

October 16, 2019

## Engagement Agenda

“Materiality Identification and Disclosure in Relation to Sustainability of Business Model”

### Status of Responses by Japanese Companies as of 2018 and Request for Their Future Identification and Disclosure

Since January 15, 2018, the Institutional Investors Collective Engagement Forum (hereinafter referred to as “IICEF”) has held engagement meetings with multiple companies, together with the five companies participating in IICEF’s collective engagement program, namely Mitsubishi UFJ Trust and Banking Corporation, the Pension Fund Association, Resona Bank, Limited, Sumitomo Mitsui DS Asset Management Company, Limited and Sumitomo Mitsui Trust Asset Management Co., Ltd. (in alphabetical order; hereinafter referred to as the “Participating Investors”), the agenda of which is “Materiality Identification and Disclosure in Relation to Sustainability of Business Model.”

It has been one and a half years since we started the engagement meetings with this agenda, and we analyzed the status of responses by Japanese companies concerning this agenda. Based on the result of the analysis, recently we summarized thoughts of the Participating Investors and started to send out letters describing the new common views to multiple companies.

\*\*\*

#### 1. Overview of this agenda (perspectives of the Participating Investors on ESG and requests to companies)

Nowadays, environmental and social issues have been bringing about tightening of laws, regulations and rules of various countries, changes in awareness of labor and in consumer behavior and innovations for products and services, causing “a game changing phenomenon” in which the competitive environment radically changes overnight. In conjunction with the transition to decarbonized economy on a global scale, responding to environmental and social issues has now become “requisites for a company to survive” rather than “good things to do for the environment and society” which should be done by a company as part of its social responsibility.

If there is a risk of losing advantages of management resources, intangible assets, etc., which are the sources of value creation by and competitive advantages of a company, due to environmental and social issues and associated changes in the management environment, it would be a significant risk which has an impact on the sustainability of the corporate value and business

model in the medium- to long-term. Meanwhile, responding to environmental and social issues, utilizing the source of value creation and competitive advantages, could be a new growth opportunity. Nowadays, while an increasing number of companies have been declaring to address Sustainable Development Goals (SDGs), many cases seem to have only presented the significance of the business in society. We recognize SDGs provide worldwide business opportunities. It is important for a company to, if its business is able to contribute to SDGs, indicate the strategies, i.e., how much investment is going to be made in the efforts, how long time of frame is to be taken and how much return is expected, as a growth driver for the business.

Investors do not evaluate ESG-related activities of a company based on appearance such as data and examples, but do evaluate them based on how the company considers environmental and social issues as risks and growth opportunities from the viewpoint of the sustainability of its business and what strategies the company is taking. Investors consider them to be information to understand what are the important environmental and social issues which are the risks when sustaining the business, and on the other hand, what are the important environmental and social issues which may possibly serve as a new opportunity for growth, as well as how the company is trying to address these important issues with its medium- to long-term strategies; or in short, whether it is possible for the company to grow sustainably. Based on these perspectives of investors, we requested companies to organize important issues (Materiality issues) arising from environmental and social issues and the specific countermeasures, including examination processes at bodies such as the board of directors, by categorizing them based on the two aspects, namely risk and growth opportunity, and disclose the information.

## 2. Status of holding collective engagement meetings

We summarized the contents of this agenda as the common views of the Participating Investors, sent letters to companies which had been actively working on ESG-related activities and have had collective meetings between their executive officers and department heads in charge and the Participating Investors. At the same time, we have disseminated the contents of this agenda broadly to Japanese companies with the cooperation of securities companies, IR supporting companies and others, by, for example, providing explanations in seminars at various locations and posting the agenda materials on our website. We received responses from the companies participated in the engagement meetings that, among other things, they did not have objection against the contents, they had already started the examination in line with the formulation of the next medium-term management plan and they had gained insight into various matters related to awareness and concerns and disclosure expected from investors. On the other hand, the

Participating Investors also gained insight through discussion with the other investors who had similar awareness and concerns and learned in detail from the companies about their actual management circumstances, top management's mindset and future direction of the companies, which led to their deeper understanding of the target companies.

### 3. Status of disclosure of Materiality in integrated reports and response from stock market

According to "Integrated Report Survey 2018: Materiality" (June 2019) published by Edge International, Inc., 18% companies identified and disclosed the Materiality specified in this agenda. It was pointed out that there were more movements toward enhancing Materiality disclosure expected from investors as compared with the time of the survey in 2017, with nearly 20% companies were making disclosure in line with the approach of this agenda.

With respect to how the stock market evaluates the companies which have disclosed the Materiality through the integrated report, etc., with the cooperation of Edge International, Inc. ("Edge Inc.") IICEF categorized the companies into three groups; "companies which have disclosed the Materiality from the perspective of investors", "companies which have disclosed the Materiality from the perspective of multi-stakeholders (excluding those which have disclosed the Materiality from the perspective of investors)" and "companies which have not disclosed the Materiality". Then we analyzed response of the stock market to each group based on the survey data.

#### \* Materiality from the perspective of investors:

Materiality defined by the International Integrated Reporting Council (IIRC) and in the "Guidance for Collaborative Value Creation" by the Ministry of Economy, Trade and Industry, among others. Issues in which environmental and social issues have a material influence a company's ability to create value. That is to say, issues related to the sustainability of the said company, which are underlying issues for this agenda.

#### Materiality from the perspective of multi-stakeholders:

Materiality defined by Global Reporting Initiative (GRI), among others. Items in which a company has a significant impact on economy, the environment and society and items in which a company has a substantial impact on evaluation and decision-making of stakeholders. That is to say, issues related to the sustainability of stakeholders.

[Analysis results]

Target: Among 398 companies which issued the 2018 integrated report covered by the survey, 393 companies having stock price data for the data collection period

(Figure (i)) Number and ratio of companies by group

Category	Number of companies
(A) Companies which have disclosed the materiality from the perspective of investors	71 companies (ratio: 18%)
(B) Companies which have disclosed the materiality from the perspective of multi-stakeholders (excluding those which have disclosed the materiality from the perspective of investors)	154 companies (ratio: 39%)
(C) Companies which have not disclosed the materiality	168 companies (ratio: 43%)

\* Calculations for the above categories were made based on the categories used by Edge International in order to prevent arbitrariness of IICEF.

(Figure (ii)) Status of PBR, beta value and ROE by group (stock price: closing price of July 18, 2019)

	Average PBR	Ratio of companies with PBR of less than 1 time	Beta value (for the past two years)	Beta value (for the last six months)	Average ROE
(A) Companies which have disclosed the materiality from the perspective of investors: 71 companies	1.69	44% 31/71 companies	0.97	1.02	9.75
(B) Companies which have disclosed the materiality from the perspective of multi-stakeholders (excluding those which have disclosed the materiality from the perspective of investors): 154 companies	1.32	49% 75/154 companies	1.08	1.11	8.58
(C) Companies which have not disclosed the materiality: 168 companies	1.33	55% 93/168 companies	1.11	1.15	6.68

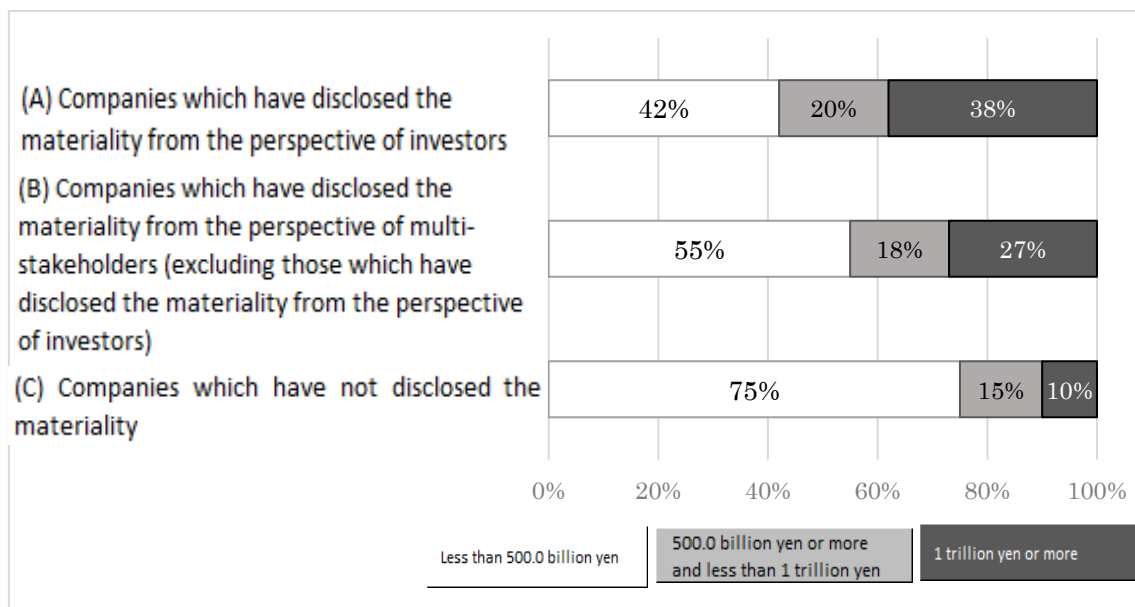
Measuring the evaluation by the stock market in the form of the price book-value ratio (PBR) which indicates value brought by ESG-related activities in human assets, brands and other non-financial assets, group (A) had the highest PBR of 1.69 times among the three groups, whereas groups (B) and (C) had the same level of PBR of 1.32 times and 1.33 times, respectively. The ratio

of companies with PBR of less than 1 times, non-financial assets for which are evaluated negative, was the lowest in group (A), followed by group (B) and then group (C) which have greater ratios. The beta value indicating the market sensitivity also showed high volatility in order of group (A), group (B) and then group (C), indicating the tendency of group (A) having lower risks. Return on equity (ROE) representing capital efficiency was the highest in group (A), followed by group (B) and then group (C) which have lower ROE.

As seen from the above, companies disclosing the Materiality from the perspective of investors seem to be relatively highly evaluated by the stock market in terms of their ability to create value as compared with companies disclosing the Materiality from the perspective of multi-stakeholders and companies which have not disclosed the Materiality.

In addition, looking at the distribution of company size, the ratio of larger-cap companies was high in order of group (A), group (B) and then group (C).

(Figure (iii)) Distribution of company size (market capitalization)



We divided companies by market capitalization and conducted similar analysis on them, because companies larger in size (market capitalization) were deemed to be able to spend more manpower and expenses as compared with companies smaller in size and therefore to proactively work on disclosure of the Materiality from the perspective of investors and IR activities.

(Figure (iv)) Status of PBR, beta value and ROE by company size

Market capitalization	Less than 500 billion yen	500 billion yen or more Less than 1 trillion yen	1 trillion yen or more
(A) Companies which have disclosed the materiality from the perspective of investors: 71 companies	30 companies (42%)	14 companies (20%)	27 companies (38%)
Average PBR	1.26	1.61	2.20
Ratio of companies with PBR of less than 1 times	21/30 companies (70%)	5/14 companies (36%)	5/27 companies (19%)
Beta value (for the past two years)	1.05	1.12	0.80
Beta value (for the last six months)	1.15	1.10	0.84
Average ROE	6.35	10.97	12.90
(B) Companies which have disclosed the materiality from the perspective of multi-stakeholders (excluding those which have disclosed the materiality from the perspective of investors): 154 companies	85 companies (55%)	28 companies (18%)	41 companies (27%)
Average PBR	1.14	1.53	1.55
Ratio of companies with PBR of less than 1 times	48/85 companies (56%)	11/28 companies (39%)	16/41 companies (39%)
Beta value (for the past two years)	1.08	1.10	0.95
Beta value (for the last six months)	1.11	1.14	0.98
Average ROE	7.20	9.47	10.85
(C) Companies which have not disclosed the materiality: 168 companies	126 companies (75%)	25 companies (15%)	17 companies (10%)
Average PBR	1.27	1.55	1.40
Ratio of companies with PBR of less than 1 times	76/126 companies (60%)	11/25 companies (44%)	6/17 companies (35%)
Beta value (for the past two years)	1.13	1.09	1.04
Beta value (for the last six months)	1.18	1.11	1.01
Average ROE	5.72	9.41	9.85

Not only companies with market capitalization of 1 trillion yen or more but also companies with market capitalization of between 500 billion yen or more and less than 1 trillion yen seem to have the similar tendency with companies as a whole. However, companies with market capitalization of less than 500 billion yen did not indicate the similar tendency. This may be interpreted as an

impact of factors such as uneven distribution of financial information and liquidity of shares, which is resulted from the ever-smaller amount of financial information due partly to limited coverage by security- analysts.

#### 4. Future expectations (requests from the Participating Investors)

As described above, identification from the perspective of investors has significant meanings in management issues of important issues (Materiality) arising from environmental and social issues. With respect to companies which have not identified and disclosed the Materiality and companies which have identified the Materiality from the perspective of multi-stakeholders, the relevance between the activities for environmental and social issues and the sources of the business model, value creation and competitive advantages is unclear, and it is difficult to well understand why these activities are undertaken and why these issues are deemed important. In addition, it is often the case that the Materiality is not reflected in their medium- to long-term strategies, and therefore, investors cannot properly evaluate the impact of the activities for environmental and social issues on long-term corporate value. Furthermore, non-financial key performance indicators (KPIs) tend not to be presented, and thus the progress of the activities cannot be measured.

We would like companies to clarify their issues by adding information such as expected changes in the management environment and the degree of impact seen as risk and an expected increase in profitability seen as growth opportunity, and provide investors with more details clearly on how the sustainable growth of the business model is planned to be achieved or how the business model is planned to be changed. At the same time, as Materiality is an important issue in future management, we expect that it is included as part of the medium- to long-term strategies, and it would help us to gain deeper understanding if companies also provide explanations on the specific details, targets and periods, the size of investment and return, systems to promote the strategies and in addition, KPIs to assess the progress.

\*\*\*

Since October 2019, IICEF have summarized the common views and started to send letters to companies with market capitalization of a certain amount or more and identifying and disclosing the Materiality to the effect that we would like them to clarify the Materiality from the perspective of investors in a way easier for investors to understand and endeavor on it as an important pillar among their medium- to long-term strategies.

Contact information:

Institutional Investors Collective Engagement Forum

Directors in charge: Yuki Kimura, Naomi Yamazaki and Ryusuke Ohori

Address: Tokyo Entre Salon, Sinmaki-chou Building Annex 1, 3-2-14, Nihonbashi, Chuo-ku,

Tokyo 103-0027 JAPAN

E-mail: [info@iicf.jp](mailto:info@iicf.jp)



<Reference>

Edge International, Inc.

“Integrated Report Survey 2018: Materiality” June 2019 (excerpt)

[http://www.edge-intl.co.jp/library/s2019\\_17.html](http://www.edge-intl.co.jp/library/s2019_17.html)

■ Overview and result of survey

A survey was conducted against Japanese listed companies which issue self-declared integrated report (\*) on whether the following elements related to “Materiality” were disclosed in their integrated report.

- (i) Materiality from the perspective of investors: 17.8% (71 companies)
- (ii) Separate disclosure concerning (i) for opportunity and risk: 9.0% (36 companies)
- (iii) Disclosure of risks and countermeasures or opportunities and risks arising from climate change: 20.4% (81 companies)
- (iv) Opportunity and risk by business unit: 17.1% (68 companies)
- (v) Materiality from the perspective of multi-stakeholders: 47.5% (189 companies)
- (vi) Specific processes of Materiality : 24.6% (98 companies)
- (vii) Consideration for SDGs concerning (vi): 23.1% (92 companies)
- (viii) Reference to SDGs: 76.1% (303 companies)

(\*) 398 listed companies in Japan, among the 414 companies in “List of Organizations in Japan Engaged in the Publication of Self-Declared Integrated Reports (2018)” which are covered by the survey by CORPORATE VALUE REPORTING LAB (operated by Edge International, Inc.).