CORPORATE GOVERNANCE

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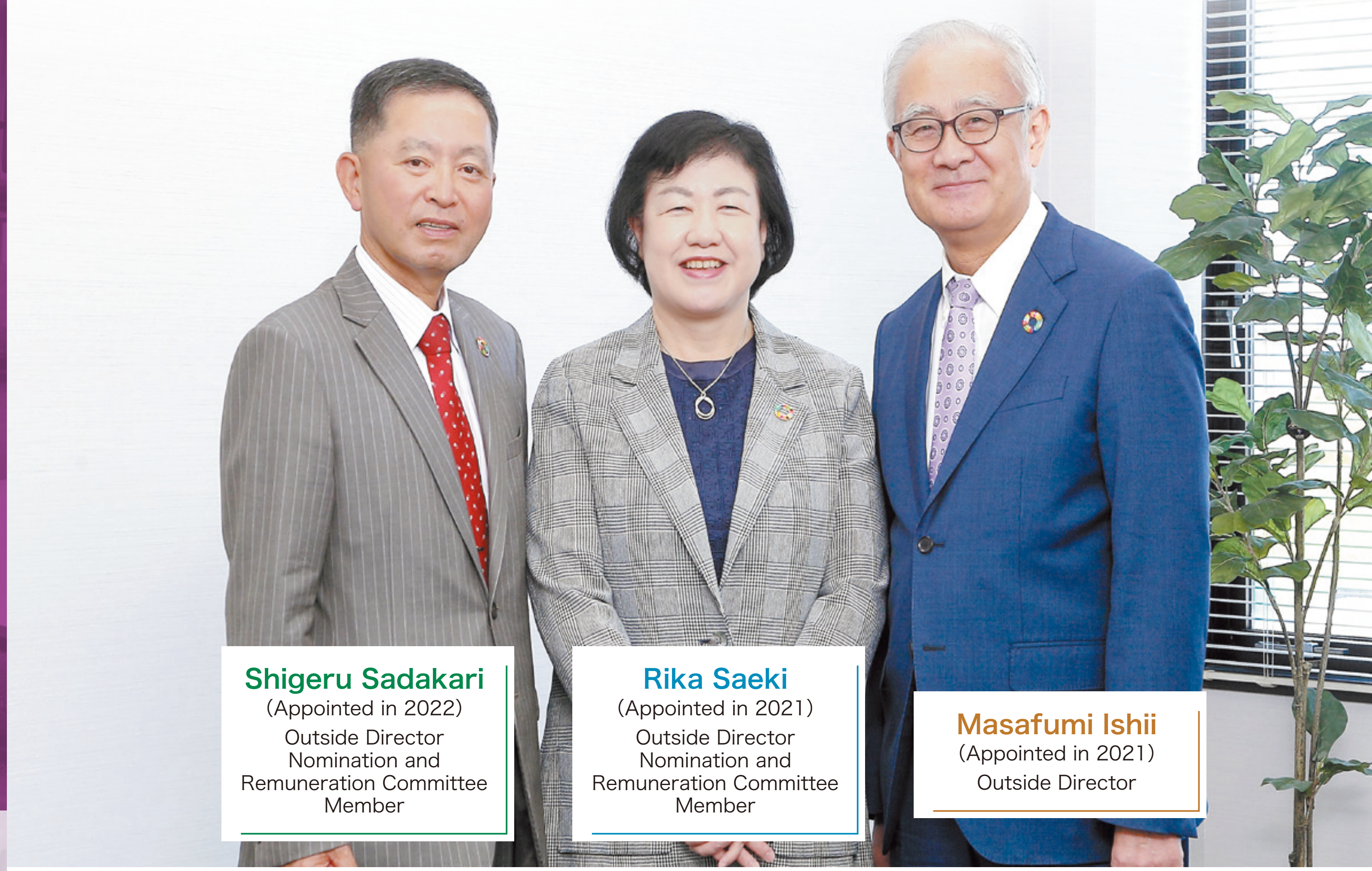
05

Initiatives for Achieving 2030 Vision and Improving Corporate Value

At Nikko, we have positioned the 2024 Medium-Term Management Plan as the investment phase for achieving 2030 Vision, aiming for business expansion from FY2025. The three outside directors of the Company discussed how to monitor the initiatives aimed at realizing the 2030 Vision as well as the effectiveness of the Board of Directors (held in August 2023).



Shigeru Sadakari
(Appointed in 2022)
Outside Director
Nomination and Remuneration Committee Member

Rika Saeki
(Appointed in 2021)
Outside Director
Nomination and Remuneration Committee Member

Masafumi Ishii
(Appointed in 2021)
Outside Director

Effectiveness of Board of Directors and quality of discussions

Sadakari: From the current fiscal year, there are three outside directors, and the percentage of outside directors on the Board of Directors is slightly down from 44% last year. Outwardly, it looks as if the Board of Directors' independence has come down, but including the three outside Audit & Supervisory Board members there are six outside officers, who have been able to oversee the management based on their respective experiences and insights. So, I feel there has been no substantial changes to its independence.

Ishii: Some of the Outside Audit & Supervisory Board members have experience in managing manufacturing enterprises, and the percentage of outside officers including them is 46%, close to half, which I think is an adequate level of independence. The six outside officers, more than half of whom have experience in managing organizations including companies, also possess specialized knowledge in ICT, finance, global matters, financial accounting, and legal and risk management. So, there is sufficient diversity. As for quality of discussions, outside officers express their views freely and actively without pandering to the management, and fulfill the function of management supervision in my opinion.

Saeki: Two years have passed since I was appointed as the first female director of Nikko. From this fiscal year I am also a member of the Nomination and Remuneration Committee. There are also meetings for outside officers to exchange opinions with Audit & Supervisory Board members and opportunities for outside officers to exchange information with executive officers who supervise the business divisions. The Company also holds preliminary briefings of the proposals to be presented to the Board of Directors meetings, which is a progress in term of establishing an environment for us to gain information useful for decision-making discussions prior to the Board of Directors meetings. At the time when I was appointed, I used to be given a large volume of materials just before the Board of Directors meetings, which was often difficult to process fully, but now I have a deeper understanding of the issues faced by Nikko, and I am able to proactively suggest a path to solving them from an outside perspective.

Sadakari: Regarding the improvement in the independence of Board of Directors sought by shareholders and investors, from a long-term perspective, I don't think it will be a problem for Nikko if outside directors have a majority. Even now the major part of decision-making discussions is carried out by the president, chairman, CFO, and the outside officers including Audit & Supervisory Board members. Internal directors responsible for the execution of specific businesses have a thorough discussion at the executive officers' meetings in advance, so they sometimes tend to make the same statements at the Board of Directors meetings. I believe that the best decision can be made through discussions from an outside perspective over whether there are any overlooked risks and whether there are any other options, after proposals are refined by the management and presented to the Board of Directors.

Ishii: A simple question from an outside perspective often triggers further discussions. The rising global inflation following Russia's invasion of Ukraine meant that the precedents set under the deflationary economy so far are no longer applicable, and proposing flexible pricing strategies in response to rising raw material and labor costs will not work with a deflationary mindset. There have been many situations where outside perspectives and ideas provide new insights during significant changes. I feel mutual trust has grown as the Company responds to outside officers' questions and views and the management provides appropriate answers.

Saeki: To be honest, right after my appointment, I had the impression that the Company was a male-centered organization as I could not see any female faces. Recently, I have had an opportunity to directly talk with a group of female employees and I was able to listen to various requests from them. I reported the outcome of the meetings at a Board of Directors meeting, and made suggestions regarding work style of female employees and their fair evaluation. The Company has already embarked on promoting flexible workstyles and revising the personnel evaluation system, although this is not an easy task as it requires a change in the prevailing mindset. Active participation of women is indispensable for revitalization and growth of the organization and I am looking forward to definitive actions on this high priority theme. I would also like Nikko to actively promote hiring of foreigners, but providing support to their families is imperative for them to play an active role. It is also necessary to raise understanding regarding LGBT community and be considerate of religions, so I would like to strive to foster a corporate culture that embraces diversity and inclusion.

Ishii: It may take some time before we see natural born female managers, but the ratio of newly hired female graduates and female mid-career hires has increased, and the Company also has built an impressive dormitory for female employees. The Company will also need to hire talented international students from countries such as Thailand, Indonesia, and Vietnam in order to accelerate the expansion into Southeast Asia. I would like Nikko to consider increasing personnel exchanges with overseas bases in order to develop a workplace where diverse employees can demonstrate their abilities to the fullest.

Sadakari: Ensuring diversity is indispensable for sustainable improvement of corporate value. So, it will be good to increase cross-border learning opportunities including interactions with a different culture also for Japanese employees. While classroom-based programs such as language training have been put in place, you learn more things through actual experiences and therefore it is necessary to firmly nurture the soil for fostering global human resources through actual practice at overseas bases. With the source of growth shifting to overseas markets, I am looking forward to that as a pillar of the human resources strategy. As for the quality of discussions at the Board of Directors meetings, we set aside time for continuous deliberations to repeatedly report on important management issues, and also discuss new measures. The Board of Directors continuously deliberates on the important issues and risks disclosed in the notice of convocation of the general meeting of shareholders and securities report to ensure awareness of the issues.

Ishii: Accurately understanding the progress in important management issues is indispensable for overseeing management. Since initiatives for eliminating occupational accidents and the progress of DX are taken up as subjects for continuous deliberations with detailed progress reports, outside officers also have a grasp of the overall picture, and this leads to deep discussions on measures necessary for the next stage. Saeki: The progress of DX is followed up in detail as a subject for continuous deliberations so that it can be discussed thoroughly at the Board of Directors meetings. We cannot have individual discussions regarding Nikko's DX without understanding the actual situation, even if we can offer general opinions. The information gap between the inside and outside directors is reduced through preliminary briefing of agenda items and initiatives on subjects for continuous deliberations.

Sadakari: From the current fiscal year, Nikko has started regular interaction of executive officers supervising business divisions with outside officers as part of efforts to reduce the asymmetry in information between management and outside officers. This is an attempt to confirm the progress of concrete initiatives and receive suggestions and advices from outside officers in order to achieve the 2030 Vision and the 2024 Medium-Term Management Plan goals. I hope it will be implemented in a way that is beneficial to both sides in order to achieve the medium- to long-term management goals.

Ishii: I would like to thoroughly understand its processes as well as the reports of its results so as to be able to discuss the progress of the medium- to long-term management goals. I can now listen to the people who are in charge of executing measures that are successful or are facing new challenges, so I believe I am now able to express opinions that are more to the point. In February this year, the six outside officers visited the production site in Thailand with the aim of understanding the situation at overseas subsidiaries as accurately as possible for future discussions of strategies. Achieving profits at the Thai subsidiary, which is at the core of the ASEAN business strategy, is an important task that we cannot afford to overlook for achieving the long-term targets. We interviewed local Thai staff there to grasp the actual situation. The subsidiary employs many foreign workers including Cambodians, and we have understood that the impact of the COVID-19 pandemic, which restricted the flow of people, was greater than imagined.

Sadakari: The way public works are carried out there is different from that in Japan, and we had been told that simply following the Japanese way of doing things will not work well. Hearing directly from local staff enabled us to deepen our understanding of the business environment. Labor market is also different from Japan, so it is necessary to aim for early profitability by raising the competency of human resources management.

Saeki: As a new initiative that began in the current fiscal year, there is a forum for outside officers to exchange opinions. The full-time Audit & Supervisory Board member also attends as an observer, and the seven people responsible for audit and supervision of management will now be holding regular discussions. As for the sharing of information and issues, in addition to the meetings between the president and outside officers that are held for some time, steady progress is being made in developing an environment that serves as a monitoring board such as meetings between outside and executive officers and preliminary briefings of agenda items.

Ishii: Personally, the details I hear in meetings with the Audit & Supervisory Board members are really helpful. I am now able to confirm minute details on individual issues being faced.

Role of the Nomination and Remuneration Committee

Sadakari: Two years have passed since the establishment of the optional Nomination and Remuneration Committee, and I think it is now in the development phase. The achievements so far are that the Company has started discussions on what the design of officers' remuneration system should be, and that there is a mechanism in place now for committee members to express their opinions freely on the appointment of executive officers or directors in response to proposals from President Tsuji, the chairperson of the committee. Issues are that sufficient discussions are yet to be held regarding how to align corporate value improvement with performance-based remuneration and that there are fewer opportunities for committee members to interact with manager-level employees who are candidates for executive officers.

Saeki: It has not been long since I became a committee member, but I would surely like Nikko to increase opportunities to have contact with executive officer candidates. Regarding nomination of the next CEO also, I feel there is a need to deepen the discussions bit by bit as to what method is the best for Nikko to raise its corporate value in a sustainable manner.

Sadakari: At present, the main evaluation indicator for officers' remuneration is the consolidated operating income. I feel there is a tendency now to emphasize quantitative evaluation including single-year sales performance of not only officers but also employees. I think it would be good to consider steady initiatives towards GX and DX from the medium- to long-term perspectives and the efforts to improve employee engagement and other such measures as axes of evaluation. Financial performance for a single year does have the advantage of being easy to understand as an evaluation indicator, but personally I would like to make changes so that we can evaluate the steady planting of seeds for the future and progress of structural reforms. The outside members of the Nomination and Remuneration Committee also have changed and I would like to carry out deliberations with responsibility and awareness so that I will be able to say with confidence that "These are the findings of the committee" regarding remuneration and nomination.

Monitoring towards achieving Vision 2030 goals

Saeki: Progress of DX is also a topic for continuous deliberations and therefore I monitor it closely. As a result of Nikko having adopted separate IT tools for each division, there was a delay in information sharing between divisions using differing tools. In order to improve that situation, the Company is building an IT platform called One Nikko Platform that can be used in common globally. It allows information to be shared across the entire value chain of Nikko Group, streamlining operations and increasing the speed of customer service. I also have expectations regarding reduction of overtime and promotion of flexible workstyles, and these are imperative for achieving the 2030 Vision.

Ishii: In overseas business, I am paying attention in particular to the implementation status of the ASEAN strategy centered on Thailand. I am also looking at the Company's forays into Vietnam, where the population exceeds 100 million, and Indonesia, which has a large market, by leveraging the production base in Thailand. While trying to make the Thai subsidiary profitable quickly, it is also necessary to continuously invest in the surrounding countries. The key to ensure success, of course, is human resource development. In addition to language skill acquisition by Japanese employees, I would like to see Nikko establish a nurturing program in a systematic way including hands-on training at the overseas site. Focus should be on hiring and education as active participation of foreign employees is also indispensable. I expect the Thai business model to have established itself with prospects of entering into Indonesia by the final fiscal year of the 2030 Vision.

Sadakari: I am also paying attention to the efficiency of the domestic business and return on invested capital in terms of monitoring the progress of 2024 medium-term plan and 2030 Vision. I would like to see Nikko break out of the situation where it cannot become the price leader in Japan although we face limited competitors and hold a 70% share of the market. Though the Company is implementing measures such as standardization of plants, the problem is that it is not receiving adequate compensation for meeting the customization demands. Strengthening the profitability of the domestic business is essential also for continuing the investments in the growing Asian markets. Towards achieving the ROE target of 8%, people will become more conscious of capital productivity in the operation process if invested capital and capital efficiency are managed by individual business divisions.

Saeki: Human resources strategy linked to management strategy will become important for achieving the targets of 2030 Vision. In the past two years, Nikko has improved personnel system and leave management system, and I recognize that it is making some progress, but there is still significant room for improvement. It is especially necessary to change the workstyle, including for male employees, by establishing a flexible and employee-friendly work environment where female employees, who could be temporarily restricted due to life events, will be able to demonstrate their abilities fully. Active participation of senior employees is also indispensable and therefore I would like Nikko to focus on health management so that employees can work long and healthy. I would like the Company to work on improving health literacy of managerial staff and employees. When you think of expansion into Asia, strengthening hiring of foreign employees also should be given importance from the perspective of human resource strategy.

Sadakari: Contributions to carbon neutrality is an important challenge in Nikko's sustainability strategy, and therefore it is necessary to steadily lay the groundwork including technological innovations. I look forward to Nikko making major contribution towards solving the issues in the environmental field given its position as a pioneer of the resource recycling economic model in recycling asphalt and concrete waste. If the Company can communicate its cutting-edge initiatives in carbon neutrality and resource recycling more to the stakeholders, it would generate more interest in Nikko. Active public relations activities have helped in increasing exposure in local media, and the Company's presence in the local community has grown. I would like to see the circle of communication expand from Hyogo prefecture to the Kinki region and further to the entire nation.

Ishii: Conducting business in emerging nations is accompanied by unforeseen risks such as political uncertainties and supply chain confusions. It is important to prepare countermeasures in advance assuming all kinds of situations. Currently Nikko has two business bases: Shanghai in China and Thailand. Extending these points into lines, and then to expand them to a wider area will, in my opinion, help in dispersing the risks.

Saeki: The Company will have to further bolster the service division if it is to increase profitability. In addition to offering the next-generation preventive and predictive service based on DX at a fixed rate, raising customer satisfaction through close collaboration of sales and service using the One Nikko Platform is also indispensable for boosting profitability. If remote operation of plants in Asia can be carried out from Japan, it could lead to improvements in customer convenience while also reducing operation risks. I believe Nikko's risks and opportunities lie in DX, GX, and overseas markets, and therefore I would like to contribute towards achieving the goals of the 2030 Vision by controlling the risks and supporting the acquisition of business opportunities.

Basic approach

Nikko positions corporate governance as "the management governance function for maximizing corporate value for our shareholders and other stakeholders." Under the Executive Officer system built upon the Board of Directors and the Audit & Supervisory Board, we endeavor to clarify management accountability, speed up business execution, increase the transparency of management decision-making, and strengthen compliance in order to ensure sound business management.

Reason for adopting a corporate structure with the Audit & Supervisory Board structure

The Company's decisions based on the on-site situation are made in an appropriate manner by human resources who understand and are capable of putting into practice the Nikko Group's Management Philosophy. We have set the term of directors and executive officers as one year to clarify management responsibilities while striving to separate the execution and supervision of duties. Further, Nikko appoints three outside directors as independent officers to enhance corporate governance. The three Outside Audit & Supervisory Board members are respectively a person with management experience, a certified public accountant, and a lawyer and are well-versed in the contents of Nikko's business. They closely cooperate with the outside directors, full-time Audit & Supervisory members, and Internal Audit Division to provide appropriate advices and thus ensure the objectivity and neutrality of management and supervision functions.

Governance structure

Nikko is a company with the Audit & Supervisory Board. To smoothly execute business, we have a committee of internal executives and other various committees as consultative organs for the President. A full-time Audit & Supervisory Board member and relevant staff members of Internal Audit Office attend the meetings of these committees.