

# **Responsible Investment**

Understanding and Improving ESG Engagement with  
Chinese Investee Companies

**Kei Yau Sin**

Supervisors

Naoko Tojo

Torbjörn Brorson

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Tel: +46 – 46 222 02 00, Fax: +46 – 46 222 02 10, e-mail: [iiice@iiice.lu.se](mailto:iiice@iiice.lu.se).

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## **Abstract**

Responsible investment is a movement to integrate environmental, social and governance (ESG) considerations in institutional investors' investing activities. Despite the rapid growth of responsible investment in worldwide markets including China, there exists a prominent knowledge gap in how investors or their professional engagement service providers engage with Chinese investee companies to monitor and improve the companies' ESG risk management and preparedness. In particular, little is known about how Chinese investees perceive ESG engagement. This thesis investigates how ESG engagement with Chinese investees is conducted, taking into account the investees' perspectives on ESG issues. It has been observed that how engagement activities contribute to the level of collective sense-making of ESG issues shared by engagement practitioners and Chinese investee companies is not as linear as literature has described. Moreover, Chinese investees in general display a relatively low awareness and limited understanding of ESG-related concepts, lack top-management support in addressing ESG matters strategically, are mostly motivated by client demand and regulations to address ESG issues, and are financially backed by the state or wealthy family shareholders. The thesis suggests an alternative model to conceptualise ESG engagement and the generated collective sense-making. The model encompasses engagement practitioners' underlying approach or aim of engagement, the alignment of engagement activities with the underlying aim, the consideration of the Chinese investees' characteristics during the engagement process, and lastly Chinese investee companies' proactiveness towards addressing ESG matters. Specific recommendations to engagement practitioners and other stakeholders to further improve ESG engagement are proposed, which will help increase the chance of successfully motivating Chinese investees to enhance their ESG performance and thus strengthen the overall business case for responsible investment.

**Keywords:** Responsible investment, ESG engagement, investor relations, Chinese investee companies





## **Executive Summary**

Responsible investment, a movement to integrate environmental, social and governance (ESG) considerations in institutional investors' investment decisions, has gained much attention from inter-governmental organisations such as the United Nations, worldwide financial industry and non-governmental organizations over the past decade. From 2007 to 2010, the number of US investment funds incorporating ESG factors showed an increase of 90% from 260 to 493, while the total net assets of such funds rose by 182% from USD 202 billion to USD 569 billion (SIFF, 2010). Meanwhile, the socially responsible investment market in Europe also expanded from EUR 2.7 trillion in 2007 to EUR 5 trillion in 2009 (Eurosif, 2010). With the launch of the first Chinese responsible investment fund in 2008, China also sees a steady growth in responsible investing activities.

Despite the fact that responsible investment has been growing steadily, there lacks a thorough understanding on how institutional investors or their professional engagement service providers conduct ESG engagement with Chinese investee companies. Engagement is one of the key processes for investors to monitor the investee companies' ESG risks and preparedness and motivate them to achieve higher ESG performance along the way. Relevant studies have mostly focused on the role of the institutional investor in driving engagement, presenting examples of successful or failing engagement from the perspective of investor and/or professional engagement firms. Perspectives of Chinese investee companies have not been much explored in the literature. Industry insiders have also expressed that professional engagement firms in general lack investee companies' feedback on ESG engagement. The lack of feedback is even more acute in emerging markets such as China because the differences between the investee and the engagement practitioners' operational and cultural environments further challenge effective communications.

This thesis investigates the missing informational feedback from the Chinese investee companies to engagement practitioners and addresses the knowledge gap on investees' perspectives in the current responsible investment literature. This research elucidates how Chinese investee companies perceive engagement activities, what drives and hinders them to attain higher ESG standards based on the engagement advice, and finally how engagement practitioners can further improve their work. The knowledge established through this research will help strengthen the overall business case for responsible investment.

As such, two research questions (RQs) with sub-questions have been developed:

*RQ1: How do engagement practitioners interact with Chinese investee companies?*

- What are the common practices in the Chinese context?
- Why do engagement practitioners opt for such practices?

*RQ2: How do Chinese investee companies perceive the engagement services they have received?*

- What are the common engagement services received?
- How do Chinese investee companies make sense of such services?
- How do Chinese investee companies decide what they should do regarding such services?

The thesis employs a combination of quantitative and qualitative data analysis. The former refers to two different sets of questionnaires for engagement practitioners identified based on desktop research and Chinese investee companies selected from the MSCI Emerging Markets

Index. Relevant questionnaire respondents were subsequently invited to semi-structured interviews to explore in depth their views on ESG engagement. To supplement the relatively low response rates of questionnaires by Chinese investee companies, additional academics and experts with China experience and Chinese branch offices of international companies were invited to provide their opinion on the topic. The author has also conducted participant observation through a one-month unpaid internship at a professional engagement service provider, GES Denmark, to observe and obtain hands-on experience on ESG engagement.

Two theoretical concepts stemming from stakeholder theories and organisation studies have been combined into a synthesised analytical framework to guide the design of the questionnaires and interviews, and the subsequent data analysis. The first one is a normative inter-organisational sense-making categorisation method proposed by Zarbafi (2011), who argued that investors should advocate their stance on ESG issues *and* inquire into the investees' perspectives to help both parties to make sense of corporate responsibility collectively. This would more likely generate positive changes in the investees' ESG performance. The second one is a descriptive research method suggested by Margolis and Walsh (2003) for examining how a company decides on social initiatives while balancing out the financial considerations. Their research agenda provided a template to develop questions to expose how Chinese investee companies make decisions regarding engagement and ESG issues in general.

Despite the fact that a very limited number of Chinese investee companies have responded to this research, the data collected has displayed some trends that were worth considering. The subsequent data analysis confirms the collective sense-making categorisation by Zarbafi (2011) that high-advocacy and high-inquiry activities classified as Shareholder Dialogue, such as face-to-face meetings, teleconferences and company or site visits, are the most desired by both of the engagement practitioners and Chinese investee companies. These activities can create a relatively higher level of collective sense-making of ESG issues. At the same time, the thesis shows that other factors may also affect the level of collective sense-making. The first observation is that investees' high level of proactiveness to addressing ESG issues may result in better collective sense-making, even when the initial engagement activity's levels of advocacy and inquiry are not that balanced. The second factor is concerned with whether the engagement practitioners' underlying approach to engagement and the means of engagement are aligned with an explicit aim to generate collective sense-making. An alignment is more likely to result in more desirable engagement outcomes.

With reference to Margolis and Walsh (2003)'s research approach on organisational decision-making, the thesis has found that Chinese investees in general have a relatively low awareness and limited understanding on ESG-related concepts and lack top-management support in addressing ESG matters strategically. Many are also backed financially by the state or wealthy family shareholders. The source of motivation to address ESG issues is primarily client demand and legal compliance. Understanding these characteristics shall help engagement practitioners execute engagement more effectively.

Based on the above findings and analysis, the thesis suggests an alternative model that describes the key elements to maximise the level of collective sense-making of ESG issues shared by the engagement practitioners and Chinese investees, which will increase the chance of successfully motivating the investee companies to improve their ESG performance. The model requires the engagement practitioner to adjust their engagement approach to include a clear aim of generating collective sense-making with Chinese investees, align its engagement activities with the underlying aim and mindfully consider the characteristics displayed by Chinese investees during the engagement process. If the Chinese investee company being

engaged is highly proactive towards ESG matters, a higher level of collective sense-making will be generated. As the thesis' findings can only reflect the views of limited number of Chinese investees surveyed and interviewed, more direct and quality feedback from Chinese investees is needed to produce more generalisable and conclusive results.

Specific recommendations for engagement practitioners and Chinese investee companies to enhance the level of collective sense-making of ESG issues are summarised below and more recommendations for policymakers and academics can be found in Chapter 6:

### ***Engagement Practitioners***

- Understand the importance of making sense of ESG issues collectively with Chinese investee companies; adopt an approach to engagement that aims to generate such collective sense-making;
- Align engagement tools and activities with the above mentioned approach to engagement;
- Prioritise resources to utilise Shareholder Dialogue as the primary engagement tool, for example face-to-face meetings, company or site visits and teleconference, to maximise collective sense-making with Chinese investee companies;
- Avoid using questionnaires as the primary tool to access and analyse investee companies' ESG information but rely more on publicly available data or well-established third-party databases (e.g. Carbon Disclosure Project); at the same time encourage Chinese investee companies to disclose their non-financial data;
- Join hands with other engagement practitioners to conduct collaborative engagement with Chinese investee companies, especially those with the state or families as the majority shareholder, in order to help them understand the ESG implications of their operations;
- Manage engagement as an ongoing process to build trust with Chinese investees and try to engage with the top management for both of negative *and* positive ESG development to avoid the possible misconception that engagement practitioners are only an 'ESG cop' without genuine interests in the investees, and;
- Raise awareness of Chinese investee companies, particularly the top and senior management, on ESG-related concepts focusing on how sound ESG management is a business case of its own that creates added values to the investees.

### ***Chinese Investee Companies***

- Disclose the company's sustainability information properly to reduce the likelihood for engagement practitioners to use specially-designed questionnaire or other inquiry tools to gather basic ESG data, so that both of the investees and engagement practitioners can allocate more of their time and resources on Shareholder Dialogue such as meetings that are more effective in producing a higher level of collective sense-making;
- Ensure the contact information posted on websites are functional and maintained by dedicated personnel properly to facilitate meaningful contacts with potential engagement practitioners, and;
- Be a learning organisation to continuously strive for a better understanding of responsible investment and ESG issues, which will give the Chinese investees an edge over others in an era when responsible investing activities are fast expanding.



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## Abbreviations

CSR	Corporate social responsibility
ESG	Environmental, social and governance
IR	Investor relations
MSCI EMI	MSCI Emerging Markets Index
UNEP FI	United National Environmental Programme Financial Initiative
UNPRI	United Nations backed Principles for Responsible Investment





# 1 Introduction

Responsible investment, a movement to integrate environmental, social, governance (ESG) values in institutional investors' investment decisions, has gained much attention from inter-governmental organisations such as the United Nations, worldwide financial industry and non-governmental organizations over the past decade (Welker & Wood, 2011). From 2007 to 2010, the number of US investment funds incorporating ESG issues showed an increase of 90% from 260 to 493, while the total net assets of such funds rose by 182% from USD 202 billion to USD 569 billion (SIFF, 2010). Meanwhile, the socially responsible investment market in Europe has also expanded from EUR 2.7 trillion in 2007 to EUR 5 trillion in 2009 (Eurosif, 2010).

The emergence of responsible investment corresponds with society's growing concern for corporate social responsibility and offers a new perspective for investors to go beyond their traditional fiduciary roles to become an active agent to influence the production of public good. Against this backdrop, a new type of industry, namely company engagement firms, emerged. Hired by institutional investors to "monitor corporate behaviour and seek changes through dialogue with (investee) companies or through the use of share ownership rights, such as filing shareholder resolutions", many of such engagement firms seek to drive the ESG performance of the investee companies (AICD, 2011).

In recent years responsible investment has started to penetrate into the so-called "emerging markets", a term first used by the International Financial Corporation in 1981 to describe the less developed countries that experienced rapid economic growth (IFC, 2013). These markets presented tremendous financial opportunities to both domestic and foreign investors. China has been one of foci among the emerging markets (EMDP & EIRIS, 2009). However, compared to other popular emerging markets such as Brazil, Russia and India, China's performance on various ESG indicators often lagged behind the others (BSR, 2009). In particular, governance, business ethics and corruption were the top concerns for most responsible investors (BSR, 2009; EMDP & EIRIS, 2009). Engagement with specific reference to the local context was deemed as one of the crucial ways to address these ESG issues (Sustainalytics, 2012a, 2012b).

While there is growing consensus on what responsible investment means in the international community, as shown in the UN backed Principles for Responsible Investment with 1155 signatories as of 31 January (to be further discussed in Chapter 2) (UNPRI, 2013b), there has been limited research on how companies being invested in perceive and react to ESG engagement, let alone studies focusing on the emerging market. This thesis investigates how engagement is conducted by engagement practitioners with Chinese investee companies, and in particular, explores the investees' perception of such activities and what drives them to adopt ESG advices or not. Such findings will help narrow the knowledge gap in responsible investment and shed light on how one can further improve engagement services, and thus strengthen the overall business case for responsible investment.

## 1.1 Problem definition & Research Aim

Based on an informal meeting with an engagement practitioner and preliminary literature review (ESP1, personal communications, 21 November, 2012; Waygood, 2006), the basic relationships between the responsible institutional investor, the engagement firm and the investee company within the environmental, social and political-economic contexts are presented in Figure 1-1. The solid black arrows are the money flows while the grey ones are

service flows. As a responsible shareholder of an investee company, the investor hires the engagement firm as a consultant to continuously monitor the investee company’s exposure to and preparedness for ESG risks. ‘Engagement Services 1’ refers to the engagement firm’s work report to its client, i.e. the investor, on the kind of ‘Engagement Services 2’ it has conducted with the investee company. Unlike the conventional relationship between a service provider and a client, in which the former receives a service order and a fee from the latter, the investee company has not explicitly requested services from and does not have any monetary relationships with the engagement firm in this case. The fact that the investee is the mere receiver of services makes it a “pseudo-client” to the engagement firm.

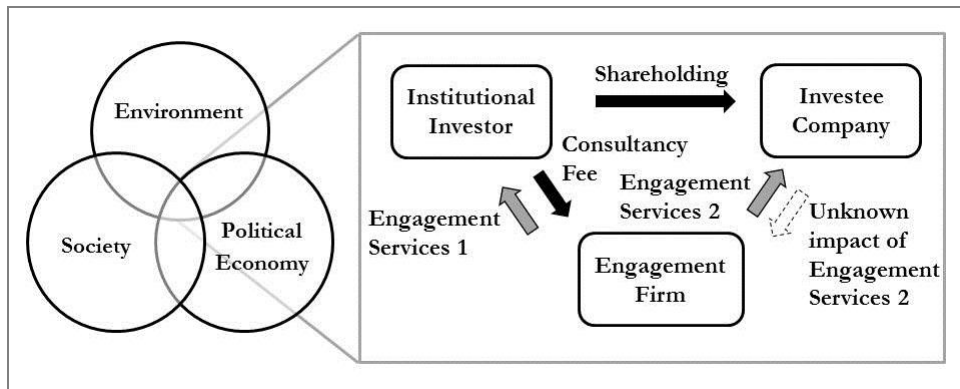


Figure 1-1 Responsible investment operating within the environmental, social and political-economic contexts

Having received engagement services that are not initiated by it but as a pseudo-client for free, the investee company does not normally have any motivation to provide feedback on the engagement firm’s quality of work. Such feedback is, however, commonly seen in a normal client relationship involving monetary exchange. For instance, if the quality of a certain product or service does not match with a client’s (the payer’s) expectation, it is likely that he or she will lodge a complaint against the product/service provider. This facilitates an informational flow back to the provider so that remedy and future improvements can be made accordingly. At the same time the engagement firm is not in the position to request feedback from the investee company either because its integrity and professionalism, as perceived by the institutional investor or the ‘real client’ who pays for the services, is built on its ability to provide engagement services based on objective research and analysis (ESP1, personal communications, 21 November, 2012). Neutrality and independence are thus of paramount importance to the engagement firm. The pseudo-client relationship between the investee and engagement firm therefore leads to a missing information flow (see black-dotted arrow in Figure 1-1) to inform the engagement practitioner its impact of work and hence making it very difficult to find out what may drive and hinder the investee to achieve better ESG standards. The lack of feedback is even more acute in emerging markets such as China because the differences between the investee and the engagement firm’s operational and cultural environments further challenge effective communications.

Although engagement continues to be seen as an essential tool to enhance investee companies’ ESG performance, existing literature by inter-governmental bodies and industry practitioners mostly focuses on the role of the institutional investor in driving engagement and presents examples of successful or failing engagement from the perspective of investor and/or engagement firms. Notable examples are Principles 2 and 3 from the United Nations backed Principles for Responsible Investment (see Appendix 1) and various case studies in numerous industry reports (BSR, 2009; DMEBA, 2011; Sustainalytics, 2012a, 2012b). Perspectives and views of investee companies are almost non-existent. As Zarbafi (2011) pointed out, investors

need to learn how to balance between advocating their own principles (e.g. ESG considerations) and inquiring into those held by the investees. It is through the processes of social interactions, communications and negotiations that one will have a better chance of generating a collective view on these issues together. By making sense of ESG matters collectively, it is more likely to induce favourable behavioural changes in the investees.

Therefore this thesis intends to explore the missing informational flow from the Chinese investee companies back to the engagement firms and address the knowledge gap on investees' perspectives in the current responsible investment literature. The end result of the thesis is a deeper understanding of how Chinese investee companies perceive engagement services; what drives and hinders them to attain better ESG standards based on the engagement advice; and finally how engagement firms can further improve their services in the long run. This shall help strengthen the overall business case for responsible investment.

## 1.2 Research question

With the aforementioned problem definition and research aim, two research questions (RQs) with sub-questions are developed:

*RQ1: How do engagement practitioners interact with Chinese investee companies?*

- What are the common practices in the Chinese context?
- Why do engagement practitioners opt for such practices?

*RQ2: How do Chinese investee companies perceive the engagement services they have received?*

- What are the common engagement services received?
- How do Chinese investee companies make sense of such services?
- How do Chinese investee companies decide what they should do regarding such services?

RQ1 aims to expose how engagement practitioners initiate and implement the engagement process. More importantly, it explores the reasons behind their current practices. RQ2 puts the limelight on the Chinese investee companies and investigate their perspective on experience with ESG engagement. It aims to provide data on the sense-making process of Chinese investee companies when receiving engagement services.

## 1.3 Method

The thesis employs a combination of quantitative and qualitative data analysis. The former refers to two different sets of questionnaires sent to engagement firms based on desktop research and 117 Chinese investee companies selected from the MSCI Emerging Markets Index (MSCI EMI). More detailed explanation on the scope of the selected companies is discussed under Section 1.4. The thesis originally intended to invite relevant engagement practitioners and Chinese investee companies who had filled out the questionnaires to a semi-structured interview to explore in depth their experience of engagement and how they made sense of it. Such qualitative data would supplement the overview of ESG engagement in the Chinese context collected in the questionnaires. However due to the extremely low questionnaire response rates by Chinese investees, the thesis adopted an alternative data collection plan to also invite academics and other industry experts to provide perspectives on the topic. Detailed discussion of the alternative plan can be found in Section 3.2. In addition a

one-month unpaid internship was also conducted at GES Denmark, an engagement firm headquartered in Sweden, to provide the author with hands-on experience in ESG engagement.

Two theoretical concepts stemming from stakeholder theories and organisation studies were combined into an analytical framework to guide the design of the questionnaires and interviews and the subsequent data analysis. The first one was a normative inter-organisational sense-making categorisation method proposed by Zarbafi (2011), which explored how different types of sense-making could be achieved collectively by the institutional investors and investee companies. Zarbafi argued that the collective sense-making was a key factor contributing to positive changes in the investees' ESG performance. The second one was a descriptive research method suggested by Margolis and Walsh (2003) to examine how a company decided on social initiatives while balancing out the financial considerations. Their research approach provided a template to develop questions to look into how Chinese investee companies made decisions regarding engagement and ESG issues in general. Both frameworks were combined into a synthesised one to guide the primary data collection and analysis, which will be discussed in detail in section 3.1.

Apart from the above primary data collection methods, secondary information sources were also employed. As responsible investment is a financial practice, it is no surprise that a lot of the literature on the topic is indeed produced by industry practitioners and governmental/intergovernmental bodies that try to promote it. While the level of academic rigor of such research reports may not be directly comparable to formal academic literature (e.g. papers in peer-reviewed journals), they do provide valuable information on how responsible investment is practiced from an insider perspective. The thesis has therefore used both academic and industry literature where deemed appropriate.

## 1.4 Limitation and scope

It was expected that the response rates of questionnaires and interviews would play a key role in determining the amount and quality of data collected for further analysis. As reflected by other field researchers, conducting surveys related to responsible investment or ESG issues with Chinese investee companies was particularly challenging as these concepts were relatively new to them and there were cultural differences on how survey should be done (BSR, 2009). The thesis has therefore taken the lessons learnt from previous research projects into consideration but was aware that low response rate was generally observed in China, and that the quality of the subsequent analysis would be limited by this factor.

In terms of scope, as mentioned in the Section 1.3, 117 Chinese investee companies in the MSCI EMI were included in the studies. These companies represented a total market capitalisation of USD 169 million (or EUR 132 million; as of February 2013) and respectable trading volumes. While sound financial performance was the primary consideration in responsible investment, as will be further explained in Chapter 2, it was hypothesised that companies with strong financial return would more likely to attract responsible investors and therefore receive some form of engagement services. Moreover, unlike some studies on responsible investment in China that focused on securities denominated in the Chinese currency of *renminbi* (or RMB) and listed in mainland China only (such as BSR, 2009), Chinese stocks listed in the Hong Kong Special Administrative Region (hereafter Hong Kong) were also included in this thesis because the Hong Kong Stock Exchange is a free market opened to international investors. Foreign investment in the Shanghai and Shenzhen Stock Exchanges are regulated and up to this date they represent only a small fraction of the total stock market (BSR, 2009). As responsible investment is a relatively new concept in China but is much more

popular among international investors such as those from Europe and North America (EMDP & EIRIS, 2009; Guo, 2012), it is only logical to also include the Hong Kong stocks, which can be traded freely by both domestic and foreign investors. As for the engagement firms, key players in the Chinese markets were identified through the review of various industry research publications as well as the list of signatories of the UN Principles for Responsible Investment.

While the thesis focuses on exploring interactions between the engagement firms and the Chinese investee companies and how ESG performance of the latter can be encouraged through improved engagement services, it does not intend to examine the correlation between responsible investing strategies and financial return. Such a correlation remains a debate not only in the academia but also the investment sector (Guo, 2012; Margolis & Elfenbein, 2008). Within the Chinese context, certain types of responsible investments such as the Industrial Social Responsibility Fund launched by Aegon Industrial Fund Management recorded exceptional performance compared to conventional investment funds (BSR, 2009). Further research will be needed to investigate if these cases were independent incidents or if they were supported by sound ESG management and practice of responsible investment. Although these further studies go beyond the scope of this thesis, what can be gathered from existing studies is that efforts to improve ESG have not shown detrimental effect on a company's financial performance (DMEBA, 2011).

## **1.5 Audience**

The thesis aims to enhance the understanding of the interactions between Chinese investee companies and engagement practitioners, as well as to address the general knowledge gap on investees' perspectives in the current responsible investment literature. As such the primary audience of the thesis is engagement practitioners and Chinese investee companies. Other organisations that strive to promote responsible investment, for example, national/international networks of responsible investors (e.g. the United States Social Investment Forum, the European Social Investment Forum) and inter-governmental organization such as the United Nations Environmental Programme Financial Initiative and the Principles for Responsible Investment will also find the thesis relevant to their work. The findings, analysis and recommendations concluded by the thesis will help these stakeholders in responsible investment to improve their engagement strategy and approach, and hence achieve a higher chance to successfully motivate investee companies to raise their ESG standards.

To a lesser extent, policymakers and government agencies may also find the thesis findings useful in terms of understanding the challenges and opportunities in engaging with investee companies in China. This may provide data for them to adjust existing policies to further encourage responsible investment. For example, countries like Denmark and Norway have national action plans for sustainable development, under which responsible investment is a major focus.

## **1.6 Disposition**

Chapter 1 introduces the thesis' research problem, corresponding research questions, research method, limitations and scope of the current research as well as the target audience.

In Chapter 2, the thesis research's background information will be presented. This includes the definition and historical development of the concept 'responsible investment', the

involved key actors and operational processes, as well as the current situation of responsible investment in China.

Chapter 3 presents the analytical framework employed by the thesis, which is comprised of a normative approach to examine how to successfully motivate investees to improve their ESG performance through collective sense-making and a descriptive research approach on how companies decide on social initiatives. These two concepts are translated into the context of responsible investment and merged to form a synthesised analytical framework to guide the data collection and subsequent analysis. This Chapter also elaborates the research methodology in details.

Chapter 4 presents the data collected in literature review, questionnaires and interviews, with reference to the research questions.

Chapter 5 turns to the analysis of the collected data based on the selected analytical framework. It also reflects on how the chosen research methodology has impacted the findings and subsequent analysis and the extent, to which the results are generalisable.

Chapter 6 concludes the key findings of this thesis and provides recommendations to engagement practitioners and Chinese investee companies to maximise engagement impact. Policymakers and academics are also advised on what they can do to promote ESG engagement in the Chinese context.

## **2 About Responsible Investment**

The United Nations backed Principles for Responsible Investment (UNPRI) defined responsible investment as:

‘an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems’ (UNPRI, 2013a).

The UNPRI is an initiative jointly undertaken by the United Nations Environmental Programme Financial Initiative (UNEP FI), the United Nations Global Compact and some of the largest institutional investors in 2006 (DMEBA, 2011). It is a set of six principles centred on the abovementioned definition and is open to practitioners’ signatory to promote responsible investment worldwide. For a detailed list of the principles, please see Appendix 1. UNPRI’s emphasis on considering environmental, social and governance (ESG) matters over a long investment horizon implies that institutional investors are expected to integrate ESG considerations at the beginning of the investment and to be an active owner to constantly monitor the ESG issues throughout the investment process. This chapter will provide an overview of the historical roots of the concept of responsible investment and how it has been shaped by various theories over time. Moreover, key actors and operational processes of responsible investment are also explained. Finally, an overview of the current situation of responsible investment in China is provided.

### **2.1 Historical Development**

The integration of non-financial values such as moral and ethical standards into investment found its roots in some of the world’s oldest religions, for example Judaism, Christianity and Muslim (Renneboog, Horst & Zhang, 2008). For instance, some churches in the US and the UK tried to avoid investment in relation to weapons and slavery back in the 17<sup>th</sup> century. Such an investment approach that was based on an individual or a specific group of peoples’ ethical standards started to gain momentum in the 1960s and 1970s, when shareholders were inspired by the civil right movement in the United States and grew more and more concerned about how their investment might fuel the problem of apartheid in South Africa or the Vietnam War (Welker & Wood, 2011; Zarbafi, 2011). To answer the changing shareholder demands, the industry of socially-responsible investment emerged, trying to formalise investing strategies and methods that incorporate social and ethical concerns.

Throughout the 1980s and 1990s, a series of environmental disasters and corporate scandals such as the explosion at Chernobyl and bankruptcy of Enron Corporation brought investors to see a wider spectrum of risks that could be associated with investments (Zarbafi, 2011). Businesses’ environmental impacts and corporate governance standards, together with their social impacts (commonly referred to as environmental, social and governance or ESG considerations), received more attention in investment decisions. This formed the basis of what is now seen as responsible investment.

Around the same period of time, new concepts about the role of institutional investors and how corporate management should be executed added new perspectives to investment practices. Monks and Minow (1995) argued that institutional investors became so big and diversified in terms of the assets and portfolios they managed that they were essentially ‘universal and permanent shareholders’, owning a part of the whole economy. This concept of

universal ownership highlighted the fact that institutional investors were in a unique position in the economy and had a stake to advance not only their financial return, but also the potential social and public good in the long term. The key motivation was that, as their portfolio was so diverse covering different sectors in different geographical regions, the negative social and environmental externalities of one of their investee companies would likely be borne by another investee company within the portfolio (Kiernan, 2007; UNPRI & UNEP FI, 2011; Urwin, 2011). Figure 2-1 illustrates the relations between two investee companies within the same portfolio of an institutional investor. According to economic theories, market failure is at the heart of the problem of externalities. It induces inefficient allocation of resources, which then becomes damage costs to the economy, in other words negative externalities. In the figure, the sample external costs of the fictional portfolio Company A are pollution and ecosystem degradation, which are expressed in terms of rising health and resource costs. Such costs, which are external to and therefore not paid by Company A, may become actual input and operating costs of Company B, which happens to be in the same portfolio of an institutional investor. As such, the institutional investor or the universal owner of these two portfolio companies will have to face the consequences of the externalities sooner or later. Therefore, from the point of view of risk management, it will be in the institutional investor's best long-term interest to encourage its investee companies to address their own ESG-related risks properly at their firm level. How this can be achieved will be discussed in Section 2.3.

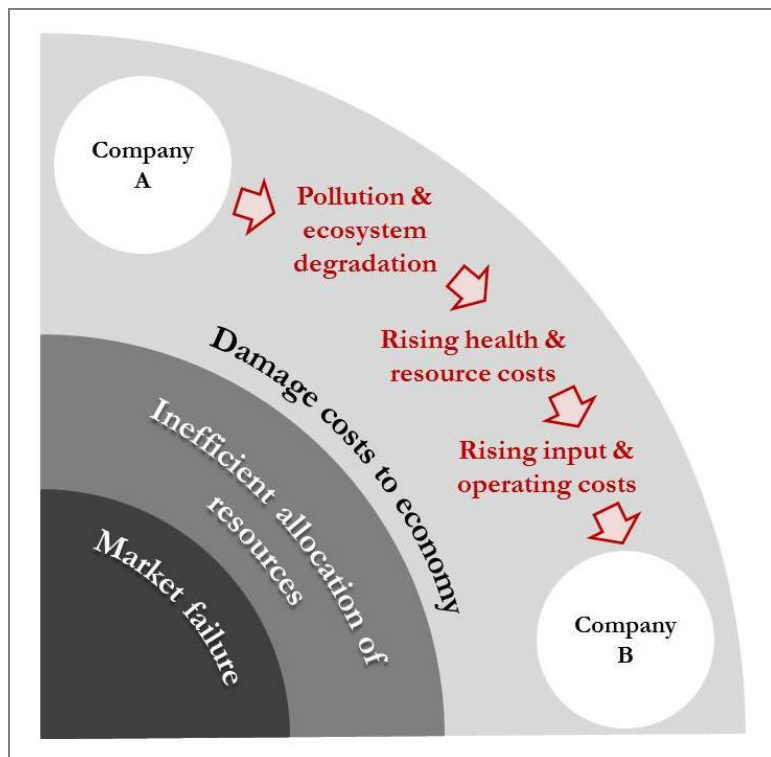


Figure 2-1 Example of how externalities created by market failure are transferred from company A to B within the same investment portfolio managed by the same institutional investor

Source: Adapted from UNPRI & UNEP FI (2011)

Furthermore, the rise of stakeholder theory in the 1980s challenged the conventional view that corporate management should solely be guided by the goal of profit maximisation, an idea popularized by Friedman (1970). Freeman (1984) advocated companies to move beyond the perspective of maximising shareholder value to adapt to the fast changing external



environment, in particular, the emergence of new stakeholder groups such as media and non-governmental organisations. Following this logic, institutional investors are demanded not only to pursue shareholder value but to take stakeholders' concern e.g. environmental impact, human rights, employee relations, into investment decisions.

All of the above ideas formed the basis of the current understanding of responsible investment. In other words, responsible investment integrates ESG factors in relevant investment analysis and portfolio selection processes, and calls for the exercise of active ownership by investors to influence the investee companies' ESG performance in the long run (DMEBA, 2011; Sullivan & Mackenzie, 2006; Urwin, 2011; Zarbafi, 2011). How active ownership can be executed will be further explained in Sections 2.2 and 2.3 below.

## **2.2 Key Actors**

### **2.2.1 Institutional Investors**

In the simplest words, institutional investors are financial institutions acting on behalf of the people who have invested their savings and capital in various financial products, for example pension funds and other types of investment funds (Sullivan & Mackenzie, 2006; Zarbafi, 2011). They are thus the intermediaries between their clients (the actual asset owners) and the investee companies, bearing a fiduciary obligation to their clients. Major institutional investors are pension funds, mutual funds, insurance companies and banks. Among them, the pension funds are of particular relevance to responsible investment because of their long-term investment horizon. Such funds match well with the argument that responsible investment, which actively addresses and mitigates both short and long-term ESG risks, is more competitive than conventional investment in the long run. As mentioned before, institutional investors have come to be known as the 'universal owners' because of their sheer size and high degree of diversification of investment portfolios. For instance, such investors in the US 'held 73% of the 1,000 largest US companies at the end of 2009' (CB, 2010). Asset managers are usually external personnel hired by the institutional investors to attend to the daily investment operations and portfolio management. In some cases, institutional investors may have in-house asset managers.

### **2.2.2 Investee Companies**

Investee companies are basically any commercial organisations that are invested by institutional investors. Most of the investee companies in the market of responsible investment are publicly listed corporations, whose shares are traded by individual and institutional investors in the stock market. While responsible investment is also present in private equity and property investment, investee companies in this thesis refer to the listed corporations. Many of these companies practice the 'separation of ownership and control' (Zarbafi, 2011), meaning shareholding and day-to-day corporate management are separated. This gives the investee company much flexibility in hiring the most suitable professionals to manage the firm in the best interests of its shareholders. The annual general meeting is the official channel for individual and institutional shareholders to meet with the management, learn about the performance of the company, raise questions regarding certain practices, vote for relevant resolutions etc. Very often presentations and meetings are also regularly arranged by the investee companies for the institutional investors, since they may have more specific and technical questions on the performance of the company. As a listed company, its operations, such as how financial information is communicated to the public, are governed by relevant listing regulations in respective countries.

### 2.2.3 Engagement Firms

Engagement firms are professional services providers in the responsible investment market. They are hired by institutional investors to ‘monitor corporate behaviour and seek changes through dialogue with (investee) companies or through the use of share ownership rights’ (AICD, 2011). They are therefore intermediaries between the investor and the investee. The goal of engagement firms is to help investors fulfil their role as active owners who shall proactively and effectively integrate ESG considerations in investment by engaging with the investee companies and driving their ESG performance. Common engagement efforts are one-to-one meetings, industry surveys, filing shareholder resolutions etc. (Zarbaifi, 2011). In general, these efforts can be categorized into (1) private, (2) public and (3) collaborative (DMEBA, 2011). Some firms prefer the confidential, or so-called “behind-the-door” (private) approach as it enhances trust-building with the investee companies. In some cases, numerous investors pool their resources together to exert collaborative influence on the investee on the concerned ESG issue (DMEBA, 2011).

It is generally agreed that Principle 2 of the aforementioned UNPRI describes the current understanding of engagement, which calls investors to be ‘active owners and incorporate ESG issues into [their] ownership policies and practices’ (UNPRI, 2006). Professional ESG service providers and advisories, however, may vary in defining what engagement is. An industry insider pointed out that some engagement firms would consider the more passive forms of communication to be engagement as well, for example pure questionnaire to collect ESG data from investees (ESP1, personal communications, 21 November, 2012). He held the view that engagement should have a clear goal of motivating investee companies to better address their ESG risks. It should also be highlighted that although engagement is usually conducted by professional firms and advisories, it is sometimes carried out by the institutional investors themselves. A survey of 25 institutional investors in Denmark in 2012 revealed that less than 10% of their engagement works were accomplished by in-house personnel (Dansif, 2012).

## 2.3 Investment Processes

Responsible investment is done through numerous stages of research and analysis. Based on various literature, a flow chart of how the processes work is presented in Figure 2-2 below (DMEBA, 2011; Sullivan & Mackenzie, 2006; Zarbaifi, 2011). The first stage describes the available investment universe, which is the total number of stocks available to the institutional investors. In the second stage, the investor conducts positive and/or negative screenings to include and/or exclude certain stocks to create the investment universe. Positive screenings refers to the selection of companies with products and services that can provide social/environmental good and/or companies with the ‘best-in-class’ ESG performance within the concerned industry. Negative screening is the process of excluding undesirable companies based on ESG considerations. Next, enhanced analysis is carried out to quantify the ESG factors and integrate them into the conventional financial analysis. The outcome of this stage is the qualified universe, i.e. companies with the most desirable financial and ESG performance. Finally, stocks that form the optimal mix for the investment fund will be chosen to create the selected portfolio, which are essentially the investee companies. While the above describes the general steps to select investee companies in responsible investment, an industry insider observed that some investors would first acquire shares based on pure financial analysis and then try to engage with the investee companies or adjust their portfolio using ESG parameters afterwards (ESP1, personal communications, 21 November, 2012).

Depending on the situation, institutional investors may take up the engagement work themselves, or hire engagement firms to provide such services. It should be highlighted that stock selection or de-selection (i.e. divestment) does not stop at the selected portfolio stage.

This is because portfolio management and engagement are on-going processes. When there is concrete evidence that certain stocks are not up to the desired ESG standards and fail to demonstrate improvements after sufficient engagement, divestment will be the result. Yet, as institutional investors may hold a large quantity of shares in these underperforming companies, which can have substantial impact on the interests of not just the investees but also the ultimate individual shareholders, divestment is normally viewed as a last resort (Danish Ministry for Economics and Business Affairs, 2011).

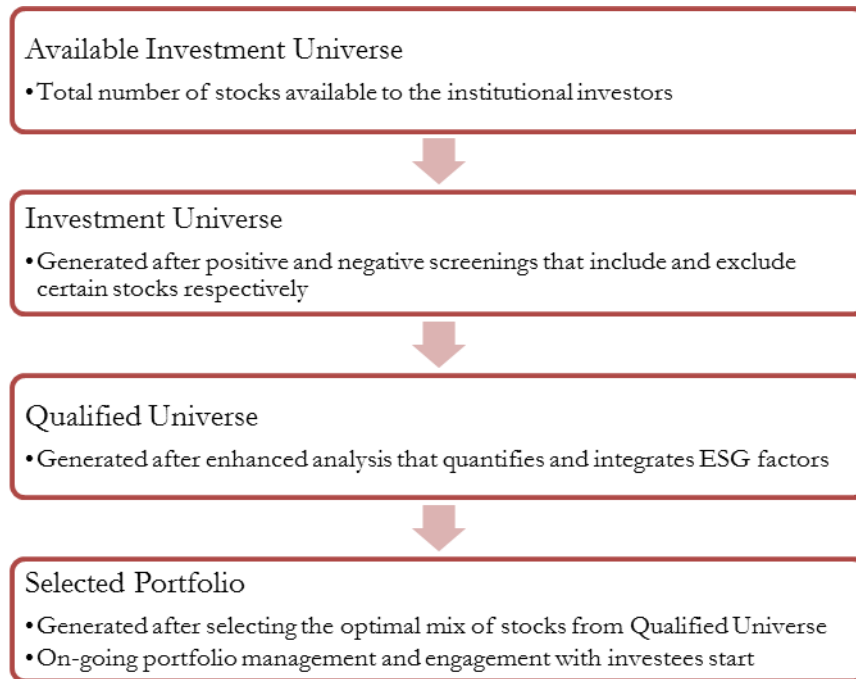


Figure 2-2 Responsible investment processes

Sources: Based on DMEBA (2011), Sullivan & Mackenzie (2006) and Zarbafi (2011)

## 2.4 Responsible Investment in China

Responsible investment is a relatively new concept in China, with the first responsible fund launched by Aegon-Industrial in 2008 and the responsible investment market has been growing steadily since then (BSR, 2009; Guo, 2012). According to Guo (2008), the idea of responsible investment in China was first encouraged by the collaboration between the People's Bank of China and the State Environmental Protection Agency to set up a database documenting companies' pollution records, which would be referenced when issuing corporate loans. Then in 2006 the Bank of China Investment Management launched the Sustainable Growth Equity Fund by incorporating some elements of responsible investment but without packaging it as a complete responsible investment fund as the Bank was unsure about the market's reception towards the new idea of responsible investment. Then in 2008 the Equator Principles, a global framework on assessing and managing environmental and social risks in project financing, set foot in China and further boosted the market's awareness of responsible practices in banking and finance. As mentioned earlier, the same year saw the launch of the first official responsible fund by Aegon-Industrial. Since then, a range of responsible investment products were developed in China, including for example funds that invest directly in securities with sound ESG performances, thematic investment such as funds specialised on green technologies, exchange traded funds that were linked to stock indexes of

corporate social responsibility (Guo, 2012). Below is a list of recent responsible investment products in China:

- 2009 Socially Responsible Exchange Traded Fund linked to the Social Responsibility Index of Shanghai Stock Exchange by China Construction Bank Asset Management
- 2010 Low Carbon Pioneer Fund by Hong Kong Shanghai Banking Corporation
- 2010 Green New Energy Fund by Zhonghai
- 2011 Green Equity Fund by Aegon
- 2011 Socially Responsible Equity Fund by China Universal Asset Management

At the same time, China's growing interest in responsible investment was also promoted by a number of corporate scandals related to ESG issues, for example the nation-wide contaminated milk formula by Sanlu in 2008, waves of suicides by workers at Foxconn in 2010, industrial air emissions leading to chronic air pollution in cities like Beijing, etc. Investors, consumers, the general public, media and other stakeholders became more and more aware of a company's role in contributing to the environmental and social wellbeing of society. Moreover, government agencies and various stock exchanges in mainland China and Hong Kong have pushed forward the non-financial disclosure of listed companies, which facilitated responsible investors to locate and analyse the ESG data of potential and current investee companies. For instance, in 2006 the State-owned Assets Supervision and Administration Commission issued a corporate social responsibility (CSR) reporting guideline that required all state-owned enterprises to publish CSR reports by 2012 (BSR, 2012). The Shanghai and Shenzhen Stock Exchanges also started requiring a subset of listed companies to report non-financial data in 2008 while the Hong Kong Stock Exchange launched a guideline on ESG disclosure in 2011.

While responsible investment is a fairly recent phenomenon in China, the country's overall ESG development is also in a nascent stage. Indeed a study by BSR (2009) showed that China's ESG performance mostly ranked below other major emerging markets Brazil, Russia and India, who together with China were usually referred as the acronym 'BRIC'. For instance, China ranked third among the BRIC countries in environmental performance. Fast-paced industrialisation without proper environmental abatement measures have contributed to significant negative environmental impacts such as air and water pollution. In the social realm, while China topped the list in terms of economic indicators such as the ease of doing businesses and the Global Competitive Index, again it ranked third in the Human Development Index. Particularly income disparity between the urban and rural communities was a stark problem in China. Among the BRIC countries, China's governance ranked second best on the Corruption Perception Index. The negative impact of corruption had been recognised by the government, who attempted to combat corrupted behaviour and promote higher business ethics. However, in general transparency and disclosure of business operations remained limited (BSR, 2009).

## 2.5 Summary

To conclude, this Chapter has presented the historical development of responsible investment as a concept. The current definition of responsible investment by the UNPRI is a result of various movements in the history of financial investment, which have been informed by the changing theories on business management. The basic key actors and operating processes of responsible investment were also examined.

Given the diversified engagement practices within the industry, the thesis will work with a looser definition of engagement when collecting data from engagement practitioners. This shall encompass all forms of communications between any engagement practitioners and the Chinese investees. However, when surveying and interviewing Chinese investee companies, the narrower definition of engagement that emphasises the aim to improve investees' ESG performance and is more in line with the UNPRI will be employed. Such a flexible use of the terms in two data collection phases is necessary to (1) provide an overview of the current norms of the engagement industry while (2) exploring how Chinese investee companies perceive the concept of engagement as reflected by the highest industry standard (i.e. the UNPRI). Moreover, as some investors actually conduct engagement themselves instead of hiring external engagement firms, the term 'engagement practitioner' shall include both types of organisations. Finally, the review of responsible investment in China will serve as a useful background for the thesis' research.

The next chapter will move on to elaborate in details the thesis' analytical frameworks and methodology.

### 3 Analytical Framework & Methodology

After delineating the responsible investment sector, its key actors and processes as well China's recent development of responsible investment in the previous chapter, the thesis now turns to elaborate the analytical framework and the research methodology employed to investigate how Chinese investee companies perceives and understand engagement, based on which recommendations on engagement services can be further developed.

#### 3.1 Analytical Framework

As previous literature review showed that perspectives from investee companies within the responsible investment sector were almost non-existent, the choice of relevant analytical framework should help the author gather and analyse such data. Moreover, the research questions developed by this thesis essentially centre around the interactions between engagement practitioners and the Chinese investee companies. Therefore organisational and inter-organisational theories with regards to corporate social responsibility and responsible investment were thus the focus of the search for relevant frameworks. Based on these research criteria, two independent theoretical concepts were identified, translated into the responsible investment context and finally merged to form a synthesised analytical framework to guide the data collection and subsequent analysis processes. The first concept was developed by Zarbafi (2011), who argued that successful engagement was driven by making sense of corporate responsibility collectively by both of the institutional investor and the investee company. The second one was put forward by Margolis and Walsh (2003), who called for descriptive research into an organisation's decision-making processes of corporate social initiatives. Based on these two concepts, an analytical framework tailored for this thesis was developed, as described in Section 3.1.3.

##### 3.1.1 Normative Inter-organisational Sense-making Categorisation

Zarbafi (2011)'s proposition on inter-organisational collective sense-making of social responsibility shed light on how a normative approach could be a useful research tool to understand what factors would contribute to the so-called 'successful engagement', i.e. investees adopting engagement comments and advices to improve their environmental, social and governance (ESG) standards. The foundation of her collective sense-making approach was based on Senge (2006)'s idea of balancing advocacy and inquiry through reciprocal inquiry. According to this argument, organisations should not only state their advocacy, but also inquire into the principles and logic behind the other organisation in a dialogue. In short, they should understand how the other organisation arrive at their current way of thinking and choice of action, an idea similar to the concept by Margolis and Walsh (2003) and would be further discussed in Section 3.1.2. To further categorise different forms of advocacy and inquiry processes, Zarbafi (2011) took reference from Ross and Roberts (1994)'s framework of analysis. Such a framework categorised acts of advocacy and inquiry into the matrix of four types of activities, namely (1) Observing, (2) Telling, (3) Asking and (4) Generating. Figure 3-1 showed sample acts under each of the four categories and their corresponding levels of advocacy and inquiry.

While Ross and Roberts (1994)'s framework of advocacy and inquiry focused on the *inter-personal* level, Zarbafi (2011) broadened the original framework into an *inter-organisational* one and explored which types of acts by the institutional investors and the investee company would lead to a higher degree of collective sense-making about corporate responsibility. The four types of inter-organisational advocacy and inquiry processes developed by her, namely (1)

Screening, (2) Questionnaires, (3) Shareholder Activism and (4) Shareholder Engagement, were summarised in Table 1.

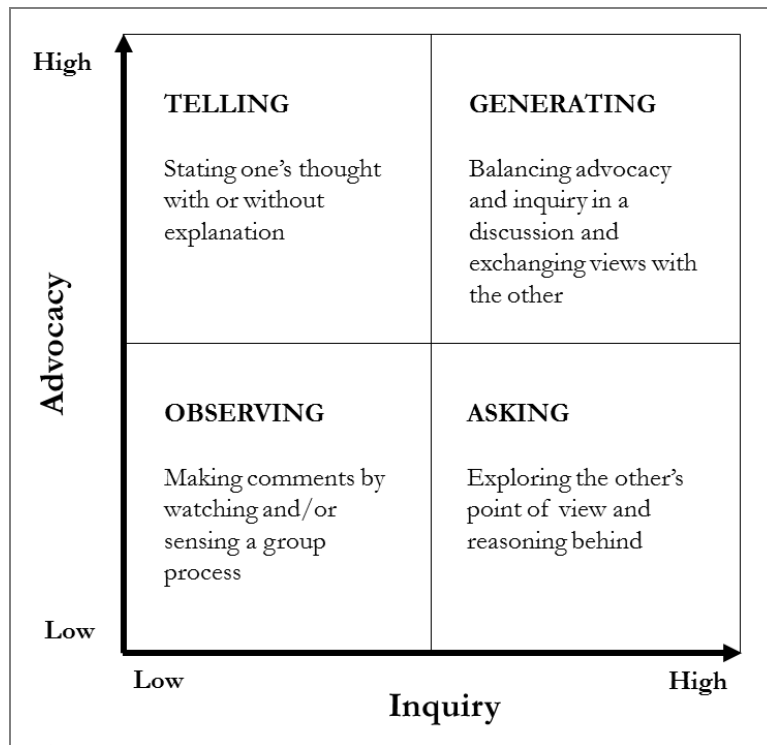


Figure 3-1 Categorisation of different types of inter-personal activities based on the level of advocacy and inquiry

Source: Adapted from Ross & Roberts (1994)

As presented in Table 1, Zarbafi (2011) argued that different types of inter-organisational advocacy and inquiry processes would create different levels of collective sense-making. In an Observing situation, since the investee company was not involved in the data collection and analysis processes (e.g. screening of companies based on publicly available ESG information) conducted by the institutional investors and/or engagement firms, both of the levels of advocacy and inquiry were low. Therefore the level of collective sense-making was also 'minimal', meaning the engagement practitioner and the investee company could only constitute a nominal account of corporate responsibility in their corresponding work environment. How they understood responsibility remained independent of each other.

In an Asking situation, while the level of inquiry was high, the level of advocacy was low. This was mostly because when asking the investee companies their ESG performance, for example through a questionnaire, the reasoning behind each of the questions might not be sufficiently provided by the engagement practitioner. Without such advocacy, investees were 'left alone with interpreting the questions' and might fail to understand why these questions were important and relevant (Zarbafi, 2011). This would lead to the 'fragmented' collective sense-making of what corporate responsibility was among the investees and engagement practitioners, and therefore inconsistent actions with regards to what would be considered as responsible behaviour.

The Telling situation was the flip of the Asking situation, where the level of inquiry was low but the level of advocacy was high. Although the investee companies could now understand the logic behind the engagement practitioners through Shareholder Activism, e.g. as expressed in proxy voting or filing shareholder resolution, there was no room for investees to communicate what and why they think to the practitioners. The subsequent collective sense-making was only restricted, producing ‘narrow’ accounts of what corporate responsibility meant from the engagement practitioners’ point of view. It could be anticipated that one-time actions to address ESG issues might be undertaken by the investee company to satisfy the practitioners but whether such actions could be sustained remained doubtful.

Table 1 Definition of the processes of advocacy and inquiry in the context of responsible investment

Ross & Roberts (1994)	Zarbafi (2011)				
Categories of inter- personal activities	Categories of inter- organisational advocacy/ inquiry process	Original definition	Level of Advocacy	Level of Inquiry	Type of Collective Sense-making
Observing	Screening	The process by which members of organization A engage in collective sense-making by gathering information about organization B without directly getting in touch with each other.	Low	Low	Minimal
Asking	Questionnaires	The process by which members of organization A engage in collective sense-making by inquiring information about organization B that goes beyond the data that is already publicly provided by members of organization B.	Low	High	Fragmented
Telling	Shareholder Activism	The process by which members of organization A engage in collective sense-making by advocating their reasoning of how to make sense of the environment to members of organization B with little inquiry into organization B’s sense-making.	High	Low	Restricted
Generating	Shareholder Engagement	The process by which members of organization A engage in collective sense-making with members of organization B by advocating their reasoning to alternative views and inquiring into the way members of organization B make sense of the environment.	High	High	Enhanced

Source: Zarbafi (2011)

Finally the Generating situation signified high levels of advocacy and inquiry and Zarbafi (2011) classified the corresponding inter-organisational processes as ‘Shareholder Engagement’. These processes, such as one-to-one meetings, were likely to allow both the engagement practitioners and investee companies involved to make sense of corporate responsibility collectively, and thus continuously refining such sense-making. This would give



rise to rich and unitary accounts of corporate responsibility, which would be indispensable to sustain consistent actions to improve a company's ESG performance.

### 3.1.2 Descriptive Organisational Decision-making Research

Companies and their stakeholders had debated for long what a firm's social role and in particular its corporate social responsibility (CSR) was. While proponents like Milton Friedman (1970) viewed that a company's only CSR was to create profit, others believed a firm should integrate CSR into operations, for example, minimising the environmental and social impact of business to stakeholders. Much of the debate revolved around how a firm, which was supposed to be a rational entity under neoclassical economics principles, should justify the costs of exercising CSR and whether CSR would bring about financial return. This unresolved debate between a firm's corporate social performance (CSP) and corporate financial performance (CFP) was similar to the one discussed by Margolis and Walsh (2003).

Margolis and Walsh (2003) examined the debate on *whether* companies should respond to social miseries external to the organisations while balancing out the financial considerations. They proposed instead of asking *whether*, researchers should take a step backward and systematically inquire *how* an organisation decided whether or not it should respond to requests for social initiatives. By social initiatives the authors meant activities to alleviate social problems that would generate social and public good. This, for example, included donations to social misery such as hunger and poverty, company-led awareness campaigns, partnering with non-governmental organisations (NGOs) etc. Their literature review showed that much of the discussion on whether a firm should participate in such initiatives could be diminished into the classical debate of a firm's CFP versus its CSP, e.g. evaluating the financial value of certain social actions. Yet after so many years of research, there had not been any conclusive results in terms of the positive or negative correlations between CFP and CSP.

Following the pragmatic approach advocated by James (1975), Margolis and Walsh (2003) first assumed that companies could 'play an effective role in ameliorating social misery', and therefore they *would* respond to such social requests. This assumption shifted the researcher's focus from the traditional CFP-CSP debate, and immediately brought new research questions into light. The research direction now turned into the examination of the impact of a company's social initiatives and how such impact could be realised. The authors then developed a 'descriptive research agenda', which inquires the following five areas:

- (1) how the stimuli for action is extracted or appraised,
- (2) how response options are generated,
- (3) how options are evaluated,
- (4) how the selected option is implemented and;
- (5) what the subsequent corporate social and financial performances are.

To them, understanding how a company decided on what they should do with social miseries was the first step towards understanding organisational behaviour, which would bring researchers to the next level, the normative research agenda on how company *should* respond to social miseries. It was clear that the authors' pragmatic approach did not evade from the traditional debate mentioned above but indeed took another route to tackle the classical question.

While the ultimate quest of Margolis and Walsh (2003) for a normative theory on organisational behaviour was less relevant to this thesis, their insight in the descriptive agenda is a useful point of reference to make sense of how Chinese investee companies perceive and

respond to engagement. Indeed, company’s responses to social misery can be mirrored to investee companies’ responses to ESG engagement practices as both social misery and engagement are external to the organisation in question and call for the organisation’s attention to address certain aspects of CSP. Besides, as mentioned in Chapter 2, the development of responsible investment was partly fuelled by the growing awareness and acceptance of stakeholder value, as opposed to the traditional shareholder value. The situation where a company evaluating and balancing these two values is similar to a company’s debate about CSP and CFP in Margolis and Walsh (2003)’s case. The five descriptive question listed above will be further elaborated with reference to the context of responsible investment in the following section.

### 3.1.3 A Synthesised Analytical Framework for the Thesis

The normative and descriptive research approaches proposed by Zarbafi (2011) and Margolis and Walsh (2003) respectively were combined into a synthesized analytical framework to guide the thesis’ research on the interactions between the engagement practitioners and Chinese investee companies. As shown in Figure 3-2, engagement practitioners and Chinese investee companies were connected through the act of ESG engagement. Firstly, the normative inter-organisational sense-making categorisation method was used to examine the overall types of engagement activities experienced and perceived by both of the engagement practitioners and Chinese investees. Secondly, the descriptive research method on organisational decision-making was applied to particularly expose how Chinese investee companies made decisions regarding ESG engagement. Findings by both research approaches were indispensable to further developing recommendations to enhance engagement activities and their levels of collective sense-making. The following section explains how these two agendas are translated into the thesis’ research scope and merged to form the synthesised analytical framework to guide the data collection methodology and the subsequent analysis.

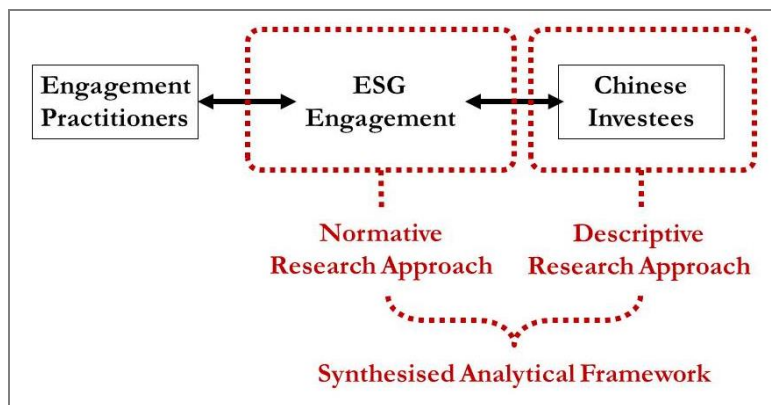


Figure 3-2 The synthesised analytical framework

#### 3.1.3.1 Collective Sense-making of Engagement in China

When applying Zarbafi (2011)’s collective sense-making categorisation to map out the kind of ESG engagement activities in China, it should be highlighted that both of the engagement practitioners and Chinese investee companies could be the inquiring organisation or the receiving one. Although it is usually the engagement practitioners, either the institutional investors or professional engagement firms, who initiate the communications and interactions, investee companies may also conduct the reciprocal inquiry to the engagement practitioners in the process. In short, reciprocal inquiry is dynamic in nature and any party involved in an

inter-organisational relationship can exercise it at any point of the interaction. Therefore in the data collection phase, special attention should be paid to situation where Chinese investee companies take the initiative to conduct advocacy and/or inquiry and to examine how such initiatives impact the level of collective sense-making of engagement.

Moreover, Zarbafi (2011) defined ‘engagement’ much more narrowly than this thesis. In fact, she considered engagement as an ‘informal approach to participating in corporate management decision-making’ and was *only* present in the Generating types of activities (see the last row of Table 1). Therefore, ‘engagement’ would not include acts of ‘Shareholder Activism’ (see the third row of Table 1). While such a distinction between ‘engagement’ and ‘activism’ may be useful in theory, this is less practical and applicable in reality. As mentioned in Chapter 2, practitioners of responsible investments held diverging views of what ‘engagement’ meant and entailed. It could range from a passive questionnaire to a one-to-one meeting. To further complicate the picture, sometimes filing shareholder resolutions (example of Shareholder Activism) may be done in conjunction with one-to-one meetings (example of Shareholder Engagement) before the formal submission resolution. In such cases, should both shareholder resolutions and meetings be considered ‘engagement’, since they are indeed within the same project scope serving the same aim? As such, the thesis works from the view that engagement should not be defined by the kind of acts, but by its aim, i.e. whether it tries to ‘seek changes’ in the investee companies no matter through meetings or filing shareholder resolution (AICD, 2011).

To minimise the confusion of the use of terms, the thesis will therefore use ‘Shareholder Dialogue’ to replace ‘Shareholder Engagement’ in Zarbafi (2011)’s original framework. The matrix of the types of collective sense-making (in capital letters) and their respective advocacy and inquiry processes (italicised) are redrawn in Figure 3-3. This matrix helps the thesis identify the types of advocacy and inquiry processes, or in other words engagement practices, conducted or received by the engagement practitioners and Chinese investee companies respectively.

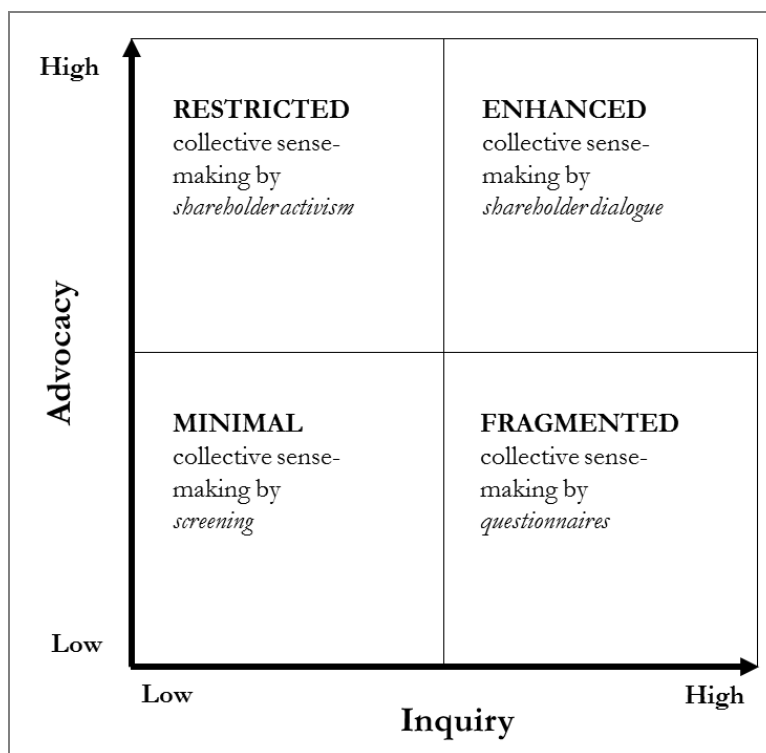


Figure 3-3 Types of inter-organisational collective sense-making produced by different types of advocacy and inquiry processes

Source: Adapted from Zarbafi (2011)

### 3.1.3.2 Five Descriptive Questions for Chinese Investee Companies

Apart from mapping out the different types of engagement practices, the thesis also modified the five descriptive questions proposed by Margolis and Walsh (2003) to inquire how Chinese investee companies perceived engagement practices and decided what they would do regarding them.

The first question concerned ‘how the stimuli for action are extracted or appraised’ (Margolis & Walsh, 2003). In the authors’ original discussion, these stimuli could include both internal and external ones and solicited and unsolicited ones. ‘Stimuli for action’ from the perspective of the Chinese investee companies in the thesis’ context were the engagement services received from either institutional investors or engagement firms. Therefore such stimuli were basically external and unsolicited in nature. Based on this understanding, the relevant questions to be asked to the Chinese investees would be what types of engagement (the stimuli) they had received, for example, questionnaire on ESG performance, meeting requests to discuss ESG issues, recommendations on how to improve ESG standards etc.

The second question was ‘how response options are generated’. Relevant questions to Chinese investee companies would be, for example, if they had responded to engagement by evaluating their internal capacity and available resources, by comparing with how industry competitors responded to ESG issues, by analysing national laws and/or international norms etc. It would also be interesting to see which departments and management level within the company were involved in the option generating process.

The third question was ‘how options are evaluated’. This would look into what criteria Chinese investee companies used in evaluating the options, such as cost implications of complying with certain international ESG norms, company’s reputational value/risks, impact on stock value, potential divestment by investors etc. This would provide insights into how Chinese investees evaluated, ranked and then selected their response to engagement.

The fourth question asked how the selected option was implemented. In the context of Chinese investee companies, it would be illuminating to find out what they would do to deliver their choice of action. For instance, if they decided that the ESG issues raised in engagement processes were not relevant, did they simply ignore the engagement initiatives by the investor or and the engagement firms? On the other hand, if they decided to address certain ESG issues suggested by the engagement practitioners, how did they manage and execute such a decision? Did they rely on internal or external resources? Did they have well-defined goals and system to manage the progress of their actions?

Finally the fifth question was what the subsequent corporate social and financial performances of their decisions were. This would inquire into the impact of the Chinese investee companies’ response to engagement. For example, did reputational value, financial return, company’s understanding of ESG issues etc. improve as a consequence of their decision to respond positively to engagement practices? The above sub-questions generated from Margolis and Walsh (2003)’s descriptive research approach would help stakeholders understand better how Chinese investee companies perceived and responded to engagement, and therefore identify strategies to better motivate them in the engagement process.

## **3.2 Methodology**

The thesis employed a combination of quantitative and qualitative data collection and analysis. The former referred to two different sets of questionnaires sent to engagement practitioners and Chinese investee companies. The latter included a month-long unpaid internship at GES Denmark, an engagement practitioner headquartered in Stockholm, and semi-structured interviews with selected engagement practitioners, Chinese investee companies, other industry experts and academics.

Questions of the questionnaires were developed based on the synthesised analytical framework discussed in section 3.1.3 and input from stakeholders, including academics and engagement practitioners. Participants’ informed consent was requested and confirmed and their provided data was kept in strict confidentiality and would be reported anonymously in the thesis. Online questionnaire was avoided because the desired online service provider, Google Inc., was not fully accessible in China. The questionnaires were therefore created using Microsoft Word that allowed participants to select or type in their answers electronically to enhance the ease of participation. Chinese investee companies had the option to complete either the Chinese or the English version of the questionnaire. For a copy of the informed consent form and the questionnaires, please refer to Appendix 2 and 3. A total of 44 practitioners of responsible investment or ESG engagement were identified based on desktop research and 117 Chinese investee companies (exclusive of those with low ESG risks based on GES’ Risk Rating Model) were selected from the MSCI Emerging Markets Index (MSCI EMI). The Index is a respectable stock index tracking the performance of 821 constituent companies in 21 “emerging markets” countries as defined by the MSCI, a provider of investment decision support tools to global investors. Chinese companies covered in the MSCI EMI are either listed in the Shanghai, Shenzhen or Hong Kong stock exchanges.

Engagement practitioners and Chinese investee companies were invited to participate in this thesis research slightly differently. For engagement practitioners, an electronic copy of the questionnaire was sent with follow-up calls and email. All of the questionnaire invitations addressed identified personnel responsible for engagement or ESG issues from publicly available sources. For the Chinese investee companies, however, they were first contacted by phone before receiving the questionnaire. This was because previous studies with Chinese companies suggested that they were in general quite reluctant to respond to research requests and researchers were advised to first establish contact with companies via phone before sending the questionnaires, which was believed to encourage a higher response rate (BSR, 2009). As the questionnaire was about the interaction with institutional investors, the investor relations department or the company secretary was contacted. Due to the relatively large sample size of companies, only 56 companies with non-financial disclosure on websites or in sustainability reports were first contacted by phone before receiving the questionnaire, while the rest of the sample companies received the questionnaire invite directly. All companies were given three weeks to submit the completed questionnaires.

The original design of the research methodology was to invite companies to fill out the questionnaires and subsequently invite the more relevant participants to a semi-structured interview to explore in depth their experience of engagement. While it was originally anticipated that a 10% response rate could be achieved for both questionnaires, the response rate of Chinese investee companies was extremely low, with only two completed questionnaires at the third week after the questionnaires were sent. As such an alternative data collection plan, encompassing the collection of primary and secondary data, was devised. Table 2 below described how the alternative plan covered various sets of targeted data of the original plan. Instead of relying on the original sample size of 117 companies, other Chinese listed companies and the Chinese offices of international companies were invited to interviews through personal networks of the author, alumni and faculty. This was envisioned to provide primary data on Chinese companies’ perspective. Meanwhile, interviews with China specialists and academics and various industry research reports were used as secondary data to supplement the limited direct responses from Chinese investee companies.

Table 2 Data covered by the alternative data collection plan

<i>Original Plan</i>		<i>Alternative Plan</i>	
<i>Method</i>	<i>Targeted Data to be Collected</i>	<i>Method</i>	<i>Data Type</i>
Questionnaires and interviews with Chinese investee companies  Sample size: 117 companies	Chinese investee companies’ experience and perception of engagement practices	<ul style="list-style-type: none"> <li>• Interviews with Chinese investee companies (through personal networks)</li> </ul>	Primary
	How Chinese investee companies respond to engagement	<ul style="list-style-type: none"> <li>• Interviews with China specialists and academics</li> <li>• Industry research reports</li> </ul>	Secondary
	What motivates Chinese investee companies to improve their ESG performance	<ul style="list-style-type: none"> <li>• Interviews with Chinese investee companies &amp; China offices of international firms (through personal networks)</li> </ul>	Primary

As discussed above, selected questionnaire participants were invited to interviews for a more in-depth discussion. Such interview questions were developed based on their questionnaire responses. However, as interviewees in the alternative plan did not answer the questionnaire in

the first place, their interview questions were modified from the questionnaire. In any case, the aim of the interview was to allow the author to ‘appreciate the different constructions and meanings that people place upon their experience’ (Easterby-Smith, Thorpe & Lowe, 1995). Appendix 4 and 5 presented the list of interviews and interview questions respectively.

Apart from questionnaires and interviews, the thesis research employed participant observation through a one-month unpaid internship at GES Denmark (GES). The aim of the internship was to observe how engagement with investee companies was conducted by professional engagement firm and obtain first-hand experience of engaging with them. While the information and experience obtained from the internship would not contribute directly to answering the research questions, a deeper understanding of the industry’s operations and its operating environment would help guide the author in the actual data collection through questionnaires and interviews, and the subsequent data analysis. Given the author’s double roles as a researcher and an intern, special measures were undertaken to ensure the integrity of the thesis research and internship. The scope of works during the internship would not be mixed with that of the thesis research. For instance, as an intern at GES, the author would only perform engagement-related tasks on companies outside of the thesis’ sample. At the same time, business information obtained in the internship was kept confidential. The author’s role as a thesis researcher was also made known to all of the staff at GES. Moreover, the 44 engagement practitioners were informed about the author’s unpaid internship (without disclosing the company name) as part of the research methodology when they were invited to fill out the questionnaires.

Data collected through questionnaire and interviews were analysed using the synthesized framework discussed in Section 3.1.3. Different kinds of advocacy and inquiry processes regarding ESG issues in the Chinese context were mapped out to identify the types of collective sense-making they had contributed to. These were invaluable data to indicate if engagement had been done to reach enhanced collective sense-making of responsible investment and ESG issues, which according to Zarbafi (2011) was the most ideal form of interaction to influence an investee company’s ESG performance. Besides exploring how Chinese companies made organisational decisions about ESG engagement would expose the factors that drove or hinder them to respond positively towards engagement. Based on these findings and analyses, recommendations on how to improve engagement practices to attain a higher level of collective sense-making of ESG issues were then developed. These would help engagement practitioners interact with Chinese investee companies and motivate them to adopt higher ESG standards and therefore strengthen the overall business case of responsible investment.

## 4 Findings

This chapter presents the findings collected in questionnaires and various interviews. The original sample size of the thesis research included (1) 44 engagement practitioners (including institutional investors and engagement firms) and (2) 117 Chinese investee companies. A total of eight engagement practitioners responded to the invite but only seven of them had completed the questionnaires, six of which were signatories of the Principles for Responsible Investment backed by the United Nations. Hence a 16% response rate was achieved among the engagement practitioners, which was higher than the anticipated 10%. Among the respondents three were institutional investors and four were engagement firms; and six companies were subsequently contacted in follow-up interviews. Besides, two of the contacted companies preferred brief interviews instead of filling out the questionnaires. One company declined to participate but had generously shared an internal research report on engagement practices in China.

The response rate of Chinese investee companies was, however, much lower. To start with, out of the sample of 117 investees, five companies' email addresses could not be located on the company website or through desktop research and 15 companies' publicly disclosed email addresses were dysfunctional. In other words, the effective sample size of companies was downsized by 17% to 97. Only two companies completed the questionnaires with another two agreed to conduct a brief interview on phone. The majority of Chinese investee companies either declined to participate or did not provide any response at all. Table 3 below summarises the various responses and their corresponding percentage of the effective sample size.

*Table 3 Summary of response rate of Chinese investee companies*

	<i>Number</i>	<i>Percentage</i>
<i>Effective sample size</i>	97	100%
<i>Agreed to participate in questionnaire or interview</i>	3	3%
<i>Declined to participate in questionnaire or interview</i>	35	36%
<i>Nil response at all</i>	59	61%

As discussed in the previous chapter, an alternative data collection plan was devised to address the low response rates among Chinese investee companies. Under this plan, a Chinese investee company, an academic and a researcher on corporate social responsibility (CSR) in China, two Chinese branch offices of international companies and a sustainability consultant advising Chinese corporate clients were interviewed. The complete list of interviews could be found in Appendix 4 and the interview questions in Appendix 5.

As a result, a total of 20 interviews including follow-up discussion with questionnaire respondents and interviewees of the alternative plan were conducted. Both of the questionnaires and interviews were the key sources of findings to address the research questions. Other literature such as industry research report as well as experience and observations obtained in the author's internship were used to supplement the key findings, where appropriate.



## 4.1 Collective Sense-making by Engagement Practitioners and Chinese Investees

### 4.1.1 ESG Engagement Activities

Data from both of the engagement practitioners (see Appendix 2 Question 8) and Chinese investee companies (see Appendix 3 Question 4) show that the kind of engagement activities conducted or experienced basically covered all of the four categories of advocacy and inquiry processes suggested by Zarbafi (2011), i.e. (1) Screening, (2) Questionnaires, (3) Shareholder Activism and (4) Shareholder Dialogue. Figure 4-1 shows the frequency of engagement activities cited by engagement practitioners, with the activities grouped according to the type of advocacy and inquiry process<sup>1</sup>. The top three most frequently quoted activities by engagement practitioners are environmental, social and governance (ESG) evaluation using publicly available data (Screening), face-to-face meetings or teleconferences (Shareholder Dialogue) and ESG rating and recommendation reports to investees (Shareholder Activism). The bottom three least frequently quoted activities by engagement practitioners are filing shareholder resolutions and divestment with explanation, which are both examples of Shareholder Activism, as well as request for progress reports on addressing ESG issues (Questionnaires). Indeed none of the responded engagement practitioners exercised filing of shareholder resolutions before. In subsequent interviews, engagement practitioners revealed that they viewed such an action as ‘rather aggressive’ and ‘almost hostile’ to the Chinese investee companies and would only use them as the last resort (II1, personal communications, 30 April, 2013; ESP6, personal communications, 2 May, 2013).

Similar to findings of previous studies (BSR, 2011), both engagement practitioners and Chinese investee companies agreed that the most effective communication channels were face-to-face meetings, teleconference and company or site visits, all of which were classified as Shareholder Dialogue in Zarbafi (2011)’s matrix. An engagement practitioner placed very high priority on face-to-face meetings because they were the key trust-building tool with Chinese investee companies to demonstrate that they had a long-term interest in the companies and let the companies understand why they cared about ESG issues at all (II1, personal communications, 30 April, 2013). A Chinese investee company also found that meetings, face-to-face or via phone, were most helpful to them as they could exchange views with the engagement practitioners so that they could better understand which direction the practitioners were after, what ESG themes they cared about and their overall expectations on ESG issues (IRO2, personal communications, 29 April, 2013). Another interviewed company maintained that discussions on ESG matters with institutional investors in meetings were similar to a ‘soul searching’ exercise for the company. It was an excellent learning opportunity for the company to improve its understanding on such issues (IRO1, personal communications, 16 April, 2013). During the author’s internship, it was also observed that calling investee companies to discuss ESG issues was much more effective than sending emails as teleconference allowed all the parties involved to explain their point of view in details.

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<sup>1</sup> ‘Collaborate engagement by more than one investor’, which was in the questionnaire and cited by two practitioners, is not included in the figure because it lacks contextual information on how the collaborative engagement is done, for example by means of meetings or letters, and is therefore impossible to assign it to any of the four categories.

Birgitte Nielsen, Head of Corporate Social Responsibility at the Investment Fund for Developing Country (IFU), also agreed that having mutual understanding with Chinese companies was indispensable to promoting better CSR standards (personal communications, 16 May, 2013). IFU collaborates with Danish partners to invest in countries including China through different capital provision schemes. All of these investment projects need to fulfil IFU’s CSR standards. When working with the local companies in China, IFU observed that the cultural differences between China and Denmark led to different understanding of ESG issues. For instance, it was much more common in China to resort to bribing partners with expensive gifts or extravagant meals to achieve what they wanted. Nielsen pointed out that the key to address these issues was not the ‘practical things’ because Chinese companies had what it took to fulfil certain standards if they wished to. The key, instead, was to establish *guanxi* (meaning relationship in Mandarin) with the Chinese companies. By getting acquainted with Chinese companies, IFU could better understand the cultural differences between itself and the Chinese companies. Such a mutual understanding would help the parties involved to look for solutions together.

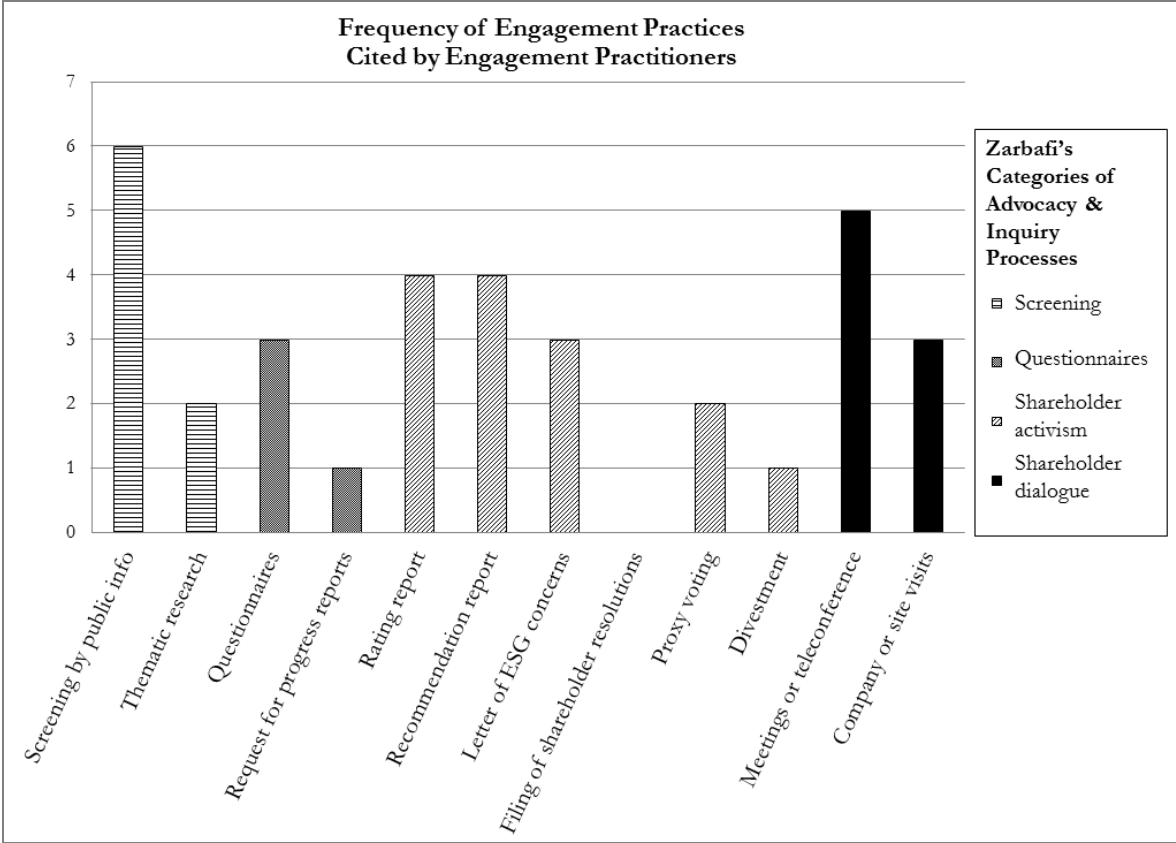


Figure 4-1 Question 8: Frequency of engagement practices cited by engagement practitioners

But not all engagement practitioners were able to carry out meetings or visits as frequently as they had wished. Two out of the five engagement practitioners who had indicated that face-to-face meetings were one of their regular engagement activities did not carry out any of them in 2012. The other three respondents had conducted meetings with 25% to 100% of the Chinese investee companies they were engaging in 2012 (see Table 4). Practitioner No. 2, an institutional investor, maintained that the high meeting ratio with investees in 2012 was due to the fact they had a policy to meet with the investees in their portfolio. Besides, they were based in China, had local staff in the office and only invested in Chinese investee companies (II2, personal communications, 2 May, 2013).

Table 4 Questions 9 &amp; 10: Number of meetings conducted by engagement practitioners in 2012

<i>Responding engagement practitioners</i>	<i>Number of Chinese investees engaged in 2012</i>	<i>Number of meetings with Chinese investees in 2012</i>	<i>Percentage</i>
Practitioner No. 2	100	100	100%
Practitioner No. 3	100	0	0%
Practitioner No. 6	1016	0	0%
Practitioner No. 7	31	20	65%
Practitioner No. 8	20	5	25%

Other responding engagement practitioners explained that meeting arrangements were usually guided by the need for additional information, client investors' request, the availability of resources and even political circumstances (ESP7, personal communications, 2 May, 2013; ESP4, personal communications, 29 April, 2013; ESP5, personal communications, 30 April, 2013; II1, personal communications, 30 April, 2013). For example, engagement practitioners might initiate meetings with Chinese investees if they could not find adequate information on the investees' ESG performance from publicly available sources or if they had specific questions regarding their ESG standards after analysing the company. Some other practitioners based outside of China found it less feasible to fly frequently to China for meetings. Sometimes meetings would be arranged because of the special request of the client investors that the engagement practitioners represented. One respondent observed that the status of the political relations between China and the respondent's country might affect the ease to conduct meetings with Chinese investee companies.

Chinese investee companies indicated that questionnaires on ESG issues (example of the advocacy and inquiry process Questionnaires) and reports on ESG rating and recommendations (example of Shareholder Activism) were also informative for them to understand institutional investors' expectation on their ESG performance (see Question 13 in Appendix 3). One respondent said the company welcomed rating and recommendations report because they were good channels to understand the company's current standing within the industry and to reflect the company's effort in ESG-related matters (IRO2, personal communications, 29 April, 2013). Another respondent indicated that the questionnaires provided the company a benchmark on ESG standards sought after by the questionnaire designers although sometimes the company might find certain questions 'quite shocking' and might not be very sure if they understood what these questions were asking for. At the same time, the respondent reflected that the company had experienced the so-called 'questionnaire fatigue' when they had to fill out complicated questions. Sometimes it could also be difficult for them to express the company's ESG situation fully in plain text (IRO1, personal communications, 16 April, 2013).

Some engagement practitioners, on the other hand, did not share the same view with the Chinese investees on how useful questionnaires were in the engagement process. Indeed only three out of seven surveyed practitioners would use questionnaires. One of the reasons was that questionnaires were usually designed for a group of respondents. Therefore they might not be directly relevant to each of them. An engagement practitioner preferred to 'cherry-pick' the mostly important and relevant ESG issues to discuss with the investees (II1, personal communications, 30 April, 2013). Another practitioner termed questionnaires to be 'demotivating' as investee companies might need to fill out a lot of them for different stakeholders already. Plus some investees might already have good ESG disclosure in the sustainability reports, which were easily accessible by the practitioner. Thus questionnaires

were not considered to be very constructive to engage with investees (ESP6, personal communications, 2 May, 2013).

#### 4.1.2 Understanding of ESG Engagement

The surveyed and interviewed engagement practitioners showed different understanding of 'ESG engagement'. Question 5 in the questionnaire for the engagement practitioners was specifically designed to explore this topic (see Appendix 2). It asked the engagement practitioners to select the statement(s) that described their approach to ESG engagement. Practitioners might choose more than one option from the list of seven:

- Ongoing monitoring of investee companies' ESG risks and preparedness
- ESG engagement is a key step to realise active ownership
- ESG engagement is carefully documented and reported to stakeholders
- ESG engagement aims to improve investee companies' ESG performance
- Investee companies are inquired how they understand ESG issues
- Investee companies are inquired why they address ESG issues the way they do
- ESG engagement actions are always clearly explained to investee companies

The first four options were derived from the United Nations backed Principles for Responsible Investment (UNPRI), which do not explicitly call for collective sense-making of ESG issues between the investors and investees but should be easily recognised and accepted as the conventional approach of ESG engagement. The last three options, on the other hand, went beyond the UNPRI and described approaches aiming to expose and exchange the investees' and engagement practitioners' perspectives on ESG-related issues. As such responses regarding the last three options were the key finding for further analysis. Among the seven surveyed engagement practitioners, six of them had selected one or more of the last three options. Figure 4-2 below presents the frequency of statements selected by the engagement practitioners. "How Chinese investee companies understood ESG issues received" was chosen by most of the engagement practitioners, followed by "why Chinese investee companies addressed the ESG issues the way they did" and then "ESG engagement actions were always clearly explained to the investees". In terms of the response by each of the engagement practitioner, only two respondents selected all of these three options while two others selected the first two of the three. The remaining two respondents chose one out of the three. Clearly respondents were divided in their opinion towards the relevance and importance of exchanging understanding on ESG issues with Chinese investees.

In a follow-up interview, an engagement practitioner explained that their approach to engagement was partly dependent on the demand of their client investors or asset managers (ESP5, personal communications, 30 April, 2013). As such, their main work was to deliver clients' requests, which might not necessarily match with all of the statements on approach to engagement listed in Question 5. Others found that understanding Chinese investee companies' view on ESG issues to be highly important as the engagement practitioner's own ESG analysis on the investees needed to be understood with reference to the investee's operating environment. Inquiring into the Chinese investees' perspective was also a way of showing respect to the companies, allowing them to explain the reasons behind their actions. Likewise, clear explanation of the engagement activities and how the investees could get involved in the process also demonstrated respect for the companies (ESP6, personal communications, May 2, 2013). An engagement practitioner shared that learning why Chinese

investee companies address ESG matters in certain manner indeed revealed a lot on their understanding of such issues:

‘We have once asked a Chinese investee how it managed labour standard and employee relations and the company ended up sending us their insurance documents. So there is clearly a gap between investors’ expectation of ESG management and investees’ understanding of ESG management (III1, personal communications, 30 April, 2013).’

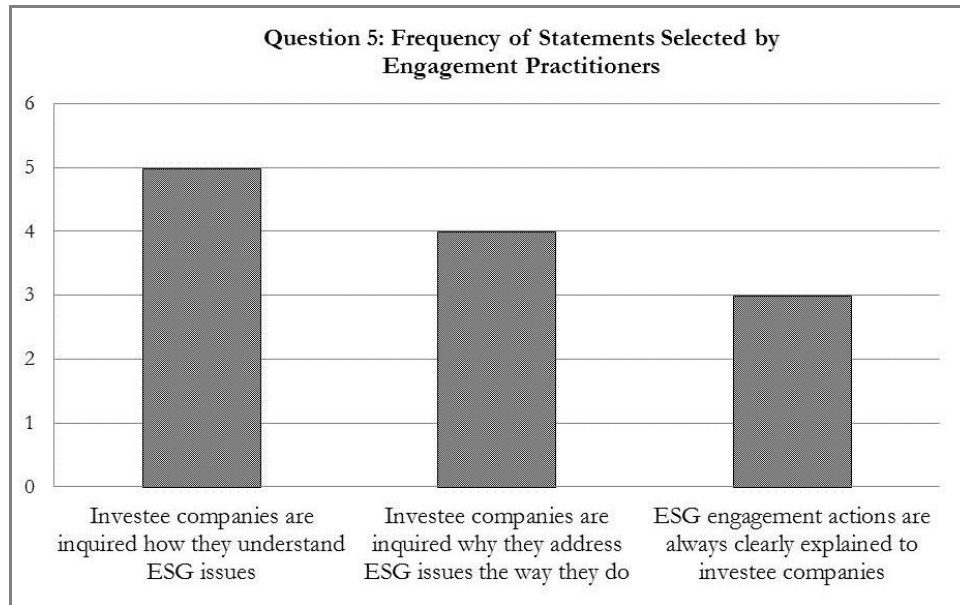


Figure 4-2 Question5: Frequency of statements selected by engagement practitioners

While the above captures how engagement practitioners understand ESG engagement, Question 14 in the questionnaire for the Chinese investee companies inquired how well the companies understood engagement representatives’ expectations on their ESG performance (see Appendix 3). The three responding Chinese investee companies viewed that they were most of the times ‘somewhat clear’ about the engagement practitioners’ expectations of their performance on environmental risks, labour and human rights issues, community outreach, transparency and reporting, as well as corporate governance. For the same five ESG matters, engagement practitioners were also asked to assign scores to show their level of relevance to Chinese investees in general and the level of difficulty to engage with them on such matters in Questions 6 and 7 (see Appendix 2). Figure 4-3Figure 4-3 summarises the average scores given by Chinese investee companies to show their level of understanding (Investees’ Understanding) and those by engagement practitioners on the levels of relevance and difficulty (Engagement Relevance and Engagement Difficulty). On a scale of one to five, five denotes higher levels of understanding, relevance and difficulty. One interesting observation from the figure is that there seems to be some degree of discrepancy between Chinese investee companies self-perceived level of understanding on ESG matters and engagement practitioners’ perception. On one hand Chinese investee companies’ self-described levels of understanding of engagement practitioners’ expectations on all five ESG issues were roughly the same (scores bit above four or ‘somewhat clear’). On the other, engagement practitioners found it much more difficult to engage with Chinese investees on the latter than the former.

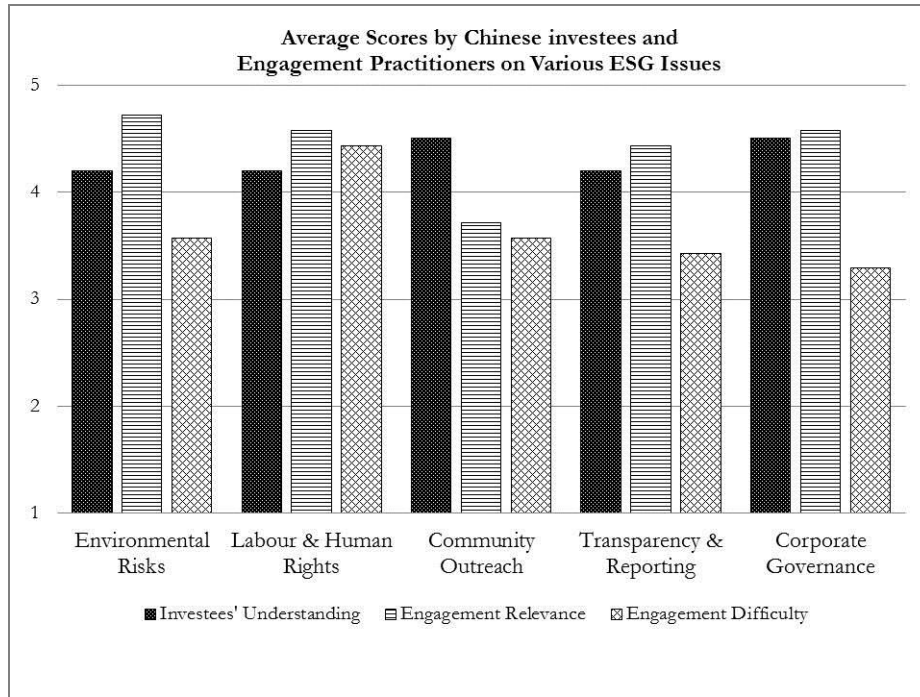


Figure 4-3 Average scores by Chinese investee companies and engagement practitioners on various ESG issues

Overall, most engagement practitioners indicated that it was more difficult to engage with Chinese investee companies on ESG issues than in other emerging markets (EMs) (see Question 12 in Appendix 2). From the engagement practitioners' perspective, the average scores of Chinese company's understanding of responsible investment (RI), responsiveness to ESG issues, transparency of operations, China's regulation and enforcement on ESG issues and language barrier of conducting engagement in China were all considered to be worse than other EMs. The only item that China scored the same as other EMs was the understanding of ESG issues by companies. Figure 4-4 presents the average scores on a scale of one to three. While two denotes the same level compared to other EMs, any score below two or above two means worse than or better other EMs respectively. An engagement practitioner who had only participated in a brief interview commented that sustainability was an under-developed area in China and that a lot of awareness raising works would be needed (ESP3, personal communications, 22 April, 2013).

In terms of tracking the impact of engagement with Chinese investee companies (see Questions 15 & 16 in Appendix 2), five out of the seven engagement practitioners reported that they would set goals for each engagement. The top three methods cited to track the progress of engagement was request for proof, regular meetings and company visits. One respondent said they did not set any goals for engagement because the only goal of getting in touch with Chinese investee companies was to obtain additional information about the companies' ESG performance (II2, personal communications, 2 May, 2013). Another respondent felt that setting goals would be ideal but that was not feasible for them at the moment because their current engagement activities were mostly sending questionnaires and ESG analysis based on publicly available information. Although Chinese investee companies might infer from the questionnaires the practitioner's expectation on ESG standards, overall the impact would be very limited. This was particularly so because the respondent's client investor only held a small amount of shares in the Chinese investees, and therefore a relatively small power of influence on them (ESP5, personal communications, 30 April, 2013).

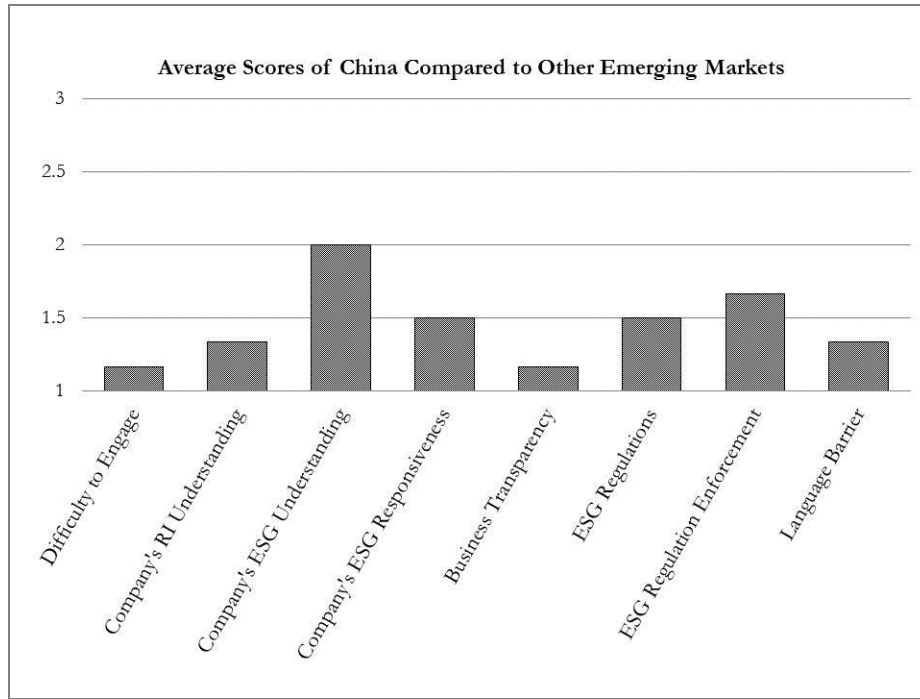


Figure 4-4 Average scores by engagement practitioners comparing China to other emerging markets

## 4.2 Organisational Decision-making by Chinese Investees

Despite the fact that only two Chinese investee companies had completed the questionnaire, data from these respondents and interviews with Chinese investees, Chinese branch offices of international companies, researchers and industry experts are able to provide an overview of Chinese investee companies’ characteristics with reference to the five descriptive questions on their organisational decision making. This section is structured according to these five questions.

The first set of questions concerns how Chinese investee companies first experience or receive engagement. The responding companies indicated that they had some experience of discussing ESG issues with the institutional investors and/or their engagement representatives but all in all those were very rare occasions. The two questionnaire respondents had been contacted by institutional investors to discuss ESG issues for twice and five times in 2012 respectively. Both email and meetings were reported to be the means of communications. One interviewed company mentioned that there was only one particular investor, who would initiate meetings on corporate social responsibility (CSR) matters every two years as it was a long-term shareholder of the company and had an in-house CSR specialist (IRO2, personal communications, 16 April, 2013). Another respondent indicated that interactions with investors mostly focused on the company’s business operations and performance. Even if a discussion on ESG issues was brought up, it was mostly on governance matters (FPRSP, personal communications, 24 April, 2013). In terms of the types of engagement activities, all of the listed engagement activities in Figure 4-1 above had been at least experienced by one of the two questionnaire respondents. Unfortunately the sample size is too small to conclude any observable pattern on the type of engagement activities at this point.

Engagement practitioners and Chinese investee companies’ average scores assigned to various communication means are presented in Figure 4-5. Engagement practitioners were asked to evaluate the level of difficulty to reach out to Chinese companies through different means on

a scale of one (least difficult) to five (highly difficult) (see Question 11 in Appendix 2). And Chinese investees were asked to evaluate their preference for such means, again on a scale of one (least favoured) to five (highly favoured) (see Question 15 in Appendix 3). Engagement practitioners seemed to be quite neutral towards these communication channels, except for fax, whose average score was four (somewhat difficult). However in subsequent interviews, several respondents stated that it was indeed quite difficult to get in touch with the right personnel of the Chinese investee companies to discuss ESG issues (CGSP, personal communications, 18 April, 2013; ESP4, personal communications, 29 April, 2013). For instance, emails listed on company websites might not work properly and a lot of times phone calls were not answered. Overall it was difficult to establish the first contact, a phenomenon also observed in previous studies (BSR, 2011), the author’s internship and this thesis research. Another engagement practitioner said once they had the first contact, then the subsequent communications became fairly easy (ESP1, personal communications, 2 May, 2013). One engagement practitioner held the view that shareholding structures in Chinese investee companies could affect how they managed investor relations. The respondent’s experience was that many of the Chinese investees with families or the state as the majority shareholders cared much less about investor relations (IR) or handling investors’ enquiry in general. Their IR departments usually worked more with the sales teams of investors, asset managers and analysts (ESP2, personal communications, 10 April, 2013). Indeed the wide-spread presence of state-owned enterprises (SOEs) was a phenomenon quite unique in China. Yet at the same time the government’s control and involvement in these enterprises could make it very challenging to engage with these companies (IA, personal communications, 10 April, 2013). This was because engagement practitioners were essentially engaging with the government, the ultimate owner of the company, instead of a simply private company on ESG issues. As for the Chinese investee companies, the most preferred communication channels were email and company or site visit. Face-to-face meetings and teleconferences were also preferred while fax and postal mail were relatively less desirable.

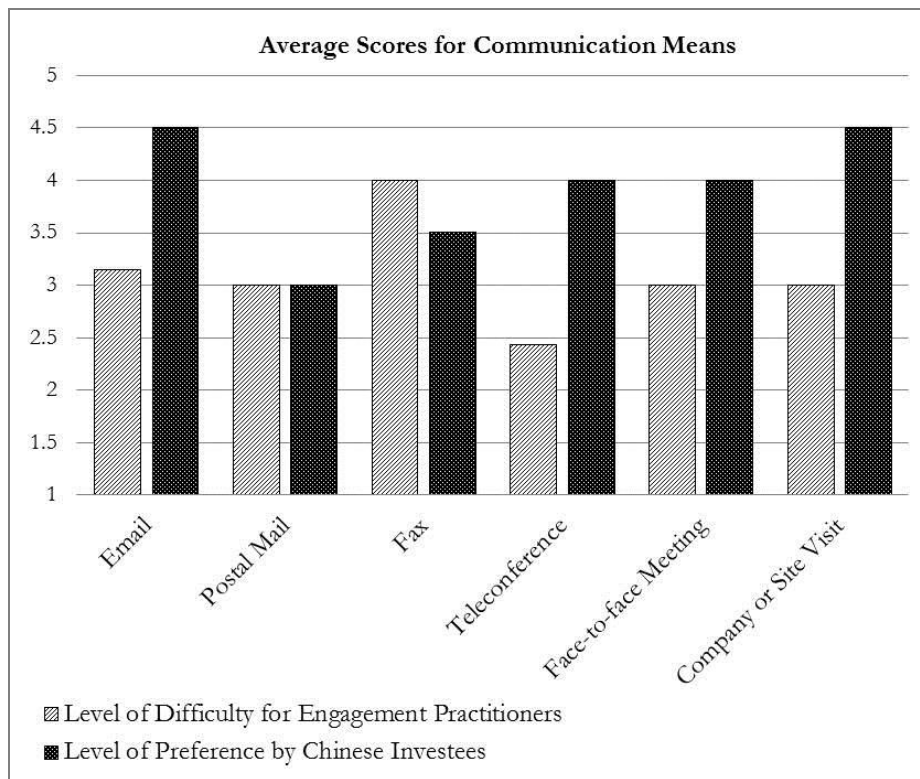


Figure 4-5 Average scores for communication means by engagement practitioners and Chinese investees



The second set of questions is on how Chinese investee companies generate response options when they are engaged by the institutional investors or their engagement representatives (see Questions 5 & 6 in Appendix 3). The two surveyed Chinese investees said middle and senior management were usually involved when discussing ESG issues. One respondent mentioned various departments such as corporate social responsibility, corporate communications etc. were involved, while the other maintained that only the investor relations personnel was involved. Experience of engagement practitioners showed that not all of the Chinese investee companies have dedicated personnel on CSR or ESG matters. One respondent found that sometimes even when a Chinese investee had a CSR personnel, such information might not be disclosed. Hence they would have to contact the company secretary or the IR team to discuss ESG issues (ESP7, personal communications, 2 May, 2013). Very often the IR officer in a company did not only maintain investor relations but carried other titles and responsibilities within the company as well (ESP2, personal communications, 10 April, 2013). Overall, these personnel were not very familiar with the company's CSR development, its ESG issues or even the broader concept of responsible investment. In short, ESG issues had not been included in the corporate agenda by many companies. Very often the top management did not understand such issues and provide support for addressing them strategically (Weihua Liu, personal communications, 23 April, 2013). Even when these issues were addressed, they were mostly done in an impulsive manner without careful planning, in response to occurred crisis or simply because of the personal affiliation of individual management personnel (Baocheng Liu, personal communications, 9 April, 2013). A sustainability consultant serving Chinese corporations also confirmed that Chinese investee companies in general did not understand the real value of sustainability very well but treated it as a marketing or publicity tool (SC, personal communications, 2 May, 2013). These characteristics were in stark contrast with Chinese branch offices belonging to international corporations. According to two interviewed organisations, sustainability was integrated in the group-level strategy by the headquarters and was subsequently implemented and monitored at different branch offices through various management systems (QM, personal communications, 25 April, 2013; SM, personal communications, 2 May, 2013).

The Chinese companies surveyed and interviewed responded most strongly towards consumer or customer demand, regulations and opinion of stakeholders when considering implementing sustainability in their operations (see Question 7 in Appendix 3). A Chinese office of an international company revealed that apart from abiding by the ESG standards set by the headquarters and maintaining high ESG performance to retain staff, the branch office was also motivated to improve its ESG performance by customers who had specific ESG requirements. By fulfilling the relevant requirements, the company was able to secure business with them (QM, personal communications, 25 April, 2013). An interviewed engagement practitioner noticed that Chinese investee companies with overseas operations tended to be more attuned to ESG issues and the corresponding standards. This was because they needed to satisfy the standards of their potential foreign customers in order to secure work contracts (ESP2, personal communications, 10 April, 2013). Researchers also found that Chinese companies addressed ESG matters mainly because of regulatory requirement. An example was the publication of CSR or sustainability report, whose number soared after the State-owned Assets Supervision and Administration Commission of the State Council as well as the Shanghai and Shenzhen Stock Exchanges had issued relevant reporting requirements (Baocheng Liu, personal communications, 9 April, 2013; Weihua Liu, personal communications, 23 April, 2013).

The third set of questions explores how response options generated by investee companies are evaluated. The two Chinese investee companies surveyed selected almost all of the provided options under Question 7 (see Appendix 2), which asked them what factors they would

consider when addressing ESG issues. While the sample was obviously too limited to provide any conclusive results, the common factors selected by both of them might still give an indication of the relatively more important factors. Those items were relevant legal requirement and regulations, best practice within the foreign industry and the costs of necessary measures to address the identified ESG issues. Besides, both Chinese investee companies and engagement practitioners confirmed that it took time for Chinese investees to digest the ESG issues internally, create response options, evaluate them and finally make a decision. Considering that companies might have six to seven board meetings per year, an engagement practitioner's experience was that it might take three to four board meetings or even a year for the company's top management to digest and discuss the concerned ESG issues before they began to address them (II1, personal communications, 30 April, 2013).

The fourth set of questions is on how the selected option is implemented by Chinese investee companies (Questions 8 & 9 in Appendix 3). In case the ESG issues raised by engagement practitioners were deemed by the investee companies as irrelevant, the two Chinese investee companies surveyed stated that they would reply the engagement practitioners that such issues were irrelevant with explanation. If the companies decided to address the identified ESG issues, setting goals and having a tracking mechanism in place were important to these two respondents. One respondent was also ready to hire external experts if needed.

The final set of questions asks the Chinese investee companies to evaluate the subsequent financial and social performances of addressing ESG issues (Questions 10-12 in Appendix 3). One questionnaire respondent observed there was positive change in the company's policy and financial performance. In particular, ESG performance compared to domestic industry, stakeholder satisfaction, overall operational costs and financial return etc. were improved. But the company was unable to reach through phone and email for an elaboration of such positive changes after submitting the questionnaire. The other respondent company said there had been no impact so far because the company was still in the process of evaluating the ESG issues internally and had not decided if further actions were needed yet (IRO2, personal communications, 29 April, 2013). For engagement practitioners that had set goals for the ESG engagement, the time needed to achieve successful engagement i.e. recording improvement in ESG performance of Chinese companies with Chinese investees varied from one year to beyond three years. One respondent mentioned some Chinese investee companies were very receptive to engagement and would implement minor improvements even after the first meeting, for example, translating their sustainability report into English and publishing the reports publicly. (ESP1, personal communications, 2 May, 2013).

## 5 ANALYSIS

The thesis now turns to analyse the obtained data with reference to the synthesised analytical framework discussed in Section 3.1.3. Firstly, such a framework analyses the types of advocacy and inquiry processes and their subsequent level of collective sense-making on environmental, social and governance (ESG) engagement from the perspectives of engagement practitioners and Chinese investee companies. Secondly, it evaluates in greater depth Chinese investees' organisational decision-making on engagement, which will help engagement practitioners to develop more effective engagement practices.

### 5.1 Application & Limitation of the Collective Sense-making Categorisation

Findings collected from the two sets of questionnaires and interviews in general confirm Zarbafi (2011)'s framework on collective sense-making. Activities classified as Shareholder Dialogue, such as face-to-face meetings, teleconference and company visit, have high levels of advocacy and enquiry. These were perceived by both of the engagement practitioners and Chinese investee companies to be the most effective in rendering an 'Enhanced' collective sense-making of ESG issues. Apart from advocating their own point of view, engagement practitioner's inquiry into how Chinese investee companies understood ESG issues and why they chose to address them in the current manner demonstrated a genuine interest in and respect for the investees' operations, their operating environment and perspectives. In short both parties were able to put their own sense-making of ESG issues on the table for discussion, and therefore contributing to an Enhanced collective sense-making. Such two-way communications were not only essential to allow investee companies to explain their worldview and therefore provide valuable feedback in the engagement process, but also build trust with the investee companies in the long run.

However unlike what Zarbafi (2011)'s framework had predicted (or some engagement practitioners had thought), some Chinese investee companies found Screening, Questionnaires and Shareholder Activism types of advocacy and inquiry processes to be beneficial and informative as well. For example, although ESG questionnaires were categorised as low level of advocacy but a high level of inquiry, investee companies considered questions in these questionnaires were based on engagement practitioners' expectation and benchmarks. In this sense, the engagement practitioners were therefore advocating certain ESG standards to them. Even an engagement practitioner who conducted questionnaires regularly with Chinese investee companies admitted that *if* the Chinese investees looked into the questionnaires, they would be able to infer, for which ESG agenda the practitioner was trying to push. Another example was proxy voting. Although it was classified as shareholder activism, a high-advocacy but low-inquiry engagement process, it had prompted some Chinese investee companies to initiate conversation with the engagement practitioners, explaining to the practitioners their approach to ESG issues. In other words, engagement practitioners were given the opportunity to inquire the investees' situation, even though their original engagement activity was not designed for that. These observations do not fit precisely into Zarbafi's collective sense-making categorisation that organises engagement activities according to their levels of advocacy and inquiry *at the moment* they are initiated by the engagement practitioners. Further explanations on the link between the observed active learning attitude and capacity among Chinese investee companies and the resulting types of collective sense-making on ESG issues are required.

The thesis suggests that Chinese investee companies’ proactiveness is a crucial factor in determining the type of collective sense-making generated in the engagement process. Such a factor was not explicitly accounted for in Zarbafi (2011)’s original categorisation (recall Figure 3-3) that paired each advocacy and inquiry process directly with the corresponding collective sense-making. Figure 5-1 redraws the original matrix into two columns of advocacy and inquiry process and collective sense-making. Each row of advocacy and inquiry process on the left leads to the corresponding type of collective sense-making on the right in the original categorisation method. The thesis’ collected data, however, shows that it may not be as linear as the original concept suggests. Chinese investee companies’ proactiveness that happens as a response to the advocacy and inquiry process will indeed affect the resulting type of collective sense-making.

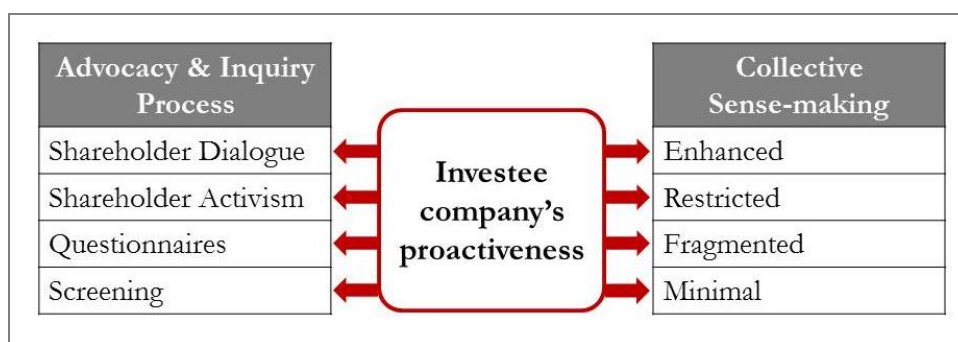


Figure 5-1 Chinese investee companies’ proactiveness in engagement process

Moreover, a closer look at the responses by each of the engagement practitioners demonstrates that three types of practitioners with different approach to engagement and means of engagement can be concluded. Type 1 practitioners are those who emphasise the importance of establishing collective sense-making with Chinese investee companies in ESG engagement but do not carry out as many meetings as they have hoped for. The number of meetings is sometimes limited by their client investors’ demand, the availability of resources or political circumstances. Type 2 practitioners do not emphasise the importance of establishing collective sense-making with Chinese investees that much but at the same time are keen on using Shareholder Dialogue like meetings to engage with Chinese investee companies. Finally Type 3 practitioners explicitly strive for collective sense-making with Chinese investee companies *and* resorting to Shareholder Dialogues as the key means of engagement. Data shows that Type 3 practitioners seem to take shorter period of time to reach successful engagement than its Type 1 and 2 counterparts. Indeed it just took around one year for a Type 1 practitioner to achieve this, the shortest indicated period of time among all respondents. It took on average two to three years and beyond three years for the Type 2 and Type 3 practitioners respectively. Table 5 summarises such findings.

Table 5 Three types of engagement practitioners

	<i>Emphasis on Establishing Collective Sense-making</i>	<i>Use of Shareholder Dialogues</i>	<i>Time needed to Achieve Successful Engagement</i>
<i>Type 1 practitioner</i>	✓	✗	Longer
<i>Type 2 practitioner</i>	✗	✓	Longer
<i>Type 3 practitioner</i>	✓	✓	Shorter

The thesis therefore proposes that using activities classified as Shareholder Dialogue or emphasising the importance of collective sense-making *alone* will not necessarily shorten the time needed for engagement or produce desirable engagement outcome. Engagement practitioners' underlying aim to generate collective sense-making *and* the means of engagement need to be aligned in order to maximise the level of the collective sense-making with Chinese investees. While Zarbafi (2011)'s categorisation assumes that engagement practitioners' approach and selected means of engagement are inherently aligned *in theory*, the thesis' data shows that it may not be the case all the time. One possible explanation is that meetings or site visits can potentially be transformed from being a Shareholder Dialogue into a high-advocacy but low-inquiry medium of communication *if* the engagement practitioner does not seek to understand the investee companies' view on ESG issues and the reasons of their current ESG-related work, or to explain clearly the aim of engagement in a meeting. This is because engagement practitioner's underlying approach to engagement will undeniably direct how a meeting is conducted. Furthermore, an engagement practitioner who highly values the importance of establishing collective sense-making on ESG issues with the investee companies may not be able to demonstrate this *if* it does not or is unable to use Shareholder Dialogue in engagement. The thesis would like to suggest that analysing an engagement practitioner's approach to engagement *in addition to* the means of engagement shall add value to Zarbafi (2011)'s original categorisation in predicting the types of resulting collective sense-making more precisely.

## 5.2 Characteristics of Chinese Investees' Response to Engagement

After analysing the collected data with reference to the collective sense-making categorisation, this section will turn to examine how the data gathered based on Margolis and Walsh (2003)'s descriptive research approach can provide further insights into the key characteristics of Chinese investees companies when responding to ESG engagement. This shall help engagement practitioners understand better what they should do *during* the selected advocacy and inquiry process so as to maximise the level of collective sense-making. The key characteristics are:

1. limited understanding and low awareness of concepts including ESG, CSR and responsible investment;
2. lack of top management support for ESG issues;
3. unique presence of state or family as majority shareholders, and;
4. regulatory requirement and customer demand as the biggest motivating factors to address ESG issues.

As confirmed by various participants of the study including engagement practitioners, academics and sustainability consultant, the lack of understanding in ESG-related concepts poses great challenges for stakeholders to motivate the Chinese investee companies to improve their ESG performance. The situation is worsened when much of the top management fail to see the intrinsic values of minimising and raising one's ESG risks and preparedness respectively because Chinese companies in general are relatively more hierarchical, exhibiting a top-down management approach. To further complicate the picture, many of the biggest listed corporations in China are indeed held in the hands of the Chinese government or wealthy families. Such a shareholding structure presents another layer of challenge for institutional investors to engage with the companies. This is particularly so if the investees' operations with questionable ESG standards are in line with the state's national policy or goals. What the investee companies fail to see is that financial backing from the government or wealthy families does not mean they can operate outside of the greater environmental, social and economic contexts (recall Figure 1-1). The problem of negative

externalities discussed in Chapter 2 still applies to them. Chinese investee companies who do respond more positively to ESG issues are likely to be driven by legislation and customer demand. While the government and customers are of course two of the key stakeholders to any company, Chinese investees who do not attempt to expand their horizon of ESG issues and seek other stakeholders' perspectives will remain rather passive in improving their ESG performance in the long run.

All of these four characteristics are not only a major road block for Chinese investee companies to continue their journey towards sustainability, but also to compete with other emerging markets. Some respondents did mention other South East Asian countries such as Thailand were displaying very promising ESG improvements and responsiveness to investors' engagement efforts.

Understanding the characteristics of Chinese investee companies regarding ESG issues will help engagement practitioners adjust what they should do *during* the advocacy and inquiry process. For example, the thesis' analysis has thus far supported the collective sense-making categorisation that Shareholder Dialogue such as face-to-face meetings is the most effective in making sense of ESG issues collectively by the engagement practitioners and Chinese investee companies. But the next question is: what can engagement practitioners do *in* the meetings to better harness such mutual understanding?

The thesis proposes that engagement practitioners can attract Chinese investees' attention and interests in ESG issues by highlighting the trends of domestic and international regulatory requirement and consumers' perspectives on such issues. These, however, should be treated as the opening of meaningful ESG discussions that shall gradually move beyond such 'immediate' values of addressing ESG issues and expand to cover the intrinsic values of having high ESG preparedness while minimising ESG risks. In particular, engagement practitioners may seek to invite top management of the main business operations, apart from the investor relations officer or company secretary, to such meetings. If the investee company concerned is a state-owned enterprise or has majority family shareholder, engagement practitioners may attempt to conduct collaborative engagement with other institutional investors, where possible. Joining hands with other engagement practitioners who share the same concern for ESG issues will make a 'louder voice' to grasp the investee companies' attention, especially those that are used to ignore ESG engagement due to their strong financial backing from their majority shareholders.

### 5.3 Reflection on Methodology

Reflecting on the methodology employed by the thesis, the relatively low response rates by Chinese investee companies in general might have been contributed by the fact that questionnaires were used as the primary data collection tool. Although the thesis' research design has basically followed recommendations by previous studies done with Chinese companies, such as establishing phone contact before sending the questionnaires, the anticipated response rates were still much overestimated. This can possibly be improved by calling all of the 117 Chinese investees in the sample instead of the current practice of calling those with ESG disclosure in sustainability reports or on website only, if time allows. An alternative is to replace the questionnaires for Chinese investee companies with interviews or even focus group discussions. After all, research respondents of this thesis have stated the phenomenon of 'questionnaire fatigue' among investee companies. And as Chinese companies value *guanxi* or relationship in Mandarin highly, the interactions and personal aspect of interviews may be a more useful medium to collect data. In addition, some of the questions developed based on Margolis and Walsh (2003)'s descriptive research agenda are rather

specific. An interview or discussion will allow the invited companies to *ask questions about* the questions and the author to provide explanation, which may encourage them to provide responses.

Overall the results can only represent the data collected and are not very generalisable. This is mainly because of the lack of direct feedback from Chinese investee companies. Much part of the data on Chinese investees is from experts or researchers who are experienced with China and Chinese companies. While they have provided valuable information on the topic, they can only represent what they think about how Chinese companies think and act. Therefore their perspective is essentially an impression of the Chinese companies, which may have discrepancy with reality.

For the engagement practitioners, one of the focus topics explored in this thesis is what they think about collective sense-making with Chinese investee companies. The method used was to ask them to select those statements on collective sense-making that they identified with in the questionnaire. As there is no widely accepted approach on collective sense-making in ESG engagement yet, these statements were drafted based on the author's own interpretation of Zarbafi (2011)'s framework as well as her work experience in engagement obtained through the internship. Engagement practitioners may have a different understanding on how collective sense-making should be defined, which has not been explored in depth in this research. As such, a change of those statements may result in different selections by the responding practitioners, which will in turn affect the analysis and results of this research.

## 5.4 Summary

In sum, this chapter has presented the data analysis with reference to the research approaches of inter-organisational collective sense-making and organisational decision-making. Figure 5-2 summarises such analysis into a conceptual model that describes the key elements affecting the level of collective sense-making on ESG issues in engagement.

First of all, with reference to Figure 5-2 and to maximise the level of collective sense-making of ESG issues, engagement practitioners need to fully understand and acknowledge the role collective sense-making plays in achieving more desirable engagement outcomes. The approach to engagement should not be just about advocacy but also inquiry. A balanced advocacy and inquiry approach is indispensable to building long-term trust in a stable relationship with Chinese investees. Such a sense of mutual understanding will pave way for both of the engagement practitioners and the investee companies to look for ways to improve the companies' ESG performance.

Secondly, advocacy and inquiry process needs to be aligned with this underlying approach to engagement. It is true that engagement practitioners always need to decide which advocacy and inquiry processes are the most cost-effective, given their limited resources. But as Shareholder Dialogue aligns the best with the aim to generate collective sense-making, priority should be given to this type of advocacy and inquiry process. Also, the actual implementation of Shareholder Dialogue should be guided by the understanding of Chinese investee companies' characteristics of addressing ESG issues. Once the advocacy and inquiry process is delivered, Chinese investee companies' own level of proactiveness towards ESG issues is the final variable in generating the resulting collective sense-making. This is important to consider because despite the presence of general characteristics of Chinese investees, some of the investees are indeed more proactive than others when it comes to addressing ESG concerns. Their proactive attitude can even improve the 'Minimal' collective sense-making generated by the Screening type of advocacy and inquiry process.

In sum, the combination of an appropriate approach to engagement, use of Shareholder Dialogue guided by the consideration of Chinese investees' characteristics and a relatively high level of proactiveness of the investees will produce the maximum level of collective sense-making of ESG issues. This will more likely result in positive changes in Chinese investee companies' ESG preparedness.

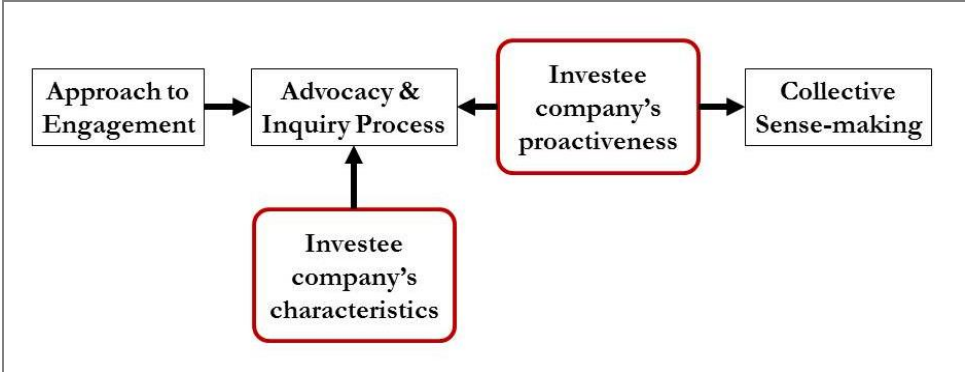


Figure 5-2 Proposed model on ESG engagement and collective sense-making



## 6 Conclusions & Recommendations

The thesis has explored the process of engagement on environmental, social and governance (ESG) issues between engagement practitioners (including institutional investors and their engagement representatives) and Chinese investee companies, with the aim to identify and understand the current practices, as well as to make recommendations to enhance the process. This particularly addresses the current knowledge gap on how ESG engagement is conducted in the Chinese contexts and how Chinese investees perceive engagement, a particular piece of information lacked by engagement practitioners to further improve their work. Two research questions with a few sub-questions were developed based on the normative inter-organisational sense-making research agenda and the descriptive organisational decision-making research agenda (Margolis & Walsh, 2003; Zarbafi, 2011):

*RQ1: How do engagement practitioners interact with Chinese investee companies?*

- What are the common practices in the Chinese context?
- Why do engagement practitioners opt for such practices?

*RQ2: How do Chinese investee companies perceive the engagement services they have received?*

- What are the common engagement services received?
- How do Chinese investee companies make sense of such services?
- How do Chinese investee companies decide what they should do regarding such services?

The thesis has found that a wide range of tools are employed by engagement practitioners but most respondents agree that Shareholder Dialogues, e.g. face-to-face meetings, teleconference and company or site visits are the most effective ways of communications. The selection of engagement tools depends on the practitioners' approach to engagement and availability of resources.

The surveyed and/or interviewed Chinese investee companies have also been engaged by the practitioners on ESG issues via various means. Same as the practitioners, most investee respondents found that Shareholder Dialogue is the most effective way to understand investors' expectations on ESG matters. Surprisingly some surveyed companies have indicated that the Screening, Questionnaires and Shareholder Activism types of engagement activities are quite useful and informative as well.

With regards to Chinese investees' response to ESG engagement, it has been found that in general they have a relative low awareness and limited understanding on ESG-related concepts and lack top-management support in addressing ESG matters strategically. Many are backed financially by the state or wealthy family shareholders. They are primarily motivated by client demand and regulations to address ESG issues.

Analysis of the collected data has contributed to a deeper understanding of the application and limitation of the chosen analytical framework. First of all, this thesis partly confirms the collective sense-making categorisation by Zarbafi (2011) that Shareholder Dialogue is the most desired advocacy and inquiry process perceived by both of the engagement practitioners and Chinese investee companies. However it has revealed that other factors may also affect the level of collective sense-making of ESG issues. Firstly, investees' higher level of proactiveness to addressing ESG issues may result in better collective sense-making. The

second factor is the alignment of the engagement practitioners' approach to and their means of engagement with an explicit aim to generate collective sense-making. Such an alignment seems to contribute to more desirable engagement outcomes. Also, with reference to Margolis and Walsh (2003)'s research approach on organisational decision-making, the thesis has suggested that an understanding of the characteristics of Chinese investees when responding to ESG engagement shall help guide engagement practitioners to execute engagement more effectively.

Based on the above findings and analysis, the thesis has proposed an alternative model that describes how to achieve the maximum level of collective sense-making on ESG issues shared by the engagement practitioners and Chinese investees, which will increase the chance of successfully motivating the investee companies to improve their ESG performance. Such a model requires the engagement practitioner to adjust their engagement approach to include a clear aim of generating collective sense-making with Chinese investees, prioritise its resources to use Shareholder Dialogue in engagement and mindfully consider the characteristics displayed by Chinese investees during the engagement process. And if the Chinese investee company being engaged is highly proactive towards ESG matters, a relatively higher level of collective sense-making will be generated.

With this alternative model in mind, the thesis will conclude with a list of recommendations for different stakeholders below.

## 6.1 Engagement Practitioners

**Engagement approach:** Being able to make sense of ESG issues collectively with Chinese investee companies is essential to maximise engagement impact. Practitioners should understand the importance of collective sense-making and adjust their existing engagement approach to include an explicit aim to generate collective sense-making with Chinese investees on ESG matters. Subsequent engagement tools and activities should be aligned with the underlying approach and aim.

**Engagement tool and activity:** Shareholder Dialogue including, for example face-to-face meetings, company or site visits and teleconference, is the most effective type of engagement tool to assist practitioners to implement their approach to allow the exchange of ideas and therefore maximise collective sense-making with Chinese investee companies. Priority should be given to these tools.

At the same time engagement practitioners should avoid using questionnaires as the primary tool to access companies' ESG information but rely more on publicly available data or well-established third-party databases (e.g. Carbon Disclosure Project) and encourage Chinese investee companies to disclose their non-financial data. The thesis suggests that a higher level of collective sense-making may be generated by the use of Questionnaires *when* the Chinese investee companies involved are more proactive on the ESG agenda. However, if these companies are already proactive, shouldn't engagement practitioner strive to maximise the potential collective sense-making by using the more desirable advocacy and inquiry process of Shareholder Dialogue? Besides, avoiding questionnaires can help minimise investees' frustration about 'questionnaire fatigue' and let them have more time and resources to develop their own sustainability reports.

Collaborative engagement can be an effective way to help Chinese investee companies, especially those with the state or families as the majority shareholder, to understand the ESG implications of their operations. While such investees tend to pay less attention to investors' concern on their ESG risks and preparedness, collaborative engagement shall pull engagement

practitioners' power of influence together to better motivate investees to address certain ESG issues properly.

Engagement practitioners should try not to conduct ESG engagement activities only when there *is* an ESG-related incident or high ESG risks are confirmed. They should manage engagement as an ongoing process to build trust between two parties. For example, they may consider communicating with investees for their *positive* ESG developments or efforts in minimising ESG risks by issuing letters to investor relations department *and* the top management. Such engagement effort requires relatively less input from the engagement practitioners, who are usually bounded by their limited time and resources and therefore tend to engage with companies with greater ESG risks only. This also communicates a strong message to the investee companies that the engagement practitioners are not an 'ESG cop' who only appears on the scene when there are risks. Instead they have a genuine interest in the ESG development of the investee companies. Moreover it enables direct communication with the top management, further motivating them to integrate sustainability into operations.

**Awareness Raising:** Engagement practitioners need to continue to educate Chinese investee companies, particularly the top and senior management, on ESG-related concepts. With top management's buying-in, ESG considerations are more likely to be integrated strategically into the company's operations, and hence delivering added values to the companies instead of being a 'green wash' or a public relations tool. Concepts that need to be promoted are responsible investment (e.g. how investors are using this as an investment strategy and why), ESG (e.g. how relevant they are to a company's risk management and hence long-term performance) and corporate social responsibility or CSR (e.g. it is not just about corporate philanthropy but a way of managing one's business). Highlighting the added values by sound ESG management will likely grasp the attention of top management, who seem to be more attuned to the business case of ESG issues.

## 6.2 Chinese Investees

**Comprehensive Disclosure:** Proper disclosure on the company's financials as well as sustainability information provides the first and key step for a meaningful dialogue with investors, which in addition will trigger a positive cycle in investor relations. With better disclosure, the likelihood for engagement practitioners to use specially-designed questionnaire or other inquiry tools to gather basic ESG data will become less. As such, both of the engagement practitioners and Chinese investee companies can allocate more of their time and resources on shareholder dialogue such as meetings that are more effective in producing a higher level of collective sense-making. Besides, public disclosure enhances the degree of accountability among the investees, which will motivate them to take responsibility of their disclosure and on the other help build trust with engagement practitioners. Trust is a key building block for successful engagement.

**Sound Communication System:** Engagement effort can be severely undermined if Chinese investee companies are out of reach by the engagement practitioners. This can easily be remedied by making sure the contact emails and phone numbers posed on websites actually work and are maintained by dedicated personnel properly. As simple and straightforward as this may sound, a lot of Chinese investees have overlooked these basics, hindering engagement practitioners from making meaningful contacts with them.

**Be a Learning Organisation:** This is a general management philosophy but it certainly helps Chinese investee companies in a time when responsible investment is gaining weight in the market. Many of the largest Chinese corporations are indeed listed on the Hong Kong Stock

Exchange, which is essentially a free market attracting international institutional investors who are in general more adept to responsible investment. Thus a better understanding of responsible investment and ESG issues will surely give these Chinese companies an edge over others in the long run. Chinese investee companies have come so far since the opening up of the economy in the 1980s. A proactive learning attitude, particularly with reference to ESG issues, will help those investees that have championed in the decades of economic transition to become even more competitive and resilient in a new era.

### 6.3 Policymakers

**Country Competitiveness:** Chinese policymakers can consider increasing the country's competitiveness through responsible investment. Many institutional investors in the study viewed emerging markets, including China, are exposed to high ESG risks. Better ESG preparedness is deemed by investors as an attractive investment environment. If the Chinese government would like to attract more foreign capital to invest in its market instead of other emerging markets, helping companies to better understand responsible investment and ESG issues will be very important. The following presents a few examples Chinese policymakers can consider:

- Fund or conduct studies on topics such as mainstreaming responsible investment in China, engaging with state-owned enterprises etc.
- Raise awareness on good sustainability reporting: Although sustainability reporting is compulsory for certain companies listed in Shanghai and Shenzhen already, the quality of reporting varies. Policymakers can engage with Chinese companies to understand what the obstacles for companies to produce quality reports and provide the necessary aid along the way.
- Enhance the domestic demand for responsible investment: Pension funds are usually regarded as the major client for responsible investment. The Chinese government can explore how similar funds in China can play a role in facilitating the development of responsible investment.

### 6.4 Academics

**Future Research Directions:** Academics may contribute to the development of ESG engagement through various research directions. The first one is to repeat similar research as this thesis but with a larger sample size of Chinese investee companies. The thesis' conclusions can only reflect the views of limited number of Chinese investees surveyed and interviewed, and more direct feedback from Chinese investees is needed to produce more generalisable and conclusive results. Another research direction is to focus on successful business case and proven business value of Chinese investee companies in enhancing their ESG preparedness. While the current thesis has briefly touched upon these topics but is unable to render more in-depth data within the research scope and the company sample size, future researchers can explore more specifically such business cases. Findings will interest both of the engagement practitioners and investee companies as the former can use the business case to encourage investees to adopt a higher ESG standards while the latter will understand the relevance between better ESG preparedness and the company's operational performance. Finally the thesis suggests researchers to carry out longitudinal studies to track Chinese investees' ongoing experience with engagement and the subsequent impact of engagement in depth. A longitudinal profile will provide a more contextualised understanding of how Chinese investees think about and react upon interactions with engagement practitioners.

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## **Appendix 1: Principles for Responsible Investment**

Source: UN PRI Website

(Retrieved on 8 January 2013 from <http://www.unpri.org/about-pri/the-six-principles/>)

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes. Possible actions:

- Address ESG issues in investment policy statements
- Support development of ESG-related tools, metrics, and analyses
- Assess the capabilities of internal investment managers to incorporate ESG issues
- Assess the capabilities of external investment managers to incorporate ESG issues
- Ask investment service providers (such as financial analysts, consultants, brokers, research firms, or rating companies) to integrate ESG factors into evolving research and analysis
- Encourage academic and other research on this theme
- Advocate ESG training for investment professionals

Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices. Possible actions:

- Develop and disclose an active ownership policy consistent with the Principles
- Exercise voting rights or monitor compliance with voting policy (if outsourced)
- Develop an engagement capability (either directly or through outsourcing)
- Participate in the development of policy, regulation, and standard setting (such as promoting and protecting shareholder rights)
- File shareholder resolutions consistent with long-term ESG considerations
- Engage with companies on ESG issues
- Participate in collaborative engagement initiatives
- Ask investment managers to undertake and report on ESG-related engagement

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest. Possible actions:

- Ask for standardised reporting on ESG issues (using tools such as the Global Reporting Initiative)
- Ask for ESG issues to be integrated within annual financial reports
- Ask for information from companies regarding adoption of/adherence to relevant norms, standards, codes of conduct or international initiatives (such as the UN Global Compact)
- Support shareholder initiatives and resolutions promoting ESG disclosure

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry. Possible actions:

- Include Principles-related requirements in requests for proposals (RFPs)
- Align investment mandates, monitoring procedures, performance indicators and incentive structures accordingly (for example, ensure investment management processes reflect long-term time horizons when appropriate)
- Communicate ESG expectations to investment service providers
- Revisit relationships with service providers that fail to meet ESG expectations
- Support the development of tools for benchmarking ESG integration

- Support regulatory or policy developments that enable implementation of the Principles

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.  
Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning
- Collectively address relevant emerging issues
- Develop or support appropriate collaborative initiatives

Principle 6: We will each report on our activities and progress towards implementing the Principles. Possible actions:

- Disclose how ESG issues are integrated within investment practices
- Disclose active ownership activities (voting, engagement, and/or policy dialogue)
- Disclose what is required from service providers in relation to the Principles
- Communicate with beneficiaries about ESG issues and the Principles
- Report on progress and/or achievements relating to the Principles using a ‘Comply or Explain’<sup>1</sup> approach
- Seek to determine the impact of the Principles
- Make use of reporting to raise awareness among a broader group of stakeholders



## Appendix 2: Informed Consent Form & Questionnaire for Engagement Practitioners

### Introduction

This research study is being conducted by Ms. Kei Yau Sin, master candidate at Lund University, Sweden to investigate how to improve engagement with investee companies in China, in order to further strengthen the business case of responsible investment.

### Procedures

You will be asked to complete a questionnaire. The questionnaire consists of 20 questions and will take approximately 20 minutes to complete. Questions will include details of your organisation's experience in interacting with Chinese investee companies on environmental, social and governance issues. After the submission of questionnaire, you may be contacted by the researcher to clarify and provide a more detailed account of certain answers in short phone interviews.

### Risks

We do not anticipate any particular risks to your participation in this research. For concerns related to information security, please refer to the section **Confidentiality** below.

### Benefits/Compensation

There is no direct compensation to participants of the questionnaire and interview. However, it is envisioned that your participation will help the researcher understand the current practices and challenges of engaging with Chinese investee companies on environmental, social and governance issues. As such, recommendations on how to improve such practices will be an outcome of the research. All participants will receive a copy of the final version of the thesis, around the fall of 2013.

### Confidentiality

All information provided will be coded, kept anonymous and confidential. It will mostly be reported as aggregate data with no identifying information. If individual comment or information is mentioned, it will be done anonymously as well. All data will be password protected, kept in a secure location and only the researcher will have access to them. After the research is completed, the master list containing the coding information and data links will be destroyed.

### Participation

Participation in this research study is voluntary. You have the right to withdraw at any time or refuse to participate entirely. However, if the withdrawal of consent occurs at the time when it affects the possibility of the finalisation of the research (for instance, shortly before publication or thesis defense), the withdrawal should result *only* in the deletion of all personally identifiable data of the participant both in published materials and in stored and processed research data.

### Questions about the Research

If you have questions regarding this study, you may contact Ms. Kei Yau Sin at [kei\\_yau.sin.577@student.lu.se](mailto:kei_yau.sin.577@student.lu.se).

### Declaration of Consent

We have read and understood the above information. We consent to take part in this research voluntarily.

Organisation Name: [Click here to enter text.](#)

Researcher Name: [Click here to enter text.](#)

Date: [Click here to enter a date.](#)

Date: [Click here to enter a date.](#)



## Part 1: Contact Information\*

Contact person: [Click here to enter text.](#)

Phone Number: (Country code) Phone No.

Title: [Click here to enter text.](#)

E-Mail: [Click here to enter text.](#)

Department: [Click here to enter text.](#)

*\* Contact details are only for short follow-up interviews, if needed.*

*All contact information will be kept anonymous and confidential throughout research.*

## Part 2: Organisational Support to Conduct Engagement in China

1. How do you identify your organisation?

Institutional investor (including asset owners and/or portfolio managers)

Engagement advisory (*Please go to [Question 5](#) directly*)

2. How do you engage with investee companies in China on environmental, social and governance (ESG) issues?

By internal personnel only (*Please go to [Question 3](#), and then [Question 5](#) directly*)

By external engagement advisory only (*Please go to [Question 4](#), and then [Question 5](#) directly*)

Both, depending on the situation (*Please answer [Question 3](#) and [Question 4](#), and continue*)

3. Following Question 0, why do you opt for “By internal personnel”?

You may choose more than one answer.

Dedicated in-house professionals on ESG engagement are available

Dedicated in-house professionals on the China market are available

Limited budget availability

Concerns for information security

To build up internal capacity to incorporate ESG considerations into traditional portfolio management

Others (Please specify): [Click here to enter text.](#)

4. Following Question 0, why do you opt for “By external engagement advisory”?

You may choose more than an answer.

Lack of in-house professionals on ESG engagement

Lack of in-house professionals on the China market

Budget availability

Others (Please specify): [Click here to enter text.](#)

## Part 3: Engagement with Chinese Investee Companies

5. Please select the statement(s) below that describes your organisation’s approach to ESG-related engagement. You may choose more than one answer.

Ongoing monitoring of investee companies’ ESG risks and preparedness

ESG engagement is a key step to realise active ownership

ESG engagement is carefully documented and reported to stakeholders

ESG engagement aims to improve investee companies’ ESG performance

Investee companies are inquired how they understand ESG issues

- Investee companies are inquired why they address ESG issues the way they do
- ESG engagement actions are always clearly explained to investee companies

6. From your organisation’s experience, please rate the level of relevance of the following ESG issues that require engagement with Chinese investee companies on a scale of 1 – 5.

	Highly irrelevant 1	Somewhat irrelevant 2	Neutral 3	Somewhat relevant 4	Highly relevant 5
Environmental risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Labour and human rights issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Community outreach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency and reporting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate governance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7. From your organisation’s experience, please rate the level of difficulty to engage with Chinese investee companies in terms of the following ESG issues on a scale of 1 – 5.

	Highly easy 1	Somewhat easy 2	Neutral 3	Somewhat difficult 4	Highly difficult 5
Environmental risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Labour and human rights issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Community outreach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency and reporting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate governance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

8. Which of the following has your organisation conducted with Chinese investee companies before? You may choose more than one answer.

- ESG evaluation and screening of investee companies based on publicly available information
- Thematic ESG research on an ad hoc or regular basis (e.g. industry-wide study)
- ESG questionnaires to investee companies
- Reports on ESG rating to investee companies
- Reports on ESG recommendations to investee companies
- Letter on specific ESG concerns to investee companies issued by one or more investors
- Request for progress reports and documentation on the handling of identified ESG issues
- Face-to-face meetings or teleconference to discuss ESG issues
- Company or site visits
- Filing of shareholder resolutions
- Proxy voting with explanation
- Collaborative engagement by more than one investor
- Divestment or recommendation for it, with explanation
- Others (Please specify): [Click here to enter text.](#)

9. In 2012, how many Chinese investee companies did your organisation engage with in total?  
[Click here to enter text.](#)

10. In 2012, how many of the following did your organisation conduct with Chinese investee companies in total? *Please skip the items that are not applicable to your organisation.*

	Number of occurrence
ESG evaluation and screening of investee companies based on publicly available information	<a href="#">Click here to enter text.</a>
ESG questionnaires to investee companies	<a href="#">Click here to enter text.</a>
Proxy voting with explanation	<a href="#">Click here to enter text.</a>
Face-to-face meetings with investee companies	<a href="#">Click here to enter text.</a>

11. Please rate the level of difficulty to reach Chinese investee companies through the following channels on a scale of 1 – 5. *Please skip the items that are not applicable to your organisation.*

	Highly easy 1	Somewhat easy 2	Neutral 3	Somewhat difficult 4	Highly difficult 5
Electronic mail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Postal mail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Facsimile	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Telephone calls and/or teleconference	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Face-to-face meetings	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Company and/or site visit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Others (Please specify): <a href="#">Click here to enter text.</a>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

12. Compared to other *emerging markets*<sup>#</sup>, please rate the level of difficulty to conduct engagement with investee companies in China on average on a scale of 1 – 3.

	Easier than average 1	Average 2	More difficult than average 3
Level of difficulty to conduct engagement with Chinese investee companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

<sup>#</sup>Emerging market countries based on MSCI definition (exclusive of China): Brazil, Chile, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey

13. Following Question 12, please rate the performance of China, as compared to other emerging markets with regards to the following statements on a scale of 1 – 3.

	Worse than Average 1	Average 2	Better than average 3
Understanding of responsible investment by companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Understanding of ESG issues by companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Responsiveness to ESG issues by companies	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Transparency of business and ESG reporting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Regulations regarding ESG issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Enforcement of regulations regarding ESG	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

issues			
Language barrier and other cultural differences	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

14. Following Questions 13, please write down other differences between China and other emerging markets with regards to ESG-related engagement below, if any.

[Click here to enter text.](#)

#### Part 4: Impact of Engagement with Chinese Investee Companies

15. Does your organisation set goals for each engagement with Chinese investee companies?

Yes

No

16. How does your organisation track the progress of such engagement?

Regular meetings or teleconferences

Regular company or site visits

Request for proof or documentation on the handling of identified ESG issues

Verification with relevant government or official agencies

Verification with non-governmental organisations

Others (Please specify): [Click here to enter text.](#)

17. Based on your organisation's experience, how long does it take to reach successful engagement with Chinese investee companies on average?

0 – 1 year

1 – 2 years

2 – 3 years

Beyond 3 years

18. On average, does it take longer for your organisation to reach successful engagement with investee companies in China than those in other emerging markets?

Yes

No

19. On average, is it more common for your organisation to exercise or advise divestment as a responsible investment strategy in China than in other emerging markets?

Yes

No

#### Part 5: Other Comments

20. If you have other comments regarding engagement with Chinese investee companies, which are not covered by any of the above questions, please indicate them below.

[Click here to enter text.](#)

## **End of Questionnaire**

Thank you for your participation. Please save and send the completed questionnaire to [kei\\_yau.sin.577@student.lu.se](mailto:kei_yau.sin.577@student.lu.se). You will receive a copy of the *Informed Consent Form* completed by the researcher shortly upon your submission. Your company may be contacted by the researcher, Ms. Kei Yau Sin, to clarify or provide a more detailed account of the answers, if needed. If you have further questions regarding this research, please do not hesitate to contact the researcher at [kei\\_yau.sin.577@student.lu.se](mailto:kei_yau.sin.577@student.lu.se).

## Appendix 3: Informed Consent Form & Questionnaire for Chinese Investee Companies

### Introduction

This research study is being conducted by Ms. Kei Yau Sin, master candidate at Lund University, Sweden to investigate how to improve engagement with investee companies in China, in order to further strengthen the business case of responsible investment.

### Procedures

You will be asked to complete a questionnaire. The questionnaire consists of 17 questions and will take approximately 20 minutes to complete. Questions will include details of your company's experience in interacting with institutional investors or engagement advisories hired by them with regards to environmental, social and governance issues. After the submission of questionnaire, you may be contacted by the researcher to clarify and provide a more detailed account of certain answers in short phone interviews.

### Risks

We do not anticipate any particular risks to your participation in this research. For concerns related to information security, please refer to the section **Confidentiality** below.

### Benefits/Compensation

There is no direct compensation to participants of the questionnaire and interview. However, it is envisioned that your participation will help the researcher understand how Chinese investee companies perceive environmental, social and governance issues, as well as investee engagement guided by the concept of responsible investment. As such, recommendations on how to improve engagement practices will be an outcome of the research. All participants will receive a copy of the final version of the thesis, around the fall of 2013.

### Confidentiality

All information provided will be coded, kept anonymous and confidential. It will mostly be reported as aggregate data with no identifying information. If individual comment or information is mentioned, it will be done anonymously as well. All data will be password protected, kept in a secure location and only the researcher will have access to them. After the research is completed, the master list containing the coding information and data links will be destroyed.

### Participation

Participation in this research study is voluntary. You have the right to withdraw at any time or refuse to participate entirely. However, if the withdrawal of consent occurs at the time when it affects the possibility of the finalisation of the research (for instance, shortly before publication or thesis defense), the withdrawal should result *only* in the deletion of all personally identifiable data of the participant both in published materials and in stored and processed research data.

### Questions about the Research

If you have questions regarding this study, you may contact Ms. Kei Yau Sin at kei\_yau.sin.577@student.lu.se.

### Declaration of Consent

We have read and understood the above information. We consent to take part in this research voluntarily.

Company Name: [Click here to enter text.](#)

Researcher Name: [Click here to enter text.](#)

Date: [Click here to enter a date.](#)

Date: [Click here to enter a date.](#)



## Part 1: Contact Information\*

Contact person: [Click here to enter text.](#)

Phone Number: (Country code) Phone No.

Title: [Click here to enter text.](#)

E-Mail: [Click here to enter text.](#)

Department: [Click here to enter text.](#)

*\* Contact details are only for short follow-up interviews, if needed.*

*All contact information will be kept anonymous and confidential throughout research.*

## Part 2: Onset of Engagement Process

1. Have your company received engagement on environmental, social and governance (ESG) issues# from the following parties?

- Institutional investors (including asset owners and managers)  
 Engagement advisories representing the institutional investors  
*(hereafter, engagement representatives)*  
 Both of the above

*#Engagement on ESG issues refers to institutional investors' effort to monitor the investee companies' ESG risks and preparedness and continuously motivate them to make improvements through dialogues. This may be done by the investors themselves or via external engagement advisories representing the investors.*

2. Which of the following ESG issues have your institutional investors or their engagement representatives raised to your company? You may choose more than one answer.

- Environmental risks  
 Labour and human rights issues  
 Community outreach  
 Transparency and reporting  
 Corporate governance  
 Others (Please specify):  
[Click here to enter text.](#)

3. In 2012, how many institutional investors or their engagement representatives contacted your company to discuss ESG issues?

[Click here to enter text.](#)

4. Below is a list of common practices conducted by institutional investors or their engagement representatives. Please indicate how frequently your company receives them on average.

	Never receive before	Less than once per year	Once per year	2 -3 times per year	4 - 5 times per year	Beyond 5 times per year
ESG evaluation and screening of your company based on publicly available information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Thematic ESG research on an ad hoc or regular basis	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ESG questionnaires to your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on ESG rating of your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on ESG recommendations for your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Letter from one or more investors sharing specific ESG concerns	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Never receive before	Less than once per year	Once per year	2 -3 times per year	4 - 5 times per year	Beyond 5 times per year
Request for proof or documentation on the handling of identified ESG issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Face-to-face meetings or teleconference to discuss ESG issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Submission of shareholder resolutions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Proxy voting with explanation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Collaborative engagement from more than one investors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Divestment or the recommendation for it, with explanation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Others (Please specify): Click here to enter text.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

### Part 3: Response to Engagement

5. When your company is contacted to discuss ESG issues, which department(s) will be involved? You may choose more than one answer.

- Corporate social responsibility
- Corporate communications
- Investor relations
- Human resources
- Finance
- Others (Please specify):  
Click here to enter text.

6. When your company is contacted to discuss ESG issues, which level(s) of management will be involved? You may choose more than one answer.

- Administrative and/or operational staff
- Middle management reporting to the senior management
- Senior management reporting to the board of directors
- Board of directors
- No managers or directors are typically involved
- Others (Please specify): Click here to enter text.

7. When deciding how to address ESG issues, which criteria would your company consider? You may choose more than one answer.

- Relevant legal requirement and regulations
- Relevant international norms (soft laws)
- Standard practice within the domestic industry
- Best practice within the domestic industry
- Best practice within the foreign industry
- Cost implication of necessary measures to address the identified ESG issues
- Financial return of addressing the identified ESG issues
- Budget availability
- Reputational value of addressing the identified ESG issues
- Impact on risk preparedness and

- Opinion of employees, if applicable
- Opinion of non-governmental organisations, if applicable
- Others (Please specify): [Click here to enter text.](#)
- management
- Impact on stock prices
- Impact on continual investment by institutional investors

8. If your company decides that the ESG issue(s) raised by the institutional investors or their engagement representatives is NOT a material concern, how would your company respond?

- Ignore their engagement or further requests
- Reply that the issue is not a material concern, without providing reason or proof
- Reply that the issue is not a material concern, providing reason or proof
- Others (Please specify): [Click here to enter text.](#)

9. If your company decides to address certain ESG issue(s), how would your company implement the relevant measures? You may choose more than one answer.

- Set well-defined goals for the implementation
- Set up a progress-tracking and reporting scheme with measurable indicators
- Hire external professionals and consultancies, if necessary
- Others (Please specify): [Click here to enter text.](#)

#### Part 4: Evaluating Engagement

10. Have engagement efforts by institutional investors or their engagement representatives led to any positive change in your company’s ESG-related policies or practices?

- Yes
- No (*Please go to [Question 12](#) directly*)

11. Following Question 10, have such changes had a positive impact on your company’s financial results?

- Yes
- No

12. If your company has addressed certain ESG issue(s) before, due to institutional investors or their engagement representatives’ involvement, OR any other factors, what are the impacts of your company’s actions? Please skip items that are not applicable to your company.

	Worsen	Neutral	Improved
Internal comprehension of ESG issue(s)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Compliance with relevant regulations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Compliance with international norms	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ESG performance compared to domestic industry	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ESG performance compared to international industry	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Stakeholder satisfaction (e.g. employee, non-governmental organisations)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Overall operational costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

	Worsen	Neutral	Improved
Overall financial return	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Company reputation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Risk preparedness and management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Stock price	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Interests from institutional investors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Others (Please specify): Click here to enter text.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

13. On a scale of 1 – 5, please rate how helpful the following practices are, to help your company understand the institutional investors or their engagement representatives’ expectation of your performance in ESG issues and corporate responsibility.

	Highly unhelpful 1	Somewhat unhelpful 2	Neutral 3	Somewhat helpful 4	Highly helpful 5
ESG evaluation and screening of your company based on publicly available information	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Thematic ESG research on an ad hoc or regular basis	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
ESG questionnaires to your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on ESG rating of your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Reports on ESG recommendations for your company	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Letter from one or more investors sharing specific ESG concerns	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Request for proof or documentation on the handling of identified ESG issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Face-to-face meetings or teleconference to discuss ESG issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Company or site visits	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Submission of shareholder resolutions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Proxy voting with explanation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Collaborative engagement from more than one investors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Divestment with explanation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Others (Please specify): Click here to enter text.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

14. On a scale of 1 – 5, please rate how well your company understand your institutional investors or their engagement representatives’ expectation on your performance in the following ESG issues:

	Highly unclear 1	Somewhat unclear 2	Neutral 3	Somewhat clear 4	Highly clear 5
Environmental risks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Labour and human rights issues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Community outreach	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Transparency and reporting	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Corporate governance (e.g. compliance)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15. On a scale of 1 – 5, please rate how your company prefers the communication channel with institutional investors or their engagement representatives.

	Highly unfavoured 1	Somewhat unfavoured 2	Neutral 3	Somewhat favoured 4	Highly favoured 5
Electronic mail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Postal mail	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Facsimile	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Telephone calls and/or teleconference	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Face-to-face meetings	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Company and/or site visit	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Others (Please specify): Click here to enter text.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

16. Please select the *top five* factors that would best motivate your company to improve your ESG performance.

- |  |   |
|--|---|
| <input type="checkbox"/> Institutional investors’ expectations on ESG issues | <input type="checkbox"/> Consumer demand  |
| <input type="checkbox"/> Legal regulations                                   | <input type="checkbox"/> Other stakeholders’ opinion (e.g. employees, non-governmental organisations) |
| <input type="checkbox"/> International norms (soft laws)                     | <input type="checkbox"/> Financial return of addressing the identified ESG issues                     |
| <input type="checkbox"/> Best practices within domestic industry             | <input type="checkbox"/> Reputational value of addressing the identified ESG issues                   |
| <input type="checkbox"/> Best practices within foreign industry              | <input type="checkbox"/> Others (Please specify):<br>Click here to enter text.                        |

**Part 5: Other Descriptive Comments**

17. If you have other comments regarding ESG-related engagement with institutional investors or their engagement representatives, which are not covered by any of the above questions, please indicate them below.  
Click here to enter text.

**End of Questionnaire**

Thank you for your participation. Please save and send the completed questionnaire to kei\_yau.sin.577@student.lu.se. You will receive a copy of the *Informed Consent Form* completed by the researcher shortly upon your submission. Your company may be contacted by the researcher, Ms. Kei Yau Sin, to clarify or provide a more detailed account of the answers, if needed. If you have further questions regarding this research, please do not hesitate to contact the researcher at kei\_yau.sin.577@student.lu.se.



## Appendix 4: List of Interviews

For interviews conducted in strict confidentiality, interviewees' names were replaced by abbreviations of their roles, while company or organisation names were replaced by a brief description of the organisation. The list is sorted according to the interviewees' last name or abbreviations in alphabetical order.

<i>No.</i>	<i>Date</i>	<i>Interviewee*</i>	<i>Position</i>	<i>Company/Organisation</i>	<i>Location</i>	<i>Method</i>
1	18-04-2013	CGSP	Head of Research	A corporate governance service provider for asset owners and managers	The United Kingdom	Telephone
2	21-11-2012 & 02-05-2013	ESP1	Managing Director	A responsible investment research and engagement service provider serving global clients	Denmark	Face-to-face
3	10-04-2013	ESP2	Senior Engagement Manager	A responsible investment research and engagement service provider serving global clients	Sweden	Telephone
4	22-04-2013	ESP3	Director of ESG Research	A carbon advisory and analytics firm serving Australia and the Asia-Pacific	Australia	Telephone
5	29-04-2013	ESP4	Researcher	A responsible investment research and engagement service provider	Korea	Telephone
6	30-04-2013	ESP5	Head of ESG Research Center	A think-tank that also provides responsible investment research and engagement service	Japan	Telephone
7	02-05-2013	ESP6	Senior Consultant	A responsible investment research and engagement service provider serving global clients	Denmark	Face-to-face
8	02-05-2013	ESP7	Researcher	A consulting firm that also provides responsible investment research and engagement service provider	China	Telephone
9	24-04-2013	FPRSP	Senior Account Executive	A home appliances manufacturer and retailer for the Chinese and overseas markets; listed in Hong Kong	China	Telephone
10	10-04-2013	IA	Principal, Head of Asia, Responsible Investment	A global investment advisory	Australia	Telephone
11	30-04-2013	II1	Analyst	Asset manager of responsible investment funds	The United Kingdom	Telephone
12	02-05-2013	II2	Assistant Analyst	Asset manager that specialises in investing in Chinese investee companies	China	Telephone
13	16-04-2013	IRO1 <sup>#</sup>	Assistant Director, Corporate Communications	A real estate developer and manager in Hong Kong and China; listed in Hong Kong	China	Telephone
14	29-04-2013	IRO2	Assistant General	A consumer goods company	China	Telephone

			Manager	focusing on retail and food and beverages in China; listed in Hong Kong		
15	09-04-2013	Dr. Liu, Baocheng <sup>#</sup>	Director	Center for International Business Ethics, University of International Business and Economics	China	Email in Chinese
16	13-04-2013	Liu, Weihua <sup>#</sup>	Vice Chairman and General Secretary	China Committee of Corporate Citizenship	China	Email in Chinese
17	16-04-2013	Nielsen, Birgitte <sup>#</sup>	Head of CSR	Investment Fund for Developing Countries	Denmark	Telephone
18	25-04-2013	QM <sup>#</sup>	Director, Quality Management	A manufacturer of polymer components for telecommunication devices	China	Telephone
19	02-05-2013	SC <sup>#</sup>	Consultant	A global management and technology consultancy; listed in New York	Singapore	Email
20	02-05-2013	SM <sup>#</sup>	Global Sustainable Material Manager	A global garment manufacturer and retailer; listed in Sweden	China	Telephone

\*Abbreviations for interviewees:

CGSP – Corporate governance service provider

ESP – Engagement service provider representing institutional investors

FPRSP – Financial public relations service provider representing a Chinese listed company

II – Institutional investor, including asset owners and/or managers

IRO – Investor relations officer of a Chinese listed company

QM – Quality manager

RIC – Responsible investment consultant

SC – Sustainability consultant

SM – Sustainability manager

<sup>#</sup> Interviewees contacted in the alternative data collection plan



## **Appendix 5: Alternative Interview Questions**

### **Chinese Investee Company**

- Can you briefly describe your company's experience in discussing ESG matters with the institutional investors?
- How well does your company understand the institutional investors' expectation of your company's ESG performance?
- What will help your company better understand the institutional investors' expectation of your company's ESG performance?

### **Academics / Researchers on corporate social responsibility (CSR) in China**

- What changes in CSR disclosure have you observed in Chinese companies in the past few years? What areas still need improvement?
- What do you think are the biggest challenge to further the development of CSR or environmental, social and governance (ESG) issues among Chinese companies?
- How well do you think Chinese companies understand international norms on CSR or ESG issues? What do you think should be considered when implementing such international norms in China so that CSR or ESG development can be promoted?
- How well do you think Chinese companies understand the concept of “responsible investment” and institutional investors’ expectation on their ESG standards?

### **Chinese branch offices of international companies operating in China**

- Can you briefly describe your company’s strategy on ESG matters?
- As part of an international company, how does the Chinese branch office implement the group-level corporate ESG-related policies in China?
- Has the Chinese branch office encountered any challenges when implementing the group's ESG-related policies in China? How does the office overcome such challenges?

### **Sustainability consultant advising Chinese companies**

- What are the greatest obstacles for Chinese companies to approach or implement sustainability or CSR in their operations?
- From your experience, how well do you think Chinese companies understand international sustainability or CSR norms such as the UN Global Compact? How can the implementation of such international norms be improved in China?
- What factors do you think best motivate Chinese companies to implement sustainability or CSR in their operations?