International Economic Research project on the Development of Integrated Domestic and External Economy Policy in 2022: Survey on Transforming Corporate Structure for Expanding Foreign Investment

Final Report

EY Strategy and Consulting Co., Ltd.

March 31, 2023

Building a better working world

Disclaimer

Pursuant to the Agreement between the Ministry of Economy, Trade and Industry (METI) and our Company dated November 14, 2022 (hereinafter referred to as the "Agreement"), our Company has conducted an international economic research project (Survey on Transforming Corporate Structure for Expanding Foreign Investment) (hereinafter referred to as the "Commissioned Work") for the international economic research project on development of integrated domestic and external economic policy in 2022.

Purpose of this Report and Restrictions on Use

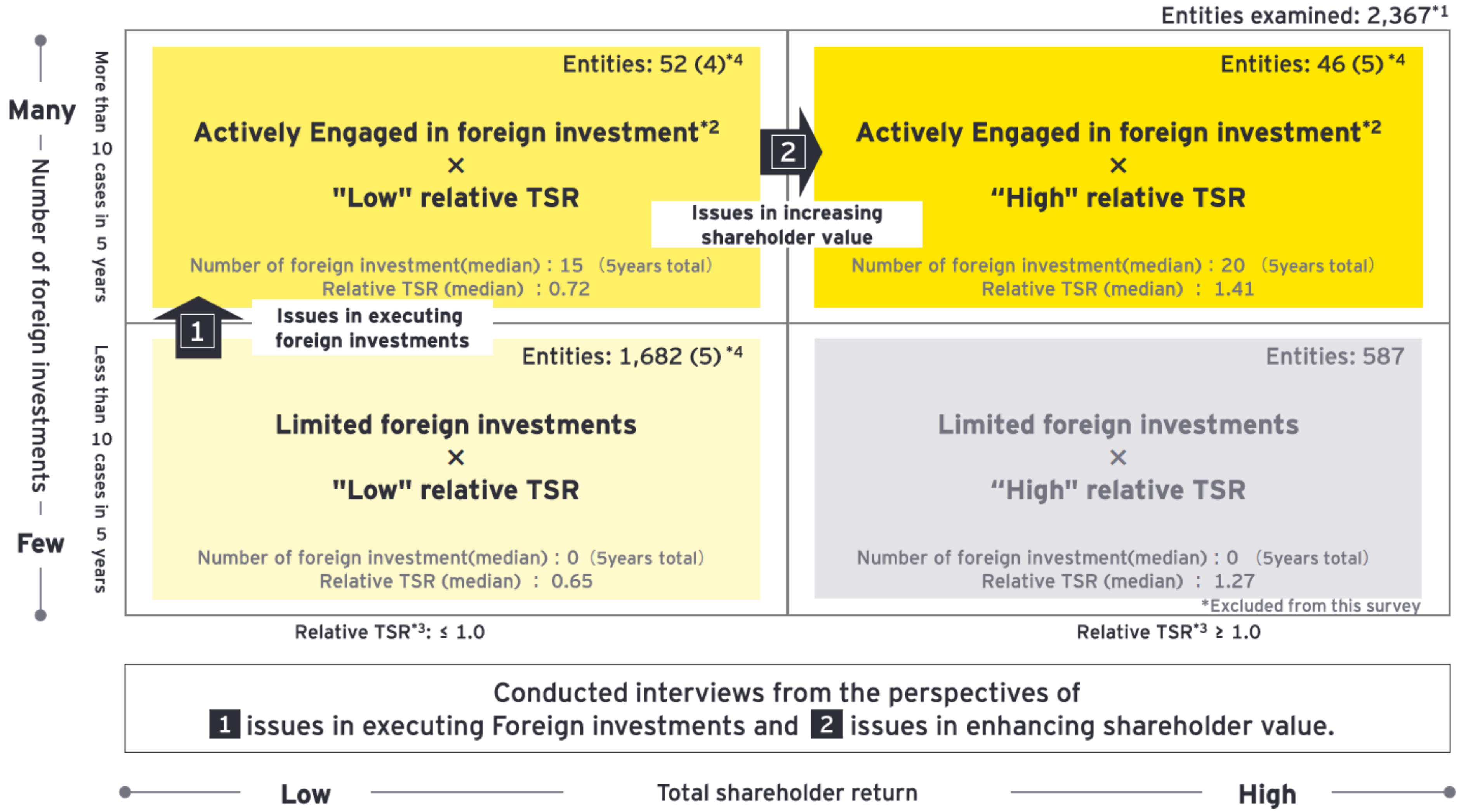
This report has been prepared solely for METI in accordance with specific instructions from METI pursuant to this engagement and should not be used or relied upon for any other purpose.
We assume no liability, contractual or otherwise, to any third party.
We do not guarantee that the results of any estimates or computations made in this report will be realized.
The contents of this report are not intended to be used for investment or financing consideration by METI or any third party.

Nature and Scope of Work

With respect to the data, information and statements provided to us, we do not assume responsibility for their completeness or accuracy and have not verified them.
Although each component of this report relates to an aspect of the work we performed, the entire report should be read in its entirety for an accurate understanding of our findings and advice.
We performed our services through March 31, 2023, in accordance with the terms of the engagement agreement. Accordingly, this report does not take into account events or circumstances that have occurred after March 31, 2023. Accordingly, we are under no obligation to update the contents of this report.

Summary of issues when actively engaging in foreign investments: Classification of each corporation type

This survey project classifies Japanese corporations into four categories based on two criteria: number of foreign investments made and total shareholder return. 46 corporations were then identified as actively engaged in foreign investment and having achieved "High" relative total shareholder return(TSR).



*1 : Listed corporations only, for groups Limited foreign investments only corporations that have not conducted stock consolidations/splits or changed accounting periods in the past five years are included.
*2 : Criteria for promoting foreign investment are at least 10 foreign investments in the past 5 years (including those made by subsidiaries and sub-subsidiaries)
*3 : Relative TSR = TSR / TOPIX growth rate including dividends *4 : Number of interviews conducted in parentheses

Identification of issues through interview survey: Issues in executing foreign investments

The issues to invest foreign entities as a routine activity are establishment of system for searching and evaluating pipelines and retaining human resources. Even companies that are actively engaged in foreign investment recognize the development and hiring of management personnel as an ongoing issue.

Steps for Foreign Investment	**Pre-Phase** Business strategy development → Initial investment study	**Deal-Phase** Due diligence → Contract signing and closing	**Post-Phase** PMI → Management and Monitoring
1 **9 issues for foreign investment execution**	**【Portfolio transformation】** ① View foreign investment as a mean to transform the business portfolio over the medium to long term, not just as an individual strategy for each business unit **【Search for pipelines】** ② Establish a system to actively search for and evaluate investment opportunities in-house **【Evaluation of investment projects】** ③ Clarify items to be evaluated and checked and investment decision criteria so that deals can be evaluated after investment	**【Decision-making process】** ④ Create a speedy decision-making process and be ready for bidding projects and start-up investments **【Securing Human Resources】** ⑤ Securing human resources capable of handling foreign investments and accumulating knowledge in the organization **【System for promoting】** ⑥ Understand business practices and be flexible in DD and contract negotiations with foreign companies **【Assumed synergies】** ⑦ Establish a mechanism to verify the "strategic significance of the acquisition" and "expected synergies" and to control the acquisition	**【Global management personnel】** ⑧ Develop and hire personnel capable of managing overseas subsidiaries **【Foreign subsidiary management】** ⑨ Implement global standards of governance rules instead of Japanese-style governance
Insights	When making foreign investments, a company is faced with the problem of creating a system for structuring and controlling projects and securing the human resources to handle them.		PMI is a common issue for Japanese companies and must be addressed from a mid- to long-term perspective.

Source： EY categorizes issues based on interviews with each company

Identification of issues through interview survey: Issues in improving shareholder value

The issues in linking foreign investments to shareholder value are, the lack of a medium- to long-term equity story in the long term, and insufficient disclosure of PMI and progress in realizing synergies for each investment project in the short term.

Steps for Foreign Investment	**Pre-Phase** Business strategy development → Initial investment study	**Deal-Phase** Due diligence → Contract signing and closing	**Post-Phase** PMI → Management and Monitoring
2 **4 issues for enhancing shareholder value**	**【Medium- to Long-term Business Strategy】** ⑩ Set forth a medium- to long-term vision for the capital markets **【Risk and Return Disclosure】** ⑪ Conduct risk studies related to changes in the external environment (geopolitical risk, currency impact, etc.) In parallel, consider the impact on the company's overall shareholder value	Execute investments consistent with disclosure of mid- to long-term business strategies  Gather expectations and concerns from shareholders and reflect them in mid- and long-term strategies.	**【Dialogue with Shareholders】** ⑫ Clearly aligning with business strategy and executing major investments for portfolio transformation **【Post-investment disclosure】** ⑬ Disclose not only press releases at the time of investment execution, but also information on progress of PMI and realization of synergies
Insights	The difference between a successful foreign investment and a poor one is the presence or absence of a medium- to long-term equity story.	Short-term viewpoint disclosure has not progressed well in Japan. (Standard practice in advanced overseas companies)	

Source： EY categorizes issues based on interviews with each company

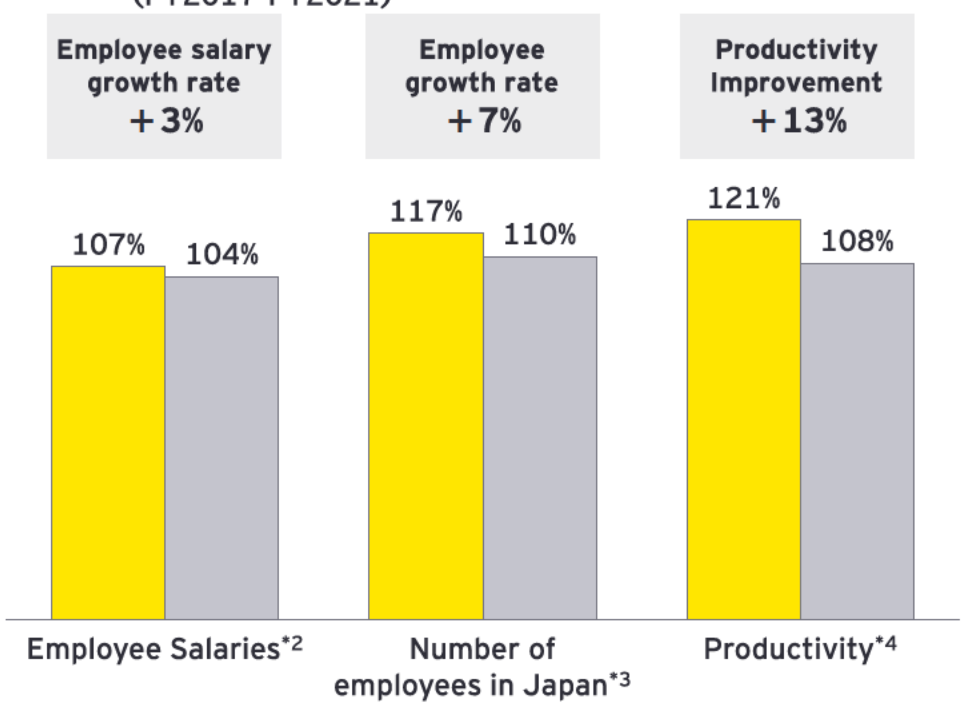
Best practices for utilizing foreign investment: Effects of domestic resource returns

As a result of foreign investment, resources are returned to the domestic market in the form of higher employee salaries, domestic job creation, and increased productivity.

Comparison of key items in each corporation's type classification

Actively engaged in foreign investment ×"High" relative TSR
Limited foreign investments ×"High" relative TSR*1

Chart 3-1 Comparison of each indicator over the past 5 years (FY2017-FY2021)



Insight

Companies promoting foreign investment directly and indirectly return resources to the domestic market in multiple items

- Increased employee salaries by utilizing cash distributed domestically from overseas subsidiaries
  - Separate the use of cash to be reinvested locally and cash to be returned to Japan
  - Paid primarily as a variable bonus
- Creation of domestic employment through business expansion in Japan and overseas
  - Hiring of administrative personnel, increase in personnel to handle sales growth, etc.
- Increased productivity due to learning effects from overseas subsidiaries and supply chain linkages
  - Multiple studies have shown that foreign investment increases domestic productivity*5

*1 : Select and analyze companies with the same industry distribution and similar employee size as on page 2, with limited foreign investment x "high" relative TSR.
*2 : Average annual employee salary of subject companies (non-consolidated)
*3 : Only companies that disclose the number of employees in Japan only are counted.
*4 : Productivity = Net sales of the entire group / Number of employees of the entire group
*5 : Positive Effects from Increasing Foreign Direct Investment on Productivity at Home Country: Panel Data Analyses for 6 Industries in Japan, etc.

Source : IR materials of each company

The real causes behind the issues facing Japanese companies' foreign investments should be the delay in transforming corporate structures, shortsighted management, and unfamiliarity with shareholder engagement.

The real causes of issues in executing foreign investments

Transformation of corporate structure has not progressed

- **Penetration of the old innovation method of "do-it-yourself"**
  - Open innovation, collaboration, and M&A efforts by some companies are progressing, but remain limited
- **Risk-Biased Approach**
  - Tendency to be overly concerned about impairment from large investments
- **Lack of leadership**
  - Lack of management team with strong leadership to lead major changes in the company

Satisfied with status quo in a long-term shrinking domestic market

- **Lack of long-term perspective in decision making**
  - In a market developed by a limited number of domestic companies, it is difficult to create incentives for foreign investment for further growth

The real causes of issues in enhancing shareholder value

Lack of balance between disclosure and commitment to investors

- **Excessive concern about committing**
  - Tendency to refrain from disclosure to avoid committing to growth initiatives and acquisition-assumed synergies

Limited incentive for investor management

- **Few institutional investors make aggressive shareholder proposals**
  - Institutional investors holding listed Japanese stocks rarely make demands on management strategy and capital policy
  - On the other hand, the number of activists who actively make shareholder proposals is increasing every year, making investor management even more important

Proposed measures to promote foreign investment

To enhance shareholder value through active use of foreign investments by Japanese companies, measures are envisioned to share know-how as a basis for execution, provide investment opportunities, and provide guidance in post-investment dialogue with shareholders.

		Proposed measures
Addressing foreign investment execution issues	**Develop guidelines**	▸ Guidelines for handling legal, tax, and other risks in executing foreign investments ▸ Governance Guidelines for Foreign Subsidiary Management and Post-Investment Monitoring ▸ Guidelines for Developing a Personnel Evaluation System to Promote Global Human Resource Development and Foreign Investment
	Knowledge sharing	▸ Best practices and past failures of Japanese companies in executing foreign investments ▸ External environmental information that can be referenced when considering foreign investments ・ Market trends, business practices, precedents, etc. by region
	Provide partnering opportunities	▸ Matching opportunities with foreign investors and companies for business creation ・ Japanese and foreign companies have needs because there are limited opportunities for matching with non-startup companies ▸ Support for building relationships with overseas universities for the recruitment of executive candidates
	Financial Support	▸ Expanding financial support from government-affiliated financial institutions, including loans for Foreign investments ・ Japanese companies ask them to support financially especially for infrastructure investments
	Rule making	▸ Reduction of antitrust trading standards ▸ Revision of tax systems related to foreign investment
Addressing enhancing shareholder value issues	**Publish guidance**	▸ Release guidance on shareholder engagement, building equity stories, and setting purpose ・ Sharing best practices from Japan and foreign, organizing disclosure content and timing, etc.