

ROUNDTABLE

DEFINING RISK MANAGEMENT FOR GLOBAL GROWTH

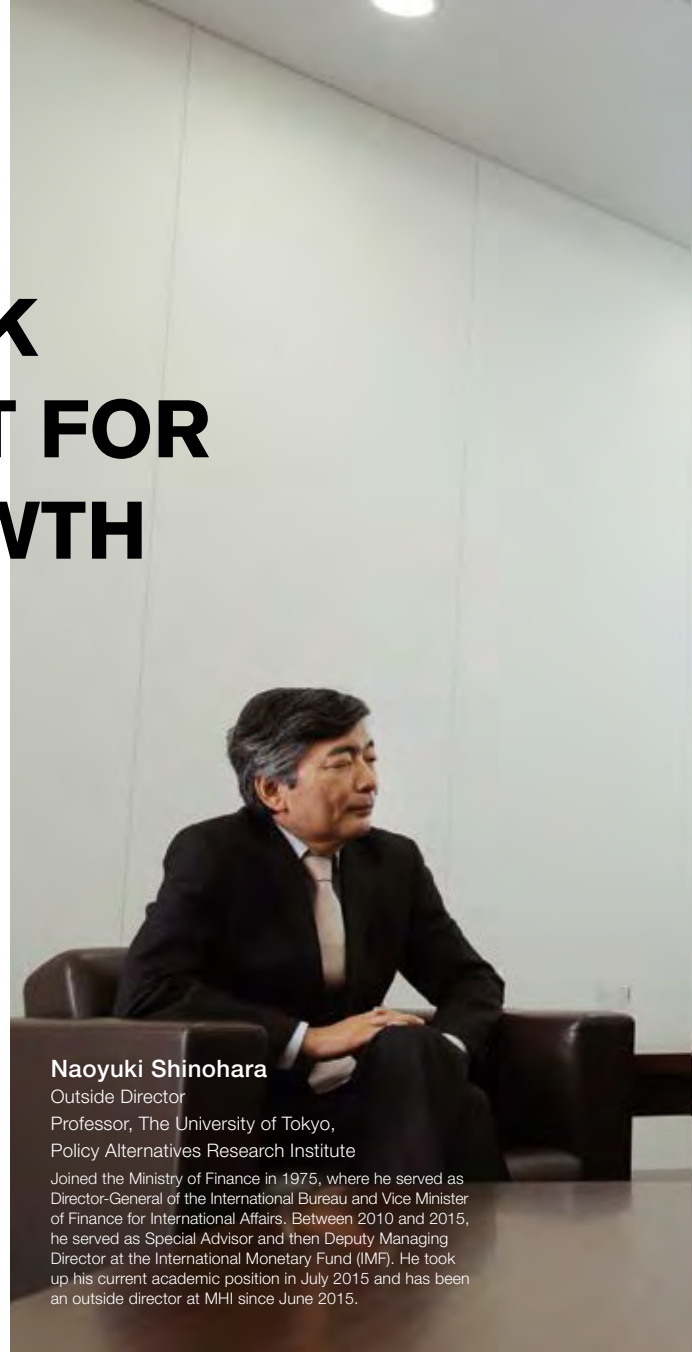
For MHI to grow into a truly global company, world-class risk management is absolutely essential. Here, CEO Shunichi Miyanaga exchanged views on this issue with two of the Company's outside directors: Naoyuki Shinohara and Christina Ahmadjian.

Impressions of Current Board of Directors Meetings

Christina Ahmadjian | When I took up my post as an outside director at MHI four years ago, risk issues were never discussed at Board of Directors meetings. Now, substantial discussions are held concerning incidents that have occurred, including analysis of their causes, consideration of methods for dealing with their consequences, and measures to prevent their recurrence in the future. In this respect, the agenda and discussions at Board of Directors meetings have changed drastically, and as a result I think the handling of risk issues today has matured greatly.

Another significant development has been the transition to an Audit and Supervisory Committee in 2015. Since the committee got under way, highly meaningful discussions about risk and such matters have become possible among just a small number of members.

Naoyuki Shinohara | In my case, I became an outside director at MHI in 2015. My initial impression of the Company is that it takes a serious and dedicated approach to manufacturing. As an example, I had occasion to visit the Nagasaki Shipyard & Machinery Works, and I was struck by how wholeheartedly the employees there approach their work. I also came away with a strong sense of how hard those in charge of business execution are striving, in various ways, to strengthen MHI's global competitiveness. Acquiring globally competitive strength demands taking up new challenges, and this inevitably harbors an element of risk. In the year since I became a director, a great amount of time has been spent debating projects in which risk has become manifest.



Naoyuki Shinohara

Outside Director

Professor, The University of Tokyo,
Policy Alternatives Research Institute

Joined the Ministry of Finance in 1975, where he served as Director-General of the International Bureau and Vice Minister of Finance for International Affairs. Between 2010 and 2015, he served as Special Advisor and then Deputy Managing Director at the International Monetary Fund (IMF). He took up his current academic position in July 2015 and has been an outside director at MHI since June 2015.

Shunichi Miyanaga | In the past, at Company Board of Directors meetings and executive committee meetings we didn't hold detailed discussions on the nature of the risks involved in our various businesses. This was because, to a large extent, our business developments were primarily confined within the limits of the specific markets in which we have had a prominent presence: the domestic market, for example, or the markets of Southeast Asia. Judgments as to when to withdraw from a particular business were therefore made by the individuals in charge of the particular business, and they typically took the withdrawal option when a business or product had completed its productive lifespan: for example when demand for it had diminished structurally or it was no longer cost-competitive. More recently, however, as we have pursued full-scale entry into the global market, the greater competition and forays into new businesses have made it necessary for us to make comprehensive business risk evaluations at the management level.



Shunichi Miyanaga
President and CEO

Christina Ahmadjian

Outside Director and Audit and Supervisory
Committee Member

Professor, Hitotsubashi University, Graduate
School of Commerce and Management

Joined Hitotsubashi University in 2001, after serving as
Assistant Professor at Columbia Business School. Her
research focuses on corporate governance, global strategy
and human resource management, and comparative sys-
tems of capitalism. She was appointed a director of MHI
in June 2012 and became a member of the Company's
Audit and Supervisory Committee in June 2015.

I try to talk as openly as possible at our Board of Directors meetings about any apparent risks or issues that may be occurring within the Company. I also strive to maintain full transparency outside the Company, for example, by providing explanations of risks or issues of concern to our shareholders and investors, and to analysts.

Improving Risk Management by Upholding Transparency

Ahmadjian | I agree that MHI has become very open, in the last year especially. A good illustration is the way the Company's situation was explained at the 2015 General Meeting of Shareholders. Virtually no information was kept from the participants, and I really got the feeling that MHI is undergoing a cultural transformation from the way it was in the past. That said, since most companies in Japan aren't very forthcoming when it comes to disclosing information on their circumstances, MHI's candid

disclosure could conceivably give people the impression that the Company has a relatively large number of risks and problems.

Miyanaga | In managing a company, there are times when you later come to realize that decisions you made in the past were ultimately wrong; and personally I believe that as a CEO, rather than trying to conceal or misrepresent what took place, it's my duty to clearly and accurately explain what criteria or reasons led to a particular decision—what policies or strategies were behind it at the given point in time—and to explain what happened as a result of that decision. Of course, it's better when you're in a position to offer assurance that such-and-such preparations were made to deal with any adverse outcome. I believe that maintaining transparency in this way and always being prepared to give clear and forthright explanations are essential to good risk management.

Shinohara | Over the course of the past year I came to understand just how much more proactive MHI is than most companies in Japan in terms of upholding transparency and explaining any issues of concern to those outside the Company.

Still, there's no denying that, as the substantial loss booked on the Company's cruise ship construction business indicates, there have been serious issues surrounding the Company's risk management, and MHI must reflect sincerely on where the fault lies. I am sure that heated debate over the matter is already taking place within the Company, to pinpoint where the management system went wrong, determine what improvements need to be made to the system going forward, and to identify what lessons need to be learned from this experience. I firmly believe the whole matter needs to be examined closely and thoroughly.

Miyanaga | Up till now, we have always taken pride in the conviction that MHI is Japan's top company in terms of advanced technology, and this may have made us overly self-confident that our risk management methods are correct, too. In reality, though, owing to the unique nature of our business, formulating optimal management methods is no

simple matter. In the automobile industry, for instance, risk resilience standards were established within the context of the history of the global auto industry, and they continue to evolve in response to environmental and consumer protection issues. But in cases like ours, as a B2B company that handles orders of extremely large scale, we rely heavily on the individual contract agreements concluded between us, as the supplier, and our customer. With business operations of this kind, very little exists in the way of clear risk management standards.

In the case of companies in Europe or the United States, typically, if it becomes clear that a particular business or project

entails a certain level of risk, in most instances a rational decision will be made—to withdraw altogether, for instance. But here in Japan, it's more difficult to make an immediate decision to withdraw, because of concerns relating to organizational morale, employment responsibility, passing down technology, and so forth. The costs, both within the organization and in the broader social context, are considerable.

Still, simply because withdrawing presents certain difficulties, we can't just abandon that course of

action. If we don't withdraw when circumstances warrant, we can never achieve any improvements.

Instead, we need to make quantitative calculations and examine specific hypothetical solutions: for example, taking the unique nature of our business into consideration, evaluating to what extent we can calculate our risks, or considering what's necessary in order to play on a level field against overseas competitors, whose best practices have been established within their particular historical contexts and financial foundations. If we can then explain these risks both internally and externally, it should be possible to perform more advanced risk management.

Development of Risk-Taking Human Resources

Shinohara | Where misunderstanding needs to be avoided is in the notion that risk is invariably negative in nature. As one of Japan's leading manufacturers, MHI must continuously take up new challenges while accepting a given level of risks. What's important is defining what those risks are, and knowing how to manage them. The Company should never fear, or retreat from, taking on risks per se.

Ahmadjian | If MHI aims to become No.1 in the world, it has to take on risks. Risk management doesn't equate to risk avoidance. Taking on sound risks, I believe, is a truly vital issue.

Miyanaga | In that respect, in order to continuously improve our risk management I believe that rather than evaluating personnel based solely on their record of demerit points, we need to promote people who have a record of having already taken up a host of new challenges, sometimes with success and sometimes with failure. We also need human resources capable of resolving both issues that involve technological difficulties as well as those that present difficulties from a business perspective. As a business enterprise, we have to seek out human resources possessing both cautious prudence and bold confidence, and give our employees opportunities to take up challenges early on, to build up their experience and enable them to grow as managers.

The Quest for Diversity in Human Resources

Shinohara | On the subject of human resources, I find the exchange of people and ideas at Primetals Technologies especially interesting. Here, the merger partner was Siemens—a company that is both MHI's competitor and a company that MHI should emulate. The situation at Primetals presents opportunities for learning a wealth of business



practices from Siemens, not the least being risk management. At the same time, Primetals also stands to learn in various ways from MHI. The result will surely be exponential growth in the capabilities of the company's personnel.

MHI perhaps suffers from a tendency to focus too much on a given project; and for that reason I think putting in place the mechanisms to enable more objective input from outside would be highly effective. What I'm referring to here is diversity of the Company's human resources. Shifting personnel within the Company may be one way of guaranteeing the objective standpoint from outside needed for the success of a project, but I think it's even more important to input the knowledge of tieup partners like Siemens and boost diversity.



Ahmadjian | I visited Primetals Technologies this March, and as you might expect from its being a joint venture with Siemens—a company that has pursued a string of international M&As until now—people of many different nationalities—Japanese, Germans, Austrians, British and so on—serve on its management team. I really got a sense of the company's diversity. My visit provided me with a wonderful chance to debate the strengths and weaknesses of how Japanese companies operate, and I came away with the hope that MHI will become a truly diverse company like Primetals in the future.

Miyanaga | Primetals Technologies is one of the various companies that have consolidated as the metals industry has matured and manufacturers of metals machinery around the world have down-scaled. The company represents the amalgamation of the wisdom of six countries—Japan, the United States, the United Kingdom, Germany, Austria and

Italy—and it also has engineering staff working at its bases in China and India. In this respect, Primetals is a paragon of diversity, and we assign our young corporate employees there to give them the greatest learning opportunities, including the opportunity to acquire expertise in risk management. We have high hopes they will apply their experience there as managers in the future.

Hopes and Expectations for Outside Directors

Miyanaga | What I hope for most from our outside directors is that they will ask frank and candid questions, without hesitation. Although we believe we are doing our utmost to provide information, I hope that our outside directors will indicate points that they nevertheless have difficulty either understanding or accepting, and tell us what points seem odd to them from their perspective. If there are things that we have trouble explaining, this means we ourselves have inadequate understanding of them, and making us aware of those points will be very valuable. Ahmadjian-san, sometimes you point out aspects that you believe to be highly unusual, and in response I have merely said it's a matter of cultural differences. But offering an "explanation" like that doesn't make for a fruitful discussion. Only when we are able to offer clear reasons for something can a discussion get under way and give birth to new ideas.

Ahmadjian | I agree, what's most important is to convey our respective views. Today, a great deal of time is allocated at Board of Directors meetings to Q&A sessions and reports. Going forward I would like to see a further increase in discussion time.

Shinohara | One of the roles of outside directors, I believe, is to monitor whether steady progress is being made in implementing initiatives targeting improvements—in the way risk management is handled, for example. Personally, I still have relatively little experience serving as an outside director, so I am always asking myself how to discuss matters in such a way that I might make positive contributions to MHI. Looking forward, while continuing to pose that question of myself, I intend to participate in discussions with the interests of the Company's stakeholders always fully in mind.

