Advancing the ESG agenda in Financial Services in China

The need for next generation ESG leaders

February 2022

As forward-thinkers with deep sustainability expertise, ESG executives from the financial services sector are in high demand as the Chinese financial services industry begins its journey toward carbon neutrality

Eighteen years have passed since the UN Global Compact first introduced the concept of ESG. ESG emphasizes sustainable development and advocates a greater operational focus on environmental friendliness (E), social responsibility (S) and corporate governance (G). During this period, sustainable development in the global financial industry has developed rapidly, and some European and American countries have taken the lead in ESG transformation. In the face of international development trends, China has also promoted ESG to the mainstream in recent years, pledging in 2020 to "have carbon emissions peak before 2030 and achieve carbon neutrality by 2060." The financial industry has followed this lead, embarking on an ESG transformation. However, companies require sustainable leadership and top-level design to guide this transition. At Russell Reynolds Associates, our purpose is to improve the way the world is led. One way we strive to do this is by helping leaders adopt more sustainable and inclusive business practices and fine tune companies' ESG efforts. In this article, we have examined the financial industry's processes and organizational structures as its sustainability journey evolves, focusing on the importance of leadership during an ESG transformation.

Global ESG development has undergone an evolutionary and cumulative process

The unprecedented scale of sustainable investment into the global financial industry did not happen overnight; there have been several years of development leading up to this point. According to the Global Sustainable Investment Alliance (GSIA), global sustainable investment assets under management reached $35.3 trillion in 2020 and grew at a compound rate of 13.02% between 2012 and 2020, far outpacing the overall growth rate of the global investment management industry (6.01%). This trend remained strong even in the last two years, as the world weathered the pandemic.

As the industry continues to expand, we have seen a shift in the leadership needs in financial services firms. First generation ESG leaders in the financial services industry have come mostly from functional roles: they were often promoted internally from a role in legal, compliance, marketing or investor relations to an ESG leader role. They mostly served as spokespeople on sustainability, answering questions from internal and external stakeholders.

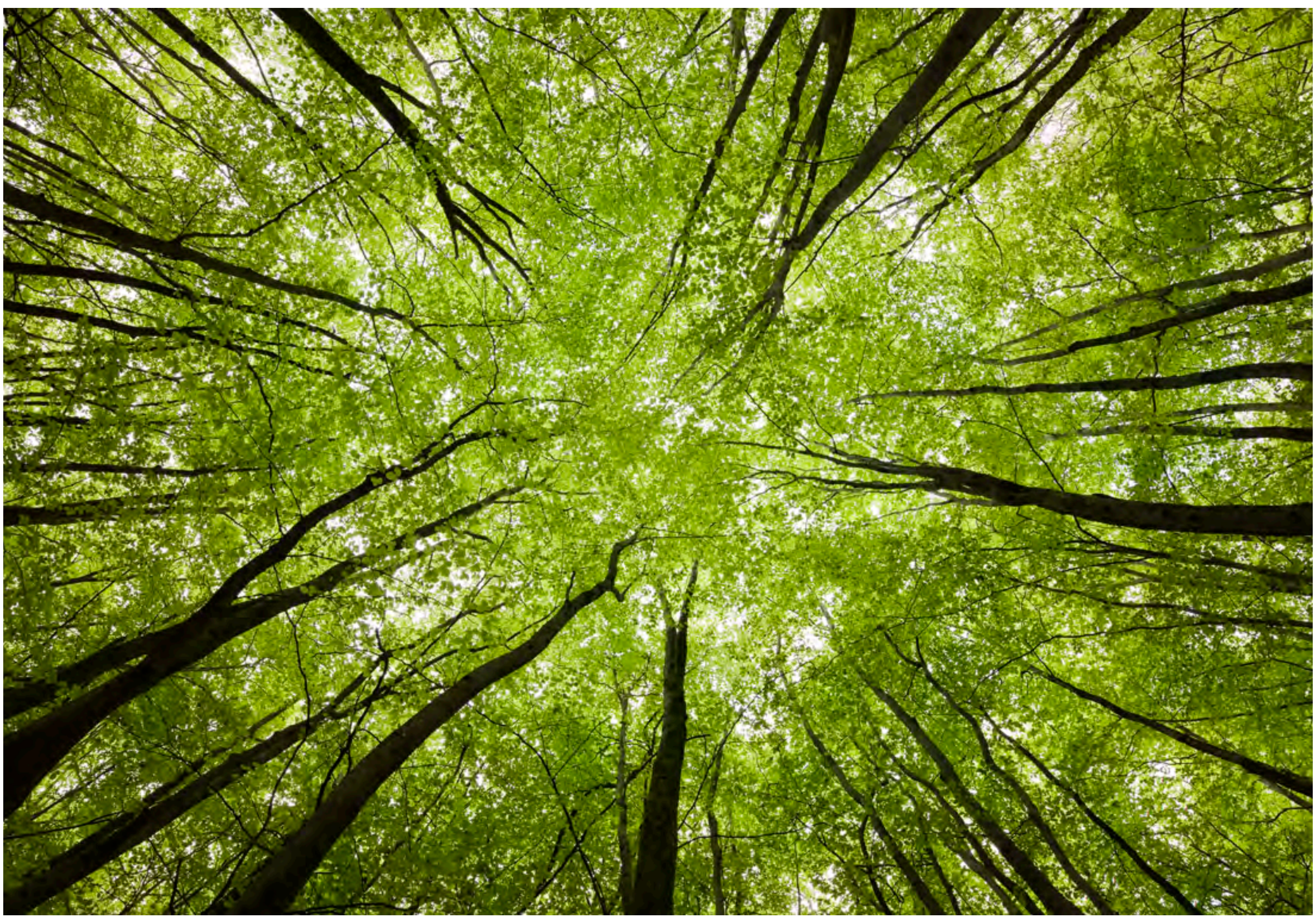
But with increased pressure from investors, consumers, employees, boards of directors, and regulators, ESG has shifted from a functional need to a value creation imperative. Industry-benchmark companies report that incorporating sustainability into their organizational and corporate investment strategies can deliver financial benefits, while also meeting stakeholder demands. This has led to a surge in corporate demand for ESG leaders, straining an already scarce talent pool. Also, the profile of the next generation of ESG leaders will be quite different: companies need a more senior, flexible, and forward-looking executive to serve as their "ESG 2.0" leader.

To better understand this shift and the specific competencies and experiences that global financial firms seek in this next generation of ESG leaders, RRA analyzed the profiles of 46 senior ESG leaders appointed in the past 18 months by large-size global organizations. Our data shows that, in contrast to the first generation of ESG leaders, these leaders have a professional background in sustainability and bring cross-functional expertise to the role. Additionally, the majority of these leaders are female and came into their roles as external hires, rather than through internal promotions.

Case study:

How Blackstone built its ESG team to progress the ESG agenda within the organization

Blackstone, the world's largest alternative asset manager, has integrated ESG considerations into its strategy since its inception. Each investment is subject to rigorous due diligence and ESG considerations are incorporated into decisions from the outset. Starting in 2021, Blackstone implemented a new initiative to provide professional and technical support in all new investments to ensure a 15% reduction in the overall carbon footprint of each investee project. Blackstone hired five new members to its ESG team that year to ensure this requirement was implemented and upheld. Elizabeth Lewis is currently Blackstone’s Deputy Head of ESG. She has held key positions in management consulting firms, international environmental protection organizations, as well as the World Bank and the International Finance Corporation (IFC). Ms. Lewis understands financial investment logic and has deep insight in multi-system thinking and stakeholder inclusion, which will help Blackstone expand its business in clean energy, energy efficiency, green finance, sustainable cities, and climate-smart agriculture.



China's Financial Services industry is undergoing multiple initiatives to accelerate its ESG focus

In China, because of national policies and investment capital, ESG has been widely accepted in the financial services to actively guide investors and investment institutions. On September 22, 2020, General Secretary Xi Jinping proposed China's commitment to achieve the goals of carbon neutrality by 2060. On April 15, 2021, Governor Yi Gang of the People's Bank of China said that China would need to invest RMB2.2 trillion per year and RMB3.9 trillion per year at a later stage to achieve its carbon reduction targets. Government budgets are not able to accommodate these investments alone, which means that there will be a lot of private capital involved. RRA has also seen data that proves this transition is taking effect; whether it is the proportion of ESG information disclosed by Chinese companies, the scale of ESG investment, the volume of green bonds issued, or the scale of ESG teams in financial institutions themselves, all are showing increasing momentum.

However, China's Corporate ESG transformation is still in its early stages

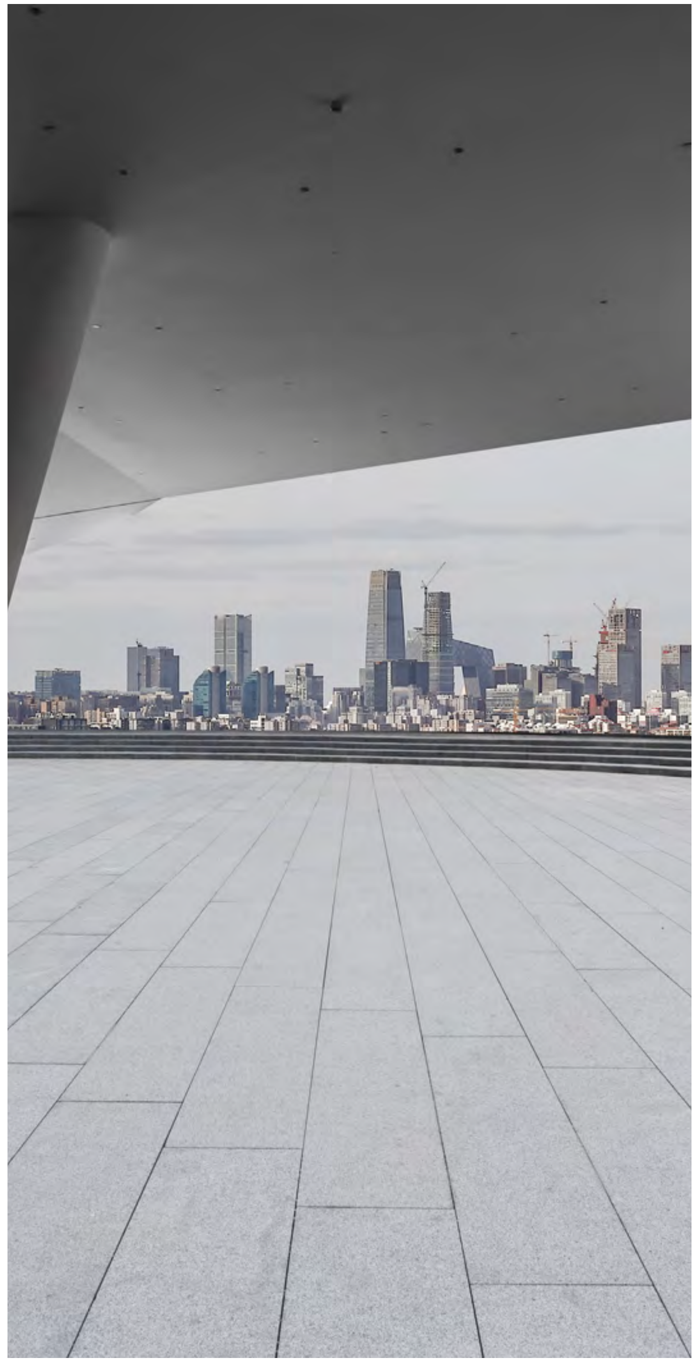
As Chinese companies move toward high-quality development, many company boards are re-examining the mission and goals of corporate governance. To achieve high-quality development, companies' goals need to evolve to assume more social and environmental responsibilities, as it relates to ESG. RRA observes that the integration of ESG concepts, driven from the top down by the board of directors, provides a new transformational opportunity for a high-quality evolution of the board of directors. In the future, a company's financial goals will be inextricably linked to its sustainability goals. This requires companies to fully integrate sustainability principles into their governance, strategy, products, and operations.

There are three stages corporates tend to go through when they embark on their sustainability transformation journey:

1. In the initial stage, companies are responsive to sustainability requirements, due to pressure from investors. ESG efforts at this stage are tactical, rather than strategic. People responsible for relevant ESG work are generally internal transfers. They are positioned as mid-level leaders and conduct their work through coordination.

2. During the growth stage, companies proactively realize that they need a clearer and more integrated ESG strategy. As a result, they upgrade their ESG departments and allocate dedicated resources to seek more experienced and professional ESG leaders.

3. In the final stage, companies understand that ESG will add value to their business. At this point, the Head of ESG will be a core member of the executive team reporting to the president or CEO and will hold responsibility for ESG deployment and execution across the company.



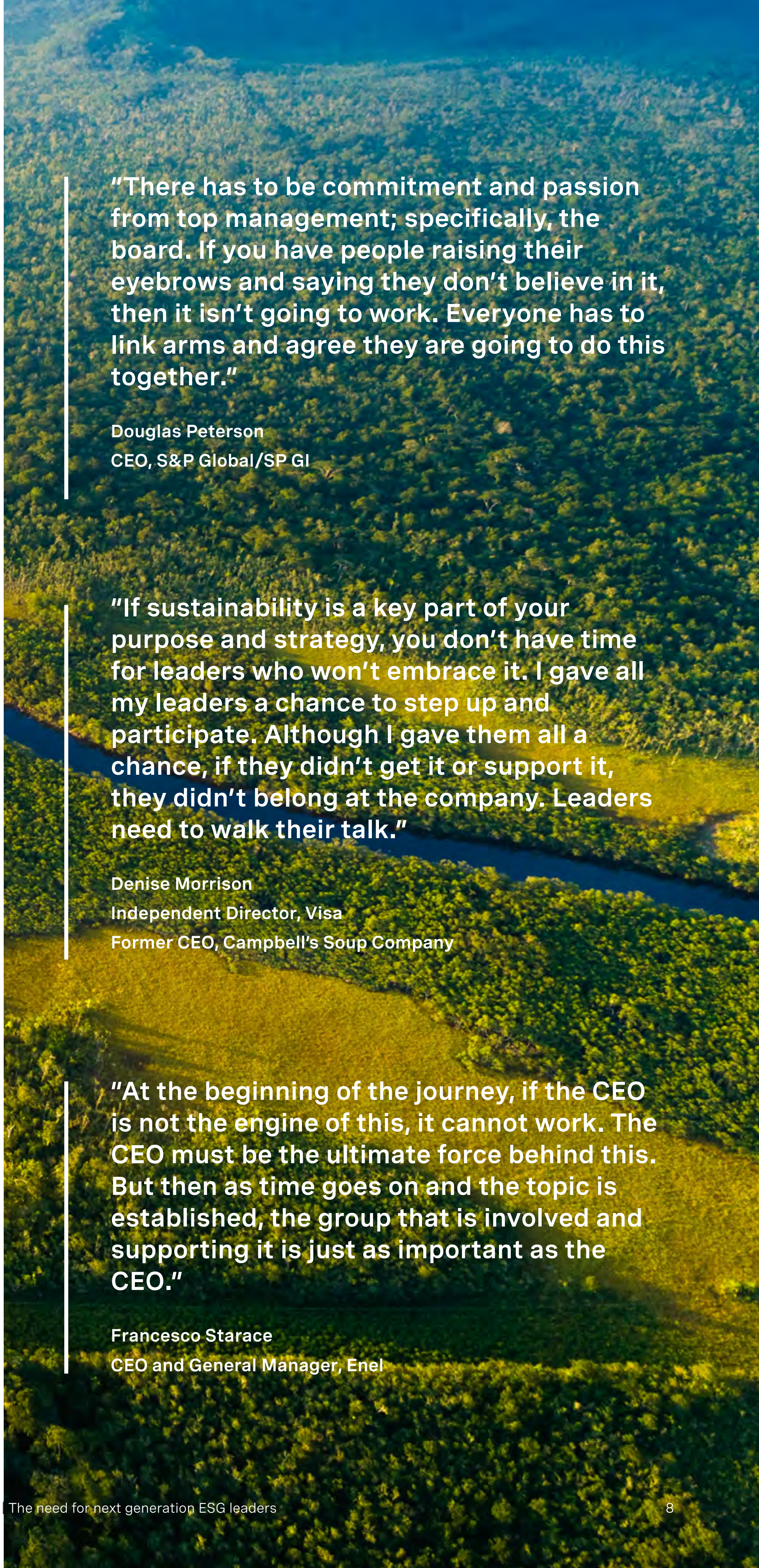
Therefore, ESG transformations are gradual processes from a single requirement to an overall strategy shift. Although all companies are striving to be the best in class and intend to become the industry benchmark, most companies in China are still in the initial stage.

	Nascent	Evolving	Best-in-class
Strategy and talent scheme	• Firm has been forced to respond to investor demand, but has done so in a purely reactive way • Limited information or no clear and quantifiable targets due to responsive ESG reporting disclosures • Sustainable development is not a core value within talent management	• Firm realizes that sustainable development is a competitive advantage and a risk-mitigation tool • Regular disclosure of ESG reports with clear goals and progress • Sustainability is a foundational value of the talent management scheme	• Firm embraces the concept of ESG leadership being accretive commercially • Sustainability Report is an integral part of the Annual Report • A clear emphasis on sustainability experience and mindset in talent selection and management, with performance linked to executive compensation
Team value proposition	• Views the ESG role as functional and tactical vs. commercial and strategic • An appointed "Head of ESG," is usually someone from within the firm who has been asked to coordinate across investments, distribution, and marketing	• Firm has appointed or recruited a credible ESG leader, who combines an investment background with sustainability domain expertise • Oversees a small team of direct reports and partners with analysts who sit within the various investment teams	• Head of ESG is a senior firm member, sitting on the Executive and/or Operating Committee and reporting to the President / CEO • "ESG Czar" is credible across all asset classes and geographies in both an investment and ESG context

Transforming a company's ESG practices starts from the top

Transforming a company's sustainability practices is not something that can be independently achieved by one person or team. Instead, organizations must begin with a mindset shift among their senior leadership team. The experience and qualities valued by companies when selecting their new ESG leaders—whether they are internal or external hires—will have a significant impact on the companies' ESG strategy and culture.

Compared to their European and American counterparts, Chinese companies are still at the initial stages of their ESG transformation. Based on MSCI[1]'s global ESG ratings, many Chinese companies receive below-average ratings, with very few companies receiving excellent ratings of AA and above. Focusing on the largest financial institutions in the industry, few asset management firms have MSCI ESG ratings. There are a few exceptions: China Construction Bank and Industrial Bank Co., Ltd. are among the few banks with A ratings, and Haitong Securities is one of the very few investment banks and securities companies with BBB ratings.



> **"There has to be commitment and passion from top management; specifically, the board. If you have people raising their eyebrows and saying they don't believe in it, then it isn't going to work. Everyone has to link arms and agree they are going to do this together."**
>
> **Douglas Peterson**
> **CEO, S&P Global/SP GI**

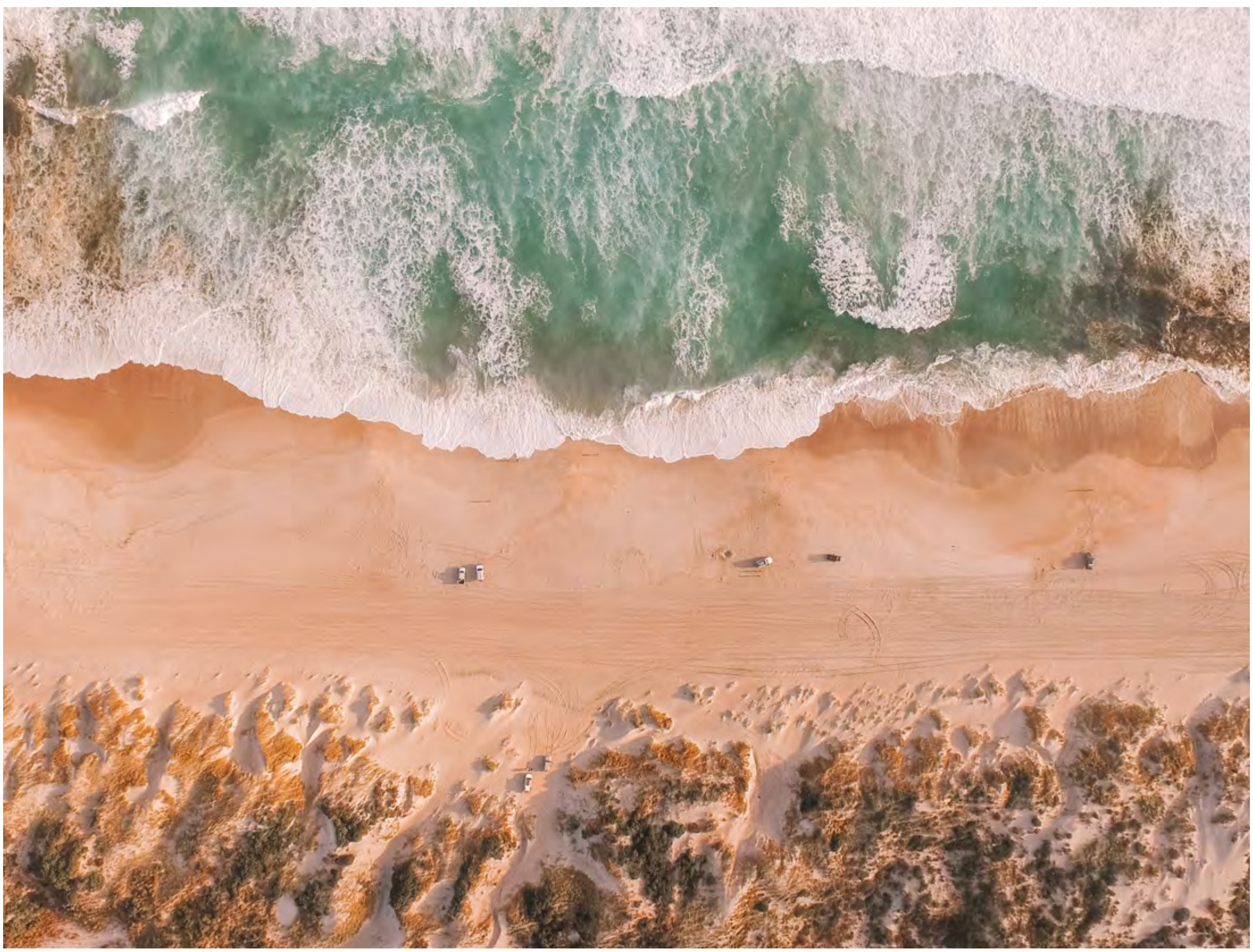
> **"If sustainability is a key part of your purpose and strategy, you don't have time for leaders who won't embrace it. I gave all my leaders a chance to step up and participate. Although I gave them all a chance, if they didn't get it or support it, they didn't belong at the company. Leaders need to walk their talk."**
>
> **Denise Morrison**
> **Independent Director, Visa**
> **Former CEO, Campbell's Soup Company**

> **"At the beginning of the journey, if the CEO is not the engine of this, it cannot work. The CEO must be the ultimate force behind this. But then as time goes on and the topic is established, the group that is involved and supporting it is just as important as the CEO."**
>
> **Francesco Starace**
> **CEO and General Manager, Enel**

Case study

How Asia Green Fund incorporated ESG into the DNA of its organization

Asia Green Fund is the first private equity fund in China to integrate ESG policy into the entire process of fundraising, investment, management, and exit, demonstrating its impact in green investment over the past five years. In its portfolio, each RMB 100 million can leverage energy savings of 1,200 GWh, reduce carbon emissions by 500,000 tons, save 2.6 million trees, and reduce waste discharges by 700,000 tons. All of these would not have been possible without the vision of Asia Green Fund's founder, Chairman, and CEO, Mr. Bai Bo. Bai Bo worked at Warburg Pincus, where he was responsible for investments in industrial, energy and business services in Asia Pacific, and was a member of Warburg Pincus' ESG committee. He realized that "to truly practice ESG principles and to truly promote capital as responsible capital, the DNA of the institution is very important." As a flag-bearer, Bai Bo has injected his ESG and carbon emissions knowledge into the DNA of Asia Green Fund. He also created the Green Technology Institute, developing a green assessment system to demonstrate the financial and social value created by his investments.



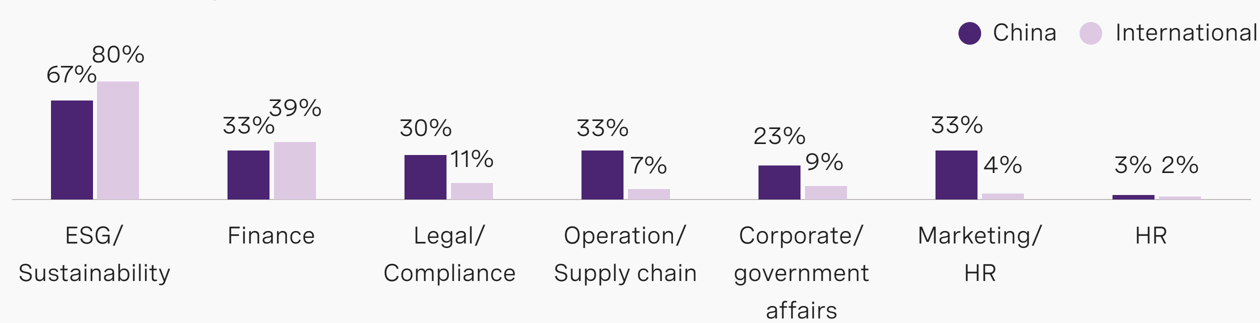
The next generation of ESG leaders in China would benefit from deeper sustainability expertise

To better understand the demand for ESG leaders in Chinese financial institutions, RRA conducted a 2021 survey of ESG/CSR/sustainability leaders in the Chinese financial industry, comparing these leaders with their international ESG 2.0 counterparts. We found that the current Chinese ESG leaders possess the following characteristics:

Less than half of the ESG leaders in China's financial industry are external hires. For those who are promoted internally, some are transferred from other functions to become ESG leaders, such as corporate/government affairs, marketing/PR, or legal/compliance, while others' responsibilities are extended to include ESG. Meanwhile, more than 90% of the ESG leaders hired globally are external experts, and 80% of them have ESG or sustainability experience and bring professional ESG knowledge and expertise to the company.

ESG leaders in China's financial industry have more cross-functional experience than the average global leader. Among them, 77% have experience in two or more functions, which is much higher than the global average of 65%. In China, 28% of ESG leaders bring experience in three or more functions, which is largely in line with the global figure (26%). Globally, cross-functional experience is not a negative for ESG leaders, and a deep understanding of other departments' operations can even make them more comfortable in communicating with internal stakeholders if they know the business well enough. Additionally, we find that women account for about two-thirds of ESG leaders, both in China and internationally, and that female leadership is well recognized in the ESG space. It is one of the few areas in which women executives are in the majority.

Past functional experience of ESG leaders (%)



Source: Russell Reynolds Associates Global and China ESG Leaders Study (2021)

When developing green finance in China, RRA makes the following recommendations for next generation ESG leaders.

1. Focus on enhancing expertise and strategy

Being an ESG leader goes beyond being a tactical spokesperson for the organization. The next generation ESG leader is strategic and comes with relevant expertise. When companies don't have in-house sustainability experts, they should look externally for candidates with relevant expertise and backgrounds, such as those who have experience in sustainability planning and implementation for various international non-profit organizations or governmental organizations.

2. Integrate ESG expertise and industry experience across the company

ESG 2.0 leaders need to understand the financial industry, as well as be able to combine industry knowledge and cross-functional experience. Corporate ESG leaders shall firstly possess relevant industry experience and understand the logic of financial businesses. These leaders are responsible for driving their company's ESG transformation, which means they must be aware of its implications for the company's business and all other departments. Communication between ESG leaders and business departments is essential for the whole company to realize that integrating sustainability into corporate strategy may lead to financial benefits. Business knowledge gives ESG leaders the credibility to convince other senior business leaders to practice ESG across all departments.

3. Sufficient attention and internal support

The ESG transformation starts from the top. Companies need to ensure that ESG leaders receive the right internal support and that the role is structured at the appropriate level to ensure ESG becomes a core component of the company's business strategy. It is critical that ESG leaders shall report directly to top management to facilitate top-level support for ESG and subsequent top-down implementation.

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References

1. Would Integrating ESG in Chinese Equities Have Worked? - MSCI

About Russell Reynolds Associates

Russell Reynolds Associates is a global leadership advisory and search firm. Our 470+ consultants in 47 offices work with public, private and nonprofit organizations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organizations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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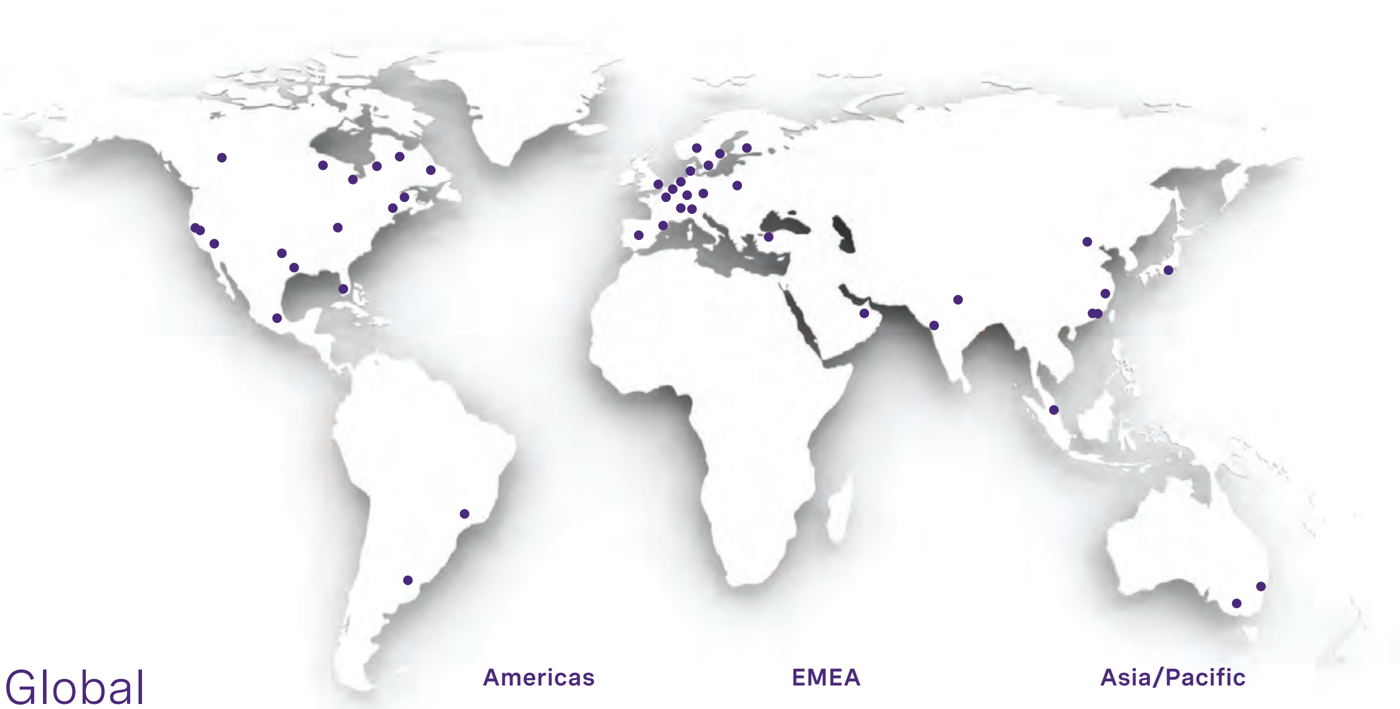

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