

Corporate Governance

As the Olympus Group approaches the 100th anniversary of its founding in 2019, it is developing global-level corporate governance systems by strengthening both the active and passive elements of these systems.

The pages that follow compile an account of a discussion between the outside directors who serve as chairmen of the Compensation Committee and the Nominating Committee, respectively, as well as an outside Audit & Supervisory Board member responsible for monitoring and supervising the Board of Directors. With the chairman of the Board of Directors as the moderator, these individuals discussed how best for Olympus to achieve governance that boasts the necessary active and passive elements and to develop its management team.



Sumitaka Fujita

Outside Director
(Chairman of the Board)
Chairman of the Compensation Committee

Global-Level Corporate Governance Effectiveness Improvements and Management Team Development

Evaluation of the Executive Management Team and the Effectiveness of the Board of Directors

Fujita

When Olympus instated the new management team in 2012 in the wake of the series of scandals, the Company's first priority was to recover from the state of crisis in which it had been placed as a consequence, and drastic governance reforms were instituted accordingly. This was the first stage of Olympus' governance reforms. It was at this stage that the Company appointed outside directors, who were also designated as independent directors as stipulated by the Tokyo Stock Exchange, to form a majority of the members of the Board of Directors in order to improve its effectiveness. In addition, the Nominating Committee, the Compensation Committee, and the Compliance Committee were established on a voluntary basis, even as Olympus continued to employ the Company with Board of Company Auditors system described in the Companies Act of Japan. Each of these committees were chaired by an outside director and had a membership primarily comprising outside directors. Olympus then moved on to a new stage of governance reforms during which it shifted its focus toward growth strategies. At this stage, Olympus adopted a forward-looking perspective in discerning the businesses that would be continued and those from which it would withdraw and in drastically reallocating

management resources to growth fields. As such, one focus of Olympus was assembling an optimal executive management team for supporting those efforts. The next stage will entail a transition to a global management team. The Company will need to strengthen its management team to accomplish this goal, making this a challenge that must be tackled going forward.

Kikawa

I became a director at the Company two years ago, after the completion of the drastic governance reforms. Accordingly, there are some internal aspects of Olympus that I have yet to fully understand. The Board of Directors meets 26 times a year, nearly twice the frequency of most Japanese companies. In addition, briefings are always held before Board meetings, during which members of executive management provide us with the information necessary to make informed decisions. Outside directors are thereby able to voice opinions responsibly. This method is beneficial, and I therefore feel that this approach has made the Board of Directors at Olympus function highly effectively.



Michijiro Kikawa

Outside Director
Chairman of the Nominating Committee



Katsuya Natori

Outside Audit &
Supervisory Board Member

Discussion between Outside Officers

Natori

Similar to Mr. Fujita, I became an outside Audit & Supervisory Board member when the new management team was instated, making this my seventh year with Olympus. Back then, there was a long laundry list of issues to be addressed in order to escape from the state of crisis the Company was in at that time. With the recovery of society's trust being of utmost importance, there was a need to quickly have the Security on Alert Designation placed on the Company's stocks removed, to boost capital under precarious conditions with an equity ratio of less than 4%, and to engage in securities litigations levied against the Company by shareholders in response to the drop in stock price. Moreover, it was a new executive management team comprising individuals without director experience who were suddenly forced to tend to this long laundry list. The highly experienced outside directors provided level-headed advice and support to the new management team as it went about this task. Various discussions were held during this process, and sometimes differences of opinions arose, but we were able to surmount the challenges that we faced. The memory of finally escaping the worst of the worst is still vividly clear.

Pre-Board meeting briefings can sometimes be insufficient to even lay the groundwork for fruitful discussions. In Olympus' case, however, outside officers raise tough questions and points at briefings, and explanations are revised based on this input over

the course of an entire day so that supplementary explanations can be provided at the actual meetings of the Board of Directors. This process increases the number and length of meetings, but I believe that it is a very functional approach for improving the effectiveness of the Board of Directors.

Fujita

There is always a risk that governance reforms will fail to go beyond structural changes. It is therefore important to take the extra step to reform the mind-sets of senior management. Throughout the process of the reforms I explained, the executive management team maintained a strong and earnest commitment to reforming governance, tackling one challenge at a time to bring us to where we are today. I have praise for Olympus' management in this regard. From my outside perspective, I often saw areas needing improvement, and I was very frank in voicing these concerns. The executive management team was receptive toward this input, which they used to drive improvements. Furthermore, Olympus holds base tours for outside directors and provides us with the information necessary to develop an understanding of its products and technologies. This understanding allows for more in-depth discussions at Board meetings and creates an environment in which outside directors are able to be effective in their roles through the Board of Directors.

Governance and Challenges at Olympus' Next Stage

Fujita

The next stage for Olympus' corporate governance reforms will entail a transition to a global management team. I was hoping to take this opportunity to ask you gentlemen for your opinions on how Olympus should structure its governance and management and the vision it should pursue during this stage. As you know, approximately 80% of the Company's sales currently come from overseas, meaning that operations are already in the global phase. I therefore would like to hear your thoughts on how to enhance these operations and how Olympus should go about evolving into a truly global company in both name and substance.

Kikawa

In my opinion, the next stage for Olympus is still the second stage. The Company has escaped from its state of crisis and is preparing to move on to its next stage, but that will be a big step. The current management team still has the sense of urgency that will motivate it to overcome any challenge. Transferring this sense of urgency to the next management team will be crucial going forward. Accordingly, it will be important to determine what type of governance will allow for this transference to occur.



Michijiro Kikawa

Natori

There are many different approaches toward global management. In the past, I worked at a global company headquartered in the United States. This company took an exhaustive approach toward pursuing overall optimization on a global scale. This was an extreme approach that meant prioritizing global optimization above regional optimization and sometimes led to policies that were disadvantageous to specific regions. This approach was also reflected in corporate governance. If the head office made a decision, it was treated as an order to be applied throughout the entire organization. Reports were to be submitted on the implementation of these orders, and these reports would be checked and instructions would be issued to address any insufficiencies. This cycle was rigorously enforced. I do not know how applicable this approach would be to Japanese companies. However, I can say that I still do not see a clear direction for Olympus in its pursuit of global

management. There is still a need for ongoing discussions by the Board of Directors to formulate concrete plans for bridging the gap between the current state and Olympus' goals with regard to global compliance, governance, and its businesses.

Fujita

I too see major obstacles that will need to be overcome for Olympus to realize a global management team. I think there might be a need to discuss whether or not it would be a good idea to directly apply the approach of a U.S.-based global company to Olympus. Conversely, the current management team will be insufficient when it comes to further enhancing the Company's already global operations. This insufficiency can be clearly seen in the Board of Directors; everyone is Japanese. Although the Olympus Group does have non-Japanese executive officers, integrating more non-Japanese individuals into the management team will be a task needing to be addressed in the future. If this integration is realized, then I can see Olympus becoming a truly global company. However, this will not be without challenges as changing just the types of individuals who are appointed as officers will not be enough. The Company will also need to manage, cultivate, and position human resources from a global perspective. Developing and positioning human resources in a manner that is comprehensive down to the individual employee level will thus be a challenge needing to be overcome.

Recent years have seen an increase in individuals interested in corporate value that also accounts for non-financial factors, such as environmental, social, and governance (ESG) factors, going beyond traditional corporate value based on financial elements. I think one could say that Olympus' corporate philosophy and business model are in line with this trend. What are your opinions on this matter?

Kikawa

The very structure of the Company's business contributes to and creates value for society, and I therefore think Olympus should keep moving forward on this course. The healthcare industry is one of the few remaining growth industries. As venture companies and various other competitors enter this industry, Olympus will need to develop a unique position. As this is a very broad industry, it would not be prudent for the Company to attempt to excel in all sectors of the industry. Rather, it should leverage its superior technological and development capabilities to contribute to the health and happiness of people in the sectors where it exhibits excellence.

Natori

Each of Olympus' businesses is beneficial to people and to society and is thus highly valuable to society and greatly appreciated by all. These long-developed businesses are something to be proud of. In this business, however, Olympus must not become overly preoccupied with profits. The bar is always rising when it comes to consideration for the human rights of factory workers, fair trade, and the environment as well as for the reinforcement of corporate governance and compliance. As such, Olympus will need to be able to communicate its efforts on these fronts to people outside of the Company as concretely as possible.

Revision of Japan's Corporate Governance Code and Issues for Olympus

Cultivation of Future Candidates for Future Management Positions and Related Issues

Fujita

Japan's Corporate Governance Code was revised in June 2018. The revised code contains stipulations pertaining to the diversity of directors, suggesting not just the appointment of women to director positions but also the utilization of non-Japanese and other diverse individuals. Other issues put forth include the clarification of procedures for nominating and dismissing chief executive officer (CEO) and the functionality of nominating committees. There is also room for discussion regarding compensation systems. Mr. Kikawa, what is your opinion on these matters as the chairman of the Nominating Committee?

Kikawa

Olympus does not employ the Company with Nominating Committee, etc., system described in the Companies Act of Japan. Accordingly, the Nominating Committee is positioned as an advisory body, and determining how the committee should function is thus an issue we need to address. At Olympus, external institutions are utilized to select director candidates. Also, candidates for executive officers positions with special titles are recommended to the Nominating Committee. We interview these candidates and then report our opinions to the Board of Directors. By having the committee examine candidates to ensure that they are suitable for appointment, rather than leaving such decisions entirely to the discretion of the president, we are able to ensure objectivity in the nomination process. The next task we need to address will be examining plans for cultivating successors for the position of president and as well as policies for nomination and dismissal. Determining how to proceed with this task is an issue, but I plan to move forward while consulting with the other committee members.

Natori

As this is a matter for executive management, it might not be my place to comment as an Audit & Supervisory Board member. Speaking from my experience, however, many companies in the United States have adopted similar succession plans. In these plans, officers will name successors who can take up office one year in the future, three years in the future, and on the following day. A single



Katsuya Natori

successor is chosen for the following day just in case something happens to the officer in question. Several successors may be selected for one year and three years in the future, but it is said that different successors should be named for each period. Moreover, officers are required to explain why each successor is suited to the position and provide clear reasons for their selection along with details on the strengths and weaknesses of successors, among other factors. Division managers also name successors in this manner. The successors named are examined by nominating committees or boards of directors based on the rationale for their selection and their potential to determine if they are suitable. This process prevents individuals from choosing successors who will be beneficial to them or who will allow them to exercise influence even after stepping down. Exercising the functions of Olympus' Nominating Committee and its Board of Directors to eliminate such possibilities would no doubt contribute to the creation of transparent succession plans.

Fujita



Sumitaka Fujita

I feel the same way. A problem with Japanese companies is that they sometimes function somewhat as a "company community (collective)." Everyone is seen as a comrade, and lifetime employment is guaranteed. Officers are chosen from among these comrades, and the president is chosen from among the officers. Moreover, it is the president who chooses auditors. This system has been very problematic. A functional nominating committee incorporating the perspectives of outside directors is vital to addressing this situation. Another important factor is to continuously evaluate directors and especially the president, and to make decisions regarding nominations and dismissals based on those evaluations. This approach should also be applied to executive officers. There will always be concern for the degree to which people from outside of a company can understand its inner workings. However, this issue can be addressed through various frameworks. Appropriately establishing and updating these frameworks and effectively evaluating directors is of extreme importance. I hope we can rely on Mr. Kikawa for those evaluations. In Europe and the United States, it is common for nominating and compensation committees to be separate but have overlapping members. However, I think there is room to examine the possibility of creating an integrated nominating and compensation committee.

Corporate Governance

Natori

On the topic of evaluations, when I was at IBM, the company once found itself on the brink of bankruptcy. However, Louis V. Gerstner Jr., an individual from outside of the company, was appointed as CEO and was able to reverse the downward trend in performance. In his book *Who Says Elephants Can't Dance?: Inside IBM's Historic Turnaround*, Gerstner Jr. explained his reason for naming Samuel J. Palmisano, a long-time IBM employee, as his successor by saying that only someone who has spent years working at IBM can understand the company's worth. Another reason Gerstner Jr. cited was Palmisano's passion. He told the directors of IBM at the time that rational evaluations were not enough, the CEO also needed to be passionate. This statement won the support of the directors. I believe that such passion is especially important to the president of a company.

Compensation Systems

Fujita

It is common in Japanese companies for there to be disparity between the levels of responsibility of directors and their compensation. When directors and executive officers diligently work to improve the corporate value of their companies, one must ask if the compensation they receive appropriately reflects those efforts. I feel that the compensation of such individuals is incredibly low and there is a particularly poor balance between the ratios of fixed and performance-linked compensation. In general, the portion of fixed compensation is very high. Meanwhile, questions to be examined pertaining to compensation include whether compensation systems sufficiently provide incentives, if payments should be made in cash or stock, and what indicators should be used for performance-linked compensation. Olympus has reworked its compensation systems several times in consideration of these questions. Currently, 50% of corporate officer compensation is fixed compensation while the remaining 50% is variable, performance-linked compensation. About half of the variable compensation is linked to short-term performance and is paid, in principle, in cash. The other half comprises restricted stock (RS) compensation and performance-linked, performance share unit (PSU) paid in stocks. The current system may not yet be ideal, but it is nonetheless the product of ongoing revisions based on the issues identified.

(Corporate Officer Compensation page 65).

Kikawa

Olympus' compensation system is very easy to understand and the evaluation standards are convincing. Mr. Fujita, you speak of how the compensation of directors at Japanese companies is low when compared with other countries. I do not think there is a need to raise compensation to the levels seen in other countries. However, if Olympus is to recruit global talent during its next stage, it will of course be necessary to develop a compensation system that will be suited to this task.

Natori

Mr. Kikawa touches on one of the strong points of Japanese companies. The presidents, employees, and everyone else at Japanese companies work together as a united team for simple and modest compensation. This modesty is reflected in the attitudes of Japanese managers. As an Audit & Supervisory Board

member, this might not be for me to say, but I cannot help but feel sorry for the presidents of Japanese companies. The CEOs of U.S. companies are clearly overpaid, and, in comparison, the presidents of Japanese companies receive too little given the weight of their responsibilities and the burdens placed upon them. Global companies based in the United States generate around 10% of their global sales and 20% of their income in Japan. However, the difference between the level of compensation of the CEOs at the U.S. headquarters of these companies and the presidents of their Japanese subsidiaries is not a factor of 10, but rather a factor of 50 or even 100. Given this reality, it might be necessary to slightly revise compensation amounts. I do not think such a change would immediately result in individuals choosing to continue to serve their companies as advisors or honorary presidents, and higher levels of pay could also encourage managers to retire and leave their companies earlier. However, such compensation would provide an incentive to individuals aspiring to become managers in Japanese companies.

Fujita

My opinion runs close to that of Mr. Natori. If Olympus is to target a global management team, it will need superior global talent, and the current compensation system may not be sufficient to secure such talent. I think that incentives should be tied to more challenging targets and that fluidity of movement in managers may be necessary at times. What I mean to say is that, if compensation schemes do not contribute to the retention of managers, Olympus might not be far from the day when it finds itself lacking talented human resources. This is still a relatively new concept to Japan, but it will be important to consider medium-to-long-term indicators and the incentives provided by compensation amounts in order to develop a system that contributes to retention.

Diversity in the Management Team

Fujita

As Olympus shifts to a global management team, the Company will need to address the lack of diversity among directors in terms of nationality and gender. I think that the overall fluidity of



managers among Japanese companies is too low. Generally, people join a company and stay until they retire. This in and of itself is not a bad thing. However, increased fluidity among managers, including middle managers, would contribute to greater dynamism in Japanese companies. The same goes for Olympus. A higher amount of fluidity among managers would help the Company incorporate a wider range of valuable wisdom. Such fluidity would bring with it the risk of talented Olympus employees leaving to go to other companies, but this might be beneficial for the corporate sector in Japan overall. Increasing management fluidity and diversity with regard to boards of directors are issues faced by all Japanese companies, Olympus included.

Natori

I think that there is a happiness to be gained by spending one's entire professional life at a single company. Just as people choose companies, companies also choose their people, and this relates to the topic of diversity. Appointing individuals from outside of the company is not the only way to increase competitiveness, and it goes without saying that if a company does not rigorously develop its own employees, it will be unable to win out against its rivals. When you quit a U.S. company, they tell you that you can come back once, but not a second time. The underlying meaning in this statement is "come back and help us after you have gained skills elsewhere." It could be said that an increase in fluidity is inevitable going forward.

Kikawa

When it comes to diversity, it would best to take the perspective of deciding what Board of Directors composition Olympus needs at any given time, appointing individuals with extensive management experience or from legal circles as necessary, for example, with consideration for the current composition and the composition that will be required in the future. As far as gender goes, the ratio of female employees at Olympus is around the average, but I have not seen a female employee give a presentation at a meeting of the Board of Directors. This situation suggests that there might be a need to provide female employees with more opportunities to exercise their talents.

Natori

At global companies based in Europe or the United States, talented individuals who can contribute are utilized whether they be male, female, from another country, or even a member of the LGBT community. These companies do not let such attributes influence their decisions. Moreover, such companies will take whatever steps necessary to keep talented individuals from leaving, whether that be paying retention bonuses or using other means. Conversely, employees who do not perform are reprimanded or shown the door. These companies are truly meritocracies. From this perspective, the promotion of diversity could be seen as more than just the protection of individuals or an act of philanthropy; it could be seen as a measure for increasing a company's competitiveness.

Fujita

The concept of employee retention is almost nonexistent in Japan, and this concept may not yet be necessary. Many traditional Japanese companies still assume that employment is for life. Accordingly, these companies do not incorporate the concept of employee retention into their compensation schemes. Lifetime employment as a system definitely has its benefits. However, under this system, one must wait around 30 years to become a corporate officer, no matter what management skills they possess or how suited they are, and this situation can lead to a significant loss of opportunities. This issue is not limited to Olympus. A little bit of change in this regard will likely end up being a plus for the Company in the long term.

Kikawa

I think that the traditional approach was enough when Japanese companies were limited to their domestic confines. However, now that Japanese companies are seeking to compete on the global stage, this approach is losing its viability.

Fujita

I hope that Olympus' executive management team will develop frameworks for appointing human resources who will take into consideration what we have just talked about.

