KEIZAI DOYUKAI

"Market Evolution" and CSR Management

The 15th Corporate White Paper

Toward Building Trust and Creating Sustainable Stakeholder Value

KEIZAI DOYUKAI

<Japan Association of Corporate Executives>

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Table of Contents

Preface
<full text>
  by Yotaro Kobayashi

Business and Society: Reconsidering the Relation
<summary of Part I>
  by Yotaro Kobayashi

"Market Evolution" and Corporation in the 21st Century:
Toward Building Trust and Creating Sustainable Stakeholder Value
<summary of Part II, Chapter 1, 2, and 3>

- **Economy and Society in the 21st Century**

- **Corporate Social Responsibility (CSR):**
  Pursuing Synergetic Development of Business and Society

- **Corporate Governance (CG):**
  Ensuring the Sustained Creation of Corporate Value

Advocating a New Corporate Vision and a New Corporate Evaluation Standard
<full text of Part II, Chapter 4>

Preface

Two years have already passed since the dawning of the 21st century. Yet, Japan remains mired in the same age of confusion and reform that has continued since the closing years of the 20th century. During this period, not only has Japan failed to identify the concepts and ideas that can serve the nation as its backbone in the new century, but it has even failed to find the path to economic revitalization. It is no exaggeration to say that Japan is adrift.

Turning our eyes to the world, more than a decade after the triumphal declaration of the "victory of the market economy," the predicted "centuries of boredom" (Francis Fukuyama) have yet to materialize. On the contrary, in an environment marked by a growing diversity of values, we are experiencing various phenomena which cast serious doubts on the market economy. Similarly, mankind finds itself faced with infinite intellectual challenges as an unending list of global problems call out for solutions. Among these must be included the "clash of civilizations" which has found new urgency since the events of 9-11, the problems of poverty and hunger which grip many parts of the world, and the challenges of "sustainable development" which concern the entire global community.

Nearly two years have passed since Prime Minister Koizumi took office under the banner of "reform," promising to deliver the Japanese economy from its long-lingering predicament. But because so little has been seen in the way of concrete reforms and economic revitalization, many voices are being raised recently, both within Japan and abroad, asking whether in fact Japan has the "political will" or the "executive capacity" to see these reforms through to fruition.

Needless to say, "political will" is not necessarily limited to or defined by the will of the politicians. The question being asked is whether Japan as a nation—including its political system, administration, corporations and citizens as a whole—has the will and the executive capacity to "do what it must do." This question goes to the heart of the governance of a nation. The question being asked of us at this historic transition point is whether Japan can decide and act on the vision that it adopts for its future, or whether it will sink passively and silently into the tides of history.

When I assumed the post of Chairman of Keizai Doyukai in April 1999, I issued the challenge of establishing the "four governances:" global governance, social (or national) governance, corporate governance, and individual governance.

In my conception, global governance addresses the question of how and who should deal with the emerging challenges which transcend national capacities and jurisdictions. These include the problems of the environment, poverty, regional conflict and terrorism,

and the international flow of capital which have been exacerbated by the advance of globalization.

Although we have long lived under the influence of the "iron triangle" of politicians, bureaucrats and the business community, there is now a new development in national governance whereby new actors are arriving on the scene.

They are the individuals who take on society through citizen organizations, such as non-profit organizations (NPOs) and non-governmental organizations (NGOs). A closer examination of this matter brings us to the issue of individual governance and the question of what values serve to provide the individual with a foundation for self-discipline. No matter what organization we look at, individual governance remains a constant and fundamental theme insofar as it is the individual who stands at the core of any organization. What we are now observing is the development of civil society and the growing social participation of individuals through NPOs and NGOs. As a result of this development, individuals are playing a far greater role than ever before in the processes of social governance.

With these new developments in governance, we are being called to review corporate governance which is deeply linked, and sometimes linked in unique ways, to global, national, and individual governance.

These thoughts and approaches were incorporated into Keizai Doyukai's *21st Century Declaration* announced in December 2000 as a "mission statement" covering such matters as the future direction of Japan, the role and responsibility of corporate executives and corporations, and the future mission of Keizai Doyukai itself. *The Declaration* argued that corporations must go beyond the pursuit of "economic value" and that corporations are responsible for creating "social value" and "human value" as well.

When the market becomes overly biased in its evaluations in the direction of "economic viability," corporations can become excessively bound by the bottom-line philosophies of "results over all else" and "shareholder profits over all else." The danger in such a state of being is that corporations may veer drastically from social needs and values which reflect Japan's unique culture, traditions and customs. In this sense, it is necessary to promote the evolution of the market so that the market is capable and geared towards rendering a more comprehensive evaluation of corporations and corporate behavior.

The Declaration advocated that corporations should not passively await the evaluation of the market, but should instead actively present their principles and philosophies to the market and to society, and take the initiative in leading the market in such a direction. We have used the phrase "market evolution" to express this concept, and we believe that indeed it is by taking the initiative in "market evolution" that corporations can express their "political will for the implementation of reform."

In reality, "market evolution" is advancing in various aspects and is taking various forms. For instance, in the United States and Europe, we have seen a growing move towards socially responsible investment (SRI). This represents an effort on the part of investors to comprehensively evaluate corporations while making full use of market mechanisms. On the corporate side, we observe a growing trend towards corporate social responsibility (CSR) which represents an effort to bolster competitiveness and to achieve sustainable growth by clearly defining the social responsibilities of the corporation, widely informing society of these self-imposed responsibilities, and finally acting to fulfill these responsibilities. This signifies a classic case of corporations taking the initiative in advancing the process of "market evolution."

In applying CSR to conditions currently prevailing in Japan, we conclude that Japanese corporations must transform themselves in two respects. First, Japanese corporations must seek to revitalize the stagnant Japanese economy by bolstering their profitability and competitiveness, and by developing more effective means of creating economic value. Moreover, these objectives must be pursued through the market mechanism. Second, in pursuit of the above objectives, Japanese corporations must commit themselves with unwavering determination to fulfilling their various responsibilities to all stakeholders. To ensure that this commitment is properly carried out, corporations must establish sound systems of governance.

While there is no essential contradiction between these two transformations, given today's very complex economic and social environment, in certain respects, corporations face a trade-off relation here. In particular, making the right choice can prove extremely difficult when the mutually exclusive interests of stakeholders are in the balance. However, Keizai Doyukai made the conscious decision to face this challenge head-on. This is because we realize that extreme positions cannot deliver fundamental solutions, and because we believe that the raison d'être and function of the corporation lies in trying to supersede the problem on hand through "innovation."

Since announcing *the 21st Century Declaration*, Keizai Doyukai has continued to study the concept of "market evolution" from a theoretical perspective, while also endeavoring to develop management philosophies and tools for the practical implementation of these objectives. *The 15th Corporate White Paper* which is now being released presents certain conclusions that have been reached at the present juncture in this process. While surveying the outlook for new social and economic ideas and principles for the 21st century, the document seeks to once again examine the social responsibilities of corporations in the context of the early 21st century. The question asked here is the same as the old, fundamental question concerning social responsibility: "What is the purpose of the existence of the corporation as a member of society, and what must it deliver to society?"

The 15th Corporate White Paper is organized into the following five major sections:

Part I (Introduction) presents the basic concepts concerning the basic issue on hand which is: "What is the purpose of the existence of the corporation as a member of society, and what must it deliver to society?" I myself am principally responsible for this section.

Part II (Practical Perspective) is centered on the results of the Study Group on Market Evolution and the Corporation in the 21st Century (chaired by Mr. Toshikazu Saito). Additionally, it examines the following subjects in light of the proposals concerning corporate governance submitted by the Committee on Corporate Management for FY2001 (chaired by Mr. Kakutaro Kitashiro): [1] In connection with "market evolution," what type of society and economy should we aim to achieve. [2] In view of the contemporary implications of CSR, how should CSR be linked to the continued creation of corporate value and to synergetic development with society. [3] How should "corporate governance" be established to ensure the desired results. [4] What are the new corporate evaluation standard that we are advocating in order to take the initiative in "market evolution."

Part III (Discussion) records the discussion between myself and Chairman-elect Kakutaro Kitashiro as we discuss the following matters in light of the above: [1] Our opinions on *the White Paper*'s prescriptions on what a corporation should be. [2] How should corporate executives fulfill their functions and responsibilities. [3] How should the tools for implementation proposed by Keizai Doyukai be developed in the future.

Part IV (Theoretical Perspective) is centered on the lectures delivered by various scholars participating in the Market Evolution Project of the Keizai Doyukai Research Institute (directed by Mr. Koichi Minaguchi until January 2003, and thereafter by Mr. Shotaro Watanabe) and establishes some parameters for the theoretical study of "market evolution."

Part V (Appendices) consists of the following: **[1] final report of the research trip to Europe** by the above-mentioned Study Group on Market Evolution and the Corporation in the 21st Century. **[2] Findings of survey** of Japanese corporate executives on CSR. **[3] Worksheet for self-assessment** under the new corporate evaluate standard proposed in the White Paper.

The following two central themes are interwoven throughout *the 15th Corporate White Paper*. In the contemporary context, what form of corporate social responsibility (CSR) is important for Japanese corporations? And, what form should "governance" take as a source of the philosophy and framework for continuing to fulfill "CSR" at higher levels? *The White Paper* also proposes a system of corporate assessment criteria designed to serve as a tool for actually implementing these central themes in the management environment. It should be noted that member corporations of Keizai Doyukai have launched trial programs based on this system.

As the purpose of the corporate evaluation standard is to attain higher levels of "CSR," the standard call on corporations to identify certain goals and objectives for themselves and to make a commitment for their achievement. Keizai Doyukai eagerly looks forward to receiving as many such commitments as possible from its member corporations. To that end, Keizai Doyukai is committing itself to continuing to seek the ideal form of CSR for our times and to improve the ease of use of the standard so that CSR can be applied in actual management situations. We present this as both the expression and practice of our "political will" for the reform of corporate models for the new age.

Finally, I take this opportunity to express my deep gratitude to the members of the Keizai Doyukai committees, the external panel of scholars and experts, members of the Working Group and many others who participated and cooperated in the preparation of this *White Paper*.

March 2003

Yotaro Kobayashi
Chairman, Keizai Doyukai

Taking the Initiative in "Market Evolution"

……Along with the strengthening of the functions of the market, we must make efforts as corporations **to facilitate the evolution of a market capable of valuing not only "economic aspects" but also "social aspects" and "human aspects."** The market is equipped with a mechanism for effective allocation of resources through the process of price formation. Should market participants, as a result of social changes, place added emphasis on values other than "economic aspects," namely "social aspects" and "human aspects," the market has the internal dynamism needed for refining its functions to effectively reflect these values. In other words, the market is able to evolve in step with changes occurring in society.

In fact, society has already begun to assess companies on the basis of a broad range of values other than simple "economic values." Leading examples of this include the movements of green and social consumerism which are vetting companies on the basis of their environmental response and their involvement in the resolution of various social problems. Similarly, "socially responsible investment funds" are being created which include an index of social behavior in their assessment and selection of companies. If this trend continues to spread, we believe that eventually the market will be able to make integrated evaluations of both economic and social values in broadly defined terms.

What is important for us is **to take the initiative in actively promoting market evolution.** It is through this means that we will be able to achieve the true form of "market economy" that we pursue and that signifies the emergence of **a system in which the expectations of society and corporate objectives can be autonomously harmonized through market dynamism**. ……

(Keizai Doyukai, *21st Century Declaration*, December 2000.)

Business and Society: Reconsidering the Relation

Yotaro Kobayashi
Chairman, Keizai Doyukai

What is the Purpose of the Existence of the Corporation as a Member of Society, and What Must It Deliver to Society.

Corporations are integral members of "society" and cannot exist if they ignore their relation to society. However, we have witnessed far too many instances of corporate behavior which leads us to doubt whether this simple truth has been accepted as self-evident. Corporations and members of corporations must return to the basic starting point of corporate management to once again examine the fundamental question: As a member of society, "what must the corporation deliver to society?"

Reconsidering "Corporate Social Responsibility"

If we consider the corporation to be the "public vehicle" of society and if we take "social responsibility" to imply a broadly-based "responsibility to society," then the responsibility of corporate executives is to order the priorities of the corporation and set the managerial balance in line with the changing needs of society, while at all times keeping an eye on the stakeholders in corporate management. This does not imply that "social responsibility" is the "primary responsibility" and "economic responsibility" the "secondary responsibility." Rather, "social responsibility" must be recognized as a concept that encompasses both, and whose aim is to create the synergetic development of society and the corporation by harmonizing the two responsibilities on a higher dimension. The basic idea of "market evolution" is that this harmonization should be voluntarily and autonomously achieved through the dynamic forces of the market.

Mutuality of Business and Society

We should not accept the corporate model that says the corporation is an inorganic machine for generating shareholder profits. The corporation brings together shareholders, customers and employees who are each unique individuals with their own unique values and preferences. The corporation provides these individuals with an arena for interaction and the development of mutual trust and confidence. The corporation is place for a "balancing game" for mutually exchanging and coordinating a diverse range of interests. Furthermore, the relations between the business and society are mutual. The raison d'être and objectives of a corporation change from time to time and emerge out of the shifting values and needs of society, and from the relationship with the interests and concerns of stakeholders. Finally, the relation between the business and society is not a one-way street where the corporation must accept all the demands of society. Rather, the

relation should be understood to be a bi-directional one where corporate actions and behavior affect the values of the individual and of society.

Changing Social Demands

Why is it necessary to re-assess "corporate social responsibilities?" The reason is that society's demands on the corporation change from period to period. When Keizai Doyukai was formed in the early postwar period of 1946, economic reconstruction represented the most urgent challenge for Japan. We can sense the zeal with which our predecessors took on this challenge in the mission statement issued at the founding of Keizai Doyukai:

> *……The Japanese people must discard their old robes, and they must weather the current storm of economic, moral and ideological ruin and confusion to erect a completely new order……*

> *……We stand ready as members of the business community to dedicate all our efforts to the construction of a new Japan. Indeed, the economy must play an extremely important role in the reconstruction of Japan, for the economy must serve as the cornerstone for the reconstruction of Japan……*

> *Mission Statement at Founding of Keizai Doyukai*, 1946)

Having gone through the period of accelerated growth and having experienced the collapse of the bubble economy, Japanese society today has arrived at a far more drastic transition point than those it has previously passed through. The changing social environment is defined by such current developments as post-industrialism (service-based and knowledge-based industry), globalization, the IT revolution, the decline in birth rates and the aging of society, the collapse of the "parties system since 1955," and the emergence of civil society as represented by NPOs and other organizations.

Given this new social environment, it is now increasingly evident that corporations must re-examine their social responsibilities for the following reasons:

- **Growing mutual influence of business and society:** Globalization has extended the scope of corporate activities. In this process, both the influence that a corporation has on society and the influence that society exerts on a corporation have grown significantly.

- **Society's changing view of the corporation:** The IT revolution has greatly facilitated access to information and expertise. This has encouraged the development of NPOs and other elements of civil society, and has fostered a far more critical view of corporations.

8

- **Rectifying the excesses of "shareholder capitalism":** As a result of the excesses of the so-called "American model of management," the need has emerged to re-establish a better balance.

- **Changing individual values:** Individual values have undergone major changes as people opt for new work styles and lifestyles.

To What Extent Should Corporations Accept Responsibility?

Society's demands on the corporation continue to grow, but corporations should not be forced to accept the new roles demanded by society. Ideally, the principal players must come together voluntarily to engage in dialogue and consultation. In other words, a more effective course of action can be developed through cross-sectoral collaboration.

At first glance, the demands of society may appear to run counter to immediate shareholder value. But the role of the corporation is to find a point of convergence between corporate objectives and social demands. This must be achieved through a breakthrough resulting from technological development and innovations in marketing, public relations and other fields. Furthermore, corporations cannot be passive players responding to social demands. Rather, they must take the initiative to constantly innovate based on the corporate executives' powers of imagination, which include their forecasting, predictive and creative capabilities. And through innovation, they must identify emerging social needs and values that have yet to become widely recognized, actively integrate these into their own corporate activities, and present and advocate these new values to society.

Corporations which succeed in this process are rewarded with competitive advantages. The most sought-after role for corporations in the 21st century is the ability to innovate and to develop short-term and long-term points of convergence between profit maximization and benefit to society.

Business Results and Process

How can business results be expressed, and how can they be measured? The general consensus today is that "profits" provide the ultimate measure. However, an alternative view is quickly gaining ground, particularly as a result of the series of recent corporate misdeeds and scandals that have occurred in the United States, Europe and Japan. This view emphasizes the corporate process and argues that business results should be measured in terms of the total impact of corporate activities on stakeholders as seen in the context the corporation's own mission.

This approach is based on two key perspectives. One involves the evaluation of "results" as defined as the sum total of the benefits accruing to all classes of stakeholders and the balance thereof as realized according to the changing needs of the time. The other perspective involves "process" evaluation which posits that long-term shareholder

profits can be ensured only by firstly maintaining customer satisfaction, secondly generating employee motivation, and thirdly establishing positive and amicable relations with society.

What we are attempting to do in this White Paper is to consider the overall responsibility of a corporation as the "public vehicle" of society, and to specify from the perspectives of process and results the type of system and leadership needed to support the uninterrupted fulfillment of this responsibility.

"Market Evolution" and the Corporation in the 21st Century:

Toward Building Trust and Creating Sustainable Stakeholder Value

Economy and Society in the 21st Century

The range of corporate activities has expanded to the global level, while the scope and degree of the mutual impact that business and society have on each other has been augmented. At the same time, individual values have become increasingly diversified and society has matured. Consequently, society's views of the corporation have also become more diversified and mature.

As we attempt to consider the form and directions of corporate management in the 21st century, we must first determine what our vision is for the future of the economy and society. It is within such a vision that we can identify the issues and challenges which corporations should engage themselves with. Such a vision will also help identify a vast range of potential opportunities for sustainable corporate development. Corporate social responsibility (CSR) implies initiating concrete steps for the synergetic development of corporations and society from the standpoint of corporations and executives, while keeping in mind the vision for the future of the economy and society.

Vision for 21st Century Economy and Society

......a society in which self-reliant individuals are able to find hope in the future, are empowered to actively pursue their individual challenges and are able to find meaning in life. It should be a society which gives full expression to and utilizes the energies of a diverse range of individuals......

(Keizai Doyukai, *21st Century Declaration*, December 2000)

- Co-existence of diverse values in a globalized environment
- Transition to knowledge-based society created by innovation in technology and knowledge
- Establishment of recycling society supporting the co-existence of economic activity and the earth's ecosystem
- Human resources development aimed at cultivating the public-mindedness of individuals, developing individual diversity, and fostering creativity and willingness to accept challenges
- Development of economic and social systems to cope with rapid decline in birth rates and aging of society

etc.

Corporate Social Responsibility (CSR):
Pursuing Synergetic Development of Business and Society

In recent years, the term "corporate social responsibility" (CSR) has attracted growing attention, although the term is by no means a new one. In Japan, CSR is frequently discussed in contemporary context without an attempt to develop a clear definition of CSR. As such, the essence of CSR is not properly understood.

CSR: Typical Japanese Interpretations

(All interpretations touch on some aspect of CSR but fail to capture its essence.)

- CSR implies providing society with economic value.
  (→ *The "economic" responsibility of the corporation is interpreted to be the "primary responsibility.")*

- CSR implies contributing to society by giving back to society part of the corporate profits.
  (→ *CSR is interpreted to be "cost" or "philanthropy.")*

- CSR implies taking steps to prevent corporate misdeeds and scandals.
  (→ *CSR is interpreted to be "statutory measures" or "compliance.")*

With the advance of information technologies, the diversification of individual values, and the maturation of civil society, market initiative has shifted from the supply-side to the demand-side. At the same time, corporate assessment and evaluation is being undertaken from highly diverse perspectives. Responding to these changes in the environment, corporations have adopted a more dynamic stance toward social changes and have heightened their efforts to link corporate development to these social changes.

CSR, which has been rapidly growing in recent years, can be defined as efforts aimed at realizing sustained corporate value-creation and a better society through the erection of mechanisms for the synergetic development of corporations and society. The crucial keyword in such efforts is "sustainability," and this is an age in which corporations are being urged to show good results on the "triple bottom lines" of economy, the environment and society.

The Essence of CSR

- **CSR aims to achieve synergetic development of corporations and society:** CSR supports sustainable social development as well as sustained corporate value-creation. In this sense, the economic aspects of corporate activity and the social and human aspects of corporate activity are not assigned "primary" and "secondary" roles. Instead, both are viewed as integral parts of the same whole.

- **CSR is an "investment" to be positioned at the core of business activities:** CSR must be positioned at the core of business activities and constitutes an "investment" in sustained corporate development.

- **CSR is a voluntary and autonomous initiative:** CSR is a voluntary initiative which goes beyond compliance (the observance of legal and ethical standards).

There are two principal reasons why CSR can contribute to sustainable corporate development and improved competitiveness:

- **Risk management – CSR reduces future risks:** CSR initiatives lead to risk reduction by encouraging corporations to engage in prior review of risk factors. Such risk factors also constitute critical concerns from the perspective of investors.

- **Business case – CSR generates future profits:** CSR initiatives encourage corporations to stay ahead of the curve of changing social needs. By integrating these initiatives into the forward-looking value-creation and the development of new markets, CSR can act as the driving force in corporate transformation. When viewed as a type of investment, corporations capable of making such investments are aiming to differentiate themselves from the competition and to ensure more stable and long-term profits.

The concept of "market evolution" is aimed at promoting the comprehensive evaluation of corporate value by encouraging market participants to embody the ethos which emphasizes not only economic values but also the social and human values; that is, an ethos that is responsive to changing social needs. Parallel to this, the real markets have also been changing and evolving. To achieve higher levels of sustained corporate value, it is necessary to become more sensitive to these changes.

" Market Evolution" in Real Markets

- **Capital markets – Rapid growth of SRI:** Socially responsible investment (SRI), or investment activities focused on CSR, is growing rapidly in the United States and Europe. In the United States, SRI currently accounts for more than 12% of total funds under management. In the United Kingdom, the revision of the Pension Law has encouraged a mayor shift in pension funds to SRI. Japanese corporate managers also will inevitably pay attention to SRI as the ratio of equity held by foreigners increases.

- **Consumer markets – Initiative has shifted to demand-side:** As market initiative continues to shift from the supply-side to the demand-side, CSR is joining the ranks of "price" and "quality" to become the third key factor in

determining consumer choices of goods and services. Environmentally-friendly products stand at the forefront of this trend.

- **Supply-chain markets – Exclusion of businesses with inadequate CSR:** When parts and materials are manufactured using methods contrary to CSR, responsibility for this failure extends to the manufacturer of the final product. For this reason, there is a growing trend to demand CSR-compliance of suppliers and to exclude from the supply chain those who fail to comply. Given the global expansion of supply chains, CSR initiatives are becoming an unavoidable and universal requirement, regardless of the nationality and size of the business.

- **Labor markets – Attracting superior human resources:** For people who have achieved "economic affluence," work is no longer merely a means to earning a living. Graduates of American and European business schools are increasingly including CSR as an important factor in their choice of employers. In the case of Japan, from the perspective of attracting superior human resources, corporations are being called on to undertake CSR activities geared to creating a job environment which is conducive to recruiting, posting and development of diverse human resources and capabilities.

Responding to these changes in society and in the markets, the evaluation of corporate value is undergoing an important transformation. Increasingly, we are seeing a trend toward evaluation of overall corporate value which goes beyond "economic value" to include "social" and "human" values as well. In the United States and Europe, SRI-related systems of corporate evaluation and rating are being refined. But that does not mean that Japanese corporations should complacently accept and follow the lead of the United States and Europe. Instead, Japanese corporations must develop their own view of CSR and actively transmit this to the rest of the world.

One of the important aspects of CSR is that it trains and develops the corporation through the process of communicating with various stakeholders in society. With changing social values, corporations are being more critically scrutinized by society. But instead of becoming defensive, corporations should take this opportunity to achieve higher standards of transparency. Corporations should accept society's process of evaluation and use this as a driving force for promoting corporate transformation that is in line with the changing environment of the age.

Corporate Governance (CG):
Ensuring the Sustained Creation of Corporate Value

Corporate governance can be defined as a system designed to ensure "sustained corporate growth and development, proper decision-making on management policies based on the implementation of more efficient and better management, and the appropriate supervision, evaluation and motivation of corporate executives in the execution of their businesses."

There are two requirements that must be met if a corporation is to fulfill its social responsibility while also improving its competitive position. First, it must establish certain principles which define the general direction that it will take. Second, it must develop a system to ensure the implementation of these principles at all times; in other words, it must establish a system of corporate governance.

Establishing Corporate Governance Aimed at Achieving Sustainable Growth and Development through Implementation of CSR

- **Establishment of principles and leadership:** Corporate philosophy and principles must be placed at the starting point of corporate governance because they give direction to corporate management and provide the foundation for the development of corporate culture. As the "champions of corporate values," it is the function of top executives to repeatedly present the corporate philosophy and principles to all members of the corporation so that they permeate the entire organization.

- **Establishment of management system:** In order to respond effectively to the changing business environment and to achieve sustained creation of corporate value, the corporation must develop a system for the objective evaluation and supervision of top executives. For a system of checks and balances to operate properly, it is desirable to separate the "executive functions" from "management supervision."

- **Establishment of compliance system:** Given that it is an important integral member of society, it is impossible for a corporation to maintain its vitality over the long run if it fails to win the trust of society. Therefore, from the perspective of corporate social responsibility, compliance delineates the minimum level of obligations that must be met. Needless to say, the establishment and implementation of a proper system of governance is essential.

- **Importance of disclosure and communication with stakeholders:** In order to create shareholder value over the long run, it is necessary to take various stakeholders into consideration in the conduct of corporate management. Therefore, it is necessary to integrate into the corporation the perspectives of

various external stakeholders and to develop a dialogue with stakeholders through active disclosure of information concerning the process and results of corporate activities.

Advocating a New Corporate Vision and a New Corporate Evaluation Standard

Advocating the Implementation of the "Corporate Evaluation Standard"

What we must do now is to move from "discussion" to "action" as soon as possible. In this *Corporate White Paper*, we are proposing a new corporate evaluation standard to be used as an implementation tool. (See diagram on following page.)

Some efforts have been recently made to develop specifications for CSR. However, it is not our intention to restrict corporate activities or to unilaterally impose uniform evaluation standards. It is our understanding that the mandatory aspects of compliance (observance of legal and ethical standards) merely delineate the minimum levels of corporate obligations. We are more interested in the frontier areas where corporations can exercise full discretion. What we hope to do is to discover and to evaluate best practices that will strategically link the frontier areas to value creation as quickly as possible.

It is corporations engaging in such a process that will be able to establish competitive advantages and enjoy long-term sustainability. This is the corporate vision which the concept of "market evolution" aims to achieve (a corporation which is valued in the market for its overall corporate value: that is, not only for its "economic value" but also its "social" and "human" values).

In this chapter, we begin by presenting our corporate vision in its ideal form. Given the diversity in corporations and their undertakings, there can be no single ideal that fits all. However, we believe that a certain degree of consensus can be established concerning the general direction of the vision. We are calling on individual corporations to study the ideal presented in the following pages and to use this as a benchmark in establishing their own ideals and developing frameworks for putting these into practice.

Dimension I: Corporate Social Responsibility (CSR)

To put corporate social responsibility into practice, it is necessary to take all stakeholders into consideration. We have divided CSR into the four broad fields of the "market," "environment," "people," and "society." We believe it is necessary to respond to the needs of society by taking into account the position of the stakeholders in each of these fields.

(1) Market

The principal stakeholders in the field of "market" are customers, shareholders,

suppliers, and competitors. To be able to achieve higher levels of dynamism and trust while enjoying sustainable development, a corporation must continuously create value by accepting and integrating the needs of society. It is also necessary to gain the trust and positive assessment of the market. For this purpose, the following responsibilities must be met, while utilizing the dynamism of the market, promoting innovation and the opening up of new frontiers, and observing market rules and norms.

- **Initiatives for Sustained Value-Creation and Creation of New Markets:** Corporations must fully utilize their core competence (unique capabilities and strengths unavailable to others), gauge social needs, engage in innovation, and continuously pursue sustained value-creation and the creation of new markets.

- **Providing Value to Customers:** Corporations must grasp customer needs and use this information to provide better products and services. They must respond to customers with sincerity and work to improve customer satisfaction.

- **Providing Value to Shareholders:** Corporations must respond to the expectations of shareholders and investors providing capital by ensuring proper levels of returns through sustained value-creation. Corporations must actively engage in IR to gain the trust and positive assessment of shareholders and investors, and to achieve higher levels of transparency and accountability.

- **Free, Fair and Transparent Transactions and Competition:** Corporations must abide by the standards of trust, justice and discipline in their relations with suppliers and in market competition with competitors. Corporations must also engage in free, fair and transparent transactions and competition to achieve higher levels of trust and valuation.

(2) Environment

The principal stakeholders in the field of "environment" are the present and future generations. Humankind is faced with the urgent challenge of responding to global environmental problems which are jeopardizing the ecology of the entire world. Corporations must also contribute to the establishment of the recycling society and must promote systems capable of simultaneously achieving the objectives of both "economy" and "environment." Japanese corporations lead the world in this field and should strive to remain at the forefront.

- **Establishment of Environmental Management System:** Environmental preservation must be a central concern in management. A step forward should be taken from "environmental measures" to the next level of accepting the challenge of "environmental management" (achieving the objectives of both economy and environment).

- **Initiatives for Reducing Environmental Burden:** Corporations must engage in resource saving, recycling, energy saving, and reduction of waste by adopting the basic principles of "reduce" (reduction of waste), "re-use" (repeated use), and "recycle" (using waste as a resource). Corporations must also pursue the development and marketing of environmentally-friendly products and services.

- **Disclosure and Partnership:** Corporations must actively disclose information concerning the process and results of their environmental preservation efforts. While gaining the positive evaluation of society, they must endeavor to make further improvements by cooperating with a broad range of players in society to promote environmental preservation activities.

(3) People

The principal stakeholders in the field of "people" are employees (as human resources) and executives. Efforts to attract highly skilled and competent personnel constitute a necessary investment in the achievement of sustainable development. Corporations must provide a wide range of opportunities allowing the individual to fully develop and express his or her capabilities and to advance toward self-realization. This process must be organically linked to the dynamism of the corporation. Corporations are social entities with a major impact on the values and lives of individuals. Corporations must strive to improve the quality of life (QOL) and to provide a better working environment by taking into consideration the relations between the corporation and the individual, and between corporate employees and their families.

- **Employing and Utilizing Highly Skilled and Competent Personnel:** Corporations must endeavor to generate internal dynamism by employing and utilizing highly skilled and competent personnel (regardless of gender, age, academic background, nationality and form of employment). Corporations must further heighten the motivation and capabilities of employees by ensuring that employee capabilities and achievements are assessed fairly.

- **Improving Employability:** Corporations must endeavor to release the full potentialities of their human resources by developing and upgrading the abilities of employees (improved employability) and by refining the talents and capacities of the next generation of top managers.

- **Creating a Family-Friendly Work Environment:** Corporations must strive to create a family-friendly work environment by taking into consideration the family responsibilities of employees in such areas as child care and rearing, education, and long-term nursing care.

- **Creating a Pleasant Work Environment:** Corporations must strive to create a pleasant work environment and to raise the level of employee satisfaction by

making due provisions for a wide choice of flexible working hours and styles of employment, and by paying due attention to the safety, health and human rights of employees.

(4) Society

The principal stakeholders in the field of "society" consist of local communities, civil society and the global community. As a constituent member of society, corporations must contribute to the realization of a better society by engaging in dialogue, cooperation and collaboration with many other players in society in such areas as education, culture, welfare and development.

- **Promoting Activities for Contribution to Society:** Corporations must utilize their management resources and special strengths to promote activities for contribution to society. They must also support the volunteer activities of employees.

- **Disclosure and Partnership:** Corporations must actively disclose information concerning the process and results of their social programs. While gaining the positive assessment of society, they must endeavor to make further improvements by cooperating with a broad range of the players in society to realize a better society.

- **Establishing Proper Relations with Politics and Government:** Corporations must formulate certain basic policies concerning their relations with politics (politicians) and government administration (civil servants), and must develop sound relations based on these policies.

- **Cooperation with Global community:** In conducting their business activities, corporations must abide by international rules and standards, and must respect the diverse cultures of the world. They must expand their vision from domestic problems to include international problems, and must utilize their management resources and special strengths to contribute to the resolution of international challenges.

Dimension II: Corporate Governance (CG)

There are two requirements that must be met to ensure the proper implementation of corporate social responsibility (CSR): the establishment of certain basic principles defining the general direction to be taken by the corporation, and a system to ensure the continuous implementation of those principles. We believe that the establishment of corporate governance involves the following four aspects: "corporate principles and leadership," "management systems," "compliance," and "disclosure and communication."

- **Corporate Principles and Leadership:** A corporation must establish certain clear management principles which take into account all stakeholders. It must then see to it that these principles permeate the entire organization. As leaders laying out these principles, corporate executives must communicate with employees and ensure that these principles are properly reflected in their practice of management leadership.

- **Management Systems:** The board of directors and board of auditors (or auditors) must have the necessary powers to function fully. A system must be in place that supports the appointment of superior executives with outstanding leadership qualities and places management under an effective system of checks and balances.

- **Compliance:** Efforts must be made to raise the awareness level of employees on compliance (the observance of legal and ethical standards). Measures must be taken to maintain effective and continued compliance, and to foster a corporate culture characterized by a high level of integrity.

- **Disclosure and Communication:** Information concerning the process and results of corporate activities, including non-financial matters, must be actively disclosed, and the levels of transparency and accountability must be raised. Corporations must endeavor to gain greater trust through an active process of dialogue with various stakeholders. Information gained from this dialogue should be fed back to contribute to the improvement of management.

Features of the New "Corporate Evaluate Standard" and Its Use as a Self-assessment Tool

(1) Features of the Corporate Evaluation Standard

We are presenting our Corporate Evaluation Standard as a method for giving concrete shape to the concept of "market evolution" from the standpoint of corporate executives. Its main features are as follows.

- **Check-List for Self-Assessment by Corporate Executives:** The Standard functions as a check-list designed to help executives become more aware of the diversity and changes in social values (criteria against which corporations are assessed), and is used by executives to evaluate the status of their corporation's current undertakings.

- **Tool for Committing to Explicit Goals:** In addition to evaluating current corporate status, the Standard functions as a tool for promoting specific initiatives by facilitating the voluntary establishment of goals concerning "performance" and establishing clear commitments for their achievement.

- **Tool for Discovery and Evaluation of Best Practices:** Unlike many third-party evaluation systems, our proposed Standard does not seek to establish unilateral and uniform evaluation standards based on specific value judgments. Nor does it seek to impose a specific framework on corporate behavior. Instead, it functions as a tool which individual corporations can use to discover and to evaluate best practices when undertaking initiatives. Therefore, weights are not assigned to individual questions and no attempt is made to rank a corporation by its total score.

- **Questions Aiming to Contribute to "Risk Management" and "Business Case":** The questions have been designed from two separate perspectives. The first is risk management. These questions try to identify future risks in advance and to support the speedy implementation of necessary improvements. This set of questions also checks whether there are any serious disparities between social values and the internal values of the corporation. The second perspective is the business case which aims to improve corporate competitiveness and to support sustainable development by identifying changes in social values and needs, and to speedily link this information to value creation and the creation of new markets.

- **Questions Focusing on "Function" not "Form":** The "form" of an effective system for achieving a certain objective should vary according to the principles and characteristics of the individual corporation. Therefore, questions concerning the system do not ask about a certain "form" (e.g., "Does the corporation have external directors?"), but instead focus on "function" (e.g., "Are external perspectives integrated into management?"). The questions are designed to identify and uncover the specific "form" of measures that have proven effective.

- **Constantly "Evolving" Tool:** The responses will be collated and analyzed to discover and evaluate best practices, and to arrive at the picture of the average corporation by type and scale of business. Furthermore, the content of the questions will be reviewed and the methodology will be refined to reflect opinions from various sectors and changing social needs.

(2) Completing the "Worksheet"

[Respondents] The Worksheet is to be completed by corporate executives and is aimed at evaluating the current status of the corporation and making commitments to goals. Because many parts of the Worksheet ask for very detailed figures which may be available only to sections with direct jurisdiction, these sections also have to participate in the process. However, the premise of the Worksheet is that the executives will review the final response and will be able to decide whether they can directly commit to the contents of the response. Furthermore, we strongly recommend that executives complete

the section on "II: Corporate Governance (CG)" by themselves.

[Structure]   The Standard consists of a total of 110 items which cover five major areas (market, environment, people, society, corporate governance). These items are categorized as follows.

I: Corporate Social Responsibility (CSR)			(83)
1. Market	1-a. Process	(Status evaluation)	15
	1-b. Performance	(Status evaluation and goal-setting)	9
2. Environment	2-a. Process	(Status evaluation)	11
	2-b. Performance	(Status evaluation and goal-setting)	10
3. People	3-a. Process	(Status evaluation)	11
	3-b. Performance	(Status evaluation and goal-setting)	11
4. Society	4-a. Process	(Status evaluation)	10
	4-b. Performance	(Status evaluation and goal-setting)	6
II: Corporate Governance (CG)			(27)
1. Principles and leadership		(Status evaluation)	6
2. Management systems		(Status evaluation)	9
3. Compliance		(Status evaluation)	8
4. Disclosure and communication		(Status evaluation)	4

[Status Evaluation]   Evaluation of current status is conducted for "Process" under "I: Corporate Social Responsibility (CSR)," and for "II. Corporate Governance (CG)." Generally, the evaluation is based on the three-level multiple choice structure outlined below. The respondent must chose one response, and the premise is that the choice will be purely subjective.

When response [2] is chosen, the respondent is asked to provide a brief description. This is aimed at identifying and evaluating outstanding initiatives. During the collation and analysis process (by appointment of Evaluation Committee or other means), particularly outstanding and unique initiatives can be identified and can be given extra points.

(Example) "Process"

N: Not applicable	N
0: No action taken	0
1: Action taken	1
2: Action taken leading to satisfactory results	2
(==> In case of 2, please give a brief description below.)	
[ ]	

[Status Evaluation and Goal-Setting]   Evaluation of current status and goal-setting is conducted for "Performance" under "I: Corporate Social Responsibility (CSR)." In this context, "current term" is defined to be the latest term for which specific figures have been announced or are available. As a rule, evaluation covers trends in the past three-year period and is based on a three-level multiple choice structure (outlined below) with one possible response. In addition to this, respondents are asked to enter the specific figures for the current term.

For goal-setting, as a rule, the respondent is asked to specify goals for three years into the future. This response is taken to represent a firm commitment on the part of the executive. The three-year time horizon is an approximate one, and the premise is that the contents of the goal are judged to be realistic (within the scope of management effort).

(Example) "Results"

(Trend over past 3 years)	N
N: Not applicable -1: Down trend 0: Flat trend 1: Up trend	-1
(Specific figures: Current status and goals)	0
	1
End of previous fiscal year _____% Goal 3 years hence _____%	

[Responding to the Comment Section]   At the end of each section, space is given to comments. Respondents can use this space to describe "process" and "performance" which are not covered by the questions, but for which evaluation is desired. During the collation and analysis process (by appointment of Evaluation Committee or other means), particularly outstanding and unique initiatives can be identified and can be given extra points.

There is also a space for indicating other notable "goals" and "vision," although this information is not subject to evaluation.

(3) Indicators

The total of 110 indicators covering five major areas (market, environment, people, society, corporate governance) are organized as follows.

I: Corporate Social Responsibility (CSR)	
1. Market	
(Process)	(Performance)

Initiatives for sustained value - creation and creation of new markets
1) core competence management
2) marketing
3) collaboration in knowledge
4) intellectual property strategies
5) brand management
Providing value to customers
6) customer satisfaction survey
7) complaint management
8) risk & crisis management
9) privacy policy
Providing value to shareholders
10) IR division
11) IR feedback
12) general meeting of shareholders
Free, fair and transparent transactions and competition
13) fair trade policy
14) CSR procurement standards
15) rigorous compliance with fair
    trade and fair competition)
	Initiatives for sustained value - creation
	1) profitability
	2) productivity
	3) number of patents registered
	Providing value to customers
	4) customer satisfaction level
	Providing value to shareholders
	5) earnings per share
	6) total market value of shares
	7) performance forecasts and
	    percentage gap to actual
	    performance
	Building trust
	8) number of violations of laws and
	    ordinances concerning
	    consumers
	9) number of violations of laws and
	    ordinances concerning fair
	    trade and fair competition

2. Environment	
(Process)	(Performance)

Establishment of environmental management system
1) policies
2) employee education
3) acquisition of external
    certifications
4) environmental accounting
Initiatives for reducing environmental burden
5) resource saving
6) recycling
7) energy saving
8) assessment of products and
    services
9) green purchases and
    procurement
Disclosure and communications
10) environmental reports
11) third-party environmental review
12) social contribution activities
	Establishment of environmental management system
	1) acquisition of external
	    certifications
	Initiatives for reducing environmental burden
	2) total materials use
	3) total energy use
	4) total water use
	5) greenhouse gas emissions
	6) total amount of waste
	7) ratio of recycled and re-used
	    resources
	8) green purchases and
	    procurement ratio
	9) production and sales ratio of
	    eco-friendly goods and
	    services
	Building trust
	10) Number of violations of
	    environmental laws and
	    ordinances)

3. People	
(Process)	(Performance)

Employing and utilizing highly skilled and competent personnel
  1) equal opportunity
  2) internal recruitment and FA systems
  3) capacity and performance assessment
Improving employability
  4) education and training
  5) leadership programs
Creating a family-friendly work environment
  6) consideration of family responsibilities
  7) support for child care and long-term nursing care
Creating a pleasant work environment
  8) employee satisfaction survey
  9) flexible working hours and styles of employment, consideration of safety, sanitation and human rights)
	Employing and utilizing highly skilled and competent personnel
	  1) ratio of female directors
	  2) ratios of female managers
	  3) ratio of foreign managers in domestic offices
	  4) ratio of foreign directors in overseas offices
	  5) ratio of employees with disabilities
	Improving employability
	  6) amounts spent for employee education and training)
	Creating a family-friendly work environment
	  7) annual paid holidays used
	  8) monthly hours of overtime
	  9) number of employees using leave of absence for child-rearing
	  10) number of employees using leave of absence to provide long-term nursing care)
	Creating a pleasant work environment
	  11) level of employee satisfaction)

4. Society	
(Process)	(Performance)

Promoting activities for contribution to society
  1) basic policy
  2) utilizing management resources and special strengths
  3) supporting the volunteer activities of employees
Disclosure and partnership
  4) sustainability reports
  5) dialogue and collaboration with NGOs and NPOs)
Establishing proper relations with politics and government
  6) Relations with politics and civil servants
Cooperation with global community
  7) observing international rules and norms observing local laws, culture and practices
  8) contributing to solution of global problems
	Promoting activities for contribution to society
	  1) amount expended
	  2) number of student interns accepted
	  3) number of employees taking advantage of system of holidays and leave of absence of volunteer work
	  4) number of collaborations with NGOs and NPOs
	Building trust
	  5) number of violations of laws in connection with domestic politicians and civil servants
	  6) number of violations of laws in connections with foreign politicians and civil servants

II: Corporate Governance (CG)	
1. Principles and Leadership	**2. Management Systems**

Clear and transparent management principles
  1) efforts for clarification and transparency
  2) level of clarification of stakeholders
  3) transparency of stakeholders
Exercise of leadership
  4) direct participation by CEO
  5) communication with employees
  6) communication from employees
	Functional powers of board of directors and board of auditors (or auditors)
	  1) participation in real discussion
	  2) integration of external perspectives
	  3) opinions of auditors/board of auditors
	  4) support given to auditors
	Appointment and assessment of CEO
	  5) appointment
	  6) assessment and removal
	  7) decisions on remuneration
	Establishment of CSR-related management systems
	  8) creation of CSR office
	  9) SRI of pension funds

3. Compliance	**4. Disclosure and Communication**

Formulation and education of corporate code of conduct
  1) formulation and publication
  2) education
  3) application or recommendation to group companies
Establishment of compliance system
  4) creation of compliance office
  5) consultation and advisory desk
  6) internal complaints desk
  7) checking of compliance status
  8) inclusion in performance assessment
	Establishment of management systems for promoting disclosure and communication
	  1) basic policy
	  2) scope and contents of disclosure
	  3) feed-back
	  4) dialogue with stakeholders

Fields of Evaluation

II: Corporate Governance

I: Corporate Social Responsibility

Customers

Shareholders

Suppliers

Competitors

Current generation

Future generation

Employees

Executives

Local communities

Civil society

Global community

Market

Environment

People

Society

Principles and leadership

Management systems

Compliance

Disclosure and communication

Process

Performance

Process

Performance

Process

Performance

Process

Performance

Status evaluation

Commitment by executives

Goal-setting