

President

Outside Director

## Shigeru Murayama × Yoshihiko Morita

Shigeru Murayama, president and representative director at KHI, and Yoshihiko Morita, the first outside director at KHI, respond to questions on the theme of improving enterprise value.



Fiscal 2014–ended March 31, 2014–was the first year of the Medium-term Business Plan 2013 (MTBP 2013). Looking back on the past year, how was the operating environment and how would you evaluate the Group's performance under these conditions?

**Murayama:** In fiscal 2014, gradual economic growth worldwide, along with a correction in the strong yen, underpinned higher sales and income for the KHI Group. In fact, net income reached an all-time high of ¥38.6 billion.

Of special note, we are seeing wider global demand for the Group's products, particularly in the areas of commercial aircraft, with demand expected to increase over the medium to long term; rolling stock, which is essential to economic development in all countries regardless of developed or emerging nation status; infrastructure, including decentralized power sources; and also for industrial robots, which are a key component of measures to mitigate soaring personnel expenses and to improve labor productivity.

Products to meet this kind of demand require sophisticated engineering to facilitate enhanced safety, efficiency, and comfort. Innovative production technology

aligns myriad components into a fine-tuned integrated whole, in addition to state-of-the-art production facilities necessitating upfront investment. Our strength lies in the ability to maximize the Group's capacity to provide such products—something other corporate groups are hard-pressed to replicate.

### Consolidated financial results and forecasts for orders received, net sales and profits (Billions of yen)

	FY2014 (Actual)	FY2015 (Forecast)
Orders received	1,455.4	1,580.0
Net sales	1,385.4	1,490.0
Operating income	72.3	73.0
Recurring profit	60.6	66.0
Net income	38.6	41.0
Before-tax ROIC	8.1%	8.6%

Before-tax ROIC = (income before income taxes + interest expense) / invested capital

Exchange rates (Actual / Assumed)	US\$ (¥/\$)	99.63	100
	EUR (¥/EUR)	134.56	135

Assumed exchange rates apply to FX exposure for FY2015 as of the date of release

**Morita:** The upturn in business results brought with it a much better financial position in fiscal 2014. Mr. Murayama led the Group to this result.

**Murayama:** Our interest-bearing debt had ballooned in recent years due to investments management had deemed necessary to sustain business expansion. By the end of fiscal 2013, interest-bearing debt had reached ¥484.6 billion. Consequently, management made it an imperative priority to reduce this balance in fiscal 2014. Our goal was to get down into the ¥450.0 billion range by the end of the fiscal year, and we—the Group as a whole—embraced measures to improve cash flow. As a matter of fact, this united approach cut our interest-bearing debt to ¥444.6 billion as of March 31, 2014. Our ultimate target, however, is to bring the level down into the ¥400.0 billion range by the end of fiscal 2016, which is the last year of MTBP 2013, and this is certainly within the realm of possibility. Overall, I would say that MTBP 2013 got off to a terrific start.

### What is the performance outlook for fiscal 2015 and where will efforts be directed?

**Murayama:** We are looking forward to another year of higher sales and income. We expect recurring profit\* of ¥66.0 billion and net income of ¥41.0 billion in fiscal 2015, which would exceed previous records.

\*Recurring profit is used in accounting standards generally accepted in Japan. It is the sum of operating income, net interest income (expense), dividend income, and other non-operating and recurring income items.

**Morita:** In fiscal 2014, the overseas sales ratio hit 56.3% on a consolidated basis. Going forward, activities in overseas markets will surely assume greater weight within the Group from a growth perspective.

**Murayama:** Absolutely right. So by business segment, here is what we will be emphasizing in fiscal 2015. In the Ship & Offshore Structure segment, we aim to establish a firm position in the offshore structure business and reinforce global business development capabilities by decentralizing production across domestic and overseas sites. In the Rolling Stock segment, we intend to lay a solid business foundation to capture demand in North America and in Asia. In the Aerospace segment, we will pursue a stronger partnership with Boeing. In the Gas Turbine & Machinery segment, we will seek a higher profile in international joint development projects on jet engines and establish a wider presence in the decentralized power source market. In the Plant & Infrastructure segment, we will pursue joint activities with overseas companies. In the Motorcycle & Engine segment, we will promote a strategy to reinforce our premium brand presence in emerging markets. Finally, in the Precision Machinery segment, we have expanded our production center for hydraulic components across six countries, and will begin overseas production of industrial robots. In these efforts, we will push further ahead with our unique global strategies for Group operations.

### With an emphasis on return on invested capital (ROIC)\* as a key performance indicator and efforts being channeled into improving the Group's enterprise value, what are your thoughts on the Kawasaki Group Mission Statement, overall management, and strengths?

\* Before-tax ROIC = (Income before income taxes + Interest expense) / Invested capital

**Murayama:** Kawasaki Value—a component of our Mission Statement—describes the responsibilities that the KHI Group,

#### Kawasaki Group Mission Statement



#### Kawasaki Value

- We respond to our customers' requirements
- We constantly achieve new heights in technology
- We pursue originality and innovation

#### The Kawasaki Group Management Principles

##### 1. Trust

As an integrated technology leader, the Kawasaki Group is committed to providing high-performance products and services of superior safety and quality. By doing so, we will win the trust of our customers and the community.

##### 2. Harmonious coexistence

The importance of corporate social responsibility (CSR) permeates all aspects of our business. This stance reflects the Kawasaki Group's corporate ideal of harmonious coexistence with the environment, society as a whole, local communities and individuals.

##### 3. People

The Kawasaki Group's corporate culture is built on integrity, vitality, organizational strength and mutual respect for people through all levels of the Group. We nurture a global team for a global era.

##### 4. Strategy

The Kawasaki Group pursues continuous enhancement of profitability and corporate value based on three guiding principles—selectively focusing resources on strategic businesses; emphasizing quality over quantity; and employing prudent risk management.



as a corporate group, must fulfill. Within this statement, I personally quite like the phrase “We constantly achieve new heights in technology,” as it reflects the Group’s colors beautifully. Enterprise value is the sum of discounted returns that appear as years go by, reflecting the value of future profits in each successive year. To boost enterprise value, we absolutely must maintain returns above the cost of invested capital while concentrating management resources, particularly personnel, capital investment, and R&D, into each segment with growth potential. The key to success is technology—and this is where the Group excels. Our technological capabilities are unrivaled. We inherited this strength from our predecessors, and each successive generation developed it further. Going forward, we must do our utmost to pass this precious asset on to the next generation.

**Morita:** The KHI Group is an organization with technologies honed over a long and industrious history. Each of the seven segment-specific, internal companies boasts world-caliber technologies, and the Group as a whole has carefully cultivated this stock of technologies.

However, I believe there is still much potential for pooling the capabilities of the seven internal companies and I would like to see the Group build on the exponential effect produced as companies access expertise beyond their respective technology inventories.

I reread *Karin no Umi* (“Sea of Steamships”) penned by Kojiro Matsukata, the first president of Kawasaki Heavy Industries in its earliest incorporation as Kawasaki Dockyard Co., Ltd. Four concepts stood out to me. First—a timely perspective. That is, responding quickly to prevailing needs while looking to the future. Second—an awareness of public interests. This really epitomizes the KHI Group Mission. Third—a competitive attitude. And fourth—thorough adherence to cost principles. This fourth one is none other than a commitment to quality over quantity, and the pursuit of capital efficiency, still applicable today. Mr. Matsukata’s

business philosophy is as pertinent today as it was all those years ago.

**Murayama:** Under Mr. Matsukata’s direction, the company established a presence in the shipbuilding business and also ventured into rolling stock and aircraft. Later, leveraging the technologies accumulated through the early businesses, the company diversified into fields such as power generating equipment and motorcycles, laying a solid foundation for today’s KHI Group. Going forward, we will, as an integrated corporate group, reinforce our ability to deliver solutions matched to customer needs, and we will lift the composite capabilities of the seven internal companies to new heights.

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#### Regarding commitment to quality over quantity and the pursuit of capital efficiency, tell us about the evaluation of business units (BUs) in fiscal 2014.

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**Murayama:** KHI adopted an internal company structure, effective from fiscal 2002, and has fully embraced financial independence and bonuses linked to corporate performance for each internal company. Ideas on getting day-to-day operations done are important, but equally important is the ability to calmly evaluate the viability of these operations as businesses. Under the new plan, we established a hurdle rate using ROIC as the evaluation standard and ranked each BU accordingly. Any BU that fails to meet the standard for that grade will be subject to review, taking into account such criteria as profitability and required management resources, with an eye toward restructuring. But if the review finds that future prospects are dim, even with corporate support, associated management resources will be shifted to growth fields instead. The underlying objective in business restructuring is to reinforce core competence. Where operations were previously lumped together under internal companies, we aim to refine the BU concept, thereby making it easier to extract the core competence from each segment.

We will also evaluate operations using the 3C Model—Customer, Competitor, and Company—and think on how best to improve our reputation in the eyes of our customers and strive to link this to higher income under a revitalized operating structure. This process will be open to all members of corporate management, and by sharing information, we will eliminate the reliance and dependence that one segment has on another while pooling knowledge and expertise for mutual use by members of other internal companies. I am sure that the newest measures will be successful in this regard.

This Kawasaki ROIC Management perspective is vital to the pursuit of capital efficiency and sustainable growth. It is the perfect business management tool for us because we are working to promote well-balanced, integrated management practices.

**Morita:** I think so, too. Being able to visualize certain dynamics, such as strengths and weaknesses within each BU and issues specific to those units, from the respective ROIC number is a definite advantage. Furthermore, sharing information among internal companies is a way to promote deeper corporate dialogue—allowing decision-makers to imagine “we could apply this here, too” or “this company’s technology could be combined with that company’s technology to achieve synergistic effects.” I would definitely like to have such dialogue lead to real concrete actions.

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### Mr. Morita, as an outside director, what are your thoughts on corporate governance at the KHI Group?

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**Morita:** I was struck by the fact that dialogue is extremely free and open here. This is a company with good communication practices. In this environment, I received a very warm welcome for which I am truly grateful. I think corporate governance has two functions. One is to maintain sound and transparent management practices, and the other is to consistently improve enterprise value.

An important perspective for an outside director is to look at corporate issues from an observer’s position. Also, however, in conjunction with shareholders and other stakeholders, the purpose of an outside director should be to help a company improve its enterprise value.

**Murayama:** Mr. Morita is extremely perceptive, and his questions have a point—a purpose. Furthermore, he speaks from a stakeholder’s perspective, on behalf of stakeholders, as it were.

For example, in regard to a particular undertaking, he said “The plan is a very good one indeed, but the time frame seems too long. Wouldn’t a swifter approach be better?” He knew that the stated time frame would ensure a perfect result, but he felt that customers and society as a whole might not be able to or want to wait that long. This was a very constructive observation.

There is a danger that management might lean in a certain direction—losing objectivity—if the executive team were to comprise only members from the same organization. The absolutely essential ingredient of good corporate governance

is therefore to have an outside director in the mix, one who voices opinions from a stakeholder’s perspective and acts as a beacon of light to reveal issues that we executives on the inside might not see. We can then discuss these issues in a free and open forum to make policy decisions that we all work steadily to implement. I believe that an outside director plays a vital role, contributing to sound management practices as well as enhanced enterprise value.

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### With regard to the environment, the KHI Group Mission Statement, “Kawasaki, working as one for the good of the planet,” addresses efforts to contribute to the global environment. The Group is promoting various initiatives, including conformity assessment of Kawasaki green products and energy visualization.

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**Murayama:** CO<sub>2</sub> emissions are increasing and this is a serious social concern. Measures to reduce emissions will continue to be absolutely imperative. Thus, it is very important for us to facilitate solutions, such as greater fuel economy and greater efficiency in the products we market to the world. Naturally, therefore, our goal is to develop environmentally conscious green products, and we intend to maintain this focus in the years ahead. Currently, we are involved in a hydrogen project,\* and I believe we should continue to promote such projects because they—and by extension the Group—can play an integral part in realizing a society of the not-too-distant future that benefits from energy supplied by hydrogen-based fuel.

**Morita:** Anything with a good efficiency rating tends to require high initial investment. However, looking at total costs, including running costs, such products are actually low-cost. It is important to highlight this cost reality from various angles.

\* For details on the hydrogen project, please go to page 29–30.

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### What are your thoughts on company stakeholders?

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**Murayama:** Company stakeholders include shareholders, customers, employees, business partners, and local communities, but the crucial support for improved enterprise value actually comes from the relationships we build and maintain with these stakeholders.

To boost enterprise value, we have to get customers to buy Kawasaki-brand products. Regardless of how sophisticated our technology may be, if no one buys our products, we are not fulfilling our role in society. In that sense, customers are indeed our first priority. We must provide what meets customer requirements.

**Morita:** Japan's manufacturing industry has always prioritized technology—call it a technology-push perspective. Going forward, that emphasis will have to shift, I think, to a demand-pull perspective favoring demand creation. Can extremely excellent technologies be turned into profitable businesses? The answer to that will require greater efforts to reinforce sales and marketing strategies, and it applies to the whole industry, including the KHI Group. I think KHI has to fully demonstrate synergies among its seven internal companies and promote global strategies premised upon the demand-pull concept.

**Murayama:** I totally agree. Backed by superior technological capabilities and a vast expanse of business pursuits, we aim to utilize our conglomerate advantage to cultivate demand from our customers, and expand our businesses along with those of our customers. For that, we have to be keenly aware of demand-pull from two positions—our commitment to sustainability and our desire to help resolve the issues facing society today—and we have to pursue manufacturing giving thought to further reinforcing our technology platform so that we can properly meet evolving demand.

We cannot forget employees; they are one of the stakeholders fulfilling a vital role in raising enterprise value. If employees are motivated in a direction conducive to realizing the Group Mission, they will gain a greater sense of satisfaction from the eventual achievement of objectives. This in turn will lead to higher enterprise value. There is a term in Japanese—*sokusenryoku*—that is used quite often in Japan right now. It means “battle-ready,” but in a job-related sense it refers to someone who has the skills to be of great benefit to a company immediately upon hiring. I often tell new employees “You hear the term *sokusenryoku* all the time, but to be someone like that you must first study hard and acquire practical abilities; that's how you get to be an expert.” Following this process is a true reflection of the principle “We constantly achieve new heights in technology,” which underpins the technological capabilities that represent the forte of the KHI Group. Creating this kind of environment is key.

Recognizing diversity is also important. Capitalizing on the latent potential of women and foreign personnel will definitely accelerate corporate growth and strengthen operations.

Moving on to business partners, we must promote a keen reciprocal awareness of the win-win benefits of a good business relationship. If our business partners subscribe to the idea that we are in the same boat, so to speak, even in a harshly competitive environment, then we will be able to maintain good relationships with each other over the medium to long term. This will certainly add strong links to our supply chain.

Additionally, we can boost enterprise value by contributing to local communities and through other approaches conveyed by our Group Mission. Building relationships with stakeholders based on mutual understanding is, in itself, sure to raise enterprise value and strengthen our position. Ultimately, shareholders benefit as

higher enterprise value leads to increased share value and returns on their investment in the KHI Group.

As I say here—and will say again many times—to realize higher enterprise value, it is exceedingly important to have a good mix of stakeholders, never leaning more toward any one type of stakeholder group than to another.

**Morita:** I agree. There is, with some disparity depending on the situation perhaps, only one kind of stakeholder interest. Higher enterprise value.

Improving enterprise value benefits all stakeholders. It is not mutually exclusive. Enterprise value is often associated with a quantitative number, such as sales or profits, benefiting investors.

But it is important to employees, too. And then there is the realization of the Group Mission—a qualitative aspect of enterprise value. It may be perceived as the polar opposite of quantitative targets but it is not. You see, the KHI Group has various technologies that make the world a better place. However, this potential will remain latent—and thus meaningless—if people around the world do not make use of the technologies. Utilizing these technologies means that the associated products have been purchased. That is, sales and profits go up. I believe a company's existence hinges on doing good for the world while concurrently increasing sales and profits.

**Murayama:** Our duty is to improve enterprise value by achieving a balance between increasing sales and profits and realizing the Group Mission. Toward this end, we must look outside the box and acknowledge diverse points of view. A company exists only because it has the support of all kinds of stakeholders, from investors and customers to employees and business partners. Every organization has its own particular perspective or ideas as a result of its own unique history and way of doing business. But to be able to acknowledge diverse points of view makes us more flexible and open. It is for this very reason that we have to actively maintain opportunities where our stakeholders can speak—and we will listen. Through Kawasaki ROIC Management, underpinned by the understanding and support of our stakeholders, we will achieve sustainable growth and higher enterprise value for the realization of a better future for all of our stakeholders.

