

Outline of the Interim Report by the Study Group on Approaches to Making More Substantial the Dialogues for Creation of Sustainable Corporate Value

**Industrial Finance Division,
Economic and Industrial Policy Bureau, METI
August 2020**

Developments from the Ito Review to the Establishment of this Study Group

Ito Review (2014)

- ◆ Paradox of sustained low profitability (continuous low profitability despite having the world's leading capability to create innovation)
 - ✓ A vicious cycle in which sustained low profitability facilitates the market's short-termism, leading to decreased investment toward innovation, which further prolongs low profitability
- ◆ Mid- to long-term improvement of corporate value through active reinvestment by companies toward long-term innovation and investment by external investors with a mid- to long-term perspective
 - ✓ It is necessary to collaboratively create corporate value through dialogues between companies and investors with a mid- to long-term perspective.
- ◆ Achievement of ROE that exceeds the capital cost (ROE of 8%)
- ◆ High-quality dialogues with investors concerning the allocation of internal reserves and ideal growth investment by companies from the viewpoint of improving corporate value on a mid- to long-term basis

Ito Review 2.0 / Guidance for Collaborative Value Creation (2017)

- ◆ Regarding reinvestment by companies, the focus should be placed on investment in intangible assets, which will serve as a source of competitive advantage and innovation.
- ◆ Passive investment and ESG investment are expanding among investors.
- ◆ If investors consider investment in intangible assets and ESG-related efforts as expenses or costs, they will not lead to improving corporate value.
 - ⇒ It is necessary to explain to investors that investment targeting ESG factors and intangible assets is the type of investment required for improving corporate value on a mid- to long-term basis.
 - ⇒ **The Guidance for Collaborative Value Creation** was formulated as a common language on the details of dialogues between companies and investors.

- **A guideline on a value-creating scenario for the improvement of corporate value on a mid- to long-term basis**
- **A common language linking companies and investors**
- **Organizing the flow of value creation**
(Values → business model → sustainability / growth → strategy → KPIs → governance)

Challenges Identified by the Study Group on Approaches to Making More Substantial the Dialogues for Creation of Sustainable Corporate Value

As more than five years have passed from the release of the Ito Review (2014), the Study Group compiled a series of challenges in achieving more substantial dialogues. These problems arose in the course of holding actual dialogues, and the Study Group considered methods of arriving at solutions, while confirming the circumstances of companies, investors and capital markets, as well as business environments.

Challenges in details of dialogues

- ◆ How to hold dialogues concerning the following themes for which it is difficult to obtain investors' understanding
 - (i) Business diversification and business portfolio management
 - (ii) Seeding to create new businesses and innovation
 - (iii) Achieving a good balance between social value (ESG) and economic value (earning power and competitive advantage)
- ◆ Changes in business environment
 - ✓ Heightening uncertainties including the coronavirus crisis, the Fourth Industrial Revolution and DX, climate change, and disruptions of global supply chains

< Directions for solutions >

- ◆ Need for long-term time scales for dialogues
 - ✓ Achievement of **sustainability transformation (SX)**
= Synchronize **corporate sustainability** (earning power) and **social sustainability** (social issues and future markets)

Challenges regarding approaches to dialogues

- ◆ Japanese companies have become triple layered with regard to dialogues with investors and most companies are seeking effective approaches to dialogues.
 - (i) Approaches to achieving high-quality dialogues with investors are not shared.
 - (ii) The elements to be focused on in dialogues need to be organized for each stage depending on the status of each company.

< Directions for solutions >

- ◆ Organizing of **the elements of substantial dialogues**
 - ✓ Organizing from the viewpoints of **(i) principles of dialogues, (ii) details of dialogues, (iii) approaches to dialogues, and (iv) actions after dialogues**

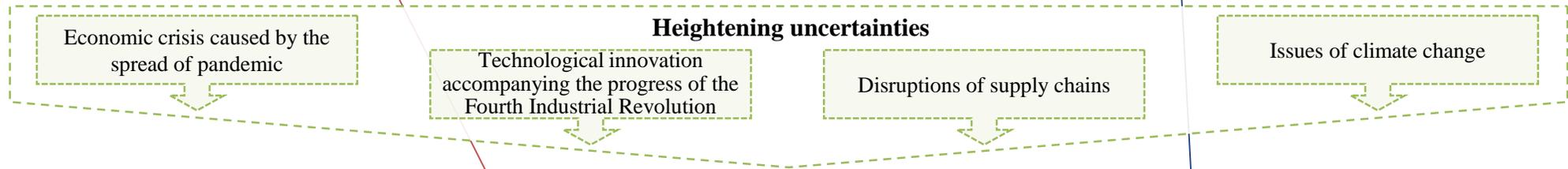
Sustainability Transformation (SX)

(i) Sustain and strengthen earning power

Sustain and strengthen companies' earning power (strengths, competitive advantage, and business models) on a mid- to long-term basis; Enhance corporate sustainability through such efforts as seeding to improve the business portfolio and innovation

(ii) Incorporate social sustainability in corporate management

Ascertain both mid- to long-term risks and opportunities regarding the sustainability and potential of corporate earning power by backcasting social sustainability (future visions of society) in preparation for uncertainties, and reflect such risks and opportunities specifically in corporate management



(i) Sustain and strengthen earning power

Business portfolio management / Seeding for innovation, etc.

(ii) Incorporate social sustainability in corporate management

Ascertain risks and opportunities

Corporate sustainability
(sustainability of earning power)

Social sustainability
(future visions of society)

Short-term time scales

Mid-term time scales

Long-term time scales

Companies

(iii) Dialogues

Investors

(iii) Strengthen resilience through dialogues in long-term time scales

In order to enhance corporate sustainability amid heightening uncertainties, companies and investors should consistently hold dialogues based goals (i) and (ii) above, with the possibility of alteration of future scenarios in mind, thereby improving companies' mid- to long-term stories of value creation and strengthening resilience in corporate management.