



IHI Independent Directors Roundtable

Achieving “Group Management Policies 2023” and aiming Subsequent Growth

The IHI Group is working to transform its business portfolio in accordance with “Group Management Policies 2023”. The advice and supervision of independent directors is crucial for strategy execution. Focusing on the “Group Management Policies 2023” and the strategy for subsequent growth, the four independent directors of IHI and Professor Nana Otsuki of the Graduate School of Management, Nagoya University of Commerce and Business, met for discussions.

Date: May 27, 2024

Venue: IHI Club Hall (25F, IHI Head Office)

Transformation of Business Portfolio

- Otsuki** IHI Group is transforming its business portfolio to achieve its goal for the future. With the first half of the “Group Management Policies 2023” over, what is your view on the progress of the strategy?
- Usui** We are seeing a favorable business environment for the IHI Group. The world looks up to Japan's *monozukuri*, and we are also seeing demand for upgrading infrastructure facilities. The decarbonization and aerospace fields are new frontiers for mankind. Since there are major business opportunities in these fields, we would like to focus on them more and raise the speed of implementation.
- Nakanishi** In fiscal 2023, the impact of the aero engine incident was significant. If you exclude that, our performance was satisfactory in my opinion. On the other hand, I also feel that we have not been able to fully catch the wave in spite of running a business that matches the megatrends. We have been setting aside time at Board of Directors meetings to discuss the transformation of the business portfolio, but we are yet to translate the restructuring of portfolio into concrete action. We would like to see accelerated implementation and full preparation for risk-taking.
- Matsuda** IHI Group boasts the excellent DNA of having made major contributions to the modernization of Japan



Nana Otsuki

Professor, Graduate School of Management,
Nagoya University of Commerce and Business

Engaged in research on financial systems at financial institutions and credit rating agencies both in Japan and overseas. While working for a foreign securities company, she was highly regarded by global investors as a banking sector analyst. In addition to serving as an outside director and auditor of listed companies, Ms. Otsuki is also a member of councils and committees of the Ministry of Finance, the Financial Services Agency, and the Ministry of Education, Culture, Sports, Science and Technology.

after the end of the Edo period through shipbuilding, which was a cutting-edge industry of the time. I believe it is a company with great prospects given the tailwind in the external environment, but I feel it somewhat lacks in thinking about overall optimization with an eye to the future. In order to demonstrate the superb DNA unique to the IHI Group and ride the tailwind, I would say that we require quick decision-making based on a total optimization viewpoint.

- **Uchiyama** Last fiscal year, the Group had to allocate resources to address the aero engine incident, but I believe that the underlying tone of the business was favorable. As for transformation of the business portfolio, we have categorized the businesses into Growth Businesses, Development-focus Businesses, and Conventional Businesses, but discussions are still at the half-way mark regarding where to focus, especially in the case of Conventional Businesses. In terms of business selection, it is also necessary to acknowledge that IHI Group may not be the best owner of some of them.
- **Otsuki** I understand that the transformation of business portfolio is still midway, and you are entering the decision-making phase with a sense of urgency. You have to make difficult decisions such as spinoff or sale of businesses. What are your thoughts on the processes to be adopted in implementing the restructuring?
- **Usui** Unless we further clarify the growth strategy and clearly set out the IHI Group's vision, it will be difficult to carry out sales of businesses. For example, I would like a future scenario to be drawn up which is more specific as

Yoshiyuki Nakanishi

Independent Director
Chairperson of Remuneration Advisory
Committee
Nomination Advisory Committee Member



Chieko Matsuda

Independent Director
Nomination Advisory Committee Member



Minoru Usui

Independent Director
Remuneration Advisory Committee
Member
Nomination Advisory Committee Member



Toshihiro Uchiyama

Independent Director
Remuneration Advisory Committee
Member
Nomination Advisory Committee Member



to how the Group will grow in the aerospace field. It is not efficient to grow all the existing businesses in a balanced way, so we would like to prioritize and to narrow down the growth fields, and push forward in a focused and specific manner.

- **Nakanishi** Instead of taking an elimination approach, we need to make it clearer which businesses are to be the core. I think the ideal approach would be to set up a few core business pillars, and then as much as we can, sort out businesses that aren't linked to them. Upon discussing the restructuring of the business portfolio, we tend to fall into the trap of considering withdrawal or sale citing ROIC being below the cost of capital as the reason. The precondition for the best decision will be compatibility with the Group goal.
- **Matsuda** I would like to clarify our equity story and actively disseminate it to the capital market. As I would like the Group to become a frontrunner in the industry, it should ensure internally sharing a story which is convincing to its shareholders and other stakeholders, and increase the speed of the restructuring. I look forward to strong leadership from head office.
- **Uchiyama** Unless you are thinking on your feet, you probably will not be able to keep pace with the way the world is moving nowadays. In the Growth and Development-focus Businesses in particular, you have to have a strong will to take the lead rather than a mindset of following the competition. Otherwise, you will miss out on business opportunities. The presence of startups is growing in the aerospace and renewable energy fields, and spinoffs are one of the ways to compete with such emerging companies.

What does it take to increase the capital market valuation?

- **Otsuki** Since you came up with the interesting point of long-established companies versus startups, let me present a piece of data. When you compare the median age since inception of Nikkei Stock Average index companies with that of U.S. companies in the S&P 500 index and European companies in the STOXX Europe 600 index, as of last year, both Europe and U.S. companies were at about 30 years against about 80 years for Japanese companies. I am not generalizing, but I feel the age of a company and its relation to the company's willingness to take on challenges and innovate is a really interesting research topic. As independent directors, how have you been advising and monitoring to raise the capital market valuation of the IHI Group?

- **Usui** The Group's Management Philosophy says "Contribute to the development of society through technology", and if technology is seen as the core competence, it is necessary to offer opportunities for Ph.D. holders, who are the highly skilled resources of the company, to play more active roles.

I think investors and shareholders are expecting the IHI Group to generate value that only it can deliver. Another thing is, even if you are an engineer, you should be strongly aware of the impact the value created by technology has on society, rather than just paying attention to technology. Technology is there to make society better, and therefore engineers should not just focus on building rockets, but also set high technological goals of contributing to society and making money through rockets.



- **Nakanishi** The IHI Group is a group of highly talented engineers. At the same time, I feel it is slightly lacking in ideas to monetize its technological excellence. Offering a perspective on how to build a business model that generates cash while meeting social needs with the technology and knowledge it possesses is something we as independent directors can contribute to value generation at the IHI Group.

- **Matsuda** What I would like to offer is a capital market perspective. I always try to engage in discussions from a strategic perspective, while being conscious of how the Group is viewed by external stakeholders, including investors. As an engineer, it is important to have the desire to create high-performance rockets, but if you are an entrepreneur, you need a strong desire to make a profit from building rockets. I would like them to think more of how to structure the rocket business in addition to building rockets.



- **Uchiyama** I would like those in the implementing side to have a clearer awareness of what IHI Group's strengths are and what its differentiating factors are. Regarding business reports and also investment projects, if you can discuss the Group's position in the market, where it is heading, and what it is trying to do, then the direction for the company will become clearer.

Integration of sustainability strategy into company-wide strategy

- **Otsuki** I would like to ask about the Group's sustainability strategy initiatives. I could not find ESG-related items on the skills matrix published by the Group, but I assumed that this is something the Board of Directors are working together to promote. How far have the discussions progressed regarding the integration of sustainability strategy into company-wide strategy?
- **Matsuda** ESG is being discussed repeatedly at the Board of Directors meetings. The IHI Group has many companies that are compatible with social sustainability, and so I am paying attention to how it will combine sustainability with business strategy. For example, the fuel ammonia value chain businesses are directly connected to sustainability, I would like the Group to promote them so that they can generate returns as a business towards the goal of decarbonization.

- **Nakanishi** Promotion of ESG is frequently an agenda item in Board of Directors' meetings, and there is a high level of awareness among the senior management. Starting this fiscal year, we have incorporated sustainability targets, including active participation of female employees, in the evaluation indicators for performance-based remuneration to increase the linkage between solving of material issues and incentive remuneration.
- **Usui** It is important to make the company sustainable. To this end, we need to define a business portfolio that enables us to contribute to the achievement of sustainability in society, and clarify where we are heading. Restructuring of the business portfolio is also at the core of the sustainability strategy, so we should present KPIs in such a way that our progress can be understood from outside.
- **Uchiyama** Replacing fossil fuels with ammonia, which is an alternative fuel, is expected to have a considerable impact on climate change. In addition, the impacts of the improvements in performance and efficiency of aero engines as well as how we respond to electrification and alternative fuels such as SAF can be presented quantitatively, and I would like to externally disseminate them in a clear manner by using easy-to-understand figures.



- **Otsuki** Please share your views regarding investment in human capital, how to quantify the investment impact, pathways linking to future financial information, and establishment of DE&I in the corporate culture.
- **Matsuda** Transfers between the head office and business divisions have increased recently, and also the mobility of human resources has increased. We will become able to view our company from a relative and a bird's-eye perspective by gaining cross-border experiences beyond the boundaries of our own company. This also leads to innovation as well as enhancement of the capability to come up

with business concepts, so I would like to see transfers promoted more actively. Regarding DE&I, IHI has been consistently appointing female officers through internal promotion. However, I feel it is necessary to make the current nurturing scheme more secure as a system.

- **Nakanishi** Regarding DE&I, it would be better if we increase the presence of foreign nationals. We have one foreign officer, but it appears to be too few for a company with a global business. I believe it is a must to incorporate the ideas of foreign nationals in management decisions for the Group to win against the global competition, so I would like to see it actively promoting them.



- **Usui** The IHI Group has many outstanding engineers with Ph.D.s, so I would like to discuss more how to refine our intellectual property strategy and leverage our technological value for the growth of the IHI Group. How to structure the organization is also important. For a large organization such as ours, we should discuss building an organization structured to operate in a total optimization way, where employees with specialized skills in sales, engineering, and so on can have cross-sectional functions cutting across multiple business domains. It is essential to identify high potential staff early on and nurture them in order to assign the right people to such posts.
- **Uchiyama** The organization will be revitalized if the Group identifies the quality and ability of its employees, gives them authority through early selection, and offers an environment where they can take on challenges. Further, we indeed need to increase the presence of foreigners in the management decision making process (as Mr. Nakanishi pointed out). I feel that the opinions and ideas of foreigners are not being heard. If we can listen to the opinions of people with different viewpoints, we would likely gain new insights on how to conduct our business.

- **Otsuki** Diversity is not limited to gender. The spread of diversity, including foreigners, can lead to innovation and also contribute to improvement in business performance. As the last theme, I would like to ask for your views on governance. Given the aero engine incident, what are the proposals you have been making from the standpoint of independent directors regarding the balance between the ability to earn cash and risk management of projects, as well as management consciousness of cost of capital and stock price, which is sought by the Tokyo Stock Exchange? Please share your thoughts, including from discussions at the Remuneration Advisory Committee meetings.
- **Usui** Regarding compliance, I feel that the Group has too many businesses and cannot keep an eye on everything. So, the best measure is to speed up the review of the business portfolio with focus on growth potential of the businesses. To strengthen governance, I feel it is time to make independent directors the majority. To ensure the company's sustainability, it is indispensable to have heteronomous functions in addition to autonomy within the company.
- **Nakanishi** I think there are no deficiencies in the internal control mechanisms at a certain level or higher, but I recognize that there are issues in communication with those on the ground. As for succession planning, insights, and ideas of employees can be confirmed through interviews with independent directors and executive officers. It is very important to know what the CEO successor candidates are thinking and what actions they are taking.
- **Matsuda** The most significant governance issue is the development of management talent. It is not simply about deciding the next president. Building a plan to develop management professionals will lead to strengthening of governance. The IHI Academy has already been implementing some initiatives, and we should build a mechanism that incorporates external viewpoints in order to select and develop the next-generation management layer who aim to become management professionals.
- **Uchiyama** It is a lesson learned from the aero engine incident that new technologies can involve major risks, which can also occur in the space-related and renewables fields. We are discussing how to predict and share or hedge such risks, including in the way we conclude contracts. One of the reasons behind compliance-related scandals may be that there are too many subsidiaries. It appears that the checking function of the head office is not functioning fully. At the same time, promotion of digitization is also a must. If we depend on manual operations too much, it can lead to human errors and compliance issues and it takes a long time to detect them. As for remuneration, I think it is desirable to move towards increasing incentive remuneration. I do not think a remuneration system which discourages employee autonomy would assist in appropriate risk-taking.
- **Otsuki** Investors are hoping that promotion of corporate governance would lead to improvement in capital allocation and trigger a major shift towards focus on profitability. Listening to your opinions, I strongly felt your passion for the IHI Group. The IHI Group suffered an unexpected incident in fiscal 2023, but I hope the Group will boldly review the business structure and achieve growth that exceeds market expectations.

