

CHAPTER III

The Stock Primary Market

1. New Issues of Stocks in the Primary Market

For the purpose of the Companies Act, companies are classified into corporations (*kabushiki kaisha*); general partnerships (*gomei-gaisha*); limited partnerships (*goshi-gaisha*); and limited liability companies (*godo-gaisha*). Of these, corporations have a number of advantages against the others in that (1) ownership interest in a company is divided into shares of stock; (2) investors may recoup contributed capital simply by selling their shareholdings; and (3) investors shall be held liable only to the extent of capital contributed by them (limited liability). These advantages help a corporation to raise a large amount of capital from various investors.

The shares issued by a corporation are capital securities, or narrowly defined securities, in that they represent certain claims and rights of their investors. Shareholders contribute capital in exchange for their shareholdings, which give them privileges to (1) participate in the management of the corporation (by attending general shareholder meetings and exercising voting rights that are proportionate to their shareholdings); (2) claim distribution of profits; (3) claim residual corporate assets; and (4) file derivative suits. Issued shares, unlike bonds, are not redeemable except when shares are repurchased by the corporation or upon liquidation. Because contributed equity may not usually be repaid by the corporation, shareholders wishing to monetize their holdings can only do so by selling them in the market. For the benefit of increased liquidity, stock is divided into a standard unit of shares and often represented by share certificates. On the other hand, with corporate bonds, another class of capital securities, the repayment value is backed by the issuer.

The legal framework for stocks has undergone substantial changes by a series of amendments to the Commercial Code introduced since 2001. Pursuant to the amendments that took effect on October 1, 2001, par value stock was abolished and all stocks are now issued with no par value. Accordingly, the par value-based *tan'i-kabu* round-lot system was replaced by the new, discretionary *tangen-kabu* system. Under the amendments enforced on April 1,

Table III-1. Principal Rights of Shareholders

Rights for personal interest (rights on benefits of owing property)	Rights for common interest (rights on participating in management)
<ul style="list-style-type: none"> · Right to claim dividend of surplus · Right to subscribe for new shares · Right to demand distribution of residual assets · Right to request registration of name transfer · Right to request purchase of shares 	<ul style="list-style-type: none"> · Right to exercise votes at general shareholder meetings · Right to bring representative suit · Right to convoke a general shareholder meeting · Right to demand suspension of illegal action by a director · Right to make a shareholder proposal · Right to request dissolution · Right to demand dismissal of a corporate officer · Right to request inspection, etc.

Table III-2. Recent Amendments to the Commercial Code Relating to Equity Financing and Main Contents of the Companies Act

<p>The amendments made in 2001 (enforced on October 1, 2001): A revision of the system of acquiring and holding one's own shares (the ban on holding treasury shares was lifted); the abolition of the system of issuing shares with face value (under this system, all shares are issued without par value); the abolition of the requirement of net asset value (a minimum of ¥50,000 or \$487.8 at the rate of ¥102.50 to the dollar); the abolition of the <i>tan'i-kabu</i> system in favor of <i>tangen-kabu</i> system; and the relaxation of the legal reserve system, etc.</p>
<p>The amendments made in 2001 (enforced on April 1, 2002): The institution of the equity warrant system and the abolition of regulation of the stock option system, the electronic of corporate documents, and a revision of regulation of the classified stock (the lifting on the ban of tracking stock*), etc.</p>
<p>The amendments made in 2002 (enforced in April 2003): A revision of regulation of the classified stocks, the institution of the system relating to lapses of stock certificates, and the rationalization of the procedure for reducing capital, etc.</p>
<p>The amendments made in 2003 (enforced on September 25, 2003): The acquisition of one's own shares by a resolution of the board of directors under the provisions of the articles of incorporation and a revision of the method of computing a limit on interim dividends, etc.</p>
<p>The amendments made in 2004 (enforced on October 1, 2005): The adoption of a system of not issuing stock certificates, the introduction of a system of issuing notices by electronic means, etc.</p>
<p>Amendments in conjunction with the enactment of the Companies Act in 2005 (enforced on May 1, 2006): A revision of regulations to make the share transfer system more flexible, the rationalization of the system of retiring shares, a revision of regulations relating to issuing of share certificates, and the abolition of fractional shares, etc.</p>
<p>The amendments made in 2014 (enforced on May 1, 2015): Revision of new share issuance procedure involving transfer of controlling shareholders Introduction of a cash-out method that allows a special controlling shareholder to request other shareholders to sell their shares, etc.</p>
<p>The amendments made in 2019 (enforced on March 11, 2021): Founding the system of share delivery</p>

Note: The ban on tracking stock (under this system, dividends are paid not out of the earnings of a company as a whole but out of the earnings of a specific division or a subsidiary of such company) was lifted.

2002, (1) new subscription rights/warrants were introduced, (2) the regulation of stock options was relaxed, and (3) the regulation regarding multiple classified stocks was relaxed.

The Commercial Code as amended in 2004 and the Law Revising the Act on Book Entry of Corporate Bonds and Shares etc., for Streamlining Settlement of Transactions in Stocks, etc., introduced a system allowing electronic bookkeeping for shares. As a result of the revision of the Companies Act, share certificates of public companies were dematerialized from January 2009. Transfer restrictions on any and/or all classes of stock and issuance of classified stocks subject to wholly call were put in place in May 2006, and a “cash out” system where controlling shareholders of a company may force minority shareholders to sell their shares to them was enacted in May 2015. The amended Companies Act of 2019 introduced a new stock delivery system as a way for companies to acquire other companies in exchange for their own shares (enacted in March 2021).

2. Forms of Issuing New Shares

Shares are first issued when a corporation is established. Establishment of a corporation can be roughly divided into incorporators-only establishment and by-subscription establishment. When a corporation is established only with the funds contributed to its capital stock by its promoters, this method of establishing a corporation has the advantage of its shares being fully subscribed to, but it has a drawback in that the number of shares it can issue is limited to the funds its promoters can raise. On the other hand, establishing a corporation with the capital raised by publicly offering its shares to an unspecified large number of investors is called “establishment through a public offering of shares.” While a large amount of capital can be raised through this method, one major drawback is that it takes time to successfully complete the public offering, and when its shares are not fully subscribed to by investors during the public offering period, the corporation cannot be established. Under the old provisions of the Commercial Code, the par value of shares issued by a corporation at the time it was established had to be ¥50,000 or more, but this restriction was abolished—and the requirement of par value has been liberalized—by virtue of the 2001 amendment to the Commercial Code.

Even after a corporation is established, it is a general practice for the corporation to issue new shares after in order to raise funds, to transfer the control of its management to a third party, or to enhance the liquidity of its shares. Usually, the method of issuing new shares is divided into paid-in capital increase and stock splits (and gratis issues).

Issuing new shares against the payment for them by shareholders is called

Table III-3. Forms of Issuing New Shares

Payment required
Capital increase through a public offering
Capital increase through a third-party allocation of new shares
Capital increase through a rights offering
The exercise of subscription rights/warrants
Payment not required
Stock split
Merger
Swap of shares
Stock transfers
Share delivery

Table III-4. Funds Raised by Equity Financing

(100 million yen)

Year	Rights offering		Public offering		Third party allotment		Exercise of subscription rights/warrants		Preferred stock and others		Total	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount	No.	Amount
1998	0	0	8	2,782	32	6,880	28	864	5	4,710	73	15,236
1999	0	0	28	3,497	75	23,473	62	2,529	25	69,894	190	99,393
2000	2	82	24	4,941	46	9,228	87	1,056	4	1,073	163	16,381
2001	3	320	18	12,015	57	4,772	85	374	5	2,161	168	19,642
2002	0	0	19	1,533	62	4,844	78	2,763	36	9,968	195	19,107
2003	2	15	35	5,672	84	2,232	121	366	74	25,322	316	33,607
2004	1	27	78	7,502	129	5,726	228	995	50	13,626	486	27,877
2005	2	37	74	6,508	150	7,781	336	1,669	45	11,678	607	27,673
2006	0	0	69	14,477	145	4,165	371	1,513	26	5,597	611	25,751
2007	1	81	60	4,570	117	6,621	347	1,650	12	7,955	537	20,877
2008	1	1	27	3,417	93	3,958	240	209	9	5,937	370	13,523
2009	0	0	52	49,668	115	7,146	169	188	28	4,740	364	61,743
2010	1	7	50	33,089	88	5,356	159	246	10	736	308	39,433
2011	0	0	45	9,678	66	3,952	171	261	7	693	289	14,584
2012	1	4	53	4,518	71	1,593	174	218	17	12,755	316	19,088
2013	1	10	114	11,137	151	3,719	350	1,904	3	1,200	619	17,970
2014	0	0	129	13,780	190	3,928	412	1,087	14	2,242	745	21,037
2015	1	1	131	9,620	187	1,635	437	815	6	7,513	762	19,583
2016	1	2	95	2,577	151	6,230	483	901	7	1,480	737	11,191
2017	2	1	116	4,242	238	8,816	526	1,926	7	613	889	15,599
2018	0	0	129	4,016	303	2,146	597	2,277	6	595	1,035	9,034
2019	0	0	93	2,198	307	9,104	572	1,431	10	1,508	982	14,241
2020	1	4	108	7,328	342	4,042	624	2,203	11	1,947	1,086	15,524
2021	1	2	159	13,692	467	17,791	709	2,235	36	1,612	1,372	35,332
2022	1	1	85	1,293	440	2,733	665	1,239	18	630	1,209	5,895

Source: Website of the Tokyo Stock Exchange.

paid-in capital increase, and a corporation can raise its equity capital by this method. Paid-in capital increase is also divided on the basis of investors to whom shares are issued into public offering, rights offering, and allotment of new shares to a third party.

By definition, a stock split, the act of splitting one share into two or more shares, does not by itself increase the assets or the capital of a corporation. However, new shares issued through a stock split play an important role. The stock split increases the number of the corporation's shares outstanding on the market, and the fall in the per share price caused thereby enhances the liquidity of shares, making it easier for the corporation to raise funds through equity financing in the future. Until 2001, there was a rule banning any stock split that reduces the value of net assets per share to less than ¥50,000, but this rule was abolished by virtue of the 2001 amendment to the Commercial Code. This step was taken because of widespread complaints among venture businesses—those that have high growth potential and whose shares are traded at high prices despite limited net assets—that on account of the restrictions against a stock split, they could not improve the liquidity of their shares. However, it was desirable to prevent share certificates from being in short supply during the period from the record date of stock split (day on which the shareholders to whom new shares are allocated are determined) to the effective date (day on which the right to new shares for shareholders goes into effect), which can disrupt the demand-supply balance and cause stock prices to fluctuate violently. Hence, it was decided that the effective date would fall on the day following the record date from January 2006.

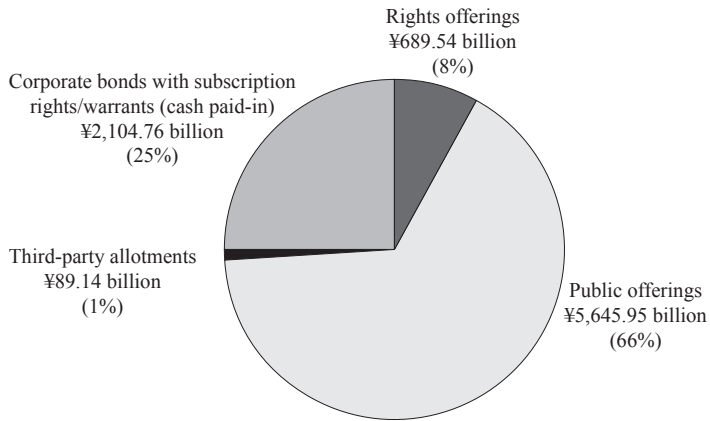
Other cases in which a corporation is authorized to issue new shares include the exercise of new share subscription rights/warrants, a new type of warrant introduced by the April 2002 amendment to the Commercial Code; equity swaps with one's subsidiaries under the equity swap system; allocation of shares to shareholders of one's subsidiaries under the stock transfer system and the newly introduced stock delivery system.

3. Procedures for Issuing New Shares

New share issuance may be done in exchange for capital paid in by investors in the form of a public offering, third-party allotment, or rights offering.

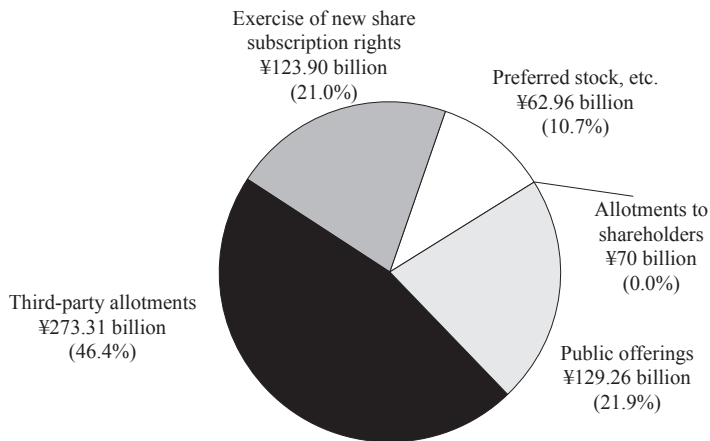
In a rights offering, shareholders on record as of a specified record date are given subscription rights in proportion to their stockholdings. In the case of public companies, grant of subscription rights or allotment of new shares to non-shareholders are only subject to board approval. On the other hand, a third-party allotment by a private company, under the Companies Act, in principle, requires a special resolution at the general shareholders meeting, but it

Chart III-1. Equity Financing in 1989 by TSE-Listed Companies, by Type of Financing
(Total capital procured: ¥8,529.39 billion)



Source: Tokyo Stock Exchange, *the Tosho tokei geppo* (TSE Monthly Report)

Chart III-2. Equity Financing in 2020 by TSE-Listed Companies, by Type of Financing
(Total capital procured: ¥589.50 billion)



Source: Web page of the Tokyo Stock Exchange.

may be conducted by ordinary resolution when provided for in the Articles of Incorporation. A rights offering to existing shareholders is a means of capital raising that is neutral to the control of corporations, in that it does not affect proportionate ownership of the shareholders. An offering of rights at par used to be the dominant measure of equity financing, but such offering is no longer common, partly due to the elimination of par value of stocks under amendments to the Commercial Code in 2001.

Public offerings grant subscription rights to the general public. A public offering raises more capital for an issuer than an offering of rights at par, which was once prevalent along with par value stock, by the excess of the issue price over par. From the viewpoint of investors, however, it deprives investors of the opportunity to earn the premium, thereby losing their incentive to subscribe. Although public offerings declined in the 1990s, they are now a primary means of raising equity capital today.

A third-party allotment raises capital by granting subscription rights to certain third parties, including banks or business corporations with special relationships with the issuer and/or its director(s). This method is often used to bail out troubled companies, strengthen relationships with corporate partners, and form a business and capital alliance rather than simply to raise capital. Additionally, the method has recently been noted as a measure for fending off hostile takeovers. Third-party allotments cause dilution of ownership of existing shareholders. They may be approved by board resolution except when terms of rights harm the interests of existing shareholders because they are unequivocally advantageous to the grantee(s) in which case a special resolution at the general shareholders meeting will be required (advantageous issuance). An issuer pursuing a capital increase by third party capital allocation has an obligation to explain the rationality and necessity of the capital increase in its securities registration statement.

Under the revised Companies Act of 2014 that went into effect in 2015, when new share issuance by a public company involves any transfer of controlling shareholders (accounting for one-half or more of voting rights), the name and other information of the underwriter must be notified to existing shareholders. Furthermore, if there is opposition by 10% or more of voting rights, the share issuance is subject to a resolution not only by the board of directors but also by the general shareholders meeting. Thus the involvement of shareholders in share issuance was strengthened.

4. The Current State of the New Issue Market

New shares are usually issued (1) in exchange for capital contribution (equity financing in the forms of public offerings, third-party allotments, rights offer-

Table III-5. The State of Issuing New Shares by Listed Companies (in thousands of shares)

Year	Paid-in capital increase	Rights offering	Public offering	Third party allotment	Preferred stock, corporate bond with subscription rights/warrants of the convertible bond type into shares, etc.	Exercise of subscription rights/warrants	Stock split	Others	Total
1982	4,919,006	1,932,416	1,760,389	111,822	1,102,860	11,519	4,265,996	318,347	9,503,352
1983	4,231,828	1,005,145	513,645	589,154	2,006,283	117,601	4,208,030	24,857	8,464,718
1984	5,312,713	1,170,322	778,686	319,665	2,835,670	208,370	4,033,617	169,830	9,516,159
1985	5,380,645	909,635	590,696	118,126	3,514,706	447,179	4,390,653	93,169	10,064,468
1986	4,503,842	371,191	346,883	78,308	2,831,297	876,161	3,939,802	621,924	9,065,569
1987	8,600,184	547,900	718,327	314,650	4,753,694	2,265,611	3,300,518	510,942	12,411,644
1988	8,052,096	849,464	1,286,177	169,633	4,623,233	2,123,587	4,004,200	96,212	13,152,509
1989	12,467,106	803,396	3,558,558	94,151	5,522,653	2,488,346	5,906,047	44,848	18,418,003
1990	4,733,374	758,546	1,284,250	252,593	1,859,145	578,839	4,383,600	1,632,879	14,649,854
1991	1,604,596	420,553	39,850	182,776	600,930	360,485	3,251,047	1,581,058	6,636,703
1992	766,227	244,895	2,180	190,340	139,205	189,605	1,584,403	414,121	2,764,752
1993	1,605,059	87,091	4,150	479,440	347,764	686,612	901,194	1,147,000	3,654,008
1994	1,530,474	24,152	33,360	543,846	445,479	483,635	2,330,679	1,190,447	5,051,602
1995	1,433,831	249,876	10,400	490,557	343,684	339,311	1,015,654	359,334	2,808,819
1996	2,546,611	455,200	200,883	583,427	506,753	800,348	847,835	1,873,163	5,267,610
1997	3,093,475	204,686	93,250	1,493,319	1,034,959	267,261	551,076	251,712	3,896,265
1998	3,641,490	7,707	97,337	2,380,126	1,079,024	77,295	168,263	22,696	3,832,450
1999	9,627,895	—	54,599	8,402,531	976,593	80,492	742,946	61,952	10,432,793
2000	3,709,565	87,140	84,200	2,621,987	835,744	80,492	1,599,465	1,158,762	6,467,792
2001	4,526,944	143,051	49,760	3,328,896	935,912	69,324	624,199	3,330,016	8,481,160
2002	4,260,986	—	238,268	2,719,749	546,153	756,815	692,917	1,412,881	6,366,784
2003	20,352	—	431,517	2,995,729	679,841	1,133,656	333,448	5,931,549	10,806,168
2004	5,659,174	18,193	516,166	1,586,466	2,404,871	2,404,871	3,051,215	1,201,938	12,971,634
2005	11,393,111	53,120	616,574	2,957,298	4,450,694	519,349	6,713,875	3,504,021	13,586,219
2006	7,459,697	—	1,638,972	850,680	2,404,871	1,119,159	11,749,100	3,504,021	31,119,819
2007	5,341,133	80,862	409,532	1,521,236	6,846,482	178,863	120,552	248,890	38,850,955
2008	3,542,021	6,998	687,868	1,549,130	1,119,159	329,833	16,193,816	238,890	10,480,708
2009	22,418,250	—	12,049,714	3,192,219	6,846,482	144,697	877,229	860,938	8,858,789
2010	10,464,418	68	7,548,008	1,935,650	835,992	144,697	1,842,238	625,267	8,645,867
2011	6,391,284	—	2,947,644	2,283,962	839,211	320,465	1,872,238	576,904	8,329,176
2012	4,309,521	34,504	2,371,349	2,653,711	1,024,399	215,492	3,759,491	8,996,091	7,365,361
2013	5,226,016	613	1,244,084	2,058,111	1,400,302	522,905	27,099,251	6,101,224	21,181,288
2014	4,624,642	—	1,422,172	627,019	1,933,058	642,391	8,841,942	6,101,224	21,383,523
2015	2,717,412	1,560	679,898	767,728	1,797,390	470,834	7,060,155	2,232,151	19,549,824
2016	5,403,536	3,699	0,40,825	4,152,569	606,834	308,115	2,232,151	2,232,151	6,150,569
2017	4,747,115	1,312	320,095	2,934,359	323,032	885,210	4,836,894	71,035,038	19,549,824
2018	2,380,544	—	251,482	572,821	1,253,032	1,253,032	4,836,894	26,497,834	6,150,569
2019	4,691,581	6,155	110,351	3,895,668	59,553	626,066	6,495,653	5,056,466	15,073,440
2020	2,955,070	—	358,199	1,380,132	214,293	1,016,292	7,360,701	25,389,212	19,638,164
2021	3,209,249	1,311	731,719	838,352	310,522	1,327,515	18,870,342	2,441,419	2,642,099
2022	1,683,940	269	87,458	479,437	594,731	522,053	5,199,522	4,241,371	2,642,099

Source: Tokyo Stock Exchange, *Shoken tokei nenpo* (Annual Securities Statistics) and *Tosho tokei geppo* (TSE Monthly Report).

ings, exercise of subscription rights, etc.); (2) in conjunction with stock splits (and gratis issues); and (3) for the purpose of corporate acquisitions. (Share counts are reduced when treasury stock is cancelled.) In 2022, the leading source of new shares issued by listed companies was stock splits and gratis issues (increase of 5.20 billion shares), followed by the conversion of preferred stock and convertible bonds with new share subscription rights (0.59 billion shares) and the exercise of new share subscription rights (0.52 billion shares).

The amendments to the Commercial Code in 1991 defined stock splits as a notion that encompasses stock dividends, gratis issues and reclassification of paid-in capital in excess of par into capital stock all of which were cases that did not involve payments by investors at the time of issuance of new shares.

Today, in Japan, equity financing is the leading source of new shares. Listed companies on the Tokyo Stock Exchange (TSE) raised approximately ¥0.6 trillion in equity in 2022. By contrast, equity financing, except for initial public offerings, is less used in the United States and the United Kingdom because it tends to cause earnings dilution and consequently pushes down the stock price. It should be noted, however, that over the past years, equity financing in Japan has undergone many changes. During the period of rapid economic growth, corporations mostly used the method of rights offering at par to raise equity capital, because investors did not have enough accumulation of financial assets, while issuing companies suffered a chronic shortage of funds. (Stock par value was abolished in 2001.) In those days, corporations mostly relied on bank borrowings for their funding requirements, and the stock market was a marginal marketplace for raising capital. However, as the economy slowed down after the oil shocks, the funding needs of businesses were reduced, and due in part to the necessity of securing a strong stockholder base, public offerings at market price became the prevalent means of raising equity among business corporations. Meanwhile, the weight of rights offerings also shifted from rights offering based on par value to that based on a median of par and market values. In the second half of the 1980s, with progress in deregulation concerning debt financing, issuing of convertible corporate bonds and corporate bonds with subscription rights/warrants increased, and so did their conversion and exercise. Particularly, as banks came under pressure to meet Tier 1 capital requirements imposed by the Basel regulatory standards, they scrambled to shore up their capital base, and such issuing accounted for about half of equity financing at the time.

In the 1990s, there was a marked decline in public offerings because of stagnant stock prices, and increasing capital through public offerings remained stagnant thereafter. However, following the global financial crisis that kicked off in 2008, equity financing picked up as companies sought to shore up their weakened financial bases by public stock offerings which be-

came active in 2009. Although significant volumes of shares have been issued through the exercise of new share subscription rights/warrants and stock splits in recent years, the overall number of issued shares has been declining, due mainly to the retirement of treasury shares.

5. New Share Underwriting

The method of issuing shares may be divided into direct offering and indirect offering, and public offering and private placement. When the issuing company itself performs the administrative procedures necessary for issuing shares and sells them to investors, this is called “direct offering (or self-offering).” Although this method helps the issuing company save the fees payable to an intermediary, it is not an easy task to perform the technically complicated procedures and sell the securities to an unspecified large number of investors. When the issuing company commissions a specialist intermediary to handle the public offering of its shares, this is called “indirect offering.” The intermediary provides the issuing company with expert advice, handles the distribution of shares and performs the necessary administrative procedures on behalf of the issuing company, and takes over the shares remaining unsold after the public offering period. At present, almost all shares are offered through the indirect offering method. A “public offering” is the public solicitation of an unspecified large number of investors for the purchase of new shares, and “private placement” is the private solicitation of a specified small number of investors to purchase them. In public offerings of new shares, indirect offering through underwriting securities companies is the general rule.

In the case of an indirect offering, the issuing company concludes an underwriting agreement with a securities company. Underwriting agreements are divided into standby underwriting (the underwriting securities company commits itself to buying up the shares remaining unsold) and firm commitment underwriting (it agrees to buy up the entire issue from the start). Today, the latter has become the general practice.

When the total amount of shares offered is too large, a securities company alone cannot accept the underwriting risk involved. Therefore, a number of securities companies often get together to form an underwriting syndicate. Of these securities companies, the firm that plays the leadership role in organizing the syndicate members and in negotiating the terms and conditions of the underwriting agreement with the issuing company is called the “lead managing underwriter.” And the group of securities companies that assumes no underwriting risk and only sells the securities is called the “selling group.”

In a public offering or secondary distribution, it is necessary to have a strategy for balancing supply and demand. Using an over-allotment option

Table III-6. Number of Lead Managing Underwriters in Shares of Securities Companies (IPOs)

(Existing stock exchanges and start-up markets in 2022)

Securities companies	Prime		Standard		Growth		Main Markets		Mothers		JASDAQ	
	No. of co.	% of total	No. of co.	% of total	No. of co.	% of total	No. of co.	% of total	No. of co.	% of total	No. of co.	% of total
SMBC Nikko Securities	2	100	2	20	17	28	1	25	2	20	—	—
Mizuho	—	—	2	20	10	17	2	50	2	20	1	100
Daiwa	—	—	1	10	14	23	—	—	1	10	—	—
SBI	—	—	—	—	9	15	—	—	2	20	—	—
Nomura	—	—	3	30	6	10	—	—	1	10	—	—
Tokai Tokyo	—	—	—	—	1	2	1	25	—	—	—	—
Ichiyoshi	—	—	1	10	1	2	—	—	—	—	—	—
Okasan	—	—	—	—	1	2	—	—	1	10	—	—
Mitsubishi UFJ Morgan Stanley	—	—	1	10	1	2	—	—	—	—	—	—
H.S.	—	—	—	—	—	—	—	—	1	10	—	—
Total	2	100	10	100	60	100	4	100	10	100	1	100

Source: PRONEXSUS, *Kabushiki Kokai Hakusho* (White Paper on Public Listings).

Table III-7. Flow from additional secondary distribution by over-allotment in initial public offering to syndicate cover transaction

Board of directors' meeting on issuance of new shares and secondary distribution Set OA offering limit	Determine provisional terms	BB (Report demand)	Set open price Set OA offering volume	Listing date (Trading start date)	SC transaction or GS exercise
BB = Book Building					
OA = Over-Allotment					
SC transaction = Syndicate Cover (short cover) transaction					
GS exercise = Exercise of Green Shoe option					
<p>Note: SC transactions and exercise of GS must be executed within 30 days from the day following the date on which the period during which investors submit their applications to securities companies is completed (normally, 2 or 3 business days prior to the listing date).</p>					

allows the securities firm that is the lead managing underwriter of an offering to borrow shares from existing shareholders and sell them if demand is greater than the original scheduled number of shares. In Japan, lead managing underwriters of offerings have been able to use the over-allotment option based on the underlying underwriting agreement since January 31, 2002. This option allows the sales of additional shares up to 15% of the scheduled number of shares in the public offering or secondary distribution. The short position arising when the lead managing underwriter the over-allotment option is cleared differently depending on whether the price in the secondary market has risen or fallen compared with the price after the listing. When the price of the shares has fallen, the lead managing underwriter purchases the excess shares in the secondary market (syndicate cover). When the price of the shares has risen, the lead managing underwriter exercises a green shoe option (right to acquire additional shares from the issuing company or from investors who have lent shares).

6. Review of public price setting process

In general terms, the process for setting the offer price for an initial public offering (IPO) is as follows: first, a securities registration statement is filed and a proposed issue price is set when the listing is approved by the stock exchange; next, a road show is held primarily for institutional investors, and provisional terms are set (usually indicated as a range). The determination of the final offer price is based on the results of a book building process under the provisional terms.

The “Action Plan of the Growth Strategy” approved by the Cabinet in June 2021 called for a review and reform of the IPO pricing process in order to encourage the development of new startup companies. In response, the Fair Trade Commission conducted an inquiry and in January 2022 it released a report setting out its views on competition policy and the Antimonopoly Act with respect to IPO transactions.

The Japan Securities Dealers Association (JSDA) established the “Working Group on the Public Offering Pricing Process” and conducted a study focused on topics such as improving the fair price discovery function and increasing confidence in the process of calculating issuing companies’ public offer prices, as well as investor protection. The working group report was published in February 2022, with discussions held subsequently to act on the suggested improvement measures.

First, in June 2022, the rules were amended to implement the improvement measures highlighted in the report. These included “ensuring the neutrality in pricing” and “satisfactory explanation of the public offer price to issuing

Table III-8. Major improvement measures implemented by JSDA

Improvement measures	Summary of improvement measures
Ensure neutrality in pricing (Revised June 2022, implemented July 2022)	The regulations explicitly require the lead managing underwriter to explain the issuer the basis for proposed issue prices, provisional terms, and public offer prices.
Satisfactory explanation of public offer price to issuing companies (Amended June 2022, implemented July 2022)	Regulations established for the lead managing underwriter to explain the basis of prices to the issuer, and for the lead underwriter's underwriting ratio to be determined after proper consultation with the issuer.
Clarification of maximum over-allotment volume in simultaneous domestic and overseas offerings (Amended June 2022, effective July 2022)	Amendment of rules to limit total over-allotment volume to 15% of the expected total volume of the domestic and overseas offerings where the domestic and overseas offerings are conducted concurrently.
Allotment to institutional investors and disclosure (Amended June 2022, effective July 2022)	Revision of guidelines to clarify cases in which an issue may be allocated to institutional investors who are deemed to contribute to improved corporate governance and corporate value on the instructions of the issuer.
Publication of initial rates of return and other metrics by the lead managing underwriter (Published from July 2022)	The JSDA collects required information and publishes it on its website.
Setting the public offer price outside the provisional range of conditions, flexibility in changing the number of shares to be offered (Amended February 2023, effective October 2023)	Clarification that the offer price and the number of shares to be sold can be set outside the range of the provisional terms within certain parameters* without having to repeat the book building process. "Certain parameters" refers to cases where all of the following conditions (i) through (iii) are met. (i) The offer price is determined within a range of 80% or more of the lower limit of the provisional terms and 120% or less of the upper limit of the provisional terms. (ii) The "number of shares to be sold at the time of the setting of the offer price" is within a range of not less than 80% and not more than 120% of the "number of shares to be sold at the time of the setting of provisional terms." (iii) "Offering size (number of shares (sum of number of shares offered and number of shares sold) × offer price)" must be within the range of "lower limit of provisional terms × number of shares when the provisional terms are set × 80% or more, and upper limit of provisional terms × number of shares when the provisional terms are set × 120% or less."
Improvement and clarification of pre-hearing (Amended February 2023, implemented October 2023)	Amendment of rules to allow pre-hearings for subsidiary listings, etc. under certain conditions.
Provision of demand information by actual name (Amended February 2023, implemented October 2023)	Amendment of rules to require lead managing underwriters, in principle, to provide actual names to issuers concerning road-show feedback and information collected during book building.
Shortening and increased flexibility of listing schedule (Implemented in October 2023)	<ul style="list-style-type: none"> · Reorganization of the practice of submission of securities registration statements (normally submitted on the date of approval of the listing) to allow submission prior to approval to shorten the process. Issuers can choose between the conventional listing method and pre-approval notification. · Flexibility to change the listing date based on factors such as changes in market environment after listing approval.

companies.” With respect to some of the other improvement measures, such as “setting the public offer price outside the provisional range of conditions,” “flexibility in changing the number of shares to be offered” and “shortening and increasing the flexibility of the listing schedule,” which have an impact on the actions of various parties involved in the IPO process, the JSDA amended its regulations, and the Financial Services Agency (FSA) held consultations with market participants and implemented revisions from October 2023, including amendments to the Cabinet Office Disclosure Ordinances.

In addition, the stock exchanges revised their listing systems for IPOs. TSE partially revised its listing regulations in March 2023 to make the initial listing process smoother (for instance, removal of the requirement to submit an audit report at the time of the application for filing, banning market orders before the initial listing price is set), as well as introducing direct listing on the Growth Market and revising the continued listing criteria regarding the amount of net assets.

7. Private Equity Market

Public offerings and other equity financing initiatives that raise capital from the general public are mostly conducted by public companies whose shares are traded on an exchange or other public market. However, that does not mean that private companies have to deal with particular legal restrictions in equity financing. In fact, equity financing regulations for private companies can be said to be more relaxed than for public companies. For example, there is no requirement to include information on the issuer’s operating performance or financial position in the written notice of securities because, unlike the securities registration statement, this is not a disclosure of information to investors. Under the Financial Instruments and Exchange Act and other Cabinet Office Orders currently in force, furthermore, if the proceeds from a proposed offering or secondary distribution of shares (securities) are less than ¥100 million, private companies are exempt from filing a securities registration statement. Instead the requirement is simply for a written notice of securities to be filed, regardless of whether or not there is solicitation of 50 or more people. In principle, if the proceeds from the offering are ¥10 million or less, or fewer than 50 persons are solicited, the issuer is not even obliged to file a written notice of securities.

However, when viewed from the standpoint of investors, private equity investments, given the limitations on information available to them, involve higher risks. While stock prices of public companies are properly formed through market transactions, reasonable values of private stocks are not easy to determine since there are various methods to estimate private stock prices,

Table III-9. Criteria for Requirement to Submit Securities Registration Statement or Written Notice of Securities Under the Financial Instruments and Exchange Act, and Cabinet Office Order, etc.

		No. of Investors*	
		Less than 50	50 or more
Issue Amount	100 million yen or more	Not necessary	Securities Registration Statement
	10 million yen or greater but less than 100 million yen	Not necessary	Written Notice of Securities
	10 million yen or less	Not necessary	

*Notes: 1. Under the current FIEA and Cabinet Office Order, etc. even when the number of investors solicited is less than 50, if the issuer has made an offering of the same type of security within six months previously and the combined number of investors solicited is 50 or more, the determination of whether a securities registration statement or written notice of securities is required must be made based on the total issuance amounts of the offerings.

2. In accordance with the revision of administrative orders effective April 1, 2003, issuance regulations have been liberalized as follows.

- (1) Under specified condition of the number of Qualified Institutional Investors being 250 or less, etc., the number of professional investors (Qualified Institutional Investors) may be deducted from the count of 50 or more of the number of investors being solicited.
- (2) In determining the issuance amount for a professional investor private equity offering in a solicitation for purchase of securities where only Qualified Institutional Investors are counterparties and there is little possibility of sales to anyone other than qualified institutional investors, equities, etc. and equity related products are to be included. In this case, regardless of the number of investors, the written notice of securities is required only for issues of 100 million yen or more (for solicitations of investor groups of less than 50, please see note 1 above).

including the net asset method of estimating based on the company's net assets, the income method based on cash flows, and the dividend discount method based on future dividend projections. Moreover, the problem with private equity investments is the difficulty of recovering invested funds due to lack of liquidity. It is hard to recover funds until the investee company goes public. Thus investment in private equity tends to be limited to a small number of investors, such as venture capital funds, which have the economic capacity to tolerate the high risks and long investment periods associated with such investments.

In order to stimulate entrepreneurial activity and foster startup businesses, streamlining the fund raising mechanism prior to going public has been discussed as a matter of priority.

The Japan Securities Dealers Association launched a public quotation system (Green Sheet system) for private equity and unlisted shares in July 1997.

Table III-10. Examples of methods of calculating stock values of private companies

1. Net assets approach
(1) Book value method Price per share = Book value of net assets/Total number of issued shares
(2) Adjusted book value method Price per share = Book value of net assets reflecting unrealized gain and losses/Total number of issued shares
(3) Market value method Price per share = Market value of net assets/Total number of issued shares
2. Income approach
(1) Income capitalization method (direct return method) Price per share = (Projected future net profit after tax/Capitalization ratio)/Total number of issued shares
(2) DCF method Price per share = Total amount of discounted present value of projected future profit/Total number of issued shares
3. Dividend discount approach
(1) Dividend discount method Price per share = (Projected future annual dividends/Capitalization ratio)/Total number of issued shares
(2) Gordon Growth Model method Price per share = (Projected future annual dividends/(Capitalization ratio - Investment return ratio × Retained ratio))

Securities companies became eligible to solicit investment in private equities for issues of OTC securities that met certain standards of information disclosure and for which the securities companies provide publicly announced buy and sell quotes. Although this system was abolished at the end of March 2018, a shareholders community system was launched in May 2015. An equity crowdfunding (CF) system was also introduced in the same month. In January 2022, certain amendments were adopted for the Order for Enforcement of the Financial Instruments and Exchange Act and the Financial Instruments Business Ordinances: calculation of the total issuance amount (less than 100 million yen) was required only for the amount issued under the CF system and the maximum investment limit (500,000 yen) for specified investors (professional investors) was removed. In July 2022, the J-Ships system was introduced to allow unlisted stocks and other securities to be issued and distributed to specified investors through securities companies.