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Behavioural Dynamics in ESG Investing: Across Mainland China and Hong Kong Markets

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Abstract. Environmental, Social, and Governance (ESG) investing is rapidly expanding across Asia, with Mainland China and Hong Kong emerging as key hubs. Yet, the behavioural foundations of investor decision-making in these markets remain underexplored. In this article, we analyze the influence of cognitive biases (overconfidence, framing and familiarity biases) and cultural norms in relation to ESG disclosure, green finance instruments, together in an integrated financial system. With the adoption of behavioural finance concepts, as well as considering current perspectives of China's green finance market. This study then further looks into how collective Confucian ethics and collectivism values, characterizing the mainland, do push China's investors in favour of green assets to a greater extent than the relatively market-liberal Hong Kong market, and examines how regulatory frameworks and institutional trust, along with greenwashing risks, can also affect investors' perceptions and behaviours. Incorporating both behavioural and contemporary changes in financial and legal frameworks, this study offers a deeper understanding of ESG investment behaviour across Asia. Policy makers, fund managers and professors have critical policy tools in fostering authentic ESG practices and managing behavioural biases in Asia's markets.

Keywords: Behavioural finance, ESG, green finance, Mainland China, Hong Kong

1. Introduction

In the past few years, huge inflows to Environmental, Social and Governance (ESG) investments have gained more attention in a diverse range of investors; thus, fund managers have been spending considerable investment in purchasing green stocks that follow ESG frameworks. Starting from the 2007-2008 global economic crash, ESG projects were encouraged and promoted by the worldwide regulators to reduce market volatility and to promote sustainable development (SD) in their respective industries.

Coincidentally, at the onset, China's booming economy and increasing world standing have intensified the linkage between mainland China and Hong Kong stock markets. Such an intensification has enabled more cross-border investment activities, which provide possible paths to explore such market reactions caused by the cross-border flow. Notwithstanding an increasing role of ESG in those markets, the underlying behaviour of decisions investors make remains relatively under-explored.

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The government's commitment to the “dual carbon” goal (meaning achieving peak CO2 emissions by 2030 and reaching net zero by 2060) has put SOEs at the center of the city’s campaign to steer its economy onto a sustainable path. The ambitious carbon-zero goal has triggered a sweeping green finance movement to direct Mainland Chinese investors to change the narrative of their perception of sustainability and the reasons behind the ascendance of the greener stocks. The momentum holds great implications for future investment practice and the overall development of ESG engagement in Asia’s capital markets [1,2].

Based on the above discussion, in this paper, we explore the behavioural drivers of ESG investment choices in Mainland China and HK, specifically addressing the effects of cognitive bias, cultural values, and regulatory environment. By a comparative method, the paper will shed light on the ways in which the differences in structure and culture in institutions and in culture affect investors’ preference, degree and way of ESG investing in China and in HK, respectively.

The combination of a behavioural finance research perspective with a discussion on sustainable investment serves the purpose of offering a holistic story on how psychological biases and salient cues may affect, to some extent, ESG reporting and green finance products, and the conclusions drawn will hopefully be of help to policy and financial decision-makers and educators in building relevant policy interventions (such as behaviour nudges or financial literacy campaigns) to foster true ESG actions and prevent potential harms such as greenwashing. Finally, this paper provides valuable insight into how local behavioural patterns inform the Asian market ESG journey.

2. Investor decision-making in ESG investing

ESG investment is largely uncharted territory with respect to the fundamentals of the securities investors’ decision-making process. Accordingly, an increasing number of research interests are aiming at the behavioural phenomena related to ESG investing in Mainland China and Hong Kong. Chinese and HKD securities investment, it seems, is strongly influenced by two critical areas, which tend to affect the behavioural manifestation. This insight is the starting point of further reflection on how the combination of cognitive biases, the subjectivity of ESG disclosure, the presence of the perils of greenwashing, and the inherent influence of mainstream culture and social norms in Mainland China shapes investor behaviour and decisions in a context changing with ESG investing [2].

The ESG-related investment choices mentioned above are being influenced by multiple key variables based on the individual preferences towards ESG, resource and reporting policies with which they direct their actions in ESG investing, locally and globally, all of which continuously mould and alter behavioural patterns in ESG investing. Combining these various ESG sources of information will, ultimately, not only prove helpful in facilitating these investments but also enable us to better grasp the behavioural mechanisms governing ESG involvement on this continent.

In Mainland China, cultural habits and long-held philosophies that prioritize common good above personal benefits, backed by solid social norms, foster a long-term adherence to one form of sustainable capitalism where environment and social matters contribute to the financial return; capital markets have responded to behavioural signals since 2020. With regards to the green finance development, particularly the equity market, green loans are up to RMB 6 trillion, transition bond accumulates to RMB 550 billion, and a series of work is done to set a standard of credible ESG and a reasonable risk management system. Meanwhile, regulating departments have been focusing more on the emission reduction aspect in terms of carbon emission, which shows more inclination in the development trends with regard to the commitment to sustainability and social responsibility in the coming period [3].

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3. Cognitive biases in investment behaviour

Bounded rationality sets investor behaviour with one assumption, that is, the decision process being determined either by the lack of or the asymmetric information, the presence of cognitive bias, uncertainty in decision making and frictions in markets. The rational and informed decision process by an investor is bound to misconstrue historical market information, and this, in turn, leads and reinforces investors' cognitive biases, which hamper rationality in judgment. Overconfidence, framing effects, and familiarity bias are just some of the numerous biases of this sort [2,4].

Overconfidence is a common bias in which people make estimates and judgments with greater precision than warranted by the available information. The overconfidence bias encourages a very high level of overestimating one's prediction ability and potential for securing profitable investment outcomes. This leads investors to feel a disproportionately high confidence and trust in their forecasts and estimates despite evidence indicating that the decision-making might not accurately reflect the constantly shifting dynamic reality of the financial markets [5].

The framing effect shows that decisions taken by investors are sensitive to the form the options take. The emotion-driven action result could be due to different forms of language, different portrayals of characters, which emphasize (or omit) information [2].

Representativeness bias (or familiarity bias) occurs where the investor, usually with a limited knowledge of the firm, forms an opinion of it, and consequently decides whether or not to invest in it, based on one or more low-dimensional characteristics it shares with the investors' other investments such as the company's address, CEO's tenure, and/or stock price changes over a recent period. Such bias appears especially amongst investors who are not well-informed about how a company runs or about its industry and thus rely on heuristics as decision aids when dealing with risk and ambiguity in investment with incomplete information [6].

Cognitive biases usually lead to partial views of the ESG info, and the decision is biased because they treat information emotionally. The quality and the specific information content in ESG data are related to investors' decision-making process empirically [3,5]. In this wide pool of information accessible to investors, transparency has always been seen as a sign of excellence, having an impact on how the firm is perceived both in its governance, management and performance. Still, this is the very reason why the market focuses on "ESG performance", being easy prey of greenwashing, a strategy of pursuing environmental activities for superficial reasons and gaining an ungrounded sympathy of market stakeholders. Such skepticism reduces investor faith and credibility in the real sustainability credentials of companies [2,4].

Furthermore, social values and prevailing cultural preferences, especially the modern elaboration of Confucian ethics, contribute to the attractiveness of green strategies and the ESG investing approach among mainland Chinese investors. Social values and cultural preferences ultimately dictate preferences and behaviours, indicating that social-cultural factors interact with biased thinking in decision-making on ESG investments [2,4,7].

4. Comparative analysis: Mainland China vs. Hong Kong

The sustainability agenda is emerging in Mainland China and Hong Kong as a critical undertaking. Relevant studies reveal the two regions are marching in relative unison toward sustainability, as there are convergent initiatives in green actions, regulation structures, and drivers. However, the behavioural underpinnings of such duality are still underexplored. Initial behaviours and emerging contingencies are especially subject to behaviours that could have an enormous impact on how sustainability projects will go down for the market. Hence, it is always necessary to examine the

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behaviours and their origins in order to put under investigate how ambidexterity could be a balance mechanism that would facilitate long-term sustainable performance [8,9].

Economically speaking, one of the biggest challenges is that financing greenhouse loans that lend themselves to support durable, productive and commercially beneficial assets is scarce, an impediment to resilient, sustainable ecosystems. The proliferation challenge faced by green lenders, the viability of which is also limited, the infrastructures which are mobilized to decrease emissions and the determination of the goal of financing, with only a few sectors being clear, is being added to this. At this stage, the supervision of the macroscopic financial regulators such as the People's Bank of China (PBOC) and China Banking and Insurance Regulatory Commission (CBIRC) is unavoidable. The intervention in advance will be an effective mechanism for banks to achieve the increasing scale of green finance and manage the corresponding risks of systemic credit caused by the sudden withdrawal of FDI and delayed governmental investment in response to the ongoing pandemic [8,9].

Green finance is promoted by a powerful institutional force. COVID-19 shock has aroused the international community's concern about the risks associated with the Chinese bond market; however, the growth of issuances of green bonds and transition bonds still indicates international demand for green finance. Under green loans and bond issuance, the focus is on projects in areas that support cleaner forms of energy and that lessen carbon emissions.

Yet in the absence of a concerted effort by institutional players, the quality of reporting metrics remains varied, and issues such as greenwashing and diverting funds from true climate objectives persist, as seen by the focus in mainland China's climate change strategy on continuing to exploit fossil resources and establish stiff demands on reducing carbon emissions. As both the two carbon targets are targeted on five-year plans only till 2035-2040, it is more meaningful to design a regulatory architecture with a long horizon and foresight, with a refreshment of rules on financial products and disclosures for further and positive development of green finance in China. Furthermore, some differences exist in both regulatory systems and developmental directions between Mainland China and Hong Kong [9,10].

4.1. Regulatory environment and its influence

China in the Mainland has been intentionally a frontrunner of ESG investment practices, as an aggressive overall and continuously reinforcing framework of regulations encourages companies to adopt already enforced ESG requirements, which serves as the backdrop to integrate ESG considerations within investments. This fine-grained knowledge of regulations leads investors to make better-informed capital allocation choices and invest in companies engaging in solid and credible ESG practices. Because the market activities will eventually be adjusted due to the effective regulation, it can imply how investors act, which demonstrates the roles of regulatory experience on the ESG investment plans. The regulatory frameworks of China Philanthropy Times demonstrate the principle of these regulations, focusing on transparency and responsibility beyond profit and loss. However, notwithstanding such wide-ranging recommendations, the exercise of ESG investing seems to be inherently both sophisticated and multiform, with ample possibilities of strategy for the providers of ESG investing and investors, along with challenges for its proper execution. Consequently, exercising it has to be "not only informed, but also increasingly dynamic by its users for success in an evolving investment market" [3,9,10].

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4.2. Investor education and awareness

The ESG investing is becoming so vital in recent months, which attracts immense attention from various regions, where investors in Mainland China and Hong Kong have shown a positive response, which can be attributed to more active movement in the social mind relevant to urgent concerns of our environment, society and governance. Still, investor interest in ESG remains multifaceted and subject to some measure of mystery.

Features of the developed markets of Mainland China that influence ESG investment behaviours, and its policy responses are also associated with the Chinese-style green financial revolution that would come from more specific cultural values and institutional framework (s) specific to its society; therefore, they are rather the outcomes of behavioural investors of a specific social and cultural nature.

Green Banking. China's advances in green banking are evident through its fast-developing green loan markets as well as carbon trading systems, transition bonds and holistic carbon management schemes, which are created through robust investment banking development with intensifying investments in embedding ESG as part of mainstream market practices [11].

4.3. The role of financial institutions in ESG investing

An important part of the challenge faced by banks is how to best engage with the trust in their institution's branding and ensure real environmental and social commitment in their investments, while helping to counteract, through the growing threat of "greenwashing," what is a powerful worldwide wave in support of green finance that makes it easier to fool with untrue claims and otherwise undermines the integrity of claims as "ESG investments."

In the background, it is instructive to look into the behavioural biases affecting investor preferences across the banking sectors in Mainland China and Hong Kong so that they can be employed in the policy designs addressing these issues. Together, two of the more active financial markets of the Asia Pacific region, i.e., Mainland China and Hong Kong's banking sectors, can influence significant amounts of capital into initiatives related to sustainable development practices and implementation of circular economy strategies conducive to long-term survival. Currently, among this set of assets in this region, institutions subject to responsible investment mandates exceed 50 percent of the world's capital management, a figure likely to increase in the coming years. This highlights the value of deeper understandings of the behavioural/institutional drivers behind ESG investment [2].

5. Conclusion

This research closely examines the complex behavioural patterns of environmental, social, and governance (ESG) investors in Mainland China and Hong Kong, where the ESG investment has grown rapidly in the past few years. In comparison with the previous studies, which found external and internal reasons for the ESG investors to choose this type of investment, we, in this paper, aim to understand how this type of external or internal factors affects the actual investment.

China is of special global interest as its current economy is the second largest in the world and a significant emitter of carbon emissions, with ESG investing in mainland China gaining recent worldwide popularity, in particular since 2020, due to increasing demands by global investors who aim to invest responsibly. Behaviours arising from the largely idiosyncratic cultural and market context of China can likely differ significantly from those observed in other markets. Hence, only in

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understanding these nuances can one gain insight into how local conditions drive the global pattern of ESG investment.

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