

VIII. Corporate Governance

Roundtable Discussion among Outside Directors



Fumitoshi Sato
Audit Committee Chairperson

Takeshi Itoh
Nomination Committee Chairperson

Mitsuhiro Nagahama
Remuneration Committee Chairperson

To improve transparency and soundness of management

Azbil Corporation, which transitioned to a company having a three-committee Board structure in June 2022, strives to improve the transparency and soundness of management through the Board of Directors, of which the majority are outside directors, and the Nomination, Audit, and Remuneration Committees, which are led by outside directors. It has been one year since the new organizational structure was inaugurated. The three outside directors who chair the three committees speak about how the separation of supervisory and business execution functions has progressed, what discussions are taking place at Board meetings, and what issues have emerged.

—It has been one year since we transitioned to the new company structure. How do you evaluate the changes during this period?

Increasing the density of information needed for decision-making and deepening discussions

Itoh: The new organization clarifies the supervisory function of the Board of Directors, which basically delegates overall operations to the executive side, led by the president, while important issues are discussed by the Board.

Sato: I believe that a great deal of authority for matters related to the execution of business operations has been delegated to the executive side. As a result, the Board of Directors has been able to spend more time discussing major management issues such as the medium-term plan, corporate strategy, risk management, and sustainability strategy.

Itoh: Regarding medium- and long-term management plans and domestic and international strategies, the president

reports directly to us, and the Board of Directors thoroughly discusses what opportunities and risks will arise in the future, adding our knowledge to those of the azbil Group.

Sato: In discussing such major issues, since outside directors make up the majority of the Board, there are more opportunities to provide the information necessary for decision-making in advance. In addition, the Liaison Meeting for Directors and Corporate Executives is held almost every month to exchange opinions with the corporate executives. These opportunities for various brainstorming sessions are very meaningful, and I feel that the substance of the discussions is gradually deepening.

Nagahama: I believe that such advance briefings and meetings between corporate executives and directors are effectively functioning as measures to ensure a smooth transition to the new company structure.

Itoh: At the same time, we are also strengthening our initiatives designed to invigorate deliberations by, for example, having a meeting of eight outside directors after each Board

of Directors meeting, where one of them chairs the discussion on a specific theme. I believe it is valuable to further define the roles of each committee and form a more efficient Board of Directors through such discussions in the future.

—As the effectiveness of the director's supervisory function is being requested, what kind of deliberations are being promoted by the Board of Directors?

It is important to discuss the rules of governance.

Sato: Following the change in the organizational design, our first step was to confirm to what extent the authority for business execution would be delegated to the corporate executives, and what we, the directors, would discuss and judge. Of course, the basis of the Board of Directors is to understand the current status of the business portfolio, monitor medium- and long-term strategies, and evaluate the performance of the CEO and corporate executives, etc. I also feel there are still some points to be discussed, such as that we must consider the extent of a director's duty of care under the Companies Act.

Nagahama: What I emphasize is a governance framework. For example, when a loss is unavoidable due to an unforeseen defect in a product, the conventional Board of Directors discussion would focus on the individual issue of the product in question, such as “why, in what process, and how the defect occurred” and “how to minimize the loss.” Under the new structure, while such individual discussions are, of course, important, the main focus of deliberations will be on the overall governance, such as whether unified and consistent management rules have been established across the group organization and across products for development, production, and sales, whether such rules are being strictly observed, what risks, if any, are present in the process, and which department is in charge of such risks. The same applies to investment projects. While careful examination at the individual investment stage is important, periodic post-investment reviews, follow-up procedures, and the existence and quality of a PDCA framework are even more important. I believe it is a major responsibility of the Board of Directors to confirm that such a governance framework is firmly in place, and, if it is inadequate, to immediately expand it.

Sato: You are absolutely right. When acquiring a company, it is possible that the acquisition price is small, but the risks subsequently incurred are very high. At that time, how do we judge this? It is not an easy decision to make, but over the past year, we have received careful reports on each event and have confirmed what we are going to do about the governance framework.

Nagahama: For a company having a three-committee Board structure, “thorough and strengthened governance” is indeed the fundamental mission of the Board of Directors. Business execution is delegated to the executive side, and the Board of Directors, while supervising execution, is responsible for establishing and expanding a broad framework of internal control and group governance on a global basis. The origin of the perspective of executive supervision lies in whether a solid governance framework, including risk management, has been established and is effectively functioning. It is important that directors and corporate executives engage in a spirited dialogue based on the expected roles of each.

—Three new committees: Nomination Committee, Audit Committee, and Remuneration Committee have been established. Please tell us about the deliberations, results, and issues that have been discussed there.

To be efficient and effective committees

Itoh: In terms of a Nomination Committee, the company did have a non-binding Nomination and Remuneration Committee. While utilizing the favorable initiatives that have been taken to date, it is necessary for the Nomination Committee to further clarify its approach to the selection



Takeshi Itoh
Nomination Committee Chairperson

In 1969, he entered Burnham & Company, Inc. In addition to his management and analyst experience at domestic and foreign investment banks and investment advisory firms, he has a strong track record in high-level corporate analysis based on his long-term overseas work experience and consulting business experience, including fund-raising and M&A advisory services. In 2014, he was appointed as an outside director of Azbil Corporation, and in order to enhance transparency and fairness of management as well as supervision of business execution, he uses his advanced specialized knowledge in the fields of international finance and investment, and his experience as a management executive, including as Representative Director of an investment advisory company, to make proactive statements from the perspective of the capital markets.

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and appointment process and create a concrete succession plan. To this end, we need to expand the pool of human resources. Even now, I believe that diversity is progressing, as evidenced by the skill matrix of directors. However, going forward, we need to be more conscious of the need for a more extensive pool of candidates, including external candidates, with diverse and specialized skills and knowledge, regardless of gender. It is also necessary to draw up a skills matrix and examine what is lacking in order to develop and acquire the human resources in light of our future business strategy, in addition to the abilities and character of candidates.

Sato: With regard to the Audit Committee, the previous approach was for the Audit & Supervisory Board members to take turns going around to the sites and identifying problems, such as violations of rules. With the change in the design of the organization, we discussed organizational audit and risk-based approach to determine how to effectively perform the monitoring function with the new members and structure. For this purpose, it is more crucial that the Audit Committee, of which the majority is composed of outside Audit Committee members, Internal Audit Department, and the auditors of the azbil Group companies cooperate with each other, and we are deepening the exchange of information. For instance, as one example, we have the general manager of the Internal



Fumitoshi Sato

Audit Committee Chairperson

He entered the Bank of Japan in 1976, where he worked as a branch manager (Aomori, Fukuoka). In addition to his extensive knowledge and extensive experience in the financial field, he has 13 years of management experience as a director and in charge of accounting, legal, human resources, and general affairs at Horiba, Ltd. In 2019, he was appointed as an outside Audit & Supervisory Board member of Azbil Corporation to audit all aspects of the company's business, and also as an outside director (Audit Committee member) from 2022, contributing to the improvement of the company's corporate governance and internal controls. He has made remarks at Board of Directors meetings with respect to the appropriateness of the company's business and financial strategies, as well as risk management and strengthening of corporate governance.

Audit Department attend the Audit Committee meetings every month and report back to us, and we feel that this has deepened our cooperation. Also, the issue of the Audit Committee and internal audit systems having different time frames for the annual audit plan was unified with an April start date. We have made the audit plan consistent for the entire company. At the same time, we increased opportunities for direct discussions with corporate executives, executive officers, and top management of group companies, and our outside Audit Committee members have been directly visiting overseas group companies to conduct on-site inspections.

Itoh: We are taking a proactive approach throughout the entire azbil Group not only to improve efficiency, but also to ensure the effectiveness and increase functionality of the new corporate structure.

Nagahama: The activities of the Remuneration Committee began with the formulation of a new remuneration policy based on the deliberations that had been held prior to the transition to the new company structure. Since then, it has focused exclusively on the development and expansion of a fair, objective, and transparent compensation system based on the basic concept of “sound incentives that contribute to medium- to long-term improvement of enterprise value.” As a result, we believe that we have established a sound remuneration system that is thoroughly understood and accepted by our stakeholders. However, on the other hand, the level of disclosure requirements has been increasing year by year, and social demands on companies have been changing. While keeping pace with the work on the next medium-term plan, it will make constant efforts to improve the quality of the system, focusing on items to be considered, such as KPIs, the ratio of performance-linked vs. non-performance-linked compensation, the ratio of stock-based compensation, and other necessary items.

—What needs to be done in the future to further increase enterprise value?

Responding to stakeholder expectations through growth fields

Nagahama: In FY2022, net sales, operating income margin, and ROE all exceeded our financial plan, and we are highly evaluated for making steady progress despite the headwinds of the COVID-19 pandemic and the shortage of semiconductors.

Sato: The medium-term plan is progressing well. Although it is necessary to review and further refine the specifics of our long-term goals in light of changes in the business environment and other factors, I believe that our focus on strategy and concentration—on three growth fields—is not mistaken. However, given the azbil Group's potential and human resource



Mitsuhiro Nagahama

Remuneration Committee Chairperson

He entered The Fuji Bank, Limited. (currently Mizuho Bank, Ltd.) in 1976. He has served in important positions at financial institutions, such as Deputy President and Chairman of the Board and has extensive knowledge and rich experience in corporate management, the finance and securities sectors, and global business. He was appointed as an outside auditor of Azbil Corporation in 2015 and has audited all aspects of the company's business by utilizing his superior insight on corporate governance and corporate management, etc. From 2019, as an outside director of Azbil Corporation, he not only supervises the execution of business operations, but also makes active comments from a capital market perspective and a global perspective in order to enhance the transparency and fairness of the management.

power, it is also true that the market and our shareholders expect us to grow even higher. When we look ahead to the coming several years, we will need to re-examine whether we are missing out on new growth opportunities.

Itoh: I feel the same. We have a very talented group of people, especially in terms of technical capabilities, and they have the flexibility to address DX, including the use of AI, and I see growth potential in them. The Group has set a sales target of ¥400.0 billion by 2030, and has set growth fields. What is needed to achieve this goal from a more comprehensive perspective? I hear that the executive side is now considering various strategies for the next medium-term plan.

Nagahama: I think what is important is the next “method of placing the stone.” This is to determine the strategic domains in which to invest new management resources. Whether to open up completely new horizons, to expand outside of the Group's current business portfolio, or to dig deeper into existing operations, solid consideration is required. Personally, I believe that while launching new businesses is indeed important, in the case of the Group, strategies to further strengthen the existing advantages of the Group are also of considerable significance. I look forward to the formulation and development of strategies to maintain and strengthen the relationships with our valued customers that we have cultivated over more than 100 years,

and to deepen the Group's unique “retention marketing” while responding directly to the increasingly sophisticated and complex needs of our customers. On the other hand, in this day and age, the most important thing we must do is to keep a close eye on the emergence of so-called “game changers.” For example, I believe that we should be addressing head-on the possibility of fundamental and structural changes in customer requirements and industry structure due to AI evolution, etc., as a key issue for mid- to long-term management awareness.

Sato: For those start-ups that could be game changers, it will be necessary to compete with resilience and mobility, and at the same time, to collaborate more proactively as we are already working on.

—Lastly, what is your message to your stakeholders?

Supporting the azbil Group's management from a supervisory perspective, including growth by capitalizing on our strengths in contributing to the environment and meeting stakeholder expectations

Sato: As I mentioned earlier, I feel that stakeholders, starting with our customers, have high expectations of us. The question is how we can provide products and services that meet these requirements. The challenge for the future is how to manage the organization in a flexible manner while taking appropriate risks, and we hope that we can support them in this endeavor.

Nagahama: The azbil Group is a corporate group that makes a significant contribution to environmental issues, as our businesses themselves emit little greenhouse gas emissions and our products and services contribute to reducing environmental impact. This is a characteristic of the Group that is worth promoting more. We are also vigorously pursuing a variety of strategies to address SDG/ESG issues that go beyond environmental issues, paying close attention to our diverse stakeholders, including society, customers, employees, business partners, suppliers, shareholders, and investors. I personally experience this on a daily basis at meetings of the Board of Directors and in dialogues with the corporate executives. I hope that this integrated report will help everyone to better understand these efforts.

Itoh: Although our stakeholders are diverse, the azbil Group has long been a corporate group that balances investment in growth, such as human resources, technology, and environmental measures, with risk countermeasures, and has placed a great deal of emphasis on what we now call ESG. Going forward, we will continue to place emphasis on these factors and support decision-making so that we can achieve growth that exceeds expectations.