



## Asia Lens on Global ESG

For those who are aiming to include Environmental, Social and Governance (ESG) factors in their investing decisions, Asia represents one of the best opportunities to gain exposure to companies that could make a long-term difference. Many global ESG issues cannot be addressed effectively unless they are first addressed and solved in Asia.

Businesses sometimes can create the illusion they are building shareholder value when, in fact, they are doing the opposite over the long term. Take, for example, a manufacturing business that cuts costs and boosts short-term profits by releasing untreated sewage into a river. This may lift the company's short-term cash flows, but it threatens its financial prospects longer term. The company could face regulatory sanctions, legal action and negative publicity that might thwart its business and, ultimately, drag down its valuation over time.

A focus solely on short-term profits may cause observers to draw misleading conclusions about a company's prospects. An accurate assessment of a firm needs to include the environmental and social impact of its business practices on all stakeholders—not only shareholders, but employees, customers and the communities in which it operates, as well as supply chain partners, industry associations and regulators.

This is what incorporation of ESG factors into investment analysis seeks to achieve. Businesses that meet ESG standards generally conduct their business in ways that have a minimal impact on the environment, and that promote positive social and economic advancement. ESG is part of a larger focus on the creation of long-term shareholder value. Companies

that act responsibly may be better able to identify and execute on growth opportunities over a longer time horizon. Of equal importance is the ability to better identify and manage risks, potentially resulting in improved risk-adjusted outcomes for shareholders.



### Managing the Environmental Consequences of Growth

On the back of impressive global growth over the past several decades, the World Bank reports that the East Asia and Pacific region accounted for 30% of global GDP in 2016.<sup>1</sup> Similarly, Asia Pacific accounted for 31% of stock market capitalization in 2017,<sup>2</sup> according to Bloomberg data. Asia's growth has lifted



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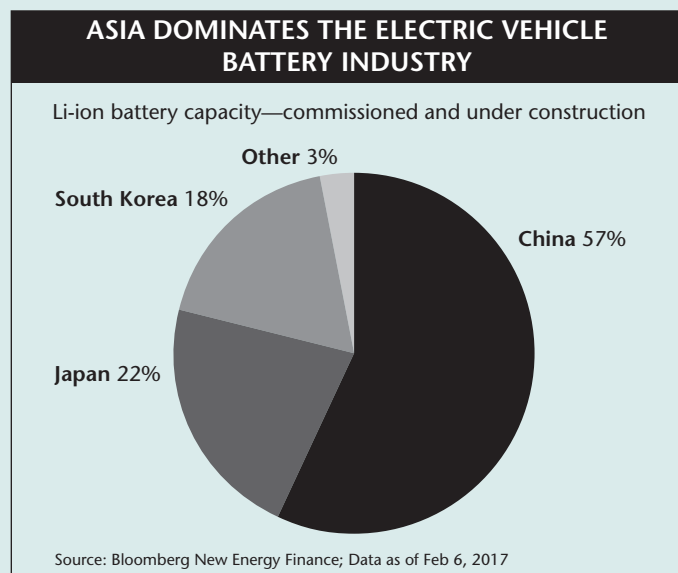
hundreds of millions of people out of poverty and created a large and vibrant middle class. An economic model that prioritized growth without regard to consequences, however, has led to a rapidly deteriorating environment. Asia has accounted for 85% of the increase in global carbon emissions over a 25-year period to 2015.<sup>3</sup>

China is the world’s second-largest economy and, since 2006, the largest CO<sub>2</sub> emitter.<sup>4</sup> 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. If China, with its much larger economy, were to do the same over the coming decades without addressing the environmental impact of growth, it would likely push the world’s atmospheric concentration of CO<sub>2</sub> over 450 parts per million (ppm)—a critical threshold at which scientists say global warming may be irreversible.

For China and Asia, climate change is not an abstract concern. There are real costs. Much of the CO<sub>2</sub> emitted has resulted from burning coal for energy, which also emits harmful particulate matter. It is not a surprise that the vast majority of the seven million global deaths annually due to air pollution occur in Asia.

These issues present an enormous challenge. They also present potentially big investment opportunities. Governments, regulators and private-sector companies are gearing up to tackle these critical issues by investing in such things as urban transit systems and infrastructure, energy efficiency and pollution-alleviation technologies. Asian countries are among the world’s leading participants in alternative and renewable energy development, including solar, wind and hydroelectric power.

China’s attitude and behavior toward environmental issues appear to be changing. In 2015, coal generated less than 70% of China’s electricity, down 10 percentage points from 2011, and China’s CO<sub>2</sub> emissions dropped for the first time in 15 years.<sup>5</sup> Meanwhile, low-carbon sources of energy such as hydroelectric and wind climbed to 28% of power production.<sup>6</sup>



In addition to the climate change and air pollution challenges, half of Asian households do not have access to safe, piped water. An estimated 3.4 billion people could be living in water-stressed areas of Asia by 2050, according to the Asian Development Bank’s 2016 Water Development Outlook. The report calls for investments in water infrastructure and institutions in the region’s developing countries. A large investment opportunity exists as countries shift from an economic model that did not care about consequences to one that does.

### Quality of Life

For Asia’s newly minted middle classes, economic growth has met basic needs, allowing them to turn to quality of life issues. Governments and regulators, meanwhile, increasingly are serious about enforcement of fair-market practices and environmental standards. This creates enormous opportunities for forward-thinking companies that can provide goods and services that improve quality of life while addressing social, economic and environmental challenges.

Asia ESG investing offers the biggest opportunity to make a global impact simply because of the sheer number of lives affected. South Asia has over 1.5 billion people who spend less than US\$100 per year on health

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care on average.<sup>7</sup> Given their lack of spending power, providing access to affordable health care is a critical social issue. South Asia has millions of people with Hepatitis C, for instance, but few, if any, have been able to afford Gilead Sciences’ highly effective drug Sovaldi. The drug was priced at US\$1,000 per pill in the U.S. and the treatment lasts 12 weeks, adding up to US\$84,000. To make this drug available to people across the developing world, Gilead licensed it to several generic drug manufacturers that make the 12-week treatment available for well under US\$1,000. With its high quality, globally competitive pharmaceutical and biotech businesses that have low cost structures, Asia has begun to address the problem of affordable access profitably.

Access to finance is another area in which Asia presents both challenges and opportunities. Hundreds of millions of people are without bank accounts or access to credit in Asia. In parts of South and Southeast Asia, access to credit is abysmally low. Credit, even in small amounts, can often make the difference between families becoming mired in poverty with no prospects or having a sustainable livelihood that will enable them to educate their children—whether that is operating a bike repair shop in Jakarta or a fresh vegetable cart at a wet market in Manila. This represents a genuine investment opportunity in Asia, as microfinancing and group-based lending models have sprung up throughout the region.

### **Gender Equality: Miles to Go**

Asia also is ripe for addressing gender diversity in the workforce, particularly in management and on corporate boards. The unequal representation of women in high places is often a reflection of underlying social and cultural mores. Some Asian countries have skewed demographic gender ratios, as families traditionally favored male children over female children. This has led to inequality that persists through school, university degrees and job markets.

Female representation on corporate boards appears to be improving, albeit at widely varying rates across Asia. South Korea noticeably lags behind, while Thailand is a surprising standout—almost on a par with the United States. In

Japan, where the government is making concerted efforts to improve corporate governance standards, progress is being made but more needs to be done.

### **Where Does Asia ESG Fit?**

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, it simply makes sense to tackle these issues in Asia. The region presents an exciting and meaningful opportunity to make an impact by virtue of being the most populous in the world, with a mix of dynamic developed, emerging and frontier countries and widely diverse growth drivers. Asia is contending with some of the most challenging ESG issues but also is producing companies that are providing effective and often innovative solutions. With an inherently long-term horizon as well as a focus on companies with a strong propensity to recognize and mitigate risks, investing in Asia from an ESG perspective has the potential to help generate solid risk-adjusted returns over time.

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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.

1 World Development Indicators database, World Bank, April 17, 2017

2 Nominal Market Capitalization, Bloomberg, October 13, 2017

3 Trends in Global CO2 Emissions: 2016 Report, PBL Netherlands Environmental Assessment Agency and European Commission Joint Research Centre; November 2016

4 Annual emissions data: World Bank (1960–2010), EU EDGAR (2012), Matthews Asia, World Development Indicators, Earth Policy Institute, 350.org

5 Global Carbon Budget 2016, Earth System Science Data, 2016

6 Decoupling of Global Emissions and Economic Growth Confirmed, International Energy Agency, March 16, 2016

7 2016 Global Health Care Outlook: Regional & Country Perspectives, Deloitte, 2016



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