Comments for the 11th Council of Experts Concerning the Follow-up of Market Restructuring

August 29, 2023

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【1】 Actions to Implement Management that is Conscious of Cost of Capital and Stock Price

(Document 1) [Status of Companies' Responses and Follow-up on "Action to Implement Management that is Conscious of Cost of Capital and Stock Price"]

- As far as the responses are concerned, I feel that the intent of the request has generally been conveyed correctly. I feel it is commendable that 31% of Prime Market listed companies have disclosed information given that a little over three months have passed since the request was made. That disclosure is progressing mainly among large market capitalization and low PBR companies is also in line with my expectations, and I believe this is a result of TSE going to the trouble of properly communicating the purpose of the disclosure request.
- On the other hand, the disclosure rate is still low among companies with small market capitalizations, the Standard Market, and companies with high PBRs. While I surmise that the disclosure rate itself will increase in the future as disclosure progresses as a whole, I am concerned that there will be cases in which disclosure remains horizontal and perfunctory and fails to meet investors' expectations.
- I feel that the challenges perceived by companies in moving ahead with disclosure highlight the awareness gap with investors. First, it is necessary to continue to impress on companies that not only companies but also investors bear the same risks, and that this is why disclosure is required. Regarding the increasing proportion of passive management, I think that this is a practical issue in that effective engagement with the constituents of TOPIX, which is the main benchmark for institutional investors, involves a considerable cost burden. In addition, correctly understanding the current status and goals of a company is a prerequisite for investors in order to invest, and failure to communicate this is an issue for which I would like to see further efforts made as a listed company that expects interaction with investors.
- If there is a misconception that the current request is irrelevant as long as the Price Book-value Ratio (PBR) is 1 or more, then I believe that this misconception needs to be cleared up. In order to increase corporate value, it is necessary to work to promote consideration and disclosure of what is needed to grow further from the current situation and what conversations with stakeholders are necessary to achieve this growth. I believe that a situation where a PBR of 1 or more is considered a passing grade will lead to a loss of global competitiveness.
- We need to demonstrate the effectiveness of disclosure efforts to companies that do not seem to be making progress in disclosure or that have not yet understood the intent of the request, by continuing

to compile examples of good practices and examples of improvements in dialogues with investors and improvements in investor evaluations. I believe that investors should also push for disclosure by using disclosure as a precondition for dialogue.

(Document 2) [Status of Companies' Responses and Follow-up on "Better Dialogue with Shareholders and Related Disclosure"]

- If a company or investor believes that an agenda is not conducive to medium- to long-term improvements in the corporate value, it is necessary to first share the gap by holding dialogue on why the agenda is not conducive to improving corporate value over the medium- to long-term to bridge the gap between the two parties. It is then necessary to seek out ongoing initiatives to make both parties aware of what efforts should be made and to provide feedback. Therefore, I believe that it would be effective (for both the company and investor) to once again carefully explain the main purpose of dialogue in disclosures on the state of engagement with respect to the careful, sincere and continuous communication of corporate and investor perceptions and possible agendas and gaps.

(Nomura Asset Management examples)

- Nomura Asset Management has a long history of pushing for engagement activities by requesting the setting of capital efficiency targets (ROE, ROIC), clarification of policies for holding financial assets, explanations of growth and financial strategies for achieving those targets.
- After the TSE announcement requesting disclosure in March, I felt that companies are accelerating their activities. I would like to introduce some examples of the results we have achieved through the above engagement activities:
  - Major tire manufacturer

    The company in question has a large cross-shareholding. Since 2021 we have been seeking to reduce its cross-shareholdings. As a result of multiple engagement activities, a quantitative target was set in April 2023 to "limit cross-shareholdings to no more than 20% of net assets" (at the same time, the company sold some of its cross-shareholdings).
  - Medium-sized semiconductor manufacturer

    Although the company in question was consistently recording profits, its considerable financial assets were a factor in its poor capital efficiency. We viewed the fact that only operating income and net income are used as indicators for executive performance-based compensation as problematic and campaigned for the addition of a capital efficiency indicator. By adding ROE as a linked indicator in 2023, we expect that management's commitment to capital efficiency will be strengthened in the future.
  - Medium-sized transportation company

    While the company in question has considerable financial assets, it has not established a policy for the use of financial assets or capital efficiency targets. Since 2021 we have conducted multiple engagement activities due to our concerns that the assets are not being used effectively. The company announced a growth strategy, ROE target, and shareholder return policy at the same time that it announced its medium-term business plan in June 2023. After the announcement, the company's stock price rose considerably, and we favorably evaluated the announcement as a reform to both its business and financial aspects to improve capital efficiency.

- On the other hand, there are also examples of challenges that still prevent engagement activities from progressing, include the following:
  - Examples of cases in which companies hesitated to sell cross-shareholdings due to concerns about deteriorating relationships with business partners
    - For example, we have seen cases of cross-shareholdings between food and beverage manufacturers and their retail and restaurant customers. In some of these cases, both companies are overly concerned about the deterioration of their relationship, even though they are willing to reduce their shareholdings. In such cases, we believe in sharing the intentions of both companies from a third party standpoint to encourage them to reduce their cross-shareholdings
  - Cases of one-off shareholder returns such as share buybacks
    - At Nomura Asset Management we believe that ongoing measures are necessary to improve capital efficiency. Our policy is to encourage continuous improvements in capital efficiency by setting capital efficiency targets and encouraging the development of medium- and long-term growth and financial strategies.
  - Companies whose disclosure of capital efficiency by business is inadequate
    - Companies with low capital efficiency often have multiple businesses, some of which are not particularly profitable and weigh heavily on the company's overall performance. Our policy with respect to such companies is to create an opportunity for them to reform their business portfolios by actively encouraging them to disclose their return on capital by business.
- Some companies with a ROE greater than 8%: Some companies with a ROE over 8% are not focusing on financial reforms based on the primary judgment that "capital efficiency is not a problem because the ROE is over 8%," even though further improvement in the ROE can be expected by liquidating excess financial assets. We feel that correct guidance is needed for these groups of companies.

[2] Promotion and Disclosure of Dialogue with Shareholders

For reference, I would like to introduce Nomura Asset Management's engagement structure.

As of August 2023, the following people are involved in engagement activities:

Engagement Department	10 members
Responsible Investment Department	11 members
Global Research Department (Corporate	20 members

Research Group)	
Global Research Department (Credit Survey Group)	5 members
Total	46 members

In 2022, we conducted 1,010 engagement meetings with 520 companies (mostly with individual companies).

(Nomura Asset Management Responsible Investment Report 2022)

- Regarding the "Issues and Concerns" listed on p.6
  - Aside from some progressive companies, these efforts toward effective dialogue between companies and investors have only just begun, and so we do not expect both sides to understand each other immediately, rather we believe that a bit more variety and ingenuity is needed. We feel that many companies do not share sufficient awareness of issues, and we feel that it is important to close this gap by having conversations, implementing measures, and devising ways to share awareness. For example, companies wants to retain cash and cash equivalents to invest in growth, while investors want a concrete plan backed by a strategy of when and how much money they need to invest. Even if a company announces a growth investment quota of tens of billions of yen over five years, without a concrete strategy, discussion will go nowhere.
  - Even if it is difficult to engage with investors on a quarterly basis, we would like to see companies providing opportunities for dialogue with investors at least once or twice a year. Ideally that dialogue should be one-on-one but adequate discussions can also happen in a format in which multiple investors participate. As mentioned in the survey, dialogue is also an effective means of deepening information sharing and communication between the IR team and management.
  - Regarding (4) and (5), we have more than 600 companies that we continuously follow up on under our engagement system, and we have been able to have effective dialogue with those companies. On the other hand, it is true that for some other companies it is difficult to get opportunities for dialogue. In fact, it is not realistic to devote active research resources to companies that are small and unlikely to be a target for our investment, and we believe that this is also an issue for the industry. For companies with passive holdings, ESG specialists in our Responsible Investment Department exchange opinions on ESG and voting issues with all companies with which we wish to engage in dialogue. However, we are aware of the limitations of our resources, and so we are not able to spend sufficient time on dialogue during busy periods such as before shareholder meetings, and there are still outstanding issues regarding effective dialogue, which we recognize as management issues.

[3] The Growth Market

Challenges facing the Growth Market

- One issue is that after a small company got listed on the Growth Market, it has to pay attention to short-term profits and is unable to make large investments for growth. Although a lower listing frontage (criteria for market capitalization in circulation) is better from the perspective of providing growth capital to startups and investment opportunities to investors, looking back at past performance leaves me to conclude that it has not encouraged growth after listing. In order to "realize high growth potential" after listing, I feel that it is necessary to (1) ensure a certain level of corporate scale that can adequately withstand growth investment and (2) attract institutional investors, by tightening the listing criteria

Awareness of issues as an institutional investor

- It may be worth considering that companies with a certain market capitalization should be targeted for investment, for example, TOPIX should also be allowed to adopt new companies from the Growth Market.
- Small cap companies have recently been holding briefings and one-on-one meetings, and I feel that the "dialogue opportunities" are not much different from those of larger cap companies. On the other hand, I feel that small cap companies are relatively less aware when it comes to taking suggestions and opinions from investors seriously and reflecting them in management. I think that this is one of the issues regarding which management awareness is low, and is something that needs to be addressed in the future.
- As for the current situation at companies, it would appear that formal requirements (governance structure, information disclosure, certification, acquisition, etc.) are difficult to meet in terms of cost, necessity, and internal resources. I have also heard that while companies understand the business strategy (growth strategy, ROIC, profit margin improvement, organizing business ports, etc.) they struggle in terms of power relationships with business partners and business models.
- I can understand that there are costs involved in timely disclosure after listing, meeting with audit firms, and other information disclosure and that this is cumbersome for listed companies in the Growth Market, which are small in size. However, I believe that the disclosure of necessary information is essential for institutional investors to make investment decisions. If companies are unfamiliar with the how to go about disclosing information, etc., TSE might want to consider measures such as strengthening and enhancing support guidance from TSE on what method should be used for information disclosure.
- After listing, it is necessary to raise expectations of high ROE in order for public offerings to be recognized as accretive. I believe that companies listed on the Growth Market also need to actively disseminate information on capital efficiency.

Proposals to nurture the Growth Market, etc.

- The Growth Market, by its very concept, also requires a mechanism that does not allow listed companies to stay unless growth can be maintained. From this perspective, there may be room to revise the current criteria for maintaining a listing in the Growth Market, which is “a market capitalization of at least 4 billion yen after 10 years of listing. It would be good if it was at least a certain amount that would make the company a target for investment by institutional investors.

- In order to encourage active fundraising and M&As after listing, one idea would be to make the disclosure of the use of funds at the time of the public offering more flexible.
- If funds were to be made available to unlisted companies by listing PE funds, etc., I think TSE would be able to contribute to the diversification of funding for startups in Japan.
- If opportunities to invest in unlisted stocks are available along with publicly-offered investment trusts, etc. through the enhancement of systems such as crossover, I believe that engagement and dialogue with unlisted companies will take place at that stage, and that engaging in dialogue with institutional investors before listing will lead to a better understanding of what the market expects from companies after listing.

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