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

Date: Tuesday, April 25, 2023 10:00 - 12:00
Place: Tokyo Stock Exchange 15F Conference Room 2
Attendees: See member list

[Kikuchi, Director, Listing Department, TSE]

The time has now come to begin the Tenth 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. Kanda is participating online.

Now, I would like to begin proceedings straight away. First, we will explain today’s agenda.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you for gathering here today.

Thank you very much for participating in the discussion at the last meeting regarding the requests made to listed companies, including the matter of “Action to implement management that is conscious of cost of capital and stock price.”

We have three major topics on the agenda today. First of all, regarding the request for “Action to implement management that is conscious of cost of capital and stock price,” we will have an update based on Document 2. Any comments after this would be appreciated. In particular, although we have received positive feedback on the details of this request, we have also received comments that it is important to have a thorough follow up on listed companies’ responses. Therefore it would be good to hear your thoughts on details such as how and when the follow up should take place. Apart from this, we would also appreciate any additional points you may have, for example about the reaction from external parties, or future initiatives.

Secondly, as we proceed with a review of the future function of the Growth Market, Mr. Iwaya, General Manager of the Equity Investment Group, Investment Division, Asset Management One, will give a presentation with reference to Document 3. After his presentation, there will be time for questions and comments.

Thirdly, to conclude, we will have an explanation of the details of our solicitation of opinions from companies listed on the Growth Market, which is part of the planned study of the functions of the Growth Market based on Document 4. We would appreciate your opinions on this.

Thank you for listening.

[Kikuchi, Director, Listing Department, TSE]

Now, we will begin with an update from TSE on “Action to implement management that is conscious of cost of capital and stock price.”

[Monden, Manager, Listing Department, TSE]

Good morning. Please refer to Document 2.

We have received substantial feedback and interest from listed companies and investors, including overseas investors, regarding the request for “Action to implement management that is conscious of cost of capital and stock price” published on March 31. We have conducted intensive public awareness activities, including seminar lectures, one-to-one interviews, and media relations initiatives, to accurately explain the purpose and details of this request.

We will have opportunities for giving information updates at seminars and other venues, so we will continue to make a conscious effort to provide information, including to foreign investors.

The second point is about the reaction of market participants, including foreign investors, following the announcement. Please refer to page 3 for a summary of the specific comments.

First, in terms of the response from investors, we had a particularly large number of comments from investors who agree with the direction we are taking and feel positive about future changes at Japanese companies. At the same time, we also received a lot of feedback that TSE should follow up on the status of listed companies’ responses on a continual basis to ensure that this request is more than just a one-off initiative.

The second point, “share buybacks and dividend increases,” has been the focus of discussion at previous meetings and is clearly laid out in the Purpose statement of the document. However, there is a tendency for companies just to take “one-off measures,” such as share buybacks. We have received feedback that the purpose of the request must continue to be fully communicated, and conversely, that there are cases where shareholder returns remain effective.

Regarding the third point about the P/B ratio, investors commented that a 1x P/B ratio is only a guideline. Just having a ratio of over 1x is not enough.

Investors expect companies to take more drastic measures such as reworking their business plans to achieve sustainable improvement in the ratio.

In addition, as referred to in the fourth point, there was also interest on how we should approach the fact that P/B ratio and ROE tend to vary by industry. As mentioned in the fifth point, although this particular request mainly applied to companies listed on the Prime and Standard Markets, there was also interest in what policy should apply to the Growth Market in the future.

Based on these opinions, I would like to ask you to return to page 1. In the section indicated by the arrow, it is not only about the cost of capital, but also about “Better Dialogue with Shareholders and Related Disclosure” and “Using ‘Explain’ to Contribute to Constructive Dialogue.” TSE will continue to monitor the status of listed companies’ responses to this request, including these points, and will continue to follow up at subsequent Follow-up Council meetings.

In terms of the specific schedule, for companies whose fiscal year ends in March, they will update their corporate governance reports in June or July after their general shareholders’ meetings. We expect that a certain number of companies will have implemented disclosures based on this request by that time, so we hope to summarize the responses and report back to you at a meeting some time in the fall.

Today, any comments you may have on points that may have come to your attention, including reactions from market participants, and based on this, your thoughts and suggested approach in terms of proceeding with follow-ups in the future would be much appreciated.

[Kikuchi, Director, Listing Department, TSE]

If there are any questions or comments about the presentation, please feel free to speak.

[Kumagai, member]

First, although this is off topic, there is a view that meetings run more smoothly in a large conference room, and are less successful in a small conference room. Today’s meeting room is slightly smaller than usual, so I hope there are no issues and that we can get through the agenda.

First of all, the fact that TSE, the operator of the market, is taking the time to provide information about this initiative is significant and I welcome it. Since some information seemed different from what was originally intended by this initiative, I believe that informing market participants directly of TSE's intentions will ensure a proper understanding of the matter. At the same time, this will enable TSE itself to collate real-time feedback from market participants.

The opinions of these market participants and the networks of human contacts developed through this will no doubt be useful when considering subsequent initiatives. It would be good to discuss future initiatives with market participants sharing their opinions at Follow-up Council, since we attach great importance to the perspectives of stakeholders.

Daiwa Institute of Research and Daiwa Securities are helping to make this initiative more effective, for instance by holding seminars, and I feel there is a high level of interest from both listed companies and investors.

In addition to the intentions of this initiative and the details of the request, I think that listed companies are paying close attention to other companies' responses and what initiatives will be implemented. In terms of future initiatives, they seem to be interested in the implementation of the reforms, including whether or not they will be more strongly enforced. Similarly, I think investors are highly interested in the intention of this initiative. High hopes have been expressed for the continuation of the reforms and questions have been asked about the conditions and environment needed for continued reforms.

Regarding the perspectives and methods of future follow-ups, I agree with the timetable for reporting and discussion this fall. For companies with a March year end, the final results announcement in May would be the first event for making these disclosures. However, given that "sufficient analysis and consideration of the current situation is required" in disclosure, it can be said that companies do not always have enough time available to prepare, and not so many companies will make such disclosures at this point. I think it would be appropriate to report and discuss this in the fall, considering that events such as shareholder meetings, disclosure of the Corporate Governance Report and first quarter financial results may provide companies with an opportunity to make preparation.

It is also most important for the Follow-up Council and TSE to ensure the effectiveness of these initiatives while demonstrating to the market their willingness to continue these reforms. This is what I believe needs to be done.

In addition to the number of companies that have made disclosures, if possible, we should also keep a tally of the number of companies that have indicated that they are reviewing their approach to disclosure and the number of companies that have indicated when they will make their disclosures. We hope to be able to review the content of the disclosures as well, insofar as it is in our scope to do so. If there are any misunderstandings about this initiative among the companies, it is essential that we reiterate TSE's approach.

Also, when we listen to the companies, it seems that although some companies have sufficient internal resources and are able to respond accordingly, there are also many companies that are struggling with this. There is no clear-cut prescription for "Action to implement management that is conscious of cost of capital and stock prices," as these will depend on factors such as the companies' individual circumstances and what phase of growth they are in. However, I believe that we can send a different message to companies that struggle with putting these measures in place compared to those that can do this. I believe that providing detailed guidance to companies that find it difficult to respond so they can practice sustainable management will help to ensure the effectiveness of this initiative.

[Ando, member]

Since the beginning of April, I have had several opportunities to share opinions with managers of other companies, and my impression is that they are generally receptive to TSE's request. The need for management that is conscious of cost of capital and stock prices has already been stated in the Corporate Governance Code, and until now this has been left to the voluntary efforts of the companies. In particular, regarding the matter of sub-1x P/B ratios being raised for the first time, many commented that they had never properly discussed this at board meetings for example, even though their companies' P/B ratios were below 1x. Naturally, we should pay close attention to the specific actions taken by companies in the future, but I have high hopes that the request will have a positive effect, since the top management of TSE and JPX Group have proactively raised awareness of this issue.

Although this is not on today's agenda, some of the companies that have selected a Prime Market listing with transitional measures have begun to consider moving to the Standard Market. I feel that we have been able to send a necessary and appropriate message to transitional companies on this matter as a result of this.

[Sampei, member]

First of all, I feel that the media has been very faithful and accurate in its coverage of this matter since we formally published the request. The word "transitional" is used in various places, and I hope it is being well communicated due to your efforts.

One of the opinions expressed is the notion of different industry trends and characteristics. Some companies use this as a kind of excuse for saying that their industry tends not have a P/B ratio above 1x. Industry comparisons are frequently used, but not simply for stating average industry metrics. Comparisons can be made for industries that have the similar growth and profitability profile. If they do not, the priority is how much difference there is in growth and profitability, and this point needs to be carefully explained when the opportunity arises.

I am sure there will be further discussion on how to deal with the Growth Market, but I understand that the priorities for that market are being dealt with separately.

Also, I think the timing for the following up should be this fall.

[Koike, member]

Since April, the foreign investors who have come to our offices and those we have met have given positive feedback on our efforts, and I feel that interest in the Japanese stock market has increased dramatically. I introduced our activity called “Project BRIDGE” at a past meeting, and I will be visiting the US, Europe, the Middle East, and Asia again after Golden Week, so I hope to share the feedback I receive there with you.

In terms of the follow-up, I agree that there should be a follow-up this fall. I think it would be a good idea to create a plan for the timeline and the KPIs for follow-up meetings in the future. I think we should guide companies and investors with KPIs and how we will follow up within a medium-term plan of three years or so.

I also think it would be good to create risk scenarios concerning the kinds of situations that might be expected in the follow-up. For example, in terms of “Better Dialogue with Shareholders and Related Disclosure,” if we are asked to engage in dialogue with 1,800 companies, as institutional investors we will do our best to respond on this. However, due to capacity issues, we cannot accept every request, so there may be a significant number of companies who request a dialogue but do not receive it. I think it is essential that we create a risk scenario on what the response should be in this type of situation. With investor expectations so high, we cannot make a mistake with our follow-up plan. The Japanese stock market needs to develop through the follow-up process, so I think we need to put a medium-term plan in place.

In addition to this disclosure, I believe that companies will make a variety of other disclosures, such as their medium-term management plans and integrated reports, and I would like to see a consistency in these disclosures.

I believe this request will improve the mindset of corporate management. However, as Mr. Ando has suggested, I think we need to request that the Board of Directors, or even outside directors, be included in this initiative.

[Matsumoto, member]

Expectations around this have been well established, market participants have high expectations, and as a result, issuers have taken various actions so we now have what could be described as a “festival of PBR [translator’s note: a trend of going on buying low P/B ratio stocks].” I think that it is a very good thing that the market is developing in this way. On the other hand, I think it is important that this continues, so I think it is important to make our observations this fall, as suggested, after a review of companies’ Corporate Governance Reports.

One more thing, as I mentioned last time, we need to get investors to engage with the companies. Therefore it is extremely important that we have measures that encourage investors to do so. It may be that stewardship and other such activities are being done outside TSE. If this is the case, it is important to have some momentum behind these initiatives. Alternatively, I think we should follow up now, rather than waiting until the fall, by putting in writing that TSE has certain expectations, even if these will not be supervised directly.

[Nagami, member]

Like Mr. Koike, I believe that there will be more emphasis on follow-up activities in the future, compared to before, so it would be good to design an actual approach for follow-up activities for the Follow-up Council.

KPIs are set as part of normal corporate management. I think it would be better to establish, say, actions for improving these in such a way that they can be observed at a fixed point in time. I think it is also important to give a full disclosure of the details. I think these things are very important from the point of continuing to promote our stance on reform of the exchange, and it would be constructive to plan out an approach of the Follow-up Council itself.

[Okina, member]

In terms of the follow-up, I expect that the companies will make annual disclosures after looking at their actions in the previous year and further brushing up on areas that need to be improved to promote management with an awareness of cost of capital and stock price. I think it is important that the follow-up process respects the fact that the companies will first of all check autonomously whether they have fulfilled their pre-commitments. It is important to see whether this is being done, and I think the follow-up process should be in a format that ensures this.

[Kanda, member]

In terms of the importance of the follow-up process, I have two observations to make.

The first is that the 1x P/B ratio is, as I understand it, a matter of “substance rather than format”, just like governance reform. It is not as simple as saying “less than 1x is no good” or “over 1x is fine.” For governance reform, we start with the formality of having independent directors as a preparation for implementing the substance of reforms later on. I think following up is important because there are similar aspects. The objective is not just to exceed 1x P/B, so how we proceed in future is very important.

The second point, which you referred to earlier and which has been discussed previously, is dialogue with investors. This is a difficult issue. Although the FSA has issued guidelines on dialogue, this needs to be discussed properly at the Follow-up Council. There are a large number of companies on the Prime and Standard Markets in total, with different institutional investor structures. It is not easy, but I think there are things that TSE can do to help, so it would be good to discuss specific measures to make a little more progress here.

[Kikuchi, Director, Listing Department, TSE]

Thank you.

We will continue with a presentation from our guest speaker. As mentioned at the beginning, we are joined by Mr. Shohei Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One. Mr. Iwaya invests in growth stocks with a focus on emerging companies, and he will give a presentation today based on his experience in this area.

Mr. Iwaya, please go ahead with give your presentation.

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

My name is Iwaya from Asset Management One. Thank you for inviting me to speak to you today. I am only an investor and it is not within my area of expertise to speak from a scientific or academic viewpoint. As a practitioner, I can only speak from my own limited experience, so I apologize in advance for any errors or inaccuracies.

Nevertheless, I can say that I am a direct participant in the market. My efforts relate to the interests of beneficiaries, the issuing companies and the stock market, and I would like to share some of my experiences.

Let me start with a brief introduction. I joined the Industrial Bank of Japan in 1998, where I was mainly responsible for finance and accounting operations. An important task was identifying and disclosing non-performing loans on a consolidated basis. Our mission was to merge three banks and to launch Mizuho Holdings. I gained experience on how asset owners are required to conduct themselves and the importance of maintaining a healthy financial position in the eyes of the market. From 2004 I worked for UBS Global Asset Management before joining DIAM Asset Management (now Asset Management One) in 2008. Here, I have gained work experience as both overseas asset manager and as a domestic asset manager. Asset Management One is an investment management company that combines the investment philosophies of both banking and insurance, so, broadly speaking, I have experience of both sides. Based on this experience, I now focus on investment in growth companies at the post-IPO stage. In addition, I am involved in the digitalization of the operational aspect of our business and in research, analysis and operating methods based on alternative data. I would like to talk a little about the challenges that we face as asset managers.

Our generation has faced a number of crises over the past 20 years. On each occasion, this has given rise to price opportunities and the emergence of value in the market, which we have been able to use to our advantage and I am grateful for that. I speak today in the hope of giving something back to the market.

I will now move on to tell you about the fund that I currently manage. This is a publicly available investment trust called the DIAM Emerging Market Japan Equity Fund. Why do institutional investors not invest in so-called emerging markets? This is an important topic of discussion because it leads to the question of whether institutional investors actually invest. I would like to talk about this fund as a good case study for delving further into the reasons for this. At present, while the fund is managed, sales of the fund are suspended, so that makes it a little easier for me to talk to you.

The fund was established on November 29 2007, and its main focus of investment is stocks listed on growth markets. The design of the fund, from its name to its principal investment targets, sets out the objective of investment in growth markets, which is unusual in itself. Since our company only has one fund of this type, it was originally run with very limited staff, but the team has now grown a little bit.

As of the end of March, the net asset value is 13.4 billion yen and the NAV per share is 102,808 yen. The cumulative distribution is 23,200 yen, making distribution-reinvested NAV just over 220,000 yen. In terms of returns, I think we are making appropriate returns for our beneficiaries. In terms of portfolio composition, just under 60% of the fund is allocated to the Growth market. The performance of the fund, which was set up in 2007, was impacted by the sub-prime crisis and NAV per share fell below 6,000 yen. This was followed by various other upheavals, including the Great East Japan Earthquake, rapid appreciation of the yen, large-scale monetary easing, consolidation of trustees, change of company name, and the COVID-19 pandemic.

A quick glance shows you that the beneficiaries have experienced high levels of volatility. As far as the beneficiaries are concerned, the return they get on their investment can vary greatly depending on the timing of setting parameters for calculation purposes, and portfolio composition suggests that setting a suitable benchmark for asset managers may be difficult. Also, for investment management companies, capacity issues and whether the fund is sufficiently profitable may also be factors to be considered. That is a brief summary of the characteristics. However, we believe that we can overcome these challenges and offer high returns to our beneficiaries. Over the long term, this means that growth markets can be an attractive place to invest.

I would like to introduce the design of the product in a little more detail. As to why there are so few of these products, or the challenges we have encountered with this, one is the characteristic of the fund that it invests primarily in emerging market stocks, TSE Growth Market stocks or similar growth markets. Since our fund universe is defined as around 800 companies, it is difficult to set up a fund that has only a small number of companies as investment targets. This means that fund performance places more weight on individual stock selection and the timing and frequency of attractive investment opportunities rather than the overall impact of portfolio diversification. The market is characterized by disproportionate composition in terms of industry and company size, which makes risk monitoring and risk management of portfolios based on normally used risk factors very difficult. For example, normal risk management is difficult, reflecting factors such as the lack of sensitivity to exchange rates due to the small number of manufacturing companies; the different approach to interest rates required due to the small number of companies with high debt; the difficulty of using P/E ratios since a large number of companies are loss-making; the extremely high P/B ratio due to low levels of capital; and the difficulty of diversifying the portfolio by industry and scale. Trends such as these make it difficult for investment managers to invest in growth markets. In addition, the frequency of individual stock opportunities varies depending on market timing. So another factor that makes it difficult for managers to offer growth market products is not knowing how many attractive investment opportunities may be available at any one time.

Another problem with stocks listed on TSE Mothers had been market transfers. Stocks that are key index components and representative of a market are more likely to transfer in turn to a different market as they reach a certain level of growth. This is particularly applicable for stocks with a high weighting in the index. Therefore, the fund’s approach is to carry on holding such stocks even after their market transfers in order to maintain continuity. This is essentially an index issue, but in any case, there have been problems with continuity, so our response was to design the fund so that it could maintain its existing holdings after a market transfer.

In addition, since other markets can also be classified as emerging markets, it is difficult to create an index that combines each of these markets. As an internal risk control measure, we have created a synthetic index that takes account of these factors, and have verified results by creating a virtual market which is similar to the current TSE Growth Market and trying to outperform against this. As a result, we had no choice but to focus on portfolio construction without regard to factors such as the proportion of industries or market capitalizations. The recent market restructuring has reduced these restrictions and made the fund easier to manage.

Going back a little, there is the issue of how to handle IPO issues concerning "stocks listed on the TSE Growth Market (including those scheduled to be listed)." For institutional investors participating in the Growth Market, the question of whether or not to include IPOs in their investment perspective cannot be avoided. There will always be a certain number of IPOs at any one time (about 10% to 20% of the number of existing listed companies), so the question is how to incorporate this in our investment perspective. We try to deal with the challenge by including these companies in our stock universe. Factors such as price changes pre- and post-listing, pricing based on only a limited trading history, and subsequent valuation changes in the secondary market are hard to predict. Given that the risks seem quite high, this is an additional point that makes it difficult for institutional investors to participate in the Growth Market. Since these issues still exist, there is clearly scope for improvement. To put it slightly differently, there is also the issue of the lag between the pre- and the post-IPO phases until a stock is included in the benchmark. It takes quite a few years to be included in the TOPIX, and even before that, it takes about a month after listing for a stock to be included in the benchmark. That means that you have to trade outside the benchmark up till that point. For these types of securities, it is hard for institutional investors to only be able to make short-term, low-value transactions. Therefore, for this fund, we deal with the challenge by constructing the portfolio based on individual stock selection.

In terms of the commonly used fund attribute classification table, the fund targets "small and mid-cap stocks." However, exactly what is meant by "small and mid-cap stocks" is another issue in itself. Investing in stocks listed on the Growth Market is not necessarily the same as investing in small- and mid-cap stocks. This seems to be another reason why institutional investors find it hard to consider products which are focused on investment in the Growth Market. The purpose of attribute classification in the first place is to explain the characteristics of an investment product. However, this can easily create a bias towards investment in small and mid-cap stocks. This causes problems for investment managers in terms of whether they have to sell stocks of companies that have outgrown the Growth Market. Although we have not been able to resolve the issue for this fund, we have changed the design of the successor fund so that it can follow a company's growth trajectory over a longer period of time.

If there were fewer market transfers from the Growth Market in future, the size of the stocks in the market might increase. In this case, the attribute of investing in small- and mid-cap stocks may be a constraint. In short, when institutional investors participate in the Growth Market, their funds do not necessarily need to be categorized as targeting small- and mid-cap stocks in terms of the design of the product.

In terms of the history of our fund, it was established in November 2007 and its articles were amended in May 2013. This was a response to the issue of how to absorb the impact of market transfers within the fund. If a company listed on an emerging market changes its market classification the following month, a shareholding in this company has to be reduced. We revised the terms and conditions to make this less onerous. In February 2013, we saw a rapid volume of applications for our fund, but we felt that it was risky to accept so many applications if potential investment targets were likely to drop out if there was a market transfer. We stopped accepting applications and worked to change the terms and conditions to make them more appropriate. Since this was right after the start of Abenomics' unprecedented policy of monetary easing, we made the early decision to suspend sales of the fund in response, and changed our terms and conditions straight away. Asset managers need to be agile when the environment is as volatile as this.

In terms of the status of the trustee company, we integrated and changed its name in 2016. Although these are external events for the fund, we need to stay abreast of trends and keep our policies up to date as the fund environment changes to ensure maximum returns for our beneficiaries. If we struggle with this, we would find it too difficult to carry on operating in the growth markets. I believe that our ability to make hands-on decisions has been the lifeblood of this fund, and I hope that institutional investors keep this in mind for creating funds which focus on investment in the Growth Market.

In summary, designing this type of fund is difficult for the following reasons: market volatility for fund beneficiaries, varying performance depending on the timing of when parameters are set, relative difficulty in setting suitable benchmarks, issues with using hedging instruments such as futures, and challenges with keeping a control of industries and individual stocks in the fund. Therefore, it can be hard to offer products to clients unless there is an investment structure in place that accommodates these factors. Since these issues cannot be identified in advance, it is necessary to be agile, including changing terms and conditions when such modifications are required.

I would like to discuss other issues later on in terms of the challenges of investing in TSE Growth Market as a domestic institutional investor, but before that, having dealt with these types of products, I would like to make some general comments and highlight the challenges of investing in the market.

As I have said, uncertainty over the stability of market structures and differences between multiple markets will cause problems for product design and management for institutional investors. The key point is there are multiple markets, each with opportunities for listing or even dual listings. Moreover, if there is market consolidation during the fund’s trust period, continuity and reproducibility may be lost. Smooth transfer between markets makes participate in them easier. In any case, I wonder if the same securities would be valued differently if their market classification changed. If this is the case, this needs to be smoothed out.

I believe that if an issuer changes market classification, stock price continuity and compounding benefits for individual securities will be disrupted. Maintaining continuity through market transfers and preserving compounding benefits will bridge the gap between markets. With an active fund, you can hold it for a long time even if there are gaps with other markets. Considering the quality of the markets, it would be more convenient if the gap were filled.

In addition, the Growth Market has companies that are in the process of growing, while the Prime Market has more mature companies. Stock dilution is more likely for companies that are in the process of growth. If a company's performance is stable and it is in a mature phase, then shareholder returns are more of a factor than dilution. So I assume market disparities are likely to arise in terms of the likelihood of dilution. In particular, listing on a certain market for only a short period of time (and transferring immediately to another market) will have a large dilution effect, so this should be avoided as much as possible.

In summary, I think it is possible for institutional investors with a long-term active investment approach to set their own benchmarks and make small-scale investments in the Growth Market. It is perfectly feasible for investors who are comfortable making such investments based on their legal and business practices to be involved in the Growth Market. Conversely, a passive management approach here is harder because of its non-continuous nature.

One issue is the large amount of trading by private individual investors, but there is also the problem that more trading is done on margin compared to cash transactions. That makes the market less resilient in crisis situations or during times of turmoil. So in this sense, I would welcome increased involvement from institutional investors.

From November 2021 to the end of January the following year, the Mothers index was one of the world's weakest performing markets. However, monetary tightening was not so severe in Japan, and the TOPIX and Nikkei 225 did not fall as much as the Mothers index. Participation of institutional involvement in the market would be desirable in order to reduce this unnecessary volatility.

Another point is that when foreign investors temporarily exited the growth markets due to monetary tightening overseas, no domestic buyers stepped in, and this may have contributed to the lack of resilience of the market. Since then there have been various examples of individual stocks where individual investors have taken a contrarian view and stepped in and the market has stopped falling. In any case, the market seems somewhat unbalanced.

However, as far as active managers are concerned, volatility is not always a bad thing. It is good to be able to pick up stocks at bargain prices when prices have fallen sharply, but I do not think that excessive volatility is good for the development of the market as a whole.

I would also like to say something about the issuing companies. If we look at the returns of the approximately 800 companies that have listed so far on the Mothers and the Growth market, more than half of them have negative returns. It depends on the starting point, but if we start measuring from the end of the month of their listing up to now, just over 500 stocks have negative returns. In other words, the market is structured in such a way that stock prices tend to decline after listing. On the other hand, there is a double digit number of stocks that have gone up tenfold or more. So while some stocks appreciate significantly, quite a lot of stocks have negative returns. I think this is something that should be acknowledged as a reality and dealt with. It is something that issuers ought to review.

One point is that excessive emphasis on listing as a milestone event has both advantages and disadvantages. There is a risk that focusing the business, facilities, employees, officers, and affiliated companies so much on the timing of the IPO leads to operational volatility. If decisions are made to postpone actions that need to be taken sooner, this can give rise to unnecessary volatility.

In terms of capital policy, IPO planning incorporates a wide range of long-term issues, such as the ratio of major shareholders, the amount of capital to be raised, and the structure of the balance sheet. I think this can be a hindrance to the smoothness of the IPO process.

Initiatives such as rapid investment, rapid hiring or rapid M&A after going public can be damaging to an organization, and boosting share price returns just at the point of the listing can change a company’s circumstances. We need to consider whether the company is hindering its growth post-listing by cramming too many unrelated tasks into its stock listing. There are good points of course, but my concern is that focusing too much disjointed effort on IPOs may lead to fatigue.

In terms of what can be done to achieve this, as an institutional investor, you can start getting to know a company’s operations from the pre-listing stage, rather than waiting until after the listing to start your research. On the other hand, for investors who have followed the company since before the IPO, it would be better if they increased their positions post-listing, rather than losing interest in the company.

Then there is quarterly disclosure, which I believe also has its good points and bad points. For some managers, regular disclosure acts as a motivating and disciplining factor in their management of the business. In general, many companies are achieving good financial results. If they are showing solid growth, listing acts as a force for good. On the other hand, if it is difficult to find a strategy for recovery when results are unsatisfactory, with regular demands for disclosure and investor relations, mental and physical fatigue can take its toll on initiatives to improve the business.

I think the volume of IR activity should increase in line with a company's actual circumstances.

The relationship between shareholder relations and investor relations should also be considered. It means that voting and IR activities may not always be fully aligned. Institutional investors exercise their voting rights based on their voting criteria, and in some cases, for example, applying those criteria to a company that is growing rapidly immediately post-listing is not always appropriate. Specifically, in the case of growth which is driven by initial operating losses, a fund manager may see the rationale from an IR perspective, but on the other hand, losses can be a problem in terms of voting criteria. I think it is important that there is agreement between shareholder relations and investor relations and to remove any obstacles to growth.

I referred to the shift in corporate governance before and after a listing. In terms of changes in the competitive environment, it is common in the Growth Market for companies to go public at a stage when they need to be competitive and to establish their superiority in their markets. If institutional investors request too much IR-related disclosure in these types of situation, competitors can then observe what is said and take action to counter this. This could unilaterally disadvantage a listed company and hinder its growth prospects.

In summary, the key questions are: what is the right timing for an IPO, is too much discontinuous volatility being created, are investors acting appropriately with regard to IPOs, and do disclosure requirements have an adverse impact on a company's competitive environment?

As for issues on the part of market participants, as I have said, the key points include product planning and maintenance, and issues related to management organization. Of course, it is important that the product satisfies the expectations of the beneficiaries.

In addition, the fund I referred to earlier is currently worth 13 billion yen, making it a small fund for our company, so it is important for the business to be profitable without adding to fixed costs. A more elaborate structure would increase fixed costs. In this sense, the structure of compensation is also important. The fund basically has a trust fee that is commensurate with the net asset balance, but it might be better for this to be covered by performance fees.

In addition, I do not agree with the argument that institutional investors cannot invest in the Growth Market because of size and liquidity constraints. It is possible to operate a fund of about 10 billion yen for 15 years if the problems above are resolved. Given that the median market cap of newly listed companies is in the billions, I believe that the size of the fund can be appropriately managed in line with this. The size of our fund has increased in line with the growth of the companies in it and the overall market. If asset management companies grow the value of their products in line with companies' growth, they can be said to be doing a good job.

[Kikuchi, Director, Listing Department, TSE]

Thank you.

Does anyone have any questions or comments on the presentation we have just heard?

[Kuronuma, member]

I am not an investment expert, but I would like to ask one question, although it will be very basic. In terms of the difficulty for institutional investors to participate in the Growth Market and emerging markets, I was under the impression that this was more feasible for small-scale, long-term active management funds. On the other hand, it seems that there are only a few funds of this type, so may I ask why there are not more of them? If many such funds were to enter the emerging markets today, would this lead to saturation, and would it be impossible to manage them?

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

As far as domestic institutional investors are concerned, one of the issues is that of benchmarks. TOPIX is the main benchmark used by domestic institutional investors, but this does not include stocks listed on the Growth Market. Therefore, trying to include stocks listed on the Growth Market would mean including stocks that are outside the benchmark universe, which is onerous in structural terms.

The other problem is that investing in the Growth Market does not yield positive results. In other words, it is considered to be unattractive for investment on an overall basis. The Growth Market itself has only been in existence for a short period of time, and the Mothers index also has a short history, so it may be that its attractions have not yet become evident. It seems that the potential returns have not been fully demonstrated.

Looking at the chart of the Mothers index, the issue is that while volatility is very high, the returns are small, and it does not seem to be an attractive investment in the first place (before any effort is made to highlight the investment appeal of the market).

[Kuronuma, member]

Even if the index itself is not growing, with active management surely you can still select and invest in attractive individual stock opportunities?

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

Even with active management, it is important to select a strong market or index and set a percentage level by which you aim to outperform. It is difficult to establish a fund simply on the basis of outperforming a weak market or index.

One other issue I would like to mention, however, is that “graduates” from the Mothers market are not included in the Mothers index. This means that the Mothers index does not include the performance of companies that have transferred from Mothers to the First Section or other markets. Since these companies still carry on their business after leaving Mothers, if we assumed that these stocks were still included in the index, in other words, if the index were to be created in such a way as to incorporate performance post transfer, it is clear that returns would be very satisfactory. If we could highlight the attractions of companies that have grown up in the Growth Market by taking into account their performance after moving to a different market, investors would be much keener to invest in these companies.

In addition, due to the recent market restructuring, the criteria for transferring from the emerging market to the First Section (the Prime Market) have been raised. In terms of returns, since components remain in the emerging markets for longer, there will be more of a compounding effect in the emerging markets, and performance will more closely match the index taking account of “graduate” stocks than the Mothers index. From that perspective, I believe this market restructuring will also increase the attractiveness of emerging markets, and that is significant for active funds that are benchmarked against these markets.

[Kumagai, member]

I have two major questions to ask.

First of all, and re-iterating Mr. Kuronuma's question, I am very concerned about what can be done to improve the attractiveness of the Growth Market. I think that the underlying problem is that startups are not so active in Japan. If you have any specific measures for revitalizing them, I would be interested to know.

The Fiscal System Council met at the Ministry of Finance yesterday to discuss the theme of "growth," for which development of startups was a major pillar. In essence, the lack of startups reflects social and cultural factors rather than individual support measures. From the standpoint of the financial authorities, it was also discussed that instead of expanding public support such as subsidies, we should utilize the knowledge of venture capital investors who have "expert capabilities". In light of this and other factors, can you tell us if there are any fundamental reasons for the lack of startups in this country compared to other countries? There is a concept known as the "Toyota Method," according to which, if you ask the question "Why?" five times, you will find the root cause. I would like to know what the fundamental reason is for the sluggish venture capital market in Japan, what specific measures we can take to improve this in future, and what TSE in particular can do. This is a slightly broader question, but I would appreciate your insight on this.

Secondly, Mr. Iwaya, I would appreciate it if you could tell me some of the key aspects of distinguishing between good companies and bad companies. For example, can you tell us the characteristics of companies that we should monitor or collect information for making a new investment, and conversely, the characteristics or features of companies to avoid? I think that companies will put more effort into IR in future, so I would be interested in a simple explanation of certain points related for example to the approach of IR, presentation of disclosures, attitude of management or other aspects of disclosure, especially from an investor's point of view.

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

First of all, I personally believe that startups are developing successfully in Japan. It is estimated that 7,000 companies or so are operating while having benefited from an injection of external capital on the assumption that they will be listed, and there is a very promising number of startups in terms of the quality of their business, human talent and governance framework. I also appreciate that the infrastructure to support this has been established.

I believe that the problem is that the market for listed stocks is not sufficiently set up to support this, or that it has not been so in the past.

Even now, I believe that the growth of startups in Japan is remarkable. I feel that the market needs to be prepared for this, as we are seeing situations where people who have experience of going public have gone on to do the same again at another company, or where companies have achieved growth through the involvement of top-class talent from large corporations and government departments. For example, analyst coverage by securities companies is mainly focused on large Prime Market companies, and buy-side coverage tends to be limited to the top tier of the TOPIX, with insufficient attention paid to companies that are looking to list. Some companies that grow before they go public say that they are not properly supported after their listing. To smooth the connection as much as possible, analysts who look at large listed stocks should follow up to late-stage startups, and investors who look at large companies should engage with startups as well. That would resolve the lack of continuity from the pre-listing to the post-listing stages.

There is also a debate about whether there is the right balance in terms of the number of listings, with around 7,000 companies on the assumption that they will be listed at present and around 100 new companies going public every year. While some people say that this should be narrowed down further, others may argue that it is not enough. If we were to narrow it further, it might be possible to encourage a process of regeneration and improvement of the 7,000 companies through having a “catchment system” in the secondary market, or improving the M&A regime. We believe that having a such a “catchment system” for startups that are not listed on the Growth Market will support the regeneration of industry in Japan.

When it comes to sorting out good companies from bad companies, my approach is to treat them as if they were all good companies. Listed companies are naturally sorted out by the market. Of course, there are cases where a share price does not rise even if you think it ought to, or where a share price goes up even if you do not rate a company. That is the sequence for looking at this from a stock analysis point of view. Once we see the positives, the market’s evaluation approach will then sort out the rest. There is a limit to the research capabilities of institutional investors, so if the market is at work, we can borrow from that collective knowledge.

And IR helps with this. It is important to understand the narrative, for example having the corporate managers talk about the motivation behind their operation of the business. In addition, we try to conduct research with more focus than is usually the case with large companies by asking them for detailed disclosure of their actions during times of emergency, or for example, what their response when economic activity was halted during the COVID-19 pandemic.

[Sampei, member]

Based on your earlier comments, the size of the fund is currently 13.5 billion yen and the number of stocks held is 134. Therefore, if the median IPO price is 1 billion yen, a very simple estimate of the average holding per company suggests it is around 10%.

This would mean that percentage holdings are much higher than for ordinary listed stock investments. With less sell-side coverage, you could have a deeper dialogue with issuers, which could have major operational benefits. I would be interested in hearing your impressions on this.

Another point is, given that you mentioned that there are about 7,000 startups and many promising ones, investors might want to invest pre-IPO. If they wanted to invest, I would be interested in a brief overview of what sort of circumstances would be conducive for this investment.

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

I think the median IPO price is around 8 billion yen, so I cannot tell you the size of our holdings, but I think the actual average percentage holding is a little lower.

[Sampei, member]

What I wanted to ask you about is that with a higher ratio of voting rights held per investee company in the fund that you manage compared to average active funds, I think that Mr. Iwaya’s comments as the voice of the market are extremely valuable for management teams that have just gone public, so it is possible to have a very in-depth dialogue with the issuers. As an investor he is committed to the companies, and I believe that company management teams appreciate this, so they will pay attention to what investors tell them, and the investors themselves will therefore be more confident about making long-term investments in such companies. I think these advantages may be greater than with the average active fund, and I would like hear your thoughts on this.

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

I think that is correct. However, there are advantages and disadvantages. While we can enjoy the returns if the relationship works, there are instances where the relationship does not work out as it should.

With regard to participation in IPOs, we have begun to invest in the preferential allotment ("oyabike" that means a sale to a person designated by the issuer) following the revision of the JSDA guidelines. We also try to utilize expressions of interest, or IOIs (Indications of Interest), and have participated in the last two IPOs using this method. Previously, we took part in bookbuilding for IPOs and investment was made according to the allocations. Now we can go back a little further and have a dialogue with the companies. However, since the fund is a publicly offered investment trust and is expected to accommodate daily investments and redemptions, it is not suited to unlisted stock investments, but we can include stocks that are due to be listed.

[Koike, member]

Just a comment, but first, there are two issues I am aware of regarding the Growth Market: one is the characteristics of the market, and the other is the origin of IPOs and the institutional framework. The Growth Market itself is a very attractive market, and I believe that investment management companies have a very important role to play in providing investors with opportunities to invest in growth companies, but I also believe that there are many restrictions. For example, low liquidity, small market caps, and relatively high valuations make it difficult to value companies properly. While there are usually analysts involved with IPOs, their numbers decrease rapidly once the companies go into the secondary market. This makes it difficult to obtain information. In such a situation, there are constraints when trying to commit to the Growth Market while balancing business operations and the fulfillment of fiduciary duty. I also believe that pricing and allocation in IPOs, the level of institutional investor involvement and the size of IPOs are major issues. However, on the other hand, I have confirmed with senior investment managers that if we were try to set up a new fund in the current business environment, its limit would be around 30 billion yen to 40 billion yen. For overseas institutional investors, this is perceived as Japan's only growth opportunity, so I think that the twin aspects of cultivating IPOs and the Growth Market itself are major issues.

[Iwaya, General Manager, Equity Investment Group, Investment Division, Asset Management One]

To follow on from Mr. Sampei's comments, the document shows the distribution of returns for Japanese listed stocks. The TOPIX return is shown in orange, while the area shown in blue is returns from normal large-cap stock investment. The idea is to trade on the premise of liquidity, while taking advantage of discrepancies between price and value. In this case, the incentive of engagement with a company and an increase in the shareholding of that company is less likely to work, and the structure is more likely to generate returns if securities can be bought and sold on a flexible basis.

On the other hand, returns from Growth Market investment are shown in yellow. Unlike the previous examples, the investment style is to hold an extremely rare asset over an extended time period to generate a high return. In this case, I would say that engagement with the company is actually the source of the returns.

However, in the latter style, the size of the fund is inevitably limited, and it has been pointed out that careful planning is needed for structuring the compensation.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much, Mr. Iwaya .

Now, I would like to move on to the last topic on the agenda, and explain the contents of the solicitation of opinions from companies listed on the Growth Market.

[Ikeda, Senior Manager, Listing Department, TSE]

I would like to provide a brief overview of the solicitation of opinions.

The target audience for this request is assumed to be senior management of companies listed on the Growth Market.

First of all we ask if they think their company is taking advantage of listing on the Growth Market to achieve high growth. Secondly, we ask them to describe issues that their company is facing in achieving high growth at the time of listing/post-listing and what actions, if any, they expect TSE to take in response to those issues.

Rather than displaying options and asking respondents to choose, we ask them to write down their thoughts freely, and TSE will conduct additional interviews as necessary. We would like to utilize their opinions in future discussions and deliberations.

Once we have confirmed the details today, we aim to inform the listed companies as soon as possible about the next steps from here. Meanwhile, since we are now entering the period for the announcement of financial results and the AGM season, we aim to receive opinions by mid-July and then proceed with interviews or other follow-up consultation after that.

[Kumagai, member]

Thank you very much for reflecting what has been communicated beforehand.

On that basis, I would like to make two key points that are important when talking with listed companies.

First, in soliciting opinions, I think we need to be considerate and thoughtful about devising ways to get managers of Growth Market companies to speak their opinions frankly. We sometimes hear that it is difficult to give honest opinions to TSE as the operator of the market, or else that there is no forum for doing so. In some cases, management may be aware that meetings of the Follow-up Council are being held, but may be too busy with running the business to know what sort of discussions are taking place. In those circumstances, if they have to respond to a survey at short notice, they may be unable to do so.

In this respect, it is important to carefully explain how their opinions will be utilized and to have a proper communication with them. First of all, we need to explain the content and significance of the Follow-up Council. It might also be important to clarify how the discussions at the Follow-up Council can prompt the actions that TSE takes. I think they would show more interest in the policy development process if there is a possibility that their opinions will be reflected in TSE’s initiatives. It is vital that these matters are carefully explained at the request for opinions stage.

Secondly, regarding the draft content of the request for opinions, I think the “Perspectives (examples)” are generally good, but regarding “(2) Post-listing,” I think it would be better to also include a cost perspective. In some cases, companies on the Growth Market operate with limited resources. If there are any systems or practices in the securities market that use up valuable resources, we could ask them to point these out.

If these systems and practices are actually needed, TSE should explain its intentions clearly. If they are not required, then it is worth thinking about abolishing them after consulting with the authorities concerned.

[Nagami, member]

I am generally satisfied, but as Mr. Kumagai has pointed out, it would be good to know what the bottlenecks are for growth. Maybe it is something to do with funding requirements, or investor relations, or maybe it is related to something else. In any case, I would appreciate it if this could be specified in the solicitation of opinions.

I also believe that corporate governance is important in the Growth Market, and I would like to see this included in the “Perspectives (examples).” We believe that corporate governance is not simply about discussions on defensive governance in terms of compliance immediately after listing, but it also includes the composition of the board of directors, whether the board is setting the correct agenda and whether this agenda is being discussed by the right people.

Regarding the first one, whether they set the right agenda, this is an open question. Regarding the second point, the composition of the members, first of all, I believe that the board of directors of a listed company, especially in the Growth Market, should have a strong mentoring role toward the CEO. One key point is whether the mentoring function is appropriately performed in terms of both offense (i.e. growth-oriented aspect) and defense (i.e. compliance aspect).

On a related note, I have recently heard that the number of concurrent independent directorships at other companies is taken into account for the screening process at the time of listing. This causes difficulties with selecting the right people. My premise is that there are not many suitable independent director candidates in society as a whole who are qualified to provide appropriate governance for growth companies. I appreciate that interest tends to be concentrated on only a limited number of candidates. I think that the screening process for listing may be something of a bottleneck. Naturally, I appreciate that the number of concurrent appointments in different companies is a factor in voting policies of proxy advisers, such as Glass Lewis, but I would be interested in whether excessively rigid screening processes are a hindrance to growth.

[Sampei, member]

Thank you for taking into account the prior comments on the timeframe for the solicitation of opinions.

Regarding the second point concerning the request for opinions, the reference is to “issues that the company is facing at the time of listing/post-listing.” I think that managers will mainly focus on issues related to their own companies, but since the premise here is a discussion from TSE’s perspective, it would be better if they talked about their awareness of issues for the market as a whole. For example, the purpose of the solicitation of opinions would be clearer if we asked the companies for their own perspective alongside a broader picture of some of the issues, for example the fact that for 60% of IPOs, the value of the offer exceeds the funds raised, or that the amount of new funds raised in IPOs is only about 10% of the actual value of shares sold, or that only about 14% of companies conduct public offerings post-listing.

[Koike, member]

I am generally comfortable with the solicitation of opinions itself, but as I mentioned earlier, I am concerned about two points: the characteristics of the Growth Market and the institutional framework for IPOs. I think we need to listen carefully not just to the top management of listed companies but also their stakeholders regarding the listing process. For example, we could consult with underwriters, investors and venture capitalists. I often hear the argument that IPOs have become a format for recouping funds. However, to come back to the original point of promoting Japan’s industrial development through growth industries, this is not just a problem that can be resolved by the efforts of management. What do they think about small-scale IPOs and valuations? What do they think about shareholder policies and support post-listing? I think these issues are crucial for the Growth Market at present. I think we also need to follow up on feedback related to these issues in future.

[Matsumoto, member]

As for the “Perspective,” examples might lead opinion, but the lack of examples might make it difficult to respond. Anyway, I think that it would be more conducive to free format responses and gaining new insight on what stakeholders really think if we did not give too much in the way of examples for points of view.

[Ando, member]

As is the case for all participants, this call for opinions is only a means to an end, and the objective is to explore the issues of the Growth Market in more detail. In that sense, based on comments gathered so far, I would like to ask TSE to conduct one-on-one meetings and small meetings to get effective feedback that can help us with the next measures.

[Kikuchi, Director, Listing Department, TSE]

Thank you.

With that, we will conclude today’s discussion.

Finally, we would like to explain the schedule for the next meeting.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you very much for the lively discussion again today.

I would like to add one point. Regarding the Ministry of Economy, Trade and Industry’s “Practical Guidelines for Independent Directors”, we plan to send it out by the end of this month, attaching Document 5.

We would also like to modify our call for opinions in light of some of the comments we have had today and will be in touch again shortly via e-mail or other means.

At that time, we will also let you know the date of the next Follow-up Council.

Thank you for listening.

[Kikuchi, Director, Listing Department, TSE]

With that, I hereby 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.