



Status of Companies' Responses and Follow-up on "Action to Implement Management that is Conscious of Cost of Capital and Stock Price"

**Exchange & beyond
Tokyo Stock Exchange, Inc.**

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Status of Disclosure on “Action to Implement Management that is Conscious of Cost of Capital and Stock Price”

- TSE compiled information on the disclosure status of listed companies based on their corporate governance reports* in response to the request in March for “Action to Implement Management that is Conscious of Cost of Capital and Stock Price.” The data was compiled as of mid-July, when updated CG reports were available for companies whose fiscal year ended in March.

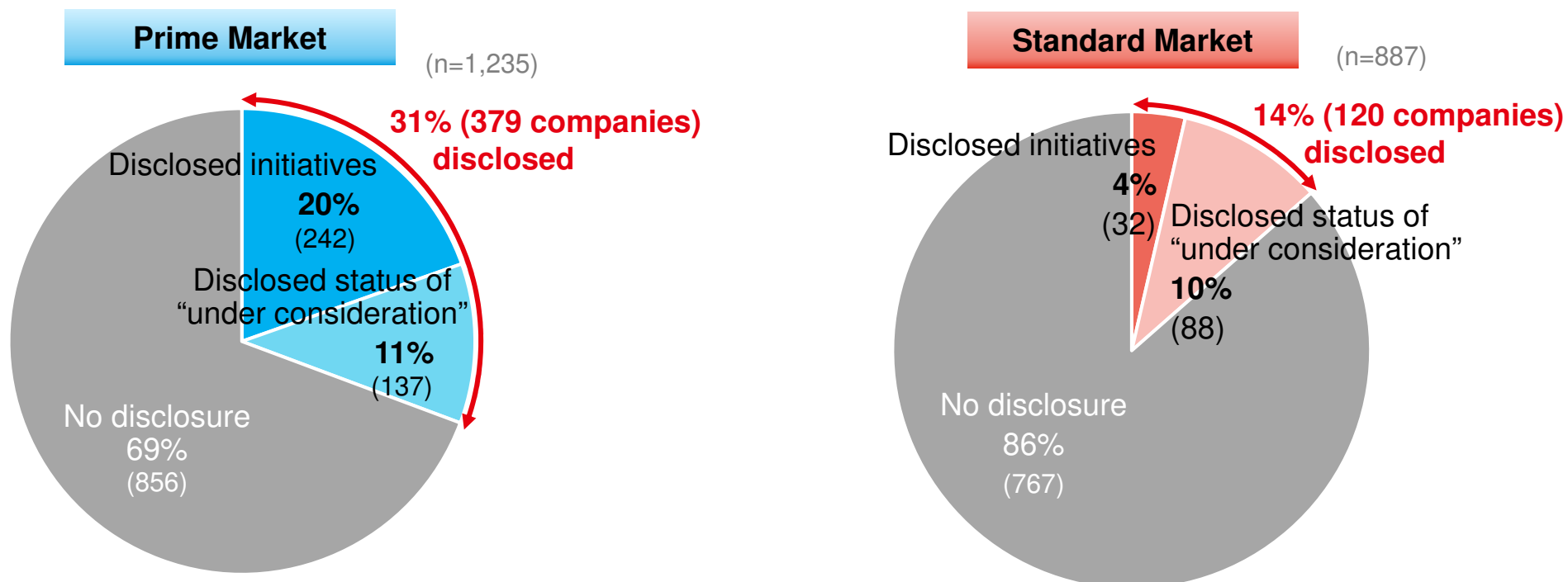
Note: Although the current request does not specify which documents should be disclosed, it requires companies to state in their CG reports that they are disclosing this information and how to access it.

- The request does not set a specific deadline for disclosure, since sufficient analysis and study of the company’s state of affairs are required as a precondition for formulating and disclosing plans, yet **31% (379 companies) of Prime Market listed companies** and **14% (120 companies) of Standard Market listed companies have already disclosed information** (based on data for companies whose fiscal year ends in March).

Note: Among companies with fiscal years that do not end in March, 20 companies in the Prime Market and 28 companies in the Standard Market disclosed information.

- Of these, a certain number of companies disclosed a status of “under consideration (TBA)” (about one-third in the Prime Market and two-thirds in the Standard Market of those that disclosed).

Status of disclosure in response to the request for “Action to Implement Management that is Conscious of Cost of Capital and Stock Price”

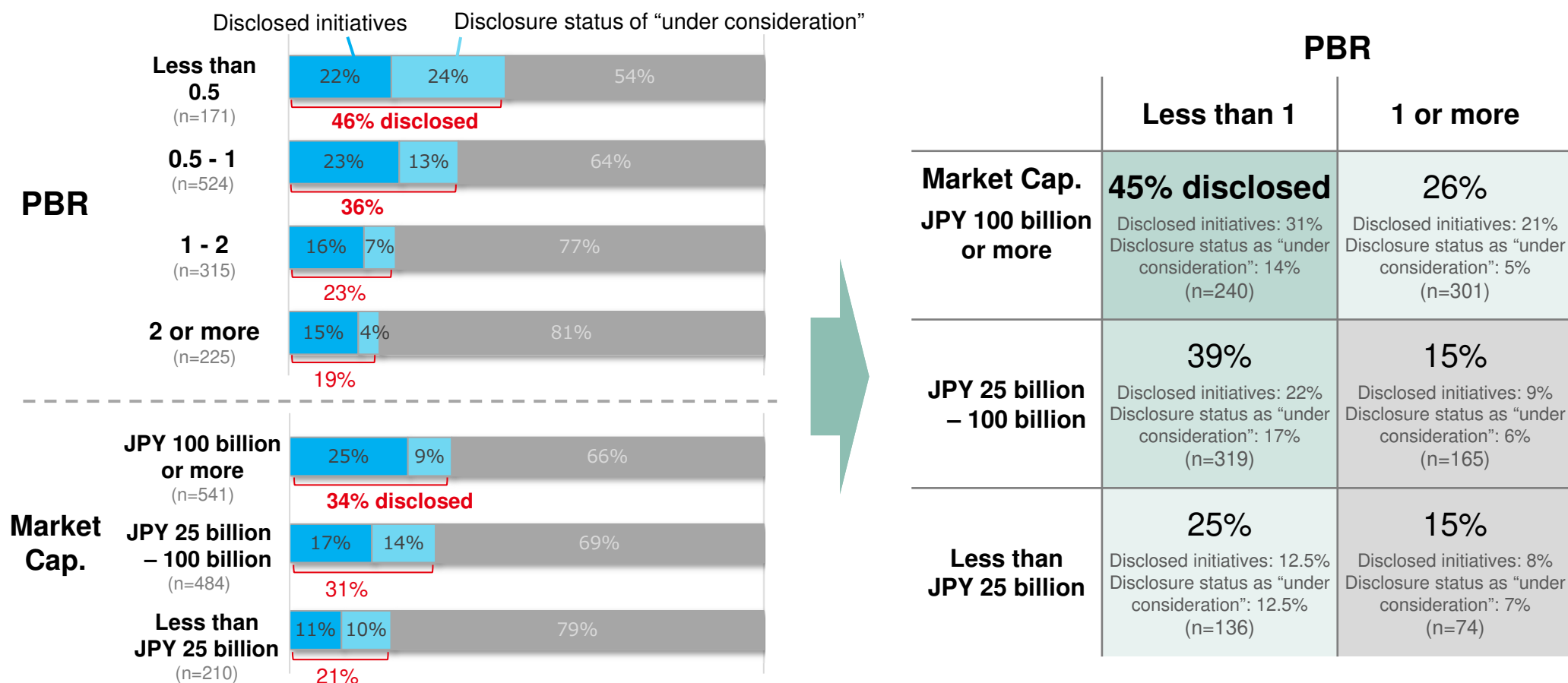


Note: Based on corporate governance reports and other information as of July 14, 2023 for Prime Market listed companies with fiscal years ending in March.

Disclosure Status by PBR and Market Cap. Levels (Prime Market)

- Disclosure progress is further along among companies with low PBRs and large market capitalizations, with 45% of Prime Market listed companies with PBRs below 1x and market capitalizations of JPY 100 billion or more disclosing information.
 - On the other hand, companies with high PBRs and small market capitalizations have made relatively little progress with disclosure.

Disclosure Status by PBR and Market Cap. Levels (Prime Market)

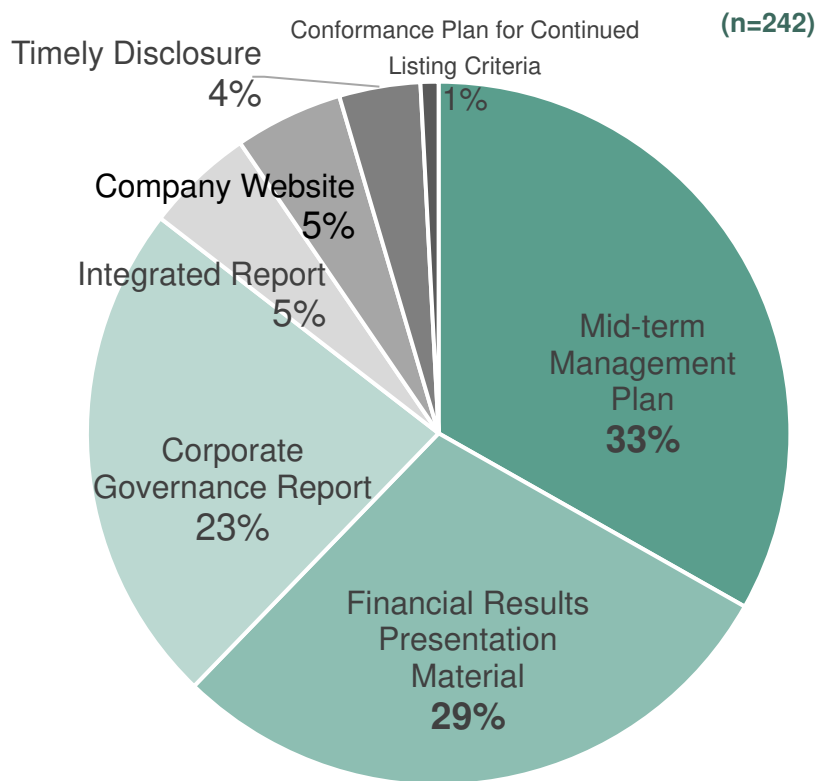


Note: Based on corporate governance reports and other information as of July 14, 2023 for Prime Market listed companies with fiscal years ending in March.

Documents Used For Disclosure / Initiative Details (Prime Market)

- Regarding which documents are used for disclosure, many companies disclose their initiatives in their mid-term management plans and financial result presentation material, at around 30% each.
- In terms of measures to improve profitability and market valuation, many companies mention investment for growth, strengthening shareholder returns, sustainability initiatives, human capital investment, review of business portfolio, etc. Many companies with relatively high ROE but less than 1x P/B ratio also mention strengthening IR. Almost no companies mention only shareholder returns.
 - However, even in cases where companies disclosed their initiatives, etc., there were a certain number of cases where the descriptions placed insufficient emphasis on the promotion of constructive dialogue with investors. For example, companies only referred to existing disclosures and made no mention of analysis and evaluation of the current situation considering the cost of capital.

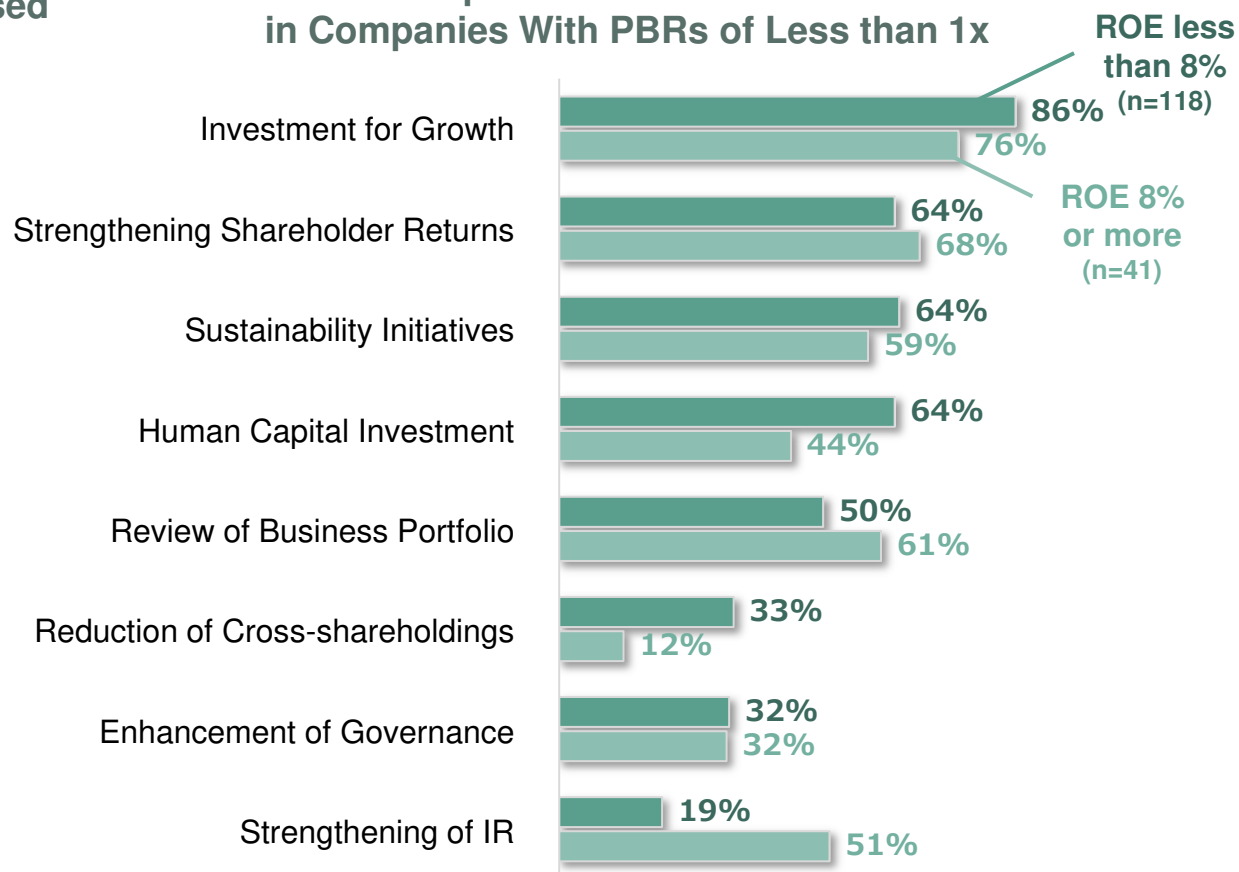
Documents in Which the Main Description is Disclosed



Note: Calculated for Prime Market listed companies whose fiscal year ends in March and have disclosed their initiatives, etc. as of July 14, 2023.

Note: If disclosure is made in more than one document, TSE counted the document in which the main statement is made.

Improvement Initiatives in Companies With PBRs of Less than 1x

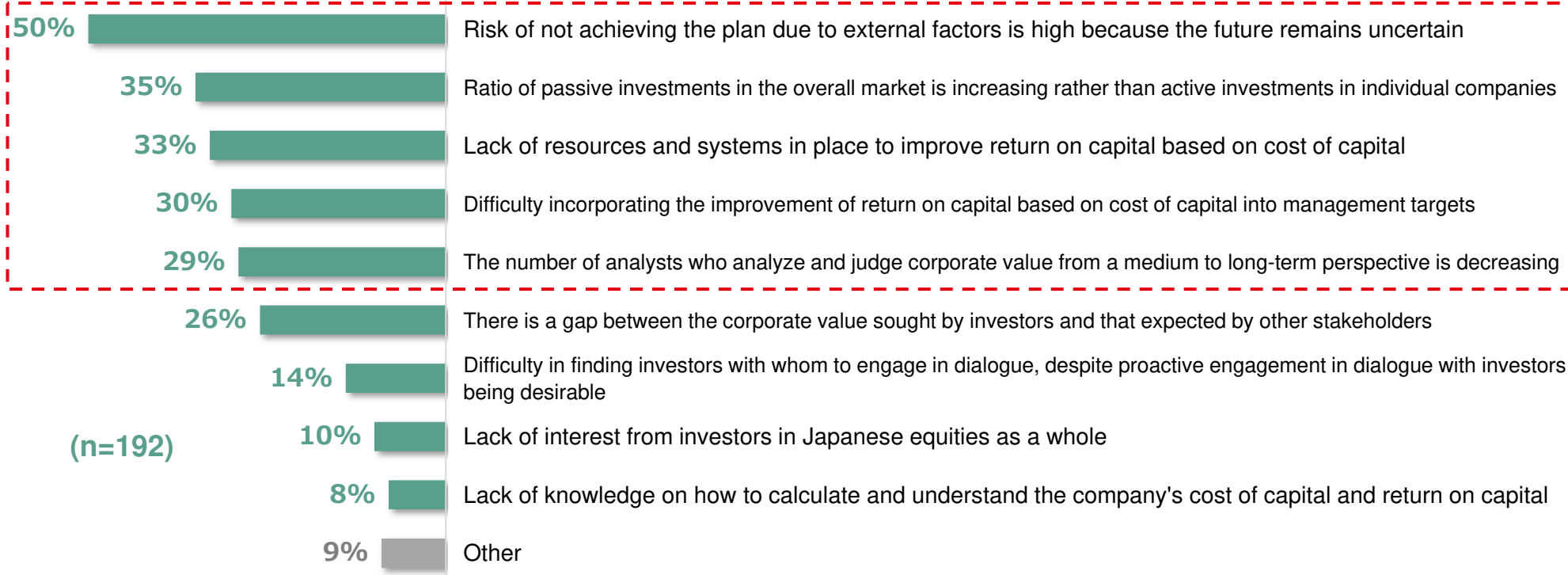


Note: Calculated for Prime Market listed companies whose fiscal year ends in March and have disclosed their initiatives, etc. as of July 14, 2023.

Challenges Perceived by Companies Regarding the Aforementioned Initiatives

- According to a survey taken of listed companies conducted by the Japan Investor Relations Association from May to June 2023, companies cited the “risk of not achieving their plans due to external factors” and the “lack of resources and systems in place” to implement such efforts as challenges in promoting “Action to Implement Management that is Conscious of Cost of Capital and Stock Price.”
- In addition, many companies cited an increase in the ratio of passive investments and a decrease in the number of analysts who analyze and judge corporate value from a medium to long-term perspective as challenges on the investor side.

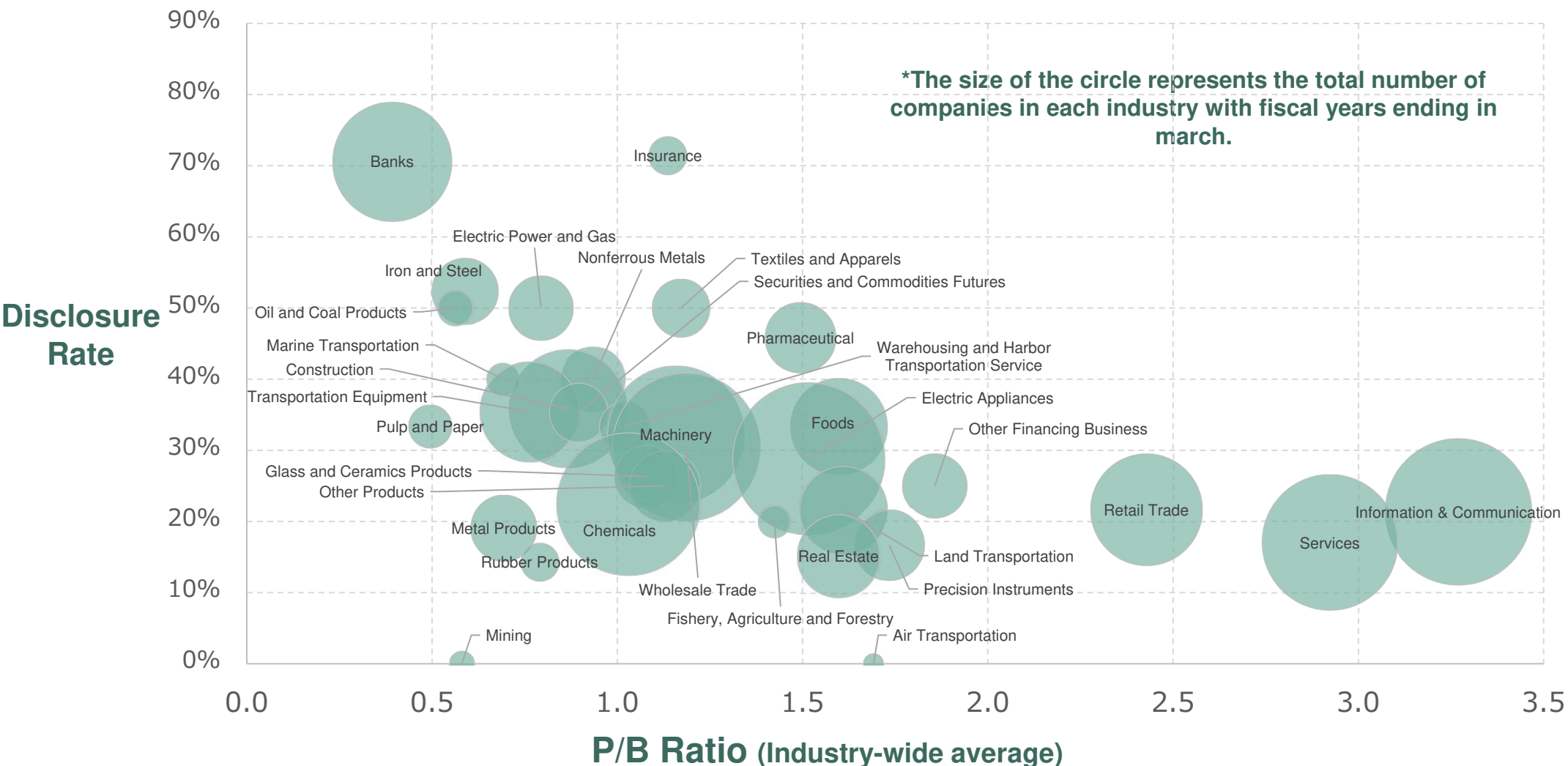
Challenges in Aforementioned Initiatives (Japan Investor Relations Association's Questionnaire for Member Companies)



Source: Excerpts from the Japan Investor Relations Association's survey of its member companies conducted from May to June 2023 (graph processed by TSE)

Reference: Disclosure Status by Industry (Prime Market)

- Disclosure progress is further along in industries with lower average PBRs; in the banking industry, about 70% of companies have disclosed. Note: Including companies with a disclosure status of “under consideration”.
- On the other hand, industries with higher average PBRs, such as Information & Communication, Services, and Retail Trade, have made relatively little progress in disclosure.



Note: Based on corporate governance reports and other information as of July 14 for Prime Market listed companies with fiscal years ending in March.
 Note: Disclosure rate includes companies disclosing status as under consideration.

- Disclosure is progressing among companies with PBRs below 1x, regardless of their ROE levels.
- Even for companies with PBRs below 1x, disclosure is relatively less advanced for companies with skewed shareholdings, especially those having controlling shareholders.

Disclosure by ROE Level (Crosstabulation with PBR level)

| | | PBR | |
|-----|--------------|--|---|
| | | Less than 1 | 1 or more |
| ROE | Less than 8% | 39% disclosed Disclosed initiatives: 23% Disclosure status as "under consideration": 16% (n=509) | 21% Disclosed initiatives: 14% Disclosure status as "under consideration": 7% (n=160) |
| | 8% or more | 37% Disclosed initiatives: 22% Disclosure status as "under consideration": 15% (n=186) | 21% Disclosed initiatives: 16% Disclosure status as "under consideration": 5% (n=380) |

Disclosure by Distribution of Shares (Crosstabulation with PBR level)

| Distribution of Shares | PBR | |
|---|--|---|
| | Less than 1 | 1 or more |
| Having a controlling shareholder | 21% disclosed Disclosed initiatives: 12% Disclosure status as "under consideration": 9% (n=33) | 21% Disclosed initiatives: 14% Disclosure status as "under consideration": 7% (n=56) |
| Having a shareholder with more than 20% of shares (No controlling shareholder) | 34% Disclosed initiatives: 21% Disclosure status as "under consideration": 13% (n=128) | 16% Disclosed initiatives: 10% Disclosure status as "under consideration": 6% (n=170) |
| Other | 40% Disclosed initiatives: 24% Disclosure status as "under consideration": 16% (n=534) | 24% Disclosed initiatives: 19% Disclosure status as "under consideration": 5% (n=314) |

Note: Based on corporate governance reports and other information as of July 14 for Prime Market listed companies with fiscal years ending in March.

- After the announcement, many investors, including foreign investors, have expressed high expectations for companies to make changes in response to the request, as the request will lead to an alignment of perspectives for investors and management.
- In fact, many domestic and foreign investors have commented that they see positive changes in companies after the request, such as companies becoming more proactive in dialogue, increased discussion of capital profitability and business portfolios in dialogue, and increased requests for advice from companies.

Responses to the Request

- “This recent request aligns with what we have been conveying to Japanese companies as investors, and it represents a very positive initiative in the right direction. We are also eager to collaborate to ensure the progress of corporate efforts.” (Foreign investor)
- “TSE's initiatives have garnered significant attention internationally, and this request is one of the factors behind our intent to increase allocation to Japanese stocks. However, with the expectations and attention come the importance of the ongoing progress of these initiatives. It's crucial to continuously communicate and appeal to institutional investors about positive changes.” (Foreign investor)

Positive Reactions to Corporate Responses

- “Recently, there are more mature discussions on topics like business profitability, handling of surplus capital, shareholder returns, and segment-specific ROIC. While there had been some progress through the introduction of the Corporate Governance Code, it had not reached this level. In addition, companies that were previously difficult to meet with, even through brokerage firms, suddenly had their CEOs come out of the woodwork during this visit, a clear change in the attitude of Japanese companies.” (Foreign investor)
- “Larger Japanese companies that had remained unresponsive despite repeated attempts have taken up the recent request and devised plans for achieving growth beyond a PBR of 1x. Such cases are prevalent and while challenges persist, the progress is dramatic. Even in the case of major manufacturers, typical examples of low-profit Japanese companies, initiatives are underway. This indicates a true sign of change for Japan.” (Foreign investor)

- On the other hand, it has been pointed out that there are still cases where management does not fully understand the significance and necessity of the initiatives, and cases where there is a sense of urgency but insufficient knowledge and resources to promote the measures.
- Many are calling for support to promote companies' efforts, such as reiteration of the content/purpose of the request, creation of more detailed guidelines, sharing examples of good practices, and provision of educational content.
 - Companies also commented that it is easier to take action if there are examples of good practices.

Challenges and Importance of Follow-Up

- “Companies with low PBR or ROE are earnestly working on their issues. **However, it is common for executives to misunderstand the purpose of the request** by merely looking at news content and thinking that it is irrelevant as long as their companies' PBR exceeds 1x. Moreover, in companies located in regions with limited interaction with market participants, there are cases where executives are not aware of the request. We would like to ask **TSE to disseminate the details of the request.**” (Domestic institutional investor)
- “Even for companies listed on the Prime Market, there are cases where **management is not fully convinced of the request**, or where it is **questionable whether they are aware of it**. Introducing good examples from TSE may raise management's awareness.” (Consultant)
- “TSE's request has garnered significant response, and there are companies that have promptly taken action, which is viewed as a commendable initiative. However, among smaller market cap companies, there is an **impression that there is insufficient financial literacy and resources to consider such initiatives.**” (Domestic institutional investor)
- “In response to TSE's request, there has been an increase in advisory requests from our investment targets' management. Conversely, **some companies express the sentiment, ‘We've never explained such matters before, so we're unsure how to proceed’**.” (Domestic institutional investor)
- “ Within companies, there are cases where they are **unsure where to start or what they don't understand**, and some cases where they believe they understand but are mistaken. To encourage corporate response, **providing educational programs and offering more detailed guidelines are conceivable.**” (Foreign investor)
- “ In order to promote initiatives, it is necessary for management to understand capital costs and profitability. However, since there are insufficient examples, **education is needed.** Additionally, the role of independent directors is crucial, and determining how to proceed with board governance is also vital.” (Foreign investor)
- “ **Investors' subsequent question is the effectiveness of these measures.** Investors are advocating for the **periodic release of the overall outcomes concerning the status of disclosure,** having the potential to exert pressure on companies not yet responding to the requests, subsequently generating a positive cycle.” (Securities firm)

Regarding Efforts Towards Improvement

- “As a result of TSE's initiatives, there has been an increasing awareness within companies about enhancing capital profitability, but the consciousness about reducing cost of capital remains weak. To lower the cost of capital, efforts to manage volatility are also crucial.” (Foreign investor)
- “While there are cases where companies should consider downsizing for future growth, some companies might engage in share buybacks to boost their stock prices in the short term, irrespective of their asset and liability situations. In fact, this year's share buybacks have reached an all-time high pace, which I believe has an overall positive impact. However, there are clearly negative cases within this trend. How TSE guides listed companies is important.” (Foreign investor)
- “In the pursuit of improving market valuation, it's essential to have capable IR professionals. IR representatives who understand the content should proactively communicate in English.” (Foreign investor)
- “Compared to other markets in developed countries, Japan's senior executives' financial incentives are remarkably misaligned with shareholders. It is crucial for senior management to have incentives aligned with shareholder perspectives for enhancing corporate value. The introduction of executive compensation linked to such KPIs should be promoted.” (Foreign investor)

Disclosure

- “Even if the company discloses that details of initiatives will be announced in the future, it would be better if the status of current considerations and the timeframe for disclosure of initiatives are described as specifically as possible.” (Domestic institutional investor)
- “When including links to disclosure documents in the Corporate Governance Report, specifying page numbers or sections to be referred to in the linked documents is important. This would make it easier to locate the disclosed information.” (Domestic institutional investors)

Indicators for Analysis, Evaluation, and Goal Setting

- “When talking with Japanese corporate executives, many focus on ROE, but since ROE can be manipulated by increasing leverage, greater emphasis should be placed on ROIC.” (Foreign investor)
- “Some companies include treasury stock in the denominator of market capitalization when calculating PBR. This is not appropriate. When calculating market capitalization. It is common practice to use the "shares outstanding excluding treasury stock" basis, which should be taken into account.” (Foreign investor)

Current Assessment and Issues

- The request has been taken seriously by companies with low PBRs. A number of companies are taking action, and domestic/foreign investors have given positive feedback about the changes.
 - However, even in cases where efforts have already been disclosed, they may **still be considered insufficient from the investor's perspective.**
- Given the **relative delays in taking action among companies with high PBRs and small market cap.**, the following could be the causes/challenges for those that have not yet made progress:
 - **Misconception that the current request is irrelevant if PBR is > 1**
 - **Management does not fully understand the significance and necessity of responding**
 - **Resources are not in place to proceed with the response**

Follow-up From TSE

- Based on the above issues, we would first like **to promote the following measures to further encourage companies to consider and disclose their efforts to improve return on capital and market valuation:**
 - The council will **continue to follow up on the status of corporate disclosure/initiatives, related issues, and investors' evaluations, and disseminate those** to the market.
 - For companies with high PBRs, reiterate the purpose of the request and that **all companies on the Prime/Standard Markets are requested to respond regardless of their P/B ratio levels.**
 - **Compile/disseminate key points of responses based on investors' perspectives** (including cases under consideration) **and examples of desirable approaches**, taking care not to induce companies to take formal measures.
- Promotion of constructive post-disclosure dialogue with shareholders and investors will be discussed in "Document 4."