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Board Effectiveness and Ensuring Diversity in the Core Human Resources in Companies for Post-COVID Transformation of Companies

The Council of Experts Concerning the Follow-up of Japan's Stewardship Code
and Japan's Corporate Governance Code

Opinion Statement No. 5

I. Introduction

The expansion of the COVID-19 crisis has accelerated changes in the environment surrounding companies. In response to digitalization and other changes in people's values and behaviors, the goods and services demanded by customers are changing and new workstyles and ways of utilizing human resources are becoming widespread. There is also a growing sense of uncertainty.

To achieve new growth in the post-COVID era, each company must recognize the challenges and get ahead of the changes. To do so, it is important for companies to share a vision of transformation with their stakeholders, including shareholders, customers, employees and communities, and to actively implement the vision through prompt and decisive decision-making.

As changes around companies are accelerating, it is imperative that they reform their corporate governance to achieve growth-oriented governance and sustainable growth while increasing corporate value over the mid- to long-term. It is necessary to work quickly on reforms, such as making the board more effective, managing businesses with a recognition of their cost of capital, ensuring confidence in audits, and improving group governance.

In particular, in order to lead non-linear changes in the post-COVID economy, society and industrial structure, and to achieve renewed growth, it is essential for a company to have diverse perspectives and values reflecting a variety of experiences, abilities and characteristics. For this reason, it is very important to ensure that the board effectively functions through an appropriate combination of knowledge, experience and abilities of directors, including independent directors, as well as the diversity of directors, management and their candidates, and to develop human resources and an internal environment that is conducive to this.

This opinion statement provides recommendations on these issues for inclusion in the next revision of the Corporate Governance Code, with the aim of demonstrating a higher level of governance under a “comply or explain” framework.

II. The policies of board effectiveness and ensuring diversity in the company's core human resources

1. Board effectiveness

As digitalization accelerates and the demand for a balance between corporate activities and social sustainability grows rapidly, it is not easy for companies to anticipate these post-COVID business challenges with their existing management personnel alone.

The board is required to support and effectively oversee management's prompt and decisive risk-taking as well as make important decisions in light of this discontinuity in the business environment.

What is essential in this regard is ensuring an appropriate combination of directors' knowledge, experience and abilities, as well as their years served as the directors of the board. Ensuring that the board as a whole has the skills necessary in light of the mid- to long-term management direction and business strategy is considered a precondition for the board to effectively fulfill its roles and responsibilities. This view on board skill composition (knowledge, experience and abilities) should be appropriately disclosed in the selection of directors and shared through dialogue with investors.

In this context, independent directors are expected to play a more important role in ensuring that companies anticipate changes in the business environment and reflect them in their business strategies. In particular, inviting people with a wide range of management experience, not limited to the relevant company, to join the board and reflecting their skills in the board's discussions are expected to contribute significantly to improving the board's effectiveness.

Looking at the codes and listing rules of other countries, the majority of countries require the appointment of enough independent directors to account for at least one-third or the majority of the board.

In Japan, especially in the "Prime Market (tentative name)" after the transition to the new market segments in 2022, a high standard of governance will be required for the market for companies representing Japan. In light of those points, companies listed on the said market should be required to appoint enough independent directors to account for at least one-third of the board. Furthermore, companies should be encouraged to appoint enough independent directors to form the majority of the board if they consider

it necessary in light of their business environment and business characteristics, etc.*

In addition, listed companies should identify the skills, etc. that the board should have in light of their business strategies when appointing directors, and then disclose the combination of skills, etc. that each inside and outside director possesses in an appropriate form according to the business environment and business characteristics, etc., such as what is known as a "skills matrix." Listed companies should also be required to include independent directors with management experience in other companies.

Additionally, in terms of leading the post-COVID transformation of the company, we will deepen our examination of the following issues for the revision of the Corporate Governance Code at future Council meetings.

- Establishment of the Nomination Committee (statutory/optional) with a high degree of independence and improvement of its functions (strengthening the function of appointing and dismissing the CEO and directors, such as enhancing the candidate pool, and improving disclosure of its activities)
- Establishment of the Remuneration Committee (statutory/optional) with a high degree of independence and improvement of its functions (building a remuneration system consistent with the business strategies and improving disclosure of its activities)
- Improved effectiveness of independent directors including: (i) appointment of the lead independent director[†]; and (ii) appointment of an independent director as the chair, etc.
- Enhancement of board evaluations (e.g., enhanced disclosure of self- and external evaluations, including the evaluation of individual directors and statutory/optional committees)

2. Ensuring diversity in the company's core human resources

For a company to lead the irregular changes in the post-COVID era and achieve new growth, a diversity of perspectives and values is required, not only in the board, but

* They may include industry, size (market capitalization, etc.), business characteristics, organizational structure, and the environment surrounding the company.

† In light of examples in other countries, the lead independent director is considered to have the functions and roles of leading discussions and sharing knowledge among independent directors, mediating communication between independent directors and management, and acting as a contact point and bridge for constructive dialogue between independent directors and investors, etc.

also in the management.

In addition, while fully recognizing the situations, etc. surrounding companies in Japan, it is very important to build a system to ensure diversity in terms of gender, internationality, work experience, etc. at the middle managerial level, which supports the top management and board, and to appoint these core human resources to the top management and directors while they accumulate experience. In this process, it is also essential to utilize mid-career hires who have management or work experience in other companies.

In order to take advantage of such diverse personnel and promote diversity within the company, it is also important to develop the human resource development system and internal environment. After embracing diverse workstyles and career development, there is a need to establish a system in which employees' skills and achievements are fairly evaluated, and they are given positions, authority, rewards and opportunities accordingly. The board is expected to promote and oversee such efforts in a proactive manner in order to ensure the diversity.

Based on this perspective, listed companies should be required to present their policies and voluntary and measurable targets for ensuring diversity in the promotion to core human resources, such as the promotion of women, foreign nationals and mid-career hires to middle managerial positions, as well as disclosing their status. The company should also be required to disclose its policies for human resource development and internal environment development to ensure diversity, as well as the status of their implementation.

III. Closing Remarks

In April 2022, the Tokyo Stock Exchange will shift to a new market segmentation that will require a higher level of governance for companies listed on the “Prime Market (tentative name).” It is expected that companies will seize the opportunity of these changes and establish effective corporate governance in a timely manner.

In preparation for the revision of the Corporate Governance Code next spring, the Council will continue to intensively discuss corporate governance issues for post-COVID corporate transformation, such as group governance, capital efficiency, human resource investment, ensuring confidence of audits, and mid- to long-term sustainability.

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