

# sustainable japan

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## ESG is a 'mega-trend' we can't put off: fund manager

### ESG Talk

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Climate change is an issue that urgently needs to be addressed, even though many countries are facing challenges to their energy security after Russia's invasion of Ukraine, according to a top investment manager.

"Some people say it's not the time to care about an ESG (environmental, social and governance) approach. But ESG is such an urgent issue that we can't put it off anymore. It is a mega-trend that we can't turn around," said Noriaki Kurose, president and representative director for Schroder Investment Management (Japan) Ltd.

Kurose compared opposition to global climate actions amid the war in Ukraine to people arguing on a ship going down. "When a ship sinks, it is meaningless for the people on board to criticize each other," he said. "We have to save the ship first."

Calls to reduce greenhouse gases and stop climate change are growing louder as natural disasters threaten more people almost every year. Recent clear signs of global warming shocked the world this summer.

Extreme heat waves set records in many parts of Europe, with the temperature rising above 40 degrees Celsius in London for the first time in history. Wildfires raged in France, Spain, Portugal, Greece and Italy. AFP reported in August that data from the European Forest Fire Information System showed that 659,541 hectares had been destroyed, a

record for that point of the year since data collection began in 2006. Heat waves also scorched Japan, with Tokyo marking the hottest day for late June in 147 years.

Torrential rain and floods hit many cities in Japan, as well as South Africa, Brazil, India and many other parts of Asia. More than one-third of Pakistan was underwater at one point, reported CNN, after torrential monsoon rains — 10 times heavier than usual — caused the Indus River to overflow, and it said more than 1,100 people died from the flooding over 2½ months starting in the middle of June.

Actions to mitigate global climate change have been led by Europe over the past decade, putting pressure on the United States and Japan to follow suit. In Japan, then-Prime Minister Yoshihide Suga declared in 2020 that the country will become a carbon-neutral society by 2050. "In the short term, the demand for fossil fuel is rising and share prices for oil companies are surging" after the war started in Ukraine in February, Kurose said. "But in the long run, they will have to change their business models to those supporting decarbonization. If they don't, their earnings and share prices will eventually get hit by the negative impact."

The war in Ukraine and declining imports of liquefied natural gas — cleaner than coal or oil — from Russia strengthened the demand for renewable energy in European nations, which had already been active in taking steps to stop climate change. Earlier this year, Germany passed renewable energy laws that set higher targets for wind and solar energy. Britain aims to reach net-



Noriaki Kurose, president and representative director for Schroder Investment Management (Japan) Ltd. HIROMICHI MATONO

zero emissions by 2050, which will require an increase in renewable energy. The government said earlier this year that it will launch a new independent body, the Future System Operator, to help the country meet the target.

Amid this strong demand, Schroders in April acquired a 75% stake in Greencoat Capital Holdings Ltd., one of Europe's largest companies for investing in renewable infrastructure, aiming to enhance its position in global sustainability investing.

Kurose said Schroders set up an ESG investment team in 1998 and has focused not just on investment returns but also on

social returns. Gauging companies' social impacts is seen as a difficult task at many financial institutions. Schroders created SustainEx, a tool to measure the costs that companies would face if their negative externalities were priced, or the boost if benefits were calculated. SustainEx, based on about 700 academic papers, thus enables Schroders' analysts and fund managers to compare companies' social impacts and analyze such costs in their overall portfolios. For example, analysis based on approximately 40 externalities shows that firms in the tobacco and defense industries have high negative externalities,

while sectors such as internet, telephone and pharmaceuticals have high positive externalities.

Tighter regulations to support ESG-minded investment also have pushed financial institutions to further focus on sustainable investing. Last year, the EU adopted the Sustainable Finance Disclosure Regulation (SFDR), which requires more disclosure to avoid "greenwashing" by organizations falsely saying they protect the environment. Asset managers need to classify their funds into three categories: Article 8 covers funds that promote a better environment and society, Article 9 covers financial products targeting sustainable investments, and Article 6 covers funds that are non-sustainable. The new categories have prompted some investor money in Europe to shift to strategies classified under Article 8 or 9. EU-based financial firms feel an urgent need to apply the new regulations to prevent money from leaving their funds.

"Japanese firms are aware of this situation in Europe, but they do not yet feel an urgent need to follow the regulations because they are not under pressure to take steps," Kurose said. If stricter rules were introduced in Japan as well, however, that would change the whole situation, he added.

Kurose said now is the time to further encourage overseas investors to invest in Japan. There are signs that they are more interested in Japanese stocks amid higher geopolitical risks, triggered by Russia's invasion of Ukraine. "Investors have been re-focusing on Japanese stocks recently. It strikes me that they are more inclined to Japan from abroad," Kurose said.

Earlier this year, Schroders set up a property investment team in Japan to launch funds to invest in Asian real estate, including Japan. The property team also observed the change in investors' capital flow shifting to the Japanese market from China and Hong Kong due to geopolitical tensions in China and Taiwan.

"We find the same signs in the Japanese



"When a ship sinks, it is meaningless for the people on board to criticize each other. We have to save the ship first." HIROMICHI MATONO

stock market. It is true that we are receiving more inquiries about Japanese equities than before," Kurose said. "I can say that it's a good chance for the Japanese market."

Asked how Japanese companies can attract overseas investors, Kurose said one of the key factors in inviting funds from abroad is whether the firms can differentiate themselves from others, as the high level of Japanese firms' technology is already well known. "One of the focuses is whether they can expand into overseas markets. If they run business only at home, they should let investors know how their business is unique, profitable and different from others," Kurose said. "Meanwhile, if they want to attract them with ESG or sustainable business strategies, it would be better to refer to the EU's SFDR."

Schroders' Japan equity team has 20 members and deals in funds worth a total of ¥1.4 trillion (\$12.6 billion), out of which ¥800 billion is from overseas. Globally, the investment firm handles assets worth a total of ¥100 trillion, of which ¥2.4 trillion is from Japanese clients' assets.

Schroders

The ESG Talk series are interviews with business leaders who are active proponents of ESG investing and practices in Japan.



The Japan Times' chairperson and publisher, Minako Sumatsu, and Kurose talk about the impacts of climate change. HIROMICHI MATONO

## Local trading companies develop circular economies in two areas

### Satoyama - Authentic Japan

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Minamioguni is a small town with a population of less than 4,000 located in the middle of Kyushu on the border between Oita and Kumamoto prefectures in the so-called semi-mountainous area. The town, nestled in the beautiful grasslands of the Aso Outer Rim and the headwaters of the Chikugo River, is famous for its clear waters and hot springs, including Kurokawa Hot Springs, which attracts more than 1 million visitors annually.

Playing the role of a regional trading company is SMO Minamioguni Co. Ltd., a public-private third-sector organization that is 99% owned by the town. The depopulation of Minamioguni over the past decade has prompted SMO Minamioguni to work to develop a sustainable community based on the citizens' strong desire to preserve a high quality of rural upland satoyama activities, scenery and lifestyle. The town has established a regional tourism development corporation to further develop the Minamioguni Town Tourism Association and sales at the town's store for traditional products, Kiyora Casa.

The company has four divisions: the Regional Trading Company Division, the Tourism Division, the Information Dissemination Division and the Future Planning Division. Each aims to maximize value through collaboration with the others and to "acquire and return capital from outside the region," said Chihiro Abe,



A concept image shows the tentative design of the completed Niseko Mirai housing development. NISEKO MACHI

manager of the Future Planning Division.

The company distributes tourist information through its own media, SMOMO, and offers initiatives to ensure that visitors can continue to engage with the town after their visit. Moreover, it provides not only food products but also products that can support the local community, called "thoughtful return gifts" that it gives back to taxpayers. The company also has worked diligently with local businesses to develop high-value products, and tax revenues have increased significantly through such product development. Despite the coronavirus disaster, sales at the Kiyora Casa exceeded ¥110 million (\$770,000) in fiscal 2020.

SMO Minamioguni has invested the capital accumulated through these activities into new resources. It has also offered internships letting young people in their 20s from other areas easily enter the region. In terms of giving back to the community, it has launched platforms such as the job sites Shigoto Convenience Store and Furusato Kengyo to help diverse people realize their desired ways of working and living. SMO Minamioguni aims to grow the economic cycle and capital for sustainable satoyama activities in the town.

### Niseko, a sustainable town

Niseko Machi Co. Ltd. is a company that works to make the town of Niseko in Hokkaido a sustainable town with a circular economy rooted in the community.

The Niseko area is an attractive resort with a concentration of world-class high-end hotels. It straddles the three towns of Kutchan, Niseko and Rankoshi. Efforts to make it an environmental model have been ongoing since 2014. In 2018, the town of Niseko was selected as one of Japan's "SDGs future cities," a municipality that will make efforts and proposals for achieving SDGs. The town has been working on the development of residential areas, centered on the NISEKO Lifestyle Model Project. The project is based on living in harmony with nature while effectively utilizing tourism resources and considering the environment. In 2020, Niseko Machi was established through public-private investment due to the need for an entity to implement this project. "Our main focus is to create a new



SMO Minamioguni organizes valley charter trips as part of tourism measures to promote the area. SMO MINAMIOGUNI

town from the three axes of a sustainable economy, society and environment," said Kento Tanaka, director of Niseko Machi.

The company is creating the Niseko Mirai housing development for a maximum of 500 residents from scratch. This project works on "evolving community development" over the next 10 years by listening to residents' voices and solving their problems with daily life. The plan calls for comfortable living even in winter, with low utility costs in energy-efficient housing complexes without burdens like snow removal. In addition, Niseko is a town with a gradually growing population and a low vacancy rate. Therefore, many people working there commute from outside the town. Resolving these issues is the background behind developing Niseko Mirai. Four construction zones in the development are planned, with the first building from the first construction zone to be completed in the next fiscal year.

Life in satoyama areas is about adding new value to things of natural origin, transforming them into sources of enduring economic benefit. It is hoped that local trading companies — key players in circular economies that are creating sustainable, recycling-oriented regions — will further develop the richness of satoyama areas.

This section, "Sustainable Japan," features issues related to the environment and a sustainable society while highlighting the satoyama activities of companies and other organizations.

For more information, see <https://sustainable-japan-times.com/satoyama>



## Investing in science, humanity: Lessons from Okinawa institute

### ESG/SDGs

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Among the hundreds of meetings that take place during the busy United Nations General Assembly, which this year began on Sept. 13, one of the most interesting is the annual Science Summit. This year many of the sessions were held remotely, which allowed one of the most interesting leaders in Japan, Peter Gruss, the president and CEO of the Okinawa Institute of Science and Technology (OIST), to join the session "Investing in Science, Investing in Humanity."

He was interviewed for this session by Tomoko Otake, a senior writer for The Japan Times who often covers science and technology. Their discussion covered a crucial challenge for the advancement of science: How can Japan's universities and government use investment to foster innovation?

This is a challenge well known to Gruss, who started his career as a renowned scientist before switching tracks to become a science administrator, eventually leading the Max Planck Society of Germany for many years. It was there that Gruss became an innovator and lifelong proponent of what is termed "high-trust funding," through which promising researchers are given five-year grants to explore their fields. The results at Max Planck were striking: multiple Nobel-winning discoveries and a decade of industry-changing patents. Gruss' mission at OIST has been to establish the same culture.

Otake's first line of questioning concerned the COVID-19 pandemic, which saw scientists developing vaccines faster than ever before. What had the pandemic revealed about the nature of scientific research and funding? Gruss pointed out that messenger RNA was discovered in the 1960s by a group of scientists including Sydney Brenner, who later became one of the founders of OIST, but only after decades of research were the start-ups Moderna and BioNTech able to develop the first mRNA vaccines against COVID-19, building on all the innovations from publicly funded university researchers. His point: "In modern research, sometimes it can take 60 years until we can finally utilize those six decades of research."

Unfortunately, Japan's methods and levels of research funding have fallen to new

lows. Otake pointed

out that Japan is the third-largest economy in the world, yet still has not developed its own mRNA vaccine. Why? Gruss' answer was friendly but blunt: "It doesn't matter that Japan is the third-largest economy. What matters is the dynamic and innovative skill of that economy. And sadly, Japan has lost its innovative capacity." He followed this statement with a shocking figure: Despite the tremendous growth rate of venture capital funds in Japan in recent years, the size is no bigger than 3% of what is available in the U.S.

This led to a broader question from Otake: If Gruss had a magic wand to change the institutions in Japan, what would he do?

His answer was long, covering the areas of high-trust research grants to the youngest and best minds in Japan, leadership reform at universities that focuses on merit and strategy, and more support for researchers starting families. The hard news: None of the above is common in Japan at all. The good news: It is already happening at OIST, and if it can happen there, that proves that it is possible in Japan.

First, Gruss described high-trust funding: "In Japan, we have mostly low-trust funding — competitive grant funding. Instead, you must give the money to the best minds and let them roam freely in their fields. This has been shown to be the most efficient way to create breakthroughs and fundamental research." He also pointed out that these grants must be given to the younger scientists. "Look at the Nobel Prize winners — most of their great work was done before they were 40. How many of Japan's best minds are now all stuck being assistants to professors, when they could be doing the greatest work of their lives?"

Second, Gruss covered the anemic world of Japanese universities. "The Japanese university system needs to be reformed at the governance level to have a clear separation between staff and a board of governors with an exclusive role of supervision and strategy, a senior management team staffed by professionals from all kinds of areas — business leaders, technology experts, management



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experts. Not retired professors!" Gruss also pointed out a simple reason why 62% of OIST professors are non-Japanese, as opposed to only 5% for Japanese universities overall: "We are able to recruit such great scientists because of our high-trust funding and competitive salary."

Finally, he described OIST's ongoing efforts to recruit female scientists as a model for other universities. "The minimum that must be delivered is a salary. You also need adequate child support at the university. If you know that your young children are well taken care of, you feel comfortable. At OIST, this child care is on-site. You can look at your kids, you can even walk over during a break if need be. Life is more than just research. So if we need to further this change, we must provide the adequate infrastructure."

The Science Summit's session explored how investment in science is actually an investment in humanity. Gruss and Otake's wide-ranging discussion focused very much on the human side of this question. Scientists are not monks; they are highly trained workers who must be recruited, rewarded and cared for. The government's support of these scientists is not a subsidy; it is a careful investment, modeled on past successes and hopeful for future discoveries. In the paradise islands of Okinawa, Gruss is doing just that ... and more. There, foreign students and professors work alongside Japan's brightest minds. Across the hall, venture capital firms are funding startups, while across the campus a child care center supports careers and equality. OIST is proving such things are possible in Japan. It is up to the rest of the country to listen.

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