

Proposal on Venture Philanthropy and Social Impact Investment

April 28, 2016



Background and Overview (1) Social Issues and Social Business

- ❑ Social issues such as “assistance for persons with physical disabilities, seniors and childcare,” “health, medicine and welfare,” “education and human resources development,” “regional revitalization and community development” and “environmental conservation and protection,” are becoming more diverse and complex in recent years due to the advancement of low birth rates and aging populations, the overall declining population, and increased disparity.
- ❑ Although difficult to sustain for solely profit purposes, social business has a growing role in addressing social issues in areas that the government cannot reach.
- ❑ Funding for social business activities relies largely on donations and non-profit oriented investment and financing, in addition to earnings from business operations. In Japan, however, the number of individuals and companies involved in donations, or investment and financing, and funding organizations such as foundations, is tremendously lower than that in the United States.

Background and Overview (2) Philanthropy Ecosystem

- ❑ In the United States, many individuals and organizations including successful Silicon Valley entrepreneurs, regional celebrities, and corporations are involved in venture philanthropy and social impact investment. This generates the philanthropy ecosystem - a cycle of giving back the gains of business to society, efficiently distributing funds to projects aimed at solving social issues that cannot be addressed by the government, and creating new markets and employment opportunities such as social business. It serves as a role model for entrepreneurs.
- * Venture philanthropy: Outcome-oriented donation, investment, and financing in which funding organizations (public interest foundations, etc.) are involved in the operations of their beneficiaries, such as NPOs or companies, through multi-year agreements or involvement in operations through the dispatch of directors, and evaluate the outcomes of beneficiaries' business.
- * Social impact investing: Investment action that emphasizes not only financial benefits but also social benefits (resolving social issues).
- ❑ Establishing this cycle in Japan is very important, especially from the perspective of bringing about a virtuous cycle of growth and distribution (new distribution in order to grow).

(2) Direction of Promotion Measures

- ❑ We aim to promote an increase in funds allocation organizations and donations while also building mechanisms that make it easier to expand venture philosophy and social impact investing in Japan. In addition, we aim to foster entrepreneurship in social business, promote innovation in the civil sector, expand the market for social services, and create jobs that will help to propel economic development in Japan.
- ❑ Therefore, we propose the government to incorporate review of related frameworks such as the public interest incorporated foundation system in the growth strategy (see next page) and to take necessary action.

Requests for Policy Changes (1)

1. Review of public interest incorporated foundation system

Review a system that enables the easy establishment and operation of public interest incorporated foundations. Create an environment in which individuals generate social reform by utilizing public interest incorporated foundations. Move from an advanced screening system to checks carried out after the fact.

◆ Administrative rules

- Elimination of the “Revenue=Public interest spending” rule
- Business plan changes to be reportable instead of certified in advance
- Improve the way of calculating the percentage of public interest business

For allocating operational profit from a for-profit business to a public interest business account, include the cost of the for-profit business in the public interest business account based on the percentage of the allocation amount out of operational profit from the for-profit business

- Ease restrictions on idle assets

◆ Rules at the time of establishment

▪ Shorten the screening period for public interest certification. Eliminate regional disparities in the Public Interest Corporation Commission.

- Exception that eliminates restrictions on relatives serving on the board of directors
cf.) Private foundations in the United States

Requests for Policy Changes (2)

2. Expansion of tax incentive regime for asset donations

Develop environment for asset donations including donations of bequests.

- ◆ Simplify procedures for receiving non-taxable status on the deemed transfer income for gifts before death and inheritance for public interest foundations and NPOs. To be more specific, do not require the approval of the Commissioner of the National Tax Agency.
- ◆ Apply non-taxable measures of inheritance tax and deemed transfer income, even when change occurs in use of assets from the original purpose to other public interest business purposes.
- ◆ Make the recipient (public interest foundations or NPOs) the taxable party in cases when it is needed to cancel non-taxable measures of inheritance tax.
- ◆ Make securities and real estate in kind also subject to specified donation trusts, without restricting the item subject to specified donation trusts to money. Expand measures to make stock dividends and gains on the transfer of assets within the trust non-taxable.

Expand venture investment promotion tax regime to social impact investment.

- ◆ Apply incentive measures for companies that invest in venture funds to companies that invest in social business funds.

< Reference >

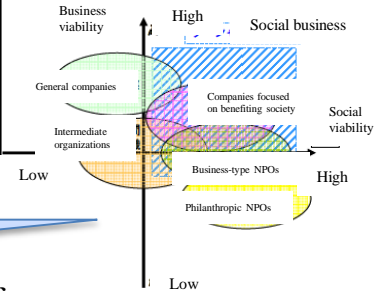
Growth Strategy for Japan through the Promotion of Venture Philanthropy

Present Issues

Social issues are becoming more diverse and challenging to address, including assistance for people with disabilities, the aged, and childcare; healthcare/medical care/welfare; education and human resource development; regional revitalization/urban development; environmental conservation and protection; etc. With government unable to address all of these issues alone, the **importance of social businesses** that work on addressing such issues as part of their business is growing.

The organizations shouldering this role (about 50% NPOs and about 20% companies) must depend on donations and non-profit oriented investment and financing with the goal of earning funding for social business activities. However, **Japan lacks people and organizations willing to donate or make this investment and financing.**

<Those bearing the torch of social business>



Required Measures

(1) Promotion of venture philanthropy

Organizations that provide funding to public interest foundations get involved with operations through such means as entering into multiyear donation agreements or the dispatch of directors, and evaluate project outcomes. Apply the investing knowledge (judgment, etc.) of entrepreneurs in venture companies to the field of philanthropy to foster greater entrepreneurship. Bring about innovation and heighten efficiency.
<Examples of donation destinations> Non-profit organizations, companies with a positive impact on society but low profitability

(2) Promotion of social impact investing

Promote investment based on not only economic returns but also social returns (contribute to the solutions to social issues).
<Examples of investment destinations> For-profit companies and companies with a positive impact on society but low profitability

Expected Effects

(1) Creation of new business and regional revitalization

(Examples) Childcare assistance for sick children, educational assistance for high school students, tourism promotion through environmental conservation
<Market size of social businesses>
Approx. 200 to 300 billion yen
Potential size of up to some 80 trillion yen

(2) Job creation

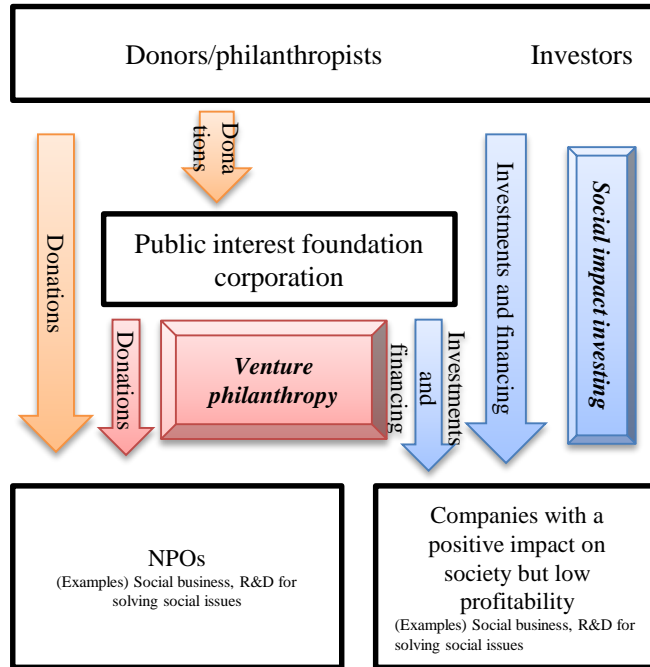
<Percentage of working population employed in the non-profit sector by country>
Japan 3.2%
United States 6.3%

(3) Ripple effect from efficient solutions to social issues

(Examples) Reduced government spending on healthcare and welfare and improved labor environment

Issues for Promoting Venture Philanthropy and Social Impact Investing

[Flow of Funds]



[Issues standing in the way of increasing the flow of funds]

<Lack of funds providers>

★Need a simple mechanism where public interest foundations can be established and operated easily

(Examples)

◇ Introduction of system modeled after private foundations in the United States

◇ Introduction of mechanism for establishing these organizations in a shorter amount of time

◇ More flexibility and easing of the restriction of the “Revenue=Public interest spending” rule, procedures to change business plans, and idle assets. Change approval process to ex-post facto system.

★Create a system for people to make donations easily

(Examples)

◇ Currently donors are subject to taxation on gains on the donation of inherited assets in kind (including land, etc.), but this tax burden should be shifted to the recipient of the donation.

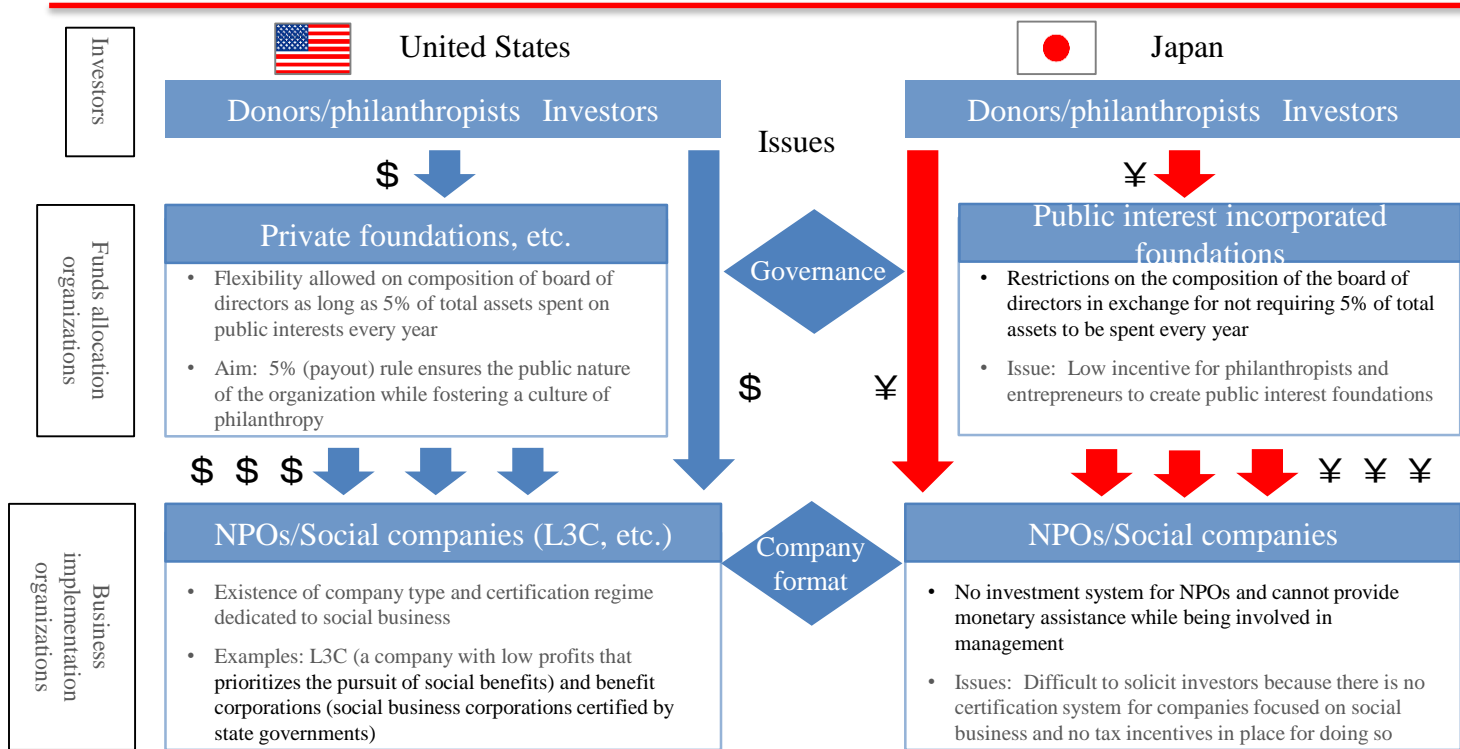
<Lack of experience among companies and business implementation organizations>

★Need to foster environment and culture for spreading venture philanthropy and social impact investing

<Undeveloped frameworks>

★Need to develop systems for social companies and systems for evaluating social impacts

[Reference 1] Systematic Differences Between Japan and the US - 1



Systematic Differences Between Japan and the US (2) Foundation Systems

	United States	Japan
(1) “Revenue=Public interest spending” rule	Tax system incentives for public interest companies shall apply as long as the IRC 501(C)(3) requirements are fulfilled. There is no rule equivalent to Japan’s “Revenue=Public interest spending” rule.	Annual revenue of a foundation cannot exceed annual expenditure for public interest purposes. (Article 5-6 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations) →Results in unnecessary spending to avoid carry-over to the next fiscal year; Cannot make a mid- to long-term business plan.
(2) Procedures to change activity	Every year an annual report of the activity must be submitted to the IRS for review. The IRS will tax the foundation after the change if the new activity does not meet IRC 503(c)(3) requirements.	Any change in scope of foundation’s activity requires pre-authorization from the administrative agency. (Article 10-1 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations) →Micro-management by administrative agency; Time consuming process – impossible to respond flexibly to changing environment
(3) Public interest activity ratio	There are no stipulations equivalent to Japan’s public interest activity ratio found in IRS 501(C)(3).	The public interest activity ratio ($(1/(1+2+3))$) (1: Public interest activity costs; 2: For-profit activity costs; 3: Administrative costs) must be at least 50%. (Article 15 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations) →3 should be allocated based on the percentage of 1 and 2.
(4) Restriction on idle assets	There are no stipulations equivalent to Japan’s public interest activity ratio found in IRS 501(C)(3). Rather, the presence of idle assets is used to determine soundness of financial standing. Lack of assets can be seen as lack of financial stability and be regarded negatively when applying for subsidies.	The amount of idle assets at the end of each year shall not exceed the amount necessary to operate in the following year to do the same content and scale of operation during the year. (Article 16-1 of the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations) →This restriction should be extended from single years to a longer period of time for the stable administration of the business.

Other differences between the US and Japan

- ◆Restriction on minimum expenditure
- ◆Tax on net investment income
- ◆Restriction on internal transactions

◆Restriction on ratio of holdings

◆Restriction on political activities

US Private Foundation

Must spend at least 5% annually on public benefit service
2% tax on net investment income (dividends, interest, leases, etc.)
Transactions with directors, managers, major donors and family members (sales, goods supply, leasing, etc.) prohibited

Greater than 20% ownership of a company’s voting rights prohibited

Lobbying or assistance to electoral candidates prohibited

Japan

No such rule

Investment income including interest and dividends is non-taxable
Provision of special interests prohibited (Article 5-3, Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations) Restrictions on transactions involving a conflict of interest with directors (Article 84, Act on General Incorporated Associations and General Incorporated Foundations)
Greater than 50% ownership of a company’s voting rights prohibited (Article 7, Order for Enforcement of the General Incorporated Associations and General Incorporated Foundations Act)

Political activities as a primary purpose are prohibited (Article 2-2-2, Act on Promotion of Specified Non-profit Activities)

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Worldwide Trends in Philanthropy (1)

Organizations are stepping up outcome-oriented philanthropy

Example: Bill & Melinda Gates Foundation

Engages in international healthcare issues such as the eradication of malaria and polio, etc. Supports challenges with risks that are difficult for governments to commit resources to. It leads efforts to solve issues using outcome-based approaches, regardless of methods and targets, including supporting NPOs, supporting pharmaceutical companies, and providing outcome-linked subsidies together with governments.

*Growing interest in social impact assessment

*Increase in family foundations established personally by business leaders



Growing interest in venture philanthropy and social impact investing



Individual Philanthropy Index 2015 (worldwide survey of philanthropists)

Most Promising Trends: World No. 1 [Impact Investment](#) (52%)

Asia No. 1 [Collaborative Philanthropy](#) (59%)

Growing inclination to provide monetary assistance through donations and investments in social business with management and technical assistance to achieve positive outcomes.

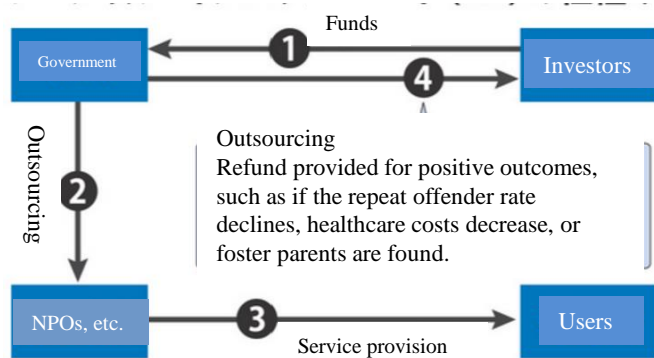
Task force on social impact investing established by the G-8
(Chaired by: Sir Donald Cohen)

Worldwide trends in philanthropy (2)

Leadership of the rich through the Giving Pledge and other initiatives

The Giving Pledge is an initiative whereby billionaires pledge to give back to society more than half of their assets over their lifetime. First advocated by Bill Gates and Warren Buffet, currently there are 143 pledgers worldwide, who are listed on the initiative's website.

Creation of new mechanisms such as social impact bonds, crowd sourcing, and social investing markets.



The Giving Pledge

Pledger Profiles

FAQ

Media

The Giving Pledge is a commitment by the world's wealthiest individuals and families to dedicate the majority of their wealth to philanthropy.

CURRENT PLEDGERS



Growing interest in SDGs



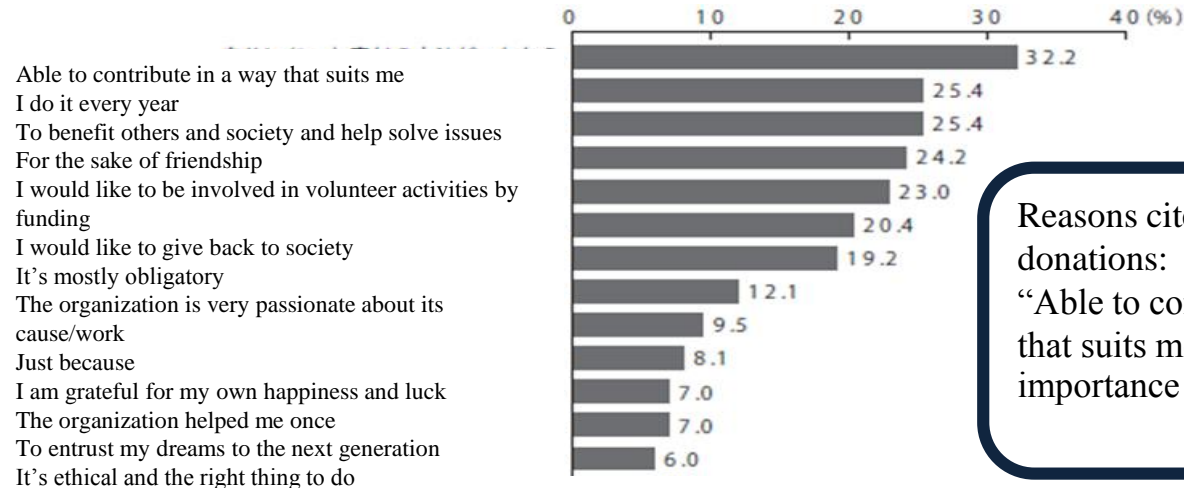
The SDGs were adopted in 2015 and include issues faced by developed countries.

Donations in Japan and other countries

Donations in the US total 36 times the number in Japan

Country	Personal donations
Japan	693.1 billion yen
United States	Approx. 25 trillion yen (228.9 billion US dollars)
United Kingdom	Approx. 1.62 trillion yen (9.3 billion pounds)
South Korea	690 billion yen (6.9 trillion Korean won)

*Corporate donations in Japan total 716.8 billion yen, while in the US they total 1.45 trillion yen (*2012 white paper on donations)



Reasons cited for making donations:

“Able to contribute in a way that suits me” and “The importance of giving back”

Comparison of philanthropic foundations – Japan vs. US

The US has 40 times the number in Japan

Country	Number of philanthropic foundations
Japan	1,897 (those known by the Japan Foundation Center)
Europe	114,000 (Europe Foundation Center study)
United States	79,616 (number of independent foundations) Of these, <u>family foundations total 38,671</u> ★49% of family foundations provide grants of less than 50,000 US dollars per year ★62% of family foundations have total assets of less than 1 million US dollars (120 million yen)

Comparison of the top 10 foundations in Japan and the US

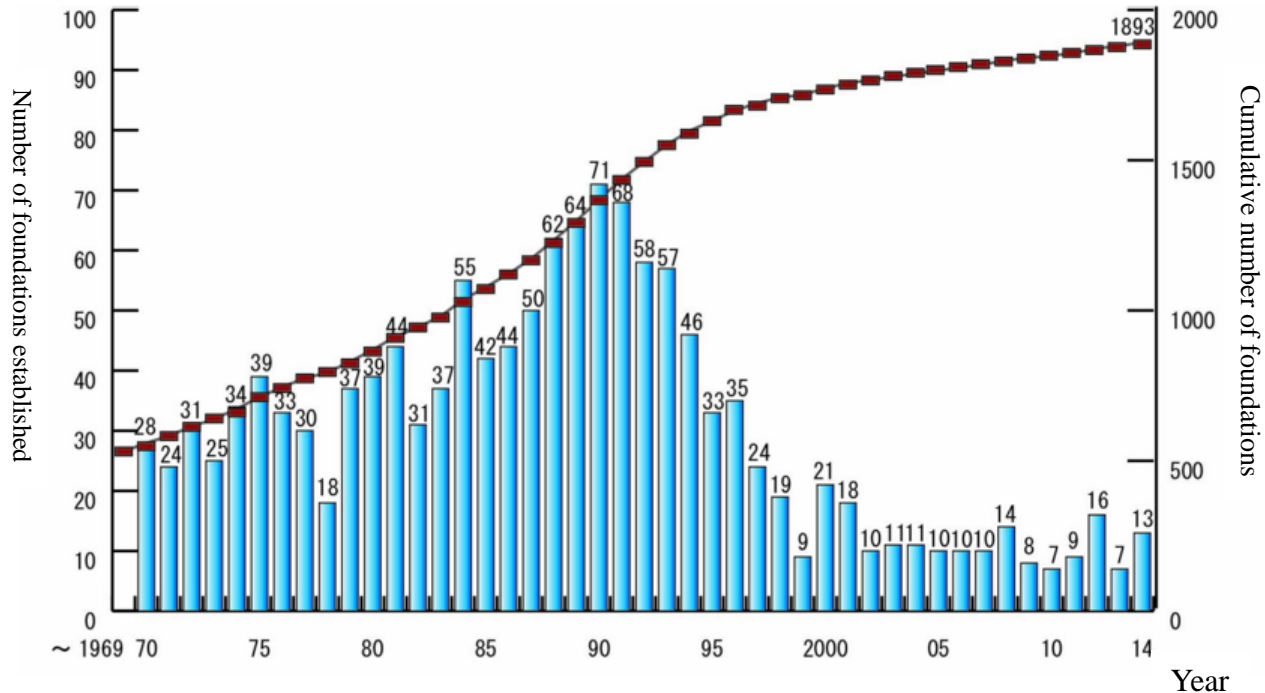
(1) Organizations established with private-sector funds

(1) Organizations established with private-sector funds					Table 6 – 20 largest foundations in the United States by annual subsidies awarded				
14	13	Foundation	Annual subsidies awarded	Total assets	13	Foundation	Annual subsidies awarded JPY	Annual subsidies awarded USD	End of fiscal year
1	-	The Nippon Foundation	219.23	2943.92	1	Bill & Melinda Gates Foundation	3,989	3,321	12/13
2	2	Nihon Kyoiku Komuin Kosaikai	43.46	336.31	2	The AbbVie Patient Assistance Foundation	1,025	853	12/14
3	-	JKA	40.69	614.47	3	The Bristol-Myers Squibb Patient Assistance Foundation, Inc.	974	811	12/13
4	5	Takeda Science Foundation	17.74	1218.09	4	Johnson & Johnson Patient Assistance Foundation, Inc.	855	712	12/13
5	6	Mitsubishi Corporation Disaster Relief Foundation	12.05	24.81	5	Merck Patient Assistance Program, Inc.	825	687	12/13
6	7	The Uehara Memorial Foundation	12.02	1199.32	6	Genentech Access To Care Foundation	817	680	12/13
7	10	Rotary Yoneyama Memorial Foundation	10.4	81.67	7	Pfizer Patient Assistance Foundation, Inc.	802	668	12/13
8	12	Kotsuji Ikuikai	9.49	308.63	8	GlaxoSmithKline Patient Access Programs Foundation	721	600	12/13
9	15	Japan Educational Exchanges and Services	7.43	71.06	9	Ford Foundation	673	560	12/13
10	-	Toyota Mobility Foundation	7.4	9.94	10	Lilly Cares Foundation, Inc.	605	503	12/14

(Units: 100 million yen; million US dollars)

Stagnant growth in the number of foundations in Japan

Figure 2 – Number of foundations established annually from 1970 to 2014



(Reference) Examples of Social Business

● Example 1 (Childcare/Participation of Women) Mama no Hatarakikata Oentai, NPO

Established: 2007

Ordinary revenue: 22 million yen (FY2012) Employees: 5 (including 3 part-time employees)

- Works to expand employment opportunities for women with children by hosting vocational training classes for mothers that are free and enable them to bring their child.
- Funds business by receiving collaboration expenses from companies and educational institutions through projects where mothers and their babies take part in outreach programs “*Mochi-no Jigyo* - life classroom” at educational institutions and facilities for elderly people, and where mothers promote sales promotions of companies.

● Example 2 (Sports Promotion) Tsuneishi Sports Act, NPO

Founded: 1994 Established: 2011

Ordinary revenue: 185 million yen (FY2013) Employees: 7

- Promotes the sound development of youth through various sports promotion activities, with a focus on soccer and cutter boat rowing. Also famous as one of Hiroshima’s most recognized soccer clubs as it receives support from Sanfrece Hiroshima, the city’s professional soccer team, and local listed company Tsuneishi Shipbuilding Co., Ltd.
- Operates soccer fields approved by the Japan Football Association and receives 62 million yen in business income from its soccer school. Does not rely on donations for its operations.

● Example 3 (Environmental Conservation) Kiritappu Wetland National Trust, NPO

Founded: 1986 Established: 2000

Ordinary revenue: 76 million yen (FY2013)

Employees: 8 (including 1 temporary employee)

- Local residents operate a national trust to purchase private land for the conservation of Kiritappu Wetland in Hamanaka Town, Akkeshi District, Hokkaido.
- The NPO opened a satellite shop and restaurant for tourism. It sells a locally developed candy made from kombu kelp and butter and organizes eco tours. The proceeds of this are used to purchase land and carry out conservation activities independently.
- A housewife serves as the organization’s representative and a person with practical work experience heads the secretariat. They work together to operate the organization.

● Example 4 (Education) Katariba, NPO

Established: 2001

Ordinary revenue: 271 million yen (FY2013) Employees: 51

- Offers motivating career education for high school students led by student volunteers (Katariba=talk session). Also, it operates after-school activity clubs in disaster-affected areas.
- Transfers and shares knowledge with local NPO partners in Hokkaido, Hyogo and other prefectures while working with major corporations such as Benesse and others.
- Has access to stable and sustainable funding for its operations through a combination of donations, event participation fees and school costs.