

Considering Upstream Issues in the Cornerstone Businesses Comprising Society

We invited four experts to participate in a dialogue entitled “Considering Upstream (natural resources extraction, agriculture, forestry) Issues in the Cornerstone Businesses Comprising Society.” President & CEO Eizo Kobayashi and members of ITOCHU Corporation’s senior management team attended and took part a discussion touching a variety of areas.

(Held on June 17, 2008)



Tell us properly where things come from

Tamba: General trading companies handle a comprehensive range of items, from raw materials through to products, from upstream through to downstream. Today, we would like to examine the “furthest” upstream area, which comprises activities that are a very important pillar of our operations, such as natural resources development and raw materials procurement. In that area, we would like to identify what society wants from trading companies and clarify what is needed in terms of CSR initiatives.

Kobayashi: With *Committed to the global good* as our corporate credo, we have developed our businesses while considering how to help enrich the world and people’s lives. Regarding today’s theme of natural resources, excepting the past five years or so, natural resources prices have been stable for about 20 or 30 years. Consequently, most consumers did not need to think about natural resources. In recent years, however, several factors, including the rapid increase in natural resources consumption by such emerging countries as China, have combined to drive natural resources prices upward. As a result, natural resources have become a significant issue for people all over the world. In a position that links products and consumers, trading companies have undertaken operations for food and energy that are essential for national security. Going forward, I believe that how to view natural resources and how to advance our businesses while achieving accountability are significant issues.

Taniguchi: Looking at the sites of large-scale natural resources development around the world gives you an idea of how large an effect natural resources development has on nature and local

residents. The world depends on developing countries for 35% of natural resources extraction, and that percentage will continue to rise. Natural resources development destroys ecosystems such as rain forests and the cultures and traditions of indigenous peoples. Particularly in Southeast Asia, Africa, and South America, the situation is worsening at an alarming rate. Such natural resources development underpins modern material civilization. Consumers have to know about such problems and change their way of thinking.

Kawaguchi: We have had a long favorable period in which consumers have not needed to consider the problem of natural resources. Companies’ approach to business was to do everything for consumers so that they did not have to think about anything. However, in an era when there are not enough upstream natural resources, using that approach to further increase demand will likely bring us to an impasse in the near future. From now on, I would like companies to tell consumers properly where things come from. I think companies have a responsibility going forward to tell consumers: “resources are finite,” “extracting them causes problems such as environmental destruction,” “a lot of effort is needed to secure natural resources,” and “therefore let’s use them carefully.”

In order to raise consumer awareness of natural resources

Tatsumi: Until now, consumers have chosen products and services almost entirely based on price. I think it is probably fair to say that consumers did not think at all about what products are made from or how they are made. Information available to consumers was scarce, and we thought about product usage and

Panelists



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perhaps, at the very most, also about product disposal. I want companies to provide information that enables consumers to discern products that are good for the environment and society, in order to create a society in which consumers make informed choices. Recently, a trend toward disclosure of CO₂ emissions volumes has begun. Soon perhaps products will include information about their carbon footprints*.

Also, I think the creation of a recycling-based society in which downstream products are returned upstream is very important. If companies tell consumers about the importance of natural resources, I believe it will motivate them to take steps toward recycling.

Tamba: Admittedly, communications between consumers and companies may not be working well. Looking at my own behavior as a consumer, I am in a “waiting” position and do not go and get information. I think the issue is how to encourage companies to take the initiative in providing information and encourage consumers to be more active.

Matsukawa: During a long association with oil field development, the first time I felt the importance of environmental problems was at the beginning of the 1990s when I was involved in developing an oil field in the North Sea. A debate arose in relation to how much money should be spent restoring the natural environment after completing extraction, and there were proposals to create standards with the countries adjacent to the site of the development. In the end, a huge amount of money, an amount which would have been unthinkable at the time, has been spent on work to restore the site to its former state. Ultimately, that cost is passed on to consumers, and I think we have to make sure consumers understand this. Some people complain about hikes in gasoline prices. If we do not

consider the environment, we can extract oil at a lower cost. On the other hand, there are calls for us to protect the environment. We have to meet both requirements.

It is the same with respect to society. Previously, when we were developing a uranium mine in Australia, we realized that aborigines have strong feelings of resistance toward the development, so we stopped the development and restored the site to its former condition. I think we have to communicate to consumers that we conduct development based on respect for the cultures of indigenous peoples and local residents.

Kumazaki: With globalization progressing to the extent that it has, the distance between consumers and the sites of natural resources development and companies involved in such development has become very large. Unless consumers learn more and think about this problem from a global perspective, I do not think that distance will decrease.

* Carbon footprint: This is an indicator that ascribes numerical values to CO₂ emissions volumes to quantify the effect of companies' products and services and individuals' activities on global warming. It is used to analyze the extent of the effect of products and services from production through to disposal.

Incorporating the value of nature into market mechanisms

Taniguchi: With the development of a material society, we have tended to overvalue wealth and convenience. As a result, environmental destruction has become more serious in areas furthest upstream due to the development of natural resources. The fundamental cause of this is that the value of nature is not incorporated into market mechanisms. Incorporating the value of nature into market mechanisms, known as “sustainability and pricing,” is becoming a worldwide trend in environmental economics. A consensus is rapidly building that we must not

regard natural resources and the environment as concepts below the economy, as we did in the 20th century.

Tatsumi: Apart from humans, all animals on the planet live within the limits of the resources nature gives them. Only humans place a burden on the environment through lifestyles that involve buying products and using services. I think prices must reflect the burden that we place on the environment in our pursuit of convenience.

Matsukawa: Companies are tasked with providing products as inexpensively as possible within social and environmental constraints. However, consumers should increasingly call on companies to take such kinds of steps as we took to restore the development site in the North Sea. As a result, costs will rise. But, at the same time companies will work to reduce these costs. That kind of interaction is a good model for reducing the environmental and social burden of producing goods.



Sato: For consumers, cheaper products are better. On the other hand, natural resources are limited. Taking the food business area as an example, previously the weather largely determined food supplies at stable prices. However, recently the number of factors causing price fluctuations have increased. If production volumes decrease due to such natural disasters as floods and hurricanes, prices rise. Further, the increased consumption of such emerging countries as China is creating imbalances between supply and demand. Also, speculative money is flowing into related markets. Other factors affecting prices include the use of agricultural products for uses other than food, such as biofuel. I think companies have to clearly communicate to consumers why products have particular prices so that they understand and accept them.

Kawaguchi: Quoting the words of wisdom by Gandhi, “earth provides enough to satisfy every man’s need, but not any man’s greed.” I think we have to differentiate between “needs” and “wants” by determining what we need and how far some things are based on desire. Products that satisfy our desires tend to be high-value-added products such as fashion goods. I would like companies to develop products in those categories that we can use and enjoy for a long time, rather than taking a low-margin high-turnover approach to the marketing of these types of products. Further, I ask companies not to entrust themselves to consumer desire and exploit natural resources accordingly but to change to business models that control consumer desire based on natural resources constraints.

Toward the sustainable use of forest resources

Kumazaki: Until now, we thought that forests were a plentiful natural resource and forecast the future of forest resources comparatively optimistically. We estimated that even if the population reached 10 billion, there would be enough forest resources to meet lumber demand. However, we based those calculations on the assumption that we would still be able to use fossil fuels. If forest resources also have to meet energy demand in the future, then we will not have sufficient forest resources.

Oshitani: I have been involved in the paper pulp business for a long time. It is a fact that for several decades paper prices hardly changed. However, I am reminded that it is important for trading companies and manufacturers to tell consumers that valuable forest resources are used to make paper. Also, paper demand will likely increase due to higher use by emerging countries. Because usable forest resources are finite, I think we should ensure we avoid wastage when using wood resources by wisely and selectively using forest resources in accordance with applications.

Kumazaki: Recently there has been a marked increase in bioethanol projects that use wood. However, making ethanol from wood resources is very difficult. Converting wood into chips and burning them as a source of heat is a way of using energy from wood that offers better energy conversion efficiency.

I am often asked how much ethanol can be extracted from forests. However, due to the nature of forestry management, it is not possible to only take wood debris for ethanol use. We have to establish a system that uses wood according to its quality, with high-quality wood used for lumber, the next quality level for plywood, and the remainder for ethanol.



Oshitani: Meanwhile, as lumber imports increase year by year, domestic lumber volumes are decreasing. However, among the world’s forest resources, we can only use a limited amount. Therefore, I think we have to revise the entire distribution system of Japan’s forest industry. And, I think trading companies can contribute a great deal to such efforts.

Kumazaki: At long last domestically produced lumber is becoming competitive. However, what worries me is that although we have reached this favorable situation, Japan does not have the infrastructure for a sustainable forest industry. Looking ahead, we have to deal with the large issue of how to make Japan’s forestry management sustainable.

Tamba: Japan’s forest industry needs revitalizing. If we can no longer import lumber, I think attention will turn to domestically produced lumber. The resource itself is already there, so the only question remaining is how to make it economically viable. I think we have to drastically change the present systems of the forest industry, including how we secure forest industry workers.

Food is also a finite resource

Kobayashi: It is not just the forest industry, we have to reinvigorate agriculture. In the near future, we may not be able to get food even if we have money. Therefore, this is a problem that cannot wait. The business world is beginning to take positive steps to address this problem.

Sato: On a calorie basis, Japan has a food self-sufficiency rate of 39%, which is one of the lowest among developed countries. How to raise that self-sufficiency rate is a major problem that we will need to tackle. In addition to securing food from overseas, I think trading companies can help invigorate Japanese agriculture. For example, I think trading companies can realize agricultural products with prices that can compete with imported agricultural products by forming tie-ups with farmers that are taking measures to reduce agricultural chemicals or increase fertilizer efficiency, supporting processing and marketing, and rationalizing distribution. In other words, trading companies can contribute by building value chains. With that in mind, we have already begun initiatives.

Taniguchi: Regarding food supply, from the perspective of the furthest upstream area, the lack of fertilizer is becoming a big problem. Agricultural products need three elements to grow: nitrogen, phosphorus, and potassium. However of those phosphorus is in short supply, triggering a worldwide scramble to acquire the element.

Sato: Just as mineral resources have a limit, agricultural products cannot be produced endlessly. Water and cultivatable land is finite, and as Mr. Taniguchi pointed out there is a shortage of mineral phosphates. I think we will soon have to recognize that agricultural products are finite.

Kawaguchi: Every year Japan discards 20 million tons of food, said to be double of the amount of worldwide food aid. I think it is important to stop wasteful food practices. Another method under debate is changing to diets that curb such cereal-intensive foods as pork and beef, which require large volumes of feed to produce.



The turning point toward a sustainable society

Taniguchi: From now, I think we need “CSR as competitive advantage.” Based on the urban mine concept, if we recycle downstream resources, which are very valuable, we will not have to extract upstream natural resources, a fact that is surprisingly unknown. It is important to understand not only that we should be careful with natural resources but also that recycling is extremely beneficial in terms of global interests. Furthermore, such recycling efforts will leave more untouched natural resources for the next generation, the value of which we can regard as corporate value. This “CSR as competitive advantage” approach involves incorporating into evaluations monetary values ascribed



according to the level of contribution made by business activities to the external economy and numerical values given to the benefits resulting from environmental activities, which conventional financial statements do not recognize.

Kobayashi: Thank you very much for making this such a lively debate. Listening to your opinions made me ask myself, “Perhaps economic growth is not compatible with protecting the earth?” and “But, on the other hand, perhaps pursuing economic growth is unavoidable?” People have desire and they want to become better. However, becoming better does not just mean economic growth. This discussion has reaffirmed to me the need to capitalize on our expertise and technology to achieve a balance between advancing business activities, protecting the environment, and benefiting society. Today, society has reached a turning point. Going forward, the shift toward a sustainable society will likely gather momentum rapidly. And, the ITOCHU Group aims to stand at the forefront and lead that change.

Reflections after the stakeholder dialogue

Through this stakeholder dialogue, themed on “Considering Upstream Issues in the Cornerstone Businesses Comprising Society,” we gained multifaceted insights from various experts regarding the type of issues that general trading companies face.

The discussion generated thought-provoking proposals, particularly with respect to companies’ responsibility to ensure that consumers receive accurate information about the environmental cost of processes needed to secure natural resources. Also, the discussion reconfirmed to us the finite nature of natural resources and the importance of using them effectively.

Based on today’s dialogue, we will consider how to balance economic growth and issues related to natural resources and the environment, think about the roles and functions that we as a general trading company should perform to achieve this goal, and reflect our conclusions in business activities.

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