



## Top Message



### Making a Fresh Start

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#### The Company Environment

2016 has been an important year for the Dentsu Group, where we have strengthened both our business and client offer in a fast-changing market.

The Group continued to make progress against its digital and data ambitions and achieved good new business momentum in challenging market conditions. We have a strong leadership team, a progressive talent agenda and we continue to invest for long-term growth. As a result, Dentsu Group is in a good position to deliver increased value for our clients.

We continued to make improvements to our working practises following the labour management issues in Japan. In November 2016, we launched the Dentsu Working Environment Reforms Commission. The Commission has been carrying out major reforms to improve our work environment and discourage long working hours.

The independent advisory committee, established in February 2017, will conduct ongoing monitoring of these reforms to ensure their progress and effectiveness. In addition, we are appointing outside directors to the Board directors as part of our Group corporate governance.

As Chief Executive Officer, I take these reforms very seriously and aim to complete all associated structural changes by the end of 2018.



## Business Changing to Reflect Society

We believe that the Group's business must also continue to evolve to keep pace with the changing business environment. Technological innovation, centred around digital technology, continues to accelerate. Client companies and business partners are responding to the changes by looking to new ways of doing business. This change provides an opportunity for Dentsu Group to ensure its clients' benefit from its market-leading products, services and capabilities to help navigate the complexity of the digital economy.

Against this backdrop, in the international business, we have made the M1™ platform, by Merkle Group Inc. (Merkle) —acquired by Dentsu Aegis Network (DAN) in 2016—the global data platform for all of DAN. Over 20 client companies of DAN have started testing M1™'s capabilities, and in 2018 we plan to link data through M1™ for all media planning and activation in the US. We will strengthen our global competitive network through our leadership in digital technology and media content.

In addition, in Japan, we will respond to the rapid changes in consumer behaviour by showcasing new ways of engaging consumers. In September 2017, we set up People Driven Marketing™ using our wealth of online and offline consumer behaviour data. This is an integrated marketing framework that visualizes targets, using some of the best and largest domestic audience data. It allows a comprehensive management of all stages - from awareness to purchase,

to repurchase - through funnel-analysis modelling (which narrows down potential target customers). The Dentsu Group is working to further strengthen its systems and develop our digital solution capabilities, including marketing intelligence.

## Group Beating Stakeholder Expectations

Companies are increasingly expected to carry out their social mission and increase corporate value through the lens of environmental, social and governance (ESG) issues. In the area of governance, a particularly important aspect of ESG, we switched to being a company with an Audit and Supervisory Committee in 2016, and are working to strengthen the auditing functions of executive officers, while enabling swift decision-making and agile business execution. We are also engaging proactively in the Sustainable Development Goals (SDGs) formulated by the United Nations, which aim to address some of the most pressing societal challenges by 2030.

The Dentsu Group will continue working to create corporate and shareholder value and I look forward to building on this momentum going forward.

## Responses to Labor Issues in Japan

### Eight Steps to Improve Work Environment

To improve our Japan work environment, we were taking steps recommended by a labor standards inspection office when, in December 2015, one of our promising young employees, the 24-year-old Ms. Matsuri Takahashi, took her own life.

The Group has been charged with violating the Labor Standards Law. On October 6, 2017, the Tokyo Summary Court pronounced a guilty verdict and imposed a ¥500,000 fine.

We recognize the significance of the responsibility and feel deep regret. Thus, we are implementing Group-wide reforms in Japan to improve the work environment.

To prevent excessive overtime, Dentsu reaffirms that employees are its most important resources and recognizes the importance of looking after each and every employee. Management is currently giving top priority to employee working environment reforms in Japan.

Providing a work environment that ensures the mental and physical health of employees is our social responsibility, as is their personal development as they follow career tracks and work styles reflecting their values.

In November 2016, we launched the Dentsu Working Environment Reforms Commission to promote work environment reform and enforce compliance. Immediately after, we launched initiatives to deal with the most urgent issues, such as preventing long working hours and the recurrence of labor issues.

We considered concrete steps to optimize workloads, reviewed each system, assessed management appropriateness, and redefined our corporate culture.

In December 2016 we moved to reform the work environment based on eight pillars.

### 1. Reinforce regulatory knowledge and insights

- (1) Train executives and all employees in Japan in labor laws and regulations.
- (2) Reduce actual working hours by reducing overtime work to the maximum agreed with employees under Article 36\* of the Labor Standards Act and ensuring strict compliance with these requirements.
- (3) Conducting regular assessments to confirm progress.

\* Article 36: An agreement in the Labor Standards Act between the labor union or other such organization and management regarding work outside normal working hours or working days. Under Article 36, in the case that the company requires work outside the required hours (8 hours a day, 40 hours a week) or on days off, the company shall enter a written agreement with the labor union or other organization, and notify the relevant labor standards agency.

### 2. Equalize workloads and reassign personnel within Dentsu Inc.

- (1) Reassign 650 employees in January 2017.
- (2) Urgently hire 60 mid-career people as full-time employees.
- (3) Appoint human resources management heads in all divisions.
- (4) Audit operations and identify those suitable for outsourcing.
- (5) Organize a committee for the revision of operations in which we have collaborated with subsidiaries and vendors.

### 3. Maintain and increase employee motivation

- (1) Fully compensate for a reduction in overtime pay in 2017 through bonus payments.

### 4. Bolster employee health management and care

- (1) Have mental health professionals on-site all times at the in-house health management center to counsel employees as needed.
- (2) Establishment of the Family Line to offer mental and physical health advice to employees with family assistance.
- (3) For new employees who are still learning operations, bolster work and career path consultations and mental health checkup program.

### 5. Offer more diverse working style alternatives

- (1) Expand number of business units offering flextime. Flextime workers are prohibited from working 10:00 p.m. and 5:00 a.m.
- (2) To activate communication among employees we will renovate work spaces.
- (3) Swiftly deploy an infrastructure to enhance work mobility.
- (4) In 2017, partially institute work-at-home program for employees who need to care for their children or other family members.

### 6. Improve and reinforce labor management (asterisks indicate measures implemented in October 2016).

- (1) In principle, maintain the prohibition on employees remaining on the premises for personal reasons.\*\*
- (2) Check on individual employees whose overtime work has neared the maximum agreed under Article 36 of the Labor Standards Act for several consecutive months.
- (3) Maintain the policy of switching off all office lights, in principle, from 10:00 p.m. through 5:00 a.m. and prohibit employees from working overtime at home.\*\*
- (4) Continue to reject applications for overtime work under the special provisions of Article 36 of the Labor Standards Act for new employees who are learning and reduce work load to within legal requirements.
- (5) All employees must take five days off in both the first and second halves of the business year.

### 7. Overhaul the manager evaluation system

- (1) Deploy 360-degree evaluations for line managers.
- (2) Reduce management evaluations to once annually to emphasize focus on mid-term contributions.
- (3) Reflect personnel and labor management skills as well as results contributions in evaluations.
- (4) Roll out aptitude screenings for line managers.

### 8. Help employees to pursue self-development

- (1) Establish medium-term growth and career development objectives for evaluations of non-managerial personnel.
- (2) Help eliminate work and personnel mismatches by deploying an in-house free agent recruiting program.
- (3) Set up program offering certain period of unpaid sabbatical leave for every five years of service to help employees broaden their knowledge and experience.
- (4) We will help employees improve their capabilities by providing up to 50,000 yen per person annually to supplement the cost of education and training courses.

### Structural Reforms Ensure Implementation of Work Environment Reforms

We have implemented various structural reforms to promote Company-wide work environment reforms in Japan.

In December 2016, we placed HRM managers in each division, and created a system to ensure the time and health management of employees, the prevention of harassment, and optimized work assignments.

In February 2017, we set up an Independent Advisory Committee for Labor Environmental Reform Activities, comprising outside experts. Committee members have been asked for advice on, and to monitor, work environment reforms, to supervise and verify the progress of these initiatives.

A new outside director appointed at the Ordinary General Meeting of Shareholders in March 2017 was added to the Board of Directors. We plan to strengthen discussions regarding the work environment reforms.

Meanwhile, the Dentsu Working Environment Reforms Commission has been steadily implementing reforms based on the eight pillars, as well as creating new initiatives. These reforms are expected to bring fundamental changes to the nation's long-standing work culture. We have held dialogues to emphasize transparency, so that each employee might have a voice and an understanding of work conditions. We collected about 25,000 opinions through surveys and internal dialogues.

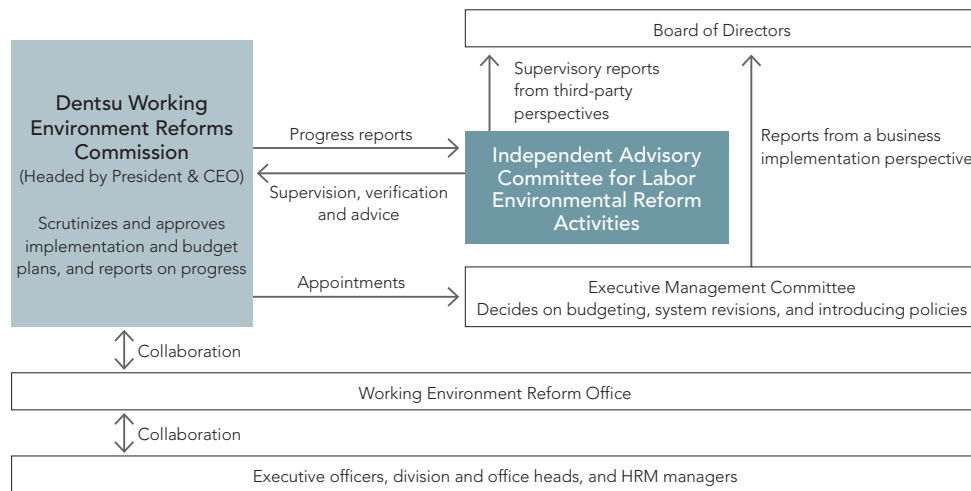
Based on employee input and talks with outside experts and Independent Advisory Committee members, in July 2017 we devised our Working Environment Reform Plan.

### Medium-term Work Environment Reform Plan

The Work Environment Reform Plan to create a New Dentsu has four stages: Commitment, Target, Challenge, and Goal. This medium- to long-term action plan includes steps to reach the final stage.

The first stage, Commitment, embodies our commitment to ensure that we fully comply with laws and regulations to prevent the reoccurrence of labor issues. We vow to reach zero violations of Article 36 of the Labor Standards Act, zero harassment, and zero overwork. Included are concrete initiatives such as the ongoing prohibition of late night work as stipulated in the eight pillars of the work environment reform, the introduction of a work efficiency metric to the evaluation criteria, and the strengthening of reporting and advising systems for harassment.

#### Work Environment Reform: Implementation, Monitoring Framework



#### Meetings Stress Transparency, Dialogue

- Dedicated glass office
- Fully transparent discussion of issues
- Reform proposals fielded from employees



#### Promotion of Management–Staff Dialogue

##### 25,000+ opinions gathered

- Company-wide questionnaires (3, over 6 months)
- Fielding of suggestions from employees
- Sessions with divisional personnel managers (HRM managers candidates)
- Employee opinion-exchange sessions → Total of 2,125 attendees across 105 sessions
- Employee recommendation/opinion box

##### Receive outside opinions in addition to in-house sessions

- Gain insights from outside experts
- Gain insights from the Independent Advisory Committee

The Target stage aims for a 20% reduction in the total number of hours worked per employee while maintaining 100% of the output. In terms of the work environment and workflow reforms, we are already promoting the hiring of full-time employees and the review of workflows. We plan to implement many measures such as satellite offices and work-from-home systems.

Through the Commitment and Target stages, we aim to prepare for reform, and achieve the objectives of these two stages by the end of 2018.

The Challenge and Goal stages involve further maintenance and expansion of reforms. In the Challenge stage, following the 80% cut in total working hours achieved in the Target stage, the aim is to support staff personal growth by using the 20% additional time to improve the

mental and physical health of employees and enrich their daily lives through experiences and learning opportunities. We plan to strengthen support systems and create new systems, such as increasing the number of vacation days that can be taken consecutively and strengthening support systems for nursing care, childcare, and volunteering.

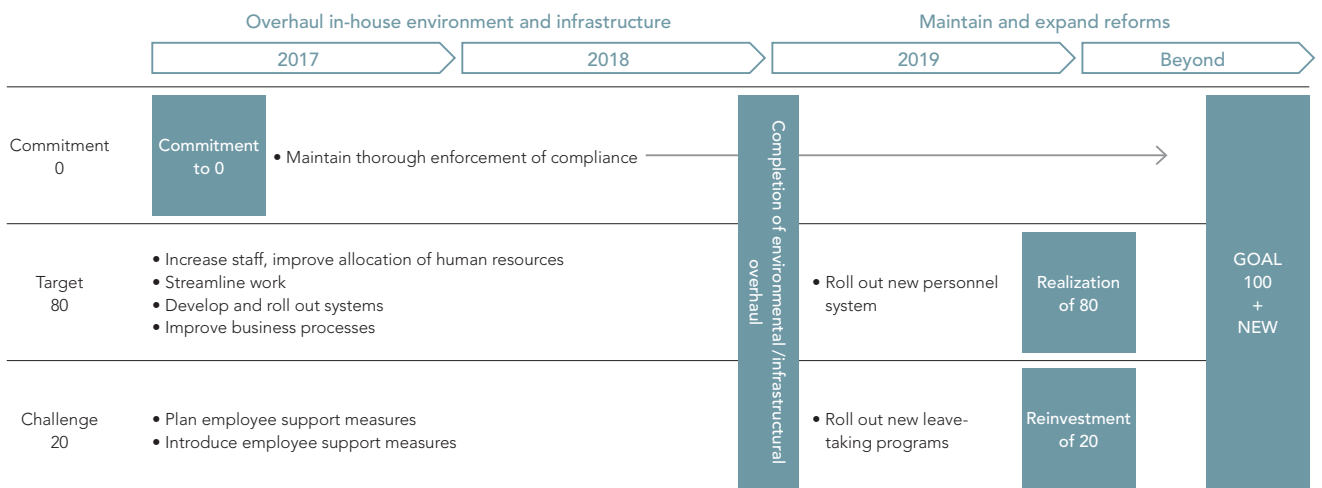
The last stage, Goal, refers to our goal of creating a New Dentsu by enabling growth of our employees and the Group by switching to new work styles.

We will continue Company-wide efforts to promote these work environment reforms in order to reach our goal even one day sooner.

Work Environment Reform Plan



Work Environment Reform Process





## Responses to Inappropriate Business Practices in Domestic Digital Advertising Services

In September 2016, the Company presented its findings after investigating digital advertising services provided by the Company and some Group companies in Japan for instances of inappropriate or potentially inappropriate practices.

An in-house committee that the Company formed on August 15, 2016, evaluated around 214,000 invoices issued for digital advertising services in Japan between November 1, 2012 and July 31, 2016. The committee, chaired by Shoichi Nakamoto, the senior executive vice president and CFO at the time, and external attorneys, drew on advice from third-party professionals (certified fraud examiners and accountants) to identify issues and their causes, and to formulate measures to prevent their recurrence.

The investigation concluded in January 2017, and we have reported individually to advertisers on any projects involving unsuitable practices.

The following includes an outline of the investigation, an overview of inappropriate business practices, investigation findings, causes of inappropriate practices, measures to prevent recurrence, and the impact on Dentsu's operating results.

Dentsu offers sincere apologies for the great concern and trouble that this matter has caused its advertisers, shareholders and other stakeholders.

### 1. Outline of the investigation

- Committee composition: A four-person in-house committee chaired by Shoichi Nakamoto and including external attorneys
- Transactions covered: Digital advertising services that Dentsu and some domestic Group companies provided in Japan to advertisers
- Companies covered: Dentsu in Japan and 17 domestic Group companies providing digital advertising services
- Investigation term: August 15, 2016 to January 16, 2017
- Period under investigation: Digital advertising services from November 1, 2012 to July 31, 2016 for which detailed accounting data exists
- Advertisers covered: 2,263 companies
- Investigation methodology
  - (a) Conducted hearings with related Dentsu Group company officers and employees in Japan, and reviewed reported details and results
  - (b) Analyzed and verified data for all 214,000 invoices that Dentsu and Group companies in Japan lodged
  - (c) Assessed related evidence, including vouchers and digital data
  - (d) Conducted one-on-one hearings regarding the organization and the business flows with Dentsu, Group company employees and officers in Japan



## 2. Four categories of issues

Our investigation identified four categories of unsuitable business practice.

### Category 1: Reports presenting incorrect total posting volumes

Reports to advertisers stated that the total number of digital postings requested were fulfilled despite this not being the case.

### Category 2: Reports with incorrect posting details

While total numbers of digital postings in reports to advertisers were as requested, daily details were not in line with advertiser instructions or expectations, with some placement result details being incorrect, albeit without any impact on total digital posting numbers.

### Category 3: Non-presentation of daily reports

While total digital posting numbers were as advertisers requested, the operational reports posted that advertisers requested were on a weekly or monthly basis, and as reporting was not done on a daily basis, reports wrongly indicated advertisement postings for all of the days required.

### Category 4: Omissions causing invoicing inaccuracies

Invoice amounts that were not fixed until the month subsequent to the posting month owing to the nature of digital advertising placement were recorded as estimates in months in which advertisements were posted and invoiced in following months, without making any adjustments. Here, total digital posting volumes and breakdowns were as advertisers requested, and operational reports were accurately produced and submitted.

## 3. Investigation findings

In the preliminary investigation findings announced last September, estimated transactions involving concerns of business impropriety were reported as encompassing 111 advertisers, 633 cases and transactions totaling ¥0.23 billion. However, a full investigation clarified the number of transactions involving concerns of business impropriety as encompassing 96 advertisers and 997 cases\*.

There were 40 cases of overcharging based on incorrect volumes (Category 1) to 10 advertisers, the amount totaling ¥3.38 million. After confirming the details of the abovementioned categories, transactions with 96 companies were determined to involve improprieties, with a total transaction amount of ¥114,82 million\*.

\* In the preliminary investigation findings announced on September 23, 2016, cases were counted according to the number of campaigns. As the current investigation places importance on verifying inappropriate billings, after detailed investigation the counting for the number of cases has been revised and counted uniformly according to billing units.



#### 4. Causes of unsuitable practices

Digital advertising services entail undertaking PDCA cycles that modify the details of digital posting plans to help address emerging consumer needs in real time, and thus require expertise and ability to efficiently handle large volumes of cumbersome work.

The investigation identified issues within the domestic digital Group structure that failed to sufficiently match such requirements.

##### (a) Business process issues

- Dentsu did not build and operate an adequate structure for standardizing work, separating duties, and conducting checks.
- At the same time, Dentsu did not provide advertisers with clear definitions of services scope or disclaimers.

##### (b) Risk management issues

- Dentsu did not fully recognize operational risks relating to business errors or other shortcomings.
- Dentsu did not sufficiently standardize flows for following up on errors.

##### (c) Human resources management issues

- Although the rapid growth of digital advertising has greatly changed the skillset and workload requirements at business sites, Dentsu did not adequately assign or train human resources in qualitative or quantitative terms.

##### (d) Inadequate coordination with the Group's domestic digital companies

- With progress in digital advertising rapidly changing the business structure, Dentsu expanded its business with the cooperation of domestic digital companies within the Group. Coordination was inadequate, however, as communication gaps arose in the course of business amid a rapidly increased diversity of human resources.

#### 5. Measures to prevent recurrence

In early September 2016, Dentsu took the interim step of rolling out an internal framework in Japan to launch a unit that would check on digital advertising orders, placements, and invoicing independently from the operations handling such work. The goal is to reinforce measures to prevent a recurrence of unsuitable business practices.

In light of issues that the investigation identified, Dentsu has launched the following additional industry-leading measures in Japan to prevent such issues from recurring by eradicating the causes of inappropriate practices.

##### (a) Addressing business process issues

- Objectively confirm digital advertisement postings and check on operations to ensure no overbilling, by making the Operation Management Office independent while setting up the Digital Confirmation Section within it and start checking postings and voucher issues for work after August, 2016.
- Reform posting reporting flows and build a framework for automating posting reports. (Task was completed in April 2017)
- Plan to introduce Internet Advertising Services Agreement that clarifies service scope and disclaimers, as well as Internet Advertising Placement Application Form that clarifies application details. (Task was completed in April 2017)
- Plan to construct a system for online applications to prevent errors in posting information from Internet Advertising Placement Application Forms. (Task was completed in December 2016)
- Roll out an internal drive at all business sites that focuses on reforming programmatic advertising and improving operational collaboration, providing separate training in-house for around 1,000 people. Through this process Dentsu will reconfirm business processes and associated tasks and collaboration between relevant in-house departments. (Task was completed by December 2016)

##### (b) Addressing risk management issues

- Deploy an internal drive and in-house training to reform programmatic advertising and improve operational collaboration to share operational errors and operational risks.
- Build a structure to increase the number of managers in programmatic advertising-related departments and make management units more focused and follow up on errors.

**(c) Overcome human resource management issues**

- Urgently increase the number of people handling programmatic advertising (by 30 for Dentsu headquarters and 90 in total among group companies), prioritizing those with experience. (Task completed by December 2016)
- Verify the optimal personnel makeup and required skillsets for Dentsu's domestic programmatic advertising services unit and Group companies and further increase personnel numbers through in-house transfers and mid-career hiring. (Task will be completed during fiscal 2017)
- Conduct in-house training on programmatic advertising reforms and improve operational collaboration.
- Plan to increase the number of managers in units related to programmatic advertising and reinforce operational management and quality oversight.

**(d) Enhance collaboration with the Group's domestic digital companies**

- Promote understanding among executives of the domestic digital advertising business and situation.
- Convene regular digital group liaison meetings.
- Review the structure for providing services and reconsider key benchmarks.
- Introduce a mechanism across Dentsu and its domestic Group companies in Japan that enables workers to share issues and solutions.
- Strengthen digital personnel training and information sharing.

The Company will work to provide better quality, higher value-added digital advertising services by improving the accuracy of its domestic digital advertising operations.

**6. Impact of errors on results**

Dentsu believes that this issue will not materially affect the company's financial results for previous fiscal years.

**7. Internal disciplinary action**

We will clarify responsibility for these issues by taking disciplinary actions against executive officers and have taken appropriate disciplinary actions against other employees in line with in-house rules.