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Trends in Socially Responsible Investment: Corporate Social Responsibility in a New Phase

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Contents

Trends in Socially Responsible Investment: Corporate Social Responsibility in a New Phase

Summary

1. Socially responsible investment (SRI), which has been promoted mainly in the US and Europe, is now attracting attention in Japan. SRI signifies investment activities based not only on financial assessment but also social assessment of investment targets, using social, environmental and ethical criteria. Typical SRI approaches in the US include (1) screening, (2) shareholder advocacy and (3) community investment. Screening means to choose investment targets in line with the values of the investors, taking account of the social as well as financial assessment of the companies concerned. Shareholder advocacy indicates exercising the rights accompanying investment such as stockholder's proposal and voting rights to call on the management of the companies to fulfill their social responsibility. Community investment means investment in communities through community development financial institutions (CDFIs).

The expansion of SRI in the US and Europe is backed by rising concerns about the social responsibility of businesses. This responsibility is often called corporate social responsibility (CSR) in the US and Europe. CSR is now drawing attention as a concept of open and transparent business practice that respects employees, communities and the environment among others, based on ethical values. The adoption of a proper CSR strategy is considered to enable a company to (1) improve its social credibility, (2) ensure its competitiveness, and (3) manage risks.

2. From the 1960s to the 1980s, SRI in the United States was linked to contemporary social concerns and criticism against businesses. With the development of criteria such as social assessment of companies, SRI experienced a significant expansion in the 1990s, largely backed by the buoyant stock market. Outstanding SRI assets in the US more than tripled in the last six years to \$2,340 million (about ¥300 trillion) in fiscal 2001, reportedly accounting for 12% of major investment assets. SRI has been adopted by a wide range of investors including institutional investors such as public corporations, universities, hospitals, foundations, insurance companies, pension funds, NPOs, churches and synagogues, as well as personal investors. Specialized organizations to support social evaluation of businesses and shareholder advocacy have also developed. Most of the evaluation criteria are related to the traditional negative screening, avoiding investments in tobacco, gambling, alcohol and weapons. SRI financial instruments seek to reconcile responsibility with investment performance, providing yields comparable with ordinary funds.

3. In Europe, 250 SRI funds were reported as of June 2001, with outstanding assets of 15.1 billion euro (about ¥1.6 trillion). They have been expanding despite being affected by the fluctuations of the stock market. SRI and corporate social responsibility are discussed actively at various levels in Europe. The promotion of SRI and CSR has been progressing at the national level, including through legislative measures.

SRI in the UK started with stock selection based on religious ethics, but followed a similar course to its US counterpart in that it has developed in connection with social issues and criticism against businesses. SRI funds expanded substantially toward the late 1990s. Recent years have also seen the adoption of SRI by institutional investors including pension funds and insurance companies. The amended Pension Law, which took effect in July 2000, requires pension funds to disclose information about their SRI policy. 60% of the pension funds are reported to be favorable toward introducing SRI in some form. In October 2001, the Association of British Insurers (ABI), a trade association for insurance companies, published guidelines requiring companies to disclose information about CSR risks (and opportunities). In addition, the advent of an SRI stock index has increased the awareness of CSR among listed companies.

The interest of consumers and investors in CSR has increased rapidly in recent years in the UK. Strong expectations can be observed particularly in such areas as education, reemployment support for the unemployed, support for the disabled, and the environment. SRI and CSR have a positive correlation in development. In this context, the UK Government has initiated policy measures to facilitate CSR, including the identification of successful cases, support, administrative coordination, international advocacy and extension to small- and medium-sized enterprises.

4. In Japan, an investment trust product considering the environment-conscious activities of businesses first appeared in August 1999 as a form of SRI trust. Nine such products have been marketed so far, most of which use positive screening with criteria focusing on the environment. Financial intermediaries are expected to assume the fiduciary duty typical of SRI such as information disclosure to investors, timely review of criteria and their rationality. Looking ahead, efforts by companies to adopt non-environmental criteria may become increasingly important in their evaluation by society. Criteria focusing on the compliance with laws and regulations on corporate ethics have already been adopted for evaluating businesses.

5. Since SRI and CSR are still in their infancy in Japan, there are opportunities for companies to emphasize CSR to enhance their competitiveness, thus adding value. However, individual companies will have different priorities and criteria to be met. Also, to ensure that management concerning CSR takes root and functions properly in Japan, voluntary efforts by businesses must be evaluated positively by stakeholders including investors and consumers in order to provide incentive for corporate managers. On the other hand, there is a trend toward the standardization of CSR at the international level, and future developments in this regard need to be monitored.

The contemporary role of SRI is to serve as an economic system that encourages businesses to meet the challenge of sustainable development. Further progress in this direction is expected in Japan.

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Introduction

In recent years, a new style of investment that considers social as well as financial aspects of corporate activities has been expanding mainly in the US and Europe. This type of investment, called socially responsible investment (SRI), has also begun to draw attention in Japan.

Outstanding assets of SRI in the US reached ¥2,340 billion in fiscal 2001. In the UK, institutional arrangements have been made for information disclosure related to SRI. SRI financial instruments have gained support due to favorable investment results in the past, as well as because they can incorporate personal values in the act of investment. Major financial institutions have started to deal in such products as a promising business.

The concept of SRI itself is not new. Some US investors were involved in such transactions for religious reasons as early as in the 1920s. However, it was not until the late 1990s that SRI became accepted by a wide range of investors and grew strongly. The current expansion of SRI is characterized by the increased interest of investors and analysts in the social responsibility of businesses, based on the idea that a company's position on the environment and social issues may have a strong financial impact. Although the responsibility of businesses has been discussed repeatedly over the years, it has been drawing renewed attention in the US and Europe under the term 'corporate social responsibility' (CSR). It is reported that companies have started to emphasize CSR in management and marketing for maximizing their business worth or as part of risk management.

This report examines this rising interest in CSR in the economy and society from the aspect of SRI. Chapter 1 describes the concept of SRI and CSR, focusing on its contemporary meaning. Chapter 2 looks at the current status of SRI in the US and Europe, where SRI is undergoing significant development, and considers its implications for Japan. Chapter 3 describes the current status of SRI in Japan and considers issues to be addressed by companies.

I Socially Responsible Investment (SRI) and Corporate Social Responsibility (CSR)

1. Definition of Socially Responsible Investment (SRI)

In recent years, socially responsible investment has been expanding mainly in the US and Europe. It has also begun to attract attention in Japan.

Simply put, SRI means investment activities that take into account the social as well as financial assessment of the company concerned, including social, environmental and ethical criteria. However, various terms are used to indicate similar investment activities, as there is no official definition.[1]

For example, Social Investment Forum, a US national nonprofit membership association, explains, "Integrating personal values and societal concerns with investment decisions is called Socially Responsible Investing (SRI). SRI considers both the investor's financial needs and an investment's impact on society. With SRI, you can put your money to work to build a better tomorrow while earning competitive returns today." This explanation is geared toward general investors.

Citing the definition of the UK Government, Mark Mansley (2000) states that SRI means "investment where social, environmental or ethical considerations are taken into account in the selection, retention and realization of investments, and the responsible use of rights (such as voting rights) attaching to investments."

SRI expanded rapidly toward the late 1990s mainly in the US and Europe. As mentioned later, outstanding SRI assets in the US reached $2,340 billion in fiscal 2001, the largest among the countries for which relevant statistics are available. In the UK, institutional arrangements have been made for information disclosure related to SRI, contributing to the increase in the number of institutional investors adopting SRI.

2. Principal Approaches to SRI

How has SRI been put into practice? In the US, a country with a long tradition of SRI, typical approaches to SRI include: (1) screening, (2) shareholder advocacy and (3) community investment (Figure 1-1).

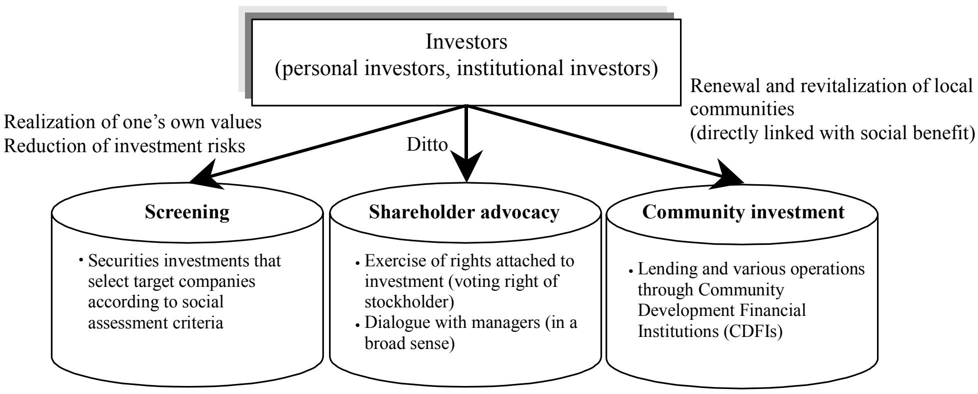


Figure 1-1 Principal Approaches to SRI in US

Note: CDFIs: Community Development Financial Institutions.
Source: Compiled by DBJ.

[1] Other terms include social investing, socially aware investing, ethical investing, mission-based investing, etc.

2.1 Screening

Screening means to choose investment targets, particularly stock investment targets, that are in line with the values of beneficiaries, based not only on the financial assessment but also the social assessment of the companies including social, environmental and ethical performance.

There are two methods of selecting investment targets from the social point of view according to the criteria used: negative screening and positive screening.

Negative screening is a traditional technique that excludes the stock of those companies providing products or services that are inconsistent with the values of beneficiaries (e.g., tobacco, gambling, alcohol and weapons). Merits of this method include the simplicity of choice (although the thorny issue of delimitation arises when potential target companies diversify their businesses) and the ease of understanding by beneficiaries. However, the portfolio may be somewhat biased as target companies are often limited.[2]

Positive screening, on the other hand, is a method of choosing "good" companies by setting criteria concerning social concerns such as industrial relations, contribution to communities, response to environmental issues, respect for international human rights and the manufacture of safe products.

The two concepts are not necessarily mutually opposite, as they are suited for different purposes and are influenced by the extent of the social orientation of beneficiaries. Indeed, investment target companies are often assessed by using multiple methods including negative screening and positive screening to allow investment funds to take account of various social concerns. The results of the assessment are weighted to produce final ratings. This technique is called the "scoring system."

Some funds also employ a technique called the "best in class." This technique sets up original (business) sectors to select the best (or above-average) companies in each sector in light of criteria based on social concerns. This approach has the merit of building balanced portfolios.

A more important question is how to balance social screening of the investment universe (the set of investment-grade companies) with financial performance, on the premise that financial return is (more or less) essential for any beneficiary. In actual investments, arrangements are made to improve financial performance. For instance, social screening is applied only in the final stage of selection after financial assessment has been made, or the definition of "good" companies is widened (to the extent acceptable to the beneficiaries) in the best-in-class technique to increase the latitude of investment (thus leaving room for the fund managers to use their expertise).

2.2 Shareholder Advocacy

Shareholder advocacy means to require the management of investment target companies to assume its social responsibility by exercising the rights attached to investment including stockholder's proposal and voting rights. Shareholder advocacy has also been attracting attention in Japan, but rather in its relation with corporate governance related to terms such as "shareholder activism," or more plainly "shareholders with voice."

As noted by many researchers, one of the reasons for the development of shareholder advocacy in the US is that the idea of expressing one's demand for increasing business worth on the premise of diversified share investment and long-term shareholding has gained ground among large institutional investors including pension funds[3] as well as among investors in

[2] Taka (2002) also points out its limit by arguing that negative screening "would be the simplest way by far for rating agencies and investment trust companies (investing agencies, etc.), if they could take or leave target companies by focusing on types of business or contents of services. However, this technique is potentially problematic because values of a certain cultural area are used to make judgment on other cultural areas based on the dichotomy of what is ethical and what is unethical."

[3] In the US, civil service pension funds in the public sector without any long-term business relations with private companies are said to be active in shareholder advocacy, including the New York City Pension Fund and California Public Employees' Retirement System (CalPERs).

volved in index investments[4]. For such investors, shareholder advocacy is less costly and less risky, as they are concerned that they cannot exit the market by selling off their huge share holdings because they cannot find purchasers, nor can they easily sell shares of particular companies.

The opinions of investors (discontent, expectation, etc.) are communicated to the management of the company through shareholder advocacy. The contents thus communicated can be classified into those intended for the improvement of corporate management efficiency and those concerning social matters including social, environmental and ethical issues (certain issues may overlap such as accountability for director's remuneration). Shareholder advocacy in the US spans a wide range of social concerns, demanding that companies operating in South Africa withdraw investment from the country as part of the anti-Apartheid movement, or encouraging companies to adopt the code of environmental conduct (CERES Principles) to address environmental issues.

There are other approaches than the direct exercise of investor's rights, including direct dialogue, particularly communicating to corporate managers necessary improvements from the viewpoint of corporate social responsibility and monitoring their implementation. This approach is called "engagement." Those approaches may be included in the voicing mechanism as a means of conveying to the management the opinions of investors on social concerns.

2.3 Community Investment

Whereas screening and shareholder advocacy mainly target public companies, community investment means investment in communities through community development financial institutions (CDFIs). CDFIs are financial institutions that have community development as their primary mission. CDFIs provide funds for the construction of housing for low-income households, for which financing from conventional financial institutions is difficult to obtain, as well as for local small businesses. They also provide professional or technical advice and vocational training.[5] Investment in CDFIs is a clear and easy-to-understand technique for investors, for it is directly linked to the renewal or revitalization of communities. Most CDFIs are non-profit organizations. One notable exception is the South Shore Bank (established in 1973), the first community development bank in the US. The Bank takes the form of commercial business, seeking to balance its social orientation and profitability.

3 Rising Interest in Corporate Social Responsibility (CSR)

The expansion of SRI in the US and Europe is backed by the rising interest in corporate social responsibility, especially on the part of investors and shareholders.

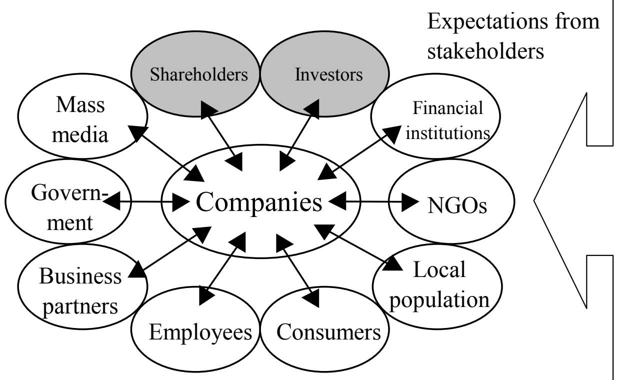
Then, what is corporate social responsibility?

As in the case of SRI, the term itself is not new, but has been repeatedly discussed everywhere over the years as an underlying principle of corporate behavior.

According to Archie B. Carroll, corporate social responsibility can be classified into four categories based on the extent of social obligation and expectation: economic responsibility, legal responsibility, ethical responsibility and

[4] Investments for the same price movement as in benchmark indices (e.g., S&P500, Nikkei Average Share Price and TOPIX). Without any research or analysis of individual companies, as conducted by active funds, they have a merit of reducing investment cost.

[5] CDFIs are further classified into four categories: (1) community development banks, (2) community development credit unions, (3) community development loan funds, and (4) community development venture capitals. Each type of CDFI may be called differently.



Patterns of corporate social responsibility (classification of Archie B. Carroll)

Classification	Social expectation	Examples
Philanthropic responsibility	Desired by society	Mécénat, philanthropy; contribution to local communities; donation to philanthropy, volunteer leave
Ethical responsibility	Expected by society	Transparency in transactions; respect for egal spirit; respect for human rights and culture; environmental conservation; safety, leadership, reputation
Legal responsibility	Required by society	Antimonopoly legislation; bribery, bid rigging and other commercial and penal law violations;various regulations; administrative guidance
Economic responsibility	Required by society	Profit maximization; share enlargement, business efficiency; anticipatory investment; management strategy; job security; technological innovation; dividend maximization

Figure 1-2 Patterns of Corporate Social Responsibility

Source: Umezu (1997).
Data compiled by DBJ.

philanthropic responsibility (Figure 1-2).[6] Note that the scope of legal responsibility has widened in contemporary discussions. With increased emphasis on private-sector initiatives, regulations have been developed to require companies to take account of environmental burdens and equality in employment. Furthermore, increased focus is now placed on ethical and philanthropic responsibilities in cases where mere compliance with legal provisions is not enough (responsibility of a higher order).

As in the case of the UK, which will be described later, companies are increasingly required to improve transparency in the eyes of the shareholders and provide bona fide explanations (accountability), in addition to actually discharging their social responsibility.

As has been discussed by many analysts, the wide range of social responsibility required of companies reflects the diversity of the parties concerned (generally known as stakeholders), including investors, shareholders, employees, consumers, business partners and communities. Stakeholders comprise those who have direct or indirect interest in the company as employees, purchasers of goods and services, depositors or corporate pension holders. Typically, they have a mutual relationship with the company, influencing corporate behavior through their expectations while also being affected by the company.

Historically, numerous action principles have been developed concerning corporate social responsibility to urge companies into responsible behavior. Examples include the Global Sullivan Principle (1974), OECD Multinationals Guideline (1976) and United Nations Global Compact (1999). In recent years, partnerships with NGOs and NPOs have been emphasized in the CERES Principle (1989), International Labor Standard (SA8000, 1997), Sustainability Reporting Guideline (Global Reporting Initiative: GRI, 1999/2000), etc. (Table 1-1).

Interest in the social responsibility of companies also increased in Japan as industrial pollution worsened in the era of rapid economic growth. The social contribution of companies (philanthropy, etc.) became the primary focus of attention in the early 1990s. Concerns about

[6] The classification of corporate social responsibility is not limited to the four categories described in this report. According to Tanimoto (2000), for example, CSR can be classified into four patterns based on the operational level at which companies exert impact on society: (1) the incorporation of social justice and ethics into the process of business activities, (2) the development of social products and businesses, (3) social contribution particularly through donation, and (4) support and voluntary activities for local communities utilizing corporate managerial resources (facilities, human resources, technology, etc.). He argues that the market society has come to appreciate activities not only at Levels (3) and (4) but also at Levels (1) and (2) since the 1990s.

Table 1-1 Principles on Corporate Social Responsibility

Classification	Name	Year of publication/ establishment	Content
Rules/ guidelines	Global Sullivan Principle	1974	Corporate behavior guidelines advocated by Rev. Sullivan of South Africa.
	OECD Multinationals Guideline	1976	Principle concerning desirable corporate behavior, fourth revision in 2000.
	CERES Principle	1989	Environmental ethics standard for businesses, published by CERES, a US NGO.
	Keidanren Charter of Business Behavior	1991	10 principles concerning desirable corporate behavior, revised in 1996.
	UN Global Compact	1999	Corporate activity principle endorsed by SG Kofi Annan in Davos.
	Sustainability Reporting Guideline	1999/2000	Published by GRI, a US NGO.
Organizations	Caux Round Table Conference	1986	Organization of Japanese, US and European business people based in Caux, Switzerland. Published an Action Agenda for Moral and Responsible Companies.
	BSR	1992	Membership organization supporting responsible business activities.
Standards	SA8000	1997	International labor standard, formulated by SAI (ex-CEPAA) of US.
	AA1000	1999	Accountability standard, published by ISEA of UK.
	ECS2000	1999	Ethical standard, published by Reitaku Research Center.

Note: GRI: Global Reporting Initiative, BSR: Business for Social Responsibility, SA8000: Social Accountability, ECS2000: Ethics Compliance Standard, SAI: Social Accountability International.
Source: Compiled by DBJ.

social responsibility of companies have been renewed in recent years in terms of response to environmental issues and corporate misconducts.

In the US and Europe, corporate social responsibility has often been referred to as CSR in recent years. It has been attracting attention as a concept of open and transparent business practice that respects employees, communities, the environment, etc., based on ethical values[7]. With the rising expectations from stakeholders including consumers and investors, the adoption of appropriate CSR strategies by companies is considered effective for (1) improving social reputation, (2) securing competitiveness, and (3) managing risks.

This chapter has described the concept of SRI and corporate social responsibility (CSR), which has a close relationship with SRI, with focus on their contemporary meanings. The following chapter outlines actual trends in SRI.

[7] Various definitions also exist for CSR. The definition cited here is by the Prince of Wales Business Forum. This report use the term as indicating contemporary implications of "social responsibility of companies."

II Trends in SRI in US and Europe

This chapter outlines SRI trends in the US and Europe. First, the discussion focuses on the current status of SRI in the US, which reportedly holds the largest SRI assets in the world. This is followed by a description of trends in the UK, where SRI has been growing rapidly, with a focus on the efforts of the government and institutional investors to encourage the disclosure of SRI and CSR information, and the underlying development of the CSR concept.

1. Trends in SRI in US

1.1 Development

The long history of SRI in the US apparently has had considerable impact on the development of its concept. This section outlines the development of SRI in the US in three stages: inception, diffusion and expansion (Table 2-1).

Inception (circa 1920s)
Although various arguments exist as to the origin of SRI, the contemporary style of SRI dates back to the 1920s, when US churches stopped investing in the stock of companies involved in alcohol, tobacco and gambling.

Diffusion (late 1960s – 1980s)
The US economic society experienced numerous social challenges including the civil rights movement and the Vietnam War in the 1960s, consumer campaigns and nuclear accidents in the 1970s, and the anti-Apartheid movement and environmental issues in the 1980s. During this period, mechanisms were formed to consider corporate social responsibility in investment activities. The 1970s saw a continued slump in the stock market, sometimes referred to as the "demise of stock[8]." At the same time, companies came under fire for not assuming their social responsibility. Campaign GM [9]

Table 2-1 Development of SRI in US

1920s-	Companies mainly involved in alcohol, tobacco and gambling are excluded from asset investments by Christian churches.
1960s-	Social issues and corporate criticism are linked to SRI.
1970	Campaign GM is initiated (inception of shareholder advocacy).
1971	The first mutual fund that considers a wide range of social issues is created.
1971	A religious group (ICCR) is established to put shareholder advocacy into practice.
1972	IRRC, a SRI survey company is established.
1973	The first US community development bank (South Shore Bank) starts operation.
1974	Elisa Law is enacted. Defined contribution pension plan (401k) is created.
1985	SIF is incorporated as a federation of organizations involved in SRI.
1988	A SRI survey company (KLD) is established.
1990s-	Rapid growth of SRI market.

Note: ICCR: Interfaith Center for Corporate Responsibility
IRRC: Investor Responsibility Research Center
KLD: Kinder, Lydenberg, Domini
Source: Compiled by DBJ.

[8] Business Week, a US economic magazine, featured an article entitled "The Demise of Stock" in 1979. The US stock market remained stagnant throughout the 1970s, with the Dow Jones Industrial Average moving within the $600-1,000 range.

[9] The problem of defective cars triggered an active campaign demanding responsible corporate behavior from GM. A stockholder's proposal was presented at the next annual general meeting (1971), urging the company to take comprehensive measures for minority employment, pollution control, etc.

marked the start of shareholder advocacy in 1970. 1971 saw the advent of the first SRI trust (mutual fund)[10] involved in social screening based on a wide range of social, environmental and other criteria (currently Pax World Balanced Fund). In 1972, a specialized organ was created (IRRC) to conduct social assessments of companies. Further, the first community development bank (the aforementioned South Shore Bank) commenced operation in 1973. In the 1980s, various events such as the anti-Apartheid movement helped increase awareness of SRI among general investors.

Expansion (1990s onward)

With favorable US stock market conditions, SRI experienced a full-scale expansion, particularly in stock investment, as SRI financial instruments showed good performance and concerns about corporate responsibility heightened largely due to the anti-tobacco sentiment. The expansion of SRI was also helped by the flow of funds into investment funds through defined contribution pension plans, which often considered SRI as an option in investment.

Thus, SRI started as a marginal investment activity in the US but became linked to contemporary social concerns and corporate criticism from the 1960s through the 1980s. With the development of necessary infrastructure including the social rating of companies, SRI grew spectacularly in the 1990s, backed largely by the buoyant stock market.

1.2 Trend of Outstanding Assets

According to the “2001 Trends Report,” published by the aforementioned US Social Investment Forum (SIF), total outstanding assets of SRI in the US (biennial, as of November) rose from $40 billion in fiscal 1984 (almost ¥10 trillion @ ¥239/$) to ¥695 billion in fiscal 1995 (almost ¥70 trillion @ ¥100/$) and to $2,340 billion (¥300 trillion @ ¥130/$) in fiscal 2001, thus more than tripling in the last six years (Table 2-2).

Taking account of the fact that the US economy experienced its longest expansion in the post-war era, with the buoyant stock market

Table 2-2 Trend of Outstanding SRI Assets in US

(Unit: $ billion, %)

Classification	CY					Change 99/01
	1984	1995	1997	1999	2001	
Screening	N/A	162	529	1,497	2,030	35.6
Mutual funds		12	96	154	153	-0.6
Separate accounts		150	433	1,343	1,870	39.2
Shareholder advocacy	N/A	529	736	922	906	-1.7
Investors also involved in screening*			84	265	601	126.8
Investors involved in shareholder advocacy only			652	657	304	-53.7
Community investment	N/A	4	4	5	8	40.2
Total (excluding *)	40	695	1,185	2,159	2,340	8.4

Note: * Excluded from total due to duplication with screening.
Some totals do not add up due to rounding.
Source: Compiled by DBJ from SIF data.

[10] Typical corporate type open-ended investment trust. A corporate type investment trust establishes a stock company for investment, in which the investors become stockholders by acquiring issued shares. An open-ended mutual trust allows free conversion in cash after initial establishment by repurchasing issued securities. The conversion is based on the value of net assets.

and the doubling of the composite share price index, the growth of the SRI market in the 1990s was largely supported by rising share prices, as well as by the inflow of new money. Underlining its popularity in the US, the SIF reported that SRI assets accounted for 12% of the major investment assets throughout the country in fiscal 2001, and that "nearly one out of eight dollars under professional management in the US today is involved in SRI."

In fiscal 2001, outstanding screening assets[11] amounted to $2,030 billion, accounting for as much as 86.8% of total assets outstanding and increasing 35.6% in two years since fiscal 1999. Out of the screening assets, SRI funds (mostly mutual funds in the US) account for $153 billion, which is only 6.5% of the total. Thus, an overwhelming part of the total outstanding assets belong to individual and institutional investors who use screening in their investment strategy (separate accounts). Although mutual funds showed a strong increase in number from fiscal 1999 (168 to 230), their outstanding assets decreased slightly, affected by falling share prices (from $154 billion to $153 billion).

Outstanding assets of shareholder advocacy accounted for 38.7% of the total ($906 billion), showing a slight decline of 1.7% from fiscal 1999. Of these assets, however, outstanding assets of methodologically "active" SRI, involved in both screening and shareholder advocacy, amounted to $601 billion, more than doubling from fiscal 1999 (up 126.8%). This is mainly due to the increase in the number of institutional investors who avoid tobacco-related stocks and are also involved in some kind of shareholder advocacy. The assets subjected to both screening and shareholder advocacy are excluded from the total SRI assets to avoid duplication.

Finally, community investment amounted to $7.6 billion, showing a substantial growth of 40.2% from fiscal 1999, but only accounted for 0.3% of the total. This extremely small volume of community investment assets can be explained by the fact that this statistic only counts in the outstanding assets of CDFIs, whereas in the US, community investment is basically required of every commercial bank under the Community Reinvestment Act (CRA)[12].

1.3 Investors and Specialized Organizations

A wide variety of investors adopt SRI in the US, ranging from personal investors to institutional investors such as public corporations, universities, hospitals, foundations, insurance companies, pension funds, NPOs, churches and synagogues.

As it is inefficient and cumbersome for those numerous investors individually to collect information, make judgment on investment and monitor management, in practice organizations specialized in SRI have been established to support the social assessment of companies and shareholder advocacy.

Typical examples of organizations specialized in SRI include the Interfaith Committee on Corporate Responsibility (ICCR: shareholder advocacy), Investor Responsibility Research Center (IRRC: corporate rating and shareholder advocacy) and Kinder, Lydenberg, Domini (KLD: corporate rating). In spite of the difference in their forms, such as private enterprises and NPOs, they are highly independent in their actions. The ICCR is an inter-religious center (religious group) for corporate responsibility established in 1971. The IRRC is a research agency/investment advisory company (NPO) to support shareholder advocacy, established in 1972. KLD, a research agency which rates corporations on social responsibility on behalf of institutional investors, provides a paid database called the Social Responsibility Rating Database (SOCRATES), which contains as-

[11] Although screening assets in these statistics are limited to those officially subjected to social screening, this is a definition in a wider sense because assets with a single screening criterion are all counted in.

[12] Legislation requiring the elimination of discrimination against low-income persons and minorities in bank loans (redlining), given that safe and sound banking management of the financial institutions is maintained. Compliance by each bank is rated (excellent, good, improvement required or unsatisfactory) by the supervising authorities almost every two years as regards lending, investment and service. The results are made public. The supervising authorities must consider this rating result when authorizing new bank branches or mergers.

sessments of more than 1,600 companies. KLD also launched in May 1990 a Domini 400 Social Index, the first benchmark for SRI investors with multiple social criteria.

1.4 Characteristics in Corporate Assessment Criteria

What kind of criteria are used commonly in the US for screening? The share of each screening item in all portfolios in fiscal 2001 (SIF survey) indicates that criteria concerning tobacco, the environment, human rights, employment, gambling, alcohol and weapons are used in more than 50% of all portfolios (Table 2-3).

Table 2-3 Major Screening Items for SRI in US

(Share in all portfolios)

50% or over	* Tobacco * Environment * Human rights * Employment/equality * Gambling * Alcohol * Weapons
30% - less than 50%	* Labor relations * Animal testing/rights * Community investing * Community relations
Less than 30%	* Executive compensation * Abortion/birth control * International labor standards

Source: Compiled by DBJ from SIF data.

The most recent "1999 Trends Report" provides more detailed information: tobacco (96%), gambling (86%), alcohol (83%), weapons (81%) and the environment (79%) were adopted in about 80% of the portfolios, followed by human rights (43%), labor (38%), birth control and abortion (23%) and animal welfare (15%).

The above data indicate that the traditional type of negative screening against companies dealing in tobacco, gambling, alcohol and weapons in particular is most common in the US, although a wide variety of social concerns are reflected in SRI.[13] It is reported, however, that screening items used currently in less than 30% of the portfolios (such as international labor standards) may become more popular in the years ahead.

1.5 Evaluation of Investment Performance

In the US, SRI financial instruments subjected to screening are evaluated as not inferior to ordinary funds in terms of investment performance. According to the aforementioned KLD, for instance, the growth of the Domini 400 Social Index (annual rate) has exceeded that of the S&P500 for more than five years as of May 2002 (see below).

	DSI	S&P500
Last 5 years	7.25%	6.16%
Last 10 years	13.25%	12.10%

According to a survey as at the end of December 2001, 63% of the SRI assets subject to screening (29 out of 46 funds) are given high ratings from investment trust rating agencies (Lipper or Morning Star), thanks to the good performance during the recent three years.[14]

2 Trends in SRI in Europe

According to the Sustainable Investment Research International (SiRi) Group[15], SRI assets (limited to SRI retail funds) in 13 European countries amount to 250 funds with an outstanding value of 15.1 billion euro (about ¥1.6 trillion). The value of assets has been rising, despite share price fluctuations. The UK leads other European countries both in the number of funds and in outstanding assets, largely due to its relatively long experience in SRI (Figure

[13] Typical SRI funds in the US adopt multiple criteria for social assessment in general.

[14] More than 90% of investment trust fund sales in the US are estimated to flow into funds given four or five stars by Morning Star (fiscal 1997 survey by Morning Star).

[15] A group designed to conduct a wide range of social investment research, whose membership include 12 agencies noted for SRI research. With over 100 investigators, it covers more than 4,000 companies in major markets worldwide.

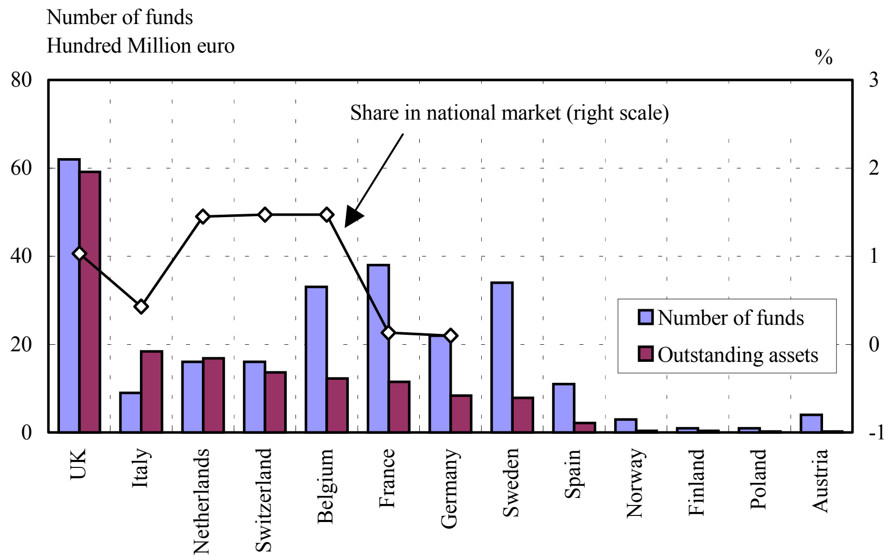


Figure 2-1 Status of Retail SRI Retail Funds in Europe (as at the end of June 2001)

Source: Compiled by DBJ from SiRi Group, "Green, Social and Ethical Funds in Europe 2001."

2-1).

In addition to this expansion in volume, SRI and corporate social responsibility have been actively discussed at various levels in Europe. For example, the European Union (EU) published a green paper entitled "Promoting a European Framework for Corporate Social Responsibility" in July 2000 for public comment to consider the role to be played by the EU in CSR at the regional and global level. The green paper refers to the growth of the European SRI market in recent years and predicts that further standardization, uniformity and transparency will be required of the screening criteria used by rating agencies. The paper also seeks to launch discussion on the necessity of a stock index for SRI at the pan-European level.

At the national level, enabling conditions for SRI and CSR have been developed including legislative measures. In France, for example, a provision for information disclosure on CSR by companies requires environmental and social reporting of listed companies. Information disclosure on SRI is also required. Furthermore, the federations of SRI-related actors in five countries—France, Germany, Italy, the Netherlands and the UK—took the lead in establishing the European Sustainable and Responsible Investment Forum (Eurosif) in 2001, as a pan-European stakeholder network to promote sustainability[16] and responsible investment.

3. Trends in SRI in UK

3.1 Development and Trend of Outstanding Assets

SRI in the UK, also known as ethical investment, has a history of at least 20 years. The term "ethical investment" however implies a bias toward negative screening, and its scope is often limited to religious or ethical approaches. For this reason, the UK Government and other organizations have been using the term "SRI," which has a wider meaning.

The history of SRI in the UK resembles that of its US counterpart, in that it started with

[16] There is no clear definition of this word, either. In a wider sense, it refers to corporate efforts to identify the company's objectives, consider the needs of all stakeholders and minimize the adverse effect of its own activities on society and the environment for creating (1) economic, (2) social and (3) environmental values (i.e. contribution), which are also known as "triple bottom lines."

Table 2-4 Development of SRI in UK

1974	First ethical bank is set up to lend to projects that have social benefit.
1981	Ecology Building Society begins financing the purchase of properties with an ecological payback.
1983	Ethical Investment Research Service (EIRIS) is established.
1984	First ethical unit trust is started.
1988	Green unit trusts are started.
1991	UK Social Investment Forum (UKSIF) is established.
1992	Co-operative Bank introduces ethical policy.
1997	A group of university lecturers launches the Ethics for USS campaign for the ethical and environmental investment of their pension fund.
2000	Pensions SRI Disclosure Regulation takes effect.
2001	FTSE 4 Good indices are created. ABI guidelines are published.

Source: Compiled by DBJ from UK Social Investment Forum data.

the selection of stock on religious ethics and has been linked with social issues and criticism against businesses (Table 2-4). The first research agency for social rating of companies was created in 1983. The year 1984 saw the advent of the first SRI trust (unit trust) in the UK, followed by the creation of green investment retail funds for environment in the late 1980s. Although some funds today are specialized in the environment, etc., the majority of them combine a wide range of criteria.

At first, SRI retail funds were not well received by financial experts in general in terms of market scale. However, SRI expanded rapidly up to the late 1990s in terms of both value of assets and number of products, reaching about £4 billion and 60 funds respectively in 2001 (Figure 2-2)[17]. Although SRI represents

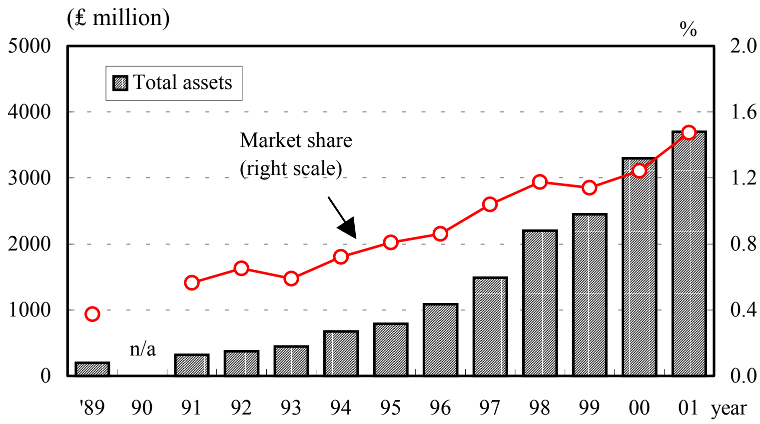


Figure 2-2 Trend of SRI Retail Funds in UK

Note: Data as of June (July for 1989, 1991 and 1994; May for 1992 and 1993).
Source: Compiled by DBJ from EIRIS, AUTIF and other data.

[17] One of the reasons for the expansion of SRI funds is that independent financial advisors (IFAs) affiliated to the UKSIF or Ethical Investment Association recommended SRI financial instruments to general investors as part of their sales strategy.

less than 1% of the UK investment trust market, it is considered a promising product.

No data are available on the total amount of SRI in the UK, comprising the three approaches of screening, shareholder advocacy and community investment. However, an estimate of outstanding assets subjected to screening was published as of October 2001.[18] The data indicate that screening assets in the UK increased from £52 billion in December 1999 to £120 billion (about ¥21 trillion) in October 2001, thus more than doubling in only 10 months. This spectacular growth is largely attributable to the rapidly increasing introduction of SRI in pension funds (up from £25 billion in December 1999 to £85 billion in October 2001).

Shareholder advocacy is also gaining attention. Traditional UK shareholders are generally reluctant to exercise their voting rights and prefer dialogue with management.[19] Also in the context of shareholder advocacy, most shareholders communicate necessary improvements from the viewpoint of corporate social responsibility through direct dialogue with company managers prior to exercising their voting right, and monitor subsequent implementation of their recommendations. This approach is called "engagement." In this case, their voting rights serves to increase the effectiveness of "engagement," as the last resort to make their voices heard. Investors actively adopting the "engagement" approach include the Local Authority Pension Fund Forum and the Universities Superannuation Scheme[20]. Backed by the influence of the sheer weight of their financial resources, some financial institutions have been marketing investment trust products that incorporate "engagement."

[18] Source: Russell Sparkes, October 2001.

[19] According to Tamura (2002), "institutional investors in the UK have an even larger share in total stockholding than in the US, but they tend to exert influence through under-the-surface consultations with managers, rather than through open confrontation with them."

[20] The fund's assets amount to £18.6 billion (about ¥3.7 trillion), of which about £14 billion is invested in corporate stock. With the launch of "Ethics for USS" (a campaign by university lecturers, etc. to demand ethical and environmental investments from pension funds), the fund introduced SRI, hired two SRI advisors and has been actively involved in shareholder advocacy.

3.2 Trends in Adoption of SRI by Institutional Investors

The UK stock market is one of the most institutionalized in the world (Figure 2-3). As mentioned above, SRI has been adopted by an increasing number of institutional investors including pension funds and insurance companies, attracting attention as a major development that will have a considerable bearing on corporate management.

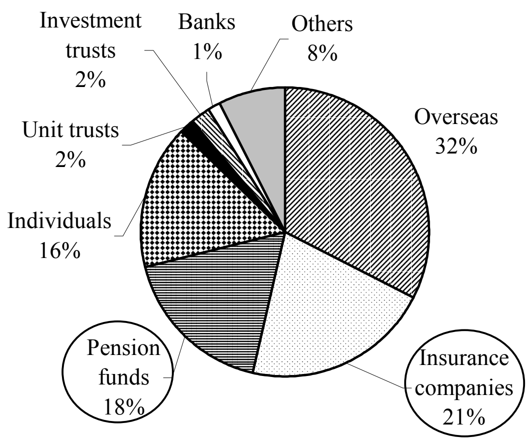


Figure 2-3 Shareholding Structure in UK (2000, market price basis)

Source: Compiled by DBJ from National Statistics, "Share Ownership."

Trends in Pension Funds

Occupational pension funds, a major category of pension fund, have expanded their asset volume thanks partly to tax relief measures in the 1990s (to £800-850 billion). However, they were traditionally reluctant to introduce SRI despite the huge amount of investment in the stock market.

Under these circumstances, the amendment to the Pensions Act 1995, which took effect in July 2000, was a landmark event in the history of SRI in the UK. The amendment is known as the SRI information disclosure regulation.

The amendment helped trigger the introduction of SRI by pension funds. The regulation requires the trustees[21] of occupational pension funds to describe in the Statement of Investment Principles (SIP), (1) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention, and realization of investments, and (2) their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investment.

Although this provision only concerns the disclosure of SRI information, its significance is that it has legally enabled pension holders to know whether their pension funds are involved in SRI. Moreover, pension fund trustees could be held accountable not only for investment performance but also for their ethical policy. Thus, they are now virtually required to consider SRI in an appropriate and serious manner. (Table 2-5)

Table 2-5 Text of amendments to the Pensions Act 1995

◆ Pension trustees shall describe the following in the statement of investment principles. 1. The extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention, and realization of investments; and 2. Their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments.

Source: Compiled by DBJ.

In this regard, it is useful briefly to describe the relationship between trustees and pension holders in occupational pension funds in the UK. The relationship changed dramatically throughout the 1990s, partially triggered by the illicit diversion of reserve funds uncovered in 1992 (Maxwell Affair)[22]. Following the establishment of a deliberative committee on the Pension Law (Goode Commission) in the same year and the publication of a White Paper on Corporate Pension Reform, the 1995 Pension Law, designed to protect pensioners (security of job area pensions), was enacted in 1995 to enhance the supervision of pension fund trustees.

As a result of a series of reforms, the relationship between trustees and trusters has been clarified in cases where UK occupational pension funds conduct investment activities on behalf of pension holders. Under fiduciary duty[23], pension fund trustees are strictly required by the supervisory regime to ensure safe investments over the long term.

While assuming those heavy responsibilities, pension funds have introduced SRI, as more pension holders have come to embrace the concept of SRI due to various factors such as the transformation of SRI from the traditional ethical investment to contemporary SRI and the good performance shown by SRI, as well as prior enlightenment activities by organizations specialized in SRI and non-governmental organizations. Indeed, an opinion survey of pension holders conducted by an organization specialized in SRI indicates that, as of 1997 (coverage: 700 adults), 73% supported the "adoption of an ethical policy by pension funds." Their acceptance of SRI in general was reconfirmed in 1999 (coverage: 493 adults), with 77% replying, "their pension scheme should operate an ethical policy whenever it can do so without reducing financial return" (Figure 2-4).

After this amendment, how many of the pension funds actually moved toward introducing SRI? According to the result of a questionnaire survey published in October 2000 by the UK Social Investment Forum[24], a federation of SRI organizations in the UK, as many as 60% of the respondent pension funds were favorable toward introducing some sort of SRI.

[21] The premium paid to pension funds is transferred from the employer (company) to the trustee, who invest assets and provide benefits. Some major pension funds hire outsiders (chartered accountants, university professors, etc.) as trustees. The trustee appoints a fund manager and oversees his/her activities.

[22] The late newspaper baron Robert Maxwell illicitly diverted over £400 million of assets from the pension funds (entrusted to a child of the president) of Maxwell Communications and Mirror Group Newspaper, both virtually owned by him. Payment of benefits to over 5,000 retirees came to a halt.

[23] Pension fund trustees have a duty to concentrate on the financial benefit of pension holders in good faith. They also have professional obligations, as they are trusted for their expertise.

[24] A membership network designed to promote SRI in the UK, established in 1991.

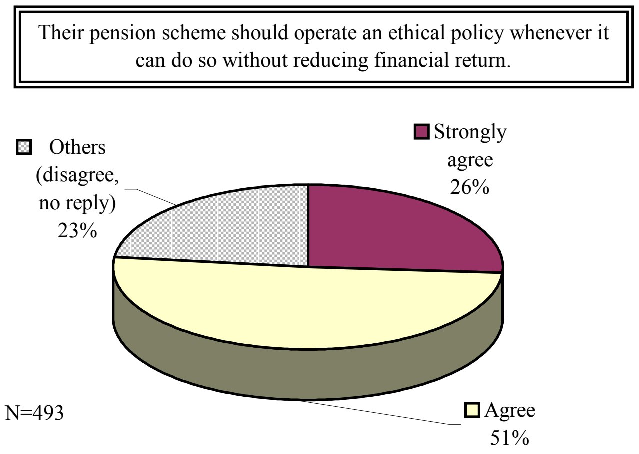


Figure 2-4 Opinion Survey of Pension Holders (1999)

Note: Survey conducted in June 1999.
Source: ERIS/NOP survey.

The survey, covering 508 pension funds including the top 500 occupational pension funds in terms of outstanding assets, also gave the following results based on 171 SIPs obtained (reply rate: 34%).

- 59% of funds, representing 78% of assets, are incorporating SRI principles into their investment process.
- 48% of funds, representing 69% of assets, have requested that their fund managers take account of the financial implications of social, environmental and ethical issues.
- Larger pension funds are more likely to take SRI considerations into account than smaller funds.
- 39% of funds mentioned the approach of engagement in their Statement.

However, some NGOs found that the introduction of SRI in pension funds was not sufficient.[25]

Trends in Insurance Companies

The UK insurance industry invests in corporate stock and other assets on behalf of millions of savers inside and outside the country. The volume of investment totals some £1.1 trillion, of which 90% is life insurance and annuity premiums for long-term investment.

UK insurance companies have their own SRI strategies. For example, Morley Fund Management, which invests some ¥20 trillion worldwide as the asset investment company of the largest UK insurance group CGNU, considers SRI as one of its core businesses and has established a special team to market multiple SRI funds. The company aims to select, from a wide range of potential investment targets, those companies that will provide long-term returns while contributing to sustainable development. The company also actively engages in dialogue with management as shareholder.[26]

In response to this development of SRI, the Association of British Insurers (ABI: the trade association for the UK's insurance industry) published in October 2001 guidelines requiring companies to disclose information regarding social, environmental and ethical risks (and

25 For example, an original survey conducted by a NGO, Friends of the Earth UK, entitled "How ethical are they?" found that among the top 100 job area pension funds in terms of assets, 10 made "good" reference to SRI policy in their SIPs, 18 made "active" reference, 33 made "poor" reference, 4 had "no policy," and 35 provided "no comment or reply."

26 In December 2001, five UK asset investment companies including Morley Fund and Henderson Asset Management as well as three pension funds in the UK, the Netherlands and Switzerland (total assets of £4 billion) sent a joint statement to their investment target companies operating in Myanmar, demanding the latter to review their activities in the country with a bad human rights record (*Nikkei Kinyu Shimbun*, December 11, 2001).

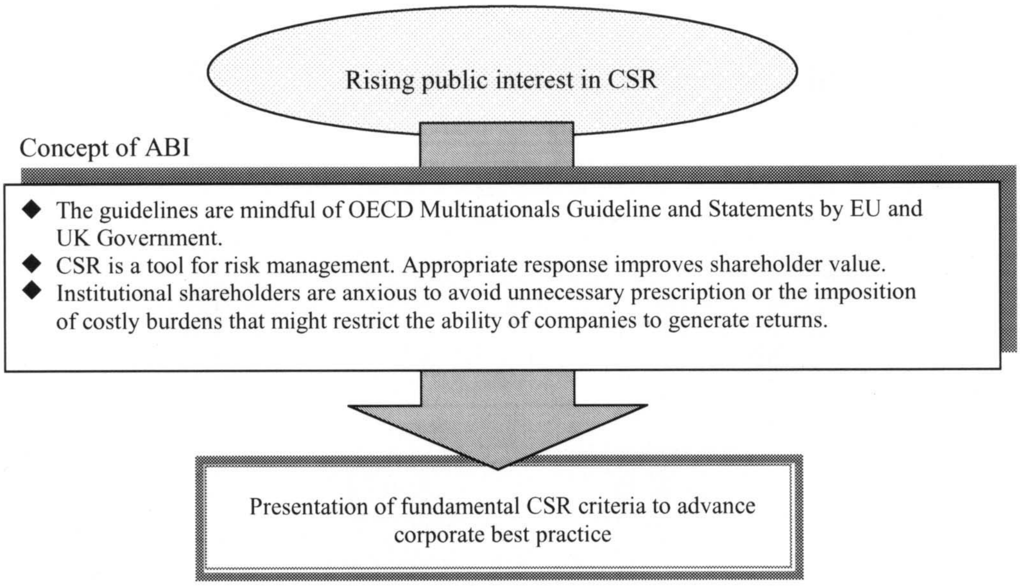


Figure 2-5 Background and Concept behind ABI Guideline

Source: Compiled by DBJ from ABI data.

opportunities). The members of ABI, some 400 insurance companies in total, account for more than 20% of the market capitalization on the London Stock Exchange.

Figure 2-5 provides an overview of ABI's stance toward SRI. The guidelines were published as public interest in CSR grew in the UK and further transparency in corporate activities was demanded. Also, insurance managers are beginning to consider SRI in investment policies to satisfy the needs of their customers.

More importantly, CSR is beginning to be regarded as an important part of risk management as well as business opportunity. Indeed, the guidelines encourage the disclosure of CSR information based on the idea that by appropriately responding to CSR risk, companies can increase their medium- to long-term shareholder value. In light of its institutional position and the technicality of this issue, the ABI limits its focus on providing a basic benchmark.

The ABI guidelines require listed companies to manage and report all the material risks (and opportunities) facing their businesses to protect their shareholder value (Figure 2-6). Specifically, it requires companies to define the responsibility of the board of directors and to describe explicitly in their annual report each of the risks affecting shareholder value, the policies or procedures to manage the risks, the evaluation of such policies or procedures, and the method of information disclosure, among others.[27]

Thus, increased focus on CSR in the UK drastically changed the relationship between money providers and institutional investors as well as between investors (shareholders) and companies, in terms of the increased transparency (reduction of information gap) required of management entities by governance entities[28]. Thus, institutional investors are systematically required to disclose SRI-related information to money providers, while companies are required to disclose CSR-related information to stakeholders including investors. This implies the increasingly compelling nature of CSR also from the viewpoint of corporate governance.

[27] In line with this ABI guideline, Trinity Mirror (the largest newspaper company in the UK) and Securicor (a security company) have disclosed social, environmental and ethical risks in their annual report.

[28] In addition to (1) the relationship between investors (shareholders) and managers, this report also includes (2) the relationship between money providers (those who deposit money with institutional investors) and institutional investors (e.g., pension funds), in dealing with the relationship between governance entities and management entities.

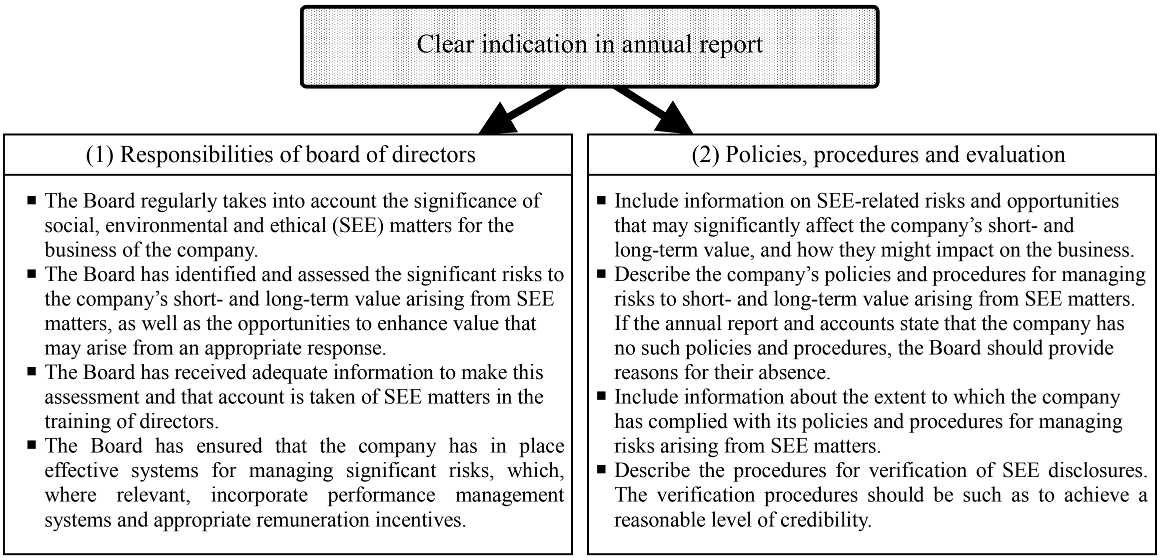


Figure 2-6 Outline of ABI Guideline

Source: ABI data summarized by DBJ.

3.3 Advent of SRI Stock Index

In addition to the amendment to the Pensions Act 1995 and the promotion of SRI policy by institutional investors, the advent of stock indices for SRI has raised the consciousness of CSR on the part of listed companies. One of the typical SRI indices is the Dow Jones Sustainability Index (DJSI), created in 1999 by Dow Jones and SAM Research. FTSE, a joint-venture stock index calculating company (established in 1995 as independent company) between the Financial Times and London Stock Exchange, followed suit in July 2001 by launching the first SRI stock index service in the UK, "FTSE 4 Good™."

Figure 2-7 shows the selection procedure of FTSE 4 Good. It partially follows the traditional concept of ethical investment, excluding tobacco producers, nuclear weapons and arms manufacturers as well as the owners or operators of nuclear power stations[29]. However, it also selects companies from the viewpoint of best practice by setting specific criteria in three focus areas: Working towards environmental sustainability, Upholding and supporting universal human rights and Positive relations with stakeholders.

FTSE 4 Good comprise four indices.[30] For example, the FTSE 4 Good Global Index (coverage: 526 companies) excludes about two-thirds of the companies comprising the base index (FTSE Developed Index). With renowned top-rated companies such as Microsoft (software & computer services), AIG (insurance), BP (oil & gas), Johnson & Johnson (pharmaceuticals) and Glaxo-SmithKline (pharmaceuticals), the FTSE 4 Good Global Index has been outperforming the FTSE Developed Index since its inception.

[29] Nuclear power generation is excluded from the investment universe because a substantial number of people are clearly against it.

[30] Benchmark indices include the Global Index, US Index, Europe Index and UK Index.

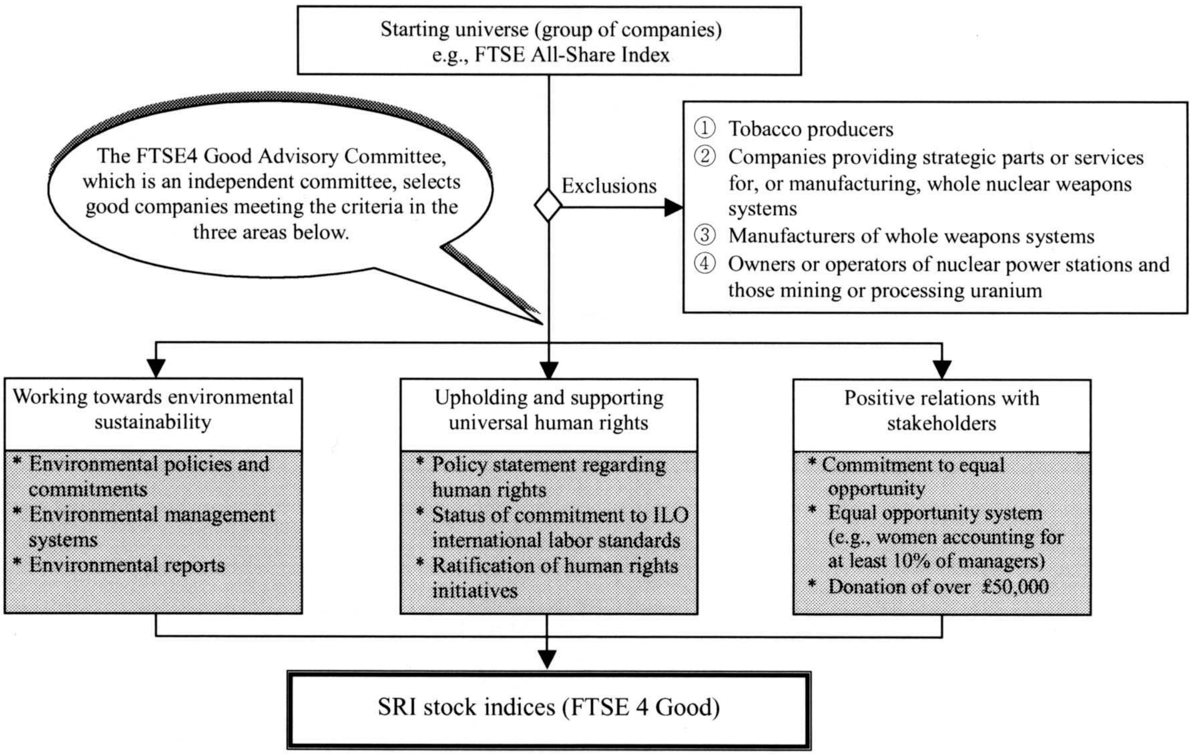


Figure 2-7 Selection Procedure of FTSE 4 Good

Source: FTSE data compiled by DBJ with some additions.

4. Relations between CSR and SRI in UK

4.1 Outline of CSR in UK

As described above, the interest of UK consumers and investors in CSR has been growing rapidly in recent years, leading to the expansion of SRI. In other words, the expansion of SRI, including the introduction of SRI by institutional investors, serves to increase further the importance of CSR. Thus, SRI and CSR have a mutually reinforcing effect.

The growing interest in CSR is observed among stakeholders including consumers, investors, employees and NGOs. For instance, a public opinion survey of UK adults (in 2001, coverage: 1,055 adults in the UK) indicates that 89% of the people replied that "CSR is important" in forming a decision about a product or service, up from 77% in 1998. Above all, the share of the response "CSR is very important" rose from 28% to 46% over the same period. Thus, consumers are increasingly interested in CSR, as well as in goods and services that meet their purposes and budgets. This implies that CSR cannot be ignored in marketing (Figure 2-8).

Figure 2-9 shows the fields in which large companies in the UK are supposed to play the so-called "philanthropic responsibility" (survey conducted in 1999: covering 2,042 UK adults). The data indicates that education comes top with 61%, followed by reemployment support for the unemployed (55%), support for the disabled (49%) and the environment (49%). As far as education is concerned, emphasis is placed on "upgrading the bottom," including basic adult literacy and arithmetic skills.

With the growth of interest in CSR, companies have taken concrete initiatives. In the case of the UK, it has been pointed out that companies should consider, among others, equal treatment of employees, ethics and good faith, respect for basic human rights, environmental conservation for future generations and care for communities.[31]

[31] Business Impact Task Force, "Winning with Integrity."

(Q) When forming a decision about a product or service from a particular company or organization, how important is it to you that it shows a high degree of social responsibility?

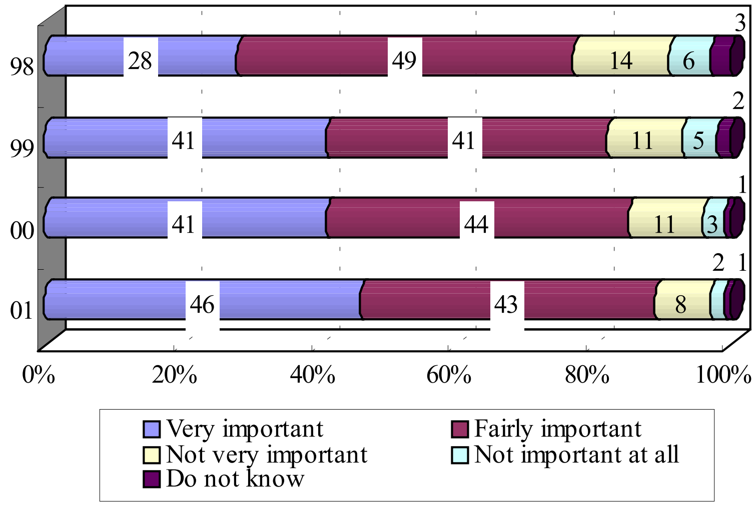


Figure 2-8 Interest of UK Consumers in CSR

Note: N=1,055 adults. Survey conducted in July-August 2001.
Source: UK DTI data.

(Q) Which areas do you feel it is extremely important that large companies contribute to or support?

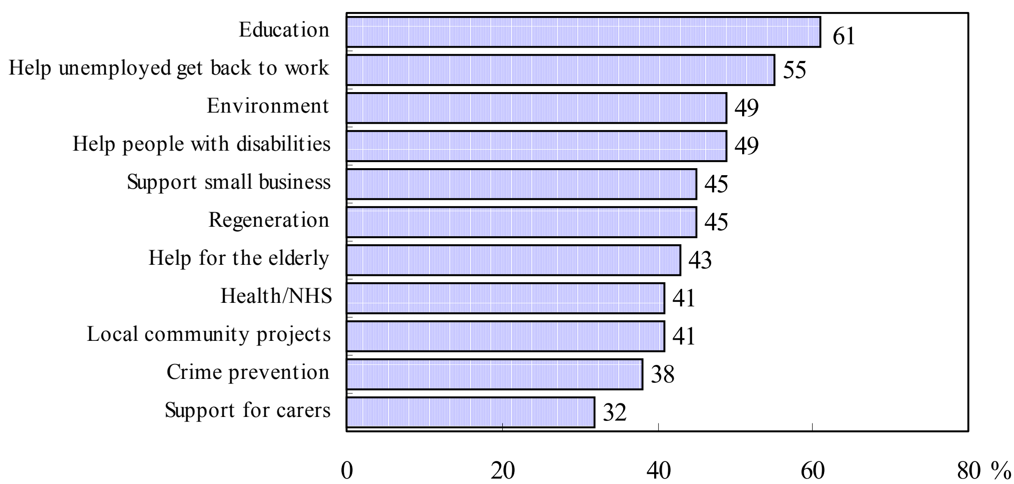


Figure 2-9 Examples of Philanthropic Responsibility Expected from Big Businesses in UK (by Sector)

Note: N=2,042 adults. Survey conducted in July-August 1999.
Source: Same as in Figure 2-8.

Information disclosure to stakeholders is progressing. Indeed, 80% of the FTSE-100 companies disclose some kind of information on their social or environmental policies. Furthermore, CSR has come to be considered seriously by small- and medium-sized enterprises (SMEs), as well as by large companies.

4.2 Government Role in CSR

Public concern about CSR, which emerged in the late 1990s, has prompted the government to take appropriate measures. As described above, the UK Government enacted a provision for the disclosure of SRI information. In March 2000, the first minister in Europe in charge of CSR[32] was appointed, supported by the Department of Trade and Industry (DTI). The DTI has been developing CSR policy, publishing the first CSR report of the UK Government in March 2001, which was entitled "Business and Society – Developing Corporate Social Responsibility in the UK." The report outlines the Government's plans and business cases related to CSR, among others.

Based on the position that CSR should not be subjected to normative regulation, the UK Government limits its functions to the collection of business cases and the recognition of achievements; support for "good" corporate behavior; the development of an effective framework for CSR reports and labeling; the coordination of government services and agencies in charge of similar policies; and the promotion of international CSR. The Government is also positive about extending CSR to SMEs.

So far, this report has reviewed the status of SRI in the US and Europe, referring to the outline of CSR in the UK. Actual forms of SRI may vary according to the vision of investors or financial intermediaries and agencies concerned. Although the objective of this report is not to provide a comprehensive list of SRI, the following inferences may be drawn.

(1) Traditionally, the prevailing method of SRI was negative screening, which excludes those companies belonging to certain sectors from the investment universe. In recent years however, it has developed into a brand-new approach designed to invest in "good" companies, assessing companies from various points of view, rather than the single viewpoint of financial performance.

(2) The expansion of SRI in the UK, interacting with the growing social interest in CSR, demands an appropriate response from corporate management, and doing so provides an opportunity to improve social reputation and competitiveness, as well as a tool for risk management.

(3) Assuming the separation of governance entities and management entities, the latter must improve transparency to the former regarding CSR and SRI. In this context, pioneering initiatives have been launched, including legislative provisions and guidelines concerning information disclosure.

[32] Dr. Kim Howells was appointed as the first minister.

III Development of SRI in Japan and Pending Issues

SRI has been introduced in Japan only recently, led by the advent of SRI funds. This chapter describes the current status of SRI in Japan and pending issues for businesses.

1. Development of SRI in Japan

1.1 Current Status of SRI Retail Funds

In Japan, a unit trust product that considers corporate environmental behavior – the so-called eco-fund – was launched in August 1999. The eco-fund attracted much more money than had been expected, drawing the attention of people who had been little involved in equity investment (most of them reported to be individuals, especially women).[33] Growing awareness of environmental issues among citizens helped this development, coupled with the recovery of share prices following the introduction of the “zero-interest” policy.

Nine retail funds (without consideration of hedging for foreign exchange) have been marketed since, mainly by major financial institutions. Although their outstanding assets exceeded ¥200 billion at one time, investment performance turned negative in fiscal 2001, affected by the slump in share prices. Total outstanding assets currently stand at ¥120 billion (Table 3-1).

Figure 3-1 shows an example of the screening process applied by an SRI fund in Japan. In this case, about 300 companies are selected through social assessment concerning four areas (following the selection of some 700 top companies based on market capitalization). The fund manager then establishes an actual portfolio from these companies. Some funds first select companies on financial criteria, followed by a social assessment.

Table 3-1 List of SRI funds in Japan

(Unit: ¥100 million, %)

Name of fund (nickname)	Sales/investment agency	Assessment agency	Classification	Date of creation	Net assets	Total return (last 12 months)	Rating
Nikko Eco-Fund	Nikko Asset Management	Good Banker	Domestic (general)	08/99	638	-22.1	2
Green Open (*Buna no Mori*)	Yasuda Fire and Marine Global Investment Trust & Investment Management	Yasuda Fire and Marine G Environmental Analysis Team	Domestic (general)	09/99	93	-14.4	4
Eco-Fund	Kogin-Daiichi Life Asset Management	Good Banker	Domestic (general)	10/99	89	-21.3	2
UBS Japanese Stock Eco-Fund (Eco Hakase)	UBS Asset Management	Japan Research Institute	Domestic (general)	10/99	52	-21.6	2
Eco Partners (Midori no Tsubasa)	UFJ Partners Investment Trust	SRIC (collaboration)	Domestic (general)	01/00	42	-20.5	2
SRI Social Contribution Fund (Asu no Hane)*	Asahi Life Asset Management	Mitsubishi Research Institute, Public Resource Center	Domestic (General)	09/00	68	-15.3	4
Eco Balance (Umi to Sora)	Mitsui Marine Asset Management	Interrisk	Balance	10/00	13	-20.5	2
Global Sustainability F (globe)*	Nikko Asset Management	SAM (Switzerland)	International (general)	11/00	18	-16.8	3
Ditto (with no hedge for foreign exchange)					33	-10.4	3
Global Eco Growth F (Mrs. Green)	Daiwa-Sumigin Investment Trust & Investment Management	Innovest (US)	Domestic (general)	06/01	49	–	–
Ditto (with no hedge for foreign exchange)					77	–	–
				Total	1,172		

Note: *: Funds subjected to social assessment other than the environment.
Ratings are according to Morning Star (on a scale of 5, the larger the number the better).
Total assets and ratings are as of 6/6/02. Total return for last 12 months is measured as of 4/30/02.
Source: Compiled by DBJ from Morning Star HP.

33 *Nikkei Sangyo Shimbun*, August 24, 1999, p.4, etc.

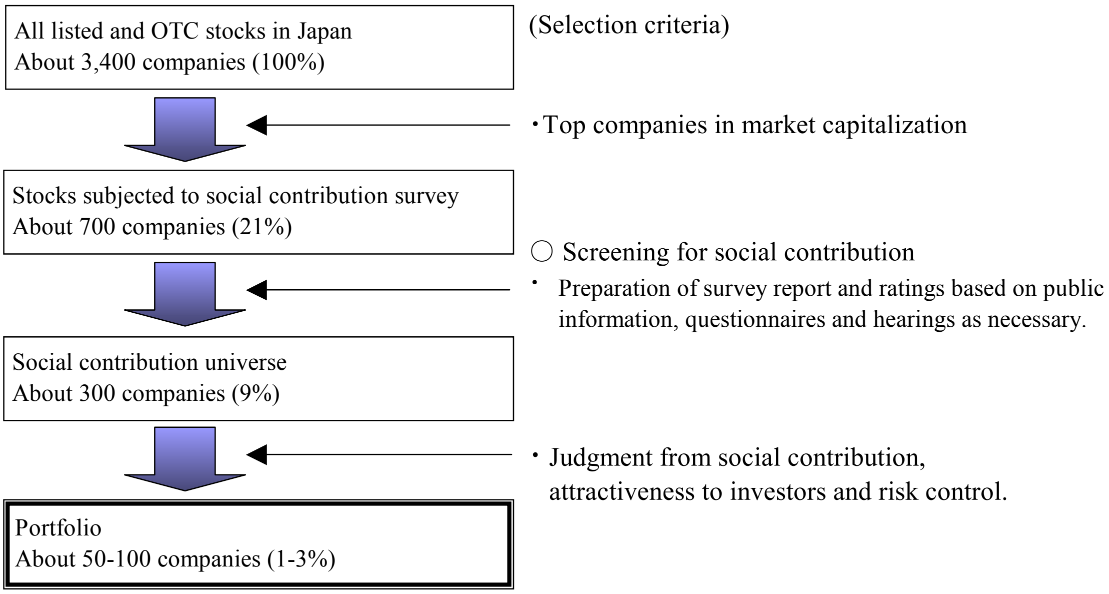


Figure 3-1 Example of Screening Process

Source: Compiled by DBJ from Asahi Life Asset Management data.

In conducting the social assessment, some funds adopt positive screening without excluding any business sectors, while others select the best companies in individual sectors to ensure portfolio diversification.

Most assessment criteria concern the environment. Only a few funds have other criteria, including *Asu no Hane* (Wings for Tomorrow), which was launched in September 2000. Unlike in the US and Europe, SRI funds in Japan mostly adopt positive screening, rather than the traditional negative screening based on the ethical standpoint. The details of social assessment adopted by individual companies may vary, including the definition of assessment criteria, assessment standard and the weighting of each assessment item.

In general, environmental criteria concern (1) regime and management (environmental policy, environmental management, EMS, ISO14001, etc.), (2) performance and its evaluation (environmentally sound products, energy conservation, CO_2 reduction, green purchasing, environmental accounting, life cycle assessment, PRTR, etc.), and (3) disclosure (environmental reporting, etc.).

Other criteria adopted include those concerning employment (employment of women, the elderly and the disabled, response to human rights and sexual harassment issues, etc.), consumer affairs (incorporation of consumers' opinions, response to producer's liability, etc.) and contribution to civil society (volunteering, interaction with local communities, etc.).

It has been almost three years since the first SRI fund was launched. Several issues inherent to SRI have already been pointed out.[34] Financial intermediaries are expected to carry out fiduciary duties including information disclosure to investors and the timely review of, and the retention of rationality in, assessment criteria.

As explained above, the development of SRI in Japan has centered on SRI funds. The advent of eco-funds in Japan provided investors with an opportunity to incorporate environmental considerations into their investment activities, and encouraged businesses to improve their awareness of "environmental management." On the contrary, there are only a few cases concerning the adoption of SRI policies by institutional investors, shareholder advocacy and community investment.

[34] Takehara (2001), etc.

1.2 Future Development

In the US and Europe the viewpoint of CSR is multi-faceted, and SRI with comprehensive assessment tends to focus on the integrated risk management capacity of companies regarding CSR. An eco-fund does not necessarily take account of risks arising in non-environmental areas, such as respect for human rights, even if it is designed to consider risks as well as the growth opportunities of companies under environmentally sound management.

In this regard, attempts to incorporate aspects other than the environment into the social assessment of companies are being made in Japan. For example, the ethics compliance standard for companies (R-BEC001[35]) published and proposed by an expert group in July 2001. It is envisaged that this standard would be used in SRI as a comprehensive framework for independent rating agencies to assess individual companies' efforts toward ethics and compliance. Indeed, an independent corporate research company has already been conducted using this standard, and its commercialization is slated for 2002 as a retail fund.

As an ethics compliance standard for assessing individual companies (to be used for both independent assessment and self-assessment), R-BEC001 emphasizes the measurement of "corporate integrity," the observation of self-regulatory capacity as an organization, and the examination of the internal management regime to ensure such capacity. Thus, a feature of the standard is that it focuses on processes that form the basis of corporate behavior (Figure 3-2).

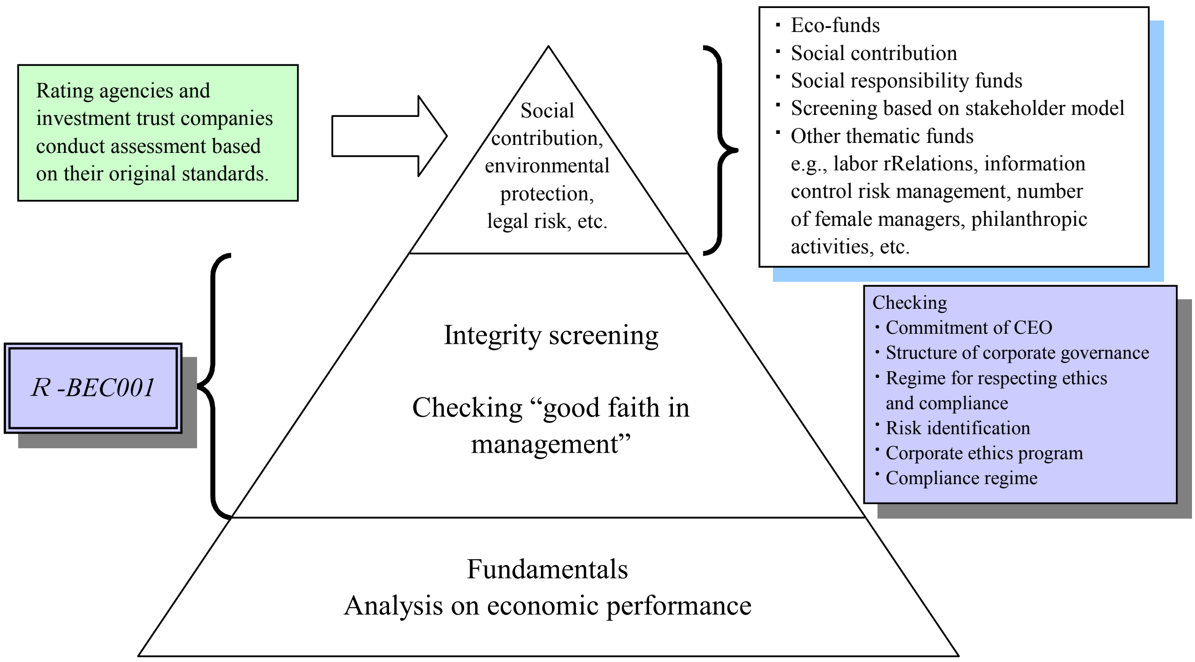


Figure 3-2 Basic Structure of Screening in R-BEC001

Source: R-BEC001 data.

[35] R-BEC stands for Reitaku University, Business Ethics and Compliance Research Center.

2. Pending Issues for Companies

Finally, this section looks at efforts toward CSR in corporate management in Japan.

2.1 Orientation of CSR in Japan

As explained earlier in this report, the concept of SRI in the US and Europe has been steadily becoming multifaceted, incorporating social, environmental and ethical viewpoints, while retaining to some extent the tradition of negative screening against religious "sins" such as tobacco, gambling, alcohol and weapons. With the participation of a wider range of investors, the standard of SRI as a whole has become less stringent. Meanwhile, the increase in the amount of funds available and the institutionalization of fiduciary duty have strengthened the demand for further disclosure from companies.

Through the discussion of CSR in Europe, it was suggested that corporate management and the provision of goods and services based on social values effectively improve social reputation and competitiveness in a market economy. The development of SRI and changes in consumer behavior, both discussed in this report, are considered to amplify this aspect of CSR. Therefore, there are opportunities for Japanese companies to gain new value by using CSR as a competitive advantage, as SRI and CSR are still at the initial stage.

In this respect, the Questionnaire Survey on Citizen's Perception of Businesses – conducted every year by the Japan Institute for Social and Economic Affairs since 1997 – provides an insight into the needs for CSR in Japan. According to the fifth survey in January 2001 (3,417 respondents with a reply rate of 70.3%), 0.5% of the respondents consider that the social role and responsibility actually carried out by businesses are "sufficient" and 37.8% considered it "acceptable," while 55.7% regarded it "unsatisfactory" and 1.5% deemed it "non-existent." The results indicate that 60% of the population is not satisfied by the social role and responsibility assumed by companies, and the result has been deteriorating year after year.

As regards the importance of the social role and responsibility assumed by companies in individual areas of activity, the share of the reply "very important" is largest in business (71.1%), i.e. corporate economic responsibility, followed by the environment with 53.6%, corporate ethics with 47.1%, risk management with 44.2%, information disclosure with 42.1% and employment (maintenance and creation) with 41.8%. The results reflect the high expectations of the public in these areas (Figure 3-3).

However, this result only shows an overall picture. Individual companies have different priorities and standards according to what and how much is expected by which stakeholders.

2.2 Consideration of CSR Management

How should individual companies translate CSR into corporate behavior? This section seeks to draw some implications by presenting a management model for CSR. Figure 3-4 describes the CSR management model prepared by the Ashridge Center for Business and Society (ACBAS) in the UK.[36]

It is one of the so-called continued improvement models. The first steps include (1) securing commitment (allocating managerial resources with the commitment of senior management), (2) identifying external concerns and relating them to business interests (identifying issues to be addressed at the level of individual companies), and (3) reviewing any current policies, processes and performance (gap with actual situation, how to measure results in implementation).

Those initial steps are then followed by (4) define strategy, plans and targets, and allocate resources (necessarily accompanied by the reconciliation of profit with stakeholder concerns), (5) put into practice, (6) measure performance (no effect to be expected without result measurement and improvement), (7) report and communicate, and (8) dialogue with external parties to review progress. Then, the procedure returns to Step (4), which is the definition of strategies, plans and targets.

[36] Source: Business Impact Task Force, "Winning with Integrity."

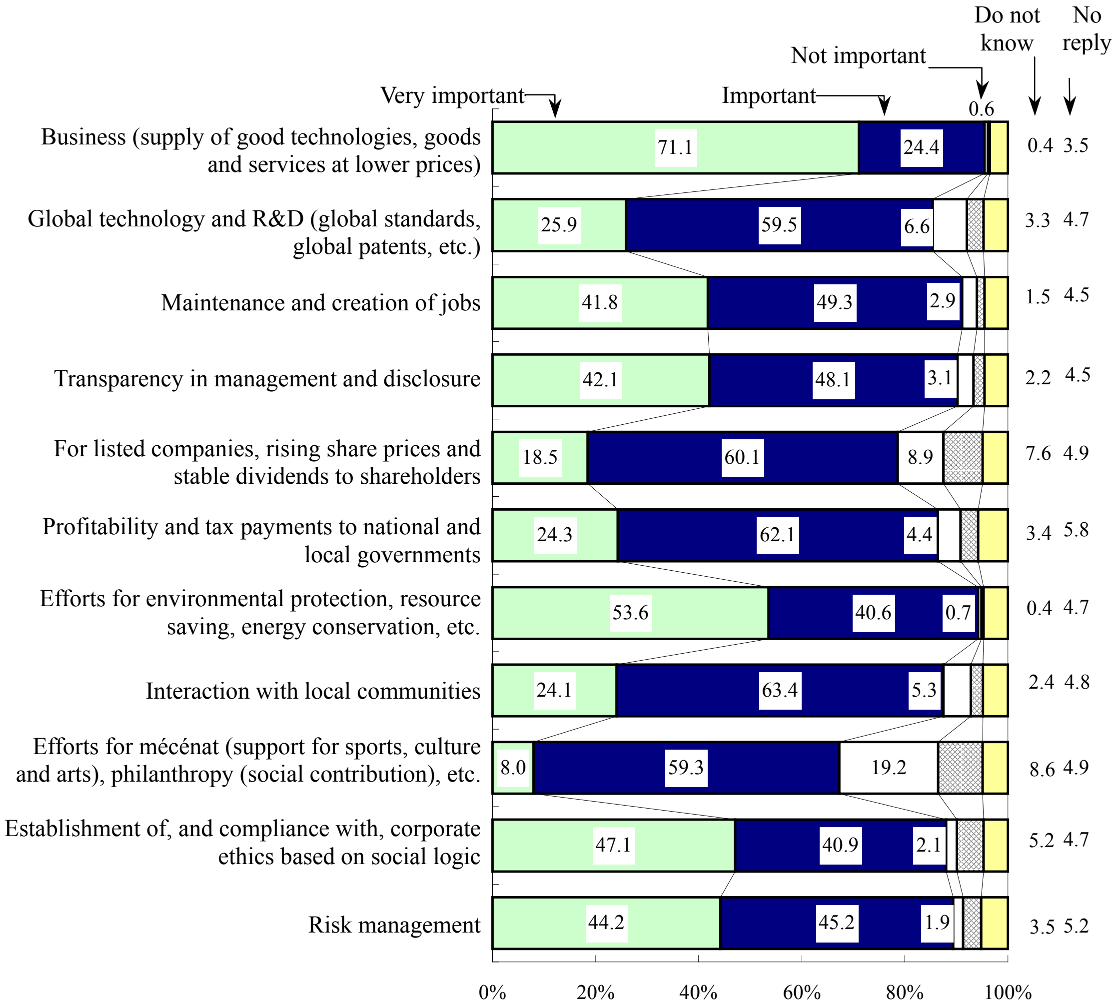


Figure 3-3 Importance of Social Role and Responsibility of Companies in Japan

Source: Japan Institute for Social and Economic Affairs, "Questionnaire Survey on Citizen's Perception of Businesses" (fifth survey).

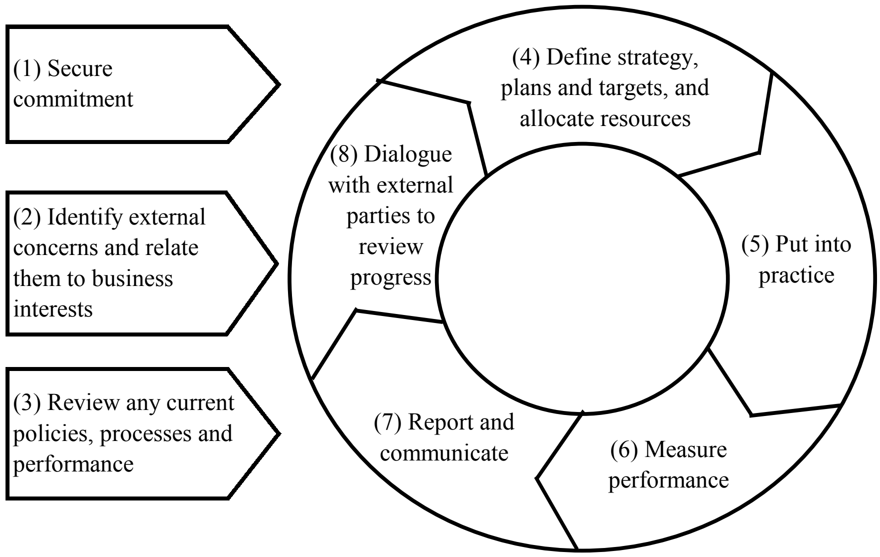


Figure 3-4 CSR Management Model

Source: Ashridge Center for Business and Society.

It is important to repeat a series of cycles based on confirmation of the current position at which each company stands. Thus, the CSR strategy of the company will become increasingly sophisticated, allowing more efficient and effective progress.

In Japan, 400-500 companies are reportedly preparing and publishing environmental reports as a medium of communication with stakeholders, providing information on their environmental activities. Although comparability and credibility need to be improved, these reports will function as a useful business tool when utilized strategically in the context of the above-mentioned cycle.

In order that CSR management takes root and functions properly in Japan, corporate efforts need to be complemented by positive evaluation of such efforts by stakeholders including investors and consumers, thus providing an incentive for management. This is one of the key functions of contemporary SRI.

In relation with the CSR management regime, but independent of voluntary efforts of companies, a movement has emerged at the international level in recent years to standardize the social and ethical responsibilities of businesses. The publication of an international labor standard (SA8000) in the US in 1997 and a corporate accountability standard (AA1000) in the UK in 1999 are two examples. A standard for ethical law compliance management system (ECS2000) was also created in Japan in 1998.

Furthermore, the standardization of CRI has been considered by the International Organization for Standardization (ISO). In May 2001, , the ISO Council directed the Committee on Consumer Policy (COPOLCO) to consider the introduction of a social accountability standard and submit a report thereon. The COPOLCO general assembly, held in June 2002, discussed the necessity of a CSR standard, and the same issue will also be discussed in the ISO Council meeting, to be held this autumn. The scope of the standard and stakeholders concerned will take shape through the consultation process. Once it becomes an international standard under the TBT Agreement, individual countries may have no room to fine-tune the provisions, as WTO member countries are required to comply with the international standards adopted under the Agreement. Close attention should be paid to the direction of future negotiations.

3. Conclusion

As described in this report, the US and Europe have experienced significant development in SRI, which is now poised to function as an economic system in market-economy societies based on self-responsibility. In contrast, SRI in Japan is still at an initial stage. Many issues are still pending for financial intermediaries and agencies, rating agencies and investors to ensure sound development of the SRI market.

Nonetheless, efforts toward CSR in corporate management will spread in Japan in order to establish social reputation, increase competitiveness and manage risks, in light of current and expected developments such as further globalization of corporate activities, active SRI by foreign investors and the negotiation on a CSR standard in the ISO. Attention will be focused on corporate processes and management, as well as final products and services provided.

In addition to satisfying the various needs of investors, the contemporary role of SRI is to serve as a rational economic system that encourages businesses to meet the challenge of sustainable development. Further progress in this direction is expected in Japan.

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