MSCI ESG Now Podcast

"Bribing Olympic Committees and Tracing Ben & Jerry's Supply Chain"

Bentley Kaplan:
Hello and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, you host for this episode. And on today's show we are gonna get into two stories. First, we're gonna put on our Swish Olympic tracksuits to take a look at a corporate bribery scandal that's tainting memories of the Tokyo Olympics. We'll work through the governance factors that has landed the Japanese publishing company, kata Corp, into the middle of the story. And then it's time to switch our track pants or fat pants as we collapse onto the couch and tuck into a tub of Ben and Jerry's. We'll look at how the company's efforts to source slavery. Free cocoa is less and less about virtue signaling and much more about regulatory imperatives. Thanks for sticking around. Let's do this.
So I love the Olympics. Full disclaimer. It has the sort of noble undertone athletes at the peak of their craft, years of sacrifice to become the best in the world and to land some hardware and podium positions for your country. And apparently, I'm not alone in the love of this event, more than 3 billion people tuned into the 2020 Olympic Games in Tokyo. But this popularity also translates into something else commercial opportunity. It's the same with something like a football World Cup. Contracts to provide goods and services for the Olympics are lucrative and with so many eyes watching, it's a great opportunity for some advertising. So it's maybe not all that surprising when companies or individuals look for a way to get a piece of that action. Sometimes through not so honorable means and Kadokawa Corp, a Japanese publishing company has been accused of making use of these less than honorable means and bribing a committee member to become an official sponsor of the event and to secure a contract to publish the official Olympic guidebook and records. And Kadokawa is not alone. Bribes were allegedly behind the companies that made the tracksuits for Japanese athletes and the official mascots for the games. But Kawa has a unique governance story, which is why we're going to focus on this company specifically and to get an expert's opinion. I called Moeko Porter, one of our team's corporate governance aces, talking to me from MSCI's Tokyo office.

Moeko Porter:
So to give a brief background of what's happened, the son of the company's founder was arrested back in September, 2022 on suspicion of offering bribes to a former executive of the Tokyo Olympics Organizing Committee. At the time he was the company chairman and also held a seat on the board of directors. Following his arrest, he resigned as company chair and ultimately resigned from the board in November. In response to this scandal, Kadokawa formed an external committee that looked into the circumstances related to the company's Olympics sponsorship selection. And the findings were just made public in January, 2023. The report noted multiple lapses in Kadokawa's internal controls, even the warnings from Kadokawa's legal counsel to the company's legal department that the payment of these

consulting fees would likely be regarded as bribery was largely ignored. The overriding theme was a sort of reverence and fear toward the chairman that ultimately resulted in rubber stamping anything he wanted. What was most surprising to me was that many of the people that had knowledge of the dealings reported having a sense of unease or concerns over the possible risks.

Bentley Kaplan:
Right. So you've got the situation where your biggest boss has allegedly okayed some bribes, and despite having some internal controls that would flag this type of behavior, nobody was willing to take the ultimate risk of alerting authorities of what was going down. Moeko told me that one of the phrases that came up quite often in the external investigation into Kadokawa Kawa was the chairman has given his approval. And in Moeko's telling of it, a company can have the best, most robust anti-corruption controls on paper. But if the actual humans in the system subverted or don't feel safe enough to speak out, it nullifies those controls. But the story gets even more interesting because you have this company trying to navigate a highly public bribery allegation. Your most senior leader has stepped aside and been arrested, and now you have to kind of pick up the pieces and get into some serious damage control. You really need your governance systems to kick into high gear. But for Kadokawa Corp, this might not be so simple

Moeko Porter:
As one can easily imagine. This scandal has thrown the company for a loop. In addition to Mr. Kadoka resigning, the vice chairman who was actually president at the time of the sponsorship transaction also gave up his vice chairmanship to take responsibility versus his role. The current CEO and board chair Tao has quite a task ahead of him, not only dealing with the fallout from the scandal, but also working to restore investor confidence. Unfortunately, he may not be able to focus a hundred percent of his attention on his duties as CEO given his numerous external commitments. Right now he serves on four unrelated corporate boards within MSCI ESG Research’s coverage. So that's a total of five boards along with several committee commitments. A moment of corporate crisis is not when you want your CEO juggling duties at five different companies.
There's also a bit of an issue with the CEO's position on the audit committee at a company called Trans Cosmos where he serves as an independent director. Normally that wouldn't be an issue, but the former CEO Transcosmos also serves as an independent director at Kadoka and is a member of their audit committee. This is creating an interlock between the boards of the two companies beyond the question of how someone could be considered an independent director giving these connections. It's not great to have this sort of appearance of a conflict of interest in the midst of an ethics scandal, especially when Transcosmos’ name has actually come up in an unrelated ethics scandal.

Bentley Kaplan:
Okay, so allow me to recap this for you. Moeko professional telling can't really convey the exclamation marks and emojis that this deserves. So you lose your company chairman who is in jail, your vice company chairman has also stepped aside. So that leaves the person behind the wheel as your c e O and board chair Mr. Nao. And not only is Mr. Nao also a director of at least four other companies, but he is also sitting on the audit committee of a company that

has an ethics scandal all of its own. And the ex CEO and current director of this other company, trans Cosmos, happens to be a director at kawa and sits on the audit committee interlocked and over boarded. It sounds like an Adam Sandler movie. But in terms of what type of risk this holds for investors, which is very much the angles that Moeko is thinking along, it means your most key person may have too many distractions and other commitments to really focus on kawa and it's very current predicament. But more broadly, investors in Japan will be thinking about what this whole saga might mean for other companies. Despite a year's long effort to revise corporate governance practices in the country, a scandal like this raises hard questions about internal oversights. As Moeko told me from a regulatory standpoint, things are moving in the right direction, but the nut of company culture is still a hard one to crack.

Moeko Porter:
So last year, amendments to Japan's Whistleblower Protection Act came into effect and companies with more than 300 employees are now required to have a whistleblower system. And one of the important aspects of the revision was the protection of the whistleblower's confidentiality and protecting them from retaliation. While Kadokawa had such a system in place, the investigation report actually noted that some people feared the company would not act on it or that the whistleblower would be added a disadvantage. So even if a company were to have a whistleblower system in place, if there isn't a shared awareness and adherence to laws and regulations, there's a question of how effective these internal systems can actually be. And if there's a corporate culture where employees believe that saying no or reporting possible misconduct may result in retaliation and make them hesitate, there are more far-reaching problems that may need to be addressed. It really is unfortunate to see these kinds of reports come out. Even before the pandemic pushed the Olympics back to 2021, there was a lot of public criticism regarding the ever expanding costs of hosting the games, which was reportedly double the quoted bid from back in 2013. Apparently the Japanese Olympic Committee and the city of Sapporo were hoping to pursue a bid to host the Winter Olympics in 2030, but these continuing scandals have likely weakened public support.

Bentley Kaplan:
So for our next story, we're both going more frivolous and more serious at the same time because we're gonna talk about ice cream, Ben and Jerry's ice cream, to be specific, we don't really get it here in South Africa, but now here it's great and it comes in pints. Ben and Jerry's is wholly owned by Unilever, which is a giant company. To put that into context, Ben and Jerry's major shy of 1 billion in 2022 sales compared with Unilever, which pulled in more than 60 billion. But like many ice cream producers, Ben and Jerry's uses a lot of cocoa. And cocoa is something we've spoken about on the show before. My unparalleled co-host, Mike Disabato, spoke to our colleague Co Martin about it in about March last year on an episode called Children in the Coco Fields, which in itself tells you a lot about the potential problems with sourcing cocoa because it's a farming process that is very difficult to automate.
And because it's a commodity where buyers have typically tried to get it as cheaply as possible, it regularly means that the labor used to harvest cocoa involves children or adult workers having to endure grueling and low paid work, which is something that some companies are trying to fix. Ben and Jerry's was already using fair trade cocoa in its products, but last year the company announced that it would be sourcing cocoa for some of its ice

cream through Tony Chaka lonely Open Chain. Tony Chocolonely, apart from being both a fun and sad name to say is also a Dutch chocolate company, and they've made it possible for other companies to sort of collaborate on their sourcing initiative called Tony's Open Chain. Now, I bugged my colleague in London, Aura Toader about what the sort of collaboration could mean, and she gave me the cheat sheet on what Tony's open chain is all about.
And basically there are five principles. First, sourcing traceable beans, which means sourcing them directly from farmers or farmer cooperatives. And second, it's about paying a living wage to your farmers. Poverty is one of the main contributing factors to child labor. And more cash on hand means that farmers don't have to rely on child labor and can in fact send their children to school. And the other three principles are about developing professional cooperatives, reaching income security through longer term contracts and minimum price thresholds, and then training on how to achieve higher yields and diversifying crops, which means new waste generate income and spread your risk around. And I've gotta be honest, all of this sounds pretty great, but as Ara told me, it's not really just about being great or getting ice cream eaters to feel good. Companies like Ben and Jerry's and its parent Unilever are facing more and more regulations that directly affect their cocoa supply chains and regulators are taking closer and closer looks under the proverbial hood.

Aura Toader:
What regulators are doing is generally pushing for more disclosure so that they can see what branded companies are doing. They might not have the resources to test these traceability claims themselves, so they can see what the companies are saying that they're doing. They can evaluate whether they have sufficient due diligence procedures in place, if they're part of, uh, certain certification schemes, you know, if they use independent auditors. All these means that the auditor can verify that the company is on the right track. They cannot actually check whether the cocoa that the company sources is traceable or not.

Bentley Kaplan:
Right. So here's the catch. If you're a company like Ben and Jerry's and you're holding a cocoa bean in your hand that's just rolled into one of your warehouses, that bean doesn't tell you anything about whether it was farmed using child labor or modern slavery. And just like companies, regulators have the same challenge. They can't audit cocoa beans themselves. So instead, they're looking at a company's efforts, their policies and pledges, evidence of tracing programs, efforts to map where these risks are in their supply chains, and then proof of how these companies are trying to tackle that risk and being able to put together these documents, these audit trails – that proof of work is becoming increasingly important, and in some cases, a legal requirement. For a company like Unilever that earns a big chunk of its sales in the US and the EU, these regulations are becoming more the norm rather than the exception.

Aura Toader:
So Unilever of which Ben & Jerry’s is a part of, derives most of its revenue in Europe and the US. So that means they need to comply with human rights laws in these regions. In the US there is the California Transparency in Supply Chains Act that requires manufacturers to disclose their efforts to protect human rights in their supply chain. The EU is very active in this space. There are human rights’ due diligence laws in individual European countries like

France, Germany, the Netherlands, but there is also EU-level human rights laws, such as the corporate sustainability reporting directive, which also requires companies to report on human rights issues.

Bentley Kaplan:
So for Ben and Jerry's and their parent company, Unilever, being able to sell their products into markets like the US and the EU and the UK is meaning that efforts to address risks around human rights in the supply chains is not just a nice to have or a footnote in a CSR report. It's being moved into a much more mainstream operational question. And Aura mentioned a few key regulations that are already in action, but there is a new directive being proposed in the EU called the Corporate Sustainability Due Diligence Directive. And if this is enacted, it's gonna really turn the screws. And instead of having companies reporting on their efforts, they're actually going to have to follow the OECD due diligence guidelines on responsible business conduct, which among other things, will compel directors to put a company's human rights due diligence into their suite of responsibilities. And in some ways, this regulatory ratcheting is only catching up to other more intangible forces that have been active in cocoa supply chains for many years before this. Things like brand reputation or consumer preferences. And the shift means that investors are pivoting away from questions like, does this higher spend in our supply chain actually make sense to questions like, how robust is this company's supplier auditing and tracing programs? Or is this company at risk of losing market access because it's dragging its heels on supply chain efforts?

Aura Toader:
I think it's really interesting that since Unilever acquired Ben & Jerry’s in 2000, Ben & Jerry’s insisted to keep its own board of directors in order to protect its core values. So I think his decision to partner with Tony's and pay farmers a living income, to work directly with farmers is probably, at least in part driven by these values. But there is also an element of risk and opportunity as well because, we were talking earlier about regulations. So you know, there is a regulatory risk within the broader Unilever group and there's also an opportunity to market itself even more as a social enterprise because this is a time where consumer attitudes are changing, particularly younger generations. They say that they are more interested in sustainability issues and even pay a premium for this, uh, sustainability, um, criteria. So, so companies like Ben & Jerry’s, I would argue that they are well positioned to tap into these opportunities.

Bentley Kaplan:
And that brings us to the tail end of this episode. Moeko walked us through a corruption challenge that is familiar to many markets, but with a distinctly Japanese governance flavor. And for investors, governance risks are not necessarily things that kick up when the sun is shining and it's plain sailing, but rather where things can go wrong when the going gets tough or a company suddenly finds itself in a headwind or, you know, an Olympics bribery scandal. And for Aura, it's an interesting time for ice cream and chocolate makers that rely on a cocoa supply chain that has long held so many people down and violated so many human rights because arguments about doing the right thing are being strengthened as regulators raise the bar on coco traceability and what's expected in a new social contract between buyer and farmer. Done in this way, regulations can better link a company's externalities to its own

bottom line and drastically shift motivations to do something about this very sticky challenge.
And that is it for the week. A massive thanks to Moeko and Aura for their take on the news with an ESG twist. And thank you very much for tuning in. It's always a treat to be able to bring you a slice of ESG cake and hopefully this will be food for thought and your week ahead. If you have the pep in your step, please do drop us some stars or reviews on your platform of choice. We would thank you kindly. Mike is gonna be back again next week, so do keep an eye out for him and in the meantime, take it easy and be kind to yourself and those around you.

The MSCI ESG Research Podcast is provided by MSCI ESG Research LLC, a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Except with respect to any applicable products or services from MSCI ESG Research, neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. The analysis discussed should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. The information contained in this recording is not for reproduction in whole or in part without prior written permission from MSCI ESG Research. Issuers mentioned or included in any MSCI ESG Research materials may include MSCI Inc., clients of MSCI or suppliers to MSCI, and may also purchase research or other products or services from MSCI ESG Research. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. The information provided here is as is and the user of the information assumes the entire risk of any use it may make or permit to be made of the information.

Thank you.

About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit **www.msci.com**.
