

ESG-Reality Sets In

Trends in ESG Disclosure of Supply Chain Listings in Hong Kong

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Disclosure of ESG Operating Risks is Improving
External Norms Beginning to Shape Responses
Industry-Specific ESG Performance Trends
Emerging Issues of Global Concern
Catalysts for Improvement
Simple Metrics Provide Insights into ESG Risk

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Disclaimer: ASrIA does not guarantee that the report is a comprehensive survey of disclosure issues in relation to supply chain listings. With the resources available, however, the report makes every effort to focus on key areas of relevance and to deliver data that is accurate and opinions that are objective and balanced.

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Executive Summary

Financial institutions are increasingly recognizing that environmental, social and governance (ESG) issues can be material to their investments. Yet, a lack of transparency by Asian corporates on ESG issues, combined with poor linkage to business risks, despite tougher enforcement trends and greater customer oversight, has presented an important challenge to investors. This issue has become particularly prominent due to the trend of western brands out-sourcing manufacturing to increasingly complex global supply chains. However, one direct result of the growth of supply chain manufacturing in Asia is that increasing numbers of Asian companies have been listing on local and global markets in order to finance the expansion of their operations. The publication of their listing documents has provided a rare opportunity to ferret out details of ESG issues facing these companies.

Hence, when ASRIA published, in 2006, a ground-breaking report on ESG disclosure by supply chain listings in Hong Kong, we titled it *A Cat and Mouse Game for Investors*¹, to reflect the obstacles which investors faced when trying to identify reliable ESG data. However, since the publication of the report, there have been some significant changes in the disclosure landscape, leading us to title this follow-up report, *Reality Sets In*.

Corporates are showing more willingness to disclose ESG operating risks

This report covers companies which listed on the Hong Kong Stock Exchange (HKEx) during 2006 and 2007 and tracks a similar spectrum of companies as the first report. A key finding is that there has been improvement in the willingness of corporates to increase disclosure and provide detail on ESG operating risks. It is also noticeable that certain sectors, such as electronics and garments, have been relatively more proactive in disclosing such information.

A Cat and Mouse Game for Investors noted that external factors, in particular customer pressure and market developments, such as rising regulatory standards, were having little noticeable impact in improving disclosure standards. However, a year on, it seems that these external pressures are now starting to have a cumulative impact in driving improved disclosure standards. It is also evident that pressure to improve disclosure is not only coming from global players, but that public and media attention from within China on corporate ESG performance is starting to influence corporate willingness to communicate on these issues.

Unexpected but valuable findings related to disclosure on the protection of intellectual property rights and on recycling and waste disposal. These disclosures provide insights into the development of China's engagement in cross-cutting issues of global concern to investors.

Investors are starting to get access to more direct ESG metrics

In summary, it is evident that Chinese corporates, particularly in certain sectors, are starting to show greater willingness to disclose and engage in ESG-related issues and that investors as a result are starting to get access to more direct ESG related metrics. Whereas previously investors often had to infer ESG information from indirect indicators, such as employee turn-over figures, now Chinese corporates are increasingly aware of the need to respond to these issues. Now is therefore the time for investors to take the initiative to include ESG issues into their discussions with supply chain related companies to continue building on this apparent momentum.

Table 1 Selected Supply Chain Companies Listing in 2006 through 1st Half of 2007

Classification	Company Name	Listing Date dd/mm/yr	Operations
Battery	SCUD Group Ltd.	21/12/06	Manufacture and sale of rechargeable battery packs for mobile phone batteries.
	Tianneng Power International Ltd.	11/06/07	Battery producer for electric bikes.
Electronics	Advanced Semiconductor Mnfg Corp Ltd.	07/04/06	Manufacture analog semiconductors and higher bipolar content-based mixed-signal semiconductors.
	Capxon International	05/07/07	Vertically integrated aluminum electrolytic capacitors manufacturer, especially high quality anode foils.
	Computime Group Ltd.	09/10/06	Design, manufacture, and sale of electronic control and automation devices and solutions.
	HannStar Board International	06/10/06	Manufacture of PCBs for the notebook computer industry.
	Kingboard Laminates Hldgs Ltd.	07/12/06	Vertically integrated manufacturer of electronic materials, specifically laminates and related products.
	Meadville Hldgs Ltd.	02/02/07	Manufacture of PCBs.
	Neo-Neon Hldgs Ltd.	15/12/06	Manufacture, design, and distribution of incandescent-based decorative lighting, LED-based decorative lighting, and entertainment lighting products.
	O2Micro International Ltd.	02/03/06	Design, develop, and market high performance integrated circuits for power management and security applications.
	Regent Manner International Hldgs Ltd.	10/07/07	Provision of integrated SMT production solutions for manufacture of TFT-LCDs.
	TC Interconnect Hldgs Ltd.	23/06/06	Manufacture of PCBs.
Yorkey Optical International Ltd.	10/02/06	Manufacture and sale of plastic and metallic parts and components of optical and opto-electronic products.	
Household Goods	Aupu Group Hldgs	12/08/06	Design, manufacture, and distribution of bathroom masters, exhaust fans and other home appliances.
Industry	China High Speed Transmission	04/07/07	Design, manufacture, and supply of mechanical transmission equipment for wind turbines.
Paper/Board	Nine Dragons Paper (Holdings) Ltd.	03/03/06	Manufacture and sale of linerboard, high performance corrugating medium and coated duplex board with grey back and unbleached kraft pulp.
Textile & Apparel Sportswear	ANTA Sports Products Ltd.	10/07/07	Manufacture and sale of branded sportswear and apparel.
	Win Hanverky Hldgs Ltd.	06/09/06	Manufacture of integrated sportswear, active and outer wear, and distribution for international sports brands.
Textiles	Co-Prosperity Hldgs Ltd.	30/03/06	Processing and sale of finished fabrics and provision of fabrics processing subcontracting services.
	Embry Hdgs Ltd.	18/12/06	Vertically integrated manufacture, sale, and distribution of lingerie.
	Hembly International Hldgs Ltd.	13/07/06	Provision of supply chain services for apparel and accessories to international brand apparel makers, and the distribution and retailing of apparel and footwear.
	Pacific Textiles Hldgs Ltd.	18/05/07	Manufacture knitted fabrics, specifically complex knit fabrics.
Toys	Smart Union Group (Holdings) Ltd.	29/09/06	Manufacture and trade of toys and recreational products.

Introduction

In 2006, ASRIA published the first comprehensive review of ESG disclosure in HKEx prospectuses for Chinese supply chain companies. This report highlighted significant disclosure gaps by China's emerging supply chain leaders concerning increasingly material ESG performance issues. The key problems identified in the report included opaque disclosure and poor linkage to business risks. This was evident despite tougher enforcement trends and greater customer oversight, and raised important questions about the quality of the due diligence work underlying some of the disclosure documents.

As a follow-up to ASRIA's 2006 report, this report tracks a more current and diverse set of companies. The previous report examined companies which listed on the HKEx in 2005. This report examines companies which listed in 2006 through the first half of 2007.

The goal of this report is to present a picture of the state of ESG reporting, to identify recent themes in supply chain ESG reporting and to provide the best examples of representative disclosure. To confirm trends, we also conducted follow up interviews with selected companies to assess the linkage between ESG disclosure trends and material operational priorities.

This work highlights a new set of trends in disclosure related to ESG risk assessment:

Disclosure of ESG operating risks is improving While gaps certainly remain, progress is apparent in the disclosure of information relevant to informed assessment by investors. This particularly relates to better disclosure about regulatory compliance for environmental and social issues.

External norms beginning to shape responses Key customers and market development trends exert strong pressure in shaping reporting. Disclosure documents and follow up visits with companies reveal preliminary moves toward adopting international market norms on ESG issues. CSR motivations are still hard to detect.

Industry-specific ESG performance trends Companies in industries with high potential environmental impacts, such as electronics and garments, as well as industries subject to risks related to health, safeties, and labour, are slowly improving their discussion of efforts to comply with specific industry-related concerns.

Emerging issues of global concern Disclosure on several issues of interest to global investors emerged that provide unique insights into the development of intellectual property rights protection and the recycling industry.

Catalysts for improvement Public sanction, local controversy and media attention from within China help drive more detailed disclosure of ESG-related problems and regulatory non-compliance.

Standard metrics providing insights into ESG risks The disclosure of standard metrics such as costs of labour, turnover, environmental fees, board structure, ongoing litigation, to name a few, yield further useful information for the assessment of ESG materiality.

Table 2 ESG Themes

Type of Disclosure	% Disclosing	Comment
Customers		
Relationships	61%	Refer to meeting customer ESG requirements.
Audits	26%	Have undergone customer audits for ESG-related issues in operations, quality and production processes.
Environment		
Water		
Water	87%	Refer to water as a risk factor or cite regulatory compliance requirements.
Water supply	35%	Deal with water supply issues primarily as a risk. Two companies have strong reporting on water supply systems, costs, and volume requirements.
Water treatment facilities	30%	Provide information on waste water treatment facilities.
Standards & Awards		
ISO 14001	61%	Acknowledge having achieved this standard. Few, however, disclose which operations were certified.
	30%	Refer to ISO 14001 correctly as an ongoing environmental management system.
RoHS	22%	Recognize the significance of RoHS for the European market.
Awards	13%	Sony "Green Partner" award winners. (3 companies)
Power		
Electricity	78%	Recognize high electricity requirements and the instability of electrical supply as a risk.
Generator	35%	Have generators or power facilities as backup for electricity shortages.
Local grid	22%	Indicate some connection to the local power grid, either for receiving power or selling power back to the grid.
Coal	13%	Mention coal as having some role in power generation in either the local grid or their facilities. (3 companies)
Social		
Labour supply	61%	Recognize risk of labour shortage.
Welfare	83%	Declare compliance with welfare contribution legislation.
	43%	Provide cost of welfare contributions.
Occupational health & safety	17%	Comply with occupational health standards. (4 companies)
	9%	OHSAS certified. (2 companies)
Remuneration	35%	Provide information about wage and/or wage increases.
	13%	Discuss impact of overtime on labour costs. (3 companies)
Training	70%	Report provision of training for new workers.
Governance		
Governance	65%	Discuss governance activities beyond those of listing requirements.
Board structure	65%	Indicate family relationships at the board level.
CFO	39%	CFO recently appointed (in the two years prior to listing).
Arbitration	13%	Provide information on worker dispute resolution. (3 companies)

Disclosure of ESG Operating Risks Improving

In our *Cat and Mouse* report, we found a persistent disconnect between disclosure of specific ESG risks and follow-up discussions. Connecting potential material risks to meaningful disclosure concerning business operations, however, is now becoming a reality. In the 2006-2007 sample, the gap between identified risk factors and related business disclosures has begun to close and additional information was often provided to demonstrate concrete steps toward environmental compliance.

Prospectuses typically feature various types of statements concerning sector-specific ESG risks. If a company is exposed to material ESG risks, it is most common to find a generic statement in the risk factors section identifying the nature of the risk. This risk factors disclosure is intended to limit the underwriter's liability by ensuring that investors are aware of relevant risks. It is then common to find a discussion of regulatory requirements which may shape a company's compliance and operating obligations. Finally, better prospectuses will have a business discussion which discusses how the company manages ESG risks in practical operating terms. In the best prospectuses, this business discussion can then be linked to a discussion of compliance strategies, capital expenditure, and financial performance.

75% of prospectuses provided details on relevant environmental laws

In a tangible sign of the progression in reporting noted in the 2006-2007 sample, 75% of the prospectuses provided details on relevant environmental laws and then disclosed company compliance efforts. Not only does this mark clear progress in terms of ESG risk management disclosure, but it is in marked contrast with the remaining 25% which failed to identify relevant ESG compliance obligations and often provided very brief statements of compliance.

Addressing Water

One of the most important issues clarified in the new set of prospectuses focused on water usage patterns. Given the scope of water usage challenges facing Chinese companies, corporate management of water pollution and usage risks can be regarded as a valuable leading indicator of a company's ability to establish medium-term strategic priorities². Indeed, recent prospectuses offer a much more realistic understanding of how companies are addressing water supply and treatment issues.

Recent prospectuses offer a much more realistic understanding of how companies are addressing water supply and treatment issues

It has been common for companies with significant water requirements to construct independent waste-water facilities to reuse and recycle water, in order to decrease reliance on local municipal water supplies and third-party suppliers. A number of companies, which already had such facilities, highlighted them as a valuable addition to their operations.

Disclosure of ongoing operating water cost issues is emerging. Detailed information on the utilization rates, quantities, and capacities of purpose built facilities is found in nearly half of the prospectuses reviewed. Pacific Textiles and Nine Dragons provided the particulars of their water fees and data on their water requirements, consumption, and subsequent discharge levels. Co-Prosperity Holdings detailed the fees it paid for

Figure 1 Detailed Disclosure on Water Usage

In order to meet the Group's significant water requirements in Dongguan, the Group constructed two fresh water reservoirs, which were completed in September 1998 and November 2004, respectively, with an aggregate storage capacity of 250,000 tonnes. The Group is also in the process of constructing a desalination plant with a planned capacity of 100,000 tonnes of water per day in two phases, with the first phase with capacity of 50,000 tonnes per day expected to be completed by March 2006

Regent Manner

We obtain water from facilities operated by the Board of Investment of Sri Lanka (BOI). Wastewater produced from our manufacturing process undergoes chemical treatment at our wastewater treatment plant prior to being transferred back to the BOI facilities for additional treatment and subsequent discharge into waterways. The BOI regulates the amount of water available to us. Limits on the amount of water available to us have been a principal constraint on our ability to increase production at our Sri Lanka facility. In August 2006, we were able to obtain from the BOI an increase of approximately 75% in our daily water quota. As described below under the caption "—Expansion Plans", we plan to enhance our wastewater processing capacity in order to permit increases in production by November 2007. Limits on the amount of water available to us could constrain our ability to increase production at our Sri Lanka facility in the future.

Pacific Textiles

the water it sourced from third party providers as part of its discussion of its water consumption permits. Other companies referred to changes in rising water costs, fees paid for water protection and water requirements of new facilities.

Nine Dragons provided perhaps the fullest disclosure on its approach to water supply issues. Because of the high requirements of their paper and pulp operations, their Dongguan production facilities consumes approximately 65,000 tonnes of water a day, while their Taicang production facilities consumes approximately 20,000 tonnes of water a day. Nine Dragons has a water treatment facility, a desalination plant and two reservoirs at their disposal. Their final backup plan is to connect to the municipal water supply.

Nine Dragons provided the fullest disclosure on its approach to water supply issues

Environmental Standards—Systems, Not Rewards

Another important area of progress in basic disclosure in the current sample was an increase in the number of companies reporting ISO14001 certification. ISO 14001 certification is a global standard which recognizes a baseline “environmental management system” within a company’s operations³. In the 2005 sample, acknowledgement of ISO14001 was limited and several companies incorrectly described certification as an achievement or an affirmation of quality control. In the current sample, however, more companies acknowledged that ISO 14001 was a systematic approach to environmental management.

A related environmental performance benchmark issue relates to our findings of improved disclosure of RoHS and WEEE compliance. Effective in July 2006 in the European Union, the Restriction of Certain Hazardous Substances (ROHS) and the Waste Electrical and Electronic Equipment (WEEE), effective August 2005, directives require countries that are members of the European Union to regulate the use of certain hazardous substances in products originating outside the EU, and facilitate the collection, reuse and recycling of waste from certain products that use or generate electricity. With Europe serving as a primary market for many Asian supply chain companies, compliance with these two directives is essential if Asian producers want to have access to European markets.

Figure 2 Acknowledgments of RoHS

Our sales can be affected by legislative and regulatory changes adopted in any of the markets to which our products are sold. For example, on 1 July 2006, the European Union adopted a new regulation, RoHS. The enactment of this regulation would lead to the delay of some of our European customers from making purchases until they could ascertain whether our products would be affected by such regulation. Similarly, various governments impose safety and environmental requirements on products such as ours, the results of which, could adversely impact our sales.

Neo-Neon

With growing concerns about environmental protection, US, the PRC, Japan, and the European Union have implemented laws and regulations concerning electronic products. For instance, the European Union adopted the RoHS, which took effect on 1 July 2006, to restrict the use of six hazardous materials including lead in the manufacture of various types of electronic and electrical equipments. RoHS applies to electronic products produced domestically, as well as overseas imports. As the European Union represents 30% of the global flat panel display market, panel manufacturers have been actively developing environmental friendly products to ensure compliance with RoHS. For instance, some Japanese and Korean panel manufacturers have already launched unleaded products or started unleaded production process.

Regent Manner

Although references to the EU legislation was in evidence, it is somewhat surprising that references to China’s own RoHS-equivalent law was absent from the prospectuses reviewed. Approved in February 2006 and made effective on March 1st 2007, this law monitors and outlaws more chemicals in more industries than RoHS as well as including standards on packaging and production materials⁴, items not included in the European RoHS. It also requires that each step in the chain from dock to retail shelf must be compliant on the effective date. Acknowledgement and preparation for the enactment of this law is material for producers of affected products and should presumably have been an element of disclosure.

It is somewhat surprising that reference to China’s own RoHS-equivalent law was absent

Power Gaining Steam

Just as water has emerged as a critical environmental and operating risk, many supply chain companies face complicated choices about how to manage access to reliable power. In the current sample of prospectuses, there was ample evidence that companies are beginning to address power availability in a more strategic fashion, and are moving beyond blanket statements of risk potential. The dependence on electricity for manufacturing operations is commonly disclosed in IPO risk sections. Contingency plans, however, were only provided by a few companies. The most common disclosure was on the use of on-site generators that can serve as a short-term solution to periodic disruptions that are, in some locales, quite frequent. Unfortunately, although many companies are reported to rely heavily on these on-site generators, disclosure on the capacity, average useful life, and associated fuel cost projections of sustaining operations on these generators is typically lacking. As the focus of supply chain carbon grows, we expect reporting, particularly on so-called dirty diesel generating sets, to increase.

Figure 3 Rare Engagement with Local Power Grid

All of the Group's power plants are connected with the regional power grid. This connection allows the Group to sell its power generation in excess of its own production needs to the grid. In addition, the connection to the grid provides the Group a back-up power source in case of need.
Nine Dragons

Strategic responses included data on the construction of more significant generating facilities, typically burning coal not diesel

Strategic responses by the better reporters included data on the construction of more significant generating facilities, typically burning coal not diesel. These are designed to sustain operations long-term and even supply power back to the local grid. Nine Dragon and Pacific Textiles both operate on-site power generation systems that meet their own operational needs. Pacific Textiles' coal-fired turbines at their China location produce 41 megawatts of electricity, which is sufficient electricity for the needs of the whole facility. Their current efforts and plans to improve power generation at factories in Sri Lanka are a direct response to high local electricity prices, which increased 14% this last year. Nine Dragons sells power from its coal-fired power plant back into the local grid. Disclosure of data on production levels, plant power requirements, costs, and the profit earned from the sale of power back to the grid, exemplifies transparency not seen in other prospectuses, probably due to the revenue potential of sales to the grid.

Social Disclosure Remains Opaque

A key labour issue facing labour-intensive supply chain companies is the increasingly tight labour market and rising wage pressure. Migrant workers are now more mobile and attuned to wage trends and options for better employment elsewhere. Recent reports suggest that while the government mandated minimum wage was RMB790 per month during the sample period, the actual market wage was RMB1100⁵. Despite tougher labour market conditions, it was common for companies in the current sample of prospectuses reviewed to describe low labour costs as a sustainable competitive advantage. While this perception may be valid from a global perspective, the failure of most prospectuses to address commonly debated Chinese labour market trends and the fact that low labour costs are neither unique nor necessarily sustainable can rob the discussion of credibility.

Staff training is essential to maintaining a stable workforce. Acknowledgment of training was present in the majority of prospectuses, but the presentation consistently lacked detail and failed to highlight the nature of the productivity and quality problems which are driving new commitments to training. When additional information was provided on training, it was usually in the context of standard safety measures or sales training. It also appeared in reference to more highly qualified personnel, management, and directors.

The lone reporter on labour turnover, Yorkey, reported a monthly rate of 5%, standard for southeastern China but very high by global standards

The most significant byproduct of labour market pressures tends to be higher rates of worker turnover⁶. The lone reporter on labour turnover, Yorkey, in the electronics sector, reported a monthly rate of 5%, which is standard for southeastern China but very high by global standards. While not highlighted in prospectuses, turnover was discussed in follow-up interviews as particularly significant during the Chinese New Year holiday and therefore an important variable for worker relations.

Governance

A critical background risk factor for many of the small- and mid-capitalization supply chain companies in our sample is corporate governance. Managing Asian operations in a transparent and sustainable fashion for international brands involves a range of challenges. As a result, it is important to appreciate the extent to which reporting of corporate governance issues increasingly extend beyond that of basic listing requirements. Five prospectuses in our sample, for example, included a discussion of efforts to establish best practices within corporate activities, including board and staff training on internal governance mechanisms, regular meetings with directors, and defining dispute mechanisms.

Table 3 Governance Strategies

Company	Additional Governance Strategies
Advanced	Shareholder enforcement may be resolved through arbitration.
HannStar	Has conducted corporate governance training with all directors and senior management.
O2Micro	Also meets requirements of the Sarbanes-Oxley Act.
Regent Manner	Holds meetings with independent non-executive Directors once every two months.
Win Hanverky	Has a company compliance manual addressing governance issues.

Other indicators for governance risks remained consistent with the previous report. These included numerous and complicated connected transactions which are not fully explained, significant family representation on the board, directors who were major shareholders, newly appointed CFOs pre-listing and other trends that are all relatively common and provide an indicator as to potential governance risks.

Indicators for governance risks included numerous and complicated connected transactions and newly appointed CFOs pre-listing

Use of Proceeds

The mapping of potential ESG risks to new and proposed facilities is an issue likely to capture the attention of regulatory authorities charged with administering higher standards. Indeed, as one of the most frequent reasons for listing, the raising of funds for capital expenditures and the construction of new facilities demands follow-up inquiry.

While the majority of prospectuses proposed new facilities (70%), only half of these discussed legislation and regulations for completing environmental impact assessments (EIA). Surprisingly, both China High Speed and Meadville reported not only on regulatory requirements for an EIA, but on how they had already begun construction without required approvals. Both also estimated and detailed potential fines and the cost of demolishing the new, unapproved construction, as well as who would indemnify them in such a case.

China High Speed and Meadville reported not only on EIA requirements, but how they had already begun construction without required approvals

Addressing the ESG risks from the abandonment or demolition of former or older facilities is of equal concern. Prospectuses have yet to take this into account.

External Norms Beginning to Shape Responses

The increasing engagement of customers concerned about ESG issues with supply chain companies continues to be a driver for better disclosure. While a disconnect was evident in the previous report between customer influences and disclosure, this set of prospectuses provided a much more credible picture of the growing importance of customer ESG requirements for supply chain companies.

Table 4 Customer Requirements

Classification	Company Name	Customer Requirements
Electronics	Computime Group*	Rigorous approval process for new vendors.
	Kingboard Laminates	Independent verification of quality control processes in manufacturing and assembly.
	Meadville*	Compliance with international environmental standards.
	Neo-Neon	Compliance with international environmental standards.
	Regent Manner International*	Environmental accreditation and quality audits.
	TC Interconnect	Utilization of lead-free processes.
	Yorkey Optical International	Compliance with international environmental standards.
Industry	China High Speed	Compliance with international environmental standards.
Paper/Board	Nine Dragons Paper	Meet environmental policies.
Textile & Apparel Sportswear	ANTA Sports Products	No customer requirements for them or their suppliers.
	Win Hanverky	Social responsibility and environmental standards.
Textiles	Co-Prosperity	Compliance with local environmental standards.
	Pacific Textiles	Social responsibility and environmental standards.
Toys	Smart Union Group	Participation in ethical manufacturing association.

*Recipient of the Sony “Green Partner” Award

The dominant trend towards tougher customer standards was evident in new compliance requirements for local or international environmental standards. The majority of the sample disclosed relevant environmental laws in their risk sections, and then detailed relevant legislation and their efforts to comply. Greater detail in the current sample focused on procedural upgrades, capital expenditures, education, and compliance costs. This was particularly true for companies in the electronics sector which face RoHS compliance requirements for product shipped into the EU.

Five companies from the sample (22%) also indicated that key customers are relying on audits as the predominant tool for assessing supply chain company compliance. The audits discussed in the prospectuses typically dealt with production management, raw material procurement, and downstream supplier qualifications. Each of these has environmental and social components.

22% indicated that key customers rely on audits as the predominant tool for assessing supply chain company compliance

Figure 4 Lack of Customer Engagement

A notable exception in reporting on efforts to meet customer requirements is found in the ANTA prospectus:

Currently, neither our customers nor we impose any environmental compliance requirements as conditions for placing orders with us or with our contract manufacturers.

It is also notable that prospectuses increasingly include references to customer awards which acknowledge compliance efforts. For example, three companies in the electronics sector received the Sony “Green Partner” Award⁷ which recognizes suppliers that cooperate in the production of environmentally sensitive products.

Prospectuses increasingly include references to customer awards

Table 5 Electronics Sector RoHS Compliance and Awards

Company Name	RoHS	"Green Partner"
Advanced Capxon		
Computime	√	√
HannStar		
Kingboard		
Meadville	√	√
Neo-Neon	√	
O2Micro		
Regent Manner Int'l Hldgs Ltd.	√	√
TC Interconnect	√	
Yorkey		
Total	5	3

As in the previous report, two companies also discussed requirements by their customers that they comply with customer-specified social responsibility requirements. A third company, the toy company Smart, complies with similar standards as part of its membership in the International Council of Toy Industries (ICTI)⁸ and its associated auditing process known as CARE (Caring, Awareness, Responsible, Ethical).

Industry-specific ESG Performance Trends

Companies in industries with high potential environmental, health, safety, and labour impacts or risks are slowly improving their discussion about efforts to comply with specific industry-related standards. Disclosures by high impact companies are particularly helpful in giving investors the information they need to understand the extent to which new industry-specific ESG performance benchmarks are shaping competitive market conditions⁹.

Uneven levels of disclosure on common industry-specific ESG issues

Textiles and Garments:

As the industry with the longest history of customer scrutiny, particularly in regard to social, labour and wage issues, it is of interest that disclosure from three of four textile companies in our sample provided uneven levels of disclosure on common industry-specific ESG issues.

Table 6 Textiles and Sportswear Sector ESG Themes

Issues	Textiles				Textiles and Apparel Sportswear		Total of 6
	Co-Prosperity	Hembly	Embry	Pacific Textile	Win Hanverky	ANTA	
Date of listing	03/30/06	07/13/06	12/18/06	05/18/07	09/06/06	07/10/07	
Social Issues							
Discuss social responsibility				√	√		2
Discuss social factors as a risk	√	√	√	√	√	√	6
Labour Issues							
Disclose and discuss labour laws				√		√	2
Low labour costs as advantage	√	√		√	√		4
Migrant workers				√			1
Refer to a workers union				√			1
Discuss worker health	√			√	√	√	4
Provide worker training		√	√		√		3
Remuneration							
Discuss wages				√		√	2
Discuss overtime							0
Report on work hours		√					1
Meet basic welfare requirements	√	√	√	√	√	√	6
Data on welfare contributions		√	√	√	√		4

The most common statement related to social issues in prospectuses from textile companies was that they can be a risk for business operations. When social issues were discussed as an issue of responsibility, it was primarily as a result of customer requirements. Reporting by Pacific Textiles best approaches industry norms in labour issues.

Pacific Textiles provides the only mention of national regulations on migrant workers, but they do not meet these because they are not requirements at the local level

Of perennial concern, overtime was surprisingly not mentioned by any of the textile companies in our sample. Nor was there a meaningful discussion of migrant worker conditions, unionization, or work hours. Pacific Textiles provides the only mention of migrant workers in its discussion of welfare contributions and national requirements. They conclude, however, that they do not meet these requirements because it is not required at the local level.

Technology and Electronics:

The electronics industry leads in reporting on ESG related issues. Compliance with environmental standards, relationships with customers, worker safety and training, overtime, the risk of strikes, and other social issues were all addressed better by electronics companies than companies in other industries. Metrics for some of this

information was also provided. For example, overtime hours and costs were disclosed by two companies. The existence of industry ESG standards was typically acknowledged in electronics sector prospectuses and references to RoHS and the “Green Partner” awards provided clear links to material customer and marketplace norms.

Social issues were better addressed by electronics than any other industry

Table 7 Electronics Sector ESG Themes

Name	Advanced	Capxon	Computime	HannStar	Kingboard	Meadville	Neo-Neon	O2Micro	RMIH	TC Inter-connect	Yorkey	
Customer												
Customer			√		√		√		√	√	√	55%
Sony Green Partner			√			√			√			27%
Audit					√				√	√		27%
Workplace												
Provides Training	√		√	√	√		√	√		√	√	73%
Strikes	√	√	√			√	√		√	√	√	73%
Safety Measures	√	√	√	√		√	√		√			64%
Overtime		√		√	√				√			36%
Low labour			√	√					√	√		36%
Environmental												
14001	√	√	√	√	√	√			√	√		73%
EMS	√			√	√				√	√		45%

Toys

The toy industry offers perhaps the best example of a sector which has been forced to address the integration of ESG variables into supply chain business practices, in part because these issues are dealt with through an industry-wide standard set by an external international association. The ICTI CARE standard promotes ethical manufacturing in the form of fair labour treatment, as well as employee health and safety in the toy industry. Smart Industries, the lone toy manufacturer in the current sample, complies with this standard. It did not, however, provide additional information about the terms of its compliance.

Other industries

Single industry companies also provided relatively coherent disclosure. Kingboard Laminates did not detail the forestry practices of its material suppliers, but it clearly detailed chemical treatment methodologies, results, and standards for its products. Nine Dragons’ prospectus provided a detailed discussion of its operations, environmental compliance efforts, industry context, and reliance on international experts.

Emerging Issues of Global Concern

Of particular interest in the sample was the emergence of two cross-cutting issues of global concern: international property rights protection and recycling. While mechanisms for addressing these issues exist in the developed world, pressure has been mounting on China for similar systematic implementation. That these issues are increasingly recognized and discussed in prospectuses as risks to corporate operations speaks again of the progress being made in IPO disclosures.

Intellectual Property Rights

The protection of intellectual property rights (IPR) has become a highly contentious issue between governments and industries globally¹⁰. The issue appeared to be of peripheral concern to Chinese companies in our previous report, with few acknowledgements of risk and little detail provided. This year's prospectuses, on the other hand, provided a clearer picture of engagement in local as well as global IPR litigation which was material to corporate activities.

The incentive to protect IPR within China has depended heavily on national regulatory drivers for enforcement rather than external factors. As a result, conformance has largely lagged that of developed nations. With the advent of increased Chinese innovation, however, companies are beginning to push for improvement of institutional capacities even as the enforcement agencies themselves have incentives to protect national interests abroad.

The acknowledgement of risk to IPR dominated disclosures (70%), particularly in the electronics sector

The acknowledgement of risk to IPR dominated disclosures (70%), particularly in the electronics sector which is concerned about protecting technological advances. Five of the eight electronics companies were involved in or continue to be involved in ongoing litigation. The disclosure of litigation both within China and internationally was well documented and clearly detailed, providing valuable information for investors. The remainder of the sample (30%) was mainly concerned about trademark protection.

Several other aspects of IPR protection were addressed for the first time. A concern for talent stealing, a frequent issue within China, was discussed in company interviews, but only addressed by ANTA. The use of anti-counterfeiting measures/technology was also addressed by only one company, SCUD, although their discussion and efforts given to anti-counterfeiting was significant.

Table 8 Intellectual Property Rights Disclosures

Company	Sector	Description
Advanced	Electronics	Accused of IPR infringement in several international cases, including one from O2Micro.
Computime	Electronics	Involved in a variety of litigation matters involving IPR.
Neo-Neon	Electronics	The plaintiff in 27 legal proceedings in the PRC in relation to infringement of their IPR.
O2Micro	Electronics	Involved in a variety of litigation matters involving IPR.
AUPU	Household Goods	Involved in 18 IPR lawsuits, either as plaintiff or defendant.
ANTA	Textile & Apparel Sportswear	Encountered incidents of counterfeit products and reported to relevant government authorities.

Recycling Undeveloped and Unregulated

Another area of significance which emerged from the current sample of prospectuses was recycling. As investors increase their focus on the waste disposal and processing practices of listed supply chain companies, it will be important to develop a realistic understanding of the existing and future marketplace realities for recycling in China and

other countries in Asia. Indeed, the current sample of prospectuses offered valuable insights into the prospects for recycling as well as strategies for dealing with e-waste and the ‘end of life’ waste cycle in Asia.

The regulatory and economic pre-conditions for the type of recycling markets that we commonly see in developed markets do not yet exist in China. In developed countries, recycling is a formal system with regulations focused on toxics. In China, the recycling market is more informal, of low cost, without a focus on toxics, and characterized by a lack of enforcement of environmental and workplace regulations.

The regulatory and economic pre-conditions for recycling markets in developed countries do not yet exist in China

International initiatives that address e-waste have been largely ineffective in China. WEEE is the EU’s attempt to regulate waste streams of products originating outside of the EU. Only one company, Meadville, discusses the WEEE initiative, even as they recognize that in many instances they will not be directly responsible for compliance.

The perception that products, once delivered, are no longer a company’s responsibility dominated our discussions with relevant corporations. Recycling activities are instead viewed as the responsibility of the brand. Several global brands, including Dell and Hewlett Packard, offer safe recycling in Asia, but of the more than 1 million tons of e-waste each year, including an estimated 10 million mobile phones, only a sliver is returned directly to the companies. Other targeted experiments in recycling have also failed because disposal to illegal operators is more lucrative¹¹.

Among prospectuses, recycling within the production process occurs primarily with water. This is typically approached as a cost-cutting measure or as a response to the serious water shortage risk in China.

Table 9 Recycling Strategies

Issues	Sector	Company	Strategy
Solids	Industrial Goods	China High Speed	Sells scrap metal, iron and waste for recycling
	Electronics	HannStar	Sells scrap metal for recycling
		Kingboard	Sells solid wastes for recycling
		Meadville*	Sells scrap metals for recycling
		Neo-Neon*	Equipped with recycling facilities
	Regent Manner*	Recycles within production process	
Education	Battery	SCUD	Waste education program for staff
Solids / Water		Tianneng	Recycles water and batteries through subsidiary
Water	Paper	Nine Dragons	Recycles materials and water within process
	Textiles & Clothing	Co-Prosperity	Recycles water within process
		Pacific Textile	Will recycle water within process

* Make reference to RoHS.

It falls on companies which have experienced the wrong side of local officials or communities to provide improved levels of disclosure

Catalysts for Improvement

Somewhat ironically, public scandals and ESG-related incidents have increasingly emerged as a catalyst for greater transparency on ESG issues in the Chinese supply chain. Indeed, some of the most realistic disclosure found in the current sample comes from companies that have been required to provide detailed accounts of public controversies. While other companies provide opaque references to potential regulatory issues and marketplace challenges, it falls to those companies which have been on the wrong side of local officials or communities to provide the type of disclosure that confirms progress toward higher ESG standards. Although most disputes or regulatory problems are described as a one-off event, the increasing frequency with which they are being acknowledged provides confirmation of their greater materiality.

Table 10 Public or Other Incidents

Company	Description
Advanced	A fire occurred on their premises. Six cases of being accused of intellectual property infringement.
ANTA	Encountered incidents of counterfeit products and reported to authorities.
Computime	Newspaper reports of breach of labour laws resulted in strikes and fines.
Meadville	Three instances of non-compliance with safety requirements.
Neo-Neon	Involved in numerous litigations, both as plaintiff and defendant.
Nine Dragons	Three workers died as a result of an industrial accident.
Pacific Textile	Third-party contractor released waste into the local water source.
SCUD	Several accusations of faulty batteries resulted in recalls.
Tianneng	Accused of causing lead-poisoning in children in surrounding area.
Yorkey	One director involved in an ongoing lawsuit in Taiwan.

Labour Disputes

Heightened attention to labour standards increasingly reflects local community issues. For example, Computime disclosed that in 2004 a processing agent experienced a labour strike that arose from a series of newspaper articles reporting breaches of applicable labour laws. These breaches included, among others, failure to pay workers the statutory minimum wage, entering into employment contracts on terms which did not comply with Chinese law, non-provision of certain social insurance benefits and requiring employees to work hours considered excessive under Chinese law. After the agent was fined RMB1.96 million, Computime became actively involved with their processing agents, monitoring their activities, providing training and reviewing human resource policies.

Environmental Impacts

Tianneng Power provided one of the more detailed disclosures of a potentially damaging and material issue. In April and May 2005, residents in a town where one of Tianneng’s factories is located alleged that their children were suffering from elevated blood lead levels due to the lead waste discharged by Tianneng’s lead-acid battery factory. Various demonstrations were held outside the production plant over the next month which interrupted production. Water supply facilities, an office building, and 80% of the production plant were destroyed during the protests. Three participants in the demonstrations were prosecuted and sentenced to one to three years. According to the results of the blood tests, 1,888 children from nine nearby villages had elevated blood lead levels. Regardless of the fact that Tianneng was not formally charged, management agreed to provide a RMB1 million subsidy to the children with elevated blood lead levels. A series of third party investigations followed, with none showing significant emission levels that could be attributed to the higher blood lead levels in the children.

Tianneng Power provided one of the more detailed disclosures of a material environmental problem

Responsibility for Subcontractors

As investors and consumers take a more pragmatic approach to the economic reality of outsourcing and supply chain relationships, it should not be surprising that brands and first-tier suppliers are increasingly finding themselves forced to respond to the failings of their suppliers. One good example of this type of challenge was disclosed by Pacific Textiles. In April 2007, mere months before Pacific Textile went public, a third party contractor released untreated wastewater from its manufacturing facility. Pacific Textiles consequently received a number of inquiries from concerned customers. One customer subsequently sent a technician to inspect the water treatment plant to verify compliance with applicable environmental standards. This is exactly the type of problem which is increasingly appearing in the Chinese press and can be expected to serve as a catalyst for inspections and fines by local officials and audits by concerned customers.

Figure 5 Rare Disclosures

International Accounting Transparency Acknowledgement

We have incurred, and continue to incur, significant costs with respect to corporate governance and financial reporting compliance. To comply with the requirements of the Sarbanes-Oxley Act, as well as new rules subsequently implemented by the SEC and adopted by the NASDAQ in response to Sarbanes-Oxley, we have made changes to our financial reporting, securities disclosure and corporate governance practices.

O2Micro

Regular Meetings on Corporate Governance

In order to strengthen corporate governance in respect of the Non-competition Deed, upon Listing, meetings will be held among all the independent non-executive Directors once every two months, together with one management representative from each of the Group and TSMT Taiwan to review the compliance with the Non-competition Deed by TSMT Taiwan.

RMIH

Labour Dispute Mechanism

When a labour dispute arises, the parties concerned may apply with the labour dispute mediation committee of their own unit for mediation. Should the mediation fail and one of the parties concerned demand arbitration, it may apply to the labour disputes arbitration committee for arbitration. Parties may also file an application directly with the labour disputes arbitration committee for arbitration. If the arbitration ruling is not accepted, the case may be brought before the People's Court.

Pacific Textiles

Shareholder Dispute Mechanism

The direct enforcement by our shareholders of any rights of shareholders in respect of violations of corporate governance procedures may be limited. In this regard, our Articles of Association and the Hong Kong Listing Rules provide that most disputes between holders of H Shares and our Company, Directors, Supervisors, officers or holders of legal person shares, arising out of our Articles of Association or the PRC Company Law and related regulations concerning the affairs of our Company, including the transfer of our shares, are to be resolved through arbitration by an arbitration tribunal in Hong Kong or the PRC, rather than by a court of law.

Advanced

Company-formed Union Equivalent

In accordance with local government requirements, we have a worker's union in our Panyu facility that is not currently active, and submit membership dues to the local union. In our Sri Lanka facility, we do not have a worker's union, but we have established a Joint Consultative Committee which represents our employees and management.

Pacific Textiles

Unnecessary Supplier Engagement

Although ANTA states that

"Our ANTA brand may be damaged if our contract manufacturers or suppliers violate any relevant laws, rules, or regulations, particularly in respect of labour and environmental protection."

They have not reviewed their compliance, however, and have received legal advice that they will not be responsible for breaches.

"We have been advised by our PRC legal adviser that we will not be responsible for any breach of rules and regulations in the PRC by our contract manufacturers and suppliers and we did not review our contract manufacturers' compliance with environmental protection and social welfare regulations during the Track Record Period.

ANTA

Simple Metrics Provide Insight into ESG Risks

Standard metrics offer a reference point for investors to track corporate disclosure of ESG-related issues and gain insights into the development of risks and opportunities in Hong Kong listed companies. Disclosure of these metrics during the track record period may not be highly visible, but prospectuses from this year allow monitoring of several key points of interest.

Metrics that can provide concrete data include:

- Cost of labour (salaries and/or benefits)
- Breakdown of staff numbers by year/turnover
- Additional labour issues (welfare contributions, overtime costs, etc.)
- Cost of energy and utilities (electricity, price of oil/ton, steam, water)
- Payment of environmental fees
- Family relationships within boards of directors
- Details of ongoing IPR litigation

Table 11 Labour and Environmental Indicators Disclosed

Metrics	% Companies Disclosing (Reality Sets In)	No. of Companies (Reality Sets In)	% Companies Disclosing (Cat and Mouse)	No. of Companies (Cat and Mouse)
Labour	100	23	83	20
Staff numbers breakdown	100	23	17	4
Staff costs	87	20	78	18
Welfare contributions	43	10		n/a
Overtime costs	4	1		n/a
Environmental	65	15	50	12
Electricity	43	10	21	5
Water costs	30	7	12	3
Environmental fees	26	6	9	2
Governance	100	23	n/a	n/a
Family relationships on the board	65	15	n/a	n/a
Litigation details	26	6	n/a	n/a

Note: the total number of companies in this report is 23, while the previous report had a similar sample composition of 24

As seen in Table 11, an update of the metrics table in *Cat and Mouse for Investors*, prospectuses from the new sample revealed an increase in the number of companies across the board that are reporting quantitative information of material value to investors.

The growing importance of detailed environmental reporting is evidenced by the doubling of companies reporting electricity, water, and environmental fees

Several notable trends are that all companies are now providing metrics about labour, that disclosure of welfare contributions has emerged as significant, and that one company provides disclosure of overtime costs in its Financials section. The growing importance of detailed environmental reporting is also evidenced by the doubling of companies reporting electricity, water, and environmental fees. The dominance of family relationships on the board continues while details about ongoing litigation are emerging as an IPR marker of value.

What Next? Issues for Investors to Watch

In light of the key findings of this report that Chinese supply chain companies are showing some improved openness towards disclosure of ESG related issues, investors can now play a valuable role in encouraging this trend by monitoring and inquiring about material trends when meeting with such companies. Focused questions from investors can assist companies in recognizing more clearly the potential impact of three key ESG related themes.

The three core theme areas are as follows:

Standards and Compliance

Global best practice

Disclosures are beginning to acknowledge global, industry-specific best practice, standards, and regulatory initiatives, yet few comply. Monitoring company efforts to meet these standards, such as REACH, RoHS, WEEE, and their new Chinese equivalents throughout the supply chain should be essential because they provide valuable operational benchmarks.

Meeting customer audit requirements

Customer audits covering company ESG-related practices, particularly regarding labor, are increasingly standard. It will be important for investors to understand if a company is focused defensively on managing audit requirements or more proactively implementing systematic improvement in partnership with brands.

Thematic Disclosure

Labour costs and turnover rates

Improved data disclosure on labor issues is commendable, but additional reporting of quantitative data would enable even more informed assessment of overtime and turnover specifically, and of how companies will respond to new Chinese labour laws.

Waste stream monitoring

The lack of compliance with WEEE in the electronics industry is material, as is the perception that recycling end-products are the responsibility of brands. It will be important to monitor the development of the waste recycling industry in China as it moves beyond the current, unregulated situation.

Water supply and water treatment facilities

The recognition of water shortage issues is significant. Additional information on source volume, operational requirements, and investment and usage projections will be material for investors to understand company contingencies to address future water shortage risk.

Strategic Management

Market advantage

Product design, emissions reductions, waste management, and carbon trading have the potential to improve market advantage. Investors should question whether management is being strategic in incorporating such ESG-related themes to increase their market profile, respond to customer interest, or build up their competitive advantage.

Downstream engagement

With increasing attention being given by global brands to downstream supply-chain management indications of strategic thinking by Chinese company management concerning their suppliers on ESG related issues is material.

Endnotes

¹A Cat and Mouse Game for Investors: Assessing ESG Disclosure of Supply Chain Listings in Hong Kong, ASrIA 2006
www.asria.org/publications#ipo

²Investing in Asia's Water Sector: A Turbulent Rush through Opening Floodgates, ASrIA 2007
www.asria.org/publications#waterr

³ISO 14001 What Investors Need to Know, ASrIA 2005
www.asria.org/publications#iso

⁴Included are automotive electronics, radar equipment, medical devices, semiconductor and other manufacturing equipment, components, some raw materials, etc.

⁵See www.scmp.com, November 19 2007

⁶An SRI Perspective on The Impactt Overtime Project: Tackling Supply Chain Labour Through Business Practice, ASrIA 2005
www.asria.org/publications#impactt

⁷See www.sony.net/SonyInfo/procurementinfo/green.html

⁸See www.icti-care.org/

⁹Taking Stock - Adding Sustainability Variables to Asian Sectoral Analysis: Supply Chain ASrIA 2006
www.asria.org/publications/lib/sector/ASrIA_Taking_Stock_Supply.pdf

¹⁰Intellectual Property Rights: A Survey of the Major Issues, Asia Business Council, September 2005
www.asiabusinesscouncil.org/research.html

¹¹Shanghai Electronic Products Repair Service Association - a government-backed industry federation, February 2007. See english.zhb.gov.cn/zwx/hjyw/200702/t20070202_100523.htm

ABOUT ASrIA

The Association for Sustainable & Responsible Investment in Asia

www.asria.org

ASrIA is a not for profit, membership association dedicated to promoting corporate responsibility and sustainable investment practice in the Asia Pacific region. ASrIA's members include investment institutions managing over US\$4 trillion in assets, however membership is open to any organisation which has an interest in sustainable investment.

ASrIA has taken a leadership role in promoting sustainable investment in Asia since our founding in 2001. ASrIA has run conferences, seminars and workshops, and published wide-ranging research on SRI issues. ASrIA has also created a very wide network of organizations and individuals interested in the broad range of policy issues and investment strategies which are essential to the implementation of SRI in Asia. ASrIA's website, www.asria.org, is the primary resource for SRI in Asia, attracting over 4,000 page views per day and over 5,000 subscribers to our regular e-bulletin.

ESG Disclosure

