

# Realizing an Effective Monitoring Board

OSG believes it is essential that corporate governance functions be enhanced so that value may be created through appropriate efforts to address environmental and social challenges as well as effectively utilize capital. Four outside directors gathered for a candid discussion about the achievements and challenges of OSG's corporate governance reform.



Member, Audit & Supervisory Committee chairperson, Nomination and Compensation Committee **Akito Takahashi**  
 Member, Audit & Supervisory Committee vice chairperson, Nomination and Compensation Committee **Kunihiko Hara**  
 Member, Audit & Supervisory Committee Member, Nomination and Compensation Committee **Kayoko Yamashita**  
 Member, Audit & Supervisory Committee Member, Nomination and Compensation Committee **Yoshitsugu Hayashi**

## Outside Directors' Expertise and the Diversity of Skills & Composition of the Board of Directors

**Takahashi:** Based on my experience as an attorney and outside director at other companies, I provide advice and supervision so that the Board of Directors may address risks and contribute to sustainably enhancing corporate value. Independent outside directors make up the majority of OSG's directors, and I feel that we work to reflect external perspectives in decision-making. The composition of the seven board members provides a foundation that, I believe, sufficiently ensures a diversity of skills among the members of the Board of Directors.

**Hara:** Having served as a director for companies in the manufacturing industry and a private research institute, I currently teach at a university. Making use of my experience in both academia and corporate practice, I believe I am able to play a role in ensuring OSG's management spearheads a robust boost in corporate performance as well as the fulfillment and happiness of company employees. I also think the skills maintained by each of the seven directors work in harmony without any overlap, enabling fair and impartial decision-making.

**Yamashita:** While practicing at an audit firm and accounting firm where I principally provided consulting services, I discussed corporate internal controls with many managers and saw firsthand their limitations. I believe the backgrounds of the current outside directors are effective from the perspective of complying with laws and regulations as well as maintaining internal controls. However, none of the outside directors is a currently serving manager. From the perspective of the Board of Directors' diversity, I feel we would be able to have more extensive discussions about an offensive stance as well as adopting defensive governance if we had an outside director who has experience akin to an executive officer, focusing on corporate management.

**Hayashi:** At university, my research focused on civil engineering and transportation systems. I also have an experience serving as an outside director at an electrical equipment manufacturer. Currently, I am also taking part in activities of the Club of Rome, a private think tank headquartered in Switzerland. I hope my experience and knowledge contribute to supporting and overseeing OSG's sustainability management.

## Nomination and Compensation Committee's Functions and Roles

**Takahashi:** I feel the trust in OSG's founding family and its unifying force are one of the company's sources of strength. In that context, it is by no means easy to stipulate specific criteria for determining whether there should be a change in management. On the other hand, it is good for the Nomination and Compensation Committee to present to stakeholders the basic approach that we are taking. I hope to discuss this issue in more detail with the other members of the Nomination and Compensation Committee. At the current point in time, I believe the company's leadership succession plans should first strive to augment a system capable of raising the level of managerial personnel, including at overseas businesses, rather than focusing on and developing only a small number of specific candidates.

**Hara:** It is a plus having the founding family heading up management not just at OSG but all companies in terms of maintaining trust with society. In that case, it is important shareholders and investors are able to see that personnel decisions are made in a fair and transparent manner. It is significant that the Nomination and Compensation Committee engages in discussions to set out its vision and qualities desired for senior management worthy of leading OSG, and share these results with the management team. Once this information is widely circulated, then, I think, it will also be positive for prospective executives as it details what sort of qualities they should acquire.

**Takahashi:** Consolidated operating income is set as a short-term incentive for determining officers' compensation. I believe it also aligns with the perspective held by shareholders. Some companies have also started to add an ESG-related metric to indices for performance-linked compensation. However, there are also concerns that such a metric may appear to be an arbitrary indicator used because it is easily attainable for the company. So, I believe we should continue to prudently discuss ways of reflecting non-financial metrics in incentive compensation.

**Hara:** I feel that it is somewhat difficult at present to directly link ESG efforts to management compensation incentives. ESG management does not necessarily produce results that have a direct bearing on operating income in the short-term. Also, at the beginning of the term, numerical targets for each aspect of ESG management need to be set out and a commitment made to achieve these targets so that such performance may be linked to compensation. I believe the Board of Directors needs to discuss how to translate all ESG management initiatives from policy management to target management.

**Yamashita:** Consolidated operating income is a very objective metric that I recognize as reasonable and easy-to-understand. Nevertheless, as capital efficiency is called for, it may be worth considering adding ROE as a metric. I think the question of whether to incorporate an ESG-related metric poses the issue of how objectively and reasonably the metric can be presented. At this stage, it is too early to incorporate such a metric when the issue is also viewed from the perspective of accountability to stakeholders.

**Hayashi:** A transition is steadily taking place as society transitions from the pursuit of economic efficiency, which is expressed as the ratio of sales to expenses, to the era of personal sufficiency, which emphasizes the ratio of well-being to the burden placed on our earth. Sustainable growth cannot be said to be achieved if large quantities of greenhouse gases are emitted, placing a burden on society and the environment, despite short-term profits being maximized. We probably also need to consider an OSG-specific metric that will measure social value as it leads to the generation of new corporate value. If we can objectively show enhancements in the well-being of stakeholders including employees, then I think such metric will also be effective as a long-term incentive metric for executive compensation.

## Audit & Supervisory Committee's Functions and Roles

**Yamashita:** One non-executive inside director and four outside directors sit on the Audit & Supervisory Committee. In order to evaluate whether appropriate risks are being taken in overseas M&A and other transactions, the committee would be able to make more multi-tiered judgments if the committee included among its members a non-Japanese individual with knowledge about global management or currently serving manager as I mentioned earlier in the discussion. There are also challenges in auditing subsidiaries overseas, so the global audit structure needs to be enhanced through closer coordination with the internal audit department.

**Takahashi:** There might also be aspects that are difficult for outside directors to directly grasp about the degree of overseas group companies' enthusiasm for internal controls. I feel the OSG Group needs to first build trusting relationships with local managers and, at the same time, maintain a system that checks their functions. Along with improving internal audits, there may also be room to consider incorporating financial and legal AI tools that make it possible to detect signs of fraud in addition to

employing external audits.

**Hara:** As an outside director that is also a member of the Audit & Supervisory Committee, I believe I am able to function fully as an advisory board member. However, if I limit my role only to advising the management team, then investors may view that as a sign we have been unable to extricate ourselves from the advisor mindset. I feel we constantly need to be aware of this. With regard to audits of overseas group companies, we need to continually monitor them so as to uncover any inconvenient truths and share these not only with the Board of Directors but also employees. Actively sharing and disclosing potential risk factors will deter wrongdoing and strengthen internal controls.

**Hayashi:** We also need to think about appointing a non-Japanese individual capable of expressing their views from a perspective different from the Japanese way of thinking or a Japanese individual who has been educated outside of Japan to serve as an outside director capable of conducting global audit work. If AI tools or other devices need to be used to conduct audits, then that individual would also be required to have knowledge about IT and AI in addition to auditing expertise.

## Capital Efficiency and Growth Strategy

**Takahashi:** While the necessity is fully understood of further raising awareness about the cost of capital and maximizing corporate value, I believe that what OSG, a cutting tool manufacturer, requires first and foremost to continue to steadily perform its work is to determine daily what customers need and make several minor refinements that will end up improving our products. To take off only in pursuit of short-term profits by, for example, drastically reshuffling the company's business portfolio or making an extreme change is not something, I think, that would instantly fit within OSG's current culture. Under such circumstances, I believe Repurchase of Shares by issuing Convertible Bonds, which were recently issued, and treasury stock acquisition are avenues for OSG to respond in a way that shows we are conscious of the cost of capital.

**Hara:** PBR, a metric for assessing corporate value, is essentially an indicator measuring the tireless efforts of management. ROE may conversely weaken a company's financial standing if it exceeds a certain level, so I am wary about feeling optimistic or pessimistic in response to such figures alone. Basically, I believe it is important to always focus on creating high-value added products and services, which is the right path for a company to take. The development team needs to talk with the sales department to set out a clear R&D policy and, at the same time, make an active effort to develop new products and services.

**Yamashita:** The purpose behind issuing Repurchase of Shares by issuing Convertible Bonds was to improve ROE. But, if that's all it is, then any effect will naturally diminish after a certain period of time passes. I believe that, as a manufacturing company, maintaining overwhelming product appeal and continuously supplying the products society demands will result in sustainably generating value that exceeds the cost of capital. I am in favor of investing more in researching and developing new products and services.

**Hayashi:** ROE is also an important metric that affects PBR. In addition, the ability to offer solutions to environmental and social challenges, which is also required by the TCFD and TNFD disclosure frameworks, significantly affects corporate value. At a time when the true worth of sustainable corporate activities is being called into question, I hope the positive effects that products and services have on the environment and society will be actively presented and communicated to shareholders, investors, and all stakeholders as being added value that OSG Group provides.