
ITO Report for Human Capital Management

August 25th, 2022

Ministry of Economy, Trade and Industry



01 Summary of “ITO Report for HCM”

- The management of Japanese companies is about to change. This year we observe a massive transformation where "human capital management" is concretely put into practice and disclosed by quite a few companies.
- The Ministry of Economy, Trade and Industry has organized two study groups to encourage human capital management in Japanese companies from 2020 to 2022, chaired by Kunio Ito, a professor emeritus at Hitotsubashi University. The culmination of these discussions is the "Ito Report for Human Capital Management" .
- Human capital management must start by clarifying the respective roles of three entities: management, boards of directors and investors. The role of the management team is to formulate and implement a human capital strategy that is linked to the business strategy. The role of the board of directors is to monitor and supervise the link mentioned above. The role of the investors is to select investment targets based on the dialogue with such a viewpoint.
- When you, as management, formulate a human capital strategy, three perspectives and five common factors are essential.

Three perspectives

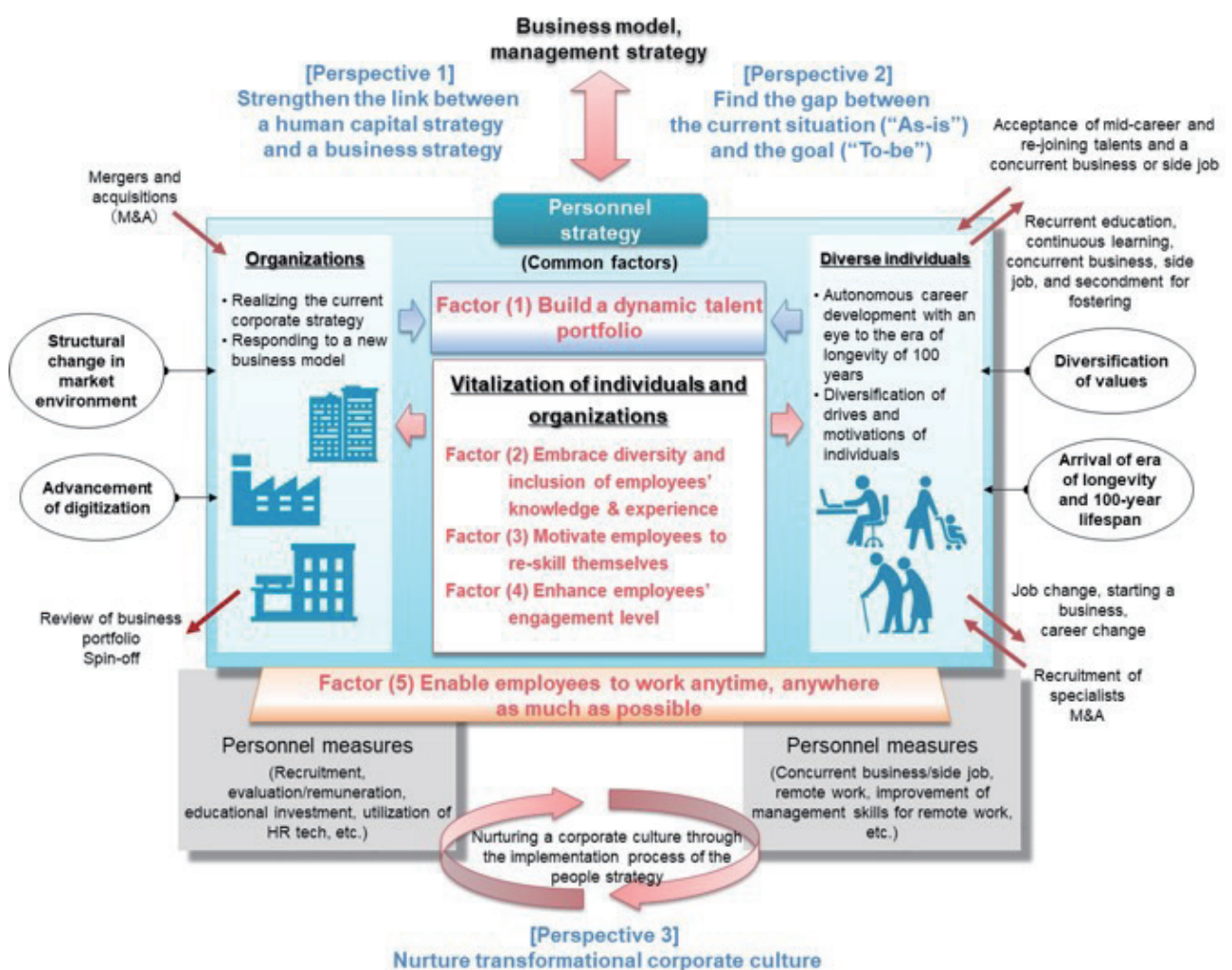
- (Perspective 1) **Strengthen the link between a human capital strategy and a business strategy**
- (Perspective 2) **Find the gap between the current situation ("As-is") and the goal ("To-be")**
- (Perspective 3) **Nurture transformational corporate culture**

Five common factors

- (Factor 1) **Build a dynamic talent portfolio**
- (Factor 2) **Embrace diversity and inclusion of employees' knowledge and experience**
- (Factor 3) **Motivate employees to re-skill themselves**
- (Factor 4) **Enhance employees' engagement level**
- (Factor 5) **Enable employees to work anytime, anywhere as much as possible**

■ The above concept is illustrated in the "3P/5F" model (Figure 1).

(Figure 1) Three perspectives and five common factors essential for a human capital strategy (3P/5F model)



- Examples of practical actions you might take, in line with the three perspectives and five factors, are shown as follows.

(Perspective 1) **Strengthen the link between a human capital strategy and a business strategy**

- ① Have CHRO (Chief Human Resource Officer) as a member of the management team, not the head of the personnel department
- ② Identify fundamental challenges in terms of human capital that could jeopardize business operations
- ③ Set KPIs related to human capital and explain why you set those KPIs to stakeholders
- ④ Examine role-sharing of the departments between HR and the operation, and increase capabilities of HR department
- ⑤ Place a higher priority on a succession planning program
- ⑥ Assign an outside director for the chairman of the nominating committee
- ⑦ Link compensation for executives to performance of HR KPIs

(Perspective 2) **Find the gap between the current situation ("As-is") and the goal ("To-be")**

- ① Build up personnel information infrastructure
- ② Set goals and timeframes of HR KPIs based on the dynamic talent portfolio plan
- ③ Narrow a list of the KPIs down to the ultimate ones that make sense for board-level discussion

(Perspective 3) **Nurture transformational corporate culture**

- ① Revisit the mission and purpose of the corporation, and define the behavior and attitude of employees leading to business success as corporate culture
- ② Develop an employee evaluation system that instills such behavior and attitudes
- ③ Allow employees to have a direct conversation with the CEO and CHRO on how much corporate culture should be maintained or updated

(Factor 1) **Build a dynamic talent portfolio**

- ① Find the gap of employees' abilities and headcount between the current situation and the goal from a mid-to-long-term viewpoint
- ② Fill the gap by reallocating employees as early as possible, and otherwise hiring necessary skilled talents
- ③ Make the hiring process of graduates more diversified and multi-tracked, which makes it easier for those who studied abroad or are recent graduates to apply, and also underscore the changes
- ④ Place a higher priority to recruit and empower PhD holders and other experts as innovators or transformers within the business operation department

(Factor 2) **Embrace diversity and inclusion of employees' knowledge & experience**

- ① Accept more mid-career and non-Japanese employees and have them perform their best and get promoted within the organization, as well as making efforts to reduce gender inequality
- ② Enhance managers' ability to run their own division with more diversity, by creating a platform, for example, for managers to learn from each other by posting and sharing their cut and try efforts

(Factor 3) **Motivate employees to re-skill themselves**

- ① Identify the skills and expertise lacking for the whole company in order for your business strategy to work out
- ② Ensure employees are equipped with those skills and expertise, not only by just hiring experts or giving employees training, but also by encouraging them to learn from each other in study groups or other activities
- ③ Tie employee compensation to her/his re-skilling effort and consequent performance
- ④ Offer various opportunities to study outside, including an extended leave for earning a degree from a graduate school
- ⑤ Support individuals' efforts at engaging in in-house entrepreneurship

(Factor 4) **Enhance employees' engagement level**

- ① Monitor employees' engagement level periodically
- ② Offer stretch assignments to those with a higher engagement level, and to those with a lower level, make sure of her/his career plan and adjust their type of assignments
- ③ Put in place open calls for as many positions as possible
- ④ Ensure a working environment that embraces an employee's will to pursue a parallel career and other various working styles
- ⑤ Invest in health and productivity management, adopting a viewpoint of enhancing employees' well-being

(Factor 5) **Enable employees to work anytime, anywhere as much as possible**

- ① Advance digitalization of tasks and remote work
- ② Re-define the meaning of face-to-face tasks

02 Why Human Capital Management?

- In this era of unprecedented structural transformation, including digitization and decarbonization, there was a movement even before COVID-19 to place human capital at the core of corporate value enhancement, as it is the people who find new value and lead innovation.
- However, with the arrival of COVID-19 and the continuation of its effects now for several years, the awareness and behavior of human capital have also drastically changed. In the U.S., the number of voluntarily unemployed workers increased to such an extent that the change has been called the "Great Resignation". Some call this the "Great Reshuffle" . This is a story in the United States, but in any case, what is happening around the world today is a growing trend among individuals, triggered by COVID-19, to rethink their motivations for working and how they choose to work.

- Japanese companies once attracted the world's attention as a source of competitiveness by valuing their employees and employing them over a long term. This was praised as "Japanese-style" management. However, as mentioned above, as structural transformation progresses and workers' sense of value changes, this style needs to be updated to a considerable degree. These problems can no longer be solved solely by HR departments. This is why we now call this transformation "human capital management" and why we are promoting it.
- Kunio Ito brought new perspectives to the study group's discussions. His first insight was that the transformation should be examined in the context of corporate governance reform. Japan has been reforming its corporate governance framework since the beginning of the 2010s. Human capital strategies were also discussed within this framework. Second, the discussion should be focused on sustainable corporate value creation. Increasing the value of human capital will lead to increasing the value of intangible assets and, as a result, boosting corporate value in a sustainable manner. The third insight is the importance of leveraging the power of capital markets. At the study group, corporate executives in charge of human capital management and investors who place importance on human capital strategies directly exchanged opinions.
- The first edition of the Ito Report on Human Capital Management, which included these perspectives, was reflected in the 2021 revision of the Corporate Governance Code, which is a set of rules for listed companies that requires their investment in and disclosure of human capital initiatives. The "Ito Report on Human Capital Management 2.0" , published in 2022, has been read by many Japanese corporate executives and managers in charge of human capital management as a guide to concrete actions to be taken.

03 What Happens Next?

- 2022 is a year that should be called “the first year of human capital management” in Japan. This is because not only has the “Ito Report on Human Capital Management” been completed and widely used by Japanese companies to recommend management reforms, but there has also been a major policy development in the area of disclosure. The Financial Services Agency has decided to add disclosure items related to human capital and diversity to the disclosure items in securities reports, and the Cabinet Secretariat has released a draft “Guidelines for Human Capital Visualization” .
- From a macroeconomic perspective, the “Ito Report for Human Capital Management” also promotes the idea that through the transformation of human capital management, the abilities of individuals working in Japanese society will be more fully realized. This means that individuals will be freed from the uniform employment system that still persists in some parts of Japanese society, and that the society as a whole will become more and more diverse in terms of individual careers. As a result, the Japanese labor market, which has long been regarded as closed, may open up, creating a globally seamless environment.
- As the industrial structure is changing worldwide and the labor market is transforming in each country, some of the “Japanese-style” human capital management that have been strengths of Japanese companies, such as training employees on the job from a long-term perspective, internal job rotation that gives one a holistic view, and investment in health and productivity management, are still effective in increasing the corporate value. However, Japanese companies now boldly reform their management systems that can no longer adapt to the times, referring to the “Ito Report for Human Capital Management” and the guidelines for disclosure. Employment systems that are compatible with COVID-19 should converge globally to some degree. It is also hoped that, as dialogue with investors and information disclosure progresses, the excellent efforts of Japanese companies will become more visible and serve as a reference for companies around the world.