



SRI in Japan

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Introduction to SRI

SRI, Sustainable and Responsible Investment or Socially Responsible Investment, is an investment approach that integrates social and environmental considerations into the decision-making process. There are several different approaches to SRI: Screening, Shareholder Engagement and Community Investment.

Screening

Screening is an investment process that considers the social and environmental consequences as well as economic consequence of investments. Several social and environmental criteria are used to select the investment targets. Negative screening is the process of excluding stocks in sectors that are not considered socially responsible, such as tobacco, pornography, arms manufacture and others. Positive screening is the process of including stocks that make a positive social and environmental contribution either directly through their operations (e.g. companies operating in sectors such as renewable energy, healthcare, mass transit and others) or through their progressive environmental and social policies and procedures.

Shareholder Engagement

This approach involves engaging with companies through regular contact with management or through exercising voting rights at shareholder meetings, with the aim of having a positive impact on company behavior. Large shareholders can have a significant impact on company behavior through this strategy. Recently there have been more and more cases of constructive shareholder advocacy and its influence is growing.

Community Investment and More

Community Investment specifically supports community economic development, frequently in an inner city. Financing to small businesses in the developing countries, fair trade and natural energy development would also be included in this category.

Current Status in the US and Europe

According to the US Social Investment Forum, total assets in SRI funds in the US reached US\$2.34 trillion in 2001, up from US\$639 billion in 1995. In 2001, this represented nearly 12% of total assets under professional management. There were 230 SRI mutual funds available at that time. SRI is also growing rapidly in Europe. In the UK alone, according to research group EIRIS, US\$180 billion is managed in institutional and retail funds with SRI policies, of which US\$6 billion is in retail funds.

SRI in Japan

Japan is the most developed SRI market in Asia outside of Australia. The first SRI fund was launched in Japan about 3 years ago and now there are already 11 fund options for a total of approximately US\$0.7 billion at current market valuations.

SRI in Japan started as something of an environmental movement. The first funds to be launched were “eco funds”, funds that incorporate ecological and economic factors into their investment strategy. The principal objective of these funds is to facilitate sustainable development by investing in companies that have progressive environmental management systems or companies that are specifically involved in the business of eco-friendly products and technologies. SRI research groups, whilst exploring the environmental policies and procedures of these companies to determine their investability, also work with them to help improve their environmental performance.

Nikko Asset Management, a founding member of ASrIA, launched the first eco fund in the summer of 1999. The Nikko Eco Fund was immensely popular, far exceeding its capital raising expectations. Initial hesitations that Japanese investors would not buy the fund because ‘they only care about maximizing returns’ proved to be wrong. Plenty of Japanese investors recognized that this was an opportunity to maximize returns as with any other investment vehicle, but to do so in line with their values. There was an overwhelming response to the fund.

The popularity of the Nikko Eco Fund spurred other fund providers to set up eco funds and the retail interest spread as more and more ‘ordinary’ people actively chose to invest in these products with dual financial and environmental returns. Labour unions and other associations also reacted positively to the new investment product.

In the autumn of 2000, the first SRI fund that includes social factors as well as environmental factors was launched in Japan. This was Asahi Life’s Wing of Tomorrow fund. Nikko Asset Management also launched an SRI fund that considers the broader triple bottom line issues later that year.

After the early period of rapid growth and success of these SRI funds, in the current weak equity market environment, the launch of more new products has slowed. Unfortunately, the performance of the eco funds has been disappointing, largely due to the lackluster performance of the Japanese market, and in particular the IT stocks in which many of the eco funds were invested. Although overall absolute performance has been weak, as with all investment products, some funds have outperformed the market and others have underperformed.

Currently in Japan there are the eight “eco funds” and three SRI funds, which also consider social factors.

Current SRI Funds for Sale in Japan

Manager	Fund Name	Fund Type	Screening (except economy)	Launch Date	Size US\$mm*
Nikko AM	Nikko Eco Fund	Domestic Equity	Environment	20 August 1999	371
Sompo Japan AM	Green Open	Domestic Equity	Environment	30 September 1999	63
Dlibj AM	Eco Fund	Domestic Equity	Environment	29 October 1999	56
UBS Global AM	Dr. Eco	Domestic Equity	Environment	29 October 1999	33
UFJ Partners AM	Green Wing	Domestic Equity	Environment	28 January 2000	26
Asahi Life AM	Wing of Tomorrow	Domestic Equity	Environment, social	28 September 2000	38
Mitsui Sumitomo Marine AM	The Sea & The Sky	Domestic Balanced	Environment (climate change)	31 October 2000	10
Nikko AM	Nikko Globe A	Global Equity	Environment, social	17 November 2000	17
Nikko AM	Nikko Globe B	Global Equity	Environment, social	17 November 2000	9
Daiwa SB Investments	Mrs. Green A	Global Equity	Environment	15 June 2001	24
Daiwa SB Investments	Mrs. Green B	Global Equity	Environment	15 June 2001	40

*As at 15th October 2002

Source: Japan Research Institute, Daiwa Institute of Research

Fund Buyers

After Nikko had launched the Nikko Eco Fund, fund distributor Nikko Cordial Securities said that 90% of the money that came into the fund in the early months was from retail investors. Many were first time investors calling Nikko directly. As Katsunosuke Ozawa of Nikko AM notes, “sales are usually done through personal relationships and the skills of sales agents, but in this case investors actually approached us directly to buy.” Mr. Ozawa also notes “the clients were different from the typical unit trust buyers. There were many more women and many more people in the 30-40 age range.” This is typical of the profile of SRI retail investors in other parts of the world, but is not typical of the profile of a Japanese retail investor who is generally male, above 40 years old and regularly invests in the stock market.

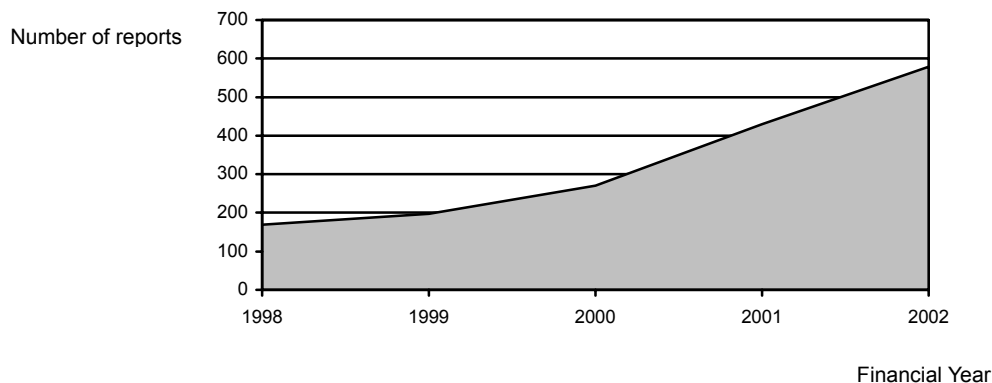
The Nikko Eco Fund had tapped a whole new pool of funds. It appealed to a section of the population already aware of their environment due to their suffering chronic pollution in the 1970s and already aware of their ability to make positive contributions to society. As an example, in the 1990s when the economy was slow, the popular Postal Savings for International Voluntary Aid Program, in which more than 20% of savings income is contributed to NGOs in developing countries, had 26 million participants.

Expanding the distribution channels is an effective way of attracting more retail investors. Last December, as part of the deregulation of the financial industry, the ban on banks selling mutual funds at counters was lifted. Mr. Masaatsu Takehara of Sompo Japan Research Institute, research company of Sompo Japan “Green Open” fund, notes “although the fund size has been negatively affected by the Japan market situation, after the distribution channels were expanded to bank counters, the number of sales units purchased by retail buyers has been steadily increasing and now half of the total fund assets comes from sales at bank counters”.

Positive SRI Impact on Reporting

Eco funds have had a significant impact on company environmental reporting. Ms. Mizue Tsukushi, President of The Good Bankers, the leading SRI research and advisory company in Japan and an ASrIA member, believes that “the birth of the eco fund has dramatically changed Japanese companies’ attitudes towards their environmental

policies.” She notes that “today the majority of firms are willing to collaborate with our research – and it is they who ask us if their stocks can be included in the eco-fund portfolios”. Almost 600 companies produced environmental reports in FY2002, compared to only 169 in 1998, the year before the first eco fund was launched. Furthermore, out of 40,970 companies globally that have achieved ISO14001 accreditation as at the end of June 2002, 9,467 companies are in Japan, the highest level of any country in the world. The Government has actively encouraged this progressive behavior through award schemes and through its environmental accounting and reporting guidelines published in 2000 and 2001.



Source: Ministry of Environment, Japan

The next challenge for environmental reporters in Japan is how to integrate reporting on social policies and management systems, and how to do so in consultation with corporate stakeholders. The Network of Environmental Reporting, a voluntary membership network of businesses, NGOs, experts and local governments, has recently conducted a survey on sustainability reporting in Japan and has determined that 90% of current reporting focuses on environmental reporting and only 10% on social reporting. According to Mizue Unno, Managing Director of So-Tech Consulting in Japan, “the biggest challenge is to get senior management to recognize the importance of social issues and show leadership in this area as they have with environmental issues. Then a Japanese framework for social issues that are relevant for Japanese culture will emerge”. But Japanese companies are considered by many to be big families. Disclosing information on wider issues such as social issues that have historically been very private matters, is a new phenomenon.

Some companies have already started comprehensive sustainability reporting. Notably some of these companies are SRI fund providers determined to ensure that their own corporate social and environmental policies and procedures are in line with those scrutinized in other companies by their funds. Nikko Cordial Group is a good example. The Group published the first sustainability report in Japan in FY2000, has obtained ISO14001, donates a proportion of profits from the eco and sustainability funds to WWF, is digitizing its offices, has installed solar panels and has replaced company cars with low emission vehicles. Similarly, the Daiwa Securities Group, ASrIA member and provider of the Mrs. Green fund, has just published its sustainability report, which highlights its own corporate innovations in CSR.

The Future for SRI in Japan

Improving Performance

After the enormous success of the first Nikko Eco Fund in 1999, there were predictions of a US\$10 billion SRI fund market in three years. However, the Japanese market has continued to suffer such heavy losses in the three years since then, that assets have not accumulated at the rate expected. Performance of SRI funds is crucially important for the growth of the SRI market in Japan. The Japan market lacks the core institutional investors like the church groups that acted as anchors for the early SRI markets in the US and Europe and it suffers from a structural weakness in that the majority of the money in SRI funds is from retail investors.

Significant effort is being made to improve the selection criteria and performance of the funds. The policies and criteria of many of the eco fund portfolios are being re-evaluated. Mr. Nobuyuki Saino, manager of the Nikko Eco Fund, is continually working on “improving the quality of both the economic and ecological screens, and building up evidence to convince a wider audience that environmentally sensitive companies gain economic advantage in the longer term”.

Individual Investors

A further challenge for the future of SRI in Japan is how to attract more individual investors. Mr. Tadashi Hayami, fund manager of “Wing of Tomorrow” says, “SRI has drawn much attention from customers, but they are not satisfied with the characteristics of the existing funds. More attractive SRI products with more stringent SRI policies are needed to attract more customers”.

Ms. Mizue Tsukushi, President of The Good Bankers, believes that “Government guidance to SRI using a tax incentive” is one of keys to the development of SRI in Japan. She suggests that a reduced capital gain or withholding tax is applied to SRI fund investors. This would be an innovative development for the industry, which would increase the attractiveness of investing in SRI funds over other fund products. Such innovations have yet to be further explored.

Pension Funds and Exercising Voting Rights

There are other movements in Japan that indicate the potential for strong longer-term growth of the SRI industry. The entry of pension funds looks imminent and promising for SRI. Public pension funds currently have assets of US\$1.4 trillion and private pension funds have assets of US\$1 trillion. These figures are expected to double by 2015.

The 401K defined contribution plans are just emerging and will encourage individuals to think about long-term investing. According to the Ministry of Health, Labor and Welfare, since the adaptation of the defined contribution pension system last October, the number of companies adapting to this system is steadily increasing and is expected to be more than 700 by March 2003.

401K plans were a strong driver of the SRI market when they emerged in the US. In the UK, Germany and Australia, regulation has been instated in the last few years requesting that all pension funds that take into consideration environmental, social and ethical considerations declare it. This has triggered enormous growth in pension funds using SRI policies for their investments. In the UK, pension funds invested with SRI policies increased from US\$38 billion in October 1999 to US\$128 billion in December 2001, largely on the back of this new legislation.

SRI is a highly relevant investment strategy for pension funds given their long-term horizon. If Japanese pension funds can provide the institutional backbone to the current predominantly retail SRI market, this will provide a good anchor to SRI funds in Japan.

Exercising voting rights is a new trend that is emerging in Japan and is starting to make people more aware of their position as shareholders. This proactive investor behavior has not naturally been embedded in Japanese institutional culture. However, some international institutions such as CalPERS, have recently exercised their voting rights in Japan and have triggered an interest in this activity.

The Pension Fund Association has released “Working Guidelines for the exercise of voting rights” which calls for fund managers to actively exercise voting rights and report on their activity as part of their fiduciary duty. The Pension Fund Association for Local Government Officials, which has Yen 13 trillion under management, has added exercising of voting rights to its pension management policy statement.

As more and more institutions recognize and exercise their voting rights, and more and more investors feel empowered as shareholders, this in turn will increase shareholder and stakeholder dialogue and will ultimately impact the responsible behavior of corporations as they take stakeholders views more into consideration.

Awareness about Corporate Social Responsibility (“CSR”)

The biggest challenge for SRI in Japan is how to promote increased awareness about CSR. Mr. Eiichiro Adachi of The Japan Research Institute notes, “There is no strong pressure group requesting that companies promote CSR in Japan”. Evidence from the US and Europe shows that without expectations or pressure from society, companies are less likely to promote their CSR activities. He also said, “Considering the situation of current Japanese society, it seems unlikely that investors alone can be the driving force to support CSR.” His indication is very meaningful. SRI is one of several tools needed to promote and develop CSR.

New attempts to promote the public’s awareness about CSR and SRI in Japan are taking place. Mr. Tadashi Hayami, fund manager of Asahi Life fund “Wing of Tomorrow”, holds a regular meeting called “SRI lounge” to discuss CSR and SRI issues. “Anyone can join this meeting” according to Mr. Hayami. The participants at the meeting have diverse backgrounds. This type of activity is designed to act as a foundation for furthering the public’s understanding of CSR and SRI.

The SRI fund market in Japan is expected to grow as more diverse CSR criteria emerge at the corporate level along with the public’s awareness. Ms. Mariko Kawaguchi of Daiwa research institute noted, “Social criteria that is acceptable to Japanese people needs to be developed in addition to environmental issues. For example, corporate

integrity, transparency, measures related to the declining birth rate and the aging of society and relationships with local communities and NGOs and so on”.

There is currently a research group at Reitaku University working on an evaluation framework focused on corporate integrity called R-EBEC001. Evaluation categories include management’s stance towards CSR, ethical policies, implementation plans, internal systems, and risk management for legal compliance failure. This reflects an expectation in the current Japanese market. The next step is to further develop the current eco fund movement into a broader SRI movement where more than environmental issues are considered.

However, there are complex cultural issues to be addressed when assessing social factors. Mizue Unno of So-tech mentioned this in terms of the complexities of reporting on these issues. She pointed to the importance of creating a “Japanese framework” for social issues. For SRI to be successful in Japan, this is a critical point. As Mr. Eiichiro Adachi of The Japan Research Institute notes, “some people are against the criteria based on Western culture” that are included in the SRI questionnaires sent to companies requesting information on their environmental and social policies and procedures. SRI needs to develop with Asian characteristics and Asian values since Western and Eastern cultures differ so widely.

The Future for SRI in Asia

SRI is in its very early stages in other parts of Asia. Australia is the most developed market with approximately US\$7 billion in SRI funds and the market is growing quickly with assets in managed funds decreasing by 0.1% in the twelve months from June 2001 to 2002 and assets in SRI funds increasing 32%. Elsewhere in Asia, the industry is in its fledgling stages with SRI fund options starting to become available in the last two years. In Hong Kong there are four global fund options for sale and one local fund management group, Kingsway Fund Management that runs all its public funds with SRI policies. In Singapore there are two global funds registered for sale. In Taiwan there is one global fund for sale and in Korea the Samsung Group has just launched a domestic Korean eco fund in August 2002.

Although SRI has taken off in the West, some doubt its ability to take off in the East. This skepticism is born of the perception people in Asia ‘only care about maximizing returns’. The concept of maximizing returns and investing in line with one’s values has not yet been accepted; indeed the majority of people in Asia do not even know that it is possible to invest this way. This was also the case in Japan prior to the launch of the first eco fund. However, the popularity of the funds in Japan is proof that there is a vast new pool of funds to be tapped and a significant proportion of the population who wanted to invest in line with their values when given the choice.

This skepticism followed by unexpected popularity was similar in Australia, the UK and other European markets. In the UK, when Friends Provident launched the first UK ethical unit trust 'Stewardship Fund' in 1984, analysts predicted that the ethical investment retail market in the UK would eventually reach a maximum size of £2 million. However, recent statistics (EIRIS, August 2001) show that the total value of SRI retail funds has soared to £4 billion - that is 2,000 times the original estimate and still the SRI retail market there shows no signs of slowing.

We believe that there are significant opportunities for SRI to be popular in other countries in Asia. In terms of the retail market, many other Asian markets have characteristics similar to Japan and relevant for SRI: active religious groups, growing environmental awareness including the emergence of vibrant NGO communities, significant female working populations, large numbers employed in caring professions plus retail investing cultures. In addition, more Asian people are gradually becoming aware of their empowered position as a shareholder.

As for the institutional market, given the legislation amendments that are taking place in Europe with regard to SRI policy, similar amendments may also take place in Asia in future. In addition, institutions such as the Asia Development Bank and the International Finance Corporation are developing coherent policies on sustainable investment.

The agenda for SRI that works in Asia has yet to be fully defined. Perspectives on social responsibility and contribution to society clearly vary considerably depending on a country or region’s history, culture and religion. Although some values can be shared with the West, many social evaluations need to be redefined for the East. Social evaluations unique to different parts of Asia need to be formulated and as the most developed SRI market in Asia outside of Australia, Japan is in the process of taking the lead on this.

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