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Introduction and Overview

I Introduction

This is the first book to provide a comparative and critical analysis of why and how corporate governance and corporate law have been or can be used to promote and protect sustainability in the four common law jurisdictions in Asia, ie Singapore, Hong Kong, India and Malaysia. Based on theoretical, doctrinal and empirical research, I critically evaluate the rationales for, and effectiveness of, six corporate mechanisms, namely (1) sustainability reporting; (2) gender diversity on the board of directors; (3) constituency directors; (4) stewardship codes; (5) directors' duty to act in the best interests of the company; and (6) liability on companies, shareholders and directors. These six corporate mechanisms provide an analytic framework for understanding the role of corporate governance and corporate law in advancing (or thwarting) sustainability in jurisdictions other than those discussed in this book.

These six mechanisms will be evaluated in light of the distinctive contexts in the four common law Asian jurisdictions, specifically their ownership structures and institutional environment. This is because the majority of the listed companies there are dominated by controlling shareholders, particularly the government[1] in state-owned enterprises (SOEs), which wield significant and substantial power.[2] The pursuit of socio-economic agendas and social objectives by the government through SOEs has facilitated sustainability, and the government plays an important role in advancing this goal. However, the government as the controlling shareholder of the SOEs poses two key problems, namely, conflicts of interest between the government as the controlling shareholder on the one hand, and as the corporate regulator on the other, as well as political interference and extractions of benefits of control by the government. These problems may affect the corporate mechanisms for promoting sustainability. In short, a central challenge is whether, and, if so, how, the corporate mechanisms should be reconceptualised to promote sustainability in an environment that is characterised by controlling shareholders, governmental interference or state ownership of companies.

[1] The term 'government' does not necessarily refer to a unitary actor but may include complex, multi-layer networks of power in different regulatory departments, agencies and ministries involving different actors.

[2] Other than the government, the other dominant group of controlling shareholders in the four common law Asian jurisdictions consists of families. While there are more family-owned listed companies than listed SOEs, the latter wield more significant and substantial power and have greater impact on societies by virtue of the fact that their controller is the government. This explains the focus on governments and SOEs, which will be elaborated in subsequent parts of this chapter.

The analysis of the relationship between corporate mechanisms and sustainability, on the one hand, and governments and SOEs, on the other, using the four Asian jurisdictions as a case study, has broader policy and scholarly relevance and importance. First, the analysis will be relevant to other concentrated ownership jurisdictions seeking to promote sustainability. This is because controlling shareholders are the norm for a majority of the world's companies,[3] and SOEs constitute a significant proportion of companies among the Fortune Global 500 as well as in developing and to certain extent developed countries.[4] Second, while there is an emerging literature examining the costs and benefits of state capitalism in relation to sustainability,[5] there is little analysis of how this stream of literature is connected to the research on corporate governance and company law,[6] which have been deployed as legal strategies to promote sustainability. Finally, this book will expand the field of comparative corporate social responsibility (CSR)/sustainability research, which has been dominated by studies comparing the United States and Europe.

This chapter is divided into five parts. Part II explains the rationales and motivations for focusing on corporate mechanisms in the four common law jurisdictions in Asia. Part III analyses the factors that drive sustainability in these four Asian jurisdictions. Part IV discusses the problems arising from the government being the controller of SOEs

[3] OECD, OECD Corporate Governance Factbook 2019 (2019) at 17.

[4] PwC, 'State-Owned Enterprises: Catalysts for Public Value Creation?' (2017) at 9–12 (the study found that (1) the proportion of SOEs among the Fortune Global 500 has grown from 9 per cent in 2005 to 23 per cent in 2014; (2) 10.2 per cent of the Fortune 2,000 largest companies were majority-owned SOEs with ownership interests spread across thirty-seven countries; and (3) the top eight countries with the highest SOE shares (which include Malaysia, India and China) collectively accounted for more than 20 per cent of world trade) www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf; Simon CY Wong, 'The State of Governance at State-Owned Enterprises' (2018) 40 *Private Sector Opinion* (IFC Corporate Governance Knowledge Publication) 3 www.ifc.org/wps/wcm/connect/b1adde06-267d-4d79-bfaf-62f17de51f4a/PSO40.pdf?MOD=AJPERES&CVID=m7T0xLQ; OECD, *The Size and Sectoral Distribution of State-Owned Enterprises* (OECD Publishing 2014).

[5] Nahee Kang and Jeremy Moon, 'Institutional Complementarity between Corporate Governance and Corporate Social Responsibility: A Comparative Institutional Analysis of Three Capitalisms' (2012) 10 *Socio-Economic Review* 85; Jeremy Moon, Nahee Kang and Jean-Pascal Gond, 'Corporate Social Responsibility and Government' in David Coen, Wyn Grant and Graham Wilson (eds), *Oxford Handbook of Business and Government* (Oxford University Press 2011) at ch 22.

[6] See eg Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability* (Cambridge University Press 2015).

and how they may affect the corporate mechanisms for promoting sustainability. Part V sets out the structure of this book.

Before proceeding further, two preliminary points are made. First, I explain why I use the term 'sustainability' instead of 'corporate social responsibility'. Second, I defend a central assumption underlying this book, which is that it is good for companies to promote sustainability.

A Terminology

Sustainability, instead of CSR,[7] is used in this book for the following reasons. To begin with, sustainability, rather than CSR, is the more widely used legal term in the common law Asian jurisdictions. It has been explicitly adopted in the listing rules in Singapore and Malaysia[8] and implicitly endorsed in Hong Kong[9] and India.[10] Given that the regulators and policy makers in common law Asia have generally adopted the term sustainability in formulating the rules and regulations.[11] and because this term has gained traction in the listed companies in the four countries, it is appropriate to use this term.

Equally important, although there is no conclusive meaning of sustainability, it is far less contested and controversial than CSR, a term that is afflicted with numerous and long-standing uncertainties.[12] A central

[7] See generally Andrew Crane, Dirk Matten, Abagail McWilliams, Jeremy Moon and Donald S Siegel (eds), *The Oxford Handbook of Corporate Social Responsibility* (Oxford University Press 2008); Kiyoteru Tsutsui and Alwyn Lim (eds), *Corporate Social Responsibility in a Globalizing World* (Cambridge University Press 2015).

[8] SGX-ST, Listing Rules, Practice Note 7.6, Sustainability Reporting Guide (2016); Bursa Malaysia, Sustainability Reporting Guide (2015).

[9] While Hong Kong uses the term Environmental, Social and Governance (ESG) Reporting Guide, it has relied extensively on the fact that other stock exchanges have implemented sustainability reporting when it sought to justify changing the regime from a purely voluntary to a comply or explain basis: see Hong Kong Exchanges and Clearing Limited, Consultation Paper: Review of the Environmental, Social and Governance Reporting Guide (July 2015).

[10] The top 100 listed companies by market capitalisation in India are required to disclose 'Business Responsibility Reports' under the listing rules. The contents of such a report are based on ESG considerations and the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, the latter of which make specific and repeated references to sustainability, and not CSR: see Securities and Exchange Board of India, Business Responsibility Reports, CIR/CFD/DIL/8/2012 (13 August 2012) paras 2 and 3.

[11] But note that in India, s 135 of the Companies Act 2013 uses the term CSR.

[12] See eg Jean-Pascal Gond and Jeremy Moon, 'Corporate Social Responsibility in Retrospect and Prospect: Exploring the Life-Cycle of an Essentially Contested Concept' in Jean-Pascal Gond and Jeremy Moon (eds), *Corporate Social Responsibility: A Reader*, vol 1 (Routledge 2011); Frank GA De Bakker, Peter Groenewegen and Frank Den Hond,

and persistent debate in the CSR literature is whether companies' compliance with laws constitutes CSR or whether CSR refers only to actions taken on a voluntary basis, ie above and beyond legal compliance. Another outstanding issue in CSR is whether companies are engaging in CSR if they are merely addressing the externalities they have caused (such as environmental damage, human rights abuses and systemic risks to the economy). The uncertainties have led to a proliferation of confusing terminologies such as 'corporate business responsibility' and 'corporate responsibility' with some commentators advocating the use of these terms instead of CSR,[13] the latter of which has been regarded by some as not materially different from corporate philanthropy. Others, however, argue that CSR should encompass both legal compliance and voluntary actions.[14] Another unresolved issue is whether companies should engage in strategic/instrumental CSR (defined as promoting the interests of non-shareholders only if doing so maximises share price or profitability), or ethical/intrinsic CSR (defined as promoting the interests of non-shareholders because these interests are morally worthy in themselves of protection, even if doing so does not increase shareholder value).[15] Given that CSR carries with it substantial political, legal and social baggage, it is not unwise to adopt a different terminology.[16] Unsurprisingly, it has been said that the controversies surrounding the definition of CSR have impeded empirical research in that area.[17]

'A Bibliometric Analysis of 30 Years of Research and Theory on Corporate Social Responsibility and Corporate Social Performance' (2005) 44 *Business and Society* 283.

13 Céline Gainet, 'Exploring the Impact of Legal Systems and Financial Structures on CR' (2010) 95 *Journal of Business Ethics* 195 at 197.

14 Tom Campbell, 'The Normative Grounding of Corporate Social Responsibility: A Human Rights Approach' in Doreen McBarnet, Aurora Voiculescu and Tom Campbell (eds), *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge University Press 2007) at 534–42.

15 David Million, 'CSR and Environmental Sustainability' in Beate Sjåfjell and Benjamin J Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press 2015) at 41–76.

16 To clarify, not adopting the term CSR does not imply that the literature in that area is not valuable. On the contrary, as I will show, the recent empirical and finance literature on the correlation between firm value and corporate governance, on the one hand, and CSR, on the other, can illuminate the analysis of the question of why the listed companies in the four common law Asian countries should pursue sustainability.

17 Cynthia Williams and Ruth V Aguilera, 'Corporate Social Responsibility in a Comparative Perspective' in Andrew Crane, Dirk Matten, Abagail McWilliams, Jeremy Moon and Donald S Siegel (eds), *The Oxford Handbook of Corporate Social Responsibility* (Oxford University Press 2008) at 453.

While there is no definitive understanding of sustainability, one widely cited definition, endorsed by the Malaysian and Singapore sustainability reporting guides, is that found in the Brundtland Report, which defines sustainable development as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs’.[18] When operationalised in the context of listed companies, sustainability is understood in this book to refer to the responsibilities of companies for the impacts that they cause to societies and the actions that should be taken by them to address these impacts, which include but are not limited to giving effect to environmental, social and governance (ESG)[19] as well as human rights considerations in their business operations and core strategies. This is consistent with the definition of sustainability provided by the United Nations Global Compact, which is ‘a company’s delivery of long-term value in financial, social, environmental and ethical terms’.[20] Sustainability, as defined here, includes both voluntary actions and actions that are mandated by the law.

Having clarified the terminology, the last preliminary question which we need to address is why companies should pursue sustainability. There are two main reasons. The first is strategic and the second ethical. The first and second reasons are also known as instrumental and intrinsic justifications.

[18] World Commission on Environment and Development, ‘Our Common Future’ (1987) para 1.

[19] Adoption of ESG factors is important because it can: provide an effective risk management framework; provide a new lens for strategy development and growth opportunities; and address the demands of stakeholders such as customers, employees and investors: see Brandon Boze, Margarita Krivitski, David F Larcker, Brian Tayan and Eva Zlotnicka, ‘The Business Case for ESG’ (23 May 2019), Rock Center for Corporate Governance at Stanford University Closer Look Series: Topics, Issues and Controversies in Corporate Governance No. CGRP-77, https://ssrn.com/abstract=3393082. There are variations in the ESG definition in the listing rules in the common law Asian jurisdictions. But, generally, environmental includes climate change, greenhouse gas emissions and resource depletion. Social includes working conditions, local communities, health and safety, employee relations, diversity, labour standards, supply chain management, product responsibility and anti-corruption. Governance, which includes executive pay, board diversity and corruption, has been partially subsumed under social considerations (with the exception of executive pay) in Singapore’s and Hong Kong’s listing rules. Malaysia’s listing rules exclude governance considerations because there are specific requirements related to corporate governance in the listing rules and corporate governance codes. Malaysia’s listing rules replaced governance with economic considerations, the latter of which refers to the company’s economic impacts on its stakeholders at local, national and global levels. So, instead of ESG, it is called EES (economic, environmental and social) in Malaysia (Bursa Malaysia, Sustainability Reporting Guide (2015)).

[20] United Nations, Global Compact (2013) at 6.

B Why Companies Should Pursue Sustainability

1 Strategic Reason

There is evidence of the benefits of promoting sustainability. This is also known as the business case for sustainability. First, it can strengthen the company's risk management because, by proactively identifying and addressing the risks, companies are in a better position to reduce the adverse impact of these risks on their businesses. For example, one study has found that companies that focus on material sustainability risks have financially outperformed other companies by 3 per cent to 8 per cent.[21]

Second, companies that have good sustainability disclosure and practices have enhanced their reputation among their investors and stakeholders.[22] After all, studies have shown that 70 per cent to 80 per cent of a company's market value is based on intangibles such as reputation and goodwill.[23] Conversely, failure to pre-empt or address serious sustainability problems (including but not limited to environmental catastrophes and egregious human rights abuses in supply chain) can have an adverse and material impact on companies' reputation.

Third, there is a correlation between promoting sustainability and firm innovation.[24] Attention to sustainability considerations can spur companies to explore business opportunities, as evidenced, for instance, in sustainability driven products and services. General Electric's Ecomagination Initiative is a prominent example. One study found that companies issued more patents after the directors considered the interests of stakeholders because this allowed for greater experimentation within companies.[25]

[21] Mozaffar Khan, George Serafeim and Aaron Yoon, 'Corporate Sustainability: First Evidence on Materiality' (2016) 91 *Accounting Review* 1697; Lawrence Loh, Thomas Thomas and Yu Wang, 'Sustainability Reporting and Firm Value: Evidence from Singapore-Listed Companies' (2017) 9 *Sustainability* 1 (concluding that sustainability reporting is positively related to a firm's market value and that this relationship is independent of sector or firm status such as government-linked companies and family businesses).

[22] Ernst & Young and Boston College Centre for Corporate Citizenship, Value of Sustainability Reporting (2013) at 3.

[23] See eg Robert G Eccles, Scott C Newquist and Roland Schatz, 'Reputation and Its Risks' (2007) *Harvard Business Review* https://hbr.org/2007/02/reputation-and-its-risks.

[24] Ram Nidumolu, CK Prahalad and MR Rangaswami, 'Why Sustainability Is Now the Key Driver of Innovation' (2009) *Harvard Business Review* https://hbr.org/2009/09/why-sustainability-is-now-the-key-driver-of-innovation.

[25] See Caroline Flammer and Aleksandra Kacperczk, 'The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment' (2014) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2353076.

Fourth, promoting sustainability can enhance access to capital. Investors take into account a company's commitment to sustainability in their investment decisions. For example, the global sustainable investment market increased by 61 per cent to US$21.4 trillion from 2012 to 2014.[26] In Asia, there was an increase in responsible investment by 32 per cent during that period.[27] Further, as of 31 March 2017, there were 1,713 institutions managing over US$45 trillion in assets who were signatories to the UN Principles for Responsible Investment (PRI), under which they were required to incorporate ESG considerations into their investment decisions.[28] In addition, the Carbon Disclosure Project, which works with 2,000 worldwide companies to collate and analyse data on companies' greenhouse gas emissions, is supported by institutional investors holding over US$92 trillion in assets.[29] Unsurprisingly, one comprehensive study that has surveyed the field found that 90 per cent of the literature demonstrates that companies with good sustainability regimes have lower cost of capital and thus improved access to capital.[30]

Finally, there are studies showing that there is a correlation between sustainability practices and firm value. For instance, one study found that indices with companies that adhere to ESG practices generally performed on par with the benchmark index at different periods.[31] A comprehensive study found that integrating ESG into the investment process had a positive impact on 65 per cent of companies in emerging markets as compared to 38 per cent in developed markets.[32] Another study found that there is a positive and significant correlation between the sustainability performance of major companies in Asia and share price.[33]

[26] Bursa Malaysia, Sustainability Reporting Guide (2015) at 12.
[27] Association for Sustainable and Responsible Investment in Asia, 2014 Asia Sustainable Investment Review (2014).
[28] UN Principles for Responsible Investment www.unpri.org/annual-report-2018.
[29] Carbon Disclosure Project, Catalyzing Business and Government Action www.cdp.net/en-US/Pages/About-Us.aspx.
[30] See Gordon L Clark, Andreas Feiner and Michael Viehs, 'From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance' (2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281.
[31] Bessemer Trust, *Integrating Value and Your Investments* (2018).
[32] Deutsche Bank, 'ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies' (14 January 2016) www.db.com/newsroom_news/2016/ghp/esg-and-financial-performance-aggregated-evidence-from-more-than-200-empirical-studies-en-11363.htm.
[33] Yan Leung Cheung, Weiqiang Tan, Hee-Joon Ahn and Zheng Zhang, 'Does Corporate Social Responsibility Matter in Asian Emerging Markets' (2010) 92 *Journal of Business*

A further recent study found that 80 per cent of the literature shows that good sustainability practices are strongly correlated with share price.[34] A recent study of 116 listed companies (which include 38 firms listed on the Stock Exchange of Hong Kong) confirmed the view that sustainability engagement (as evidenced in sustainability disclosure) is significantly and positively associated with financial performance.[35]

In short, not only are there studies that show that good sustainability practices lead to improved innovation, operating performance and share price,[36] but there is also a study showing that companies with good corporate governance engage in sustainability conduct.[37] And the study rebuts the criticism that sustainability is associated with poor corporate governance.[38]

That said, there are commentators that have argued that boards and management pursue sustainability to enrich themselves at the shareholders' expense[39] and that the pursuit of sustainability practices by the

Ethics 401; Priyanka Garg, 'CSR and Corporate Performance: Evidence from India' (2016) 43 *Decision* 333 at 341–3.

34 See Gordon L Clark, Andreas Feiner and Michael Viehs, 'From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance' (2015) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281. A study of the listed companies in Hong Kong found that markets react positively to ESG initiatives, but less positively to companies' being included in sustainability indexes or rankings by the companies; this is because companies did not explain, and investors did not appreciate, the impact of these investments on the companies' financial performance: Kar Yee Lo and Calvin Lee Kwan, 'The Effect of Environmental, Social, Governance and Sustainability Initiatives on Stock Value: Examining Market Response to Initiatives Undertaken by Listed Companies' (2017) 24 *Corporate Social Responsibility and Environmental Management* 606 at 615. But one study found that sustainability practices are positively correlated with both return on capital and expectations of future performance only if these practices are strategic rather than common: Ioannis Ioannou and George Serafeim, 'Corporate Sustainability: A Strategy?' (1 January 2019). Harvard Business School Accounting & Management Unit Working Paper No. 19-065 https://ssrn.com/abstract=3312191.

35 Cornelia Beck, Geoffrey Frost and Stewart Jones, 'CSR Disclosure and Financial Performance Revisited: A Cross Country Analysis' (2018) 43 *Australian Journal of Management* 517 at 530–1.

36 See eg Xin Deng et al, 'Corporate Social Responsibility and Stakeholder Value Maximization: Evidence from Mergers' (2013) 110 *Journal of Financial Economics* 87; Elroy Dimson, 'Active Ownership' (2015) 28 *Review of Financial Studies* 3225.

37 See eg Allen Ferrell, Hao Liang and Luc Renneboog, 'Socially Responsible Firms' (2016) 122 *Journal of Financial Economics* 585.

38 Ibid.

39 See eg Ing-Haw Cheng, Harrison G Hong and Kelly Shue, 'Do Managers Do Good with Other Peoples' Money?' (2011) Chicago Booth Research Paper No. 12-47 https://ssrn.com/abstract=1962120; Ronald W Masulis and Syed Walid Reza, 'Agency Problems of Corporate Philanthropy' (2015) 28 *Review of Financial Studies* 592.

board can be time-consuming and distract them from fulfilling their core duties.[40] However, the literature overall demonstrates that promoting sustainability/CSR is consistent with maximisation of shareholder value.[41]

2 Ethical Reason

The second reason why companies should pursue sustainability is that it is a morally good thing to do. It is telling that in the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, issued by India's Ministry of Corporate Affairs (MCA), and which subsequently inspired the promulgation of the mandatory business responsibility reporting requirement, the Union Minister said that '[b]usiness involvement in social welfare and development has been a tradition in India'[42] stretching all the way back to Mahabharata[43] and the Arthashastra.[44] He also said that many Indian businessmen were influenced by Ghandi's idea of trusteeship to contribute to the betterment of society. Interestingly, he rejected the idea that it is a Western import. Before one dismisses these statements as a politician's rhetoric, there is substantial literature demonstrating that in India, corporate sustainability practices are grounded in Hinduism.[45] Moreover, a survey of the directors and senior officers of sixteen listed companies in India consisting of different industries found that while the participants justified the companies' sustainability actions on the basis of both

40 Michael Jensen, 'Value Maximisation, Stakeholder Theory and the Corporate Objective Function' (2010) 22 *Journal of Applied Corporate Finance* 32.

41 See eg Allen Ferrell, Hao Liang and Luc Renneboog, 'Socially Responsible Firms' (2016) 122 *Journal of Financial Economics* 585; Alex Edmans, 'Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices' (2011) 101 *Journal of Financial Economics* 621; Xin Deng, Jun-koo Kang and Buen Sin Low, 'Corporate Social Responsibility and Stakeholder Value Maximization: Evidence from Mergers' (2013) 110 *Journal of Financial Economics* 87.

42 Ministry of Corporate Affairs, National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (2011) at 1 www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf.

43 Mahabharata is one of the two major Sanskrit epics in India. See *The Mahabharata* (John D Smith tr, Penguin 2009).

44 Arthashastra is an ancient Indian treatise on economic policy and military strategy. See N Siva Kumar and US Rao, 'Guidelines for Value Based Management in Kautilya's Arthashastra' (1996) 15 *Journal of Business Ethics* 415.

45 See eg the copious literature cited in Balakrishnan Muniapan, 'The Roots of Indian Corporate Social Responsibility (CSR) Practice from a Vedantic Perspective' in Kim Cheng Patrick Low, Samuel O Idowu and Sik Liong Ang (eds), *Corporate Social Responsibility in Asia: Practice and Experience* (Springer 2014) at ch 2.