

# ESG Innovation Practice of Real Estate Enterprises under the Background of Uncertain Economic Policy

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**Abstract.** The deep reform of China's economic system has greatly increased the uncertainty of economic policy, and at the same time caused fundamental changes in the underlying logic of the real estate industry. In 2021, the Central Economic Work Conference proposed for the first time a new development model for real estate industry, and ESG is becoming a new "track" for real estate enterprises to compete. ESG leading real estate companies carry out unique innovative practices, and ESG practices are rooted in corporate culture and integrated into strategic operations, while making efforts to focus on key issues and strengthen organizational guarantee, to achieve "corner overtaking", and become the global ESG leader in the industry. In this paper, Sino-Ocean Group Holdings Ltd. ,a company in the real estate development and diversified activities industry in China, is selected as the research object, and the case analysis method is adopted to conduct the research, in order to provide experience reference for the ESG innovation practice of real estate development and diversified enterprises, and promote the high-quality development of China's real estate development and diversified activities industry.

**Keywords:** ESG; innovation; ESG rating; Economic policy uncertainty; Sino-Ocean Group

## 1 Introduction

In recent years, China's economic system has undergone profound reform and transformation, which has greatly increased the uncertainty of the economic environment. In particular, the "supply-side structural reform" has played the strongest voice of China's economic transformation and upgrading. The China Economic Policy Uncertainty Index, published by Stanford University and the University of Chicago, reached 935.3 in December 2019 (up from 100 in 1995), the highest point since 1995. Economic policy uncertainty can significantly depress business investment [1-3]. The real estate industry has been paid close attention by the government because of its particularity, and the government has introduced a series of policies to regulate the industry. The positioning of "housing does not speculation" and the promulgation of the "three red lines" make the purchase demand and the financing supply side shrink at the same time, which means that the high-speed expansion mode supported by high debt, high turnover and high return of the real estate industry in the past will never return. To this end, the Central Economic Work Conference in 2021 proposed for the first time a new development model for the real estate industry, prompting real estate enterprises to actively explore a new "track" of competition.

At the same time, China's economy is in the transition stage from high-speed growth to high-quality development, and ESG has increasingly become a direction strongly advocated by all sectors of the domestic society [4]. Especially for the real estate development and diversified activities industry (referred to as the real estate industry), a typical capital-intensive industry, the competitiveness mainly comes from economies of scale, the development of the industry and the increase of output greatly rely on capital investment to promote, so financing is an indispensable link. While the capital market is paying more and more attention to the sustainable development of enterprises, giving positive market feedback to green enterprises, and investors are more inclined to hold stocks with good ESG performance [5]. Leading real estate company in ESG rating Sino-Ocean Group issued US \$320 million 3.5 year secured green notes in 2021, with a coupon rate of only 2.70%, setting a record for the lowest interest rate of US dollar bonds issued by domestic companies in overseas markets. Motivated by this, Chinese real estate development enterprises have strengthened their ESG practices, promoting the overall improvement of the industry's MSCI ESG rating, and the proportion of enterprises reaching the "industry average level" increased significantly from 26% in 2018 to 68% in 2021, reflecting the industry's attention to ESG management and the overall improvement of management level. Some real estate companies stand out and achieve corner overtaking on the new ESG track, becoming the global leader in the industry.

## 2 ESG Innovation Practices Of Leading Real Estate Companies In ESG Rating: Measures And Results

This paper selects Sino-Ocean Group Holdings Co., LTD. (Sino-Ocean Group), a real estate company in China, as case studies. The company's ESG ratings in 2018 was B grade, lower than the "industry average level". In the past two years, whether it is in the ESG rating of the world's largest index company MSCI (MSCI), or in the ESG rating of China Securities, which is widely recognized by the domestic academic and practical circles [6], Sino-Ocean Group is in the first two grades of the industry, and is currently the highest ESG rating and the fastest improvement of real estate enterprises in the domestic peers. Considering that MSCI ESG rating is the ESG rating system with the highest market attention and recognition, this paper mainly analyzes Sino-Ocean Group based on its rating results (see Table 1 for details).

**Table 1** Basic situation of Sino-Ocean Group

	Data for 2022
ESG rate	MSCI: AA
corporate property	state enterprise
Industry sales ranking	20th
Sales scale in 2022	100.39 billion yuan
Average selling price	17,800 yuan /m <sup>2</sup> , higher than the industry average price

Sino-Ocean Group is the first real estate company in China to win the MSCI ESG rating of A and AA, and is currently the highest ESG rating. In the MSCI ESG ratings for 2022, Sino-

Ocean Group scored above the industry global average in green buildings, product quality and safety, health and safety, and corporate governance.

In terms of green buildings (E), Sino-Ocean Group's green buildings and products performed particularly outstanding, about 2.7 points (on a 10-point scale) higher than the peer average. As a pioneer of healthy building, Sino-Ocean Group started its comprehensive practice in the field of green building as early as 2006, and achieved the upgrade from "green building" to "healthy building" in 2015. Sino-ocean Group then took the lead in introducing the international WELL healthy building standard (hereinafter referred to as WELL) to Guangzhou Sino-Ocean Tianjiao project, and then issued and upgraded the Sino-Ocean Healthy Building System with the copyright certification of the National Copyright Administration. By the end of 2021, all new construction projects have met the national green building standards and are committed to achieving higher levels of certification. Sino-Ocean Group's health products have been distributed in 45 cities, landing more than 130 projects, covering an area of more than 22 million square meters, and 28 projects have completed WELL registration, of which 12 projects have obtained the final level of WELL certification. Sino-Ocean Group has become the leading enterprise in both the number and area of WELL certification projects in China.

In terms of product quality and safety, health and safety (S), in 2021, Sino-Ocean Group completed the iterative upgrading of the quality control system in the three areas of process quality, delivery quality, demonstration area and customer display quality, and its quality management is at the industry-leading level. Sino-Ocean Group also pioneered the "healthy future factory", "super site", and invited the owner to "cloud" supervision, with finely manufactured products to boost market confidence. In addition, Sino-Ocean Group implemented strong measures in the areas of service quality performance monitoring, supplier quality assurance training and clear responsible marketing policies, and scored ahead of its peers on ESG-related topics. At the same time, Sino-Ocean Group pays attention to the health and safety of employees, fully protects the rights and interests of employees through a variety of well-designed measures, attaches importance to their safety and health, and helps talent development through incentive guidance and training. In 2022, employee satisfaction of Sino-Ocean Group reached 4.8 out of 5 points. In terms of employee rights and interests, Sino-Ocean Group has formulated the Sino-Ocean Group Human Rights Policy to ensure that the human rights of employees, customers, investors, suppliers and other partners are fully respected and protected; In terms of employee safety, Sino-Ocean Group set up a safety committee to be responsible for daily safety management, organized a total of 1,435 special safety inspections annually, and the accident rate of one million square meters continues to be at the lowest level in the industry.

In terms of corporate governance (G), Sino-Ocean Group leads the world in score. In order to build a "healthy" company, Sino-Ocean Group has formulated the Sino-Ocean Group Board Diversity Policy. The Nominating Committee of the Board reviews the structure, size, composition and diversity of the Board annually, including but not limited to gender, age, nationality, educational background, professional skills, knowledge and experience, independence and service tenure. Taking independence as an example, as of December 31, 2022, the Board of Directors consisted of 13 directors, including three executive directors, five non-executive directors and five independent non-executive directors. At the same time, Sino-Ocean Group is also working in detail, paying attention to and disclosing the handling of daily

disciplinary violations. In 2022, Sino-Ocean Group accepted a total of 75 disciplinary clues such as abuse of power, dereliction of duty, and violation of business order; punished approximately 130 employees for violating discipline, achieving strict handling of serious disciplinary issues and strengthening education and persuasion on dereliction of duty. By grasping small and fine points early, Sino-Ocean Group can prevent problems before they happen and ensure the health of the organization.

### **3 The Way For Leading Real Estate Companies To Rise In ESG Ratings**

ESG innovation practice is rooted in the corporate culture, integrated into the strategy and operations, seize the key issues to make efforts, and has a strong organizational system to ensure implementation, which is the basis for leading real estate companies in ESG rating to achieve a leap in rating and surpass.

#### **3.1 Rooted in corporate culture**

Corporate culture is the corporate values and basic beliefs formed in the long-term development process of an enterprise and accepted by most employees, which affects the thinking mode and behavior mode of employees and determines the growth gene of an enterprise. As a new business development concept and corporate value standard, whether ESG can be compatible with and even supported by corporate culture is the key to gaining employee recognition and forming corporate consensus. ESG practice is more likely to produce ESG results only when it is rooted in corporate values and has a stronger cultural driving force. Therefore, in the top-level planning of ESG, it is an important part to trace the root of the enterprise culture and obtain the "enterprise culture drive".

Sino-Ocean Group's main shareholders are China Life Insurance Company Limited and Everyone Life Insurance Company Limited. Influenced by the major shareholders' high attention to health and life span, Sino-Ocean Group has been deeply branded with health in its development, and has formed a corporate culture of "responsibility, sharing and health". Among them, "health" as the core concept of corporate culture, its connotation includes healthy products, healthy enterprises and healthy teams. Sino-Ocean Group is committed to becoming a healthy enterprise and is determined to be the forerunner of "building health" in China. As the corporate culture of Sino-Ocean Group is highly compatible with the ESG concept, its health-themed ESG innovation practice is actually an important measure and inseparable content of corporate culture construction, which can be recognized by employees to a greater extent.

#### **3.2 Integration into corporate strategy and operations**

The role of enterprise strategy is to maximize the value of the enterprise through the choice of the road, the balance of the priority and the sequencing. Enterprise value comes not only from the short term, but also from the long-term sustainable return on investment. ESG, which conforms to the development trend of The Times, can win long-term competitive advantages for enterprises, so ESG innovation practice is also a kind of enterprise value creation. Therefore, ESG should be integrated into corporate strategy. If ESG is not integrated into the

company's overall strategy, senior management can only promote and monitor the company's ESG practices in a piecemeal manner. However, fragmented ESG practices do not truly change the core drivers and business logic of enterprise development, and enterprises cannot enter the sustainable development track with long-term growth. Therefore, ESG innovation practices should avoid "fragmentation" in the first place. Second, to avoid "homogenization," companies need to design ESG innovation practices that combine strategic and operational characteristics to respond to different pressures from regulators, consumers, and peers.

Real estate enterprises with leading ESG ratings show obvious systematic characteristics in the integration of ESG practice with strategy and operation. On the one hand, leading ESG real estate enterprises integrate stakeholders and their concerns into the strategic planning and operational decision-making process through the identification of important ESG issues, so as to avoid the phenomenon of "two skins" of ESG management and operation management. Sino-Ocean Group has launched the fifth phase strategy in 2020, and "build health" has been written into the development strategy of Sino-Ocean Group. With the continuous upgrading of the overall strategic pace of the company, the ESG management of Sino-Ocean Group has become a multi-dimensional systematic professional management embedded in the operation of the company, which is guaranteed by the coordination of various businesses and functions. On the other hand, by developing ESG strategic planning, building ESG management system framework, ESG index system, ESG evaluation and other management measures, leading ESG housing enterprises strive to promote the integration of ESG management and daily operation from multiple aspects such as corporate governance, risk management and control, product innovation and human resource management, and drive the virtuous cycle of ESG construction. Sino-Ocean Group's ESG strategy takes Sino-Ocean Group's five-phase strategic planning cycle, the target year of the United Nations Sustainable Development Goals (2030), and the target year of the long-term sustainable development planning (2050) as the time node, and achieves the long-term strategic vision by goals and steps. Focusing on strategic goals and visions, Sino-Ocean Group's ESG strategy is supported by the company's main business, and takes the five sustainable development directions of corporate governance, products and services, environment, employees, community and society as pillars to implement ESG specific projects.

Real estate companies with leading ESG ratings demonstrate differentiated characteristics in ESG innovation practices and match their differentiated competitive strategies. ESG innovation practice is also an important means for enterprises to participate in market brand competition. Companies can link business goals to social needs, differentiate themselves from competitors through differentiated or more effective ESG innovation practices, and earn excess returns. With the mission of "creating a high-quality environment for middle and high-end urban residents and high-end business customers", Sino-Ocean Group continues to build differentiated advantage barriers through health products. Since the establishment of "health" as the product positioning of enterprise development strategy in 2015, Sino-Ocean Group has established a healthy building research and development center, strengthened technology accumulation and product research, selected green environmental protection raw materials, and continuously strengthened the brand image of health. In fact, at present, the domestic real estate enterprises MSCI-ESG rating of A, there are Shenzhen Holding Group and Logan Group two companies, all adopt a differentiated strategy, positioning in the middle and high-end market. While Country Garden Group and China Evergrande Group, which have chosen a

cost leadership strategy and mainly focus on mid to low end products, have been at the lowest CCC level in MSCI-ESG ratings for five consecutive years, falling behind in the real estate industry and without leading issues. How to improve the key issues such as green building, product quality and safety of housing enterprises with cost leadership strategy still needs to make innovative breakthroughs in practice.

### **3.3 Strengthen organizational support and institutional implementation**

Efficient ESG innovation practice requires strong leadership to integrate ESG elements, so it is necessary to strengthen organizational guarantee and mechanism implementation, and ESG governance structure and institutional system are two basic strength points. Among them, Real estate companies with leading ESG ratings have adopted the ESG governance structure with three levels of management, namely, decision-making, management and executive. The ESG governance structure with division of responsibilities and clear rights and responsibilities can ensure that ESG matters are integrated into the performance process at different levels, and help to improve the comprehensive governance level of the company.

Sino-Ocean Group's Board of Directors, as the highest decision-making level of ESG management, comprehensively oversees the work of sustainable development; The Sustainability Management Committee is responsible for the promotion and management of ESG, and regularly reports relevant work to the decision-making level. The President serves as the chairman of the Sustainability Management Committee, and the Executive President, vice President, company secretary and general manager of relevant functional departments serve as members. As the executive level, the Sustainable development working group is composed of people from various professions, business divisions and projects, responsible for the implementation and integration of relevant work in various professional lines. In addition to the support of the system platform, Sino-Ocean Group has issued and implemented a series of systems such as the "Sino-Ocean Group Sustainable Development Working Methods", which clearly gives relevant management principles and decision-making procedures.

### **3.4 Focus on key issues**

The key issues and weightings of the MSCI ESG rating framework vary greatly by industry, and the MSCI ESG research team reviews the indicators and weightings of each industry every November and makes necessary adjustments. If the MSCI ESG rating is considered a big test, it is obviously important to understand the exam syllabus and marking rules. Overall, the MSCI ESG rating framework has 3 Pillars, 10 Themes and 35 ESG key issues, but the 2022 rating of the real estate industry only involves 7 themes of the 3 pillars and 13 ESG key issues (see Table 2 for details).

Among them, the key issues of different weights of the environmental pillar and the social pillar are adopted by the "10-point scoring system". Under the environmental pillar, the MSCI ESG index focuses on the green building situation of housing companies, with a weight of 27.8%. Companies are evaluated based on the resource consumption and carbon intensity of their real estate assets, their potential risk to environmental building regulations, and their efforts to improve the environmental performance of their real estate assets. Sino-Ocean Group's score on this key topic is the industry leader. Under the social pillar, the MSCI ESG index mainly considers the personnel health and safety, product safety and quality of housing enterprises, with a weight of 17.0% and 14.7% respectively. Employee health and safety is an

assessment of a company's workplace safety management and workplace safety standards in its industry and region. Product safety and quality issues are evaluated on the basis of the recalls or product safety issues the company may face, the strength of its supply chain and procurement systems, its quality management efforts in the manufacturing industry, and its responsible marketing practices. Sino-Ocean Group also lead the industry in scores on this key issue.

Under the governance pillar, the MSCI ESG rating uses a "10-point backsliding" approach to assess the impact of corporate governance and ethical business practices on investors, including issues of ownership and control, boards, compensation, accounting, business ethics and tax transparency. In 2022, the total weight of housing enterprises in this pillar is 39.6%, and the deduction is mainly generated from three aspects: 1. Failure to disclose relevant information content. When making relevant disclosure, real estate enterprises should pay attention to the disclosure of key performance. For example, in the field of product quality and safety, they should pay attention to the disclosure of key performance of product responsibility, including the number of complaints received about products and services and the response methods, describing the quality verification process and product recovery procedures, and the percentage of the total number of products sold that need to be recovered for safety and health reasons; In the area of corruption and instability, attention should be paid to the number of corruption lawsuits and the disclosure of their results. In the 2019 Environmental, Social and Governance Report issued by China Evergrande Group, the anti-Corruption section disclosed the company's integrity supervision and anti-corruption work system and policies, anti-corruption training activities, preventive measures and reporting procedures, but did not disclose the number of corruption cases and litigation results filed and concluded against the issuer or its employees during the reporting period. All of these deficiencies lead to higher penalty points on ESG-related topics. 2. Not up to standard. For example, in the key issue "Board of directors", the key indicator "Board independence" tests whether the proportion of independent directors on the board of directors is less than 51%, and "board diversity" tests whether the proportion of women on the board of directors is less than 30%. For cases where less than 30% of the board is female, and where there are no women on the board, it is a deduction for the governance pillar in the rating process. 3. Negative information. For example, at the March 15 party in 2020, Vanke Group was exposed by CCTV for housing quality problems. For a time, Vanke Group, known for its quality, was pushed to the forefront. Although Vanke Group made a public apology, and launched an investigation and rectification, in the time since, Vanke buildings across the country are still frequently reported quality problems. According to MSCI's ESG assessment, Vanke Group's performance on the "product safety and quality" issue lags behind the global peer average. Not only do quality issues result in lower scores on product safety and quality topics, they often result in lower marks on corporate behavior topics as well.

**Table 2** Key issues and weights of ESG in real estate industry

category	theme	key issue	2022 weight	2023 weight
environmental	climate change	carbon emission		0.1%
	natural capital	water resource stress	0.3%	0.1%

		raw material purchase		0.1%
		biodiversity and land use		0.1%
	environmental opportunity	opportunities in the green building sector	27.8%	29.0%
		staff management	0.2%	0.2%
	human capital	human resources development	0.2%	18.3%
social		health and safety	17.0%	5.6%
	product liability	product safety and quality	14.7%	3.5%
		privacy and data security	0.1%	0.8%
		ownership and control		
	corporate management	remuneration		
		board of directors	39.6%	42.1%
governance		accountant		
	commercial activity	commercial ethics		
		tax transparency		

It is worth noting that in response to the slowdown of the development of the real estate industry, the enterprises no longer widely pursue high turnover, and the large loss of employees, MSCI significantly reduced the weight of product safety and quality, health and safety in the social responsibility pillar in 2023, and increased the weight of human capital development and governance.

#### 4 Conclusion

From the perspective of ESG innovation practice of real estate enterprises with leading ESG rating, real estate enterprises with backward ESG rating should grasp at least the following three points if they want to learn from experience and achieve corner overtaking. First, obtaining recognition is a prerequisite. The commitment of the board of directors is the primary and indispensable factor in the construction of an enterprise's ESG. Meanwhile, the implementation of ESG usually needs to be combined with the construction of corporate culture to build a sustainable development culture. Second, boosting business is key. The essence of enterprise operation is the pursuit of economic benefits. In the early stages of ESG construction, only by focusing ESG's work on the key issues most relevant to its business and achieving a balance between short-term economic benefits and long-term environmental and social benefits can ESG construction be better promoted. Finally, organizational construction is the guarantee. ESG governance architecture is a useful supplement to traditional corporate governance architecture, and even an important component. On the basis of improving the management structure and functions, real estate enterprises can further improve the ESG management system, and promote the company's normal management of ESG work.

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