

Dialogue between Outside Audit & Supervisory Board Members (Independent)

Audits Contribute to Enhancement of Corporate Value in the Spirit of “Throwing Stones to Make Waves”



Tadashi Kunihiro
Audit & Supervisory Board
Member (Independent)
Member of the Corporate
Governance Committee

Hideyo Uchiyama
Audit & Supervisory Board
Member (Independent)
Member of the Corporate
Governance Committee

Dilution of the Venture Spirit: Challenge for the Audit & Supervisory Board

Kunihiro: In our discussion presented in the previous Integrated Report, we mentioned our concern that OMRON’s venture spirit based on the founder’s philosophy has become diluted in recent years, resulting in OMRON’s lack of growth. The long-term vision “SF2030” launched last year positions the three years covered by the current medium-term management plan “SF 1st Stage” as the “Transformation Acceleration Phase.” In other words, in SF 1st Stage, it is critically important to demonstrate the venture spirit in order to accelerate the transformation of OMRON’s capabilities to create value in response to social issues and to grow sustainably. Therefore, from the standpoint of Outside Audit & Supervisory Board Members, we are striving to reinforce and enhance the venture spirit, and moreover, we are working to ensure everyone at OMRON is part of this endeavor. Let’s start with this topic.

Uchiyama: Yes. As regards the venture spirit, which is the source of a company’s long-term development, OMRON founder Kazuma Tateishi urged us to “prevent mental aging and continue to embrace new challenges.” He also commented on how the organizational structure can encourage a venture spirit. He maintained it is necessary to bring top management and the frontline closer together and, by thoroughly decentralizing power, to establish an operational structure conducive to self-contained decision making. These concepts shaped the prototype of “high cycle management” that OMRON is currently pursuing.

Returning to the founder’s philosophy and analyzing OMRON’s venture spirit, I feel that we, Outside Audit & Supervisory Board Members, should re-examine the ideal configuration of the Audit & Supervisory Board and change our own posture, rather than just urging the executive team to transform the corporate culture. We have been asking ourselves a question: “What can the Audit & Supervisory Board do to enhance corporate value?” Through ongoing

discussion on this theme and proceeding by trial and error, we are endeavoring to establish a formula. Specifically, the Audit & Supervisory Board analyzes the facts and data we obtain through daily auditing activities, formulates hypotheses about latent management issues, and when necessary, raises issues at meetings of the Board of Directors to achieve shared recognition. We are also working to establish a system for monitoring the executive team’s initiatives addressing the issues we have raised and for evaluating the impact on OMRON’s corporate value of what is being done to resolve these issues.

Of course, we do not think our hypotheses concerning management issues are always 100% correct. Nevertheless, whenever we think tackling a particular issue would be beneficial to OMRON, we will tenaciously raise that issue and endeavor to get a grip on the actual situation through mutual verification with the executive team. The Audit & Supervisory Board doesn’t have to be right all the time in order to be useful and we think this posture will help spur the venture spirit.

Kunihiro: Audit & supervisory board members at Japanese companies are typically viewed as people who point out deficiencies and errors. But OMRON’s Audit & Supervisory Board plays a very different role. Naturally, we meticulously check to ensure there are no irregularities, which, of course, is a fundamental requirement. But besides that, we make recommendations to the executive team with the goal of enhancing corporate value.

For example, we engage in dialogue with individual organization heads on the executive side. Such dialogues are always two-way and wide ranging. We ask open questions: What is the executive side trying to achieve? How do you want to proceed? What are the issues? What can we, the Audit & Supervisory Board Members, do to support you? The ensuing discussion is typically broad and deep. Recently, we have been receiving positive feedback from executives. They find the discussions inspiring and stimulating. I believe that such initiatives express the

venture spirit of the Audit & Supervisory Board. As I mentioned in last year's discussion among Outside Audit & Supervisory Board Members, although tackling challenges and innovating to advance boldly are integral to management based on the OMRON Principles, my impression is that OMRON employees feel comfortable just chanting the corporate philosophy by rote and sometimes don't translate it into action. This is a drawback of management based on a corporate philosophy. The OMRON Principles are put in a "frame" and hung on the wall instead of inspiring people to take up challenges. Last year, the Audit & Supervisory Board thoroughly discussed this point with Chairman Yamada (then President and CEO) and achieved a higher level of shared recognition. The idea is that, although management based on the OMRON Principles is important, it is not something that should be framed and hung on the wall, but rather it is an unwavering "axis." The concept can be expressed thus: "Transition from management based on a framed corporate philosophy to management based on corporate philosophy as the axis."

The Audit and Supervisory Board is rising to the challenge, and we discuss these matters with the executive side virtually every day.

Uchiyama: A problem arises if the definition of the board of company auditors and the authority of company auditors for monitoring and supervising as stipulated by the Companies Act acts as a constraint. Let me be clear: if the discussion takes its cue solely from the provisions of the Companies Act, we risk losing the venture spirit by failing to rise to new challenges. Laws must be complied with, but our role must go beyond that. It would be a shame to limit our initiatives to strict observance of the letter of the law, because it would inhibit growth.

Kunihiro: Exactly. Whether you are outside officers, company auditors, or directors, you are all expected to fulfill your respective roles in pursuit of the enhancement of corporate value. If you restrict yourselves to a minimal role, the company's development will be impeded. Company auditors are

not allowed to engage in execution. But the law does not prohibit them from participating in vigorous exchanges of opinions at board meetings. In the course of discussion with the executive side from an independent and objective viewpoint, they should express opinions on how to improve performance and offer advice on how to resolve issues. Company auditors have an important role in providing a firm footing for the executives and encourage them to boldly take on challenges. If company auditors do not do this, the company is likely to miss opportunities to enhance corporate value.

Discussion on Management for Further Growth and Expectations of the New Executive Management Structure

Uchiyama: I mentioned earlier the founder's observations about the importance of thoroughly decentralizing power while bringing the top management and the frontline closer, an orientation that has led to the current "high cycle management." Given this orientation, with an eye to OMRON's further growth, wouldn't it be advisable to change the organizational structure underpinning group management so as to increase autonomy and self-sustainability? This is the theme of our current discussion. Though speed is essential for growth, OMRON's current multi-layered decision-making process is a constraining factor. Since this is an issue concerning management from a macro perspective, there has been considerable discussion at meetings of the Audit & Supervisory Board. It is a hallmark of OMRON that such an issue is discussed and shared without being constrained by the framework of the Board of Directors or the Audit & Supervisory Board.

Kunihiro: OMRON has inaugurated a new executive management structure led by President Tsujinaga, and the heads of all business companies have changed. Equipped with this fresh structure, now is the time to unleash OMRON's growth potential, which is the

Group's overarching theme. We have been having dialogues with the new leaders on the executive team. I think the atmosphere is very positive.

At meetings of the Board of Directors, there are additional opportunities for Directors and Audit & Supervisory Board Members (not limited to Outside Directors and Audit & Supervisory Board Members) to put questions to the heads of executive divisions. From the executives, we are not looking for prepared, polished answers reflecting pre-established harmony. In their responses, executives share their concerns and problems, and a process of visualization leads to clarification of the issues that need to be addressed. Reflecting the diverse backgrounds of Directors and Audit & Supervisory Board Members, questions range far and wide, shaped by different perspectives.

Questions may not follow one another in a seamless sequence but are intended to open issues for lively and fruitful discussion. I also feel that grappling with the issues through discussion can lead to innovation that pre-established harmony would prevent.

My earnest desire is that such discussion will foster flexibility and speed within OMRON, enabling the company to respond effectively to circumstances in an era in which the external environment is undergoing rapid change and there is high uncertainty and opacity.

Uchiyama: I would like the new executive management team to prioritize medium and long-term growth, without being tempted or pressured to achieve short-term results or performance targets. Such matters should be pointed out and confirmed at future board meetings and whenever opportunities arise. With overseas sales accounting for more than 60% of total sales, can the executive team establish the OMRON brand globally so that it appeals to local talent, thereby positioning OMRON an enterprise whose organization and operations attract local human resources and facilitate their engagement? When we consider OMRON's growth from now on, I believe this is a key issue.

Kunihiro: Even under the new executive management team, I feel that the culture of "management based on a corporate philosophy put in

a frame” lingers. Clearly, everything isn’t OK simply because we have the new management team, including new business company heads. OMRON must continue its drive to achieve “management based on corporate philosophy as the axis.” How can we change the rigid old mindset that remains like bedrock into something malleable and moldable, while continuing to enjoy the benefits of management based on the OMRON Principles, so that excellent human resources can bring their capabilities into full play and take on the challenge of growth? We must consciously work on this.

Principles of Conduct for OMRON Audit & Supervisory Board Members Established Setting the Pace with “Audit 3.0”

Kunihiro: In December 2022, four members of the Audit & Supervisory Board held discussions and established the Principles of Conduct for OMRON Audit & Supervisory Board Members, which defines the roles and the behavior expected of OMRON’s Audit & Supervisory Board Members. In other words, it documents what we have been practicing and describes our vision. The first item reads: “We not only conduct compliance audits (Audit 1.0) and point out deficiencies; but also conduct risk-based/internal control audits (Audit 2.0) and state our views; and conduct management issue audits (Audit 3.0) and provide advice.” This is the nature of audits at OMRON. We, Audit & Supervisory Board Members, will continue to evolve the Audit & Supervisory Board in the runup to “Audit 3.0.”

Uchiyama: I believe that proactively communicating our views on the evolution of the Audit & Supervisory Board and the initiatives we are implementing, not only within OMRON but also to external parties, will ultimately lead to the enhancement of OMRON’s corporate value. In view of our pivotal role in the context of Audit 3.0, in taking action we should always be mindful of this contribution. This is what we intend to do.

Regarding the audit stance, the Principles of Conduct for OMRON Audit & Supervisory Board Member states: “In a spirit of “throwing stones to make waves,” we question conventional wisdom inside OMRON from diverse perspectives, including those of stakeholders.” I believe this is the starting point for constructive communication between us, Audit & Supervisory Board Members, and our counterparts within OMRON as we endeavor to contribute to the enhancement of corporate value.

Kunihiro: Of course, those who throw stones are responsible for their actions, and the promotion of initiatives also entails responsibility. We, Audit & Supervisory Board Members, are not at risk as long as we quietly do the minimum required by law during our term of office, but we must ask ourselves whether that would be in the best interest of the stakeholders. Hence, Audit & Supervisory Board Members should take calculated risks and rise to the challenge.

Uchiyama: For future audits, we need to deepen our initiatives in cooperation with the Internal Audit Division. How best to establish an internal audit system is a major concern, especially as OMRON is expanding its business globally.

Kunihiro: The reality is that collaboration with the Internal Audit Division is still in its infancy and dealing with the issue of establishing Group governance will take time. With the support of the Audit & Supervisory Board, the Internal Audit Division is striving to transition from its traditional activity of pointing out deficiencies to risk-based audits, improvement opinions, and advice. In regard to the evolution of the Audit & Supervisory Board, reinforcement of the organization needs to proceed in parallel with the change of the mindset.

Uchiyama: Today’s discussion centered on our views and what we do, touching on issues ranging from the venture spirit to the evolution of the Audit & Supervisory Board. Although, among OMRON’s various organizations, the Audit & Supervisory Board is the one whose members’ average age is the highest, we are eager to take on challenges.

Kunihiro: Through this discussion, I have realized afresh that our initiatives should aim to shatter the conventional image of the Audit & Supervisory Board and reveal what its objective should be, namely, to enhance corporate value. For my part, I will continue to do my utmost to contribute to the ongoing evolution of the Audit & Supervisory Board, together with Mr. Uchiyama and the full-time Audit & Supervisory Board Members.

<Principles of Conduct for OMRON Audit & Supervisory Board Members>

Audit & Supervisory Board Members shall strive for self-improvement, be trustworthy at all times, uphold high ethical standards, and conduct themselves with humility.

1. We not only conduct compliance audits (Audit 1.0) and point out deficiencies; but also conduct risk-based/internal control audits (Audit 2.0) and state our views; and conduct management issue audits (Audit 3.0) and provide advice.
2. We emphasize listening attentively, dialogue, and empathy,
 - (1) Ask questions with curiosity and discuss freely and openly.
 - (2) Express opinions vigorously, including harsh ones, and be persistent.
 - (3) Strive for objective, fair, and impartial discussion and opinions based on data and evidence.
3. In the spirit of “throwing stones to make waves,” we question conventional wisdom inside OMRON from diverse perspectives, including those of stakeholders.
 - (1) Insight into the true causes and issues, not just the surface of things
 - (2) An inquiring mind based on a healthy skepticism that does not accept the status quo
 - (3) Assumption that there are two sides to everything (light and shade)
4. We promote behavioral changes in management that will enable future-oriented, transparent, fair, swift, and decisive decision-making.