Ito Review 3.0

(Ito Review SX Edition)

Report of the Study Group on Dialogues that Contribute to Long-term Corporate Management and Investment for Creation of Sustainable Corporate Value (SX Study Group)

August 30, 2022

Ministry of Economy, Trade and Industry

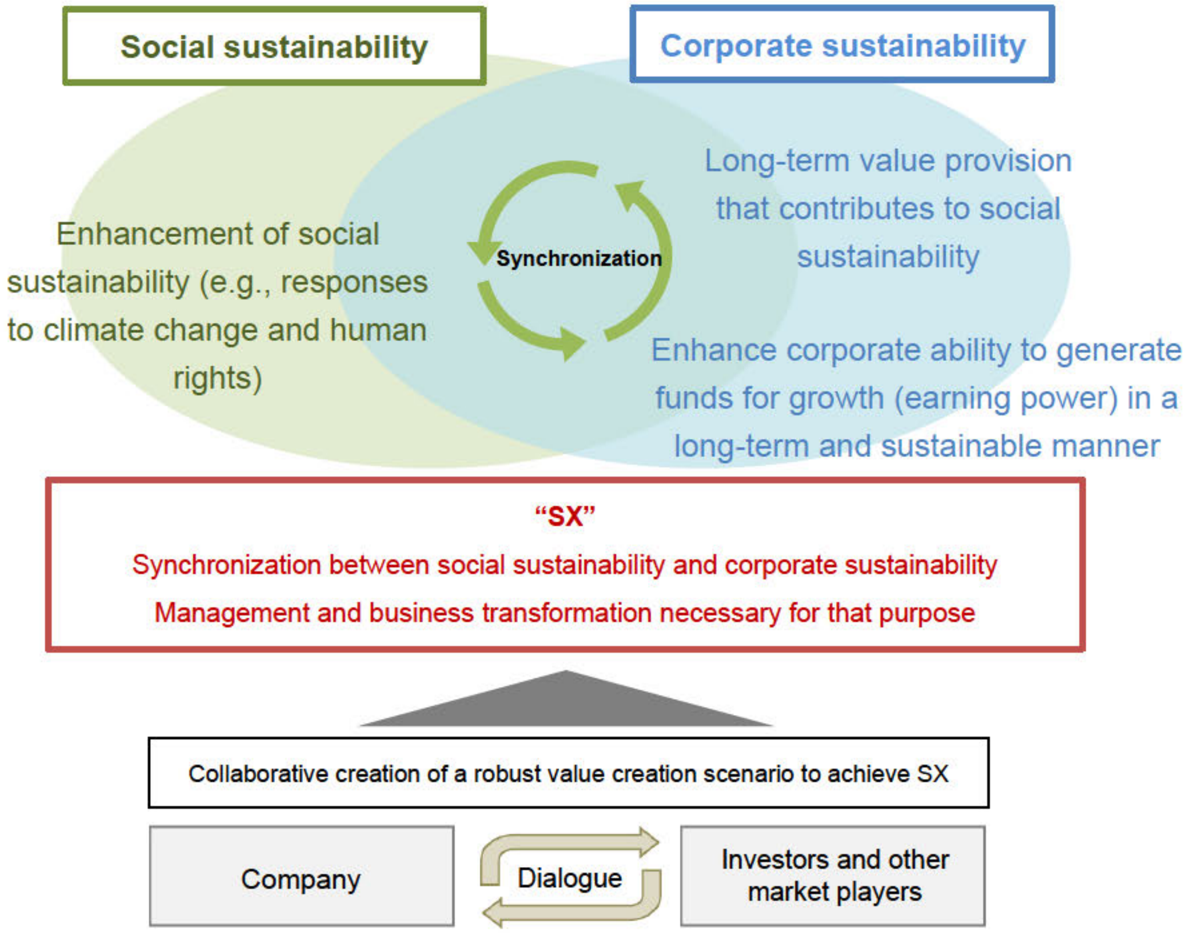
Sustainability Transformation (SX)

"Sustainability Transformation (SX)" refers to the "synchronization" between social sustainability and corporate sustainability, and the necessary management and business transformation.

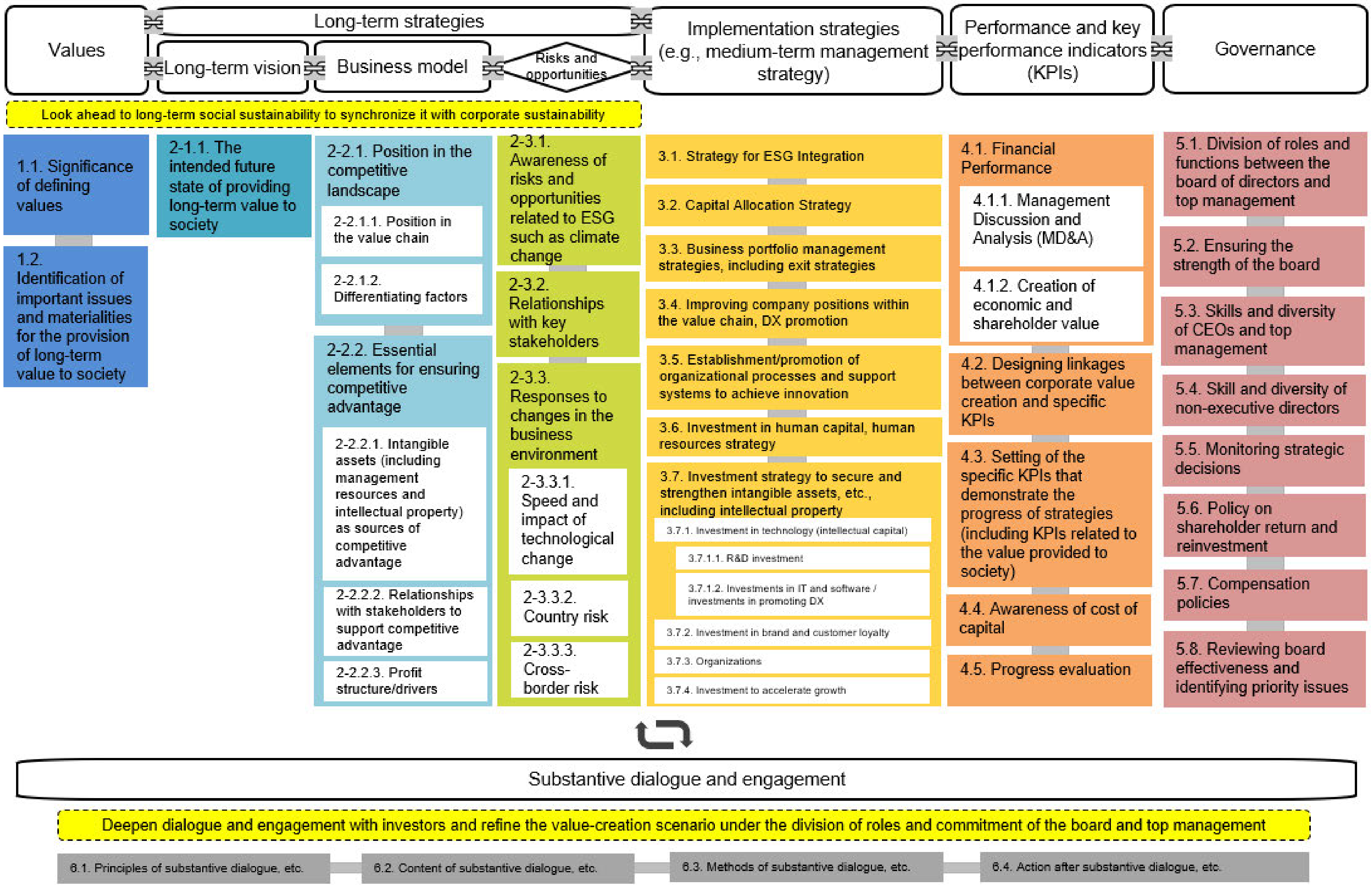
The synchronization between social sustainability and corporate sustainability means that a company make efforts to enhance social sustainability through its provision of long-term value that contributes to social sustainability, thereby strengthening its ability to generate funds for its growth (i.e., earning power) in a long-term and sustainable manner and creating further value.

SX will not be achieved only by corporate efforts. For the purpose of achieving SX, various players in the investment chain (companies, investors, clients, etc.) must engage in constructive and substantial dialogue on how corporate management should be over a long-term timeframe and refine such management, taking into account the demands of building a sustainable society.

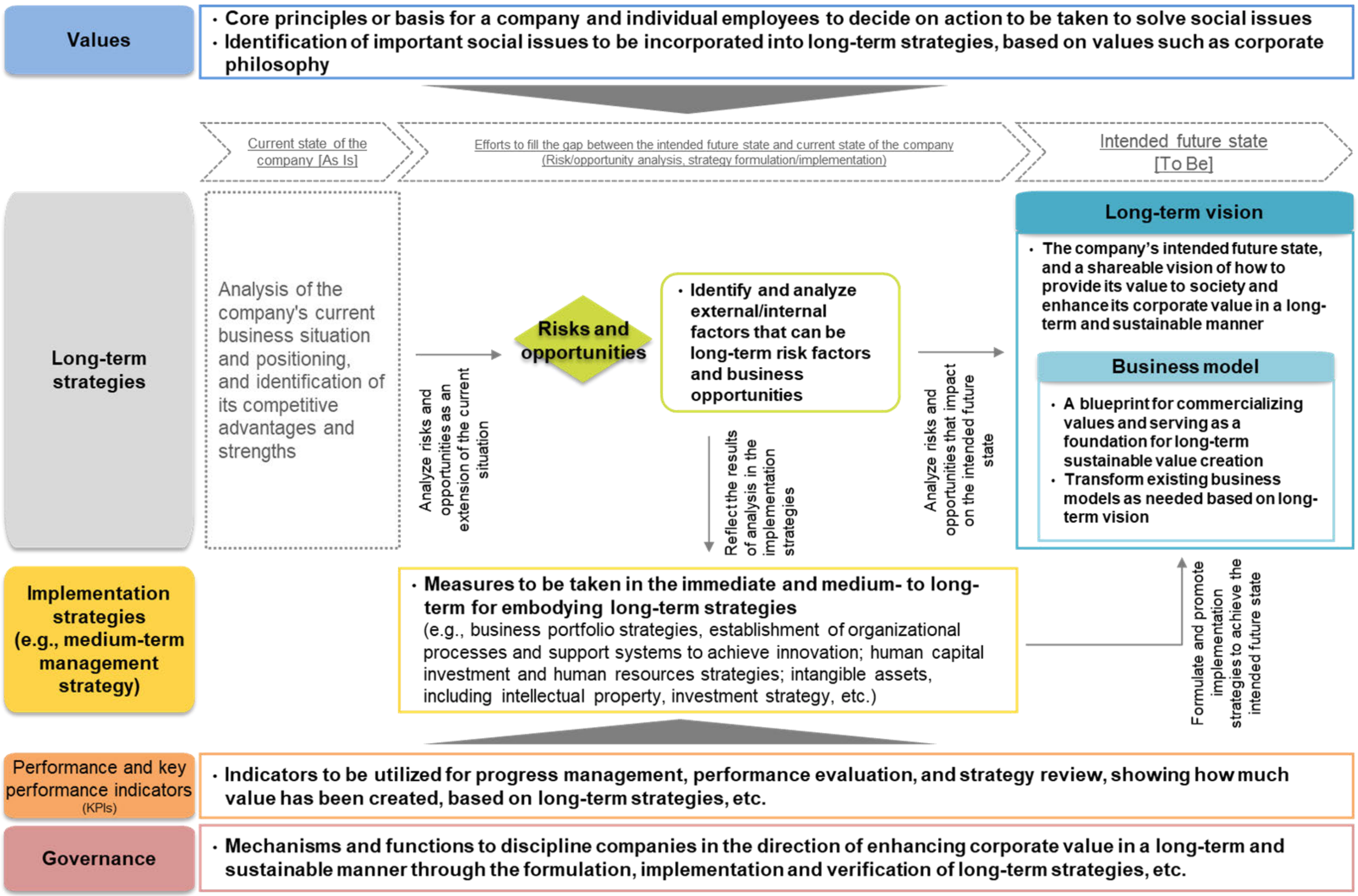
In order to secure sustainable competitive advantage in an increasingly complex business environment (e.g., diversified sustainability issues such as climate change and human rights, changes in various rule environments including such diversified issues, and emergence of economic security related issues such as cybersecurity), it is expected to collaboratively create and implement a robust value creation scenario to achieve SX.



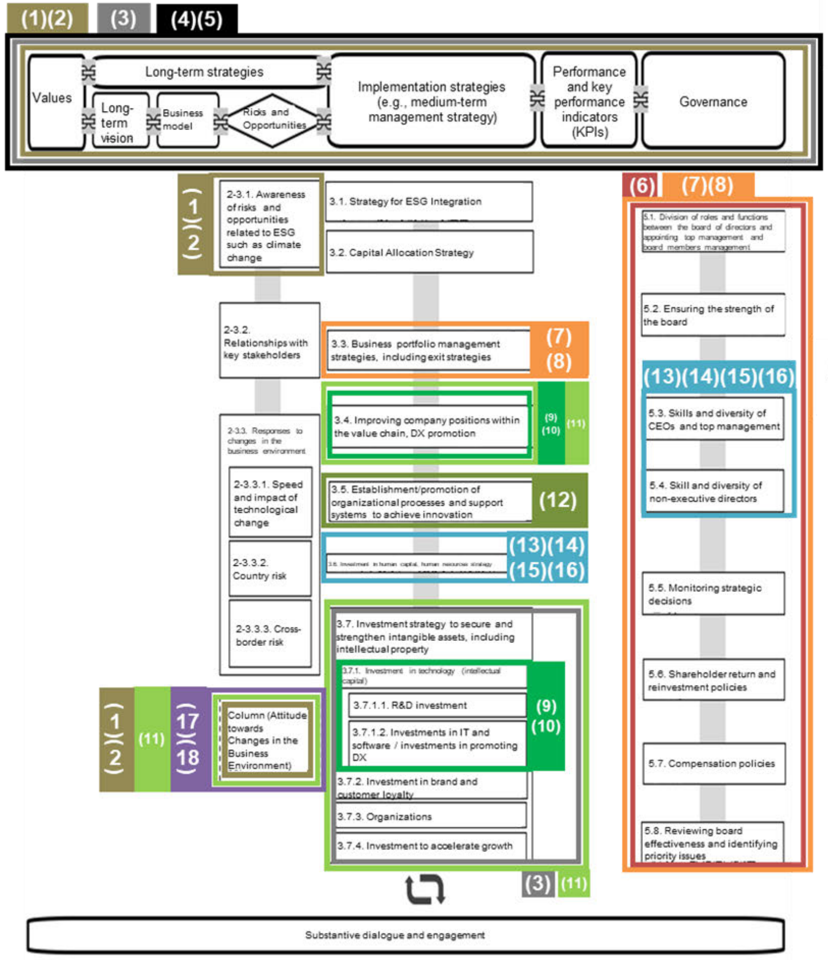
Framework for Achieving Sustainability Transformation (SX)
(Overview of the Guidance for Collaborative Value Creation 2.0)



Guidance for Collaborative Value Creation 2.0 Captured by the As Is – To Be Framework



Relationship Diagram between the Guidance for Collaborative Value Creation 2.0 and Other Guidelines, etc. (as of August 2022)



● Effective guidelines for further exploration of the overall value-creation scenario for specific sectors and industries

(1) Guidance on Climate-related Financial Disclosures 2.0 (TCFD Guidance 2.0)
(2) Disclosure and Dialogue Guidance for Promoting Sustainable Finance in the Circular Economy
(3) Intellectual Property and Intangible Asset Governance Guidelines
(*1)

(4) Guidance for Integrated Corporate Disclosure Concerning Industrial and Product Safety
(5) Guidance for Collaborative Value Creation: Biomedical Industry

etc.

● Effective guidelines for further exploration of each element of the Guidance for Collaborative Value Creation 2.0

(6) CGS Guidelines

(7) Business Restructuring Guidelines
(8) Group Guidelines

(9) DX Promotion Guidelines
(10) Digital Governance Code

(11) Market Formation Guidance - Towards the Practice of Rule-forming Market Creation

(12) Action Guidelines for Japanese Companies' Management for Value Creation

(13) Ito Review for Human Capital Management
(14) Ito Review for Human Capital Management 2.0
(15) Diversity 2.0 Action Guidelines
(16) Guidelines for Human Capital Visualization

(17) Guidelines for Respecting Human Rights in Responsible Supply Chains (public comment period open until August 29, 2022)
(18) Cybersecurity Management Guidelines
(*2)

etc.

* It is desirable to deepen the understanding of each of (1) through ⑱ in an integrated manner by reading them together with the Guidance for Collaborative Value Creation 2.0, while taking into account the overall structure and description of the Guidance for Collaborative Value Creation. This Diagram shows the relationship between items (1) through ⑱ from the viewpoint of clearly indicating the items, etc., in the Guidance for Collaborative Value Creation 2.0 that are particularly relevant to each item.

(*1) (1) and (2) can be effectively utilized in exploring the elements of 2-3.1., etc., of the Guidance for Collaborative Value Creation 2.0, and (3) can also be effectively utilized in exploring the elements of 3.7. of the same Guidance.

(*2) "Business and human rights" and "cybersecurity" are mentioned in a column under the "Risks and Opportunities" in the Guidance for Collaborative Value Creation 2.0; however, as in other areas, from the perspective of considering how to create long-term value based on the analysis of risks and opportunities, it is desirable to utilize ⑰ and ⑱ also at the stage of development of "implementation strategies".

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1. Why Sustainability Transformation (SX) Now?

Although Japanese companies' earnings have been recovering since the release of the Ito Review in 2014, their capital efficiency is still lagging behind that of their Western counterparts, and their investments for long-term growth have been sluggish. It is very urgent to strengthen the ability of companies to generate funds for their own growth (i.e., earning power) in a long-term and sustainable manner and to enhance their corporate value, which are issues to be solved since the publication of the Ito Review.

Turning our eyes to the international trend, the situations over sustainability issues (e.g., climate change and human rights issues) has had significant impacts on the sustainability of corporate activities.

"Sustainability" is more than a risk factor to be addressed by companies, and responses to sustainability are now becoming a fundamental element of management strategies for long-term sustainable value creation. It is no exaggeration to say that it is essential to integrate sustainability into management in order to strengthen the ability of companies to generate funds for their own growth (i.e., earning power) in a long-term and sustainable manner.

In fact, companies that do not address sustainability issues are finding it difficult to gain recognition from investors, consumers and labor markets, which, as a result, increasingly impacts on the continuation of business activities.

This is not only a major challenge for the whole investment chain including Japanese companies and investors, but, at the same time, it is also a chance.

Now is a good time to implement sustainability transformation (SX). This is what will become the mainstream of "how to earn money" in the future.

SX refers to the "synchronization" between social sustainability and corporate sustainability, and the necessary management and business transformation. The "synchronization" means that a company make efforts to enhance social sustainability through its provision of long-term value that contributes to social sustainability, thereby strengthening of its ability to generate funds for its growth (i.e., earning power) and creating further value in a long-term and sustainable manner.

In order to achieve SX, it is necessary for not only companies but also various players in the investment chain such as investors, to engage in constructive and substantial dialogue on the way of corporate management in a long-term timeframe and refine such management.

Through such dialogues with investors, etc., a company can further accelerate X (transformation) by boldly promoting discontinuous transformation that is not an extension of its traditional activities, not only in its specific business or department but also in its entire corporate activities.

This Review organizes the essence of SX for enhancing the long-term sustainable corporate value through the cooperation between companies and investors, etc., amidst the drastic change in the environment surrounding companies and describes concrete efforts to be made for achieving SX. In other words, it is a "compass" that indicates the path to be taken by Japanese companies and investors, etc., for the future.

It is hoped that companies will, while utilizing this Review, actively communicate their efforts for SX to attract global investment, thereby further expanding investment for long-term growth.

< Further promotion of "new capitalism" through SX >

It is expected that the "virtuous cycle of growth and distribution" upheld by the "new capitalism" will be further strengthened if each company earns revenue by solving issues held by stakeholders through its competitively advantageous business activities and generates an "SX cycle" in which earned revenue is used for shareholder return and future investment.

Also, for the purpose of integrated and efficient promotion of SX and Green Transformation (GX) that is regarded as a priority investment area in the “new capitalism”, it is useful to work on GX by placing it in SX that is intended for wide sustainability issues such as climate change.

In this connection, for further effective and prompt promotion of SX and GX, it is desirable for companies to deal with Digital Transformation (DX) in an integrated manner with SX and GX.

2. Discussions in the SX Study Group and the Position of this Review

With the awareness of the aforementioned issues as the point of departure, the Study Group on Dialogues that Contribute to Long-term Corporate Management and Investment for Creation of Sustainable Corporate Value (SX Study Group) had eight occasions since May 2021 to discuss key points of SX and various relevant elements, and the direction of responses to be required in the future. In particular, the Study Group and its subordinate working group (i.e., the Working Group for the Revision of the Guidance for Collaborative Value Creation) have engaged in vigorous discussions on the state, and the direction of revision, of the Guidance for Collaborative Value Creation (2017)—a framework for constructing corporate value-creation scenarios, thereby contributing to high-quality information disclosure and dialogue.

In parallel, from a perspective of “strategies”, the Study Group toward Achieving Human Capital Management considered the direction of specific measures for the achievement of human resources strategy and human capital management for growth of sustainable corporate value, and released the Ito Report 2.0: Human Resources in May 2022. Furthermore, from the perspective of “disclosure”, the Cabinet Secretariat’s Study Group on Visualizing Non-financial Information considered the Guidelines for Human Capital Visualization that indicated how information related to human capital should be disclosed, and its final draft was released in August 2022.

This Review can be called a “volume on theory” in that it introduces the essence and discussion of SX as the basic concept that underlies a series of these initiatives. It is recommended to utilize the entirety of the report framework in an integrated and consistent manner by placing this Review as a foundation and referring to the Guidance for Collaborative Value Creation 2.0 (2022), the Ito Review for Human Capital Management 2.0 (2022), the Guidelines for Human Capital Visualization (2022), etc., which can be called "volume on practice".

Volume on theory

Ito Review 3.0 (Ito Review SX Edition) (2022)

- In a rapidly changing business environment (diversification of sustainability issues, increase in uncertainty in the global economy), addressing sustainability goes beyond being a risk that companies must deal with and is a fundamental element of business strategy
- Various players (e.g. companies and investors) should implement SX by engaging in constructive dialogues on how long-term management should be and refining such management. This is what will become the mainstream of "how to earn money" in the future
- Formulated the Guidance for Collaborative Value Creation 2.0 (i.e., a framework for the management enhancement, effective information disclosure and constructive dialogues to achieve SX)

Growing demand for sustainability
Deepened discussion on the nature of capitalism

Ito Review 2.0 (2017)

- For the purpose of reinvestment by companies, "intangible asset investment" is important, which forms the source of competitive advantage and innovation
- Need to provide a scenario to explain that intangible asset investments and ESG responses are "investments" necessary to enhance corporate value over the medium- to long-term
- Formulated the Guidance for Collaborative Value Creation as a “common language” for the content of dialogue between companies and investors

Growing importance of enhancing sustainable corporate value and promoting medium- to long-term investment (Japan Revitalization Strategy 2016)

Ito Review (2014)

- Awareness of the paradox of Japanese companies' sustained low profitability despite their ability to create innovations, and of investors' short-term orientation
- Reinvestment by companies for long-term innovation and medium- to long-term corporate value growth through investment from investors with a medium- to long-term perspective are important
- From the perspective of capital efficiency, it is important to achieve ROE that exceeds the cost of capital

Increased momentum for corporate governance reform

Volume on practice

Guidance for Collaborative Value Creation 2.0 (2022)
(Comprehensive Framework for achieving SX)

Ito Review for Human Capital Management 2.0 (2022)
(“Compilation of ideas” for the embodiment of human capital management)

Guidelines for Human Capital Visualization (to be released in summer 2022)
(A guide focusing on how human capital should be disclosed, including how to utilize existing guidelines, etc.)

etc.

3. Essence of SX

In the discussions at the SX Study Group, particular emphasis was placed on
① the view of "value" as a prerequisite for SX,
② issues and directions for the achievement of SX, and
③ specific efforts to achieve SX.
The Review discusses these discussion points.

① View of "Value" as a Prerequisite for SX

As long as a company is organized as a stock company, the ultimate profits generated by the company belong to its shareholders. At the same time, in order for a company to conduct business activities sustainably, it is important to solve the issues of various stakeholders (e.g., customers, business partners in the value chain, partners in joint research and joint ventures, local communities, and public institutions) and to earn profits in return therefor.

Therefore, it is important to view the "value" created by a company in a cyclical manner where the company earns profits by solving the issues faced by stakeholders through its competitively advantageous business activities, thereby enhancing corporate value in a medium- to long-term and sustainable manner, while using such profits for shareholder return and reinvestment to solve further issues.

Such thinking will accelerate the synchronization of social sustainability (responding to the demands for a sustainable society) and corporate sustainability (maintaining and strengthening companies' ability to generate funds for growth (earning power) in a long-term and sustainable manner).

Viewing corporate value in this way is consistent with the approach that emphasizes viewing intangible assets (including intellectual property) in a medium- to long-term timeframe, and with the integrated thinking by which to view the various components of corporate value in an integrated manner, as mentioned in the Ito Review and the Ito Review 2.0.

(Reference) Global Discussion on the View of "Value"—Multi-Stakeholder Discussion

In recent years, there has been a growing international discussion on the view of "value."

The Business Roundtable (BRT), which is comprised of executives from major U.S. companies, issued a statement in August 2019 redefining the purpose of a company as making a commitment to all stakeholders. This was a major shift from the shareholder capitalism that were espoused by the BRT since 1997, in which companies exist primarily for the benefit of their shareholders.

In December 2019, the World Economic Forum (WEF) released the Davos Manifesto 2020, which summarizes the purpose of companies as "engaging all stakeholders in the creation of shared and sustainable value, and, in creating such value, providing value to all stakeholders, not only their shareholders, but also their employees, customers and suppliers, local communities, and society as a whole".

Also among investors, there is a growing call for companies to consider stakeholder value. In January 2022, Larry Fink, CEO of asset management firm BlackRock, sent a letter to CEOs of his investee companies stating, among other things, "To create long-term value for shareholders, companies must create value for and be recognized by all stakeholders".

Also, in the SX Study Group, many participants gave opinions that, in order for each company to sustainably enhance its corporate value, it must provide long-term sustainable value to its stakeholders.

However, it is important to note that, if Japanese companies lose sight of the relevance of earnings and corporate value and fall into the trap of focusing solely on profits for stakeholders, their efforts for long-term value growth and management transformation may be further delayed.

Based on the aforementioned cyclical view of value, Japanese companies are expected to achieve corporate value growth by providing value to stakeholders after establishing their long-term competitive advantage through management transformation, thereby leading the way to generation of sustainable earnings and further strengthening of their competitive advantage.

② Issues and Directions for the Achievement of SX

②-1 Complexity of business environment (including sustainability agendas)

Companies are exposed to rapid changes in the business environment, including the diversification of global sustainability agendas.

Sustainability agendas, including climate change and human rights issues, have a tremendous impact on the sustainability of corporate activities, not to mention that of society. Companies that do not address these agendas will find it difficult to gain recognition from investors, consumers and the labor markets and, as a result, will have difficulty continuing their business activities.

In addition, the world economy faces even greater uncertainty due to the recent COVID-19 pandemic and the rapid destabilization of the international order.

Rising costs associated with soaring oil and commodity prices have posed challenges to the entire value chain regarding how price-pass through and cost burden should be. If disruption in international logistics and/or concern about raw materials supplies are actualized, it cannot be ignored that the existing value chains may become dysfunctional.

Cyber security risks are always present for companies. Even in the case where a company thinks it has a complete security system in place, if its business partners do not have sufficient measures in place, security may be breached from unexpected sources and the company may be subject to cyber attacks.

From the perspective of economic security, it is becoming increasingly important for a company to keep a close eye on not only its industry or business field, but also the state of international society (e.g., international security) and trends in international rulemaking, and to identify and analyze their potential impact on its business in the future.

②-2 Challenges in incorporating social sustainability into management

In this increasingly complex business environment, it is essential for a company to maintain and strengthen its ability to generate long-term sustainable funds for growth (earning power) by incorporating social sustainability into its management.

However, there are various international discussions under way on what specific business activities will contribute to the sustainability of society and how these activities can enhance corporate value, and companies are sometimes unsure of what it should tackle and how to do so.

In addition, many of the sustainability agendas are issues that have been left behind because companies could not find any economic rationality in solving them; therefore, it is inherently difficult to create profits through the solution of these issues.

This is why it is important to build a business model that enables both business solution and economic rationality through innovation (innovative value creation) as well as invention (technological innovation and invention). However, if a company becomes short-term oriented in its management and investment behavior, it will be difficult to work on innovation from a long-term perspective and scale it as a business.

In addition, because social sustainability agendas are common to society, they tend to be common to all companies in the sector (herding), and there is a significant risk of falling into cutthroat competition for profits (red ocean) as each company's actions become common and it becomes difficult for them to demonstrate their uniqueness.

At the same time, it has also been pointed out that investors are sometimes confused as to how to conduct an integrated evaluation that links a company's sustainability efforts to its corporate value, and that, as a result, corporate valuation may remain superficial and formal. Some are concerned that this way of corporate valuation will spur uniformity in corporate behavior.

②-3 Management direction for overcoming challenges

In order to overcome the challenges described above, each company must manage its business based on its own unique long-term sustainable value-creation scenario without neglecting to search for business opportunities, while taking risk countermeasures in anticipation of environmental changes.

Specifically, the company first needs to set its intended long-term future state. It is also important to proactively build a value-creation scenario unique to the company, while engaging in constructive dialogue with investors, etc., from a long-term perspective on what social issues the company aims to solve through what business model and how these efforts will lead to long-term corporate value growth. On this basis, the company is expected to position its efforts to promote DX, create inventions, and achieve innovations on the value-creation scenario and promote them as its own unique strategies.

In this connection, it is also desirable for the company to further strengthen management by drawing up multiple scenarios of environmental changes that could affect the company and establishing a strategy that can respond to any of these scenarios.

It is important for a company to actively communicate such long-term value-creation scenario to a wide range of investors, etc., thereby leading the way to attract global investment and further accelerating long-term growth investments, including innovation initiatives. In addition, a long-term view scenario is also a basic idea in maintaining and improving the creditworthiness of the company, which is expected to facilitate financing by communicating the scenario in conjunction with efforts to improve creditworthiness.

③ Specific Efforts to Achieve SX

As mentioned above, SX refers to the "synchronization" between social sustainability and corporate sustainability, and the necessary management and business transformation. The Study Group organized the following three specific efforts to achieve SX.

(1) Clarification of the intended future state that is based on social sustainability
(2) Development of strategies to achieve long-term value creation based on the intended future state
(3) KPIs and governance to effectively promote long-term value creation and their further refinement through substantive dialogues

③-1 Clarification of the intended future state that is based on social sustainability

In order to achieve SX, first, it is important for a company to clarify its intended long-term future state, while also taking into account social sustainability.

To this end, the company must first <u>clarify the values that will serve as its core principles of decision-making for providing long-term sustainable value to society and, based on these values, identify the important issues to be solved through its business activities</u>. On this basis, it is important for the company to <u>establish an intended future state</u> of how to provide value to society in a manner consistent with its values and important issues, and thereby achieve long-term value growth.

In setting the intended future state, it is useful for the company to combine "backcasting" (i.e., consideration of what efforts need to be taken to achieve the intended future state, looking ahead to changes in society that can be expected in short-, medium-, and long-term timeframes, and assuming its positioning, etc., in the future market) with "forecasting" (i.e., consideration of how to sustain and strengthen its competitive advantages/strengths in the future).

In the dialogue with investors, etc. (③-3), it is also useful to explain in an easy-to-understand manner the reasons and process of how the company came to set such an intended future state, taking into account the long-term outlook for social changes, the impact of social issues on the company in terms of both risks and opportunities, and the company's perception of its competitive advantages and strengths.

③-2 Development of strategies to achieve long-term value creation based on the intended future state

Each company is required to establish <u>a long term-strategy that shows its desirable enterprise-wide value creation for a long-term period</u> on how it will specifically achieve value creation based on its intended future state, and to formulate <u>short-, medium- and long-term strategies to embody such long-term strategy</u>.

When establishing the long-term strategy, it is important for the company to not only (1) <u>set its intended long-term future state</u>, but also (2) <u>establish and transform its business model that will serve as the foundation for achieving that future state</u>, and (3) <u>analyze the risks and opportunities</u> that should be taken into account, in an integrated manner. The long-term strategy is, in other words, a "grand strategy," which indicates the desirable enterprise-wide long-term sustainable value creation as a prerequisite for individual strategies, and it is essential that such long-term strategy be formulated in a manner consistent with the values and important issues of the company.

In order to embody and realize the long-term strategy established in this way, from the perspective of filling the gap between its intended future state and current state, it is important for the company to promote a business portfolio strategy, DX promotion, establishment and promotion of organizational processes and support systems to achieve innovation, investment in human capital and a human resources strategy, an investment strategy for intangible assets, including intellectual property, etc., according to the short-, medium-, and long-term timeframes.

In order to properly identify such gap, it is important for the company to analyze its current business situation and positioning in the market, etc., and its financial position and operating results (e.g., MD&A) to accurately recognize its competitive advantage and the management resources, etc., as a source thereof. It would also be beneficial for the company to review its relationship with stakeholders that support its competitive advantage, and to seek collaboration with new business partners that are not bound by the existing value chain with the aim of strengthening the foundation for long-term value creation.

③-3 KPIs and governance to effectively promote long-term value creation and their further refinement through substantive dialogues

In order to effectively promote long-term sustainable corporate value growth, it is effective to set KPIs and develop a governance structure. Through these efforts, each company is expected to steadily develop its intended future state and implement strategies based on that future state, and to review them appropriately in response to changes in its external environment and other factors.

When setting KPIs, it is useful for the company to link them not only to its strategies, but also to its values and important issues. In addition, the company can promote deeper understanding for investors, etc., by presenting the outlook for how these KPIs will be achieved over a long-term timeframe and how such achievement will lead to long-term value creation.

With regard to governance, it is desirable for the company to show why it has built its governance system from the perspective of enhancing its long-term value, and how such system is positioned and works in its unique value-creation scenario. On this basis, it would be beneficial to clarify the division of roles and functions between the board of directors and top management, and design medium- to long-term incentive compensation, such as executive compensation linked to KPIs related to important issues and strategies, and equity compensation.

Furthermore, it is important for the company to constantly refine its value-creation scenario, which consists of its intended future state, strategies to achieve it, governance system, etc., by deepening dialogue and engagement with investors, etc., that will contribute to the long-term corporate value growth. In doing so, while keeping in mind global trends in non-financial disclosure (Reference 2), it is important for the company to engage in constructive dialogue with its investors, etc., by providing high-quality disclosure based on its own unique value-creation scenario without falling into the trap of standardizing the content (boilerplating).

4. Revision of the Guidance for Collaborative Value Creation for Achieving SX

The value-creation scenario serving as the foundation for SX should be collaboratively refined based on dialogue between a company and various players, including investors, involved in the investment chain, rather than constructed solely by the company. In order to achieve this, the company needs a framework serving as a basis for information disclosure and dialogue to collaboratively create corporate value, in other words, a "common language" to link the company with investors, etc.

The Guidance for Collaborative Value Creation formulated in 2017 is intended to serve precisely as a guide for disclosure and dialogue for long-term value growth. Since its formulation, the Guidance has emphasized the significance of companies and investors, etc., collaborating on value-creation scenarios through constructive and substantive dialogue for the purpose of providing long-term value towards the achievement of a sustainable society. It is important now and in the future.

The SX Study Group and the Working Group for the Revision of the Guidance for Collaborative Value Creation deepened discussions to further specify the efforts required to implement long-term management and investment. In response to a variety of domestic and international developments in non-financial disclosure, we also considered how the value-creation scenario consistent with these developments should be.

While retaining the significance emphasized in the current Guidance for Collaborative Value Creation since its formulation, we have decided to revise it as the Guidance for Collaborative Value Creation 2.0 as an update to the framework to strengthen management for achieving SX, and to conduct effective information disclosure and constructive and substantive dialogue.

The five main points of this revision are as follows:

(1) The significance of SX is clarified in the Guidance. Specifically, all items clearly state the importance of long-term sustainable value provision by companies towards the achievement of a sustainable society, and the direction of responses based on such importance.

(2) In order to emphasize the importance of management and business transformation on a long-term timeframe, we have added a new major item entitled "Long-term Strategies," which consists of three sub-items: "Long-term Vision" that describes the intended future state of company; "Business Model" that serves as the foundation for long-term sustainable corporate value growth; and "Risks and Opportunities" that is used to identify and analyze risk factors and business opportunities and apply them to short-, medium- and long-term actions. On this basis, at the beginning of each item, we have briefly described "points" that should be particularly emphasized.

(3) In order to ensure consistency with the disclosure structure of "governance," "strategy," "risk management," and "metrics and targets," which has been gaining ground since the TCFD recommendations, we have organized the Guidance so that the corresponding items of "Governance," "Implementation Strategies (e.g., medium-term management strategy)," "Risks and Opportunities" and "Performance and Key Performance Indicators (KPIs)" in the Guidance for Collaborative Value Creation can be utilized.

(4) We have reorganized the Guidance to further emphasize the importance of human capital investment and human resources strategies in "Implementation Strategies (e.g., medium-term management strategy)" in light of the fact that there is a growing awareness that investment in human capital is an important element from the perspective of ensuring the synchronization between social sustainability and corporate sustainability and is closely related to various components of corporate value.

(5) We have added a new item on "Substantive Dialogue and Engagement" in order to further clarify the importance of companies and investors collaboratively creating and refining the overall value-creation scenario through constructive and substantive dialogue.

5. Further Issues for Consideration Towards Accelerating SX

It goes without saying that, in order to achieve long-term sustainable growth of corporate value through the solution of issues concerning sustainability, it is important for each company to build its own unique value-creation scenario and advance its efforts step by step, starting with what it can do.

On this basis, in order to further accelerate SX through the concerted efforts of Japanese companies, investors, etc., it is important for <u>business partners in the value chain and various players in the investment chain</u> to <u>develop SX in a collective manner</u> by promoting their proactive efforts while also asking themselves what roles they are expected to play in the achievement of SX, seeking to cooperate and collaborate with other players.

In light of the above perspective, we will discuss in the following what is expected of various players, not limited to large companies and institutional investors, in effectively and efficiently promoting SX, while also utilizing the Guidance for Collaborative Value Creation 2.0.

① Promotion of SX Throughout the Value Chain, Including SMEs and Startups

Amid rapid changes in the industrial structure and business environment on a global scale (e.g., further progress in greening and digitalization, growing importance of cybersecurity, and destabilization of the international order), there is an urgent need to promote SX by building and transforming the entire value chain, including SMEs and startups, as the foundation for long-term sustainable corporate value creation. To this end, it is important for each company to <u>promote, for example, the optimization of cost and profit allocation, the establishment of a risk management system, and efforts to improve productivity not only in the company but also throughout the value chain</u>.

In light of the importance of building a foundation for long-term value creation throughout the value chain, including the companies that receive orders, it is essential for companies in the value chain to deepen dialogue with each other and properly share the burden of cost increases (e.g., increases in purchase prices due to exchange rate fluctuations) in order to ensure long-term business continuity and corporate value growth.

In establishing a risk management system and promoting efforts to improve productivity, it is first important for key large companies in the value chain to take the initiative in establishing and sharing an intended long-term future state for the entire value chain, while also engaging in dialogue with other companies in the value chain. Furthermore, in order to achieve such intended future state, it would be beneficial for each company to enhance the governance structure not only of itself, but also of the entire value chain.

In order to achieve such intended future state, SMEs, etc., are expected to be willing to actively plan and promote efforts for long-term value creation, such as by proceeding with capital investment plans, etc., from a long-term perspective and flexibly transforming the way of management and business. In this connection, the Guidance for Collaborative Value Creation 2.0 provides a useful perspective to each company in organizing ideas for management and business transformation from a long-term perspective, and in embodying the considerations according to its situation.

It would also be beneficial for the company to actively communicate its efforts for long-term value creation on its website and in its integrated report, etc. This will also help the company to identify its own issues and review the direction for strengthening its competitive advantage through deepening internal discussions in preparation for communication.

However, many SMEs have limited resources such as human, technical and financial resources, for example, in implementing digital technology and acquiring professional personnel. For the purpose of improving productivity throughout the value chain, it would also be beneficial if large companies with extra resources approach such SMEs with limited resources, with an idea of inter-company cooperation, open innovation, etc.

Furthermore, in order to flexibly form a foundation for long-term corporate value creation while keeping in mind changes in society as a whole and in industrial structure, it is also beneficial for companies to actively promote collaboration with new companies with which they have had no contact in the past, by going beyond existing business field. For example, in order to innovate the value chain, it is worth considering focusing on the innovation-creation potential of startups and developing channels with startups that can share the same intended long-term future state.

From the perspective of establishing a foundation for their long-term value creation, it is beneficial also for startups to actively work towards acquiring new positions in the value chain, and they are expected to utilize the Guidance for Collaborative Value Creation 2.0 for this purpose.

For example, each company can persuasively communicate how its strengths specifically lead to corporate value growth, by positioning intangible assets such as technology and intellectual property—its competitive advantages and strengths—in the value-creation scenario. In addition, each company can also enhance the trust from other companies in the value chain by putting in place the governance system starting from what it can do by reference to the Guidance for Collaborative Value Creation 2.0. This will also lay the groundwork for the enhancement of governance structure that will be required in the future as the scale of the business grows.

② Utilization of the Guidance for Collaborative Value Creation 2.0 by Various Players in the Investment Chain

In order to promote SX throughout the investment chain, it is also important to change the behavior of institutional investors, asset owners, securities analysts, and ESG rating agencies that make up the chain. From this perspective, it is desirable to promote the utilization of the Guidance for Collaborative Value Creation 2.0 as a means to enhance and strengthen stewardship activities that contribute to medium- to long-term corporate evaluation and corporate value growth. Specific measures to be taken include the following efforts:

②-1 Asset management institutions and asset owners

Asset management institutions are expected to contribute to the long-term sustainable growth of corporate value through constructive dialogue, etc., with investee companies based on a long-term timeframe. While understanding by asset owners is essential in order for asset management institutions to engage in such corporate valuation and dialogue from a long-term perspective, it has been pointed out that some asset owners evaluate asset management institutions from a short-term perspective.

However, in the Japanese Stewardship Code, asset owners are expected to demonstrate their basic policies for fulfilling their stewardship responsibilities, contribute to the corporate value growth of investee companies through actions of their own or asset management institutions, and endeavor to evaluate asset management institutions based on the purpose of the Code, rather than focusing solely on short-term perspectives.

In light also of the above, it is desirable <u>for asset management institutions and asset owners to engage in dialogue based on a long-term perspective to promote the long-term corporate value</u>

growth of investee companies while utilizing the Guidance for Collaborative Value Creation 2.0 to foster a common understanding of the importance of long-term corporate value growth.

②-2 Securities analysts

In order to achieve SX, it is also important to change the behavior of securities analysts, including sell-side and buy-side analysts, who serve as the link between companies and investors.

Sell-side analysts are finding it more difficult to conduct high-value-added research due to the declining profitability of the business model in which to receive commissions in consideration for stock trading, and they are devoting most of their resources to analyzing short-term financial information, leaving little room for medium- to long-term corporate analysis. It has also been pointed out that access to information other than publicly available information has become more difficult.

In addition, some say that there are growing expectations for the roles of buy-side analysts not only to provide investment views to corporate fund managers, but also to promote long-term sustainable growth of corporate value by evaluating companies from a long-term perspective and engaging with investee companies to enhance companies' sustainability, including their creditworthiness.

Under these circumstances, it is hoped that corporate valuation from a medium- to long-term perspective will be widely spread throughout the market, including various securities analysts such as equity and bond analysts, through the utilization of the Guidance for Collaborative Value Creation 2.0.. In particular, we hope to see a change in the market environment, such that sell-side analysts' research from a long-term perspective will be highly regarded and that they will be paid fairly for such high value-added research.

To this end, it is also important for securities analysts themselves to achieve their behavioral changes such as by improving their senses to medium- and long-term topics (e.g., technological trends, multi-industry trends, and industry restructuring), and improving their ability to explain how such topics will be linked to long-term corporate valuation, and their ability to present performance models that clearly show the relevance of such topics.

②-3 ESG rating agencies

It has long been pointed out that there is a low correlation between the evaluation results of ESG rating agencies. However, what is important is not that the correlation of evaluation results is ensured, but that the evaluation methods (i.e., evaluation process) are transparent, and some say that the difference in results between institutions is not necessarily a problem, as long as the evaluation is conducted in accordance with disclosed methods.

It can be said that ESG rating agencies are first required to present information related to the evaluation process (e.g., the purpose and approach of ESG rating, specific rating methods, and information sources used for the rating) in an easy-to-understand manner. This is expected to deepen dialogue among companies, investors, and rating agencies and thereby lead to the development of ESG rating methods and to the deepening of long-term ESG efforts by companies that utilize such methods as leverage. In this connection, in order to engage in dialogue with companies and investors who place importance on long-term sustainable value creation, it would also be beneficial for ESG rating agencies not only to evaluate the ESG efforts alone, but to develop a perspective for evaluation that links such efforts to long-term value creation by reference to the Guidance for Collaborative Value Creation 2.0.

③ Further Efforts to Promote the Utilization of the Guidance for Collaborative Value Creation

As mentioned above, there is a growing trend among European and U.S. regulators to set rules regarding the non-financial disclosure. Also, as for voluntary standards and frameworks for non-financial disclosure, although there are some moves towards organizational integration among standard setters, multiple standards, etc., are still in place. In addition, there can be progress in the rulemaking, etc., to address new sustainability agendas in the future, and some companies have voiced hesitation as to how to respond to these increasingly complex situations.

Investors with long-term perspective are interested in not only non-financial information itself such as climate-related information, but also an integrated value-creation scenario that shows how a company's efforts in these areas are positioned in its overall activities, how such efforts are linked to long-term competitive advantage, and how such efforts affect its finances.

Considering these investors' perspectives, it can be said that what is first and foremost required of companies is to proactively build their own unique value-creation scenarios by organizing their ability to generate funds for growth in a long-term and sustainable manner, and the relationship between their financial and social value. On this basis, by clearly positioning sustainability-related efforts in the value-creation scenario, companies will be able to respond effectively and efficiently to various information disclosure requests. Based on this direction, companies are expected to make effective utilization of the Guidance for Collaborative Value Creation 2.0.

From the viewpoint of further spreading and promoting the Guidance for Collaborative Value Creation 2.0, including the method of utilization mentioned above, the following opinions were presented for future directions at the Study Group. Based on these opinions, companies are expected to deepen their consideration for future promotion of the Guidance for Collaborative Value Creation 2.0.

- Creation of a forum for dialogue between companies and investors with a long-term perspective for further promotion of long-term value creation, in which investors share their awareness of corporate issues in light of recent changes in the business environment, and companies deepen their understanding of investors' perspectives on corporate evaluation in light of international disclosure trends.
- Preparation of a collection of examples of the utilization of the Guidance for Collaborative Value Creation 2.0 in order to show in an easy-to-understand manner, together with examples, how companies and investors should aim for long-term collaborative value creation through what specific disclosure and dialogue.
- Consideration of creating mechanisms to encourage proactive efforts to implement SX (e.g., selection and commendation of companies that are actively working on SX).
- Our engagement in international communication and approach to ensure the wider use of the Guidance for Collaborative Value Creation 2.0 as a global framework.
- SX dissemination and awareness activities (e.g., seminars).

(Reference 1) Current Status of Japanese Companies and Capital Markets

(1) Current status of Japanese companies

In 2021, there remains a gap in the ROE between Japanese companies and European and U.S. companies (Figure 1). The Ito Review noted the importance of achieving "ROE above cost of capital," but there is a gap between companies and investors in terms of how they view it. Results of a questionnaire show that, while about 50% of companies answered that their ROE "exceeds" their cost of capital, more than 90% of investors answered that their ROE is "about the same" or "below" the cost of capital (Figure 2).

Corporate ordinary income is on the rise and reached a record high in fiscal year 2018. Accordingly, cash and deposits held by companies are increasing. However, compared to these growth rates, the allocation of management resources (e.g., personnel expenses and capital investment) towards medium- to long-term growth remains low (Figure 3). This can be clearly seen in the survey results, in which a small number of companies cited intangible asset investments (e.g., human resource investments, IT investments (DX-Ready / digitalization), and R&D investments) as important medium- to long-term investments (Figure 4).

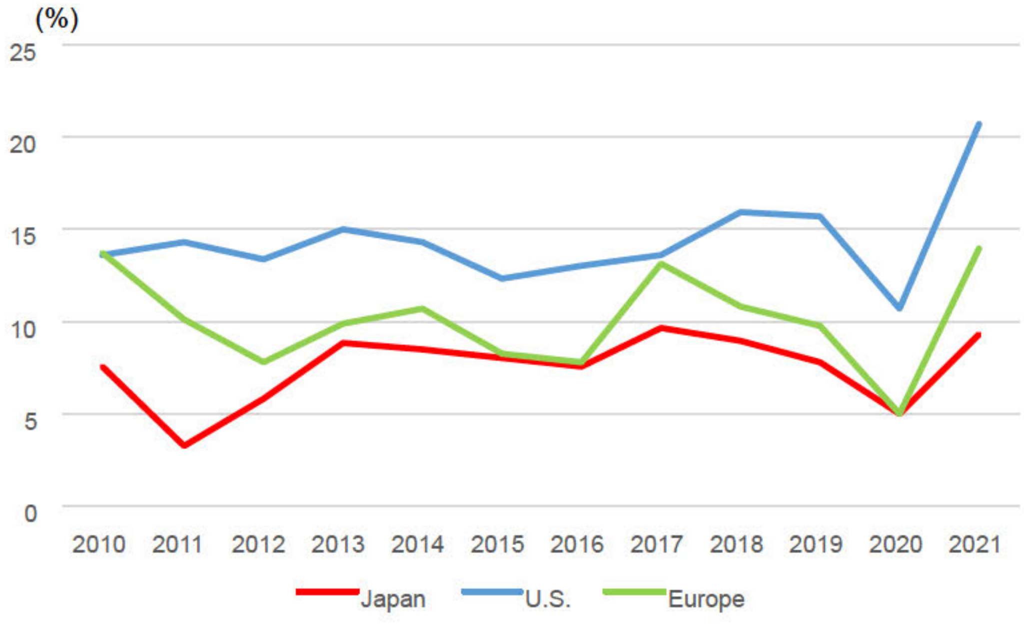
It was also pointed out in the Study Group that Japanese companies have only focused on investment (input), even though it is more important to show how investment (input) leads to outcomes (outcome).

The percentage of Japanese companies with a PBR of less than 1x is about 40% (Figure 5); therefore, some expressed a view that the low allocation of management resources to medium- to long-term growth investments by Japanese companies is leading to a harsh evaluation by investors.

In the Study Group, some members also expressed a view that management with an awareness of the cost of capital and capital efficiency will become even more important because there is downward pressure on capital efficiency while the cost of capital is rising due to recent uncertainties and the growing demand for a sustainable society. The shift to this type of management has only just begun in Japan, and efforts to improve and strengthen long-term competitive advantage and enhance corporate value remain a major challenge.

Japanese companies cannot afford to remain complacent about this situation. According to the IMD (International Institute for Management Development) World Competitiveness Yearbook 2022, Japan's "Management Practices" ranks 63rd, only second from the bottom (Figure 6). It can be said that it is an urgent challenge for Japanese companies to decisively implement management and business transformation to enhance global competitiveness.

(Figure 1) Trends in ROE of major listed companies in Japan, the U.S. and Europe



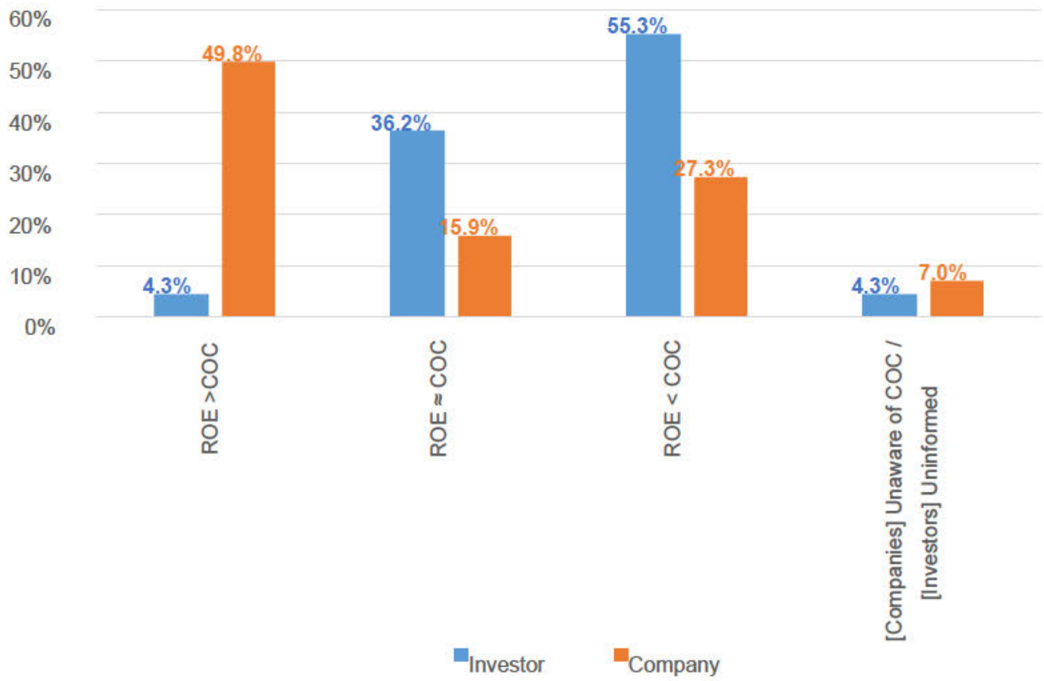
(Note) ROE = Net income (latest 12 months) / Shareholders' equity (average of beginning and end of period)

Excluding companies with negative shareholders' equity

Japan: TOPIX500, U.S.: S&P500, Europe: BE500

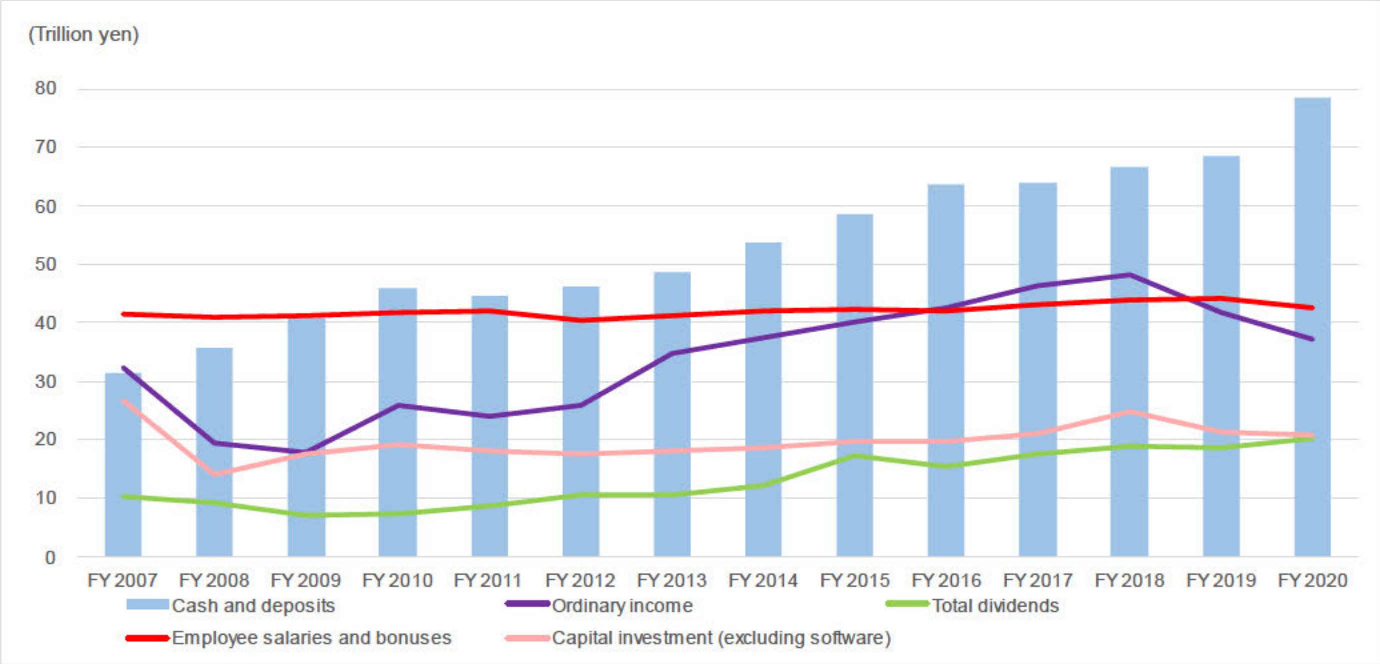
(Source) Prepared based on data from Bloomberg

(Figure 2) View of ROE level relative to cost of capital



(Source) Prepared based on the Initiatives by Life Insurers to Reinvigorate the Equity Market and Achieve a Sustainable Society through Asset Management (April 2022), The Life Insurance Association of Japan.

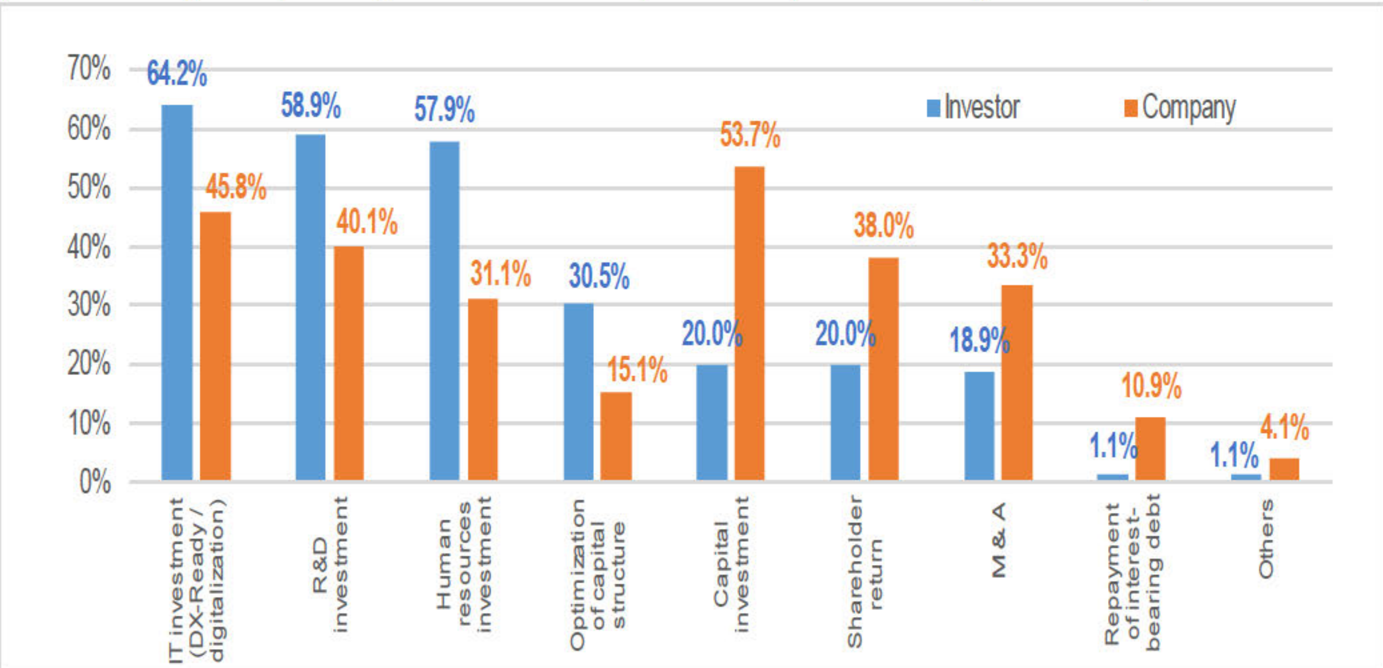
(Figure 3) Trends in various figures for large companies



(Note) Figures for all industries except finance and insurance and for companies with capital of at least one billion yen.

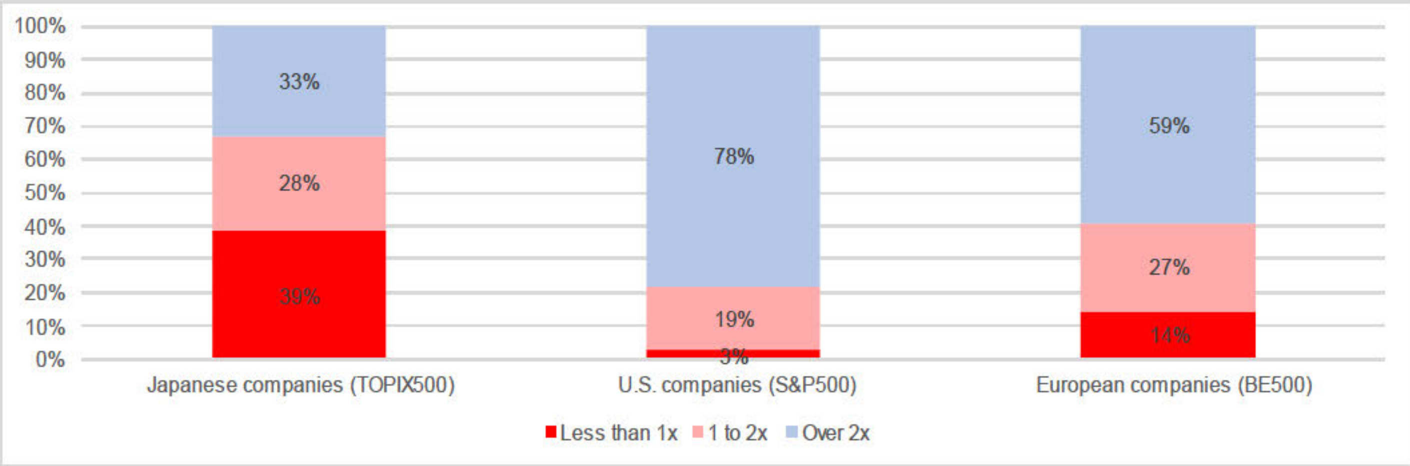
(Source) Prepared based on Financial Statements Statistics of Corporations by Industry

(Figure 4) Important items for medium- to long-term investment and financial strategies (answered by companies) / items to be emphasized (answered by investors)



(Source) Prepared based on the Initiatives by Life Insurers to Reinvigorate the Equity Market and Achieve a Sustainable Society through Asset Management (April 2022), The Life Insurance Association of Japan.

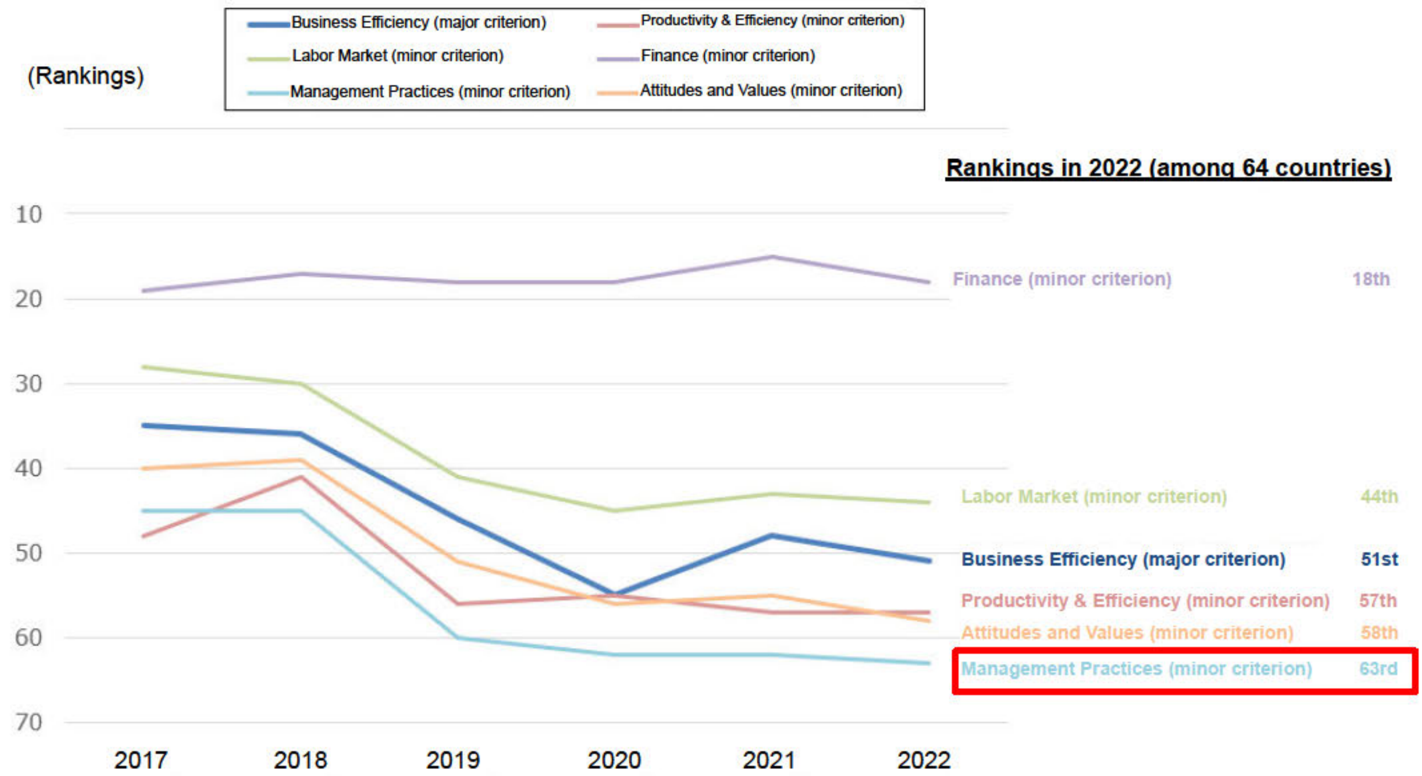
(Figure 5) Distribution of PBR of major listed companies in Japan, the U.S., and Europe (as of the end of 2021)



(Note) PBR = Market capitalization / Net assets Excluding companies with negative net assets

(Source) Prepared based on data from Bloomberg (as of December 30, 2021)

(Figure 6) Trends in Japan's ranking for "Management Practices," etc. (IMD World Competitiveness Yearbook)



(Notes) Published in the IMD World Competitiveness Yearbook include rankings in four main criteria (i.e., Economic Performance, Government Efficiency, Business Efficiency, and Infrastructure) and rankings in sub-criteria of each main criterion, in addition to the overall rankings combining all factors. The graph above shows the rankings for "Business Efficiency" and for the sub-criteria included therein (e.g., "Management Practices").

Rankings among 63 countries/regions in 2017-2020 and among 64 countries/regions in 2021 and 2022

(Source) Prepared based on the IMD World Competitiveness Yearbook 2022 and other sources

(2) Current status of capital markets

In the capital markets, the trend towards passive investment and ESG investment is continuing to grow.

The percentage of passive investment in domestic equities by the Government Pension Investment Fund (GPIF) accounted for approximately 94% as of the end of fiscal year 2021 (Figure 7).

The number of PRI signatory institutional investors exceeds 3,800 as of 2021, and the size of their investments exceeds $100 trillion (Figure 8). In addition, ESG investments worldwide as of 2020 amount to approximately $35.3 trillion (Figure 9).

Some members in the Study Group commented that there is a growing trend in regulation for investors on ESG investments such as the EU's Sustainable Finance Disclosure Regulation (SFDR) and other regulations, and that the impact on the entire market needs to be closely monitored. Although ESG rating agencies have been increasing their presence along with the rise in ESG investment, it would be a mistake to get caught up in evaluations by ESG rating agencies and thereby fail to conduct an integrated evaluation in which to link a company's sustainability efforts to its corporate value. Furthermore, some members in the Study Group commented that an increasing number of investors are making investment decisions by proactively evaluating how each company's efforts lead to long-term corporate value, while also consulting evaluations by ESG rating agencies.

In order to enhance long-term corporate value, it is important also for investors to encourage long-term management of companies through constructive dialogue based on a long-term perspective.

However, some have voiced concern that, at present, dialogues between companies and investors have become formalized. In fact, results of a questionnaire show that the top issues facing investors in dialogue are "shallow analysis and understanding of the company (dialogue content is formal)" and "conducting dialogue based on short-term perspectives and themes" (Figure 10).

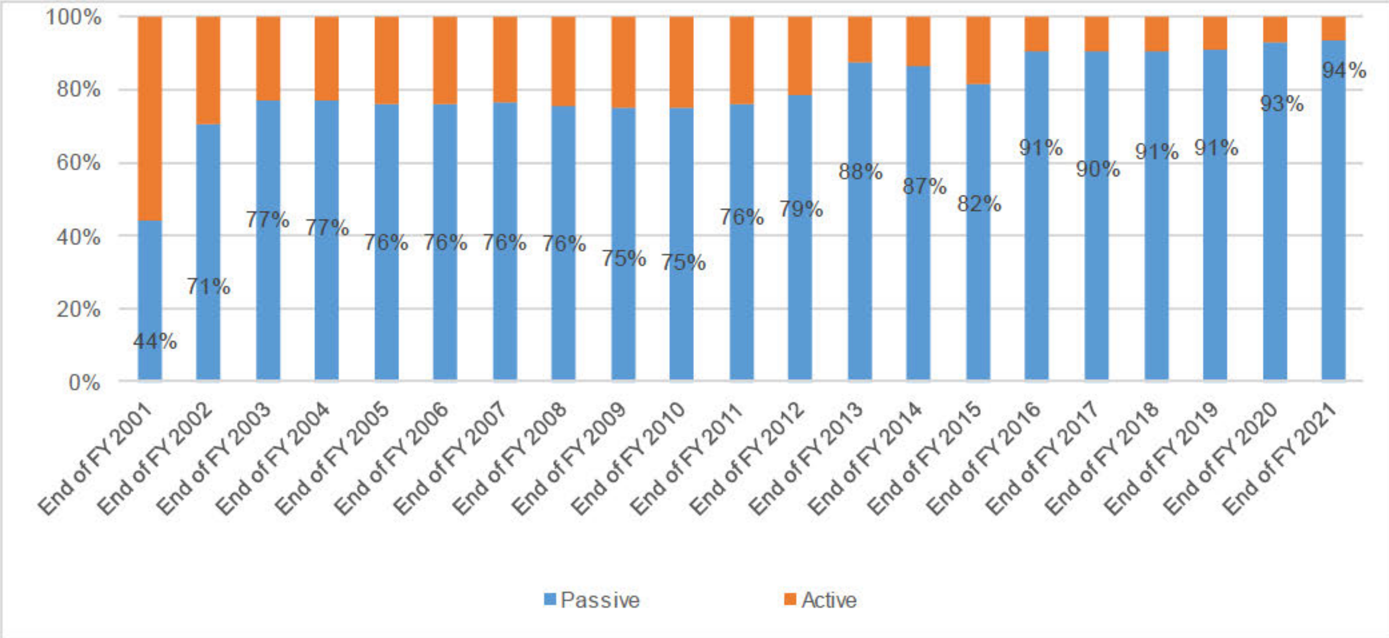
Sell-side analysts are also expected to play important roles in the capital markets.

Sell-side analysts are expected to contribute to the price discovery function of capital markets by providing investors with meaningful information from a neutral standpoint, and to play important roles in connecting companies with investors and encouraging dialogue between them by evaluating business strategies, and suggesting measures to be taken, for the benefit of companies.

However, the reduction of research expenses in response to the EU's Second Markets in Financial Instruments Directive (MiFID II) and competition to lower stock trading commissions have significantly reduced the profitability of the business model of receiving commissions in consideration for stock trading. It is said that it has become even more difficult to conduct high value-added research.

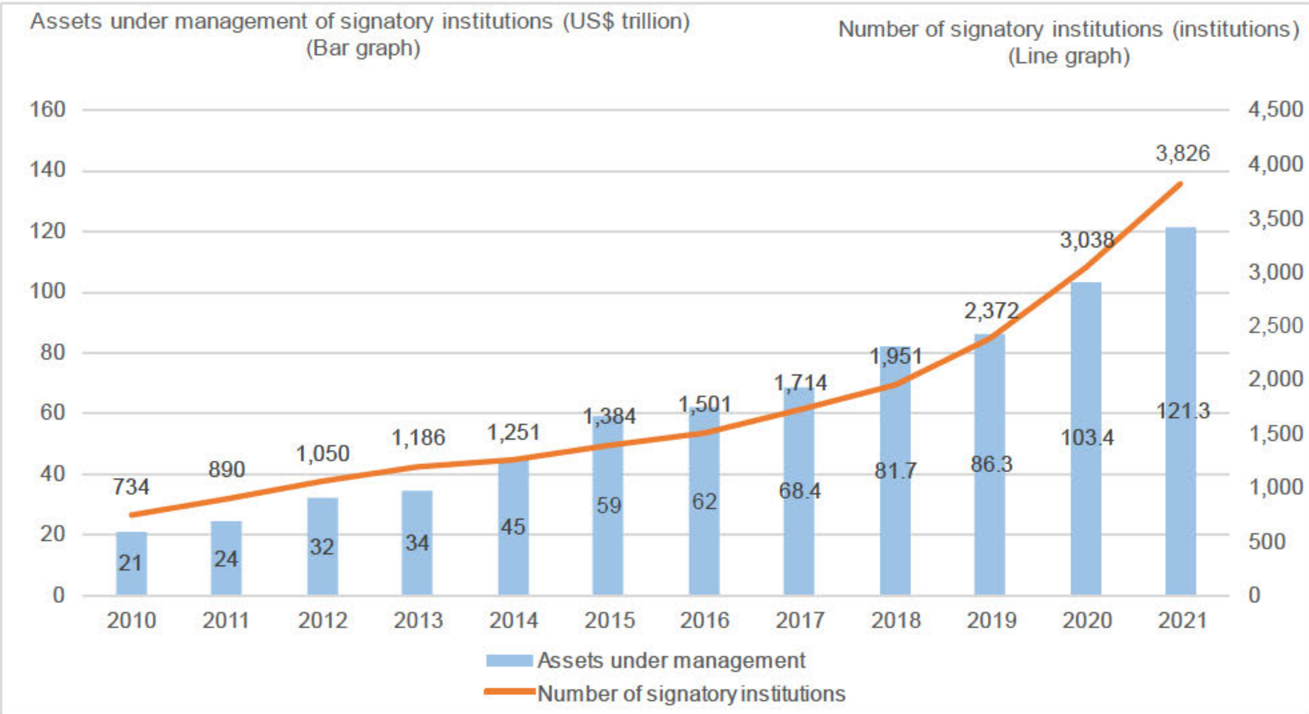
Some also pointed out that the expansion of ESG investment and the increase in the number of companies conducting cross-industry business have made it difficult for traditional sector analysts to conduct appropriate corporate analysis, while others said that the tightening of regulations on the operation for corporate-related information has made it difficult to handle information other than publicly available information.

(Figure 7) Trends in percentage of GPIF's passive investment in domestic equities



(Source) Prepared based on the Trends in the Percentage of Passive and Active Investment by the Government Pension Investment Fund

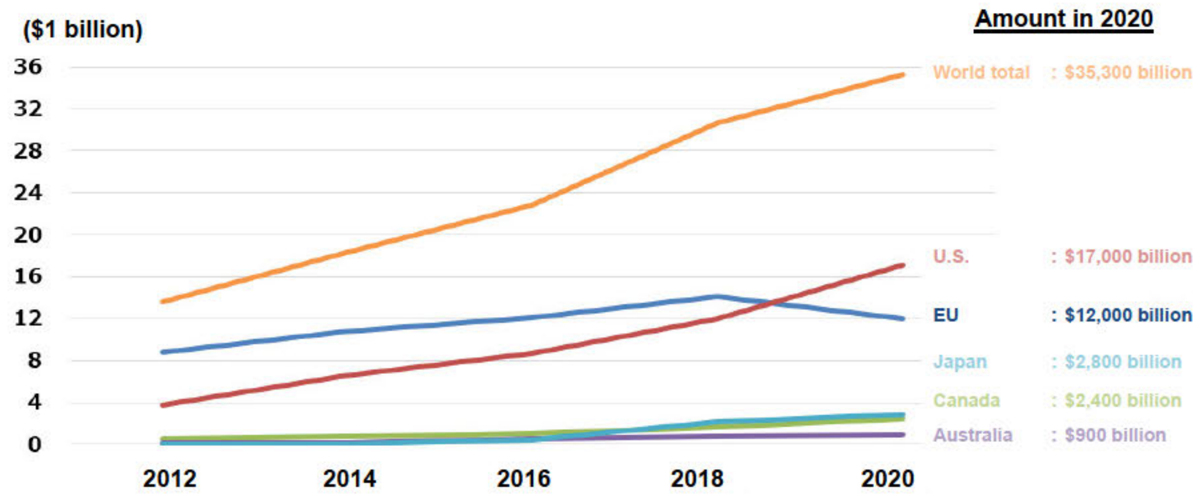
(Figure 8) Trends in the number of PRI signatory institutional investors and in the assets under management



(Note) The PRI are the six Principles for Responsible Investment established by the United Nations: (1) We will incorporate ESG issues into investment analysis and decision-making processes; (2) We will be active owners and incorporate ESG issues into our ownership policies and practices; (3) We will seek appropriate disclosure on ESG issues by the entities in which we invest; (4) We will promote acceptance and implementation of the Principles within the investment industry; (5) We will work together to enhance our effectiveness in implementing the Principles; and (6) We will each report on our activities and progress towards implementing the Principles.

(Source) Prepared based on the Principles for Responsible Investment website.

(Figure 9) Trends in amount of ESG investments worldwide



(Notes)

"Sustainable investment" as defined in the source material as "an investment approach that considers environmental, social and governance (ESG) factors in portfolio selection and investment management" is referred to as "ESG investment" in this page.

<2012> The data for countries except Australia is aggregated based on data reported as of the end of 2011, and the data for Australia, based on data reported as of the end of June 2011.

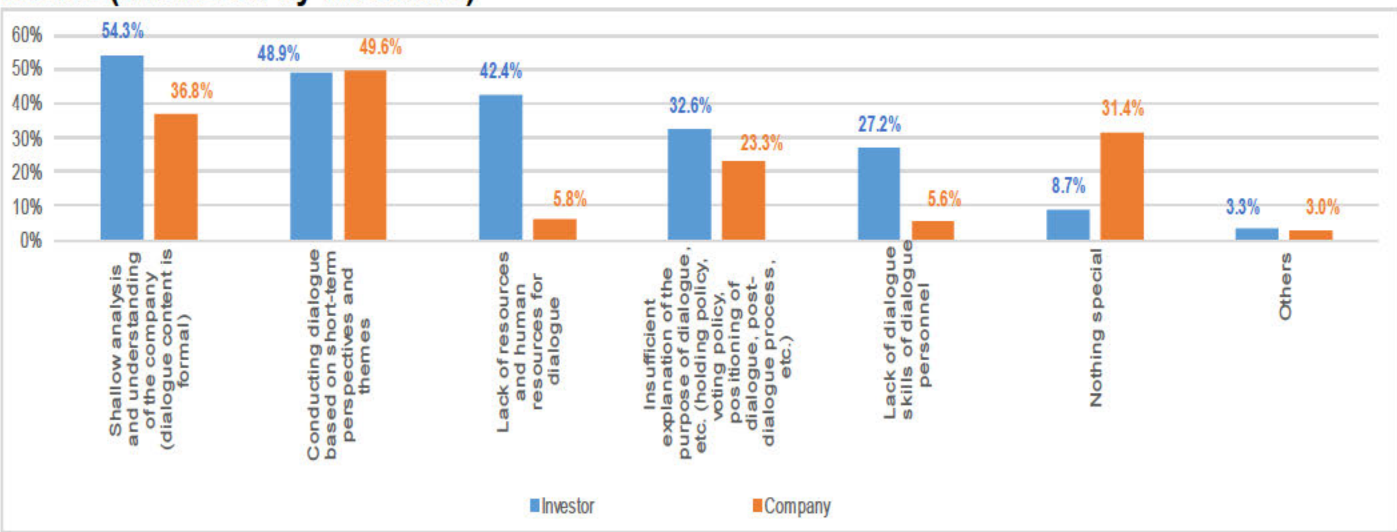
<2014> The data for countries except Japan is aggregated based on data reported as of the end of 2013, and the data for Japan, based on data reported as of the end of September 2014.

<From 2016 onward> The data for countries except Japan is aggregated based on data reported as of the end of the previous year, and the data for Japan, based on data as of the end of March in each year.

Although ESG investments appear to be declining in the EU and Australia, it is difficult to make simple comparisons over time because the definition of ESG investments is modified in each country (e.g., regulations on sustainability standards tightened in EU, and data sources modified in Australia).

(Source) Prepared based on the 2012, 2016 and 2020 editions of the Global Sustainable Investment Review published by the Global Sustainable Investment Alliance (GSIA).

(Figure 10) Challenges in the face of investors in dialogue (answered by companies) / priority issues (answered by investors)



(Source) Prepared based on the Initiatives by Life Insurers to Reinvigorate the Equity Market and Achieve a Sustainable Society through Asset Management (April 2022), The Life Insurance Association of Japan.

(Reference 2) Trends in non-financial disclosure

With the rise of ESG investment and various views of corporate value, discussions on international non-financial disclosure standards have become more active.

- Based on the TCFD recommendations released in June 2017 by Task Force on Climate-related Financial Disclosures (TCFD) which was established by the Financial Stability Board (FSB), the number of companies engaging in climate-related disclosures in Japan is on a upward trend, more than 1,000 companies and institutions (as of July 25, 2022) have indicated their support for the recommendations.
- In September 2020, the five major standard-setting bodies for non-financial disclosure (CDP, CDSB, GRI, IIRC and SASB) issued a joint statement that they would work together to achieve comprehensive corporate reporting, and in December of the same year, they released a document entitled "Reporting on enterprise value: Illustrated with a prototype climate-related financial disclosure standard."

  Of the five bodies, the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) merged to form the Value Reporting Foundation (VRF) in June 2021. In addition, the Climate Disclosure Standards Board (CDSB) and VRF were integrated into the IFRS Foundation in January 2022 and August 2022, respectively.

  The IFRS Foundation announced the establishment of the International Sustainability Standards Board (ISSB) in November 2021, and in March 2022, the ISSB published the exposure drafts of the “General Requirements for Disclosure of Sustainability-related Financial Information” and "Climate-related Disclosures." It has indicated its intention to establish disclosure standards that focus on information that is important for investors' decision making, including those for areas other than climate change.
- In April 2021, the European Commission published a proposal for a Corporate Sustainability Reporting Directive (CSRD) as a new directive to amend the Non-Financial Reporting Directive (NFRD). In April 2022, the European Financial Reporting Advisory Group (EFRAG) launched a call for comments on a working paper on the European Sustainability Reporting Standard, which details disclosure requirements under CSRD.
- In August 2020, the U.S. Securities and Exchange Commission (SEC) amended its rules to require listed companies to disclose information on human capital. In addition, in March 2022, the SEC issued a proposal to revise rules on climate-related disclosures.
- In Japan, the Report by the Working Group on Corporate Disclosure of the Financial System Council (June 2022) indicates the following policies: creation of a new "description column" for sustainability information in securities reports; for human capital, addition of "human resources development policy" and "internal environment development policy" to the disclosure items in the "strategy" section of the "description column" under sustainability information in securities reports; and for diversity, addition of "gender pay gap," "female manager ratio," and "male childcare leave acquisition rate" to the disclosure items in the "employee situation" section under sustainability information in securities reports. In the future, listed companies, etc., will be required to disclose such information as a matter to be included in their annual securities reports after the amendment of the Cabinet Office Order on Disclosure.
- Furthermore, the Guidelines for Human Capital Visualization which indicate how information related to human capital should be disclosed, was discussed by the Cabinet Secretariat Non-Financial Information Visualization Study Group, and the final draft was released in August 2022.

As described above, various considerations are being conducted at a rapid pace on the disclosure of information necessary to determine "corporate value," especially non-financial and sustainability-related information. Companies are now expected to establish their own strategies and consider how they disclose, and engage in dialogue on, such strategies, while keeping a close eye on developments of these disclosure standards.

(Reference 3) Main Flow of Events After the Release of the Ito Review

The Ito Review published by the Ministry of Economy, Trade and Industry in 2014 pointed out the following issues and directions for action in order for companies to improve their earning power and continue to generate corporate value on a sustainable basis.

- Although Japanese companies are recognized as having the world's greatest capacity to create innovation, only their stock prices have remained sluggish in the major economies over a quarter of a century. ROE (i.e., a key indicator of return on capital), and ROA and ROS (i.e., representative indicators of profitability) also continue to show a large gap from European and U.S. companies. In other words, Japanese companies are caught in a paradox in which they continue to have low profitability in spite of having the world’s leading capacity to create innovation.
- The persistent low profitability of companies has contributed to the short-termism of capital markets, which in turn has led to a reduction in growth investment to create innovation, and a vicious cycle of even more persistently low profitability.
- To overcome this current situation, it is necessary for companies to actively invest in long-term innovation creation and improve their earning power and capital productivity through "collaborative creation" of corporate value through "dialogue" between companies and investors with a medium- to long-term perspective. Therefore, from the perspective of shifting to corporate value management with an awareness of capital efficiency, it is important to set as a core management goal the achievement of ROE that exceeds the cost of capital over the medium to long term and to promote high-quality constructive dialogue with investors regarding the strategic allocation of retained earnings and the way of growth investment by companies.

The Ito Review 2.0, subsequently published in 2017, states the following points, including the importance of building a medium- to long-term value-creation scenario and deepening dialogue between companies and investors:

- The Fourth Industrial Revolution has drastically changed the way companies compete, and the source of competitiveness has shifted from tangible to intangible assets, and there is the increasing importance of strategic investment in intangible assets. However, investment in intangible assets by Japanese companies is at a lower level compared to European and U.S. companies.
- It is important to organize how companies should respond to the expansion of ESG investment and how investors should incorporate non-financial information into their corporate valuation to improve the quality of dialogue and engagement.
- Many intangible asset investments and ESG-related efforts are treated as expenses for financial accounting purposes. Therefore, there is a concern that focusing solely on short-term profits will constrain investments that will lead to medium- to long-term profitability and medium- to long-term corporate value growth.
- From the above perspective, in order to accurately communicate its intangible asset investments, etc., to investors and lead the way to appropriate evaluation, it is important for each company to construct a corporate value-creation scenario based on integrated thinking about how intangible asset investments, etc., will lead to medium- to long-term corporate value growth, and to deepen dialogue based on this scenario.

Based on this awareness, the "Guidance for Collaborative Value Creation," in which the flow of the value-creation scenario based on integrated thinking and the relationship between each item are organized, was formulated prior to the release of the Ito Review 2.0, as a framework serving as, in other words, a "common language," for deepening mutual understanding between companies and investors through information disclosure and dialogue, and for encouraging them to act towards sustainable collaborative value creation.

Even thereafter, the TCFD Guidance, in which the way of climate change disclosure is organized based on the Guidance for Collaborative Value Creation, followed by the Ito Review for Human Capital Management, the Digital Governance Code, the Intellectual Property and Intangible Assets Governance Guidelines, the CGS Guidelines, and other guidelines focusing on individual items in the Guidance for Collaborative Value Creation have been formulated, which substantiated dialogue and supported efforts for collaborative value creation based thereon.

It is the Study Group on Approaches to Making More Substantial the Dialogues for Creation of Sustainable Corporate Value that, looking back on the results of the series of efforts, has considered issues and measures for collaborative value creation through dialogue, amid various environmental changes faced by companies and investors. Its interim report released in August 2020 advocated "sustainability transformation (SX)" in order to close perception gaps that exist between companies and investors. The main points of the report are as follows:

- The ROE of Japanese companies is on the rise, but there remains a gap with European and U.S. companies, and investment in intangible assets remains at low levels. Although the number of dialogues between companies and investors is increasing, not a few dialogues remain formal and do not lead to a virtuous cycle of dialogue and corporate value growth.
- On the part of investors, there is a lack of long-term active investors who play a central role in the investment chain. Important players in the capital markets, such as ESG rating agencies and sell-side analysts, also face their own challenges.
- Amid uncertainty and society's growing demand for sustainability that have brought about changes in the business environment, there are perception gaps between companies and investors in terms of (1) diversified management and business portfolio strategies, (2) planting seeds for new business creation and innovation, and (3) ensuring the compatibility between social value (SDGs/ESG) and economic value (earning power and competitive advantage).
- In order to close the perception gaps between companies and investors and substantiate dialogue, it is important to implement sustainability transformation (SX) that synchronizes corporate sustainability with social sustainability based on a long-term timeframe, that is to say, (1) to plant seeds for business portfolio strategies and innovation to sustain and strengthen corporate earning power over the medium to long term, (2) to use backcasting for social sustainability to accurately identify medium- to long-term risks and opportunities for the sustainability and growth potential of corporate earning power and reflect them in specific management, and (3) to refine the value-creation scenario and improve the resilience of corporate management through repeated dialogues between companies and investors based on the assumption of uncertainty and with an eye to changing scenarios in the future.

In addition, in light of the recognition of the current situation in which the methods, etc., of dialogue that contribute to the realization of high-quality dialogue are not shared, the report organizes the "elements of substantive dialogue" from the following four perspectives: "principles of dialogue," "content," "methods," and "post-dialogue actions."