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ARE MALAYSIAN COMPANIES RAISING THE BAR ON ESG?

THE GOOD NEWS IS THAT SOME MALAYSIAN COMPANIES ARE UPPING THEIR GAME IN THE ESG SPACE. BUT BEST PRACTICES CONTINUE TO EVOLVE, SO THEY WILL HAVE TO KEEP UP THE PACE.

BY TAN ZHAI YUN

While much attention has been focused on Malaysian companies that fail to comply with ESG requirements, it would not be fair to paint all companies with the same brush.

Malaysian companies have come a long way in terms of ESG adoption. For instance, the FTSE4Good Bursa Malaysia (F4GBM) Index was launched in December 2014 with only 24 constituents. In June 2022, it had grown to 87 constituents. To qualify for the index, companies need to meet the ESG standards set by FTSE Russell.

Additionally, in terms of the content and disclosure of sustainability reporting, Malaysia is only ranked behind Singapore in the region, based on an analysis by the Asean CSR Network and NUS Business School in December 2020.

Of course, some would argue that there is still a long way to go, especially for small and medium enterprises (SMEs) that lack awareness and resources to adopt ESG practices. Investors and consumers also have to do their homework to ascertain whether the ESG claims made by companies are just greenwashing.

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KOK

Regardless, it is worthwhile to note the best practices of Malaysian companies that are raising the bar on ESG in their respective industries. Some are going beyond what is expected of them and investing in resources that they believe are needed for the future, even though the immediate returns are not obvious.

"I think the enlightened companies are those who have got themselves on the F4GBM Index. They're probably the ones seeing the benefits now. A lot of the companies that get on the index do so because of the quality of their [sustainability] reports. FTSE reviews their reporting and tells them how they can improve," says Phang Oy Cheng, head of sustainability advisory services at KPMG in Malaysia.

She believes companies on the F4GBM Index have seen improvements in reputation, brand protection, share price maintenance and trust. "If you get on a sustainability index, you build trust with your shareholders, investors, local community and other stakeholders. It is not easy to get on and it's not easy to stay on."

Arina Kok, partner in the climate change and sustainability services practice at Ernst & Young Consulting Sdn Bhd, shares a similar view. She notes that companies engaged in ESG-related projects are gaining positive outcomes.

"One is renewable energy projects. Then there is urban farming, which addresses food security. The third is digitalisation or the potential outcomes of 5G. These are critical projects [driven by] economics but will also drive efficiency and [promote] the circular economy agenda," says Kok.

WHAT ARE THE BEST PRACTICES?

The companies raising the bar on ESG are those that have a clear climate strategy based on good quality data, Phang opines. "Without good data, you cannot set up a climate strategy and targets. And you definitely cannot explore options for a technology or process shift," she adds.

This is an important point since access to data — whether it is on emissions or waste — is often cited as a challenge by companies embarking on their sustainability journey.

Some companies in Malaysia have calculated their Scope One, Two and Three emissions, the last of which is usually the biggest component and most difficult to manage, since it looks at emissions from the supply chain.

On a similar note, Kok observes that the best companies have set near-, mid- and long-term goals for ESG and report on this performance over time. Companies must be transparent about their actions because transitioning to a low-carbon economy requires a change in their business model.

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Even if a company reports a variety of data, how does one verify its authenticity? This is where David Ng, deputy managing director and chief investment officer at Affin Hwang Asset Management Bhd, highlights the best practice of using independent external auditors to look into the accuracy of such disclosures.

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NG

"In the manufacturing industry, for instance, we have seen companies opening their facilities to consultants and auditors that specialise in environmental and social audits. The importance of such audits and certification is also notable in the palm oil sector, where continued access to premium export markets is an important incentive to adhere to stricter ESG practices," he says.

Another tell-tale sign of a company doing well in ESG is a strong governance structure, where the board members understand that managing ESG is part of their fiduciary duty.

"We have companies that are cascading ESG responsibilities throughout the organisation. [This means] not just having a sustainability department but making sure that it is embedded in everyone's role and responsibilities. Then

they have a performance evaluation at the end. I would say that companies working on this are at the higher end of ESG management in Malaysia," says Phang.

It is a common saying that without good governance, environmental and social policies cannot be implemented well. In Ng's view, a forward-looking management team and a company with strong financial ability to execute strategies are hallmarks of ESG leaders.

He believes that these companies can set ESG commitments that are complementary to their existing core business operations without disrupting business-as-usual practices.

"For companies that are able to 'raise the bar', they are able to price their products with a green premium or have seen their listed securities trade at relatively higher valuations. This is most evident in the solar panel or renewables sector," he adds.

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A *wayang kulit* or traditional shadow puppet performance after lights are turned off for Earth Hour in Kuala Lumpur

REUTERS

Phang says that the best companies in the social category are looking at human rights risks from a human capital perspective. They are not just looking at how the company impacts the community, but also how the community impacts the company.

"With that approach, you get a much broader view of what your risk is. There are companies where the risk and strategy departments are working together very closely. So, whatever strategy [is introduced in the future], it has been infused and integrated with ESG risk," she says.

For instance, the company will consider

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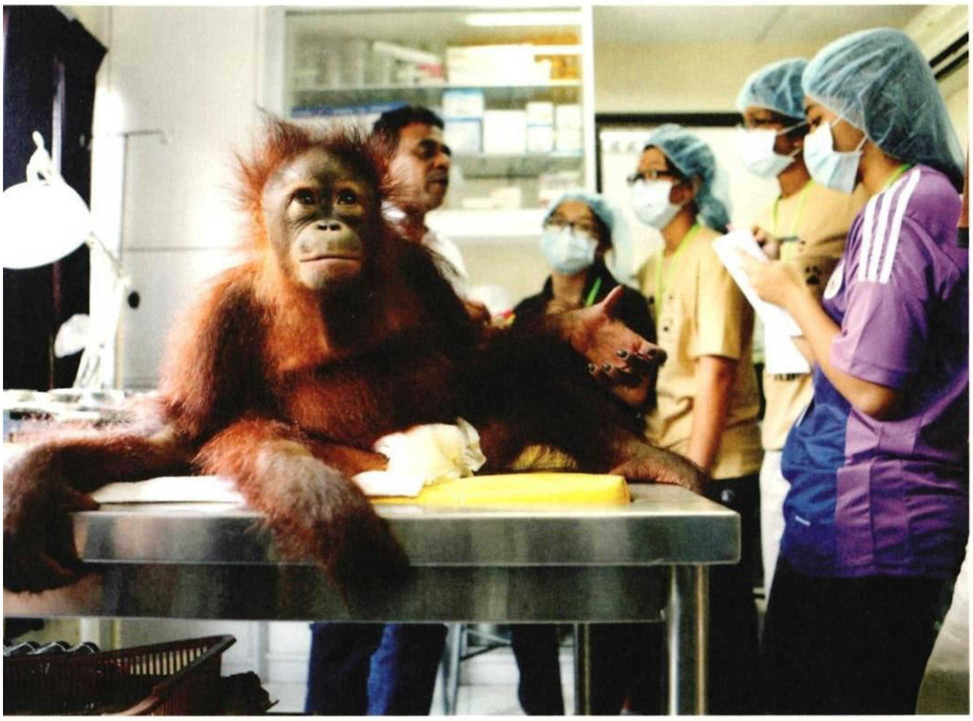

An orangutan named Hang Lipo is seen at a blood collection centre at the Bukit Merah Orang Utan Island Foundation in Perak

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climate change and human rights risks when making investment decisions.

A point to emphasise, however, is that ESG risks are ever evolving. It will be important for companies to adapt to the industry's best practices as these change over time.

"The palm oil sector, for example, has been under scrutiny for many years before ESG became mainstream, primarily for its environmental risks. More established palm oil companies have committed to higher operating standards, such as no deforestation, no peat, no exploitation and the zero-burning policy," says Ng.

"As investors' focus shifts from environmental to social, plantation giants are pushed to better manage their labour and stakeholder relations."

A LONG WAY TO GO

Alongside the surveys and reports that highlight Malaysia's progress in adopting ESG are numbers that indicate much more needs to be done. For instance, a recent report by the UN Global Compact (UNGC) Network Malaysia & Brunei highlighted that 45% of the Malaysian companies it surveyed had not allocated any budget for their sustainability initiatives.

Most Malaysian companies are now driven to do well in ESG due to push rather than pull factors, Phang acknowledges. This includes pressure from regulators, customers and investors.

"If you cannot relate how ESG impacts your corporate value and client requirements, you will hit a wall sooner or later. Three-quarters of clients come to us because there is a push in some way," she says.

Companies have to look for consultants who are credible and have experience, which can be a challenge as there is a shortage of ESG practitioners globally. "My best advice is to go to Bursa [for advice] if you are a public-listed company. If you're an SME, go to SME Corporation Malaysia, because it is working with UNGC to develop a programme for SMEs," says Phang.

To produce more high-quality sustainability reports, companies must not self-censor when it comes to providing data. "Historically, boards were very sensitive about what data they put in [reports]," she notes. "But if your competitors are reporting [on such data] and you're not, does it mean you have something to hide? Who gains better value in terms of shareholder trust and investor interest if you don't report?"

Ultimately, for the ESG journey to be self-sustaining, the push should come from individuals and corporates, says Ng. "Despite having the regulatory framework and incentives to spur the ESG movement, having a collective mindset change in wanting to do better is much more important. Perspectives need to shift from 'why' to 'why not' in helping solve some of the most existential challenges in sustainability today."

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If sustainability goes beyond just a "box-ticking exercise" and corporates start internalising ESG principles in their process, "it snowballs into a meaningful movement that can have a positive impact on all stakeholders", says Ng.