

How Should SRI be Promoted in Japan?

We invited experts in fields closely related to financial affairs, including Mr. Takejiro Sueyoshi, Special Adviser to the United Nations Environment Programme Finance Initiative (UNEP FI), Ms. Mariko Kawaguchi, General Manager at the Management Strategy Research Department of the Daiwa Institute of Research Ltd., and Mr. Eiichiro Adachi, Research Chief, Head of the Environment Social and Governance Research Center of the Japan Research Institute, Ltd., to join our dialogue with stakeholders. A heated debate was held on how SRI (Socially Responsible Investment) should be promoted in Japan.



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Japan's SRI Left Behind in Global Trend——

Kanai: Recently, there have been active discussions surrounding SRI. This year marks the 10th anniversary of the launch of SRI in Japan, providing a good opportunity for discussion on the subject from a fresh perspective. Based on data compiled by the Social Investment Forum Japan (SIF-J), an NPO, the balance of investments made through SRI funds in Japan as of the end of March 2009 is estimated at slightly less than 400 billion yen. As the global balance of such investments has grown by around 200 trillion yen over the past 10 years to more than 600 trillion yen, the balance in Japan is nowhere near in comparison, both on a stock and flow basis. However, the number of SRI investment trusts has been consistently increasing in Japan. To summarize my point, although Japan's SRI market is not shrinking, its growth is lagging far behind compared with the global trend. In light of this situation, first of all, I would like you to express your opinions regarding the current state of the SRI sector and sum up SRI activities in Japan over the past 10 years.

Social Atmosphere Conducive to CSR and SRI——

Kawaguchi: The other day, as part of a research project being carried out by the Research Institute for Policies on Pension & Aging, I visited Europe in order to look at the current state of ESG (Environment, Society and Governance) investment (ESG invest-

ment, which is similar in concept to SRI, refers to an investment method of selecting investment target companies from the viewpoint of whether their business management is conducted with due consideration given to the environment, society and governance) that are taking place both in Europe and in the U.S. I got the impression that in Europe, there is a consensus that ESG investment is desirable because it sometimes serves as a political tool to obtain understanding from labor unions, or it is strongly supported by the people, or it forms part of national strategies. In contrast, there is not enough social backing in Japan that compels ESG investment. That is why given this unfavorable situation, I think Japan did a good job in the past 10 years, as the number of SRI investment funds increased.

Sueyoshi: In my opinion, Japan adopted CSR and SRI on the fly because of pressure from abroad. In Japan, there has not been any fundamental debate about the significance of CSR. Therefore, as soon as business conditions take a turn for the worse, as they have now, CSR gets singled out as a costly burden. Now, the whole world is considering more seriously than ever the consequences of the pursuit of corporate earnings with no regard for ethics, so we should seize this opportunity to address the fundamental question of what kind of SRI and CSR Japan should pursue.

Adachi: Ten years ago, I began my research work with the goal of starting a movement to create a market that assesses not only eco-



conomic value, but also that takes into consideration factors relating to human and social value. Regrettably, the movement did not turn into a huge ground swell. Meanwhile, the situation has clearly changed abroad, and I believe that Japanese companies will have to change over the next 10 years because of pressure from overseas investors. Therefore, major financial institutions should not shy away from the task of establishing funds that give consideration to social problems and dilemmas.

Kanai: The foundation for CSR has not fully developed in Japan, and there seems to be a huge gap between other countries. Do you think that Japan can catch up with the global standard?

Sueyoshi: Until now, Japanese companies have been able to sell products without having to care much about the views of other countries, so they have had no problems. However, from now on, it will be necessary to seriously consider what should be done to enable Japan to survive economic globalization and become a sustainable country. There is no doubt that Japanese companies will become unable to do business with foreign countries unless they incorporate into their business strategies the unique local perspectives of the countries with which they do business. But I am sure we can definitely achieve that. What I want Japanese business managers to do is to pay due heed to the needs of the international community, as well as those of the Japanese society, and communicate to find out how to meet them. If Japanese companies more actively raise issues and commit themselves to them, CSR and SRI will become more firmly entrenched in Japan.

Kawaguchi: Pursuing “globalization” is not the same thing as seeking to be “universal.” While the adverse effects of globalization have been pointed out, being universal means having a well-balanced sense of what is acceptable based on the recognition of what is good and bad about other countries. Japan should consider adopting a universal attitude that embraces unfamiliar and diverse values while maintaining its uniqueness.

Dialogue with Stakeholders——

Kanai: It has been pointed out that Japanese companies have not conducted business in a way that reflects the voice of the society and foreign countries. What do you think is the reason for that?

Sueyoshi: Until now, the Japanese society has not demanded that business managers conduct business in such a way. To put it the other way around, the Japanese business community should acknowledge the importance of NGOs that convey the voice of the

society, which they are not able to easily pick up on, and they should consider fostering such NGOs.

Adachi: Japanese companies shrink from mentioning or publicly acknowledging the negative aspects of their products. Pharmaceutical manufacturers, for example, are hesitant about mentioning negative side effects of their pharmaceuticals in CSR reports. This reminds me of the report compiled by the Dutch bank, ABN AMRO, where it candidly disclosed an internal process. For example, in the report, it was clearly documented that they were being criticized for such and such matter, that they were holding discussions on the issue until such and such point, and this is what they concluded on the subject. I have to say this is strikingly different from how Japanese companies behave.

Kawaguchi: I presume that the aristocratic class that has inherited the tradition of noblesse oblige (the notion that responsibilities come with wealth, power and social prestige) and commands the respect of the society forms the foundation of NGOs in Europe. There is also a social mechanism for raising funds, enabling NGOs to maintain their status as mature economic entities. In the United States too, there is a mechanism that provides social support for grass-roots NGO activities, reflecting the origin of the country as a society built by immigrants with various aspirations. Meanwhile, in Japan, the postwar reform of the land distribution system got rid of the privileged class of landowners, realizing social equality. However, this also meant a loss of upper-class gentlemen who can act as social leaders. In place of this class, politicians and bureaucrats exerted their leadership in driving the country’s economic growth. Now that this system has collapsed, how should we create a new class of genuine leaders who will call into account the benefits of the society? I find it a hopeful sign that in recent years, an increasing number of young people who were born in this affluent era and received good education are trying to establish NPOs and socially responsible companies in order to contribute to the society as something to live for, rather than just earn a living.

Sueyoshi: Business and political elites are the only people in Japan who know the factors that move the society and the economy in the world and who can compete and cooperate with the outside world. In fact, they could be said to be the aristocratic class of the Japanese society.

Kanai: For a long time, I thought that it might be difficult to have an NGO activity entrenched in the Japanese society. However, I changed my mind after attending a recent meeting of multi-stakeholders. I am beginning to think that NGOs could act as the driving force that



breaks the deadlock that may arise from a conflict of interests of various parties.

Adachi: At the multi-stakeholder dialogue facilitated by the European Commission, an NGO will accuse companies for their half-baked CSR activities, while companies argue they will lose competitiveness if they obey what the NGOs say, leading to a confrontation. However, what is important is the fact that despite the friction, such a dialogue is held over and over again. This is because it is believed that confrontation is only a part of the natural process. However, in Japan, dialogue focuses on confirming the points of agreement. I believe that this approach must change.

The Role of the Financial Sector in Creating a Sustainable Society

Kanai: Now, I would like to discuss matters related to the financial sector. Do you think that the financial sector should be categorized together with the economic sector? What do you think should be the financial institutions' relationship to the economy as a whole?

Sueyoshi: That is a question I would like the Japanese financial sector to consider seriously. Money handled by financial institutions, whether it be deposits or pension funds, is the money of our society. Therefore, I would like the financial sector such as banks to really think about changing the flow of funds so that the money can be used to resolve the problems of our society, including global warming and poverty, and from there, I would like them to start a dialogue with the economic sector and the industrial sector. The industrial sector and the financial sector are the two wheels that mutually work to move our society, so I hope there will be continuous collaboration and exchange between them through the financial functions so as to realize a sustainable society. These two sectors should be neither enemies nor cozy friends, but should maintain an arm's length relationship (the condition that the parties to a business transaction are on equal footing).

Kawaguchi: At a gathering of people with many years of experience working in the financial sector, I asked them what is the essence of finance, and I found that nobody had ever seriously considered that question. Most people working in the financial sector think of finance only in terms of financial engineering and never consider what finance is actually for. Such people would be puzzled if they were told that the purpose of finance is to create a sustainable society.

Kanai: When we consider a new financial scheme, regardless of whether it is related to SRI or not, we start with the goal of creating a new flow of funds. However, profitability inevitably emerges as an issue. Also in the financial industry, I am sure there are many people who would like to make a difference to the society, but we tend to shy away from schemes that do not generate profits. In the end, the schemes that we develop are similar to the existing ones created by someone else, and we are unable to come up with original schemes to create a new social mechanism.

Sueyoshi: The history of finance is the story of nurturing new industries needed by the society. Given the importance of shifting business emphasis to new energy and energy conservation, financial institutions should funnel funds into those fields. From now on, the combination of green finance and green industry will be the only formula for corporate survival.

Adachi: Triodos Bank of the Netherlands, which focuses on providing low-interest loans to companies that make significant contributions to the society, has been consistently growing amid the ongoing economic and financial crisis. This means that the key is whether citizens and stakeholders have the freedom and energy to create new financial institutions. In Japan, the number of financial institutions decreased every time a financial crisis occurred, clearly indicating a decline in the ability to create new schemes. Unless the dynamism of creating new financial institutions is allowed to flourish, the birth of new concepts would be impossible. In Europe, there are many cases where bankers have quit their banks to create new ones or some group creates a new bank as a result of citizens' backing.

Kawaguchi: Grameen Bank, which was founded by Mr. Muhammad Yunus, the creator of the micro-credit system, which provides unsecured small loans to meet the needs of the poor, evaluates the performance of its employees based not on how much money they collect, but on how much their loan programs contribute to the improvement of the recipient community. It might be a good idea for major Japanese banks to introduce a presidential commendation for loan programs that make significant social contributions on a trial basis. When Daiwa Securities developed a novel financial product called the "vaccine bond," which is a two-year bond intended to raise funds to pay for vaccines in developing countries, the company's president liked the concept of this bond so much that he went around sales offices cogently arguing its significance and encouraged employees to do their best in selling. Because of this, an eagerness to develop products that make contributions to the society and generate profits at the same time grew within the company.



How Should SRI be Promoted in Japan?——

Kanai: SRI has an active starting point endowed with the mission to change the society. Companies that receive investment through SRI are also required to have and act on the management philosophy incorporating the concept of CSR, which is to create beneficial results through its businesses that contribute to the good of the society. If investors find companies that are really practicing CSR, they can earn return on investment. On the other hand, unless investors such as pension fund managers actively encourage the development of SRI funds by saying, “We are ready to invest, so create a good scheme and show it to us,” the market will not grow. However, in Japan, we have yet to see the takeoff of a successful cycle of SRI. Do you have any good ideas?

Sueyoshi: The U.S. Securities Exchange Commission is under pressure to impose the obligation for the disclosure of ESG information, and I expect this to take place soon. The prevalence of information disclosure is good news in terms of spreading SRI.

Kanai: I hear that under the leadership of the Federation of European Accountants, efforts are under way to establish a system of connecting reporting, which integrates financial and non-financial information. Although details have yet to be decided, we need to assume that this will become obligatory in the future.

Kawaguchi: The initiatives by public pension funds will be the key to spreading SRI. I think that providing a reason for public pension funds to adopt SRI will be the quickest path to spreading it. The moment investment managers of pension funds, with their huge amount of assets, express willingness to consider adopting SRI, the market will get going. The right approach would be to first suggest that the adoption of SRI by public pension funds will be socially acceptable because of their public nature and then explain that SRI brings about extra benefits in addition to ordinary return on investment. There is a reason for this. After having accepted the idea of investing in an SRI, it is okay to explain that there are a variety of financial products to choose from with elements of an SRI that are performing strongly at the specific point of selecting a product to invest in. However, if we present it in a way by saying that an SRI definitely performs better than other products from the get-go, there is a risk where people can come back claiming that in the end, SRI did not perform well. This effectively ends any room for further discussion.

Kanai: We may assume that in the long term, companies that fulfill their social responsibilities will show a relatively good business

performance. However, we cannot assure that returns on SRI will be better than those on ordinary investment. On the other hand, it would be wrong to argue that returns on SRI can never be better than those on ordinary investment because SRI focuses only on ethical aspects of business activity and ignores important financial information. As there are various sorts of value investment, so there are various SRI schemes, including those that can withstand active investment and those that cannot. By the way, do you have any good ideas for encouraging individual investors to buy SRI products?

Kawaguchi: About 70% of individual customers think it is natural to take SRI elements into consideration. I hear that an investment trust company affiliated with Daiwa Securities Group receives complaints from customers saying, “How could you buy shares of a company where a corporate scandal has occurred?” when those shares are included in their portfolio. In this context, what seems to be lacking the most is that the asset management industry, which stands between investors and the targeted companies for investment, thinks that they cannot obtain any information on scandals and CSR, nor effectively make an assessment based on that. The reality is that the intermediary that links the provider of funds and recipient of them is absent, when in fact the latter two parties are hoping that CSR measures are taken into consideration or implemented.

Kanai: We must admit that asset management companies have not made adequate efforts promoting SRI. It is necessary to discover potential needs and pour human and financial resources into the development of SRI funds that are attractive for investors.

Adachi: Although the Principles for Responsible Investment (PRI) require that ESG be always taken into consideration when investment decisions are made, Japanese financial institutions are not addressing this issue in earnest. The question is, if an asset management company has changed its way of making investments so as to require all fund managers and analysts to take ESG factors into consideration, whether Sumitomo Trust would be willing to follow suit. It is not until a financial institution makes such a move that customers believe its commitment to SRI. In the United States and the United Kingdom, the financial industry as a whole is being led to embrace ESG and SRI by organizations specializing in and devoted to ESG and SRI. A similar situation may be necessary in Japan too.

Sueyoshi: Regarding the “E” (environment) of ESG, particularly CO₂, SRI has already passed from the conceptual stage to the practical stage. However, when CO₂ is taking the center stage, dealing with other CSR matters is quite a challenge. Japanese companies



must pay attention, whether they are problems related to poverty or refugee issues. Otherwise, Japan, as a nation, will start to lose its place in the international community.

Kanai: Nowadays, CO₂ is not only considered to bring about business opportunities, but also to serve as crucial financial information. Similarly, it is becoming increasingly important to disclose information based on common standards.

Necessary Legal Framework——

Sueyoshi: As the global trend of SRI is starting to change significantly, we must bear in mind that SRI in Japan—impacted by the trend—will have to change accordingly when we consider the future of SRI. I also think that Japan must establish legislation concerning fiduciary duty although this may require patient efforts and a long time. In a survey that we conducted in nine countries when we introduced the PRI, we found that Japan was the only country that had no such legislation and that it was barely ensuring appropriate conduct by relying on the “duty of care of a good manager.” Unless there is a legal basis, corporate conduct could change overnight with a change in management. To have CSR firmly entrenched in Japan, we need to establish a legal basis, as the United Kingdom has done in order to enforce compliance with its CO₂ reduction target.

Kawaguchi: A law or some other solid framework is necessary. Otherwise, people who are reluctant to practice CSR will continue to fudge on the pretext of a conflict with their fiduciary duty. Even if we try to convince them that there may be a different logic that does not go against their fiduciary duty, it is over when they say, “I disagree. I will not take ESG factors into consideration.” Therefore, legislation in some form or other is necessary, even a notional one would suffice. I would recommend something along the lines of “fiduciary duty referring to the requirement for proper consideration to non-financial value that is considered necessary when measuring corporate value.”

Hopes for SRI——

Kanai: Lastly, I would like each of you to express your hopes for SRI.

Sueyoshi: Although the problems faced by our society are becoming more diverse and serious, the public sector, which is traditionally entrusted with the duty to resolve them, is losing the ability to do so. Someone else should undertake the task of resolving these problems and that job is clearly meant for companies and

citizens. If they are to undertake this, they should make investments in ways that contribute to resolving social problems. I call this “responsible investment for future generations.” Any investment should involve social responsibility. SRI funds will lead the way in spreading this concept throughout Japan’s investment community. Therefore, SRI has a very significant role to play, and it will become mainstream in the future. That is how I perceive SRI and my hope for it.

Kawaguchi: Looking back at the history of finance, greed has been the motivation for financial activity until now. However, new initiatives like SRI and sustainable finance do not bring about direct benefits to investors but rather involve elements that contribute to the society, such as the reduction of poverty and the prevention of environmental damage. Such initiatives are made possible only when the level of people’s sense of value is raised enough to enable them to feel satisfied with the benefits for society as a dividend for themselves. The fact that we are seeing the green shoots of such enterprise may be evidence that change is taking place. Human beings have evolved to the point where they can feel happier by finding delight in contributing to the society than by merely satisfying their own desires. SRI is the manifestation of this evolution. SRI serves as a tool for people’s happiness, and the financial industry should try to ensure that.

Adachi: I would like to diversify SRI further and try various approaches. Over the past 10 years, the cast of people involved in SRI-related activities has not changed, so we should bring in more young people. Meanwhile, we should always keep in mind the maxim “the road to hell is paved with good intentions.” There are numerous cases such as multi-level marketing schemes, in which a pretense of goodwill causes people to suffer or become victims of crime. While we need a catalyst to bring about change in the society, we must bear in mind the importance of being humble as a lesson for the next 10 years.

Kanai: Providing an opportunity for meaningful debate like this and communicating the concept of SRI widely is part of what our CSR activities are all about. As we intend to continue efforts to foster a favorable environment for spreading SRI, we would appreciate your continued support. Thank you very much for your valuable insight.