

# JAPAN PERSPECTIVES

No. 17

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## Japan's "Missing Landowners"

# JAPAN PERSPECTIVES

*Japan Perspectives* is an English-language journal published by the Tokyo Foundation containing articles from the Foundation's website. In addition to translations of the public policy research recommendations made by the Foundation, *Japan Perspectives* offers timely insights into and analyses of Japanese politics, economy, society, and culture written specifically for overseas readers.

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# JAPAN PERSPECTIVES

Recent Articles from the Tokyo Foundation Website

No. 17, September 2016

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July 22, 2016

## Rage in the West, Apathy in Japan

### *Reflections on the Upper House Election*

Katsuyuki Yakushiji

*In the wake of the July 10 House of Councillors election, political analyst Katsuyuki Yakushiji contrasts the inertia and resignation of Japanese voters with the tide of populist rage that has led to Brexit in Britain and the rise of Donald Trump in the United States.*

\* \* \*

**T**he July 10 House of Councillors election has come and gone, leaving scarcely a ripple in its wake. The election campaign inspired little excitement or enthusiasm, and the ruling coalition's widely predicted victory left the parliamentary balance of power basically unchanged. After four straight electoral triumphs since 2012 (two in the House of Representatives and two in the House of Councillors), the Liberal Democratic Party–Komeito coalition seems securely ensconced at the helm.

In the midst of an uneventful national election came the stunning news that the British people had voted to leave the European Union, as nationalist, anti-immigrant sentiment carried the day. The US presidential race also continued to grab headlines, most of them concerning Donald Trump and his inflammatory, anti-establishment rhetoric. In both countries, a middle-class backlash against the political and economic elites had upset all the pundits' predictions. In Japan, meanwhile, it was business as usual.

Make no mistake, Japan has serious problems of its own, and everyone knows it. It is saddled with public debt in excess of ¥1,000 trillion—the largest of any country in the world—a rapidly aging population, and a social security system that will inevitably bankrupt the government if not reformed. Among the nation's younger workers, income equality is a serious and mounting problem. Nonetheless, Japanese voters—in stark contrast to their American and British counterparts—

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Katsuyuki Yakushiji    Senior Associate, Tokyo Foundation; Professor, Toyo University.

have quietly opted to support the status quo. How can we account for this contrast?

## Understanding the Upper House Election

The House of Councillors, or upper house, has 242 members. National elections are held every three years to select half of those members for a six-year term. Unlike polls for the more powerful House of Representatives, upper house elections do not lead directly to a change of government; instead they are treated as an opportunity for an interim assessment of the government in power.

In this last election, the ruling coalition won 70 out of 121 contested seats, for a gain of 10, with 56 going to the LDP and 14 to its junior coalition partner, Komeito. This gave the ruling bloc 146 of the 242 seats in the upper house and left the Democratic Party (Minshintō)—the nation’s second-largest party and number-one opposition force—with only 49, a loss of 11. The results of the nationwide proportional-representation vote were particularly discouraging for the DP, which received a mere 11.8 million votes, as compared with 20.1 million for the LDP.

This may sound like a ringing endorsement of the government’s policies, but voter turnout suggests otherwise. Amid a long-term decline in voter participation,

## Upper House Election Results

Party	Seats won	Uncontested	Total strength*
Liberal Democratic Party (LDP)	56	65	121 (115)
Democratic Party (DP)	32	17	49 (60)
Komeito	14	11	25 (20)
Japanese Communist Party (JCP)	6	8	14 (11)
Initiatives from Osaka (Ishin)	7	5	12 (7)
Social Democratic Party (SDP)	1	1	2 (3)
People’s Life Party (Seikatsu)	1	1	2 (3)
Party for Japanese Kokoro	0	3	3 (3)
New Renaissance Party (Kaikaku)	0	0	0 (1)
Other	4	10	14 (18)
Total	121	121	242 (241)

\* Figures in parentheses are preelection strength (one vacant seat).

particularly in upper house elections, the turnout for the July 10 poll was 54.7%, the fourth-lowest of the post–World War II era. Around the nation the predominant mood was one of apathy and resignation.

But perhaps this is understandable, given the choice facing Japanese voters as they went to the polls.

### **Lackluster Opposition**

The ruling LDP and Komeito decided to make the economy the focus of their electioneering, emphasizing progress made under the Abenomics policies of Prime Minister Shinzo Abe. Of course, the success of these policies is open to debate. While employment and wages have risen slightly since Abe took office, economic growth remains negligible, and the key objective of halting deflation has yet to be achieved. The government continues to rely on fiscal expansion to keep the economy afloat, despite Japan's enormous public debt. Regulatory and other structural reforms needed for sustained growth—the vital third “arrow” of Abenomics—have yet to be seriously addressed.

On the eve of the election, with economic growth stalled, the government announced plans to delay a scheduled hike in the consumption tax. The ruling parties also promised voters yet another emergency stimulus package in the fall (without specifying how this was to be financed). In short, the parties in power are using unsustainable fiscal outlays to pacify vested interests and reassure elderly voters, who have a large impact on election results.

Of course, many Japanese voters regard these policies with skepticism. But the opposition failed to galvanize their support. One major problem was its election strategy. Fearing an LDP sweep in the 32 districts that had only one seat up for election, four ideologically diverse parties chose to cooperate, fielding one candidate among them in each of those districts. In a narrow sense, the strategy seems to have worked, since 11 of those candidates were elected. But the net result was a loss of seats, particularly by the DP. Voters were understandably suspicious of a “united front” encompassing the most conservative wing of the DP at one end of the spectrum and the Japanese Communist Party at the other. They saw it for the cynical expedient that it was.

In terms of message, the DP and its allies opted to focus on upholding the war-renouncing Constitution, targeting one of Abe's obvious vulnerabilities. It is true that the Abe cabinet drew intense criticism for pushing through legislation that opened the door to Japan's limited participation in collective defense, and it is also true that many voters oppose amending the Constitution. But these are abstract

issues compared with the languishing economy. The opposition was unwilling to challenge Abe's postponement of the tax increase, and it had nothing to offer as an alternative to Abenomics.

Faced with such a choice, Japanese voters either stayed home or took the safe route and voted to maintain the status quo. The disillusionment and apathy surrounding the election were almost palpable.

### **Where Are the Firebrands?**

The erosion of the middle class is progressing in Japan as it is in other countries. The situation may not be as dire as in the United States or Britain, but bottom-line-oriented corporate reforms have led to a sharp increase in the number of part-time, temporary, and other "nonregular" employees; in 2015, they constituted more than 40% of all workers in Japan, according to government figures. As a result, income inequality is on the rise, and more people than ever are worried about their financial future. Yet on the eve of a national election that could have altered the course of national policy, the mood was one of quiet resignation. There were no demonstrations and no large political rallies of the sort seen in Britain and the United States.

One reason for this mood is doubtless the quality and character of our politicians. These days one rarely sees the sort of political firebrand who can tap into popular discontent and galvanize people to action, such as Trump in the United States and Boris Johnson and Nigel Farage in Britain. Of course, we can do without rabble-rousers who stir up fear and anger while offering only irresponsible and unrealistic solutions. But charismatic, inspiring politicians serve an important purpose by motivating and mobilizing voters. Among Japan's national parties, no one since Prime Minister Jun'ichiro Koizumi has demonstrated the ability to tap into dissatisfaction with the status quo and rise above the ordinary. Perhaps the current environment is simply not conducive to that political style.

Part of the problem, however, is the general reluctance of our politicians, whether in the ruling coalition or the opposition camp, to take aim at Japan's structural problems. After all, if they were to confront the fiscal crisis head-on, they would be obliged to call for higher taxes across the board and propose budget cuts that could impact influential blocs of voters. This is not considered the best way to win elections. For now, the safest strategy is to skirt the issue of fiscal sustainability and promise new benefits without identifying new sources of funding, on the pretense that it is possible to get something for nothing. At some level, most Japanese voters realize that this is a pyramid scheme that will cost Japan's young people and



future generations dearly. But they are too cynical about politicians and the political process in general to stage an electoral revolt.

## Looking Ahead

What is next for the Abe cabinet, now that the LDP and its allies have bolstered their Diet majority? The media have made much of the fact that those who favor revising Japan's postwar Constitution (including some in the opposition) now occupy more than two-thirds of the seats in both houses of the Diet—the threshold for initiating constitutional amendments. The LDP earlier released a hawkish draft of an amended Constitution that eschews Article 9's "renunciation of war" in favor of the heading "national defense" and renames Japan's Self-Defense Forces the National Defense Force. With a pro-revision supermajority in both houses, upholders of the current pacifist Constitution are getting worried.

But Prime Minister Abe seems to realize that economic recovery is a far more pressing issue than constitutional revision. Even the Bank of Japan's radical negative interest rate policy has failed to resuscitate the economy, and now the Brexit vote and China's economic slowdown are further clouding the outlook. The future of the Trans-Pacific Partnership, which Abe has called a key to sustained growth, is also in doubt. Although American and Japanese negotiators reached an agreement on the free-trade framework early this year, it is by no means clear that the US Congress will approve it. Faced with such economic challenges and uncertainties, it is hard to imagine where Abe will find the time and political energy to embark on such a controversial undertaking as amendment of the Constitution.

In fact, at a press conference on July 11, immediately following the election, the prime minister focused squarely on the economy, announcing that he had instructed his cabinet to prepare a new stimulus package. The government has pledged bold investment in public works, including infrastructure to support agricultural exports, accelerated construction of a maglev railway line, and expansion of the nation's Shinkansen bullet train network—a laundry list of ambitious construction projects recalling the bygone days of rapid economic growth. It is also promising to spend more on services for the elderly and scholarships for college students.

The LDP's parliamentary position may look unassailable, but most policymakers understand how quickly voters can turn on their leaders when their livelihood is threatened. In this respect, Japanese voters are no more stoical than their American or British counterparts. They may seem docile now, but their apathy will surely turn to rage if and when the bottom falls out of the Japanese economy.

July 8, 2016

## Coalition Victory Unlikely to Lead to Constitutional Amendment

Tsuneo Watanabe

*The LDP-Komeito coalition is expected to win big in the July 10 upper house election, but even if it secures a two-thirds majority, this is unlikely to prompt moves toward a constitutional amendment. Voters may not be happy with Abenomics, says Senior Fellow Tsuneo Watanabe, but they find the opposition parties even less attractive.*

\* \* \*

**T**he coalition government of Prime Minister Shinzo Abe is expected to score a solid victory in the July 10, 2016, House of Councillors election, but even if the ruling Liberal Democratic Party and its coalition partner Komeito win a two-thirds majority, this is unlikely to prompt moves toward a constitutional amendment. One big factor is the presence of Komeito in the coalition, which is very reluctant to amend Article 9.

The strong support for the coalition clearly indicates that the opposition parties have failed to appeal to their constituencies with attractive alternative policies for social security and long-term economic strategy. The Democratic Party actually agreed with Abe's decision in June to postpone the consumption tax hike, so it squandered an opportunity to make fiscal consolidation a key election issue.

The public is not yet comfortable with amending Article 9 of the Constitution, as suggested by the protests last year when the Abe administration enacted new security legislation. This was not a popular move, and Komeito is now very reluctant to go any further because they have already spent a lot of political capital.

The two-thirds majority that the coalition and other likeminded parties are likely to win in the upper house contest is a kind of coincidence—an issue that the opposition parties have created in an effort to gain public support. The reality is

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*Tsuneo Watanabe      Senior Fellow and Director of Foreign and Security Policy Research, Tokyo Foundation.*

that the government is not serious about making a constitutional amendment at this time.

### **Voters Look for Stability**

People do not feel very comfortable with the economic situation. They are not really in favor of the Abe administration but want a stable government that can take measures to stimulate economic activity, create long-term stability, and advance fiscal consolidation. The LDP will likely seek a continuation of the Abenomics policy of economic growth, the focus shifting henceforth to structural issues like utilization of women's labor and the revitalization of outlying areas.

Public support for Abenomics, though, is not very high, as it has not yet produced the results that were promised. This is a problem faced not just by Abe, though, as achieving immediate results with any economic policy can be very difficult. There was initial optimism after the implementation of the first two “arrows”—monetary easing and fiscal stimulus—but this has not led smoothly to the next stage, which was structural reform. This last arrow takes time to produce results, so Abe has been facing a difficult situation.

The opposition parties are really helping Abe's hand because of their own troubles. The negative legacy of the years when the Democratic Party of Japan was in power from 2009 to 2012 has hindered efforts to create a reliable alternative. Although they have agreed to pool their support in certain electoral districts for the upper house election, the opposition parties have not made much progress in strengthening cooperation in other areas because they do not have a common understanding on policy.

After their expected setback in the upcoming election, the opposition parties are likely to be beset by internal struggles, which will prove to be an even bigger obstacle to winning back the public's trust and support.

May 26, 2016

## Policy Challenges for the Abe Administration

Tsuneo Watanabe, Sota Kato

*Tsuneo Watanabe and Sota Kato, both senior fellows and directors of policy research at the Tokyo Foundation, discuss the big issues confronting the Shinzo Abe administration in an article originally published on May 25, 2016, as part of a Japan Times special supplement on the Group of Seven Ise-Shima Summit. Watanabe credits the prime minister with pursuing a realistic foreign policy aimed at elevating Japan's international standing through "proactive contributions to international peace," while Kato warns against populist fiscal policies that may appeal to voters today but could saddle future generations with massive debts.*

\* \* \*

### The Realism in Abe's Foreign Policy



*Tsuneo Watanabe*

The centerpiece of Prime Minister Abe's foreign policy is to promote regional cooperation within the framework of the Japan-US security alliance and through regional, multilateral arrangements. Until now, Japan's role had been severely limited because of constitutional and legal constraints, but with the enactment of new security legislation last September, the country should be able to make a more 'proactive contribution to international peace'—such as through

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*Tsuneo Watanabe      Senior Fellow and Director of Foreign and Security Policy Research, Tokyo Foundation.*

*Sota Kato      Executive Director, Senior Fellow, and Director of Policy Research, Tokyo Foundation.*

capacity building support—in keeping with the rapidly changing security landscape.

The prime minister appears to be taking a very practical, realistic approach to leadership, balancing the need to address emerging security concerns with efforts to promote economic growth through fiscal stimulus, monetary easing, and structural reform.

In that sense, he's hardly a revisionist, as some of his political opponents have labeled him. After all, key cabinet members like Foreign Minister Kishida and Defense Minister Natakani belong to the liberal wing of the LDP, and he's strongly committed to strengthening—not weakening—the alliance with the United States.

He's also aware that government, especially those like Japan's with sizable fiscal deficits, can't protect the Asia-Pacific region's public goods alone, so he's been very active in tapping the resources of the private sector, including think tanks and NGOs.

Given that his approval ratings have been remarkably stable the Japanese public seems to be satisfied with the job he's been doing. Whether or not his legacy survives, though, will hinge on whether he can place the interests of the country ahead of his personal ambitions in choosing the right moment to step down.

## Japan's Narrowing Fiscal Options

*Sota Kato*

Japan's public debt is around 230% of GDP, the highest, by far, among the G7 countries; the fiscal situation is nearly as bad as Greece. What's more worrisome is that Japan's population—that is, the number of taxpayers—is aging and shrinking. Some economists project that spiraling healthcare and social security costs could push up Japan's debt to as high as 600% of GDP by 2050.

If Japan continues to neglect its efforts toward fiscal consolidation, market adjustment in the shape of hyperinflation could devastate Japan's public finances well before 2050.

There are three approaches to achieving fiscal consolidation: economic growth, higher taxes, and fiscal austerity. Abenomics is an attempt to cut the deficit by encouraging growth, mainly through fiscal stimulus and monetary easing. But given



Japan's rapid demographic changes, achieving growth high enough to ease the debt dilemma will be a daunting task.

Market credibility hinges on doing more than pursuing an uncertain growth scenario; the administration will also need to raise taxes and cut spending, which, unfortunately, are unpopular with voters.

Japanese politicians, like their Western counterparts, seem to be pursuing more populist policies. Voters must be made to realize, though, that by choosing candidates who promise to keep taxes low without slashing expenditures, they are, in effect, asking future generations—people who can't vote today—to pick up the tab.

Restoring fiscal health requires not only sound economic policy but political leadership. Fortunately, voters appear to be less selfish than most economists assume, as demonstrated by a willingness to put other people's interests ahead of their own in the wake of the March 2011 tsunami. What we need are political leaders who, instead of placating to populist demands, can rally the country around the need to make personal sacrifices for the good of their children and grandchildren

*Reprinted from the G7 Ise-Shima Summit Special supplement, Japan Times, May 25, 2016, [http://info.japantimes.co.jp/ads/pdf/20160525-G7\\_Ise-Shima\\_Summit\\_Special.pdf](http://info.japantimes.co.jp/ads/pdf/20160525-G7_Ise-Shima_Summit_Special.pdf)*

May 23, 2016

## Japan's "Missing Landowners"

*Legal Framework for Land Ownership Inadequate to Cope with Aging, Depopulation*

Shoko Yoshihara

*Measures to enhance the collection of land ownership data are urgently needed, but this will entail decisions on who will spearhead such efforts and how the costs will be shared. Research fellow Shoko Yoshihara points out that the growing cases of "missing landowners" raise fundamental questions about how land will be passed on to future generations in an aging and depopulating society. A new legal framework for land ownership is an urgent priority.*

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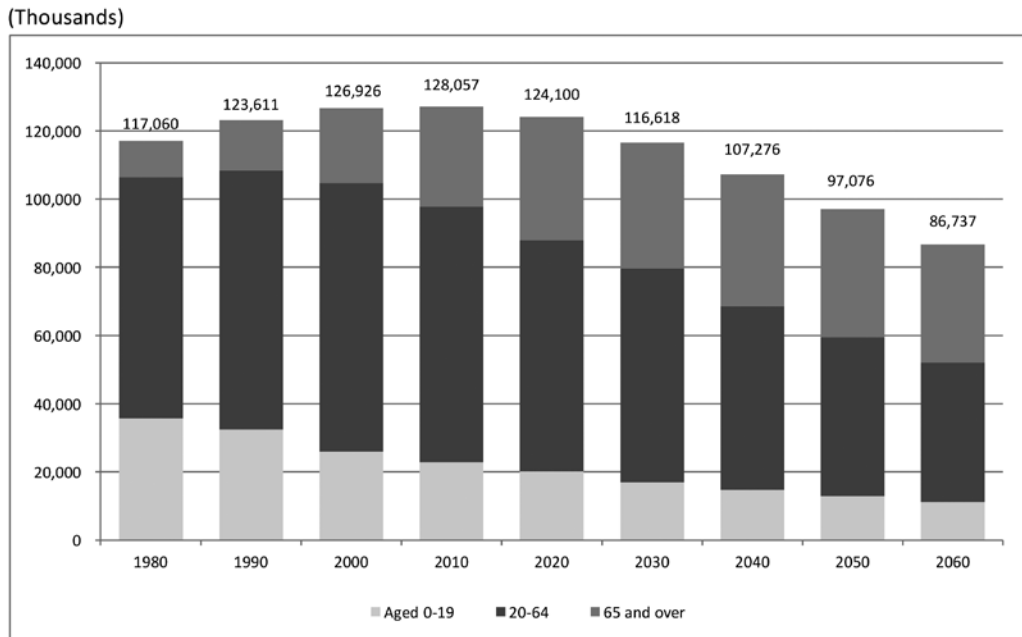
Japan is the world's most aged country, according to the World Bank, with 26% of the population being 65 or older as of 2014. Italy and Germany are next with 22% and 21%, respectively. Japanese government projections see the share of the elderly in Japan rising even further—to as high as 40% by 2060—and the general population shrinking by one-third (Figure 1).

This unprecedentedly rapid demographic change will have far-reaching implications for public finances, the pension and healthcare systems, and voting patterns. It is also expected to affect the current system of land ownership, as revealed by the gaping lapses in ownership records that seriously thwarted reconstruction efforts in the wake of the Great East Japan Earthquake of March 2011.

Recovery from the earthquake and tsunami was significantly delayed in some areas due to a lack of land-ownership and cadastral data. Local authorities were unable to purchase the land needed to rebuild communities on higher ground because they could not identify the owners. This is a direct consequence of Japan's land registration system, under which the registration of land titles is not mandatory. In other words, if the registered owner dies, and the survivors never bother to

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Shoko Yoshihara      Research Fellow and Project Manager, Tokyo Foundation.

**Figure 1. Japan's Aging and Shrinking Population**

*Note: 2020 to 2060 are estimates.*

*Source: National Institute of Population and Social Security Research*

transfer the title, the local records will continue to list the deceased person as the owner. If this continues for several generations, the number of direct descendants or other relations legally eligible to inherit the property can multiply geometrically.

In many rural areas, the price of land is so low that the cost of registering and maintaining the title is higher than what one would receive by selling the property. In outlying regions, therefore, there is no financial incentive to claim the land; it is cheaper to keep a deceased person's name registered as the owner.

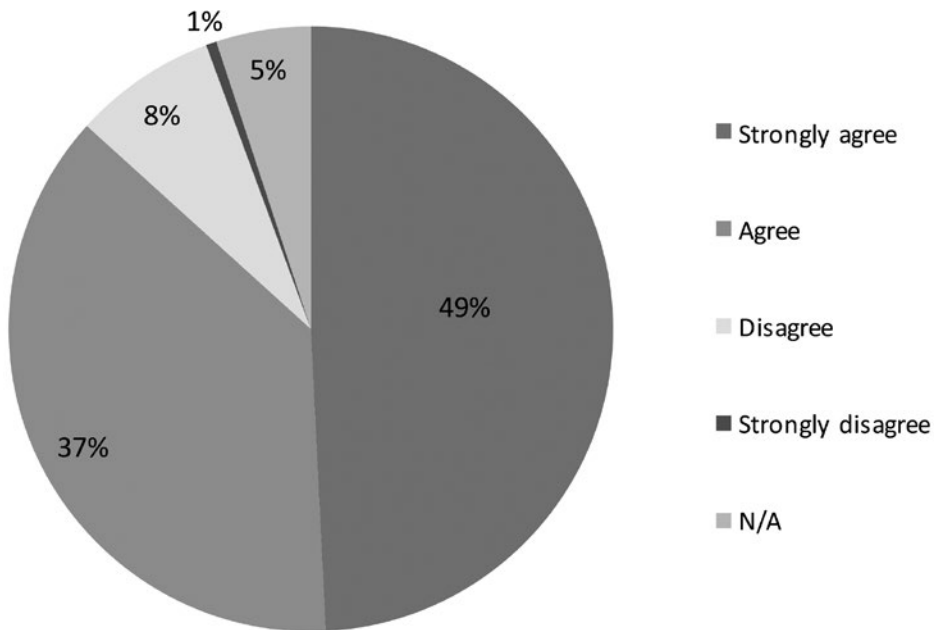
Interestingly, now that the myth of ever-rising land values in Japan has been shattered, this trend has begun to appear in more developed areas as well. This has hindered attempts to introduce large-scale farming by aggregating agricultural land, address the growing problem of abandoned homes, and advance reconstruction and public works projects, since approval from landowners cannot be obtained.

### **Broad Recognition of the Problem**

To gain a quantitative understanding of the problem, in fiscal 2015 the Tokyo Foundation conducted a questionnaire survey targeting Japan's 1,718 municipali-



**Figure 2. Do You Agree with the Statement, “Taxes on Deceased Persons Will Increase in the Future”?**



*Source: Missing Landowners: Findings of a Nationwide Survey on Land Ownership (in Japanese), Tokyo Foundation, 2016, p. 17.*

ties and the 23 wards of Tokyo; responses were received from 888 local governments.

Asked whether they had ever encountered a problem due to the unknown identity of the landowner, 557 municipalities, or 63% of all respondents, said that they had. The largest difficulty was being unable to collect property taxes (486 municipalities), while other problems included the dangerous dilapidation of vacant houses (253 municipalities) and the deterioration of abandoned farm- or forestland (238 municipalities).

They were then asked about levying taxes on deceased persons, which occurs when the survivors of a deceased landowner fail to transfer the title, and municipal tax officials are unable to track down the heir, as a result of which taxes continue to be levied under the dead person's name. There were 146 municipalities (16% of the total) that reported having taken such a measure, and only 7 (1%) said that they had never come across such a case. The remaining 735 respondents (83%) said they did not know, suggesting how difficult it was even to ascertain whether or not landowners were alive.

## POLICY PROPOSALS

This was corroborated by the fact that 770 respondents, or 87% of the total, believed that levies on deceased persons were likely to increase in the future (Figure 2).

Asked for their reasons, respondents pointed both to institutional factors (“prevalence of untransferred titles is not likely to decline,” “confirming the death of owners living in other municipalities is difficult”) and to changes in society (“people abandoning their inheritance claims will probably increase,” “attitudes toward the value of land are shifting”). Specific comments offered by respondents included: “Given the falloff in real estate transactions in recent years, the failure to register the rightful owner has not, for the time being, been very problematic.” “Many heirs of forestland and abandoned farms are beginning to feel that transferring the title is not worth the trouble.” “The descendants have moved out of town long ago, and they don’t even know the location of their own land.”

These comments not only point to why taxes on the deceased have been rising but also suggest how lapses in land ownership data could become increasingly pronounced in the years to come.

### **Measures Needed to Improve Data Governance**

One structural factor behind this phenomenon is the weakness in Japan’s data governance regarding land ownership and utilization. A nationwide cadastral survey that was launched in 1951 has been significantly delayed, and today it covers barely 51% of the countryside. The most reliable data available is that based on the voluntary registering of claims under the Real Property Registration Act, but its limits have become increasingly obvious in recent years. Countermeasures for abandoned homes and efforts to keep the basic farmland register up-to-date, for example, now frequently need to refer to the inheritance records of the property tax register to make up for missing data.

But if more heirs henceforth neglect to register inherited real estate due to low land values or the hassle and cost of transferring the title, there would be no halting the expansion in the phenomenon of unknown landowners. The accuracy even of the property tax register would be affected, as already seen with the levying of taxes on deceased persons.

Poor governance of land ownership data will have ramifications not only for tax revenues but also for property rights, and it is not a problem that can be adequately addressed at the municipal level alone; measures, including legislative revisions, to improve the data governance infrastructure are needed under national leadership. At the same time, steps must provisionally be taken to reduce the cost of transferring the title—both for the owner and the government.

## POLICY PROPOSALS

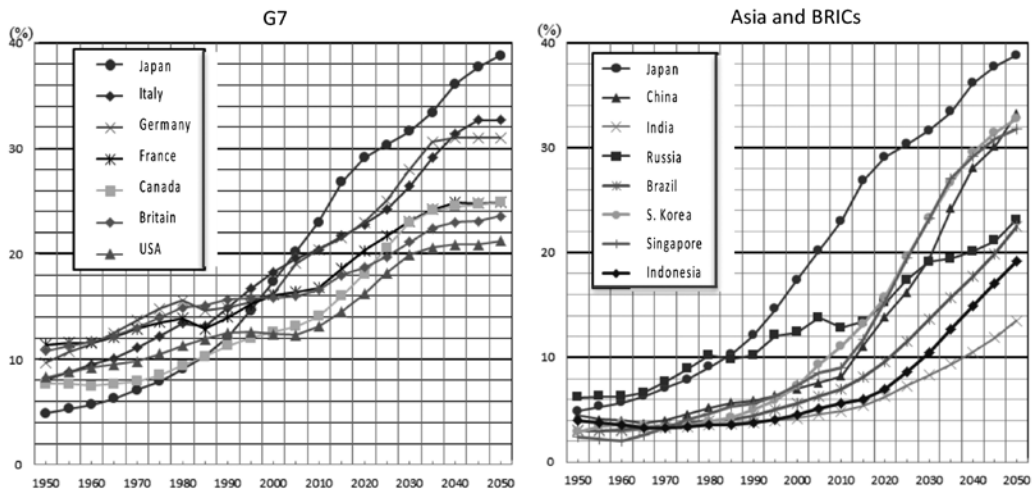
Steps are also needed to prevent the expansion of unidentified landowners, such as by allowing heirs to donate unused land to nonprofit, community groups at no cost and by transferring ownership to the local government after a property remains unregistered for several generations. Owners should also be provided with a broader array of options when they no longer have the will or ability to claim or manage the land.

The Tokyo Foundation survey found that, for the most part, the only cases in which local governments accepted land donations from residents were when the land in question could be expected to be used for public purposes, such as roads. One municipality wrote that the overriding reason cited for donations was that the owner had no use for the land and was unable to manage it properly. Local governments, on their part, were usually reluctant to acquire new land at a time when they were seeking to sell off or dispose of unused public assets. “Under the circumstances,” one respondent wrote, “there appears to be no alternative for landowners to safely relinquish their property other than to simply abandon it.” Serious debate must begin quickly on developing new options, such as donations to community and other nonprofit groups.

Posted land prices have long been declining, the only exception being a bump in average residential and commercial land prices of Japan’s three largest urban areas in 2014—the first rise in six years. A questionnaire survey on attitudes toward land conducted each year by the Ministry of Land, Infrastructure, Transport, and Tourism showed that in fiscal 2014, 40% of respondents—the highest on record—said that they did not consider land to be better assets than savings or stocks. The share is twice as high as the figure from 20 years ago, and it was notably higher among residents of outlying areas (44%) than those in the largest urban areas (33%). Given the long-term decline in land prices, people no longer seem to regard land as a valuable asset.

Even if cases of owners abandoning their land are isolated and limited in scale today, the lack of countermeasures and the pervasiveness of the phenomenon suggest that the problem could seriously hinder regional developments initiatives in the future. It could eventually wind up robbing the community—and even the country itself—of its dynamism and strength.

The Ministry of Internal Affairs and Communications notes that the aging of the population is a global phenomenon, with the 65-and-over population projected to reach 18.3% worldwide by 2060. Japan may have been the first to become a super-aged country, but many others, including emerging economies, are quickly following in its tracks (Figure 3). The number of years required for the elderly population to rise from 7% to 14% was 115 years for France, 40 years for Ger-

**Figure 3. Aging of the Population in the G7 and in Asia/BRICs**

Source: Ministry of Internal Affairs and Communications, Council Report on the Vision of ICT Ultra-Aging Society (in Japanese), 2013, p. 5 (charts based on the United Nations, World Population Prospects: The 2012 Revision).

many, and 47 years for Britain. Japan took only 24 years. Other Asian countries, though, now appear to be graying at an even faster pace, with the share in South Korea rising from 9.3% in 2005 to a projected 33.6% in 2060.

Coping with an aging population is not an issue for individual countries to address alone; clearly, it is a growing, global concern. Japan was the first country to see the share of the elderly population reach 20%, and the world can draw many lessons from its experience, both its successes and failures.

In this context, the question of land inheritance is both a personal issue and one that has larger policy implications for industrial production and for disaster prevention and recovery. There is no doubt that measures to enhance the collection of ownership data are urgently needed, but this will entail decisions on who will spearhead such efforts and how the costs will be shared between the national, prefectural, and municipal governments. The growing cases of “missing landowners” raise fundamental questions about how land will be passed on to future generations in an aging and depopulating society. A new legal framework for land ownership is an urgent priority.

July 20, 2016

## Five Key Perspectives for Japan's Energy Mix

*Need for Close Attention to Shifting Domestic and Global Realities*

The Tokyo Foundation

*The government issued an energy outlook in July 2015 projecting Japan's future energy mix in the wake of the March 2011 nuclear power plant accident. The outlook will lose its relevance, though, unless close attention is paid to domestic conditions and international trends. This policy proposal, a summary of which has been translated here into English, presents five perspectives that will be essential in making the government's energy outlook substantive and realistic.*

\* \* \*

In July 2015, the Ministry of Economy, Trade, and Industry approved a Long-Term Energy Supply and Demand Outlook indicating the future composition of Japan's energy mix in the wake of the March 2011 Fukushima nuclear power plant disaster. This outlook is an important guideline for Japan's energy policy in such areas as strategy for the procurement of resources from overseas, plans for energy supply and demand, and plans for domestic energy infrastructure construction.

Similar roadmaps have been presented for Japan's energy mix in the past. For example, in June 2012, when the Democratic Party of Japan was in power, the government released a document titled "Options for Energy and the Environment," which presented three scenarios for future energy use. The breakdowns by type of energy source have tended to be unrealistic, however, consisting of percentages calculated on the basis of such theoretical factors as energy potential, power generation efficiency, and generating capacity—without sufficient consideration of the actual issues relating to the use of each power source and relevant global conditions.

The 2015 outlook, too, appears divorced from reality, as coal-fired thermal power, which is projected to decline in the period up to 2030, has instead continued to rise in response to the liberalization of the retail electric power market in April 2016. The global energy picture has been changing rapidly as well; since the adop-

tion of the 2015 outlook, oil prices have taken a record plunge, and a global shift in energy use could accelerate with the adoption of the Paris Treaty by all the participating countries at the 2015 UN Climate Change Conference (COP 21). These and other developments are sure to affect Japan's energy mix.

The 2015 outlook will lose its relevance in shaping Japan's energy mix unless close attention is paid to both domestic conditions and international trends. The following five perspectives will be essential in making the government's energy mix outlook substantive and realistic.

### **Five Perspectives in Building Japan's Energy**

#### *Perspective 1: Keep Abreast of the Global Energy Shift*

Over the years since the March 2011 nuclear accident, Japan has been scrambling to rebuild its energy policy, but the global energy situation has undergone substantial changes in the interim. In December 2014 the price of oil dropped below \$60 a barrel for the first time since 2009, and in February 2016 it plunged to less than \$30—the lowest since 2003.

In December 2015, meanwhile, the countries participating in COP 21 adopted the Paris Agreement by consensus, setting forth their intention to head for an energy shift by promoting a full-scale move away from fossil fuels and expanded use of clean energy regardless of the price of crude oil. Through this energy shift, countries are aiming to improve their competitive positions by investing in clean energy sources and seeking to establish technologies and reduce costs, while also building up their clean energy industries. The clean energy sector is expected to grow to a scale comparable to that of the global auto industry, and Japan cannot let itself fall behind in this field.

Japan has the technological prowess to lead the clean energy sector. In order to tap this know-how and become a major player in this sector, greater use of clean energy must be promoted domestically so as to build up a home market for the industry. This is another reason for Japan to keep abreast of developments in the global energy shift and to reflect such trends in its energy mix.

#### *Perspective 2: Consider the Impact of the Unprecedented Changes Caused by the Liberalization of the Electricity Market*

The retail market for electricity in Japan was deregulated in April 2016. Previously, power company's rates were set on a cost-plus basis, and each company held a

## POLICY PROPOSALS

monopoly on the retail market for electricity in its region, but now transactions in the market have been liberalized. In the deregulated wholesale market, electricity with low marginal costs will be consumed first, and so the idea of deliberately packaging electricity categorized as base load power, mid-range load power, and peak load power—as has been done up to now—no longer makes much sense.

In Europe, a pioneer in electricity market deregulation, the use of renewable energy with zero marginal cost was promoted, pushing unprofitable nuclear power and thermal power out of the market. In Japan, there have been moves to build new coal-fired power plants, whose generating costs are lower than those for liquefied natural gas. Market deregulation will have a major impact on the power mix, and this should be fully considered.

### *Perspective 3: Set Shares for Different Power Sources in Tandem with Measures to Resolve Issues Specific to Each Source*

Each power source has its advantages and disadvantages, so simply ranking one over another is not possible. Also, there are issues in the use of each power source, and we must consider the prospects for and difficulties in resolving those issues in setting energy mix targets. An energy mix containing sources with problems for which no solution is in sight will not be realistic.

An energy mix blueprint should present not just the shares of each power source but also the concrete steps, including a timetable, for solving the issues relating to each source.

### *Perspective 4: Do Not Rigidly Fix the Energy Mix but Revise It Flexibly in Line with Changing Conditions*

The energy mix is generally formulated from a medium- to long-term viewpoint, but conditions change on a daily basis. We need to keep a watch on the progress toward resolving the issues for each power source, as mentioned in perspective 3, and respond accordingly. To have the energy mix reflect actual conditions, including progress toward the resolution of issues, it should not be set rigidly but be subject to flexible revision.

### *Perspective 5: Create a Platform for Greater Collaboration among Government Ministries and Enhanced Transparency in the Formulation of Energy Policy*

Energy is a major concern for a broad range of fields, including economic activity,

## POLICY PROPOSALS

technological development, environmental protection, national security, land use, and regional development. Formulating an energy mix thus requires close coordination among the relevant government ministries and agencies. A report issued by the Ministry of the Environment in April 2015 indicated that it should be possible for renewable energy sources to provide at least 30% of Japan's domestic electric power generation by 2030, but the Long-Term Outlook for Energy Supply and Demand approved by METI in July of the same year set the renewable share for 2030 at 22%–24%.

This discrepancy should have been resolved before the announcements were made. No disclosures were made, moreover, regarding the kind of discussions that took place among the ministries. This is something that needs to be addressed before analyzing which of the two outlooks is more realistic.

To prevent such inconsistencies in future announcements, the relevant government organs should promote greater cross-functionality (collaboration) and enhance the transparency of their deliberations. This will require, at the very least, closer coordination among the ministries' energy-related research institutes and committees; it should also be accompanied by the creation of a platform or forum where all the relevant organs share information and conduct deliberations based on a full range of data to come up with a common, scientifically grounded judgment.

*This policy proposal was originally issued in Japanese in May 2016, by the Tokyo Foundation research project on “Rebuilding Japan’s Energy Policy.”*

*Project Leader:*

*Hikaru Hiranuma, Research Fellow & Project Manager*



June 13, 2016

## Proposals for Streamlined, Localized Health Insurance Coverage

The Tokyo Foundation

*In this policy proposal, the Tokyo Foundation calls for the reorganization of Japan's health insurance system into prefectural units with streamlined finances. Ensuring greater resident involvement and autonomy and the integrated administration of health- and nursing-care services at the municipal level can help create an optimum mix of services that best meets the needs of each community.*

\* \* \*

**I**n 1961, Japan became only the fourth country in the world to achieve universal health insurance coverage. The system—divided into Employees' Health Insurance for salaried workers and National Health Insurance for the self-employed—was highly effective in meeting the country's healthcare needs during the high-growth era.

But the world today—over half a century later—has been vastly transformed; life expectancies have increased, employment formats have diversified, and the global economy is now more closely interconnected. Japan has emerged as a super-aged society, with one in four people being 65 or older, and this is pushing up health- and nursing-care costs year by year. As the graying of the population is projected to continue, concern has been voiced about the sustainability of Japan's health insurance system.

To meet these challenges, the government has implemented a number of revisions in recent years: promoting community-based care, adjusting payment rates for medical services, and consolidating municipally administered health insurance schemes at the prefectural level. But many of these measures were built on existing practices and have been unable to adequately cope with the scale of changes in society. The revisions have been spearheaded by the central government, moreover, meaning that they have not been tailored to the needs of each locality.

In this policy proposal, whose summary is offered here in English, the Tokyo Foundation focuses on how the health insurance system should be revamped to better meet today's needs and to offer four major recommendations, as cited below.

### Overview

The proposal identifies four issues and directions for reform in Japan's health insurance system, which is financed on the social insurance principle. Recommendations are offered in the areas of (1) distributing risk, (2) balancing payments and benefits, (3) encouraging resident involvement, and (4) giving insurers greater say in the coverage they provide.

First, the social insurance principle is designed to disperse healthcare cost risks among a group of contributors to an insurance scheme. Under Japan's current system, however, those enrolled in Employees' Health Insurance are generally working-age people with full-time employment, while those belonging to National Health Insurance schemes—which are provided by local municipalities—include many retirees and people working under nonregular employment formats. As a result, there is a great discrepancy in the amount of premiums paid by contributors to the two systems. Healthcare cost risks are thus not being evenly distributed in society as a whole.

Second, because the contributions paid under the social insurance format are inherently used only to provide insurance coverage, those enrolled in the system have a clearer view of the balance between payments and benefits. Many municipalities, though, are now being forced to take elaborate steps to cover the perennial deficit in their National Health Insurance schemes with taxes and other fiscal revenues, making the payment-benefit balance harder to see. This may be discouraging cost-conscious behavior among some beneficiaries.

Third, the social insurance principle assumes the participation of insured persons in the administration of the scheme and democratic decision-making. At present, none of the various health insurance schemes in Japan guarantees such self-autonomy.

Fourth, health insurance providers are expected to play a role in securing the accessibility, quality, and efficiency of healthcare services; this is their primary difference with pension insurers, which are merely responsible for fund management. Attention should therefore be given to reforming the provision of medical services in Japan, particularly in the light of the importance of primary care in offering holistic and continuous care, by enhancing the authority of health insurers.

### Proposals

To address the issues outlined above, the Tokyo Foundation offers the following four proposals.

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### *Proposal 1. Unify Insurance Schemes on Regional Basis*

The various health insurance schemes that are now offered according to age and employment status should be unified on a regional basis. The separation of Employees' Health Insurance and regionally administered National Health Insurance has resulted in an unequal distribution of cost risks in society. The schemes should be reorganized into a community-based system.

Prefectural governments should be assigned fiscal responsibility for the new system, with municipal governments contributing to healthcare policy through the collection of premiums, coordination between health- and nursing-care services, and in the areas of disease prevention and public health. The new setup should be designed to enable the optimum mix of health- and nursing-care services for each region and, consequently, a lowering of healthcare expenses.

### *Proposal 2. Simplify Fiscal Administration*

A simpler system of fiscal administration should be instated so as to clarify the balance between contributions and benefits. A ceiling should be set on the share of expenses covered by tax revenues, and medical expenditures exceeding other prefectures' levels should be paid for by raising residents' contributions or the percentage of costs billed to patients. Efforts should be made to encourage residents to give greater thought to the balance between medical services (benefits) and insurance premiums (contributions).

### *Proposal 3. Strengthen Resident Involvement*

Councils to deliberate on health- and nursing-care policies should be set up both at the prefectural and municipal levels. These bodies should be established on a permanent basis and include representatives of local residents, local assemblies, and healthcare associations so as to promote resident participation and autonomy. The councils should be charged with coming up with the most appropriate policies to meet local needs, including those pertaining to healthcare expenses and insurance premiums.

### *Proposal 4. Delegate Authority to Insurers*

As measures are advanced to institutionalize the "gatekeeping" role of primary care physicians, greater authority should be delegated to prefectural insurers regarding

## POLICY PROPOSALS

the distribution of medical fees and the number of healthcare facilities and personnel made available. A system of planned disbursements linking benefits and contributions should be established to enable insurers to play a bigger role in fiscal administration, and a “fiscal stabilization fund” should be set up in each prefecture to limit the use of public funds (taxes) to cover healthcare costs.

\* \* \*

Reforms based on these proposals should lead to the reorganization of Japan’s health insurance system into prefectural units with streamlined finances. Ensuring greater resident involvement and autonomy and the integrated administration of health- and nursing-care services at the municipal level can help create an optimum mix of services that best meets the needs of each community.

*This policy proposal was originally issued in Japanese in June 2015, by the Tokyo Foundation research project on “Crafting the Medical, Nursing Care, and Social Security Systems of the Future.”*

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April 11, 2016

# The False Promise of Reduced Consumption-Tax Rates

## *A Plea for Targeted Credits*

Shigeki Morinobu

*The government's plan to exempt food and drink from the consumption-tax hike scheduled for April 2017 is a serious mistake, writes tax expert Shigeki Morinobu. In an essay based on his expert testimony before the lower house Committee on Financial Affairs, Morinobu exposes the false allure of reduced rates and makes the case for refundable tax credits as a cheaper and more effective means of helping low-income households.*

\* \* \*

**T**he government of Shinzo Abe has announced plans to apply a reduced tax rate to food and drink when the national consumption tax is raised from 8% to 10% in April 2017. The idea is to maintain the current 8% rate for foodstuffs, excluding meals eaten out and alcoholic beverages, to cushion the impact of the tax increase on low-income families.

While the aim of offsetting the regressive impact of the consumption tax is laudable, the adoption of special reduced rates for specific goods is bad policy. I recommend dropping this expensive and ill-considered break and replacing it with a refundable tax credit targeted to the households most in need of support.

### **Redistribution in Favor of the Wealthy**

Why are reduced consumption-tax rates such a bad idea?

First, lower rates on food purchases will not serve the purpose of redistributing income to address economic inequalities. To begin with, the tax break is not tar-

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*Shigeki Morinobu* Senior Fellow, Tokyo Foundation; Professor of Law, Chuo University; President, Japan Tax Institute.

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geted to low-income households, since it actually grows as one goes up the income ladder. In addition, to help offset the projected ¥1 trillion shortfall resulting from the reduced rates, the government is scrapping a new social security policy that would have benefited low-income households by setting a ceiling on their payments of total healthcare and childcare costs. Ultimately, the new policy is unlikely to lead to the redistribution of income and is incongruous with the integrated tax and social security reform plan approved in 2012.

The second problem is that the application of reduced rates ultimately imposes a higher burden across the board by increasing the complexity and cost of tax collection. Compared with income taxes, which depend on the self-reporting of expenses to calculate taxable income, consumption taxes tend to be straightforward and inexpensive to administer; this is one of their major advantages. But once multiple rates enter the picture, businesses are obliged to keep separate books for different categories of goods and services, and the added cost is passed on to the consumer. This complexity also increases the cost of administration and enforcement by the tax authorities.

In European countries that apply a reduced value-added tax rate to food purchases, problems have arisen over the distinction between take-out and eat-in restaurant meals, and one can easily imagine similar issues emerging here in Japan. The complexity of a system with multiple tax rates also facilitates tax evasion and fraud, leading to further loss of tax revenue. Ultimately, it is the nation as a whole that pays the cost.

The third problem with reduced rates is that they create an incentive for intensive lobbying by industries and other interests, opening the door to political corruption. Already the healthcare and housing industries are trying to mobilize public opinion in favor of further expansion of lower rates. In Europe, political parties have incorporated reduced tax rates into their election platforms to drum up campaign support. Not so long ago, corporations and industry groups vied for preferential legislative and administrative treatment; reduced rates could take us back to the bad old days of rampant collusion, influence peddling, and pork-barrel politics.

In April 2014, tax authorities from the world's leading industrial nations gathered in Tokyo for the second meeting of the Global Forum on VAT of the Organization for Economic Cooperation and Development. One of the topics of discussion at that meeting was the inefficiency of reduced rates from the standpoint of tax policy. Experts from the OECD Secretariat and the IMF urged governments to limit the application of reduced rates and zero rates as much as possible, arguing that such consumption-tax (or value-added tax) breaks are an extremely

ineffective means of providing relief to low-income households. The consensus of the meeting was summed up as follows in an April 18 press release: “Countries often implement reduced rates to alleviate the burden on poorer households, but discussions at the Forum confirmed that this is a very expensive way of providing support to the poor, particularly when compared to the use of targeted cash transfers.”

This view was underscored by Pascal Saint-Amans, director of the OECD’s Center for Tax Policy and Administration, in a conversation with the author. His advice on the subject of reduced rates was clear and unambiguous: “Don’t follow Europe.”

### **Dangling the Lure of Tax Cuts**

To my mind, the most troubling aspect of the recent decision to adopt reduced rates was the government’s failure to explain to the public its plans for financing them. It seems to me that the ruling coalition is treating the voters with disdain by dangling the prospect of a tax break in the form of reduced rates while delaying any serious discussion of offsetting the revenue shortfall until after the House of Councillors election this summer.

Japan’s consumption tax is levied for the express purpose of fully financing the nation’s social security system. If rates are to be cut for some items, it follows that they need to be raised for others. A rational plan for a ¥1 trillion exemption for certain goods should also include an increase in the standard rate sufficient to offset the loss of revenue. According to my own rough calculations, this would mean bumping up the standard consumption tax from the planned 10% to 10.5%. Why not let the public choose between a flat 10% rate and a 10.5% standard rate with an 8% reduced rate—while simultaneously discussing the merits of a refundable tax credit as an alternative for providing tax relief for the poor?

Unfortunately, the only choice the people were offered this time around was between reduced rates and no reduced rates. And given a simple choice between lower and higher taxes, people will naturally choose the former.

The media must bear part of the blame for the simplistic content of the debate. Given that newspaper publishers were vigorously lobbying the ruling coalition for a reduced rate themselves, the press’s inadequate coverage of the issue—including its failure to provide opportunities to debate the pluses and minuses of a refundable tax credit—has struck some as a case of biased reporting. Let us hope that the papers do not leave themselves open to such charges in the future.

## Merits of a Refundable Tax Credit

The failure to seriously consider a refundable tax credit is particularly perplexing given that the 2012 legislation revising the consumption tax calls for just such a system as an anti-regressive measure to alleviate the burden on low-income households. In the following, I would like to outline a concrete proposal for a refundable tax credit.

My inspiration is Canada's GST/HST credit, under which households with low or modest incomes receive quarterly payments intended to offset all or part of the goods and services tax (GST) that they pay. The payments are adjusted according to the family's net income, but for those making less than the threshold of \$35,465, the basic credit is \$272 per adult and \$143 per child. Taxpayers who wish to apply for the GST credit need only indicate that option on their tax returns. The tax agency then determines eligibility and the amount of the credit on the basis of the family income and makeup and deposits it directly in the taxpayer's bank account. This simple, user-friendly system minimizes the potential for fraud. In fact, Japan already has a similar system in place for an income-based child allowance, and the same infrastructure could be used for the refundable tax credit. Under Japan's new taxpayer number system, which was introduced in January this year, it would be a simple matter to calculate such a credit on the basis of net household income. The central government would design the system, with administration being carried out at the local level.

The Canadian tax system has another feature worth emulating, namely, the Working Income Tax Benefit. This cash benefit is available only to low-income households with earned income, and it increases with each dollar earned above base income (up to a certain ceiling), thus incentivizing work. In other words, the WITB is specifically targeted to the problem of the working poor. By adopting similar tax credits in Japan, we could not only offset the regressive nature of the consumption tax but also provide much-needed support to this country's working poor, particularly the swelling ranks of nonregular employees.

Using the Canadian system for reference, I compiled the following table tentatively indicating the amount of the proposed credit and the estimated cost under a comparable system in Japan.

Here I have posited a system under which households with annual income of less than ¥3 million would receive ¥40,000 per member (adults and children) in benefits, while those making ¥3 million to ¥4 million would receive ¥20,000 per member. As a consumption-tax rebate, this would make the ratio of tax paid to income roughly the same for lower-income households as for middle-income



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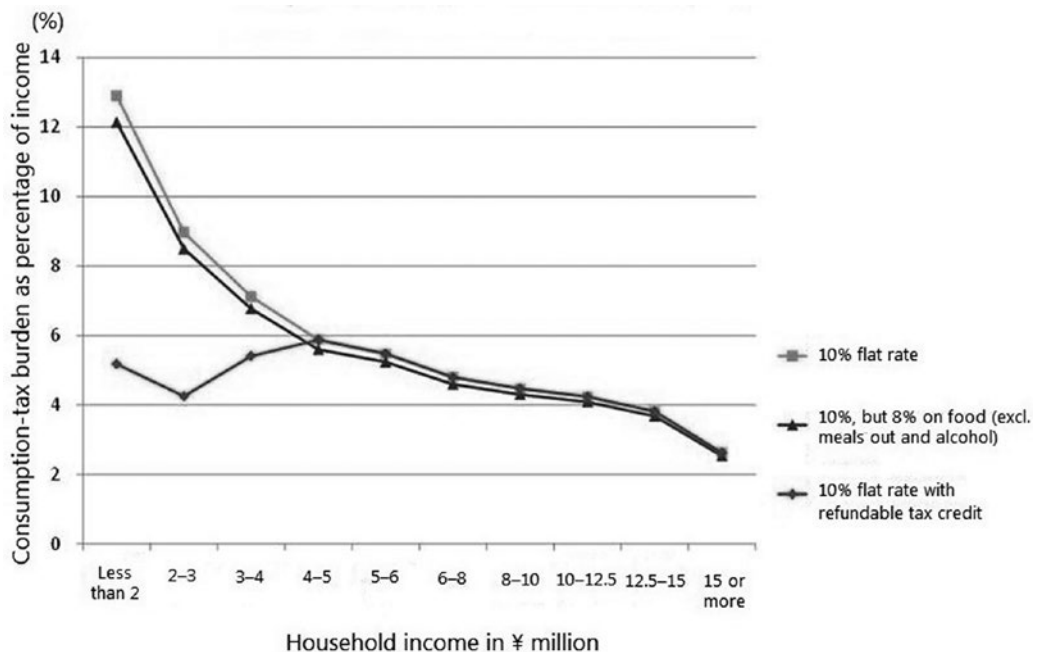
### Amounts and Cost of Proposed Refundable Credits (rough calculation)

Income level	Benefit	Number of beneficiaries	Cost
Less than ¥3 million	¥40,000	8.8 million	¥355 billion
¥3 million–¥4 million	¥20,000	9.4 million	¥188 billion
			<b>¥543 billion</b>

households. (Those receiving public assistance or old-age pensions would not be eligible for credits, as cost-of-living increases would be incorporated in these benefits.) The total projected cost of the tax credit would be around ¥540 billion, as compared with the ¥1 trillion lost by the application of reduced rates (8%) to food and drink.

But what about the impact on household finances? The figure below charts the effective burden of the consumption tax (as a percentage of income) on a family of

### Comparison of Tax Burden on Three-Member Households by Income Level (married couple and one child)



Source: Compiled by the author in cooperation with Hitachi Consulting on the basis of statistics from the fiscal 2014 National Survey of Family Income and Expenditure and the fiscal 2014 Family Income and Expenditure Survey.

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three at each income level under three scenarios: a flat 10% consumption tax, a 10% standard rate with an 8% rate for food and beverages, and a 10% rate accompanied by the refundable tax credit outlined above.

As the chart indicates, the consumption tax hits lower-income families the hardest, but the reduced rate proposed by the government barely mitigates the regressive nature of the tax. However, the refundable tax credit turns this regressive burden into a progressive one, substantially easing the relative impact on low-income households.

### Turn Back Now

The ¥1 trillion that the reduced rate would cost the government could finance not only the aforementioned tax credit but also an earned income tax credit to support the working poor, including the growing ranks of employees in nonregular formats. In the process, it could also address the problem of the “1.3 million yen ceiling” that discourages married women from taking full-time positions out of pension-premium payment considerations.

Japan is facing ever more daunting economic challenges. Even with the government focusing its full attention on the domestic economy, business performance is flagging under the impact of China’s economic slowdown and the stronger yen. Abenomics, Prime Minister Abe’s vaunted economic revitalization policy, is in danger of coming unraveled.

To meet these challenges and shore up the foundations of the Japanese economy, the government must shift its policy focus from the elderly to the younger, working population. It must channel serious fiscal resources into measures to boost the fertility rate, while taking decisive action to address the problem of the working poor stemming from the expansion of nonregular employment. Japan is virtually the only advanced industrial country today that has no consistent policy in place to support the so-called working poor.

The adoption of reduced consumption-tax rates is a counterproductive policy fraught with problems. The government should scrap this ill-conceived plan and begin deliberations on the adoption of a refundable tax credit.

*Based on the author’s February 29, 2016, presentation to the House of Representatives Committee on Financial Affairs.*

July 19, 2016

## The Fallout from the South China Sea Ruling

Paul J. Saunders

*The recent ruling by the Permanent Court of Arbitration rejecting China's historic claims to much of the South China Sea is not likely to soften Beijing's position. In fact, cautions Paul Saunders, it could make conflicts more likely rather than less, forcing the United States and its regional allies to think carefully about what they are prepared to do in pursuing their options.*

\* \* \*

**T**he conventional wisdom among many concerned by China's territorial claims in the South China Sea is that the recent ruling by the Permanent Court of Arbitration in The Hague is a major defeat for China and an important step forward. In fact, however, the ruling may have only a limited impact on the realities of Asia's maritime territorial disputes—and could ultimately make conflicts more likely rather than less.

### Question of Legitimacy

One key goal of the United Nations Convention on the Law of the Sea (UNCLOS) has been to facilitate the peaceful resolution of disputes through arbitration or other legal means. In theory, the availability of these mechanisms would allow parties to UNCLOS, including China, to avoid dangerous confrontations over their competing territorial claims. In practice, however, China has explicitly rejected the convention's dispute resolution procedures since 2006 and, indeed, refused to take part in the proceedings. This makes it much more difficult to reach peaceful and mutually accepted solutions.

China appears to prefer peaceful outcomes that may not be mutually accepted,

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*Paul J. Saunders*     *Executive Director, Center for the National Interest (Washington, DC).*

ensuring peace primarily through intimidation. Those on the other end of China's territorial claims probably hope for the same result—though obviously with the results in their favor rather than Beijing's. The underlying problem here is that no one has yet identified solutions that satisfy everyone. It is quite challenging to resolve disputes peacefully and sustainably when there is no point at which the parties' self-defined interests intersect.

Some hope that the court's ruling will undermine the "legitimacy" of China's claims, since an internationally constituted tribunal has largely invalidated them. The flaw in this line of thinking is that legitimacy is overwhelmingly in the eye of the beholder. Chinese officials—and the Chinese public—are likely to see the court's decision as illegitimate and, accordingly, will not lose any enthusiasm for their government's claims vis-à-vis the Philippines or other countries. If anything, they will become more determined.

Conversely, leaders and people in the Philippines, and probably in some other countries engaged in similar disputes, will accept the decision as a legitimate one and hold more strongly to their own claims. From this perspective, the ruling will serve primarily to harden positions rather than to facilitate a peaceful solution to this dispute or others.

With a few exceptions (most notably the United States), most other governments will strive to avoid becoming involved, so that they can continue to pursue key national objectives in their bilateral relations with China and those on the receiving ends of its many maritime claims. Whether or not they view China's claims as "legitimate" will be secondary to national interests and priorities.

### **Taking Sides without Taking Sides**

A third problem surrounds the enforcement of the tribunal's decision. Many commentators have already acknowledged that UNCLOS does not have an effective enforcement mechanism. Like all UN-sponsored agreements, including the treaty that established the UN Security Council, effective implementation is entirely dependent upon its members. Few governments (including even the Philippines) will likely seek to impose significant costs on China if it does not comply with the ruling.

The most significant possible exception, again, is the United States. Some in the Philippines and in other countries contesting Chinese maritime claims may hope that Washington will become the "enforcement mechanism" in Asia's territorial disputes. Indeed, they may see this as the most likely path to a peaceful but favorable resolution of their disputes with China. Some in America may seek this role as well.

With this in mind, it is notable that State Department press spokesperson John Kirby has already stated, “the United States expresses its hope and expectation that both parties will comply with their obligations.” [[www.state.gov/md259587.htm](http://www.state.gov/md259587.htm)] The court’s verdict certainly provides Washington with an opportunity to attempt to take sides without taking sides—often attractive to diplomats—by supporting the ruling without supporting the Philippines. Kirby’s statement tried to do just this, saying, “[we] have no comment on the merits of the case.”

Unfortunately, the pseudo-subtlety of this diplomatic posture is unlikely to be sustainable. Few in Beijing will believe it and far more are likely to see it as rather bold hypocrisy from a government that has refused to ratify UNCLOS, in no small part because a number of Americans value their sense of national sovereignty more highly than the Convention’s potential benefits. China has in essence taken a similar position, though its legal ground seems somewhat compromised since Beijing ratified UNCLOS and only a decade later rejected its dispute resolution procedures.

The fact that China tried to have it both ways—benefitting from UNCLOS without accepting its costs—and then lost should be a reminder for those who want the United States to try something fundamentally similar by enforcing UNCLOS arbitration rulings without being a party to the agreement and by backing rulings without backing claims.

There are three possible outcomes to this approach. The first, which seems to be the most unlikely, is that the United States, the Philippines, and other interested parties will succeed in peacefully pressuring China into acceding to the ruling and largely abandoning its claims in the case. The second and probably most likely is that peaceful pressure will fail and that neither Washington nor others will be willing to use nonpeaceful pressure. This outcome would undermine UNCLOS by demonstrating that its dispute resolution procedures do not work. The third is that Washington or others will decide in dealing with this case (or perhaps a future one) that the threat or use of force is essential to upholding a rules-based international system. But could China’s leaders afford to back down?

Before proceeding much further, US officials and America’s many allies and partners in Asia should think carefully about what they are prepared to do in pursuing each of these paths and when and how they could step off an unsuccessful path at the least cost. This kind of thinking is usually a better guide to policy than momentum and reflexes.

April 27, 2016

## Taiwan's New President and the Outlook for Regional Relations

Kazuyuki Suwa

*The Taiwanese people handed Tsai Ing-wen a decisive victory in the January 2016 presidential election in a repudiation of the Kuomintang and the strongly pro-China policies of President Ma Ying-jeou. What does her historic win signify for the future of cross-strait and Japan-Taiwan relations?*

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Taiwan's first woman president will take office on May 20, 2016. In the nation's January 16 election, Tsai Ing-wen of the Democratic Progressive Party trounced her Kuomintang opponent Eric Chu (Chu Li-luan) by a 3 million-vote margin. At the same time, the DPP took control of Taiwan's Legislative Yuan, relegating the Kuomintang to the status of a minority party for the first time ever. The outcome ensures that Tsai, unlike previous DPP President Chen Shui-bian (2000–8), will have an opportunity to govern effectively, free from partisan obstruction. But what does this historic outcome signify for the future of cross-strait and Japan-Taiwan relations?

### Behind the DPP's Victory

Broadly speaking, the DPP's triumph can be attributed to two basic factors.

The first was a carefully planned and well-executed election strategy. The DPP designated Tsai, the party chair, as its presidential nominee back in April 2015. Factional quarrels have been a recurring problem in the DPP, formed in 1986 from a motley group of anti-Kuomintang activists. But this time party unity prevailed in the nomination process and the election campaign.

On relations with China, the single biggest election issue, Tsai took a carefully

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balanced, strategically ambiguous position. In her nomination acceptance speech, she stressed maintenance of the status quo as the basic principle for management of cross-strait relations. This represented a significant departure from the position she staked out in her unsuccessful 2012 bid for the presidency, when she was challenging pro-China KMT incumbent Ma Ying-jeou. On that occasion, Tsai explicitly rejected the “1992 consensus” and its premise of unification, and the opposition accused her of being an independence extremist.<sup>1</sup> In fact, her statements were well within the bounds of the DPP’s traditional stance, namely, that Taiwan is already an independent state (and therefore has no need to declare independence). But her failure to endorse Beijing’s longstanding position that Taiwan and the mainland are part of “one China” was enough to elicit dire warnings from the Chinese government.

In 2012, Tsai’s stance on cross-strait relations and Beijing’s suspicions of the DPP fueled US misgivings about the impact of a Tsai presidency on regional stability, doubts that she was ultimately unable to dispel. Some degree of backing from Washington is a must for a Taiwanese presidential candidate, given the importance of US support to Taiwan’s security and its status in the international community. This time around, Tsai worked hard to win an implicit endorsement from US officials. On the occasion of a much-anticipated visit to Washington in June 2015, she pledged to “treasure and secure the accumulated outcomes of more than twenty years of negotiations and exchanges” as the basis of efforts to “further the peaceful and stable development of cross-strait relations.”<sup>2</sup> During the visit, she became the first Taiwanese presidential candidate ever invited inside the US Department of State, an important token of the administration’s confidence.

Even more important, however, was the fact that her position on cross-strait relations was in synch with the sentiments of Taiwanese voters. In a poll conducted by the Election Study Center at National Chengchi University in June 2015, almost 60% of respondents indicated that they favored maintaining the status quo in

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<sup>1</sup> The term “1992 consensus” refers to the outcome of a meeting between the semi-official representatives of the People’s Republic of China and the Republic of China (Taiwan) in 1992. By the account of both the PRC and the Kuomintang, both sides verbally affirmed the principle that there is only one China. However, they did not reach a consensus on the meaning of “one China.” Beijing announced that the two sides “verbally affirmed the ‘one China principle’” (and the ‘one China principle’ is by Beijing’s definition the principle that the government of the PRC is the sole legitimate government representing the whole of China, which includes Taiwan). The Kuomintang insists that the two sides “agreed to disagree” on the definition of “one China.”

<sup>2</sup> “Dr. Tsai Ing-wen Speaks at Center for Strategic and International Studies,” Democratic Progressive Party International Site, June 3, 2015, <http://english.dpp.org.tw/dr-tsai-ing-wen-speaks-at-center-for-strategic-and-international-studies/>.

cross-strait relations, whether permanently or “for the time being.”<sup>3</sup> Amid this climate, the DPP seems to have made a strategic decision to reach out to voters in the middle of the political spectrum, confident of continued support from younger Taiwanese, who tend to be more unequivocally pro-independence. The decision appears to have paid off. The more radically anti-China, pro-independence Taiwan Solidarity Union lost all three of its seats in the national legislature in the January election. Taken together, these developments indicate an increasingly hostile climate of opinion toward hardline supporters of *de jure* independence.

### The Kuomintang Self-Destructs

The second major factor behind the DPP’s big win in January was the steep decline in support for the KMT as a result of the party’s own missteps.

The failed leadership and policies of incumbent president Ma Ying-jeou are doubtless the biggest reason for the KMT’s disarray. I attended a campaign rally for KMT candidate Eric Chu in Taipei on January 9, 2016. The crowd was enthusiastic until President Ma appeared on stage; the energy level dropped perceptibly as soon as he began speaking. Even the party faithful had turned on President Ma.

When Ma Ying-jeou came to office in May 2008, he quickly drew up a series of bold policies aimed at stepping up trade, investment, and interchange between Taiwan and mainland China. There is no question that these policies helped mollify Beijing and stabilize cross-strait relations. But Ma also assured the nation that liberalization and expansion of trade and investment with China would pay off economically, allowing Taiwan to reach the ambitious economic targets he had laid out in his “633” election campaign: annual growth averaging 6% or higher, unemployment averaging 3% or lower, and per capita GDP of \$30,000 by 2016. The result instead has been an accelerating exodus of manufacturing jobs, growing income inequality, and a spike in unemployment among the young. (Although overall unemployment averaged 3.8% in 2014, the rate among those aged 20–24 jumped to 12.6%.)

Meanwhile, new policies that opened the floodgates to Chinese tourists had the perverse effect of making the Taiwanese more aware of cultural differences between themselves and the mainland Chinese and reinforcing a growing sense of Taiwanese identity. Mounting opposition to Ma’s pro-China policies came to a head in March and April 2014, when several hundred members of the so-called

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<sup>3</sup> Election Study Center, National Chengchi University, “Taiwan Independence vs. Unification with the Mainland Trend Distribution in Taiwan” (1992/06 to 2015/06), <http://esc.nccu.edu.tw/app/news.php?Sn=167>.



Sunflower Student Movement stormed the Legislative Yuan to block the impending ratification of the Cross-Strait Service Trade Agreement.

Ma has also come under harsh criticism for his highhanded and erratic party leadership, particularly in connection with the disastrous expulsion of Legislative Yuan President Wang Jin-pyng from the KMT. In September 2013, the prosecutor-general of the Supreme Prosecutors Office accused Wang, a longtime rival of Ma's, of interfering in a court decision. Ma responded swiftly by calling an emergency meeting of the relevant KMT committee and having Wang's party membership revoked. The next day Wang filed suit with the Taipei District Court and secured an injunction against the expulsion. The KMT leadership appealed the court's ruling and lost. As of this writing, Wang retains his party membership. He also held onto his position as president of the Legislative Yuan until the end of last January, when his term expired.

But the coup de grâce for the KMT was its own aberrant behavior in the selection of a presidential nominee. In July 2015, the party duly nominated Hung Hsiu-chu, deputy speaker of the Legislative Yuan, in accordance with its own selection protocol. But as concerns mounted over Hung's electability (given her strong pro-unification stance) the KMT held an extraordinary party convention in October 2015 and replaced her with party Chairman Eric Chu. It was a desperation move on the part of the KMT, which gambled that a young and charismatic leader—representing a new generation of politicians—could pull the party out of its tailspin. But by this time the people's confidence in the KMT was shattered.

## Outlook for Cross-Strait Relations

Although recent statements on both sides have downplayed the potential for a major change in cross-strait relations, Tsai's election has introduced a new and uncertain dynamic into the delicate dance between Beijing and Taipei.

During the election campaign, Tsai maintained a deliberately cautious and ambiguous stance regarding cross-strait relations. While refusing to explicitly endorse the "1992 consensus," she repeatedly promised to work for the development of peaceful relations "on the basis of the existing foundation" and studiously avoided the kind of language that tends to provoke a backlash from Beijing. She maintained this cautious stance in the January 17 press conference following her election.<sup>4</sup>

The official Chinese response to Tsai's election has been muted by Beijing's

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<sup>4</sup> "Full Text of Tsai's Victory Speech at International Press Conference," *Focus Taiwan*, January 16, 2016, <http://focustaiwan.tw/news/aip/201601160053.aspx>.

standards. As soon as the results were out, the Taiwan Work Office of the Communist Party's Central Committee issued a statement stressing that the mainland's basic principles and policies concerning Taiwan "are consistent and clear, and will not change with the results of Taiwan elections." In a reaffirmation of the government's longstanding position, it stated, "We will continue to adhere to the 1992 Consensus and resolutely oppose any form of secessionist activities seeking 'Taiwan independence,'" adding that Beijing was willing to enhance communication and exchanges with all political parties and groups that recognize the principle that the Chinese mainland and Taiwan belong to one China.<sup>5</sup>

As president, Tsai will have to perform a difficult balancing act. She must affirm the status quo in cross-strait relations without denying the fact of Taiwan's emerging national identity. She must also promote the kind of economic development that will translate into a better quality of life for the people of Taiwan. As the ruling party, the DPP, notwithstanding its pro-independence roots, will have to forge policies rooted in today's realities—such as the fact that Taiwan depends on China (including Hong Kong) for 30% of its trade and that more than 1 million Taiwanese are currently residing in mainland China.

At the same time, the people will expect Tsai to stay true to her message of "respect for the Taiwanese people." According to the aforementioned opinion poll of the Election Study Center, a full 59% of voters now think of themselves as Taiwanese, while only 3% think of themselves as Chinese (34% think of themselves as both). To affirm the trend toward Taiwanese identity while maintaining the status quo in cross-strait relations will mean preserving just the right distance between Taiwan and China. This is easier said than done, and a certain amount of trial-and-error will doubtless continue for the time being.

How, then, does China—or, more specifically, President Xi Jinping—envision the development of relations with Taiwan over the next few years?

The state-controlled media had this to say in a commentary released soon after Tsai's election: "The mainland is always in the driver's seat when it comes to cross-strait relations. . . . From a fundamental viewpoint, the key to Taiwan's prospects and the future of cross-strait relations lies with the development and progress of the mainland. Development is our unshakable purpose. As long as the mainland has its own issues in hand, it can face any new developments on the Taiwanese side with composure."<sup>6</sup>

<sup>5</sup> "Tsai Ing-wen Wins Taiwan Leadership Election," Xinhuanet, January 16, 2016, [http://news.xinhuanet.com/english/2016-01/16/c\\_135016019.htm](http://news.xinhuanet.com/english/2016-01/16/c_135016019.htm).

<sup>6</sup> Xinhuanet, January 16, 2016, [http://news.xinhuanet.com/tw/2016-01/16/c\\_1117797534](http://news.xinhuanet.com/tw/2016-01/16/c_1117797534)

The underlying intent is difficult to discern. One possible interpretation is, “As long as China’s economic development continues, we can deal with the Taiwan problem in our own way and eventually achieve unification.” If this is Beijing’s thinking, there could be trouble ahead for cross-strait relations. Such a viewpoint betrays a failure to understand the change in attitudes underway in Taiwanese society—most notably, the fast-rising percentage of residents who identify themselves as citizens of an independent Taiwanese state and regard mainland China as a foreign country.

Of course, everything will depend on how well the new president governs, but given the current disarray of the Kuomintang, Tsai Ing-wen has a good chance of being reelected four years down the road. Will this prospect tax the patience of President Xi Jinping, given his manifest ambitions for superpower China? Beijing was wise to choose the path of “peaceful development” in defining its relationship with Taiwan under Ma Ying-jeou. It must have realized that the prospects for unification on its own terms are exceedingly remote, given the likelihood of US intervention and the strong desire for stability among the other countries of East Asia. Will President Xi allow his sense of destiny and the Chinese dream of unification to cloud his judgment where Taiwan is concerned?

From a rational, objective viewpoint, it seems clear that Tsai Ing-wen’s Taiwan and Xi Jinping’s China will need to reach a mutual accommodation, and in all likelihood such efforts are already underway behind the scenes. The most urgent priority is to find a way to sidestep the issue of the “1992 consensus” in such a way that both sides can save face while maintaining the status quo in cross-strait relations.

### **Managing the Japan-Taiwan-China Triangle**

Japan is another country that figures prominently in Tsai Ing-wen’s foreign policy. When she visited Japan as the DPP nominee in October 2015, Tsai traveled to Yamaguchi Prefecture, the constituency of Prime Minister Shinzo Abe, where Abe arranged for his younger brother, House of Representatives member Nobuo Kishi, to show her around. Such warm hospitality should be seen as a token of the Abe cabinet’s fundamentally friendly stance toward Taiwan.

The statement issued by Minister for Foreign Affairs Fumio Kishida in response to the election results also sounded a warm and welcoming note. “Taiwan is an important partner and a precious friend of Japan,” he said. “We share basic values

and enjoy close economic relationship and people to people exchange. The Government of Japan will work toward further deepening cooperation and exchanges between Japan and Taiwan, based on the existing position to maintain Japan-Taiwan relations as working relationship on a non-governmental basis.”<sup>7</sup> This was high praise indeed considering Japan has no diplomatic ties with Taiwan, and it signaled the government’s hope of further strengthening the bilateral relationship.

The Japanese government has good reason to think that Tsai will respond positively to these overtures. One encouraging signal was her meeting on January 17—the day after the election—with Mitsuo Ohashi, head of the Interchange Association and Japan’s *de facto* representative to Taiwan. Another was the president-elect’s effort to downplay the territorial dispute over the Senkaku Islands during her post-election press conference.

Asked to comment on the territorial dispute, Tsai stated that the islands belong to Taiwan but stressed that she did not wish to damage relations with Japan by entering into an active dispute.<sup>8</sup> Views about the Senkakus in Taiwan run the gamut, including the position (articulated recently by former President Lee Teng-hui) that they belong to Japan. Historically, the DPP, while referring to the islands as Taiwanese territory, has avoided making too much of the issue. Given this tendency and the president-elect’s recent statement, it seems unlikely that Tsai will allow the dispute to undermine relations between Japan and Taiwan.

Yet even with both sides ready and willing to do their part, strengthening ties between Japan and Taiwan is a tricky business. It depends first and foremost on the tacit assent of Beijing—which in turn depends on smooth cross-strait relations. Developments since 2000 testify to this inconvenient truth. During the presidency of Chen Shui-bian, whom the Chinese government branded a “troublemaker,” Beijing was hypersensitive to any real or perceived bid by Japan and Taiwan to strengthen ties. Under Ma Ying-jeou, who presided over a dramatic improvement in cross-strait relations, Japan and Taiwan concluded a landmark fishing agreement, despite Ma’s supposedly anti-Japanese bias.

The majority of Taiwanese have abandoned the notion that Taiwan is an integral part of a single Chinese nation and that Taipei is that nation’s legitimate gov-

<sup>7</sup> “The Result of the Presidential Election in Taiwan,” Ministry of Foreign Affairs of Japan, January 16, 2016, [http://www.mofa.go.jp/press/release/press3e\\_000053.html](http://www.mofa.go.jp/press/release/press3e_000053.html).

<sup>8</sup> Text of Tsai’s international press conference on January 16, Democratic Progressive Party website, January 17, 2016, [http://www.dpp.org.tw/news\\_content.php?k-w=&m1=03&y1=2016&menu\\_sn=&sub\\_menu=43&show\\_title=新聞&one\\_page=10&page=7&start\\_p=1&act=&sn=8774&stat=&order\\_type=desc&order\\_col=add\\_date&data\\_type=新聞](http://www.dpp.org.tw/news_content.php?k-w=&m1=03&y1=2016&menu_sn=&sub_menu=43&show_title=新聞&one_page=10&page=7&start_p=1&act=&sn=8774&stat=&order_type=desc&order_col=add_date&data_type=新聞).

ernment. Furthermore, Taiwan has proven itself a vital and functioning democracy in successive elections, ousting the incumbent party three times since 2000 without succumbing to social or political turmoil. Firm friendship with such a neighbor is the desire of the Japanese people. But Japan-Taiwan ties must be predicated on good cross-strait relations.

The stability of the Taiwan Strait is vital to Japan's own interests. In our regional diplomacy, accordingly, we must focus on being the best possible neighbor to both China and Taiwan by helping them avoid mutual antagonism, deepen mutual understanding, and continue the task of building stable and peaceful cross-strait relations.

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## Social Responsibility in the B2B Sector: Denso

Zentaro Kamei

*The simplest way for a company to gain public recognition for the value it adds to society is through marketing efforts directed at consumers, but this is a platform that is often unavailable to B2B firms. The Denso Group, a maker of automotive parts and components, has come up with unique approaches to overcoming the CSR challenges in the B2B sector to ensure the sustainable growth of the business while contributing to the sustainable development of society.*

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Case studies in corporate social responsibility tend to focus on companies that have succeeded in boosting sales, profits, or other clear indicators of corporate value in the process of implementing socially responsible policies—“strategic CSR,” as it is sometimes called. But linking CSR to corporate value is a special challenge for “business-to-business” (B2B) firms that provide goods or services almost exclusively for other companies.

The starting point for any company’s CSR policy is its affirmation, internally and outwardly, of its social *raison d’être*. A company’s *raison d’être* can be understood in terms of its net social value added—meaning its sum total of positive and negative contributions to society at every stage of the value chain—as judged by the stakeholders that make up society (not by the company itself).

The most obvious way in which a company can gain public recognition for the value it adds to society is through its marketing and provision of products or services to consumers. This is a platform unavailable to B2B firms. For such businesses, the focus is on minimizing the negatives in the value chain, as by reducing the environmental load or addressing human rights issues at the development, production, or distribution phase. Of course, the quality of a B2B manufacturer’s intermediate goods affects the quality of the finished product and is therefore a key

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to its competitiveness. But once the parts are integrated into the final product, judging the value of the supplier's contribution is often difficult.

When one considers how many Japanese manufacturers are suppliers of intermediate goods, one realizes the extent to which this issue affects Japanese industry.<sup>1</sup> In the following, I describe the efforts of the Denso Group, a major manufacturer of automotive parts and components, to grapple with and overcome the CSR challenges facing manufacturers in the B2B sector.

### **Denso's CSR Approach**

Let us begin with a brief survey of Denso's CSR program. Despite the challenges explained above, Denso has placed great emphasis on contributing social value through its products, particularly in respect to the environment. At the same time, it has worked continuously to minimize negative value across the supply chain.

Denso embraces economically, environmentally, and socially responsible business conduct, viewing CSR as a means of ensuring the sustainable growth of the business while contributing to the sustainable development of society. In business terms, Denso divides its CSR activities broadly between stakeholder satisfaction and risk management.

The first category encompasses policies for creating value vis-à-vis each of five stakeholder groups: customers, employees, shareholders and investors, business partners, and the international and local communities. Risk management pertains to such nonemergency areas of risk as compliance and information security. The characterization of routine risk management as an aspect of CSR is one of the distinctive features of Denso's CSR policy (Figure 1).<sup>2</sup>

The organizational structure Denso has developed for its CSR efforts is worthy of attention. At one point the company had six separate committees for the environment, safety, corporate ethics, social philanthropy, risk management (routine), and risk management (emergency). Over time it streamlined the organization. Cur-

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<sup>1</sup> According to the 2011 White Paper on International Economy and Trade published by the Ministry of Economy, Trade, and Industry, the share of intermediate goods (parts and semi-finished goods) in Japanese export volume has grown substantially since 1990, reaching 58.7% in 2009. In that year, intermediate goods and capital goods (used in production) together accounted for 81.4% of Japanese exports, while consumer goods accounted for only 17.3%. See <http://www.meti.go.jp/english/report/downloadfiles/2011WhitePaper/2-1.pdf>.

<sup>2</sup> For emergency management, Denso has established a Risk Management Meeting with a limited number of members to facilitate a rapid initial response in the event of an emergency.

rently, there remain only committees on the environment, safety, and emergency risk management—groupwide priorities that involve regulatory compliance. CSR policy as a whole is under the jurisdiction of the Corporate Strategy Planning Center within the Corporate Planning Division. This reflects Denso's view of CSR as an integral aspect of business management and strategy.

**Figure 1. Elements of Stakeholder Satisfaction and Risk Management**

<p><b>Stakeholder Satisfaction</b></p> <ul style="list-style-type: none"> <li>• Customers: Establishment of trust, creation of new value</li> <li>• Employees: Respect for employees, creation of a rewarding work environment</li> <li>• Shareholders and investors: Enhancement of corporate value, promotion of dialogue</li> <li>• Business partners: Free, open, transparent transactions</li> <li>• International and local communities: Environmental conservation, improved security and safety, social philanthropy, fair business practices</li> </ul> <p><b>Risk Management</b></p> <ul style="list-style-type: none"> <li>• Compliance, information security, risk control (nonemergency)</li> </ul>
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*Sources: Corporate materials and Tokyo Foundation interviews with corporate officers.*

On the surface, it might seem more efficient to establish separate units to address different themes. But when people are grouped and segregated according to theme, they have a tendency to focus narrowly on the clearly visible, easily anticipated, and quantifiable problems in their designated field and become less aware of society's changing needs.

Denso has refined its CSR system with a view to streamlining the organization while clarifying its functional division of labor. The result is an organizational structure that directly addresses various management issues integral to CSR, including the creation and maintenance of corporate value, the integration of social initiatives into business activities, and risk management.

## Key Performance Indicators and Concrete Action

Denso has received especially high marks for its environmental policies. It is the area in which the company has made the most progress integrating action on social issues into its products and business processes. Characteristic of Denso's approach is the adoption of key performance indicators and action measures for each area of environmental concern (climate change, resource recycling, toxic substances, biodiversity, etc.), broken down by stakeholder group.



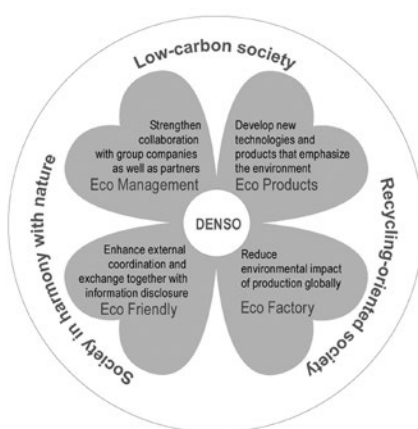
In terms of research and development, Denso's commitment to the environment has yielded concrete results in the form of lighter and smaller parts as well as advanced hybrid and idle-stop (stop-start) technology. Denso believes it has a responsibility to actively suggest improvements in this area. In terms of production, Denso has developed and adopted low-impact manufacturing processes, including energy-efficient production lines, and is actively collaborating with other companies on such matters as green procurement.

Underpinning these efforts is the company's basic environmental plan, Denso EcoVision. The long-term plan sets 10-year goals and lays the basis for five-year action plans. Denso EcoVision 2015, adopted in November 2005, was revised in November 2010 and again in March 2013 (see Figure 2).

On the basis of this EcoVision, Denso draws up an Environmental Action Plan every five years. It is currently implementing its fifth five-year plan, which articulates concrete targets under four approaches, dubbed "eco-management," "eco-products," "eco-factory," and "eco-friendly" (Figure 3).

Here I would like to focus particularly on products and production ("eco-products" and "eco-factory"), the areas in which Denso has achieved a high degree of integration. Through its action plan, Denso has publicly committed itself to quantitative targets and concrete actions in both areas. In so doing, it provides clear goals and guidelines for management, which doubtless contribute to the workplace environment.

**Figure 2. Denso EcoVision 2015**



#### **Denso EcoVision 2015 Environmental Policies (Summary)**

1. Eco Management: Strive to strengthen environmental management through Denso Group collaboration from a global perspective.
2. Eco Products & Eco Factory: Pursue development, design and production activities that emphasize the environment from a holistic perspective at every stage of the product lifecycle from manufacture to market use and disposal.
3. Eco Friendly: Actively disseminate information and coordinate with outside entities in a way that transcends industry borders while working to communicate with all stakeholders.

Source: Denso CSR Report 2014.

**Figure 3. Excerpts from Denso's Fifth Environmental Action Plan (ending 2015)**

*2. Environment- and Performance-Oriented Design and Development (Eco-Products)*

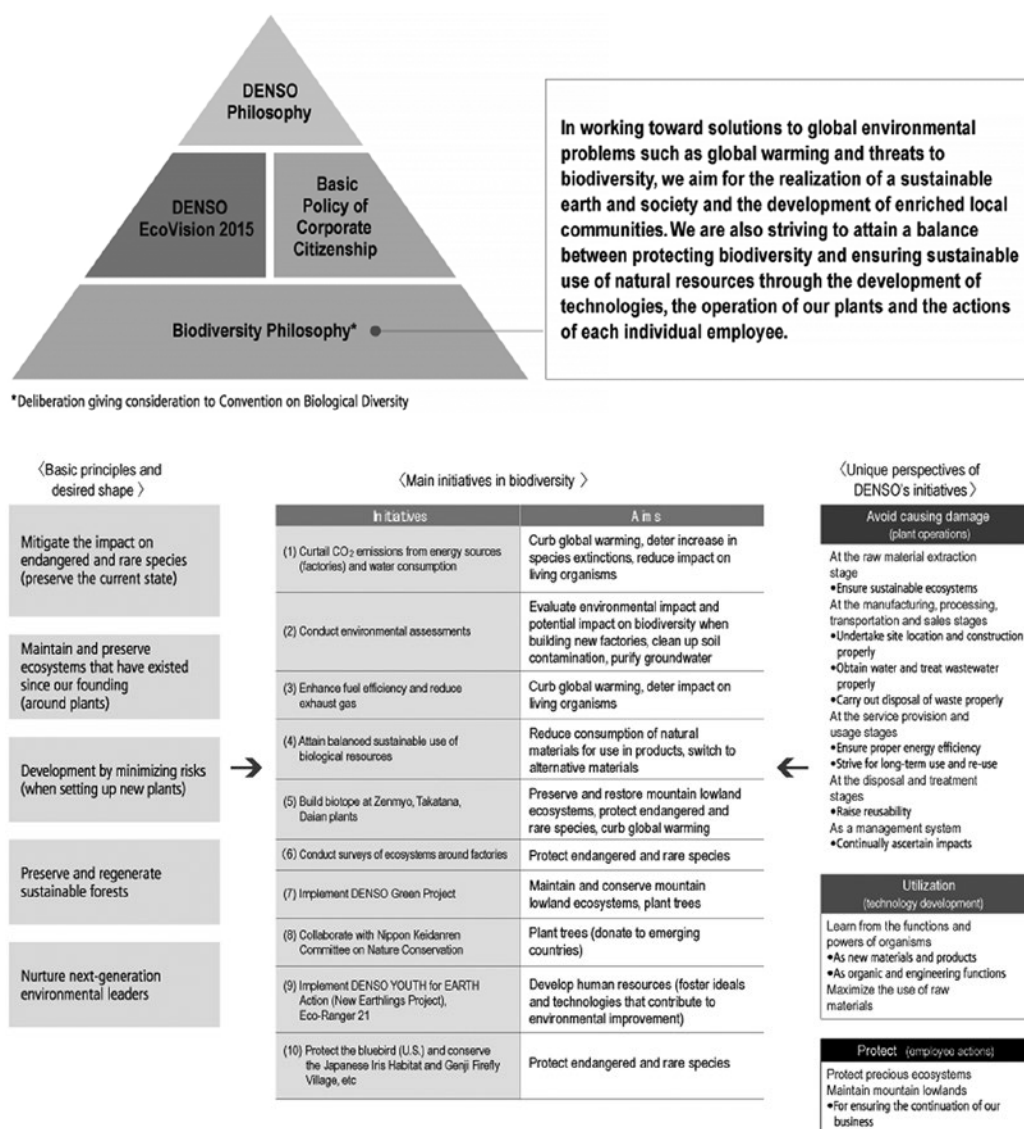
Initiative	Actions and Targets
(7) Develop new technologies and products that contribute to superior fuel economy	<p>Work with automakers in developing new technology that conforms to the fuel-economy regulations of each country/region as well as automakers' own targets.</p> <ol style="list-style-type: none"> <li>1. Develop and commercialize low-carbon-emissions technology <ul style="list-style-type: none"> <li>• Develop core-business products to improve average global fuel economy by 25% from 2005 levels by 2015</li> <li>• Develop core-business technology to help automakers meet next generation of EU fuel-economy regulations by 2015</li> </ul> </li> </ol>
(8) Develop parts for clean-energy vehicles	<p>Work with automakers in developing and commercializing components for clean-energy vehicles</p> <ol style="list-style-type: none"> <li>2. Develop components for hybrid vehicles (HVs) <ul style="list-style-type: none"> <li>• Develop compact, low-cost components geared to automakers' 2015 HV sales plan</li> </ul> </li> <li>3. Develop components for low-emissions vehicles (LEVs) <ul style="list-style-type: none"> <li>• Develop engine components and HV units to meet US LEV-III standards by 2015</li> </ul> </li> </ol>
(9) Develop new technologies for diversified energy	<ol style="list-style-type: none"> <li>4. Pursue development of electric systems &amp; components for next-generation vehicles <ul style="list-style-type: none"> <li>• Develop stop-start systems and HV systems for increased energy regeneration by 2015</li> <li>• Develop components for plug-in hybrid vehicles (PHVs) designed for daily use</li> </ul> </li> <li>5. Pursue technological development of components for limited-use electric vehicles (EVs) and fuel cell vehicles (FCVs) <ul style="list-style-type: none"> <li>• Pursue development of new technologies geared to various types of biofuels and synthetic fuels that can contribute to reduction of carbon emissions</li> <li>• Develop engine management systems &amp; components capable of handling biofuels by 2015</li> </ul> </li> </ol>
(10) Help stem global warming through car air-conditioning technology	<ol style="list-style-type: none"> <li>6. Pursue development and commercialization of low-global-warming-potential (GWP) auto air-conditioners <ul style="list-style-type: none"> <li>• Pursue commercialization and promote use of A/C systems using new refrigerant with 1/100th the GWP of current refrigerants</li> </ul> </li> <li>7. Commercialize and promote use of low-power-input, highly efficient A/C systems <ul style="list-style-type: none"> <li>• Develop low-power-input A/C systems that function while engine is stopped for HVs and vehicles with stop-start systems</li> </ul> </li> </ol>

### 3. Steady Reduction in Environmental Load of Production Worldwide (Eco-Factory)

Initiative	Actions and targets																			
(16) Reduce CO <sub>2</sub> emissions from production and logistics activities	<i>Production</i> 1. Dramatically boost productivity through technical innovation, etc. 2. Develop a resilient energy-saving policy applicable to changing conditions and drastically improve CO <sub>2</sub> emissions intensity through such structural measures as “just-in-time” for energy with the aim of halving energy consumption over long term																			
	<i>Logistics</i> 3. Reduce emissions worldwide through transportation improvements and eco-driving																			
	<i>2015 CO<sub>2</sub> Reduction Targets</i>																			
	<table><tr><td></td><td colspan="2">Production</td><td colspan="2">Logistics</td></tr><tr><td></td><td>Denso Global</td><td>Denso Corp.</td><td>Denso Global</td><td>Denso Corp.</td></tr><tr><td>Indicator</td><td>Emissions intensity per sales*</td><td>Emissions intensity per sales*</td><td rowspan="2">Top-level emission reduction in each country</td><td>Emissions intensity per sales*</td></tr><tr><td>Target</td><td>7% lower than 2010</td><td>65% lower than 1990</td><td>9% lower than 2006</td></tr></table>		Production		Logistics			Denso Global	Denso Corp.	Denso Global	Denso Corp.	Indicator	Emissions intensity per sales*	Emissions intensity per sales*	Top-level emission reduction in each country	Emissions intensity per sales*	Target	7% lower than 2010	65% lower than 1990	9% lower than 2006
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	Denso Global	Denso Corp.	Denso Global	Denso Corp.																
Indicator	Emissions intensity per sales*	Emissions intensity per sales*	Top-level emission reduction in each country	Emissions intensity per sales*																
Target	7% lower than 2010	65% lower than 1990		9% lower than 2006																
	* Real production value corrected for cost of living.																			
(17) Reduce greenhouse gas emissions from production activities	4. Reduce emissions of five greenhouse gases (fluorocarbons, hydrofluorocarbons, SF <sub>6</sub> , N <sub>2</sub> O, and CH <sub>4</sub> ) by recovery/removal of PFCs, HFCs, and SF <sub>6</sub> used in semiconductor manufacture and by replacement with other gases  <i>2015 Emission Reduction Target for Five GHGs (Denso Corp.):</i> 50% lower than 2003																			

According to the results of the Tokyo Foundation’s 2014 CSR corporate survey, the preservation of ecosystems is an area in which many companies’ environmental efforts have lagged, probably owing to the difficulty of setting clear objectives and drafting concrete measures. Denso has approached this challenge by drawing up a Philosophy on Biodiversity. In addition, it has outlined a three-pronged approach to its own engagement with ecosystems: avoid causing damage (plant operations), optimally utilize (technology development), and protect (employee actions). On the basis of these shared principles and a respect for the autonomy of local operations, the companies of the Denso Group are working actively to preserve biodiversity in partnership with local communities.

Figure 4. Denso's Biodiversity Initiatives



Source: Denso CSR Report 2014.

## Taking the Long View

A key factor underlying Denso's remarkable CSR performance is the company's long-range approach to the creation of social value. In April 2013, the Denso Group adopted its Long-Term Policy 2020. To arrive at the plan, corporate leaders pictured the world in the year 2025 and deliberated at length on how their com-

pany could help surmount the social challenges of the future. Keeping in mind the nature of Denso's business as a supplier of auto parts, the company embraced two basic goals for the ideal automotive society of the future.

The first was environmentally sustainable growth, which means minimizing the environmental load. The second was individual safety, security, and happiness, which involves accident prevention. In this way Denso, as a member of the automotive industry, has made a commitment to address these social challenges as part of its mission and *raison d'être*.

This twin focus is reflected in Denso's global CSR policies. Environmental protection and safety are the shared priorities of Denso Group companies and subsidiaries worldwide.

Last year's Tokyo Foundation CSR White Paper stressed the vital importance of a long-range perspective for the integration of socially responsible policies into a company's business strategy. Denso's business strategy begins with its Long-Term Policy, a kind of management "compass" that sets the basic direction for the next 5–10 years. This forms the basis for the concrete objectives and measures laid out in the Mid-Term Policy/Mid-Term Plan, a 3–5-year strategy.

The existence of a document guiding management policy from a long-range perspective and a corporate culture that continually asks how the company can deliver added value to society have enabled Denso to accelerate the integration of CSR into corporate management.

Denso also merits mention for its willingness to publicize negative as well as positive information. Since fiscal 2009, Denso's CSR Report has included a section titled "Highlights & Lowlights," in which it lists not only its achievements but also problems and areas in which more work needs to be done. Objectively disclosing the negative as well as the positive is a vital step toward winning public trust. It may not seem that difficult, but in fact it takes great courage. This section of the CSR Report also exemplifies Denso's practice of approaching CSR in terms of objective, concrete indicators and actions and making the company's progress (or lack thereof) clearly visible.

Even as a supplier of parts and components, Denso has worked hard to build its credentials as a company that creates social value through low-cost, high-quality products and cutting-edge technology. At the same time, it has worked to improve and refine its business processes through benchmarking with an eye to the latest business trends and changes in the social environment. These efforts at continuous improvement are predicated on the understanding that the expectations of society—comprising the entire spectrum of stakeholders—are constantly changing.

The use of a long-range management policy as the starting point for business strategy and planning is a matter of common sense in the business world. Yet surprisingly few Japanese companies have been able to put it into practice, particularly in relation to CSR. Denso's approach may offer a simple solution to the CSR challenges that continue to confront so many Japanese businesses.

### **Creating Windows to Society**

Denso has secured a position as one of Japan's most socially responsible companies, particularly in the environmental field, thanks to its willingness to respond to social change, its long-range perspective—so essential to the integration of CSR and business strategy—and its commitment to quantifying and visualizing its progress or lack thereof. That said, Denso is by no means exempt from the CSR dilemmas facing many B2B companies. True, it has made impressive gains in CSR integration in the environmental realm, where it is relatively easy to set quantitative targets and draw up concrete plans for meeting them. But Denso is aware that other areas pose more of a challenge.

Viewing CSR as an integral aspect of business management, Denso has long focused its CSR efforts on improving its products and business processes. In recent years, however, it has also come to the realization that CSR has an even more fundamental role to play: that of creating the kind of corporate culture from which quality products and sound business processes can emerge. It has come to see that CSR has the power to transform the corporate culture and, by extension, the thinking and behavior of each employee.

One of the most salient “personality traits” of Denso as a business is its enduring commitment to establishing close ties with the local community and standing by that community over the long run. This emphasis on nurturing strong community ties is most obvious in its longstanding relationship with the city of Kariya in Aichi Prefecture, where the company was founded and has its headquarters, but it is also apparent wherever Denso has established operations, both in Japan and overseas.

Paradoxically, this in itself can become a problem. Denso has ties with so many members of the community that it can sometimes be difficult to incorporate an outsider's perspective. True, Denso employees work in a corporate culture that emphasizes continuous efforts to innovate, improve, and cut costs, and most of them strive hard to meet those challenges. They also benefit from working alongside other highly motivated and talented employees. Still, in such a self-sufficient environment, a tendency toward insularity is hard to avoid.

In our ever-changing society, problems can emerge unexpectedly in areas with no obvious relationship to the development and production of automotive parts. Insularity could leave the organization vulnerable to such problems. To maintain CSR policies that deliver on Denso's commitments to stakeholder satisfaction and risk management, the company needs employees trained to respond to social change of all sorts. Nurturing that sort of social awareness and responsiveness among each member of the organization is therefore a crucial goal of Denso's CSR program.

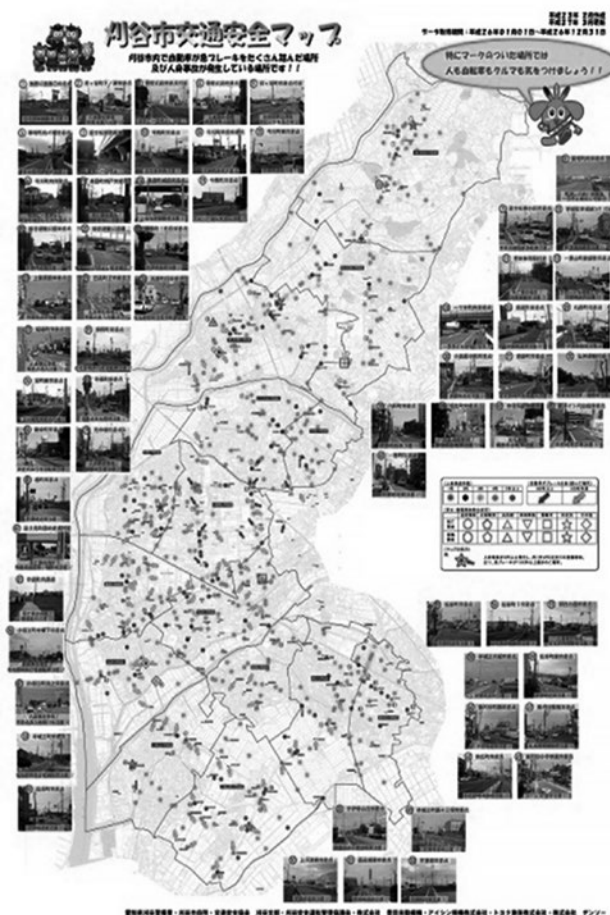
This is the rationale behind what Denso refers to as "employee enlightenment." As Denso sees it, employee involvement in CSR activities provides the company with windows to society. The more employees interact with and listen to the broader community, the greater their opportunities for independent thinking, initiative, and growth. In this sense, CSR can be an important tool for rethinking the company from an outsider's perspective. By changing the company's corporate culture in this manner, Denso hopes to make the organization more adaptive, responsive, and resilient.

With this in mind, the Denso Group has called on each of its companies, in Japan and overseas, to draw up and implement plans for leveraging their own technical and organizational resources to contribute to the local community's environmental health or human safety (the group's shared priority commitments). It also compiles an abridged CSR report for employee consumption.

In Kariya, Aichi Prefecture, Denso launched a project to compile local traffic safety maps with employee participation. It used sudden-braking data gathered from event data recorders installed in company-owned vehicles, together with police accident reports, to pinpoint locations on the map where drivers and pedestrians need to be particularly on their guard. The company has distributed the maps to local schools and elsewhere for display and use in traffic safety campaigns.

In 2013, moreover, the company moved to "open the window to society wider" by expanding the initiative via an employee volunteer program to "make the community safer each time you drive." Employee volunteers downloaded Denso's own data-recording application onto their smartphones, which they placed in their private cars to collect traffic hazard data, including sudden braking events, while driving to and from work. Over a period of three months, some 120 employees provided about 120,000 kilometers worth of data on traffic conditions. The result was the identification of some 20 locations, primarily in Aichi Prefecture, that were prone to sudden braking. Judging from the feedback, many of the volunteers regarded the project as a valuable opportunity to take a fresh look at their community and their own driving habits from the standpoint of traffic safety.

## Kariya Municipal Traffic Safety Map



Denso Group companies around the globe have also been undertaking their own traffic safety initiatives geared to their communities. After identifying the sources of local traffic hazards and fatalities, they consult with local government agencies and nonprofit groups to come up with measures to mitigate those hazards and work together to solve the problems.

The factors contributing to traffic hazards vary from locale to locale. In Thailand, a major factor behind traffic fatalities is the fact that children rarely wear bicycle helmets. The need for such helmets is not widely understood, and as a result, only about 7% of Thai children wear them. Having identified the issue, Denso set to work in collaboration with local nonprofit groups on a campaign to promote the wearing of bike helmets.





*A poster displayed in Thai elementary schools to encourage students to wear bike helmets (left). Thai children don bike helmets donated by Denso (right) as part of the company's local traffic safety program. (Courtesy of Denso)*

It is easy to view such programs merely as charitable projects, but the real point of these initiatives is to make managers and employers more aware of and responsive to the local community. By attuning their eyes and ears to the outside world, company personnel can transcend the insular in-house viewpoint and gain the perspective needed to pursue meaningful innovation with society's ever-changing needs in mind.

For Denso, this is an ongoing effort. Through concrete CSR activities, the company is actively opening windows to society and creating opportunities for its employees to ponder the kind of value that Denso as a company—and they themselves as individuals—can offer the world.

July 28, 2016

## Social Sabbatical Program Combines CSR and Leadership Development: SAP

Mikiko Fujiwara

SAP is a global software company headquartered in Germany. Founded in 1972 by five engineers from IBM, the company has grown dramatically over the 40-plus years since then, becoming a major worldwide corporation with over 70,000 employees and offices in over 130 countries. The company supplies enterprise software to hundreds of thousands of customers, probably including the employers of many readers of this article.

SAP's corporate social responsibility program took its current shape only recently, though, following the company's adoption of a global CSR strategy in 2011. Before then, its CSR activities had consisted mainly of donations. There was no globally coordinated program; instead, the companies' offices in each country made donations on the basis of local considerations.

In truth, SAP had nothing to point to as its own CSR. The company's focus was on business operations in line with the corporate mission, namely, to develop standard application software for real-time data processing. This was the basis for the company's name, which stands for "System Analysis and Program [Development]." And the engineers' mindset that had informed the company since its establishment relegated CSR to the status of philanthropic activities unrelated to the company's main business.

After years of writing checks for charitable causes, however, the company began to wonder if it was doing the right thing. Giving money is helpful, but is it going where it should, and is it being used for proper purposes? Is the company generating an impact identifiable as its own? Are the donations helping bring about change? These are the questions that began to nag managers at SAP.

These concerns prompted, in 2010, the adoption of a new corporate vision: "To make the world run better." This was refined in 2011 to: "To help the world run

better and improve people's lives." The adoption of this explicit commitment to social improvement led to the formulation of a global CSR strategy.

### **Tools to Tackle Society's Problems**

The task began with a search for ways that SAP could "help the world run better and improve people's lives" using the distinctive capabilities of a company that had grown into a world-leading software developer in four decades. The approach needed to draw on its main business operations and also to contribute to those operations in order to win the support of shareholders and other stakeholders and thus ensure its sustainability. After substantial consideration, the company came up with two planks for its CSR program: entrepreneurship and STEM education, "STEM" being short for science, technology, engineering, and mathematics.

As a company founded by former IBM engineers, SAP had entrepreneurship in its corporate blood. The firm has an office in Palo Alto, California, in the heart of Silicon Valley, and supporting and training entrepreneurs was a key to SAP's own future. Also essential for SAP was the development of specialists versed in the STEM subjects, which are the core elements of information technology. So when SAP considered how it could undertake CSR activities that would draw on its business operations, it was only natural that it settled on the twin planks of entrepreneurship and STEM education, focused on equipping the world's youth with the tools they would need to tackle society's problems in the twenty-first century.

The next question was how to turn these planks into concrete action. The company's experience suggested that simply giving money tended to leave the company without a direct stake in the activities it was supporting. In order to conduct CSR activities that would both draw on the company's existing business operations and provide inputs for future operations, it was essential to turn the CSR program into something to which the entire company would be committed—an undertaking directly related to SAP's way of doing business, not a special operation handled by an isolated unit within the company.

In order to make the program sustainable, moreover, it needed to appeal to the pride of the company's professionals and make them want to play an active part. Another key requirement was for the activities to produce a social impact. After considering these factors, in 2012 the company launched its Social Sabbatical program, which combines CSR with human resources development, particularly for the company's future executives.

Under this program, teams of employees from SAP offices around the world, working in various departments, are sent to assist social entrepreneurs and non-

governmental organizations involved in tackling social issues in emerging markets. Spending four weeks at the target organization, the team members tap into their respective skills to help find solutions for the organization's management issues. Eligibility to participate is limited to the "top performers," a designation applied to the top 10% of SAP employees from around the world.

In 2012, the first year of the program, teams were dispatched to three countries: Brazil, India, and South Africa. The number of target countries has since risen to eight, including China, Turkey, and the Philippines, and about 120 employees now take part, including some from SAP Japan. Other companies have implemented similar programs, but what distinguishes SAP's undertaking is that the targets are explicitly limited to organizations aligned to its CSR strategy, such as social businesses and NGOs dedicated to addressing social issues, and that participation is limited to the top 10% tier of employees—the company's top performers.

SAP positions this program not only as a means of providing CSR education to the participating employees but also as opportunities for leadership training and market development. The teams are created specifically for the program and include members from different professional backgrounds and nationalities. While members have virtual meetings and other contacts from their respective offices before they set off, they do not meet face to face until they arrive at their destination. In order to produce results within four weeks, members must quickly transcend differences and start functioning as a team. And they must operate in an emerging market where the conventional wisdom of their home countries does not necessarily apply. On top of that, in order to grasp the background of the target organization's problems and find clues to dealing with them, they must communicate with the organization's employees and build a team with them, even though in many cases they do not have a common business language.

SAP employees must thus display team-building skills on two levels, among themselves and with members of the target organization, along with cross-cultural adaptability. And their stay tests and hones their ability to identify and resolve issues within a short time frame.

In addition, SAP expects them to sow the seeds for future business by winning high marks from the target organization. Since the dispatched team members represent SAP's top tier of employees, a certain degree of success is taken for granted. If the target organization is able to solve its problems and improve its operations through the development of new skill sets and the acquisition of new perspectives as a result of the team's activities, it will think highly both of the team members and of SAP as the company that sent them. Even if it does not currently have the resources to adopt software or IT solutions from SAP, it may consider doing so in

the future. In this way, the team's success means the birth of a new potential client for the company.

The team members are responsible sowing such seeds, and during their stay they learn about the various needs of an emerging economy. They have the opportunity to put their own professional skills to work in dealing with social issues, to benefit others, and also to develop future clients. Their activities are the embodiment of SAP's vision: "To help the world run better and improve people's lives."

### **Producing Results in China and Kenya**

Let us next look at two actual cases. In the first, a team was sent to provide support for a start-up in Shanghai. China has been achieving dramatic economic growth, but many people have been left behind, and fighting poverty is an urgent task. NuoMi Shanghai, a fashion firm launched in 2006, has been designing and selling high-quality, stylish apparel made from natural materials, and from the start it has operated as a social business, hiring orphans, homeless people, and people with disabilities so as to allow them to break out of the poverty cycle. Often hired without any previous experience, new employees receive on-the-job training, learning how to sew and eventually becoming skilled workers capable of supporting themselves.

Bonita Lim, the founder and chief executive of NuoMi, wanted to increase its earnings so as to create more jobs. She was confident that IT could be used to develop new sales channels for the company's products. But she is a designer by profession, and she had little familiarity with IT-related matters. SAP dispatched a team made up of experts in technological support, corporate finance, and marketing.

The members listened to Lim's hopes, and they also spoke with employees who said their jobs at NuoMi had changed their lives. They came up with a branding strategy based on the firm's distinctive identity as a social enterprise. Lim declares that the team members were "heaven-sent helpers." Based on the strategy they devised, the company's website was revamped to highlight the social value of NuoMi products. And both in shops and at its periodic fashion shows, NuoMi strongly pushed the message that wearing NuoMi clothes has a positive impact on society.

The other case involves a team sent to Kenya. The target was Juhudi Kilimo, a microfinance start-up headquartered in Nairobi. In addition to offering loans to smallholder farmers, the firm provides various sorts of training to help them improve their lives. It actively finances farmers' purchases of livestock and installation

of hothouses. It has extended more than \$20 million in loans to some 30,000 farmers. The firm wanted to improve the communications between headquarters in the capital and the sites of its lending activities, which are conducted locally across the country.

The team from SAP consisted of specialists in IT support and project management. When they arrived in Nairobi, the reality they encountered at Juhudi Kilimo's headquarters was on an entirely different level than what they had imagined from the company's reference to "improvement of communications." The company's operating processes were all paper-based, and employees' workspaces were buried under piles of documents. The company warehouse was also full to overflowing with papers. Unsurprisingly, the loan approval process was time-consuming.

The team members also traveled to a rural village where the firm had been providing loans. There they heard from farmers who had used financing from Juhudi Kilimo to buy dairy cattle, thanks to which they had increased their income and found hope in the future. Talking to the farmers allowed the SAP team members to view the lending process from the clients' perspective. Farmers seeking a loan had to travel to Nairobi, which took a long time. Often they had to spend an entire day on the process—meaning a day away from work on their farm.

The SAP team proposed streamlining the loan approval system by using mobile phones, which are widespread in Kenya, and automating the process. Under the new arrangement, farmers no longer needed to travel to Nairobi, and the processing period was cut from two weeks to three days. The digital data is stored in the cloud, and the company's headquarters is no longer overloaded with paper. Thanks to the new system, the burden on farmers has been lightened, and the company's employees are able to spend more time gathering opinions and requests from farmers. And the company is now able to provide loans to a larger number of them.

### **Positive Repercussions**

As can be seen from these two cases, participation in the Social Sabbatical program puts SAP's future leaders into environments unlike anything they had experienced until then and gives them a visceral understanding of social issues. They tap their own skills and experience to solve business problems at the target organization, and they see how this can also contribute to the resolution of social issues. They learn that their work for SAP can be socially meaningful and help people live better—in other words, they directly experience the realization of the company's vision, "to help the world run better and improve people's lives." The program encourages them to internalize the concept of CSR and to integrate it naturally with

the company's business operations. And it has become a gateway to success for the company's executives-to-be.

The participants so far have given high ratings to this program. Unlike their ordinary business-to-business work, which offers little opportunity to sense that they are contributing to society, it allows them to experience a direct connection between the deployment of their abilities and skills and the resolution of social issues. Many have said that participating in it changed their lives. Team members gain confidence from the successes they achieve in addressing social issues, and they have a heightened awareness of and interest in tackling such issues after they return to their home countries. In addition, the concept of CSR takes root and grows in the minds of each of these future leaders.

The participants also share their experiences with other SAP employees, enthusiastically relating how they were able to put their skills to work for the benefit of society. In effect they become CSR ambassadors within the company. As a result, the number of participants has been growing from year to year, jumping from 29 in 2012, the first year, to 360 in 2014, and this has been accompanied by a rise in competitiveness, there being nearly four times as many applicants as participants. The range of target countries—10 locations in 2015—has also expanded, broadening the variety of participants' experiences and extending the social impact of the program.

The benefits of the program are by no means limited to the top 10% tier of employees chosen to participate. Every year SAP designates October as a "Month of Service" and implements more than 550 volunteer activities for employees at offices in over 50 countries around the world. The participants in the Social Sabbatical program play a major part in planning and implementing these activities. SAP has also launched a locally targeted version of the program, called "SAP Engaging for Local Impact," under which local employees are dispatched for a month to support the activities of local NGOs and social enterprises involved in tackling social issues. The program is currently being implemented in Ireland, China, India, the United States, Mexico, Bulgaria, and Australia.

Though the Social Sabbatical program itself is a company-launched initiative, the experiences that participants gain from it allow them to internalize the concept of CSR and exercise leadership informed by this concept, coming up with new initiatives of their own. And their activities are having a favorable impact on other employees. A positive cycle is now operating both for the employees and for SAP as a whole.

To be sure, this program is still young, and the process of trial and error is likely to continue for some time yet. A long-term perspective will be required to gauge

the social impact generated by the program, and this may clash with the focus on short-term results that is commonly seen in the business world. Finding the key performance indicators for measuring long-term social impact is an issue for SAP.

The company may be said just to have reached one milestone on the long journey of implementing CSR. But over the course of time, the hundreds of employees who have participated in this program will come to form the mainstay of the company. These employees, with an internalized awareness of how their own work can change society, will shape SAP's future. This is the leadership-development side of SAP's agenda for its Social Sabbatical program.

One of the points brought into view by the Tokyo Foundation's CSR Corporate Survey is the tendency of Japanese companies to address social issues that have already become widely recognized rather than seek to mitigate emerging issues. Japanese firms may thus benefit from looking at SAP's program, which puts participants face to face with social issues in emerging economies, an environment totally different from their usual one, and heightens their sensitivity to social issues in general.

One aspect of SAP's program that may be difficult for Japanese firms to imitate is the focus on elite training limited to the top performers. But SAP's carefully considered integration of efforts to resolve social issues with business operations—encouraging employees to internalize the concept of CSR through experience that combines leadership training and activities aimed at tackling social issues—is an approach that can offer valuable insights for Japan's companies as well.



July 13, 2016

## Making CSR Synonymous with Corporate Management: Fuji Xerox

Zentaro Kamei

**F**uji Xerox espouses the principle that corporate social responsibility is synonymous with corporate management. The Top Commitment section of the company's Sustainability Report 2014 contains a clear exposition of the meaning of CSR and of the efforts being made to integrate business operations and CSR initiatives to address social issues.<sup>1</sup> The document explains what CSR is in concrete terms in the context of the company's *raison d'être* in society.<sup>2</sup>

### Efforts toward Quantification

Talk is cheap, some may note. But at Fuji Xerox, words are backed up with action. The sustained implementation of honest effort has resulted in the evolution and deepening of the company's CSR program.

Many companies report that they have a hard time getting their business divisions to embrace CSR goals, especially when the task entails setting and managing quantitative targets and monitoring progress. This points to the difficulty of achieving the integration of CSR activities with business operations—the central theme of the Tokyo Foundation's 2014 CSR White Paper. Our 2015 report, meanwhile, reveals that even when companies are monitoring the results of their CSR activities and the progress toward achieving quantitative targets, there is an overall tendency for individual activities to become drawn out. This can be taken as an indication that the PDCA—plan, do, check, act—cycle is not being properly carried out and that the quantitative targets were just for show.

Progress, indeed, is being achieved in some quarters toward the quantification

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*Zentaro Kamei      Research Fellow and Project Manager, Tokyo Foundation.*

<sup>1</sup> See the appendix at the end of this article.

<sup>2</sup> This exposition is similar to the definition of CSR as revealed in the Tokyo Foundation's 2014 CSR White Paper.

of CSR. In the area of environmental issues, for example, where quantification is easy, numerical goals have been adopted in an effort to prevent pollution and mitigate climate change. The impact of such measures can be calculated by keeping track of the reductions in energy consumption. Quantification is also widely conducted to confirm the achievements of a company's own CSR activities.

But companies still maintain that evaluating results quantitatively is difficult. In the case of environmental issues, relevant laws and regulations (including voluntary "soft laws" introduced by industry groups) set clear standards, making it easy to measure performance. But the regulatory frameworks for such issues as human rights, poverty, and gender normally have only qualitative provisions and are vague in defining to whom they apply; as such, it can be difficult to identify achievements that all can agree as having been successful. The difficulty many companies cite in quantifying the results of initiatives other than those relating to the environment may, in truth, be an admission that they do have the means to quantify the results of such initiatives.

In his Top Commitment message, President Tadahito Yamamoto declares: "Goals established by management are embedded in frontline plans for product development, procurement, manufacturing, sales, and other activities. As I have been emphasizing, it is critically important to clarify the link between CSR and the mission and objectives of each organization and to achieve a full integration between CSR and our core business." This is something that many companies are finding difficult to achieve. The following is an overview of Fuji Xerox's CSR initiatives, with a focus on the quantification of targets and results.

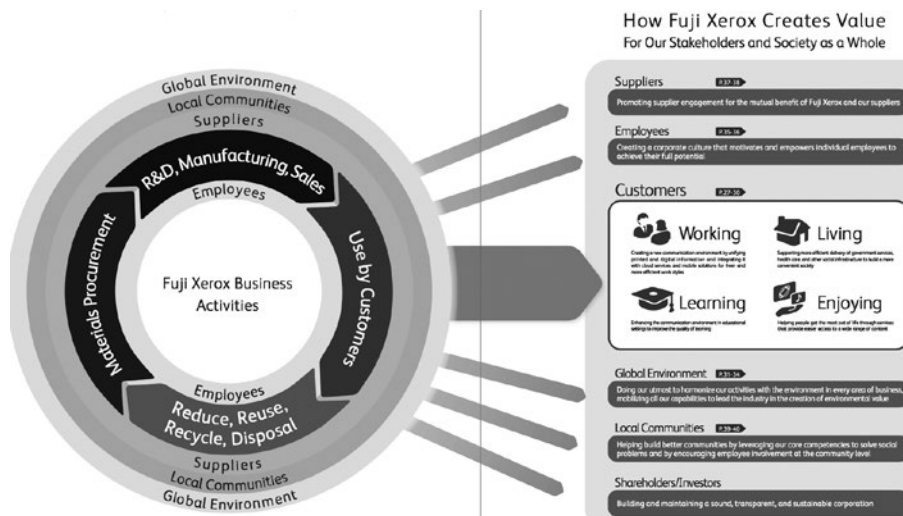
### **CSR as a Key Component of Business**

Let us look more closely at the contents of Fuji Xerox's Top Commitment.

The company believes in "creating value for society throughout the value chain" (Figure 1). It considers the impact it has on society (both positive and negative) and the value it can provide for its stakeholders through its business operations, from the procurement of materials and R&D to manufacturing, sale, use by customers, and, ultimately, the disposal of products.

Value is not something the company can unilaterally proclaim to have created; it is generated only when it is recognized as such by the company's diverse stakeholders. And to ascertain what its stakeholders are thinking, it uses two approaches: "communication" and "monitoring."

The company promotes communication and dialogue through its Sustainability Report, its website, and other channels. The Sustainability Report is a key tool not

**Figure 1. Business Activities and Value Creation**

Source: *Fuji Xerox Sustainability Report 2014*, pp. 5–6.

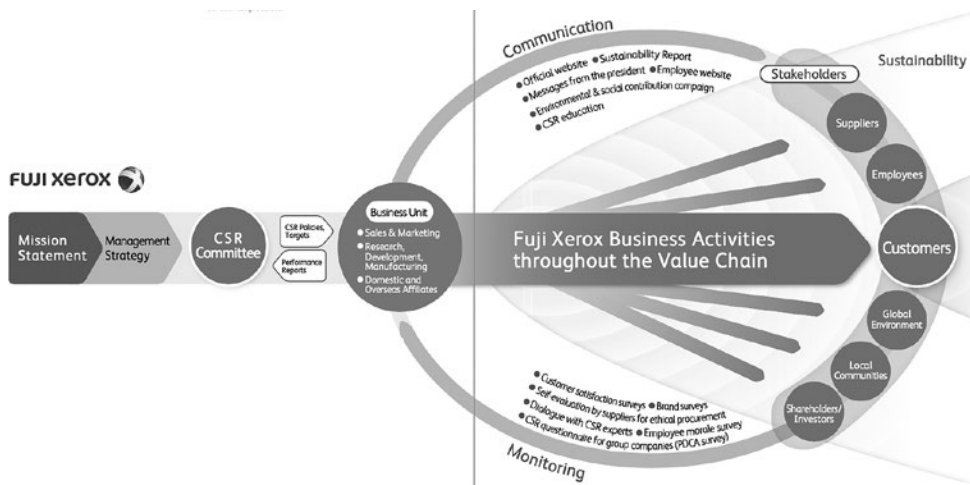
just for customers and prospective job applicants but also for current employees. The explanations of corporate policy and activities contained in the report can give employees a deeper awareness of society's concerns and help them come up with new ideas for their respective workplaces, thereby enabling them to provide higher value to stakeholders.

In the area of monitoring, Fuji Xerox is now taking steps to quantitatively measure the degree to which it is meeting the expectations and demands of stakeholders and also to reflect the results into management decisions in order to further develop its CSR management. The company regularly conducts customer satisfaction surveys, ethical procurement surveys targeting suppliers, dialogue between executives and outside CSR experts, employee satisfaction surveys, and CSR questionnaire surveys of group companies in Japan and overseas (Figure 2).

Communication and monitoring are extremely important in deepening the integration of business operations and CSR initiatives. The most difficult part of quantitatively measuring the degree to which the company is meeting society's expectations is developing quantitative indicators for those expectations. They need to be adjusted in response to changing social expectations and in keeping with the company's growth projections. The company needs to constantly scrutinize its relationship with various stakeholders, and it must adopt a long-term perspective.

Fuji Xerox calls these quantitative indices "CSR indicators." The targets are set

**Figure 2. Communication and Monitoring for CSR Management**



Source: Sustainability Report 2014, pp. 11–12.

by the company’s CSR Committee,<sup>3</sup> progress toward them is reviewed by top management twice a year, and adjustments are made as necessary based on the PDCA cycle. The principal indicators are presented in the Sustainability Report in tables showing the results for previous years and goals for the year ahead with respect to six categories of stakeholders: customers, employees, suppliers, the global environment, local communities, and shareholders/investors.

## Employees as Stakeholders

Let us look at the indicators for two of the six categories, namely, those relating to employees and to suppliers.

At Fuji Xerox, the stakeholder initiatives with the longest history are those targeting employees. The 2014 Sustainability Report presents six indicators for employees:

1. “Core Morale” as an indicator of employee satisfaction
  - Average score (using a five-point scale) of the five key “Core Morale” compo-

<sup>3</sup> Fuji Xerox established the CSR Committee in April 2010 as part of its effort to fully integrate CSR into its business operations. This is one of several function-based committees under the board of directors and the corporate executive committee that serve as decision-making bodies for management in particular areas.

## CSR WHITE PAPER

nents<sup>4</sup> of the employee satisfaction survey conducted at Fuji Xerox and its affiliates and sales companies in Japan.

2. Share of companies with improved employee satisfaction scores

- Percentage of Fuji Xerox group companies with a higher overall employee satisfaction score than in the previous fiscal year.

3. Percentage of women in executive and managerial positions

- Percentage of executive and managerial positions occupied by women at Fuji Xerox group companies.

4. Percentage of companies clearing the legally stipulated rate of employment of people with disabilities

- Percentage of Fuji Xerox group companies in Japan whose rate of employment of people with disabilities is 2.0% or above, as stipulated by the Act on Employment Promotion etc. of Persons with Disabilities.

5. Annual work hours per employee

- Average annual work hours per employee (excluding managerial staff) at Fuji Xerox group companies, disaggregated by job category.

6. Number of workplace accidents per 1,000 employees

- Frequency of work- or commuting-related accidents at each company, converted into a ratio of accidents per 1,000 employees.

The scores for past fiscal years (April to March) and the goals for the year ahead are as indicated in Figure 3.

The company does not set targets for the “Core Morale” indicator given the dangers that such goals can turn the “means” of ensuring worker satisfaction into an end in itself; it simply presents the data collected. For the other indicators, targets have been set by considering not just what would be ideal but also what would be even more ambitious in the light of actual improvements made to date.

The indicators have also evolved over the years, and Figure 4 shows how the list has changed since 2009. Until 2012, for example, the CSR indicators looked at the percentage of group companies conducting employee satisfaction surveys; since

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<sup>4</sup> Work satisfaction, workplace satisfaction, satisfaction with superiors, satisfaction with personnel management, and satisfaction with organizational management.

Figure 3. Employee-Related CSR Indicators

**“Core Morale” score as employee satisfaction indicator**

**Definition** Average score (using a five-point scale) on the five key “Core Morale” components<sup>\*1</sup> of the morale survey of employees conducted at Fuji Xerox and our affiliates and sales companies in Japan.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 performance	Fiscal 2014 goal
Fuji Xerox (unconsolidated)	3.29	3.37	3.36	—
Affiliates in Japan (excluding sales companies)	3.15	3.16	3.23	—
Sales companies in Japan	3.56	3.59	3.47	—

**Notes on fiscal 2013 performance** Fiscal 2013 produced no significant change in Core Morale scores at Fuji Xerox (unconsolidated) and our affiliates and sales companies in Japan.

**Goals/ challenges** Fuji Xerox and our affiliates will continue working to improve our Core Morale scores by using the results of morale surveys to identify specific issues and applying the PDCA cycle for continuous improvement.

<sup>\*1</sup> The five components of Core Morale are work satisfaction, workplace satisfaction, satisfaction with superiors, satisfaction with personnel management, and satisfaction with organizational management.

**Ratio of companies achieving improvement in employee satisfaction score**

**Definition** Percentage of companies among Fuji Xerox and our affiliates that achieved a higher overall employee satisfaction score on their employee satisfaction surveys than in the previous fiscal year.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
Fuji Xerox and affiliates	—	60.0%	90% + / 27.4%	Increase in rate of positive responses to Core Morale questions (5%) <sup>*2</sup>

**Notes on fiscal 2013 performance** Fuji Xerox has been carrying out an ongoing corporate climate reform campaign aimed at boosting employee satisfaction while achieving sustainable growth. In fiscal 2013, we worked at fostering dialogue and discussion in all our workplaces in response to the results of the 2012 morale survey, but the improvement in scores was marginal.

**Goals/ challenges** While continuing to foster discussion and dialogue in all our workplaces, we will strive to enhance employee satisfaction at Fuji Xerox (unconsolidated) by promoting adoption of new work styles. To this end, our business division heads will hold workshops to foster better understanding of the benefits of the new work styles. Meanwhile, we will continue our efforts to standardize the structure and core content of morale surveys among all group companies, including our overseas affiliates.

<sup>\*2</sup> Beginning in fiscal 2014, the performance indicator for employee satisfaction improvement will be “increase in rate of positive responses to Core Morale questions.”

**Percentage of women in executive and managerial positions**

GRI LA12 GC Principle 6

**Definition** Percentage of executive and managerial positions occupied by women at Fuji Xerox and our affiliates. “Managerial positions” here includes all positions categorized as management under the company’s personnel system, regardless of whether they involve supervision of other employees.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 performance	Fiscal 2014 goal
Fuji Xerox (unconsolidated)	3.3% <sup>*1</sup>	4.1% <sup>*1</sup>	4.9% <sup>*1</sup>	5.5%
Affiliates in Japan	1.9%	2.7%	2.8%	—
Overseas affiliates	25.5%	28.1%	29.2%	—

**Notes on fiscal 2013 performance** Fuji Xerox has been working to promote the appointment of women to managerial positions at all our companies. At Fuji Xerox (unconsolidated), we have taken active steps to reach an ambitious numerical target, and although we fell short of our annual goal of 5.2% in fiscal 2013, we were able to increase the share by 0.8 points, to 4.9%. The percentage of women in managerial positions also continued to grow among our affiliates in Japan and overseas.

**Goals/ challenges** We will continue to encourage the promotion of women employees at Fuji Xerox and all our affiliates. At Fuji Xerox (unconsolidated), we will redouble our efforts to support workplace diversity by evaluating and promoting employees fairly, emphasizing individual performance, competence, and motivation, with the aim of boosting the ratio of managerial positions held by women to 7% by fiscal 2015.

<sup>\*1</sup> At Fuji Xerox (unconsolidated), the basis for calculation was changed from “staff with direct employment agreements” to “employees actually in the office.”

**Percentage of companies attaining the legally stipulated rate of employment of people with disabilities**

GRI LA12 GC Principle 6

**Definition** Percentage of companies among Fuji Xerox and our affiliates in Japan that have attained a 2.0% rate of employment of people with disabilities, as stipulated under the Act on Employment Promotion etc. of Persons with Disabilities.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
Fuji Xerox (unconsolidated)	100% (employment rate: 2.19%)	100% (employment rate: 2.08%)	100% / 100% (employment rate: 2.07%)	100%
Affiliates in Japan (excluding sales companies)	29% (2 of 7 companies)	75% (6 of 8 companies)	100% / 88% (7 of 8 companies)	100%
Sales companies in Japan	62% (21 of 34 companies)	74% (23 of 31 companies)	100% / 81% (25 of 31 companies)	100%

**Notes on fiscal 2013 performance** In fiscal 2013, we launched an aggressive hiring program aimed at achieving Japan’s legally stipulated 2% rate of employment of people with disabilities at Fuji Xerox and all our affiliates in Japan. As a result, the number of affiliates and sales companies in Japan surpassing the 2% target rose to 32, out of a total of 39 companies.

**Goals/ challenges** Going forward, we intend to explore best practices with regard to the development of jobs and adaptation of work processes to diverse abilities and attitudes and look more closely at appropriate hiring processes in order to promote employment of people with disabilities at Fuji Xerox and all our affiliates in Japan.

## CSR WHITE PAPER

### Annual work hours per employee

GRI LA6 GC Principle 1

Definition Average annual work hours per employee at Fuji Xerox and our affiliates (excluding managerial staff), disaggregated by job category.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 performance	Fiscal 2014 goal
Fuji Xerox (unconsolidated)	1,985 hours <sup>a4</sup>	2,008 hours <sup>a4</sup>	1,947 hours	1,835 hours
Affiliates in Japan (sales personnel, office staff, etc.)	2,030 hours	2,018 hours	1,986 hours	—
Affiliates in Japan (manufacturing staff)	2,093 hours	2,029 hours	2,025 hours	—
Overseas affiliates (sales personnel, office staff, etc.) <sup>a5</sup>	2,063 hours <sup>a6</sup>	2,010 hours <sup>a6</sup>	2,011 hours	—
Overseas affiliates (manufacturing staff)	2,315 hours	2,219 hours	2,274 hours	—

Notes on fiscal 2013 performance While falling short of our fiscal 2013 goal of 1,896 annual working hours, Fuji Xerox (unconsolidated) made further progress in reducing hours thanks to concerted efforts by management and employees to reform business processes and work-hour regulations with an eye to achieving a robust organization, good health, work-life balance, and workforce diversity. At our affiliates and sales companies in Japan and overseas, we stepped up efforts to educate management regarding the need to monitor working hours and rethink business processes on a daily basis in close communication with employees.

Goals/challenges We will work to further reduce working hours by redoubling our efforts to foster new attitudes within management, continuing our review and reform of business processes and work-hour regulations, and promoting the adoption of new work styles.

<sup>a4</sup> At Fuji Xerox (unconsolidated), the basis for calculation was changed from "staff with direct employment agreements" to "staff with direct employment agreements who were not seconded during the period."

<sup>a5</sup> Excludes companies that have adopted the discretionary working system.

<sup>a6</sup> Figures are recalculated, excluding companies that have adopted the discretionary working system.

### Number of workplace accidents per 1,000 employees

GRI LA6 GC Principle 1

Definition Frequency of work- or commuting-related accidents per company, calculated on the basis of the assumption that each company employs 1,000 employees.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 performance	Fiscal 2014 goal
Fuji Xerox (unconsolidated)	4.86 <sup>a7</sup> (5.00) <sup>a8</sup>	2.57 <sup>a7</sup> (2.29) <sup>a8</sup>	2.49 <sup>a7</sup> (2.65) <sup>a8</sup>	0 <sup>a7</sup> (0) <sup>a8</sup>
Affiliates in Japan (excluding sales companies)	1.74	4.31	4.75	0
Sales companies in Japan	5.17	5.27	5.74	0
Overseas affiliates (excluding sales companies)	1.69	2.19	4.18	0
Overseas sales companies	7.21	3.69	5.89	0

Notes on fiscal 2013 performance At Fuji Xerox (unconsolidated, excluding dispatched employees), the number of workplace accidents per 1,000 employees rose by 0.36 year on year to 2.65. As in the previous fiscal year, many of these accidents occurred while employees were in transit, whether commuting, traveling, or out on business. There was also an increase in the rate of workplace accidents among our overseas affiliates and sales companies.

Goals/challenges We will work through the occupational health and safety committee at each business site to bolster programs for raising awareness of the prevention accidents, "near misses," and other hazards with a view to preventing workplace accidents, particularly in our overseas operations.

<sup>a7</sup> Includes dispatched employees.

<sup>a8</sup> Excludes dispatched employees.

Source: Sustainability Report 2014, pp. 44–46.

2013 they have measured the ratio of companies that have improved their employee satisfaction scores. The company has developed its CSR indicators in response both to changes in stakeholder perspectives and to advances in its own capabilities.

It is interesting to note the presence of an indicator that was used a single year and then eliminated, suggesting how difficult it can be to find ways to quantify real conditions. An indicator provides just one perspective and cannot express an entire spectrum of settings. Taking this into account, Fuji Xerox constantly seeks to optimize its CSR indicators in keeping with changes in society and advances in its own capabilities.

These indicators represent key targets for the management and operation departments responsible for each type of stakeholder. The role of the CSR department

**Figure 4. Changes in the Set of Employee-Related Indicators (Disclosed) by Year**

FY 2009	2010	2011	2012	2013	2014
				Ratio of companies achieving improvement in employee satisfaction score	→
				“Core Morale” score as employee satisfaction indicator	→
Ratio of direct employment to total employment	→	→	→		
Percentage of companies conducting employee satisfaction surveys	→	→	→		
Percentage of women in executive and managerial positions	→	→	→	→	→
Percentage of companies attaining the legally stipulated rate of employment of people with disabilities	→	→	→	→	→
Annual work hours per employee	→	→	→	→	→
Number of workplace accidents per 1,000 employees	→	→	→	→	→
Number of employees per industrial physician / occupational health professional	→	→	→		
Changes in employee numbers by country/region					

Source: Compiled by the Tokyo Foundation from Fuji Xerox Sustainability Reports.

is to provide opportunities for other divisions to directly perceive society’s changing needs, such as through stakeholder dialogue, and to support their setting of goals. Needless to say, the underlying intent is for each department to deepen its own awareness of society’s needs and to come up with its respective ideas, implement innovations, and provide greater value to stakeholders.

### Building a Distinct Corporate Culture

“Core Morale” has a history dating back to 1978, when the company implemented an employee satisfaction survey, and was updated with the announcement of the “New Work Way” in 1988. Yotaro Kobayashi, who had become company president by that time, presents his ideas in a number of publications.<sup>5</sup>

<sup>5</sup> Works referred include the transcript of a presentation titled “Kore kara no kigyo keiei” (The Future of Corporate Management) by Yotaro Kobayashi and Akira Miyahara and the



Fuji Xerox was established in 1962 as a joint venture between Rank Xerox Ltd. (whose name was changed to Xerox Ltd. on October 31, 1997) and Fuji Photo Film Co. It was originally charged with disseminating and selling<sup>6</sup> US-made Xerox products, but in 1971 it added a manufacturing function aimed at making products matching the conditions in the Japanese market, which differed from those in the US and European markets. Iwatsuki Photo Optical Works Co., an affiliate of Fuji Photo Optical, was transferred to Fuji Xerox as the Iwatsuki Plant. Different corporate cultures were brought together in the new company. In order to create a distinct culture for Fuji Xerox as a manufacturing and sales company and to compete with rivals on the quality front, in 1976 the company embraced the concept of “total quality control.”

Fundamentally, TQC is a process of solving problems using scientific management methods based on the implementation of the PDCA cycle. In addressing a problem, the cycle begins with a “why.” To answer the question, managers “plan” a set of measures to resolve it, “do” the implementation of those measures, “check” the results, and “act” on ways to improve remaining issues. To get to the root of a problem, the cycle needs to be implemented five times, starting with a new “why” each time, until the true, underlying cause is found.

TQC was intended to create a universal language for the new manufacturing-and-sales company—as a distinct entity from the companies that created it—and thereby to change how individual employees work, how they function as a team, and how the company operates.

In 1978 Fuji Xerox marketed the FX 3500, a medium-speed copier to compete against the improved products of its rivals. Thanks to TQC, the company succeeded in shortening its four-year lead time to two years. And in 1980 Fuji Xerox won the Deming Prize, representing the pinnacle of TQC achievement. According to Kobayashi, the company intended to seek the Japan Quality Medal (now the Deming Grand Prize), awarded to companies that have implemented TQC for five years or more<sup>7</sup> after winning the Deming Prize and achieved substantial improvements in their quality management. But, as Kobayashi recalls, TQC had unexpected side effects.

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article “‘Jibun ni shojiki de are’: Seizensetsu no keiei, Kobayashi Yotaro no 50 nen” (“Be Honest to Yourself”: Yotaro Kobayashi’s 50 Years of Good-by-Nature-Theory Management), *Purejidento (President)*, May 14, 2012.

<sup>6</sup> Strictly speaking, the joint venture was disseminating Xerox products through rentals. This method, which facilitated the use of costly copying machines for customers, had been adopted and found successful by all the Xerox group companies around the world.

<sup>7</sup> Changed to “three years or more” in 2000.

Implementing the PDCA cycle five times was the standard approach to TQC, but Kobayashi reports that people began making excuses—putting off the effort to find the underlying causes because there was no time for a five-cycle run. The “five times” rule had taken on a life of its own and was discouraging attempts to find answers. TQC failed to produce significant results for some time thereafter, and Fuji Xerox stagnated.

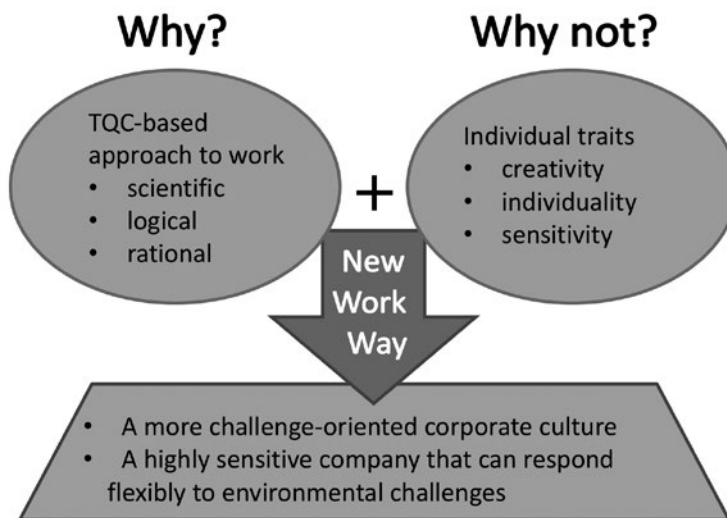
Kobayashi’s response was to introduce the New Work Way. While TQC focused on “why,” the New Work Way asked “why not”—an incitement, in other words, to at least make an attempt to change the status quo. The importance of “why” continued to be recognized, but with the New Work Way, Fuji Xerox sought to create a corporate culture and work style that would focus on both the search for deeper, root causes and a commitment to action (Figure 5).

Under the New Work Way, Fuji Xerox experimented with new job arrangements, such as working at satellite offices and at home. It also took the lead over other companies in introducing programs for childcare leave (adopted in 1988, Figure 6) and nursing care leave (adopted in 1990).

Underlying Fuji Xerox’s efforts to fully draw out its employees’ potential and allow them to achieve growth is its adherence to the “Good Company Concept.”

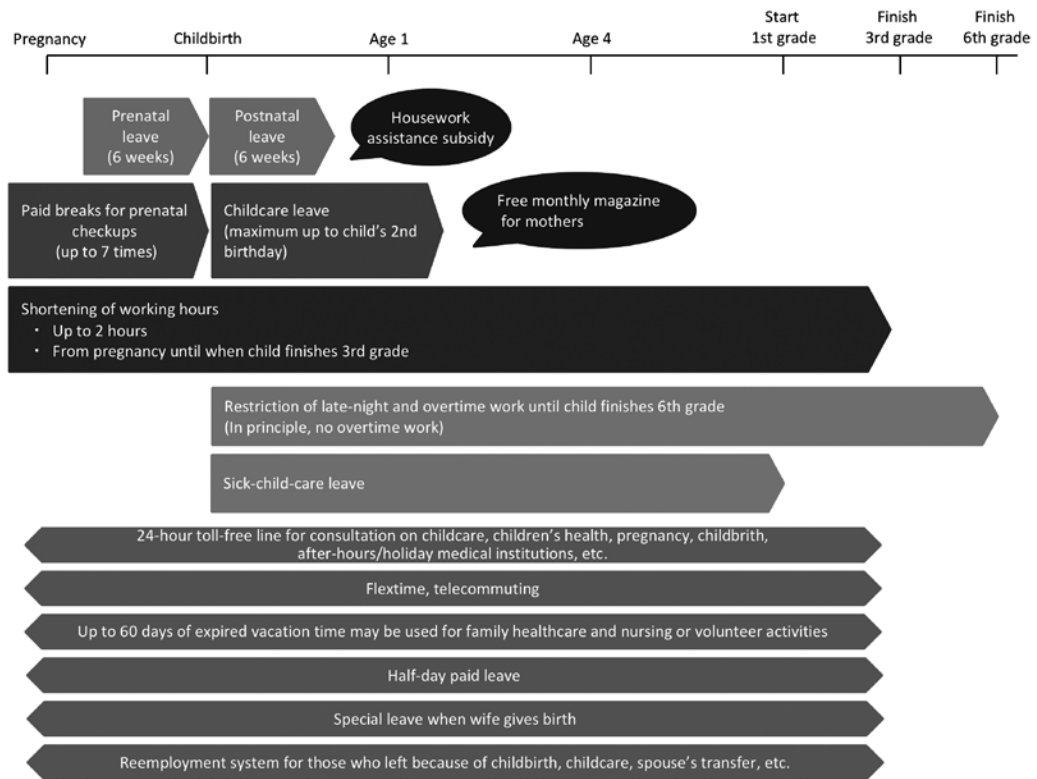
For Fuji Xerox, a “good company” has three attributes (Figure 7): It is a “strong” company able to satisfy customers and shareholders by developing and

**Figure 5. The Basic Approach of the “New Work Way”**



*Source: Compiled by the Tokyo Foundation based on Kobayashi and Miyahara, “Kore kara no kigyo keiei.”*

**Figure 6. Childcare Leave Arrangements at Fuji Xerox**



*Source: Compiled by the Tokyo Foundation on the basis of information from Fuji Xerox's website and interviews with company representatives.*

**Figure 7. Fuji Xerox's "Good Company" Concept (announced in 1992)**



*Source: Compiled by the Tokyo Foundation on the basis of information from Fuji Xerox's website and interviews with company representatives.*

marketing outstanding products and maintaining competitiveness. It is “kind” to the environment and to local and global communities. And it is an “interesting” company where employees find work fulfilling. These attributes may not seem unusual, but setting them forth in concrete terms is a form of communication with stakeholders and is an expression of the company’s ongoing efforts to monitor society’s expectations and to make ongoing improvements.

### **Engaging with Suppliers**

Let us now look at a second category of Fuji Xerox’s CSR indicators, namely, those relating to suppliers. This is an area in which the company has achieved rapid progress.

Many readers, seeing Fuji Xerox’s approach toward employees, may assume that CSR requires cumulative efforts over a long period as well as excellent management; this may discourage other companies from attempting to catch up. But Fuji Xerox’s initiatives toward suppliers began in 2007. Developing and deepening CSR does not necessarily require a long history; a glance at the steps taken by Fuji Xerox toward suppliers show how far a company can get in less than a decade through meticulous, honest effort. It can also reveal what the company is doing now to further develop its CSR.

The essence of Fuji Xerox’s engagement with suppliers is “ethical procurement”—presenting suppliers with procurement standards that include CSR-related elements and seeking their strict compliance with those standards.

When Fuji Xerox was contemplating moves toward ethical procurement, it faced three issues. One was a series of inquiries about such a program from US and European clients, who noted that this would be a factor in whether or not they continued to purchase from the company. The inquiries were forwarded to the CSR department, which pointed to the establishment of the Electronic Industry Code of Conduct by companies like Dell and IBM. This was a powerful impetus toward the adoption of ethical procurement.

A second issue was the European Union’s adoption of the Restriction of Hazardous Substances Directive, which came into effect in 2006. Coping with this directive was the top priority of Fuji Xerox’s procurement department at the time, and ethical procurement was widely viewed as a matter for future consideration.

The third was the rising demands on suppliers for quality, cost, and deadlines (QCD) in the face of intensifying market competition. Many of Fuji Xerox’s suppliers were small and midsize businesses that lacked the leeway to adequately meet new procurement standards, thus heightening QCD-related risks.

The ethical procurement project team, set up jointly by the procurement and CSR departments, thus faced a difficult set of questions: How should Fuji Xerox advance ethical procurement? How should it be positioned vis-à-vis QCD, which had a direct impact on the company's competitiveness? And in terms of priority, should it come before or after measures to cope with the RoHS Directive?

The project team ultimately decided that (1) ethical procurement is an inevitable trend, something that will eventually become a matter of course, and (2) rather than simply presenting suppliers with demands, the company should undertake ethical procurement in a manner that would be beneficial to suppliers as well.

The company sums up this thinking as follows: "At Fuji Xerox, . . . we share goals and develop shared values with suppliers by deepening mutual understanding. We call this approach 'supplier engagement.' When the action plan was proposed in 2007, President Yamamoto (then executive vice-president) said that the basic approach must be to pursue win-win relations with suppliers and that implementation of the program must not be dictated by the convenience of Fuji Xerox. To achieve the required QCD, reliable supply, and flexible adjustment of manufacturing systems, it is absolutely essential that supplier capacity be raised and cooperative relations developed. There is no benefit for Fuji Xerox if we fail to develop shared values that strengthen both Fuji Xerox and its suppliers."<sup>8</sup> This philosophy continues to underlie the company's ethical procurement today.

This policy was turned into more concrete form through cooperation with suppliers. In June 2006 the ethical procurement project team held its first CSR study meeting with a group of Fuji Xerox's key transaction partners. The theme of the meeting was ethical procurement, and suppliers were asked how this could be implemented in a way that would be useful for them.

Toshiaki Ota, representative director of Kinjo Rubber Co., who participated in the meeting, commented: "This concept is something that is definitely necessary for our survival even if Fuji Xerox hadn't approached us. I appreciate the fact that Fuji Xerox gave us the opportunity to think about this together. We will need to make an all-out effort regarding quality, cost, and the CSR activities that we have learned here today. That is the type of business environment in which we find ourselves today. The managing member companies . . . [of this group] must take the initiative and expand these activities to include other member companies."<sup>9</sup> Needless to say, this strong endorsement helped convince Fuji Xerox to embrace ethical procurement.

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<sup>8</sup> Sustainability Report 2013, p. 17.

<sup>9</sup> Sustainability Report 2007, p. 18.

After a series of meetings, the group identified a number of common issues, such as production and shipment stoppages resulting from labor disputes at overseas sites. At the time, about 80% of Fuji Xerox's production was being carried out in China, and many of the group's managing member companies also had production plants in China. Steady progress was being made with respect to environmental issues there, but less visible was the situation regarding human rights and labor issues. To gain a clearer picture, the group held a meeting in Shenzhen, China, in November 2006.

In Shenzhen, members of Fuji Xerox's ethical procurement project team and representatives of the study group's managing member companies learned much at the Institute of Contemporary Observation, a nonprofit organization specializing in labor issues in China. They gained the shared perception that continuing with the current system of labor management would eventually make it impossible to hire talented workers and jeopardize the continuation of their operations. Instead of conducting simple yes/no checks, there was a need to adopt ethical procurement standards that would lead to concrete solutions, hedge against risks, and provide advice that would lead to direct improvements. Fuji Xerox became convinced that this sort of approach would result in ethical procurement matching the ideas of cooperating with suppliers and creating a program that would be useful for them—and that would also benefit Fuji Xerox's corporate character.

The project team made a list of the expectations of society's various stakeholders, taking note of such existing guidelines as the Electronic Industry Citizenship Coalition Code of Conduct, ISO 26000, and the UN Global Compact, as well as of the dialogue it had conducted up to that point:

- Items related to laws and regulations (highest priority): Areas in which noncompliance would likely threaten the company's business or survival or result in an order to suspend operations from regulators or government authorities
- Items related to laws and regulations (high priority): Areas in which noncompliance would likely result in strong warnings or notices from regulators or government authorities or social sanctions, such as consumer boycotts
- Items related to laws and regulations (medium importance): Areas in which noncompliance may result in warnings or notices from regulators or government authorities and pose the risk of damage or other impacts to company management, even if resolved
- Other items: Items not enshrined in laws or regulations but are required by society

Regarding "other items," Fuji Xerox drew up an ethical procurement checklist

with the idea of having suppliers provide information in advance concerning matters that may eventually require responses in the light of moves by nongovernmental and nonprofit organizations. This checklist, confirming compliance with the suppliers' code of conduct, included more than 300 items. In preparing and sharing this checklist, Fuji Xerox provided detailed background explanations of emerging CSR-related social issues, since the aim was not just to have suppliers submit reports but to have them fully understand the significance of each item and to take the appropriate next steps based on this understanding. There was no point in collecting a set of documents that were signed by suppliers without their full understanding of the contents. The checklist, after all, was a tool to encourage further action, bring mutual benefits to Fuji Xerox and its suppliers, and to enhance competitiveness while fulfilling social responsibilities.

In addition to monitoring suppliers based on the checklist, Fuji Xerox sent teams of experts for on-site checks to suppliers that seemed to have major issues or presented possible future risks. These teams consisted of members of the procurement, personnel, environmental, general affairs, legal, and CSR departments who had not only practical experience in various positions but also expertise in their respective fields of responsibility. At the outset of each visit, the procurement department representative explained that the on-site check was being implemented for the benefit of the supplier itself. The team requested that the supplier's top executives, such as the president and executive vice-president, participate in the process. The team members visited offices, plants, and even dormitories to see and learn about the situation for themselves—rather than simply relying on the supplier's self-assessed checklist. Sometimes the members looked at areas like the management of factory personnel and the safety of dormitories. While the process was called on-site checking, the team's real mission was to enable suppliers to address their own problems. Inspections by other companies might end with a check for regulatory violations and the conveying of the findings. But Fuji Xerox inspectors did not stop there. They had their own experience and knowledge to draw on with respect to issues like relations with local government officials and workers, and they were able to offer practical advice about possible solutions, sharing stories about how they overcame similar problems in their own work.

To repeat, the purpose of Fuji Xerox's ethical procurement program was not to inspect or monitor; even if a supplier fell short in some respects, a path was offered for continued relations if it had the will to implement improvements. And if it did, the company would work with the supplier to achieve a win-win outcome. This approach, originally launched jointly by the CSR and procurement departments, has become standard practice in the procurement department. Many in the depart-

ment have gained a deeper appreciation of the essence of CSR, namely, that ethical procurement and QCD—which were previously seen as separate entities—actually have the same objective. “When we visit suppliers,” explains a member of Fuji Xerox China’s procurement department, “the executives listen closely to what we say. Our job is to secure a steady flow of high-quality products from them. And for this, we need to understand the supplier’s management philosophy as well.”

Such heightened awareness comes from the same source that produced the checklists on which Fuji Xerox’s quantitative CSR indicators are based and that continues to drive the company’s determination to further develop and deepen its CSR initiatives. Such resolve becomes meaningful when it is embraced not just by specific, CSR-related departments but in the day-to-day operations of workplaces throughout the company.

In concluding this section, let us look at Fuji Xerox’s CSR indicators relating to suppliers, as presented in its 2014 Sustainability Report (Figure 8).

**Figure 8. Supplier-Related CSR Indicators**

**Ratio of production materials suppliers with compliance rate of 90% or higher on “very important” items and “important” items (among those completing Ethical Procurement Self-checklist)** GRI EN33, LA15, HR11, SO10 GC Principle 1-10

**Definition** Percentage of production materials suppliers completing the Ethical Procurement Self-Checklist that achieved a compliance rate of 90% or higher on “important” and “very important” items.<sup>\*\*</sup>

Companies	Items	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
Suppliers in Japan and overseas	Very important items	95.6%	93.8%	100% / 90.4%	100%
	Important items	83.1%	81.9%	100% / 72.8%	100%

**Notes on fiscal 2013 performance** The overall level of compliance decreased in fiscal 2013 owing in part to the expansion of procurement contracts to new suppliers, notwithstanding ongoing support for improvement in areas of noncompliance, on-site checks of selected suppliers by our expert teams, and stepped up efforts to educate management.

**Goals/ challenges** We will redouble our efforts to ensure supplier compliance primarily by providing management with continued reminders of the importance of socially responsible operations and by adding opportunities for on-site checks by our expert teams, focusing on suppliers with less than 90% compliance on very important items.

<sup>\*\*</sup> Existing suppliers include companies that achieved a compliance rate of 90% or higher by devising and implementing improvement plans for the items of noncompliance in the previous year (i.e., not for all important or very important items).

**Ratio of logistics partners with compliance rate of 90% or higher on “very important” items (among those completing Ethical Procurement Self-checklist)** GRI EN33, LA15, HR11, SO10 GC Principle 1-10

**Definition** Percentage of first-tier logistics partners and sites in Japan completing the Ethical Procurement Self-checklist that achieved a compliance rate of 90% or higher on “very important” items.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
First-tier logistics partners and sites in Japan	98.4% <sup>*10</sup>	100%	100% / 100%	100%

**Notes on fiscal 2013 performance** Continuing our domestic ethical procurement initiatives in fiscal 2013, we again achieved our goal, with 100% of our surveyed Japanese logistics partners reporting 90% or higher compliance on the checklist’s 100 “very important” items. We also carried out on-site checks to verify compliance.

**Goals/ challenges** While maintaining at least 90% compliance on the 100 “very important” checklist items by all our first-tier logistics partners, we plan to enlist the cooperation of these partners in extending compliance to second-tier partners. We will also work to increase the percentage of companies achieving 90% or better compliance among our overseas logistics partners while preparing to expand the scope of ethical procurement to companies that are not our direct partners.

<sup>\*10</sup> In Sustainability Report 2012, this was mistakenly reported as 98.5%.



## CSR WHITE PAPER

### Ratio of suppliers worldwide in full compliance with requirements of Fuji Xerox for paper procurement

GRI EN33, LA15, HR11, SO10 GC Principle 1-10

Definition Percentage of suppliers determined to be in full compliance with Environmental, Health and Safety Requirements for Fuji Xerox for Paper Procurement.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
All companies supplying paper to Fuji Xerox and our affiliates in Japan and overseas	—	100 %	100 % / 100 %	100 %

Notes on fiscal 2013 performance At Fuji Xerox, we are calling on our paper suppliers to conduct their operations in accordance with the standards for social responsibility outlined in our Environmental, Health and Safety Requirements for Paper Procurement, revised in 2012. Since 2012, our managers in charge of paper purchasing and sales in Japan and overseas have been meeting regularly to review and confirm compliance with these requirements. In fiscal 2013, our paper suppliers confirmed 100 % compliance.

Goals/challenges We will continue to monitor suppliers' compliance with our requirements for paper procurement as part of our commitment to sustainable paper sourcing.

### Ratio of suppliers submitting conflict minerals report

GRI HR11 GC Principle 1-6

Definition Percentage of suppliers subject to conflict minerals reporting that completed and returned the Electronics Industry Citizenship Coalition and Global e-Sustainability Initiative (EICC/GeSI) conflict minerals reporting template.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 goal / performance	Fiscal 2014 goal
Suppliers of components of key Fuji Xerox products		Fiscal 2013 was the first year of conflict minerals initiative of Fuji Xerox	70 % / 87.5 %	90 %

Notes on fiscal 2013 performance In fiscal 2013, the first year of our conflict minerals initiative, we held briefing sessions for our suppliers in each of our major supplier countries (Japan, China, South Korea, and Vietnam) and focused on building understanding of the reasons for this initiative and the content of the reporting template. We also set up a Conflict Minerals Staff Coordinating Committee as part of our effort to strengthen our internal apparatus for addressing the issue. As a result, the percentage of companies submitting reports substantially exceeded our goal.

Goals/challenges We will work to further increase the percentage of suppliers submitting conflict minerals reports and step up efforts, in cooperation with our suppliers, to gather more accurate information on mineral smelters, the central purpose of the reporting initiative.

### Local content ratio for raw materials and parts at overseas production sites (China)

GRI EC9

Definition Percentage of raw materials and parts procured by Fuji Xerox of Shenzhen, Ltd. and Fuji Xerox of Shanghai, Ltd. that are purchased from companies within China, by transaction value.

Companies	Fiscal 2011 performance	Fiscal 2012 performance	Fiscal 2013 performance	Fiscal 2014 goal
Fuji Xerox of Shenzhen, Fuji Xerox of Shanghai	60.3 %	60.6 %	65.7 %	Maintain a consistent level of local procurement

Notes on fiscal 2013 performance Exchange rates fluctuation played a major role in boosting the local content ratio at our production sites in China to 65.7 %. When excluding exchange-rate effects, the ratio rose slightly to 61.4 %, as we maintained our adherence to responsible procurement practices.

Goals/challenges We will continue to emphasize local content as we pursue responsible procurement and production aimed at maximizing our contribution to the development of the local economies where we operate.

Source: Sustainability Report 2014, pp. 46–47.

Above we looked at the evolution of Fuji Xerox's ethical procurement. The company now uses five indicators, arranged by value chain and social issues: production materials, logistics, paper supplies, conflict minerals, and local content.

As the company's initiatives advanced, the indicators themselves have undergone renewal, as indicated by the changes in the set of indicators over the years (Figure 9). What began with a self-assessment checklist and the rate of response later led to a closer examination of the checklist's content, as demonstrated by the addition in 2014 of an indicator for conflict minerals.

## Diligent, Cumulative Effort

One difference between the sustainability reports of Fuji Xerox and other compa-

**Figure 9. Changes in the Set of Supplier-Related Indicators (Disclosed) by Year**

2009	2010	2011	2012	2013	2014
Rate of Supplier Response to Production Materials Ethical Procurement Self-Checklist	→	→	→		
Ratio of production materials suppliers with compliance rate of 90% or higher on "important" items (among those completing Ethical Procurement Self-checklist)	→	Ratio of production materials suppliers with compliance rate of 90% or higher on "very important" items and "important" items (among those completing Ethical Procurement Self-checklist)	→	→	→
		Rate of Response by Logistics Partners to Ethical Procurement Self-Checklist	→		
		Ratio of logistics partners with compliance rate of 90% or higher on "very important" items (among those completing Ethical Procurement Self-checklist)	→	→	→
					Ratio of suppliers worldwide in full compliance with requirements of Fuji Xerox for paper procurement
					Ratio of suppliers submitting conflict minerals report
Local content ratio for raw materials and parts at overseas production sites (China)	→	→	→	→	→

Source: Compiled by the Tokyo Foundation from Fuji Xerox Sustainability Reports.

nies is that Fuji Xerox clearly presents the course of its progress and its current position in each area of CSR (Figure 10).

The timeframes for the various CSR initiatives differ, with some starting back in the 1970s and others beginning less than 10 years ago. But progress can be seen in all fields. Fuji Xerox indicates where it stands now based on a record of their concrete accomplishments and in the context of major social trends.

The same is true of the CSR indicators described above. They have been carefully developed to express as accurately as possible the actual state of key management concerns at Fuji Xerox. Only through such diligent, cumulative effort has it been possible to quantify the progress being made in each area.

Some have attributed Fuji Xerox's CSR accomplishments to the company's prescient executive leadership or the liberal corporate culture of foreign-owned companies. Readers of this report will no doubt realize that this is an oversimplification. In fact, people who voice these mistaken views about the source of Fuji Xerox's success often use them as excuses for their own companies' lack of similar progress, pointing their finger at structural factors rather than at their own lack of effort.

An outstanding chief executive may indeed be important. But having a charismatic leader alone is not enough to push CSR forward, let alone to turn CSR into

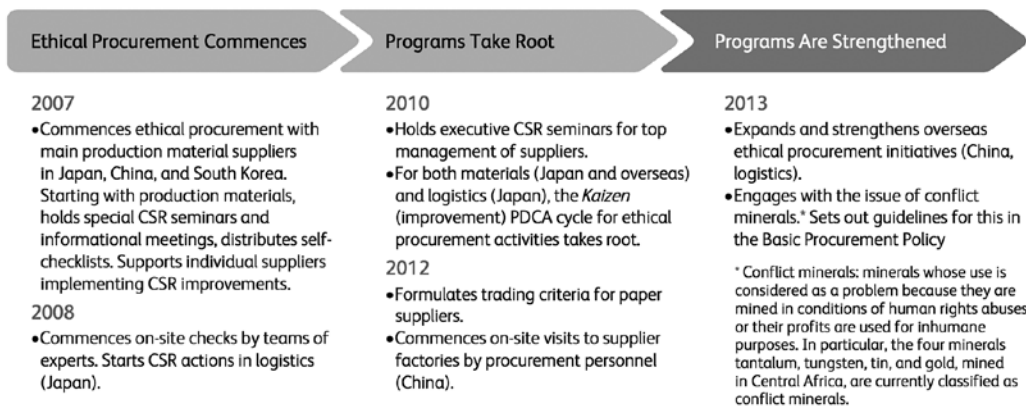
**Figure 10. Progress of CSR at Fuji Xerox**  
*Engagement with Global Environment*



*Engagement with Employees*



*Engagement with Suppliers*



To promote ethical procurement, we provide support for highly satisfactory and effective improvements by our suppliers by such means as holding informational meetings and executive seminars, providing management guidelines and CSR self-checklists, and conducting on-site checks.

## Engagement with Local Communities



Source: Sustainability Report 2014, pp. 31, 35, 37, 39.

the guiding principle of corporate management, business operations, and individual projects.

At Fuji Xerox, everyone from the chief executive to the rank and file has an accurate grasp of CSR. They are able to articulate how CSR is an integral component of their business. CSR has meaning only if a company's *raison d'être* and the value it creates are recognized by society. Just as society constantly undergoes change, the company, too, must be flexible enough to adapt to those changes. These concepts are fundamental to CSR, and it would appear that Fuji Xerox employees have a deep understanding of them.

They also understand that CSR is just not a matter of definitions, principles, or management philosophies; more important is implementation, putting the ideals into practice in their respective workplaces. This is a mutually reinforcing process wherein individual CSR initiatives can grow and evolve together with the company's business operations, as well as further deepen employees' awareness of CSR.

CSR at Fuji Xerox is being advanced through such diligent efforts by individual employees to integrate the ideals of CSR into everyday business operations.

**APPENDIX**

Excerpts from President Tadahito Yamamoto's "Top Commitment" Message  
(Fuji Xerox Sustainability Report 2014)

*1. CSR: Synonymous with Corporate Management*

Fuji Xerox is acting swiftly to globalize all its activities, including development, manufacturing, and sales, with the aim of achieving sustained growth. While global business development presents many new opportunities, it also comes with various risks. Differences in commercial practices as well as labor laws and practices and interactions with overseas suppliers can at times lead to unintended involvement in environmental destruction and human rights violations. With the development of information and communication technologies (ICT), the expansion of socially responsible investment (SRI) funds, and the integration of environmental, social, governance (ESG) issues into investment, both society and investors are more rigorously monitoring the activities of businesses. Companies are now expected to recognize that they are accountable for their entire value chain, including all upstream and downstream activities, and to pay careful attention to environmental and social factors in their operations.

At Fuji Xerox, we find our calling in document services and communications. Our primary objectives are to assist customers in creating value and to contribute to the progress of society by providing an environment for valuable communications. Our Mission Statement commits us to "Build an environment for the creation and effective utilization of knowledge," "Contribute to the advancement of the global community by continuously fostering mutual trust and enriching diverse cultures," and "Achieve growth and fulfillment in both our professional and personal lives." These three points are our CSR objectives. For Fuji Xerox, CSR is synonymous with corporate management and cannot be separated from our business pursuits. For us, CSR starts with insightful observation of social issues and extends to thoughtful reflection on how to deliver value to customers, how our actions impact stakeholders, and how to realize the vision of Fuji Xerox including our organizational culture.

Providing customers with outstanding products and services is an essen-

tial requirement for any business. No less important is the question of how to accomplish this. “Transforming business processes while making a firm commitment to stakeholders to uphold values that the company believes to be right” and implementing the necessary activities through “unity of words and deeds” (*genko-itchi* in Japanese) pose an enormous challenge, particularly in light of the broad range of issues related to quality and cost competitiveness. Regardless of the difficulty of this challenge, we at Fuji Xerox understand this to be an indispensable part of becoming an Excellent Company that is truly cherished by its customers.

## *2. Integrating CSR with Our Core Business*

I believe that significant changes have to be made to establish CSR as an integral part of corporate culture at Fuji Xerox. All business processes and work styles at the front lines of our business must be transformed with an eye to CSR values, and we must create an environment in which all corporate activities are assessed and executed from the perspective of whether or not they contribute to delivering value to stakeholders. . . .

Goals established by management are embedded in frontline plans for product development, procurement, manufacturing, sales, and other activities. As I have been emphasizing, it is critically important to clarify the link between CSR and the mission and objectives of each organization and to achieve a full integration between CSR and our core business. By helping us obtain new technologies, develop attractive products and services, and strengthen cost competitiveness, I believe the integration of CSR and our core business activities is key to creating a new awareness within the company as we pursue our principal business and to changing work processes. My ultimate objective is to create a situation in which each employee realizes the social significance of the work that he or she is performing and CSR management evolves in a natural and self-sustaining way.

July 6, 2016

## Rebuilding CSR around Human Resources: Fancl Corp.

Zentaro Kamei

Curious to know what kind of things Fancl Corp. does in the way of CSR, I had a look at the website of the cosmetics company. There was a page labeled “CSR Topics,” but the content there was not particularly informative. Just looking at this page was not going to tell me what I wanted to know. So I opened Fancl’s monthly CSR activities report. And there I was surprised to find a remarkable range of initiatives being undertaken by this manufacturer of safe, additive-free cosmetics and health products.

### Broad Array of CSR Activities

The report for February 2015, for example, begins with a report on the 2015 Low-Carbon Cup held at Tokyo Big Sight. The company was chosen as one of 39 finalists from 1,730 applicant organizations (including companies, schools, NPOs, and other groups), and after a final presentation won the Alterna Best Story Award. The company received the prize for its home-and-office environmental program that purported to be “friendly to employees and tough on executives.”

The next article is another report: this one on the company winning the Social Inclusion Prize at the twelfth Corporate Philanthropy Awards. The award was in recognition of Fancl Smile, a special subsidiary company set up to promote the employment of people with disabilities.

There is also a story about monthly Fancl Seminars, which are led by employees who volunteer their time to teach students at schools and vocational facilities for people with disabilities on grooming, personal hygiene, and health. In February 2015 alone, 19 seminars were held involving 69 employees and 574 participants. The report includes comments from participants and staff at the various schools and institutions where the seminars were conducted.

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*Zentaro Kamei      Research Fellow and Project Manager, Tokyo Foundation.*

The CSR activities report concludes with an update on the “We Can Achieve More” Fund—named after the company’s slogan—established with donations from employees. The article reports that assistance from the Fund was conferred to a nongovernmental, nonprofit group called Action against Child Exploitation (on February 20) and the Kanagawa Aerobic Federation (on February 27).

The February issue was not particularly special. Even when no special events are held, the monthly newsletter offers details on Fancl Seminars and other initiatives. Month after month, it contains the same quantity and quality of information on a broad array of activities.

### **Change of Direction**

What can we read into the overwhelming volume of Fancl’s CSR initiatives? A quick glance at the activities involving the company and its employees on a daily basis is not enough to reveal the coherent relationship linking them together. How does the company seek to integrate its business activities with efforts to address social issues?

This is a question with which Fancl once grappled. From the perspective of their connection to society and various stakeholders, the company’s undertakings—quality control, pharmaceuticals, the environment, human resources, and social contributions—all seemed indispensable and important. There was a pervasive feeling within the company that CSR consisted largely of environmental and social contribution activities that existed outside the company’s main business, that it largely helped to ensure that corporate activities were not in violation of rules and regulations, and that it was something employees and the company should do when they had the time or energy to spare.

Fancl was keen on “eliminating the negatives” from society (another key company slogan) in each of these activities, but no attempt had been made to coordinate them by analyzing their core motives, gaining an understanding of underlying social trends, and ascertaining who the key stakeholders were and what they expected of the company. The company remained without a clearly identified CSR goal, contenting itself with a vague sense of “doing good” for society.

It has laudably continued to engage with welfare facilities since its founding and has been actively pursuing environmental activities through efforts to reduce the volume of waste it produced. It also has a strong tradition of proactively investing in human resources. But an important element was missing: an awareness of what Fancl was in a unique position to provide. This realization prompted a



major rethink. It was not enough for the company to recognize the value of its own initiatives; they needed to be acknowledged and appreciated by society as a whole for them to have real meaning. The result was a thoroughgoing refocusing of the company's CSR program.

### **Remaking CSR Policy**

Before discussing Fancℓ's relaunch of its CSR policies in greater depth, let us take a brief look at the company's history. Fancℓ is a cosmetics company that was founded in April 1980 by Kenji Ikemori, who still serves as chairman and CEO. Ikemori started the company from a desire to offer additive-free cosmetics to customers who suffered skin problems caused by preservatives and other additives in conventional cosmetics. The company later branched out into health supplements. Supplements were expensive at the time, and Fancℓ's affordable prices played an important role in helping them enter the mainstream. Today the company also runs a health food business and prides itself on being a company that helps its customers to "create beauty from the inside out."

The company's ideal when it was founded was "to have a sense of justice and equity, to eliminate the negatives in the world." Inspired by a philosophy of "we can achieve more," the company continues to "strive to eliminate customers' negative experiences, and pursue gentleness, safety, and assurance" in its products. The company aims to "put ourselves in customers' shoes" and claims that "the happiness of our customers forms the basis of everything we do."

After becoming chairman in 2003, Ikemori receded from active management to become honorary chairman in 2005 but returned as CEO in June 2013 to oversee the reorganization of company management.

Fancℓ was a startup whose name quickly became synonymous with additive-free cosmetics. But the success was not without growing pains. As Ikemori admitted when retaking the reins at the company, "We were able to build up the brand quickly and to achieve growth. But I think my stepping aside as CEO during our growth phase coincided with a lot of changes in the competitive environment as we expanded into new business areas. This may have blurred the company's *raison d'être*, and we began to lose sight of what made us competitive in the beginning. We became less clear about where our targets lie, and this ultimately led to a decline in the company's results."<sup>1</sup>

The task of rebuilding Fancℓ's CSR therefore coincided with the remaking of

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<sup>1</sup> Interview in *Sankei Shimbun*, October 30, 2013, and other sources.

the company itself. It was guided by the company's founding aim of eliminating the negatives from people's lives and the notion that the value of the company would be determined by whether or not this was recognized by society.

The first step was gaining an understanding of society's views. Using the ISO 26000 guidelines on corporate social responsibility and the UN Global Compact, Fanc! went about identifying who its stakeholders were, what they were thinking, and what they expected from the company, carefully examining all activities that could be considered CSR, including those relating to quality control and pharmaceuticals. The company also announced its participation in the Global Compact.

It was not enough, though, for the CSR department alone to understand ISO 26000. The effort would have little meaning unless all employees were aware of society's expectations and standards. Fanc!'s next step was therefore to translate and edit the guidelines into language that was relevant to employees at each step of the value chain, from research and planning to production and distribution, sales, human resources, society and management, and the environment. This was an inspired way of making use of ISO 26000, which provides guidelines rather than a set of standards.

Outside opinion was incorporated without losing sight of the things that made Fanc! unique, as expressed in the founder's desire to eliminate the negatives—people's anxieties, unease, inconvenience, and dissatisfaction. The meaning of the company's existence was to eliminate these negatives with high-quality products and services. After soul-searching on what they could do as a group of specialists in additive-free cosmetics and health foods and how they could pursue such efforts while working closely with society, Fanc!'s managers concluded that the company's main business operations was exactly the channel through which it should implement its CSR.

Once the company resolved to build a CSR program that would make the most of Fanc!'s unique strengths and characteristics, it turned its attention to developing the human resources needed to carry this out. The key to success was educating employees so they would have a full understanding of Fanc!'s approach as they went about putting initiatives into practice. Human resources, after all, play a pivotal role in business operations, from product planning to sales. The process of rebuilding Fanc!'s CSR thus hinged on employees gaining a new, heightened awareness of their actions.

One byproduct of this effort was a rediscovery of the many outstanding programs that the company had been implementing for years that encouraged a CSR-oriented mindset in its workforce.

## Fancl Seminars for People with Disabilities

The Fancl Seminar began after Ikemori made a visit in 1987 to Homon no Ie, a daycare facility in Yokohama for people with severe motor and intellectual disabilities. The facility is managed by a social welfare corporation founded in 1986 that now operates 15 facilities in the city of Yokohama, including group homes for the disabled and support facilities for the elderly.<sup>2</sup>

A comment made by Michie Hiura, founder of Homon no Ie, on this visit made a lasting impression on Ikemori: “Four to five people out of a thousand are born with a disability, and it’s only natural for the other 995 to look after them. Another way of seeing this is to say that you owe your good health to those five.” After the visit, Ikemori began to think of what he and his company could do to fulfill their responsibilities as part of the 99.5%; in addition to providing donations, Fancl launched a program involving employee visits to the care facility.

Hiura says: “Operating facilities for the disabled has made me realize that most people are unlikely to pay much attention to what we do, but there are a few who really care. Mr. Ikemori was one of those who stopped to take a closer look and to ask himself whether giving donations was really enough. In the fall after his visit, he invited our staff to a lunch meeting at the Fancl cafeteria. The polite way we were treated by the company employees, all attired in business suits, made a big impression on our staff, who were dressed in jeans. It was a good opportunity for us to learn about business manners. The invitations to lunch have continued each year and are now extended to the disabled users of our facilities as well. This exchange spawned a number of volunteer initiatives by Fancl employees, and since then our relationship has deepened further. Mr. Ikemori has generously spoken of how the program has engendered a culture of kindness at Fancl. At a glance, a relationship between a cosmetics company and a welfare organization might seem unusual, but we share the ideals of treating people with respect. I’ve learned from my conversations with Mr. Ikemori the importance of regarding disabled people not as targets of welfare programs but as ordinary people who happen to have special needs. A truly healthy



*A personal grooming seminar for high school students. © Fancl*

<sup>2</sup> <http://www.houmon-no-ie.or.jp/index.php>

society is probably one in which people with disabilities can lead full lives without having to rely on special help.”

One outgrowth of the exchange between the company and Homon no Ie is the employee-led Fanci Seminar, designed to promote active community involvement among people with disabilities. The seminar offers instruction on personal grooming for third-year high school students who are soon expected to join the workforce and advice on makeup and staying healthy at care centers for the elderly. During fiscal 2014, a total of 250 employees took part in 138 lectures for 3,257 participants—a slight increase from fiscal 2013 (185 employees taking part in 120 lectures for 2,705 participants). Some 10% of all Fanci employees are now involved in these seminars.

At the seminar for high school students, employee volunteers take a hands-on approach to offering participants such personal grooming tips as washing their face, putting on a necktie, and applying makeup.

### **Comments from Participants and Facility Staff**

- “The experience brought smiles we don’t normally see and revealed things about participants’ personalities that are often hidden from view.”
- “Family members praised the young men who washed their faces the next morning and the young women who put on makeup. Instruction from the volunteers seemed to resonate with the participants more deeply than advice offered by the staff. I’m sure the experience will become personal assets for the participants.”
- “I used to wash my face just with water, but now I know how to do it properly and realize what a difference it makes. I’m going to give greater attention to my daily appearance from now on.”
- “The students were all nervously looking forward to welcoming the teachers from Fanci. The theme of the seminar was “Making a Good First Impression through Personal Grooming,” and the students received instruction on face-washing, skincare, and natural makeup. There were lots of discoveries and surprises. This kind of hands-on demonstration has made them much more aware of grooming than before.”

*Source: Fanci Report, February 2015.*

Such positive comments from participants and staff members are very gratifying, to be sure, but the biggest beneficiaries of the program may be the volunteer employees themselves, who are able to gain valuable insights into the conditions of people with disabilities.

In many cases, extra effort is needed to communicate what the volunteers want to say. It is not a question of simply speaking louder. They must see the world as the listeners perceive it, enunciate clearly, and choose words that are easy to under-

stand and convey a clear mental image. They also need to use gestures and body language. Most important of all, they must constantly check to make sure that the person they are talking to has understood correctly. Only then will real communication take place.

The experience gives employees a sense of how difficult it can be to communicate a simple idea. Taking the time to think seriously about how other people view reality and being thanked for making such an effort can lead to a deeper awareness of the value they should be offering society. For Fancℓ, this is an integral part of human resources development.

Employers who have internalized these insights can apply them in developing user-friendly products and improving customer service. One concrete example is the adoption of universal design in packaging so that products can be easily opened, even by people with limited hand strength. Many Fancℓ users notice that the company's products are constantly being modified and improved—a result of employees who have a heightened awareness of user needs. Fancℓ's success in integrating its engagement in social issues and the company's main operations through a human resources development initiative is a model of CSR that others can emulate.



*A cosmetic product featuring universal design packaging to promote ease of use and facilitate recycling. © Fancℓ*

## Values that Emerge from Working Together

Perhaps the best example of Fancℓ's employee-based approach to CSR is Fancℓ Smile, launched in February 1999. It originally employed 10 people with intellectual disabilities, but the workforce today includes 48 people with a variety of mental and physical disabilities. The range of work it performs has also expanded over the years to encompass preparing direct mailings and customer survey questionnaires; assembling, packaging, and wrapping products; cleaning Fancℓ offices and the surrounding neighborhood; printing business cards; collecting mail; sending parcels; operating a cafeteria, and working in shops (see figure ).

Needless to say, the inspiration for Fancℓ Smile came from the exchange program with Homon no Ie, through which Fancℓ developed a desire to provide people with intellectual disabilities an opportunity for gainful employment. Initial tasks included stuffing envelopes with either questionnaires or advertising and posting

## Number of Workers and Range of Activities at Fancl Smile



Fiscal year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Employees	10	17	20	22	29	29	29	33	39	39	40	42	44	44	45	47	48

Share of Fancl Group employees with disabilities: 2.50% (as of April 1, 2015)

Source: Fancl Smile.

them. After these tasks were assigned to Fancl Smile, there was a significant improvement in the response rate.

The process of sending out direct mail consists of several simple processes: (1) fold the questionnaire or pamphlet to a size that fits the envelope and (2) stick the label printed with the name and address of the recipient onto the envelopes, (3) into which the folded questionnaire or pamphlet are placed—along with any sample products—and then sealed.

While it is not unusual to receive direct mail with sloppily folded or inserted pieces of paper or twisted address labels, this rarely happens with direct mail posted by Fancl Smile. An internal report explains why: “At Fancl Smile, all the work is done with painstaking care. Every questionnaire and pamphlet is carefully folded to make sure that the ends meet exactly and there is no overlap. Anyone watching the employees can see at a glance that every stage of the work is approached very seriously. Employees pour their hearts into what they are doing. The results of this are clear from the response rates. Although the regular rate of customer response to mailings like this is between 20% and 30%, when Fancl Smile is in charge we get responses from 40% to 50% of customers. Thus there is nearly a 50% increase

in the response rate. Customers have no way of knowing who did the work, but the difference in the response is unmistakable. There is no way to explain the phenomenon except to say that even the way a letter is folded can reveal something about the person who folded it.”

The quality of the work and the results that followed earned Fanc! Smile the confidence of divisions throughout Fanc!, leading to additional assignments for the new company. By its second year it was able to turn a profit with a subsidy from the head company, and by its third year it found itself in the black even without a subsidy. Today, Fanc! Smile receives orders for work from between 50 and 60 Fanc! departments and offices every month.

One Fanc! product feature developed with the help of employees with disabilities is the “touch mark seal.” Many Fanc! products, such as face lotion and oil, come in similar packaging, which can be confusing for people with impaired vision. The seals, which are printed with the name of the product in large, easy-to-read letters and have tactile markers, make these products easier to tell apart. Customers desiring products with these seals can now choose to purchase them if they wish. This kind of universal access design is useful not just for people with disabilities but also for those who have removed their contact lenses or when people have their eyes closed. Having employees from Fanc! Smile involved in the development of such packaging is another example of the workforce diversity that Fanc! is actively encouraging.

Fanc! Smile has earned the trust of other departments and expanded the range of its activities thanks to the diligence of the people with disabilities who work there. But equally important have been the dedication of Fanc! managers and the guidance provided by Fanc! employees who volunteered to transfer to Fanc! Smile. Institutional measures to support employees with disabilities include personnel policies and assignments that account for the needs of people with different types



*“Touch mark seal” product labels and the Fanc! Smile employees who helped develop them. © Fanc!*

## CSR WHITE PAPER

of disabilities and efforts to provide work at the Fancl head office to increase their contact with other Fancl employees.

At Fancl, everyone works to offer value to society, whether they have a disability or not. Workplace diversity is considered natural and an advantage in integrating the company's operations with initiatives to address social issues. This is Fancl's approach to CSR, founded on the hard work and shared aspirations of its diverse human resources.



June 7, 2016

## Enhancing Dialogue, Engaging with Society: Shiseido

Zentaro Kamei

Everyone seems to agree that dialogue is one of the keys to enhancing CSR. But opinions differ as to the precise nature of the dialogue required. Judging from the results of the 2015 Tokyo Foundation CSR Survey, many Japanese companies are actively involved in some form of stakeholder dialogue. But few companies clearly describe the ways they go about engaging employees, shareholders, community members, and nonprofit organizations, let alone the specific aims and outcomes of such dialogue. In most companies, dialogue is treated as an end in itself, useful primarily as a CSR indicator.

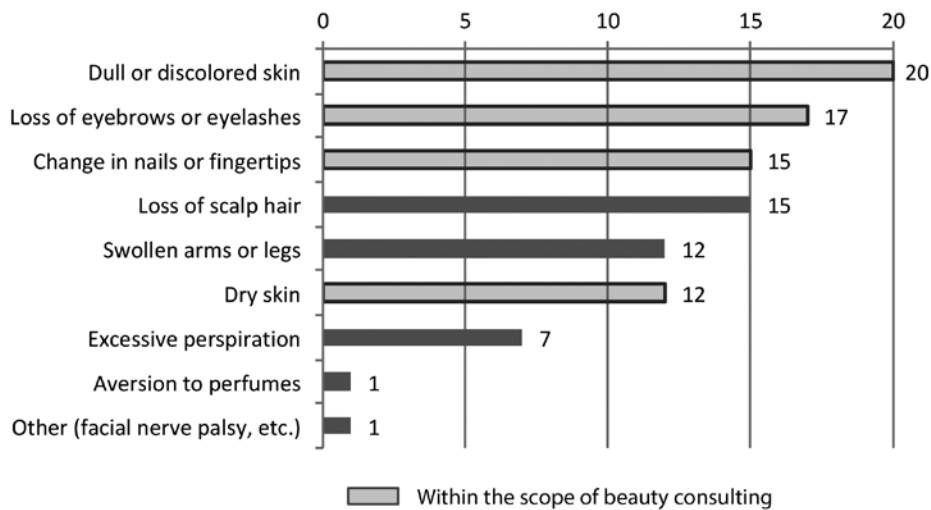
What, then constitutes meaningful dialogue? To help answer that question, I would like to consider two initiatives undertaken by Shiseido.

Shiseido, Japan's largest cosmetic company, engages in dialogue of various types, but here I would like to focus on two specific cases. The first is a program that skillfully combines the company's technical and human resources to provide skin, hair, and other personal care services to people afflicted by cancer or other grave illnesses based on attentive dialogue with the patients and survivors themselves. This is an initiative that embodies the company's commitment to meeting society's expectations while affirming its own *raison d'être*.

The second example is the process surrounding Shiseido's change in policy on animal testing. This began with a proactive effort to identify social issues—cognizant of the diversity of attitudes and perspectives on such issues—advanced through close dialogue with a variety of stakeholders, and led ultimately to a decision that involved a major shift in business strategy.

### Beauty Care for Cancer Patients

In the posh Ginza district of Tokyo, where Shiseido first opened shop, stands the

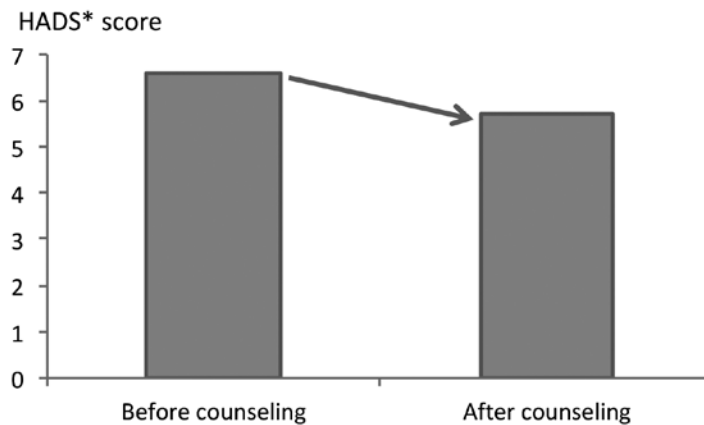
**Figure 1. Cosmetic Complaints Linked to Cancer Treatment (% of respondents)**

*Source: Compiled from the results of a questionnaire of participants in beauty seminars conducted jointly by the Japan Cancer Society and Shiseido, January 2010–December 2012; 475 responses by 120 participants.*

Shiseido Life Quality Beauty Center. The facility is staffed by expert cosmetologists who use every technique at their disposal to help people with serious skin problems using the “power of makeup.”

The cosmetic concerns of cancer patients and survivors have surfaced as a growing problem in recent years. Cancer treatment typically involves chemotherapy in conjunction with surgery. Thanks to advances in technology, patients are more likely than ever to experience either remission or a complete cure (that is, remission with no recurrence for five years). But even as they return to normal life, they may continue to suffer from the side effects of chemotherapy, including changes in appearance.

A questionnaire distributed to participants in the center’s seminars identified changes in skin and eyebrows and eyelashes as their biggest concerns. While wigs and other solutions are readily available to those suffering from the loss of scalp hair, other problems can be trickier to address. Some individuals experience overall darkening or dulling of their complexion, while others have patchy discoloration. Some lose their eyebrows entirely, while others experience uneven thinning. Women describe being shocked by the face they see in the mirror. Many are reluctant to reveal their illness to others and fret that their appearance will give their illness away.

**Figure 2. Cosmetic Counseling and Depression in Breast Cancer Patients**

\*Hospital anxiety and depression scale.

Source: Reprinted (with slight modifications) from Ryoko Hijikata, et al., “Kagaku ryoho no biyoho no fukusayo ni taisuru biyo kea ni yoru nyugan kanja no QOL kaizen koka” (QOL Impact of Beauty Care for Cancer Patients Experiencing Cosmetic Side-Effects of Chemotherapy), *Journal of the Japanese Cosmetic Science Society*, vol. 37 (2013), no. 3.

To support such patients and survivors, the Shiseido Life Quality Beauty Center offers both group seminars and free individual counseling. In both cases, the cosmetologists are at pains to impart makeup know-how and techniques that amateurs can easily apply at home.

The seminars, carried out in cooperation with nonprofit patient support groups and healthcare providers, are an opportunity for people with common issues to gather, exchange information, and provide mutual support and encouragement. Many participants go home with a much more positive outlook.

For those who shy away from the gaze of strangers, the center offers individual cosmetic counseling sessions in a private setting. An employee who has worked with many cancer patients and survivors at the center spoke of the delight she had seen on clients’ faces when they saw their transformation at the end of a session. Women who had previously avoided looking at themselves in the mirror positively beamed as they examined their reflection.

Many cancer patients are reluctant to go out in public, meet with acquaintances, or talk to people because of concerns about their appearance. Using quality products with skill and empathy, the cosmetologists at the Shiseido Life Quality Beauty Center are able to alleviate some of these concerns. Studies suggest that such cosmetic counseling can measurably improve quality of life for cancer patients. The staff of the center get to witness this “power of makeup” firsthand.

## The Shiseido Way

Initiatives like these seem to come naturally to Shiseido, which has a long tradition of leveraging the “power of makeup” to contribute to society.

In 1956, with the Japanese economy expanding rapidly, the government declared that the era of postwar reconstruction was over. That same year, Shiseido was finally able to relaunch its beauty business with the opening of a 900-square-meter



*Shiseido's Spots Cover, launched in 1956. (Courtesy of Shiseido)*

salon near Shibuya Station in Tokyo. The following year, it reopened its Ginza salon, originally established in the 1920s.

At the same time, the company was pursuing another project, motivated not by commercial but by humanitarian concerns. Notwithstanding the government's declaration of a new era, many citizens still bore serious scars from the war, particularly burns resulting from the bombing of Japanese cities. Shiseido decided to

develop a foundation matching Japanese skin tones that women could easily apply to minimize the appearance of raised, pitted, or discolored scar tissue. It launched that foundation, Spots Cover, in 1956. Setting aside economic considerations, it priced this advanced makeup no differently from its other foundations, even though similar products were being sold for 10 times the price in the United States.

Today Shiseido divides its emphasis between product development and the training of professionals to provide beauty care that brings together the power of their products and the power of human know-how.

For 60 years now, since its launch of a product to help women scarred by the ravages of war, Shiseido has tapped the power of makeup to provide support for people with serious skin concerns, including angiomas, birthmarks, vitiligo, and, most recently, the side-effects of chemotherapy. All of this began with a simple question: “What can we do to help?”

## How One Employee Made a Difference

The specific impetus for the establishment of the Shiseido Life Quality Beauty Center came from a single employee and her first-hand experience of the power of makeup.

Shiseido employs a large number of credentialed beauty professionals, including makeup artists. Ranking high among the settings in which makeup artists apply

their skills are fashion shows, where they use masterful techniques to display the models to best advantage. However, once the show is over, those models remove their makeup and go home.

One day, a Shiseido makeup artist was working on a woman with a serious skin condition. After applying the makeup, the woman looked at herself in the mirror and sighed, “Look how it changes me. I wish I never had to remove this makeup.” It was the lament of someone who had no one to turn to for help. Hearing her words, the makeup artist decided it was up to her to do something. She voiced her ideas to a colleague charged with collecting feedback from various work sites, who then conveyed them to the president. The makeup artist’s desire to make a difference galvanized the entire organization. A project was launched, and the result was the establishment of the Shiseido Life Quality Beauty Center in the heart of Ginza.

It took two full years before the center opened its doors to cancer patients and survivors. Much of that time was spent listening carefully to patients and survivors and implementing improvements on the basis of their comments. One woman’s observation that the chairs at the center were painful to sit on precipitated a total change in attitude. The staff began asking others, and soon they realized that patients who had lost weight during their bout with cancer often found it difficult to sit for long periods on hard seats. Cushions made all the difference.

Similar inquiries led to other changes. Finding that some people were easily chilled, the staff began offering lap blankets and started offering a choice of cold, hot, and room-temperature drinks. They also decided to inform clients that they could cancel on the same day of the appointment if they were not feeling well. They realized that there were any number of ways in which they could alleviate the suffering or discomfort of cancer patients simply by listening attentively and making adjustments accordingly.

One patient put it like this. “We can confide things here that we can’t tell anyone else, and the staff always listens carefully and responds thoughtfully. This helps to nurture trust. That’s why it’s always such a treat for me to meet with Shiseido’s cosmetologists.”

The Shiseido employees who are helping cancer survivors through the power of makeup teach us that dialogue is something that can and should take place in all settings, not just around a conference table.

### **Initiative on Abolishing Animal Testing**

The other example of meaningful dialogue at Shiseido pertains to the company’s policy on animal testing in the development of cosmetics.

In March 2010, Shiseido announced its intent to “phase out the use of animal testing for cosmetics.” Eventually, having developed a safety assurance system based on alternative methods, the company officially abolished animal testing at in-house and external facilities alike for the development of any cosmetic or quasi-drug product undertaken on or after April 1, 2013. The adoption of this policy entailed not only extensive in-house deliberations but also wide-ranging dialogue with external stakeholders—most notably, the roundtable on ending animal testing of cosmetic ingredients, launched in June 2010.

Since there has been some misunderstanding on this point, let us be clear: the decision to stop animal testing was a business decision taken by the management of Shiseido. The roundtable was not mere window dressing designed to impart a veneer of objectivity to that decision, nor was it established in a bid to shift part of the responsibility for the company’s own policy.

Animal testing is a contentious issue for those closely involved, and a relatively obscure issue to the average consumer. By providing an opportunity for various stakeholders to sit down at the same table, exchange ideas, and listen to one another’s viewpoints, the company hoped to accomplish several things: to raise public awareness of the issue; to clarify points of contention; to build a consensus, bridging “pro or con” polarities, on the basic direction in which society should be heading; and to chart next steps for each stakeholder group.

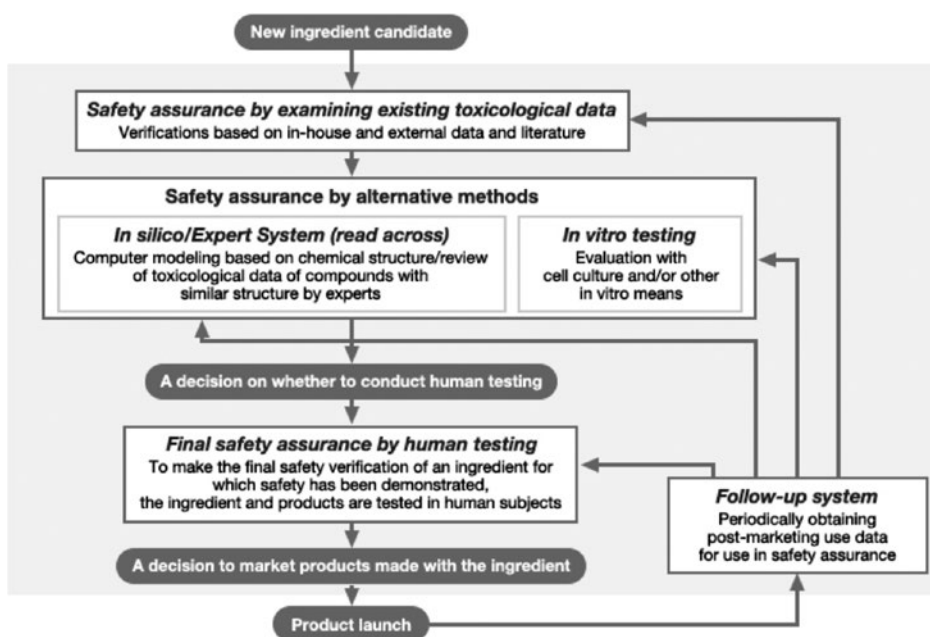
As I stated, Shiseido is the party responsible for the company policy of ending animal testing and the steps taken to implement that policy. The roundtable dialogues provided an opportunity for other stakeholders—not just people in the company—to take ownership of this social issue in their own way. This approach deserves special attention as one process by which a company can engage with society and address social issues.

### **Developing Alternative Methods**

Animal testing in the development of Japanese cosmetics began after outbreaks of pigmented contact dermatitis traced to ingredients in certain cosmetics triggered a major controversy in the late 1970s. With consumers suing manufacturers over their condition, the companies were under intense pressure to adopt rigorous testing processes comparable to those used in the pharmaceutical industry to ensure consumer safety. In the 1980s, animal testing became the norm in the cosmetics industry. But the 1980s also witnessed the rise of a movement to ban animal testing.

Many different ingredients go into a typical cosmetic formulation, including chemical and plant-based substances. When developing such a product, a manu-

Figure 3. Shiseido Safety Assurance System



Source: Shiseido.

facturer must investigate those ingredients carefully to determine their potential side effects as well as cosmetic and other benefits, with human safety as the first and foremost consideration.

Shiseido has long stressed safety and quality as its top priorities and has implemented rigorous safety assurance protocols consistent with its commitment to sell no product that might be deemed unsafe. These are divided into three basic phases. The first is “ingredient safety assurance” by means of rigorous screening and refining of individual ingredients. The second is “product safety assurance” via safety-first product design, trial production, and product testing. And the third is “post-market safety monitoring,” which involves gathering and following up on customer feedback of all kinds to track any problems that may arise as a result of individual intolerances or the use of the product in ways or amounts the manufacturer did not envision.

Animal testing has long been a standby in the first area—ingredient safety. In the case of quasi-drugs in particular, manufacturers may be required to submit animal testing data in order to secure regulatory approval to market a new product.

The chart below illustrates the safety assurance system for new ingredients that Shiseido instituted in the wake of its decision to eliminate animal testing. Under the

new system, toxicological data and alternative testing methods take the place of animal testing. The important thing to note in this regard is that development of an ingredient is suspended if its safety cannot be guaranteed by these alternative methods. The substance will not proceed to the phase of human testing and, needless to say, it will not reach the market.

A number of alternatives to animal testing are under consideration, including computer simulations and in vitro testing on tissue cells. To speed the standardization and acceptance of such methods, Shiseido has released to the public its own patented technologies and test data on alternative methods and is actively collaborating with various companies and agencies in Japan and around the world.

Beginning in August 2012, Shiseido also brought together specialists from several universities and research institutions to meet for the purpose of identifying and deliberating the issues surrounding alternative methods from a scientific standpoint. The first six sessions were open only to Shiseido personnel, but since the seventh meeting (November 2014), other companies have been encouraged to participate, and the initiative has helped spur industrywide movement on the issue.

## **Stakeholder Dialogue Begins**

The foregoing is a brief overview of the developments leading up to the phasing out of animal-testing in 2013. Now let us back up and take a closer look at Shiseido's stakeholder dialogue on ending animal testing of cosmetic ingredients, including its launch, evolution, and outcomes.<sup>1</sup>

The first session of the roundtable was held in June 2010, three months after the company's initial announcement regarding its intent to eliminate animal testing for cosmetics. Below is a list of the names and positions of the in-house and outside participants at the time of the first meeting.

### *External Stakeholders*

Akiko Asano

Attorney, Takagi Kunio Law Offices

Hiromi Kamekura

Director, Japan Anti-Vivisection Association (JAVA)

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<sup>1</sup> For more information on the content of the discussions, see Hideto Kawakita's essay, "Lessons from Shiseido's Roundtable on Abolishing Animal Testing."



## CSR WHITE PAPER

Noriho Tanaka

Former president, Japanese Society for Alternatives to Animal Experiments

Eiko Nakano

Producer, Nikkei BP Consulting

Chizuko Yamaguchi

Veterinary inspector, Japan Animal Welfare Society

Keiko Yamazaki

Executive Board member, Japanese Coalition for Animal Welfare

Takemi Yoshida

President, Japanese Society of Toxicology

Hideto Kawakita, moderator

CEO, International Organization for Human, Organization, and the Earth

### *Shiseido Personnel*

Tsunehiko Iwai

Director in charge of technical planning and quality management

Hiroshi Itagaki

Senior researcher, Quality Assessment Center

Yasuko Takayama

General manager, Corporate Social Responsibility Department

The opinions presented by the external stakeholders were quite varied. The synopses provided below highlight their unique concerns and provide a baseline from which to assess the progress of the dialogue.

**AKIKO ASANO** From the standpoint of protecting the vulnerable members of society, laboratory animals are in need of protection, too, and in this sense we want to see progress toward the elimination of testing. However, from a safety assurance standpoint, we don't think that animal testing in the broadest sense is likely to disappear. With this in mind, instead of just debating whether to stop or continue testing, it seems to me that we need to address the nature of the experiments and the adoption of workable protocols. We'll also need statutory changes at the national level, and as the industry leader, it seems to me Shiseido's role is to ensure that the laws effectively address real concerns.

**HIROMI KAMEKURA** Our organization launched its campaign against Shiseido's animal testing at the beginning of 2009. We've been urging action by individual

consumers to convey their opposition to Shiseido, and we sent an open letter to the company with about 46,000 signatures. Shiseido is Japan's biggest cosmetics manufacturer, and if takes the lead in the total elimination of animal testing, it will win kudos from the international community, and other companies are sure to follow its example.

**NORIHO TANAKA** Animal testing is often equated with cruelty, but in fact not all testing is brutal. Since its establishment in 1989, the Japanese Society for Alternatives to Animal Experiments has been pursuing a variety of initiatives to promote the 3 Rs [replacement, reduction, refinement]. We're looking to Shiseido, an industry leader, to promote and support further study on alternative methods.

**EIKO NAKANO** If the safety of a chemical substance can be verified by alternative methods, then those methods should be used, but if animal testing is the only way to demonstrate the safety of a substance, then it's unavoidable. Not all consumers see things the same way. Some are looking for products whose safety has been scientifically established. It seems to me that the important thing is the ability of consumers to choose products that accord with their own judgment and beliefs. There are also concerns about the impact that the elimination of animal testing could have on the business's ability to compete internationally and develop new products.

**CHIZUKO YAMAGUCHI** Even if it's impossible to stop animal testing immediately, we mustn't ignore the suffering that animals endure for the sake of human beings. There've been some improvements over the past thirty years in the conditions under which animals are kept, but the situation is still not acceptable. There's an urgent need to improve animal welfare in Japan. The cosmetics industry has already put considerable effort into the development of alternative testing methods. Now it's time for government to step in with financial and regulatory support, and we're ready to back up Shiseido's initiatives where we can.

**KEIKO YAMAZAKI** Human beings are the cause of suffering by countless animals. To change this reality, we need to look at things from a broad perspective without emotionalizing and soberly chart a path to reduce the number of laboratory animals and minimize their suffering. . . . We would be glad to know of ways that citizens like us can help to put an end to animal testing and enhance animal welfare.

**TAKEMI YOSHIDA** There are still many unknowns when it comes to determining

the safety or toxicity of chemical substances on the cellular level. At present there are about 30 million chemicals in existence, and somewhere around 100,000 that are actually in use. It's true that animal testing is not the answer to all safety concerns, but if safety is our first consideration, then for now, we have little choice but to continue animal testing in cases where there's no reliable alternative method. . . . We need to foster a more relative perspective regarding chemicals, instead of an all-or-nothing attitude.

As these statements make clear, there were stark differences among the participants on the subject of animal testing, even with an eventual phase-out as the basic premise.

We should also note that the regulatory climate surrounding animal testing differs substantially from country to country. In Europe, which frowns on such testing, the regulatory framework is moving in the direction of a complete ban. In Japan, regulators currently almost never accept data from alternative methods. In China, meanwhile, regulators require animal testing of all final products as a safety precaution.

The most important outcome of the first roundtable was a shared recognition among the participants that addressing the issue of animal testing would require understanding and action by a wide range of stakeholders and that all of them—not just Shiseido—had important roles to play. Thanks to the meeting, these stakeholders were able to come together, affirm the existence of animal testing as an issue, and gain a better understanding of differing perspectives. This was possible because Shiseido approached the roundtable with a genuine desire to understand the background and rationale of each stakeholder's views and to learn from them by listening carefully and openly, without prejudice or preconceptions.

## **Progressive Deepening**

The roundtable continued to evolve after the first session, and the level of dialogue progressively deepened. A consistent format also took shape.

Early on in the second session, held in November 2010, the participants were able to agree on four basic tasks: (1) developing viable alternative testing methods, (2) getting other companies to take similar action, (3) lobbying the government, and (4) educating consumers. The discussion then moved to such issues as how to build a coalition among stakeholders representing a variety of interests and what kinds of action would be most effective in accelerating the process. While expressing high expectations of Shiseido, the participants also made clear their desire to

take appropriate steps on their own. In this way, the conference became a springboard for concrete action.

To repeat, the issue of animal testing is a complex and contentious one. In addition to diametrically opposing views on basic questions, there are a wide range of opinions on the best way to move forward. There is also a lack of awareness within our society as a whole. As with other social issues, such as economic inequality, there is insufficient recognition of the problem owing to a shortage of information.

In such cases, the first and foremost task is to raise society's awareness of the issue. It is also essential to bridge the gap between different positions and foster a general willingness to find common ground and use it as the basis for action. In this sense, the roundtable managed to get everyone more or less on the same page by the second session. This may be a necessary condition for a deeper and more productive dialogue.

### **A Shift in Course**

At the third roundtable session, held six months later in June 2011, representatives from Shiseido announced that the company had stopped all in-house animal testing as of March 30. They also unveiled a new strategy for product development.

The new strategy emphasized a more holistic approach to value creation through product development, going beyond “functional value”—as embodied in the whitening, anti-aging, anti-wrinkle, oil-control, and moisturizing agents for which Shiseido is known—to embrace “sensation value” (the pleasant feeling and satisfaction customers get from using a product) and even “emotional value” deriving from a product's appeal to customers' sensibilities and discerning tastes. This was management's answer to lingering concerns that Shiseido might fall behind other companies with regard to functional value if it suspended development of new ingredients whose safety could not be verified by alternative methods. It bespoke a commitment not to allow the new policy to lessen the appeal of Shiseido products or undermine the company's competitiveness.

The implication is that the focus of competition will shift away from functional value, in which Shiseido has been the industry leader, and this constitutes a major change in business strategy. From the standpoint of R&D personnel, it could mean the suspension of product-research projects that they had been pursuing for years. For a researcher, this could amount to abandoning one's ideals.

Needless to say, the decision to embark on such a shift in course could not be made solely on the basis of dialogue with external stakeholders. Paralleling the

roundtable conferences were internal meetings at various levels in each division, where the fundamentals of business strategy were debated, including the source of Shiseido's competitive strength, changing consumer perceptions, the nature of cosmetics, and the way forward.

One factor driving this may have been Shiseido's own concerns about the company's future. Thanks to its superior R&D program, Shiseido had long dominated the competition in terms of product functionality, most notably through the use of such whitening agents as arbutin and transexamic acid. But in recent years, this superiority had not translated into growth in market share. Each division was grappling with the same basic questions: What do our customers really want? What must Shiseido do in a particular region or market to achieve a competitive advantage? In the midst of this reevaluation, the animal testing issue played a significant role as an impetus for the adoption of a competitive strategy stressing value as something more than functional superiority.

A company's relationship to society bears directly on its *raison d'être* and its source of competitive strength. Confronted with calls from society for the elimination of animal testing, Shiseido made the decision to treat its response as a central issue of business strategy. In a sense, this epitomizes the integration of social responsibility into business management. In pursuing dialogue both internally and externally and firmly linking the two processes, Shiseido was fulfilling an important condition for genuine integration of CSR into corporate activity.

### **What Is Dialogue?**

The sixth and last roundtable session was held in March 2014. By that time, Shiseido had reached the decision to do away with animal testing, at in-house and outside facilities alike, in the development of any cosmetic or quasi-drug product undertaken on or after April 1, 2013.

The content of the discussions conducted over the course of these six meetings impresses on one the importance of establishing common ground as a basis from which stakeholders can consider the problem and devise next steps for addressing it. Simply asserting one's own opinion without responding to what others are saying tends to accentuate differences and make it all the more difficult to bridge the gap between divergent views. If that is all that is going to happen, then there is not much point in bringing people together.

There is a tendency in Japan to avoid a stalemate by steering participants toward a predetermined compromise. Shiseido contends that it had no such blueprint, despite the fact that a number of company executives had voiced reservations

about holding such open-ended discussions. Considering the matter closely, one realizes how difficult it would be to predetermine a conclusion on such a complex issue as animal testing. In holding a roundtable on such a theme, the company may have been taking a leap into the unknown. But those involved did not flinch from taking such a risk. They recognized that this was an issue that had to be met head-on and that Shiseido, having already broken new ground on the question, had a responsibility to see it through.

I do not mean to imply that Shiseido's decision was heroic or that there was never any second guessing. They experienced all the frustrations that attend any effort to tackle a serious social issue. As one participant told me, "There was no satisfying sense of accomplishment when it was over. Maybe the decision will work out well for the company, maybe not. But in any case, if society is asking something of us, responding to those demands is our *raison d'être*."

People often talk about "resolving social problems," but the reality is that social problems are not so easy to solve. In its roundtable on animal testing, as in its work supporting cancer patients and survivors, Shiseido has announced its intention to confront social issues head-on and to do so in partnership with the stakeholders concerned. As one of the executives at Shiseido put it, "Controversial social issues are going to keep arising. We have to keep our eyes open for emerging issues and ask ourselves what we can do in response to society's demands. That's the mission of a social trailblazer."

These words, no doubt, capture the very essence of CSR.

June 6, 2016

## Lessons from Shiseido's Roundtable on Abolishing Animal Testing

Hideto DeDe Kawakita

**H**ow does your organization go about making important policy decisions? When called on to make a tough value judgment, especially in the face of harsh criticism from others, would your organization create a framework for ongoing dialogue with external stakeholders—including critics—in order to gather all the information needed to make the best possible policy decision and to implement that decision as effectively as possible?

### The True Meaning of Stakeholder Engagement

Unfortunately, the overwhelming majority of Japanese corporations seem to believe that they are engaging with stakeholders simply by creating a chance for outside experts to air their lofty views on social or consumer issues. Speakers at such forums are usually limited to scholars and a few representatives of nonprofit organizations, who explain their positions in the abstract. Management listens politely to their opinions, and that is as far as it goes. Most Japanese companies treat such dialogue as something utterly divorced from their internal decision-making process, especially where important policy matters are concerned.

In this connection, it behooves us to recall that ISO 26000, the international guidelines on organizational social responsibilities, defines stakeholder engagement as “activity undertaken to create opportunities for dialogue between an organization and one or more of its stakeholders, *with the aim of providing an informed basis for the organization's decisions*” (my italics).

To be clear, then, it is not enough to go through the motions of sitting down with stakeholders and asking their opinions. Engagement is something done for the purpose of determining “how best to increase the beneficial impacts of the organi-

zation's decisions and activities and how to lessen any adverse impact" (ISO 26000, 5.3.3 Stakeholder Engagement). The idea is to ensure better policies and better implementation by involving external stakeholders at the stage of deliberation, before decisions are reached, not after they have been made by a small group of executives with little or no input from outside directors.

The quality of a company's decision-making and implementation becomes all the more critical when it is called on to make an important decision or deal with a serious problem. Speed may be of the essence, but so is the breadth and depth of the decision makers' perspective and the care and efficacy with which they put a decision into effect. This is why companies need to engage routinely in intensive, wide-ranging dialogue with stakeholders—including critics—who have something to contribute to the quality of management's decisions and their implementation. However lively the discussion with outside "experts" and noted authorities, and however warmly those experts might praise the company and its management, such dialogue is meaningless as stakeholder engagement if it does not contribute to the quality of decision-making and implementation.

There is one major corporation in Japan that has actively involved outside stakeholders through a series of meaningful dialogues in preparation for a major policy decision. When Shiseido was deliberating the best way to proceed with the phase-out of animal testing in the development of new product ingredients, it held a series of six roundtable discussions with the participation of some of the company's harshest critics. The first five of those sessions, spanning a period of two years, laid the foundation for a major policy decision by Shiseido by providing genuine opportunities for dialogue and input. In the following, I provide an overview of the progress of the meetings, which I had the good fortune to moderate.

## **Shiseido's Dilemma**

The European Union began phasing out animal testing on cosmetic products and their ingredients under the Cosmetics Directive of March 2003 (later replaced with the EU Cosmetics Regulation). In March 2009 it banned testing on all finished products and ingredients inside the EU. At the same time, it banned the sale of cosmetics, regardless of their origin, that used animal-tested ingredients, although exceptions were made for certain types of toxicity testing for which validated alternatives were unavailable. Under the directive's timetable, the marketing ban was to be extended in March 2013 to cover all types of animal testing.

In China, meanwhile, submission of animal testing data is still required for approval of imported cosmetics. The Japanese government requires a certain



amount of animal testing to verify the safety of new ingredients used in so-called “quasi-drugs,” which include a wide range of hair tonics and skin preparations treated as cosmetics in other countries. Amid conflicting regulations and intense market competition, Shiseido faced a difficult dilemma on how to ensure safety while continuing to make progress with the development of new products.

In March 2010, Shiseido announced its intent to phase out animal testing for general cosmetics (excluding quasi-drugs). The goal, it said, was to eliminate animal testing in the development of its cosmetic products, eliminating in-house testing by the end of March 2011 and testing in external facilities by 2013. The next step was to flesh out a plan for achieving those goals.

For this purpose, Shiseido decided to hold a series of roundtable discussions with representatives of key external stakeholder groups.<sup>1</sup> Session 1 of the roundtable on ending animal testing of cosmetic ingredients was held in June 2010 with the participation of seven outside participants from various sectors, including the scientific community (toxicology and the study of alternative testing methods), animal-welfare and animal-rights groups, and the media. The meeting proceeded as follows.

First, representatives of Shiseido provided a detailed report on the progress being made in developing and validating alternatives to animal testing for safety assurance, as well as regulatory trends in major world markets. Next, each of the invited participants presented questions and opinions grounded in that stakeholder’s specialty or focus, with Shiseido representatives responding to each in turn. Finally, the moderator (myself) provided a summary of the day’s discussion and suggested points and directions for subsequent discussion.

At Session 2, held on November 2010, participation was extended to other stakeholders, including representatives of consumer advocacy groups and researchers involved in CSR studies. After an update on Shiseido’s progress and regulatory developments in Japan and abroad, the participants agreed on the need to prioritize four tasks: supporting the development and validation of practicable alternatives to animal testing, pressing for change by other cosmetics companies, lobbying the government, and educating consumers.

At Session 3, held in June 2011, Shiseido announced its termination of in-house animal testing and closure of company testing facilities, as well as its decision to place external stakeholders on the company’s advisory committee on animal testing, following a suggestion put forth at Session 2. Participants also heard a progress

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<sup>1</sup> Reports (in Japanese) on each of the six roundtable meetings can be accessed at <http://www.shiseidogroup.jp/csr/communication/canference/>.

report on efforts to gain official approval from regulatory authorities for nonanimal alternatives. They then shared ideas on ways to accelerate acceptance of these methods by agencies and consumers and to encourage other cosmetics manufacturers to follow Shiseido's lead.

When Session 4 was held in May 2012, it was still unclear whether the EU would adhere to the timetable set forth in the Cosmetics Directive, which called for a total marketing ban on animal-tested products effective March 2013. Shiseido had nonetheless pushed ahead with efforts to develop and validate alternatives to animal testing and had continued to lobby regulatory authorities in Japan and around the world for acceptance of data from such methods. Moreover, the Ministry of Health, Labor, and Welfare had issued guidelines on the use of alternatives to animal testing. Session 4 featured reports on these developments, as well as activities by stakeholder groups, including a meeting between animal welfare activists, agency officials, and Diet members.

### **From Dialogue to Action: Shiseido Goes a Step Further**

This progressively deepening dialogue culminated with Session 5 of the roundtable, held in January 2013.

Session 5 came at a critical moment for Shiseido. Because it was proving difficult to perfect nonanimal alternatives for the full range of safety testing, many had expected the EU to delay or modify its plan to ban all cosmetics with animal-tested ingredients beginning in March 2013. By January 2013, however, it was clear that the ban would become an EU regulation, legally binding on all members, by July 2013. Yet China still required safety data based on animal testing for approval of both general and special-use cosmetics (the equivalent of Japan's quasi-drugs). How should Shiseido proceed, given its commitment to eliminate animal testing by 2013?

On February 28, following the January roundtable meeting, Shiseido's board of directors reached a final decision: The company would officially eliminate animal testing for both cosmetics and quasi-drugs from April 2013.<sup>2</sup>

Multinational companies, and particularly industry leaders, are obliged to adapt their policies to the changing cultural attitudes, practices, and regulatory requirements of countries around the world. Faced with such challenges, should local managers and top executives decide on a course of action among themselves? Or should they build a broader foundation for their decisions—and lobbying ef-

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<sup>2</sup> See <http://www.shiseidogroup.jp/releimg/2133-j.pdf> (in Japanese).

forts targeting lawmakers and regulators—by soliciting the input of outside experts and even fiercely critical NPOs and NGOs?

By taking the latter path and proactively opening the process to external stakeholders, management can forge alliances that can offer valuable support at critical junctures. In the event of an unfortunate accident or incident, such alliances can spell the difference between a relentless storm of criticism and an attitude of forbearance by those who appreciate the company's history of doing the right thing. The basic rule is, the more difficult the problem, the more important it is to involve outsiders in the deliberation and decision-making process in order to reach an appropriate decision and implement it effectively and efficiently.

Shiseido's executives realized that such stakeholder engagement would not immediately boost their brand image, let alone business results. They are to be applauded for taking the long view by creating opportunities for meaningful and extended dialogue and making that dialogue a cornerstone of corporate decision making on a major policy issue.

### Chronology of Shiseido's Decision on Animal Testing

	Action	Roundtable Discussions
2010	<p><b>Shiseido</b> decides to close in-house animal-testing facilities by March 2011</p> <p><b>Shiseido</b> announces policy of phasing out animal testing for (general) cosmetics by March 2013</p>	<p><b>Session 1 (June 2): Launch of dialogue</b>            Attended by seven outside stakeholders representing animal welfare and animal-rights groups, the science of toxicology and alternative testing, the legal community, and the media. From these diverse perspectives, participants presented a range of opinions on such issues as safety assurance, the 3 Rs (<i>reduce</i> the number of animals, <i>refine</i> methods to minimize suffering, and <i>replace</i> tests with alternative methods), disclosure and enhanced communication, development of alternatives to animal testing, development of new products, and the need to press industry groups and the government for progress.</p> <p><b>Session 2 (November 1): Identification of four priority tasks</b>            Participants agreed on four priority tasks: (1) promoting development and validation of practicable alternatives, (2) pressing other companies to adopt similar policies, (3) lobbying the government, and (4) educating consumers. With a focus on these challenges, they discussed coalition building and next steps.</p>
2011	<p><b>Shiseido</b> ends in-house animal testing and closes its testing facilities</p>	<p><b>Session 3 (June 2): Update and discussion of progress</b>            Participants heard and discussed reports on Shiseido's closure of in-house testing facilities, its inclusion of external stakeholders on the internal advisory committee on animal testing (in accordance with a proposal at the previous session), and progress on securing official approval of alternative methods by regulatory authorities.</p>

## CSR WHITE PAPER

2012	<b>Japan</b> passes revised Act on Welfare and Management of Animals	<b>Session 4 (May 30): Update and discussion of progress</b> Participants heard and discussed a variety of reports: Shiseido's work on the development of its new safety assurance system, its efforts to boost public acceptance (consultation with industry groups and outside experts), and its vision for creating new value; activities by animal-welfare groups, including a workshop with Diet members and submission of a petition to the ruling party, Environment Ministry, and Health, Labor, and Welfare Ministry for abolition of animal testing and approval of alternatives; and the health ministry's release of guidelines on the use of alternatives to animal testing.
2013	<b>EU</b> bans sale of all cosmetics containing animal-tested ingredients  <b>Shiseido</b> ends animal testing for both (general) cosmetics and quasi-drugs	<b>Session 5 (January 25): Solicitation of input prior to final decision</b> Participants heard and discussed reports from Shiseido on the company's new safety assurance system and establishment of a Safety Assurance Panel including outside experts and exchanged views on recent international trends, consumer education, and lobbying efforts directed at government and other cosmetics firms.
2014		<b>Session 6 (March 19): Post-decision report and discussion</b> Summation and final thoughts. Participants heard and discussed reports on Shiseido's achievements in fiscal 2013 and reviewed efforts by the participating stakeholders.

June 2, 2016

## Building Responsive Companies

*The Tokyo Foundation's CSR White Paper 2015*

Zentaro Kamei

**T**he Tokyo Foundation launched the CSR Research Project in 2013 and began publishing the CSR White Paper the following year. We are often asked why a think tank devoted to public-policy research and recommendations would undertake a long-term project on corporate social responsibility. Our answer is simple: The job of building a sustainable society is too big for government alone.

### **Sustainable Business, Sustainable Society**

With government's policy options increasingly hemmed in by fiscal realities and other harsh constraints, people have begun looking elsewhere for answers to society's problems, and corporations—transnational entities whose basic job is responding to society's varied needs—have a particularly important role to play. From the corporation's perspective, moreover, the ability to respond to society's diverse and changing needs is a necessary condition for a sustainable business. In this sense, sustainable businesses and a sustainable society go hand in hand.

In Japan, the term CSR entered into common usage more than a decade ago, and in recent years it has become commonplace to talk about integrating social initiatives into core business activities. Yet we see more and more Japanese companies revising their CSR policies in ways that suggest a flagging commitment. Many business leaders appear unsure as to why their companies should pursue CSR initiatives, particularly activities that do not lead directly to corporate profits. They sometimes seem unclear as to the precise meaning of corporate social responsibility.

A company's CSR is integral to its *raison d'être* and is manifested in the value it adds to society. By "value" we mean the net contribution a company makes through its business activities—as judged by society, not by the company. CSR

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*Zentaro Kamei      Research Fellow and Project Manager, Tokyo Foundation.*

initiatives are policies and activities designed to maximize the positive “social value added” generated by the company along each step of the value chain while minimizing any negative value added. Value chain analyses suggest that positive value added is more easily generated through downstream activities, such as sales, which involve the delivery of products and services. Upstream activities, such as procurement and production, are more likely to have a negative impact in the form of environmental degradation, human rights violations, and so forth.

Of course, the perceptions and expectations of stakeholders change as society changes. This means that society’s assessment of a business’s social value added is also subject to change. That is why each company needs to keep up with changes in the social climate while continuously analyzing and assessing the value it generates.

With these challenges in mind, the Tokyo Foundation conducted its first CSR survey of Japanese corporations during the summer and fall of 2013. After analyzing the quantitative data acquired through this survey, along with information from multiple interviews of corporate officers, we compiled our observations and conclusions in the 2014 CSR White Paper in order to provide an overview of the current state of Japanese CSR and highlight key issues going forward. The report led to three basic conclusions. First, to develop sustainable businesses in a sustainable society, companies need to integrate social initiatives seamlessly into their business activities in such a way that what benefits the corporation also benefits society, and vice versa. Second, in order to achieve such integration, we must find new ways of linking the long-term interests of society to business activity. And finally, while many Japanese companies affirm the importance of integration, very few have made significant progress in achieving it.

### **Being Responsive to Change**

In the summer and fall of 2014, the Tokyo Foundation conducted its second CSR survey, and once again we were gratified by the large number of companies that returned completed questionnaires. We also continued our practice of interviewing officers of companies actively involved in CSR. In the essay “How Japanese Businesses Practice Social Sustainability: A Profile,” we outline the next steps for Japanese CSR based on these survey results and interviews.

Like each individual, each business exists in relation to the rest of society. Contributing to a sustainable society entails clarifying one’s own role and *raison d’être* in it. But society is continuously changing. New social issues emerge, and with them, new expectations of the corporate sector. Our latest CSR survey reveals that most Japanese companies base their grasp of current social issues almost solely on

the perceptions of people inside the company, sometimes supplemented by input from a handful of clients and business partners. They create few opportunities for feedback from the wider community and are anything but open to outside opinions. They have made little or no progress in developing mechanisms for monitoring early signs of change, translating their observations into new tasks and goals, and sharing those goals internally in such a way as to mobilize the organization as a whole. Instead of seeking out challenges no one has successfully tackled, most seem content to maintain existing programs and policies.

On the other hand, those companies that can overcome this tendency toward insularity, rigidity, and conservatism have a good chance of becoming industry leaders, blazing a path toward sustainability at the corporate and social level.

There is a word that aptly describes companies that are open to all stakeholders, that listen to a wide range of opinions and accept differing viewpoints, that strive to see things that were previously invisible and make them clear to all, that have the courage to take on new challenges and launch new platforms for action when they see that the old frameworks are keeping them from reaching their potential and addressing emerging issues. That word is “responsive.”

The figure below sums up the conclusions of our survey and case studies in schematic form. It begins with a breakdown of CSR into its basic processes, from identifying social issues to resolving them. Within this framework, it sums up the challenges facing Japanese companies and the strengths exemplified by the responsive companies highlighted in our case studies.

### **Dialogue and Internalization**

CSR is a process requiring a company to first identify social issues to address, then to internalize those issues in such a way as to mobilize the company’s organizational strengths, and finally to make concrete progress in resolving them. Most companies tend to neglect the first two phases, focusing their efforts on solutions. But responsive businesses work hard on identifying and internalizing issues and constantly strive to make improvements in these two areas. Genuine dialogue with stakeholders with a wide range of social viewpoints enhances companies’ ability to identify issues. Internal assessments based on quantitative targets that change as improvements are made contribute to the internalization process. And development of human resources equipped to promote dialogue and internalization helps accelerate the shift to a more responsive and resilient corporate culture.

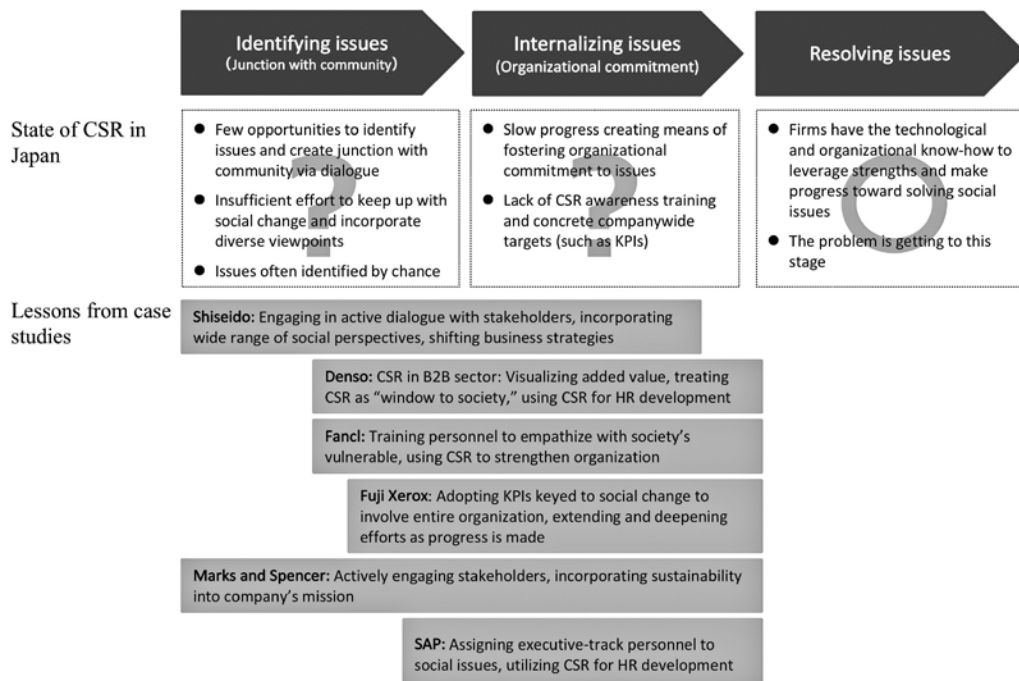
Our 2015 white paper offers six examples of responsive companies, explaining what they are doing and where they are focusing their efforts.

Amid the constant collision of values that characterizes today's society, Shiseido has succeeded in building a company that earnestly engages the community through ongoing efforts to enhance dialogue. Here we catch a glimpse of the sort of genuine exchange that only a responsive company can engage in, and of the challenges corporations must overcome in addressing social issues head-on.

British retail giant Marks and Spencer has achieved a rare degree of dialogue and collaboration with stakeholders by actively involving the community in its CSR initiatives. The progress it has made at every organizational level since adopting its current sustainability vision—a surprisingly recent development—epitomizes responsive management and underscores the importance of companywide commitment and of putting one's principles into practice.

Denso is an example of a company in the B2B (business to business) sector that has taken pains to assess the value it delivers to society and the burden it imposes. Denso has developed detailed indicators and targets and rigorous process management geared to a quality-first manufacturing ethos. Regarding its CSR program as the company's "window" to the broader community, it has made its social initiatives an integral part of its personnel training program. In this way, responsive management has led to ongoing evolution in the area of CSR.

## Japan's CSR Challenges and Lessons from Our Case Studies





Fancl has a fairly long history of involvement with society and especially with society's most vulnerable members, but it has recently taken its CSR a step further by redefining its social commitment as central to its *raison d'être*. Through its meticulous engagement with the community and its commitment to training highly responsive personnel, it has built a CSR program that has made the company stronger.

German software giant SAP views its CSR program as a training ground for the development of responsive personnel and a steppingstone to upper management. It claims there is no better learning experience than being assigned to the forefront of efforts to deal with social issues and taking responsibility for implementing solutions backed by the power of the organization. This focus on CSR as a key aspect of human resource development is immensely valuable to businesses and society alike.

Fuji Xerox sets quantitative targets that are adjusted as the company makes progress in various aspects of CSR—an area that is notoriously difficult to quantify—and translates those targets into action at every level. In the evolution of the company's CSR program, we see how continued practice leads to deeper and more effective involvement and how a responsive organization tackles one new challenge after another.

The importance of responsiveness is a view shared by the CSR experts whose essays appear in this white paper. What are the social issues of tomorrow, and how should we approach them? How are social and economic changes altering the viewpoint of investors and the market? What are the implications for corporate engagement with civil society and the whole spectrum of stakeholders? Only a responsive company can stay abreast of these trends. This report also focuses on CSR in the European Union, a global leader in corporate ethics and social responsibility. Some of the findings regarding aspects of social change and differences between Europe and Japan are highly instructive.

Responsive companies can help build a responsive society—this is the kind of virtuous circle for which we should strive. But what conditions are needed to set the cycle in motion? This report makes clear that the key requirements are dialogue (in order to identify issues) and internalization (in order to translate the issues identified into action). Unfortunately, most Japanese companies are lacking in these two basic prerequisites. Now they are facing a critical test of their ability to chart a new course with the understanding that dialogue and internalization are both essential steps toward a sustainable future. Can Japanese businesses pass the test?

May 30, 2016

## Encouraging Sustainable and Responsible Investment

Masaru Arai

For years now, Japan's glacial progress in the direction of socially responsible investment (SRI) has made the country a holdout from global trends and threatened to turn it into an isolated "investment Galapagos." But that may be about to change. In the wake of recent reform initiatives, Japan—like Europe and North America—is about to embark on a new era of SRI spearheaded by institutional investors.

This is not to suggest that responsible investing is a new concept in Japan. In fact, the beginnings of the movement go back to 1999, which witnessed the establishment of multiple "eco-funds" committed to investment in environment-friendly businesses. By December 2007, the value of these funds' equity investments had reached ¥1.12 trillion. But the global financial crisis of 2008 abruptly brought that trend to a halt. By March 2015, the assets under management by eco-funds had dropped to ¥242 billion, just over a fifth of their peak value. Although the overall volume of stock market trading has jumped since 2012, boosted by Prime Minister Shinzo Abe's expansionary policies, there has been no sign of a similar recovery in responsible equity investment.

To be sure, Japanese investment in social impact bonds has increased sharply since 2008. Investment in these instruments—which are used to fund social initiatives, such as child immunization and micro-financing in developing countries or water management in the Asia-Pacific region—was valued at ¥623.8 billion in March 2015, about 2.5 times the value of SRI assets invested in the stock market. Even so, investment in both categories combined amounted to just ¥891.8 billion, well below the peak recorded back in October 2007.

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Masaru Arai     *Chair, Japan Sustainable Investment Forum.*

## Global Explosion

The growth in Japanese SRI over the past few years has been negligible in comparison with global trends. According to *Global Sustainable Investment Review 2014* (a collaboration of the Global Sustainable Investment Alliance and the Japan Sustainable Investment Forum (JSIF), SRI assets worldwide reached \$21.4 trillion at the beginning of 2014, about five times the total market capitalization of the Tokyo Stock Exchange.

The *Global Sustainable Investment Review* divides SRI into seven strategies.<sup>1</sup> In dollar terms, the category of SRI that experienced the greatest growth between 2012 and 2014 was “ESG integration,” also known as “ESG investing,” in which environmental, social, and governance factors are considered alongside companies’ financial data. ESG investing more than doubled during those two years from \$5.94 trillion to \$12.85 trillion. One of the key factors driving the growth in ESG investing was the 2006 release of the Principles for Responsible Investment under the leadership of the UNEP Financial Initiative and the UN Global Compact. The signatories to the PRI commit themselves to ESG investing by following the guidelines for investment analysis and decision-making set forth in that document. As of June 2, 2015, there were 1,395 signatories—of which 32 were Japanese organizations—consisting primarily of pension funds, investment managers, and investment information services. In 2014, the PRI signatories managed assets in excess of \$45 trillion.

Pension funds control more assets than any other category of investors worldwide, and 10 of the world’s 20 biggest pension funds have already signed the PRI. Among the global top 20 are 3 huge Japanese funds, but none of these have signed thus far. If they did, the combined assets of the PRI’s pension-fund signatories would amount to 76% of the world’s top 20 funds.

According to *Asia Sustainable Investment Review 2014*, compiled by the Hong Kong-based Association for Sustainable and Responsible Investment, SRI assets in East Asian countries other than Japan totaled \$44.9 billion in the year under review, almost six times the Japanese figure (\$7.6 billion). Malaysia (\$15.1 billion), Hong Kong (\$11.3 billion), and South Korea (\$8.4 billion) all ranked higher than Japan in responsible investing.

The limited scale of SRI in Japan is a function of the lack of participation by

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<sup>1</sup> The strategies are (1) negative/exclusionary screening, (2) positive/best-in-class screening, (3) norms-based screening, (4) integration of ESG factors, (5) sustainability-themed investing, (6) impact/community investing, and (7) corporate engagement and shareholder action.

institutional investors; most sustainable investment assets in Japan are individually owned. In this sense, Japan contrasts sharply with Europe, where public pensions have driven the SRI movement.

In 2013, the Japan Sustainable Investment Forum distributed questionnaires to more than 2,000 Japanese pension funds in an attempt to quantify institutional investors' thinking on ESG investing. Unfortunately, only 46 of those funds returned completed surveys. Nonetheless, the results were illuminating.

To begin with, they suggested a surprising awareness of the importance of ESG efforts by private companies. When asked about the importance of ESG factors at the corporate level, a full 100% responded either "yes, they are important" or "they are becoming important." With regard to the impact of ESG factors on corporate value and stock prices, 98% answered either "they have already had an impact," "they could have an impact henceforth," or "they will become increasingly important."

On the other hand, a mere 7% of respondents reported that their funds had begun factoring ESG into their investment decisions. Asked what prevented them from pursuing such policies, 45% replied that they had "little opportunity to build real knowledge and understanding of ESG investing," while 33% admitted that it had never even come up for consideration. More than 50% expressed interest in JSIF seminars on the topics of "socially responsible investment and the difference between SRI and ESG investing," "practical approaches to ESG investing," and "trends in the integration of financial and nonfinancial corporate data and their significance for investing."

On the basis of these results, we concluded that JSIF and its members needed to work harder to promote ESG investing. At the same time, the failure of so many pension funds even to consider ESG investment options suggested a fundamental lack of interest or initiative on their part.

## **Recent Progress**

Fortunately, this longstanding inertia appears to be coming to an end, thanks to initiatives undertaken in the past year or two.

One milestone was the February 2014 release of the Principles for Responsible Institutional Investors—also known as Japan's Stewardship Code—by the Financial Services Agency. As of March 2015, a full 184 of Japan's institutional investors had put their names to the code, committing themselves to engagement (purposeful dialogue) with investee companies. Meanwhile, the Corporate Governance Code, which entered into force on June 1, 2015, calls on companies to adopt and imple-

ment proactive governance to enhance accountability to stakeholders, and facilitate swift and effective decision-making.

The new guidelines grew out of the current government's Basic Policies for Economic and Fiscal Management and Reform. These revitalization policies, adopted by a cabinet decision in June 2013, spawned a slew of reform initiatives. An expert panel drew up recommendations to introduce more sophisticated principles and methods into the management of the Government Pension Investment Fund (GPIF). The Financial Services Agency set to work drawing up Japan's Stewardship Code. The Ministry of Economy, Trade, and Industry forged ahead with projects geared to governance and investment reform, including the Corporate Reporting Lab and the so-called Ito Review ("Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationships between Companies and Investors"), which published its final report in August 2014. The Ministry of the Environment also launched an initiative in support of ESG investing. The GPIF subsequently commissioned a study on stewardship responsibilities and approaches to ESG investing, and in the medium-term (five-year) plan released in April 2015, the fund announced that it would begin examining options for considering ESG factors along with financial data to ensure returns when investing in the stock market.

As the foregoing illustrates, the Japanese government has made considerable progress with programs to encourage SRI in conjunction with the prime minister's Abenomics program for economic growth. This has fostered high expectations—both within Japan and overseas—for a sea change in Japanese investment practices.

## **Global Standards for Corporate Disclosure**

With the global advance of SRI and the advent of Japan's Stewardship Code calling for dialogue between corporations and institutional investors, there is an urgent need for Japanese businesses to rethink their approach to the disclosure and reporting of corporate data. The key challenge is to bring their practices into conformance with global reporting standards and expectations.

The current trend in corporate disclosure is integrated reporting, which combines financial data with indicators of sustainability and social responsibility. While the number of Japanese companies embracing integrated reporting is on the rise, the quality and content of their reports—even many of those singled out for praise in Japan—are rarely such as to meet the expectations of overseas investors. While adopting the basic IR approach, they tend to omit or gloss over categories that are required by foreign investors, including water use, biodiversity impact, responsibility to customers, supply-chain impact, and tax payment. To meet the expectations

of foreign investors, Japanese companies need to spend as much time as it takes to improve their reporting in these areas.

People sometimes ask me to name some companies that do a particularly good job when it comes to disclosing corporate information. Overseas, Unilever, BMW, Nestle, and Intel are among the businesses most frequently praised for the quality of their reporting. Among Japanese businesses, Omron receives consistently high marks, and the Lixil Group deserves mention for the clarity of its reporting. In the area of governance—typically a weak point of Japanese businesses—I would cite the example of Konica Minolta, which demonstrates that Japanese companies, too, can successfully incorporate Anglo-American systems of corporate governance.

Hitachi and Toshiba are also good at disclosure, though from a different standpoint. Both of these companies have accumulated a wealth of data in various categories spanning a number of years, organized it, and made it easily accessible on their websites. The information attests to a sustained and serious effort on their part.

“Conciseness” is one of the qualities emphasized in the International Integrated Reporting Framework, and Japanese companies have been quick to zero in on this term. What they need to realize, however, is that “concise” in this context means “to the point,” not “as brief as possible.” European companies tend to disclose far more information than their Japanese counterparts, and their integrated reports are typically much longer. Even so, they are easy to absorb. It seems to me that a foreign investor accustomed to such reports would find the integrated reports of most Japanese companies vague, lacking in detail, and suggestive of a half-hearted commitment. This is a major issue for corporate reporting in Japan.

## **The Role of the Financial Sector**

Why have ESG issues assumed such a high profile in the contexts of investment and corporate management? As I see it, there are three basic underlying factors. One is the fact that the corporate and financial sectors have come to play the leading roles in our capitalist economy. The second is the fact that, thanks to globalization, an individual business can have a greater impact on a given society—particularly in the emerging markets—than national policies and programs. And the third is the fact that many investors and business leaders, chastened by the devastating impact of the 2008 financial crisis, recognize the danger of focusing on short-term profits and the need to adopt a more sustainable, long-term approach.

Such are the forces behind the growing calls for the financial sector—particularly investors and shareholders—to adopt a long-range perspective oriented to the

sustainable growth of business and society and for business to provide goods and services that contribute to the international and regional community while pursuing strategies conducive to long-term growth.

Humanity is facing a host of urgent problems in the twenty-first century, including rising carbon emissions, deforestation, the deterioration of ecosystems and decline in bioproductivity, a decline in biodiversity, the growing list of endangered species, growth in global water demand, water scarcity due to economic activity, food shortages, the depletion of marine resources, the impact of global population growth, energy security and supply concerns, economic development and urbanization, and growth in consumption.

According to “eco-footprint” calculations published by the World Wide Fund for Nature, if everyone in the world lived as the average resident of Japan does, it would take two earths to sustain them. For everyone on the planet to live like the average American, we would need five and a half earths. The inhabitants of the developed world are already taking far more from the earth than the planet can provide, and the developing world and future generations will end up footing the bill for their extravagance.

In their investment and business decisions, investors and companies must act on their moral responsibility and reject the kind of behavior that eats into the assets of future generations or saddles them with negative assets. This is why public pensions in Europe and elsewhere have actively embraced SRI. The time has come for Japanese investors and businesses to assume the role of global citizens and start thinking seriously about their *raison d'être* and the impact of their actions on future generations.

April 19, 2016

## From Dialogue to Partnership: Marks & Spencer

Mikiko Fujiwara

**M**arks & Spencer is a major British retailer with some 850 stores in the United Kingdom—including department stores, supermarkets, and convenience stores—and branches in 59 countries around the world. It is also a world-renowned presence in the field of CSR. Under a CSR strategy called Plan A, M&S has vigorously engaged nongovernmental organizations and other stakeholders in dialogue and translated such dialogue into collaboration, partnering with them to involve customers in Plan A and enlisting them in a larger effort to address environmental and social problems. In 2014 alone, the company received 36 awards for its CSR initiatives.

### Getting Customers Involved

A brief tour of the M&S Plan A website page conveys a sense of the company's commitment to getting customers involved. Under the words "Welcome to Plan A" are three main menus, with "Get Involved" in the center. Under "Get Involved" are the words "Be Inspired by M&S Plan A."

Clicking "Get Involved" takes you to an overview of eight CSR projects currently underway. The introductory text on the page contains these memorable words: "Environmental and ethical goals aren't achieved just by talking—we believe in doing. Over the

years we're proud to have got involved in a number of great projects that really do make a difference. Why not join us? . . . Let's do it!" The orientation is participatory instead of explanatory, opening a door to engagement rather than pointing out the



*The Marks & Spencer Plan A website.*

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Mikiko Fujiwara      Project Member, CSR Research, Tokyo Foundation.



company's own accomplishments. It involves the viewer and reveals the company's determination to make a difference by joining forces with others.

Let us look at some of these customer-involvement projects. In one, you can donate a portion of the price of coffee to a charity that supports cancer victims. In another, you can join with M&S employees and a marine conservation society to clean up the country's beaches. You can contribute money or supplies to an organization that helps the homeless and promotes housing for low-income families, or you can recycle used clothes by donating them to an international aid organization.

All are projects that M&S is carrying out in partnership with various NGOs. In other words, each of these opportunities for customer involvement is the result of collaboration between M&S and a nonprofit organization. These partnerships are products of the company's ongoing dialogue with various NGOs. In fact, engagement with NGOs and other stakeholders is central to Plan A. Thanks to the company's assiduous and continuing efforts, engagement and collaboration with stakeholders have become an everyday affair at M&S.

### **Beginnings of Plan A**

Why does M&S place such emphasis on stakeholder dialogue? What does it hope to get out of it?

The answer to that question can be found in the content of Plan A. Plan A is not just a gimmick cooked up by the company's CSR department. It is a paradigm change involving the company's core philosophy and the way it does business. So, what exactly is Plan A? Let us take a look at the plan's origins and development to understand why Marks & Spencer, which has shaped its business model and brand image around Plan A, has embraced stakeholder engagement so enthusiastically.

Marks & Spencer began as a family-run business in the late nineteenth century. Even after the family fully relinquished control in the 1980s, a strong current of paternalism persisted in the company's management style. Paternalistic management tends to be inward looking, looking after employees as if they were family but paying relatively little attention to the concerns of external stakeholders. The idea of incorporating external feedback is foreign to management in such a corporate culture. While M&S spent considerable sums on charitable causes in those days, such philanthropy was completely divorced from the company's business operations.

This culture began to change as the concept of CSR took hold. By 2006, the company's CSR efforts in the areas of compliance and risk management, as well as philanthropy, had earned it the title of Company of the Year from Business in the

Community, Britain's corporate network for social responsibility. But M&S recognized that further change was required.

The main impetus for the company's transformation into a business that grasped the importance of stakeholder engagement and made it central to corporate management was the appointment of Stuart Rose as chief executive officer in 2004. When Rose took the helm, M&S was still in the habit of handing environmental and social concerns over to a dedicated CSR team to deal with them separately from other management issues. Because of this, Rose felt that the company's lofty social, environmental, and ethical goals all too often failed to materialize as concrete action. He felt that what the company needed to do was reassess its day-to-day operations, or "the way we do business," in the light of its social, environmental, and ethical responsibilities, and to take the lead in addressing important issues.

In 2007, under Rose's vigorous leadership, M&S released Plan A, a five-year plan outlining 100 commitments relating to five priority environmental, social, and ethical issues: Climate Change, Waste, Sustainable Raw Materials, Fair Partner, and Health. As the company's 2007 "How We Do Business" report explained it, "We've only got one world. And time is running out." The thinking was, "There is no plan B." To tackle the problems facing society, it was necessary to commit to Plan A, which meant changing the way the company did business.

## **Governance Structure**

Chief Executive Stuart Rose announced up front, "The changes we are planning will only succeed if Plan A is fully integrated into the way we do business." In other words, he made implementation of Plan A a basic governance issue. With his emphasis on top-down initiatives, Rose replaced the Corporate Social Responsibility Committee with a new executive-level committee. The How We Do Business Committee, as it was dubbed, met monthly with himself as chair and consisted of the company's senior officers for social, environmental, and ethical affairs.

Each of Plan A's five themes was assigned to a committee member, who assumed responsibility for ensuring that the commitments in that area were met. One member was also put in charge of employee involvement, demonstrating the company's seriousness about spreading the word to employees. With the structures for implementation in place, Marks & Spencer began putting Plan A into action.

One of the most noteworthy features of Plan A is the explicit understanding that dialogue and collaboration with external stakeholders are essential to its implementation. In the 2007 sustainability report, M&S concluded its introduction to the Plan A philosophy as follows: "We don't have all the answers, and we will

need to work with suppliers, the Government and other partners to put Plan A into action.”

## Listening to Stakeholders

Let us look at Plan A more closely to see how this works. Under each of the five themes mentioned above, the plan provides a list of relevant external stakeholders, including specific NGOs involved in that area. For example, under Sustainable Raw Materials, it lists not only customers, suppliers, and shareholders but also a wide-ranging selection of NGOs: the Marine Stewardship Council, the Marine Conservation Society, the WWF-UK, the Forest Stewardship Council, the Forest & Trade Network, LEAF (Linking Environment and Farming), and the RSPCA (Royal Society for the Prevention of Cruelty to Animals).

It also sets forth 20 commitments in that area, such as, “phasing out a further 19 pesticides used in fruit, vegetable and salad production by the start of 2010 in addition to the 60 we have already banned,” “ensuring all the fish (fresh and processed) we sell is Marine Stewardship Council (MSC) certified or, where MSC is not available, another equivalent independent standard,” and “work[ing] with animal welfare groups to develop sourcing policies on animal welfare for leather and wool.” The plan does likewise for the other four themes, naming a total of 21 partner NGOs in the process.

## The External Stakeholders of Priority Environmental, Social, and Ethical Issues

Climate Change	Waste	Sustainable Raw Materials	Fair Partner	Health
Customers	Customers	Customers	Customers	Customers
Suppliers	Suppliers	Suppliers	Suppliers	Suppliers
Shareholders	Shareholders	Shareholders	Shareholders	Shareholders
The Climate Group	WRAP (Waste & Resources Action Programme)	Marine Stewardship Council	Ethical Trading Initiative	Food Standard Agency
The Carbon Trust	Closed Loop London	Marine Conservation Society	Fairtrade Foundation	
Energy Savings Trust	London Remade	WWF-UK	Shell Foundation	
WWF-UK	Government	Forest Stewardship Council	Breast Cancer Campaign	
National Federation of Women's Institute		Forest & Trade Network		
Forum for the Future		LEAF (Linking Environment and Farming)		
		RSPCA (Royal Society for the Prevention of Cruelty to Animals)		

*Compiled by the Tokyo Foundation from Your M&S: How We Do Business 2007 Report.*

Specifying organizations by name in connection with each of the plan's major initiatives demonstrated the company's commitment to meaningful dialogue and collaboration. Once it had put those names in writing, there would be no backing down. With other parties involved, it could hardly lie about what it had done or not done. And to say, "We meant to do it, but it didn't go as planned," would compromise the company's credibility as a trustworthy brand.

Engaging with external stakeholders almost always causes headaches. It takes time to build mutual understanding, and sometimes the two sides cannot see eye to eye. As a result, such engagement is all too often reduced to a formality, with management holding a meeting or two in the name of dialogue. But M&S had made a written pledge to achieve specific goals by listening and collaborating with specific stakeholders. One cannot make such a commitment in writing unless one is prepared to follow through.

The How We Do Business Committee was charged with upholding that commitment. In each division and department, management actively engaged in dialogue with its stakeholders. On any given day, it was almost certain that someone somewhere in the company would be listening to and interacting with stakeholders. Through its dialogue with NGOs, management received valuable feedback regarding the current version of Plan A, including some harsh criticism of individual commitments, and gained new perspectives on social and environmental issues that drove the identification of new commitments.

Such exchange also gave M&S an opportunity to explain the kinds of things it could and could not do as a private corporation. The aim was not asserting one side's dominance or superiority over the other; it was building relationship in which both sides could talk openly, on an equal footing. This is the kind of relationship that leads to collaboration.

### **Making Plan A "How We Do Business"**

The original Plan A was a five-year project intended to fulfill 100 commitments by 2012. Prior to the target date, the company unveiled Plan A 2010, adding 80 further commitments. The explicit goal this time was to make Plan A part of the company's DNA, building the spirit of Plan A into all 2.7 billion of its products. The new plan preserved the five original environmental, social, and ethical themes more or less intact: Climate Change, Waste, Natural Resources, Fair Partner, and Health and Wellbeing. But Plan A 2010 also featured two new pillars aimed at extending the plan's reach and integrating it more fully into business operations. These were Involving Customers and Making Plan A 'How We Do Business.'

To achieve its goals, the company moved to strengthen its Plan A management and promotion apparatus. In place of the How We Do Business Committee, it created a two-tiered apparatus. The How We Do Business Executive Committee, made up of all the members of the board and chaired by the CEO, would meet every two months to ensure that the company's business strategy meshed with Plan A. The How We Do Business Operating Committee, made up of division heads and chaired by the director of Plan A, would meet every month to review day-to-day operations and performance. This two-tiered framework has continued up to the present.

Plan A 2010 also established key performance indicators for all 180 commitments and a mechanism for monitoring progress toward the objectives. In addition, it established Plan A targets for all its executives and adopted a system linking bonuses to the achievement of those objectives.

Like the original Plan A, the new plan spelled out the pivotal role of dialogue and partnership with stakeholders. With the development of a stronger Plan A management system, stakeholder engagement became even more central to the company's management practices.

### **Further Evolution of Plan A**

In 2014 M&S adopted Plan A 2020, and set about building a whole new mechanism for achieving sustainability. The change is apparent in the plan's pillars. Previously, the pillars of Plan A were specific social and environmental issues, such as climate change and waste. In truth, neither the process of identifying objectives nor the internal systems for achieving them were particularly novel compared to the perspective adopted by Japanese businesses. However, all that changed dramatically with Plan A 2020. The new pillars of the company's long-term drive to become "a truly sustainable retailer" are more in the nature of corporate ideals: Inspiration, In Touch, Integrity, and Innovation.

Quite frankly, these headings are so abstract that it is difficult to know what their intent is without delving further. Let us see if the captions provided in the 2014 report shed some light on the matter. Under Inspiration, we read, "We aim to excite and inspire our customers at every turn"; under In Touch, "We listen actively and act thoughtfully"; under Integrity, "We always strive to do the right thing"; and under Innovation, "We are restless in our aim to improve things for the better."

From these brief glosses, we can see that the four new pillars are in fact standards of conduct. The social and environmental themes that previously served as Plan A's pillars are embedded in these standards, and any further social and environmental challenges that the company takes on henceforth will likewise be em-

bedded in them. By holding up these four standards, the company is encouraging individual employees to think how each one applies to their work. This fosters initiative and autonomy, fostering the internalization of the spirit of Plan A in each of its employees.

In terms of stakeholder engagement, the latest report specifies the ways in which management listens to and works with each of the six categories of stakeholders: customers, employees, shareholders, suppliers, government and regulators, and nongovernmental organizations. Like previous plans, the latest version provides the names of specific NGOs, citing WWF, Oxfam, RSPCA, and Greenpeace among their major partners. Engagement with such organizations takes the form of visits and meetings, participation in benchmarking and surveys, joint projects, and Plan A stakeholder conferences. The 2014 report notes that NGO stakeholders have voiced concern about supply chain management, transparency, the living wage, food waste, reporting, and the impact of climate change.

In addition, the M&S website specifies 11 NGOs that are actively engaged in partnerships with the company.

## Dialogue and Collaboration with Stakeholder under Plan A

Our Stakeholders	How We Listen
<b>Customers</b>	<ul style="list-style-type: none"> <li>– Participation in Plan A activities and campaigns</li> <li>– Contacts to our Retail Customer Services</li> <li>– Research and surveys</li> <li>– Social media</li> </ul>
<b>Employees</b>	<ul style="list-style-type: none"> <li>– Plan A Champions</li> <li>– Annual Your Say survey</li> <li>– Participation in Plan A activities and campaigns</li> </ul>
<b>Shareholders</b>	<ul style="list-style-type: none"> <li>– Annual General Meeting</li> <li>– Meetings with institutional investors</li> <li>– Survey of institutional investors</li> <li>– Ethical investment surveys</li> </ul>
<b>Suppliers</b>	<ul style="list-style-type: none"> <li>– Supplier conferences</li> <li>– Supplier Exchange website and network</li> <li>– Visits and meetings</li> </ul>
<b>Government and regulators</b>	<ul style="list-style-type: none"> <li>– Meetings</li> <li>– Responses to consultations</li> <li>– Plan A stakeholder conferences</li> </ul>
<b>Nongovernmental organizations</b> Such as WWF, Oxfam, RSPCA, Greenpeace, Friends of the Earth and the UK Green Building Council	<ul style="list-style-type: none"> <li>– Visits and meetings</li> <li>– Participation in benchmarking and surveys</li> <li>– Joint projects</li> <li>– Plan A stakeholder conference</li> </ul>

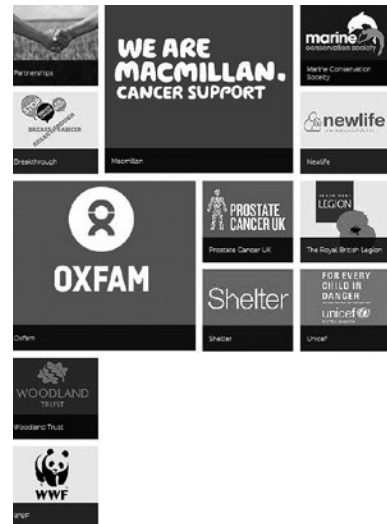
Source: *Your M&S: Plan A Report, 2014.*

When M&S first launched Plan A, it announced its commitment with the words, “Because we’ve only got one world. And time is running out.” In his introduction to Plan A 2020, Mike Barry, director of Plan A writes, “If there is one overarching lesson we draw from the first seven years of Plan A, it’s one of humility. We won’t change the world alone; in fact we can’t even change our own business alone . . . we know that the importance of partnership is growing.” This is exactly why M&S has put so much effort into honest dialogue with its stakeholders. Today, the partnerships that have grown out of such dialogue have become standard operating procedure for Marks & Spencer.

The Tokyo Foundation survey of Japanese businesses reveals that those companies that engage in dialogue with NGOs, NPOs, and socially vulnerable groups are more conscious of social and environment problems and are more likely to be taking concrete steps to address those problems. The example of Marks & Spencer confirms the idea that serious dialogue leads to constructive action. By engaging NGOs in dialogue as equals, management has gained a new awareness of social and environmental issues that preoccupy those organizations. This has led to new Plan A commitments and opened the way for partnership with the NGOs. Dialogue and partnership are the keys to Marks & Spencer’s success in building and maintaining a reputation as a global leader in CSR.

To be sure, as a British firm, Marks & Spencer is operating in a particularly favorable climate for initiatives of this sort. Britain’s pursuit of smaller government in the cause of fiscal austerity has greatly augmented the role of its civic groups, local communities, and NGOs, which have acquired considerable financial and political clout as a result. These circumstances have fostered greater mobility of human resources between sectors. Those NGOs with the highest name recognition have drawn talent from the private sector, and business has recruited personnel from the nongovernmental sector as well. As a result, an increasing number of people in both sectors are able to communicate in the same language, and people with experience in both sectors are establishing human links between businesses and NGOs. For this reason, Britain today provides a particularly fertile ground for dialogue between the two.

This may convey the impression that the situation in Japan, by contrast, is



*Partner NGOs on the M&S Plan A Website*

unconducive to the kind of dialogue that can progress to collaboration. It is true that until now few Japanese companies have made dialogue with specific NGOs part of their CSR plans or engaged with such organizations on equal terms the way Marks & Spencer has. But is Japan's situation really so different from Britain's? Is there not good reason to suppose that the environment in Japan will come increasingly to resemble Britain's as the role of the central government declines and other stakeholders are called on to play a larger role in addressing social problems?

In Japan as in Britain, a growing number of young people care deeply about these issues. Some have even made the switch from the business to nonprofit sector. Japanese companies have begun seconding personnel to work with nonprofits on a pro bono basis, and nonprofits have dispatched personnel to work with businesses. Slowly but surely, these trends are laying the groundwork for meaningful dialogue and partnership.

How quickly we can build this groundwork into a sturdy foundation for success will be a challenge for Japanese society as a whole in the years ahead. Marks & Spencer's experience engaging and partnering with NGOs for the betterment of society holds rich implications for Japanese business in the years ahead.





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