

## **Management “true to the Sun-Lord”**

### **— Japanese corporate governance and social responsibility —**

#### **Executive Summary**

##### **Three key points**

1. CSR (corporate social responsibility) has three aspects: social benefit responsibility, social norms responsibility, and civic responsibility.
2. The essence of CSR is the responsibility to be socially beneficial. This entails business management that gives priority to social benefit even though at times it may be at the expense of profit.
3. Governance to advance the implementation of such CSR must be people-focused.

#### **1. Basic stance**

The corporation system has undergone a major transformation from the initial simple system so it can better adapt to social change as it occurs. And this transformation is likely to continue. The reason for this is that the corporation system is deeply rooted in modern society, and a new structure that can replace this system has yet to be uncovered.

However, a corporation structure based only on a relationship between the stockholders and the company is already falling out of step with today’s society. Both in Japan and the United States, we have seen the negative impact of management that considers only maximizing market value. Considering a company’s significance within society, though, it is not enough for companies simply to take the attitude that all they have to do is not break the law.

The extensive debate over corporate governance and CSR currently taking place is, we believe, an indication of the world-wide effort to make corporations and the enterprise system much more functional. The corporation system emphasizes profit for the stockholders, but at the same time, it has no real significance unless the system facilitates the harmonious coexistence of companies with the various surrounding factors, and the concurrent accelerated growth by stockholders, companies and society.

Considering the future shape of companies from such a broad-ranging perspective, discussion based on Japanese flexibility and ethics is thought to be very important. Since early times, merchants in Japan have believed “the Sun-Lord is watching” (*O-Tento-Sama ga mite-iru*) — that they have certain moral obligations to the community and cannot hide how they conduct their business affairs in relation to those obligations. This saying encompasses a great deal. Also contained within it are considered to be the basic stance of the corporate governance and CSR theories.

Although it may sound surprising, we believe that herein lies the start of the future corporation theory that values a connection with all aspects of society by shifting emphasis from a “money-focused” corporation theory to “people-focused” and “concept-focused” companies.

## **2. Definition of governance and social responsibility**

- Governance is a manager monitoring, appointment and dismissal mechanism.
- CSR is broadly classified into three types of social responsibility.

The first is a contribution to increasing benefit within society as a public institution of society, and is referred to as a social benefit responsibility (benefit responsibility). The two types of contribution are a contribution to society through business activities (includes making people’s lives richer by providing better products and services, and contributing in employment and tax payments through greater added value company activities), and contribution to society that can only be done by companies, such as maintaining the global environment.

The second CSR is the social norms responsibility (norms responsibility), in which companies take the lead in upholding social norms, and through this, contribute to social stability. This includes compliance with laws and social practice, and a responsibility to avoid social impacts that disrupt social stability, such as pollution.

The third CSR is a civic responsibility as a company whose presence has been accepted within society, and as a company that has a substantial influence on society. This includes contribution to cultural activities, and social contribution to regional society.

- The basis of CSR is norms responsibility. Compliance should be considered a responsibility beyond merely abiding by the law that a company must fulfill so that the overall social base functions. This contains one of the foundations for the “Sun-Lord” idea

that has been with Japanese society since ancient times. Conducting oneself in a manner that is “true to the Sun-Lord” is essentially whether one contributes to social stability through upholding social norms or not. Companies have such an important social presence.

Companies’ civic responsibility is complementary to norms responsibility, and is a responsibility that companies must fulfill as citizens within a society for the stable development of the society.

- The most intrinsic significance of CSR is in the benefit responsibility. The essence of CSR is that there are times when priority must be given to social benefit, even though it may be at the expense of profit. Of course, as economic entities that are designed to generate profit, companies have a profit responsibility. It is natural for companies by way of their profit responsibility to consider the long-term viewpoint and take action that may have a negative impact on profit in the short term but would facilitate their sustained growth. There are times, though, when companies should give priority to social benefit even at the expense of the idea of gaining profit to ensure such long-term sustainability. This is true corporate social responsibility. Of course, often giving priority to social benefit will heighten a company’s standing and reputation within the community, and this in turn will have a positive impact on company profits. However, companies that carry out socially significant activities on the grounds they will add to company profit are only fulfilling their long-term profit responsibility. In this case, there is no need to bring out the idea of social benefit responsibility. Long-term profit responsibility will suffice. We believe, however, that a preparedness to at times sacrifice long-term profit is required as the essence of CSR for socially important companies.

- This can be taken as a restriction on the individual property rights of the stockholders, who are the legal owners of companies that exist to generate profit, but the fact that the public good at times takes precedence over individual rights is a concept recognized in the Constitution. Of course, restrictions on individual property rights should not be abused, so naturally companies must be held strictly accountable when profits are being sacrificed.

- Managers seeking to fulfill such CSR have an obligation to make a comprehensive judgement between social benefit and profit. For this, high moral standards are essential. The “Sun-Lord” long referred to within Japanese society is perhaps one source of such morals. The Sun-Lord symbolizes one’s internal sense — an inner voice — that places value on social benefit.

### **3. Relationship between CSR and governance**

- The implementation of CSR in itself is, in fact, managers' governance. The reason is that aiming to implement CSR also functions as a mechanism of self-discipline on managers' actions. Managers that view CSR seriously should give deep consideration to the significance of CSR as this self-governing mechanism. And high moral standards by managers are essential for this self-discipline to function.
- There is, however, great risk in depending solely on the self-governance mechanism for governance (checks on top-management). There is a need to design a mechanism for checking whether CSR and the activities of companies as public institutions of society are being carried out appropriately in a form that suits the characteristics of Japanese capitalism.
- What has been developed as a governance mechanism is the stock-market-centered mechanism with stockholders at its core. There is also the idea of having this mechanism include the check function of CSR implementation. An example of this is the idea of social responsibility investment. However, while giving such a mechanism the function of a mechanism for checking the implementation of CSR can be worthwhile as a supplementary mechanism for CSR, it would be inadequate as the primary CSR checking mechanism. This is because of the risk that the essence of CSR we consider in the sense of "even at the expense of profit" may conflict with the stock-market-centered mechanism.
- Governance has an important relationship with the conventional wisdom of how companies are perceived within society. The situation is basically different between Japan and the United States in that in the United States the conventional wisdom is that companies belong to the stockholders, and there is general social support for governance by the stockholders. In Japan, though, there is a deeply rooted view that companies are not just stockholders' capital investment corporations, but rather are groups of workers and not merely an aggregate of assets. Therefore, in Japan a range of devices have been created within the framework of the Corporations Law so that full consideration is given to workers. One example is the internal appointment of directors. There is, though, a risk that such devices may undermine the governance function. Such an inadequacy should not be left unresolved, so there is a need for a governance structure suited to conditions in Japan that also takes into account the implementation of CSR.
- An example of a governance device to promote the implementation of CSR is to obligate external directors to state their assessment of managers and the state of management and their vision of CSR in the business reports etc. of notices to convene general meetings of stockholders. However, for this suggestion to be carried out, companies will require

extensive planning and effort to make the appropriate information available to the external directors.

Another suggestion is that companies release CSR reports with messages by CEOs and the like, and obtain certification by independent organizations. In short, securing transparency can expect to lead to accountability, and also to governance.

There is also a concept of governance that incorporates the perceptions of employees and outsiders to keep a check not just on CSR, but on the authority of managers as well.

Examples of this is a review by stakeholders of the actions of managers and implementation of CSR. Another method is to establish a manager review committee that includes persons from outside the company by resolution of the board of directors to review the broad performance of managers. Within this review, there is a need for some form of mechanism by which the views of employees can also be considered.

- Japan is essentially a deeply conflicted country over the issue of governance because of the widely accepted conventional wisdom about companies. The source of this sense of conflict is in the nature of companies in that they are both a collective body of people, and at the same time, a collective body of money. Japanese companies have been facing the dilemma arising from both aspects. And because this sense of conflict runs deep, in reality there is a chance that the fundamental solution to this will come from Japan.

It is hoped that this solution can form a single world standard that goes beyond cultural differences. From Japan we should convey a CSR and governance stand, or a basic idea that can be applied anywhere in the world.

However, we also need to note that the specifics about the nature of governance differ from country to country, and will change with the trends of the times. We should not attempt to impose Japan's way of thinking, nor should we think that the optimum nature of governance in one era will continue to have permanent meaning.