



Outside Director Roundtable Discussion

Expecting Further Proof of the Power to Change and Stronger Global Governance Toward its Second Founding

On June 20, 2022, four Hitachi Construction Machinery Co., Ltd. Outside Directors gathered for a roundtable discussion. The directors candidly discussed their assessments of group initiatives, challenges, and their expectations for the sustainable improvement of corporate value.

Outside Director
Toshiko Oka
In 1986, Ms. Oka joined Tohmatsu Touche Ross Consulting Ltd., After working at Asahi Arthur Andersen Ltd., Ms. Oka served as President and Representative Director of ABeam M&A Consulting Ltd. She also served as Partner at PwC Advisory LLC. Currently, she is an Outside Director at Sony Group Corporation, Outside Director at Happinet Corporation, Outside Director at ENEOS Holdings, Inc., and full-time Professor at Meiji University Graduate School of Global Business. She was named Outside Director of Hitachi Construction Machinery Co., Ltd. in June 2021.

Outside Director
Kazushige Okuhara
In 1970, Mr. Okuhara joined Fuji Heavy Industries Ltd. (now Subaru Corporation). Mr. Okuhara has served as the Director, Corporate Executive Vice President, and General Manager of the Human Resources department at Fuji Heavy Industries. Other posts have included President and Chair of the Business Reforms Promotion Committee at Subaru System Service Co., Ltd., Representative Director and Deputy President of Fuji Heavy Industries Ltd., and Representative Director and President of Subaru Kohsan Co., Ltd. He joined Hitachi Construction Machinery Co., Ltd. as an Outside Director in June 2016.

Outside Director
Maoko Kikuchi
In 1992, Ms. Kikuchi was appointed as a prosecutor in the Public Prosecutor's Office of the Ministry of Justice. She later joined the Los Angeles office of Paul Hastings LLP and, later, the law offices of Nagashima Ohno & Tsunematsu. Other posts have included the General Secretariat of the Fair Trade Commission, Chief Compliance Officer of Softbank Corp., Executive Officer in Charge of legal and public Affair at Microsoft Japan Co., Ltd., and a full-time member of the Audit and Supervisory Board Mitsui-Soko Holdings Co., Ltd., and an outside member of the Audit and Supervisory Board of KADOKAWA Corporation. Currently, she has served as Outside Director for Mitsui-Soko Holdings and Outside Director of Hitachi Construction Machinery Co., Ltd. since July 2020.

Outside Director
Haruyuki Toyama
Mr. Toyama joined the Bank of Japan in 1982. After serving as Director General of the Financial Markets Department, General Manager for the Americas, and Director General of the International Department. Mr. Toyama retired from the Bank of Japan in 2014. He became registered as an attorney at law in 2015. Since January 2019, he has served as Special Counsel at IWATA GODO (current position). In March 2021, he was named Non-Executive Director of Horiba, Ltd. (current position). He has served as Outside Director of Hitachi Construction Machinery Co., Ltd. since June 2015.

Integration of Materiality Initiatives and Business Strategy

Toshiko Oka : Since being appointed an outside director of Hitachi Construction Machinery approximately one year ago, I have seen the company focus its efforts on strengthening its value chain business, which I believe is a key initiative for the future. We understand that this strategy is the result of serious consideration as to how Hitachi Construction Machinery responds in the future to matters such as trends in sustainability and changes to the business environment. Generally, when we talk about climate change and resource recycling, the discussion tends to focus on how to meet rules and guidelines. In the case of Hitachi Construction Machinery, however, the company has focused on the idea of protecting the earth, addressing ESG in a serious manner. I think this is meaningful. The reason the company has come to this conclusion is because it deals with construction machinery – products that impact the earth.

Haruyuki Toyama : The company has made considerable progress in its sustainability efforts over the past year or two, especially in its Materiality Theme: "Product and technology development contributing to Climate Change Mitigation and Adaptation. Hitachi Construction Machinery set specific targets to reduce CO₂ emissions from their products by 33% by the year 2030 (compared to 2010). The company is also committed to becoming carbon-neutral by the year 2050. We are seeing a rising awareness of this materiality amongst our employees. One thing that concerns me, however, is that these numerical targets are representative of new product sales. But we understand that the service life of construction machinery is longer than that of automobiles – parts can be stocked for up to 15 years. In other

words, new machines sold in a year represent only a small percentage of stock. In consideration of this, working on an emissions target for the "stock" portion of the business will be a challenge for the future. When new disruptive technologies emerge, changes to the customer base tend to occur as a result, which offers an opportunity for Hitachi Construction Machinery to make an appeal to the entire world.

Oka : As you say, we must continue to keep tabs on where and what kind of disruptive technological changes are taking place.

Kazushige Okuhara : Hitachi Construction Machinery operates and conducts business in complex regions, many of which have differing values on such matters as politics and religion. For this reason, it is imperative to be abreast of matters from the front lines of the business. Two types of technological change exists: change that arises from the needs of the business front lines and change that's driven by Hitachi Construction Machinery. It is important to have a good mix of both. To this end, I believe care is required to ensure management do not lose sight of the front lines.

Maoko Kikuchi : In this sense, we have seen opinions of major overseas distributors, such as Kiesel in Europe, etc., incorporated into product manufacturing and development. I believe Hitachi Construction Machinery has always had a strong inclination for innovation and change. In its earliest days, the company revolutionized mechanical excavators and produced Japan's first hydraulic excavators. The current situation must be a good opportunity for the company to once again demonstrate its capacity for transformation.

The Speed of Response to Changes in Society: Assessments and Issues

Oka : The world is moving at an ever-increasing pace, and this has a significant impact on the purchasing users. We must pay attention to several risks closely as the Hitachi Construction Machinery management structure, including its capital structure, is likely to undergo major change in the future. One example is cyber security risk. In the future, I expect an increase in co-creation utilizing outside assistance, in addition to the company's own management resources. At the same time, while the company must maintain connections to external networks, outside connections and information retention can be risk factors for management. I think the company should discuss again what information will be required, how to acquire it, and what to do if the information cannot be acquired.

Toyama : We have seen the emergence of pandemics, wars, and other events for which past rules of thumb are no longer suitable. I think it would be pertinent to consider whether the Japanese decision-making system of carefully laying the groundwork before making decisions is sufficient to deal with such events.

For example, we could consider changing product development to a process of releasing products after completion to a certain extent. After receiving customer feedback, the company could identify areas for improvement, in order to make our prod-

ucts even better. This process might allow for responding to a wider range of risks. It is often said that DX development is a transition from a waterfall style to an agile style of development. I think the issue now is how to build management across the entire organization based on the same concept.

Okuhara : The organization as a whole is strategically orientated in several ways, but I am also worried that agile decision-making may be difficult unless the organization itself is simplified further.

Another issue is that there are surprisingly few opportunities for a management review of products and technologies that form the core of the business. In the case of automobiles, product planning meetings are very important. In the case of this company, however, I think management should have more discussions, particularly around decisions for electrification and other areas that cannot be achieved iteratively.

Kikuchi : It has been said for some time that Japan's manufacturing industry must shift from products to services and solutions. At the same time, Japan is under pressure to change attitudes away from the era of growth based on mass production and mass consumption; the country is unable to respond to this change adequately. As Mr. Toyama pointed out, Hitachi Construction Machinery is in the process of switching from a strategy

of preparing and releasing products in a very carefully conservative manner to an agile strategy of making changes based on



Maoko Kikuchi

customer feedback.

In the two years alone since I was named director, I have gained a very good sense that the company is striving move forward in that direction. For example, over the past two years, I believe that communication between Hitachi Construction Machinery Japan, the sales company, and the manufacturing division at headquarters has become more lively and the company's relationship with its customers has get closer. In the past, there was a certain distance between the front lines and the Board of Directors regarding investments. Now, the front lines have primary responsibility, including submission of investment proposals to the Board of Directors. I think things are moving in the right direction here.

What contributions do you make to the Board of Directors as an Outside Director?

Okuhara : Looking back at our history, I believe the company had a strong connection and identity as a member of the Hitachi Ltd. group. However, the capital structure will change considerably this year due to recent business changes, and the upcoming year will be a kind of second Founding of the company. We will see a new Hitachi Construction Machinery, but one that still retains the best historical aspects of the company. In this sense, I believe that the *Kenkijin Spirit* will be important as the watchword for the future of the Hitachi Construction Machinery Group. In any case, this year will be a year of new beginnings, let's call it, second founding. And I hope the company will be bold in taking up the challenge. In this context, I hope the outside directors will also be of some help in the management of the new version of Hitachi Construction Machinery. As for myself, I tend to think in more conventional ways, but I am aware that I am a newly appointed outside director of a company that has made a leap forward in independence. So I want to do my part in learning the perspective of those on the front lines, while providing support and assistance to everyone in the company.

Kikuchi : I want to pay particular attention to human resources. I have seen diverse cultures across a variety of organizations, including government agencies, law firms, and Japanese and foreign-owned companies. In the shift from membership-based employment to job-based employment in Japan, we hope to support an environment in which human resources play a more active role. I would like to bring my experience here and help further improve the employee engagement index further.

Oka : At the timing of the second founding, I would like to make it an even more wonderful company in terms of corporate culture. Since my days as a consultant, I have observed many companies in how they operate. Currently, I teach at a business school, so there are many things I can see from my experience. What has caught my attention recently is the attitude of today's young people toward work. They tend to leave a company when they can't see the future direction of their company. They even leave when they see role models and their own likely career path take a direction that they do not agree with, and become disappoint-

ed. The younger generation will be the future of Hitachi Construction Machinery. So I hope to contribute towards making the company a place where young people become inspired, where they have high expectations and hopes, and where the company can improve corporate value by mobilizing its human resources.

Toyama : The neoliberalism that began in the 1980s is coming to an end, and I believe that the relationship between the state and the market will change dramatically. Recently, we are seeing a movement toward what is called an economic security guarantee, in which the state imposes certain restrictions on corporate activities. But whatever new order emerges, I imagine the concept of corporate social responsibility will be increasingly emphasized. Of course, making a solid profit and paying taxes are the basics, but I think it will become increasingly important to think about how to meet society's expectations and put those ideas into practice.

Hitachi Construction Machinery has developed governance as a publicly listed subsidiary of Hitachi Ltd. Now, the company must execute governance independently. The company needs to concentrate on creating this structure, particularly during this first year. In so doing, the company must make sure that it understands and reflects the expectations of society and shareholders. That sums up my thoughts.



Kazushige Okuhara

What initiatives are required in exercising global governance?

Kikuchi : Japanese companies have come to be known as "international," but not "global." Since almost 80% of Hitachi Construction Machinery sales come from overseas, it has become a major issue how to manage the entire group in the future. For example, there is a case that a Japanese company has established a subsidiary overseas that audits group companies on a global basis in very efficient manner. Rather than trying to manage everything from the head office, Hitachi Construction Machinery could, for example, utilize its European locations to lead climate change measures since Europe is leading the way in terms of regulations. Also, local managers manage companies which Hitachi Construction Machinery Group acquired overseas, many other locations are headed by Japanese expatriates, and it seems there is no clear path for local employees to participate in management. As Ms. Oka mentioned, exceptional people might leave from a company overseas as well, because they cannot see the future of the company. In the future, the development and promotion of global human resources will be important as well as organizing a global organization.

Oka : Global governance is a big issue, and there are two major forms of governance here. One is operational governance and the other is corporate governance. Japanese companies began their overseas expansion through functional subsidiaries overseas, such as production and sales subsidiaries. The head office would provide detailed instructions to the overseas functional subsidiaries on what to produce, where to ship, what to sell, etc. In this way, the head office controlled the operational level of overseas subsidiaries to a certain extent. This is what I mean by operational governance, and Japanese companies are good at this. On the other hand, we are seeing more corporate acquisitions in which complete value chains already established within the acquired company. In this case, there is no need for the head office in Japan to issue operational instructions to run the operation. This means, the head office cannot affect operational governance. If so, functioning corporate governance becomes more important. In this form of governance, as a shareholder, parent company tell its subsidiaries what to do and have them do what they need to do. Japanese companies, however, do not respond to this governance. As in the past, sometimes, compa-



Haruyuki Toyama

nies tend to exert pressure, interfering in every detail of operations, or, conversely, tend to be reluctant and neglectful of the details of management. When operating globally, companies must understand the diversity and the different levels of compliance awareness in each country. Conducting effective corporate governance in this context will be a great challenge in the future. This second founding of the company may be a good opportunity to revisit this topic.

Okuhara : I agree. I believe that mergers and acquisitions (M&A) will become more necessary in the future. But from what I have seen, there are still many issues to be addressed in this area, such as post-acquisition Post Merger Integration. I have a feeling that global governance may present some real business challenges.

The other challenge for a company like Hitachi Construction Machinery, which is primarily engaged in direct sales and direct service, is the great deal of risk, including compliance. We have seen several cases in point. This is something very difficult to keep under control. However, Hitachi Construction Machinery is not the only company expanding globally. I think the company can conduct wide-ranging benchmarking to find out what fits its needs.

Toyama : Even with roughly 80% of sales from overseas, this company essentially makes and sells the same products made for Japan in the same way to global markets. We recognize that the powerful term, *Made by Hitachi*, stems from this practice. However, the shift from product sales to services and solutions will be more difficult to expand overseas in the same way as in Japan. It will be important for the company to develop business practices globally in a way that reflects local expectations. One of the challenges will be changing to a decentralized organization model.

At the same time, global control will still be necessary. This will be a very difficult balance to achieve. And it will be a corporate imperative to explore this balance carefully for each market. Even if the company doesn't reach its ideal vision in one step, it will reflect the best aspects of each location and office to the whole, fostering a sense of cohesiveness. I hope to help Hitachi Construction Machinery achieve this ideal.



Toshiko Oka