The Evolution of Corporate Social Responsibility in Japan (Part 1)—Parallels with the History of Corporate Reform

by Masahiko Kawamura

Social Development Research Group

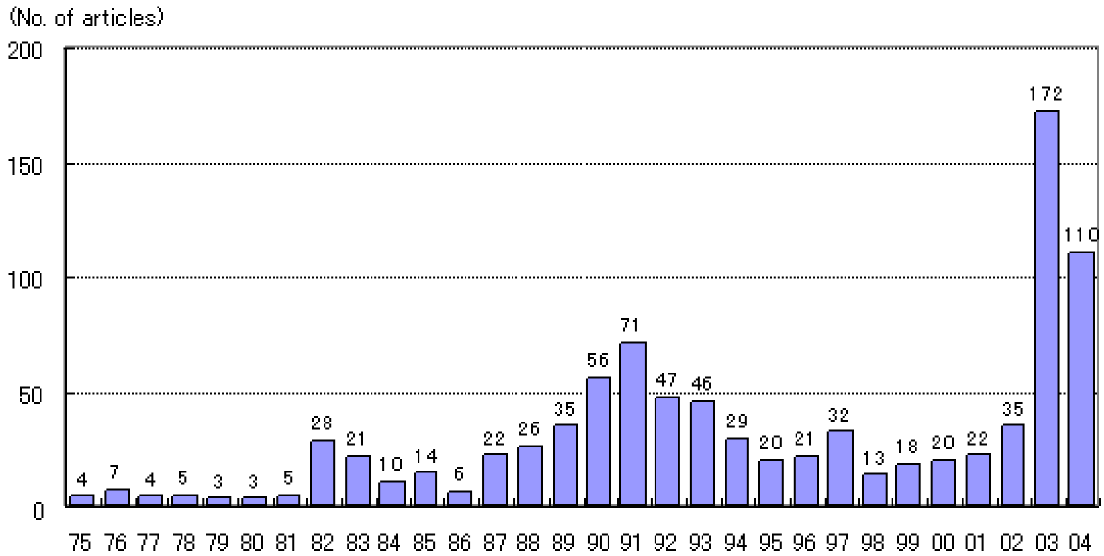
kawam@nli-research.co.jp

Introduction

Corporate social responsibility (CSR) is both a new concept and an old one in Japan. While the English term has grown widespread in recent years, the concept itself has actually been debated in the Japanese context for almost 50 years. As the newspaper article count for CSR shows (for the four Nikkei business dailies dating from 1975), CSR tends to engage the media roughly once every decade. This coincides with a repeating pattern among Japanese companies to commit abuses and scandals, followed by reflection and corrective measures (Figure 1).

Starting with the 1956 resolution by the Keizai Doyukai (Japan Association of Corporate Executives), this paper traces the evolution of the concept and practice of corporate social responsibility over the past 50 years in the context of changing economic and social conditions.

Figure 1 Number of Newspaper Articles on CSR in Japan



Notes: Period covers up to the end of March 2004.
Source: Compiled from Nikkei Telecom 21.

1. Definitions of CSR Vary Widely

1. Basic Approach of CSR

Although widely bandied about, a consensus is very difficult to form regarding the definition of CSR. However, people generally agree that corporate social responsibilities broadly cover legal, economic, ethical, social contribution, environmental areas. More specifically, CSR emphasizes ethical and social aspects of corporate behavior such as corporate ethics, legal compliance, prevention of improprieties and corruption, labor and employment practices, human rights, safety and hygiene, consumer protection, social contribution, procurement standards, and overseas operations.

However, precisely because of the social dimensions of CSR, differences emerge regarding the values, ethics, and sense of justice sought by society. The differences stem from local and national characteristics (history, culture, religion, etc.), as well from social and economic conditions of the particular era. While some aspects of CSR transcend time and place, we must also keep these other variables in mind when dealing with CSR.

2. Backdrop to the Growing Demand for CSR

Sustainable global community—The perception is growing that when companies perform social responsibilities, not only companies, but their stakeholders and local communities also become more sustainable. This in turn promotes the balanced development of nations and regions around the world, leading to sustainable prosperity for the global community.

SRI as gaiatsu *(foreign pressure)*—To screen individual stocks and compile indexes for SRI funds, Western rating agencies have carefully researched major Japanese companies. The surveys cover not only environmental issues but a wide range of ethical and social issues. Concerned about their assessment by foreign investors, many companies have grudgingly responded to the surveys.

Corporate scandals—Against the backdrop of corporate scandals such as Enron and Andersen Consulting, and Worldcom in the U.S., as well as numerous scandals in Japan, markets and consumers have been very critical of business ethical practices, legal compliance and transparency. Companies have recognized the direct implications for corporate sustainability, and turned to CSR out of necessity.

Emergence of CSR evaluation tools—After each wave of corporate scandals, companies were repeatedly scrutinized regarding their management stance and ethical values. But these introspections depended largely on the whims of managers, and a framework for objective self-evaluation or third-party evaluation failed to emerge. Moreover, because managers were consensus-oriented and industries practiced a convoy-style approach to protect weak companies, CSR failed to take root in corporate management.

However, the SRI surveys proved to be instrumental in providing the necessary CSR evaluation tools. When both domestic and foreign rating agencies began announcing CSR ratings and indexes, companies became increasingly aware of CSR issues in management.

3. The Orthodox Position on CSR

In the debate over corporate social responsibility, the orthodox position has plainly asserted that the chief social responsibility of companies was to enhance shareholder value by earning profits and to pay taxes. The leading proponent was Konosuke Matsushita, founder of Matsushita Electric, who viewed companies as a social institution. He dismissed the pollution problem of the 1970s as being outside of the social responsibility of companies. (However, he later said that "companies that do as they please will not last long. Companies must adopt an appropriate social perspective. In today's era, companies must have the insight to contribute to society, and to grow by so doing.")

The same idea was expressed in 1966 by another chairman of Keizai Doyukai, Hosai Hyuga: "Corporate profits are a compensation obtained from consumers, and the result of the contribution companies make to society. Managers must above all else do their best to grow profits, with is the essential aim of companies."

The opposing view of CSR proponents was expressed by Kazutaka Kikawada, Keizai Doyukai chairman and chairman of Tokyo Electric Power Co.: "Rather than looking at society from the company's perspective, companies must consider their role from society's perspective." Similarly, Sadatsune Iba, second-generation chairman of the Sumitomo group, stated that "profits are a worthy aim, but the method used must also be worthy." Tomiro Nagase, founder of Kao Soap Co., said that "companies have a social mission that transcends profit-making."

The CSR debate culminated around the time of the first oil shock in 1973. Corporate power had grown during the global economic expansion before the shock, and in the chaotic period of runaway inflation after the shock, some companies resorted to rampant anti-social behavior. However, what companies then did was limited to making contributions and setting up foundations as a way of returning profits to society. Companies objected to this type of stopgap approach to social responsibility, and CSR proponents were no match for the orthodox position.

While a strong anti-profit sentiment existed at the time, nowadays from the perspective of sustainability, almost no resistance exists to the idea that unprofitable companies cannot perform social responsibilities. Indeed, the emphasis now is on using the profit motive to create stakeholder value.

2. Evolution of CSR in Japan

1. Five Phases of Evolution

Interestingly, over the past 50 years, major corporate scandals and issues have erupted in an almost predictable ten-year cycle, and each cycle has rekindled the debate on corporate social responsibility, introspection and corrective action. Since the content of CSR varies depending on the specific conditions in each era, we have identified five separate phases of evolution (Figure 2). Based on this scheme, we trace the evolution of CSR beginning with the CSR resolution issued by Keizai Doyukai in 1956.

2. CSR Originated in Keizai Doyukai's 1956 Resolution

While CSR has been a theme of business administration in the U.S. since the 1920s, the CSR concept was introduced in Japan in the postwar era. The direct cause is attributed to a book by Howard R. Bowen called *Social Responsibilities of the Businessman,* published in the U.S. in 1953 (translated into Japanese in 1960), which became the basis of the resolution.

The resolution, "Awareness and Practice of the Social Responsibilities of Businessmen," issued just after the postwar reconstruction period, clearly defines the CSR concept: "Companies need to move out of the simplistic private domain and become a powerful part of social systems. Management is not simply entrusted by investors who provide capital, but by all of society." In today's terminology, this amounts to corporate citizenship, and implies not only the enhancement of shareholder value, but the creation of stakeholder value through core business operations.

The resolution also states: "In both ethics and practice, today's businessman cannot simply pursue corporate profit, but must seek harmony with the economy and society by combining factors of production as effectively as possible to supply high quality and inexpensive products and services… The social responsibility of the businessman is none other than to pursue this goal."

Figure 2 Five Phases of CSR in Japan

Phase I	1960s	Industrial pollution creates distrust of companies and anti-business sentiment Civic movements arise, problems resovled case-by-case
Phase II	1970s	Criticism of supremacy of corporate profits in post-oil shock era Companies set up anti-pollution departments and foundations to return profit
Phase III	1980s	Excess liquidity, bubble economy expands, land prices soar Corporate citizens practice philanthropy and *mecenat* (support for the arts)
Phase IV	1990s	Bubble collapses, business ethics becomes a problem, global warming worsens Keidanren formulates Charter for Good Corporate Behavior Companies set up global environment departments, engage in social contribution
Phase V	2000s	Corporate scandals emerge, stakeholders face crisis SRI funds emerge, CSR ratings become widespread Companies establish CSR departments 2003 is recognized as start of CSR management era

Source: NLI Research Institute

3. Overview of the Five Phases of CSR

Phase I (1960s)—During Japan's rapid growth era, as companies single-mindedly pursued profit, industrial pollution and other social problems emerged mainly in heavy and chemical industries. These included air and water pollution from factory waste water and sulfurous acid gas (causing the Minamata mercury poisoning and other diseases), food contamination (PCB poisoning in the Kanemi rice oil incident), and malformation of infants due to mothers using the sedative thalidomide during pregnancy.

These incidents raised the issue of liability without fault, and triggered protest movements by residents and victims. A strong anti-business sentiment emerged that regarded companies as inherently evil. In 1967 the Basic Law for Environmental Pollution Control was enacted.

Phase II (1970s)—A second land price surge occurred against the backdrop of the new plan to remodel the Japanese archipelago, and land speculation and rampant commodity speculation of trading companies became social issues. In particular, after the first oil shock of 1973, price hikes in the oil industry prompted opportunistic price hikes and market cornering elsewhere, causing inflation in daily necessities, while the problem of defective products also added to the anti-business sentiment.

With the single-minded pursuit of profit by companies under fire, the Diet also conducted intensive debate on runaway inflation. CSR was cited as part of a Diet resolution attached to the Commercial Code revision of 1974. Responding to corporate criticism at its peak in 1973, Keidanren (Japan Federation of Economic Organizations) proposed ideals for corporate behavior. At the company level, new departments were set up to deal with pollution, and foundations were hastily formed to return some of the profits back to society.

Another key development in 1973 was the introduction of the floating exchange rate system, which along with the above developments symbolized the end of Japan's rapid growth era. The self-righteousness that companies acquired from rapid growth as well as corporate criticism both culminated at this time, and companies subsequently had little choice but to recognize CSR. Incidentally, CSR also first appeared in that year's edition of the *Encyclopedia of Contemporary Words* (Jiyu Kokuminsha).

Phase III (1980s)— The CSR debate subsided rapidly from the late 1970s to the early 1980s, due in part to the voluntary restraint of companies in Phase II. But while CSR was downplayed, a spate of *sokaiya* racketeering occurred.

Following the 1985 Plaza Accord and the yen's surge, Japanese companies began to expand operations overseas, ushering in the era of globalization. In particular, companies entering the U.S. market experienced a culture shock due to differences in corporate culture and lifestyles. Domestically, while excess liquidity was fueling the imminent bubble economy, Japan's low standard of living—"rabbit hutch" dwellings, long work hours, and the unequal treatment of men and women—raised social issues which directly involved companies and employees.

In response, the idea of the "good corporate citizen" was introduced as companies actively financed social contributions in areas such as academics, the arts, welfare, and international exchange. The Japan Association of Charitable Organizations compiled the first edition of the *Japan Directory of Grant-Making Foundations*. In addition, corporate philanthropy and *mecenat* (support for the arts) flourished in the form of sponsored events and chair endowments. The Association for Corporate Support of the Arts was formed in 1989, and the Keidanren "1% Club" in 1990.

Phase IV (1990s)—Land prices surged for a third time from the late 1980s as Japan's economy entered the bubble era, but plunged in 1991 when the bubble collapsed. Companies suffered a series of blows in the post-bubble 1990s: securities firms scurried to compensate the losses of large investors, Yamaichi Securities and Hokkaido Takushoku Bank fell into bankruptcy, Toshiba Machine violated COCOM regulations, and contract rigging scandals surfaced among construction companies. Distrust of Japanese companies swelled to international proportions. Keidanren was prompted to compile a Charter for Good Corporate Behavior, which can be construed as the prototype for today's CSR.

Meanwhile, global warming, destruction of tropical rainforests, destruction of the ozone layer, and desertification were becoming serious global environmental problems. A strong demand emerged for companies to look beyond local environmental issues and consider the environmental load of operations, products and services. Two key developments symbolizing the response to environmental problems were the U.N. Conference on Environment and Development (UNCED) in 1992, and issuance of the ISO 14001 standard for environmental management systems in 1996.

Phase V (2000s)—A new era of CSR began in 2000. Socially responsible investment (SRI) had reached Japan in the summer of 1999 with the emergence of Japan's first eco funds, and Japanese companies were bombarded with intrusive surveys by Western research agencies for SRI screening purposes. While eco funds initially focused on the environmental stance of companies, the scope of SRI gradually expanded to corporate governance and social contribution. Since the surveys influenced corporate valuations in capital markets, Japanese companies grudgingly complied.

Meanwhile, a series of corporate scandals erupted including Snow Brand and Nippon Meat Packers, causing the scope of CSR to expand to corporate ethics, compliance, accountability, and disclosure. Ricoh became the first of several companies to set up a CSR department in 2003, and Japanese companies began to implement new CSR initiatives from the perspective of risk management and sustainability.

3. Commercial Code Revision and CSR

1. CSR Enters the Debate on Commercial Code Revision

The Commercial Code, which regulates Japan's company system and corporate governance, has been revised over the years in response to corporate scandals and criticisms. Recently, it has become possible to shift to a U.S.-style "committee system" of corporate organization (with nomination, compensation, and audit committees that include outside board members).

Thus far, the Commercial Code revision of greatest relevance to CSR has been a Diet resolution attached to the 1974 revision called "basis of Commercial Code revision." Its importance lies in designating CSR as an issue for study by the Legislative Council.

The Diet resolution contained seven items: (1) corporate social responsibility, (2) shareholders' meetings, (3) directors and the board of directors, (4) stock system, (5) accounting methods and disclosure, (6) mergers & acquisitions and breakups, and (7) minimum capital requirements and distinctions between large and small companies. Some of these items became major issues and incorporated in subsequent Commercial Code revisions. Items 2, 3, 4, and 5 were enacted into law in 1979 following scandals at Lockheed, Nissho

Iwai, and KDD. The other three items are still being debated.

The Commercial Code revisions aimed to eradicate *sokaiya* racketeering, overhaul accounting systems, and enhance disclosure practices. However, in 1982, when falsified records were found of the board of directors' meetings at Nissho Iwai, criticism was focused on the weak stance on compliance, and the underlying corporate climate that blurred the distinction between public and private domains. At the same time, it was pointed out that CSR is predicated on the awareness that companies have a social existence.

2. Pros and Cons of CSR Legislation

Commercial Code revisions to establish CSR regulations have been a contentious issue since the beginning. In 1975, Keidanren published an opinion piece in the *Nikkei Sangyo Shimbun* entitled "Problems Pertaining to the Commercial Code Revision." While not rejecting CSR, the article said: "Of course, there is no contradiction in doing both—legislating corporate social responsibility through general regulations, and implementing specific measures within various systems. But in fact a strong consensus exists that the latter method is more important, and that the former method not legally meaningful." In the next year, the Kansai Economic Federation released an opinion paper stating that "the problem is one of business ethics, and thus not suited to the character of corporate law," and opposed incorporating CSR into the Commercial Code.

Almost 30 years later, Keidanren released an opinion paper this February regarding the establishment of ISO standards for CSR, entitled "Basic Approach to the Promotion of Corporate Social Responsibility." In the paper, Keidanren clearly opposes standardization or legislation for CSR, proposing three alternatives: (1) Keidanren will actively engage in promoting CSR, (2) CSR should be promoted voluntarily by the private sector, and not by the government, and (3) CSR guidelines will be derived from revision of the Charter for Good Corporate Behavior and implementation manual.

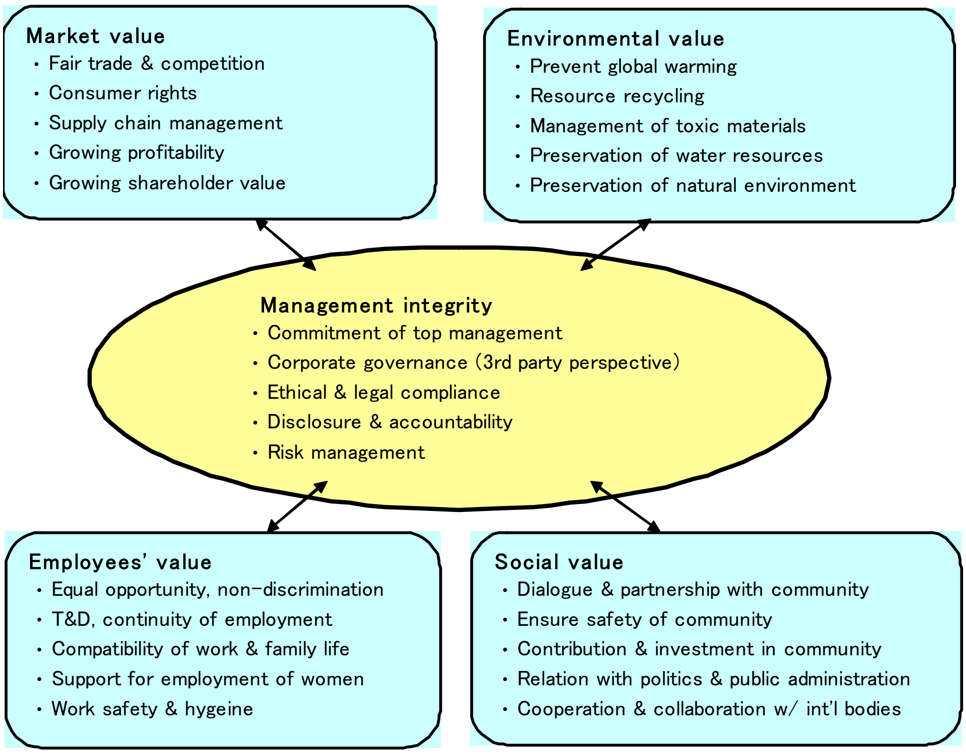
As CSR becomes a serious management issue for Japanese companies, problems are likely to arise with the vague effectiveness of general regulations based on a holistic or abstract approach (for example, giving board members the duty of social responsibility). In some cases, it could lead to abuse and exploitation through expanded interpretations. A more effective approach, in the author's view, would be to address various systems separately, and ensure social responsibility by striving to protect stakeholders through inspections and rules in each system.

4. CSR in Today's Society

Based on the developments discussed above, we propose a conceptual framework for CSR centered around management integrity and four areas of corporate value (Figure 4). Regardless of industry or company size, companies are judged based on management integrity. This involves a company's basic stance or moral character, and can be broadly defined as corporate governance.

To improve corporate value and brand value, we propose four separate domains. While actual domains will vary based on industry and company size, they are: (1) market value, (2) environmental value, (3) employee value, (4) social value. The four domains correspond to the basic stakeholders in companies—(1) business partners, (2) global environment, (3) employees, and (4) local communities.

Figure 3 Japan-Style CSR (Management Integrity and the 4 Areas of Enterprise Value)



Source: NLI Research Institute

Conclusion—CSR Faces a Crucial Turning Point in June 2004

A crucial event that will determine the future of CSR at the global level is the ISO international conference this June, where the decision will be made whether to establish standards for CSR. The future course of CSR will be greatly affected by standardization, whether it takes the form of specifications or guidelines. If agreement is not reached, a diverse range of CSR management systems will evolve in the world. Thus the importance of the conference cannot be overemphasized.

While this paper has discussed the overall picture of CSR in Japan, specific CSR issues raised in the cases mentioned are beyond the scope of this paper and will be addressed elsewhere.

References

Arimori, Takashi, *Nihon kigyo moraru hazado shi* (in Japanese; History of Moral Hazard of Japanese Companies), Bunshun Bunko, September 2003.

Kawamura, Masahiko, *Semarareru nihon-gata CSR no kakuritsu*, (in Japanese; Pressure Mounts to Establish Japan-Style CSR) *Nissay Kisoken Report*, November 2002.

Kawamura, Masahiko, "How Socially Responsible Investment (SRI) Could Redefine Corporate Excellence in the 21st Century," *NLI Research*, January 2002 (http://www.nli-research.co.jp/eng/resea/life/li0201a.pdf).

Kawamura, Masahiko, "Japanese Companies Launch a New Era of CSR Management in 2003," *NLI Research*, August 6, 2003 (www.nli-research.co.jp/eng/resea/life/li030806.pdf).

Moriyama, Mutsuru, *Conpuraiansu keiei manuaru* (in Japanese; Compliance Management Manual), Shoji Homu, December 2003.

Taka, Iwao, *Conpuraiansu no chishiki*, (in Japanese; Compliance Knowledge), Nikkei Bunko, December 2003.