

Governance

Interview with Outside Directors [Dialogue among Outside Directors]

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The Board of Directors Plays a Major Role in Enhancing Corporate Value

Independent Outside Director

HAKODA Junya

Chairperson of Audit Committee

Independent Outside Director

SATO Rieko

Member of Audit Committee

Independent Outside Director

YAGO Natsunosuke

Chairperson of Nomination Committee

Evaluation of the Company's governance

Yago: I think it is safe to say that our governance has been done honorably, so to speak, and meets the necessary requirements. However, in order to grow and be more appreciated by shareholders, we must fulfill sufficient conditions such as corporate growth. Shareholders may not feel comfortable investing in a company that does not meet the necessary conditions, so I think it is important that the Company has been evaluated as meeting the necessary conditions. However, we are now entering Phase 2, and it will be important for us to find a way to grow the Company and obtain a high valuation in the stock market. That will be our final results, and how we work toward that goal is the challenge we will face in the future. I understand that we are entering a phase of high difficulty.

Sato: In my current role, I am a

member of the Audit Committee and the lead director of the executive session, which is a gathering of Outside Directors only, and we hold an executive session once a month after the pre-meeting briefing and an expanded executive session with the President after the Board meeting. I think this is a very good initiative compared to other companies. It is not a structure under the Companies Act, but I believe it works well in terms of governance.

As Mr. Yago just said, I think we meet the necessary conditions for a Company with Three Committees (Nomination, Audit, and Remuneration Committees). In the sense of moving on to the next step, we do not pre-determine the agenda in executive sessions, but rather, the Outside Directors exchange opinions without any restrictions on the issues raised in the pre-meeting briefing and other related issues that they think are important on the spot, and provide feedback to the President on what is necessary.

We take that feedback, recognize

it as it is, and hold extended executive sessions. In other words, we have a mechanism to feed back the Outside Directors' awareness of issues directly to the executive side, and after careful consideration by the President, other Executive Officers may be invited to participate, and they may be asked to return the feedback to us. I have the impression that communication between Outside Directors on the supervisory side and the executive side has taken a step forward through executive sessions and extended executive sessions.

In that sense, I think that the executive session or the extended executive session is playing a role as one of the Phase 2 initiatives that Mr. Yago mentioned. Of course, that is not enough, and we need to do more and more things in the future, but I think it is a progress, a step forward.

Hakoda: When I talk with people in other companies and people involved in governance, I feel that

our governance is highly regarded. Currently, seven of the 11 Directors are Outside Directors, which is close to two-thirds of the Board of Directors. The composition of the Board of Directors has become closer to that of Western boards with a majority of independent outside directors, and I feel that the Board's discussions have deepened even more in terms of content. In terms of Phase 2, I hope that it will be more appreciated by foreign investors in the future.

Looking at the changes in market capitalization, although stock prices have recently returned due to the post-COVID-19 era, strictly speaking, they are still in the 300 billion to 400 billion yen range and have not quite reached the peak over the past 10 years or so, above 500 billion yen.

There are many companies that are not so large, but are highly valued by investors and attract funds, with a market capitalization of over one trillion yen. I hope that by going beyond comparisons in the department store sector and strongly emphasizing its vision and specific initiatives for sustainable growth, both Japanese and foreign investors will pay more attention to the Company.

Evaluation of the effectiveness of the Board of Directors

Yago: The current level of effectiveness evaluation is a comparison with general benchmarks, such as how much time was spent, whether that time was appropriate, and whether the necessary document information was provided in advance, and I think we have satisfied them. Interviews with individual Directors have identified the real challenges that the Board of Directors faces, but the next stage is not to compare with benchmarks, but to uncover the unique challenges that the Board of Directors faces and

to improve its effectiveness. Fixed-point observation is important, but I think we are entering a stage where we are taking a step forward from there. However, it is also true that if everyone does not have the same awareness, it is difficult to move forward efficiently.

Sato: I believe our Board of Directors has an effective approach on a general level. We are a holding company, and I wonder, in terms of the division of roles between the holding company and the operating companies, if we can confirm or discern what the holding company's Board of Directors has to decide, what it has to look at, and to what extent the operating companies are empowered to do so. I feel that it will be a challenge from now on to see if we ourselves can play our roles with a clear understanding of these issues.

As a holding company, I wonder a little if there is still a lack of differentiation in the way we tell the operating companies what they should do, how much profit they should make, and what we will do in return. I believe that this will be the next step after demonstrating the general effectiveness and functions of the Board of Directors. I think there is still a lot of room for discussion.

Hakoda: Regarding the evaluation of the effectiveness of the Board of Directors, I think we need to consider two things: the current evaluation process and the future issues of

the Board of Directors itself. In that sense, I think the evaluation process is very efficient. The members of the Board of Directors all have their own opinions and are very outspoken, so I think the current questionnaires and interviews should be enough to get a good grasp of their thoughts.

As for how to change this approach and make it better, I have heard that in the U.K. and the U.S., for example, the entire board of directors is evaluated, then each committee is evaluated, and even individual directors are evaluated. In our case, committee evaluations are conducted, so in terms of formality, I think the only thing left is how to evaluate individual Directors.

I think what Ms. Sato mentioned what to do with the Board of Directors itself is a very big theme. Recently, I have been concerned about the fact that we have a pure holding company structure, and while a company of a reasonable size can manage a corporate headquarters, a pure holding company of our current size with a hundred and dozens of employees seems to have some overlap in functions with the operating companies. I think it is necessary to deepen the discussion on the content, including whether this type of holding company is appropriate in terms of our capabilities.

Progress of the Medium-term Business Plan

Yago: Mr. Yoshimoto often says, "Move up a gear for change." However, we should take seriously

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the fact that the market sees no future for our industry if we continue to make gradual progress through improvement and refinement. We have to change a lot, and the market expects us to change a lot. Even when change begins, it can take as long as three or five years for the market to react. Without a significant change in the shape of our business, I think we will be buried under the average expectations for the industry as a whole.

Hakoda: I think we are making realistic progress in the direction of our current medium-term plan, but on the other hand, there is the question of whether three years are enough for our medium-term plan. We have a time-consuming business such as the Developer Business, and if we are trying to grow around it, three years may be a little short. Perhaps, in the span of management, we need to plan for a longer period of time, like five years or something. If we are going to look at the Developer Business, which aims for significant growth, I think it will be very important for the Board of Directors to manage the progress of the plan. In particular, investment and cash flow. In what plan will we manage their progress? We need to look at it over a long span of time, such as five years or so.

Sato: I think it is absolutely necessary to look at reforms and business changes over a certain span of time, and we are currently

in a situation where the Group has Daimaru, Matsuzakaya, Parco, GINZA SIX, and now we have purchased XENOZ. I think we have not been able to explain these five elements to the market with a story and talk to them about what dream we have and how we are going to achieve it.

It may be difficult to come up with reforms from there, but first of all, I feel that the stock price does not rise easily because we do not have something like the current strength, such as what story we envision and how we go from here with the story. I believe this is one of the reasons why we have not been able to differentiate ourselves from our peers in the capital market and remain mired in the department store sector.

Hakoda: Although ROIC management has been adopted in the execution from the viewpoint of upgrading business management, I have the impression that ROIC management has not yet fully understood within the Company. That is really important and we need to make sure that the Board of Directors, including executive members, can properly discuss these issues, because investment and cash flow are the indicators for our medium- to long-term business.

Our medium- to long-term vision is to Create and Bring to Life “New Happiness.” As a message to the capital market, we need to strongly emphasize what initiatives we are taking to realize our vision. As a

result, if investors are interested in various figures such as ROE and ROIC, the stock price and various other figures will rise.

Yago: ROIC may not be easily understood by the entire organization. However, in terms of penetration among employees, I believe that it is sufficient for employees to understand the return on investment capital, in other words, how efficiently profits can be generated using the money raised through borrowing and equity. I think that if everyone starts to understand that it is not just a matter of sales growth, but also of how efficiently the invested funds are being used, things will gradually change.

I included ROIC as a goal in the medium-term plan at my previous company, and although it took some time, the ROIC numbers themselves have changed significantly. I realized that it works if we try it. I believe that when the importance of effective use of invested funds begins to be understood across the board, the way of thinking will change from what it has been up to now. The company’s officer remuneration structure, in which stock-based remuneration (performance share) is determined by ROIC results, was also a major factor. In the process of bringing ROIC down from officers to the management level, everyone naturally gained a better understanding of what ROIC is all about.

ROIC by business, as we are trying to adopt, will be a challenge, but I think it will be effective in raising awareness throughout the Group.

Hakoda: I think what you just said is very important. We see a big difference in the effect of adoption of ROIC between the companies that reflect it in officer remuneration and those that do not. We need to make sure that executive officers have a sense of how much money they

are spending and how much profit and cash they are generating in their respective businesses. I think it is important to link it to officer remuneration in some way.

Yago: The Company currently reflects ROE in officer remuneration, but not ROIC, and I think we need to consider whether to use ROIC or to include something like TSR so that the stock market view is reflected in officer remuneration.

To improve corporate value over the medium to long term

Yago: The Company has focused on strengthening governance and created appropriate mechanisms, but the current situation is that the PBR is one or less, and we are not sufficiently evaluated in the capital market. The reason why we are not being evaluated is simple: we are not able to talk about our dreams and hopes for the future, and we are not able to draw a trajectory toward our future goals. Companies with a high PBR have high profit levels, of course, but more than that, they are the companies that give their shareholders dreams and hopes, and we need to be aware of this. I think the roles and responsibilities of the Board of Directors are very important in that regard. In reality, it is what the executive side does, but one of the roles of the Board of Directors is to provide guidance or advice on what they are trying to do. I feel that it is necessary to strengthen the roles of the Board of Directors a little more. To this end, it will be important to consciously strengthen the roles and responsibilities of each Director.

Hakoda: The main reason why the investment for this medium-term three-year period is far below the plan is that the Developer Business has not progressed as much as originally planned. From the very

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beginning, we have stated that the Developer Business would be one of the pillars of our business, so we had to think more properly about our investments and put them into action. In the Developer Business, if we really try to realize what the executive side is thinking now, we can probably expect to invest 200 billion yen, 300 billion yen, or even more over the medium to long term, and this is a business that will take 15 to 20 years to complete.

As we expand the Developer Business in the future, capital efficiency may decline, but if we can clearly show the time frame and investment return, I believe we will be able to gain the understanding of the capital market.

Sato: The Developer Business is basically about diverting the properties that we own. My impression is that other developer companies renew what they have found and sell it back to the market, but we renew or renovate our properties in Ikebukuro, Nagoya, Hakata, etc. to create something new and put them on the market. My honest impression is that the Developer Business is a little different.

Yago: Since we have been thinking about how to use the land we originally owned for our own business, I think we were not aware of how much return we could get from our investment, including the value of the land we own, as Mr.

Hakoda mentioned earlier. The strong involvement of the finance division is indispensable, as we are starting from a situation where we are asked to come up with cash flow, investment efficiency, etc., but we are not sure how to think about it.

Sato: When the Developer Business is viewed from the market, some questions may arise, such as “Really?” and “How far are they willing to go?” Speaking of the new investment of 90 billion yen, I think there is a need to show a story or whatever we will tell about where we will expand and how we will develop it from existing commercial field, but it is undeniable that I feel that such story lacks on the executive side.

I personally think that the investment in XENOZ is one key point, but the market should have expectations as to what will develop from there. I think the situation “now” is that we cannot see that point.

Yago: When thinking about medium- to long-term growth, I always think that “discontinuity” has to come into play somewhere. I think that raising awareness of the importance of this discontinuity is what is required of Outside Directors, but I don’t have any specific ideas. I hope to see a sense of “flying discontinuously” at least in the next medium-term plan.

Role to be fulfilled by the Board of Directors

Yago: The functions of the Board of

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Directors include both “checking” and “pushing.” It is fine to keep things in check as part of the oversight function, but the truth is that we “want to do something like push people’s backs.” Nevertheless, the fact that it is difficult to see the backs to be pushed is a bit disappointing and unsettling.

Hakoda: Diverse human capital is the basis of our innovation. Forming this kind of human capital will be the driving force behind value creation, and I believe that we will be able to expand the Company in the truest sense of the word. Ultimately, I believe that it is important for employees to be motivated to do their jobs and for them to be able to think out of the box. To this end, we may have to seriously consider making the salary structure more attractive and creating an environment where employees can work with vigor and enthusiasm.

Sato: As for human resources, I have a strong sense that the Company is composed mainly of people from Daimaru and Matsuzakaya, both of which have long histories, but I would really like to hear from the younger generation when we formulate a new medium-term plan. The aging population and declining birthrate are inevitable, and the Millennials and Generation Z, who will be at the center of consumption in the future, are said to focus on social media and not to watch TV or read newspapers very often. I would like to hear from young people what we can provide and what kind of

value we can provide to such people.

Yago: We have brought Parco, a company with a different culture from that of the Department Store, into the Group, but we cannot clearly see what kind of chemistry is taking place as a result of this. In other words, I am wondering if the culture of Parco is not being viewed as part of the cultural flow of the Daimaru and Matsuzakaya department stores. As a group, I think it would be better to be conscious of putting the new culture that we have adopted at the core of the Group, in other words, wearing the robe of the Parco side by making human resource exchanges and communication more active. Otherwise, it will be difficult to find solutions to how newly adopted things such as CVC and XENOX can be used to help shape a new culture for the entire Group.

Sato: The subscription business “AnotherAddress” is still small, but I think it is a great venture. It is growing because it is accepted by consumers, and I think this kind of idea would have been difficult to come up with from a traditional retailer. I think it would be good to ask young people, including people from Parco, GINZA SIX, and XENOX, “What are you looking for, in what form?” in the form of brainstorming. We are the Showa generation, and we may not have enough knowledge to offer new values. I think “discontinuity” is one important keyword, and we must incorporate new knowledge to create it. To this end, I really feel that it is important

to adopt the perspectives of young people in terms of diversity.

Yago: As Ms. Sato said, it is very important to talk with people close to the frontline, including young people, and while it is necessary for Outside Directors to take a third-party stance, I think it would be good if we could go inside a little more. It takes time and effort, but I feel that if we do not go that far, we will not reach the so-called ideal state of the Board of Directors that is expected of us.

I cannot deny that some companies don’t like such things, but I don’t think there will be much resistance from those around us when we start doing such things. I think this is something the Board of Directors needs to consider. It may involve how to draw the line as to how far the roles and responsibilities of Directors go. We must not get too involved and become a complementary force to the “ruling party,” so it is difficult to strike a balance between them, but I feel that we are in a situation where we have to step in now.

Sato: After all, mutual trust cannot be created unless communication is further enhanced. If you are just shown what is there and asked to make a judgment based on that, it can be a rather superficial judgment. I think it is one of the important roles of a Director to go another half or one step further and communicate with the people on the ground who are doing various things.

Message from Newly Appointed Outside Director

Independent Outside Director

KATAYAMA Eiichi

Member of Audit Committee



I could say that I have been alternately and repeatedly “inside and outside” by choice in my life. As a member of society, I started out as a securities analyst, and first looked at operating companies from the capital market side. After studying in the U.S., I was transferred to the M&A department, where I was in a position to look at investors from the side of an operating company. Then I returned to a completely different sector analyst.

Having spent most of my career in finance, at some point I began to ask myself a question, “Am I demanding from the operating companies something that the parties involved have no choice in?” If I went to the operating company side and looked at the landscape I had seen from the other side, I would be able to see what is true. At that time, I happened to have the opportunity to join Panasonic.

I joined Panasonic as an officer in charge of M&A at the head office. As there are about 50 business units, I felt there again that the view from the head office was definitely not close to the truth. So I asked the president at the time to put me in charge of a business unit. When I served as president of an operating company, I felt that the joy of success was irreplaceable, so I was thinking of staying at the operating company, but I was called back to be responsible for planning at the head office. In this way, I have been alternately “inside and outside” and repeated this many times, and now I am pushing forward with the execution of our business again.

I value “self-contemplation,” moving forward while looking at myself as objectively and directly as possible. The words that are very important to

me are “evolution” and “growth,” and that may be my way of life. I want to do a job that I think is better today than yesterday, and I think I have to keep evolving in order to feel that way. In order to evolve, I want to take the opposite position and get closer to the essence of things, that is, the truth, rather than defending my current job. I believe that the keywords that make this possible are “inside and outside.”

I have just been asked to serve as an Outside Director of the Company, and I believe that it is meaningful for someone like me, who is currently on the executive side, to become an Outside Director. In addition, I am the head of a business unit, so this would be a very rare case. If there is something that the top management is worried about, I can share that feeling, and there must be things that only active managers can feel. I believe I will be able to set up a discussion that will allow for more options on the executive side precisely because I am involved in business right now. My theory is that the more choices you have, the better. When you don’t have a lot of options, you usually fail. As an Outside Director, I would like to contribute to the creation of an atmosphere conducive to such thinking and to the generation of concrete ideas.

The Company has the idea of “departing from the department store,” and I understand what it means. However, on the other hand, there is no doubt that the Department Store and the Shopping Center (SC) are our core businesses. Both the Developer Business and the Payment and Finance Business, which we intend to grow in the future, are meaningful only because the Department Store Business and

the SC Business are strong. It may be true that the Department Store will almost never increase the number of stores. However, I would like to ask the question, “Has the Department Store really done it all?”

I think we should separate the discussion of our evolution as a group from the fact that there is more to be done in the Department Store. The number of businesses for high-income earners will increase, and I think it is important to fight for them, but unless we change the business to one where the total number of customers and the absolute number grows, we will not be able to bring in good human resources who have dreams. The fact that the number of department stores cannot be increased is one thing and the fact that the Department Store does not have to aim for growth is another, and I think there are still many ways to grow and definitions.

I believe that the most important part of the consumer business is transactions. Watches make money when sold, and paintings may also make money, but only once in a lifetime or a few times a year. If we rely on them alone, our business will not be revitalized. I think that a company will not be able to evolve and grow unless it has a business that can significantly increase the numbers.

We may need to discuss over the long term whether the current pure holding company structure is the best way for the Group to move closer to such an ideal state. First of all, I believe that we need to make our interactions with operating companies even more dynamic, and I would like to contribute to realizing that.

