GUIDANCE FOR INTEGRATED CORPORATE DISCLOSURE AND COMPANY-INVESTOR DIALOGUE FOR COLLABORATIVE VALUE CREATION

(Guidance for Collaborative Value Creation)

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Ministry of Economy, Trade and Industry
Background

【Japan Revitalization Strategy】

This Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation (the “Guidance”) has been compiled based on the work done by the Ministry of Economy, Trade and Industry’s “Study Group on Long-Term Investment (including ESG and Intangible Assets) towards Sustainable Growth” (the “Study Group”).

The Study Group was launched as a forum for considering policy measures to promote sustainable growth of corporate value and long-term investment as part of corporate governance reform under the Japan Revitalization Strategy 2016, which outlines the Japanese government’s growth strategy. Specifically, the “Strategy 2016” specified the mission of the Study Group as follows: the Study Group will “consider the manner in which corporate management and investment for creating sustainable corporate value should be conducted and how such value should be evaluated, along with the mechanism of governance facilitating the optimization of investments in human, intellectual, manufacturing, and other capital based on long-term management strategies. The Study Group will also consider how corporate managers should make investment decisions, how investors should evaluate such decisions, and how information should be provided, and will propose policy measures the Government should take.” The Study Group held nine rounds of discussion from August 2016 onward.

【Corporate Governance Reform and Sustainable Growth of Corporate Value】

Japanese corporate governance reform is being carried out as an urgent priority. Behind the urgency of this governance reform is the fact that for the past quarter century, the profitability and capital efficiency of Japanese companies have stagnated, and share prices, an indicator of future corporate value, have also remained low.

Over this period, Japanese companies’ relationships with capital markets and investors have not been necessarily close, as they have long depended on indirect financing (aka bank financing). Among companies, there have been complaints that investors only focus on short-term financial figures and make unilateral demands without paying attention to corporate philosophies/principles and values that companies uphold as critical. Companies have also complained that while investors have choices over which companies to invest in, companies cannot choose their investors.

On the other hand, investors have long had the impression that corporate managers and directors do not pay attention to business metrics which investors consider important when making corporate decisions.

1 “ESG” refers to Environmental, Social, and Governance factors.
decisions or that they use internal management metrics different from metrics mentioned in dialogue with investors (“double standard management”).

To overcome this situation, the Project on Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationships between Companies and Investors (the “Ito Review”) was launched in July 2013, and the final report was published in August 2014. The Ito Review pointed out the need to grow companies’ earning power and capital efficiency, along with the importance of collaborative value creation by companies and investors through constructive dialogue and engagement. The Ito Review also recommended various measures to promote long-term growth and sustainable value creation.

With respect to institutional reforms addressing these corporate governance issues, two codes (Japan’s Stewardship Code and Corporate Governance Code) have been formulated, and governance-related tax reforms have also been successively implemented.

【Need for the Guidance as a Shared Language】

There is no doubt that as a result of these initiatives, the mindset of companies and investors has been changing. However, unless these changes lead to concrete improvements in the conduct of management and take root in line with the direction of the corporate governance reforms cited above, it will be difficult to reap the benefits of the reforms. From this viewpoint, gradual progress in voluntary initiatives by companies and investors who understand the spirit of the reforms is desirable. If we reflect on the serious situation that Japan has long faced, it is also important to consider additional measures to accelerate and expand such initiatives.

However, merely introducing more institutionalized systems and regulations could discourage motivation toward voluntary initiatives and impede improvements in the business practices. On the other hand, to accelerate the governance reform and encourage collaborative value creation between companies and investors, it is essential to have a shared language that serves as a framework for communication between companies and investors. Such a framework will provide companies and investors with the basis for improving corporate governance and fulfilling their accountability and stewardship responsibilities required by the two codes.

Recognizing these challenges, the Study Group formulated and proposed a basic framework for promoting dialogue between companies and investors and for enhancing the quality of information disclosure in hopes that it will serve as guidance for voluntary and proactive initiatives.
**Expected Role of the Guidance**

The Guidance is intended to deepen mutual understanding between companies and investors through information disclosure and dialogue/engagement and promote collaborative activities to create sustainable value. From that viewpoint, the Guidance is expected to fulfill the following roles.

**【As a Guideline for Corporate Managers and Directors】**

First, the Guidance is expected to serve as a guideline according to which corporate managers and directors are able to comprehensively communicate key information to investors, including their management philosophies, business models, strategies and governance systems. As a direct goal, the Guidance aims to promote corporate information disclosure and enhance the quality of company-investor dialogue. Through efforts to achieve this goal, corporate managers and directors are expected to review their approaches to business management and take further actions with a view to creating corporate value.

Corporate value creation processes are specific to individual companies. Therefore, when using the Guidance as a basic framework, companies are expected to flexibly incorporate specific items relevant to their business models, rather than being rigidly bound by each item, and apply them in a manner suited to their own value-creation scenarios. Consequently, it is assumed that the order and content of the items of the Guidance will be applied flexibly in accordance with individual companies’ circumstances and goals.

It is not appropriate to regard the Guidance as principles to be implemented independent of institutional requirements such as mandatory disclosure rules and the Corporate Governance Code and other disclosure frameworks that companies apply voluntarily. Rather, companies are expected to regard the Guidance as a means of systematically and comprehensively outlining the information that they should provide in response to disclosure requirements and/or in accordance with the circumstances of their communication and dialogues.

**【As a Guideline for Investors】**

Second, the Guidance is expected to serve as a guideline for investors in evaluating companies from a long-term perspective, making investment decisions, and conducting stewardship activities. While there are various types of investors in the capital markets, the Guidance is intended for institutional/individual investors who are interested in sustainable growth of corporate value. Instead of waiting for companies to provide the information with respect to the items in the Guidance, investors and analysts are expected to initiate dialogue with companies in order to obtain the...
information necessary for their investment decisions and remedy any information/perception gaps by referring to the Guidance.

The Guidance is also designed to be used as a framework for investors to monitor investee companies and conduct dialogue to fulfill their stewardship responsibilities. It is expected that the Guidance will not only be used when institutional investors engage in stewardship activities themselves, but also when asset owners hold dialogue with asset managers.

【As a Shared Language That Evolves through Practice】

In order for the Guidance to function as a shared language that enhances the quality of corporate disclosure and dialogue with investors, it needs to evolve through practical use.

As the Guidance is the first step toward enhancing high-quality dialogue, it is important to constantly review it in order to improve its content and explore better usage while identifying and analyzing companies’ good practices and investor assessments. In doing so, it is essential to avoid treating disclosure and dialogue, which are means to an end, as ends in themselves, and to maintain a focus on how companies can achieve sustainable value creation and how companies and investors can cooperate with each other to achieve the goal.

The drafting process of the Guidance took into consideration global inputs and other relevant frameworks. As Japanese corporate activities and shareholding structure are globalized, it is important to obtain feedback from stakeholders around the world in order to make effective use of the Guidance.
1. Values

01. When companies regard solving social issues as business opportunities and seek to establish unique missions while continuously pursuing competitive advantage amidst global competition, the values exemplified in corporate philosophies/principles and visions serve as the core principles for making decisions on future corporate directions and strategies.

02. By identifying the essences of the corporate philosophies that have supported their mission in society, companies can provide value while maintaining long-term perspectives and forward-looking attitudes without being content with the status quo. Having clear corporate philosophies and visions is also important for emerging companies, including startup companies, in generating social value and achieving growth.

03. Corporate culture directs business processes and priorities of management and employees. An important management challenge is cultivating a corporate culture that allows individual employees to act on their own initiative in ways supportive of the corporate philosophy and vision while ensuring that the culture is flexible and adaptive enough to address new challenges and business circumstances which may arise.

04. For investors with long-term perspectives, becoming familiar with values such as corporate philosophies, visions, and culture is important in understanding a company’s core principles for decision-making. This knowledge is also an important element in judging a company’s ability to execute their strategies and feasibility of business models. Explaining the linkage between corporate values and business models [2.] is the first step in allowing investors to appropriately assess corporate value.

1.1. Corporate Philosophy and Vision

05. Companies should explain the corporate philosophies which serve as the basis for their business models and management decisions. Companies should also explain how such philosophies are embodied in their corporate systems.

06. When doing so, it will also be beneficial if corporate managers and directors clearly define a management vision and indicate their priorities for both future directions for the company and issues to be tackled.
07. By understanding the future directions of companies and their prioritized issues, investors can appropriately evaluate corporate management strategies [4.] and key performance indicators (KPIs) and execution plans [5.] that indicate the timeframe for achieving KPIs.

1.2. Relationship with Society

08. Social issues which change with the times can become risks for companies as well as business opportunities. It is a crucial management decision for companies to identify social challenges as risks and opportunities based on corporate philosophies and vision, and also to incorporate these issues into their business models [2.] and strategies [4.].

09. When evaluating corporate value from a long-term perspective, it is important for investors to understand corporate philosophies and their relationship with society and how they link with companies’ competitive advantages and their business model [2.].

10. When companies identify social issues material to their businesses, it is beneficial to take into consideration the relationship with various stakeholders such as shareholders, employees, business partners, and local communities [2.2.] and relevant global frameworks, such as the Sustainable Development Goals (SDGs), which have identified shared and global social issues.
2. Business Model

01. A business model describes how companies generate value for customers and society and grow corporate value in a sustainable manner. Specifically, it refers to the sequence of processes whereby a company creates products and services using tangible and intangible resources as inputs and provides them to customers at prices commensurate with the added value.

02. A business model is not just an outline of a company’s business or profit-earning structure. A business model can be seen as a “model,” because it describes the systems and methods whereby the company establishes and maintains its competitive advantage as a blueprint for realizing the company’s values [1.]. Therefore, if companies have created clear business models, it suggests that they are likely to have higher levels of growth, profit margins, or capital efficiency over the long-term compared with their competitors.

03. For investors, the description of a company’s business model should include what the company does as a business, in which market or field it maintains a competitive advantage and holds an important position in the value chain, the value it provides through its business, and how it creates sustainable cash flow as a result. Therefore, the business model is the most important blueprint for investors in evaluating the company’s sustainable profitability.

04. The most important question for investors interested in the growth of a company’s corporate value is whether the company can be successful in the face of global competition. For investors to evaluate the feasibility of the business model from that viewpoint, they must understand the competitive environment of the market, the management resources and relationships with stakeholders essential for maintaining the competitive advantage, the main earning sources, and the profit-earning structure. Investors seek to identify these factors that drive the sustainable growth of corporate value (“drivers”).

05. When disclosing information or conducting dialogue with investors, companies should link important elements of their business model, including the items described below, into a value-creating scenario. In particular, when a company engages in multiple businesses, it is important to explain the rationale for selecting those businesses, the overall corporate business model, and the respective business models of the main businesses.
2.1. **Position in the Competitive Landscape**

06. In order to understand a company’s business model and evaluate the model’s feasibility, it is necessary to identify the value chain and competitive environment of the company’s main market, the company’s position in the value chain, and the differentiating factors that provide a competitive advantage.

07. For management, presenting their viewpoints and recognizing gaps between corporate and investor perspectives through dialogue is an important opportunity to review and revise their business models and strategies [4.]. In particular, it is beneficial for companies to know whether their assessments of sources of competitive advantages are regarded as such by the investors who compare multiple companies for these qualities.

2.1.1. **Position in the Value Chain**

08. What kind of value-add a company provides in the various processes ranging from upstream to downstream in the value chain constitutes the core of its business model.

09. Investors attempt to understand which of the various players in the value chain is setting the direction of the value chain by providing the greatest or most critical value-add, the influence and leadership that the company has, and whether there are ways of increasing its influence and leadership.

10. If a company communicates its view concerning these matters to the investors, it will increase their understanding. In doing so, it is important for the company to explain the sources of its products’ and services’ success in the market and with customers, rather than describing the detailed specifications of the products and services.

11. In the case of companies that provide products and services for business users, identifying both direct and final product consumers and the company’s specific value-add in the value chain will be useful for increasing investor understanding.

2.1.2. **Differentiating Factors**

12. In order for companies to create and maintain competitive advantages in the face of changes in the market and competition, it is important that their business models have factors that differentiate them from competitors.
13. In evaluating companies’ business models, investors require information concerning their competitive positions in the market and the future prospects, and in particular factors that differentiate the company from competitors. In this respect, it is important for companies to understand that what investors need is not classified information (which, if leaked, could put the companies at a competitive disadvantage), but an overview of the differentiation factors that enables investors to appropriately understand the business models.

2.2. Essential Elements for Ensuring Competitive Advantage

14. If companies identify the resources, assets/liabilities, and their relationships with stakeholders that are the key to maintaining their competitive advantages and enhance their efficiency by investing to maintain and strengthen these elements, the sustainability of their business models will improve.

15. When investors assess the future potential and sustainability of companies’ business models, it is necessary to understand those elements and how the companies intend via their corporate strategies [4.4.] to maintain and strengthen the elements through resource allocation and investment.

16. In particular, the greatest threat to company business models is their failure to consistently secure resources or losing available resources. For investors, how companies recognize and intend to deal with this risk is important information.

2.2.1. Management Resources/Intangible Assets

17. Companies that maintain competitive advantages and grow their corporate value in a sustainable manner possess essential management resources and assets for providing customers with unique value that cannot be easily acquired or emulated by competitors. Because the determining factor of companies’ competitiveness and sustainable profitability lies in securing and enhancing intangible assets such as human capital, technology, knowhow and intellectual capital, rather than physical expansion of equipment and facilities, appropriate evaluation of the intangible assets not listed in financial statements is crucial for corporate managers and investors.
18. Companies should identify the essential resources and intangible assets for maintaining their competitive advantages and communicate, together with their strategies [4.], the necessary investment (e.g., acquisition, resource allocation, and training) for developing and reinforcing those resources/assets. Companies should also comprehensively explain, together with their performance and the KPIs [5.], how those resources/assets contribute to value creation and sustainable profitability and within what timeframes and methods they evaluate the effect and efficiency of the investment based on objective facts. These efforts will promote appropriate evaluation of companies by investors.

19. Because essential management resources and assets should be regarded as facets of value-creation scenarios specific to individual companies, they should not be evaluated by a uniform standard. However, it will be useful for obtaining investors’ understanding if companies explain their competitive advantages keeping in mind the competitive environment in the business fields and sectors in which their businesses operate.

20. When doing so, it is important for companies to indicate how they recognize and plan to respond to risks/threats of infringement and disruption of their key resources/assets and reduction or elimination of their competitive advantages. For investors, appropriately assessing the impact of such risks/threats, together with the risk factors related to sustainability, such as ESG factors [3.], is critical for making long-term investment decisions and conducting stewardship activities.

2.2.2. Relationships with Stakeholders to Support Competitive Advantage

21. For companies to maintain competitive advantages and execute on their business models, it is essential to develop good relationships with various stakeholders, including suppliers, business partners, customers, local communities and public organizations. Companies should explain how their relationships with stakeholders should be and indicate how they are developing the relationships from a strategic perspective based on their values.

22. For evaluating the sustainability of business models [3.], information concerning relationships with the various stakeholders is also critical. In many cases, ESG information sought by long-term investors provides information on how companies view their relationship with society, including whether they view the relationship as a risk or an opportunity, and what actions they will take from a strategic perspective. Therefore, integrated explanation of these issues is important for sharing understanding with investors.
23. Furthermore, when there are not only stakeholders involved through formal contracts or business relationships but also stakeholders who support or collaborate with the company out of sympathy, it is beneficial for investors if companies indicate how they intend to maintain the relationships with this type of stakeholder.

2.2.3. Profit Structure/Drivers

24. When investors attempt to understand company business models, they pay attention to what factors ("drivers") generate earnings, leading to growth in returns, including revenues and profits, and whether those drivers will continue into the future. These drivers serve as a shared language in dialogue between companies and investors.

25. Investors look at drivers linked to profits and corporate value from various perspectives. For example, they evaluate increases in production volumes, product price increases due to increased value-add and cost reductions from the perspective of factors related to growth ("growth drivers," such as the market, demand trends, and convenience breakthroughs), factors that determine the supply capacity ("supply capacity drivers," such as production capacity, workforce, R&D, and technology), and factors related to profit margins ("margin drivers," such as pricing power, cost control capability, and the fixed and variable cost structure), as well as factors existing inside and outside of the company (internal and external drivers).

26. Therefore, when companies explain their business models and profit structures through dialogue with investors, it is beneficial if they bear in mind those drivers and link them with their strategies [4.] and financial results and KPIs [5.].
3. Sustainability/Growth

01. For companies to grow their corporate value in a sustainable manner, it is essential not only that they have clear business models but also that their business models are sustainable and have growth potential. To ensure that, companies must first identify factors that may pose a threat to the sustainability and growth of their business models.

02. Although many threats are risk factors for companies, they can also be important business opportunities. If companies overcome threats, they can gain sustainable competitive advantages. Sustainable growth requires companies to make continuous changes by responding to changes in business environments, and not just doing the same thing over a long period.

03. From a long-term perspective, a company’s relationship with society is critical and a prerequisite for its survival. Maintaining a positive relationship and providing value to society are of utmost importance, and will grow corporate value.

04. From this viewpoint, investors with long-term perspectives attach importance to ESG (environmental, social, and governance) factors. For investors, it is important to understand how companies understand the materiality of ESG factors to the sustainability of their business models and the ESG factors’ linkage with the growth of corporate value over the long-term, rather than looking at ESG in isolation.

05. In particular, institutional investors are required to understand the business risks and opportunities for investee companies and matters that may undermine corporate value from the perspective of fulfilling their stewardship responsibilities for their clients and beneficiaries. For instance, it is important for institutional investors to understand how ESG factors relate to and affect the business risks, opportunities, and corporate value.

06. When disclosing information or engaging in dialogue with investors, companies should identify the risks to the sustainability of their business, including the items described below, and explain how they intend to create value in a sustainable manner through their strategies [4.].

3.1. Recognition of ESG Factors

07. Particularly for investors with long-term perspectives, the importance given to ESG factors in evaluating their investments is growing. Such investors evaluate ESG factors to assess their impact on the sustainability of the business model and feasibility of strategies, rather than evaluating respective ESG factors in isolation.
08. The concept and scope of ESG factors vary widely. While some investors regard them as a source of excess return, most investors view them as risk factors over the long-term. Moreover, investors recognize that there are differences in nature between the environmental and social (E and S) factors, which are closely related to corporate sustainability, and the governance (G) factor, which is seen as a discipline and prerequisite for growing corporate value.

09. Therefore, companies should indicate the social and environmental factors material to their corporate value and business models over the long-term and risks to the continuation of their business and the impact. Companies should also explain their responses to the risks and strategies for turning the risks into opportunities [4].

10. When companies identify material ESG factors, keeping in mind the items widely recognized (e.g., in global frameworks or organizations) as major risk factors in their industrial sectors is useful for obtaining investors’ understanding. The objective is not merely to follow the framework and items recommended by various organizations. Companies should identify and explain the items to which they are committed, in consideration of the effects on their corporate value.

11. With respect to the governance factor, keeping in mind the issues described in the Governance section [6], it is important for companies to consistently execute strategies to implement their business models and earn investors’ trust that discipline and incentives work to grow corporate value in a sustainable manner under companies’ governance systems.

3.2. Relationships with Key Stakeholders

12. If a company is to maintain the sustainability of its business, it is necessary to maintain and strengthen its relationships with stakeholders [2.2.2.]. In particular, from a long-term perspective, if companies design business models that minimize conflicts of interest with stakeholders while supporting their shared interests, their social value will increase.

13. Investors believe that creating value for non-investor stakeholders also leads to the sustainable and stable provision of value to investors, so they are interested in how companies engage with key stakeholders and how they reflect the results of that engagement in their business.

14. Companies should communicate to their investors how they develop relationships with key stakeholders and what measures they implement in order to maintain the relationships based on their corporate values [1].
3.3. **Risk in a Changing Environment**

15. The business environment surrounding companies has become increasingly complex. The fact that companies are connected with the world through IoT (Internet of Things) and that their domestic businesses are affected by overseas events through supply chains increases the scope and impact of risks and uncertainties. How companies recognize and respond to such risks and uncertainties is important for their sustainability and growth.

16. The risks and uncertainties that should be taken into consideration by companies vary depending on the industrial sectors in which their businesses operate. In particular, the items described below are risks to be considered across all sectors.

3.3.1. **Speed and Impact of Technological Change**

17. With the progress of the Fourth Industrial Revolution, rapid technological evolution and market entry from various industries may pose risks to the competitive advantages or sustainability of companies. In particular, disruptive innovations created by competitors may mean risks that threaten the survival of a company.

18. Companies should communicate to investors how they identify and respond to such technological changes and timeframes of the impacts on their competitive advantages, linking these factors with their corporate strategies, including investment in R&D and human capital [4].

3.3.2. **Country Risk**

19. For companies conducting business globally, country risk is a factor that may significantly affect the sustainability of their business models. It is important for companies to identify and analyze material country risks to their business as part of their external environment and share the results and strategies based on that analysis with investors. Sharing analyses of companies and investors with respect to country risks will provide companies with insights and opportunities to test and review their hypotheses.
3.3.3. Cross-Border Risk

20. In a situation where companies’ businesses and their supply chains extend across multiple countries, responding to changes in local laws and regulations and to social responsibilities constitute both cost factors and long-term risk factors. Explaining and obtaining the understanding of investors on the significance of and response to these challenges, such as securing resilient supply chains, will contribute to the shared interests of stakeholders, including investors.
4. Strategy

01. The main objective of a strategy is to realize a sustainable business model by maintaining and strengthening companies’ resources, assets and relationships with stakeholders, which constitute sources of competitive advantage, and prepare for business risks. Companies can acquire growth potential through the execution of strategies, gain trust of stakeholders, including investors, and create shared value for the stakeholders.

02. Companies should communicate to investors their strategies to secure and reinforce management resources and other factors that underpin the competitive advantages of their business models to improve their position [2.1.1] in the value chain.

03. Companies should also explain to investors their strategies for ensuring sustainability of their business [2&3], including how they will incorporate social challenges (e.g., ESG) into their value creation process over the long-term and how they will develop relationships with stakeholders.

04. When doing so, it is important for companies to explain how they measure the success of strategies (performance and KPIs [5.]) and reflect these evaluations in future activities.

4.1. Improving Company Positions within the Value Chain

05. It is important for deepening investors’ understanding that companies indicate the goals of their strategies and explain how they secure and reinforce their resources, assets, and relationships [4.2., 4.3.]. Explaining their strategies of investment and business portfolios [e.g., 4.4.] in a consistent manner is also important.

06. For example, strengthening the influence and leadership in the value chains [2.1.1.] on which the business models rely is an important strategic goal.

07. If companies provide an overview of strategies to maintain or change their position in the value chains, and whether they have proper systems to execute such strategies, investors can understand the companies’ resilience against changes in the environment, which is a factor essential for making investment decisions from a long-term perspective, and appropriately evaluate their business models and strategies.
4.2. **Securing and Enhancing Management Resources and Intangible Assets**

08. Important elements of corporate strategy include the strategic investment to secure and develop resources and intangible assets that constitute the source of their competitive advantages [2.2.1.] and the deployment of the resources/assets to provide value to customers and grow corporate value in a sustainable manner.

09. Indicating the expected timeframes and the methods for evaluating strategies in the context of KPIs [5.] is important for allowing investors to assess corporate strategies and execution capability.

10. On company balance sheets strategic spending on intangible assets are not recognized as assets, so strategic investment in those assets to grow corporate value over the long-term is treated as expenses for the current expenditure. Moreover, disclosure concerning intangible assets is not always linked with companies’ business models and business portfolios/segments. Therefore, investors may regard strategic investment in intangible assets merely as inefficient expenditures that reduce profits. Investment in tangible assets (e.g., equipment and facilities) recognized as assets on the balance sheet is not necessarily explained in relation to the business model or strategy either.

11. Therefore, in order for investors to appropriately evaluate strategic long-term investment by companies, description of the scale and contents of such investments and their contribution to sustainable value creation is important. Communicating that information with qualitative/quantitative data together with the benchmarks and methods for evaluation is also useful. In this respect, “capitalizing” such investment (expenditure) with the life of the investment generating cash flow is useful information for investors to assess the return on investments.

12. Indicating alternative measures to be taken in the event that key resources or assets are lost, such as making up for the loss with other resources/assets, is also important for gaining the trust of investors.

13. Strategic investment in key management resources and intangible assets varies by business field and industrial sectors. Companies may refer to the following elements and incorporate them into their communication with investors.
4.2.1. Investment in Human Capital

14. The fundamental element that supports a company’s competitive advantages and innovations is human capital. Therefore, how companies recognize and invest in human capital, including acquisition, training, and utilization, and how they evaluate the contributions of such investment to their corporate value, is critical.

15. For investors, corporate policies for acquisition, motivation, education, and training of human capital in different layers, including top/middle managers, researchers/professionals, and rank-and-file employees, and resource allocation and methods used (e.g., processes and evaluation systems) with respect to these activities is important information for evaluating long-term corporate value.

16. With respect to securing, selecting, and training top managers, companies should indicate processes, remuneration systems, career backgrounds, and experiences in relation to governance [6.] in accordance with the roles expected of the managers. When doing so, it is also important for companies to clarify what capabilities and attributes they require top managers to possess and how they intend to ensure the diversity of the management team based on their values [1.] and business model [2.].

17. The presence of key personnel linked to companies’ competitive advantages, such as researchers and professionals, and measures for hiring and training such personnel are important information for investors. How companies motivate employees and exploit their capabilities in order to increase productivity and quality of engagement (including work style reform) is also important information for investors.

18. In accounting terms, investment in acquiring and training personnel is often hidden among current expenditures in the form of training expenditures, compensation, or other items. Measuring the effect of investment in human capital is of utmost importance for management and also useful information for investors.

4.2.2. Investment in Technology (Intellectual Capital)

19. Technology in the broad sense of the term, i.e., intellectual capital, is a source of both differentiation and competitive advantage for companies. Turning tacit knowledge such as skills and knowhow into explicit knowledge throughout the business processes, including R&D, business development, production, distribution, sales, and service provision, in order to create innovation is an important management challenge for companies.
20. In order to evaluate their competitiveness, companies need to understand whether and to what extent their technology is superior to those of competitors. If their technology is currently inferior, how the company intends to overcome the disadvantages and at what speed, are also important information for investors to evaluate companies’ strategies.

21. It is beneficial for investors to understand companies’ technologies if companies provide various opportunities for communicating with investors such as factory tours or technology seminars in addition to general information disclosures.

22. The technology/intellectual capital of companies varies depending on the business field and industry. Described below are important points for corporate disclosure and dialogue with investors regarding R&D and IT/software investment, which concern many companies.

4.2.2.1. R&D Investment

23. Developing a strategy that connects R&D investment to competitive advantage and creates intellectual assets that contribute to the sustainable growth of corporate value is an important challenge for the managers/directors of companies. Investors need to understand this in evaluating company’s value creation capacity from a long-term perspective.

24. On the other hand, it is difficult to objectively evaluate how R&D investment contributes to profitability and corporate value (i.e., R&D efficiency) for various reasons: the causal relationship is complex, because a typical research project leads to multiple development programs; basic research does not directly lead to product development; and generating earnings takes a long time.

25. The focus of attention for investors when they evaluate a company’s R&D investment is how the investment is positioned within its business model. For example, it would be beneficial if companies disclosed not only the total amount of R&D expenditure but also R&D expenditure by segment and provided objective data that indicate the market viability of their R&D, possible changes in their position(s) in the value chain, and the source of their advantages (e.g., the specialties and number of researchers). Information on the useful life of R&D is also informative for investors’ evaluation.

26. Concerning patents and licenses acquired as a result of investment, investors focus their attention not only on the numbers of patents, etc., but also on their quality in terms of whether they are useful in creating barriers to entry for other companies.
27. These information items are generally monitored by companies and are often disclosed in some way or another. The focus of attention for investors is not classified information that may affect the competitive conditions of companies, but how companies position the information items under their business models and strategies, and from what viewpoint and based on which facts performance is evaluated.

28. Moreover, R&D investment is also an important element from the viewpoint of either creating or responding to the disruptive/discontinuous innovations mentioned in 3.3.1. By definition, such innovations are difficult to evaluate at the investment stage. However, it is beneficial for investors if companies explain the importance of the social challenges and markets that underlie their R&D fields and directions, specific targets for generating earnings, and unconventional organizational structures and methodologies used to create such innovations.

4.2.2.2. IT/Software Investment

29. The Fourth Industrial Revolution has created a situation where the introduction of IT systems and development and integration of software programs should be treated not only as a business cost but also as part of the intangible asset investment that constitutes a source of a company’s growth and competitive advantage. It would be beneficial if companies shared objective facts and evaluation methods with respect to how their investment enhanced their technological superiority and within what period of time they expect to start generating earnings under their business models.

4.2.3. Investment in Brand and Customer Loyalty

30. Corporate brands and customer bases represent the trust in companies and their products and services that has been gained through their past activities. Considering what investment to make in order to develop and enhance brands and customer bases, which are intangible assets, is a strategic investment decision.

31. Although the asset value of brands and customer base does not appear on the balance sheet, their value declines if nothing is done to maintain or grow them, as with the value of equipment. From that viewpoint, some companies evaluate how much the brand value declines each year and report the amount of investment intended to make up for the decline.
32. There are different views of brands and customer bases between corporate managers and investors. While corporate managers tend to believe that these values are difficult to quantify, investors consider that the value should somehow be quantified. For example, investors assume that a company’s brand superiority is reflected in their profitability through their pricing power and their influence in the value chain. Investors also believe that the development of customer bases and customer loyalty leads to reduced expenditures in sales activities, improvements in contract renewal rates for contract-based services, and decreases in the costs of obtaining new customers or preventing contract cancellations.

33. Therefore, it would be effective in deepening the understanding of investors if companies showed that they are measuring and monitoring those effects, by sharing strategic objectives that incorporate the effects of those investment and activities intended to maintain the superiority of their brands and customer bases.

4.2.4. Organizations

34. Deciding how companies are organized and operated is one of the most important management decisions. Reorganization indicates both management’s recognition that existing business models cannot adapt to changes in the competitive environment and their intention to develop new business models.

35. For investors, verifying the objectives and process of a company’s reorganization, its relevance to their strategies, the organization’s decision-making/operational processes, and the relevant KPIs, are important issues.

36. It is beneficial for investors if companies explain their views concerning the above items and continuously show the results of reorganizations together with the progress of the KPIs [5.].

37. How companies develop and enhance their relationships with business partners or their franchises in the value chain and how they establish production and supply systems, including distribution systems, are also important elements of corporate strategies.

38. In particular, for companies whose supply chains, including group companies, are the source of their competitive advantages, strategies for maintaining resilient supply chains is information that investors should obtain and understand.
4.2.5. Investment to Accelerate Growth

39. Strengthening business models and accelerating growth by forming alliances with or acquiring companies with desirable technologies, networks, or human capital and investing in resources and intangible assets, are important strategies for companies.

40. Facing rapid technological evolution and change, companies are expected to explain to investors how they intend to complement and enhance their competitive advantages through open innovation and M&A in relation to their business portfolio [4.4.1.]. It is also important to explain the governance structure with respect to business divisions and subsidiaries, including monitoring systems to be developed after the acquisition and the division of responsibilities with alliance partners.

4.3. Strategy for ESG Integration

41. How companies manage risks related to ESG challenges that they have identified and integrate measures to mitigate any impacts on their strategies is valuable information for investors.

42. It is essential for companies to indicate within their strategies whether/how they recognize ESG factors not only as risks/threats but also as opportunities to strengthen their business models. Strategic investments and resource allocation to this end is also important information.

43. For companies conducting global business activities in particular, it is useful to keep in mind creating “shared value” (CSV), meaning that a company’s efforts to grow its corporate value in a sustainable manner contributes to the resolution of societal challenges. One of the frameworks identifying global societal challenges is the Sustainable Development Goals (SDGs) and companies may prioritize their activities, taking into account the SDGs, based on their corporate philosophies [1.] as well as their assessment of the social and environmental impact of their business operations.

44. Referring to frameworks concerning globally recognized societal challenges is useful for promoting global investors’ understanding of their activities and promote constructive dialogue with them. Engaging in global discussion and dialogue may also allow companies to recognize previously untapped and unnoticed advantages and value they possess.
4.4. Capital Allocation Strategy

45. Growing corporate value in a sustainable manner by optimizing management resources and capital allocation, including investment in tangible and intangible assets, is an important decision for corporate managers/directors.

46. In order to optimize resources and capital allocation, it is important for companies to monitor and evaluate the contribution of respective investment to the growth of their earnings and corporate value over the long-term [2.].

47. For investors, it is important to understand not only companies’ investment decisions concerning individual resources/assets [e.g., 4.2] but also how they develop the business portfolios and link respective resources and assets under their overall strategies.

4.4.1. Business Portfolio Management, including Exit Strategies

48. In order to encourage investors to support corporate strategies and make long-term investments, it is important for companies not only to steadily execute their strategies but also to clearly communicate their business portfolio management, including strategies for M&A and business exit (e.g., sale of business operations).

49. As the resources possessed by individual companies are limited, investors attach importance to management decisions on exiting businesses that are not expected to contribute to the growth of corporate value, while allocating resources to priority businesses for the purpose of securing and maximizing management options and freedom. By explaining their long-term strategies, including their approach to business portfolio management and its relationship with governance [6.], companies gain the trust of investors.

4.4.2. Measuring Intangible Assets and Monitoring Investment Returns

50. Failing to appropriately recognize and quantify the value of intangible assets in the same manner as tangible and financial assets could impede the optimization of resource and capital allocation (insufficient or excessive investment) by companies. In particular, in order to “capitalize” investments (expenditures) in intangible assets that grow corporate value over the long-term, it is necessary to introduce appropriate timeframes and methods of measurement. If the contribution of investments to corporate value is properly evaluated, it will be useful in formulating and executing strategies and increasing the understanding of investors for these underlying investments.
51. In the food and daily products industries, for example, there is an initiative to improve profitability by optimizing expenditures on product brands, sales promotion, and advertisement. For example, one company is dividing products into groups based on brand superiority, reducing the sales promotion expenditures per group and allocating the cost savings achieved to advertising expenditures for superior brands.

52. For companies, continuously monitoring and demonstrating the results of investments is important in enabling investors to engage in dialogue with the companies and to evaluate companies’ strategies for resource/capital allocation based on shared understanding of timeframes and perspectives.
5. Performance and Key Performance Indicators (KPIs)

01. Discussing plans for the next 100 years without demonstrating past achievements does not gain the trust of investors. If companies want to attract investors they must first demonstrate the economic value they have created and indicate how corporate managers analyze and evaluate their financial performance.

02. From this perspective, it is beneficial for companies to set key performance indicators (KPIs) as benchmarks for growing corporate value throughout their businesses and as a yardstick to measure the achievement of their objectives and share the KPIs with investors. Setting KPIs and sharing evaluations of progress on specific objectives is important for companies to enhance their accountability to investors and gain their trust.

5.1. Financial Performance

03. Sustainable growth of companies can be realized by achieving performance (cash-on-cash return) above the cost of capital over the long-term. Investors can make long-term investments in companies in expectation of sustainable value creation.

04. Therefore, how management evaluate and analyze the result of their value creation, business performance and financial circumstances, in the process of executing the strategy for growth of corporate value, is an important element that investors take into consideration.

5.1.1. Management Discussion and Analysis (MD&A)

05. Companies can review their existing business models and strategies and the business environments that have affected the models and strategies by analyzing and evaluating current financial conditions and business performance (e.g. financial results for the current fiscal year).

06. It is beneficial to use the review as an opportunity to revise strategies and set effective and appropriate KPIs.

5.1.2. Creation of Economic and Shareholder Value

07. When companies aim to grow their corporate value over the long-term, they should review the economic/shareholder value that has increased and communicate the results to investors. For example, they should indicate the total shareholder return (TSR; the increase/decrease in the share price plus dividends) if investors had possessed their shares over the past five to ten years and how shareholders who made long-term investments in the companies have been rewarded.
08. Analyzing corporate outcomes, including business strategies, investments made and the cash flow and profit generated thereby, is important for enhancing the effectiveness of future strategies and gaining the trust of investors.

5.2. **Setting Strategic KPIs**

09. Although sharing KPIs with respect to the creation of overall corporate value, such as ROE (Return on Equity) and ROIC (Return on Invested Capital), is beneficial, those KPIs alone are not sufficient to convince investors to invest in a company, because it is difficult to grasp the linkage between specific actions companies intend to take and those KPIs.

10. Therefore, companies should formulate forward management plans in line with their own strategies [4.] and set company-specific quantitative/qualitative KPIs in order to monitor the progress of the plans.

11. As changes to KPIs can be regarded as significant revisions to strategy, companies are expected to explain the reason for these changes to investors.

5.3. **Designing Linkages between Corporate Value Creation and Specific KPIs**

12. In some cases, the linkage between company-specific KPIs and more general KPIs that relate to corporate value (e.g., ROE, ROIC) can be difficult to discern. For example, if the company-specific KPIs are too detailed, investors may find it difficult to understand and evaluate them.

13. Therefore, companies should set KPIs in such a way that the breakdown of more general KPIs can be linked with the company-specific KPIs, or in such a way that the total results expressed through the individual KPIs can lead to the more general KPIs.

14. If companies provide such a structure of the KPIs, investors can monitor and evaluate the performance in light of company-specific KPIs and understand them in relation to other information items, including organizational design and outcomes, performance evaluations, and remuneration.

5.4. **Awareness of Cost of Capital**

15. Fostering awareness of KPIs for the creation of corporate value and communicating strategies that ensure a return greater than the cost of capital in making corporate investment decisions is important for gaining high regard from investors.
16. Cost of capital refers to the rate of return expected by the market. While “weighted average cost of capital” (WACC) is a quantitative measure that takes the weighted average cost of a company’s equity capital and debt capital, there is no absolute definition of a company’s cost of capital. It is important for companies to recognize the variety of factors that underpin a company’s cost of capital, including the trust and expectations of investors, and communicate their views on their cost of capital as part of their awareness of their creation of economic and shareholder value.

5.5. Progress Evaluation

17. After the establishment of KPIs, reporting to investors on the status of KPI achievement is important. In particular, if companies fail to achieve KPI targets, explaining the reason for failure in reference not only to the business environment but also to their business models and strategies is important for obtaining investor understanding.

18. It is beneficial for companies to refine their strategies on an ongoing basis through dialogue with investors in order to reduce their susceptibility to the business environmental and to develop a PDCA (plan-do-check-act) cycle to strengthen their management capabilities. For investors, it is important to understand KPIs and companies’ underlying strategies to increase their confidence in companies.
6. Governance

01. It is imperative for investors that companies steadily execute the strategies that underpin their business models [4.] and possess appropriately functioning governance systems that exert discipline to grow corporate value in a sustainable manner. By confirming the functioning of corporate governance, investors can trust and invest in companies with confidence.

02. Companies should clearly communicate the effectiveness of their governance systems through information disclosure and dialogue with investors with particular reference to the items described below.

6.1. Ensuring the Strength of the Board

03. For investors, the sustainability of companies’ governance systems is an essential data point in making investment decisions. Investors focus their attention on whether companies elect top management/directors suitable for resolving challenges in the execution of corporate strategies, whether performance-based evaluation is conducted, and whether appropriate governance systems can be continuously ensured.

04. Companies should share management priorities and major challenges with investors and indicate the qualifications for top management that are necessary for resolving challenges, together with the systems for electing and fostering qualified managers and clear succession plans. Companies should also demonstrate that their board of directors is capable of ensuring such systems.

6.2. Skill and Diversity of CEOs and Senior Executives

05. Investors expect that the top management ultimately responsible for the business (the president/CEO responsible for making management decisions, inside directors/executive officers responsible for executing business plans) possess the required qualifications and capabilities for steady execution. Furthermore, investors consider it important that companies ensure a sufficient diversity of attributes, experiences, and other elements are present in the board and executive team so that they can exercise their roles as a unit, and that a highly transparent and objective decision-making process exists.

06. Companies should provide information concerning the qualifications of the board and executive team with investors and effectively use feedback gained through dialogue with investors.
6.3. **Skill and Diversity of Non-Executive Directors**

07. Investors expect that directors mainly responsible for supervision of business execution (i.e., non-executive directors) hold an independent and objective position and a will to act with independence and objectivity from the viewpoint of securing general shareholders’ interests. Furthermore, investors expect individual non-executive directors to have sufficient capabilities and experiences to allow them to discuss with executive directors on an equal basis. Further, non-executive directors are expected to act and contribute to monitoring conflicts of interest with general shareholders by ensuring diversity of expertise among non-executive directors.

08. Companies should provide information concerning the career backgrounds and attributes of non-executive directors and the roles that they have actually played. As necessary and appropriate, non-executive directors should also be involved in dialogue with investors.

6.4. **Monitoring Strategic Decisions**

09. Investors often insist that highly competent directors who represent the shareholders appropriately supervise/monitor and evaluate strategic decisions by top management. Companies should explain the supervision and evaluation systems and the results of monitoring.

6.5. **Shareholder Return Policies**

10. For investors, shareholder return is an essential source of income, and a company’s shareholder return policy will affect investment decisions. Companies should therefore communicate their shareholder return policy to investors.

6.6. **Compensation Policies**

11. When evaluating companies, investors take into consideration how executive remuneration is linked to a company’s management strategies and performance, rather than the remuneration amount alone.

12. Companies should communicate the design of the remuneration system, including the relationship between remuneration and corporate performance and KPIs [5.] to investors. It is also important for companies to make efforts to obtain investor understanding and trust in terms of executive remuneration and its contribution to the growth of corporate value.
6.7. Reviewing Board Effectiveness and Identifying Priority Issues

13. Investors hold the board of directors responsible for its decision-making and objective evaluation of whether its past board decisions were effective. Companies should inform investors of the results of board evaluations and the challenges to be tackled in order to improve the effectiveness of the board.