経済産業省
Ministry of Economy, Trade and Industry

Guidance for Collaborative Value Creation

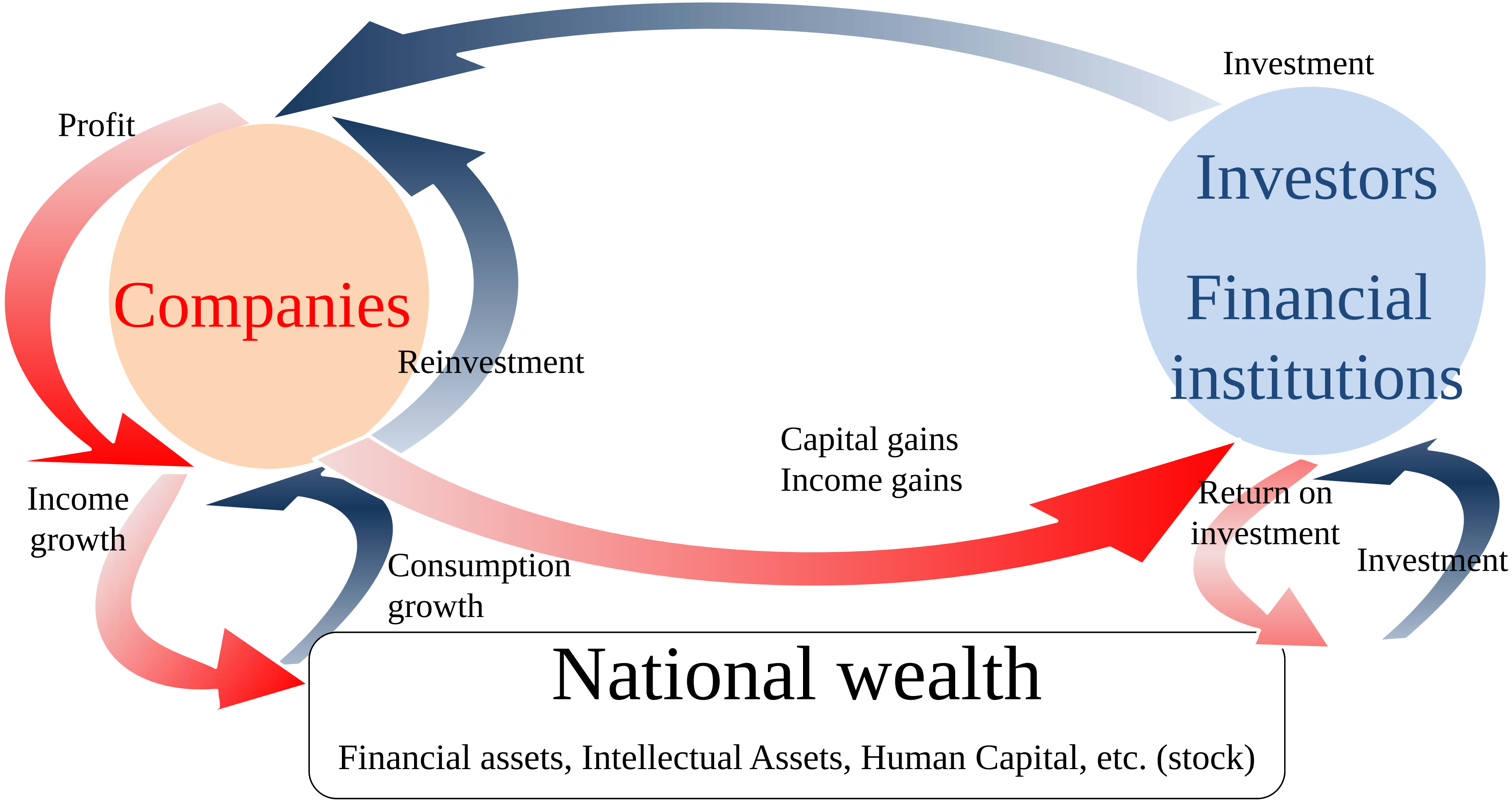
May 29, 2017
METI
(Ministry of Economy, Trade and Industry)

1. Optimization of the investment chain

As Japan faces a rapid aging of society and population shrinkage, it is essential **to grow its national wealth over the long term by enhancing capital efficiency concerning various "capitals" (financial, human, intellectual capital, etc.)** that are available only in limited amount.

Creation of a virtuous cycle and **sustainable growth** through **the overall optimization of the economy's investment chain(*)** is crucial. In such an investment chain, companies deliver sustained value creation and generate returns on long-term investments by enhancing their **earning power**.

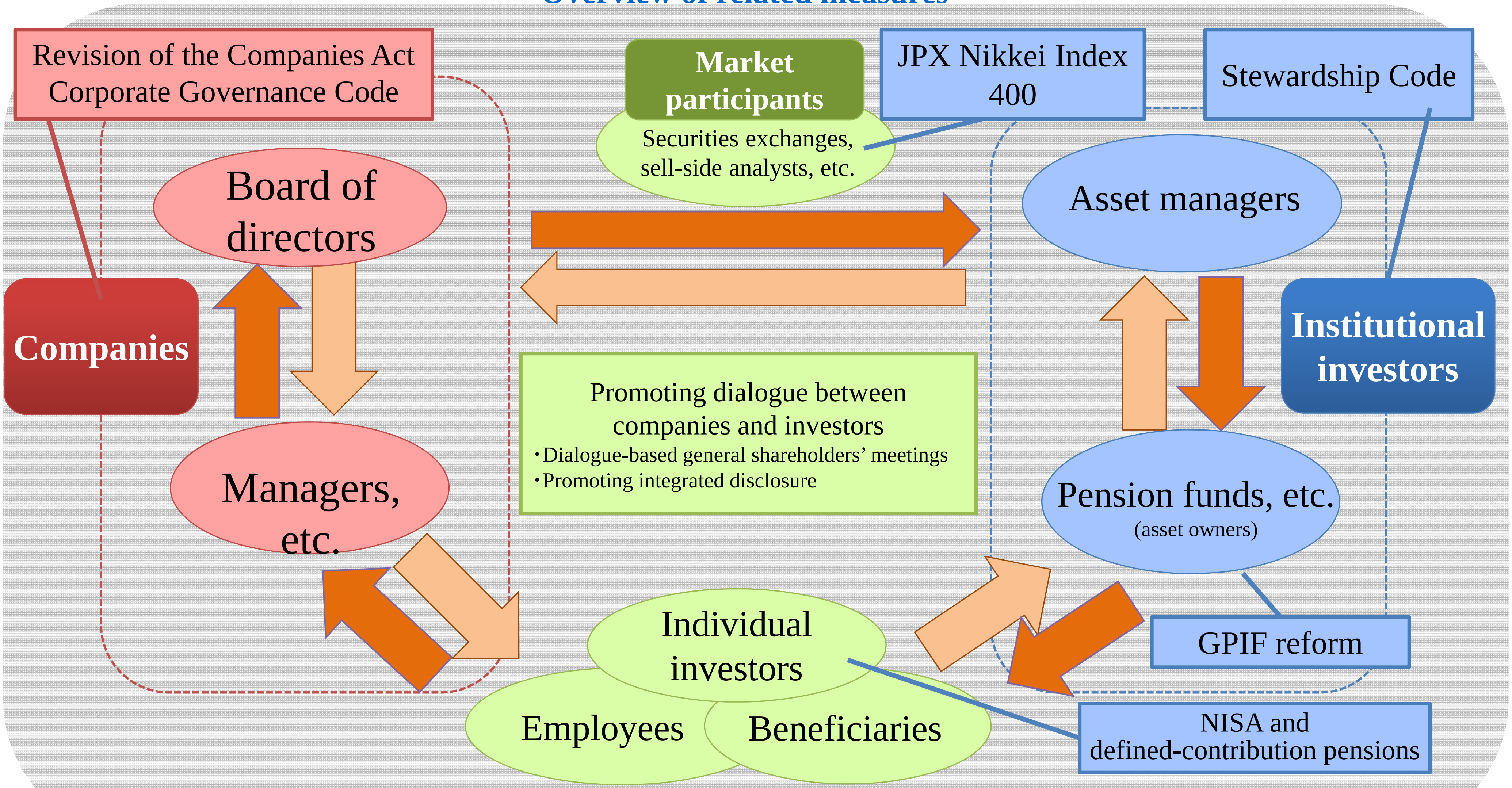
(*) The "investment chain" refers to the various paths and processes of capital flowing from its providers to the companies that allocate it to business activities.



2. Overview of measures related to the investment chain

In order for companies to enhance their earning power and deliver sustainable corporate value creation, it is important to **ensure that appropriate governance exercised** and to **encourage constructive dialogue between companies and their investors**.

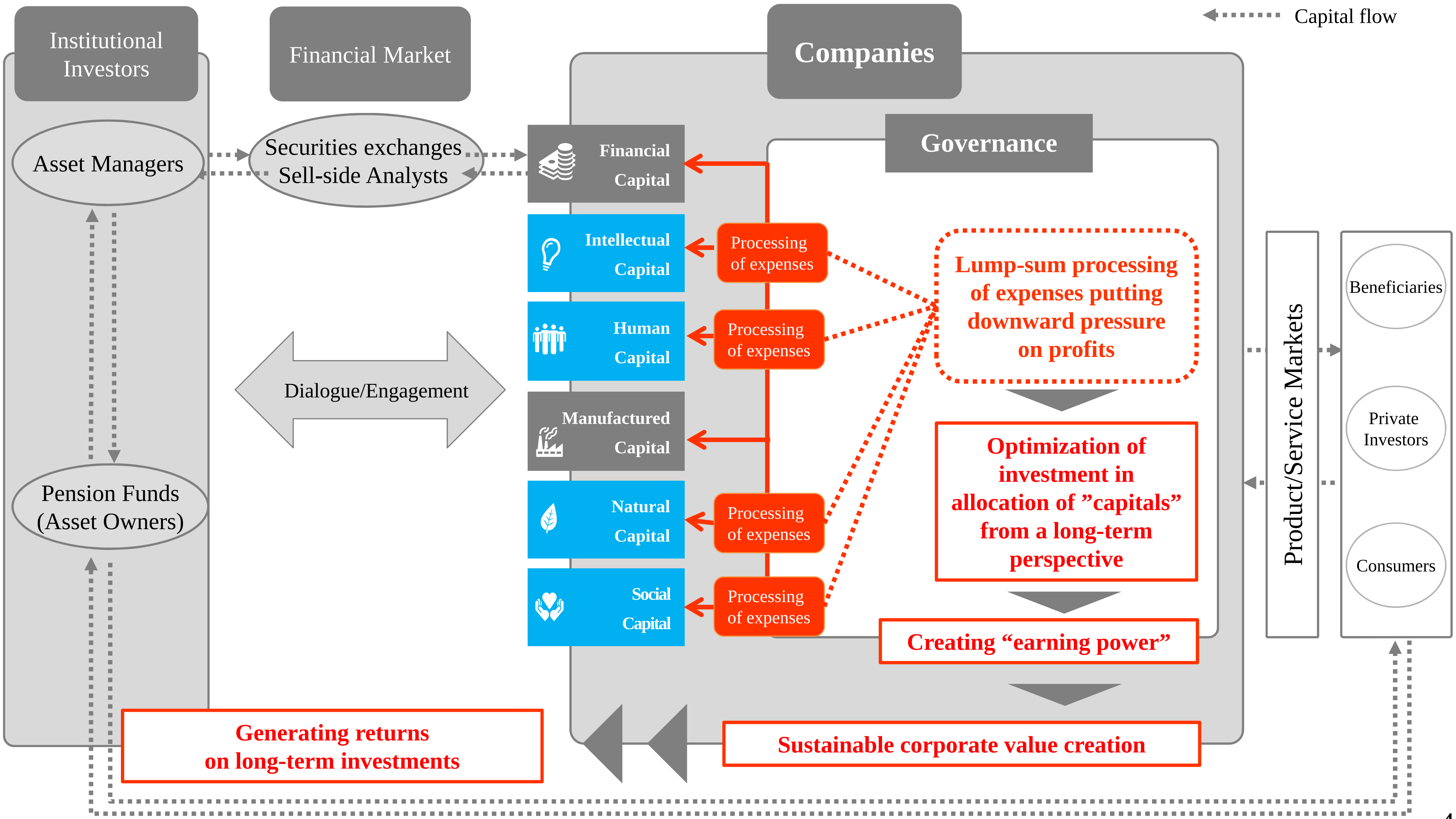
<Overview of related measures>



Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationships between Companies and Investors Project (Ito Review)

3. Corporate investment in the investment chain

It is pointed out that strategic investment in intangible assets and efforts involving ESG factors are recognized as expenditures which drive profits downward in the short term.
For creating corporate value, corporate governance, optimization of investments in allocation of various types of capital based on long-term strategies.



4. Establishing a study group based on the Japan Revitalization Strategy 2016

Japan Revitalization Strategy 2016

(i) Strengthening the initiatives that promote effective governance reform

A) “Promoting sustainable corporate value creation and mid/long-term investment”

Not only from the standpoint of promoting investments based on ESG (environment, society and governance) factors, the Government will also consider **the way in which corporate management and investments creating sustainable corporate value should be and how such value should be evaluated,** and **the mechanism of governance** facilitating the optimization of investments in human, intellectual, manufacturing and other capital resources based on **long-term management strategies, and how managers should make investment decisions and how investors should evaluate those decisions, as well as how information should be provided,** and **reach conclusion** on what policy measures the Government should take to encourage optimization of investments **by the end of this fiscal year.**

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The Study Group on Long-term Investment (Investment Evaluating ESG Factors and Intangible Assets) was established at the Ministry of Economy, Trade and Industry (*) in August 2016.

(*) The Financial Services Agency and other entities are participating in the group as observers.

5. Study Group on Long-term Investment (Investment Evaluating ESG Factors and Intangible Assets)

Based on the Japan Revitalization Strategy 2016, the Study Group examined management decisions, governance systems, investment decisions by investors, and information sharing that optimize investment in human and intellectual capital, etc. as measures to promote sustainable corporate value creation and mid/long-term investment and conducted a study on measures that will optimize investment.
The Study Group **held the first meeting on August 24, 2016** and has held monthly meetings since then. **The ninth meeting was held on May 25, 2017.**

Kunio Ito	Professor, Graduate School of Commerce and Management, Hitotsubashi University ※Chairman	Izumi Kobayashi	Board member, International Integrated Reporting Council (IIRC)
Toshio Arima	United Nations Global Compact Board Member/Executive Advisor, Fuji Xerox Co., Ltd.	Hiroki Sampei	Head of Engagement, Fidelity International, Japan
Satoshi Ando	Director, OMRON Corporation	Megumi Suto	Professor, Graduate School of Business and Finance, Waseda University
George Iguchi	General Manager of Equity Investment Department / Head of Corporate Governance, Nissay Asset Management Corporation	Mitsuru Takahashi	Director of the Board, Corporate Executive Vice President, Chief Financial Officer, Fuji Heavy Industries Ltd.
Yuko Ichikawa	General Manager, Investor Relations Department, Rakuten, Inc.	Keisuke Takegahara	Executive Officer, Deputy Chief Research Officer, Development Bank of Japan Inc.
Akitsugu Era	Vice President, Head of Investment Stewardship, BlackRock Japan Co., Ltd.	Daisuke Hamaguchi	Chief Investment Officer, Pension Fund Association, Japan
Yuri Okina	Vice Chairman, The Japan Research Institute, Ltd.	Yasuhito Hirota	Member of the Board, Executive Vice President, Corporate Functional Officer, Mitsubishi Corporation
Kazushige Okuno	Managing Director (CIO), Norinchukin Value Investments Co., Ltd.	Noriyuki Matsushima	Chief Research Advisor, Equity Research Department, Equity Research Division, Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
Toshiaki Oguchi	Representative Director, Governance for Owners Japan KK	Hiromichi Mizuno	Executive Managing Director and Chief Investment Officer, Government Pension Investment Fund, Japan
Tetsuya Kikuta	Executive Officer, Chief General Manager, Investment, The Dai-ichi Life Insurance Company, Ltd.	Tsutomu Miyagawa	Dean and Professor, Faculty of Economics, Gakushuin University
Masaharu Kubo	Representative Director Member of the Board, Executive Vice President, Mitsui Chemicals, Inc.		

＜Observers＞The Financial Services Agency (FSA), the Ministry of the Environment (MOE), Japan Exchange Group, Inc., and Japan Business Federation（KEIDANREN）

6. Direction of policy study concerning information disclosure and dialogue between companies and investors

Importance of long-term investments by companies and investors and challenges concerning Japan's information disclosure system

- As a **source of competitiveness** that enables companies to create sustained corporate value under the Fourth Industrial Revolution is a robust business model and a strategy for connecting the model to sustainable growth, it is important for **corporate management to measure strategic investment** not only in tangible assets but also **in intangible assets**, such as human resources, technology and knowledge. It is also important to **appropriately explain the value of these management strategies in order to attract long-term investors.**
- However, (i) Japanese corporate information disclosure methods, which also communicate value to investors, are inconsistent between companies, and (ii) there are complaints about a lack of disclosure concerning information on management strategies and non-financial information on ESG and other matters, which are often the bases for long-term investment decisions.
- In order to develop an environment that realizes **the most effective and efficient methods of international disclosure of information items to which long-term investors attach importance**, efforts will be made to simultaneously **(i) improve the efficiency of the disclosure system** and **(ii) enhance disclosure of information relevant to assessment of long-term corporate value, improving the understanding of institutional investors and the quality of their dialogue with the companies, thereby increasing corporate earning power**.

Revision of the information disclosure system

Standardization
- Identifying similar items contained in securities reports and business reports and implementing standardization

Rationalization
- Increasing the freedom of information disclosure by streamlining disclosure items—by consolidating some items and abolishing others

Integration
- Permitting companies to combine securities, business and other reports into a single document
- **Enhancing disclosure of non-financial information items** to which long-term investors attach importance

"The most effective and efficient disclosure internationally"

Enhancing disclosure in a manner reflecting the Guidance

Study by the Study Group on Long-term Investment

Releasing the Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation (Collaborative Value Creation Guidance)

- **Releasing the Guidance** which serves as a reference for how companies should both disclose information and engage in dialogue with investors in order to create value over the long term
  - A framework under which companies can present and explain information that should be taken into consideration, such as business models, sustainability and growth potential, strategy, performance and KPIs, and governance, under a value-creation scenario

Specific actions

Companies

Information disclosure and dialogue based on the Guidance
- Deepening understanding through advanced examples of information disclosure (publishing best practices)
- Promoting effective and efficient disclosure of non-financial information
- Raising awareness of and distributing and disseminating the Guidance (holding symposiums, etc.)

Investors

Dialogue and Assessment of Companies based on the Guidance
- Institutional investors develop governance systems and asset owners assess asset management institutions, taking stewardship responsibilities into account
- Consideration, development and dissemination of investment formats that simultaneously achieve sustainable corporate value creation and an increase in investment returns over the mid/long term

Development of infrastructure
- Enhancing surveys and statistics (identifying the value and contents of and future prospects for investment in intangible assets through statistics)

Promoting long-term investment and high-quality dialogue and engagement by companies and investors ⇒ **Promoting sustainable corporate value creation and long-term investment**

7. Overview of the Guidance

Values — Business model — Sustainability/growth — Strategy — Performance and key performance indicators (KPIs) — Governance

Recognition of business environment

1.1. Corporate philosophy and vision

1.2. Relationship with society

2.1. Position in the competitive landscape
- 2.1.1. Position in the value chain
- 2.1.2. Differentiating factors

2.2. Essential elements for ensuring competitive advantage
- 2.2.1. Management resources/intangible assets
- 2.2.2. Relationships with stakeholders to support competitive advantage
- 2.2.3. Profit structure/drivers

3.1. Recognition of ESG factors

3.2. Relationships with key stakeholders

3.3. Risk in a changing environment
- 3.3.1. Speed and impact of technological change
- 3.3.2. Country risk
- 3.3.3. Cross-border risk

4.1. Improving company positions within the value chain

4.2. Securing and enhancing management resources and intangible assets
- 4.2.1. Investment in human capital
- 4.2.2. Investment in technology (intellectual capital)
  - 4.2.2.1. R&D investment
  - 4.2.2.2. IT/software investment
- 4.2.3. Investment in brand and customer loyalty
- 4.2.4. Organizations
- 4.2.5. Investment to accelerate growth

4.3. Strategy for ESG integration

4.4. Capital allocation strategy
- 4.4.1. Business portfolio management, including exit strategies
- 4.4.2. Measuring intangible assets and monitoring investment returns

5.1 Financial performance
- 5.1.1. Management discussion and analysis (MD&A)
- 5.1.2. Creation of economic and shareholder value

5.2. Setting strategic KPIs

5.3. Designing linkages between corporate value creation and specific KPIs

5.4. Awareness of cost of capital

5.5. Progress evaluation

6.1. Ensuring the strength of the board

6.2. Skill and diversity of CEOs and senior executives

6.3. Skill and diversity of non-executive directors

6.4. Monitoring strategic decisions

6.5. Shareholder return policies

6.6. Compensation policies

6.7. Reviewing board effectiveness and identifying priority issues

Reference (1) Summary of the Ito Review (*)

"Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationships between Companies and Investors" Project
Published in August 2014 by the Ministry of Economy, Trade and Industry.

Fundamental concerns and current status	Proposals and recommendations
A paradox of long-term low profitability ● Low profitability persisting despite Japan's capacity to innovate ● The limitations of the practice of "double standard management," which refers to the use of internal management metrics that differ from metrics used in the markets ● Concerns over the "short-termism in Japanese corporate management," which results from insufficient policy for capital efficiency and long-term value creation	**Toward simultaneous realization of innovation and high profitability** ● Sustainable value creation through "collaborative creation" by companies and investors ● Shift to capital efficiency-focused management to raise corporate value • Awareness of capital costs • Strengthening CFO role • Japanese-style ROE-focused management, which adopts a mid/long-term increase of ROE as a management goal
Japan: a country lagging in asset investment due to the absence of long-term investors ● The shallow foundation of long-term investors to support corporate value creation ● Incentive structures that encourage the short-termism that is characteristic of the Japanese market ● Low confidence in analysts' ability to assess corporate value	**Toward overall optimization of the investment chain** ● Changing incentive structures for asset managers and analysts ● Shifting from passive investment to selection of stocks based on in-depth analysis ● Developing individual investors into long-term company supporters
Vicious cycle resulting from the absence of company-investor dialogue ● Fundamental difference in methods of defining corporate value ● Insufficient disclosure for assessing mid/long-term corporate value ● Insufficient dialogue for assessing mid/long-term corporate value	**Promoting high-quality dialogue** ● Establishing the Management-Investor Forum to develop a favorable relationship between companies and investors ● Towards corporate disclosure that leads to sustainable corporate value ● Promoting true dialogue between companies and investors through "cooperation and struggle"

Reference (2) Importance of intangible assets as a source of corporate value

Intangible assets (human resources, technology, knowhow, brands, etc.) are gradually replacing tangible assets (plants, facilities, etc.) as sources of corporate value.

✓ **In the United States, the share of intangible asset investment in added value created by companies is higher than that of tangible asset investment.**

✓ **The share of intangible assets in the market value of S&P500 issues (500 major issues listed in the United States) has been growing annually.**

Investment in tangible and intangible assets by U.S. companies

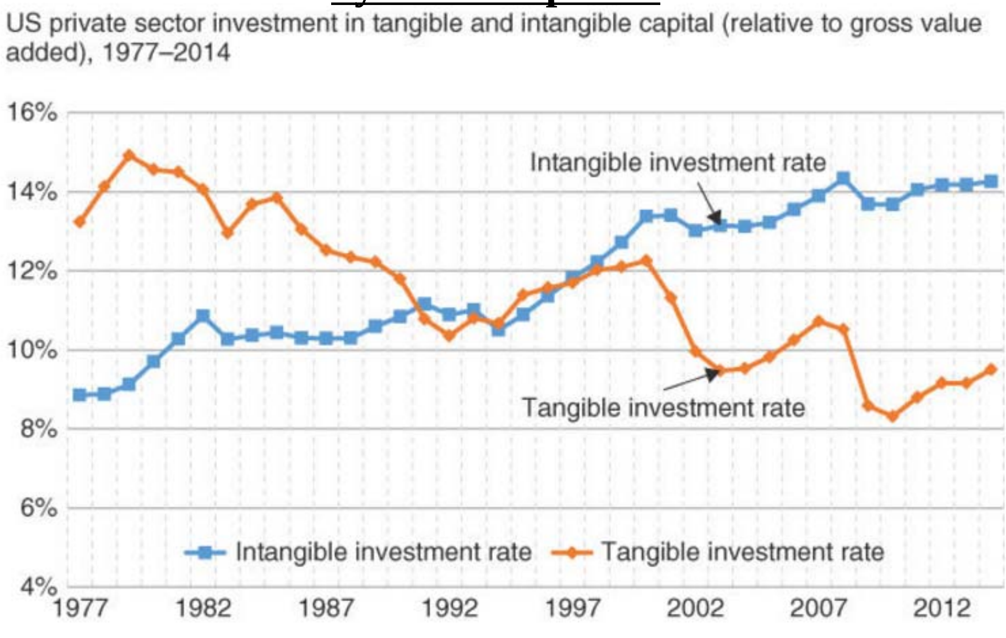
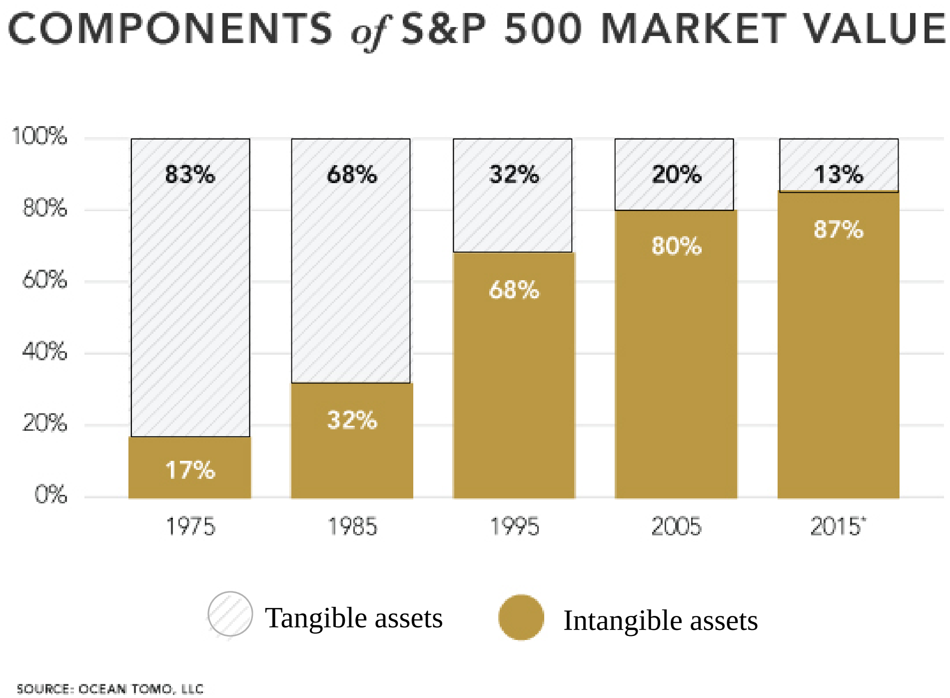


Figure 8.1 The Intangibles Revolution

Source: The End of Accounting and the Path Forward for Investors and Managers (Baruch Lev, Feng Gu), Willy Financial Series, Page 82

Components of S&P500 market value



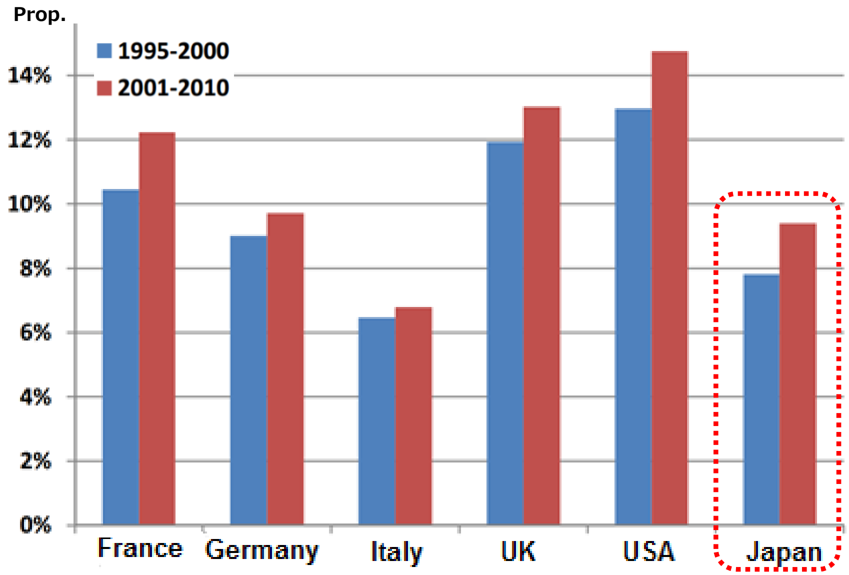
Reference (3) Status of intangible asset investment

The value of intangible asset investment in Japan is smaller than the amounts in the U.S. and major European countries.

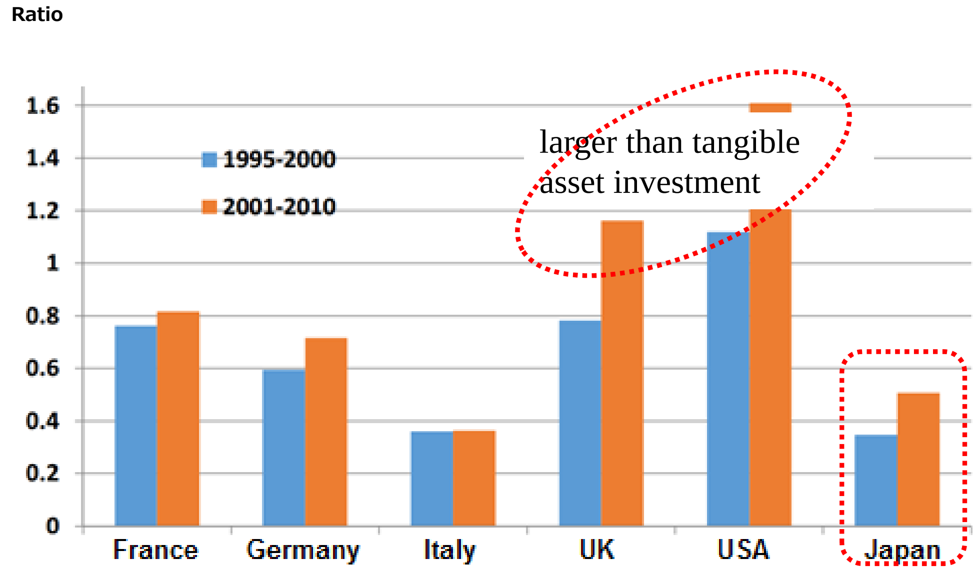
- ✓ **The share of intangible asset investment in GDP is smaller in Japan than in countries such as the U.S., the U.K. and France.**

- ✓ **In the U.S. and the U.K., the share of intangible asset investment is larger than that of tangible asset investment.**
- ✓ **The share of intangible asset investment in Japan is around half of tangible asset investment.**

The proportion of Investments in intangible assets in GDP



The ration of investments in intangible assets to investments in tangible assets

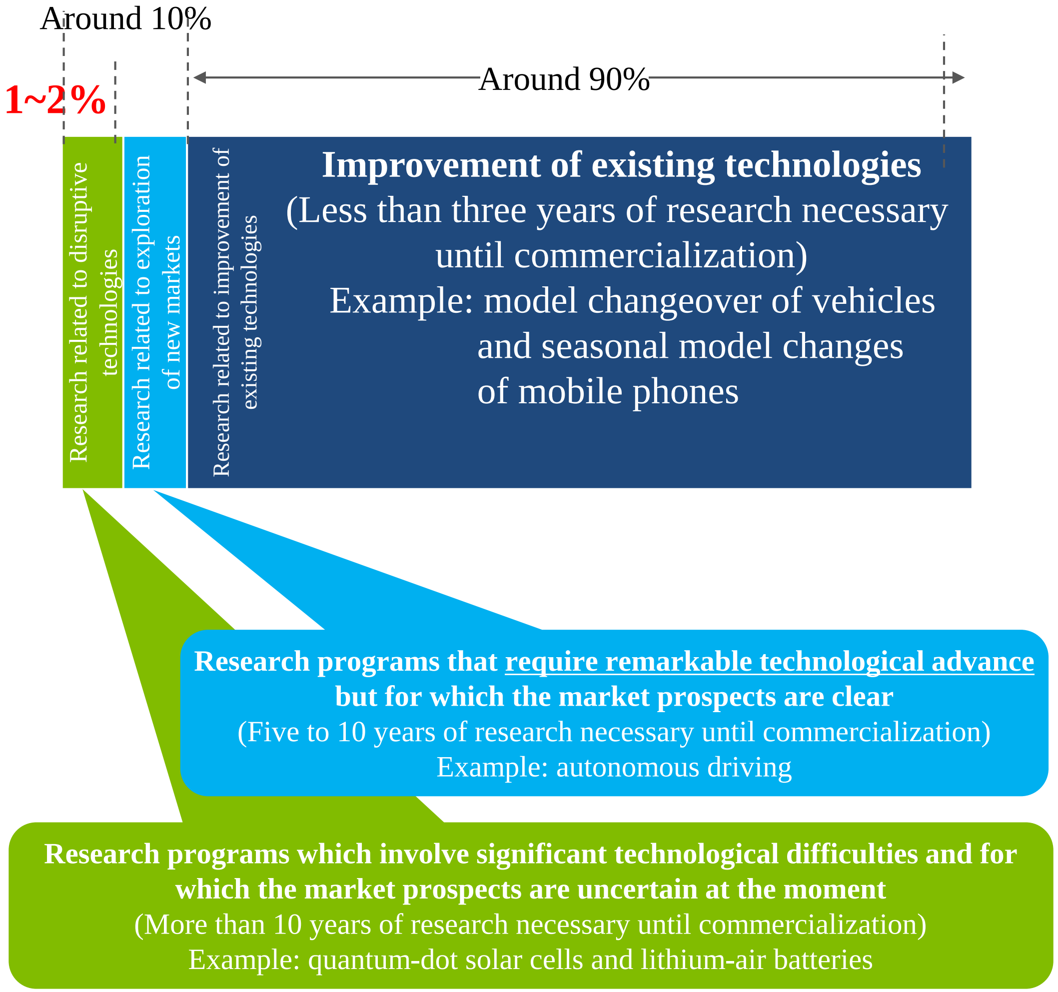


Source : RIETI, Policy Discussion Paper, Japan's economic growth and its intangible assets (June, 2015)

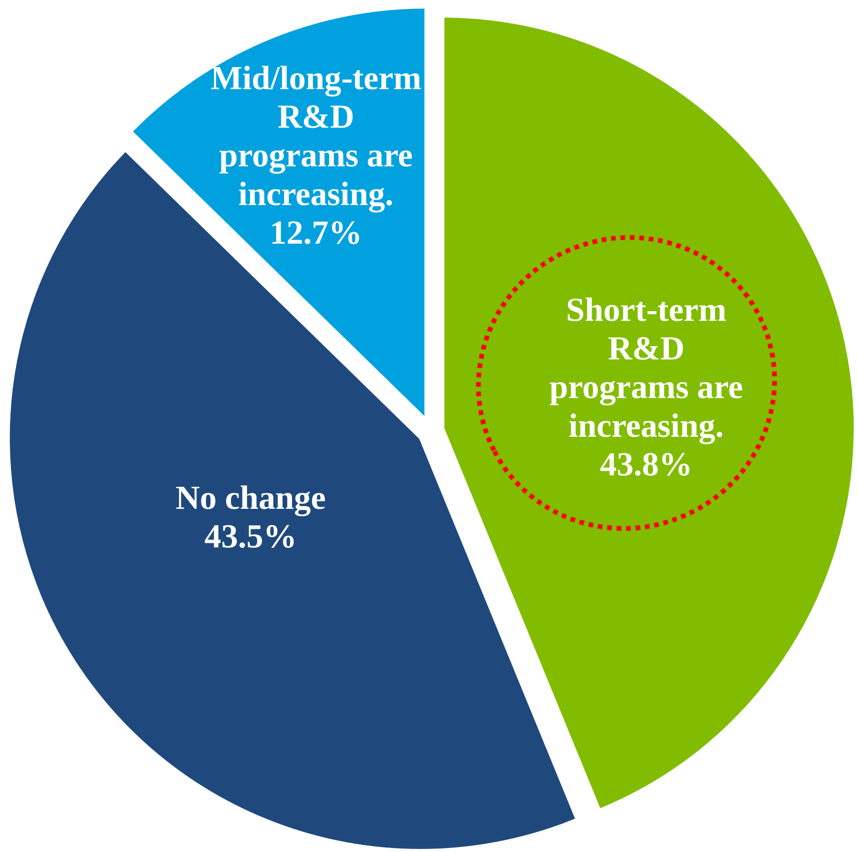
Reference (4) R&D investment of Japanese companies

Japanese companies are faced with a situation in which it is difficult to make long-term R&D investment intended to explore new markets.

Breakdown of R&D expenditure by Japanese companies



Changes in the substance of R&D programs conducted by Japanese companies



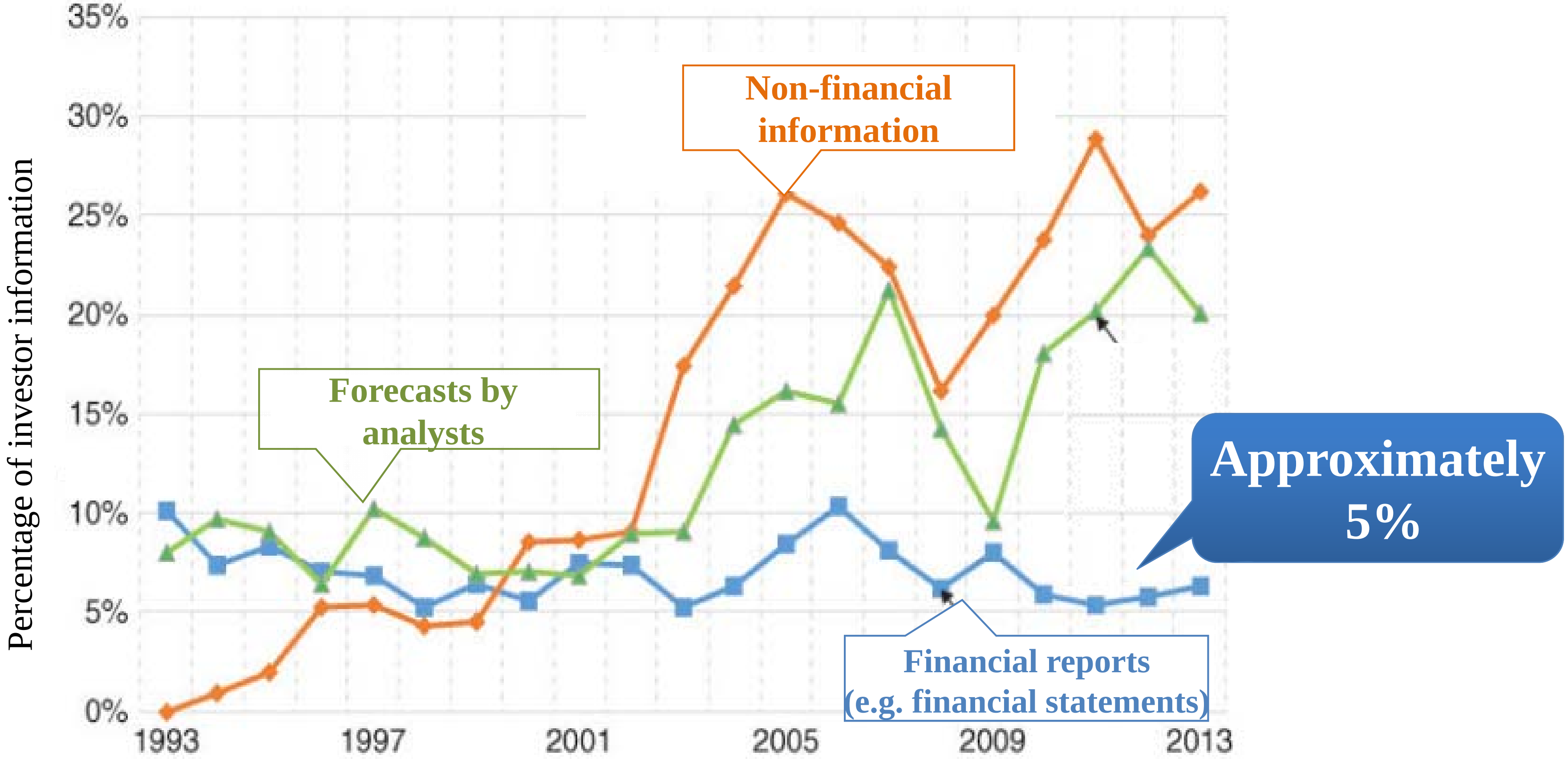
Source: Reference materials distributed at a meeting of the R&D and Innovation Subcommittee of the Committee on Industrial Science and Technology Policy and Environment under the Industrial Structure Council

Reference (5) Non-financial information as a reference for investment decisions by investors

For investors the importance of non-financial information when making investment decisions is increasing.

The Unique Contribution to Investors' Information:
Financial Reports, Analysts' Forecasts, and Nonaccounting SEC Filings

From 1993 to 2013



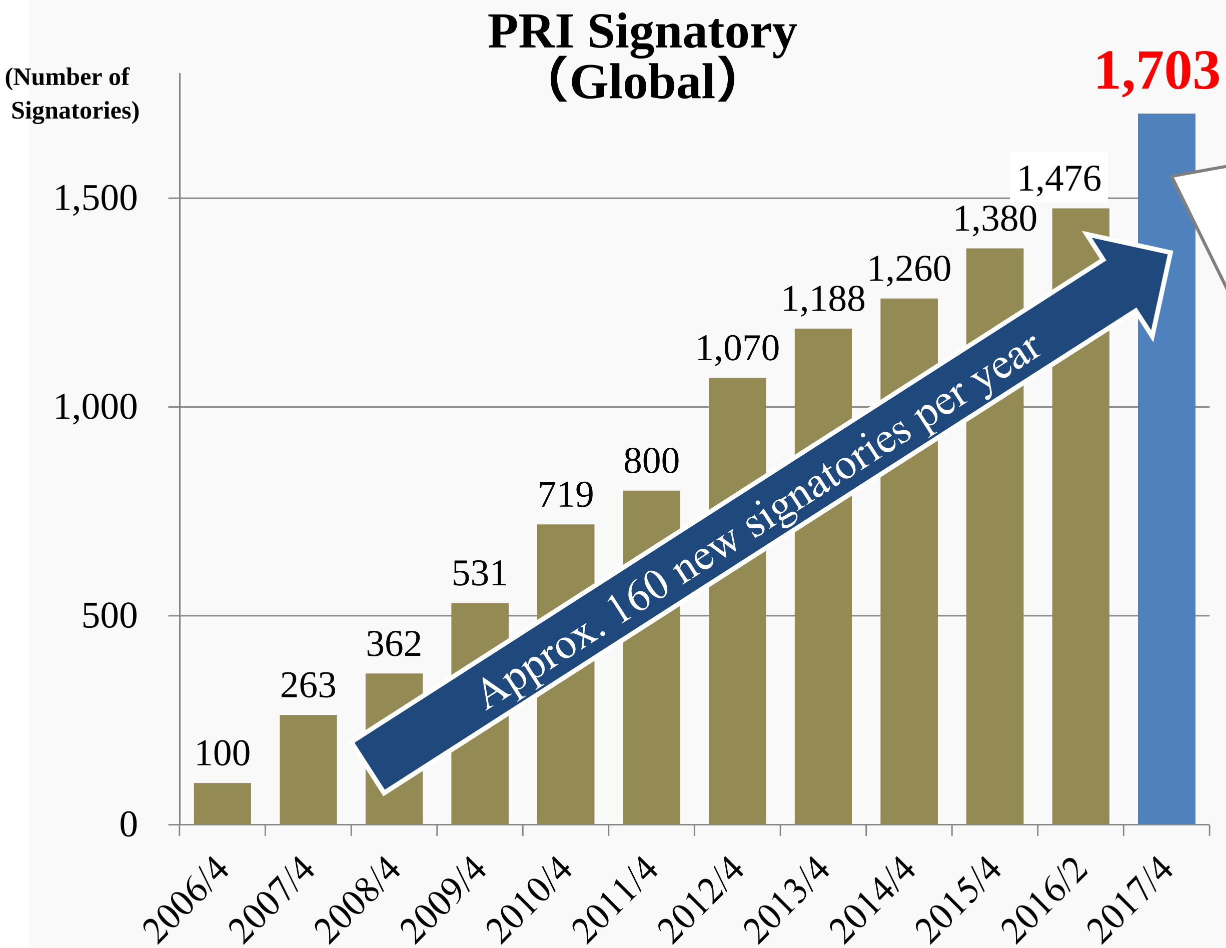
*Earnings forecasts by companies excluded from the above graph

Source: The End of Accounting and the Path Forward for Investors and Managers (Baruch Lev, Feng Gu)

Reference (6) Investors' interest in ESG

The number of PRI（※） signatories has been consistently increasing from its establishment and reached almost 1,700 as of April 2017.

※A voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice.



PRI Signatories by Nation

#	Nation	Signatories	%
1.	USA	315	18%
2.	UK	246	14%
3.	France	161	9%
4.	Australia	120	7%
5.	Netherlands	101	6%
6.	Canada	94	6%
7.	Sweden	73	4%
8.	Switzerland	65	4%
9.	Germany	62	4%
10.	**Japan**	**55**	**3%**
11.	South Africa	54	3%
12.	Brazil	50	3%

As of April, 2017

Source：UNPRI, Signatories to the Principles for Responsible Investment