Asia Business Council

NIKKEI Asia

BLAVATNIK SCHOOL OF GOVERNMENT

UNIVERSITY OF OXFORD

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Private Money for the Public Good – Unlocking Private Equity for Asia's Sustainable Finance

Economy, Trade, and Finance

Foreword and Acknowledgements

2020 was a year like no other as the pandemic changed many aspects of our lives. In a sense, that made early 2021 an ideal time to ask the question: how would you address some of the biggest challenges in Asia in the coming decade? In January 2021, the Asia Business Council joined hands with Nikkei Asia and the Blavatnik School of Government at the University of Oxford to launch the Asia's Challenge 2030 Global Essay Competition, open to students aged 18-22 anywhere in the world.

Given the many obstacles facing young people pursuing their studies during a global pandemic, we did not know how many essays we would receive. Yet we were impressed by thoughtful submissions from universities across Asia and as far afield as California and London. We pored over essays on topics ranging from artificial intelligence and aquaculture to smart cities and virus sequencing and learned a lot in the process.

The essays reflect a generation that is asking hard questions about the challenges facing Asian societies and optimistic about the prospects for creating a better world through new modes of doing business and innovative approaches to policymaking.

Young people from Asia are increasingly globally aware. They want policymakers to adopt international best practices in public health and environmental protection, especially in areas like sustainable finance and mental health awareness. But they reject the uncritical adoption of Western models, from urban design to economic development. Many call for a celebration of their unique national and regional identities, whether through locally inspired architectural designs or the increased representation of indigenous perspectives.

Participants in the Economy, Trade, and Finance category want to improve existing economic models so that a balance is struck between economic growth and a fairer, more sustainable, and more stable world.

In the Public Health and the Natural Environment category, respondents called for holistic approaches to health. Concerns about mental wellness reflect the pressures brought about by increasingly competitive academic and professional environments, while essays about communications and interpersonal relationships demonstrate the desire for a more intentional focus on modeling healthy relationships. Still other submissions addressed the existential crisis posed by climate change and the complicated web of interrelated challenges, from plastic waste to fossil fuel use. Proposed solutions range from changes in consumer behavior to an entirely new model of development.

In the Cities and Urban Development category, the essays we received reflected a desire for smarter, more walkable, climate resilient cities, and urban environments that reflect their unique local character. Whether as consumers, as employees, or as entrepreneurs themselves, this younger generation will demand that businesses and governments adopt sustainable practices and modes of operation that benefit their communities.

This global essay competition would not have been possible without the support of the former and current Chairmen of the Asia Business Council, Lim Boon Heng of Temasek and Daniel Tsai of Fubon Group. We are also indebted to Vice-chairman Tak Niinami of Suntory Group and Council Trustee Nazir Razak of Ikhlas Capital, who made key introductions to Nikkei Asia and the Blavatnik School.

Special thanks must also go to Shigasaburo Okumura and Daisuke Akazawa, Editor-in-chief and Chief Producer of Nikkei Asia, and Ngaire Woods and Luna Sidhu, Founding Dean and Director of Development of the Blavatnik School, for making this competition possible.

We would also like to thank our judges who generously volunteered their time and energy.

Economy, Trade, and Finance category:

- Nobuyoshi John Ehara, Co-founder, Unison Capital
- Emily Jones, Associate Professor, Blavatnik School of Government
- Katsuhiko Hara, Chief Desk Editor, Nikkei Asia

Public Health and the Natural Environment category:

- George Tahija, Principal, PT Austindo Nusantara Jaya Tbk
- Maya Tudor, Associate Professor, Blavatnik School of Government
- Futoshi Kuwamoto, Business & Market News Editor, Nikkei Asia

Cities and Urban Development category:

- Zhang Xin, Founder and CEO, SOHO China
- Sir Paul Collier, Professor, Blavatnik School of Government
- Shin Nakayama, News Editor, Nikkei Asia

Finally, we would like to acknowledge the assistance of Ashleigh Au of SOHO China Scholarships and Ruth Collier of Oxford University in publicizing the contest.

There is no doubt that this generation will be profoundly shaped by the experience of living through the world-altering events of 2020 during their formative years. But most essays took the longer view instead of focusing solely on the pandemic, looking ahead to the challenges of the next decade and beyond. Policymakers and business leaders around the world should take note of their ideas as this young generation comes of age and begins to lead local and international development in multiple fields.

Pauline Yeung
Program Director
Asia Business Council

Colleen Howe
Program Associate
Asia Business Council

Award-winning Essays

Economy, Trade, and Finance

Krati Gupta (India)
Rajiv Gandhi National University of Law
The Three Pillar Multi-Stakeholder Approach to Responsible Financing: Addressing Asia's Challenges in the "Decade of Action"

Chloris Jiaqi Kang (Singapore)
National University of Singapore
Private Money for the Public Good –
Unlocking Private Equity for Asia's Sustainable Finance

Henry Michael Mayhew (United Kingdom)
University College London
Asian Central Bank Mandates: What about Equality?

Public Health and the Natural Environment

Hanun Thalia (Indonesia)
Universitas Indonesia
KomU as a Strategy to Improve Family Communications

Yao Yuanchen (China)
Tokyo University of Foreign Studies
Meeting the Challenge of Plastic Waste Recycling in Japan and China

Suzu Yokoyama (Japan)
Tsuda University
Tackling Unrealistic Beauty Standards in Japan and South Korea

Cities and Urban Development

Matthew Flores (Philippines)
Ateneo de Manila University
Indigenous Cities: Reframing Modernity and Our Cities

Rya Jetha (United States)
Pomona College
Reinventing the Asian Megacity: Absorbing Climate Change with Sponge Design

Ranita Ma Tsz Yu (Hong Kong SAR)
Chinese University of Hong Kong
From a City-scale Beauty Pageant to a Continent-wide Diversified Gallery

Ashley Faith Santoso (Indonesia)
Atma Jaya Catholic University of Indonesia
The Neglected Effects of Gender-based Violence towards Jakarta's Urban Walkability

Chloris Jiaqi Kang (Singapore)
National University of Singapore

Private Money for the Public Good – Unlocking Private Equity for Asia's Sustainable Finance

Sustainable Finance and the Role of PE

"Capital markets are one of the most powerful tools we have in the fight against climate change – and one of the most overlooked," Michael Bloomberg has said, shedding light on the importance of mobilizing private capital to facilitate sustainable development. His opinion is unprecedentedly relevant now amidst the widespread devastation of global supply chains and exacerbation of existing social problems such as income inequality, as a result of the COVID-19 pandemic. 71 million more people will be pushed into extreme poverty in 2020, according to the United Nations. Moreover, the events of last year have demonstrated the resilience of businesses with high Environmental, Social and Corporate Governance (ESG) credentials, as evident from the fact that The ESG Focus Index outperformed the MSCI ACWI Index by 93 basis points per year.

Figure 1: Total Assets Under Management (AUM) of dedicated impact PE/VC funds

Globally, realising the tangible benefits of sustainable investments in the aspects of reducing costs, increasing operational efficiency, and mitigating risks, more private capital is pouring into sustainable funds (Figure 1). Private equity (PE)-focused investors planned to double their capital raised in 2020 as compared to 2019 levels, higher than the planned increase among private debt-focused investors. According to a 2019 survey by UBS of over 600 asset owners in 46 countries, 78% of Limited Partners (LPs) are already integrating ESG principles into their investment processes. This high level of demand from LPs is now pushing General Partners (GPs) to respond with their own ESG initiatives.

Amongst various asset classes, PE funds, with their unique combination of risk capital and expertise in improving portfolio companies' operations, are exceptionally well-positioned to using equity and quasi-equity to grow the best sustainable business models, thus driving sustainable finance to greater heights. Amidst the rising momentum of sustainable investing, LPs encounter greater demands from regulators, investors, and civil society to accelerate sustainability, due to their close contact with GPs, who are directly in charge of managing funds and monitoring portfolio companies' performance. It is therefore crucial to ensure that fund managers adopt a "long-termism" for portfolio management and are able to identify promising firms that generate both competitive financial returns and responsible outcomes.

Asia's Role in Responsible Investment and Its Current Development

Asia, amongst other regions, plays a pivotal role in driving global sustainable development due to its abundant investment opportunities and pressing sustainability issues. To achieve global sustainability, Asia needs approximately US$66 trillion to limit temperature rise to 1.5° C - over half the investment required globally. The region also presents the world's largest investment opportunity of US$10 trillion in contributing to three of the most tangible infrastructure sustainable development goals (SDGs). Just Southeast Asia's green economy alone could provide up to US$1 trillion in annual economic opportunities by 2030.

Encouragingly, more governments are joining traditional trendsetters, such as Japan and South Korea, in the sustainability drive. China notably pledged to achieve carbon neutrality before 2060. In the private sector, there was a 15% increase between 2018 and 2019 in Asian fund managers who have signed up to the Principles of Responsible Investment (PRI).

Despite immense efforts from different stakeholders, all countries, including those in ASEAN, are falling short of the progress needed to achieve the SDG targets by 2030. Moreover, Asian investors are more reluctant to invest in sustainable funds as ESG investing in East Asia trails other regions with just 5% of AUM invested in green funds, compared to 30% in North America. Such reluctance stifles capital flows to PE funds that could potentially generate positive societal outcomes.

Therefore, this essay aims to unpack the key challenges faced by Asia's PE funds in integrating ESG considerations and to propose three strategies that could help GPs manage ESG issues across their portfolios, consequently enhancing investment value.

Key Challenges

Non-Standardized ESG Disclosure Undermines Impacts Measurement

While there is a global consensus for PE funds to align their investment strategies to the UN's SDGs, "sustainability" as a term is extremely broad—comprising 17 goals, 169 targets, and 232 indicators (Figure 2), and a globally-binding taxonomy is yet to be established. Some of the SDGs are by nature more quantifiable (eg. affordable and clean energy), while others are less quantifiable (eg. gender equality).

Figure 2: United Nations' Sustainable Development Goals 2030

The lack of a globally-recognized ESG disclosure framework not only leads to the fragmentation of impact measurement, it also disincentivizes investments into promising companies. To date, there are various ESG frameworks drafted by different organizations, with the main ones being the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and the Taskforce for Climate-related Financial Disclosures (TCFD), all of which have different guidelines. Most of them simply present a list of requirements for PE funds to adhere to, which are none other than a "tick-the-box" exercise. For instance, while GRI outlines ESG reporting standards, these guidelines focus mainly on inputs, rather than the actual outcomes of those policies and practices.

In reality, many industry-led initiatives rely on firms' self-reporting and inevitably, some firms turn to "green-washing" by using "sustainable language'' for PR purposes. Tarioq Fancy, the former chief investment officer of Sustainable Investing at BlackRock, pointed out that existing funds are often cynically rebranded as "green" — with no discernible change to the fund's underlying strategies. In other cases, ESG products comprise companies such as petroleum majors and other large polluters like "fast fashion" manufacturing to boost the fund's returns. This diverts capital away from truly sustainable funds.

Inconsistent Integration of ESG Considerations Across the Fund Lifecycle

PE funds in Asia integrate ESG principles to varying degrees—some have extremely detailed guidelines in place while others have none. In addition, 56% of LPs believed that GPs' focus on ESG was inconsistent across the entire fund lifecycle, with ESG considerations appearing important during the due diligence stage to mitigate risks but tapering off during the post-investment and value creation period.

Among most funds, only a few followed up on portfolio companies' ESG metrics and used this data to inform decisions during portfolio management. Consequently, this undermines the creation of returns for funds as ESG incorporation not only mitigates risk, it also adds value to investments as well. For instance, having high ESG credentials provides funds' portfolio companies with a value uplift by boosting sales, provided they can prove that they source their raw materials sustainably.

Data Challenges Skewed Investment Decisions

While data science technologies enable fund managers to filter out material ESG metrics from distracting ones, problems of data scarcity, inconsistency, and poor validity are prevalent. As Asia is still a developing region, most countries do not have scientific and real-time data available, leading to a lack of valid data. Moreover, some data are by nature harder to measure, especially the "social" metrics. For instance, while diversity data are material for fund managers to identify promising companies, they are usually collected from employee surveys that collect subjective responses. Such data are considered "qualitative data'' and have major validity issues.

Data inconsistency is another major challenge in developing Asia. A large proportion of sustainable data exists in inconsistent forms, including figures found in research reports which are not raw datasets, and data sources obtained from regulatory disclosure requirements, thereby limiting the application of data analysis methods to derive meaning from them. For instance, within mainland China alone, its 34 provincial-level regions report data in different formats—some in pdf, Word or even an image. Such data requires the extensive deployment of technology like image recognition so as to extract the data. Given the complex landscape of sustainable data, it is extremely challenging for fund managers to interpret it.

From Investing in Values to Driving Value

Standardizing ESG Reporting Frameworks

Financial reporting standards must be aligned to each SDG. I propose a set of globally-binding "International Sustainability Reporting Standards (ISRS)", which would serve as the sustainability reporting equivalent of the IFRS, to facilitate due diligence on ESG factors. The basis of this framework should be scientifically driven, quantifiable, and capable of demonstrating to investors that the companies' inputs to sustainability are indeed yielding meaningful impacts. Since there are already multiple reporting frameworks in place, such as the SASB, the ISRS does not have to be drafted from ground up, rather, it can be done through reviewing and consolidating existing frameworks.

Simply put, we cannot expect firms to voluntarily report or self-regulate their sustainability impacts, and thus there needs to be a legally-binding framework that is calibrated to financial materiality and sustainability outcomes, as investors want concrete data on how their contributions to funds are yielding fruitful impacts. In terms of taxonomy building, some progress has been made on a regional scale as finance ministers from ASEAN announced their support for an ASEAN Taxonomy of Sustainable Finance on 30 March this year. Like the EU's taxonomy, it will serve as ASEAN's common language for sustainable finance and account for both international goals and ASEAN's specific needs.

ESG Integration through Subscription Credit Facility

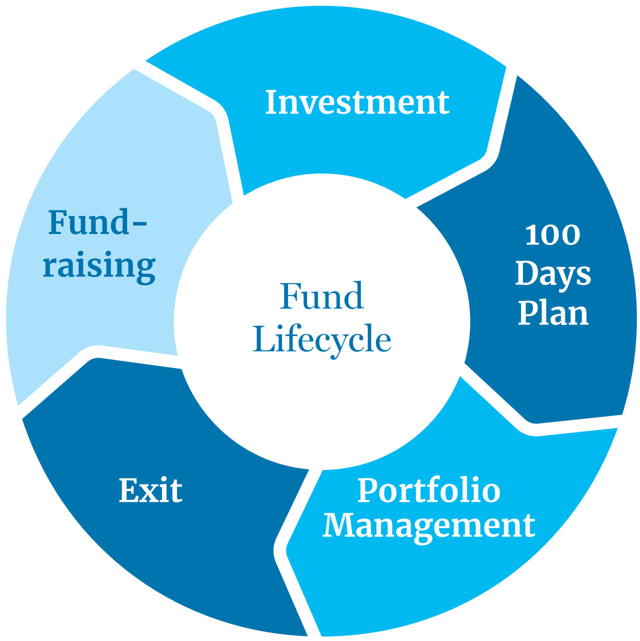

Figure 3: Integrating ESG considerations into every stage of funds' life cycle

Sustainability considerations can be embedded into every phase of funds' lifecycle as follows (Figure 3):

- Due Diligence: Perform positive and negative screening on companies based on ESG metrics and alongside financial criteria.

- 100 Day Plan: Identify key priorities related to ESG integration during the initial investment period, such as building up clear reporting guidelines within portfolio companies.

- Portfolio Management: Establish clear metrics to measure ESG impacts so the fund can monitor financial and sustainable outcomes simultaneously.

- Exit: Possible multiple enhancement due to the improved ESG profile leading to reduced risk and enhanced returns.

- Fundraising: Attractive returns on assets due to positive ESG impact will improve the reputation of the GP, allowing for more successful fundraising.

Furthermore, innovative financial instruments such as a sustainability-linked Subscription Credit Facility (SCF) can be introduced to future-proof companies and allow GPs to integrate ESG throughout all aspects of funds' operations. One leading example would be the largest ever ESG-linked SCF launched in June 2020 by EQT Group. The SCF adopts an innovative pricing model designed to incentivize portfolio companies to improve their performance in the areas of gender equality, renewable energy transition, and corporate governance. The aggregated results from the portfolio companies' ESG efforts will be compared with pre-set KPI targets and eventually impact the SCF's interest rate. Essentially, the more ESG achievement the portfolio companies demonstrate, the better the financing terms the fund will receive.

Digitizing an Open Cloud-Database

Data quality and availability are keys to developing the sustainable investment industry. As such, a cloud database where portfolio managers disclose data associated with sustainable deals can be developed by leveraging big data, artificial intelligence (AI), satellite sensor technologies and advanced analytics.

In particular, the dataset should be free-of-charge and open to all—both technically (i.e., available in a machine-readable standard format so that it can be meaningfully processed by a computer application) and legally (i.e., explicitly licensed in a way that permits commercial and non-commercial use without restrictions). This enhances data transparency and allows investors and fund managers to track the impacts of investments.

Moreover, deploying robust data science helps bridge the communication gap between financial professionals and environmentalists. As these two professions often look at different metrics, with each party focusing more on their field of expertise, it is vital for them to achieve consensus so that asset managers can better monitor their funds.

Conclusion: Profits with Purpose

In the face of global challenges, sustainable PE funds will continue to serve as a new frontier of capitalism that devotes private money to the public good. Overall, for all the three proposed strategies to work, there is a need for regional advocacy in Asia given its varied economies and diverse ESG issues. For GPs, the emerging trend toward the integration of sustainable practices presents both challenges and opportunities. As the ESG movement grows, it is becoming more apparent that, with a little creativity, there are innovative ways for GPs to address LPs' expectations regarding ESG issues.

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