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Provisional Translation

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Summary

First Proposal for Creating an Affluent Society through Capital Efficiency Optimization

"Implementation of Business Restructuring for Stronger Profitability"

I: Awareness of Issues

1. The root cause of low ROE in Japanese companies is the retention of low-profit businesses

   ROE (Return On Equity) in Japanese companies is lower than in companies in Europe and the United States, and the main cause is low profitability. The major factors identified as the causes of low profitability include business practices, labor practices, the burden of corporate taxes, energy costs, etc. Meanwhile, we believe that the retention of low-profit businesses to which sufficient management resources are not allocated impairs the improvement of productivity and leads to the deterioration of capital efficiency throughout the entire company.

   Japanese companies tend to retain low-profit businesses while reducing the associated labor costs and research and development expenses. As a result, there are no innovations to create new added value and companies face fierce competition, relying on price cutting and long working hours.

2. "Bedrock in management's inner thoughts" blocking business restructuring

   The main reason why companies retain low-profit businesses instead of carving them out is management's hesitation to sell these businesses and integrate them into other companies' businesses. In this proposal, we draw attention to the following examples of management's thoughts and behaviors and refer to them collectively as the "bedrock in management's inner thoughts":

   - ☑ Management has not determined its core businesses and non-core businesses based on its management visions, long-term strategies, and objective criteria derived from management visions and long-term strategies, and regards all businesses as core businesses.
   - ☑ Management continues to make investments in research and development without examining the consistency between the investments and the management visions and the growth potential of the businesses.
   - ☑ Management selects businesses to narrow its focus, but retains businesses that have not been selected.

- ☑ Management considers it desirable to continue to retain employees rather than putting them out on the street.
- ☑ Management creates subsidiaries to which sufficient management resources cannot be allocated and retains them within the group unless they fall into the red. However, wages lower than those in the parent company are applied to these subsidiaries.
- ☑ Management believes that it is not good to sell businesses and subsidiaries and is afraid of being criticized for selling them, both from inside and from outside the group.

3. Business restructuring when the business situation is favorable

These thoughts and behaviors of the management impair business restructuring. There is a chance for businesses that are not expected to grow if they stay in a company to become core businesses, and for employees to be provided with more opportunities through internal or external business combinations. However, since restructuring after the financial position deteriorates may not generate favorable results, it is the management's responsibility to examine and restructure the business portfolio when the business situation is favorable.

II: Main Points of This Proposal

The ROE level that Japanese companies are expected to achieve, the true purpose of management emphasizing capital efficiency, and a mechanism to promote business restructuring as described in this proposal are as follows:

1. Management that emphasizes capital efficiency to create a "cycle of enrichment" within society

(1) <u>Need for ROE in excess of the cost of equity</u>

To ensure the sustainability of management, a company needs to achieve a ROE that at the very least exceeds the cost of equity, which is the yield that investors require, over the medium to long term. Moreover, Japanese companies need to achieve the same level of profitability as companies in Europe and the United States and improve their ROE to come out on top in global competition.

(2) <u>Enhancing Japan's industrial competitiveness to create a "cycle of enrichment"</u>

The purpose of management that emphasizes capital efficiency is not simply to improve ROE or focus entirely on shareholders. Rather, the true purpose is to create a cycle of social enrichment by improving the industrial competitiveness through dramatic gains in productivity and stronger profitability at Japanese companies, as well as by way of optimization that entails the appropriate distribution of profits earned to wages and investment in growth fields.

2. Advantages that the removal of low-profit businesses provides to employees

Business restructuring is the key to improved productivity and wage rises

Companies' retention of low-profit businesses and involvement in excessive price competition and fierce competition is a cause of sluggish income growth of working generations. The removal of low-profit businesses and the concentration of management resources in innovations will boost productivity and increase wages.

3. Introduction of a mechanism to promote business restructuring

For business restructuring, companies need to introduce objective criteria and a mechanism for rational decision-making as described below.

(1) Analyzing capital efficiency by business

One of the factors that impair the removal of low-profit businesses is the lack of analysis of capital efficiency by business. Companies need to consider future profitability in each business and classify assets, liabilities, and net assets by business as much as possible.

(2) Restructuring the business portfolio with objective criteria

Companies need to pay attention to the business model, functions, and base technologies of each business in the business portfolio so that they can maintain those that have core competence and carve out those whose competitiveness has declined. They need to classify businesses based on objective criteria for capital efficiency and market growth potential. They need to consider growth potential in ten to twenty years in anticipation of economic and social changes.

Companies need to invest in research and development to create innovations. When they consider investment in businesses that are expected to take a long time to make a profit, they need to examine the consistency between investment in those businesses and the management visions and the growth potential of the businesses. To maintain temporarily loss-making businesses, management needs to have the will to produce results from research and development investment.

(3) Using outside directors and communication with investors for rational decision-making

(i) Using the original functions of outside directors

Outside directors need to give advice about business restructuring in consideration of the current status, vision, and growth potential of each business.

(ii) Communication with investors about long-term management visions and strategies

Communication with investors enables the company to consider and make decisions about the value of existing businesses and whether to maintain them in a more objective manner. Institutional investors are expected to pay attention to capital efficiency in each business and consistency between the businesses and the company's growth strategy, and to engage in constructive dialogue with the company.

4. Future discussions

The Capital Efficiency Optimization Committee plans to make proposals on the following subjects:

- Creation of new businesses and promotion of innovation in consideration of capital efficiency
- Reform of the tax system and labor law in relation to business restructuring
- Enhancement of corporate value using non-financial performance indicators

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