

# The Investor's Perspective on Such Matters as Parent-Subsidiary Listings

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Tokyo Stock Exchange, Inc.

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- ◆ Tokyo Stock Exchange, Inc. (TSE) has been asking listed companies in parent-subsidary relationships and those in relationships under the equity method to develop initiatives and make disclosures on group management and the protection of minority shareholders.
- ◆ Recently, there has been a growing need for companies to **consider and disclose the nature of parent-subsidary listings in terms of appropriate allocation of management resources to achieve medium- to long-term improvements in corporate value, as required by TSE's request to take “Action to Implement Management that Is Conscious of Cost of Capital and Stock Price.”**
- ◆ Meanwhile, TSE has heard from investors who have pointed out that, in most cases, current initiatives and disclosures on group management and the protection of minority shareholders **“still do not consider the significance of parent-subsidary listings from the investor's perspective”** and that **“the contents of the disclosures are not aligned with investors’ expectations.”**
- ◆ In light of these circumstances, TSE has prepared **“The Investor's Perspective on Such Matters as Parent-Subsidary Listings”** based on feedback received from interviews with many investors in Japan and overseas.<sup>1</sup>
- ◆ TSE hopes that this document, which contains **the investor's perspective** and **examples of specific situations where companies' initiatives are not aligned with it**, will help companies to consider their group management and protection of minority shareholders and to engage in dialogue with investors.<sup>2</sup>

<sup>1</sup> Since the publication of "Action to Implement Management that Is Conscious of Cost of Capital and Stock Price" in March 2023, TSE has conducted interviews with more than 100 investment companies in Japan and overseas, focusing on those (e.g., active funds) that emphasize medium- to long-term improvements in corporate value.

<sup>2</sup> TSE will also encourage companies to explain their group management and protection of minority shareholders in light of this document in such cases as when a new subsidiary is listed.

# (Ref.) Structure of This Document



**The Investor's Perspective**  
Learn how investors generally view your company's form of listing and what they expect



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- ✓ The company believes that investors do not expect any particular response from companies that are not in a parent-subsidiary relationship

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1. The listed subsidiary defers to its parent company and does not consider whether the current form of listing is optimal for itself
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3. Investors are unable to confirm the effectiveness of the subsidiary's governance system
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### Companies with a Quasi-controlling Shareholder

#### ■ The Investor's Perspective on Companies with a Quasi-controlling Shareholder P21-22

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- ✓ The company believes that investors do not expect any particular response from companies that are not in a parent-subsidiary relationship



#### Cases of Misalignment with the Investor's Perspective

- ✓ Compare your company's initiatives with the cases of misalignment with the investor's perspective and re-examine your company's initiatives

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- The listing of subsidiaries is one of the forms of listing that TSE has recognized.
- Meanwhile, investors have pointed out that, **in many cases, parent companies have not sufficiently explained their reasons for listing their subsidiaries in terms of capital efficiency and medium- to long-term improvements in the group's corporate value.**
- In addition, while parent companies **should adequately ensure the governance systems of their subsidiaries in order to address conflict-of-interest risks and protect minority shareholders (and ensure the common interests of the subsidiaries' shareholders),** some investors are concerned that **some parent companies are not sufficiently aware of this.**
- Taking the investor's perspective into account, the boards of listed parent companies **are required to continually review their parent-subsidary listings in terms of both group management and the protection of minority shareholders.** They also have a responsibility to explain their decisions adequately through disclosure and dialogue with investors.

## Points Requiring Consideration and Explanation

### Group Management

- ✓ Whether owning and listing the subsidiary is **optimal in terms of capital efficiency and making medium- to long-term improvements in the group's corporate value**

### Minority Shareholder Protection

- ✓ Whether the parent company **gives sufficient consideration to the protection of minority shareholders** and whether it considers ensuring that the listed subsidiary is independent and has an effective governance system

## Group Management



### Investors

- ✓ A parent-subsidary listing is useful transitionally in a business restructuring, such as the listing of an in-house venture.
- ✓ I have no problem with a parent-subsidary listing as long as the parent company properly considers it and explains to investors that it is the best option in terms of medium- to long-term improvements in the group's corporate value.
- ✓ A parent company needs to explain its reasons for its parent-subsidary listings because some investors believe the following. If the parent company respects the independence of the subsidiary's management, it should either sell or form a business alliance with the subsidiary. However, if the parent company wants to enhance synergies within the group, it should convert the subsidiary into a wholly owned subsidiary.
- ✓ It is an irregular form of listing because the subsidiary is listed with minority shareholders. Therefore, companies have a responsibility to give a reasonable explanation for it. However, currently few companies can give their rationale for maintaining their parent-subsidary listings.
- ✓ Because many parent companies do not give their rationale for their parent-subsidary listings, they have a higher cost of capital and discounted valuations.

## Minority Shareholder Protection



### Investors

- ✓ If a parent company uses its influence to enjoy profits in excess of its shareholding ratio, there is a risk that the interests of the minority shareholders of its subsidiaries will be undermined. The parent company needs to take appropriate measures to protect the minority shareholders of its subsidiaries in light of this conflict-of-interest risk, but investors are concerned that parent companies are not sufficiently aware of their role in the matter.
- ✓ When speaking with parent companies, their explanations often focus on the advantages of parent-subsidary listings in terms of group management, such as the realization of synergies, but they should recognize the need to consider the pros and cons of parent-subsidary listings in terms of both group management and the protection of minority shareholders.

## 1. The parent only cites the advantages of listing its subsidiary

Example (based on an actual disclosure)

We have decided to keep the subsidiary listed because we believe that its credibility as a listed company will help expand our client base, secure human resources, and maintain and improve employee morale, and this will contribute to increasing our group's corporate value.

Example (based on an actual disclosure)

We believe that we have sufficient grounds for keeping the subsidiary listed because doing so helps it acquire talented human resources, maintain and improve employee morale, and receive flexible financing from the capital market.

### Investors' Comments

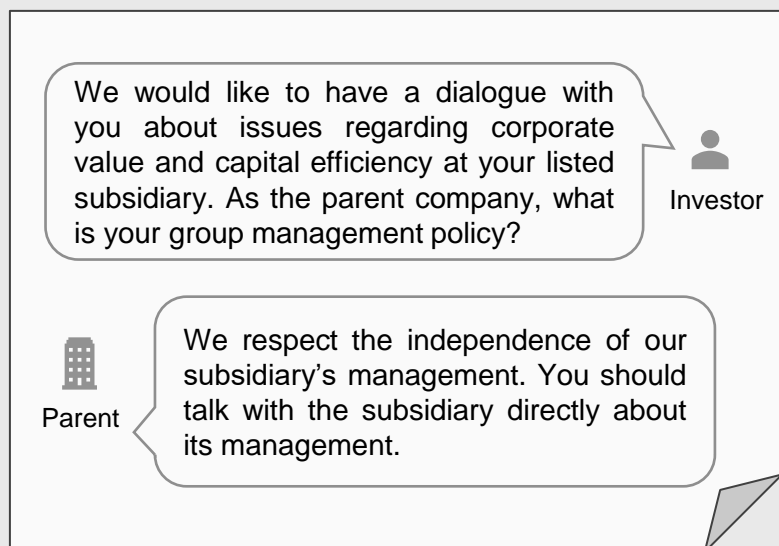


- ✓ There are many cases where the parent company merely cites the advantages of listing its subsidiaries and does not consider or explain **whether this is optimal in terms of capital efficiency and improving the group's corporate value**.
- ⇒ In TSE's request to take "Action to Implement Management that Is Conscious of Cost of Capital and Stock Price," companies are expected to **appropriately allocate management resources by being conscious of the cost of and returns on capital** and doing such things as reviewing their business portfolios.
- ⇒ As the parent company **considers the balance sheet and cash allocation policy that it is hoping to achieve**, it should also discuss and explain **how it will position and utilize its listed subsidiaries**.
- ⇒ In addition to qualitative analysis, the parent company needs to perform **quantitative analysis** from the perspective of **capital returns** (e.g., ROE and ROIC) and **market valuation** (e.g., PER and PBR) to determine such things as **whether the subsidiary is achieving a return on capital that exceeds the cost of capital**.
- ⇒ It is also important for the parent company to consider **the best owner principle (whether it is the holding entity that maximizes its subsidiary's corporate value)**. As a result, it may choose to sell its subsidiary to a third party. Investors applauded companies like Hitachi and Fujitsu for **considering their business portfolio strategy and selling some of their subsidiaries**.



## 2. The parent is reluctant to take action because they see it as the "subsidiary's problem"

Example (based on an actual conversation)



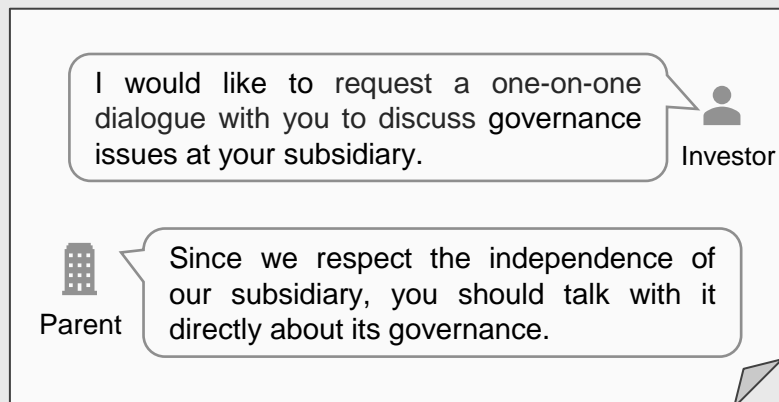
### Investors' Comments



- ✓ When we attempt to have a dialogue with parent companies about issues with the group management of their listed subsidiaries, **some of them refuse to discuss it, saying that "the subsidiaries are independent" and it is their problem.**
- ✓ Some subsidiaries have told us that even when they are aware of the need for considerations of and disclosures on group management, **discussions have not progressed** due to the parent company's lack of awareness.
- ⇒ Group management is **the parent company's problem**. We expect parent companies **to recognize that they are responsible for explaining their group management policy and the reasons for having parent-subsidary listings** in terms of medium- to long-term improvements in the group's corporate value **and to actively engage in dialogue with investors.**
- ⇒ A parent company must ensure that its subsidiaries have the independence and governance necessary to protect their minority shareholders. However, it is sensible for the parent company **to aim to improve its subsidiaries' and the group's corporate value by exercising its supervisory function and its influence over its subsidiaries** by exercising its shareholder rights as a major shareholder and through the group's internal control. If that is the parent company's policy, it is important for the parent company to explain it properly.

## 3. The parent is not involved in ensuring the effectiveness of the subsidiary's governance system because the subsidiary is independent

Example (based on an actual conversation)



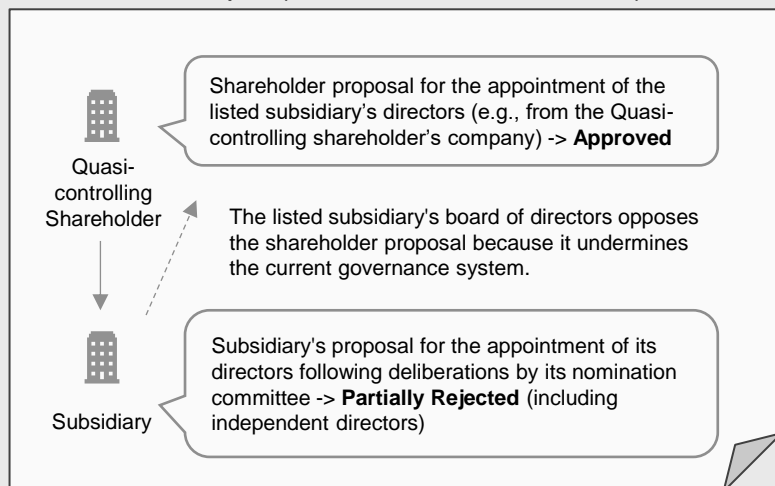
### Investors' Comments



- ✓ It is **very important** for a listed subsidiary's minority shareholders to **know what the parent company thinks about their protection and the subsidiary's governance system**. However, many parent companies **turn down requests for dialogue to confirm their intentions because they say that their listed subsidiaries are independent**.
- ✓ On the other hand, while some parent companies say that they respect their listed subsidiaries' independence, **they also have material contracts and agreements with their listed subsidiaries regarding such things as the dispatching of executives from the parent company**.
- ⇒ **A parent company has the authority to elect and dismiss the directors of its listed subsidiaries**. The directors are responsible for protecting the minority shareholders of their companies. **The parent company must ensure that its listed subsidiaries have the independence and the governance systems necessary** for such things as the mandatory appointment of independent directors.
- ⇒ In addition, a parent company **is responsible for explaining** the governance systems of its listed subsidiaries and is expected to **respond to dialogue appropriately**.
- ⇒ Companies will be **required to disclose material contracts with shareholders** in future Annual Securities Reports. In light of this, parent companies are also expected to **adequately explain the outlines and effects of material contracts that they have concluded, if those contracts could have an effect on governance**.

## 4. The parent shows a disregard for minority shareholders in the election and dismissal of the subsidiary's directors

### Example (based on an actual case)



### Investors' Comments



- ✓ At some listed subsidiaries, **the parent company exercises its voting rights in a way that shows a disregard for the listed subsidiary's minority shareholders** with respect to the election of candidates that are not in line with the parent company's wishes.
  - ✓ In many cases, the parent company's voting policy and other documents contain only such abstractions as "ensure the subsidiary's governance system."
- ⇒ In terms of protecting its listed subsidiaries' minority shareholders and ensuring the effectiveness of their governance systems, the parent company has a responsibility to appropriately explain **its policy on the election and dismissal of its listed subsidiaries' directors and the results of exercising its authority.**

\* Also see pages 13, 14, and 17-19 for the investor's perspective on the protection of listed subsidiaries' minority shareholders.

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- The listing of subsidiaries is one of the forms of listing that TSE has recognized.
- On the other hand, investors are **keenly interested** in whether listing under the parent company's umbrella is **optimal in terms of increasing the subsidiary's corporate value**.
- In addition, with regard to conflict-of-interest issues between parent companies and the minority shareholders of their listed subsidiaries, investors have said that they are still **concerned about the protection of minority shareholders (ensuring shareholders' common interests) at some of the listed subsidiaries**. Investors are also **concerned about whether the listed subsidiaries have adequate governance systems in place**, considering that it is the responsibility of their boards of directors (particularly their independent directors) to protect their minority shareholders.
- Taking the investor's perspective into account, the boards of listed subsidiaries **are required to continually review parent-subsidiary listings in terms of both group management and the protection of minority shareholders and consult with their parent company**. They also have a responsibility to explain their decisions adequately through disclosure and dialogue with investors.

## Points Requiring Consideration and Explanation

### Group Management

- ✓ Whether being listed under the parent company's umbrella is **optimal in terms of capital efficiency and making medium- to long-term improvements in the subsidiary's corporate value**
- \* Note that simply following the parent company's wishes is not sufficient

### Minority Shareholder Protection

- ✓ Whether the listed subsidiary is **independent from the parent company and has an effective governance system in place, both of which are necessary** so that its board of directors (particularly its independent directors) can manage the structural conflict-of-interest risks and fulfill their responsibility to protect the subsidiary's minority shareholders

## Group Management



### Investors

- ✓ A parent-subsidary listing is useful transitionally in a business restructuring, such as the listing of an in-house venture.
- ✓ I have no problem with a subsidiary listing under its parent company's umbrella as long as the subsidiary properly considers it and explains to investors that it is the best option in terms of improving the subsidiary's corporate value.
- ✓ It is an irregular form of listing because the subsidiary is listed with minority shareholders. Therefore, companies have a responsibility to give a reasonable explanation for it. However, when we have dialogues with listed subsidiaries, many of them are only concerned about their parent companies and do not seem to have a sincere attitude toward the market.
- ✓ Originally, we expected that listed subsidiaries would consider how various factors, including parent-subsidary listings, improve their corporate value, in light of TSE's request to take "Action to Implement Management that Is Conscious of Cost of Capital and Stock Price." However, our impression is that they have not considered this as much as other companies.

## Minority Shareholder Protection

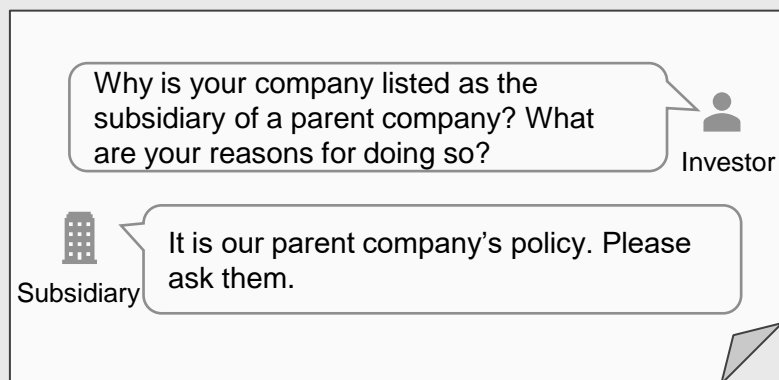


### Investors

- ✓ There are still a considerable number of cases where we are concerned that the interests of a listed subsidiary's minority shareholders are being undermined.
- ✓ There have also been cases where a parent company and its listed subsidiary have pointed fingers at each other to avoid responsibility for conflict-of-interest issues. A listed subsidiary's directors, particularly its independent directors, should be fully aware that they are responsible for protecting the listed subsidiary's minority shareholders and for explaining this to investors.
- ✓ Disclosures by listed subsidiaries regarding their independence from their parent companies and the effectiveness of their governance systems are still insufficient. The lack of transparency is a hindrance to long-term investment. And if we decide to invest under such conditions, we must make a reasonable discount to the listed subsidiary's corporate value.

## 1. The listed subsidiary defers to its parent company and does not consider whether the current form of listing is optimal for itself

Example (based on an actual conversation)



### Investors' Comments



- ✓ When we ask subsidiaries for their reasons for being listed under their parent companies' umbrellas, their only response is that it is the "parent company's policy." Many of them defer to their parent companies. Only a few of them are thinking independently in terms of improving their own corporate value.
- ✓ Some listed subsidiaries are still not making progress in quantitative analysis, such as whether they are achieving a return on capital in excess of their cost of capital.
- ⇒ We understand that parent companies do not always accept the wishes of their listed subsidiaries. However, we expect listed subsidiaries not to shy from considering and discussing their reasons for the parent-subsidary listing in terms of capital efficiency and improving their own corporate value because they are listed companies with minority shareholders.
- ⇒ Listed subsidiaries should not just consider this in terms of being a listed subsidiary versus being a wholly-owned subsidiary. It is extremely important that they also take into account such things as the parent company's business portfolio strategy and consider this in terms of whether the parent company is the best owner for them.

※ See pages 6-9 for investors' perspectives on parent companies' group management.

## 2. The explanation of reasons for using the parent's cash management system is limited to a comparison with bank interest rates

Example from a subsidiary (based on an actual disclosure)

The Company deposits its funds into the parent company group's cash management system. After considering the balance with its need for funds, the company does so because it is convenient and the conditions are more favorable than interest rates on bank deposits.

### Investors' Comments



- ✓ Most listed subsidiaries explained their reasons for participating in the group's cash management system only by saying that the interest rate is more favorable than bank interest rates.
- ✓ **Essentially, there are significant issues with the listed subsidiaries' capital efficiency and their balance sheets.** In fact, many of them have deposited large sums of excess funds relative to their market capitalization at their parent companies at low interest rates below the cost of capital. **This results in low ROEs and PBRs.**
  - ⇒ Listed subsidiaries need to reexamine **their reasons for participating in group cash management in terms of capital efficiency and medium- to long-term improvements in their corporate value**, as well as in light of TSE's request to take "Action to Implement Management that Is Conscious of Cost of Capital and Stock Price."
  - ⇒ Listed subsidiaries should also consider **how to allocate the excess funds currently on deposit for investments in growth that exceed the cost of capital and returns to shareholders over the medium to long term.**
  - ⇒ Listed subsidiaries are also expected to disclose **the actual state of the group's cash management system (details on interest rates and other arrangements).**



## 3. Investors are unable to confirm the effectiveness of the subsidiary's governance system

Example (based on an actual disclosure)

The Company has established a special committee composed of independent directors to serve as an advisory body to the board of directors and to deliberate and review material transactions and actions where a conflict of interest exists between the Company's controlling shareholder and its minority shareholders.

\* No description of the actual activities of the special committee or the items they discussed

Example (based on an actual conversation)

From the perspective of protecting minority shareholders, we would like to have a one-on-one dialogue with your outside directors.

Investor

We do not allow anyone to have a dialogue with our outside directors.

Subsidiary

Investors' Comments



- ✓ Although listed subsidiaries are making progress in appointing independent directors and establishing special committees, **they do not disclose what is actually discussed by their boards of directors or their special committees, so the effectiveness of their meetings is questionable.**
  - ✓ Because of the central role that independent directors play, **dialogue with them is an effective way** of assessing the effectiveness of a listed subsidiary's governance system. However, we get the impression that **many companies refuse such requests without giving a rational reason, particularly in the case of parent-subsidary listings.**
- ⇒ It is useful **to disclose what is actually discussed at the board of directors meetings and the special committee meetings (e.g., the agendas)** regarding the following issues because they are likely to cause problems in terms of conflicts of interest.

<b>Decision-Making</b>	Appointment of directors, parent company's involvement in the decision-making process
<b>Financial Affairs</b>	Use of the group's cash management system
<b>Transactions with the Parent Company</b>	Direct transactions, business transfers/business coordination, conversion to a wholly-owned subsidiary

- ⇒ In particular, it is also desirable for listed subsidiaries to **actively encourage their independent directors to engage in dialogue and post messages** so that investors know what they think.

## 4. It is unclear whether the process for electing and dismissing the subsidiary's independent directors is independent from the parent

Example (based on an actual disclosure)

The Company has appointed X outside directors who have no special relationship with the parent company's group. These directors are responsible for the appropriate execution and supervision of business operations from an independent standpoint.

\* No description of the process for appointing independent directors

### Investors' Comments



- ✓ Independent directors are expected to play a central role in protecting a listed subsidiary's minority shareholders. Because of this, **it is extremely important to ensure their independence.**
- ✓ However, few listed subsidiaries currently disclose in detail **whether their processes for appointing independent directors are independent from their parent companies.**
- ⇒ A listed subsidiary is required to sufficiently explain **whether its parent company is involved in the nomination of candidates (e.g., prior consultation) and how it uses its nomination committee** to ensure independence.

## 5. The reasons for such things as the dispatching of executives are unclear

Example (based on an actual disclosure)

Although Y of our X directors have been dispatched from our parent company, we believe that our parent company has ensured us some degree of independence by stipulating that it respects our independent business judgment.

\* No mention of the reasons for the dispatching or what the listed subsidiary thinks.

### Investors' Comments



- ✓ While an effective governance system, including the appointment of a sufficient number of independent directors, is a given, there are still many cases where **part of a listed subsidiary's management team is dispatched from its parent company.**
- ✓ Although a parent company is not flatly denied from dispatching executives to its listed subsidiary, **the problem is that there are cases where the listed subsidiary cannot explain the reasons for doing so or its function in terms of improving the listed subsidiary's corporate value,** such as when executives are dispatched to a company with little or no synergy.
- ⇒ A listed subsidiary is also expected **to consider and explain the reasons for the dispatching of executives from its parent company and whether the executives are appropriate candidates in terms of improving the listed subsidiary's corporate value.**
- ⇒ In addition, if a large number of a listed subsidiary's minority shareholders **vote against the dispatching of executives from the parent company,** the listed subsidiary should proactively **analyze the reasons why and have dialogues with its shareholders.**
- ⇒ Please note that companies will be required to disclose material contracts with their shareholders in their Annual Securities Reports. In light of this, **if a company has contracts regarding such matters as the right to nominate officers, it will be required to adequately disclose the contents of such contracts.** If a parent company or its nomination committee has no formal contract but instead has **a policy or other document regarding nominations, it is expected to disclose and explain the contents of such a policy.**

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- Investors are aware that companies in a quasi-controlling/quasi-controlled relationship<sup>1</sup> (e.g., cases where one company holds a certain percentage of voting rights in another company) **have issues with group management and the protection of minority shareholders (ensuring shareholders' common interests)<sup>2</sup> that are similar to those of parent-subsidary listings.**
  - The boards of companies that are quasi-controlling shareholders and companies with a quasi-controlling shareholder are expected **to take the investor's perspective into account and continually consider their current state in terms of both group management and the protection of minority shareholders. They also have a responsibility to explain their decisions adequately through disclosure and dialogue with investors.**
- <sup>1</sup> People have observed cases where there is a strong degree of control or influence based on such things as the exercising of voting rights at general shareholders meetings and the conclusion of governance-related contracts, even when the percentage of voting rights is less than a majority.
- <sup>2</sup> Please also refer to "The Investor's Perspective on Parents" (P5-11) for companies that are quasi-controlling shareholders, and "The Investor's Perspective on Subsidiaries" (P12-19) for companies with a quasi-controlling shareholder.

## Points Expected to Be Considered and Explained

### Group Management

- ✓ Whether the quasi-controlling/quasi-controlled form of listing is **optimal in terms of capital efficiency and improving the company's own corporate value.**

### General Shareholder Protection

- ✓ **Whether the company is independent from the quasi-controlling shareholder and has an effective governance system in place, both of which are necessary for the protection of the company's general shareholders.**

## Group Management



### Investor

- ✓ Like parent-subsidary listings, investors also find quasi-controlling/quasi-controlled relationships difficult to grasp because some of them believe the following. If the quasi-controlling shareholder respects the independence of the management of the quasi-controlled company, it should either sell or form a business alliance with that company. However, if the quasi-controlling shareholder wants to enhance synergies within the group, the quasi-controlled company should be converted into a wholly-owned subsidiary.
- ✓ Because the upstream company has the responsibility to protect the downstream company's general shareholders despite lacking the right of control, it could be interpreted as a half measure in terms of improving the group's corporate value, and thus requires careful explanation.

## Minority Shareholder Protection

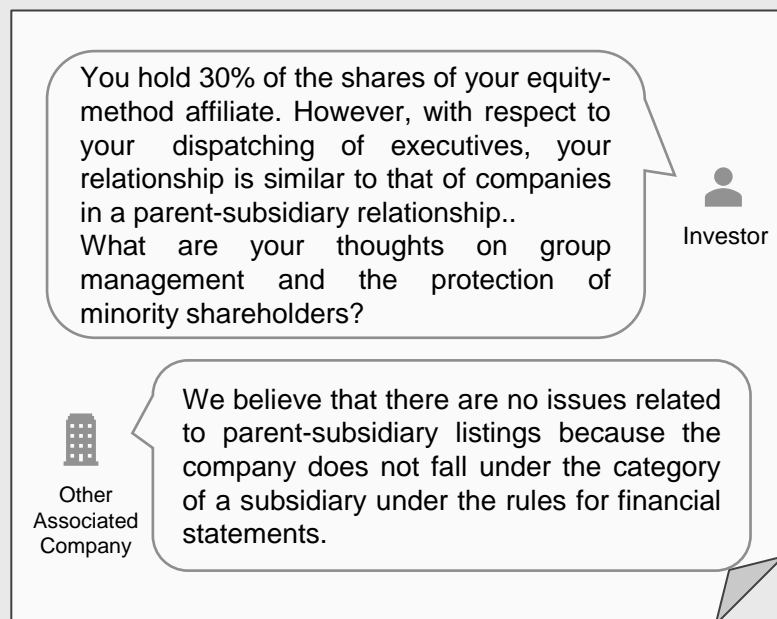


### Investor

- ✓ In companies with a quasi-controlling shareholder, conflict-of-interest issues similar to those of listed subsidiaries arise between the quasi-controlling shareholder and general shareholders. Just because it is not a parent-subsidary listing does not mean that there will be no issues related to the protection of minority shareholders.
- ✓ It is fine to disclose that no special measures have been taken because the conflict-of-interest risks are minimal. What hinders long-term investment is the lack of transparency.
- ✓ In order to understand the company's relationship with the quasi-controlling shareholder and its influence on the company, it is important to have information not only on its shareholding ratio but also on its dispatching of executives. As in the case of companies in parent-subsidary relationships, companies will be required to adequately disclose the contents of any material contracts regarding the dispatching of executives.

## The company believes that investors do not expect any particular response from companies that are not in a parent-subsidary relationship

Example (based on an actual conversation)



### Investors' Comments



- ✓ While we feel that listed companies in parent-subsidary relationships have started to make progress in considering the nature of group management, listed companies in quasi-controlling/quasi-controlled relationships **have yet to make progress in this area.**
- ✓ Companies mistakenly believe that there are no problems if they are not in a parent-subsidary relationship. As a result, we have seen some parent companies move to **dissolve their parent-subsidary relationships simply by reducing their holdings in their subsidiaries to 20% or 30%.**
- ⇒ When a company has less than a majority of the voting rights in another company but exerts a quasi-controlling influence over it by such means as the dispatching of executives, investors **generally regard the relationship as “similar to a parent-subsidary listing” and engage the company on such matters as group management and the protection of minority shareholders.**
- ⇒ For example, there are conflict-of-interest risks between specific parties not only at companies in parent-subsidary relationships but also **at companies in relationships under the equity method and at companies in relationships where one company holds a certain number of shares in another company through such means as a capital and business alliance.**
- ⇒ Issues of group management and the protection of general shareholders exist to varying degrees at companies in quasi-controlling/quasi-controlled relationships. **Depending on such things as the relationship and degree of influence between the individual companies, companies in such relationships are expected to consider such issues and fulfill their responsibility to explain them adequately to investors.**



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