

Discussion with Outside Directors 1 (Non-Audit and Supervisory Committee Members)



We held a conversation with three outside directors who are non-Audit and Supervisory Committee Members: Mr. Sadayuki Sakakibara, Mr. Yoshihiko Miyauchi, and Ms. Naoko Yoshizawa (newly appointed). The themes discussed included the distinguishing characteristics of the NITORI Group's Board of Directors and the sustainable growth of the NITORI Group. The conversation was led by Kenichiro Aoya, Executive Officer and General Manager of the Legal Office.

*To avoid spreading COVID-19, those present wore face masks during the discussion and removed their masks only to have their photographs taken.

Enhancing the Effectiveness of the Board of Directors

Could you tell us what you regard as the distinguishing characteristics of the Company's Board of Directors, having attended its meetings?

Sakakibara: It's been exactly two years since I assumed the position of outside director. During that time, the outward characteristic that struck me most was that NITORI Group's Board of Directors is an extremely objective and progressive. The percentage of members who are independent outside directors is over 40%, and as the skills matrix shows, the mix of outside directors' skills is extremely well-balanced. In terms of the way meetings are run too, the outside directors lead a lively exchange of opinions, and for that reason, I feel that it really is a Board of Directors in the true sense. The board chairperson, Akio Nitori, is an owner-manager, but he always listens to the outside directors' opinions and comments and reflects them in his business management faithfully and with a sense of urgency. I feel that this is a distinguishing characteristic lacking in other companies managed by their founders. As outside directors are in the position of monitoring the executive directors, I try to comment from the perspective of shareholders and society at large. I can see that the executive directors take our comments very seriously, and instigate actions and improvements accordingly. When I first assumed this position, numerous detailed business execution-related matters would be selected for discussion by the Board of Directors, but recently, matters relating to management strategy and business

strategy have become the main topics of discussion. I have a real sense that this Board of Directors has evolved into a forum that can engage in enthusiastic discussion while emphasizing a strategic approach, considering practical management strategy from a long-term perspective, and incorporating the shareholder perspective.

Miyauchi: In my case, a year has passed since I became an outside director, so I am now in my second year. To address the question from a corporate governance perspective, I believe that the essential purpose of governance is to help a company continue generating value over the medium to long term. The responsibility for generating value lies with the executive directors, and it's the role of the Board of Directors to monitor whether they are on the right track toward their purpose and goals. That being the case, my own focus is on monitoring from an external perspective as a representative of the market. In fact, the Company's Board of Directors is moving in the right direction faster than I imagined it would. It may still be developing in some respects, but in light of my own experiences as an outside director at more than ten companies, I think the Company's Board of Directors is on course to be top class, so to speak. I've also been extremely impressed by how the Board's chairperson, Akio Nitori, who is also the Company's founder, listens with humility to the outside directors' opinions, and in no time at all, carefully considers them and incorporates them into the business. Mr. Sakakibara and I both have experience of running companies ourselves, and in our view

the Company's Board of Directors is making progress in discussing major themes such as management strategy and we're looking forward to future discussions.

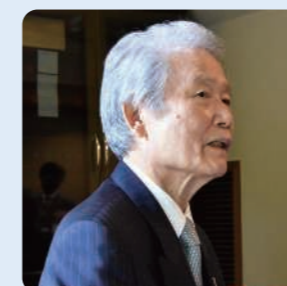
Yoshizawa: This is the first time I've ever been a member of the Board of Directors at a listed company. I've learned a great deal personally from attending the Company's Board meetings. At other companies' Board meetings that I experienced in Japan, there was often very little opportunity to discuss business strategy. On the other hand, my impression is that Board meetings at venture companies overseas are very strategic and discussions are guided by the directors' skills, drawing on their various perspectives as specialist professionals. To be honest, before attending the meetings of the Company's Board of Directors, I thought the atmosphere might be similar to the first group of companies I'd experienced, but once I attended meetings here, I gained the definite impression that this Board belongs to the second group. I'm very impressed by how the Board of Directors discusses strategy properly.

At the shareholders' meeting two female directors were appointed. Could you tell us what changes you're expecting with the addition of a female perspective?

Sakakibara: I regard the addition of two female directors as a major reform. With women's participation, the atmosphere at Board meetings will change completely and both the content and quality of comments will naturally differ from before, especially as opinions from a new perspective are voiced. And when you consider that, in the case of consumer goods such as the products the Company handles, the authority for purchasing decisions often lies with women, a management strategy focused on women's perspective is indispensable. In terms of diversity too, we could perhaps add another female member. And I also think it would be a good idea to have non-Japanese directors in future from a diversity standpoint.

Miyauchi: I think of diversity as meaning variety. But it's not a case of a woman speaking on behalf of women or a man speaking on behalf of men. What will be important as the next step, I think, will be to avoid categorizing people in terms of separate genders or nationalities in the name of "diversity," and instead, to ensure that people with an array of different backgrounds and skills can bring variety into debates.

Could you tell us what perspectives you yourselves adopt when commenting or expressing opinions at Board meetings?



Sadayuki Sakakibara
Outside Director, NITORI Group

Sakakibara: As I mentioned earlier, I monitor and comment from the perspective of shareholders and society at large. There are three generations of outside director arrangements: Generation 1.0, Generation 2.0, and Generation 3.0. The

Generation 1.0 arrangement was what we might call an extension of relationships between friends. Generation 2.0 could be described as an arrangement whereby outside directors keep corporate governance and compliance in mind as they monitor management. I think Japan is currently in Generation 2.0, and Generation 3.0 is an arrangement whereby, in addition to the role outside directors play in Generation 2.0, they not only advise on management strategy, but also become involved in its formulation. Based on my own experience of running a company, my comments are intended to enable discussion of management strategy from a Generation 3.0 perspective. As an outside director, I try to probe deeply, primarily as a means of helping to formulate better management strategy.

Miyauchi: I think the current executive directors are a great team: they're extremely passionate about their work, they work quickly, and they thoroughly understand the relevant issues. It's important that this continues to be the case. And this is the perspective from which I intend to approach monitoring.

Have there been any occasions when you felt that your comments at a Board meeting changed the result of a discussion, or led to improvements in how duties are executed or how the Board of Directors is run?

Sakakibara: Although the Company's Board of Directors is still developing, I think it has evolved significantly even in just these last two years. The opinions of outside directors including myself are taken seriously; for example, the suggestion that we should allow more time to discuss medium- to long-term strategy was properly addressed. I feel that the executive directors are very quick to act.

Miyauchi: When the outside directors offer their opinions, the executive directors give those opinions serious thought and come up with plans. Even if the plans don't come to fruition, the outside directors have fulfilled their duty by expressing their opinions. When I give my opinions to the Company's executive directors, I feel confident that they will always seriously discuss the issues I raise. From that point of view, I feel that my role as an outside director at the Company is meaningful.

Achieving Sustainable Growth and Enhancing Corporate Value for the Company

Could you tell us the potential issues to be aware of when implementing digital transformation (DX) in NITORI Group over the medium to long term?

Sakakibara: DX has become a key shared concept, not only throughout Japan, but throughout the entire world. Yet, it seems to me that many companies in Japan are taking an over-simplistic approach by directly equating DX to IT. IT and AI are merely tools; the real objective lies elsewhere. That's to reform businesses and operations. In addition to reforming the Company's actual businesses for the DX era, therefore, we will also need to reform all the operations that make up each business, including store operations and the product mix. I think we should treat DX as our actual management strategy and create a specialized internal



Yoshihiko Miyauchi
Outside Director, NITORI Group

organization to promote it. This organization should not only develop the physical infrastructure necessary for DX, but should also deliberate on how to create a new NITORI Group, drawing on the opinions of the outside directors.

Miyauchi: We should think about how DX could be

incorporated into, or combined with, the Company's main business model. Effective use of DX might enable us to change NITORI Group's business formats in positive ways. However, doing so will require human resources with the business management skills to determine the changes to be made; I therefore think we should develop such human resources.

Yoshizawa: I believe there are three hurdles to overcome in implementing DX. The first is the "ideas hurdle," the second is the "investment decision hurdle," and the third is the "execution hurdle." I myself often talk to companies about DX, and the most common cause of failure for DX initiatives is the poor quality of the initial ideas on which they're based. The first requirement when implementing DX is usually to conduct a POC (Proof of Concept), but POCs generally achieve only a 20% success rate. Or it might be even less than that. Accordingly, the reality is that, unless a DX-related idea proves to be at least five times more successful than usual at the POC stage, it won't be a worthwhile investment. So, the number of high-quality ideas that can be generated at the beginning is important. The next most common pattern of failure is an inability to get others involved. Within a company, individual people and departments have their own differing opinions and aims. But, when implementing DX, it's essential for the entire company to proceed based on a shared understanding. DX is a business reform aimed at providing added value to customers. As it entails creating an organization and corporate culture that can provide added value continuously, I believe it's necessary to involve the entire company. And next we come to the third pattern of failure, which is employing low-quality solutions to issues. For example, if one takes a tools-based approach to dealing with a certain issue, and decides from the start to solve the issue using AI, that mindset is in itself misguided. AI is just a means to an end; there are many other factors and choices to be considered when solving an issue. Failing to think about those other elements is a mistake. The keys to avoiding failures such as these are commitment to DX on the part of the management, and a shared understanding among employees. And, when coming up with ideas, it's important to ensure diversity by, for instance, introducing a variety of opinions from outside the company. This is because people inside a company sometimes regard things as normal when they're actually not.

Could you tell us how the sustainable growth of NITORI Group should be combined and balanced with ESG and SDGs?

Sakakibara: In the last year or two, ESG and SDGs have come to be recognized as the top priority in business management worldwide. However, instead of undertaking related initiatives for nebulous reasons, as in the past, we should engage with ESG and SDGs as key issues for the company, acknowledging that our business depends on doing so to remain viable. Amid major worldwide trends including efforts to achieve net-zero carbon emissions by 2050, and to address human rights issues, NITORI Group cannot survive as an enterprise unless it sets out its policy and priorities. At this very moment we're at a fork in the road, and as a company it will be crucial to have guiding principles.

Miyauchi: I too sense rapid change. With regard to assessments by organizations such as ESG assessment bodies, for the time being I think we have no choice but to aim for just a "pass mark," but in future we must earn better assessments in a way that is workable from a business perspective. This is because corporate activities are set to come under increasing pressure from outside, both socially and politically. In future, we should aim to be among the top companies that lead the way in terms of ESG and SDGs, as well as in other areas. I see this as the path we must follow.

Yoshizawa: Given that shareholders provide the capital that funds sustainable growth, I think it's essential to focus action on the issues that are currently of greatest concern among institutional investors and other shareholders—namely, the environment, and climate change in particular. As the Company's Integrated Report shows, its initiatives to tackle environmental issues have made great progress. However, when business expands, distribution centers and stores, for example, increase, and this results in a vast number of route permutations. It may therefore become impossible to improve the efficiency of distribution routes from within the existing system. For that reason, NITORI Group always needs to be taking action focused on the next step ahead, such as considering new technologies now.

Could you tell us your thoughts regarding the challenges of globalization?

Sakakibara: My perception is that the Company's global business development is still far from adequate. Growth in the Group's global business will be crucial to achieve its mission and vision, but simply persisting with the current way of doing things won't be enough. In terms of the organization, for instance, the Group should create an internal organization dedicated exclusively to global business development. Overseas strategy is a specialist field that requires sophisticated skills; an organization and overseas



Naoko Yoshizawa
Outside Director, NITORI Group
(newly appointed)

operating sites need to be put in place to focus on this strategic area. There can be no doubt that overseas expansion is challenging. Accordingly, I believe that, rather than trying to control overseas operations from Japan, it's only once human resources totally committed to a certain country are living and working there that the first signs of success will emerge. The Company has only just made it to the start line in terms of global business development. I think it should develop specialist human resources who can formulate overseas strategy, and undertake upfront investment, while holding more discussions including exchanges of opinions with outside directors.

Miyauchi: It's fantastic that the entire company is heading in the same direction, guided by a vision for the next ten years. Looking back at the Company's business model to date, it hasn't branched out into new products or services, but has instead concentrated on its original furniture and home fashion businesses as a means of building a wide network of stores and achieving success. And now that it's become a leading company in the domestic arena, the Company's taken on the ambitious task of trying to do two difficult things at the same time: enter the markets for new formats and services, and advance into new geographical areas overseas. Both of these endeavors require knowledge, but if the Company is to make progress on these fronts, what it lacks above all are human resources. The Company needs to engage in serious, probing discussions to determine how to develop the human resources that will be central to its plans. The fact is that it's trying to do something unprecedented that no other retail or services business has ever done. Japan boasts numerous outstanding retail and services businesses, but few of them have been successful outside this country. So, I'm really looking forward to seeing the Company make inroads overseas according to the NITORI Way, and my expectations are high. That's another reason for the Company to hold repeated discussions as a matter of urgency and put its plans into action.

Yoshizawa: In my own experience, growth in the size of overseas operating sites gives rise to the issue of how to ensure effective governance over them. It's important to delegate certain aspects of governance to local operating sites that fully understand their own markets, but in cases where it's necessary for the NITORI Group

as a whole to move in a single direction globally, this issue becomes very difficult to deal with. To cite some specific examples, the Company needs to consider how to implement employee appraisals and management accounting. It will be important to design systems that take local approaches into account. Meanwhile, another issue is, of course, human resources. A company can't just start managing overseas operations overnight if experience hasn't been accumulated well in advance. I'm well aware that the Company's investing effort in developing human resources, but it's important to tackle the issue of how to cultivate individuals capable of management suited to different countries and regions from a young age.

Could you tell us your thoughts on further strengthening the Company's corporate governance?

Sakakibara: An important role of the Board of Directors is choosing the next generation of senior managers. In fact, one could even say that taking the lead in the replacement of senior management is another one of our key functions as outside directors. The Company has set up a discretionary Nominating and Compensation Committee, so the Board of Directors needs to be kept fully informed of the types of discussions that take place at this committee. I also believe that key issues and strategies shouldn't be discussed only at meetings of the Board of Directors. I think it would be a good idea to also have something like a separate discussion forum made up entirely of outside directors.

Miyauchi: The Company shouldn't aim merely to be a corporate governance high-flier by Japanese standards, within the framework of the Japanese Companies Act; it should aim to lead the way overseas as well. And surely it should also consider the future possibility of changing its corporate governance structure to become a Company with a Nominating Committee, etc. Progress is being made in delegating business execution-related matters to the executive directors, but I also think it would be great if we could create a setup whereby even more authority for reporting, such as monthly reporting, is delegated to executive directors to enable more dynamic discussion of medium- to long-term topics.

