



Executive Summary
(unofficial translation)

**“Market Evolution”
and CSR Management**
Toward Building Integrity and
Creating Stakeholder Value

**The 15th
Corporate
White Paper**

KEIZAI DOYUKAI
<Japan Association of Corporate Executives>

March 2003

Introduction:
Some Thoughts on the Summarization of the 15th Corporate White Paper

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 sustained 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.

Section 1 (Defining the Issue) 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.

Section 2 (Implementation) is centered on the results of the Study Group on Market Evolution and the Corporation in the 21st Century (Chairman Toshikazu Saito). Additionally, it examines the following subjects in light of the proposals concerning corporate governance submitted by the Committee on Corporate Management for Fiscal 2001 (Chairman 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 standards that we are advocating in order to take the initiative in "market evolution."

Section 3 (Dialogue) records the dialogue 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.

Section 4 (Theory) is centered on the lectures delivered by various scholars participating in the Market Evolution Project of the Keizai Doyukai Research Institute (Director Koichi Minaguchi until January 2003, and thereafter Director Shotaro Watanabe) and establishes some parameters for the theoretical study of "market evolution."

Section 5 (Reference Materials) consists of the following: [1] European research report of the above-mentioned Study Group on Market Evolution and the Corporation in the 21st Century. [2] Results of questionnaire survey of Japanese corporate executives. [3] Evaluation sheet for self-evaluation under the new corporate evaluations standards 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 evaluation standards 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 evaluation standards is to attain higher levels of "CSR," the evaluation standards 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 evaluation standards 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

Executive Summary

What Is "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.

"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)

Section 1 (Defining the Issue)

Society and the Corporation—Reconsidering the Relation

Yotaro Kobayashi, Chairman of 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 corporations 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 a "balancing game" for mutually exchanging and coordinating a diverse range of interests. Furthermore, the relations between the corporation 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 corporation 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.

Mission Statement at Founding of Keizai Doyukai (selective summary)

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.

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 "1955 political system," 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.

Reasons Why "Corporate Social Responsibility" Must Be Re-Examined

- **Growing mutual influence of society and corporations** : 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.

- **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 profits. 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.

Section 2 (Implementation)

"Market Evolution" and the 21st Century Corporation: Toward Building Trust in Corporations and Sustained Value-Creation

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 corporations 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 sustained corporate development. Corporate social responsibility (CSR) implies initiating concrete steps for the synergetic development of

Diagram: Corporate Evaluation System

