

Outside Directors Roundtable

Corporate Governance: The Strength Sustaining MHI Group's Value Creation



Director
Nobuyuki Hirano



Director
Audit and Supervisory
Committee Member
Noriko Morikawa



Director
Audit and Supervisory
Committee Member
Hiroo Unoura

MHI Group as Viewed from Outside Directors



Facilitator: Ryoko Ueda

Ms. Ueda is Adjunct Professor at the Graduate School of Management, Kyoto University. After joining Mizuho Securities in 2001 and later moving to Japan Investor Relations and Investor Support, Inc. (J-IRIS Research), she assumed her current position in 2020. Ms. Ueda currently serves on numerous government and official councils, including the Certified Public Accountants and Auditing Oversight Board and the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

Ueda Good afternoon. I'm Ryoko Ueda, and I will be facilitating today's discussion. My areas of research are the capital markets and corporate governance. Today I will focus on topics that I think will be of interest to institutional investors reading the MHI Report. To begin, I would like to ask you for your overall impression of MHI Group from the perspective of an outside director, including issues you believe the company needs to address.

Hirano I was appointed as an outside director in June 2019, and since then I feel MHI Group has achieved significant changes. In February 2023, for example, the company made the momentous decision to terminate SpaceJet development.

Today, the environment in which MHI Group operates is undergoing major changes as issues of global scope evolve with increasing speed and intensity: issues including climate change, widening economic disparity, and rapid developments in artificial intelligence. How quickly MHI Group will be able to respond to these and other changes will be key, I believe, to ensuring the company's success going forward.

MHI Group has a history stretching back well over 100 years, and during this long time the company has played a major role in Japan's social and economic development while building a large portfolio of technologies. In the years ahead, how MHI uses its many resources to address the environmental changes I just spoke of will be of critical importance. So too will be the company's ability to recalibrate its vast business portfolio and to prioritize specific areas on which to focus when making capital allocations for the future. Another matter of vital importance will be how well MHI Group can open itself to outside partners instead of insisting on self-reliance, recognizing that there are limits to what one company can do on its own.

Unoura I too became an outside director in June 2019. To be frank, I took my position thinking that MHI was a very old-fashioned company cast in a traditional mold, but I was surprised to learn that the company had already begun making many changes with great success.

That said, I think MHI today remains too focused on total self-reliance and gives too much priority to product development without considering how the new products should be marketed. Times are changing, and rather than embracing a perspective focused on choosing good business partners, it's more important for MHI to be a corporate

group that outstanding partners will want to work with.

Morikawa I was appointed as an outside director in June 2020, and the following year I became a member of the Audit and Supervisory Committee. MHI Group has many strengths and positive aspects, but I feel that many barriers still exist within the organization: between business domains, for example, or even between bases of operations. To counter this, the HR division has taken the lead by launching an internal recruitment system and other programs.

One other point of concern is that there are too many mild-mannered employees with excellent credentials, while there are very few disruptors who aren't afraid to think and act completely outside the box. This homogeneity may put too much pressure on employees to go with the flow. Even when interacting with external parties, employees tend to have a rigid sense of identity as MHI employees, and this pride often prevents them from contact with those outside the Group. It would be better, I believe, if employees were more flexible and compromising while being more open to association with a wide variety of people. If MHI could cultivate a more open corporate culture, I think the company would be more likely to proactively engage in external partnerships, as Mr. Hirano and Mr. Unoura mentioned.

Medium-Term Business Plan (MTBP)

Ueda **FY2023 is the final year of the current 2021 Medium-Term Business Plan. How do you assess the progress being made under the current plan, and what would you like to see incorporated into the next MTBP?**

Hirano The three years of the 2021 MTBP have been a transition period – a period for clearing up earlier issues and preparing for future changes. As I mentioned earlier, a major decision was taken to terminate SpaceJet development, and we succeeded in achieving our goal to improve the company's profitability, enabling a start to investments into strategic areas.

In addition, our 2040 Carbon Neutral Declaration was epoch-making and came as a welcome surprise, both within and outside the company. Two technologies in particular are of extreme importance for MHI to firmly establish our position as a leading company in the global pursuit of Carbon Neutrality: one

is combustion technologies for power generation using hydrogen and other zero-carbon fuels; the other is carbon capture, utilization, and storage (CCUS), an area in which we hold the top global market share. Another growth area is ΣSynX (read "Sigma Syncs"), our initiative aimed at efficiency improvement and value creation by integrating a variety of products and services through digital technology. I expect this initiative will take a more definite shape going forward.

The Board of Directors has already been involved in a number of discussions considering the next MTBP. In the new plan, I expect two things will become clear: the company's swift and appropriate response to global changes, and a new willingness to join forces with other companies and entrust them with areas they are better equipped to handle. I have high expectations that this will help raise MHI Group's value.



Unoura As Mr. Hirano said, the 2021 MTBP has been a period of transition. I believe it has been a good plan, and its

targets are fully achievable. The upcoming 2024 MTBP, on the other hand, is likely to be a bigger challenge, calling for the achievement of substantial results.

I naturally expect that the views expressed by the outside directors will be fully taken into consideration when preparing the new MTBP, and we will each offer suggestions based on our own bodies of experience.

Today, it is no longer possible for one company to respond to all of society's needs. The days are over when a company could win approval just by providing efficient products of high quality. Today, we have to consider how our products can be best put to use, and determine how to integrate them with products and solutions from outside the Group in order to accomplish this. To achieve sustained development, it will be extremely important both to choose good partners and to be a company that potential partners will want to work with. This is especially true in fields which we have designated as future growth areas, and this will be a major focus of the upcoming MTBP.

Developing Human Resources to Support Continuous Growth

Ueda Today, we are seeing growing interest in human capital. People are what enable a company to continue to grow, a fact that makes HR development increasingly important. What are your views on this issue?

Morikawa There are many good examples of HR development outside Japan, and I think MHI should incorporate the best ideas available. I have many years of experience working for foreign companies. American and German companies, for example, have completely different approaches to HR development.

MHI Group has established a new HR development policy and is beginning to put in place systems to support the growth of employees' individual skills and careers. Two examples are the company's many educational programs and the internal recruiting system. Employees who want to expand their individual potential within MHI Group can avail themselves of a variety of programs. Or they can also leave and take on new challenges outside the Group, and then return later, bringing with them experience acquired elsewhere. If employees use this flexibility to consciously strive to enhance their individual market value, I believe that MHI Group will become all the stronger.

▶ For details, please see "HR Strategy" on pages 86-93.



Unoura Up until now, HR development in Japan has mainly been predicated on lifetime employment. The company had roles it wanted employees to fill, and it would assign employees to the appropriate training to fill them. From now on, though, the main focus will be on providing opportunities to employees to enhance their own individual value. In the future, diverse business areas are expected to support MHI Group's growth, and a variety of specialized capabilities will be needed for this. Offering employees a wide range of options for their own personal development and allowing them to choose for themselves should achieve the desired results.

Employees returning from a period of work outside MHI Group, as well as mid-career hires, will help stimulate the company. Also, because each business unit within the Group has its own specific regional characteristics and areas of specialization, I think it will be necessary for the company to hold internal HR exchanges and consciously increase networking opportunities.

Hirano MHI Group also has robust programs for developing next-generation leaders. There are three tiers of programs: one for employees in their fifties, one for those in their forties, and one for employees under 40. There is another leadership development program that includes participants from MHI Group's global companies. This marks a major advance for MHI Group. These training programs also provide opportunities for networking among participants from different workplaces, so I think these programs make for a truly excellent and well-organized system to develop human resources.

MHI Group's Corporate Governance System

Ueda **MHI has an Audit and Supervisory Committee. As directors, how would you evaluate the committee's activities, and what would you describe as the characteristics of MHI's governance system?**



I'd also like to touch briefly on the personnel-related discussions conducted at Board of Directors meetings. On a regular basis, when we receive reports from the business divisions, they include results of their employee engagement surveys and the extent to which actions have been made in response to the survey findings. It's rare for such details to be reported at corporate Board of Directors meetings, and I believe this is a practice that merits high praise.

As a final note, I'd like to add that diversity is of extreme importance. To provide an example, MHI Group is proposing solutions to connect forklifts and refrigeration facilities through digital technology – one illustration of how business today must transcend borders. Increasing the number of mid-career hires and proactively conducting personnel exchanges within the company will help the company integrate new perspectives and ideas.

Unoura Companies with an audit and supervisory committee adopt a mode of governance unique to Japan, and in my view each company should have its own approach to making the system function effectively.

In MHI's case, we have two full-time Audit and Supervisory Committee members, and the committee is expertly supported by dedicated staff. An outstanding team from an external audit firm monitors our governance activities, and

Outside Directors Roundtable



they provide detailed guidance from a third-party perspective. MHI also has a solid risk management framework in place on the executive side, so in my view risk management is of the highest standard.

Another positive aspect is that MHI Group personnel are often called on to attend meetings of the Audit and Supervisory Committee to explain specific topics. For example, we recently had in-depth discussions with HR concerning human capital, an area of keen interest to us.

Morikawa At Audit and Supervisory Committee meetings, we regularly engage in meaningful discussions on such topics as the progress of key company projects and bottom-line performance, taking into account issues identified by our outside audit firm. At the same time, holding talks on company projects with the executive side is extremely important to help us understand the status of each project from a risk management perspective. On such occasions, transparent explanations and quick reporting are important. MHI Group employees have a strong sense of responsibility, and although this is a point of strength in the company's corporate culture, it also can potentially cause employees to attempt to solve issues involving risk on their own while withholding information. We are always sure to remind the executive side of the importance of full disclosure of information regarding perceived risks, and we request that such information be reported as quickly as possible.

Hirano I too formerly served on the Audit and Supervisory Committee, at which time I proposed drawing up risk maps. MHI Group is involved in a wide range of businesses and undertakes projects with long construction periods requiring large financial investments. To avoid inflicting any unwelcome surprises on our investors and other stakeholders, I suggested creating a system that would clearly show where risks exist, their scale, and their probability of materializing. The result was the creation of a three-tier risk management structure. In the first tier, staff identify potential risks by reviewing risks recognized and reported in the business activities. In the second tier, management reviews staff reports and recognizes risks. And in the third tier, management reports the results of risk reviews to the Board of Directors, which deliberates how to deal with these risks.

Discussions among MHI's directors tend to focus on business strategy, but, needless to say, the Board of Directors is an organization that oversees all aspects of company management, which include internal control and risk management. Knowing that the Audit and Supervisory Committee looks closely at the details of each issue provides us with a great sense of security.

Unoura With the Board of Directors and the Audit and Supervisory Committee both fulfilling their roles in this way, I believe MHI Group has achieved a highly effective governance system. In the company's annual survey evaluating the effectiveness of the Board of Directors, I suggest including evaluations on how well the company's governance system – including the Audit and Supervisory Committee – is functioning, and then publicizing the results externally.

Composition of the Board of Directors and the Role of Outside Directors

Ueda Before we close, I would like to ask about the composition of the Board of Directors and your views concerning your individual roles as outside directors. The Board includes directors from other Mitsubishi brand companies. Do you have any comment concerning this point?

Morikawa The Board of Directors includes two female directors, and the atmosphere at Board meetings is very much conducive to free discussion. Also, at each meeting, the directors voice opinions from many different perspectives based on their varied backgrounds, so I feel there's a good amount of diversity.

That said, considering the skill set of the Board as a whole, given the specialized nature of MHI Group and the direction of future business development, I think the Board might benefit from including an outside director who is a specialist in IT or other technical areas. I would also like to see the company consider appointing a non-Japanese director to the Board.

Unoura Two members of the Board of Directors, Mr. Hirano and Mr. Kobayashi, are former executives of other Mitsubishi brand companies. While both of them are very kind and caring people, they can be quite strict with our executives. They have excellent insights concerning MHI Group and an amazing depth of knowledge concerning the company's management and business operations. Since they can be uncompromising in their assessments when necessary, I believe that, from the perspective of effective oversight, they are both properly fulfilling their roles as Board members.

In my case, I provide a slightly different perspective at Board meetings, and I always strive to keep the executive side on their toes. In addition, as an outside director I have some opportunities to speak with young employees at locations throughout the company's network, and my personal ambition is to inspire young employees to succeed.

Hirano The formalism of corporate governance isn't important. History has shown that even companies considered to have excellent corporate governance systems – companies with three committees, for example – have in many instances caused scandals or gone bankrupt, as we've

seen with Enron and the collapse of Lehman Brothers.

With respect to the independent position of outside directors also, formalism isn't important. What's most important is whether or not outside directors will protect the interests of diverse stakeholders, including minority shareholders, and offer suggestions on how the company can increase corporate value. Outside directors thus need to be people with diverse bodies of experience, perspectives, skill sets, and global mindsets. A good understanding of the company is also extremely important, and this demands a fair amount of study, even after appointment to the outside director position. Finally, good outside directors love the company they work for. It is my personal belief that those who love the company they serve for have the deepest insights and the most constructive criticisms, which are the most valuable contributions people in these positions can provide.

Ueda Listening to what you have said today, I can see how much respect you each have for MHI. I've also gotten a clear picture of how lively Board of Directors meetings – and how deep the deliberations that take place at them – must be. From my perspective as an outsider, I've also come to look forward to watching MHI grow over the long term.

Thank you all for making today's roundtable such a valuable experience.

