

Cases Where Companies Are Not Aligned With Investors' Perspectives

Tokyo Stock Exchange, Inc.

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Introduction

Level 1 (Insufficient analysis of the current situation and consideration of measures)

Level 2 (Analysis of the current situation and measures are not up to investors' standards)

Level 3 (Further improvements are required after receiving a certain level of recognition from investors)

- ◆ In March 2023, TSE requested that all listed companies on the Prime and Standard Markets take **“Action to Implement Management That is Conscious of Cost of Capital and Stock Price.”** To help listed companies consider these measures, we published **“Considering The Investor’s Point of View in Regard to Management Conscious of Cost of Capital and Stock Price”** in February 2024.
- ◆ In light of recent feedback from investors, we have revised **“Considering the Investor’s Point of View in Regard to Management Conscious of Cost of Capital and Stock Price”** by adding new points and examples, etc. Conversely, we have compiled and published **“Cases Where Companies Do Not Align With Investors’ Perspectives”** in these slides.
- ◆ By gaining a deeper understanding of points where there is a tendency for a gap to arise between investors’ perspectives and the information disclosed, we hope that **listed companies currently considering their response to this request will find this useful as a reference, and listed companies that have already disclosed will find it useful for future updates and improving their initiatives.**

Introduction

Level 1 (Insufficient analysis of the current situation and consideration of measures)

Level 2 (Analysis of the current situation and measures are not up to investors' standards)

Level 3 (Further improvements are required after receiving a certain level of recognition from investors)

Examples of Misalignment 1

Analysis and evaluation of the current situation is only superficial

Example A (Created Based on Actual Disclosure)

Action to Implement Management That is Conscious of Cost of Capital and Stock Price

At the end of each fiscal year, we calculate the cost of capital with the help of outside experts and report the results to the Board of Directors.

The Board of Directors has confirmed the company has been able to secure a return on capital that exceeds the cost of capital on an ongoing basis, including the most recent fiscal year.

*No mention of specific levels or target setting for capital profitability/cost of capital

Comments From Investors

- ✓ The statement “The Board of Directors has confirmed the company has been able to secure a return on capital that exceeds the cost of capital” **does not explain what kind of confirmation was carried out or what kind of medium- to long-term goals have been set, and does not lead to further dialogue.**
- ⇒ We expect companies **not to be satisfied with simply ensuring a return on capital that exceeds the cost of capital and continue to set targets.** (Point I.2 Document 3 Page 10 and Point II.1 Document 3 Page 15) *

Example B (Created Based on Actual Disclosure)

Action to Implement Management That is Conscious of Cost of Capital and Stock Price

We are working to improve our corporate value over the medium- to long-term based on the FY2022-FY2024 “X Medium-Term Management Plan.”

(Link to medium-term management plan referenced above)

*Even if you look at the plan in the link, there is almost no analysis, evaluation, or initiatives that are conscious of capital profitability, capital costs, or market evaluation.

- ✓ **The disclosure is limited to providing links to past medium-term management plans, etc.** Even if you look at the documents in the link, it is difficult to say that sufficient consideration has been given, and **it feels like the management team does not have a sense of urgency.** In addition, **the stock price (market evaluation) reflects profitability, future potential, etc. over a longer period than the medium-term management plan, and there is a discrepancy in the scope of the period.**
- ✓ **Investors expect that the company will not necessarily be constrained by the framework of the medium-term management plan, but will actively review its current initiatives and progress in relation to its future vision to see whether they are meeting investors’ expectations, and make improvements where necessary.** (Point I.2 Document 3 Page 10 and Point III.4 Document 3 Page 26)

Examples of Misalignment 2

Disclosures are just a list of initiatives

Example (Created Based on Actual Disclosure)

We are taking the following measures to improve our corporate value:

1. Improving profitability

We are steadily implementing the various strategies set out in our medium-term management plan and strengthening our profitability.

2. Investing in growth

We have positioned (X) business as a new growth business for our company, and we are accelerating related efforts.

3. Expanding shareholder returns

Based on the current dividend level, the funds obtained from increased profits will be allocated to growth investments and dividends.

4. Strengthening corporate governance

A nomination and compensation committee has been established to increase the transparency and objectivity of management appointments and compensation, and to meet the expectations of stakeholders.

5. Strengthening IR activities

To improve our market recognition, we are working to further distribute information through various media outlets, as well as holding financial results briefings and individual meetings with investors.

*No quantitative explanation of the above initiatives in other disclosure materials either.



Comments from Investors

✓ Because there are **no concrete initiatives that could be applied to other companies**, and there is **no quantitative explanation**, it is **impossible to judge how they will contribute to improving corporate value in the future**.

⇒ Even if it is difficult to show quantitatively, we expect that the company and management will show their ideas as clearly and concretely as possible, explaining how each initiative will solve problems and contribute to improving corporate value and through what route **(Point II.5 Document 3 Page 19)**

Examples of Misalignment 3

Requests for dialogue are denied without legitimate reason

Example (Created Based on Actual Disclosure)

I would like to request a one-on-one dialogue  Investor

 Company A: We do not conduct one-on-one dialogues, as we do not have a sufficient IR system in place.

 Company B: We refuse all meetings with overseas investors

 Company C: For fair disclosure reasons, we are unable to accept one-on-one dialogues

Comments from Investors

- ✓ Even when we request a one-on-one meeting, we are turned down without a convincing reason. Even if they declare compliance with the principles described in CG Code 5-1 (Policy for Constructive Dialogue with Shareholders), refusing to engage in dialogue without a convincing reason **can only be described as non-compliance**. In addition, we are **requesting one-on-one meetings to deepen our understanding of growth strategies and capital policies and to communicate the views of investors**. We are not asking for insider information, so it is inappropriate to turn down the meeting on the grounds of fair disclosure.
- ⇒ **Setting up a system for responding to dialogue with investors is a minimum requirement for listed companies**. While we understand that there are busy periods, we would like companies to respond as much as possible when they are not busy. (Point III.1 Document 3 Page 22)

Example (Created Based on Actual Disclosure)

I would like to have a dialogue with the outside director to deepen my understanding of your company's governance structure and the status of deliberations at the Board of Directors.  Investor

 Company D: The outside director is too busy at the moment

 Company E: The outside director only has shallow knowledge and understanding of our business, so please talk to someone within the company

 Company F: Our company denies requests for dialogues with the outside director *Specific reason not given

- ✓ Even for companies that have declared compliance with the supplementary principles of the CG code 5-5-1 (To the extent reasonable, the senior management, directors, including outside directors, etc., should have a basic position to engage in dialogue with shareholders), **when you request a meeting with an outside director, they will refuse on the grounds of being too busy or having insufficient knowledge or understanding**.
- ⇒ Outside directors are in a position to participate in discussions at board meetings from an outside perspective and **should essentially play a role in representing the position of minority shareholders**. With this in mind, outside directors should **communicate with shareholders and investors and strive to understand their ideas**.
- ⇒ Investors are also well aware that in some cases, outside directors may only have a limited knowledge and understanding of the business. What we want to confirm with outside directors is whether **governance is functioning adequately, whether there are any issues, and what kind of discussions are taking place at board meetings regarding management issues**. (Point III.1 Document 3 Page 22)

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Examples of Misalignment 1

Misalignments in companies' evaluation of their current situation

Example A (Created Based on Actual Disclosure)

Action to Implement Management That is Conscious of Cost of Capital and Stock Price

Our ROE is 5.0%, which exceeds the cost of capital of 4.0% calculated using CAPM.

In addition, our most recent PBR is 1.1 times, which is above 1.0.

We will continue to promote management that is conscious of the cost of capital and stock price.

Comments From Investors

- ✓ The company is using a **cost of capital that deviates from the level recognized by investors and does not lead to effective goal setting or initiatives.**
 - ⇒ Since CAPM often results in a lower value than investors expect, it is a good idea to **use other calculation methods in conjunction with CAPM, listen to the opinions of investors**, and check whether there is a misalignment in perspective with investors. [\(Point I.1 Document 3 Page 8\)](#)
- ✓ **Just because ROE is slightly above the cost of capital or PBR is slightly over 1 does not mean consideration of further improvements to improve profitability or market valuation is not necessary.**
 - ⇒ We hope to see proactive efforts to improve upon the current situation based on a time-series analysis comparing the present with the past. [\(Point I.2 Document 3 Page 10\)](#)

Example B (Created Based on Actual Disclosure)

Action to Implement Management That is Conscious of Cost of Capital and Stock Price

While our ROE is 10.0%, which exceeds the cost of shareholders' capital, our PER is low at 9 times, and our PBR is below 1.

We believe that the reason for the low PER is that investors do not fully understand our business, and we will work to improve the PER and PBR by strengthening our IR activities in the future.

- ✓ **The company concludes that the reason for their low PER is a lack of understanding on the part of investors (lack of IR), but this is not necessarily the case.**
 - ⇒ While a lack of IR may be a factor, **it is also possible that the business and growth strategies are not being evaluated, and investors are not confident about the sustainability and growth of earnings**, so we hope to see an analysis of essential issues. [\(Point I.2 Document 3 Page 10\)](#)

Examples of Misalignment 2

Insufficient consideration given to ideal balance sheets and capital allocation policies

Example A (Created Based on Actual Disclosure)

Strengthening Shareholder Returns

In order to secure a ROE that exceeds the cost of capital, we will raise the dividend payout ratio from the current 30% to 50% during the period of this medium-term plan (through FY2025). In addition, we will implement a share buyback of JPY 10 billion in total during the period of this medium-term plan.

*Provides no reference to ideal balance sheet or capital allocation policies.



Comments From Investors

- ✓ We feel that the company is **taking short-term measures to boost their share price and returning profits to shareholders as a one-off response, as they have not fully considered the ideal balance sheet or capital allocation policy.**
- ⇒ In order to gain the support of investors with a medium- to long-term perspective, it is important to **give thorough consideration and show shareholders what kind of balance sheet your company is aiming for in order to improve corporate value over the medium to long term, and how you will allocate the cash you have on hand (or will acquire in the future) to growth investment, shareholder returns, etc.** (Point I.3 Document 3 Page 12)

Example B (Created Based on Actual Disclosure)

Reduction of Cross-Shareholdings

By fiscal 2025, the final year of the medium-term management plan, the ratio of cross-shareholdings will be reduced to 10% or less of consolidated net assets, and the total amount of approximately JPY 20 billion in cross-shareholdings will be sold off in stages.

*Provides no reference to ideal balance sheet or capital allocation policies.

- ✓ It is good that the company is aiming to reduce its cross-shareholdings, but without indicating **what they will do with the funds obtained from selling these stocks, such as investing in growth or returning them to shareholders, it will be difficult to see this as a positive investment opportunity, as the company will simply be selling them off.**
- ⇒ We expect companies to **disclose their medium- to long-term capital allocation policy, including the funds obtained from the sale of cross-shareholdings.** (Point I.3 Document 3 Page 12)

Examples of Misalignment 3

Target setting is not in line with investors' perspectives

Example A (Created Based on Actual Disclosure)

Our ROE has remained low, at around 3%, and our PBR has continued to be under 1. (Omitted)
As a target to be reached by 2027, we aim for an ROE of 5%, and we will continue to promote the initiatives set out in our medium-term management plan in order to achieve further growth and improve profitability in our business going forward.
* No mention of cost of capital



Comments From Investors

- ✓ It is possible that the **ROE target** set is **lower than the cost of capital**.
- ⇒ **Cost of capital should be properly understood, and targets that exceed this should be set. In addition, it is expected that the relationship between the level of cost of capital and targets will be mentioned in the disclosure.** (Point II.1 Document 3 Page 15)

Example B (Created Based on Actual Disclosure)

Although our ROE of 6% exceeds the cost of equity capital of 5% calculated using CAPM, it is lower than the 7% expected return for our company that we have ascertained through interviews with investors, and we recognize that we are not meeting the expectations of investors.
By steadily promoting the various initiatives set out in our medium-term management plan, we aim to achieve an ROE of 8% by 2035.

- ✓ Although it is good that the company set targets based on investors' expected returns, **but if the deadline is set too far in the future** that are not commensurate with the target level, **it makes investors wonder whether the management is really serious about achieving them.**
- ⇒ It is important to set targets not only at a level that investors can understand, but also with a time frame that investors can understand. (Point II.1 Document 3 Page 15)

Example C (Created Based on Actual Disclosure)

In order to improve our corporate value over the medium to long term through sustainable growth, we place importance on net sales, **operating income, and operating income ratio**, and disclose target values for each of these in our medium-term management plan. We are also aware of capital costs and capital profitability, but we will first work to improve our financial figures by placing importance on **net sales, operating income, and operating income ratio**.
*No other reference to capital costs or capital profitability.

- ✓ **Only setting targets based on the profit and loss statement, such as sales and profits, and there is a lack of perspective on how to make the most efficient use of capital to make a profit while being conscious of the balance sheet.**
- ⇒ To gain the support of investors with a medium- to long-term perspective, **indicators that investors value, such as capital efficiency based on the balance sheet, are expected to be used in setting targets.** (Point II.1 Document 3 Page 15)

Examples of Misalignment 4

Analysis of issues and consideration of additional responses are not considered flexibly

Example (Created Based on Actual Disclosure)

The progress of management indicators disclosed in June 2023 is as follows. Although we have not yet reached the target values for any of the indicators, we will continue to work towards achieving the targets by the end of FY2025.

	FY2024		FY2025	FY2026
	Goal	Results	Goal	Goal
Sales	JPY X Billion	JPY X Billion	JPY X Billion	JPY X Billion
Earnings	JPY X Billion	JPY X Billion	JPY X Billion	JPY X Billion
ROE	8%	4.5%	10%	12%
PBR	1.0x	0.6x	1.2x	1.4x

Comments From Investors

✓ **The status of progress is only presented as a numerical value**, and although progress is not going according to planned, **no measures for improvement have been indicated**.

⇒ When disclosing progress, **if there is a deviation from the original plan, it is expected that the company will explain in its own words how it is analyzing and evaluating the causes of this deviation and what measures it is considering to improve the situation.**

⇒ To gain the trust of investors with a medium- to long-term perspective, **it is important to present a reasonable explanation and countermeasures, even if the plan is not progressing well.**

(Point III.4 Document 3 Page 26)

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Examples of Misalignment 1

Insufficient focus is given to downsizing or withdrawing from unprofitable business

Example (Created Based on Actual Disclosure)

Revision of Business Portfolio

In order to improve our profitability, we will consider proactive M&A with the aim of entering the (X) sector, in which market expansion is expected in the future.

In addition, we will invest a total of JPY (X) billion in our (X) business, which is currently experiencing a slump in profitability, by 2027 in order to improve profitability.

Comments from Investors

- ✓ While it is of course important to invest in growth areas and improve the profitability of existing businesses, this alone is not enough to achieve medium- to long-term improvements in corporate value.
- ✓ In Japan, there are many companies that cannot **quit existing businesses** while their **profitability is continuously below their cost of capital** with no prospect of improvement, **so their decision not to downsize or withdraw is not very convincing.**
- ⇒ **Companies should consider more drastic measures, including the downsizing or withdrawal (sale, carve-out, etc.) of unprofitable businesses.**
(Point II.2 Document 3 Page 16)
- ⇒ In some cases, it may be difficult to publicly announce the specific details of the situation regarding the downsizing or withdrawal of existing businesses, but even just indicating the policy or approach regarding downsizing or withdrawal can reassure investors.

Examples of Misalignment 2

Performance-linked executive compensation is not necessarily an incentive for medium- to long-term improvements in corporate value

Example A (Created Based on Actual Disclosure)

In order to further motivate our directors to contribute to increasing corporate value and ensure that we achieve the targets set out in our management plan, we have introduced performance-linked compensation linked to management indicators (sales growth rate and operating profit growth rate) as shown in the table below.

Category	Ratio *In the case that 100% of targets are achieved	Method of Determination
Base compensation	60%	Fixed
Performance-based compensation	40%	Determined according to degree of target achievement for sales growth rate and operating profit growth rate (each weighted at 50%)

Comments from Investors

- ✓ While the introduction of performance-based compensation is a positive, the linked indicators are all based on the profit and loss statement, such as sales and operating profit, and there is a risk that this will prevent withdrawal from unprofitable businesses, etc. which does not lead to an awareness of efficient capital use.
- ⇒ In order to use executive compensation as a tool to align the perspective of executives with that of investors, we would like to see TSR, EPS, equity spread, and other indicators that investors place importance on more closely linked to executive compensation.
(Point II.4 Document 3 Page 18)

Example B (Created Based on Actual Disclosure)

In order to further motivate our directors to contribute to increasing corporate value and ensure that we achieve the targets set out in our management plan, we have introduced performance-linked compensation linked to management indicators (sales growth rate and operating profit growth rate) as shown in the table below.

Category	Ratio *In the case that 100% of targets are achieved	Method of Determination
Base compensation	60%	Fixed
Performance-based compensation	40%	Determined according to degree of achievement of the initial forecasted revenue and net income (each weighted at 50%)

- ✓ Performance-linked compensation is determined based on the “earnings forecast” announced at the beginning of the fiscal year, and there is a concern that this may provide an incentive to lower the earnings forecast.
- ⇒ While there is no uniform rejection of using earnings forecasts as the standard, it is expected that executive compensation should be carefully designed to provide a sound incentive for medium- to long-term improvement in corporate value.
(Point II.4 Document 3 Page 18)

Examples of Misalignment 3

Disclosure of dialogue implementation status lacks specificity

Example A (Created Based on Actual Disclosure)

Status of Dialogue With Shareholders, Etc.

We disclose a wide range of IR information, including our medium-term management plan, in a fair and timely manner. We also engage in constructive dialogue with shareholders and investors at general meetings of shareholders, financial results briefings, etc. In addition, we ensure that our IR activities comply with internal regulations to prevent insider trading.

Comments From Investors

- ✓ Although it says “Status of Dialogue,” **the content of the disclosure is limited to the dialogue policy. In addition, there are cases where companies provide only a one-way explanation in financial results briefings etc., which can hardly be described as an “opportunity for dialogue.”**
- ⇒ **By disclosing information such as dialogue results and feedback received, the company can show that they are working to improve their initiatives through constructive dialogue with shareholders and investors.**
(Point III.3 Document 3 Page 24)

Example B (Created Based on Actual Disclosure)

Status of Dialogue With Shareholders

In FY2023, we held two financial results briefings for institutional investors and analysts and 30 individual meetings, during which we engaged in dialogue about the progress of our medium-term management plan, an overview of our financial results and earnings forecasts, shareholder returns, and other topics. For Individual investors, we held four company information sessions and participated in two exhibitions.

- ✓ Regarding the status of dialogue implementation, **only the number of times each IR activity was held is disclosed, and the content of the dialogue is only described in general terms.**
- ⇒ **By showing examples of dialogue and how the input gained there was incorporated into management decision-making, it is possible to convey that the management team and board of directors are actively involved, leading to further deepening of dialogue and engagement.** (Point III.1 Document 3 Page 22 and Point III.3 Document 3 Page 24)



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