

Sustainable Finance Business and CSR

# A discussion with Daiwa Securities Group executives and academics regarding the future of the finance business and CSR in the aftermath of the current financial crisis

(Held on March 5, 2009 and hosted by Mariko Kawaguchi, General Manager of the Daiwa Institute of Research Ltd.'s Management Strategy Research Department)

*Right to left:*

*Toshiro Muto, Chairman of the Daiwa Institute of Research Ltd.*

*Takeshi Mizuguchi, Professor of Economics,  
Takasaki City University of Economics*

*Kumi Fujisawa, Vice President of the think tank, SophiaBank*

*Masaaki Goto, Corporate Executive Officer,  
Daiwa Securities Group Inc.*



## Could you elaborate on your perception of the current financial crisis?

**Muto:** There are many factors that brought about this financial crisis. The first factor lies in the significant development of securitization markets associated with further innovations made in the finance industry. A significant amount of housing loans were included among the underlying assets that had been used to formulate securitization products. However, the housing bubble began to collapse beginning with the plunge in housing prices in the United States around the middle of 2006, and this has impacted financial markets worldwide.

The problem was that in the pursuit of globalization, there was a lack of rules and supervisory functions in financial markets. While new markets were emerging, an awareness of these problems remained unrealized. Despite the surfacing of the subprime loan problem in August 2007, it was considered to be a regional problem only. As a consequence, no one was able to imagine that global financial markets would be disrupted to such an extent.

**Mizuguchi:** Investment is, so to speak, a type of fund that is set aside for regular use for the future. However, housing by its very nature does not lend itself to producing future cash flow. Although securitization products are a means to disperse risk, is it not fair to say that excessively concentrating funds in these products has gone too far, judging by the nature of the original investments?

**Muto:** Judging from the situation surrounding the global money glut, surplus funds that exceeded demand for funds used in capital investment

were being collected among financial institutions as savings, while the housing market was drawing attention as one area of investment. Demand for housing actually increased with a rise in the number of immigrants moving to the United States during the 1990s. Consequently, there was a need for investment in housing initially, making this a substantial area of business growth. However, intrinsic utility values and the market values gradually began to diverge.

Yet, it is not appropriate to fundamentally deny market principles in relation to these excesses. Based on the understanding that the market makes mistakes from time to time, the problem pertaining to what type of safety net needed to be installed has been raised.

**Fujisawa:** I believe that free markets must coexist with essential ethics and morals. Since it is unusual for a majority of people to buy two or three houses, I believe that governments and central banks should play an important role in regulating markets and businesses from an ethical point of view.

**Muto:** In order to prevent market failure, it is necessary for the market to have a built-in, rational system that can function in a truly effective manner, rather than simply relying only on ethics. Based on what has been learned from this experience, it is critical to determine what measures will be useful in the future. In the midst of financial globalization, a single regulatory body of an individual country is no longer able to understand the real situation underlying investment banks.\* Consequently, there has been a movement to make information exchanges based on macro prudence more effective. Macro prudence refers to creating monitoring mechanisms not yet in place by sharing macro data and other information to determine if there is excessive bloating within the market.



Furthermore, despite differences in each country's laws and financial systems, deeper discussions on an international level are needed regarding individual financial institutions' own rules and behavioral principles. Although this is one set of ideas that needs to be instituted, there are no simple solutions for this.

**Mizuguchi:** Well-organized behavioral principles have everything to do with the future shape of the market, rather than just preventing the market from overheating.

**Goto:** Information disclosure is also important. Including descriptions of business activities and profit sources, third parties are able to examine information based on unequivocal and timely disclosure of information.

**Fujisawa:** While the severe strain placed on companies from regulations and the pressure to disclose information could be dangerous, the real issue here is finding a balance.

**Muto:** The financial rules used by Europe and North America to date did not work this time. On the other hand, if the market becomes overly regulated, it also becomes inefficient, or even dysfunctional, depending on the circumstances.

Because disclosure is meant to increase the efficiency of market mechanisms, this is not a matter of strengthening regulations. The market also needs negative information to be disclosed as well, since this heightens transparency, and most likely saves businesses.

**Mizuguchi:** There is a tendency to associate ethics with simple justice. However, I believe that it is more a matter of what is rational for society as a whole. Individual financial institutions that placed a priority on short-

term profits and acted accordingly caused the current situation. Because of this, it is rational to adhere to a policy of moderation and take actions based on a long-term perspective.

## **As global rules are enhanced, what actions should securities companies take?**

**Goto:** The highly leveraged, ROE-driven management style practiced by investment banks, which involved investing huge amounts of borrowed funds, needs to be corrected. As members of society, companies must also place importance on such responsibilities as paying taxes and hiring employees rather than simply focusing on the market value of their stocks.

The core businesses of securities companies include evaluating businesses and carrying out negotiations in relation to mergers and acquisitions, assisting in raising capital by underwriting stocks as risk money intermediaries and providing advisory services for managing investors' assets. These functions are also an integral part of financial and capital markets. Securities companies assist in raising capital by steadily conducting market research and developing new businesses, which is definitely a part of their core business.

By undertaking this business on a sustainable basis, suitable profits will continue to increase. There will also be a continual need in society for such companies. To be certain, there are important questions about sustainability. In terms of the social function of businesses and other organizations that raise capital, vaccine bonds and other similar products are perhaps one example of investments that can convince investors that there is social meaning in investing and that investments can be helpful.



### Kumi Fujisawa

Vice President of the think tank, SophiaBank  
Vice President, Japan Social Entrepreneur Forum  
Visiting Professor, Hosei Business School, Hosei University

Graduating from Osaka City University's Graduate School of Economics in 1989, Ms. Fujisawa has worked for investment management companies in Japan and overseas. In 1996, she founded Japan's first company for evaluating mutual funds and participated in the founding of SophiaBank in 2000. Continuing efforts to interview foreign and Japanese company managers, provide on-the-spot coverage and convey information via such media sources as television, radio and magazines, Ms. Fujisawa is making efforts to create a new society by way of the media.



### Takeshi Mizuguchi

Professor of Economics, Takasaki City University of Economics  
Member of the Management Research Group of the Japanese Institute of Certified Public Accountants  
Chairman of the Special Committee on Sustainability and Information Disclosure

Graduating from the University of Tsukuba's College of Policy and Planning Sciences, Professor Mizuguchi joined Nichimen Corporation and Eiwa Auditing Corporation in 1984 and 1989, respectively, before becoming an lecturer at Takasaki City University of Economics in 1997. Professor Mizuguchi specializes in environmental accounting and CSR investments. He continues to make proposals for the introduction of responsible investing in such areas as disclosing information about climate risk for investors and public pensions.

**Fujisawa:** Despite the fact that funding is truly needed, the ability of companies to raise capital is difficult at the moment. While there are many expected roles to be played by the government, if investment banks and nations are to cooperate with each other further, what are the first things that must be considered?

**Goto:** First, the areas that contribute to industrial growth must be thoroughly analyzed, and subsequently, consulting should perhaps take place. On the basis of surveys, if our research shows that these markets and companies can contribute to industrial growth, efforts should be made to raise capital.

**Mizuguchi:** Taking a global perspective, the problems related to adequate food and safe water sources, ecological and other issues are enormous. Yet, because businesses do not feel that they have a duty to confront such problems, the mechanisms for providing funds in these areas have not been exploited. A social vision must emerge that aims to make small changes in such attitudes, examines ways to allow people to live securely and fosters a society that can provide prosperity for people in developing countries. Is this not the role of countries and leading companies? For example, remarks have been made regarding overseas financial institutions creating networks to combat risks associated with climate change. To that end, I would like to see Japanese financial institutions creating links across industries and taking on a leadership role as well.

**Fujisawa:** Since wages in developing countries remain low, investment efficiency tends to be low as well. If that is the case, can financial products be made by gathering tiny investments and using financial innovation? Cannot securitization and leverage be used in these areas?

For example, there is a fund in Switzerland that invests in micro finance\*\* and manages the assets and pensions of wealthy Europeans. This can be done in Japan as well.

**Goto:** Firstly, creating investment products out of micro finance investments poses challenges in such areas as risk/return and the amount of funds necessary to formulate these products. However, it is necessary, for example, to develop mechanisms that contain incentives based on preferential tax systems and other factors, as well as fostering such things as micro finance-specific venture capital. In the case of large companies,

there needs to be a change towards bold ideas. Concerning the pursuit of profits, in leveraged management, major questions must be dealt with. Although the desire exists to take on big projects to achieve profits, this in itself is starting to come under question by a growing number of people, particularly among the younger generation.

**Fujisawa:** I believe that is important for Japan as a developed nation to show the world its intent to find solutions for problems associated with an aging population and environmental issues. As China and India develop, they will likely be directly confronted with the same issues. It would be great if Japan could make use of its financial tools to be an ideal social role model for the world 20 years from now. In order to do this, Japan should start by changing the attitudes of its own citizens.

**Muto:** Within the movement to reform global financial rules, what contributions Japan can make to this in relation to America and Europe has become another challenge. Although Japan has not shown much skill in creating these types of international rules, the opportunity is at hand to attempt this.

Moreover, because Japan makes excessive use of indirect finance compared with other countries, there is still a potential for securities businesses that support direct finance.

**Mizuguchi:** Just as Ms. Fujisawa mentioned, if solutions can be presented for social problems through the use of finance, understanding regarding the nature of finance and investments will increase. As this understanding spreads, business chances are sure to follow.

In the case of finance and investment, I believe the key word here is trust. In the past, business transactions were made based on face-to-face relationships. With the spread of globalization, however, this is no longer the case. In addition, although it takes a long time to develop trust, it can be lost in an instant. Indeed, I believe that trust is gained through a multitude of actions based on very carefully devised behavioral principles.

**Muto:** The trust of consumers and investors cannot be gained overnight. Rather, it is a matter of how it is fostered. With CSR in mind, it is extremely important to gain and sustain the trust of local communities.

## Could you share your thoughts about the future of the Daiwa Securities Group?

**Mizuguchi:** I would like to see the spread of socially responsible investment and for the Daiwa Securities Group to make “leverage financial capabilities to contribute to a sustainable society” an important issue. With this in mind, the Daiwa Securities Group has many excellent employees who have released numerous financial products that take the environment and society into consideration. However, I tend to wonder if the Group is performing on an organizational level to carry out these efforts and if they are taking root in society. I look forward to initiatives undertaken by the entire Group to address this.

**Fujisawa:** It is important that the function of securities companies be communicated throughout the world. For this reason, communication must be undertaken through their main business, above all else. This involves securities companies providing citizens with tools that enable them to participate in efforts to bring about a recovery of the economy—showcasing leading industries, for example. I would be very happy to see the Daiwa Securities Group reveal its vision through its primary business to raise awareness among citizens.

Vaccine bonds represent a major opportunity regarding this matter. Even among people who hesitate to donate to charity, this bond will strike a chord when people realize that they can get a return on their investment while making a contribution to society. A broader social perspective can be gained via investment.

**Goto:** That is excellent advice. We must make an even greater effort to put forth proposals on what direction society should take.

**Muto:** The Daiwa Securities Group values its workforce as a part of its corporate principles. Because people are the greatest asset any company has, I would like to see this tradition continue and for further efforts to be made in this area.

**Goto:** Education is also critical for encouraging people to view investing as a regular activity. To this end, the Group is making efforts in the area of economic and finance education. This concerns children learning about how to make judgments about the future so that they can think clearly about how to invest their money when they become adults.

**Muto:** Education related to savings has been taken throughout the post war period by those affiliated with indirect finance. In elementary schools, there were programs for making entries in bank account books. However, education programs that allow children to gain experience in the investment business have become more prevalent in the United States.

**Mizuguchi:** This type of education is vital for allowing people to consider making long-term investments. As it is important to take a long-term perspective of 10 to 20 years, I believe that it is necessary for securities companies to take this stance when dealing with customers.

**Fujisawa:** It would be better for this CSR report in the future to be more of a strategic report, or more specifically, a manifesto: “This is how we were in the past but this is what we aim to be in the future.” In the case of workforce development as well, it would be fantastic if the Daiwa Securities Group could communicate its corporate vision and align this with its main business.

**Mizuguchi:** Although there is the tendency to consider CSR as the business of the CSR Department, it is really an issue for the entire company to deal with. I would like the Group to evolve more in terms of analysts and fund managers doing their work while giving full consideration to the environment and society, and this in turn would reinforce the concept of being a socially responsible company without the need for labels such as CSR or SRI.

**Goto:** I would like to develop the Daiwa Securities Group into a company in which CSR is an inherent part of our actions, rather than specifically mentioning the term, “CSR.” I think it is important to undertake sustainable initiatives with a long-term perspective. I have been reminded today of the importance of the hearts and minds of all employees. Thank you very much.

\* Investment banks: Financial institutions that assist in the raising of funds from capital markets by issuing financial instruments for companies and provide advice pertaining to such financial strategies as mergers and acquisitions.

\*\* Micro finance: Financial services of limited sums that target people who are not eligible for such services as loans from commercial banks due to a lack of collateral, stable employment and verifiable credit records based on such factors as their impoverished circumstances.



**Toshiro Muto**

Chairman of the Daiwa Institute of Research Ltd.

Graduating from the University of Tokyo Faculty of Law in 1966, Mr. Muto joined Japan's Ministry of Finance that same year. He became director-general of the Budget Bureau in 1999, administrative vice minister of finance in 2000, deputy governor of the Bank of Japan in 2003 and visiting professor at the University of Tokyo's Research Center for Advanced Science and Technology in 2008. That same year, he began serving in his current position as chairman of the Daiwa Institute of Research Ltd.



**Masaaki Goto**

Corporate Executive Officer, Daiwa Securities Group Inc.

Graduating from Keio University's Faculty of Economics in 1982, Mr. Goto entered Daiwa Securities. In 2005, he was appointed general manager and head of the Structured Finance Department at Daiwa Securities SMBC Co. Ltd. He became general manager and head of the Corporate Communications Department at Daiwa Securities Group Inc. in 2006. He assumed the post of corporate executive officer at Daiwa Securities Group Inc. in 2007, which is his current position as of April 2008.

\*As of April 2009, Mr. Goto serves concurrently as a corporate executive officer at Daiwa Securities Group Inc. and chairman of Daiwa America Corporation.