ESG

NSSK on Japan's ESG revolution

Japanese LPs increasingly view strong ESG credentials as a must-have, say NSSK's Jun Tsusaka, Yuzuru Ichinohe and Kiyomi Matsuda.

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Japan may not have been the first country to make ESG a priority in its financial sector, but there is no doubt that Japanese financial institutions are waking up to the benefits of strong ESG policies.

Jun Tsusaka, CEO of Nippon Sangyo Suishin Kiko (NSSK), Yuzuru Ichinohe, leader of NSSK's Value Up Program and Kiyomi Matsuda, the firm's finance director and ESG director, say that more and more institutional investors see managers' ESG performance as an important factor in their investment decisions. The key to sustaining investor interest, they tell Private Equity International, will be to demonstrate that there is no trade-off between ESG and financial returns.

The clear winners, they say, will be those GPs that can demonstrate that their ESG activities are driving superior returns.

How does NSSK approach responsible investing?

Jun Tsusaka: From our perspective, it's pretty straightforward – we aim to do the right thing as human beings. We have a holistic strategy around what we want to achieve when it comes to protecting the environment and promoting important societal causes, and we make sure that there is full transparency around our governance as we pursue those ESG objectives.

We are managing money on behalf of Japanese and global investors. As a fiduciary, we owe it to our investor base to provide evidence around our

Jun Tsusaka

performance on ESG and the UN Sustainable Development Goals. We have a methodology to track how we are performing against our objectives, and we make sure we present data that is trackable, traceable and can be monitored. This is backed up by a third-party audit process, which serves to help our portfolio companies more effectively execute on their commitments around ESG.

Yuzuru Ichinohe

Yuzuru Ichinohe: One of the unique features of our approach is that we employ a chief philosophy officer, whose role is to help NSSK companies and their employees to revisit their corporate missions and incorporate key ESG values. This is really fundamental in what we do, because our whole approach to ESG depends on getting buy-in.

Trying to impose a top-down ESG strategy on our portfolio companies wouldn't work – it is much better to get people to believe that this is the right thing to do.

So, the chief philosophy officer works with our management teams and employees to challenge the mission statements of our companies. We go through a process where the chief philosophy officer encourages our companies to engage in dialogue to redraw their mission statements, so that they reflect the importance of key ESG objectives, such as environmental protection and gender inclusivity.

How are Japanese LPs reacting to the rise of ESG?

JT: Around 30 percent of our investor base is composed of public sector entities, and ESG initiatives are very important for these investors. Our approach to ESG is an important factor in deciding to invest with us.

er investors, including private institutional investors, the interest in ies according to their mission statement. Some investors view ESG as a gating factor, others are much more focused on the investment track record and don’t put as much emphasis on non-financial factors. But what we see increasingly is that ESG is becoming a must-have, as opposed to a nice-to-have.

Are you seeing any signs of the US backlash against ESG spreading to Japan?

JT: It’s not really visible in Japan. Arguably, Japan was a little late in adopting ESG as a priority, so we are still in the phase of implementing goals and objectives. The LP universe sees ESG as something that is generally positive.

What is important for ESG policies to remain relevant is that we show that there is a positive correlation between ESG and creating better companies, which translates into good financial returns. It is not sustainable in the long term for investors to focus on ESG or the various SDGs at the expense of returns. As custodians of capital, we need to demonstrate that ESG actually helps generate better financial performance so that we avoid an ESG backlash.

Do you find that Japanese companies are now taking climate change more seriously than in the past?


Kiyomi Matsuda

Kiyomi Matsuda: One of the surprising positive trends in the Japanese market is that companies that have robust transition plans in place to reduce their carbon emissions, along with other policies and procedures around ESG, are becoming very attractive to potential buyers.

Lenders are also becoming more positive about financing the acquisition of companies that perform well on ESG. So, we are certainly seeing that ESG policies help generate value and are correlated with good financial performance.

I[illegible] Japan, like everywhere in the world, we are feeling the impact of [illegible] change in our everyday lives. People know we need to do something about it. To reverse this trend, it is critical that private equity firms ensure that their portfolio companies have strong policies in place to preserve the environment and reduce waste. Japanese companies are certainly thinking about this more and more, and we have the chance to become one of the leading nations globally in addressing climate change and achieving the broader sustainable development goals.

How is your approach to impact investing evolving?

JT: Our approach has evolved in that we no longer accept a trade-off between impact and returns. When we launched our first impact fund in 2017, we raised approximately $50 million, and our target return was 12 percent – around half of what we normally aim for. We accepted this target at the behest of our anchor investor, the Japanese government, who wanted to make sure social and environmental objectives were the top priorities for the fund.

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>
> ***Jun Tsusaka***

When we raised our second impact fund, which we closed in 2022, we were able to raise a similar amount of capital, but this time without support from the government. We set our returns target at 18-20 percent – much closer to our normal range, as we are confident in our ability to do positive things around ESG while also generating strong returns.

In 2023, we raised our third flagship fund (Fund III), and have encouraged all of our 'impact investors' to become LPs, as we have now developed a proven modus operandi incorporating all the ESG objectives, tools and processes while driving world-class returns.

…e some of your key priorities for achieving a positive social impact?

JT: One of the main things we focus on is gender inclusivity. This is an area where Japan has not done a good job overall. If you look at the World Economic Forum's Global Gender Gap Report 2023, Japan was ranked 125 out of 146 countries.

So, we at NSSK came up with the investment thesis that if we empower women, give women more chances to succeed, we will have better outcomes across the board. We will have better financial outcomes, because we are unlocking the potential of half our population and enabling them to play a much bigger role in the workforce.

The numbers show that we're right. Because we are control investors, we are able to direct our companies to significantly increase the number of women in our workforce, especially at the management level. In our flagship fund, which has performed very well, 71 percent of all our employees are women, 29 percent of managerial positions are held by women and 30 percent of our CEOs/COOs are women. If you compare that to publicly listed companies, the average share of managerial roles held by women is 11-14 percent.

What is NSSK doing to promote good ESG practices among other private firms in Japan and the APAC region?

KM: NSSK was invited to join the ESG committee of the Japan Private Equity Association (JPEA). I serve as one of the members of the committee and lead the best practice sharing initiative. The good news is GPs and portfolio company management want to contribute to ESG objectives, but are often unable to implement them due to inexperience with driving fundamental change in business processes.

In addition to sharing our expertise through our annual ESG report, we provide resources and coaching for our peers, and we advise other firms on the factors that have helped us be successful on ESG, including creating organisational urgency and structure to effect results. In addition, we are working with other JPEA ESG committee members to provide information on calculating CO_2 emissions through external vendors.

also the Asia Regional Chair for the Operating Principles for Impact ement. As part of this role, we orchestrate best practice sharing in the Asia region, with our collective goal to protect and preserve a better place for the future.

Solar powered: NSSK-backed Sakura Pharmacy Group is working to install photovoltaic power generation and energy storage facilities in its stores

What are the key challenges for Japanese private equity firms in achieving net zero?

Yuzuru Ichinohe: *We have committed to becoming carbon neutral by 2050 and we are asking our portfolio companies to reduce greenhouse gas emissions by 30 percent by 2030. To achieve this, companies need to have a practical and transparent way of measuring their carbon footprints.*

There is still a lot of work being done to develop consistent standards and software tools for tracking emissions – but we are not going to wait for those. We are doing our best to measure where we are today and work with consistent methodologies to track our performance over time.

Kiyomi Matsuda: *We are finding that the first wave of emissions reductions comes from basic things, like using energy more efficiently and reducing waste. Companies can get a lot of quick wins that also produce financial savings. In the longer term, of course, companies need to look for alternative sources of energy.*

The key thing is to develop a robust and realistic transition plan, and then to hold management teams accountable for the KPIs that they commit to. Once achieving climate KPIs are part of the criteria for compensation, alignment is created and progress can really accelerate.