

[Reference] Outline of the ITO Review 3.0 and Guidance for Collaborative Value Creation 2.0

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** This document is a reference material to provide an easy-to-understand overview of the Ito Report 3.0 and Guidance for Collaborative Value Creation 2.0. For details, please refer to the text of the Report and the Guidance, respectively.

Volume on theory

Ito Review 3.0 (Ito Review SX Edition) (2022)

- In a rapidly changing business environment (diversification of sustainability issues, increase in uncertainty in the global economy), addressing sustainability goes beyond being a risk that companies must deal with and is a fundamental element of business strategy
- <u>Various players (e.g. companies and investors) should implement SX by engaging in constructive dialogues on how long-term management should be and refining such management.</u> This is what will become the mainstream of "how to earn money" in the future
- Formulated the Guidance for Collaborative Value Creation 2.0 (i.e., a framework for the management enhancement, effective information disclosure and constructive dialogues to achieve SX)



Ito Review 2.0 (2017)

- · For the purpose of reinvestment by companies, "intangible asset investment" is important, which forms the source of competitive advantage and innovation
- Need to provide a scenario to explain that intangible asset investments and ESG responses are "investments" necessary to enhance corporate value over the medium- to long-term
- · Formulated the Guidance for Collaborative Value Creation as a "common language" for the content of dialogue between companies and investors



Ito Review (2014)

- Awareness of the paradox of Japanese companies' sustained low profitability despite their ability to create innovations, and of investors' short-term orientation
- Reinvestment by companies for long-term innovation and medium- to long-term corporate value growth through investment from investors with a medium- to long-term perspective are important
- · From the perspective of capital efficiency, it is important to achieve ROE that exceeds the cost of capital



Volume on practice

Guidance for Collaborative Value Creation 2.0 (2022)

(Comprehensive Framework for achieving SX)

Ito Review for Human Capital Management 2.0 (2022) ("Compilation of ideas" for the embodiment of human capital management)

Guidelines for Human Capital Visualization (to be released in summer 2022)

(A guide focusing on how human capital should be disclosed, including how to utilize existing guidelines, etc.)

Overview of ITO Review 3.0 and the Guidance for Collaborative Value Creation 2.0

Rapid changes in the business environment (e.g., diversification of sustainability issues / increasing uncertainty in the global economy) Climate change Human rights issue Biodiversity Cybersecurity Pandemic Economic security etc.

Growing importance of incorporating social sustainability into corporate management

SX (Sustainability Transformation) practices will become the mainstream of "how to earn money" in the future

*SX: Synchronization between corporate sustainability and social sustainability, and the necessary management and business transformation

Current status and issues

"Hesitation" of both companies and investors, etc.

- <u>Difficulties in linking</u> solutions for sustainability issues <u>to</u> profit generation
- <u>Difficulties in scaling innovation</u> in a long-term perspective due to short-term orientation
- Competition for profit between companies working on sustainability (i.e., a common social issue)
- Formal evaluations by investors spur uniformity in corporate behavior.

Specific efforts to achieve SX

Construct a company-specific value-creation scenario based on dialogue with investors, etc., in a long-term perspective

(1) Clarification of the "intended future state" that is based on social sustainability

Clarification of "values"

Basis (e.g., corporate philosophy) for a company and each and every employee to decide on action to be taken to solve social issues

Identification of "important issues

Identify social issues to be solved through the company's business activities based on its values

Clarification of the "intended future state"

Shareable vision of how to provide the company's value to society and enhance its corporate value in a long-term and sustainable manner (i.e., long-term vision)

(2) Development of strategies to achieve long-term value creation

Long-term strategies

Analyze long-term risk factors and business opportunity factors, and then establish the intended future state (i.e., long-term vision), while building and reforming he business model based on such state.

Implementation strategies (e.g., mid-term management strategy)

Examples: Business portfolio strategies, establishment of organizational processes and support systems to achieve innovation; human capital investment and human resources strategies; intangible assets, including intellectual property, investment strategy, etc.

(3) KPIs and governance to effectively promote long-term value creation and further refinement of such value creation through substantive dialogues

Setting of KPIs

Set KPIs by linking to each company's values, important issues, and long-term strategies

Establishment of

"governance"

Examples: Succession plan, executive compensation (e.g., equity compensation)

"Substantive dialogue"

- Collaborative value creation with investors, etc.
- · High-quality disclosure

Utilization of the Guidance for Collaborative Value Creation 2.0

Framework for management enhancement, effective information disclosure and constructive and substantive dialogues to achieve SX

Further efforts

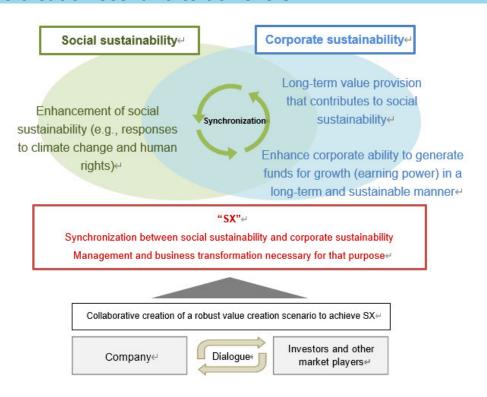
Further acceleration of SX across all Japanese companies

- Promotion of <u>SX</u> throughout the value <u>chain</u>, including SMEs and startups
- <u>Utilization of the Guidance for Collaborative Value Creation 2.0 by diverse actors in the investment chain</u>
 - Asset management institution / asset owner
 - Securities analyst
 - ESG rating agency

etc.

What is SX?

- Sustainability Transformation (SX)" refers to the "synchronization" between social sustainability and corporate sustainability, and the necessary management and business transformation.
- For the purpose of achieving SX, various players in the investment chain (companies, investors, clients, etc.) must engage in constructive and substantial dialogue on how corporate management should be over a long-term timeframe and refine such management, taking into account the demands of building a sustainable society.
- In order to secure sustainable competitive advantage in an increasingly complex business environment (e.g., diversified sustainability issues such as climate change and human rights, changes in various rule environments including such diversified issues, and emergence of economic security related issues such as cybersecurity), it is expected to collaboratively create and implement a robust value creation scenario to achieve SX.



(note) Relationship between SX, GX, and DX

For the purpose of integrated and efficient promotion of SX and Green Transformation (GX) that is regarded as a priority investment area in the "new capitalism", it is useful to work on GX by placing it in SX that is intended for wide sustainability issues such as climate change.

In this connection, for further effective and prompt promotion of SX and GX, it is desirable for companies to deal with Digital Transformation (DX) in an integrated manner with SX and GX.

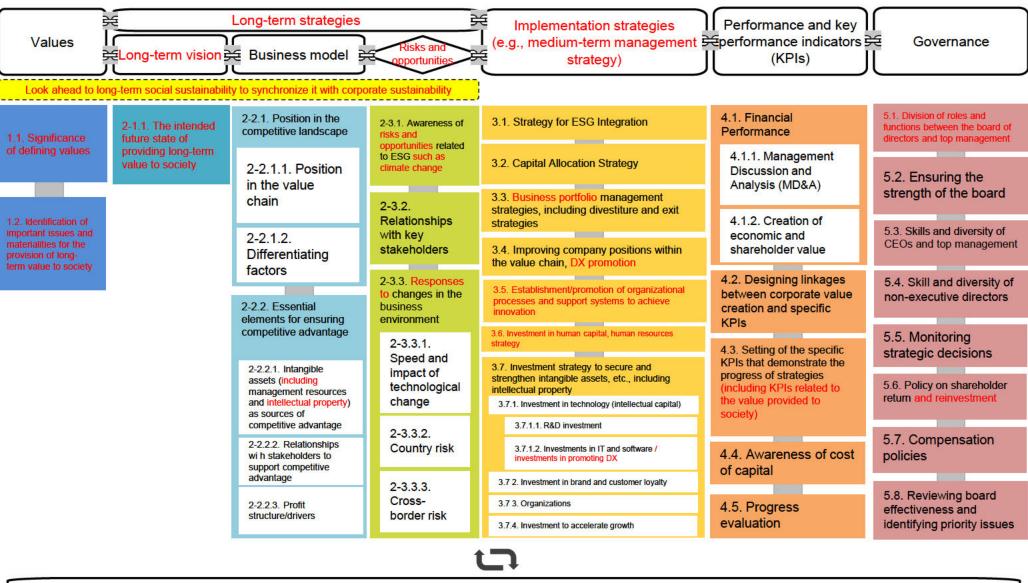
Points of Revision of the Guidance for Collaborative Value Creation

In light of the essential points of SX as organized in the ITO Review 3.0, the **Guidance for Collaborative**Value Creation was revised to serve as a framework for management enhancement, effective information disclosure and constructive dialogues to achieve SX.

Main points of the revision

- (1) To clarify the significance of SX, more emphasis is placed on the importance of companies providing long-term sustainable value toward the achievement of a sustainable society (descriptions in each section are enhanced)
- (2) Added a new section titled "Long-term Strategies" to emphasize the importance of management and business transformation on a long-term timeframe
- (3) Ensured consistency with the disclosure structure of "governance," "strategy," "risk management," and "indicators and targets" in the TCFD recommendations, etc.
- (4) Reorganized the structure to further emphasize the importance of investment in human capital and human resources strategy (as specified in the section titled "Implementation Strategies")
- (5) Further clarified the importance of companies and investors collaboratively creating and refining the overall value-creation scenario through substantive dialogues (a section titled "Substantive Dialogue and Engagement" is newly added)

Overall diagram of the Guidance for Collaborative Value Creation 2.0 (Red: Revision made to the current guidance)



Substantive dialogue and engagement

Deepen dialogue and engagement with investors and refine the value-creation scenario under the division of roles and commitment of the board and top management

6.1. Principles of substantive dialogue, etc.

6.2. Content of substantive dialogue, etc.

6.3. Me hods of substantive dialogue, etc.

6.4. Action after substan ive dialogue, etc.

Reference diagram using the As Is - To Be Framework

- · Core principles or basis for a company and individual employees to decide on action to be taken to solve social issues
 - · Identification of important social issues to be incorporated into long-term strategies, based on values such as corporate philosophy

Current state of the company [As Is]

Intended future state [To Be]

Long-term strategies

Values

Analysis of the company's current business situation and positioning, and identification of its competitive advantages and strengths

.........

Risks and opportunities

Analyze risks and opportunities as an extension of the current situation

· Identify and analyze

Reflect the results of analysis in the implementation strategies

external/internal

and business

opportunities

factors that can be

long-term risk factors

Analyze risks and

opportunities that

impact on the

intended future

state

Long-term vision

The company's intended future state, and a shareable vision of how to provide its value to society and enhance its corporate value in a longterm and sustainable manner

Business model

- A blueprint for commercializing values and serving as a foundation for long-term sustainable value creation
- Transform existing business models as needed based on longterm vision

Implementation strategies (e.g., medium-term management strategy)

· Measures to be taken in the immediate and medium- to longterm for embodying long-term strategies (e.g., business portfolio strategies, establishment of organizational processes and support systems to achieve innovation; human capital investment and human resources strategies; intangible assets, including intellectual property, investment strategy, etc.)

Formulate and promote implementation strategies to achieve the intended future state

Performance and key performance indicators

Indicators to be utilized for progress management, performance evaluation, and strategy review, showing how much value has been created, based on long-term strategies, etc.

Governance

(KPIs)

· Mechanisms and functions to discipline companies in the direction of enhancing corporate value in a long-term and sustainable manner through the formulation, implementation and verification of long-term strategies, etc.

Relationship Diagram between the Guidance for Collaborative Value Creation and Other Guidelines, etc. (4)(5) Effective guidelines for further exploration of the overall value-creation scenario for specific sectors and industries Long-term strategies Performance (1) Guidance on Climate-related Financial Disclosures 2.0 (TCFD Guidance 2.0) Implementation strategies and key Values (e.g., medium-term performance Governance Long-Husines model management strategy) indicators term (2) Disclosure and Dialogue Guidance for Promoting Sustainable Finance in the Circular (KPIs) -(*1) vision **Economy** (6) (7)(8)2-3.1. Awareness (3) Intellectual Property and Intangible Asset Governance Guidelines 3.1. Strategy for ESG Integration of risks and 5.1. Division of roles and function opportunities tween the board of directors and related to ESG appointing top management and such as climate board members management (4) Guidance for Integrated Corporate Disclosure Concerning Industrial and Product Safety 3.2. Capital Allocation Strategy change (5) Guidance for Collaborative Value Creation: Biomedical Industry 5.2. Ensuring the strength of etc. 2-3.2. Relationships with 3.3. Business portfolio management key stakeholders strategies, including exit strategies Effective guidelines for further exploration of each element of (13)(14)(15)(16) the Guidance for Collaborative Value Creation 2.0 5.3. Skills and diversity of .4. Improving company positions within (9) (10) CEOs and top man (6) CGS Guidelines 2-3.3. Responses to the value chain, DX promotion changes in the business environmen (7) Business Restructuring Guidelines 2-3.3.1. Speed 5.4. Skill and diversity of 3.5. Establishment/promotion of (12)and impact of non-executive directors organizational processes and support (8) Group Guidelines technological systems to achieve innovation change (13)(14)(9) DX Promotion Guidelines 2-3.3.2. 3.6. Investment in human capital, human resources stra egy (15)(16) Country risk 5.5. Monitoring strategic (10) Digital Governance Code decisions 3.7. Investment strategy to secure and 2-3.3.3. Cross strengthen intangible assets, including (11) Market Formation Guidance - Towards the Practice of Rule-forming Market Creation border risk ntellectual property 5.6. Shareholder return and reinvestment policies (12) Action Guidelines for Japanese Companies' Management for Value Creation 3.7.1.1. R&D investment 17 Column (Attitude (10) 3.7.1.2. Investments in IT and (13) Ito Review for Human Capital Management Changes in the software / investments in promoting 18 Business 5.7. Compensation policies Environment) (14) Ito Review for Human Capital Management 2.0 3.7.2. Investment in brand and customer loyalty (15) Diversity 2.0 Action Guidelines 3.7.3. Organizations (16) Guidelines for Human Capital Visualization 5.8. Reviewing board

effectiveness and identifying

priority issues

(3) (11)

3.7.4. Investment to accelerate growt

Substantive dialogue and engagement

(18) Cybersecurity Management Guidelines

(17) Guidelines for Respecting Human Rights in Responsible Supply

Chains (public comment period open until August 29, 2022)

^{*} It is desirable to deepen the understanding of each of (1) through () in an integrated manner by reading them together with the Guidance for Collaborative Value Creation 2.0, while taking into account the overall structure and description of the Guidance for Collaborative Value Creation. This Diagram shows the relationship between items (1) through () from the viewpoint of clearly indicating the items, etc., in the Guidance for Collaborative Value Creation 2.0 that are particularly relevant to each item.

^{(*1) (1)} and (2) can be effectively utilized in exploring the elements of 2-3.1., etc., of the Guidance for Collaborative Value Creation 2.0, and (3) can also be effectively utilized in exploring the elements of 3.7. of the same Guidance.

^{(*2) &}quot;Business and human rights" and "cybersecurity" are mentioned in a column under the "Risks and Opportunities" in the Guidance for Collaborative Value Creation 2.0; however, as in other areas, from the perspective of considering how to create long-term value based on the analysis of risks and opportunities, it is desirable to utilize (†) and (†) also at the stage of development of "implementation strategies".