

Megumi Suto · Hitoshi Takehara

Corporate Social Responsibility and Corporate Finance in Japan

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Megumi Suto · Hitoshi Takehara

Corporate Social Responsibility and Corporate Finance in Japan

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*This book is dedicated to Nobuhiko Suto and
Kazuko Takehara for their ongoing moral
support.*

Preface

Good relationships with society are a long-standing theme of the survival of business professionals in continuously changing societal and environmental surroundings. With rapid financial globalization since the late 1980s, academic researchers have broadly engaged in debates on corporate social responsibility (CSR) to ensure the long-term success of business as well as sustainable social development and have been increasingly concerned with the role of finance in motivating corporate managers to formulate sustainable management practices.

The global financial crisis in the late 2000s was a warning to financial institutions, investors, and businesses not to prioritize short-sighted economic success over social and environmental issues faced by global society and communities. With the erosion of business ethics and trust through myopia, we understand anew that alignment of business with social norms requires positioning business models and direct corporate management towards sustainable business. Alignment of business strategy with CSR is an urgent issue for corporate governance as well as the long-term success of corporate strategies. CSR awareness and practices of companies are deeply rooted in the societal and cultural background of an economy and are influenced by changes in a society's cultural circumstances. From a global perspective, the relationship of CSR awareness and practices to corporate financing and governance varies by country and region.

This book is based on our joint research investigating how multifaceted CSR practices have aligned with business and finance, and how they have influenced the corporate governance structure of Japanese companies since the 2000s. The conventional view of Japanese business is characterized as relationship oriented, with dependency on relationship banking and trading credits, cooperation between management and employees owing to long-term employment and career paths, and harmonization of businesses with the benefits they bring to the communities in which they operate. This uniquely Japanese business model, which is based on close relationships with lenders, employees, business partners, and communities, is sometimes called an insider-oriented system, compared to an outsider-oriented system, which prioritizes benefits for outside shareholders. With increasing economic and financial globalization since the 1990s, the conventional view of

Japanese corporate governance and corporate finance has become too narrow to understand this field in Japan since the late 2000s. The Japanese financial system has been shifting from a relationship-based system to a more market-oriented system, while retaining some features of the traditional Japanese system. In the process, the agents in companies' corporate governance and CSR awareness and practices have been changing.

This book aims to explore the linkages between CSR and corporate financing and governance in general, and changing corporate finance and governance of Japanese firms in particular. Financial globalization has gradually eroded the Japanese style of business and corporate governance based on relationships, in addition to influencing the awareness and practices of CSR in Japan. Although research on Japanese business and governance in transition has accumulated since the 1980s, few studies clarify the link between CSR and corporate finance and governance in Japan. We intend for this book to act as a stepping stone in research on the linkages between business and society and to provide empirical evidence on changes in Japanese corporate finance and governance.

The publication of this book was made possible by the cooperation of many people. First, we thank Ryuzo Sato, Editor-in-Chief of *Advances of Japanese Business and Economics*, who gave us an opportunity to add this book to the series. We also thank Rosita Chang, Keiichi Kubota, S. Ghon Rhee, and Akinobu Shuto for their valuable comments and discussions.

We acknowledge financial support from the Ministry of Education, Culture, Sports, Science and Technology under a Grant-in-Aid for Scientific Research ((C) 20380481 and (C) 15K03690) and the Health Labour Sciences Research Grant from the Ministry of Health, Labour and Welfare of Japan. We appreciate the Japan Sustainable Investment Forum, Nomura Securities Co., Ltd, and Kudo & Associates for making their data available.

To our editor, Juno Kawakami of Springer Nature, we are grateful for her excellent assistance in getting the book published.

Tokyo, Japan

Megumi Suto
Hitoshi Takehara

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Chapter 1

Introduction: Corporate Social Responsibility and Japanese Corporations



Corporate social responsibility (CSR) is globally recognized as one of the core components of corporate strategy for ensuring the long-term value and sustainable growth of a firm. In the rapid globalization of business and finance since the 1980s, business corporations have had unprecedented influence on the societies and communities in which they operate, natural environment preservation, and resource allocation. Alongside financial liberalization and globalization since the 1990s, the linkage between the financial market's perception of CSP and corporate financing has been attracting interest among researchers. In corporate financing, however, investors and financial institutions might not have a shared comprehensive understanding of CSR with their investees and borrowers, and there could be a perception gap of CSR between investors and financial institutions.

After the global financial crisis in the late 2000s, alignment of business strategy with social norms from a long-term perspective became an urgent issue for corporate governance. CSR awareness and practices of companies are deeply rooted in the societal and cultural backgrounds of the economies in which they operate, and are influenced by changes in societal and cultural circumstances. From a global perspective, the relationship between CSR awareness and practices with corporate financing and governance vary by country and region. Alignment of business and finance with social norms might depend on the degree of multinational business development.

This book explores the linkages between evolving CSR and the corporate financing and governance of Japanese firms in the late 2000s, when financial globalization gradually eroded the conventional Japanese style of business based on relationships, which is firmly intertwined with Japan's governance system and understanding of CSR. Since the 1990s, the business model and corporate financing peculiar to Japanese companies seem to have changed gradually by continuing to enact financial reform for the creation of a more market-oriented system. CSR awareness and practices of Japanese companies have been influenced by social and environmental issues faced by global society and communities. In the process,

major players in corporate governance and components of governance structure have continued to change.

Conventionally, Japanese business is characterized by long-term relationships with financial institutions, cross-shareholding within a business group, and long-term employment with the seniority system. Thus, it is widely understood that Japanese companies tend to be biased toward prioritizing inside stakeholders' benefits over outside stakeholders and to be insufficiently concerned with shareholder value. In addition, the Japanese financial system is characterized as a typical bank-centric system and the function of the capital market remains relatively insufficient in terms of the volume of fundraising, variety of issuances, and diversification of market participants. In a so-called insider-oriented business style, major players in corporate governance are not shareholders and investors but rather, are lenders and employees. With respect to CSR awareness and practices, corporate responsibility for society has been a familiar feature of traditional Japanese business in terms of sharing benefits with the communities in which they operate and ensuring product quality so as to build the trust of customers and business partners. However, such an understanding of corporate responsibility focusing on stakeholders who have close relationships with a corporation might tend to lack comprehensiveness in terms of recent global CSR standards.

This book examines how CSR awareness and practices of Japanese companies have changed with financial globalization, link to changes in corporate financing, and influence components of corporate governance.

1.1 Focus and Contributions

CSR includes broad management of social issues and stakeholder relationship by corporations (Mitchell et al. 1997). Since 2000, many researchers have focused on the strategic implications of CSR and corporate managers have devoted more attention to CSR to conduct their business operations strategically, responding to changing social norms and diversified demands of stakeholders in order to manage risk and explore business opportunities. CSR is multifaceted, is related to various business activities, and influences corporate governance and financing. McWilliams et al. (2006) define CSR as incorporating *“social characteristics or features into products and manufacturing processes, adopting progressive human resource management practices, achieving higher levels of environmental performance through recycling and pollution abatement, and advancing the goals of community organizations”* (p. 1).

Thus, CSR can be a focus for broad social issues, which leads to numerous definitions of CSR. Among academic researchers concerned with CSR, there seems to be a consensus in defining CSR as situations in which the firm goes beyond compliance and engages in *“actions that appear to further some social good, beyond the interests of the firm and that which is required by law”* (McWilliams and Siegel 2001, p. 117). This definition is consistent with the practical definition

by the European Commission (2001), following which Chen et al. (2014) define CSR and measure the extent to which corporations practically handle their responsibilities toward stakeholders. Within the context of this research stream of understanding CSR, in this book, CSR is narrowly defined as corporate strategies to construct good relationships with stakeholders for the long-term success of the firm.

Given the importance and ubiquity of CSR for corporate management, corporate social performance (CSP) refers to corporations' achievements in taking social responsibility for running their business. Wood (1991) defines CSP, following Wartick and Cochran's (1985) definition of CSP, as assessing "*a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs and observable outcomes as they relate to the firm's social relationships*" (Wood 1991, p. 693). CSP measures the extent to which corporations practically handle their social responsibilities to stakeholders. CSR is too multifaceted to be incorporated into corporate management and the stakeholder perspective is a core conceptual approach (e.g., Donaldson and Preston 1995; Mitchell et al. 1997; Hillman and Keim 2001; Brammer et al. 2006).

In the 2000s, many empirical studies began to be concerned with differences in concepts and activities of CSR among national settings and cross-cultural differences in stakeholder orientation toward CSR. Matten and Moon (2008) conceptually discuss how and why CSR differs among countries and how and why it changes; the authors suggest that an implicit–explicit framework for CSR comprising three levels (descriptive, instrumental, and normative) contributes to identifying differences. Some research empirically examines differences in CSR conceptualization and activities by country and culture.

Maignan and Ferrell (2000) support the notion that corporate citizenship differs from country to country, by defining corporate citizenship as a construct of four correlated factors (economic, legal, ethical, and discretionary). Maignan and Ralston (2002) emphasize that companies with different management styles and stakeholder relations hold substantially different perspectives on CSR, by comparing European and US businesses. Brammer et al. (2006) investigate geographical diversification of CSP of UK firms from a stakeholder perspective and conclude that the relationship between geographical diversification and CSP varies significantly across different components of social performance. Scholtens and Dam (2007) analyze business ethical policies in 24 industrialized countries and find that culture plays a significant role. In addition, some studies discuss CSR in developing countries (e.g., Shafer et al. 2007; Visser 2008). Visser (2008) emphasizes that CSR in developing countries is distinct from CSR in developed countries in terms of its lucrative growth, acuteness of social and environmental crises, dramatic social and environmental impacts by economic growth and business activities, and distinct set of CSR agenda they face. Shafer et al. (2007) examine business managers' perceptions of the importance of ethics and social responsibility by researching cultural differences between China and the West by comparing US and Chinese managers.

To analyze CSR in the context of Japanese firms, this book is based on a stakeholder approach of identifying different components of CSR activities and CSP dimensions, focusing on corporate managers' motivations to implement and

sustain operations for the long-term success of the business. As there are no available published CSP data that are consistently sorted according to stakeholder theory, we construct five dimensional CSP metrics according to stakeholder relationships (i.e., employee relations, environmental preservation, social contributions, product quality, and internal governance), which are further integrated in a comprehensive CSP metric. The five dimensional CSP metrics and the composite CSP are calculated with the results from a questionnaire derived from the Toyo Keizai Corporate Social Responsibility Database, which provides data during the period between 2007 and 2016.

By using our originally calculated CSP data, we conduct consistent analyses to respond to the following research questions on the relationships between CSP and corporate finance and governance in the period of transition. We empirically answer the following questions in the chapters denoted in parentheses.

- (1) What are the features of Japanese CSR activities that link CSP to financial performance and risk management? (Chap. 4)
- (2) How does ownership structure influence CSP and align business strategy? Who plays a major role as CSR drivers and in corporate finance: foreign investors, institutional investors, or financial intermediaries? (Chap. 5)
- (3) How does the financial market perceive CSR activities? How does CSP influence the determination of the cost of capital in the financial markets? (Chap. 6)
- (4) How does CSR awareness of managers improve the quality of information they provide in the market? How does CSP influence the determination of the cost of capital in the financial markets? (Chap. 7)
- (5) How does CSR influence assessment of default probability in the context of the bank-centric financial system? How does superior CSP reduce the default risk of the firm? (Chap. 8)
- (6) How do CSR activities relate to a firm's long-term technology competitiveness? How does superior CSP link to technology development as an instrument to manage firm risk in research and development (R&D) activities? (Chap. 9)

By empirically answering these questions, we intend to reveal changes in the business model and governance system of Japanese companies and we expect to obtain insights about the future development of CSR activities for sustainable business.

This book makes the following contributions. First, it provides a comprehensive analysis to identify determinants and mechanisms to link CSR activities to corporate strategies, by examining the influences of ownership structure on CSP, the influence of market perceptions of CSP on the cost of capital, managers' CSR awareness and self-discipline with regard to disclosure, and risk management.

Second, by focusing on CSR and corporate strategies, this study reveals the importance of a non-financial governance mechanism in recent corporate circumstances. Since the end of the 1990s, many researchers have addressed changes in the components of the corporate governance mechanism peculiar to Japanese firms,

by highlighting the behavior of financial intermediaries and the employee system (e.g., Hoshi and Kashyap 2001; Aoki et al. 2007). However, there is little work concerned with the non-financial alignment mechanism of corporate valuation, explicitly incorporating the role of stakeholder relationships other than financial stakeholders and employees. In other words, this book contributes to exploring how changes in stakeholders' demands for responsible business can substantially influence corporate strategies and financing through aligning business with social norms as well as financial criteria. To bridge business and society, this study highlights managers' incentives for CSR activities to adapt to a changing corporate environment.

Third, this book provides comparative evidence about the linkage between CSP and corporate financing in different financial systems with different regulatory, economic, and cultural backgrounds. There are a number of studies on the relationship between CSP and corporate financing for US and UK firms in a market-based financial system, but research on Japanese firms is limited. This study provides insights into the linkage between CSP and corporate finance in a bank-centric system in the transition to a more market-oriented system.

1.2 Corporate Responsibility and Japanese Business

Business responsibility has been a familiar concept in the traditional business model in Japan. The country's well-known philosophy of responsible business, known as *Sanpo-yoshi*, means that a business has to achieve three-sided benefits for the seller, buyer, and local community. The concept comes from the traditional business policy of merchants in western Japan (*Ohmi shonin*), who held a nationwide commerce network for 400 years from the 17th century in the Edo era. The philosophy was incorporated in the guiding precepts of the management of descendent companies and has remained as the company policy of some modern established firms in Japan, including Mitsui, Mitsubishi, and Sumitomo groups.

The core concept of this philosophy is that self-discipline to build trust within a society is the foundation for the development and sustainability of business over regions and generations, by means of fair pricing, caring for employees, securing the best quality of goods and services, and avoiding myopic decision-making for short-term profits. Furthermore, profits generated from business have to be used for the communities and society in which the business is run (Banba 2006).

Based on numerous prior studies, Wokutch and Shepard (1999) indicates the existence of a sort of micro moral unity paradigm in Japan, wherein business activity is linked to society's moral values within a carefully defined community of interests and individuals outside this community do not reap the full benefits (p. 527). According to the approach of these authors, such understanding of social responsibility forms the foundation of Japanese business model as well as corporate governance structure, which prioritize the benefits of employees and communities over shareholders and also prioritize customers in transactions.

Japanese CSR has both positive and negative aspects (Wokutch and Shepard 1999). The former are reflected in the quality of goods and services; participative employee management techniques, lifetime employment practices, extensive employee benefits, and workplace safety and health promotion activities; and support of local community activities and other philanthropic practices to be good corporate citizens. Japanese CSR is a set of moral standards that exist to govern a firm's interactions with people within these micro communities, and a different set of standards exists for individuals outside these communities. However, it is well known that Japan's relationship-based business and CSR activities have contributed to the sustainability of business.¹

On the other hand, Japanese corporate management tends not only to be opaque for outside stakeholders but also to conflict with the moral unity paradigm within an organization. For example, there are substantial discrepancies in working conditions between the regular employees of major employers and workers in subsidiary firms or temporary workers, while there are fewer opportunities for female and foreign workers than there are for male and Japanese workers, respectively. Diversity of working practices as well as management structure have become pressing issues for Japanese companies. Another example is the tendency of employees' to work overtime owing to loyalty or awareness about cooperation within the organization, which might harm the work-life balance of employees and lower labor productivity.

Compared to other developed countries, Japan has less awareness about outside monitoring of corporate management of business, which is considered the other side of the coin of Japan's micro moral unity. In globalization of business and finance, Japanese companies in general appear to stick to the insider model and to be less aware about the importance of outside monitoring. Nevertheless, as previously discussed in the literature, the conventional self-discipline mechanism embedded in insider-oriented business does not work as effectively as before while an alternative alignment mechanism has not been sufficiently incorporated. In the late 2000s, several corporate scandals engulfed large Japanese companies, such as typically window-dressing settlement accounts for the long term by top management of Toshiba in 2015 and Olympus in 2011, and a scandal involving manipulation of Mitsubishi Motors' fuel economy data in 2016. It has been revealed that Japanese CSR and corporate governance are transitioning into greater transparency and accountability for outside shareholders and other stakeholders.

¹Actually, Japanese companies have the highest longevity in the world. According to a 2016 report by Teikoku Databank Ltd., 28,972 companies are more than 100 years old and 173 companies are more than 400 years old (Teikoku Databank, 2016).