Corporate Value in Longer Time Horizons

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Question

How much of corporate value will derive from cash flows in next three years?

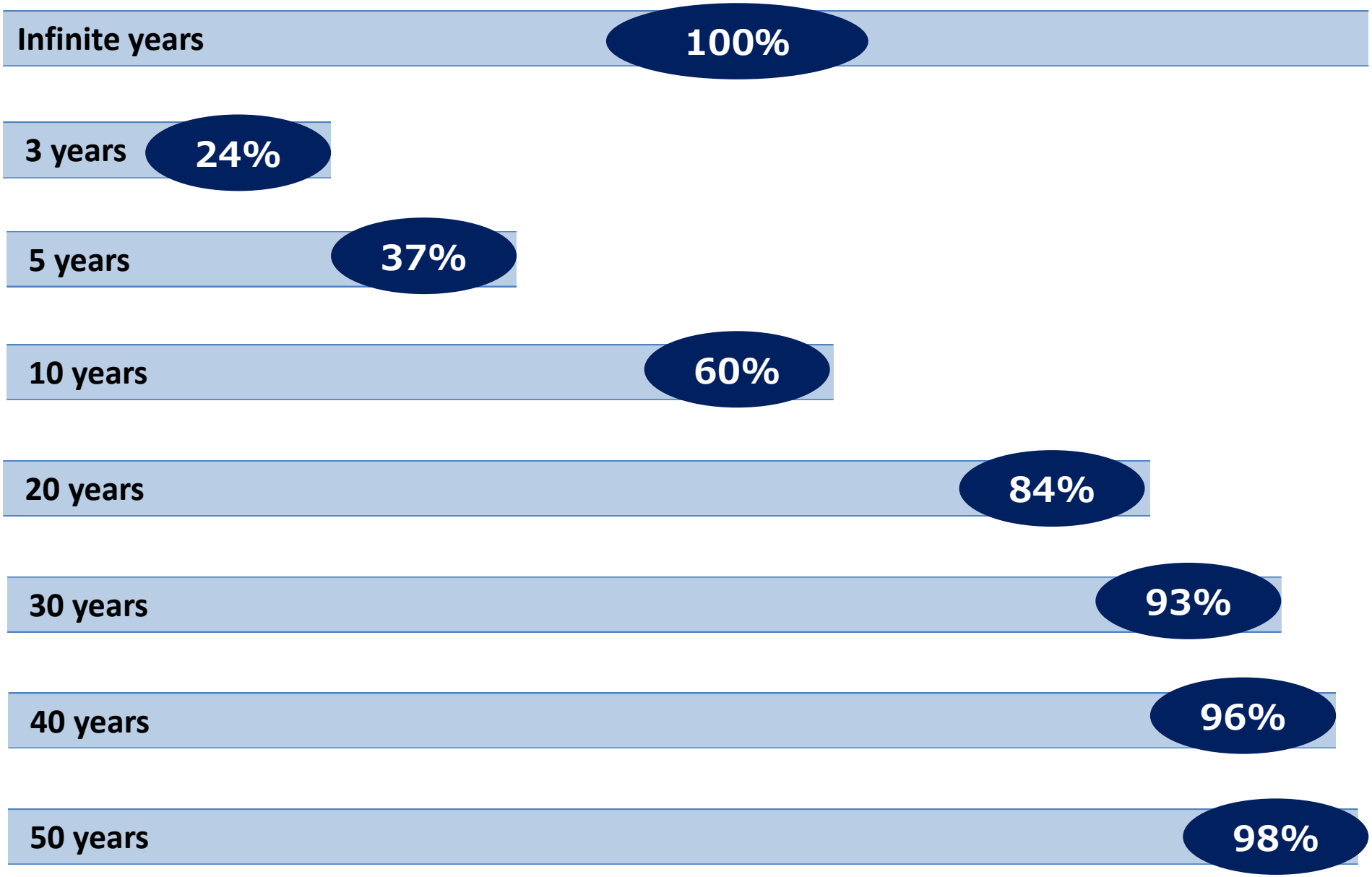
Where

- *its annual cash flows will be constantly 100;*
- *its cost of capital is 10%.*

Answer

24%

Corporate Value in Time Horizons



Tragedy of the Horizon

Climate change is the Tragedy of the Horizon. *The catastrophic impacts of climate change will be felt beyond the traditional horizons of most actors - imposing a cost on future generations that the current generation has no direct incentive to fix. That means beyond the business cycle, the political cycle, and the horizon of technocratic authorities.*

- Mark Carney, Governor, Bank of England -

Financial filings and their power of prediction?

*いま、日本の自動車産業に危機が迫っている。**しかし、その危機は決算書からは見えてこない**。近年、多くの日本の自動車会社は世界最大の市場である中国や、2位のアメリカで販売を伸ばしている。そのうえ円安の恩恵も受けており、業績はおおむね好調。表面的には到底、危機が目の前にあるようには見えないからだ。*

*　では、どこに危機が潜んでいるのか。じつは今、自動車産業の大きなパラダイムシフトが進みつつある。…ところが、日本の自動車産業は、そうした変化に対応できているようには見えない。…しかも一部の経営者はそうした現実から目を逸らそうとしているようにさえ見える。それこそが危機なのだ。*

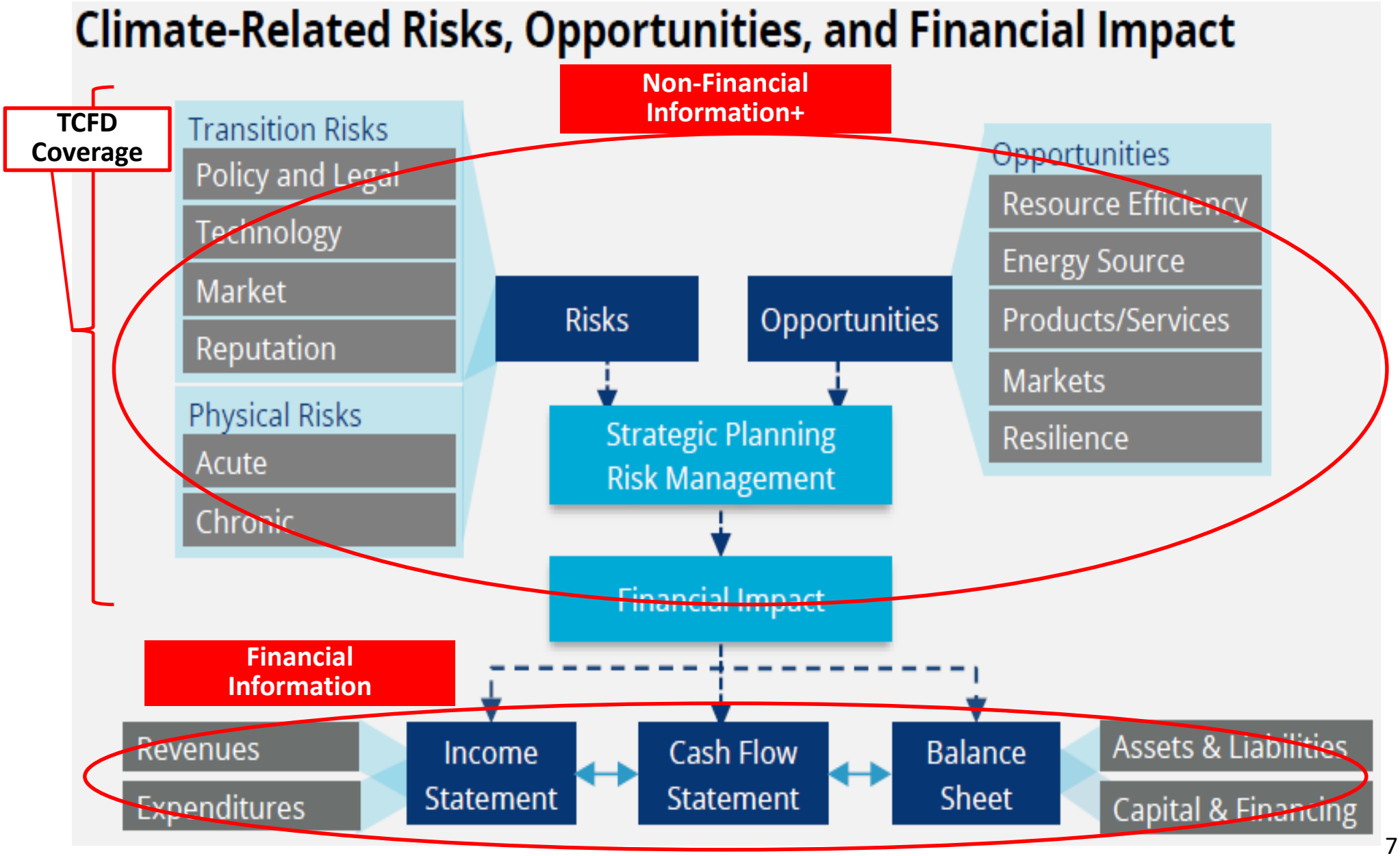
- 井上久男「自動車会社が消える日」(2017)より-

TCFD Framework

- *TCFD (**T**askforce on **C**limate-related **Financial** **D**isclosure) is almost Taskforce on Climate-related Disclosure of **Non-financial information**.*
- *Beyond financial forecasts for next 3 to 5 years, **non-financial information** will provide essential clues to the prediction of **corporate performance in the future**.*

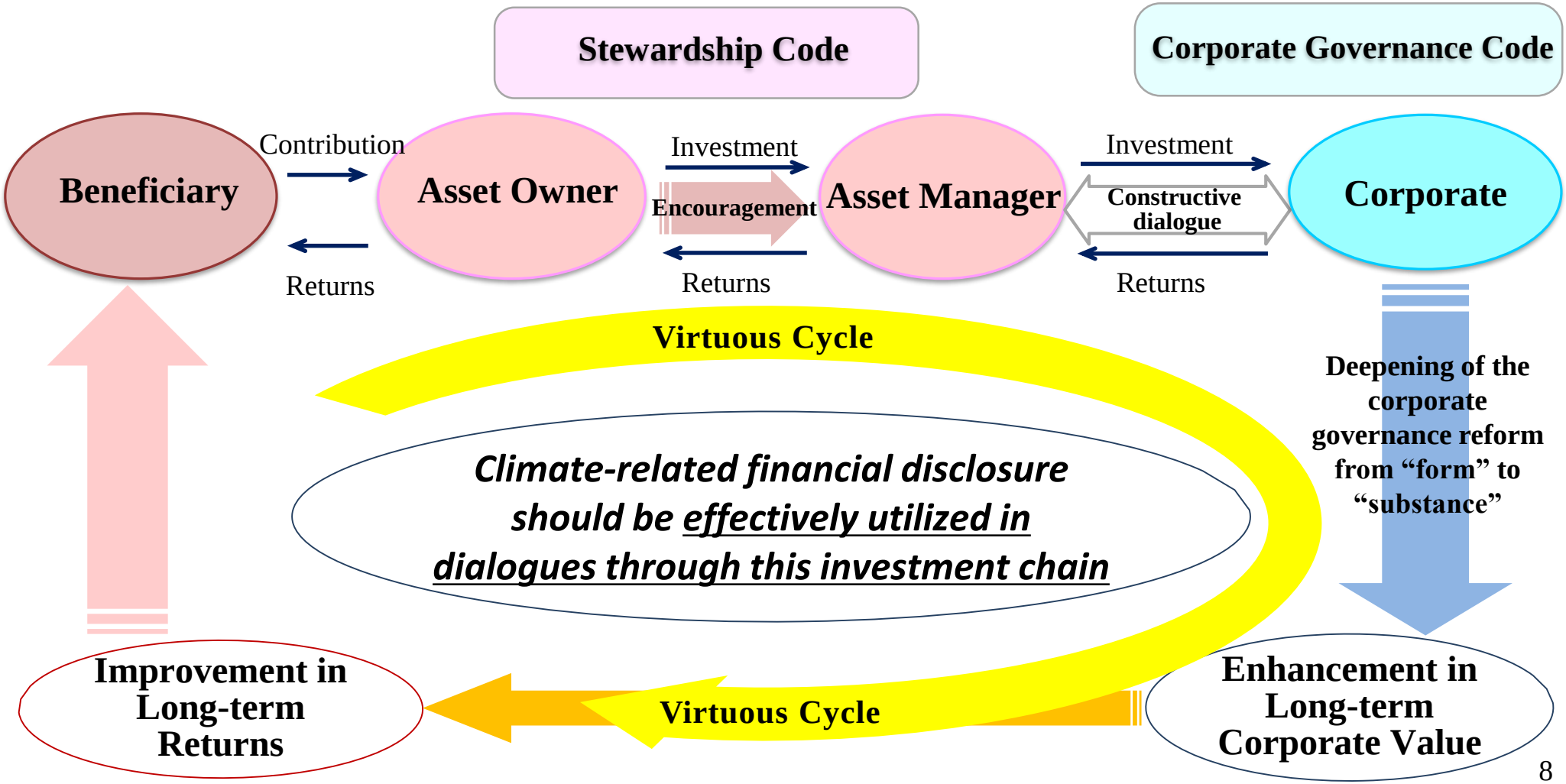
Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

TCFD Framework and Risks, Opportunities and Impact



TCFD within the Investment Chain

- *Japan's "**Stewardship Code**" and "**Corporate Governance Code**" provides a framework for enhancing long-term corporate value and improving long-term returns through the investment chain.*
- *By implementing TCFD recommendations through this framework, the **pursuit of investment returns** will be aligned with **addressing climate-related risks and opportunities** and thereby **enhancing long-term corporate value**.*



Japan's Stewardship Code and Corporate Governance Code on Sustainability

Stewardship Code (Excerpt)

Principle 3

Institutional investors should monitor investee companies so that they can appropriately fulfil their stewardship responsibilities with an orientation towards the sustainable growth of the companies.

Guidance 3-3

*When investors monitor investee companies, a variety of factors, including non-financial ones, may be considered as relevant. Factors may include, for example, the investee companies' **governance**, strategy, performance, capital structure, business risks and opportunities (including **risks and opportunities arising from social and environmental matters**), and how the companies address them. Relevance of a factor may depend on each investor's investment policy and may differ according to specific investee companies. Institutional investors need to use their own judgment in choosing which factors to focus on in light of their stewardship responsibilities. They should endeavor to identify at an early stage issues that may result in a material loss in the value of investee companies.*

Corporate Governance Code (Excerpt)

Principle 2-3. Sustainability Issues, Including Social and Environmental Matters

*Companies should take appropriate measures to address **sustainability issues, including social and environmental matters**.*

Supplementary Principle 2.3.1

*With the recognition that dealing with **sustainability issues** is an important element of risk management, the board should take appropriate actions to this end. Given the increasing demand and interest with respect to **sustainability issues** in recent years, the board should consider addressing these matters positively and proactively.*

Japan's Corporate Governance Code on Disclosure

Section 3: Ensuring Appropriate Information Disclosure and Transparency (Excerpt)

- *Companies are legally required to disclose a wide range of information.*
- *Companies should actively strive to **provide information other than what is required by laws and regulations**.*
- *It has been noted that while the quantitative part of financial statements of Japanese companies conform to a standard format and therefore excel with respect to comparability, **non-financial information**, such as **financial standing, business strategies, risks and ESG (environmental, social and governance) matters**, is often boiler-plate and lacking in detail, therefore less valuable. The board should actively commit to **ensure that disclosed information, including non-financial information, is as valuable and useful as possible**.*
- *Irrespective of whether the disclosed information is required by law, the appropriate provision of information is an effective means to **develop a shared awareness and understanding with shareholders and other stakeholders**, in particular given that as outsiders they suffer from information asymmetry. Appropriate information disclosure will also **contribute to constructive dialogue** based on Japan's Stewardship Code.*

General Principle 3

*Companies should appropriately **make information disclosure in compliance with the relevant laws and regulations**, but should also **strive to actively provide information beyond that required by law**. This includes both **financial information**, such as financial standing and operating results, and **non-financial information**, such as business strategies and business issues, risk and governance.*

*The board should recognize that disclosed information will serve as the basis for constructive dialogue with shareholders, and therefore ensure that such information, particularly **non-financial information**, is accurate, clear and useful.*

Japan's Guidelines for Investor and Company Engagement

- *The Guidelines provide **agenda items for engagement** that institutional investors and companies are expected to focus on, based on the Stewardship Code and the Corporate Governance Code, in recognition of the prevalent corporate governance issues.*
- *Through **constructive dialogue with institutional investors**, companies are expected to **generate sustainable growth** and **increase corporate value** over the mid- to long-term.*
- *The Guidelines are intended to be a **supplementary document** to the Stewardship Code and the Corporate Governance Code.*

1. Management Decisions in response to Changes in the Business Environment

- ***1.1*** ***Are specific business strategies and business plans*** *to generate sustainable growth and increase corporate value over the mid- to long-term* ***established and disclosed****? Are these business strategies and business plans* ***consistent with the company's vision and values****?*
- ***1.2.*** *Does the management accurately* ***identify the company's cost of capital****, reflecting risks associated with the business in an appropriate manner.? Does the management* ***manage the business with a recognition of the company's cost of capital by setting targets on profitability and capital efficiency*** *to generate sustainable growth and increase corporate value over the mid- to long-term? Does the management clearly* ***explain why they decided upon such targets****? Does the company* ***achieve returns that cover the cost of capital*** *on a mid- to long-term basis?*
- ***1.3.*** *Does the management* ***understand the business environment and business-related risks*** *appropriately and* ***make decisions*** *decisively,* ***such as restructuring the company's business portfolio****, i.e., investment in new businesses and exit from or sale of existing businesses, based on the company's business strategies and business plans? Is a* ***policy on reviewing a business portfolio*** *clearly established and is the* ***review process*** *effective?*

Japan's Disclosure Working Group Recommendations

Recommendations

I. Enhancement of "Financial Information" and "Descriptive (Non-financial) Information"

e.g., Business Strategy, Management Discussion and Analysis (MD&A), and Risks

II. Communication and Information for Constructive Dialogue

e.g., Calculation of Directors' Remuneration, Cross-shareholdings

III. Reliability and Timeliness of Disclosed information

e.g., Auditor Tenure

IV. Others

e.g., Usability of the EDINET, Encouragement of Disclosure in English

Way Forward

① Principle-based Guidance

Develop Guidance for Disclosure on Business strategy, MD&A, and Risks from the Management's perspective through discussions with corporates and investors

② Collection and Dissemination of Best Practices in Disclosure

③ Disclosure rules

- *Directors' remuneration (Remuneration program, Payment)*
- *Cross-shareholdings*
- *Auditor tenure* *etc.*