ESG in Indonesia: Access to Finance

2023

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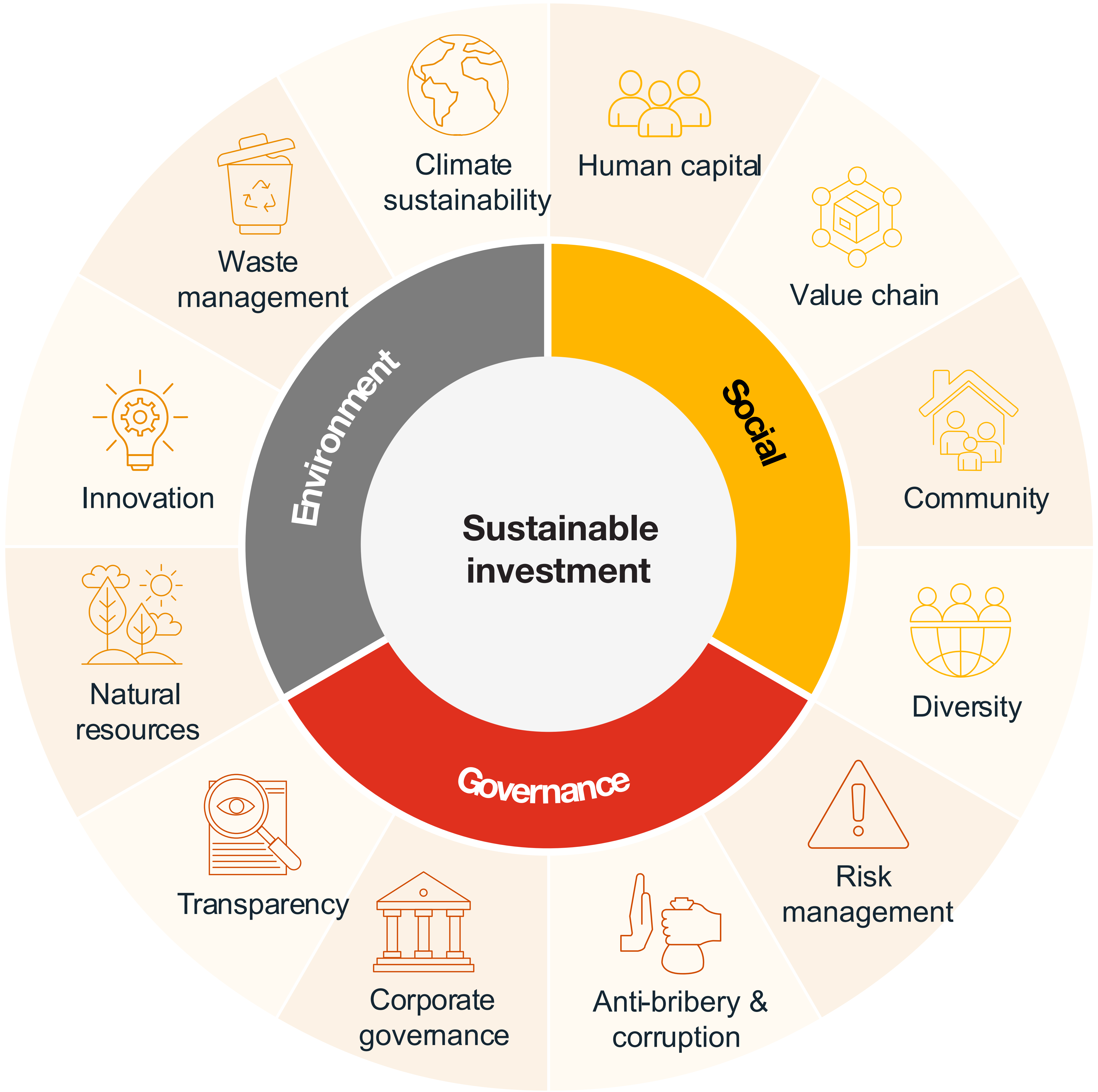
pwc

Incorporation of ESG principles can widen access to finance because sustainable investors look beyond financial returns



Sustainable finance & ESG

Sustainable finance involves the incorporation of ESG factors into investment decisions. This may include mitigation of the climate crisis, consumer protection and responsible corporate management practices.

ESG ratings can ease access to finance

Investors, funds and financial institutions are increasingly taking the ESG performance of companies into consideration. Companies that demonstrate transparency and good performance on ESG-related matters can achieve higher ESG ratings and consequently enjoy better access to funding. However it is important to understand that a company can achieve a strong ESG rating even with weak performance in some factors if it is strong in others so investors need to look beyond ratings at the detail of a company's performance.

ESG investing & analysis

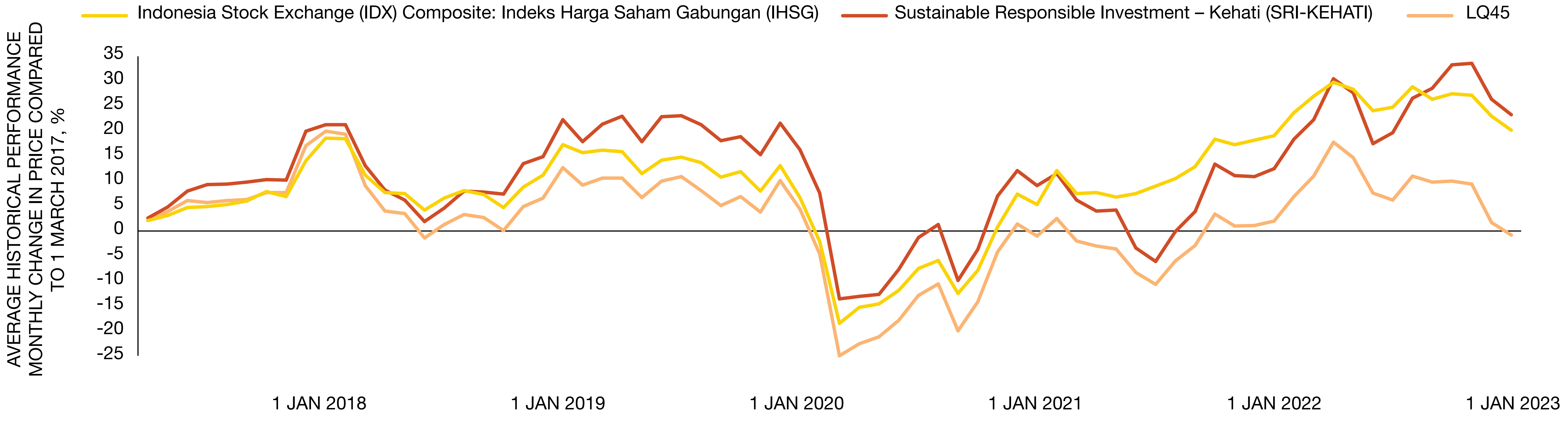
Investors are increasingly applying ESG metrics to manage risk and identify value-creation opportunities. While ESG measurements may not be required for financial disclosures, a growing number of organisations are including ESG disclosures in their annual and sustainability reports. Multiple institutions are working to develop international standards and materiality considerations – which can support the incorporation of ESG into the investment process. Chief among these efforts is the ongoing formation of standards by the ISSB (see slide 26).

- **Indonesia's G20 Presidency gave the country an opportunity to spearhead discussions on global economic governance (see slides 13-16).**
- **Net-zero targets are increasingly being adopted by Indonesia's public and private sector organisations (see slides 17-22).**
- **Sustainable finance principles include responsible investment, sustainable business strategy and practice, and coordination and collaboration (see slides 23-28), according to the Financial Services Authority (OJK).**

Sources: *CFA; G20 Indonesia 2022; Harvard; OJK; PwC*

The region's ESG-rated indices have performed on a par with peer indices

Indonesia's sustainability-aligned indices performed in line with heavily traded stocks, 2017-23



SRI-KEHATI

Launched in June 2009, this index of 25 listed companies was jointly developed and selected by the Indonesian Biodiversity Foundation (KEHATI Foundation) for good performance in SRI.

In December 2021 the IDX and the KEHATI Foundation launched two new ESG-aligned indices: ESG Sector Leaders IDX KEHATI comprises top sector representatives, based on an above-average ESG score; ESG Quality 45 IDX KEHATI measures the top-45 stocks based on ESG and financial indicators.

SRI-KEHATI was affected considerably from early 2020 until mid-2021 by factors including:

- Drop in share price of a multinational consumer goods company
- Decline in financial and infrastructure sector
- Shift in appetite towards technology until mid-2021

SRI-KEHATI began to recover, aligned with broader economic recovery, from the second half of 2021

LQ45

Index of 45 companies, selected from the top 60 by liquidity traded over the past 12 months.
In November 2022 the IDX launched the IDX LQ45 Low Carbon Leaders Index, which contains companies that seek to reduce their carbon intensity by 50% compared to LQ45.

IDX ESG Leaders (IDXESGL)

Launched in December 2020, this index comprises 15-30 constituents from the IDX80 with low ESG risk ratings.

Since the December 2020 launch of the IDXESGL, it:

- Maintained a similar trend line to the LQ45, with a more positive performance, until end-April 2022
- Followed a similar trend line to the SRI-KEHATI, with a lower performance, for the remainder of 2022

Sources: *EY; IDX; Investing; KEHATI; Legal Centric; Morningstar; PwC; Refinitiv; SET*

Some of Asia's ESG-rated indices have delivered higher returns than non-ESG counterparts over recent years

4%
outperformance of the Singapore Exchange's ESG Leaders Index compared to Straits Times Index, which tracks the performance of the bourse's top-30 companies, January-September 2021

3.7%
outperformance of Malaysia's FTSE4GOOD, the responsible investment index of the FTSE Group, compared to FTSE Bursa Malaysia Kuala Lumpur Composite Index, January-September 2021

-2.9%
underperformance of Stock Exchange of Thailand (SET) Thailand Sustainability Investment (THSI) index compared to broader SET index, from 2018 to end-September 2021

3%
outperformance of the SET-THSI compared to the broader SET index, from December 2020 through to end-May 2021

1.7%
outperformance of Morningstar's Asia-Pacific ESG index compared to non-ESG equivalents, full-year 2021

There are four key drivers of sustainable investing

Demand from investors, the market, risks and regulations are driving sustainable investing

Sustainable investing

1 Client & investor demand

Private and institutional investors are increasingly demanding ESG-focused products

Professional investors need to adopt sustainable investment strategies to meet their clients' needs

2 Investment opportunities

Robust financial returns may attract investees to new markets

Some ESG funds and indices have outperformed non-ESG focused counterparts in the years to 2023

3 Risk management

ESG concepts help stakeholders to understand, measure, and manage physical and transition risk

For example, brown investees could pose a risk due to the shutdown of stranded assets

4 Regulations & standards

Evolving regulations and standards are raising supervisory expectations across sustainability metrics

Voluntary commitments, as well as supervisory initiatives, promote ESG adoption along the value chain

UN PRI signatories commit to six principles of ESG incorporation

1. Incorporate ESG issues into investment analysis and decision-making
2. Be active owners and incorporate ESG issues into policies and practices
3. Seek appropriate ESG disclosure by investees
4. Promote implementation of the principles within the investment ecosystem
5. Collaborate to enhance effectiveness in implementing the principles
6. Report on activities and progresses in implementing principles

What are the UN Principles of Responsible Investment (PRI)?
The PRI is an independent global proponent of responsible investment. It aims to understand the investment implications of ESG factors, and encourages investors to use responsible investment to enhance returns and better manage risks. The network engages with global policymakers and is supported by the UN.

PRI is the most widely adopted responsible investing framework

4902
signatories, end-Mar 2022

$121.3trn
assets under management (AUM), end-Mar 2022

28%
y-o-y growth in signatories, end-Mar 2022

77.3%
growth in AUM, 2017-22

Sources: PRI; PwC

Traditional investors are pushing for the incorporation of ESG considerations into company decision-making

Balanced approach

- The years leading to 2023 have seen the emergence of new and innovative approaches to investment.
- Traditional investors are becoming more conscious of their impact on the environment and society, and are pushing for the incorporation of ESG. Traditional philanthropists and donors are growing more reliant on innovative financing or investment schemes in addition to traditional development assistance or philanthropy.
- The incorporation of ESG criteria can help to bridge the gap between finance-focused investors and those who prioritise philanthropic goals. Common goals of traditional investment and philanthropy include the creation of long-term value, the mitigation of investment risk, and the search for measurable environmental and social impacts.

Investment spectrum	Traditional investment	Responsible investment	Sustainable investment	Impact investment (return first)	Impact investment (impact first)	Venture philanthropy	Traditional philanthropy
Focus	Limited or no ESG incorporation	ESG incorporation to meet investor requirements & ESG regulations	ESG incorporation to create long-term value by mitigating risks & identifying growth opportunities	Investment designed to have measurable social & environmental impacts	Investment designed to have meaningful social & environmental impacts	Venture investment focused on addressing societal environmental issues	Grants focused on addressing societal environmental issues
Financial & social return expectation	Financial return only	Financial return prioritised	Financial return focused on long-term value creation	Social return & adequate market rate of financial return	Social return & submarket financial return	Social environmental return prioritised	Social environmental return only

ESG incorporation

Sources: OECD; PwC

Research partner: PwC Indonesia

OBG's research partner for this publication, PwC Indonesia, aims to help clients build trust and deliver sustained outcomes.

Strategy & transformation — Climate — Operations — Disclosure — Finance

CASE STUDY
ESG strategy, roadmap, governance and reporting

PwC was engaged by an Indonesian food and beverage company to develop its corporate sustainability framework to help drive the implementation of sustainability across the organisation.

CASE STUDY
Buy-side ESG due diligence and reporting

PwC was engaged by an Indonesian investment management enterprise to assist with financial, tax, and ESG due diligence and valuation services, including ESG risk assessment, for four target entities.

CASE STUDY
Sustainability assurance services for sustainability report

PwC was engaged by an Indonesian technology group to undertake a limited assurance engagement with respect to selected sustainability information in the company's sustainability report.

In 2020 PwC made a science-based commitment to reach net-zero greenhouse gas (GHG) emissions globally by 2030, including in Indonesia

Halve emissions

- Switch to 100% renewable electricity in all PwC firms worldwide
- Drive energy efficiency improvements in all offices
- Reshape client service model to balance remote and on-site work
- Engage with suppliers to tackle their climate impact
- Reduce air travel, which accounts for 85% of PwC's emissions

Work with clients

- Advance non-financial reporting so stakeholders understand their organisation's climate impact
- Embed implications of ESG factors into work for clients

Public policy discussions

- Advance thinking on structural reforms across economies

Sources: *PwC*

Managing physical and transition risk as identified by TCFD presents an opportunity for ESG value creation

Risk & opportunity

- Inaction towards climate change may lead to value erosion for economies and businesses across the world.
- The Task Force on Climate-related Financial Disclosures (TCFD) identifies two broad types of risk related to climate change: physical and transition risk. Physical risk equates to negative economic impacts that result directly from climate change phenomena. Transition risk is a consequence of strategic changes aimed at reducing negative climate impacts, relative to market and industry.
- Strategic management of these risks can offer positive financial impacts, including new revenue streams from green business models and cost reduction across the value chain.

Physical risk

Acute physical risk: Short-lived extreme weather impacts; disruptions to operations, transport and supply chains, among others; damage to physical assets and impact on insurance liabilities

Chronic physical risk: Impacts due to slow, insidious change, such as increasing temperature or water stress; degradation or limitations on resource availability, including labour and natural resources

Transition risk

Policy & legal risk: Compliance costs; stranded assets; restrictions and limitations on carbon-intensive assets; asset depreciation

Market & economic risk: Company or securities valuations; asset impairment; viability of certain business models; credit ratings implications

Technology risk: Write-offs for investments in disrupted technologies; required investment in new technologies; process change costs to accommodate new technologies

Reputational risk: Damage to brand value or reputation resulting in lost revenue and additional expenditure, including corporate affairs and litigation

Opportunities

Resource efficiency: Use of more efficient modes of transport; efficient buildings; reduced water usage; recycling

Energy sources: Integration of lower-emission sources of energy; use of supportive policy incentives; adoption of new technologies; participation in carbon markets

Products and services: Development of low-emission goods and services; climate adaptation and risk solutions; research and development, and innovation

Market opportunities: Exploring new markets or types of assets in order to diversify activities

Potential financial impacts

- Physical damage to assets
- Production disruption
- Supply chain disruption
- Changes in input prices
- Changes in demand for products and services
- Cost reduction
- Indirect tax savings
- New revenue streams

Sources: OJK; PwC; TCFD