Provisional Translation

Opinion Statement for the 23rd Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

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１，Solving problems with parent-subsidiary listings by establishing disciplines for protecting minority shareholders

As I have pointed out earlier, it is meaningless to formally regulate parent-subsidiary listings. <u>Fundamentally, problems with parent-subsidiary listings arise when a parent company, which is the controlling shareholder of a publicly-listed subsidiary, exerts management influence, including the exercise of its shareholder rights, for its own benefit. The essence of the problem is conflict of interest that may arise concerning the protection of common interests of shareholders of the subsidiary and interests of minority shareholders.</u> Essentially, if effective disciplines have been stipulated for preventing controlling shareholders from taking on any behavior that may give rise to conflicts of interest, parent-subsidiary listings in terms of the form itself does not need to be considered problematic.

With respect to conflicts of interest, all countries which have decent capital markets have some kind of strict disciplines. The fundamental solution for the problems with parent-subsidiary listings in Japan would be the introduction of similar disciplines. Conflicts of interest are structural and objective problems, and, in this light, there is no room for using the uniqueness of Japanese corporate culture as an excuse.

<u>First of all, it should be clearly defined that controlling shareholders of listed companies should have fiduciary responsibilities to minority shareholders to the same extent as directors do. Furthermore, in order to ensure the effectiveness of this discipline, the board of listed companies with controlling shareholders (with ownership ratio of roughly 30% as a guideline) should be required to appoint independent directors representing a majority of the board. Conversely, if these two points are appropriately disciplined, there are sufficient measures to prevent conflicts of interest, so there is no need for restricting the form of parent-subsidiary listings itself.</u> While the business community is concerned about the cases of parent-subsidiary listings that arise in the process of spinning off a business with high potential, or that arise in the process of restructuring the business portfolio, these disciplines will not preclude such cases, so there is no need to worry.

２，Disclosure that facilitates a paradigm shift related to human resources investment (the era of developing human resources with high market value)

“Japanese-style management places importance on the employment as well as human resources” Such an ethos has been much discussed. However, in reality, human resources investment by Japanese companies is clearly smaller than that in many other advanced countries. Furthermore, according to various comparative studies concerning employees’ engagement and loyalty in their companies, Japan’s scores are generally behind those of many other advanced countries. On the other hand, according to some corporate management surveys, as for the ratios of those who stated that they place the top priority on employment and human resources, corporate managers in Japan marked higher percentages. It is naturally difficult to make a simple international comparison, yet it is clear that there is a considerable mismatch between perceptions of the management and employees of Japanese companies, indicating that currently, Japanese companies are not necessarily successful in motivating their human resources and unlocking their potential.

As mentioned above, Japanese companies make smaller investments in human resources, and there is a gap in the perception of the relationship between companies and their employees. Such a situation is a serious problem in the midst of the paradigm shift to the knowledge-based industries and the management of intangible assets, where talent is the source of corporate value creation.

When I was studying at Stanford University in 1990, Japanese companies used to dispatch a large number of employees to the US and Europe universities to study an MBA program, etc. However, a significant percentage of those who studied abroad, after returning to Japan, left their companies for other jobs. In response, many personnel officers of large corporations told me, “Once they obtain degrees or qualifications, their market value increases, and it becomes easier to find another job. We don’t have to learn from Europe and the US anymore, so we should abolish the study-abroad program,” “The retention ratio of those who passed the bar exam, like Mr. Toyama, is low, so actually we don’t want to hire such people,” and “To develop human resources, it is the best to provide OJT in the world’s strongest Japanese companies.” I clearly remember such remarks.

However, after that, we saw changes in the industrial structure, non-linear changes triggered by disruptive innovation, and the dawn of a game-changing era. Consequently, the Japanese model of human resources development, which places an excessive emphasis on OJT and skills for exclusively internal purposes, faced a big hurdle. Companies reached the limit of capabilities of organizations and talent. In various industries, Japanese companies have been forced to experience a setback. The analogy is like this: They developed baseball players in a baseball-only environment, and improved their skills for managing the baseball team, but alone with such efforts, they were no match for competitors in games of newly-emerged football and tennis, and such fields as animation, and R&B dance.

In Western companies, most part of high-level human resources investments is dedicated to developing key attributes that can be shared on a cross-company basis or advanced capabilities that are valued by the market, along with the acquisition of advanced knowledge or highly skilled talent. This is inevitable in such trends as the shift to knowledge-based industries, shift to Software Defined Society, and digitalization. In such trends, human resources with high potential tend to concentrate in such companies that make extensive human resources investments and provide growth opportunities so that they can increase their market value. It is natural that excellent human resources have more opportunities for job mobility, and it should not be blamed.

Meanwhile, in Japanese companies, human resources investments are still governed by the inertia of such traditions as lifetime employment and seniority system. Consequently, many companies still stick to traditional in-house education like OJT. Within a company, this system creates a large cluster of employees whose value is appreciated exclusively by the company; this also has the negative effect of making it harder for the company to implement dynamic restructuring of its business portfolio and functional portfolio that transcend existing company boundaries.

Japanese companies are far behind leading companies in the US and Europe in terms of what the companies and their human resources are in the new era. In this regard, we should consider such a measure that either the Corporate Governance Code or the Disclosure Guidelines imposes stricter disciplines concerning human resources investments and human resources management than Western standards, and requires them to disclose information that is comparable with other companies from the viewpoint of investors and human resources market inside and outside the company. Such disclosure would reveal the old-fashioned seniority system, Japanese male domination, favorable treatment of those who joined the company as new graduates, small investments in human resources development, etc. Accordingly, on the premise of the “culture of shame” in Japan, we can expect that companies’ initiatives for improving/reforming such situations, or transformation will be accelerated.