COLUMBIA THREADNEEDLE INVESTMENTS

ESG VIEWPOINT

Stuck at a standstill? Evaluating ESG progress at South Korean companies

Cassandra Traeger
Vice President,
Responsible Investment

At a glance

- Korean companies have environmental, social and governance (ESG) standards that should mirror global best practice, yet there is still room for improvement in implementation. Concerns remain around gender diversity, ownership structure, and board effectiveness.
- The appointment of President Yoon Suk-yeol in March 2022 may exacerbate specific investor concerns around diversity, equity, and inclusion (DEI). The election was contentious around age and gender demographics, and he won by a margin of less than 1%.
- We travelled to Seoul in 2022 to understand and evaluate companies progress on improving their Environmental, Social and Governance (ESG) practices.
- Progress during recent years has been slow; the voice of both domestic and international investors will remain essential to drive further improvement.

Issued March 2023

Background

ESG standards in South Korea have been a concern for international investors for some time. The market continues to lag other countries in the region, both from a regulatory standpoint and from expected company practice, especially as other countries improve their ESG standards.

We have consistently engaged with South Korean companies for many years and have previously visited Seoul in the spring of 2018 and March of 2014, both as part of an international investor delegation led by the Asian Corporate Governance Association (ACGA) – a group that works with companies, regulators, and other investors to implement effective corporate governance throughout Asia. Following President Yoon's appointment in 2022, there were questions as to how he would work on addressing both institutionalised corruption and domestic human rights, including gender equality, discrimination, and LGBTQIA+ rights. In line with his campaign promises, no improvements have materialised thus far, meaning change at companies will rely heavily on investor engagement and not through regulation.

While President Yoon represents a more conservative view on matters such as ESG compared to his predecessor, it is unlikely he will be able to effect much change in that direction given the National Assembly is still controlled by the liberal Democratic Party and likely will continue to be until April 2024 when the next general election takes place.

Despite that, President Yoon will still be able steer the direction of any regulation and enforcement. For example, it's possible we will still see movement on financial services regulation or employment law – after all, his campaign promises included an emphasis on deregulation and reducing red tape. From a corporate governance perspective, he's pledged to introduce measures that could insulate management from investors, which could include things such as allowing for dual class share structures with unequal voting rights.

We have engaged with South Korean companies for many years.

Interested in learning more? Keep scrolling or click the quick links

ACGA delegation
– our visit to Seoul

Diversity, Equality
& inclusion
– improvement needed

Case study:
SK Innovation

A mixed bag
– what next?

2022 ACGA investor delegation

We visited Seoul in 2022, again as part of a delegation organised by the Asian Corporate Governance Association (ACGA). Most of the concerns we have regarding the South Korean market are common to other investors, and the ACGA gives us an effective platform to discuss these with companies.

The trip included meetings with:

Companies: SK Innovation, Samsung Electronics, LG Chem

Regulators: The Korean Stock Exchange (KRX), and the Korean Securities Depository (KSD)

The following sets out highlights of these meetings and our views on some of the key governance issues in the market:

Potential introduction of ISSB standards

When looking at the changes and trends in sustainability reporting, we would be remiss if we overlooked the efforts of the International Sustainability Standards Board (ISSB). As investors have increasingly demanded high-quality, consistent ESG reporting, the ISSB is attempting to define a comprehensive baseline for sustainability-related disclosures that can be adopted globally.

However, we expect to see regional fragmentation. While many countries have agreed to report along ISSB reporting standards, there is already pushback in some markets, including South Korea. There are even suggestions that a sort of ISSB-lite, Korean Sustainability Standards Board (KSSB), be implemented, considering local market standards and expectations.

While it is understandable that this sort of reporting may be newer to some markets, effective sustainability reporting has a role to play in driving change, be it behaviour or perception, and can eventually lead to better company performance. A global baseline will be essential for international investors to assess a company's progress on sustainability integration and oversight, no matter their regional location. However, regardless of the standards chosen, the **Korean Financial Services Commission** (FSC) and **KRX** have announced that by 2030, ESG disclosure in some form will be required for all KOSPI-listed companies, which is a positive step forward.

Climate

Some of the largest companies in South Korea have made significant and demonstrable progress on climate change management. For example, **Samsung Electronics** announced in October that it plans to achieve net zero direct and indirect carbon emissions by 2050, with its Device eXperience (DX) division meeting this goal by 2030. Samsung joins other heavyweights like **SK Innovation**, one of the first Korean companies to publicly announce a net zero roadmap, in leading the way on climate change management in South Korea.

This progress followed on the heels of former President Moon Jae-in's Green New Deal. However, there are still concerns with greenwashing, pricing monopolies and the strength of the government's Nationally Determined Contributions (NDC) and overall climate policy, which remain "highly insufficient" according to Climate Action Tracker. Further, President Yoon has taken a more conservative stance than his predecessor on environmental issues by advocating for a slower pace for net zero ambitions and opposing the introduction of carbon taxes. Pushing for disclosure of companies' progress against their climate commitments will continue to be an engagement priority for us.

Diversity, Equity, and Inclusion (DEI)

Much of the ESG progress in South Korea has lately focused on the 'E'. It is clear that companies are much more comfortable speaking about improvements on climate and emissions targets, but often struggle to articulate robust 'S' programmes.

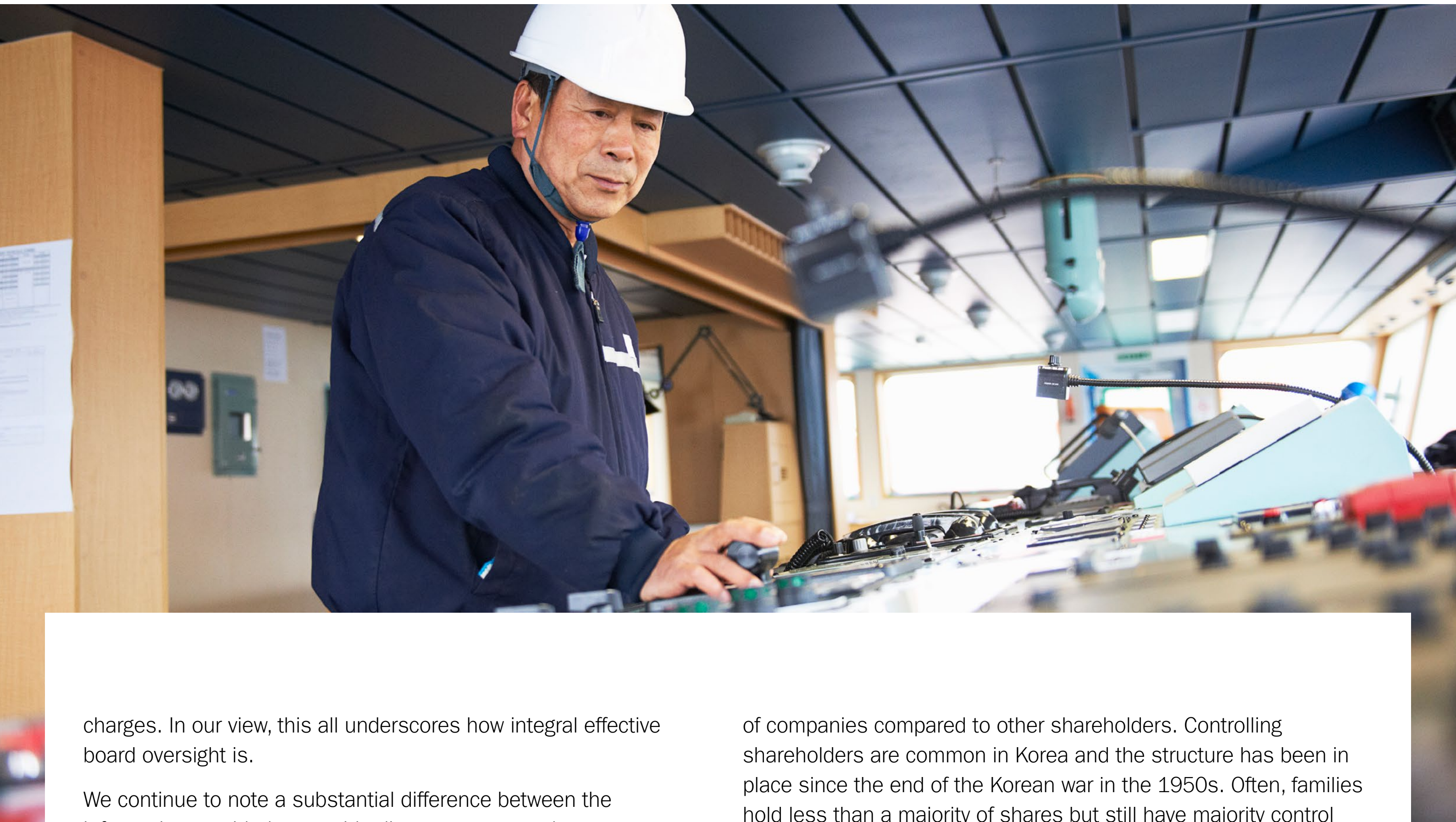
Even the government is slow to respond; as of January 2020, the National Assembly amended the Capital Markets Act to require large companies (those with assets of at least KRW 2 trillion) to appoint at least one woman to the board. If that requirement appears unambitious, it's worth noting the number of women executives at South Korean companies is even further behind, sitting at just around 5.6% for the nation's top 100 companies (it is noteworthy that such a low figure is, nonetheless a record high for the country). South Korea also consistently ranks worst among OECD countries for its gender wage gap, with the gap standing around 30%.

It appears as though change through regulation will be slow, if not non-existent, under President Yoon's administration, and South Korea itself may be enduring a backlash against what Interior Minister Lee Sang-min called 'women's policies'. However, we believe that through continued engagement, companies will continue to listen to investors on the subject of DEI. During our company engagements, the consistent refrain was that companies understand the importance of gender diversity and skills and that this is front of mind for them as they go through their board nominations processes and retention analysis. We will continue to ask companies to improve gender diversity, adopt quantitative time bound targets for these goals, and explicitly report out on DEI indicators such as mentorship programmes and employee resource groups.

Board oversight

Effective board oversight and director independence remain a concern at South Korean companies. For example, it is expected that Lee Jae-yong, the de-facto head of **Samsung** who was convicted of bribery and embezzlement in 2017, will re-join the company after he was pardoned by President Yoon. Shin Dong-bin, chair of the Lotte Group, also received a pardon from the president on bribery

> Change through regulation will be slow, if not non-existent, under President Yoon's administration



charges. In our view, this all underscores how integral effective board oversight is.

We continue to note a substantial difference between the information provided to outside directors compared to company executives. This makes it exceedingly difficult for outside board members to provide effective oversight of management, despite this being their main responsibility. In fact, during our engagements, we heard from at least one company that some issues, such as compensation setting, do not rise to a board level discussion at all.

One way that companies are beginning to tackle independence and oversight concerns is through board evaluations. Several of the companies we engaged with highlighted their efforts to have internal board evaluations. These often consist of a mixture of self-evaluation, quantitative performance, and sometimes includes a governance evaluation. While this is a positive step forward, our preference is for greater accountability through independent outside assessments.

Independent, external board evaluations, while common in other markets like the UK, are nearly non-existent in South Korea. When pressed by investors on why companies have not looked at external assessors, the common refrain is that they are unable to locate good consultants that speak Korean or that the company is unconvinced an outside party would be able to assess roles accurately. We consider these third-party evaluations to be best in class and will continue asking companies to consider this.

Circular shareholding

Circular shareholding has been a concern for investors in the South Korean market for some time; 'chaebols', or large family-owned business conglomerates, often exercise outsized control of companies compared to other shareholders. Controlling shareholders are common in Korea and the structure has been in place since the end of the Korean war in the 1950s. Often, families hold less than a majority of shares but still have majority control through circular shareholding structures.

While many laws and regulations have been enacted to manage this type of shareholding, progress is slow. Even more concerning is the rise of companies using treasury shares to acquire shares in other companies. For example, in September 2022 **KT Corporation** (KT) and **Hyundai Motor Company** (HMC) agreed to exchange treasury shares, allowing HMC a 7.7% stake in KT while KT will hold just over 1% in HMC. This practice will likely exacerbate existing concerns around circular holdings and, understandably, investors are questioning whether this is an effective use of capital.

Even with the consistent investor focus on circular holdings, companies are reluctant or slow to unwind these and shareholders are obliged to complement this discussion with additional topics like appropriate succession planning. The nomination process for directors and executives remains opaque and it is vital investors understand how companies are managing key person risk.

It is difficult for outside board members to provide effective oversight of management

Case Study: SK Innovation

During our trip, we met with Kim Jong-hoon, the chair of **SK Innovation** (SK). We have been able to meet with the board chair now for several years as part of the ACGA delegation. This type of high-level access can still be elusive at South Korean companies and so the chair's focus on shareholder engagement and ESG improvements was very welcome.

Lessons learned in our engagement

SK has been a market leader in addressing ESG themes and we were pleased to see that continue. While they are a large conglomerate, SK has made it a priority to balance the influence of the CEO through strong governance structures such as a majority independent board and the establishment of key committees with independent oversight. During our engagement, they also stressed the robustness of their internal board evaluation process; while we found that process encouraging, we re-iterated our preference for an independent external evaluation.

SK also directly ties their net zero climate commitments to the CEO's KPI process, linking the roadmap's implementation to KPI evaluations. Oftentimes, even basic remuneration disclosure is lacking., so the tying of ESG metrics to executive remuneration is an unusual practice in South Korea and one that we hope will take hold with other companies. Additionally, SK has an ESG committee that reports to the board, further enhancing the company's ESG oversight.

Engagement outlook

Through our continued dialogue with SK, we hope to see continued market leadership of ESG practices that can provide investors comfort around how chaebols can balance their structure with appropriate oversight and management.

Next steps

While there had been some expectations of meaningful ESG reform under the former administration, the results were very much a mixed bag. Sustainability reporting is on the rise and large companies are stepping up on climate, with net zero commitments and roadmaps. However, the devil is – as always – in the details. We will be keeping an eye on the implementation of these plans and ensuring companies deliver on their promises.

DEI remains an area of weakness and it is clear investors and companies (rather than regulators or lawmakers), will play a key role in any improvement here in the near future. Director independence and oversight also remains a concern, but in our view, increased engagement, and company willingness to discuss these issues can lead to meaningful change.

We will be monitoring companies to ensure they deliver on their promises

Get to know the author

Cassandra Traeger, Vice President, Responsible Investment

Cassie joined the Responsible Investment team in 2022 and leads engagement on governance throughout EMEA and APAC. She is also a thematic specialist on diversity, equity, and inclusion and sector specialist for tech companies. Outside work, Cassie enjoys gaming, reading, and baking.

Contact us

columbiathreadneedle.com

Follow us on LinkedIn

To find out more visit **columbiathreadneedle.com**