Minutes of the Eighth Council of Experts Concerning the Follow-Up of Market Restructuring

Date: Wednesday, February 15, 2023 13:00 – 14:40
Place: Tokyo Stock Exchange, 15F Special Conference Room
Attendees: See member list

[Kikuchi, Director, Listing Department, TSE]
The time has now come to begin the eighth Council of Experts Concerning the Follow-Up of Market Restructuring. Thank you for joining us today.

First of all, I would like to mention that Mr. Nagami and Mr. Matsumoto are participating online.

Now, I would like to begin proceedings straight away. First, let us explain today's agenda.

[Ikeda, Senior Manager, Listing Department, TSE]
First of all, I would like to thank you for discussing Summary of Discussions, TSE's Future Actions, transitional measures and so on at the meetings up to last month.
From today onward, we will continue to discuss mainly issues related to the Growth Market, and we will also discuss TSE's Future Actions, which was recently published, and follow up on the situation as appropriate.

Since today is the first time to discuss the Growth Market, we would like to start by presenting TSE's awareness of the issues and various factual data based on Document 2. Then we would like you to express a wide range of opinions and suggestions as to, for example, how we should proceed with the discussion in the future or whom we should interview.

In addition, we would like to receive your comments on our requests for Prime and Standard Markets to promote management that is conscious of cost of capital and stock price, based on Document 3, which shows the outlines we would like to present to listed companies in the future.
After receiving your opinions today, we would like to brush up on the content

by asking investors and others for their opinions, and then present the updated version for your review at the next meeting. After that, we would like to promptly notify the listed companies.

That’s all.

[Kikuchi, Director, Listing Department, TSE]

Now a TSE representative will provide explanations. Since we have two items on the agenda today, the session will be divided into two parts. First, the representative will explain the issues related to the Growth Market according to Document 2, and then I would like to hear your opinions. We will have time later to explain and receive your comments on TSE’s requests to promote management that is conscious of cost of capital and stock price.

As these were explained during the preliminary explanation, we will keep the explanation short.

[Monden, Manager, Listing Department, TSE]

I will now explain Document 2.

First, on page 2, we reiterate the concept and institutional design of the Growth Market.

The first feature of its institutional design is that it is open to a wide range of companies seeking listing. Listing criteria for the former Mothers market used to be moderate, thus allowing relatively small startups to raise funds for growth. The Growth Market took over such a role, and maintains accessibility for a wide scope of companies seeking initial or continued listing, for example, those with a tradable share market cap of 500 million yen or more. Furthermore, based on the concept of realizing high growth potential, TSE has newly institutionalized the disclosure of growth potential, etc., and will apply the continued listing criteria where companies are required to have a market cap of at least 4 billion yen after 10 years of listing.

In addition, especially in the Growth Market, listing of voting class shares is also expected.

Page 3 provides details on listing criteria, and page 4 provides details on disclosures related to growth potential and other information.

Next slides show the current status of the Growth Market. The first section is about the situation regarding IPOs.

Page 6 shows a summary. First, as for trends in the IPO market, recently about 100 companies are listed each year, and about 70% of them are in the Mothers or Growth Market. In terms of the market cap and size of fundraising at the time of IPO, those in Japan are smaller on average than those overseas. Specifically, the majority of IPOs are relatively small ones with a market cap of less than 10 billion yen and a fundraising amount of less than 1 billion yen. As for the allocation of shares, the allocation to institutional investors accounts for a small percentage, while more than 80% is allocated to individual investors.

In addition, approximately 60% of IPOs recorded a larger amount of secondary offering compared to an amount of funds raised at IPO, and such IPOs have been on the rise in recent years.

Moving on to the next page, TSE established a listing system for voting class shares in 2008, but only one company has actually listed such shares on the market.

The fundraising environment for non-listed companies at the pre-IPO stage has been improving in recent years, with the amount of funds supplied to non-listed companies increasing more than 10-fold in the last 10 years.

In addition, the government's "Startup Development Five-year Plan" formulated in last November set a target of increasing investment in startups tenfold to 10 trillion yen in five years, and it is expected that efforts will progress toward achieving this target.

The following pages refer to concrete data, I'll just mention titles. Page 7 shows the number of IPOs and the market cap and amount of funds raised at the time of IPOs, page 8 shows the distribution of IPOs in more detail, page 9 shows comparative data on the amount of funds raised at IPOs and the amount of secondary offering, page 10 shows the listing of class shares with voting rights, page 11 shows the supply of funds to unlisted companies, and page 12 shows the main initiatives set forth in the government's "Startup Development Five-year Plan". Page 10 shows the listing of class shares, page 11 shows the status of funds supplied to unlisted companies, and page 12 shows the main initiatives set forth in the government's "Startup Development Five-year Plan.

The following Section 2 shows the status of the listed company after the listing. Here again, a summary is provided on page 14.

First of all, it is mainly individual investors that purchase, sell, and hold stocks in the Growth Market, and even though some companies are in the red, their P/B ratios are high, indicating that investors have high expectations for their future growth potential.

On the other hand, in terms of whether the companies have actually achieved growth since their listing, while on average, some growth has been observed, few companies have achieved significantly high growth, and about half of all companies have failed to achieve growth.

In order to achieve such high growth, it is conceivable that even after listing, companies would raise large amounts of funds through public offerings and aggressively invest in growth, but in reality, only 14% of the companies have actually made public offerings after listing.

We have also seen cases where companies failed to achieve high growth even after a certain period of time after listing, for example, violating the criteria of market cap of at least 4 billion yen after 10 years of listing.

Regarding the latter part about the disclosure, the newly institutionalized disclosure of growth potential has been positively evaluated by investors and analysts as a step forward in information disclosure. However, some pointed out the importance of continuous disclosure and called for further enhancement of disclosure, so I believe that continued follow-up is required.

As for the reference data that follows, I'll just mention titles: page 15 for composition of buyers/sellers and shareholding distribution; page 16 for P/B ratio and ROE distribution; page 17 for changes in market cap after listing, which we already presented at the first meeting; page 18 for a list of companies that have grown to market cap of 100 billion yen or more after listing on the Mothers/Growth Market; page 19 for changes and breakdown of fundraising amounts; page 20 for the percentage of companies that conducted public offerings after listing; page 21 for distribution of market cap by the number of years since listing; and pate 22 for investors' evaluation of information disclosure.

These are the current status of the Growth Market. In the following Part III, we provide an overview and current status of the TOKYO PRO Market operated by TSE in terms of its potential to be used as a part of an ecosystem to support startups.

First of all, as outlined on page 24, the TOKYO PRO Market is designed as a flexible system based on the premise that it is for specific investors, and is a market that can accommodate a wide variety of companies.

A key feature of the listing is that instead of TSE or the lead managing securities company conducting the examination, a J-Adviser designated by TSE will investigate and confirm the eligibility of a company for listing and provide ongoing support.

Page 25 shows the current status of TOKYO PRO Market.

In recent years, the number of companies listed on this market has been increasing, and although the number of companies itself is not large, we are gradually seeing cases of companies raising funds at the time of listing or transferring to a public market once they are listed on the PRO Market.

On the other hand, in terms of liquidity in the secondary market, there are many companies that have little trading throughout the year, so liquidity is an issue.

As shown on page 26, the FIEA was amended in July last year to expand the scope of individuals who can become Specified Investors.

On page 27, you will find a list of J-Advisers and the status of new entrants in recent years.

Based on the above, in Part IV, we summarized issues we would like you to discuss.

First, on page 29, we are asking what measures should be taken in the future in order for the Growth Market to further demonstrate its function and role. Specifically, first, from a) in terms of functioning as an IPO market, we have listed three points to be discussed based on the current situation.

First, we would like to ask what you think about the level of future requirements for listing on the Growth Market, which currently has relatively moderate criteria, in light of recent changes in the fundraising environment and the current status of IPOs.

Secondly, we would like to ask what measures can be taken to promote the participation of institutional investors for the purpose of ensuring stability in price

formation and supporting growth after listing.
Third, we would like to ask what direction you see for startups to utilize listing by means of voting class shares.

Next, b) in terms of supporting high growth after listing, we have three points of discussion based on the current situation here as well.
The first point is how to follow up on the newly institutionalized disclosure of growth potential, etc., in order to further enhance its effectiveness in the future, as investors have high expectations for such disclosures.
The second point is related to a somewhat abstract, but major challenge that is to increase the number of companies that achieve high growth while making bold growth investments. We would like you to discuss possible efforts to promote such growth.
The third point is the nature of the continued listing criteria in order to seek a sound demonstration of high growth potential. In the Growth Market, there is a requirement for market cap of 4 billion yen or more after 10 years of listing, and this requirement will be applied from the end of the transitional measures. We would like you to discuss how such criteria should be.

Page 30 is about TOKYO PRO Market.
In the last year's public consultation, we received opinions that the TOKYO PRO Market should be used for startups aiming for earlier listing and fundraising. Do you think the market can be utilized this way? If so, what roles and functions should be fulfilled, and what points should be considered in doing so?
These are the items we would like you to discuss today, and on the last page or page 31, we summarize the relevant discussions at the Follow-up Council to date.
That's all from me.

[Kikuchi, Director, Listing Department, TSE]
Now, I would like to hear from our members.
If you would like to speak, please raise your hand and I will nominate you. Since some members are participating online today, I would appreciate it if you would first start by saying your name before stating your opinion. Mr. Nagami and Mr. Matsumoto, our online participants, if you wish to speak, I would

appreciate you indicating it in the chat.

So, who would like to start?

[Kumagai, member]

Last November, the Kishida administration formulated the "Startup Development Five-year Plan," which, in a nutshell, aims to create an ecosystem to foster startups in Japan. I recognize that the Growth Market will play a very important role as a listing market that should be part of the ecosystem to support the growth of startups, and it goes without saying that we should keep pace with this Plan and take action to achieve the targets. I believe that It is easy to get listed on the Growth Market among other global exchanges, and this market provides an opportunity for companies to raise funds at an early stage of their growth by utilizing the exchange, while at the same time encouraging the enhancement of various internal management systems in companies, such as governance and information disclosure, that accompany a listing.

In light of these points, I will now comment on specific issues.

First, I'd like to make some comments on page 29, 1.a) functioning as an IPO market. I think it is appropriate to discuss the nature of the initial listing criteria for the Growth Market in relation to improving the fundraising environment for non-listed companies. However, I believe it is premature to take such action as raising the bar for initial listing in the near future. We just transitioned to the new market segments last April and should now be in the process of carefully assessing the situation. In this sense, I am concerned that frequent changes to the system may lead to a decrease in the predictability of companies.

Secondly, I think it is extremely important to encourage institutional investors to enter the Growth Market. Although we are gradually seeing some listings that utilize investments by cornerstone investors, it is mainly individual investors that trade and hold shares, as mentioned in the secretariat's materials.

Therefore, I suggest that we conduct interviews with institutional investors to first identify issues based on the actual situation. I think it was mentioned at the previous follow-up meeting that it is difficult for institutional investors to invest because of the small size of the market cap and other factors at the time of listing, but why don't we first investigate the actual situation with regard to other issues as well?

Voting class shares are used by IT and technology companies in the U.S., and are seen as one of the factors contributing to the vitality of US companies. On the other hand, I am aware that there are many discussions from the perspective of the principle of equality of shareholder, and I believe that detailed discussions will be necessary, taking into account the intention of companies to utilize such class shares and the intentions of investors. In conclusion, I believe that it is first necessary to sort out opinions from various perspectives as one of the options to revitalize the market.

Next, I would like to discuss 1.b) in terms of supporting high growth after listing.

Some listed companies in the Growth Market have not been able to take advantage of the capital market because their liquidity has declined and their growth has stalled after some time after listing. Can you provide some guidelines for listed companies in the Growth Market to avoid such a situation?

As I mentioned earlier, individual investors account for the majority of trading in the Growth Market, but I think it is vital to increase liquidity so that institutional investors can also trade more actively. To this end, in addition to such criteria as business performance, liquidity, and market cap, I suggest that TSE should interview institutional investors about their rules for investing in listed companies, including governance, information disclosure, and investor relations activities, and summarize them as guidelines and encourage companies to consider taking action. These efforts are expected to contribute to closing the communication gap, if any, that exists between institutional investors and listed companies.

Also, as discussed at the JPX Research Institute, I believe that one way to improve liquidity would be to include stocks of some Growth Market-listed companies in TOPIX.

Second, as for initiatives for increasing the number of companies that make bold investment in growth and achieve a high level of growth, I’m afraid that the number of companies making losses at the time of or after listing will increase. In such cases, I believe that dialogue with investors will become even more important, in addition to further improvement of governance and proactive information disclosure by listed companies.

It is important to have a thorough discussion on the continued listing criteria applicable after 10 years from initial listing, from the perspective of enhancing the market's metabolism. I am aware that the current continued listing criteria regarding market cap of at least 4 billion yen was set based on the criteria for the former market. If so, it would be meaningful to conduct a stocktaking of ideas about the level of market cap. However, I believe that it is not realistic to discuss raising the continued listing criteria too quickly at this point. I feel that it is important to first analyze the impact of the termination of the transitional measures, and that we must proceed with caution.

Next, I’d like to discuss 2. TPM on page 30.

According to materials from companies listed on the TPM in 2019, the purpose of their listing was, first, to improve their creditworthiness, second, to diversify their funding sources, and third, to step up their efforts with a view to listing on a public market. In particular, with regard to the third point, stepping up with a view to listing on a public market, the secretariat's data also shows listings transferred from TPM, and it appears that TPM is beginning to play a role in the ecosystem that supports the growth of startups.

Since TPM’s listing criteria, etc., are more relaxed than those of the Growth Market, and J-Adviser’s support is available, I think it can be used to improve internal systems and other aspects of a company. It could be positioned as a gateway to "promotion" to one of public markets, typically, the Growth Market, and could be used to expand options within the ecosystem.

Finally, I would like to add a few words on measures that may be necessary to revitalize startups, although they may be outside the scope of TSE's operations.

The "Startup Development Five-year Plan" formulated by the government is very comprehensive, but some people involved in startups have pointed out that it lacks three critical points that we might call the finishing touches.

The first point is to realize diverse and flexible work styles according to the reality of startups. Specifically, as far as startups meet certain requirements such as venture capital funding, laws and regulations should be established to ensure that a system is established to allow individuals to choose diverse and flexible workstyles based on their own will, for example, by exempting such startups from overtime caps, and that individual contracts specify working hours, working arrangements, compensation, conditions for termination of employment, etc. for smooth termination and re-contracting of employment.

The second point is to review the regular amortization of "goodwill" for stimulating M&As. Specifically, with respect to goodwill, which is expensed as an intangible fixed asset held by a company, the Japanese accounting standards (GAAP) that stipulate regular amortization should be revised to conform to IFRS and US-GAAP, and also to allow companies adopting Japanese GAAP to choose the method of accounting for goodwill in accordance with their actual circumstances under certain conditions.

The third point is the granting of incentives through stock options. Specifically, it is recommended that the accounting standards for paid stock options be revised and that flexible use of paid stock options be permitted, such as by eliminating the need to record expenses under certain conditions, and that the annual total exercise price limit of 12 million yen for tax-qualified stock options be raised.

I hope that TSE will actively support the realization of these three points I have just mentioned through discussions with the parties concerned.

[Koike, member]

First, I would like to give you a quick overview of the IPO landscape from the viewpoint of an institutional investor and asset manager. It is our major concern that even when we participate in IPOs, allocations are not easily made in accordance with the fund size. In addition, it is difficult to participate even in the secondary market due to the scale and liquidity, and this is an area that must be closely monitored from the perspective of ensuring and fulfilling fiduciary duties. On the other hand, we believe that one of our social roles is to provide investors with diverse investment opportunities and to introduce growth opportunities in Japan to investors around the world. However, so far, we have not successfully done so. It is a major challenge for asset managers involved in IPOs.

In the meantime, from my experience, I think there are issues in terms of pricing processes of investment banks and securities firms, diversification of market participants, and provision of liquidity, and I recognize that one of the issues is to consider a mechanism to enable institutional investors to get a firm footing in the IPO process.

There is no doubt that the easier it is to get listed, the more active it will be. Meanwhile, I feel that there are challenges. According to the reference material, I think it is difficult to say that the growth after listing has been sufficiently achieved. Furthermore, more than 100 companies go public every year, and if the number of IPOs increases further, I'm afraid there will be a capacity problem for IPOs, including capacities of screening teams of securities firms and auditing firms, so I am concerned about the quality of IPOs. I think the diversification of pre-IPO fundraising and improvement of the fundraising environment, and IPOs as an exit strategy should not necessarily be the same. Therefore, in the sense of encouraging growth after listing and the participation of institutional investors, the continued listing criteria, such as 500 million yen market cap of tradable shares and 4 billion yen market cap after 10 years of listing, for example, could be made a little stricter.

Although this is not the purpose of this Council, looking at the METI's data on startups, more than 75% of startup exits in Japan are via IPO, while in the U.S., it is about 10%. In other words, in the U.S., 90% of exits are via trade sale or M&A, and it seems that there is a trend for startups to grow at the unlisted stage and have institutional investors involved at the time of IPO. I think such data may also serve as helpful reference.

We are also interested in and considering crossover investment. In the U.S., it is a well-established practice for mutual funds to put money into early- and late-stage companies to increase corporate value through engagements, and performance is naturally expected to outperform the index, so we are looking at this with great interest. I am aware that this area is still under discussion in Japan, but I believe that incorporating this type of financing would allow for diversification of pre-IPO fundraising.

As for voting class shares, although it is considered to be very important to prepare them for diversifying fundraising, as an asset manager, our stance is neither for or against them, as we believe ingenuity and discussion are still needed. If class shares are issued in a way where the business owner has a high percentage of shareholdings, the issue of protecting the rights of minority shareholders will arise. So I think it is necessary to devise solutions, for example, by including a sunset clause, and to enhance the disclosure of governance, reasons for issuing class shares, equity stories, and use of funds.

[Sampei, member]

I would like to talk about three points in combination with the issues you raised on page 29 regarding 1.a) functioning as an IPO market and 1.b) supporting high growth after listing. Also, since this is the first time we are discussing the Growth Market, I would like to talk about my expectations for and holistic view of the market.

The first point is that it is very problematic that the amount of funds raised at IPO is equivalent to roughly 10% of the market cap, and that capital increases after listing are limited as only 14% of the companies have done so. The problem lies in the assumption on the part of both investors and companies that a capital increase is a negative thing. This is a problem that is unique to Japan. People recognize that capital increase is equal to dilution. On the other hand, foreign institutional investors look at a capital increase to judge whether they are dilutive or accretive. Such a judgment is made by comparing the growth rate with the capital increase ratio. For example, if the growth rate is 25% and the capital increase ratio is 10%, it is judged as accretive. I think we need to educate people a little more about this point of view.

Second, regarding the criteria requiring a market cap of 4 billion yen after 10 years of listing and the fact that an offering amount is larger than the amount of funds raised at IPO, while the original purpose of IPO is for growth and IPO should be an entry point, it is highly likely that a listing has become an exist for the founder or investors who made investments before a company goes public. Accordingly, it is necessary to provide incentives that suit the original purpose of a growth market. For example, you could set a condition of an IPO requiring that the amount of funds raised at IPO must be greater than the amount of secondary offering, and you could raise the level of market cap required in the continued listing criteria. For example, it may be assumed that at least one of the following must be met: a market cap of 25 billion yen after 5 years or 200 billion yen after 10 years. You may be surprised to hear “200 billion yen,” but when you consider the CAGR that institutional investors expect from the Growth Market, 25% would be the minimum. On the other hand, if it doesn't reach 25%, I don't think it can be called the “Growth” Market. For example, assuming 5 billion yen at IPO, a 25% CAGR would be 15.3 billion yen after 5 years; a 35% CAGR would be 22.4 billion yen after 5 years; and a 10-year 45% CAGR would be about 200 billion yen. Although it depends on your viewpoint, you can make such estimates, and I think you need to indicate clearly what growth rate you are considering as well as the level expected in the Growth Market.

Third, I think there may be a relationship between voting class shares and the ratio of tradable shares. Regarding voting class shares, I believe that the importance of corporate governance is not yet fully understood in Japan, both on the corporate side and on the side of institutional investors. As you have pointed out, voting class shares pose a possible risk of distorting governance. I think that simply copying examples of U.S. high-tech companies here is a response that only looks at one aspect. In the U.S., the separation of business execution and oversight is a basic premise, and the institutional design of the board of directors differs from that in Japan. Besides, it is also necessary to consider that only the General Principles of the Corporate Governance Code are applied to the Growth Market. I’m not totally against voting class shares here. However, I believe it is necessary to balance conditions of issuing voting class shares: for example, business execution and oversight should be strictly separated; a board of directors has a majority of independent directors; as for the Corporate Governance Code, not only General Principles but also Principles and Supplementary Principles are applied to companies issuing class shares; and a ratio of tradable shares should be at 50% or more.

As for the minimum ratio of tradable shares being 25%, even in the case of common stock, it could be loosened a little, for example, to a minimum of 10%, taking into account the founder's rights to control the company. In this case, it would be possible to gradually increase the ratio of tradable shares to a minimum of 20% from 5 years after listing and 25% from 10 years after listing. As Mr. Kumagai said, this may or may not be done right now, but I mentioned it as a possible solution when considering the current issues.

[Nagami, member]

I would like to discuss roughly three points.

First, regarding the listing criteria, I am opposed to raising the initial listing criteria. I remember that the starting point of the discussion at this Council was to promote the metabolism of industries and companies, so raising the hurdle for new listings is not desirable from the perspective of the metabolism.

Secondly, as for what I would like to see the Exchange lead, as you referred to Startup Development Five-year Plan earlier, the fundraising environment for unlisted companies has been improving every year. As a result, the timing of listings has been delayed from year to year, creating a tremendous need for secondary trading of unlisted stocks. Compared to the U.S., an environment for such trading has not yet been established. From the perspective of creating larger listed companies, I believe that secondary trading of unlisted stocks should be institutionalized, and the idea of making good use of the current PRO market, or even creating a new one, could be considered.

Third, I'd like to suggest that TSE should make some requests to its stakeholders. There are four in total.

First, although investments into later-stage companies have been increasing, the main players are foreign institutional investors and hedge funds, and so-called domestic investment trusts are a tiny minority. In talking with institutional investors, I got an impression that there are circumstances where it is difficult to do so due to fund rules, but if such fund rules can be revised in a way allowing such investments, I would like TSE to encourage domestic investment trusts to do so. I believe it is important to develop an environment to enable domestic investment trusts to enter the market.

The second suggestion is about the IPO allocation. Our company has negotiated with securities companies to change this, but normally 80% is allocated to individual investors and 20% is allocated to institutional investors. As Mr. Koike pointed out, the allocation to institutional investors is small and accordingly they are unable to buy more even in the secondary market. We would like to break this situation and would be grateful if the flexibility is secured. I believe that this is primarily a matter for the securities companies, and I would like to see TSE provide guidance on this.

The third suggestion is also a matter to be communicated with securities companies. It is about analyst coverage. In six months or a year after initial listing, listed companies will no longer attract attention, and institutional investors will have difficulty analyzing such stocks. Naturally, it is a matter of course for issuers to enhance disclosure, but I believe that sell-side analysts at securities companies are important in terms of providing a third-party perspective. On the other hand, coverage of newly listed companies is very thin, and that leads to neglect. Although this may not be beyond guidance and communication, I'd like TSE to communicate with securities companies to promote analyst coverage.

The fourth suggestion is about stock incentives. Regarding stock incentives, while they are becoming more common in newly listed companies, looking at U.S. growth companies, shareholdings are diluted by only 1-3% per year among GAFA and 5-10% among companies with a higher ratio by stock compensation alone. This means people who create innovation are that important. In Japan, there are still very few cases, so it is necessary to raise the awareness among issuers themselves, and it is also important to reinforce relevant communications and raise the awareness of the calculation of valuations by investors based that. I think we are competing with U.S. tech companies in an inferior situation from this perspective as well.

[Matsumoto, member]

Overall, I think we need to think in terms of how to design the capital market as a whole. There are various agenda items and issues, but I think we should not deviate from the perspective of what to do with the capital market in Japan as a result of responding to each one in too much detail.

From this perspective, looking over the current situation, the problem seems to be that the size of IPOs is too small. In terms of market cap and amount of funds raised, those in Japan are roughly 3% of those in the U.S. It would be like a Series A company in the U.S. being listed on the Growth Market in Japan, which seems too small as a listing market.

A major point is how to revise the issue. One problem, as Mr. Nagami mentioned, is the lack of rules regarding the secondary market for unlisted shares in Japan. When there was an initiative to try to bring this to Japan in the past, it addressed only partial aspects, and follow-up efforts went only half way two years ago. Going forward, I believe it is important to establish such rules. Because of this system in the U.S., it is possible to grow a company from seed, to early-stage, to later-stage, with different funders before going public, and finally to IPO with the company becoming a unicorn. However, since this is a legal issue, it is something that will take time and is a medium- to long-term issue for the future.

As another way, I think the criteria for IPO should be raised, but as Mr. Kumagai said, some may think that since the rules have just been changed, it is not a good idea to change them again so soon. There is also the idea that Mr. Nagami mentioned. I do believe that the criteria should be raised in the future, but in any case, it is something that should not be done at this time.

Also, the 60% of companies recorded a larger amount in the secondary market compared to the amount raised at public offering. I think this percentage is terribly high. It means that at the time of initial listing, companies do not receive sufficient funds to grow. The ratio of secondary offering should be limited by setting a threshold such as less than a certain percent, but I don’t think this should be done too quickly, because if it is done at this point, there will be problems such as the loss of exit opportunities for venture capitalists. We believe that this is something that should be done over time in combination with the development of a secondary market for unlisted shares and the raising of listing standards that I mentioned earlier.

So, what can we do now? There is a problem that most companies are not growing after getting listed at a small scale, and their market cap is not increasing. There may be many reasons for this, including the motivation of management, but rather than changing the listing system of the Growth Market, we should think about how to foster listed companies. I can think of two possible ways for that. One is to share best practices in disclosure and IR, and create a venue, something like a school, to raise the awareness of companies in the Growth Market under the initiative of TSE. Through such efforts, we should ensure that corporate managers will be exposed to the market so that they can be stimulated and achieve the growth.

Another one is related to the continued listing criteria. As Mr. Sampei mentioned, I think that the minimum market cap of 4 billion yen after 10 years of listing is too low. It means that the companies can remain in the market, even if they have made little or no growth in the first 10 years after listing. I mentioned earlier that there is no need for changing the IPO criteria now, but as for this 4 billion yen criterion, it is indeed low, so I suggest that the threshold should be raised to 10 billion yen, or 20 billion, and then provide support in disclosure and IR as well as stimulus.

Someone earlier mentioned the inclusion in an index, but it is a vexing issue. I used to think that venture companies should also be included in TOPIX in order to allow institutional investors' funds to enter the market, but there is a problem that our country's indexes, whether TOPIX or Nikkei 225, do not go up. Accordingly, I now consider that it would be more adequate to create an index that goes up as in the U.S. and use it as a benchmark, so that the capital market grows. Therefore, I believe we should be cautious about including Growth Market-listed companies in TOPIX.

Finally, regarding TPM, it is quite a problem that there is very little trading as if it were a semi-listed market, so to speak. Before deciding how to utilize TPM, I think it is important to conduct a thorough fact-finding survey and analysis of what the market is used for. The direction of the reform may not necessarily be to just promote its utilization, but in any case, a survey of the actual situation should be conducted as a prerequisite for such consideration.

[Kuronuma, member]

I'd like to discuss the listing criteria in terms of the ease of listing. When we started discussing the market restructuring, we first defined the concept of each market segment, and since the Growth Market is characterized by the fact that even small market cap can be listed, I do not think this concept should be changed for the time being.

However, I understand that there are currently many small IPOs, and that is a problem. Going forward, as trading on TPM will become more active and a secondary market for unlisted stocks will be established, there will be more options for startups other than listing on the Growth Market, so it would be good to have such multiple options so that companies can choose which path they wish to take. This would allow some companies to grow first and then make an IPO. In this case, I think the advantage of listing on the Growth Market is that it is easier to raise funds during and after the IPO, so a mechanism to support fundraising, especially after listing, is necessary.

I also think it is important to promote growth after listing, but even if TSE takes various measures, it is difficult to grow a non-growing company, so in the end, I think it will come down to how to set the continued listing criteria. There is a threshold of 4 billion yen after 10 years of listing. If this is too low, I think it should be raised, and as Mr. Sampei mentioned, raising the threshold in a phased manner would be an effective way to achieve a certain effect. However, it seems a little unreasonable to ask a company that is currently listed with a market cap of 500 million yen for tradable shares to have a market cap of 10 or 20 billion yen in 10 years. We fear that this would lead to a number of companies giving up on the idea of going public with a market cap of 500 million yen for tradable shares.

Regarding measures to promote the participation of institutional investors, we should interview institutional investors and ask them under what circumstances they would invest in the Growth Market. In addition, what I expect most from institutional investors is support after listing, but we also need to consider how investors who support growth would be able to enter the market, and I believe this is of utmost importance.

The voting class shares system was launched in order to allow startups to get listed by using such shares, which are compatible with startups. I think we should keep the system as it is, and do not have to promote the use.

As for the support of high growth after listing, which is the second point of discussion in the Document, as I mentioned earlier, based on the current continued listing criteria, it is conceivable to raise the criteria, to raise them in a phased manner, such as in 5 years, or 10 years.

[Kanda, member]

The theme of emerging markets and growth financing is a longstanding issue that has been discussed since the time of the Abe and possibly Koizumi administrations. Of course, the system has been gradually improving, but the speed is lacking. Various points have already been made today, and continuous improvement is needed.

Regarding the criteria for new listings, I think it is good that the criteria is moderate at this point. However, the future state of the criteria should be considered based on the relationship with the secondary market for unlisted shares, which should be developed as soon as possible anyway. I am not sure if the criteria should be raised at that time, but it is important to ensure that institutional investors can participate. The development of a secondary market for unlisted shares has been discussed for some time, and the situation should be improved as soon as possible.

The current situation shows that IPO has become "LPO," or last public offering, and is simply an exit opportunity. Since funds are needed to invest in growth, there is a concern that not raising funds may mean that the company is not investing in growth and not making growth efforts. If a company fails to grow despite its efforts after its IPO, that is something that cannot be blamed, and there is nothing particularly wrong with the fact that there are many such companies in the market. However, in case an IPO is simply an exit, and those who remain afterwards do not invest in growth or raise funds for that purpose, then I feel that what is being done is not right. It may be an oversimplification to say that the market is exploiting ordinary shareholders, but talking in the abstract, I am concerned about whether the market is being used unfairly in the abstract. As for how to improve the current situation through the listing system, we can think of such measures as having companies disclose their fundraising plans or, as Mr. Sampei mentioned, gradually raising the continued listing criteria, such as the market cap of tradable shares, after listing.

I think TPM had a good idea and focus, but the reality of the situation is that trading is not carried out. This is due to the fact that there are very few professional investors in Japan. Therefore, although it is not an issue for this Council, I believe that we need to develop professional investors comparable to those in the U.S. and Europe, so that TPM and other systems for professional investors can function. As it is now, it will inevitably become just a tentative place for moving to another place. This is a major challenge for Japan, and in order to truly move the Japanese securities markets forward, it is necessary to develop and expand the pool of professional investors, as defined by global standards.

[Ando, member]

Although this is not about the institutional design of the Growth Market, I assume that the management of companies listed on the Growth Market may have two kinds of concerns.

The first one is that despite being a publicly traded company, there may be a lack of opportunities to showcase the value and growth potential of the company. Given the environment surrounding securities companies, it is difficult to expect sell-side analyst coverage, and even if we encourage companies to enhance disclosure of management information disclosure and strengthen investor relations, it is meaningless if they are not visible to investors. Therefore, how about TSE providing public relations opportunities for the companies listed on the Growth Market? The number of companies is large, and it is burdensome to hold these events on a regular basis, but when implemented, the benefits of being listed on the Growth Market will be realized.

Second, as Member Kanda pointed out earlier in relation to growth investments, it is not necessary to raise funds for growth only through equity, but it is also possible to raise funds through debt from financial institutions. Although this is a different dimension from the purpose of this Follow-up Council, it may be necessary to review the role financial institutions play in nurturing startups, especially in the Growth Market, as well as the current challenges.

In any case, the two points I made are just matters of speculation, so it is necessary for TSE to conduct a broad survey of Growth Market-listed companies regarding their post-listing issues and concerns, as well as any expectations they had before listing that have not been realized. Of course, investors' opinions are important in the investment chain, but the first step is to investigate what the listed companies are concerned about.

[Okina, member]

The government has issued the Five-year Plan for startup development, but I think the biggest challenge is how to scale up startups. As mentioned by Mr. Matsumoto, I understand that the theme is how to solve the problem of too small scale or lack of growth.

In the current Five-year Plan, the government was conscious of foreign investors as well. In order [for startups] to scale up, they need to be attractive not only to Japanese investors but also to foreign investors, so I think it is very important to consider how they are seen by foreign investors. In this regard, it seems important to deal with not only the small size, but also how the market is viewed by individual investors, who account for 84% (of the allocation). We have heard from U.S. venture capitalists that they are looking at what kind of investors are included as core or continuing investors. I am wondering if we could have interviews on how companies listed on this market are viewed from the eyes of foreign investors. In Japan, the percentage of venture capital in the pre-listing stage is about 40%, but I think it would be good to find out about the actual situation and stance of venture capital investment. Earlier you mentioned restrictions on the secondary offering ratio, and in considering this, I would like to know how it is viewed by venture capitalists, institutional investors, startups, etc.

We also need to hear how the system and criteria look from a global perspective. Regarding the initial listing criteria, I think it is good that the current criteria is rather moderate, but you should send a message that larger IPOs are preferable even at this point, and as many members have said, it would be good if the criteria could be higher in the future. I also suggest that we consider gradually raising the threshold of 4 billion yen after 10 years of listing in order to make the discipline work. In any case, it is necessary to check what the Growth Market is really like, how it is viewed by venture capitalists, institutional investors, start-ups, etc., and how it appears from a global perspective.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much.

All members expressed their opinions, and now I would like to ask a representative of the Ministry of Economy, Trade and Industry, who is participating today as an observer, to make some comments.

[Asano, Director, Industrial Finance Division, Ministry of Economy, Trade and Industry]

The reference material [Document 4] distributed to you was prepared, taking into account the notion that IPOs have become "LPOs" where the goal is to go public and no further fundraising takes place. There is only one company listed on TSE with dual class shares. I think it is necessary to examine closely whether companies do not want to dilute voting rights, or whether they have no intention of raising funds in the first place. We need to investigate what hampers the use of dual class shares. I don't think TSE disapproves listing of dual class shares at its listing examination. Then do securities firms exclude such shares? What has been considered between securities firms and company founders? We need to consider where the problem lies.

You also need to find out how TSE Listing Regulations and the examination criteria clarified in 2014 are perceived by company founders and securities firms in the first place. Then, as a matter of course, we suggest that you also consider such factors, including room for facilitating coordination with existing shareholders when going public.

In addition to the approach of giving management shares having multiple voting rights, there could also be the idea of realizing a medium- to long-term growth strategy for startups through the capital market by giving preferential treatment to long-term shareholdings. However, I think we should consider this from a comprehensive perspective, taking into account the discipline of the capital market and the need to secure liquidity in the market.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much.

Next, we would like to explain our requests in order to promote management that is conscious of the cost of capital and stock price, according to Document 3.

[Monden, Manager, Listing Department, TSE]

As per the policy for future actions published last month, TSE intends to make requests to promote management that is conscious of the cost of capital and stock prices in the future, and today we would like to ask for your opinions on the outlines we would like to present to listed companies in our guidance.

First of all, assuming that our requests will be made to all listed companies in the Prime and Standard Markets, we would like to clearly state in the notice that adequate measures are required, especially in cases where P/B ratios are below 1x, except in cases considered temporary, such as market downturns.

When we discussed the policy for future actions last month, we stated that we "strongly request disclosure when a company's P/B ratio is consistently below 1x." Some pointed out that we should specify a period of time referred to as "consistently." However, if a specific period of time is indicated, there is a concern that it may discourage proactive consideration and action, as if they did not have to take action unless the situation falls within that time frame. Therefore, we do not indicate a specific period for a P/B ratio below 1x, and exclude cases where it is considered to be temporary.

The specific requests are shown in the table below in light green color. We would like to request not only the disclosure of information, but also the implementation of a series of such cycles, including an analysis of the current situation that is a premise for the disclosure, actions to be taken after the disclosure, and updates on progress.

First, regarding the analysis of the current situation, we would like to request that, upon identifying the cost of capital and return on capital, companies analyze/evaluate, for example, whether they have achieved a return on capital that exceeds the cost of capital; and if not, what the factors behind this are; and even if they have achieved a return on capital that exceeds the cost of capital, if they are not valued by the market - for example, if a P/B ratio of less than 1x, what the factors behind this are.

As written below, based on these analyses of the current situation, we expect the companies to discuss and disclose their policies, targets, and initiatives for improving the current situation.

In the right column, we described three points to note in doing so. First, we assume that each company will set its own indicators for improvement based on its unique circumstances.

Second, if they believe that the current level is sufficient, we expect them to indicate such an evaluation of the company in their disclosures.

Third, we currently envision that TSE will provide a new format for disclosure that includes items newly required to be disclosed. In addition to disclosing information in accordance with that format, we would like to make it possible to present similar information in the medium-term business plan or the like in accordance with the intent of Principle 5.2 of the Corporate Governance Code.

In either case, we assume that companies should state in their corporate governance reports that such disclosure is made so that investors can easily find such information.

Once the disclosure is made, companies are expected to proceed with initiatives in accordance with the plan, and actively engage in dialogue with investors based on the disclosure.

We would also like to request that the disclosure not be the end of the process, but that an analysis of the progress be conducted at least once a year, and that the disclosure be updated.

The above is an outline of our requests. We will finalize the details after discussions at the Follow-up Council and interviews with investors, and then notify the listed companies by spring of this year.

That’s all from me.

[Kikuchi, Director, Listing Department, TSE]

Now, I would like to hear your opinions. Who would like to start?

[Ando, member]

Regarding the direction and content explained by the secretariat, I myself pointed out the problem of companies with P/B ratios below 1x at the first meeting and stated, "the management of companies with P/B ratios below 1x need to understand the essence of sustainability management, create a roadmap of priorities for their reform efforts, and continue the PDCA cycle of dialogue and engagement with investors regarding the content of the roadmap." Therefore, I have no objection. However, on page 3 of the Document, to the right of "Planning and Disclosure," there is a reference to a "new format to be provided by TSE," and I am not in favor of TSE creating a new format. The secretariat also commented to the effect that "companies should be proactive," and since this is a measure to enhance the overall strength of management, it will not achieve its objective if it becomes a boilerplate response.

In the discussion on the topic for the first half of the meeting, as noted on page 4 of Document 2, TSE has already required companies listed on the Growth Market to disclose their business plans as well as strategies and initiatives regarding growth potential by indicating only disclosure items, and I believe that the same approach should be sufficient in the Prime and Standard Markets as well. It is necessary for investors to evaluate the so-called "free performance" of a company's voluntary efforts, and it is extremely difficult for a company to improve its P/B ratio unless it voluntarily discloses information with management's thoughts in mind.

Furthermore, guidelines and guidance have already been published with the intention of increasing corporate value. For example, the Ministry of Economy, Trade and Industry has provided "Guidance for Collaborative Value Creation 2.0" and many corporate executives have referred to various guidelines. Of course comparability is important, but I would like to emphasize that it is not advisable to create a new format because the issue of a P/B ratio below 1x is not an issue at a level that cannot be solved by applying something like a mold.

[Kumagai, member]

First, I think the secretariat's material appropriately reflects the discussions we have had at previous meetings. On top of that, these requests are for all listed companies in the Prime and Standard Markets, which means that there are a very large number of parties to communicate with. In light of this, as I mentioned before, communications and delivery to the listed companies will be very important.

It is extremely important to convey TSE's view that this measure is not merely a request for disclosure, but rather a call for a fundamental reconsideration of corporate behavior, in a way to ensure common understanding and avoid any misunderstanding. To take this a step further, it is essential to send out strong and careful information that reaches top management, as a financial officer of a company may not be willing to admonish top management.

In addition, TSE should pay close attention to efforts to accurately and firmly communicate its view not only to listed companies, but also to investors, securities firms, consulting firms, and other parties surrounding the companies.

One last question: I believe that notification to listed companies of these requests is scheduled for the spring of 2023. For example, what is the expected timing of disclosure for companies with a March fiscal year end, if any?

[Monden, Manager, Listing Department, TSE]

We would like to request that companies with a fiscal year ending in March also take action as soon as possible after we give notice in the spring of 2023. However, from a practical standpoint, companies whose fiscal year ends in March are still considering their business plans for the next fiscal year, for example, so we do not believe that it is always necessary to disclose immediately after notification.

We would like to communicate this interpretation as well when we make the actual announcement.

[Ando, member]

Regarding what Mr. Kumagai just mentioned, I think it would make a lot of sense to clearly state that when a company announces its policy in response to the requests, targets and KPIs, it must go through a board discussion.

[Sampei, member]

First, I agree that the target of these requests include all companies in the Prime and Standard Markets. I also agree with the structure of these requests, which is a series of steps starting with an analysis of the current situation, in other words, Why→What→How, as well as an annual update.

However, there is a point of concern in the "planning and disclosure" section. The terms "planning" and "time period of the plan" tend to be rigid, and there is a danger that they will be associated with the Japanese style of medium-term planning, leading to a formalistic response.

In particular, plans tend to be described in terms of timeframe and monetary levels, such as "by when" and "yen amount," but it is difficult to achieve such plans. As a result, if a company continuously fails to meet plans, the market valuation declines. Companies may fall into such a vicious circle. Rather, in other countries, it is considered important to indicate a trajectory for the percentage change, such as a percentage of ROE or EPS growth, and to continue to demonstrate such growth.

These indicators in terms of percentage change are directly related to valuations and are easy for investors to comprehend. What companies need to do is to indicate what reforms they need to make and what actions they need to take and by when, in order to stay on track with such a percentage change.

Also, as Mr. Ando pointed out, the term "format" is a misleading expression.

In this regard, I believe that the disclosure of "matters concerning business plan and growth potential" introduced in the Growth Market is very good. TSE website also provides examples of disclosures and other information, and such examples cover a variety of expressions, not the same old story. It seems to me to be helpful as such examples demonstrate a high level of flexibility, and also cover important points to be made. In particular, I feel that when P/B ratios are below 1x, discussions tend to focus on ROE and cost of shareholders' equity, and the importance of growth potential is often overlooked. In that sense, I think the disclosure of items intended for the Growth Market is useful.

However, I believe that companies listed on the Prime and Standard Markets often have mature and traditional businesses. Accordingly, in addition to the disclosure items intended for the Growth Market, the sustainability perspective is also very important. In particular, some companies with P/B ratios below 1x may have a high ROE at present, but may be undervalued because they have not yet established a business that can replace such old businesses, for instance, due to a large environmental burden, or because of the uncertainty of transformations, so it is important to add a sustainability perspective.

The term "format" may be interpreted differently from what is intended, but I think it would be useful if the content is something like the disclosure items for the Growth Market.

[Nagami, member]

Basically, I am comfortable with the content, but as the title says, "Management to be more conscious of cost of capital and stock prices," I believe the main issue is how to make corporate managers aware of such factors.

From this perspective, one point that I'd like you to incorporate into the process is whether or not the logic for determining directors' compensation includes factors related to capital efficiency. An indicator could be ROE, ROIC, or TSR (Total Shareholder Return).

I believe that corporate managers of Japanese listed companies basically have too much of a PL mindset, and that is why it is important to make sure or encourage them to include capital efficiency-conscious items in the logic for determining directors' compensation in order to plug in the BS and capital efficiency mindset.

In the U.S., directors' compensation and EPS are fairly well-linked. Good performance is the best, but if a company does not perform well, it will buy back its own shares. I think that excessive share buybacks are not necessarily good, but I believe that such behavior of corporate managers are proof of their awareness of capital efficiency.

[Okina, member]

I too think you should be careful with the term "format". There is a risk that your request itself will lose its meaning if you provide a detailed template, and I believe it is important to encourage listed companies to think carefully about this disclosure on their own initiative.

I'm also very concerned that players in the same industry will just do what others do and make similar disclosures. To avoid such a situation, I believe it is important for the board of directors to think carefully and disclose information.

In addition, while it would be essential to analyze and update progress, as Mr. Sampei pointed out earlier, I am concerned that an excessive commitment to numbers may lead some companies to take short-term actions such as share buybacks and dividends. To avoid that, it is important to thoroughly communicate the meaning of your request so that, for example, companies will be committed to certain actions, closely check the progress at the board, and then make a disclosure.

In any case, since it is considered important to achieve profitability that exceeds the cost of capital over the long term, I suggest that you should consider ways to promote discussion at board meetings, including perspectives such as sustainability.

[Matsumoto, member]

Without going over the points made by other members, I would like to offer a different point of view. A capital market is a platform and consists of an exchange which is the rule maker, issuers and investors.

The proposed requests themselves are good. However, in light of the fact that although similar requests have been made in the past, as in Principle 5.2 of the Corporate Governance Code, companies are still in this situation, I believe it is extremely important for investors to properly make engagement and have dialogue with issuers.

Even if TSE makes these requests, I'm afraid that there is a possibility that the trend of P/B ratios will not change much, even if listed companies make requested disclosures. In such a case, I believe it is important for institutional investors to engage in a thorough dialogue with the companies, taking into account the framework of the requests.

TSE will take a very in-depth approach in making the request, but I presume that TSE and issuers alone may not be able to solve all problems, so it is necessary to communicate the responsibility of investors as well.

[Koike, member]

I basically agree with the outline. That said, I'd like to make a few remarks. When I think about why Japanese stocks are undervalued, I assume it is because foreign investors do not have an impression that they can expect growth. I believe that investors will not be resonant unless you put forth a story of seeking capital efficiency and profitability based on the premise of long-term growth, and that it is not enough to simply pursue efficiency.

Also, as we have been discussing the format earlier, I do not agree with the provision of the format, either. On the other hand, if companies are to respond to your request through self-help efforts, there may be a significant number of companies that cannot figure out what to do, so it would be good to create sample disclosures.

Even among institutional investors, there are concerns that they do not know who to engage and what to engage, and that their portfolio companies do not accept engagements. I hope TSE’s action will be a major catalyst for active engagement. In the meantime, as Mr. Matsumoto mentioned, I believe institutional investors also need to disclose the status of their engagement.

To ensure that information disclosed by each investor and company will not scatter, I suggest that TSE should skillfully compile examples of disclosure about engagement and best practices so that parties concerned will be able to share the examples, thus improving the situation.

[Kanda, member]

I would like to make two points, although there are some overlaps with what other members said.

As to the first point, basically, I think it is fine to have companies respond to what you proposed in Document 3. In other words, it is great to request that PDCA be performed, including disclosure, rather than merely requesting disclosure. I understand that there may be things that go wrong in corporate efforts, but similarly to what I mentioned about growth in the Growth Market, that is inevitable, and the results should be evaluated by investors in the marketplace.

That said, I’d like to suggest that three points should be clarified in making these requests. First, regarding the status of dialogue with investors, I don't think it is necessarily a matter of increasing the number of dialogues, but I think it would be a good idea to have such information presented. One more thing, regarding the "current situation analysis," I think it would be good to point out that for companies that operate more than one business segment, the cost of capital and return on capital for each business segment should be identified and analyzed. As Mr. Nagami mentioned earlier, many companies have a grasp of PL, but I feel that very few have a grasp of BS as well. Thirdly, as to what Mr. Sampei said, growth potential and return on capital are in a trade-off relationship, so I believe it would be better if companies could also describe where they put an emphasis when establishing their business models.

My second point is about the format. I think it would be better to skillfully communicate points to keep in mind, rather than providing the format. For example, it is not good to only take denominator measures for ROE, it is not good to only take financial measures without reviewing the business model, and it is not good to not recognize or be aware of the cost of capital, etc. I believe that it is a good idea to provide points to keep in mind when dealing with these issues.

[Sampei, member]

I would like to make one additional point regarding dialogue between companies and investors. I was very surprised to hear that a relatively young investor involved in engagement seemed to think that engagement was only focused on ESG issues. It means that even among the key players in the dialogue, such misunderstandings occur. Mr. Matsumoto mentioned earlier that the suggested action will not work unless institutional investors also take action in response. I think it is necessary to thoroughly communicate with and raise awareness of institutional investors regarding what they are expected to do and who is expected to do what.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much.

Now I declare today's meeting adjourned. Thank you very much for your participation today. We look forward to talking to you all again at the next meeting.

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