

# **Creating Companies with Global Competitiveness**

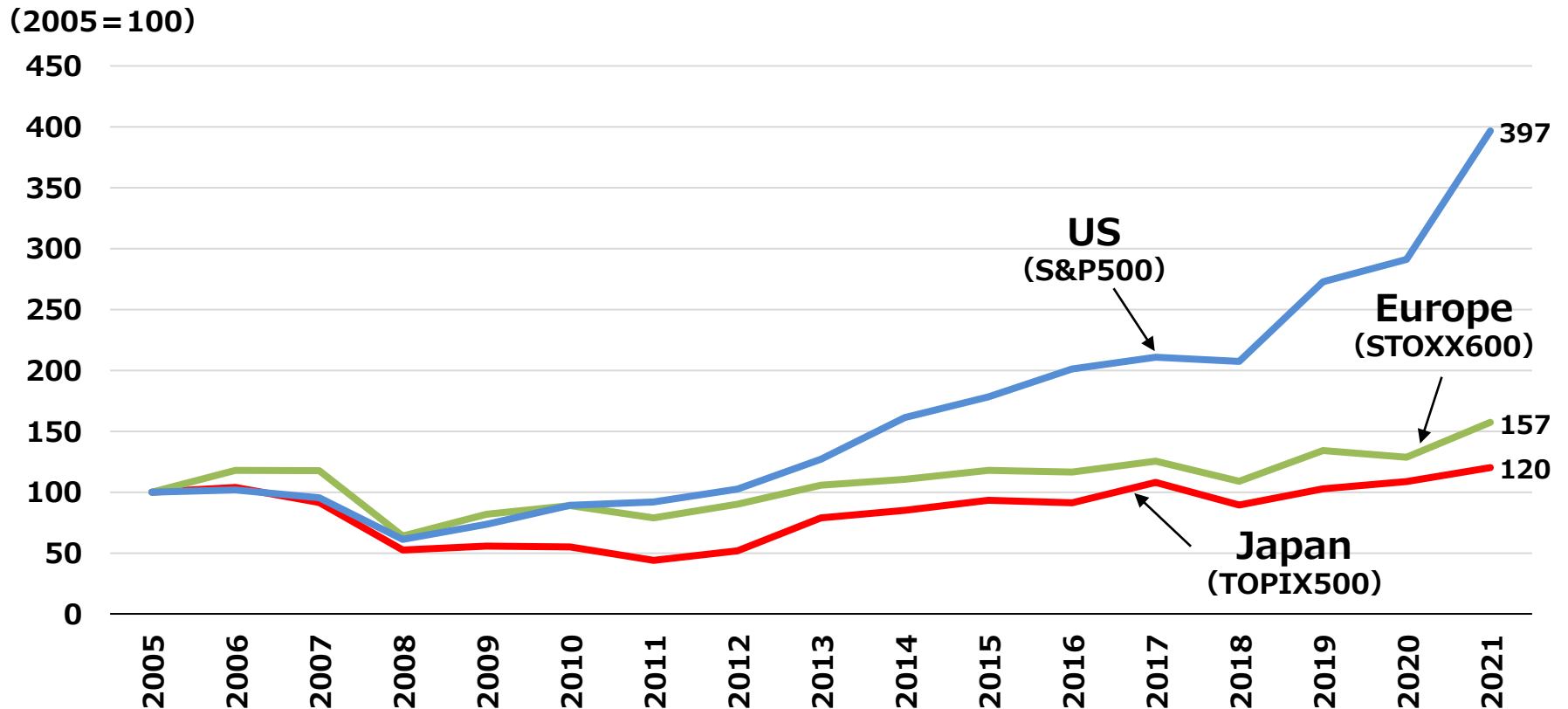
**Ministry of Economy, Trade and Industry**

# **Current Situation and Issues**

# Value Creation (Innovation) of Japanese companies are sluggish

- Growth in listed stock price of Japan (TOPIX500) lags behind US (S&P500), and Europe (STOXX600). During this period, **value creation of Japanese companies has been sluggish.**
- From perspectives of supplying well-paying jobs and increasing employees' wages, it is important for large companies to create value in the Japanese economy, given that they possess rich resources like talented employees.
- Issues exist in both value creation (innovation) in companies and market structure/environment.

## Comparison of listed stock price growth between Japan, US and Europe

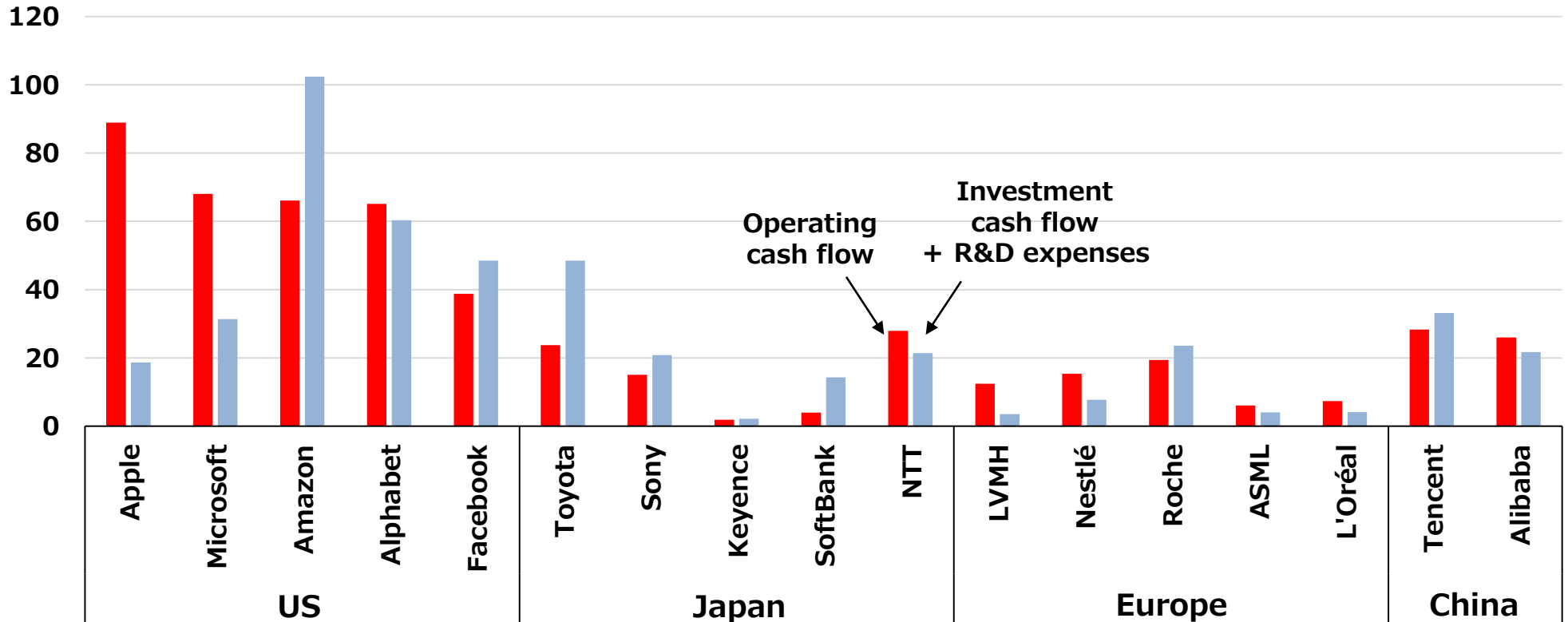


# Investment in Long-term Value Creation Requires Rich Cash Flow

- For long-term value-creation, it is necessary to take risks and make large-scale and long-term investment. To do so, it is essential to earn rich cash flow continuously.
- Both operating cash flow and investment cash flow (including R&D expenses) is lower in Japanese companies compared to US companies.

Top 5 companies ranked by market capitalization in Japan, US, Europe, and China (2020)

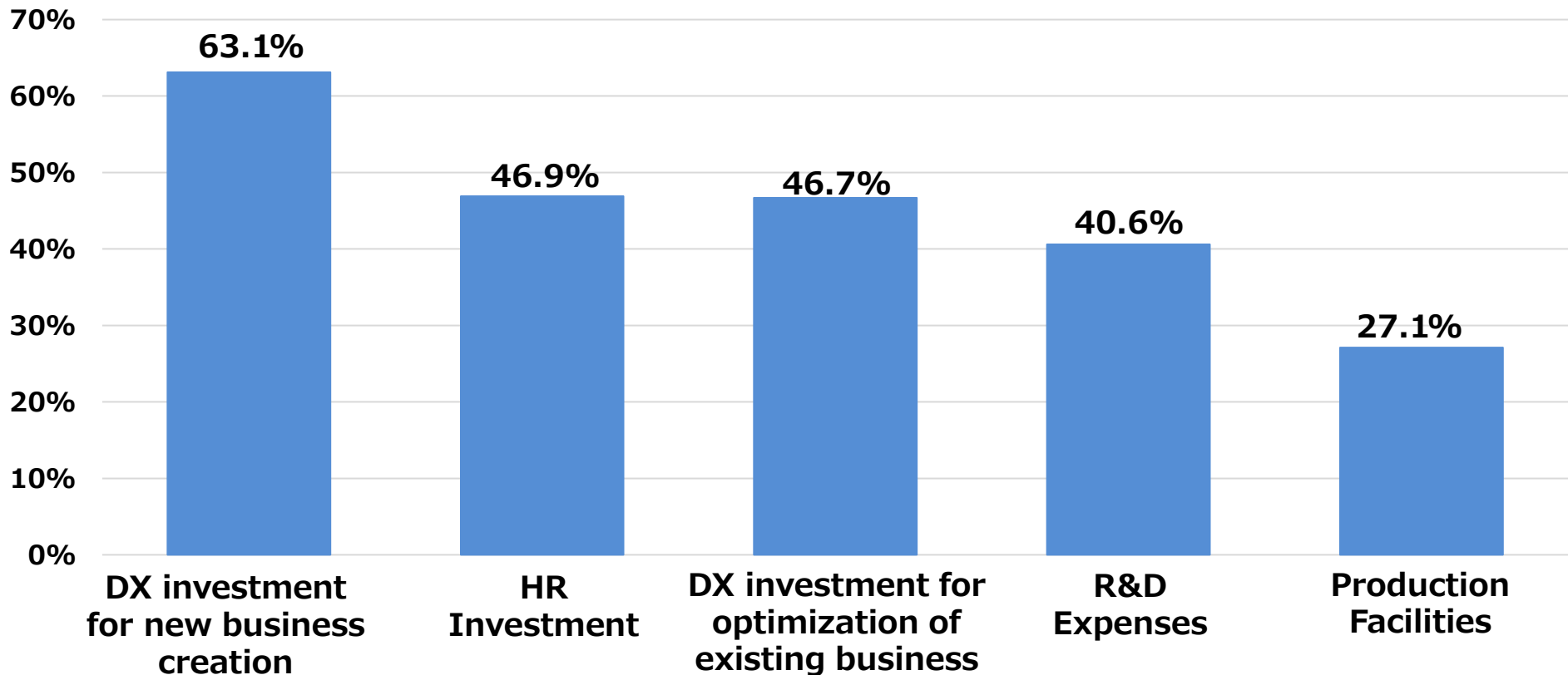
(\$ Billion)



# (Reference) Delay of Investment for Growth in Japanese Companies

- According to a survey for companies, many Japanese companies recognize that **investment for growth has been insufficient**, and competitiveness declined. This trend appears strongest in DX investment for new business creation.

## % of companies answering investment was insufficient and competitiveness declined (for each type of investment)



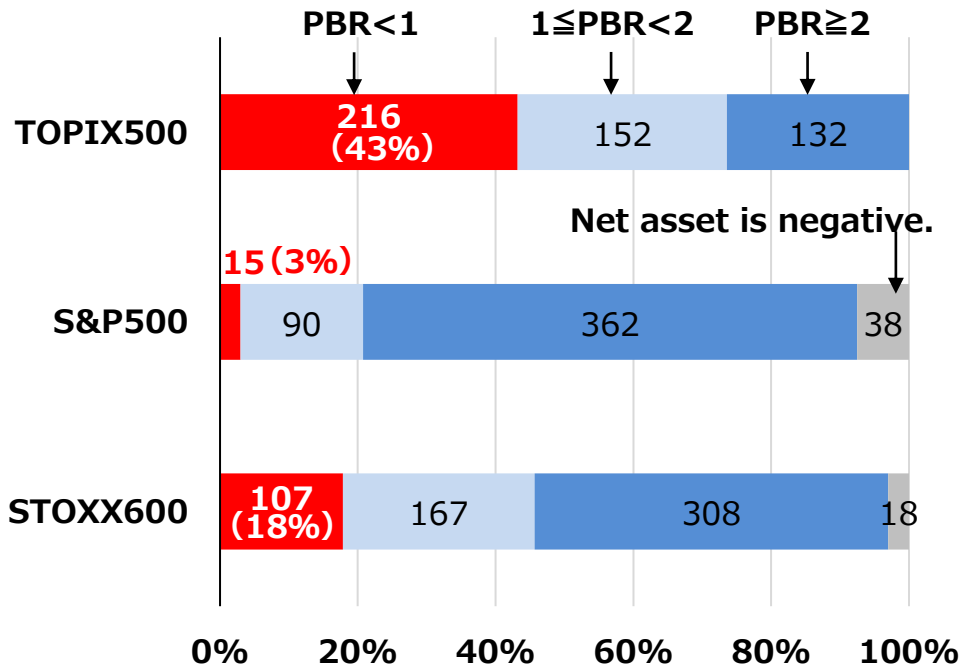
(note) About each investment for growth, companies answered the four-choice questions from “investment was not enough and behind the competitive companies” to “making an enough investment to establish a competitive advantage in the market”. The percentage above is described as total of two answers which is close to former answer. N = 441 companies listed in First and Second Section of Tokyo Stock Exchange

# 40% of TOPIX500 Companies have Negative Non-Financial Capital (PBR (Price to Book Ratio) is lower than 1)

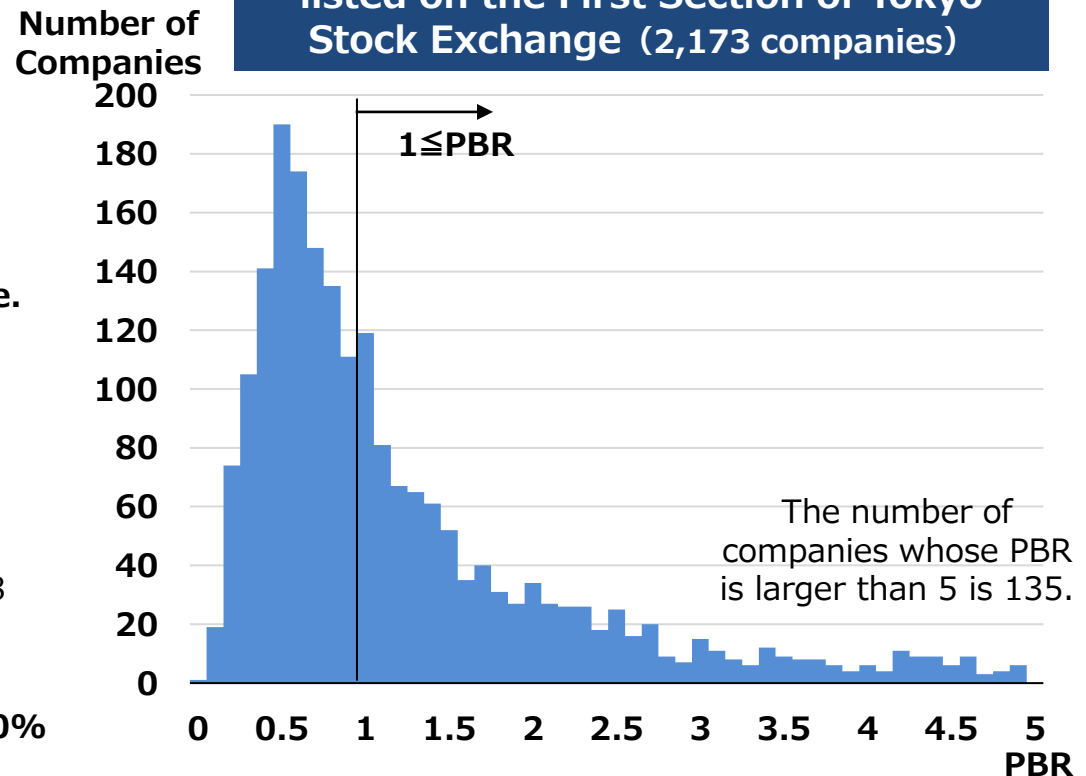
- The ratio of companies having negative non-financial capital (=PBR<1 (net asset larger than market capital)) within major stock indices is **43% in Japan (TOPIX500)** compared to 3% in the US (S&P500) and 18% in Europe (STOXX600). The mode PBR among companies listed on the First Section of Tokyo Stock Exchange is 0.5-0.6.

(Among 2,173 companies listed on the First Section of Tokyo Stock Exchange, 1075 companies have a PBR over 1 (49.5%)  
※at March 2, 2022)

## PBR distribution of companies in TOPIX500, S&P500, and STOXX600



## PBR distribution of the companies listed on the First Section of Tokyo Stock Exchange (2,173 companies)



(note) PBR is calculated by stock price divided by net asset per stock. If PBR is larger than 1, market seems to evaluate that the company has values over net asset. Calculated based on stock prices as of March 7, 2022 (left figure) and March 2, 2022 (right figure).

# Management Issues Pointed at IMD Competitiveness Ranking

- Japanese global competitiveness ranking is low, especially in business efficiency including “management practices” and “attitudes and values.” Issues may exist in management and actions towards value creation.

## IMD Competitiveness Ranking

Country	Overall			
	Business Efficiency			
		Management Practices	Attitudes and Values	
Sweden	2	2	3	4
US	10	10	6	25
Germany	15	23	29	45
China	16	17	23	12
UK	18	19	27	31
Japan	31	48	62	55

## Examples of Criteria of IMD Competitiveness Ranking

### Management practices

- Agility of companies
- Changing market conditions
- Opportunities and threats
- Credibility of managers
- Corporate boards
- Entrepreneurship

### Attitudes and values

- Attitudes toward globalization
- National culture
- Flexibility and adaptability
- Need for economic and social reforms
- Digital transformation in companies

# **Direction of Policy Responses**



# Enhancing Value Creation in Japanese Economy

- To enhance value creation within our economy, we must create companies with global competitiveness, along with creating startups. This would lead to innovation and improved productivity of many firms including SMEs, and supply of well-paying jobs in the economy.
- On the other hand, large startups are not being created, and the values of companies facing global competition are not being maximized. For example, **nearly half of the companies listed in the First Section of the Tokyo Stock Exchange has a price-to-book ratio (PBR) below 1.** Structural issues of the market must be analyzed and resolved so that companies' efforts are fairly evaluated.
- At the same time, continuous efforts for growth by companies must be encouraged, and supportive industrial policies must take this into consideration. **When partnering with companies to pursue "mission-oriented" policies** that aim to simultaneously achieve economic growth and overcome social issues, **such partner firms must be capable of creating value and overcoming global competition (including rapidly-growing companies from startups).**
- Therefore, the companies we support shall be such firms. We shall create a cohort of companies that could overcome global competition and maximize the outcomes of mission-oriented policies.

## **"Value-Creating Management" to compete globally may include the following factors:**

- ① **Profiting and investing** : Benchmarking global competitors, engaging in reform, earning cash flow, financing through evaluation from the market, responding swiftly and flexibly to changes in industrial structure, and investing and creating value with high speed and scale including intangible assets.
- ② **Global issue resolution** : Aiming for sustainability and resolving global socio-economic issues, and capturing the large market created in the mid-to-long term.
- ③ **Consideration for human capital and multi-stakeholders** : Investing in human capital, distribution to multi-stakeholders and achieving sustainable growth

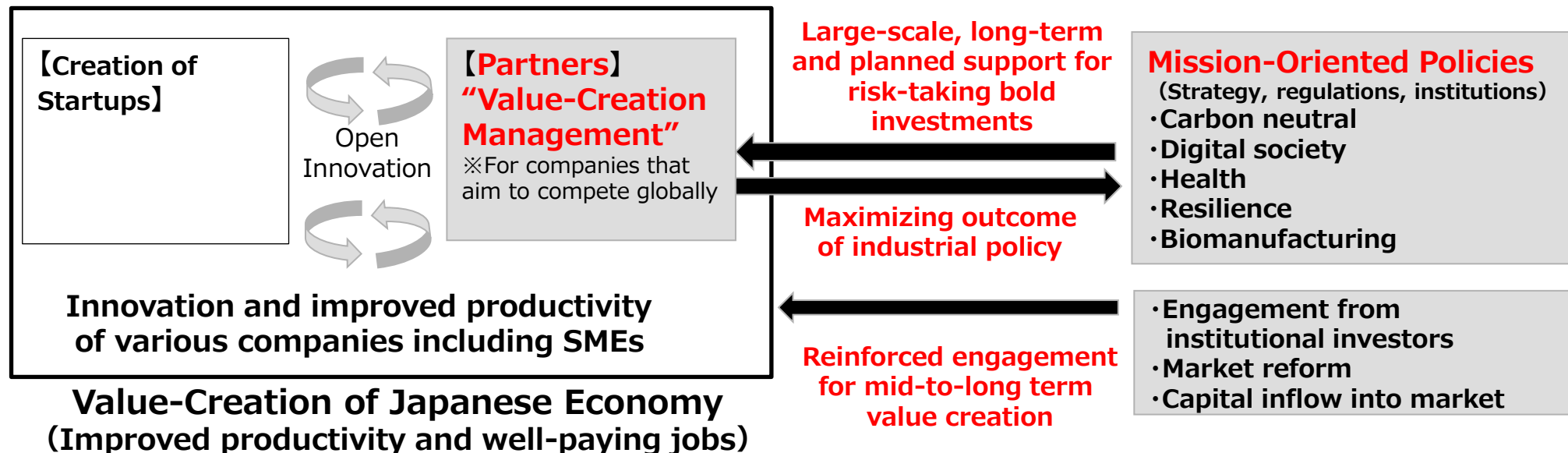
Such efforts shall be explained to stakeholders in the capital market to gain their evaluation.

# Partners for Large-Scale, Long-Term and Planned Support

To be considered

- To maximize the outcomes of large-scale, long-term and planned industrial policy, **we will consider requiring partnering companies to commit to “value-creation management”** enabling them to earn resources necessary to invest and compete globally.
- To create value in the mid-to-long term, **both management efficiency (ROE) and efforts toward future growth (PER) must be improved**. We shall **consider benchmarking partners’ PBR (a product of ROE and PER), and requiring partners’ valuation to be higher than their net assets (PBR>1)**. For partners with valuations below their net assets ( $PBR^* < 1$ ), we will consider having them create and disclose a plan to improve their PER and ROE.
- Issues to be addressed through public-private partnership shall be addressed swiftly.

\*PBR shall be evaluated based on an average of a certain term (such as 5 years), and taking industrial characteristics into account by benchmarking global competitors



# Policies to create companies that can compete globally

## Companies

### Action①

#### Companies : "Value-creating management"

- ①Profiting and investing
- ②Global issue resolution
- ③Consideration for human capital and multi-stakeholders

#### Disclosure of "Value-creating management"

#### •Synchronizing sustainability of society and companies :

Management and engagement based on "Guidance for Collaborative Value Creation"

#### •Reinforcing the function of CEO/execution :

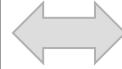
- ①Selecting CEO from global pool, creation of succession plan
- ②Abolishing CEO "terms"
- ③Long-term incentive-based compensation at the global level (40~50%)

#### •Improved governance :

Board and nominating committee with >50% independent outside directors

#### •Innovation/business portfolio management

#### •Human capital management



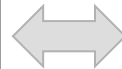
## Government

### Action③

#### Government : Long-term, large scale and planned support

- To maximize the outcomes of industrial policy, we will consider requiring partnering companies to commit to "value-creation management," and requiring partners' valuation higher than net assets (PBR>1).
- For partners with valuations below their net assets (PBR\*<1), we will consider having them create and disclose a plan to improve their PER and ROE.

\*Determined by an average (such as 5 years)



## Capital Market

### Action④

#### Engagement of institutional investors

- Engagement toward mid-to-long term value creation
- Engagement of corporate pension foundations

### Action⑤

#### Market reform, improving capital inflow

- Reform of market and cross-shareholding
- Capital inflow from individual assets and corporate pension foundations

### Action②

#### "Value-creating management" forum/award

Forum for interaction between companies and investors, and awarding excellent practices