

Message from the Chairman



For Value Creation Across the Future OMRON's Ever-Evolving, Unique Governance

September 2020
Chairman

Fumio Tateishi

Over the years, OMRON's corporate governance has continued to evolve based on the OMRON Principles. In fiscal 2015, OMRON introduced board of directors evaluations to further improve the effectiveness of the Board of Directors. It is especially in uncertain times that the Board of Directors is called on to be its most effective. We asked Chairman of OMRON, Fumio Tateishi, about how effective the Board of Directors has been, citing specific examples.

(Interviewer: Integrated Report Production Team)

—— **Editor (in bold): OMRON has been working to build and reinforce its governance systems since the 1990s, when corporate governance was still in its early stages in Japan. Could you tell us about how OMRON's Board of Directors has evolved through those efforts?**

The history of OMRON's governance began in 1996, when Nobuo Tateishi, the then Chairman of OMRON, participated as Japan's representative in a business advisory group of the Organisation for Economic Co-operation and Development (OECD). From the OECD's activities, he came to recognize the importance of governance and the need for Japanese companies to introduce corporate governance. Holding to the adage, "start with the first step," OMRON established its Management Personnel Advisory Committee (today's Personnel Advisory Committee) in 1996. In 1999, it cut the number of directors from 30 to 7 and introduced an executive officer system at the same time. These were quite advanced initiatives at that time in Japan.

Subsequently, outside directors were brought onto the Board in 2001 and the positions of Chairman of the Board of Directors and CEO were separated in 2003. That same year, the Compensation Advisory Committee was established, followed by the CEO Selection Advisory Committee in 2006 and the Corporate Governance Committee in 2008. A process of evaluating the Board of Directors was introduced in 2015 to evaluate the effectiveness of the Board, and executive directors (excluding the Chairman of the Board) were abolished in 2017 to enhance the oversight functions of the Board. In this way, for the past quarter of a century, OMRON has been improving the Board of Directors' effectiveness, step by step.

One of the most unique features of OMRON's corporate governance framework is that the CEO is not a member of any of the advisory committees. Further, all advisory committees are chaired by outside directors, which ensures a high degree of transparency, objectivity, and effectiveness. For example, to realize both effectiveness and objectivity, the Board evaluation process, which was introduced in fiscal 2015, is carried out by the Corporate Governance Committee, which is chaired by an outside director and whose five members are all outside directors and outside members of the Audit & Supervisory Board.

In this process, the outcomes of the evaluation of the Board's operations are analyzed every fiscal year, and, based on the analysis, operational policies and important themes for the following

year are decided.

In this way, as well as building up our corporate governance framework step by step, most recently, we have been improving the Board's effectiveness by rotating the PDCA cycle of this Board of Directors evaluation process.

—— **In fiscal 2019, the Board of Directors, which has led the evolution of the corporate governance system over the past 25 years, came to deliberate on a major proposal to transfer one of our main businesses, the Automotive Electronic Components Business (AEC), to Nidec Corporation. There must have been several hurdles in the process that led to the final decision. What were the deliberations like?**

OMRON has positioned corporate governance as the mechanism by which management based on the OMRON Principles will be accelerated and corporate value will be enhanced over the long term. Since the Board of Directors evaluation process was introduced, our aim has been to turn the Board of Directors into something akin to a "monitoring board," one that focuses on the discussion of key medium- and long-term issues. In fact, 70% of the Board's agenda is now given over to topics that concern medium- and long-term strategies. This is why the Board of Directors also deliberated on the AEC from short-, medium-, and long-term perspectives.

As symbolized by EVs (electric vehicles) and ADASs (Advanced Driver-Assistance Systems), the automotive electronic components market is entering a once-in-a-century period of great transformation.

The Board of Directors refrained from making short-sighted assessments about the transfer of the AEC, and instead deliberated on the matter from mid- and long-term perspectives based on the OMRON Principles before reaching a determination. My view is that we were able to achieve this precisely because the three conditions needed to achieve it were in place. Those three conditions were management based on the OMRON Principles, underpinned by the OMRON Corporate Motto established by the founder in 1959, management based on our long-term vision that has been reviewed every 10 years since 1991, and the strengthening of our corporate governance over the past 25 years.

In the process of these deliberations, the matter was considered from many different angles, and the Directors raised various questions, such as whether we really ought to be selling off a business

whose earnings are on a par with the industry average, and whether, even if we did sell it, should we sell off the entire business, which could provide a foothold into growth areas such as EVs and ADAS.

In making a final decision, we debated the matter multiple times from three different points. Specifically, the first point was whether OMRON would be able to contribute to future social development through the Automotive Electronic Components Business according to the OMRON Principles. In other words, would OMRON be able to remain the best owner of that business? The second point was whether the business could continue to create new value and be needed by society under Nidec Corporation's management. In other words, would Nidec Corporation be the best option for the business? The third point was whether, if the business were to be sold, the employees working in the Automotive Electronic Components Business would be able to keep hold of their dream of solving social issues in the automobile industry.

Regarding the first point, as I mentioned earlier, the automobile industry is entering a once-in-a-century period of great transformation, the impacts of which are also being felt in the automotive electronic components market. In the area of electronic control units (ECU), where OMRON's control technologies can demonstrate their strength, cars now have about 70 such units, but these are predicted to be aggregated into only three in-vehicle computers in the future. In such a severe environment, OMRON would need to make large investments over the next five to ten years to ensure that the AEC could offer OMRON value to society. However, given our policy of positioning the Industrial Automation Business (IAB) and Healthcare Business (HCB) as our growth businesses and investing aggressively in those areas, it would have been difficult to invest in the AEC to the same degree. For these reasons, we reached the conclusion that it would be best to transfer the operation of the business to another party who would be capable of creating value in the future while the business was still competitive and performing sufficiently in terms of net sales and profit.

Regarding the second point, if Nidec Corporation, whose strengths lie in motor technology, and OMRON AEC business, whose strengths lie in control technology, were to come together, they would be able to create competitive modules. We determined that such a pairing would be the best

option for allowing the AEC business to contribute to the automobile industry and to broader society beyond that over the long term.

The last point concerned the motivation of the employees. We decided that, by transferring the AEC to Nidec Corporation, it could continue to contribute to the automobile industry for the next 10, or even 20 years, and its employees would be able to engage in their work with hopes and dreams. Having said that, a change of company is a massive change for employees. I asked executive management to explain the transfer carefully to the employees, so that they could stay positive and perform to their fullest ability even after the transfer.

The most important thing is for the AEC business to grow even further after the transfer by contributing to society. This is an example of putting the OMRON Principles into practice.

— In the end, OMRON was able to achieve the best negotiations with the best timing, but what do you think was the most important point that made that possible?

I think there were two key points. The first is the future potential of the AEC business in the automobile industry.

The other point is that the Board of Directors has conducted discussions on important themes from mid- to long-term perspectives. The very reason we were able to make a prompt decision with such good timing was that oversight and executive functions were already communicating with each other in a constructive manner.

The decision on the sale of the business was made through business portfolio management (PPM) under OMRON's ROIC management. From around 2006, OMRON started to focus on return on invested capital (ROIC) and to evaluate its businesses based on ROE and ROA as well. At that time, ROIC was still only an indicator of the results of business evaluations, but after Yamada became CEO, he formally advocated ROIC management in fiscal 2013. Since then, the individual businesses have been asked to achieve return on invested capital (ROIC) over and above capital costs. Since the company's foundation, OMRON has pursued innovation driven by social needs without limiting itself to certain domains. We have strived to create greater social value by withdrawing from businesses in which it had become difficult to create social value and concentrating our management resources on businesses with higher potential. Our pursuit to date of ROIC management

that is conscious of capital costs is what enabled us to make the decision to transfer the AEC Business.

—— **How will the Board of Directors perform its role during the current COVID crisis and as we head toward the new normal era post-COVID?**

Our first priority is to protect the health and safety of our employees. On that premise, we have asked the executive side to strive to keep the business running, and we check whether or not a balance between the two is being achieved. The executive was actually swift in its responses by stepping up remote work to keep our employees safe and resuming production to fulfill our supply responsibilities to our customers. The very reason the executive function was able to act so quickly was that, because the Board of Directors has been communicating constructively with the executive function in normal times and evaluating it accurately, the executive function has had the confidence to put its responses in place even under such crisis conditions.

The next key theme for the Board of Directors in fiscal 2020 is to consider the role that OMRON should play in the post-COVID era. There are three points to discuss on this theme.

Firstly, how will society change and what form will it take in the post-COVID era? Secondly, in the new normal era post-COVID, what kind of social needs will drive innovation at OMRON? Thirdly, what kinds of new businesses will meet those social needs? What should our business model, including that of our existing businesses, look like?

Currently, one of the most important items on the Board of Directors' agenda is the growth of OMRON. To this end, we recognize the extreme importance of thinking about the post-COVID era. Specifically, creating new businesses that will provide new business pillars and transforming our business model from a goods-based to a service-based one will be key. However, these new challenges also come with risks. Taking into account the opinions of our experienced outside directors and outside members of the Audit & Supervisory Board, the Board of Directors will accelerate new innovation driven by social needs by providing mechanisms and an environment to support the executive function as it takes on challenges and risks in the lead-up to the post-COVID era.

—— **Recently, stock exchanges and institutional investors are calling for the further acceleration of ESG-based and diversity-based management. How will the Board of Directors respond to these kinds of global demands?**

Commitment to ESG is the epitome of the practice of the OMRON Principles. OMRON's position is that the practice of the OMRON Principles equals the promotion of sustainability. By that I mean that we are engaging in ESG with the belief that accelerating the practice of the OMRON Principles will accelerate the promotion of sustainability. In 2016, we deliberated on the OMRON Sustainability Policy and identified our material sustainability issues (materialities). Since the Sustainability Office was established under the direct control of the Board of Directors in 2017, the Board of Directors has selected sustainability as a key theme and has been checking the state of progress and the issues on a regular basis. Our sustainability initiatives are also linked to our directors' remuneration. Specifically, we have adopted the Dow Jones Sustainability Index (DJSI) as our sustainability evaluation index, which we are using to accelerate our initiatives, by reflecting the index in medium-to-long-term performance-linked remuneration.

Regarding the diversity of the Board of Directors, we have worked to incorporate more diverse perspectives and views by having outside directors and outside members of the Audit & Supervisory Board on the board from an early stage. Diversity really is essential for dealing with today's chaotic external environment. I believe that, as well as gender and nationality, diversity can be achieved by bringing together the strengths of people with diverse views and different business experiences. I also believe that innovation can be created by diverse human resources performing to their full ability. As such, I have urged the executive function to promote diversity.

OMRON will work to create the kind of value that only OMRON can offer by responding to social needs such as SDGs. To this end, the Board of Directors will strive to achieve sustainable improvement of corporate value through the continuous exercise of its oversight function.