Encouraged actions to create “Value for Society” by corporations to achieve SDGs

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CSR Forum of JAPAN

Contents

Executive Summary

<u>Preface</u>

- ✓ Purpose of this paper

  Based on the understanding that more contribution by corporations in achieving Sustainable Development Goals (SDGs) is increasingly encouraged among society, this paper aims to:

  - ➢ Put together the framework to explain and clarify basic words and concepts concerning the creation of values through corporate activities to solve social problems including SDGs.
  - ➢ Carry out research and disseminate the critical problems to be solved and the possible approaches to evaluate achievements of corporate activities as well as to invite engagement from stakeholders.

- ✓ Background recognition
  - ➢ Whereas words and phrases relating to SDGs or Environment, Social and Governance (ESG) are widely used these days, it is not clear if the situation brings out material effects in solving social problems in environmental or social areas or not.
  - ➢ Various concepts such as "Non-Financial Value," "Social Value," "Outcome," and "Impact" are utilized in different ways without common clear definitions for them. This seems to have caused confusion in communication.
  - ➢ Japanese corporations have traditionally placed value on behaving as social components, which brought them strong momentum to address social issues, but that may, on the other hand, possibly have disturbed potential systemic reforms to solve complicated social issues that can't easily be achieved within the traditional social framework.
  - ➢ Many Japanese firms are having a hard time finding ways to solve social issues.

1. “Value for Society” that is encouraged to be created by corporations today

A corporation is an entity that attracts customers by supplying goods and services that match the needs of society, and that makes profits through providing value to customers and society. The profits are to be distributed in the long run to shareholders that have provided financial capital to the corporation, after distributing some portion to other stakeholders. Based on this fundamental understanding, the up-to-date background situation as to why corporations are encouraged to create “Value for Society” is explained as follows, especially from the viewpoint of transition of the relation between a corporation and society.

1) Accommodating customers’ needs and contributing to solve social issues

In the period when customers’ needs and social issues are closely connected and when the relationship among corporations, their supply chains and stakeholders is not very complicated, such as the period in Japan decades after WW II, many corporations solved social issues mainly through supplying goods or services. Corporate philosophies and initial intentions of corporate founders motivated and urged such activities together with revised legal restrictions.

2) Increased negative impact on society by corporate value chains and introduction of the concept, “Corporate Social Responsibility (CSR)”

Especially after the 1990’s, the negative impact on society from corporate activities attracted wide global concern in the middle of the development of globalization and interconnected value chains. In these circumstances, more and more requests were raised to corporations to voluntarily and positively manage their negative impact on society and to contribute to cover external social costs through activities based on CSR, as well as to be accountable for the results of the activities.

Related Concepts, Guidelines: Corporate Social Responsibility (CSR), Global Compact, ISO 26000, Guiding Principles on Business and Human Rights, Global Reporting Initiative (GRI) Standard.

3) **Attention to the reverse impact on a corporation from social issues and the following integration of the issues into corporate management**

While an increasing number of corporations are trying to voluntarily and positively manage their negative impact on society regarding the problems stated in paragraph 2), some stakeholder groups have come to appreciate those corporate actions. At the same time, more attention was drawn to the effects that social issues cause on corporate operations or competitiveness. Key elements of the attention are risks and opportunities for corporate management, in which investment risks and returns are examined more intensely. The idea started to circulate gradually that social problems were actually new future business opportunities.

Related Concepts, Guidelines: Creating Shared Value (CSV), Environment, Social and Governance (ESG), Sustainability Accounting Standards Board (SASB), Task force on Climate-related Financial Disclosures (TCFD).

4) **Creation of "Value for Society" to contribute to solve social issues that may possibly damage sustainability in society and businesses**

Overviewing the transition from 1) to 3), the 3 phases are best considered to be piled up layer upon layer.

It has been commonly recognized that social problems are high risk elements in promoting business activities that can hinder further growth. Whereas central and local governments, international organizations and NGOs have tackled social issues in the past, other entities including investors, financial entities and non-financial businesses are now encouraged to take a significant part in solving social issues as well.

Corporations are now urged not only to gain profits by providing value to their customers and society grounded in their traditional purposes, but also to create "Value for Society" by significant contributions and material performance to solve social problems.

2. Concepts of “Value for Multi-Stakeholders” and “Value for Society”

Many different words and phrases are used as terms relating to “Value for Multi-Stakeholders” and “Value for Society.” Many of those meanings are not clearly determined as common definitions. The traditional concept of “Corporate Value,” which has placed the main emphasis on profits for shareholders, may not fully imply the up-to-date value of corporations by itself.

New concepts, “Value for Multi-Stakeholders” and “Value for Society” are proposed here in this paper to embody a set of fundamental concepts. The former is different from the traditional concept of “Corporate Value.”

2-1 “Value for Multi-Stakeholders”

The concept of “Value for Multi-Stakeholders” in this paper stands for the value that is created by businesses not just for shareholders but also for stakeholders. It is evaluated from the following three viewpoints:

✓ **Viewpoint of finance:**

Monetary value at present or in the past which is obtained as a total sum or evaluated figures of revenues and costs from corporate operations. Major tools or measures used in evaluation on the viewpoint of finance are financial documents, e.g. a balance sheet and an income statement, or such indexes as sales, operating profit, operating income margin, return on equity.

✓ **Viewpoint of ESG:**

Value that is not presented in financial documents such as the distribution of profits to stakeholders, arrangements for human rights, effects of businesses on local societies or global environments, internal governance framework of a corporation to manage and audit corporate activities. An example of the measures to evaluate from this viewpoint is the ESG index method.

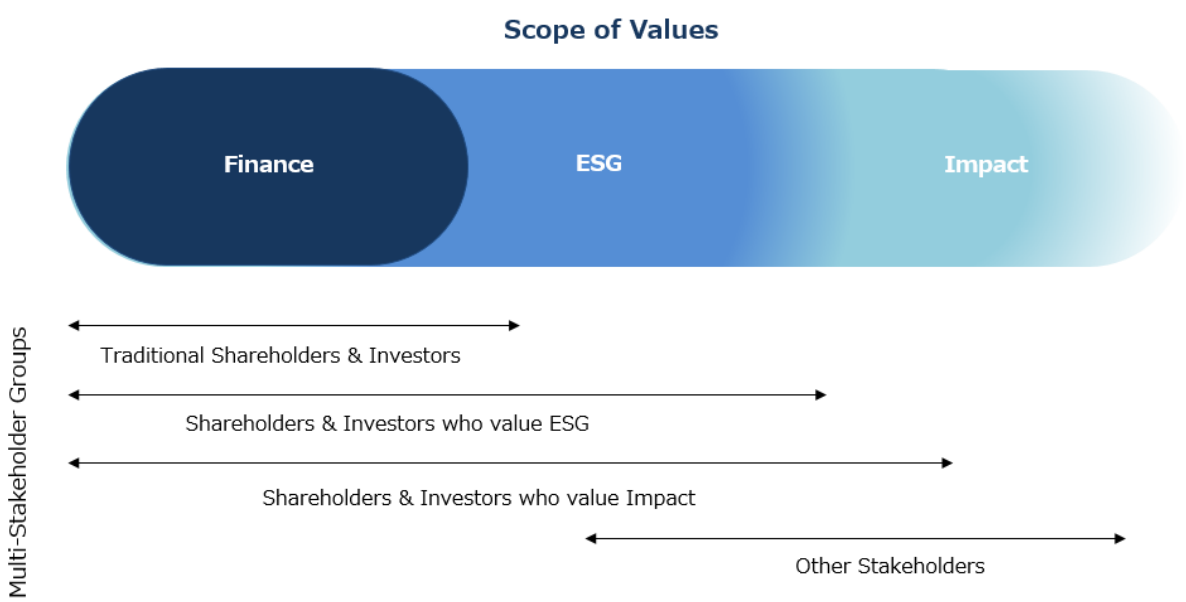
✓ **Viewpoint of impact:**

Values that are created by producing material effects in solving social problems that go beyond individual or corporate merits. The effects can be positive to strengthen or negative to ruin momentum to solve social issues.

(*) The viewpoint of ESG and that of impact are correlated. In many cases, the focus of the ESG viewpoint is the result of corporate activities, and the focus of the impact viewpoint is its core consideration on what kind of influence the results of corporate activities have made and what kind of social effects the outcome has generated.

The practical scope in evaluating "Value for Multi-Stakeholders" may vary by the principles of evaluation. Evaluation views from the corporate side may have varied sets of attention points depending on the management policy and philosophy or pursuant corporate activities. Evaluation views from other stakeholders may have different perspectives according to their areas of interest or their attitudes.

Chart 1: The Concept of "Value for Multi-Stakeholders"

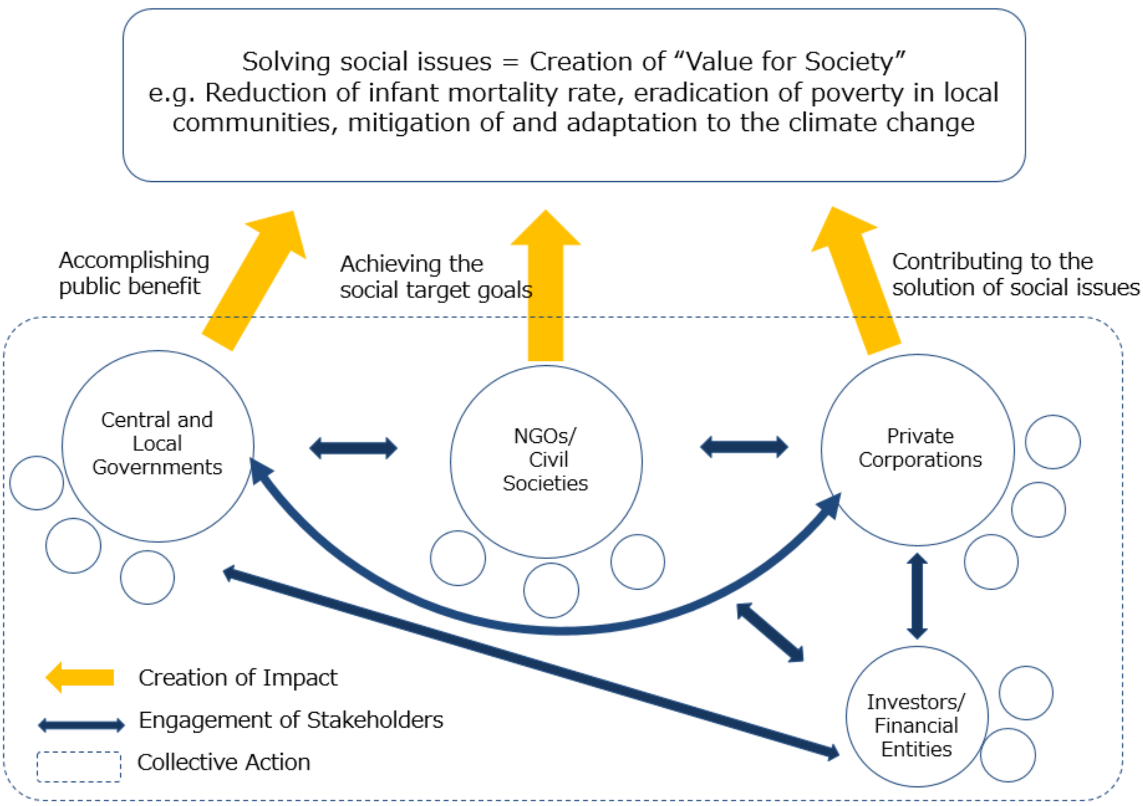


2-2 "Value for Society"

The concept of "Value for Society" proposed in this paper indicates the value that is generated through bringing society into a more desirable condition in the light of the common rules under some social consensus. This concept is fundamentally shared among various bodies including central and local governments, international organizations, NGOs and civil societies, investors and financial entities and private corporations who are all respectively involved in the processes of solving social issues.

The methods and benchmarks to evaluate "Value for Society" may vary from the standpoint of what kind of social issues should be focused on. Some kinds of values should be easy to be measured, whereas some others may not. Or some other values may take considerable time before their real effects become clearly evident. In addition, the range on which each body or element produces its outcome in the creation of "Value for Society" may not be easily separated from other factors.

Chart 2: Players related to the creation of "Value for Society"



2-3 Relation between "Value for Multi-Stakeholders" and "Value for Society"

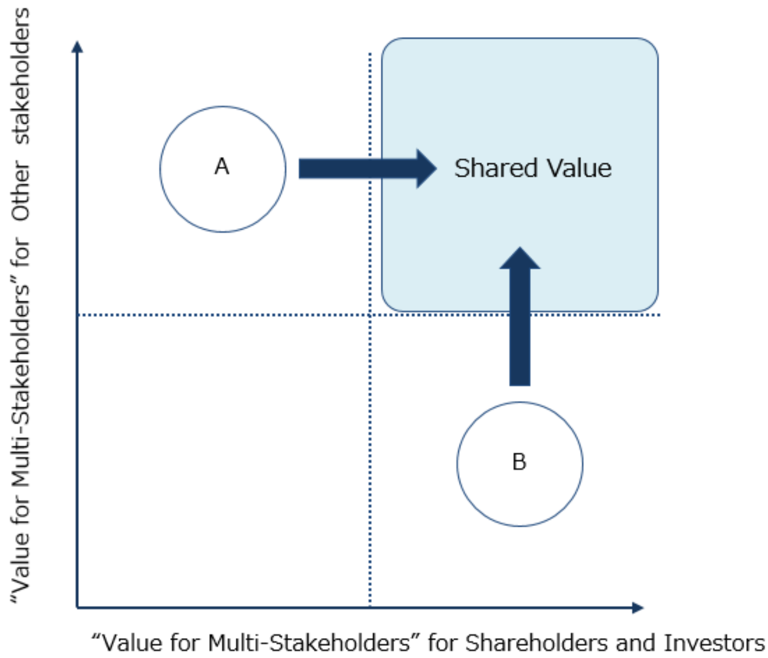
Among the three viewpoints that form "Value for Multi-Stakeholders," both the impact viewpoint and ESG viewpoint are the factors closely associated to creating "Value for Society," and these two values do influence each other.

- Eradication of child labor at a factory in the supply chain ("Value for Multi-Stakeholders") brought total eradication of child labor in that community and these developments caused the school attendance rate and common knowledge level to rise ("Value for Society").
- Increase in local school attendance rate ("Value for Society") enabled neighboring firms to hire well educated workers and to raise productivity and profits accordingly ("Value for Multi-Stakeholders").

Whether the "Value for Society" created by a corporation is evaluated and regarded as "Value for Multi-Stakeholders" depends a great deal on social perception of the related social issues, longtime relationship between the social issue and the corporate behaviors, and on the sense of values of judging bodies. Therefore, the relation between "Value for Multi-Stakeholders" and "Value for Society" should be understood that it does dynamically vary by surrounding conditions, like time and venue. For example, global climate change has now come to be widely accepted in society to affect corporate financial figures. In other words, corporate operations to reduce greenhouse gas emissions to cope with global warming currently gets positive recognition as actions of "Value for Multi-Stakeholders" even by traditional shareholders and investors as well as other stakeholders or conscious investors who highly value ESG activities and impact investments.

An example of abstraction models to help understand these dynamic changes is shown in chart 3.

Chart 3: Change in the accepting process of "Value for Multi-Stakeholders"



The horizontal and vertical axes in chart 3 show the degree of "Value for Multi-Stakeholders" for shareholders & investors and that of "Value for Multi-Stakeholders" for other stakeholders respectively. The top-right block indicates the area of "Shared Value" which has significant value both for shareholders & investors and other stakeholders.

When a company tries to create "Value for Society" through solving social problems, enhancing projects in area A and area B toward ones in the "Shared Value" area is essential. In the background, coinciding actions from both corporations and public sectors are important to increase activities in the "Shared Value" area.

3. Steps to measure and evaluate activities to produce "Value for Society" by a corporation

There are various views regarding procedures to produce "Value for Society" and the potential scope of it. Clear and unified definitions are not yet shared. In these circumstances, many groups in public sectors, such as NGOs, civil societies, central and local governments, who have long been working to solve social problems, are trying to search for how to measure and evaluate activities to create "Value for Society" by a corporation. Some other activities are now being promoted to establish a common framework for it among several stakeholder groups.

3-1 Terms concerning evaluation objects with respect to creation of "Value for Society"

When trying to measure and evaluate "Value for Society," many approaches take similar procedures to break down the steps or factors that were created in business activities and to explain them as a series of actions to tackle and accomplish targets. Dividing the series of processes into several major stages makes these complex facts a simple-framed story in many cases.

In these attempts, most of the methods use concepts like "Input," "Output," "Outcome" and "Impact." The definitions for "Input" and "Output" are shared in common among the international community, whereas those of "Outcome" and "Impact" are not unified but made use of for various implications.

3-2 Actions to construct common framework to measure and evaluate activities to produce "Value for Society" by corporations

Several actions are now being carried out among investors, academia, corporations and government bodies to establish a common framework to measure and evaluate "Value for Society" produced by a corporation. Some groups try to add relevant elements of non-financial information into international accounting standards. These common frameworks are now needed in order to prevent "Impact

Washing" which disguises its level of "Value for Society" to be larger than it is, or to limit free-riding that earns indirect merits with little contribution in creating it. It will also serve as one of essential rules for establishing a level playing field among corporations.

1) Developing benchmark indexes to evaluate corporate performances for achieving SDGs

- World Benchmark Alliance (WBA)

WBA is trying to devise benchmarks that provide an essential tool for measuring and comparing corporate performances regarding SDGs by 2023. In this process, WBA has identified 2,000 companies whose contribution are definitely needed in accomplishing SDGs in seven areas where structural transformation is unavoidable to realize a sustainable world, namely, society, food & agriculture, decarbonisation & energy, circulation, digital, urban city and financial system.

(WBA was established in 2018, by core members of the UN Foundation, an insurance company in UK, Aviva, a NGO in the Netherlands, Index Initiative.)

2) Developing new structure of financial statements with the concept of externality

- Impact-Weighted Accounts (IWA)

IWA projects to create financial accounts that reflect a company's financial, social and environmental performance. The final goal is to create accounting statements that transparently capture external impacts in a way that drives investor and managerial decision making and to organize a practical methodology that is adopted and widely used by investors and companies.

(IWA is a project started in 2019, headed by Prof. George Serafeim at Harvard Business School.)

3) Model scheme building by frontier corporations

- Value Balancing Alliance (VBA)

VBA is a non-profit organization that tries to change the way company performance is measured and valued. The alliance is trying to create a global impact measurement standard for disclosing positive and negative impacts of corporate activity and to provide guidance on how these impacts can be integrated into business management. The project focuses on standardizing how to assess and monetize the value of a company and its contributions to society, designing a disclosure frame to compare performance across companies, developing a blueprint in business management and scaling the uptake of impact measurement and valuation methodology.

(VBA was founded in 2019 and is currently joined by 9 international corporations. Mitsubishi Chemical Holdings has joined the group from Japan.)

4) Evaluation of social impact by classification - Taxonomy

EU has placed "sustainable finance" as one of the important pillar policies under the need to build a single market for capital. In March 2020, the European Commission's Technical Expert Group on Sustainable Finance (TEG) published its final report on "EU Taxonomy," which set forth its recommendations regarding the design and implementation of a unified classification system. The EU Taxonomy shows what economic activities are considered environmentally sustainable with concrete standards and clear criteria, and contains a draft of 68 climate change adaptation activities in 7 sectors.

Shortly before this final report, in December 2019, the European Council and the European Parliament reached political agreement on the text of a proposed Regulation on the Establishment of a Framework to Facilitate Sustainable Investment – the so-called "Taxonomy Regulation." The regulation will require financial firms and non-financial firms to provide the degree of environmental sustainability of their businesses with regard to the taxonomy standards and criteria.

In the near future, the regulation of taxonomy standards and criteria of each business activity will be legislated as an EU delegated act by the European Commission in line with the TEG final report.

5) Creation of impact through investment - Impact Investment

Several international groups intend to measure and evaluate investment effects on SDGs with regard both to investment impact on society and to financial value of risk and return. For example, the Global Impact Investing Network (GIIN) set up the definition of "impact investing" and estimated the amount of related investments. SDG Impact seeks to establish standards to certify investors and enterprises that have authentic alignment with the standards.

(GIIN is organized with leadership of the Rockefeller Foundation. SDG Impact is a group powered by the United Nations Development Programme (UNDP).)

6) A initiative by the accounting standards body to set up a framework to describe related information

The International Accounting Standards Board (IASB) that develop international financial reporting standards (IFRS) is now projecting to draft guidance of Management Commentary (MC) which is a narrative report on non-financial information that complements the financial statements and is part of general purpose financial reporting. This guidance is a non-binding framework for preparing management commentary, and it is different from prerequisite rules for financial statements.

At the same time, EU intends to lead drafting of disclosure standards regarding non-financial information, and a European group proposed in public to establish another international non-financial reporting standards board apart from IASB.

3-3 Corporate efforts to create "Value for Society" and actions to measure and evaluate the outcome

1) Corporate efforts to create "Value for Society"

When reviewing corporate creation of "Value for Society," one practical way is to break down the effects by scope of corporate businesses. However, methods of measurement and evaluation or actual reliability of the results depend largely on the scope of the target.

The basic unit of a corporate activity is a specific business project, which is a business project for acquiring profits or, in some cases, a philanthropic activity. The largest unit, on the other hand, is a corporation as a whole. The scope of evaluation for this unit covers the entire organization, and its main target is the behaviors of top management.

The level of expenses to measure "Value for Society" also vary widely by the scope and methods of measurement or the reliability level of the output, which should be designed based on the purpose of the research.

2) An organized internal management system to increase "Value for Multi-Stakeholders" and to create "Value for Society"

An organized internal management system is essentially needed to create integrated values by incorporating social demands into business operations. The arranged management system requires its principles to be shared with all members of top management, project groups and employees. The following steps are suggested:

a) Analyzing mega-trends, revising corporate principles and clarifying business purposes
b) Establishing long-term corporate vision and introducing back-casting thinking
c) Devising a business model to create shared values
d) Instituting a strategy for sustainable operation
e) Integrating existing projects toward management strategy and implementing PDCA cycle management
f) Disclosing information to stakeholders and inviting them to engage
g) Setting the playing field and controlling businesses activities to be sustainable

3) Current ideas to measure and evaluate "Value for Society" of a corporation

A logical explanation as a consistent story is substantial in disclosing information on the created "Value for Society" to stakeholders. Some means have been devised in this regard. The Logic Model method, the approach to organize the pathway to achieve goals or to clarify the causality between inputs and impacts, is perceived as a useful standard these days. The London Benchmarking Group (LBG) Model puts focus on the quality and quantity of inputs. The Social Return on

Investment (SROI) Model tries to monetize and quantify values created for society. Other methods of corporations that show their unique indexes concerning the effects on society of their own products and services should be helpful to their employees and investors & shareholders. At the same time, this approach should be objectively examined or monitored so as not to be "washing" to disguise the real situation, for example by showing clear linkage to SDGs targets.

Recently some corporations in the US and Europe have attempted to put together and disclose their own "Integrated Profit & Loss Statements" or "Value Added Statements" that quantify "Value for Society" of the whole corporation in monetary figures.

4. [Suggestions] Encouraging corporate creation of "Value for Society" to accomplish SDGs

4-1 Leadership by top management to create an integrated set of "Value for Multi-Stakeholders" and "Value for Society"

A corporation is required to find the best process to perform value creation from clear target setting to acquiring proper results as well as to allocate necessary resources under both short-term and long-term timeframe management, while having in mind the importance of integrating "Value for Multi-Stakeholders" and "Value for Society." It is the privilege and the competence of top management to establish the pursuant strategy of the firm, select suitable steps among alternative choices, and establish an internal structure to implement the processes. The critical elements in these points are to envision a long-term business environment on the basis of scrutinized analysis of mega trends in the global society, to build up a practical business model that enables both financial profit and solution of social issues, to design and carry out tactics to pursue the model with improved company structure, to arrange governing programs for supporting sufficient progress of the processes, and to invite engagement from stakeholders for related discussion, cooperation and coalition.

4-2 Self-evaluation of the information regarding creation of "Value for Society"

An important element of the creation of "Value for Society" by a corporation is to assess the created value by itself to move the management cycle forward by making proper decisions in allocating management resources in a balanced way and to acquire sufficient understanding among stakeholders. Management is asked to determine the target of its businesses, the clear and logical roadmap to reach the target with methods, e.g. logic model, and to internally share the situation of actions and results as a visible workflow from inputs to outputs. Furthermore, the scope of produced outcome should be examined during these tasks.

In these processes, negative effects should be sufficiently taken into account, and perfunctory measurement to obtain superficial figures should be avoided.

4-3 Positive disclosure of information and upgrading activities to shared value type with dialogue and engagement

It is essentially significant for a corporation to disclose its information in a positive manner and to promote dialogue and engagement with shareholders, so that their activities to create integrated value of both "Value for Multi-Stakeholders" and "Value for Society" can be appreciated by stakeholders including investors, civil societies, with the aim of boosting the idea of "Shared Value" among all related stakeholders keeping in mind that creation of "Value for Society" is its own "Value for Multi-Stakeholders".

The target of the approach is not limited to outside of the company. Management policies under the integrated thinking should be sufficiently shared among internal employees. This is not always easy to perform, and may, in some cases, require constructing a new culture of the whole organization.

4-4 Inviting to cooperative activities with other corporations and entities

Coinciding activities among various entities are crucial in creating more substantial "Value for Society" to solve complicated social issues. Corporations are encouraged to urge other companies in the supply chains to collaborate, to take part in initiatives of each business sector, or to cooperate with related NGOs in dealing with specific issues. Collective impact, or producing wide-ranged effects through collaborative actions in the eco-system made up of varied entities should be developed and supported, which may not be accomplished by one company.

4-5 Role of stakeholders to encourage creation of "Value for Society" by a corporation

Suppliers of financial capitals like institutional investors are encouraged to support corporate creation of integrated value of both "Value for Multi-Stakeholders" and “Value for Society” in the medium and long-term timeframe based on their value standards. Industry associations are also requested to lead the construction of a system of coalition framework that is not performed by just one company. Examples of this framework are to identify the prior and common targets, to develop cooperative initiative for tackling the issues, or to put together concrete measures to evaluate the results. NGOs are also invited to provide their specialized experiences in establishing an effective framework for cooperative actions.

The Japanese government is asked to arrange an institutional scheme for that cooperative framework and to help establish a platform for collective actions and to encourage actual cooperative actions through that framework.

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Outlines of CSR Forum of Japan

CSR Forum of Japan was established by Business Policy Forum, Japan in 2004, with support from the Ministry of Economy, Trade and Industry, so as to encourage efforts of Japanese companies for Corporate Social Responsibility (CSR).

Since then, the forum that consists of major Japanese companies, business organizations and NPOs in related fields, has been a unique CSR network in Japan that has worked to put together and disseminate survey reports every year in the following viewpoints;

- Providing relevant experiences, insights and the up-to-date information on CSR to companies.
- Studying the ways to enhance CSR policies and related businesses activities.
- Promoting communication and collaboration between companies and related organizations.

(Survey Reports from 2015 to 2020)

2020

- Encouraged actions to create "Value for Society" by corporations to achieve SDGs

2019

- Investigative Research on How "Business and Human Rights" Should BE for the New Era

2018

- Investigative Research Report on Ideal Non-financial Information Disclosure in the New Era

2017

- Investigative Research Report Concerning the Desirable State of Efforts and Partnerships with International Organizations, the Government, and the Industrial World Aimed at Resolving Social Issues (Such as the SDGs)

2016

- Research report on international strategies of CSR towards strengthening Japanese companies' competitiveness

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