value chain) targets and promising to leverage digital platforms to influence and advocate for a low-carbon approach across the Group.

Separately, the Green Energy Initiative led by Ant Group in its 'Ant Forest' is open to brands that wish to incentivise their customers to go green. Ant Forest is an enormously successful tree planting initiative launched in 2016, which has supported ecological conservation and ecosystem restoration. Since then, the campaign has engaged over 650 million Chinese users (150 million in 2021 alone) in 'gamified, participatory pro-environmental communication.' The concept is simple: consumers collect 'green energy points' on Alipay, the world's top mobile payment platform, when they opt for low-carbon lifestyle choices such as renting shared bikes and using mass transit instead of driving to the office. By collecting a certain amount of points, the user can ask Ant Forest to plant a real tree in his or her name, the location of which users can view via satellite.

2. Baidu 2021 ESG Report: Page 6, Promoting Green Ideas

3. Ant Group 2021 ESG report: Page 31, Measures to facilitate less carbon emission across Ant Group's value chain, Green and low-carbon development

Chinese tech participants have also increasingly seen the importance of using their collective voices to call for positive change in other areas of sustainability, including the need to address biodiversity and nature loss. Tencent and JD.com have, for example, joined more than 1,000 companies worldwide to support the 'Nature Is Everyone's Business' call to action, urging international governments to adopt policies to reverse nature loss in this decade.

Communicating the value of ESG; Governance remains an issue, diversity & inclusion need greater focus

Our research finds that, despite significant progress, challenges remain within the Chinese tech sector on key aspects of ESG. Greater transparency is still required, particularly around the need for more effective communications around how ESG creates value and supports business strategies, as well as greater integration of ESG aspects within the business itself. Greater focus is also needed around stakeholder engagement and outreach. Our analysis of key players' carbon reduction plans showed very few details on how they will achieve carbon neutrality. They are lax in their explanations of how year-on-year reductions will be achieved as part of an effective and transparent climate roadmap. The notable exceptions to this are Baidu, Ant, Alibaba and Tencent.

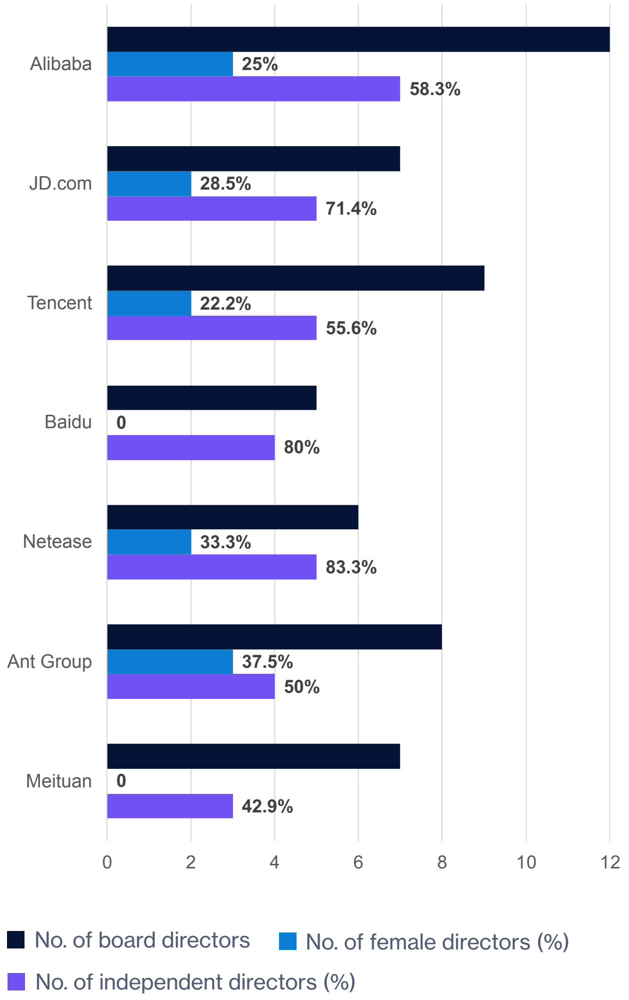
While the Hong Kong Stock Exchange has been highlighting and advocating for the importance of strengthened corporate governance for many years, we do see encouraging signs that Chinese mainland companies in the tech space are making progress in the G domain. Independent Non-Executive Directors (INEDs) have become a feature of leading tech company boards, including Baidu, Tencent, JD.com, Alibaba and NetEase (Table 3). Ant Group is now a member of this growing club, recently announcing its plan to bring in a fifth INED, which would increase its board members to nine people in total.[4] The company has also announced that founder Jack Ma will reduce his voting power, further enhancing the transparency and effectiveness of corporate governance within Ant and enabling them to have greater independence from its main shareholder, the Alibaba Group.

However, board diversity remains an issue among Chinese mainland companies in general. Gender diversity is weak, and female directors remain a minority. Unlike in Europe and North America, where board diversity has been driven by regulatory, political and market pressures, women in China still have low representation on corporate boards (only 11.8% of companies have 30% or more women on their boards according to MSCI).[5] Gender diversity is slightly better in the tech space; however, two out of the top seven tech companies still have no women on their boards (Table 3).

4. https://www.antgroup.com/en/notices/1

5. Women on Boards, 2021 Progress Report, MSCI

Table 3: CSR/ESG report publishing history among leading Chinese tech companies



In the future, we expect to see a greater focus on diversity of background, with a specific focus on directors with expertise in specific, required areas such as climate change, data security and other material issues on companies' risk registers. In this regard, the Chinese mainland can look to the Hong Kong Stock Exchange for inspiration, where ESG factors are becoming increasingly core for listed businesses.

Despite the challenges and recent regulatory pressures, we see significant long-term growth opportunities in this all-important sector in China. Continued investment in technology to support environmental objectives will be critical in enabling the government to achieve its carbon neutrality targets. The tech sector has the opportunity to assume a leading role in this space and can potentially become a beacon for ESG in the Chinese mainland. There is still a considerable way to go, but the sector is aware of the challenges and opportunities and is well-placed to lead the way towards a new era of greener, more socially responsible business practices.

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